LANCASHIRE HOLDINGS LIMITED

GROWTH IN FULLY CONVERTED BOOK VALUE PER SHARE, ADJUSTED FOR DIVIDENDS, OF 7.0% IN Q4, 26.5% IN 2009
COMBINED RATIO OF 25.7% IN Q4 2009, 44.6% FOR 2009
FINAL DIVIDEND OF 10.0 CENTS PER COMMON SHARE
FULLY CONVERTED BOOK VALUE PER SHARE OF $7.41 AT 31 DECEMBER 2009

26 February 2010
Hamilton, Bermuda

Lancashire Holdings Limited ("Lancashire" or "the Group") today announces its preliminary financial results for the fourth quarter of 2009 and the twelve month period ended 31 December 2009.

Financial highlights for the fourth quarter of 2009:

- Fully converted book value per share of $7.41 at 31 December 2009 compared to $6.89 at 31 December 2008. Return on equity, defined as growth in fully converted book value per share adjusted for dividends, of 7.0% (Q4 2008: 8.3%);
- Operating return on equity of 7.7% (Q4 2008: 8.1%);
- Gross written premiums of $103.4 million (Q4 2008: $130.1 million). Net written premiums of $100.0 million (Q4 2008: $130.1 million);
- Reported loss ratio of negative 0.8% (Q4 2008: 11.5%) and combined ratio of 25.7% (Q4 2008: 35.4%). Accident year loss ratio of 24.0% (Q4 2008: 21.1%);
- Annualised total investment return of 2.1% (Q4 2008: 8.9%);
- Net operating profit of $122.4 million (Q4 2008: $98.3 million), or $0.65 (Q4 2008: $0.55) diluted operating earnings per share;
- Net profit after tax of $129.6 million (Q4 2008: $81.1 million), or $0.69 (Q4 2008: $0.46) diluted earnings per share;
- Special dividend of $263.0 million (Q4 2008: $nil) or $1.25 per common share; and
- Share repurchases of $16.9 million (Q4 2008: $nil).

Financial highlights for the twelve months to 31 December 2009:

- Return on equity, defined as growth in fully converted book value per share adjusted for dividends, of 26.5% (2008: 7.8%);
- Operating return on equity of 24.9% (2008: 9.6%);

- 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 combined ratio of 44.6% (2008: 86.3%). Accident year loss ratio of 27.2% (2008: 66.5%);
- Total investment return of 3.9% (2008: 3.1%);
- Net operating profit of $364.7 million (2008: $119.4 million), or $1.94 (2008: $0.65) diluted operating earnings per share;
- Net profit after tax of $385.4 million (2008: $97.5 million), or $2.05 (2008: $0.53) diluted earnings per share;
- Interim dividend of $10.5 million (2008: $nil) or 5.0 cents per common share declared in July 2009, paid in October 2009;
- Special dividend of $263.0 million (2008: $nil) or $1.25 per common share declared in November 2009, paid in January 2010; and
- Share repurchases of $16.9 million (2008: $58.0 million).

Richard Brindle, Group Chief Executive Officer, commented:

"Lancashire had an excellent 2009. Return on equity, defined as growth in fully converted book value per share adjusted for dividends, was 7.0% in the fourth quarter, and 26.5% for the year. Since inception, our compound annual return on equity is 19.8%.

Our performance was largely driven by underwriting, evident in the combined ratios of 25.7% for the fourth quarter and 44.6% for the year. Our accident year loss ratios, removing the impact of favourable prior year reserve development, were an excellent 24.0% for the fourth quarter and 27.2% for the year. Since we started in business, our weighted average combined ratio is 57.5%, a testament to our most important strategic cornerstone: Underwriting Comes First. Our investments also generated a significant contribution, with a total return for the year of 3.9%. Our appetite for investment risk remains low, and will continue to be so. We are very pleased to have achieved a positive total investment return for our shareholders in fifteen out of sixteen quarters. Capital management again played an important role in our overall performance and we were delighted to return a substantial amount of capital to our shareholders during the year. Finally, we were very proud to list on the Main Market of the London Stock Exchange in 2009, joining the FTSE 250 in the process.

