THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt about the contents of this document, you should immediately seek your own personal financial advice from your stockbroker, bank manager, solicitor, accountant or other independent financial adviser duly authorised under the Financial Services and Markets Act 2000 if you are in the United Kingdom or, if not, another appropriately authorised independent financial adviser. The whole text of this document should be read.

This document comprises a prospectus relating to Lancashire Holdings Limited (the "**Company**" or "**LHL**") prepared in accordance with the Prospectus Rules made under section 73A of the Financial Services and Markets Act 2000, as amended (the "**FSMA**"). This document has been filed with, and approved by, the Financial Services Authority pursuant to section 87A of FSMA and has been made available to the public in accordance with paragraph 3.2 of the Prospectus Rules. Application has been made to the UK Listing Authority for all the share capital of the Company to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange for the Company to be admitted to trading on the London Stock Exchange's main market for listed securities (together "**Admission**"). Admission to the Official List of the UK Listing Authority, together with admission to trading on the London Stock Exchange's main market for listed securities, constitutes admission to official listing on a stock exchange. It is expected that Admission will become effective and that dealings will commence at 8.00 am on 16 March 2009.

The Directors of the Company and the Company accept responsibility for the information contained in this document. To the best of the knowledge and belief of the Directors and the Company (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and contains no omission likely to affect the import of such information.

This document should be read in its entirety. In particular, your attention is drawn to the section of this document headed "Risk Factors" for a discussion of certain risk factors that should be considered in connection with an investment in Common Shares.

Merrill Lynch International, which is authorised and regulated in the United Kingdom by the Financial Services Authority, is acting as sponsor to the Company in relation to the matters described in this document and is not acting for any other person and will not be responsible to any other person for providing the protections afforded to customers of Merrill Lynch International nor for advising them on the contents of this document or any other matter in relation to this Prospectus.

LANCASHIRE HOLDINGS LIMITED

(incorporated and registered in Bermuda under registration number 37415)

Prospectus relating to
Admission to the Official List and to trading on the London Stock Exchange

Sponsor

Merrill Lynch International

182,503,063 Common Shares are being admitted to the Official List pursuant to the Admission. The Company will not receive any proceeds in connection with the Admission. The distribution of this document in jurisdictions other than the UK may be restricted by law and therefore persons into whose possession this document comes should inform themselves about and observe such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. This document does not constitute an offer to sell or issue, or the solicitation of an offer to buy or subscribe for, shares in any jurisdiction in which such offer or solicitation is unlawful.

This document does not constitute an offer or an invitation to any person to subscribe for or to purchase any Common Shares. The Common Shares have not been, and will not be, registered under the United States Securities Act of 1933, as amended (the "**Securities Act**"), or qualified for sale under the laws of any state of the United States or under the applicable laws of any of Canada, Australia or Japan, and, subject to certain exceptions, may not be offered or sold in the United States or to any national, resident or citizen of Canada, Australia or Japan. Neither this document nor any copy of it may be sent to or taken into the United States, Canada, Australia or Japan nor may it be distributed to any Canadian person. The distribution of this document in jurisdictions other than the UK may be restricted by law and therefore persons into whose possession this document comes should inform themselves about and observe such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction.

No person has been authorised to give any information or make any representations other than those contained in this document and, if given or made, such information or representations must not be relied upon as having been authorised. Neither the delivery of this document nor any sale made under this document shall, in any circumstances, create any implication that there has been no change in the affairs of the Company since the date of this document and that the information contained in this document is correct as of any time subsequent to the date of this document.

THE UNITED STATES FEDERAL TAX ADVICE CONTAINED HEREIN IS WRITTEN IN CONNECTION WITH THE ADMISSION OF THE COMMON SHARES, AND IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY ANY PERSON, FOR THE PURPOSE OF AVOIDING US TAX PENALTIES. PROSPECTIVE INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISORS WITH RESPECT TO THEIR PARTICULAR CIRCUMSTANCES CONCERNING THE US FEDERAL, STATE, LOCAL AND NON-US TAX CONSEQUENCES OF OWNING COMMON SHARES.

TABLE OF CONTENTS

		Page
PART I	– SUMMARY	3
PART II	– RISK FACTORS	8
PART III	– INFORMATION ON THE GROUP	23
PART IV	– MANAGEMENT AND CORPORATE GOVERNANCE	32
PART V	– OPERATING AND FINANCIAL REVIEW	36
PART VI	– FINANCIAL INFORMATION	55
PART VII	– REGULATION	107
PART VIII	– ADDITIONAL INFORMATION	116

PART I

SUMMARY

The following information should be read as an introduction to, and in conjunction with, the full text of this document. Any decision to invest in the Common Shares should be based on consideration of this document as a whole.

Where a claim relating to the information contained in a prospectus is brought before a court, a plaintiff investor might, under the national legislation of the European Economic Area States, have to bear the costs of translating the Prospectus before the legal proceedings are initiated. Civil liability attaches to those persons who are responsible for this summary, including any translation of this summary, but only if this summary is misleading, inaccurate or inconsistent when read together with the other parts of this document.

1. INTRODUCTION

Lancashire Holdings Limited ("**LHL**") is the holding company of the Lancashire group of companies incorporated in Bermuda on 12 October 2005. LHL is a specialty provider of insurance and reinsurance on a global basis. It specialises predominantly in property specialty insurance and has subsidiaries in Bermuda, London and Dubai. LHL writes risks primarily within property, energy, marine and aviation segments of the market and has a group rating from A.M. Best of A- (excellent). On 16 December 2005, LHL's shares were admitted to trading on AIM, a market operated by the LSE. A secondary listing on the Bermuda Stock Exchange was approved on 21 May 2007.

2. OVERVIEW OF THE GROUP

Lancashire writes a diversified book of business, mostly on a direct basis, in four principal lines: property, energy, marine and aviation. In 2008, gross premiums written for risks exposed to natural catastrophes represented approximately 35 per cent. of total written premium.

In 2008, the percentage of Lancashire's business written in the four principal lines by gross premium volume was as follows:

- Property 47.5 per cent.
- Energy 29.0 per cent.
- Marine 12.3 per cent.
- Aviation 11.2 per cent.

Lancashire writes mostly direct risks. A small proportion (approximately 17 per cent. of 2008 gross premium) relates to reinsurance risks.

3. KEY STRENGTHS

Lancashire has established a strong three year record and considers that its key strengths are in the following areas:

- *Strong underwriting track record:* the Group's overriding goal is to create a superior risk adjusted return over time. The Group had a combined ratio of 44.3, 46.3 and 86.3 per cent. for 2006, 2007 and 2008, respectively.

- *Strong underwriting team:* the Group's underwriting team is highly experienced. Team leaders in major lines of business have, on average, almost twenty years' experience and, in the opinion of the Directors, are well matched to the lines of business written.

- *Underwriting discipline:* the Group's priority is excellence in underwriting and the pricing thereof, which Lancashire has demonstrated by pro-actively moving into and out of certain business lines as terms and pricing fluctuate.

- *Focus on shareholder returns:* since inception, Lancashire has returned a total of US$397.3 million to shareholders via a share buy-back programme and a strategic dividend, which represents 93 per cent. of cumulative earnings as at 31 December 2008.

- *Strong investment performance:* the Group has a conservative investment philosophy and has produced a total investment return of 6.1 per cent., 6.4 per cent. and 3.1 per cent. for 2006, 2007 and 2008 respectively.

- *Financial strength:* as at 31 December 2008, Lancashire's total capital was US$1.404 billion and its average annual investment performance since inception was 5.1 per cent. The Group has a rating of A- (excellent) from A.M. Best.

- *Distribution strength:* the Group maintains good relationships with the largest global broking firms as well as individual brokers, which it believes is an important factor in achieving effective distribution of its products.

4. SHAREHOLDER RETURNS SINCE INCEPTION

Lancashire aims to maximise risk-adjusted returns through the insurance cycle. Lancashire has been successful in executing this strategy during both hard and soft insurance markets, producing strong operating results in the last three years. Lancashire returned US$339.3 million of capital to shareholders in 2007 via a share buyback programme and a strategic dividend, which was declared in 2007 and paid in 2008. In 2008 Lancashire returned approximately US$58 million via an on-market share buyback programme. Lancashire has produced a compound annual return of 17.7 per cent. since inception.

5. INVESTMENT STRATEGY

The Group's investment guidelines are established by the Investment Committee of the Board of Directors. Lancashire's primary investment objectives are to preserve capital and provide adequate liquidity to the Group. As liquidity is a significant criterion, the Group aims to maintain liquid securities at sufficient levels to meet expenses.

6. SUMMARY OF FINANCIAL INFORMATION

The summary historical financial information of the Group set out below has been extracted without material adjustment from Part VI – Financial Information of this document.

The financial information has been prepared in accordance with IFRS.

Income Statement Information for the years ended 31 December 2006, 2007 and 2008

	Year ended 31 December		
	2006	*2007*	*2008*
		US$m	
Gross premiums written	626.0	753.1	638.1
Net premiums written	547.5	666.8	574.7
Net premiums earned	**243.5**	**611.2**	**607.3**
Net investment income	54.2	78.4	59.5
Net realised (losses) gains and impairments on investments	0.8	9.1	(11.0)
Total net revenue	**302.2**	**704.3**	**646.6**
Net insurance losses	**39.1**	**146.3**	**375.5**
Total expenses	130.4	297.7	535.0
Profit before tax	159.5	391.9	97.6
Profit after tax	**159.3**	**390.9**	**97.5**
Net operating income	180.5	390.1	119.4
Earnings per share – basic	US$0.81	US$2.01	US$0.55
Earnings per share – diluted	US$0.79	US$1.91	US$0.53
Dividend per share	—	US$1.10	—
Leverage	10.2%	9.8%	9.3%
Net loss ratio	16.1%	23.9%	61.8%
Net acquisition cost ratio	14.3%	12.5%	16.4%
Administrative expense ratio	13.9%	9.9%	8.1%
Combined ratio	44.3%	46.3%	86.3%

Balance Sheet Information as at 31 December 2006, 2007 and 2008

	As at 31 December		
	2006	*2007*	*2008*
		US$m	
Cash and investments	1,378.2	1,906.5	2,018.8
(Re)Insurance assets	244.3	287.4	303.5
Other assets	40.2	40.8	166.7
Total assets	**1,662.7**	**2,234.7**	**2,489.0**
(Re)Insurance liabilities	373.3	586.7	889.9
Long-term debt	128.6	132.3	130.8
Other payables	23.2	300.1	195.6
Total liabilities	**525.1**	**1,019.1**	**1,216.3**
Net assets	**1,137.6**	**1,215.6**	**1,272.7**
Net tangible assets	1,128.9	1,194.9	1,245.1
Total liabilities and Shareholders' Equity	**1,662.7**	**2,234.7**	**2,489.0**
Net asset value per share (book value per share)	US$5.81	US$6.67	US$7.36
Net tangible asset value per share	US$5.77	US$6.56	US$7.20
Fully converted book value per share ("**FCBVS**")	US$5.68	US$6.38	US$6.86
Change in FCBVS adjusted for dividends	17.4%	31.7%	7.5%
No. of shares in issue	195,743,346	182,283,095	172,849,927
No. of fully diluted shares	233,755,958	222,538,497	218,148,358

7. CURRENT TRADING AND PROSPECTS

From 31 December 2008 to 9 March 2009 (being the latest practicable date prior to the publication of this document) Lancashire has continued to trade in line with the Directors' expectations. Early indications are that pricing and terms are meeting expectations and that there will be a broad-based improvement in pricing across most of the lines of business that the Company writes, as well as some areas of beneficial improvements in terms and conditions.

8. DIVIDEND POLICY

Lancashire intends to maintain a strong balance sheet at all times, while generating an attractive risk-adjusted total return for shareholders. It will actively manage capital to achieve those aims. Capital management is

expected to include the payment of a sustainable annual dividend, supplemented by special dividends from time to time. Dividends will be linked to past performance and future prospects. Under most scenarios, the annual dividend is not expected to reduce from one year to the next. Special dividends are expected to vary substantially in size and in timing.

9. RISK FACTORS

Risks relating to the Group and the industry in which it operates, which could materially adversely affect the business, financial condition or results of operations of the Group, include:

Risks relating to the Group and its industry

- The Group is exposed to risks relating to the current general economic climate.
- Underwriting of insurance risks can be volatile and losses may be incurred.
- If actual claims exceed the Group's claim reserves, the financial condition and results of operations of the Group could be significantly adversely affected.
- Control systems may prove inadequate.
- The Group may not maintain its desired financial strength rating.
- The Group is substantially dependent on a number of key individuals.
- The Group is subject to Bermuda and Dubai employment restrictions.
- The failure of any of the loss limitation methods employed by the Group could have a material adverse effect on the Group's financial condition or its results of operations.
- Coverage disputes can increase expenses and incurred losses.
- Competition within the industry may make profitable pricing difficult.
- The Group may fail to obtain new insurance or reinsurance business.
- The Group depends on brokers to distribute its products, and the loss of business provided by brokers could adversely affect it.
- The Group is exposed to the credit risk of its brokers.
- The Group is subject to the credit risk of its reinsurers and to the availability of reinsurance.
- Changes to the regulatory systems or loss of permits or licences under which the Group operates or breach of regulatory requirements by the Group could have a material adverse effect on its business.
- The terms of the credit facilities available to the Group may impose restrictions on operations, and may restrict growth, result in a competitive disadvantage or adversely affect its ability to conduct business.
- The Group may require additional capital in the future, which may not be available or may only be available on unfavourable terms.
- The Group is exposed to unpredictable and multiple losses.
- Emerging claim and coverage issues could adversely affect the Group's business.
- Bermuda is subject to catastrophe risks.
- There is uncertainty surrounding the Terrorism Risk Insurance Act.
- Loss of business reputation or negative publicity could have a material adverse effect on the Group.
- The Group is exposed to risk of litigation.
- The Group is reliant on third-party service providers and IT systems.
- Investment performance and incorrect assessment of investment risk can affect profitability and the solvency position of the Group.
- Acquisitions or strategic investments could expose the Group to further risks.
- Industry-wide developments could adversely affect the Group's business.

Risks relating to taxation

- The Company and LICL may be subject to UK tax.
- The Group is subject to the UK transfer pricing regime.
- The Company and LICL may become subject to taxes in Bermuda.
- LMEL may be subject to taxes in Dubai/the UAE.
- The Group may be subject to US tax.
- The federal insurance excise tax may apply on a cascading basis and may apply to LUK.
- Holders of 10 per cent. or more of the Common Shares may be subject to US income taxation under the "controlled foreign corporation" rules.

- US Persons who hold Common Shares may be subject to US income taxation at ordinary income rates on their proportionate share of LICL's or LUK's "related person insurance income".
- US Persons who hold Common Shares will be subject to adverse tax consequences if the Company is considered to be a passive foreign investment company for US federal income tax purposes.
- US Persons who dispose of Common Shares may be subject to US federal income taxation at the rates applicable to dividends on a portion of such disposition.
- US tax-exempt organisations who own Common Shares may recognise unrelated business taxable income.
- Changes in US federal income tax law could materially adversely affect an investment in the Common Shares.
- The impact of the Organisation for Economic Cooperation and Development's action to eliminate harmful tax practices is uncertain and could adversely affect the Company's tax status in Bermuda.
- Premium taxes may be payable on premiums received in respect of direct insurance business written by LICL or LUK.

Regulatory risks

- If the Company becomes subject to insurance statutes and regulations in jurisdictions other than Bermuda and the United Kingdom, or there is a change to the law or regulations or application of the law or regulations of Bermuda or the United Kingdom, there could be a significant and negative impact on its business.

Risks relating to the Common Shares

- There are limitations on the ownership, transfers and voting rights of the Common Shares.
- Enforcement of judgments in Bermuda may be difficult.
- A change of control of the Company may be difficult to effect under applicable insurance laws.
- Market risk – the value of Common Shares may go down as well as up.
- US and other non-UK holders of Common Shares may not be able to exercise pre-emption rights.
- Future sales of Common Shares may affect their market price and the future exercise of Warrants or Options will result in immediate and substantial dilution.
- The Company's Common Shares and operating results are subject to currency fluctuations.
- Holding company structure and restrictions on dividends.
- No Takeover Code protection.

10. REASONS FOR MOVE TO THE OFFICIAL LIST

Since its admission to AIM in 2005, the Group has both grown significantly and matured as an insurance underwriter and the Directors believe that a move to the Official List and to trading on the main market of the London Stock Exchange is now appropriate for the next stage of the Group's development. The Directors also believe that due to the higher number of institutional investors who regularly trade in companies admitted to the Official List and the higher profile of such companies, the Company will be better placed to achieve improved liquidity and visibility in the Common Shares following Admission. Furthermore, the Directors believe that a move to the Official List will improve the Company's profile in the insurance market and increase public awareness of Lancashire. This move underlines the success and progress that the Group has made since December 2005.

PART II

RISK FACTORS

An investment in the Common Shares is subject to a number of risks. Accordingly, prospective investors and existing shareholders should consider carefully all of the information set out in this document and the risks attaching to an investment in the Company, including, in particular, the risks described below. The risks listed below do not necessarily comprise all those associated with an investment in the Company, but do comprise those which the Directors regard as material or significant in these circumstances. Additional risks and uncertainties not presently known to the Directors, or those which the Directors currently consider to be immaterial, may also have an adverse effect on the Group.

The Group's business, financial condition or results of operations could be materially and adversely affected by any of the risks described below. In such case, the market price of the Common Shares may decline due to any of these risks and investors may lose all or part of their investment. Investors and prospective investors should consider carefully whether an investment in the Company is suitable for them in light of the information in this document and the financial resources available to them.

1. Risks relating to the Group and its industry

The Group is exposed to risks relating to the current general economic climate.

As at the date of this document, economies and capital markets throughout the world are subject to major uncertainty. The result of private and public investment directed at stabilising the economic and capital markets is uncertain. Business risk for the future may therefore be subject to commercial conditions never before witnessed.

The markets in which the Group offers its services are directly affected by many national and international factors that are beyond its control. Any one of the following factors may cause a substantial decline in the financial markets in which the Group offers its services: legislative and regulatory changes; economic and political conditions in Bermuda, the UK, the US, continental Europe and elsewhere in the world; concerns about terrorism and war; the level and volatility of equity, property and commodity markets; the level and volatility of interest rates and foreign currency exchange rates and concerns over inflation and changes in institutional and consumer confidence levels. In recent years, the financial markets have been adversely affected by acts of war, terrorism and other armed hostilities. They have also been affected by natural disasters.

In addition, the financial crisis in the global credit markets has caused a global liquidity crisis in which interbank lending rates have become significantly higher and lending volumes have contracted. The financial crisis has caused a decline in stock markets worldwide, which have become highly volatile, a loss in investment value of hedge funds, a widening of credit spreads, co-ordinated central bank interventions and the insolvency of several mortgage lenders and banks. It is unclear whether measures taken by central banks and global regulators will be effective or, if effective, when markets will stabilise. Any worsening of general economic conditions in the markets and industries in which the Group operates due to the current disruption in global credit markets and associated impacts on its clients, could result in a decrease in the demand for the Group's products and services and have a material adverse effect on its business, results of operation, prospects and financial condition, such as a reduced ability to raise credit, its liquidity and a reduction in investment returns.

Underwriting of insurance risks can be volatile and losses may be incurred.

The underwriting of insurance risks is, by its nature, a high risk business. Earnings can be volatile and losses may be incurred which have the effect of reducing shareholders' equity. The Group's underwriting is generally focused on low frequency, high severity losses worldwide. The Group's results will be subject to unpredictable and potentially multiple losses.

It is inherent in the nature of insurance business that it is difficult to forecast short-term trends or returns. Not only do underwriting results change but investment income and capital appreciation or depreciation, which from an important part of the return to an investor, are affected by, *inter alia*, interest rates, exchange rates, taxation changes and other economic events (which are outside the Group's control) as well as investment policy and performance and market events. Results may be further impacted in more unusual, volatile or unforeseen ways by the currently unprecedented turmoil in the financial markets

Insurance business is cyclical in nature. The past results of the Group are an historical record and may not necessarily be a reliable guide to future prospects. Previously profitable business may subsequently become unprofitable; the nature of business underwritten may change; reserves created against claims may prove to be inadequate; the Group's reinsurance programme may be insufficient and/or its reinsurers may fail. High returns may be the result of a skilful underwriting or benign weather conditions, but may also indicate an exposure to more volatile risks.

The results of participants in the insurance industry worldwide vary widely as do the results of insurers operating within the Bermudian and London insurance market. Even if the Bermudian and/or London insurance market makes an overall profit, some individual insurers or lines of business may incur losses. The past results of the market are an historical record and may not necessarily be a reliable guide to future prospects.

Previously profitable business may subsequently become unprofitable; the nature of business written may change; reserves created against future claims may prove to be inadequate; an insurer's reinsurance programme may be insufficient and/or its reinsurers may fail.

Underwriting is a matter of judgment, involving important assumptions about matters that by their nature are unpredictable and beyond the control of the Group and for which historical experience and probability analysis may not provide sufficient guidance. One or more catastrophic or other events could result in claims that substantially exceed the Group's expectations, which could have a material adverse effect on the Group's financial condition. A single event could result in significant losses across multiple classes of business. Certain risks are harder to model, and these are managed through aggregate exposure and not probabilistic modelling. The incorrect usage or misunderstanding of these tools may lead to unanticipated exposure to risks relating to certain perils or geographic regions that could negatively impact results.

If actual claims exceed the Group's claim reserves, the financial condition and results of operations of the Group could be significantly adversely affected.

The Group's financial condition and results of operations will be affected by its ability to assess accurately the potential losses associated with the risks that it insures and reinsures, the reliability of the models and the quality of the data that it uses to assist in the decision-making. To the extent actual claims exceed the Group's expectations, it will be required to recognise immediately the less favourable experience. This could cause a material increase in the Group's liabilities and a reduction in its profitability, including an operating loss and reduction of capital.

LICL and LUK are required to maintain reserves to cover estimated ultimate liability for claims (including claims handling expenses) with respect to reported and unreported claims incurred at the end of each accounting period (net of estimated related salvage and subrogation claims and reinsurance recoverables). These reserves are estimated using actuarial and statistical projections based on the Group's expectations at that time of the ultimate settlement and administration of claims. These expectations are derived from facts and circumstances then known, predictions of future events, estimates of future trends in claims severity and other variable factors such as inflation and new concepts of liability. As additional information is developed, it is necessary to revise estimated potential claims and therefore the Group's reserves. The inherent uncertainties of estimating claim reserves are exacerbated for reinsurers by the significant periods of time that often elapse between the occurrence of an insured loss, the reporting of the loss to the primary insurer and, ultimately, to the reinsurer, and the primary insurer's payment of that loss and subsequent indemnification by the reinsurer. Establishing an appropriate level of claim reserves is an inherently uncertain process. Accordingly, actual claims and claim expenses paid will likely deviate, perhaps substantially, from the reserve estimates reflected in the Group's consolidated financial statements.

If the Group's claim reserves are determined to be inadequate after taking into account outwards reinsurance coverage, it will be required to increase claim reserves at the time of such determination with a corresponding reduction in the Group's net income in the period in which the deficiency is rectified. This could have a material adverse effect on the Group. In addition, claim reserves may prove to be inadequate in the event that outwards reinsurance cannot be collected. The Group may be forced to fund its obligations by liquidating investments unexpectedly in unfavourable market conditions or by raising funds at unfavourable costs. It is possible that claims in respect of events that occur could exceed the Group's claim reserves and have a material adverse effect on the Group.

Control systems may prove inadequate.

The Directors believe that the Group has appropriate underwriting, claims, reserving, information technology and financial and management controls in place. However, any disruption in the development of these systems or processes may result in the Group incurring additional costs and may negatively impact the Group's ability to execute its strategy and to analyse in a timely and efficient manner its financial and other business information, and may ultimately have a material adverse effect on the Group.

Underwriting decisions also involve underwriting judgment and the use of important information and data submitted to underwriters by the brokers. Failure to ensure that sound underwriting disciplines are maintained and that risks reflect the business plan and strategy of the Group can affect the underwriting losses of the Group.

In the event that any employee or Director of a member of the Group undertakes unauthorised underwriting activities on behalf of the Group beyond the contemplated scope of the Group's business, this would change the anticipated risk profile of the Group and could have a material adverse effect on the Group.

Whilst the Directors believe the Group has in place appropriate protections against fraud, theft, misuse of funds, money laundering or other unauthorised or criminal activities, such systems may prove inadequate. In the event that the Group is subject to such activities and such systems prove inadequate this may lead to a material adverse effect on the Group.

The Group may not maintain its desired financial strength rating.

Third-party credit rating agencies assess and rate the claims-paying ability of insurers and reinsurers based upon criteria established by the rating agencies. The claims-paying ability ratings assigned by rating agencies to insurance and reinsurance companies represent independent opinions of financial strength and ability to meet policyholder or other obligations, but are not directed toward the protection of investors. Insureds and intermediaries use these ratings as one measure by which to assess the financial strength and quality of

insurers and reinsurers. These ratings are often a key factor in the decision by an insured or an intermediary on whether to place business with a particular insurance or reinsurance provider. Many insureds, cedants and intermediaries maintain a listing of acceptable insurers or reinsurers, generally based upon credit ratings, and an "A-" financial strength rating is the minimum rating normally acceptable for these insureds, cedants and intermediaries to include a particular insurer or reinsurer on such a list. The Group has a rating of A- (excellent) from A.M. Best.

The Group understands that its performance will continue to be monitored by A.M. Best on a regular basis and any material deviation from the Group's business plan could lead to a ratings downgrade or placing on a negative credit watch. A ratings downgrade or placing of LICL or LUK on negative credit watch by A.M. Best or another rating agency could have an adverse effect on the Group's ability to write business generally and/ or the Group's ability to write in certain classes of business. Failure to qualify for inclusion on lists of acceptable insurers or reinsurers would seriously reduce the volumes of business presented to the Group's underwriters. A downgrade or placing of the Group on negative credit watch could, therefore, result in a substantial loss of business as insureds, cedants and brokers that place business with the Group might move to other insurers and reinsurers with higher credit ratings or insist on less favourable terms as a condition of continuing to do business with the Group. A credit rating downgrade might also give rise to a right of termination or amendment to any credit facilities the Company may have or reinsurance contracts placed with the Group or under which the Group is reinsured.

Third-party credit rating agencies may increase the levels of capital they require an insurer or reinsurer to hold in order to maintain a certain credit rating. Such changes could result in the Group having to raise additional capital in the longer term in order to maintain its credit rating, or, should the Group not raise such additional capital, could result in a downgrade of its credit rating, and could have a material adverse effect on the Group.

The Group is substantially dependent on a number of key individuals.

The Group's future success is substantially dependent on the continued services and continuing contributions of its Directors, senior underwriters, senior management and other key personnel and its ability to continue to attract, motivate and retain the services of suitable personnel. The loss of the services of any of the Group's Directors, senior underwriters, senior management or other personnel could have a material adverse effect on the Group's business. While the Group has entered into employment contracts or letters of appointment with such key personnel, the retention of their services cannot be guaranteed.

The success of the Group depends in part upon its continuing ability to recruit and retain employees with suitable skills and experience. There can be no assurance that the Group will be able to recruit sufficient or suitable staff, or that the individuals that it would like to recruit will be able to obtain the necessary work permits if required or that it will be able to retain such staff. In addition, there may be other factors affecting the Group's ability to recruit and retain staff, such as a lack of accommodation of sufficient quality in Bermuda and Dubai. The inability to recruit and retain staff of suitable quality could have a material adverse effect on the ability of the Group to continue to conduct business.

The Group is subject to Bermuda and Dubai employment restrictions.

From time to time, the Group may need to hire additional employees in Bermuda and Dubai. Under Bermuda law, non-Bermudians (other than spouses of Bermudians) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of Bermudian) is available who meets the minimum standard requirements for the advertised position. In April 2001, the Bermuda government announced a policy limiting the duration of work permits to six years, with certain exemptions for key employees. The government in Bermuda has also considered from time to time, legislation that could impose burdens on companies that may make it more difficult to operate in Bermuda. It is possible that due to these restrictions, the Group may lose services of key employees or future key employees in Bermuda who are non-Bermudian if the Group was unable to obtain or renew their work permits, which could have a material adverse effect on the Group's business.

In addition, the right of non-UAE nationals to reside and work anywhere in the UAE is subject to certain restrictions under applicable federal laws and regulations. In particular non-UAE nationals may not take up any employment without first obtaining from the relevant federal authorities a residence visa with "work permit" endorsement. Such visas are usually valid for a period of 3 years, but may be renewed for further periods on application to the concerned authorities. The federal rules regarding residence and employment apply to non-nationals employed in all the various free zone areas that have been established in Dubai, which includes the DIFC.

The failure of any of the loss limitation methods employed by the Group could have a material adverse effect on the Group's financial condition or its results of operations.

The Group seeks to limit its exposure to insurance losses through a number of loss limitation methods, including internal risk management and security procedures as well as through the purchase of outwards reinsurance protection. The Group's underwriting processes include the setting and monitoring of underwriting guidelines and the monitoring and control of risks written. Underwriting is a matter of judgment involving important assumptions about matters that are inherently unpredictable and beyond the Group's control and for which historical experience, probability analysis and data quality may not provide sufficient guidance.

Various provisions of policies written by LICL and LUK, such as limitations or exclusions from coverage or choice of forum, may not be enforceable in the manner the Directors intend due to, among other things, disputes relating to coverage and choice of legal forum.

Notwithstanding the risk mitigation and underwriting controls employed, one or more catastrophic or other loss events or a greater frequency of losses than expected could result in claims that substantially exceed the Group's expectations, which could have a material adverse effect on its financial condition or results of operations, possibly to the extent of eliminating the Group's shareholders' equity.

There can be no assurance that outwards reinsurance or retrocession will be available to the Group in the future, or that it will be available on terms or at a cost deemed by the Group to be appropriate or acceptable (including as to its accounting and regulatory treatment) or from entities with satisfactory credit-worthiness.

Coverage disputes can increase expenses and incurred losses.

There can be no assurance that various provisions of the Group's insurance policies and reinsurance contracts, such as limitations on, or exclusions from, coverage, will be enforceable in the manner intended. Disputes relating to coverage and choice of legal forum can be expected to arise, as a result of which a Group company may incur losses beyond those that it considered might be incurred at the time of underwriting the insurance policy or reinsurance contract.

Competition within the industry may make profitable pricing difficult.

The insurance industry is highly competitive. In its underwriting activities, the Group may find itself in competition with other insurers that may have an established position in the market or greater financial, marketing and management resources available to them. Competition in the types of business that the Group may underwrite is based on many factors, including premiums charged and other terms and conditions agreed, services provided, financial strength ratings assigned by third-party credit rating agencies, speed of claims payment, reputation, and perceived financial strength and experience in the line of business to be written. Competition can adversely affect premium levels by increasing insurance industry capacity, reducing prices in response to favourable loss experience, affecting the pricing of underlying direct coverage and other factors, any of which can develop in a relatively short period of time. In addition, the Group cannot predict the extent to which competition from new competitors (including hedge funds, capital markets products such as catastrophe bonds and, in the near future, new entrants that provide similar products) or existing competitors raising capital could mitigate projected increases of premium rates. There is a divergence of views among market participants on the likely duration and extent of anticipated rate improvements. Increased competition could result in fewer submissions, lower premium rates or less favourable policy terms and conditions with respect to the Group's business, which could adversely affect the Group's potential growth and profitability and have a material adverse effect on the Group's financial condition.

The Group may fail to obtain profitable new insurance or reinsurance business.

The Group may fail to obtain new insurance business at the desired profitable rates. There can be no assurance that business will be available to the Group on terms or at a pricing that it considers to be attractive, nor can there be any assurance that if such terms or pricing exist at present, they will continue as policies renew.

The Group depends on brokers to distribute its products, and the loss of business provided by brokers could adversely affect it.

The Group will be dependent upon brokers to distribute its products. Brokers are independent and, therefore, no broker is committed to recommend or sell the products of the Group. Accordingly, the Group's relationships with brokers distributing its products will be important, and any failure, inability or unwillingness of brokers to distribute the Group's products could have a material adverse affect on the Group.

The Group is exposed to the credit risk of its brokers.

In accordance with industry practice, the Group generally pays amounts owed on claims under its insurance and reinsurance contracts to brokers, and these brokers, in turn, pay these amounts over to the clients that have purchased insurance or reinsurance from the Group. If a broker fails to make such a payment, it is possible that the Group will be liable to the client for the deficiency because of local laws or contractual obligations. Likewise, in certain jurisdictions, when the insured or ceding insurer pays premiums for these policies to brokers for payment over to the Group, these premiums might be considered to have been paid and the insured or ceding insurer will no longer be liable to the Group for those amounts, whether or not the Group has actually received the premiums from the broker. Consequently, the Group assumes a degree of credit risk associated with brokers around the world with respect to most of its insurance and reinsurance business.

The Group is subject to the credit risk of its reinsurers and to the availability of reinsurance.

The Group follows the customary insurance practice of reinsuring and retroceding with other insurance and reinsurance companies a portion of the risks under the insurance and reinsurance contracts that it writes. These reinsurance and retrocession arrangements should protect the Group against the severity of losses on individual claims and unusually serious occurrences in which a number of claims produce an aggregate extraordinary loss. The amount of coverage purchased is determined by the Group's risk strategy together with the price, quality and availability of such coverage. Coverage purchased for one year will not necessarily conform to purchases for another year. There can be no assurance that the Group will be able to obtain reinsurance or to enter into retrocession arrangements at a price, quality or in respect of amounts which the

Group requires. There can be no assurance that the Group's outwards reinsurance or retrocession protection will be sufficient for all eventualities.

Although reinsurance will not discharge LICL and LUK from their primary obligation to pay under an insurance policy for losses insured, or under a reinsurance agreement for losses assumed, reinsurance does make the assumed reinsurer or retrocessionaire liable to the Group for the reinsured or retroceded portion of the risk. Collectability of reinsurance and retrocessions is dependent upon the solvency of reinsurers and their willingness to make payments under the terms of reinsurance or retrocession agreements. A reinsurer's insolvency or inability or unwillingness to make payments under the terms of a reinsurance or retrocession arrangement could have a material adverse effect on the Group. The ultimate level of outwards reinsurance cover obtained by LICL and LUK will depend on a number of factors, including the Group's assessment of the level of reinsurance cover appropriate at the time such cover is sought in light of capacity, pricing, terms and conditions and the actual portfolio of risks assumed by these Group companies.

Changes to the regulatory systems or loss of permits or licences under which the Group operates or breach of regulatory requirements by the Group could have a material adverse effect on its business.

Because the Company and LICL are incorporated in Bermuda, while LUK is incorporated in the United Kingdom, they will be subject to changes of law or regulation in these jurisdictions which may have an adverse impact on their operations, including imposition of tax liability or increased regulatory supervision. In addition, the Company, LICL and LUK will be exposed to changes in the political environment in Bermuda and the United Kingdom. The Bermuda insurance and reinsurance regulatory framework has recently become subject to increased scrutiny in many jurisdictions, including in the US and in various states within the US.

The Group's ability to conduct insurance and reinsurance business in different countries generally requires the holding and maintenance of certain licences, permissions or authorisations, and compliance with rules and regulations promulgated from time to time in these jurisdictions. A principal exception to this is with respect to cross border reinsurance in the US and other countries. For reinsurance there are no US licences required, although the Group operates outside the US and is, in common with other non-US reinsurers, required to post letters of credit or establish other security in order to enable US cedants to take financial statement credit for ceded liabilities.

A failure to comply with rules and regulations in a jurisdiction could lead to disciplinary action, the imposition of fines or the revocation of the licence, permission or authorisation necessary to conduct the Group's business in that jurisdiction, which could have a material adverse effect on the continued conduct of business in a particular jurisdiction. Among other things, insurance laws and regulations applicable to members of the Group may:

- require the maintenance of certain solvency levels;
- regulate transactions undertaken, including transactions with affiliates and intra-group guarantees;
- in certain jurisdictions, restrict the payment of dividends or other distributions; or
- require the disclosure of financial and other information to regulators.

In the US, generally, only the first and last of the above requirements would apply to the Group.

It is possible that insurance regulators in the US or elsewhere may review the activities of the Company, LICL and LUK and claim that they are subject to such jurisdiction's licensing requirements, although the Directors believe that it unlikely under the circumstances, that the Company, LICL and LUK comply with applicable laws regarding non-admitted business in each jurisdiction. Having to meet such requirements, however, could materially and adversely affect the Company's, LICL's and LUK's results of operations. Alternatively, any necessary changes to operations could subject the Company, LICL and LUK to taxation in the US.

In recent years, the insurance industry in the US, the UK, Europe and other markets in which the Group operates has been, and is in the future likely to be, subject to increased scrutiny by regulatory bodies. This scrutiny has led to changes in certain legal and regulatory provisions which govern the operations of the Group, and it can be expected that further reviews and changes to applicable laws and regulations will occur in the future. The Group cannot predict the effect that any proposed or future law or regulation may have on the financial condition or results of operations of the Group. It is possible that the Group or any of its subsidiaries may be adversely affected by changes in applicable laws or regulations or in their interpretation or enforcement.

In particular, changes in regulatory capital requirements in the US, the UK or Bermuda may impact upon the level of capital reserves required to be maintained by individual Group entities or by the Group as a whole.

The terms of the credit facilities available to the Group may impose restrictions on operations, and may restrict growth, result in a competitive disadvantage or adversely affect its ability to conduct business.

The terms of the credit facilities available from time to time to the Group may contain operating and financial covenants. Any such covenants may reduce the Group's flexibility to respond to changing business and economic conditions, including increased competition in the insurance industry, and/or may prevent the Group from expanding the business.

The Group may require additional capital in the future, which may not be available or may only be available on unfavourable terms.

The Group's future capital requirements depend on many factors, including any changes to capital requirements imposed by regulators or third-party credit rating agencies (in order to maintain a particular

financial strength rating) and the Group's ability to write new business and to establish premium rates and reserves at levels sufficient to cover losses and maintain the rating and solvency levels. To the extent that current capital is insufficient to fund future operating requirements including the maintenance of an appropriate financial strength rating, the Group may need to raise additional funds through financings or curtail its growth, although it does not anticipate taking any such measures prior to the conclusion of the 12 month period following Admission. Any equity or debt financing, if available at all, may be on terms that are not favourable to the Group. In the case of equity financings, dilution to the Company's Shareholders could result, and in any case such securities may have rights, preferences and privileges that are senior to those of the Common Shares. If the Group cannot obtain adequate capital on favourable terms or at all, its business, financial condition or operating results could be adversely affected.

The Group is exposed to unpredictable and multiple losses.

The Group may have substantial exposure to losses resulting from natural disasters and other catastrophic events. Catastrophes can be caused by various events, including hurricanes, volcanic eruptions, tsunamis, earthquakes, hailstorms, severe weather, floods, fires and explosions. Many observers believe that the Atlantic basin is in the active phase of a multi-decadal cycle in which conditions in the ocean and atmospheres, including warmer-than-average sea-surface temperatures and low wind shear, enhance hurricane activity. The increase in the number and intensity of tropical storms and hurricanes can span multiple decades (approximately 20 to 30 years).

The incidence and severity of such catastrophes are inherently unpredictable and the Group's losses from such events could be substantial. The occurrence of claims from such events could have a material adverse effect on the Group's financial condition or results and its ability to write new business. Although the Group will attempt to manage its exposure to such events, a single catastrophic event, for example, could affect multiple geographic zones. The frequency or the severity of catastrophic events could exceed the Group's estimated tolerance factors for underwriting risk, which could have a material adverse effect on the Group's financial condition.

The Group has exposure to large, unexpected losses resulting from future man-made catastrophic events, such as acts of war, acts of terrorism and political instability. Although the Group may attempt to exclude losses from terrorism and certain other similar risks from certain types of insurance and reinsurance it underwrites, it may not necessarily be successful in doing so, and the Group also specifically underwrites risks relating to terrorism. These risks are inherently unpredictable as to the frequency and severity of losses. It is impossible to predict the timing of such events or to estimate the amount of loss that any given occurrence will generate. To the extent that losses from such risks occur, the Group's financial condition and results of its operations could be materially adversely affected.

Emerging claim and coverage issues could adversely affect the Group's business.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect the Group's business by either extending coverage beyond the Group's intent with respect to insurance written or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after the Group has written business under insurance and/or reinsurance contracts that are affected by the changes. As a result, the full extent of liability under the insurance and/or reinsurance contracts may not be known for some time after the event has occurred.

Bermuda is subject to catastrophe risks.

Bermuda is an island that has communications systems and power systems that are limited to one or a few providers and are exposed to interruption by catastrophe, both natural and non-natural. Where the power or communications systems to be interrupted for any material length of time, this could result in commercial or reputation damage to the Group and have a negative impact on its results of operations.

*There is uncertainty surrounding the Terrorism Risk Insurance Act ("**TRIA**").*

TRIA (the Federal Terrorism Risk Insurance Act, as amended) was extended on 26 December 2007 by the Terrorism Risk Insurance Program Reauthorization Act, to 31 December 2014. TRIA was enacted to ensure the availability of insurance coverage for terrorist acts in the United States. This law requires insurers, including the Group, writing certain lines of property and casualty insurance to make available coverage against certain acts of terrorism causing damage within the United States or to US flagged vessels or aircraft. TRIA also imposes various administrative and record keeping obligations on the Group. In return, the law requires the federal government to indemnify insureds for 85 per cent. of insured losses resulting from covered acts of terrorism, subject to a premium-based deductible. For a covered act of terrorism to have occurred, the US Treasury Secretary must make several findings. However, there have not been any terrorist events occurring that would trigger TRIA to date and there remains some uncertainty as to how TRIA would respond and operate in practice.

Loss of business reputation or negative publicity could have a material adverse effect on the Group.

The Group is vulnerable to adverse market perception since it operates in an industry where integrity and customer trust and confidence are paramount. In addition, any negative publicity (whether well founded or not) associated with the business or operations of the Group could result in a loss of clients and/or business. Accordingly, any mismanagement, fraud or failure by its employees to satisfy fiduciary responsibilities, or the

negative publicity resulting from such activities or any allegation of such activities and consequential loss of reputation, could have a material adverse effect on the Group.

The Group is exposed to risk of litigation.

The extent and complexity of the legal and regulatory environment in which the Group operates and the products and services the Group offers mean that many aspects of the business involve substantial risks of liability. Any litigation brought against the Group in the future could have a material adverse effect on the Group. The Group's insurance may not necessarily cover any of the claims that clients or others may bring against the Group or may not be adequate to protect it against all the liability that may be imposed.

In addition, litigation may have a material adverse effect upon the Group's business in that legal decisions may expand the scope of legal liabilities, which in turn could increase the amount of claims which have to be paid by the Group, thereby reducing profits and profit commission to the Group.

The Group may be involved in litigation against third parties in the normal course of business and the probable outcome of all such litigation may be taken in the assessment of the Group's liabilities. If the outcome of such litigation is incorrectly estimated, the Group's results could be adversely affected.

The Group is reliant on third-party service providers and IT systems.

The Group is reliant on third parties for the provision of important services it needs to run its business including finance and underwriting systems and processes, IT infrastructure including software, claims management and investment management services. If any of these service providers should fail to perform to the necessary level this may have a severe impact on the business of the Group and its IT systems. The Group requires complex and extensive IT systems to run its business. Any failure of these systems or by these service providers could lead to an interruption in the Group's business activities which, in turn, could have a material adverse effect on the Group.

Investment performance and incorrect assessment of investment risk can affect profitability and the solvency position of the Group.

The Group holds significant investments to support its liabilities and its profits are affected by the returns achieved on its investment portfolios. Therefore, changes in interest rates, credit ratings and other economic variables could substantially affect the Group's profitability. The capital value of the Group's investments may fall as well as rise and the income derived from them may fluctuate. A fall in such capital values may adversely affect the Group's net income and solvency position, which in turn may result in a reduction in the level of premium which the Group is able to underwrite.

Acquisitions or strategic investments could expose the Group to further risks.

As part of its strategy, the Group may pursue growth through acquisitions and/or strategic investments in businesses. The negotiation of potential acquisitions or strategic investments as well as the integration of an acquired business or new personnel could result in a substantial diversion of management resources. Acquisitions could involve numerous additional risks such as potential losses from unanticipated litigation, higher levels of claims than is reflected in reserves and an inability to generate sufficient revenue to offset acquisition costs.

The Group's ability to manage its growth through acquisitions or strategic investments will depend, in part, on its success in addressing such risks. Any failure by the Group to effectively implement its acquisitions or strategic investment strategies could have a material adverse effect on its business, financial condition or results of operations.

Industry-wide developments could adversely affect the Group's business.

The availability and price of insurance and reinsurance coverage has been affected by factors such as asbestos and environmental liability claims, other liability claims such as directors' and officers' liability and medical malpractice, stock market performance, interest rates, the 2001 US terror attacks and hurricanes such as Ike, Katrina, Rita and Wilma and major investment losses (including losses arising as a result of the current turmoil in the financial markets). This tightening of supply may result in governmental intervention in the insurance and reinsurance markets which may affect the demand for the Group's products or the risks which may be available for it to consider underwriting. At the same time, threats of further terrorist attacks and the military initiatives, political unrest in the Middle East and Asia, and continued uncertainty arising directly and indirectly from the current financial markets crisis have adversely affected general economic, market and political conditions, increasing many of the risks associated with the insurance and reinsurance industry worldwide.

2. Risks relating to taxation

Any change in the Company's tax status or in taxation law could negatively affect the Company's ability to provide returns to Shareholders. Statements in this document concerning the taxation of the Group or of investors in Common Shares are based on current tax law and practice which is subject to change. The taxation of an investment in the Company also depends on the individual circumstances of the relevant investor. Any shareholder who is in doubt as to its tax position should consult an appropriate advisor.

The Company and LICL may be subject to UK tax.

Any change in the Company's or LICL's UK tax status or any change in UK taxation law could affect the Company's ability to provide returns to Shareholders.

Statements in this document concerning the UK taxation of investors in Common Shares are based on current UK tax law and practice, which are subject to change. The taxation of an investment in the Company depends on the individual circumstances of investors.

Neither the Company nor LICL is incorporated in the UK. Accordingly, neither the Company nor LICL should be treated as being resident in the UK for corporation tax purposes unless its central management and control is exercised in the UK. The concept of central management and control is indicative of the highest level of control of a company, which is wholly a question of fact. Both the Company and LICL intend to manage their affairs so that neither of them is resident in the UK for UK tax purposes.

A company not resident in the UK for corporation tax purposes can nevertheless be subject to UK corporation tax if it carries on a trade through a permanent establishment in the UK, but the charge to UK corporation tax is limited to profits (including revenue profits and capital gains) attributable directly or indirectly to such permanent establishment.

Both the Company and LICL intend to operate in such a manner that neither of them carries on a trade through a permanent establishment in the UK. Nevertheless, because neither case law nor UK statute completely defines the activities that constitute trading in the UK through a permanent establishment, HMRC might contend successfully that either or both of the Company and LICL are trading in the UK through a permanent establishment in the UK.

The UK has no income tax treaty with Bermuda. There are circumstances in which companies that are neither resident in the UK nor entitled to the protection afforded by a double tax treaty between the UK and the jurisdiction in which they are resident may be exposed to income tax in the UK (other than by deduction or withholding) on the profits of a trade carried on there even if that trade is not carried on through a permanent establishment. However, each of the Company and LICL intends to operate in such a manner that neither of them will fall within the charge to income tax in the UK (other than by deduction or withholding) in this respect.

If the Company or LICL were treated as being resident in the UK for UK corporation tax purposes, or if the Company or LICL were to be treated as carrying on a trade in the UK through a permanent establishment or otherwise subject to UK income tax, the results of the Group's operations could be materially adversely affected.

The Group is subject to the UK transfer pricing regime.

The reinsurance arrangements between LICL and LUK and the marketing services arrangements between LICL and LIMSL and between LMEL and LUK are subject to the UK transfer pricing regime. Consequently, if the reinsurance and/or provision of marketing services is found not to be on arm's length terms and, as a result, a UK tax advantage is being obtained, an adjustment will be required to compute UK taxable profits as if the reinsurance and/or provision of marketing services were on arm's length terms. Any transfer pricing adjustment could adversely impact the Group's tax charge.

The Company and LICL may become subject to taxes in Bermuda.

The Company and LICL may become subject to taxes in Bermuda after 28 March 2016, which may have a material adverse effect on the Group's results of operations and the value of the Common Shares.

The Bermuda Minister of Finance, under the Exempted Undertakings Tax Protection Act 1966, as amended, of Bermuda, has given the Company an assurance that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax will not be applicable to the Company or LICL or any of either company's operations, shares, debentures or other obligations until 28 March 2016. Given the limited duration of the Minister of Finance's assurance, it cannot be certain that the Company and LICL will not be subject to any Bermuda tax after 28 March 2016. See paragraph 7.2 of Part VIII – Additional Information.

LMEL may be subject to taxes in Dubai/the UAE.

Subject to certain exceptions, there are currently no local Dubai or Federal (ie UAE) taxes payable on the profits or revenue of businesses operating within the UAE (including the DIFC). However there are discussions at the Dubai and Federal level regarding the possible introduction of VAT and personal and corporate taxes within the region. However it should be noted that Dubai Law No 9 of 2004 ("**Law No 9**") provides at Article 14 that DIFC establishments (which would include LMEL) and their employees shall be subject to a zero rate of tax on income for fifty years from the enactment of Law No 9. Moreover, transfers of assets out of the DIFC shall similarly benefit from such rate for such period. The period can be extended for a further fifty years upon the resolution of the ruler of Dubai. Notwithstanding this moratorium on income tax, it is unclear as to its precise scope and, currently, specifically refers to income tax and taxes on transfer. Accordingly, it does not necessarily rule out the introduction of alternative taxation measures and, further, Law No 9 is not constitutionally immune from future amendment or repeal.

The Group may be subject to US tax.

If any member of the Group were considered to be engaged in a trade or business in the US, it could be subject to US corporate income and additional branch profits taxes on the portion of its earnings effectively connected to such US business, in which case its results of operations could be materially adversely affected.

The Company and LICL are Bermuda companies; LUK, LISL and LIMSL are UK companies and LMEL is a DIFC company. The Directors intend to manage the business of the Company, LICL, LUK, LISL, LIMSL and

LMEL so that each of these companies should operate in such a manner that none of these companies should be subject to US tax (other than US excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring US risks and US withholding tax on certain US source investment income), because none of these companies should be treated as engaged in a trade or business within the US. However, because there is considerable uncertainty as to the activities which constitute being engaged in a trade or business within the US, it cannot be certain that the US Internal Revenue Service ("**IRS**") will not contend successfully that Group members are engaged in a trade or business in the US. See paragraph 7.4.1 of Part VIII – Additional Information.

The federal insurance excise tax may apply on a cascading basis and may apply to LUK.

The IRS, in Revenue Ruling 2008-15, has formally announced its position that, absent a US income tax treaty exception, the US federal insurance excise tax ("**FET**") is applicable (at a 1 per cent. rate on premiums) to all reinsurance cessions or retrocessions of risks by non-US insurers or reinsurers to non-US reinsurers where the underlying risks are either (i) risks of a US entity or individual located wholly or partly within the United States or (ii) risks of a non-US entity or individual engaged in a trade or business in the United States which are located within the United States ("**US Situs Risks**"), even if the FET has been paid on prior cessions of the same risks. The legal and jurisdictional basis for, and the method of enforcement of, the IRS' position is unclear. Absent a US income tax treaty exception, if the cascading FET is applicable to premiums paid to, or by, one of LICL or LUK, it should apply at a 1 per cent. rate, even though the FET also applies on prior premium payments with respect to such risks. Additionally, if LUK is generally entitled to the benefit of the FET exemption in the US income tax treaty with the UK (the "**UK Treaty**"), but it cedes business with respect to US Situs Risks in transactions that are characterized as conduit arrangements for purposes of the UK Treaty, it would not be entitled to the UK Treaty FET exemption with respect to these US Situs Risks.

*Holders of 10 per cent. or more of the Common Shares may be subject to US income taxation under the "controlled foreign corporation" ("**CFC**") rules.*

If a direct or indirect US investor is a "**10 per cent. US Shareholder**" of a foreign corporation (defined as a US Person (as defined in paragraph 7.4.4 of Part VIII – Additional Information) who owns (directly, indirectly through foreign entities or "constructively" (as defined below)) at least 10 per cent. of the total combined voting power of all classes of stock entitled to vote of a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during a taxable year), and owns shares in the foreign corporation directly or indirectly through foreign entities on the last day of the foreign corporation's taxable year on which it is a CFC, a direct or indirect US investor must include in its gross income for US federal income tax purposes its *pro rata* share of the CFC's "subpart F income", even if the subpart F income is not distributed. "Subpart F income" of a foreign insurance corporation typically includes foreign personal holding company income (such as interest, dividends and other types of passive income), as well as insurance and reinsurance income (including underwriting and investment income). A foreign corporation is considered a CFC if "10 per cent. US Shareholders" own (directly, indirectly through foreign entities or by attribution by application of the constructive ownership rules of section 958(b) of the Code (that is, "constructively")) more than 50 per cent. of the total combined voting power of all classes of stock of that foreign corporation, or the total value of all stock of that foreign corporation. For purposes of taking into account insurance income, a CFC also includes a foreign insurance company in which more than 25 per cent. of the total combined voting power of all classes of stock (or more than 25 per cent. of the total value of the stock) is owned by 10 per cent. US Shareholders on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration for the reinsurance or the issuing of insurance or annuity contracts exceeds 75 per cent. of the gross amount of all premiums or other consideration in respect of all risks.

The Directors believe that because of the anticipated dispersion of the Company's share ownership, provisions in the Bye-laws that limit voting power (these provisions are described under paragraph 5.4 of Part VIII – Additional Information) and other factors, no US Person who owns shares of the Company directly or indirectly through one or more foreign entities should be treated as owning (directly, indirectly through foreign entities or constructively) 10 per cent. or more of the total voting power of all classes of shares of the Company. It is possible, however, that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge. See paragraph 7.4.4 of Part VIII – Additional Information.

*US Persons who hold Common Shares may be subject to US income taxation at ordinary income rates on their proportionate share of LICL's or LUK's "related person insurance income" ("**RPII**").*

If the RPII (determined on a gross basis) of LICL or LUK were to equal or exceed 20 per cent. of such Company's gross insurance income in any taxable year and direct or indirect insureds (and persons related to those insureds) own directly or indirectly through entities 20 per cent. or more of the voting power or value of the Company, then a US Person who owns any shares of the Company (directly or indirectly through foreign entities) on the last day of the taxable year would be required to include in its income for US federal income tax purposes such person's *pro rata* share of such Company's RPII for the entire taxable year, determined as if such RPII were distributed proportionately only to US Persons at that date regardless of whether such income is distributed, in which case a direct or indirect US investor's investment could be materially adversely affected. In addition, any RPII that is includible in the income of a US tax-exempt organisation may be treated as unrelated business taxable income. The amount of RPII earned by LICL or LUK (generally, premium and related investment income from the direct or indirect insurance or reinsurance of any direct or indirect US holder of shares or any person related to such holder) will depend on a number of factors, including the identity of persons directly or indirectly insured or reinsured by such Company. The Directors believe that

either the direct or indirect insureds of each of LICL and LUK (and related persons) should not directly or indirectly own 20 per cent. or more of either the voting power or value of the Common Shares for the foreseeable future or that the gross RPII of each of LICL and LUK, respectively, should not equal or exceed 20 per cent. of its gross insurance income in any taxable year for the foreseeable future, but the Directors cannot be certain that this will be the case because some of the factors which determine the extent of RPII may be beyond their control. See paragraph 7.4.5 of Part VIII – Additional Information.

*US Persons who hold Common Shares may be subject to adverse tax consequences if the Company is considered to be a passive foreign investment company ("**PFIC**") for US federal income tax purposes.*

If the Company is considered a PFIC for US federal income tax purposes, a US Person who owns any shares of the Company directly or indirectly (for example, through a foreign partnership) will be subject to adverse tax consequences including subjecting the investor to a greater tax liability than might otherwise apply and subjecting the investor to tax on amounts in advance of when tax would otherwise be imposed, in which case a direct or indirect potential US investor's investment could be materially adversely affected. In addition, if the Company is considered a PFIC, upon the death of any US individual owning shares, such individual's heirs or estate would not be entitled to a "step-up" in the basis of the shares that might otherwise be available under US federal income tax laws. The Directors believe that the Company should not be a PFIC, and currently is not expected to become, a PFIC for US federal income tax purposes. There can be no assurance however, that the Company will not be deemed a PFIC by the IRS. If the Company were considered a PFIC, this could have material adverse tax consequences for an investor that is subject to US federal income taxation. There are currently no regulations regarding the application of the PFIC provisions to an insurance company. New regulations or pronouncements interpreting or clarifying these rules may be forthcoming. See paragraph 7.4.9 of Part VIII – Additional Information.

US Persons who dispose of Common Shares may be subject to US federal income taxation at the rates applicable to dividends on a portion of such disposition.

The RPII rules provide that if a US Person disposes of shares in a foreign insurance corporation in which US Persons own 25 per cent. or more of the shares (even if the amount of gross RPII is less than 20 per cent. of the corporation's gross insurance income and the ownership of its shares by direct or indirect insureds and related persons is less than the 20 per cent. threshold), any gain from the disposition will generally be treated as a dividend to the extent of the holder's share of the corporation's undistributed earnings and profits that were accumulated during the period that the holder owned the shares (whether or not such earnings and profits are attributable to RPII). In addition, such a holder will be required to comply with certain reporting requirements, regardless of the amount of shares owned by the holder. These RPII rules should not apply to dispositions of Common Shares because the Company will not itself be directly engaged in the insurance business. The RPII provisions, however, have never been interpreted by the courts or the US Treasury Department in final regulations, and regulations interpreting the RPII provisions of the Code exist only in proposed form. It is not certain whether these regulations will be adopted in their proposed form or what changes or clarifications might ultimately be made thereto or whether any such changes, as well as any interpretation or application of the RPII rules by the IRS, the courts, or otherwise, might have retroactive effect. The US Treasury Department has authority to impose, among other things, additional reporting requirements with respect to RPII. Accordingly, the meaning of the RPII provisions and the application thereof to the Group is uncertain. See paragraph 7.4.8 of Part VIII – Additional Information.

US tax-exempt organisations who own Common Shares may recognise unrelated business taxable income.

A US tax-exempt organisation may recognise unrelated business taxable income if a portion of the insurance income of LICL or LUK is allocated to the organisation, which generally would be the case if such Company is a CFC and the tax-exempt shareholder is a US 10 per cent. Shareholder or there is RPII, certain exceptions do not apply and the tax-exempt organisation owns any shares of the Company. Although the Directors do not believe that any US Persons should be allocated such insurance income, they cannot be certain that this will be the case. US tax-exempt investors are advised to consult their own tax advisers. See paragraph 7.4.7 of Part VIII – Additional Information.

Changes in US federal income tax law could materially adversely affect an investment in the Common Shares.

Legislation has been introduced in the US Congress intended to eliminate certain perceived tax advantages of companies (including insurance companies) that have legal domiciles outside the US but have certain US connections. It is possible that legislation could be introduced in and enacted by the current Congress of future Congresses that could have an adverse impact on the Company or its shareholders.

Additionally, the US federal income tax laws and interpretations regarding whether a company is engaged in a trade or business within the US, or is a PFIC, or whether US Persons would be required to include in their gross income the "subpart F income" or the RPII of a CFC are subject to change, possibly on a retroactive basis. There are currently no regulations regarding the application of the PFIC rules to insurance companies and the regulations regarding RPII are still in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be forthcoming. The Directors cannot be certain if, when or in what form such regulations or pronouncements may be provided and whether such guidance will have a retroactive effect.

The impact of the OECD's review of harmful tax competition.

The impact of the Organisation for Economic Cooperation and Development's (the "**OECD**") action to eliminate harmful tax practices is uncertain and could adversely affect the Company's tax status in Bermuda.

The OECD has published reports and launched a global dialogue among member and non-member countries on measures to limit harmful tax competition. These measures are largely directed at counteracting the effects of tax havens and preferential tax regimes in countries around the world. In the OECD's report dated 18 April 2002 and periodically updated, Bermuda was not listed as a tax haven jurisdiction because it had previously signed a letter committing itself to eliminate harmful tax practices and to embrace international tax standards for transparency, exchange of information and the elimination of any aspects of the regimes for financial and other services that attract business with no substantial domestic activity. The Directors are not able to predict what changes will arise from the commitment or whether such changes will subject the Company and LICL to additional taxes.

Premium tax.

Premium taxes may be payable on premiums received in respect of direct insurance business written by LICL and LUK. The amount of premium tax levied will depend on the location of the risk and the premium tax regime of that territory. It is impossible to calculate the likely level of premium taxes incurred due to the expected diversity of the book of business written. Premium taxes should not affect the profitability of LICL or LUK as such taxes generally will be paid by the insured on top of the premiums received. However, premium taxes can have an impact on cash flows. Reinsurance is normally exempt from premium taxes.

3. Regulatory risks

If the Group becomes directly subject to insurance statutes and regulations in jurisdictions other than Bermuda and the United Kingdom, or there is a change to the law or regulations or application of the law or regulations of Bermuda or the United Kingdom, there could be a significant and negative impact on its business.

LICL is a registered Bermuda Class 4 insurer and as such, it is subject to regulation and supervision in Bermuda. LUK operates from the United Kingdom and is authorised by the FSA to underwrite certain classes of general insurance. LUK also has certain EEA freedom of service authorisations. LIMSL is a UK based insurance intermediary authorised by the FSA. It acts as a marketing representative for LICL in the UK. Bermuda and UK insurance statutes, regulations and policies of the Bermuda Monetary Authority and the Financial Services Authority may require LICL, LUK and LIMSL to, among other things:

- maintain a minimum level of capital, surplus and liquidity;
- satisfy solvency standards;
- restrict dividends and distributions;
- obtain prior approval of ownership and transfer of shares;
- maintain a principal office and appoint and maintain a principal representative in Bermuda and the United Kingdom respectively; and
- provide for the performance of certain periodic examinations of LICL, LUK and LIMSL and their financial condition.

These statutes, regulations and policies may affect the Group's ability to write insurance and/or reinsurance policies, to distribute funds and to pursue its investment strategy. See Part VII – Regulation.

The Group does not presently intend that it will be admitted to do business in any jurisdiction in the United States or elsewhere (other than Bermuda, Dubai and the United Kingdom). However, it cannot assure that insurance regulators in the United States or elsewhere will not review the activities of the Group or related companies or its agents and claim that the Group is subject to such jurisdiction's licensing requirements. If any such claim is successful and the Group must obtain a licence, it may be subject to taxation in such jurisdiction. In addition, the Group is subject to indirect regulatory requirements imposed by jurisdictions that may limit its ability to provide insurance or reinsurance. For example, the Group's ability to write insurance may be subject, in certain cases, to arrangements satisfactory to applicable regulatory bodies. Proposed legislation and regulations may have the effect of imposing additional requirements upon, or restricting the market for, alien insurers or reinsurers with whom US companies place business.

Bermuda and United Kingdom insurance statutes and regulations applicable to the Group may be less restrictive than those that would be applicable if LICL and LUK were licensed in and governed by the laws of any state in the United States. In the past, there have been Congressional and other initiatives in the United States regarding proposals to supervise and regulate insurers domiciled outside the United States. If in the future the Group becomes increasingly subject to any insurance laws of the United States or any state thereof or of any other jurisdiction, the Group cannot assure you that it would be in compliance with those laws or that coming into compliance with those laws would not have a significant and negative effect on its business.

The process of obtaining licences in the United States and elsewhere is very time consuming and costly, and LICL or LUK may not be able to become licensed in a jurisdiction other than Bermuda, the United Kingdom or Dubai, should they choose to do so. The modification of the conduct of the Group's business resulting from LICL or LUK becoming licensed in certain jurisdictions could significantly and negatively affect its business. In addition, the Group's inability to comply with insurance and/or reinsurance statutes and regulations could significantly and adversely affect its business by limiting its ability to conduct business as well as subjecting the Group to penalties and fines.

Because LICL is incorporated in Bermuda, it is subject to changes of Bermuda law and regulation that may have an adverse impact on its operations, including imposition of tax liability or increased regulatory supervision. LUK is similarly subject to such changes of UK law and regulation that may have an adverse

impact on its operations. In addition, LICL expects to be exposed to changes in the political environment in Bermuda. The Bermuda insurance and reinsurance regulatory framework recently has become subject to increased scrutiny in many jurisdictions, including in the United States and in various states within the United States. The Group cannot predict the future impact on its operations of changes in the laws and regulations to which it is or may become subject.

4. Risks relating to the Common Shares

There are limitations on the ownership, transfers and voting rights of the Common Shares.

There are provisions in the Bye-laws which may reduce or increase the voting rights of the Common Shares. In general, and except as provided below, Shareholders have one vote for each Common Share held by them and are entitled to vote at all meetings of Shareholders. However, if, and so long as, the Common Shares of a Shareholder are treated as "controlled shares" (as determined under section 958 of the Code) of any US Person (as defined in paragraph 7.4.2 of Part VIII – Additional Information) and such controlled shares constitute 9.5 per cent. or more of the votes conferred by the Company's issued shares, the voting rights with respect to the controlled shares of such US Person (a "**9.5 per cent. US Shareholder**") shall be limited, in the aggregate, to a voting power of less than 9.5 per cent., under a formula specified in the Bye-laws. The formula is applied repeatedly until the voting power of all 9.5 per cent. US Shareholders has been reduced to less than 9.5 per cent. In addition, the Board may limit a Shareholder's voting rights where it deems it appropriate to do so to (i) avoid the existence of any 9.5 per cent. US Shareholder; and (ii) avoid certain adverse tax, legal or regulatory consequences to the Company or any of the Company's subsidiaries or any shareholder or its affiliates. "*Controlled shares*" includes, among other things, all shares of the Company that such US Person is deemed to own directly, indirectly or constructively (within the meaning of section 958 of the Code).

Under these provisions, certain Shareholders may have their voting rights limited, while other Shareholders may have voting rights in excess of one vote per share. See paragraph 5.4 of Part VIII – Additional Information. Moreover, these provisions could have the effect of reducing the votes of certain Shareholders who would not otherwise be subject to the 9.5 per cent. limitation by virtue of their direct share ownership.

