Patience
is a virtue

Annual Report & Accounts 2012

lancashire
HOLDINGS LIMITED

Introduction

The Lancashire Group is a global provider of specialty insurance products operating in Bermuda and London. We focus on short-tail, mostly direct, specialty insurance risks under four general categories: Property, Energy, Marine and Aviation.

At Lancashire, the most important measure of success is long-term return on equity. In order to achieve this, it is important that we remain patient, and wait for the right market conditions to arise as we continue to look for opportunities, and quickly seize them when they come along.

2012 presented a challenging market but we stuck to our strategic priorities; underwriting always comes first, we effectively balance risk and return and continue to operate nimbly through the cycle. We believe that our patience will pay off over the long term.

Underpinning our strategic approach are our five core values that are part of everything that we do: teamwork, agility, passion, success and respect. It's what makes us Lancashire.

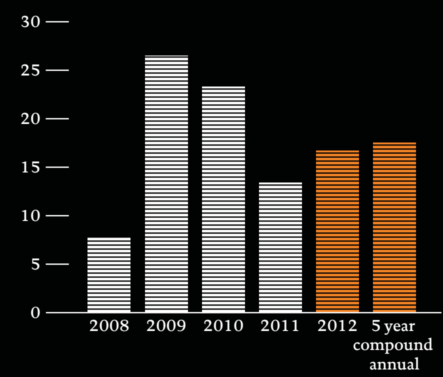
Operating highlights

- Continued focus on our core book – new opportunities in retro, energy, satellite and sovereign
- Accident Year loss ratio – 34.6% despite one of the largest insured U.S. windstorm losses ever
- Utilising our underwriting expertise – further development of Accordion and the launch of Saltire
- Enhancing our capital mix – with the issuance of $130 million of ten-year unsecured senior debt
- LHL moves to UK tax residency
- Investment return of 3.1%

Financial highlights

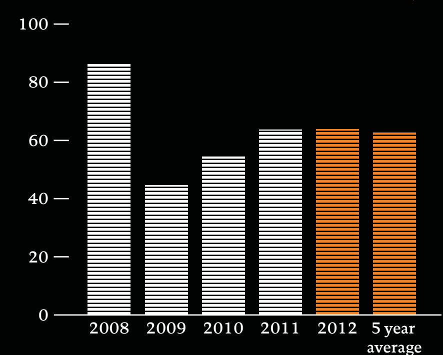
Return on equity
(per cent)

16.7%



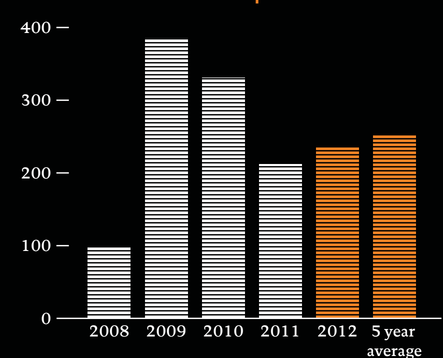
Combined ratio
(per cent)

63.9%



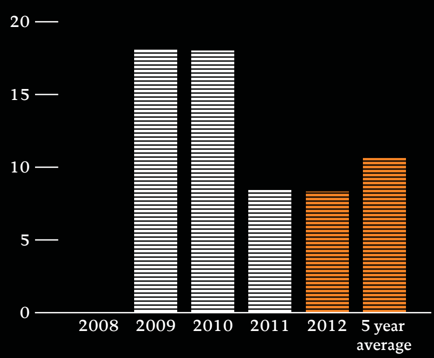
Profit after tax
($m)

$234.9m



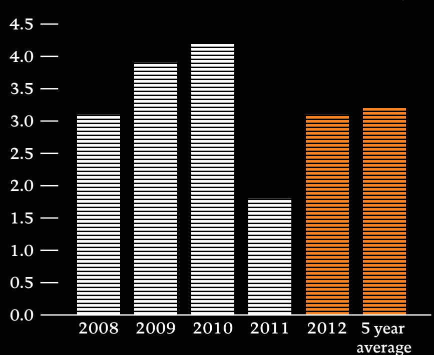
Dividend yield
(per cent)

8.3%



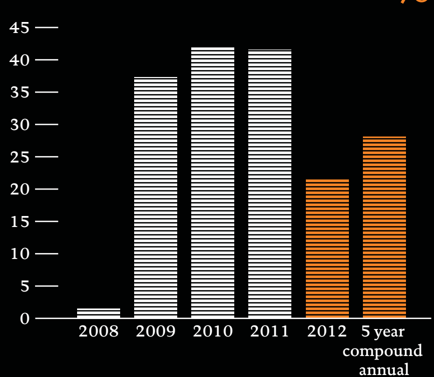
Total investment return
(per cent)

3.1%



Total shareholder return
(per cent)

21.6%



Contents

Our approach and business lines

Our aim is to provide an attractive risk-adjusted total return to shareholders over the long term.

Balancing risk and responsibility is at the heart of our business model. This ethos guides our approach to underwriting and is reflected in both our organisational culture and our charitable work through the Lancashire Foundation.

The main operating companies of the Group are LICL in *Bermuda* and LUK in the *United Kingdom* which both provide insurance and reinsurance to their clients, with an emphasis on the Property, Energy, Marine and Aviation lines of business.

Brokers are our distribution base. We therefore build strong partnerships with them to provide solutions to our clients.

Our *Clients* trust our expertise, technologies and processes to deliver the appropriate solutions to them, that protect their interests and minimise risks.

Our four classes of business

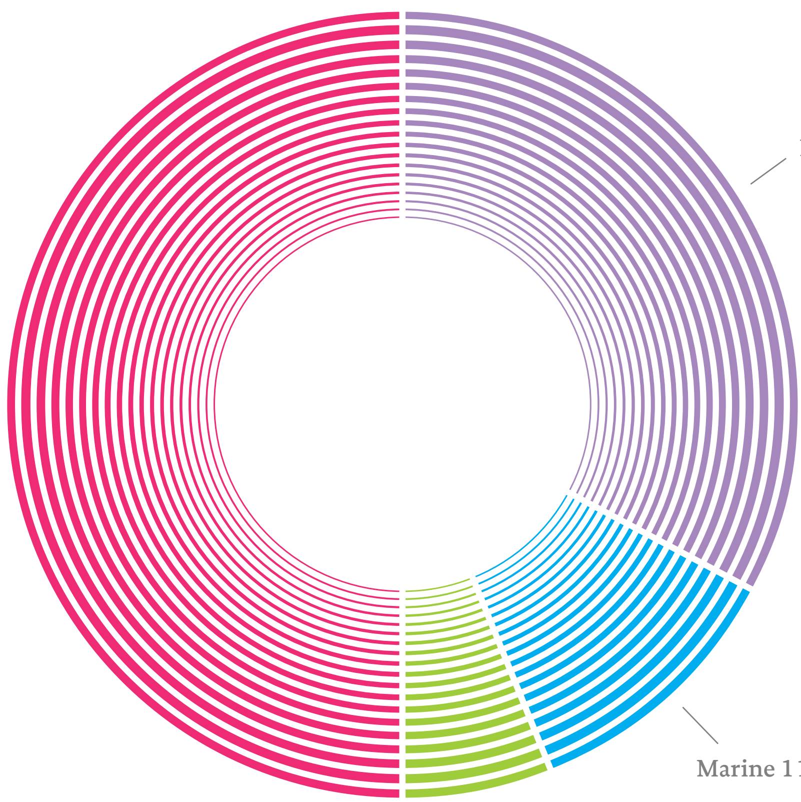
Property

We have two main property reinsurance products: retrocession written on either a single territory or worldwide basis; and catastrophe excess of loss, focusing on excess layers for regional placements with exposures around the globe. On the primary side we write terrorism and political violence business on an excess or quota share basis, as well as political and sovereign risks in the form of confiscation and deprivation-type risks as well as obligors' cover for sovereign and quasi-sovereign entities. *See pages 26 and 27.*

Energy

We cover international upstream operational and upstream construction all risks business. We offer standalone catastrophe coverage for wind, and offer leadership for deepwater Gulf of Mexico windstorm policies. We write on either a quota share basis or excess of loss basis for both upstream operational and upstream construction business. *See pages 28 and 29.*

We have strong business partnerships across our classes of business. At Lancashire, we believe in always being ready to respond to the market. So no matter where we are in the world, our people are connected by conversations. Our daily underwriting call enables us to learn from each other, identify business opportunities and move quickly to respond to the needs of the market. Lancashire writes risks within the following segments:



Marine

We offer a range of coverages within our Marine portfolio: Marine hull, total loss only, mortgagees' interests insurance, mortgagees' additional perils, excess protection and indemnity, marine war and builder's risks. We prefer high-value accounts like cruise ships and liquid natural gas carriers. We also offer a limited amount of capacity for marine reinsurances, both excess of loss and retrocession, including the International Group. *See pages 30 and 31.*

Aviation

We write a comprehensive book of AV52 terrorism liability with worldwide trading patterns. Attachment points vary, offering consistency, broad coverage, timely response and commitment to our core account through the cycle. We also write satellite business, covering launch and orbit. *See pages 32 and 33.*

Martin Thomas – Chairman

In a year of generally flat demand and ample industry capacity, the Board has supported management in its patient and diligent maintenance of its core business lines which has helped deliver an RoE of 16.7 per cent and a total shareholder return of 21.6 per cent.

2012 results

Lancashire delivered a strong performance in 2012. The RoE for 2012 was 16.7 per cent and the total shareholder return was 21.6 per cent. The year for Lancashire was marked by the Costa Concordia loss in January (the largest marine single hull loss ever) and Sandy, which hit the Caribbean and the U.S. in late October. These have not proved to be major market-moving events, but the Board and management continue to work patiently to match the Company's capital resources to underwriting opportunities.

Capital management

In October 2012, Lancashire issued U.S. $130 million 5.7 per cent senior unsecured notes due 2022. I would like to thank and welcome Lancashire's new debt investors.

During 2012, Lancashire focused on the development of its strategy to build partnerships with capital market participants to deliver attractive returns to its shareholders through the Accordion and Saltire facilities (see page 9 for further discussion).

We remain committed to ensuring that our capital management remains flexible and that our capital base matches underwriting opportunities. The Board was pleased to declare ordinary and special dividends in respect of the 2012 year amounting in total to $2.10 per common share (see page 52 for further details). I would like to thank our shareholders for their vote at the 2012 AGM in support of a resolution granting standing authority to the Board to issue up to 10 per cent of shares on a non pre-emptive basis. The ability of Lancashire to raise equity capital rapidly when insurance market conditions change remains a central plank of our capital management strategy and equips our underwriters to respond nimbly to market opportunities.

Corporate governance

The Board continues to maintain a good balance in its work. It has continued to ensure appropriate oversight of, and engagement with, management and the business. We continue to monitor regularly Lancashire's compliance with the UK Corporate Governance Code to ensure good practice in the areas of Board leadership, effectiveness, independence, remuneration, accountability and shareholder relations. The skills of our Non-Executive Directors and Executive Directors remain appropriately deployed to best serve the work of the Board and its Committees. At Lancashire it remains an important priority for the Board to ensure a strong and effective risk management culture is embedded throughout the business and informed by a clear and widespread understanding of risk and risk tolerances. I am pleased to report that the external Board evaluation process for 2012 has concluded that the Board continues to operate effectively.

UK tax residency

Lancashire Holdings Limited has now completed its first year as a tax resident of the UK. The move was a direct result of the UK Government's desire to promote the UK as a business friendly environment. It also allows us to further enhance the operation of our Board and management team. While there is a marginal cost to the Group of the change in residency, the benefits outweigh these.

Directors and senior management

During 2012 Neil McConachie relinquished his executive role and now serves on the Board in a Non-Executive capacity. On behalf of all of us at Lancashire, I should like to extend our sincere thanks to Neil for his tremendous contribution to the Group since he joined Lancashire at its beginning.

Elaine Whelan, Group Chief Financial Officer, was appointed as an Executive Director with effect from 1 January 2013. Elaine has been with Lancashire almost from its beginning and I am pleased to welcome her to the Board.

Samantha Hoe-Richardson was appointed as a Non-Executive Director on 20 February 2013. I have high hopes for the contribution she will be able to make, and welcome her to the Board.

Greg Lunn, the General Counsel and LHL Company Secretary since Lancashire's foundation, has decided to leave Lancashire, though he has agreed to continue on a consultancy basis while his responsibilities are transferred. I should like to thank Greg for his significant contribution to Lancashire and to wish him the very best for the future. I welcome John Cadman, who will be joining us as the new General Counsel in March, and I congratulate Christopher Head, following his promotion to LHL Company Secretary. The Board has also overseen a transition in the role of Group Chief Risk Officer from Mike Pearson to Charles Mathias. Charles has been with the Group as a senior underwriter since 2005, which equips him well for the role, and I would like to thank Mike for his work at Lancashire.

During 2012, Paula Porter and Dan Soares stepped down as CEOs of the Group's UK and Bermuda operating subsidiaries respectively. Dan continues to serve as a Director on the Bermuda company board. Both have been with Lancashire since the early days, and I should like to thank them for their contributions to the Group and to wish them every success in the future.

At Lancashire we have reaped the benefits of experience and continuity from the service of a number of long-standing Board members. As Chairman I will seek to ensure over the coming few years that we implement a staged programme of renewal for the Board. We remain alive to the benefits of diversity in Board composition and we continue to seek candidates from a wide range of backgrounds.

Outlook for 2013

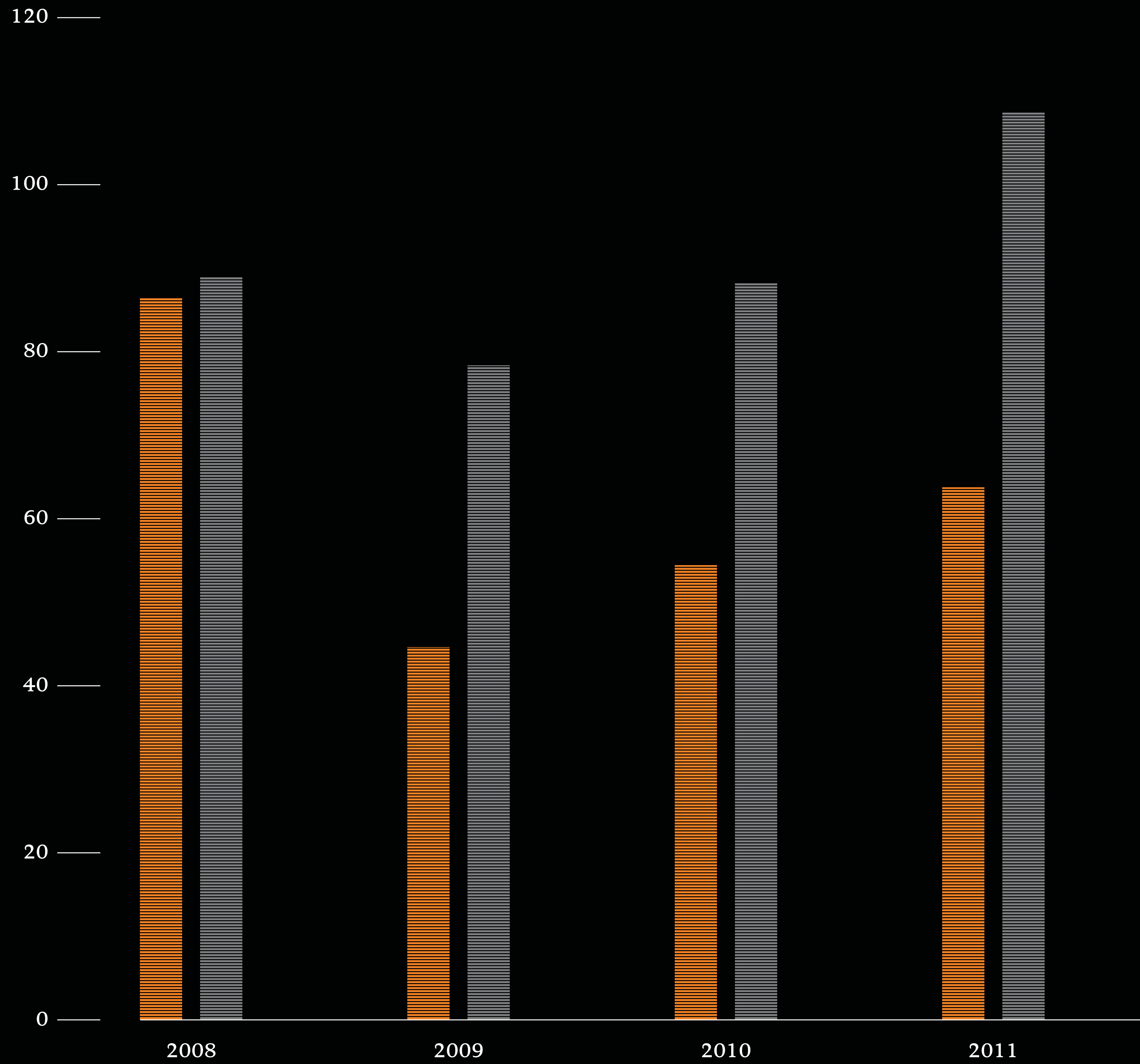
In 2013, Lancashire expects to consolidate further its proven track record for building shareholder value by continuing to focus on serving its core portfolio of clients whilst exploring new opportunities to leverage the Lancashire brand and expertise. I am confident that our investors and brokers will find that Lancashire is well prepared to meet their needs.

Finally, shareholders will note that 2012 was Lancashire's seventh full year of operations since the company was founded by Richard Brindle in late 2005. Shareholders will, I am sure, join me in congratulating Richard and his executive team, in another very satisfying set of results. The company has come a long way since it was founded, and is now recognised as an important player in its sector, whilst remaining true to the business plan and ethical culture that Richard has led from the outset.

Martin Thomas
Non-Executive Chairman

Consistency: exceptional underwriting performance

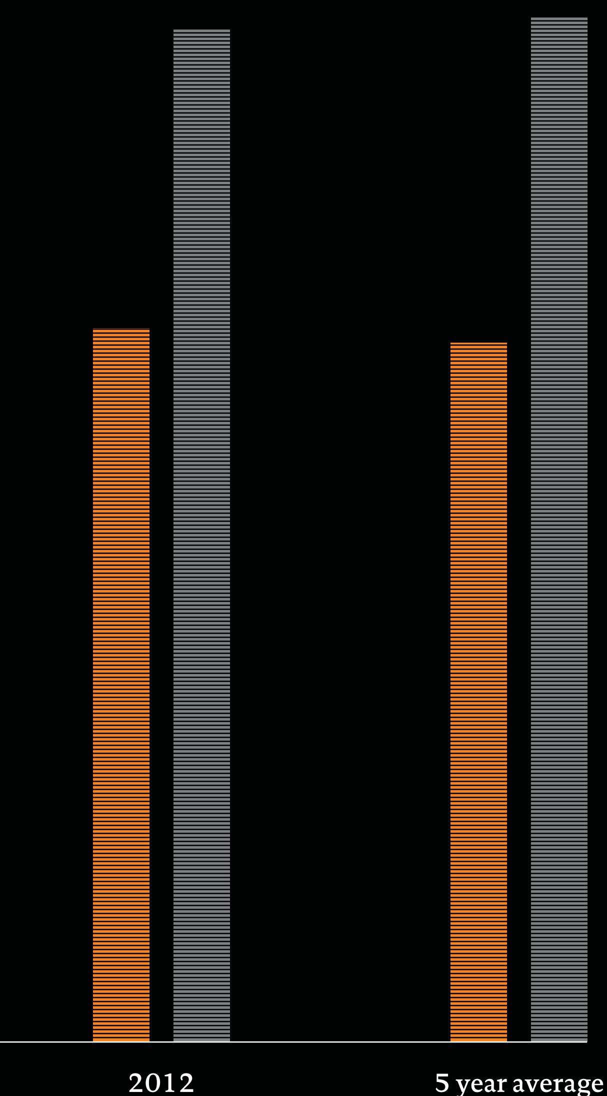
Combined ratio[1] *(per cent)*



1 Five-year average based on 2008 to 2012 reporting periods. Lancashire and sector ratios are weighted by annual net premiums earned.