The outlook for 2010 looks reasonable. The reinsurance market, while modestly off its all-time highs, remains fairly disciplined. As expected, the specialist insurance classes are coming under some pressure, but remain relatively attractive overall. In the past 12 months, industry capital has recovered well, faster than expected. We are encouraged to see increasing numbers of companies returning capital, but remain concerned that insufficient efforts will be made across the broader market. This increased supply of capital is placing pressure on pricing in certain areas, a trend we unfortunately expect to gather pace as the year progresses. With that in mind, we actively sought to shift our renewal pattern forward for 2010, writing an increased level of well-priced property catastrophe reinsurance compared to 2009; thereby taking advantage of what we believe may be the high point of rates in the year. Correspondingly, we expect to write less business in later months than we did last year.

Most importantly, in 2010 the Lancashire approach will be business as usual: stay disciplined, don't be tempted to sacrifice profits for volume, and prepare for the unexpected – good or bad. All in all, we are positive about the prospects for Lancashire in the next 12 months, and believe our strategy will continue to produce an attractive return for shareholders."

Neil McConachie, President and Group Chief Financial Officer, commented:

"In 2009 we generated comprehensive income of $388.2 million. Between recent share repurchases and dividends, including our final dividend of $20.8 million announced today, we are returning $314.8 million or fully 81% of 2009 comprehensive income. More will be returned in the next weeks and months.

At Lancashire, we strongly believe that prudent but active management of capital is fundamental to our business, and this will be at the forefront of our minds in 2010. Currently, we have significant levels of capital above our requirements. At today's share price, our favoured method of returning capital is to buy back shares. As of 25 February, we have $171.5 million remaining under existing share repurchase authorisations and anticipate requesting shareholder approval for additional capacity at our forthcoming AGM. Should prices remain attractive, this is something that we expect to do in increasing amounts. At the same time, we will continually monitor alternative approaches to capital management. Should trading conditions remain the same or gradually deteriorate, absent a change in our business plan, we would anticipate returning more capital than we generate during 2010."

Lancashire Renewal Price Index for Major Classes

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 and reflects Lancashire's assessment of relative change in price, terms, conditions and limits and is weighted by premium volume. See "Note Regarding RPI Tool" at the end of this announcement.

The following RPIs are expressed as an approximate percentage of pricing achieved on similar contracts written in 2008:

Class	**Q1 2009**	**Q2 2009**	**Q3 2009**	**Q4 2009**
Aviation (AV52)	100%	99%	100%	95%
Gulf of Mexico Energy	250%	216%	172%	100%
Energy Offshore Worldwide	113%	113%	110%	103%
Marine	105%	99%	100%	101%
Direct & Facultative	108%	110%	108%	100%
Property Reinsurance	146%	118%	129%	98%
Terrorism	93%	93%	95%	94%
Combined	**113%***	**113%***	**107%***	**98%****

The overall RPI for the year to 31 December 2009 is 109% **

Notes

* Q1, Q2 and Q3 combined RPI have been updated for subsequent adjustments to bound premium.
** Q4 and overall RPI are taken at the end of the quarter.

Underwriting results

Gross written premiums decreased by 20.5% in the fourth quarter of 2009 and by 1.6% for the twelve months ended 31 December 2009 compared with the same periods in 2008.

The Group's four principal classes, and a discussion of the key market factors impacting them, are as follows:

Gross Written Premium

	Q4				**Twelve months to 31 December**			
	2009	**2008**	**Change**	**Change**	**2009**	**2008**	**Change**	**Change**
	$m	**$m**	**$m**	**%**	**$m**	**$m**	**$m**	**%**
Property	47.2	59.0	(11.8)	(20.0)	317.3	302.7	14.6	4.8
Energy	14.7	16.1	(1.4)	(8.7)	175.5	185.2	(9.7)	(5.2)
Marine	12.7	13.0	(0.3)	(2.3)	73.7	78.6	(4.9)	(6.2)
Aviation	28.8	42.0	(13.2)	(31.4)	61.3	71.6	(10.3)	(14.4)
Total	**103.4**	**130.1**	**(26.7)**	**(20.5)**	**627.8**	**638.1**	**(10.3)**	**(1.6)**

Property gross written premiums decreased by 20.0% for the fourth quarter compared to the same period in 2008, and increased by 4.8% in the twelve months to 31 December 2009 compared to the twelve months to 31 December 2008. In 2009 overall 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. This was done in anticipation of improving trading conditions in some classes, including property catastrophe, later in the year. Subsequently, the Group expanded into the property catastrophe excess of loss market. In the fourth quarter of 2009, as compared to the same period of 2008, there was a reduction in property retrocession premiums due to a reduction in underlying exposures in addition to the impact of certain multi-year political risk contracts which are not yet due for renewal.

