GALLAGHER ARTHUR J & CO
Form 10-K
February 05, 2007
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2006

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from _______ to _______

Commission file number 1-9761

ARTHUR J. GALLAGHER & CO.

(Exact name of registrant as specified in its charter)

DELAWARE	**36-2151613**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**
Two Pierce Place	**60143-3141**

Itasca, Illinois	
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (630) 773-3800

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $1.00 per share	**New York Stock Exchange**
Common Share Purchase Rights	**New York Stock Exchange**

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x.

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨.

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant, computed by reference to the last reported price at which the stock was sold on June 30, 2006 (the last day of the registrant s most recently completed second quarter) was $2,363,751,000.

The number of outstanding shares of the registrant s Common Stock, $1.00 par value, as of December 31, 2006 was 98,354,000.

Documents incorporated by reference:

Portions of Arthur J. Gallagher & Co. s Annual Report to Stockholders for the year ended December 31, 2006 are incorporated by reference into this Form 10-K in response to Parts I and II to the extent described herein.

Portions of Arthur J. Gallagher & Co. s definitive 2007 Proxy Statement are incorporated by reference into this Form 10-K in response to Parts II and III to the extent described herein.

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Arthur J. Gallagher & Co.

Annual Report on Form 10-K

For the Fiscal Year Ended December 31, 2006

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Part I

Item 1. Business.

General

Arthur J. Gallagher & Co. and its subsidiaries (collectively referred to as Gallagher unless the context otherwise requires) are engaged in providing insurance brokerage, risk management and related services to clients in the U.S. and abroad. Gallagher s principal activity is the negotiation and placement of insurance for its clients. Gallagher also specializes in furnishing risk management services. Risk management involves assisting clients in analyzing risks and determining whether proper protection is best obtained through the purchase of insurance or through retention of all or a portion of those risks and the adoption of corporate risk management policies and cost-effective loss control and prevention programs. Risk management services also include claims management, loss control consulting and insurance property appraisals. Gallagher believes that its ability to deliver comprehensively structured risk management and brokerage services is one of its major strengths. In addition, Gallagher has a financial services operation that manages its investment portfolio.

Gallagher operates through a network of more than 250 sales and service offices located throughout the U.S. and six countries abroad and through a network of correspondent brokers and consultants in 120 countries around the world. Some of these offices are fully staffed with sales, marketing, claims and other service personnel; others function as servicing offices for the brokerage and risk management service operations of Gallagher. Gallagher s international operations include a Lloyd s of London broker and affiliated companies in England and other facilities in Australia, Bermuda, Canada, Scotland and Singapore.

Gallagher was founded in 1927 and was reincorporated as a Delaware corporation in 1972. Gallagher s executive offices are located at Two Pierce Place, Itasca, Illinois 60143-3141, and its telephone number is (630) 773-3800.

Information Concerning Forward-Looking Statements

This annual report contains forward-looking statements within the meaning of that term in the Private Securities Litigation Reform Act of 1995 (the Act) found at Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Additional written or oral forward-looking statements may be made by Gallagher from time-to-time in filings with the Securities and Exchange Commission (SEC), press releases, or otherwise. Statements contained in this report that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Act and the Exchange Act.

Forward-looking statements may include, but are not limited to, discussions concerning revenues, expenses, earnings, cash flow, capital structure and financial losses, as well as market and industry conditions, premium rates, financial markets, interest rates, foreign exchange rates, contingencies and matters relating to Gallagher s operations and income taxes. In addition, when used in this report, the words anticipates, believes, should, estimates, expects, intends, plans and variations thereof and similar expressions are intended to identify forward-looking statements. Such forward-looking statements are based on available current market and industry material, experts reports and opinions and long-term trends, as well as management s expectations concerning future events impacting Gallagher.

Forward-looking statements made by or on behalf of Gallagher are subject to risks and uncertainties, including but not limited to the following: Gallagher s commission revenues are highly dependent on premiums charged by insurers, which are subject to fluctuation; lower interest rates reduce Gallagher s income earned on invested funds; alternative insurance markets continue to grow which could unfavorably impact commission and favorably impact fee revenue, though not necessarily to the same extent; Gallagher s revenues vary significantly from period-to-period as a result of the timing of policy inception dates and the net effect of new and lost business production; the insurance brokerage industry is subject to a great deal of uncertainty due to investigations into its business practices by various governmental authorities and related private litigation; the general level of economic activity can have a substantial impact on Gallagher s renewal business; Gallagher s operating results, returns on investments and financial position may be adversely impacted by exposure to various market risks such as interest rate, equity pricing, foreign exchange rates and the competitive environment; Gallagher s revenues and net earnings may continue to be subject to reduction due to the elimination of certain contingent commission arrangements on January 1, 2005 and related developments in the insurance industry; and Gallagher s effective income tax rate may be subject to increase as a result of changes in income tax laws, unfavorable interpretations of such laws or changes in crude oil prices or developments resulting in the loss or unavailability of IRC Section 29 tax credits. Gallagher s ability to grow has been enhanced through acquisitions, which may or may not be available on acceptable terms in the future and which, if consummated, may or may not be advantageous to Gallagher. Accordingly, actual results may differ materially from those set forth in the forward-looking statements. For a further discussion of certain of the matters described above see Item 1A, Risk Factors.

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Readers are cautioned not to place undue reliance on any forward-looking statements contained in this report, which speak only as of the date set forth on the signature page hereto. Gallagher undertakes no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect events or circumstances after such date or to reflect the occurrence of anticipated or unanticipated events.

Operating Segments

Gallagher has identified three operating segments: Brokerage, Risk Management and Financial Services. The Brokerage Segment, for commission or fee compensation, primarily places commercial property/casualty (P/C) and employee benefit-related insurance on behalf of its customers. The Risk Management Segment provides P/C claim third-party administration, loss control and risk management consulting and insurance property appraisals. Third party administration is principally the management and processing of claims for self-insurance programs of Gallagher s clients or clients of other brokers. The Financial Services Segment is responsible for managing Gallagher s investment portfolio.

The two major sources of operating revenues for Gallagher are commissions from brokerage operations and service fees from brokerage and risk management operations. Information with respect to all sources of revenue, by operating segment, for each of the three years in the period ended December 31, 2006, is as follows (in millions):

	2006		2005		2004	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commissions						
Brokerage	$ 849.5	56%	$ 784.3	53%	$ 726.8	51%
Retail contingent commissions						
Brokerage	2.5	0%	28.8	2%	33.8	2%
Fees						
Brokerage	188.5	12%	169.8	11%	146.2	10%
Risk Management	397.3	26%	367.7	25%	343.8	24%
Investment income and other						
Brokerage	30.2	2%	17.9	1%	13.4	1%
Risk Management	4.0	0%	2.9	0%	1.7	0%
Financial Services	62.0	4%	112.5	8%	171.3	12%
Total revenues	$ 1,534.0	100%	$ 1,483.9	100%	$ 1,437.0	100%

See Note 20 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which are incorporated herein by reference, for additional financial information, including earnings from continuing operations before income taxes and identifiable assets, by operating segment, for 2006, 2005 and 2004.

