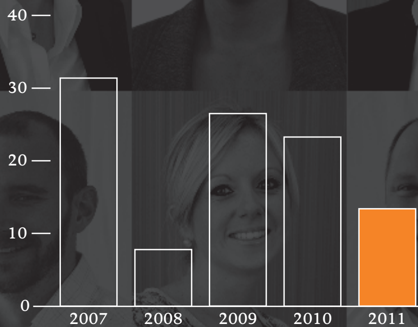
Annual Report & Accounts 2011

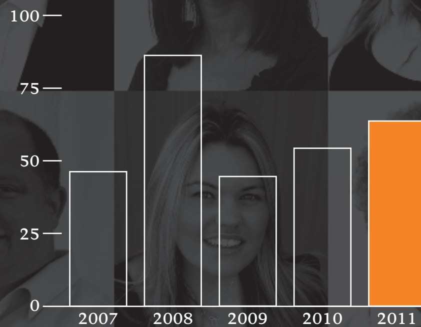
lancashire
HOLDINGS LIMITED

Key performance indicators (KPIs)

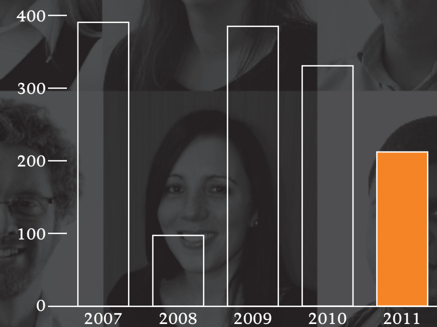
Return on Equity *(per cent)*



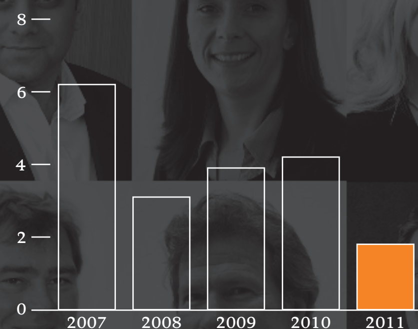
Combined Ratio *(per cent)*



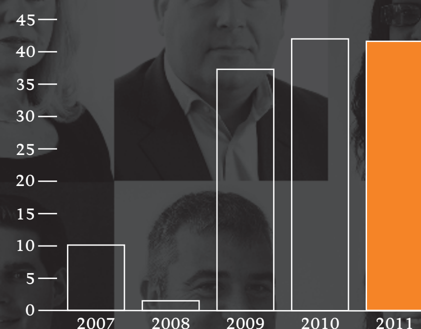
Profit After Tax *($m)*



Total Investment Return *(per cent)*



Total Shareholder Return *(per cent)*



Percentage of Profit Returned to Shareholders *(per cent)*

Operating highlights

- **Weathering the storm.** Lancashire achieved an accident year loss ratio of 59.3 per cent in a year with over $100 billion of industry losses.
- **Capitalising on opportunities**. The launch of Accordion, a fully collateralised property retrocession sidecar vehicle with an efficient capital drawdown feature.
- **Hanging in there**. In volatile investment markets, we managed an investment return of 1.8 per cent for the year.

What's important to us

At Lancashire, the most important measure of success is long-term Return on Equity. We concentrate on striking a balance between underwriting and management of both capital and risk.

– Our focus is not on top-line growth per se, unless market conditions warrant it, and the same goes for capital growth.

– Although we pay high attention to our investment portfolio, we have no requirement for it to provide a major source of return.

– Nor do we believe it's important to pursue Mergers and Acquisitions, unless we can almost guarantee an improvement to long-term Return on Equity.

It is often important to think and move in the opposite direction to other companies, and quickly. Our business is risk but at the heart of it lies opportunities that require a balance of our people's experience with creativity and discipline. We've delivered successful results by staying true to our strategic priorities and will continue to do so.

It's what makes us Lancashire, and some things should never change.

Contents

Inside front cover
Key performance indicators

Overview
1 What's important to us
2 Chairman's statement
4 2011 CEO, President & CUO report
7 Our strategy
8 Striking a balance
14 CFO review

16 Business review
17 Strong business partnerships
18 Business environment and outlook
18 Business structure and locations
19 Distribution
19 Renewal Price Index
19 Investments
20 Managed investment portfolio allocations
20 Liquidity and cash flow
21 Capital management
22 2011 financial performance
23 Underwriting results
25 Loss Triangles
26 Investment performance
27 Other operating expenses
27 Capital
27 Non pre-emptive issue of shares
28 Repurchase program
28 Dividends

29 Risk management
30 The ERM governance framework
30 Sources of risk
30 Our key ERM objectives
30 Our three core ERM principles
31 Our primary risk management tool: BLAST
31 How do we use BLAST?

32 Corporate responsibility
33 The Lancashire Foundation
33 Lancashire and the environment
34 Doing it for the kids
35 Breaking the barriers to medical care
36 Making a difference in a day
36 International Care Ministries
37 Putting our people first

38 Governance
39 The Board
40 Directors' report
46 Corporate governance
52 Directors' remuneration report
63 Statement of Directors' responsibilities

64 Financial statements
65 Independent auditors' report
66 Consolidated financial statements
70 Accounting policies
77 Risk disclosures
103 Notes to the accounts

132 Shareholder information
133 Glossary
136 Contact information

Chairman's statement

While 2011 proved a volatile and difficult year for the insurance industry, the Lancashire Group remained resilient, delivering an RoE of 13.4 per cent and a total shareholder return of 41.6 per cent.

$0.95
Dividends per share

Taking responsibility for managing risks

Effective risk management is at the core of our business. This focus is mirrored in the fact that the entire Board takes shared responsibility for debating the Company's risks and overseeing risk management, rather than delegating these issues to a specialist Committee. So, in 2011, it was enormously gratifying to see A.M. Best upgrade our financial strength rating to 'A' and S&P grant us an 'A minus' financial strength rating.

Capital management and engagement with shareholders

This year we learned an important lesson in shareholder communication.

At the AGM in May the Board had asked shareholders to vote in favour of permitting the issue of up to 10 per cent of shares on a non pre-emptive basis, just as we had in previous years. To our great surprise the vote did not carry the necessary majority to pass. So we redoubled our efforts to engage with shareholders to explain Lancashire's need for this facility. That need comes from the fact that the ability to act quickly to raise equity capital when market circumstances so dictate can be hugely significant. It gives us the ability to take best advantage of underwriting opportunities.

The problem had been that, for some shareholders and proxy voting and advisory services, the normal objection to waiving pre-emption rights over the recommended limit of 5 per cent had neither taken into account the specifics of the market in which we operate nor the Group's strong track record in reliable and proactive capital management. Once we explained this to shareholders individually, they overwhelmingly approved the proposal at the SGM in August 2011.

Approach to corporate governance

At Lancashire we strive to ensure that standards of good governance inform all our Board and Committee business, and in particular our strategic thinking. The U.K. Corporate Governance Code establishes standards of good practice relating to Board leadership, effectiveness, independence, remuneration, accountability and shareholder relations. As a Board we carefully monitor our compliance with the Code quarterly. Board and Committee business is supported by an effective secretariat, experienced external advisers and accurate, clear and timely materials. Our Non-Executive Directors bring a robustly independent perspective to the business of the Board, and the talents of all our Directors are well deployed on the Committees and the Board, which ensures an effective setting of our strategic objectives and oversight of management. In particular the Board leads in the determination of risk tolerances, ensuring that an effective risk management culture is established by the Board and embedded throughout the business. I am pleased to report that the internal Board evaluation process for 2011 has concluded that the Board continues to operate effectively.

Our experienced team

Over the past six years Lancashire has established a strong Board of Directors and senior management team. Not only do we enjoy the benefits of long-serving members, maturity and robust leadership, we also gain from the deep collegiate experience built from working together since the Group was launched in 2005.

"While 2011 proved a volatile and difficult year for the insurance industry, the Lancashire Group remained resilient, delivering a Return on Equity of 13.4 per cent."

Martin Thomas,
Non-Executive Chairman

With this experience comes the need to ensure that the leadership of our Board and senior management does not stagnate. Diversity encourages debate. It promotes different views and drives the Group to explore new opportunities and directions. I would like to welcome some individuals who joined Lancashire in 2011, who have contributed to the strategic strengthening of our team, including: Stuart Blakeborough, Group Chief Operating Officer; Louise Wells, Head of Internal Audit; and Debbie Hall, Group Human Resources Director.

In 2012, we look forward to making additional efforts to capture the best possible, and widest range of talent in making further appointments to the Board. This will reinforce our desire to invigorate an already strong Board with fresh perspectives. It will also reflect the Financial Reporting Council's move to establish gender and ethnic diversity within FTSE 350 boardrooms.

During 2011 Lancashire wound up its Dubai marketing office. Lancashire is an established participant in the insurance of energy risks, and our experienced underwriting team is well equipped to manage its international energy client base from London. I would like to thank Lancashire's Dubai team for all their hard work in helping to spread the Lancashire story, securing key relationships, and to wish them well for the future.

Our move to U.K. tax residency

With effect from 1 January 2012, Lancashire Holdings Limited moved its tax residence to the U.K. This move followed publication by the U.K. Government of reforms to the U.K.'s Controlled Foreign Companies (CFC) rules and has been facilitated by approval by our shareholders, at the SGM in August 2011, of a change to our Bye-laws.

Although we have moved our tax residence, we were not required to change our place of incorporation. We welcome the U.K. Government's desire to explore ways of treating insurance business differently under the new CFC regime. In the process we had discussions with HM Revenue and Customs, and were pleased to inform and shape policy regarding international insurance businesses operating within the U.K.

The move to U.K. tax residency will help facilitate the conduct of Board business and even more effective management. It will also increase opportunites for the Board to engage with our U.K. investor base. However, the Lancashire Group intends to maintain a thriving presence in Bermuda and an openness to international business and opportunities.

Looking forward to 2012

Although trading conditions for 2012 are hard to read, there is clear evidence of opportunity over the coming months, particularly in Lancashire's reinsurance lines. Lancashire is well placed to develop these, thanks to a fast and flexible underwriting culture that responds rapidly to pricing and coverage movements.

By remaining anchored in our strategic priorities and strengths, we are perfectly positioned to react nimbly and effectively to new challenges.

Martin Thomas

Non-Executive Chairman

2011 CEO, President & CUO report

Summary of 2011

63.7%

Combined ratio

2011 was a tough year to be in the insurance industry. The market continued its steady decline from the heights of 2006, and the premium that was taken in flowed right back out to pay for record levels of losses. Compounding the challenge were very low investment yields. 2011 will be remembered as the Year of the Surprise, with huge claims from events that were not anticipated to generate such losses. The insurance sector experienced industry losses in excess of $100 billion, by far the highest total in our history and the second highest industry loss total since records began. Given that the United States experienced only one modest land falling hurricane, and no major earthquakes, that is quite an incredible statistic. The largest insured loss in 2011 was the Tohuku earthquake suffered in Northern Japan in April. The industry loss is estimated to be in the region of $40 billion. To put this into perspective, it is the second largest single insured loss *ever*. The flooding in Thailand – a region of the world previously considered by much of the industry as presenting very little risk – will also likely rank as one of the largest losses in history. If there was ever a lesson on the downside of excessive diversification, it was the floods in Thailand.

Yet again, too many in the industry ignored the need for discipline and continuing the relentless pursuit of growth, opened ever more offices and returned very little capital. This may be good for management ego, but it's bad for shareholders. We're pleased to report that this is not our approach and we've remained true to our initial promise to focus first and foremost on shareholder return.

Our results

In 2011, Lancashire grew fully converted book value per share, including the impact of dividends, by 13.4 per cent. Our average compound RoE is 19.5 per cent. We returned $180.5 million of capital to shareholders, or 89.5 per cent of comprehensive income. Since inception we have returned $1.3 billion of capital to shareholders, or 83.3 per cent of cumulative comprehensive income. In 2011, our combined ratio was 63.7 per cent. Our combined ratio since inception is 57.9 per cent.

Although 2011 saw our second lowest RoE since we started in business (in 2008 our RoE was 7.8 per cent), in the context of the industry losses, it was one of our best results.

Underwriting

Underwriting is our single most important area of focus. Lancashire had a good absolute and relative underwriting performance in 2011. This was partly achieved by refusing to follow the policy of many, of diversification without regard to underwriting fundamentals. Lancashire's losses sustained in the major events of the year were within expectations and in total, were well below the average percentage of capital for our competitors. Our strategy of matching risk appetite to the post-loss opportunities worked well in 2011. Our largest loss was suffered in Japan, while our losses in New Zealand and Thailand were far smaller. Another cornerstone of our strategy is to be nimble. That worked well too. Because we carry significant capital headroom, Lancashire quickly took advantage of post-loss market dislocation to secure advantageous terms and conditions in the many parts of the world that suffered catastrophe events in the past two years.

The Property Retrocession market grew in 2011 as Validus, Alterra and others either established, or sought to expand, retrocession vehicles. Lancashire launched a contingent capacity sidecar, Accordion, a fully collateralised joint venture with outside investors to accept a quota share of Lancashire's retrocession writings within certain parameters.

"Underwriting is our single most important area of focus. Lancashire had a good absolute and relative underwriting performance in 2011."

The Energy market experienced a second year of individual risk losses both on and offshore of approximately $1 billion, with the largest being a $1.3 billion loss at a Canadian facility. Total upstream losses for the year were approximately $3 billion. Whilst some carriers have exited the market there have been some new entrants as well. Overall capacity seems to be broadly stable, despite the continuing run of poor results. Our preference in energy remains tilted towards deep-water offshore risks, both in the Gulf of Mexico and worldwide.

In Marine, Lancashire maintained its discipline and stuck to a small section of mostly newer and larger vessels. The Marine market had another largely benign year in 2011 in terms of losses, although there is much discussion of potential losses to cargo programmes from the Thailand flooding. There will also be an impact from the January 2012 loss of the Costa Concordia cruise ship. As a result, Marine pricing and terms and conditions may finally edge up, but we shall see.

In the Terrorism arena, despite the Arab Spring, which caused losses under both terrorism contracts and property contracts, there was no sign of any significant reduction in capacity, nor of any sustained effort to increase pricing. The London market remains a key hub for terrorism business and loss ratios are excellent, so there is little impetus for change at present. Similarly with Political Risks, which cover acts like expropriation and confiscation, the lack of losses has meant that pricing is stable. Lancashire has continued to build a conservative portfolio focusing on the exposures of both the risk territory and the counterparties.

In our niche segment of the Aviation market (AV52) there has similarly been a very benign loss record, with no reported losses. Lancashire's principal Aviation exposures are to terrorism liability for airlines, airports and service providers and this coverage has not experienced any losses of substance in our history. As a consequence rates have been declining, although at a slower pace than in past years.

A significant change in 2011 was the issuance by RMS, a catastrophe modeling company, of its version 11 U.S. windstorm model. RMS is used by a large proportion of the world's reinsurers to model their exposures. This new version assumes dramatically increased expected losses from severe events in several areas of the United States. The market pricing impact from this has been less than originally expected, although it is possible that this may have further impacts in 2012.

Capital management

Capital management is our second most important area of focus after underwriting. We are possibly the best-known and biggest proponent of active capital management in the industry. There were two very visible actions in 2011. Firstly, we returned $180.5 million of capital, the majority via a special dividend which was a more accretive method than via share repurchases. We were one of the very few companies with the discipline and wherewithal to return a meaningful proportion of capital in 2011. In fact, we would have returned more were it not for the increasing opportunities that arose near the end of the year. Secondly, as mentioned above, we sponsored an innovative new sidecar called Accordion, in which we have a minority interest. Lancashire cedes a proportion of its retrocession contracts to Accordion, accepting in return a cession fee and profit commission. More importantly, because of Accordion, Lancashire now carries more leverage in the retrocession market. Accordion is explained in more detail on page 15 in Elaine's CFO review.

"Capital management is our second most important area of focus after underwriting."

Risk management

Since 2007 we have generally reduced our risk levels as the market opportunities have declined. There are exceptions to this of course, which were mainly driven by changes in market opportunity.

So while our U.S. catastrophe risk levels were mostly lower in 2011 than they were in 2010, our Japanese earthquake exposure increased after the Tohoku earthquake and the resulting Tsunami. As we head into 2012, we are becoming a little more bullish on the U.S. catastrophe market and our PMLs will probably edge up again. However you will not see dramatic changes until the market hardens a lot more. Less visible but probably more important is our day-to-day strategic risk management. There is constant dialogue between senior underwriters, our actuaries, our CRO, finance people and others about whether to take on more risk, less risk or alter the mix of what we have got. You're not given an office if you work at Lancashire. The authors of this letter all sit in the open plan environment, where walls or cubicles don't interfere with instant communication on risk management or anything else.

"For the sixth year in a row, we achieved a positive return on our investments ."

Investments

For the sixth year in a row, we achieved a positive return on our investments. The total return was 1.8 per cent. Not enormous, but that's ok in what seems to be a never-ending tough investment environment. We have more or less given up predicting what the market will do next, so for 2012 all we plan to do is to keep the portfolio as balanced as it can be against various Realistic Investment Disaster Scenarios (RIDS). While we aim and expect to make a modest investment return in 2012, our strategy from the start has been to avoid any reliance on investments to drive RoE.

People and values

We are fortunate indeed to have some extraordinarily talented managers and staff, people who contribute greatly to RoE. Thank you all very much for your efforts over the past year. We believe in certain core values in our culture. Our core values are teamwork, agility, passion, success and respect. Adherence to these Lancashire values has been a huge part of our success. Lancashire also takes its Corporate Responsibility (CR) very seriously. Right from the start, the Lancashire Foundation has aimed to contribute well above average for a FTSE 250 company, and we have forged key partnerships with Médecins Sans Frontières and Kids Company amongst others. We are proud of what we have achieved but we can do more, and we feel this is particularly important at a time of economic austerity. In 2012 we will be expanding our CR efforts.

Outlook

We see the underwriting cycle as tantalisingly near to turning, but, other than certain pockets of opportunity, it's fair to say we are still in a soft market. We are optimistic though. While the outlook for much of our portfolio is for trading conditions similar to 2011, the prospects for classes exposed to natural catastrophes is improving, especially for property retrocession. Because of our dominant position in that particular area, enhanced by Accordion, we believe that we may be in the best position of any company in our sector to reap the benefits.

Though they may be loath to admit it, many companies are feeling pressure from their shareholders to improve their results. Our industry does not have nearly the levels of excess capital that it had only 18 months ago, and the ongoing financial crisis means few are in a position to raise new money. The obvious way out of the hole is to practise greater underwriting discipline, demand higher rate increases, and be miserly with their capital. We can only keep our fingers crossed. In the meantime, Lancashire moves into 2012 with plenty of capital and more than our fair share of opportunities.

Richard Brindle
Group Chief Executive Officer

Neil McConachie
Group President

Alex Maloney
Group Chief Underwriting Officer

Our strategy

We aim to provide shareholders with an attractive risk-adjusted total return. How? By striking a balance between creativity and discipline, risk and reward, and strength and agility.

Strategic priorities
Financial targets are achieved by concentrating on a small number of key priorities

Financial targets
Success in achieving our goal is measured against risk and return targets

Our goal
To provide an attractive risk-adjusted return to shareholders over the long term

Creativity meets discipline

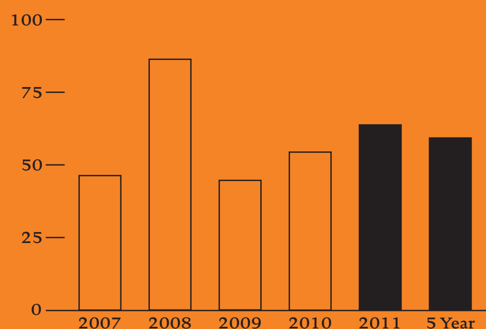
Creativity underpinned by rigorous discipline.

Underwriting always comes first. We make the most of every market. We consider our actions, scrutinise every risk, and capitalise on opportunities.

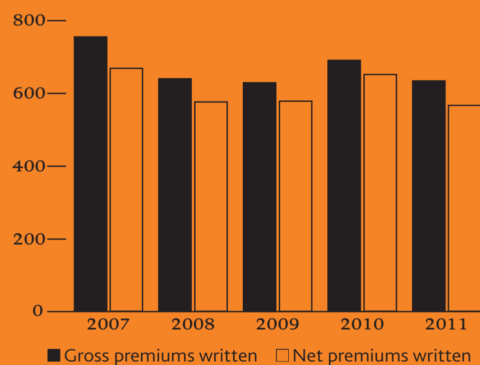
2011 saw the launch of Accordion, a fully collateralised property retrocession sidecar vehicle. Accordion offers an efficient capital drawdown feature. This means capital won't be deployed if the price is not right. Key to underwriting success is risk selection. Our daily underwriting call is the linchpin of our risk selection and is part of our DNA.

We don't care about constant top-line growth, or growth by acquisition for that matter. Size isn't everything and bigger is not always better. Maximising risk-adjusted return for our shareholders is our ultimate goal. Looking ahead – and in an uncertain world – we remain true to our number one priority: underwriting always comes first.

Combined Ratio *(per cent)*



Premiums Written *($m)*



Risk meets *return*

Risk and return go hand in hand.

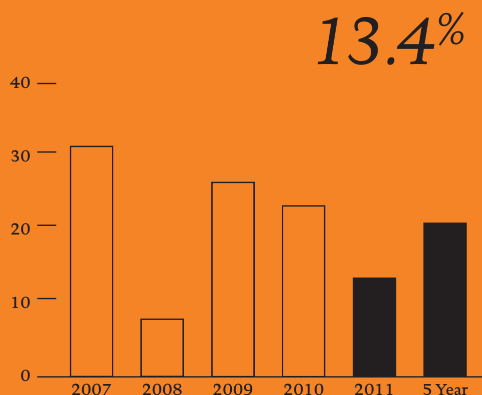
We effectively balance risk and return. That's why risk management is at the heart of everything we do. Achieving the best returns comes as a result of taking only the right risks.

It takes time and effort to balance risk and return. So everyone at Lancashire works together to do just that. In fact, finding the right equilibrium between both is so important, it permeates every area of our business.

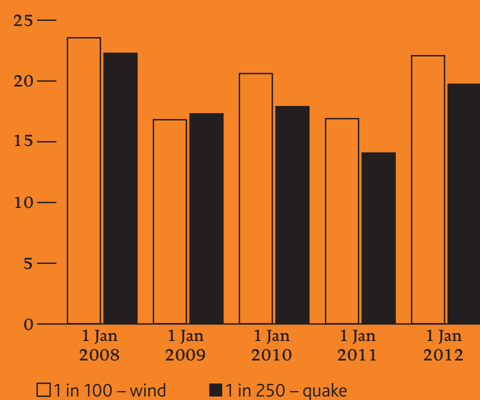
We believe we're getting the balance right. We have reduced our risk in softening markets and increased it when they hardened. We adjust our portfolio to make sure it's always as efficient as it can be. We continually improve our risk management, learning and adapting from our past experiences.

The result? Attractive shareholder returns that, at the very least, correspond with the risks we're prepared to accept.

Return on Equity *(per cent)*

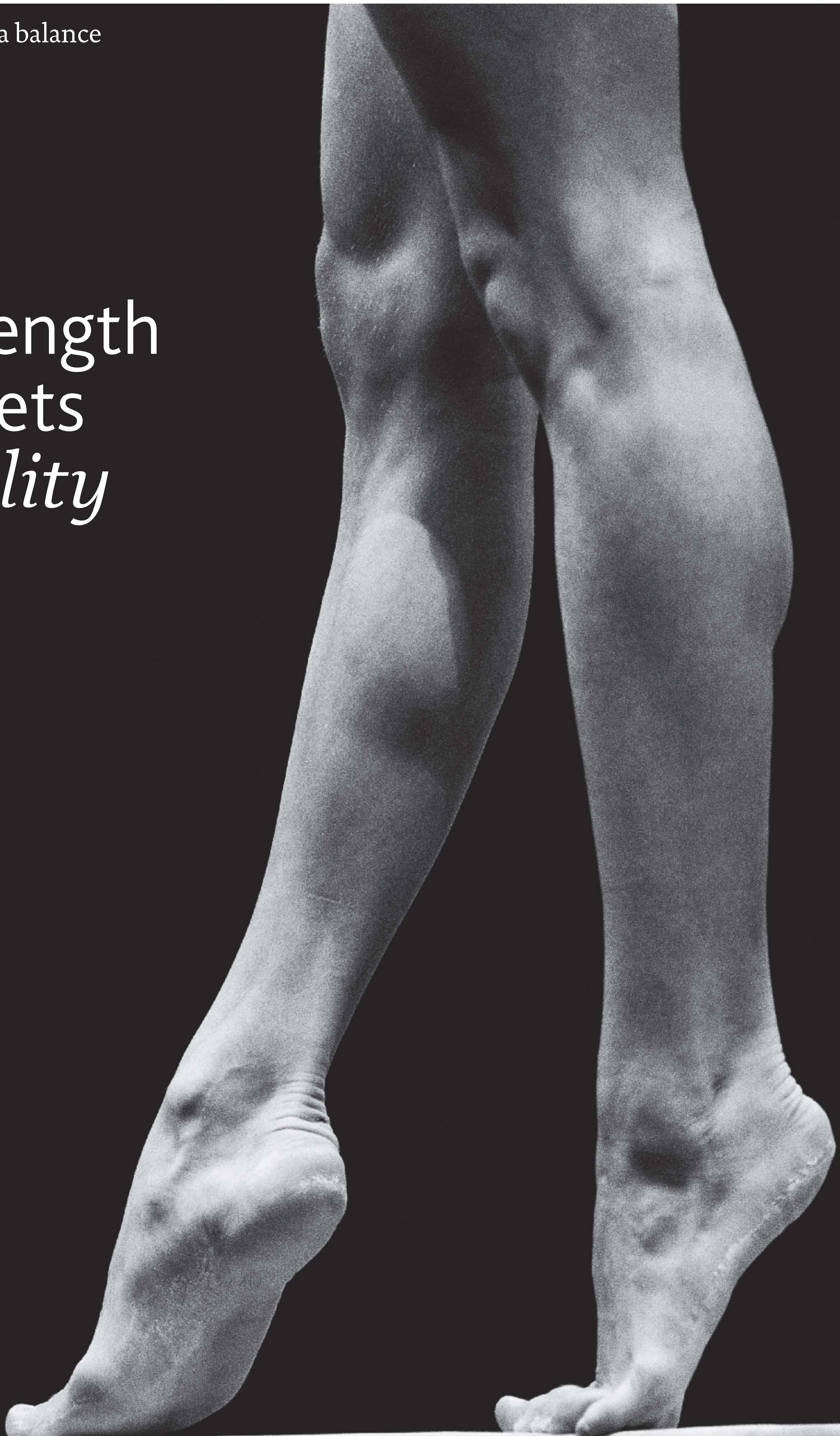


Probable Maximum Loss as a Percentage of Capital[1] *(per cent)*



[1] Net loss estimates shown are the largest 1 in 100 wind and largest 1 in 250 quake as at each date; these estimates are before income tax, net of reinstatement premiums and net of outward reinsurance (see page 79).