Energy gross written premiums decreased by 8.7% for the fourth quarter of 2009 compared to the same period in 2008 and by 5.2% in the twelve months to 31 December 2009 compared to the twelve months to 31 December 2008. Gulf of Mexico volumes were lower in the first half 2009 compared to 2008 due to a reduction in demand. Some construction projects were also curtailed in the recessionary environment. This reduction in volume was somewhat offset by increased volume in the worldwide offshore line later in the year despite a significant fourth quarter contract renewing in 2010.

Marine gross written premiums decreased by 2.3% for the fourth quarter of 2009 compared to the same period in 2008 and by 6.2% in the twelve months to 31 December 2009 compared to the twelve months to 31 December 2008. The decline is largely due to recessionary driven reductions in shipbuilding projects and the timing of certain multi-year contract renewals.

Aviation gross written premiums decreased by 31.4% for the fourth quarter compared to the same period in 2008 and decreased by 14.4% in the twelve months to 31 December 2009 compared to the twelve months to 31 December 2008. These reductions were driven primarily by the non-renewal of a satellite risk programme in the first quarter of 2009.

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Ceded premiums increased by $3.4 million in the fourth quarter compared to the same period in 2008. For the twelve month period to 31 December 2009, ceded premiums reduced by 20.0% compared to the same period in 2008 due to a reduction in the level of reinsurance purchased in respect of Gulf of Mexico energy catastrophe risks. This is directly related to the lower volumes of premium written in this class compared to the previous year.

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Net earned premiums as a proportion of net written premiums were 155.6% in the fourth quarter of 2009 compared to 109.1% in the same period in 2008 and 103.0% in the twelve months to 31 December 2009 compared to 105.7% in the same period 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. The significant increase in the volume of property catastrophe business written in June and July 2009 served to increase earned premiums in the second half of 2009, bringing the ratio of earned premium for the year in line with 2008.

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The net loss ratio for the fourth quarter was negative 0.8% compared to 11.5% for the same period in 2008. The net loss ratio for the twelve months to 31 December 2009 was 16.6% compared to 61.8% for the twelve months to 31 December 2008. The low loss ratios are mainly a reflection of 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. Hurricane Ike net reserves developed $17.1 million favourably in the fourth quarter and $17.1 million adversely in 2009 overall.

Loss Development by Class

			Twelve months to 31 December	
	Q4 2009	**Q4 2008**	**2009**	**2008**
	$m	**$m**	**$m**	**$m**
Property	7.5	2.8	44.4	22.3
Energy	29.6	8.3	9.3	5.5
Marine	2.2	1.3	6.1	-
Aviation	0.2	0.1	3.7	0.8
Total	**39.5**	**12.5**	**63.5**	**28.6**

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

Net prior accident year reserve releases were $39.5 million for the fourth quarter and $63.5 million for the twelve months to 31 December 2009 compared to $12.5 million and $28.6 million for the same periods in 2008. The increase in reserve releases in 2009 is a result of a lower number of attritional losses reported on expiring years than expected, resulting in IBNR releases, plus the favourable negotiation and settlement of a number of individually insignificant smaller and medium sized reported losses. The accident year loss ratio for the fourth quarter of 2009 was 24.0% compared to 21.1% for the same period in 2008. For the twelve months to 31 December 2009, the accident year loss ratio was 27.2% compared to 66.5% for the 2008 accident year. The higher ratio in 2008 is largely due to losses from Hurricane Ike. During 2009, previous accident years developed as follows:

- 2006 - favourable development of $4.4 million;
- 2007 - favourable development of $25.2 million; and
- 2008 - favourable development of $33.9 million.

Investments

Net investment income was $14.0 million for the fourth quarter, a small increase of 4.5% from the fourth quarter of 2008, due to a larger amount of invested assets compared to the same period in the prior year. Net investment income was $56.0 million for the twelve months to 31 December 2009, a decrease of 5.9% over the same period in 2008, which 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 $11.1 million for the fourth quarter compared to $37.9 million for the same period in 2008. The increase in treasury yields in December 2009 resulted in net unrealised losses for the Group in the fourth quarter of 2009 compared to net unrealised gains in the same period of 2008, when treasury yields fell. For the twelve months to 31 December 2009 total investment return was $82.9 million versus $54.7 million for the same period in 2008. Given the improved economic environment in 2009 compared to 2008, there were less impairments recognised. Impairment losses in 2009 were $0.4million 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-held philosophy, with a strong emphasis on preserving capital. The corporate bond allocation, excluding Federal Deposit Insurance Corporation guaranteed bonds, has 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 securities and 7.1% cash and cash equivalents versus the 2008 year end of 80.3% fixed income securities, 19.4% cash and cash equivalents and 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 portfolio in emerging market debt.

