lancashire
HOLDINGS LIMITED

Through "hell and high water" we remain consistently Lancashire

Annual Report & Accounts 2009

Contents

Lancashire is a global provider of specialty insurance products operating in Bermuda, London and Dubai. We focus on short-tail, specialty insurance risks, mostly on a direct basis, under four main classes: property, energy, marine and aviation.

Our long-term goal is to achieve an above average risk adjusted return.

We have a consistent strategy that has delivered value each year:

- Underwriting comes first
- Maintain a strong balance sheet
- Stay nimble
- Manage capital through the cycle

Since inception, we have produced a 19.8% compound annual return.

2005/2006

As the winds of change blew things off course

We established our first rule of business
Underwriting comes first

We place excellence in underwriting first and foremost. Each risk underwritten must bear scrutiny individually and as part of our portfolio. If we can achieve this year in, year out, we will create superior returns for our shareholders.

We don't focus on consistent top line growth. Our appetite has grown when the opportunities were attractive and we have cut back smartly when they went away. That's been the right strategy. Our loss ratio to date from inception is 32.1%. If we had aimed for consistent top line growth it would be a lot higher.

The market in 2010 is softening: we expect to write less business than in 2009, with fewer deals meeting our return requirements. That will keep the quality of our portfolio high and gives us the best chance to keep our loss ratio low.

UNDERWRITING PERFORMANCE (%)

	2006	**2007**	**2008**	**2009**	**Inception to date**
Loss ratio	16.1	23.9	61.8	16.6	32.1
Acquisition cost ratio	14.3	12.5	16.4	17.8	15.4
Expense ratio	13.9	9.9	8.1	10.2	10.0
Combined ratio	44.3	46.3	86.3	44.6	57.5

RETURN ON EQUITY (%)

	Lancashire	**S&P 500**
Compound(1)	19.8	-4.3
2009	**26.5**	**26.5**
2008	7.8	-37.0
2007	31.4	5.5
2006	17.8	15.8

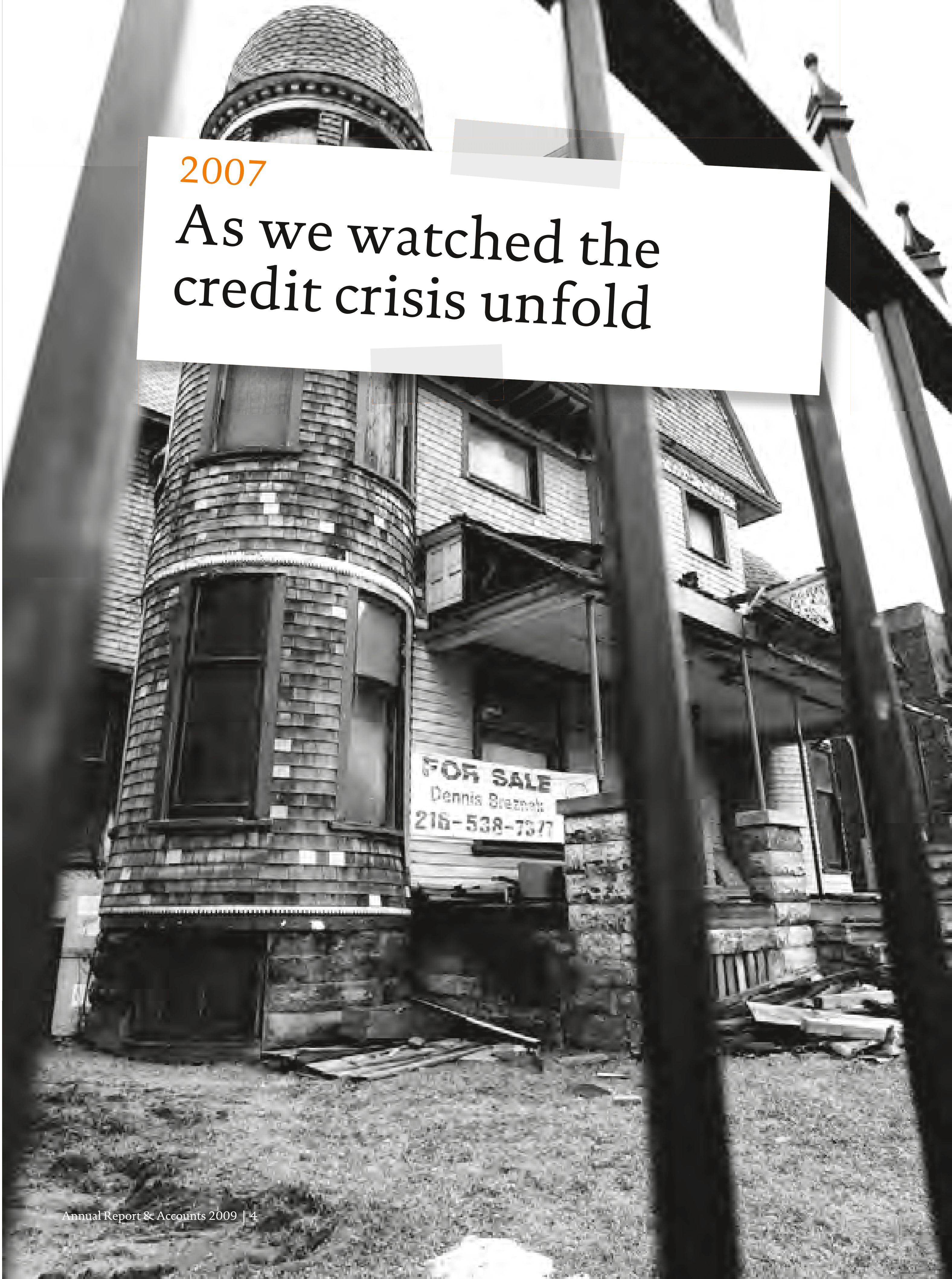
Return on Equity (ROE) = growth in fully converted book value per share, adjusted for dividends.

(1)Compound annual return from inception, 15 December 2005 through 31 December 2009. The S&P 500 figures include the effect of reinvested dividends

Hurricane Katrina, August 2005 ~ Hurricane Katrina changed the insurance market, altering the balance of supply and demand in favour of those companies ready to grasp the opportunity. Lancashire was very ready, very quickly, and took full advantage: we underwrote the right risks, and turned down the rest.

2007

As we watched the credit crisis unfold



We stayed firm in our belief
Maintain a strong balance sheet

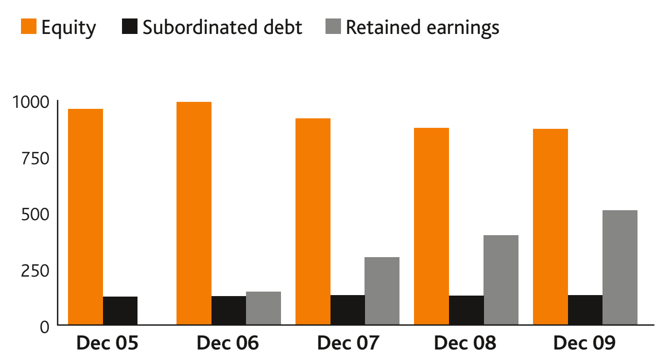
We meet policyholders' claims promptly, accurately and completely. Our balance sheet should instill a high level of confidence in all stakeholders, including shareholders, regulators, rating agencies, counter-parties and employees.

We have always adopted a cautious approach when investing shareholders' funds. Back in 2006, in our very first annual report, we wrote: 'Not losing money is more important than shooting the lights out.' That approach has served us well. We have outperformed in down years and we have underperformed in strong years – but most importantly we have made money every year.

Heading into 2010, our investment portfolio looks pleasingly dull. It's evolving, of course, but remains firmly positioned to protect the downside should markets fall, accepting that we may lose some upside return if markets perform strongly.

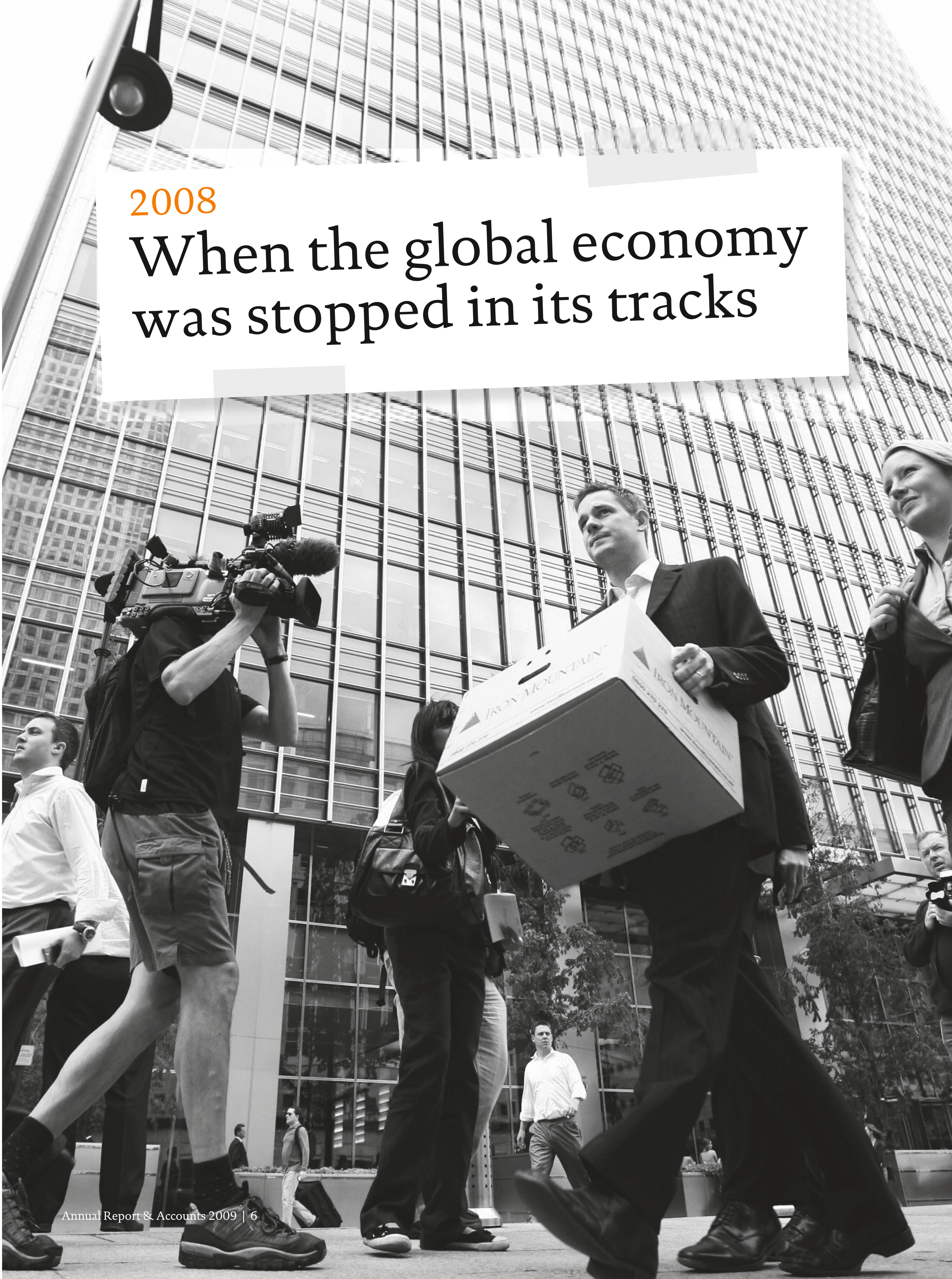
Sub-prime mortgage collapse, November 2007 ~ The credit bubble finally burst in 2007, in spectacular fashion. Supposedly blue chip assets were suddenly worthless. The insurance industry failed to see that if something looks too good to be true, it probably is. Fortunately, we were more skeptical and adopted an even more conservative investment policy.

CAPITAL US$M



2008

When the global economy was stopped in its tracks



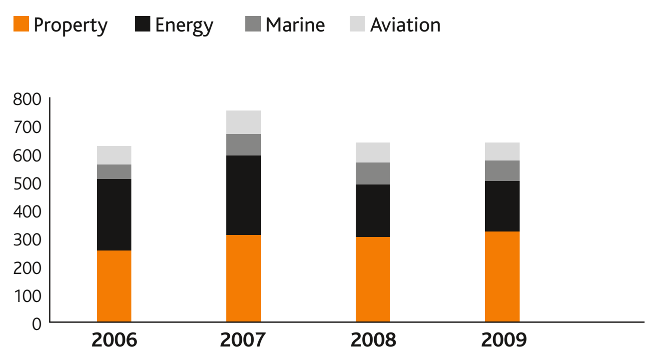
We kept on our toes, true to our third rule
Stay nimble

Staying nimble means growing in a hard market and shrinking in a soft market: we underwrite the good deals and we turn down the bad ones. We achieve this through a collegiate underwriting approach, keeping tight control on overheads and our eyes open for opportunities.

Ruling the insurance world is not important to us. Big is not always better: we can implement strategic decisions within hours, not months. Being nimble means avoiding diversification for the sake of it and resisting the temptation to jump into areas beyond our expertise.

In 2010, nimbleness probably means cutting back overall, but not across the board. We plan to expand in certain areas – Property Catastrophe Reinsurance being one. Importantly though, Lancashire doesn't have a vast and expensive operating structure. This means we can be disciplined AND make attractive returns.

GROSS PREMIUMS WRITTEN US$M



Fall of Lehman Brothers, September 2008 ~ The financial world almost fell apart in 2008. The business environment was changing at breakneck speed. The trick is being able to move faster than the competition, avoiding the pitfalls while grasping the opportunities. We did both.

2009

As an oil spill threatened one of the world's greatest ecosystems

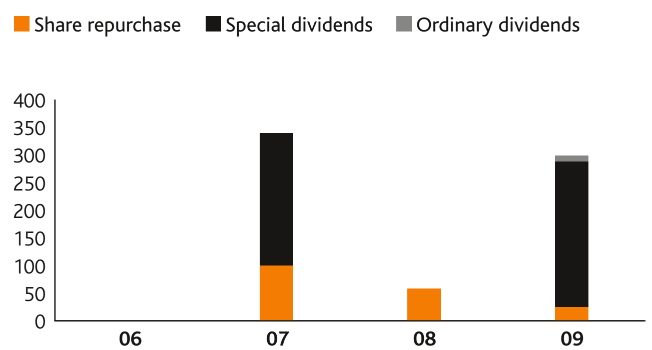
We did, as always
Manage capital through the cycle

We don't have a strategic target level of capital. Underwriting opportunities will drive capital, not the other way around. We carry sufficient capital to support all the deals which meet our return hurdles; we don't let our capital levels drive how much premium we generate. Granted this is an unusual approach, but one that works.

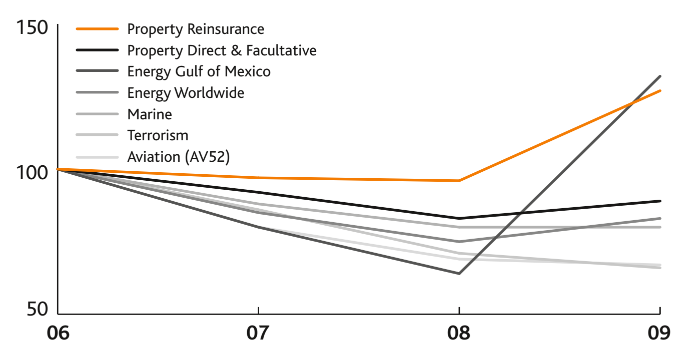
We measure Return on Equity ("ROE") as the growth in fully converted book value per share adjusted for dividends. We aim to generate an attractive ROE over the long term. We actively manage capital because it improves our ROE.

In 2010 we will continue to pay close attention to our capital needs. We have a new $150 million share repurchase authorisation in place, and expect to buy our own shares steadily should our share price trade within certain parameters.

RETURN OF CAPITAL US$M



RENEWAL PRICE INDEX



Montara platform fire, November 2009 ~ The East Timor oil rig explosion was one of the worst energy losses seen in decades. The energy sector took its share of knocks last year. We managed to avoid more than most, allowing us to return more capital than most.

How we do it

The infamous daily call… we hold a daily Underwriting and Marketing Conference Call to review underwriting submissions across all lines, to maximise marketing and cross-selling possibilities and to exchange market information.

Representatives from the Group's offices in London, Bermuda and Dubai participate in the daily call. Underwriting decisions, however, are always made at the local operating entity level.

HAMILTON, BERMUDA
45 Staff

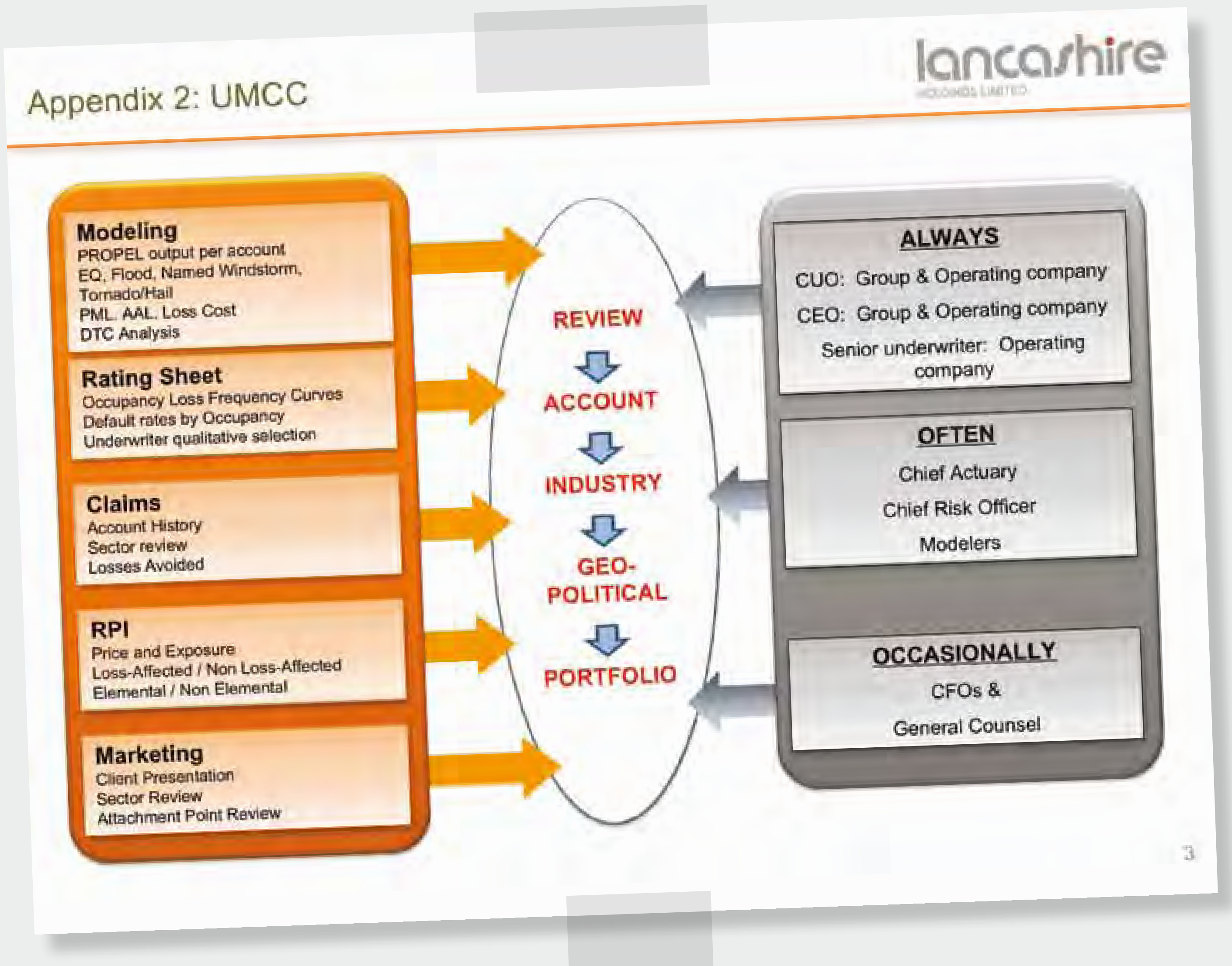
Established in 2005, Lancashire's corporate headquarters, along with an experienced underwriting team, is based in Bermuda. Many of the Group's clients, which include some of the world's largest companies, insured with Lancashire from its beginnings in Bermuda.

LONDON, UK
53 Staff

From its base in Fenchurch Street in the heart of the London insurance market, Lancashire's UK operations include a fully fledged underwriting platform staffed by experienced underwriters, managers and support staff. The London platform was established in 2006 to expand the Group's operations and provide access to the specialty insurance market in London.

DUBAI
3 Staff

Located in the Dubai International Financial Centre and led by two experienced insurance executives, the focus in Dubai is on marketing the Group's insurance products to clients in the Middle East and Asia Pacific regions.

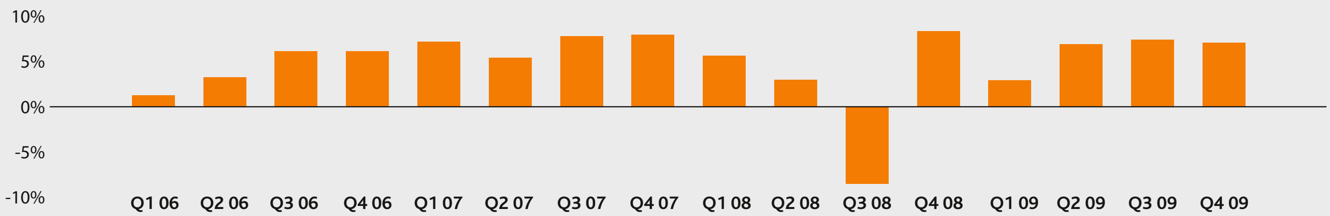

Appendix 2: UMCC
lancashire
Modeling
PROPEL output per account
EQ, Flood, Named Windstorm, Tornado/Hail
PML, AAL, Loss Cost
DTC Analysis
Rating Sheet
Occupancy Loss Frequency Curves
Default rates by Occupancy
Underwriter qualitative selection
Claims
Account History
Sector review
Losses Avoided
RPI
Price and Exposure
Loss-Affected / Non Loss-Affected
Elemental / Non Elemental
Marketing
Client Presentation
Sector Review
Attachment Point Review
REVIEW
ACCOUNT
INDUSTRY
GEO-POLITICAL
PORTFOLIO
ALWAYS
CUO: Group & Operating company
CEO: Group & Operating company
Senior underwriter: Operating company
OFTEN
Chief Actuary
Chief Risk Officer
Modelers
OCCASIONALLY
CFOs &
General Counsel
3

How we do it

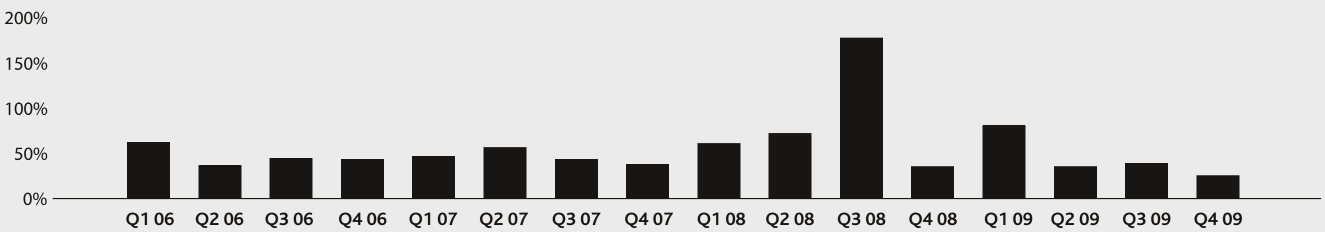
Since inception we have produced a compound annual return of 19.8%.

CONSISTENCY: ONLY ONE NEGATIVE QUARTER SINCE INCEPTION

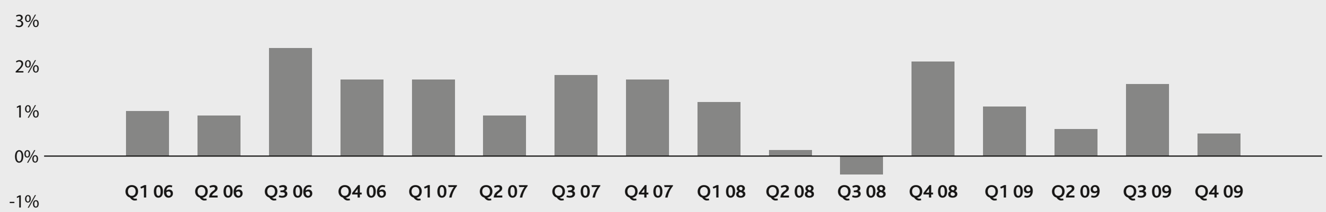
RETURN ON EQUITY SINCE INCEPTION



COMBINED RATIO SINCE INCEPTION



TOTAL INVESTMENT RETURN SINCE INCEPTION



2009 FINANCIAL HIGHLIGHTS

- Fully converted book value per share of $7.41 (2008 – $6.89). Return on Equity, defined as growth in fully converted book value per share, adjusted for dividends of 26.5% (2008 – 7.8%);
- Gross written premiums of $627.8 million (2008 – $638.1 million). Net written premiums of $577.1 million (2008 – $574.7 million);
- Reported loss ratio of 16.6% (2008 – 61.8%) and a combined ratio of 44.6% (2008 – 86.3%); Accident year loss ratio of 27.2% (2008 – 66.5%);
- Inception to date combined ratio of 57.5%;
- Total investment return of 3.9% (2008 – 3.1%);
- Net operating profit of $364.7 million (2008 – $119.4 million), or $1.94 diluted operating earnings per share (2008 – $0.65);
- Net profit after tax of $385.4 million (2008 – $97.5 million), or $2.05 diluted earnings per share (2008 – $0.53);
- Interim dividend of $10.5 million (2008 – $nil) or 5.0 cents per common share; final dividend of approximately $20.8 million (2008 – $nil) or 10.0 cents per common share;
- Special dividend of $263.0 million (2008 –$nil) or $1.25 per common share; and
- Capital returned to shareholders via share repurchases $16.9 million (2008 – $58.0 million).

OPERATING HIGHLIGHTS:

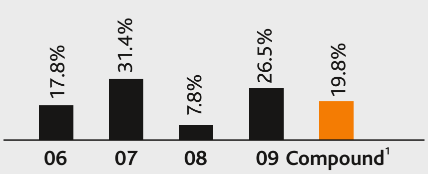
- Underwriting discipline maintained. Capacity withheld earlier in 2009 in uncertain markets to take advantage of the improving pricing environment in Property Catastrophe Reinsurance, significant expansion in that line at the July renewals;
- Exceptional underwriting performance with a loss ratio of 16.6%. Lack of major catastrophes combined with favourable prior year development;
- Solid investment return sustained, tactical restrictions reduced in late 2009, but conservative portfolio positioning continues; and
- Active capital management – "right sizing" capital via special dividend and share repurchases as the economic outlook becomes more positive and 2010 business opportunities become more certain.

How we do it

Our key performance indicators ("KPIs"). Consistent performance even in difficult years.

Financial KPIs (Non-GAAP)

RETURN ON EQUITY

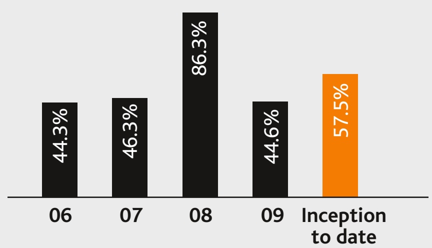


[1]Compound annual return from inception, 15 December 2005 through 31 December 2009.

26.5 per cent

Return on Equity, including dividends declared, in 2009

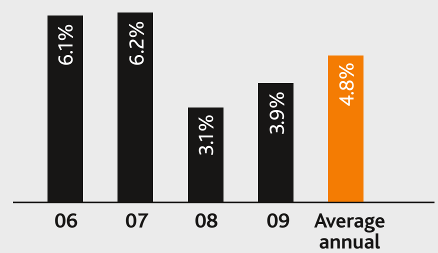
COMBINED RATIO



44.6 per cent

Combined ratio achieved in 2009

TOTAL INVESTMENT RETURN



3.9 per cent

Net total return on investments in 2009

AIM
The Group's aim is to provide shareholders with a risk adjusted return on equity of 13% in excess of a risk-free rate over the insurance cycle.

MEASUREMENT
The ROE is measured by management in terms of the internal rate of return of the increase in fully converted book value per share in the period adjusted for dividends.

RISK MANAGEMENT
The stated aim is a long-term goal, acknowledging that management expects both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver of 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.

AIM
The Group aims to limit its exposure in connection with insurance contracts, in the event of insured losses, to the level of premium which will be sufficient to cover the loss payments and expenses.

MEASUREMENT
The combined ratio is the sum of the loss ratio, the acquisition cost ratio and the expense ratio.

RISK MANAGEMENT
The Group's underwriters assess likely losses, using tools such as BLAST (the Group's economic capital model) and their experience and knowledge of past loss experience, industry trends and current circumstances. This allows them to estimate the premiums sufficient to meet likely losses and expenses. The Group considers insurance risk at an individual contract level, at sector level, geographic level, and at an aggregate portfolio level to ensure careful risk selection, limits on concentration and appropriate portfolio diversification are accomplished.

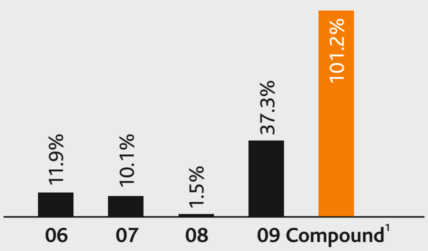
AIM
The Group's primary investment aim remains unchanged since inception – liquidity and capital preservation are first and foremost. Its secondary aim is to maximise returns from its portfolio.

MEASUREMENT
The total investment return includes: net investment income, net realised gains, losses and impairments, and net change in unrealised gains and losses.