Strength meets *agility*

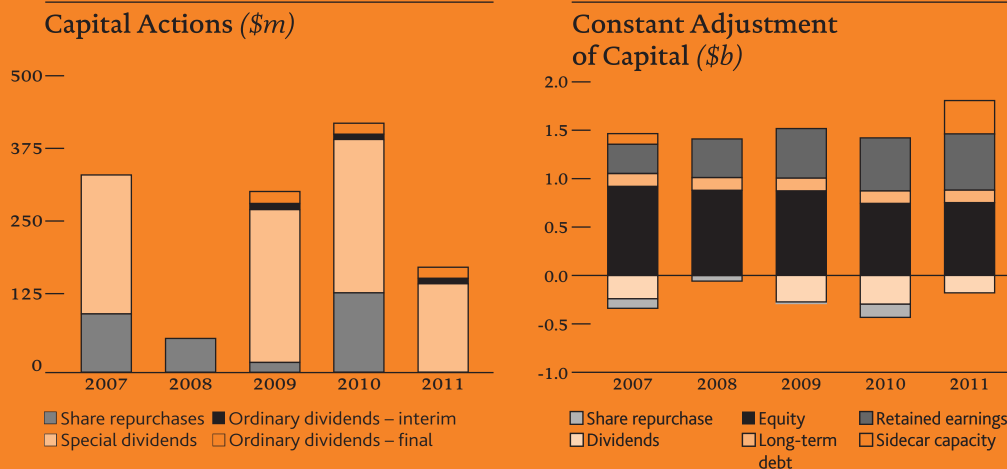


Strength is a virtue, while agility is a skill.

We operate nimbly through the cycle. Our daily underwriting call allows us to spot opportunities quickly. Our structure means we can take advantage of those opportunities when they arise.

We believe in keeping things simple by staying small and lean.

At Lancashire we react to markets – which change constantly – and we change with them. We do this by quickly adapting to underwriting developments, managing our money carefully, and watching and waiting. Sometimes that means doing less business to maximise returns and giving money back to our shareholders. Occasionally it means asking them for more.



CFO review

$212.2m

Profit after Tax

In the 2010 Annual Report, I commented on the level of natural catastrophe losses impacting the industry that were almost double those of 2009. “Unprecedented” was a word used by many in the industry to describe the 2010 losses. If that was the case, I don’t know what word can be used to describe the level of losses in 2011, which have been more than double those of 2010. If 2010 was a tough year, 2011 was worse. Add to all this the volatility we’ve seen in the investment markets – tough times indeed.

While, aside from Hurricane Irene, there were no major hurricanes making landfall in the U.S., there were many other U.S. natural catastrophe losses in the form of storms and floods, plus the severe tornadoes of the second quarter. The international property catastrophe market experienced the Tohoku earthquake and tsunami, further earthquakes and aftershocks in New Zealand, flooding in Thailand, Danish cloudbursts…. The list goes on. And let’s not forget the risk losses, with the storm damage to the Gryphon Floating Production Storage and Offloading vessel in the North Sea, amongst others.

With all this in mind, we’re delighted to have produced a profit after tax of $212.2 million, a combined ratio of 63.7 per cent and an RoE of 13.4 per cent.

Premiums

Our gross premiums written were $632.3 million, a decrease of $56.8 million, or 8.2 per cent, compared to 2010. The reduction was due mostly to a number of multi-year deals, written in 2010, which are not currently up for renewal yet, offset by new business opportunities in loss affected regions.

In contrast to 2010, in 2011 we were even more cautious in our sovereign obligors, political risk and terrorism books given the state of the world. We reduced premiums substantially in those lines. Gulf of Mexico offshore energy pricing remained solid and we saw some increases in pricing and exposures in our worldwide offshore energy book, but – by far – our most attractive lines this year were property catastrophe excess of loss and retrocession. While we trimmed our retrocession book early in the year, the endless accumulation of losses led to significant improvements in pricing and terms and conditions and we moved rapidly back into that space, also launching a sidecar, Accordion. More on that below. In addition, Property Catastrophe Excess of Loss benefited from post loss opportunities in Australia, New Zealand and Japan.

Losses

Despite the spate of industry losses during the year, and the adverse development of industry loss estimates for some of the 2010 events, the Group’s loss ratio for the year was 31.7 per cent, with an accident year loss ratio of 59.3 per cent. Apart from the Gryphon North Sea energy loss, reported risk losses for the year were low and the Group had minimal exposure to the smaller catastrophe losses. Losses from the Tohoku earthquake and tsunami, the New Zealand Christchurch earthquakes and the flooding in Thailand were well within expectations, reflecting our previously low appetite in these markets.

“The Group’s loss ratio for the year was 31.7 per cent, with an accident year loss ratio of 59.3 per cent.”

In early 2011, with a full five years of loss history to reference, the Group commissioned an independent reserve study in order to begin to incorporate the Group’s own experience into the industry data previously used. $36.9 million of prior year reserves were released on completion of this study. Total prior year reserve releases in 2011 amounted to $155.3 million. Along with the study, we were able to release $15.6 million in relation to our 2010 Chilean earthquake reserves, $4.7 million in relation to Hurricane Ike reserves, $7.4 million of political risk reserves (due to a lack of reported claims) plus $12.2 million for other property reserves, where we received new information on the magnitude of expected losses. Other releases were across various classes and years, as a result of better than expected claims experience.

"We returned $152.0 million of capital to shareholders by way of a special dividend, bringing total capital returns in 2011 to $180.5 million and $1.318 billion since Lancashire's inception in 2005."

Investments

We produced a total return for the year of 1.8 per cent. Investment markets in 2011 showed significant volatility, more so even than the crisis of 2008/2009. With knee-jerk reactions to virtually every piece of news, expectation of a global recession, the continuation of the European debt crisis and U.S. political gridlock, it was exceptionally difficult to determine investment allocations. The ebb and flow of the risk on/risk off trade was exacerbated by the continued low yield environment. With all that uncertainty, our focus towards the end of the year was "back to basics", back to our core beliefs and underlying philosophy of capital preservation first and foremost. Our asset allocation at the end of 2011 reflects that and, while we will initially miss any upside when markets recover, we hope we are well positioned to limit the downside risk of such volatile markets. We continue to allocate around 6.3 per cent of our portfolio to emerging market debt as the fundamentals remain strong and they produce slightly higher yields, without increasing the risk of our portfolio. Our appetite for local currency denominated emerging market debt is, however, low.

Accordion

Accordion, a property retrocession sidecar, was launched in May 2011 as a fully collateralised vehicle with a difference. It was designed with both a capital drawdown and a step-up feature to ensure the capital called, best fitted the underwriting opportunities and maximised returns for our investment partners. This structure affords us maximum flexibility in relation to underwriting opportunities. This has worked very well for the Group, with around 15 per cent of the capital called at the June and July renewal dates and about 55 per cent called for the 1 January 2012 renewals. We expect all capital to be fully called later in 2012 due to the continuing dislocation in the property catastrophe and retrocession markets. In addition to our quota share agreement with Accordion, which provides us with a profit commission based on future performance, Lancashire also has a 20 per cent equity investment in the vehicle.

Capital

We returned $152.0 million of capital to shareholders by way of a special dividend, bringing total capital returns in 2011 to $180.5 million and $1.318 billion since Lancashire's inception in 2005. Excluding our sidecar capacity, our total capital at the end of the year was $1.455 billion, giving us ample capital for the underwriting opportunities that we anticipate in 2012. Capital requirements, as always, will be monitored actively and re-assessed as the market develops.

Elaine Whelan

Group Chief Financial Officer

Business review

17 Strong business partnerships
18 Business environment and outlook
18 Business structure and locations
19 Distribution
19 Renewal Price Index
19 Investments
20 Managed investment portfolio allocations
20 Liquidity and cash flow
21 Capital management
22 2011 Financial performance
23 Underwriting results
25 Loss Triangles
26 Investment performance
27 Other operating expenses
27 Capital
27 Non pre-emptive issue of shares
28 Repurchase program
28 Dividends

"In a year of exceptional catastrophe losses spanning the globe from Japan, New Zealand and Thailand, to America and Europe, Lancashire's focus on underwriting profitability enabled us to produce market leading results. Our responsiveness to our brokers and clients makes us a go-to market when they need quick and clear solutions."

Alex Maloney – Group Chief Underwriting Officer

Strong business partnerships across four classes of businesses

Lancashire

Wherever we are in the world, our people are connected by conversations. Every day, we hold a daily underwriting and marketing conference call. These calls enable us to learn from each other, identify new business opportunities and monitor the market.

Brokers

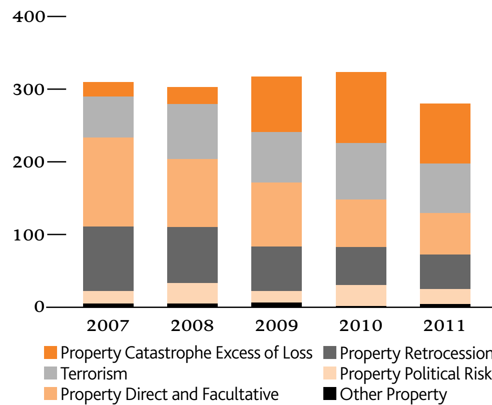
Brokers are the lifeblood of our business. So it's only natural that we establish strong partnerships with them. These relationships allow us to act nimbly, react rapidly to the market and deliver solutions exactly when our brokers need them most.

Clients

Clients trust our specialist knowledge and systems to satisfy their needs across four business classes: Property, Energy, Marine and Aviation. Each client knows we have the expertise, technologies and processes necessary to protect their interests and minimise risks.

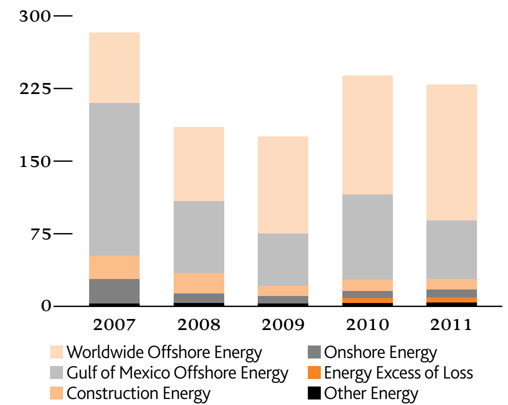
Property $279.8m

Gross Premiums Written *($m)*



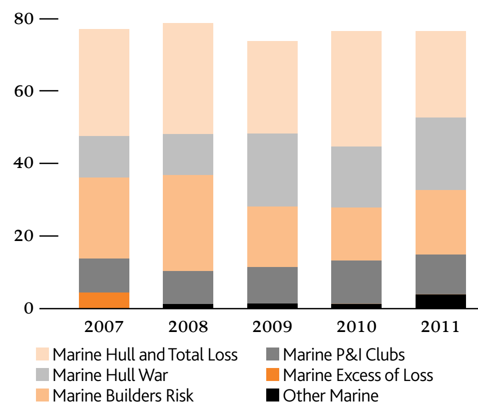
Energy $229.0m

Gross Premiums Written *($m)*



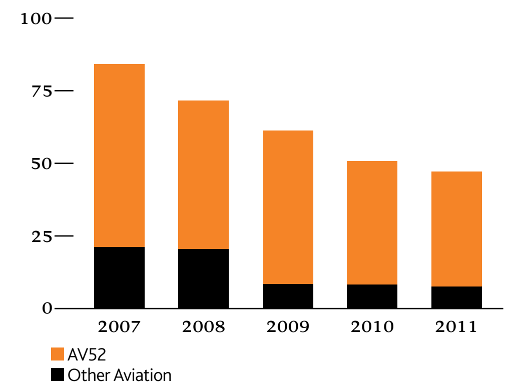
Marine $76.4m

Gross Premiums Written *($m)*



Aviation $47.1m

Gross Premiums Written *($m)*



Business environment and outlook

The trend of recent years continued in 2011. While the Atlantic windstorm season was one of the most active on record, with 19 named storms, only Irene made landfall in the U.S., so resulting losses to the industry were not as great as they might otherwise have been. Conversely, the spate of large international catastrophe losses was unrelenting. Non-elemental losses were also sizeable, most notably with the Gryphon floating production and storage facility loss. 2011 produced in excess of $100 billion of insured losses to the industry, yet industry capacity remains largely intact and the long awaited broad market hardening has yet to materialise.

There are, however, pockets of opportunity. The international catastrophe losses have led to significantly improved pricing and terms and conditions in both property retrocession and property catastrophe excess of loss. While Lancashire typically focuses more on insurance than reinsurance, with great opportunities in these lines, in 2012, we expect the balance to shift slightly. We anticipate underwriting the largest number of property reinsurance risks for Lancashire to date, in order to take advantage in of the dislocation in those markets. We therefore envisage being able to utilise fully the capacity of the Accordion sidecar vehicle, with a great deal of this business already having been written at the 1 January 2012 renewal season.

Energy pricing post the North Sea Gryphon loss remains positive, and demand has again increased somewhat. The major renewal period for energy risks is March through June and we expect further growth in our energy book. The tragic loss of the Costa Concordia should drive premium increases in the marine book, particularly for the larger, more expensive vessels. Through all this, we continue to support our core clients across the cycle.

The volatility in the investment markets can be expected to continue in 2012. With the protracted European debt crisis and U.S. political gridlock, which is likely to worsen in an election year, investment income is virtually non-existent. Our approach is to batten down the hatches, rather than stretching for return, and position our portfolio to limit the downside risk in such unpredictable markets.

Lancashire's aim of providing shareholders with a risk-adjusted return of 13 per cent in excess of a risk free rate across the cycle remains unchanged. Given current premium pricing expectations, the outlook for 2012 is relatively promising.

"2011 produced in excess of $100 billion of insured losses to the industry."

Business structure and locations

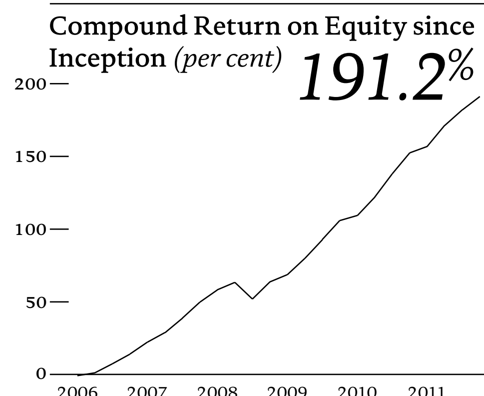
The main operating companies of the Group are LICL in Bermuda and LUK in London which both provide insurance and reinsurance to their customers, with an emphasis on the Property, Energy, Marine and Aviation lines of business. The Group's Dubai marketing office has been closed and the region will now be serviced by LUK.

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.

The Bermuda office focuses on the Group's reinsurance lines of business, with a larger proportion of business written exposed to natural catastrophes.

Compound Return on Equity since Inception *(per cent)*



Distribution

Almost all of our business is transacted through brokers and we work hard to foster close working relationships. We prefer to direct our efforts to a small group of business partners who know and understand us well.

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 and reflects Lancashire's assessment of relative changes in price, terms, conditions and limits on like for like renewals only, and is weighted by premium volume. This does not include new business or contracts with fundamental changes to terms and conditions or exposures. The calculation involves a degree of judgement in relation to comparability of contracts and the assessment noted above. To enhance the RPI tool, management 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.

The following table summarises the RPI figures for the main business classes using 2006 as the base year:

RPI

Class	2006	2007	2008	2009	2010	2011
Property Reinsurance	100	97	96	127	121	131
Property Direct & Facultative	100	92	83	90	84	88
Energy Gulf of Mexico	100	80	64	137	139	140
Energy Worldwide Offshore	100	80	68	84	88	97
Marine	100	88	80	82	80	79
Terrorism	100	86	71	66	60	57
Aviation (AV52)	100	80	69	68	62	59
Combined	**100**	**86**	**76**	**83**	**81**	**83**

Investments

Since inception, our primary objective for our investment portfolio has been capital preservation and liquidity. That objective remains unchanged, and is more important than ever in today's volatile and reactive markets. Driving for yield is not our focus. At the beginning of 2011 markets looked more stable than they had in some time. However, with fears of a global recession, the U.S. debt ceiling debacle and subsequent downgrade by S&P, and the European debt crisis, volatility rapidly returned to the market. The third quarter of the year, in particular, was dominated by the "risk off" trade. Following that, we have become more defensive than ever, positioning our portfolio to limit downside risk in market shocks. Nonetheless, we produced a total investment return of 1.8 per cent (2010 – 4.2 per cent) for the year. Our average annual total investment return since inception is 4.2 per cent, and we have made a positive investment return in every year since inception, including 2008.

Our portfolio mix illustrates our philosophy as shown in the table below and on page 87. With the 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.

Managed investment portfolio allocations

	2007	2008	2009	2010	2011
Cash	38.8%	19.6%	7.1%	21.9%	13.2%
Short-term	–%	8.2%	14.2%	0.5%	4.0%
Government debt	13.7%	12.3%	16.2%	22.4%	27.2%
Agency debt	11.2%	5.8%	5.6%	1.6%	4.2%
Agency MBS	12.9%	30.9%	23.8%	15.3%	13.2%
Non-agency RMBS, ABS, CMBS	0.4%	–%	–%	2.9%	5.8%
FDIC corporate bonds	–%	7.7%	9.5%	4.3%	2.5%
Corporate bonds	19.2%	15.2%	23.6%	31.1%	29.9%
Equities	3.8%	0.3%	–%	–%	–%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Given the investment portfolio's high credit quality, the U.S. downgrade did not materially impact the portfolio's overall credit quality. The U.S. treasury market continues to be a backstop for liquidity, and any further downgrades are unlikely to impact the valuation of the portfolio in any significant way. The portfolio does not have any European peripheral sovereign debt exposure. The Group does hold a small allocation of eastern European sovereign and corporate debt within the emerging market debt portfolio.

The composition, duration and asset allocation of the investment portfolio is reviewed 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, while putting our objective of capital preservation first and foremost. 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. Recent history has been tumultuous and we remain ever watchful. We will continue to monitor the economic environment closely.

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. As noted earlier, 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. Given the current global outlook and incessant volatility in the markets, this is unlikely to occur in the near future.

More detail on the practical application of this approach to liquidity is set out in the discussion of investment performance on pages 26 and 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.

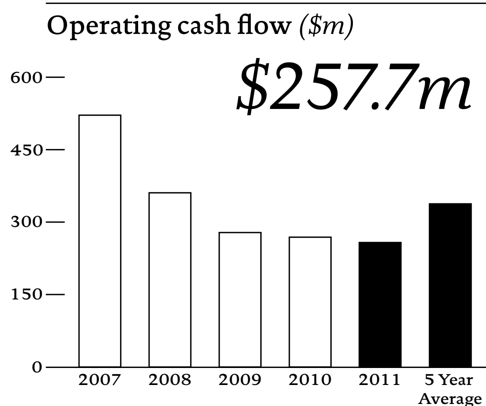
Cash flows from operating activities

In 2011, 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 $257.7 million (2010 – $268.8 million).

Cash flows from investing activities

There was a net cash outflow from investing activities in 2011 of $3.8 million (2010 – $259.2 million inflow) primarily as a result of the net purchase of fixed income and equity securities of $12.7 million (2010 – $193.0 million net sale), an investment in associate of $50.0 million (2010 – $nil) offset to a degree by interest and dividends received of $59.6 million (2010 – $66.9 million).

During 2011, the investment portfolio yielded lower cash returns than 2010 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.



Cash flows from financing activities

Financing activities resulted in a net outflow of $454.5 million (2010 – $448.1 million) as a result of dividends paid of $444.4 million (2010 – $293.2 million), settlement of share purchases of $nil (2010 – $149.5 million), interest payments made to the Group's long-term debt holders of $5.6 million (2010 – $5.4 million) and distributions from the EBT of $4.5 million (2010 – $nil).

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 actively 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. With the 2011 special dividend of $152.0 million, total capital returns since inception amount to $1.318 billion, or 134.7% of initial capital raised. 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.

As previously mentioned, the sidecar vehicle, Accordion, was launched in May 2011 with a unique capital drawdown plus a step-up feature to ensure maximum capital efficiency and return on investment. This structure allows maximum flexibility around underwriting opportunities and has worked very well for the Group and its capital management philosophy.

The composition of capital is also driven by management's appetite for leverage. In appropriate circumstances, management would be willing to modestly increase leverage. 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 three standard letter of credit facilities in the total amount of $800.0 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.

The Repurchase Program had all of the authorised maximum of 16,860,242 shares remaining to be purchased at 31 December 2011.

2011 financial performance

2011 financial highlights

- FCBVS of $7.62 (2010 – $7.57). RoE of 13.4 per cent (2010 – 23.3 per cent);
- gross premiums written of $632.3 million (2010 – $689.1 million). Net premiums written of $565.1 million (2010 – $649.9 million);
- reported loss ratio of 31.7 per cent (2010 – 27.0 per cent) and a combined ratio of 63.7 per cent (2010 – 54.4 per cent);
- accident year loss ratio of 59.3 per cent (2010 – 42.9 per cent);
- inception to date combined ratio of 57.9 per cent (2010 – 56.7 per cent);
- total investment return of 1.8 per cent (2010 – 4.2 per cent);
- net operating profit of $219.0 million (2010 – $306.5 million), or $1.23 diluted operating EPS (2010 – $1.73);
- net profit after tax of $212.2 million (2010 – $330.8 million), or $1.20 diluted earnings per share (2010 – $1.86);
- interim dividend of $9.5 million (2010 – $9.4 million) or $0.05 per common share; final dividend of approximately $19.0 million (2010 – $18.9 million) or $0.10 per common share; and
- special dividend of $152.0 million (2010 – $264.0) or $0.80 per common share (2010 – $1.40).

Financial Highlights	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m
Gross premiums written	753.1	638.1	627.8	689.1	632.3
Net premiums written	666.8	574.7	577.1	649.9	565.1
Net premiums earned	611.2	607.3	594.7	614.2	574.5
Net insurance losses	146.3	375.5	98.7	165.7	182.3
Net underwriting income	388.4	132.2	390.0	342.2	279.8
Net investment income	78.4	59.5	56.0	53.4	43.2
Net realised gains (losses) and impairments	9.1	(11.0)	23.8	33.2	8.6
Profit after tax	390.9	97.5	385.4	330.8	212.2
Change in net unrealised gains (losses) on investments	12.0	6.9	2.8	(2.2)	(10.6)
Comprehensive income	402.9	104.4	388.2	328.6	201.6
Diluted earnings per share	$1.91	$0.53	$2.05	$1.86	$1.20
Return on equity	31.4%	7.8%	26.5%	23.3%	13.4%
Net loss ratio	23.9%	61.8%	16.6%	27.0%	31.7%
Net acquisition cost ratio	12.5%	16.4%	17.8%	17.3%	19.6%
Expense ratio	9.9%	8.1%	10.2%	10.1%	12.4%
Combined ratio	46.3%	86.3%	44.6%	54.4%	63.7%
Net total return on investments	6.2%	3.1%	3.9%	4.2%	1.8%

Gross Premiums Written	2010 $m	2011 $m	Change $m	Change %
Property	323.6	279.8	(43.8)	(13.5%)
Energy	238.3	229.0	(9.3)	(3.9%)
Marine	76.4	76.4	–	–%
Aviation	50.8	47.1	(3.7)	(7.3%)
Total	**689.1**	**632.3**	**(56.8)**	**(8.2%)**

Underwriting results

Gross premiums written decreased by 8.2 per cent compared to 2010. The Group's four principal classes, and the key market factors impacting them, are discussed below.