Key investment portfolio statistics as at 31 December are:

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

Other operating expenses

Other operating expenses, excluding employee remuneration, are broadly consistent compared to 2008 for the quarter and the year, 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.

Equity based compensation was $7.1 million in the fourth quarter of 2009 compared to $8.9 million in the same period of 2008. For the twelve months to 31 December 2009 and 2008 the charges 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

The Group continues to repurchase its own shares by way of on market purchases utilising the approximately $21.5 million remaining to be repurchased under the facility approved in 2008, and the $150.0 million facility approved by the Board of Directors on 4 November 2009 and by shareholders at the Special General Meeting held on 16 December 2009 (the "Repurchase Program"). $16.9 million of shares were repurchased and held in Treasury during 2009 compared to $58.0 million during 2008.

The Board will be proposing at the Annual General Meeting, to be held on 4 May 2010, that the shareholders approve a renewal of the Repurchase Program with such authority to expire on the conclusion of the 2011 Annual General Meeting or, if earlier, 15 months from the date the resolution approving the Repurchase Program is passed.

Dividends

During 2009 the Lancashire Board declared an interim and special dividend of 5.0 cents and $1.25 per common share respectively.

The Group also announces that its Board has declared a final dividend of 10.0 cents per common share (approximately 6.4 pence per common share at the current exchange rate), which results in an aggregate payment of approximately $17.0 million. The dividend will be paid in GBP on 14 April 2010 (the "Dividend Payment Date") to shareholders of record on 19 March 2010 using the GBP£/US$ spot market exchange rate at the close of business in London on the record date.

In addition to the dividend payment to shareholders, $3.8 million in aggregate will be paid on the Dividend Payment Date to holders of warrants issued by the Company pursuant to the terms of the warrants.

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

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

Financial information and posting of accounts

The consolidated financial statements set out below are unaudited. The audited Annual Report and Accounts are expected to be posted to shareholders no later than 30 March 2010 and will also be available on the Company's website by this date.

Further details of our 2009 fourth quarter results can be obtained from our Financial Supplement. This can be accessed via our website www.lancashiregroup.com.

Analyst and Investor Earnings Conference Call

There will be an analyst and investor conference call on the results at 2:00pm UK time / 9:00 am EST on Friday 26 February 2010. The call will be hosted by Richard Brindle, Chief Executive Officer, Neil McConachie, President and Chief Financial Officer, Alex Maloney, Group Chief Underwriting Officer and Simon Burton, Deputy Chief Executive Officer.

The call can be accessed by dialing +44 (0)20 7806 1953 / +1 718 354 1387 with the passcode 2144649. The call can also be accessed via webcast, please go to our website (www.lancashiregroup.com) to access.

A replay facility will be available for two weeks until Saturday 13 March 2010. The dial in number for the replay facility is +44 (0)20 7111 1244 / + 1 347 366 9565 and the passcode is 2144649#. The replay facility can also be accessed at www.lancashiregroup.com .

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Investor enquiries and questions can also be directed to info@lancashiregroup.com or by accessing the Company's website www.lancashiregroup.com.

About Lancashire

Lancashire, through its UK and Bermuda-based insurance subsidiaries, is a global provider of specialty insurance products. Its insurance subsidiaries carry the Lancashire group rating of A minus (Excellent) from A.M. Best with a stable outlook. Lancashire has capital in excess of $1 billion and its Common Shares trade on the main market of the London Stock Exchange under the ticker symbol LRE. Lancashire is headquartered at Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda. The mailing address is Lancashire Holdings Limited, P.O. Box HM 2358, Hamilton HM HX, Bermuda. For more information on Lancashire, visit the Company's website at www.lancashiregroup.com

NOTE REGARDING RPI TOOL

LANCASHIRE'S RENEWAL PRICE INDEX ("RPI") IS AN INTERNAL TOOL THAT ITS MANAGEMENT USES TO TRACK TRENDS IN PREMIUM RATES OF A PORTFOLIO OF INSURANCE AND REINSURANCE CONTRACTS. THE RPI IS CALCULATED ON A PER CONTRACT BASIS AND REFLECTS LANCASHIRE'S ASSESSMENT OF RELATIVE CHANGES IN PRICE, TERMS, CONDITIONS AND LIMITS AND IS WEIGHTED BY PREMIUM VOLUME. THE CALCULATION INVOLVES A DEGREE OF JUDGMENT 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.