During 2006, 2005 and 2004, Gallagher s total revenues and expenses each increased sequentially from quarter-to-quarter within the calendar years, except for total revenues in fourth quarter 2006, due to investment losses recognized in the Financial Services Segment, first quarter 2005, which was negatively impacted by litigation and retail contingent commission related charges, and fourth quarter 2005, due to the reduction in retail contingent commissions and charges related to retail contingent commission related matters and claims handling obligations. However, commission and fee revenues and the related expenses can vary from quarter-to-quarter as a result of the timing of policy inception dates that historically are heaviest in third and fourth quarters. Alternatively, salaries and employee benefits, rent, depreciation and amortization expenses generally tend to be more uniform throughout the year. In addition, the timing of acquisitions will also impact the trends in Gallagher s quarterly operating results. See Note 19 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which are incorporated herein by reference, for unaudited quarterly operating results for 2006 and 2005.

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Brokerage

The Brokerage Segment comprises three operating divisions: the Brokerage Services-Retail Division (BSD), Specialty Marketing and International (SMI) and Gallagher Benefit Services (GBS).

BSD primarily places insurance for and services commercial, industrial, institutional, governmental, religious and personal accounts throughout the U.S. SMI places insurance for and services commercial, industrial, institutional, governmental, religious and personal accounts throughout the U.S. and abroad. BSD and SMI act as agents in soliciting, negotiating and effecting contracts of insurance through insurance companies worldwide, as brokers in procuring contracts of insurance on behalf of insureds, and as administrators in setting up and managing self-insured programs. In addition, SMI places insurance on behalf of other brokers. BSD and SMI both have the capability to handle insurable risks and related coverages for a wide variety of P/C products. SMI also places surplus lines coverages, which are coverages for various specialized risks not available from insurance companies licensed by the states in which the risks are located. In addition, SMI s reinsurance intermediary operations place reinsurance coverages for its insurance company clients.

GBS specializes in the management of employee benefit programs through fully insured and self-insured programs. GBS provides services in connection with the design, financing, implementation, administration and communication of compensation and employee benefit programs (including pension and profit-sharing plans, group life, health, accident and disability insurance programs and income tax deferral plans), and provides other professional services in connection therewith.

The primary source of Gallagher s compensation for its Brokerage Segment is commissions paid by insurance companies which are usually based upon a percentage of the premium paid by insureds. Commission rates are dependent on a number of factors including the type of insurance, the particular insurance company and the capacity in which Gallagher acts. In some cases, Gallagher is compensated for brokerage or advisory services directly by fees from clients. Historically, Gallagher also has received contingent commissions which are based on the estimated profit the underwriting insurance company earns and/or the overall volume of business placed by Gallagher in a given period of time. Occasionally, Gallagher shares commissions with other brokers who have participated with Gallagher in placing insurance or servicing insureds. GBS receives a fee for acting in the capacity of advisor and administrator with respect to employee benefit programs and receives commissions in connection with the placement of insurance under such programs. As previously reported, on May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to certain investigations conducted by the IL State Agencies involving contingent commission arrangements. As stipulated in the AVC, on January 12, 2006, Gallagher paid $26.9 million into a fund (the Fund) to be distributed to certain eligible policyholder clients. As of December 31, 2006, $8.6 million remained in the Fund, which is available to satisfy existing and future AVC related claims and other potential settlement obligations as allowed by the AVC. In addition, under the AVC, Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.-domiciled retail contingent compensation as defined in the AVC. On October 26, 2004, Gallagher announced that it would not enter into any new volume-based or profit-based contingent commissions agreements as a retail broker effective January 1, 2005. However, as allowed under the AVC, Gallagher has continued to accept contingent compensation from non-retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired up to three years from the acquisition date. See Note 17 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements for a discussion of the material terms of the AVC. In 2005, Gallagher began to experience reduced contingent commission revenue and it is expected that future contingent commission revenues will continue to be substantially reduced. The reduction in retail contingent commissions, as discussed above, has continued to have a substantial negative impact on Gallagher s pretax earnings in 2006 and is expected to continue to have such effect on future earnings.

Risk Management

The Risk Management Segment consists of Gallagher s wholly-owned subsidiary, Gallagher Bassett Services, Inc. (GB).

GB provides a full range of risk management services including claims management, risk control consulting services, information management, and property appraisals on a totally integrated or select, stand-alone basis. GB provides these services for Gallagher s clients through a network of service offices located throughout the U.S., Canada, England, Scotland and Australia.

GB primarily markets its risk management services directly to clients on an unbundled basis independent of Gallagher s brokerage operations. GB also markets these services to BSD and SMI clients who use P/C risk management related services.

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In connection with its risk management services, GB provides claims administration services related to self-insurance programs for large institutions, risk sharing pools and associations, and large commercial and industrial customers. Self-insurance, as administered by GB, is a program in which the client assumes a manageable portion of its insurance risks, usually (although not always) placing the less predictable and larger loss exposures with an insurance carrier that specializes in these less predictable exposures.

GB s revenues for risk management services are substantially in the form of fees. These fees are typically negotiated in advance on an annual basis based upon the type and estimated volume of the services to be performed.

GB received a subpoena from the Office of the Attorney General of the State of New York on December 2, 2004 and the Office of the Attorney General of the State of Connecticut on July 24, 2006. On August 21, 2006, GB received a similar subpoena from the Office of the Attorney General of the State of Illinois. The subpoenas request information in connection with separate investigations being conducted by each state and none of the subpoenas relate to Gallagher's brokerage operations. Gallagher is fully cooperating with these investigations.

Financial Services

The Financial Services Segment is primarily responsible for Gallagher s investment portfolio, which includes tax advantaged investments, real estate partnerships, an alternative investment fund manager, notes receivable from investees and, prior to January 25, 2007, an investment in an airplane leasing company that leases two cargo airplanes to the French Postal Service. Financial Services manages Gallagher s invested assets in order to maximize the long-term after-tax return to Gallagher. See Note 3 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which are incorporated herein by reference, for a summary of Gallagher s investments.

Gallagher s overall non-fiduciary investment strategy going forward will be primarily focused on tax advantaged investments. Gallagher has used the limited partnership or limited liability company forms of legal ownership to fund many of its investments in order to obtain favorable tax treatment with respect to gains, losses and distributions, while limiting its liability. Based on the ownership structure of these investments, management believes that Gallagher s exposure to losses related to these investments is limited to the combination of its net carrying value, letters of credit, financial guarantees and funding commitments. In the event that certain of these limited partnerships or limited liability companies were to default on their debt obligations and Gallagher s net carrying value became impaired, the amount to be written-off could have a material effect on Gallagher s consolidated financial position or operating results. In some cases, Gallagher may be at risk for tax credits taken in previous years, which may also be material to its operations. See Note 3 and Note 17 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which are incorporated herein by reference, for a summary of outstanding letters of credit, financial guarantees and funding commitments and Note 8 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements for a summary of outstanding debt and contingent commitments. In addition, see Note 3 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements for a summary of Gallagher s tax credit exposure.