RISK MANAGEMENT
The conservative nature of the Group's portfolio and investment philosophy means that it does not expect to generate spectacular returns in periods of market recovery, but it prefers not to produce significant losses in periods of market turmoil. Management reviews the composition, duration and asset allocation of the investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions.

Non-financial KPIs

TOTAL SHAREHOLDER RETURN



[1]Compound TSR from inception, 15 December 2005 through 31 December 2009.

37.3 per cent

Total shareholder return in 2009

AIM

The Group's aim is to provide shareholders with a total shareholder return ("TSR") in line with the growth in fully converted book value per share.

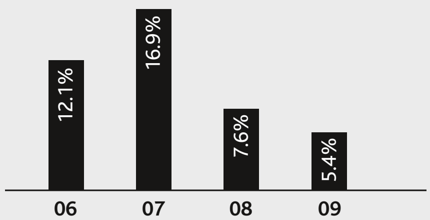
MEASUREMENT

The total shareholder return is measured in terms of the internal rate of return of the increase in share price, in the period, measured in U.S. dollars, adjusted for dividends.

RISK MANAGEMENT

The Group's aim is a long-term goal, recognising that the cyclicality and volatility of both the insurance market and the equity markets in general will impact management's ability to maximise the share multiple in the immediate term. TSR is an effective measure to ensure that management's goals are aligned with those of shareholders.

STAFF TURNOVER



5.4 per cent

Staff turnover in 2009

AIM

The Group aims to offer Lancashire staff competitive compensation packages but, more importantly, exposure to a wide breadth of responsibilities and the opportunity for continuous learning. To the extent possible and appropriate, the Group seeks to promote from within its ranks.

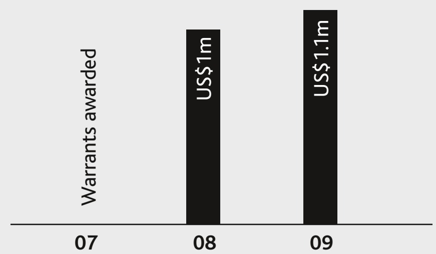
MEASUREMENT

Since the Group started trading in 2005, two staff surveys have been performed by independent third parties, on an anonymous basis. The results of both of the surveys have been consistently positive overall.

RISK MANAGEMENT

The Group's remuneration policy is geared towards providing competitive compensation packages in an effort to attract, retain and motivate employees of the highest calibre.

LANCASHIRE FOUNDATION



US$1.1 million

Donated to The Foundation in 2009

AIM

The Group established The Lancashire Foundation ("The Foundation") in 2007 with the aim of creating a charitable trust for the benefit of charitable causes in Bermuda, the UK and worldwide.

MEASUREMENT

The charities that The Foundation supports provide regular updates on how the funds donated are spent. The Group is satisfied that its contributions to The Foundation are being put to good use.

RISK MANAGEMENT

The Foundation's trustee is an independent third party professional trust company that makes donations following recommendations made by The Foundation's Donations Committee. This consists of Lancashire employees and independent members. Specific criteria have been set for the Foundation's charitable giving.

Statement from Martin Thomas, non-executive Chairman

"I am very pleased to present the outstanding results produced by Lancashire for the financial year ended 31 December 2009. Net profit after tax was $385.4 million or $2.05 per common share and Return on Equity was 26.5%.

These exceptional results were not achieved by deviating from our stated objectives but as a result of us embracing those objectives: disciplined underwriting, maintaining a strong balance sheet, staying nimble and managing our capital through the cycle."

UNDERWRITING RESULTS

In my last letter to shareholders, written in early 2009, I said that it was "unclear to what extent the insurance industry has been reshaped" in the wake of Hurricane Ike and the worst financial crisis since the Great Depression. In the short-term there appeared to have been a significant estimated reduction in capacity and a hardening in rates across most lines of business the Group writes and we held back capacity in anticipation.

As 2009 unfolded, it turned out that prices did not harden quite in the way expected, and improvements to terms and conditions did not materialise across all classes of business. In particular, there was a significant reduction in demand for Gulf of Mexico energy hurricane cover.

In response, and in line with our nimble yet disciplined underwriting philosophy, a deliberate decision was taken to employ some of the capital we had been holding back in building our property catastrophe book in many of the United States' critical catastrophe zones and internationally with the intention of becoming a significant market participant.

The net result was an underwriting profit of $390.0 million for 2009.

Forever looking forward, in October 2009, we announced our co-venture with GCube, a leading underwriting agency in the renewable energy market, established to write Renewable Energy Excess Cover; we continue to be ever vigilant for opportunities to diversify into new areas that fit our existing business strategy of writing short-tail speciality risks within the property, energy, marine and aviation segments.

INVESTMENTS

The losses in the investment markets that contributed so significantly to the erosion of capital of so many companies in the insurance industry during 2008 were dramatically reversed in 2009, mostly as a result of massive government intervention. During 2009 we adhered to, and we continue to have no intention of departing from, our highly conservative investment approach: preserve liquidity and limit downside risk. However, we do assess on a constant basis the composition of our investment portfolio and the correlation between investment and underwriting risks.

Therefore, it came as no surprise that we achieved a positive 3.9% total return on our investment portfolio for 2009. Although we are well aware that this result will not match some of the investment results announced by our peers, we are satisfied that we continue to perform consistently and we take pride in the transparency of that performance.

CAPITAL MANAGEMENT

As 2009 progressed we began holding capital in excess of all our trading, rating and regulatory requirements and as always we sought to actively manage that capital. We returned a total of $290.4 million of capital through dividends and share repurchases in 2009.

On 29 July 2009, an interim dividend of $0.05 per common share and warrant, equivalent to £0.03 at prevailing exchange rates, was declared by the Board and paid on 7 October 2009 and a special dividend of $1.25 per common share and warrant, equivalent to £0.76 at prevailing exchange rates, was declared on 5 November 2009 and paid on 6 January 2010.

On 26 February 2010, a final dividend of $0.10 per common share and warrant was declared by the Board, to be paid in pounds sterling on 14 April 2010.

Finally, in order to have the capacity to continue to return capital to shareholders over the next year, on 4 November 2009 the Board authorised a share repurchase program up to an aggregate purchase price of $150.0 million, to expire 12 months following shareholder approval; that approval was given at a Special General Meeting held on 16 December 2009. This is in addition to the $25.1 million of the $100.0 million share repurchase program authorised by the Board in April 2008, which remained available at the end of 2009.

2,406,674 common shares, valued at $16.9 million, were repurchased during 2009 and are being held in Treasury.

Although we do not intend to commit to specific capital actions far in advance, we are still intent upon generating an attractive risk adjusted total return for shareholders over time.

MOVING UP

Lancashire's shares were admitted to the Official List and to trading on the main market of the London Stock Exchange (the "Main Market") on 16 March 2009 and Lancashire was included in the FTSE 250 Index with effect from 10 June 2009.

We are proud to report that Lancashire's shares consistently outperformed both the FTSE AIM Index and the FTSE 250 Index during 2009.

IN CONCLUSION

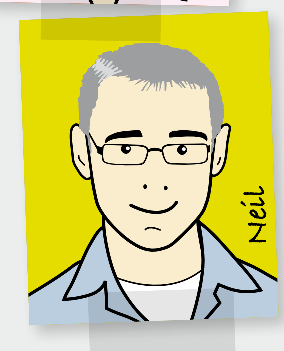
The executive management team and all our staff deserve credit for producing yet another consistently good result.

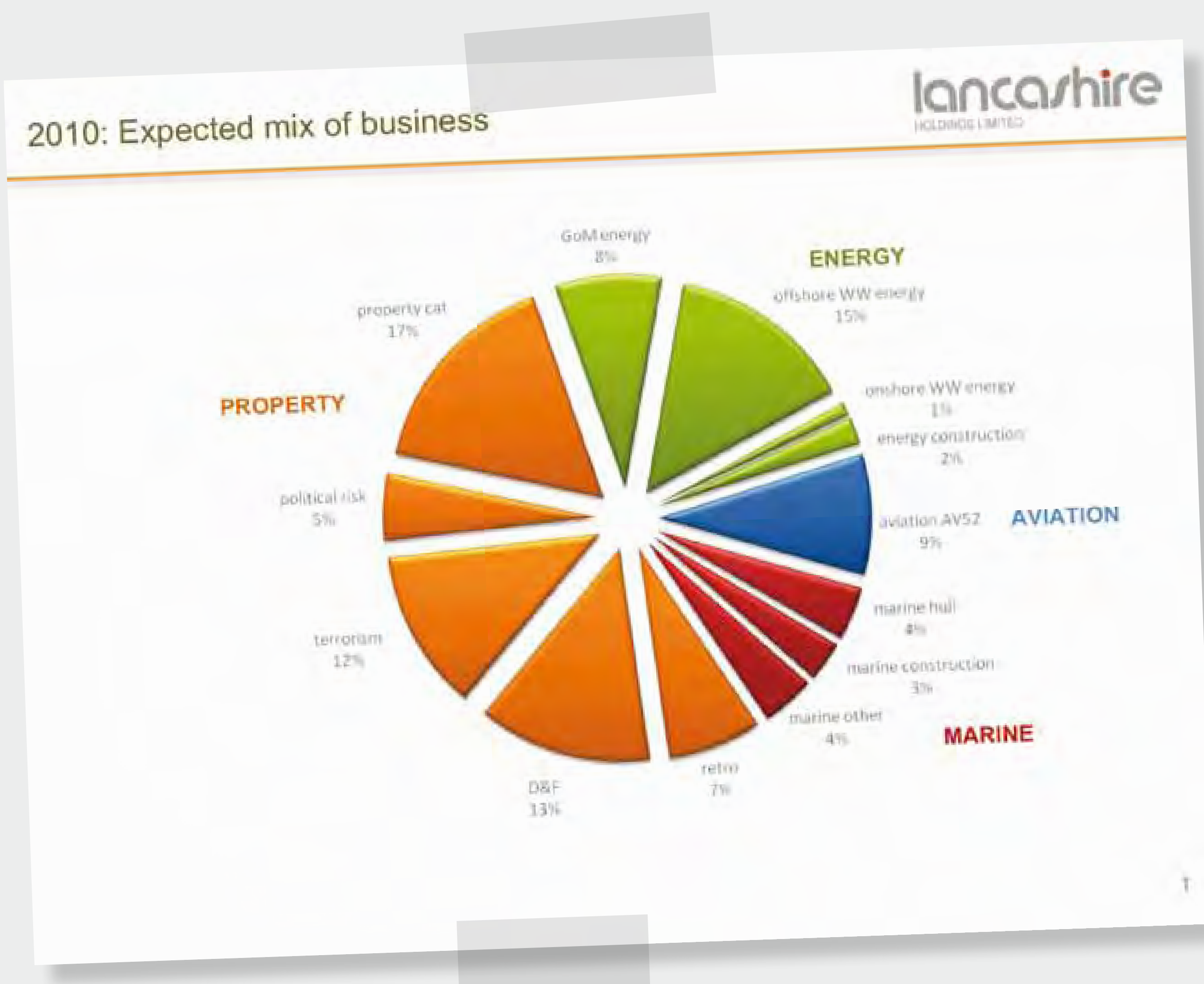
Martin Thomas
Non-Executive Chairman

Statement from the CEO and President & CFO

Where are we going?

The Lancashire strategy for 2010 will be our usual one: stay disciplined, don't be tempted to sacrifice profits for volume, and be prepared for the surprises that this industry always throws up. We aim to be ready for any eventuality.





2009 was a great year for Lancashire, in all sorts of ways. We achieved an excellent Return on Equity of 26.5%, a low combined ratio of 44.6% and a net profit after tax of $385.4 million. Since inception, our compound annual return is almost 20% and our average combined ratio is under 60% – which speaks for itself. We were very pleased to have been able to return a large amount of capital to shareholders in 2009, as a result of our financial success. We also listed on the London Stock Exchange's main market for listed securities last year, joining the FTSE 250 in the process. Finally, we're ever more proud of the Lancashire Foundation and the difference it is making to people around the world who are far less well off than anyone reading this report.

UNDERWRITING PERFORMANCE

Underwriting is, and always will be, THE most important part of Lancashire. In 2009, the most important part of Lancashire had an absolutely cracking year, producing a loss ratio of only 16.6%. We, along with everyone else in the insurance industry, were fortunate to have experienced lower than average industry losses. Nonetheless, our preference for quality, not quantity, meant that we avoided several nasty losses and in consequence produced one of the sector's best underwriting results.

INVESTMENT PERFORMANCE

It is well known that we dislike losing money – especially on our invested assets. Since we started in business, we have managed Not To Lose Money in every quarter bar one. We're pleased to say that we had a good record in 2009, achieving a positive return every quarter and a total return for the year of 3.9%. We admit that it was a lot easier to avoid investment losses in 2009 than 2008 – and predictably, we took a smaller slice of the windfall pie than most. We don't mind – that's how it's meant to work.

CAPITAL MANAGEMENT

Lancashire's management team spends what many might consider an unhealthy amount of time thinking about capital management. It seems to us that, only too often, it doesn't get the attention it deserves. The ROE equation has a top AND a bottom! In 2009, we returned $290.4 million of our profits via dividends and repurchases of shares. In addition, we have declared a final dividend of $20.8 million and have a further $170.4 million remaining in our current share repurchase authorisations. All told, we have now returned, or committed to return, approximately 88% of the equity we raised when Lancashire started in business just over four years ago. We don't know if that's some sort of record, but it's certainly clear evidence of how seriously we take this subject – and of how much we think about it.

PEOPLE

It may sound like a cliché, but it's true: we could not have achieved our success without our wonderful team. We deliberately operate with a small headcount by industry standards – another example of quality over quantity – but everyone works very hard, and they deliver the goods. Going to work may not be the way most people would choose to spend their day, but we try hard to make it as fulfilling as possible. And we seem to be getting it right: we're pleased to report that staff turnover in 2009 was only 5.4%. Our compensation structure right through the company includes an element of company ROE, and every employee is eligible for annual stock awards. We thank all employees for their sterling efforts throughout 2009.

CORPORATE RESPONSIBILITY

We started the Lancashire Foundation in our first year of operations. It supports charities in Bermuda, the UK and worldwide, especially those that address young people with special needs or disadvantaged circumstances and crisis relief work. In 2009, Lancashire pledged a total of $1.1 million to the Foundation. The funds were distributed to several charities, including Médecins Sans Frontières ("MSF"), Vauxhall City Farm, The Sunshine League and JusB. In 2010 so far, funds have also gone to the people of Haiti. Our thanks go to everyone who has helped with the Foundation's continuing efforts.

OUTLOOK

The trading outlook for 2010 looks reasonable, although not as good as it was at the beginning of 2009. The industry's supply of capital grew a lot last year, and while some of that capital will be returned, we fear it will not be enough. Competition for business has increased and renewal prices are mostly lower than they were a year ago. Fortunately, there are still a number of good deals if you know where to look.

The reinsurance market, while modestly off its all-time highs, remains disciplined. As expected, the specialist insurance classes are coming under pressure, but remain reasonably attractive overall.

We actively put additional capital to work at the January renewals in Property Catastrophe Reinsurance to take advantage of what we feel will be the best-rated business during the year. We see some opportunities in Alternative Energy, Sovereign Risk and Catastrophe-oriented Managing General Agency business. We're working with brokers and clients to exploit these opportunities carefully and slowly.

The Lancashire strategy for 2010 will be our usual one: stay disciplined, don't be tempted to sacrifice profits for volume, and be prepared for the surprises that this industry always throws up. We aim to be ready for any eventuality.

Richard Brindle
Chief Executive Officer

Neil McConachie
President & Chief Financial Officer

Underwriting is, and always will be, the most important part of Lancashire.

In 2009, the most important part of Lancashire had an absolutely cracking year, producing a loss ratio of only 16.6%.

Financial highlights

RETURN ON EQUITY

26.5 per cent
(2008 – 7.8 per cent)

COMBINED RATIO

44.6 per cent
(2008 – 86.3 per cent)

NET PROFIT

$385.4 million
(2008 – $97.5 million)

TOTAL INVESTMENT RETURN

3.9 per cent
(2008 – 3.1 per cent)

GROSS PREMIUMS WRITTEN

$627.8 million
(2008 – $638.1 million)

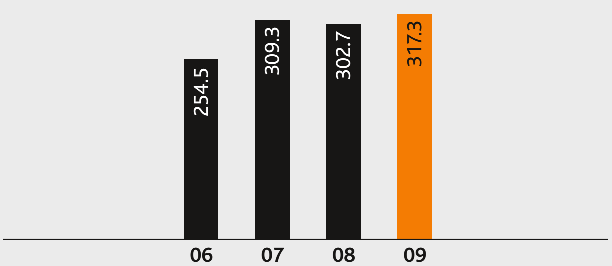
1

Business review

In 2009 Lancashire's business was written in its four main classes.

Our business lines

PROPERTY ($M)

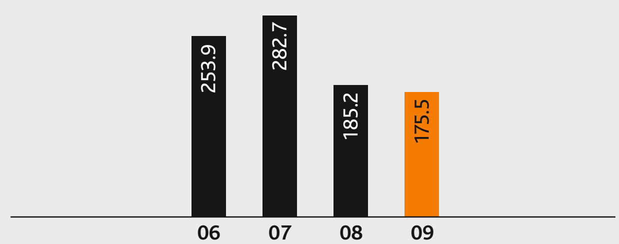


Key highlights

- Gross premiums written of $317.3 million (2008 – $302.7 million)
- Loss ratio negative 3.1% (2008 – 37.1%)
- Net underwriting income of $256.6 million (2008 – $137.2 million)
- Significant expansion of Property Catastrophe Reinsurance
- Performed very well – low incidence of large catastrophe and risk losses combined with prior year reserve releases

Analysed by geographical zone:	$M
Worldwide offshore	1.0
U.S. and Canada	156.0
Worldwide, including U.S. & Canada	51.5
Europe	30.3
Worldwide, excluding U.S. & Canada	35.1
Far East	10.9
Middle East	8.6
Rest of World	23.9

ENERGY ($M)

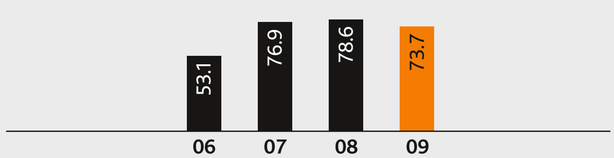


Key highlights

- Gross premiums written of $175.5 million (2008 – $185.2 million)
- Loss ratio of 44.6% (2008 – 119.5%)
- Net underwriting income of $60.8 million (2008 – $68.6 million loss)
- One of the leading energy writers in the world
- Significant reduction in Gulf of Mexico premium in 2009, given market environment
- Respectable performance given level of energy sector risk losses during the year

Analysed by geographical zone:	$M
Worldwide offshore	154.9
U.S. and Canada	2.2
Worldwide, including U.S. & Canada	7.4
Europe	3.5
Worldwide, excluding U.S. & Canada	–
Far East	2.1
Middle East	3.3
Rest of World	2.1

MARINE ($M)

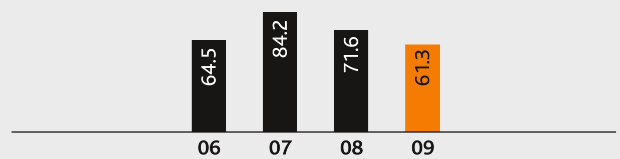


Key highlights

- Gross premiums written of $73.7 million (2008 – $78.6 million)
- Loss ratio of 38.7% (2008 – 54.0%)
- Net underwriting income of $24.1 million (2008 – $13.1 million)
- Book continues to be highly profitable
- Focus remains on finding attractive niche areas whilst retaining caution for the sector as a whole

Analysed by geographical zone:	$M
Worldwide offshore	71.4
U.S. and Canada	0.1
Worldwide, including U.S. & Canada	-0.6
Europe	2.1
Worldwide, excluding U.S. & Canada	0.4
Far East	0.2
Middle East	–
Rest of World	0.1

AVIATION ($M)



Key highlights

- Gross premiums written of $61.3 million (2008 – $71.6 million)
- Loss ratio of 2.1% (2008 – 10.9%)
- Net underwriting income of $48.5 million (2008 – $50.5 million)
- Market lead on the majority of accounts
- Continued absence of loss events drives performance

Analysed by geographical zone:	$M
Worldwide offshore	–
U.S. and Canada	–
Worldwide, including U.S. & Canada	60.9
Europe	0.3
Worldwide, excluding U.S. & Canada	0.1
Far East	–
Middle East	–
Rest of World	–

Markets change. But we've stuck to our four fundamental business principles throughout.

Our cornerstones in action during 2009

1 UNDERWRITING COMES FIRST

We don't believe in annual premium targets, and 2009 showed why. At the start of the year, industry capacity was short; prices were on the up and prospects looked rosy. Then investment returns rocketed. Suddenly, capacity was restored and trading conditions weakened. But when deals came along that we didn't like the look of, we just turned a blind eye – because premium targets are a trap we would rather not walk into.

2 MAINTAIN A STRONG BALANCE SHEET

By March 2009, the FTSE 100 index was nearly 50% off its 1999 peak. That was quite a temptation, we'll admit. But did we change our conservative investment strategy? Not for one moment. And the FTSE rose strongly for the rest of the year. OK, so we missed some upside; but our strategy is for the long-term, and it's served us well.

3 STAY NIMBLE

Following Hurricane Ike, we expected huge demand for Gulf of Mexico energy cover in 2009. By April, we simply had to admit that we were wrong – demand was much less than we had anticipated. But we didn't just sit there navel-gazing: we pulled ourselves together, adjusted our tactics and swiftly switched capacity to Property Catastrophe Reinsurance instead.

4 MANAGE CAPITAL THROUGH THE CYCLE

To us at Lancashire, this one falls into the category of the blindingly obvious. In 2009, we made a net profit after tax of $385.4 million – more than we expected. We couldn't think of any smart ways to use the cash, so we gave three-quarters of it back to our shareholders. We return capital to them regularly, and we fully expect to keep it coming, in the absence of good business opportunities.

BUSINESS STRUCTURE AND LOCATIONS

The main operating companies of the Group are Lancashire Insurance Company Limited ("LICL") in Bermuda and Lancashire Insurance Company (UK) Limited ("LUK") in London, which both provide insurance and reinsurance products to their customers, with an emphasis on the property, energy, marine and aviation lines of business.

In addition, Lancashire Marketing Services (Middle East) Limited ("LMEL"), which operates from Dubai, undertakes insurance intermediation activities, on behalf of both LICL and LUK, in the Middle East and Asia Pacific regions.

These three offices provide a good balance between Group underwriting control, access to business and low operating costs.

The Bermuda and London underwriting centres are both authorised to write every class of business in Lancashire's business plan.

The London office primarily writes the following types of business:

- property direct and facultative;
- terrorism and political risk;
- energy;
- direct marine; and
- AV52 aviation third party.

In the Bermuda office there is a balance between specialty insurance and treaty reinsurance, with a larger proportion of business exposed to natural catastrophes.

DISTRIBUTION

It is difficult to overstate the importance of broker and customer relationships in achieving effective distribution of our products. Almost all of our business is transacted through brokers and we work hard to foster close working relationships. Brokers need to know that insurers 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. We believe we meet all of these requirements.

RENEWAL PRICE INDEX

Lancashire's Renewal Price Index ("RPI") is an internal tool that its management uses to track trends in premium rates on a portfolio of insurance and reinsurance contracts.

The RPI is calculated on a per contract basis, reflects Lancashire's assessment of relative change in price, terms, conditions and limits and is weighted by premium volume. The calculation involves a degree of judgement in relation to comparability of contracts and the assessment noted above. To enhance the RPI tool, management of Lancashire may revise the methodology and assumptions underlying the RPI, so the trends in premium rates reflected in the RPI may not be comparable over time.

Consideration is only given to renewals of a comparable nature so it does not reflect every contract in Lancashire's portfolio. The future profitability of the portfolio of contracts within the RPI is dependent upon many factors besides the trends in premium rates.

RPI STATISTICS SINCE INCEPTION

Class	2006	2007	2008	2009	Estimated 2010[1]
Property Reinsurance	100	97	96	127	117
Property Direct & Facultative	100	92	83	90	77
Energy Gulf of Mexico	100	80	64	137	110
Energy Worldwide Offshore	100	80	68	84	73
Marine	100	88	80	82	82
Terrorism	100	86	71	66	66
Aviation (AV52)	100	80	69	68	68

[1] As at 31 December 2009. Represents management's estimates of potential movement in annual rates between 2009 and 2010

MANAGED INVESTMENT PORTFOLIO ALLOCATIONS (%)

	2006	2007	2008	2009
Cash	28	39	19	7
Short-term	1	0	9	14
Government debt	2	13	12	16
Agency debt	11	11	6	6
Agency MBS	16	13	31	24
Non-agency CMBS, RMBS, ABS	20	0	0	0
FDIC corporate bonds[1]	0	0	8	9
Corporate bonds	17	20	15	24
Equities	5	4	0	0

[1] FDIC guaranteed corporate bonds are protected by the Federal Deposit Insurance Corporation, an independent agency of the U.S. government

INVESTMENTS

Our primary investment objective remains unchanged since inception – liquidity and capital preservation are first and foremost. Our secondary aim is to maximise returns from our portfolio. We will not compromise capital preservation in order to generate superior investment returns. We are an underwriting company, not an investment company.

In 2009 we have generated a total investment return of 3.9% (2008: 3.1%). Our average annual total investment return since inception is 4.8%. We have made money every year since inception, including in the unprecedented market conditions that ensued in 2008, something we are very proud of. The conservative nature of our portfolio and our investment philosophy means that we do not expect to generate spectacular returns in periods of market recovery, but we prefer not to produce significant losses in periods of market turmoil. Our portfolio mix illustrates our philosophy as shown above.

The Group's investment guidelines regulate the composition of each portfolio. We have three investment portfolio categories: "core", "core plus" and "surplus". The "core" portfolio contains at least enough funds required to meet near-term obligations and cash flow needs following an extreme event. Assets in excess of those required to be held in the "core" portfolio may be held in any of the three portfolio categories.

We review the composition, duration and asset allocation of our 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. Conversely, if the risk profile is expected to move outside of tolerance levels, adjustments may be made to reduce the risks in the portfolio.

We try to be nimble in our investment strategy. We believe in the application of common sense, and do not place much reliance on "black box" approaches to investment selection.

Investments are, however, inherently unpredictable and there are risks associated with any investment strategy decisions. Some of our tactical decisions have proved to be timely and invaluable. Recent history has been tumultuous, and we have avoided many of the pain points with our defensive decisions. In 2009, as the economic outlook has improved, we have relaxed some of these tactical restrictions.

Some of our more significant decisions taken over the last few years are as follows:

- **Q4 2007:** Exited non-agency structured product classes including CMBS, RMBS and ABS classes;

- **Q1 2008:** Significantly reduced exposure to financial sector corporate bonds, including selling all Lehman Brothers holdings. Increased weighting in Treasuries;
- **Q2 2008:** Remained defensive, including increasing allocation to cash to 39% of total invested assets;
- **Q3 2008:** Continued to reduce equity holdings from 5% to less than 1% by 31 December 2008;
- **Q4 2008:** Reduced weighting in Treasuries and increased weighting to FDIC backed corporate debt, Agency debt and Agency MBS;
- **Q1 2009:** Retained defensive position;
- **Q2 2009:** Retained defensive position, increased allocation to Treasury Inflation Protected Securities;
- **Q3 2009:** Deployed excess cash and increased allocation to corporate bonds, reduced some of the tactical restrictions on corporate sectors and names;
- **Q4 2009:** Continued to reduce tactical restrictions and increase allocation to corporate bonds; and
- **Q1 2010:** Allocated a small portion of surplus funds to Emerging Market Debt.

We have no plans to change our investment philosophy in the foreseeable future. We will continue to monitor the economic environment closely. We are more optimistic than a year ago, but cautiously so.

We frequently monitor investment opportunities, such as equities, emerging and global market debt, but remain, as always, opposed to driving for return if it results in excessive risk taking.

1. Underwriting comes first: Taking a fresh look at risk

Alex Maloney

Alex is Group Chief Underwriting Officer

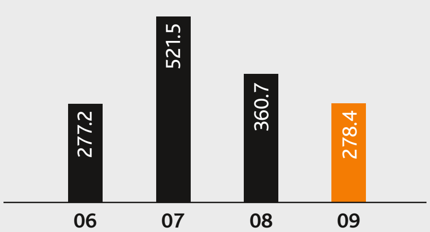
Lancashire is an underwriting company – not an investment manager or a hedge fund. Successful underwriting takes constant vigilance, so every day, during our Underwriting & Marketing Conference Call, we examine our appetite for each category of risk. We differentiate carefully, selecting mainly the higher and middle layers of risk, and look for profitable niches within less attractive classes of business. We maintain consistent support for our core portfolio of high quality clients, and we shrink or expand our non-core portfolio as the market changes.

In 2009 we re-examined Gulf of Mexico Energy risks in the aftermath of Hurricane Ike. We tested our models against claims experience and what actually happened to energy assets in deep water and on the continental shelf. The outcome was a re-balancing of our portfolio towards deep water spars and drill-ships, which proved to be robust in exceptional storm conditions. As a result, we were able to launch our OCTOPUS catastrophe facility to new as well as existing Gulf of Mexico Energy clients, offering them a measure of certainty when the industry's capacity was limited.

Where can I find out more?

Page 22. Business lines.
Page 25. Renewal price index.
Page 29. Underwriting results.

OPERATING CASH FLOW $M



LIQUIDITY AND CASH FLOW

Liquidity

Lancashire is a short-tail insurance and reinsurance group. As such, the investment portfolio must be liquid, of short duration, and highly credit-worthy. Lancashire's investment strategy places an emphasis on the preservation of invested assets and provision of sufficient liquidity for the prompt payment of claims in conjunction with providing a reasonably stable income stream.

Liquid securities will be maintained at an adequate level to more than meet expenses, including unanticipated claims payments. Only once safety, liquidity, and investment income requirements are satisfied, then additional growth in the investment portfolio may be pursued.