Property gross premiums written decreased by 13.5 per cent for the year ended 31 December 2011 compared to the year ended 31 December 2010. Premiums for the year remain behind the prior year mostly due to the impact of multi-year deals not up for renewal yet, offset to a degree by new business in Property Catastrophe and Retrocession. While the Property Retrocession book was significantly reduced in the first quarter of 2011, relative to the first quarter of 2010, the remainder of the year brought substantially improved trading conditions following the accumulation of industry losses with a number of new deals written, a portion of which were ceded to the sidecar vehicle, Accordion. 2011 also included $7.0 million of reinstatement premiums compared to $14.2 million in 2010. In Terrorism and Political Risk there was an overall reduction for the year. New business volumes this year were lower in these classes and long-term deals written in previous years were not up for renewal yet. Otherwise, the pressure on Property Direct and Facultative pricing abated somewhat. While volumes are behind the prior year, the reduction is less than had been anticipated at the beginning of the year.

Energy gross premiums written decreased by 3.9 per cent for the year ended 31 December 2011 compared to the year ended 31 December 2010. Pricing has remained positive in the offshore sectors following the 2010 Deepwater Horizon loss and the 2011 storm damage to a Floating Production Storage and Offloading (FPSO) vessel stationed in the North Sea Gryphon field. Overall, Energy premiums written are broadly flat year on year. Worldwide offshore premium, however, increased due to rate and exposure increases. Conversely, Gulf of Mexico premiums decreased, primarily due to long-term contracts amounting to $33.4 million written in 2010 and not currently up for renewal. Offsetting this to some extent, the Gulf of Mexico book continued to see strong new business flow in 2011, with some business again written on a multi-year basis.

Marine gross premiums written were flat for the year ended 31 December 2011 compared to the year ended 31 December 2010. Pricing and renewal rates have been broadly stable. Reductions due to multi-year deals written in the prior year that are not currently up for renewal were offset by a few opportunistic Marine Retrocession deals in the post Deepwater Horizon market in the second quarter.

Aviation gross premiums written decreased 7.3 per cent for the year ended 31 December 2011, compared to the year ended 31 December 2010. The reduction was driven by further competition in this market (in its primary renewal period in the fourth quarter) but also by increased retained limits in the main hull and liability programs for the AV52 peril, which reduced the exposures which we write.

Ceded reinsurance premiums increased by $28.0 million, or 71.4 per cent, for the year ended 31 December 2011 compared to the year ended 31 December 2010. This year included reinstatement premiums following the recent flood losses in Thailand, plus $12.2 million of cessions from the Property Retrocession book to the Accordion sidecar facility, as well as an opportunistic catastrophe cover and additional reinsurance cover purchased given the favourable rates available in early 2011. Rate increases on our outwards Marine and Energy reinsurance program following the Deepwater Horizon loss, together with reinstatement premiums on Energy losses, were largely offset by reductions across the remainder of our program.

Net premiums earned as a proportion of net premiums written were 101.7 per cent for the year ended 31 December 2011, compared to 94.5 per cent for the year ended 31 December 2010. The higher value of multi-year deals in 2010 compared to 2011 results in a lag in premium earnings into 2011.

The Group's net loss ratio was 31.7 per cent for the year ended 31 December 2011 compared to 27.0 per cent for the year ended 31 December 2010. 2011 includes total estimated net losses, after reinsurance and reinstatement premiums, of $117.3 million in relation to the Tohoku earthquake, $21.2 million in relation to the Christchurch Lyttleton earthquakes, $52.5 million in relation to the Gryphon loss and $25.1 million in relation to the Thailand floods. The Group has immaterial losses in relation to the U.S. tornadoes and the June New Zealand earthquake. 2010 includes the impact of the Chilean earthquake of $84.7 million plus a net claim on the Deepwater Horizon loss of $25.0 million. Absent these losses, the net loss ratios would have been negative 2.4 per cent for 2011 and positive 7.2 per cent for 2010. The Group has no direct exposure to the floods in Thailand from the Japanese treaty products, including Japanese Interests Abroad. Assessment of exposure to this event is ongoing and uncertainty remains on the ultimate loss. Significant uncertainty continues to exist on the eventual ultimate market loss in relation to these events.

Net prior year reserve releases were $155.3 million for the year ended 31 December 2011 compared to $100.1 million for the year ended 31 December 2010, reducing the net loss ratio by 27.0 points for 2011 and 16.3 points for 2010. In early 2011 an independent external reserve study was commissioned in order to incorporate the Group's own loss experience with industry factors previously used. On completion, net reserves of $36.9 million were released. The remaining favourable prior year development in 2011 arose from releases due to fewer than expected reported losses, plus some further information on outstanding case reserves.

Loss development by class	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m
Property	(1.8)	22.3	44.4	28.8	63.5
Energy	5.0	5.5	9.3	47.6	57.3
Marine	1.3	–	6.1	17.7	28.6
Aviation	(0.1)	0.8	3.7	6.0	5.9
Total	**4.4**	**28.6**	**63.5**	**100.1**	**155.3**

Note: Positive numbers denote favourable development

Loss Triangles

Accident year	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m
Estimate of ultimate liability[1]					
At end of accident year	151.2	403.9	161.7	263.6	340.8
One year later	125.0	370.3	106.5	185.8	
Two years later	99.5	334.4	72.4		
Three years later	91.3	304.2			
Four years later	80.2				
As at 31 December 2011	**80.2**	**304.2**	**72.4**	**185.8**	**340.8**
Payments made	(69.3)	(250.5)	(42.0)	(88.9)	(33.9)
Total net liability	**10.9**	**53.7**	**30.4**	**96.9**	**306.9**
Accident year loss ratio[1]	13.1%	50.1%	12.2%	30.3%	59.3%
Initial accident year loss ratio	24.7%	66.5%	27.2%	42.9%	n/a
Change in loss ratio post accident year	(11.6%)	(16.4%)	(15.0%)	(12.6%)	n/a

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2011

The accident year loss ratio for the year ended 31 December 2011, including the impact of foreign exchange revaluations, was 59.3 per cent compared to 42.9 per cent for the year ended 31 December 2010. The 2011 accident year loss ratio for the year ended 31 December 2011 included:

- 20.6 per cent for the Tohoku earthquake;
- 8.7 per cent for the Gryphon loss;
- 4.0 per cent for the Christchurch Lyttleton earthquake; and
- 3.9 per cent for the flooding in Thailand.

The 2010 accident year loss ratio for the year ended 31 December 2010 included:

- 15.2 per cent for the Chilean earthquake; and
- 4.5 per cent for Deepwater Horizon.

Otherwise, both years experienced relatively low levels of reported losses.

Excluding the impact of foreign exchange revaluations, previous accident years' ultimate losses developed as follows during 2011:

- 2006 – favourable development of $2.9 million (2010 – $0.3 million);
- 2007 – favourable development of $11.1 million (2010 – $8.3 million);
- 2008 – favourable development of $29.8 million (2010 – $36.0 million);
- 2009 – favourable development of $33.7 million (2010 – $55.5 million); and
- 2010 – favourable development of $77.8 million (2010 – n/a).

The ratio of IBNR to total reserves was 33.5 per cent at 31 December 2011 compared to 40.6 per cent at 31 December 2010.

33.5%

2011 ratio of IBNR to total reserves

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 2011, the managed portfolio comprised 86.8 per cent fixed income securities and 13.2 per cent cash and cash equivalents compared to 78.1 per cent fixed income securities and 21.9 per cent cash and cash equivalents at 31 December 2010. The Group is not currently invested in equities, hedge funds or other alternative investments.

Net investment income, excluding realised and unrealised gains and losses, was $43.2 million for the year ended 31 December 2011 compared to $53.4 million for the prior year, a decrease of $10.2 million, reflecting the lower yield environment.

Total investment return, including net investment income, net realised gains and losses, impairments and net change in unrealised gains and losses, was $40.7 million for the year ended 31 December 2011, compared to $84.5 million for the year ended 31 December 2010. Returns for the year were lower than 2010 due to the following impacts:

- reduced investment portfolio duration;
- a lower yield environment and the volatility in the financial markets;
- realised losses on the liquidation of the Group's equity portfolio offset to a degree by realised gains on the liquidation of the Group's Treasury Inflation-Protected Securities ("TIPS") portfolio; and
- foreign exchange losses from the investment portfolio of $6.0 million (2010 – $0.8 million gain) for the year.

As the Group continued to maintain a strong emphasis on capital preservation and liquidity, the portfolio was more defensively positioned towards the end of the third quarter with the liquidation of the equity portfolio and a reduction in emerging market debt local currency positions.

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

$1.455bn

2011 total capital

The Group continues to hold an emerging market debt portfolio given the future growth expectations for those regions. At 31 December 2011, 6.3 per cent of the portfolio was allocated to emerging markets with an overall average credit quality of BBB compared to 6.8 per cent and an overall credit quality of BBB– at 31 December 2010. The Group has no exposure to European peripheral sovereign debt. Exposure to European peripheral corporate debt is less than $5.0 million, consisting of Spanish and Italian non-financial corporate debt. The corporate bond allocation, excluding FDIC guaranteed bonds, represented 29.9 per cent of managed invested assets at 31 December 2011 compared to 31.1 per cent at 31 December 2010.

Key investment portfolio statistics	2007	2008	2009	2010	2011
Duration	1.4 years	1.8 years	2.3 years	2.2 years	1.8 years
Credit quality	AA+	AA+	AA+	AA	AA–
Book yield	5.0%	3.4%	2.8%	2.4%	1.9%
Market yield	4.7%	2.7%	2.2%	1.9%	1.5%

Other operating expenses

Other operating expenses, excluding employee remuneration, are broadly consistent compared to 2010, reflecting the Group's stable operating platform. Excluding a reduction of $6.7 million for the prior year in relation to the final determination of the previous year's variable compensation and equity based compensation, total employment costs were $40.8 million for the year ended 31 December 2011 compared to $39.9 million for the year ended 31 December 2010.

Equity based compensation was $18.8 million for the year ended 31 December 2011 and $21.1 million for the year ended 31 December 2010. During 2011 there was an adjustment of $5.6 million to the estimated fair value of our existing RSS plan across all years, reflecting some minor revisions to underlying assumptions. Absent this adjustment the 2011 expense reflects the maturing restricted share awards program, plus an increase in vesting assumptions given the Group's 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 and shares typically vest after a two or three year period.

Capital

At 31 December 2011, total capital was $1.455 billion, comprising shareholders' equity of $1.327 billion and $128.0 million of long-term debt. Leverage was 8.8 per cent. Total capital at 31 December 2010 was $1.416 billion.

Non pre-emptive issue of shares

As part of Lancashire's flexible approach to capital management the Board has requested and received authority to issue up to 10 per cent of its shares on a non pre-emptive basis. This request had been defeated in a vote at the May 2011 AGM, but was carried with strong support in a vote put to shareholders at an SGM in August 2011. Lancashire believes that this ability to raise capital quickly is important in securing first mover advantage in the catastrophe insurance and reinsurance business which it underwrites. The Board proposes to put a similar request for authority to shareholders in a resolution at the 2012 Annual General Meeting to be held on 3 May 2012.

Repurchase program

No shares were repurchased during the year ended 31 December 2011 compared to $136.4 million of shares repurchased during the year ended 31 December 2010. The Group's current authorised share Repurchase Program permits a maximum of 16,860,242 remaining shares to be repurchased.

The Board will be proposing at the 2012 Annual General Meeting, to be held on 3 May 2012, that the shareholders approve a renewal of the Repurchase Program with such authority to expire on the conclusion of the 2013 Annual General Meeting or, if earlier, 15 months from the date the resolution approving the Repurchase Program is passed.

Dividends

During 2011 the Lancashire Board declared an interim and special dividend of $0.05 and $0.80 per common share respectively.

A final dividend of $0.10 per common share has been declared and will be paid to the shareholders of record on 16 March 2012.

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 returns on equity.

Risk management

"ERM is embedded within our business culture. BLAST is Lancashire's internal capital model and has been used since the inception of the Lancashire Group."

Mike Pearson – Chief Risk Officer

Enterprise risk management

One of our three strategic priorities is to "effectively balance risk and return" which means that ERM is at the heart of all of the key business decisions we make. Our key strengths are that ERM is embedded within our business culture, supported by a robust ERM governance framework, and the business has the right tools for the job at its disposal – the most significant being our internal capital model "BLAST".

"Protecting our capital and providing our investors with a superior risk adjusted return over the long term are constants."

The ERM governance framework

Each operating entity has a Risk Committee that meets quarterly and reports its activities to the respective Operating Entity Board which, in turn, reports to the Group Board. Both the Group and Operating Entity Boards retain responsibility for ERM. The Group Board also operates a Risk Forum where, by rotation, all Directors and subject matter experts from the business apply a "blue sky" approach to risk identification, evaluation, quantification and management, including the identification of emerging risks. Comprehensive risk management metrics are provided at each stage of these processes.

Internal Audit provides independent feedback and assurance regarding the effectiveness, accuracy, completeness and status of individual risks and controls within the business, their consistency with the risk registers and day-to-day processes and procedures.

Sources of risk

Lancashire manages risks that can arise from a number of different sources, insurance risk being the most significant. These risks have been defined within six categories: insurance, market, liquidity, credit, operational and strategic. The risk disclosures section of the consolidated financial statements provides further details and explanation of how we define and report these risk categories on pages 77 to 102.

Our key ERM objectives

- to manage volatility to enable a cross cycle total return of the risk-free rate plus 13%;
- to consider, evaluate and then balance risk and return in all important business decisions thereby optimising risk adjusted RoE; and
- to provide the business with the framework and tools that it needs to make informed risk and return decisions.

Our three core ERM principles

- **Establish and keep under review a risk appetite that is aligned with our business objectives**. The Group Board of Directors has established, and keeps under review, a risk appetite in respect of each of our risk categories. 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.
- **Operate within appropriate risk tolerances**. The Group and Operating Entity Boards of Directors have established, and keep under review, detailed risk tolerances that are consistent with their risk appetite and influenced strongly by the results of our assessment of the risk reward trade-off in all key decisions. Tolerances are monitored regularly and enforced rigorously.

- **Risk ownership.** All key risks and compensating controls are stated within the Group and Operating Entities' risk registers, and are assigned to an individual responsible for managing them in accordance with our risk appetite and risk tolerance. They are also responsible for ensuring that the risk is represented accurately within the inputs to our internal capital model. Every quarter the business completes an affirmation exercise whereby all control operators and risk owners are required, amongst other things, to review and verify the existence and status of key controls and the accuracy and completeness of risks. This process is coordinated by the CRO and the results are reported to senior management.

Our primary risk management tool: BLAST

BLAST is Lancashire's internal capital model. It has been used since inception of the Lancashire Group in late 2005. We continue to develop and refine it to this day, as it matures with our business. It is an integral part of our decision making processes across all areas of the business from Board level to individual underwriting decisions.

BLAST incorporates all of the risk groups within Lancashire's operations and risk profile. It is a single integrated Group model that considers all material risks and produces results for Lancashire's Insurance Subsidiaries as well as the Group. It explicitly models the interaction between each of the Lancashire companies and correlations between classes of business within the Group.

The BLAST framework comprises an internally developed ReMetrica simulation model as the calculation kernel along with our internally developed SHARP aggregation tool and RMS catastrophe modeling software.

How do we use BLAST?

BLAST is used widely within the business. Some of its key uses are:

- ensuring that capital levels are adequate and commensurate with the risk profile of the business;
- internal and regulatory capital planning and management;
- capital allocation and analysis of RoE by class of business;
- portfolio optimisation;
- modeling of elemental catastrophe insurance and reinsurance;
- modeling of non elemental exposures based upon realistic disaster scenarios;
- monitoring insurance risk levels versus tolerances;
- modeling and analysis of the outwards reinsurance program; and
- stress and scenario testing.

Corporate responsibility

33 The Lancashire Foundation
33 Lancashire and the environment
34 Doing it for the kids
35 Breaking the barriers to medical care
36 Making a difference in a day
36 International Care Ministries
37 Putting our people first

"Being part of the Lancashire Group is like belonging to one big family. We look out for one another within, and want to help people outside the Company too. We are driven by compassion and a sense of responsibility to help those less fortunate than ourselves around the world."

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

Our commitment to helping others isn't just words on a page. It's part of who we are. That's why we do more than donate. We also roll up our sleeves and go to work in the places people need us most.

The Lancashire Foundation

At the Lancashire Group, our success is built on strong relationships with our people, clients and stakeholders. However many communities do not benefit from the success our relationships have created. War, famine, natural disaster, disease, endemic poverty and a lack of opportunity are powerful inhibitors to development worldwide. It's natural for us to want to show our commitment to do what we can to change this. That's why we established the Lancashire Foundation as the cornerstone to these commitments. The Foundation aims to:

- give something back, for example we support Médecins Sans Frontières because it is an excellent charity that works in catastrophe torn zones. As our business is in part offering insurance against catastrophe, giving back to those areas is very important to us;
- improve the lives and prospects of those less fortunate than ourselves;
- promote awareness among our staff by giving them opportunities to donate to causes they feel close to, and to participate personally in helping those who need our support;
- give our people enriching and challenging experiences that help them learn about the lives of other communities and our wider corporate responsibilities; and
- ensure we meet our corporate social responsibilities, in accordance with principles of good corporate governance.

Comprising members of staff and Board Directors, the Lancashire Foundation's Donation Committee guides the Lancashire Foundation's efforts. We support many charities that are local to our offices in Bermuda and the U.K. Our major drive is in supporting worldwide relief efforts and charities at the forefront in providing humanitarian assistance, empowering communities, supporting sustainable enterprise, and promoting social cohesion and increased opportunities.

Lancashire supports a range of charities in a variety of ways. The following pages outline just some of the key relationships we have with a number of deserving causes.

Lancashire and the environment

Our team is encouraged to recycle and save energy wherever they can, and we have a number of initiatives in place, which include:

- Energy – switching off all electrical appliances and lights, also our computers at the end of each working day and using power saving options.
- Paper – discouraging printing, using recycled or environmentally friendly paper when we have to print, printing double sided and keeping shredders and photocopiers side by side.
- Carbon Footprint – video-conferencing as an alternative to air travel when feasible, measuring and monitoring our carbon footprint: and working with Carbon Clear to offset the carbon for flights, electricity, taxis and gas consumption. This year we have chosen to offset our carbon emissions with Carbon Clear by making charitable donations towards two different emission reduction projects based in China and Thailand, using standards that meet the ICROA Code of Best Practice.

Our total carbon dioxide footprint calculated between 1 October 2010 and 30 September 2011 was 1,186 CO_2 tonnes. This figure takes into account the energy emissions from our business travel across the Group, as well as energy use within our offices.

"Our major drive is in supporting worldwide relief efforts and charities at the forefront in providing humanitarian assistance, empowering communities, supporting sustainable enterprise, and promoting social cohesion and increased opportunities."

Doing it for the kids

Founded in 1996 by Camila Batmanghelidjh, Kids Company supports over 17,000 marginalised and excluded children and young people every year in London.

An amazing charity, led by an amazing lady

It's estimated that over 1.5 million children in the U.K. suffer from violence, abuse and neglect*. They are some of the most vulnerable children in society today. So many feel alone and unsupported and around 97 per cent of children come to Kids Company without adult help or knowledge. From there, Kids Company does all it can to help turn their lives around, delivering services at two drop-in centres, a post-16 educational academy, an early intervention therapy centre, and across 40 inner-city schools.

Bringing colour to children's lives

Kids Company focuses on the arts to help develop children's communication, self-esteem and skills. Some of the U.K.'s most important galleries, such as Tate Modern, The Royal Academy of Arts and the Saatchi gallery, have recognised the children's talents by housing their work. Eminent artists and designers, including Damien Hirst, Stella McCartney and Nina Campbell, have also worked with the children to raise funds.

How Lancashire Group helped Kids Company in 2011

In addition to our main donation which is not hypothecated, Lancashire made a specific donation to help bridge a shortfall of Christmas presents for young boys who would otherwise have received no gift at Christmas. Lancashire staff involvement with the charity includes regular liaison and plans to help decorate children's bedrooms. Lancashire is looking to initiate an internship scheme with Kids Company starting with a client from Sierra Leone who has had a tough start in life and who has now achieved a degree, and build from there.

* (Cawson (2002), Child Maltreatment in the Family: The Experience of a National Sample of Young People, NSPCC.)

"I have been deeply touched by the generosity of Lancashire Group and its commitment to help with the challenges faced by thousands of vulnerable and incredibly courageous children. This act of kindness will have a profound and positive impact on those for whom the future is a frightening and uncertain place."

Camila Batmanghelidjh, Founder and Director of Kids Company

Breaking the barriers to medical care

MSF is an independent humanitarian organisation that provides medical aid where it's most needed, regardless of race, religion, politics or gender.

The organisation delivers emergency aid in more than 60 countries to those affected by armed conflict, epidemics, natural and man-made disasters, and exclusion from healthcare. During emergencies and their aftermath, MSF rehabilitates and runs hospitals and clinics, performs surgery, battles epidemics, performs vaccination campaigns, operates feeding centres for malnourished children, and offers mental healthcare.

Helping without fear or favour

As an independent organisation, MSF is neutral, impartial and guided only by medical ethics. This means MSF offers help to all who need it, irrespective of their race, religion, gender or political affiliation. To do this, MSF strives for the power to freely evaluate medical needs, access populations, and directly control the aid it provides.

How Lancashire Group helped MSF in 2011

MSF is at the heart of our charitable efforts, particularly because much of our business is connected to insuring against catastrophes. In 2011 we donated funds for MSF to use in emergencies which assisted them in reacting rapidly in times of crises in countries like Libya, Somalia, Turkey, Japan and Haiti to name just a few. Additional support was given for specific emergencies as the needs arose.

"Lancashire Insurance is MSF U.K.'s largest corporate supporter both in terms of donations and employee support. We are incredibly grateful to everyone at Lancashire for their continued assistance throughout 2011, which has helped ensure our independence, impartiality and ability to react rapidly in times of crisis. Lancashire employees have shown huge compassion in supporting specific emergencies, including the conflict in the Ivory Coast in May and the crisis in Somalia, which has been particularly critical since July. Thank you to everyone at Lancashire for enabling us to treat those patients most in need and save lives throughout 2011."

Josie Emslie, Major Gifts Manager, Médecins Sans Frontières, UK

Making a difference in a day

London

We encourage our staff and senior management to identify a preferred cause from selected charities and then to donate a day to helping them. In 2011, we saw our people give their time and efforts to supporting the elderly, children's education, the environment and animal welfare. We hosted a tea party for Age Concern. Members of staff have visited residents since, to serve a Christmas lunch, take flowers and chat to the residents. They also collected money and presents from friends and colleagues for Christmas gifts and hampers. For school children we assisted Getting Ahead on a mentoring day, we built rabbit hutches for Vauxhall City Farm, and assisted in the Thames 21 project to clean up the Thames.

Bermuda

For two months, staff of the Bermuda office provided breakfast every school day to the pupils of the Victor Scott Primary school – working with the Coalition for the Protection of Children. Staff also agreed to forego their Christmas gifts to raise funds to purchase thousands of dollars worth of food hampers that were packed by employees and donated to the Department of Family Services.

Towards the end of 2011, the Foundation provided monetary support to the Sandys 360 Foundation, a Bermuda registered charity which provides a community-gathering place for young people and prepares them for life beyond school.

"Lancashire staff have done a superb job. The entire Family Services Team are extremely thankful and delighted to be a part of this exciting partnership."

Foster care coordinator at the Department of Child and Family Services, **Selena Simons** (pictured, 5th from the right).

International Care Ministries

Lancashire has supported ICM with both monetary donations and physical assistance on the ground.

How Lancashire helped ICM in 2011 – Project Transform

In November, a team from Lancashire travelled again to the Philippines to work with International Care Ministries, a Hong Kong based charity helping people in Filipino slums. The goal of Project Transform is to bring permanent change to the lives of those living in poverty. The team worked with the community on a house-building project, and helped at a malnourished children's feeding programme and at pre-school centres.

It was a life changing experience but a thoroughly enjoyable and rewarding challenge.

Going the extra mile

Before and after the trip to the Philippines, clothes were collected from friends and colleagues for the children living in the slums. Staff have initiated their own fund raising to provide schooling, clothes, food and outings for the children. Already the 2012 trip to the Philippines is being planned.