International Operations

Total revenues by geographic area for each of the three years in the period ended December 31, 2006 are as follows (in millions):

	2006	2005	2004

	Amount	% of Total	Amount	% of Total	Amount	% of Total
United States	$ 1,335.9	87%	$ 1,323.8	89%	$ 1,289.7	90%
Foreign, principally United Kingdom, Australia and Bermuda	198.1	13%	160.1	11%	147.3	10%
Total revenues	$ 1,534.0	100%	$ 1,483.9	100%	$ 1,437.0	100%

The Brokerage Segment s international operations comprise the following: a Lloyd s of London broker and an insurance and reinsurance brokerage and risk management operation in the United Kingdom; an insurance and reinsurance brokerage operation, a captive management operation and two rent-a-captive insurance and segregated account company facilities in Bermuda; reinsurance intermediary operations in Australia and Singapore; and a network of correspondent brokers and consultants in 120 countries around the world.

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Arthur J. Gallagher (UK) Limited (AJG UK) is a wholly-owned London-based subsidiary of Gallagher. It provides brokerage and other services to clients primarily located outside the United Kingdom. The principal activity of AJG UK is to negotiate and place insurance and reinsurance with London underwriters and insurance companies worldwide. In addition, AJG UK is a Financial Services Authority (FSA) registered broker and an approved Lloyd s of London broker. AJG UK s brokerage services encompass most classes of business within the general categories of aviation, marine, reinsurance (treaty and facultative) and P/C. The focus of AJG UK s business development has been with non-United Kingdom brokers, agents and insurers rather than domestic United Kingdom retail business. Its clients are primarily insurance and reinsurance companies, underwriters at Lloyd s of London, Gallagher s non-United Kingdom subsidiaries, other independent agents and brokers and major business corporations requiring direct insurance and reinsurance placements.

Connor Hale Kerslake Limited (CHK) is a wholly-owned London-based subsidiary of Gallagher. CHK acts primarily as a wholesale broker, placing business with Lloyd s of London and the London Company market for other insurance brokers. Substantially all of CHK s business is derived from Ireland.

Risk Management Partners Ltd. (RMP) is a wholly-owned London-based subsidiary of Gallagher that markets customized insurance and risk management products and services to United Kingdom public entities through offices in England and Scotland. RMP was formed in 1994 and Gallagher believes that RMP is now the third largest provider of insurance brokerage related services to the public entity market in the United Kingdom.

Arthur J. Gallagher & Co. (Bermuda) Limited is a wholly-owned subsidiary of Gallagher that provides clients with direct access to the risk-taking capacity of foreign insurers for both direct and reinsurance placements. It also acts as a wholesaler to Gallagher s marketing efforts by accessing global insurance and reinsurance companies in the placement of U.S. and foreign risks. In addition, it provides services relating to the formation and management of offshore captive insurance companies.

Gallagher has ownership interests in two Bermuda-based insurance companies that operate segregated account rent-a-captive facilities: Artex Insurance Company, a partially owned joint-venture, and Protected Insurance Company, a wholly-owned subsidiary. Rent-a-captives enable clients to receive the benefits of owning a captive insurance company without certain disadvantages of ownership. Captive insurance companies are created for clients to insure their risks and capture underwriting profit and investment income, which is then available for use by the insured generally for reducing future costs of their insurance programs.

Arthur J. Gallagher Australasia Holdings Pty Ltd is a wholly-owned subsidiary of Gallagher that is headquartered in Sydney, Australia. This subsidiary provides insurance and reinsurance placements for international or local Australian companies, and specialty programs and coverages for Australian and other clients through underwriting facilities with Lloyd s of London and local underwriters.

Arthur J. Gallagher Asia Pte Ltd is a 51% owned joint-venture of AJG UK that is based in Singapore. It specializes in treaty and facultative reinsurance placements for insurance companies located throughout Asia. These placements are made directly with reinsurance companies or through Gallagher s subsidiaries and encompass several lines of business.

The Brokerage Segment also has strategic alliances with a variety of international brokers in countries where Gallagher does not have a physical presence. Through a network of correspondent brokers and consultants in 120 countries globally, Gallagher is able to fully serve its clients coverage and service needs in virtually any geographic area where their operations are located.

The Risk Management Segment s international operations principally comprise risk management companies in the United Kingdom and Australia.

Gallagher Bassett International Ltd. (UK) (GB UK), a wholly-owned subsidiary of GB, provides risk management services for foreign operations, as well as U.S. operations that are foreign controlled. Headquartered in London with additional offices in England and Scotland, GB UK works with insurance companies, reinsurance companies, overseas brokers, and risk managers of overseas organizations. Services include consulting, claims management, information management, loss control and property valuations.

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Gallagher Bassett Services Pty Ltd is a wholly-owned subsidiary of GB that is headquartered in Brisbane, Australia with additional facilities located throughout Australia. This subsidiary is principally engaged in providing claims adjusting and risk management services in Australia. Services include consulting, claims management, crisis management, information management, loss control and property valuations.

Gallagher also has risk management service facilities in Canada that are not material to Gallagher s Risk Management Segment.

See Note 18 and Note 20 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which are incorporated herein by reference, for additional financial information related to Gallagher s foreign operations, including earnings from continuing operations before income taxes and identifiable assets, by operating segment, for 2006, 2005 and 2004.

Markets and Marketing

A large portion of the commission and fee business of Gallagher is derived from all types of business institutions, not-for-profit organizations, associations and municipal and other governmental entities. Gallagher s clients include U.S. and multi-national corporations engaged in a broad range of commercial and industrial businesses. Gallagher also places insurance for individuals. Gallagher services its clients through its network of more than 250 sales and service offices in the U.S. and six countries abroad. No material part of Gallagher s business is dependent upon a single customer or on a few customers. The loss of any one customer would not have a materially adverse effect on Gallagher. In 2006, the largest single customer represented approximately 1% of total revenues and the ten largest customers represented approximately 6% of total revenues.

Gallagher believes that its ability to deliver comprehensively structured risk management and brokerage services, including the placement of insurance and reinsurance, is one of its major strengths. Gallagher also believes that its risk management business enhances and attracts insurance brokerage business due to the nature and strength of business relationships that it forms with clients when providing a variety of risk management services on an ongoing basis.

Gallagher requires its employees serving in a sales or marketing capacity, including all executive officers of Gallagher, to enter into agreements with Gallagher restricting disclosure of confidential information and solicitation of clients and prospects of Gallagher upon their termination of employment. The confidentiality and non-solicitation provisions of such agreements terminate in the event of a hostile change in control of Gallagher, as defined therein.

Competition

According to *Business Insurance* magazine (July 17, 2006 edition), Gallagher is the fourth largest insurance broker worldwide based on total revenues. The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals on a global basis who actively compete with Gallagher in every area of its business. Gallagher competes with three firms that are as large or significantly larger than Gallagher in global risk management and brokerage markets. In addition, there are various other competing firms that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large or larger than the particular local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients.

