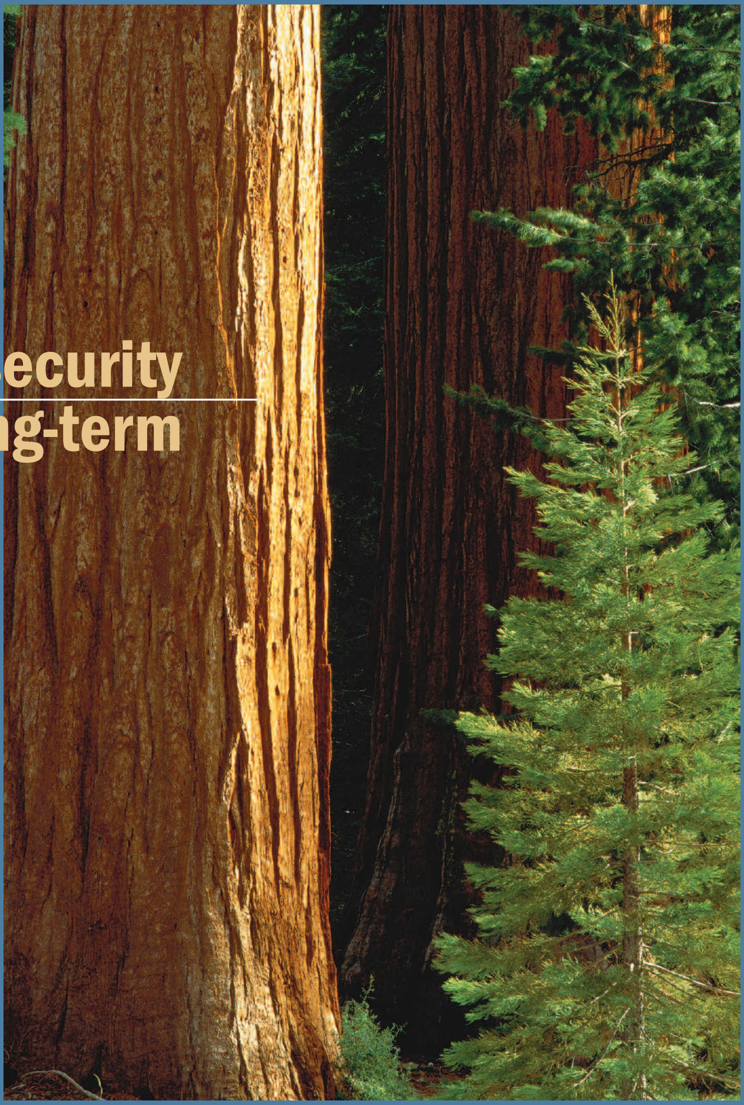
Western World Insurance Group

2005 Annual Report

strength & security
for the long-term



Western World Insurance Group

Binding Authority • Brokerage • Programs

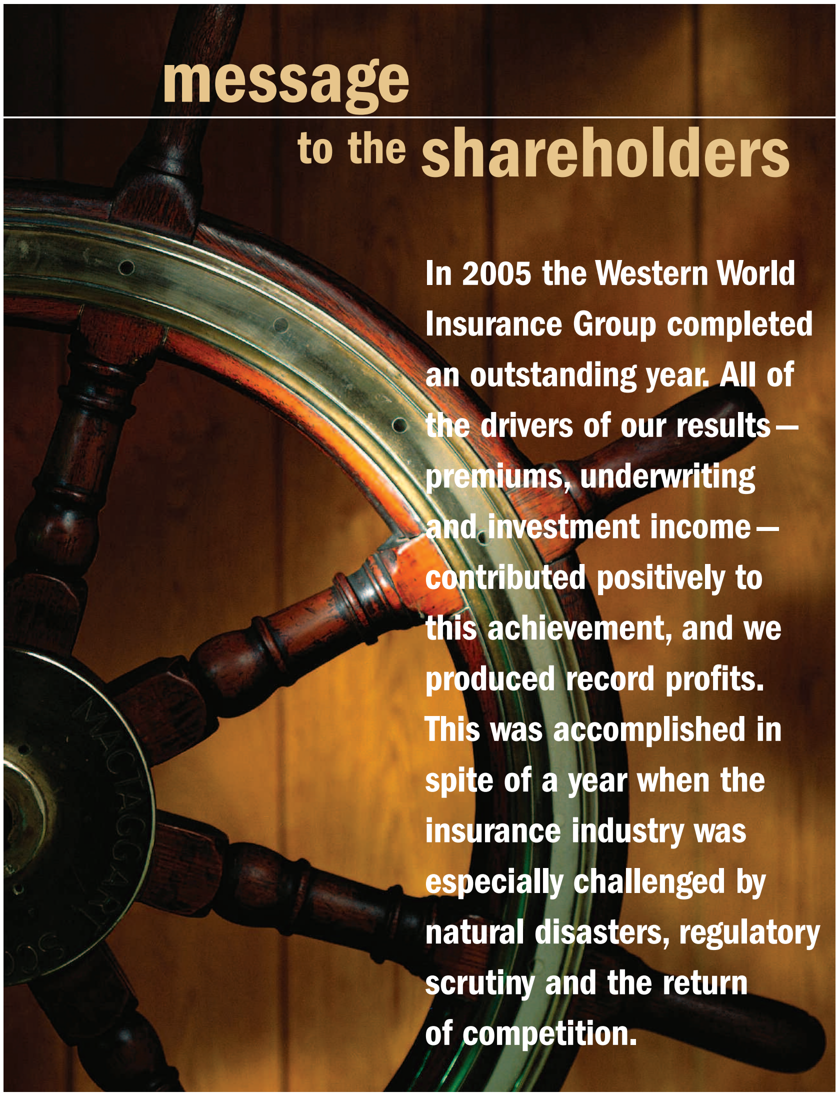
Western World Insurance Company
A.M. Best A+ (Superior), Financial Size Category Class VIII