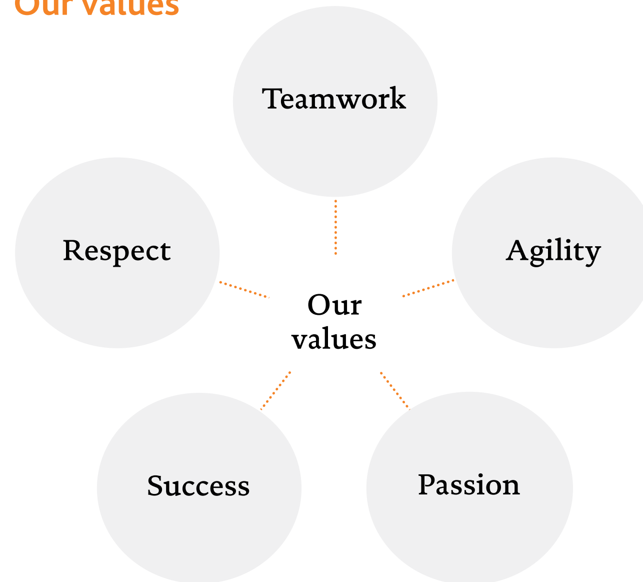
"The Lancashire Group faithfully returned to the slums of the Philippines again this year. They inspired laughter in each community they visited and certainly left a mark on each of the ICM staff they spent time with. It's refreshing to know we are not alone in the fight against poverty in the Philippines and having the Lancashire team visits seems to refresh us all to keep going."

Peter Fry, Travel Manager, ICM Hong Kong

Putting our people first

Every company says it, but we truly believe that the talents of our people set us apart from our competitors. We strive to attract and retain the very best employees in the insurance industry. Lancashire devotes time and attention to delivering an effective recruitment process. Once on board, we encourage employees to stretch themselves and perform to the highest standards. While expectations are high, we manage and support our people to meet both our business requirements and develop their own skills in a supportive environment.

Our values



Rewarding our employees

Our staff receive a wide range of quality benefits, including competitive salaries and bonuses, pensions, private healthcare and contributions to gym memberships. Employees share in our success by giving staff the opportunity to become shareholders in Lancashire through our RSS Awards.

We are committed to being an Equal Opportunities employer and ensuring there is no discrimination on the grounds of race, age, sex, sexual orientation, or any other status.

Developing our middle management teams

Our people are vital to Lancashire's continuing success. During 2011, we explored ways of developing the performance and potential of our managers. To help them achieve their goals, we invested significantly in a management development programme. Some were sceptical to begin with, but are now fully on-board and committed to the programme as feedback on the programme's delivery has been very positive.

"I must admit that at the outset I was a bit cynical, even just from doing the questionnaires – but as soon as I had my first induction I realised this thing had legs! I think it's fair to say that throughout the sessions we all learned something and it changed our perceptions. And it was good for internal department networking. Bring on the next module."

Hayley Johnston, Deputy Chief Underwriting Officer

39 The Board
40 Directors' report
46 Corporate governance
52 Directors' remuneration report
63 Statement of Directors' Responsibilities

"Lancashire's excellent track record is underpinned by strong risk management and respect for corporate governance. The ability to move quickly when new opportunities present themselves needs very disciplined and clear decision-making leadership. Nimbleness does not mean we cut corners on corporate governance."

Greg Lunn – Group General Counsel

The Board

Non-Executive Directors

Martin Thomas *(age 48), Non-Executive Chairman*
Martin Thomas is a partner and board member of Altima Partners, LLP, the hedge fund manager, and a director of two significant farming businesses. Prior to this, he was an official at the Bank of England and was previously Deputy Chief Executive of the Financial Law Panel. He started his career in private practice at Travers Smith and Clifford Chance. ● ●

John Bishop *(age 66), Non-Executive Director*
John Bishop is an actuary with broad experience in the insurance sector. He is currently a non-executive director of Berkshire Hathaway International and Houston Capital Corporation International. Mr Bishop has previously worked at the Euler Group and Eagle Star Insurance Company Ltd. ● ● ●

Emma Duncan *(age 52), Non-Executive Director*
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. Ms. Duncan has an honours degree in politics, philosophy and economics from Oxford University. ● ● ●

Ralf Oelssner *(age 67), Senior Independent Non-Executive Director*
Ralf Oelssner was Vice President of corporate insurance for Lufthansa German Airlines until 31 October 2007. In 1979, he was appointed Director of corporate insurance, and in 1990 was appointed Managing Director of Lufthansa's in-house broker. He is President of the German Risk Managers' Association and holds an M.A. in Economics from Cologne University. ● ● ● ● ●

Robert Spass *(age 55), Non-Executive Director*
Robert Spass is a founding partner of Capital Z Partners, an investment firm he joined on its formation in 1998. Mr Spass previously held similar positions at Insurance Partners, L.P. and International Insurance Advisors L.P. He currently serves on the board of Universal American Financial Corp., Endurance Specialty Holdings, Ltd. and other privately-held companies. ● ● ●

William Spiegel *(age 49), Non-Executive Director*
William Spiegel is a founding partner of Pine Brook Road Partners, LLC, a private equity firm specialising in energy and financial services investing. Mr Spiegel has worked in the private equity industry since 1990. He 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. ● ● ● ●

Executive Directors

Richard Brindle *(age 49), Chief Executive Officer*
Richard Brindle was the driving force behind the establishment of Lancashire in late 2005. Prior to this Mr Brindle was a non-executive member of the Ascot Underwriting Agency Board from 2001 until September 2005. Mr Brindle started his career in 1984 working at Posgate and Denby Managing Agency and as a Director of Charman Underwriting Agencies. ● ● ●

Alex Maloney *(age 38), Chief Underwriting Officer*
Alex Maloney joined Lancashire in December 2005 and now leads the Group's underwriting operations. Mr Maloney built the energy business and team for the Lancashire Group after joining from Zurich Insurance where he spent 15 years. He assisted in establishing Zurich Global Energy's presence in the Bermuda Insurance market, and has significant experience in the London Market. ● ●

Neil McConachie *(age 39), President*
Neil McConachie joined Lancashire in February 2006 and serves as Group President. Mr McConachie was previously Senior Vice President, Treasurer and Chief Accounting Officer of Montpelier Re Holdings Ltd. Prior to joining Montpelier he worked for PricewaterhouseCoopers and at Stockton Holdings Limited. 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
Greg Lunn joined Lancashire in March 2006. He is responsible for all legal affairs for the Group. Prior to joining Lancashire, Mr Lunn was employed with the ACE Group of Companies. He 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.

Key

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

Directors' report

Overview of the Group

Lancashire Holdings Limited ("the Company") is a Bermuda incorporated company with operating subsidiaries in Bermuda and London. 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 London Stock Exchange on 16 March 2009. The shares have been included in the FTSE 250 index since 22 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

For the year ended 31 December 2011, the following dividends were declared:

- an interim dividend of $0.05 per common share and warrant was declared on 26 July 2011 and paid on 28 September 2011 in pounds sterling at the pound/U.S. dollar exchange rate of 1.6319 or £0.0306 per common share and warrant;
- a special dividend of $0.80 per common share and warrant was declared on 3 November 2011 and paid on 21 December 2011 in pounds sterling at the pound/U.S. dollar exchange rate of 1.5489 or £0.5165 per common share and warrant; and
- a final dividend of $0.10 per common share and warrant was declared on 22 February 2012 to be paid on 18 April 2012 in pounds sterling at the pound/U.S. dollar exchange rate on the record date of 16 March 2012 or approximately £0.0633 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 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 (Senior Independent Non-Executive 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 2011 and 2010 including interests held by family members were as follows:

Director	Common shares held at 31 December 2011	Common shares held at 31 December 2010
John Bishop	4,807	4,807
Richard Brindle[(1)]	724,600	368,800
Emma Duncan	–	–
Alex Maloney[(2)]	157,828	73,613
Neil McConachie[(3)]	–	261,342
Ralf Oelssner	–	–
Robert Spass[(4)]	–	–
William Spiegel	–	–
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 2011:

- 20 May – exercise of 358,453 RSS awards and related sale of 74,529 resultant shares to cover tax liabilities;
- 30 June – cashless exercise of 37,500 options, realising 27,438 shares and related sale of 5,362 resultant shares to cover tax liabilities; and
- 30 June – purchase of 49,800 shares at an average price of £6.28 costing £312,610.

(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 2011:

- 1 June – exercise of 75,227 RSS awards and related sale of 39,197 resultant shares to cover tax liabilities; and
- 30 June – cashless exercise of 137,500 options, realising 100,605 shares and related sale of 52,420 resultant shares to cover tax liabilities.

(3) Neil McConachie conducted the following transactions in the Company's shares during 2011:

- 22 February – sold 50,000 shares at an average price of £6.01 realising £300,500;
- 22 February – cashless exercise of 100,000 time vesting warrants, realising 47,257 shares;
- 30 June – exercise of 100,598 RSS awards and related sale of 2,017 resultant shares to cover tax liabilities;
- 30 June – purchase of 25,217 shares at an average price of £6.19 costing £156,087;
- 10 August – purchase of 50,734 shares at an average price of £6.20 costing £314,551;
- 19 August – purchase of 37,500 shares at an average price of £6.24 costing £234,000;
- 12 September – purchase of 50,000 shares at an average price of £6.30 costing £315,000;
- 4 November – sold 100,000 shares at an average price of £7.32 realising £732,000;
- 7 November – sold 150,000 shares at an average price of £7.50 realising £1,125,000;
- 8 November – sold 80,000 shares at an average price of £7.72 realising £617,600;
- 9 November – sold 130,631 shares at an average price of £7.61 realising £994,233;
- 10 November – sold 60,000 shares at an average price of £7.58 realising £454,800;
- 14 November – cashless exercise of 170,869 time vesting warrants and 185,492 performance warrants, realising 246,406 shares;
- 17 November – sold 40,000 shares at an average price of £7.75 realising £310,000;

- 24 November – sold 35,000 shares at an average price of £6.99 realising £244,650;
- 25 November – sold 100,000 shares at an average price of £6.84 realising £684,000;
- 28 November – sold 71,406 shares at an average price of £6.97 realising £497,700 and cashless exercise of 50,000 options, realising 41,640 shares;
- 1 December – sold 10,000 shares at an average price of £7.29 realising £72,900; and
- 2 December – sold 31,640 shares at an average price of £7.34 realising £232,238.

Neil McConachie exercised and sold all of his Shares, Warrants and LTIPs and exercised and sold a number of his RSS awards during the latter half of 2011 following his decision to relocate back to the UK after several years in Bermuda. Neil expects to move back to the UK in early 2012 and the sales were for tax mitigation purposes.

(4) Robert Spass – 25 February – cashless exercise of 465,000 Founder warrants resulting in the acquisition of 227,052 shares and subsequent sale at a price of $9.52 realising $2,161,535.

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 owns 6,367,181 ordinary and performance warrants and 46,260 Founder warrants and Robert Spass is the beneficial owner of 1,084,135 Founder warrants.

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

Transaction in own shares

During 2011 the Company did not repurchase any of its own common shares.

Between 19 January 2010 and 16 September 2010 the Company repurchased 18,509,239 of its common shares for a total consideration of approximately $136.4 million.

The Group's current repurchase program had 16,860,242 common shares remaining to be purchased at 31 December 2011 (approximately $189.5 million at the 31 December 2011 share price). Further details of the share repurchase authority and program are set out in note 22 to the consolidated financial statements on page 125.

Directors' remuneration

Details of the Directors' remuneration are set out in the Directors' Remuneration Report on pages 52 to 62.

Substantial shareholders

As at 22 February 2012 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 22 February 2012	% of shares in issue
Legal & General Group Plc	10,147,077	6.4%
BlackRock, Inc.	9,889,764	6.3%
William Blair & Company, LLC	8,369,891	5.3%
Standard Life Investments Ltd	8,121,525	5.1%
Alken Luxembourg Sàrl	7,043,075	4.5%
Franklin Mutual Advisers, LLC	6,534,160	4.1%

Corporate governance – compliance statement

The Company's compliance with the Code is summarised in the Corporate Governance section of this report on pages 46 to 51. It is to be noted that awards made previously under the Company's LTIP and warrant schemes do not wholly comply with the provisions of Schedule A of the Code (principle D.1.1 of the Code) as more fully described in the Company's 2009 Prospectus relating to Admission to the Official List and to trading on the LSE. Awards under the current RSS, which was adopted in 2008, are compliant with the Code. In the 2010 annual report, the Company advised that the Board had decided not to comply with the principle of the annual re-election of all Directors. Following further consideration of this matter, the Board determined in November 2011 that, subject to the approval by shareholders at the 2012 AGM of the requisite changes to the Company's Bye-laws, all Directors will stand for re-election at the 2012 AGM and in future years (see pages 47 and 56 for further details). Subject to these areas of non-compliance the Company confirms, in accordance with the principle of 'comply or explain', that there are no areas of material non-compliance with the Code.

Donations

In November 2010 the Board of Directors approved a cash donation of $1,250,000 (2010 – $1,100,000) to the Lancashire Foundation, payable in respect of 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.

A summary of the work of the Lancashire Foundation during 2011 can be found in the Corporate Responsibility section on pages 33 to 36.

The Group did not make any political donations or expenditure during 2011.

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 and the UK.

Employees

Lancashire is an equal opportunity employer, and does not tolerate unfair discrimination of any kind in any area of employment or corporate life. 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 staff 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 section on pages 77 to 102 of the consolidated financial statements. The Group's use of derivative financial instruments can be found on pages 90 to 94.

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.

Annual and Special General Meetings

At the 2011 AGM held on 5 May 2011 the shareholders approved resolutions to receive the audited consolidated financial statements for the year ended 31 December 2010, to approve the Directors' Remuneration Report for the year ended 31 December 2010, to re-appoint Ernst & Young LLP as auditors, to elect Emma Duncan and Alex Maloney, and to re-elect Richard Brindle and Robert Spass, as Directors of the Company, to grant the Company a general and unconditional authority to allot and issue shares and a special resolution to authorise a repurchase program pursuant to which the Company may repurchase its own shares by way of market purchases up to a maximum of 16,860,242 common shares to expire at the conclusion of the 2012 AGM or, if earlier, 15 months following the 2011 AGM.

At an SGM held on 18 August 2011 the shareholders approved two resolutions. The first resolution (which was passed as a Special Resolution and was approved by 95.62% of the votes cast) granted authority to the Directors of the Company to allot and issue common shares for cash in an amount up to 10% of issued share capital on a non pre-emptive basis. A similar resolution had not received the requisite 75% support at the 2011 AGM, and as this is an important tool in the Company's strategy of flexible capital management, the Directors felt it important that the matter should be put again to shareholders, together with a more detailed explanation of the reasons for the request for the authority. This authority gives Lancashire the ability to raise capital rapidly when market circumstances so dictate, particularly where catastrophe losses may present opportunities in the short-term. The second resolution was to approve amendments to the Company's Bye-laws in connection with the migration of the Company's tax residence from Bermuda to the UK. This ordinary resolution was approved by 99.68% of the votes cast. Please see the Chairman's Statement on pages 2 and 3 for a further discussion of the authority to issue shares on a non pre-emptive basis, and the adoption by the Company of a UK tax residence from January 2012.

Further details of the matters presented and passed at the AGM and the SGM are available on the Company's website. The Company will propose, at the 2012 AGM, that the repurchase program authority and the request for authority to allot up to 10% of its issued share capital for cash on a non pre-emptive basis be renewed.

The Company's 2012 AGM is scheduled for 2.00pm U.K. time on 3 May 2012. Notice of the AGM and the form of proxy accompany this Annual Report & Accounts. 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 shareholders by electronic and/or website communications. The Company will notify shareholders (either in writing or by other permitted means) when a relevant document or other information is placed on the website and a shareholder may request a hard copy version of the document or information.

Going concern

The Business Review section on pages 16 to 28 sets out details of the Group's financial performance, capital management, business environment and outlook. In addition, starting on page 77 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 & Accounts.

Auditors

Resolutions will be proposed at the Company's 2012 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 or she ought to have taken as a Director in order to make himself or herself 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

22 February 2012

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 Code published in May 2010 by the UK Financial Reporting Council ("FRC"). The Code replaced the FRC Combined Code issued in June 2008, which was the corporate governance standard adopted by the Company for purposes of its 2010 Annual Report. The FSA requires companies with a premium listing to "comply or explain" against the Code (i.e. to disclose how they have complied with Code provisions or, if the Code provisions have not been complied with, provide an explanation for the non-compliance). The Company monitors its compliance with the Code, and in this Corporate Governance section and throughout this Annual Report for the 2011 financial year, areas of corporate governance compliance and non-compliance are explained by reference to the Code. Subject to the comment made in the Compliance Statement appearing on page 43, there are no areas of material non-compliance with the Code. We also monitor our compliance with applicable corporate governance requirements under Bermuda law.

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. A copy of the schedule of matters reserved to the Board for its decision, and the Terms of Reference of the Board's main Committees can be found on Lancashire's website at www.lancashiregroup.com.

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, led by the CEO. 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, risk tolerances, compliance and any other key matters affecting the Group. 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 2011 of the Directors who held office during the year is detailed below. The table below reflects the number of meetings held and the number of meetings attended 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	4/4	4/4	–	–	–	4/4
Emma Duncan	4/4	–	–	4/4	4/4	–
Ralf Oelssner	4/4	4/4	4/4	4/4	–	4/4
Robert Spass	4/3	4/3	–	–	4/3	–
William Spiegel	4/4	–	4/1	4/3	4/1	–
Martin Thomas	4/4	–	4/4	–	–	–
Executive Directors						
Richard Brindle	4/4	–	–	–	4/4	4/4
Alex Maloney	4/4	–	–	–	–	4/4
Neil McConachie	4/4	–	–	–	4/4	–

The Directors

Appointments to the Board are made on merit, 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. At its meeting held on 17 February 2011 the Board determined, further to a recommendation from the Nomination and Corporate Governance Committee, that both John Bishop and Robert Spass continue to be independent in character and judgement. The Board's reasoning for this determination was explained in the 2010 Annual Report. Following this determination of independence Robert Spass was re-elected as a Director at the AGM held on 5 May 2011. At the Board meeting held on 22 February 2012, further to a recommendation of the Nomination and Corporate Governance Committee, the Board affirmed its judgement that five out of the nine members of the Board (including Mr Spass and Mr Bishop) are independent Non-Executive Directors. Therefore in its judgement the Board composition complies with the Code requirement that independent Non-Executive Directors, excluding the Chairman, should make up at least half the Board.

Pursuant to Bye-law 49.1 of the Company's Bye-laws, one-third of the Directors shall retire from office by rotation at each AGM. The new Code published in 2010 recommends that all Directors of FTSE 350 companies should be subject to annual re-election by shareholders. At its meeting held on 3 November 2011, the Board resolved that the Company change from its current three-year election cycle to the annual re-election of all Directors. Accordingly, all the Directors will stand for re-election at the 2012 AGM and a resolution will be put to shareholders to approve appropriate amendments to the Company's Bye-laws.

The Board, having conducted a formal performance evaluation (see page 48), is satisfied with the performance of each of the 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 3 May 2012, as detailed in the notice of AGM accompanying this report. Shareholders are asked to note that Ralf Oelssner, Robert Spass and William Spiegel will each have served as Non-Executive Directors for more than six years. Notwithstanding these periods of service, the Board is of the view that these Directors continue to offer valuable service to the Company, and proposes to recommend the re-election of all the current Directors at the 2012 AGM.

Information and training

On appointment the Directors receive written information regarding their responsibilities as Directors and information about the Group. An induction process is tailored for each new Director in the light of his or her existing skill set and knowledge of the Company, and includes meeting with senior management and visiting the Company's operations. Information regarding the Company's Official List and Bermuda law obligations and on the Company's compliance with the requirements of the Code is provided on a regular basis.

An analysis of the Company's compliance with the Code is collated and summarised in quarterly reports together with a more general summary of corporate governance developments which are prepared by the Company's Legal and Compliance department for consideration by the Nomination and Corporate Governance Committee. The Directors have access to the Company Secretary who is responsible for advising the Board on all legal and governance matters. The Directors also have access to independent professional advice as required. Regular sessions are held between the Board and management as part of the Company's 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 and comment thereon.

Board performance evaluation

A formal performance evaluation of the Board, its Committees and individual Directors is undertaken 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 Committees in terms of performance, composition, supporting processes and management of the Group as well as to review each Director's performance, training and development needs. The 2009 performance evaluation was facilitated by external consultants, whilst in 2010 and 2011 the evaluation was conducted internally.

During 2011, each Board member met with the Head of Corporate Affairs 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 2011 evaluation included: 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 management; the size and composition of the Board and its Committees, and whether the Board has appropriate skill sets properly deployed and with due regard to the benefits of diversity; 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 2012 Board meeting.

In addition to the performance evaluation the CEO undertook individual performance reviews for the Executive Directors, and the Senior Independent Director conducted a review of the performance of the Chairman during 2011 by holding a meeting with all the Non-Executive Directors.

The evaluations undertaken for the 2011 financial year found that the Board operates effectively and has a good blend of insurance, financial, investment and regulatory expertise. All Non-Executive Directors are committed to the continued success of the Company and to making the Board and its Committees work effectively. Attendance at and preparation in advance of Board meetings is generally good (though scheduling and operational constraints for Committee business had affected attendance during 2011). The CEO and Executive Directors are also operating effectively.

Infrastructure, processes and governance mechanisms are in place to support the effective performance of the Board. The Board's risk management processes and expertise have been further improved during 2011, particularly with the continued use of the risk management forums (which operate as both training sessions and discussion groups, organised by the Group CRO, and including participation by Non-Executive Directors), the attendance of the Directors at Underwriting Committee meetings and discussion at the quarterly Board meetings of a report from the CRO, as well as the consideration and approval by the Board of various risk tolerances. The number of Directors on the Board is felt to be broadly appropriate (although consideration is being given to the appointment of a further Non-Executive Director) and the Board Committees are considered to have an appropriate balance of skills and to function effectively.

The Board will continue to review its procedures, its effectiveness and development in 2012.

Relations with shareholders

During 2011 the Group's Head of Investor Relations, usually accompanied by the CFO, the CEO, the Chairman, the CUO or a senior member of the underwriting team, gave presentations to major shareholders, analysts and the investor community. Formal reports of these meetings were given to the Board on at least a quarterly basis. In particular, the Company worked intensively to engage with shareholders in advance of the vote concerning the Board's authority to issue up to 10% of shares on a non pre-emptive basis (see the Chairman's statement on pages 2 and 3).

Conference calls with shareholders and analysts hosted by senior management are held quarterly following the announcement of the Company's financial results. The CEO, President, CFO and CUO are generally available to answer questions at these presentations.

Shareholders are invited to request meetings with the Chairman, the Senior Independent Director and/or the other Non-Executive Directors by contacting the Head of Investor Relations. All of the Directors are available to meet with shareholders at the Company's AGM.

The Company commissions regular independent shareholder analysis reports together with independent research on feedback from shareholders and analysts following the Company's results announcements. This research, together with the analysts' notes, is made available to all Directors.

Committees

The Board has established Audit, Nomination and Corporate Governance, Remuneration, Investment and Underwriting Committees. Each of the Committees has written terms of reference, which are reviewed regularly and are available on the Company's website (www.lancashiregroup.com). The Committees are generally scheduled to meet quarterly.

The composition of the Committees as at 31 December 2011 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 Audit Committee comprises three independent Non-Executive Directors and is chaired by John Bishop, a qualified actuary, whom the Board considers to have recent and relevant financial experience (see Mr Bishop's biography on page 39). The Audit Committee's responsibilities include providing assistance to the Board on matters of financial reporting, internal control and risk management systems, compliance and internal audit. 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 monitors and reviews the independence and objectivity of the external auditors and the effectiveness of the internal and external audit processes. The internal and external auditors have the right of direct access to the Audit Committee.

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 2011, the Audit Committee reviewed the effectiveness of the Company's internal financial controls and internal control systems, reviewed the Company's financial reporting and held closed sessions with the Company's internal and external auditors and with management.

The Audit Committee has adopted a policy on the provision of non-audit services by the external auditors. It has also approved the Company's procedures for anti-money laundering, bribery, financial crime and conflicts of interest. The Audit Committee regularly reviews the "whistleblowing" arrangements by which staff may, in confidence, raise any concerns they may have about improprieties within the workplace.

Nomination and Corporate Governance Committee

The Nomination and Corporate Governance Committee's responsibilities include keeping under review the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board and its Committees. The Committee is responsible for identifying and nominating for approval by the Board candidates to fill Board vacancies as and when they arise. It also considers succession planning for Directors and other senior executives, in particular for the Chairman and CEO.

The Committee also reviews the Company's corporate governance, especially compliance with the Code, and ensuring the performance evaluation of the Board – see page 48. During 2011 the Committee reviewed and recommended for adoption by the Board revised terms of reference for the Audit, Nomination and Corporate Governance, Remuneration and Investment Committees, in line with ICSA best practice guidance. The Committee also recommended adoption by the Board of a protocol for the Division of Responsibilities between the Chairman and CEO and other reporting lines and responsibilities. The Committee also considered amendments to the Lancashire Group operating guidelines procedure and the share dealing code. Other matters included the appointment of Derek Stapley as an independent Non-Executive Director and Chairman of LICL, and the appointment of Dan Soares as the LICL CEO. The Committee also considered a response to the Davies report on female representation on Boards, published in February 2011, and the Group Succession Plan.

A majority of the members of the Nomination and Corporate Governance Committee are independent Non-Executive Directors. The Committee chairman is Martin Thomas who is the Chairman of the Board.