2 Sector includes Amlin, Argo, Aspen, Axis, Beazley, Catlin, Endurance, Hiscox, Montpelier, Renaissance Re and Validus for the years 2008 to 2012.

Source: Company reports.



Strategic review

While the insurance cycle changes, our strategy remains. We constantly learn, improve and adapt but always maintain our focus on our three strategic priorities. That produces superior combined ratios and risk-adjusted returns over the cycle. It's what makes us Lancashire.

Richard Brindle – Chief Executive Officer

2012 didn't have the sequence of large catastrophe claims seen in late 2010 and throughout 2011. So after a solid start to the year we had to work hard to find our pockets of opportunity. Our core portfolio served us very well, and we found new opportunities in retro, energy, satellite and sovereign risk.

Summary of 2012

Although 2012 lacked the succession of very large catastrophe losses that characterised 2011 as the year of surprises, there were nevertheless some major insured events. The largest of these was Sandy which impacted the Caribbean and North-Eastern U.S. Occurring late in the North Atlantic storm season, it is too early at the time of writing to make a definitive judgement on the final amount of the loss, but it will clearly be one of the largest insured U.S. wind/flood losses on record. There were three other major losses around the $1 billion mark this year; the Costa Concordia cruise liner tragedy in January; and the Midwest and Dallas Hailstorms of April and June, respectively. Nonetheless when compared to the major loss tally in 2011 of well over $110 billion, the major loss environment for 2012 was much less challenging.

Lancashire stuck to its strategy of maintaining its core portfolio and looking for new opportunities where there is dislocation or a specific opportunity.

Results

We are pleased to report a strong set of results for 2012. Lancashire grew fully converted book value per share, including the impact of dividends, by 16.7 per cent. In 2012, our combined ratio was 63.9 per cent. Our combined ratio since inception is 58.9 per cent.

Underwriting

At Lancashire we say "Underwriting comes First" and we mean it. At our daily underwriting conference call underwriters from both offices convene via a video link to discuss the risks that our brokers have submitted to us. We also discuss matters of more general interest, and anyone from the CFO to the Chief Actuary or CRO can sit in. We believe that it is a special strength of our underwriting process that our CEO and CUOs oversee the underwriting of individual risks every day. We also believe that this is a very good risk management tool that allows real-time peer review of our underwriting.

In Property we saw strong demand for the Accordion Worldwide Retrocession product. We had buyers from Europe, Bermuda, Lloyd's and the U.S. Lancashire also wrote some regional (i.e. not worldwide) retrocession business which we retain for our own account.

On the catastrophe excess of loss (Cat XL) side the main event of the year was the first renewal of the Japanese earthquake contracts which took into account the full loss information from the Tohoku earthquake. In addition to expanding our Cat XL portfolio we were able to write some quota share lines, and some new windstorm business, all at improved pricing. Otherwise it was largely a steady year in which we exercised the patience to stick with our core clients and await an opportunity, rather than growing for growth's sake.

One big change for Lancashire was that we took the decision to close our property direct and facultative business. Since 2007 the portfolio had shrunk from $122.8 million of written premium to an original projection for 2012 of around $50 million. At the same time reinsurance costs had been growing and the exposures of our global clients had been spreading all over the world. We had taken various measures over the last three years to reduce the catastrophe exposures, and to try to improve the risk and return balance by limiting some of the terms and conditions. However, in the end we had to conclude that, as one underwriter in a very large market place, we could not enforce on our own all the changes we believe are required. We feel that our property capacity can be deployed for better risk-adjusted returns in the property reinsurance arena and we will continue to look for further opportunities there.

The Energy market remained a significant part of our activities in 2012. Here there was organic growth as existing clients developed new assets, activity in the Gulf of Mexico increased, and regions such as Brazil and Africa saw continuing expansion. After recording four consecutive years of positive RPIs we believe that rating is at adequate levels, and in a benign loss year with no recorded billion-dollar events we are satisfied with our portfolio performance.

In Marine we had expected more of a rating reaction to the Costa Concordia cruise ship grounding. This may be the largest marine loss of all time affecting the hull, P&I and cargo markets, with the most costly removal of wreck plan ever undertaken. However, although the owners of Costa Concordia conducted themselves very well at the renewal, the market as a whole failed to react. Supply outstrips demand and some clients are prepared to shop around for the cheapest premium.

In Aviation the supply and demand imbalance has been exacerbated by the lack of major losses. As a class of business which is not exposed to elemental catastrophe exposure many underwriters are attracted to it, hence driving down pricing. In our niche areas of AV52, war and contingent hull there has been no loss activity so pricing is under pressure. We are writing satellite business again and are pleased with the initial response from brokers and clients.

In terrorism and political and sovereign risk there is a similar dynamic at play as potential loss events are not correlated to windstorms or earthquakes, and losses have been few. There were some claims from the Arab Spring events and over the last couple of years riots in Thailand and other civil unrest incidents have impacted the market. However, there has not been a major insured terrorism event since the 9/11 attacks, so pricing is under pressure as competition grows. Lancashire seeks to use a rigorous risk selection process including the UMCC to find risks that we believe have lower relative exposure to loss (for example, construction projects), and we look for excess of loss attachment points where appropriate.

Capital management

During 2012 we continued to demonstrate our strategic focus on capital management. In November, building on our previous experience with alternative capital vehicles, we announced the creation of Saltire. SRL is a collateralised special purpose insurance vehicle, writing an elemental and non-elemental combined aggregate reinsurance product; see Lancashire Capital Management below.

Risk management

As noted last year we planned to increase our exposure to Japanese Earthquake following the Tohoku loss and we were able to do this. Our marketing efforts, including three trips to Japan, allowed us to see several new opportunities. The decision to increase exposures was based on greater certainty about our clients' market shares, in a real as opposed to a modeled event, and the change in pricing, which we believe is now adequate. As always we look at ways to balance our exposure and were able to buy some reinsurance which we believe improves our risk and return balance. In the U.S. our exposures remained relatively stable.

People and values

Our people are one of our key stakeholder groups at Lancashire and we are very grateful for the tremendous efforts that they have made during 2012 to keep Lancashire hungry for improvement. As you can read elsewhere (see pages 36 to 41), we have made a conscious effort to build more on our values culture, not least by including

Lancashire Capital Management

In what looks like being a protracted low interest rate environment, the desire for yield and diversification is driving an increased level of interest in the insurance markets. From hedge funds to pension funds, investors are increasingly attracted to the insurance, and especially the reinsurance arena. Lancashire has been involved with third-party capital since 2006 when we initiated the Sirocco (liquidated in 2008) energy sidecar. This involvement has continued with Accordion, a property retrocession sidecar launched in 2011 and developed in 2012, and most recently Saltire, a market facing entity writing a combined elemental and non-elemental aggregate product. Lancashire has a 20 per cent equity stake in Accordion and a 16.9 per cent equity stake in Saltire.

In addition we have made private deals on a collateralised basis for specific reinsurance products with a number of non-traditional markets. Lancashire has the superior track record and marketing penetration to attract investors with an interest in this space, and where this can benefit the Group, its shareholders and clients, management is keen to exploit this opportunity.

In bringing together a Lancashire Capital Management team, the Group recognises that a multi-disciplinary approach is needed to optimise the opportunity, whilst ensuring that the core business remains our central priority. With representatives from underwriting, actuarial, finance, legal, risk and investor relations there is a wide range of experience and knowledge to tap into. Where appropriate we bring in dedicated outside resources, as was the case with Saltire. This ensures that management do not compromise their focus on the Lancashire "mothership".

these values as a component in employee appraisals. Our training programmes are reaching more people each year and are well received. Our Corporate Responsibility efforts continue unabated; we are working very closely with our key partner charities and we continue to afford our people opportunities to donate their time as well as their money to a variety of charities. We have expanded our efforts in 2012, for instance increasing our donation to Kids Company and helping to lead a special fund-raising programme for them.

Outlook

The outlook for 2013 is perhaps more obscure than is often the case. Whilst Sandy is a major insured event and will have some impact on pricing and capacity, we are not as bullish about pricing in general as some of our peers. In terrorism, aviation and marine business the supply comfortably outstrips the demand. In energy there are some risks where demand stretches the supply pretty tight, and where underwriters have the conviction to do so, like Lancashire, they can insist on decent pricing. Both in energy and non-loss affected property reinsurance and retrocession we expect pricing to be flat, but we think the current prices are generally adequate. So overall, although we need to be vigilant in our underwriting – something the UMCC has built in to our DNA – we think the market is in a reasonable state.

Richard Brindle
Group Chief Executive Officer

Our strategy

Our aim is to provide an attractive risk-adjusted total return to shareholders over the long term. This has been achieved, with a compound annual return of 19.2 per cent from inception to date.

Financial targets

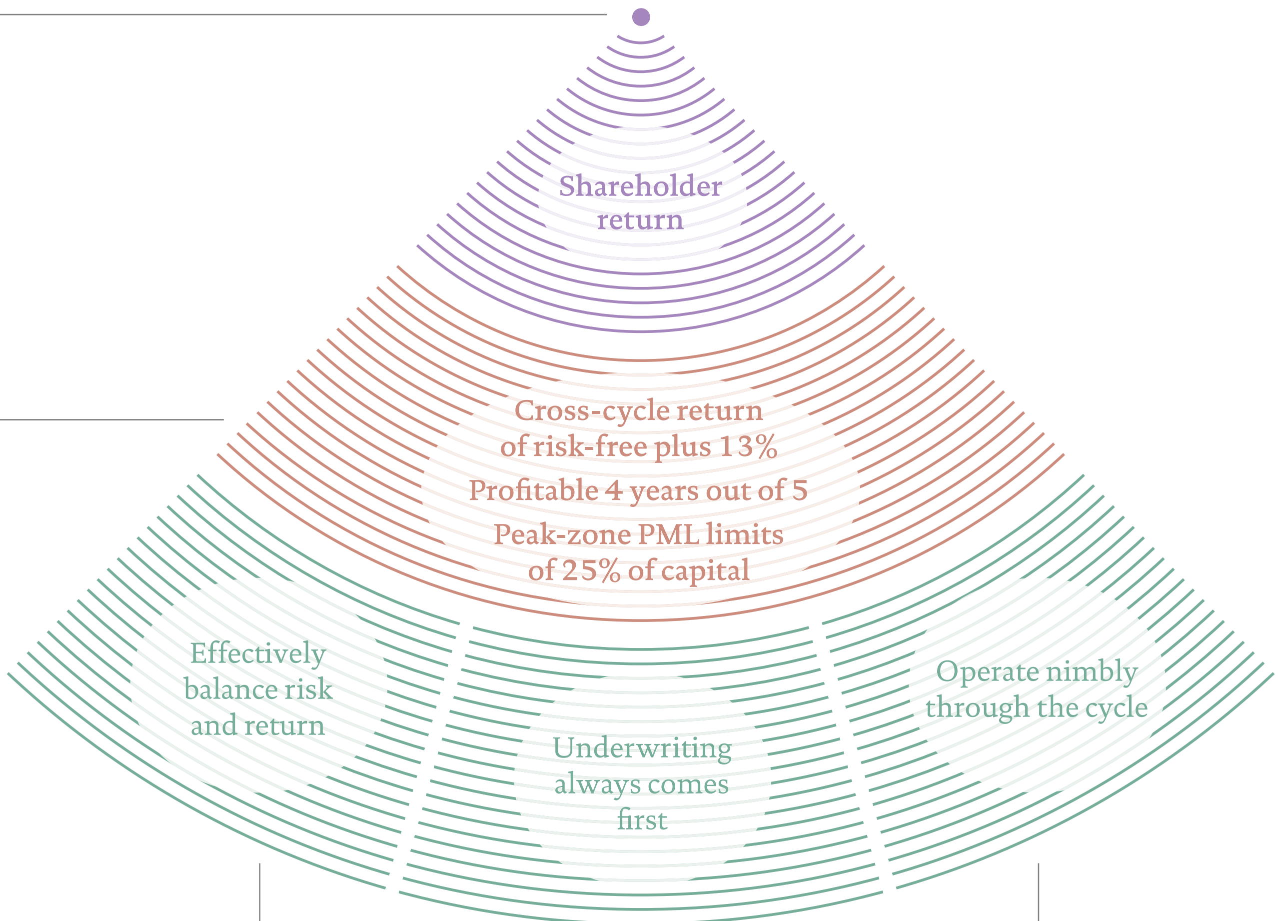
Success in achieving our goal is measured against risk and return targets.

Strategic priorities

Our success has been achieved by focusing on three fundamental business principles.

Our culture

Our approach to how we do business is also reflected in our commitment to helping others.

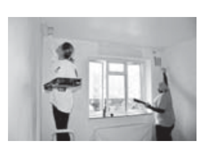


Risk meets reward

Lancashire is committed to supporting MSF and we recognise the risk that their teams around the world take for the reward of saving lives.

See page 14

Creativity meets discipline



We give our staff the opportunity to show their commitment to their local community. Giving back improves the quality of life for all.

See page 12

Strength meets agility

Staff have spent time in the Philippines working to improve the lives of the poor. Hard work and perseverance pay off here as well as in the office.

See page 16

Creativity meets discipline

Creating a better environment for at risk kids

Whilst we are proud to donate money each year to charities working around the globe, we also like to give our staff the opportunity to show their commitment to their local community. Here two of our London colleagues are renovating rooms for Kids Company in North London. Giving back to the communities we live and work in improves the quality of life for all, and working with Kids Company reminds us that risk has many faces.

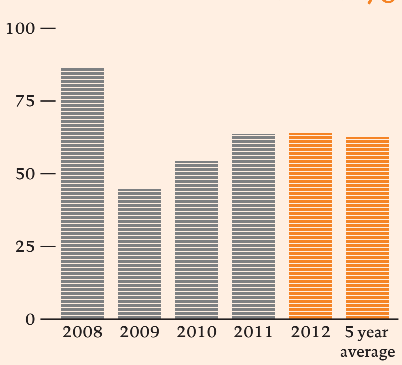
Strategic priority No. 1

Underwriting always comes first

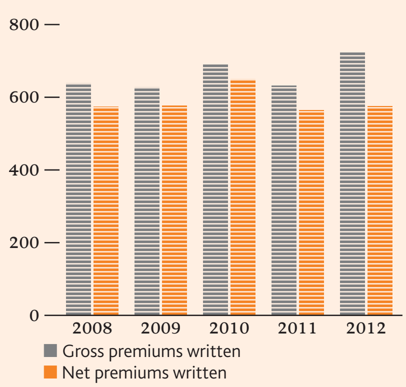
Our daily underwriting call ensures careful risk selection, with many pairs of eyes reviewing each opportunity. The daily call also enables us to quickly spot changes in the market and respond swiftly. We don't set premium targets for our underwriters and all staff are remunerated on Group RoE performance. Our strong ongoing relationships with brokers are of paramount importance to us, leveraging their extensive distribution base.

Combined ratio
(per cent)

63.9%



Premiums written
($m)



> "Our daily call is still the focal point of our underwriting activities."

Alex Maloney – **Group Chief Underwriting Officer**

Our daily call is especially important in allowing a proper consideration of how an individual risk fits in with broader views about the portfolio as a whole, marketing relationships and cycle management. It also helps with the exercise of patience as our underwriters cannot be pressured into hasty decisions, but rather have to consult their colleagues and management. All our risks continue to be presented for the appropriate subsidiary authorisation.

Our daily call is also supplemented by our RRC which was restructured in 2012. Previously focused primarily on underwriting, it now looks at the full range of risks that the Group faces whilst maintaining its primary focus on our key insurance risks. Due to the limited number of individual risks that the Group writes, and with just two operating companies, the internal model can be run efficiently in a matter of hours. At least every two weeks the RRC is able to look at the key portfolio metrics, the elemental PMLs and non-elemental RDS, as well as the capital ratios and risk measures. We bring together members of our actuarial, capital, underwriting, risk, operations and finance teams for the meeting to have a broad panel of views represented. We have real-time information about our portfolio and a multi-disciplinary review.

We work hard at our core portfolio, which is central to the execution of our strategy. However, in 2012 we were able to find new business streams in the satellite market, which we returned to after a gap of four years, and in retrocession business. In the latter, Accordion was expanded and Saltire was launched, again showing how we can respond nimbly to new opportunities.

Risk meets reward

Working with communities in catastrophe zones

MSF has a commitment to address the suffering people endure and the obstacles encountered in providing assistance.

Lancashire is committed to supporting MSF and we recognise the risk that their teams working on their many projects around the world take for the reward of saving lives. Our support of MSF allows them to respond when an emergency hits, and we also directly funded their work when a cholera epidemic broke out in Haiti, to help the people in Rakhine state in Myanmar and for their emergency response in South Sudan.

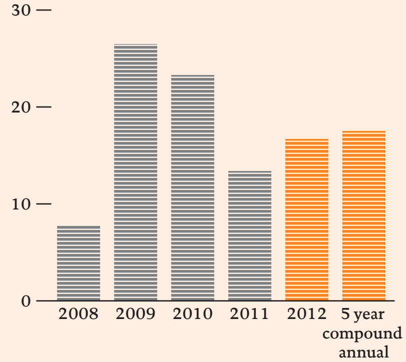
James Keogh – MSF

Effectively balance risk and return

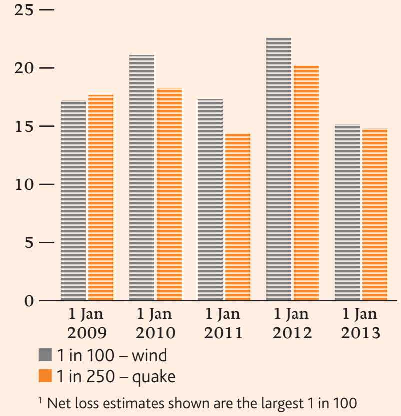
It takes time and effort to effectively balance risk and return. This is embedded in everything that we do, with many risk management tools used across the business, including common sense. What is key to generating the best returns is taking the right risks. We don't diversify for diversification's sake or blindly follow models. We adjust our portfolio to make sure it's as efficient as it can be and learn from past experience. Maximising risk-adjusted return for our shareholders is our ultimate goal.

