

Five years of Lancashire
Four business segments
Three strategic priorities
Two underwriting centres
One goal

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Five reasons to invest in Lancashire.

This is what we do:

1. Lancashire puts underwriting first.
2. Lancashire has a reputation for strength in the face of challenges.
3. Lancashire adopts a conservative investment strategy.
4. Lancashire communicates clearly and openly.
5. Lancashire delivers industry leading returns.

We have stuck with our strategy - operating as a nimble, focused, speciality insurer.

Turn the page to learn more.....

Our long-term goal is to achieve an above average risk adjusted return. Since inception, we have produced a 20.3% compound annual return.

How do we do this? By keeping it simple.

- 1 Underwriting comes first.
- 2 Effectively balance risk and return.
- 3 Operate nimbly through the cycle.



At Lancashire, **underwriting always comes first**. Each risk underwritten must bear scrutiny on an individual basis and as part of our overall portfolio.

APPROPRIATE MIX OF TECHNOLOGY AND CULTURE

Culture and techniques

- Daily underwriting call
- Collegiate approach
- Multiple pricing assessments
- No hard premium targets
- Underwriters compensated on Group RoE

BLAST proprietary model

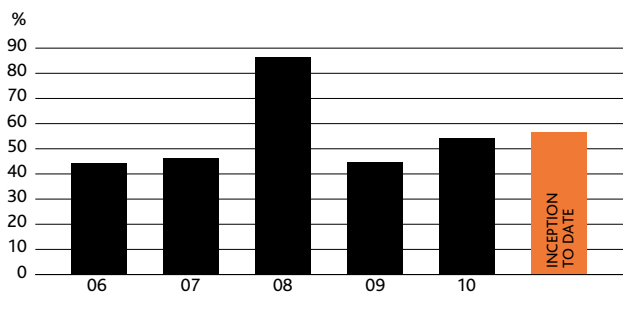
- Remetrica platform
- Lancashire custom features
- Blends multiple types of risk
- Optimisation capability to improve risk-return of portfolio

If we can achieve this, year in year out, consistently, we believe it will generate a superior return for shareholders

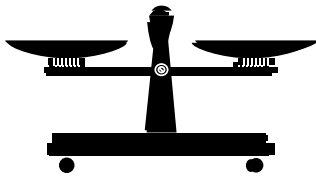
In our five years of underwriting, our strategy hasn't changed. We grow when it makes sense to do so, when attractive opportunities are there. When those opportunities go away, we shrink. We write well-priced good quality business. We don't believe in pushing for growth when there is no good reason to grow.

We will continue to improve the expected contribution that underwriting makes to Lancashire's RoE, within agreed risk tolerances. We will reduce capital needs per dollar of premium and enhance our operating leverage.

COMBINED RATIO

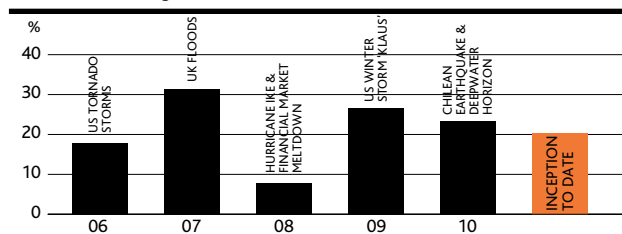


What's next?
 Make our insurance portfolio even more efficient.
 Maximise its contribution to RoE.

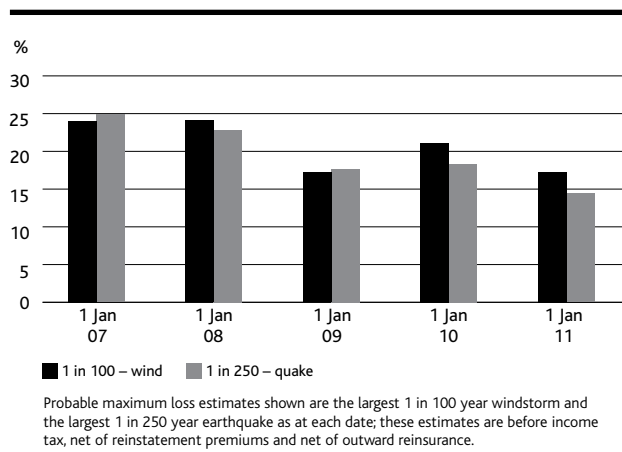


We aim to make an attractive return, within a controlled level of risk. To **effectively balance risk and return** requires co-ordination across all departments – time and effort very well spent.

RETURN ON EQUITY



PROBABLE MAXIMUM LOSS AS A PERCENTAGE OF CAPITAL



At Lancashire, risk management is part of our DNA.

It permeates every facet of our business, every decision we make. We believe that our balance between risk and return is appropriate. We are making returns at least commensurate with the levels of risk we accept.

How do we get there? We reduce our risk in softening markets and increase it in hardening markets. We adjust our insurance portfolio to make it as efficient as possible and we continually develop and enhance our risk measures. We learn and grow from past mistakes.

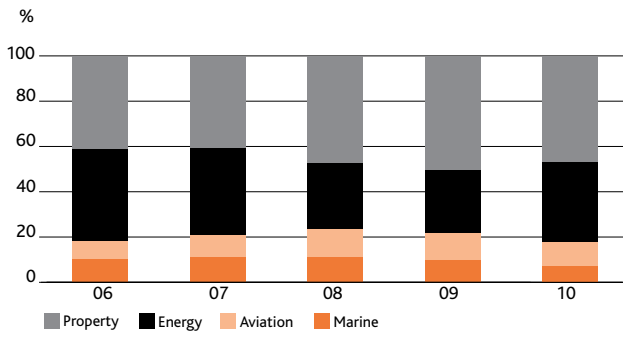
What's next?

- Keep learning.
- Keep adapting.
- Get the balance right.



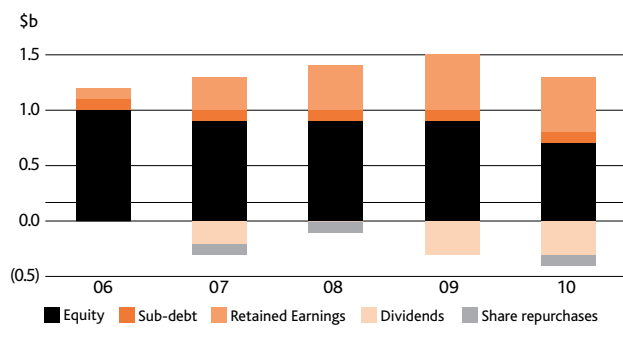
The cycle changes. So do we. We achieve this by adapting our underwriting, managing our capital, being patient and keeping our eyes open. **Operate nimbly through the cycle.**

ACTIVE PORTFOLIO REBALANCING



Operating nimbly sometimes means doing less business to achieve a greater return. It means giving back money to shareholders when we don't need it. Occasionally it means asking for more. It means staying small so decisions can be made quickly.

CONSTANT ADJUSTMENT OF CAPITAL



What's next?
 Be smart.
 Be prepared.
 Be ready for the next market changing event.

Financial highlights

RETURN ON EQUITY

23.3%

2006 – 17.8% 2007 – 31.4% 2008 – 7.8% 2009 – 26.5%

COMBINED RATIO

54.4%

2006 – 44.3% 2007 – 46.3% 2008 – 86.3% 2009 – 44.6%

PROFIT AFTER TAX

\$330.8m

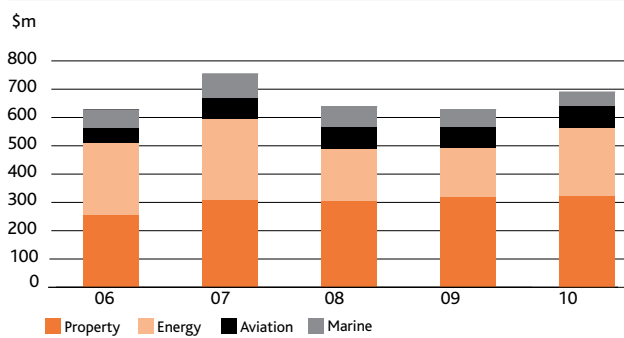
2006 – \$159.3m 2007 – \$390.9m 2008 – \$97.5m 2009 – \$385.4m

INVESTMENT RETURN

4.2%

2006 – 6.1% 2007 – 6.2% 2008 – 3.1% 2009 – 3.9%

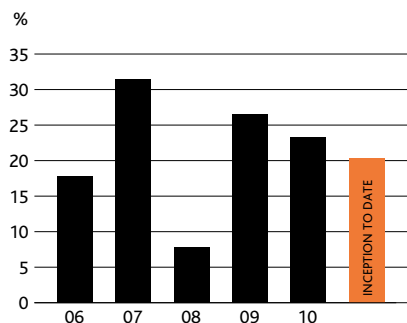
GROSS PREMIUMS WRITTEN



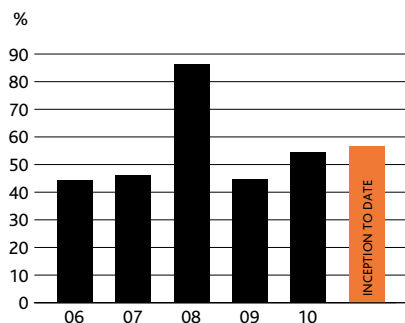
OPERATING HIGHLIGHTS

- **Excellent underwriting performance.** An accident year loss ratio of 42.9% despite numerous natural disasters around the world and the total loss of the Deepwater Horizon drilling unit;
- **Underwriting discipline maintained.** Increased appetite for energy risks, but reductions in other lines;
- **Solid investment return.** Conservative portfolio positioning continues with some expansion into emerging market debt; and
- **Active capital management.** Continuing to "right size" capital via special dividends and share repurchases as the market outlook changes.

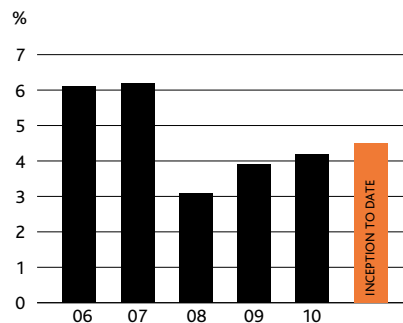
**RETURN ON EQUITY
SINCE INCEPTION**



**COMBINED RATIO
SINCE INCEPTION**



**TOTAL INVESTMENT RETURN
SINCE INCEPTION**



Five strengths of Lancashire's business strategy

- 1 Lancashire puts underwriting first.
- 2 Lancashire focuses its investment strategy on balance sheet protection.
- 3 Lancashire manages risk and return through the underwriting cycle.
- 4 Lancashire stays nimble and adaptable.
- 5 Lancashire thrives on opportunity and innovation.

How we operate

THE DAILY UNDERWRITING CALL

3 LOCATIONS

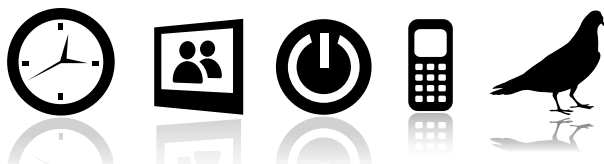
5 DAYS A WEEK

52 WEEKS A YEAR

103 POTENTIAL PARTICIPANTS*



**HAMILTON
BERMUDA
43 STAFF**



AT THE SAME TIME EVERY DAY BY VIDEO CONFERENCE,
INTERNET, PHONE (OR IF NECESSARY CARRIER PIGEON).

We hold a daily Underwriting and Marketing Conference Call to evaluate business across all lines, to learn from each other, and to monitor market trends.

* Plus Pompey the dog

CLASSES OF BUSINESS

4 Property Marine
Energy Aviation

To find out more go to page 20

FTSE 250 RANKING

No. 110*

March 2009 secured a full listing on the London Stock Exchange

* Position at 31 December 2010

OUR LOCATIONS



**LONDON
UK
57 STAFF**

**DUBAI
UAE
3 STAFF**

HAMILTON, BERMUDA

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

LONDON, UK

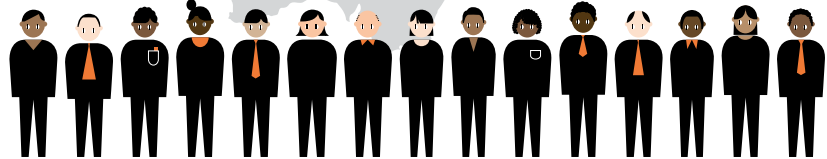
From its base in Fenchurch Street, in the heart of the London insurance market, Lancashire's UK operations include a fully fledged underwriting platform staffed by experienced underwriters, managers and support staff. The platform was established in 2006 to expand the Group's operations and provide access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

DUBAI, UAE

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

NUMBER OF EMPLOYEES

103



2006 – 57 2007 – 79 2008 – 91 2009 – 101

STRATEGIC PRIORITIES

3

Underwriting comes first
Effectively balance risk and return
Operate nimbly through the cycle

Our strategic priorities are at the heart of everything we do. To find out more go to page 18

Five years in review...

In August 2005 Hurricane Katrina devastated much of the U.S. Gulf Coast, followed shortly thereafter by Hurricanes Rita and Wilma. All told over \$100 billion of insured losses resulted. These exceptional natural catastrophes resulted in a dramatic rise in insurance rates. Within three months Lancashire was incorporated and licensed to underwrite insurance business making 2010 our 5th anniversary.

The first five years have produced consistently strong results for Lancashire, demonstrated not least by an inception to date combined ratio of 56.7 per cent and a compound annual RoE of 20.3 per cent. 2010 has proved no exception. Lancashire has once again produced robust results. Net profit after tax was \$330.8 million or \$1.86 per common share and RoE was 23.3 per cent.

These impressive results have not been achieved through rapid growth, but rather through rigorous underwriting discipline and the ability to adapt quickly to changing market conditions. Lancashire prides itself on its ability to grow or contract in the core areas of its business, redeploying its capital quickly and efficiently. Becoming the biggest fish in the sea might matter to some, but for Lancashire we continue to grow only when market conditions are favourable. Continued success at Lancashire means constantly embracing our core objectives: disciplined underwriting, effectively balancing risk and return, and to operate nimbly through the cycle.

DIVIDENDS

On 5 August 2010, an interim dividend of \$0.05 per common share and warrant, equivalent to £0.03 at prevailing exchange rates, was declared by the Board and paid on 13 October 2010 and a special dividend of \$1.40 per common share and warrant, equivalent to £0.89 at prevailing exchange rates, was declared on 8 November 2010 and paid on 19 January 2011.

On 20 February 2011, a final dividend of \$0.10 per common share and warrant was declared by the Board, to be paid in pounds sterling on 20 April 2011.

SOLVENCY II AND EQUIVALENCE

Solvency II becomes effective in Europe on 1 January 2013. Lancashire's London insurance operation has spent a lot of time during 2010 on Solvency II preparations and these will continue in 2011 and 2012. Meanwhile Bermuda continues to introduce new legislation to ensure it will meet the Solvency II equivalence criteria and will begin to be assessed by the European Insurance and Occupational Pensions Authority ("EIOPA") later this year. Whilst we do not anticipate these developments materially impacting our required capital levels, they will require additional resources to ensure full compliance with the new regulations.

PERSONNEL

As Lancashire has developed over the past five years, so has the structure of the Board of Directors and senior management. We have a team which demonstrates rich and varied experience and diverse talents.

In 2010 Simon Burton, Barry Volpert and Jens Juul stepped down from their positions on the Board. I would like personally to thank them for their commitment and dedication to Lancashire. We also welcomed new Board members, Emma Duncan and Alex Maloney, and I look forward to working more closely with them in 2011.

The quality of the people at Lancashire makes a large contribution to the Group's success, and I would like to express my thanks for the continuing hard work and my pride in being part of such a strong team.

IN CONCLUSION

We find ourselves in a soft underwriting market in many lines of business. However, with Lancashire's continuing commitment to disciplined underwriting, capital management and producing attractive returns to our investors, we believe we are ideally positioned to meet and exceed these challenges over the next 5 years and beyond.

Martin Thomas, Non-Executive Chairman

Our strategy



Well, our first five years have flown by!

In December 2005, you could count all of us on one hand. We spent every waking hour in the office, which was underground in a former bank vault previously used to store furniture.

Our time was juggled between pitching to investors, being nice to rating agencies, drumming up business, and buying stationery. Oh, and we decided to do an IPO on our first day.

INCEPTION TO DATE COMBINED RATIO

56.7%

INCEPTION TO DATE TOTAL SHAREHOLDER RETURN

176.4%

It was nothing, if not busy and looking back, it's not exactly clear how we got through those mad first few months. Fortunately we did because it's been tons of fun ever since, especially as the fun is now shared with a lot more people. Since we started in business, the collective efforts of the whole Lancashire team have produced a compound annual RoE of 20.3 per cent.

2010 REVIEW

Lancashire had a very healthy performance in what was a reasonably challenging year. The year didn't have any mega industry losses. Rather, it had a number of smaller events which, when combined, had the potential to trip companies up. The most significant event, certainly in our areas of focus, was the loss of the Deepwater Horizon drilling unit in April. Despite Lancashire being one of the industry's largest energy markets, our net loss was contained within one month's profits. Other notable industry events in 2010 were the earthquakes in Chile and New Zealand, the flooding in Queensland, and the dramatic drop in bond values in the fourth quarter.

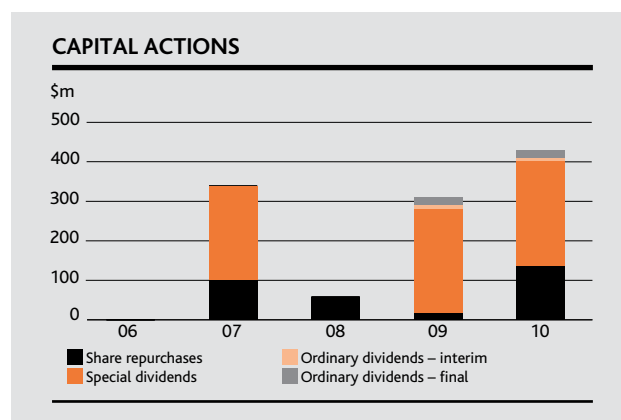
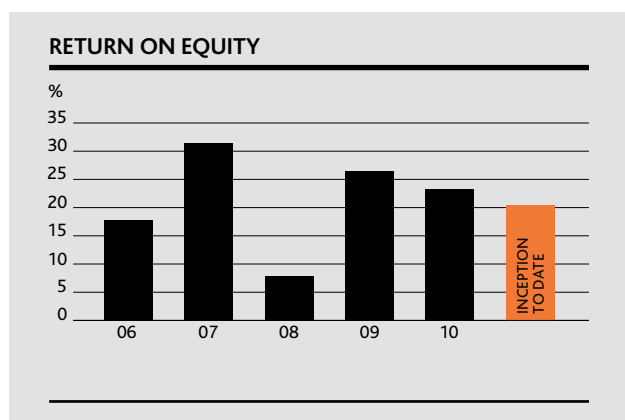
Against that background, we're very pleased to be reporting a RoE of 23.3 per cent, a combined ratio of 54.4 per cent and a total investment return of 4.2 per cent. We also returned \$430.6 million of capital to shareholders. It was, once again, an industry leading performance.

UNDERWRITING

In 2010, our underwriting strategy performed as intended. We expect to suffer losses from time to time, but we try to keep the frequency low. We try especially hard not to lose much money when the event doesn't impact premium rates. The only event of 2010 to turn around rates materially was the loss of the Deepwater Horizon drilling unit. Lancashire incurred some losses, but immediately reaped the benefits of increased energy rates. We had a very manageable loss from the Chilean earthquake and immaterial losses from other events.

All told, our reported loss ratio for the year was 27.0 per cent. Perhaps more telling of our performance was our accident year loss ratio of 42.9 per cent. These numbers indicate a conservative approach to reserving, but more importantly they show that Lancashire's underlying underwriting performance remains excellent despite the soft market.

At the risk of repeating ourselves, the importance of our relationships with brokers and clients is embedded in Lancashire's DNA. They are the lifeblood of our business and in return we strive to provide the very best service we can.



INVESTMENTS

We had good news and bad news on investments in 2010. The good news is that for the fifth year running, we produced a positive investment result for the year. The bad news is that we suffered a loss in the fourth quarter of 0.4%. It was only the second quarter since inception that our investments failed to produce a positive return. While we were disappointed this happened, there was relatively little we could have done to avoid it. U.S. Treasury bonds had one of their largest drops in value in history. We will look to bolster our aim of "Don't Lose Your Money" in 2011.

CAPITAL MANAGEMENT

In late 2005 Lancashire raised \$978.6 million of share capital. By the end of 2010, we had returned \$1.1 billion dollars of capital back to shareholders. At the start of 2010, we publicly promised to end the year with less capital than we started. We emphatically met that promise, giving shareholders back \$100 million more than we earned.

It is our firm belief that pro-active and flexible capital management is crucial in helping generate a superior return over time. Conversely, a reactive or inflexible (or worse, non-existent) approach to capital management will significantly dampen the long-term performance of even the best run companies.

PEOPLE

All the technology in the world doesn't take away from the fact that this is a people business, and we count ourselves extremely lucky to work with such a great bunch. For the level of premium we write, there aren't many of us – just over 100 at the end of the year – which is very low for a company that predominantly writes insurance business.

At Lancashire, we have a strong culture where everyone works hard and everyone pulls in the same direction. This is helped by the fact that all permanent staff are eligible for share awards and jointly participate in the success of the Group. All variable compensation is based on challenging RoE hurdles, and the calculations are the same for everyone regardless of seniority or department. We watch our costs very carefully which is reflected in our low expense ratio. No-one turns left on airplanes, including the authors of this letter! We are also immensely proud of the major difference being made by the Lancashire Foundation. In 2010, notable events were our responses to crises in Haiti and Burma which were generous and fast. There was also a highly successful trip made by a team of staff to help build houses in the Philippines.

OUTLOOK

In last year's report, we described the trading outlook as reasonable. For the upcoming year, we can just about use the same description again. If it were not for improved conditions in two of our areas of focus – energy and sovereign risk – the adjective would have changed to 'challenging'. For the P&C industry as a whole, it is firmly in the challenging stage of the cycle. We won't pretend that the outlook for Lancashire is encouraging on an absolute basis, but on the other hand, it looks pretty good on a relative basis. There are three main reasons we say this:

First, a meaningful proportion of our portfolio is in classes that are either showing increases or at least holding steady. We will take advantage of those, while shrinking the rest of the portfolio. We do not care about our top-line volumes, and as things currently stand we expect to write less business in 2011 than we wrote in 2010. The business that we do write will be attractive.

Second, we are actively managing capital as the cycle evolves. We are starting 2011 with less capital than we had a year ago. By reducing the denominator in the equation last year, we help shareholder returns this year.

Third, we have one of the smallest and most efficient operating structures of our sector. The benefits of this can be seen most clearly at the bottom of the cycle, when we can comfortably cut back on premium without worrying about the pay checks for hundreds of people or the rent for numerous offices.

The market will not stay soft forever. Conditions were far from easy in 2010 but we still managed to make a return for our shareholders of 23.3 per cent. It will probably worsen further in 2011, and while we can't guarantee the same level of return, we believe we are in better shape than most. And when the cycle does turn, which hopefully can't be too far away, you can rest assured that Lancashire will be ready.

Richard Brindle, Chief Executive Officer

Neil McConachie, President

2010 has not been an easy year. Natural catastrophes produced insured losses almost double those of 2009.

We saw one of the busiest Atlantic wind storm seasons on record, numerous earthquakes around the world and ended 2010 with the extreme floods in Australia. April brought the total loss of the Deepwater Horizon drilling unit and ensuing pollution. Investment markets stabilised somewhat but volatility has continued, particularly in the final quarter of the year. Against that backdrop, Lancashire has produced a profit after tax of \$330.8 million with a combined ratio of 54.4 per cent and an RoE of 23.3 per cent.

PREMIUMS

Despite expectations of price reductions in most of our business lines, we grew our top line by \$61.3 million, or 9.8 per cent. However, this is largely due to a small number of multi-year deals which were written early in the year to lock in the best available pricing. Excluding multi-year deals and reinstatement premium in relation to Chile we are actually \$8.5 million, or 1.4 per cent, behind 2009. We saw significant price increases in the energy sector following the Deepwater Horizon loss and if we also exclude energy premiums we are \$41.3 million, or 9.1 per cent, behind 2009. Other than energy, the other bright spot in our top line numbers was the growth of our sovereign obligors line within our political risk portfolio.

LOSSES

2010 saw an active claims environment. We had exposure to both the Chilean earthquake and the Deepwater Horizon disaster. Despite the active Atlantic wind season, fortunately there were few storms making landfall and industry loss levels were very low. In respect of the New Zealand earthquake and the December Queensland floods, our exposure is minimal. The Group's loss ratio for the year was 27.0 per cent, with an accident year loss ratio of 42.9 per cent reflecting both a very manageable loss on the Chilean earthquake and modest exposure to Deepwater Horizon, with de minimus exposure to the liability side of the loss.

INVESTMENTS

We have produced a total return on investments of 4.2 per cent. Yields have remained low during 2010 and, while the markets have been more stable, considerable volatility and uncertainty has remained. As a result, the Group maintains its conservative investment philosophy with the primary goal of liquidity and capital preservation. We have increased our allocation to corporate bonds from 33.1 per cent to 35.4 per cent of our portfolio and have also allocated 6.8 per cent to emerging market debt. These asset classes have provided slightly higher yields without increasing the risk profile of our portfolio. We also hold some Treasury Inflation Protected Securities to hedge against any eventual inflation that may materialise.

CAPITAL

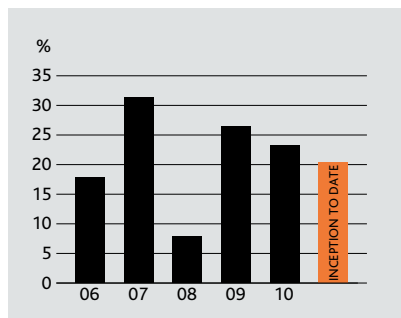
Our obsession with capital management has continued in 2010 with share repurchases of \$136.4 million through the year and a special dividend of \$264.0 million, in conjunction with our small interim and final ordinary dividends.

RATING AGENCIES

Lastly, we're proud that, in our fifth year of operation, we have ratings from three major rating agencies. A.M. Best this year upgraded our A- (Excellent) financial strength rating to a positive outlook. Standard and Poor's and Moody's Investor Services both assigned ratings during the year of A- and A3 respectively.

Elaine Whelan, Chief Financial Officer

Key performance indicators (KPIs)



23.3 per cent RoE, including dividends declared, in 2010.

RETURN ON EQUITY

AIM

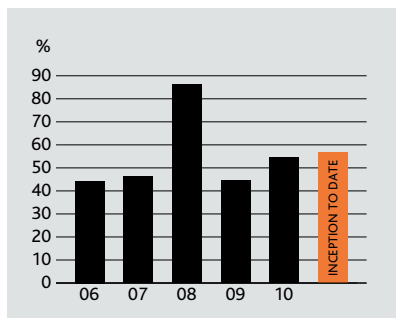
The Group's aim is to provide shareholders with a risk adjusted RoE of 13 per cent in excess of a risk-free rate over the insurance cycle.

MEASUREMENT

The RoE is measured by management in terms of the IRR of the increase in FCBVS in the period adjusted for dividends.

RISK MANAGEMENT

The stated aim is a long-term goal, acknowledging that management expects both higher and lower results in the shorter term. The cyclical nature 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.



54.4 per cent combined ratio achieved in 2010.

COMBINED RATIO

AIM

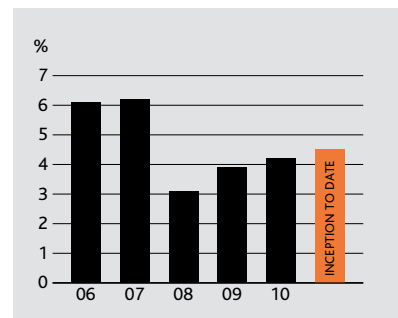
The Group aims to limit its exposure in connection with insurance contracts, in the event of insured losses, to the level of premium which will be sufficient to cover the loss payments and expenses. That is, we aim to price our business to ensure that the combined ratio in any year is less than 100 per cent.

MEASUREMENT

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

RISK MANAGEMENT

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



4.2 per cent net total return on investments in 2010.

TOTAL INVESTMENT RETURN

AIM

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

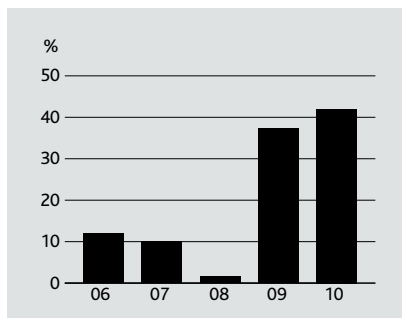
MEASUREMENT

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

RISK MANAGEMENT

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

- Financial KPIs (Non-GAAP)
- Non-financial KPIs



42.0 per cent total shareholder return in 2010.