Gallagher is also in competition with certain insurance companies that write insurance directly for their customers. Government benefits relating to health, disability, and retirement are also alternatives to private insurance and hence indirectly compete with the business of Gallagher.

Regulation

In every state and foreign jurisdiction in which Gallagher does business, Gallagher and/or an employee is required to be licensed or receive regulatory approval in order for Gallagher to conduct business. In addition to licensing requirements applicable to Gallagher, most jurisdictions require that individuals who engage in brokerage and certain insurance service activities be personally licensed.

Gallagher s insurance brokerage and risk management operations depend on its continued good standing under the licenses and approvals pursuant to which it operates. Licensing laws and regulations vary from jurisdiction to jurisdiction. In all jurisdictions, the applicable licensing laws and regulations are subject to amendment or interpretation by regulatory authorities. Generally such authorities are vested with relatively broad and general discretion as to the granting, renewing and revoking of licenses and approvals.

As previously discussed, on May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into the AVC with the IL State Agencies to resolve all of the issues related to investigations conducted by the IL State Agencies. Under the AVC, Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.-domiciled retail contingent compensation as defined in the AVC. See Note 17 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements for a discussion of the material terms of the AVC.

Business Combinations

In 2006, Gallagher acquired substantially all the net assets or common stock of ten insurance brokerage firms and a premium finance company (ten asset purchases and one stock purchase) in exchange for its common stock and/or cash and accounted for them as business combinations. See Note 4 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which is incorporated herein by reference, for a summary of the 2006 acquisitions, the amount and nature of the consideration paid and the dates of acquisition.

Since December 31, 2006, Gallagher has completed two acquisitions, which are as follows:

On January 5, 2007, Gallagher acquired substantially all of the net assets of Financial Profiles, Inc., a corporation engaged in the benefits insurance business, in exchange for 305,000 shares of Gallagher s common stock, cash of $9.0 million and a contingent earnout obligation of $9.5 million that, if any is earned, will be paid in cash or stock, at Gallagher s election.

On January 25, 2007, Gallagher acquired substantially all of the net assets of InterNational Insurance Group, Ltd., a corporation engaged in the insurance brokerage business, in exchange for shares of Gallagher s common stock with an aggregate fair value of $1.5 million plus the assumption of approximately $1.2 million of debt.

In addition, on January 24, 2007, Gallagher entered into a Share Purchase Agreement to acquire all of the outstanding capital stock of Lowndes Lambert Group Canada Ltd., a group of corporations engaged in the insurance brokerage business in Canada. The transaction is subject to customary closing conditions and is anticipated to be closed in mid-February 2007.

Gallagher believes that the net effect of these acquisitions has been and will be to expand the volume of general services rendered by Gallagher and the geographical areas in which Gallagher renders such services and not to change substantially the nature of the services performed by Gallagher.

Gallagher is considering and intends to consider from time-to-time, additional acquisitions and divestitures on terms that it deems advantageous. Gallagher at this time is engaged in preliminary discussions with a number of candidates for possible future acquisitions. No assurances can be given that any additional acquisitions or divestitures will be consummated, or, if consummated, will be advantageous to Gallagher.

Employees

As of December 31, 2006, Gallagher employed approximately 8,750 employees, none of whom is represented by a labor union. Gallagher continuously reviews benefits and other matters of interest to its employees and considers its relations with its employees to be satisfactory.

Available Information

Gallagher makes available free of charge on its website at www.ajg.com its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after electronically filing or furnishing such material to the Securities and Exchange Commission.

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Gallagher s Governance Guidelines, Audit Committee Charter, Compensation Committee Charter and Nominating/Governance Committee Charter are also available on our website or upon written or verbal request. Requests for copies of any of these documents should be directed in writing to Investor Relations, Arthur J. Gallagher & Co., Two Pierce Place, Itasca, Illinois 60143-3141, or by telephone to (630) 773-3800.

Item 1A. Risk Factors.

Volatility or declines in premiums or other adverse trends in the insurance industry may seriously undermine Gallagher s profitability.

Gallagher derives much of its revenue from commissions and fees for brokerage and risk management services. Gallagher does not determine the insurance premiums on which its commissions are generally based. Moreover, insurance premiums are cyclical in nature and may vary widely based on market conditions. For example, for an extended period of years through late 2000, heavy competition for market share among insurance carriers, increased underwriting capacity and improved economies of scale following consolidations resulted in flat or reduced premium rates (a soft market), which in turn put downward pressure on Gallagher s commission revenue in many lines and in many geographic areas. After this period of time, the insurance industry transitioned to a hard market, in which premium rates were stable or increasing. This trend was accentuated by the events of September 11^{th}, following which insurance coverage in many lines became less available and premium rates increased, in some cases dramatically. More recently, during the period from 2004 to 2006, the market softened again in many lines and in many geographic areas. However, the abnormally high level of hurricane activity and other natural disasters in those years has hardened the market in certain geographic areas and business lines. Because of these market fluctuations for insurance products, which Gallagher cannot predict or control, its brokerage revenues and profitability can be volatile.

In addition, there have been and may continue to be various trends in the insurance industry toward alternative insurance markets including, among other things, greater levels of self-insurance, captives, rent-a-captives, risk retention groups and non-insurance capital markets-based solutions to traditional insurance. While Gallagher historically has been able to participate in certain of these activities on behalf of its customers, and obtain fee revenue for such services, there can be no assurance that Gallagher will realize revenues and profitability as favorable as those realized from its traditional brokerage activities.

Gallagher s results may be adversely affected if it is unable to successfully implement a new business compensation model.

In October 2004, Gallagher announced that, effective January 1, 2005, it would not enter into any new volume-based or profit-based contingent commissions agreements as a retail broker. In connection with the elimination of contingent commissions, Gallagher established a new business compensation model and commission structure that it implemented in 2005 and continues to refine. There can be no assurance that it will generate incremental commission revenues equivalent to those previously received from contingent commissions. The inability to generate adequate revenues from Gallagher s new business compensation model and commission structure may significantly undermine Gallagher s operating results and profitability.

Gallagher is subject to a number of investigations and legal proceedings concerning contingent compensation, other industry practices and certain conduct, which, if determined unfavorably to Gallagher, could adversely affect its financial strength and results of operations.

Private parties have filed civil litigation against Gallagher under a variety of legal theories relating, among other things, to broker compensation practices. Gallagher is named as a defendant in a purported class action lawsuit pending in the Circuit Court of Cook County, Illinois, which challenges the propriety of alleged undisclosed contingent commissions paid pursuant to certain compensation arrangements between Gallagher and various insurance carriers. Additionally, Gallagher is one of a number of insurance brokerage and insurance company defendants in a Federal Multi-District class action litigation (MDL) pending before the U.S. District Court for the District of New Jersey against commercial insurers and brokers relating to industry-wide contingent commission matters, and is party to various other litigation matters. On December 29, 2006, Gallagher reached an agreement to resolve all claims in the MDL. Gallagher admitted no wrongdoing, but chose to conclude its involvement, rather than prolong what would have been a costly and burdensome lawsuit. The MDL settlement, which is subject to court approval, provides for Gallagher to distribute $28.0 million to current and former clients and others that used a broker to purchase retail insurance from 1994 to 2005. Gallagher will also pay $8.9 million in plaintiffs attorney fees. In the event the MDL settlement is not approved by the court, Gallagher may incur significant additional legal costs and face potential liability in connection with the MDL.