Return on equity
(per cent)

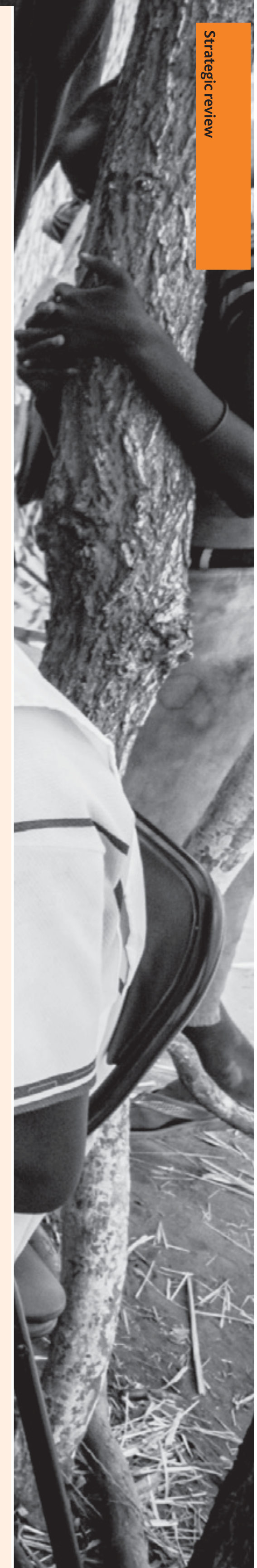
16.7%



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.



> "Balancing risk and return is at the heart of our business – it is our 'day job'."
>
> **Paul Gregory** – Chief Underwriting Officer, LUK

We constantly examine all our sources of risk and scour the market for new products to optimise our returns. Through the RRC, Lancashire monitors its portfolio against the business plan and reviews new opportunities to ensure that they meet the targeted returns.

One key development in this area in 2012 was the decision to withdraw from the property direct and facultative line. This was a difficult decision as it meant that we parted company with a number of colleagues. But we had been reducing exposures in the direct property side for over two years as we built up our reinsurance side. We did this because the parameter risk (the risk that the model result is wrong) and the tail risk (the risk of very large events) were both much bigger for direct property than for catastrophe excess of loss and retrocession. Coupled with this, the broad coverage given in direct business, and the increasing frequency of losses such as the Tohoku Tsunami, flooding in Thailand and U.S. tornadoes meant that the expected rewards were shrinking. So although it was a tough decision and we explored several different options to see if we could continue with a reduced portfolio, ultimately it was the right thing to do.

Where we saw better potential returns, whether in energy, property reinsurance, satellite or political and sovereign risk, we were happy to take on more risk and grow the portfolios. Our active scrutiny of our entire portfolio enables us to get the balance right between risk and return.

Strength meets agility

Helping build schools in the Philippines

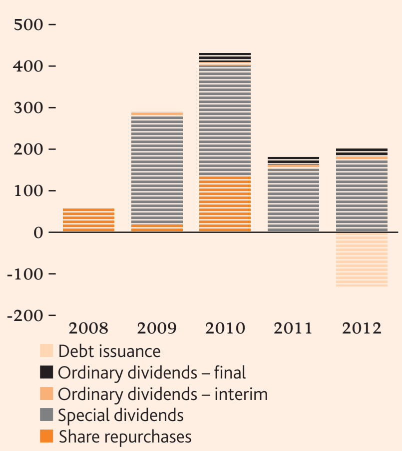
Over the last three years eighteen of our colleagues have spent a week in the Philippines working to improve the lives of the poorest of the poor – people living on less than 55 cents a day. This has proven to be a wonderful team-building exercise as well as giving practical help and hope to local people. Our local partner ICM has become one of our key charities and largest recipients of our donations. Hard work and perseverance pay off here as well as in the office.

Strategic priority No. 3

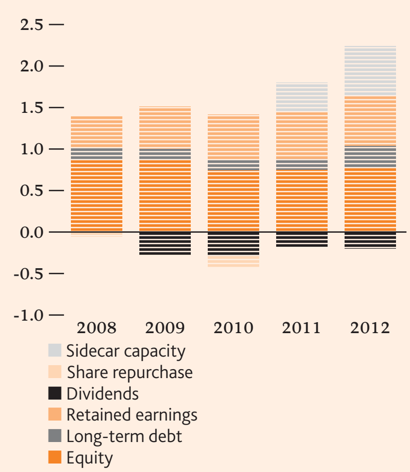
Operate nimbly through the cycle

Our simple operating structure enables our nimble approach, providing both speed to market and effective management of the cycle. We look for opportunities in the market that others haven't spotted and move quickly. When opportunities aren't there we have to be patient. That can mean doing less business when rates don't meet our requirements and giving money back to shareholders. Alternatively, when opportunities arise, we benefit from their trust and flexibility to raise money and capitalise on those opportunities.

Capital actions *($m)*



Constant adjustment of capital *($b)*



> "If balancing risk and return is our 'day job', cycle and capital management is our key strategic focus."

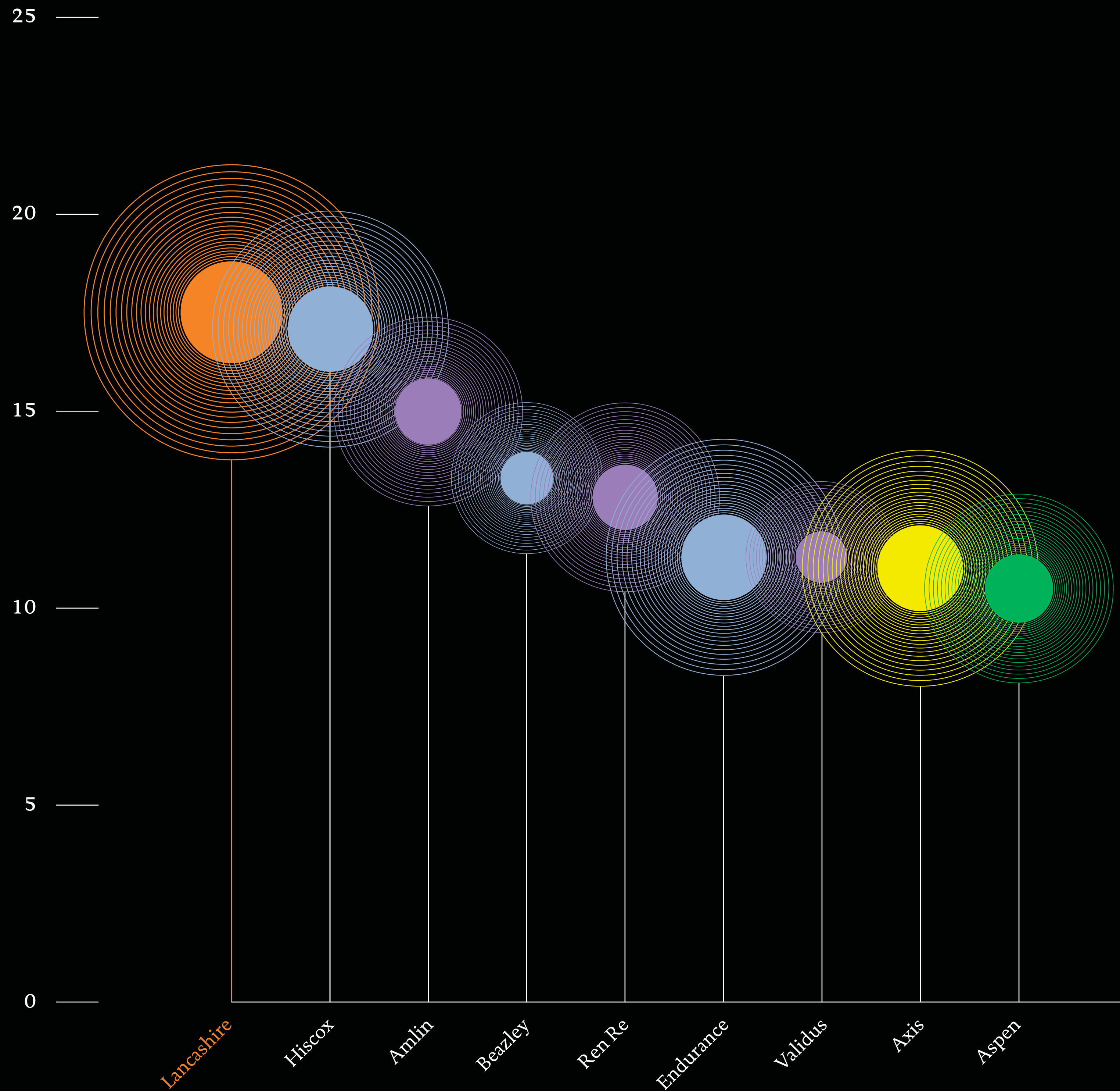
Elaine Whelan – **Group Chief Financial Officer**

We are at a difficult point in the cycle. Cycles seem shorter with the peaks and troughs less deep. Market-changing events need to be significantly bigger to move pricing. Some of our lines have strong pricing, some are just adequate, but in almost all areas there is plenty of capacity. However, as more non-traditional capacity comes to the market Lancashire is being presented with multiple new opportunities to underwrite with and for third parties. It's companies like Lancashire with a strong underwriting track record, and a history of successful engagement with capital markets, who stand to benefit from this trend. With a track record of being quick to respond to market opportunities and post-loss events, our capital management is just as important as a cycle management tool as our underwriting.

We also constantly monitor the debt markets. We were able to swiftly take advantage of the historically low interest rates in 2012 with a small debt issuance. This makes our capital mix more efficient while also giving us that extra bit of headroom to take advantage of underwriting opportunities.

Consistency: long-term performance vs peers[1]

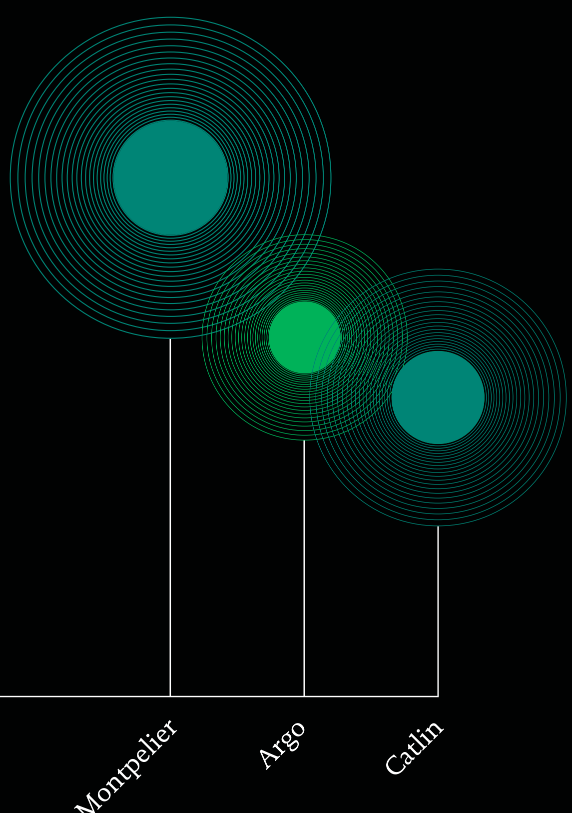
Five-year compound annual RoE[2] *(per cent)*



1 Peer group as defined by the Board of Directors.

2 RoE calculated as the internal rate of return of the change in FCBVS in the period plus dividends accrued. For Amlin, Beazley, Catlin, Hiscox and Ren Re basic book value per share is used as FCBVS is not reported by these companies. Compound annual returns for LHL and sector are from 1 January 2008 through 31 December 2012. Data source: Company reports.

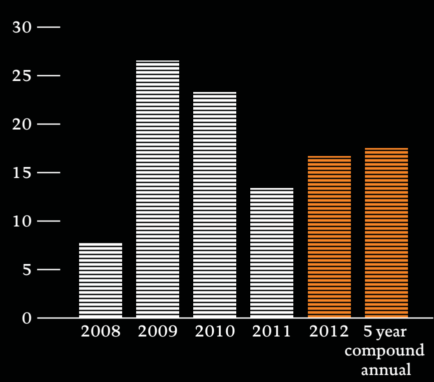
Performance



Whilst there has been no cross-line hardening of rates in the last five years, there have been areas that are well priced and areas of opportunity. While we wait for the cycle to turn, we have continued to diligently serve our core clients.

Key performance indicators

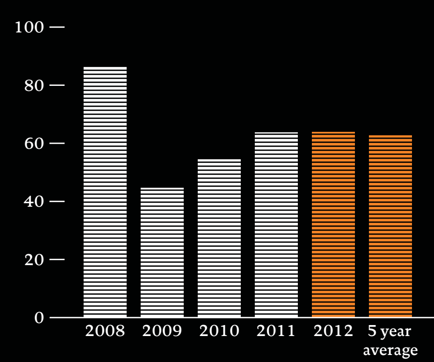
Return on equity
(per cent)



16.7%

RoE, including dividends declared, in 2012.

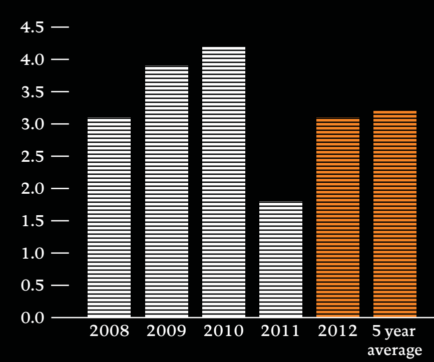
Combined ratio
(per cent)



63.9%

combined ratio achieved in 2012.

Total investment return
(per cent)



3.1%

net total return on investments in 2012.

Aim

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

Measurement

The return on equity is measured by management as the internal rate of return of the increase in fully converted book value per share in the period adjusted for dividends.

Risk management

The stated aim is a long-term goal, acknowledging that management expects both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver of this pattern. Management monitors these peaks and troughs – adjusting the Group's portfolio using BLAST to make the most effective use of available capital and seeking to maximise the risk-adjusted return.

Aim

The Group aims to price its business to ensure that the combined ratio in any year is less than 100 per cent.

Measurement

The combined ratio is the ratio of total costs to total net earned premium and is a measure of an insurance company's operating performance. It is calculated as the sum of the loss ratio, the acquisition cost ratio and the expense ratio.

Risk management

The Group's underwriters assess likely losses, using tools such as BLAST and their experience and knowledge of past loss experience, industry trends and current circumstances. This allows them to estimate the premiums sufficient to meet likely losses and expenses. All risks are peer reviewed during the daily underwriting call before being bound, enabling the Group to ensure careful risk selection, limits on concentration and appropriate portfolio diversification. The RRC then monitors performance at a portfolio level.

Aim

The Group's primary investment objectives are to preserve capital and provide adequate liquidity to support the Group's payment of claims and other obligations.

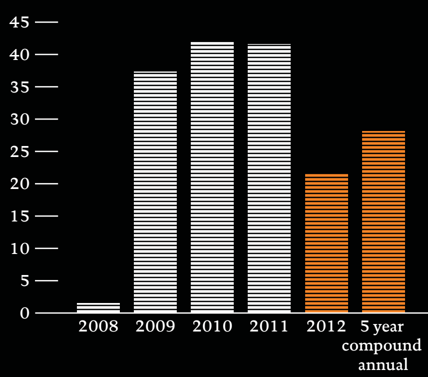
Measurement

Total investment return measures investment income and net realised and unrealised gains and losses produced by the Group's managed investment portfolio.

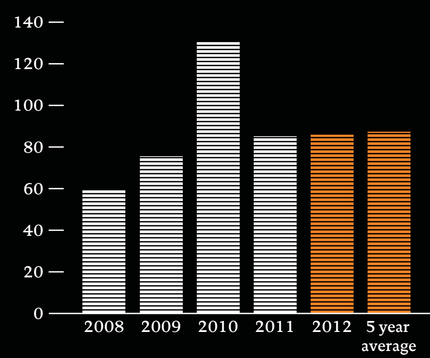
Risk management

The 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. These objectives are reflected in the Group's investment guidelines and its conservative asset allocation. Management reviews the composition, duration and asset allocation of the investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. In the current volatile investment markets the focus is on minimising downside risk from "risk on/risk off" fluctuations.

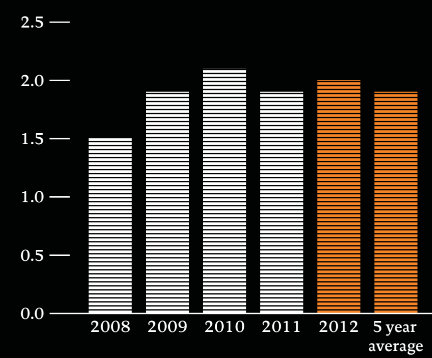
Total shareholder return *(per cent)*



Percentage of profit returned to shareholders *(per cent)*



Lancashire Foundation *($m)*



21.6%

total shareholder return in 2012.

85.7%

of profit returned to shareholders in 2012.

$2.0 million

in cash donated and dividends on warrants to the Lancashire Foundation in 2012.

Aim

The Group's aim is to provide an attractive risk-adjusted return to shareholders over the long term. The Group's aim is a long-term goal, recognising that the cyclicality and volatility of both the insurance market and the financial markets in general will impact management's ability to maximise the share multiple in the immediate term.

Measurement

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

Risk management

The Lancashire remuneration structure and share scheme ensures that staff are highly motivated and closely aligned to the Group's goals, and therefore with shareholders. All permanent staff are awarded restricted share scheme awards for which total shareholder return is an element of the vesting criteria. The full participation of employees in the restricted share scheme ensures that there is a strong focus on sustainable long-term shareholder value.

Aim

The Group aims to carry the right level of capital to match attractive underwriting opportunities, utilising an optimal mix of capital tools. Over time, through pro-active and flexible capital management across the cycle, we aim to generate optimum returns for shareholders.

Measurement

The percentage of profit returned to shareholders equals the total capital returned to shareholders through dividends and share repurchases in a given year, divided by the Group's profit after tax.

Risk management

Risk tolerances are set at a level that aims to prevent the Group incurring losses that would impair its ability to operate. The amount of capital that the Group is willing to expose to peak zone risk is 25 per cent i.e. a 1 in 100 year windstorm probable maximum loss or a 1 in 250 year earthquake probable maximum loss will be less than 25 per cent of our total capital base. The Group also maintains sufficient capital to meet rating agency requirements, plus an excess to absorb any large loss and maintain the rating. A similar approach is applied to regulatory capital requirements.

Aim

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

Measurement

Money is donated by Lancashire through an annual cash donation and by dividends on Lancashire warrants that were donated to the Foundation on its inception.

Risk management

The Lancashire Foundation is a charity registered in England and Wales (registration number 1149184). The charity's trustees are all Group staff members and the day-to-day operations of the Foundation are supervised by the Foundation's Donations Committee. The Committee consists of Lancashire employees and operates within specific criteria set for the Foundation's charitable giving. The charities supported provide regular updates on how the funds donated are spent. The Group is satisfied that its contributions to the Lancashire Foundation are being put to good use.

Elaine Whelan – Group Chief Financial Officer

With a multi-disciplinary approach to capital and risk-adjusted return, we are constantly watching the world around us, always striving for improvement. When we saw the opportunity this year, with rates at historic lows, we tapped the U.S. debt markets, giving us a nice incremental boost to our RoE, plus a new investor base.