TOTAL SHAREHOLDER RETURN

AIM

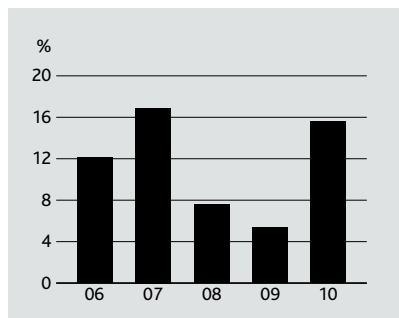
The Group's aim is to provide an attractive risk-adjusted return to shareholders over the long-term.

MEASUREMENT

The TSR is measured in terms of the IRR of the increase in share price, in the period, measured in U.S. dollars, adjusted for dividends.

RISK MANAGEMENT

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



15.6 per cent staff turnover in 2010.

STAFF TURNOVER

AIM

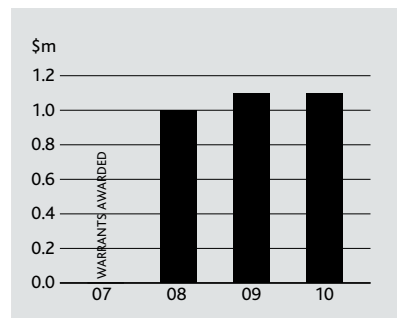
The Group aims to offer Lancashire staff competitive compensation packages but, more importantly, exposure to a wide breadth of responsibilities and the opportunity for continuous learning. To the extent possible and appropriate, the Group seeks to promote from within its ranks.

MEASUREMENT

Every two years staff surveys are performed by independent third parties, on an anonymous basis. The results of the surveys have been consistently positive.

RISK MANAGEMENT

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



\$1.1 million donated to the Lancashire Foundation in 2010.

LANCASHIRE FOUNDATION

AIM

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

MEASUREMENT

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

RISK MANAGEMENT

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

We're 5 years old now. But we have not changed our fundamental business principles.

Our strategic cornerstones

1 UNDERWRITING COMES FIRST

Underwriting is first and foremost and always will be. We don't believe in annual premium targets. Risk selection is key and this is evident in our loss experience this year. In a year of headline loss after headline loss we did pretty well.

2 EFFECTIVELY BALANCE RISK & RETURN

Risk management is a larger part of our DNA than ever. Balance sheet strength is a key component of this. We've produced a compound annual return of 20.3% since inception and an RoE of 23.3% in 2010. And take a look at our risk levels. Our PMLs are lower than they've ever been.

3 OPERATE NIMBLY THROUGH THE CYCLE

Operating nimbly and capital management go hand in hand. Early in the year we took advantage of the strong property catastrophe reinsurance prices and wrote some large multi-year deals. We reduced premium in other lines as prices declined. Then, following Deepwater Horizon and the resulting increase in pricing and demand, we wrote more energy business. By the end of the year we declared a large special dividend given the outlook for 2011. We keep moving as the environment around us changes.

Underwriting continues to be the most important part of Lancashire. In the active claims environment of 2010, the most important part of Lancashire demonstrated its superior risk selection, producing a loss ratio of 27.0 per cent.

BUSINESS STRUCTURE AND LOCATIONS

The main operating companies of the Group are LICL in Bermuda and LUK in London which both provide insurance and reinsurance to their customers, with an emphasis on the property, energy, marine and aviation lines of business.

In addition, LMEL, which operates from Dubai, undertakes insurance intermediation activities, on behalf of both LICL and LUK, in the Middle East and Asia Pacific regions. In late 2010 LICL submitted an application to SUSEP to establish a marketing office in Brazil to undertake insurance intermediation activities. We hope to receive authorisation in early 2011.

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

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

The London office primarily writes the following types of business:

- Property direct and facultative;
- Terrorism, political risk and sovereign obligors;
- Energy;
- Direct marine; and
- AV52 aviation third party.

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

DISTRIBUTION

It is difficult to overstate the importance of broker and customer relationships in achieving effective distribution of our products. Almost all of our business is transacted through brokers and we work hard to foster close working relationships. Brokers need to know that insurers of their clients have excellent financial strength, a thorough understanding of the risks at hand, and a willingness and ability to provide first class service. We believe we meet all of these requirements.

RENEWAL PRICE INDEX

Lancashire’s RPI is an internal tool that 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, reflecting Lancashire’s assessment of relative change in price, terms, conditions and limits and is weighted by premium volume. The calculation involves a degree of judgement in relation to comparability of contracts and the assessment noted above. To enhance the RPI tool, management of Lancashire may revise the methodology and assumptions underlying the RPI, so the trends in premium rates reflected in the RPI may not be comparable over time. Consideration is only given to renewals of a comparable nature so it does not reflect every contract in Lancashire’s portfolio. The future profitability of the portfolio of contracts within the RPI is dependent upon many factors besides the trends in premium rates.

INVESTMENTS

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

In 2010 we generated a total investment return of 4.2 per cent (2009 – 3.9 per cent). Our average annual total investment return since inception is 4.7 per cent. We have made a positive investment return every year since inception, including in the unprecedented market conditions that ensued in 2008, something we are very proud of. The conservative nature of our portfolio and our investment philosophy means that we do not expect to generate spectacular returns in periods of market recovery, but we prefer not to produce significant losses in periods of market turmoil. Our portfolio mix illustrates our philosophy as shown on page 22.

With composition regulated by the Group’s investment guidelines we have three investment portfolio categories: “core”, “core plus” and “surplus”. The “core” portfolio contains at least enough funds required to meet near term obligations and cash flow needs following an extreme event. Assets in excess of those required to be held in the “core” portfolio may be held in any of the three portfolio categories.

RENEWAL PRICE INDEX STATISTICS

	2006	2007	2008	2009	2010
Property reinsurance	100	97	96	127	121
Property direct and facultative	100	92	83	90	84
Energy Gulf of Mexico	100	80	64	137	139
Energy worldwide offshore	100	80	68	84	88
Marine	100	88	80	82	80
Terrorism	100	86	71	66	60
Aviation (AV52)	100	80	69	68	62
Combined	100	86	88	109	97

Our classes of business

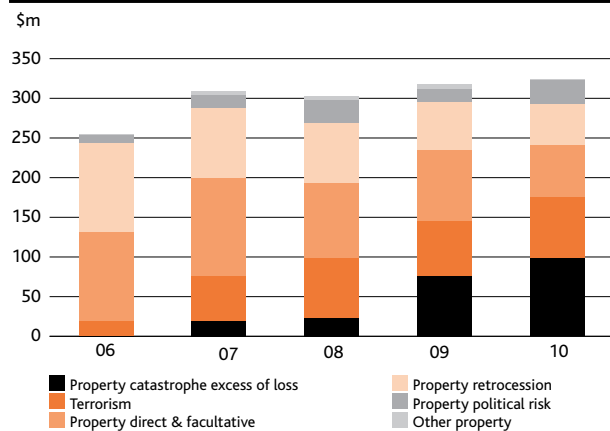
Property

- Gross premiums written of \$323.6 million (2009 – \$317.3 million)
- Loss ratio of 34.9% (2009 – negative 3.1%)
- Net underwriting income of \$164.7 million (2009 – \$256.6 million)
- Capital deployed early in the year on reinsurance lines in the face of a declining pricing environment
- Performed well given the high incidence of natural catastrophes

GROSS PREMIUMS WRITTEN BY GEOGRAPHICAL ZONE \$m

Worldwide offshore	1.2
U.S. and Canada	133.3
Worldwide, including U.S. & Canada	53.9
Europe	42.9
Worldwide, excluding U.S. & Canada	40.6
Far East	15.9
Middle East	6.1
Rest of the world	29.7
Total	323.6

PROPERTY PREMIUM SPLIT



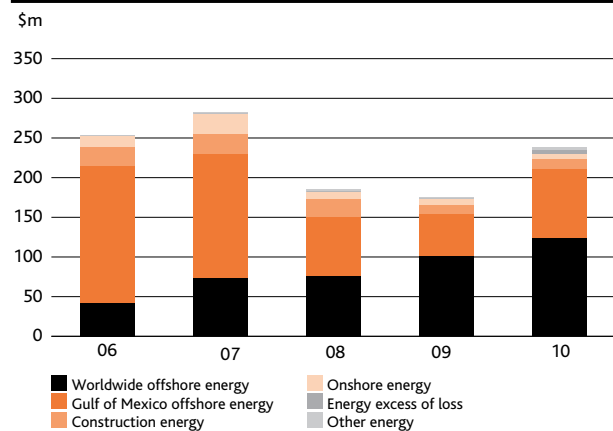
Energy

- Gross premiums written of \$238.3 million (2009 – \$175.5 million)
- Loss ratio of 20.2% (2009 – 44.6%)
- Net underwriting income of \$109.4 million (2009 – \$60.8 million)
- Significant increase in volume and pricing in the offshore sector post Deepwater Horizon loss
- Deepwater Horizon loss contained to approximately one month's earnings

GROSS PREMIUMS WRITTEN BY GEOGRAPHICAL ZONE \$m

Worldwide offshore	225.0
U.S. and Canada	2.6
Worldwide, including U.S. & Canada	7.6
Europe	0.3
Worldwide, excluding U.S. & Canada	0.2
Far East	0.3
Middle East	0.7
Rest of the world	1.6
Total	238.3

ENERGY PREMIUM SPLIT



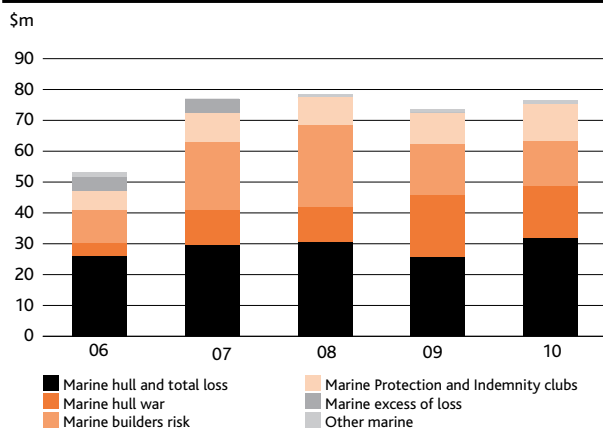
Marine

- Gross premiums written of \$76.4 million (2009 – \$73.7 million)
- Loss ratio of 38.6% (2009 – 38.7%)
- Net underwriting income of \$21.8 million (2009 – \$24.1 million)
- Book continues to remain profitable
- Focus remains on finding attractive niche areas whilst retaining caution for the sector as a whole

GROSS PREMIUMS WRITTEN BY GEOGRAPHICAL ZONE \$m

Worldwide offshore	75.2
U.S. and Canada	–
Worldwide, including U.S. & Canada	0.5
Europe	0.2
Worldwide, excluding U.S. & Canada	0.1
Far East	0.4
Middle East	–
Rest of the world	–
Total	76.4

MARINE PREMIUM SPLIT



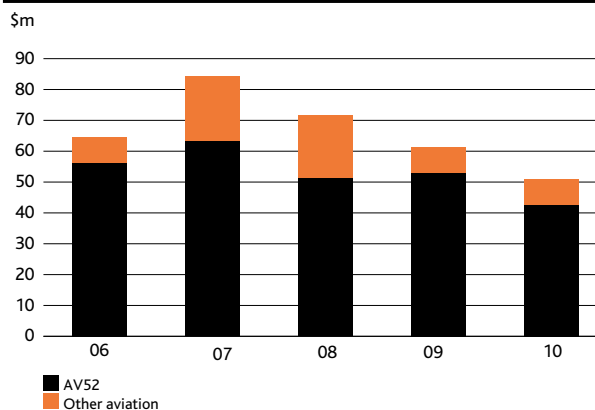
Aviation

- Gross premiums written of \$50.8 million (2009 – \$61.3 million)
- Loss ratio of negative 11.1% (2009 – 2.1%)
- Net underwriting income of \$46.3 million (2009 – \$48.5 million)
- Market lead on the majority of accounts

GROSS PREMIUMS WRITTEN BY GEOGRAPHICAL ZONE \$m

Worldwide offshore	–
U.S. and Canada	–
Worldwide, including U.S. & Canada	50.7
Europe	0.1
Worldwide, excluding U.S. & Canada	–
Far East	–
Middle East	–
Rest of the world	–
Total	50.8

AVIATION PREMIUM SPLIT



MANAGED INVESTMENT PORTFOLIO ALLOCATIONS

	2006	2007	2008	2009	2010
Cash	28.6%	38.8%	19.6%	7.1%	21.9%
Short-term	0.5%	–	8.2%	14.2%	0.5%
Government debt	2.3%	13.7%	12.3%	16.2%	22.4%
Agency debt	11.1%	11.2%	5.8%	5.6%	1.6%
Agency MBS	15.9%	12.9%	30.9%	23.8%	15.3%
Non-agency RMBS, ABS, CMBS	20.2%	0.4%	–	–	2.9%
FDIC corporate bonds	–	–	7.7%	9.5%	4.3%
Corporate bonds	16.2%	19.2%	15.2%	23.6%	31.1%
Equities	5.2%	3.8%	0.3%	–	–

4.7%
Average annual total investment return since inception.

We review the composition, duration and asset allocation of each investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. If certain asset classes are anticipated to produce a higher return within management’s risk tolerance an adjustment in asset allocation may be made. Conversely, if the risk profile is expected to move outside of tolerance levels, adjustments may be made to reduce the risks in the portfolio. We try to be nimble in our investment strategy. We believe in the application of common sense, and do not place much reliance on “black box” approaches to investment selection.

Investments are, however, inherently unpredictable and there are risks associated with any investment strategy decisions. Some of our tactical decisions have proved to be timely and invaluable. Recent history has been tumultuous, and we have avoided many of the pain points with our defensive decisions. We remain vigilant. Some of our more significant decisions taken over the last few years are as follows:

- Q4 2007: Exited non-agency structured product classes including CMBS, RMBS and ABS classes, prior to the 2008 liquidity crisis;
- Q1 2008: Significantly reduced exposure to financial sector corporate bonds, including selling all Lehman Brothers holdings. Increased weighting in Treasuries;
- Q2 2008: Remained defensive, including increasing allocation to cash to 39% of total invested assets;

- Q3 2008: Continued to reduce equity holdings from 5% to less than 1% by 31 December 2008;
- Q4 2008: Reduced weighting in Treasuries and increased weighting to FDIC backed corporate debt, Agency debt and Agency MBS;
- Q1 2009: Retained defensive position;
- Q2 2009: Retained defensive position, increased allocation to Treasury Inflation Protected Securities;
- Q3 2009: Deployed excess cash and increased allocation to corporate bonds, reduced some of the tactical restrictions on corporate sectors and names;
- Q4 2009: Continued to reduce tactical restrictions and increase allocation to corporate bonds;
- Q1 2010: Allocated a small portion of surplus funds to EMD;
- Q3 2010: Allocated a further small portion of surplus funds to EMD;
- Q4 2010: Reduced our Treasury holdings; and
- Q1 2011: Reduce duration and consider a small allocation to equities.

We have no plans to change our investment philosophy in the foreseeable future. We will continue to monitor the economic environment closely.

We continually monitor investment opportunities, such as equities, EMD and global market debt, but remain, as always, opposed to driving for return if it results in risk taking beyond our limited appetite.

LIQUIDITY AND CASH FLOW

Liquidity

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

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

More detail on the practical application of this approach to liquidity is set out in the discussion of investment performance on page 27.

Cash flow

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

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

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

Cash flows from operating activities

In 2010, cash flow was again strong, driven by the Group’s robust underwriting performance, including some favourable development on prior accident year loss reserves.

A net positive cash inflow arose from operations during the year of \$268.8 million (2009 – \$278.4 million).

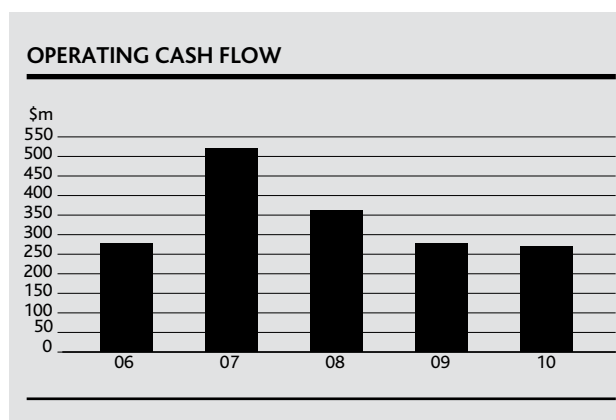
Cash flows from investing activities

There was a net cash inflow from investing activities in 2010 of \$259.2 million (2009 – \$210.7 million outflow) primarily as a result of the net sale of fixed income securities of \$193.0 million (2009 – purchase of \$270.8 million) and interest and dividends received of \$66.9 million (2009 – \$62.8 million).

During 2010, the investment portfolio yielded lower cash returns than 2009 as a result of the continuing lower interest rate environment. As higher yielding securities matured or were sold, the proceeds were reinvested in securities with coupon payments at lower prevailing interest rates. However, the Group still managed to realise a positive cash flow benefit as the underlying market value of the investments increased, leading to higher realised cash gains from investment sales.

Cash flows from financing activities

Financing activities resulted in a net outflow of \$448.1 million (2009 – \$41.8 million) as a result of dividends paid of \$293.2 million (2009 – \$10.5 million), settlement of share purchases of \$149.5 million (2009 – \$24.9 million) made and interest payments made to the Group’s long-term debt holders of \$5.4 million (2009 – \$6.4 million).



2010 Financial performance

2010 FINANCIAL HIGHLIGHTS

- FCBVS of \$7.57 (2009 – \$7.41). RoE, defined as growth in FCBVS adjusted for dividends, of 23.3% (2009 – 26.5%);
- Gross premiums written of \$689.1 million (2009 – \$627.8 million). Net premiums written of \$649.9 million (2009 – \$577.1 million);
- Reported loss ratio of 27.0% (2009 – 16.6%) and a combined ratio of 54.4% (2009 – 44.6%); Accident year loss ratio of 42.9% (2009 – 27.2%);
- Inception to date combined ratio of 56.7% (2009 – 57.5%);
- Total investment return of 4.2% (2009 – 3.9%);
- Net operating profit of \$306.5 million (2009 – \$364.7 million), or \$1.73 diluted operating EPS (2009 – \$1.94);
- Net profit after tax of \$330.8 million (2009 – \$385.4 million), or \$1.86 diluted earnings per share (2009 – \$2.05);
- Interim dividend of \$9.4 million (2009 – \$10.5 million) or 5.0 cents per common share; final dividend of approximately \$18.9 million (2009 – \$20.8 million) or 10.0 cents per common share;
- Special dividend of \$264.0 million (2009 – \$263.0) or \$1.40 per common share (2009 – \$1.25); and
- Capital returned to shareholders via share repurchases \$136.4 million (2009 – \$16.9 million).

FINANCIAL HIGHLIGHTS

	2006 \$m	2007 \$m	2008 \$m	2009 \$m	2010 \$m
Gross premiums written	626.0	753.1	638.1	627.8	689.1
Net premiums written	547.5	666.8	574.7	577.1	649.9
Net premiums earned	243.5	611.2	607.3	594.7	614.2
Net insurance losses	39.1	146.3	375.5	98.7	165.7
Net underwriting income	169.5	388.4	132.2	390.0	342.2
Net investment income	54.2	78.4	59.5	56.0	53.4
Net realised gains (losses) and impairments	0.8	9.1	(11.0)	23.8	33.2
Profit after tax	159.3	390.9	97.5	385.4	330.8
Change in net unrealised gain/ losses on investments	8.7	12.0	6.9	2.8	(2.2)
Comprehensive income	168.0	402.9	104.4	388.2	328.6
Diluted earnings per share	\$0.79	\$1.91	\$0.53	\$2.05	\$1.86
Return on Equity	17.8%	31.4%	7.8%	26.5%	23.3%
Loss ratio	16.1%	23.9%	61.8%	16.6%	27.0%
Acquisition cost ratio	14.3%	12.5%	16.4%	17.8%	17.3%
Expense ratio	13.9%	9.9%	8.1%	10.2%	10.1%
Combined ratio	44.3%	46.3%	86.3%	44.6%	54.4%
Net total return on investments	6.1%	6.2%	3.1%	3.9%	4.2%

GROSS PREMIUMS WRITTEN

	2009 \$m	2010 \$m	Change \$m	Change %
Property	317.3	323.6	6.3	2.0
Energy	175.5	238.3	62.8	35.8
Marine	73.7	76.4	2.7	3.7
Aviation	61.3	50.8	(10.5)	(17.1)
Total	627.8	689.1	61.3	9.8



UNDERWRITING RESULTS

Gross premiums written increased by 9.8 per cent compared to 2009. Excluding reinstatement premiums and the impact of multi-year contracts, gross premiums written in 2010 were 1.4 per cent lower than 2009, with the declining pricing environment being offset by an improvement in energy pricing following the Deepwater Horizon loss. The Group's four principal classes, and the key market factors impacting them, are discussed below.

Property gross premiums written increased by 2.0 per cent for the year ended 31 December 2010 compared to the year ended 31 December 2009. The growth area of political risk was attributable to the addition of the sovereign obligors line within this class in 2010. Reinsurance premiums for the year were marginally down on the prior year. At the start of 2010, price reductions in this line were minor and a tactical decision was taken to deploy more of the Group's capital at the January 2010 reinsurance renewals than in prior years. A significant amount of new business across this line was therefore written in the first quarter of 2010, including some large multi-year property catastrophe reinsurance contracts, with a corresponding reduction in appetite in these lines during the remainder of the year. The property retrocession line was also impacted by declining pricing throughout the year, but included approximately \$12.1 million of reinstatement premiums in connection with the February Chilean earthquake. Within the terrorism line, premiums increased year on year due to opportunities that arose earlier in 2010 from the post recession recommencement of construction projects around the world, plus increased participation in international terror pools.

Energy gross premiums written increased by 35.8 per cent for the year ended 31 December 2010 compared to the year ended 31 December 2009. Pricing has remained positive in the offshore sectors following the Deepwater Horizon loss.

The timing of some worldwide offshore contract renewals also had a positive impact on premiums written in 2010. Gulf of Mexico premium volume was also considerably higher compared to the prior year. This was driven by increased demand, including insureds seeking new layers and increased limits following the Deepwater Horizon loss. Premiums written were also buoyed by a number of large Gulf of Mexico catastrophe accounts being written or renewed on a multi-year basis. The Group also wrote some non-elemental Industry Loss Warranty covers following insurance industry losses suffered from Deepwater Horizon. \$5.4 million of the premium in respect of these covers is included in the premium numbers for the energy excess of loss class.

Marine gross premiums written increased by 3.7 per cent for the year ended 31 December 2010 compared to the year ended 31 December 2009. Pricing and renewal rates were broadly stable. The small increase for the year was largely driven by the timing of certain multi-year contract renewals and some contract extensions or exposure increases.

Aviation gross premiums written decreased 17.1 per cent for the year ended 31 December 2010 compared to the year ended 31 December 2009. The reduction was driven primarily by a reduction in the number of flights flown and passengers travelling in the recent recessionary environment plus a competitive fourth quarter renewal environment.

LOSS DEVELOPMENT BY CLASS

	2006 \$m	2007 \$m	2008 \$m	2009 \$m	2010 \$m
Property	–	(1.8)	22.3	44.4	28.8
Energy	–	5.0	5.5	9.3	47.6
Marine	–	1.3	–	6.1	17.7
Aviation	–	(0.1)	0.8	3.7	6.0
Total	–	4.4	28.6	63.5	100.1

LOSS RATIO

27.0%

2006 – 16.1% 2007 – 23.9% 2008 – 61.8% 2009 – 16.6%

Ceded premiums decreased by \$11.5 million, or 22.7 per cent, for the year ended 31 December 2010 compared to the same period in 2009. The reduction in the cost of outwards reinsurance cover for the year was helped by improved pricing compared to 2009 and by a re-structuring of the Group's cover, from a whole account cover to an individual risk cover, offset by the Group purchasing additional catastrophe cover on its U.S. property direct and facultative portfolio, and reinstating non-elemental cover on its marine and energy book in the second quarter.

Net premiums earned as a proportion of net premiums written were 94.5 per cent for the year ended 31 December 2010, compared to 103.0 per cent in 2009. The significant increase in premium written volumes in the first quarter of 2010 as compared to 2009 resulted in a comparatively large deferral of earnings from earlier to later in the year and partially into 2011. Premiums on a significant multi-year contract within the property catastrophe reinsurance and several within the energy Gulf of Mexico classes of \$36.7 million and \$33.4 million respectively, also drove the material deferrals of earning of premiums written earlier in the year.

The Group's loss ratio was 27.0 per cent for the year ended 31 December 2010 compared to 16.6 per cent for 2009. The twelve months to 31 December 2010 include the impact of the February Chilean earthquake of \$84.7 million, plus the total loss of the Deepwater Horizon drilling unit. Lancashire's net claim for the Deepwater Horizon loss is \$25.0 million. Excluding these two events, the loss ratio for the year would have been 7.2 per cent, reflecting an otherwise low number of reported losses combined with favourable development of prior year loss reserves. The Group's current expected loss range for the Chilean earthquake is \$77.6 - \$92.4 million. While our reserves in relation to the Chilean earthquake have become somewhat clearer, there continues to be considerable uncertainty on the eventual ultimate loss. In respect of the New Zealand earthquake and Queensland floods less than \$5.0 million has been recorded within reserves for these events combined.

Net prior year reserve releases were \$100.1 million for the year ended 31 December 2010 compared to \$63.5 million for the year ended 31 December 2009. The favourable development in 2010 arose primarily from IBNR releases due to fewer than expected reported losses. Net adverse development on Hurricane Ike in 2009 was \$17.1 million.

LOSS TRIANGLES

Accident year	2006 \$m	2007 \$m	2008 \$m	2009 \$m	2010 \$m
Estimate of ultimate net liability ⁽¹⁾					
At end of accident year	39.1	151.2	403.9	161.7	263.6
One year later	34.7	125.0	370.3	106.5	
Two years later	32.0	99.5	334.4		
Three years later	27.6	91.3			
Four years later	27.2				
As at 31 December 2010	27.2	91.3	334.4	106.5	263.6
Payments made	(21.0)	(62.6)	(207.7)	(25.9)	(34.2)
Total net liability	6.2	28.7	126.7	80.6	229.4
Accident year loss ratio	11.2%	14.9%	55.1%	17.9%	42.9%
Initial accident year loss ratio	16.1%	24.7%	66.5%	27.2%	n/a
Change in loss ratio post accident year	(4.9%)	(9.8%)	(11.4%)	(9.3%)	n/a

⁽¹⁾ Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2010.

The accident year loss ratio for the year ended 31 December 2010 was 42.9 per cent compared to 27.2 per cent for the year ended 31 December 2009. Losses in relation to the Chilean earthquake and Deepwater Horizon drilling unit contributed 15.2 per cent and 4.5 per cent respectively to the year to date accident year loss ratio. Excluding the impact of foreign exchange revaluations, previous accident years' ultimate losses developed as follows during 2010:

- 2006 - favourable development of \$0.3 million (2009 – \$4.4 million);
- 2007 - favourable development of \$8.3 million (2009 – \$25.2 million);
- 2008 - favourable development of \$36.0 million (2009 – \$33.9 million); and
- 2009 - favourable development of \$55.5 million (2009 – n/a).

The ratio of IBNR to total reserves was 38.4 per cent at 31 December 2010 compared to 42.4 per cent at 31 December 2009.

INVESTMENT PERFORMANCE

The Group continues to hold a conservative investment portfolio, consistent with its long-held philosophy, with a strong emphasis on preserving capital. At 31 December 2010, the

managed portfolio comprised 78.1 per cent fixed income securities and 21.9 per cent cash and cash equivalents compared to 92.9 per cent fixed income securities and 7.1 per cent cash and cash equivalents at 31 December 2009.

Net investment income was \$53.4 million for the year ended 31 December 2010 compared to \$56.0 million for the prior year, a decrease of \$2.6 million, or 4.6 per cent, reflecting the lower yield interest rate environment in 2010 compared to 2009.

Total investment return, including net investment income, net realised gains and losses, impairments and net change in unrealised gains and losses was \$84.5 million for the year ended 31 December 2010 compared to \$82.9 million for 2009. Returns for the year were marginally higher than 2009 due to the increased allocation to both corporate bonds and EMD, which is now 6.8 per cent of managed investments. The EMD portfolio at 31 December 2010 was allocated as follows: sovereign debt 58.1 per cent, quasi-sovereign debt 24.8 per cent, and corporate bonds 17.1 per cent; and has an overall average credit quality of BBB-. The corporate bond allocation, excluding FDIC guaranteed bonds, represented 31.1 per cent of managed invested assets at 31 December 2010 compared to 23.6 per cent at 31 December 2009. There were no impairments recorded in 2010 compared to \$0.4 million in 2009.

KEY INVESTMENT PORTFOLIO AVERAGE STATISTICS

	2006	2007	2008	2009	2010
Duration	1.6 years	1.4 years	1.8 years	2.3 years	2.2 years
Credit quality	AA+	AA+	AA+	AA+	AA
Market yield	5.2%	4.7%	2.7%	2.2%	1.9%
Book yield	5.1%	5.0%	3.4%	2.8%	2.4%

“The Group continues to hold a conservative investment portfolio, consistent with its long-held philosophy, with a strong emphasis on preserving capital.”