Tudor Insurance Company
A.M. Best A+ (Superior), Financial Size Category Class VIII

Stratford Insurance Company
A.M. Best A+ (Superior), Financial Size Category Class VIII

- General Liability
- Products Liability
- Professional Liability
- Commercial Automobile
- Property

message to the shareholders



In 2005 the Western World Insurance Group completed an outstanding year. All of the drivers of our results—premiums, underwriting and investment income—contributed positively to this achievement, and we produced record profits. This was accomplished in spite of a year when the insurance industry was especially challenged by natural disasters, regulatory scrutiny and the return of competition.

The Western World Insurance Group enters the second half of this decade in the strongest position ever to serve our shareholders, agents, brokers and policyholders.

As the charts on the following pages demonstrate, the Group has achieved significantly above-average growth in revenues, earnings, assets and equity in recent years. Of course, this rate of growth will not continue indefinitely in our highly cyclical industry. As favorable market conditions recede, this trend can be expected to moderate.

Group Results

In 2005, Group after-tax profits grew 23% from $23.0 million in 2004 to a new record of $28.3 million. On a per share basis, profits improved from $513 to $627.

Group revenues, which include net earned premiums and investment income, increased 4% from $299 million in 2004 to $311 million in 2005. While our premiums may have reached a plateau at this stage of the insurance cycle, our investment income grew by 15%—the largest increase in many years. The reversal of the long decline in interest rates, combined with strong cash flow, has allowed investment income to begin to reflect the growth of the underlying business that accelerated several years ago.

Group assets grew from $1.2 billion to $1.3 billion. Our investment portfolio now stands at $918 million and provides substantial security to our policyholders and earning power to our shareholders. Long-term interest rates remain at historically low levels, and the capital markets offer little incentive to assume investment risk. However, in our view, interest rate risk, economic risk and event risk are high, not low. Therefore, our investment policy remains conservative, and our investments are concentrated in liquid, high-grade, short-duration, fixed-income securities. This policy provides an optimal balance between capital protection and preserving the opportunity to invest in a more attractive investment environment in the future.

Shareholders' equity rose from $271 million in 2004 to $291 million in 2005 and book value per share increased from $6,034 to $6,451. We are pleased to report that our tangible book value has increased every year for more than 40 years, a record few corporations, especially insurance companies, can match.

Company Results

Direct premiums written in 2005 by our five underwriting divisions were $317 million compared to $325 million in 2004. This plateau at a level over $300 million is more than three times the amount of business we wrote just a few short years ago at the end of the last soft market. Soft market conditions have now returned again to the casualty sector of the specialty/surplus line market in which we specialize. However, we expect that the present cyclical downturn will be less severe than the last, as discussed later in this letter.

Our secure private ownership allows Western World to manage capital and growth effectively over the cycles in the insurance market. These cycles are magnified in the surplus lines sector in which we operate. Nevertheless our leverage ratio of 1.1 net premiums written to policyholders surplus remains conservative despite our rapid growth over the past five years.

The consolidated statutory combined ratio improved from 99.4% in 2004 to 98.7% in 2005.

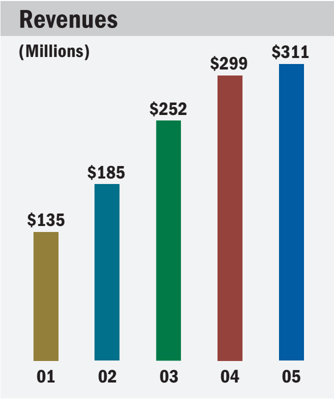
This result includes our losses attributable to hurricanes Katrina, Rita and Wilma. Western World has never been known as a leading property insurer although we are active writers of commercial package business. Consistent with our cautious approach, we have typically purchased catastrophe reinsurance to the estimated 1000 year event. Over the years Western World has never penetrated its catastrophe reinsurance with the notable exception of 2005. Reinsurance purchased to the 100 year event would have been insufficient, as others learned with Katrina.

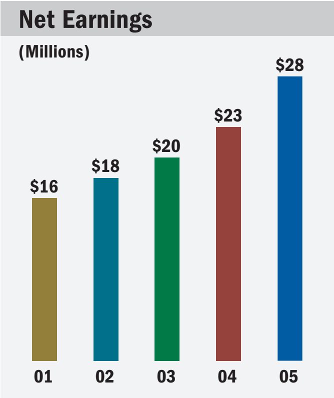
As a result of this approach, our net property loss ratio in 2005 was 71%, including hurricane losses. However, after having experienced no losses for many years, our catastrophe reinsurer absorbed a significant loss in 2005.