Following the significant loss activity of 2011, 2012 has been a more 'normal' year for the industry. Losses from natural catastrophes and man-made disasters are estimated to be in the region of $65 billion versus in excess of $110 billion for 2011, a little above the ten-year average run-rate of around $50 billion but very manageable for the industry. That said, Sandy was a notable event, impacting the U.S. and the Caribbean, with some $20 to $25 billion of industry losses now expected. The U.S. also saw some significant losses from the tornadoes and hail storms earlier in the year plus Hurricane Isaac and crop losses in the third quarter. On the risk side, apart from the human cost, the Costa Concordia disaster could ultimately cost the industry in excess of $1.25 billion.

Investment markets have again been characterised by the risk on/risk off trade, with the fourth quarter being particularly volatile following the U.S. Presidential election and the uncertainty around the outcome of the budgetary constraints, the 'Fiscal Cliff'.

Despite these challenges, we have produced a profit after tax of $234.9 million, a combined ratio of 63.9 per cent and a Return on Equity of 16.7 per cent. We have now generated an annual compound return of 19.2 per cent since inception.

Premiums

Our gross premiums written were $724.3 million, an increase of $92.0 million, or 14.6 per cent, compared to 2011. With the Accordion sidecar affording us increased leverage in the property retrocession markets, $77.6 million of the increase was due to expanding that portfolio. On a net written basis, however, premiums were fairly stable, with only an $11.0 million, or 1.9 per cent, increase to the prior year. Other lines of business were broadly stable with some expansion in the property catastrophe reinsurance and political risk books offset by reductions in the property direct and facultative book, as we reduced our appetite prior to our formal exit from that class on 1 July 2012. The energy lines were generally in line with new multi-year contracts in the Gulf of Mexico book maintaining premium volumes.

Losses

The Group's loss ratio for the year was 29.9 per cent with an accident year ratio of 34.6 per cent. While we had exposure to both the Costa Concordia and Sandy, we had minimal exposure to the crop losses of the third quarter. We booked $59.2 million in relation to the Costa Concordia and our net loss for Sandy was $44.5 million, well contained within our fourth quarter's earnings and in line with our expectations for this type of event. Otherwise, reported losses for 2012 were light and we released $27.4 million of prior year reserves.

Investments

We produced a total return for the year of 3.1 per cent. With the U.S. Presidential elections, the Fiscal Cliff, continuing fears about the European debt crisis and the U.S. debt ceiling debate once again looming, 2012 has been another challenging year in the investment markets. In line with our philosophy of capital preservation, in determining asset allocations, we have been defensive with a focus on minimising the downside risk in our portfolio. Going forward we will continue to manage our interest rate risk given the likely increase in rates in the not too distant future.

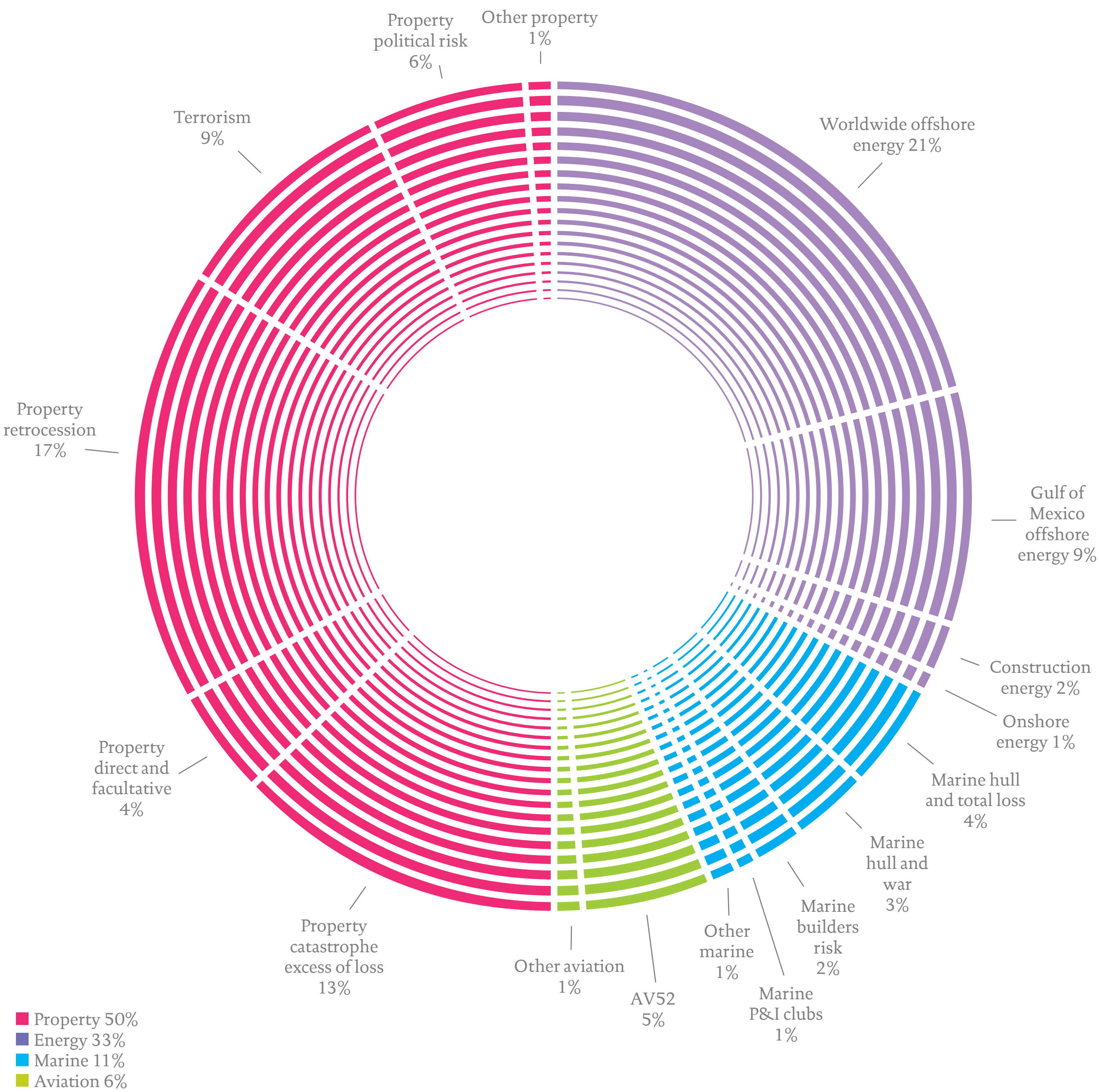
Capital

During 2012, we returned $172.6 million of capital, or 68.3 per cent of comprehensive income, to shareholders by way of a special dividend, bringing total capital returns since inception to $1.5 billion. Excluding alternative capital vehicles, our total capital at the end of the year was $1.6 billion.

We enhanced our capital mix by issuing $130 million of ten-year unsecured senior debt into the U.S. institutional markets, taking advantage of the low rates and strong investor appetite there. Our debt issuance essentially provided us with significant excess capital headroom through the 1 January renewal season, which gave us maximum flexibility to take advantage of post-Sandy pricing. Taking stock post 1 January, we adjusted our capital position to the environment and our outlook and will return approximately $220.0 million of capital on 17 April 2013 to shareholders on record at 22 March 2013. This includes our standard final ordinary dividend of approximately $19.1 million. As ever, we will continue to adjust our capital position to match the business opportunities and generate the best risk-adjusted return for our shareholders.

Elaine Whelan
Group Chief Financial Officer

Lancashire writes risks across four classes of business.
2012 gross premiums written across these classes comprised:



Alex Maloney – Group Chief Underwriting Officer

Business environment and outlook

Following 2011, a year of record industry losses, 2012 was relatively quiet in terms of large catastrophe events until Sandy struck in October, causing an estimated $20 to $25 billion in insured losses. Prior to Sandy the lack of catastrophe events in 2012 allowed companies to repair balance sheets impacted by the losses of 2011. With the continued inflow of capital from traditional and non-traditional sources capacity has remained high and, absent any other events, we expect there to be continued pressure on prices through 2013.

The market outlook in our core lines of business is mostly stable with some decent pockets of opportunity. Lancashire will continue to focus on servicing its core insurance and reinsurance clients, who make up the majority of our portfolio, whilst looking for opportunistic areas of dislocation, or new demand, to leverage the Lancashire brand. With the ever growing flow of alternative funds into our market place, we also continue to explore opportunities to build partnerships with capital market participants seeking underwriters with a proven track record for building shareholder value. During the fourth quarter of 2012 Saltire was launched as a market facing vehicle providing a unique combined exposure ultimate net loss aggregate reinsurance product for the January 2013 reinsurance renewal season.

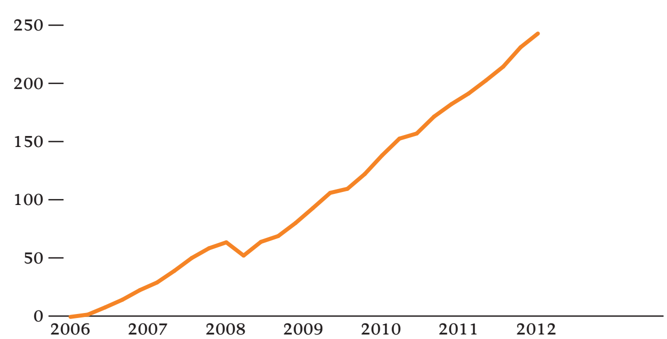
The international catastrophe losses of 2011 led to significantly improved pricing and terms and conditions in certain geographies for both the property retrocession and the property catastrophe excess of loss lines of business. While we don't expect rate increases on these lines to continue we believe they remain attractive areas of opportunity in 2013. The exception may be for accounts directly impacted by the losses from Sandy. As a result we once again expect the Accordion sidecar vehicle to be highly utilised, with a great deal of this business having been written at the 1 January renewal season.

Energy pricing continued to rise in 2012, following the storm damage in 2011 to an FPSO vessel stationed in the North Sea Gryphon field. The major renewal period for energy risks is March through June and while we do not expect continued price increases, we have a stable outlook on our energy book. Disappointingly, the tragic loss of the Costa Concordia did not drive significant premium increases in the marine book as there continues to be ample capacity in this market.

The volatility in the investment markets can be expected to continue in 2013. With the protracted European debt crisis, the continued global economic slowdown and record low interest rates, investment income is precarious. Our approach is to position our portfolio to limit the downside risk in such unpredictable markets.

Lancashire's emphasis on risk selection helps us to produce superior results across the cycle. 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 pricing expectations, there is still plenty of good business available.

Compound return on equity since inception
(per cent)



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

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

2012 Financial Performance

Financial highlights

	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m
Gross premiums written	638.1	627.8	689.1	632.3	724.3
Net premiums written	574.7	577.1	649.9	565.1	576.1
Net premiums earned	607.3	594.7	614.2	574.5	582.6
Net insurance losses	375.5	98.7	165.7	182.3	174.1
Net underwriting income	132.2	390.0	342.2	208.8	289.1
Net investment income	59.5	56.0	53.4	43.2	32.5
Net realised gains (losses) and impairments	(11.0)	23.8	33.2	8.6	11.8
Net operating profit	119.4	364.7	306.5	219.0	220.3
Profit after tax	97.5	385.4	330.8	212.2	234.9
Change in net unrealised gains (losses) on investments	6.9	2.8	(2.2)	(10.6)	17.8
Comprehensive income	104.4	388.2	328.6	201.6	252.7
Dividends	–	273.5	294.2	180.4	201.4
Diluted earnings per share	$0.53	$2.05	$1.86	$1.20	1.29
Diluted operating earnings per share	$0.65	$1.94	$1.73	$1.23	1.21
Fully converted book value per share	$6.89	$7.41	$7.57	$7.62	7.83
Return on equity	7.8%	26.5%	23.3%	13.4%	16.7%
Net loss ratio	61.8%	16.6%	27.0%	31.7%	29.9%
Net acquisition cost ratio	16.4%	17.8%	17.3%	19.6%	20.5%
Expense ratio	8.1%	10.2%	10.1%	12.4%	13.5%
Combined ratio	86.3%	44.6%	54.4%	63.7%	63.9%
Accident year loss ratio	66.5%	27.2%	42.9%	59.3%	34.6%
Net total return on investments	3.1%	3.9%	4.2%	1.8%	3.1%

Note: Dividends included in the financial statement year in which they were recorded

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	2012
Property Reinsurance	100	97	96	127	121	131	157
Property Direct & Facultative	100	92	83	90	84	88	93
Energy Gulf of Mexico	100	80	64	137	139	140	140
Energy Worldwide Offshore	100	80	68	84	88	97	100
Marine	100	88	80	82	80	79	86
Terrorism	100	86	71	66	60	57	55
Aviation (AV52)	100	80	69	68	62	59	55
Combined	100	86	76	83	81	83	84

Underwriting results

	2012					2011				
	Property $m	Energy $m	Marine $m	Aviation $m	Total $m	Property $m	Energy $m	Marine $m	Aviation $m	Total $m
Gross premiums written	356.5	240.9	81.0	45.9	724.3	279.8	229.0	76.4	47.1	632.3
Net premiums earned	279.1	207.8	53.3	42.4	582.6	256.4	195.9	77.3	44.9	574.5
Net loss ratio	40.4%	12.9%	61.2%	4.7%	29.9%	50.8%	27.5%	5.3%	(12.9%)	31.7%
Net acquisition cost ratio	12.2%	25.0%	43.3%	24.3%	20.5%	13.7%	21.7%	32.3%	21.6%	19.6%
Expense ratio	–	–	–	–	13.5%	–	–	–	–	12.4%
Combined ratio	52.6%	37.9%	104.5%	29.0%	63.9%	64.5%	49.2%	37.6%	8.7%	63.7%

Premiums
Gross premiums written increased by 14.6 per cent compared to 2011. The Group's four principal classes, the key market factors impacting them and their outlook, are discussed in detail at the bottom of this page through to page 33.

Ceded premiums increased by $81.0 million, or 120.5 per cent, for the year ended 31 December 2012 compared to the year ended 31 December 2011. Cessions to the Accordion sidecar were $64.8 million in 2012 compared to $12.2 million in 2011. We also opportunistically purchased Industry Loss Warranties, amongst other reinsurance programmes, and expanded our marine and energy cover following the first quarter's Costa Concordia loss.

Net premiums earned as a proportion of net premiums written were 101.1 per cent for the year ended 31 December 2012, compared to 101.7 per cent in 2011.

Losses
The Group's net loss ratio was 29.9 per cent for the year ended 31 December 2012 compared to 31.7 per cent for 2011. The twelve months to 31 December 2012 include total estimated net losses, after reinsurance and reinstatement premiums, of $59.2 million in relation to the total loss of the Costa Concordia and $44.5 million in relation to Sandy. These losses compare to specific event net losses, after reinsurance and reinstatement premiums, of $138.5 million in the twelve months to 31 December 2011 in relation to the Tohoku and Christchurch earthquakes, $25.1 million for Thailand flood losses and $52.5 million for the damage to the FPSO vessel in the North Sea Gryphon field.

Net prior year reserve releases were $27.4 million for the year ended 31 December 2012 compared to $155.3 million for the year ended 31 December 2011. The twelve months to 31 December 2012 included adverse development for the Thailand floods of $23.1 million following updated reports from the loss adjusters. After reinstatement premium and foreign exchange movements, this is $10.4 million of net adverse development in 2012. 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 of that study, net reserves of $36.9 million were released. Both years otherwise experienced releases due to lower than expected reported losses, with 2011 experiencing exceptionally low reported prior year losses.

Property – Market Review and Outlook

The property retrocession market has been stable and we expect the demand for our worldwide product to continue in 2013. Pricing remains adequate on our U.S. property catastrophe book of business, with post-loss rate increases on accounts impacted by Sandy. Japan and other areas of Asia remain key focus areas for Lancashire and we intend to expand our European footprint through 2013.

Our terrorism and political violence programme saw a predominantly flat market in 2012. With new capital expected to enter the market in 2013 there will be further pressure on the rating environment.

The political and sovereign risk market was also flat for 2012. The challenges to the European banking market are projected to continue into 2013, restricting the amount of business coming to market from these clients. We have experienced success developing alternative client bases, which we see continuing into 2013. Lancashire will maintain its selective approach to navigating both of these markets.

2012 gross premiums written increased by 27.4 per cent compared to 2011. The property catastrophe and retrocession lines brought improved trading conditions following the accumulation of industry losses in 2011 with a number of new deals written. Offsetting this increase to an extent was our decision to exit the property direct and facultative line of business. Terrorism and political risk premiums increased slightly due to new business volume.

2012 losses were down compared to 2011. Sandy was the only significant property loss incurred by LHL in 2012 resulting in $44.5 million of losses and contributing 16.3 per cent to the property combined ratio. In 2011 LHL suffered $163.6 million of large losses from the Thailand floods and Tohoku and New Zealand earthquakes.

The table below provides further detail of the prior year's loss development by class, excluding the impact of foreign exchange revaluations:

Loss development by class	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m
Property	22.3	44.4	28.8	63.5	(36.0)
Energy	5.5	9.3	47.6	57.3	37.4
Marine	–	6.1	17.7	28.6	25.9
Aviation	0.8	3.7	6.0	5.9	0.1
Total	**28.6**	**63.5**	**100.1**	**155.3**	**27.4**

Note: Positive numbers denote favourable development.

The following tables show the impact of prior year development and notable current year losses on the Group's loss ratio, both individually and on a combined basis:

For the year ended 31 December 2012	Losses $m	Loss ratio %
At 31 December 2012	174.1	29.9
Absent Costa Concordia	128.3	21.5
Absent Sandy	128.1	22.0
Absent prior year development	201.5	34.6
Adjusted losses and ratio	**109.7**	**18.7**

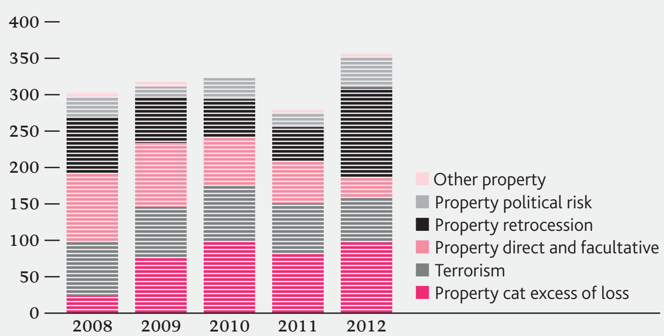
Note: Adjusted loss ratio excludes large losses plus prior year development. The table does not sum to a total due to the impact of reinstatement premiums.

Prior year development includes adverse development after reinsurance of $23.1 million in relation to the Thailand floods loss. Absent this loss, the net loss ratio would have been 26.3 per cent for 2012.

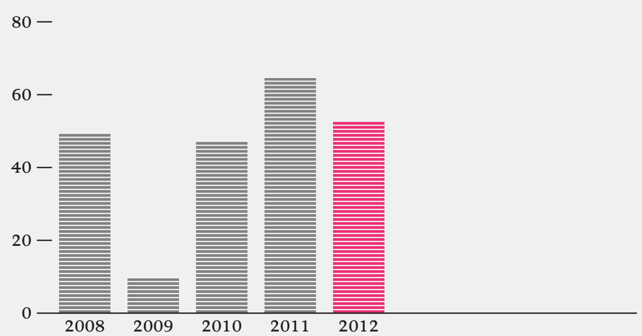
For the year ended 31 December 2011	Losses $m	Loss ratio %
At 31 December 2011	182.3	31.7
Absent Tohoku and Christchurch earthquakes	37.5	6.6
Absent Gryphon FPSO	134.2	23.2
Absent Thailand floods	163.2	28.1
Absent prior year development	337.6	58.8
Adjusted losses and ratio	**125.6**	**21.7**

Note: Adjusted loss ratio excludes large losses plus prior year development. The table does not sum to a total due to the impact of reinstatement premiums.