OTHER OPERATING EXPENSES

Other operating expenses, excluding the cost of equity based compensation, are broadly consistent compared to 2009, reflecting the Group’s stable operating platform. Total employment costs, excluding equity based compensation, were \$33.2 million for the year ended 31 December 2010 compared to \$35.6 million for the year ended 31 December 2009.

Equity based compensation was \$21.1 million for the year ended 31 December 2010 and \$16.4 million for the year ended 31 December 2009. The increased 2010 expense reflects the maturing restricted share awards program, plus an increase in vesting assumptions given the Group’s excellent performance and an increase in the proportion of employees’ variable compensation provided as deferred shares compared to prior years. The restricted share program began in 2008.

CAPITAL

At 31 December 2010, total capital was \$1.416 billion, comprising shareholders’ equity of \$1.287 billion and \$128.8 million of long-term debt. Leverage was 9.1 per cent. Total capital at 31 December 2009 was \$1.510 billion.

REPURCHASE PROGRAM

\$136.4 million shares were repurchased in the year ended 31 December 2010 and \$16.9 million in the year ended 31 December 2009. The Repurchase Program had 7,841,826 shares of the authorised maximum of 18,250,306 remaining to be purchased at 31 December 2010.

The Board will be proposing at the AGM to be held on 5 May 2011, that the shareholders approve a renewal of the Repurchase Program with such authority to expire on the conclusion of the 2012 AGM or, if earlier, 15 months from the date the resolution approving the Repurchase Program is passed.

DIVIDENDS

During 2010 the Lancashire Board declared an interim and special dividend of 5.0 cents and \$1.40 per common share respectively.

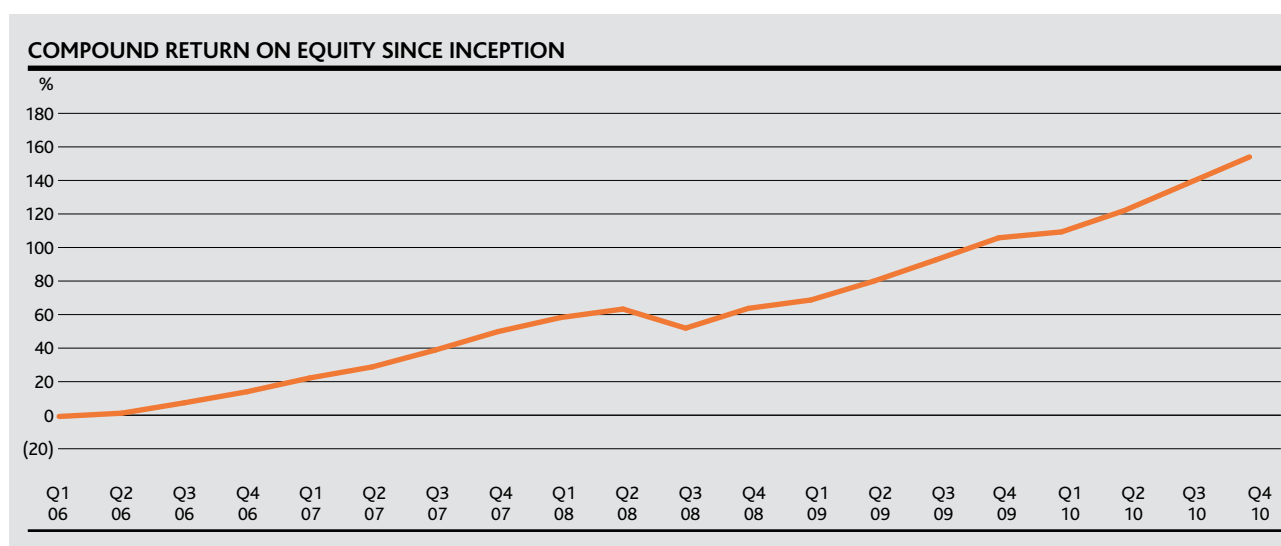
A final dividend of 10.0 cents per share has been declared and will be paid to shareholders of record on 18 March 2011.

The Group will continue to review the appropriate level and composition of capital for the Group with the intention of managing capital to enhance risk-adjusted RoE.

CAPITAL MANAGEMENT

Lancashire aims to maintain a strong balance sheet at all times. An appropriate level and mix of capital must be maintained to support the Company’s underwriting. The Group reviews the level and composition of capital on an ongoing basis with a view to:

- Maintaining sufficient capital to take advantage of underwriting opportunities and to meet obligations to policyholders;
- Maximising the return to shareholders within pre-determined risk tolerances;



- Maintaining adequate financial strength ratings; and
- Meeting internal and regulatory requirements.

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

Capital actions from inception to date are as follows:

- 2007 – \$100.2 million shares repurchased;
- 2007 – Special dividend of \$239.1 million or \$1.10 (approximately 56 pence) per share;
- 2008 – \$58.0 million shares repurchased;
- 2009 – \$16.9 million shares repurchased;
- 2009 – Special dividend of \$263.0 million or \$1.25 (approximately 76 pence) per share;
- 2009 – Ordinary dividends of \$31.3 million or \$0.15 (approximately 10 pence) per share;
- 2010 – \$136.4 million of shares repurchased;
- 2010 – Special dividend of \$264.0 million or \$1.40 (approximately 89 pence) per share; and

- 2010 – Ordinary dividends of \$28.3 million or \$0.15 (approximately 9 pence) per share.

The Repurchase Program had 7,841,826 shares of the authorised maximum of 18,250,365 remaining to be purchased at 31 December 2010.

The composition of capital is also driven by management's appetite for leverage. In appropriate circumstances, management would be willing to increase leverage modestly. An increase in leverage is entirely dependent on the availability and price of debt and the Group's ability to raise finance in the capital markets. Maintaining a strong balance sheet will be the over-riding factor in all capital management decisions.

Internal methods have been developed to review the profitability of classes of business and their estimated capital requirements plus 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 in compliance with local regulatory requirements.

Lancashire has two standard letter of credit facilities in the total amount of \$400.0 million with a \$75.0 million loan sub-limit available for general corporate purposes. There was no outstanding debt under this facility at any reporting date. There are no off-balance sheet forms of capital.

“The Company’s aim is to provide shareholders with a risk-adjusted RoE of 13 per cent in excess of a risk free rate over the insurance cycle.”

BUSINESS ENVIRONMENT AND OUTLOOK

Lancashire is in a mature trading position, having now had over five years to develop broker and client relationships. Our core lines are Property (which includes the Terror book), Energy, Marine and Aviation.

Following a relatively benign loss year in 2009, 2010 was a more active year in terms of both man-made and natural catastrophes. Although the 2010 Atlantic windstorm season was one of the most active on record with 18 named storms, none of them made significant landfall in the U.S. However there were substantial earthquakes in Chile and New Zealand, a large European windstorm in Xynthia and serious flooding in Australia. This has meant that elemental losses for 2010 were considerably higher than in 2009, but are close to the long-term average for the industry. On the non-elemental side the key story was the Deepwater Horizon energy loss, where coverage ramifications look set to play out over a protracted period. As a result, catastrophe pricing has remained under pressure across all the property lines, but energy business has seen both increased pricing and increased demand, albeit against a background of plentiful capacity. Terrorism pricing is also competitive, but in political risk, and specifically sovereign obligors, it has held up well throughout 2010.

As primarily an insurance provider, Lancashire writes business over the course of the year and results are not driven by the strength of the 1 January renewal season. However, we write

a substantial part of our property retrocession and property catastrophe excess of loss lines at 1 January.

Our next major line of business renewal period is March through June on our energy Gulf of Mexico line. The Company's property direct and facultative and energy offshore worldwide lines are written throughout the year.

We have reduced our property reinsurance exposures at the January renewals in the face of price reductions which we felt were unsustainable. We continue to support our core clients through the cycle and, through careful risk selection, are still able to find adequately priced business. We see opportunities in the year ahead in offshore energy and sovereign risk. We are working with our distributors to exploit these opportunities slowly and carefully.

In 2011, the industry should continue to pay attention to interest rate and inflation risk, investment income and the drying-up of reserve releases. Investment markets have stabilised somewhat but volatility continues. When deciding strategy on risk classes, we see the combined ratio as the key to profitability. The Company's aim is to provide shareholders with a risk-adjusted RoE of 13 per cent in excess of a risk free rate over the insurance cycle. Taking into account the current pricing expectations for our preferred lines of business, the outlook for 2011 appears adequate.

Five major tests for Lancashire

- 1 2008 Hurricanes Ike and Gustav.**
- 2 2008 Financial meltdown.**
- 3 2010 Chilean earthquake.**
- 4 2010 Deepwater Horizon drilling unit.**
- 5 2010 New Zealand earthquake.**

ENTERPRISE RISK MANAGEMENT

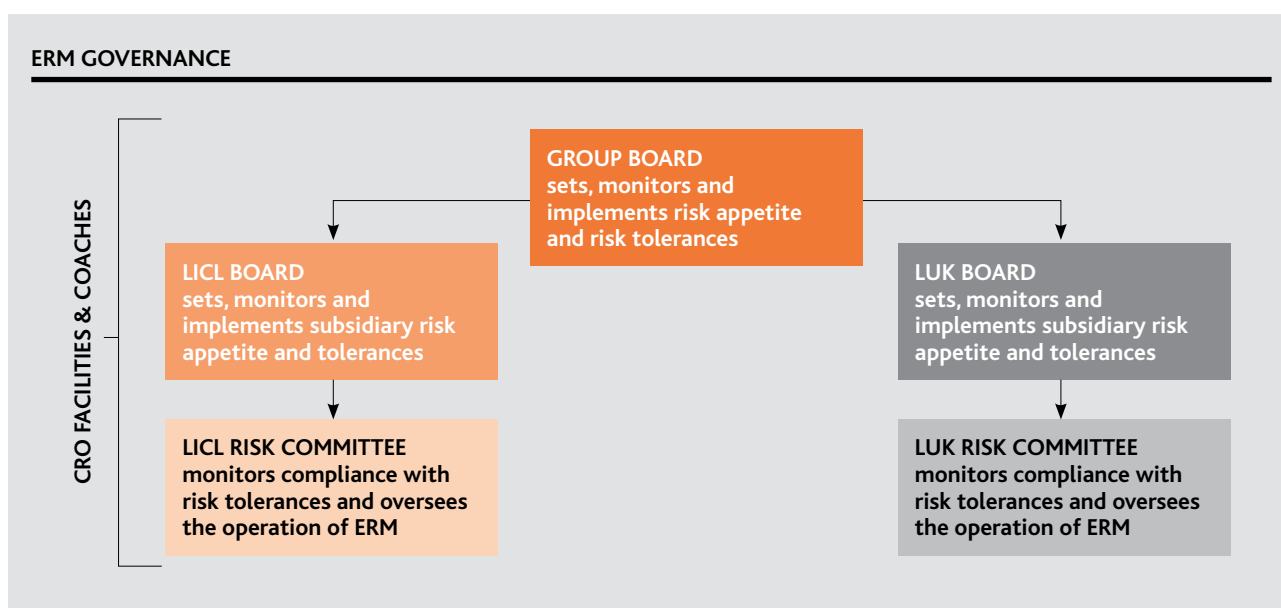
The primary objective of Lancashire’s ERM approach is to ensure that the amount of capital we hold is consistent with the risk profile of the Group and therefore that the balance between risk and reward is considered as part of all of our key business decisions. The Group has formulated, and keeps under review, a risk appetite which is set by the Board of Directors. Our appetite to risk will vary marginally from time to time to reflect the potential risks and rewards that present themselves to us. However, protecting our capital and providing our investors with a superior risk adjusted return over the long-term are constants. Our risk appetite is central to how we run our business and permeates into the risk appetites that the operating entity Boards have adopted. These risk appetites are expressed through detailed risk tolerances at both a Group and operating entity level. Simply, our risk tolerances are the maximum amount of capital that we are prepared to expose to certain risks.

The Group Board of Directors is responsible for setting and monitoring group risk tolerances whereas the Risk Committees of the subsidiary companies are responsible for setting and monitoring their risk tolerances. All risk tolerances are subject to at least annual review and consideration by the respective Board or Risk Committee. The Group and operating entity boards review actual risk levels versus tolerances, emerging risks and any risk learning events quarterly. In addition, usually on a fortnightly basis, management reviews the output from its internal capital model BLAST in order to

monitor modeled potential losses against risk tolerances and ensures that risk levels are managed in accordance with them.

Lancashire faces risks from a number of different sources and has defined these risks in six categories: insurance, market, liquidity, credit, operational, and strategic risks. The risks recorded within the Group and subsidiary risk registers have been classified under these headings. The risk disclosures section of the financial statements provide further details and explanation of how we define these risk categories on pages 76 to 98.

The primary role of the CRO is to facilitate the effective operation of ERM throughout the Group at all levels. Responsibility for the management of individual risks has been assigned to, and forms part of the performance objectives of, the risk owners within the business. Each quarter risk owners affirm the status of their risks and the effectiveness of the controls that mitigate them and ensure that these risks and controls are consistent with their day to day processes and the entries made in the Group and subsidiary Risk Registers, which are a direct input to BLAST. Internal Audit provides the CRO with independent feedback and assurance regarding the effectiveness, accuracy, completeness and status of individual risks and controls within the business and their consistency with the Risk Registers. The CRO provides regular reports within the business outlining the status of Lancashire’s ERM activities and strategy as well as formal reports to the Board of Directors of the operating entities and the Group in this regard.



Our values and ethics

1. **People:** We value our employees and endeavour to develop and support them in meeting the challenges of our business and enriching their careers.
2. **Openness:** We strive to be honest, open and accountable to our clients, our employees, and our investors. Clear communication is important to us.
3. **Charity:** We support the Lancashire Foundation with regular and generous giving, and promote and facilitate its range of charitable work.
4. **Communities:** We encourage and facilitate engagement and participation of our employees in charitable and community projects, both locally and internationally.
5. **Environment:** As a group we take our environmental responsibilities very seriously.



Our business is built on our commitment to lasting and productive relationships: with our employees; with our clients and brokers; with our investors and analysts; and with our regulators.

EMPLOYEE BENEFITS

\$54.3m

2006 – \$36.0m 2007 – \$51.2m 2008 – \$35.6m 2009 – \$52.0m

“Lancashire’s support in settling the Deepwater Horizon loss with the utmost dispatch validated our long standing relationship and why we look to Lancashire for our insurance needs.”

Todd Jordan, Transocean Offshore Deepwater Drilling Inc.

Constructive engagement with both our local communities and environment in Bermuda and London, and in more distant areas suffering from poverty or catastrophe, helps Lancashire make a difference, and benefits our employees engaged in the work.

In 2010 we strengthened our commitment to marketing, to enhance further our access to insurance business placed in the market in the classes underwritten by Lancashire.

BROKERS AND CLIENTS

Our business is largely transacted through brokers, and we place the highest value on maintaining and developing these relationships and in understanding and serving clients’ needs. We understand our brokers’ need to know that their clients’ insurers are financially strong, have a thorough understanding of the risks at hand, and a willingness to address client requirements and provide first class service.

In 2010 we demonstrated our commitment to marketing with the appointment of Paula Porter to the role of Group Marketing Director. We continue to foster our broker and client relationships so as to afford us access to the major risks placed in the market in those classes which Lancashire underwrites.

EMPLOYEES

Lancashire’s staff add great value to the organisation. Lancashire devotes time and attention to each recruitment

process, and our employees are encouraged to test themselves and to perform to the highest standards. Expectations are high, and we manage and support our people to meet our business requirements and to develop their skills.

The Lancashire remuneration structure and share scheme ensure that staff are highly motivated and closely aligned to the Lancashire goals. All permanent staff are given the opportunity to become shareholders.

In 2010 we recruited in the areas of underwriting, risk modelling, IT, legal and corporate governance, and we worked with many employees to provide targeted and focused training and development.

Lancashire staff are offered competitive compensation but, more importantly, they are exposed to a wide breadth of responsibility and the opportunity to develop their experience in a supportive environment.

Jennifer Wilson who works for Lancashire as a member of the Finance department made the following comment:

"After being a consultant for many years it was great to officially become part of the Lancashire finance team during 2010. I like the fact that executive management know everyone – in this sense it feels more like a small organisation until you remember that we are a \$1.5 billion company. Our

open plan office structure and relaxed culture mean that staff can generally approach other departments without having to schedule meetings, which definitely helps to boost efficiency."

NOTABLE EMPLOYEE INITIATIVES DURING 2010

During 2010, Lancashire:

- Provided enhanced training and development to all staff through the use of internal and external training sessions which are integrated with the employee appraisal and development program;
- Produced a revised employee handbook which seeks to align practices and benefits across the group;
- Awarded shares under the RSS during March 2010 so that all those permanently employed at 31 December 2009 now have a stake in the Company's equity, and introduced amendments to the RSS in December 2010 to allow for the conversion of previously granted conditional awards to nil-cost options, which will help facilitate an alignment between our employees and the Company's share performance in the longer term; and
- Reviewed the Group's reward systems to ensure their continuing alignment with good corporate governance and principles of remuneration.

Five reasons to work at Lancashire

- 1 Lancashire is a dynamic and rewarding environment in which to work.
- 2 Lancashire has a flat structure and senior management are very accessible.
- 3 Every permanent employee is eligible for the Group's equity compensation scheme, everyone's enabled to become a shareholder.
- 4 Lancashire's collegiate environment encourages employee interaction across all departments, which offers greater opportunities for continual learning and development.
- 5 It's fun to work somewhere that's successful.

REGULATORS

We place great importance on our relationship with regulators and we monitor changes in regulatory requirements closely. Both our Bermuda insurance operations (regulated by the BMA) and our UK insurance operations (regulated by the FSA) are subject to routine regulatory reviews. During 2010 LUK received a generally positive report from the FSA, following an "on-site review visit", and LICL obtained similarly constructive and positive feedback from the BMA following its regulatory inspection during the Autumn. Our marketing company in Dubai is regulated by the DFSA.

Lancashire has also obtained eligibility as an excess and surplus lines insurer in many U.S. states. As at February 2011, LICL and LUK were eligible for surplus lines insurance and reinsurance in 47 and 46 U.S. jurisdictions respectively, but are not licensed insurers in any U.S. state or territory. For those U.S. states where LICL or LUK is not currently excess and surplus lines eligible, Lancashire, subject to compliance with applicable law and regulation, may write insurance on a direct procurement basis or take advantage of available exemptions.

RATING AGENCIES

Lancashire enjoys a positive relationship with its rating agencies. LUK and LICL carry the Lancashire Group rating of A minus (Excellent) from A.M. Best with a positive outlook.

During 2010, Lancashire received ratings from both S&P and Moody's. S&P has assigned an A minus financial strength rating to LUK and LICL. S&P has also assigned a "BBB" long-term issuer rating to LHL. The S&P ratings outlook for all entities is stable. Moody's has assigned an "A3" financial strength rating to LUK and LICL. Moody's has also assigned a "Baa2" long-term issuer rating on LHL. The Moody's ratings outlook for all entities is stable. These ratings allow the Group to trade successfully in all the major global insurance markets.

INVESTOR RELATIONS

Lancashire has a full-time Head of Investor Relations who, in collaboration with the Board and management of the Company, focuses on developing our relationships with investors, potential investors and analysts. A significant number of investor presentation meetings with analysts, sales teams, investors and potential investors were held during 2010 in the U.K., Europe and the U.S.

Since 16 March 2009 Lancashire's shares have traded on the main market of the LSE where it has a Premium listing under the ticker symbol LRE. Since 10 June 2009, Lancashire has been included in the FTSE 250 index.

The Directors of the Company are available to meet shareholders at the AGM, or by arrangement during the year.

CORPORATE RESPONSIBILITY HIGHLIGHTS

- Employees are a key strength of our business and add tremendous value being encouraged and supported with appropriate training to achieve high performance standards.
- Through the work of the Lancashire Foundation, the Group treats charitable giving and community involvement as important in building the morale and motivation of its employees, in enhancing the Lancashire brand and reputation, and in helping to benefit those who are less fortunate.
- We enjoy a positive relationship with its rating agencies and the Group has a financial strength rating of A minus (Excellent) with a positive outlook from A.M. Best and during 2010 received operating company ratings of A minus from S&P and A3 from Moody's with a stable outlook on all entities.
- Our business is connected to insuring against natural catastrophes. The Lancashire Foundation supports Médecins Sans Frontières which provides immediate aid to people affected by catastrophes.

ENVIRONMENT

The Lancashire Group is committed to managing our carbon footprint and our effect on the environment, and we are pleased with our status as Carbon Positive.



The Group has chosen to offset emissions associated with our business travel and the energy usage in our offices in Bermuda, London and Dubai with Carbon Clear. In offsetting with Carbon Clear, we have made a charitable donation that will support emissions reduction projects around the world using standards that meet the U.K. Government's Code of Best Practice.

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

IN THE COMMUNITY

Charitable giving and community involvement has never been seen at Lancashire as just a box ticking exercise. From our earliest days, commitment to support important causes in a

complex and ever changing world has been an important motivating factor for our staff.

The Lancashire Foundation, was established in 2007 and it remains the cornerstone of our commitment to the wider community. The Lancashire Foundation has four principal aims:

1. To assist the Group in fulfilling its corporate social responsibilities, both explicit and implicit, including corporate governance codes and government mandates;
2. To provide morale building and motivational opportunities for our employees through donation and active participation, and to offer enriching and challenging experiences for them to learn about the lives of other communities and about our Group's wider corporate responsibilities;
3. To help to build the brand and reputation of the Lancashire operating companies in the markets that they serve by participating in market-supported charities and charitable initiatives; and
4. To ameliorate the lives of and prospects for those less fortunate than ourselves.

Five reasons Lancashire donates to charity

- 1 To assist communities where Lancashire insures against catastrophes.
- 2 To help generate a community spirit.
- 3 To make a difference.
- 4 Because we care.
- 5 It's just not right not to give back.

THE LANCASHIRE FOUNDATION

The donation and monitoring efforts of the Lancashire Foundation are guided by a Lancashire Foundation Committee comprised of staff members from all disciplines and all levels of the Company and our operating companies, from internal audit team members to Board Directors, all members of the Committee have an equal standing and voice. Support is given to a wide range of charities in Bermuda, the UK and worldwide that variously provide humanitarian assistance, empower local communities, support sustainable enterprise and seek to promote social cohesion and opportunity. We encourage all our staff to identify causes close to their heart to the Lancashire Foundation Committee so that we can try and support them.

Currently, the Lancashire Foundation supports 18 charities directly ranging from Kiva, www.kiva.org a microloan specialist, to Family Health ISIS a London African/Caribbean mental well-being and community care charity, to the Family Centre a leading early intervention service provider for children and families in crisis in Bermuda. Additionally the Lancashire Foundation makes matching payments to charities for whom staff members take part in a variety of sponsored events such as the London and New York marathons.

Since a significant element of Lancashire's business is connected to insuring against catastrophes, it only seemed right to take the decision to support Médecins Sans Frontières, www.msf.org.uk a charity that the Lancashire Foundation views as uniquely well equipped to provide immediate and lasting humanitarian aid to people directly affected by such catastrophes due to their international presence and the extraordinary commitment of their people. We are constantly amazed by their nimble and flexible approach; something we

try to replicate in our approach to business. MSF remains the central charitable relationship for the Lancashire Foundation.

In 2010 we were proud to meet our stated commitment to provide personal assistance in the developing world. A team of six volunteers went to the Philippines working with the charity International Care Ministries ("ICM") www.caremin.com on a number of community projects. The Lancashire volunteers assisted the charity in its day to day work helping some of the poorest people in the Philippines. The main focus for the team was to work with local Filipinos on a house building project where slum residents would eventually be relocated. They also assisted at a malnourished children's feeding program and at pre-school centres. We are committed to repeating this volunteering initiative and are actively seeking ways to allow more of our staff to engage in volunteering and community initiatives.

While it is our business to underwrite specialty line risks, Family Centre is in the business of risk prevention. It seemed a natural fit for the Lancashire Foundation to support this local Bermuda charity in their efforts to provide counselling and therapeutic services for children and families in crisis. We are proud to support Family Centre in its commitment to creating a healthier and stable community for children.

Our partnership with the Family Centre has developed and our people have become involved in not only donating their time but also through other forms of charitable giving. For the past two years our staff provided food items for Family Centre's annual Children's Christmas party. This event continues to be a huge success and provided gifts, and food hampers to 200 families in 2010.

LANCASHIRE FOUNDATION

18 charities directly supported

LANCASHIRE FOUNDATION DONATIONS

\$1.1m

2006 – N/A 2007 – Warrants awarded 2008 – \$1.0m 2009 – \$1.1m

Lancashire in the community

“On behalf of the children and families, we would like to thank the employees of Lancashire...for generously providing the food for our Children’s Christmas Party again this year.

We provided these to a record number of families this year and additional supplies are being distributed through our community team.”

“The Lancashire team pioneered our first team into the Cabug Reconstruction Project, working alongside the eight families who had become political refugees. I still hear stories from the families about the Lancashire team. You have made an impact on these eight families which they have not forgotten.

Peter J. Carey, Director of Development & Community Education Family Centre



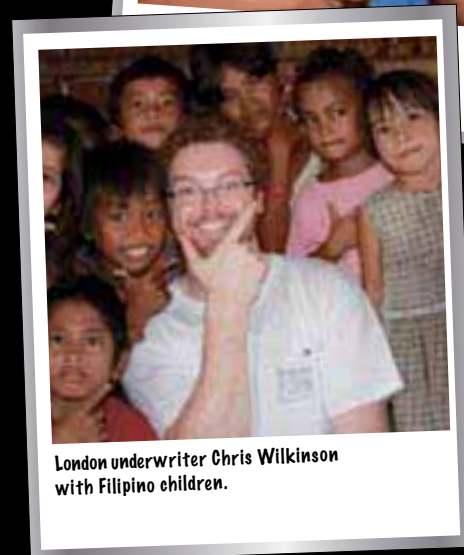
On behalf of ICM, thank you so much for taking the time to come here and be part of the lives of these families and show that people do care and we will not forget them.

The Lancashire team worked continuously and were very willing to get out of their comfort zone in order to engage with as many people as possible. For me they were the best and most joyful group ICM had in 2010.”

Peter Fry, International Care Ministries



Lancashire's work in the Philippines included giving malnourished children something to smile about by providing hot meals daily.



London underwriter Chris Wilkinson with Filipino children.

Non-Executive Directors

MARTIN THOMAS ● ●

Non-Executive Chairman (age 47)

Martin Thomas is a partner and board member of Altima Partners, LLP, the hedge fund manager, and a Director of two significant family businesses El Tejar Limited and Spearhead International Limited. Prior to this, he was an official of the Bank of England, most recently on secondment to the EU Commission where he worked in the Financial Services Policy and Financial Markets Directorate of the Internal Market and Services Directorate General. Before Mr Thomas joined the Commission, he established the Financial Markets Law Committee at the Bank of England. Prior to that, he was Deputy Chief Executive of the Financial Law Panel and prior to that, senior counsel to the European Central Bank in Frankfurt. He started his career in private practice, specialising in corporate and commercial litigation at Travers Smith and in the law and regulation of financial services at Clifford Chance.

JOHN BISHOP ● ● ●

Non-Executive Director (age 65)

John Bishop is an actuary with broad experience in the insurance sector. He has served on the boards of a number of insurance companies, both in an executive capacity and as a non-executive Director. He is currently a non-executive Director of Berkshire Hathaway and Houston Capital Corporation International. Mr Bishop has previously worked at the Euler Group on its managing board and as Chairman and Chief Executive Officer of Eagle Star Insurance Company Ltd where he was responsible for the worldwide general insurance operations and, before that, as Managing Director of Sun Alliance UK Insurance Company.

EMMA DUNCAN ● ● ●

Non-Executive Director (age 51)

Emma Duncan is the Deputy Editor of The Economist. She has also held several other posts on the paper, including Britain Editor and Asia Editor. She has covered the media business, the Middle East, home affairs, agriculture, commodities and the transport industry and has served as Delhi correspondent, covering India, Pakistan, Bangladesh and Sri Lanka. She has written special reports for the paper on Saudia Arabia and the Gulf states, India, Pakistan and the food industry. Ms Duncan appears regularly on television and radio programmes. She has written widely on a freelance basis, for publications such as the Times, the Sunday Times, the Daily Telegraph, Vogue and

Cosmopolitan. She has an honours degree in politics, philosophy and economics from Oxford University and started her career as a researcher and reporter at Independent Television News.