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Additionally, the insurance industry in general, and Gallagher individually, continue to be the subjects of a significant level of scrutiny by various regulatory bodies, including State Attorneys General and the departments of insurance for various states, with respect to contingent commission arrangements. On May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to investigations conducted by the IL State Agencies, pursuant to which it paid $26.9 million into a fund to be distributed to eligible retail customers by March 31, 2006, and agreed to undertake certain business changes. As stipulated in the AVC, on January 12, 2006, Gallagher paid $26.9 million into a fund to be distributed to certain eligible policyholder clients. As of December 31, 2006, $8.6 million remained in the Fund which is available to satisfy existing and future AVC related claims and other potential settlement obligations as allowed by the AVC. For a more detailed discussion of these matters refer to Note 17 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements.

The ultimate outcome of the matters referred to above and similar matters cannot be ascertained and liabilities in indeterminate amounts may be imposed on Gallagher. Gallagher s future results of operations or cash flows for any particular quarterly or annual period could be materially affected by an unfavorable resolution of these matters. In addition, even if Gallagher does not experience significant monetary costs, there has been and may continue to be adverse publicity associated with these matters that could result in reputational harm to Gallagher or to the insurance brokerage industry in general that may adversely affect Gallagher s business.

Gallagher faces significant competitive pressures in each of its businesses.

The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals on a global basis who actively compete with Gallagher in one or more areas of its business. Gallagher competes with three firms that are as large or significantly larger than Gallagher in global risk management and brokerage markets. In addition, there are various other competing firms that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large or larger than the particular local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients. Losing business to competitors offering similar products at lower prices or having other competitive advantages would adversely affect Gallagher s business.

In addition, the increase in competition due to new legislative or industry developments could adversely affect Gallagher. These developments include:

- an increase in capital-raising by insurance underwriting companies, which could result in new capital in the industry which in turn may lead to a soft market and lower insurance premiums and commissions;

- the selling of insurance by insurance companies directly to insureds without the involvement of a broker or other intermediary;

- changes in Gallagher s business compensation model as a result of regulatory developments;

- the establishment of programs in which state-sponsored entities provide health insurance or, in certain cases, property insurance in catastrophe-prone areas or other alternative markets types of coverage;

- an increase in competition from newly-formed or existing insurance brokers who have not agreed to limit their use of contingent commission arrangements, thereby giving them a competitive advantage over those brokers, such as Gallagher, which have agreed to limit the use of such arrangements; and

the creation of in-house servicing capabilities by insurance companies or by certain insurance consumers which compete with the third party administration and other administration, servicing and risk management products offered by Gallagher s Risk Management Segment.

New competition as a result of these or other competitive or industry developments could cause the demand for Gallagher s products and services to change, which could in turn adversely affect Gallagher s results of operations and financial condition.

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Gallagher faces a variety of risks in its Gallagher Bassett Services operations which are distinct from those it faces in its brokerage operations.

Gallagher s Risk Management Segment, which accounted for approximately 26% of Gallagher s total 2006 revenues, operates primarily through its subsidiary, Gallagher Bassett Services, Inc. (GB). GB is a third party administrator and risk consultant that provides a range of risk management services, including claims management, risk control consulting services, information management and property appraisals. While GB s business has less exposure to the hard and soft market cycles described above to which Gallagher s brokerage business is exposed, GB faces a variety of other risks which are unique to its operations, including:

- the risk that the favorable trend among insureds toward outsourcing of various types of claims administration and risk management services will reverse or slow, causing GB to experience reduced revenues or a reduced rate of revenue growth;

- the risk that contracting terms will become less favorable or that the margins on GB s services will be decreased due to increased competition, regulatory constraints or other developments;

- the risk that GB cannot satisfy regulatory requirements on third party administrators or that regulatory developments will impose additional burdens, costs or business restrictions that make GB s business less attractive; and

- the risk that GB cannot control its labor and technology costs in such a manner as to remain competitive in the marketplace for claims administration and risk management services and to conclude its existing contracts (other than those that provide cost-plus or other margin protection) in a cost-efficient and profitable manner.

Gallagher s business, results of operations, financial condition or liquidity may be materially adversely affected by errors and omissions and the outcome of certain actual and potential claims, lawsuits and proceedings.

Gallagher may be subject to various actual and potential claims, lawsuits and other proceedings relating principally to alleged errors and omissions in connection with the placement of insurance and reinsurance in the ordinary course of business. Because Gallagher often assists clients with matters involving substantial amounts of money, including the placement of insurance coverage and the handling of related claims, errors and omissions claims against Gallagher may arise which allege potential liability for all or part of the amounts in question. Claimants may seek large damage awards and these claims may involve potentially significant legal costs.

Gallagher purchases insurance to provide protection from errors and omissions claims that may arise in the ordinary course of business, subject to self-insured deductibles and limits. As of December 31, 2006, the amounts of Gallagher s deductible and limit for claims were $5.0 million and $165.0 million, respectively. Gallagher s business, results of operations, financial condition and liquidity may be adversely affected if, in the future, its insurance coverage proves to be inadequate or unavailable or there is a general increase in the number or amounts of claims to which Gallagher is exposed. Gallagher s future ability to obtain professional indemnity insurance in the amounts and with the deductibles and limits it desires may be adversely impacted by general developments in the market for such insurance or Gallagher s own claims experience. In addition, claims, lawsuits and other proceedings may harm Gallagher s reputation or divert management resources away from operating its business.

Gallagher historically has engaged in a large number of acquisitions of insurance brokers and agencies. Gallagher may not be able to continue to implement such an acquisition strategy in the future and there are risks associated with such acquisitions.

In the past several years, Gallagher has completed numerous acquisitions of insurance brokers and agencies and may continue to make such acquisitions in the future. Gallagher s acquisition program has been an important part of its historical growth and Gallagher believes that similar acquisition activity will be critical to maintaining comparable growth in the future. Failure to successfully identify and complete acquisitions likely will result in Gallagher achieving slower growth. Various factors may affect Gallagher s ability to attract acquisition targets, including Gallagher s inability to continue certain contingent commission compensation structures, particularly in light of the fact that certain other companies in the insurance brokerage industry are not limited in this manner. Moreover, even if Gallagher is able to identify appropriate acquisition targets, it may not be able to execute acquisition transactions on favorable terms or integrate such targets following acquisition in a manner which allows Gallagher to realize the anticipated benefits of such acquisitions, thereby negatively affecting Gallagher s results of operations or leading to unanticipated contingent liabilities and losses.

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Gallagher is subject to insurance industry regulation worldwide. If Gallagher fails to comply with regulatory requirements or if regulations change in a way that adversely affects Gallagher s operations, Gallagher may not be able to conduct its business or may be less profitable.