The Company also has the authority under the Bye-laws to request information from any Shareholder for the purpose of determining whether a Shareholder's voting rights are to be reallocated under the Bye-laws. If a Shareholder fails to respond to the Company's request for information or submits incomplete or inaccurate information in response to a request by it, the Company may, in its sole discretion, eliminate such Shareholder's voting rights.

Under a general policy of the BMA, the Common Shares may be freely transferred under the Bermuda Exchange Control Act 1972 and the related regulations. If, at any time following Admission, the BMA withdraws its consent to the free transferability of the Common Shares, then the Admission and trading of those Common Shares on the Main Market of the LSE will be immediately suspended. Such suspension would remain in force until the BMA reinstated its consent to the free transferability of the Common Shares.

Enforcement of judgments in Bermuda may be difficult.

As the Company is a Bermuda exempted company, the rights of Shareholders will be governed by Bermuda law and the Company's memorandum of association and Bye-laws. The rights of Shareholders under Bermuda law may differ from the rights of shareholders of companies incorporated in other jurisdictions. The majority of the Directors are not residents of the UK and substantially all of the Company's assets are located outside of the UK. As a result, it may be difficult for investors to effect service of process on those persons in the UK or to enforce in the UK judgments obtained in UK courts against the Company or those persons who may be liable under UK law. The current position with regard to enforcement of judgments in Bermuda is set out below but this may be subject to change. A final and conclusive judgment of a superior foreign court against the Company, under which a sum of money is payable (not being a sum of money payable in respect of multiple damages, or a fine, penalty tax or other charge of a like nature) may be enforceable in the Supreme Court of Bermuda against the Company if the foreign court is situated in a country to which The Judgments (Reciprocal Enforcement) Act 1958 of Bermuda (the "**1958 Act**") applies. The procedure provided for in the 1958 Act must be followed if the 1958 Act applies. The 1958 Act applies to the UK. Under the 1958 Act, a judgment obtained in the superior courts of a territory to which it applies would be enforced by the Supreme Court of Bermuda without the necessity of any retrial of the issues subject of such judgment or any re-examination of the underlying claims. Where such foreign judgment is expressed in a currency other than Bermuda dollars, registration of the judgment will involve the conversion of the judgment debt into Bermuda dollars on the basis of the exchange rate prevailing at the date of such judgment as is equivalent to the judgment sum payable. The present policy of the BMA is to give consent for the Bermuda dollar award made by the Supreme Court of Bermuda to be paid in the original judgment currency. No stamp duty or similar or other tax or duty is payable in Bermuda on the enforcement of a foreign judgment. Court fees will be payable in connection with proceedings for enforcement.

A change of control of the Group may be difficult to effect under applicable insurance laws.

A change of control of various regulated companies in the Group could require consents from regulators in various jurisdictions in which the Group operates. In the UK, a person who intended to acquire 10 per cent. or 20 per cent. or more of the Common Shares or voting power in the Company would become a controller of LUK and LIMSL, respectively, and would have to obtain prior approval of the FSA before completing the acquisition of such shares or voting power. In addition, the BMA is required by the Bermuda Insurance Act

1978 to determine whether a person who proposes to control 10 per cent., 20 per cent., 33 per cent. or 50 per cent. (as applicable) of the voting powers of a Bermuda registered insurer or its parent company is a fit and proper person to exercise such degree of control. These laws (and laws having similar effect in other jurisdictions) may discourage potential acquisition proposals and may delay, deter or prevent a change of control of the Group, including through transactions, in particular unsolicited transactions that some or all of the Shareholders might consider to be desirable.

Market risk – the value of Common Shares may go down as well as up.

The Company's share price can fluctuate and may not always accurately reflect the underlying value of the business. The value of Common Shares may go down as well as up and investors may lose some or all of the original sum invested. The price that investors may realise for their holdings of Common Shares, when they are able to do so, may be influenced by a large number of factors, some of which are specific to the Company and others of which are extraneous. Such factors may include the possibility that the market for the Common Shares will be less liquid than for other equity securities and that the price of the Common Shares will be relatively volatile.

US and other non-UK holders of Common Shares may not be able to exercise pre-emption rights.

Holders of Common Shares have certain pre-emption rights under the Bye-laws in respect of certain issues of shares by the Company unless those rights are disapplied by a special majority of the Shareholders at a general meeting. Securities laws of certain jurisdictions may restrict the Group's ability to allow participation by Shareholders in such jurisdictions in any future issue of shares carried out on a pre-emptive basis.

In particular, US holders of Common Shares may not be able to exercise their pre-emption rights unless a registration statement under the Securities Act is effective with respect to such rights or an exemption from the registration requirements is available thereunder. The Directors intend to evaluate at the time of any rights issue the cost and potential liabilities associated with any such registration statement, as well as the indirect benefits to the Company of enabling the exercise by US holders of their pre-emption rights to Common Shares and any other factors considered appropriate at the time, and then to make a decision as to whether to file such a registration statement. No assurance can be given that any registration statement would be filed, or that an exemption would be available, so as to enable the exercise of such Shareholders' pre-emption rights.

Future sales of Common Shares may affect their market price and the future exercise of Warrants or Options will result in immediate and substantial dilution.

The Company cannot predict what effect, if any, future sales of Common Shares, or the availability of Common Shares for future sale, will have on the market price of Common Shares including potential sales of substantial amounts of Common Shares following the exercise of the Warrants or Options. Sales of substantial amounts of Common Shares in the public market, or the perception that such sales could occur, could materially adversely affect the market price of Common Shares and may make it more difficult for Shareholders to sell Common Shares at a desirable time and price.

The Company's Common Shares and operating results are subject to currency fluctuations.

The nominal value of the Company's Common Shares and the majority of its income are denominated in US dollars. This may be a different currency to that in which Shareholders hold their own funds. Any future payments to Shareholders of dividends or distributions in respect of surplus capital (subject to the future financial performance and position of the Group and applicable laws, regulation, and rating and tax requirements) made in US dollars or pounds sterling or other currencies may be subject to exchange rate fluctuations. In addition, the Company's Common Shares on Admission will be quoted and payable in pounds sterling. Currency fluctuations may therefore affect Shareholder returns.

While a large portion of the Group's premiums are written in US dollars, some of its operating expenses are payable in pounds sterling. The Group may, from time to time, experience losses resulting from fluctuations in the values of pounds sterling and other non-US currencies, which could adversely affect its operating results. Future capital raisings may also be adversely affected by currency exchange fluctuations.

Holding company structure and restrictions on dividends.

The Company is a holding company and does not conduct insurance or reinsurance operations of its own. Dividends and other distributions from subsidiaries together with any investment income, are the Company's main source of funds to pay expenses and dividends, and other distributions, if any. Dividends are declared by the Company to its Shareholders (at the discretion of the Board after taking into account many factors, including those summarised above and below) and, in particular, the dividend policy mentioned in paragraph 16 of Part III – Information on the Group should not be construed as a dividend forecast. Additionally, at certain times, the Company may be contractually limited or prohibited from declaring dividends, including at any time when the Company is deferring interest with regard to, or is in default under, the notes that are described in paragraph 19 of Part VI – Financial Information.

The other members of the Group may from time to time be subject to restrictions on their ability to make dividend and/or other distributions to the Company, as a result of a number of factors including lack of distributable reserves, restrictive covenants contained within loan agreements, regulatory, fiscal or other restrictions. There can be no assurance that such restrictions will not have a material adverse effect on the Group's results or financial condition. In particular, part or all of the declared underwriting profits of LICL accruing on a particular year of account may be required to be retained by the Group, to comply with the

applicable insurance regulatory solvency rules or other restrictions placed on them by regulators (see Part VII – Regulation for more details on this) or to maintain capital adequacy levels to maintain necessary rating agency requirements. These require that each insurance entity be able to show sufficient assets to meet its liabilities plus a solvency margin. Where the applicable solvency tests show a deficiency, the affected entity is required to provide additional assets and these may include any unrealised underwriting profits. To meet the requirements of a rating agency for a particular financial strength rating LICL and LUK may be required to retain profits in order to maintain such financial strength rating or else suffer a downgrade. All or any of these requirements may affect the ability of the Group to pay a dividend.

Furthermore, any change in the tax treatment of dividends or interest received by the Company may reduce the level of yield received by Shareholders.

The results of the Group may fluctuate significantly as a result of a variety of factors, many of which may be outside the Group's control. Period to period comparisons of the Group's results may not be meaningful and investors should not rely on them as indications of the Group's future performance. The Group's results may fall below the expectations of securities analysts and investors. In addition, stock markets from time to time suffer significant price and volume fluctuations that affect the market prices for securities and which may be unrelated to the Group's operating performance. Any of these events could result in a decline in the market price of the Common Shares.

No Takeover Code protection.

As the Company is incorporated in Bermuda, it is subject to Bermuda law. The Takeover Code will not apply to the Company. Bermuda law does not contain any provisions similar to those applicable in the UK which are designed to regulate the way in which takeovers are conducted. It is therefore possible that an offeror may gain control of the Company in circumstances where non-selling Shareholders do not receive, or are not given the opportunity to receive, the benefit of any control premium paid to selling Shareholder(s). The Bye-laws contain certain takeover protections, although these will not provide the full protections afforded by the Takeover Code. The relevant provisions of the Bye-laws are summarised in paragraph 5.18 of Part VIII – Additional Information.

Forward-looking statements

Some of the statements in this document include forward looking statements which reflect the Directors' current views with respect to financial performance, business strategy, plans and objectives of management for future operations (including development plans relating to the Group's products and services). These statements include forward looking statements both with respect to the Group and the sectors and industries in which the Group operates. Statements which include the words 'believes', 'anticipates', 'plans', 'projects', 'intends', 'expects', 'estimates', 'predicts', 'may', 'will', 'seeks', 'should' or, in each case, their negative or comparable terminology and similar statements are of a future or forward looking nature. All forward looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause the Group's actual results to differ materially from those indicated in these statements. These factors include but are not limited to those described in the part of this document entitled "Risk Factors", which should be read in conjunction with the other cautionary statements that are included in this document. Any forward looking statements in this document reflect the Directors' current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to the Group's operations, results of operations, growth strategy and liquidity. Given these uncertainties investors are cautioned not to place any undue reliance on such forward looking statements. These forward looking statements speak only as of the date of this document. Subject to any obligations under the Prospectus Rules, the Listing Rules, the Disclosure and Transparency Rules or as otherwise required by law, the Company undertakes no obligation to publicly update or review any forward looking statement, whether as a result of new information, future developments or otherwise. All subsequent written and oral forward looking statements attributable to the Group or individuals acting on behalf of the Group are expressly qualified in their entirety by this paragraph. Prospective investors should specifically consider the factors identified in this document which could cause actual results to differ before making an investment decision.

PART III

INFORMATION ON THE GROUP

1. Introduction

The Company was incorporated in Bermuda on 12 October 2005 and commenced business when it raised over US$1 billion at the time of its initial public offering on AIM on 16 December 2005. A secondary listing on the Bermuda Stock Exchange was approved on 21 May 2007. The Group's operations consist of underwriting and marketing operations in Bermuda and London, and a marketing office in Dubai.

The Company is the Bermuda-based holding company of the Lancashire group of companies. The Group, through its UK and Bermuda-based insurance subsidiaries, is a global provider of specialty insurance and reinsurance.

2. Current Trading and Prospects

Early indications are that pricing and terms are meeting expectations and that there will be a broad-based improvement in pricing across most of the lines of business that the Company writes, as well as some areas of beneficial improvements in terms and conditions.

The Company is in a mature trading position having had three years to develop broker and client relationships. Across most of its classes it is able to access all the business that it wishes to review. In 2008 there were very substantial losses to the (re)insurance markets, both from insured losses and balance sheet events. The consensus outlook in the specialty insurance and reinsurance markets is that there will be a resultant general hardening of pricing and some improvements to terms and conditions in 2009. Lancashire supports this view.

Energy

The 2008 losses to the Gulf of Mexico market from Hurricanes Gustav and Ike were substantial. They followed heavy hurricane losses in 2004 and 2005. Similarly, in other offshore energy and energy construction business, there have been some major insured losses recorded in 2008. Lancashire is established as a significant market for this business and expects to see improvements in both pricing and terms and conditions.

Property

US property which is exposed to catastrophe perils is a core element of Lancashire's business through both specialty insurance and reinsurance products. Lancashire is an established major market for excess of loss property business with most of the major brokers. For this line, major insured losses, both risk and catastrophe**,** are creating upwards pricing pressure as supply contracts. For worldwide non-US business Lancashire has a less established presence due, in part, to the generally weaker pricing of this line. For terrorism business the Group is well established as a significant market for both US and non-US business. The lack of major losses in recent years has led to reduced pricing, although the rate of reduction has slowed noticeably.

Marine

Within each marine class written, the Group has narrowly defined appetites which are well known to its brokers. Significant growth in this business is not therefore expected. Pricing has been stabilising over recent months following a downward trend for several years.

Aviation

Lancashire is well established as a leader or agreement party for its niche AV52 product and participates on all the market lineslips which are the principal means for placing this business. Pricing has stabilised recently following a downward trend for several years and Lancashire's position as a significant participant in this market is expected to be maintained.

3. Information on the Group

Lancashire has five wholly-owned subsidiaries operating in three key jurisdictions: Bermuda, London and Dubai. Details of the Group's operating structure and subsidiaries are outlined below.

Lancashire's insurance subsidiaries carry the Lancashire Group claims-paying ability rating of A- (Excellent) from A.M. Best.

LICL and LUK are currently the Group's principal operating subsidiaries based at their respective centres of the world's most important specialty markets. LICL was incorporated under the laws of Bermuda on 28 October 2005 and is authorised and regulated by the BMA as a Class 4 general insurer. LICL provides insurance and reinsurance products to its customers, with an emphasis on property, energy, marine and aviation lines of business. LUK was incorporated under the laws of England and Wales on 17 March 2006 and is a wholly-owned subsidiary of LIHL. LUK was authorised by the FSA to underwrite certain classes of general insurance business in the UK. LUK also has certain EEA freedom of service authorisations to operate within the EEA. The products provided by LUK are the same as those provided by LICL. LUK is also registered as a Class 3 general insurer under the Insurance Act 1978 in Bermuda and has a permit issued under the Act to enable certain activities related to its insurance business to be performed from Bermuda.

LISL was incorporated under the laws of England and Wales on 17 March 2006 and provides support services to the Group.

LIMSL is a UK based insurance intermediary authorised by the FSA to undertake insurance mediation activities. LIMSL provides business introduction and other marketing and support services to LICL in the UK, and was incorporated under the laws of England & Wales on 7 October 2005.

LMEL was incorporated under the laws of the Dubai International Financial Centre on 11 March 2007 and is authorised by the Dubai Financial Services Authority ("**DFSA**") to undertake insurance intermediation activities. This Middle Eastern presence helps Lancashire increasingly access business not normally placed outside the region.

4. Key Strengths

Lancashire has established a strong three year record and considers that its key strengths can be categorised into the following areas:

- *Strong underwriting track record:* the Group's overriding goal is to create a superior risk adjusted return over time. The Group had a combined ratio of 44.3, 46.3 and 86.3 per cent. for 2006, 2007 and 2008, respectively.
- *Strong underwriting team:* the Group's underwriting team is highly experienced. Team leaders in major lines of business have, on average, almost twenty years' experience and, in the opinion of the Directors, are well matched to the lines of business written.
- *Underwriting discipline:* the Group's priority is excellence in underwriting and the pricing thereof, which Lancashire has demonstrated by pro-actively moving into and out of certain business lines as terms and pricing fluctuate.
- *Focus on shareholder returns:* since inception, Lancashire has returned a total of US$397.3 million to shareholders via a share buy-back programme and a strategic dividend, which represents 93 per cent. of cumulative earnings as at 31 December 2008.
- *Strong investment performance:* the Group has a conservative investment philosophy and has produced a total investment return of 6.1 per cent., 6.4 per cent. and 3.1 per cent. for 2006, 2007 and 2008 respectively.
- *Financial strength:* as at 31 December 2008, Lancashire's total capital was US$1.404 billion and its average annual investment performance since inception was 5.1 per cent. The Group has a rating of A- (excellent) from A.M. Best.
- *Distribution strength:* the Group maintains good relationships with the largest global broking firms as well as individual brokers, which it believes is an important factor in achieving effective distribution of its products.

5. Operating Principles and Business Strategy

The Group's rolling three year strategic plan is centred on the overriding goal of generating an above-average risk-adjusted return over time. In the belief that the Group's greatest strength is excellence in the underwriting risk selection process, the Directors believe this strategy will result in outperformance compared to the Group's peers over such time.

Operating Principles

The Group seeks to pursue the following operating principles:

- *a dynamic approach to underwriting:* as an insurance group, Lancashire places the operational aim of excellence in underwriting first. Lancashire's underwriting strategy concentrates on individual risk selection and discriminates between classes instead of pursuing a fully diversified strategy. Each risk underwritten must bear scrutiny on an individual basis and as part of the overall portfolio. If it can achieve this year in, year out, consistently, the Directors believe this will achieve a superior risk-adjusted return over time for shareholders.
- *maintain a strong balance sheet*: Lancashire has a range of risk tolerances, and its balance sheet must be sufficient at all times to meet those requirements. It aims to meet policyholders' claims promptly, accurately and completely. It believes it is important to ensure that its balance sheet instils a high level of confidence in all stakeholders, including shareholders, regulators, rating agencies, counter-parties and employees.
- *stay nimble*: to grow in a hard market and shrink in a soft market with efficiency means staying nimble. The Group seeks to achieve this through a collegiate underwriting approach – maintaining tight control on overheads and keeping its eyes open for good opportunities.
- *manage shareholders' capital through the cycle*: underwriting opportunities and the risk they carry will drive capital, not the other way around. Lancashire plans to carry sufficient capital to support the risk it assumes and to take advantage of underwriting opportunities as and when they arise. Lancashire has actively managed its capital base since inception, returning most of its cumulative earnings to its shareholders.

- *underwrite a diversified short-tail property specialty book of insurance risks:* the Group underwrites a diversified short-tail property specialty book of insurance risks. It aims to maintain a balance between classes exposed to natural catastrophes and classes that are not. Less than half of its portfolio is exposed to natural catastrophes. Lancashire intends to allocate capital between these two areas as the relative attractiveness of each ebbs and flows reflecting both rates and terms achievable. Within the two areas it shifts focus between segments, individual classes within segments, and down to the individual contract level in each class. By doing so, it plans to maintain an efficient portfolio at all times.
- *maintain a conservative investment approach:* the Group's risk tolerance on investments is low, and particularly low in more turbulent times. Its primary investment objectives are to preserve capital and provide adequate liquidity to support the Company's payment of claims. A secondary objective is to maximise total risk-adjusted return, with low volatility. Counterparty risk in the investment process is also critically assessed.

6. Information on the Business

Lancashire writes a diversified book of business, mostly on a direct basis, in four principal lines: property, energy, marine and aviation. In 2009, the Group's gross premiums are expected to grow as market opportunities present themselves. In 2008, gross premium for risks exposed to natural catastrophes represented approximately 35 per cent. of total written premium.

In 2008, the percentage of Lancashire's business written in the four principal lines by gross premium volume was as follows:

- Property 47.5 per cent.
- Energy 29.0 per cent.
- Marine 12.3 per cent.
- Aviation 11.2 per cent.

Lancashire writes mostly direct risks. A small proportion (approximately 17 per cent. of 2008 gross premium) relates to reinsurance risks.

The UK and Bermuda underwriting centres are both authorised to write each class of business undertaken by the Group, although regional differences in expertise, broker specialisation and resources have resulted in variances in appetite by class. As a rule reinsurance risks are written in Bermuda; both offices write insurance risks although the majority is written in London. For most classes of business, the allocation between offices is drawn by the type of business; for example, for marine the International Group of Protection and Indemnity Associations ("**IGPIA**") covers are written in Bermuda as they are a reinsurance class, while other marine classes are generally written in London. For some classes of business, there is a territorial distinction. For example, terrorism risk whose principal exposure is a Manhattan location is generally written in Bermuda, while other regions are generally written in London. For a third group the distinction is made on the basis of which office has access to the best distribution. For example, in direct and facultative property the business is often allocated between offices by broker. Overriding these approaches is the need to take into account differences in client preference and in licensing between the companies (i.e. LUK can write EU direct business through the "passporting" provision which LICL can not).

Property

The property segment includes direct commercial property insurance and terrorism, all written on a facultative basis, as well as property catastrophe retrocession and property catastrophe excess of loss. The Group has also written a small number of political risk contracts, although political risk cover is written on an individual case by case basis and coverage can vary significantly between policies.

Property direct and facultative is typically written on a first loss basis, i.e. for a limit smaller than the total insured values and on an excess of loss basis, i.e. the exposure is excess both of a deductible retained by the insured and of layers of coverage provided by other (re)insurers. Cover is generally provided to medium to large commercial and industrial enterprises with location values ranging from tens of millions to billions of dollars. Coverage is for non-elemental perils, including fire and explosion and elemental (natural catastrophe) perils including flood, windstorm, earthquake and tornado. Not all risks include both elemental and non-elemental coverage. Coverage generally includes indemnification for both property damage and business interruption.

Property retrocession is written on an excess of loss basis covering elemental risks only. Programmes are often written on a pillared basis, with separate geographic zonal limits for risks in the United States and Canada and for risks outside the United States and Canada.

Property catastrophe excess of loss again covering elemental risks only is written on a treaty basis. The property catastrophe excess of loss portfolio is currently written mainly in areas outside the United States. Cover is offered for specific perils and regions.

The Group is exposed to large catastrophic losses such as wind storm and earthquake loss from its property retrocession and property catastrophe excess of loss risks and from most of its property direct and facultative portfolio. Exposure to such events is controlled and measured through setting limits on aggregate exposure per geographic zone and through loss modelling. The accuracy of the latter is limited by the quality of data and effectiveness of the modelling. It is possible that a catastrophic event exceeds the expected modelled

event loss. Reinsurance has also been purchased to mitigate gross losses from certain events on a worldwide basis including the United States and Canada.

Two contracts in force provide excess of loss reinsurance of property nuclear pools, one predominantly in Europe and the other in North America. Coverage is for elemental and non-elemental risks including limited nuclear exposure.

Terrorism cover is provided for the United States and worldwide property risks, but excludes nuclear, chemical and biological coverage in most territories. The client base is similar to the property direct and facultative portfolio; generally medium to large commercial and industrial entities. All policies are for scheduled locations only and exposure is controlled through setting limits on aggregate exposure within a ''blast zone'' radius.

Energy

The energy segment includes offshore and onshore energy written on a worldwide basis. The Gulf of Mexico offshore energy class represented approximately 40.1 per cent. of energy gross premiums written as at 31 December 2008.

Energy risks are mostly written on a direct basis. Gulf of Mexico energy programmes cover elemental and non-elemental risks. The largest exposure is from hurricanes in the Gulf of Mexico. Exposure to such events is controlled and measured through loss modelling but the accuracy of this exposure analysis is limited by the quality of data and effectiveness of the modelling. It is possible that a catastrophic event exceeds the expected event loss. Policies generally have sub-limits on coverage for elemental losses. Non-elemental energy risks include fire and explosion. Reinsurance protection has been purchased to protect a portion of loss from elemental and non-elemental energy claims.

Worldwide offshore energy programmes are generally for non-elemental risks. Onshore energy risks can include onshore Gulf of Mexico and worldwide energy installations and are largely subject to the same loss events as described above. Energy construction contracts generally cover all risks of platform and drilling units under construction.

Energy reinsurance was written on a very limited basis in 2006 and 2007 but no contracts are in force as at the date of this document.

Marine

The marine segment includes marine excess of loss and a number of marine hull, marine war, marine P&I and other miscellaneous marine classes.

Marine hull and total loss is generally written on a direct basis and covers marine risks on a worldwide basis primarily for physical damage. Marine builders risk covers the building of ocean going vessels in specialised yards worldwide. Marine hull war is direct insurance of loss of vessels from war or terrorist attack. Marine P&I is mostly the reinsurance of the IGPIA. Marine excess of loss is generally written on a treaty basis. Marine cargo programmes are not normally written. The largest expected exposure is from physical loss rather than from elemental loss events.

Other marine business includes marine hull war, marine yacht, mortgagee's interest and additional perils and marine reinsurance.

Aviation

The Group's aviation focus has historically been centred on AV52 war carve-out business. As at the date of this document, Lancashire does not write general aviation business, including hull and liabilities, as it believes pricing is inadequate.

Aviation AV52 provides coverage for third-party liability, excluding own passenger liability, resulting from acts of war, terrorism or hijack of aircraft, excluding US commercial airlines and certain other countries whose governments provide a backstop coverage. The cover is for commercial airlines and entities involved in other aspects of the aviation business.

Aviation reinsurance includes satellite cover. Lancashire does not generally provide cover for satellite launch. Cover is typically limited to ''in orbit'' risks.

Other aviation business can include aviation hull war risks and contingent hull which the Group writes from time to time.

Reinsurance

Outwards Reinsurance

Lancashire, in the normal course of business and in accordance with its risk management practices, often seeks to reduce certain types of loss that may arise from events that could cause unfavourable underwriting results by entering into reinsurance arrangements. Reinsurance covers purchased typically include a combination of excess of loss reinsurance, proportional reinsurance and occasionally include industry loss warranty covers.

The mix of reinsurance cover is dependent on the specific loss mitigation requirements, market conditions and available capacity and the approach taken varies between peril types. Depending on available capacity, reinsurance can be a relatively attractive tool to hedge the Group's exposure. At certain times, traditional reinsurance can be expensive and difficult to place. As well as considering traditional reinsurance market products, the Group considers alternative hedging products including parametric covers and ''side-car'' quota

share capacity. Reinsurance for non-elemental risks tends to be more cyclical in price than elemental catastrophe covers. The Group would generally expect to hedge a slightly larger proportion of its exposure in a soft market compared to hard market conditions. The form of this cover would most likely be treaty rather than facultative as the former has a more subjective approach to pricing that potentially creates pricing anomalies that can be attractive.

The three key drivers of Lancashire's reinsurance programme to date have been the desire to reduce the Group's net exposure to a large natural catastrophe loss in the United States, to reduce the Group's net exposure to large non-catastrophic or risk losses on a world wide scale and to preserve the Group's market share in the Gulf of Mexico energy market. In order to achieve this goal, the Group has entered into catastrophe excess of loss treaties, per risk treaties and quota share arrangements. With these and all reinsurance policies purchased by the Group, the evaluation of reinsurers' security is paramount. To that end, the Group has formed a Reinsurance Security Committee.

As at the date of this document, the Group's Reinsurance Security Committee is composed of the Group Chief Risk Officer, the LICL Chief Financial Officer, the Group Chief Actuary, the LICL Chief Underwriting Officer, the LUK Chief Underwriting Officer, the Group Underwriting Director, the LUK Claims Manager and the LICL Ceded Reinsurance Manager and meets at least quarterly. As reinsurance does not relieve Lancashire of its obligations to policyholders, a key responsibility of the Reinsurance Security Committee is evaluating the financial condition of the Group's reinsurers and the Group's level of exposure to individual reinsurers. Under Lancashire's reinsurance security policy, reinsurers are assessed and approved as having appropriate security based on their financial strength ratings and other factors. The Group's Reinsurance Security Committee has defined limits per market by rating and an aggregate exposure to a rating band. Lancashire considers reinsurers that are not rated or do not fall within the pre-defined rating categories on a case by case basis, and would usually require collateral to be posted to support obligations. Lancashire monitors the credit-worthiness of its reinsurers on an ongoing basis.

7. Business Distribution

Almost all of the Group's business is transacted through brokers.

Lancashire does not delegate binding authority to any broker. Where it does participate on brokers' lineslips Lancashire is either a leader or agreement party and so agrees the terms of each risk before binding, or has delegated the authority to bind Lancashire to another leader whom Lancashire has assessed as competent to protect its interests. The Group's relationships with its brokers are an important factor in achieving effective distribution of its products. Brokers need to know that the insurers and reinsurers of their clients have excellent financial strength, a thorough understanding of the risks at hand, and a willingness and ability to provide first class service. Lancashire strives to meet all of these requirements and maintains close working relationships with key broking firms and individual brokers. The Group also places an emphasis on marketing, which it believes will continue to afford access to virtually all of its target business. In 2008 Lancashire created a senior level marketing role that focuses on marketing its products to brokers. The Group does not commit in advance to accept any business that is submitted to it by brokers. All new and renewal business is subject to acceptance by the Group.

8. Rating Agencies

The Group has a financial strength rating of A- (Excellent) with a stable outlook from A.M. Best. This rating is sufficient to allow the Group to trade successfully in all the major global insurance markets.

9. Underwriting Process and Controls

Subject to certain limited exceptions, the underwriting processes and controls are identical for both the Bermuda and London underwriting units. The main variances are to allow LUK to handle "walk-in" broker business. Each of LICL and LUK has its own underwriting procedure document setting out the steps to be taken by individual underwriters and assistants in the handling of business. Each underwriter is assigned a specific level of underwriting authority commensurate with their experience. However it is a key premise of Lancashire's underwriting that wherever possible underwriting decisions should be subject to full peer review, and a second signatory is required and documented. Very little business is written without a second signatory.

Lancashire considers that a key element of its underwriting process is the daily conference call that takes place between its underwriting and marketing offices. This ensures that the vast majority of potential business is discussed in an open forum including senior management, before the relevant company's underwriting quorum considers the relevant incoming proposal and decides whether and in what amount to accept a risk. Some small amounts of potential business are not subject to this process but these are exceptions.

All risk details, from initial enquiry to binding of a risk, are handled in the Lancashire Insurance Portal Submission System. At the point of binding a risk, select data fields from LIPSS are validated and re-entered into Re Systems Group where premium and earnings calculations are handled and all claims actively recorded. This system shares a common clearance system for London and Bermuda to prevent duplication of risks being written by both offices. It also incorporates a licensing check to ensure that the company in question holds the appropriate licences to write the business from the relevant platform.

10. Enterprise Risk Management

Lancashire has a comprehensive Enterprise Risk Management ("**ERM**") programme. The Board of Directors sets the overall risk profile and risk appetite and is responsible for monitoring risk at Group level. Day to day ERM activities are coordinated by Lancashire's Chief Risk Officer.

Risk Committees have been formed at the operating entity level. Each Risk Committee operates under terms of reference that details its scope and operation. The Risk Committees define tolerance levels over categories of risk for the operating entities. This includes the level of capital the Group and individual operating entities are willing to expose to certain risks.

Lancashire has developed a sophisticated economic capital model called BLAST. BLAST provides management and the Board with information on risk and return that can assist with business decisions. BLAST is an integral part of Lancashire's ERM programme. It is primarily a stochastic model. It encompasses insurance risk, market risk, credit risk and other general risks including operational risk. It requires the input of a large number of parameters and a large amount of data. The inputs include historical data and projected future premium income, reinsurance programmes, loss ratios, default rates, asset allocations and operational costs. All classes of business, including non-elemental classes, are within the capabilities of the model. BLAST helps the Group determine the level of capital required at both Lancashire and the operating entity level to meet the combined risk from a wide range of categories. BLAST is a useful tool in which the results are incorporated into the day-to-day decision making and assists management in monitoring its risk adjusted returns.

The management of various types of risks is described in more detail in the Operating and Financial Review section.

11. Claims Management

The key responsibilities of the claims management department are to:

- efficiently and accurately process, manage and resolve reported insurance and reinsurance claims, using workflow management systems, to ensure the proper application of intended coverage, timely reserving for the probable ultimate cost of both indemnity and expense and make timely payments in the appropriate amount on those claims for which the Group are legally obligated to pay;
- contribute to the underwriting process by collaborating with both underwriting teams and senior management in terms of the evolution of policy language and endorsements and providing claim-specific feedback and education regarding legal activity;
- contribute to the analysis and reporting of financial data and forecasts by collaborating with the finance and actuarial functions relating to the drivers of actual claim reserve developments and potential for financial exposures on known claims; and
- support Lancashire's marketing efforts through the quality of its claims service.

Lancashire has a team of experienced claims professionals, and will expand the team as needed to service the Group's clients and to properly adjust reported claims. Lancashire has developed processes and internal business controls for identifying, tracking and settling claims, and authority levels have been established for all individuals involved in the reserving and settlement of claims. Its underwriters do not make the final decisions regarding the ultimate determination of reserves and settlement of claims; rather, this is a function separately determined by the claims team, except for ex gratia payments which are subject to approval by the relevant underwriter or members of senior management (depending on the amount of such payment).

Members of the department regularly report to senior management on the status of reserves and settlement of claims, it being recognised that fair interpretation of reinsurance agreements and insurance policies with customers, and timely payment of valid claims, are a valuable service to clients of the Group.

12. Investments

Lancashire's primary investment objectives are to preserve capital and provide adequate liquidity to support the Company's payment of claims. A secondary objective is to maximise total risk adjusted return on invested assets, with low volatility. These objectives are reflected in the Group's investment guidelines and evidenced by the Group's present asset allocation. Provided the Group's primary objectives have been satisfied, additional growth in the investment portfolio may be pursued through longer duration fixed income investments and equity investments. The equity investments may include common stocks, direct equity investments, private equity limited partnerships and hedge funds. Derivatives and the selling short of securities may be used on an ad-hoc basis to reposition or hedge the investment portfolio or business exposures.

The Group reviews the composition, duration and asset allocation of its investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. As at the date of this document, Lancashire's Value at Risk ("**VaR**") tolerance is 4.0 per cent. of shareholders' equity over a 90 day period at a 95 per cent. confidence level. The ninety day VaR, at a 95 per cent. confidence interval, measures the minimum amount by with the portfolio is expected to lose in a ninety day time horizon, under normal condition, 5 per cent. of the time.

The fixed income portfolios are managed by three external investment managers (regulated by the SEC), Blackrock Financial Management, Inc. ("**Blackrock**"), Goldman Sachs Asset Management L.P. ("**GSAM**") and

Pacific Investment Management Company LLC ("**PIMCO**"). The equity portfolio is managed by one investment manager, Prospector Partners. The equity portfolio represents less than one per cent. of total invested assets and is invested predominantly in US securities in a range of sectors, and includes convertible debt. The performance of the managers is monitored on an on-going basis.

The Group's investment guidelines are established by the Investment Committee of the Board of Directors. Investment guidelines set parameters within which the Group's external investment managers must operate. Important parameters include guidelines on permissible assets, duration ranges, credit quality and maturity. Investment guidelines exist at the individual portfolio level and for the Group's consolidated portfolio. Compliance with guidelines is monitored on a monthly basis. Any adjustments to the investment guidelines are approved by the Investment Committee and the Board of Directors.

Within the Group guidelines is a sub-set of guidelines for the portion of funds required to meet potential insurance liabilities in an extreme event, plus other near term liquidity requirements, the "core" portfolio. The core portfolio is invested in fixed income securities and cash and cash equivalents. The sub-set of guidelines adds a further degree of requirements, including fewer allowable asset classes, higher credit quality, shorter duration and higher liquidity. The primary objective of this portion of assets is liquidity and capital preservation.

Assets in excess of those required to settle potential insurance liabilities in an extreme event, plus other near term liquidity requirements, may be held in the "core" portfolio, the "core plus" portfolio or in the "surplus" portfolio. The core plus and the surplus portfolios are invested in fixed income securities, cash and cash equivalents and a modest amount of equity securities. These assets are not matched to specific insurance liabilities. In general, the duration is slightly longer, while maintaining focus on high quality assets. Lancashire also holds a modest amount of convertible debt securities. Currently, the Group holds less than one per cent. in equities but does not hold any alternative investments such as hedge funds.

At a high level, the investment guidelines permit the following:

- 60 per cent. to 100 per cent. of shareholders' equity in fixed income
- Up to 40 per cent. of shareholders' equity in non-fixed income
- Up to 10 per cent. of shareholders' equity in alternative investments (includes hedge funds)
- The core portfolio duration target is within 0.75 years of the duration of insurance liabilities
- The core plus portfolio duration target is 2 years
- The surplus portfolio duration target is the duration of the Barclays Capital (previously Lehman Brothers) Intermediate Aggregate Index
- The core portfolio's minimum average credit quality is AA+

Investment Market Performance

Lancashire's investment philosophy is to preserve liquidity and limit downside risk. The Group's investment policy reflects management's cautious approach to investment risk management, with the majority of investments held in cash and cash equivalents and highly rated fixed income securities.

Investment income is a function of the asset category market yield and the asset category holdings. During late 2007 and most of 2008, interest rates and yields declined significantly as a result of the housing and financial markets crisis and credit spreads widened. This crisis impacted returns but also the Group's mix of asset holdings. The Group disposed of certain perceived higher risk investments in order to preserve capital. This necessarily led to lower investment returns. While investment market losses are at historic levels, the Group's conservative investment strategy has meant that the Group's investment return has been positive. Active asset category re-allocation has also ensured relatively good performance.

Net investment income was US$59.5 million in the twelve months to 31 December 2008, a decrease of 24.1 per cent. over 2007. The decrease in net investment income was primarily due to lower yields on the Group's bond portfolio. The lower yields were driven to a large extent by reductions in U.S. interest rates throughout 2008, together with the impact of executing the tactical decision to exit certain higher yielding fixed income classes, including all non-agency structured products, in the fourth quarter of 2007.

Total investment return, including net investment income, net realised gains and losses and net change in unrealised gains and losses, was a positive US$55.1 million for the year. Given the continued volatility of equity markets, the Company's modest allocation to equities was nearly all liquidated in the fourth quarter. The fixed income portfolio performed well in relative terms due to the defensive position in government backed securities and being underweight in corporate bonds. In the uncertain markets of 2008, the strategy also included holding an overweight position in cash and maintaining a high quality, short duration bond portfolio with underweight allocations to the financial sector securities that do not directly benefit from government support.

At 31 December 2008 the fixed income portfolio plus managed cash had a duration of 1.8 years, a credit quality of AA+ and a market yield of 3.1 per cent. Investment assets were comprised of 80.3 per cent. fixed income, 0.3 per cent. equities and 19.4 per cent. cash. Lancashire did not invest in hedge funds or other alternative investments in 2008 and has no plans to make investments in hedge funds or other alternative investments at this time.

Investment and interest rate risk

Lancashire reviews the composition, duration and asset allocation of its investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. If certain asset classes are anticipated to produce a higher return within management's risk tolerance an adjustment in asset allocation may be made.

The Group's net asset value is directly impacted by movements in the value of investments held. Values can be impacted by movements in interest rates, credit ratings, economic environment and outlook and exchange rates.

The majority of the Group's investments comprise fixed income securities. The fair value of the Group's fixed income portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's fixed income investments would tend to rise and vice versa.

The sensitivity of the price of fixed income securities is indicated by its duration. The greater a security's duration, the greater its percentage price volatility. The Board of Directors limits interest rate risk on the investment portfolio by establishing and monitoring duration ranges within investment guidelines.

In addition to duration management, the Group uses VaR to measure potential losses in the estimated fair values of its cash and invested assets. Management measures VaR on a monthly basis to understand and monitor risk.

The Group has issued long-term debt. The loan notes bear interest at a floating rate that is re-set on a quarterly basis plus a fixed margin of 3.7 per cent. The Group is subject to interest rate risk on the coupon payments of the long-term debt. The Group has mitigated the interest rate risk by entering into swap contracts on 50 per cent. of its exposure to the interest rates.

13. Competition

Lancashire operates in the global specialty insurance markets with a small line in global catastrophe reinsurance. The industry consists of a wide range of insurers, reinsurers, brokers, agents, loss adjustors and consultants providing insurance and reinsurance services to small, medium and large corporate entities on a worldwide basis. Lancashire's peer group consists of specialty (re)insurers that are well capitalised with good rating agency ratings. These peers are located in four main concentrations: London, continental Europe, the USA and Bermuda. The largest have capitalisation in the order of several billion dollars, the smallest of just a hundred million dollars. Many of the companies are publicly owned on the major exchanges, others are privately held by management and institutional investors. The clients range from Fortune 100 companies with global exposures and multiple assets, to small private corporations with a single asset.

The international specialty insurance and reinsurance markets are highly competitive, encompassing a range of niche and multi-product insurers and reinsurers. Some operate on a global or regional scale, others on a very local one such as a specific area of a single US State. The Group's principal competitors vary by line of business, with some being common to more than one line of business.

14. Reasons for Move to Official List

Since its admission to AIM in 2005, the Group has both grown significantly and matured as an insurance underwriter and the Directors believe that a move to the Official List and to trading on the main market of the London Stock Exchange is now appropriate for the next stage of the Group's development. The Directors also believe that due to the higher number of institutional investors who regularly trade in companies admitted to the Official List and the higher profile of such companies, the Company will be better placed to achieve improved liquidity and visibility in the Common Shares following Admission. Furthermore, the Directors believe that a move to the Official List will improve the Company's profile in the insurance market and increase public awareness of Lancashire. This move underlines the success and progress that the Group has made since December 2005.

15. Share Schemes

Lancashire has three forms of equity based compensation: warrants, a long term incentive plan and a restricted share scheme. See paragraph 8 of Part VIII – Additional Information for further information.

16. Dividend Policy

Lancashire intends to maintain a strong balance sheet at all times, while generating an attractive risk-adjusted total return for shareholders. It will actively manage capital to achieve those aims. Capital management is expected to include the payment of a sustainable annual dividend, supplemented by special dividends from time to time. Dividends will be linked to past performance and future prospects. Under most scenarios, the annual dividend is not expected to reduce from one year to the next. Special dividends are expected to vary substantially in size and in timing.

17. Voting Rights

The voting rights of the Common Shares are described in paragraph 5.4 of Part VIII – Additional Information of this document.

If, and so long as, the "controlled shares" of any US Person (as defined in paragraph 7.4.2 of Part VIII – Additional Information) would otherwise represent more than 9.5 per cent. of the total combined voting power

of all of the Company's issued and outstanding shares entitled to vote, then the votes conferred by the controlled shares owned by such person will be limited, in the aggregate, to a voting power of 9.5 per cent., as set forth in the Bye-laws. In addition, the Directors may limit a Shareholder's voting rights where it deems it necessary to do so to avoid certain adverse tax consequences. See Part VIII – Additional Information of this document.

18. Admission, dealings, CREST and Depositary Interests

Application has been made to the FSA for the admission of 182,503,063 Common Shares to the Official List and to the London Stock Exchange for the Common Shares to be admitted to trading on the London Stock Exchange's main market for listed securities. It is expected that Admission will become effective and that unconditional dealings on the London Stock Exchange will commence in the Common Shares on 16 March 2009. Upon Admission, the admission of the Common Shares to AIM will be cancelled.

CREST is a paperless settlement procedure enabling securities to be evidenced otherwise than by a certificate and transferred otherwise than by a written instrument. Euroclear UK & Ireland is unable to take responsibility for the electronic settlement of shares issued by non-UK companies. However, to enable investors to settle international securities under the CREST system, Euroclear UK & Ireland provides a method whereby a custodian acts as depositary of the international securities and issues dematerialised depositary interests representing the underlying international securities which it holds on trust for the holders of the securities.

On Admission, CREST Members will continue to be able to hold and transfer interests in the Common Shares within CREST, pursuant to the existing depositary interest arrangement established by the Company which is incorporated in Bermuda.

The Common Shares are not themselves be admitted to CREST, rather Capita IRG Trustees Limited, the Company's registrars, will continue to issue the Depositary Interests in respect of underlying Common Shares. The Depositary Interests are independent securities constituted under English law which are held and transferred through the CREST system. Depositary Interests have the same security code (ISIN) as the underlying Common shares and require a separate admission to the Official List. The Depositary Interests were created and issued pursuant to a deed poll entered into by Capita IRG Trustees Limited. Further details of these arrangements are set out in paragraph 21.2 of Part VIII – Additional Information of this document.

19. Further Information

Further information relating to the Group is set out in Part VIII – Additional Information of this document.

PART IV

MANAGEMENT AND CORPORATE GOVERNANCE

1. Directors and Management

Chairman and Non-Executive Directors

Martin Thomas (age 45) Non-Executive Chairman

Martin Thomas is a partner and board member of Altima Partners LLP, a UK-based hedge fund manager. Prior to this, he was an official of the Bank of England, most recently on secondment to the EU Commission where he worked in the Financial Services Policy and Financial Markets Directorate of the EU Commission's Internal Market and Services Directorate General. Before Mr Thomas joined the Commission, he established the Financial Markets Law Committee at the Bank of England. Prior to that, he was deputy chief executive of the Financial Law Panel and prior to that, senior counsel to the European Central Bank in Frankfurt. He started his career in private practice, specialising in corporate and commercial litigation at Travers Smith and in the law and regulation of financial services at Clifford Chance.

Jens Juul (age 60) Non-Executive Director

Jens Juul, the Honorary Consul of Sweden for Bermuda, has 29 years of international reinsurance experience. He founded and managed subsidiaries for the Storebrand Group in Latin America and Canada and was also the CFO of their US subsidiary, Christiana General, prior to moving to Bermuda, where he was the founding chief executive officer of Scandinavian Re until his retirement in 2002. He is an ARIAS-US certified arbitrator and umpire.

Ralf Oelssner (age 64) Non-Executive Director and Senior Independent Non-Executive Director

Ralf Oelssner was vice president of corporate insurance for Lufthansa German Airlines until 31 October 2007. In 1979, he was appointed director of corporate insurance, and in 1990 was appointed managing director of Lufthansa's in-house broker. Mr Oelssner became a member of the executive board of the captive insurance and reinsurance companies of Lufthansa in 2000 and served as chairman of the International Air Transport Association ("**IATA**") in 1982 and 1983 and as chairman of the IATA Risk & Insurance Managers' Panel in 2001 and 2002. He was chairman and president of Airline Mutual Insurance, Bermuda from its foundation on 13 May 1986 until dissolution of the company on 30 March 2007. He is president of the German Risk Managers' Association. He holds an M.A. in Economics from Cologne University.

Robert Spass (age 53) Non-Executive Director

Robert Spass is a founding partner of Union Square Partners, an investment firm he joined on its formation in February 2007. He previously held similar positions at Capital Z Partners (which he joined as a founding partner in 1998), and before that at Insurance Partners, L.P. and International Insurance Advisors L.P. Mr Spass currently serves on the board of directors of Universal American Financial Corp., Endurance Specialty Holdings, Ltd. and other privately-held companies.

William Spiegel (age 46) Non-Executive Director

William Spiegel is a founding partner of Pine Brook Road Partners, LLC, a private equity firm specialising in energy and financial services investing. Mr Spiegel has worked in the private equity industry since 1990 at Lehman Brothers and the Cypress Group. Mr Spiegel has a B.Sc. in Economics from the London School of Economics, an M.A. in economics from the University of Western Ontario and an M.B.A. from the University of Chicago. Mr Spiegel has served on the boards of Catlin Group Limited, Financial Guaranty Insurance Co., MedPointe, Inc., Montpelier, and Scottish Re Group Limited.

Barry Volpert (age 49) Non-Executive Director

Barry Volpert is co-founder, chairman and chief executive officer of Crestview Partners, LP a private equity firm. Prior to founding Crestview Partners, LP he was a partner at Goldman, Sachs & Co., where he was most recently head of the merchant banking division in Europe, co-chief operating officer of the principal investment area worldwide and a director of Goldman Sachs International. He has a J.D. and M.B.A. from Harvard and received an A.B. from Amherst College. He has served on the boards of many public and private companies, including Oxbow Carbon LLC, FHC Health Systems, Inc. and Key Safety Systems Inc.

John Bishop (age 63) Non-Executive Director

John Bishop was appointed to the Board on 19 March 2008. Mr Bishop is an actuary with broad experience in the insurance business. He has served on the boards of a number of insurance companies, including Sun Alliance Group and Eagle Star Group, both in an executive capacity and as a non-executive director. Mr Bishop has previously worked at the Euler Group on its managing board and as chairman and chief executive officer of Eagle Star Insurance Company Ltd where he was responsible for the worldwide general insurance operations and, before that, as a managing director of Sun Alliance UK Insurance Company.

Executive Directors

Richard Brindle (age 46) Chief Executive Officer

Richard Brindle was the driving force behind the establishment of Lancashire in late 2005 and serves as a member of the Board. Mr Brindle joined Ascot Underwriting Agency in 2001 as a non-executive member of the Ascot board, which was a position he held until his resignation in September 2005. As part of his directorship

duties at Ascot, Mr Brindle was responsible for a number of independent underwriting reviews and was chair of the Strategic Business Development Committee. Mr Brindle started his career in 1984 working at Posgate and Denby Managing Agency which was later taken over by Charman Underwriting Agencies. In 1989 Mr Brindle was appointed as deputy underwriter of Syndicate 488. In 1991 he was appointed as a director of Charman Underwriting Agencies and acted as main underwriter until 1999. Mr Brindle left Charman Underwriting Agencies when it was sold to the ACE Group of Companies in Bermuda.

Simon Burton (age 38) Deputy Chief Executive Officer

Simon Burton joined Lancashire in March 2006 and leads the Bermuda subsidiary Lancashire Insurance Company Limited. He is also a member of the Board. Mr Burton previously spent 10 years at Financial Solutions International ("**FSI**"), an underwriting division of the ACE Group of Companies that specialised in non-traditional products including insurance, reinsurance, retrocessional and retrospective risks. He held various roles within FSI, his most recent being president of the unit with responsibility for underwriting, operations and financial performance of FSI's offices in Bermuda, London, Dublin and Sydney. Prior to joining ACE, Mr Burton was a consulting actuary at Tillinghast-Towers Perrin in London and Bermuda.

Neil McConachie (age 36) Chief Financial Officer

Neil McConachie joined Lancashire in February 2006 and leads the finance functions of the Group and serves as a member of the Board. Mr McConachie was previously treasurer and chief accounting officer of Montpelier Re Holdings Ltd. Mr McConachie has extensive experience in debt and equity capital markets transactions in the UK and the US including the initial public offerings of Lancashire and Montpelier Re Holdings Ltd. Prior to joining Montpelier Re Holdings Ltd, Mr McConachie worked for PricewaterhouseCoopers in London and Bermuda and at Stockton Holdings Limited.

Company Secretary

Greg Lunn, Group General Counsel

Greg Lunn joined Lancashire in February 2006 and is responsible for all legal affairs as well as being Company Secretary. Before joining Lancashire in 2006, Mr Lunn spent almost 9 years with the ACE Group of Companies, most recently at ACE Limited in Bermuda where he was compliance counsel. Between 2000 and 2003 Mr Lunn was legal counsel for ACE European Group in London. His responsibilities included the reviewing of legal service requirements for ACE Europe and provisions of European and English law legal advice on a wide range of strategic and transactional issues affecting the ACE European Group, including the implementation of FSMA.

Senior Management

Alex Maloney, Group Underwriting Director

Alex Maloney joined Lancashire in December 2005 and leads Lancashire's underwriting operations. Mr Maloney built the energy business and team for the Group after joining from Zurich Insurance Company UK where he spent 15 years. His team at Zurich wrote, amongst others, insurance for independent oil and gas companies and national oil companies, both key classes for Lancashire. Mr Maloney assisted in establishing Zurich Global Energy's presence in the Bermuda insurance market, spent 2 years in Zurich's New York office and has significant experience in the London insurance market.

Charles Mathias, Group Underwriting Operations Director and Chief Underwriting Officer – Lancashire Insurance Company Limited

Charles Mathias joined Lancashire in November 2005 and is responsible for the underwriting function at LICL. Mr Mathias has over 24 years of experience as an underwriter and broker, having previously worked for Leslie and Godwin, Alexander Howden and opened a reinsurance brokerage for an A&A affiliate in Mexico. In 1991 he was appointed senior vice president of a managing general agent based in Texas underwriting property business throughout Latin America and the Pacific Rim and was responsible for all aspects of production, administration and underwriting of the portfolio. Mr Mathias returned to London in a broking role before joining Lancashire and worked on property and specialty business for RK Harrison.

Paula Porter, Chief Executive Officer – Lancashire Insurance Company (UK) Limited

Paula Porter joined Lancashire in January 2006 and leads the Group's UK operating subsidiary. Mrs Porter has over 26 years' experience in the insurance industry, having previously worked for Sedgwick Insurance Brokers as managing director until 1999 when she moved to Houston Casualty Company in London as senior property underwriter for the start-up London office of that company. While at Houston Casualty, Mrs Porter was responsible for underwriting a US and international open market book, primarily for Fortune 500 companies.

2. Corporate Governance

The Board of Directors

As a Bermuda incorporated company, Lancashire is governed through a set of Bye-laws, as well as through the provisions of the Act. The Board seeks to achieve the highest standards of corporate governance. Since the admission of the Company's shares to trading on AIM in 2005, the Board has sought to comply with the requirements of the Combined Code although technically the Combined Code does not apply to AIM listed companies. There are no Bermudian corporate governance standards similar to the UK Combined Code that

apply to Lancashire. As at the date of this document, Lancashire complies with the UK Combined Code except as stated below.

The Board has overall responsibility for the leadership and control of Lancashire's business. The Board has reserved a number of matters for its decision including responsibility for the overall management of the Group and approval of the Group's long-term objectives and commercial strategy. The Board has delegated certain matters to the committees described below. The committees report to the Board. The Board has separate appointments for the roles of Chairman and Chief Executive Officer and adopted a formal division of responsibilities for these positions during 2007. These divisions of responsibility remain in effect as at the date of this document. The day to day management of the Company and implementation of Board decisions and strategy is carried out by the executive Directors and senior management. The Board of Directors meets on a quarterly basis and occasionally more frequently as circumstances dictate. At Board meetings, the Directors review all areas and developments in the Group's business and receive reports from management on finance, underwriting and any other key matters affecting the Company. The Directors are provided with information necessary for them to fulfil their responsibilities including quarterly reports and full board papers. Additional information is provided to the Board as and when necessary and the Directors have access to independent professional advice as required.

The Board has established audit, nomination and corporate governance, remuneration, investment and underwriting committees. The committees' responsibilities are contained in their terms of reference and their reporting obligations are to the Board. A summary of the terms of reference of each of the audit, nomination and corporate governance and remuneration committees is set out in Part VIII – Additional Information of this document.

Audit Committee

The members of the audit committee are Robert Spass (Chair), John Bishop, Jens Juul, Ralf Oelssner and William Spiegel. The composition of the committee currently does not conform to the Combined Code requirement that the committee should be comprised of independent non-executive Directors. Robert Spass, although a non-executive Director, is not considered independent for the purposes of the Combined Code. All the other members are independent non-executive Directors. However, the Board considers that the audit committee's current membership is appropriate and that Robert Spass is suitable for the role of audit committee chair because he has recent and relevant financial experience. The audit committee is responsible for the effectiveness of the internal and external audit functions. The audit committee's responsibilities are contained in their terms of reference. These include reviewing and reporting to the Board on the preparation of the Company's financial information, announcements relating to the Company's financial results and monitoring the independence of the Company's auditors.

Nomination and Corporate Governance Committee

The members of the nomination and corporate governance committee are Martin Thomas (Chair), John Bishop and Jens Juul. The nomination and corporate governance committee's responsibilities are contained in their terms of reference. These include reviewing the structure, size and composition (including the skills, knowledge and experience) of the Board and making recommendations regarding changes.

Remuneration Committee

The members of the remuneration committee are William Spiegel (Chair), Jens Juul, Ralf Oelssner and Martin Thomas. The remuneration committee's responsibilities are contained in their terms of reference. These include determining remuneration for the Company's executives and senior management of the Group within a framework agreed with the Board.

Investment Committee

The members of the investment committee are Barry Volpert (Chair), Richard Brindle, Neil McConachie, and Robert Spass. The investment committee's responsibilities are contained in their terms of reference. These include recommending and monitoring investment strategies, recommending appointments of fund managers for the Group's investments and monitoring the cash flow, liquidity and working capital of the Group.

Underwriting Committee

The director members of the underwriting committee are Richard Brindle (Chair), John Bishop, Simon Burton, Jens Juul and Ralf Oelssner. Additional members of the underwriting committee, who are not directors, are Bryan Bumsted, Charles Mathias, Paula Porter and Alex Maloney. The underwriting committee's responsibilities are contained in its terms of reference. These include reviewing and monitoring compliance with the Group's underwriting guidelines and policies, formulating underwriting strategy, reviewing aggregate underwriting exposures and reviewing compliance with probable maximum loss limits.

Other Matters related to Compliance with the Combined Code

Currently, the Company complies with the Combined Code except as set out above and as follows:

John Bishop, Jens Juul, Ralf Oelssner and William Spiegel are independent Directors as each is independent in character and judgment and has no relationship or circumstance likely to affect his judgment. Martin Thomas was independent upon his appointment as Chairman on 1 May 2007. Robert Spass and Barry Volpert are not independent under the Combined Code due to their appointment by and affiliation with specific shareholders.

Accordingly, four of the ten Directors are independent non-executive Director and the Board's composition does not currently comply with the Combined Code requirement that independent non-executive Directors, excluding the Chairman, should make up at least half of the Board. However, the Board believes that its present composition is appropriate for the current stage of the Company's development. The Company is seeking to appoint an additional non-executive director during 2009 and is actively pursuing suitable candidates.

The Company's Long Term Incentive Plan does not contain certain provisions which are included in the current guidelines on executive remuneration published by the Association of British Insurers or the Combined Code. Further details are contained in paragraph 8 of Part VIII – Additional Information. In addition, the Warrants granted to employees do not contain certain provisions which are included in the current guidelines on executive remuneration established by the Association of British Insurers or the Combined Code. Further details are contained in paragraph 8 of Part VIII – Additional Information.

PART V

OPERATING AND FINANCIAL REVIEW

1. Introduction

This section provides details of the financial and operating performance of the Group. The Group's history and a description of its business are included at Part III – Information on the Group. This section should be read in conjunction with the Group's consolidated financial statements and related notes included in Part VI – Financial Information.

The Group's consolidated financial statements are prepared in accordance with accounting principles generally accepted under International Financial Reporting Standards ("**IFRS**") as adopted by the European Union. Where IFRS is silent, as it is in respect of the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, management determines appropriate measurement bases, to provide the most useful information to users of the consolidated financial statements, using their judgment and considering the accounting principles generally accepted in the United States ("**US GAAP**").

Unless otherwise stated, financial information included in this section has been extracted without material adjustment from the audited consolidated financial statements of the Group as set out in the Annual Report and Accounts for the Group for the three financial years ended 31 December 2006, 2007 and 2008. These documents, which include the financial statements of the Group and, where relevant, the accompanying audit reports referred to above, are set out in Part VI – Financial Information of this document. Further unaudited financial information has been extracted without material adjustment from internal accounting records.

2. Overview

The Group underwrites contracts that transfer insurance risk. The Group underwrites worldwide short-tail insurance and reinsurance risks, including risks exposed to natural and man-made catastrophes. Its four principal classes, or lines, are property, energy, marine and aviation. The Group has a rating of A- (excellent) from A.M. Best.

During the first three years of operation, the Group has expanded from one location in Bermuda to dual operating platforms in Bermuda and London, with a marketing office in Dubai. This structure affords the Group access to the global (re)insurance markets in which it operates.

Management's over-riding goal is to generate a superior risk-adjusted return over time. The Group's expected return in any one year will however vary through the insurance cycle. Insurance and reinsurance markets are cyclical and premium rates and terms and conditions vary by line of business depending on market conditions and the stage of the cycle. Market conditions are impacted by capacity and recent loss events, among other factors. Large loss events, or an accumulation of losses, typically drive an increase in prices. In the absence of such losses, prices generally decline. The market is competitive. When prices decline, many companies seek to further diversify their business in an attempt to offset premium reductions, thereby exacerbating the pressure on pricing. Lancashire's management team does not endorse this approach. When new opportunities arise and a growth strategy is appropriate, Lancashire believes the desired returns are normally best achieved through organic growth rather than strategic acquisitions. Conversely, when market conditions deteriorate for an extended period, Lancashire believes its goal is best achieved through focus on underwriting integrity and an active capital management strategy, maintaining a lean operational base and a sophisticated IT platform.

3. Key Factors Affecting Results of Operations

The profitability of the Group is driven by management's ability to manage risk and exposures and whether premium and investment income will be sufficient to cover loss payments and expenses.

The following factors and/or potential developments may have a material effect on the Group's future operating results:

Insurance Market Cycle

Excess capacity drives premium rates and terms and conditions down, with improved premium pricing and terms and conditions when capacity is restricted or largely unavailable. Different classes, or lines, in which the Group underwrites may be affected differently in any future period. With the active hurricane seasons of 2004 and 2005, and more specifically with the reduced capacity available post hurricanes Katrina, Rita and Wilma there was a period of significantly improved market pricing and terms and conditions in the property and energy classes, in particular in the property retrocession and property direct and facultative and energy Gulf of Mexico subclasses. These improved market conditions endured through 2006 and 2007. This, and the lack of catastrophe losses for the Group, produced favourable results for the Group for those years. In 2008 the initial lack of catastrophic losses prompted a downturn in the cycle, with prices falling and terms and conditions weakening.

During the 2008 hurricane season, Hurricanes Gustav and Ike passed through the Gulf of Mexico oil fields, making landfall in the United States. Hurricane Ike in particular was an especially destructive storm, causing damage to and destruction of a significant number of oil platforms. Hurricane Ike proved to be a very large

loss event for the offshore industry. While the Group incurred relatively significant losses in relation to this event, energy Gulf of Mexico pricing and terms and conditions have once again improved.

In addition to the hurricane activity of 2008, the year also produced a considerable number of risk losses to the industry. The Group's participation on these risk losses was relatively small. However, pricing in the areas affected has improved, principally in the property and energy classes. The largest driver of the 2009 hard market appears to be the large reduction in industry capacity as a result of the investment market turmoil. The ongoing crisis has reduced capacity in terms of erosion of capital from investment portfolio losses and impairments. Some competitors have withdrawn from sectors of the market or reduced their market share.

Loss Reserve Development

Prior to the hurricane season of 2008 there were no major loss events that materially impacted the Group's results. Hurricane Ike was however a meaningful loss event for Lancashire. For offshore losses in particular, estimation of the ultimate liability is complex. Loss assessments require skilled loss adjusters. The availability of loss adjusters with the necessary expertise is scarce and large events put a further strain on this resource.

Loss and loss adjustment expense reserves are maintained to cover the Group's estimated liability for both reported and unreported claims. Reserving methodologies that calculate a point estimate for the ultimate losses are utilised, and then a range is developed around the point estimate. The point estimate represents management's best estimate of ultimate loss and loss adjustment expenses.

For most insurance and reinsurance companies, the most significant judgement made by management is the estimation of loss and loss adjustment expense reserves. The estimation of the ultimate liability arising from claims made under insurance and reinsurance contracts is a critical estimate for the Group.

Under US generally accepted accounting principles, loss reserves are not permitted until the occurrence of an event which may give rise to a claim. As a result, only loss reserves applicable to losses incurred up to the reporting date are established, with no allowance for the provision of a contingency reserve to account for expected future losses or for the emergence of new types of latent claims. Claims arising from future events can be expected to require the establishment of substantial reserves from time to time. All reserves are reported on an undiscounted basis.

Loss reserve calculations for direct insurance business are not precise in that they deal with the inherent uncertainty of future contingent events. Estimating loss reserves requires management to make assumptions regarding future reporting and development patterns, frequency and severity trends, claims settlement practices, potential changes in the legal environment and other factors such as inflation.

In general, claims relating to short-tail property risks, such as the majority of risks underwritten by the Group, are reported more promptly by third parties than those relating to long-tail risks, including the majority of casualty risks. However, the timeliness of reporting can be affected by such factors as the nature of the event causing the loss, the location of the loss, and whether the losses are from policies in force with primary insurers or with reinsurers.

There is a time lag inherent in reporting from the original claimant to the primary insurer to the broker and then to the reinsurer. Also, the combination of low claim frequency and high severity make the available data more volatile and less useful for predicting ultimate losses.

During the loss settlement period, which may be years in duration, additional facts regarding individual claims and trends often will become known, and current laws and case law may change, with a consequent impact on reserving. For certain catastrophic events there is greater uncertainty underlying the assumptions and associated estimated reserves for losses and loss adjustment expenses. Complexity resulting from problems such as policy coverage issues, multiple events affecting one geographic area and the resulting impact on claims adjusting (including allocation of claims to event and the effect of demand surge on the cost of building materials and labour) by, and communications from, insureds or ceding companies, can cause delays to the timing with which the Group is notified of changes to loss estimates.

The claims count on the types of insurance and reinsurance that the Group writes, which are low frequency and high severity in nature, is generally low.

At 31 December 2008 management's estimates for IBNR represented 32.6 per cent. of total net loss reserves (2007 – 60.1 per cent.; 2006 – 96.9 per cent.). The majority of the estimate relates to potential claims on non-elemental risks where timing delays in insured or cedant reporting may mean losses could have occurred which management were not made aware of by the balance sheet date.

Investment Market Performance

Lancashire's investment philosophy is to preserve liquidity and limit downside risk. The Group's investment strategy reflects management's cautious approach to investment risk management, with the majority of investments held in cash and cash equivalents and highly rated fixed income securities. The primary aim is to generate satisfactory investment returns while preserving shareholders' capital.

The Group's net asset value is directly impacted by movements in the value of investments held. Values can be impacted by movements in interest rates, credit ratings, economic environment and outlook, and exchange rates. The majority of the Group's investments comprise fixed income securities. The fair value of the Group's fixed income portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's fixed income investments would tend to rise and vice versa. The sensitivity of the price of fixed income securities is indicated by its duration. Duration is the weighted average

maturity of a security's cash flows, where the present values of the cash flows serve as the weights. The greater a security's duration, the greater its percentage price volatility. Interest rate risk is limited by establishing a monitoring duration ranges within pre-defined investment guidelines and utilising VaR to understand and monitor risk.

Investment income is a function of the asset category market yield and the asset category holdings. During late 2007 and most of 2008, interest rates and yields declined significantly as a result of the housing and financial markets crisis and credit spreads widened. This crisis impacted returns but also the Group's mix of asset holdings. The Group disposed of certain perceived higher risk investments in order to preserve capital. This necessarily led to lower investment returns. While investment market losses are at historic levels, the Group's conservative investment strategy has meant that the Group's investment return has been positive. Active asset category re-allocation has also ensured relatively good performance.

Lastly, credit and liquidity risk are mitigated by holding highly rated, high quality, liquid securities with concentration restrictions in place by issuer and sector. The Group has significant credit concentration with respect to fixed income securities issued by the US government and government agencies.