RALF OELSSNER ● ● ● ● ●

Non-Executive Director and Senior Independent Director (age 66)

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

ROBERT SPASS ● ● ●

Non-Executive Director (age 54)

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

WILLIAM SPIEGEL ● ● ● ●

Non-Executive Director (age 48)

William Spiegel is a founding partner of Pine Brook Road Partners, LLC, a private equity firm specialising in energy and financial services investing. Mr Spiegel has worked in the private equity industry since 1990 at Lehman Brothers and the Cypress Group. Mr Spiegel has a B.Sc. in Economics from the London School of Economics, an M.A. in Economics from the University of Western Ontario and an M.B.A. from the University of Chicago. Mr Spiegel has served on the Boards of a number of publicly traded companies, and currently serves on the Board of four Pine Brook portfolio companies, Aurigen Capital Limited, Essent Group Ltd., Green Bancorp, Inc., and Syndicate Holding Corp.

Executive Directors

RICHARD BRINDLE ● ● ●

Chief Executive Officer (age 48)

Richard Brindle was the driving force behind the establishment of Lancashire in late 2005 and serves as a member of the Board. Mr Brindle joined Ascot Underwriting Agency in 2001 as a non-executive member of the Ascot Board, which was a position he held until his resignation in September 2005. As part of his directorship duties at Ascot, Mr Brindle was responsible for a number of independent underwriting reviews and was chair of the Strategic Business Development Committee. Mr Brindle started his career in 1984 working at Posgate and Denby Managing Agency which was later taken over by Charman Underwriting Agencies. In 1989 Mr Brindle was appointed as Deputy Underwriter of Syndicate 488. In 1991 he was appointed as a Director of Charman Underwriting Agencies and acted as main underwriter until 1999. Mr Brindle left Charman Underwriting Agencies when it was sold to the ACE Group of Companies in Bermuda.

ALEX MALONEY ● ●

Chief Underwriting Officer (age 37)

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

NEIL MCCONACHIE ● ●

President (age 38)

Neil McConachie joined Lancashire in February 2006 and serves as Group President and a member of the Board. Mr McConachie was previously Treasurer and Chief Accounting Officer of Montpelier Re Holdings Ltd. He has extensive experience in debt and equity capital markets transactions in the UK and the U.S. public markets, and has also previously held positions of Chief Financial Officer, Chief Risk Officer and Chief Operating Officer. Mr McConachie has a B.A. in Accounting and Finance from Heriot-Watt University and an M.B.A. from Edinburgh Business School.

Company Secretary

GREG LUNN

Group General Counsel

Greg Lunn joined Lancashire in March 2006. He is Chief Executive Officer of Lancashire Insurance Company Limited in Bermuda and he is also responsible for all legal affairs for the Group. Prior to joining Lancashire, Mr Lunn was employed with the ACE Group of Companies, most recently at ACE Limited in Bermuda where he was Compliance Counsel. Between 2000 and 2003 Mr Lunn was Legal Counsel for ACE European Group in London. Mr Lunn is a qualified solicitor in England and is also an attorney admitted to the Bermuda Bar. He obtained his law degree from the University of Buckingham in England. Prior to becoming a lawyer Mr Lunn spent a number of years as an Investment Manager with HSBC in Hong Kong. He also served a short service commission in the British Army.

-
- Main Board member
 - Audit Committee
 - Nomination and Corporate Governance Committee
 - Remuneration Committee
 - Underwriting Committee
 - Investment Committee

OVERVIEW OF THE GROUP

LHL ("the Company") is a Bermuda incorporated company with operating subsidiaries in Bermuda, London and Dubai. The Company's common shares were admitted to trading on AIM in December 2005 and were subsequently moved up to the Official List and to trading on the main market of the LSE on 16 March 2009. The shares have been included in the FTSE 250 index since 10 June 2009.

PRINCIPAL ACTIVITIES

The Company's principal activity, through its wholly owned subsidiaries, is the provision of global specialty insurance and reinsurance products. An analysis of the Group's business performance can be found in the Business review on pages 16 to 28.

DIVIDENDS

In respect of the year ended 31 December 2010, the following dividends have been declared:

- an interim dividend of \$0.05 per common share and warrant was declared on 5 August 2010 and paid on 13 October 2010 in pounds sterling at the pound/U.S. dollar exchange rate of 1.5445 or £0.0324 per common share and warrant;
- a special dividend of \$1.40 per common share and warrant was declared on 8 November 2010 and paid on 19 January 2011 in pounds sterling at the pound/U.S. dollar exchange rate of \$1.5808 or £0.8856 per common share and warrant; and
- a final dividend of \$0.10 per common share and warrant was declared on 20 February 2011 to be paid on 20 April 2011 in pounds sterling at the pound/U.S. dollar exchange rate on the record date of 18 March 2011 or approximately £0.0622 per common share and warrant.

DIVIDEND POLICY

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

DIRECTORS

John Bishop (Non-Executive Director)
Richard Brindle (Chief Executive Officer)
Emma Duncan (Non-Executive Director)
Alex Maloney (Chief Underwriting Officer)
Neil McConachie (President)
Ralf Oelssner (Non-Executive Director and Senior Independent Director)
Robert Spass (Non-Executive Director)
William Spiegel (Non-Executive Director)
Martin Thomas (Non-Executive Chairman)

DIRECTORS' INTERESTS

The Directors' beneficial interests in the Company's common shares as at 31 December 2010 and 2009 including interests held by family members were as follows:

Director	Common shares held at 31 December 2010	Common shares held at 31 December 2009
John Bishop	4,807	4,807
Richard Brindle ⁽¹⁾	368,800	658,761
Emma Duncan	–	–
Alex Maloney ⁽²⁾	73,613	50,255
Neil McConachie ⁽³⁾	260,577	239,270
Ralf Oelssner	–	–
Robert Spass ⁽⁴⁾	–	222,500
William Spiegel ⁽⁵⁾	–	7,000
Martin Thomas	6,950	6,950

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

(1) Includes 23,521 forfeitable shares awarded on 25 March 2010 pursuant to the LHL bonus deferral scheme. Richard Brindle conducted the following transactions in the Company's shares during 2010:

- 25 March – vesting of 23,521 forfeitable shares awarded pursuant to the LHL bonus deferral scheme;
- 28 March – vesting of 33,381 RSS exceptional awards, realising 28,239 shares net of UK taxation;
- 1 April – cashless exercise of 265,630 options, realising 129,922 shares;
- 6 August – cashless exercise and subsequent sale of 37,500 options realising a gain of £89,471;
- 6, 9, 10 August – sold 356,643 shares at an average price of £5.23 realising £1,864,811;
- 13 August – sold 100,000 shares at an average price of £5.22 realising £522,103; and
- 18 August – sold 15,000 shares at an average price of £5.25 realising £78,885.

(2) Includes 10,252 forfeitable shares awarded on 25 March 2010 pursuant to the LHL bonus deferral scheme. Alex Maloney conducted the following transactions in the Company's shares during 2010:

- 25 March – vesting of 10,252 forfeitable shares awarded pursuant to the LHL bonus deferral scheme;
- 26 March – cashless exercise and subsequent sale of 32,087 options realising a gain of £95,288;
- 26 March – cashless exercise and subsequent sale of 397,147 time vesting warrants and 95,064 performance vesting warrants realising a gain of £841,167; and
- 28 March – vesting of 22,254 RSS exceptional awards, realising 13,106 shares net of UK taxation.

(3) Neil McConachie conducted the following transactions in the Company's shares during 2010:

- 28 March – vesting of 22,254 RSS exceptional awards;
- 7 May – cashless exercise of 133,348 options, realising 81,711 shares;
- 17, 18 June – sold 75,000 shares at an average price of £4.97 and £4.99;
- 25 June – sold 18,235 shares at an average price of £4.98 realising £90,810;
- 6 August – cashless exercise and subsequent sale of 150,000 options, realising £356,635;
- 28 September – sold 35,000 shares at an average price of £5.60 realising £196,000;
- 23 December – sold 35,000 shares at an average price of £5.515 realising £193,025; and
- 29 December – cashless exercise of 150,000 time vesting warrants realising 80,577 shares.

(4) Robert Spass sold 222,500 shares on 8 and 9 September 2010 at a price of \$8.23 and \$8.46 respectively, realising \$1,831,449.

DIRECTORS' REPORT

(5) William Spiegel sold 63,240 shares on 30 September 2009 at a price of \$8.13 realising \$513,888. Mr Spiegel's father owns 7,000 shares previously included in Mr Spiegel's holdings as a connected person. During 2010 it was determined that Mr Spiegel's father no longer met the definition of connected person and these shares are no longer included in his holdings.

Certain of the Directors hold warrants over the Company's shares which were awarded prior to the Company's admission to AIM in December 2005 along with other warrants awarded to the Company's founders and employees as follows: Richard Brindle 8,367,181 and Neil McConachie 806,359 ordinary and performance warrants. Robert Spass is the beneficial owner of 1,549,135 initial Founders' warrants over the Company's shares.

Richard Brindle also holds 46,260 initial Founders' warrants.

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

TRANSACTION IN OWN SHARES

The Company repurchased 18,509,239 of its own common shares from 19 January 2010 through to 16 September 2010 for a total consideration of approximately \$136.4 million. These repurchases were made pursuant to resolutions of the shareholders passed at an SGM on 16 December 2009 which conferred authority upon the Company to purchase up to 18,250,306 of its shares, and at the AGM held on 4 May 2010 granting a new authority for the repurchase of 18,250,306 shares. Some of the repurchased shares are held in Treasury and some have been cancelled. The repurchase program had 7,841,826 common shares remaining to be purchased at 31 December 2010. Further details are set out in note 20 to the consolidated financial statements on page 120.

DIRECTORS' REMUNERATION

Details of the Directors' remuneration are set out in the Directors' Remuneration Report on pages 54 to 63.

SUBSTANTIAL SHAREHOLDERS

As at 20 February 2011 the Company was aware of the following interests of 3% or more in the Company's issued share capital:

Name	Number of shares as at 20 February 2011	% of shares in issue
Legal & General Group Plc	11,148,999	7.3%
BlackRock, Inc.	11,122,835	7.3%
Alken Luxembourg Sarl	7,963,618	5.2%
Artisan Partners Limited Partnership	7,693,815	5.0%
Franklin Templeton Institutional, LLC	7,634,452	5.0%
William Blair & Company LLC	6,536,424	4.3%
Steadfast Financial, LP	5,779,600	3.8%
JP Morgan Chase	4,991,172	3.3%
Franklin Mutual Advisers, LLC	4,896,079	3.2%
F&C Management Ltd	4,681,505	3.1%

CORPORATE GOVERNANCE

The Company's compliance with the Combined Code is set out in the Corporate Governance section of this report on pages 47 to 53.

DONATIONS

In May 2010 the Board of Directors approved a cash donation of \$1.1 million (2009 – \$1.1 million) to the Lancashire Foundation. In November 2010 the Board of Directors approved a cash donation of \$1.3 million for 2011.

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

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

The Group did not make any political donations or expenditure during 2010.

HEALTH AND SAFETY

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

EMPLOYEES

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

CREDITOR PAYMENT POLICY

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

FINANCIAL INSTRUMENTS AND RISK EXPOSURES

Information regarding the Group's risk exposure is included in the risk disclosures in the consolidated financial statements. The Group's use of derivative financial instruments can be found on pages 87 to 90.

ACCOUNTING STANDARDS

The Group's consolidated financial statements are prepared in accordance with accounting principles generally accepted under 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 Board determines appropriate measurement bases, to provide the most useful information to users of the consolidated financial statements, using their judgement and considering U.S. GAAP.

AGM AND SGM

At the 2010 AGM held on 4 May 2010 the shareholders approved a repurchase program authority pursuant to which the Company may repurchase its own shares by way of on market purchases up to a maximum of 18,250,306 common shares to expire 15 months following the 2010 AGM. The Company will propose, at the 2011 AGM, that the repurchase program authority be renewed.

At an SGM held on 22 December 2010 the shareholders approved resolutions to amend the Company's Bye-Laws and to vary the terms of the employee RSS to convert previously granted conditional awards to nil-cost options. Details of the matters presented and passed at the SGM are available on the Company's website.

The Company's 2011 AGM is scheduled for 1.00pm Bermuda time on 5 May 2011. Notice of the AGM and the form of proxy accompany this Annual Report. The Notice of the AGM is also available on the Company's website.

ELECTRONIC AND WEB COMMUNICATIONS

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

GOING CONCERN

The business review section on pages 16 to 31 sets out details of the Group's financial performance, capital management, business environment and outlook. In addition, starting on page 76 the risk disclosures section of the consolidated financial statements sets out the major risks the Group is exposed to, including insurance, market, liquidity, credit, operational and strategic, together with the Group's policies for monitoring and controlling its exposures to these risks.

The Directors believe that the Group is well placed to manage its business risks successfully having taken into account the current economic outlook.

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

AUDITORS

Resolutions will be proposed at the Company's 2011 AGM to re-appoint Ernst & Young LLP as the Company's auditors and to authorise the Directors to set the auditors' remuneration. Ernst & Young has served as the Company's auditors since 2005.

DISCLOSURE OF INFORMATION TO THE AUDITORS

Each of the persons who is a Director at the date of approval of this Annual Report confirms that:

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

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

Greg Lunn, Company Secretary
20 February 2011

CORPORATE GOVERNANCE

Lancashire seeks to achieve the highest standards of corporate governance. The Company by virtue of its premium listing on the LSE measures its corporate governance compliance against the requirements of The Combined Code on Corporate Governance (the "Combined Code") issued in June 2008 by the UK Financial Reporting Council ("FRC"). In this report the Company has opted to comply with or explain its non-compliance for the 2010 financial year with the Combined Code. In May 2010 the FRC issued a revised UK Corporate Governance Code (the "UK Corporate Governance Code"), which will replace the Combined Code for financial years commencing after 29 June 2010. It should be noted that the Company has started to monitor its compliance with the new UK Corporate Governance Code. However, in this Corporate Governance section and throughout this Annual Report for the 2010 financial year, areas of corporate governance compliance and non-compliance are explained by reference to the Combined Code. There are no Bermudian corporate governance standards similar to the Combined Code that apply to Lancashire.

BOARD AND COMMITTEE ADMINISTRATION

The Board has overall responsibility for the leadership and control and the long-term success of Lancashire's business. The Board has reserved a number of matters for its decision, including responsibility for the overall management of the Group and approval of the Group's long-term objectives and commercial strategy. The Board has delegated certain matters to the committees described below. The committees report to the Board.

The Board has separate appointments for the roles of Chairman and CEO. The day to day management of the Company and implementation of Board decisions and strategy is carried out by the executive Directors and senior management. The Board and its committees meet on a quarterly basis and occasionally more frequently as circumstances dictate. At Board meetings, the Directors review all areas and developments of the Group's business and receive reports from management on underwriting, finance and any other key matters affecting the Company. The Directors are provided with information necessary for them to fulfil their responsibilities including quarterly reports and full board papers. Additional information is provided to the Directors as and when necessary and the Directors have access to independent professional advice as required.

MEETING ATTENDANCE SCHEDULE

The Board and committee attendance record during 2010 of the Directors who held office during the year is detailed below. The table below reflects the number of meetings attended and the number of meetings held during the period the Director was a member of the Board or committee as follows:

	Board	Audit Committee	Nomination and Corporate Governance Committee	Remuneration Committee	Investment Committee	Underwriting Committee
Non-Executive Directors						
John Bishop ⁽¹⁾	5/6	4/4	5/5	–	–	4/4
Emma Duncan ⁽²⁾	2/3	–	–	–	–	–
Jens Juul ⁽³⁾	4/4	3/3	4/4	3/3	–	3/3
Ralf Oelssner ⁽⁴⁾	6/6	4/4	4/4	4/4	–	4/4
Robert Spass ⁽⁵⁾	4/6	1/1	–	–	3/4	–
William Spiegel ⁽⁶⁾	5/6	4/4	–	4/4	2/2	–
Martin Thomas ⁽⁷⁾	5/6	–	5/5	4/4	–	–
Barry Volpert ⁽⁸⁾	2/2	–	–	–	2/2	–

(1) John Bishop was appointed Chairman of the Audit Committee on 4 August 2010.

(2) Emma Duncan was appointed to the Board on 4 August 2010, and was appointed to the Remuneration Committee and the Investment Committee on 5 November 2010.

(3) Jens Juul resigned from the Board, the Audit Committee, the Nomination and Corporate Governance Committee, Remuneration Committee and the Underwriting Committee on 19 October 2010. He has retained his role as the Non-Executive Chairman of the Board of Lancashire Insurance Company Limited, the Bermuda operating subsidiary of the Company.

(4) Ralf Oelssner was appointed a member of the Nomination and Corporate Governance Committee on 25 February 2010.

(5) Robert Spass resigned as Chairman of the Audit Committee and was appointed Chairman of the Investment Committee on 4 August 2010.

(6) William Spiegel was appointed a member of the Investment Committee on 4 August 2010.

(7) Martin Thomas resigned as a member of the Remuneration Committee on 5 November 2010.

(8) Barry Volpert resigned from the Board and as Chairman and a member of the Investment Committee on 7 July 2010.

	Board	Audit Committee	Nomination and Corporate Governance Committee	Remuneration Committee	Investment Committee	Underwriting Committee
Executive Directors						
Richard Brindle	6/6	–	–	–	4/4	4/4
Simon Burton ⁽¹⁾	1/1	–	–	–	–	1/1
Alex Maloney ⁽²⁾	1/2	–	–	–	–	3/4
Neil McConachie	6/6	–	–	–	4/4	–

(1) Simon Burton resigned from the Board and the Underwriting Committee on 27 April 2010.

(2) Alex Maloney was appointed to the Board on 5 November 2010.

THE DIRECTORS

Appointments to the Board are made against objective criteria and with due regard for the benefits of diversity on the Board, including gender. All Non-Executive Directors are independent.

Emma Duncan, Ralf Oelssner and William Spiegel are independent as each is independent in character and judgement and has no relationship or circumstance likely to affect his or her independence. Ralf Oelssner is the senior independent Director. Martin Thomas was independent upon his appointment as Chairman on 1 May 2007. The Board determined, on 4 November 2009, that Robert Spass was independent following the termination, earlier in that year, of a monitoring agreement between Lancashire and Capital Z, which agreement had been in existence since the Company was founded. At the Board meeting held on 5 November 2010, the Board approved a one off payment to Robert Spass (details of which are given in the Directors' Remuneration report) to achieve alignment of the fees of all Non-Executive Directors of the Company. With effect from July 2010 John Bishop accepted an appointment as a consultant to LUK to advise on matters relating to compliance with UK Solvency II requirements.

At its meeting held on 17 February 2011 the Board determined, further to a recommendation of the Nomination and Corporate Governance Committee held on 16 February 2011, that both John Bishop and Robert Spass continue to be independent in character and judgement. With regard to John Bishop the arrangement is considered by the Board not to be financially material and to be of benefit to the Group without impugning his independence. With regard to Robert Spass, while the payment to him is material in nature, and accordingly could appear to affect his independence of judgement, the purpose of the payment, to align the structure of his fees with those of the other Directors of the Company (over the longer term the payment will represent a saving to the Company) makes it clear that the payment was not such as to impact his independence. Further, Mr Spass' consistently beneficial contribution to the operation of the Board since the Company's foundation was also taken into account, and it was also noted that Capital Z is no longer a major shareholder of the Company.

Accordingly, five out of the nine members of the Board are independent Non-Executive Directors and the Board composition complies with the Combined Code requirement that independent Non-Executive Directors, excluding the Chairman, should make up at least half of the Board.

Pursuant to the Company's Bye-laws 47.2 and 49.1 Alex Maloney and Emma Duncan, who were appointed by the Board as Directors of the Company on 4 August 2010 and 5 November 2010 respectively, shall retire at the AGM and are thus eligible for re-election. In addition, pursuant to Bye-law 49.2 of the Company's Bye-laws, one-third of the Directors (or, if their number (excluding, for this purpose, Directors eligible for re-election under Bye-law 47.2) is not three or a multiple of three, the number nearest to, but (except where less than three Directors are subject to retirement by rotation) not greater than, one-third) shall retire from office by rotation at each AGM. The Directors eligible for re-election are those who have been longest in office since their last re-election or appointment. The Directors selected for retirement at the AGM pursuant to Bye-law 49 are Richard Brindle and Robert Spass. Both Richard Brindle and Robert Spass have offered themselves for re-election. The Board, having conducted a formal performance evaluation, is satisfied with the performance of each of Alex Maloney, Emma Duncan, Richard Brindle and Robert Spass who are Directors of the Company and proposes their re-election for a further term to be determined in accordance with the Company's Bye-laws at the AGM scheduled to take place on 5 May 2011 as detailed in the notice of AGM accompanying this report.

The new UK Corporate Governance Code has introduced a requirement that all Directors of FTSE 350 companies should be subject to annual election by shareholders. This is not a requirement of the Combined Code, which applies to the 2010 financial year. At its meeting held on 4 August 2010, the Nomination and Corporate Governance Committee considered this requirement and determined that the Company should retain its current practice of rotating the election of Directors on a 3-year staggered cycle, and for the Company to explain clearly in its Annual Report & Accounts that it does not intend to comply with the annual re-election of all Directors on the grounds that both the continuity and the collegiality of the Board could be compromised by the application of this provision of the UK Corporate Governance Code.

INFORMATION AND TRAINING

On appointment the Directors receive written information regarding their responsibilities as Directors and information about the Group. The new Director induction process is tailored for each new Director in the light of their existing skill set and knowledge of the Company and includes meeting with senior management, visiting the Company's operations and the provision of key information.

Since before the Company's admission to the Official List in March 2009 and to trading on the main market of the LSE, information regarding the obligations of the Company and the Directors to comply with the Listing Rules of the FSA has been provided in written form and by oral presentation to the Directors. Information regarding the Company's Official List and Bermuda law obligations and on the UK Corporate Governance Code continues to be provided on a regular basis and is collated and summarised in quarterly reports on corporate governance developments which are prepared by the Company's legal and compliance department for consideration by the Nomination and Corporate Governance Committee. All the Directors have access to the Company Secretary who is responsible for updating the Board with any legal, regulatory or compliance developments affecting the Company. During 2010 the Company appointed Christopher Head, a UK qualified solicitor, to the new role of Head of Corporate Affairs, reporting to the Company Secretary. The Directors also have access to independent legal advice as required. Regular sessions are held between the Board and management as part of the Company's regular quarterly Board Meetings during which in-depth presentations covering areas of the Group's business are made. The Directors have the opportunity during these presentations to ask questions about the subject matter.

BOARD PERFORMANCE EVALUATION

Performance evaluation of the Board, its committees and individual Directors takes place on an annual basis and is initiated by the Chairman under the direction of the Nomination and Corporate Governance Committee. The aim of this work is to assess the effectiveness of the Board and its sub-committees in terms of performance, composition, supporting processes and management of the Group as well as to review each Director's training and development needs. The process during 2009 was facilitated by external consultants, whilst in 2010 the evaluation was conducted internally.

Each Board member met with the Head of Corporate Affairs to discuss a questionnaire to ascertain their views on the effectiveness of the Board and its Committees, the contribution of the individual Directors, and the management of the Company.

Areas assessed in the 2010 evaluation included: consideration of matters reserved to the Board and the balance of delegated responsibilities as between the Board and executive management and specifically between the Chairman and CEO; the Board's understanding of key issues and risks and its ability to guide and review strategy; the Board's understanding of shareholders' priorities; the ability of the Board to communicate with, challenge, guide and support executive management; the size and composition of the Board and its Committees, and whether the Board has appropriate skill sets properly deployed; the operation of Board Committees and the adequacy of the reporting of Committee business to the full Board; the commitment and effectiveness of all Board members including the Chairman, the Senior Independent Director and the CEO; the performance of the company secretarial department including arrangements for Board and Committee meetings, the preparation of agendas, Board papers and minutes; and the ongoing training requirements of the Board. Feedback from this process was incorporated into a summary report for consideration by the Chairman and discussion between the Chairman, Company Secretary and Head of Corporate Affairs. A final report, including conclusions and recommended action points, was reviewed by the Nomination and Corporate Governance Committee, made available to the Board, and discussed at the February 2011 Board meeting.

In addition to the performance evaluation the CEO undertook individual performance reviews of the executive Directors, and the Senior Independent Director conducted a review of the performance of the Chairman during 2010 by holding a meeting with all the Non-Executive Directors. Copies of the executive Director performance appraisals were supplied to the Remuneration Committee.

The evaluations undertaken for the 2010 financial year found that the Board operates effectively and has a good blend of insurance, investment and regulatory expertise. All Non-Executive Directors are committed to the continued success of the Company and to making the Board work effectively. Attendance at and preparation in advance of Board meetings is good; Non-Executive Directors provide further support via membership of sub-committees and through informal discussion and debate with both the executive and other Non-Executive Directors. The CEO and executive Directors are also operating effectively.

Infrastructure, processes and governance mechanisms are in place to support effective performance of the Board. The Board's risk management processes and expertise have been further enhanced during 2010, particularly with the introduction of the risk management forums (which operate as both training sessions and discussion groups, organised by the Group CRO) and the attendance of all Directors at Underwriting Committee meetings. The number of Directors on the Board is felt to be broadly appropriate and the Board Committees are considered to have an appropriate balance of skills and to function effectively. There may be scope to introduce another Non-Executive Director in 2011. The Nomination and Corporate Governance Committee will continue to ensure that appropriate training and advice is provided to the Directors, with the assistance of the Legal and Compliance department. The administration of the Board and the organisation and minuting of Board and Committee meetings is considered to be operating well.

The Board will continue to review its procedures, its effectiveness and development in 2011.

RELATIONS WITH SHAREHOLDERS

Throughout 2010, the Group's Head of Investor Relations presented to several of the Company's major shareholders and the investor community, often in conjunction with the CFO, the CEO or Chairman. Feedback from analysts following presentations was reported to the Board on a regular basis. Conference calls with the shareholders and the investment community hosted by the senior management of the Company have been held on a quarterly basis following announcement of the Company's financial results. The CEO, President, CFO and CUO are generally available to answer questions at these presentations. The Company has also commissioned shareholder reports to review the make-up of its beneficial shareholder base. The Company's Chairman and the Non-Executive Directors are also available to meet with major shareholders at the Company's AGM and throughout the year. Shareholders wishing to meet the Chairman or other Non-Executive members of the Board are invited to contact the Head of Investor Relations. Shareholders are encouraged to attend the Company's AGM and to vote on shareholder resolutions.

THE UK STEWARDSHIP CODE COMPLIANCE

The UK Stewardship Code sets out good practice principles for investor companies and their monitoring and engagement with the companies in which they invest. The Company does not currently invest in equities, but recognises the importance of engaging with its own investors.

COMMITTEES

The Board has established Audit, Nomination and Corporate Governance, Remuneration, Investment and Underwriting Committees. Each of the Committees has detailed Terms of Reference, which can be viewed on the Company's website (www.lancashiregroup.com). The Committees are generally scheduled to meet quarterly prior to the Board meetings at which they report.

CORPORATE GOVERNANCE

The composition of the Committees as at 31 December 2010 was as follows:

	Audit Committee	Nomination and Corporate Governance Committee	Remuneration Committee	Investment Committee	Underwriting Committee
John Bishop	(Chair) ✓				✓
Emma Duncan			✓	✓	
Ralf Oelssner	✓	✓	✓		✓
Robert Spass	✓			(Chair) ✓	
William Spiegel		✓	(Chair) ✓	✓	
Martin Thomas		(Chair) ✓			
Richard Brindle				✓	(Chair) ✓
Alex Maloney					✓
Neil McConachie				✓	

AUDIT COMMITTEE

The composition of the Audit Committee conforms to the Combined Code requirement that the Audit Committee should be comprised of independent Non-Executive Directors. The Audit Committee is chaired by John Bishop, who has recent and relevant financial experience. The Audit Committee is responsible for the effectiveness of the internal and external audit functions. The Audit Committee's responsibilities are contained in their terms of reference. These include reviewing and reporting to the Board on the preparation of the Company's financial information, announcements relating to the Company's financial results, reviewing the Company's procedures for detecting fraud and implementing appropriate whistle blowing procedures, monitoring the independence of the Company's auditors including the review and approval of the provision of non-audit services and monitoring and considering on a regular basis the internal audit plan and the reports from the internal auditor.

The Audit Committee has reviewed arrangements by which staff may, in confidence, raise concerns about improprieties in matters of financial reporting or other matters and such arrangements have been documented in a Whistle-blowing Policy and Procedure. The Audit Committee has also recently approved amendments to the Company's procedures for anti-money laundering, bribery and financial crime and training within these areas is provided to all staff members.

NOMINATION AND CORPORATE GOVERNANCE COMMITTEE

The Nomination and Corporate Governance Committee's responsibilities are contained in their terms of reference. These include reviewing the structure, size and composition (including the skills, knowledge, independence and experience) of the Board and its committees and making recommendations regarding changes. The Committee considered and recommended the appointment of Emma Duncan to the Board, and her appointment as a Non-Executive Director became effective in August 2010. Emma Duncan was identified as a suitable candidate from contacts within the Company. The Committee also considered and recommended changes to the composition and membership of the Board's Committees during the year. The Committee also regularly considers reports upon developments in corporate governance and questions of compliance with the Combined Code. The work of the Nomination and Corporate Governance Committee includes responsibility for ensuring the performance evaluation of the Board – see pages 49 and 50.