More detail on the practical application of this approach to liquidity is set out in the discussion of investment performance on page 31.

Cash flow

Lancashire's cash inflows are primarily derived from net premiums received, from losses recovered under reinsurance contracts and from net investment income. Excess funds are invested in the investment portfolio, which consists of high quality, liquid fixed income securities of short duration. Other cash inflows result from the sale and redemption of investments.

The principal outflows for the Group are the settlement of claims, the payment of reinsurance cover, the payment of general and operating expenses, the servicing of debt, the purchase of investment products, the distribution of dividends and the repurchasing of shares.

We have generated positive operating cash flows in each year of operation since inception.

Cash flows from operating activities

In 2009, cash flow was again strong, driven by the Group's robust underwriting performance, including some favourable development on prior accident year loss reserves.

A net positive cash inflow arose from operations during the year of $278.4 million (2008 – $360.7 million).

In 2008 a positive cash flow from operations was achieved despite the Group's exposure to losses from Hurricanes Ike and Gustav. Due to the complexity of Ike claims in particular, a relatively low number of Ike claims had been settled by 31 December 2008. 35.3% ($66.1 million), of the ultimate Hurricane Ike liability has been settled by 31 December 2009. The majority of the remaining liability of $120.9 million (excluding reinstatement premiums) is expected to settle in 2010, with more than adequate liquid resources available to settle these claims.

Cash flows from investing activities

There was a net cash outflow from investing activities in 2009 of $210.7 million (2008 – $358.6 million) primarily as a result of the net purchase of fixed income securities of $270.8 million (2008 – $479.8 million) as the Group deployed excess cash balances, including the purchasing of corporate bonds. This outflow was partially offset by inflows of interest and dividends received of $62.8 million (2008 – $82.1 million) and net proceeds of $4.8 million received from the sale of equities (2008 – $66.7 million).

During 2009, the investment portfolio yielded lower cash returns than 2008 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 interest 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 realised cash gains from investment sales.

Cash flows from financing activities

Financing activities resulted in a net outflow of $41.8 million (2008 – $316.5 million) as a result of interest payments made to the Group's long-term debt holders of $6.4 million (2008 – $10.0 million), settlement of $24.9 million (2008 – $68.3 million) of share repurchases made, and dividends paid of $10.5 million (2008 – $238.2 million).

FINANCIAL PERFORMANCE

2009 financial highlights:

- Fully converted book value per share of $7.41 (2008 – $6.89). Return on Equity, defined as growth in fully converted book value per share, adjusted for dividends of 26.5% (2008 – 7.8%);
- Gross written premiums of $627.8 million (2008 – $638.1 million). Net written premiums of $577.1 million (2008 – $574.7 million);
- Reported loss ratio of 16.6% (2008 – 61.8%) and a combined ratio of 44.6% (2008 – 86.3%); Accident year loss ratio of 27.2% (2008 – 66.5%);
- Inception to date combined ratio of 57.5% (2008 – 62.7%);
- Total investment return of 3.9% (2008 – 3.1%);
- Net operating profit of $364.7 million (2008 – $119.4 million), or $1.94 diluted operating earnings per share

(2008 – $0.65);

- Net profit after tax of $385.4 million (2008 – $97.5 million), or $2.05 diluted earnings per share (2008 – $0.53);
- Interim dividend of $10.5 million (2008 – $nil) or 5.0 cents per common share; final dividend of approximately $20.8 million (2008 – $nil) or 10.0 cents per common share;
- Special dividend of $263.0 million (2008 – $nil) or $1.25 per common share; and
- Capital returned to shareholders via share repurchases $16.9 million (2008 – $58.0 million).

UNDERWRITING RESULTS

Gross written premiums decreased by 1.6% compared to the prior year. The Group's four principal classes, and a discussion of the key market factors impacting them, are as follows:

Property gross written premiums increased by 4.8% compared to the prior year. In 2009, the Group wrote significantly more Property Catastrophe Reinsurance risks than in 2008. In the first quarter of 2009, a tactical decision was made to reduce volumes in the retrocession and direct and facultative classes as compared to the first quarter in 2008. Subsequently, the Group expanded into the Property Catastrophe Reinsurance market.

Energy gross written premiums decreased by 5.2% compared to the prior year. Gulf of Mexico volumes were lower in the first half of the year compared to 2008 and construction projects were curtailed in the recessionary environment. This reduction in volume was somewhat offset by increased volume in the worldwide offshore line later in the year.

Marine gross written premiums decreased by 6.2% compared to the prior year. The decline is largely due to the recessionary driven reductions in shipbuilding projects and the timing of certain multi-year contract renewals.

FINANCIAL HIGHLIGHTS

	2006 $M	2007 $M	2008 $M	2009 $M
Gross premiums written	626.0	753.1	638.1	627.8
Net premiums written	547.5	666.8	574.7	577.1
Net premiums earned	243.5	611.2	607.3	594.7
Net insurance losses	39.1	146.3	375.5	98.7
Net underwriting income	169.5	388.4	132.2	390.0
Net investment income	54.2	78.4	59.5	56.0
Net realised gains (losses) and impairments	0.8	9.1	(11.0)	23.8
Profit after tax	159.3	390.9	97.5	385.4
Change in net unrealised gains (losses) on investments	8.7	12.0	6.9	2.8
Comprehensive income	168.0	402.9	104.4	388.2
Diluted earnings per share	$0.79	$1.91	$0.53	$2.05
Return on equity	14.0%	31.4%	7.8%	26.5%
Net loss ratio	16.1%	23.9%	61.8%	16.6%
Net acquisition cost ratio	14.3%	12.5%	16.4%	17.8%
Expense ratio	13.9%	9.9%	8.1%	10.2%
Combined ratio	44.3%	46.3%	86.3%	44.6%
Net total return on investments	6.1%	6.2%	3.1%	3.9%

GROSS PREMIUMS WRITTEN

	2008 $M	2009 $M	Change $M	Change %
Property	302.7	317.3	14.6	4.8
Energy	185.2	175.5	(9.7)	(5.2)
Marine	78.6	73.7	(4.9)	(6.2)
Aviation	71.6	61.3	(10.3)	(14.4)
Total	638.1	627.8	(10.3)	(1.6)

LOSS TRIANGLES

	2006 $M	2007 $M	2008 $M	2009 $M
Estimate of ultimate net liability:				
At end of accident year	39.1	151.2	403.9	161.7
One year later	34.7	125.0	370.3	
Two years later	32.0	99.5		
Three years later	27.6			
As at 31 December 2009	**27.6**	**99.5**	**370.3**	**161.7**
Net payments made	(20.5)	(52.6)	(126.8)	(6.1)
Total net liability	**7.1**	**46.9**	**243.5**	**155.6**
Accident year loss ratio(1)	11.3%	16.3%	61.0%	27.2%
Initial accident year loss ratio	16.1%	24.7%	66.5%	n/a
Change in loss ratio post accident year	(4.8%)	(8.4%)	(5.5%)	n/a

(1)Accident year loss ratio is calculated using the ultimate liability revalued at the current balance sheet date

Aviation gross written premiums decreased by 14.4% compared to the prior year, driven primarily by the non-renewal of a satellite risk program in the first quarter of 2009.

Ceded premiums reduced by 20.0% in 2009 compared to 2008. The main reason for the change is a reduction in the level of reinsurance purchased in respect of Gulf of Mexico energy catastrophe risks. This is directly related to the lower than expected volumes of premium written in this class.

Net earned premiums as a proportion of net written premiums were 103.0% compared to 105.7% in 2008. 2008 premium volumes were lower than 2007, which led to a reduction in the deferral of earnings into 2009. The Group also reduced premiums written in the first quarter of 2009 compared to 2008, resulting in a greater amount of premium being earned comparatively later in the year. However, the significant increase in volume of Property Catastrophe Reinsurance business written in June and July served to increase earned premiums in the second half of 2009, bringing the ratio of earned premium for the year in line with 2008.

The net loss ratio of 16.6% (2008 – 61.8%) mainly reflects an unusually low number of reported losses during the year and some favourable development of prior accident year reserves. The table below provides further detail of development by class, excluding the impact of foreign exchange revaluations.

LOSS DEVELOPMENT BY CLASS

	2008 $M	2009 $M
Property	22.3	44.4
Energy	5.5	9.3
Marine	–	6.1
Aviation	0.8	3.7
Total	28.6	63.5

Note: Positive numbers denote favourable development and negative numbers denote adverse development.

Net prior accident year reserve releases were $63.5 million compared to $28.6 million in 2008. The accident year loss ratio was 27.2% compared to 61.0% for the 2008 accident year. The higher ratio in 2008 is largely due to losses from Hurricane Ike. The ratio of IBNR to total reserves was 43.8% at 31 December 2009, compared to 32.6% at 31 December 2008.

INVESTMENT PERFORMANCE

Net investment income was $56.0 million for the year, compared to $59.5 million in 2008. The decrease of 5.9% is largely due to a reduction in the overall portfolio yield.

Total investment return, including net investment income, net realised gains and losses, impairments and net change in unrealised gains and losses, was $82.8 million for the 2009 year versus $54.9 million for 2008. Given the improved economic environment in 2009 compared to 2008, there were less impairments recognised. Impairment losses in 2009 were $0.4 million versus $21.6 million in 2008. The Group also realised significant net gains as a result of a re-alignment of its investment portfolio as the Group's investment outlook evolved.

The Group continues to hold a highly conservative portfolio, consistent with its long-term philosophy, with a strong emphasis on preserving capital. The corporate bond allocation, excluding Federal Deposit Insurance Corporation guaranteed bonds, was increased by 8.4% from 31 December 2008, bringing the total holding to 23.6% of managed invested assets. There was a small increase in the allocation to Treasury Inflation Protected Securities to hedge against potential future inflationary pressures, bringing the total holding of these securities to 4.0% of managed invested assets. At 31 December 2009, the managed portfolio comprised 92.9% fixed income assets and 7.1% cash versus the prior year end of 80.3% fixed income assets, and 19.4% cash with 0.3% equities. The Group is not currently invested in equities, hedge funds or other alternative investments. Subsequent to the year end, the Group invested 3.9% of its managed portfolio in emerging market debt.

2. Maintain a strong balance sheet: Sticking to our principles

Elaine Whelan

Elaine is Deputy CFO of Lancashire Holdings and CFO of Lancashire Bermuda

In Finance, we have to make sure we get the balance right. We need enough capital for business opportunities and to meet security requirements, pay insurance claims and keep rating agencies and regulators happy, but not so much that our return on equity is reduced. We work closely with the Chief Underwriting Officers and actuaries on business plans, so that we can determine how much capital we need under a whole host of circumstances. We place limits on the capital we're prepared to expose to various loss events, and we work within those boundaries to optimise our portfolio and capital usage. We continually re-assess our position as the market moves.

We also monitor our investment portfolio closely. Although 2008 was definitely a more challenging year, we remained cautious in 2009, staying true to our belief that as an underwriting company, we should never lose money on our investments by taking on too much risk.

On reserving, we review all larger reported losses individually and re-evaluate them regularly. We try to consider all possibilities and derive our best estimate. They're estimates, of course, but it's important to us that we have a robust process and come up with a reasonable reserve, as that feeds back into our investment and capital stance.

Where can I find out more?

Page 14. How we do it.
Page 26. Investments.
Page 28. Financial performance.
Page 32. Dividends.

KEY INVESTMENT PORTFOLIO STATISTICS

	2008	2009
Duration	1.8 years	2.3 years
Credit quality	AA+	AA+
Market yield	2.7%	2.2%
Book yield	3.4%	2.8%

OTHER OPERATING EXPENSES

Other operating expenses, excluding employee remuneration, are broadly consistent compared to 2008, reflecting the Group's stable operating platform. Fixed employee remuneration costs were 33.1% of other operating expenses in 2009 compared to 36.3% in 2008. Variable employee remuneration costs were 27.2% in 2009 compared to 16.0% in 2008, reflecting the strong performance of the Group in 2009.

For 2009 and 2008 the charges for equity based compensation were $16.4 million and $10.6 million respectively. Annual restricted stock awards typically vest over three years. The increased 2009 expense reflects two years' worth of restricted stock awards. The restricted stock program began in 2008. This expense also includes mark-to-market adjustments on certain performance warrants plus charges associated with the revaluation of options due to amendments made to their strike price as a result of dividend declarations.

CAPITAL

At 31 December 2009, total capital was $1.510 billion, comprising shareholders' equity of $1.379 billion and $131.4 million of long-term debt. Leverage was 8.7%. Total capital at 31 December 2008 was $1.404 billion and leverage was 9.3%.

REPURCHASE PROGRAM

$16.9 million of shares have been repurchased and held in treasury compared to $58.0 million in 2008.

DIVIDENDS

During 2009 the Lancashire Board declared an interim and special dividend of 5.0 cents and $1.25 per share respectively. A final dividend of 10.0 cents per share has been declared and will be paid on 14 April 2010 to shareholders of record on 19 March 2010.

Lancashire will continue to review the appropriate level and composition of capital for the Group with the intention of managing capital to enhance risk adjusted returns on equity.

OUTLOOK

The Group aims to achieve a cross-cycle return of 13% including dividends above a risk free rate. This is unchanged from previous guidance.

CAPITAL MANAGEMENT

Lancashire aims to maintain a strong balance sheet at all times. An appropriate level and mix of capital must be maintained to support the Company's underwriting. The Group 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 within pre-determined risk tolerances;
- Maintaining adequate financial strength ratings; and
- Meeting internal and regulatory requirements.

Lancashire's capital is increased or returned as appropriate. The retention of earnings generated leads to an increase in capital. Capital raising can include debt or equity and returns of capital may be made through dividends, share repurchases, a redemption of debt or any combination thereof. Other capital management tools and products available to the Group may also be utilised. Capital actions from inception to date are as follows:

- 2007 – $100.0 million share repurchase completed;
- 2007 – special dividend of $239.1 million or $1.10 (approximately 56 pence) per share;
- 2008 – $100.0 million share repurchase authority in place, of which approximately $75.0 million repurchased by 31 December 2009;
- 2009 – introduction of first recurring ordinary dividend of approximately $31.3 million or $0.15 per share;
- 2009 – special dividend of $263.0 million or $1.25 (approximately 76 pence) per share; and
- 2009 – $150.0 million share repurchase authorised for future utilisation.

The composition of capital is also driven by management's appetite for leverage. In appropriate circumstances, management would be willing to modestly 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.

Internal methods have been developed to review the profitability of classes of business and their estimated capital requirements, in addition to 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.

Lancashire has a standard letter of credit facility in the amount of $200.0 million with a $75.0 million loan sub-limit available for general corporate purposes. This $75.0 million loan facility has not been drawn down upon. There are no off-balance sheet forms of capital.

ENTERPRISE RISK MANAGEMENT IN 2009

Lancashire has an effective Enterprise Risk Management ("ERM") structure. One of the objectives of its ERM program is to provide a framework within which the Group can confidently maximise shareholder returns while still ensuring a strong risk and control environment that mitigates concentration risks.

At Lancashire, the Board is responsible for the governance of the Group, ensuring that risks are adequately managed and that appropriate levels of capital are held to support all risks to the Group. To assist the Board in managing these responsibilities Risk Committees exist at the operating entity level.

The Risk Committees were established with representation from both the Boards of Directors of each operating company and members of the management team. The objectives of the Committees are set out in the terms of reference and include the following:

"...to assist the Board and the Audit Committee in its oversight duties in respect of the management of risk, especially: (i) considering the risk profile of the Company; (ii) establishing the Company's risk management strategy, policies, methods and risk tolerances; (iii) monitoring the implementation of the Company's risk management strategy, policies, methods and risk tolerances."

ERM in action

Strategy

– Economic capital model (BLAST) assists in portfolio optimisation, monitoring capital headroom and monitoring compliance with risk tolerances and risk appetite

Culture

– Risk learning mitigates risks and creates opportunities

Infrastructure

– Organisational structure in place that enables strong governance and oversight

Process

– Emerging risk process that assists in identifying current and future risks
– Risk identification, measurement, assessment, monitoring and mitigation processes

The duties and responsibilities of the Risk Committees consist of the following:

- Assess and evaluate the risks facing the Group;
- Review the methods for risk measurement and risk adjusted capital calculations;
- Monitor the ratings methods employed by rating agencies in assigning insurer financial strength ratings and evaluate the implications of the methods on the Group;
- Review key and emerging risks facing the Group and operating entities; and
- Assign risk management and risk measurement/monitoring activities to other Group committees as deemed appropriate.

Embedding of ERM

Lancashire remains committed to further embedding ERM into its day-to-day activities. For example, in underwriting, management maintains a significant amount of control and oversight of the underwriting process through its daily Underwriting and Marketing Conference Call ("UMCC").

The UMCC is an effective enabler of ERM. It is an interactive forum where significant risks that affect the underwriting risk profile are discussed including, but not limited to, the review of individual submissions, emerging risks and threats, product enhancements and market conditions. Underwriting decisions, however, are always made at the local operating entity level.

Also, late in 2009, the risk function worked together with IT to develop a new Group Risk Management Tool. The purpose of the system is to allow risk owners the ability to track, score and affirm quarterly those risks that they are responsible for. The system allows for risk owners to assign control operators. The control operators must affirm that the controls that they are responsible for are in place and operating effectively. Lancashire believes that this new system further encourages the embedding of ERM throughout the entire Group through greater staff engagement and involvement in the risk and controls process.

> 'One of the Group's overriding principles is that 'underwriting comes first!'
>
> Lancashire's underwriting risk appetite is driven by the requirement that each risk underwritten must bear scrutiny on an individual basis and as part of the overall portfolio with the intention of producing a superior risk adjusted return for shareholders.

RISKS FACING LANCASHIRE

BLAST

The Group's economic capital model, BLAST, is at the heart of Lancashire's capital monitoring. BLAST is a critical component of the Group's ERM program. BLAST helps senior management and the Board of Directors determine the level of capital required to meet the combined risk from a wide range of categories.

BLAST also allows management to make an early assessment of whether additional capital will be required to ensure all of its acceptable risk tolerances are satisfied so the Group may plan accordingly.

INSURANCE RISK

Insurance risk is the risk of the timing, frequency and severity of insured events, by individual class or on an aggregated basis, relative to the expectations of Lancashire at the time of underwriting. Insurance risk can also refer to fluctuations in the timing and amount of claim settlements.

Lancashire's risk appetite aligns with the Group's related business strategy which is to write only particular types of non-life classes of business on the basis of a risk and reward equation.

Lancashire writes four principal classes of business: Property, Energy, Marine and Aviation classes which act as complementary to the other business lines of the Lancashire Group by way of the following characteristics:

- They are principally non-clashing with the exception of AV52 and Terrorism;
- They present attractive returns;
- They avoid long-tail exposures; and
- They attract a low level of attritional losses.

The level of insurance risk tolerance per class per occurrence and in aggregate are monitored by the Risk Committees and management but the risk tolerance limits are ultimately approved and also monitored by the Board.

Finally, one of the Group's overriding principles is that 'underwriting comes first!' Lancashire's underwriting risk appetite is driven by the requirement that each risk underwritten must bear scrutiny on an individual basis and as part of the overall portfolio with the intention of producing a superior risk adjusted return for shareholders.

REINSURANCE

Through regular monitoring of its insurance exposures, Lancashire seeks to reduce certain types of loss, including natural and man-made catastrophes and may enter into cost effective reinsurance arrangements. However, reinsurance does not relieve the Group of its obligations to policyholders.

Lancashire uses its Reinsurance Security Committee to assess the quality and financial strength of its reinsurers based on a combination of their financial strength, ratings and other factors. There is also continuous monitoring of the credit-worthiness of its reinsurers.

MARKET RISK

Market risk is the risk of financial loss due to movements in market factors. For Lancashire, this can manifest itself in several ways:

- Investment market movements; and/or
- "Weaker" pricing in the primary insurance market.

The Group has a low investment risk appetite. Investment guidelines set parameters which Lancashire's external investment managers must operate within. Compliance with these guidelines is monitored on a monthly basis, while regular monitoring of the portfolio takes place in order to respond to market conditions.

Lancashire also acknowledges the patterns and cycles associated with its business and in the market generally. In anticipation of

3. Stay nimble: How to survive an imperfect storm

Paul Gregory

Paul is Chief Underwriting Officer at Lancashire UK

2008's Hurricane Ike was the third costliest offshore energy loss on record, causing an estimated $32 billion of damage. As the clear-up began, we predicted a surge in Gulf of Mexico Energy premiums and allocated capital to write the business. By 2009 rates had improved dramatically, but demand fell far short of our expectations. Energy companies saw that rates had doubled, and with the oil price low at $40 per barrel, they shied away. From our point of view, Ike was an imperfect storm.

But for Lancashire, it goes against the grain to see capital standing idle. We put our heads together and quickly spotted an opportunity: for regulatory and other reasons, insurers were under pressure to buy additional cover. That suited our book, and in a matter of days we switched the capital we had allocated to Gulf of Mexico Energy to Property Catastrophe Reinsurance.

We can move quickly because our lines of communication are short: our underwriters speak directly to the senior management team every day, during our underwriting conference call. We don't have to compare diaries to get things done.

Where can I find out more?

Page 22. Business lines.
Page 25. Renewal price index.
Page 29. Underwriting results.

4. Manage capital through the cycle: Returned with thanks

Charles Mathias

Charles is Chief Underwriting Officer, Lancashire Bermuda and Group Underwriting Operations Director

At Lancashire, we don't want the tail to wag the dog: capital is a means to an end, not an end in itself. We make sure we have enough to pay claims and write business, but too much capital would only reduce our return on equity and burn a hole in our pockets. If we can't think of a smart way to use our shareholders' capital, it seems right to give it back.

During the credit crunch in 2008-09, we couldn't count on being able to tap the financial markets should we need to – so we set aside much more capital than we would otherwise have done, to make sure we had capacity. Towards the end of 2009, the debt and equity markets were recovering and we had seen other insurers raise funds successfully. So with our markets beginning to soften, we decided to pass that excess capital back.

In 2009, Lancashire returned $263 million to shareholders through a special dividend: including the currently authorised buyback, we will have returned approximately 88% of the money we raised when we did the IPO in 2005.

Where can I find out more?

Page 09. Return of capital.
Page 13. Return on Equity.
Page 32. Dividends.

either a "soft" or "hard" market scenario in the future, Lancashire's underwriters will maintain high underwriting and pricing standards in order to maximise its risk adjusted returns. Market conditions are regularly assessed as the market changes and these assessments may involve input from the Risk and Underwriting Committees.

LIQUIDITY RISK

Liquidity risk is the risk that the Group, although solvent, might not have sufficient available resources to enable it to meet its obligations as they fall due, or secure them only at an excessive cost. The Group's liquidity objective is to preserve capital and provide adequate liquidity to support Lancashire's underwriting operations. Moreover, it is not merely the intent to remain solvent following a period of significant loss, but also to have the resources to continue writing business, and to have sufficient capital to take advantage of any market dislocation.

The Board has also 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 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.

CREDIT RISK

Credit risk is the risk of loss in the value of financial assets due to counter-parties failing to meet part or all of their obligations (and potentially creating difficulties in Lancashire's ability to pay valid claims), or changes to the market value of assets caused by changed perceptions of the credit-worthiness of counter-parties.

Lancashire is exposed to credit risk on its fixed income investment portfolio and derivative instruments, its inward premiums receivable from insureds and cedants and on any amounts recoverable from reinsurers.

Lancashire mitigates its credit risk through the execution on its investment and credit strategy and policy, monitoring and avoidance of credit concentration and controls over premiums receivable from insureds and cedants as well as a strong broker vetting process and criteria.

OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems including the risks of fraud, damage to physical assets, business disruption, system failure and transaction processing failure.

Lancashire has identified numerous operational risks to the Group including, but not limited to, risks from IT systems failures, Business Continuity Planning, tax, regulatory, compliance, reputation and even ratings agencies actions. The Group has also set appropriate tolerances where necessary and/or implemented controls, policies and procedures while maintaining a robust corporate governance framework in order to mitigate its operational risks.

STRATEGIC RISK

The Group has identified several strategic risks, including the risks that either the poor execution of the business plan or poor business planning in itself results in a strategy that fails to adequately reflect the trading environment. The Group has also identified risks from the failure to maintain adequate capital plus the inability to access capital or access capital at an inflated cost. This includes unanticipated changes in regulator and/or rating agency models that could result in an increase in capital requirements. Lastly, the Group has identified succession planning, staff retention and key man risks as strategic risks.

The Group addresses the risks from poor planning through an iterative annual budget process, Board approval of the budget, frequent monitoring of actual versus budgeted results and through a continual assessment and re-forecasting as market conditions change.

Risks associated with the effectiveness of the Group's capital management are mitigated through the use of the BLAST model, which is an integral part of the review of profitability and capital utilisation, as well as regular monitoring of the regulatory and rating agency capital requirements as stated above. 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.

Finally, succession planning, staff retention and key man risks are mitigated through the identification of key personnel and maintaining appropriate back-up and succession plans, while employment contracts are also in place.

FURTHER DETAILS

Further discussion of the risks affecting Lancashire and those policies in place to mitigate them can be found in the Risk disclosures section on pages 81 to 100.

BUSINESS ENVIRONMENT AND OUTLOOK

Lancashire is in a mature trading position, having now had over four years to develop broker and client relationships. Our core books are Property (which includes the Terror book), Energy, Marine and Aviation. The development of our Property Catastrophe Reinsurance book has moved forward as planned.

In contrast with the previous year, 2009 was a benign year for losses across the entire industry and we experienced lower reported losses than the industry average.

Competition for business has increased in 2010 and renewal prices are mostly lower than they were a year ago. Rates in the reinsurance market are around 5% lower than the all-time high that was reached in 2009, but the market remains disciplined.

As we expected, the specialist insurance classes are coming under pressure, but are mainly holding up well.

As primarily an insurance provider, Lancashire writes business over the course of the year and results are not driven by the strength of the 1 January renewal season. However, we write a substantial part of our Property Retrocession and Property Catastrophe Reinsurance books at 1 January. Our next major line of business renewal period is March through June on our Energy Gulf of Mexico book. The Company's Property Direct and Facultative and Energy Offshore Worldwide books are written throughout the year.

We have actively put capital to work at January renewals in the reinsurance market in order to take advantage of what we feel will be the best-rated business during the year. We see other opportunities throughout the year in Alternative Energy, Sovereign Risk and Catastrophe-oriented Managing General Agency business. We are working with our distributors to exploit these opportunities slowly and carefully.

In 2010, the industry should pay attention to interest rate and inflation risk, investment income and the drying-up of reserve releases. When deciding strategy on risk classes, we see the combined ratio as the key to profitability. The Company's aim is to provide shareholders with a risk adjusted ROE of 13% in excess of a risk-free rate over the insurance cycle. Taking into account the current pricing expectations for our preferred lines of business, the outlook for 2010 appears reasonable.

We value our relationships and believe that success is unlikely to be achieved without a significant amount of effort put into those relationships.

We are placing greater emphasis on marketing, which we believe will continue to afford us access to virtually all major risks placed in the market in the classes underwritten by Lancashire.

Highlights

LANCASHIRE:

- Staff add tremendous value and are encouraged to stretch themselves and strive for high performance standards.
- Enjoys a positive relationship with its rating agencies and the Group has a financial strength rating of A minus (Excellent) with a stable outlook from A.M. Best.
- Shares were admitted to the Official List and to trading on the Main Market of the London Stock Exchange on 16 March 2009.
- Business is connected to insuring against natural catastrophes. The Lancashire Foundation supports Médecins Sans Frontières which provides immediate aid to people affected by catastrophes.

BENEFITS

$52.0million

Cost of providing employee benefits during 2009.

LANCASHIRE FOUNDATION

$1.1million

Donation made to The Lancashire Foundation during 2009.

2

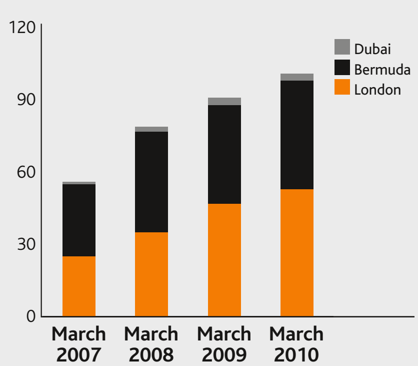
At Lancashire, we value our relationships and believe that success is unlikely to be achieved without a significant amount of effort maintaining those relationships.

These relationships encompass clients and brokers, employees, regulators, rating agencies, the community, analysts and others.

NUMBER OF PERMANENT EMPLOYEES

101 employees

At March 2010 Lancashire had 101 employees; 53 in London, 45 in Bermuda and 3 in Dubai



BROKERS

It is difficult to overstate the importance of broker and customer relationships. Our business is almost all transacted through brokers. Brokers need to know that insurers 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.