Many of Gallagher s activities are subject to regulatory supervision. Failure to comply with some of these regulations could lead to disciplinary action that may include requiring clients to be compensated for loss, the imposition of penalties and the revocation of Gallagher s authorization to operate. In addition, changes in legislation or regulations and actions by regulators, including changes in administration and enforcement policies, could from time-to-time require operational changes which could result in lost revenues or higher costs or hinder Gallagher s ability to operate its business.

Gallagher s future success depends, in part, on its ability to attract and retain experienced and qualified personnel.

Gallagher believes that its future success depends, in part, on its ability to attract and retain experienced personnel, including its senior management, brokers and other key personnel. The insurance brokerage industry has experienced intense competition for the services of leading brokers, and Gallagher has lost key brokers to competitors in the past. The loss of any of its senior managers, brokers or other key personnel, or its inability to identify, recruit and retain such personnel, could materially and adversely affect Gallagher s business, operating results and financial condition.

Gallagher has significant non-U.S. operations which expose it to certain additional risks, including the risk of exchange rate fluctuations and geopolitical risk.

A significant portion of Gallagher s operations is conducted outside the U.S. Accordingly, Gallagher is subject to legal, economic and market risks associated with operating in foreign countries. Operating in these countries may present risks that are different from, or greater than, risks to Gallagher of doing comparable business in the U.S.

Some of Gallagher s foreign subsidiaries receive revenues or incur obligations in currencies that differ from their functional currencies. Gallagher must also translate the financial results of its foreign subsidiaries into U.S. dollars. Although Gallagher had a foreign currency hedging strategy in 2006, such risks cannot be eliminated entirely, and significant changes in exchange rates may adversely affect Gallagher s results of operations.

Gallagher also operates in certain countries where the risk of political and economic uncertainty is relatively greater than that present in the U.S. and more established countries. Gallagher s operations in these countries may be temporarily or permanently disrupted by adverse geopolitical or economic conditions in these locations. For example, Gallagher uses third-party service providers located in India for certain back office services. To date, the dispute between India and Pakistan involving the Kashmir region, incidents of terrorism in India and general geopolitical uncertainties have not adversely affected Gallagher s infrastructure in India. However, such factors could potentially affect Gallagher s infrastructure or ability to utilize third-party providers in the future. Should Gallagher s access to these services be disrupted, Gallagher s business, operating results and financial condition could be adversely affected.

Gallagher is exposed to various risks relating to losses on investments held by its Financial Services business.

Gallagher s Financial Services business holds a variety of investments, including (i) an interest in a holding company that holds interests in private investment management firms, (ii) early-stage loans and partnership interests relating to low income housing developments, (iii) investments in partnerships formed to develop energy that qualifies for tax credits under Internal Revenue Code (IRC) Section 29 and (iv) certain other real estate and other investments. These investments are subject to risk of impairment due to a variety of causes, including general overall economic conditions, the effects of changes in interest rates, various regulatory issues, credit risk, potential litigation, failure to monetize in an effective and/or cost-efficient manner and poor operating results. Any of these consequences may diminish the value of Gallagher s invested assets and adversely affect its net worth and profitability.

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Gallagher has historically benefited from Section 29 tax credits. The disallowance or termination of Section 29 tax credits, or the loss of all or part of its Section 29 tax credits due to phase out of such credits, would decrease Gallagher s revenues, increase its costs, increase its effective tax rate and decrease its income.

Under current law, IRC Section 29 tax credits are not available for synthetic fuel sold after December 31, 2007, and, if the law is not extended, Gallagher s effective federal income tax rate in 2008 will likely adjust upward to fall within a range of approximately 40.0% to 42.0%. In addition, there have been initiatives from time-to-time to consider the early repeal or modification of IRC Section 29, and the IRS is continuing to audit taxpayers claiming IRC Section 29-tax credits related to synthetic fuel facilities with respect to a variety of issues. In addition, through December 31, 2007, IRC Section 29 has a phase-out provision that is triggered when domestic crude oil reaches certain Phase-out Prices as determined by the IRS. It is not possible for Gallagher to calculate exactly what oil prices will average (as determined by the IRS) for all of calendar year 2006 nor forecast what they will be in 2007. Accordingly, for purposes of recognizing revenues and expenses related to IRC Section 29-related investments for 2006, Gallagher assumed an average 2006 calendar year New York Mercantile Exchange (NYMEX) Price of $66.12. This average produces an IRC Section 29 phase-out of approximately 36% and was determined by using actual daily closing prices from January 1 to December 29, 2006. For calendar year 2007, Gallagher estimates that the commonly reported crude oil price (NYMEX price) would need to average approximately $62.00 per barrel for calendar 2007 for any phase-out to begin and average approximately $78.00 per barrel for calendar 2007 for a complete phase-out. The average daily NYMEX Price for 2007 through January 25 was $54.23 per barrel.

To partially mitigate the financial risk of a phase-out, which reduces the value of the tax credits earned and reduces the installment sale gains from Gallagher s IRC Section 29-Syn/Coal investments, Gallagher entered into arrangements in both 2006 and 2007 with unaffiliated third parties which constitute call spreads on oil futures to create financial hedges that were designed to generate gains to Gallagher in the event of certain levels of increased oil prices. These hedges are not intended to be perfect hedges for accounting purposes, but are intended to mitigate a substantial portion of the negative impact to Gallagher of increased oil prices. Any oil price derivative gains are designed to offset a portion of the expenses associated with operating Gallagher s IRC Section 29-Syn/Coal facilities in the event of a phase-out of IRC Section 29 tax credits, which phase-outs are based on oil prices averaging certain levels for calendar years 2006 and 2007.

There can be no assurance that future oil prices will be below future phase-out levels. Should Gallagher or its partners anticipate that oil prices may cause a significant Phase-out of the IRC Section 29 tax credits in 2007, some or all of Gallagher s IRC Section 29 operations could be curtailed, resulting in Gallagher earning fewer tax credits, realizing a higher effective tax rate for federal income tax purposes and triggering indemnification payment obligations under various agreements which Gallagher has with its investment partners. For further information about the negative effects these contingencies could have on Gallagher s results of operations, see the discussion on IRC Section 29 tax credits included in Management s Discussion and Analysis of Financial Condition and Results of Operations, which is included in Gallagher s 2006 Financial Statements under the caption entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and is incorporated herein by reference.

Item 2. Properties.

Gallagher s executive offices and certain subsidiary and branch facilities are located at Two Pierce Place, Itasca, Illinois, where Gallagher leases approximately 308,000 square feet of space, or approximately 60% of the building. The lease commitment on this property expires February 28, 2018. Gallagher has a 60% ownership interest in a real estate limited partnership that, prior to December 7, 2006, owned the Two Pierce Place property. On December 7, 2006, the partnership sold its ownership interest in Gallagher s home office land and building and extinguished related debt of $75.2 million. Related to this sale, Gallagher received cash of $7.9 million and recognized a $4.2 million pretax loss. Prior to December 7, 2006, this investment was consolidated into Gallagher s Consolidated Financial Statements. See Notes 3, 8 and 17 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which are incorporated herein by reference for additional information with respect to this ownership interest and related lease commitment.