Remuneration Committee

The Remuneration Committee comprises three independent Non-Executive Directors. It is responsible for determining the framework for the remuneration, including the pension arrangements, for all Executive Directors, the Chairman and executive management. The Committee is also responsible for approving employment contracts for senior executives. During 2011 the Remuneration Committee approved changes to the RSS for 2012 awards to be subject to claw back in the hands of Executive Directors and the CFO, further details of which are set out on page 53. The Remuneration Committee also approved the adoption of share ownership guidelines for senior employees.

The remuneration report for which the Committee is responsible can be found on pages 52 to 62 of this report.

Investment Committee

The Investment Committee comprises three independent Non-Executive Directors, two Executive Directors and the Corporate Finance Manager. It is responsible for monitoring the management of the Company's investments and for recommending investment strategies, guidelines and policies for approval by the Board. The Committee is also responsible for recommending the appointment of fund managers for the Group's investments. During 2011, Denise O'Donoghue, Lancashire's Corporate Finance Manager, was appointed as a member of the Investment Committee. The Investment Committee also commissioned work on portfolio testing against various realistic investment risk scenarios.

Underwriting Committee

The Underwriting Committee comprises two independent Non-Executive Directors, two Executive Directors and the following members of senior management: Simon Fascione, Paul Gregory, Charles Mathias and Paula Porter. The positions and summaries of experience of these members of senior management are available on the Company's website (www.lancashiregroup.com). The responsibilities of the Underwriting Committee 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. A more detailed analysis of the Lancashire underwriting performance appears in the Business Review section of this Annual Report.

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. During 2011 the Company continued to use the services of PricewaterhouseCoopers to carry out specialist internal audit work and to provide additional capacity on an as required basis. Louise Wells took up the appointment as Group Head of Internal Audit in September 2011. Louise had previously worked for KPMG in London and Sydney, and most recently at the Corporation of Lloyd's. This appointment was ratified and approved by the Audit Committee.

External audit and provision of non-audit services

The Audit Committee, following its policy on the provision of non-audit services by the external auditors, 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 2011, Ernst & Young LLP performed certain non-audit services in relation to Solvency II and a transfer pricing review. Fees for non-audit service work for the 2011 year totalled $84,638 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. The CRO's remuneration is subject to annual review by the Remuneration Committee.

Further discussion of the risks affecting Lancashire and the policies in place to manage them can be found in the Risk disclosures section on pages 77 to 102.

Directors' remuneration report

As a company incorporated in Bermuda, Lancashire is not bound by U.K. law or regulation to the same extent that it applies to U.K. incorporated companies in the area of Directors' remuneration. However, by virtue of the Company's premium listing on the LSE, and, for the purposes of explaining its compliance against the requirements of the Code, the Board is committed to providing information on Directors' remuneration to shareholders and complying with U.K. 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):

- Emma Duncan
- Ralf Oelssner
- William Spiegel (Chair)

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 the framework for the remuneration, including pension arrangements, for all Executive Directors, the Chairman and executive management. The Committee is also responsible for approving employment contracts for senior executives, including the CRO and Head of Internal Audit.

During 2011 New Bridge Street (a brand of Aon Hewitt Limited) was the independent adviser to the Remuneration Committee. Neither New Bridge Street nor any other part of Aon Hewitt Limited provided other services to the Company during the year. New Bridge Street advised the Remuneration Committee on market trends, data for remuneration for Executive Directors and members of senior management, and advice on the structure of the remuneration policy. 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 2011.

Meetings of the Remuneration Committee may also be attended by other Directors including the CEO and President, but such attendance is by invitation only. No Director is involved in deciding 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 Board reviews and approves annually the framework for Executive Director and senior management remuneration based on a recommendation from the Remuneration Committee.

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;
- There is a high level of share ownership amongst employees meaning that there is a strong focus on sustainable long-term shareholder value. From 2012, there will be a new policy formalising the requirement for senior executives to build and maintain significant shareholdings; and
- From 2012, there will be a new policy, applying to Executive Directors and the CFO, giving the Company the power to claw back annual bonus, and long-term incentive payments made, due to material misstatements in the Company's financial statements, error in the calculation of any performance condition, or gross misconduct by an individual.

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

The Executive Directors' remuneration comprises the following elements:

- Base salary;
- Annual bonus;
- Long-term equity-based incentives (subject to share ownership guidelines for executives and senior employees);
- Pension; and
- Other benefits, comprising medical, dental, vision, life insurance coverage and gym membership, as well as a housing allowance for expatriates.

Base salary

Salaries for Executive Directors are determined by the Remuneration Committee at the beginning of each year and when an individual changes responsibility or position. Salaries for Executive Directors for 2012 have been frozen at their 2011 levels.

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

Annual bonus

Bonuses, earned in respect of 2012, and payable in 2013, 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 for 2012 will have two components:

(i) absolute financial performance against the Company's Board approved 2012 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 2012 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 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, with oversight from the Remuneration Committee.

The level of bonus for 2012 will be capped at 400%, 350% and 350% of base salary for the Executive Directors – the CEO, CUO and President respectively. This cap is unchanged from prior years and is considered to be broadly competitive with the market in which the Company operates for executive talent. The target level of bonus has been set at 12.0% RoE for 100% of target, with a minimum of 10% RoE for 25% of target, and a maximum of 20% RoE for 200% of target payout. 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 shares. Similar to the 2011 bonus, for the 2012 bonus 25% of the bonus earned will be deferred into RSS awards with 33% vesting annually over three years.

In February 2012 the Board approved a policy to enable the claw back of bonus payments made in the event of the discovery of an error or in the event of a misstatement in the Company's financial statements, or in the event of gross misconduct.

Long-term incentives

The Company operates an RSS. Under the RSS, executives and all 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 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.

Other than award levels, which differ by seniority, the plan is operated on the same terms for all employees.

The Remuneration Committee has considered carefully the grant levels and performance conditions for awards in 2012. For Executive Directors, RSS awards for 2012 will be 240,263 for the CEO, 187,165 for the CUO and 146,833 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 (see page 62) 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 based on the Company's RoE, measured over the three 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 bill 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 bill 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.

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 60.

Share ownership guidelines

A policy for formal shareholding guidelines was introduced for 2012, requiring the CEO and other Executive Directors to build and maintain a shareholding in the Company worth two times annual salary and one times annual salary respectively. To the extent that existing shareholdings are below the guideline threshold, they will be expected to retain no less than 50% of the net of taxes value that vests under the RSS, including bonus deferral.

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 57.

Other benefits

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

Service contracts

Richard Brindle was appointed as CEO of the Company under an original service contract dated 10 December 2005. Alex Maloney was first appointed as an employee of the Group under an original service contract dated 31 December 2005 and became CUO on 14 May 2009. Neil McConachie was appointed as CFO under an original service contract dated 1 February 2006 and became President on 1 January 2011.

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 10 December 2008 for Richard Brindle and 1 January 2009 for Alex Maloney and Neil McConachie. As of 1 January 2012 Richard Brindle's service contract with LHL was amended to take effect under English law following LHL's move of head office from Bermuda to London.

In the event of early termination, the Executive Directors' contracts provide for compensation up to a maximum of base annual salary plus the value of benefits to which the Executive Directors are contractually entitled for the unexpired portion of the notice period. No Director has a contractual right to a bonus for any period of notice not worked. The Company seeks to apply the principle of mitigation in the payment of compensation on the termination of the service contract of any Executive Director. There are no special provisions in the service contracts for payments to Executive Directors on a change of control of the Company.

The Board may allow Executive Directors to accept external appointments. In accordance with the 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.

Copies of the Executive Directors' service contracts are available for inspection at the Company's AGM.

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 two three-year terms, although the Board may invite a Non-Executive Director to serve for an additional period. Their letters of appointment are available for inspection at AGMs.

In accordance with best practice under the Code, the Board proposes to submit all the Directors individually for re-election by the shareholders at the 2012 AGM, subject to approval by shareholders at the AGM of an amendment to the Company's Bye-laws to permit the annual re-election of all Directors.

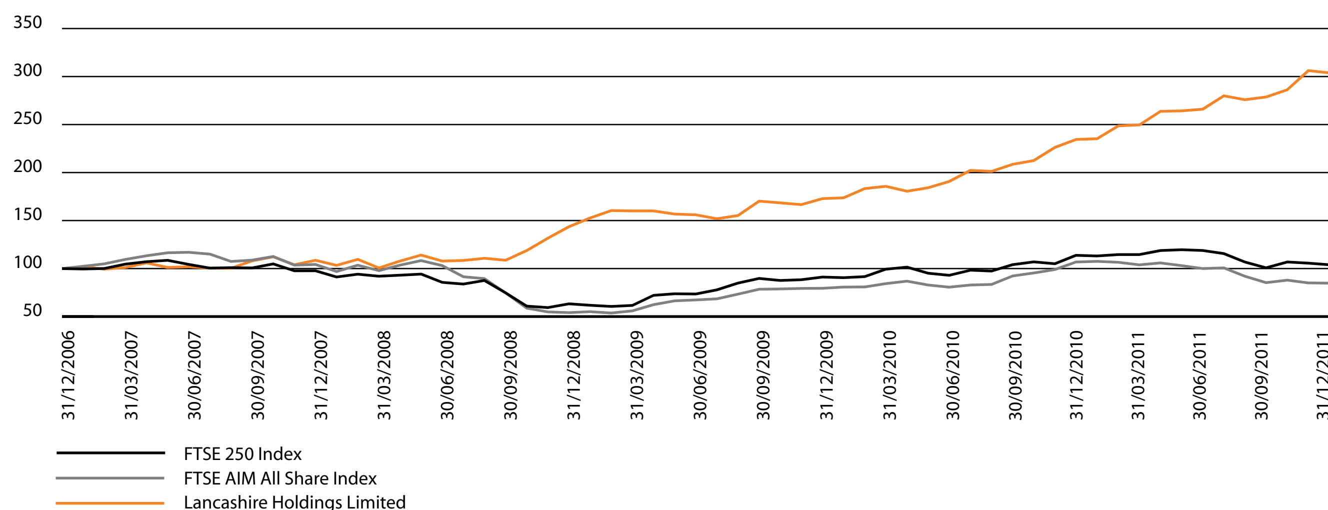
Name	Position	Date of letter of appointment
Martin Thomas	Non-Executive Chairman	16 April 2007(i)
John Bishop	Non-Executive Director, Chairman of Audit Committee	19 March 2008
Emma Duncan	Non-Executive Director	17 September 2010
Ralf Oelssner	Non-Executive Director, Senior Independent Director	31 July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

(i) Date of initial letter of appointment to the Board 15 September 2006

(ii) Date of initial letter of appointment to the Board 12 December 2005

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 22 June 2009 and this index best reflects its nature and size now.



Directors' emoluments

Directors' emoluments in U.S. dollars for the year ended 31 December 2011:

Director	Base salary/fees	Other[(ix)]	Benefits (viii) (ix) (x)	Pension[(xi)]	Annual bonus cash[(xii)]	RSS	Total 2011 emoluments	Total 2010 emoluments (xiii)
Non-Executive Directors								
John Bishop[(i)]	175,000	21,000	–	–	–	–	196,000	197,690
Emma Duncan[(ii)]	175,000	–	–	–	–	–	175,000	75,144
Ralf Oelssner[(iii)]	175,000	60,000	–	–	–	–	235,000	225,000
Robert Spass[(iv)]	175,000	–	–	–	–	–	175,000	855,000
William Spiegel	175,000	–	–	–	–	–	175,000	175,000
Martin Thomas[(v)]	325,000	100,000	–	–	–	–	425,000	406,678
Executive Directors								
Richard Brindle[(vi)(ix)]	675,000	405,000	35,812	108,000	2,375,730	791,910	4,391,452	5,305,728
Alex Maloney[(vii)(ix)]	356,043	–	8,874	39,525	760,770	253,590	1,418,802	196,934
Neil McConachie[(viii)]	500,000	–	223,760	50,000	944,344	314,781	2,032,885	2,342,763

(i) John Bishop entered into a consulting agreement with LUK in 2010 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 and her annual fee was increased from $140,000 to $175,000 effective 5 November 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 LISL in respect of his employment, paid in sterling.

(vii) Alex Maloney was appointed to the Board on 5 November 2010 and his 2010 emoluments relate only to the period he was a Director. Both base salary and pension have been adjusted to reflect his U.K. salary sacrifice pension contributions.

(viii) Neil McConachie's benefits include his housing allowance which was increased from $10,000 per month to $16,000 per month effective 1 January 2011, which fully covered the cost of his accommodation.

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

(x) Benefits include payroll taxes, medical, dental, vision coverage, air travel and housing and other allowances paid by the Company for expatriates, but exclude U.K. national insurance contributions.

(xi) Including a 10% contribution of £25,305 (2010 – £26,149) to a UK defined contribution pension plan in respect of Richard Brindle's salary and employment with LISL.

(xii) For 2011 the Lancashire Group delivered strong results in the context of industry losses. Bonus targets were set at the beginning of 2011 and based on a clear split between Company financial performance and personal performance on a 75:25 basis. Company financial performance had two components, absolute financial performance and relative financial performance weighted 60:40 respectively. The absolute component paid out at 112% of target as RoE was 13.4% against a budget of 12.3% 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. For the personal element of Executive Directors' bonus opportunity, the pay-out ranged from 58.6% to 72.5% of the maximum.

Cash awards were made up of 75% of total bonus award and 25% of total bonus award which will be deferred into stock with one third vesting annually, each year, over a three year period with the first third becoming exercisable, subject to the Company being in an "open period", in February 2013.

(xiii) Some comparatives have been restated to reflect the exclusion of U.K. national insurance contributions.

Directors' warrants, options and RSS awards

(a) Founder warrants

Name	Warrants held at 1 January 2011	Warrants exercised during the year	Warrants sold during the year	Warrants held at 31 December 2011	Exercise price(iii)	Date from which first exercisable(i)	Expiry date
Richard Brindle							
16/12/2005	46,260	–	–	46,260	$5.00	16/12/2005	16/12/2015

(b) Time vesting ordinary warrants(i)

Name	Warrants held at 1 January 2011	Warrants exercised during the year	Warrants sold during the year	Warrants held at 31 December 2011	Exercise price(iii)	Date from which first exercisable(i)	Expiry date
Richard Brindle							
16/12/2005	5,718,912	–	2,000,000	3,718,912	$5.00	16/12/2005	16/12/2015
16/12/2005	1,906,305	–	–	1,906,305	$3.90	16/12/2008	16/12/2015
Total	7,625,217	–	2,000,000(iv)	5,625,217			
Neil McConachie							
16/12/2005	294,293	–	294,293	–	$5.00	16/12/2005	16/12/2015
16/12/2005	8,859	8,859	–	–	$3.90	16/12/2008	16/12/2015
09/03/2006	158,859	103,152	55,707	–	$5.00	09/03/2006	16/12/2015
09/03/2006	158,858	158,858	–	–	$3.90	16/12/2008	16/12/2015
Total	620,869	270,869	350,000(v)	–			

(c) Performance vesting ordinary warrants(ii)

Name	Warrants held at 1 January 2011	Warrants exercised during the year	Warrants sold during the year	Warrants held at 31 December 2011	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	47,155	–	–	47,155	$3.90	31/12/2008	16/12/2015
16/12/2005	405,967	–	–	405,967	$2.60	31/12/2009	16/12/2015
Total	741,965	–	–	741,965			
Neil McConachie							
16/12/2005	36,106	36,106	–	–	$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	36,106	36,106	–	–	$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
Total	185,492	185,492	–	–			

(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 the performance vesting ordinary warrants lapsed.

(iii) On 10 December 2007, the Company declared a special dividend of $1.10 per common share payable to shareholders of record, 11 January 2008. The declaration of the dividend triggered a contractual obligation, pursuant to the terms of all warrants, for the Company to pay an amount per warrant equivalent to the dividend for each vested warrant; and to adjust automatically the exercise price for each unvested warrant by an amount equivalent to the dividend. Consequently on 25 January 2008, the Company paid a dividend of £0.5622 per warrant on all of the vested ordinary warrants and the vested performance warrants, reflecting the dividend paid to shareholders. The payments on 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 LLP 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 make a dividend equivalent payment 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 now vested or lapsed, there were no further adjustments to the exercise price as a result of the dividends declared after 1 January 2010.

(iv) On 29 September 2011 Richard Brindle sold 2,000,000 time vesting warrants at a price of $6.688 per warrant, realising $13,376,000.

(v) On 27 May 2011 Neil McConachie sold 350,000 time vesting warrants at a price of $5.65 per warrant, realising $1,977,500.

(vi) See pages 41 and 42 for details of any gains due to the exercise of warrants.

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

- 16 December 2005 – £3.21
- 9 March 2006 – £3.27

Dividends paid to Executive Directors on warrants

	Founder Warrants £	Time Vesting Ordinary Warrants £	Performance Vesting Ordinary Warrants £	Total £
Richard Brindle				
Special dividend of $1.25 (£0.7562) paid 6 January 2010	34,984	5,766,544	254,097	6,055,625
Final dividend of $0.10 (£0.0666) paid 14 April 2010	3,080	507,671	49,398	560,149
Interim dividend of $0.05 (£0.0324) paid 13 October 2010	1,498	246,850	24,020	272,368
Special dividend of $1.40 (£0.8856) paid 19 January 2011	40,969	6,753,102	657,104	7,451,175
Final dividend of $0.10 (£0.0616) paid 20 April 2011	2,849	469,678	45,701	518,228
Interim dividend of $0.05 (£0.0306) paid 28 September 2011	1,417	233,630	22,733	257,780
Special dividend of $0.80 (£0.5165) paid 21 December 2011	23,893	2,905,400	383,221	3,312,514
Alex Maloney[(i)]				
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[(ii)]				
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
Final dividend of $0.10 (£0.0616) paid 20 April 2011	–	32,083	11,425	43,508
Interim dividend of $0.05 (£0.0306) paid 28 September 2011	–	5,235	5,683	10,918

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

(ii) All of Neil McConachie's warrants had been exercised by 15 November 2011.

(d) Share options under the 2005 LTIP

Name	Options held at 1 January 2011	Options exercised during the year[(ii)]	Options held at 31 December 2011	Date from which first exercisable[(i)]	Expiry date
Richard Brindle					
29/06/2007	37,500	37,500	–	29/06/2008	28/06/2017
Alex Maloney					
29/06/2007	137,500	137,500	–	29/06/2008	28/06/2017
Neil McConachie					
29/06/2007	50,000	50,000	–	29/06/2008	28/06/2017

(i) The options vested as to 25% on each of the first, second, third and fourth anniversaries of the date of grant provided that the option holder remained in the employment of the Group at the relevant anniversary. The share options under the 2005 LTIP were not subject to any performance conditions.

(ii) The initial grant price for the 29 June 2007 LTIP grant was $6.87. At an SGM of shareholders held on 4 January 2008 the Company's shareholders approved, and the Remuneration Committee subsequently exercised its discretion to reduce the exercise price for all outstanding vested and unvested options by the amount of any dividend paid by the Company. Consequently, when Richard Brindle and Alex Maloney exercised their options on 30 June 2011 the exercise price was $2.82 and when Neil McConachie exercised his options on 28 November 2011 the exercise price was $1.97. See pages 41 and 42 for details of any exercise gains.

The market value of the common shares on the date of grant, 29 June 2007, was £3.42.

(e) Awards under the RSS

Name	Awards held at 1 January 2011	Awards granted during the year	Awards exercised during the year	Awards lapsed during the year	Awards held at 31 December 2011	Vesting date(iv)
Richard Brindle						
2008 performance award(ii)	360,001	–	358,453	1,548	–	28/03/2011
2009 performance award(ii)	318,750	–	–	–	318,750	(iv)
2009 erss performance award(iii)	31,875	–	–	–	31,875	(iv)
2009 deferred bonus Bermuda	67,223	–	–	–	67,223	(iv)
2010 performance award(iv)	375,000	–	–	–	375,000	(iv)
2010 deferred bonus	–	191,938	–	–	191,938	(iv)
2011 performance award(iv)	–	312,741	–	–	312,741	(iv)
Total	1,152,849	504,679	358,453	1,548	1,297,527	
Alex Maloney						
2008 performance award(ii)	75,552	–	75,227	325	–	28/03/2011
2009 performance award(ii)	63,750	–	–	–	63,750	(iv)
2009 erss performance award(iii)	6,375	–	–	–	6,375	(iv)
2010 performance award(iv)	96,250	–	–	–	96,250	(iv)
2010 deferred bonus	–	41,105	–	–	41,105	(iv)
2011 performance award(iv)	–	236,198	–	–	236,198	(iv)
Total	241,927	277,303	75,227	325	443,678	
Neil McConachie						
2008 performance award(ii)	101,032	–	100,598	434	–	28/03/2011
2009 performance award(ii)	99,375	–	–	–	99,375	(iv)
2009 erss performance(iii)	9,938	–	–	–	9,938	(iv)
2009 deferred bonus	35,662	–	–	–	35,662	(iv)
2010 performance award(iv)	152,500	–	–	–	152,500	(iv)
2010 deferred bonus	–	77,753	–	–	77,753	(iv)
2011 performance award(iv)	–	261,994	–	–	261,994	(iv)
Total	398,507	339,747	100,598	434	637,222	

(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 and 4 March 2011 £6.19.

(ii) The vesting of the RSS performance awards is subject to two performance conditions as follows:

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 (see page 62 for a list of comparator companies for each grant year), over a three-year performance period. 25% of this half of the 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 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 half of the award will vest if average annual RoE over the performance period exceeds the criteria set out in the table below, whilst all of this part of the award will vest if the Company's average RoE is equal to the more stringent criteria set out in the table below. Between these two points vesting will take place on a straight line basis from 25% to 100% for RoE performance.

TSR Targets for RSS

	2008	2009	2010	2011	2012
100%	75^{th}percentile	75^{th}percentile	75^{th}percentile	75^{th}percentile	75^{th}percentile
25%	= median	= median	= median	= median	= median
Nil	< median	< median	< median	< median	< median

RoE Targets for RSS

	2008	2009	2010	2011	2012
100%	3M LIBOR + 18%	13 week Tr + 18%	13 week Tr + 18%	13 week Tr + 15%	13 week Tr +15%
25%	3M LIBOR + 8%	13 week Tr + 8%	13 week Tr + 8%	13 week Tr + 6%	13 week Tr + 6%
Nil	<3M LIBOR + 8%	<13 week Tr + 8%	<13 week Tr + 8%	<13 week Tr + 6%	<13 week Tr + 6%

Comparator companies	2008 awards	2009 awards	2010 awards	2011 awards	2012 awards
Amlin plc	X	X	X	X	X
Arch Capital	X	X			
Aspen Insurance Holdings Limited		X		X	X
Axis Capital Holdings Limited	X	X	X	X	X
Beazley plc			X	X	X
Brit Insurance Holding N.V.			X		
Catlin Group Ltd.			X	X	X
Endurance Specialty Holdings Ltd.	X	X	X	X	X
Flagstone Reinsurance Holdings Limited	X	X	X	X	X
Hiscox Ltd.	X	X	X	X	X
IPC	X	X			
Kiln	X				
Montpelier Re Holdings Ltd.	X	X	X	X	X
Partner Re	X	X			
Platinum	X	X			
RenaissanceRe Holdings Ltd.	X	X	X	X	X
Validus Holdings Ltd.	X	X	X	X	X

(iii) 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% vesting, see table.

(iv) The vesting dates are subject to being out of a close period and, for the 2009 to 2011 performance and deferred bonus awards, are as follows:

2009 – first open period following the release of the Company's 2011 year end results

2010 – first open period following the release of the Company's 2012 year end results

2011 – first open period following the release of the Company's 2013 year end results

The market value of the common shares at 31 December 2011 was £7.245 and the range during the year was £5.275 to £7.835.

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

William Spiegel, LHL Remuneration Committee Chairman

22 February 2012

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 UK Corporate Governance 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, and the President, Neil McConachie and this statement is made to the best of their knowledge and belief.

22 February 2012

Financial statements

65 Independent auditors' report
66 Consolidated financial statements
70 Accounting policies
77 Risk disclosures
103 Notes to the accounts

Additional information

132 Shareholder information
133 Glossary
136 Contact information

"Disciplined and creative capital management is critical, and has materially improved our returns. But it's only part of the story. The risk levels for the return have to be right for the market environment we face. In 2011 we launched a sidecare vehicle, Accordion, with a unique capital draw down feature as part of that ongoing commitment to capital management and innovation."

Elaine Whelan – Group Chief Financial Officer

Independent auditors' report to the shareholders of Lancashire Holdings Limited

We have audited the financial statements of Lancashire Holdings Limited and its subsidiaries (collectively "the Group") for the year ended 31 December 2011 which comprise the consolidated balance sheet as at 31 December 2011, 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 29. 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 25 July 2011. 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 63, 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 Consolidated 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 Company'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. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on the Consolidated Financial Statements

In our opinion the consolidated financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2011 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 2010 UK Corporate Governance code.

Ernst & Young LLP

London

22 February 2012

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 consolidated financial statements since they were initially presented on the website.