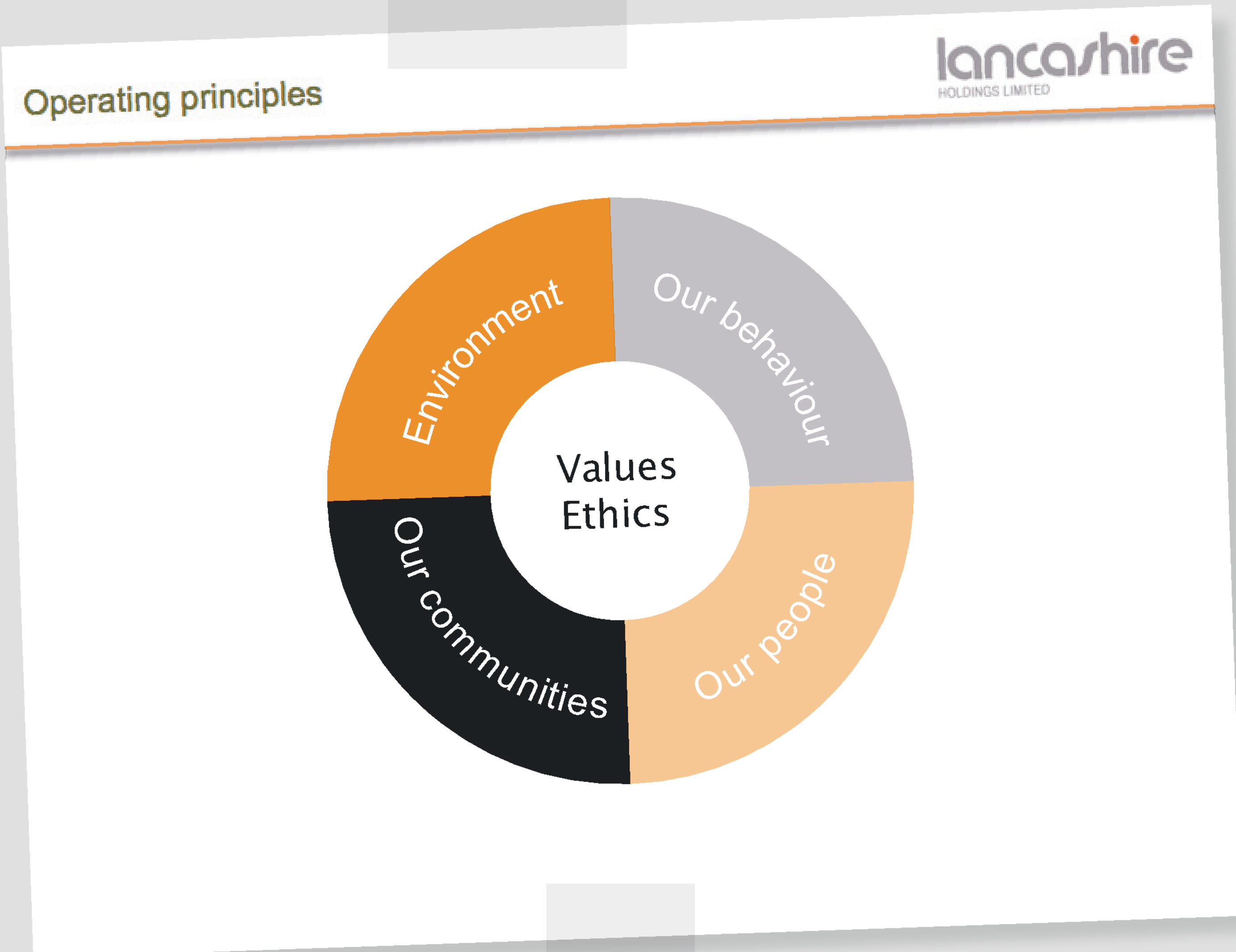
Lancashire strives to meet all of these requirements. More than ever we are placing greater emphasis on marketing, which we believe will continue to afford us access to virtually all major risks placed in the market in the classes underwritten by Lancashire.

EMPLOYEES

Lancashire staff add tremendous value to the organisation and are encouraged to stretch themselves and strive for high performance standards. Expectations are high and our people work efficiently and decisively in order to capitalise on changing conditions.

Staff are highly aligned to the Lancashire goals and this is reflected in the results of our 2008 employee opinion survey.

- Over 90% of respondents' understand how their job contributes to the overall success of the Group
- Over 80% of respondents believe that the majority of employees at Lancashire are committed to making it a successful business
- Almost 80% of respondents believe that "if the Group does well, I will do well"


Operating principles
lancashire
HOLDINGS LIMITED
Environment
Our behaviour
Values
Ethics
Our communities
Our people

In return Lancashire staff are offered competitive compensation but, more importantly, they are exposed to a wide breadth of responsibility and the opportunity for continuous learning.

The following are quotes from staff when asked "What do you like most about Lancashire?"

"When I first joined I felt it was an extremely close knit environment with a family feel, which makes the office an easy place to work in."

"1. The people. 2. The fact that hard work is recognised and rewarded. 3. Variety in my work."

"Good people, high standards, [all] trying to do the right thing."

"The feeling that all staff are committed and pull together, especially within the team I work."

"A lot of great people who want the best for each other and the company."

Notable initiatives during 2009

During 2009, Lancashire:

- Reviewed the Group's reward systems and their alignment with the Combined Code;
- Increased the number of flexible benefits offered to all employees at Lancashire;
- Provided enhanced training to all staff resulting in numerous training sessions being held internally on a variety of topics;
- Undertook a review of the employee handbook ensuring that staff members, in each of the Group's three offices, were subject to equivalent privileges, rules and obligations; and
- Awarded shares under the Restricted Share Scheme during May 2009 so that all those employed at 31 December 2008 now have a stake in the Company's equity.

"What do you like most about Lancashire?"

"1. The people.
2. The fact that hard work is recognised and rewarded.
3. Variety in my work."

REGULATORS

We place high importance on our relationship with regulators and we monitor changes in regulatory requirements closely. Both our Bermuda insurance operations (regulated by the Bermuda Monetary Authority ("BMA")) and our UK insurance operations (regulated by the Financial Services Authority ("FSA")) are subject to routine regulatory reviews, although no such reviews were conducted during 2009. Our marketing company in Dubai is regulated by the Dubai Financial Services Authority ("DFSA").

Lancashire has also obtained eligibility as an excess and surplus lines insurer in many U.S. states. As at March 2010, LICL and LUK were eligible for surplus lines insurance and reinsurance in 45 and 44 U.S. jurisdictions respectively, but are not licensed insurers in any U.S. state or territory. For those U.S. states where LICL or LUK is not currently excess and surplus lines eligible, Lancashire, subject to compliance with applicable law and regulation, may write insurance on a direct procurement basis or take advantage of available exemptions.

RATING AGENCIES

Lancashire enjoys a positive relationship with its rating agencies. The Group has a financial strength rating of A minus (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. It is also in discussion with Standard and Poor's ("S&P") and Moody's with a view to obtaining ratings from them in due course.

INVESTOR RELATIONS

Lancashire has a full-time Head of Investor Relations and Marketing who focuses on developing our relationships with investors, potential investors and analysts. A significant number of investor meetings in the U.K., Europe and the U.S., presenting to analysts, sales teams, investors and potential investors, have been held during 2009.

Lancashire's shares were admitted to the Official List and to trading on the main market of the London Stock Exchange (the "Main Market") under the ticker symbol LRE.L on 16 March 2009. With effect from 10 June 2009, Lancashire was included in the FTSE 250 index.

ENVIRONMENT

The Group has a commitment to the environment and is pleased with its status as Carbon Positive. The Group's office emissions have been calculated by PURE, the Clean Planet Trust, and the carbon emissions associated with the energy usage in Lancashire's offices in Bermuda, Dubai and London have been offset with PURE. In offsetting with PURE, the Group has made a charitable donation that will support emissions reduction projects around the world using standards that meet the U.K. Government's Code of Best Practice. In addition, all carbon emissions resulting from the Group's business travel are offset with Climate Care.

LUK is a founding supporter of the London City Climate Pledge. The goal of the London City Climate Pledge is to develop projects that verifiably reduce carbon emissions and which demonstrably benefit local communities by increasing incomes and improving quality of life. The London City Climate Pledge is administered by PURE.

LICL has endorsed the Association of Bermuda Insurers and Reinsurers' Policy Statement on Climate Change.

IN THE COMMUNITY

Lancashire established The Lancashire Foundation, a Bermuda charitable trust in 2007 with the aim of creating a charitable trust for the benefit of charitable causes in Bermuda, the U.K. and worldwide. The Foundation's trustee is an independent third party professional trust company that makes donations following recommendations made by the Foundation's Donations Committee consisting of Lancashire employees and independent members. Specific criteria have been set for the Lancashire Foundation's charitable giving. These criteria include causes where Lancashire staff or independent Donations Committee members have a close relationship with those who operate the charity and therefore have the ability to monitor and influence outcomes.

During 2009, The Foundation has continued to support charities in Bermuda, the U.K. and worldwide with an emphasis on those that address young people with special needs or disadvantaged circumstances and crisis relief work.

MÉDECINS SANS FRONTIÈRES

In light of the fact that a significant element of Lancashire's business is connected to insuring against natural catastrophes, The Foundation decided to support Médecins Sans Frontières ("MSF"), a charity that The Foundation views as well equipped to provide immediate and lasting humanitarian aid to people directly affected by such catastrophes, due to its international presence.

Introduction

MSF is an independent international medical humanitarian organisation that delivers emergency aid in more than 60 countries to people affected by armed conflict, epidemics, natural or man-made disasters or exclusion from healthcare.

In emergencies and their aftermath, MSF rehabilitates and runs hospitals and clinics, performs surgery, battles epidemics, carries out vaccination campaigns, operates feeding centres for malnourished children and offers mental health care. When needed, MSF also constructs wells, dispenses clean drinking water, and provides shelter materials like blankets and plastic sheeting.

Through longer-term programs, MSF treats patients with infectious diseases such as tuberculosis, sleeping sickness and HIV/AIDS and provides medical and psychological care to marginalised groups, such as street children.

Founded by doctors and journalists in 1971, MSF is now a worldwide movement with sections in 19 countries and an international coordination office in Geneva, Switzerland.

'You're here and you give us help'

The above is not a direct quote but summarises what MSF hear over and over again on the ground. It demonstrates a few key things: MSF are often the only Non Governmental Organisation ("NGO") in the region; MSF deliver the medical care themselves rather than merely dropping off supplies; MSF offer impartial medical care responding to the real crisis not to the cry of the media or government.

Emergency response – Zimbabwe

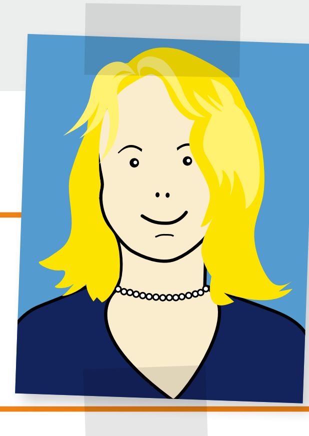
In all MSF projects, they are prepared for emergencies. For instance, the bulk of MSF's work in Zimbabwe is HIV/AIDS programs. However, when in late 2008 a cholera outbreak steadily broke out throughout the country, MSF teams were able to respond immediately. The outbreak lasted far longer than anyone anticipated – beyond April 2009 – and affected over 100,000 people. MSF treated around 60,000 of those people. Emergency response such as this is, arguably, what they do best and what they are best equipped to do over any other medical NGO. It is their financial independence, which The Foundation contributes to, that makes this possible.

ZIMBABWE CHOLERA OUTBREAK

60,000 people

Of the 100,000 treated for cholera in Zimbabwe between 2008-2009, MSF treated 60,000 of those people.

5. Charitable giving: With us, it's personal



Paula Porter

Paula Porter is Chief Executive Officer, Lancashire UK

For the Lancashire Group, support for charities means more than putting a cheque in the post. From our earliest days, we've made charitable giving a Group-wide activity, and our people have backed us enthusiastically. There's usually a personal connection between our employees and the charities we support: they include charities that have helped family members with health conditions, and smaller, local charities that have to compete for donations with better-known national organisations. The Lancashire Foundation supports charities in Bermuda, the U.K. and worldwide. Its Donations Committee comprises members of staff at every level of seniority, including receptionists and Board Directors. All have equal standing and voice.

In 2009 the Foundation made a substantial donation to Médecins Sans Frontières ("MSF"), the medical and humanitarian aid organization (www.msf.org.uk). Because our business is affected by natural disasters, we feel a strong connection to the work of MSF with some of the world's poorest and most vulnerable people, especially those in catastrophe – torn zones. Our contribution has helped MSF provide medical aid to those regions around the world where it was most needed, including an additional donation we made specifically for use in Haiti after the earthquake. Lancashire also supported an employee-inspired fund-raising whereby the Foundation matched donations made by staff and their families to the Haiti earthquake. The initiative raised a substantial sum and gave all our staff an opportunity to get involved in this important work.

We're personally involved with most of the charities we support. Our people contribute their time and expertise, as well as voting donations through the Foundation. Examples of the charities we supported in 2009 were Bermuda's Sunshine League, and in the U.K., JusB and Vauxhall City Farm.

- **The Sunshine League** (www.sunshineleague.bm) is a residential care home for displaced Bermudian children between the ages of 8 and 16 years. The Sunshine League provides high-quality, therapeutic care and promotes traditional family values. It aims to help children develop skills and values that they can draw on throughout their lives. One of our employees acted as a mentor to one of the children supported by The Sunshine League.
- **JusB** (www.jusb.org.uk), which is based in the London Borough of Bromley, offers a brighter future to the area's young people, helping them to develop their identity and self-esteem, avoid involvement in crime and anti-social behaviour, discover new skills and talents, and live in harmony within their community.
- **Vauxhall City Farm** (www.vauxhallcityfarm.org) provides an opportunity for Londoners to encounter farm animals from around the world, face-to-face. It aims to provide an educational, recreational and therapeutic program for children and people of all ages, abilities and cultures, to contribute to community cohesion and regeneration, and to promote environmental awareness.

Other charities supported by the Lancashire Foundation in 2009 included, in Bermuda: Coalition for the Protection of Children, Family Centre, and Tomorrow's Voices; and in the UK: Family Health ISIS, L'Arche, Edward Lloyd Trust, CrossFlow, Operation Smile, and Lloyd's Patriotic Fund.

The Foundation also matches funds raised by members of staff through sponsored activities. In order to receive support, employees must choose a charity which is approved by the Donations Committee and demonstrate a strong personal commitment, for example by training for, and taking part in, a marathon or long-distance cycle race.

In 2010, we are investigating opportunities to send teams of volunteers from the Lancashire Group of companies to personally assist charities in a number of developing countries.

Lancashire seeks to achieve the highest standards of corporate governance; the Company aims to comply with the UK Combined Code on Corporate Governance as revised in 2008.

Highlights

TOTAL SHAREHOLDER RETURNS

FTSE 250 and AIM All Share Indices
Lancashire shares traded above the FTSE 250 and AIM All Share Indices throughout 2009

SHARE OWNERSHIP

8 out of 10
8 out of its 10 Directors hold shares in the Company

CORPORATE GOVERNANCE

Six out of the ten members of the Board are independent non-executive Directors and the Board composition complies with the UK Combined Code.

The composition of the audit committee conforms to the UK Combined Code requirement that the audit committee should be comprised of independent non-executive Directors.

REMUNERATION

- Policy designed to attract, retain and motivate highest calibre of executive directors and senior management
- Policy based on our core principles:
  - Knowledge of how remuneration is determined; and
  - Bonuses based on clear split between Company and personal performance

3

The Board

NON-EXECUTIVE DIRECTORS

MARTIN THOMAS (age 46)
Non-Executive Chairman
Martin Thomas is a partner and board member of Altima Partners LLP, a UK-based hedge fund manager, and a director of Spearhead International Limited. 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.

JOHN BISHOP (age 65)
Non-Executive Director
John Bishop is an actuary with broad experience in the insurance sector. He has served on the boards of a number of insurance companies, both in an executive capacity and as a non-executive Director. He is currently a non-executive Director of Berkshire Hathaway International, Motability Finance Ltd. and Houston Capital Corporation Underwriting Agency. 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 Managing Director of Sun Alliance UK Insurance Company.

JENS JUUL (age 61)
Non-Executive Director
Jens Juul, the Honorary Consul of Sweden for Bermuda, has 31 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 U.S. subsidiary, Christiana General, prior to moving to Bermuda, where he was the founding Chief Executive Officer of Scandinavian Reinsurance Company Limited until his retirement in 2002. He is an ARIAS-U.S. certified arbitrator and umpire.

RALF OELSSNER (age 65)
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 in May 1986 until dissolution of the company in March 2007. He is president of the German Risk Managers' Association. He holds an M.A. in Economics from Cologne University.

ROBERT SPASS (age 54)
Non-Executive Director
Robert Spass is a founding partner of Capital Z Partners, an investment firm he joined on its formation in 1998. Mr Spass previously held similar positions at Insurance Partners, L.P. and International Insurance Advisors L.P. He currently serves on the Board of Universal American Financial Corp., Endurance Specialty Holdings, Ltd. and other privately-held companies.

WILLIAM SPIEGEL (age 47)
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 Re Holdings Ltd., and Scottish Re Group Limited.

BARRY VOLPERT (age 50)
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.

EXECUTIVE DIRECTORS

RICHARD BRINDLE (age 47)
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.

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NEIL MCCONACHIE (age 37)
President & Chief Financial Officer
Neil McConachie joined Lancashire in February 2006 and leads the finance functions of the Group and serves as Group President and 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 U.K. and the U.S. public markets, and has also previously held positions of Chief Risk Officer and Chief Operating Officer. Mr McConachie has a B.A. in Accounting and Finance from Heriot-Watt University and an M.B.A. from Edinburgh Business School.

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SIMON BURTON (age 39)
Deputy Chief Executive Officer
Simon Burton joined Lancashire in March 2006, and serves as 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 has 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 Towers Watson in London and Bermuda.

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COMPANY SECRETARY

GREG LUNN
Group General Counsel
Greg Lunn joined Lancashire in February 2006. He is Chief Executive Officer of Lancashire Insurance Company Limited in Bermuda and he is also responsible for all legal affairs for the Group. Prior to joining Lancashire, Mr Lunn was employed 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. Mr Lunn is a qualified solicitor in England and is also an attorney admitted to the Bermuda Bar. He obtained his law degree from the University of Buckingham in England. Prior to becoming a lawyer Mr Lunn spent a number of years as an Investment Manager with HSBC in Hong Kong. He also served a short service commission in the British Army.

Key

- ● *Main board member*
- ● *Audit committee*
- ● *Nomination and corporate governance committee*
- ● *Remuneration committee*

Directors' report

OVERVIEW OF THE GROUP

Lancashire is a Bermuda incorporated company with operating subsidiaries in Bermuda, London and Dubai. The Company's common shares were admitted to trading on AIM in December 2005 and were subsequently moved to the Official List and to trading on the main market of the London Stock Exchange on 16 March 2009.

PRINCIPAL ACTIVITIES

The Company's principal activity, through its wholly owned subsidiaries, is the provision of global specialty insurance and reinsurance products. An analysis of the Group's business performance can be found in the Business review on pages 20 to 37.

RESULTS AND DIVIDENDS

For the year ended 31 December 2009, the following dividends were declared:

- an interim dividend of $0.05 per common share and warrant was declared on 29 July 2009 and paid on 7 October 2009 in pounds sterling at the pound/U.S. dollar exchange rate of 1.6221 or £0.030824 per common share and warrant;
- a special dividend of $1.25 per common share and warrant was declared on 5 November 2009 and paid on 6 January 2010 in pounds sterling at the pound/U.S. dollar exchange rate of 1.6529 or £0.75625 per common share and warrant; and
- a final dividend of $0.10 per common share and warrant was declared on 26 February 2010 to be paid on 14 April 2010 in pounds sterling at the pound/U.S. dollar exchange rate on the record date of 19 March 2010 or approximately £0.064 per common share and warrant.

DIVIDEND POLICY

Lancashire intends to maintain a strong balance sheet at all times, while generating an attractive risk adjusted total return for shareholders. We 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.

DIRECTORS

John Bishop (Non-Executive Director)
Richard Brindle (Chief Executive Officer)
Simon Burton (Deputy Chief Executive Officer)
Jens Juul (Non-Executive Director)
Neil McConachie (President, Chief Financial Officer)
Ralf Oelssner (Senior Independent Non-Executive Director)
Robert Spass (Non-Executive Director)
William Spiegel (Non-Executive Director)
Martin Thomas (Non-Executive Chairman)
Barry Volpert (Non-Executive Director)

DIRECTORS' INTERESTS

The Directors' beneficial interests in the Company's common shares as at 31 December 2009 and 2008 including interests held by family members were as follows:

Director	Common shares held at 31 December 2009	Common shares held at 31 December 2008
John Bishop	4,807	4,807
Richard Brindle	657,191	430,065
Simon Burton	180,000	240,000
Jens Juul	10,000	10,000
Neil McConachie	239,270	47,500
Ralf Oelssner	–	–
Robert Spass	222,500	372,500
William Spiegel	70,240	70,240
Martin Thomas	6,950	6,950
Barry Volpert	–	–

There have been no changes in Directors' shareholdings between the end of the financial year and the date of this report.

Certain of the Directors hold warrants over the Company's shares which were awarded prior to the Company's admission to AIM in December 2005 along with other warrants awarded to the Company's founders and employees as follows: Richard Brindle 8,367,181, Neil McConachie 956,359, Simon Burton 676,660 and William Spiegel 481,182. In addition to the Directors' interests set out above, Barry Volpert is managing member, chairman and CEO of Crestview Partners, LP which at 31 December 2009 had an interest in 12,800,000 shares in the Company and 1,183,180 warrants over the Company's shares. Robert Spass is the beneficial owner of 1,549,135 warrants over the Company's shares.

Further details of the executive Directors' warrants are included in the Directors' Remuneration Report.

TRANSACTIONS IN OWN SHARES

The Company repurchased 2,406,674 of its own common shares from November 2009 through to 31 December 2009 for a total consideration of approximately $16.9 million as part of the $100.0 million share buyback program authorised by the Board on 30 April 2008. The repurchased shares are held in Treasury.

DIRECTORS' REMUNERATION

Details of the Directors' remuneration are set out in the Directors' Remuneration Report on pages 59 to 67.

SUBSTANTIAL SHAREHOLDERS

As at 5 March 2010 the Company was aware of the following interests of 3% or more in the Company's issued share capital:

Name	Number of shares as at 5 March 2010	% of shares in issue
Crestview Partners LP	12,800,000	7.5%
Legal & General Group Plc	10,192,432	6.0%
Wellington Management Company, LLP	9,382,650	5.5%
BlackRock Merrill Lynch Investment Managers	8,616,832	5.1%
Steadfast Capital LP	8,564,154	5.0%
Artisan Partners Limited Partnership	6,310,933	3.7%
Franklin Resources, Inc.	5,825,871	3.4%
RH Moore, LP	5,128,098	3.0%

CORPORATE GOVERNANCE

The Company's compliance with the Combined Code on Corporate Governance 2008 is set out in the Corporate Governance section of this report on pages 54 to 58.

DONATIONS

On 14 May 2009 the Board of Directors approved a cash donation of $1.1 million (2008 – $1.0 million) to the Lancashire Foundation. Lancashire established the Lancashire Foundation, a Bermuda charitable trust in 2007 with the aim of creating a trust for the benefit of charitable causes in Bermuda, the U.K. and worldwide (the "Foundation"). The Foundation's trustee is an independent third party professional trust company that makes donations following recommendations made by the Foundation's Donations Committee consisting of Lancashire employees and independent members. Specific criteria have been set for the Foundation's charitable giving. These criteria include causes where Lancashire staff or independent Donations Committee members have the ability to monitor and influence outcomes.

The Lancashire Foundation has continued to support charities in Bermuda, the UK and worldwide with an emphasis on causes that address young people with special needs or disadvantaged circumstances and crisis relief work.

The Group did not make any political donations or expenditure during 2009.

HEALTH AND SAFETY

The Group considers the health and safety of its employees to be a management responsibility equal to that of any other function. The Group operates in compliance with health and safety legislative requirements in Bermuda, the U.K. and Dubai.

EMPLOYEES

Lancashire is an equal opportunity employer, and does not tolerate unfair discrimination of any kind in any aspect of employment, including retirement, recruitment, training, promotion, compensation, benefits, advancement and career development. The Group believes that education and training for employees is a continuous process and employees are encouraged to discuss training needs with their managers. The Group's health and safety, equal opportunities, training and other policies are available to all employees in the employee handbook which is available on the Group's intranet.

CREDITOR PAYMENT POLICY

The Group aims to pay all creditors promptly and in accordance with contractual and legal obligations.

FINANCIAL INSTRUMENTS AND RISK EXPOSURES

Information regarding the Group's risk exposure is included in the risk disclosures in the consolidated financial statements. The Group's use of derivative financial instruments can be found at note 19 of the consolidated financial statements.

ACCOUNTING STANDARDS

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 judgement and considering the accounting principles generally accepted in the United States ("U.S. GAAP").

ANNUAL GENERAL MEETING

The Company's annual general meeting is scheduled for 1.00pm on 4 May 2010. Notice of the annual general meeting and the form of proxy accompany this annual report. At the Special General Meeting ("SGM") held on 16 December 2009 the shareholders approved a repurchase program authority pursuant to which the Company may repurchase its own shares by way of on market purchases up to an aggregate purchase price of $150.0 million, to expire 12 months following the SGM. The Company will propose, at the annual general meeting, that the repurchase program authority be renewed.

ELECTRONIC AND WEB COMMUNICATIONS

Provisions of the Companies Act 1981 of Bermuda enable companies to communicate with members by electronic and/or website communications. Before the Company can communicate with a member by means of website communication, the relevant member must be asked individually by the Company to agree that the Company may send or supply documents or information to him by means of a website and the Company must have received a positive response. The Company will notify the member (either in writing, or by other permitted means) when a relevant document or other information is placed on the website and a member can always request a hard copy version of the document or information.

GOING CONCERN

The business review section on pages 20 to 37 sets out details of the Group's financial performance, capital management, business environment and outlook. In addition, starting on page 81 the risk disclosures section of the consolidated financial statements sets out the major risks the Group is exposed to, including insurance, market, liquidity, credit, operational and strategic, together with the Group's policies for monitoring and controlling its exposures to these risks.

The Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue its operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

AUDITORS

Resolutions will be proposed at the Company's annual general meeting to re-appoint Ernst & Young as the Company's auditors and to authorise the Directors to set the auditors' remuneration. Ernst & Young have served as the Company's auditors since 2005.

DISCLOSURE OF INFORMATION TO THE AUDITORS

Each of the persons who is a Director at the date of approval of this annual report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Approved by the Board of Directors and signed on behalf of the Board.

GREG LUNN, COMPANY SECRETARY
5 MARCH 2010

Corporate governance

Lancashire seeks to achieve the highest standards of corporate governance. Currently, the Company complies with the UK Combined Code on Corporate Governance as revised in 2008 (the "Combined Code") except as stated in this Corporate Governance section of this annual report. There are no Bermudian corporate governance standards similar to the Combined Code that apply to Lancashire.

BOARD AND COMMITTEE ADMINISTRATION

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 oversight of the 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. 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 and its committees meet on a quarterly basis and occasionally more frequently as circumstances dictate. At Board meetings, the Directors review all areas and developments of the Group's business and receive reports from management on underwriting, finance and any other key matters affecting the Company. The Directors are provided with information necessary for them to fulfill their responsibilities including quarterly reports and full board papers. Additional information is provided to the Directors as and when necessary and the Directors have access to independent professional advice as required.

MEETING ATTENDANCE SCHEDULE

The Board and committee attendance record during 2009 of the Directors who held office at the end of the year is as follows:

	Board	Audit committee	Nomination and corporate governance committee	Remuneration committee	Investment committee	Underwriting committee
Non-executive directors						
John Bishop	4/4	4/4	4/4	–	–	4/4
Jens Juul	4/4	4/4	4/4	5/5	–	4/4
Ralf Oelssner	3/4	3/4	–	4/5	–	3/4
Robert Spass	4/4	4/4	–	–	4/4	–
William Spiegel	4/4	4/4	–	5/5	–	–
Martin Thomas – Chairman	4/4	–	4/4	4/5	–	–
Barry Volpert	4/4	–	–	–	4/4	–
Executive directors						
Richard Brindle – Chief Executive Officer	4/4	–	–	–	4/4	4/4
Neil McConachie	4/4	–	–	–	4/4	–
Simon Burton	4/4	–	–	–	–	4/4

THE DIRECTORS

John Bishop, Jens Juul, Ralf Oelssner, William Spiegel and Martin Thomas are independent under the Combined Code as each is independent in character and judgement and has no relationship or circumstance likely to affect his independence. Ralf Oelssner is the senior independent Director. Martin Thomas was independent upon his appointment as Chairman on 1 May 2007. The Board determined, on 4 November 2009, that Robert Spass was independent following the termination, earlier in the year, of a monitoring agreement between Lancashire and Capital Z, which agreement had been in existence since early in the Group's history. Barry Volpert is not independent under the Combined Code due to his appointment by and affiliation with specific shareholders.

Accordingly, six out of the ten members of the Board are independent non-executive Directors and the Board composition complies with the Combined Code requirement that independent non-executive Directors, excluding the Chairman, should make up at least half of the Board.

In accordance with the Company's Bye-laws, one-third of the Directors shall retire by rotation at each Annual General Meeting ("AGM"). The Directors eligible for re-election are those who have been longest in office since their appointment or last re-election. Jens Juul and John Bishop were appointed by the Board as Directors on 16 November 2007 and 19 March 2008, respectively. Martin Thomas and Neil McConachie were re-appointed at the 2007 annual general meeting held on 1 May 2007 to hold office until 2010. Accordingly Jens Juul, John Bishop, Martin Thomas and Neil McConachie will stand for re-election, for a further three years, by the Company's shareholders at the annual general meeting scheduled to take place on 4 May 2010 as detailed in the notice of annual general meeting accompanying this report.

INFORMATION AND TRAINING

On appointment the Directors receive written information regarding their responsibilities as Directors and information about the Group. The new Director induction process includes meeting with senior management, visiting the Company's operations and the provision of key information.

Prior to the Company's admission to the Official List in 2009 and to trading on the Main Market of the London Stock Exchange the Board was kept informed of the Company's AIM and Bermuda law requirements on a regular basis. Leading up to the Company's admission to the Official List in March 2009 and to trading on the Main Market, information regarding the obligations of the Company and the Directors to comply with the Listing Rules of the Financial Services Authority was provided in written form and by oral presentation to the Directors. Information regarding the Company's Official List and Bermuda law obligations and on the Combined Code continues to be provided on a regular basis. All the Directors have access to the Company Secretary who is responsible for updating the Board with any legal, regulatory or compliance developments affecting the Company. The Directors also have access to independent legal advice as required. Regular sessions are held between the Board and management during which in-depth presentations covering areas of the Group's business are made. The Directors have the opportunity during these presentations to ask questions about the subject matter.