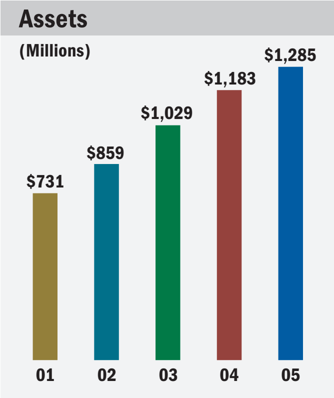
It is unusual for Western World to report combined ratios below 100% because of our conservative reserving practices and our attitude of caution in recognizing profit in a business where true costs take many years to reveal themselves. The underwriting profits in 2004 and 2005 associated with these combined ratios are a testament to improved pricing and policy terms available in the market in recent years.

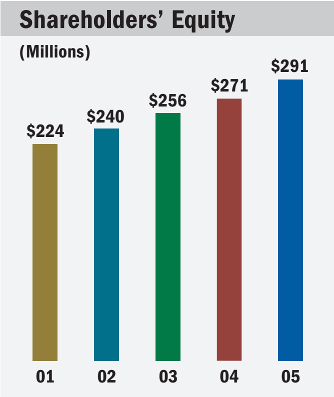
Western World is not alone in reporting good results in 2005, especially for commercial casualty lines of business. Many companies are reporting historically low combined ratios, reflecting optimistic loss estimates for business written recently. However, even though this optimism may well prove to be warranted, commercial casualty insurance has proven itself over and over to be risky and volatile.

The recently benign casualty loss experience, combined with the diversion of property catastrophe losses, is no justification for complacency. Western World continues its conservative approach to managing loss reserves. Our reserves are at the high end of the range established by our independent actuaries and fully 80% of our loss reserves are for claims not yet reported to us. Using this approach, our reserves established in the past have developed favorably every year for two decades. As a further result, the inevitable surprises of the insurance business have been absorbed without disruption to our agents or shareholders.









message to the shareholders continued

The statutory surplus of Western World Insurance Company grew from $222 million in 2004 to $246 million in 2005. The statutory surpluses of Western World's two subsidiaries, Stratford and Tudor Insurance Companies, also grew in 2005.

All three companies carry the A.M. Best rating of A+ (Superior) Financial Size Category VIII. For the 11th consecutive year, the Group was awarded "Ward's 50" status as one of the nation's top performing property/casualty insurers.

Business Conditions

As we enter 2006, the property/casualty insurance business must be divided into two parts: hurricane exposed coastal property and everything else.

Coastal Property Insurance

The hurricanes of 2004 and 2005, especially Katrina, have made all assumptions about hurricane frequency and severity obsolete.

New assumptions will drive pricing higher and promote more caution in the aggregation of exposure to catastrophe risk. In the near term, there is already an availability/affordability insurance crisis for property owners in hurricane-exposed areas from Texas to New England. It may present opportunities for companies willing to enter the market.

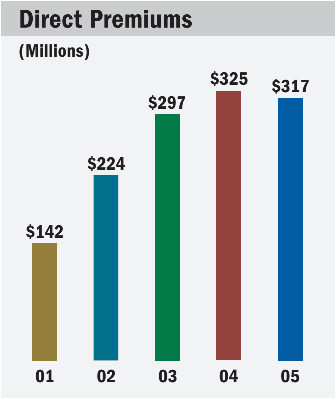
This crisis has been seen before in other lines of insurance and will naturally produce many headlines and calls for government to solve the problem of the unusually high cost of property insurance in catastrophe prone locations. The government can pass the costs to other citizens via taxes or other policyholders via surcharges, but the costs will not change.

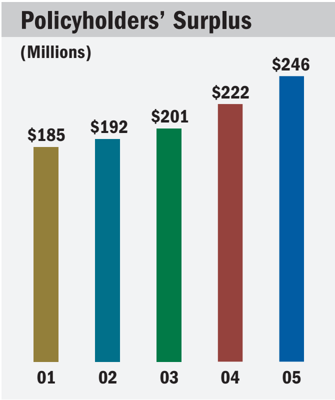
The consequences of recent catastrophes cannot be minimized and are, in some cases, heart-breaking. Furthermore, the near-term disruption caused by an availability crisis cannot be ignored. However, Western World is concerned that the federal government's growing interest in interfering in the business of insurance—however well-intentioned—will lead to long-term adverse results for most consumers and insurance providers.

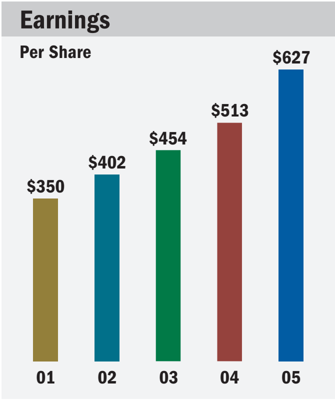
The Rest of the Market

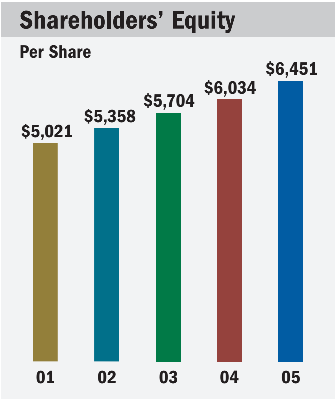
The vast majority of insurance sold in the United States does not have hurricane exposure. This includes commercial liability—the specialty of Western World. The commercial liability market is especially cyclical given the long time lag between the moment new business is underwritten and the time well in the future when true loss costs become known.