REMUNERATION COMMITTEE

The Remuneration Committee's responsibilities are contained in their terms of reference. These include determining remuneration for the Company's executives, Directors and senior management of the Group, within a framework agreed with the Board. The remuneration report for which the committee is responsible can be found on pages 54 to 63 of this report.

INVESTMENT COMMITTEE

The Investment Committee's responsibilities are contained in their terms of reference. These include recommending and monitoring investment strategies, recommending investment guidelines to the Board for approval, recommending appointments of fund managers for the Group's investments and monitoring the cash flow, liquidity and working capital of the Group.

UNDERWRITING COMMITTEE

Additional members of the Underwriting Committee, who are not Directors of the Company, are Simon Fascione, Paul Gregory, Charles Mathias and Paula Porter. The positions and summaries of the experience of these non-director members of the Underwriting Committee can be found on the Company's website at www.lancashiregroup.com. The Underwriting Committee's responsibilities are contained in its terms of reference. These include reviewing and monitoring compliance with the Group's underwriting guidelines and policies, formulating underwriting strategy, reviewing aggregate underwriting exposures and reviewing compliance with Probable Maximum Loss tolerance limits.

INTERNAL CONTROL

The Board is responsible for maintaining a robust framework of internal control and risk management and for overseeing and ensuring the effectiveness of the Group's risk management and internal control systems. The Board has assigned responsibility to the Audit Committee for reviewing the integrity of the Group's internal controls and internal control systems (including financial, operational and compliance controls).

The Audit Committee reports, and makes recommendations, to the Board regarding the effectiveness of internal controls and the Company's financial and fraud risk management policies and procedures. During 2010, the Audit Committee reviewed the effectiveness of the Company's internal financial controls and internal control systems and financial and fraud risk management policies and procedures, reviewed the Company's financial reporting and held closed sessions with the Company's internal and external auditors and with management.

INTERNAL AUDIT

The Group's internal audit department reports directly to the Audit Committee. Each year it presents an audit plan to the Audit Committee for consideration and approval. The key objective of internal audit is to audit annually those areas of the Group's business that could present the highest risk to the achievement of the Group's business objectives, and to audit all other areas of the Group's operations at least once every three years. The findings of each internal audit are reported to the Audit Committee which has a responsibility to ensure the timely implementation of agreed management actions and to review the status of these at each of its meetings. The Company continues to engage PricewaterhouseCoopers to carry out specialist internal audit work and to provide additional capacity on an as required basis.

EXTERNAL AUDIT AND PROVISION OF NON-AUDIT SERVICES

The Audit Committee is responsible for reviewing and monitoring the external auditors' objectivity and reporting to the Board to ensure that the auditors' objectivity and independence is safeguarded. The Board is responsible for reviewing the effectiveness of the external audit which is reported on by the Audit Committee. In 2010, Ernst & Young LLP performed certain non-audit services in relation to: Solvency II, FSA Arrow visit training, a review of significant influence, transfer pricing review work and project specific work in relation to debt structuring. Fees for non-audit service work for the 2010 year amounted to \$311,287 and the nature of the work and amount of fees charged was not considered likely to affect the objectivity or independence of Ernst & Young LLP as auditors. The Audit Committee and the Board are currently satisfied with the objectivity and independence of Ernst & Young LLP as auditors.

ENTERPRISE RISK MANAGEMENT

The Board is responsible for setting the Group's risk appetite and preferences, defining its risk tolerances, and monitoring and ensuring compliance with risk tolerances. The CRO reports directly to the Group and subsidiary Boards and facilitates and aids the identification, evaluation, quantification and control of risks at a Group and subsidiary level. The CRO provides regular reports to the Group and subsidiary Boards and subsidiary company Risk Committees covering, amongst other things, actual risk levels against tolerances, emerging risks and any lessons learned from risk events. The Board considers that a supportive ERM culture, established at the Board and embedded throughout the business, is key. Facilitating the embedding of ERM and helping the Group to improve its ERM practices is a major responsibility assigned to the CRO.

Further discussion of the risks affecting Lancashire and the policies in place to manage them can be found in the Risk and Other Disclosures section on pages 76 to 98.

DIRECTORS' REMUNERATION REPORT

As a company incorporated in Bermuda, Lancashire is not bound by UK law or regulation to the same extent that it applies to UK incorporated companies in the area of Directors' remuneration. However the Board, by virtue of the Company's premium listing on the LSE, and for the purposes of explaining its compliance against the requirements of the Combined Code is committed to providing information on Directors' remuneration to shareholders and complying with corporate governance standards and best practices to the appropriate extent, taking into account the Company's size and the nature of its business.

All information shown below is unaudited.

REMUNERATION COMMITTEE

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

Emma Duncan (appointed 5 November 2010)
Jens Juul (resigned 19 October 2010)
Ralf Oelssner
William Spiegel (Chair)
Martin Thomas (resigned 5 November 2010)

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

ADVICE TO THE REMUNERATION COMMITTEE

During 2010, as in 2009, HNBS were appointed by the Remuneration Committee to give advice on market trends, practices and appropriate levels of remuneration for executive Directors and members of senior management. HNBS also advised the Company on amendments to the RSS to introduce a mechanism for the grant of nil-cost options during 2010. Greg Lunn, the Company Secretary, and Dewey & LeBoeuf LLP, the Company's legal counsel, provided the Remuneration Committee with advice in relation to remuneration matters including the operation of the Company's share schemes. Dewey & LeBoeuf LLP provided other legal services to the Group during 2010.

Meetings of the Remuneration Committee may also be attended by other Directors including the CEO and President, but such attendance is by invitation only and not by right. No Director plays any part in any discussion about his or her own remuneration.

REMUNERATION POLICY

The Company's remuneration policy is geared towards providing a level of remuneration which attracts, retains and motivates executive Directors and senior management of the highest calibre to further the Company's interests and to optimise long-term shareholder value creation, within appropriate risk parameters. The remuneration policy also seeks to ensure that executive Directors and senior management are provided with appropriate incentives to drive individual performance and to reward them fairly for their contribution to the successful performance of the Company.

The Remuneration Committee has adopted the principle that base salary should be set broadly in line with the median of peer companies for executives in a role of comparable standing and that executive Directors should be able to achieve total remuneration at the upper quartile level (compared to peer companies generating similar returns) when justified by superior performance. The Remuneration Committee also takes into account levels of pay elsewhere in the Group, when determining the pay levels for executive Directors and senior management.

The Remuneration Committee has considered whether there is any element of the current remuneration policy which could conceivably encourage executives to take inappropriate risks and has concluded that the policy is appropriate in this regard taking into account the following factors:

- There is an appropriate balance between fixed and variable pay, so executives are not required to earn performance related pay to maintain their day to day living expenses;
- There is a blend of short-term and long-term performance metrics with an appropriate mix of performance conditions meaning that there is no undue focus on particular metrics over specific timeframes; and
- There is a high level of share ownership amongst employees meaning that there is a strong focus on sustainable long-term shareholder value.

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

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

- Base salary;
- Annual bonus;
- Long-term equity-based incentives;
- Pension; and
- Other benefits, comprising medical, dental, vision and life insurance coverage, gym membership as well as a housing allowance for expatriates.

Base salary

Salaries for executive Directors are determined by the Remuneration Committee at the beginning of each year and where an individual changes responsibility or position.

- From 1 January 2011, the salaries for the executive Directors have been increased as follows: Richard Brindle, CEO – no increase; Alex Maloney, CUO 30.2%; and Neil McConachie, President – no increase. The increase to Alex Maloney's salary reflects the market value of the individual and his appointment as a Director to the LHL Board. This new role represents an increase in the scope and complexity and this new salary level has been arrived at following a detailed market benchmarking exercise. The effect of this change is to move Alex Maloney's total compensation to a position broadly comparable to a median position of peers;

In determining appropriate levels of salary increases the Remuneration Committee considers the level of salary increases in the workforce generally.

Annual bonus

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

Financial performance will have two components:

- (i) absolute financial performance against the Company's board approved 2011 budget. This component will be measured by the achievement of a target growth in book value per share, adjusted for dividend payments. Growth in book value per share continues to be the most appropriate operational metric to measure the growth in value that the shareholders have received over the course of the financial year.
- (ii) relative financial performance against a well defined peer group. This component will be measured by comparing Lancashire's growth in book value per share against a peer group. The 2011 defined peer group consists of: Amlin plc, Aspen Insurance Holdings Limited, Axis Capital Holdings Limited, Beazley plc, Catlin Group Ltd., Endurance Specialty Holdings Ltd., Flagstone Reinsurance Holdings Limited, Hiscox Ltd., Montpelier Re Holdings Ltd., RenaissanceRe Holdings Ltd. and Validus Holdings Ltd. Should one of these companies undergo extensive change in capital size or market focus the Remuneration Committee will consider whether they should still remain in the peer group. If the Company loses any money in a year, the relative performance component will not be used as an input for financial performance.

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

The level of bonus for 2011 will be capped at 400%, 350% and 350% of base salary for the executive Directors – the CEO, CUO and President respectively. The target level of bonus is half of the maximum. Bonus payments will be made when all information necessary to compute the bonuses has been obtained.

A portion of each executive Director's bonus may be paid in stock. For the 2010 bonus, cash awards were made up to 100% of bonus target and any excess beyond that was paid in stock that cliff vests on 1 January 2013. For 2011 cash bonus awards, 25% of any bonus earned will be deferred into stock with 33% vesting annually over three years.

Long-term equity-based incentives

The Company operates an RSS. Under the RSS, executives and other employees may be granted a conditional award of shares or share equivalents in the form of nil-cost options exercisable over a period of up to ten years from the date of vesting, which are released to the employee after three years, subject to the satisfaction of certain criteria, including for example the achievement of stretching performance conditions and continued employment. The purpose of awards under the RSS is to motivate and retain members of staff in the attainment of the primary long-term performance goals of the Company and its subsidiaries. The executive Directors are eligible to receive share awards under the RSS at the discretion of the Remuneration Committee. Awards are made each year following the announcement of the Company's results.

The Remuneration Committee has considered carefully the grant levels and performance conditions for awards in 2011. Restricted award levels for 2011 will be 312,741 for the CEO, 236,198 for the CUO and 261,994 for the President with the actual number of shares received subject to satisfaction of time and performance conditions as set out below.

For one half of each award the performance condition is based on the Company's TSR performance against a pre-defined comparator group of international insurance companies over the three year performance period. 25% of this part of the award will vest if the Company's TSR is equal to the company whose TSR is ranked at the median. All of this part of the award will vest if the Company's TSR is equal to or above the company whose TSR is ranked at the upper quartile. Vesting will take place on a straight line between 25% and 100% for TSR performance between median and upper quartile.

For the other half of each award the performance condition is RoE over the 3 financial years of the performance period. 25% of this half of the award will only vest if average annual RoE over the performance period exceeds the 13 week treasury rate (the average taken quarterly over the performance period) plus 6%. All of this part of the award will vest if the Company's average RoE is equal to the 13 week treasury rate (the average taken quarterly over the performance period) plus 15%. Vesting will take place on a straight line basis between 25% and 100% for RoE performance.

TSR and RoE were chosen as performance criteria on the basis that TSR provides an objective reward for stock market performance against the Company's peers and RoE provides a focus on the Company's underlying financial performance.

On 22 December 2010 at an SGM the Company received shareholder approval to amend the RSS rules to allow nil (or nominal) cost options to continue until the tenth anniversary of the grant of the award and to provide that the dividend equivalent payment may also include sums in relation to dividends paid during the period from the time the award vests and the time such awards are exercised.

The Company operated an LTIP from 2006, which was replaced by the RSS in 2008. Details of the executive Directors' awards under the LTIP are shown on page 62.

Pension

Executive Directors receive pension contributions from the Company under defined contribution pension plans. For the Bermuda based plan executive Directors receive a Company contribution of 10% of base salary. The Group CEO and the CUO receive a 10% base salary contribution to a UK defined contribution pension plan in respect of their salary and employment with the Company's UK operations. Details of the pension contributions made to executive Directors are set out on page 59.

Other benefits

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

SERVICE CONTRACTS

The executive Directors of the Company are Richard Brindle, Alex Maloney and Neil McConachie. Richard Brindle was appointed as CEO of the Company under an original service contract dated 9 December 2005. Alex Maloney was appointed as CUO of the Company under an original service contract dated 31 December 2005. Neil McConachie was appointed as CFO under an original service contract dated 1 February 2006.

Richard Brindle's, Alex Maloney's and Neil McConachie's original service contracts with the Company were replaced with new service contracts entered into with effect from 1 January 2009.

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

Simon Burton resigned as a Director of the Company on 27 April 2010, and as an employee effective 30 June 2010.

The Board may allow executive Directors to accept external appointments. In accordance with the Combined Code, the Board will not agree to a full-time executive taking on more than one Non-Executive Directorship in a FTSE 100 company, or the chairmanship of such a company.

NON-EXECUTIVE DIRECTORS

Remuneration policy

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

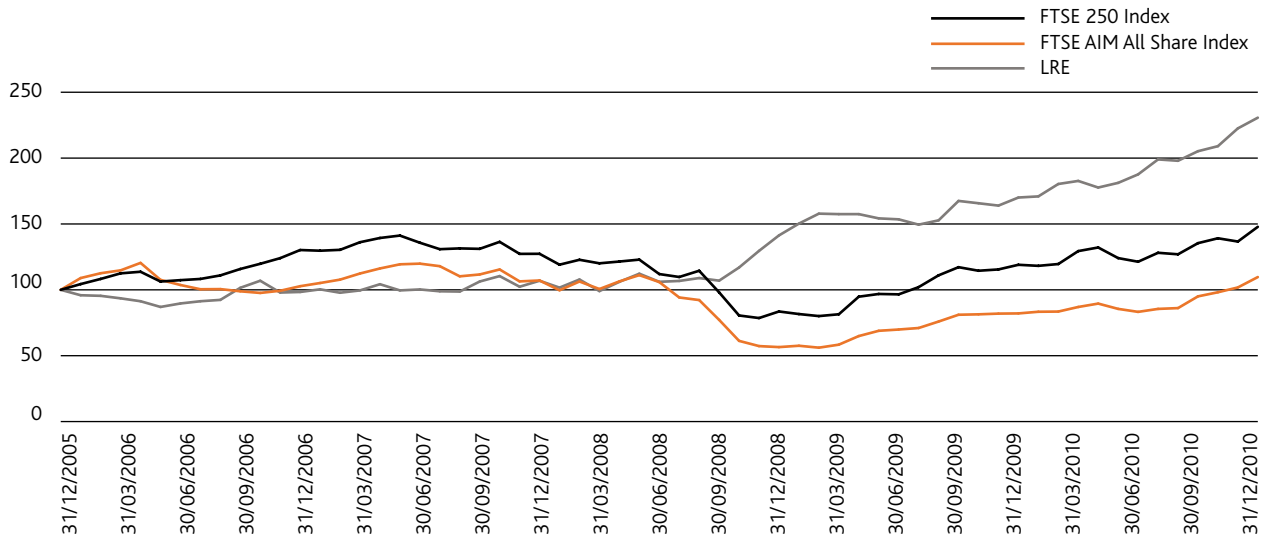
Terms of appointment

The Non-Executive Directors serve subject to the Company's bye-laws and under letters of appointment and are appointed for varying terms which are terminable by either party on six months' notice except in the event of earlier termination in accordance with the Bye-laws. The Non-Executive Directors are typically expected to serve twice for three year terms, although the Board may invite a Non-Executive Director to serve for an additional period. Their letters of appointment are available for inspection at AGMs.

Name	Position	Date of letter of appointment	Date of next re-appointment
Martin Thomas	Non-Executive Chairman	16 April 2007	2013 AGM
John Bishop	Non-Executive Director, Chairman of Audit Committee	19 March 2008	2013 AGM
Emma Duncan	Non-Executive Director	17 September 2010	2011 AGM
Ralf Oelssner	Non-Executive Director, Senior Independent Director	31 July 2007	2012 AGM
Robert Spass	Non-Executive Director, Chairman of Investment Committee	9 December 2005	2011 AGM
William Spiegel	Non-Executive Director, Chairman of Remuneration Committee	9 December 2005	2012 AGM

RELATIVE PERFORMANCE

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



DIRECTORS' REMUNERATION REPORT

DIRECTORS' EMOLUMENTS

Directors' emoluments in U.S. dollars for the year ended 31 December 2010:

Director	Base salary/fees	Other ^(xi)	Benefits ^(xii)	Pension ^(xiii)	Annual bonus cash ^(xiv)	Annual bonus RSS ^(xiv)	Total 2010 emoluments	Total 2009 emoluments
Non-Executive Directors								
John Bishop ⁽ⁱ⁾	156,517	41,173	–	–	–	–	197,690	196,000
Emma Duncan ⁽ⁱⁱ⁾	70,000	–	–	–	–	–	70,000	–
Ralf Oelssner ⁽ⁱⁱⁱ⁾	175,000	50,000	–	–	–	–	225,000	221,000
Robert Spass ^(iv)	302,500	552,500	–	–	–	–	855,000	302,500
William Spiegel	175,000	–	–	–	–	–	175,000	175,000
Martin Thomas ^(v)	306,678	100,000	–	–	–	–	406,678	375,000
Executive Directors								
Richard Brindle ^(vi)	675,000	405,000	291,233	108,000	2,160,000	1,890,000	5,529,233	4,320,877
Alex Maloney ^(vii)	50,649	–	7,097	5,065	75,973	64,102	202,886	–
Neil McConachie	500,000	–	267,281	50,000	875,000	765,625	2,457,906	1,575,394
Former Directors								
Jens Juul ^(viii)	111,467	70,000	–	–	–	–	181,467	175,000
Barry Volpert ^(ix)	90,856	–	–	–	–	–	90,856	166,250
Simon Burton ^(x)	106,133	505,491	130,411	10,613	557,200	–	1,309,848	1,302,186

- (i) John Bishop was also a Non-Executive Director of LUK and received a fee of \$35,000 per annum, and \$2,000 for each LUK Board or committee meeting that he attended in respect of his appointment. In addition, he received a fee of \$5,000 per annum in respect of his chairmanship of the LUK Audit Committee. John Bishop resigned from the Board of LUK effective 12 July 2010 and entered into a consulting agreement with LUK whereby he is paid a fee of \$21,000 per annum to assist LUK in respect of its Solvency II project.
- (ii) Emma Duncan was appointed to the Board on 4 August 2010.
- (iii) Ralf Oelssner is also a Non-Executive Director of LUK and receives a fee of \$30,000 per annum, and \$2,000 for each LUK Board or committee meeting that he attends in respect of his appointment.
- (iv) Robert Spass' annual fee was reduced from \$345,000 to \$175,000 effective 1 October 2010. He was also paid \$552,500 in October 2010. This payment to Mr Spass was made in order to align the structure of his Director's fees with those of the other Directors of the Company.
- (v) Martin Thomas' annual fee was increased from \$275,000 to \$325,000 effective 4 May 2010. He also receives a fee of \$100,000 per annum for his appointment as Non-Executive Chairman of LUK.
- (vi) Richard Brindle receives an annual salary of \$405,000 from LUK in respect his employment, paid in sterling.
- (vii) Alex Maloney was appointed to the Board on 5 November 2010 and as such his emoluments have been prorated accordingly.
- (viii) Jens Juul resigned from the Board on 19 October 2010. He is also a Non-Executive Director of LUK and received a fee of \$35,000 per annum in respect of this appointment until 17 October 2010 when the fee was increased to \$100,000 per annum and he entered into a consulting agreement with LUK whereby he is paid a consulting fee of \$75,000 per annum.
- (ix) Barry Volpert resigned from the Board on 7 July 2010.
- (x) Simon Burton resigned from the Board on 27 April 2010 and as an employee effective 30 June 2010 and as such his emoluments have been pro-rated accordingly. However, he received the amount of \$505,491 as compensation for loss of office, in addition to his bonus payment for the year.
- (xi) Some amounts were paid in pounds sterling and converted at prevailing exchange rates.
- (xii) Benefits include UK national insurance contributions, payroll taxes, medical, dental, vision coverage, air travel and housing and other allowances paid by the Company for expatriates.
- (xiii) Including a contribution of £26,149 (2009 – £25,985) to a UK defined contribution pension plan in respect of Richard Brindle's salary and employment with LUK.
- (xiv) Bonus targets were set at the beginning of 2010 and based on a clear split between company financial performance on a 75:25 basis. Company financial performance had two components, absolute financial performance and relative financial performance weighted 60:40 respectively. The absolute component paid out at maximum and the relative component is provisionally cited at maximum pending the final audited results of peer companies needed in order to calculate the final bonus payable. Cash awards were made up of 100% of target and any excess beyond that will be deferred into stock that cliff vests on 1 January 2013.

DIRECTORS' WARRANTS, OPTIONS AND RSS AWARDS

(i) Time vesting ordinary warrants

Name	Warrants held at 1 January 2010	Warrants exercised during the year ^(iv)	Warrants lapsed during the year	Warrants held at 31 December 2010	Exercise price ⁽ⁱⁱⁱ⁾	Date from which first exercisable ⁽ⁱ⁾	Expiry date
Richard Brindle							
16/12/2005	5,718,913	–	–	5,718,913	\$5.00	16/12/2005	16/12/2015
16/12/2005	1,906,304	–	–	1,906,304	\$3.90	16/12/2008	16/12/2015
Alex Maloney							
16/12/2005	297,858	297,858	–	–	\$5.00	16/12/2005	16/12/2015
16/12/2005	99,289	99,289	–	–	\$3.90	16/12/2008	16/12/2015
Neil McConachie							
16/12/2005	294,293	–	–	294,293	\$5.00	16/12/2005	16/12/2015
16/12/2005	158,859	150,000	–	8,859	\$3.90	16/12/2008	16/12/2015
09/03/2006	158,859	–	–	158,859	\$5.00	09/03/2006	16/12/2015
09/03/2006	158,858	–	–	158,858	\$3.90	16/12/2008	16/12/2015

(ii) Performance vesting ordinary warrants

Name	Warrants held at 1 January 2010	Warrants exercised during the year ^(iv)	Warrants lapsed during the year	Warrants held at 31 December 2010	Exercise price ⁽ⁱⁱⁱ⁾	Date from which first exercisable ⁽ⁱⁱ⁾	Expiry date
Richard Brindle							
16/12/2005	288,843	–	–	288,843	\$5.00	31/12/2007	16/12/2015
16/12/2005	47,154	–	–	47,154	\$3.90	31/12/2008	16/12/2015
16/12/2005	405,967	–	–	405,967	\$2.60	31/12/2009	16/12/2015
Alex Maloney							
09/03/2006	22,566	22,566	–	–	\$5.00	31/12/2007	16/12/2015
09/03/2006	3,684	3,684	–	–	\$3.90	31/12/2008	16/12/2015
09/03/2006	31,716	31,716	–	–	\$2.60	31/12/2009	16/12/2015
21/09/2006	14,442	14,442	–	–	\$5.00	31/12/2007	16/12/2015
21/09/2006	2,358	2,358	–	–	\$3.90	31/12/2008	16/12/2015
21/09/2006	20,298	20,298	–	–	\$2.60	31/12/2009	16/12/2015
Neil McConachie							
16/12/2005	36,105	–	–	36,105	\$5.00	31/12/2007	16/12/2015
16/12/2005	5,894	–	–	5,894	\$3.90	31/12/2008	16/12/2015
16/12/2005	50,746	–	–	50,746	\$2.60	31/12/2009	16/12/2015
09/03/2006	36,105	–	–	36,105	\$5.00	31/12/2007	16/12/2015
09/03/2006	5,894	–	–	5,894	\$3.90	31/12/2008	16/12/2015
09/03/2006	50,746	–	–	50,746	\$2.60	31/12/2009	16/12/2015

DIRECTORS' REMUNERATION REPORT

- (i) The time vesting ordinary warrants vested 25% on issuance on the admission of the Company's shares to trading on AIM on 16 December 2005. 25% of each warrant then vested on each of the first, second and third anniversaries of the admission of the Company's shares to trading on AIM.
- (ii) The performance vesting ordinary warrants were scheduled to vest in three tranches: 20% on 31 December 2007, 40% on 31 December 2008 and 40% on 31 December 2009. The performance conditions were based on a combination (50:50) of compound return and fully converted book value targets. As a result of some of the performance conditions not being fully met in 2007, 2008 and 2009 a number of performance vesting ordinary warrants lapsed.
- (iii) (a) On 10 December 2007, the Company declared a special dividend of \$1.10 per common share payable to shareholders of record, 11 January 2008. The declaration of the dividend triggered a contractual obligation, pursuant to the terms of all warrants, for the Company to pay an amount per warrant equivalent to the dividend for each vested warrant; and to adjust automatically the exercise price for each unvested warrant by an amount equivalent to the dividend. Consequently on 25 January 2008, the Company paid a dividend of £0.5622 per warrant on all of the vested ordinary warrants and the vested performance warrants, reflecting the dividend paid to shareholders. The payments on performance warrants were made once the exact number of vested performance warrants was confirmed following completion of a review of the application of the performance conditions by Ernst & Young as required by the terms of the performance warrants. The exercise price for the unvested ordinary and performance warrants was adjusted downwards by \$1.10 to \$3.90 per warrant. The contractual obligation to pay a dividend equivalent on each vested warrant and to adjust the exercise price for all unvested warrants, applied to all future dividends declared by the Company. Since all warrants have vested or lapsed, there will be no further adjustments of the exercise price as a result of the dividends declared after 1 January 2010.
- (b) On 29 July 2009, the Company declared an interim dividend of \$0.05 per Common share payable to shareholders of record, 28 August 2009. On 7 October 2009, the Company paid a dividend of £0.0308 per warrant on all of the vested ordinary warrants and the vested performance warrants, reflecting the dividend paid to shareholders. On 5 November 2009, the Company declared a special dividend of \$1.25 per common share payable to shareholders of record, 20 November 2009.
- (iv) See page 43 for details of any exercise gains.

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

16 December 2005 – £3.21

9 March 2006 – £3.25

21 September 2006 – £3.44

Dividends paid on ordinary and performance warrants

	Time Vesting Ordinary Warrants £	Performance Vesting Ordinary Warrants £	Total £
Richard Brindle			
Interim dividend of \$0.05 (£0.0308) paid 7 October 2009	235,042	10,357	245,399
Special dividend of \$1.25 (£0.7562) paid 6 January 2010	5,766,544	254,097	6,020,641
Final dividend of \$0.10 (£0.0666) paid 14 April 2010	507,671	49,398	557,069
Interim dividend of \$0.05 (£0.0324) paid 13 October 2010	246,850	24,020	270,870
Special dividend of \$1.40 (£0.8856) paid 19 January 2011	6,753,102	657,104	7,410,206
Alex Maloney⁽ⁱ⁾			
Interim dividend of \$0.05 (£0.0308) paid 7 October 2009	12,242	1,327	13,569
Special dividend of \$1.25 (£0.7562) paid 6 January 2010	300,341	32,556	332,897
Final dividend of \$0.10 (£0.0666) paid 14 April 2010	26,441	6,329	32,770
Neil McConachie			
Interim dividend of \$0.05 (£0.0308) paid 7 October 2009	23,761	2,589	26,350
Special dividend of \$1.25 (£0.7562) paid 6 January 2010	582,966	63,524	646,490
Final dividend of \$0.10 (£0.0666) paid 14 April 2010	51,323	12,350	63,673
Interim dividend of \$0.05 (£0.0324) paid 13 October 2010	24,955	6,005	30,960
Special dividend of \$1.40 (£0.8856) paid 19 January 2011	682,703	164,276	846,979

(i) All of Mr. Maloney's warrants had been exercised by 31 March 2010.

DIRECTORS' REMUNERATION REPORT

(iii) Share options under the 2005 LTIP

Name	Options held at 1 January 2010	Options exercised during the year ⁽ⁱ⁾	Options lapsed during the year	Options held at 31 December 2010	Exercise price ^(iv)	Date from which first exercisable ⁽ⁱⁱⁱ⁾	Expiry date
Richard Brindle							
09/03/2006	190,630	190,630	–	–	£0.92	09/03/2007	08/03/2016
29/06/2007	150,000	112,500	–	37,500	\$2.92	29/06/2008	28/06/2017
Alex Maloney							
09/03/2006	32,087	32,087	–	–	£0.92	09/03/2007	08/03/2016
29/06/2007	137,500	–	–	137,500	\$2.92	29/06/2008	28/06/2017
Neil McConachie							
09/03/2006	133,348	133,348	–	–	£0.92	09/03/2007	08/03/2016
29/06/2007	200,000	150,000	–	50,000	\$2.92	29/06/2008	28/06/2017

(i) See page 43 for details of any exercise gains.

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

(iii) The options vest as to 25% on each of the first, second, third and fourth anniversaries of the date of grant provided that the option holder remains in the employment of the Group at the relevant anniversary.