BOARD PERFORMANCE EVALUATION

Performance evaluation of the Board, its committees and individual Directors takes place on an annual basis and is conducted by the Chairman under the direction of the nomination and corporate governance committee. The aim of this work is to assess the effectiveness of the Board and its sub-committees in terms of performance, composition, supporting processes and management of the Group. In 2009, as in prior years, external consultants were appointed to assist in the evaluation. Each Board member and selected executives completed on-line questionnaires to assess individual and team styles. These questionnaires were followed by interviews with the external specialists to ascertain their views on the Board's effectiveness and the management of the Company.

Views were collated under six categories: Performance of the Board, Processes, Role of the Chairman, Non-Executive Directors, Leadership and the Performance of Sub-Committees. These views were incorporated into a summary report on an anonymous basis, under the sub headings Strengths and Areas for Improvement. The report, including Conclusions and Recommendations, was reviewed and evaluated by the Nomination and Corporate Governance Committee, made available to the Board, and discussed at the following Board meeting.

In addition to the performance evaluation noted above: the Chairman led an assessment of the Chief Executive Officer, the Chief Executive Officer undertook individual performance reviews for the executive Directors, and the senior independent Director conducted a review of the performance of the Chairman by having a meeting with all the non-executive Directors. Copies of the executive Director performance appraisals were supplied to the remuneration committee.

The evaluations undertaken in the 2009 financial year found that the Board operates effectively and has a good blend of insurance, investment and regulatory expertise. All non-executive Directors are committed to the continued success of the Company and to making the Board work effectively. Attendance at and preparation in advance of Board meetings is good; non-executive Directors provide further support via membership of sub-committees and through informal, bi-lateral discussion and debate.

Infrastructure, processes and governance mechanisms are in place to support effective performance of the Board. Steps will be taken to build the Board's risk expertise and enhance further the effectiveness of risk management processes. The Nomination and Corporate Governance Committee will review top level organisation structure and reporting, leadership capability, succession and talent pipeline at executive and non-executive level. Work is under way beneath Board level to strengthen the overall management of the business.

The Board will continue to review its procedures, its effectiveness and development in the financial year ahead.

RELATIONS WITH SHAREHOLDERS

Throughout 2009, the Head of Investor Relations and Marketing presented to several of the Company's major shareholders and the investor community. Feedback from analysts following presentations was reported to the Board. Conference calls with the investment community have been held following announcement of the Company's financial results. The Company has also commissioned shareholder reports to review the make up of its beneficial shareholder base. The Company's Chairman and the non-executive Directors are also available to meet with major shareholders at the Company's annual general meeting and throughout the year. Shareholders are encouraged to attend the Company's annual general meeting and to vote on shareholder resolutions.

COMMITTEES

The Board has established audit, nomination and corporate governance, remuneration, investment and underwriting committees. Each of the committees has detailed Terms of Reference, which can be viewed on the Company's website (www.lancashiregroup.com). The committees are generally scheduled to meet quarterly prior to the Board meetings at which they report.

The composition of the committees as at 31 December 2009 was as follows:

	Audit committee	Nomination and corporate governance committee	Remuneration committee	Investment committee	Underwriting committee
John Bishop	✓	✓			✓
Jens Juul	✓	✓	✓		✓
Ralf Oelssner	✓		✓		✓
Robert Spass	✓ (chair)			✓	
William Spiegel	✓		✓(chair)		
Martin Thomas		✓ (chair)	✓		
Barry Volpert				✓(chair)	
Richard Brindle				✓	✓ (chair)
Neil McConachie				✓	
Simon Burton					✓

AUDIT COMMITTEE

The composition of the audit committee conforms to the Combined Code requirement that the audit committee should be comprised of independent non-executive Directors. The audit committee is chaired by Robert Spass, who 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.

The audit committee has reviewed arrangements by which staff may, in confidence, raise concerns about improprieties in matters of financial reporting or other matters and such arrangements have been documented in a Whistle-blowing Policy. Training on the Whistle-blowing Policy is provided to all staff members every year.

NOMINATION AND CORPORATE GOVERNANCE COMMITTEE

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. Much of the work of the nomination and corporate governance committee involved the performance evaluation of the Board – see page 55.

REMUNERATION COMMITTEE

The remuneration committee's responsibilities are contained in their terms of reference. These include determining remuneration for the Company's executives, Directors and senior management of the Group, within a framework agreed with the Board.

INVESTMENT COMMITTEE

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

Additional members of the underwriting committee, who are not directors of the Company, are Bryan Bumsted, Alex Maloney, Charles Mathias and Paula Porter. The positions and summaries of the experience of these non-director members of the underwriting committee can be found on the Company's website at www.lancashiregroup.com. 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 tolerance limits.

INTERNAL CONTROLS

The Board is responsible for maintaining a robust framework of internal control and risk management and for overseeing and ensuring the effectiveness of the Group's risk and control processes. While retaining overall responsibility for risk management, including establishing the Group's overall risk profile and risk tolerances, the Board has assigned responsibility to the audit committee for reviewing the Group's internal control and financial reporting systems (including financial, operational, compliance and risk management). These systems are designed to identify promptly significant risks facing the Company so that such risks remain within the tolerance levels agreed by the Board. The Board acknowledges that the Company cannot eliminate all risks, but believes that comprehensive assessment and management of the risks facing the Company enables the business to operate within acceptable levels of risk. The audit committee reports, and makes recommendations, to the Board regarding the effectiveness of internal controls and its risk management policies and procedures. During 2009, the audit committee reviewed the effectiveness of the Company's internal controls and risk management systems, reviewed the Company's financial reporting and held closed sessions with the Company's internal and external auditors and with management.

INTERNAL AUDIT

The Group internal audit department reports directly to the audit committee. Each year it presents an audit plan to the audit committee for consideration and approval. The key objective of internal audit is to audit annually those areas of the Group's business that could present the highest risk to the achievements of the Group's business objectives, and to audit all other areas of the Group's operations at least once every three years.

The findings of each internal audit are reported to the audit committee which has a responsibility to ensure the timely implementation of agreed management actions and to review the status of these at each of its meetings.

The Company continues to engage PricewaterhouseCoopers to carry out specialist internal audit work and to provide additional capacity on an as required basis.

EXTERNAL AUDIT AND PROVISION OF NON-AUDIT SERVICES

The audit committee is responsible for reviewing and monitoring the external auditors' objectivity and reporting to the Board to ensure that the auditors' objectivity and independence is safeguarded. The Board is responsible for reviewing the effectiveness of the external audit which is reported on by the audit committee. In 2009, Ernst & Young performed certain non-audit services in relation to: the Company's application for admission on the Official List of the London Stock Exchange; transfer pricing; Solvency II; Individual Capital Assessment; and taxation advisory. During 2009, the audit committee monitored the provision of these services. The audit committee and the Board are currently satisfied with the objectivity and independence of the auditors.

ENTERPRISE RISK MANAGEMENT

An integrated approach to governance, risk management and compliance is at the core of the Group's risk management strategy. This integrated approach helps to provide a more robust and sustainable approach to compliance management while meeting related risk and governance requirements.

The risk management department increased its focus on the application of its enterprise risk management principles in 2009 while emphasising the need to continue to embed ERM and integrate good governance, risk management and compliance into the organisation.

Further discussion of the risks affecting Lancashire and those policies in place to mitigate them can be found in the Risk disclosures section on pages 81 to 100.

DIRECTORS' REMUNERATION REPORT

As a company incorporated in Bermuda, the UK Directors' Remuneration Report Regulations 2002 do not apply to Lancashire. However, the Board is committed to providing information to shareholders and complying with corporate governance standards and best practices to the appropriate extent, taking into account the Company's size and the nature of its business.

All information shown below is unaudited.

REMUNERATION COMMITTEE

The remuneration committee comprised the following members during the year and to the date of this report (all of whom are independent non-executive Directors excluding Martin Thomas, the Chairman of the Board, who was independent on appointment):

Jens Juul
Ralf Oelssner
William Spiegel (Chair)
Martin Thomas

The remuneration committee's responsibilities are contained in their terms of reference, a copy of which is available on the Company's website. These responsibilities include determining remuneration for the Company's executive Directors and senior management of the Group within a framework agreed with the Board. The committee's remit includes determining the remuneration of the Chief Risk Officer and Head of Internal Audit.

ADVICE TO THE REMUNERATION COMMITTEE

During 2009, as in 2008, Hewitt New Bridge Street ("HNBS") were appointed by the remuneration committee to give advice on market trends, practices and appropriate levels of remuneration for executive Directors and members of senior management. HNBS did not provide any other services to the Company during 2009. Greg Lunn, the Company Secretary, and Dewey & LeBoeuf LLP, the Company's legal counsel, provided the remuneration committee with advice in relation to remuneration matters including the operation of the Company's share schemes. Dewey & LeBoeuf LLP provided other legal services to the Group during 2009.

Meetings of the remuneration committee may also be attended by other Directors including the Chief Executive Officer and Chief Financial Officer, but such attendance is by invitation only and not by right. The Chairman and the executive Directors are not involved in determining their own remuneration.

REMUNERATION POLICY

The Company's remuneration policy 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, within appropriate risk parameters. 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.

The remuneration committee has adopted the principle that base salary should be set broadly in line with the median of peer companies 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.

The details of the component parts of the remuneration package for executive Directors are set out below.

The executive Directors' remuneration is made up of the following elements:

- base salary
- annual bonus
- long-term share-based incentives ("restricted shares")
- pension
- other benefits, comprising medical, dental, vision and life insurance coverage, gym membership as well as a housing allowance for expatriates.

BASE SALARY

Salaries for executive Directors are determined by the remuneration committee at the beginning of each year and when an individual changes responsibility or position.

From 1 January 2010, the salaries for executive Directors have been increased as follows: Richard Brindle, Chief Executive Officer – no increase; Neil McConachie, President and Chief Financial Officer – 25.6% increase; and Simon Burton, Deputy Chief Executive Officer – no increase. The increase to Neil McConachie's salary reflects the market value of the individual and his new role as Group President. This new role represents a significant increase in scope and complexity and the new salary level has been arrived at following a detailed market benchmarking exercise. The effect of this change is to move Neil McConachie's salary and total compensation to a position broadly comparable to a median position of peers.

ANNUAL BONUS

Bonuses will be based on a clear split between Company financial performance and personal performance on a 75:25 basis for the three executives.

Financial performance will have two components:

(i) absolute financial performance against the Company's board approved 2010 budget. This component will be measured by the achievement of a target growth in book value per share. Growth in book value per share continues to be the most appropriate operational metric to measure the growth in value that the shareholders have received over the course of the financial year.

(ii) relative financial performance against a well defined peer group. This component will be measured by comparing Lancashire's growth in book value per share against a peer group. The 2010 defined peer group consists of: Amlin plc, Axis Capital Holdings Limited, Beazley plc, Brit Insurance Holdings N.V., Catlin Group Ltd., Endurance Specialty Holdings Ltd., Flagstone Reinsurance Holdings Limited, Hiscox Ltd., Montpelier Re Holdings Ltd., RenaissanceRe Holdings Ltd. and Validus Holdings Ltd. Should one of these companies undergo extensive change in capital size or market focus the remuneration committee will consider whether they should still remain in the peer group. If the Company loses any money in a year, the relative performance component will not be used as an input for financial performance.

Personal performance will be based upon individual achievement of clearly articulated goals created at the beginning of each fiscal year and agreed to by the Group CEO.

As in 2009, the level of bonus for 2010 will be capped at 400%, 350% and 350% of salary for the executive Directors – the Chief Executive Officer, President and Chief Financial Officer and Deputy Chief Executive Officer respectively. The target level of bonus is half of the maximum. Bonus payments will be made when all information necessary to compute the bonuses has been obtained.

A portion of each executive Director's bonus may be paid in stock that cliff vests in two years from 1 January of the year in which the stock is awarded. For the 2009 bonus, cash awards were made up to 100% of bonus target and any excess beyond that was paid in stock that cliff vests on 1 January 2012.

LONG-TERM INCENTIVES

In 2008, the Company introduced a restricted share scheme ("RSS"). Under the RSS, executives may be granted a conditional award of shares which are released to the executive after three years, subject to the achievement of performance conditions and continued employment. 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 are eligible to receive share awards under the RSS at the discretion of the remuneration committee. Awards are made each year following the announcement of the Company's results.

The remuneration committee has considered carefully the grant levels and performance conditions for awards in 2010. Restricted award levels will be 375,000 for the Chief Executive Officer, 152,500 for the President and Chief Financial Officer and 81,250 for the Deputy Chief Executive Officer with the actual number of shares received subject to satisfaction of time and performance conditions as set out below.

For half of each award the performance condition will be based on the Company's total shareholder return ("TSR") performance against a pre-defined comparator group of international insurance companies over the three year performance period. 25% 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% and 100% for TSR performance between median and upper quartile.

For the remaining half of each award the performance condition is based on ROE over 3 financial years in the performance period. 25% of this award will only vest if average annual ROE over the performance period exceeds the 13 week treasury rate (the average taken quarterly over the performance period) plus 8%. All of this part of the award will vest if the Company's average ROE is equal to the 13 week treasury rate (the average taken quarterly over the performance period) plus 18%. Vesting will take place on a straight-line basis between 25% and 100% 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.

PENSION

Executive Directors receive pension contributions from the Company under defined contribution pension plans. For the Bermuda based plan executive Directors receive a Company contribution of 10% of base salary. The Group CEO receives a 10% base salary contribution 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 on page 63.

OTHER BENEFITS

Other benefits for executive Directors comprise medical, dental, vision and life insurance coverage, gym membership, as well as a housing allowance for expatriates.

SERVICE CONTRACTS

The executive Directors of the Company are Richard Brindle, Neil McConachie and Simon Burton. 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, Neil McConachie's and Simon Burton's original service contracts with the Company were replaced with service contracts entered into with effect from 1 January 2009.

In the event of early termination, the executive Directors' contracts provide for compensation up to a maximum of base annual salary plus the fair value of benefits to which the executive Directors are contractually entitled for the unexpired portion of the notice period. The Company seeks to apply the principle of mitigation in the payment of compensation on the termination of the service contract of any executive Director. There are no special provisions in the service contracts for payments to executive Directors on a change of control of the Company.

The Board may allow executive Directors to accept external appointments. In accordance with the Combined Code, the Board will not agree to a full-time executive taking on more than one non-executive directorship, or the chairmanship of any company.

NON-EXECUTIVE DIRECTORS

Remuneration policy

The Company's policy for the non-executive Directors' and Chairman's remuneration is to set fees at an appropriate level so as to attract individuals with the range of skills and experience suitable for an international insurance group of the Company's size and complexity. The Chairman and the non-executive Directors receive no benefits in addition to their fees and do not participate in any incentive or performance plans or pension arrangements. The Company encourages share ownership by the Chairman and non-executive Directors. Non-executive Directors who do not own shares are encouraged to use a proportion of their fees to buy shares in the Company and retain such shareholdings for their remaining periods of office.

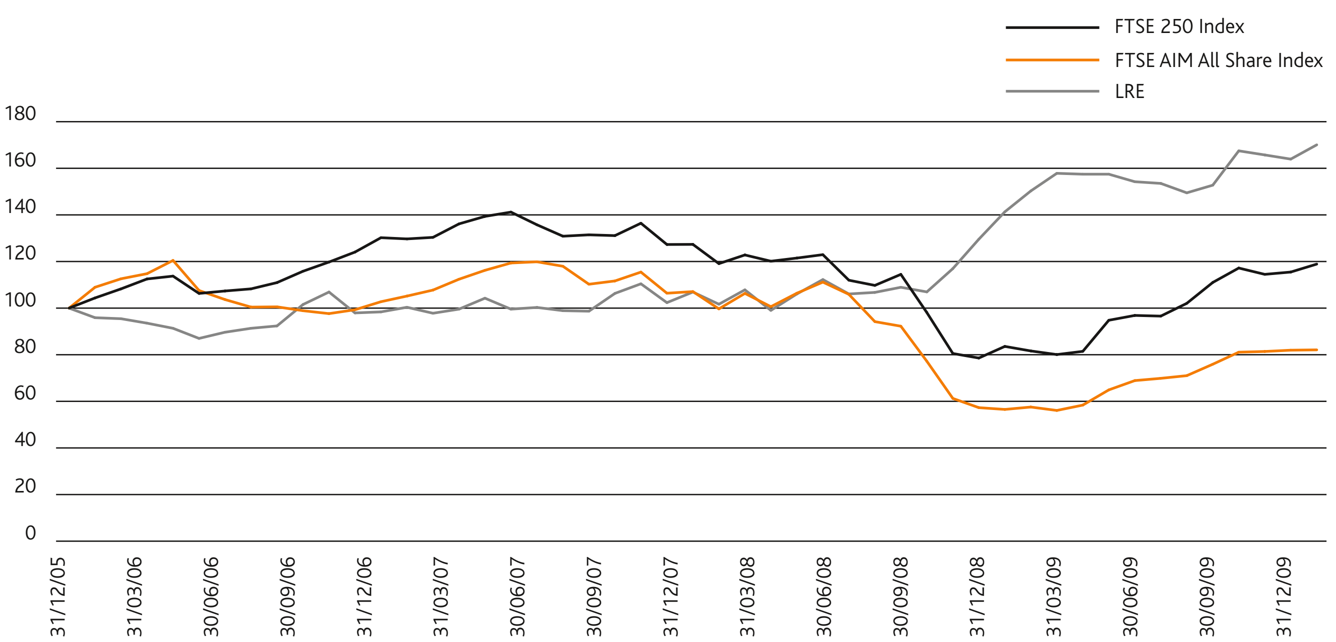
Terms of appointment

The non-executive Directors serve subject to the Company's bye-laws and under letters of appointment and are appointed for varying terms which are terminable by either party on six months' notice in the absence of earlier termination in accordance with the bye-laws. The non-executive Directors are typically expected to serve two three year terms although the Board may invite a non-executive Director to serve for an additional period. Their letters of appointment are available for inspection at annual general meetings.

Name	Position	Date of letter of appointment	Date of next re-appointment
John Bishop	non-executive director	19 March 2008	2010 AGM
Jens Juul	non-executive director	16 November 2007	2010 AGM
Ralf Oelssner	non-executive director, senior independent director	31 July 2007	2012 AGM
Robert Spass	non-executive director, chairman of audit committee	9 December 2005	2012 AGM
William Spiegel	non-executive director, chairman of remuneration committee	9 December 2005	2012 AGM
Martin Thomas	non-executive chairman	16 April 2007	2010 AGM
Barry Volpert	non-executive director, chairman of investment committee	12 December 2005	2011 AGM

RELATIVE PERFORMANCE

The following graph shows the Company's performance, measured by Total Shareholder Returns ("TSR"), compared with the performance of the FTSE AIM Index and the FTSE 250 Index. These indices have been chosen because the Company's common shares were listed on AIM until 16 March 2009 when its common shares commenced trading on the main market of the London Stock Exchange. The Company joined the FTSE 250 Index on 10 June 2009 and this index best reflects its nature and size now.



DIRECTORS' EMOLUMENTS

Directors' emoluments for the year ended 31 December 2009:

Director	Base salary/fees	Other(i) (ii)	Benefits(i)(iv)	Pension(i)	Annual bonus cash(v)	Annual bonus RSS	Total 2009 emoluments	Total 2008 emoluments
Non-executive Directors								
John Bishop	140,000	56,000	–	–	–	–	196,000	152,067
Jens Juul	140,000	35,000	–	–	–	–	175,000	140,000
Ralf Oelssner	175,000	46,000	–	–	–	–	221,000	223,000
Robert Spass	302,500	–	–	–	–	–	302,500	175,000
William Spiegel	175,000	–	–	–	–	–	175,000	175,000
Martin Thomas	275,000	100,000	–	–	–	–	375,000	375,000
Barry Volpert	166,250	–	–	–	–	–	166,250	140,000
Executive Directors								
Richard Brindle	675,000	405,000	213,460	108,890(iii)	2,160,000	758,527	4,320,877	3,078,041
Neil McConachie	398,000	–	189,593	39,800	696,500	251,501	1,575,394	1,110,584
Simon Burton	358,200(vi)	–	186,555	35,820	626,850	94,761	1,302,186	1,100,679

(i) Some amounts were paid in pounds sterling and converted at prevailing exchange rates.

(ii) Martin Thomas receives a fee of $100,000 per annum for his appointment as non-executive Chairman of LUK. John Bishop and Ralf Oelssner are also non-executive Directors of LUK and receive fees of $35,000 and $30,000 per annum respectively and $2,000 for each LUK Board or committee meeting that they attend in respect of their appointments. In addition, John Bishop receives a fee of $5,000 per annum in respect of his chairmanship of the LUK Audit Committee. Jens Juul is also a non-executive Director of LICL and receives a fee of $35,000 per annum in respect of his appointment. Richard Brindle receives an annual salary of $405,000 from LUK in respect his employment, paid in sterling.

(iii) Including a contribution of £25,985 (2008 – £23,547) to a UK defined contribution pension plan in respect of Richard Brindle's salary and employment with LUK.

(iv) Benefits include UK national insurance contributions, payroll taxes, medical, dental, vision coverage, air travel and housing and other allowances paid by the Company for expatriates.

(v) Bonus targets were set at the beginning of 2009 and based on a clear split between company financial performance and personal performance on a 75:25 basis. Company financial performance had two components, absolute financial performance and relative financial performance weighted 60:40 respectively. The absolute component paid out maximum and the relative component paid out at threshold. Cash awards were made up of 100% of target and any excess beyond that will be deferred into stock that cliff vests on 1 January 2012.

(vi) This salary reflects Simon Burton moving to a 4-day week during 2009.

DIRECTORS' WARRANTS, OPTIONS AND RSS AWARDS

(i) Time vesting ordinary warrants

Name	Warrants held at 1 January 2009	Warrants granted during the year	Warrants exercised during the year	Warrants lapsed during the year	Warrants held at 31 December 2009	Exercise price[iii]	Date from which first exercisable[i]	Expiry date
Richard Brindle								
16/12/2005	5,718,913	–	–	–	5,718,913	$5.00	16/12/2005	16/12/2015
16/12/2005	1,906,304	–	–	–	1,906,304	$3.90	16/12/2008	16/12/2015
Neil McConachie								
16/12/2005	294,293	–	–	–	294,293	$5.00	16/12/2005	16/12/2015
16/12/2005	158,859	–	–	–	158,859	$3.90	16/12/2008	16/12/2015
09/03/2006	158,859	–	–	–	158,859	$5.00	09/03/2006	16/12/2015
09/03/2006	158,858	–	–	–	158,858	$3.90	16/12/2008	16/12/2015
Simon Burton								
09/03/2006	333,603	–	–	–	333,603	$5.00	09/03/2006	16/12/2015
09/03/2006	111,201	–	–	–	111,201	$3.90	16/12/2008	16/12/2015
21/09/2006	86,083	–	–	–	86,083	$5.00	21/09/2006	16/12/2015
21/09/2006	28,295	–	–	–	28,295	$3.90	16/12/2008	16/12/2015

(ii) Performance vesting ordinary warrants

Name	Warrants held at 1 January 2009	Warrants granted during the year	Warrants exercised during the year	Warrants lapsed during the year[ii]	Warrants held at 31 December 2009	Exercise price[iii]	Date from which first exercisable[ii]	Expiry date
Richard Brindle								
16/12/2005	288,843	–	–	–	288,843	$5.00	31/12/2007	16/12/2015
16/12/2005	47,154	–	–	–	47,154	$3.90	31/12/2008	16/12/2015
16/12/2005	1,220,035	–	–	814,068	405,967	$2.60	31/12/2009	16/12/2015
Neil McConachie								
16/12/2005	36,105	–	–	–	36,105	$5.00	31/12/2007	16/12/2015
16/12/2005	5,894	–	–	–	5,894	$3.90	31/12/2008	16/12/2015
16/12/2005	152,505	–	–	101,759	50,746	$2.60	31/12/2009	16/12/2015
09/03/2006	36,105	–	–	–	36,105	$5.00	31/12/2007	16/12/2015
09/03/2006	5,894	–	–	–	5,894	$3.90	31/12/2008	16/12/2015
09/03/2006	152,505	–	–	101,759	50,746	$2.60	31/12/2009	16/12/2015
Simon Burton								
09/03/2006	25,274	–	–	–	25,274	$5.00	31/12/2007	16/12/2015
09/03/2006	4,126	–	–	–	4,126	$3.90	31/12/2008	16/12/2015
09/03/2006	106,754	–	–	71,232	35,522	$2.60	31/12/2009	16/12/2015
21/09/2006	20,460	–	–	–	20,460	$5.00	31/12/2007	16/12/2015
21/09/2006	3,340	–	–	–	3,340	$3.90	31/12/2008	16/12/2015
21/09/2006	86,419	–	–	57,663	28,756	$2.60	31/12/2009	16/12/2015

(i) The time-vesting ordinary warrants vested 25% on issuance on the admission of the Company's shares to trading on AIM on 16 December 2005. 25% of each warrant then vested on each of the first, second and third anniversaries of the admission of the Company's shares to trading on AIM.

(ii) The performance warrants were scheduled to vest in three tranches: 20% on 31 December 2007, 40% on 31 December 2008 and 40% on 31 December 2009. The performance conditions were based on a combination (50:50) of compound return and fully converted book value targets. As a result of some of the performance conditions not being met in 2007, 2008 and 2009 a number of performance warrants lapsed.

(iii) On 10 December 2007, the Company declared a special dividend of $1.10 per common share payable to shareholders of record, 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 and the vested performance warrants, reflecting the dividend paid to shareholders. The payments on the performance warrants were made 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.The exercise price for the unvested ordinary and performance warrants was adjusted downwards by $1.10 to $3.90 per warrant. The contractual obligation to pay a dividend equivalent on each vested warrant, and to adjust the exercise price for all unvested warrants, applies to all past present and future dividends declared by the Company.
On 29 July 2009, the Company declared an interim dividend of $0.05 per common share payable to shareholders of record, 28 August 2009. On 7 October 2009, the Company paid a dividend of £0.0308 per warrant on all of the vested ordinary warrants and the vested performance warrants, reflecting the dividend paid to shareholders.
On 5 November 2009, the Company declared a special dividend of $1.25 per common share payable to shareholders of record, 20 November 2009. On 6 January 2010, the Company paid a dividend of £0.7562 per warrant on all of the vested ordinary warrants and the vested performance warrants, reflecting the dividend paid to shareholders.

The market value of the common shares on each date of grant was as follows:
16 December 2005 – £3.21
9 March 2006 – £3.27
21 September 2006 – £3.44

Dividends paid on ordinary warrants	**Time vesting ordinary warrants £**	**Performance vesting ordinary warrants £**	**Total £**
Richard Brindle			
Special dividend of $1.10 (£0.5622) paid 25 January 2008	3,215,172	162,388	3,377,560
Interim dividend of $0.05 (£0.0308) paid 7 October 2009	235,042	10,357	245,399
Special dividend of $1.25 (£0.7562) paid 6 January 2010	5,766,544	254,097	6,020,641
Neil McConachie			
Special dividend of $1.10 (£0.5622) paid 25 January 2008	254,761	40,597	295,358
Interim dividend of $0.05 (£0.0308) paid 7 October 2009	23,761	2,589	26,350
Special dividend of $1.25 (£0.7562) paid 6 January 2010	582,966	63,523	646,489
Simon Burton			
Special dividend of $1.10 (£0.5622) paid 25 January 2008	235,779	25,711	261,490
Interim dividend of $0.05 (£0.0308) paid 7 October 2009	17,236	1,640	18,876
Special dividend of $1.25 (£0.7562) paid 6 January 2010	422,879	40,232	463,111

(iii) Share options under the 2005 LTIP

Name	Options held at 1 January 2009	Options granted during the year	Options exercised during the year	Options lapsed during the year	Options held at 31 December 2009	Exercise price[(iii)]	Date from which first exercisable[(ii)]	Expiry date
Richard Brindle								
09/03/2006	762,522	–	571,892	–	190,630	£1.90	09/03/2007	08/03/2016
29/06/2007	150,000	–	–	–	150,000	$4.47	29/06/2008	28/06/2017
Neil McConachie								
09/03/2006	508,348	–	375,000	–	133,348	£1.90	09/03/2007	08/03/2016
29/06/2007	200,000	–	–	–	200,000	$4.47	29/06/2008	28/06/2017
Simon Burton								
09/05/2007	300,000	–	–	–	300,000	$4.71	09/05/2008	08/05/2017
29/06/2007	500,000	–	–	–	500,000	$4.47	29/06/2008	28/06/2017

(i) The share options under the 2005 LTIP were not subject to any performance conditions.

(ii) The options vest as to 25% 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.

(iii) Following an amendment to the 2005 LTIP, approved by the Company's shareholders at the special general meeting of shareholders held on 4 January 2008, the remuneration committee exercised its discretion to reduce the exercise price for all outstanding vested and unvested options by $1.10 or £0.5622 effective 9 January 2008. The adjustment was made to reflect the special dividend paid by the Company in January 2008, and the consequent reduction in shareholders' equity. Similarly the remuneration committee exercised its discretion to reduce the exercise prices for all outstanding vested and unvested options by $0.05 or £0.0308 effective 7 October 2009. The adjustment was made to reflect the interim dividend paid by the Company on 7 October 2009, and the consequent reduction in shareholders' equity. The remuneration committee also exercised its discretion to reduce the exercise prices for all outstanding vested and unvested options by $1.25 or £0.7562 effective 6 January 2010. The adjustment was made to reflect the special dividend paid by the Company on 6 January 2010, and the consequent reduction in shareholders' equity.