This sector of the market has experienced very favorable business conditions for the past several years. This follows the era of destructive competition in the late 1990s that caused numerous competitors to abandon the market.









By now, balance sheets have been repaired, new competitors have arrived and confidence is back. Those are all of the ingredients necessary to promote competition, and as a result, soft market conditions are now fully evident. In fact, the hard market in hurricane-exposed property may serve to accelerate the softening trend in the rest of the market. This is because once they have filled their target catastrophe aggregates property insurers and reinsurers will seek to deploy their capital elsewhere.

Market Outlook

If history is a guide, market conditions will continue to erode, either slowly or quickly, until generally unprofitable underwriting is revealed in reported results. In the 1990s, the turning point took an extraordinarily long time to arrive.

However, there are reasons to believe that the emerging soft market of today will be shorter and less severe than the one that preceded it.

First, there are new accounting standards. The positive side of the Sarbanes-Oxley legislation is a much greater focus on accurate accounting. The penalties for managers, directors and outside auditors are far too great to risk reporting misleading financial information. The consequence will be that deteriorating underwriting terms will show up as deteriorating financial results sooner than before. Shareholders and directors will be quicker to demand corrective action when they are quicker to learn of inadequate results.

Second is the aftermath of on-going insurance industry investigations. While the more spectacular revelations dealt with producer compensation, the more far-reaching impact will be felt in the use of finite reinsurance products. Some finite reinsurance products caused delay in the recognition of poor financial results or spread the recognition of a loss over a number of years. In most cases these were legitimate and disclosed transactions. Today, finite reinsurance is out of bounds for use for any accounting purpose. Once again, the consequence will be faster recognition of actual results.

Third are the property/casualty industry results themselves. Here at the cyclical peak of prosperity, industry profitability is below the profitability of the average for all other industries. While the industry may never achieve above-average returns because of low barriers to new entrants, investors are unlikely to tolerate low returns for very long.

For these reasons we believe that the emerging soft market may be inevitable, but not intolerable. Western World and its like-minded competitors focused on long-term results will prosper and remain reliable business partners in this environment. Companies focused on exceeding quarterly expectations or executing exit strategies will have difficulty.

Western World

In the property/casualty insurance industry, as well as other industries, longevity is emerging as a weakness rather than as a strength. At Western World, longevity remains a strength and a source of stability. Our seasoned staff, tenured directors and secure private owners have worked together effectively under all market conditions. The relationships developed over the decades with the best producers and reinsurers are invaluable in an industry that is based upon trust and a promise.

With this foundation, we are eager to tackle the many challenges and opportunities that lie ahead with new approaches to technology, products and marketing. With this foundation, we continue to build strength and security for the long term.

Our annual message is never complete without acknowledging the contributions of those responsible for producing so many successful years of operation and such a strong platform from which to compete in the future: our staff and management, our producers and reinsurers, our directors and shareholders. Thank you all for your efforts, counsel and support.

Andrew S. Frazier

Andrew S. Frazier
President and Chief Executive Officer

March 2006

consolidated balance sheet*

Western World Insurance Group, Inc.

Assets

	2005	December 31, 2004
Bonds and Sinking Fund Preferred Stocks (Held to Maturity) — at Amortized Cost (Market Value $808,206,409 and $692,935,066)	$ 804,643,919	$ 676,714,948
Bonds and Sinking Fund Preferred Stocks (Available for Sale) — at Market Value (Amortized Cost $96,797,600 and $111,962,667)	96,555,189	114,017,824
Common and Other Preferred Stocks — at Market Value (Cost $17,054,339 and $14,824,338)	17,200,860	16,004,679
Total Investments	918,399,968	806,737,451
Cash	255,787	489,866
Uncollected Premiums	37,903,439	39,184,151
Deferred Policy Acquisition Costs	33,906,438	34,029,759
Deferred Federal Income Tax	27,635,600	21,532,295
Reinsurance Balances Recoverable	252,699,496	267,836,903
Other Assets	14,538,790	12,841,495
Total Assets	$1,285,339,518	$1,182,651,920

Financial Highlights*

	2005	2004	Change
Revenues	$ 310,615,883	$ 298,601,635	4.0%
Assets	1,285,339,518	1,182,651,920	8.7%
Shareholders' Equity	290,775,705	271,291,788	7.2%
Net Income	28,253,296	23,029,738	22.7%
Earnings Per Share	627	513	22.2%
Book Value Per Share	6,451	6,034	6.9%
Return on Equity	10.4%	9.0%	

*These GAAP statistics have been condensed from the Group's financial statements as audited by Ernst & Young LLP.