Gallagher generally operates in leased premises. Certain of Gallagher s office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain annual escalation clauses generally related to increases in an inflation index. See Note 17 to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements, which is incorporated herein by reference, for information with respect to Gallagher s lease commitments at December 31, 2006.

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Item 3. Legal Proceedings.

Information regarding legal proceedings of Gallagher is included in Note 17 (Litigation) to the Consolidated Financial Statements of Gallagher s 2006 Financial Statements and is incorporated herein by reference.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during Gallagher s fourth quarter ended December 31, 2006.

Item 4A. Executive Officers of the Registrant.

The executive officers of Gallagher are as follows:

Name	Age	Position and Year First Elected
J. Patrick Gallagher, Jr.	55	Chairman since 2006, President since 1990, Chief Executive Officer since 1995
Elizabeth J. Brinkerhoff	63	Vice President since 1993
Richard C. Cary	44	Controller since 1997, Chief Accounting Officer since 2001, Acting Chief Financial Officer September 2002 to April 2003
James W. Durkin, Jr.	57	Vice President since 1985, President of GBS since 1985
James S. Gault	55	Vice President since 1992, President and Chief Operating Officer of BSD since June 2002
Douglas K. Howell	45	Vice President since March 2003 and Chief Financial Officer since April 2003
David E. McGurn, Jr.	54	Vice President since 1993, President of SMI since 2001
Richard J. McKenna	60	Vice President since 1994, President of GB since 2000
John C. Rosengren	60	Vice President and General Counsel since 1995, Secretary since 2002

With the exception of Mr. Howell, each such person has been principally employed by Gallagher in management capacities for more than the past five years. All executive officers are elected annually and serve at the pleasure of the Board of Directors.

Prior to joining Gallagher on March 3, 2003, Mr. Howell was employed as Senior Vice President and Chief Financial Officer of 21st Century Insurance Group (NYSE:TW) from April 2001 to February 2003 and prior thereto as Senior Vice President and Chief Financial Officer of GuideOne Insurance Group since 1997.

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Part II

Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Gallagher s common stock is listed on the New York Stock Exchange, trading under the symbol AJG. The following table sets forth information as to the price range of Gallagher s common stock for the two-year period January 1, 2005 through December 31, 2006 and the dividends declared per common share for such period. The table reflects the range of high and low sales prices per share as reported on the New York Stock Exchange composite listing.

	High	Low	Dividends Declared per Common Share
Quarterly Periods			
2006			
First	$ 31.77	$ 27.65	$ .30
Second	28.32	24.75	.30
Third	28.14	24.42	.30
Fourth	30.42	26.44	.30
2005			
First	$ 32.85	$ 28.55	$ .28
Second	29.15	26.48	.28
Third	29.78	26.54	.28
Fourth	31.94	28.16	.28

As of December 31, 2006, there were approximately 900 holders of record of Gallagher s common stock.

Issuer Purchases of Equity Securities

(in thousands, except per share data)

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
October 1 to October 31, 2006		$		4,600.0
November 1 to November 30, 2006	592.0	29.26	592.0	4,008.0
December 1 to December 31, 2006	104.0	29.93	104.0	3,904.0

Total	696.0	$ 29.36	696.0

(1) As set forth in its public filings, Gallagher has a common stock repurchase plan that was adopted by the Board of Directors on May 10, 1988 and has been periodically amended (last amendment was on July 21, 2005) since that date to authorize additional shares for repurchase. Under the provisions of the repurchase plan, as of December 31, 2006, Gallagher continues to have the capacity to repurchase approximately 3.9 million shares. On January 18, 2007, Gallagher announced the continuation of the repurchase plan bringing the cumulative total repurchase authorization to 5.0 million shares. There is no expiration date for the plan and Gallagher is under no commitment or obligation to repurchase any particular amount of common stock under the plan. At its discretion Gallagher may suspend the repurchase plan at any time.

Information relating to the compensation plans under which equity securities of Gallagher are authorized for issuance is included in the disclosure set forth under the caption Equity Compensation Plan Information in Gallagher s 2007 Proxy Statement and is incorporated herein by reference.

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Item 6. Selected Financial Data.

The following selected consolidated financial data for each of the five years in the period ended December 31, 2006 have been derived from Gallagher s Consolidated Financial Statements. Such data should be read in conjunction with Gallagher s Consolidated Financial Statements and related notes thereto, which have been incorporated by reference in Item 8 of this annual report.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In millions, except per share and employee data)				
Consolidated Statement of Earnings Data:					
Commissions	$ 852.0	$ 813.1	$ 760.6	$ 705.5	$ 621.8
Fees	585.8	537.5	490.0	418.7	352.2
Investment income and other	96.2	133.3	186.4	96.9	46.6
Total revenues	1,534.0	1,483.9	1,437.0	1,221.1	1,020.6
Total expenses before litigation and contingent commission matters and claims handling obligations	1,371.9	1,267.1	1,199.7	1,028.3	836.0
Litigation and contingent commission matters and claims handling obligations	9.0	219.6			
Earnings (loss) before income taxes	153.1	(2.8)	237.3	192.8	184.6
Provision (benefit) for income taxes	24.6	(31.4)	47.8	46.9	55.2
Earnings from continuing operations	128.5	28.6	189.5	145.9	129.4
Earnings (loss) on discontinued operations, net of income taxes		2.2	(1.0)	0.3	0.5
Net earnings	$ 128.5	$ 30.8	$ 188.5	$ 146.2	$ 129.9
Per Share Data:					
Diluted earnings from continuing operations per share (1)	$ 1.31	$ .30	$ 2.00	$ 1.57	$ 1.41
Diluted net earnings per share (1)	1.31	.32	1.99	1.57	1.41
Dividends declared per common share (2)	1.20	1.12	1.00	.72	.60
Share Data:					
Shares outstanding at year end	98.4	95.7	92.1	90.0	88.5
Weighted average number of common shares outstanding	97.1	94.1	91.5	90.0	87.3
Weighted average number of common and common equivalent shares outstanding	98.4	96.1	94.5	93.3	91.9
Consolidated Balance Sheet Data:					
Total assets	$ 3,420.1	$ 3,389.5	$ 3,233.3	$ 2,900.4	$ 2,463.5
Long-term debt less current portion	25.9	107.6	140.0	122.1	128.3
Total stockholders equity	864.1	769.1	761.0	619.1	528.2
Return on beginning tangible net worth (3)	37%	8%	48%	37%	42%
Employee Data:					
Number of employees at year end	8,757	8,135	7,840	6,808	6,664
Total revenue per employee (4)	$ 175,000	$ 182,000	$ 183,000	$ 179,000	$ 153,000
Earnings from continuing operations before litigation and contingent commission matters and and claims handling obligations per employee	$ 15,000	$ 21,000	$ 24,000	$ 21,000	$ 19,000

(4) (5)

(1) Based on the weighted average number of common and common equivalent shares outstanding during the year.
(2) Based on the total dividends declared on a share of common stock outstanding during the entire year.
(3) Represents net earnings divided by total stockholders equity, less net balance of goodwill and amortizable intangible assets, as of the beginning of the year.
(4) Based on the number of employees at year end.
(5) Represents earnings from continuing operations before the after tax impact of litigation and contingent commission matters and claims handling obligations related charges.