NOTE REGARDING FORWARD-LOOKING STATEMENTS:

CERTAIN STATEMENTS AND INDICATIVE PROJECTIONS (WHICH MAY INCLUDE MODELED LOSS SCENARIOS) MADE THAT ARE NOT BASED ON CURRENT OR HISTORICAL FACTS ARE FORWARD-LOOKING IN NATURE INCLUDING WITHOUT LIMITATION, STATEMENTS CONTAINING THE WORDS 'BELIEVES', 'ANTICIPATES', 'PLANS', 'PROJECTS', 'FORECASTS', 'GUIDANCE', 'INTENDS', 'EXPECTS', 'ESTIMATES', 'PREDICTS', 'MAY', 'CAN', 'WILL', 'SEEKS', 'SHOULD', OR, IN EACH CASE, THEIR NEGATIVE OR COMPARABLE TERMINOLOGY. ALL STATEMENTS OTHER THAN STATEMENTS OF HISTORICAL FACTS INCLUDING, WITHOUT LIMITATION, THOSE REGARDING THE GROUP'S FINANCIAL POSITION, RESULTS OF OPERATIONS, LIQUIDITY, PROSPECTS, GROWTH, CAPITAL MANAGEMENT PLANS, BUSINESS STRATEGY, PLANS AND OBJECTIVES OF MANAGEMENT FOR FUTURE OPERATIONS (INCLUDING DEVELOPMENT PLANS AND OBJECTIVES RELATING TO THE GROUP'S INSURANCE BUSINESS) ARE FORWARD-LOOKING STATEMENTS. SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER IMPORTANT FACTORS THAT COULD CAUSE THE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS OF THE GROUP TO BE MATERIALLY DIFFERENT FROM FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS.

THESE FACTORS INCLUDE, BUT ARE NOT LIMITED TO: THE NUMBER AND TYPE OF INSURANCE AND REINSURANCE CONTRACTS THAT WE WRITE; THE PREMIUM RATES AVAILABLE AT THE TIME OF SUCH RENEWALS WITHIN OUR TARGETED BUSINESS LINES; THE LOW FREQUENCY OF LARGE EVENTS; UNUSUAL LOSS FREQUENCY; THE IMPACT THAT OUR FUTURE OPERATING RESULTS, CAPITAL POSITION AND RATING AGENCY AND OTHER CONSIDERATIONS HAVE ON

THE EXECUTION OF ANY CAPITAL MANAGEMENT INITIATIVES; THE POSSIBILITY OF GREATER FREQUENCY OR SEVERITY OF CLAIMS AND LOSS ACTIVITY THAN OUR UNDERWRITING, RESERVING OR INVESTMENT PRACTICES HAVE ANTICIPATED; THE RELIABILITY OF, AND CHANGES IN ASSUMPTIONS TO, CATASTROPHE PRICING, ACCUMULATION AND ESTIMATED LOSS MODELS; LOSS OF KEY PERSONNEL; A DECLINE IN OUR OPERATING SUBSIDIARIES' RATING WITH A.M. BEST COMPANY AND/OR OTHER RATING AGENCIES; INCREASED COMPETITION ON THE BASIS OF PRICING, CAPACITY, COVERAGE TERMS OR OTHER FACTORS; A CYCLICAL DOWNTURN OF THE INDUSTRY; THE IMPACT OF A DETERIORATING CREDIT ENVIRONMENT CREATED BY THE FINANCIAL MARKETS AND CREDIT CRISIS; A RATING DOWNGRADE OF, OR A MARKET DECLINE IN, SECURITIES IN OUR INVESTMENT PORTFOLIO; CHANGES IN GOVERNMENTAL REGULATIONS OR TAX LAWS IN JURISDICTIONS WHERE LANCASHIRE CONDUCTS BUSINESS; LANCASHIRE OR ITS BERMUDIAN SUBSIDIARY BECOMING SUBJECT TO INCOME TAXES IN THE UNITED STATES OR THE UNITED KINGDOM; AND THE EFFECTIVENESS OF OUR LOSS LIMITATION METHODS. ANY ESTIMATES RELATING TO LOSS EVENTS INVOLVE THE EXERCISE OF CONSIDERABLE JUDGEMENT AND REFLECT A COMBINATION OF GROUND-UP EVALUATIONS, INFORMATION AVAILABLE TO DATE FROM BROKERS AND INSUREDS, MARKET INTELLIGENCE, INITIAL AND/OR TENTATIVE LOSS REPORTS AND OTHER SOURCES. JUDGEMENTS IN RELATION TO NATURAL CATASTROPHE AND MAN MADE EVENTS INVOLVE COMPLEX FACTORS POTENTIALLY CONTRIBUTING TO THESE TYPES OF LOSS, AND WE CAUTION AS TO THE PRELIMINARY NATURE OF THE INFORMATION USED TO PREPARE ANY SUCH ESTIMATES.