Operational and Strategic Planning

The Group's ability to generate the desired risk-adjusted return is impacted by its ability to optimise its portfolio of risk against its capital base. The Group's aim is to provide Shareholders with a return on equity of 13 per cent. in excess of a risk free rate over the insurance cycle. The return is measured by management as the internal rate of return ("**IRR**") of the increase in fully converted book value per share ("**FCBVS**") in the period plus dividends accrued. This aim is a long-term goal, acknowledging that management expect both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market drives this pattern and the management team monitors these peaks and troughs – adjusting the Group's portfolio to make the most effective use of available capital and seeking to maximise the risk adjusted return. Within the insurance industry, downturns in the profitability of the cycle present the biggest challenge. The Group's economic capital model ("**BLAST**") assists the Group's underwriting team in determining the mix of the portfolio. If the assumptions in the model are incorrect or appropriate judgement is not applied, the Group may assume a risk that does not provide an appropriate return.

Accounting, Tax and Regulatory Developments

The Group's operations are regulated in each of the jurisdictions it does business. Changes in local regulatory frameworks or taxation regulations could impact the way the local entities and/or the Group conducts business. In particular, the impending implementation of the European regulatory framework, Solvency II, could have a significant impact on the Group, as could United States Treasury taxation rulings or interpretations.

Solvency II will require European insurers to consider their balance sheet on an 'economic basis' and assess their regulatory capital requirements within a forward looking risk sensitive framework. Insurers will be required to conduct their own risk and solvency assessment ("**ORSA**"), based on their risk profile, risk appetite and business strategy and submit the results to their supervisors as part of the supervisory review process. As part of the public disclosure, insurers will be required to make public disclosure on their solvency and capital position. Solvency II will replace Solvency I and is currently planned to take effect in October 2012.

Forthcoming Changes in IFRS

There are no new or amended IFRS and International Financial Reporting Interpretations Committee ("**IFRIC**") standards adopted by or materially impacting the Group. IFRS 8, Operating Segments, which has been issued but is not yet effective, has not been early adopted by the Group. The Group continues to apply IAS 14, Segment Reporting. This Standard, and other IFRS and IFRIC standards issued but not yet effective, is not expected to have a material impact on the results and disclosures reported in the annual or interim consolidated financial statements.

The International Accounting Standards Board ("**IASB**") currently have a number of projects underway that will lead to revisions of existing standards or implementation of new standards during 2009 and beyond. A standard is expected to be issued in 2011 in relation to the measurement of insurance contracts. The Group currently defers to US GAAP for measurement of insurance contracts. The impending standard could have a significant impact on the Group's results should the IASB choose to implement a fair value model of accounting for non life insurance contracts. This is unconfirmed and will remain so until such time as the IASB issues an exposure draft.

The Group recognises that Solvency II and changes in the regulatory requirements can have an impact on its future capital requirements and is planning accordingly. However, the anticipated legislation containing the necessary technical implementation measures will not be finalised until 2011.

Critical Accounting Policies

Revenue recognition

The Group's principal source of revenue is (re)insurance premiums, income derived from its underwriting operations. Though the Group writes predominantly insurance business it does also write some reinsurance. Where the insured is not an insurance company, premiums written are referred to as insurance or direct premiums. Where the insured is an insurance company, premiums written are referred to as reinsurance or assumed premiums. Policies are written based on agreed terms and conditions at an agreed price, or

premium, for the coverage provided. The premium is recorded as income based on the date that coverage starts, the inception date of the policy. Any subsequent changes in the terms and conditions or price, such as an extension of the expiration date or additional or removal of assets subject to cover, are endorsed to reflect the revised basis. If the endorsement generates any change in premium an adjustment is recorded at the effective date of the endorsement. If the premium for the policy is estimated, based on the expected ultimate cover that will be provided, it is typically adjusted at the expiration of the policy when the risks attaching to the policy are known. Premium adjustments generally occur within six months of the expiration of the policy. Some reinsurance contracts may have a provision to reinstate cover should a loss occur. Reinstatement generates further premium to the policy. The reinstatement may be for a portion of cover or for the entire cover in the event of a full limit loss.

Premiums written are generally earned on a pro-rata basis over the term of the policy cover. In any reporting period the premiums earned will relate partly to business written in that period and partly to premiums written in prior periods which are earning out. The premiums written in the period will not all be earned in that period but will be deferred to subsequent periods. The portion of premiums written that has been deferred is unearned premium and is recorded as a liability on the balance sheet. Unearned premium reflects the unexpired portion of the (re)insurance policies written. The unearned premium reserve reduces as the policy term progresses and is recognised in income. The Group writes policies of varying contract length and the mix of business written can also change from one reporting period to another. These changes can cause the pattern of written to earned premium to differ over time. Reinstatement premiums are fully earned when triggered.

When the Group purchases reinsurance protection for the business it has written, the premiums for the cover provided are paid, or ceded, to a retrocessionaire. Premiums ceded are recorded and adjusted in a similar manner to premiums written. Reinstatement premium may also be generated on ceded premiums.

Loss recognition

Losses and loss adjustment expenses are paid in respect of claims made by policyholders to the Group for loss of or damage to their property. A reserve is maintained for the payment of these claims. The reserve is an estimate of the amount that will ultimately be paid in respect of events that have already occurred but that have not yet been reported or where they have been reported but the full settlement amount is not yet known. The process of estimating the reserve required is complex and involves a considerable amount of judgement. The estimate is based on the available facts at the time the reserve is established and can include numerous assumptions which are subject to change. As new information is received the reserve may be adjusted to better reflect the facts. The Group regularly reviews and updates the methods and assumptions used to derive the loss reserve.

Reinsurance recoveries includes amounts due to the Group from retrocessionaires for claims that have been made in respect of losses incurred by the Group. Generally, the amount recovered is calculated based on the amount of loss that the Group has incurred. Ceded reserves are maintained for expected recoveries. This is developed in conjunction with the establishment of the Group's loss reserve and is subject to the same uncertainty.

For more information on the subjectivity and inherent uncertainty of establishing the Group's loss reserve refer to "Loss Reserve Development" on page 37 of this document.

4. Current Trading and Prospects

As primarily an insurance provider, the Group writes business over the course of the year and results are not significantly driven by the strength of the 1 January renewal season. The Group does write a substantial part of its property retrocession book at 1 January, however, and pricing has been in line with expectations, with rate increases in the region of 20 per cent. and some improvement in terms and conditions. The Group's next major business renewal period is March through June on its energy Gulf of Mexico book. Current expectations are that rates in this area will continue to improve with significant improvements in terms and conditions. The Group's property direct and facultative book is written throughout the year. Rates in this line of business are beginning to improve and expectations are that rates will improve through 2009.

As rates in the insurance market increase, the same is true for reinsurance that the Group may purchase. Reinsurance rates are increasing and certain covers that the Group may previously have purchased, or had access to, may no longer be available or may have increased in cost.

While the turmoil in the investment markets continues, investment returns will remain lower than at historic levels. The Group has a conservative investment strategy, with the primary goal of maintaining capital and liquidity.

5. Group Financial Performance

Consolidated results of operations

Consolidated results for the years ended 31 December 2006, 2007 and 2008 are as follows:

	As at 31 December		
	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Gross premiums written	626.0	753.1	638.1
Outwards reinsurance premiums	(78.5)	(86.3)	(63.4)
Net premiums written	**547.5**	**666.8**	**574.7**
Change in unearned premiums	(323.1)	(56.1)	42.2
Change in unearned premiums on premium ceded	19.1	0.5	(9.6)
Net premiums earned	**243.5**	**611.2**	**607.3**
Net investment income	54.2	78.4	59.5
Net other investment income (losses)	1.8	(3.3)	0.1
Net realised (losses) gains and impairments	0.8	9.1	(11.0)
Net fair value gains (losses) on investments at fair value through income	—	0.4	(0.6)
Share of profit of associate	3.2	6.2	(0.2)
Net foreign exchange (losses) gains	(1.3)	2.3	(8.5)
Total net revenue	**302.2**	**704.3**	**646.6**
Insurance losses and loss adjustment expenses	39.1	150.0	418.8
Insurance losses and loss adjustment expenses recoverable	—	(3.7)	(43.3)
Net insurance losses	**39.1**	**146.3**	**375.5**
Insurance acquisition expenses	40.0	95.6	106.9
Insurance acquisition expenses ceded	(5.1)	(19.1)	(7.3)
Other operating expenses	56.4	74.9	59.9
Total expenses	**130.4**	**297.7**	**535.0**
Results of operating activities	**171.8**	**406.6**	**111.6**
Financing costs	12.3	14.7	14.0
Profit before tax	**159.5**	**391.9**	**97.6**
Tax	0.2	1.0	0.1
Profit for the year attributable to equity shareholders	**159.3**	**390.9**	**97.5**
Earnings per share			
Basic	US$0.81	US$2.01	US$0.55
Diluted	US$0.79	US$1.91	US$0.53

Lancashire's first full year of operations was the year ending 31 December 2006.

6. Operating review for the financial year ended 31 December 2008

Gross premiums written

In 2008 gross written premiums decreased by US$115.0 million, or 15.3 per cent., as compared to 2007. The reduction in written premiums is largely attributable to lower rates than in previous periods, and a corresponding greater proportion of submissions declined.

Reinsurance premium ceded

Ceded premium reduced from US$86.3 million for 2007, to US$63.4 million for 2008. Contributing factors were the reduction in the purchase of protection against natural catastrophes, including the commutation of the quota share cession to the Lancashire sponsored energy sidecar, Sirocco Re, at the end of 2007. This was partially offset by an increase in reinsurance purchased to mitigate losses from events other than natural disasters, most of which was purchased in the first quarter of 2008. Net written premium decreased by 13.8 per cent. for the year. This was chiefly due to lower gross written premiums, offset somewhat by lower purchases of reinsurance.

Net premiums earned

Net earned premiums as a proportion of net written premiums were 105.7 per cent. for the full year 2008 compared to 91.7 per cent. for 2007. The increase reflects that, after reaching its third year of operations, Lancashire has built a mature portfolio of business, whereas in 2007 the portfolio was still in a growth phase.

Policy acquisition costs

Policy acquisition costs increased by 3.9 per cent., from 12.5 per cent. in 2007 to 16.4 per cent. in 2008. This was partially due to changing business mix and a softening market, but it was primarily driven by the business of Sirocco Re, the energy sidecar sponsored by Lancashire in 2006 and 2007, being commuted effective 31 December 2007. A profit commission received from Sirocco of US$7.8 million was recognised in acquisition

costs in 2007. Without the impact of this commutation policy acquisition costs would have been 13.8 per cent. for 2007 as compared to 16.4 per cent. for 2008.

Losses and loss expenses

The loss ratio was 61.8 per cent. for 2008, an increase from 23.9 per cent. in 2007. The absence of significant catastrophic losses in 2007 is evident in the ratios. The 2008 ratio is largely driven by the third quarter losses associated with Hurricane Ike.

Investment performance

Net investment income was US$59.5 million in the twelve months to 31 December 2008, a decrease of 24.1 per cent. over the same period in 2007. The decrease in net investment income is primarily due to lower yields on the bond portfolio. The lower yields were driven to a large extent by reductions in US interest rates throughout 2008, together with the tactical decision to exit certain higher yielding fixed income classes, including all non-agency structured products, in the fourth quarter of 2007.

Total investment return, including net investment income, net realised gains and losses and net change in unrealised gains and losses, was US$54.9 million for the year compared to US$96.6 million for 2007. The fixed income portfolio returned 5.2 per cent.

Administrative and other expenses

General and administrative expense ("**G&A**"), excluding the cost of warrants and options, decreased by US$11.2 million or 18.5 per cent. from US$60.5 million in 2007. The decrease is due to a reduction in bonus awards given the loss activity of the year. Employee compensation costs were 50.7 per cent. of G&A in 2008 compared to 60.8 per cent. in 2007.

Profit for the year

Lancashire generated net income of US$97.5 million in 2008 compared to US$390.9 million in 2007, and returned US$58.0 million of capital to shareholders. The reduction in profit year on year is driven by the net financial impact of Hurricanes Gustav and Ike of approximately US$152.9 million, premium rate reductions and reduced returns on investments, including impairments in the equity portfolio. Fully converted book value per share was US$6.86 at 31 December 2008, a return of 7.5 per cent. measured as the growth in fully converted book value per share plus dividends. The combined ratio was 86.3 per cent. Diluted earnings per share was US$0.53 versus prior year of US$1.91.

7. Operating review for the financial year ended 31 December 2007

Gross premiums written

In 2007 gross written premiums increased by US$127.1 million, or 20.3 per cent., as compared to 2006. Overall, the growth in annual premium written, despite some year on year rate reductions in certain classes, was due to fully operational platforms in Lancashire's second year, including the UK operating platform which began underwriting in late 2006.

Reinsurance premium ceded

During 2007, a greater amount of premium was ceded than in 2006, US$86.3 million in 2007 versus US$78.5 million in 2006, partly reflecting the growth in written premium. Net written premiums increased in 2007 compared to 2006 from US$547.5 million to US$666.8 million.

Net premiums earned

Net premiums earned increased from US$243.5 million to US$611.2 million in 2007 and as a proportion of net written premiums were 91.7 per cent. for the year compared to 44.5 per cent. in 2006. This is a reflection of the relative maturity of the business. As most policies tend to be twelve month policies there is less than a full year of earnings in the start up year. In the second year of the Group's history, the deferred earnings from the first year flow through.

Policy acquisition costs

Policy acquisition costs decreased by 1.8 per cent. from 14.3 per cent. in 2006 to 12.5 per cent. in 2007. This was partially due to changing business mix but it was primarily driven by the business of Sirocco Re, the energy sidecar sponsored by Lancashire in 2006, being commuted effective 31 December 2007. A profit commission received from Sirocco of US$7.8 million was recognised in acquisition costs. Without the impact of this commutation policy acquisition costs would have been 13.8 per cent. for 2007 as compared to 14.3 per cent. for 2006.

Losses and loss expenses

The loss ratio was 23.9 per cent. for 2007, an increase from 16.1 per cent. in 2006. The absence of significant catastrophic losses in both years is evident in the ratios. There was also a low level of risk losses reported for the Group and the industry as a whole for both years.

Investment performance

Net investment income was US$78.4 million in the twelve months to 31 December 2007, an increase of 44.6 per cent. over the same period in 2006. The increase in investment income is primarily due to high net operating cashflow, resulting in higher net invested assets.

Total investment return, including net investment income, net realised gains and losses and net change in unrealised gains and losses, was US$96.6 million for the year compared to US$65.5 million for 2006. The fixed income portfolio returned 6.2 per cent. Total investment return was boosted by an 8.9 per cent. gain from the equity portfolio for the year.

Administrative and other expenses

G&A, excluding the cost of warrants and options, increased by US$26.6 million or 78.5 per cent. from US$33.9 million in 2006. The increase is due to the expansion of the Group's underwriting platform to 2 locations in late 2006 and the continuing build up of the respective teams in all locations. Employee compensation costs were 60.8 per cent. of G&A in 2007 compared to 39.8 per cent. in 2006.

Profit for the year

Lancashire generated net income of US$390.9 million in 2007 compared to US$159.3 million in 2006, and returned US$339.3 million to shareholders via share repurchases and dividends. The increased profit year on year is largely driven by a full year's operations, the recognition of deferred earnings and a higher asset base on which to earn investment returns. Profit commission income of US$7.8 million was also received from the Group's sidecar venture. Fully converted book value per share was US$6.38 at 31 December 2007, a return of 31.7 per cent. measured as the growth in fully converted book value per share plus dividends. The combined ratio was 46.3 per cent. Diluted earnings per share was US$1.91 versus prior year of US$0.79.

8. Operating review for the financial year ended 31 December 2006

Gross premiums written

Gross written premiums for the twelve month period ended 31 December 2006 were US$626.0 million.

Reinsurance premium ceded

Outwards reinsurance premiums ceded in the twelve month period were US$78.5 million, including US$29.9 million of Gulf of Mexico offshore energy premiums ceded to Sirocco Reinsurance Limited, a Bermuda reinsurer in which Lancashire invested US$20.0 million in June 2006.

Net premiums earned

Net premiums earned were US$243.5 million for the year. The differential between the relative size of premiums written and premiums earned is due to timing in the first year of operation, *i.e.* with no existing portfolio of unearned premium at the beginning of the year and with policies written generally earning over a twelve month period, the earnings are deferred into subsequent periods. Net premiums earned as a proportion of net premiums written were 44.5 per cent. in 2006.

Policy acquisition costs

The acquisition cost ratio for the period was 14.3 per cent. and the G&A expense ratio was 13.9 per cent. The G&A expense ratio for 2006 is higher than the expected long-term ratio due to the lag in net premiums earned in the first year of operations.

Losses and loss expenses

The loss ratio for the twelve months to 31 December 2006 was 16.1 per cent. This is a factor of the relative absence of large loss events in the major classes written by Lancashire. All but a *de minimis* amount of the loss expense recorded is in respect of losses incurred but not reported.

Investment performance

Net investment income for 2006 was US$54.2 million. Total investment return, including net investment income, net realised gains and losses and net change in unrealised gains and losses was US$65.5 million. The fixed income portfolio returned 5.3 per cent.

Administrative and other expenses

The employee warrants and option expense is the accrual of the fair value of warrants and options granted to employees. The fair value was calculated on the grant date and is expensed over the vesting period of each security, which is between three and four years. The fair value is expensed in the income statement and there is a corresponding credit to share premium in the balance sheet, resulting in a net zero impact on total shareholders' equity. The warrants were a one-off issue at the time of the IPO in late 2005. Due to their non-recurring nature, they are not included in operating income as defined. Options are a recurring expense and are included within operating income.

In the fourth quarter of 2006 the Group opened an underwriting office in London. Prior costs related to only one underwriting platform. As 2006 was the first year of operations, employees were hired throughout the year

and costs correspondingly ramped up over the course of the year. Employee compensation costs were 39.8 per cent. of G&A.

Profit for the year

Lancashire generated net income of US$159.3 million in 2006 and increased fully converted book value per share by 17.4 per cent. The combined ratio was 44.3 per cent. Diluted earnings per share was US$0.79.

9. Consolidated financial position

Net assets as at 31 December 2006, 2007 and 2008 were as follows:

	As at 31 December		
	2006 Audited	*2007 Audited*	*2008 Audited*
	US$m	*US$m*	*US$m*
Assets			
Cash and cash equivalents	400.1	737.3	413.6
Accrued interest receivable	7.5	9.8	10.1
Investments			
– Fixed income securities			
– Available for sale	896.3	1,069.7	1,595.4
– At fair value through profit and loss	—	23.5	4.0
– Equity securities			
– Available for sale	70.3	71.6	5.8
– Other investments	11.5	4.4	—
Investment in associate	23.2	22.9	—
Reinsurance assets			
– Unearned premium on premium ceded	19.1	19.6	10.0
– Reinsurance recoveries	—	3.6	42.1
– other receivables	—	8.2	3.2
Deferred acquisition costs	51.5	57.8	60.9
Other receivables	6.3	3.8	154.0
Inwards premium receivable from insureds and cedants	173.7	198.2	187.3
Deferred tax asset	0.8	2.0	1.2
Property, plant and equipment	2.4	2.3	1.4
Total assets	**1,662.7**	**2,234.7**	**2,489.0**
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	39.1	179.6	528.8
– Unearned premiums	325.7	381.8	339.6
– Other payables	5.2	16.5	17.6
Amounts payable to reinsurers	0.8	5.7	2.0
Deferred acquisition costs ceded	2.5	3.1	1.9
Other payables	20.8	296.2	190.3
Corporation tax payable	1.0	1.2	—
Interest rate swap	0.9	2.2	4.9
Accrued interest payable	0.5	0.5	0.4
Long-term debt	128.6	132.3	130.8
Total liabilities	**525.1**	**1,019.1**	**1,216.3**
Shareholders' equity			
Share capital	97.9	91.1	91.1
Treasury shares	—	—	(58.0)
Share premium	33.6	49.5	60.1
Contributed surplus	849.7	754.8	754.8
Fair value and other reserves	8.7	20.7	27.6
Retained earnings	147.7	299.5	397.1
Total shareholders' equity attributable to equity shareholders	**1,137.6**	**1,215.6**	**1,272.7**
Total liabilities and shareholders' equity	**1,662.7**	**2,234.7**	**2,489.0**

1. Balance sheet review as at 31 December 2008

At 31 December 2008 the fixed income portfolio plus managed cash had a duration of 1.8 years and a credit quality of AA+.

2. Balance sheet review as at 31 December 2007

At 31 December 2007 the fixed income portfolio plus managed cash had a duration of 1.4 years and a credit quality of AA+. Shareholders' equity at the year end is net of the accrual of the strategic dividend of US$239.1 million which was paid in January 2008.

3. Balance sheet review as at 31 December 2006

At 31 December 2006 the fixed income portfolio plus managed cash had a duration of 1.6 years and a credit quality of AA+.

10. Consolidated cash flows

Consolidated cash flows for the years ended 31 December 2006, 2007 and 2008 were as follows:

	2006 Audited	*2007 Audited*	*2008 Audited*
	US$m	*US$m*	*US$m*
Cash flows from operating activities			
Profit before tax	159.5	391.9	97.6
Tax paid	—	(2.4)	(0.9)
Depreciation	0.6	1.4	1.1
Interest expense	10.6	11.6	9.8
Interest and dividend income	(53.6)	(79.3)	(59.6)
Amortisation of fixed income securities	(1.2)	(0.7)	—
Equity based compensation	22.5	14.4	10.6
Foreign exchange	1.9	(3.1)	9.4
Share of loss (profit) of associate	(3.2)	(6.2)	0.2
Net other investment (income) losses	(1.8)	3.3	(0.1)
Net realised losses (gains) and impairments	(0.8)	(9.1)	11.0
Net fair value gains on investments at fair value through profit and loss	—	(0.4)	0.6
Unrealised loss on interest rate swaps	0.9	1.3	2.7
Reinsurance assets			
– Unearned premium on premium ceded	(19.1)	(0.5)	9.6
– Reinsurance recoveries	—	(3.5)	(38.5)
– other receivables	—	(8.2)	5.0
Deferred acquisition costs	(51.0)	(6.3)	(3.1)
Other receivables	(6.0)	2.4	(150.2)
Inwards premium receivable from insureds and cedants	(171.4)	(23.8)	8.2
Insurance contracts			
Losses and loss adjustment expenses	39.1	140.0	349.8
Unearned premiums	323.1	56.2	(42.2)
Other payables	3.6	11.3	2.0
Amounts payable to reinsurers	2.4	4.9	(3.7)
Deferred acquisition costs ceded	2.5	0.5	(1.2)
Other payables	18.6	25.8	142.6
Net cash flows from operating activities	**277.2**	**521.5**	**360.7**
Cash flows used in investing activities			
Interest received and dividends received	47.8	77.0	59.4
Purchase of property, plant and equipment	(2.6)	(1.3)	(0.2)
Investment in associate	(20.0)	—	—
Dividends received from associate	—	6.5	22.7
Purchase of fixed income securities	(2,086.1)	(2,143.3)	(3,882.4)
Purchase of equity securities	(76.1)	(30.9)	(31.9)
Proceeds on maturity and disposal of fixed income securities	1,185.6	1,960.4	3,402.6
Proceeds on disposal of equity securities	20.9	36.9	66.7
Net proceeds on other investments	(9.7)	5.1	4.5
Net cash flows used in investing activities	**(940.2)**	**(89.6)**	**(358.6)**
Cash flows used in financing activities			
Interest paid	(10.5)	(11.6)	(10.0)
Dividend paid	—	—	(238.2)
Shares repurchased	—	(89.3)	(68.3)
Net Cash flows used in financing activities	**(10.5)**	**(100.9)**	**(316.5)**
Net increase (decrease) in cash and cash equivalents	(673.5)	331.1	(314.4)
Cash and cash equivalents at beginning of year	1,072.4	400.1	737.3
Effect of exchange rate fluctuations on cash and cash equivalents	1.2	6.2	(9.3)
Cash and cash equivalents at end of year	**400.1**	**737.3**	**413.6**

11. Segmental Information

Management and the Board of Directors review the Group's business primarily by its four principal classes: property, energy, marine and aviation. Management has therefore deemed these classes to be its business and primary segments for the purposes of segmental reporting. Further sub-classes of business are underwritten within each primary segment.

Segment review for the financial years ended 31 December 2006, 2007 and 2008

Revenue and expense by business segment – for the year ended 31 December 2006

Gross Premium Written (audited)

	Property	*Energy*	*Marine*	*Aviation*	*Total*
	US$m	*US$m*	*US$m*	*US$m*	*US$m*
Analysed by geographical segment					
Worldwide offshore	—	175.5	33.9	—	209.4
Worldwide, including the US and Canada[1]	71.5	26.2	7.4	63.1	168.2
US and Canada	111.7	31.4	0.4	—	143.5
Worldwide, excluding the US and Canada[2]	31.4	0.5	0.6	0.1	32.6
Far East	10.6	2.6	6.7	—	19.9
Middle East	6.7	9.0	1.3	0.1	17.1
Europe	12.3	1.9	2.8	—	17.0
Rest of world	10.3	6.8	—	1.2	18.3
Total	**254.5**	**253.9**	**53.1**	**64.5**	**626.0**
Net premiums earned	**98.5**	**107.6**	**24.3**	**13.1**	**243.5**
Net underwriting profit	**74.1**	**73.9**	**11.0**	**10.5**	**169.5**
Profit before tax					**159.5**

(1) worldwide, including the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area.

(2) worldwide, excluding the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area, but that specifically exclude the United States of America and Canada.

Revenue and expense by business segment – for the year ended 31 December 2007

Gross Premiums Written (audited)

	Property	*Energy*	*Marine*	*Aviation*	*Total*
	US$m	*US$m*	*US$m*	*US$m*	*US$m*
Analysed by geographical segment:					
Worldwide offshore	0.7	213.1	54.3	—	268.1
Worldwide, including the US and Canada[1]	75.1	34.2	12.5	83.2	205.0
US and Canada	114.2	12.8	0.2	—	127.2
Worldwide, excluding the US and Canada[2]	43.9	4.1	1.5	0.3	49.8
Europe	35.4	2.8	4.4	0.6	43.2
Far East	10.4	2.7	4.2	—	17.3
Middle East	6.2	8.2	(1.0)	0.1	13.5
Rest of world	23.4	4.8	0.8	—	29.0
Total	**309.3**	**282.7**	**76.9**	**84.2**	**753.1**
Net premiums earned	**262.4**	**203.6**	**69.0**	**76.2**	**611.2**
Net underwriting profit	**194.3**	**116.7**	**16.1**	**61.3**	**388.4**
Profit before tax					**391.9**

(1) worldwide, including the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area.

(2) worldwide, excluding the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area, but that specifically exclude the United States of America and Canada.

Revenue and expense by business segment – for the year ended 31 December 2008

Gross Premiums Written (audited)

	Property	*Energy*	*Marine*	*Aviation*	*Total*
	US$m	*US$m*	*US$m*	*US$m*	*US$m*
Analysed by geographical segment:					
Worldwide offshore	0.9	159.1	72.6	—	232.6
Worldwide, including the US and Canada[1]	44.5	7.2	2.1	70.4	124.2
US and Canada	108.5	4.2	0.1	—	112.8
Worldwide, excluding the US and Canada[2]	47.5	0.5	0.2	0.3	48.5
Europe	34.1	4.6	2.9	0.4	42.0
Far East	14.1	2.1	0.7	0.4	17.3
Middle East	8.9	3.5	—	—	12.4
Rest of world	44.2	4.0	—	0.1	48.3
Total	**302.7**	**185.2**	**78.6**	**71.6**	**638.1**
Net premiums earned	**272.2**	**191.2**	**70.6**	**73.3**	**607.3**
Net underwriting profit (loss)	**137.2**	**(68.6)**	**13.1**	**50.5**	**132.2**
Profit before tax					**97.6**

(1) worldwide, including the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area.

(2) worldwide, excluding the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area, but that specifically exclude the United States of America and Canada.

The active hurricane seasons of 2004 and 2005 led to significant market dislocation in certain lines of business. The Group sought to take advantage of this dislocation, which was primarily perceived to be in catastrophe exposed property lines and Gulf of Mexico energy business. The resulting business written in 2006 was broadly in line with these expectations, with the property and energy segments making up the bulk of the Group's business. These catastrophe exposed lines were supported by non-correlating lines of marine and aviation.

2007 income was categorised by a few key drivers. Firstly, 2006 was a benign year for loss activity which introduced the very beginnings of a soft market cycle. While premium rates were maintained in 2007, a further year with a lack of significant catastrophe losses for the industry as a whole led to the expectation that premium rates, particularly in catastrophe exposed lines, would fall in 2008. It was also the Group's second year of operations, including the continued build out of its UK platform, which led to increased business flow combined with the underwriting teams developing a more mature, renewing book of business than in the first year of operations. These two factors, on balance, led to a broadly similar business mix and, with some pro-rata business plus deferred premiums flowing through from 2006, both gross premium written and earned increased in 2007.

2008 brought the softening market cycle as predicted, particularly in the energy lines which had previously shown more dislocation and therefore had further to decline. This is reflected in the business mix written in 2008, with the property lines becoming a more significant portion of the Group's business due to the expansion of the Group's terrorism product. Earnings were more mature and therefore while earnings continued to increase as a proportion of written premiums as deferred earnings were recognised, the impact is less dramatic than in the 2006 to 2007 movements.

2008 however was also characterised by both significant industry risk losses and significant industry catastrophe losses, specifically as regards Hurricanes Gustav and Ike which generated an approximate US$25 billion industry loss. As a result the Group incurred losses in the energy segment. The significance of the loss for the industry, combined with asset impairment as a result of the financial markets crisis is expected to create a hard market for 2009.

12. Liquidity and Capital Resources

The Group aims to maintain a strong balance sheet at all times. An adequate level of capital must be maintained to support the Group's underwriting and the mix of capital must be sufficiently conservative in order to preserve that capital. The primary sources of funds for the Group are the collection of premium and investment income. The primary outflows or uses are payment of losses and expenses, including reinsurance purchased, plus the servicing of debt and other financing obligations.

Liquidity

The Group is exposed if proceeds from financial assets are not sufficient to fund obligations arising from its insurance contracts. The Group can be exposed to daily calls on its available investment assets, principally from insurance claims. Liquidity risk is the risk that cash may not be available to pay obligations when they are due without incurring an unreasonable cost.

The Group's liquidity needs are primarily to meet insurance liabilities and other short-term liabilities, including interest payments on the Group's long-term debt and capital management actions. The Group has not in the past paid an ordinary dividend but did pay a strategic dividend of US$239.1 million on 25 January 2008. The Group may also repurchase shares from time to time. The primary sources of liquidity are from premiums received from losses recovered under reinsurance contracts and from investments and investment income. The principal outflows for the Group are the settlement of claims, payment for reinsurance cover, payment of general and operating expenses, servicing of debt, and the distribution of dividends and the repurchasing of shares.

Cash flow to date has been positive. In 2006 net cash flow from operating activities was US$277.2 million. In 2007 it was US$521.5 million and in 2008 it was US$360.7 million. The significant positive cash flow in 2006 and 2007 is partly a function of the low number of catastrophic loss events in those years. In 2008 there was still significant positive cash flow despite the occurrence of Hurricane Ike. Ike claims are complex and therefore subject to loss adjustment and as a result do not settle immediately. It is expected that the majority of Ike claims will settle in 2009. The Group has more than adequate liquid resources available to fund these claims. For 2008, total claims payments were US$69.1 million with US$16.4 million in relation to Hurricane Ike.

There was a net cash outflow from investing activities in 2008 of US$358.6 million (2007: US$89.6 million, 2006: US$940.2 million) primarily as a result of the net purchase of fixed income securities of US$479.8 million. This was partially offset by inflows of interest and dividends received of US$82.1 million (2007: US$83.5 million, 2006: US$47.8 million) and proceeds of US$34.8 million received from the sale of equities (2007: US$6.0 million, 2006: US$(55.2) million).

During 2008, the investment portfolio yielded lower cash returns than 2007 as a result of the lower interest rate environment. As higher yielding securities matured or were sold, the proceeds were reinvested in securities with coupon payments at lower prevailing market rates. However, the Group still managed to realise a positive cash flow benefit as the underlying market value of the investments increased, leading to higher realized cash gains from investment sales.

Financing activities resulted in a net outflow of US$316.5 million as a result of a strategic dividend paid in January of US$238.2 million, shares repurchased during the year of US$68.3 million and US$10.0 million of interest payments made to holders of the Company's long term debt.

The Group manages its liquidity risks via its investment strategy to hold high quality, highly liquid securities, sufficient to meet its insurance liabilities. Within the Group investment guidelines is a sub-set of guidelines for the portion of funds required to meet potential insurance liabilities in an extreme event, plus near term liquidity requirements. This is defined as the largest event plus loss reserves and the funds to cover this liability are designated as the "core" portfolio. The primary objective of this portion of assets is liquidity and capital preservation. Assets in excess of those required to settle potential insurance liabilities in an extreme event, plus other near term liquidity requirements may be held in the "core", "core plus" or in the "surplus" portfolio. The core portfolio is invested in fixed income securities and cash and cash equivalents. The core plus portfolio has a similar investment mix and strategy to the core portfolio but allows a modestly longer duration to be held. The surplus portfolio, is invested in fixed income securities, cash and cash equivalents and can invest in a modest amount of equity securities and derivative instruments. These assets are not matched to specific insurance liabilities. The focus on high quality assets is maintained across all three classes of portfolio. The Group also holds a modest amount of convertible debt securities. These instruments are either bifurcated into their component parts with the embedded option fair valued through the income statement or designated as at fair value through profit and loss with changes in estimated fair value recognised directly in income. Currently, the Group does not hold any alternative investments such as hedge funds.

Credit risk on the fixed income portfolio is mitigated through the Group's policy to invest in instruments of high credit quality issuers and to limit the amounts of credit exposure with respect to particular ratings categories and any one issuer. Securities rated below BBB- / Baa3 may comprise no more than 5 per cent. of shareholders' equity, with the exception of US government and agency securities. In addition, no one issuer should exceed 5 per cent. of shareholders' equity. The Group is therefore not exposed to any significant credit concentration risk on its investment portfolio, except for fixed income securities issued by the US government and government agencies.

Capital Resources

Management and the Board reviews the level and composition of capital on an ongoing basis with a view to:

- maintaining sufficient capital to take advantage of underwriting opportunities and to meet obligations to policyholders;
- maximising the return to shareholders with pre-determined risk tolerances; and
- maintaining adequate financial strength ratings and meeting regulatory requirements.

Capital is therefore raised or returned as appropriate. Capital raising can include debt or equity and returns of capital may be made through dividends, share buy backs or redemption of debt. Other capital management tools and products available to the Group may also be utilised.

There are several inter-linked factors which lead to decisions on the level of capital to maintain:

- the underwriting opportunities: matching capital to the underwriting opportunities ahead;
- the level of various risk factors which the Group currently has, and what the Group anticipates having in the short to medium-term;
- the ability to raise capital or debt from the financial markets; and
- the stage of the cycle.

Internal methods have been developed to review the profitability of classes of business and their estimated capital requirements, and the capital requirements of the combination of a wide range of other risk categories. Management increasingly uses these approaches in decision making. The operating companies also conduct capital requirement assessments under internal measures and in compliance with local regulatory requirements.

The Group has developed a sophisticated economic capital model ("**BLAST**"). BLAST provides management with information on risk and return that can assist with business decisions. BLAST is an integral part of the Group's ERM programme. It is primarily a stochastic model that incorporates insurance risk, market risk, credit risk and other general risks, including operational risk. It requires the input of a large number of parameters and data. The inputs include historical data and projected future premium income, reinsurance programmes, loss ratios, default rates, asset performance and operational costs. All classes of business, including non-elemental classes, are within the capabilities of the model.

BLAST produces data in the form of a stochastic distribution. The distribution includes the mean outcome and the result at various return periods, including very remote events. This is analysed at both the micro and the macro level. BLAST includes the calculation of present and projected financial outcomes for each insurance class, including non-elemental classes. BLAST also recognises diversification credit. This arises as individual risks are generally not strongly correlated and are unlikely to all produce profits or losses at the same time. Diversification credit is calculated within categories, most notably within the insurance category, and across a range of risk categories. BLAST helps the Group determine the level of capital required at both the Group and operating entity level to meet the combined risk from a wide range of categories. Assisted by BLAST, the Group seeks to achieve an improved risk-adjusted return over time.

There are several areas of uncertainty associated with achieving accurate results from BLAST. These include the following: incorrect assumptions on parameters including frequency and severity of losses; external environmental factors, including trading conditions or major loss events; correlation factors between different types of risk; counter-party credit-worthiness; and changes in laws and regulations or their interpretation. The management of various types of risks is described in more detail below.

The composition of capital is also driven by management's appetite for leverage. Leverage at 31 December 2008 was 9.3 per cent. In appropriate circumstances, management would be willing to increase leverage somewhat. An increase in leverage would more likely take place after a market hardening event, but this may not necessarily be the case, and is entirely dependant on the availability and price of debt and the Group's ability to raise finance in the capital markets. Maintaining a strong balance sheet will be the overriding factor in all capital management decisions.

The holding company relies on dividends from its subsidiaries to provide cash flow required for debt service and dividends to shareholders. The subsidiaries' ability to pay dividends and make capital distributions is subject to the legal and regulatory restrictions of the jurisdictions in which they operate. For the primary operating subsidiaries these are based principally on the amount of premiums written and reserves for losses and loss expenses, subject to overall minimum solvency requirements. Statutory capital and surplus is different from shareholders' equity due to certain items that are capitalised under IFRS but expensed or have a different valuation basis for regulatory reporting, or are not admitted under insurance regulations.

As at 31 December 2006, 2007 and 2008 the regulatory capital requirements of all three jurisdictions in which the Group had operating subsidiaries were met.

As at 31 December 2008 the Group had the following capital resources:

On 15 December 2005 the Group issued, via a trust company, US$97 million in aggregate principal amount of subordinated loan notes and €24 million in aggregate principal amount of subordinated loan notes ("**long-term debt**") at an issue price of US$1,000 and €1,000 of their principal amounts, respectively. The US dollar subordinated loan notes are repayable on 15 December 2035 with a prepayment option available from 15 March 2011. Prior to 15 March 2011, upon the occurrence and during the continuation of a "Special Event", the Group may, at its option, redeem the securities, in whole but not in part, at a sliding scale redemption price. A Special Event is a change in the tax and/or investment status of the issuing trust. Interest on the principal is based on a set margin (3.7 per cent.) above the variable Libor rate and is payable quarterly. The Euro subordinated loan notes are repayable on 15 June 2035 with a prepayment option available from 15 March 2011. Prior to this time prepayment would only be available in the event of a "Special Event". Interest on the principal is based on a set margin (3.7 per cent.) above the variable EURIBOR rate and is payable quarterly.

As the operating companies are non-admitted insurers or reinsurers throughout the US, the terms of certain contracts require them to provide letters of credit to policyholders as collateral. On 17 May 2006, the Group entered into a syndicated collateralised three year credit facility in the amount of US$350.0 million. This was re-financed on 16 July 2007 to a syndicated collateralised five year credit facility in the amount of US$200.0 million. The facility contains a US$75.0 million loan sub-limit available for general corporate purposes.

The facility is available for the issue of letters of credit ("**LOCs**") to ceding companies. As at 31 December 2008, letters of credit totalling US$26.7 million (2007 – US$37.0 million; 2006 – US$25.1 million) had been issued to third parties and there was no outstanding debt under this facility (2007 and 2006 – US$nil). Letters of credit are required to be fully collateralised. As at 31 December 2008 US$118.0 million (2007 – US$110.8 million; 2006 – US$25.1 million) of collateral had been posted to a trust account, the beneficiaries of which are the banks who have issued letters of credit on behalf of Group companies. Under the terms of the facility, investments in the trust account are subject to various discounts to allow for market fluctuations in the investments provided as security. The discounts are determined per investment type.

The facility terms also include standard default and cross default provisions which require certain covenants to be adhered to. These include the following:

- a financial strength rating of at least B++; and
- a maximum debt to capital ratio of 30 per cent., where the current long-term debt issuance is excluded from this calculation.

The Group maintains compliance with all covenants under this facility.

Capital actions taken by the Group are as follows:

In April 2008, a strategic decision was made to return up to US$100.0 million of excess capital to shareholders via a share repurchase. An amount of US$17.0 million of approved repurchase remains under the current authorisations. Total capital at 31 December 2008 was US$1,403.5 million comprising US$1,272.7 million of shareholders equity and US$130.8 million of long-term debt.

In December 2007, a strategic decision was made to return US$339.3 million of excess capital to shareholders, leaving total capital of US$1,347.9 million at 31 December 2007, comprising US$1,215.6 million of shareholders' equity and US$132.3 million of subordinated debt. The return to shareholders totalling US$339.3 million comprised a share repurchase totalling US$100.2 million and a strategic dividend of US$239.1 million.

In 2006, the Group sponsored a side-car called Sirocco Reinsurance Limited ("**Sirocco Re**"). Sirocco Re provided reinsurance protection to the Group for named windstorm damage to Gulf of Mexico energy risks. The protection was in the form of a quota share, with the Group receiving a ceding commission and a profit commission. The Group originally invested US$20.0 million in Sirocco Holdings Limited ("**Sirocco**"). Following two successful years, the quota share agreement with Sirocco Re was commuted. Sirocco was wound-up in 2008.

The Group does not hold a material amount of capital assets and does not have any significant planned capital expenditure.

13. Market Risk

Insurance risk

Lancashire underwrites contracts that transfer insurance risk. Lancashire underwrites worldwide short-tail insurance and reinsurance risks, including risks exposed to natural and man-made catastrophes. Lancashire's exposure in connection with insurance contracts is, in the event of insured losses, whether premium will be sufficient to cover the loss payments and expenses. Insurance and reinsurance markets are cyclical and premium rates and terms and conditions vary by line of business depending on market conditions and the stage of the cycle. Market conditions are impacted by capacity and recent loss events, among other factors. Lancashire's underwriters assess likely losses using their experience and knowledge of past loss experience as well as current circumstances. This allows them to estimate the premium sufficient to meet likely losses and expenses. Lancashire considers insurance risk at an individual contract level, sector level, geographic level and at an aggregate portfolio level to ensure careful risk selection, limits on concentration and appropriate portfolio diversification are accomplished. Natural catastrophe exposed risks are modelled prior to execution.

Lancashire is also subject to market risk on its insurance portfolio. The most important measure to mitigate insurance market risk is to maintain strict underwriting standards. Examples of how the Group reacts to insurance market risk include the following:

- Review and produce underwriting plans and budgets as necessary;
- Reduce exposure to market sectors where conditions have softened;
- Purchase appropriate reinsurance cover to mitigate increased exposures;
- Closely monitor movements in rates, and terms and conditions; and
- Regular review of output from Lancashire's economic capital model, BLAST, to judge up-to-date profitability of classes and sectors.

Reinsurance

Lancashire, in the normal course of business and in accordance with its risk management practices, seeks to reduce certain types of loss that may arise from events that could cause unfavourable underwriting results by entering into reinsurance arrangements. Reinsurance does not relieve Lancashire of its obligations to policyholders.

Under Lancashire's reinsurance security policy, the Reinsurance Security Committee assesses reinsurers as appropriate security based on their financial strength, ratings and other factors. Lancashire monitors the credit-worthiness of its reinsurers on an ongoing basis.

Lancashire regularly reviews its exposure to natural and man made catastrophic events and under the right set of circumstances will purchase reinsurance in order to reduce its exposure to a catastrophic event.

Investment and interest rate risk

Investment guidelines are established by the Investment Committee of the Board of Directors. Investment guidelines set parameters within which the Group's external investment managers must operate. Important parameters include guidelines on permissible assets, duration ranges, credit quality and maturity. Investment guidelines exist at the individual portfolio level and for Lancashire's consolidated portfolio. Compliance with guidelines is monitored on a monthly basis. Any adjustments to the investment guidelines are approved by the Investment Committee and the Board of Directors.

Within the Group guidelines is a sub-set of guidelines for the portion of funds required to meet potential insurance liabilities in an extreme event, plus other near term liquidity requirements, the "core" portfolio. The core portfolio is invested in fixed income securities and cash and cash equivalents. The sub-set of guidelines adds a further degree of requirements, including fewer allowable asset classes, higher credit quality, shorter duration and higher liquidity. The primary objective of this portion of assets is liquidity and capital preservation.

Assets in excess of those required to settle potential insurance liabilities in an extreme event, plus other near term liquidity requirements, may be held in the "core" portfolio, the "core plus" portfolio or in the "surplus" portfolio. The core plus and the surplus portfolios are invested in fixed income securities, cash and cash equivalents and a modest amount of equity securities. These assets are not matched to specific insurance liabilities. In general, the duration is slightly longer, while maintaining focus on high quality assets. Lancashire also holds a modest amount of convertible debt securities. Currently, the Group holds less than one per cent. in equities but does not hold any alternative investments such as hedge funds.

Lancashire reviews the composition, duration and asset allocation of its investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. If certain asset classes are anticipated to produce a higher return within the Group's risk tolerance an adjustment in asset allocation may be made.

The Group's net asset value is directly impacted by movements in the value of investments held. Values can be impacted by movements in interest rates, credit ratings, economic environment and outlook and exchange rates.

The majority of the Group's investments comprise fixed income securities. The fair value of the Group's fixed income portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's fixed income investments would tend to rise and vice versa.

The sensitivity of the price of fixed income securities is indicated by its duration. The greater a security's duration, the greater its percentage price volatility. The Board of Directors limits interest rate risk on the investment portfolio by establishing and monitoring duration ranges within investment guidelines.

In addition to duration management, the Group uses VaR to measure potential losses in the estimated fair values of its cash and invested assets. Management measures VaR on a monthly basis to understand and monitor risk.

The Group has issued long-term debt. The loan notes bear interest at a floating rate that is re-set on a quarterly basis plus a fixed margin of 3.7 per cent. The Group is subject to interest rate risk on the coupon payments of the long-term debt. The Group has mitigated the interest rate risk by entering into swap contracts on 50 per cent. of its exposure to the interest rates.

Liquidity risk

Lancashire is exposed if proceeds from financial assets are not sufficient to fund obligations arising from its insurance contracts. Lancashire can be exposed to daily calls on its available investment assets, principally from insurance claims. Liquidity risk is the risk that cash may not be available to pay obligations when they are due without incurring an unreasonable cost.

Lancashire manages its liquidity risks via its investment strategy to hold high quality, highly liquid securities, sufficient to meet its insurance liabilities. The creation of the core portfolio with its sub-set of guidelines ensures funds are readily available to meet potential insurance liabilities in an extreme event plus other near term liquidity requirements.

In addition, the Board of Directors has established asset allocation and maturity parameters within the investment guidelines such that the intention is to have the majority of Lancashire's investments in high quality assets which could be converted into cash promptly and at minimal expense. The Group monitors market changes and outlooks and re-allocates assets as deemed necessary.

Credit risk

Credit risk is the risk that a counterparty may fail to pay, or repay, a debt or obligation. Lancashire is exposed to credit risk on its fixed income investment portfolio and derivative instruments, its inwards premium receivable from insureds and cedants, and on any amounts recoverable from reinsurers.

Credit risk on the fixed income portfolio is mitigated through Lancashire's policy to invest in instruments of high credit quality issuers and to limit the amounts of credit exposure with respect to particular ratings categories and any one issuer. Securities rated below BBB-/Baa3 may comprise no more than 5 per cent. of shareholders' equity, with the exception of US government and agency securities. In addition, no one issuer should exceed 5 per cent. of shareholders' equity, with the exception of US government and agency securities. Lancashire aims to limit its exposure to any significant credit concentration risk on its investment portfolio, except for fixed income securities issued by the US government and government agencies.

Lancashire is exposed to credit risk in the event of non-performance of counter -parties to derivative contracts. These counter-parties are high credit quality banks and therefore exposure is expected to be negligible. Further, these instruments are typically net settled and are short-term in nature. Credit risk on inwards premium receivable from insureds and cedants is managed by conducting business with reputable broking organisations with established relationships and by rigorous cash collection procedures. Credit risk from reinsurance recoverables is primarily managed by review and approval of reinsurer security by Lancashire's Reinsurance Security Committee.

Lancashire also periodically monitors the creditworthiness of brokers pursuant to its broker vetting procedures.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems including the risk of fraud, safety, damage to physical assets, business disruption, system failure and transaction processing failure. Lancashire has a robust internal corporate governance framework. Policies and procedures are documented and are reviewed periodically. Lancashire's internal audit function assesses the key risk areas on an annual basis and performs periodic reviews of these areas to evaluate whether controls are in place and are operating effectively. Information technology risk tolerances have been identified and system performance is monitored continuously. Lancashire's disaster recovery plan is assessed and updated on a regular basis.

Lancashire's operations are regulated in each of the jurisdictions it does business. Changes in local regulatory frameworks or taxation regulations could impact the way the local entities and/or the Group conducts business. Therefore, Lancashire regularly monitors for changes in law and regulation that could impact its business.

Lancashire is in a mature trading position having had over three years to develop broker and client relationships and has established an enviable market reputation. Lancashire is vulnerable to adverse market perception since it operates in an industry where customer integrity, trust and confidence are paramount. In addition, any negative publicity (whether well founded or not) associated with the business or operations of the Group could result in a loss of clients and/or business. Lancashire therefore actively assesses its relationships with brokers to identify strengths and also assesses for improvements.

Strategic risk

Strategic risk encompasses the risk that poor business planning and vision may produce a lower return on capital and value creation. Further, this could lead to risk tolerances being unclear or inappropriate. The Group addresses this risk by a continual rigorous assessment of business goals. Lancashire's BLAST model is increasingly an integral part of the review of profitability and capital utilisation. Lancashire's Board has established a rolling three-year strategy that is reviewed at least annually. Business performance within the context of the overall strategy is reviewed with the Board on a quarterly basis. Market or economic events may lead to a need to re-assess strategy more frequently. Further discussion of the risks affecting the Group can be found in Part II – Risk Factors, and the policies in place to mitigate those risks can be found in the risk disclosures section of the financial statements.

14. Capitalisation and Indebtedness

The Group's capitalisation and indebtedness, extracted from the financial information set out in Part VI is set out in the table below as at 31 December 2008.

Statement of Capital and Indebtedness

Capitalisation and indebtedness (as at 31 December 2008)	*As at 31 December 2008*
	US$ million
Total current debt	
Guaranteed	—
Secured	—
Unguaranteed/Unsecured	0.4
	0.4
Total non-current debt (excluding current portion of long-term debt)	
Guaranteed	—
Secured	—
Unguaranteed/ Unsecured	130.8
	130.8
Shareholders' equity	
Share capital	91.1
Treasury shares	(58.0)
Share premium	60.1
Contributed surplus	754.8
	848.0
Total	979.2
Net indebtedness	
Cash	7.9
Cash equivalents	405.7
Trading securities	—
Liquidity	**413.6**
Current Financial Receivable	—
Current Bank debt	—
Current portion of non current debt	0.4
Other current financial debt	—
Current Financial Debt	**0.4**
Net Current Financial Liquidity	**413.2**
Non current Bank loans	
Bonds issued	—
Other non current loans	130.8
Non current Financial Indebtedness	**130.8**
Net Financial Liquidity	**282.4**

(Source: audited financial statements)

Cash and cash equivalents totalling US$24.5 million were on deposit in various trust accounts for the benefit of policyholders or counter-parties to agreements to cover their credit risk. Cash and cash equivalents totalling US$37.7 million were on deposit as collateral in favour of letters of credit issued for the benefit of policyholders or counter-parties to cover their credit risk. Cash and cash equivalents totalling US$2.8 million were on deposit as collateral for the benefit of the counter-party to the interest rate swaps.

There has been no material change in the Group's capital position since 31 December 2008.

On 15 December 2005 the Group issued US$97.0 million in aggregate principal amount of subordinated loan notes and €24.0 million in aggregate principal amount of subordinated loan notes at an issue price of US$1,000 and €1,000 of their principal amounts respectively. The US dollar subordinated loan notes are repayable on 15 December 2035 with a prepayment option available from 15 March 2011. Prior to 15 March 2011, upon the occurrence and during the continuation of a ''Special Event'', the Group may, at its option, redeem the securities, in whole but not in part, at a sliding scale redemption price. A Special Event is a

change in the tax and/or investment status of the issuing trust. Interest on the principal is based on a set margin (3.7 per cent.) above the variable Libor rate and is payable quarterly.

The Euro subordinated loan notes are repayable on 15 June 2035 with a prepayment option available from 15 March 2011. Prior to this time prepayment would only be available in the event of a "Special Event". Interest on the principal is based on a set margin (3.7 per cent.) above the variable Euribor rate and is payable quarterly.

The Group has no off-balance sheet debt.

On 17 May 2006, the Group entered into a syndicated collateralised three year credit facility in the amount of US$350.0 million. On 16 July 2007, LHL and LICL re-financed the syndicated collateralised credit facility in the amount of US$200.0 million for a five year term. The facility contains a US$75.0 million sub-limit for general corporate purposes.

As at 31 December 2008, letters of credit totalling US$61.9 million had been issued to a subsidiary company and letters of credit totalling US$26.7 million had been issued to third parties. There was no outstanding debt under this facility. Letters of credit are required to be fully collateralised. As at 31 December 2008 US$118.0 million (2007 – US$110.8 million) of collateral had been posted to a trust account, the beneficiaries of which are the banks who have issued letters of credit on behalf of Group companies. Under the terms of the facility, investments in the trust account are subject to various discounts to allow for market fluctuations in the investments provided as security. The discounts are determined per investment type.

The facility terms also include standard default and cross default provisions which require certain covenants to be adhered to. These include the following:

(i) a financial strength rating of at least B++; and

(ii) a maximum debt to capital ratio of 30 per cent., where the current long-term debt issuance is excluded from this calculation.

As at 31 December 2007 and 2008 the Group was in compliance with all covenants under this facility.

PART VI

FINANCIAL INFORMATION

Accountants' Report on the Company

The Directors
Lancashire Holdings Limited
Mintflower Place
8 Par-la-Ville Road
Hamilton HM 08
Bermuda

11 March 2009

Dear Sirs

Lancashire Holdings Limited

We report on the financial information set out in this Part VI. This financial information has been prepared for inclusion in the prospectus dated 11 March 2009 of Lancashire Holdings Limited on the basis of the accounting policies set out in the paragraph entitled ''Summary of Significant Accounting Policies'' in this Part VI. This report is required by item 20.1 of Annex I of the Prospectus Directive Regulation and is given for the purpose of complying with that item and for no other purpose.

Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with item 23.1 of Annex I to the Prospectus Directive Regulation, consenting to its inclusion in the prospectus.

Responsibilities

The Directors of Lancashire Holdings Limited are responsible for preparing the financial information on the basis of preparation set out in the paragraph entitled ''Basis of Preparation'' in this Part VI and in accordance with International Financial Reporting Standards as adopted by the European Union.

It is our responsibility to form an opinion as to whether the financial information gives a true and fair view, for the purposes of the prospectus, and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in other jurisdictions and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion, the financial information gives, for the purposes of the prospectus dated 11 March 2009, a true and fair view of the state of affairs of Lancashire Holdings Limited as at the dates stated and of its profits, cash flows and changes in shareholders' equity for the periods then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Declaration

For the purposes of Prospectus Rule 5.5.3R (2)(f) we are responsible for this report as part of the prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the prospectus in compliance with item 1.2 of Annex I of the Prospectus Directive Regulation.

Yours faithfully

Ernst & Young LLP

Financial Information for the years ended 31 December 2006, 2007 and 2008

Consolidated Income Statement

For the years ended 31 December 2006, 2007 and 2008

	Notes	*2006*	*2007*	*2008*
		US$m	*US$m*	*US$m*
Gross premiums written	2	626.0	753.1	638.1
Outwards reinsurance premiums	2	(78.5)	(86.3)	(63.4)
Net premiums written		**547.5**	**666.8**	**574.7**
Change in unearned premiums	2	(323.1)	(56.1)	42.2
Change in unearned premiums on premium ceded	2	19.1	0.5	(9.6)
Net premiums earned		**243.5**	**611.2**	**607.3**
Net investment income	3	54.2	78.4	59.5
Net other investment income (losses)	3, 20	1.8	(3.3)	0.1
Net realised (losses) gains and impairments	3	0.8	9.1	(11.0)
Net fair value gains (losses) on investments at fair value through income	3	—	0.4	(0.6)
Share of profit (loss) of associate	12	3.2	6.2	(0.2)
Net foreign exchange (losses) gains		(1.3)	2.3	(8.5)
Total net revenue		**302.2**	**704.3**	**646.6**
Insurance losses and loss adjustment expenses	2	39.1	150.0	418.8
Insurance losses and loss adjustment expenses recoverable	2	—	(3.7)	(43.3)
Net insurance losses		**39.1**	**146.3**	**375.5**
Insurance acquisition expenses	2, 4, 25	40.0	95.6	106.9
Insurance acquisition expenses ceded	2, 4	(5.1)	(19.1)	(7.3)
Other operating expenses	5, 6, 7, 23	56.4	74.9	59.9
Total expenses		**130.4**	**297.7**	**535.0**
Results of operating activities		**171.8**	**406.6**	**111.6**
Financing costs	19, 20	12.3	14.7	14.0
Profit before tax		**159.5**	**391.9**	**97.6**
Tax	8,9	0.2	1.0	0.1
Profit for the year attributable to equity shareholders		**159.3**	**390.9**	**97.5**
Earnings per share				
Basic	24	US$0.81	US$2.01	US$0.55
Diluted	24	US$0.79	US$1.91	US$0.53

Consolidated Balance Sheet

As at 31 December 2006, 2007 and 2008

	Notes	*2006*	*2007*	*2008*
		US$m	*US$m*	*US$m*
Assets				
Cash and cash equivalents	10	400.1	737.3	413.6
Accrued interest receivable	14	7.5	9.8	10.1
Investments				
– Fixed income securities				
– Available for sale	11	896.3	1,069.7	1,595.4
– At fair value through profit and loss	11	—	23.5	4.0
– Equity securities				
– Available for sale	11	70.3	71.6	5.8
– Other investments	11, 20	11.5	4.4	—
Investment in associate	12	23.2	22.9	—
Reinsurance assets				
– Unearned premium on premium ceded	13	19.1	19.6	10.0
– Reinsurance recoveries	13	—	3.6	42.1
– Other receivables	13	—	8.2	3.2
Deferred acquisition costs	15	51.5	57.8	60.9
Other receivables	14	6.3	3.8	154.0
Inwards premium receivable from insureds and cedants	14	173.7	198.2	187.3
Deferred tax asset	8, 9	0.8	2.0	1.2
Property, plant and equipment	18	2.4	2.3	1.4
Total assets		**1,662.7**	**2,234.7**	**2,489.0**
Liabilities				
Insurance contracts				
– Losses and loss adjustment expenses	13	39.1	179.6	528.8
– Unearned premiums	13	325.7	381.8	339.6
– Other payables	13, 16	5.2	16.5	17.6
Amounts payable to reinsurers	13, 16	0.8	5.7	2.0
Deferred acquisition costs ceded	17	2.5	3.1	1.9
Other payables	16	20.8	296.2	190.3
Corporation tax payable	8	1.0	1.2	—
Interest rate swap	20	0.9	2.2	4.9
Accrued interest payable	19	0.5	0.5	0.4
Long-term debt	19	128.6	132.3	130.8
Total liabilities		**525.1**	**1,019.1**	**1,216.3**
Shareholders' equity				
Share capital	21, 22	97.9	91.1	91.1
Treasury shares	21	—	—	(58.0)
Share premium	21, 22	33.6	49.5	60.1
Contributed surplus	27	849.7	754.8	754.8
Fair value and other reserves	3, 11	8.7	20.7	27.6
Retained earnings		147.7	299.5	397.1
Total shareholders' equity attributable to equity shareholders		**1,137.6**	**1,215.6**	**1,272.7**
Total liabilities and shareholders' equity		**1,662.7**	**2,234.7**	**2,489.0**

Consolidated statement of changes in shareholders' equity
For the three years ended 31 December 2006, 2007 and 2008

	Notes	*Share capital*	*Treasury shares*	*Share premium*	*Contributed surplus*	*Fair value and other reserves*	*Retained (deficit) earnings*	*Total*
		US$m	*US$m*	*US$m*	*US$m*	*US$m*	*US$m*	*US$m*
Balance as at 31 December 2005		**97.9**	**—**	**860.8**	**—**	**—**	**(11.6)**	**947.1**
Profit for the year		—	—	—	—	—	159.3	159.3
Change in investment unrealised gains (losses)	3, 11	—	—	—	—	8.7	—	8.7
Total recognised income for the year		**—**	**—**	**—**	**—**	**8.7**	**159.3**	**168.0**
Issue of share capital	21	—	—	0.3	(0.3)	—	—	—
Transfer from share premium to contributed surplus	26	—	—	(850.0)	850.0	—	—	-
Warrant issues – management and performance	6, 22	—	—	20.5	—	—	—	20.5
Options issues – management	6, 22	—	—	2.0	—	—	—	2.0
Balance as at 31 December 2006		**97.9**	**—**	**33.6**	**849.7**	**8.7**	**147.7**	**1,137.6**
Profit for the year		—	—	—	—	—	390.9	390.9
Change in investment unrealised gains (losses)	3, 11	—	—	—	—	12.4	—	12.4
Corporation tax	8	—	—	—	—	(0.4)	—	(0.4)
Total recognised income for the year		**—**	**—**	**—**	**—**	**12.0**	**390.9**	**402.9**
Shares repurchased	21	(6.9)	—	—	(93.3)	—	—	(100.2)
Dividends on common shares	16, 21	—	—	—	—	—	(200.5)	(200.5)
Dividends on warrants	16, 21	—	—	—	—	—	(38.6)	(38.6)
Warrant issues – management and performance	6, 21, 22	0.1	—	10.8	(1.6)	—	—	9.3
Options issues	6, 22	—	—	5.1	—	—	—	5.1
Balance as at 31 December 2007		**91.1**	**—**	**49.5**	**754.8**	**20.7**	**299.5**	**1,215.6**
Profit for the year		—	—	—	—	—	97.5	97.5
Change in investment unrealised gains (losses)	3, 11	—	—	—	—	7.1	—	7.1
Corporation tax	8	—	—	—	—	(0.2)	—	(0.2)
Total recognised income for the year		**—**	**—**	**—**	**—**	**6.9**	**97.5**	**104.4**
Shares repurchased	21	—	(58.0)	—	—	—	—	(58.0)
Dividends on common shares	16, 21	—	—	—	—	—	0.1	0.1
Warrant issues – management and performance	6, 22	—	—	2.4	—	—	—	2.4
Options issues – management	6, 22	—	—	6.7	—	—	—	6.7
Restricted stock issues	6, 22	—	—	1.5	—	—	—	1.5
Balance as at 31 December 2008		**91.1**	**(58.0)**	**60.1**	**754.8**	**27.6**	**397.1**	**1,272.7**

Consolidated cash flow statement

For the three years ended 31 December 2006, 2007 and 2008

	Notes	*2006*	*2007*	*2008*
Cash flows from operating activities		*US$m*	*US$m*	*US$m*
Profit before tax		159.5	391.9	97.6
Tax paid		—	(2.4)	(0.9)
Depreciation	7, 18	0.6	1.4	1.1
Interest expense		10.6	11.6	9.8
Interest and dividend income		(53.6)	(79.3)	(59.6)
Amortisation of fixed income securities		(1.2)	(0.7)	—
Equity based compensation	5, 6	22.5	14.4	10.6
Foreign exchange		1.9	(3.1)	9.4
Share of loss (profit) of associate	12	(3.2)	(6.2)	0.2
Net other investment (income) losses	3, 20	(1.8)	3.3	(0.1)
Net realised losses (gains) and impairments	3	(0.8)	(9.1)	11.0
Net fair value gains on investments at fair value through profit and loss	3	—	(0.4)	0.6
Unrealised loss on interest rate swaps	20	0.9	1.3	2.7
Reinsurance assets				
– Unearned premium on premium ceded	13	(19.1)	(0.5)	9.6
– Reinsurance recoveries	13	—	(3.5)	(38.5)
– Other receivables	13	—	(8.2)	5.0
Deferred acquisition costs	15	(51.0)	(6.3)	(3.1)
Other receivables		(6.0)	2.4	(150.2)
Inwards premium receivable from insureds and cedants		(171.4)	(23.8)	8.2
Insurance contract				
– Losses and loss adjustment expenses	13	39.1	140.0	349.8
– Unearned premiums	13	323.1	56.2	(42.2)
– Other payables		3.6	11.3	2.0
Amounts payable to reinsurers		2.4	4.9	(3.7)
Deferred acquisition costs ceded	17	2.5	0.5	(1.2)
Other payables		18.6	25.8	142.6
Net cash flows from operating activities		**277.2**	**521.5**	**360.7**
Cash flows used in investing activities				
Interest received and dividends received		47.8	77.0	59.4
Purchase of property, plant and equipment	18	(2.6)	(1.3)	(0.2)
Investment in associate	12	(20.0)	—	—
Dividends received from associate	12	—	6.5	22.7
Purchase of fixed income securities	26	(2,086.1)	(2,143.3)	(3,882.4)
Purchase of equity securities		(76.1)	(30.9)	(31.9)
Proceeds on maturity and disposal of fixed income securities	26	1,185.6	1,960.4	3,402.6
Proceeds on disposal of equity securities		20.9	36.9	66.7
Net proceeds on other investments		(9.7)	5.1	4.5
Net cash flows used in investing activities		**(940.2)**	**(89.6)**	**(358.6)**
Cash flows used in financing activities				
Interest paid		(10.5)	(11.6)	(10.0)
Dividend paid	26	—	—	(238.2)
Shares repurchased	21, 26	—	(89.3)	(68.3)
Net cash flows used in financing activities		**(10.5)**	**(100.9)**	**(316.5)**
Net increase (decrease) in cash and cash equivalents		**(673.5)**	**331.0**	**(314.4)**
Cash and cash equivalents at beginning of year		1,072.4	400.1	737.3
Effect of exchange rate fluctuations on cash and cash equivalents		1.2	6.2	(9.3)
Cash and cash equivalents at end of year	10	**400.1**	**737.3**	**413.6**

Accounting Policies

For the years ended 31 December 2008, 31 December 2007 and 31 December 2006

Summary of Significant Accounting Policies

The basis of preparation, consolidation principles and significant accounting policies adopted in the preparation of Lancashire Holdings Limited ("**LHL**") and its subsidiaries' (collectively "**the Group**") consolidated financial statements are set out below. These policies have been consistently applied to all the years presented.