Liabilities

	December 31, 2005	2004
Losses and Loss Adjustment Expenses	**$ 738,098,599**	$ 666,727,541
Unearned Premiums	**136,837,540**	139,585,262
Funds Held Under Reinsurance Treaties	**78,266,537**	69,875,780
Other Liabilities	**41,361,137**	35,171,549
Total Liabilities	**$ 994,563,813**	$ 911,360,132

Shareholders' Equity

Common Stock	**$ 903,460**	$ 903,460
Paid-In Capital	**7,335,745**	6,596,714
Retained Earnings	**282,536,500**	263,791,614
Total Shareholders' Equity	**$ 290,775,705**	$ 271,291,788
Total Liabilities and Shareholders' Equity	**$1,285,339,518**	$1,182,651,920

Statutory Highlights**

	2005	2004	2003	2002	2001
Premiums Written	**$317,022,547**	$324,929,589	$296,805,905	$223,675,731	$141,588,052
Policyholders' Surplus	**246,406,937**	222,113,355	201,133,619	192,472,093	184,840,781
Assets	**981,605,217**	859,190,021	749,845,990	647,373,255	578,046,644
Combined Ratio	**98.7%**	99.4%	100.1%	101.6%	106.5%
Ratio of Net Premiums Written to Policyholders' Surplus	**1.1 to 1.0**	1.2 to 1.0	1.2 to 1.0	.9 to 1.0	.6 to 1.0

*These GAAP statistics have been condensed from the Group's financial statements as audited by Ernst & Young LLP.

**These statistics were condensed from the Companies' Statutory Annual Statements as filed with the New Hampshire Insurance Department.

Policyholders' Rating A+ (Superior) Financial Size Category Class VIII by A.M. Best Company.

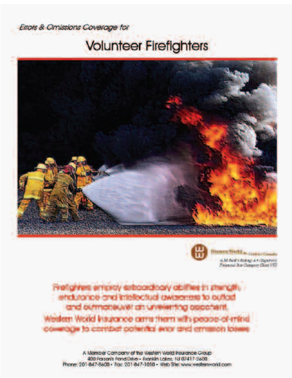
General Agency Division

capitalizing
on market opportunities

The General Agency Division business is distributed through select general agents located throughout the United States. The Division is made up of distinct Underwriting Departments: Western World Contract Casualty and Stratford Transportation.

The cornerstone of the General Agency Division is the binding authority granted to our agents and the trust necessary for our partnerships to be successful. The Western World Insurance Group has been a leader in surplus lines binding authority distribution for 42 years.

Our products, authority and services can be tailored to the specific market opportunities and challenges presented to our agents as well as the marketing strengths of the agency itself. Our personalized service, unique range of products and favorable market conditions contributed to another strong top-line performance in 2005.



The Contract Casualty Department offers general and professional liability on small-to-medium size commercial risks which can be packaged with property coverage. The Transportation Department offers commercial automobile liability, physical damage and cargo coverages. All contract agents with access to the General Agency Division also have access to our Specialty Brokerage Division and are encouraged to explore professional liability opportunities with Tudor Professional.

During 2005, we moved several technology projects forward with specific emphasis on greater connectivity between the Company, our agents and brokers. Most notable are our recently updated and enhanced web site and the electronic transfer of policy information which will greatly improve the efficiency of all parties to the transaction.

The General Agency Division can provide a completely autonomous product line, or we can work in conjunction with other underwriting areas to fulfill several product needs for our select general agents. In our view, our success in distributing small-to-medium size commercial risks, on a binding authority basis, depends on our careful selection of classes, the management of our underwriting authority and aligning ourselves with the best possible business partners. We have made a commitment to enhance these business relationships by using all the tools available to us in underwriting, marketing, technology, claims and customer service.

Western World *Contract Casualty*

Examples of general and professional liability classes underwritten are as follows:

- Alcohol/Drug Rehab Centers
- Ambulance Attendants
- Amusement Devices
- Apartments
- Athletic Events
- Buildings
- Clubs
- Contractors
- Daycare
- Dwellings
- Exercise or Health Studios
- Home Health Care
- Homeowners' Associations
- Janitorial
- Law Enforcement
- Nurses/Nurses' Registries
- Outpatient Clinics
- Pest Control
- Schools
- Social Workers
- Special Events
- Tanning Salons
- Therapists
- Volunteer Firefighters

The majority of classes offered can be packaged with property coverage.

In 2005, Western World Contract Casualty premium volume remained consistent with the prior year in both mono-line (general liability) and package policies. This represents the fourth consecutive year of premium volume written at a new, historically high plateau. With our continual enhancements in technology, we will improve our service and efficiencies to our agents.