The market value of the common shares on each date of grant was as follows:

9 March 2006 – £3.27

9 May 2007 – £3.57

29 June 2007 – £3.42

(iv) Awards under the Restricted Share Scheme

Name	Awards held at 1 January 2009	Awards granted during the year	Awards exercised during the year	Awards lapsed during the year	Awards held at 31 December 2009	Vesting date
Richard Brindle						
2008 performance award(ii)	360,001	–	–	–	360,001	28/03/2011
2008 exceptional award(iii)	33,381	–	–	–	33,381	28/03/2011
2009 performance award(iv)	–	318,750	–	–	318,750	19/05/2012
2009 erss performance award(v)	–	31,875	–	–	31,875	05/11/2012
Neil McConachie						
2008 performance award(ii)	101,032	–	–	–	101,032	28/03/2011
2008 exceptional award(iii)	22,254	–	–	–	22,254	28/03/2011
2009 performance award(iv)	–	99,375	–	–	99,375	19/05/2012
2009 erss performance award(v)	–	9,938	–	–	9,938	05/11/2012
Simon Burton						
2008 performance award(ii)	109,378	–	–	–	109,378	28/03/2011
2008 exceptional award(iii)	22,254	–	–	–	22,254	28/03/2011
2009 performance award(iv)		93,125	–	–	93,125	19/05/2012
2009 erss performance award(v)		9,313	–	–	9,313	05/11/2012

(i) The market value of the common shares on the date of grant (28 March 2008) was £2.86.

(ii) The vesting of 2008 RSS awards is subject to two performance conditions. Half of each award is subject to a performance condition measuring the Total Shareholder Return ("TSR") performance of the Company against the TSR performance of a select group of comparator companies, over a three-year performance period. 25% of this half of an award vests for median performance by the Company, rising to 100% vesting of this half of the award for upper quartile performance by the Company or better (with straight-line vesting between these two points). The comparator group of companies comprises Amlin, Arch Capital, Axis Capital, Endurance, Flagstone, Hiscox, Montpelier, Partner Re, Platinum, RenaissanceRe and Validus. The other half of each award is subject to a performance condition based on average annual return on equity ("ROE") over a three-year performance period. If average annual ROE is between the three-month U.S. dollar LIBOR calculated on a daily basis plus 8% and the three-month U.S. dollar LIBOR calculated on a daily basis plus 13% , between 0% and 50% of this half of the award will vest, on a straight-line basis. If average annual ROE is between the three-month U.S. dollar LIBOR calculated on a daily basis plus 13% and the three-month U.S. dollar LIBOR calculated on a daily basis plus 18% or more, between 50% and 100% of this half of the award will vest, on a straight-line basis.

(iii) The exceptional RSS awards were made in 2008 to assist in the continuing incentivisation of executives between the closure in January 2008 of the LTIP to further awards and the future vesting of the RSS awards made subject to performance conditions.

(iv) The vesting of 2009 RSS awards is subject to two performance conditions. Half of each award is subject to a performance condition measuring the Total Shareholder Return ("TSR") performance of the Company against the TSR performance of a select group of comparator companies, over a three-year performance period. 25% of this half of an award vests for median performance by the Company, rising to 100% vesting of this half of the award for upper quartile performance by the Company or better (with straight-line vesting between these two points). The comparator group of companies comprises Amlin, Arch Capital, Aspen, Axis Capital, Endurance, Flagstone, Hiscox, Montpelier, Partner Re, Platinum, RenaissanceRe and Validus. The other half of each award is subject to a performance condition based on average annual return on equity ("ROE" over a three-year performance period. 25% of this part of the award will only vest if average annual ROE over the performance period exceeds the 13 week treasury rate (the average taken quarterly over the performance period) plus 8%. All of this part of the award will vest if the Company's average ROE is equal to the 13 week treasury rate (the average taken quarterly over the performance period) plus 18%. Vesting will take place on a straight-line basis between 25% and 100% for ROE performance.

(v) The remuneration committee reviewed the RSS awards and decided to make a modest increase to the grant levels, recognising that Lancashire is Bermudian based and 'US facing', where long term incentive grant levels tend to be higher. For these awards there is a toughening of the performance conditions compared with the mainstream awards, Total Shareholder Return ("TSR") is the sole performance measure. These awards vest on a straight-line basis with reference to a sliding scale range between the 60th percentile to the 85th percentile for 25% to 100%.

The market value of the common shares at 31 December 2009 was £4.45 and the range during the year was £4.11 to £5.40.

Approved by the Board of Directors and signed on behalf of the Board

GREG LUNN, COMPANY SECRETARY
5 MARCH 2010

We are proud to present the financial results for Lancashire for the year ended 31 December 2009.

Lancashire is a global provider of specialty insurance products operating in Bermuda, London and Dubai. We focus on short-tail, specialty insurance risks, mostly on a direct basis, under four main classes: property, energy, marine and aviation.

Highlights

COMPREHENSIVE INCOME

$388.2 million

(2008 – $104.4 million)

DILUTED EARNINGS PER SHARE

$2.05

(2008 – $0.53 per share)

BASIC EARNINGS PER SHARE

$2.23

(2008 – $0.55 per share)

NET ASSETS

$1,378.9 million

(2008 – $1,272.7 million)

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Statement of Directors' responsibilities

The Directors are responsible for preparing the Group's consolidated financial statements, in accordance with applicable laws and regulations, which give a true and fair view of the state of affairs of the Group and the results of the Group for that period. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS"). Where IFRS is silent, as it is in respect of the measurement of insurance products, U.S. generally accepted accounting principles are considered. Further detail on the basis of preparation is described in the consolidated financial statements. In preparing the consolidated financial statements, the Directors are required to:

- Select suitable accounting policies and apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether they have been prepared in accordance with IFRS;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Prepare the consolidated financial statements on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group, and to enable them to ensure that the consolidated financial statements comply with applicable laws and regulations. They are also responsible for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors have elected to include the corporate governance and remuneration information contained in this annual report, although the Company is not required to include these corporate governance and remuneration disclosures.

Legislation in Bermuda governing the preparation and dissemination of the consolidated financial statements may differ from legislation in other jurisdictions. In addition, the rights of shareholders under Bermuda law may differ from those for shareholders of companies incorporated in other jurisdictions.

Independent auditors' report to the shareholders of Lancashire Holdings Limited

We have audited the accompanying consolidated financial statements of Lancashire Holdings Limited and its subsidiaries (collectively the "Group"), which comprise the consolidated balance sheet as at 31 December 2009 and the consolidated income statement, consolidated statement of changes in shareholders' equity and statement of consolidated cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

We read other information contained in the Annual Report and consider whether it is consistent with the audited consolidated financial statements. This other information comprises the Introduction, Lancashire at a Glance, Chairman's Statement, Business Overview, Business Review, Directors' Report, Corporate Governance, Directors' Remuneration Report and Statement of Directors' Responsibilities. We consider the implications of our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2009, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Ernst & Young Ltd.
5 March 2010
3 Reid Street
Hamilton, Bermuda

Consolidated statement of comprehensive income for the year ended 31 December 2009

	Notes	2009 $m	2008 $m
Gross premiums written	2	627.8	638.1
Outwards reinsurance premiums	2	(50.7)	(63.4)
Net premiums written		**577.1**	**574.7**
Change in unearned premiums	2	22.0	42.2
Change in unearned premiums on premiums ceded	2	(4.4)	(9.6)
Net premiums earned		**594.7**	**607.3**
Net investment income	3	56.0	59.5
Net other investment income (losses)	3, 19	0.3	(0.7)
Net realised gains (losses) and impairments	3, 19	23.8	(11.0)
Net foreign exchange gains (losses)		3.4	(8.5)
Total net revenue		**678.2**	**646.6**
Insurance losses and loss adjustment expenses	2	104.4	418.8
Insurance losses and loss adjustment expenses recoverable	2	(5.7)	(43.3)
Net insurance losses		**98.7**	**375.5**
Insurance acquisition expenses	2, 4	112.6	106.9
Insurance acquisition expenses ceded	2, 4	(6.6)	(7.3)
Other operating expenses	5, 6, 7, 22	76.9	59.9
Total expenses		**281.6**	**535.0**
Results of operating activities		**396.6**	**111.6**
Financing costs	18, 19	8.1	14.0
Profit before tax		**388.5**	**97.6**
Tax	8, 9	3.1	0.1
Profit for the year attributable to equity shareholders		**385.4**	**97.5**
Net change in unrealised gains (losses) on investments	3	2.7	7.1
Tax benefit (expense) on net change in unrealised gains (losses) on investments	8	0.1	(0.2)
Other comprehensive income		**2.8**	**6.9**
Total comprehensive income attributable to equity shareholders		**388.2**	**104.4**
Earnings per share			
Basic	23	$2.23	$0.55
Diluted	23	$2.05	$0.53

Consolidated balance sheet as at 31 December 2009

	Notes	2009 $m	2008 $m
Assets			
Cash and cash equivalents	10, 18	440.0	413.6
Accrued interest receivable	13, 18	12.0	10.1
Investments			
– Fixed income securities			
– Available for sale	11, 18	1,892.5	1,595.4
– At fair value through profit and loss	11, 18	–	4.0
– Equity securities – available for sale	11, 18	–	5.8
Reinsurance assets			
– Unearned premiums on premiums ceded	12	5.6	10.0
– Reinsurance recoveries	12, 13	35.8	42.1
– Other receivables	12, 13	4.3	3.2
Deferred acquisition costs	14	52.9	60.9
Other receivables	13	4.3	154.0
Inwards premiums receivable from insureds and cedants	13	178.2	187.3
Deferred tax asset	9	3.3	1.2
Property, plant and equipment	17	8.2	1.4
Total assets		**2,637.1**	**2,489.0**
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	12	488.9	528.8
– Unearned premiums	12	317.6	339.6
– Other payables	12, 15	15.8	17.6
Amounts payable to reinsurers	12, 15	4.2	2.0
Deferred acquisition costs ceded	16	2.7	1.9
Other payables	15	291.4	190.3
Corporation tax payable	8	2.4	–
Interest rate swap	19	3.6	4.9
Accrued interest payable	18	0.2	0.4
Long-term debt	18	131.4	130.8
Total liabilities		**1,258.2**	**1,216.3**
Shareholders' equity			
Share capital	20	91.2	91.1
Own shares	20	(76.4)	(58.0)
Share premium		2.4	2.4
Contributed surplus		757.0	758.2
Accumulated other comprehensive income	11	30.4	27.6
Other reserves	21	65.3	54.3
Retained earnings		509.0	397.1
Total shareholders' equity attributable to equity shareholders		**1,378.9**	**1,272.7**
Total liabilities and shareholders' equity		**2,637.1**	**2,489.0**

The consolidated financial statements were approved by the Board of Directors on 5 March 2010 and signed on its behalf by:

Martin Thomas Neil McConachie

Consolidated statement of changes in shareholders' equity for the year ended 31 December 2009

	Notes	Share capital $m	Own shares $m	Share premium $m	Contri-buted surplus $m	Accumu-lated other compre-hensive income $m	Other reserves $m	Retained earnings $m	Total $m
Balance as at 31 December 2007		**91.1**	**–**	**2.4**	**758.2**	**20.7**	**43.7**	**299.5**	**1,215.6**
Total comprehensive income for the year	3, 8	–	–	–	–	6.9	–	97.5	104.4
Shares repurchased and held in treasury	20	–	(58.0)	–	–	–	–	–	(58.0)
Dividends on common shares		–	–	–	–	–	–	0.1	0.1
Warrant issues – management and performance	6	–	–	–	–	–	2.4	–	2.4
Option issues	6	–	–	–	–	–	6.7	–	6.7
Restricted stock issues – ordinary and exceptional	6	–	–	–	–	–	1.5	–	1.5
Balance as at 31 December 2008		**91.1**	**(58.0)**	**2.4**	**758.2**	**27.6**	**54.3**	**397.1**	**1,272.7**
Total comprehensive income for the year	3, 8	–	–	–	–	2.8	–	385.4	388.2
Shares repurchased and held in treasury	20	–	(16.9)	–	–	–	–	–	(16.9)
Shares repurchased by trust	20	–	(8.0)	–	–	–	–	–	(8.0)
Shares distributed by trust	20	–	6.5	–	(6.5)	–	–	–	–
Dividends on common shares	15, 20	–	–	–	–	–	–	(225.0)	(225.0)
Dividends on warrants	15, 20	–	–	–	–	–	–	(48.5)	(48.5)
Warrant exercises – founders	20	0.1	–	–	(0.1)	–	–	–	–
Option exercises		–	–	–	5.4	–	(5.4)	–	–
Warrant issues – performance	6	–	–	–	–	–	3.4	–	3.4
Option issues	6	–	–	–	–	–	5.7	–	5.7
Restricted stock issues	6	–	–	–	–	–	7.3	–	7.3
Balance as at 31 December 2009		**91.2**	**(76.4)**	**2.4**	**757.0**	**30.4**	**65.3**	**509.0**	**1,378.9**

Statement of consolidated cash flows for the year ended 31 December 2009

	Notes	2009 $m	2008 $m
Cash flows from operating activities			
Profit before tax		388.5	97.6
Tax paid		(2.7)	(0.9)
Depreciation	7	0.8	1.1
Interest expense	18	6.4	9.8
Interest and dividend income		(64.7)	(59.6)
Accretion of fixed income securities		5.3	–
Equity based compensation	5, 6	16.4	10.6
Foreign exchange (gains) losses		(2.3)	9.4
Net other investment (income) losses	3, 19	(0.3)	0.7
Net realised (gains) losses and impairments	3	(23.8)	11.0
Unrealised (gain) loss on interest rate swaps	19	(1.3)	2.7
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		(32.6)	285.9
– Other assets and liabilities		(11.3)	(7.6)
Net cash flows from operating activities		**278.4**	**360.7**
Cash flows used in investing activities			
Interest and dividends received		62.8	59.4
Net purchase of property, plant and equipment		(7.6)	(0.2)
Dividends received from associate		–	22.7
Purchase of fixed income securities	25	(2,711.6)	(3,882.4)
Purchase of equity securities		–	(31.9)
Proceeds on maturity and disposal of fixed income securities	25	2,440.8	3,402.6
Proceeds on disposal of equity securities		4.8	66.7
Net proceeds on other investments		0.1	4.5
Net cash flows used in investing activities		**(210.7)**	**(358.6)**
Cash flows used in financing activities			
Interest paid		(6.4)	(10.0)
Dividends paid	25	(10.5)	(238.2)
Shares repurchased	25	(24.9)	(68.3)
Net cash flows used in financing activities		**(41.8)**	**(316.5)**
Net increase (decrease) in cash and cash equivalents		**25.9**	**(314.4)**
Cash and cash equivalents at beginning of year		413.6	737.3
Effect of exchange rate fluctuations on cash and cash equivalents		0.5	(9.3)
Cash and cash equivalents at end of year	10	**440.0**	**413.6**

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.

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.

While a number of new or amended IFRS and International Financial Reporting Interpretations Committee standards have been issued there are no standards that have had a material impact. The following standards have been adopted by the Group:

- IFRS 8, Operating Segments, which replaces IAS 14, Segment Reporting has been adopted with no significant changes to the Group's disclosures;
- IAS 1, Presentation of Financial Statements (Revised), has been adopted resulting in minor changes to presentation in the primary statements, most notably within the consolidated statement of changes in shareholders' equity; and
- IFRS 7, Financial Instruments: Disclosures, has been adopted with the additional disclosures required in respect of valuation categories for fixed income securities, included in notes 11 and 19 to the Group's consolidated financial statements. Under the standard's transitional rules prior year comparative disclosure is not required in the year of adoption and has not been presented.

IFRS 9, Financial Instruments: Classification and Measurement, which has been issued but is not yet effective, has not been early adopted by the Group. The Group continues to apply IAS 39, Financial Instruments: Recognition and Measurement and classifies most of it its fixed income securities as available for sale. The new standard is not expected to have a material impact on the results and disclosures reported in the consolidated financial statements, but would result in a re-classification of fixed income securities from available for sale to fair value through profit or loss and a re-classification of the net change in unrealised gains and losses on investments from other comprehensive income to income.

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 78 and also in the risk disclosures section from page 87. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 78.

Estimates may also be made in determining the estimated fair value of certain financial instruments. These are discussed on page 79 and in note 11. 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% 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 statement of comprehensive income. 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 accumulated other comprehensive income 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 acquisition 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 premiums.

Where contract terms require the reinstatement of coverage after an insured's or ceding company's loss, the estimated mandatory reinstatement premiums are recorded as written premiums 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 as an expense 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 ceded which are 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 as an expense 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 in 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 Group'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 losses reported by insureds or ceding companies, as well as a provision for losses which have occurred but which have not yet been reported by insureds or ceding companies. IBNR reserves are estimated by management using various actuarial methods as well as a combination of own loss experience, historical insurance industry loss experience, 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.

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, broker-dealers, recognised indices or pricing vendors. 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 accumulated other comprehensive income in shareholders' equity.

On derecognition of an investment, previously recorded unrealised gains and losses are removed from accumulated other comprehensive income in 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.

Accretion and amortisation of premiums and discounts on available for sale fixed income securities 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 and high liquidity. 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 accumulated other comprehensive income 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 option, swap, forward and future exchange-traded 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 annum
Office furniture and equipment	33% per annum
Leasehold improvements	20% 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 statement of comprehensive income. 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 restricted share scheme. The Group has also operated a management warrant plan and an option plan in the past. The fair value of the equity instruments granted is estimated on the date of grant. The estimated fair value is recognised as an expense pro-rata over the vesting period of the instrument, adjusted for the impact of any non-market vesting conditions. No adjustment to the estimated fair value is made in respect of market vesting conditions.

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

On exercise, the differences between the expense charged to the consolidated statement of comprehensive income 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 statement of comprehensive income in the period to which they relate.

TAX

Income tax 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 statement of comprehensive income 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.

OWN SHARES

Our shares include shares repurchased under shares repurchase authorisations and held in treasury plus shares repurchased and held in trust for the purposes of employee equity-based compensation schemes. Own shares are deducted from shareholders' equity. No gain or loss is recognised on the purchase, sale, cancellation or issue of own shares and any consideration paid or received is recognised directly in equity.

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") program. ERM is co-ordinated by the Chief Risk Officer ("CRO") who reports to the Board of Directors on matters related to risk. The Board of Directors sets the overall risk profile and risk appetite for the Group, while the Group's senior management team is actively involved in all aspects of risk and capital management. Risk Committees are in place at the operating entity level. The Committees provide reports and updates to the operating entity and Group Boards of Directors. The Risk Committees operate within the framework of agreed Terms of Reference and help to define and monitor risk 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. 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. The CRO is responsible for monitoring the adherence to the tolerance levels. Any risk tolerance breaches are reported to the Risk Committees, and thus to the Boards of Directors.

Identification of emerging risks, and monitoring of already recognised risks, is the responsibility of individual risk owners but the process is facilitated by the CRO. Risk owners periodically perform an exercise to identify the Group's most significant risks. Risk reports are provided to the management team on a regular basis to assist in monitoring risk levels, threats and opportunities. The Group's risk register is a fundamental tool for integrating risk and capital management into the day to day operations of the Group, and is a point of reference for decision making and change management. Risk registers also assist in embedding ERM through the Group and strengthen the risk assessment, risk identification, risk monitoring and risk mitigation process. Risk registers are formally reviewed at least quarterly by each risk owner and the CRO.

The Group's ERM framework has four primary drivers:

a. strategy;
b. culture;
c. process; and
d. infrastructure.

a. Strategy
Strategy is the core of the Group's ERM framework and includes risk appetite and performance targets.

b. Culture
The risk management tone is set by the Group Board of Directors and communicated throughout the organisation by the management team. The management team ensures consistent communication of risks across the Group and has established an environment that provides continuous training and development of employees, and a structured method of performance measurement and remuneration.

c. Process
Process incorporates five elements:

- Risk identification;
- Risk assessment;
- Risk mitigation and management;
- Risk measurement and reporting; and
- Roles and responsibilities.

An important component of the ERM process is the quarterly affirmation certification where each risk owner is required to affirm their key risks and the performance of control activities under their remit. Risk owners are also required to comment on control failures or instances of fraud, if they occur, and the status of policies and procedures as part of their affirmations.

d. Infrastructure
Setting and monitoring of risk tolerance limits and design and monitoring of controls is supported by the Group's infrastructure, which includes IT systems and processes and regular management and executive meetings.

INTERNAL AUDIT

Internal audit plays a key role by providing an independent opinion regarding the accuracy and completeness of risks, in addition to verification of the effectiveness of key and compensating controls. Internal audit's roles and responsibilities are clearly defined through the Internal Audit Charter. The head of internal audit reports directly to the Group Audit Committee. The CRO also receives a copy of each audit report and considers the findings and agreed actions in the context of the risk policies and risk management strategy of each area.

The integration of internal audit and ERM into the business helps facilitate the Group's management and the protection of its assets and reputation.

ECONOMIC CAPITAL MODEL

The foundation of the Group's risk based capital approach to decision making is its economic capital model ("BLAST"), which is based on the widely accepted economic capital modeling tool, ReMetrica. Management uses BLAST primarily for monitoring its insurance risks. However, BLAST is also used to monitor the entire spectrum of risks including market, credit and operational risks.

BLAST produces data in the form of a stochastic distribution for all classes, including non-elemental classes. 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, and 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 or across a range of risk categories, with the most significant impact resulting from insurance risks.

BLAST also measures the Group's aggregate insurance exposures. It therefore helps senior management and the Board of Directors determine the level of capital required 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.

BLAST is used in strategic underwriting decisions as part of the Group's annual planning process. Management utilises BLAST in assessing the impact of strategic decisions on individual classes of business that the Group writes, or is considering writing, as well as the overall resulting financial impact to the Group. BLAST output is reviewed, including the anticipated loss curves and combined ratios, to determine profitability and risk tolerance headroom by class. The output from BLAST assists in portfolio optimisation decisions.

In addition, usually on a fortnightly basis, management reviews BLAST output to monitor its expected losses against its risk tolerances for each class of business. Should a tolerance breach occur, action is taken to mitigate the breach and the risk owner is required to produce a breach mitigation plan. A breach form is required which is approved by the CRO and the operating entity CEO. Breaches may be reported to members of management, the Risk Management Forum, the Risk Committee and the Board of Directors, depending on the circumstances.

A. INSURANCE RISK

The Group underwrites worldwide short-tail insurance and reinsurance contracts that transfer insurance risk, 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 premiums 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, amongst other factors. The Group's underwriters assess likely losses using their experience and knowledge of past loss experience, industry trends and current circumstances. This allows them to estimate the premiums sufficient to meet likely losses and expenses.

The Group considers insurance risk at an individual contract level, at a sector level, a 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. These classes are deemed to be the Group's operating segments. The level of insurance risk tolerance per class per occurrence and in aggregate is set by the Risk Committees and ultimately approved by the Board of Directors.

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

- The Group has a rolling three year strategic plan that helps establish the over-riding business goals that the Board of Directors aims to achieve;
- A detailed business plan is produced annually which includes expected premiums and combined ratios by class and considers capital usage and requirements. The plan is approved by the Board of Directors and is monitored and reviewed on an on-going basis;
- BLAST 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 regular basis;
- A daily underwriting meeting is held to peer 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 modeling tools are deployed to simulate catastrophes and resultant losses to the portfolio and the Group; and
- Reinsurance may be purchased to mitigate both frequency and severity of losses.

The Group also maintains targets for the maximum proportion of capital, including long-term debt, that can be lost in a single extreme event or a combination of events.

Some of the Group's business provides coverage for natural catastrophes (i.e. hurricanes, earthquakes and floods) and is subject to potential seasonal variation. A proportion of the Group's business is exposed to large catastrophe losses in North America, Europe and Japan as a result of windstorms. The level of windstorm activity, and landfall thereof, during the North American, European and Japanese wind seasons may materially impact the Group's loss experience. The North American and Japanese wind seasons are typically June to November and the European wind season November to March. 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 and other events.

The Group's exposure to certain events, as a percentage of capital, including long-term debt, are shown below. Net loss estimates are before income tax and net of reinstatement premiums and outward reinsurance.

As at 31 December 2009

		$m	% of capital	$m	% of capital
			100 year return period estimated net loss		**250 year return period estimated net loss**
Zones	**Perils**				
Gulf of Mexico(1)	Hurricane	278.5	18.4	391.2	25.9
California	Earthquake	190.1	12.6	292.6	19.4
Pan-European	Windstorm	163.2	10.8	261.7	17.3
Japan	Earthquake	138.2	9.2	236.1	15.6
Japan	Typhoon	86.3	5.7	170.8	11.3

(1) Landing hurricane from Florida to Texas

As at 31 December 2008

		$m	% of capital	$m	% of capital
			100 year return period estimated net loss		**250 year return period estimated net loss**
Zones	**Perils**				
Gulf of Mexico(1)	Hurricane	250.2	17.8	357.1	25.4
California	Earthquake	177.1	12.6	255.6	18.2
Pan-European	Windstorm	143.7	10.2	203.0	14.5
Japan	Earthquake	213.3	15.2	244.2	17.4
Japan	Typhoon	110.3	7.9	170.4	12.1

(1) Landing hurricane from Florida to Texas

There can be no guarantee that the modeled assumptions and techniques deployed in calculating these figures are accurate. There could also be an unmodeled loss which exceeds these figures. In addition, any modeled loss scenario could cause a larger loss to capital than the modeled expectation.

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

	2009		2008	
	$m	%	$m	%
Property	317.3	50.5	302.7	47.5
Energy	175.5	28.0	185.2	29.0
Marine	73.7	11.7	78.6	12.3
Aviation	61.3	9.8	71.6	11.2
Total	**627.8**	**100.0**	**638.1**	**100.0**

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

	2009		2008	
	$m	%	$m	%
Worldwide offshore	227.3	36.2	232.6	36.5
U.S. and Canada	158.3	25.2	112.8	17.7
Worldwide, including the U.S. and Canada(1)	119.2	19.0	124.2	19.4
Europe	36.2	5.8	42.0	6.6
Worldwide, excluding the U.S. and Canada(2)	35.6	5.7	48.5	7.6
Far East	13.2	2.1	17.3	2.7
Middle East	11.9	1.9	12.4	1.9
Rest of World	26.1	4.1	48.3	7.6
Total	**627.8**	**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 U.S. 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:

	2009 $m	2008 $m
Property direct and facultative	88.6	93.8
Property catastrophe excess of loss	76.3	23.4
Terrorism	69.1	75.5
Property retrocession	61.2	76.4
Property political risk	15.5	28.1
Other property	6.6	5.5
Total	**317.3**	**302.7**

Property direct and facultative business is typically written on a first loss basis, i.e. for a limit smaller than the total insured values, on an excess of loss basis where the exposure is excess of a deductible retained by the insured, plus lower layers of coverage provided by other (re)insurers. Cover is generally provided to medium to large commercial and industrial enterprises with high value locations 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 usually includes indemnification for both property damage and business interruption.

Property catastrophe excess of loss covers elemental risks and is written on an excess of loss treaty basis. The property catastrophe excess of loss portfolio is written within the U.S. and also internationally. Cover is offered for specific perils and regions or countries.

Terrorism business is written on an excess of loss basis and can be written either ground up (i.e. the insured does not retain a deductible) or for primary or excess layers, with cover provided for U.S. and worldwide property risks, but excluding nuclear, chemical and biological coverage in most territories. Cover is, as for direct and facultative business, generally provided to medium to large commercial and industrial enterprises. Policies are typically written for scheduled locations and exposure is controlled by setting limits on aggregate exposure within a "blast zone" radius. Some national pools are also written, which may include nuclear, chemical and biological coverage.

Property retrocession is written on an excess of loss basis through treaty arrangements and covers elemental perils. 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.

Political risk cover is generally written on a ground up excess of loss basis, on an individual case by case basis and coverage can vary significantly between policies. Within its political risk class the Group also offers cover for sovereign and quasi-sovereign credit risk. The Group does not currently write private obligor trade credit.

The Group is exposed to large natural catastrophic losses, such as windstorm and earthquake loss, from assuming property catastrophe excess of loss and property retrocession portfolio risks and also from its property direct and facultative portfolio. Exposure to such events is controlled and measured by setting limits on aggregate exposures in certain classes per geographic zone and through loss modeling. The accuracy of the latter exposure analysis is limited by the quality of data and effectiveness of the modeling. It is possible that a catastrophic event significantly exceeds the expected modeled event loss. The Group's appetite and exposure guidelines to large losses are set out on page 83.

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:

	2009 $m	2008 $m
Worldwide offshore energy	100.5	76.3
Gulf of Mexico offshore energy	53.8	74.3
Construction energy	10.7	21.5
Onshore energy	7.8	10.0
Other energy	2.7	3.1
Total	**175.5**	**185.2**

Energy risks are written mostly on a direct excess of loss basis and may be ground up or on primary or high excess of loss basis. Worldwide offshore energy policies are typically "package" policies which may include physical damage, business interruption and third party liability sections. Coverage can include fire and explosion and occasionally elemental perils. Individual assets covered can be high value and therefore most are written on a subscription basis.

Gulf of Mexico offshore 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 modeling. The accuracy of this exposure analysis is limited by the quality of data and effectiveness of the modeling. 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 83. Most policies have sub-limits on coverage for elemental losses.

Construction energy contracts generally cover all risks of platform and drilling units under construction. 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.

Reinsurance protection may be purchased to protect a portion of loss from elemental and non-elemental energy claims, and from the accumulation of smaller, attritional losses.

c. Marine
Gross premiums written, for the year:

	2009 $m	2008 $m
Marine hull and total loss	25.6	30.6
Marine hull war	20.0	11.3
Marine builders risk	16.7	26.3
Marine P&I clubs	10.0	9.2
Other marine	1.4	1.2
Total	**73.7**	**78.6**

Marine business is predominantly written on an excess of loss basis.With the exception of the marine P&I clubs where high excess layers are written, most policies are written on a ground up basis. 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 hull war is direct insurance of loss of vessels from war, piracy or terrorist attack. Marine builders risk covers the building of ocean going vessels in specialised yards worldwide. Marine P&I is mostly the reinsurance of The International Group of Protection and Indemnity Clubs. Marine cargo programs are not normally written.

The largest expected exposure in the marine class 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:

	2009 $m	2008 $m
AV52	52.9	51.2
Aviation reinsurance	–	13.7
Other aviation	8.4	6.7
Total	**61.3**	**71.6**

AV52 is written on a risk attaching excess of loss basis and provides coverage for third party liability, excluding own passenger liability, resulting from acts of war or hijack of aircraft, excluding U.S. commercial airlines and certain other countries whose governments provide a backstop coverage. Other aviation business includes aviation hull war risks and contingent hull, which the Group writes from time to time. The Group does not presently write general aviation business, including hull and liabilities.