Basis of Preparation

The Group's consolidated financial statements are prepared in accordance with accounting principles generally accepted under International Financial Reporting Standards ("**IFRS**") as adopted by the European Union.

Where IFRS is silent, as it is in respect of the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, the Group determines appropriate measurement bases, to provide the most useful information to users of the consolidated financial statements, using their judgement and considering the accounting principles generally accepted in the United States ("**U.S. GAAP**").

All amounts, excluding share data or where otherwise stated, are in millions of United States ("**U.S.**") dollars.

There are no new or amended IFRS and International Financial Reporting Interpretations Committee ("**IFRIC**") standards adopted by or materially impacting the Group.

IFRS 8, Operating Segments which has been issued, but is not yet effective, has not been early adopted by the Group. The Group continues to apply IAS 14, Segment Reporting. The new standard is not expected to have a material impact on the results and disclosures reported in the consolidated financial statements.

The consolidated balance sheet of the Group is presented in order of decreasing liquidity.

Use of Estimates

The preparation of financial statements in conformity with IFRS requires the Group to make estimates and assumptions that affect the reported and disclosed amounts at the balance sheet date and the reported and disclosed amounts of revenues and expenses during the reporting period. Actual results may differ materially from the estimates made.

The most significant estimate made by management is in relation to losses and loss adjustment expenses. This is discussed on page 61 and also in the risk disclosures section from page 65.

Estimates may also be made in determining the estimated fair value of certain financial instruments. This is discussed in the risk disclosures section from page 65. Management judgement is applied in determining impairment charges.

Basis of Consolidation

i. Subsidiaries

The Group's consolidated financial statements include the assets, liabilities, shareholders' equity, revenues, expenses and cash flows of LHL and its subsidiaries. A subsidiary is an entity in which the Group owns, directly or indirectly, more than 50 per cent. of the voting power of the entity or otherwise has the power to govern its operating and financial policies. The results of subsidiaries acquired are included in the consolidated financial statements from the date on which control is transferred to the Group. Intercompany balances, profits and transactions are eliminated.

Subsidiaries' accounting policies are consistent with the Group's accounting policies.

ii. Associates

Investments, in which the Group has significant influence over the operational and financial policies of the investee, are initially recognised at cost and thereafter accounted for using the equity method. Under this method, the Group records its proportionate share of income or loss from such investments in its results of operations for the period. Adjustments are made to associates' accounting policies, where necessary, in order to be consistent with the Group's accounting policies.

Foreign Currency Translation

The functional currency, which is the currency of the primary economic environment in which operations are conducted, for all Group entities is U.S. dollars. Items included in the financial statements of each of the Group's entities are measured using the functional currency. The consolidated financial statements are also presented in U.S. dollars.

Foreign currency transactions are recorded in the functional currency for each entity using the exchange rates prevailing at the dates of the transactions, or at the average rate for the period when this is a reasonable approximation. Monetary assets and liabilities denominated in foreign currencies are translated at period end exchange rates. The resulting exchange differences on translation are recorded in the consolidated income statement. Non-monetary assets and liabilities carried at historical cost denominated in a foreign currency are translated at historic rates. Non-monetary assets and liabilities carried at fair value denominated in a foreign currency are translated at the exchange rate at the date the fair value was determined, with resulting exchange differences recorded in the fair value reserves in shareholders' equity.

Insurance Contracts

i. Classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Contracts that do not transfer significant insurance risk are accounted for as investment contracts. Insurance risk is transferred when an insurer agrees to compensate a policyholder if a specified uncertain future event adversely affects the policyholder.

ii. Premiums and Acquisitions costs

Premiums are first recognised as written at the date that the contract is bound. The Group writes both excess of loss and pro-rata (proportional) contracts. For the majority of excess of loss contracts, written premium is recorded based on the minimum and deposit or flat premium, as defined in the contract. Subsequent adjustments to the minimum and deposit premium are recognised in the period in which they are determined. For pro-rata contracts and excess of loss contracts where no deposit is specified in the contract, written premium is recognised based on estimates of ultimate premiums provided by the insureds or ceding companies. Initial estimates of written premium are recognised in the period in which the contract is bound. Subsequent adjustments, based on reports of actual premium by the insureds or ceding companies, or revisions in estimates, are recorded in the period in which they are determined.

Premiums are earned rateably over the term of the underlying risk period of the insurance contract, except where the period of risk differs significantly from the contract period. In these circumstances, premiums are recognised over the period of risk in proportion to the amount of insurance protection provided. The portion of the premium related to the unexpired portion of the risk period is reflected in unearned premium.

Where contract terms require the reinstatement of coverage after an insured's or ceding company's estimated loss, the estimated mandatory reinstatement premiums are recorded as written premium when a specific loss event occurs. Reinstatement premiums are not recorded for losses included within the provision for losses incurred but not reported ("**IBNR**") which do not relate to a specific loss event.

Inwards premiums receivable from insureds and cedants are recorded net of commissions, brokerage, premium taxes and other levies on premiums, unless the contract specifies otherwise. These balances are reviewed for impairment, with any impairment loss recognised in income in the period in which it is determined.

Acquisition costs represent commissions, brokerage, profit commissions and other variable costs that relate directly to the securing of new contracts and the renewing of existing contracts. They are generally deferred over the period in which the related premiums are earned to the extent they are recoverable out of expected future revenue margins. All other acquisition costs are recognised as an expense when incurred.

iii. Outwards Reinsurance

Outwards reinsurance premiums comprise the cost of reinsurance contracts entered into. Outwards reinsurance premiums are accounted for in the period in which the contract is bound. The provision for reinsurers' share of unearned premiums represents that part of reinsurance premiums written which is estimated to be earned in future financial periods. Unearned reinsurance commissions are recognised as a liability using the same principles. Any amounts recoverable from reinsurers are estimated using the same methodology as the underlying losses.

The Group monitors the credit-worthiness of its reinsurers on an ongoing basis and assesses any reinsurance assets for impairment, with any impairment loss recognised in income in the period in which it is determined.

iv. Losses

Losses comprise losses and loss adjustment expenses paid in the period and changes in the provision for outstanding losses, including the provision for IBNR and related expenses. Losses and loss adjustment expenses are charged to income as they are incurred.

A significant portion of the Group's business is classes with high attachment points of coverage, including property catastrophe. Reserving for losses in such programs is inherently complicated in that losses in excess of the attachment level of the Group's policies are characterised by high severity and low frequency and other factors which could vary significantly as losses are settled. This limits the volume of industry loss experience available from which to reliably predict ultimate losses following a loss event. In addition, the Group has limited past loss experience, which increases the inherent uncertainty in estimating ultimate loss levels.

Losses and loss adjustment expenses represent the estimated ultimate cost of settling all losses and loss adjustment expenses arising from events which have occurred up to the balance sheet date, including a provision for IBNR. The Group does not discount its liabilities for unpaid losses. Outstanding losses are initially set on the basis of reports of losses received from third parties. Additional case reserves ("**ACRs**") are determined where the company's estimate of the reported loss is greater than that reported. Estimated IBNR reserves may also consist of a provision for additional development in excess of case reserves reported by insureds or ceding companies, as well as a provision for losses which have occurred but which have not yet been reported to us by insureds or ceding companies. IBNR reserves are estimated by the Group using various actuarial methods as well as a combination of our own loss experience, historical insurance industry loss experience, our underwriters' experience, estimates of pricing adequacy trends, and management's professional judgement.

The estimation of the ultimate liability arising is a complex process which incorporates a significant amount of judgement. It is reasonably possible that uncertainties inherent in the reserving process, delays in insureds or

ceding companies reporting losses to the Group, together with the potential for unforeseen adverse developments, could lead to a material change in losses and loss adjustment expenses.

v. Liability Adequacy Tests

At each balance sheet date, the Group performs a liability adequacy test using current best estimates of future cash outflows generated by its insurance contracts, plus any investment income thereon. If, as a result of these tests, the carrying amount of the Group's insurance liabilities is found to be inadequate, the deficiency is charged to income for the period, initially by writing off deferred acquisition costs and subsequently by establishing a provision.

Financial Instruments

i. Cash and Cash Equivalents

Cash and cash equivalents are carried in the consolidated balance sheet at amortised cost and includes cash in hand, deposits held on call with banks and other short-term highly liquid investments with a maturity of three months or less at the date of purchase. Carrying amounts approximate fair value due to the short-term nature and high liquidity of the instruments.

Interest income earned on cash and cash equivalents is recognised on the effective interest rate method. The carrying value of accrued interest income approximates fair value due to its short-term nature and high liquidity.

ii. Investments

The Group's fixed income and equity securities are quoted investments that are classified as available for sale or fair value through profit and loss and are carried at estimated fair value. The classification is determined at the time of initial purchase and depends on the category of investment. Investments with an embedded conversion option purchased since 1 January 2007 are designated as at fair value through profit and loss. Movements in estimated fair value relate primarily to the option component. The option component of securities with an embedded conversion option purchased prior to 1 January 2007 is included in other investments. They are recorded at estimated fair value based on financial information received and other information available to management, including factors restricting the liquidity of the investments where appropriate.

Regular way purchases and sales of investments are recognised at estimated fair value less transaction costs on the trade date and are subsequently carried at estimated fair value. Estimated fair value of quoted investments is determined based on bid prices from recognised exchanges or broker-dealers. Investments are derecognised when the Group has transferred substantially all of the risks and rewards of ownership. Realised gains and losses are included in income in the period in which they arise. Unrealised gains and losses from changes in estimated fair value of available for sale investments are included in the fair value reserve in shareholders' equity.

On derecognition of an investment, previously recorded unrealised gains and losses are removed from shareholders' equity and included in current period income. Changes in estimated fair value of investments classified as at fair value through profit and loss are recognised in current period income.

Amortisation and accretion of premiums and discounts on available for sale fixed income investments are calculated using the effective interest rate method and are recognised in current period net investment income. Interest income is recognised on the effective interest rate method. The carrying value of accrued interest income approximates fair value due to its short-term nature. Dividends on equity securities are recorded as revenue on the date the dividends become payable to the holders of record.

The Group reviews the carrying value of its available for sale investments for evidence of impairment. An investment is impaired if its carrying value exceeds the estimated fair value and there is objective evidence of impairment to the asset. Such evidence would include a prolonged decline in estimated fair value below cost or amortised cost, where other factors, such as expected cash flows, do not support a recovery in value. If an impairment is deemed appropriate, the difference between cost or amortised cost and estimated fair value is removed from the fair value reserve in shareholders' equity and charged to current period income.

Impairment losses on equity securities are not subsequently reversed through income. Impairment losses on fixed income securities may be subsequently reversed through income.

iii. Derivative Financial Instruments

Derivatives are recognised at estimated fair value on the date a contract is entered into, the trade date, and are subsequently carried at estimated fair value. Derivative instruments with a positive fair value are recorded as derivative financial assets and those with a negative fair value are recorded as derivative financial liabilities. Embedded derivatives that are not closely related to their host contract are bifurcated and changes in estimated fair value are recorded through income.

Derivative and embedded derivative financial instruments include swap, option, forward and future contracts. They derive their value from the underlying instrument and are subject to the same risks as that underlying instrument, including liquidity, credit and market risk. Estimated fair values are based on exchange or broker-dealer quotations where available or discounted cash flow models, which incorporate the pricing of the underlying instrument, yield curves and other factors, with changes in the estimated fair value of instruments that do not qualify for hedge accounting recognised in current period income. For discounted cash flow

techniques, estimated future cash flows are based on management's best estimates and the discount rate used is an appropriate market rate.

Derivative financial assets and liabilities are offset and the net amount is reported in the consolidated balance sheet only to the extent there is a legally enforceable right of offset and there is an intention to settle on a net basis, or to realise the assets and liabilities simultaneously. Derivative financial assets and liabilities are derecognised when the Group has transferred substantially all of the risks and rewards of ownership or the liability is discharged, cancelled or expired.

iv. Long-Term Debt

Long-term debt is recognised initially at fair value, net of transaction costs incurred. Thereafter it is held at amortised cost, with the amortisation calculated using the effective interest rate method. Derecognition occurs when the obligation has been extinguished.

Property, Plant and Equipment

Property, plant and equipment is carried at historical cost, less accumulated depreciation and any impairment in value. Depreciation is calculated to write-off the cost over the estimated useful economic life on a straight-line basis as follows:

IT equipment	33 per cent. per annum
Office furniture and equipment	33 per cent. per annum
Leasehold improvements	20 per cent. per annum

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property, plant or equipment is derecognised on disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Gains and losses on the disposal of property, plant and equipment are determined by comparing proceeds with the carrying amount of the asset, and are included in the consolidated income statement. Costs for repairs and maintenance are charged to income as incurred.

Leases

Rentals payable under operating leases are charged to income on a straight-line basis over the lease term.

Employee Benefits

i. Equity compensation plans

The Group operates a management warrant plan, an option plan and a restricted share scheme. The fair value of the equity instruments granted were estimated on the date of grant. The fair value is recognised as an expense pro-rata over the vesting period of the instrument. The total amount to be expensed is determined by reference to the fair value of the awards estimated at the grant date, excluding the impact of any non-market vesting conditions.

At each balance sheet date, the Group revises its estimate of the number of warrants, options and restricted shares that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated income statement, and a corresponding adjustment is made to shareholders' equity over the remaining vesting period.

On exercise, the differences between the expense charged to the consolidated income statement and the actual cost to the Group is transferred to retained earnings. Where new shares are issued, the proceeds received are credited to share capital and share premium.

ii. Pensions

The Group operates a defined contribution plan. On payment of contributions to the plan there is no further obligation to the Group. Contributions are recognised as employee benefits in the consolidated income statement in the period to which they relate.

Founder and Sponsor Warrants

The Group issued warrants to certain founding shareholders, including LHL's Chief Executive Officer, and a sponsor on listing. The fair value of the equity instruments granted were estimated on the date of grant.

Warrants issued to founding shareholders were treated as a capital transaction and the associated fair value was credited to the share premium account. The fair value of warrants issued to the sponsor for assistance with incorporation and other start-up services was credited to the share premium account. The total amount to be credited was determined by reference to the fair value of the awards estimated at the grant date, excluding the impact of any non-market vesting conditions.

Tax

Income tax expense represents the sum of the tax currently payable and any deferred tax. The tax payable is calculated based on taxable profit for the period. Taxable profit for the period can differ from that reported in the consolidated income statement due to certain items which are not tax deductible or which are deferred to subsequent periods.

Deferred tax is recognised on temporary differences between the assets and liabilities in the consolidated balance sheet and their tax base. Deferred tax assets or liabilities are accounted for using the balance sheet liability method. Deferred tax assets are recognised to the extent that realising the related tax benefit through future taxable profits is likely.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

Treasury Shares

Treasury shares are deducted from shareholders' equity. No gain or loss is recognised on the purchase, sale, cancellation or issue of treasury shares and any consideration paid or received is recognised directly in equity.

Risk Disclosures

For the three years ended 31 December 2006, 2007 and 2008

Risk Disclosures: Introduction

The Group is exposed to risks from several areas including insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk. The primary risk to the Group is insurance risk.

The Group has a comprehensive Enterprise Risk Management ("**ERM**") programme. ERM is co-ordinated by the Chief Risk Officer ("**CRO**"). Risk Committees have been formed at the operating entity level. At the Group level, the Board of Directors receives and considers reports from the Risk Committees. The Board of Directors sets the overall risk profile and risk appetite for the Group.

The Risk Committees define tolerance levels over all categories of risk for the operating entities. This includes the level of capital the operating entities are willing to expose to certain risks. Identification of emerging and monitoring already recognised risks is the responsibility of individual risk owners. The CRO is responsible for monitoring the adherence to these. Any breaches are reported to the Risk Committees, and thus to the Board of Directors. Risk owners periodically perform an exercise to identify the Group's most significant risks. The Risk Committees monitor progress in reducing these risks where deemed necessary or maintaining them at acceptable levels. The Committees meet formally at least quarterly to review, amongst other things, established tolerance levels, actual risk levels versus tolerances, emerging risks and material risk failures or losses. Risk reports are provided to the management team on at least a monthly basis to help the team monitor risk levels.

Economic Capital Model

The Group has developed a sophisticated economic capital model ("**BLAST**"). BLAST provides information on risk and return that can assist with business decisions. BLAST is an integral part of the Group's ERM program. It is primarily a stochastic model that incorporates insurance risk, market risk, credit risk and other general risks, including operational risk. It requires the input of a large number of parameters and amount of data. The inputs include historical data and projected future premium income, reinsurance programs, loss ratios, default rates, asset performance and operational costs. All classes of business, including non-elemental classes, are within the capabilities of the model.

BLAST produces data in the form of a stochastic distribution. The distribution includes the mean outcome and the result at various return periods, including very remote events. BLAST includes the calculation of present and projected financial outcomes for each insurance class, including non-elemental classes. BLAST also recognises diversification credit. This arises as individual risks are generally not strongly correlated and are unlikely to all produce profits or losses at the same time. Diversification credit is calculated within categories, most notably within the insurance category, and across a range of risk categories. BLAST helps the Group determine the level of capital required at both the Group and operating entity level to meet the combined risk from a wide range of categories.

There are several areas of uncertainty associated with achieving accurate results from BLAST. These include the following: incorrect assumptions on parameters including frequency and severity of losses; external environmental factors, including trading conditions or major loss events; correlation factors between different types of risk; counter-party credit-worthiness; and changes in laws and regulations or their interpretation. The management of various types of risks is described in more detail below.

A. Insurance Risk

The Group underwrites worldwide short-tail insurance and reinsurance risks, including risks exposed to both natural and man-made catastrophes. The Group's exposure in connection with insurance contracts is, in the event of insured losses, whether premium will be sufficient to cover the loss payments and expenses. Insurance and reinsurance markets are cyclical and premium rates and terms and conditions vary by line of business depending on market conditions and the stage of the cycle. Market conditions are impacted by capacity and recent loss events, among other factors. The Group's underwriters assess likely losses using their experience and knowledge of past loss experience and current circumstances. This allows them to estimate the premium sufficient to meet likely losses and expenses. The Group considers insurance risk at an individual contract level, sector level, geographic level and at an aggregate portfolio level to ensure careful risk selection, limits on concentration and appropriate portfolio diversification are accomplished.

The Group's four principal classes, or lines, are property, energy, marine and aviation. The level of insurance risk tolerance per class per occurrence and in aggregate is set by the Risk Committees.

A number of controls are deployed to control the amount of insurance exposure assumed:

- The Group has a rolling 3 year strategic plan, adopted in the second quarter each year, which sets the overriding business goals that the Board aims to achieve;
- A business plan is produced annually which includes expected premium and combined ratios by class. The plan is approved by the Board of Directors;
- The business plan is monitored and reviewed on an on-going basis;
- An economic capital model is used to measure occurrence risks, aggregate risks and correlations between classes;
- Each authorised class has a pre-determined normal maximum line structure;

- The Group has pre-determined tolerances on probabilistic and deterministic losses of capital for certain single events and aggregate losses over a period of time;
- Risk levels versus tolerances are communicated broadly on a frequent and regular basis, helping identify where limits are being approached or exceeded;
- A daily underwriting meeting is held to review insurance proposals, opportunities and emerging risks;
- Sophisticated pricing models are utilised in certain areas of the underwriting process, and are updated frequently;
- BLAST and other computer modelling tools are deployed to simulate catastrophes and resultant losses to the portfolio and the Group; and
- Reinsurance may be purchased to mitigate losses in peak areas of exposure.

The Group has established an internal audit function which is independent of the ERM and underwriting processes. The head of internal audit reports directly to the Audit Committee. The internal audit function is required to perform risk reviews on the underwriting function to ensure compliance with Group policies and required procedures.

The Group establishes targets for the maximum proportion of capital, including long-term debt, that can be lost in extreme events.

A number of lines of business are subject to seasonal variation. A proportion of the Group's business is exposed to large catastrophe losses in North America as a result of windstorms. The level of windstorm activity, and landfall thereof, during the North American hurricane season may materially impact the Group's loss experience. The typical North American hurricane season is June to November. The Group also bears exposure to large losses arising from other non-seasonal natural catastrophes, such as earthquakes, from risk losses throughout the year and from war, terrorism and political risk. Given seasonality, the risk of a very large earthquake is more relevant than U.S. hurricanes at 31 December 2008.

As part of the Group's risk management process the BLAST model is run on a fortnightly basis. This enables the management team to monitor exposures to pre-determined elemental and non-elemental event risk tolerances. BLAST is also employed in the Group's budgeting and forecasting process. The Group's exposure to certain events, as a percentage of capital, including long-term debt, are shown below, net of tax, after collection of reinsurance and after payment and collection of reinstatement premiums.

	31 December 2006		*31 December 2007*		*31 December 2008*	
	US$m	*%*	*US$m*	*%*	*US$m*	*%*
California earthquake	307.5	24.3	249.3	18.5	249.8	17.8
Gulf of Mexico windstorm	297.0	23.5	317.2	23.5	246.6	17.6
European windstorm	233.6	18.4	244.0	18.1	143.4	10.2
New Madrid earthquake	67.5	5.3	59.5	4.4	27.3	1.9
Northeast U.S. earthquake	8.7	0.7	0.9	0.1	7.3	0.5

The windstorm events have an assumed probability of 1 in 100 years with the earthquake events at 1 in 250 years. There can be no guarantee that the assumptions and techniques deployed in calculating these figures are accurate. There could also be an unmodelled loss which exceeds these figures. In addition, any modelled earthquake loss with an occurrence probability of greater than 1 in 250 years or a modelled windstorm loss with an occurrence probability of greater than 1 in 100 years could cause a larger loss to capital, as could a different type of loss event with a different occurrence probability.

Details of annual gross premiums written by line of business are provided below:

	2006		*2007*		*2008*	
	US$m	*%*	*US$m*	*%*	*US$m*	*%*
Property	254.5	40.6	309.3	41.1	302.7	47.5
Energy	253.9	40.6	282.7	37.5	185.2	29.0
Marine	53.1	8.5	76.9	10.2	78.6	12.3
Aviation	64.5	10.3	84.2	11.2	71.6	11.2
Total	**626.0**	**100.0**	**753.1**	**100.0**	**638.1**	**100.0**

Details of annual gross premiums written by geographic area of risks insured are provided below:

	2006		*2007*		*2008*	
	US$m	*%*	*US$m*	*%*	*US$m*	*%*
Worldwide offshore	209.4	33.5	268.1	35.6	232.6	36.5
Worldwide, including U.S. and Canada(1)	168.2	26.9	205.0	27.2	124.2	19.4
US and Canada	143.5	22.9	127.2	16.9	112.8	17.7
Worldwide, excluding U.S. and Canada(2)	32.6	5.2	49.8	6.6	48.5	7.6
Europe	17.0	2.7	43.2	5.7	42.0	6.6
Far East	19.9	3.2	17.3	2.3	17.3	2.7
Middle East	17.1	2.7	13.5	1.8	12.4	1.9
Rest of world	18.3	2.9	29.0	3.9	48.3	7.6
Total	**626.0**	**100.0**	**753.1**	**100.0**	**638.1**	**100.0**

(1) worldwide, including the U.S. and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area.

(2) worldwide, excluding the U.S. and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area, but that specifically exclude the United States of America and Canada.

Sections a to d below describe the risks in each of the four principal lines of business written by the Group.

a. Property

Gross premiums written, for the year:

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Property direct and facultative	111.4	122.8	93.8
Property retrocession	112.8	88.5	76.4
Terrorism	18.9	56.6	75.5
Property cat excess of loss	0.6	19.3	23.4
Property political risk	9.4	16.9	28.1
Other property	1.4	5.2	5.5
Total	**254.5**	**309.3**	**302.7**

Property direct and facultative is written for the full value of the risk, generally on an excess of loss basis. Cover is generally provided to large commercial enterprises with high value locations. Coverage is for non-elemental perils including fire and explosion and elemental (natural catastrophe) perils including flood, windstorm, earthquake and tornado. Coverage generally includes indemnification for both property damage and business interruption.

Property retrocession is written on an excess of loss basis through treaty arrangements. Programs are often written on a pillared basis, with separate geographic zonal limits for risks in the U.S. and Canada and for risks outside the U.S. and Canada. Property cat excess of loss may be written in a similar manner to property retrocession but is not written on a pillared basis. The Group is exposed to large catastrophic losses such as windstorm and earthquake loss from assuming property retrocession and property cat excess of loss risks. Exposure to such events is controlled and measured through setting limits on aggregate exposures per geographic zone and through loss modelling. The accuracy of the latter exposure analysis is limited by the quality of data and effectiveness of the modelling. It is possible that a catastrophic event exceeds the expected modeled event loss. The Group's appetite and exposure guidelines to large losses are set out on page 66.

Terrorism cover is provided for U.S. and worldwide property risks, but excludes nuclear, chemical and biological coverage in most territories.

Political risk cover is written on an individual case by case basis and coverage can vary significantly between policies.

Reinsurance may be purchased to mitigate exposures to large natural catastrophe losses in the U.S. and Canada. Reinsurance may also be purchased to reduce the Group's worldwide exposure to large risk losses.

b. Energy

Gross premiums written, for the year:

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Worldwide offshore energy	42.3	72.7	76.3
Gulf of Mexico offshore energy	171.8	157.5	74.3
Construction energy	24.5	24.5	21.5
Onshore energy	13.5	25.3	10.0
Other energy	1.8	2.7	3.1
Total	**253.9**	**282.7**	**185.2**

Energy risks are mostly written on a direct basis. Gulf of Mexico energy programs cover elemental and non-elemental risks. The largest exposure is from hurricanes in the Gulf of Mexico. Exposure to such events is controlled and measured through loss modelling but the accuracy of this exposure analysis is limited by the quality of data and effectiveness of the modelling. It is possible that a catastrophic event exceeds the expected event loss. The Group's appetite and exposure guidelines to large losses are set out on page 66. Most policies have sub-limits on coverage for elemental losses. Non-elemental energy risks include fire and explosion.

Worldwide offshore energy programs are generally for non-elemental risks. Onshore energy risks can include onshore Gulf of Mexico and worldwide energy installations and are largely subject to the same loss events as described above. Energy construction contracts generally cover all risks of platform and drilling units under construction.

Reinsurance protection may be purchased to protect a portion of loss from elemental and non-elemental energy claims.

c. Marine

Gross premiums written, for the year:

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Marine hull and total loss	26.1	29.4	30.6
Marine builders risk	10.5	22.3	26.3
Marine hull war	4.1	11.4	11.3
Marine P&I clubs	6.4	9.4	9.2
Marine excess of loss	4.3	4.4	—
Other marine	1.7	—	1.2
Total	**53.1**	**76.9**	**78.6**

Marine hull and total loss is generally written on a direct basis and covers marine risks on a worldwide basis primarily for physical damage. Marine builders risk covers the building of ocean going vessels in specialised yards worldwide. Marine hull war is direct insurance of loss of vessels from war or terrorist attack. Marine P&I is mostly the reinsurance of The International Group of Protection and Indemnity Clubs.

Marine excess of loss is generally written on a treaty basis. Marine cargo programs are not normally written. The largest expected exposure is from physical loss rather than from elemental loss events.

Reinsurance may be purchased to reduce the Group's exposure to both large risk losses and an accumulation of smaller, attritional losses.

d. Aviation

Gross premiums written, for the year:

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
AV52	56.2	63.1	51.2
Aviation reinsurance	1.1	10.7	13.7
Other aviation	7.2	10.4	6.7
Total	**64.5**	**84.2**	**71.6**

Aviation AV52 provides coverage for third party liability, excluding own passenger liability, resulting from acts of war or hijack of aircraft, excluding U.S. commercial airlines. Aviation reinsurance is mostly satellite cover. Other aviation business includes aviation hull war risks.

Reinsurance may be purchased to mitigate exposures to an AV52 event loss.

Reinsurance

The Group, in the normal course of business and in accordance with its risk management practices, seeks to reduce certain types of loss that may arise from events that could cause unfavourable underwriting results by entering into reinsurance arrangements. Reinsurance does not relieve the Group of its obligations to policyholders. Under the Group's reinsurance security policy, reinsurers are assessed and approved as appropriate security based on their financial strength ratings and other factors. The Group Reinsurance Security Committee ("**GRSC**") has defined limits per market by rating and an aggregate exposure to a rating band. The Group considers reinsurers that are not rated or do not fall within the pre-defined rating categories on a case by case basis, and would usually require collateral to be posted to support obligations. The Group monitors the credit-worthiness of its reinsurers on an ongoing basis. The GRSC meets formally at least quarterly.

Reinsurance protection purchased typically includes a combination of excess of loss reinsurance, proportional reinsurance and occasionally includes industry loss warranty covers. The mix of reinsurance cover is dependent on the specific loss mitigation requirements, market conditions and available capacity. The Group regularly reviews its catastrophe exposures and may purchase reinsurance in order to reduce the Group's net exposure to a large natural catastrophe loss and/or to reduce net exposures to other large losses. There is no guarantee that reinsurance coverage will be available to meet all potential loss circumstances, as it is possible that the cover purchased is not sufficient. Any loss amount which exceeds the program would be retained by the Group. Some parts of the reinsurance program have limited reinstatements therefore the number of claims which may be recovered from second or subsequent losses in those particular circumstances is limited.

Insurance liabilities

For most insurance and reinsurance companies, the most significant judgement made by management is the estimation of loss and loss adjustment expense reserves. The estimation of the ultimate liability arising from claims made under insurance and reinsurance contracts is a critical estimate for the Group.

Under generally accepted accounting principles, loss reserves are not permitted until the occurrence of an event which may give rise to a claim. As a result, only loss reserves applicable to losses incurred up to the reporting date are established, with no allowance for the provision of a contingency reserve to account for expected future losses or for the emergence of new types of latent claims. Claims arising from future events can be expected to require the establishment of substantial reserves from time to time. All reserves are reported on an undiscounted basis.

Loss and loss adjustment expense reserves are maintained to cover the Group's estimated liability for both reported and unreported claims. Reserving methodologies that calculate a point estimate for the ultimate losses are utilised, and then a range is developed around the point estimate. The point estimate represents management's best estimate of ultimate loss and loss adjustment expenses. The Group's internal actuaries review the reserving assumptions and methodologies on a quarterly basis with loss estimates being subject to a quarterly corroborative review by independent actuaries, using U.S. generally accepted actuarial principles. The independent review is presented to the Group's Audit Committee. The Group has established a Reserve Committee which has responsibility for the review of large claims, their development and also any changes in reserving methodology and assumptions on a quarterly basis.

The extent of reliance on management judgement in the reserving process differs as to whether the business is insurance or reinsurance, whether it is short-tail or long-tail and whether the business is written on an excess of loss or on a pro-rata basis. Over a typical annual period, the Group expects to write the large majority of programs on a direct basis. Typically, over 80 per cent. of programs are expected to be written on an excess of loss basis. The Group does not currently write a significant amount of long-tail business.

a. Insurance versus reinsurance

Loss reserve calculations for direct insurance business are not precise in that they deal with the inherent uncertainty of future contingent events. Estimating loss reserves requires management to make assumptions regarding future reporting and development patterns, frequency and severity trends, claims settlement practices, potential changes in the legal environment and other factors such as inflation. These estimates and judgements are based on numerous factors, and may be revised as additional experience or other data becomes available or reviewed as new or improved methodologies are developed or as current laws change.

Furthermore, as a broker market reinsurer, management must rely on loss information reported to brokers by insurers who must estimate their own losses at the policy level, often based on incomplete and changing information. The information management receives varies by cedant and may include paid losses, estimated case reserves, and an estimated provision for IBNR reserves. Additionally, reserving practices and the quality of data reporting may vary among ceding companies which adds further uncertainty to the estimation of the ultimate losses.

b. Short-tail versus long-tail

In general, claims relating to short-tail property risks, such as the majority of risks underwritten by the Group, are reported more promptly by third parties than those relating to long-tail risks, including the majority of casualty risks. However, the timeliness of reporting can be affected by such factors as the nature of the event causing the loss, the location of the loss, and whether the losses are from policies in force with primary insurers or with reinsurers.

c. Excess of loss versus proportional

For excess of loss business, management are aided by the fact that each policy has a defined limit of liability arising from one event. Once that limit has been reached, there is no further exposure to additional losses from that policy for the same event. For proportional treaties, generally an initial estimated loss and loss expense ratio (the ratio of losses and loss adjustment expenses incurred to premiums earned) is used, based upon information provided by the insured or ceding company and/or their broker and management's historical experience of that treaty, if any, and the estimate is adjusted as actual experience becomes known.

d. Time lags

There is a time lag inherent in reporting from the original claimant to the primary insurer to the broker and then to the reinsurer. Also, the combination of low claim frequency and high severity makes the available data more volatile and less useful for predicting ultimate losses. In the case of proportional contracts, reliance is placed on an analysis of a contract's historical experience, industry information, and the professional judgement of underwriters in estimating reserves for these contracts. In addition, if available, reliance is placed partially on ultimate loss ratio forecasts as reported by insureds or cedants, which are normally subject to a quarterly or six month lag.

e. Uncertainty

As a result of the time lag described above, an estimation must be made of IBNR reserves, which consist of a provision for additional development in excess of the case reserves reported by insureds or ceding companies, as well as a provision for claims which have occurred but which have not yet been reported by insureds or ceding companies. Because of the degree of reliance that is necessarily placed on insureds or ceding companies for claims reporting, the associated time lag, the low frequency/high severity nature of much of the business that the Group underwrites, and the varying reserving practices among ceding companies, reserve estimates are highly dependent on management judgement and therefore uncertain. During the loss settlement period, which may be years in duration, additional facts regarding individual claims and trends often will become known, and current laws and case law may change, with a consequent impact on reserving.

The claims count on the types of insurance and reinsurance that the Group writes, which are low frequency and high severity in nature, is generally low.

For certain catastrophic events there is greater uncertainty underlying the assumptions and associated estimated reserves for losses and loss adjustment expenses. Complexity resulting from problems such as policy coverage issues, multiple events affecting one geographic area and the resulting impact on claims adjusting (including allocation of claims to event and the effect of demand surge on the cost of building materials and labour) by, and communications from, insureds or ceding companies, can cause delays to the timing with which the Group is notified of changes to loss estimates.

At 31 December 2008 management's estimates for IBNR represented 32.6 per cent. of total net loss reserves (2007 – 60.1 per cent., 2006 – 96.9 per cent.). The majority of the estimate relates to potential claims on non-elemental risks where timing delays in insured or cedant reporting may mean losses could have occurred which the Group were not made aware of by the balance sheet date.

B. Market risk

The Group is at risk of loss due to movements in market factors. These include investment market factors and insurance market factors. The Group is also subject to interest rate risk on its debt and investments and currency risk to the extent foreign currency balances are not hedged. These risks and the management thereof are described below.

a. Investments

Investment guidelines are established by the Investment Committee of the Board of Directors. Investment guidelines set parameters within which the Group's external investment managers must operate. Important parameters include guidelines on permissible assets, duration ranges, credit quality and maturity. Investment guidelines exist at the individual portfolio level and for the Group's consolidated portfolio. Compliance with guidelines is monitored on a monthly basis. Any adjustments to the investment guidelines are approved by the Investment Committee and the Board of Directors.

Within the Group guidelines is a sub-set of guidelines for the portion of funds required to meet cash flow needs following an extreme event. The funds to cover this potential liability are designated as the "core" portfolio and the portfolio duration is matched to the duration of the insurance liabilities. The core portfolio is invested in fixed income securities and cash and cash equivalents. The core portfolio may, at times, contain assets significantly in excess of those required to meet insurance liabilities. The sub-set of guidelines adds a further degree of requirements, including fewer allowable asset classes, higher credit quality, shorter duration

and higher liquidity. The primary objective of this portion of assets is to provide liquidity to meet claims and capital preservation.

Assets in excess of those required to settle potential insurance liabilities in an extreme event may be held in the core portfolio, the "core plus" portfolio or in the "surplus" portfolio. The core plus portfolio is invested in fixed income securities and cash and cash equivalents. The surplus portfolio is invested in fixed income securities, cash and cash equivalents and can invest in equity securities and derivative instruments. The assets in the core plus and surplus portfolios are not matched to specific insurance liabilities. In general, the duration may be slightly longer than in the core portfolio, while maintaining focus on high quality assets. The Group also holds a modest amount of convertible debt securities in its surplus portfolio. These instruments are either bifurcated into their component parts with the embedded option fair valued through the income statement or designated as at fair value through profit and loss with changes in estimated fair value recognised directly in income. Currently, the Group does not hold any alternative investments such as hedge funds.

The Group reviews the composition, duration and asset allocation of its investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. If certain asset classes are anticipated to produce a higher return within management's risk tolerance an adjustment in asset allocation may be made.

The fixed income portfolios are managed by three external investment managers with similar mandates. The equity portfolio is managed by one investment manager. The equity portfolio has been liquidated with less than 1 per cent. of the total investment portfolio remaining in equities at 31 December 2008. The performance of the managers is monitored on an on-going basis.

Asset allocation by manager is as follows:

	As at 31 December 2006				
	Goldman Sachs	*Blackrock*	*Pimco*	*Equity manager*	*Total*
	US$m	*US$m*	*US$m*	*US$m*	*US$m*
Fixed income securities	430.8	434.8	—	30.7	896.3
Equity securities	5.7	—	—	64.6	70.3
Other investments	—	—	—	11.5	11.5
Cash	110.1	108.3	—	6.6	225.0
Total	**546.6**	**543.1**	**—**	**113.4**	**1,203.1**
	%	*%*		*%*	*%*
Fixed income securities	35.8	36.1	—	2.6	74.5
Equity securities	0.4	—	—	5.4	5.8
Other investments	—	—	—	1.0	1.0
Cash	9.2	9.0	—	0.5	18.7
Total	**45.4**	**45.1**	**—**	**9.5**	**100.0**

	As at 31 December 2007				
	Goldman Sachs	*Blackrock*	*Pimco*	*Equity manager*	*Total*
	US$m	*US*$m	*US*$m	*US*$m	*US*$m
Fixed income securities	629.9	421.8	—	41.5	1,093.2
Equity securities	0.5	—	—	71.1	71.6
Other investments	—	—	—	4.4	4.4
Cash and cash equivalents	79.7	267.9	—	7.1	354.7
Total	**710.1**	**689.7**	**—**	**124.1**	**1,523.9**
	%	%		%	%
Fixed income securities	41.3	27.7	—	2.7	71.7
Equity securities	—	—	—	4.7	4.7
Other investments	—	—	—	0.3	0.3
Cash and cash equivalents	5.2	17.6	—	0.5	23.3
Total	**46.5**	**45.3**	**—**	**8.2**	**100.0**

	As at 31 December 2008				
	Goldman Sachs	*Blackrock*	*Pimco*	*Equity manager*	*Total*
	US$m	*US$m*	*US$m*	*US$m*	*US$m*
Fixed income securities	711.0	589.2	294.9	4.3	1,599.4
Equity securities	—	—	—	5.8	5.8
Other investments	—	—	—	—	—
Cash and cash equivalents	36.7	112.3	37.6	0.5	187.1
Total	**747.7**	**701.5**	**332.5**	**10.6**	**1,792.3**
	%	%	%	%	%
Fixed income securities	39.7	32.9	16.5	0.2	89.3
Equity securities	—	—	—	0.3	0.3
Other investments	—	—	—	—	—
Cash and cash equivalents	2.0	6.3	2.1	—	10.4
Total	**41.7**	**39.2**	**18.6**	**0.5**	**100.0**

The investment mix of the fixed income portfolio is as follows:

	As at 31 December 2006							
	Core		*Core plus*		*Surplus*		*Total*	
	US$m	*%*	*US$m*	*%*	*US$m*	*%*	*US$m*	*%*
Available for sale								
– Short-term investments	2.1	0.2	—	—	4.8	0.5	6.9	0.7
– U.S. treasuries	15.0	1.7	—	—	15.8	1.8	30.8	3.5
– U.S. government agency debt	102.1	11.4	—	—	48.3	5.4	150.4	16.8
– Asset backed securities	80.8	9.0	—	—	40.3	4.5	121.1	13.5
– U.S. government agency mortgage backed securities	77.6	8.7	—	—	137.0	15.3	214.6	24.0
– Non-agency mortgage backed securities	63.0	7.0	—	—	89.5	10.0	152.5	17.0
– Corporate bonds	125.4	14.0	—	—	65.7	7.3	191.1	21.3
– Convertible debt securities	—	—	—	—	28.9	3.2	28.9	3.2
	—	—						
Available for sale	**466.0**	**52.0**	**—**	**—**	**430.3**	**48.0**	**896.3**	**100.0**
At fair value through income								
– Convertible debt securities	—	—	—	—	—	—	—	—
Total fixed income securities	**466.0**	**52.0**	**—**	**—**	**430.3**	**48.0**	**896.3**	**100.0**

	As at 31 December 2007							
	Core		*Core plus*		*Surplus*		*Total*	
	US$m	*%*	*US$m*	*%*	*US$m*	*%*	*US$m*	*%*
Available for sale								
– Short-term investments	—	—	—	—	0.7	0.1	0.7	0.1
– U.S. treasuries	207.9	19.0	—	—	46.5	4.3	254.4	23.3
– Asset backed securities	—	—	—	—	—	—	—	—
– U.S. government agency debt	195.7	17.9	—	—	13.6	1.2	209.3	19.1
– U.S. government agency mortgage backed securities	153.5	14.0	—	—	87.6	8.0	241.1	22.0
– Non-agency mortgage backed securities	6.0	0.6	—	—	1.0	0.1	7.0	0.7
– Corporate bonds	309.8	28.3	—	—	33.5	3.1	343.3	31.4
– Convertible debt securities	—	—	—	—	13.9	1.3	13.9	1.3
Available for sale	**872.9**	**79.8**	**—**	**—**	**196.8**	**18.1**	**1,069.7**	**97.9**
At fair value through profit and loss								
– Convertible debt securities	—	—	—	—	23.5	2.1	23.5	2.1
Total fixed income securities	**872.9**	**79.8**	**—**	**—**	**220.3**	**20.2**	**1,093.2**	**100.0**

	As at 31 December 2008							
	Core		Core plus		Surplus		Total	
	US$m	*%*	*US$m*	*%*	*US$m*	*%*	*US$m*	*%*
Available for sale								
– Short-term investments	101.5	6.4	9.9	0.6	52.2	3.3	163.6	10.2
– U.S. treasuries	148.3	9.3	15.8	1.0	27.6	1.7	191.7	12.0
– Other government bonds	27.7	1.7	11.4	0.7	15.0	0.9	54.1	3.3
– U.S. government agency debt	39.5	2.5	15.5	1.0	59.5	3.7	114.5	7.2
– U.S. government agency mortgage backed securities	180.9	11.3	82.2	5.1	351.3	21.9	614.4	38.4
– Corporate bonds	138.3	8.6	52.0	3.2	113.2	7.1	303.5	18.9
– Corporate bonds - FDIC guaranteed[1]	108.8	6.8	14.6	0.9	30.0	1.9	153.4	9.6
– Convertible debt securities	—	—	—	—	0.2	—	0.2	—
Available for sale	**745.0**	**46.6**	**201.4**	**12.5**	**649.0**	**40.6**	**1,595.4**	**99.7**
At fair value through profit and loss								
– Convertible debt securities	—	—	—	—	4.0	0.3	4.0	0.3
Total fixed income securities	**745.0**	**46.6**	**201.4**	**12.5**	**653.0**	**40.9**	**1,599.4**	**100.0**

(1) FDIC guaranteed corporate bonds are protected by the Federal Deposit Insurance Corporation, an independent agency of the United States government.

The Group's net asset value is directly impacted by movements in the value of investments held. Values can be impacted by movements in interest rates, credit ratings, economic environment and outlook, and exchange rates.

The impact on net unrealised gains and losses of a 10 per cent. fall in the value of the Group's equity portfolio at 31 December 2008 would be US$0.6 million (2007 – US$7.2 million, 2006 – US$7.0 million). Valuation risk in the equity portfolio is mitigated by diversifying the portfolio across sectors.

The majority of the Group's investments comprise fixed income securities. The fair value of the Group's fixed income portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's fixed income investments would tend to rise and vice versa.

The sector allocation of the corporate bonds and convertible debt securities is as follows:

	31 December 2006		31 December 2007		31 December 2008	
Sector	*US$m*	*%*	*US$m*	*%*	*US$m*	*%*
Industrial	141.6	64.4	123.3	32.4	172.7	37.5
Financial	65.0	29.5	234.3	61.5	254.6	55.2
Utility	2.0	0.9	19.5	5.1	15.7	3.4
Other	11.4	5.2	3.6	1.0	18.1	3.9
Total	**220.0**	**100.0**	**380.7**	**100.0**	**461.1**	**100.0**

The financial sector allocation includes US$153.4 million (2007 – US$nil, 2006 – US$nil) of FDIC guaranteed bonds.

The sensitivity of the price of fixed income securities is indicated by its duration[1]. The greater a security's duration, the greater its percentage price volatility. The sensitivity of the Group's fixed income portfolio to interest rate movements is detailed below, assuming linear sensitivity to movements in interest rates.

	31 December,					
	2006		2007		2008	
Immediate shift in yield (basis points)	*US$m*	*%*	*US$m*	*%*	*US$m*	*%*
100	(21.0)	(2.3)	(25.9)	(2.4)	(43.1)	(2.7)
75	(15.8)	(1.7)	(19.5)	(1.8)	(32.3)	(2.0)
50	(10.5)	(1.2)	(13.0)	(1.2)	(21.6)	(1.4)
25	(5.3)	(0.6)	(6.5)	(0.6)	(10.8)	(0.7)
-25	5.3	0.6	5.7	0.5	6.6	0.4
-50	10.5	1.2	11.4	1.0	13.1	0.8
-75	15.8	1.7	17.1	1.6	19.7	1.2
-100	21.0	2.3	22.8	2.1	26.2	1.6

(1) Duration is the weighted average maturity of a security's cash flows, where the present values of the cash flows serve as the weights.

The effect of convexity on the portfolios response to changes in interest rates has been factored into the data above.

The Group limits interest rate risk on the investment portfolio by establishing and monitoring duration ranges within investment guidelines. The duration of the core portfolio is matched to the duration of the insurance reserves. The permitted duration range for the core plus portfolio it is between zero and four years and for the surplus portfolio is between one and five years. The duration of the fixed income portfolios at 31 December 2008 was 1.7 years for the core portfolio (2007 – 1.9 years, 2006 – 1.5 years), 1.4 years for the core plus portfolio (2007 and 2006 – not applicable) and 2.6 years for the surplus portfolio (2007 – 3.4 years, 2006 – 3.2 years).

In addition to duration management, the Group uses Value at Risk ("**VaR**") to measure potential losses in the estimated fair values of its cash and invested assets. Management measures VaR on a monthly basis to understand and monitor risk.

The VaR calculation is performed using variance / covariance risk modelling to capture the cash flows and embedded optionality of the portfolio. Securities are valued individually using market standard pricing models. These security valuations serve as the input to many risk analytics, including full valuation risk analyses as well as parametric methods that rely on option adjusted risk sensitivities to approximate the risk and return profiles of the portfolio.

The principal measure that is produced is a ninety day VaR at a 95th percentile confidence level. Management also monitors the 99th percentile confidence level. The ninety day VaR, at a 95th percentile confidence level, measures the minimum amount by which the assets should be expected to lose in a ninety day time horizon, under normal conditions, 5 per cent. of the time. The current VaR tolerance is 4.0 per cent. of shareholders' equity, using the ninety day VaR at a 95th percentile confidence level. The Group's VaR calculations are as follows:

	31 December,					
	2006		*2007*		*2008*	
	US$m	*%*	*US$m*	*%*	*US$m*	*%*
99th percentile confidence level	18.6	1.6	21.4	1.8	60.9	4.8
95th percentile confidence level	13.2	1.2	15.2	1.3	43.1	3.4

The fair value of securities in the Group's investment portfolio is estimated using the following techniques:

(i) quoted prices in active markets for the same instrument; or

(ii) quoted prices on active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data; or

(iii) valuation techniques for which any significant input is not based on observable market data.

Securities that have quoted prices in active markets include publicly traded equity securities and U.S. treasuries.

Securities that have their fair value estimated based on observable market data include:

- U.S. government agency debt;
- U.S. government agency mortgage backed securities;
- non-agency mortgage backed securities;
- corporate bonds;
- convertible debt securities; and
- non-publicly traded equity securities.

Prices for the Group's investment portfolio are provided by a third party investment accounting firm whose pricing processes, and the controls thereon, are subject to an annual audit on both the operation and the effectiveness of those controls – a "SAS 70" audit. SAS 70 audit reports are publicly available to clients of the firm and the report is reviewed annually by management. In accordance with their pricing policy, various recognised reputable pricing sources are used including index providers, broker dealers, and pricing vendors. The pricing sources use bid prices where available, otherwise indicative prices are quoted based on observable market trade data. The prices provided are compared to the investment managers' and custodian's pricing.

The majority of the Group's assets are invested in U.S. government or U.S. government agency securities which are less subject to pricing risk.

b. Insurance

The Group is exposed to insurance market risk from several sources, including the following:

- The advent of a soft insurance market, which may result in a stabilisation or decline in premium rates and/or terms and conditions for certain lines, or across all lines;

- The actions and reactions of key competitors, which may directly result in volatility in premium volumes and rates, fee levels and other input costs; and
- Market events which may cause a limit in the availability of cover, including unusual inflation in rates, causing political intervention or national remedies.

The most important measure to mitigate insurance risk is to maintain strict underwriting standards. Examples of how the Group reacts to insurance risk include the following:

- Reviews and amends underwriting plans and budgets as necessary;
- Reduces exposure to market sectors where conditions have reached unattractive levels;
- Purchases appropriate reinsurance cover to mitigate exposure;
- Closely monitors changes in rates, and terms and conditions; and
- Regularly reviews output from the Group's economic capital model, BLAST, to assess up-to-date profitability of classes and sectors.

Insurance contract liabilities are not directly sensitive to the level of market interest rates, as they are undiscounted and contractually non-interest bearing.

c. Debt

The Group has issued long-term debt as described in note 19. The loan notes bear interest at a floating rate that is re-set on a quarterly basis plus a fixed margin of 3.7 per cent. The Group is subject to interest rate risk on the coupon payments of the long-term debt. The Group has mitigated the interest rate risk by entering into swap contracts as follows:

	Maturity date	*Prepayment date*	*Interest hedged*
Subordinated loan notes US$97 million	15 December 2035	15 December 2011	50%
Subordinated loan notes €24 million	15 June 2035	15 March 2011	50%

The notional amounts of US$50.0 million and €12.0 million respectively are due on 15 March 2011.

In certain circumstances the subordinated notes can be prepaid from 16 December 2005, with a sliding scale redemption price penalty which reduces to zero by 15 December 2011. Refer to note 19 for further details.

The current Euribor interest rate on 50 per cent. of the Euro subordinated loan notes has been fixed at 3.33 per cent. (2007 – 4.95 per cent., 2006 – 3.67 per cent.). The current LIBOR interest rate on 50 per cent. of the US dollar subordinated loan notes has been fixed at 2.00 per cent. (2007 – 4.99 per cent., 2006 – 5.36 per cent.). The Group retains exposure to interest rate risk on the remaining portion of the notes.

d. Currency risk

The Group currently underwrites from two locations, Bermuda and London, although risks are assumed on a worldwide basis. Risks assumed are predominantly denominated in U.S. dollars.

The Group is exposed to currency risk to the extent its assets are denominated in different currencies to its liabilities. The Group is also exposed to non-retranslation risk on non-monetary assets such as unearned premiums and deferred acquisition costs. Exchange gains and losses can impact income.

The Group has hedged non U.S. dollar liabilities with non U.S. dollar assets. The Group's main foreign currency exposure relates to its insurance obligations, cash holdings, premiums receivable and the €24.0 million subordinated loan notes long-term debt liability.

The Group's assets and liabilities, categorised by currency at their translated carrying amount were as follows:

Assets	*US$m* *US$*	*US$m* *Sterling*	*US$m* *Euro*	*US$m* *Other*	*US$m* *Total*
Cash and cash equivalents	359.0	1.3	37.1	2.7	400.1
Accrued interest receivable	7.5	—	—	—	7.5
Investments	978.1	—	—	—	978.1
Unearned premium on premium ceded	19.1	—	—	—	19.1
Deferred acquisition costs	48.5	0.2	1.6	1.2	51.5
Other receivables	5.1	1.2	—	—	6.3
Inwards premium receivable from insureds and cedants	161.6	0.7	5.6	5.8	173.7
Deferred tax asset	—	0.8	—	—	0.8
Investments in associate	23.2	—	—	—	23.2
Property, plant and equipment	1.4	1.0	—	—	2.4
Total assets as at 31 December 2006	**1,603.5**	**5.2**	**44.3**	**9.7**	**1,662.7**

Liabilities	US$m US$	US$m Sterling	US$m Euro	US$m Other	US$m Total
Losses and loss adjustment expenses	38.0	0.2	0.9	—	39.1
Unearned premiums	304.9	2.0	10.4	8.4	325.7
Insurance contracts – other payables	5.2	—	—	—	5.2
Amounts payable to reinsurers	0.8	—	—	—	0.8
Deferred acquisition costs ceded	2.5	—	—	—	2.5
Other payables	19.8	1.0	—	—	20.8
Corporation tax payable	—	1.0	—	—	1.0
Interest rate swap	1.0	—	(0.1)	—	0.9
Accrued interest payable	0.4	—	0.1	—	0.5
Long-term debt	97.0	—	31.6	—	128.6
Total liabilities as at 31 December 2006	**469.6**	**4.2**	**42.9**	**8.4**	**525.1**

Assets	US$m US$	US$m Sterling	US$m Euro	US$m Other	US$m Total
Cash and cash equivalents	401.3	266.3	66.5	3.2	737.3
Accrued interest receivable	9.8	—	—	—	9.8
Investments					
– Fixed income securities					
– Available for sale	1,069.7	—	—	—	1,069.7
– At fair value through profit and loss	23.5	—	—	—	23.5
– Equity securities					
– Available for sale	71.6	—	—	—	71.6
– Other investment	4.4	—	—	—	4.4
Investment in associate	22.9	—	—	—	22.9
Reinsurance assets	31.4	—	—	—	31.4
Deferred acquisition costs	48.1	1.7	4.3	3.7	57.8
Other receivables	2.6	1.2	—	—	3.8
Inwards premium receivable from insureds and cedants	159.1	11.4	18.3	9.4	198.2
Deferred tax asset	—	2.0	—	—	2.0
Property, plant and equipment	0.6	1.6	—	0.1	2.3
Total assets as at 31 December 2007	**1,845.0**	**284.2**	**89.1**	**16.4**	**2,234.7**

Liabilities	US$m US$	US$m Sterling	US$m Euro	US$m Other	US$m Total
Losses and loss adjustment expenses	156.6	1.8	16.1	5.1	179.6
Unearned premiums	323.8	15.7	23.9	18.4	381.8
Insurance contracts – other payables	14.3	0.5	1.0	0.7	16.5
Amounts payable to reinsurers	5.7	—	—	—	5.7
Deferred acquisition costs ceded	3.1	—	—	—	3.1
Other payables	284.3	11.7	0.2	—	296.2
Corporation tax payable	—	1.2	—	—	1.2
Interest rate swap	2.5	—	(0.3)	—	2.2
Accrued interest payable	0.4	—	0.1	—	0.5
Long-term debt	97.0	—	35.3	—	132.3
Total liabilities as at 31 December 2007	**887.7**	**30.9**	**76.3**	**24.2**	**1,019.1**

Assets	*US$m US$*	*US$m Sterling*	*US$m Euro*	*US$m Other*	*US$m Total*
Cash and cash equivalents	368.8	7.6	33.9	3.3	413.6
Accrued interest receivable	10.1	—	—	—	10.1
Investments					
– Fixed income securities					
– Available for sale	1,595.4	—	—	—	1,595.4
– At fair value through profit and loss	4.0	—	—	—	4.0
– Equity securities					
– Available for sale	5.8	—	—	—	5.8
Reinsurance assets	55.3	—	—	—	55.3
Deferred acquisition costs	48.8	1.7	5.5	4.9	60.9
Other receivables	152.2	1.7	—	0.1	154.0
Inwards premium receivable from insureds and cedants					
Deferred tax asset	143.9	7.8	25.0	10.6	187.3
Property, plant and equipment	—	1.2	—	—	1.2
	0.1	1.2	—	0.1	1.4
Total assets as at 31 December 2008	**2,384.4**	**21.2**	**64.4**	**19.0**	**2,489.0**

Liabilities	*US$m US$*	*US$m Sterling*	*US$m Euro*	*US$m Other*	*US$m Total*
Losses and loss adjustment expenses	488.2	3.1	20.0	17.5	528.8
Unearned premiums	274.2	14.0	26.6	24.8	339.6
Insurance contracts - other payables	13.3	0.2	3.2	0.9	17.6
Amounts payable to reinsurers	1.9	0.1	—	—	2.0
Deferred acquisition costs ceded	1.9	—	—	—	1.9
Other payables	184.3	5.8	0.2	—	190.3
Interest rate swap	4.4	—	0.5	—	4.9
Accrued interest payable	0.2	—	0.2	—	0.4
Long-term debt	97.0	—	33.8	—	130.8
Total liabilities as at 31 December 2008	**1,065.4**	**23.2**	**84.5**	**43.2**	**1,216.3**

The impact on net income of a proportional foreign exchange movement of 10 per cent. up and 10 per cent. down against the US dollar at the year end spot rates would be an increase or decrease of US$0.4 million (2007 – US$28.2 million, 2006 – US$21.7 million).

C. Liquidity risk

The Group is exposed if proceeds from financial assets are not sufficient to fund obligations arising from its insurance contracts. The Group can be exposed to daily calls on its available investment assets, principally from insurance claims. Liquidity risk is the risk that cash may not be available to pay obligations when they are due without incurring an unreasonable cost.

The maturity dates of the Group's fixed income portfolio are as follows:

	31 December 2006			
Fixed income securities	*US$m Core*	*US$m Core plus*	*US$m Surplus*	*US$m Total*
Less than one year	21.3	—	—	21.3
Between one and two years	114.8	—	27.1	141.9
Between two and three years	61.7	—	11.4	73.1
Between three and four years	28.0	—	27.6	55.6
Between four and five years	3.3	—	30.5	33.8
Over five years	15.6	—	66.8	82.4
Asset-backed and mortgage-backed securities	221.3	—	266.9	488.2
Total	**466.0**	**—**	**430.3**	**896.3**

	31 December 2007			
Fixed income securities	*US$m Core*	*US$m Core plus*	*US$m Surplus*	*US$m Total*
Less than one year	45.8	—	2.0	47.8
Between one and two years	347.6	—	29.9	377.5
Between two and three years	166.4	—	5.8	172.2
Between three and four years	56.6	—	15.4	72.0
Between four and five years	75.3	—	14.7	90.0
Over five years	21.7	—	63.9	85.6
Asset-backed and mortgage-backed securities	159.5	—	88.6	248.1
Total	**872.9**	**—**	**220.3**	**1,093.2**

	31 December 2008			
Fixed income securities	*US$m Core*	*US$m Core plus*	*US$m Surplus*	*US$m Total*
Less than one year	184.4	22.2	69.8	276.4
Between one and two years	128.8	30.8	39.9	199.5
Between two and three years	157.7	48.7	63.7	270.1
Between three and four years	61.7	8.9	20.8	91.4
Between four and five years	18.4	6.8	27.0	52.2
Over five years	13.1	1.8	80.5	95.4
Mortgage-backed securities	180.9	82.2	351.3	614.4
Total	**745.0**	**201.4**	**653.0**	**1,599.4**

The maturity profile of the financial liabilities of the Group is as follows:

As at 31 December 2006

	US$m	US$m	US$m	US$m	US$m	US$m
		Years until liability becomes due				
	Balance sheet	*Less than one*	*One to three*	*Three to five*	*Over five*	*Total*
Losses and loss adjustment expenses	39.1	17.0	13.6	4.6	3.9	39.1
Insurance contracts – other payables	5.2	4.7	0.5	—	—	5.2
Amounts payable to reinsurers	0.8	0.8	—	—	—	0.8
Other payables	20.8	20.8	—	—	—	20.8
Corporation tax payable	1.0	1.0	—	—	—	1.0
Accrued interest payable	0.5	0.5	—	—	—	0.5
Long-term debt	128.6	—	—	—	128.6	128.6
Total	**196.0**	**44.8**	**14.1**	**4.6**	**132.5**	**196.0**

As at 31 December 2007

	US$m	US$m	US$m	US$m	US$m	US$m
		Years until liability becomes due				
	Balance sheet	*Less than one*	*One to three*	*Three to five*	*Over five*	*Total*
Losses and loss adjustment expenses	179.6	64.4	71.8	24.2	19.2	179.6
Insurance contracts – other payables	16.5	15.3	0.8	0.4	—	16.5
Amounts payable to reinsurers	5.7	5.7	—	—	—	5.7
Other payables	296.2	296.2	—	—	—	296.2
Corporation tax payable	1.2	1.2	—	—	—	1.2
Accrued interest payable	0.5	0.5	—	—	—	0.5
Interest rate swap	2.2	0.7	1.3	0.2	—	2.2
Long-term debt	132.3	11.5	23.0	23.0	395.0	452.5
Total	**634.2**	**395.5**	**96.9**	**47.8**	**414.2**	**954.4**

As at 31 December 2008

	US$m	US$m	US$m	US$m	US$m	US$m
		Years until liability becomes due				
	Balance sheet	*Less than one*	*One to three*	*Three to five*	*Over five*	*Total*
Losses and loss adjustment expenses	528.8	188.5	211.0	72.2	57.1	528.8
Insurance contracts – other payables	17.6	14.0	3.2	0.4	—	17.6
Amounts payable to reinsurers	2.0	2.0	—	—	—	2.0
Other payables	190.3	190.3	—	—	—	190.3
Interest rate swap	4.9	2.1	2.8	—	—	4.9
Accrued interest payable	0.4	0.4	—	—	—	0.4
Long-term debt	130.8	7.9	15.8	15.8	303.4	342.9
Total	**874.8**	**405.2**	**232.8**	**88.4**	**360.5**	**1,086.9**

Actual maturities of the above may differ from contractual maturities because certain borrowers have the right to call or pre-pay certain obligations with or without call or prepayment penalties. The prepayment options for the Group's long-term debt are discussed in note 19. While the estimation of the ultimate liability for losses and loss adjustment expenses is complex and incorporates a significant amount of judgement, the timing of payment of losses and loss adjustment expenses is also uncertain and cannot be predicted as simply as for other financial liabilities. Actuarial and statistical techniques, past experience and management's judgement have been used to determine a likely settlement pattern.

The Group manages its liquidity risks via its investment strategy to hold high quality, highly liquid securities, sufficient to meet its insurance liabilities and other near term liquidity requirements. The creation of the core portfolio with its subset of guidelines ensures funds are readily available to meet potential insurance liabilities in an extreme event plus other near term liquidity requirements.

In addition, the Investment Committee of the Board of Directors has established asset allocation and maturity parameters within the investment guidelines such that the majority of the Group's investments are in high quality assets which could be converted into cash promptly and at minimal expense. The Group monitors market changes and outlooks and re-allocates assets as deemed necessary.

D. Credit risk

Credit risk is the risk that a counter-party may fail to pay, or repay, a debt or obligation. The Group is exposed to credit risk on its fixed income investment portfolio and derivative instruments, its inwards premium receivable from insureds and cedants, and on any amounts recoverable from reinsurers.

Credit risk on the fixed income portfolio is mitigated through the Group's policy to invest in instruments of high credit quality issuers and to limit the amounts of credit exposure with respect to particular ratings categories and any one issuer. Securities rated below BBB- / Baa3 may comprise no more than 5 per cent. of shareholders' equity, with the exception of US government and agency securities. In addition, no one issuer should exceed 5 per cent. of shareholders' equity. The Group is therefore not exposed to any significant credit concentration risk on its investment portfolio, except for fixed income securities issued by the US government and government agencies.

Credit risk on inwards premium receivable from insureds and cedants is managed by conducting business with reputable broking organisations with established relationships and by rigorous cash collection procedures. Credit risk from reinsurance recoverables is primarily managed by review and approval of reinsurer security by the Group's Reinsurance Security Committee as discussed on page 69.

The table below presents an analysis of the Group's major exposures to counter-party credit risk, based on their Standard & Poor's or equivalent rating. The table includes amounts due from policyholders and unsettled investment trades. The quality of these receivables is not graded, but based on management's historical experience there is limited default risk associated with these amounts.

	31 December 2006			
	US$m	*US$m*	*US$m*	*US$m*
	Equity securities and other investments	*Cash & fixed income securities*	*Inward premium and other receivables*	*Reinsurance recoveries*
AAA	—	1,018.8	—	—
AA+, AA, AA-	—	43.6	—	—
A+, A, A-	—	173.8	—	—
BBB+, BBB, BBB-	—	51.9	—	—
Other	81.8	8.3	180.0	—
Total	**81.8**	**1,296.4**	**180.0**	**—**

	31 December 2007			
	US$m	*US$m*	*US$m*	*US$m*
	Equity securities and other investments	*Cash & fixed income securities*	*Inward premium and other receivables*	*Reinsurance recoveries*
AAA	—	1,478.8	—	—
AA+, AA, AA-	—	119.2	—	—
A+, A, A-	—	161.2	8.2	3.6
BBB+, BBB, BBB-	—	56.3	—	—
Other	76.0	15.0	202.0	—
Total	**76.0**	**1,830.5**	**210.2**	**3.6**

	31 December 2008			
	US$m	*US$m*	*US$m*	*US$m*
	Equity securities and other investments	*Cash & fixed income securities*	*Inward premium and other receivables*	*Reinsurance recoveries*
AAA	—	1,572.6	—	—
AA+, AA, AA-	—	207.9	—	—
A+, A, A-	—	190.8	3.2	42.1
BBB+, BBB, BBB-	—	38.9	—	—
Other	5.8	2.8	341.3	—
Total	**5.8**	**2,013.0**	**344.5**	**42.1**

The counter-party to the Group's interest rate swap is currently rated AA by Standard & Poor's.

The following table shows inwards premium receivables that are past due but not impaired:

	31 December 2006	*31 December 2007*	*31 December 2008*
	US$m	*US$m*	*US$m*
Less than 90 days past due	20.2	21.6	4.3
Between 91 & 180 days past due	3.7	0.7	1.4
Over 180 days past due	0.5	0.8	0.5
Total	**24.4**	**23.1**	**6.2**

Provisions of US$1.5 million (2007 – US$0.3 million, 2006 – US$nil) have been made for impaired or irrecoverable balances. No provisions have been made against balances recoverable from reinsurers.

E. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes or systems including the risk of fraud, safety, damage to physical assets, business disruption, system failure and transaction processing failure. Business may also be disrupted by a rating agency action, loss of key personnel, or changes in local employment restrictions.

The Group has a robust self governance framework. Policies and procedures are documented and are reviewed and updated at least quarterly. The Group's internal audit function assesses the key risk areas on an annual basis and performs reviews over these areas to ensure controls are in place and are operating effectively.

Information technology risk tolerances have been defined and system performance is monitored continuously. The Group's disaster recovery plan is re-assessed and updated on a regular basis.

F. Strategic risk

Strategic risk encompasses the risk that poor business planning and vision may produce a lower return on capital and value creation. Further, this could lead to risk tolerances being unclear or inappropriate. The Group address this risk by a continual rigorous assessment of business goals. BLAST is increasingly an integral part of the review of profitability and capital utilisation. The Group's strategy is reviewed by the Board of Directors quarterly. Market or economic events may lead to a need to re-assess strategy more frequently.

(a) Capital risk management

The total capital of the Group as at 31 December 2008 is determined as US$1,403.5 million (2007 – US$1,347.9 million, 2006 – US$1,266.2 million) comprising US$1,272.7 million of shareholders' equity (2007 – US$1,215.6 million, 2006 – US$1,137.6 million) and US$130.8 million of long-term debt (2007 – US$132.3 million, 2006 – US$128.6 million). The Group's capital requirements vary with the insurance cycle.

The Group reviews the level and composition of capital on an ongoing basis with a view to:

- maintaining sufficient capital for underwriting opportunities and to meet obligations to policyholders;
- maximising the return to shareholders within pre-determined risk tolerances; and
- maintaining adequate financial strength ratings and meeting regulatory requirements.

Capital is therefore raised or returned as appropriate. Capital raising can include debt or equity and returns of capital may be made through dividends, share buy backs or redemption of debt. Other capital management tools and products available to the Group may also be utilised. All capital actions require approval by the Board of Directors.

Internal methods have been developed to review the profitability of classes of business and their estimated capital requirements, and the capital requirements of the combination of a wide range of other risk categories. Management increasingly uses these approaches in decision making. The operating companies also conduct capital requirement assessments under internal measures and local regulatory requirements.

Refer to note 27 for a discussion of the regulatory capital requirements of the Group's operating companies.

(b) Value creation and risk adjusted return

The Group's aim is to provide its shareholders with a return on equity of 13 per cent. in excess of a risk free rate over the insurance cycle. The return is measured by management in terms of the internal rate of return ("**IRR**") of the increase in fully converted book value per share ("**FCBVS**") in the period plus dividends accrued. This aim is a long-term goal, acknowledging that management expect both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver this pattern. Management monitors these peaks and troughs - adjusting the Group's portfolio to make the most effective use of available capital and seeking to maximise the risk adjusted return. Within the insurance industry, downturns in the profitability of the cycle present the biggest challenge. The BLAST model assists the Group's underwriting team in determining the mix of the portfolio. There is a risk that incorrect assumptions in BLAST will lead the Group to assuming a risk that does not provide an appropriate return. Parameter risks are discussed further on page 66. The management team reduces this risk by continual re-assessment of the assumptions made.

IRR achieved is as follows:

	Annual Return	*Compound Annual Return*	*Inception to date return*
31 December 2005[1]	(3.2%)	n/a	(3.2%)
31 December 2006	17.4%	13.6%	13.6%
31 December 2007	31.7%	22.3%	49.6%
31 December 2008	7.5%	17.7%	63.1%

IRR achieved in excess of the 3 month treasury yield is as follows:

	Annual Return	*Compound Annual Return*	*Inception to date return*
31 December 2005[1]	(3.4%)	n/a	(3.4%)
31 December 2006	12.6%	8.8%	8.8%
31 December 2007	27.2%	17.7%	40.1%
31 December 2008	6.1%	14.1%	52.1%

(1) The returns shown are for the period from the date of incorporation on 12 October 2005 to 31 December 2005.

NOTES TO THE FINANCIAL STATEMENTS

1. General information

The Group is a provider of global property insurance and reinsurance products. LHL was incorporated under the laws of Bermuda on 12 October 2005. LHL is listed on AIM, a subsidiary market of the London Stock Exchange ("**LSE**"). A secondary listing on the Bermuda Stock Exchange ("**BSX**") was approved on 21 May 2007. The registered office of LHL is Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. LHL has five subsidiaries, all wholly owned: Lancashire Insurance Company Limited ("**LICL**"), Lancashire Insurance Holdings (UK) Limited ("**LIHL**"), Lancashire Insurance Marketing Services Limited ("**LIMSL**"), Lancashire Insurance Services Limited ("**LISL**") and Lancashire Marketing Services (Middle East) Limited ("**LMEL**"). LIHL is a holding company for a wholly owned operating subsidiary, Lancashire Insurance Company (UK) Limited ("**LUK**").

The subsidiaries were incorporated and licensed as insurance companies or intermediaries as follows:

	LICL	*LIHL*	*LUK*	*LIMSL*	*LISL*	*LMEL*
date of incorporation	28 October 2005	11 April 2006	17 March 2006	7 October 2005	17 March 2006	11 March 2007
licensing body	BMA[1]	none	FSA[2]	FSA[2]	none	DFSA[3]
nature of business	General Insurance Business	Holding Company	General Insurance Business	Insurance Mediation Activities	Support Services	Insurance Mediation Activities

(1) Bermuda Monetary Authority ("**BMA**")

(2) United Kingdom, Financial Services Authority ("**FSA**")

(3) Dubai Financial Services Authority ("**DFSA**")

2. Segmental reporting

Management and the Board of Directors review the Group's business primarily by its four principal classes: property, energy, marine and aviation. Management has therefore deemed these classes to be its business and primary segments for the purposes of segmental reporting. Further sub-classes of business are underwritten within each primary segment.

	Revenue and Expense by Business Segment – for the year ended 31 December 2006				
Gross Premiums Written	*US$m Property*	*US$m Energy*	*US$m Marine*	*US$m Aviation*	*US$m Total*
Analysed by geographical segment:					
Worldwide offshore	—	175.5	33.9	—	209.4
Worldwide, including the US and Canada[1]	71.5	26.2	7.4	63.1	168.2
US and Canada	111.7	31.4	0.4	—	143.5
Worldwide, excluding the US and Canada[2]	31.4	0.5	0.6	0.1	32.6
Far East	10.6	2.6	6.7	—	19.9
Middle East	6.7	9.0	1.3	0.1	17.1
Europe	12.3	1.9	2.8	—	17.0
Rest of world	10.3	6.8	—	1.2	18.3
Total	**254.5**	**253.9**	**53.1**	**64.5**	**626.0**
Outwards reinsurance premiums	(39.8)	(38.7)	—	—	(78.5)
Change in unearned premiums	(123.5)	(119.4)	(28.8)	(51.4)	(323.1)
Change in unearned premiums ceded	7.3	11.8	—	—	19.1
Net premiums earned	**98.5**	**107.6**	**24.3**	**13.1**	**243.5**
Insurance losses and loss adjustment expenses	(13.2)	(17.2)	(8.7)	—	(39.1)
Insurance acquisition expenses	(12.7)	(20.1)	(4.6)	(2.6)	(40.0)
Insurance acquisition expenses ceded	1.5	3.6	—	—	5.1
Net underwriting profit	**74.1**	**73.9**	**11.0**	**10.5**	**169.5**

Revenue and Expense by Business Segment – for the year ended 31 December 2006

Gross Premiums Written	*US$m Property*	*US$m Energy*	*US$m Marine*	*US$m Aviation*	*US$m Total*
Net investment income					54.2
Net other investment income					1.8
Net realised gains and impairments					0.8
Share of profit of associate					3.2
Net foreign exchange losses					(1.3)
Operating expenses unrelated to underwriting					(33.9)
Equity based compensation					(22.5)
Financing costs					(12.3)
Profit before tax					**159.5**
Tax					(0.2)
Profit for the period attributable to equity shareholders					**159.3**

	Property	*Energy*	*Marine*	*Aviation*	*Total*
Loss ratio	13.4%	16.0%	35.8%	—	16.1%
Acquisition cost ratio	11.4%	15.3%	18.9%	19.8%	14.3%
Expense ratio	—	—	—	—	13.9%
Combined ratio	**24.8%**	**31.3%**	**54.7%**	**19.8%**	**44.3%**

Assets and liabilities by business segment – as at 31 December 2006

Assets	*US$m Property*	*US$m Energy*	*US$m Marine*	*US$m Aviation*	*US$m Total*
Attributable to business segments	82.2	82.7	29.3	57.0	251.2
Other assets					1,411.5
Total assets					**1,662.7**
Liabilities					
Attributable to business segments	128.8	154.6	38.2	51.7	373.3
Other liabilities					151.8
Total liabilities					**525.1**
Total net assets					**1,137.6**

	Revenue and Expense by Business Segment – for the year ended 31 December 2007				
Gross Premiums Written	*US$m Property*	*US$m Energy*	*US$m Marine*	*US$m Aviation*	*US$m Total*
Analysed by geographical segment:					
Worldwide off	0.7	213.1	54.3	—	268.1
Worldwide, including the US and Canada[1]	75.1	34.2	12.5	83.2	205.0
US and Canada	114.2	12.8	0.2	—	127.2
Worldwide, excluding the US and Canada[2]	43.9	4.1	1.5	0.3	49.8
Europe	35.4	2.8	4.4	0.6	43.2
Far East	10.4	2.7	4.2	—	17.3
Middle East	6.2	8.2	(1.0)	0.1	13.5
Rest of world	23.4	4.8	0.8	—	29.0
Total	**309.3**	**282.7**	**76.9**	**84.2**	**753.1**
Outwards reinsurance premiums	(23.0)	(63.3)	—	—	(86.3)
Change in unearned premiums	(23.8)	(16.4)	(7.9)	(8.0)	(56.1)
Change in unearned premiums ceded	(0.1)	0.6	—	—	0.5
Net premiums earned	**262.4**	**203.6**	**69.0**	**76.2**	**611.2**
Insurance losses and loss adjustment expenses	(36.8)	(71.3)	(38.0)	(3.9)	(150.0)
Insurance losses recoverable	—	3.7	—	—	3.7
Insurance acquisition expenses	(32.3)	(37.4)	(14.9)	(11.0)	(95.6)
Insurance acquisition expenses ceded	1.0	18.1	—	—	19.1
Net underwriting profit	194.3	116.7	16.1	61.3	388.4
Net investment income					78.4
Net other investment income					(3.3)
Net realised gains and impairments					9.1
Net fair value gains on investments at fair value through income					0.4
Share of profit of associate					6.2
Net foreign exchange gains					2.3
Operating expenses unrelated to underwriting					(60.5)
Equity based compensation					(14.4)
Financing costs					(14.7)
Profit before tax					**391.9**
Tax					(1.0)
Profit for the period attributable to equity shareholders					**390.9**

	Property	*Energy*	*Marine*	*Aviation*	*Total*
Loss ratio	14.0%	33.2%	55.1%	5.1%	23.9%
Acquisition cost ratio	11.9%	9.5%	21.6%	14.4%	12.5%
Expense ratio	—	—	—	—	9.9%
Combined ratio	**25.9%**	**42.7%**	**76.7%**	**19.5%**	**46.3%**

Assets and liabilities by business segment – as at 31 December 2007

Assets	*US$m Property*	*US$m Energy*	*US$m Marine*	*US$m Aviation*	*US$m Total*
Attributable to business segments	100.2	88.2	37.0	64.8	290.2
Other assets					1,944.5
Total assets					**2,234.7**
Liabilities					
Attributable to business segments	200.2	240.0	81.7	64.8	586.7
Other liabilities					432.4
Total liabilities					**1,019.1**
Total net assets					**1,215.6**

	Revenue and Expense by Business Segment – for the year ended 31 December 2008				
Gross Premiums Written	*US$m Property*	*US$m Energy*	*US$m Marine*	*US$m Aviation*	*US$m Total*
Analysed by geographical segment:					
Worldwide offshore	0.9	159.1	72.6	—	232.6
Worldwide, including the US and Canada[1]	44.5	7.2	2.1	70.4	124.2
US and Canada	108.5	4.2	0.1	—	112.8
Worldwide, excluding the US and Canada[2]	47.5	0.5	0.2	0.3	48.5
Europe	34.1	4.6	2.9	0.4	42.0
Far East	14.1	2.1	0.7	0.4	17.3
Middle East	8.9	3.5	—	—	12.4
Rest of world	44.2	4.0	—	0.1	48.3
Total	**302.7**	**185.2**	**78.6**	**71.6**	**638.1**

	US$m Property	*US$m Energy*	*US$m Marine*	*US$m Aviation*	*US$m Total*
Outwards reinsurance premiums	(23.1)	(25.6)	(7.6)	(7.1)	(63.4)
Change in unearned premiums	(2.3)	36.9	(0.5)	8.1	42.2
Change in unearned premiums ceded	(5.1)	(5.3)	0.1	0.7	(9.6)
Net premiums earned	**272.2**	**191.2**	**70.6**	**73.3**	**607.3**
Insurance losses and loss adjustment expenses	(100.9)	(271.8)	(38.1)	(8.0)	(418.8)
Insurance losses recoverable	—	43.3	—	—	43.3
Insurance acquisition expenses	(35.3)	(36.7)	(19.8)	(15.1)	(106.9)
Insurance acquisition expenses ceded	1.2	5.4	0.4	0.3	7.3
Net underwriting profit (loss)	**137.2**	**(68.6)**	**13.1**	**50.5**	**132.2**
Net investment income					59.5
Net other investment income (losses)					0.1
Net realised (losses) gains and impairments					(11.0)
Net fair value gains (losses) on investments at fair value through income					(0.6)
Share of profit (loss) of associate					(0.2)
Net foreign exchange (losses) gains					(8.5)

	US$m Property	US$m Energy	US$m Marine	US$m Aviation	US$m Total
Operating expenses unrelated to underwriting					(49.3)
Equity based compensation					(10.6)
Financing costs					(14.0)
Profit before tax					**97.6**
Tax					(0.1)
Profit for the period attributable to equity shareholders					**97.5**

	Property	Energy	Marine	Aviation	Total
Loss ratio	37.1%	119.5%	54.0%	10.9%	61.8%
Acquisition cost ratio	12.5%	16.4%	27.5%	20.2%	16.4%
Expense ratio	—	—	—	—	8.1%
Combined ratio	**49.6%**	**135.9%**	**81.5%**	**31.1%**	**86.3%**

Assets and liabilities by business segment – as at 31 December 2008

Assets	US$m Property	US$m Energy	US$m Marine	US$m Aviation	US$m Total
Attributable to business segments	108.3	102.9	40.8	55.3	307.3
Other assets					2,181.7
Total assets					**2,489.0**
Liabilities					
Attributable to business segments	281.2	430.1	111.6	67.0	889.9
Other liabilities					326.4
Total liabilities					**1,216.3**
Total net assets					**1,272.7**

(1) worldwide, including the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area.
(2) worldwide, excluding the US and Canada, comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area, but that specifically exclude the United States of America and Canada.

The Group’s net assets are located primarily in Bermuda. Less than 10 per cent. of total net assets were attributable to the UK operations for the three years ended 31 December 2006, 2007 and 2008.

3. Investment return

The total investment return for the Group is as follows:

	2006	*2007*	*2008*
	US$m	US$m	US$m
Investment income			
– Interest on fixed income securities	33.3	60.0	46.5
– Net amortisation of discount	3.2	2.6	3.5
– Interest income on cash and cash equivalents	19.2	18.6	12.2
– Dividends from equity securities	0.8	0.8	0.9
– Investment management and custodian fees	(2.3)	(3.6)	(3.6)
Net investment income	**54.2**	**78.4**	**59.5**
Net realised and unrealised (losses) gains on other investments	**1.8**	**(3.3)**	**0.1**
Net realised gains (losses) and impairments			
– Fixed income securities	(2.4)	5.0	10.6
– Equity securities	3.2	4.1	(21.6)
Net realised gains (losses) and impairments	**0.8**	**9.1**	**(11.0)**
Net change in unrealised gains recognised in shareholders' equity			
– Fixed income securities	2.6	9.2	16.5
– Equity securities	6.1	3.2	(9.4)
Net change in unrealised gains recognised in shareholders' equity	**8.7**	**12.4**	**7.1**
Total investment return on available for sale investments	**65.5**	**96.6**	**55.7**
Net fair value gains (losses) on investments at fair value through income	**—**	**0.4**	**(0.6)**
Total investment return	**65.5**	**97.0**	**55.1**

Net realised gains and impairments on fixed income and equity securities includes an impairment loss of US$21.6 million (2007 – US$1.3 million, 2006 – US$0.4 million) recognised on fixed income and equity investments held by the Group.

Movements within unrealised gains and losses within shareholders' equity are as follows:

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Fixed income securities			
– Net unrealised gains losses released to income statement	2.4	(2.7)	(3.7)
– Net unrealised gains recorded within equity	0.2	11.5	17.6
– Net unrealised losses released for impairments to income statement	—	0.4	2.6
Equity securities			
– Net unrealised gains released to income statement	(3.6)	(4.4)	(1.0)
– Net unrealised gains (losses) recorded within equity	9.3	7.1	(20.6)
– Net unrealised losses released for impairments to income statement	0.4	0.5	12.2
Net unrealised gains recognised in shareholders' equity	**8.7**	**12.4**	**7.1**

4. Net insurance acquisition expenses

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Insurance acquisition expenses	91.0	101.9	110.0
Changes in deferred insurance acquisition expenses	(51.0)	(6.3)	(3.1)
Insurance acquisition expenses ceded	(7.6)	(19.7)	(6.1)
Changes in deferred insurance acquisition expenses ceded	2.5	0.6	(1.2)
Total	**34.9**	**76.5**	**99.6**

5. Other operating expenses

	2006	2007	2008
	US$m	US$m	US$m
Operating expenses unrelated to underwriting	33.9	60.5	49.3
Equity based compensation	22.5	14.4	10.6
Total	**56.4**	**74.9**	**59.9**

6. Employee benefits

	2006	2007	2008
	US$m	US$m	US$m
Wages and salaries	5.4	12.8	14.2
Pension costs	0.6	0.9	1.2
Bonus and other benefits	7.5	23.1	9.6
Equity based compensation	22.5	14.4	10.6
Total	**36.0**	**51.2**	**35.6**

Equity based compensation

There are three forms of equity based compensation: warrants, a long term incentive plan and a restricted share scheme.

On the admission of the Group's common shares to trading on AIM in December 2005, a pool of warrants to purchase common shares was created. Subsequently, a number of warrants were issued to certain members of management. The warrants that were issued to management were of two types: ordinary warrants and performance warrants. The unissued balance was reserved for future allocation. 648,143 ordinary warrants that had not been issued to management were subsequently issued to the Lancashire Foundation ("**the Foundation**") on 1 December 2007.

All warrants issued to management and the Foundation expire on 16 December 2015 and are exercisable at an initial price per share of US$5.00, equal to the price per share paid by investors in the initial public offering, adjusted for dividend payments made prior to vesting. Settlement is at the discretion of the Group and may be in cash or shares.

Under the terms of the warrants, warrant holders are entitled to receive a payment equivalent to any dividend or distribution that LHL makes to holders of common shares pro-rata, based on the number of warrant shares for which the warrant is then exercisable and have vested in accordance with any time, performance or other criteria, without adjusting the exercise price in respect thereof. In addition, the exercise price of each warrant share that has not become exercisable, and has not vested in accordance with any time, performance, or other criteria at the time of such dividend or other distribution will be adjusted by way of a deduction from such exercise price of an amount equal to the value per common share of any such dividend or other distribution. In January 2008 the exercise price for all unvested warrants was automatically adjusted downwards by US$1.10 per warrant share to reflect the strategic dividend declared on 10 December 2007 and paid to shareholders of record on 11 January 2008.

Management team ordinary warrants ("ordinary warrants")

Ordinary warrants vest on a time basis only and do not have associated performance criteria. 25 per cent. of such warrants vested immediately upon issuance. Thereafter, 25 per cent. of such warrants vest on the first, second and third anniversary of the grant date.

Ordinary warrants	Number	Weighted average exercise price US$
Outstanding as at 31 December 2006	**12,708,695**	**US$5.00**
Exercised during the year	(627,087)	US$5.00
Transferred during the year	(648,143)	US$5.00
Outstanding as at 31 December 2007	**11,433,465**	**US$5.00**
Outstanding as at 31 December 2008	**11,433,465**	**US$4.71**
Exercisable as at 31 December 2008	**11,433,465**	**US$4.71**

The fair value of ordinary warrants granted for all periods was US$2.62 per share as there have been no further issues. A charge of US$3.3 million (2007 – US$7.1 million, 2006 – US$14.5 million) for share-based payment is included in other operating expenses in the consolidated income statement.

Management team performance warrants ("performance warrants")

Performance warrants vest over a four year period and are dependent on certain performance criteria with specific measurement dates of 31 December 2007, 31 December 2008 and 31 December 2009. A maximum of 50 per cent. of performance warrants will vest only on achievement of a fully converted book value per share in comparison to a required appreciation threshold at certain dates. A maximum of 50 per cent. of performance warrants will vest only on achievement of an internal rate of return ("**IRR**") in comparison to a required IRR at certain dates.

Performance warrants	*Number*	*Weighted average exercise price US$*
Outstanding as at 31 December 2006	**7,236,331**	**US$5.00**
Lapsed during the year	(761,985)	US$5.00
Outstanding as at 31 December 2007	**6,474,346**	**US$5.00**
Lapsed during the year	(2,782,659)	US$3.90
Outstanding as at 31 December 2008	**3,691,687**	**US$4.10**
Exercisable as at 31 December 2008	**839,994**	**US$4.85**

The fair value of warrants granted for all periods was US$2.62 per share as there have been no further issues. A credit of US$0.9 million (2007 – US$2.2 million charge, 2006 – US$6.0 million) for share-based payment is included in other operating expenses in the consolidated income statement.

Long term incentive plan ("LTIP") and restricted share scheme ("RSS")

Prior to 4 January 2008 share options could be granted under the long term incentive plan ("**LTIP**") at the discretion of the Remuneration Committee. On 4 January 2008 LHL's shareholders in a Special General Meeting voted in favour of the LHL Board's proposal to close the LTIP to future awards of options and to replace the LTIP with a Restricted Share Scheme ("**RSS**"). Options granted under the LTIP were limited to 5 per cent. of the fully diluted common share capital in issue at the Initial Public Offering date, 16 December 2005. All LTIP options issued will expire ten years from the date of issue. The exercise price for LTIP options issued prior to 2007 is equal to or greater than the average closing price of the shares on the twenty previous trading days prior to grant. The exercise price for options awarded in 2007 is equal to the closing price of the shares by reference to a single valuation date occurring five days after the end of the close period ("close period" as defined in the Glossary to the AIM Rules for Companies – February 2007) most recently concluded prior to grant or five days after the decision to make the award if such decision was made outside a close period.

Long term incentive plan

The range of exercise prices for options awarded under the LTIP are as follows:

31 December 2006		*31 December 2007*		*31 December 2008*	
Low	*High*	*Low*	*High*	*Low*	*High*
£3.25	£3.55	£3.25	£3.55	£2.69	£2.99
US$6.37	US$6.95	US$4.71[1]	US$7.26	US$3.90	US$6.16

(1) adjusted for revaluation at the exchange rate as at 31 December 2008

25 per cent. of LTIP options vest on each of the first, second, third and fourth anniversary of the grant date. There are no associated performance criteria. Settlement is at the discretion of the Group and may be in cash or shares.

The fair value of each LTIP option was estimated on the date of grant using the Black-Scholes option-pricing model. Assumptions used for valuation of these grants were as follows: risk free interest rate range of 3.0 per cent. – 5.125 per cent.; an expected life of four to six years; volatility of 30 per cent. being the maximum contractual rate; dividend yield of US$nil; the Group will settle in shares; no forfeitures, other than leavers which are assumed to be 10 per cent. of total employees, and no dilutive events.

Options	*Number*	*Weighted average exercise price US$*
Outstanding as at 31 December 2006	2,401,943	US$6.56
Granted during the year	4,590,105	US$7.04
Forfeited during the year	(12,709)	US$7.11
Outstanding as at 31 December 2007	6,979,339	US$6.26[(1)]
Forfeited during the year	(86,039)	US$6.10
Outstanding as at 31 December 2008	6,893,300	US$5.24
Exercisable as at 31 December 2008	2,157,899	US$5.28

(1) adjusted for revaluation at the exchange rate as at 31 December 2008

The weighted fair value of options granted during the year ended 31 December 2008 was US$nil as there were no options granted during the year (2007 – US$2.77 per option, 2006 – US$2.32 per option). A share-based payment expense of US$5.5 million (2007 – US$5.1 million, 2006 – US$2.0 million) is included in other operating expenses in the consolidated income statement.

On 4 January 2008 the LHL shareholders also voted in a Special General Meeting to give the Remuneration Committee the discretionary power to adjust the option exercise price to neutralise the devaluing impact of dividend payments on the value of options. On 14 February 2008 the Remuneration Committee exercised this discretionary power and adjusted the exercise price by US$1.10 or £0.5622 per option. The resulting charge to the consolidated income statement was US$1.2 million and a US$nil impact to shareholders' equity.

Restricted Share Scheme – ordinary

The Rules of the RSS approved by the shareholders permit the granting of restricted share awards subject to time and, normally, performance conditions. The ordinary restricted share awards vest after a three year period and are dependent on certain performance criteria. Awards were granted on 28 March and 1 July 2008. A maximum of 50 per cent. of ordinary restricted share awards will vest only on the achievement of a total shareholder return in excess of the 75th percentile of the total shareholder return of a pre-defined comparator group. A maximum of 50 per cent. of ordinary restricted share awards will vest only on the achievement of a return on equity by LHL in excess of a required amount.

Ordinary restricted Shares	*Number*	*Fair value US$*
Outstanding as at 31 December 2007	—	—
Granted during the year	1,851,701	US$5.75
Forfeited during the year	(18,914)	US$5.73
Outstanding as at 31 December 2008	1,832,787	US$5.75
Exercisable as at 31 December 2008	—	—

The fair value of each restricted share granted pursuant to an ordinary restricted share award is equal to the share price of LHL on the date of grant. A share-based payment expense of US$1.1 million is included in other operating expenses in the consolidated income statement.

Restricted Share Scheme – exceptional

The exceptional restricted shares vest after a two year period and do not have associated performance criteria.

Exceptional restricted Shares	*Number*	*Fair value US$*
Outstanding as at 31 December 2007	—	—
Granted during the year	166,904	US$5.73
Outstanding as at 31 December 2008	166,904	US$5.73

The fair value of each restricted share granted pursuant to an exceptional restricted share award is equal to the share price of LHL on the date of grant. A share-based payment expense of US$0.4 million is included in other operating expenses in the consolidated income statement.

7. Results of operating activities

Results of operating activities are stated after charging the following amounts:

	2006	2007	2008
	US$m	US$m	US$m
Depreciation on owned assets	0.6	1.4	1.1
Operating lease charges	1.1	1.8	1.8
Auditors remuneration			
– Group audit fees	0.7	1.3	1.2
– Other services	0.3	0.2	0.2
Total	**2.7**	**4.7**	**4.3**

Fees paid to the Group's auditors for other services are approved by the Group's Audit Committee. Such fees comprise the following amounts:

	2006	2007	2008
	US$m	US$m	US$m
Tax advice	0.1	0.1	0.1
FSA regulatory advice	0.2	—	—
Other	—	0.1	0.1
Total	**0.3**	**0.2**	**0.2**

8. Tax

Bermuda

LHL, LICL and LUK have received an undertaking from the Bermuda government exempting them from all Bermuda local income, withholding and capital gains taxes until 28 March 2016. At the present time no such taxes are levied in Bermuda.

United States

The Group does not consider itself to be engaged in trade or business in the United States and, accordingly, does not expect to be subject to United States taxation on its income or capital gains.

United Kingdom

The UK subsidiaries are subject to normal UK corporation tax on all their profits.

	2006	2007	2008
Tax Charge	US$m	US$m	US$m
Corporation tax charge for the year	1.0	2.1	(0.3)
Adjustments in respect of prior year corporation tax	—	0.1	(0.4)
Deferred tax for the year	(0.8)	(1.1)	0.3
Adjustments in respect of prior year deferred tax	—	(0.1)	0.5
Total	**0.2**	**1.0**	**0.1**

	2006	2007	2008
Tax Reconciliation	US$m	US$m	US$m
Profit before tax	159.5	391.9	97.6
Less profit not subject to tax	(161.6)	(389.0)	(101.9)
Profits subject to tax	(2.1)	2.9	(4.3)
UK corporation tax at weighted average rate	(0.6)	0.9	(1.2)
Adjustments in respect of prior period	—	—	0.1
Non-deductible expenses	—	0.1	—
Other expense timing differences	0.8	(0.1)	1.2
Deferred tax at a rate other than weighted average rate	—	0.1	—
Total	**0.2**	**1.0**	**0.1**

As at 1 April 2008 the standard rate of corporation tax in the UK is 28 per cent. (2007 – 30 per cent., 2006 – 30 per cent.). The weighted average rate for 2008 is 28.5 per cent. For all previous periods the standard rate and the weighted average rate was 30 per cent. The current tax charge as a percentage of the Group's profit before tax is 0.1 per cent. (2007 – 0.3 per cent., 2006 – 0.1 per cent.) due to the different tax paying jurisdictions throughout the Group.

A current corporation tax expense of US$0.2 million was charged to shareholders' equity during the year (2007 – US$0.4 million, 2006 – US$nil), which relates to unrealised investment gains and losses recognised directly in fair value and other reserves within shareholders' equity.

	2006	*2007*	*2008*
Taxation payable	*US$m*	*US$m*	*US$m*
UK corporation tax payable	1.0	1.2	—

9. Deferred tax

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Deferred tax assets	0.8	2.0	2.4
Deferred tax liabilities	—	—	(1.2)
Net deferred tax asset	**0.8**	**2.0**	**1.2**

Deferred tax assets are recognised to the extent that realising the related tax benefit through future taxable profits is likely. It is anticipated that the Lancashire UK group of companies will be profitable in 2009, thus the entire deferred tax asset is recognised.

The deferred tax asset relates to the warrants, options and restricted stock employee benefit schemes and tax losses carried forward. The deferred tax liability relates to claims equalisation reserves. All deferred tax assets and liabilities are classified as non-current.

The movement on the total net deferred tax asset is as follows:

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
As at 1 January	—	0.8	2.0
Income statement credit	0.8	1.2	(0.8)
As at 31 December	**0.8**	**2.0**	**1.2**

10. Cash and cash equivalents

	2006	*2007*	*2008*
	US$m	*US$m*	*US$m*
Cash at bank and in hand	50.0	22.8	7.9
Cash equivalents	350.1	714.5	405.7
Total	**400.1**	**737.3**	**413.6**

Cash equivalents have an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

Cash and cash equivalents totalling US$24.5 million (2007 – US$22.1 million, 2006 – US$10.9 million) were on deposit in various trust accounts for the benefit of policyholders or counter-parties to agreements to cover their credit risk.

Cash and cash equivalents totalling US$37.7 million (2007 – US$36.9 million, 2006 – US$25.1 million) were on deposit as collateral in favour of letters of credit issued for the benefit of policyholders or counter-parties to cover their credit risk.

Cash and cash equivalents totalling US$2.8 million (2007 – US$nil, 2006 – US$nil) were on deposit as collateral for the benefit of the counter-party to the interest rate swaps.

11. Investments

	As at 31 December 2006			
	US$m	*US$m*	*US$m*	*US$m*
	Cost or amortised cost	*Gross unrealised gain*	*Gross unrealised loss*	*Estimated fair value*
Fixed income securities				
– Short-term investments	6.9	—	—	6.9
– US treasuries	30.8	—	—	30.8
– US government agency debt	150.3	0.2	(0.1)	150.4
– Asset backed securities	121.0	0.2	(0.1)	121.1
– US government agency mortgage backed securities	214.0	0.9	(0.3)	214.6
– Non-agency mortgage backed securities	151.6	1.1	(0.2)	152.5
– Corporate bonds	190.2	1.1	(0.2)	191.1
– Convertible debt securities	28.9	—	—	28.9
Total fixed income securities – available for sale	893.7	3.5	(0.9)	896.3
Equity securities – available for sale	64.2	7.0	(0.9)	70.3
Total available for sale securities	957.9	10.5	(1.8)	966.6
Other investments – at fair value through income (note 20)	9.7	1.9	(0.1)	11.5
Total investments	**967.6**	**12.4**	**(1.9)**	**978.1**

	As at 31 December 2007			
	US$m	*US$m*	*US$m*	*US$m*
	Cost or amortised cost	*Gross unrealised gain*	*Gross unrealised loss*	*Estimated fair value*
Fixed income securities				
– Short-term investments	0.7	—	—	0.7
– US treasuries	251.6	2.9	(0.1)	254.4
– US government agency debt	206.5	2.8	—	209.3
– US government agency mortgage backed securities	237.2	4.0	(0.1)	241.1
– Non-agency mortgage backed securities	7.0	—	—	7.0
– Corporate bonds	341.1	3.5	(1.3)	343.3
– Convertible debt securities	13.9	0.3	(0.3)	13.9
Total fixed income securities – available for sale	1,058.0	13.5	(1.8)	1,069.7
Equity securities – available for sale	62.2	12.1	(2.7)	71.6
Total available for sale securities	1,120.2	25.6	(4.5)	1,141.3
Fixed income securities – at fair value through income	23.1	0.8	(0.4)	23.5
Other investments – at fair value through income (note 20)	4.4	0.4	(0.4)	4.4
Total investments	**1,147.7**	**26.8**	**(5.3)**	**1,169.2**

Equity securities and other investments are deemed non-current. Fixed income maturities are presented in the risk disclosures section on page 78.

	As at 31 December 2008			
	US$m	US$m	US$m	US$m
	Cost or amortised cost	*Gross unrealised gain*	*Gross unrealised loss*	*Estimated fair value*
Fixed income securities				
– Short-term investments	163.6	—	—	163.6
– US treasuries	186.8	6.5	(1.6)	191.7
– Other government bonds	52.5	1.6	—	54.1
– US government agency debt	109.1	5.4	—	114.5
– US government agency mortgage backed securities	600.0	15.3	(0.9)	614.4
– Corporate bonds	306.6	3.8	(6.9)	303.5
– Corporate bonds – FDIC guaranteed(1)	148.4	5.0	—	153.4
Convertible debt securities	0.2	—	—	0.2
Total fixed income securities – available for sale	1,567.2	37.6	(9.4)	1,595.4
Equity securities – available for sale	5.8	—	—	5.8
Total available for sale securities	1,573.0	37.6	(9.4)	1,601.2
Fixed income securities – at fair value through income (note 20)	4.3	—	(0.3)	4.0
Total investments	**1,577.3**	**37.6**	**(9.7)**	**1,605.2**

(1) FDIC guaranteed corporate bonds are protected by the Federal Deposit Insurance Corporation, an independent agency of the United States government.

12. Investment in associate

On 15 June 2006 the Group made an investment of US$20.0 million which represented a 21.1 per cent. interest in Sirocco Holdings Limited ("**Sirocco**"), a company incorporated in Bermuda. Sirocco's operating subsidiary, Sirocco Reinsurance Limited ("**Sirocco Re**"), was authorised as a Class 3 insurer by the BMA. Sirocco Re was established to assume Gulf of Mexico energy risks from the Group. Effective 31 December 2007, the reinsurance agreement entered into with Sirocco Re was commuted. Sirocco entered into a members' voluntary liquidation on 12 June 2008 and was dissolved on 17 September 2008.

	2006	*2007*	*2008*
		US$m	
As at 1 January	—	23.2	22.9
Acquisition	20.0	—	—
Share of profit of associate	3.2	6.2	(0.2)
Dividends received	—	(6.5)	(22.7)
As at 31 December	**23.2**	**22.9**	**—**

Key financial information for Sirocco for the three years ended 31 December 2006, 31 December 2007 and 31 December 2008 is as follows:

	2006	*2007*	*2008*
		US$m	
Assets	124.6	117.0	—
Liabilities	14.3	8.2	—
Shareholders' equity	110.3	108.8	—
Revenues	18.6	36.4	—
(Loss)Profit	15.2	29.8	(1.5)

13. Insurance and reinsurance contracts

Insurance liabilities	*Unearned premiums*	*Other payables*	*Total*
		US$m	
As at 31 December 2005	2.6	—	2.6
Current year	323.1	—	323.1
Other	—	5.2	5.2
As at 31 December 2006	**325.7**	**5.2**	**330.9**
Net deferral for:			
Prior years	(281.6)	—	(281.6)
Current year	337.7	—	337.7
Other	—	11.3	11.3
As at 31 December 2007	**381.2**	**16.5**	**398.3**
Net deferral for:			
Prior years	(317.5)	—	(317.5)
Current year	275.3	—	275.3
Other	—	1.1	1.1
As at 31 December 2008	**339.0**	**17.6**	**357.2**

Losses and loss adjustment expenses	*Losses and loss adjustment expenses*	*Losses and loss adjustment expenses recoverable*	*Net losses and loss adjustment expenses*
		US$m	
As at 31 December 2005	—	—	—
Net incurred losses for:			
Current year	39.1	—	39.1
As at 31 December 2006	**39.1**	**—**	**39.1**
Net incurred losses for:			
Prior years	(4.4)	—	(4.4)
Current year	154.4	(3.7)	150.7
Exchange adjustments	0.4	0.1	0.5
Incurred losses and loss adjustment expenses	**150.4**	**(3.6)**	**146.8**
Net paid losses for:			
Prior years	4.7	—	4.7
Current year	5.2	—	5.2
Paid losses and loss adjustment expenses	**9.9**	**—**	**9.9**
As at 31 December 2007	**179.6**	**(3.6)**	**176.0**
Net incurred losses for:			
Prior years	(26.0)	(2.6)	(28.6)
Current year	444.8	(40.7)	404.1
Exchange adjustments	(0.5)	—	(0.5)
Incurred losses and loss adjustment expenses	**418.3**	**(43.3)**	**375.0**
Net paid losses for:			
Prior years	34.6	(0.4)	34.2
Current year	34.5	(4.4)	30.1
Paid losses and loss adjustment expenses	**69.1**	**(4.8)**	**64.3**
As at 31 December 2008	**528.8**	**(42.1)**	**486.7**

Reinsurance assets and liabilities	*Unearned premiums*	*Other payables*	*Other receivables*	*Total*
		US$m		
As at 31 December 2005				
Current year	19.1	—	—	19.1
Other	—	(0.8)	—	(0.8)
As at 31 December 2006	**19.1**	**(0.8)**	**—**	**18.3**
Net deferral for:				
Prior years	(19.1)	—	—	(19.1)
Current year	19.6	—	—	19.6
Other	—	(4.9)	8.2	3.3
As at 31 December 2007	**19.6**	**(5.7)**	**8.2**	**22.1**
Net deferral for:				
Prior years	(18.6)	—	—	(18.6)
Current year	9.0	—	—	9.0
Other	—	3.7	(5.0)	(1.3)
As at 31 December 2008	**10.0**	**(2.0)**	**3.2**	**11.2**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section, which starts on page 65. The risks associated with general insurance contracts are complex and do not readily lend themselves to meaningful sensitivity analysis. The impact of an unreported event could lead to a significant increase in our loss reserves. The Group believes that the loss reserves established are adequate, however a 20 per cent. increase in estimated losses would lead to a US$105.8 million (2007 – US$35.9 million, 2006 – US$7.8 million) increase in loss reserves. There was no change to reserving assumptions during the year.

The split of losses and loss adjustment expenses between notified outstanding losses, additional case reserves assessed by management and losses incurred but not reported is shown below:

	2006	*2007*	*2008*
		US$m	
Outstanding losses	1.2	56.0	303.4
Additional case reserves	—	17.8	63.8
Losses incurred but not reported	37.9	105.8	161.6
Losses and loss adjustment expenses	**39.1**	**179.6**	**528.8**

It is estimated that our reserve for unpaid losses and loss adjustment expenses has a duration of approximately two years.

Claims development

The development of insurance liabilities is indicative of the Group's ability to estimate the ultimate value of its insurance liabilities. The Group began writing insurance and reinsurance business in December 2005. Due to the underlying risks and lack of known loss events occurring during the period to 31 December 2005, the Group does not expect to incur any losses from coverage provided in 2005. Accordingly, the loss development tables do not include that year.

Accident year	2006	2007	2008
		US$m	
Gross claims			
Estimate of net ultimate liability[1]			
At end of accident year	39.1	154.8	444.6
One year later	34.7	131.2	—
Two years later	32.0	—	—
Current estimate of cumulative liability	**32.0**	**131.2**	**444.6**
Payments made	**(18.8)**	**(25.7)**	**(34.5)**
Total gross liability	**13.2**	**105.5**	**410.1**

Accident year	2006	2007	2008
		US$m	
Reinsurance			
Estimate of net ultimate liability[1]			
At end of accident year	—	3.6	40.7
One year later	—	6.2	—
Two years later	—	—	—
Current estimate of cumulative liability	—	**6.2**	**40.7**
Total gross recovery	—	**(0.4)**	**(4.4)**
	—	**5.8**	**36.3**

Accident year	2006	2007	2008
		US$m	
Net claims			
Estimate of net ultimate liability[1]			
At end of accident year	39.1	151.2	403.9
One year later	34.7	125.0	—
Two years later	32.0	—	—
Current estimate of net cumulative liability	**32.0**	**125.0**	**403.9**
Payments made	**(18.8)**	**(25.3)**	**(30.1)**
Total net liability	**13.2**	**99.7**	**373.8**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2008.

The inherent uncertainty in reserving gives rise to favourable or adverse development on the established reserves. The total favourable development on net losses and loss adjustment expenses from prior years was US$28.6 million (2007 – US$4.4 million, 2006 – US$nil) with US$26.0 million (2007 – US$nil, 2006 – US$nil) from the 2007 accident year and US$2.6 million (2007 – US$4.4 million, 2006 – US$nil) from the 2006 accident year.

Prior to the hurricane season of 2008 there were no major loss events that impacted the Group's losses and loss adjustment expenses. During the 2008 hurricane season, Hurricanes Gustav and Ike passed through the Gulf of Mexico oil fields, making landfall in the United States. Hurricane Ike was a particularly destructive storm, causing damage to and destruction of a significant number of oil platforms. US$172.7 million, before tax, in relation to Hurricane Gustav and Ike is included within the Group's net insurance losses with US$206.7 million in losses and loss adjustment expenses and US$34.0 million in losses and loss adjustment expenses recoverable. Reinstatement premium of US$8.9 million was earned as a result of these losses. The impact of tax and other adjustments brings the overall net financial impact to the Group to US$152.9 million. Estimation of the ultimate liability is complex for offshore losses. Loss assessments require skilled loss adjusters. The availability of loss adjusters with the necessary expertise is scarce and large events put a further strain on this resource. A substantial degree of judgement is involved in assessing the ultimate cost of Hurricanes Gustav and Ike and the amount could be materially different from that currently reported. Management's best estimate of losses and loss adjustment expenses, net of reinsurance and reinstatement premiums but before taxes and other adjustments, for Hurricanes Gustav and Ike is US$163.8 million. Using a lognormal distribution with a standard deviation of US$25.0 million a confidence interval was derived around the best estimate. The 90th percentile of this distribution is US$196.9 million, which would be an increase of US$33.1 million over the current best estimate. The 95th percentile is US$208.0 million, or an increase of US$44.2 million.

14. Insurance, reinsurance and other receivables

	2006	2007	2008
		US$m	
Inwards premium receivable from insureds and cedants	173.7	198.2	187.3
Accrued interest receivable	7.5	9.8	10.1
Reinsurance assets – other receivables	—	8.2	3.2
Other receivables	6.3	3.8	154.0
Reinsurance assets – reinsurance recoveries	—	3.6	42.1
Total receivables	**187.5**	**223.6**	**396.7**

Other receivables consist primarily of unsettled investment trades. All receivables are considered current other than US$24.0 million (2007 – US$10.6 million, 2006 – US$8.9 million) of inwards premium receivable related to multi-year contracts. The carrying value approximates fair value due to the short-term nature of the receivables. There is no significant concentration of credit risk within the Group's receivables.

15. Deferred acquisition costs

The reconciliation between opening and closing deferred acquisition costs is shown below:

	US$m
As at 31 December 2005	**0.5**
Net deferral during the year	91.0
Income recognised for the year	(40.0)
As at 31 December 2006	**51.5**
Net deferral during the year	101.9
Income recognised for the year	(95.6)
As at 31 December 2007	**57.8**
Net deferral during the year	110.0
Income recognised for the year	(106.9)
As at 31 December 2008	**60.9**

16. Insurance, reinsurance and other payables

	2006	2007	2008
		US$m	
Dividends payable	—	239.1	—
Other payables	20.8	57.1	190.3
Total other payables	**20.8**	**296.2**	**190.3**
Insurance contracts – other payables	5.2	16.5	17.6
Amounts payable to reinsurers	0.8	5.7	2.0
Total payables	**26.8**	**318.4**	**209.9**

Dividends payable are discussed in note 21. Other payables include unsettled investment trades, unsettled share repurchases and other accruals. Insurance payables relate to amounts due to policyholders for profit commission, return premiums and claims payable. All payables are considered current. The carrying value approximates fair value due to the short-term nature of the payables.

17. Deferred acquisition costs ceded

The reconciliation between opening and closing deferred acquisition costs ceded is shown below:

	US$m
As at 31 December 2005	—
Net deferral during the year	7.6
Income recognised for the year	(5.1)
As at 31 December 2006	**2.5**
Net deferral during the year	19.7
Income recognised for the year	(19.1)
As at 31 December 2007	**3.1**
Net deferral during the year	6.1
Income recognised for the year	(7.3)
As at 31 December 2008	**1.9**

18. Property, plant and equipment

	Office furniture and equipment	*Leasehold improvements*	*IT equipment*	*Total*
		US$m		
Cost				
As at 1 January 2006	**—**	**—**	**0.4**	**0.4**
Additions	1.0	0.6	1.0	2.6
As at 31 December 2006	**1.0**	**0.6**	**1.4**	**3.0**
Additions	0.5	0.6	0.2	1.3
As at 31 December 2007	**1.5**	**1.2**	**1.6**	**4.3**
Additions	0.1	—	0.1	0.2
As at 31 December 2008	**1.6**	**1.2**	**1.7**	**4.5**
Accumulated depreciation				
As at 1 January 2006	**—**	**—**	**—**	**—**
Charge for the year	0.2	0.1	0.3	0.6
As at 31 December 2006	**0.2**	**0.1**	**0.3**	**0.6**
Charge for the year	0.7	0.2	0.5	1.4
As at 31 December 2007	**0.9**	**0.3**	**0.8**	**2.0**
Charge for the year	0.3	0.3	0.5	1.1
As at 31 December 2008	**1.2**	**0.6**	**1.3**	**3.1**
Net book value				
As at 31 December 2006	**0.8**	**0.5**	**1.1**	**2.4**
As at 31 December 2007	**0.6**	**0.9**	**0.8**	**2.3**
As at 31 December 2008	**0.4**	**0.6**	**0.4**	**1.4**

19. Long-term debt and financing arrangements

	2006	*2007*	*2008*
		US$m	
Subordinated loan note of US$97.0 million	97.0	97.0	97.0
Subordinated loan note of €24.0 million	31.6	35.3	33.8
Carrying value and fair value	**128.6**	**132.3**	**130.8**

On 15 December 2005 the Group issued, via a trust company, US$97.0 million in aggregate principal amount of subordinated loan notes and €24.0 million in aggregate principal amount of subordinated loan notes (“**long-term debt**”) at an issue price of US$1,000 and €1,000 of their principal amounts respectively. Due to the floating interest rates, the carrying value approximates fair value.

The US dollar subordinated loan notes are repayable on 15 December 2035 with a prepayment option available from 15 March 2011. Prior to 15 March 2011, upon the occurrence and during the continuation of a "Special Event", LHL may, at its option, redeem the securities, in whole but not in part, at a sliding scale redemption price. A Special Event is a change in the tax and/or investment status of the issuing trust. Interest on the principal is based on a set margin (3.7 per cent.) above the variable Libor rate and is payable quarterly.

The Euro subordinated loan notes are repayable on 15 June 2035 with a prepayment option available from 15 March 2011. Prior to this time prepayment would only be available in the event of a "Special Event". Interest on the principal is based on a set margin (3.7 per cent.) above the variable Euribor rate and is payable quarterly. The Group is exposed to cash flow interest rate risk and currency risk. Further information is provided in the risk disclosures section from page 65.

The interest accrued on the loans payable was US$0.4 million (2007 – US$0.5 million, 2006 - US$0.5 million) at the balance sheet date. The interest expense for the year was US$9.8 million (2007 – US$11.6 million, 2006 - US$10.6 million).

Letters of credit

As both LICL and LUK are non-admitted insurers or reinsurers throughout the US, the terms of certain contracts require them to provide letters of credit to policyholders as collateral. On 16 July 2007, LHL and LICL re-financed its syndicated credit facility in the amount of US$200.0 million for a five year term. The facility contains a US$75.0 million loan sub-limit available for general corporate purposes.

The facility is available for the issue of letters of credit ("**LOCs**") to ceding companies. The facility is also available for LICL to issue LOCs to LUK to collateralise certain insurance balances. As at 31 December 2008, letters of credit totalling US$61.9 million had been issued to LUK (2007 – US$61.9 million, 2006 – US$nil). Letters of credit totalling US$26.7 million (2007 – US$37.0 million, 2006 – US$25.1 million) had been issued to third parties by LICL and there was no outstanding debt under this facility (2007 – US$nil, 2006 – US$nil). Letters of credit are required to be fully collateralised. As at 31 December 2008 US$118.0 million (2007 – US$110.8 million, 2006 – US$25.1 million) of collateral had been posted to a trust account, the beneficiaries of which are the banks who have issued letters of credit on LICL's behalf. Under the terms of the facility, investments in the trust account are subject to various discounts to allow for market fluctuations in the investments provided as security. The discounts are determined per investment type.

The facility terms also include standard default and cross default provisions which require certain covenants to be adhered to. These include the following:

- a financial strength rating of at least B++; and
- a maximum debt to capital ratio of 30 per cent., where the current long-term debt issuance is excluded from this calculation.

As at and for the years ended 31 December 2007 and 2008 the Group was in compliance with all covenants under this facility.

20. Derivative financial instruments

The Group hedges a portion of its floating rate borrowings using interest rate swaps to transfer floating to fixed rate. These instruments are held at estimated fair value through profit and loss. During the year, US$3.6 million (2007 – US$1.3 million, 2006 – US$1.0 million) was charged to financing costs in respect of the interest rate swap. The net fair value position owed by the Group was US$4.9 million (2007 – US$2.2 million, 2006 – US$0.9 million). The Group has the right to net settle these instruments. The next cash settlement due on these instruments is US$0.5 million (2007 – negligible, 2006 – negligible) and is due on 15 March 2009. The counter-party requires collateralisation of positions in excess of US$2.0 million. These instruments will expire on 15 March 2011.

The Group invests a small portion of its investment portfolio in convertible debt securities. The option to convert is an embedded derivative, which is required to be bifurcated from the host contract with changes in estimated fair value recorded through income, unless the security has been designated as at fair value through profit and loss. As at 31 December 2008 the derivative instrument was valued at US$nil (2007 – US$4.4 million, 2006 – US$11.5 million), with changes in net realised gains of US$0.1 million (2007 – US$1.8 million change in net unrealised losses, 2006 – US$1.8 million changes in net realised gains) reflected in the consolidated income statement in other investment income (losses).

The Group occasionally invests in the mortgage backed securities "to be announced" securities. These instruments may be physically settled or net settled. Net settled instruments are deemed to be derivatives and changes in estimated fair value recognised in current period income. As at 31 December 2008 and 2007 the Group did not hold any such instruments and no realised gains or losses were recorded in the consolidated income statement.

The Group entered into a contingent equity physically settled put option on 13 June 2007. The option gave the Group the right to put up to 9,786,000 shares to the counter-party at a guaranteed price of US$5.00 per share or the available market rate, if higher. The option expired on 30 November 2007. There was no obligation to exercise the option. During 2007 US$1.1 million was charged to financing costs in respect of the option, and US$1.5 million was charged to other investment income (losses) in respect of the value of the derivative at inception of the contract which expired unexercised.

21. Share capital

Authorised ordinary shares of US$0.50 each	*Number*	*US$m*
As at 31 December 2006, 2007 and 2008	**3,000,000,000**	**1,500**

Allocated, called up and fully paid	*Number*	*US$m*
As at 31 December 2005	**195,713,902**	**97.9**
Shares issued	113,219	—
Shares repurchased	(83,775)	—
As at 31 December 2006	**195,743,346**	**97.9**
Shares issued	627,087	0.1
Shares repurchased	(14,087,338)	(6.9)
As at 31 December 2007	**182,283,095**	**91.1**
Shares repurchased	(9,433,168)	—
As at 31 December 2008	**172,849,927**	**91.1**

On 15 May 2007, 127,087 shares were issued and 94,447 repurchased as part of a cashless exercise of warrants (see note 22). On 15 August 2007, 500,000 shares were issued and 351,975 repurchased as part of a cashless exercise of warrants (see note 22).

The Board of Directors granted share repurchase authorisations as follows:

Date	*Authorisation*
	US$m
29 October 2007	100.0
30 April 2008	25.0
9 June 2008	25.0
1 July 2008	25.0
Total	**175.0**

An amount of US$17.0 million of approved repurchase remains in place under the current authorisations.

To date, shares have been repurchased as follows:

Date	*Number of shares*	*Weighted average share price*	*US$m*
9 November – 18 December 2007(1) (2)	13,640,916	£3.54	100.2
12 May – 10 June 2008(3)	3,965,590	£3.19	25.0
13 June – 13 August 2008(3)	4,143,657	£3.05	25.0
13 August – 29 August 2008(3)	1,323,921	£3.24	8.0
Total	**23,074,084**	**£3.37**	**158.2**

(1) Due to the movement of exchange rates between trade and settlement dates, the amount paid for the US$100.0 million share repurchase programme was US$100.2 million versus the authorised program of US$100.0 million. The variance was ratified by the Board of Directors on 14 February 2008.

(2) These shares were repurchased and cancelled.

(3) These shares were repurchased and transferred to treasury shares.

Shares were repurchased from significant founding shareholders as follows:

(i) On 9 November 2007 the Group repurchased 6,026,925 of its common shares of US$0.50 par value per share at a price of £3.55 per common share. The sellers were SAB Capital Partners, L.P., SAB Capital Partners II, L.P., and SAB Overseas Master Fund, L.P. (together "**SAB**").

(ii) On 15 November 2007 the Group repurchased 5,000,000 of its common shares of US$0.50 par value per share at a price of £3.50 per common share. As part of the transaction, the Group repurchased 3,000,000 of its common shares from Och-Ziff Management, L.P. and affiliated investment funds (together, "**Och-Ziff**").

At the balance sheet date US$0.2 million (2007 – US$10.5 million, 2006 – US$nil) was yet to be settled.

On 10 December 2007 the Board of Directors authorised the payment of a strategic dividend of US$1.10 (£0.5622) per common share to be paid in pounds sterling to shareholders of record on 11 January 2008 with a settlement date of 25 January 2008. The total dividend amount payable was US$239.1 million and was recorded in other payables in the consolidated balance sheet.

22. Warrants, options and restricted shares

Warrants	*Number*	*Number*	*Number*	*Number*
	Founder's warrants	*Foundation warrants*	*Management ordinary warrants*	*Management performance warrants*
Outstanding as at 31 December 2006	**25,303,917**	**—**	**12,708,695**	**7,625,218**
	—			
Exercised	—	—	(627,087)	—
Lapsed	—	—	—	(802,935)
Transferred	—	648,143	(648,143)	—
Outstanding as at 31 December 2007	**25,303,917**	**648,143**	**11,433,465**	**6,822,283**
Lapsed	—	—	—	(2,932,201)
Outstanding as at 31 December 2008	**25,303,917**	**648,143**	**11,433,465**	**3,890,082**
Exercisable as at 31 December 2008	**25,303,917**	**648,143**	**11,433,465**	**839,994**

Options and restricted shares	*Number*	*Number*	*Number*
	Options	*Ordinary restricted shares*	*Exceptional restricted shares*
Outstanding as at 31 December 2005			
Issued	2,503,613	—	—
Forfeited	(101,670)	—	—
Exercised	—	—	—
Outstanding as at 31 December 2006	**2,401,943**	**—**	**—**
Issued	4,590,105	—	—
Forfeited	(12,709)	—	—
Outstanding as at 31 December 2007	**6,979,339**	**—**	**—**
Issued	—	1,851,701	166,904
Forfeited	(86,039)	(18,914)	—
Outstanding as at 31 December 2008	**6,893,300**	**1,832,787**	**166,904**
Exercisable as at 31 December 2008	**2,157,899**	**—**	**—**

All warrants issued will expire on 16 December 2015 and are exercisable at an initial price per share of US$5.00 equal to the price per share paid by investors in the initial public offering on 16 December 2005. The warrant holder may request a cashless exercise. The method of settlement is at the discretion of the Group and may be in cash or shares. In January 2008 the exercise price for all unvested warrants was automatically adjusted downwards by US$1.10 per warrant share to reflect the strategic dividend declared on 10 December 2007 and paid to shareholders of record on 11 January 2008.

Founders' warrants issued in 2005 were issued to the Group's founders' for providing expertise, resources and relationships during the Group's incorporation, and to one of the Group's sponsors for incorporation services. These warrants were fully vested at the date of grant and exercisable upon issuance. In 2006 the sponsor holding founders' warrants sold its entire holding of warrants to an unrelated third party. The weighted average exercise price for all founders' warrants at 31 December 2008 is US$5.00.

In December 2007 allocated but unissued ordinary time-vesting warrants were issued to the Foundation, a charity established under Bermuda Law. Refer to note 25 for additional information on the Foundation. These ordinary time-vesting warrants were issued from the ordinary warrants that remained allocated but unissued to management. As at 31 December 2008 these warrants are fully vested and exercisable. The weighted average exercise price for the foundation warrants is US$4.73. Management warrants, options and restricted shares are discussed in note 6. Included in the table above are 198,395 (2007 – 347,937, 2006 – 388,886) management performance warrants that remain unallocated.

23. Lease commitments

The Group has payment obligations in respect of operating leases for certain items of office equipment and office space. Operating lease expenses for the period were US$1.8 million (2007 – US$1.8 million, 2006 – US$1.1 million). Future minimum lease payments under non-cancellable operating leases are as follows:

	2006	*2007*	*2008*
		US$m	
Due in less than one year	1.2	1.9	1.7
Due between one and five years	4.5	2.3	6.7
Due in more than five years	0.3	—	—
Total	**6.0**	**4.2**	**8.4**

In January 2008 LICL entered into an agreement to lease new office premises in Bermuda. The lease will be for a five year period and is due to commence in 2009 upon completion of construction. The lease obligations as currently drafted are included in the table above.

24. Earnings per share

Basic earnings per share amounts are calculated by dividing net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to shareholders by the weighted average number of common shares outstanding during the year plus the weighted average number of common shares that would be issued on the conversion of all potentially dilutive common shares into common shares.

The following reflects the profit and share data used in the basic and diluted earnings per share computations:

	2006	*2007*	*2008*
		US$m	
Profit for the year attributable to equity shareholders	159.3	390.9	97.5

	Number of shares thousands	*Number of shares thousands*	*Number of shares thousands*
Basic weighted average number of shares	195,714	194,201	177,468
Potentially dilutive shares related to share-based compensation	6,325	10,959	7,683
Diluted weighted average number of shares	202,039	205,160	185,151

Share based payments are only treated as dilutive when their conversion to common shares would decrease earnings per share or increase loss per share from continuing operations. In the current period, incremental shares from the assumed exercising of performance warrants, where relevant performance criteria are based on future dates, are not included in calculating dilutive shares. In addition, the options which are antidilutive are not included in the number of potentially dilutive shares. Unvested restricted shares without performance criteria are also included in the number of potentially dilutive shares.

In the prior period, incremental shares from the assumed exercising of performance warrants are not included in calculating dilutive shares as the relevant criteria had not been met. In addition, the options were antidilutive and were therefore not included in the number of potentially dilutive shares.

25. Related party disclosures

The consolidated financial statements include Lancashire Holdings Limited and the entities listed below:

Name	*Domicile*
Lancashire Insurance Company Limited	Bermuda
Lancashire Insurance Marketing Services Limited	United Kingdom
Lancashire Holdings Financing Trust I	United States
Lancashire Holdings Employee Benefit Trust	Jersey
Lancashire Insurance Holdings (UK) Limited	United Kingdom
Lancashire Insurance Company (UK) Limited	United Kingdom
Lancashire Insurance Services Limited	United Kingdom
Lancashire Marketing Services (Middle East) Limited	United Arab Emirates

All subsidiaries are wholly owned, either directly or indirectly.

The Group has issued loan notes via a trust vehicle – Lancashire Holdings Financing Trust I (the "**Trust**") (see note 19). The Group effectively has 100 per cent. of the voting rights in the Trust. These rights are subject to the property trustee's obligations to seek the approval of the holders of the Trust's preferred securities in case of default and other limited circumstances where the property trustee would enforce its rights. While the ability of the Group to influence the actions of the Trust is limited by the Trust Agreement, the Trust was set up by the Group with the sole purpose of issuing the loan notes and is in essence controlled by the Group, and is therefore consolidated.

On 14 February 2008 the Group established the Lancashire Holdings Employee Benefit Trust (the "**EBT**") as to assist in the administration of the Group's employee incentive arrangements equity based compensation schemes. The EBT has not undertaken any transactions during 2008. While the Group does not have legal ownership of the EBT, and the ability of the Group to influence the actions of the EBT is limited by the Trust Deed, the EBT was set up by the Group with the sole purpose of assisting in the administration of these schemes and is, in essence, controlled by the Group, and is therefore consolidated.

Key management compensation

Remuneration for key management (meaning the Group's three executive directors) for the year ending 31 December was as follows:

	2006	*2007*	*2008*
		US$m	
Short-term compensation	4.5	11.3	5.3
Equity based compensation	12.1	10.8	5.8
Total	**16.6**	**22.1**	**11.1**

Transactions with directors and shareholders

Significant shareholders have a representation on the Board of Directors. During the year the Group paid US$1.8 million (2007 – US$1.2 million, 2006 – US$0.9 million) in directors' fees and expenses, including US$0.7 million (2007 – US$0.5 million, 2006 – US$0.4 million) to directors representing significant shareholders. A further US$0.2 million (2007 – US$0.2 million, 2006 – US$0.3 million) was paid in respect of monitoring fees for significant founding shareholders.

Transactions with associates

There was no cession to Sirocco Re during 2008. During 2007 the Group ceded US$25.1 million (2006 – US$29.9 million) of premium to Sirocco Re and received US$11.6 million (2006 – US$5.4 million) of commission income. As at 31 December 2007 US$8.2 million was included in reinsurance assets – other receivables in the consolidated balance sheet. The final profit commission of US$7.8 million was included in other receivables of US$8.2 million.

Transactions with Lancashire Foundation

On 1 December 2007 648,143 warrants were allocated to the Foundation. As a result the initial funding of the Foundation was achieved with no impact on LHL's return on equity.

As at 31 December 2007, LHL had loaned the Foundation US$0.4 million (2007 – US$0.4 million, 2006 – US$nil) evidenced by limited resource promissory notes executed by the Foundation Trustees in favour of LHL. The loans were made to fund the Foundation's activities pending the exercise of the warrants donated to the Foundation. They are interest free and payable on demand. Subsequent to 31 December 2007 the loan was repaid in full.

On 30 April 2008 the Board of Directors approved a cash donation of US$1.0 million (2007 – US$nil, 2006 – US$nil) to the Foundation.

26. Non-cash transactions

Available for sale mortgage backed to be announced security purchases and sales of US$223.2 million and US$228.4 million respectively were net settled during the year through the use of derivative instruments.

The unsettled element of the share repurchase discussed in note 21 is not reflected in the 2007 cash flow. In addition, the dividend declared on 10 December 2007 is not reflected in the 2007 cash flows as the settlement date was 25 January 2008. The cash flows on both of these transactions are recorded in 2008.

27. Statutory requirements and dividend restrictions

As a holding company, LHL relies on dividends from its subsidiaries to provide cash flow required for debt service and dividends to shareholders. The subsidiaries' ability to pay dividends and make capital distributions is subject to the legal and regulatory restrictions of the jurisdictions in which they operate. For the primary operating subsidiaries these are based principally on the amount of premiums written and reserves for losses and loss expenses, subject to overall minimum solvency requirements. Statutory capital and surplus is different from shareholders' equity due to certain items that are capitalised under IFRS but expensed or have a different valuation basis for regulatory reporting, or are not admitted under insurance regulations.

Annual statutory capital and surplus reported to regulatory authorities by the primary operating subsidiaries is as follows:

	As at 31 December 2006	
	LICL	*LUK*
	US$m	*£m*
Statutory capital and surplus	1,079.2	56.3
Minimum required statutory capital and surplus	271.1	7.4

	As at 31 December 2007	
	LICL	*LUK*
	US$m	*£m*
Statutory capital and surplus	1,387.1	55.4
Minimum required statutory capital and surplus	311.1	13.4

	As at 31 December 2008	
	LICL	*LUK*
	US$m	*£m*
Statutory capital and surplus	1,080.1	125.1
Minimum required statutory capital and surplus	256.8	22.7

For LUK, various capital calculations are performed and an individual assessment of LUK's capital needs (an "**ICA**") is presented to the FSA. The FSA then considers the capital calculations and issues an individual capital guidance ("**ICG**"), reflecting the FSA's own view as to the level of capital required. The FSA considers that a decrease in an insurance company's capital below the level of its ICG represents a regulatory intervention point.

LICL is required to maintain a minimum liquidity ratio, whereby relevant assets, as defined in the regulations, must exceed 75 per cent. of relevant liabilities. As at 31 December 2008 and 2007 the liquidity ratio was met. LICL is also required to perform various capital calculations under the BMA's regulatory framework. An assessment is made of LICL's capital needs and a target capital amount is determined. The BMA may require a further capital loading on the target capital amount in certain circumstances. The BMA considers that a decrease in capital below the target level represents a regulatory intervention point.