Stratford *Transportation*

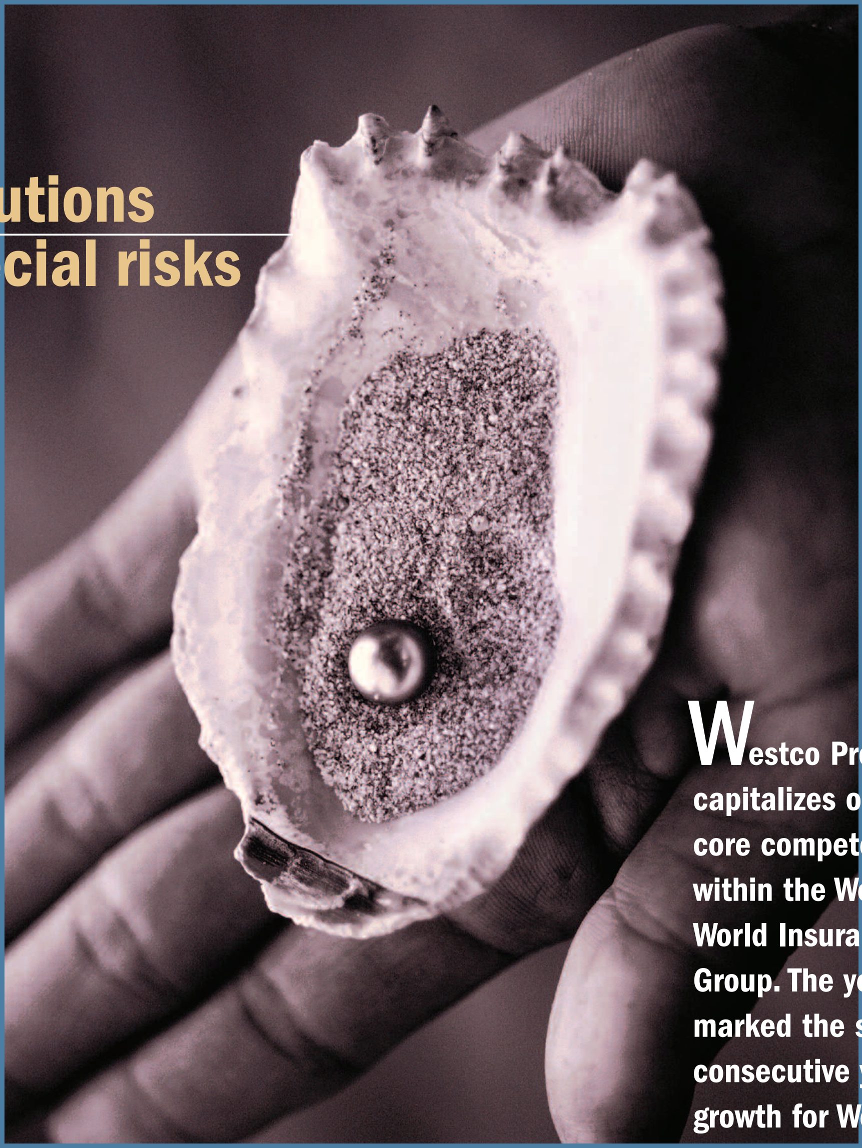
Examples of commercial auto classes underwritten are as follows:

- Bobtail/Deadhead
- Contractors/Artisans
- Daycare Buses
- Dump Trucks
- Flatbeds
- Grain Haulers
- Limousines
- Loggers
- Social Service Agencies
- Taxis
- Truckers
- Wreckers

Coverages offered include liability, physical damage and cargo.

The growth in Commercial Auto that began in 1999 stabilized in 2005 at a level consistent with our expectations. Terms and pricing stabilized, but at levels significantly higher than those of the soft market period of the 1990's. We expect the market to remain at this plateau through 2006.

The Commercial Automobile Department maintains a very selective distribution system of approximately 35 agents with commercial auto expertise.



tailored solutions
designed for special risks

Westco Programs capitalizes on the core competencies within the Western World Insurance Group. The year 2005 marked the sixth consecutive year of growth for Westco Programs with written premiums rising 10% through further diversification of supported programs.

Westco Programs caters to program administrators who place a high value on personalized attention and program protection and who add value to the distribution process through their own expertise in a specific class of business. The clients of Westco Programs focus on affinity group marketing, which often involves trade association ties and may require tailored solutions for unique liability exposures.

In Westco Programs, we take the time necessary to completely understand the needs of an affinity group and the underwriting expertise of the agent. We serve a market niche where a lofty premium volume commitment is not essential to our business plan. All of our clients have the attention of senior management, receive our highest levels of service and have access to all areas of the Company.

In addition, Westco Programs offers exclusivity and program protection where warranted. Westco Programs' customers usually have established books of business and are in search of a market that will be more protective and responsive to their needs. As a business practice, Westco provides greater access to management and demonstrates the value of the relationship through service, exclusivity and attention to detail. Westco Programs generally seeks programs that initially have production between $1 million and $5 million per year.

Westco *Programs*

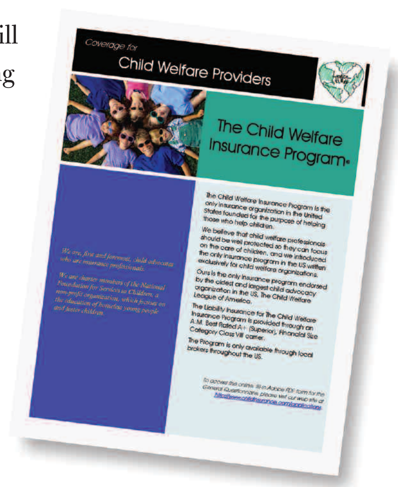
The Westco team takes pride in the number of unique programs successfully underwritten thus far and has applied its formula for success to such diverse affinity groups as:

- Agricultural Contractors
- Affordable Housing
- Equine Risk
- Fire Suppression Contractors
- Foster Care Services
- HVAC Contractors
- Hospitality
- Hot Air Balloons
- Janitorial Services
- Landscapers
- Pest Control Services
- Property Recovery Agencies
- Psychologists
- Security Services
- Sports Camps
- Swim Clubs
- Whitewater Outfitters & Guides

The Westco Programs Underwriting Department designs tailored solutions for the following types of exposures:

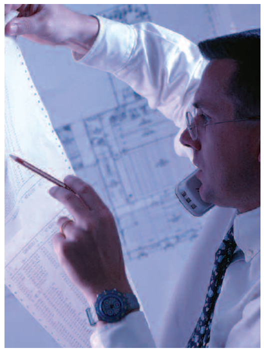
- Professional and commercial general liability.
- Classes that are difficult to price and where published rates are not available.
- Clients needing manuscripted coverages.
- Unique risks that are typically recognized only in the Surplus Lines marketplace.