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, amongst other factors. The Group Reinsurance Security Committee ("GRSC") has defined limits by reinsurer by rating and an aggregate exposure to a rating band. The GRSC 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 such obligations. The GRSC monitors the credit-worthiness of its reinsurers on an ongoing basis and meets formally at least quarterly.

Reinsurance protection is typically purchased on an excess of loss basis 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 structure varies between types of peril and subclass. 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 these point estimates. 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. This independent review is presented to the Group's Audit Committee. The Group has also established Large Loss and Reserve Committees at the operating entity level, which have responsibility for the review of large claims, their development and any changes in reserving methodology and assumptions on a quarterly basis.

The extent of reliance on management's 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 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 other 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 insureds, 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 business, 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 claims 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 the allocation of claims to the specific 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 2009 management's estimates for IBNR represented 43.8% of total net loss reserves (2008 – 32.6%). 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, insurance, debt and currency risks. These risks, and the management thereof, are described below.

a. Investment risk

Movements in investments resulting from changes in interest and inflation rates, amongst other factors, may lead to an adverse impact on the value of the Group's investment portfolio. Investment guidelines are established by the Investment Committee of the Board of Directors to manage this risk. 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 near term obligations and 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 within an agreed range. 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 or other defined funding needs. 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 objectives of this portion of assets are capital preservation and providing liquidity to meet insurance and other near term obligations.

Assets in excess of those required to be held in the core portfolio, are typically held in the "core plus" or "surplus" portfolios. 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 also be invested 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 of the surplus portfolio may be slightly longer than the core or core plus portfolio, while maintaining a focus on high quality assets. Currently, the Group does not hold any equity securities or 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. Conversely, if the risk profile is expected to move outside of tolerance levels, adjustments may be made to reduce the risks in the portfolio.

The Group's fixed income portfolios are managed by three external investment managers. The equity portfolio was managed by one investment manager and was fully liquidated in the first half of 2009. The performance of the managers is monitored on an on-going basis.

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

As at 31 December 2009	$m	%	$m	%	$m	%	$m	%
	Core		Core plus		Surplus		Total	
Available for sale – external								
– Short-term investments	164.3	8.7	3.5	0.2	14.5	0.8	182.3	9.7
– U.S. treasuries	49.8	2.6	8.4	0.4	196.6	10.4	254.8	13.4
– Other government bonds	14.0	0.7	–	–	62.3	3.3	76.3	4.0
– U.S. government agency debt	35.1	1.9	10.7	0.6	69.2	3.7	115.0	6.2
– U.S. government agency mortgage backed securities	64.0	3.4	16.4	0.9	404.0	21.3	484.4	25.6
– Corporate bonds	151.0	8.0	11.8	0.6	317.0	16.8	479.8	25.4
– Corporate bonds – FDIC guaranteed(1)	124.3	6.5	5.0	0.3	64.1	3.4	193.4	10.2
Total available for sale – external	**602.5**	**31.8**	**55.8**	**3.0**	**1,127.7**	**59.7**	**1,786.0**	**94.5**
Available for sale – internal								
– Short-term investments	106.5	5.5	–	–	–	–	106.5	5.5
Total fixed income securities	**709.0**	**37.3**	**55.8**	**3.0**	**1,127.7**	**59.7**	**1,892.5**	**100.0**

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

As at 31 December 2008	$m	%	$m	%	$m	%	$m	%
	Core		Core plus		Surplus		Total	
Available for sale – external								
– Short-term investments	101.5	6.4	9.9	0.6	52.2	3.3	163.6	10.3
– 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	22.0	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 – external	**745.0**	**46.6**	**201.4**	**12.5**	**649.0**	**40.6**	**1,595.4**	**99.7**
At fair value through profit and loss – external								
– 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 U.S. government

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

	2009		2008	
as at 31 December	$m	%	$m	%
Sector				
Financial	344.1	51.1	254.6	55.2
Industrial	262.9	39.1	172.7	37.5
Utility	52.7	7.8	15.7	3.4
Other	13.5	2.0	18.1	3.9
Total	**673.2**	**100.0**	**461.1**	**100.0**

The financial sector allocation includes $193.4 million (2008 – $153.4 million) of FDIC guaranteed bonds.

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.

Following the liquidation of its equity portfolio in the first half of 2009, the Group has no exposure to valuation risk from equity securities. The impact on net unrealised gains and losses of a 10% fall in the value of the Group's equity portfolio at 31 December 2008 would have been $0.6 million. Valuation risk in the equity portfolio was mitigated by diversifying the portfolio across sectors.

The Group's investment portfolio is comprised mainly of 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 securities would tend to rise and vice versa.

The sensitivity of the price of fixed income securities and certain derivatives to movements in interest rates is indicated by their duration(1). The greater a security's duration, the greater its price volatility to movements in interest rates. The sensitivity of the Group's fixed income and derivative investment portfolio to interest rate movements is detailed below, assuming linear movements in interest rates:

	2009		2008	
as at 31 December	$m	%	$m	%
Immediate shift in yield (basis points)				
100	(56.7)	(3.0)	(43.1)	(2.7)
75	(42.5)	(2.2)	(32.3)	(2.0)
50	(28.3)	(1.5)	(21.6)	(1.4)
25	(14.2)	(0.7)	(10.8)	(0.7)
(25)	10.0	0.5	6.6	0.4
(50)	20.0	1.1	13.1	0.8
(75)	29.9	1.6	19.7	1.2
(100)	39.9	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 portfolio's response to changes in interest rates has been factored into the data above

The Group mitigates interest rate risk on the investment portfolio by establishing and monitoring duration ranges in its investment guidelines. The duration of the core portfolio is matched to the modeled duration of the insurance reserves, within a permitted range. The permitted duration range for the core plus portfolio is between one and four years and the surplus portfolio is between one and five years.

The duration of the externally managed portfolios, expressed in years, is as follows:

As at 31 December	2009	2008
Core portfolio	1.6	1.7
Core plus portfolio	1.9	1.4
Surplus portfolio	3.2	2.6

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

The VaR calculation is performed using variance/covariance risk modeling 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 the 95th percentile confidence level. Management also monitors the 99th percentile confidence level. The ninety day VaR, at the 95th percentile confidence level, measures the minimum amount the assets should be expected to lose in a ninety day time horizon, under normal conditions, 5% of the time. The current VaR tolerance is 4.0% of shareholders' equity, using the ninety day VaR at the 95th percentile confidence level.

The Group's VaR calculations are as follows:

	2009		2008	
As at 31 December	$m	%	$m	%
95th percentile confidence level	40.4	2.9	43.1	3.4
99th percentile confidence level	57.0	4.1	60.9	4.8

DERIVATIVE FINANCIAL INSTRUMENTS

The Group may utilise derivative instruments for yield enhancement, duration management, interest rate and foreign currency exposure management, or to obtain an exposure to a specific financial market, currency or product. The Group currently invests in the following derivative financial instruments:

MORTGAGE BACKED "TO BE ANNOUNCED" SECURITIES ("TBAs")

The TBA market is essentially a forward or delayed delivery market for mortgage-backed securities issued by U.S. government agencies, where securities of a specific term and interest rate are bought or sold for future settlement on a "to be announced" basis. TBAs are generally physically settled and classified as available for sale fixed income securities. Occasionally TBAs may be traded for net settlement. Such instruments are deemed to be derivative instruments. All TBAs classified as derivatives are held on a non-leveraged basis. The credit exposure is restricted to the differential between the settlement value of the forward purchase and the forward sale. The credit-worthiness of the counter-party is monitored and collateral may be required on open positions.

The estimated fair value of TBA positions is an asset and corresponding liability of $nil (2008 – $116.4 million).

FUTURES

The Group's investment guidelines only permit the use of futures that are exchange-traded. Such futures provide the Group with participation in market movements, determined by the underlying instrument on which the futures contract is based, without holding the instrument itself or the individual securities. This approach allows the Group more efficient and less costly access to the exposure than would be available by the exclusive use of individual fixed income and money market securities. Exchange-traded futures contracts may also be used as substitutes for ownership of the physical securities.

All futures contracts are held on a non-leveraged basis. An initial margin is provided, which is a deposit of cash and/or securities in an amount equal to a prescribed percentage of the contract value. The fair value of futures contracts is estimated daily and the margin is adjusted accordingly with unrealised gains and/or losses settled daily in cash and/or securities. A realised gain or loss is recognised when the contract is closed.

Futures contracts expose the Group to market risk to the extent that adverse changes occur in the estimated fair values of the underlying securities. Exchange-traded futures are, however, subject to a number of safeguards to ensure that obligations are met, including: the use of clearing houses (thus reducing counter-party credit risk); the posting of margins; and the daily settlement of unrealised gains and losses. The amount of credit risk is therefore considered low.

The notional value of open futures contracts as at 31 December 2009 is as follows:

	$m	$m
	Long	**Short**
Eurodollar futures contracts	570.0	–

A Eurodollar futures contract is an exposure to 3 month LIBOR, based on a commitment to a $1.0 million deposit. The estimated fair value based on expectations of 3 month LIBOR, is determined using exchange-traded prices, and is negligible as at 31 December 2009. The contracts currently held by the Group expire in December 2010. There were no Eurodollar futures contracts in place during 2008.

The sensitivity of the Group's Eurodollar futures position to interest rate movements as at 31 December 2009 is detailed below:

(basis points)	**$m**
Immediate shift in 3 month LIBOR	
100	(1.4)
75	(1.1)
50	(0.7)
25	(0.4)
(25)	0.4
(50)	0.7
(75)	1.1
(100)	1.4

OPTIONS

The Group's investment guidelines only permit the use of options which are exchange-traded. Options are held on a similar basis to futures and are subject to similar safeguards. Options are contractual arrangements that give the purchaser the right, but not the requirement, to either buy or sell an instrument at a specific set price at a future date, which may or may not be pre-determined. There were no open option contracts in place as at 31 December 2009 and there were no options contracts in place during 2008.

The net gains or losses recognised in the consolidated statement of comprehensive income on exchange-traded derivatives in 2009 were as follows:

	$m
Eurodollar futures contracts	1.6
Treasury futures contracts	(1.7)
Options on treasury futures contracts	0.2
Total	**0.1**

b. Insurance risk
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 method to mitigate insurance market risk is to maintain strict underwriting standards. The Group manages insurance market risk in numerous ways, including the following:

- Reviews and amends underwriting plans and budgets as necessary;
- Reduces exposure to market sectors where conditions have reached unattractive levels;
- Purchases appropriate cost effective 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 risk
The Group has issued long-term debt as described in note 18. The loan notes bear interest at a floating rate that is re-set on a quarterly basis, plus a fixed margin of 3.70%. 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 interest rate swap contracts as follows:

	Maturity date	Prepayment date	Interest hedged
Subordinated loan notes $97.0 million	15 December 2035	15 March 2011	50%
Subordinated loan notes €24.0 million	15 June 2035	15 March 2011	50%

The swaps expire on 15 March 2011.

In certain circumstances the subordinated loan notes can be prepaid from 16 December 2005, with a sliding scale redemption price penalty which reduces to zero by 15 March 2011. Refer to note 18 for further details.

The current Euribor interest rate on 50% of the Euro subordinated loan notes has been set at 0.71% (2008 – 3.33%). The current LIBOR interest rate on 50% of the US dollar subordinated loan notes has been set at 0.25% (2008 – 2.00%). The Group has no 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 hedges non-U.S. dollar liabilities primarily with non-U.S. dollar assets. The Group's main foreign currency exposure relates to its insurance obligations, cash holdings, premiums receivable, dividends due 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	$m	$m	$m	$m	$m
	U.S. $	Sterling	Euro	Other	Total
Cash and cash equivalents	124.9	271.1	37.8	6.2	440.0
Accrued interest receivable	12.0	–	–	–	12.0
Fixed income securities – available for sale	1,892.5	–	–	–	1,892.5
Reinsurance assets	45.7	–	–	–	45.7
Deferred acquisition costs	43.4	1.0	4.6	3.9	52.9
Other receivables	4.0	0.3	–	–	4.3
Inwards premiums receivable from insureds and cedants	143.6	4.8	19.1	10.7	178.2
Deferred tax asset	–	3.3	–	–	3.3
Property, plant and equipment	6.9	1.3	–	–	8.2
Total assets as at 31 December 2009	**2,273.0**	**281.8**	**61.5**	**20.8**	**2,637.1**

Liabilities	$m	$m	$m	$m	$m
	U.S. $	Sterling	Euro	Other	Total
Losses and loss adjustment expenses	445.0	3.6	21.4	18.9	488.9
Unearned premiums	265.8	8.4	22.7	20.7	317.6
Insurance contracts – other payables	12.4	0.2	2.1	1.1	15.8
Amounts payable to reinsurers	4.2	–	–	–	4.2
Deferred acquisition costs ceded	2.7	–	–	–	2.7
Other payables	18.9	274.6	0.3	–	293.8
Interest rate swap	3.0	–	0.6	–	3.6
Accrued interest payable	0.1	–	0.1	–	0.2
Long-term debt	97.0	–	34.4	–	131.4
Total liabilities as at 31 December 2009	**849.1**	**286.8**	**81.6**	**40.7**	**1,258.2**

Assets	$m	$m	$m	$m	$m
	U.S. $	Sterling	Euro	Other	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 premiums receivable from insureds and cedants	143.9	7.8	25.0	10.6	187.3
Deferred tax asset	–	1.2	–	–	1.2
Property, plant and equipment	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	$m	$m	$m	$m	$m
	U.S. $	**Sterling**	**Euro**	**Other**	**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% up and 10% down against the U.S. dollar at the year end spot rates would be an increase or decrease of $0.7 million (2008 – $0.4 million).

C. LIQUIDITY RISK

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 main exposures to liquidity risk are with respect to its insurance and investment activities. 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.

Exposures in relation to insurance activities are as follows:
- Large catastrophic events, or multiple medium-sized events in quick succession, resulting in a requirement to pay a large amount of claims within a relatively short time-frame;
- Failure of insureds or cedants to meet their contractual obligations with respect to the payment of premiums in a timely manner; and
- Failure of reinsurers to meet their contractual obligations with respect to the payment of claims in a timely manner.

Exposures in relation to investment activities are as follows:
- Adverse market movements and/or a duration mismatch to obligations, resulting in investments being disposed of at a significant realised loss; and
- An inability to liquidate investments due to market conditions.

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

As at 31 December 2009	$m	$m	$m	$m
	Core	**Core plus**	**Surplus**	**Total**
Fixed income securities – external				
Less than one year	180.4	4.8	29.1	214.3
Between one and two years	120.1	3.5	131.2	254.8
Between two and three years	156.2	15.3	152.0	323.5
Between three and four years	39.8	14.3	70.1	124.2
Between four and five years	38.6	1.5	193.0	233.1
Over five years	3.4	–	148.3	151.7
Mortgage backed securities	64.0	16.4	404.0	484.4
Total fixed income securities – external	**602.5**	**55.8**	**1,127.7**	**1,786.0**
Fixed income securities – internal				
Less than one year	106.5	–	–	106.5
Total	**709.0**	**55.8**	**1,127.7**	**1,892.5**

As at 31 December 2008	$m	$m	$m	$m
	Core	Core plus	Surplus	Total
Fixed income securities – external				
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 fixed income securities – external	**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 2009	$m	$m	$m	$m	$m	$m
		Years until liability becomes due – undiscounted values				
	Balance sheet	Less than one	One to three	Three to five	Over five	Total
Losses and loss adjustment expenses	488.9	183.5	181.7	67.0	56.7	488.9
Insurance contracts – other payables	15.8	12.7	2.4	0.7	–	15.8
Amounts payable to reinsurers	4.2	4.2	–	–	–	4.2
Other payables	291.4	291.4	–	–	–	291.4
Corporation tax payable	2.4	2.4	–	–	–	2.4
Interest rate swap	3.6	2.9	0.7	–	–	3.6
Accrued interest payable	0.2	0.2	–	–	–	0.2
Long-term debt	131.4	5.2	10.7	10.7	243.1	269.7
Total	**937.9**	**502.5**	**195.5**	**78.4**	**299.8**	**1,076.2**

As at 31 December 2008	$m	$m	$m	$m	$m	$m
		Years until liability becomes due – undiscounted values				
	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 18. 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 Group has established asset allocation and maturity parameters within the investment guidelines such that the majority of the 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 premiums 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% of shareholders' equity, with the exception of U.S. government and agency securities. In addition, no one issuer, with the exception of U.S government and agency securities, should exceed 5% 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 U.S. government and government agencies.

Credit risk on derivative instruments is mitigated by the use of exchange-traded instruments which use clearing houses to reduce counter-party credit risk, require the posting of margins and settle unrealised gains and losses daily.

Credit risk on inwards premiums receivable from insureds and cedants is managed by conducting business with reputable broking organisations with whom the Group has established relationships and by rigorous cash collection procedures. The Group also has a broker approval process in place. Credit risk from reinsurance recoverables is primarily managed by review and approval of reinsurer security by the GRSC as discussed on page 86.

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.

As at 31 December 2009	**$m**	**$m**	**$m**	**$m**
	Equity securities and other investments	**Cash and fixed income securities**	**Inwards premiums receivable and other receivables**	**Reinsurance recoveries**
AAA	–	1,830.6	–	–
AA+, AA, AA-	–	110.8	–	–
A+, A, A-	–	295.9	4.3	35.8
BBB+, BBB, BBB-	–	95.0	–	–
Other	–	0.2	182.5	–
Total	**–**	**2,332.5**	**186.8**	**35.8**

As at 31 December 2008	$m	$m	$m	$m
	Equity securities and other investments	Cash and fixed income securities	Inwards premiums receivable 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 premiums receivables that are past due but not impaired:

As at 31 December	2009 $m	2008 $m
Less than 90 days past due	8.6	8.1
Between 91 and 180 days past due	0.4	1.4
Over 180 days past due	0.3	0.5
Total	**9.3**	**10.0**

Provisions of $1.4 million (2008 – $1.5 million) have been made for impaired or irrecoverable balances and $0.2 million (2008 – $1.4 million) was charged to the consolidated statement of comprehensive income in respect of bad debts. 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, inadequate health and safety for employees, damage to physical assets, business disruption, system failure and transaction processing failure. The Group's main operational risks are as follows:

- Underwriters may operate outside of approved authority levels;
- Employees may fail to comply with the Group's operating guidelines;
- IT systems may fail to meet business needs;
- Key processes may fail, leading to delays and/or inaccurate or untimely management information;
- Effective and comprehensive enterprise risk management practices and philosophies may not be embedded throughout the Group;
- Unintended insurance coverage may be provided or received due to the misinterpretation of insurance contract policy wording;
- Management may fail to address or identify an unforeseen or unexpected risk;
- Compliance and regulatory failures; and
- Loss of key personnel.

The Group has a robust self governance framework. Policies and procedures are documented, reviewed and updated when necessary and affirmed by management on a quarterly basis. The Group's internal audit function considers the accuracy and completeness of key risks and controls, and independently verifies the effective operation of these through substantive testing. All higher risk areas are subject to annual audit, with all other areas audited, on a rotational basis, at least once every three years.

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

The Group has identified several strategic risks. These include the risks that either the poor execution of the business plan or poor business planning in itself results in a strategy that fails to adequately reflect the trading environment, resulting in an inability to optimise performance. The Group has also identified risks from the failure to maintain adequate capital, accessing capital at an inflated cost or the inability to access capital. This includes unanticipated changes in regulatory and/or rating agency models that could result in an increase in capital requirements or a change in the type of capital required. Lastly, the Group has identified succession planning, staff retention and key man risk as strategic risks.

The Group addresses the risks associated with planning and execution of the business plan through a combination of the following:

- An iterative annual budget process with cross departmental involvement;
- Approval of the annual budget by the Board of Directors;
- Regular monitoring of actual versus budgeted results; and
- Periodic review and re-forecasting as market conditions change.

Risks associated with the effectiveness of the Group's capital management are mitigated as follows:

- Regular monitoring of current regulatory and rating agency capital requirements;
- Oversight of capital requirements by the Board of Directors; and
- Maintaining contact with regulators and rating agencies in order to stay abreast of upcoming developments.

Risks associated with succession planning, staff retention and key man risks are mitigated through a combination of resource planning processes and controls, including:

- The identification of key personnel with appropriate succession plans;
- Documented recruitment procedures, position descriptions and employment contracts; and
- Resource monitoring and the provision of appropriate compensation and training schemes.

a. Capital risk management

The total capital of the Group as at 31 December 2009 is determined as $1,510.3 million (2008 – $1,403.5 million) comprising $1,378.9 million of shareholders' equity (2008 – $1,272.7 million) and $131.4 million of long-term debt (2008 – $130.8 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;
- Maintaining adequate financial strength ratings; and
- Meeting internal and regulatory capital requirements.

Capital is increased or returned as appropriate. The retention of earnings generated leads to an increase in capital. Capital raising can include debt or equity and returns of capital may be made through dividends, share repurchases, a redemption of debt or any combination thereof. 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 entities also conduct capital requirement assessments under internal measures and local regulatory requirements. Refer to note 26 for a discussion of the regulatory capital requirements of the Group's operating entities.

b. Risk adjusted return

The Group's aim is to provide its shareholders with a return on equity of 13% in excess of a risk-free rate over the insurance cycle. The return is generated within a broad framework of risk parameters. 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 of 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.

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	17.8%	14.0%	14.0%
31 December 2007	31.4%	22.4%	50.3%
31 December 2008	7.8%	17.9%	63.7%
31 December 2009	26.5%	19.8%	105.8%

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

IRR achieved in excess of the three 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	13.0%	9.2%	9.2%
31 December 2007	26.9%	17.8%	40.8%
31 December 2008	6.4%	14.3%	52.7%
31 December 2009	26.4%	17.1%	94.6%

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

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. On 16 March 2009 LHL was listed on the main market of the London Stock Exchange ("LSE"); previously LHL was listed on AIM, a subsidiary market of the 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. The registered office from 1 March 2010 will be Power House, 7 Par-La-Ville Road, 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. These classes are therefore deemed to be the Group's operating segments for the purposes of segment reporting. Further sub-classes of business are underwritten within each operating segment. The nature of these individual sub-classes is discussed further in the risk disclosures section on pages 84 to 86. Operating segment performance is measured by the net underwriting profit or loss and the combined ratio.

All amounts reported are transactions with external parties. There are no inter-segmental transactions and there are no insurance or reinsurance contracts that insure or reinsure risks in Bermuda, the Group's country of domicile.

2. Segmental reporting continued

Revenue and expense by operating segment – for the year ended 31 December 2009

Gross premiums written	**$m**	**$m**	**$m**	**$m**	**$m**
	Property	**Energy**	**Marine**	**Aviation**	**Total**
Analysed by geographical zone:					
Worldwide offshore	1.0	154.9	71.4	–	227.3
U.S. and Canada	156.0	2.2	0.1	–	158.3
Worldwide, including the U.S. and Canada(1)	51.5	7.4	(0.6)	60.9	119.2
Europe	30.3	3.5	2.1	0.3	36.2
Worldwide, excluding the U.S. and Canada(2)	35.1	–	0.4	0.1	35.6
Far East	10.9	2.1	0.2	–	13.2
Middle East	8.6	3.3	–	–	11.9
Rest of World	23.9	2.1	0.1	–	26.1
Total	**317.3**	**175.5**	**73.7**	**61.3**	**627.8**
Outwards reinsurance premiums	(17.2)	(13.5)	(9.3)	(10.7)	(50.7)
Change in unearned premiums	(14.8)	14.9	9.8	12.1	22.0
Change in unearned premiums ceded	(1.8)	(4.3)	1.7	–	(4.4)
Net premiums earned	**283.5**	**172.6**	**75.9**	**62.7**	**594.7**
Insurance losses and loss adjustment expenses	8.9	(82.6)	(29.4)	(1.3)	(104.4)
Insurance losses recoverable	–	5.7	–	–	5.7
Insurance acquisition expenses	(37.8)	(37.8)	(23.1)	(13.9)	(112.6)
Insurance acquisition expenses ceded	2.0	2.9	0.7	1.0	6.6
Net underwriting profit	**256.6**	**60.8**	**24.1**	**48.5**	**390.0**
Net unallocated income and expenses					(1.5)
Profit before tax					**388.5**
Loss ratio	(3.1%)	44.6%	38.7%	2.1%	16.6%
Acquisition cost ratio	12.6%	20.2%	29.5%	20.6%	17.8%
Expense ratio	–	–	–	–	10.2%
Combined ratio	**9.5%**	**64.8%**	**68.2%**	**22.7%**	**44.6%**

(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 U.S. and Canada

2. Segmental reporting continued

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

Gross premiums written	**$m**	**$m**	**$m**	**$m**	**$m**
	Property	**Energy**	**Marine**	**Aviation**	**Total**
Analysed by geographical zone:					
Worldwide offshore	0.9	159.1	72.6	–	232.6
U.S. and Canada	108.5	4.2	0.1	–	112.8
Worldwide, including the U.S. and Canada[(1)]	44.5	7.2	2.1	70.4	124.2
Europe	34.1	4.6	2.9	0.4	42.0
Worldwide, excluding the U.S. and Canada[(2)]	47.5	0.5	0.2	0.3	48.5
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**
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	**137.2**	**(68.6)**	**13.1**	**50.5**	**132.2**
Net unallocated income and expenses					(34.6)
Profit before tax					**97.6**
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%**

(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 U.S. and Canada

3. Investment return

The total investment return for the Group is as follows:

	2009 $m	2008 $m
Net investment income		
– Interest on fixed income securities	62.6	46.5
– Net (accretion) amortisation	(5.2)	3.5
– Interest income on cash and cash equivalents	2.1	12.2
– Dividends from equity securities	–	0.9
– Investment management and custodian fees	(3.5)	(3.6)
Net investment income	**56.0**	**59.5**
Net other investment income (loss)[1]	**0.3**	**(0.7)**
Net realised gains (losses) and impairments		
– Fixed income securities	24.7	10.6
– Equity securities	(1.0)	(21.6)
– Derivative financial instruments	0.1	–
Net realised gains (losses) and impairments	**23.8**	**(11.0)**
Net change in unrealised gains recognised in other comprehensive income		
– Fixed income securities	2.7	16.5
– Equity securities	–	(9.4)
Net change in unrealised gains (losses)	**2.7**	**7.1**
Total investment return	**82.8**	**54.9**

(1) A share of loss of associate of $0.2 million is included in the year ended 31 December 2008

Net realised gains (losses) and impairments includes an impairment loss of $0.4 million (2008 – $21.6 million) recognised on fixed income and equity securities held by the Group.

Movements within unrealised gains and losses within accumulated other comprehensive income are as follows:

	2009 $m	2008 $m
Fixed income securities		
– Net unrealised gains released	(21.8)	(3.7)
– Net unrealised gains recorded	24.1	17.6
– Net unrealised losses released for impairments	0.4	2.6
Equity securities		
– Net unrealised losses (gains) released	1.1	(1.0)
– Net unrealised losses recorded	(1.1)	(20.6)
– Net unrealised losses released for impairments	–	12.2
Net change in unrealised gains (losses) on investments	**2.7**	**7.1**

4. Net insurance acquisition expenses

	2009 $m	2008 $m
Insurance acquisition expenses	104.6	110.0
Changes in deferred insurance acquisition expenses	8.0	(3.1)
Insurance acquisition expenses ceded	(5.2)	(6.1)
Changes in deferred insurance acquisition expenses ceded	(1.4)	(1.2)
Total	**106.0**	**99.6**

5. Other operating expenses

	2009 $m	2008 $m
Operating expenses unrelated to underwriting	60.5	49.3
Equity based compensation	16.4	10.6
Total	**76.9**	**59.9**

6. Employee benefits

	2009 $m	2008 $m
Wages and salaries	15.7	14.2
Pension costs	1.5	1.2
Bonus and other benefits	18.4	9.6
Equity based compensation	16.4	10.6
Total	**52.0**	**35.6**

Equity based compensation
The Group's primary equity based compensation scheme is its restricted stock scheme ("RSS"). Previously the Group also administered a warrant plan and a long term incentive plan ("LTIP").

The following charges are included in other operating expenses in the consolidated statement of comprehensive income:

	2009 $m	2008 $m
RSS – ordinary	6.8	1.1
RSS – exceptional	0.5	0.4
LTIP	5.7	6.7
Warrants – ordinary	–	3.3
Warrants – performance	3.4	(0.9)
Total	**16.4**	**10.6**

RSS – ordinary
On 4 January 2008 the LTIP was closed and replaced with an RSS. RSS are 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. A maximum of 50% 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% of ordinary restricted share awards will vest only on the achievement of a return on equity by LHL in excess of a required amount.

6. Employee benefits continued

Ordinary restricted shares	Number	Weighted average fair value
Granted during the year	1,851,701	$5.75
Forfeited during the year	(18,914)	$5.73
Outstanding as at 31 December 2008	**1,832,787**	**$5.75**
Granted during the year	2,480,125	$7.79
Forfeited during the year	(20,029)	$5.73
Outstanding as at 31 December 2009	**4,292,883**	**$6.93**
Issuable as at 31 December 2009	**–**	**–**

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. The fair value of ordinary restricted share awards granted ranges between $5.73 and $8.58.

RSS – exceptional

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

Exceptional restricted shares	Number	Weighted average fair value
Granted during the year ending 31 December 2008	166,904	$5.73
Outstanding as at 31 December 2008 and 2009	**166,904**	**$5.73**
Issuable as at 31 December 2009	**–**	**–**

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.

LTIP

No further options have been granted since the close of the LTIP plan. 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. 25% 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.