As at 31 December 2006, 31 December 2007 and 31 December 2008, the capital requirements of both regulatory jurisdictions were met.

28. Presentation

Certain amounts in the 31 December 2006 and 31 December 2007 consolidated financial statements have been re-presented to conform with the current year's presentation and format. These changes in presentation have no effect on the previously reported net profits.

PART VII

REGULATION

1. General

The Group operates primarily through two companies licensed to underwrite insurance and reinsurance business: LICL, a Bermudian incorporated company, and LUK, a UK incorporated company. LICL and LUK are eligible for surplus lines insurance and reinsurance in 45 and 42 US jurisdictions respectively, but are not licensed insurers in any US state or territory. LUK is also currently licensed to provide insurance services from the UK to 24 European Union member states. LIMSL is currently licensed to provide insurance mediation services from the UK to 21 European Union member states and LMEL is currently licensed to provide insurance intermediation services from the Dubai International Financial Centre.

Set out below is more detail on the regulatory regimes in which the Group's operating companies conduct its business. Such regimes are designed to protect policyholders rather than investors, and relate to such matters as authorisation and licensing of insurers and agents, solvency requirements, internal systems and controls, related party transactions, dividend limitations, disciplinary and other sanctions and reporting obligations.

2. Bermuda Insurance Regulation

The Insurance Act 1978

As a holding company, the Company is not subject to Bermuda insurance regulations. However, the Insurance Act regulates the insurance business of the Group's operating subsidiary in Bermuda, LICL, and provides that no person shall carry on any insurance business in or from within Bermuda unless registered as an insurer under the Insurance Act by the BMA, which is responsible for the day to day supervision of insurers. Under the Insurance Act, insurance business includes reinsurance business. The BMA, in deciding whether to grant registration, has broad discretion to act as it thinks fit in the public interest. The BMA is required by the Insurance Act to determine whether the applicant is a fit and proper body to be engaged in the insurance business and, in particular, whether it has, or has available to it, adequate knowledge and expertise to operate an insurance business. The continued registration of a company as an insurer under the Insurance Act is subject to its complying with the terms of its registration and such other conditions as the BMA may impose from time to time.

An Insurance Advisory Committee appointed by the Bermuda Minister of Finance advises the BMA on matters connected with the discharge of its functions. Sub-committees of the Insurance Advisory Committee supervise and review the law and practice of insurance in Bermuda, including reviews of accounting and administrative procedures.

The Insurance Act imposes on Bermuda insurance companies solvency and liquidity standards and auditing and reporting requirements and grants the BMA powers to supervise, investigate, require information and the production of documents and intervene in the affairs of insurance companies. Certain significant aspects of the Bermuda insurance regulatory framework are set forth below. Unless the context specifies otherwise, the following description assumes that LICL is registered as a Class 4 insurer under the Insurance Act.

Classification of insurers

The Insurance Act distinguishes between insurers carrying on long-term business and insurers carrying on general business. There are six classifications of insurers carrying on general business, with Class 4 insurers subject to the strictest regulation. LICL has been registered to carry on general business as a Class 4 insurer in Bermuda and is regulated as such under the Insurance Act. The continued registration of LICL as an insurer is subject to LICL complying with the terms of its registration and such other conditions as the BMA may impose from time to time.

Cancellation of an insurer's registration

An insurer's registration may be cancelled by the BMA on certain grounds specified in the Insurance Act, including failure of the insurer to comply with its obligations under the Insurance Act or if, in the opinion of the BMA, the insurer has not been carrying on business in accordance with sound insurance principles.

Principal representative

An insurer is required to maintain a principal office in Bermuda and to appoint and maintain a principal representative in Bermuda. For the purpose of the Insurance Act, the principal office of LICL is at Mintflower Place, 8 Par-la-Ville Road, Hamilton HM 08, Bermuda, and LICL's principal representative is Colin Alexander. Without a reason acceptable to the BMA, an insurer may not terminate the appointment of its principal representative, and the principal representative may not cease to act as such, unless 30 days' notice in writing to the BMA is given of the intention to do so. It is the duty of the principal representative, within 30 days of reaching the view that there is a likelihood of the insurer for which the principal representative acts becoming insolvent or that a reportable "event" has, to the principal representative's knowledge, occurred or is believed to have occurred, to make a report in writing forthwith to the BMA setting out all the particulars of the case that are available to the principal representative. Examples of such a reportable "event" include failure by the insurer to comply substantially with a condition imposed upon the insurer by the BMA relating to a solvency margin or a liquidity or other ratio.

Independent approved auditor

Every registered insurer must appoint an independent auditor who will annually audit and report on the statutory financial statements and the statutory financial return of the insurer, both of which, in the case of LICL, are required to be filed annually with the BMA. The independent auditor of LICL must be approved by the BMA and may be the same person or firm who audits LICL's financial statements and reports for presentation to its shareholders. LICL's independent auditor is Ernst & Young.

Loss reserve specialist

As a registered Class 4 insurer, LICL is required to submit an opinion of its approved loss reserve specialist with its statutory financial return in respect of its loss and loss expense provisions. The loss reserve specialist, who will normally be a qualified casualty actuary, must be approved by the BMA. LICL's approved loss reserve specialist is Mr François Morin, FCAS of Towers Perrin.

Annual statutory financial statements

LICL must prepare annual statutory financial statements. The Insurance Act prescribes rules for the preparation and substance of such statutory financial statements (which include, in statutory form, a balance sheet, an income statement, a statement of capital and surplus and notes thereto). LICL is required to give detailed information and analyses regarding premiums, claims, reinsurance and investments. The statutory financial statements are not prepared in accordance with US generally accepted accounting principles and are distinct from the financial statements prepared for presentation to LICL's shareholders under the Insurance Act, which financial statements will be prepared in accordance with IFRS. LICL, as a general business insurer, is required to submit the annual statutory financial statements as part of the annual statutory financial return. The statutory financial statements and the statutory financial return do not form part of the public records maintained by the BMA.

Annual statutory financial return

LICL will be required to file with the BMA a statutory financial return no later than four months after its financial year end (unless specifically extended upon application to the BMA). The statutory financial return for a Class 4 insurer includes, among other matters, a report of the approved independent auditor on the statutory financial statements of such insurer, solvency certificates, the statutory financial statements, the opinion of the loss reserve specialist and a schedule of reinsurance ceded. The solvency certificates must be signed by the principal representative and at least two directors of the insurer who are required to certify, among other matters, that the minimum solvency margin has been met and whether the insurer complied with the conditions attached to its certificate of registration. The independent approved auditor is required to state whether in its opinion it was reasonable for the directors to so certify. Where an insurer's accounts have been audited for any purpose other than compliance with the Insurance Act, a statement to that effect must be filed with the statutory financial return.

Minimum solvency margin and restrictions on dividends and distributions

Under the Insurance Act, the value of the general business assets of a Class 4 insurer must exceed the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margin. LICL, being a registered Class 4 insurer:

1. is required, with respect to its general business, to maintain a minimum solvency margin (the prescribed amount by which the value of its general business assets must exceed its general business liabilities) equal to the greatest of:
   - 1.1 BD$100,000,000;
   - 1.2 50 per cent. of net premiums written (being gross premiums written less any premiums ceded by LICL but LICL may not deduct more than 25 per cent. of gross premiums when computing net premiums written); and
   - 1.3 15 per cent. of loss and other insurance reserves;
2. is prohibited from declaring or paying any dividends during any financial year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio (if it has failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any financial year, LICL will be prohibited, without the approval of the BMA, from declaring or paying any dividends during the next financial year);
3. is prohibited from declaring or paying in any financial year dividends of more than 25 per cent. of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless it files (at least seven days before payment of such dividends) with the BMA an affidavit stating that it will continue to meet the required margins;
4. is prohibited, without the approval of the BMA, from reducing by 15 per cent. or more its total statutory capital as set out in its previous year's financial statements and any application for such approval must include an affidavit stating that it will continue to meet the required margins; and
5. is required, at any time it fails to meet its solvency margin, within 30 days (45 days where total statutory capital and surplus falls to US$75 million or less) after becoming aware of that failure or having reason to believe that such failure has occurred, to file with the BMA a written report containing certain information.

Additionally, under the Act, LICL may not declare or pay a dividend, or make a distribution from contributed surplus, if there are reasonable grounds for believing that it is, or would after the payment be, unable to pay its liabilities as they become due, or the realisable value of its assets would be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

Minimum liquidity ratio

The Insurance Act provides a minimum liquidity ratio for general business insurers, such as LICL. An insurer engaged in general business is required to maintain the value of its relevant assets at not less than 75 per cent. of the amount of its relevant liabilities. Relevant assets include, but are not limited to, cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, account and premiums receivable and reinsurance balances receivable. There are certain categories of assets which, unless specifically permitted by the BMA, do not automatically qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans. The relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities (by interpretation, those not specifically defined).

Bermuda Solvency Capital Requirement

The Insurance Act was amended in 2008 by the introduction, *inter alia*, of the Bermuda Solvency Capital Requirement (the "**BSCR**") which is a standard mathematical model designed to give the BMA more advanced methods for determining an insurer's capital adequacy. Where insurers apply in-house models that deal more effectively with their own particular risks and where such models satisfy the standards established by the BMA, such insurers may apply to the BMA to use such models in lieu of the BSCR. Underlying the BSCR is the belief that all insurers should operate on an ongoing basis with a view to maintaining their capital at a prudent level in excess of the Minimum Solvency Margin otherwise prescribed under the Insurance Act.

With effect from 31 December 2008, all Class 4 insurers must maintain their capital at a target level being 120 per cent. of the minimum amount calculated in accordance with the BSCR or the company's approved in-house model (the "**Enhanced Capital Requirement**" or "**ECR**"). In circumstances where the BMA concludes that the company's risk profile deviates significantly from the assumptions underlying the ECR or the company's assessment of its management policies and practices, it may issue an order requiring that the company adjust its ECR.

Supervision, investigation and intervention

The BMA may appoint an inspector with extensive powers to investigate the affairs of an insurer if the BMA believes that an investigation is required in the interest of the insurer's policyholders or persons who may become policyholders. In order to verify or supplement information otherwise provided to the BMA, the BMA may direct an insurer to produce documents or information relating to matters connected with the insurer's business.

If it appears to the BMA that there is a risk of LICL becoming insolvent, or that it is in breach of the Insurance Act or any conditions imposed upon its registration, the BMA may, among other things, direct LICL (a) not to take on any new insurance business, (b) not to vary any insurance contract if the effect would be to increase LICL's liabilities, (c) not to make certain investments, (d) to realise certain investments, (e) to maintain in, or transfer to, the custody of a specified bank, certain assets, (f) not to declare or pay any dividends or other distributions or to restrict the making of such payments and/or (g) to limit its premium income.

Notification by shareholder controller of new or increased control

Any person who becomes a holder of at least 10 per cent., 20 per cent., 33 per cent. or 50 per cent. of Lancashire's shares must notify the BMA in writing within 45 days of becoming such a holder, or 30 days from the date such person has knowledge of having such a holding, whichever is later. The BMA may, by written notice, object to such a person if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce such holder's shareholding in Lancashire and may direct, among other things, that the voting rights attaching to such holder's shares will not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offence.

Objection to existing shareholder controller

For so long as Lancashire has as a subsidiary an insurer registered under the Insurance Act, the BMA may at any time, by written notice, object to a person holding 10 per cent. or more of Lancashire's shares if it appears to the BMA that the person is not or is no longer fit and proper to be such a holder. In such a case, the BMA may require the shareholder to reduce its holding of Lancashire's shares and direct, among other things, that such shareholder's voting rights attaching to such shares shall not be exercisable. A person who does not comply with such a notice or direction from the BMA will be guilty of an offence.

Disclosure of information

In addition to powers under the Insurance Act to investigate the affairs of an insurer, the BMA may require certain information from an insurer (or certain other persons) to be produced to the BMA. Further, the BMA has been given powers to assist other regulatory authorities, including foreign insurance regulatory authorities with their investigations involving insurance and reinsurance companies in Bermuda but subject to restrictions. For example, the BMA must be satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities of the foreign regulatory authority. Further, the BMA must consider

whether to co-operate is in the public interest. The grounds for disclosure are limited and the Insurance Act provides sanctions for breach of the statutory duty of confidentiality.

3. Certain other Bermuda Law Considerations

The Company is designated as non-resident for exchange control purposes by the BMA. Pursuant to its non-resident status, the Company may engage in transactions in currencies other than Bermuda dollars and there are no restrictions on its ability to transfer funds (other than funds denominated in Bermuda dollars) in and out of Bermuda or to pay dividends to non-Bermuda residents who are holders of its shares. The Company is required to obtain the permission of the BMA for the issue and transfer of all of its shares.

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

The Company has been incorporated in Bermuda as an "exempted company". Under Bermuda law, exempted companies are companies formed for the purpose of conducting business outside Bermuda from a principal place in Bermuda. As a result, they are exempt from Bermuda laws restricting the percentage of share capital that may be held by non-Bermudians, but they may not participate in certain business transactions, including: (a) the acquisition or holding of land in Bermuda (except that required for their business and held by way of lease or tenancy for terms of not more than 50 years) without the express authorisation of the Bermuda legislature, (b) the taking of mortgages on land in Bermuda to secure an amount in excess of BD$50,000 without the consent of the Minister of Finance, (c) the acquisition of any bonds or debentures secured by any land in Bermuda, other than certain types of Bermuda government securities or (d) the carrying on of business of any kind in Bermuda, except in furtherance of their business carried on outside Bermuda or under licence granted by the Minister of Finance. An insurer is permitted to reinsure risks undertaken by any company incorporated in Bermuda and permitted to engage in the insurance and reinsurance business as an exempted company only if it obtains a special licence granted by the Minister of Finance to insure Bermuda domestic risks or risks of persons of, in or based in Bermuda subject to certain conditions.

The Bermuda government actively encourages foreign investment in "exempted" entities (i.e. a company which does not comply with the Act in respect of a local company) such as Lancashire that are based in Bermuda, but do not operate in competition with local businesses. As well as having no restrictions on the degree of foreign ownership, LICL and Lancashire are not currently subject to taxes on income or dividends or to any dividends or to any foreign exchange controls in Bermuda. In addition, there currently is no capital gains tax in Bermuda.

The Company must comply with the provisions of the Act regulating the payment of dividends and making distributions from contributed surplus. Under the Act, a company shall not declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that: (a) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realisable value of the company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. Under the Act, where a Bermuda company issues shares at a premium (that is for a price above the par value), whether for cash or otherwise, a sum equal to the aggregate amount or value of the premium on those shares must be transferred to an account, called "the share premium account". The provisions of the Act relating to the reduction of the share capital of a company apply as if the share premium account were paid-up share capital of that company, except for certain matters such as premium arising on a particular class of shares may be used in paying up unissued shares of the same class to be issued to shareholders as fully paid bonus shares. The paid-up share capital may not be reduced if on the date the reduction is to be effected there are reasonable grounds for believing that the company is, or after the reduction would be, unable to pay its liabilities as they become due.

Exempted companies, such as the Company and LICL, must comply with Bermuda resident representation provisions under the Act. The Company does not believe that such compliance will result in any material expense to it.

Under Bermuda law, non-Bermudians (other than spouses of Bermudians or holders of permanent residency certificates) may not engage in any gainful occupation in Bermuda without an appropriate Bermuda government work permit. The Group's success may depend in part upon the continued services of key employees in Bermuda. Certain key employees may neither be a Bermudian, a spouse of a Bermudian nor an individual holding a permanent resident certificate. Accordingly, any such key employee will require specific approval to work for the Company and LICL in Bermuda. A work permit may be granted or extended upon showing that, after proper public advertisement, no Bermudian (or spouse of a Bermudian or an individual holding a permanent resident certificate) is available who meets the minimum standards reasonably required by the employer. The Bermuda government recently announced a new policy that places a six year term limit on individuals with work permits, subject to certain exemptions for key employees (see also Part II – Risk Factors).

4. US Insurance Regulation

LICL is licensed in Bermuda to write insurance and reinsurance and is not admitted to do business in any jurisdiction in the US. LUK is authorised in the United Kingdom to write insurance and reinsurance and is not admitted to do business in any jurisdiction in the US. The insurance laws of each state of the US and of many other jurisdictions regulate the sale of insurance and reinsurance within their jurisdictions by non-admitted insurers and reinsurers, such as LICL and LUK. LICL and LUK conduct their business so as not to be subject to the licensing requirements of insurance regulators in the US.

Many aspects of the activities of LICL and LUK are similar to those employed by other non-admitted reinsurers that provide reinsurance to US and other cedants. Specifically, and in accordance with common practice, the transaction of reinsurance by non-admitted reinsurers is generally exempt from US regulation, except for the credit for reinsurance requirements discussed below. With respect to insurance business, LICL and LUK have been granted a listing with the International Insurers Department of the National Association of Insurance Commissioners, which enabled LICL and LUK to write surplus lines insurance in 18 states of the US. LICL is now an eligible surplus lines insurer in 45 US jurisdictions, while LUK is an eligible surplus lines insurer in 42 US jurisdictions. By virtue of LICL's and LUK's status as eligible or approved surplus lines insurers with the IID and in the various states, LICL and LUK are required to maintain separate US surplus lines trust funds (each trust fund currently required to contain an amount equal to 30 per cent. of US surplus lines liabilities for the first US$200 million, 25 per cent. for US$300 million excess of US$200 million, 20 per cent. for US$500 million excess of US$500 million and 15 per cent. excess of US$1 billion., subject to a cap of US$100 million). LICL and LUK must also make periodic financial and business disclosure filings, and to that extent LICL and LUK are subject to limited regulatory oversight in the US in connection with their direct insurance activities. In common with other surplus lines insurers, LICL's and LUK's rates and forms are not regulated by any state.

It is nonetheless possible, however, that insurance regulators in the US or elsewhere may review the activities of LICL and LUK and claim that LICL or LUK are subject to such jurisdiction's licensing requirements, although the Company believes it unlikely under the circumstances, assuming LICL and LUK comply with applicable laws regarding non-admitted business in each jurisdiction. Having to meet such requirements, however, could materially and adversely affect LICL's or LUK's results of operations. Alternatively, any necessary changes to operations could subject LICL or LUK to taxation in the US.

In addition to the regulatory requirements imposed by the jurisdictions in which they are licensed, reinsurers are subject to indirect regulatory requirements through the "credit for reinsurance" mechanism imposed by jurisdictions in which they are not licensed but where their cedants are licensed. A cedant which obtains reinsurance from a reinsurer that is licensed, accredited or approved by the jurisdiction or state in which the insurer files statutory financial statements is permitted to reflect in its statutory financial statements a credit in an aggregate amount equal to the liability for unearned premiums and loss as well as adjustment expense reserves ceded to the reinsurer. In the US, many states allow credit for reinsurance ceded to a reinsurer that is domiciled and licensed in another state of the US and meets certain financial requirements. As a non-licensed and non-accredited reinsurer, LICL and LUK have to post acceptable collateral as dictated by each state's credit for reinsurance laws and regulations (such as a letter of credit, trust or other acceptable security arrangement) in order for a cedant to be able to take credit for the reinsurance on its balance sheet.

5. UK Insurance Regulation

General

Effecting and carrying out contracts of insurance in the UK by way of business, as well as arranging and advising on contracts of insurance in the UK by way of business, are regulated activities under the FSMA. A firm must either be authorised by the FSA or "exempt" in order to carry on these (or any other) regulated activities. Under FSMA, references to "insurance" includes reinsurance.

As an insurer, LUK is authorised and regulated by the FSA with permission, *inter alia*, to effect and carry out contracts of general insurance and to accept deposits. As an insurance intermediary (an entity which arranges or advises on insurance policies but does not underwrite the risk on such policies), LIMSL is authorised and regulated by the FSA with permission to carry on the regulated activities of arranging (bringing about) deals in, advising on making arrangements with a view to transactions in non-investment insurance contracts, and agreeing to carry on a regulated activity.

Authorisation by the FSA of LUK and LIMSL and their ongoing compliance with the FSA's regulatory regime is very important to the Group's business. The ability of LUK and LIMSL to continue to conduct their regulated activities in the UK is dependent on their continued compliance with the relevant legal and regulatory requirements. The FSA's requirements for firms carrying on insurance and/or reinsurance business and insurance intermediary business cover areas such as:

- prudential supervision of insurers and insurance groups, requiring insurers and reinsurers to maintain capital resources (namely an amount of assets in excess of its liabilities as calculated in accordance with the FSA's rules) and insurance intermediaries to maintain financial resources equal to or in excess of certain financial requirements set out in the FSA's rules;
- internal systems and controls, including approval by the FSA of persons carrying on certain key functions which are identified in the FSA Handbook; and
- extensive periodic reporting requirements.

Failure to comply with the relevant legal and regulatory requirements could lead to the FSA taking disciplinary and/or remedial action (including public statements and censures and/or financial penalties) against a firm, or employing measures to secure redress or restitution (such as requiring a firm to compensate its customers). The FSA also has the power to cancel or vary a firm's permission, to withdraw a firm's authorisation, and to take action against specific individuals who have failed to comply with the relevant requirements.

Solvency Requirements

LUK is required to maintain a margin of solvency at all times, the calculation of which depends on the type and amount of insurance business written. The method of calculation of the solvency margin (or ''capital resources requirement'') is set out in the FSA's Prudential Sourcebook for Insurers, and for these purposes, all assets and liabilities are subject to specific valuation rules. Failure to maintain capital resources equal to or in excess of the capital resources requirement is one of the grounds on which the wide powers of intervention conferred upon the FSA may be exercised. For financial years ending on or after 1 January 2004, the calculation of the required capital resources requirement has been amended as a result of the implementation of the E.U. Solvency I Directives. In respect of liability business accepted, 150 per cent. of the actual premiums written and claims incurred must be included in the calculation, which has the effect of increasing the capital resources requirement for LUK.

LUK is required to calculate an Enhanced Capital Requirement (''**ECR**''), which is a risk-based formula for calculating capital needs, in addition to its required minimum solvency margin. An insurer is also required to maintain financial resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. This process is called the Individual Capital Assessment (''**ICA**''). As part of the ICA, the insurer is required to take comprehensive risk factors into account, including market, credit, operational, liquidity and group risks, and to carry out stress and scenario tests to identify an appropriate range of realistic adverse scenarios in which the risk crystallises and to estimate the financial resources needed in each of the circumstances and events identified. The FSA gives individual capital guidance regularly to insurers following receipt of ICAs. If the FSA considers that there are insufficient capital resources it can give guidance advising the insurer of the amount and quality of capital resources it considers necessary for that insurer. The FSA has powers under section 45 of FSMA to require firms (including insurers) to hold capital in accordance with its guidance.

In addition, an insurer that is part of a group is required to perform and submit to the FSA a solvency margin calculation return in respect of its ultimate parent undertaking, in accordance with the FSA's rules. This return is not part of an insurer's own solvency return and hence will not be publicly available. Although there is no requirement for the parent undertaking solvency calculation to show a positive result where the ultimate parent undertaking is outside the EEA, the FSA may take action where it considers that the solvency of the insurance company is or may be jeopardised due to the Group solvency position. Further, an insurer is required to report in its annual returns to the FSA all material related party transactions (e.g. intra-group reinsurance, whose value is more than 5 per cent. of the insurer's general insurance business amount).

Restrictions on Dividend Payments

The UK Companies Act 2006 prohibits LUK from declaring a dividend to its shareholders unless it has ''profits available for distribution''. The determination of whether a company has profits available for distribution is based on its accumulated realised profits less its accumulated realised losses. While FSMA does not impose any statutory restrictions on a general insurer's ability to declare a dividend, the FSA's rules require maintenance of each insurance company's solvency margin within its jurisdiction.

Reporting Requirements

UK insurers must prepare their financial statements under the UK Companies Act, which requires the filing with Companies House of audited financial statements and related reports. In addition, UK insurers are required to file with the FSA periodic regulatory returns, which include a revenue account, a profit and loss account and a balance sheet in prescribed forms. These returns must be filed with the FSA within two months and 15 days (or three months where the delivery of the return is made electronically) after year-end.

Supervision of Management

The FSA supervises the management of insurers through the approved person regime, by which any appointment of individuals to perform certain specified ''controlled functions'' within a regulated entity must be approved by the FSA. These individuals are subject to an ongoing obligation to comply with the FSA's fitness and propriety requirements to continue to perform these controlled functions.

Control & FSA Consent

As firms regulated by the FSA, LUK and LIMSL must ensure compliance with the rules relating to ''controllers'' contained in Part XII of the FSMA. In particular, where a person:

(a) holds 10 per cent. or more of the shares in a parent undertaking (''**P**'') of a company undertaking a regulated activity (''**A**'') or 10 per cent. or more of the shares of A; or

(b) is able to exercise significant influence over the management of A through its shareholding in A or P through his shareholding in P; or

(c) is able to exercise significant influence over the management of A through its voting power in A or of P through its voting power in P; or

(d) is entitled to exercise or control the exercise of 10per cent. or more of the voting power in A or P,

then such person will be regarded by the FSA as a "controller" of A, in this case A being any Group Company which is regulated by the FSA (namely, LUK and LIMSL). However, in respect of LIMSL (as an insurance intermediary) the controller threshold will be 20 per cent., rather than the 10 per cent. threshold referred to in paragraph (a) above.

Any proposed changes to existing controllers or the appointment of new controllers must first be approved by the FSA in accordance with the relevant provisions of FSMA. If a person who is already a controller proposes to increase its control in line with certain thresholds set out in section 180 of FSMA, such person will also require the prior approval of the FSA. Under FSMA, the FSA is afforded a period of three months from the date of notification of the proposed acquisition of or increase in control to approve or object to such proposed acquisition of or increase of control. Under section 185 of FSMA, the FSA's approval may be unconditional or subject to such conditions as it considers appropriate. Where approval is granted, subsequent notification of the relevant change of control must be made to the FSA under section 178 of FSMA within 14 days of it having occurred.

If a person acquires shares (including by way of a transfer of shares or acquiring a right to be issued shares) which would result in a controlling interest or relevant change in a controlling interest without first obtaining the FSA's approval, they will be committing a criminal offence under Section 191 of FSMA. Section 189 of FSMA confers powers on the FSA to serve notice on a person who becomes a controller, or increases existing control in line with a FSMA specified threshold, by acquiring shares without first obtaining such approval, that it directs that any such shares as it specifies are subject to one or more of the following restrictions:

(1) the transfer of the shares or in the case of unissued shares, any transfer of the right to be issued with them, is void;

(2) no voting rights are to be exercisable in respect of those shares;

(3) no further shares are to be issued in light of them or in pursuance of any offer made to their holder; and

(4) except in a liquidation, no payment is to be made of any sums due from the body corporate on the shares, whether in respect of capital or otherwise.

The court also has the power, on the application of the FSA, to make such order relating to the sale or transfer of the shares acquired without approval as it thinks fit.

In addition, an existing controller who, among other things, proposes to reduce its control in line with certain thresholds set out at section 181 of FSMA or proposes to cease to have control of a relevant kind must notify the FSA of this proposal and must subsequently notify the FSA on reducing or ceasing to have control in questions. Where an existing controller ceases to have a relevant kind of control or reduces any such relevant kind of control in line with the thresholds set out in section 181 of FSMA without itself having taken any steps to so reduce or cease such control, it must notify the FSA under section 190 of FSMA within 14 days of such cessation or reduction of control having occurred.

FSA Powers of Supervision, Intervention and Investigation

The FSA carries out periodic on-site visits to regulated firms (such as LUK and LIMSL) as part of its supervisory work to evidence that they continue to comply with the requirements of FSMA.

The FSA has substantial powers of intervention in relation to the entities it regulates. The FSA's wide powers of intervention and investigation under FSMA allow it to, among other things, require an insurance company to take such action as it appears to the FSA to be appropriate to protect policyholders against the risk that the relevant company may be unable or unwilling to meet its liabilities.

The FSA also has the power to require an authorised firm to provide specified information or produce specified documents, to the extent such information or documents are reasonably required by the FSA in connection with the exercise of its functions under FSMA. If necessary, the FSA may in addition require an authorised firm (or any member of its group) to provide the FSA with a report (prepared by a person nominated or approved by the FSA) on any matter in relation to which it has required or could require information or production of documents.

Fees and Levies

As an authorised insurer in the United Kingdom, LUK is subject to FSA fees and levies based on LUK's gross written premiums and gross technical liabilities. The fees and levies charged by the FSA to LUK are not material to the Company. LUK's fees and levies paid to the FSA were £112,559.19 for 2008. The FSA also requires authorised insurers to participate in an investors' protection fund, known as the Financial Services Compensation Scheme.

European Regulatory Framework

The regulatory framework of the insurance industry in the UK is significantly derived from European Union directives (which are required to be implemented by Member States through national legislation). Changes to applicable law or regulation in the United Kingdom or at European Union level may affect the regulatory environment in which LUK and LIMSL operate. The Group cannot predict the financial effect that any proposed regulations or future law or regulation may have on the financial condition or results of operations of LUK or LIMSL. It is possible that LUK and LIMSL may be adversely affected by any proposed or future changes in applicable laws or regulations or in their interpretation or enforcement.

A significant current European Union regulatory development is Solvency II. Solvency II is the name given to the process of review of the European Union insurance directives, the objective of which is to introduce a pan-European economic risk based solvency requirements framework providing appropriate protection for consumers across European Union member states and to improve capital allocation across the European Union's financial markets. One of the ways it will achieve this will be to promote higher quality risk management and assessment, and to ensure the integration of capital assessment, risk management and business planning processes. In particular, insurers will be required to hold capital against market risk (i.e. fall in the value of insurers' investments), credit risk (e.g. when third parties cannot repay their debts) and operational risk (e.g. risk of ineffective systems and controls or malpractice). These are all risks which are currently not covered by the European Union's regime, although these are covered by the current ICA requirements do take such risks into account. Still in draft form, the process of implementation of Solvency II is currently expected to commence in 2009, with the regime to be in force by 2012.

LICL

LICL is not, and the Group intends that LICL will continue conducting its business so as not to be, subject to insurance regulation in the UK. However, if it were determined that LICL is effecting or carrying out contracts of insurance (including contracts of reinsurance) in the UK, it would be required to be authorised and regulated by the FSA. In the event that LICL effects or carries out such contracts without first having obtained FSA authorisation, it will commit a criminal offence. LICL and any officer of LICL who consented to or connived in the offence or whose negligence led to the offence would be liable to be proceeded against and if found guilty punished accordingly. Further, any contract made by LICL whilst not authorised by the FSA when it should have been will be unenforceable against the other party unless the relevant court otherwise allows.

Insurers who are authorised by the FSA to carry on the business of effecting and carrying out contracts of insurance in the UK are required to provide information relating to their insurance and reinsurance arrangements to the FSA and insurers headquartered outside the European Union are required to maintain assets in the UK in accordance with the requirements of the FSA. The FSA has wide-ranging powers of intervention in relation to such insurers, which may be triggered if the FSA has a concern relating to such arrangements or the solvency of such insurers as a result of the receipt of such information or otherwise. Having to meet such requirements could materially and adversely affect LICL's results of operations. Authorisation in the UK is also likely to subject LICL to taxation in the UK.

6. Dubai Regulation

Lancashire Marketing Services (Middle East) Limited ("**LMEL**") is a limited liability company incorporated in the DIFC, which is a Federal Financial Free Zone within Dubai established in 2004 pursuant to Federal Law No 8 of 2004 and Dubai Law No 9 of 2004. These laws, together with a number of further enactments, constitute the DIFC as a zone having financial and administrative independence whilst remaining 'attached' to the Government of Dubai. Furthermore, the DIFC is not subject to the civil and commercial laws of the UAE and Dubai (although it remains subject to the criminal law and, in particular, legislation relating to Money Laundering). The DIFC has established its own framework of laws and regulations to govern conduct of business within its jurisdiction and, in particular, the provision of financial services (including insurance) in and from the DIFC. The DIFC has passed legislation seeking to codify legal concepts key to, *inter alia*, the transaction of business and has established an independent court system for the administration of justice and the application of its laws under the supervision of the DIFC Judicial Authority.

The incorporation and registration of companies (including LMEL) within the DIFC is overseen by the DIFC Registrar of Companies ("**ROC**").

Responsibility for regulating the provision of financial services (including insurance services) within and from the DIFC rests with the Dubai Financial Services Authority, an independent regulator (but part of the DIFC), established to license and regulate such activities and which administers a comprehensive framework for the authorisation and supervision of financial services and financial services institutions (and certain specified individuals) within the DIFC. It has also been granted significant powers of intervention, investigation and enforcement to enable it maintain and enforce compliance with the legal and regulatory requirements applicable to the conduct of financial services within or from the DIFC.

The institutions, laws and regulations of the DIFC have been in existence for a relatively short period of time and, whilst the DIFC has established a comprehensive body of law and a highly qualified and respected judiciary to preside over the administration of justice pursuant to such law, there remain areas that might be relevant to LMEL, but where the legal position cannot be stated with certainty. It might reasonably be expected that, over time, the areas of uncertainty will diminish as DIFC authorities/regulators clarify matters of interpretative uncertainty and/or the DIFC Courts reach decisions that resolve such issues. However, given the wide range of factors that would influence the speed and nature of such a process, it is not possible to forecast its likely trajectory.

The regulatory status of LMEL in the DIFC

The principal activity of LMEL is to provide business introduction and other marketing services to LUK and LICL pursuant to services agreements entered into with them. This activity constitutes the carrying on of a financial service in or from the DIFC by virtue of the DIFC Regulatory Law (DIFC Law No 1 of 2004) and the Rules of the DFSA and, accordingly, LMEL is required to be authorised by the DFSA to conduct such activity.

LMEL has been authorised, since 19 March 2007, to conduct its business which is classified as Insurance Intermediation for the purpose of determining the level and degree of regulation and supervision to which it is subject. LMEL does not enter into contracts of insurance or re-insurance nor does it offer or sell any products or other services as agent. LMEL's authorisation by the DFSA is limited to the scope of business submitted to the DFSA and does not permit LMEL to conduct other business without the approval of the DFSA.

As an authorised entity, LMEL is subject to the comprehensive framework of regulation administered by the DFSA including requirements that govern, *inter alia*, the maintenance of adequate capital, the conduct of business and the treatment of clients, the management of client assets, the adequacy of internal systems and controls, record keeping, the content and frequency of reports and returns to be made to the DFSA. In addition, the regulatory framework requires that certain functions be performed within authorised entities by persons who are themselves fit and proper and competent to do so and who obtain individual authorisation. These functions are those of senior executive officer, finance officer, compliance officer and money laundering reporting officer. LMEL has made appointments to these positions and the incumbents are authorised for that purpose by the DFSA.

LMEL's authorisation to carry on its business is based upon, among other things, disclosure and approval of the entity that controls LMEL. The DFSA Rules contain comprehensive provisions as to its requirements in the event that there is a prospective change of control or a change of control occurs without prior approval. In addition, there are specific notification requirements that apply in the event that a controller's shareholding varies by given percentages. In its annual report to the DFSA, LMEL is obliged to confirm relevant information regarding its controller.

Consequences of breach of DFSA Rules

Failure to comply with the regulatory and legal requirements, including the carrying on of activities outside the scope of its authorisation, could result in disciplinary action by the DFSA that might lead to the imposition of enforcement remedies available to the DFSA (either directly or through the DIFC Court) that range in severity from censure or fine through to withdrawal of authorisation or, in extreme cases, the compulsory winding up of a firm. A breach might additionally have an adverse impact upon the reputation of LMEL and/or Lancashire. Accordingly, continued compliance with DFSA regulatory and legal requirements is fundamental to the ability of LMEL to conduct its activities.

Conducting business in the UAE

LMEL is only authorised to conduct business in and from the DIFC. Accordingly, to the extent that it has dealings with persons or entities within the UAE (including Dubai) it must do so in a manner that it is not deemed to be conducting financial business within the UAE for the purposes of relevant UAE Central Bank law and regulation thereby requiring LMEL to be licensed by the Central Bank to conduct such activities. Contravention of such laws and regulations could result in penalties and might additionally have adverse impact upon the reputation of LMEL and/or Lancashire.

Consequences of incorporation within the DIFC

LMEL is a company limited by shares incorporated pursuant to the Companies Law (DIFC Law No 3 of 2006) (the "**Companies Law**").

The Companies Law governs on a comprehensive basis, *inter alia*, i) the formation and registration of DIFC companies and their constitutional documents, ii) the powers and duties of directors, iii) rights attaching to shares, iv) rights of shareholders, v) share capital, vi) meetings, vii) dividends/distributions, and viii) accounts and audit. In addition, the Companies Law defines the role and scope of authority of the ROC. The ROC has wide ranging powers to maintain compliance with the Companies Law and other relevant regulations. These powers include, by way of example, i) the ability to institute the appointment of inspectors to investigate the affairs of a company, such inspectors having wide ranging powers if appointed to require production of books and records, ii) the right to issue directions to companies to comply with the law, iii) the power to have a company struck off the register (subject to DFSA consent if such company is an authorised entity), iv) the right to apply to the DIFC Court for a receiver to be appointed or for a company to be wound-up, and v) the imposition of a fine for certain contraventions of relevant law.

Accordingly, failure to comply with relevant company law and regulation might have a materially adverse impact on LMEL's ability to conduct its activities.

Dividends

Article 49 of the Companies Law provides that a company may only declare or resolve to pay a dividend if the directors are satisfied that the company will be able to pay its debts as they fall due immediately after the distribution. Furthermore it is provided that distributions/dividends can only be made/paid out of 'profits and/or surplus of the Company, as shown in the accounts....'.

Fees

LMEL is required to pay certain fees to maintain i) its authorisation with the DFSA and ii) its registration with the ROC. The relevant authorities have the right to increase such fees.

PART VIII

ADDITIONAL INFORMATION

1. Responsibility Statements

1.1 The Company and the Directors, whose names appear in paragraph 9.1 of this Part VIII, accept responsibility for the information contained in this document. To the best of the knowledge of the Company and the Directors (each of whom has taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and contains no omission likely to affect the import of such information.

2. Incorporation, Registered Office and Business

2.1 The Company was incorporated and registered in Bermuda on 12 October 2005 as an exempted company limited by shares with the name Lancashire Holdings Limited and with registration number EC37415.

2.2 The Company's registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11 Bermuda.

2.3 The Company is a company limited by shares and accordingly the liability of the members of the Company is limited.

2.4 The sole activity of the Company is to act as a holding company for the Group. The Group's principal activity is the provision of global property insurance and reinsurance products.

2.5 The principal legislation under which the Company operates is the Act and regulations made thereunder. The Company is domiciled in Bermuda. The Common Shares have been issued under the Act.

2.6 The Company's principal place of business is Mintflower Place, 8 Par-la-Ville Road, Hamilton HM 08, Bermuda (telephone + 1 441 278 8950).

3. Principal Subsidiaries

As at the date of this document, the Company had the following subsidiaries incorporated in the following jurisdictions, each of which is wholly-owned:

Name of subsidiary	*Place of incorporation*	*Date of Incorporation*	*Nature of Business*	*Percentage of voting power held (whether directly or indirectly)*
Lancashire Insurance Company Limited	Bermuda	28 October 2005	General Insurance Business	100
Lancashire Insurance Marketing Services Limited	United Kingdom	7 October 2005	Insurance Mediation Activities	100
Lancashire Insurance Services Limited	United Kingdom	17 March 2006	Support Services	100
Lancashire Insurance Holdings (UK) Limited	United Kingdom	11 April 2006	Holding company	100
Lancashire Marketing Services (Middle East) limited	Dubai	11 March 2007	Insurance Mediation Activities	100
Lancashire Insurance Company (UK) Limited	United Kingdom	17 March 2006	General Insurance Business	100

4. Share Capital

4.1 The Company was incorporated with an authorised share capital of £120,000 divided into 1,200,000 common shares of US$0.10 of which 120,000 common shares were subscribed for by Pembroke Company Limited and were issued, nil paid.

4.2 The following changes in the authorised and issued share capital of the Company have occurred between its incorporation on 12 October 2005 and 9 March 2009 (being the latest practicable date prior to the publication of this document):

4.2.1 Pursuant to a Shareholders' resolution and a Directors' resolution, each duly adopted on 20 October 2005, the authorised share capital of the Company was increased from US$120,000 to US$1,500,000,000;

4.2.2 On 27 October 2005, 16,000,000 common shares of US$0.10 each were issued fully paid and the original 120,000 common shares issued on incorporation were repurchased by the Company;

4.2.3 On 9 December 2005, a Shareholders' resolution and a Directors' resolution were passed to consolidate the authorised share capital of 15,000,000,000 common shares of US$0.10 into 3,000,000,000 Common Shares of US$0.50 each of which 3,200,000 were in issue;

4.2.4 On 16 December 2005, an aggregate of 192,513,902 new Common Shares were issued as part of LHL's private placement in the US and initial public offering in the UK, which included shares issued on the exercise of an over-allotment option;

4.2.5 During 2006, 113,219 Common Shares were issued and 83,775 Common Shares were repurchased as part of a cashless exercise of warrants (see paragraph 21 of Part VI – Financial Information);

4.2.6 During 2007, 627,087 Common Shares were issued and 446,422 Common Shares were repurchased as part of a cashless exercise of warrants (see paragraph 21 of Part VI – Financial Information);

4.2.6 On 29 October 2007, the Board of directors authorised a US$100 million share repurchase programme pursuant to which 13,640,916 Common Shares were repurchased for a total cash consideration of US$100.2 million (the excess expenditure was confirmed and ratified by the Board on 14 February 2008) and cancelled during 2007;

4.2.7 On 30 April 2008, the Board of Directors authorised a US$100 million share repurchase programme pursuant to which 9,433,168 Common Shares were repurchased for a total cash consideration of US$57.9 million. These shares are held in Treasury; and

4.2.8 During March 2009, 833,200 Common Shares were issued and 613,232 Common Shares were repurchased as part of a cashless exercise of warrrants.

4.3 As at the date of this document, and as at the date of the Admission, the authorised and issued share capital of the Company is, and will be, as follows:

	Authorised Share capital (number)	*US$*	*Issued Fully Paid Common Share capital (number)*	*US$*
Common Shares as at the date of this document	3,000,000,000	1,500,000,000	182,503,063	91,251,531.50
Common Shares as at the date of Admission	3,000,000,000	1,500,000,000	182,503,063	91,251,531.50

4.4 Save as disclosed in paragraph 8 of this Part VIII, no share or loan capital of the Group is currently proposed to be issued or is under option or agreed, conditionally or unconditionally to be put under option.

5. Summary of the Memorandum and Bye-Laws

The objects and powers of the Company are set out in paragraph 6 of its memorandum of association and include acting as a holding company. The rights attaching to the Common Shares are set out in the Bye-laws of the Company. The Bye-laws, which were adopted on 9 December 2005, contain, *inter alia*, provisions to the following effect.

5.1 Rights attached to share capital

The holders of the Common Shares (subject to the other provisions of the Bye-laws) are: entitled to one vote per share, except as provided below; entitled to receive notice of, and attend and vote at, general meetings of the Company; entitled to such dividends as the Board may from time to time declare; and in the event of a winding-up or dissolution of the Company, entitled to be paid the surplus assets of the Company remaining after payment of its liabilities (subject to the rights of holders of any shares in the Company then in issue having preferred rights on the return of capital) in respect of their holdings of Common Shares *pari passu* and *pro rata* to the number of Common Shares held by each of them.

The Company's major Shareholders do not have any different voting rights to what is described in this paragraph.

LHL may acquire its own shares to be held as treasury shares provided that the amount of shares held in treasury shall not exceed 10 per cent. of the Company's issued share capital.

5.2 Modification of rights

Subject to the Act, all or any of the special rights for the time being attached to any class of shares may, unless otherwise provided in the rights attached to the terms of issue of the shares of that class, be altered or abrogated with the consent in writing of the holders of not less than 75 per cent. of the issued shares of that class or with the sanction of a resolution passed by a majority of the votes cast at a separate general meeting of the holders of such shares voting in person or by proxy at which special meeting the quorum shall be two persons at least holding or representing by proxy one-third of the issued shares of the class.

5.3 **Alteration of capital**

The Company may, if authorised by a resolution of the Board, increase its share capital and, if authorised by a resolution of the Shareholders, divide, consolidate, subdivide, change the currency denomination of, diminish or otherwise alter or reduce its share capital in any manner permitted by the Act. Where, on any alteration or reduction of share capital, fractions of shares or some other difficulty would arise, the Board may deal with or resolve the same in such manner as it thinks fit, provided that any such action does not result in, after taking into account the restrictions on exercise of voting rights contained in Bye-laws 39-43 (inclusive), any non *de minimis* adverse tax, regulatory or legal consequences to the Company, any subsidiary of the Company, or any direct or indirect holder of shares or its affiliates.

5.4 **Voting rights**

In general, and except as provided below, Shareholders have one vote for each Common Share held by them and are entitled to vote at all meetings of Shareholders. However, if, and so long as, the Common Shares of a Shareholder in the Company are treated as ''controlled shares'' (as determined pursuant to section 958 of the Code and Treasury Regulations promulgated thereunder and under section 957 of the Code) of any US Person and such controlled shares constitute 9.5 per cent. or more of the votes conferred by the issued shares of the Company, the voting rights with respect to the controlled shares owned by such US Person shall be limited, in the aggregate, to a voting power of less than 9.5 per cent., under a formula specified in the Bye-laws. The formula is applied repeatedly until the voting power of all 9.5 per cent. US Shareholders has been reduced to less than 9.5 per cent. In addition, the Board may limit a Shareholder's voting rights when it deems it appropriate to do so to (i) avoid the existence of any 9.5 per cent. US Shareholder; and (ii) avoid certain adverse tax, legal or regulatory consequences to the Company or any of its subsidiaries or any Shareholder or its affiliates. ''*Controlled shares*'' includes, among other things, all shares of the Company that such US Person is deemed to own directly, indirectly or constructively (within the meaning of section 958 of the Code and Treasury Regulations promulgated thereunder and under section 957 of the Code). The amount of any reduction of votes that occurs by operation of the above limitations will generally be reallocated proportionately among all other Shareholders of the Company whose shares were not ''controlled shares'' of the 9.5 per cent. US Shareholder so long as such reallocation does not cause any person to become a 9.5 per cent. US Shareholder.

Under these provisions, certain Shareholders may have their voting rights limited, while other Shareholders may have voting rights in excess of one vote per Common Share. Moreover, these provisions could have the effect of reducing the votes of certain Shareholders who would not otherwise be subject to the 9.5 per cent. limitation by virtue of their direct share ownership.

The Company can require any Shareholder to provide such information as the Directors may reasonably request for the purpose of determining whether a Shareholder's voting rights are to be adjusted. If any Shareholder fails to respond to this request or submits incomplete or inaccurate information in response to such request, the Directors may, in their sole discretion, determine that the Shareholder's shares shall carry no voting rights until otherwise determined by the Board. All information provided by the Shareholder shall be treated by the Company as confidential information and shall be used by the Company solely for the purpose of establishing whether any 9.5 per cent. US Shareholder exists (except as otherwise required by applicable law or regulation).

5.5 **Voting of Non-US Subsidiary shares**

If the Company is required or entitled to vote at a general meeting of LICL or LUK or any other directly held non-US subsidiary of the Company (together, the ''**Non-US Subsidiaries**''), the Company's Directors shall refer the subject matter of the vote to the Shareholders on a poll and seek authority from such Shareholders as to how the Company should vote on the resolution proposed by the Non-US Subsidiary. Substantially similar provisions are or will be contained in the Bye-laws (or equivalent governing documents) of the Non-US Subsidiaries.

5.6 **Transfer of shares**

Transfers of shares may be effected by an instrument of transfer in writing in the form contemplated by section 12.1 of the Bye-laws, or as near thereto as the circumstances admit, or in such other form as the Board may accept. An instrument of transfer shall be signed by or on behalf of the transferor and (where any share is not fully paid) the transferee. The Directors may, in their absolute discretion and without assigning any reason therefore, decline to register any transfer of any share which is not a fully-paid share. Further, the Directors may decline to register a transfer of shares if they believe that the result of such transfer may result in a non *de minimis* adverse tax, legal or regulatory consequence to the Company, LICL or LUK, any other subsidiary of the Company or any direct or indirect holder of shares or its affiliates provided that such refusal does not prevent dealings in such shares taking place on an open and proper basis and provided that such provision would only be exercised to avoid any non *de minimis* adverse tax, legal or regulatory consequence arising out of the US CFC rules as described in paragraph 7.4 of this Part VIII. Shares may be transferred without a written instrument if transferred by an appointed agent or otherwise in accordance with the Act.

The Bye-laws do not contain any restrictions other than those described above on the transferability of fully-paid shares provided that the Company has no lien over such shares, is duly stamped (if so required) and the Directors are satisfied that all applicable approvals under Bermuda law required to be obtained prior to such transfer has been obtained.

5.7 **Power to issue shares**

Subject to the Bye-laws and to any resolution of Shareholders to the contrary, the Directors shall have the power to issue any unissued shares of the Company on such terms and conditions as they may determine.

5.8 **Authority to issue shares**

The Directors shall not exercise any power of the Company to allot "Relevant Securities" (meaning any shares of the Company (other than shares allotted in pursuance of any Employee Share Scheme (as defined in the Bye-laws), or Warrants exercised under the Warrant Certificates (as defined in the Bye-laws)) and any right to subscribe for, or to convert any security into, shares in the Company) unless authorised to do so by a shareholders' resolution in a general meeting. Relevant Securities shall not include shares allotted or the right to subscribe for or convert any security into shares granted as part of any offering of shares culminating in an "Admission" (meaning the first occurring admission of any class of shares of the Company to trading on AIM or to the Official List and to trading on the London Stock Exchange's market for listed securities) (including any shares so allotted or rights granted, whether before or after Admission, in accordance with any over-allotment or stabilisation arrangements entered into by the Company in connection therewith). Any authority, whether it is unconditional or subject to conditions, or whether given generally or for a particular exercise, shall state the maximum amount of Relevant Securities that may be allotted under it and the date on which it will expire, to be no more than five years from the date on which the resolution is passed, unless previously revoked or varied by resolution of the shareholders in general meeting. Whether the definition of Relevant Securities applies to any rights to subscribe for or to convert any security into shares, the authority relates to the maximum number of shares which may be allotted pursuant to such rights. The Directors may allot Relevant Securities after the expiry of the authority, in pursuance of an offer or agreement made by the Company before the expiry of such authority. No breach of these provisions shall affect the validity of any allotment or any Relevant Securities.

5.9 **Pre-emption rights**

The Bye-laws contain provisions giving pre-emption rights to holders of "Relevant Shares" (meaning the shares in the Company other than (i) those shares giving rights to participate only up to a specified amount of dividend and capital in a distribution; and (ii) shares acquired or to be allotted pursuant to any Employee Share Scheme or pursuant to any warrants exercised under the Warrant Certificates (each as defined in the Bye-laws), entitling them to be offered "Equity Securities" meaning Relevant Shares and the right to subscribe for or convert securities into Relevant Shares, excluding shares or any rights to subscribe for or convert any security into shares as part of any offering of shares or any rights to subscribe for or convert any security into shares as part of any offering of shares culminating in an Admission (including any shares so allotted or rights granted, whether before or after Admission, in accordance with any over-allotment or stabilisation arrangements entered into by the Company in connection therewith), in proportion to their existing shareholdings. These pre-emption provisions do not apply to allotments of Equity Securities which are paid otherwise than in cash (meaning where paid up otherwise than by cash received by the Company or cheque received by the Company in good faith which the Directors have no reason to suspect will not be paid or release of a liability of the Company for a liquidated sum or an undertaking to pay cash to the Company at a future date, where "cash" also includes foreign currency) and they do not apply to the allotment of securities which would be held under any Employee Share Scheme (as defined in the Bye-laws). Any Equity Securities which the Company has offered to a holder of Relevant Shares may be allotted to him, or to anyone in whose favour he has renounced his right to their allotment, without contravening these provisions. Any offer made under these provisions must state a period of not less than 21 days during which it may be accepted and this offer shall not be withdrawn before the end of such period.

5.10 **Disapplication of pre-emption rights**

The pre-emption rights contained summarised above may be disapplied in whole or modified as the Directors determine, provided the Directors are given power by resolution of a special majority of not less than three-fourths of the Company's shareholders as (being entitled to do so) vote in person or by proxy at a general meeting of the Company, which shall not be proposed unless recommended by the Directors and a notice is circulated to shareholders with a Directors' statement setting out reasons for making such recommendation, the amount to be paid to the Company in respect of such allotment, and the Directors' justification of such amount.

5.11 **Dividends and other distributions**

The Company may by resolution of the Directors (subject to its constitutional documents and the Act), declare a dividend or other distribution to be paid to Shareholders from funds legally available for payment of dividends or distributions, in accordance with their respective rights and interests. The Board may fix any date as the record date for determining the Shareholders entitled to receive any dividend. Such dividend or other distribution may be paid in cash or wholly or partly by the distribution of specific assets and may fix the value for dividend or distribution purposes of any such specific assets. The Directors may resolve to capitalise any sum outstanding to the credit of the Company's share premium or other reserve accounts or to the credit of the profit and loss account or otherwise available for distribution by applying such sum in paying up additional Common Shares in the Company, credited as fully paid, instead of cash in respect of all or part of a dividend.

Any dividend and/or other moneys payable in respect of a Common Share which has remained unclaimed for seven years from the date when it became due for payment shall, if the Board so resolves, be forfeited and cease to remain owing by the Company. The payment of any unclaimed dividend or other moneys payable in respect of a Common Share may (but need not) be paid by the Company into an account separate from the Company's own account. Such payment shall not constitute the Company as a trustee in respect thereof.

5.12 **Shareholders' meetings**

5.12.1 *Annual general meetings*

The annual general meeting of the Company shall be held in each year (other than the year of incorporation) at such time and place as the President or the Chairman or the Board shall appoint, provided that no general meeting shall be held in the UK.

5.12.2 *Special general meetings*

The President or the Chairman or the Board may convene a special general meeting of the Company whenever in their judgement such a meeting is necessary, provided that no special general meeting shall be held in the UK.

5.12.3 *Requisitioned general meetings*

The Board shall, on the requisition of Shareholders holding at the date of the deposit of the requisition not less than one-tenth of such of the paid-up share capital of the Company as at the date of the deposit carries the right to vote at general meetings of the Company, forthwith proceed to convene a special general meeting of the Company and the provisions of the Act shall apply.

5.12.4 *Notice*

5.12.4.1 At least 21 days' notice of an annual general meeting shall be given to each Shareholder entitled to attend and vote thereat, stating the date, place and time at which the meeting is to be held, that the election of Directors will take place thereat, and as far as practicable, the other business to be conducted at the meeting.

5.12.4.2 At least 21 days' notice of a special meeting shall be given to each Shareholder entitled to attend and vote thereat, stating the date, place and general nature of the business to be considered at the meeting.

5.12.4.3 The Board may fix any date as the record date for determining the Shareholders entitled to receive notice of and to vote at any general meeting of the Company.

5.12.4.4 A general meeting of the Company shall, notwithstanding that it is called on shorter notice than that specified in the Bye-laws, be deemed to have been properly called if it is so agreed by (i) all the Shareholders entitled to attend and vote thereat in the case of an annual general meeting; and (ii) by a majority in number of the Shareholders having the right to attend and vote at the meeting, being a majority together holding not less than 95 per cent. in nominal value of the shares giving a right to attend and vote thereat in the case of a special general meeting.

5.12.4.5 The accidental omission to give notice of a general meeting to, or the non-receipt of a notice of a general meeting by, any person entitled to receive notice shall not invalidate the proceedings at that meeting.

5.12.5 *Giving notice*

5.12.5.1 A notice may be given by the Company to any Shareholder either by delivering it to such Shareholder in person or by sending it to such Shareholder's address in the Register of Shareholders or to such other address given for the purpose. For the purposes of this Bye-law, a notice may be sent by letter mail, courier service, cable, telex, telecopier, facsimile, electronic mail or other mode of representing words in a legible form.

5.12.5.2 Any notice required to be given to a Shareholder shall, with respect to any shares held jointly by two or more person, be given to whichever of such persons is named first in the Register of Shareholders and notice so given shall be sufficient notice to all the holders of such shares.

5.12.5.3 Save as provided in paragraph 5.12.5.4 below, any notice shall be deemed to have been served at the time when the same would be delivered in the ordinary course of transmission and, in proving such service, it shall be sufficient to prove that the notice was properly addressed and prepaid, if posted, at the time when it was posted, delivered to the courier or to the cable company or transmitted by telex, facsimile, electronic mail, or such other method, as the case may be.

5.12.5.4 Mail notice shall be deemed to have been served seven days after the date on which it is deposited, with postage prepaid, in the mail of any member state of the European Union, the US or Bermuda.

5.12.5.5 The Company shall be under no obligation to send a notice or other document to the address shown for any particular Shareholder in the Register of Shareholders if the Board considers that the legal or practical problems under the laws of, or the requirements of any regulatory body or stock exchange in, the territory in which that address is situated are such

that it is necessary or expedient not to send the notice or document concerned to such Shareholder at such address and may require a Shareholder with such an address to provide the Company with an alternative acceptable address for delivery of notices by the Company.

5.12.6 *Postponement or cancellation of general meeting*

The Chairman or the President may, and the Secretary on instruction from the Chairman or the President shall, postpone or cancel any general meeting called in accordance with the provisions of the Bye-laws (other than a meeting requisitioned under the Bye-laws) provided that notice of postponement or cancellation is given to each Shareholder before the time for such meeting. Fresh notice of the date, time and place for the postponed or cancelled meeting shall be given to the Shareholders in accordance with the provisions of the Bye-laws.

5.12.7 *Attendance and security at general meetings*

Shareholders may participate in any general meeting by means of such telephone, electronic or other communication facilities as permit all persons participating in the meeting to communicate with each other simultaneously and instantaneously, and participation in such a meeting shall constitute presence in person at such meeting.

The Board may, and at any general meeting, the chairman of such meeting may make any arrangement and impose any requirement or restriction it or he considers appropriate to ensure the security of a general meeting, including, without limitation, requirements for evidence of identity to be produced by those attending the meeting, the searching of their personal property and the restriction of items that may be taken into the meeting place. The Board and, at any general meeting, the chairman of such meeting are entitled to refuse entry to a person who refuses to comply with any such arrangements, requirements or restrictions.

5.12.8 *Quorum at general meetings*

At any general meeting of the Company two or more persons present in person at the start of/ throughout the meeting shall form a quorum for the transaction of business.

If within half an hour from the time appointed for the meeting a quorum is not present, then, in the case of a meeting convened on a requisition, the meeting shall be deemed cancelled and, in any other case, the meeting shall stand adjourned to the same day one week later, at the same time and place or to such other day, time or place as the Secretary may determine. If the meeting shall be adjourned to the same day one week later or the Secretary shall determine that the meeting is adjourned to a specific date, time and place, it is not necessary to give notice of the adjourned meeting other than by announcement at the meeting being adjourned. If the Secretary shall determine that the meeting be adjourned to an unspecified date, time or place, fresh notice of the resumption of the meeting shall be given to each Shareholder entitled to attend and vote thereat in accordance with the provisions of the Bye-laws.

5.12.9 *Chairman to preside*

Unless otherwise agreed by a majority of those attending and entitled to vote thereat, the Chairman, if there be one, and if not the President, shall act as chairman at all meetings of the Shareholders at which such person is present. In their absence, the Deputy Chairman or Vice President, if present, shall act as chairman and in the absence of all of them a chairman shall be appointed or elected by those present at the meeting and entitled to vote.

5.12.10 *Representation of corporate member*

A corporation which is a Shareholder may, by written instrument, authorise such person or persons as it thinks fit to act as its representative at any meeting of the Shareholders and any person so authorised shall be entitled to exercise the same powers on behalf of the corporation which such person represents as that corporate could exercise if it were an individual Shareholder, and that Shareholder shall be deemed to be present in person at any such meeting attended by its authorised representative or representatives.

Notwithstanding the foregoing, the chairman of the meeting may accept such assurances as he thinks fit as to the right of any person to attend and vote at general meetings on behalf of a corporation which is a Shareholder.

5.12.11 *Adjournment of general meeting*

The chairman of any general meeting at which a quorum is present may with the consent of Shareholders holding a majority of the voting rights of those Shareholders present in person or by proxy (and shall if so directed by Shareholders holding a majority of the voting rights of those Shareholders present in person or by proxy), adjourn the meeting.

In addition, the chairman may adjourn the meeting to another time and place without such consent or direction if it appears to him that: it is likely to be impracticable to hold or continue that meeting because of the number of Shareholders wishing to attend who are not present; or the unruly conduct of persons attending the meeting prevents, or is likely to prevent, the orderly continuation of the business of the meeting; or an adjournment is otherwise necessary so that the business of the meeting may be properly conducted.

Unless the meeting is adjourned to a specific date, place and time announced at the meeting being adjourned, fresh notice of the date, place and time for the resumption of the adjourned meeting shall be given to each Shareholder entitled to attend and vote thereat in accordance with the provisions of the Bye-laws.

5.12.12 *Written resolutions*

Subject to the following, anything (except for the removal of an auditor or Director before the expiration of his terms of office) which may be done by resolution of the Company in general meeting or by resolution of a meeting of any class of the Shareholders may, without a meeting and without any previous notice being required, be done by resolution in writing signed by, or in the case of a Shareholder that is a corporation whether or not a company within the meaning of the Act, on behalf of, all the Shareholders who at the date of the resolution would be entitled to attend the meeting and vote on the resolution (after giving effect to any adjustment in voting rights described in paragraph 5.4 of this Part VIII – Additional Information).

A resolution in writing may be signed by, or in the case of a Shareholder that is a corporation whether or not a company within the meaning of the Act, on behalf of, all the Shareholders, or all the Shareholders of the relevant class thereof, in as many counterparts as may be necessary.

5.13 **Directors**

Election of Directors

5.13.1 The Board shall consist of such number of Directors being not less than 2 Directors and not more than such maximum number of Directors, not exceeding 15 Directors, as the Board may from time to time determine.

5.13.2 Only persons who are proposed or nominated in accordance with Bye-law 46 shall be eligible for election as Directors. Any Shareholder or the Board may propose any person for election as a Director. Where any person, other than a Director retiring at the meeting or a person proposed for re-election or election as a Director by the Board, is to be proposed for election as a Director, notice must be given to the Company of the intention to propose him and of his willingness to serve as a Director. Where a Director is to be elected at an annual general meeting, that notice must be given not less than 90 days nor more than 120 days before the anniversary of the last annual general meeting prior to the giving of the notice or, in the event the annual general meeting is called for a date that is not 30 days before or after such anniversary the notice must be given not later than 10 days following the earlier of the date on which notice of the annual general meeting was posted to Shareholders or the date on which public disclosure of the date of the annual general meeting was made. Where a Director is to be elected at a special general meeting, that notice must be given not later than 10 days following the earlier of the date on which notice of the special general meeting was posted to Shareholders or the date on which public disclosure of the date of the special general meeting was made. Where there are more nominees for election than the number of Directors to be elected, the person(s) receiving the most votes shall be elected as the Director(s), otherwise nominees shall be elected by a majority vote of the Shareholders present and voting at the relevant general meeting.

5.13.3 At any general meeting the Shareholders may authorise the Board to fill any vacancy in their number left unfilled at a general meeting.

5.13.4 A Director may also be appointed or elected pursuant to the special rights that may be designated by the Board in respect of a class or series of shares pursuant to Bye-law 4.2(c).

5.13.5 On or before the date of the first annual general meeting of Shareholders following the incorporation of the Company, the Directors shall be divided by the Shareholders into three classes designated Class I, Class II and Class III. Each class of Directors shall consist, as nearly as possible, of one third of the total number of Directors constituting the entire Board.

No Share qualification

5.13.6 A Director is not required to hold any shares in the capital of the Company and is entitled to attend and speak at general meetings or at any separate meeting of the holders of any class of shares or debentures in the capital of the Company, notwithstanding that the Director does not hold shares.

Term of office of Directors

5.13.7 The term of office of the first Class I Directors shall expire at the 2009 annual general meeting of the Shareholders, the term of office of the first Class II Directors shall expire at the 2008 annual general meeting of the Shareholders and the term of office of the first Class III Directors shall expire at the 2007 annual general meeting of the Shareholders. At each annual general meeting, successors to the class of Directors whose term expires at that annual general meeting shall be elected for a three year term. If the number of Directors is changed, any increase or decrease shall be apportioned among the classes so as to maintain the number of Directors in each class as nearly equal as possible, and any Director of any class elected to fill a vacancy shall hold office for a term that shall coincide with the remaining term of the other Directors of that class, but in no case shall a decrease in the number of Directors shorten the term of any Director then in office. A Director shall hold office until the annual general meeting for the year in which his term expires, subject to his office being vacated earlier pursuant to Bye-law 50 or Bye-law 51.

Alternate Directors

5.13.8 The Bye-laws provide for the appointment of alternate Directors (Bye-law 49).

Removal of Directors

5.13.9 Subject to the Bye-laws, the Shareholders may remove a Director at any special general meeting (in the case of Richard Brindle, only with cause until the earlier of Admission or 1 April 2006), provided that the notice of any such meeting be served on such Director not less than 14 days before the meeting and at such meeting the Director shall be entitled to be heard on the motion for such Director's removal.

5.13.10 If a Director is removed from the Board under the provisions of Bye-law 50 and 51 the Shareholders may fill the vacancy. In the absence of such election or appointment, the Board may fill the vacancy.

Vacancy in the office of Director

5.13.11 The office of Director shall be vacated if the Director: is removed from office pursuant to the Bye-laws or is prohibited from being a Director by law, is or becomes bankrupt, or makes any arrangement or composition with his creditors generally, is or becomes of unsound mind or dies, resigns his office by notice in writing to the Company or upon his term of office expiring pursuant to the special rights of any class or series of shares.

5.13.12 The Shareholders in general meeting or the Board shall have the power to appoint any person as a Director to fill a vacancy on the Board occurring as a result of the death, disability, disqualification or resignation of any Director or as a result of an increase in the size of the Board and to appoint an Alternate Director to any Director so appointed.

Directors' fees

5.13.13 The amount of any remuneration payable to Directors shall be determined by the Directors and paid in accordance with the Bye-laws.