(iv) Following an amendment to the 2005 LTIP, approved by the Company's shareholders at the special general meeting of shareholders held on 4 January 2008, the Remuneration Committee exercised its discretion to reduce the exercise price for all outstanding vested and unvested options by \$1.10 or £0.5622 effective 9 January 2008. The adjustment was made to reflect the special dividend paid by the Company in January 2008, and the consequent reduction in shareholders' equity. Similarly, the Remuneration Committee exercised its discretion to reduce the exercise prices for all outstanding vested and unvested options on all further dividends, as shown below:

	9 March 2006 grant	29 June 2007 grant
Initial exercise price	£3.25	\$6.87
Dividend paid 25 January 2008	£ (0.56)	\$(1.10)
Dividend paid 7 October 2009	£ (0.03)	\$(0.05)
Dividend paid 6 January 2010	£ (0.76)	\$(1.25)
Dividend paid 4 April 2010	£ (0.07)	\$(0.10)
Dividend paid 13 October 2010	£ (0.03)	\$(0.05)
Dividend paid 19 January 2011	£ (0.89)	\$(1.40)
Exercise price adjusted for dividends	£0.92	\$2.92

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

9 March 2006 – £3.25

29 June 2007 – £3.42

DIRECTORS' REMUNERATION REPORT

(iv) Awards under the Restricted Share Scheme

Name	Awards held at 1 January 2010	Awards granted during the year	Awards vesting during the year	Awards lapsed during the year	Awards held at 31 December 2010	Vesting date ^(ix)
Richard Brindle						
2008 performance award ⁽ⁱⁱⁱ⁾	360,001	–	–	–	360,001	28/03/2011
2008 exceptional award ^(iv)	33,381	–	33,381	–	–	28/03/2010
2009 performance award ^(v)	318,750	–	–	–	318,750	31/12/2011
2009 erss performance award ^(vi)	31,875	–	–	–	31,875	31/12/2011
2009 deferred bonus Bermuda ^(vii)	–	67,223	–	–	67,223	01/01/2012
2009 deferred bonus UK ^(vii)	–	23,521	–	–	23,521	N/A
2010 performance award ^(viii)	–	375,000	–	–	375,000	31/12/2012
Alex Maloney						
2008 performance award ⁽ⁱⁱⁱ⁾	75,552	–	–	–	75,552	28/03/2011
2008 exceptional award ^(iv)	22,254	–	22,254	–	–	28/03/2010
2009 performance award ^(v)	63,750	–	–	–	63,750	31/12/2011
2009 erss performance award ^(vi)	6,375	–	–	–	6,375	31/12/2011
2009 deferred bonus ^(vii)	–	10,252	–	–	10,252	N/A
2010 performance award ^(viii)	–	96,250	–	–	96,250	31/12/2012
Neil McConachie						
2008 performance award ⁽ⁱⁱⁱ⁾	101,032	–	–	–	101,032	28/03/2011
2008 exceptional award ^(iv)	22,254	–	22,254	–	–	28/03/2010
2009 performance award ^(v)	99,375	–	–	–	99,375	31/12/2011
2009 erss performance ^(vi)	9,938	–	–	–	9,938	31/12/2011
2009 deferred bonus ^(vii)	–	35,662	–	–	35,662	01/01/2012
2010 performance award ^(viii)	–	152,500	–	–	152,500	31/12/2012

(i) The market value of the common shares on the dates of grant were 28 March 2008 – £2.86, 19 May 2009 £5.10, 5 November 2009 £5.20, 25 March 2010 £4.86.

(ii) Simon Burton, who resigned as a Director on 27 April 2010, was granted 81,250 RSS awards on 28 March 2010.

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

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

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

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

(vii) For Richard Brindle and Alex Maloney the RSS bonus deferral awards in the UK were granted net of UK personal taxation structured as forfeitable common shares and resulted in the receipt of 23,521 and 10,252 forfeitable common shares respectively.

(viii) The vesting of 2010 RSS awards is subject to two performance conditions. Half of each award is subject to a performance condition measuring the TSR performance of the Company against the TSR performance of a select group of comparator companies, over a three-year performance period. 25% of this half of an award vests for median performance by the Company, rising to 100% vesting of this half of the award for upper quartile performance by the Company or better (with straight-line vesting between these two points). The comparator group of companies comprises Amlin, Axis Capital plc, Beazley plc, Brit Insurance Holding N.V., Catlin Group Ltd., Endurance, Flagstone, Hiscox, Montpelier, RenaissanceRe, and Validus. The other half of each award is subject to a performance condition based on average annual RoE over a three-year performance period. 25% of this part of the award will only vest if average annual RoE over the performance period exceeds the 13 week treasury rate (the average taken quarterly over the performance period) plus 8%. All of this part of the award will vest if the Company's average RoE is equal to the 13 week treasury rate (the average taken quarterly over the performance period) plus 18%. Vesting will take place on a straight line basis between 25% and 100% for RoE performance.

(ix) Subject to being out of a close period.

The market value of the common shares at 31 December 2010 was £5.53 and the range during the year was £4.25 to £6.50.

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

Greg Lunn, Company Secretary

20 February 2011

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Group's consolidated financial statements, in accordance with applicable laws and regulations, which give a true and fair view of the state of affairs of the Group and the results of the Group for that period including the assets, liabilities, financial position and profit and loss of the Group. The consolidated financial statements have been prepared in accordance with IFRS. Where IFRS is silent, as it is in respect of the measurement of insurance products, U.S. GAAP is considered. Further detail on the basis of preparation is described in the consolidated financial statements.

In preparing the consolidated financial statements, the Directors are required to:

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

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

The Directors have elected to include the remuneration information contained in this Annual Report, although as a company incorporated in Bermuda, Lancashire is not bound by UK law or regulation to the same extent that it applies to UK incorporated companies in the area of Directors' remuneration. As an LSE listed company with a premium listing the Company adopts a comply or explain approach against the requirements of the Combined Code, and to this end the Company reports on both corporate governance and remuneration matters to facilitate its shareholders' better understanding. This Annual Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

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

The Directors responsible for authorising the responsibility statement on behalf of the Board are the Chairman, Martin Thomas, President, Neil McConachie and the Company Secretary, Greg Lunn and this statement is made to the best of their knowledge and belief.

20 February 2011

We have audited the financial statements of Lancashire Holdings Limited and its subsidiaries (collectively "the Group") for the year ended 31 December 2010 which comprise the consolidated balance sheet as at 31 December 2010, consolidated statement of comprehensive income, consolidated statement of changes in shareholders' equity and the statement of consolidated cash flows for the year then ended and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is International Financial Reporting Standards as adopted by the European Union.

This report is made solely to the Group's shareholders, in accordance with our engagement letter dated 6 July 2010. Our audit work has been undertaken so that we might state to the Group's Directors those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Group and its Directors as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF THE DIRECTORS AND AUDITOR

As explained more fully in the Statement of Directors' Responsibilities included on page 64, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2010 and of its profit for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following:

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Group's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Ernst & Young LLP
London
20 February 2011

The maintenance and integrity of the Group's website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME For the year ended 31 December 2010

	Notes	2010 \$m	2009 \$m
Gross premiums written	2	689.1	627.8
Outwards reinsurance premiums	2	(39.2)	(50.7)
Net premiums written		649.9	577.1
Change in unearned premiums	2	(33.0)	22.0
Change in unearned premiums on premiums ceded	2	(2.7)	(4.4)
Net premiums earned		614.2	594.7
Net investment income	3	53.4	56.0
Net other investment income	3	0.1	0.3
Net realised gains (losses) and impairments	3	33.2	23.8
Net foreign exchange (losses) gains		(0.1)	3.4
Total net revenue		700.8	678.2
Insurance losses and loss adjustment expenses	2, 12	194.7	104.4
Insurance losses and loss adjustment expenses recoverable	2, 12	(29.0)	(5.7)
Net insurance losses		165.7	98.7
Insurance acquisition expenses	2, 4	109.9	112.6
Insurance acquisition expenses ceded	2, 4	(3.6)	(6.6)
Other operating expenses	5, 6, 22	61.8	60.5
Equity based compensation	6	21.1	16.4
Total expenses		354.9	281.6
Results of operating activities		345.9	396.6
Financing costs	7	6.7	8.1
Profit before tax		339.2	388.5
Tax charge	8	8.4	3.1
Profit for the period attributable to equity shareholders		330.8	385.4
Net change in unrealised gains/losses on investments	3, 10	(2.0)	2.7
Tax (expense) benefit on net change in unrealised gains/losses on investments	10	(0.2)	0.1
Other comprehensive (loss) income	10	(2.2)	2.8
Total comprehensive income attributable to equity shareholders		328.6	388.2
Earnings per share			
Basic	23	\$2.08	\$2.23
Diluted	23	\$1.86	\$2.05

CONSOLIDATED BALANCE SHEET As at 31 December 2010

	Notes	2010 \$m	2009 \$m
Assets			
Cash and cash equivalents	9, 19	512.5	440.0
Accrued interest receivable		13.4	12.0
Investments			
– Fixed income securities, available for sale	10, 19	1,719.1	1,892.5
– Other investments	10	(0.2)	–
Reinsurance assets			
– Unearned premiums on premiums ceded	11	2.9	5.6
– Reinsurance recoveries	12	35.9	35.8
– Other receivables	11	5.6	4.3
Deferred acquisition costs	14	61.2	52.9
Other receivables		45.7	4.3
Inwards premiums receivable from insureds and cedants	13	217.5	178.2
Deferred tax asset	15	6.4	3.3
Property, plant and equipment	16	7.4	8.2
Total assets		2,627.4	2,637.1
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	12	507.5	488.9
– Unearned premiums	17	350.6	317.6
– Other payables	17, 18	20.6	15.8
Amounts payable to reinsurers	11, 18	4.4	4.2
Deferred acquisition costs ceded	14	0.1	2.7
Other payables	18	321.4	291.6
Corporation tax payable		6.3	2.4
Interest rate swap	19	0.8	3.6
Long-term debt	19	128.8	131.4
Total liabilities		1,340.5	1,258.2
Shareholders' equity			
Share capital	20	84.3	91.2
Own shares	20	(106.9)	(76.4)
Share premium		2.4	2.4
Contributed surplus		662.6	757.0
Accumulated other comprehensive income	10	28.2	30.4
Other reserves	21	70.7	65.3
Retained earnings		545.6	509.0
Total shareholders' equity attributable to equity shareholders		1,286.9	1,378.9
Total liabilities and shareholders' equity		2,627.4	2,637.1

The consolidated financial statements were approved by the Board of Directors on 20 February 2011 and signed on its behalf by:

Martin Thomas, Director/Chairman

Neil McConachie, Director/President

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY For the year ended 31 December 2010

	Notes	Share capital \$m	Own shares \$m	Share premium \$m	Contributed surplus \$m	Accumulated other comprehensive income \$m	Other reserves \$m	Retained earnings \$m	Total \$m
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	10	–	–	–	–	2.8	–	385.4	388.2
Shares repurchased and held in treasury	20	–	(16.9)	–	–	–	–	–	(16.9)
Shares repurchased and held in trust	20	–	(8.0)	–	–	–	–	–	(8.0)
Shares distributed by trust	20	–	6.5	–	(6.5)	–	–	–	–
Dividends on common shares	18, 20	–	–	–	–	–	–	(225.0)	(225.0)
Dividends on warrants	18, 20	–	–	–	–	–	–	(48.5)	(48.5)
Equity based compensation – exercises	6, 20, 21	0.1	–	–	5.3	–	(5.4)	–	–
Equity based compensation – expense	6	–	–	–	–	–	16.4	–	16.4
Balance as at 31 December 2009		91.2	(76.4)	2.4	757.0	30.4	65.3	509.0	1,378.9
Total comprehensive income for the year	10	–	–	–	–	(2.2)	–	330.8	328.6
Shares repurchased and held in treasury	20	–	(32.6)	–	–	–	–	–	(32.6)
Shares repurchased and held in trust	20	–	(13.0)	–	–	–	–	–	(13.0)
Shares repurchased and cancelled	20	(6.9)	–	–	(96.7)	–	–	–	(103.6)
Shares distributed by trust	20	–	16.6	–	(16.6)	–	–	–	–
Shares donated to trust	24	–	(1.5)	–	1.5	–	–	–	–
Dividends on common shares	18, 20	–	–	–	–	–	–	(237.2)	(237.2)
Dividends on warrants	18, 20	–	–	–	–	–	–	(57.0)	(57.0)
Equity based compensation – tax	15	–	–	–	–	–	2.0	–	2.0
Equity based compensation – exercises	6, 20, 21	–	–	–	17.7	–	(17.7)	–	–
Equity based compensation – expense	6	–	–	–	(0.3)	–	21.1	–	20.8
Balance as at 31 December 2010		84.3	(106.9)	2.4	662.6	28.2	70.7	545.6	1,286.9

STATEMENT OF CONSOLIDATED CASH FLOWS For the year ended 31 December 2010

	Notes	2010 \$m	2009 \$m
Cash flows from operating activities			
Profit before tax		339.2	388.5
Tax paid		(5.8)	(2.7)
Depreciation	5	2.6	0.8
Interest expense on long-term debt	7	5.4	6.4
Interest income		(68.3)	(64.7)
Net amortisation of fixed income securities		11.0	5.3
Equity based compensation	6	21.1	16.4
Foreign exchange (gains) losses		(2.1)	(2.3)
Net other investment income		(0.1)	(0.3)
Net realised (gains) losses and impairments	3	(33.2)	(23.8)
Net unrealised gain on interest rate swaps		(2.8)	(1.3)
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		9.0	(32.6)
– Other assets and liabilities		(7.2)	(11.3)
Net cash flows from operating activities		268.8	278.4
Cash flows from (used in) investing activities			
Interest received		66.9	62.8
Net purchase of property, plant and equipment		(2.3)	(7.6)
Purchase of fixed income securities		(2,635.5)	(2,711.6)
Proceeds on maturity and disposal of fixed income securities		2,828.5	2,440.8
Proceeds on disposal of equity securities		–	4.8
Proceeds on disposal of other investments		1.6	0.1
Net cash flows from (used in) investing activities		259.2	(210.7)
Cash flows used in financing activities			
Interest paid		(5.4)	(6.4)
Dividends paid	20	(293.2)	(10.5)
Shares repurchased	20	(149.5)	(24.9)
Net cash flows used in financing activities		(448.1)	(41.8)
Net increase in cash and cash equivalents			
Cash and cash equivalents at beginning of period		440.0	413.6
Effect of exchange rate fluctuations on cash and cash equivalents		(7.4)	0.5
Cash and cash equivalents at end of period	9	512.5	440.0

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basis of preparation, consolidation principles and significant accounting policies adopted in the preparation of LHL and the Group's 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 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 U.S. GAAP.

All amounts, excluding share data or where otherwise stated, are in millions of U.S. dollars.

While a number of new or amended IFRS and IFRIC standards have been issued there are no standards that have had a material impact on the Group.

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 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. It would, however, result in a re-classification of fixed income securities from available for sale to estimated fair value through profit or loss and a re-classification of the net change in unrealised gains and losses on investments from accumulated other comprehensive income to income.

IFRS 4, Insurance Contracts, issued in March 2004, specifies the financial reporting for insurance contracts by an insurer. The current standard is Phase I in the IASB's insurance contract project and, as noted above, does not specify the recognition or measurement of insurance contracts. This will be addressed in Phase II of the IASB's project and a standard is scheduled to be released in 2011, with potential implementation in 2013. It will include a number of significant changes regarding the measurement and disclosure of insurance contracts. The Group will continue to monitor the progress of the project in order to assess any potential impacts the new standard will have on its results and the presentation and disclosure thereof.

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 72 and also in the risk disclosures section from page 82. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 72.

Estimates may also be made in determining the estimated fair value of certain financial instruments. These are discussed on page 73 and in note 10. Management judgement is applied in determining impairment charges.

BASIS OF CONSOLIDATION

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.

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 estimated fair value denominated in a foreign currency are translated at the exchange rate at the date the estimated fair value was determined, with resulting exchange differences recorded in accumulated other comprehensive income in shareholders' equity.

INSURANCE CONTRACTS

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.

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 ratably 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 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.

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.

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. 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.

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

Cash and cash equivalents

Cash and cash equivalents are carried in the consolidated balance sheet at amortised cost and include 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 estimated fair value due to its short-term nature and high liquidity.

Investments

The Group's fixed income securities are quoted investments that are classified as available for sale 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 are designated as at estimated 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.

Amortisation and accretion 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 estimated fair value due to its short-term nature and high liquidity.

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 fixed income securities may be subsequently reversed through income.

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 estimated fair value are recorded as derivative financial assets and those with a negative estimated fair value are recorded as derivative financial liabilities.

Derivative financial instruments include exchange-traded future and option contracts, forward foreign currency contracts, interest rate swaps, credit default swaps and interest rate swaptions. 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. Changes in the estimated fair value of instruments that do not qualify for hedge accounting are recognised in current period income. The Group does not hold any derivatives classified as hedging instruments. 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.

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

Equity compensation plans

The Group currently operates an RSS under which nil-cost options have been granted. The Group has also operated a management warrant plan and an LTIP 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 vesting assumptions is made in respect of market vesting conditions.

At each balance sheet date, the Group revises its estimate of the number of RSS nil-cost options, LTIP options and warrants 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 contributed surplus. Where new shares are issued, the proceeds received are credited to share capital and share premium.

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.

Where the current estimated fair value of equity based compensation awards exceeds the estimated fair value at the time of grant, adjusted where applicable for dividends, the related corporation tax and deferred tax charge or credit is recognised directly in other reserves.

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 sources. These include insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk. The primary risk to the group is insurance risk.

The primary objectives of the Group's ERM is to ensure that the amount of capital held is consistent with the risk profile of the Group and therefore that the balance between risk and reward is considered as part of all of key business decisions. The Group has formulated, and keeps under review, a risk appetite which is set by the Board of Directors. The Group's appetite to risk will vary marginally from time to time to reflect the potential risks and rewards that present themselves. However, protecting the Group's capital and providing investors with a superior risk-adjusted return over the long-term are constants. The risk appetite of the Group is central to how the business is run and permeates into the risk appetites that the individual operating entity Boards of Directors have adopted. These risk appetites are expressed through detailed risk tolerances at both a Group and an operating entity level. Risk tolerances are the maximum amount of capital that the Group and its entities are prepared to expose to certain risks.

The Group's Board of Directors is responsible for setting and monitoring Group risk tolerances whereas the Risk Committees of the individual entities are responsible for setting and monitoring entity level risk tolerances. All risk tolerances are subject to at least an annual review and consideration by the respective Boards of Directors or Risk Committees. The Group and individual entity Boards of Directors review actual risk levels versus tolerances, emerging risks and any risk learning events quarterly. In addition, usually on a fortnightly basis, management reviews the output from BLAST in order to assess modeled potential losses against risk tolerances and ensure that risk levels are managed in accordance with them.

The primary role of the CRO is to facilitate the effective operation of ERM throughout the Group at all levels. Responsibility for the management of individual risks has been assigned to, and forms part of the performance objectives of, the risk owners within the business. Each quarter risk owners affirm the status of their risks and the effectiveness of the controls that mitigate them. They also ensure that these risks and controls are consistent with their day to day processes and the entries made in the Group and subsidiary Risk Registers, which are a direct input to BLAST. The CRO provides regular reports to the business outlining the status of the Group's ERM activities and strategy as well as formal reports to the Boards of Directors of the operating entities and the Group in this regard.

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 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 receives a copy of each internal audit report and considers the findings and agreed actions in the context of the risk appetites and tolerances, plus 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 and to assist in portfolio optimisation decisions. Management also 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, combined ratios and risk-adjusted profitability, to determine profitability and risk tolerance headroom by class.

The six primary risk categories listed above are discussed in detail below.

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 manage 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 risk-adjusted profitability, 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 monitored 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 on a treaty or facultative basis.

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 outwards reinsurance.

As at 31 December 2010		\$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	250.7	17.7	352.8	24.9
Japan	Earthquake	130.9	9.2	225.6	15.9
Pan-European	Windstorm	141.1	10.0	214.6	15.2
Pacific North West	Earthquake	56.9	4.0	209.0	14.8
Japan	Typhoon	92.8	6.6	191.5	13.5
California	Earthquake	110.9	7.8	186.3	13.2

(1) Landing hurricane from Florida to Texas.

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
Japan	Earthquake	138.2	9.2	236.1	15.6
Pan-European	Windstorm	163.2	10.8	261.7	17.3
Pacific North West	Earthquake	48.5	3.2	215.6	14.3
Japan	Typhoon	86.3	5.7	170.8	11.3
California	Earthquake	190.1	12.6	292.6	19.4

(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 geographic area of risks insured are provided below:

	2010		2009	
	\$m	%	\$m	%
Worldwide offshore	301.4	43.7	227.3	36.2
U.S. and Canada	135.9	19.7	158.3	25.2
Worldwide, including the U.S. and Canada ⁽¹⁾	112.7	16.4	119.2	19.0
Europe	43.5	6.3	36.2	5.8
Worldwide, excluding the U.S. and Canada ⁽²⁾	40.9	5.9	35.6	5.7
Far East	16.6	2.4	13.2	2.1
Middle East	6.8	1.0	11.9	1.9
Rest of world	31.3	4.6	26.1	4.1
Total	689.1	100.0	627.8	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.

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

	2010		2009	
	\$m	%	\$m	%
Property	323.6	46.9	317.3	50.5
Energy	238.3	34.6	175.5	28.0
Marine	76.4	11.1	73.7	11.7
Aviation	50.8	7.4	61.3	9.8
Total	689.1	100.0	627.8	100.0

Further details of the gross premiums written and the risks associated with each of these four principal lines of business are described on the following pages.

i. Property

Gross premiums written, for the year:

	2010 \$m	2009 \$m
Property catastrophe excess of loss	98.1	76.3
Terrorism	77.8	69.1
Property direct and facultative	64.8	88.6
Property retrocession	52.4	61.2
Property political risk	29.1	15.5
Other property	1.4	6.6
Total	323.6	317.3

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 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 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 which can include flood, windstorm, earthquake, brush fire, tsunami and tornado. Not all risks include both elemental and non-elemental coverage. Coverage usually includes indemnification for both property damage and business interruption.

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

Property 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 the political risk class the Group also offers cover for sovereign and quasi-sovereign obligor 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, primarily from assuming property catastrophe excess of loss and property retrocession portfolio risks but 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 pages 77 and 78.

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.

ii. Energy

Gross premiums written, for the year:

	2010 \$m	2009 \$m
Worldwide offshore energy	123.1	100.5
Gulf of Mexico offshore energy	87.4	53.8
Construction energy	12.2	10.7
Onshore energy	6.9	7.8
Energy excess of loss	5.4	–
Other energy	3.3	2.7
Total	238.3	175.5

Energy risks are written mostly on a direct excess of loss basis and may be ground up or for primary or excess layers. 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 risks. 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. Most policies have sub-limits on coverage for elemental losses. 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 significantly exceeds the expected modeled event loss. The Group's appetite and exposure guidelines to large losses are set out on pages 77 and 78.

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.

Energy excess of loss currently consists of excess of loss and industry loss warranty covers protecting underlying energy reinsurance portfolios.

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.

iii. Marine

Gross premiums written, for the year:

	2010 \$m	2009 \$m
Marine hull and total loss	31.7	25.6
Marine hull war	16.9	20.0
Marine builders risk	14.6	16.7
Marine P&I clubs	11.9	10.0
Other marine	1.3	1.4
Total	76.4	73.7

With the exception of the marine P&I clubs where 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 and covers marine liabilities. 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.

iv. Aviation

Gross premiums written, for the year:

	2010 \$m	2009 \$m
AV52	42.6	52.9
Other aviation	8.2	8.4
Total	50.8	61.3

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 GRSC has defined limits by reinsurer by rating and with 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. The Group can purchase both facultative and treaty reinsurance. 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.

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.

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.

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.

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 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.

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.

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 are 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 are greater uncertainties 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.

As at 31 December 2010 management's estimates for IBNR represented 40.6% of total net loss reserves (2009 – 43.8%). 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. The main risks include:

- i. Insurance risk;
- ii. Investment risk;
- iii. Debt risk; and
- iv. Currency risk.

These risks, and the management thereof, are described below.

i. Insurance risk

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

- The advent or continuation of a soft 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 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.

ii. 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. 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, derivative instruments and cash and cash equivalents and can also be invested in equity securities. 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.

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 2010	\$m	%	\$m	%	\$m	%	\$m	%
Available for sale – external	Core		Core plus		Surplus		Total	
– Short-term investments	10.7	0.6	–	–	1.4	0.1	12.1	0.7
– U.S. treasuries	74.7	4.4	43.2	2.5	182.6	10.6	300.5	17.5
– Other government bonds	14.5	0.8	44.3	2.6	122.6	7.1	181.4	10.5
– U.S. municipal bonds	0.1	–	2.4	0.1	8.4	0.5	10.9	0.6
– U.S. government agency debt	8.6	0.5	10.9	0.6	14.9	0.9	34.4	2.0
– Asset backed securities	4.1	0.2	6.5	0.4	9.1	0.5	19.7	1.1
– U.S. government agency mortgage backed securities	24.0	1.4	149.1	8.7	164.4	9.5	337.5	19.6
– Non-agency mortgage backed securities	2.4	0.1	6.1	0.4	8.0	0.5	16.5	1.0
– Non-agency commercial mortgage backed securities	1.2	0.1	8.6	0.5	16.9	1.0	26.7	1.6
– Corporate bonds	113.3	6.6	293.6	17.0	277.0	16.2	683.9	39.8
– Corporate bonds – FDIC guaranteed	34.8	2.0	48.5	2.9	12.2	0.7	95.5	5.6
Total fixed income securities	288.4	16.7	613.2	35.7	817.5	47.6	1,719.1	100.0

As at 31 December 2009	\$m	%	\$m	%	\$m	%	\$m	%
Available for sale – external	Core		Core plus		Surplus		Total	
– 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	–	–	59.8	3.2	73.8	3.9
– U.S. municipal bonds	–	–	–	–	2.5	0.1	2.5	0.1
– 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	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

The sector allocation of the corporate bonds is as follows:

As at 31 December	2010		2009	
	\$m	%	\$m	%
Financial	368.3	47.3	344.1	51.1
Industrial	300.3	38.5	262.9	39.1
Utility	64.6	8.3	52.7	7.8
Foreign agencies	34.3	4.4	–	–
Other	11.9	1.5	13.5	2.0
Total	779.4	100.0	673.2	100.0

The financial sector allocation includes \$95.5 million (2009 – \$193.4 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, exchange rates and economic environment and outlook.

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 Group's investment portfolio is comprised mainly of fixed income securities. The estimated 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. 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:

As at 31 December	2010		2009	
	\$m	%	\$m	%
Immediate shift in yield (basis points)				
100	(52.5)	(3.1)	(56.7)	(3.0)
75	(39.4)	(2.3)	(42.5)	(2.2)
50	(26.3)	(1.5)	(28.3)	(1.5)
25	(13.1)	(0.8)	(14.2)	(0.7)
(25)	11.9	0.7	10.0	0.5
(50)	23.8	1.4	20.0	1.1
(75)	35.7	2.1	29.9	1.6
(100)	47.6	2.8	39.9	2.1

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 zero 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	2010	2009
Core portfolio	1.7	1.6
Core plus portfolio	2.1	1.9
Surplus portfolio	3.7	3.2
Overall portfolio	2.8	2.6

The overall duration for fixed income and managed cash and cash equivalents is 2.2 years (2009 – 2.3 years).

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

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

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

The Group's VaR calculations are as follows:

As at 31 December	2010		2009	
	\$m	%	\$m	%
95th percentile confidence level	34.4	2.7	40.4	2.9
99th percentile confidence level	48.6	3.8	57.0	4.1

Derivative financial instruments

The Group's investment guidelines permit the investment managers to utilise exchange-traded futures and options contracts, interest rate swaps, credit default swaps, interest rate swaptions and forward foreign currency contracts, the latter being non-exchange traded OTC instruments due to their customised nature. Derivatives may be used for yield enhancement, duration management, interest rate and foreign currency exposure management or to obtain an exposure to a particular financial market. These positions are monitored regularly. The Group principally has exposure to derivatives related to the following types of risks: foreign currency risk, interest rate risk and credit risk.

The Group currently invests in the following derivative financial instruments:

- a. TBAs;
- b. Futures;
- c. Options;
- d. Forward foreign currency contracts;
- e. Swaps; and
- f. Swaptions.

These are discussed in detail below.

The net gains or losses on the Group's derivative financial instruments recognised in the consolidated statement of comprehensive income are as follows:

	\$m	\$m	\$m	\$m
	Net other investment income	Net realised gains (losses)	Net foreign exchange gains (losses)	Financing costs
As at 31 December 2010				
Eurodollar futures	–	0.8	–	–
Treasury futures	–	0.2	–	–
Forward foreign currency contracts	–	–	0.3	–
Interest rate swaps – investments	(0.1)	–	–	–
Interest rate swaps – debt	–	–	–	(0.3)
Credit default swaps	0.2	–	–	–
Total	0.1	1.0	0.3	(0.3)

	\$m	\$m	\$m	\$m
	Net other investment income	Net realised gains (losses)	Net foreign exchange gains (losses)	Financing costs
As at 31 December 2009				
Eurodollar futures	–	1.6	–	–
Treasury futures	–	(1.7)	–	–
Options on treasury futures	–	0.2	–	–
Interest rate swaps – debt	–	–	–	(1.3)
Total	–	0.1	–	(1.3)

Foreign exchange gains and losses on foreign currency denominated derivatives are included in foreign exchange gains and losses in the consolidated statement of comprehensive income.