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Certain Non-GAAP Financial Measures. The line item in the preceding selected financial data table entitled Earnings from continuing operations before litigation and contingent commission matters and claims handling obligations per employee may be considered a non-GAAP financial measure within the meaning of SEC regulations because it is derived from Gallagher s consolidated financial information but is not required to be presented in financial statements that are prepared in conformity with U.S. generally accepted accounting principles (GAAP). Consistent with SEC regulations, a description of such information is provided in the table above and a reconciliation of certain of such items to GAAP is provided herein. Charges in 2006 related to retail contingent commission related matters totaled $9.0 million (or $5.4 million after tax). Charges in 2005 related to litigation related matters, retail contingent commission related matters and claims handling obligations totaled $131.0 million (or $84.2 million after tax), $73.6 million (or $44.2 million after tax) and $15.0 million (or $9.8 million after tax), respectively. There were no such items in 2002 to 2004. These amounts, which Gallagher believes are non-recurring, were added back to earnings from continuing operations in 2006 and 2005 in order to calculate earnings from continuing operations before litigation and contingent commission related matters and claims handling obligations per employee.

Gallagher believes the items included above provide meaningful additional information, which may be helpful to investors in assessing certain aspects of Gallagher's operating performance and financial condition that may not be otherwise apparent from GAAP. Industry peers provide similar supplemental information, although they may not use the same or comparable terminology and may not make identical adjustments. This non-GAAP information should be used in addition to, but not as a substitute for, the GAAP information.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Information regarding Management s Discussion and Analysis of Financial Condition and Results of Operations is included in Gallagher s 2006 Financial Statements under the caption entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and is incorporated herein by reference. All of such information should be read in conjunction with Gallagher s Consolidated Financial Statements and related notes thereto, which have been incorporated by reference in Item 8 of this annual report.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Information regarding Quantitative and Qualitative Disclosures about Market Risk is included in Gallagher s 2006 Financial Statements under the caption entitled Quantitative and Qualitative Disclosures about Market Risk and is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

Gallagher s Consolidated Financial Statements, the related notes thereto and Report of Independent Registered Public Accounting Firm are included in Gallagher s 2006 Financial Statements and are incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

There were no changes in or disagreements with accountants on accounting and financial disclosure.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures.

As of December 31, 2006, Gallagher s management, including Gallagher s Chief Executive Officer (CEO) and Chief Financial Officer (CFO), have conducted an evaluation of the effectiveness of its disclosure controls and procedures pursuant to Rule 13a-15(b) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that Gallagher s disclosure controls and procedures were effective as of December 31, 2006.

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Design and Evaluation of Internal Control Over Financial Reporting.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, Gallagher included a report of management s assessment of the design and effectiveness of its internal controls as part of this Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Gallagher s independent registered public accounting firm also attested to, and reported on, management s assessment of the effectiveness of internal control over financial reporting. Management s report and the independent registered public accounting firm s attestation report are included in Gallagher s 2006 Financial Statements under the captions entitled Management s Report on Internal Control Over Financial Reporting and Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting and are incorporated herein by reference.

Changes in Internal Control Over Financial Reporting.

There has been no change in Gallagher s internal control over financial reporting during fourth fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, Gallagher s internal control over financial reporting.

Item 9B. Other Information.

Not applicable.

Part III

Item 10. Directors, Executive Officers of the Registrant and Corporate Governance.

Information regarding directors and nominees for directors of Gallagher is included under the caption entitled Election of Directors in the 2007 Proxy Statement and is incorporated herein by reference. Information regarding executive officers of Gallagher is included under the caption entitled Executive Officers of the Registrant in Part I of this annual report. Information regarding Gallagher s Audit Committee is included under the caption entitled Board of Directors and Committees - Audit Committee in the 2007 Proxy Statement and is incorporated herein by reference.

The Board of Directors has determined that Gary P. Coughlan qualifies as an Audit Committee financial expert, as such term is defined in rules of the Securities and Exchange Commission implementing requirements of the Sarbanes-Oxley Act of 2002. Gallagher s Audit Committee is a separately designated committee of the Board of Directors and is comprised of the following independent directors: William L. Bax, T. Kimball Brooker, Gary P. Coughlan and James R. Wimmer.

Gallagher has adopted a Code of Business Conduct and Ethics that applies to all of Gallagher s employees and directors, including its principal executive officer, principal financial officer and principal accounting officer. Gallagher s Code of Business Conduct and Ethics covers all areas of professional conduct including, but not limited to, conflicts of interest, disclosure obligations, insider trading, confidential information, as well as compliance with all laws, rules and regulations applicable to Gallagher s business.

A copy of Gallagher s Code of Business Conduct and Ethics is posted on its website at www.ajg.com. In the event that an amendment to, or a waiver from, a provision of Gallagher s Code of Business Conduct and Ethics that applies to any of Gallagher s officers or directors is necessary, Gallagher intends to post such information on its website.

Gallagher undertakes to provide without charge to any person, upon written or verbal request of such person, a copy of Gallagher s Code of Business Conduct and Ethics. Requests should be directed in writing to Investor Relations, Arthur J. Gallagher & Co., Two Pierce Place, Itasca, Illinois 60143-3141, or by telephone to (630) 773-3800.

There have been no material changes to the procedures by which stockholders may recommend nominees to Gallagher s Board of Directors since Gallagher s disclosure of such procedures under the caption entitled Corporate Governance - Nomination of Directors in the 2006 Proxy Statement.

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Item 11. Executive Compensation.

Information regarding executive compensation of Gallagher s directors and executive officers is included in the 2007 Proxy Statement under the caption entitled Compensation of Executive Officers and Directors, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information regarding beneficial ownership of the Common Stock by certain beneficial owners and by management of Gallagher is included under the caption entitled Principal Holders of Securities in the 2007 Proxy Statement and is incorporated herein by reference.

Information regarding the number of shares of Common Stock available under Gallagher s equity compensation plans is included under the caption entitled Equity Compensation Plan Information in the 2007 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information relating to relationships and related transactions is included under the heading Certain Relationships and Related Transactions, and Director Independence in the 2007 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services.

Information regarding principal accountant services is included in the 2007 Proxy Statement under the caption entitled Principal Accountant Fees and Services, and is incorporated herein by reference.

Part IV

Item 15. Exhibits and Financial Statement Schedules.

The following documents are filed as a part of this report:

1. Consolidated Financial Statements from Gallagher s 2006 Financial Statements which are incorporated herein by reference:

(a) Consolidated Statement of Earnings for each of the three years in the period ended December 31, 2006.

(b) Consolidated Balance Sheet as of December 31, 2006 and 2005.

(c) Consolidated Statement of Cash Flows for each of the three years in the period ended December 31, 2006.

(d)