Gross written premiums ($m) $356.5m



Combined ratio (per cent) 52.6%



Accident year loss ratios	2008	2009	2010	2011	2012
Accident year loss ratio(1)	49.8%	11.0%	29.3%	55.6%	34.6%
Initial accident year loss ratio	66.5%	27.2%	42.9%	59.3%	n/a
Change in loss ratio post accident year	(16.7%)	(16.2%)	(13.6%)	(3.7%)	n/a

Note: Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2012.

The year to date accident year loss ratio, including the impact of foreign exchange revaluations was 34.6 per cent compared to 59.3 per cent for the twelve months to 31 December 2011. The 2012 accident year loss ratio for the year ended 31 December 2012 included:

- 8.5 per cent for the total loss of the Costa Concordia; and
- 7.8 per cent for Sandy.

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 FPSO loss;
- 4.0 per cent for the Christchurch Lyttleton earthquake; and
- 3.9 per cent for the Thailand floods.

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

Excluding the impact of foreign exchange revaluations, during the year to 31 December 2012 previous accident years' ultimate losses developed as follows:

Ultimate loss development by accident year	2011 $m	2012 $m
2006 accident year	2.9	0.4
2007 accident year	11.1	2.3
2008 accident year	29.8	1.7
2009 accident year	33.7	7.1
2010 accident year	77.8	6.4
2011 accident year	n/a	9.5
Total	**155.3**	**27.4**

Note: Positive numbers denote favourable development.

Acquisition costs

The year to date accident acquisition costs ratio was 20.5 per cent compared to 19.6 per cent for the twelve months to 31 December 2011. The increase was largely due to changes in business mix and the impact of outwards reinstatement premiums following the Costa Concordia loss. Absent these reinstatement premiums the 2012 acquisition cost ratio would be 20.0 per cent.

Energy – Market Review and Outlook

The worldwide offshore account continues to be very profitable for Lancashire. While market capacity remains at an all time high on this line of business the scale of new drilling projects around the world is stretching capacity limits. After a light year for Gulf of Mexico storms in 2012, energy pricing in the Gulf of Mexico is under some pressure. We expect this to be offset somewhat by the end of the moratorium on drilling in the Gulf of Mexico and improvements in the licensing process that have seen a resurgence in projects. We have also seen some of the major players who do not buy insurance divesting assets to smaller players who do buy, further increasing demand. The Deepwater Horizon/Macondo experience is driving additional demand for high excess layers for pollution liabilities and pricing can be very attractive. Lancashire is marketing its appetite for this niche carefully to ensure we see a good spread of these risks.

For 2013 we expect supply and demand for capacity to remain in balance. The development of new wells around the globe will be the engine of growth and we will continue to work with our brokers and clients to find new opportunities.

2012 gross premiums written increased by 5.2 per cent compared to 2011. The increase in premiums year on year was driven primarily by new business plus premium flow from prior year risks attaching in the offshore worldwide book. Gulf of Mexico premiums increased, primarily due to long-term contracts that were cancelled and replaced before their expiry date, as clients sought to lock in wind cover beyond the original term.

In 2012 there were no major losses experienced on our energy line. 2011 results were impacted by the damage to the FPSO vessel in the North Sea Gryphon field which contributed a loss of $52.5 million, net of reinsurance and reinstatement premiums.

Investments, liquidity and cash flow

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. As market volatility continues, 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 3.1 per cent (2011 – 1.8 per cent) for the year. Our average annual total investment return since inception is 4.0 per cent, and we have made a positive investment return in every year since inception, including 2008.

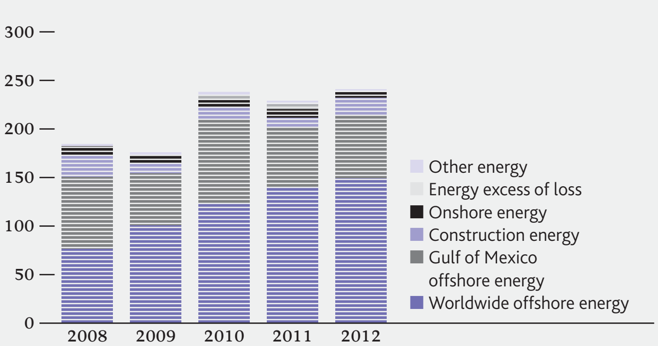
Our portfolio mix illustrates our philosophy as shown in the table below and on page 89. With the composition regulated by the Group's investment guidelines we have three investment portfolio categories: 'core', 'core plus' and 'surplus'. The core portfolio contains at least enough funds required to 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 which are discussed further on page 89. At 31 December 2012 the managed portfolio comprised 88.9 per cent fixed income securities and 11.1 per cent cash and cash equivalents compared to 86.8 per cent fixed income securities and 13.2 per cent cash and cash equivalents at 31 December 2011. The Group is not currently invested in equities, hedge funds or other alternative investments.

Performance

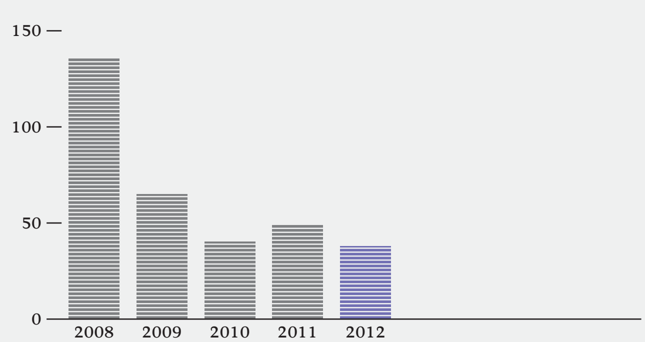
Managed investment portfolio allocations

	2008 %	2009 %	2010 %	2011 %	2012 %
Cash	19.6	7.1	21.9	13.2	11.1
Short-term	8.2	14.2	0.5	4.0	5.4
Government debt	12.3	16.2	22.4	27.2	18.8
Agency debt	5.8	5.6	1.6	4.2	6.2
Agency MBS, CMBS	30.9	23.8	15.3	13.2	19.2
Non-agency RMBS, ABS, CMBS	–	–	2.9	5.8	5.3
FDIC corporate bonds	7.7	9.5	4.3	2.5	–
Corporate bonds	15.2	23.6	31.1	29.9	32.2
Bank loans	–	–	–	–	1.8
Equities	0.3	–	–	–	–
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Gross written premiums *($m)* $240.9m



Combined ratio *(per cent)* 37.9%



The Group continues to hold an emerging market debt portfolio. Currently 4.5 per cent of the portfolio is allocated to emerging markets with an overall average credit quality of BBB compared to 6.2 per cent and an overall credit quality of BBB at 31 December 2011. The corporate bond allocation, excluding FDIC guaranteed bonds, represented 32.2 per cent of managed invested assets at 31 December 2012 compared to 29.9 per cent at 31 December 2011. During 2012 the Group invested a small portion of the portfolio, 1.8 per cent, to bank loans. The allocation to bank loans will ultimately be approximately 3.5 per cent of total managed assets and, as floating rate notes, is part of our interest rate risk management strategy.

The composition, duration and asset allocation of the investment portfolio are 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 risk 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.

Investment performance

Net investment income was $32.5 million for the year ended 31 December 2012 compared to $43.2 million for the prior year, a decrease of $10.7 million, or 24.8 per cent. Overall lower yields and a reduction in the emerging market portfolio contributed to the decrease in investment income for the year to date compared to 2011.

Total investment return, including net investment income, net realised gains and losses, impairments and net change in unrealised gains and losses was $62.8 million for the year ended 31 December 2012 compared to $40.7 million for 2011. Credit spreads tightened significantly across the portfolio for the twelve months to 31 December 2012.

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.

Key investment portfolio statistics	2008	2009	2010	2011	2012
Duration	1.8 years	2.3 years	2.2 years	1.8 years	1.8 years
Credit quality	AA+	AA+	AA	AA–	AA–
Market yield	2.7%	2.2%	1.9%	1.5%	1.1%
Book yield	3.4%	2.8%	2.4%	1.9%	1.8%

Marine – Market Review and Outlook

It is disappointing that, following the largest ever insured marine loss in Costa Concordia, market over-capacity has meant that even flat renewal terms are seen as a victory for underwriters. Absent a market-changing event ample capacity will likely remain in the market maintaining the downward pressure on prices. In marine hull some of the larger risks may see marginal increases following the Costa Concordia loss and Lancashire will continue to focus on underwriting high-value accounts, cruise vessels and liquid natural gas carriers. We expect the continuing competition for business between the different underwriting hubs in London, Scandinavia, Continental Europe, Singapore and the U.S. to have a negative effect on pricing for all but the largest risks. Therefore we will not be looking for any major growth in our portfolio in 2013, but rather to work with our existing clients and wait for an upturn in pricing. We are also working actively to find new opportunities, especially in our preferred niches such as marine war, mortgagees' interest insurance and mortgagees' additional perils.

2012 gross premiums written increased by 6.0 per cent compared to 2011. The year to date increase was largely driven by the timing of multi-year contract renewals, which included significant price increases on loss affected contracts following the Costa Concordia marine loss. However, despite this loss in early 2012, pricing and renewal rates have been broadly stable with ample capacity remaining in the market.

2012 losses increased significantly over 2011 primarily due to the Costa Concordia total loss. LHL recorded a loss of $59.2 million, net of reinsurance and reinstatement premiums for this event, which contributed 89.7 per cent of the marine combined ratio for the year ended 31 December 2012. No large losses on the Marine programme were experienced in 2011.

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.

Cash flow

Lancashire's cash inflows are primarily derived from net premiums received, from losses recovered from reinsurers, from the issuance of debt 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.

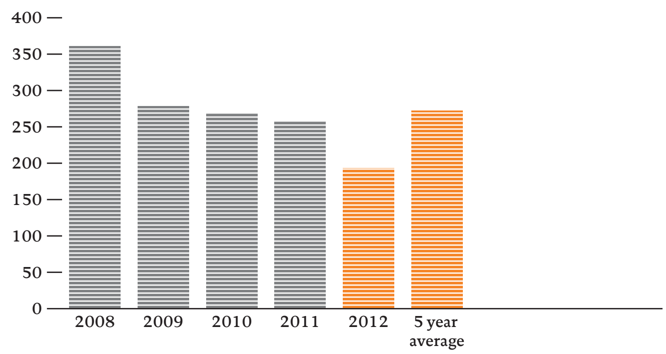
The principal outflows for the Group are the settlement of claims, the payment of reinsurance cover, payment of general and operating expenses, the servicing of debt, the purchase of investment products, the distribution of dividends and the repurchasing of shares.

In 2012, cash flow was again strong, driven by the Group's robust underwriting performance. A net positive cash inflow arose from operations during the year of $193.3 million (2011 – $257.7 million). We have generated positive operating cash flows in each year of operation since inception.

Other operating expenses

	2011 $m	2012 $m
Employee remuneration	40.8	46.9
Other operating expenses	30.2	31.5

Operating cash flow *($m)*

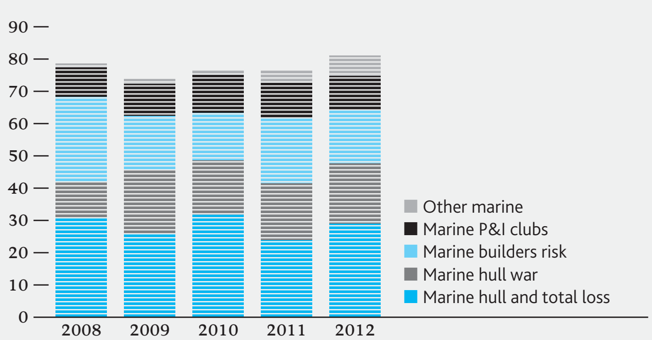


In the first quarter of 2012 employee remuneration included a one-off national insurance charge of $6.9 million, incurred as a result of the Group's tax residency move to the UK effective from 1 January 2012.

Equity based compensation was $16.4 million for the year ended 31 December 2012 and $18.8 million for the year ended 31 December 2011. During 2011 there was a one-off adjustment of $4.2 million in relation to dividend strike price revisions on option awards under the Group's 2005 Long-Term Incentive Plan Option Scheme, which was closed to further awards in 2008. By 2012 the majority of these previously issued option awards had been exercised and the remaining charges on them were negligible.

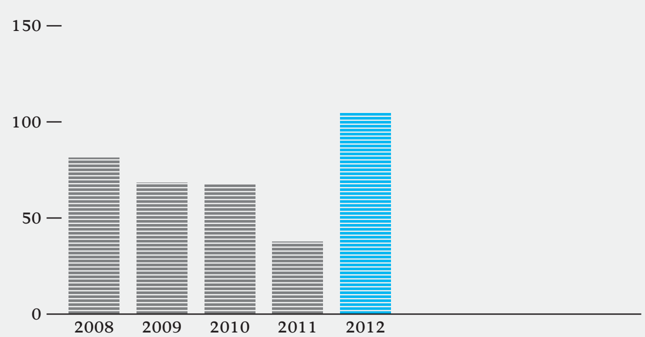
Gross written premiums *($m)*

$81.0m



Combined ratio *(per cent)*

104.5%



Performance

Capital management

Lancashire has built a reputation for being the best known and most active proponent of capital management in the industry. Capital management is our second most important area of focus after underwriting and it is our firm belief that pro-active and flexible capital management is crucial in helping to generate a superior risk-adjusted return over time. With our focus on maximising shareholder return we will return capital where this offers the best returns for our shareholders. Including dividends declared in February 2013 we have returned 93.7 per cent of comprehensive income generated via dividends or share repurchases since inception.

The Group actively reviews the level and composition of capital on an ongoing basis. 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. The key aim of the capital management process is to maintain a strong balance sheet, whilst:

- maintaining sufficient capital to take advantage of underwriting opportunities and to meet obligations to policyholders;
- maximising the return to shareholders within predetermined risk tolerances;
- maintaining adequate financial strength ratings; and
- meeting internal, regulatory and rating agency requirements.

The subsidiary operating entities also conduct capital requirement assessments under internal measures and in compliance with local regulatory requirements.

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. All capital actions require approval by the Board of Directors. The retention of earnings generated also leads to an increase in capital.

The composition of capital is driven by management's appetite for leverage, amongst other factors. In 2012 the Group issued $130 million of 5.7 per cent senior unsecured notes due 2022, accessing a new investor base and therefore increasing financial flexibility.

Following the successful launch of the Accordion sidecar in 2011, a market facing vehicle, Saltire, was launched in 2012 which represents a further development of Lancashire's strategy to build partnerships with capital market participants. It will give the Group the opportunity to leverage its underwriting expertise whilst affording flexibility in the management and deployment of its own capital.

Other capital management tools and products available to the Group may also be utilised.

Maintaining a strong balance sheet will be the over-riding factor in all capital management decisions.

Capital

At 31 December 2012, total capital was $1.646 billion, comprising shareholders' equity of $1.387 billion and $258.7 million of long-term debt. Leverage was 15.7 per cent. Total capital at 31 December 2011 was $1.455 billion.

Dividends

During 2012 the Lancashire Board declared an interim and special dividend of $0.05 and $0.90 per common share respectively as well as a final dividend in respect to 2011 of $0.10 per common share. With the 2013 special dividend of $1.05 per common share and a final dividend in respect to 2012 of $0.10 per common share, total capital returns since inception amount to $1.7 billion, or 175.8 per cent of initial capital raised. The final dividend of

Aviation – Market Review and Outlook

The aviation market's risk profile remains attractive and passenger numbers are picking up. Offsetting this is downward pressure on pricing as capacity for AV52 remains at an all time high. The lack of insured losses is encouraging new capital both from existing market players and new entrants who are happy to compete on price. AV52 cover is often bought as it is mandated by regulation rather than because the insured perceives a real threat and clients are more inclined to buy the cheapest product than to think about continuity. As such Lancashire has to compete on price. With excess capacity in the AV52 market set to continue to put pressure on pricing in 2013 Lancashire will focus on maintaining its market share.

We re-entered the satellite market for launch and orbit in the third quarter of 2012, which we last wrote in 2008. We have a good track record with this class and believe these exposures fit our portfolio well. We aim to increase penetration into this market in 2013 through our existing relationships as the number of launches increases.

2012 gross premiums written decreased 2.5 per cent compared to 2011. The reduction was driven by further competition in the AV52 market in its primary renewal period combined with continued downward pressure on pricing. Offsetting this to an extent was good deal flow on our satellite launch and orbit class.

2012 losses increased slightly over 2011 although neither year experienced any significant insured losses. The loss charge primarily relates to an attritional IBNR allocation. As shown on page 27, Aviation reserve releases relating to prior year losses decreased compared to 2011.

$0.10 per common share and 2013 special dividend of $1.05 per common share have been declared and will be paid on 17 April 2013 to the shareholders of record on 22 March 2013.

Non pre-emptive issue of shares
As part of Lancashire's flexible approach to capital management the Board has in recent years requested and received from shareholders authority to issue up to 10 per cent of its shares on a non pre-emptive basis. 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 2013 Annual General Meeting to be held on 1 May 2013.

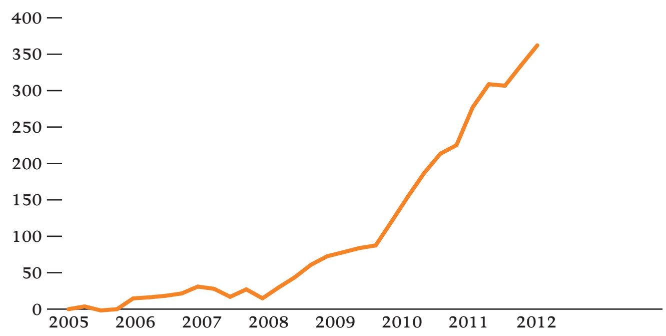
Repurchase programme
No shares were repurchased during the years ended 31 December 2012 and 2011. The Group's current authorised share repurchase programme permits a maximum of 16,860,242 shares to be repurchased of which all remained available at 31 December 2012.

The Board will be proposing at the 2013 Annual General Meeting, to be held on 1 May 2013, that the shareholders approve a renewal of the repurchase programme with such authority to expire on the conclusion of the 2014 Annual General Meeting or, if earlier, fifteen months from the date the resolution approving the repurchase programme is passed.

Letters of credit
Lancashire has three standard letter of credit facilities in the total amount of $750.0 million with a $75.0 million loan sub-limit available for general corporate purposes. There was no outstanding debt under this facility at any reporting date. There are no off-balance sheet forms of capital.

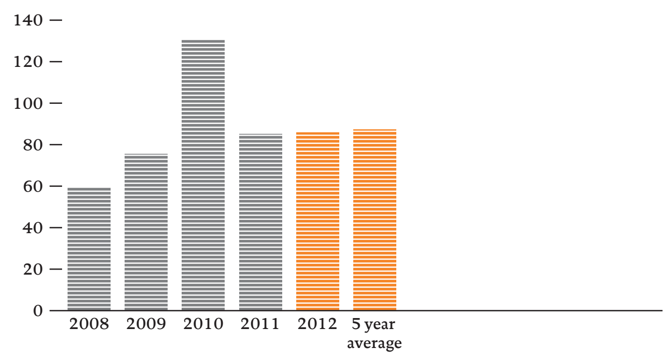
Maintaining a strong balance sheet will be the over-riding factor in all capital management decisions.