The estimated fair value of the Group's derivative instruments is as follows:

	2010		2009	
	\$m Other Investments	\$m Interest rate swap	\$m Other Investments	\$m Interest rate swap
As at 31 December				
Forward foreign currency contracts	(0.3)	–	–	–
Interest rate swaps – investment	(0.1)	–	–	–
Interest rate swaps – debt	–	(0.8)	–	(3.6)
Credit default swaps	0.2	–	–	–
Total	(0.2)	(0.8)	–	(3.6)

a. 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 as at 31 December 2010 and 2009 is an asset and corresponding liability of \$nil.

b. 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 investment guidelines restrict the maximum notional futures position as a percentage of the investment portfolio's estimated fair value.

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 was negligible as at 31 December 2010 and 2009. The contracts currently held by the Group will expire throughout 2012.

The sensitivity of the Group's Eurodollar futures position to interest rate movements is detailed below:

As at 31 December	2010 \$m	2009 \$m
Immediate shift in 3 month LIBOR (basis points)		
100	(0.7)	(1.4)
75	(0.6)	(1.1)
50	(0.4)	(0.7)
25	(0.2)	(0.4)
(25)	0.2	0.4
(50)	0.4	0.7
(75)	0.6	1.1
(100)	0.7	1.4

c. Options

The Group's investment guidelines permit the use of exchange-traded options on U.S. treasury futures and Eurodollar futures, which are used to manage exposure to interest rate risk and also to hedge duration. 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 obligation, to either buy or sell an instrument at a specific set price at a future date, which may or may not be pre-determined.

The Group may enter into option contracts that are secured by holdings in the underlying securities or by another means which permits immediate satisfaction of the Group's obligations. The investment guidelines also restrict the maximum notional options exposure as a percentage of the investment portfolio's estimated fair value.

d. Forward foreign currency contracts

A forward foreign currency contract is a commitment to purchase or sell a foreign currency at a future date at a defined rate. The Group may utilise forward foreign currency contracts to manage the impact of fluctuations in foreign currencies on the value of its foreign currency denominated investments, or to gain exposure to a certain currency or market rate.

Forward contracts expose the Group to credit, market and liquidity risks. Credit risk arises from the potential inability of counter-parties to perform under the terms of the contract. The Group is exposed to market risk to the extent that adverse changes occur in the exchange rate of the underlying foreign currency. Liquidity risk represents the possibility that the Group may not be able to rapidly adjust the size of its forward positions at a reasonable price in times of high volatility and financial stress. These risks are mitigated by requiring a minimum counter-party credit quality, restricting the maximum notional exposure as a percentage of the investment portfolio's estimated fair value and restricting exposures to foreign currencies, individually and in aggregate, as a percentage of the investment portfolio's estimated fair value.

As at 31 December 2010, the Group had the following open forward foreign currency contracts:

	\$m Notional receivable	\$m Notional payable
Chinese Renminbi	4.0	1.0
Mexican Peso	2.7	3.2
Euro	–	11.2
Other ⁽¹⁾	16.2	5.7
Total	22.9	21.1

(1) Individual currencies included in "other" have a notional payable or receivable of less than \$2.0 million U.S. dollars or equivalent.

There were no open forward foreign currency contracts as at 31 December 2009.

e. Swaps

The Group's investment guidelines permit the use of interest rate swaps and credit default swaps which are traded OTC. These are subject to credit risk on the counter-party's inability to perform. Swaps are used to manage interest rate exposure, portfolio duration or capitalise on anticipated changes in interest rate volatility without investing directly in the underlying securities. Swaps are recorded at estimated fair values at the end of each period with unrealised gains and losses recorded in the consolidated statement of comprehensive income.

Interest rate swap agreements entail the exchange of commitments to pay or receive interest, such as an exchange of floating rate payments for fixed rate payments, with respect to a notional amount of principal. These agreements involve elements of credit and market risk. Such risks include the possibility that there may not be a liquid market, that the counter-party may default on its obligation to perform or that there may be unfavourable movements in interest rates. These risks are mitigated through defining a minimum counter-party credit quality and a maximum notional exposure to interest rate swaps as a percentage of the investment portfolio's estimated fair value.

The Group uses credit default swaps as a way to add or reduce credit risk to an individual issuer, or a basket of issuers, without investing directly in their securities. The Group may also sell credit default protection. As at 31 December 2010, the maximum amount of loss the Group could incur on its open credit default swaps was the notional value of \$9.8 million (2009 – \$nil).

f. Swaptions

The Group uses swaptions, options on interest rate swaps, to manage interest rate risk exposure and portfolio and yield curve duration. The Group is subject to the credit risk of the counter-party but is only subject to market risk to the extent of the premium paid. As a swaption writer, the Group is not subject to credit risk but is subject to market risk, due to its obligation to make payments under the terms of the contract. These risks are mitigated through maximum allowable notional exposures as a percentage of the investment portfolio's estimated fair value.

iii. Debt risk

The Group has issued long-term debt as described in note 19. The loan notes bear interest at a floating rate that is re-set on a quarterly basis, plus a fixed margin of 3.70%. 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 could have been prepaid from 16 December 2005, with a sliding scale redemption price penalty which reduces to zero by 15 March 2011. Refer to note 19 for further details.

The current Euribor interest rate on 50% of the Euro subordinated loan notes has been set at 1.03% (2009 – 0.71%). The current LIBOR interest rate on 50% of the U.S. dollar subordinated loan notes has been set at 0.30% (2009 – 0.25%). The Group has no interest rate risk on the remaining portion of the notes.

iv. Currency risk

The Group 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 payable and the €24.0 million subordinated loan notes long-term debt liability. The Group also has exposure to foreign currencies through its EMD investment portfolio. These positions may not be hedged depending on the currency outlook.

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

Assets	\$m U.S.\$	\$m Sterling	\$m Euro	\$m Other	\$m Total
Cash and cash equivalents	141.5	269.8	93.2	8.0	512.5
Accrued interest receivable	13.4	–	–	–	13.4
Fixed income securities, available for sale	1,685.6	–	10.7	22.8	1,719.1
Other investments	0.2	–	(0.2)	(0.2)	(0.2)
Reinsurance assets	44.4	–	–	–	44.4
Deferred acquisition costs	50.1	0.8	6.0	4.3	61.2
Other receivables	41.5	4.2	–	–	45.7
Inwards premiums receivable from insureds and cedants	172.8	3.8	29.2	11.7	217.5
Deferred tax asset	–	6.4	–	–	6.4
Property, plant and equipment	5.7	1.7	–	–	7.4
Total assets as at 31 December 2010	2,155.2	286.7	138.9	46.6	2,627.4
Liabilities	\$m U.S.\$	\$m Sterling	\$m Euro	\$m Other	\$m Total
Losses and loss adjustment expenses	395.9	9.9	86.6	15.1	507.5
Unearned premiums	296.4	6.5	27.1	20.6	350.6
Insurance contracts – other payables	17.6	0.2	1.6	1.2	20.6
Amounts payable to reinsurers	4.4	–	–	–	4.4
Deferred acquisition costs ceded	0.1	–	–	–	0.1
Other payables	51.9	275.6	0.2	–	327.7
Interest rate swap	0.7	–	0.1	–	0.8
Long-term debt	97.0	–	31.8	–	128.8
Total liabilities as at 31 December 2010	864.0	292.2	147.4	36.9	1,340.5

Assets	\$m U.S.\$	\$m Sterling	\$m Euro	\$m Other	\$m 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 U.S.\$	\$m Sterling	\$m Euro	\$m Other	\$m 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	19.0	274.6	0.4	–	294.0
Interest rate swap	3.0	–	0.6	–	3.6
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

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 \$0.2 million (2009 – \$0.7 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 2010	\$m	\$m	\$m	\$m
	Core	Core plus	Surplus	Total
Fixed income securities – external				
Less than one year	48.4	80.1	23.3	151.8
Between one and two years	117.4	142.8	52.9	313.1
Between two and three years	49.7	102.4	76.2	228.3
Between three and four years	25.1	63.4	96.1	184.6
Between four and five years	12.8	42.1	120.3	175.2
Over five years	3.3	12.1	250.3	265.7
Asset backed and mortgage backed securities	31.7	170.3	198.4	400.4
Total	288.4	613.2	817.5	1,719.1

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

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

As at 31 December 2010	\$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	507.5	191.5	194.3	66.6	55.1	507.5
Insurance contracts – other payables	20.6	17.6	2.8	0.2	–	20.6
Amounts payable to reinsurers	4.4	4.4	–	–	–	4.4
Other payables	321.4	321.4	–	–	–	321.4
Corporation tax payable	6.3	6.3	–	–	–	6.3
Interest rate swap	0.8	0.8	–	–	–	0.8
Long-term debt	128.8	5.0	10.8	10.8	241.1	267.7
Total	989.8	547.0	207.9	77.6	296.2	1,128.7

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	291.6	291.6	–	–	–	291.6
Corporation tax payable	2.4	2.4	–	–	–	2.4
Interest rate swap	3.6	2.9	0.7	–	–	3.6
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

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

The Group manages its liquidity risks via its investment strategy to hold high quality, highly liquid securities, sufficient to meet its insurance liabilities and other near term liquidity requirements. The creation of the core portfolio with its subset of guidelines ensures funds are readily available to meet potential insurance liabilities in an extreme event plus other near term liquidity requirements. In addition, the 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 an S&P or equivalent rating of 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 exchange-traded 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 OTC derivatives is mitigated by monitoring the credit-worthiness of the counter-parties and by requiring collateral to be posted for positions which are in the money by amounts exceeding predetermined thresholds.

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 the review and approval of reinsurer security by the GRSC as discussed on pages 81 and 82.

The table below presents an analysis of the Group's major exposures to counter-party credit risk, based on their 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 2010	\$m	\$m	\$m	\$m
	Other investments	Cash and fixed income securities	Inwards premiums receivable and other receivables	Reinsurance recoveries
AAA	–	1,186.0	–	–
AA+, AA, AA-	(0.3)	366.2	–	–
A+, A, A-	0.1	451.3	5.6	35.9
BBB+, BBB, BBB-	–	182.9	–	–
Other	–	45.2	263.2	–
Total	(0.2)	2,231.6	268.8	35.9

As at 31 December 2009	\$m	\$m	\$m	\$m
	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

The counter-party to the Group's long-term debt interest rate swap is currently rated AA by S&P.

The following table shows inwards premiums receivable that are past due but not impaired:

	2010 \$m	2009 \$m
Less than 90 days past due	8.1	8.6
Between 91 and 180 days past due	0.6	0.4
Over 180 days past due	0.2	0.3
Total	8.9	9.3

Provisions of \$0.6 million (2009 – \$1.4 million) have been made for impaired or irrecoverable balances and \$0.6 million (2009 – \$0.2 million charge) was released 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. The Group and its subsidiaries have identified and evaluated their key operational risks and these are incorporated in the risk registers and in BLAST. The Group has also established, and monitors compliance with, internal operational risk tolerances.

In order to manage operational risks, the Group has implemented a robust governance framework. Policies and procedures are documented and identify the key risks and controls within processes. The existence and operation of key risks and controls and the adequacy of documented policies and procedures is affirmed by management on a quarterly basis. The Group's internal audit function provides independent feedback with regard to 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.

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 of the failure to maintain adequate capital, accessing capital at an inflated cost or the inability to access capital. This includes unanticipated changes in vendor, 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 risks as strategic risks.

i. Business plan risks

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

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

ii. Capital management risk

The total capital of the Group as at 31 December 2010 is determined as \$1,415.7 million (2009 – \$1,510.3 million) comprising \$1,286.9 million of shareholders' equity (2009 – \$1,378.9 million) and \$128.8 million of long-term debt (2009 – \$131.4 million). The Group's capital requirements vary with the insurance cycle.

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 vendors, regulators and rating agencies in order to stay abreast of upcoming developments.

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 plus 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.

The Group's aim is to provide its shareholders with a RoE 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 IRR of the increase in FCBVS in the period adjusted for dividends accrued. This aim is a long-term goal, acknowledging that management expect both higher and lower results in the shorter term. The cyclical 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%
31 December 2010	23.3%	20.3%	152.4%

(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%
31 December 2010	23.2%	18.2%	141.1%

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

iii. Retention risks

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.

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 LSE; previously LHL was listed on AIM, a subsidiary market of the LSE. A secondary listing on the BSX was approved on 21 May 2007. The registered office is Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda.

LHL has five subsidiaries, all wholly owned: LICL, LIHL, LIMSL, LISL and LMEL. LIHL is a holding company for a wholly owned operating subsidiary, LUK.

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

	Date of incorporation	Licensing body	Nature of business
LICL	28 October 2005	BMA	General insurance business
LIHL	11 April 2006	None	Holding company
LUK	17 March 2006	FSA	General insurance business
LIMSL	7 October 2005	FSA	Insurance mediation activities
LISL	17 March 2006	None	Support services
LMEL	11 March 2007	DFSA	Insurance mediation activities

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 79 to 81. 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 significant insurance or reinsurance contracts that insure or reinsure risks in Bermuda, the Group's country of domicile.

2. SEGMENTAL REPORTING continued

Revenue and expense by operating segment – for the year ended 31 December 2010

Gross premiums written	\$m	\$m	\$m	\$m	\$m
	Property	Energy	Marine	Aviation	Total
(Analysed by geographical region)					
Worldwide offshore	1.2	225.0	75.2	–	301.4
U.S. and Canada	133.3	2.6	–	–	135.9
Worldwide, including the U.S. and Canada ⁽¹⁾	53.9	7.6	0.5	50.7	112.7
Europe	42.9	0.3	0.2	0.1	43.5
Worldwide, excluding the U.S. and Canada ⁽²⁾	40.6	0.2	0.1	–	40.9
Far East	15.9	0.3	0.4	–	16.6
Middle East	6.1	0.7	–	–	6.8
Rest of world	29.7	1.6	–	–	31.3
Total	323.6	238.3	76.4	50.8	689.1
Outwards reinsurance premiums	(18.9)	(13.9)	(0.9)	(5.5)	(39.2)
Change in unearned premiums	5.3	(38.8)	(6.9)	7.4	(33.0)
Change in unearned premiums ceded	1.7	(2.3)	(1.8)	(0.3)	(2.7)
Net premiums earned	311.7	183.3	66.8	52.4	614.2
Insurance losses and loss adjustment expenses	(108.7)	(66.0)	(25.8)	5.8	(194.7)
Insurance losses recoverable	–	29.0	–	–	29.0
Insurance acquisition expenses	(38.8)	(39.7)	(19.3)	(12.1)	(109.9)
Insurance acquisition expenses ceded	0.5	2.8	0.1	0.2	3.6
Net underwriting profit	164.7	109.4	21.8	46.3	342.2
Net unallocated income and expenses					(3.0)
Profit before tax					339.2
Loss ratio	34.9%	20.2%	38.6%	(11.1%)	27.0%
Acquisition cost ratio	12.3%	20.1%	28.7%	22.7%	17.3%
Expense ratio	–	–	–	–	10.1%
Combined ratio	47.2%	40.3%	67.3%	11.6%	54.4%

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

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

2. SEGMENTAL REPORTING continued

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

Gross premiums written	\$m	\$m	\$m	\$m	\$m
	Property	Energy	Marine	Aviation	Total
(Analysed by geographical region)					
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.

3. INVESTMENT RETURN

The total investment return for the Group is as follows:

For the year ended 31 December 2010	\$m	\$m	\$m	\$m
	Investment income and other investment income	Net realised gains (losses) and impairments	Net change in unrealised gains/losses	Total investment return
Fixed income securities	52.5	32.2	(2.0)	82.7
Other investments	0.1	1.0	–	1.1
Cash and cash equivalents	0.9	–	–	0.9
Total investment return	53.5	33.2	(2.0)	84.7

For the year ended 31 December 2009	\$m	\$m	\$m	\$m
	Investment income and other investment income	Net realised gains (losses) and impairments	Net change in unrealised gains/losses	Total investment return
Fixed income securities	53.9	24.7	2.7	81.3
Equity securities	–	(1.0)	–	(1.0)
Other investments	0.3	0.1	–	0.4
Cash and cash equivalents	2.1	–	–	2.1
Total investment return	56.3	23.8	2.7	82.8

Net realised gains (losses) and impairments includes an impairment loss of \$nil (2009 – \$0.4 million) recognised on fixed income securities held by the Group.

Refer to page 88 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.

Included in investment income is \$4.0 million (2009 – \$3.5 million) of investment management and custodian fees.

4. NET INSURANCE ACQUISITION EXPENSES

	2010 \$m	2009 \$m
Insurance acquisition expenses	118.2	104.6
Changes in deferred insurance acquisition expenses	(8.3)	8.0
Insurance acquisition expenses ceded	(3.2)	(5.2)
Changes in deferred insurance acquisition expenses ceded	(0.4)	(1.4)
Total net insurance acquisition expenses	106.3	106.0

5. RESULTS OF OPERATING ACTIVITIES

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

	2010 \$m	2009 \$m
Depreciation on owned assets	2.6	0.8
Operating lease charges	3.2	1.6
Auditors' remuneration		
– Group audit fees	1.3	1.2
– Tax advice	–	0.1
– Other services	0.3	0.5
Total	7.4	4.2

Fees paid to the Group's auditors for tax advice and other services are approved by the Group's Audit Committee.

6. EMPLOYEE BENEFITS

	2010 \$m	2009 \$m
Wages and salaries	19.0	15.7
Pension costs	1.5	1.5
Bonus and other benefits	12.7	18.4
Total cash compensation	33.2	35.6
RSS – ordinary	14.3	6.8
RSS – bonus deferral	1.0	–
RSS – exceptional	0.1	0.5
LTIP	5.3	5.7
Warrants – performance	0.4	3.4
Total equity based compensation	21.1	16.4
Total employee benefits	54.3	52.0

Equity based compensation

The Group's primary equity based compensation scheme is its RSS. Previously the Group also administered an LTIP and a warrant plan.

RSS

On 22 December 2010 LHL's shareholders, in a Special General Meeting, voted in favour of the LHL Board's proposal to modify the existing awards program to a nil-cost options program. This extends the exercise period to ten years from the grant date for all outstanding and future RSS grants. Previously, all awards were issued upon the vesting date. As the options are nil-cost, the estimated fair value under the Black-Scholes model of each RSS option granted pursuant to the plan is equal to the estimated fair value used prior to the modification of the plan, the share price of LHL on the date of grant.

RSS – ordinary

The ordinary RSS options vest after a three year period and are dependent on certain performance criteria. A maximum of 50% of the ordinary RSS options will vest only on the achievement of a TSR in excess of the 75th percentile of the TSR of a pre-defined comparator group. A maximum of 50% of the ordinary RSS options will vest only on the achievement of an RoE by LHL in excess of a required amount.

6. EMPLOYEE BENEFITS continued

	Number	Weighted average fair value
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
Granted during the year	2,145,681	\$7.24
Forfeited during the year	(533,119)	\$7.16
Outstanding as at 31 December 2010	5,905,445	\$7.02
Exercisable as at 31 December 2010	–	–

	2010	2009
Weighted average remaining contractual life	8.3	8.8

The estimated fair value of ordinary restricted share options granted ranges between \$5.73 and \$8.58. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

RSS – bonus deferral

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

	Number	Weighted average fair value
Outstanding as at 31 December 2008 and 2009	–	–
Granted during the year	390,024	\$7.06
Forfeited during the year	(18,190)	\$7.05
Outstanding as at 31 December 2010	371,834	\$7.06
Exercisable as at 31 December 2010	–	–

	2010	2009
Weighted average remaining contractual life	9.2	–

The estimated fair value of bonus deferral restricted share options granted ranges between \$7.05 and \$7.13. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

6. EMPLOYEE BENEFITS continued

RSS – exceptional

The exceptional restricted shares vested on 28 March 2010 after a two year period and did not have associated performance criteria for vesting.

	Number	Weighted average fair value
Outstanding as at 31 December 2008 and 2009	166,904	\$5.73
Issued during the year	(166,904)	\$5.73
Outstanding as at 31 December 2010	–	–

An amount of \$0.3 million (2009 – \$nil) of dividend equity payments was paid at the time of vesting.

LTIP

The LTIP plan was closed on 4 January 2008. All LTIP options will expire ten years from the date of grant. 25% of LTIP options vested on each of the first, second, third and fourth anniversary of the grant date. There were no associated performance criteria. Settlement is at the discretion of the Group and may be in cash or shares.

	Number	Weighted average exercise price ⁽¹⁾
Outstanding as at 31 December 2008	6,893,300	\$5.34
Exercised during the year	(2,220,059)	\$4.28
Forfeited during the year	(56,489)	\$5.57
Outstanding as at 31 December 2009	4,616,752	\$4.32
Exercised during the year	(2,547,678)	\$3.76
Forfeited during the year	(285,911)	\$4.38
Outstanding as at 31 December 2010	1,783,163	\$2.88
Exercisable as at 31 December 2010	987,474	\$2.71

(1) Amounts for prior years have been revalued at the exchange rate as at 31 December 2010.

	2010	2009
Weighted average remaining contractual life	6.3	7.3

As approved by the Remuneration Committee on 18 November 2009, all option exercise prices are automatically adjusted on the dividend Record Date to neutralise the devaluing impact of dividend payments. Prior to this date the Remuneration Committee met and approved each individual exercise price adjustment. The resulting charge to equity based compensation in the consolidated statement of comprehensive income is shown below. In all cases there is a net \$nil impact to shareholders' equity.

6. EMPLOYEE BENEFITS continued

Date	Adjustment to exercise price		2010 \$m	2009 \$m
	\$	£		
14 February 2008	1.10	0.56	0.3	0.7
4 November 2009	1.30	0.79	2.9	2.0
19 March 2010	0.10	0.07	0.5	–
3 September 2010	0.05	0.03	0.1	–
10 December 2010	1.40	0.89	0.8	–
Total			4.6	2.7

Management team ordinary warrants

Ordinary warrants were all fully vested by 31 December 2008. All ordinary warrants will expire ten years from the date of issue. The fair value of all ordinary warrants granted was \$2.62 per share. Ordinary warrants granted and outstanding are:

	Number	Weighted average exercise price
Outstanding as at 31 December 2008 and 2009	11,433,465	\$4.71
Exercised during the year	(1,398,670)	\$4.62
Outstanding as at 31 December 2010	10,034,795	\$4.72
Exercisable as at 31 December 2010	10,034,795	\$4.72
	2010	2009
Weighted average remaining contractual life	5.0	6.0

Management team performance warrants

Performance warrants were all fully vested by 31 December 2009. All performance warrants will expire ten years from the date of issue. Vesting was dependent on achieving certain performance criteria. The fair value of all warrants granted was \$2.62 per share. Performance warrants granted and outstanding are:

	Number	Weighted average exercise price
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
Exercised during the year	(415,500)	\$3.62
Outstanding as at 31 December 2010	1,344,810	\$3.62
Exercisable as at 31 December 2010	1,344,810	\$3.62

6. EMPLOYEE BENEFITS continued

	2010	2009
Weighted average remaining contractual life	5.0	6.0

The exercise price of warrants was automatically adjusted for dividends declared prior to their vesting dates, as follows:

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

Refer to note 21 for further disclosure on non-management warrants outstanding.

7. FINANCING COSTS

	2010 \$m	2009 \$m
Interest expense on long-term debt	5.4	6.4
Net change in unrealised gains/losses on interest rate swap	0.3	1.3
Other financing costs	1.0	0.4
Total	6.7	8.1

Refer to note 19 for details of long-term debt and financing arrangements.

8. TAX CHARGE

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 taxable profits.

8. TAX CHARGE continued

Dubai

There are currently no local Dubai or Federal (UAE) taxes payable on the profits or revenue of businesses operating in the UAE. Current law states that DIFC establishments shall be subject to a zero tax rate on income until the year 2054.

	2010 \$m	2009 \$m
Tax charge		
Corporation tax charge for the period	8.9	4.8
Adjustments in respect of prior period corporation tax	1.0	0.4
Deferred tax credit for the period	(1.5)	(1.5)
Adjustments in respect of prior period deferred tax	–	(0.6)
Total tax charge	8.4	3.1

	2010 \$m	2009 \$m
Tax reconciliation		
Profit before tax	339.2	388.5
Less profit not subject to tax	(308.8)	(372.9)
Profits subject to tax	30.4	15.6
UK corporation tax at 28%	8.5	4.4
Adjustments in respect of prior period	1.0	(0.2)
Differences related to equity based compensation	(2.5)	(1.0)
Other expense permanent differences	(0.6)	(0.1)
Tax recognised directly in other reserves	2.0	–
Total tax charge	8.4	3.1

Due to the different taxpaying jurisdictions throughout the Group the current tax charge as a percentage of the Group's profit before tax is 2.5% (2009 – 0.8%).

As at 31 December 2010, a corporation tax credit of \$0.4 million (2009 – \$nil) is included in other reserves which relates to tax deductions for equity based compensation award exercises in excess of the cumulative expense at the reporting date. Refer to note 15 for further details of tax credits included in other reserves.

Refer to note 10 for details of the tax expense related to the net change in unrealised gains and losses on investments that is included in accumulated other comprehensive income within shareholders' equity.

9. CASH AND CASH EQUIVALENTS

	2010 \$m	2009 \$m
Cash at bank and in hand	34.5	288.9
Cash equivalents	478.0	151.1
Total cash and cash equivalents	512.5	440.0

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 at 31 December 2009 is \$232.5 million of cash held on deposit by LHL's share registrar to fund the special dividend payment disclosed in note 20.

Refer to note 19 for the cash and cash equivalent balances on deposit as collateral.

10. INVESTMENTS

As at 31 December 2010	\$m	\$m	\$m	\$m
	Cost or amortised cost	Gross unrealised gain	Gross unrealised loss	Estimated fair value
Fixed income securities				
– Short-term investments	12.1	–	–	12.1
– U.S. treasuries	295.8	5.5	(0.8)	300.5
– Other government bonds	179.0	3.9	(1.5)	181.4
– U.S. municipal bonds	10.9	0.1	(0.1)	10.9
– U.S. government agency debt	34.2	0.6	(0.4)	34.4
– Asset backed securities	19.4	0.3	–	19.7
– U.S. government agency mortgage backed securities	331.2	8.4	(2.1)	337.5
– Non-agency mortgage backed securities	16.4	0.1	–	16.5
– Non-agency commercial mortgage backed securities	26.3	0.6	(0.2)	26.7
– Corporate bonds	670.2	16.8	(3.1)	683.9
– Corporate bonds – FDIC guaranteed	93.7	1.8	–	95.5
Total fixed income securities – available for sale	1,689.2	38.1	(8.2)	1,719.1
Other investments	–	0.6	(0.8)	(0.2)
Total investments	1,689.2	38.7	(9.0)	1,718.9

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	72.5	1.5	(0.2)	73.8
– U.S. municipal bonds	2.5	–	–	2.5
– 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	191.0	2.6	(0.2)	193.4
Total investments – available for sale	1,861.6	34.1	(3.2)	1,892.5

Accumulated other comprehensive income is in relation to the Group's fixed income investment securities classified as available for sale and is as follows:

	2010 \$m	2009 \$m
Gross unrealised gain	38.1	34.1
Gross unrealised loss	(8.2)	(3.2)
Net foreign exchange gains	(1.0)	–
Tax provision	(0.7)	(0.5)
Accumulated other comprehensive income	28.2	30.4

Fixed income maturities are presented in the risk disclosures section on page 94. Refer to note 19 for the investment balances in trusts in favour of ceding companies and on deposit as collateral.

10. INVESTMENTS continued

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

Category (i)

Category (i) includes securities with quoted prices in active markets. A financial instrument is regarded as quoted in an active market 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 arm's length basis. The Group determines securities classified as category (i) to include highly liquid U.S. treasuries and certain highly liquid short-term investments.

Category (ii)

Category (ii) investments include securities with quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data. 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 include:

- Broker-dealer quotes;
- Pricing models or matrix pricing;
- Present values;
- Future cash flows;
- Yield curves;
- Interest rates;
- Prepayment speeds; and
- Default rates.

Other similar quoted instruments or market transactions may be used.

The Group determines securities classified as category (ii) to include short-term and fixed maturity investments such as:

- Non-U.S. government bonds;
- U.S. municipal bonds;
- U.S. government agency debt;
- Asset-backed securities;
- US government agency mortgage backed securities;
- Non-agency mortgage backed securities;
- Corporate bonds; and
- OTC derivatives, including futures, options, forward foreign exchange contracts, interest rate swaps, credit default swaps and swaptions.

Category (iii)

Category (iii) includes securities for which valuation techniques are not based on observable market data. During the years ended 31 December 2010 and 2009, the Group did not hold any category (iii) investments.

The Group determines the estimated fair value of each individual security utilising the highest level inputs available. 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.