Remuneration of executive Director

5.13.14 Any Director who holds any executive office (including for this purpose the office of chairman or deputy chairman), or who serves on any committee, or who, at the request of the Directors, goes or resides abroad, makes any special journey or otherwise performs services which in the opinion of the Directors, determined in a resolution of the Directors, are outside the scope of the ordinary duties of a Director, may be paid such remuneration by way of salary, commission or otherwise as the Directors may determine in addition to or in lieu of any fee payable to him for his services as Director pursuant to the Bye-laws.

Expenses

5.13.15 The Company shall repay to any Director all such reasonable expenses as he may properly incur in the performance of his duties.

Directors' pensions and other benefits

5.13.16 The Directors may exercise all the powers of the Company to establish and maintain a pension or superannuation funds for the benefit of, and give or procure the giving of donations, gratuities, pensions, allowances or emoluments to, any persons who are or were at any time in the employment or service of the Company or any other company in which the Company has any interest whether direct or indirect and to the families and dependants of any such persons, and also establish and subsidise or subscribe to any institutions, associations, clubs or funds calculated to be for the benefit of or to advance the interests and well-being of the Company or of any such other company, or of any such persons as aforesaid, and, subject to the Act, make payments for or towards the insurance of any such persons as aforesaid, and do any of the matters aforesaid either alone or in conjunction with any such other company.

Defect in appointment of Director

5.13.17 All acts done in good faith by the Board or by a committee of the Board or by any person acting as a Director shall be as valid as if every such person had been duly appointed and was qualified to be a Director.

Directors to manage business

5.13.18 The business of the Company shall be managed by the Board, who may exercise all such powers as are not required to be exercised by the Company in general meeting subject always to the Bye-laws and the provisions of any statute. The Board may delegate to any company, firm, person, or body of persons any power of the Board (including the power to sub-delegate).

Certain powers of the Board of Directors

5.13.19 The Board may appoint one or more Directors to the office of managing director or chief executive officer of the Company, who shall, subject to the control of the Board, supervise and administer all of the general business and affairs of the Company. The Board may also delegate any of its powers to a committee which may consist partly or entirely of non-Directors or to any person on such terms and in such manner as the Board may see fit, provided that such person is resident outside the UK whether nominated directly or indirectly by the Board. The Board may exercise all the powers of the

Company to borrow money and to mortgage or charge its undertaking, property and uncalled capital, or any part thereof, and may issue debentures, debenture stock, and other securities whether outright or as security for any debt, liability or obligation of the Company or of any third party.

Officers

5.13.20 Officers are appointed by the Board and shall consist of a President and a Vice President or a Chairman and a Deputy Chairman, a Chief Executive Officer, a Chief Underwriting Officer, a Chief Financial Officer, a Secretary and such additional Officers as the Board may determine. All Officers must also be Directors. The Officers shall have such powers and perform such duties in the management, business and affairs of the Company as may be delegated to them by the Board from time to time. The Officers shall receive such remuneration as the Board may determine.

Conflicts of interest

5.13.21 Any Director, or any Director's firm, partner or any company with whom any Director is associated, may act in any capacity for, be employed by or render services to the Company and such Director or such Director's firm, partner or company shall be entitled to remuneration as if such Director were not a Director. Nothing herein in the Bye-laws shall authorise a Director or Director's firm, partner or company to act as an auditor to the Company.

5.13.22 A Director who is directly or indirectly interested in a contract or proposed contract or arrangement with the Company shall declare the nature of such interest as required by the Act. Following such a declaration, unless disqualified by the chairman of the relevant Board meeting, a Director may vote in respect of any contract or proposed contract or arrangement in which such Director is interested and may be counted in the quorum for such meeting.

Indemnification and exculpation of Directors and Officers

5.13.23 Subject to the proviso that the indemnity (as summarised below) shall not extend to any matter which would render it void or unenforceable pursuant to the Act, the Directors, Secretary and other Officers shall be indemnified and secured harmless out of the assets of the Company from and against all actions, costs, charges, liabilities, losses, damages and expenses which they or any of them, their heirs, executors or administrators, shall or may incur or sustain by or by reason of any act done, concurred in or omitted in or about the execution of the Company's business, or their duty, or supposed duty, or in their respective offices or trusts.

5.13.24 The indemnity (as described in the paragraph above) shall not extend to any matter in respect of any fraud or dishonesty which may attach to any of the said persons. Each Shareholder agrees to waive any claim or right of action such Shareholder might have, whether individually or by or in the right of the Company, against any Director or Officer on account of any action taken by such Director or Officer, or the failure of such Director or Officer to take any action in the performance of his duties with or for the Company or any subsidiary thereof, provided that such waiver shall not extend to any matter in respect of any fraud or dishonesty which may attach to such Director or Officer. The indemnity provided to the persons specified in Bye-law 62.1 shall apply if those persons are acting in the reasonable belief that they have been appointed or elected to any office or trust of the Company, or any subsidiary thereof, notwithstanding any defect in such appointment or election.

5.13.25 To the extent that any person is entitled to claim an indemnity pursuant to Bye-law 62 in respect of amounts paid or discharged by him, the indemnity shall take effect as an obligation of the Company to reimburse the person making such payment or effecting such discharge.

5.13.26 No monies shall be paid unless payment is authorised in the specific case by the Board, by a majority vote at a meeting duly constituted by a quorum of Directors not party to the proceedings or matter with regard to which the indemnification is, or would be claimed, or if such meeting cannot be constituted because of a lack of disinterested quorum, by independent legal counsel in a written opinion, or by a resolution of the Shareholders.

5.13.27 The Company may purchase and maintain insurance for the benefit of any Director or Officer of the Company against any liability incurred by him under the Act in his capacity as a Director or Officer of the Company or indemnifying such Director or Officer in respect of any loss arising or liability attaching to him by virtue of any rule of law in respect of any negligence, default, breach of duty or breach of trust of which the Director or Officer may be guilty in relation to the Company or any subsidiary thereof.

5.13.28 Bye-law 62 provides the broadest indemnity allowable under applicable law.

5.14 **Board meetings**

Board meetings

5.14.1 The Board may regulate its meetings as it sees fit, provided that no meeting of the Board shall be held in the UK. Subject to the provisions of the Bye-laws, a resolution put to the vote at a meeting of the Board shall be carried by the affirmative votes of a majority of the votes cast and in the case of an equality of votes the resolution shall fail.

Notice of Board meetings

5.14.2 A Director may, and the Secretary on the requisition of a Director shall, at any time summon a meeting of the Board. Notice of a meeting of the Board shall be deemed to be duly given to a Director if it is given to such Director verbally (in person or by telephone) or otherwise communicated or sent to such Director by post, cable, telex, telecopier, facsimile, electronic mail or other mode of representing words in a legible form at such Director's last known address or any other address given by such Director to the Company for this purpose.

Participation in meetings by telephone

5.14.3 Directors may participate in any meeting of the Board by means of such telephone, electronic or other communication facilities provided that such person is physically outside the UK. Such a meeting shall be deemed to take place outside the UK where the largest group of those Directors participating in the meeting is physically assembled, or, if there is no such group, where the chairman of the meeting then is.

Quorum at Board meetings

5.14.4 The quorum of the Board shall be two Directors. No meetings of the Board shall be quorate if the majority of the Directors present consist of persons who are resident in the UK for UK tax purposes, respectively.

Board to continue in the event of vacancy

5.14.5 The Board may act notwithstanding any vacancy in its number but, if and so long as its number is reduced below the number fixed by the Bye-laws as the quorum necessary for the transaction of business at meetings of the Board, the continuing Directors or Director may act for the purpose of (i) summoning a general meeting of the Company; or (ii) preserving the assets of the Company.

Chairman to preside

5.14.6 Unless otherwise agreed by a majority of the Directors attending, the Chairman, if there be one, and if not, the President shall act as chairman at all meetings of the Board at which such person is present. In their absence the Deputy Chairman or Vice President, if present, shall act as chairman and in the absence of all of them a chairman shall be appointed or elected by the Directors present at the meeting.

Written resolutions

5.14.7 Bye-law 69 provides for unanimous written resolutions of Directors to be as valid as though passed at a meeting of the Board.

Validity of prior acts of the Board

5.14.8 No regulation or alteration to the Bye-laws made by the Company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation or alteration had not been made.

5.15 **Notification of interests in shares and disenfranchisement**

Shareholders are required under the Bye-laws to notify the Company whenever they (or any person who is interested in any shares held by them) become interested in shares in the capital of the Company representing more than 3 per cent. of the issued share capital of any class of shares of the Company, and of any addition to or reduction of such interests by 1 per cent. or more of the issued share capital of any class of share of the Company. If any Shareholder fails to comply with these requirements, the Board may, by notice to the holder of the shares, suspend their rights as to voting, dividends and transfer for so long as the default continues.

5.16 **Power of the Company to investigate interests in shares**

Under the Bye-laws the Company may give notice to any person whom the Company knows or has reasonable cause to believe to be or, at any time during the 3 years immediately preceding the date on which the notice is issued, to have been interested in the Company's shares requiring them to confirm whether or not they have such an interest and where they hold or have during that time held an interest in the Company's shares, to give such further information as may be requested. If any Shareholder appearing to have such an interest does not comply with the request for information the Board may by notice to the Shareholder suspend their rights as to voting, dividends and transfer.

5.17 **Return of capital**

The Board may resolve to capitalise all or any part of any amount standing to the credit of any reserve or fund which is available for distribution or to the credit of any share premium account by applying such amount in paying up unissued shares to be allotted as fully paid bonus shares *pro rata* to the Shareholders who would be entitled thereto if distributed by way of dividend and in the same proportions. Capital may also be returned by way of a reduction of capital pursuant to section 46 of the Act, or by way of a distribution of contributed surplus pursuant to section 54 of the Act. Further the Company has power pursuant to the Act to issue redeemable preference shares, and also to repurchase its Common Shares pursuant to the Act.

5.18 **Takeover provisions**

To the extent permitted under the Act, Bye-law 88 adopts certain of the provisions of the Takeover Code, including provisions dealing with compulsory takeover offers and shareholder treatment along the lines of the General Principles (including, "**Equal Treatment**") and the rules governing substantial acquisitions of shares (each to the extent permitted by Bermuda law), which are to be administered by the Board. Bye-law 88 is to have effect only during such times as the Takeover Code does not apply to the Company.

Pursuant to Bye-law 88, a person must not: (i) acting by himself or with persons determined by the Board to be acting in concert, seek to acquire shares in the Company which carry 30 per cent. or more of the voting rights attributable to the shares in the Company; or (ii) acting by himself or with persons determined by the Board to be acting in concert, hold 30 per cent. but not more than 50 per cent. of the voting rights, and seek to acquire, by himself or with persons determined by the Board to be acting in concert, additional shares which, taken together with the shares held by the persons determined by the Board to be acting in concert with him, increase his voting rights, except as a result of a "permitted acquisition" (meaning an acquisition either consented to by the Board, or made in compliance with Rule 9 of the Takeover Code, or arising from the repayment of a stock borrowing arrangement); or (iii) effect or purport to effect an acquisition which would breach or not comply with the rules governing substantial acquisitions of shares and Rules 4, 5, 6 or 8 of the Takeover Code (as amended from time to time), if the Company were subject to the Takeover Code.

Where the Board has reason to believe that any of such circumstances has taken place, it may take all or any of certain measures: (i) require the person(s) appearing to be interested in the shares of the Company to provide such information as the Board considers appropriate; (ii) have regard to such public filings as may be necessary to determine any of the matters under Bye-law 88; (iii) make any determination under Bye-law 88 as it thinks fit, either after calling for submissions by the relevant person(s) or without calling for any; (iv) determine that the voting rights attached to such shares in breach of the Bye-laws, the "**Excess Shares**", are from a particular time incapable of being exercised for a definite or indefinite period; (v) determine that some or all of the Excess Shares are to be sold; (vi) determine that some or all of the Excess Shares will not carry any right to any dividends or other distributions from a particular time for a definite or indefinite period; and (vii) taking such actions as it thinks fit for the purposes of Bye-law 88, including prescribing rules not inconsistent with Bye-law 88, setting deadlines for the provision of information, drawing adverse inferences where information requested is not provided, making determination or interim determinations, executing documents on behalf of a shareholder, converting any Excess Shares held in uncertificated form into certificated form and vice-versa, paying costs and expenses out of proceeds of sale, and changing any decision or determination or rule previously made.

The Board has the full authority to determine the application of Bye-law 88, including the deemed application of the whole or any part of the Takeover Code, and such authority shall include all the discretion that the Panel on Takeovers and Mergers in the UK would exercise if the whole or part of the Takeover Code applied. Any resolution or determination made by the Board, any Director or the chairman of any meeting acting in good faith is final and conclusive and is not open to challenge as to its validity or as to any other ground. The Board is not required to give any reason for any decision or determination it makes.

5.19 **New Bye-laws to be adopted at the AGM**

At the AGM of the Company to be held on 14 May 2009, the Company will adopt the New Bye-Laws which will make a number of changes to the Bye-Laws. The principal changes introduced in the New Bye-Laws are set out below. Other changes, which are of a minor, technical or clarifying nature, have not been noted.

5.19.1 *Definitions*

The Definitions section is to be updated to insert new definitions, which are relevant to a Main Market company, and to remove definitions relating to the Company's admission to AIM in 2005.

5.19.2 *Untraced Shareholders*

The New Bye-laws will contain an additional Bye-law which would allow Lancashire to sell, in such manner and for such price as it thinks fit, the shares of shareholders whose accounts have been dormant for a twelve year period.

5.19.3 *Forfeiture of shares*

The New Bye-laws will contain additional provisions relating to statutory declaration on forfeiture and extinction of all interests.

5.19.4 *Notice*

The New Bye-laws will change a notice period for a special general meeting of the Company from 21 days to 14 days.

5.19.5 *Voting on Resolutions*

The following amendments are to be made to Bye-law 30.1 (Voting on Resolutions): "and in the case of an equality of votes the resolution shall fail" will be changed to "In the case of an equality of votes both for and against the resolution, whether on a show of hands or on a poll, the chairman of the meeting at which the show of hands takes place or at which the poll is demanded shall be entitled to a casting vote in addition to the votes to which he may be entitled as a member or as a representative or proxy of a member"; and "In the event that a Member participates in a general meeting by telephone or electronic means, the chairman of

the meeting shall direct the manner in which such Member may cast his vote on a show of hands'' is to be added.

5.19.6 *Term of Office of Directors*

Bye-laws relating to term of office of Directors in the Bye-laws will be deleted in their entirety as they refer to the admission of Lancashire to AIM. A new Bye-Law will be added in place of Bye-Law 48, whereby one-third of the Directors shall retire by rotation at each AGM; the Directors eligible for retirement will include any Director wishing to retire and those who have been longest in office since their last re-election or appointment. A retiring Director (subject to the provisions of the Act and the Bye-laws) will be eligible for re-election.

5.19.7 *One Class of Directors*

Following the incorporation of the Company in 2005, the Directors were divided by the Members into three classes designated Class I, Class II and Class III. Each class of Directors consists, as nearly as possible, of one third of the total number of Directors. References to the different classes of Directors will be removed from the New Bye-laws.

5.19.8 *Removal of Directors*

Bye-law 50.1 the words ''(in the case of Richard Brindle, only with cause until the earlier of Admission of 1 April 2006)'' is to be deleted.

5.19.9 *Remuneration of Directors*

Bye-Law 50 (Remuneration of Directors) is to be amended to remove all references to the admission to AIM. The New Bye-laws will provide that the amount of any remuneration payable to Directors shall be determined by the Board and shall be deemed to accrue from day to day.

5.19.10 *Conflicts of Interest*

The New Bye-laws will include additional Bye-Law to Bye-Law 61 restricting any director of Lancashire voting and counting in the quorum on a resolution concerning his/her appointment.

5.19.11 *Disclosure of Interests in Shares and Company Investigations*

Following Admission, Chapter 5 of the Disclosure and Transparency Rules will govern the disclosure of interests in shares by the Company or its Members. Bye-Law 87.A (Disclosure of Interests in Shares and Company Investigations) is to be amended to delete references to AIM admission and include the provisions required under the Disclosure and Transparency Rules and which are specific to Official List companies.

5.19.12 *Communications*

The New Bye-laws will contain the following additional Bye-Laws: permitting the Company to be communicated to in electronic form; and permitting the Company to communicate with its members in electronic form and also by posting documents on its website if members have agreed, in accordance with the Act, to the Company sending or supplying documentation or information in these ways.

6. Exchange Controls and the Takeover Code

6.1 Each of the Company and LICL has been designated as ''non-resident'' for Bermuda exchange control purposes by the BMA. Where a company is so designated, it is free to deal in currencies of any other country outside the Bermuda exchange control area which are freely convertible into currencies of any other country. The permission of the BMA is required for the issue of any securities (such as shares, warrants or options) by the Company and the subsequent transfer of such securities. In granting such permission, the BMA accepts no responsibility for the financial soundness of any proposals or for the correctness of any statements made or opinions expressed in any document with regard to such issue. Before the Company can issue or transfer any further securities in excess of the amounts already approved, it must obtain the prior consent of the BMA.

6.2 Persons resident in Bermuda for Bermuda exchange control purposes may require the prior approval of the BMA in order to acquire any Common Shares. Upon Admission and for so long as the Common Shares continue to be admitted to listing on the Official List and to trading on the London Stock Exchange's main market for listed securities, the Common Shares may be freely issued and transferred without further consent of the BMA, pursuant to a general permission given by the BMA under the Exchange Control Act 1972 which permits such free issue and transferability provided that voting securities of the Company remain so admitted, subject to the condition that the issue or transfer is to and among persons not resident in Bermuda for exchange control purposes.

Any person who becomes a holder of at least 10 per cent., 20 per cent., 33 per cent. or 50 per cent. of the Common Shares must notify the BMA in writing within 45 days of becoming such a holder or 30 days from the date they have knowledge of having such a holding, whichever is later. The BMA may, by written notice, object to a person holding 10 per cent., 20 per cent., 33 per cent. or 50 per cent. of such Common Shares if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce their holding of Common Shares in the Company and direct, among other things, that voting rights attaching to the Common Shares shall not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offence.

6.3 As the Company is incorporated in Bermuda, it is subject to Bermuda law and the Takeover Code does not apply. Accordingly, any person or persons acting in concert will be able to acquire shares in the Company which, when taken together with the shares already held by them, carry 30 per cent. or more of the voting rights in the Company without being required to make general offer for the entire issued share capital of the Company. Additionally, any party intending to acquire all or a substantial part of the issued share capital of the Company will not be obliged to comply with the provisions of the Takeover Code as to announcements, equality of treatment for shareholders as to the value and type of consideration offered, and will not be subjected to the scrutiny and sanctions of the Panel on Takeovers and Mergers. The Bye-laws contain certain takeover protections, although these will not provide the full protections afforded by the Takeover Code. The relevant provisions of the Bye-laws are summarised in this Part VIII – Additional Information.

6.4 The following summaries of provisions of the Act apply in relation to acquisition of 90 per cent. or 95 per cent. of the shares of a Bermuda company:

6.4.1 section 102 of the Act has application where a scheme or contract involving the transfer of shares has been approved by the holders of 90 per cent. of the shares of a Bermuda company to be transferred within four months of the offer. The offeror can then give notice in the prescribed form to any dissenting shareholder(s) that it desires to acquire their shares, and upon such notice being given to the offeror, unless on an application made by the dissenting shareholder (within one month from the date on which the notice was given) the Supreme Court of Bermuda thinks fit to order otherwise, shall be entitled and bound to mandatorily acquire the dissenting shareholder(s) holdings; and

6.4.2 under section 103 of the Act, a holder of 95 per cent. of the shares of a Bermuda company can, on giving notice to the minority shareholders, force them to sell their interest to the 95 per cent. shareholders provided that the terms offered are the same for all of the holders of the shares whose acquisition is involved. The 5 per cent. shareholders can apply to the Supreme Court of Bermuda for an appraisal of their shares. Once notice has been given, the acquiring shareholder is bound to acquire the outstanding shares on the terms set out in the notice.

7. Taxation

The following summary of the taxation of the Shareholders is based upon current law and is for general information only. Legislative, judicial or administrative changes may be forthcoming that could affect this summary.

7.1 Certain UK tax consequences

The following paragraphs are intended as a general guide only for Shareholders of the Company who are resident or ordinarily resident and domiciled individuals or companies resident in the UK for tax purposes and who hold Common Shares of the Company as investments and not in the course of a trade, and are based on current legislation and case law and HMRC practice at the date of this document. Prospective investors who are in any doubt about their tax position, or who are subject to taxation in a jurisdiction other than the UK, should consult their own professional independent adviser immediately.

(a) *Taxation of chargeable gains*

If a shareholder disposes of Common Shares or Depositary Interests, a liability to UK tax on chargeable gains may arise, depending on the shareholder's circumstances. Companies are eligible for indexation allowance which may reduce the chargeable gain.

(b) *Dividends*

Except in the case of Common Shares or Depositary Interests held by individuals or companies dealing in shares, dividends paid by the Company will (under current law) be assessable to UK income tax under section 402 of the Income Tax (Trading and Other Income) Act 2005 or corporation tax under section 18 of Income and Corporation Taxes Act 1988 ("**ICTA**") (Schedule D Case V).

On the basis that the Company is not resident for tax purposes in the UK, individual holders of Common Shares or Depositary Interests will, if they own less than 10 per cent. of the issued share capital in the Company, be entitled to a tax credit equal to one-ninth of the dividend received from the Company. Such an individual will be taxable on the total of the dividend and the related tax credit (the "**gross dividend**"), which will be regarded as the top slice of the individual's income. The tax credit will be treated as discharging the individual's liability to UK income tax in respect of the gross dividend, unless and to the extent that the gross dividend falls above the threshold for the higher rate of income tax, in which case (under current law) the individual will, to that extent, pay UK income tax at 32.5 per cent. on the gross dividend, less the related tax credit (equating to 25 per cent. of the dividend received). The UK Government has announced that from 6 April 2011 there will be three rates of income tax for dividends – individual shareholders whose annual taxable income exceeds £150,000 will, under these proposals, be subject to UK income tax at 37.5 per cent. on the gross dividend, less the related tax credit (equating to 30.56 per cent. of the dividend received).

On the basis that the Company is not resident for tax purposes in the UK, individual holders of Common Shares or Depository Interests who own 10 per cent. or more of the issued share capital in the Company are not entitled to a tax credit in respect of dividends received from the Company. The dividend receipt will be regarded at the top slice of the individual's income. Such individual shareholders who are liable to income tax at no more than the basic rate will be subject to income tax on the dividend income at the rate of 10 per

cent. whilst individual shareholders liable to income tax at the higher rate will (under current law) be subject to income tax on the dividend income at the rate of 32.5 per cent. The UK Government has announced proposals, to take effect from 6th April 2011, to increase the rate of income tax on dividend income for individuals whose annual taxable income exceeds £150,000 to 37.5 per cent.

The UK Government has announced proposals, to take effect from April 2009, to extend the availability of a tax credit to individuals who own 10 per cent. or more of the issued share capital in distributing non-UK resident companies if certain conditions are satisfied. One of these conditions is expected to mean that the tax credit will not be available if the source country does not have a double tax treaty with the UK. In the case of dividends paid by the Company, on the basis that the Company is resident in Bermuda for tax purposes, which does not have a double tax treaty with the UK, no such tax credit is expected to be available, even after April 2009, to such individual shareholders.

On the basis that the Company is not resident for tax purposes in the UK, any dividends received by a corporate holder of Common Shares or Depositary Interests will not constitute franked investment income but will (under current law) be liable to corporation tax at the rate applicable to the company in question, the standard rate of corporation tax being 28 per cent.

The UK Government has announced proposed changes to the taxation of the foreign profits of companies, to be included in the Finance Bill 2009. These include the introduction of an exemption for foreign dividends received by large and medium-sized groups on a wide range of ordinary shareholdings, subject to certain targeted anti-avoidance rules to protect against avoidance activity to exploit this dividend exemption.

(c) *Stamp duty and stamp duty reserve tax ("**SDRT**")*

Issue

No stamp duty or SDRT should arise in respect of the issue of Common Shares or Depositary Interests provided that the central management and control of the Company is not exercised in the UK and that the Company's share register is not kept in the UK.

Transfer

An agreement to transfer Common Shares will not be subject to SDRT provided that the Company's share register is kept outside the UK. A conveyance or transfer on sale of Common Shares will not be subject to stamp duty provided that the instrument of transfer is not executed in the UK and does not relate to any property situate, or any matter or thing done, or to be done, in the UK.

No stamp duty or SDRT should be payable on the transfer of Depositary Interests within CREST provided that the central management and control of the Company is not exercised in the UK and that the Company's share register is not kept in the UK.

7.2 Certain Bermuda tax consequences

In the opinion of Conyers Dill & Pearman, special Bermuda counsel to the Company, as of the date of this document, there is no Bermuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable in respect of capital gains realised on a disposition of Common Shares or in respect of distributions by the Company with respect to Common Shares. Furthermore, each of the Company and LICL has received from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act of 1966 an undertaking that, in the event of there being enacted in Bermuda any legislation imposing any tax computed on profits or income, including any dividend or capital gains withholding tax, or computed on any capital assets, gain or appreciation or any tax in the nature of an estate or inheritance tax or duty, the imposition of such tax shall not be applicable to the Company or LICL or any of their operations, nor to the Common Shares nor to obligations of the Company or LICL until the year 2016. This undertaking applies to the Common Shares. It does not, however, prevent the application of Bermuda taxes to persons ordinarily resident in Bermuda.

7.3 Certain Dubai tax consequences

Subject to certain exceptions, there are currently no local Dubai or Federal (UAE) taxes payable on the profits or revenue of businesses operating within the UAE (including the DIFC). However there are discussions at the Dubai and Federal level regarding the possible introduction of VAT and personal and corporate taxes within the region. However it should be noted that Dubai Law No 9 of 2004 ("**Law No 9**") provides at Article 14 that DIFC Establishments (which would include LMEL) and their employees shall be subject to a zero rate of tax on income for fifty years from the enactment of Law No 9. Moreover, transfers of assets out of the DIFC shall similarly benefit from such rate for such period. The period can be extended for a further fifty years upon the resolution of the Ruler of Dubai. Notwithstanding this moratorium on income tax, it is unclear as to its precise scope and, currently, specifically refers to income tax and taxes on transfer. Accordingly, it does not necessarily rule out the introduction of alternative taxation measures and, further, Law No 9 is not constitutionally immune from future amendment or repeal.

7.4 Certain US tax consequences

The following legal discussion (including and subject to the matters and qualifications set forth in such summary) is based upon the advice of Dewey & LeBoeuf LLP, New York, New York. The advice of such firm does not include any factual or accounting matters, determinations or conclusions, including amounts and computations of RPII and amounts of components thereof or facts relating to the Group's business or activities. The tax treatment of a holder of Common Shares, or of a person treated as a holder of Common Shares for US federal income, state, local or non-US tax purposes, may vary depending on the holder's

particular tax situation. Statements contained herein as to the beliefs, expectations and conditions of the Company and its subsidiaries as to the application of such tax laws or facts represent the view of management as to the application of such laws and do not represent the opinions of counsel. THE US FEDERAL TAX ADVICE CONTAINED HEREIN IS WRITTEN IN CONNECTION WITH THE ADMISSION OF THE COMMON SHARES, AND IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY ANY PERSON, FOR THE PURPOSE OF AVOIDING US TAX PENALTIES. PROSPECTIVE INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISERS WITH RESPECT TO THEIR PARTICULAR CIRCUMSTANCES CONCERNING THE US FEDERAL, STATE, LOCAL AND NON-US TAX CONSEQUENCES OF OWNING COMMON SHARES.

7.4.1 *Taxation of the Group*

The following discussion is a summary of all material US federal income tax considerations relating to the Group's operations. A foreign corporation that is engaged in the conduct of a US trade or business will be subject to US tax as described below, unless entitled to the benefits of an applicable tax treaty. Whether business is being conducted in the US is an inherently factual determination. Because the Code, regulations and court decisions fail to identify definitively activities that constitute being engaged in a trade or business in the US, the Directors cannot be certain that the IRS will not contend successfully that the Company, LICL, LUK, LISL, LIMSL and/or LMEL are or will be engaged in a trade or business in the US. A foreign corporation deemed to be so engaged would be subject to US income tax at regular corporate rates, as well as the branch profits tax, on its income which is treated as effectively connected with the conduct of that trade or business unless the corporation is entitled to relief under the permanent establishment provision of an applicable tax treaty, as discussed below. Such income tax, if imposed, would be based on effectively connected income computed in a manner generally analogous to that applied to the income of a US corporation, except that a foreign corporation is generally entitled to deductions and credits only if it timely files a US federal income tax return. LICL and LUK file protective US federal income tax returns on a timely basis in order to preserve the right to claim income tax deductions and credits if it is ever determined that it is subject to US federal income tax. The highest marginal federal income tax rates currently are 35 per cent. for a corporation's effectively connected income and 30 per cent. for the additional "branch profits" tax.

If LICL is entitled to the benefits under the income tax treaty between Bermuda and the US (the "**Bermuda Treaty**"), LICL would not be subject to US income tax on any income found to be effectively connected with a US trade or business unless that trade or business is conducted through a permanent establishment in the US. Similarly, if each of LUK, LISL and LIMSL is entitled to the benefits under the income tax treaty between the UK and the US (the "**UK Treaty**") (discussed below) it would not be subject to US income tax on any income found to be effectively connected with US trade or business unless that trade or business is conducted through a permanent establishment in the US. LICL, LUK, LISL and LIMSL each currently intends to conduct its activities so that it does not have a permanent establishment in the US, although the Directors cannot be certain that this result will be achieved.

An insurance enterprise resident in Bermuda generally will be entitled to the benefits of the Bermuda Treaty if (i) more than 50 per cent. of its shares are owned beneficially, directly or indirectly, by individual residents of the US or Bermuda or US citizens; and (ii) its income is not used in substantial part, directly or indirectly, to make disproportionate distributions to, or to meet certain liabilities of, persons who are neither residents of either the US or Bermuda nor US citizens. No regulations interpreting the Bermuda Treaty have been issued. The Directors cannot be certain that LICL will be eligible for Bermuda Treaty benefits because of factual and legal uncertainties regarding the residency and citizenship of the Company's shareholders. The Company would not be eligible for treaty benefits because it is not an insurance company. Additionally as the US does not have an income tax treaty with Dubai, LMEL would not be eligible for treaty benefits. Accordingly, the Company, LICL and LMEL intend to conduct substantially all of their foreign operations outside the US and to limit their US contacts so that none of the Company, LICL and LMEL should be treated as engaged in the conduct of a trade or business in the US.

Foreign insurance companies carrying on an insurance business within the US have a certain minimum amount of effectively connected net investment income, determined in accordance with a formula that depends, in part, on the amount of US risk insured or reinsured by such companies. If LICL is considered to be engaged in the conduct of an insurance business in the US and it is not entitled to the benefits of the Bermuda Treaty in general (because it fails to satisfy the limitations on treaty benefits discussed above), the Code could subject a significant portion of LICL's investment income to US income tax. In addition, while the Bermuda Treaty clearly applies to premium income, it is uncertain whether the Bermuda Treaty applies to other income such as investment income. If LICL is considered engaged in the conduct of an insurance business in the US and is entitled to the benefits of the Bermuda Treaty in general, but the Bermuda Treaty is interpreted to not apply to investment income, a significant portion of LICL's investment income could be subject to US income tax.

Under the UK Treaty, a UK resident company is entitled to the benefits of the treaty only if various complex requirements can be satisfied. Broadly, these requirements include (i) during at least half of the days during the relevant taxable period, at least 50 per cent. of a UK resident company's stock must be beneficially owned, directly or indirectly, by citizens or residents of the US and the UK, and less than 50 per cent. of such company's gross income for the relevant taxable period is paid or accrued, directly or indirectly, to persons who are not US or UK residents in the form of payments that are deductible for purposes of UK taxation; (ii) with respect to specific items of income, profit or gain derived from the US, if such income, profit or gain is

considered to be derived in connection with, or incidental to such company's business conducted in the UK; or (iii) at least 50 per cent. of the aggregate vote and value of its shares is owned directly or indirectly by five or fewer companies the principal class of shares of which is listed and regularly traded on a recognised stock exchange. Although the Directors cannot be certain that LUK, LISL or LIMSL will be eligible for treaty benefits under the UK Treaty because of factual and legal uncertainties regarding (i) the residency and citizenship of the Company's shareholders, and (ii) the interpretation of what constitutes income incidental to or connected with a trade or business in the UK, they will endeavour to so qualify. If each of LUK, LISL and LIMSL qualifies for treaty benefits, each of LUK, LISL or LIMSL should be subject to US federal income tax on its income found to be effectively connected with a US trade or business only if such income is attributable to the conduct of a trade or business carried on through a permanent establishment in the US. LUK, LISL and LIMSL have conducted and intend to conduct their activities in a manner so that none of them should have a permanent establishment in the US, although the Directors cannot be certain that they will achieve this result.

Under the UK Treaty, the additional US branch profits tax may be imposed at a rate of up to 5 per cent. absent an applicable exception to the extent a UK resident company has a permanent establishment in the US.

Foreign corporations not engaged in a trade or business in the US are nonetheless subject to US income tax imposed by withholding on certain "fixed or determinable annual or periodic gains, profits and income" derived from sources within the US (such as dividends and certain interest on investments), subject to exemption under the Code or reduction by applicable treaties. Generally under the UK Treaty the withholding rate is reduced (i) on dividends from less than 10 per cent. owned corporations to 15 per cent.; (ii) on dividends from 10 per cent. or more owned corporations to 5 per cent.; and (iii) on interest to 0 per cent. The Bermuda Treaty does not reduce the US withholding rate on US-sourced investment income.

The US also imposes a federal insurance excise tax (the "**FET**") on insurance premiums paid to it with respect to (i) risks of a US entity or individual that are located wholly or partly within the United States and (ii) risks of foreign entity or individual engaged in trade or business in the United States that are located within the United States ("**US Situs Risks**") and on reinsurance premiums for any reinsurance policy covering any such risks. The rates of FET applicable to premiums paid are 4 per cent. for direct property and casualty insurance premiums and 1 per cent. for reinsurance premiums or life insurance premiums, subject to elimination pursuant to a US income tax treaty. The UK Treaty provides for the elimination of the FET on insurance premiums paid to UK residents, otherwise entitled to the benefits of the treaty, with respect to US Situs Risks, provided the UK resident does not cede the risks in a transaction characterised as part of a conduit arrangement for purposes of the UK Treaty. If LUK is entitled to the benefit of the FET exemption in the UK Treaty, but it cedes business with respect to US Situs Risks in transactions that are characterised as conduit arrangements for purposes of the UK Treaty, it would not be entitled to the UK Treaty FET exemption with respect to these US Situs Risks.

The IRS, in Revenue Ruling 2008-15, has formally announced its position that, absent a US income tax treaty exception, the FET is applicable (at a 1 per cent. rate on premiums) to all reinsurance cessions or retrocessions of risks by foreign insurers or reinsurers to foreign reinsurers where the underlying risks are US Situs Risks, even if the FET has been paid on prior cessions of the same risks. The legal and jurisdictional basis for, and the method of enforcement of, the IRS' position is unclear. Absent a US income tax treaty exception, if the cascading FET is applicable to premiums paid to, or by, LICL or LUK, it should apply at a 1 per cent. rate, even though the FET also applies on prior premium payments with respect to such risks.

7.4.2 *Taxation of holders of Common Shares*

The following summary sets forth the material US federal income tax considerations related to the purchase, ownership and disposition of the Common Shares. Unless otherwise stated, this summary deals only with Shareholders that are US Persons (as defined below) who hold their Common Shares as capital assets within the meaning of section 1221 of the Code. The following discussion is only a discussion of the material US federal income tax matters as described herein and does not purport to address all of the US federal income tax consequences that may be relevant to a particular Shareholder in light of such Shareholder's specific circumstances. In addition, the following summary does not address the US federal income tax consequences that may be relevant to special classes of Shareholders, such as financial institutions, insurance companies, regulated investment companies, real estate investment trusts, dealers or traders in securities, tax exempt organisations, expatriates, investors in pass through entities, persons who are considered with respect to the Company or its subsidiaries as "United States shareholders" for purposes of the controlled foreign corporation ("**CFC**") rules of the Code (generally, a US Person, as defined below, who owns or is deemed to own 10 per cent. or more of the total combined voting power of all classes of the Company's or its subsidiaries' shares entitled to vote (that is 10 per cent. US Shareholders)), or persons who hold their shares as part of a hedging or conversion transaction or as part of a short-sale or straddle or in currency other than the US dollar, who may be subject to special rules or treatment under the Code. This discussion is based upon the Code, the Treasury Regulations promulgated thereunder and any relevant administrative rulings or pronouncements or judicial decisions, all as in effect on the date hereof and as currently interpreted, and does not take into account possible changes in such tax laws or interpretations thereof, which may apply retroactively. This discussion does not include any description of the tax laws of any state or local governments within the US or of any foreign government. Persons considering making an investment in the Common Shares should consult their own tax advisers concerning the application of the US federal tax laws to their particular situations as

well as any tax consequences arising under the laws of any state, local or foreign taxing jurisdiction, prior to making such investment.

If a partnership holds the Common Shares, the tax treatment of the partners will generally depend on the status of the partner and the activities of the partnership. If a potential investor is a partner of a partnership owning Common Shares, it should consult its tax adviser.

For purposes of this discussion, the term "*US Person*" means: (i) a citizen or resident of the US; (ii) a partnership or corporation, created or organised in or under the laws of the US, or organised under the laws of any political subdivision thereof; (iii) an estate the income of which is subject to US federal income taxation regardless of its source; or (iv) a trust if either (a) a court within the US is able to exercise primary supervision over the administration of such trust and one or more US Persons have the authority to control all substantial decisions of such trust or (b) the trust has a valid election in effect to be treated as a US Person for US federal income tax purposes or (v) any other person or entity that is treated for US federal income tax purposes as if it were one of the foregoing.

7.4.3 *Taxation of distributions*

Subject to the discussions below relating to the potential application of the CFC, RPII and PFIC rules, cash distributions, if any, made with respect to the Common Shares will constitute dividends for US federal income tax purposes to the extent paid out of current or accumulated earnings and profits of the Company (as computed using US tax principles). Dividends paid by the Company will not be eligible for reduced rates of tax as qualified dividend income because the Common Shares will not be treated as readily tradable on an established securities market in the US. Additionally, such dividends will not be eligible for the dividends received deduction. To the extent such distributions exceed the Company's earnings and profits, they will be treated first as a return of the Shareholder's basis in their Common Shares to the extent thereof, and then as gain from the sale of a capital asset. If earnings and profits are not computed using US tax principles, all distributions should constitute dividend.

7.4.4 *Classification of the Company, LICL, LUK, LISL, LIMSL or LMEL as controlled foreign corporations*

Each 10 per cent. US Shareholder (as defined below) of a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during a taxable year, and who owns shares in the foreign corporation, directly or indirectly through foreign entities, on the last day of the foreign corporation's taxable year on which it is a CFC, must include in its gross income for US federal income tax purposes its *pro rata* share of the CFC's "subpart F income", even if the subpart F income is not distributed. A foreign corporation is considered a CFC if 10 per cent. US Shareholders own (directly, indirectly through foreign entities or by attribution by application of the constructive ownership rules of section 958(b) of the Code (that is "constructively")) more than 50 per cent. of the total combined voting power of all classes of voting stock of such foreign corporation, or more than 50 per cent. of the total value of all stock of such corporation. For purposes of taking into account insurance income, a CFC also includes a foreign insurance company in which more than 25 per cent. of the total combined voting power of all classes of stock or more than 25 per cent. of the total value of all stock is owned by 10 per cent. US Shareholders on any day of the taxable year of such corporation, if the gross amount of premiums or other consideration for the reinsurance or the issuing of insurance or annuity contracts exceeds 75 per cent. of the gross amount of all premiums or other consideration in respect of all risks. A "10 per cent. US Shareholder" is a US Person who owns (directly, indirectly through foreign entities or constructively) at least 10 per cent. of the total combined voting power of all classes of stock entitled to vote of the foreign corporation. The Directors believe that because of the anticipated dispersion of the Company's share ownership, provisions in the Bye-laws that limit voting power and other factors, no US Person who owns Common Shares of the Company directly or indirectly through one or more foreign entities should be treated as owning (directly, indirectly through foreign entities, or constructively) 10 per cent. or more of the total voting power of all classes of shares of the Company, LUK, LISL, LIMSL or LMEL. It is possible, however, that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge.

7.4.5 *The RPII CFC Provisions*

The following discussion generally is applicable only if the RPII of LICL or LUK, determined on a gross basis, is 20 per cent. or more of such company's gross insurance income for the taxable year and the 20 per cent. Ownership Exception (as defined below) is not met. The following discussion generally would not apply for any taxable year in which LICL and LUK meets either the 20 per cent. Ownership Exception or the 20 per cent. Gross Income Exception (as defined below). Although the Directors cannot be certain, the Directors believe that each of LICL and LUK should meet either the 20 per cent. Ownership Exception or the 20 per cent. Gross Income Exception for each taxable year for the foreseeable future. Additionally, as the Company, LISL, LIMSL and LMEL are not licensed as insurance companies the Directors do not anticipate that any of them will have insurance income, including RPII.

RPII is any "insurance income" (as defined below) attributable to policies of insurance or reinsurance with respect to which the person (directly or indirectly) insured is a "RPII shareholder" (as defined below) or a "related person" (as defined below) to such RPII shareholder. In general, and subject to certain limitations, "insurance income" is income (including premium and investment income) attributable to the issuing of any insurance or reinsurance contract which would be taxed under the portions of the Code relating to insurance companies if the income were the income of a US insurance company. For purposes of inclusion of the RPII of LICL or LUK in the income of RPII shareholders, unless an exception applies, the term "RPII shareholder" means any US Person who owns (directly or indirectly through foreign entities) any amount of the Company's

shares. Generally, the term "related person" for this purpose means someone who controls or is controlled by the RPII shareholder or someone who is controlled by the same person or persons which control the RPII shareholder. Control is measured by either more than 50 per cent. in value or more than 50 per cent. in voting power of stock applying certain constructive ownership principles. A corporation's pension plan is ordinarily not a "related person" with respect to the corporation unless the pension plan owns, directly or indirectly through the application of certain constructive ownership rules, more than 50 per cent. measured by vote or value, of the stock of the corporation. LICL and LUK should be treated as CFCs under the RPII provisions if RPII shareholders are treated as owning (directly, indirectly through foreign entities or constructively) 25 per cent. or more of the shares of the Company by vote or value.

7.4.5.1 *RPII exceptions*

The special RPII rules do not apply to each of LICL and LUK if (i) direct and indirect insureds and persons related to such insureds, whether or not US Persons, are treated as owning (directly or indirectly through entities) less than 20 per cent. of the voting power and less than 20 per cent. of the value of the shares of the Company (the "**20 per cent. Ownership Exception**"); (ii) RPII, determined on a gross basis, is less than 20 per cent. of the gross insurance income of LICL and LUK, respectively for the taxable year (the "**20 per cent. Gross Income Exception**"); (iii) LICL and LUK, respectively, elects to be taxed on its RPII as if the RPII were effectively connected with the conduct of a US trade or business, and to waive all treaty benefits with respect to RPII and meet certain other requirements; or (iv) LICL and LUK, respectively, elects to be treated as a US corporation and waives all treaty benefits and meets certain other requirements. Neither LICL nor LUK intends to make either of these elections. Where none of these exceptions applies to LICL nor LUK, each US Person owning (directly or indirectly through foreign entities) any shares in the Company (and therefore, indirectly, in LICL or LUK respectively) on the last day of such Company's taxable year will be required to include in its gross income for US federal income tax purposes its share of the RPII of such Company for the portion of the taxable year during which the Company was a CFC under the RPII provisions, determined as if all such RPII were distributed proportionately only to such US Persons at that date, but limited by each such US Person's share of the Company's current-year earnings and profits as reduced by the US Person's share, if any, of certain prior-year deficits in earnings and profits. LICL and LUK each intend to operate in a manner that is intended to ensure that it qualifies for the 20 per cent. Gross Income Exception or 20 per cent. Ownership Exception. Although, it is possible that they will not be successful in qualifying under these exceptions.

7.4.5.2 *Computation of RPII*

In order to determine how much RPII LICL or LUK has earned in each taxable year, each of LICL or LUK may obtain and rely upon information from its insureds and reinsureds to determine whether any of the insureds, reinsureds or persons related thereto own (directly or indirectly through foreign entities) shares of the Company and are US Persons. LICL and LUK may not be able to determine whether any of their underlying direct or indirect insureds are shareholders or related persons to such shareholders. Consequently, LICL and LUK may not be able to determine accurately the gross amount of RPII earned by them in a given taxable year. For any year in which the 20 per cent. Gross Income Exception and the 20 per cent. Ownership Exception do not apply, the Company may also seek information from its shareholders as to whether beneficial owners of shares at the end of the year are US Persons so that the RPII may be determined and apportioned among such persons; to the extent the Company is unable to determine whether a beneficial owner of shares is a US Person, the Company may assume that such owner is not a US Person, thereby increasing the per share RPII amount for all known RPII shareholders.

If, as expected, for each taxable year each of LICL and LUK meets the 20 per cent. Gross Income Exception or 20 per cent. Ownership Exception, RPII shareholders will not be required to include RPII in their taxable income. The amount of RPII includable in the income of a RPII shareholder is based upon the net RPII income for the year after deducting related expenses such as losses, loss reserves and operating expenses.

7.4.5.3 *Apportionment of RPII to US Holders*

Every RPII shareholder who owns shares on the last day of any taxable year of the Company in which the 20 per cent. Ownership Exception and the 20 per cent. Gross Income Exception do not apply to either LICL or LUK should expect that for such year it will be required to include in gross income its share of such Company's RPII for the portion of the taxable year during which the Company was a CFC under the RPII provisions, whether or not distributed, even though such shareholder may not have owned the shares throughout such period. A RPII shareholder who owns shares during such taxable year but not on the last day of the taxable year is not required to include in gross income any part of LICL's or LUK's RPII.

7.4.5.4 *Basis adjustments*

A RPII shareholder's tax basis in its shares will be increased by the amount of any RPII that such shareholder includes in income. The RPII shareholder may exclude from income the amount of any distributions by the Company out of previously taxed RPII income. The RPII shareholder's tax basis in its shares will be reduced by the amount of such distributions that are excluded from income.

7.4.5.5 *Uncertainty as to application of RPII*

The RPII provisions have never been interpreted by the courts or the US Treasury Department in final regulations, and regulations interpreting the RPII provisions of the Code exist only in proposed form. It is not certain whether these regulations will be adopted in their proposed form or what changes or clarifications might ultimately be made thereto or whether any such changes, as well as any interpretation or application of

RPII by the IRS, the courts or otherwise, might have retroactive effect. These provisions include the grant of authority to the US Treasury Department to prescribe "such regulations as may be necessary to carry out the purpose of this subsection including ... regulations preventing the avoidance of this subsection through cross insurance arrangements or otherwise". Accordingly, the meaning of the RPII provisions and the application thereof to LICL and LUK is uncertain. In addition, the Directors cannot be certain that the amount of RPII or the amounts of the RPII inclusions for any particular RPII shareholder, if any, will not be subject to adjustment based upon subsequent IRS examination. Any prospective investors considering an investment in the Common Shares should consult his tax adviser as to the effects of these uncertainties.

7.4.6 *Information reporting*

Under certain circumstances, US Persons owning shares in a foreign corporation are required to file IRS Form 5471 with their US federal income tax returns. Generally, information reporting on IRS Form 5471 is required by (i) a person who is treated as a RPII shareholder, (ii) a 10 per cent. US Shareholder of a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during any tax year of the foreign corporation and who owned the stock on the last day of that year; and (iii) under certain circumstances, a US Person who acquires stock in a foreign corporation and as a result thereof owns 10 per cent. or more of the voting power or value of such foreign corporation, whether or not such foreign corporation is a CFC. For any taxable year in which the Company determines that the 20 per cent. Gross Income Exception and the 20 per cent. Ownership Exception do not apply, the Company will provide to all US Persons registered as shareholders of its shares a completed IRS Form 5471 or the relevant information necessary to complete the form. Failure to file IRS Form 5471 may result in penalties.

7.4.7 *Tax-Exempt shareholders*

Tax-exempt entities will be required to treat certain subpart F insurance income, including RPII, that is includible in income by the tax-exempt entity as unrelated business taxable income. Prospective investors that are tax exempt entities are urged to consult their tax advisers as to the potential impact of the unrelated business taxable income provisions of the Code. A tax-exempt organisation that is treated as a 10 per cent. US Shareholder or a RPII Shareholder also must file IRS Form 5471 in the circumstances described above.

7.4.8 *Dispositions of Common Shares*

Subject to the discussions below relating to the potential application of the Code section 1248 and PFIC rules, US holders of Common Shares generally should recognise capital gain or loss for US federal income tax purposes on the sale, exchange or other disposition of Common Shares in the same manner as on the sale, exchange or other disposition of any other shares held as capital assets. If the holding period for these shares exceeds one year, any gain will be subject to tax at a current maximum marginal tax rate of 15 per cent. for individuals and 35 per cent. for corporations. Moreover, gain, if any, generally will be a US source gain and generally will constitute "passive" or "general income" for foreign tax credit limitation purposes.

Code section 1248 provides that if a US Person sells or exchanges stock in a foreign corporation and such person owned, directly, indirectly through certain foreign entities or constructively, 10 per cent. or more of the voting power of the corporation at any time during the five-year period ending on the date of disposition when the corporation was a CFC, any gain from the sale or exchange of the shares will be treated as a dividend to the extent of the CFC's earnings and profits (determined under US federal income tax principles) during the period that the shareholder held the shares and while the corporation was a CFC (with certain adjustments). The Directors believe that because of the anticipated dispersion of the Company's share ownership, provisions in the Bye-laws that limit voting power and other factors, that no US person that owns shares directly or through foreign entities in the Company should be treated as owning (directly, indirectly through foreign entities or constructively) 10 per cent. or more of the total voting power of the Company; to the extent this is the case, the application of Code Section 1248 under the regular CFC rules should not apply to dispositions of Common Shares. It is possible, however, that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge. A 10 per cent. US Shareholder may in certain circumstances be required to report a disposition of shares of a CFC by attaching IRS Form 5471 to the US federal income tax or information return that it would normally file for the taxable year in which the disposition occurs. In the event this is determined necessary, the Company will provide a completed IRS Form 5471 or the relevant information necessary to complete the Form. Code section 1248 in conjunction with the RPII rules also applies to the sale or exchange of shares in a foreign corporation if the foreign corporation would be treated as a CFC for RPII purposes regardless of whether the shareholder is a 10 per cent. US Shareholder or whether the 20 per cent. Gross Income Exception or the 20 per cent. Ownership Exception applies. Existing proposed regulations do not address whether Code section 1248 would apply if a foreign corporation is not a CFC but the foreign corporation has a subsidiary that is a CFC and that would be taxed as an insurance company if it were a domestic corporation. The Directors believe, however, that this application of Code section 1248 under the RPII rules should not apply to dispositions of the Common Shares because the Company will not be directly engaged in an insurance business. The Directors cannot be certain, however, that the IRS will not interpret the proposed regulations in a contrary manner or that the US Treasury Department will not amend the proposed regulations to provide that these rules will apply to dispositions of Common Shares. Prospective investors should consult their tax advisers regarding the effects of these rules on a disposition of Common Shares.

7.4.9 *Passive foreign investment companies*

In general, a foreign corporation will be a PFIC during a given year if (i) 75 per cent. or more of its gross income constitutes ''passive income'' (the ''**75 per cent. test**''); or (ii) 50 per cent. or more of its assets produce passive income (the ''**50 per cent. test**'').

If the Company were characterised as a PFIC during a given year, each US Person holding Common Shares would be subject to a penalty tax at the time of the sale at a gain of, or receipt of an ''excess distribution'' with respect to, their Common Shares, unless such person (i) is a 10 per cent. US Shareholder and the Company is a CFC or (ii) made a ''qualified electing fund election''. In addition, if the Company were considered a PFIC, upon the death of any US individual owning shares, such individual's heirs or estate would not be entitled to a ''step-up'' in the basis of their Common Shares that might otherwise be available under US federal income tax laws. In general, a Shareholder receives an ''excess distribution'' if the amount of the distribution is more than 125 per cent. of the average distribution with respect to the shares during the three preceding taxable years (or shorter period during which the taxpayer held the Common Shares). In general, the penalty tax is equivalent to an interest charge on taxes that are deemed due during the period the Shareholder owned the Common Shares, computed by assuming that the excess distribution or gain (in the case of a sale) with respect to the Common Shares was taken in equal portion at the highest applicable tax rate on ordinary income throughout the Shareholder's period of ownership. The interest charge is equal to the applicable rate imposed on underpayments of US federal income tax for such period. In addition, a distribution paid by the Company to US Shareholders that is characterised as a dividend and is not characterised as an excess distribution would not be eligible for reduced rates of tax as qualified dividend income.

For the above purposes, passive income generally includes interest, dividends, annuities and other investment income. The PFIC rules provide that income ''derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business ... is not treated as passive income''. The PFIC provisions also contain a look-through rule under which a foreign corporation shall be treated as if it ''received directly its proportionate share of the income ...'' and as if it ''held its proportionate share of the assets ...'' of any other corporation in which it owns at least 25 per cent. of the value of the stock.

The insurance income exception is intended to ensure that income derived by a *bona fide* insurance company is not treated as passive income, except to the extent such income is attributable to financial reserves in excess of the reasonable needs of the insurance business. Under the look-through rule, the Company should be deemed to own its proportionate share of the assets and to have received its proportionate share of the income of LICL, LUK, LISL, LIMSL and LMEL for purposes of the 75 per cent. test and the 50 per cent. test. It is expected that the income and assets of the Company other than the income generated by LICL and LUK and the assets held by LICL and LUK will be *de minimis* in each year of operations with respect to the overall income and assets of the Company. Further, it is expected that each of LICL and LUK will be predominantly engaged in an insurance business and is unlikely to have financial reserves in excess of the reasonable needs of its insurance business for purposes of the PFIC rules. As a result, the Directors believe that the Company should not currently be treated as a PFIC. There can be no certainty, however, as there are currently no regulations regarding the application of the PFIC provisions to an insurance company and new regulations or pronouncements interpreting or clarifying these rules may be forthcoming, that the IRS will not challenge this position and that a court will not sustain such challenge. Prospective investors should consult their tax adviser as to the effects of the PFIC rules.

7.4.10 *Foreign tax credit*

Because it is anticipated that US Persons will own a majority of the Common Shares, only a portion of the current income inclusions, if any, under the CFC, RPII and PFIC rules and of dividends paid by the Company (including any gain from the sale of Common Shares that is treated as a dividend under section 1248 of the Code) will be treated as foreign source income for purposes of computing a Shareholder's US foreign tax credit limitations. The Company will consider providing Shareholders with information regarding the portion of such amounts constituting foreign source income to the extent such information is reasonably available. It is also likely that substantially all of the ''subpart F income'', RPII and dividends that are foreign source income will constitute either ''passive'' or ''general'' income. Thus, it may not be possible for most Shareholders to utilise excess foreign tax credits to reduce US tax on such income.

7.4.11 *Information reporting and backup withholding on distributions and disposition proceeds*

Information returns may be filed with the IRS in connection with distributions on the Common Shares and the proceeds from a sale or other disposition of the Common Shares unless the holder of the Common Shares establishes an exemption from the information reporting rules. A holder of Common Shares that does not establish such an exemption may be subject to US backup withholding tax on these payments if the holder is not a corporation or non-US Person or fails to provide its taxpayer identification number or otherwise comply with the backup withholding rules. The amount of any backup withholding from a payment to a US Person will be allowed as a credit against the US Person's US federal income tax liability and may entitle the US Person to a refund, provided that the required information is furnished to the IRS.

7.4.12 *Proposed US tax legislation*

Legislation has been introduced in the US Congress intended to eliminate certain perceived tax advantages of companies (including insurance companies) that have legal domiciles outside the US but have certain US connections. It is possible that legislation could be introduced in, and enacted by the current Congress or future Congress that could have an adverse impact on the Company or the Shareholders.

Additionally, the US federal income tax laws and interpretations regarding whether a company is engaged in a trade or business within the US or is a PFIC, or whether US Persons would be required to include in their gross income the "subpart F income" or the RPII of a CFC, are subject to change, possibly on a retroactive basis. There are currently no regulations regarding the application of the PFIC rules to insurance companies and the regulations regarding RPII are still in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be forthcoming. The Directors cannot be certain if, when or in what form such regulations or pronouncements may be provided and whether such guidance will have a retroactive effect.

7.4.13 *Premium tax*

Premium taxes may be payable on premiums received in respect of direct insurance business written by LICL or LUK. The amount of premium tax levied will depend on the location of the risk and the premium tax regime of that territory. It is impossible to calculate the likely level of premium taxes incurred due to the expected diversity of the book of business written. Premium taxes should not affect the profitability of LICL or LUK as such taxes generally will be paid by the insured on top of the premiums received. However, premium taxes can have an impact on cash flows. Reinsurance is normally exempt from premium taxes.

8. Share Schemes

The Company has allocated warrants, share options and restricted share awards to the executive Directors and other employees of the Group. Information regarding these share schemes is set out below.

8.1 Management Ordinary and Performance Warrants

During 2006, the Company allocated time-vesting warrants ("**Ordinary Warrants**") and performance-vesting warrants ("**Performance Warrants**") to the executive Directors, Senior Managers and other employees of the Group out of warrants approved by the Company's shareholders in 2005.

The Ordinary Warrants vested 25 per cent. on issuance on the admission of the Company's shares to trading on AIM on 16 December 2005. 25 per cent. vested on each of the first and, second anniversaries of the admission of the Company's shares to trading on AIM and 25 per cent. vested on the third anniversary of the admission of the Company's shares to trading on AIM.

The Performance Warrants were scheduled to vest in three tranches: 20 per cent. on 31 December 2007, 40 per cent. on 31 December 2008 and the remaining 40 per cent. on 31 December 2009. As a result of the compound IRR target for 2007 and 2008 not being met a number of Performance Warrants for executive Directors and Senior Managers lapsed, as reflected in the table below. The 40 per cent. of the originally issued number of Performance Warrants that remain to vest on 31 December 2009 will vest subject to the Company achieving certain performance conditions. The performance conditions are based on a combination of compound return and fully converted book value targets. Fifty per cent. of the 40 per cent. will vest if the compound IRR target is met and the other 50 per cent. of the 40 per cent. will vest if the fully converted book value target is met. There are minimums established for both targets below which zero warrants will vest. The performance conditions are described in more detail at Note 6 of Part VI.

The Ordinary Warrants and Performance Warrants do not contain certain provisions which are included in the current guidelines on executive remuneration established by the Association of British Insurers and the Combined Code. In particular the Ordinary Warrants do not contain the following provisions: a requirement that the vesting of the Ordinary Warrants should be subject to the satisfaction of performance criteria and related requirements for the performance conditions including what happens on a change of control or in relation to early leavers; a requirement that the Ordinary Warrants should have a vesting period of at least three years; a requirement that the vesting of Ordinary Warrants should be on a *pro rata* basis depending on what period of the vesting period has expired before the change of control; a requirement that the vesting of Ordinary Warrants should be on a *pro rata* basis depending on what period of the vesting period has expired before early exercise on retirement. Similarly, the Performance Warrants do not contain, in particular, the following provisions: a requirement that the Performance Warrants should have a vesting period of at least three years; a requirement that the vesting of Performance Warrants should be on a *pro rata* basis depending on what period of the vesting period has expired before a change of control; a requirement that the vesting of Performance Warrants should be on a *pro rata* basis depending on what period of the vesting period has expired before early exercise on retirement. Both the Ordinary Warrants and the Performance Warrants are freely transferable once vested.

Details of the Ordinary Warrants and Performance Warrants held by the executive Directors and Senior Managers as at 31 December 2006, 2007 and 2008 are as follows:

(i) Time vesting warrants

Name of Director/Senior Manager	*Ordinary Warrants at 31 December 2006*	*Ordinary Warrants at 31 December 2007*	*Ordinary Warrants at 31 December 2008*	*Date of award*	*Price paid*	*Exercise price*	*Expiry date*
Richard Brindle	7,625,217	7,625,217	5,718,913	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	1,906,304	16/12/2005	US$nil	US$3.90	16/12/2015
	7,625,217	7,625,217	7,625,217				
Simon Burton	444,804	444,804	333,603	09/03/2006	US$nil	US$5.00	16/12/2015
	—	—	111,201	09/03/2006	US$nil	US$3.90	16/12/2015
	114,378	114,378	86,083	21/09/2006	US$nil	US$5.00	16/12/2015
	—	—	28,295	21/09/2006	US$nil	US$3.90	16/12/2015
	559,182	559,182	559,182				
Neil McConachie	635,435	453,152	294,293	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	158,859	16/12/2005	US$nil	US$3.90	16/12/2015
	635,434	317,717	158,859	09/03/2006	US$nil	US$5.00	16/12/2015
	—	—	158,859	09/03/2006	US$nil	US$3.90	16/12/2015
	1,270,869	770,869	770,870				
Alex Maloney	397,147	397,147	297,860	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	99,287	16/12/2005	US$nil	US$3.90	16/12/2015
	397,147	397,147	397,147				
Charles Mathias	317,717	317,717	238,288	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	79,429	16/12/2005	US$nil	US$3.90	16/12/2015
	317,717	317,717	317,717				
Paula Porter	508,348	508,348	381,261	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	127,087	16/12/2005	US$nil	US$3.90	16/12/2015
	508,348	508,348	508,348				

(ii) Performance vesting warrants

Name of Director/Senior Manager	*Performance Warrants at 31 December 2006*	*Performance Warrants at 31 December 2007*	*Performance Warrants at 31 December 2008*	*Date of award*	*Price paid*	*Exercise price*	*Expiry date*
Richard Brindle	3,050,087	2,745,078	288,843	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	1,267,189	16/12/2005	US$nil	US$3.90	16/12/2015
	3,050,087	2,745,078	1,556,032				
Simon Burton	266,884	240,196	25,274	09/03/2006	US$nil	US$5.00	16/12/2015
	—	—	110,880	09/03/2006	US$nil	US$3.90	16/12/2015
	216,048	194,443	20,460	21/09/2006	US$nil	US$5.00	16/12/2015
	—	—	89,759	21/09/2006	US$nil	US$3.90	16/12/2015
	482,932	434,639	246,033				
	381,261	343,135	36,105	16/12/2005	US$nil	US$5.00	16/12/2015
Neil McConachie	—	—	185,859	16/12/2005	US$nil	US$3.90	16/12/2015
	381,261	343,135	36,105	09/03/2006	US$nil	US$5.00	16/12/2015
	—	—	185,859	09/03/2006	US$nil	US$3.90	16/12/2015
	762,522	686,270	389,008				
Alex Maloney	238,288	238,288	26,250	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	95,315	16/12/2005	US$nil	US$3.90	16/12/2015
	152,504	152,504	16,799	21/09/2006	US$nil	US$5.00	16/12/2015
	—	—	61,002	21/09/2006	US$nil	US$3.90	16/12/2015
	390,792	390,792	199,366				
Charles Mathias	190,630	190,630	21,000	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	76,252	16/12/2005	US$nil	US$3.90	16/12/2015
	152,504	152,504	16,999	21/09/2006	US$nil	US$5.00	16/12/2015
	—	—	61,002	21/09/2006	US$nil	US$3.90	16/12/2015
	343,134	343,134	175,053				
Paula Porter	305,009	305,009	33,600	16/12/2005	US$nil	US$5.00	16/12/2015
	—	—	122,004	16/12/2005	US$nil	US$3.90	16/12/2015
	228,757	228,757	25,200	21/09/2006	US$nil	US$5.00	16/12/2015
	—	—	91,503	21/09/2006	US$nil	US$3.90	16/12/2015
	533,766	533,766	272,307				

On 10 December 2007, the Company declared a strategic dividend of US$1.10 per Common Share payable to shareholders of record, as at 11 January 2008. The declaration of the dividend triggered a contractual obligation, pursuant to the terms of all warrants, for the Company to pay an amount per warrant equivalent to the dividend for each vested warrant; and to adjust automatically the exercise price for each unvested warrant by an amount equivalent to the dividend. Consequently on 25 January 2008, the Company paid a dividend of

£0.5622 per warrant on all of the vested ordinary warrants, reflecting the dividend paid to shareholders. The exercise price for the unvested ordinary and performance warrants has been adjusted downwards by US$1.10 to US$3.90 per warrant.

Payment to holders of vested performance warrants of an amount equivalent to the strategic dividend was made in 2008 once the exact number of vested performance warrants was confirmed following completion of a review of the application of the performance conditions by Ernst & Young as required by the terms of the performance warrants.

On 13 August 2007 Neil McConachie exercised 500,000 Ordinary Warrants by way of a cashless exercise at a sale price of US$7.10 (based on a market value five day average) resulting in the acquisition of 148,025 Common Shares by him. On 17 August, 2007 Mr. McConachie sold the 148,025 Common Shares at a price of £3.32 each, realising £491,443.

8.2 **Long Term Incentive Plan**

In 2005, the Board adopted a Long Term Incentive Plan ("**LTIP**") (which has not been submitted for approval by HM Revenue & Customs or any other tax authority) to enable any full-time executive Director or employee of the Group (provided that the individual is not within six months of retirement) to be granted share options at the discretion of the remuneration committee. The options are time-vesting and there are no performance conditions to be satisfied before exercise of an option. The options vest as to 25 per cent. on each of the first, second, third and fourth anniversaries of the date of grant provided that the option holder remains in the employment of the Group at the relevant anniversary.

The LTIP does not contain the following provisions which are included in the current guidelines on executive remuneration published by the Association of British Insurers or in the Combined Code, namely: a requirement that the vesting of the Options should be subject to the satisfaction of performance criteria and related requirements for the performance conditions including what happens on a change of control or in relation to early leavers; a requirement that Options should be in grants phased on an annual basis; a requirement that the Options should have a vesting period of at least three years; a requirement that the vesting of Options should be on a *pro rata* basis depending on what period of the vesting period has expired before a change of control; a requirement that the Options may only be granted in the 42 day period following the publication of results for the Company (although under the Plan the grant of Options may not be made during a close period); a requirement that the vesting of Options should be on a *pro rata* basis depending on what period of the vesting period has expired before early exercise on retirement.