Total Shareholder Return since inception
(per cent)



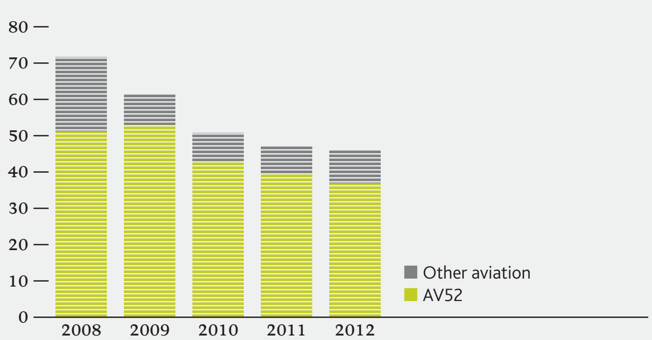
Percentage of profit returned to shareholders *(per cent)*

85.7%



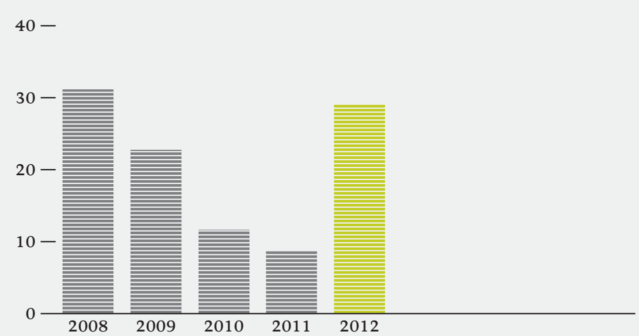
Gross written premiums
($m)

$45.9m



Combined ratio
(per cent)

29.0%



Performance

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 major business decisions we make. Our major 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".

Our ERM governance framework

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.

Our ERM strategy

Lancashire's ERM strategy is designed to support the business in attaining its strategic aims. This drives two key objectives:

- ensure that all important decisions include a consideration of risk and reward within clearly defined risk boundaries aligned to the overall strategy; and
- promote informed risk taking with a view to optimising the risk-adjusted RoE.

We aim to do this by:

- promoting a culture of risk understanding, quantification and challenge;
- ensuring that capital resources are appropriate for the risk levels; and
- complying with regulatory requirements in all jurisdictions.

We have a risk appetite that is measured in two of our fundamental risk management objectives:

- we target a risk-free plus 13 per cent cross-cycle RoE; and
- we expect to make a profit four years out of every five.

At present we have a compound annual RoE since we began the business of 19.2 per cent and have made a profit in every one of the seven years we have been in business, demonstrating that we are managing our profile in accordance with our stated targets.

Our three core ERM principles

- **Establish and keep under review a risk appetite that is aligned with our business objectives.** The Group Board 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. Each year the business completes an 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.

The daily call and the fortnightly committee

Since insurance is far and away the biggest driver of Lancashire's capital needs, it is only natural that we exercise great care in our selection of insurance and reinsurance risks and analysis of our exposures and aggregations. We have two key gatekeepers of this risk – the daily underwriting call and the fortnightly RRC. The former brings together our senior underwriting management including the Group CEO and Group and subsidiary CUOs as well as junior underwriters, actuarial and modeling staff and other disciplines as required. This looks at all the risks that our underwriters wish to quote and provides real-time opportunities for management to align the portfolio to our strategy. The RRC reviews a full risk dashboard of PMLs and RDS about every fortnight and brings together underwriting, finance, actuarial, capital modeling and operational staff to look at all areas of risk. A full schedule of meetings across the year ensures that all areas are reviewed and the ability to raise ad hoc issues means that emerging risks and opportunities can be discussed nimbly.

Our primary risk management tool: BLAST

The key tool that helps us to quantify and monitor risks is the BLAST model – BLAST stands for the Best Lancashire Assessment of Solvency over Time. We model all of our quantifiable risks and allocate capital to them. We categorise risks under the following headings:

- Insurance Risk
- Operational Risk
- Reserve Risk
- Investment Risk
- Credit Risk
- Liquidity Risk

We populate the internal model with data about our risks. For insurance risk, for example, we take our risk modeling from our third-party models such as RMS and AIR, add assumptions agreed between our actuaries and underwriters about other risks, and generate a capital requirement for the level of risk we run.

We also use BLAST to model correlations between risks. For insurance risks for instance we look at the potential correlation of an AV52 aviation terrorism loss that also affects a building that we insure under our property terrorism portfolio. For broader economic analyses we look at the risk of sustaining a major insurance loss in a year when there is also a downturn in the investment markets – something that actually happened in 2008 when Hurricanes Gustav and Ike coincided with the beginning of the financial crisis.

Principal risks

Type	Risk	Possible Impact	Controls and Mitigation	Monitoring
Insurance	**Underwriting pricing** – the failure to price business at a level that supports business plan objectives.	Reduced profit or increased losses with consequent impact on reputation and share price.	Use of appropriate pricing tools including models, monitoring of the RPI, use of the daily UMCC to allow senior management oversight.	Underwriting reports submitted to management and Boards covering RPI, loss ratios and expected pricing movements.
Insurance	**Underwriting exposure management** – the failure to establish appropriate risk measures and tolerances or to manage exposures within them.	Exposures inconsistent with the business strategy and risk appetite leading to outsize losses that erode capital and threaten ratings with consequent impact on reputation and share price.	Boards set risk tolerances and appetite that are implemented by management. Appropriate reinsurance is used to mitigate peak exposures.	PML and RDS reports sent weekly to management and included in Board materials. RRC monitors PML and RDS risk dashboard every two weeks.
Operational	**Rating agency capital management** – the failure to maintain sufficient capital headroom to satisfy the key rating agency capital requirements.	A rating below A.M. Best A- would allow some clients to cancel policies and would damage the Group's ability to trade if not rectified swiftly.	Current A.M. Best rating is one notch above standard A- requirement. Regular contact with all rating agencies.	BLAST output includes rating agency capital charts to show the current positions and the annual forecast process includes a synthetic portfolio analysis of capital headroom.
Operational	**Availability of systems and services** – the failure of critical systems such as the underwriting system, emails or finance database.	Delays in ability to respond to clients or provide data for reports and regulators.	Both Lancashire offices have disaster recovery plans and systems are designed with external back-up and redundancy. Rigorous change management systems are implemented for IT development.	Real-time monitoring of applications, systems and links on a priority basis. Capacity thresholds and other system metrics are monitored to pre-empt issues.
Investment	**Investment strategy** – the failure to align the investment strategy to the business plan and the current and anticipated economic and fiscal environment.	Investment losses reducing the amount of capital available to the business and damaging the reputation of the company as a safe custodian of shareholders' funds.	The Board of LHL has an Investment Committee comprising experienced Executive and Non-Executive Directors and uses four external portfolio managers. Tolerances are established for investment losses.	An investment report is sent to management weekly which monitors various realistic loss and disaster scenarios. Board reports include extensive materials.

Corporate responsibility

Why corporate responsibility is important to Lancashire

Lancashire is committed to understanding risk and helps companies and people around the world to deal with the various threats that our societies face. We deal with the effects of the unexpected including major disasters like earthquakes, floods, windstorms and terrorist attacks and our industry plays a unique and vital role not just in repairing damage, but in giving the confidence to invest, or to start a new enterprise.

So risk and responsibility are central to our business strategy and ensuring that we are responsible corporate citizens and individuals in all that we do is a key part of our approach to business at Lancashire. It means that we are able to manage our own potential risks and respond to issues that we face as an industry and society, to secure the future of our clients and our shareholders. Our underwriting business focuses on Property (including terrorism and political and sovereign risks), Energy, Marine and Aviation, all of which are subject to external socio-economic, political, environmental and climatic factors. Understanding these and the global trends affecting our markets and customers is crucial to ensuring our own corporate sustainability.

Our approach

Our approach to being a responsible business is simple. We recognise the role that we play as a business and the impacts that we have, and try to ensure that we manage these effectively. We also understand that acting in a responsible and caring way differentiates us with our clients, our colleagues and our communities.

Community

Supporting local communities in the countries where we operate and around the world where there is significant need.

$7.5m

donated through the Lancashire Foundation since inception

Environment

Lancashire's commitment to engaging with clients, brokers, investors and rating agencies means we have to travel the world, but we always seek to mitigate the environmental impact.

100%

of business travel CO_2 emissions offset

Marketplace

Lancashire has established a respected position in the marketplace and is using its influence for good causes.

80

entities and individuals contributed to the Kids Company summer campaign

Workplace

Treating our employees fairly to recruit, retain and develop the talent that drives our success.

100%

of employees eligible for share awards

Living by our values

Lancashire works hard to embed the values that set us apart, define how we want to operate and to attract the best talent.

Teamwork – we encourage everyone to contribute fully to activities across Lancashire. Having a collegiate approach allows ideas and information to be shared, for example the UMCC.

Success – being pragmatic delivers the best when the best is required, or good enough when it fits Lancashire's risk appetite. Being disciplined and understanding the risks and emerging risks, and managing them effectively, is critical.

Agility – being nimble, quick, well co-ordinated and task-focused allows us to take advantage of opportunities and to be aware of the big picture. We aim to embrace change and respond quickly to new opportunities, demands and challenges.

Passion – we strive to ensure Lancashire is a great place to work and our staff are dedicated, keen, innovative and thoughtful. We expect our people to go the "extra mile" in the pursuit of Lancashire's vision.

Respect – demonstrating respect and fair treatment to all is important and this supports and embraces our Corporate Responsibility activities. We expect people to act with honesty and integrity at all times.

Community

Introduction
We are keenly aware that our products are only available to those who are able to pay for them, and that our expertise often relies on a level of education that is only available to a small proportion of the world population. So we take particular interest in disaster relief and young people when we are looking for ways to give back to the broader community.

Our approach
At Lancashire, the nature of our business means that we recognise the privileged role that we have in society. We are able to support community organisations in two ways: through direct cash donations and through using the skills and talents of our colleagues.

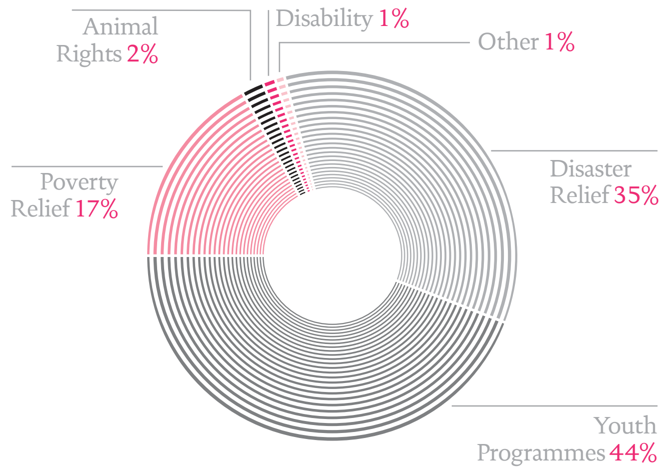
Our focus areas
Responding to the effects of natural disasters and world events means that we have an acute sense of risks and their consequences.

Having a highly skilled workforce, we recognise that the same opportunities – access to education, to shelter and to aspirations aren't always available to young people across the world.

The focus of our community investment endeavours is therefore closely tied to working on these issues. We have supported Médecins Sans Frontières (MSF) and Kids Company as flagship partners for a number of years and continue to engage our staff in projects for these organisations.

The Lancashire Foundation
The Lancashire Foundation is a crucial component of our community investment activity. The Foundation is committed to channelling our resources in an effective way to meet community needs, particularly focused on helping young people and the severely disadvantaged in society. We recognise the financial pressure that charities face and therefore our contributions are generally not tied to particular programmes or activities. We believe that the organisations themselves are best placed to direct funds in the most efficient and effective way to ensure their sustainability and to meet their beneficiaries' needs. The Foundation is funded by an annual donation from the Company which has grown from $1 million in 2007 to $1.4 million for 2013. Part of the initial funding was in the form of 648,143 Lancashire ordinary warrants. This means that the Foundation receives additional income from dividends payable on the warrants and benefits from the increase in the share price, linking the performance of the Company to the resources of the Foundation.

In 2012, the Foundation supported the following types of organisations *(per cent)*



The Foundation funds our key flagship partnerships with MSF and Kids Company, as well as smaller charities nominated by our staff. Organisations are asked to deliver a presentation to the Donations Committee and requests are debated and decided by the group. Committee members act as advocates for the organisations that we support throughout the year. In exceptional circumstances we can provide additional emergency funding, as we did in 2012 for ICM after the flooding in the Philippines, when we gave an additional $10,000 which helped to fund a relief operation that reached 28,947 people.

Living by our values

Sharing our success

Company share scheme
Everyone at Lancashire is eligible to be awarded shares in the Company. This creates a shared ownership culture where everyone has a vested interest in the success of the Company and goes towards supporting staff engagement. This benefit is unusual in the market and sets Lancashire apart – we believe this provides a real benefit to staff.

In certain circumstances we also sponsor charities suggested by others in our market place, and on this basis in 2012 we have supported Street Child of Sierra Leone, Edward Lloyd Charity Trust, Find a Better Way and Cancer Research UK.

Our flagship partnerships

Kids Company

Kids Company was founded by Camila Batmanghelidjh in 1996. They provide practical, emotional and educational support to vulnerable inner-city children.

Their services reach 18,000 children across London, including the most deprived and at risk whose parents are unable to care for them due to their own practical and emotional challenges. For many, the roles of adult and child are reversed and, despite profound love, both struggle to survive.

These exceptionally vulnerable children not only negotiate significant challenges in their family homes, they also face immense threat within their neighbourhoods. Often they are exposed to relentless violence, some are forced into working as drug couriers or prostitutes, and many experience chronic abuse.

Kids Company provides a safe, caring, family environment where support is tailored to the needs of each individual. The services and support empower children who have experienced enormous challenges to lead positive and fulfilling lives. Despite great difficulties, the children involved are hugely courageous and embrace the support offered.

In 2007 Kids Company was awarded the Liberty and JUSTICE Human Rights Award. In 2010 it was selected as a 'Child Poverty Champion' by the End Child Poverty project for its success in enabling children to achieve their full potential.

The Lancashire Foundation has donated $490,000 to Kids Company since the relationship began in 2011. With the majority of our staff working and often living in London we believe that it is vital to ensure the future cohesion of our community and society, so supporting Kids Company makes sense. We are proud to have a young man who graduated through the Kids Company programme and who was introduced to us by them, now entering his second year of internship in our London office. This demonstrates how the benefits of the philanthropic work of the Group can have tangible benefits.

In 2012 Lancashire was approached by Kids Company with a unique project. The summer school holidays are a time of heightened risk for the most vulnerable children. Without free school meals, the safety of school premises and support of the staff, many children face a very uncertain couple of months. Camila asked if Lancashire could help galvanise support for a £200,000 fundraising campaign to support 3,000 children. Using our qualities of nimbleness and agility we immediately set about publicising the campaign using our contacts in the marketplace, especially the trade press and advocating for the charity on the fundraising committee. Lancashire staff also called senior level contacts in the insurance marketplace as well as other areas of the City and a total of £208,475 was raised in eight days. Lancashire received positive press coverage enhancing the profile of the Company.

Médecins Sans Frontières

Médecins Sans Frontières (MSF) is an international, independent, medical humanitarian organisation that delivers emergency aid to people affected by armed conflict, epidemics, natural disasters and exclusion from healthcare. They offer assistance to people based on need and irrespective of race, religion, gender or political affiliation.

They provide medical care to help people survive catastrophic situations, where communities and health structures may be overwhelmed. Their actions are guided by medical ethics and the principles of neutrality and impartiality. They do not take sides but seek to bring assistance to those who need it most urgently. In situations of conflict, they do not accept funds from governments or other parties who are directly involved.

Living by our values

Teamwork with our partners

Kids Company

In November 2012 Kids Company had an urgent funding need which Lancashire was able to meet. Camila Batmanghelidjh wrote, "You've all done such an exceptional amount for our kids, and the difference your recent donation will make to their experience of Christmas is indescribable. When the donation came through I breathed a sigh of relief so heartfelt that all the candles in my office went out. I simply don't know what we would do without your amazing friendship and support."

In carrying out humanitarian assistance, MSF also seeks to raise awareness of crisis situations. MSF acts as a witness and will speak out, either in private or in public, about the plight of populations in danger for whom they work. In doing so, MSF sets out to alleviate human suffering, to protect life and health and to restore respect for human beings and their fundamental human rights.

Lancashire's Foundation has donated $1.89 million to MSF over the last three years, comprised of an annual donation of $500,000 and emergency and matching donations as required. The most recent emergency donation was to support the work that MSF is doing with the Rohingya population of Burma.

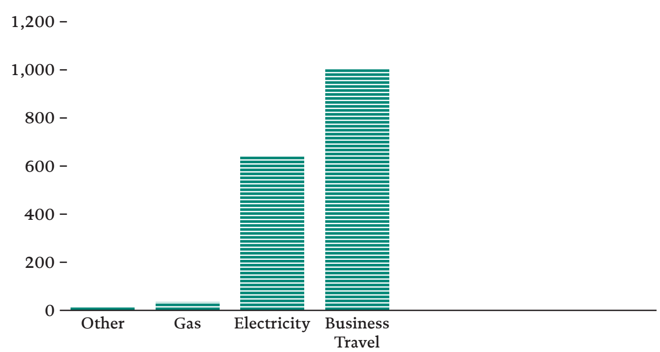
Employee engagement
At Lancashire we recognise the talent of our colleagues and their commitment to "give something back" to the communities that they work in.

We provide a range of ways for colleagues to get involved in local and international projects organised through our community partners. These range from helping out at an old people's home to serving breakfast for schoolchildren, to building houses and toilets in the Philippines. For those that have had the opportunity to travel abroad, it is also an incredibly valuable experience to see the after effects of global events such as hurricanes and earthquakes first hand in order to recognise the importance of what we do as a business. Since 2010 eighteen colleagues have taken part in our annual trip to work with ICM in the Philippines.

Through our volunteering policy we support our employees to engage in charitable events and programmes during working hours.

Our matching contribution programme is a way for us to support the causes that are close to our colleagues hearts. We know that people value the contribution that we make to help support the fundraising activities such as marathon runs that they do for good causes.

Source of emissions *(tCO_2e)*



Environment

Our approach
As a business focused on understanding global risks, we understand all too clearly the impact of climate change on the world. Our environmental footprint is not as significant as some other sectors as we are a service industry and predominantly office-based. However, we do take care to limit our use of resources, to recycle where possible and to manage our environmental impact by measuring and offsetting our carbon emissions.

The Company's carbon footprint, calculated between 1 October 2011 and 30 September 2012, was 1,692 tonnes of CO_2e (tCO_2e). In accordance with ISO 14064 standards, the Company's carbon figure measures scope 1 and 2 emissions. This includes direct and energy indirect emissions. The Company has also decided to measure and offset its Scope 3 emissions, relating to business travel and other indirect emissions.