Westco Programs will provide tailored binding authority to qualified program managers (retail or wholesale) and can bring together the underwriting and claims expertise from all Divisions in the Group.



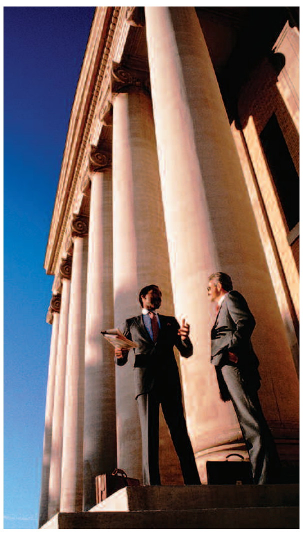
peace of mind
liability protection

The Western World Insurance Group has specialized in writing professional liability coverage for the majority of its 40-plus years of operation. Tudor Professional continues that tradition with a dedicated staff and high service standards.



The 2005 legal and social environment continued to challenge the insurance industry in several sectors, with the professional liability marketplace no exception. The liability faced by the professionals we insure is of a personal nature, and maintaining professional liability coverage is often vital to their continued operation.

During 2005, we were able to maintain our underwriting principles, adjust our business mix for the best possible results and continue the moderate, but steady, annual growth that we have experienced for the past five years.



The year 2005 will undoubtedly be looked upon as a transitional year for the Professional market with the return of increased competition, while others withdrew from unprofitable classes of business. With the volatility of this market, we constantly re-evaluate our underwriting guidelines and policy wording for the purpose of providing the proper coverage for the expected exposures. We combine our disciplined approach with the financial strength of the Western World Insurance Group to maintain our historically profitable book of business while achieving controlled growth.