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

Consolidated statement of comprehensive income

For the year ended 31 December 2011

	Notes	2011 $m	2010 $m
Gross premiums written	2	632.3	689.1
Outwards reinsurance premiums	2	(67.2)	(39.2)
Net premiums written		**565.1**	**649.9**
Change in unearned premiums	2	3.5	(33.0)
Change in unearned premiums on premiums ceded	2	5.9	(2.7)
Net premiums earned		**574.5**	**614.2**
Net investment income	3	43.2	53.4
Net other investment (losses) income	3	(0.5)	0.1
Net realised gains (losses) and impairments	3	8.6	33.2
Share of profit of associate	16	0.9	–
Net foreign exchange losses		(9.4)	(0.1)
Total net revenue		**617.3**	**700.8**
Insurance losses and loss adjustment expenses	2, 12	225.3	194.7
Insurance losses and loss adjustment expenses recoverable	2, 12	(43.0)	(29.0)
Net insurance losses		**182.3**	**165.7**
Insurance acquisition expenses	2, 4	114.2	109.9
Insurance acquisition expenses ceded	2, 4	(1.8)	(3.6)
Other operating expenses	5, 6, 24	71.0	61.8
Equity based compensation	6	18.8	21.1
Total expenses		**384.5**	**354.9**
Results of operating activities		**232.8**	**345.9**
Financing costs	7	14.2	6.7
Profit before tax		**218.6**	**339.2**
Tax charge	8	6.4	8.4
Profit for the year attributable to equity shareholders		**212.2**	**330.8**
Net change in unrealised gains/losses on investments	3, 10	(10.5)	(2.0)
Tax provision on net change in unrealised gains/losses on investments	10	(0.1)	(0.2)
Other comprehensive loss	10	**(10.6)**	**(2.2)**
Total comprehensive income attributable to equity shareholders		**201.6**	**328.6**
Earnings per share			
Basic	25	$1.38	$2.08
Diluted	25	$1.20	$1.86

Consolidated balance sheet

As at 31 December 2011

	Notes	2011 $m	2010 $m
Assets			
Cash and cash equivalents	9, 21	311.8	512.5
Accrued interest receivable		10.0	13.4
Investments			
– Fixed income securities	10, 21	1,714.0	1,719.1
– Other investments	10	(0.6)	(0.2)
Reinsurance assets			
– Unearned premiums on premiums ceded	11	8.8	2.9
– Reinsurance recoveries	12	69.7	35.9
– Other receivables	11	6.2	5.6
Deferred acquisition costs	14	61.4	61.2
Other receivables		48.6	45.7
Inwards premiums receivable from insureds and cedants	13	212.1	217.5
Deferred tax asset	15	8.2	6.4
Investment in associate	16	50.9	–
Property, plant and equipment	17	5.3	7.4
Intangible asset	18	1.2	–
Total assets		**2,507.6**	**2,627.4**
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	12	571.2	507.5
– Unearned premiums	19	347.1	350.6
– Other payables	19, 20	23.5	20.6
Amounts payable to reinsurers	11, 20	17.8	4.4
Deferred acquisition costs ceded	14	0.7	0.1
Other payables	20	85.2	321.4
Corporation tax payable		1.2	6.3
Interest rate swap	21	6.1	0.8
Long-term debt	21	128.0	128.8
Total liabilities		**1,180.8**	**1,340.5**
Shareholders' equity			
Share capital	22	84.3	84.3
Own shares	22	(83.0)	(106.9)
Share premium		2.4	2.4
Contributed surplus		660.5	662.6
Accumulated other comprehensive income	10	17.6	28.2
Other reserves	23	67.6	70.7
Retained earnings		577.4	545.6
Total shareholders' equity attributable to equity shareholders		**1,326.8**	**1,286.9**
Total liabilities and shareholders' equity		**2,507.6**	**2,627.4**

The consolidated financial statements were approved by the Board of Directors on 22 February 2012 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 2011

	Notes	Share capital $m	Own shares $m	Share premium $m	Contributed surplus $m	Accumulated other compre-hensive income $m	Other reserves $m	Retained earnings $m	Total $m
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	22	–	(32.6)	–	–	–	–	–	(32.6)
Shares repurchased and held in trust	22	–	(13.0)	–	–	–	–	–	(13.0)
Shares repurchased and cancelled	22	(6.9)	–	–	(96.7)	–	–	–	(103.6)
Distributed by trust	22	–	16.6	–	(16.6)	–	–	–	–
Shares donated to trust	22, 26	–	(1.5)	–	1.5	–	–	–	–
Dividends on common shares	22	–	–	–	–	–	–	(237.2)	(237.2)
Dividends on warrants	22	–	–	–	–	–	–	(57.0)	(57.0)
Equity based compensation – tax	8	–	–	–	–	–	2.0	–	2.0
Equity based compensation – exercises	6, 22, 23	–	–	–	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**
Total comprehensive income for the year	10	–	–	–	–	(10.6)	–	212.2	201.6
Distributed by trust	22	–	33.7	–	(38.2)	–	–	–	(4.5)
Shares donated to trust	22, 26	–	(15.4)	–	15.4	–	–	–	–
Dividends on common shares	22	–	–	–	–	–	–	(147.7)	(147.7)
Dividends on warrants	22	–	–	–	–	–	–	(32.7)	(32.7)
Warrant exercises – founders	22	–	5.6	–	(1.1)	–	(4.5)	–	–
Equity based compensation – tax	8	–	–	–	–	–	4.4	–	4.4
Equity based compensation – exercises	6, 22, 23	–	–	–	21.8	–	(21.8)	–	–
Equity based compensation – expense	6	–	–	–	–	–	18.8	–	18.8
Balance as at 31 December 2011		**84.3**	**(83.0)**	**2.4**	**660.5**	**17.6**	**67.6**	**577.4**	**1,326.8**

Statement of consolidated cash flows

For the year ended 31 December 2011

	Notes	2011 $m	2010 $m
Cash flows from operating activities			
Profit before tax		218.6	339.2
Tax paid		(9.7)	(5.8)
Depreciation	5	2.9	2.6
Interest expense on long-term debt	7	5.6	5.4
Interest and dividend income		(56.2)	(68.3)
Net amortisation of fixed income securities		8.7	11.0
Equity based compensation	6	18.8	21.1
Foreign exchange losses (gains)		11.5	(2.1)
Share of profit of associate		(0.9)	–
Net other investment losses (income)	3	0.5	(0.1)
Net realised (gains) losses and impairments	3	(8.6)	(33.2)
Net unrealised losses (gains) on interest rate swaps		5.4	(2.8)
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		38.2	9.0
– Other assets and liabilities		22.9	(7.2)
Net cash flows from operating activities		**257.7**	**268.8**
Cash flows (used in) from investing activities			
Interest and dividends received		59.6	66.9
Net purchase of property, plant and equipment		(0.6)	(2.3)
Purchase and development of intangible asset	18	(1.2)	–
Investment in associate	16	(50.0)	–
Purchase of fixed income securities		(1,944.5)	(2,635.5)
Purchase of equity securities		(87.4)	–
Proceeds on maturity and disposal of fixed income securities		1,939.0	2,828.5
Proceeds on disposal of equity securities		80.2	–
Proceeds on disposal of other investments		1.1	1.6
Net cash flows (used in) from investing activities		**(3.8)**	**259.2**
Cash flows used in financing activities			
Interest paid		(5.6)	(5.4)
Dividends paid	22	(444.4)	(293.2)
Share repurchases		–	(149.5)
Distributions by trust		(4.5)	–
Net cash flows used in financing activities		**(454.5)**	**(448.1)**
Net (decrease) increase in cash and cash equivalents		**(200.6)**	**79.9**
Cash and cash equivalents at beginning of year		512.5	440.0
Effect of exchange rate fluctuations on cash and cash equivalents		(0.1)	(7.4)
Cash and cash equivalents at end of year	9	**311.8**	**512.5**

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 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 is expected to 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 the potential impacts the new standard will have on its results and the presentation and disclosure thereof.

IFRS 9, Financial Instruments: Classification and Measurement, which has been issued but is not yet effective, and therefore has not yet been adopted by the Group. The Group continues to apply IAS 39, Financial Instruments: Recognition and Measurement and classifies its fixed income and equity securities as available for sale. The new standard, the effective date of which has been deferred until 1 January 2015, is not expected to have a material impact on the results and disclosures reported in the consolidated financial statements. It will, 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 profit or loss.

IFRS 10, Consolidated Financial Statements, issued in May 2011, redefines the principle of control and establishes control as the basis for determining which entities are consolidated in an entity's financial statements. IFRS 12, Disclosure of Involvement with Other Entities, was issued concurrently and sets out the disclosure requirements for consolidated financial statements. Both standards are effective from 1 January 2013 and are not expected to have a material impact on the Group's results, although additional disclosures may be required.

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 73 and also in the risk disclosures section from page 83. 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 and equity compensation plans. The estimation of the fair value of financial instruments is discussed on pages 73 and 74 and in note 10. Management judgement is applied in determining impairment charges. The estimation of the fair value of equity based compensation awards granted is discussed in Note 6.

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. Intercompany balances, profits and transactions are eliminated.

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

Associates

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

Foreign currency translation

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

Foreign currency transactions are recorded in the functional currency for each entity using the exchange rates prevailing at the dates of the transactions, or at the average rate for the period when this is a reasonable approximation. Monetary assets and liabilities denominated in foreign currencies are translated at period end exchange rates. The resulting exchange differences on translation are recorded in the consolidated statement of comprehensive income. Non-monetary assets and liabilities carried at historical cost denominated in a foreign currency are translated at historic rates. Non-monetary assets and liabilities carried at 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 rateably over the term of the underlying risk period of the insurance contract, except where the period of risk differs significantly from the contract period. In these circumstances, premiums are recognised over the period of risk in proportion to the amount of insurance protection provided. The portion of the premium related to the unexpired portion of the risk period is reflected in unearned premiums.

Where contract terms require the reinstatement of coverage after an insured's or ceding company's loss, the estimated mandatory reinstatement premiums are recorded as written premiums when a specific loss event occurs. Reinstatement premiums are not recorded for losses included within the provision for 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. Contingent profit commissions on reinsurance contracts entered into with ARL are accrued when it is virtually certain that the income will be realised.

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 best 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 set on a best estimate basis and 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 including transaction costs on the trade date and are subsequently carried at estimated fair value. The estimated fair values of quoted investments are 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.

Intangible assets

Internally developed computer software is capitalised on the basis of the costs incurred to bring into use the specific software. These costs are amortised over the expected useful life of the software of five years on a straight-line basis.

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, if any, 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 objective 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 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 at least 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 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 business 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, covering all of the risk groups the Group is exposed to, 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, predominantly 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 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 ongoing basis;
- BLAST is used to measure occurrence risks, aggregate risks and correlations between classes and other non-insurance risks;
- each authorised class has a pre-determined normal maximum line structure;
- each underwriter has a clearly defined limit of underwriting authority;
- the Group has pre-determined tolerances and preferences 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 call is held to peer review insurance proposals, opportunities and emerging risks;
- sophisticated pricing and aggregation models are utilised in certain areas of the underwriting process, and are updated frequently;
- BLAST and other 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 (e.g. 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, tsunamis and tornadoes, from risk losses throughout the year and from war, terrorism and political risk and other events. ARL bears similar exposure to catastrophe losses and any significant loss event could potentially result in impairment in the value of the Group's investment in AHL.

The Group's exposures to certain peak zone elemental losses, 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 2011		100 year return period estimated net loss		250 year return period estimated net loss	
		$m	% of capital	$m	% of capital
Zones	**Perils**				
Gulf of Mexico[(1)]	Hurricane	249.1	17.1	368.0	25.3
Japan	Earthquake	165.4	11.4	260.0	17.9
Japan	Typhoon	108.5	7.5	235.0	16.2
California	Earthquake	97.3	6.7	195.7	13.5
Pan-European	Windstorm	126.5	8.7	188.3	12.9
Pacific North West	Earthquake	43.7	3.0	124.9	8.6

(1) Landing hurricane from Florida to Texas.

As at 31 December 2010		100 year return period estimated net loss		250 year return period estimated net loss	
		$m	% of capital	$m	% of capital
Zones	**Perils**				
Gulf of Mexico[(1)]	Hurricane	250.7	17.7	352.8	24.9
Japan	Earthquake	130.9	9.2	225.6	15.9
Japan	Typhoon	92.8	6.6	191.5	13.5
California	Earthquake	110.9	7.8	186.3	13.2
Pan-European	Windstorm	141.1	10.0	214.6	15.2
Pacific North West	Earthquake	56.9	4.0	209.0	14.8

(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:

	2011		2010	
	$m	%	$m	%
Worldwide offshore	284.3	45.0	301.4	43.7
Worldwide, including the U.S. and Canada(1)	119.4	18.9	112.7	16.4
U.S. and Canada	84.2	13.3	135.9	19.7
Europe	31.5	5.0	43.5	6.3
Worldwide, excluding the U.S. and Canada(2)	26.3	4.2	40.9	5.9
Far East	26.2	4.1	16.6	2.4
Middle East	8.5	1.3	6.8	1.0
Rest of world	51.9	8.2	31.3	4.6
Total	**632.3**	**100.0**	**689.1**	**100.0**

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

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

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

	2011		2010	
	$m	%	$m	%
Property	279.8	44.2	323.6	46.9
Energy	229.0	36.2	238.3	34.6
Marine	76.4	12.1	76.4	11.1
Aviation	47.1	7.5	50.8	7.4
Total	**632.3**	**100.0**	**689.1**	**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:

	2011 $m	2010 $m
Property catastrophe excess of loss	82.0	98.1
Terrorism	68.4	77.8
Property direct and facultative	57.5	64.8
Property retrocession	46.8	52.4
Property political risk	20.4	29.1
Other property	4.7	1.4
Total	**279.8**	**323.6**

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 can be written either ground up or for primary or high excess layers, with cover provided for U.S. and worldwide property risks, but typically 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 (e.g. 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 or on an individual case by case basis. 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 catastrophe 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 the 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 78 and 79.

Reinsurance may be purchased to mitigate exposures to large natural catastrophe losses in the U.S., Canada and worldwide with certain exclusions. Reinsurance may also be purchased to reduce the Group's worldwide exposure to large risk losses. Reinsurance is typically purchased on an excess of loss basis but, from time to time, quota share arrangements, such as with ARL, may be entered into.

ii. Energy

Gross premiums written, for the year:

	2011 $m	2010 $m
Worldwide offshore energy	140.3	123.1
Gulf of Mexico offshore energy	60.7	87.4
Construction energy	10.5	12.2
Onshore energy	8.6	6.9
Energy excess of loss	5.2	5.4
Other energy	3.7	3.3
Total	**229.0**	**238.3**

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. 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 the 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 78 and 79.

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. Reinsurance is typically purchased on an excess of loss basis but, from time to time, quota share arrangements may be entered into.

iii. Marine

Gross premiums written, for the year:

	2011 $m	2010 $m
Marine hull and total loss	23.8	31.7
Marine builders risk	20.0	14.6
Marine hull war	17.7	16.9
Marine P&I clubs	11.0	11.9
Other marine	3.9	1.3
Total	**76.4**	**76.4**

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 builders risk covers the building of ocean going vessels in specialised yards worldwide. Marine hull war is direct insurance of loss of vessels from war, piracy or terrorist attack. Marine P&I clubs 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. Reinsurance is typically purchased on an excess of loss basis.

iv. Aviation

Gross premiums written, for the year:

	2011 $m	2010 $m
AV52	39.6	42.6
Other aviation	7.5	8.2
Total	**47.1**	**50.8**

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. Cover excludes 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 liability.

Reinsurance may be purchased to mitigate exposures to an AV52 event loss. Reinsurance is typically purchased on an excess of loss basis.

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 or quota share arrangements, such as with ARL. 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 particularly given the nature of the business written.

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 2011 management's estimates for IBNR represented 33.5% of total net loss reserves (2010 – 40.6%). The majority of the estimate relates to potential claims on non-elemental risks where timing delays in insured or cedant reporting may mean losses could have occurred which the Group were not made aware of by the balance sheet date.

B. Market risk

The Group is at risk of loss due to movements in market factors. 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;
- market events which may cause a limit in the availability of cover, including unusual inflation in rates, causing political intervention or national remedies; and
- failure to maintain broker and client relationships, leading to a limited or substandard choice of risks inconsistent with the Group's risk appetite.

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 outlook 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;
- holds a daily underwriting meeting to discuss, inter alia, market conditions and opportunities;
- regularly reviews output from BLAST to assess up-to-date profitability of classes and sectors; and
- holds a quarterly Underwriting Committee meeting to review underwriting strategy.

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, maturity, sectors, geographical and sovereign issuer exposures. 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.

The Group's fixed income portfolios are managed by three external investment managers. The Group held equities for a short period of time in 2011, which were managed by one investment manager. The equity portfolio was liquidated in the third quarter to limit the Group's exposure to further anticipated volatility. The performance of the managers is monitored on an ongoing basis.

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 investment mix of the fixed income portfolios is as follows:

	Core		Core plus		Surplus		Total	
As at 31 December 2011	**$m**	**%**	**$m**	**%**	**$m**	**%**	**$m**	**%**
– Short-term investments	32.6	1.9	32.6	1.9	13.7	0.8	78.9	4.6
– U.S. treasuries	101.1	5.9	85.0	5.0	165.0	9.6	351.1	20.5
– Other government bonds	5.0	0.3	21.5	1.3	132.6	7.7	159.1	9.3
– U.S. municipal bonds	3.2	0.2	10.0	0.6	14.5	0.9	27.7	1.7
– U.S. government agency debt	9.8	0.6	11.9	0.7	61.3	3.6	83.0	4.9
– Asset backed securities	14.5	0.8	36.7	2.1	18.4	1.1	69.6	4.0
– U.S. government agency mortgage backed securities	28.2	1.6	101.3	5.9	130.8	7.6	260.3	15.1
– Non-agency mortgage backed securities	2.4	0.2	4.2	0.2	6.5	0.4	13.1	0.8
– Non-agency commercial mortgage backed securities	1.7	0.1	8.5	0.5	21.3	1.2	31.5	1.8
– Corporate bonds	113.7	6.6	238.5	13.9	238.3	13.9	590.5	34.4
– Corporate bonds – FDIC guaranteed	23.1	1.4	14.2	0.8	11.9	0.7	49.2	2.9
Total fixed income securities	**335.3**	**19.6**	**564.4**	**32.9**	**814.3**	**47.5**	**1,714.0**	**100.0**

	Core		Core plus		Surplus		Total	
As at 31 December 2010	**$m**	**%**	**$m**	**%**	**$m**	**%**	**$m**	**%**
– 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**

Non-FDIC guaranteed corporate bonds and non-U.S. sovereign bonds by country are as follows:

As at 31 December 2011	Financials $m	Other industries $m	Total corporate bonds $m	Other Government bonds $m	Total corporate and other Government bonds $m
United States	127.0	216.9	343.9	–	343.9
Canada	40.5	11.5	52.0	23.8	75.8
United Kingdom	16.8	23.6	40.4	15.8	56.2
Australia	4.7	5.0	9.7	14.4	24.1
Norway	21.5	–	21.5	1.9	23.4
Netherlands	3.5	8.9	12.4	10.5	22.9
France	1.7	15.0	16.7	–	16.7
Sweden	13.3	–	13.3	–	13.3
Switzerland	4.3	7.0	11.3	–	11.3
Belgium	–	7.2	7.2	–	7.2
Germany	–	5.0	5.0	–	5.0
Supranationals	1.5	–	1.5	–	1.5
Emerging market corporates	3.0	38.6	41.6	–	41.6
Emerging market sovereign	–	–	–	71.8	71.8
Emerging market agency	–	–	–	11.9	11.9
Other	2.5	11.5	14.0	9.0	23.0
Total	**240.3**	**350.2**	**590.5**	**159.1**	**749.6**

As at 31 December 2010	Financials $m	Other industries $m	Total corporate bonds $m	Other Government bonds $m	Total corporate and other Government bonds $m
United States	186.1	247.6	433.7	–	433.7
Canada	13.8	13.6	27.4	1.9	29.3
United Kingdom	14.9	25.3	40.2	9.1	49.3
Australia	17.0	5.0	22.0	21.7	43.7
Norway	8.8	–	8.8	–	8.8
Netherlands	4.6	6.5	11.1	9.1	20.2
France	4.8	12.1	16.9	–	16.9
Sweden	6.8	–	6.8	18.2	25.0
Switzerland	9.1	20.5	29.6	–	29.6
Germany	–	3.3	3.3	22.7	26.0
Supranationals	11.9	–	11.9	–	11.9
Spain	0.7	6.9	7.6	–	7.6
Italy	–	6.2	6.2	–	6.2
Emerging market corporates	3.2	47.4	50.6	–	50.6
Emerging market sovereign	–	–	–	87.7	87.7
Emerging market agency	–	–	–	11.0	11.0
Other	2.8	5.0	7.8	–	7.8
Total	**284.5**	**399.4**	**683.9**	**181.4**	**865.3**

The sector allocation of the corporate bonds is as follows:

As at 31 December	2011 $m	2011 %	2010 $m	2010 %
Financial	238.8	37.3	272.8	35.0
Financial – FDIC guaranteed	49.2	7.7	95.5	12.3
Industrial	277.5	43.4	300.3	38.5
Utility	43.2	6.8	64.6	8.3
Foreign agencies	29.5	4.6	34.3	4.4
Supranationals	1.5	0.2	11.9	1.5
Total	**639.7**	**100.0**	**779.4**	**100.0**

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 third quarter of 2011, the Group has no exposure to valuation risk from equity securities. The Group's investment portfolio is now mainly comprised of cash and cash equivalents and 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	2011 $m	2011 %	2010 $m	2010 %
Immediate shift in yield (basis points)				
100	(36.2)	(2.1)	(52.5)	(3.1)
75	(27.1)	(1.6)	(39.4)	(2.3)
50	(18.1)	(1.1)	(26.3)	(1.5)
25	(9.0)	(0.5)	(13.1)	(0.8)
(25)	8.7	0.5	11.9	0.7
(50)	17.3	1.0	23.8	1.4
(75)	26.0	1.5	35.7	2.1
(100)	34.6	2.0	47.6	2.8

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 durations of the externally managed portfolios are as follows:

As at 31 December	2011 years	2010 years
Core portfolio	1.3	1.7
Core plus portfolio	1.2	2.1
Surplus portfolio	2.8	3.7
Overall portfolio	**2.0**	**2.8**

The overall duration for fixed income and managed cash and cash equivalents is 1.8 years (2010 – 2.2 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 Group also models various periods of significant stress in order to better understand the investment portfolios risks and exposures.

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 90 day VaR at the 95th percentile confidence level. Management also monitors the 99th percentile confidence level. The 90 day VaR, at the 95th percentile confidence level, measures the minimum amount the assets should be expected to lose in a 90 day time horizon, under normal conditions, 5% of the time. The current VaR tolerance is 4.0% of shareholders' equity, using the 90 day VaR at the 95th percentile confidence level.

The Group's 90 day VaR calculations are as follows:

	2011		2010	
As at 31 December	$m	%	$m	%
95th percentile confidence level	18.5	1.4	34.4	2.7
99th percentile confidence level	26.1	2.0	48.6	3.8

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 are 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 may also use internally managed derivatives to mitigate interest rate risk and foreign currency exposures. 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.

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

As at 31 December 2011	Net other investment income $m	Net realised gains (losses) $m	Net foreign exchange gains (losses) $m	Financing costs $m
Eurodollar futures	–	1.6	–	–
Treasury futures	–	(1.6)	–	–
Forward foreign currency contracts	–	–	2.1	–
Interest rate swaps – investments	(0.1)	(0.2)	–	–
Interest rate swaps – debt	–	–	–	(7.4)
Credit default swaps	(0.4)	–	–	–
Total	**(0.5)**	**(0.2)**	**2.1**	**(7.4)**

As at 31 December 2010	Net other investment income $m	Net realised gains (losses) $m	Net foreign exchange gains (losses) $m	Financing costs $m
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)**

The estimated fair values of the Group's derivative instruments are as follows:

	2011			2010	
As at 31 December	Other investments $m	Other assets $m	Interest rate swap $m	Other investments $m	Interest rate swap $m
Forward foreign currency contracts	0.1	0.2	–	(0.3)	–
Interest rate swaps – investments	(0.2)	–	–	(0.1)	–
Interest rate swaps – debt	–	–	(6.1)	–	(0.8)
Credit default swaps	(0.5)	–	–	0.2	–
Total	**(0.6)**	**0.2**	**(6.1)**	**(0.2)**	**(0.8)**

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 2011 and 2010 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. These include 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 2011 and 2010. 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	2011 $m	2010 $m
Immediate shift in 3 month LIBOR (basis points)		
100	(1.2)	(0.7)
75	(0.9)	(0.6)
50	(0.6)	(0.4)
25	(0.3)	(0.2)
(25)	0.3	0.2
(50)	0.6	0.4
(75)	0.9	0.6
(100)	1.2	0.7

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 other means which permit 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 gain exposure to a certain currency or market rate or manage the impact of fluctuations in foreign currencies on the value of its foreign currency denominated investments and/or insurance related currency exposures.

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.