Living by our values

Respecting our communities

"Maban is an extremely hostile and difficult place to work in terms of the environment. You'd be hard-pushed to pick a worse place to accommodate 120,000 refugees. The people were fleeing an armed conflict in Blue Nile state, across the Border in Sudan.

Thanks to donors like Lancashire, MSF can respond faster than anyone else to the most acute and complex humanitarian emergencies. Without the people who support our mandate of independence, donors who trust in our expertise and experience, we would be far less effective in saving lives in emergencies."

Hannah Richardson, Major Gifts Manager, MSF UK

Performance

The Company has chosen to offset its carbon emissions with Carbon Clear by contributing towards a reforestation project in Uganda and a fuel-switch project in Brazil. We are pleased to announce that the Lancashire Group continues to be carbon neutral and is dedicated to exploring initiatives that ensure we limit emissions and positively manage our footprint.

Paper Use: Ours is a document-based industry but we are looking to mitigate this by signing up to e-trading initiatives, having recycling bins and shredders around the office, encouraging double-sided printing and providing frequently used documents on our intranet.

Business Travel: Meeting our clients, investors and reinsurers is important to us and we travel extensively around the world to do so. However, for internal meetings we make as much use as possible of video conferencing – the daily UMCC and fortnightly RRC are good examples.

Energy Use: Both our office buildings (of which we are tenants) have smart technology to reduce energy usage, and we encourage colleagues to turn off unused electrical equipment.

Marketplace

Our approach

Lancashire is conscious that both in Bermuda and London it is a member of a marketplace consisting of insurers, reinsurers, brokers, loss adjusters, lawyers, auditors and other professionals. With an outstanding track record over the last seven years we now have a respected position within the industry and we can leverage that to differentiate ourselves and provide leadership. The summer Kids Company fundraising effort referred to above is a good example of Lancashire taking a leading role in the marketplace.

We take our responsibilities to our stakeholders seriously and work hard to ensure a good flow of communication. This involves travelling to visit them, hosting them at our offices and at social events and providing materials that describe our business.

Clients: As a company that specialises in risk selection we think our clients are vital to the success of the business. We try to look not just at the numbers but the soft factors too – how the client conducts themselves in their marketplace, how they deal with losses.

Brokers: We recognise that our brokers are the lifeblood of our business, and we try to be clear and frank in our dealings with them. When we took the difficult decision to come out of Property Direct and Facultative business in 2012 we sent a letter explaining our decision to all our brokers and followed up with meetings and phone calls where appropriate.

Investors: We are fortunate to have a well-diversified shareholder register, both by type and geography. As with our other stakeholders we travel to meet with them, and in December 2012 held an analyst presentation day where we asked our underwriters to explain our business in more detail than usual. Some of the comments include: “Lancashire’s communication to the market is top quartile. Updates on pricing and market conditions on its quarterly calls are outstanding, particularly post large catastrophes” and, “I think Lancashire communicates very well with analysts, with the key strengths being responsiveness (quick to return calls or respond to email queries) and also a proactive approach.”

Workplace

Introduction

Every company says it, but we truly believe that the talents of our people and our unique culture set us apart from our competitors. We strive to attract and retain the very best employees in the insurance industry. We devote time and effort to delivering an effective recruitment process. While expectations are high, we manage and support our people both to meet our business requirements and to develop their own skills ultimately supporting their career success.

Living by our values

Passion for the future of underwriting

Sandys 360

Through our partnership with Sandys 360 Sport, Aquatic and Enrichment Centre, a number of our staff were able to provide career guidance to young boys who attend Sandys Secondary Middle School. Each presentation was well received and afterwards we received several letters from the boys. “The three steps you taught us really got me thinking about what I want to pursue as my career. Now I know how and what I need to reach my goal.”

Our staff enjoy assisting the community and in particular sharing with the youths their passion for underwriting, accounting and IT services.

In 2012 we have developed new tools for our colleagues, namely an updated Global Staff Handbook, a management development programme and the launch of the Lancashire Values framework. The revised Global Staff Handbook includes an improved Equal Opportunities Policy. We will be rolling out a further training programme during 2013 for colleagues that will build on the successes of our 2011/12 development programme. The Lancashire Values are designed to set out how we want people to carry out their role and help shape our culture to meet our business needs.

The business necessity to focus on our underwriting priorities unfortunately resulted in staff redundancies in the middle part of this year. Despite this challenging time, staff morale is positive and there is a clear effort from teams looking to the future and understanding the rationale for change.

Our approach

Recruiting the right people for Lancashire will always be a high priority for the business. It is critical that the aspirations and values of new recruits are a good match to both the role and the Company Values that were launched in 2012.

Communication is also a key priority. Lancashire is small enough to be able to communicate and engage with staff more directly than larger organisations. Lancashire has a flat structure and operates in a way where senior individuals are accessible. As well as normal and regular informal forms of communication, there are two structured methods through which we speak directly to our staff: the monthly Staff Meetings hosted by the CEOs in the UK and Bermuda aim to share information from senior management and the Executive with staff about the business, and also half-yearly Open Forum events are held. These are focused on upwards communication from staff to the Executive.

Diversity

We are committed to being an equal opportunities employer. This will be supported by training and development interventions for all staff in 2013. There is a near 50/50 split of males to females (see page 50) that work at Lancashire across the Group and internal career progression is actively managed and encouraged.

Training and development

Resources are allocated for staff training and we see this as being a key retention tool.

Of particular note was the global Management Development Programme run during 2012. This programme was devised and delivered by an external training provider to twenty middle managers. The programme consisted of an initial 360-degree feedback process with analysis conducted through one-to-one coaching. Once that stage was completed, the managers attended a series of nine training modules over the course of 2012, with an ongoing feedback process.

There has been a lot of anecdotal feedback relating to the benefits of the programme. This is evidenced through the 360-degree reports where there has been increased positive feedback from peers and senior management. In general, participants themselves have enjoyed the programme, gained a lot of practical knowledge and tips on how to manage and develop their teams better.

Rewarding our employees

Our voluntary staff turnover rate is within the normal and healthy range we would expect. However, we still strive to reward our employees competitively and want to add something a bit different to value and, therefore, retain our people. We believe that we have some key differentiated benefits that help attract people and keep them motivated. We want everyone to benefit from the success of the business and have a shared ownership scheme providing free company shares to staff which vest depending upon the performance of the Group. Our company has been financially successful since its inception and our people have benefited from this.

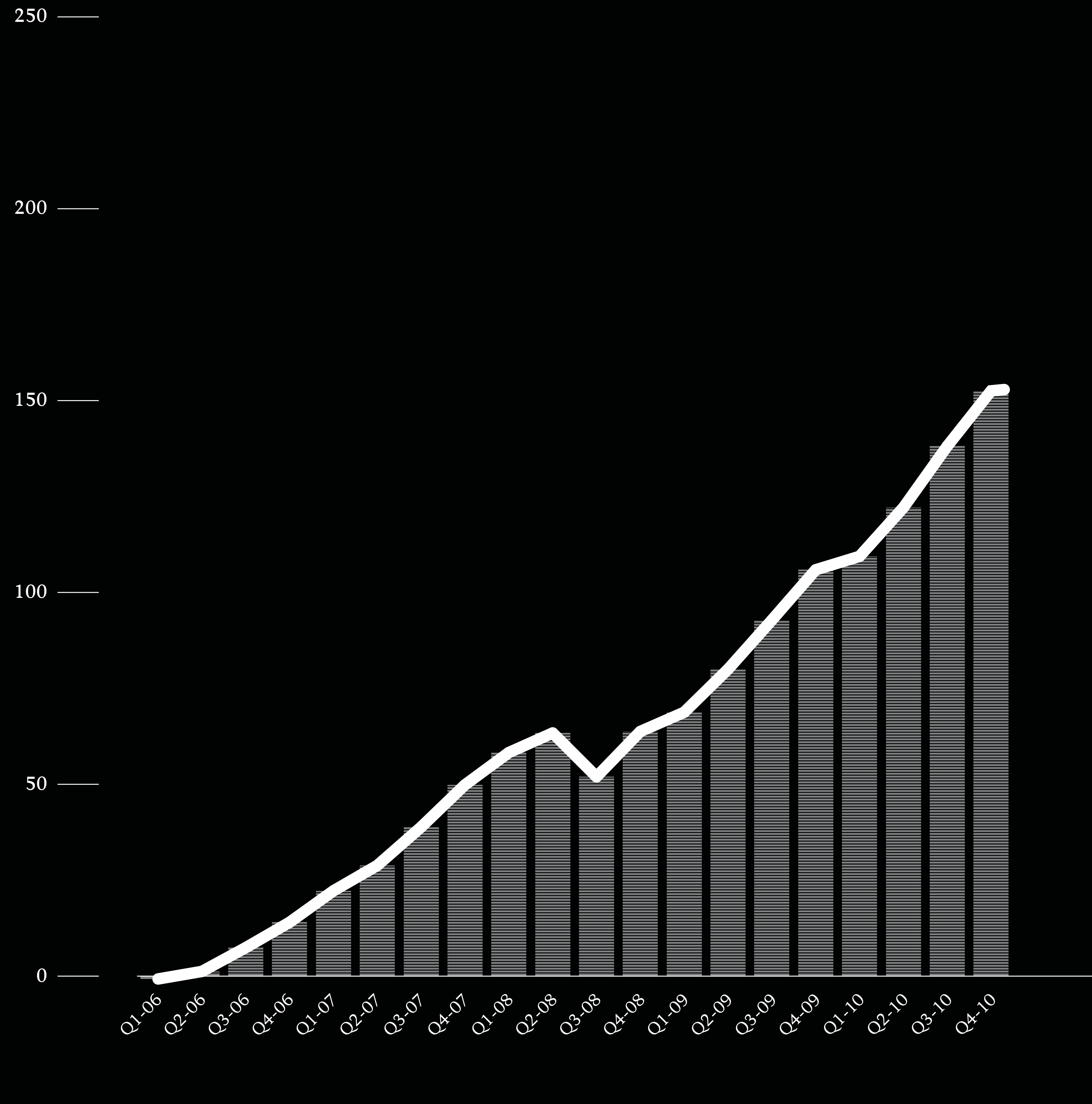
Living by our values

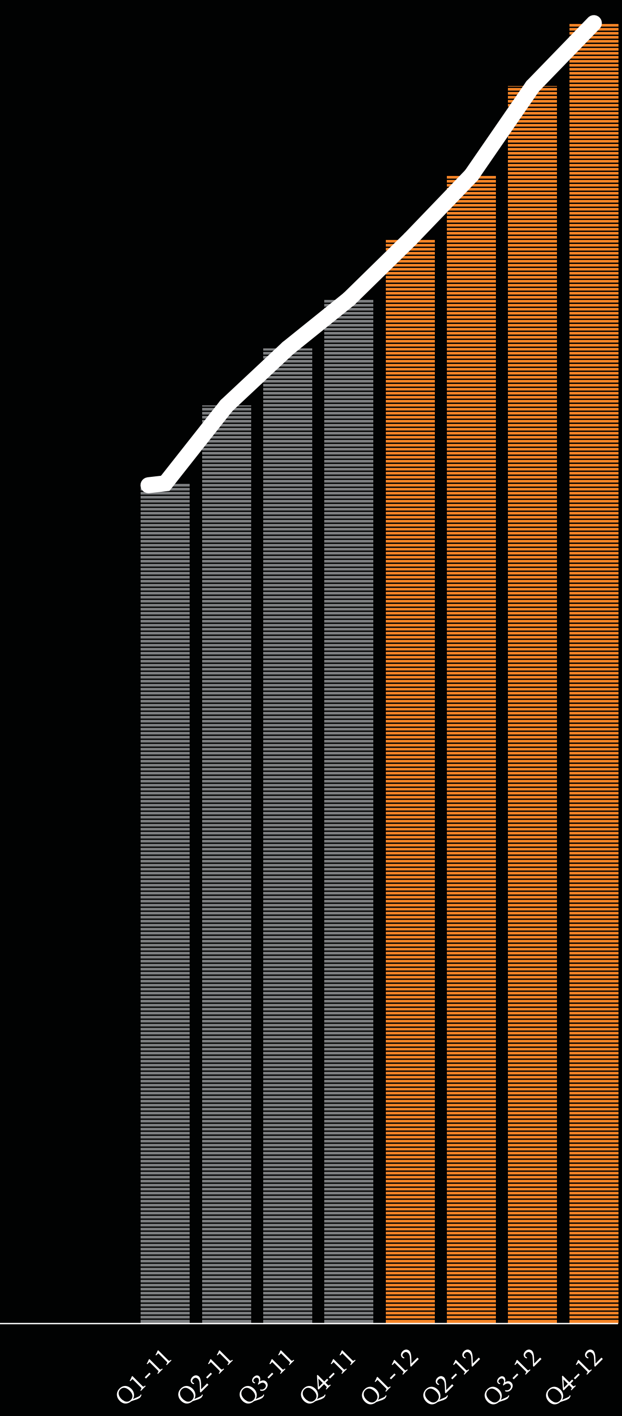
Developing an agile team

Management training

Lancashire's Management Development Programme delivered success in 2012. Managers benefited from the investment in their personal development. The return on investment is evident from the improved 360-degree feedback that managers have received and this will be built upon in 2013 with the roll-out of Phase II of the programme. Phase II will include four modules covering a range of topics, Action Learning Sets (problem solving for managers in groups) and Coaching Clinics.

Growth in fully converted book value per share plus dividends *(per cent)*





Governance

"We place great importance on good governance, not for its own sake, but because when it is done well it can result in not only effective oversight of the Company, but the accomplishment of its strategic objectives."

Martin Thomas (Chairman)

Non-Executive Directors

Martin Thomas (age 49), 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 El Tejar Limited and Spearhead International Limited. Prior to this, he was an official of the Bank of England, most recently on secondment to the EU Commission where he worked in the Financial Services Policy and Financial Markets Directorate of the Internal Market and Services Directorate General. Before Mr Thomas joined the Commission, he established the Financial Markets Law Committee at the Bank of England. Prior to that, he was Deputy Chief Executive of the Financial Law Panel and prior to that, senior counsel to the European Central Bank in Frankfurt. He started his career in private practice, specialising in corporate and commercial litigation at Travers Smith and in the law and regulation of financial services at Clifford Chance.

John Bishop (age 67), Non-Executive Director
John Bishop is an actuary with broad experience in the insurance sector. He has served on the boards of a number of insurance companies, both in an executive capacity and as a non-executive director. He is currently a non-executive director of Berkshire Hathaway International and Houston Capital Corporation International. Mr Bishop has previously worked at the Euler Group on its managing board and as chairman and chief executive officer of Eagle Star Insurance Company Ltd. where he was responsible for the worldwide general insurance operations and, before that, as Managing Director of Sun Alliance UK Insurance Company.

Emma Duncan (age 53), 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 and has served as Delhi correspondent, covering India, Pakistan, Bangladesh and Sri Lanka. She has written special reports for the paper on Saudia Arabia and the Gulf states, India, Pakistan and the food industry. Ms Duncan appears regularly on television and radio programmes. She has written widely on a freelance basis, for publications such as The Times, The Sunday Times, The Daily Telegraph, Vogue and Cosmopolitan. She has an honours degree in politics, philosophy and economics from Oxford University and started her career as a researcher and reporter at Independent Television News.

Samantha Hoe-Richardson (age 42), Non-Executive Director
Samantha Hoe-Richardson is Head of Sustainable Development & Energy for Anglo American plc, one of the world's leading mining and natural resources companies. Ms Hoe-Richardson is responsible for improving sustainable development performance across the breadth of Anglo American's business units in areas such as water and climate change. She is also a Director of Anglo American Zimele Green Fund (Pty) Ltd, which supports entrepreneurs in South Africa, and is a member of the sustainable development committee of the board of De Beers. Prior to her role with Anglo American, Ms Hoe-Richardson worked in investment banking and audit and she holds a masters degree in nuclear and electrical engineering from the University of Cambridge. She also has a chartered accountancy qualification.

Neil McConachie (age 40), Non-Executive Director
Neil McConachie worked at the Lancashire Group from February 2006 to June 2012 and during that time held the roles of CFO, CRO, COO and President. He also served as an executive member of the Board of Directors. Mr McConachie was previously Senior Vice President, Treasurer and Chief Accounting Officer of Montpelier Re Holdings Ltd. He has had extensive involvement in debt and equity capital markets transactions, including the Initial Public Offerings of Lancashire and Montpelier. Prior to joining Montpelier, Mr McConachie worked for PricewaterhouseCoopers in London and Bermuda 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.

Ralf Oelssner (age 68), Senior Independent Non-Executive Director
Ralf Oelssner was Senior Vice President Corporate Insurance for Lufthansa German Airlines until 31 October 2007. In 1979, he was appointed Director of Corporate Insurance, and in 1990 was appointed Managing Director of Lufthansa's in-house broker. Mr Oelssner became a member of the executive board of the captive insurance and reinsurance companies of Lufthansa in 2000 and served as chairman of the Lufthansa sub committee of the International Air Transport Association (IATA) in 1982 and 1983 and as chairman of the IATA Risk & Insurance Managers' Panel in 2001 and 2002. He was chairman and president of Airline Mutual Insurance, Bermuda from its foundation in May 1986 until its dissolution in March 2007. He was President of the German Risk Managers' Association for ten years and holds an M.A. in Economics from Cologne University.

Robert Spass (age 56), 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 50), Non-Executive Director
William Spiegel is a founding partner and head of the financial services investing activities of Pine Brook Road Partners, LLC, a private equity firm. He has twenty-two years of private equity experience, including more than eleven years of financial services investment experience. Mr Spiegel was with The Cypress Group from its inception in 1994 until 2006. Prior to joining Cypress, Mr Spiegel worked in the Merchant Banking Group of Lehman Brothers. He has served on the board of directors of seventeen companies, four of which have been publicly traded. Mr Spiegel currently serves on the board of directors of seven Pine Brook portfolio companies, AloStar Bank of Commerce, Aurigen Capital Limited, Essent Group Ltd., Green Bancorp, Inc., SPI Aeolus, Syndicate Holding Corp. and Third Point Reinsurance Ltd. Mr Spiegel holds 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 50), Chief Executive Officer
Richard Brindle was the driving force behind the establishment of Lancashire in late 2005. He has been instrumental in ensuring an innovative and rigorous approach to underwriting, which has produced a series of financial results for Lancashire consistently to the top of its insurance peer group. He has also prioritised a keen focus on Lancashire's corporate social responsibilities and is proud of Lancashire's record in establishing and developing the Lancashire Foundation, which gives valuable support to a number of local and international charities, including Kids Company and MSF.

Mr Brindle started his career in 1984 working at Posgate and Denby Managing Agency which was later taken over by Charman Underwriting Agencies. In 1989 Mr Brindle was appointed as Deputy Underwriter of Syndicate 488. In 1991 he was appointed as a Director of Charman Underwriting Agencies and acted as main underwriter until 1999, during a period in which Syndicate 488 achieved consistently market beating results and grew to be amongst the largest syndicates at Lloyd's. Mr Brindle left Charman Underwriting Agencies when it was sold to the Ace Group of Companies in Bermuda. Mr Brindle joined Ascot Underwriting Agency in 2001 as a non-executive member of the Ascot Board, which was a position he held until September 2005.