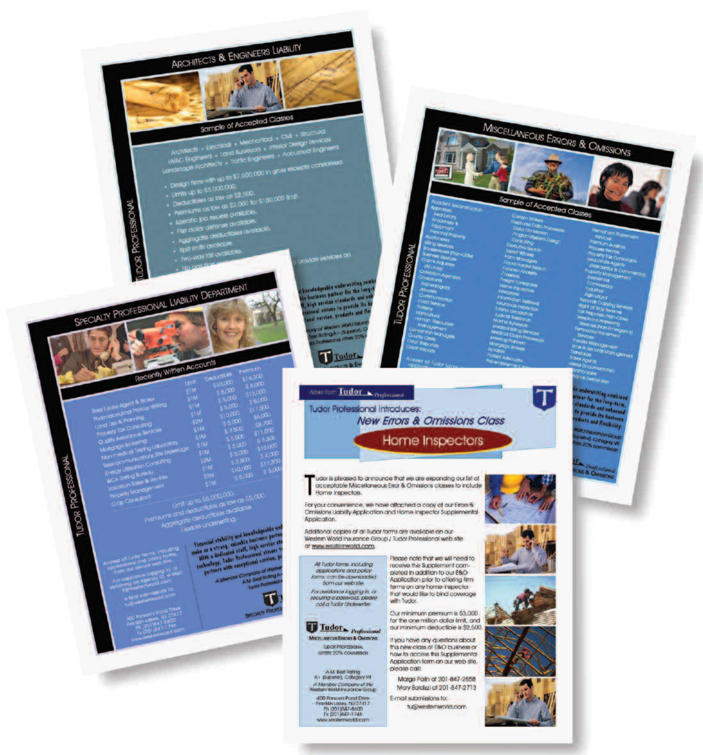
Tudor Professional

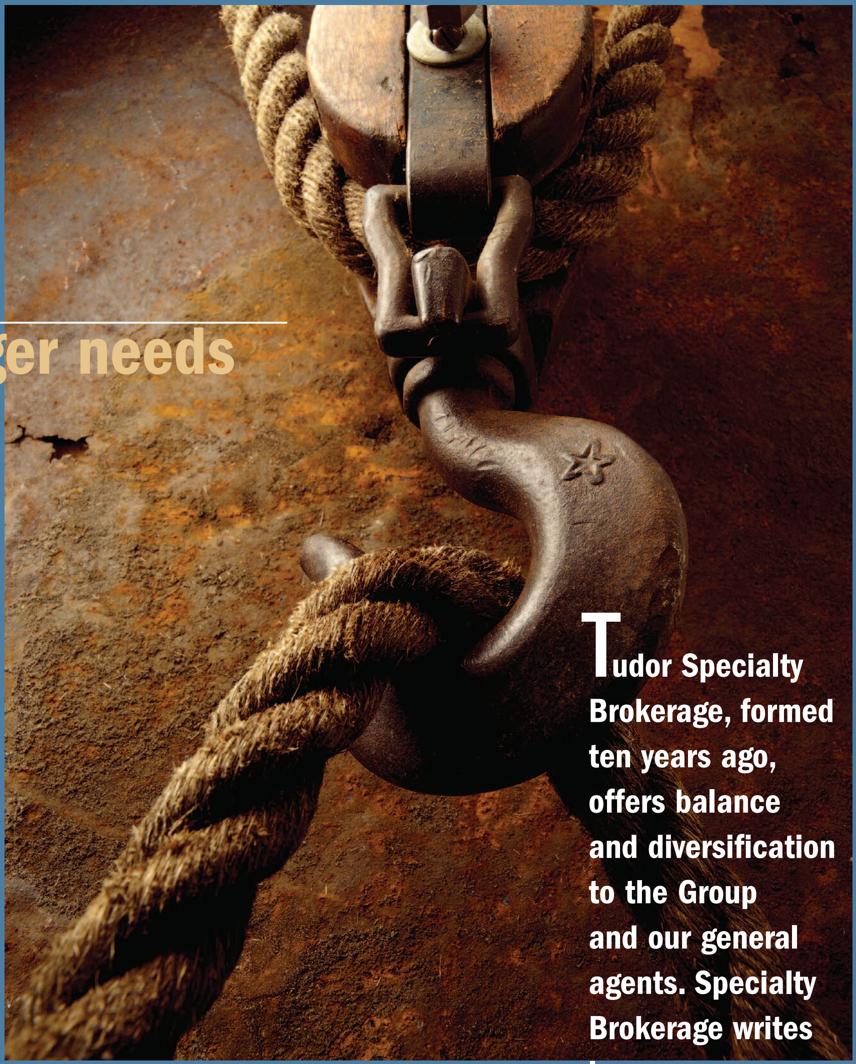
Financial stability and knowledgeable underwriting combined to make us a strong and valuable business partner. In addition, our diverse and extensive menu of products meets the vast majority of our brokers' professional liability product needs.

Current products written by Tudor Professional include:

- Specialty Professional Liability
- For-Profit Directors & Officers Liability
- Non-Profit Directors & Officers Liability
- Non-Profit Organization Professional Liability
- Information Technology Professional Liability
- School Board Liability
- Public Officials Liability
- Miscellaneous Professional Liability
- Architects & Engineers Liability
- Business and Technical Consultants Errors & Omissions
- Real Estate Professional Liability

Tudor Professional is available to appointed brokers.





resources to meet larger needs

Tudor Specialty Brokerage, formed ten years ago, offers balance and diversification to the Group and our general agents. Specialty Brokerage writes larger, more complex general liability and product liability risks distributed through excess and surplus lines brokers.

Tudor Specialty Brokerage complements the Western World portfolio through:

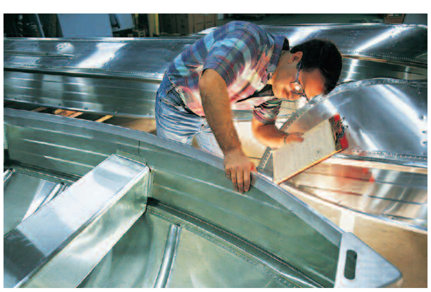
• The utilization of a distinct distribution channel;

• A staff of seasoned underwriters dedicated to the service standards required to compete in the middle market segment;

• The resources to analyze intricate and hard-to-place primary business driven by the risk of severe loss.

The Division has an ample appetite for a broad spectrum of general liability risks such as large habitational risks, heavy equipment manufacturers, equipment rental and millwright contractors. Specialty's risk portfolio is divided between general liability and products liability exposures.

The long-term objective is to grow Tudor Specialty Brokerage profitably to enhance the Group's binding authority relationships and to evolve into an increasingly influential player in the individual risk Surplus Lines casualty marketplace. To this end the Division executes its focused marketing strategy by limiting the number of producers with access to the facility, allowing Specialty to offer the highest possible service standards. In addition, the Division also understands the culture of the Group's binding authority agents who have relationships with other underwriting divisions. This dual focus is unique to the Specialty Brokerage Division and will enable Specialty to achieve longer-term competitive advantages.



In order to make difficult risks acceptable or affordable, accounts can be written on either an occurrence or claims-made policy form. In addition, the Division makes extensive use of deductibles and unique forms.

The premiums typically range from $10,000 to $250,000 per policy, but vary depending on risk.

Tudor Specialty Brokerage

Examples of classes of business written by the Specialty Brokerage Division are as follows:

- Apartments
- Automobile Parts Manufacturers
- Boat Builders
- Furniture Manufacturers
- General Contractors (Commercial Construction)
- Riggers, Crane & Contractors Equipment Rental Companies
- Shopping Centers
- Sporting Goods Manufacturers
- Steel Erection & Fabrication
- Toy Manufacturers
- Trailer Manufacturers

The Division prides itself on a commitment to underwriting integrity. Advances in information technology enable us to make the most informed underwriting decisions. This facilitates the ability to provide superior service to our valued wholesale distribution partners.

Our enhanced web site allows our Specialty Brokerage producers to access a secure area for viewing and printing policy forms and endorsements. A "What's New" section informs our producers of Division news and provides examples of recently bound accounts.

Tudor Specialty Brokerage is available to appointed brokers.

Western World Insurance Group

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