The notional amount of a derivative contract is the underlying quantity upon which payment obligations are calculated. A long position is equivalent to buying the underlying currency whereas a short position is equivalent to having sold the underlying currency.

The Group has the following open forward foreign currency contracts:

	2011			2010		
As at 31 December	Notional long $m	Notional short $m	Net notional long (short) $m	Notional long $m	Notional short $m	Net notional long (short) $m
Japanese Yen	24.3	0.3	24.0	–	–	–
Canadian Dollar	0.3	21.8	(21.5)	–	–	–
Euro	0.6	12.0	(11.4)	–	11.2	(11.2)
Australian Dollar	–	10.7	(10.7)	–	–	–
Brazilian Real	5.3	9.2	(3.9)	0.9	0.2	0.7
Mexican Peso	3.5	3.6	(0.1)	2.7	3.2	(0.5)
South African Rand	4.8	4.9	(0.1)	0.2	1.5	(1.3)
Chinese Renminbi	5.6	5.6	–	4.0	1.0	3.0
Russian Ruble	4.5	4.5	–	0.7	–	0.7
Turkish Lira	3.5	3.5	–	1.6	–	1.6
Indonesian Rupiah	3.4	3.4	–	0.5	0.8	(0.3)
Malaysian Ringgit	2.4	2.4	–	0.9	0.1	0.8
Other[1]	8.7	10.0	(1.3)	11.4	3.1	8.3
Total	**66.9**	**91.9**	**(25.0)**	**22.9**	**21.1**	**1.8**

(1) Individual currencies included in 'other' have a notional payable and receivable of less than $2.0 million.

e. Swaps

The Group's investment guidelines permit the use of interest rate swaps and credit default swaps which are primarily 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 2011, the maximum amount of loss the Group could incur on its open credit default swaps was the notional value of $20.8 million (2010 – $9.8 million).

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 21. 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	Interest hedged
Subordinated loan notes $97.0 million	15 December 2035	100%
Subordinated loan notes €24.0 million	15 June 2035	100%

Two-thirds of the U.S. dollar swaps expire on 15 March 2016 while the remaining balance expires on 3 August 2016. The Euro swaps expire on 4 August 2016.

The Group currently has no interest rate risk on the subordinated loan notes. At the prior year-end, the Euribor interest rate on 50% of the Euro subordinated loan notes had been set at 1.03%, while the LIBOR interest rate on 50% of the U.S. dollar subordinated loan notes had been set at 0.30%.

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, but may also use derivatives to mitigate foreign currency exposures. 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. See page 93 for a listing of the Group's open forward foreign currency contracts.

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

Assets	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Cash and cash equivalents	153.9	10.2	80.8	60.9	6.0	311.8
Accrued interest receivable	10.0	–	–	–	–	10.0
Fixed income securities	1,664.4	1.3	10.8	–	37.5	1,714.0
Other investments	(0.6)	–	–	–	–	(0.6)
Reinsurance assets	84.7	–	–	–	–	84.7
Deferred acquisition costs	46.9	1.0	7.0	0.9	5.6	61.4
Other receivables	47.9	0.7	–	–	–	48.6
Inwards premiums receivable from insureds and cedants	160.1	3.4	26.6	5.7	16.3	212.1
Deferred tax asset	–	8.2	–	–	–	8.2
Investment in associate	50.9	–	–	–	–	50.9
Property, plant and equipment	3.6	1.7	–	–	–	5.3
Intangible asset	–	1.2	–	–	–	1.2
Total assets as at 31 December 2011	**2,221.8**	**27.7**	**125.2**	**67.5**	**65.4**	**2,507.6**

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	319.2	6.9	67.4	161.5	16.2	571.2
Unearned premiums	279.0	7.4	29.0	8.3	23.4	347.1
Insurance contracts – other payables	16.2	0.1	5.6	–	1.6	23.5
Amounts payable to reinsurers	17.8	–	–	–	–	17.8
Deferred acquisition costs ceded	0.7	–	–	–	–	0.7
Other payables	75.6	10.3	0.4	–	0.1	86.4
Interest rate swap	4.8	–	1.3	–	–	6.1
Long-term debt	97.0	–	31.0	–	–	128.0
Total liabilities as at 31 December 2011	**810.3**	**24.7**	**134.7**	**169.8**	**41.3**	**1,180.8**

Assets	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Cash and cash equivalents	141.5	269.8	93.2	3.2	4.8	512.5
Accrued interest receivable	13.4	–	–	–	–	13.4
Fixed income securities	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	0.4	3.9	61.2
Other receivables	41.5	4.2	–	–	–	45.7
Inwards premiums receivable from insureds and cedants	172.8	3.8	29.2	0.3	11.4	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**	**3.9**	**42.7**	**2,627.4**

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	395.9	9.9	86.6	1.9	13.2	507.5
Unearned premiums	296.4	6.5	27.1	2.3	18.3	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**	**4.2**	**32.7**	**1,340.5**

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 $4.2 million (2010 – $0.2 million).

The 31 December 2011 losses and loss adjustment expenses include the equivalent of $57.1 million (2010 – $nil) of Japanese Yen denominated insurance liabilities. These losses are contained within the Group's outwards reinsurance program which limits the Group's net liability to $15.0 million. The Group has therefore not hedged the foreign currency exposure in relation to these losses.

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 value 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 2011	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	118.5	117.5	47.5	283.5
Between one and two years	79.2	128.7	139.9	347.8
Between two and three years	60.0	114.2	136.8	311.0
Between three and four years	9.0	19.1	37.7	65.8
Between four and five years	16.4	28.0	60.4	104.8
Over five years	5.4	6.2	215.0	226.6
Asset backed and mortgage backed securities	46.8	150.7	177.0	374.5
Total fixed income securities	**335.3**	**564.4**	**814.3**	**1,714.0**

As at 31 December 2010	Core $m	Core plus $m	Surplus $m	Total $m
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 fixed income securities	**288.4**	**613.2**	**817.5**	**1,719.1**

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

		Years until liability becomes due – undiscounted values				
As at 31 December 2011	Balance sheet $m	Less than one $m	One to three $m	Three to five $m	Over five $m	Total $m
Losses and loss adjustment expenses	571.2	244.9	214.6	68.3	43.4	571.2
Insurance contracts – other payables	23.5	18.0	5.3	0.2	–	23.5
Amounts payable to reinsurers	17.8	17.8	–	–	–	17.8
Other payables	85.2	85.2	–	–	–	85.2
Corporation tax payable	1.2	1.2	–	–	–	1.2
Interest rate swap	6.1	1.8	2.7	1.6	–	6.1
Long-term debt	128.0	5.4	11.4	11.4	235.7	263.9
Total	**833.0**	**374.3**	**234.0**	**81.5**	**279.1**	**968.9**

Risk disclosures *continued*

As at 31 December 2010	Balance sheet $m	Years until liability becomes due – undiscounted values Less than one $m	One to three $m	Three to five $m	Over five $m	Total $m
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**

Actual maturities of the above may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. The prepayment options for the Group's long-term debt are discussed in note 21. 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 10% of shareholders' equity. 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 page 83. Reinsurance recoverables from ARL are fully collateralised.

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 2011	Other investments $m	Cash and fixed income securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	–	407.5	–	–
AA+, AA, AA-	–	883.9	–	–
A+, A, A-	(0.6)	519.5	6.2	69.7
BBB+, BBB, BBB-	–	165.9	–	–
Other	–	49.0	260.7	–
Total	**(0.6)**	**2,025.8**	**266.9**	**69.7**

As at 31 December 2010	Other investments $m	Cash and fixed income securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
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**

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

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

	2011 $m	2010 $m
Less than 90 days past due	10.5	8.1
Between 91 and 180 days past due	0.3	0.6
Over 180 days past due	0.1	0.2
Total	**10.9**	**8.9**

Provisions of $0.8 million (2010 – $0.6 million) have been made for impaired or irrecoverable balances and $0.3 million (2010 – $0.6 million release) was charged to the consolidated statement of comprehensive income in respect of bad debts. No provisions have been made against balances recoverable from reinsurers.

E. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes or systems. The Group and its subsidiaries have identified and evaluated their key operational risks and these are incorporated in the risk registers and modeled directly within 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 an inappropriate business plan 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 business planning process with cross departmental involvement;
- evaluation of and approval of the annual business plan by the Board of Directors;
- regular monitoring of actual versus planned results;
- periodic review and re-forecasting as market conditions change; and
- feedback to senior management via the daily underwriting and marketing conference call.

ii. Capital management risk

The total capital of the Group is as follows:

As at 31 December	2011 $m	2010 $m
Shareholders' equity	1,326.8	1,286.9
Long-term debt	128.0	128.8
Total capital	**1,454.8**	**1,415.7**

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 28 for a discussion of the regulatory capital requirements of the Group's operating entities.

The Group's aim is to provide its shareholders with an 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 expects both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver of this pattern. Management monitors these peaks and troughs – adjusting the Group's portfolio to make the most effective use of available capital and seeking to maximise the risk-adjusted return.

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
31 December 2011	13.4	19.5	191.2

(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
31 December 2011	13.3	17.7	179.9

(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, including equity based compensation which vests over a defined time horizon, and training schemes.

1. General information

The Group is a provider of global specialty insurance and reinsurance products. LHL was incorporated under the laws of Bermuda on 12 October 2005. On 16 March 2009 LHL was added to the official list and its common shares were admitted to trading on the main market of the LSE; previously LHL's shares were listed on AIM, a subsidiary market of the LSE. Since 21 May 2007 LHL's shares have had a secondary listing on the BSX. LHL's registered office is Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda. From 1 January 2012 LHL's head office is at Level 11, Vitro, 60 Fenchurch Street, London, EC3M 4AD, United Kingdom.

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 on the following dates and as at 31 December 2011 held the following licence or authorisations as insurance companies or intermediaries:

	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	None	In liquidation

Following the Group's application to close its Dubai subsidiary (LMEL), the DFSA withdrew its licence to perform insurance intermediation activities on 18 December 2011.

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 80 to 83. 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 2011	Property $m	Energy $m	Marine $m	Aviation $m	Total $m
Gross premium written by geographical region					
Worldwide offshore	0.6	210.0	73.7	–	284.3
Worldwide, including the U.S. and Canada[1]	59.4	11.6	1.3	47.1	119.4
U.S. and Canada	80.9	3.3	–	–	84.2
Europe	30.2	0.6	0.7	–	31.5
Worldwide, excluding the U.S. and Canada[2]	25.8	0.5	–	–	26.3
Far East	25.9	0.2	0.1	–	26.2
Middle East	7.7	0.8	–	–	8.5
Rest of world	49.3	2.0	0.6	–	51.9
Total	**279.8**	**229.0**	**76.4**	**47.1**	**632.3**
Outwards reinsurance premiums	(41.2)	(18.3)	(3.9)	(3.8)	(67.2)
Change in unearned premiums	12.0	(15.1)	4.8	1.8	3.5
Change in unearned premiums ceded	5.8	0.3	–	(0.2)	5.9
Net premiums earned	**256.4**	**195.9**	**77.3**	**44.9**	**574.5**
Insurance losses and loss adjustment expenses	(171.4)	(55.6)	(4.1)	5.8	(225.3)
Insurance losses recoverable	41.2	1.8	–	–	43.0
Insurance acquisition expenses	(36.3)	(43.0)	(25.1)	(9.8)	(114.2)
Insurance acquisition expenses ceded	1.2	0.4	0.1	0.1	1.8
Net underwriting profit	**91.1**	**99.5**	**48.2**	**41.0**	**279.8**
Net unallocated income and expenses					(61.2)
Profit before tax					**218.6**
Net loss ratio	50.8%	27.5%	5.3%	(12.9%)	31.7%
Net acquisition cost ratio	13.7%	21.7%	32.3%	21.6%	19.6%
Expense ratio	–	–	–	–	12.4%
Combined ratio	**64.5%**	**49.2%**	**37.6%**	**8.7%**	**63.7%**

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

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

Revenue and expense by operating segment

For the year ended 31 December 2010	Property $m	Energy $m	Marine $m	Aviation $m	Total $m
Gross premium written by geographical region					
Worldwide offshore	1.2	225.0	75.2	–	301.4
Worldwide, including the U.S. and Canada[1]	53.9	7.6	0.5	50.7	112.7
U.S. and Canada	133.3	2.6	–	–	135.9
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**
Net loss ratio	34.9%	20.2%	38.6%	(11.1%)	27.0%
Net 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.

3. Investment return

The total investment return for the Group is as follows:

For the year ended 31 December 2011	Investment income and other investment income $m	Net realised gains (losses) and impairments $m	Net change in unrealised gains (losses) $m	Total investment return excluding foreign exchange $m	Foreign exchange gains (losses) $m	Total investment return including foreign exchange $m
Fixed income securities	41.2	16.0	(10.5)	46.7	(7.4)	39.3
Equity securities	1.1	(7.2)	–	(6.1)	–	(6.1)
Other investments	(0.5)	(0.2)	–	(0.7)	1.4	0.7
Cash and cash equivalents	0.9	–	–	0.9	–	0.9
Total investment return	**42.7**	**8.6**	**(10.5)**	**40.8**	**(6.0)**	**34.8**

For the year ended 31 December 2010	Investment income and other investment income $m	Net realised gains (losses) and impairments $m	Net change in unrealised gains (losses) $m	Total investment return excluding foreign exchange $m	Foreign exchange gains (losses) $m	Total investment return including foreign exchange $m
Fixed income securities	52.5	32.2	(2.0)	82.7	0.5	83.2
Other investments	0.1	1.0	–	1.1	0.3	1.4
Cash and cash equivalents	0.9	–	–	0.9	–	0.9
Total investment return	**53.5**	**33.2**	**(2.0)**	**84.7**	**0.8**	**85.5**

Net realised gains (losses) and impairments includes impairment losses of $0.3 million (2010 – $nil) recognised on fixed income securities held by the Group.

Refer to page 91 in the risk disclosures section for the estimated fair values 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 $4.3 million (2010 – $4.0 million) of investment management, accounting and custodian fees.

4. Net insurance acquisition expenses

	2011 $m	2010 $m
Insurance acquisition expenses	114.4	118.2
Changes in deferred insurance acquisition expenses	(0.2)	(8.3)
Insurance acquisition expenses ceded	(2.4)	(3.2)
Changes in deferred insurance acquisition expenses ceded	0.6	(0.4)
Total net insurance acquisition expenses	**112.4**	**106.3**

5. Results of operating activities

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

	2011 $m	2010 $m
Depreciation on owned assets	2.9	2.6
Operating lease charges	1.8	3.2
Auditors' remuneration		
– Group audit fees	1.3	1.3
– Other services	0.1	0.3
Total	**6.1**	**7.4**

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

6. Employee benefits

	2011 $m	2010 $m
Wages and salaries	19.3	19.0
Pension costs	1.8	1.5
Bonus and other benefits	19.7	12.7
Total cash compensation	**40.8**	**33.2**
RSS – ordinary	10.6	14.3
RSS – bonus deferral	4.1	1.0
RSS – exceptional	–	0.1
LTIP	4.1	5.3
Warrants – performance	–	0.4
Total equity based compensation	**18.8**	**21.1**
Total employee benefits	**59.6**	**54.3**

Equity based compensation

The Group's primary equity based compensation scheme is its RSS. Previously the Group also issued options to employees pursuant to an LTIP, which has been closed to further issues, and also authorised and issued warrants at its formation in 2005 and 2006. Further details of the warrants can be found in note 23.

6. Employee benefits continued

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 RSS awards program to a nil-cost options program. The modification introduced an exercise period of ten years from the grant date for all outstanding and future RSS grants. Previously, all awards were automatically converted to shares on the vesting date.

The fair value of any TSR component of the nil-cost options is estimated using a stochastic model. For all other components the Black-Scholes model is used to estimate the fair value.

The following table lists the assumptions used in the stochastic model for the RSS awards granted during the years ended 31 December 2011 and 2010:

Assumptions	2011	2010
Dividend yield	0.0%	0.0%
Expected volatility(1)	22.1% – 24.9%	25.7%
Risk-free interest rate(2)	0.96% – 1.49%	2.53%
Expected average life of options	3 years	3 years
Share price	$9.67 – $11.14	$7.24

(1) The expected volatility of LHL and comparator companies share prices are calculated based on the movement in the share prices over a period prior to the grant date, equal in length to the expected life of the award.

(2) The risk-free interest rate is consistent with UK government bond yields.

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 an LHL 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 LHL RoE in excess of a required amount. 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.

	Number
Outstanding as at 31 December 2009	**4,292,883**
Granted	2,145,681
Forfeited	(533,119)
Outstanding as at 31 December 2010	**5,905,445**
Granted	1,955,830
Exercised	(1,500,995)
Lapsed	(7,223)
Forfeited	(124,220)
Outstanding as at 31 December 2011	**6,228,837**
Exercisable as at 31 December 2011	**2,277,055**

	2011	2010
Weighted average remaining contractual life	8.1 years	8.3 years
Weighted average fair value at date of grant during the year	$7.98	$5.79
Weighted average share price at date of exercise during the year	$10.53	n/a

RSS – bonus deferral

The bonus deferral RSS options vesting periods range from one to two years and do not have associated performance criteria for vesting. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise.

	Number
Outstanding as at 31 December 2009	**–**
Granted	390,024
Forfeited	(18,190)
Outstanding as at 31 December 2010	**371,834**
Granted	549,738
Forfeited	(4,417)
Outstanding as at 31 December 2011	**917,155**
Exercisable as at 31 December 2011	**–**

	2011	2010
Weighted average remaining contractual life	8.8 years	9.2 years
Weighted average fair value at date of grant during the year	$10.01	$7.06

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
Outstanding as at 31 December 2009	**4,616,752**	**$4.32**
Exercised	(2,547,678)	$3.76
Forfeited	(285,911)	$4.38
Outstanding as at 31 December 2010	**1,783,163**	**$2.88**
Exercised	(1,379,379)	$2.53
Forfeited	(66,720)	$2.32
Outstanding and exercisable as at 31 December 2011	**337,064**	**$2.11**

	2011	2010
Weighted average remaining contractual life	5.5 years	6.3 years
Weighted average share price at date of exercise during the year	$10.61	$7.97

6. Employee benefits continued

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.

	Adjustment to exercise price			
Date	$	£	2011 $m	2010 $m
14 February 2008	1.10	0.56	0.1	0.3
4 November 2009	1.30	0.79	0.5	2.9
19 March 2010	0.10	0.07	0.1	0.5
3 September 2010	0.05	0.03	0.1	0.1
10 December 2010	1.40	0.89	2.5	0.8
18 March 2011	0.10	0.06	0.1	–
26 August 2011	0.05	0.03	–	–
25 November 2011	0.80	0.52	0.6	–
Total			**4.0**	**4.6**

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 warrant. Ordinary warrants granted and outstanding are:

	Number	Weighted average exercise price
Outstanding as at 31 December 2009	**11,433,465**	**$4.71**
Exercised	(1,398,670)	$4.62
Outstanding as at 31 December 2010	**10,034,795**	**$4.72**
Exercised	(1,169,766)	$4.62
Sale to external buyer	(2,350,000)	$5.00
Outstanding and exercisable as at 31 December 2011	**6,515,029**	**$4.65**

	2011	2010
Weighted average remaining contractual life	4.0 years	5.0 years
Weighted average share price at date of exercise during the year	$10.80	$7.47

Refer to note 26 for further disclosure on the warrants sale.

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 warrant. The exercise price of warrants was automatically adjusted for dividends declared prior to their vesting dates.

Performance warrants granted and outstanding are:

	Number	Weighted average exercise price
Outstanding as at 31 December 2009	**1,760,310**	**$3.62**
Exercised	(415,500)	$3.62
Outstanding as at 31 December 2010	**1,344,810**	**$3.62**
Exercised	(417,494)	$3.61
Outstanding and exercisable as at 31 December 2011	**927,316**	**$3.62**

	2011	2010
Weighted average remaining contractual life	4.0 years	5.0 years
Weighted average share price at date of exercise during the year	$11.09	$7.50

Refer to note 23 for further disclosure on non-management warrants outstanding.

7. Financing costs

	2011 $m	2010 $m
Interest expense on long-term debt	5.6	5.4
Net losses on interest rate swaps	7.4	0.3
Other financing costs	1.2	1.0
Total	**14.2**	**6.7**

Refer to note 21 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 2035. 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.

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.

Tax charge	2011 $m	2010 $m
Corporation tax charge for the period	6.0	8.9
Adjustments in respect of prior period corporation tax	(0.1)	1.0
Deferred tax charge (credit) for the period	0.5	(1.5)
Total tax charge	**6.4**	**8.4**

Tax reconciliation	2011 $m	2010 $m
Profit before tax	218.6	339.2
Less profit not subject to tax	(196.6)	(308.8)
Profits subject to tax	**22.0**	**30.4**
UK corporation tax at 26.5% (28.0%)	5.8	8.5
Adjustments in respect of prior period	(0.1)	1.0
Differences related to equity based compensation	(0.1)	(0.5)
Other expense permanent differences	0.1	(0.7)
Tax rate change adjustment	0.7	0.1
Total tax charge	**6.4**	**8.4**

Due to the different taxpaying jurisdictions throughout the Group the current tax charge as a percentage of the Group's profit before tax is 2.9% (2010 – 2.5%).

As at 31 December 2011, a corporation tax credit of $2.0 million (2010 – $0.4 million) 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/losses on investments that is included in accumulated other comprehensive income within shareholders' equity.

9. Cash and cash equivalents

	2011 $m	2010 $m
Cash at bank and in hand	122.9	34.5
Cash equivalents	188.9	478.0
Total cash and cash equivalents	**311.8**	**512.5**

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

Refer to note 21 for the cash and cash equivalent balances on deposit as collateral.

10. Investments

As at 31 December 2011	Cost or amortised cost $m	Gross unrealised gain $m	Gross unrealised loss $m	Estimated fair value $m
Fixed income securities				
– Short-term investments	78.9	–	–	78.9
– U.S. treasuries	349.7	1.4	–	351.1
– Other government bonds	158.6	2.8	(2.3)	159.1
– U.S. municipal bonds	26.8	1.0	(0.1)	27.7
– U.S. government agency debt	82.5	0.5	–	83.0
– Asset backed securities	69.9	0.2	(0.5)	69.6
– U.S. government agency mortgage backed securities	251.8	8.6	(0.1)	260.3
– Non-agency mortgage backed securities	13.1	0.1	(0.1)	13.1
– Non-agency commercial mortgage backed securities	30.2	1.3	–	31.5
– Corporate bonds	587.0	10.4	(6.9)	590.5
– Corporate bonds – FDIC guaranteed	48.8	0.4	–	49.2
Total fixed income securities	**1,697.3**	**26.7**	**(10.0)**	**1,714.0**
Other investments	(0.3)	2.6	(2.9)	(0.6)
Total investments	**1,697.0**	**29.3**	**(12.9)**	**1,713.4**

10. Investments continued

As at 31 December 2010	Cost or amortised cost $m	Gross unrealised gain $m	Gross unrealised loss $m	Estimated fair value $m
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	**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**

Accumulated other comprehensive income is in relation to the Group's fixed income securities and is as follows:

	2011 $m	2010 $m
Gross unrealised gains	26.7	38.1
Gross unrealised losses	(10.0)	(8.2)
Net foreign exchange losses (gains)	1.7	(1.0)
Tax provision	(0.8)	(0.7)
Accumulated other comprehensive income	**17.6**	**28.2**

Fixed income maturities are presented in the risk disclosures section on page 97. Refer to note 21 for the investment balances in trusts in favour of ceding companies and on deposit as collateral.

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

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;
- U.S. 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 2011 and 2010, 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. The 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.

10. Investments continued

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.

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

As at 31 December 2011	(i) $m	(ii) $m	Total $m
Fixed income securities			
– Short-term investments	72.1	6.8	78.9
– U.S. treasuries	351.1	–	351.1
– Other government bonds	–	159.1	159.1
– U.S. municipal bonds	–	27.7	27.7
– U.S. government agency debt	–	83.0	83.0
– Asset backed securities	–	69.6	69.6
– U.S. government agency mortgage backed securities	–	260.3	260.3
– Non-agency mortgage backed securities	–	13.1	13.1
– Non-agency commercial mortgage backed securities	–	31.5	31.5
– Corporate bonds	–	590.5	590.5
– Corporate bonds – FDIC guaranteed	–	49.2	49.2
Total fixed income securities	**423.2**	**1,290.8**	**1,714.0**
Other investments	–	(0.6)	(0.6)
Total investments	**423.2**	**1,290.2**	**1,713.4**

As at 31 December 2010	(i) $m	(ii) $m	Total $m
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	**311.6**	**1,407.5**	**1,719.1**
Other investments	–	(0.2)	(0.2)
Total investments	**311.6**	**1,407.3**	**1,718.9**

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

	Unearned premiums ceded $m	Amounts payable to reinsurers $m	Other receivables $m	Total $m
As at 31 December 2009	**5.6**	**(4.2)**	**4.3**	**5.7**
Net deferral for prior years	(5.6)	–	–	(5.6)
Net deferral for 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**
Net deferral for prior years	(2.9)	–	–	(2.9)
Net deferral for current year	8.8	–	–	8.8
Other	–	(13.4)	0.6	(12.8)
As at 31 December 2011	**8.8**	**(17.8)**	**6.2**	**(2.8)**

12. Losses and loss adjustment expenses

	Losses and loss adjustment expenses $m	Reinsurance recoveries $m	Net losses and loss adjustment expenses $m
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**
Net incurred losses for:			
Prior years	(168.5)	13.2	(155.3)
Current year	393.8	(56.2)	337.6
Exchange adjustments	2.5	–	2.5
Incurred losses and loss adjustment expenses	**227.8**	**(43.0)**	**184.8**
Net paid losses for:			
Prior years	130.2	(9.2)	121.0
Current year	33.9	–	33.9
Paid losses and loss adjustment expenses	**164.1**	**(9.2)**	**154.9**
As at 31 December 2011	**571.2**	**(69.7)**	**501.5**

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 83. 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 $114.2 million (2010 – $101.5 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, additional case reserves assessed by management and IBNR is shown below:

As at 31 December	2011 $m	2011 %	2010 $m	2010 %
Outstanding losses	276.7	48.4	251.8	49.6
Additional case reserves	123.9	21.7	61.1	12.0
Losses incurred but not reported	170.6	29.9	194.6	38.4
Total	**571.2**	**100.0**	**507.5**	**100.0**

The Group's reserve for unpaid losses and loss adjustment expenses as at 31 December 2011 and 2010 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.