The Group has not made any adjustments to any pricing provided by independent pricing services or its third party investment managers for either year ending 31 December.

10. INVESTMENTS continued

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

As at 31 December 2010	\$m	\$m	\$m
	(i)	(ii)	Total
Fixed income securities			
– Short-term investments	11.1	1.0	12.1
– U.S. treasuries	300.5	–	300.5
– Other government bonds	–	181.4	181.4
– U.S. municipal bonds	–	10.9	10.9
– U.S. government agency debt	–	34.4	34.4
– Asset backed securities	–	19.7	19.7
– U.S. government agency mortgage backed securities	–	337.5	337.5
– Non-agency mortgage backed securities	–	16.5	16.5
– Non-agency commercial mortgage backed securities	–	26.7	26.7
– Corporate bonds	–	683.9	683.9
– Corporate bonds – FDIC guaranteed	–	95.5	95.5
Total fixed income securities – available for sale	311.6	1,407.5	1,719.1
Other investments	–	(0.2)	(0.2)
Total investments	311.6	1,407.3	1,718.9
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	–	73.8	73.8
– U.S. municipal bonds	–	2.5	2.5
– 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	–	193.4	193.4
Total fixed income securities – available for sale	429.9	1,462.6	1,892.5

There have been no transfers between categories (i) and (ii) or movements within category (iii), therefore no reconciliations have been presented.

11. REINSURANCE ASSETS AND LIABILITIES

	\$m	\$m	\$m	\$m
	Unearned premiums ceded	Amounts payable to reinsurers	Other receivables	Total
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
Net deferral for:				
Prior years	(5.6)	–	–	(5.6)
Current year	2.9	–	–	2.9
Other	–	(0.2)	1.3	1.1
As at 31 December 2010	2.9	(4.4)	5.6	4.1

12. 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 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
Net incurred losses for:			
Prior years	(104.9)	4.8	(100.1)
Current year	299.6	(33.8)	265.8
Exchange adjustments	(1.8)	–	(1.8)
Incurred losses and loss adjustment expenses	192.9	(29.0)	163.9
Net paid losses for:			
Prior years	123.0	(11.8)	111.2
Current year	51.3	(17.1)	34.2
Paid losses and loss adjustment expenses	174.3	(28.9)	145.4
As at 31 December 2010	507.5	(35.9)	471.6

12. LOSSES AND LOSS ADJUSTMENT EXPENSES continued

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from page 82. 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 \$101.5 million (2009 – \$97.8 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:

As at 31 December	2010		2009	
	\$m	%	\$m	%
Outstanding losses	251.8	49.6	258.6	52.9
ACR	61.1	12.0	22.9	4.7
IBNR	194.6	38.4	207.4	42.4
Total	507.5	100.0	488.9	100.0

The Group’s reserve for unpaid losses and loss adjustment expenses as at 31 December 2010 and 2009 had 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.

12. LOSSES AND LOSS ADJUSTMENT EXPENSES continued

Accident year	2006 \$m	2007 \$m	2008 \$m	2009 \$m	2010 \$m	Total \$m
Gross losses						
Estimate of ultimate liability ⁽¹⁾						
At end of accident year	39.1	154.8	444.6	163.3	297.4	
One year later	34.7	131.2	417.4	107.8		
Two years later	32.0	103.5	377.5			
Three years later	27.6	94.8				
Four years later	27.2					
Current estimate of cumulative liability	27.2	94.8	377.5	107.8	297.4	904.7
Payments made	(21.0)	(65.6)	(233.4)	(25.9)	(51.3)	(397.2)
Total gross liability	6.2	29.2	144.1	81.9	246.1	507.5

Accident year	2006 \$m	2007 \$m	2008 \$m	2009 \$m	2010 \$m	Total \$m
Reinsurance						
Estimate of ultimate recovery ⁽¹⁾						
At end of accident year	–	3.6	40.7	1.6	33.8	
One year later	–	6.2	47.1	1.3		
Two years later	–	4.0	43.1			
Three years later	–	3.5				
Four years later	–					
Current estimate of cumulative recovery	–	3.5	43.1	1.3	33.8	81.7
Payments received	–	(3.0)	(25.7)	–	(17.1)	(45.8)
Total gross recovery	–	0.5	17.4	1.3	16.7	35.9

Accident year	2006 \$m	2007 \$m	2008 \$m	2009 \$m	2010 \$m	Total \$m
Net losses						
Estimate of ultimate liability ⁽¹⁾						
At end of accident year	39.1	151.2	403.9	161.7	263.6	
One year later	34.7	125.0	370.3	106.5		
Two years later	32.0	99.5	334.4			
Three years later	27.6	91.3				
Four years later	27.2					
Current estimate of cumulative liability	27.2	91.3	334.4	106.5	263.6	823.0
Payments made	(21.0)	(62.6)	(207.7)	(25.9)	(34.2)	(351.4)
Total net liability	6.2	28.7	126.7	80.6	229.4	471.6

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2010.

12. LOSSES AND LOSS ADJUSTMENT EXPENSES continued

The inherent uncertainty in reserving gives rise to favourable or adverse development on the established reserves. The total favourable development on net losses and loss adjustment expenses, excluding the impact of foreign exchange revaluations, was as follows:

	2010 \$m	2009 \$m
2006 accident year	0.3	4.4
2007 accident year	8.3	25.2
2008 accident year	36.0	33.9
2009 accident year	55.5	–
Total favourable development	100.1	63.5

During 2010 the Group was impacted by significant losses in relation to the Chilean earthquake and subsequent aftershocks as follows:

	\$m
Insurance losses and loss adjustment expenses	96.8
Reinstatement premium	(12.1)
Net ultimate loss as at 31 December 2010	84.7

The Group has exposure to risks in Chile in the following classes: property retrocession, property direct and facultative, property catastrophe excess of loss and marine. Loss information after a severe earthquake can take longer to obtain than for other events, particularly in the property retrocession portfolio which accounts for the majority of the Group's exposure. As additional information emerges the actual ultimate net loss from the earthquake could be materially different from this estimate. The 90th percentile of the loss distribution for this estimate is \$100.9 million with the 95th percentile being \$106.4 million.

During 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
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
Change in insurance losses and loss adjustment expenses	1.6
Change in insurance losses and loss adjustment expenses recoverable	1.4
Change in reinstatement premium	(2.0)
Change in other deductions	(0.5)
Net ultimate financial impact as at 31 December 2010	167.1

12. LOSSES AND LOSS ADJUSTMENT EXPENSES continued

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 current best estimate of the ultimate liability for Hurricane Ike is \$179.7 million. The 90th percentile of the loss distribution for this estimate is \$194.0 million with the 95th percentile being \$198.8 million.

13. INSURANCE, REINSURANCE AND OTHER RECEIVABLES

All receivables are considered current other than \$30.7 million (2009 – \$21.1 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 AND DEFERRED ACQUISITION COSTS CEDED

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

	Incurred \$m	Ceded \$m	Net \$m
As at 31 December 2008	60.9	(1.9)	59.0
Net deferral during the year	104.6	(7.4)	97.2
Income (expense) for the year	(112.6)	6.6	(106.0)
As at 31 December 2009	52.9	(2.7)	50.2
Net deferral during the year	118.2	(1.0)	117.2
Income (expense) for the year	(109.9)	3.6	(106.3)
As at 31 December 2010	61.2	(0.1)	61.1

15. DEFERRED TAX ASSET

	2010 \$m	2009 \$m
Deferred tax assets (related to equity based compensation)	7.8	3.9
Deferred tax liabilities (related to claims equalisation reserves)	(1.4)	(0.6)
Net deferred tax asset	6.4	3.3

During 2010, the UK government enacted a change in the corporation tax rate from 28.0% to 27.0% that will become effective from 1 April 2011. A deferred tax expense of \$0.1 million was recognised during the period with respect to this change. Deferred tax on temporary differences that are expected to unwind in 2011 have a tax rate of 27.3% applied to them and a rate of 27.0% is applied to those that are expected to unwind in subsequent years.

As at 31 December 2010, a deferred tax credit of \$1.6 million (2009 – \$nil) was recognised in other reserves which relates to deferred tax credits for unexercised equity based compensation awards where the estimated market value is in excess of the cumulative expense at the reporting date.

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 2011, thus the entire deferred tax asset is recognised. All deferred tax assets and liabilities are classified as non-current.

16. PROPERTY, PLANT AND EQUIPMENT

	2010 \$m	2009 \$m
Cost	11.9	10.2
Accumulated depreciation	(4.5)	(2.0)
Net book value	7.4	8.2

17. INSURANCE LIABILITIES

	\$m Unearned premiums	\$m Other payables	\$m Total
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
Net deferral for:			
Prior years	(259.1)	–	(259.1)
Current year	292.1	–	292.1
Other	–	4.8	4.8
As at 31 December 2010	350.6	20.6	371.2

18. INSURANCE, REINSURANCE AND OTHER PAYABLES

	2010 \$m	2009 \$m
Dividends payable	258.4	263.0
Other payables	62.7	28.4
Accrued interest payable	0.3	0.2
Total other payables	321.4	291.6
Insurance contracts – other payables	20.6	15.8
Amounts payable to reinsurers	4.4	4.2
Total payables	346.4	311.6

Further information on dividends declared is shown in note 20. Other payables include unsettled investment trades, unsettled share repurchases, accrued interest 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.

19. LONG-TERM DEBT AND FINANCING ARRANGEMENTS

Long-term debt

On 15 December 2005 the Group issued, via a trust company, \$97.0 million and €24.0 million in aggregate principal amount of subordinated loan notes at an issue price of \$1,000 and €1,000 of their principal amounts respectively. The carrying values are shown below:

As at 31 December	2010 \$m	2009 \$m
Long-term debt \$97.0 million	97.0	97.0
Long-term debt €24.0 million	31.8	34.4
Carrying value	128.8	131.4

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. 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 91.

The fair value of the long-term debt is estimated as \$118.7 million (2009 – \$121.4 million). The fair value is estimated by reference to similar financial instruments quoted in active markets.

The interest accrued on the long-term debt was \$0.3 million (2009 – \$0.2 million) at the balance sheet date and is included in other payables.

Refer to note 7 for details of the interest expense for the year included in financing costs.

Interest rate swaps

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. Refer to the risk disclosures section from page 91 for further details. The Group has the right to net settle these instruments. The final cash settlement on these instruments is \$0.8 million (2009 – \$0.8 million) and is due on 15 March 2011 when these instruments expire. The counter-party requires collateralisation of positions in excess of \$2.0 million.

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

Refer to note 7 for the net impact from cash settlement and changes in estimated fair value 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 LOCs 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. There was no outstanding debt under this facility at any reporting date.

19. LONG-TERM DEBT AND FINANCING ARRANGEMENTS continued

On 23 April 2010, LHL and LICL entered into a bi-lateral collateralised two year credit facility in the amount of \$200.0 million with Lloyds TSB Bank PLC.

The facilities are available for the issue of LOCs to ceding companies. The facilities are also available for LICL to issue LOCs to LUK to collateralise certain insurance balances.

The total of LOC facilities available to LHL and LICL is \$400.0 million.

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

- (i) an S&P or equivalent financial strength rating of at least B++; and
- (ii) a maximum debt to capital ratio of 30%, where the current long-term debt issuance is excluded from this calculation.

As at all reporting dates the Group was in compliance with all covenants under these facilities.

The following LOCs have been issued:

	2010 \$m	2009 \$m
Issued to affiliates	–	–
Issued to third parties	18.9	25.7

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.

As at and for the years ended 31 December 2010 and 2009 the Group was in compliance with all covenants under its trust facilities.

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

As at 31 December	2010		2009	
	\$m	\$m	\$m	\$m
	Cash and cash equivalents	Fixed income securities	Cash and cash equivalents	Fixed income securities
In various trust accounts for policyholders	7.7	223.8	14.1	100.9
In favour of letters of credit	12.3	22.8	1.9	37.0
In favour of interest rate swap	–	–	2.8	–
In favour of derivative contracts	0.5	0.1	0.6	–
Total	20.5	246.7	19.4	137.9

20. SHARE CAPITAL

Allocated, called up and fully paid	Number	\$m
As at 31 December 2008	182,283,095	91.1
Shares issued due to warrant exercise	219,968	0.1
As at 31 December 2009	182,503,063	91.2
Shares repurchased and cancelled	(13,900,636)	(6.9)
As at 31 December 2010	168,602,427	84.3

	Number held in treasury	\$m	Number held in trust	\$m	Total number of own shares	\$m
Own shares						
As at 31 December 2008	9,433,168	58.0	–	–	9,433,168	58.0
Shares repurchased	2,406,674	16.9	1,078,403	8.0	3,485,077	24.9
Shares distributed	–	–	(885,575)	(6.5)	(885,575)	(6.5)
As at 31 December 2009	11,839,842	74.9	192,828	1.5	12,032,670	76.4
Shares repurchased and held	4,608,603	32.6	1,819,926	13.0	6,428,529	45.6
Shares distributed	–	–	(2,276,729)	(16.6)	(2,276,729)	(16.6)
Shares donated to trust	(1,000,000)	(7.3)	1,000,000	8.8	–	1.5
As at 31 December 2010	15,448,445	100.2	736,025	6.7	16,184,470	106.9

The number of common shares in issue with voting rights (allocated share capital less shares held in treasury) as at 31 December 2010 was 153,153,982 (31 December 2009 – 170,663,221).

Share repurchases

At the AGM held on 4 May 2010 the Group's shareholders approved a renewal of the Repurchase Program authorising the repurchase of a maximum of 18,250,306 shares, 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 was passed.

The Group continues to repurchase its own shares by way of on and off market purchases utilising the current Repurchase Program, which had 7,841,826 shares remaining to be purchased at 31 December 2010 (approximately \$67.1 million at the 31 December 2010 share price).

Previously share repurchase authorisations were approved for a dollar value. As at 31 December 2009 \$175.1 million of approved repurchase remained in place under the authorisations that were current at that date.

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

	Number of shares cancelled	Number of shares transferred to treasury shares	Weighted average share price	\$m
As at 31 December 2008	13,640,916	9,433,168	£3.38	158.2
Repurchases	–	2,406,674	£4.28	16.9
As at 31 December 2009	13,640,916	11,839,842	£3.46	175.1
Repurchases	13,900,636	4,608,603	£4.89	136.4
Stamp duty refund	–	–	–	(0.2)
Shares donated to trust	–	(1,000,000)	£4.84	(7.3)
As at 31 December 2010	27,541,552	15,448,445	£4.05	304.0

At the balance sheet date \$nil (2009 – \$0.1 million) remained to be settled.

20. SHARE CAPITAL continued

In 2010 the trustees of the EBT acquired 1,819,926 (2009 – 1,078,403) shares in accordance with the terms of the trust and distributed 2,276,729 (2009 – 885,575). 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:

Dividends	Record date	Payment date	\$m
Interim dividend of \$0.05 (£0.03082)	28 August 2009	7 October 2009	10.5
Special dividend of \$1.25 (£0.75625)	20 November 2009	6 January 2010	263.0
Final dividend of \$0.10 (£0.06658)	19 March 2010	14 April 2010	20.8
Interim dividend of \$0.05 (£0.03237)	3 September 2010	13 October 2010	9.4
Special dividend of \$1.40 (£0.88563)	10 December 2010	19 January 2011	264.0

21. OTHER RESERVES

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

Warrants	Number		Number
	Founders' warrants	Foundation warrants	Management performance warrants unallocated
As at 31 December 2008	25,303,917	648,143	198,395
Cancelled	–	–	(198,395)
Exercised	(833,200)	–	–
As at 31 December 2009 and 2010	24,470,717	648,143	–
Exercisable as at 31 December 2010	24,470,717	648,143	–
Weighted average exercise price as at 31 December 2010	\$5.00	\$4.73	–
		2010	2009
Weighted average remaining contractual life		5.0	6.0

The exercise price of the Lancashire Foundation warrants was automatically adjusted for dividends declared prior to the vesting date. Refer to note 6 for further details. This did not apply to the Founders' warrants as they were fully vested at the date of grant and exercisable upon issuance.

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 \$3.2 million (2009 – \$1.6 million). Future minimum lease payments under non-cancellable operating leases are as follows:

	2010 \$m	2009 \$m
Due in less than one year	2.5	2.1
Due between one and five years	7.6	9.0
Due in more than five years	5.2	6.5
Total	15.3	17.6

23. EARNINGS PER SHARE

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

	2010 \$m	2009 \$m
Profit for the period attributable to equity shareholders	330.8	385.4
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	Number of shares	Number of shares
Basic weighted average number of shares	158,806,410	172,740,238
Dilutive effect of RSS	3,990,315	1,903,964
Dilutive effect of LTIP	500,310	494,544
Dilutive effect of warrants	14,214,198	12,649,142
Diluted weighted average number of shares	177,511,233	187,787,888
<hr/>		
	2010	2009
Earnings per share		
Basic	\$2.08	\$2.23
Diluted	\$1.86	\$2.05

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 ordinary restricted share options where relevant performance criteria have not been met are not included in the calculation of 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
Subsidiaries	
LICL	Bermuda
LIHL	United Kingdom
LUK	United Kingdom
LIMSL	United Kingdom
LISL	United Kingdom
LMEL	United Arab Emirates
Other controlled entities	
LHFT	United States
EBT	Jersey

All subsidiaries are wholly owned, either directly or indirectly.

The Group has issued subordinated loan notes via a trust vehicle – LHFT (refer to note 19). The Group effectively has 100% of the voting rights in LHFT. These rights are subject to the property trustee's obligations to seek the approval of the holders of LHFT'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 LHFT is limited by the Trust Agreement, LHFT was set up by the Group with the sole purpose of issuing the subordinated loan notes, is in essence controlled by the Group, and is therefore consolidated.

24. RELATED PARTY DISCLOSURES *continued*

The EBT was established 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 the year the Group made cash donations of \$nil (2009 – \$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 \$20.0 million. The Facility may only be used by the Trustees for the purpose of achieving the objectives of the EBT. During the year ended 31 December 2010, the Group had made advances of \$10.0 million (2009 – \$7.0 million) to the EBT under the terms of the Facility.

The Group donated 1,000,000 (2009 – nil) treasury shares to the EBT at the prevailing market rate on 13 December 2010. The total value of the treasury share donation was \$8.8 million (2009 – \$nil).

LICL holds \$306.4 million (2009 – \$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.

Key management compensation

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

	2010 \$m	2009 \$m
Short-term compensation	5.1	5.6
Equity based compensation	5.1	6.1
Directors' fees and expenses	1.9	1.7
Monitoring fees	–	0.1
Total	12.1	13.5

The Directors' fees and expenses includes \$0.7 million (2009 – \$0.7 million) paid to significant founding shareholders. The monitoring fees were previously paid to significant founding shareholders. These fee agreements ended in 2009. 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 a founding shareholder

Under the share repurchase authorisations discussed in note 20, the Group repurchased common shares for cancellation from a significant founding shareholder with representation on the Group's Board of Directors. The details are as follows:

Date	Number of shares	Price per share	\$m
1 April 2010	4,120,879	\$7.28	30.0
11 June 2010	1,000,000	\$7.03	7.0
1 July 2010	500,000	\$7.42	3.7
Total	5,620,879	\$7.24	40.7

24. RELATED PARTY DISCLOSURES continued

The sellers were Crestview Partners, L.P., Crestview Offshore Holdings (Cayman), L.P., Crestview Holdings (TE), L.P., Crestview Partners ERISA, L.P. and Crestview Partners (PF), L.P (collectively, "Crestview"). All of the shares were repurchased in off-market transactions at a discount to the then prevailing market price. As of 2 July 2010 Crestview no longer owned any common shares of the Group but continues to hold 1.2 million Founders' warrants. The founding shareholder resigned from the LHL Board of Directors as of 7 July 2010.

Transactions with Lancashire Foundation

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

Date	\$m
14 May 2009	1.1
25 February 2010	1.1
5 November 2010	1.3

25. NON-CASH TRANSACTIONS

TBAs classified as derivatives were settled net during the year with purchases and sales of \$246.2 million (2009 – \$229.3 million) and \$246.6 million (2009 – \$229.5 million) respectively.

There was no unsettled element of share repurchases as at 31 December 2010. The 2009 unsettled amount of \$0.1 million discussed in note 20 was not reflected in that year's cash flows. It was recorded in the subsequent year when it was actually settled. The 2010 special dividend declared of \$264.0 million (2009 – \$263.0 million) is not reflected in the current year cash flows. The settlement date was 19 January 2011 (2009 – 6 January 2010) and the cash flow on this transaction has been recorded in the year it was actually settled.

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 2010	\$m	£m
	LICL	LUK
Statutory capital and surplus	1,324.7	131.7
Minimum required statutory capital and surplus	289.1	25.4
<hr/>		
As at 31 December 2009	\$m	£m
	LICL	LUK
Statutory capital and surplus	1,213.6	120.0
Minimum required statutory capital and surplus	257.1	22.6

26. STATUTORY REQUIREMENTS AND DIVIDEND RESTRICTIONS *continued*

For LUK, various capital calculations are performed and an ICA is presented to the FSA. The FSA then considers the capital calculations and issues an 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 2010 and 2009 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 2010 and 2009 the capital requirements of both regulatory jurisdictions were met.

27. CONTINGENCIES

Litigation

LICL has been engaged in litigation in connection with the assignment of a leasehold interest. The judgement at first instance is subject to an appeal which is likely to be heard in 2011. Efforts are continuing to sub-let or assign the remaining leasehold interest.

28. SUBSEQUENT EVENTS

Establishment of a marketing office in Brazil

In November 2010, LICL made an application for admitted reinsurer status to SUSEP, the Brazilian regulatory agency which is responsible for the supervision and control of the insurance, reinsurance, open private pension and capitalisation markets in Brazil. It is intended that LICL will be authorised in Brazil as an admitted reinsurer and that a subsidiary of the Group will be incorporated to act as LICL's representative office. This subsidiary will be subject to the disclosure requirements, internal controls and restrictions of activities as prescribed by SUSEP regulations. The representative office will also be required to maintain a permanent representative in Brazil.

Dividend

On 20 February 2011 the Board of Directors declared the payment of a final ordinary dividend of 10.0 cents per common share to shareholders of record on 18 March 2011, with a settlement date of 20 April 2011. The total dividend payable will be approximately \$18.9 million. An amount equivalent to the dividend accrues on all RSS options and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

SHAREHOLDER INFORMATION

ANNUAL GENERAL MEETING

The Company's AGM is scheduled for 1.00pm on 5 May 2011. Notice of this year's AGM and the form of proxy accompany this Annual Report. If you have any queries regarding the notice or return of the proxy please contact Greg Lunn, (Company Secretary and General Counsel) at Lancashire Holdings Limited, Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda, Tel: + 1 441 278 8950 and email: greg.lunn@lancashiregroup.com.

FURTHER INFORMATION

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

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

NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

Acquisition cost ratio – Ratio, in per cent, of net acquisition expenses to net earned premiums

Additional case reserves (ACR) – Additional reserves deemed necessary by management

Aggregate – Accumulations of insurance loss exposures which result from underwriting multiple risks that are exposed to common causes of loss

AGM – Annual General Meeting

A.M. Best Company (A.M. Best) – A.M. Best is a full-service credit rating organisation dedicated to serving the financial services industries, focusing on the insurance sector

Best Lancashire Assessment of Solvency over Time (BLAST) – The Group's economic capital model

BMA – Bermuda Monetary Authority

BSX – Bermuda Stock Exchange

Catastrophe reinsurance – A form of excess of loss reinsurance which, subject to a specified limit, indemnifies the reinsured company for the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event or series of events

Ceded – To transfer insurance risk from a direct insurer to a reinsurer and/or from a reinsurer to a retrocessionaire

Combined ratio – Ratio, in per cent, of the sum of net insurance claims, net acquisition expenses and other operating expenses to net earned premiums

CEO – Chief Executive Officer

CFO – Chief Financial Officer

CRO – Chief Risk Officer

CUO – Chief Underwriting Officer

Deferred acquisition costs – Costs incurred for the acquisition or the renewal of insurance policies (e.g. brokerage and premium taxes) which are deferred and amortised over the term of the insurance contracts to which they relate

DFSA – Dubai Financial Services Authority

Duration – Duration is the weighted average maturity of a security's cash flows, where the present values of the cash flows serve as the weights. The effect of the convexity, or sensitivity, of the portfolio's response to changes in interest rates is also factored in to the calculation.

Earnings per share (EPS) –

Basic EPS – Calculated by dividing the net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year, excluding treasury shares and shares held by the EBT

Diluted EPS – Calculated by dividing the net profit for the year 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

EBT – Lancashire Holdings Employee Benefit Trust

EMD – Emerging Market Debt

ERM – Enterprise Risk Management

Excess of loss – Reinsurance or insurance that indemnifies the reinsured or insured against all or a specified portion of losses on an underlying insurance policy in excess of a specified amount

Expense ratio – Ratio, in per cent, of other operating expenses to net earned premiums

Facultative reinsurance – A reinsurance risk that is placed by means of a separately negotiated contract as opposed to one that is ceded under a reinsurance treaty

Fully converted book value per share (FCBVS) – Calculated by dividing the value of the total shareholders' equity plus the proceeds that would be received from the exercise of all outstanding dilutive options, dilutive warrants, and dilutive RSS awards by the sum of all shares, including dilutive options, dilutive warrants, and dilutive RSS awards, assuming all are exercised

FDIC Guaranteed Corporate Bonds – Corporate bonds protected by the Federal Deposit Insurance Corporation, an agency of the U.S. government

FSA – United Kingdom, Financial Services Authority

Gross premiums written – Amounts payable by the insured, excluding any taxes or duties levied on the premium, including any brokerage and commission deducted by intermediaries

the Group – LHL and its subsidiaries

GRSC – Group Reinsurance Security Committee

HNBS – Hewitt New Bridge Street

International Accounting Standard(s) (IAS) – Standards, created by the IASB, for the preparation and presentation of financial statements	LMEL – Lancashire Marketing Services (Middle East) Limited	Retrocessionaire – A reinsurance company that sells reinsurance
International Accounting Standards Board (IASB) – An international panel of accounting experts responsible for developing IAS and IFRS	LOC – Letter of credit	RPI – Renewal Price Index
Incurred but not reported (IBNR) – These are anticipated or likely losses that may result from insured events which have taken place, but for which no losses have yet been reported. IBNR also includes a reserve for possible adverse development of previously reported losses.	Loss ratio – Ratio, in per cent, of net insurance losses to net earned premiums	RSS – Restricted share scheme
ICA – Individual capital assessment	Losses – Demand by an insured for indemnity under an insurance contract	SGM – Special General Meeting
ICG – Individual capital guidance	LSE – London Stock Exchange	Special Event – A Special Event is a change in the tax and/or investment status of the issuing trust
IFRS – International Financial Reporting Standard(s)	LTIP – Long-term incentive plan	Standard & Poor's Ratings Services (S&P) – Standard & Poor's is a worldwide insurance rating and information agency whose ratings are recognised as an ideal benchmark for assessing the financial strength of insurance related organisations
IFRIC – International Financial Reporting Interpretations Committee	LUK – Lancashire Insurance Company (UK) Limited	SUSEP – The Superintendence of Private Insurance, Brazil
IRR – Internal rate of return	Moody's Investors Service (Moody's) – Moody's is a leading provider of credit ratings, research and risk analysis	TBAs – Mortgage backed "to be announced" securities
Lancashire Foundation – The Lancashire Foundation is a Bermuda registered charitable trust	Net operating profit – Net operating profit excludes net realised gains and losses, equity based compensation expenses for warrants issued at IPO, net foreign exchange gains and losses and tax charges	Treaty reinsurance – A reinsurance contract under which the reinsurer agrees to offer and to accept all risks of a certain size within a defined class
LHL – Lancashire Holdings Limited	Net premiums written – Net premiums written is equal to gross premiums written less outwards reinsurance premiums written	Total shareholder return (TSR) – The IRR of the increase in share price, in the period, measured in U.S. dollars, adjusted for dividends
LHFT – Lancashire Holdings Financing Trust I	OTC – Over the counter	Unearned premiums – The portion of premium income that is attributable to periods after the balance sheet date is deferred and amortised to future accounting periods
LICL – Lancashire Insurance Company Limited	Pro-rata/proportional – Reinsurance or insurance where the reinsured or insured shares a proportional part of the original premiums and losses of the reinsured or insured	U.S. GAAP – Accounting principles generally accepted in the United States
LIHL – Lancashire Insurance Holdings (UK) Limited	Retention limits – Limits imposed upon underwriters for retention of exposures by the Group after the application of reinsurance programs	Value at Risk (VaR) – A measure of the risk of loss on a specific portfolio of financial assets
LIMSL – Lancashire Insurance Marketing Services Limited	Return on Equity (RoE) – The IRR of the change in FCBVS in the period plus accrued dividends	
LISL – Lancashire Insurance Services Limited		

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The printer is an EMAS certified CarbonNeutral® Company and its Environmental Management System is certified to ISO14001. 100% of the inks used are vegetable oil based, 95% of press chemicals are recycled for further use and on average 99% of any waste associated with this production will be recycled.