THESE FORWARD-LOOKING STATEMENTS SPEAK ONLY AS AT THE DATE OF PUBLICATION. LANCASHIRE HOLDINGS LIMITED EXPRESSLY DISCLAIMS ANY OBLIGATION OR UNDERTAKING (SAVE AS REQUIRED TO COMPLY WITH ANY LEGAL OR REGULATORY OBLIGATIONS (INCLUDING THE RULES OF THE LONDON STOCK EXCHANGE)) TO DISSEMINATE ANY UPDATES OR REVISIONS TO ANY FORWARD-LOOKING STATEMENTS TO REFLECT ANY CHANGES IN THE GROUP'S EXPECTATIONS OR CIRCUMSTANCES ON WHICH ANY SUCH STATEMENT IS BASED.

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 March 2010 and signed on its behalf by:

consolidated statement of changes in shareholders' equity
for the year ended 31 december 2009

	notes	share capital	own shares	share premium	contributed surplus	accumulated other comprehensive income	other reserves	retained earnings	total
		$m	$m	$m	$m	$m	$m	$m	$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 impact on 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 10 and also in the risk disclosures section from page 23. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 10.

Estimates may also be made in determining the estimated fair value of certain financial instruments. These are discussed on page 11 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

Own shares include shares repurchased under share 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 the 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 in 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 exposures 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**
zones	**perils**	**100 year return period estimated net loss**		**250 year return period estimated net loss**	
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**
zones	**perils**	**100 year return period estimated net loss**		**250 year return period estimated net loss**	
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 high 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 18.

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. 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 are therefore mostly 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 18. 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 95^{th} percentile confidence level. Management also monitors the 99^{th} percentile confidence level. The ninety day VaR, at the 95^{th} 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 long	$m 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 is 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:

	$m
immediate shift in 3 month LIBOR (basis points)	
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 U.S. 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 23.

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 equity securities and other investments	$m cash and fixed income securities	$m inwards premiums receivable and other receivables	$m 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 receivable 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 3 month treasury yield is as follows:

	annual return	**compound annual return**	**inception to date return**
31 december 2005[1]	(3.4%)	n/a	(3.4%)
31 december 2006	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 subclasses 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 19 to 22. 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.

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

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.

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

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.

	adjustment to exercise price		**charge**	
			2009	**2008**
date	**$**	**£**	**$m**	**$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**

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**

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, warrant and option 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 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	**$m**	**$m**	**$m**	**$m**
	cost or amortised cost	**gross unrealised gain**	**gross unrealised loss**	**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	**$m**	**$m**	**$m**	**$m**
	cost or amortised cost	**gross unrealised gain**	**gross unrealised loss**	**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 34. 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.

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 and regularly 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 arms 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**

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 23. 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		2008	
	$m	%	$m	%
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**

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

claims development

The development of insurance liabilities is indicative of the Group's ability to estimate the ultimate value of its insurance liabilities. The Group began writing insurance and reinsurance business in December 2005. Due to the 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

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 debt 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 date 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 31.

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.

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:

	2009		2008	
as at 31 december	**$m cash and cash equivalents**	**$m fixed income securities**	**$m cash and cash equivalents**	**$m 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 29 and 30 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.

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.

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 the 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	7 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	7 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.

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	6.6	5.3
equity based compensation	6.1	5.8
directors' fees and expenses	1.7	1.6
monitoring fees	0.1	0.2
total	**14.5**	**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 in 2009 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 7 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 entity 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 event

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.

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.