Following an amendment to the LTIP as approved by the Company's shareholders at the special general meeting of shareholders held on 4 January 2008, the Company's Remuneration Committee exercised its discretion to reduce the exercise price for all outstanding vested and unvested options by US$1.10 or £0.5622 effective 9 January 2008. The adjustment was made to reflect the strategic dividend paid by the Company in January 2008, and the consequent reduction in shareholders' equity.

No options were exercised during 2006, 2007 or 2008. Details of the Directors' share options position are as follows:

Name of Director/ Senior Manager	*Share options at 31/12/ 2008*	*Date of award*	*Price paid*	*Exercise price*	*Date from which first exercisable*[1]	*Expiry date*	*Vesting conditions*
Richard Brindle	762,522	09/03/2006	US$nil	£2.69105	09/03/2007	08/03/2016	Time-vesting
	150,000	29/06/2007	US$nil	US$5.77	29/06/2008	28/06/2017	Time-vesting
Simon Burton	300,000	09/05/2007	US$nil	US$6.01	09/05/2008	08/05/2017	Time-vesting
	500,000	29/06/2007	US$nil	US$5.77	29/06/2008	28/06/2017	Time-vesting
Neil McConachie	508,348	09/03/2006	US$nil	£2.69105	09/03/2007	08/03/2016	Time-vesting
	200,000	29/06/2007	US$nil	US$5.77	29/06/2008	28/06/2017	Time-vesting
Alex Maloney	127,087	09/03/2006	US$nil	£2.69105	09/03/2007	08/03/2016	Time-vesting
	275,000	29/06/2007	US$nil	US$5.77	29/06/2008	28/06/2017	Time-vesting
Charles Mathias	63,543	09/03/2006	US$nil	£2.69105	09/03/2007	08/03/2016	Time-vesting
	0	29/06/2007	US$nil	US$5.77	29/06/2008	28/06/2017	Time-vesting
Paula Porter	127,087	09/03/2006	US$nil	£2.69105	09/03/2007	08/03/2016	Time-vesting
	275,000	29/06/2007	US$nil	US$5.77	29/06/2008	28/06/2017	Time-vesting

(1) The options vest as to 25 per cent. on each of the first, second, third and fourth anniversaries of the date of grant provided that the option holder remains in the employment of the Group at the relevant anniversary.

Following the adoption of the new restricted share scheme (described below) by the Company's shareholders on 4 January 2008, the Company closed the LTIP to further awards.

8.3 **Restricted share scheme**

In 2008, the Company introduced a new restricted share scheme ("**RSS**"), which has replaced the LTIP for new awards and the Remuneration Committee subsequently made RSS awards to executive Directors in two categories. One category of RSS awards was made subject to a time condition and no performance conditions (with 100 per cent. of the award to vest after two years from the award date subject to continued employment).

For the 2008 RSS awards made in the second category, executives were granted a conditional award of shares which will be released to the executive recipients after three years, subject to the achievement of stretching performance conditions and continued employment.

For half of each award in the second category the performance condition will be based on the Company's total shareholder return ("**TSR**") performance against a comparator group of international insurance companies over a three year period measured from the date of grant. 25 per cent. of this part of the award will vest if the Company's TSR is equal to the company whose TSR is ranked at the median. All of this part of the award will vest if the Company's TSR is equal to the company whose TSR is ranked at the upper quartile or above. Vesting will take place on a straight line between 25 per cent. and 100 per cent. for TSR performance between median and upper quartile.

For the remaining half of each award in the second category the performance condition is based on Return on Equity ("**ROE**") over 3 financial years in the performance period. 25 per cent. of this award will only vest if average annual ROE over the performance period exceeds 3-month US$ LIBOR calculated on a daily basis plus 8 per cent. All of this part of the award will vest if the Company's average ROE is equal to 3-month US$ LIBOR calculated on a daily basis plus 18 per cent. Vesting will take place on a straight line basis between 25 per cent. and 100 per cent. for ROE performance.

TSR and ROE were chosen as performance criteria on the basis that TSR provides an objective reward for stock market out-performance of the Company's peers and ROE provides a focus on underlying financial performance.

Further information regarding the terms of the RSS is set out below.

Name of Director	*Performance Award*	*Exceptional Award*	*Date awarded*
Richard Brindle	360,001	33,381	28/03/2011
Simon Burton	109,378	22,254	28/03/2011
Neil McConachie	101,032	22,254	28/03/2011
Name of Senior Manager			
Alex Maloney	75,552	22,254	28/03/2011
Charles Mathias	66,762	11,127	28/03/2011
Paula Porter	90,195	5,563	28/03/2011

8.3.1 *General*

The RSS is a long term incentive scheme under which awards to acquire the Company's Common Shares may be granted to participants subject to certain time and, normally, performance conditions ("**Awards**"). The purpose of awards under the RSS is to motivate and retain certain individuals who are responsible for the attainment of the primary long-term performance goals of the Company and its subsidiaries. The executive Directors and Senior Managers are eligible to receive share awards under the RSS at the discretion of the Remuneration Committee. It is intended that awards will be made each year following the announcement of preliminary results although additional awards may be made at other times. The RSS has not been submitted for approval by HM Revenue & Customs or any other tax authority.

The RSS will be administered by the Remuneration Committee or such other committee or person as may be appointed by the Board (the "**Committee**"). In respect of participants other than executive officers and senior management, decisions on (i) who should participate in the RSS, (ii) the quantum of their Awards (within any overall limit set by the Remuneration Committee), (iii) what, if any, performance conditions should apply to their Awards and (iv) the administration of those Awards after grant (for example, the application of the early leaver provisions summarised below) shall be at the discretion of the Company's Chief Executive Officer and references to the "Committee" in this summary shall be interpreted accordingly in relation to such participants.

8.3.2 *Eligibility*

The employees, executive Directors of the Company and its subsidiaries, and, if approved by the Board, the Chairman of the Company will be eligible to participate in the RSS.

8.3.3 *Grant of Awards*

The Committee may grant Awards at any time when it is not in a Close Period (as defined in the Listing Rules).

The Committee may grant Awards as conditional Common Shares, as a nil (or nominal) cost option with a short exercise period or as forfeitable Common Shares. The Committee may also decide to grant cash-based Awards of an equivalent value to share-based Awards or to satisfy share-based Awards in cash, although it does not currently intend to do so.

An Award may not be granted more than 10 years after Shareholder approval of the RSS.

No payment is required for the grant of an Award. Awards are not transferable, except on death. Awards are not pensionable.

8.3.4 *Individual limit under the RSS*

The Remuneration Committee may, from time to time, determine the maximum market value of Common Shares over which Awards may be granted to any particular participant in any financial year of the Company.

8.3.5 *Vesting and Performance Conditions*

Awards may vest over such period, and in such instalments, as the Committee shall specify at the time of grant. The current intention is that the initial grant of Awards will vest in equal instalments on the first, second and third anniversaries of the date of grant.

The vesting of the Awards may be subject to the attainment of one or more performance conditions and, where this is to be the case, such performance conditions will be set by the Committee at the time of grant. The performance conditions shall be chosen from among earnings per share, economic value added, net income, operating income, return on assets, return on capital, return on equity, return on investment, gross or net underwriting results, revenue, share price, stock price growth or total shareholder return.

The Committee may also vary the performance conditions applying to existing Awards if an event has occurred which causes the Committee to consider that it would be appropriate to amend the performance conditions, provided the Committee considers the varied conditions are fair and reasonable and not materially less challenging than the original conditions would have been but for the event in question.

8.3.6 *Voting rights and dividend rights*

Awards of conditional Common Shares and options will not confer any Shareholder rights until the Awards have vested or the options have been exercised and the participants have received their Common Shares. Holders of Awards of forfeitable Common Shares will have Shareholder rights from when the Awards are made (except they may be required to waive their rights to receive dividends).

The Committee may, and currently intends to, decide that participants will receive a payment (in cash and/or Common Shares) on or shortly following the vesting of their Awards of an amount equivalent to the dividends that would have been paid on those Common Shares between the time when the Awards were granted and the time when they vest. Alternatively, participants may have their Awards increased as if dividends had been paid on the Common Shares subject to their Awards and then reinvested in further Common Shares.

8.3.7 *Termination of Employment*

As a general rule, an Award will lapse upon a participant ceasing to hold employment or be a director within the Company's group. However, if a participant ceases to be an employee or a director because of his or her death, injury, disability, retirement, redundancy, his or her employing company or the business for which he or she works being sold out of the Company's group or in other circumstances at the discretion of the Committee, then his or her Award will vest on the date or dates when it would have vested if he or she had not ceased such employment or office, subject to: (i) the performance conditions, if any, measured at that/ those time(s); and (ii) pro-rating by reference to the time of cessation, although the Committee can decide not to pro-rate an Award if it regards it as inappropriate to do so in the particular circumstances.

Alternatively, if a participant ceases to be an employee or director in the Company's group for one of the "good leaver" reasons specified above, the Committee can decide that his or her Award will vest when he or she leaves. The extent to which an Award will vest in these situations will depend upon two factors: (i) the extent to which the performance conditions, if any, have been satisfied by reference to the date of cessation or, if the Committee so determines, the extent to which, in the opinion of the Committee, the performance conditions would have been met had the performance period(s) run its/their full course; and (ii) the pro-rating of the award to reflect the reduced period of time between its grant and vesting, although the Committee can decide not to pro-rate an Award if it regards it as inappropriate to do so in the particular circumstances.

8.3.8 *Change of Control*

Notwithstanding any provision of the RSS to the contrary, if there should be a change in control (which will occur if the Company becomes aware that any person has the power to secure, by holding the Company's Common Shares or through the possession of voting rights, that the affairs of the Company are managed in accordance with the wishes of such person), not being an internal corporate reorganisation or a winding up of the Company, all Awards will vest early subject to: (i) the extent that the performance conditions, if any, have been satisfied at that time; and (ii) the pro-rating of the Awards to reflect the reduced period of time between their grant and vesting, although the Committee can decide not to pro-rate an Award if it regards it as inappropriate to do so in the particular circumstances.

In the event of an internal corporate reorganisation pursuant to which a new holding company is inserted above the Company, Awards will be replaced by equivalent new Awards over shares in that new holding company unless the Committee decides that Awards should vest on the basis which would apply in the case of a change of control.

If a demerger, special dividend or other similar event is proposed which, in the opinion of the Committee, would affect the market price of Common Shares to a material extent, then the Committee may decide that Awards will vest on the basis which would apply in the case of a change of control as described above.

8.3.9 *Adjustments in Event of Change of Share Capital*

In the event of changes to the Company's share capital by reason of any dividend, recapitalisation, reorganisation, merger, amalgamation, consolidation, split-up, combination or exchange of shares, the number and type of shares that may be awarded under the RSS and which are subject to outstanding Awards, and

the exercise price payable (if any) in relation to outstanding Awards, may be adjusted in such manner as the Committee deems equitable to prevent substantial dilution or enlargement of the rights granted to or available for participants.

8.3.10 *Rights attaching to Common Shares*

Any Common Shares allotted when an Award vests or is exercised will rank equally with Common Shares then in issue (except for rights arising by reference to a record date prior to their allotment).

8.3.11 *Overall limits under the RSS*

The RSS may operate over new issue Common Shares, treasury Common Shares or Common Shares purchased in the market.

In any ten calendar year period, the Company may not issue (nor grant rights to issue) more than 10 per cent. of the issued common share capital of the Company under the RSS and any other employee share plan adopted by the Company.

In addition, and in conformity with current stock market views typically insisted upon by bodies representing institutional investors, treasury Common Shares used to satisfy awards made under the RSS will also count towards this limit, for as long as those views continue to be held. Common Shares issued or to be issued under awards or options granted before the Company was listed on AIM will not count towards this limit and therefore the Common Shares issued under the Company's management ordinary warrants and management performance warrants which were described in the Company's AIM Admission Document will not count towards this limit.

8.3.12 *Amendment of the RSS*

The RSS may be amended at any time, provided that the prior approval of Shareholders is obtained for any amendments that are to the advantage of participants in respect of the rules governing eligibility, limits on participation, the overall limits on the issue of Common Shares or the transfer of treasury Common Shares, the basis for determining a participant's entitlement to, and the terms of, the Common Shares or cash to be acquired and the adjustment of Awards.

However, no Shareholder approval is necessary for minor amendments or additions to benefit the administration of the RSS, to take into account any changes in legislation or to obtain or maintain favourable taxation, exchange control or regulatory treatment for the participant or for any company in the Company's group.

9. Directors and Senior Management

9.1 The Directors and their respective roles are:

John Bishop, *Non-Executive Director*
Richard Brindle, *Chief Executive Officer*
Simon Burton, *Group Deputy Chief Executive Officer*
Jens Juul, *Non-Executive Director*
Neil McConachie, *Chief Financial Officer*
Ralf Oelssner, *Non-Executive Director*
Robert Spass, *Non-Executive Director*
William Spiegel, *Non-Executive Director*
Martin Thomas, *Non-Executive Chairman*
Barry Volpert, *Non-Executive Director*

Brief biographical details of each of the Directors are set out in Part IV – Management and Corporate Governance.

9.2 The following are the Senior Managers of the Group:

Alex Maloney, *Group Underwriting Director*
Charles Mathias, *Group Underwriting Operations Director and Chief Underwriting Officer (LICL)*
Paula Porter, *Chief Executive Officer (LUK)*

Brief biographical details of each of the Senior Managers are set out in Part IV – Management and Corporate Governance.

9.3 The current business address of each of the Directors is Mintflower Place, 8 Par-la-Ville Road, Hamilton HM 08, Bermuda.

9.4 The current business address of each of the Senior Managers based in Bermuda is Mintflower Place, 8 Par-la-Ville Road, Hamilton HM 08, Bermuda and for those based in the United Kingdom is Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, United Kingdom.

9.5 As at the date of this document, no Director or Senior Manager:

9.5.1 except as disclosed in paragraph 9.6 of this Part VIII, has been at any time in the five years prior to the date of this document, a director (or otherwise a member of any administrative, management or supervisory body) or partner of any companies or partnerships other than directorships or partnerships of any member of the Group from time to time; or

9.5.2 has any convictions in relation to fraudulent offences; or

9.5.3 has been adjudged bankrupt or been a party to a deed of arrangement or any form of voluntary arrangement or has had an administrative or other receiver appointed in respect of any asset belonging to him; or

9.5.4 in the five years prior to the date of this document, has been a director or senior manager of any company which, while he was such a director or senior manager, was put into receivership or compulsory liquidation or creditors' voluntary liquidation or company voluntary arrangement or has had an administrator or an administrative or other receiver appointed or entered into any composition or arrangement with its creditors generally or any class of its creditors; or

9.5.5 has received any official public incrimination and/or sanctions by any statutory or regulatory authorities, including designated professional bodies, or been disqualified by a court from acting as a director or member of the administrative, management or supervisory body of a company or from acting in the management or conduct of the affairs of any company in the previous five years.

9.6 Other directorships or memberships of the administrative, management or supervisory bodies or partnerships held by the Directors and the Senior Managers in the five years preceding the date of this document in respect of companies other than the Company and other member of the Group are as follows:

Director's Name	*Current directorships/partnerships*	*Past directorships/partnerships*
Martin Thomas	Downside Up Limited Crossflow Limited Guidestar International Limited	The Balance Charitable Foundation for Unclaimed Assets
Richard Brindle	Crossflow Limited Prospect Entertainment Limited Downside Up Limited	Ascot Underwriting Limited Risk 2 Risk Limited
Simon Burton	—	—
Neil McConachie	—	Montpelier Agency Ltd Rockbridge Reinsurance Ltd
John Bishop	Berkshire Hathaway International British Medical Association Motability Finance Ltd. Houston Casualty Company Underwriting Agency (formerly Illium Insurance Group)	CET Group
Jens Juul	Catalina Holdings Canopius (Bermuda) Ltd	Rosemont Reinsurance Company GHK First Equity Fund
Ralf Oelssner	Nürnberger Beamten Allgemeine Versicherung AG Nürnberger Beamten Lebensversicherung AG Gerling Vertriebs Industrie Gerling Vertrieb Firmen & Privat Industrie – Pensions – Verein Alte Leipziger Hallesche Hanse Merkur Gothaer HDI HUK – Coburg AIG Worldsource	Airline Mutual Insurance Bermuda
Robert Spass	Universal American Financial Corp Endurance Specialty Insurance Ltd Mountainview Capital Holdings LLC Capital Z Management LLC & Affiliates	Aames Financial Corporation CERES Group Inc. USI Services Corp. British Marine Insurance Associates
William Spiegel	Aurigen Re Capital Ltd Narragansett Bay Insurance Co. Syndicate Holdings Corp Scottish Re Group Ltd MedPointe Inc. Cinemark USA	Montpelier Re Holdings Ltd Catlin Group Ltd Financial Guaranty Insurance Co.
Barry Volpert	Crestview Advisers LLC Crestview LLC Key Safety Systems Oxbow Carbon LLC FHC Health Systems, Inc.	

Director's Name	*Current directorships/partnerships*	*Past directorships/partnerships*
Alex Maloney	—	—
Charles Mathias	—	—
Paula Porter	—	—

9.7 No Director nor Senior Manager has, or has had, any interest, whether direct or indirect, in any transaction which is or was unusual in its nature or conditions or significant to the business of the Group taken as a whole and which was effected by any member of the Group during the current or immediately preceding financial year or which was effected by any member of the Group during an earlier financial year and remains in any respect outstanding or unperformed.

9.8 There are no outstanding loans or guarantees granted or provided by any member of the Group to, or for the benefit of, any Director.

9.9 There is no conflict of interest between any of the Directors' or Senior Managers' duties to the Company and their private interests. Save as set out in paragraph 15.2 of this Part VIII, there is no arrangement or understanding between the Company and any major Shareholders, customers, suppliers or others, pursuant to which any Director or Senior Manager was selected as a Director or member of senior management.

10. Interests in Shares and Options

10.1 *Interests of Directors and Senior Managers*

The interests in the issued share capital of the Company upon Admission which are interests of the Directors which have been notified by the relevant directors to the Company will be as follows (all such interests being beneficial unless otherwise noted).

Directors	*Number of Common Shares*	*Percentage of issued share capital*
Martin Thomas	6,950	0.004%
Richard Brindle	430,065	0.248%
Simon Burton	240,000	0.139%
Neil McConachie	47,500	0.027%
John Bishop	4,807	0.003%
Jens Juul	10,000	0.005%
Ralf Oelssner	—	—
Robert Spass	372,500	0.215%
William Spiegel	70,240[(1)]	0.041%
Barry Volpert	—	
	—	
Senior Managers		
Alex Maloney	—	—
Charles Mathias	—	—
Paula Porter	—	—

(1) Including 7,000 Common Shares held by a family member.

10.2 *Initial Founders' Warrants*

In addition to the information on Director's interests provided in Part VIII paragraph 8 – Share Schemes above, warrants over the Company's shares were awarded to the Company's founders prior to the admission of the Company's shares to trading on AIM in December 2005. Richard Brindle (executive Director and Chief Executive Officer) holds 46,260, Robert Spass (non-executive Director) holds 1,549,135 and William Spiegel (non-executive Director) holds 481,182 initial founders' warrants.

In addition to the Directors' interests noted above, Barry Volpert (non-executive Director) is co-founder, Chairman and CEO of Crestview Partners, L.P. which holds an interest in 15,000,000 shares in the Company. Crestview Partners, L.P. and affiliated entities also hold the following initial founders' warrants.

Name of Holder	*Number of Founders' Warrants*
Crestview Partners, L.P.	740,301
Crestview Holdings (TE), L.P.	52,360
Crestview Partners (ERISA), L.P.	61,002
Crestview Partners (PF), L.P.	131,408
Crestview Offshore Holdings (Cayman), L.P.	17,391

10.3 The direct or indirect interests (within the meaning of Chapter 5 of the Disclosure and Transparency Rules) in 3 per cent. or more of the total voting rights in the Company as at 9 March 2009 (being the latest practicable date prior to the publication of this document) of which the Company is aware were as set out below:

Name	*Number of Common Shares*	*Percentage of issued share capital*
Crestview Partners, LP	15,000,000	8.7
Wellington Management Company, LLP	9,382,650	5.4
BlackRock Merrill Lynch Investment Mgrs.	8,616,832	5.0
Steadfast Capital LP	8,564,154	5.0
Goldman Sachs International	6,369,675	3.7
SAB Capital Partners, L.V.	6,286,483	3.6
Franklin Resources, Inc.	5,825,871	3.4

10.4 None of the persons listed above has or will have, in relation to their Common Shares, special voting rights.

11. Service Agreements and Remuneration of Directors

11.1 **Executive Directors' Service Contracts**

The following are particulars of the executive Directors' service contracts with the Company:

The executive Directors of the Company are Richard Brindle, Simon Burton and Neil McConachie. Richard Brindle was appointed as Chief Executive Officer of the Company under an original service contract dated 9 December 2005. Neil McConachie was appointed as Chief Financial Officer under an original service contract dated 1 February 2006. Simon Burton was appointed Deputy Chief Executive Officer under an original service contract dated 1 January 2007.

Richard Brindle's, Simon Burton's and Neil McConachie's original service contracts with the Company have been replaced by new service contracts entered into with effect from 1 January 2009. All service contracts contain six month notice provisions. Richard Brindle is also employed by the Group's UK operations under a service contract dated 21 August 2006. This service contract contains a six month termination provision. Details of the salaries payable under these contracts are set out in the emoluments table below.

During November 2008, the Remuneration Committee adopted a new framework which is to be applied for 2009 and future years and is geared towards providing a level of remuneration which attracts, retains and motivates executive Directors and senior management of the highest calibre to further the Company's interests and to optimise long-term shareholder value creation. The remuneration policy also seeks to ensure that executive Directors and senior management are provided with appropriate incentives to drive individual performance and to fairly reward them for their contribution to the successful performance of the Company.

11.1.1 The executive Directors' remuneration is made up of the following elements:

- base salary
- bonus
- share options and restricted shares
- performance warrants
- time-vesting warrants
- pension
- benefits, including medical, dental, vision coverage, air travel and housing and other allowance for expatriates.

Details of these elements are set out in detail below.

11.1.2 Base Salary

The Remuneration Committee has adopted the principle that basic salary should be set broadly in line with the median for executives in a role of comparable standing and that executive Directors should be able to achieve total remuneration at the upper quartile level (compared to peer companies generating similar returns) when justified by superior performance. The Remuneration Committee also takes into account levels of pay elsewhere in the Group, when determining the pay levels for executive Directors and senior management.

Salaries for executive Directors are determined by the Remuneration Committee before the start of each year and where an individual changes responsibility or position. The Company needs to offer salaries at around median market levels so that it is able to attract and retain executive Directors and senior executives of a suitable calibre to execute the Company's strategic plans and provide long-term shareholder value creation. The Remuneration Committee also takes into account pay levels elsewhere in the Group when setting the salary levels for executive Directors and senior executives.

From 1 January 2009, the salaries for executive Directors have been increased as follows: Richard Brindle, Chief Executive Officer – no increase; Simon Burton, Deputy Chief Executive Officer – a 3 per cent.

inflationary increase; and Neil McConachie, Chief Financial Officer – 4.5 per cent. increase to reflect the market value of the individual and his role.

11.1.3 *Bonus*

The Company operates a bonus plan based on annual performance of the Company and the individual executive.

The Company performance will be based on growth in book value and Return on Equity ("**ROE**"). Individual performance metrics will be set at the start of the financial year and assessed by way of a performance rating.

The target level of bonus is half of the maximum and stretching sliding scales determine bonus payments between threshold, target and maximum.

The use of maximums, which is a requirement under the Combined Code and is inherently necessary if there are to be calculated elements, does not preclude the Remuneration Committee from awarding higher amounts if the circumstances so require.

Since 2007 no minimum bonus entitlements have been set. For 2006, the Company's first year of operations, Richard Brindle and Neil McConachie were entitled to a minimum bonus of 75 per cent. of basic salary, and Simon Burton was entitled to a minimum bonus of 50 per cent. of basic salary.

The maximum bonus payable for 2008 was 400 per cent of basic salary (2007 – 400 per cent., 2006 – 250 per cent) for Richard Brindle, 350 per cent of base salary for Simon Burton (2007 – 350 per cent.) and 325 per cent of base salary (2007 – 300 per cent., 2006 – 200 per cent) for Neil McConachie. Details of the bonuses awarded to Richard Brindle, Simon Burton and Neil McConachie under this plan are set out in the emoluments table below. In addition, the amounts of annual bonuses in the aggregate under the basic bonus plan and the additional bonus plan (described below) which may be paid to any individual were subject to a maximum amount described in relation to the additional bonus plan below. The actual amount of the bonus paid out by the Company to the executive Directors is determined by the remuneration committee (upon the recommendation of the Chief Executive Officer in respect of the Deputy Chief Executive Officer and Chief Financial Officer) based on individual and corporate performance.

11.1.4 *Additional Bonus Plan*

In addition to the basic bonus plan, the Company operated an additional bonus plan under which formula-based additional bonuses may be paid to the executive Directors and other eligible employees in addition to the basic bonuses described above. For 2006, the additional bonuses were determined following the publication and review of comparator peer group companies in accordance with the plan. The amounts payable under the additional bonus plan were based on a formula which reflected both absolute and relative returns for 2006, with each such performance condition/threshold met contributing 50 per cent. of the possible sum paid to the individual. Under the additional bonus plan, one half of the bonus was payable under an absolute return pool that comprised 2.5 per cent. of the profits generated to the extent the Group's return on equity for that year exceeded the Group's return on equity for that year as projected at the time of the Company's admission to AIM. The other one half of the additional bonus was payable under a relative return pool that comprised 2.5 per cent. of the profits generated to the extent the Group's return on equity exceeded the average of a peer group of comparable insurance and reinsurance companies. The allocation of amounts in the pools payable under the additional bonus plan to the Chief Executive Officer was limited to 35 per cent and in addition is subject to the aggregate maximum limits below. The maximum amount payable in the aggregate for 2006 under the combination of the basic bonus plan and the additional bonus plan was 500 per cent. of base salary in the case of the Chief Executive Officer and 400 per cent. of base salary for the Chief Financial Officer.

The amounts paid to each executive under the additional bonus plan in 2007, in respect of the year ended 2006 are shown under Directors' emoluments. The additional bonus plan has been succeeded by the Restricted Share Scheme described below, and there will be no further payments under this plan.

11.1.5 *Long Term Incentive Plan*

Please see Part VIII paragraph 8 – Share Schemes above.

11.1.6 *Management Warrants*

Please see Part VIII paragraph 8 – Share Schemes above.

11.1.7 *Restricted share scheme*

Please see Part VIII paragraph 8 – Share Schemes above.

11.1.8 *Pensions*

Richard Brindle, Simon Burton and Neil McConachie receive pension contributions from the Company under a defined contribution pension plan the Company operates for its employees. Under this plan, and in line with market practice in Bermuda, the Company contributes 10 per cent. of base salary up to a maximum of US$20,000. In addition Richard Brindle receives contributions to a UK defined contribution pension plan in respect of his salary and employment with the Company's UK operations. Details of the pension contributions made to executive Directors are set out in the emoluments table below.

11.1.9 *Executive Director Emoluments*

The aggregate remuneration (including benefits in kind) paid to the Directors and Senior Managers for the financial year ended 31 December 2008 was US$8,224,864[1]. The executive Directors' salaries and their emoluments for the year ended 31 December 2008 are as follows:

Director	*Year*	*Salary/ fees for the Company*	*Salary/fee for other Group companies*	*Basic bonus*	*Additional Bonus*	*Pension*	*Other benefits*	*Total*
Richard Brindle	2008	675,000	447,292[1]	1,561,753[1]	—	64,729[1]	329,267[1]	3,078,041[1]
Simon Burton	2008	386,250	—	512,023	—	20,000	182,406	1,100,679
Neil McConachie	2008	381,037	—	530,642	—	20,000	178,904	1,110,584

(1) Some amounts were paid in pounds sterling and converted at prevailing exchange rates.

11.1.10 *Pension, retirement and similar benefits*

In relation to the year ended 31 December 2008 the total amount set aside by the Group to provide pension, retirement and similar benefits to the Directors and the Senior Managers is US$256,518.

11.2 **Non-Executive Director Letters of Appointment**

The following are particulars of the non-executive Directors' letters of appointment with the Company:

Non-executive Director	*Position*	*Date of Letter of Appointment*	*Annual Director Fee*
John Bishop	Non-executive Director	19 March 2008	US$140,000
Jens Juul	Non-executive Director	16 November 2007	US$140,000
Ralf Oelssner	Non-executive Director, Senior Independent Director	31 July 2007	US$175,000
Robert Spass	Non-executive Director, Chairman of Audit Committee	9 December 2005	US$175,000
William Spiegel	Non-executive Director, Chairman of Remuneration Committee	9 December 2005	US$175,000
Martin Thomas	Non-executive Chairman	16 April 2007	US$275,000
Barry Volpert	Non-executive Director, Chairman of Investment Committee	12 December 2005	US$140,000

Non-executive Directors are paid a flat fee per annum, payable quarterly in arrears which is subject to an annual review by the Board which takes into account performance evaluation and any other factors considered relevant by the Board. The table above lists the fees currently payable to each of the non-executive Directors. In addition, the Company reimburses non-executive Directors for all reasonable and properly documented expenses, including business class travel, incurred in performing the duties of their office. Some non-executive Directors receive further fees for services provided as directors of subsidiary companies within the Group.

Unless otherwise terminated earlier pursuant to the Bye-laws of the Company, each non-executive Director appointment continues at the discretion of either party upon six months written notice. Continuation of appointment is contingent on satisfactory performance and re-election at forthcoming annual general meetings. Non-executive Directors are typically expected to serve two three-year terms, although the board of Directors of the Company may invite Non-executive Directors to serve for an additional period.

Appointment will terminate immediately without notice (or a payment in lieu of notice) if the non-executive Director is not re-appointed by the Company in general meeting; or if the non-executive Director is removed as a Director by the Company in general meeting; or the non-executive Director resigns the Directorship or otherwise ceases to be a Director in accordance with the provisions of the Company's Bye-laws.

Non-executive Directors are required to devote such time to their duties as the Board reasonably considers necessary to fulfil their role as non-executive Director of a public listed company; including attendance at Board meetings, the AGM and one annual Board away day. Non-executive Directors are required to attend any meetings of the non-executive Directors and also any meetings of Board committees to which they are appointed. In addition, they are expected to devote appropriate preparation time ahead of each meeting. In addition, they are obliged, when requested by major shareholders or by the Company, to attend meetings with such shareholders.

By accepting their appointment, each non-executive Director has confirmed that they are able to allocate sufficient time to meet the expectations of their role. The agreement of the Chairman should be sought before accepting additional commitments that might affect the time they are able to devote to their role as a non-executive Director of the Company.

12. Employees

At 31 December 2008, Lancashire had 91 employees: 47 in London, 41 in Bermuda and 3 in Dubai. The number of staff employed by the Group at the 31 December 2008, 2007, 2006 was 91, 74 and 55, respectively. The following table shows the total number of staff by category of activity and location at 31 December 2008.

London	*Bermuda*	*Dubai*
Underwriting and Modelling (20)	Underwriting and Modelling (14)	Underwriting (2)
Administrative Staff: Finance & Operations, Legal and IT (27)	Administrative Staff: Finance & Operations, Legal and IT (27)	Administrative Staff (1)
Total Number of Staff (47)	Total Number of Staff (41)	Total Number of Staff (3)

13. Corporate Governance

The following are summaries of the terms of reference under which each of the Audit, Nomination and Corporate Governance and Remuneration committees operate. Information as to the composition of the committees is contained in Part IV – Management and Corporate Governance.

Audit Committee

The Audit Committee shall be appointed by the Board and shall consist of the chairman and, so long as there are two non-executive directors in addition to the chairman, not less than two non-executive directors, or, otherwise, one non-executive director. The chairman of the Audit Committee shall be appointed by the Board and shall be a non-executive director. The quorum shall be two members. The Audit Committee is required to meet at least 2 times each year. The duties of the Audit Committee include, *inter alia*:

- keeping under review the nature, scope and results of the external audit and its effectiveness and the independence and objectivity of the auditors;
- keeping under review the nature and extent of non-audit services provided by the external auditor and reporting to the Board as necessary;
- making recommendations to the Board to be put before the members of the Company for approval at general meeting in relation to the (re)appointment, remuneration and removal of the external auditors and approving the terms of engagement of the external auditor if authorised by the members to do so;
- liaising with the external auditors concerning the production of the interim and annual financial statements and any formal announcements relating to the Company's financial performance;
- discussing any issues arising from the interim and final audits or any other matters that the external auditor might raise with the Company;
- reviewing the external auditor's management letter and the Company's response to it;
- reviewing quarterly any related party transactions;
- reviewing the Group's internal control and financial reporting systems and making recommendations to the Board;
- reviewing the Company's statement on internal control systems prior to endorsement by the Board;
- reviewing the internal audit plan ensuring its smooth efficient running and appropriate standing within the Company and reviewing the major findings of the internal audit investigations and management's response;
- reviewing arrangements by which staff of the Company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters and ensuring that arrangements are in place for the proportionate and independent investigation of such matters with appropriate follow-up action; and
- considering other topics, as requested by the Board.

Nomination and Corporate Governance Committee

The Nomination and Corporate Governance Committee shall be appointed by the Board and shall consist of a chairman and not less than one non-executive director and the Chief Executive provided that at all times a majority of the members of the committee shall be independent non-executive directors. The chairman of the committee shall be the Chairman of the Company. The quorum shall be two members. The committee is required to meet at least 2 times in a year. The duties of the Nomination and Corporate Governance Committee include, *inter alia*:

- responsibility for identifying, and nominating for the approval of the Board, candidates to fill Board vacancies as and when they arise, save that appointments as chairman or Chief Executive Officer of the Company shall be matters for the whole Board. Candidates from a wide range of backgrounds, beyond the obvious types of candidate, are considered;
- before recommending an appointment, evaluating the balance of skills, knowledge and experience on the Board and, in the light of this evaluation, preparing a description of the role and capabilities required for a particular appointment;

- reviewing annually the time required from each non-executive Director, according to their particular committee appointments and any other specific role;
- giving full consideration to succession planning, both executive and non-executive, in the course of its work, taking into account the challenges and opportunities facing the Company and the skills and expertise are needed on the Board in the future;
- regularly reviewing the structure, size and composition (including the skills, knowledge and experience) of the Board and making recommendations to the Board with regard to any changes;
- keeping up to date and fully informed about strategic issues and commercial changes affecting the Company and the market in which it operates;
- ensuring an appropriate statement is made in the annual report about its activities, including the process it has used in relation to Board appointments, and an explanation given if neither an external search consultancy nor open advertising had been used in the appointment of the chairman of the Company or a non-executive Director; and the membership of the Committee, number of Committee meetings and attendance over the course of the year;
- making these terms of reference available on request, explaining its role and the authority delegated to it by the Board;
- ensuring that on appointment to the Board, non-executive Directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, committee service and involvement outside Board meetings; ensuring that such letter is updated as circumstances change; and instructing the Secretary to make the current version of each such letter available for inspection by any person at the Company's registered office during normal business hours and at the Annual General Meeting (for 15 minutes prior to the meeting and during the meeting); and
- making recommendations to the Board concerning: succession planning; re-appointment of non-executive directors; re-election by shareholders of any directors under the retirement provisions in the Bye-Laws; the continuation in office of any director; (re)appointment of any of the members/chairman of any of the Company's committees; and the appointment of any director to executive or other office.

Remuneration Committee

The Remuneration Committee shall be appointed by the Board and shall consist of the chairman and not less than one non-executive director. The quorum shall be two members. The chairman of the Company may be appointed by the Board as an additional member of the Committee and shall be a non-executive director. The Remuneration Committee is required to meet at least 2 times in a year. The chairman of the committee shall report to shareholders in compliance with relevant regulatory and legal requirements. The duties of the Remuneration Committee will include, *inter alia*:

- determining and agreeing with the Board the Company's framework of executive director remuneration and its cost;
- determining the remuneration in all its forms (including, where appropriate, bonuses, incentive payments and share options) of the individual Senior Executives. The Committee may draw on outside advice as necessary in fulfilment of its duties under this paragraph;
- taking into account all factors which it deems necessary to ensure that members of the executive management of the Company are provided with appropriate incentives to encourage enhanced individual and corporate performance and are, in a fair and responsible manner, rewarded for their individual contributions to the success of the Company;
- ensuring that no Director, manager or other officer shall be involved in any decisions as to their own remuneration;
- determining targets for, advising on, and monitoring any performance related bonus or other incentive schemes;
- seeing that awards under the Group's share option schemes and incentive plans, if any, while complying with the statutory and other requirements, are consistent with the Group's overall performance and the performance of individuals and provide an additional incentive to management;
- ensure that there are appropriate pension arrangements (if any) for the executive directors entitled to such arrangements;
- administering the Group's share option schemes and incentive plans;
- staying abreast of and advising on any major changes in employee benefit structures throughout the Group;
- approving contracts of employment or related contracts and material amendments thereto with Senior Executives on behalf of the Company;
- determining terms of any compensation package in the event of the early termination of the contract of any Senior Executive having regard to the contents of the Combined Code of Corporate Governance published in July 2003 by the Financial Reporting Council and the Rules of the London Stock Exchange plc and any associated guidance and ensuring that such terms and any payments made are fair to the individual and the Company, that failure is not rewarded and that the duty to mitigate loss is fully recognised;

- agreeing the policy for authorising claims for expenses from the Chief Executive Officer and the Chairman of the Company;
- being exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee;
- co-ordinating closely with the Board's Nomination Committee in relation to the remuneration to be offered to any new executive Director;
- making recommendations to the Board regarding the contents of the Board's annual report to shareholders on Directors' remuneration (including pensions); and
- making available the committee's terms of reference which should set out the Committee's delegated responsibilities and be reviewed and, where necessary, updated annually.

In undertaking the above duties the committee should bear in mind the size, profitability and market capitalisation of the Group, its reputation and its performance relative to other similar companies, the performance of individuals and the best interests of shareholders.

14. Related Party Transactions

Save as disclosed in the financial information set out in this document and the material contracts listed in this Part VIII of this document, there are no related party transactions between the Company and its associated companies or joint venture companies that were entered into during the financial years ended 31 December 2006, 2007 and 2008 and during the period between 1 January 2009 and 9 March 2009 (being the latest practicable date prior to the publication of this document).

15. Material Contracts

The following contracts, not being contracts entered into in the ordinary course of business, are contracts which are material and have either been entered into by the Company or another member of the Group within the two years immediately preceding the date of this document or (regardless of when entered into) contain obligations or entitlements which are material to the Company or to a member of the Group:

15.1 Syndicated Collateralised Credit Facility

On 16 July 2007, LICL and the Company entered into a syndicated collateralised five year credit facility in the amount of US$200 million with a US$75 million loan sub-limit with HSBC Bank USA, National Association (Syndication Agent), Bank of America, N.A. (Administrative Agent, Fronting Bank and L/C Administrator), Banc of America Securities LLC (Joint Lead Arranger and Joint Book Manger), HSBC Securities (USA) Inc. (Joint Lead Arranger and Joint Book Manger), ING Bank N.V., London Branch (Co-Documentation Agent) and Bank of New York (Co-Documentation Agent).

The facility is available and used to satisfy certain regulations and the terms of certain insurance and reinsurance contracts that require the Company's operating subsidiaries to provide letters of credit to policyholders as collateral. For example, as the Company's operating subsidiaries are not admitted insurers or reinsurers in the US, the Company's operating subsidiaries are required to provide security, via letters of credit or trust funds, for excess and surplus lines policies placed with Lancashire.

15.2 Monitoring Fee Agreement

On 1 January 2006 the Company entered into an agreement with Capital Z Lancashire Partners, L.P. ("**Capital Z**"); Cypress Lancashire Partners, L.P. ("**Cypress**"); and Crestview Advisors, L.L.C., ("**Crestview**" and, together with Capital Z and Cypress, the "**Advisers**") (the "**Monitoring Agreement**"). Pursuant to the terms of the Monitoring Agreement, while an Adviser has a representative on the Board of the Company, the Company is required to pay a fee to such Adviser for their respective assistance in providing monitoring services to the Company and its subsidiaries as may be requested from time to time by the Company during the term of the Monitoring Agreement, and recommendations with respect to investments and/or divestments by the Company and/or its subsidiaries. Any fee paid to such Director is offset against the fee paid to the Adviser for the monitoring services. The term of the Monitoring Agreement shall continue until the earlier to occur of 1 January 2016; or the date on which all of the Advisors (or their respective affiliates) have ceased to hold a seat on the Board of directors of the Company. In May 2006 Cypress ceased to have a representative on the Board of directors of the Company and the Company consequently ceased paying a fee to Cypress.

15.3 Sponsor Agreement

On 11 March 2009 the Company entered into the Sponsor Agreement with Merrill Lynch International pursuant to which Merrill Lynch International was appointed to act as sponsor to the Company for the purposes of the Listing Rules and in connection with Admission. The Sponsor Agreement contains certain warranties and indemnities from the Company in favour of Merrill Lynch International which are customary for an agreement of this nature**,** together with provisions which enable Merrill Lynch International to terminate the Sponsor Agreement on or prior to Admission in certain specified circumstances, including circumstances where any warranties are found to be untrue or inaccurate.

The Sponsor Agreement also contains certain undertakings given by the Company in respect of, *inter alia*, compliance with the Listing Rules, and other applicable laws and regulations.

16. Litigation

There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Company is aware) which may have, or have had during the 12 months preceding the date of this document, a significant effect on the financial position or profitability of the Company or of the Group.

17. Working Capital

The Company is of the opinion that the working capital available to the Company and the Group is sufficient for its present requirements, that is for at least the next 12 months from the date of publication of this document.

18. Consents

18.1 Ernst & Young LLP has given and has not withdrawn its written consent to the inclusion in this document of its report set out in Part VI of this document and references to its name in the form and context in which they appear and has authorised the contents of such report for the purpose of paragraph 5.5.4R(2)(f) of the Prospectus Rules.

18.2 Merrill Lynch International has given and has not withdrawn its written consent to the inclusion in this document of the references to its name in the form and context in which they appear.

19. Significant Change

There has been no significant change in the financial or trading position of the Group since 31 December 2008, being the end of the last financial period for which audited consolidated accounts of the Group have been prepared.

20. Research and Development

The Company does not undertake significant research and development activities, and has not operated formal research and development policies for the financial years ended 31 December 2006, 2007, 2008.

21. CREST and Depositary Interests

21.1 Introduction

Details of CREST and Depositary Interests arrangements are set out in paragraph 18 of Part III.

The DIs were admitted to CREST on 16 December 2005. The DIs have the same security code (ISIN) as the underlying Common Shares (BMG526551004) and do not require a separate listing on the Official List.

Holders of Common Shares in certificated form who wish to hold DIs through the CREST system may be able to do so and should contact their broker.

21.2 Summary of the material terms of the Deed Poll

As mentioned above, the Depositary Interests will be created pursuant to and issued on the terms of the Deed Poll. The Deed Poll is executed by the Depositary, in favour of the holders of the DIs from time to time.

Prospective holders of DIs should note that they will have no rights against the operator of the CREST system or its subsidiaries in respect of the underlying Common Shares or the DIs representing them.

Common Shares will be transferred to an account of the Depositary or its nominated custodian (the "**Custodian**") and the Depositary will issue DIs to participating members.

Each DI will be treated as one Common Share for the purposes of determining, for example, eligibility for any dividends. The Depositary will pass on to holders of DIs any stock or cash benefits received by it as holder of Common Shares on trust for such DI holder. DI holders will also be able to receive from the Depositary notices of meetings of holders of Common Shares and other information issued by the Company to the Shareholders to make choices and elections. In summary, the Deed Poll contains, *inter alia*, provisions to the following effect:

(a) The Depositary will hold (itself or through the Custodian), as bare trustee, the underlying securities issued by the Company and all and any rights and other securities, property and cash attributable to the underlying securities for the time being held by the Depositary or Custodian pertaining to the DIs for the benefit of the holders of the DIs. The Depositary will re-allocate securities or distributions allocated to the Depositary or the Custodian *pro rata* to the Common Shares held for the respective accounts of the holders of DIs but will not be required to account for fractional entitlements arising from such re-allocation.

(b) Holders of DIs warrant, *inter alia*, that the securities in the Company transferred or issued to the Depositary or Custodian on behalf of the Depositary for the account of the DI holder are free and clear of all liens, charges, encumbrances or third-party interests and that such transfers or issues are not in contravention of the Company's memorandum of association or Bye-laws or any contractual obligation, or applicable law or regulation binding or affecting such holder.

(c) The Depositary and any Custodian shall pass on to DI holders, and so far as reasonably able exercise on their behalf, all rights and entitlements received by the Depositary or the Custodian in respect of the underlying securities. Rights and entitlements to cash distributions, to information, to make choices and

elections and to attend and vote at meetings shall, subject to the Deed Poll, be passed on in the form which they are received, together with amendments and additional documentation necessary to effect such passing-on, or exercised in accordance with the Deed Poll. If arrangements are made which allow a holder to take up rights in the Company's securities requiring further payment, the holder must put the Depositary in cleared funds before the relevant payment date or other date notified by the Depositary if it wishes the Depositary to exercise such rights.

(d) The Depositary will be entitled to cancel DIs and treat the holders as having requested a withdrawal of the underlying securities in certain circumstances including where a DI holder fails to furnish to the Depositary such certificates or representations as to material matters of fact, including his identity, as the Depositary deems appropriate.

(e) The Deed Poll contains provisions excluding and limiting the Depositary's liability. For example, the Depositary shall not be liable to any DI holder or any other person for liabilities in connection with the performance or non-performance of obligations under the Deed Poll or otherwise except as may result from its negligence or wilful default or fraud or that of any person for whom it is vicariously liable, provided that the Depositary shall not be liable for the negligence, wilful default or fraud of any Custodian or agent which is not a member of its group unless it has failed to exercise reasonable care in the appointment and continued use and supervision of such Custodian or agent. Furthermore, the Depositary's liability to a holder of DIs will be limited to the lesser of:

    (i) the value of the Common Shares and other deposited property properly attributable to the DIs to which the liability relates; and

    (ii) that proportion of £10 million which corresponds to the portion which the amount the Depositary would otherwise be liable to pay to the DI holder bears to the aggregate of the amounts the Depositary would otherwise be liable to pay to all such holders in respect of the same act, omission, or event or, if there are no such amounts, £10 million.

(f) The Depositary is entitled to charge holders of DIs fees and expenses for the provision of its services under the Deed Poll.

(g) The holders of DIs are required to agree and acknowledge with the Depositary that it is their responsibility to ensure that any transfer of DIs by them which is identified by the CREST system as exempt from stamp duty reserve tax is so exempt, and to notify the Depositary forthwith if this is not the case, and to pay to the operator of the CREST system any interest, charges or penalties arising from late or non-payment of stamp duty reserve tax in respect of such transaction.

(h) Each holder of DIs is liable to indemnify the Depositary and any Custodian (and their agents, officers and employees) against all liabilities arising from or incurred in connection with, or arising from any act performed in accordance with or for the purposes of or otherwise related to, the Deed Poll so far as they relate to the DIs (and any property or rights held by the Depositary or Custodian in connection with the DIs) held by that holder, other than those resulting from the wilful default, negligence or fraud of the Depositary, or the Custodian or any agent if such Custodian or agent is a member of the Depositary's group or if, not being a member of the same group, the Depositary shall have failed to exercise reasonable care in the appointment and continued use and supervision of such Custodian or agent.

(i) The Depositary is entitled to make deductions from any income or capital arising from the underlying securities, or to sell such underlying securities and make deductions from the sale proceeds therefrom, in order to discharge the indemnification obligations of DI holders.

(j) The Depositary may terminate the Deed Poll by giving 30 days' notice. During such notice period holders may cancel their DIs and withdraw their deposited property and, if any DIs remain outstanding after termination, the Depositary must, among other things, deliver the deposited property in respect of the DIs to the relevant DI holders or, at its discretion sell all or part of such deposited property. It shall, as soon as reasonably practicable, delivery the net proceeds of any such sale, after deducting any sums due to the Depositary, together with any other cash held by it under the Deed Poll *pro rata* to holders of DIs in respect of their DIs.

(k) The Depositary may suspend registration of transfers of DIs and may, in addition, request the operator of the CREST system to suspend the DIs if transfers of the deposited securities are suspended, if trading in the deposited securities is suspended or if the deposited securities are no longer transferable for any other reason, if the operator of the CREST system is entitled (under the CREST Regulations or the rules within the meaning of the CREST Regulations and/or FSMA made by the operator of the CREST system) to suspend the deposited securities, or if, in all the circumstances, the Depositary considers it reasonable to do so.

(l) The Depositary or the Custodian may require from any holder information as to the capacity in which DIs are or were owned and the identity of any other person with or previously having any interest in such DIs and the nature of such interest and evidence or declarations of nationality or residence of the legal or beneficial owners of DIs and such information as is required for the transfer of the relevant Common Shares to the holders. Holders agree to provide such information requested and consent to the disclosure of such information by the Depositary or Custodian to the extent necessary or desirable to comply with their legal or regulatory obligations. Furthermore, to the extent that the Company's memorandum of association and/or Bye-laws require disclosure to the Company of, or limitations in

relation to, beneficial or other ownership of the Company's securities, the holders of DIs are to comply with such memorandum of association and Bye-laws and the Company's instructions with respect thereto.

It should also be noted that holders of DIs may not have the opportunity to exercise all of the rights and entitlement available to holders of Common Shares including, for example, the ability to vote on a show of hands. In relation to voting, it will be important for holders of DIs to give prompt instructions in writing to the Depositary to vote the underlying shares on their behalf.

21.3 **Summary of material terms of the Depositary Agreement**

Under the depositary agreement dated 8 December 2005 (the "**Depositary Agreement**") between the Company and the Depositary, the Company appoints the Depositary to constitute and issue from time to time, upon the terms of the Deed Poll, series of Depositary Interests representing securities issued by the Company and to provide certain other services in connection with such DIs.

The Depositary Agreement contains, *inter alia*, provisions to the following effect:

(a) The Depositary agrees that it will comply, and will procure certain other persons to comply with the terms of the Deed Poll and that it and they will perform their obligations and exercise all rights in good faith and with all reasonable skill, diligence and care. The Depositary assumes certain specific obligations including, for example, to arrange for the DIs to be admitted to CREST as participating securities and provide copies of and access to, the register of DIs.

(b) The Depositary warrants that it is an authorised person under the FSMA and is duly authorised to carry out custodial and other activities under the Deed Poll. It also undertakes to maintain that status and authorisation.

(c) The Depositary will either itself or through its appointed Custodian as bare trustee hold the deposited property (which includes, *inter alia*, the securities represented by the DIs) for the benefit of the holders of the DIs as tenants in common, subject to the terms of the Deed Poll.

(d) The Company agrees to provide such assistance, information and documentation to the Depositary as is reasonably required by the Depositary for the purposes of performing its duties, responsibilities and obligations under the Deed Poll and Depositary Agreement. In particular, the Company is to supply the Depositary with all documents it sends to its shareholders so that the Depositary can distribute the same to all holders of DIs.

(e) The Depositary will not be obliged to accept transfers of DIs if the transfer would place the Depositary in breach of any law or regulation. If such circumstances were to occur the Depositary will discuss this with the Company as soon as is reasonably practicable in order to review how to proceed.

(f) The Depositary Agreement sets out the procedures to be followed where the Company is to pay or make a dividend or other distribution.

(g) The Depositary is to indemnify the Company and each of its subsidiaries and subsidiary undertakings against claims made against any of them by any holder of DIs or any person having any direct or indirect interest in any such DIs or the underlying securities which arises out of any breach or alleged breach of the terms of the Deed Poll or any trust declared or arising thereunder.

(h) The Depositary Agreement is to remain in force for as long as the Deed Poll remains in force. The Company may by giving not less than 30 days written notice to the Depositary terminate the appointment of the Depositary if an Event of Default (as defined in the Depositary Agreement) occurs in relation to the Depositary or if it commits an irremediable material breach of the agreement or the Deed Poll or any other material breach which is not remedied within 30 days of being required to do so by written notice given by the Company. The Depositary has, by giving not less than 30 days' written notice to the Company, the same termination rights in respect of Events of Default occurring or any such breach by the Company. Either of the parties may terminate the Depositary's appointment by giving not less than 45 days' written notice.

(i) The Depositary may not subcontract or delegate its obligations under the Deed Poll to any person without the Company's prior consent (not to be unreasonably withheld).

(j) The Company is to pay certain fees and charges including, inter alia, an annual fee, a fee based on the number of DIs per year and certain CREST related fees. The Depositary is also entitled to recover reasonable out of pocket fees and expenses.

22. Miscellaneous

22.1 The total expenses of, preparatory to, or incidental to Admission which are payable by the Group are estimated to account for approximately US$1.43 million.

22.2 The Company's auditors are Ernst & Young whose registered office is Reid Hall, 3 Reid Street, Hamilton HM 11, Bermuda. Ernst & Young are the Registered Auditors and audited the statutory IFRS financial statements of the Lancashire Group, without qualification, for the years ended 31 December 2006, 2007 and 2008 in accordance with generally accepted auditing standards in the United Kingdom. Ernst & Young LLP whose registered office is 1 More London Place, London SE1 2AF are the Reporting Accountant for this transaction.

22.3 The Company's registrars and receiving agents are Capita Registrars (Jersey) Limited of Victoria Chambers, Liberation Square, 1/3 The Esplanade, St. Helier, Jersey JE4 0FF.

22.4 The Common Shares have not been marked, nor are they available, in whole or in part, to the public in connection with the application for listing.

22.5 The Company confirms that the information contained in Part III of this document sourced from any third party has been accurately reproduced and, so far as the Company is aware and is able to ascertain from information published by any such third party, no facts have been omitted which would render the reproduced information inaccurate or misleading.

22.6 The Company confirms that it does not hold a proportion of the capital in any undertaking likely to have a significant effect on the assessment of its own assets and liabilities, financial position or profits and losses.

23. Documents available for Inspection

Copies of the documents listed below may be inspected free of charge at the offices of the Company at Mintflower Place, 8 Par-la-Ville Road, Hamilton HM 08, Bermuda, and Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, United Kingdom and at the offices of Merrill Lynch International at Merrill Lynch Financial Centre, 2 King Edward Street, London EC1A 1HQ, United Kingdom during normal business hours on any weekday (Saturdays, Sundays and public holidays excepted) from the date of this document until one month from the date of Admission:

(a) the memorandum of association and Bye-laws of the Company;

(b) the audited financial statements of the Company for the two financial years ended 31 December 2008 and 31 December 2007; and

(c) this document.

Date: 11 March 2009

DEFINITIONS

The following definitions apply throughout this document, unless the context requires otherwise:

"A.M. Best"	A.M. Best Company, Inc.
"Act"	the Companies Act 1981 of Bermuda, as amended.
"Admission"	the admission of the Common Shares of the Company to (a) the Official List becoming effective in accordance with the Listing Rules and (b) trading on the London Stock Exchange's market for larger and established companies becoming effective in accordance with the Admission and Disclosure Standards of the London Stock Exchange.
"AGM"	the annual general meeting of the Company to be held in 2009.
"AIM"	a market operated by the London Stock Exchange.
"BMA"	the Bermuda Monetary Authority.
"Board" or **"Directors"**	the directors of the Company for the time being and (where the context requires) comprises those persons as at the date of this document, whose names appear in paragraph 9.1 of Part VIII of this document.
"Bye-laws"	the Bye-laws of the Company, a summary of which is set out in paragraph 5 of Part VIII of this document.
"certificated" or **"in certificated form"**	not in uncertificated form.
"change in FCBVS adjusted for dividends"	the calculation is the internal rate of return of the increase in fully converted book value per share in the period plus dividends accrued.
"Combined Code"	the code of best practice published in June 2006 by the Financial Reporting Council and including the principles of good governance appended to, but not forming part of, Listing Rules.
"combined ratio"	the combined ratio is the sum of the loss ratio, the acquisition cost ratio and the administrative expense ratio.
"Common Shares"	common shares of US$0.50 each in the capital of the Company.
"Company" or **"LHL"**	Lancashire Holdings Limited, a company incorporated in Bermuda with registered number EC37415.
"CREST"	the relevant system (as defined in the Regulations) for the paperless settlement of share transfers and the holding of shares in uncertificated form (as defined in the Regulations) in respect of which Euroclear UK & Ireland is the Operator (as defined in the Regulations).
"CREST Member"	a person who has been admitted by Euroclear UK & Ireland Limited as a system member (as defined in the Regulations).
"Currencies"	all references in this document to "pounds", "pounds sterling", "sterling", "£", "penny" and "p" are to the lawful currency of the UK, references to "US dollars" or "US$" are to the lawful currency of the US, all references to "BD$" or "Bermuda dollars" are to the lawful currency of Bermuda and all references to "€" are to the lawful currency of the European Union (as adopted by certain member states).
"Depositary"	Capita IRG Trustees Limited.
"Depositary Interest" or **"DI"**	a depositary interest representing an underlying Common Share, details of which are set out in paragraph 21 of Part VIII – Additional Information.
"DIFC"	Dubai International Financial Centre.
"Disclosure and Transparency Rules"	the Disclosure and Transparency Rules of the FSA brought into effect on 20 January 2007.
"Euroclear UK & Ireland"	Euroclear UK & Ireland Limited.
"FSA"	the Financial Services Authority of the United Kingdom.
"FSMA"	the Financial Services and Markets Act 2000, as amended.
"fully converted book value per share" or **"FCBVS"**	the calculation is based on the following: the value of total shareholders' equity plus the proceeds that would be received from the exercise of all dilutive outstanding options and warrants, excluding performance warrants that have not yet met the relevant criteria; divided by: the sum of all shares, dilutive options, warrants outstanding and restricted stock units, assuming all are exercised, excluding performance warrants and restricted stock units that have not yet met the relevant criteria.
"Group" or **"Lancashire"**	the Company and its subsidiary undertakings from time to time (or any of them).

"HMRC"	Her Majesty's Revenue and Customs.
"IFRS"	International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) (including those International Accounting Standards issued by the International Accounting Standards Committee (IASC) which have been adopted by the IASB, as well as interpretations of International Financial Reporting Standards developed by the International Financial Reporting Interpretations Committee (IFRIC) and approved by the IASB, as endorsed by the European Union.
"leverage"	the calculation is based on the following: long-term debt divided by long-term debt plus total shareholders' equity attributable to equity shareholders.
"LICL"	Lancashire Insurance Company Limited, a wholly owned subsidiary of LHL incorporated in Bermuda.
"LIHL"	Lancashire Insurance Holdings (UK) Limited, a wholly owned subsidiary of LHL incorporated in England and Wales.
"LIMSL"	Lancashire Insurance Marketing Services Limited, a wholly owned subsidiary of LHL incorporated in England and Wales.
"LISL"	Lancashire Insurance Services Limited, a wholly owned subsidiary of LHL incorporated in England and Wales.
"Listing Rules"	The rules and regulations made by the FSA in its capacity as the UK Listing Authority under FSMA and contained in the UK Listing Authority's publication of the same name.
"LMEL"	Lancashire Marketing Services (Middle East) Limited, a wholly owned subsidiary of LHL incorporated in the Dubai International Financial Centre.
"London Stock Exchange"	London Stock Exchange plc.
"LUK"	Lancashire Insurance Company (UK) Limited
"net acquisition cost ratio"	the net acquisition cost ratio is the net acquisition expenses divided by net premiums earned.
"net operating income"	net operating income excludes realised gains and losses; warrants issued at IPO; foreign exchange and tax.
"net loss ratio"	the net loss ratio is the net insurance losses and loss adjustment expenses divided by net premiums earned.
"New Bye-laws"	the Bye-laws as amended by the proposed changes to be adopted at the AGM.
"Official List"	the official list of the UK Listing Authority.
"Prospectus"	this document.
"Prospectus Rules"	the prospectus rules of the UK Listing Authority made under Section 73A of FSMA.
"SEC"	the Securities and Exchange Commission
"Securities Act"	the United States Securities Act of 1933, as amended.
"Shareholders"	holders of Common Shares from time to time.
"Sponsor Agreement"	the agreement dated 11 March 2009 and made between the Company and Merrill Lynch International which is summarised in Part VIII of this document.
"the Takeover Code"	the UK City Code on Takeovers and Mergers.
"UAE"	the United Arab Emirates.
"UK Listing Authority" or **"UKLA"**	the FSA acting in its capacity as the competent authority for the purposes of Part VI of FSMA.
"UK" or **"United Kingdom"**	the United Kingdom of Great Britain and Northern Ireland.
"uncertificated" or **"in uncertificated form"**	shares recorded on the Company's register of Shareholders as being held in uncertificated form in CREST, title to which may be transferred by means of an instruction issued in accordance with the rules of CREST.
"US" or **"United States"**	the United States of America, its territories and possessions, any State of the United States, the District of Columbia and all other areas subject to its jurisdiction.
"US Person"	has the meaning provided in Section 902(K) of Regulation S under the Securities Act, save as specified in paragraph 7.4.2 of Part VIII.
"VAT"	value added tax.

GLOSSARY

"binding authority"	authority given by an insurer or reinsurer to brokers or agents to bind insurance or reinsurance risks on its behalf
"broker"	one who negotiates contracts of insurance or reinsurance, receiving remuneration for placement and other services rendered, between (1) a policy holder and a primary insurer, on behalf of the insured party, (2) a primary insurer and reinsurer, on behalf of the primary insurer or (3) a reinsurer and a retrocessionaire, on behalf of the reinsurer
"capacity"	underwriting capacity or stamp capacity, as the context requires, being the limit (as agreed with Lloyd's) on the premium income which may be written by a syndicate
"casualty insurance"	insurance that is primarily concerned with the losses caused by injuries to third persons (i.e. persons other than the policyholder) and the legal liability imposed on the insured resulting therefrom and reinsurance of such losses
"catastrophe"	a severe loss, typically involving multiple claimants. Common perils include earthquakes, hurricanes, hailstorms, severe winter weather, floods, fires, tornadoes, explosions and other natural or man-made disasters. Catastrophe losses may also arise from acts of war, acts of terrorism and political instability
"catastrophe losses"	losses and directly identified loss adjustment expenses resulting from catastrophes
"cedant"	when a party reinsures its liability with another, it "cedes" business and is referred to as the "cedant" or "ceding company", an alternative for reinsured
"direct insurance"	insurance sold by an insurer that contracts with the insured, as distinguished from reinsurance
"elemental"	common perils include earthquakes, hurricanes, typhoons, storms, hailstorms, severe winter weather, floods, bush and brush fires, tornadoes, and other natural disasters
"excess of loss"	reinsurance or insurance that covers the reinsured or insured against all or a specified portion of losses over a specified currency amount known as a "retention" or "deductible"
"facultative"	the reinsurance of part or all of the insurance of an individual risk covered by a single policy on negotiated terms and conditions
"gross written premiums"	total premiums for insurance written and reinsurance assumed during a given period
"IBNR reserves"	estimated losses which an insurer or reinsurer, based on its knowledge or experience of underwriting similar contracts, believes have arisen or will arise under one or more contracts of insurance or reinsurance, but which have not been notified to an insurer or reinsurer at the time of their estimation
"layers"	each of the portions of insurance or reinsurance in which excess of loss policies are written
"lineslips"	a facility operated by a Lloyd's broker whereby risks can be bound to a panel of insurers through the agreement of a leading underwriter plus one or two following markets (as specified on the slip at placement)
"long-tail"	a term to describe insurance business where it is known from experience that notification and settlement of claims could take many years
"non-admitted insurer"	an insurer which is not licensed to transact the business of insurance in a given US state, including an insurer which is nevertheless eligible to write surplus lines insurance in any US state
"net premiums written"	gross premiums written for a given period less premiums ceded to reinsurers and retrocessionaires during such period
"P&I"	Protection and Indemnity insurance in respect of third party liabilities and expenses arising from owning ships or operating ships as principals
"reinsurance"	an arrangement in which a reinsurer agrees to cover another insurer or reinsurer, the cedant, against all or a portion of the insurance or reinsurance risks underwritten by the cedant under one or more policies. Reinsurance can provide a cedant with several benefits, including a reduction in net liability on individual risks and catastrophe protection from large or multiple losses. Reinsurance also provides a cedant with

	additional underwriting capacity by permitting it to accept risks and write more business than would be possible without a concomitant increase in capital and surplus, and facilitates the maintenance of acceptable financial ratios by the cedant. Reinsurance does not legally discharge the primary insurer from its liability with respect to its obligations to the insured
"retrocession"	reinsurance of reinsurance business
"return period"	the estimated frequency of occurrence of a particular event, measured by the number of times it is expected to occur. For example a 1 in 20 return period would indicate that it is expected losses would impact a cover once every 20 years
"short-tail"	a term used to describe business where it is known from experience that claims are normally notified and settled quickly
"speciality"	lines of insurance and reinsurance that provide coverage for risks that are often unusual or difficult to place and do not fit the underwriting criteria of standard commercial products carriers
"surplus lines"	a generic US regulatory classification referring to insurance permitted by the laws of a US state to be placed by a properly licensed surplus lines broker with a non-admitted insurer that has met the relevant state's criteria for eligibility to accept such placements
"syndicate"	a group of Names and/or corporate members underwriting insurance business at Lloyd's through the agency of a managing agent to which a particular syndicate number is assigned by or with the authority of the Council
"unearned premium"	the portion of premiums written that is allocable to the unexpired portion of the policy term

DIRECTORS, REGISTERED OFFICE AND ADVISERS

DIRECTORS

Martin Thomas (Non-Executive Chairman)
Richard Brindle (Chief Executive Officer)
Simon Burton (Deputy Chief Executive Officer)
Neil McConachie (Chief Financial Officer)
John Bishop (Non-Executive Director)
Jens Juul (Non-Executive Director)
Ralf Oelssner (Non-Executive Director)
Robert Spass (Non-Executive Director)
William Spiegel (Non-Executive Director)
Barry Volpert (Non-Executive Director)

all of
Registered Office of the Company
Clarendon House
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Hamilton HM 11
Bermuda

COMPANY SECRETARY

Greg Lunn
Lancashire Holdings Limited
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8, Par-la-Ville Road
Hamilton HM 08
Bermuda

SPONSOR

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2 King Edward Street
London EC1A 1HQ
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LEGAL COUNSEL TO THE COMPANY

As to English and US law:
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Mincing Lane
London EC3R 7YL
England

As to Bermuda law:
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Hamilton HM 11
Bermuda

AUDITORS AND REPORTING ACCOUNTANT

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Hamilton HM 11
Bermuda

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Kent BR3 4TU
England

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