Accident year	2006 $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $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	397.0	
One year later	34.7	131.2	417.4	107.8	209.4		
Two years later	32.0	103.5	377.5	73.1			
Three years later	27.6	94.8	345.1				
Four years later	27.2	83.5					
Five years later	24.4						
Current estimate of cumulative liability	**24.4**	**83.5**	**345.1**	**73.1**	**209.4**	**397.0**	**1,132.5**
Payments made	**(21.7)**	**(72.4)**	**(284.4)**	**(42.5)**	**(106.4)**	**(33.9)**	**(561.3)**
Total gross liability	**2.7**	**11.1**	**60.7**	**30.6**	**103.0**	**363.1**	**571.2**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2011.

Accident year	2006 $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	Total $m
Reinsurance							
Estimate of ultimate recovery[1]							
At end of accident year	–	3.6	40.7	1.6	33.8	56.2	
One year later	–	6.2	47.1	1.3	23.6		
Two years later	–	4.0	43.1	0.7			
Three years later	–	3.5	40.9				
Four years later	–	3.3					
Five years later	–						
Current estimate of cumulative recovery	**–**	**3.3**	**40.9**	**0.7**	**23.6**	**56.2**	**124.7**
Payments made	**–**	**(3.1)**	**(33.9)**	**(0.5)**	**(17.5)**	**–**	**(55.0)**
Total gross recovery	**–**	**0.2**	**7.0**	**0.2**	**6.1**	**56.2**	**69.7**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2011.

Accident year	2006 $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $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	340.8	
One year later	34.7	125.0	370.3	106.5	185.8		
Two years later	32.0	99.5	334.4	72.4			
Three years later	27.6	91.3	304.2				
Four years later	27.2	80.2					
Five years later	24.4						
Current estimate of cumulative liability	**24.4**	**80.2**	**304.2**	**72.4**	**185.8**	**340.8**	**1,007.8**
Payments made	**(21.7)**	**(69.3)**	**(250.5)**	**(42.0)**	**(88.9)**	**(33.9)**	**(506.3)**
Total net liability	**2.7**	**10.9**	**53.7**	**30.4**	**96.9**	**306.9**	**501.5**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2011.

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:

	2011 $m	2010 $m
2006 accident year	2.9	0.3
2007 accident year	11.1	8.3
2008 accident year	29.8	36.0
2009 accident year	33.7	55.5
2010 accident year	77.8	–
Total favourable development	**155.3**	**100.1**

In early 2011 an independent external reserve study was commissioned in order to incorporate the Group's own loss experience with the industry factors previously used. On completion net reserves of $36.9 million were released. The remaining favourable prior year development in 2011 arose primarily from further IBNR releases of $96.2 million due to fewer than expected reported losses plus net releases on outstanding case reserves and additional case reserves of $22.2 million as a result of updated information received, including the Chile Maule earthquake and Hurricane Ike reserves discussed below. In 2010, the favourable development related primarily to IBNR releases, again due to fewer than expected reported losses.

12. Losses and loss adjustment expenses continued

During 2011 the Group was impacted by significant losses in relation to the Japan Tohoku earthquake and following tsunami. Management's current best estimate of the ultimate net loss in relation to this event is $117.3 million. The 90th percentile of the loss distribution for this estimate is $137.1 million with the 95th percentile being $143.7 million. Significant uncertainty exists on the eventual ultimate loss in relation to earthquakes.

During 2010 the Group was impacted by significant losses in relation to the Chile Maule earthquake and subsequent aftershocks. Management's current best estimate of the ultimate net loss in relation to this event is $69.0 million. The 90th percentile of the loss distribution for this estimate is $74.6 million with the 95th percentile being $76.5 million.

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. Management's current best estimate of the ultimate net loss in relation to this event is $174.5 million. The 90th percentile of the loss distribution for this estimate is $179.4 million with the 95th percentile being $181.1 million.

The Group's estimated ultimate net losses, after reinstatement premiums, for these significant events are as follows:

	Japan $m	Chile $m	Ike $m
Net ultimate losses as at 31 December 2009	**–**	**–**	**178.8**
Change in insurance losses and loss adjustment expenses	–	96.8	1.6
Change in insurance losses and loss adjustment expenses recoverable	–	–	1.4
Change in reinstatement premium	–	(12.1)	(2.0)
Net ultimate losses as at 31 December 2010	**–**	**84.7**	**179.8**
Change in insurance losses and loss adjustment expenses	119.2	(15.6)	(6.4)
Change in insurance losses and loss adjustment expenses recoverable	–	–	1.7
Change in reinstatement premium	(1.9)	(0.1)	(0.6)
Net ultimate losses as at 31 December 2011	**117.3**	**69.0**	**174.5**

13. Insurance, reinsurance and other receivables

All receivables are considered current other than $28.0 million (2010 – $30.7 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 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**
Net deferral during the year	114.4	(2.4)	112.0
Income (expense) for the year	(114.2)	1.8	(112.4)
As at 31 December 2011	**61.4**	**(0.7)**	**60.7**

15. Deferred tax asset

	2011 $m	2010 $m
Deferred tax assets (related to equity based compensation)	10.1	7.8
Deferred tax liabilities (related to claims equalisation reserves)	(1.9)	(1.4)
Net deferred tax asset	**8.2**	**6.4**

A deferred tax credit of $2.3 million (2010 – $1.6 million) 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 sufficient taxable profits will be available within the Lancashire UK group of companies in 2012 and subsequent years to utilise the deferred tax assets recognised when the underlying temporary differences reverse, thus the entire deferred tax asset is recognised. All deferred tax assets and liabilities are classified as non-current.

16. Investment in associate

The Group has a commitment of up to $50.0 million representing a 20% interest in AHL, a company incorporated in Bermuda. AHL's operating subsidiary, ARL, is authorised as a Special Purpose Insurer by the BMA.

ARL assumes worldwide property retrocession risks from LICL. AHL is an unquoted investment and its shares do not trade on an active market. By 31 December 2011 the full $50.0 million commitment had been called. Subsequent to year end $14.9 million of committed capital was returned by AHL to the Group. See note 29 for details. As at 31 December 2011 the carrying value of the Group's investment in AHL is $50.9 million. The Group's share of comprehensive income for AHL for the period was $0.9m. Investments in associates are generally deemed non-current. Key financial information for AHL for the period from the date of incorporation, 1 June 2011, to 31 December 2011 is as follows:

	$m
Assets	260.1
Liabilities	5.8
Shareholders' equity	39.1
Amounts advanced in respect of shares to be issued	215.2
Revenues	6.1
Comprehensive income	4.3

17. Property, plant and equipment

	2011 $m	2010 $m
Cost	12.6	11.9
Accumulated depreciation	(7.3)	(4.5)
Net book value	**5.3**	**7.4**

18. Intangible asset

Intangible assets comprise costs directly attributable to internally developed software relating to a new underwriting system for the Group. On completion, the software will be amortised over a five year period.

19. Insurance liabilities

	Unearned premiums $m	Other payables $m	Total $m
As at 31 December 2009	**317.6**	**15.8**	**333.4**
Net deferral for prior years	(259.1)	–	(259.1)
Net deferral for current year	292.1	–	292.1
Other	–	4.8	4.8
As at 31 December 2010	**350.6**	**20.6**	**371.2**
Net deferral for prior years	(273.3)	–	(273.3)
Net deferral for current year	269.8	–	269.8
Other	–	2.9	2.9
As at 31 December 2011	**347.1**	**23.5**	**370.6**

20. Insurance, reinsurance and other payables

	2011 $m	2010 $m
Dividends payable	–	258.4
Other payables	84.9	62.7
Accrued interest payable	0.3	0.3
Total other payables	**85.2**	**321.4**
Insurance contracts – other payables	23.5	20.6
Amounts payable to reinsurers	17.8	4.4
Total payables	**126.5**	**346.4**

Further information on dividends declared is shown in note 22. Other payables include unsettled investment trades, 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.

21. Long-term debt and financing arrangements

Long-term debt

On 15 December 2005 the Group issued $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	2011 $m	2010 $m
Long-term debt $97.0 million	97.0	97.0
Long-term debt €24.0 million	31.0	31.8
Carrying value	**128.0**	**128.8**

The U.S. dollar subordinated loan notes are repayable on 15 December 2035 with a prepayment option available from 15 March 2011. Interest on the principal is based on a set margin, 3.70%, above the variable LIBOR rate and is payable quarterly. The loan notes were issued via a trust company.

The Euro subordinated loan notes are repayable on 15 June 2035 with a prepayment option available from 15 March 2011. Interest on the principal is based on a set margin, 3.70%, above the variable Euribor rate and is payable quarterly.

On 21 October 2011 the Cayman Islands Stock Exchange admitted to the official list the Group's U.S. dollar and Euro subordinated loan notes.

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 on pages 94 and 95.

The fair value of the long-term debt is estimated as $108.4 million (2010 – $118.7 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 (2010 – $0.3 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 94 for further details. The Group has the right to net settle these instruments.

The final cash settlement on expiring swaps was $0.8 million and was paid on 15 March 2011. The net fair value position owed by the Group on new swap agreements is $6.1 million. Further information is provided on pages 91 and 94. The Group has the right to net settle these instruments. Cash settlements are completed on a quarterly basis and the total of the next cash settlement on these instruments is $0.5 million. The net impact from cash settlement and changes in estimated fair value is included in financing costs.

The interest rate swaps are held at estimated fair value, priced using observable market inputs, and are therefore classified as category (ii) 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 the following facilities in place as of 31 December 2011:

(i) a $200.0 million syndicated collateralised five year credit facility with $75.0 million loan sub-limit that has been in place since 16 July 2007 and will expire on 16 July 2012. There was no outstanding debt under this facility at any reporting date;

(ii) a $200.0 million bi-lateral collateralised credit facility with Lloyds TSB Bank PLC which will expire on 16 July 2012; and

(iii) a $400.0 million bi-lateral uncommitted LOC facility with Citibank Europe 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.

21. Long-term debt and financing arrangements continued

The terms of both $200.0 million LOC 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 $400.0 million bi-lateral uncommitted LOC facility does not contain default provisions or covenants.

The following LOCs have been issued:

As at 31 December	2011 $m	2010 $m
Issued to third parties	9.4	18.9

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 2011 and 2010 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:

	2011		2010	
As at 31 December	Cash and cash equivalents $m	Fixed income securities $m	Cash and cash equivalents $m	Fixed income securities $m
In various trust accounts for policyholders	14.6	166.0	7.7	223.8
In favour of letters of credit	0.3	10.3	12.3	22.8
In favour of derivative contracts	0.9	0.5	0.5	0.1
Total	**15.8**	**176.8**	**20.5**	**246.7**

22. Share capital

Allocated, called up and fully paid	Number	$m
As at 31 December 2009	**182,503,063**	**91.2**
Shares repurchased and cancelled	(13,900,636)	(6.9)
As at 31 December 2010 and 2011	**168,602,427**	**84.3**

Own shares	Number held in treasury	$m	Number held in trust	$m	Total number of own shares	$m
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**
Shares distributed	(906,696)	(5.6)	(3,497,027)	(33.7)	(4,403,723)	(39.3)
Shares donated to trust	(4,028,423)	(25.4)	4,028,423	40.8	–	15.4
As at 31 December 2011	**10,513,326**	**69.2**	**1,267,421**	**13.8**	**11,780,747**	**83.0**

The number of common shares in issue with voting rights (allocated share capital less shares held in treasury) as at 31 December 2011 was 158,089,101 (31 December 2010 – 153,153,982).

Share repurchases

At the AGM held on 5 May 2011 the Group's shareholders approved a renewal of the Repurchase Program authorising the repurchase of a maximum of 16,860,242 shares (approximately $189.5 million at the 31 December 2011 share price), 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 was passed. No shares were repurchased during the year and the authority remains in place.

At 31 December 2010 $67.1 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 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**
Shares distributed	–	(906,696)	£3.12	(5.6)
Shares donated to trust	–	(4,028,423)	£3.21	(25.4)
As at 31 December 2011	**27,541,552**	**10,513,326**	**£4.16**	**273.0**

As at 31 December 2011 and 2010 no amounts remained to be settled.

In 2011 the trustees of the EBT acquired nil shares (2010 – 1,819,926) in accordance with the terms of the trust and distributed 3,497,027 (2010 – 2,276,729). There were no unsettled balances in relation to EBT purchases at either balance sheet date.

22. Share capital continued

Dividends

The Board of Directors have authorised the following dividends:

Type	Per share amount	Record date	Payment date	$m
Special	$1.25	20 Nov 2009	6 Jan 2010	263.0
Final	$0.10	19 Mar 2010	14 Apr 2010	20.8
Interim	$0.05	3 Sep 2010	13 Oct 2010	9.4
Special	$1.40	10 Dec 2010	19 Jan 2011	264.0
Final	$0.10	18 Mar 2011	20 Apr 2011	18.9
Interim	$0.05	26 Aug 2011	28 Sep 2011	9.5
Special	$0.80	25 Nov 2011	21 Dec 2011	152.0

23. Other reserves

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

	Number of Founder warrants	Number of Lancashire Foundation warrants	Number of ordinary warrants
Outstanding at 31 December 2009 and 2010	**24,470,717**	**648,143**	**–**
Exercised	(1,710,497)	–	–
Sale to external buyer	–	–	2,350,000
Outstanding and exercisable as at 31 December 2011	**22,760,220**	**648,143**	**2,350,000**
Weighted average exercise price as at 31 December 2011	**$5.00**	**$4.73**	**$5.00**

	2011	2010
Weighted average remaining contractual life	4.0 years	5.0 years
Weighted average share price at date of exercise during the year	$10.64	n/a

The fair value of all warrants granted was $2.62 per warrant. 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 Founder warrants as they were fully vested at the date of grant and exercisable upon issuance.

Refer to note 26 for further disclosure on the 2,350,000 ordinary warrants sold to an external buyer.

24. Lease commitments

The Group has payment obligations in respect of operating leases for certain items of office equipment and office space. Operating lease expenses for the year were $1.8 million (2010 – $3.2 million). Future minimum lease payments under non-cancellable operating leases are as follows:

	2011 $m	2010 $m
Due in less than one year	2.4	2.5
Due between one and five years	5.6	7.6
Due in more than five years	–	5.2
Total	**8.0**	**15.3**

25. Earnings per share

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

	2011 $m	2010 $m
Profit for the year attributable to equity shareholders	212.2	330.8

	2011 Number of shares	2010 Number of shares
Basic weighted average number of shares	154,339,421	158,806,410
Dilutive effect of RSS	5,088,005	3,990,315
Dilutive effect of LTIP	269,355	500,310
Dilutive effect of warrants	17,754,552	14,214,198
Diluted weighted average number of shares	**177,451,333**	**177,511,233**

Earnings per share	2011	2010
Basic	$1.38	$2.08
Diluted	$1.20	$1.86

Equity based compensation awards 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.

26. 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
Associate	
AHL	Bermuda
Other controlled entities	
LHFT	United States
EBT	Jersey

All subsidiaries are wholly owned, either directly or indirectly. The Group is in the process of liquidating its LMEL subsidiary.

The Group has issued subordinated loan notes via a trust vehicle – LHFT, refer to note 21. 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.

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.

The Group has 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 $40.0 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 2011, the Group had made advances of $4.0 million (2010 – $10.0 million) to the EBT under the terms of the Facility.

During the year ended 31 December 2011 the Group donated 4,028,423 (2010 – 1,000,000) treasury shares to the EBT at the prevailing market rate. The total value of the treasury share donation was $40.8 million (2010 – $8.8 million).

LICL holds $311.5 million (2010 – $306.4 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, was as follows:

For the year ended 31 December	2011 $m	2010 $m
Short-term compensation	6.5	5.1
Equity based compensation	6.0	5.1
Directors' fees and expenses	2.4	1.9
Total	**14.9**	**12.1**

The Directors' fees and expenses includes $0.9 million (2010 – $0.7 million) paid to significant founding shareholders. Non-Executive Directors do not receive any benefits in addition to their agreed fees and expenses and do not participate in any of the Group's incentive, performance or pension plans.

Transactions with a shareholder

During the year two of the Group's Executive Directors sold management team ordinary warrants to an external buyer who has substantial existing interest in Lancashire warrants. The details are as follows:

Date	Number	Price per share	$m
27 May 2011	350,000	$5.65	2.0
29 September 2011	2,000,000	$6.69	13.4
Total	**2,350,000**	**$6.53**	**15.4**

Transactions with a founding shareholder

Under the share repurchase authorisations discussed in note 22, 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**

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 Founder warrants. The founding shareholder resigned from the LHL Board of Directors as of 7 July 2010.

26. Related party disclosures continued

Transactions with Lancashire Foundation

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

Date	$m
25 February 2010	1.1
5 November 2010	1.3
3 November 2011	1.3

Transactions with associate

During the year ended 31 December 2011 the Group ceded $12.2 million of premium to ARL and received $1.5 million of commission income. The following amounts are included in the consolidated balance sheet:

As at 31 December	2011 $m
Unearned premiums on premiums ceded	5.5
Amounts payable to reinsurers	(2.7)
Deferred acquisition costs ceded	(0.7)

Contingent profit commission will be payable to the Group based on the ultimate performance of ARL over the period 1 June 2011 to 30 June 2012.

27. Non-cash transactions

TBAs classified as derivatives were settled net during the year with purchases and sales of $4.8 million (2010 – $246.2 million) and $4.8 million (2010 – $246.4 million) respectively.

The 2010 special dividend declared of $264.0 million is not reflected in the 2010 cash flows. The settlement date was 19 January 2011 and the cash flow on this transaction has been recorded in the year it was actually settled. There was no unsettled element of the 2011 special dividend as at 31 December 2011.

28. 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	2011 LICL $m	2011 LUK £m	2010 LICL $m	2010 LUK £m
Statutory capital and surplus	1,132.2	145.1	1,324.7	131.7
Minimum required statutory capital and surplus	250.5	25.4	289.1	25.4

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 2011 and 2010 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 2011 and 2010 the capital requirements of both regulatory jurisdictions were met.

29. Subsequent events

Tax residency change

As of 1 January 2012 LHL moved its tax residency from Bermuda to the UK. LHL expects to meet the conditions for the temporary period exemption from the UK's Controlled Foreign Company rules which were introduced by the UK Finance Act 2011, and has obtained comfort on this matter from the HM Revenue and Customs.

Dividend

On 22 February 2012 the Board of Directors declared the payment of a final ordinary dividend of 10.0 cents per common share to shareholders of record on 16 March 2012, with a settlement date of 18 April 2012. The total dividend payable will be approximately $19.0 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.

Return of capital from associate

Following the 1 January 2012 property retrocession renewals, and resulting capital requirements in ARL, on 18 January 2012 AHL returned previously called capital requirements to the Group in the amount of $14.9 million. The capital returned remains committed to future calls from AHL.

Shareholder information

Annual general meeting

The Company's AGM is scheduled for 2.00pm on 3 May 2012. 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, Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, United Kingdom, Tel: + 44 (0) 20 7264 4000 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.

Glossary

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

AHL
Accordion Holdings Limited

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

ARL (Accordion)
Accordion Reinsurance Limited

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

Code
UK Corporate Governance Code published by the U.K. Financial Reporting Council

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

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

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 equity based compensation awards into common shares under the treasury stock method

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)
Calculated by dividing 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

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 premiums earned

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

FDIC guaranteed corporate bonds
Corporate bonds protected by the Federal Deposit Insurance Corporation, an agency of the U.S. government

FSA
Financial Services Authority, United Kingdom

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 dilutive equity compensation awards, by the sum of all shares, including equity compensation awards assuming all are exercised

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

ICA
Individual capital assessment

ICG
Individual capital guidance

IFRIC
International Financial Reporting Interpretations Committee

IFRS
International Financial Reporting Standard(s)

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

International Accounting Standard(s) (IAS)
Standards, created by the IASB, for the preparation and presentation of financial statements

International Accounting Standards Board (IASB)
An international panel of accounting experts responsible for developing IAS and IFRS

IRR
Internal rate of return

Lancashire Foundation
The Lancashire Foundation is a Bermuda registered charitable trust

LHFT
Lancashire Holdings Financing Trust I

LHL
Lancashire Holdings Limited

LICL
Lancashire Insurance Company Limited

LIHL
Lancashire Insurance Holdings (UK) Limited

LIMSL
Lancashire Insurance Marketing Services Limited

LISL
Lancashire Insurance Services Limited

LMEL
Lancashire Insurance Marketing Services (Middle East) Limited

LOC
Letter of credit

Losses
Demand by an insured for indemnity under an insurance contract

LSE
London Stock Exchange

LTIP
Long-term incentive plan

LUK
Lancashire Insurance Company (UK) Limited

Moody's Investor Service (Moody's)
Moody's is a leading provider of credit ratings, research and risk analysis

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

Net loss ratio
Ratio, in per cent, of net insurance losses to net premiums earned

Net operating profit
Profit before tax excluding realised gains and losses, foreign exchange gains and losses

Net premiums written
Net premiums written is equal to gross premiums written less outwards reinsurance premiums written

OTC
Over the counter

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

Retention limits
Limits imposed upon underwriters for retention of exposures by the Group after the application of reinsurance programs

Retrocessional reinsurance
The reinsurance of the reinsurance account

Return on Equity (RoE)
The IRR of the change in FCBVS in the period plus accrued dividends

RIDS
Realistic Investment Disaster Scenarios

RPI
Renewal Price Index

RSS
Restricted share scheme

SGM
Special General Meeting

Sidecar

A specialty reinsurance company designed to provide additional capital to another (re)insurance company. Investors invest in a sidecar to reinsure specific risks for a specific (re)insurance company.

Standard & Poor's (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

TBAs
Mortgage backed "to be announced" securities

Total Shareholder Return (TSR)
The IRR of the increase in share price, in the period, measured in U.S. dollars, adjusted for dividends

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

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

U.S. GAAP
Accounting principles generally accepted in the United States

Value at Risk (VaR)
A measure of the risk of loss of a specific portfolio of financial assets

Contact information

Head office

Lancashire Holdings Limited
Level 11, Vitro
60 Fenchurch Street
London EC3M 4AD
United Kingdom

Phone: + 44 (0) 20 7264 4000
Fax: + 44 (0) 20 7264 4077

Registered office

Lancashire Holdings Limited
Power House
7 Par-la-Ville Road
Hamilton HM 11
Bermuda

Phone: + 1 441 278 8950
Fax: + 1 441 278 8951

Bermuda office

Lancashire Insurance Company Limited
Power House
7 Par-la-Ville Road
Hamilton HM 11
Bermuda

Phone: + 1 441 278 8950
Fax: + 1 441 278 8951

UK office

Lancashire Insurance Company (UK) Limited
Level 11, Vitro
60 Fenchurch Street
London EC3M 4AD
United Kingdom

Phone: + 44 (0) 20 7264 4000
Fax: + 44 (0) 20 7264 4077

Legal counsel to the company

As to English and U.S. law:
Dewey & LeBoeuf LLP
No 1 Minster Court
Mincing Lane
London EC3R 7YL
United Kingdom

As to Bermuda law:
Conyers, Dill & Pearman
Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

Auditors

Ernst & Young LLP
1 More London Place
London SE1 2AF
United Kingdom

Registrar

Capita Registrars (Jersey) Limited
PO Box 532
St Helier
Jersey JE4 5UW
Channel Islands

Depositary

Capita IRG Trustees Limited
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU
United Kingdom

We have built our business and our Annual Report and Accounts on our people. Thank you to the staff who have kindly allowed us to use their photograph.

This report is printed on Olin. Olin is made in the EU using chemical woodfree pulp. The pulp is bleached using Chlorine Dioxide, not Chlorine gas. This production method produces Elemental Chlorine Free ("ECF") pulp which is less harmful to the environment.

The printer 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.

Designed and produced by Black Sun Plc.
Printed by Principal Colour.

www.lancashiregroup.com