Options	Number	Weighted average exercise price
Outstanding as at 31 December 2007	**6,979,339**	**$6.42**(1)
Forfeited during the year	(86,039)	$6.11(1)
Outstanding as at 31 December 2008	**6,893,300**	**$5.38**(1)
Exercised during the year	(2,220,059)	$4.39
Forfeited during the year	(56,489)	$5.57
Outstanding as at 31 December 2009	**4,616,752**	**$4.34**
Exercisable as at 31 December 2009	**1,798,832**	**$4.40**

(1) Adjusted for revaluation at the exchange rate as at 31 December 2009

6. Employee benefits continued

On the dates listed below the Remuneration Committee exercised their discretionary power to adjust option exercise prices to neutralise the devaluing impact of dividend payments. The resulting charge to equity based compensation in the consolidated statement of comprehensive income is also shown. In all cases there is a net $nil impact to shareholders' equity.

Date	Adjustment to exercise price $	Adjustment to exercise price £	Charge 2009 $m	Charge 2008 $m
14 February 2008	1.10	0.56	0.7	1.2
4 November 2009	1.30	0.79	2.0	–
Total	**2.40**	**1.35**	**2.7**	**1.2**

Management team ordinary warrants ("ordinary warrants")

Ordinary warrants were all fully vested by 31 December 2008. The fair value of ordinary warrants granted for all periods was $2.62 per share. Ordinary warrants granted and outstanding are:

Ordinary warrants	Number	Weighted average exercise price
Outstanding as at 31 December 2008 and 2009	**11,433,465**	**$4.71**
Exercisable as at 31 December 2009	**11,433,465**	**$4.71**

Management team performance warrants ("performance warrants")

Performance warrants were all fully vested by 31 December 2009, vesting was dependent on achieving certain performance criteria. The fair value of warrants granted for all periods was $2.62 per share. Performance warrants granted and outstanding are:

Performance warrants	Number	Weighted average exercise price
Outstanding as at 31 December 2007	**6,474,346**	**$5.00**
Lapsed during the year	(2,782,659)	$3.90
Outstanding as at 31 December 2008	**3,691,687**	**$4.10**
Lapsed during the year	(1,931,377)	$2.60
Outstanding as at 31 December 2009	**1,760,310**	**$3.62**
Exercisable as at 31 December 2009	**1,760,310**	**$3.62**

Refer to note 21 for further disclosure on the total management warrants outstanding.

7. Results of operating activities

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

	2009 $m	2008 $m
Depreciation on owned assets	0.8	1.1
Operating lease charges	1.6	1.8
Auditors' remuneration		
– Group audit fees	1.2	1.2
– Other services	0.6	0.2
Total	**4.2**	**4.3**

7. Results of operating activities continued

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

	2009 $m	2008 $m
Tax advice	0.1	0.1
Other	0.5	0.1
Total	**0.6**	**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 U.S. and, accordingly, does not expect to be subject to U.S. taxation on its income or capital gains.

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

Tax charge	2009 $m	2008 $m
Corporation tax charge (credit) for the year	4.8	(0.3)
Adjustments in respect of prior year corporation tax	0.4	(0.4)
Deferred tax (credit) charge for the year	(1.5)	0.3
Adjustments in respect of prior year deferred tax	(0.6)	0.5
Total	**3.1**	**0.1**

Tax reconciliation	2009 $m	2008 $m
Profit before tax	388.5	97.6
Less profit not subject to tax	(372.9)	(101.9)
Profits (losses) subject to tax	15.6	(4.3)
UK corporation tax	4.4	(1.2)
Adjustments in respect of prior period	(0.2)	0.1
Other expense temporary differences	(1.2)	1.2
Other expense permanent differences	0.1	–
Total	**3.1**	**0.1**

8. Tax continued

On 1 April 2008 the standard rate of corporation tax in the UK decreased from 30% to 28%. The standard rate of tax for 2009 is 28% (2008 – weighted average rate of 28.5%). The current tax charge as a percentage of the Group's profit before tax is 0.8% (2008 – 0.1%) due to the different tax paying jurisdictions throughout the Group.

A current corporation tax expense of $0.1 million was credited to other comprehensive income during the year (2008 – $0.2 million charge), which relates to unrealised investment gains and losses included in accumulated other comprehensive income within shareholders' equity.

Taxation	2009 $m	2008 $m
UK corporation tax payable	2.4	–

9. Deferred tax

	2009 $m	2008 $m
Deferred tax assets	3.9	2.4
Deferred tax liabilities	(0.6)	(1.2)
Net deferred tax asset	**3.3**	**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 2010, thus the entire deferred tax asset is recognised.

The deferred tax asset relates to the RSS, warrants and options employee benefit schemes. 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:

	2009 $m	2008 $m
As at 1 January	1.2	2.0
Statement of comprehensive income credit (charge)	2.1	(0.8)
As at 31 December	**3.3**	**1.2**

10. Cash and cash equivalents

	2009 $m	2008 $m
Cash at bank and in hand	288.9	7.9
Cash equivalents	151.1	405.7
Total	**440.0**	**413.6**

Cash equivalents have an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

Included in cash at bank and in hand is $232.5 million (2008 – $nil) of cash held on deposit by the LHL's share registrar to fund the special dividend payment disclosed in note 20.

Refer to note 18 for the cash and cash equivalent balances on deposit as collateral.

11. Investments

As at 31 December 2009	$m Cost or amortised cost	$m Gross unrealised gain	$m Gross unrealised loss	$m Estimated fair value
Fixed income securities				
– Short-term investments	288.8	–	–	288.8
– U.S. treasuries	251.9	4.1	(1.2)	254.8
– Other government bonds	75.0	1.5	(0.2)	76.3
– U.S. government agency debt	114.1	1.0	(0.1)	115.0
– U.S. government agency mortgage backed securities	473.7	11.6	(0.9)	484.4
– Corporate bonds	467.1	13.3	(0.6)	479.8
– Corporate bonds – FDIC guaranteed(1)	191.0	2.6	(0.2)	193.4
Total investments	**1,861.6**	**34.1**	**(3.2)**	**1,892.5**

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

As at 31 December 2008	$m Cost or amortised cost	$m Gross unrealised gain	$m Gross unrealised loss	$m Estimated fair value
Fixed income securities				
– Short-term investments	163.6	–	–	163.6
– U.S. treasuries	186.8	6.5	(1.6)	191.7
– Other government bonds	52.5	1.6	–	54.1
– U.S. government agency debt	109.1	5.4	–	114.5
– U.S. 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 profit and loss	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 U.S. government

Equity securities and other investments held as at 31 December 2008 are deemed non-current. Fixed income maturities are presented in the risk disclosures section on page 95. Refer to note 18 for the investment balances in trusts in favour of ceding companies and on deposit as collateral.

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, U.S. treasuries and certain derivative financial instruments.

11. Investments continued

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
- Certain derivative financial instruments.

A financial instrument is regarded as quoted in an active market, and included in category (i), if quoted prices are readily available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. Instruments included in category (ii) are valued via independent external sources using modeled or other valuation methods. Such methods are typically industry accepted standard and consider the following: broker-dealer quotes; present value; future cash flows; yield curves; interest rates; prepayment speeds; default rates; and similar quoted instruments and/or market transactions.

The fair value hierarchy of the Group's investment holdings is as follows:

As at 31 December 2009	$m	$m	$m
	(i)	(ii)	Total
Fixed income securities			
– Short-term investments	175.1	113.7	288.8
– U.S. treasuries	254.8	–	254.8
– Other government bonds	–	76.3	76.3
– U.S. government agency debt	–	115.0	115.0
– U.S. government agency mortgage backed securities	–	484.4	484.4
– Corporate bonds	–	479.8	479.8
– Corporate bonds – FDIC guaranteed(1)	–	193.4	193.4
Total fixed income securities – available for sale	**429.9**	**1,462.6**	**1,892.5**

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

Prior year comparative disclosure is not required in the year of adoption and has not been presented. There were no category (iii) investments as at 31 December 2009 or 2008 therefore a reconciliation of movements within that category has not been presented. There are no realised or unrealised gains or losses recorded on category (iii) investments in the consolidated statement of comprehensive income or accumulated other comprehensive income. There have been no transfers between categories (i) and (ii) during the year.

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 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.

12. Insurance and reinsurance contracts

Insurance liabilities	$m	$m	$m
	Unearned premiums	Other payables	Total
As at 31 December 2007	**381.8**	**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	**339.6**	**17.6**	**357.2**
Net deferral for:			
Prior years	(274.8)	–	(274.8)
Current year	252.8	–	252.8
Other	–	(1.8)	(1.8)
As at 31 December 2009	**317.6**	**15.8**	**333.4**

Losses and loss adjustment expenses	$m	$m	$m
	Losses and loss adjustment expenses	Reinsurance recoveries	Net losses and loss adjustment expenses
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**
Net incurred losses for:			
Prior years	(59.5)	(4.0)	(63.5)
Current year	163.9	(1.7)	162.2
Exchange adjustments	(0.4)	(0.1)	(0.5)
Incurred losses and loss adjustment expenses	**104.0**	**(5.8)**	**98.2**
Net paid losses for:			
Prior years	137.8	(12.1)	125.7
Current year	6.1	–	6.1
Paid losses and loss adjustment expenses	**143.9**	**(12.1)**	**131.8**
As at 31 December 2009	**488.9**	**(35.8)**	**453.1**

12. Insurance and reinsurance contracts continued

Reinsurance assets and liabilities	$m Unearned premiums on premiums ceded	$m Amounts payable to reinsurers	$m Other receivables	$m Total
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**
Net deferral for:				
Prior years	(9.7)	–	–	(9.7)
Current year	5.3	–	–	5.3
Other	–	(2.2)	1.1	(1.1)
As at 31 December 2009	**5.6**	**(4.2)**	**4.3**	**5.7**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section, from page 87. 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% increase in estimated losses would lead to a $97.8 million (2008 – $105.8 million) increase in loss reserves. There was no change to the Group's reserving methodology during the year.

The split of losses and loss adjustment expenses between notified outstanding losses, ACRs assessed by management and IBNR is shown below:

	2009 $m	2009 %	2008 $m	2008 %
Outstanding losses	258.6	52.9	303.4	57.4
Additional case reserves	22.9	4.7	63.8	12.1
Losses incurred but not reported	207.4	42.4	161.6	30.5
Losses and loss adjustment expenses	**488.9**	**100.0**	**528.8**	**100.0**

It is estimated that the Group's reserve for unpaid losses and loss adjustment expenses has an estimated duration of approximately two years.

12. Insurance and reinsurance contracts continued

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 minimal number of 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 $m	2007 $m	2008 $m	2009 $m	Total $m
Gross losses					
Estimate of ultimate liability[1]					
At end of accident year	39.1	154.8	444.6	163.3	
One year later	34.7	131.2	417.4		
Two years later	32.0	103.5			
Three years later	27.6				
Current estimate of cumulative liability	**27.6**	**103.5**	**417.4**	**163.3**	**711.8**
Payments made	**(20.5)**	**(55.1)**	**(141.2)**	**(6.1)**	**(222.9)**
Total gross liability	**7.1**	**48.4**	**276.2**	**157.2**	**488.9**

Accident year	2006 $m	2007 $m	2008 $m	2009 $m	Total $m
Reinsurance					
Estimate of ultimate recovery[1]					
At end of accident year	–	3.6	40.7	1.6	
One year later	–	6.2	47.1		
Two years later	–	4.0			
Three years later	–				
Current estimate of cumulative recovery	**–**	**4.0**	**47.1**	**1.6**	**52.7**
Payments received	**–**	**(2.5)**	**(14.4)**	**–**	**(16.9)**
Total gross recovery	**–**	**1.5**	**32.7**	**1.6**	**35.8**

Accident year	2006 $m	2007 $m	2008 $m	2009 $m	Total $m
Net losses					
Estimate of net ultimate liability[1]					
At end of accident year	39.1	151.2	403.9	161.7	
One year later	34.7	125.0	370.3		
Two years later	32.0	99.5			
Three years later	27.6				
Current estimate of net cumulative liability	**27.6**	**99.5**	**370.3**	**161.7**	**659.1**
Payments made	**(20.5)**	**(52.6)**	**(126.8)**	**(6.1)**	**(206.0)**
Total net liability	**7.1**	**46.9**	**243.5**	**155.6**	**453.1**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2009

12. Insurance and reinsurance contracts continued

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, excluding the impact of foreign exchange revaluations, was as follows:

	2009 $m	2008 $m
2006 accident year	4.4	2.6
2007 accident year	25.2	26.0
2008 accident year	33.9	–
Total favourable development	**63.5**	**28.6**

During the year ending 31 December 2009 there were no major loss events that impacted the Group. In September 2008, Hurricane Ike passed through the Gulf of Mexico oil fields, making landfall in the U.S.. Hurricane Ike was a very destructive storm, causing damage to and destruction of a significant number of oil platforms. The net ultimate financial impact of Hurricane Ike is as follows:

	$m
Insurance losses and loss adjustment expenses	204.1
Insurance losses and loss adjustment expenses recoverable	(33.5)
Reinstatement premium	(8.9)
Other deductions	(10.9)
Net ultimate financial impact as at 31 December 2008	**150.8**
Change in insurance losses and loss adjustment expenses	21.0
Change in insurance losses and loss adjustment expenses recoverable	(4.6)
Change in reinstatement premium	0.7
Change in other deductions	(1.3)
Net ultimate financial impact as at 31 December 2009	**166.6**

Estimation of the ultimate liability of offshore losses 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. A substantial degree of judgement is involved in assessing the ultimate cost of Hurricane Ike, and the final amount could be materially different from that currently reported. Management's best estimate of the ultimate liability for Hurricane Ike is $178.7 million. The 90th percentile of the loss distribution for this estimate is $202.3 million with the 95th percentile being $210.2 million.

The Hurricane Ike ultimate financial impact developed adversely during 2009 by $15.8 million. This was offset by favourable development on other prior accident year reserves for attritional losses, plus reductions in a small number of reported losses based on new information received from loss adjusters. These developments are individually insignificant.

13. Insurance, reinsurance and other receivables

	2009 $m	2008 $m
Accrued interest receivable	12.0	10.1
Reinsurance assets		
– Reinsurance recoveries	35.8	42.1
– Other receivables	4.3	3.2
Other receivables	4.3	154.0
Inwards premiums receivable from insureds and cedants	178.2	187.3
Total receivables	**234.6**	**396.7**

All receivables are considered current other than $21.1 million (2008 – $24.0 million) of inwards premiums receivable related to multi-year contracts. The carrying value approximates fair value due to the short-term nature of the receivables. There are no significant concentrations of credit risk within the Group's receivables.

14. Deferred acquisition costs

The reconciliation between opening and closing deferred acquisition costs is shown below:

	$m
As at 31 December 2007	**57.8**
Net deferral during the year	110.0
Expense incurred for the year	(106.9)
As at 31 December 2008	**60.9**
Net deferral during the year	104.6
Expense incurred for the year	(112.6)
As at 31 December 2009	**52.9**

15. Insurance, reinsurance and other payables

	2009 $m	2008 $m
Dividends payable	263.0	–
Other payables	28.4	190.3
Total other payables	**291.4**	**190.3**
Insurance contracts – other payables	15.8	17.6
Amounts payable to reinsurers	4.2	2.0
Total payables	**311.4**	**209.9**

Dividends payable are discussed in note 20. 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.

16. Deferred acquisition costs ceded

The reconciliation between opening and closing deferred acquisition costs ceded is shown below:

	$m
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**
Net deferral during the year	7.4
Income recognised for the year	(6.6)
As at 31 December 2009	**2.7**

17. Property, plant and equipment

	2009 $m	2008 $m
Cost	10.2	4.5
Accumulated depreciation	(2.0)	(3.1)
Net book value	**8.2**	**1.4**

18. Long-term debt and financing arrangements

As at 31 December	2009 $m	2008 $m
Subordinated loan notes $97.0 million	97.0	97.0
Subordinated loan notes €24.0 million	34.4	33.8
Carrying value	**131.4**	**130.8**

On 15 December 2005 the Group issued, via a trust company, $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 $1,000 and €1,000 of their principal amounts respectively. The fair value of the long-term debts is estimated as $121.4 million (2008: $97.1 million).

The U.S. 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 (3.70%) 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 (3.70%) above the variable Euribor rate and is payable quarterly.

The Group is exposed to cash flow interest rate risk and currency risk on its long-term debt. Further information is provided in the risk disclosures section from page 93.

The interest accrued on the long-term debt was $0.2 million (2008 – $0.4 million) at the balance sheet date. The interest expense for the year was $6.4 million (2008 – $9.8 million) and is included in financing costs.

18. Long-term debt and financing arrangements continued

Letters of credit

As both LICL and LUK are non-admitted insurers or reinsurers throughout the U.S., the terms of certain contracts require them to provide letters of credit to policyholders as collateral. LHL and LICL have a syndicated collateralised credit facility in the amount of $200.0 million which expires on 16 July 2012. The facility contains a $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. LOCs issued by LICL are as follows:

As at 31 December	2009 $m	2008 $m
Issued to affiliates	–	61.9
Issued to third parties	25.7	26.7

There was no outstanding debt under this facility at either reporting date. Letters of credit are required to be fully collateralised.

Trusts

The Group has several trust arrangements in place in favour of policyholders and ceding companies in order to comply with the security requirements of certain reinsurance contracts and/or the regulatory requirements of certain jurisdictions.

The following cash and cash equivalents and investment balances were held in trust and other collateral accounts in favour of third parties:

As at 31 December	2009 $m	2009 $m	2008 $m	2008 $m
	cash and cash equivalents	fixed income securities	cash and cash equivalents	fixed income securities
In various trust accounts for policyholders	14.1	100.9	11.3	–
In favour of letters of credit	1.9	37.0	37.7	80.0
In favour of interest rate swaps	2.8	–	2.8	–
In favour of futures contracts	0.6	–	–	–
Total	**19.4**	**137.9**	**51.8**	**80.0**

As at and for the years ended 31 December 2009 and 2008 the Group was in compliance with all covenants under its trust facilities.

19. Derivative financial instruments

Derivate instrument gains and losses recorded in the consolidated statement of comprehensive income are as follows:

	2009 $m	2008 $m
Net realised gains (losses) and impairments	0.1	–
Net other investment income	–	0.1
Financing costs	(1.3)	(3.6)
Total derivative net losses	**(1.2)**	**(3.5)**

Refer to pages 91 and 92 in the risk disclosures section for the estimated fair value of the Group's derivative instruments. Realised gains and losses on futures and options contracts are included in net realised gains (losses) and impairments. The net impact of TBAs is $nil for all reporting periods.

19. Derivative financial instruments continued

In previous years the Group invested a small portion of its investment portfolio in convertible debt securities. The option to convert was an embedded derivative, which was required to be bifurcated from the host contract with changes in estimated fair value recorded through income, unless the security was designated as at fair value through profit and loss. The Group's investments in convertible debt securities were liquidated in the first half of 2009. As at 31 December 2008 the derivative component of these instruments was valued at $nil. Changes in estimated fair value are included in net other investment income.

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. The net fair value position owed by the Group was $3.6 million (2008 – $4.9 million). The Group has the right to net settle these instruments. The next cash settlement due on these instruments is $0.8 million (2008 – $0.5 million) and is due on 15 March 2010. The counter-party requires collateralisation of positions in excess of $2.0 million. These instruments will expire on 15 March 2011. The net impact from cash settlement and changes in estimated fair value is included in financing costs.

The interest rate swaps are held at estimated fair value, priced using observable market inputs, and are therefore classified as category (ii) in the fair value hierarchy.

20. Share capital

Authorised ordinary shares of $0.50 each	Number	$m
As at 31 December 2009 and 2008	**3,000,000,000**	**1,500.0**

Allocated, called up and fully paid	Number	$m
As at 31 December 2008 and 2007	**182,283,095**	**91.1**
Shares issued due to warrant exercises	219,968	0.1
As at 31 December 2009	**182,503,063**	**91.2**

Own shares	Number	$m
As at 31 December 2007	**–**	**–**
Shares repurchased and held in treasury	9,433,168	58.0
As at 31 December 2008	**9,433,168**	**58.0**
Shares repurchased and held in treasury	2,406,674	16.9
Shares repurchased by trust	1,078,403	8.0
Shares distributed by trust	(885,575)	(6.5)
As at 31 December 2009	**12,032,670**	**76.4**

The net shares outstanding as at 31 December 2009 were 170,470,393 (2008 – 172,849,927).

Share repurchases

The Board of Directors have granted share repurchase authorisations as follows:

Date	$m
29 October 2007	100.0
30 April 2008	100.0
4 November 2009	150.0
Total	**350.0**

An amount of $175.1 million (2008 – $42.0 million) of approved repurchase remains in place under the current authorisations.

20. Share capital continued

To date, shares have been repurchased by the Group under share repurchase authorisations as follows:

Date	Number of shares	Weighted average share price	$m
Repurchased and cancelled			
2007[1]	13,640,916	£3.54	100.2
Total repurchased and cancelled	**13,640,916**	**£3.54**	**100.2**
Repurchased and transferred to treasury shares			
2008	9,433,168	£3.14	58.0
2009	2,406,674	£4.28	16.9
Total repurchased and transferred to treasury shares	**11,839,842**	**£3.37**	**74.9**
Total repurchased	**25,480,758**	**£3.46**	**175.1**

(1) Due to the movement of exchange rates between trade and settlement dates, the amount paid for the $100.0 million share repurchase program was $100.2 million versus the authorised program of $100.0 million. The variance was ratified by the Board of Directors on 14 February 2008

At the balance sheet date $0.1 million (2008 – $0.2 million) remained to be settled.

In 2009 the trustees of the Lancashire Holdings Employee Benefit Trust (the "EBT") acquired 1,078,403 (2008 – nil) shares in accordance with the terms of that trust and distributed 885,575 (2008 – nil). There were no unsettled balances in relation to EBT purchases at either balance sheet date.

Dividends

The Board of Directors have authorised the following dividends during the year ended 31 December 2009:

Dividends	Authorisation date	Payment date	$m
Interim dividend of $0.05 (£0.0308)	28 July 2009	7 October 2009	10.5
Special dividend of $1.25 (£0.75625)	4 November 2009	6 January 2010	263.0

There were no dividends declared during the year ended 31 December 2008.

21. Warrants, options and restricted shares

Other reserves represents the Group's warrants, options and restricted shares. Changes in the number of options and restricted shares outstanding are disclosed in note 6. The change in the total number of warrants outstanding is as follows:

Warrants	Number	Number	Number	Number	Number
	Founders' warrants	Foundation warrants	Management ordinary warrants	Management performance warrants granted	Management performance warrants unallocated
Outstanding as at 31 December 2007	**25,303,917**	**648,143**	**11,433,465**	**6,474,346**	**347,937**
Lapsed	–	–	–	(2,782,659)	(149,542)
Outstanding as at 31 December 2008	**25,303,917**	**648,143**	**11,433,465**	**3,691,687**	**198,395**
Cancelled	–	–	–	–	(198,395)
Exercised	(833,200)	–	–	–	–
Lapsed	–	–	–	(1,931,377)	–
Outstanding and exercisable as at 31 December 2009	**24,470,717**	**648,143**	**11,433,465**	**1,760,310**	**–**

The exercise price for all unvested warrants was automatically adjusted for dividends declared as follows:

Authorisation date	Payment date	U.S.$	Number	Number	Number	Number
			Founders' warrants	Foundation warrants	Ordinary warrants	Performance warrants
10 December 2007	25 January 2008	1.10	–	162,036	2,858,366	5,789,065
28 July 2009	7 October 2009	0.05	–	–	–	2,894,532
4 November 2009	6 January 2010	1.25	–	–	–	2,894,532

The weighted average exercise price for the warrants is:

	$	$	$	$
	Founders' warrants	Foundation warrants	Ordinary warrants	Performance warrants
As at 31 December 2008	5.00	4.73	4.71	4.85
As at 31 December 2009	5.00	4.73	4.71	3.62

22. 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 year were $1.6 million (2008 – $1.8 million).

Future minimum lease payments under non-cancellable operating leases are as follows:

	2009 $m	2008 $m
Due in less than one year	2.1	1.7
Due between one and five years	10.1	6.7
Total	**12.2**	**8.4**

23. 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 under the treasury stock method.

The following reflects the profit and share data used in the basic and diluted earnings per share computations:

	2009 $m	2008 $m
Profit for the year attributable to equity shareholders	385.4	97.5

	Number of shares thousands	Number of shares thousands
Basic weighted average number of shares	172,740	177,468
Potentially dilutive shares	15,048	6,931
Diluted weighted average number of shares	**187,788**	**184,399**

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. Unvested restricted shares without performance criteria are therefore included in the number of potentially dilutive shares. Incremental shares from the assumed exercising of performance warrants and ordinary restricted share awards, where relevant performance criteria have not been met, are not included in calculating dilutive shares. In addition, where options are antidilutive, they are not included in the number of potentially dilutive shares.

24. Related party disclosures

The consolidated financial statements include LHL 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 subordinated loan notes via a trust vehicle – Lancashire Holdings Financing Trust I (the "Trust") (see note 18). The Group effectively has 100% 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 subordinated loan notes, is in essence controlled by the Group, and is therefore consolidated.

24. Related party disclosures continued

LICL holds $271.3 million of cash and cash equivalents and fixed income securities in trust for the benefit of LUK relating to intra-group reinsurance agreements.

On 14 February 2008 the Group established the EBT to assist in the administration of the Group's employee equity based compensation schemes. 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, is in essence, controlled by the Group, and is therefore consolidated.

During 2009 the Group made cash donations of $1.2 million to the EBT for funding. The Group also entered into a Loan Facility Agreement (the "Facility") with RBC Cees Trustee Limited, the Trustees of the EBT. The Facility is an interest free revolving credit facility under which the Trustee can request advances on demand, within the terms of the facility, up to a maximum aggregate of $10.0 million. The Facility may only be used by the Trustees for the purpose of achieving the objectives of the EBT. As at 31 December 2009 the Group had made advances of $7.0 million to the EBT under the terms of the Facility. There were no transactions with the EBT during 2008.

Key management compensation

Remuneration for key management (the Group's executive and non-executive Directors) for the years ending 31 December was as follows:

	2009 $m	2008 $m
Short-term compensation	5.6	5.3
Equity based compensation	6.1	5.8
Directors' fees and expenses	1.7	1.6
Monitoring fees	0.1	0.2
Total	**13.5**	**12.9**

The Directors' fees and expenses includes $0.7 million (2008 – $0.7 million) paid to significant founding shareholders. The monitoring fees are paid to significant founding shareholders. Non-executive Directors do not receive any benefits in addition to their agreed fees and expenses and do not participate in any of the Group's incentive, performance or pension plans.

Transactions with Lancashire Foundation

Cash donations to the Foundation have been approved by the Board of Directors as follows:

30 April 2008	$1.0 million
14 May 2009	$1.1 million

25. Non-cash transactions

Available for sale mortgage backed to be announced security purchases and sales of $229.3 million (2008 – $223.2 million) and $229.5 million (2008 – $228.4 million) respectively were net settled during the year through the use of derivative instruments.

The unsettled element of the share repurchase of $0.1 million (2008 – $0.2 million) discussed in note 20 is not reflected in the 2009 cash flows. It has been recorded in the subsequent year when it was actually settled. The 2009 special dividend declared of $263.0 million is not reflected in the 2009 cash flows. The settlement date was 6 January 2010 and the cash flow on this transaction has been recorded in 2010.

The unsettled element of the share repurchase in 2007 of $10.5 million was not reflected in the 2007 cash flows. It was recorded in 2008 when it was actually settled. The 2007 special dividend declared of $239.1 million was not reflected in the 2007 cash flows. The settlement date was 25 January 2008 and the cash flow on this transaction was recorded in 2008.

26. Statutory requirements and dividend restrictions

The primary source of capital used by the Group is equity shareholders' funds and borrowings. As a holding company, LHL relies on dividends from its operating entities to provide the cash flow required for debt service and dividends to shareholders. The operating entities' 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 entities these are based principally on the amount of premiums written and reserves for losses and loss adjustment expenses, subject to overall minimum solvency requirements. Operating entities statutory capital and surplus is different from shareholder's 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 entities is as follows:

As at 31 December 2009	**$m**	**£m**
	LICL	**LUK**
Statutory capital and surplus	1,215.4	120.0
Minimum required statutory capital and surplus	257.1	22.6

As at 31 December 2008	**$m**	**£m**
	LICL	**LUK**
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% of relevant liabilities. As at 31 December 2009 and 2008 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 2009 and 2008 the capital requirements of both regulatory jurisdictions were met.

27. Subsequent events

On 25 February 2010 the Board of Directors authorised the payment of a final ordinary dividend of 10.0 cents per common share to shareholders of record on 19 March 2010, with a settlement date of 14 April 2010. The total dividend payable will be approximately $20.8 million. The Remuneration Committee has the discretionary power to adjust the exercise price of options issued under the LTIP to neutralise the devaluing impact of dividend payments. The Committee has not yet approved any such adjustment. An amount equivalent to the dividend accrues on all RSS awards and is paid at the time of vesting, pro-rata according to the number of RSS awards that vest.

The Group has exposures to risks in Chile in the following classes; onshore energy; property retrocession; property direct and facultative; and property catastrophe excess of loss. It is premature to estimate the extent of any potential losses likely to be incurred from claims arising from the 27 February 2010 earthquake and subsequent aftershocks that struck Chile or the resulting impact on 2010 results, reinstatement premiums or market pricing.

28. Presentation

Certain amounts in the 31 December 2008 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 profit.

Shareholder information

ANNUAL GENERAL MEETING

The Company's annual general meeting ("AGM") is scheduled for 1.00pm on 4 May 2010. Notice of this year's AGM and the form of proxy accompany this annual report. If you have any queries regarding the notice or return of the proxy please contact Greg Lunn, (Company Secretary and General Counsel) at Lancashire Holdings Limited, Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda, Tel: + 1 441 278 8950 and email: greg.lunn@lancashiregroup.com.

FURTHER INFORMATION

Lancashire Holdings Limited is registered in Bermuda under company number EC 37415 and has its registered office at Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda.

Further information about the Group including this annual report, press releases and the Company's share price is available on our website at www.lancashiregroup.com. Please address any enquiries to info@lancashiregroup.com.

Note regarding 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 disclosures'', 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 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.

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Printed by Park Communications.