Alex Maloney (age 39), 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. His team at Zurich wrote, amongst others, insurance for independent oil and gas companies and national oil companies, both key classes for Lancashire. Mr Maloney assisted in establishing Zurich Global Energy's presence in the Bermuda Insurance market, spent two years in Zurich's New York office and has significant experience in the London Market.

Elaine Whelan (age 38), Chief Financial Officer
Elaine Whelan joined Lancashire in March 2006 and leads both the Group finance function and the Bermuda subsidiary, reporting to the Group Chief Executive Officer. Ms Whelan was previously Chief Accounting Officer of Zurich Insurance Company, Bermuda Branch. Prior to joining Zurich, Ms Whelan was an Audit Manager at PricewaterhouseCoopers, Bermuda where she managed a portfolio of predominately (re)insurance and captive insurance clients.

Company Secretary

Christopher Head (age 46)
Christopher Head joined Lancashire in September 2010. Mr Head is Company Secretary of Lancashire Holdings Limited and advises on issues of corporate governance and generally on legal affairs for the Group. Prior to joining Lancashire, Mr Head was in-house Counsel with the Imagine Insurance Group, advising specifically on the structuring of reinsurance transactions. He transferred to Max at Lloyd's in 2008 as Lloyd's and London Counsel. Between 1998 and 2006 Mr Head was Legal Counsel at KWELM Management Services Limited, where he managed an intensive programme of reinsurance arbitration and litigation for insolvent members of the HS Weavers underwriting pool. Mr Head is a qualified solicitor having trained at Barlow Lyde and Gilbert where he worked in the Reinsurance and International Risk Team. Mr Head has a history degree and legal qualification from Cambridge University, where he was a choral scholar in the choirs of King's College and Trinity College.

> "As a Board we place great store in allowing time for strategic and broader 'blue sky' thinking."
>
> **Martin Thomas**
> Non-Executive Chairman

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 UK Corporate Governance Code published by the UK Financial Reporting Council (FRC). 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 2012 financial year, areas of corporate governance compliance and non-compliance are explained by reference to the Code. There are no areas of material non-compliance with the Code. The Company notes that the FRC published a revised code in September 2012 which will apply to accounting periods beginning on or after 1 October 2012. The Company also monitors its 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 2012 of the Directors who held office during the year is detailed below. The table 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. Robert Spass and William Spiegel are resident in the U.S.* Each of them attended all the main quarterly Board and Committee meetings. Due to the need to adhere to strict Group tax and regulatory operating guidelines Directors are unable to participate in Board and Committee meetings while they are in the U.S.

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. The Board considers all of the Non-Executive Directors, except for Neil McConachie, to be independent within the meaning of the Code. Mr McConachie served as President and Executive Director until 30 June 2012 when he relinquished his executive role. He has served as a Non-Executive Director since 1 July 2012.

Emma Duncan, Samantha Hoe-Richardson (who was appointed to the Board on 20 February 2013), 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. 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

	Board	Audit Committee	Nomination and Corporate Governance Committee	Remuneration Committee	Investment Committee	Underwriting and Underwriting Risk Committee
Non-Executive Directors						
John Bishop	6/6	4/4	–	–	–	4/4
Emma Duncan	6/5	–	–	7/7	4/4	–
Neil McConachie	6/5	–	–	–	4/4	–
Ralf Oelssner	6/5	4/4	4/4	7/7	–	4/4
Robert Spass*	6/4	4/4	–	–	4/4	–
William Spiegel*	6/4	–	4/4	7/4	4/4	–
Martin Thomas	6/6	–	4/4	–	–	–
Executive Directors						
Richard Brindle	6/6	–	–	–	4/4	4/4
Alex Maloney	6/5	–	–	–	–	4/4

character and judgement, notwithstanding the existence of circumstances under the Code which might affect independence, previously disclosed and discussed in the Company's 2010 and 2011 Annual Reports. Ralf Oelssner is the Senior Independent Director. Martin Thomas was independent upon his appointment as Chairman on 1 May 2007. At the Board meeting held on 19 February 2013, further to a recommendation by the Nomination and Corporate Governance Committee, the Board affirmed its judgement that six of the eleven members of the Board are independent Non-Executive Directors. Therefore in the Board's judgement the Board composition complies with the Code requirement that at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent.

In accordance with the provisions of the Code, all Directors are subject to annual election by shareholders. Shareholders are asked to note that Ralf Oelssner, Robert Spass, William Spiegel and Martin Thomas 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 2013 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.

An externally facilitated evaluation of the Board, its Committees and the individual Directors was conducted during 2012. The evaluation process also consisted of a structured interview with each Director to discuss a broad range of topics including strategic development and planning, the composition of the Board and executive team, financial and operational resources and plans, communications with employees, shareholders and other stakeholders, risk management, remuneration policy, and the Company's core values. On completion of the interviews, reports were provided to the Nomination and Corporate Governance Committee and the Board and the Committee reports were provided to the relevant Committee Chairman and the reports and recommendations were discussed during the Committee and Board meetings held on 19 and 20 February 2013. The individual Director performance reports were provided exclusively to the Chairman. The Chairman's performance report was provided to the Senior Independent Director. Armstrong Bonham Carter LLP (ABC) was appointed as the external facilitator. ABC has no other connection with the Company.

The CEO also met with each of the Executive Directors to discuss their performance during 2012 and to set targets for 2013. In addition, the Non-Executive Directors meet periodically without the Executive Directors present to discuss a broad range of issues concerning the Company, including as appropriate the performance of the Executive Directors.

The 2012 evaluations 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 good. The CEO and Executive Directors are also operating effectively.

Appropriate infrastructure, processes and governance mechanisms are in place to support the effective performance of the Board and its Committees. The Board's risk management processes and expertise have been further expanded during 2012, with the incorporation of the risk management forums into the quarterly Board meetings and the attendance of all the Directors at the Underwriting and Underwriting Risk Committee meetings. The number of Directors on the Board is considered to be appropriate, although consideration is being given to the appointment of an additional 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, training requirements, effectiveness and development in 2013.

Relations with shareholders

During 2012, 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, made presentations to major shareholders, analysts and the investor community. Formal reports of these meetings were provided to the Board on at least a quarterly basis.

Conference calls with shareholders and analysts hosted by senior management are held quarterly following the announcement of the Company's financial results. The CEO, 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.

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. Each of the Committees is responsible for various elements of risk. 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 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 80 to 103.

Committees

The Board has established Audit, Nomination and Corporate Governance, Remuneration, Investment and Underwriting and Underwriting Risk 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 2012 was as set out in the table appearing on page 46. A report from each of the Committees is set out on this page through to page 51.

Audit Committee

John Bishop – Chairman
Ralf Oelssner
Robert Spass

- Monitors the integrity of the Company's financial statements
- Reviews the adequacy and effectiveness of the Company's internal financial controls and internal control and risk management systems
- Reviews the Company's 'whistleblowing' arrangements, procedures for detecting fraud, and systems and controls for the prevention of bribery
- Monitors and reviews the effectiveness of the Group's internal audit function in the context of the Group's overall risk management system
- Considers and makes recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the Company's external auditors

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 44). The 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 internal and external auditors have the right of direct access to the Committee.

Financial reporting and external audit

The Committee reviews at its quarterly meetings all the Company's financial statements for purposes of recommending their adoption to the Board. As part of this review process the Committee pays particular attention to the adequacy of the Company's insurance reserves for which purpose it considers information from management and from Towers Watson, as independent reserving consultants. The Committee also considers quarterly reports on the financial statements from the external auditors, including an interim review report for the half-year statement and a full year end audit report. These are discussed with the external auditors at the Committee's meetings. The Committee also receives regular reports from management on developments in accounting and financial reporting requirements. The Committee also has oversight of all the Company's quarterly financial press releases, which it recommends to the Board for adoption. It also monitors the activities of the Company's Disclosure Committee.

The Committee is responsible for assessing the independence and objectivity of the external auditors, taking into account relevant professional and regulatory requirements and the Company's relationship with the auditors as a whole, including the provision of non-audit services. The Committee also assesses annually the qualifications, expertise and resources of the auditors, and the effectiveness of the audit process. This includes the practice of the Committee Chairman conducting informal meetings with the auditors and the CFO prior to, during and after the audits, and the review by the Committee of a report from the external auditors on their own internal quality control procedures.

The Audit Committee has recommended to the Board the re-appointment of Ernst & Young LLP (E&Y). E&Y has been the Group's external auditors since 2005. The Committee continues to be satisfied with E&Y's performance, independence and objectivity, fees charged, compliance with ethical standards, and audit partner rotation policy.

The Audit Committee has approved and adopted a policy to ensure that the provision of non-audit services by the external auditors does not impair their independence or objectivity. In 2012, E&Y provided non-audit services in relation to Group capital management projects. Fees for non-audit services provided in 2012 totalled $340,683. The Committee determined that the nature of the work and the level of fees charged were not likely to affect the independence or objectivity of E&Y as auditors.

Internal controls and risk management systems

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 Committee for reviewing the integrity of the Group's internal controls and internal control systems (including financial, operational and compliance controls). During 2012, the Committee reported and made recommendations to the Board regarding the adequacy and effectiveness of the Company's internal controls and financial and fraud risk management policies and procedures. The Committee regularly monitors developments in the Solvency II regime and the progress made within the Group in readiness for its implementation.

Compliance, whistleblowing and fraud

The Committee has approved, and recommended to the Board, adoption of the Company's policies on anti-money laundering, bribery and financial crime and conflicts of interest. The Committee regularly reviews the 'whistleblowing' arrangements by which employees and contractors may, in confidence, raise concerns about improprieties within the workplace. The Committee also keeps under review the adequacy and effectiveness of the Company's legal and compliance function.

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 on at least an annual basis those areas of the Group's business that are deemed to pose the greatest 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 2012, the Committee reviewed and approved the internal audit charter. The Committee also received a report from management on its annual review of the implementation of the internal audit programme, to ensure its efficiency and appropriate standing and the effectiveness of the internal audit function and activities. The Committee concluded that the internal audit programme is operating effectively and efficiently and is adequately resourced. During 2012 the Company continued to use the services of PricewaterhouseCoopers to provide specialist assistance to the internal audit department.

Nomination and Corporate Governance Committee

Martin Thomas – Chairman
Ralf Oelssner
William Spiegel

- Reviews the structure, size and composition of the Board
- Considers succession planning for Directors and other senior executives
- Nominates candidates to fill Board vacancies and for membership of Board Committees
- Makes recommendations to the Board concerning the re-election by shareholders of Directors
- Reviews corporate governance matters

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.

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, particularly compliance with the Code, and is responsible for the performance evaluation of the Board – see page 47.

The Committee recommended to the Board at its meeting on 19 February 2013 the appointment of Samantha Hoe-Richardson as a Non-Executive Director (see the biography on page 44), and for these purposes it used the services of Sciteb, an independent search consultancy.

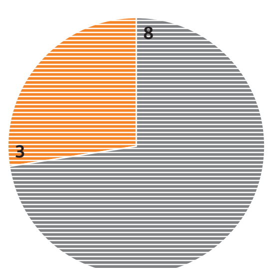
The Committee noted that awards made under the Company's former LTIP (which closed to further awards in January 2008) and warrant schemes (under which awards were made in 2006) did not wholly comply with the provisions of Schedule A of the Code (principle D.1.1 of the Code), as described in the Company's 2009 Prospectus relating to Admission to the Official List and to trading on the LSE. The Committee had further noted, however, that awards made under both schemes were now fully vested and that the three-year vesting period that is recommended by the Code had now passed. Accordingly, a recommendation was made to and approved by the Board that this should no longer be considered an area of non-compliance with the Code.

During 2012 the Committee reviewed and recommended for adoption by the Board a statement on the representation of women on the Board. This is published on the Company's website. In the context of the Davies Report, the Committee recognises the benefits that a broad diversity of skills, experience and gender, amongst other factors bring to enhance Board performance but considers that quotas are not the best option for achieving diversity.

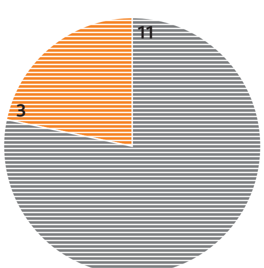
The Committee considered statistics relevant to the gender composition of the Board, executive management and in the Company as a whole. A pie chart detailing the composition of Lancashire's workforce at various levels of seniority is shown below. The Committee also recommended adoption by the Board of revised terms of reference for the Underwriting and Underwriting Risk Committee and a protocol for the division of responsibilities between the Chairman and CEO and other reporting lines and responsibilities. Other matters considered by the Committee during 2012 included the transition of Neil McConachire from his position as Executive Director and President to Non-Executive Director, the nomination of Elaine Whelan for appointment to the Board, the appointment of Christopher Head as Company Secretary and the appointment of Charles Mathias as CRO. The Committee also recommended the approval and adoption by the Board of the Company's Succession Plan 2012. The Committee also recommended the appointment of Sylvain Perrier (the Company's Chief Actuary) and Ben Readdy (Head of Capital Modeling) to the Underwriting and Underwriting Risk Committee.

Board, management and employee gender diversity

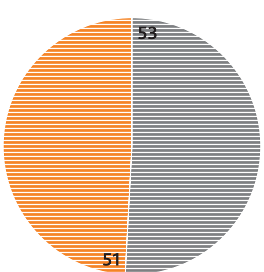
LHL Board members



Group management excluding LHL Non-Executive Board members



Overall Lancashire Group employees



■ Male ■ Female

Remuneration Committee

William Spiegel – Chairman
Emma Duncan
Ralf Oelssner

- Agrees with the Board the framework or broad policy for the remuneration of the Company's Chairman, CEO, the Executive Directors, the Company Secretary and other senior executives
- Approves contracts of employment with senior executives on behalf of the Company
- Determines each year whether awards will be made under the Company's restricted share scheme and, if so, the overall amount of such awards, the individual awards to Executive Directors, the Company Secretary and other designated senior executives and the performance targets to be used
- Ensures that contractual terms on termination, and any payments made, are fair to the individual, and the Company

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.

The remuneration report for which the Committee is responsible can be found on pages 56 to 66 of this report.

Investment Committee

Robert Spass – Chairman
Richard Brindle
Emma Duncan
Neil McConachie
William Spiegel
Denise O'Donoghue – Non Director

- Recommends investment strategies, guidelines and policies for the boards of the Company and other members of the Group to approve annually
- Recommends the appointment of fund managers for all investments to the relevant boards
- Monitors the performance of the investment strategies against set benchmarks
- Monitors cash flow, liquidity and working capital of the Company and the other members of the Group
- Reviews the Company's treasury policy

The Investment Committee comprises four Non-Executive Directors (three of whom are independent), one Executive Director and the Group Head of Investments and Treasury. 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. It regularly monitors the performance of the appointed investment fund managers. During 2012, the Investment Committee recommended to the Board the establishment and progressive modification of the 2012 investment strategy including recommendations as to asset allocation. Changes during the year included approval of a bank loan portfolio under the management of Pinebridge Investment (see page 114), which assists in managing interest rate risk. The Committee also recommended authorisation by the Board of the use of foreign exchange forward derivatives in order to manage currency exposure within the investment portfolios. The Committee regularly considers risk factors relevant to the investment portfolio, and adapts strategy in the light of changing risks and risk preferences.

Underwriting and Underwriting Risk Committee

Alex Maloney – Chairman
John Bishop
Richard Brindle
Ralf Oelssner
Simon Fascione – Non Director
Paul Gregory – Non Director
Sylvain Perrier – Non Director
Ben Readdy – Non Director

- Oversees the development of and adherence to underwriting guidelines by operating company CUOs
- Reviews underwriting performance
- Reviews significant changes in underwriting rules and policy
- Establishes, reviews and maintains strict underwriting criteria and limits
- Monitors underwriting risk and its consistency with Lancashire's risk profile and risk appetite

The Underwriting and Underwriting Risk Committee (formerly the Underwriting Committee) comprises two independent Non-Executive Directors, two Executive Directors, the CUOs of each of the operating subsidiaries (Simon Fascione and Paul Gregory), the Company's Chief Actuary (Sylvain Perrier) and Head of Capital Modeling (Ben Readdy). Underwriting risk is one of the key risks faced by the Company and the Committee is actively engaged in the development of strategy and underwriting risk tolerances, which are approved by the Board. The terms of reference of the Underwriting and Underwriting Risk Committee were revised in July 2012 and include: formulating underwriting strategy, developing and monitoring compliance with the Group's underwriting guidelines and policies, establishing, reviewing and maintaining strict underwriting criteria and limits, and monitoring underwriting risk and its consistency with the Company's risk profile and risk appetite. A more detailed analysis of the Lancashire underwriting performance appears in the Business review section of this Annual Report.

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 LSE 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 23 to 33.

Dividends

For the year ended 31 December 2012, the following dividends were declared:

- an interim dividend of $0.05 per common share and warrant was declared on 24 July 2012 and paid on 26 September 2012 in pounds sterling at the pound/U.S. dollar exchange rate of 1.5838 or £0.0316 per common share and warrant;
- a special dividend of $0.90 per common share and warrant was declared on 7 November 2012 and paid on 19 December 2012 in pounds sterling at the pound/U.S. dollar exchange rate of 1.6056 or £0.5605 per common share and warrant;
- a final dividend of $0.10 per common share and warrant was declared on 19 February 2013; and
- an additional special dividend of $1.05 per common share and warrant was declared on 19 February 2013.

Both the final dividend and the additional special dividend are to be paid on 17 April 2013 in pounds sterling at the pound/U.S. dollar exchange rate on the record date of 22 March 2013 or approximately £0.74 in the aggregate, 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)
- Samantha Hoe-Richardson (Non-Executive Director) (appointed effective 19 February 2013)
- Alex Maloney (Chief Underwriting Officer)
- Neil McConachie (President to 30 June 2012/Non-Executive Director from 1 July 2012)
- Ralf Oelssner (Senior Independent Non-Executive Director)
- Robert Spass (Non-Executive Director)
- William Spiegel (Non-Executive Director)
- Martin Thomas (Non-Executive Chairman)
- Elaine Whelan (Chief Financial Officer) (appointed effective 1 January 2013)

Directors' interests

The Directors' beneficial interests in the Company's common shares as at 31 December 2012 and 2011 including interests held by family members were as follows:

Director	Common shares held at 31 December 2012	Common shares held at 31 December 2011
John Bishop[(1)]	4,807	4,807
Richard Brindle[(2)]	858,022	724,600
Emma Duncan	–	–
Samantha Hoe-Richardson	–	–
Alex Maloney[(3)]	191,415	157,828
Neil McConachie[(4)]	144,975	–
Ralf Oelssner	–	–
Robert Spass[(5)]	–	–
William Spiegel	–	–
Martin Thomas	6,950	6,950
Elaine Whelan[(6)]	44,087	43,887

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

(1) John Bishop conducted the following transactions in the Company's shares during 2012:
- 26 July – purchased of 4,807 shares at an average price of £7.85 costing £37,733; and
- 2 August – sold 4,807 shares at a price of £7.91 realising £38,024. Sale conducted by his spouse, Rosalind Bishop, after she acquired 4,807 shares on 26 July from John Bishop for no consideration.

(2) Richard Brindle conducted the following transactions in the Company's shares during 2012:
- 27 February – exercise of 318,750 RSS awards, 31,875 ERSS awards, and 67,223 deferred bonus RSS awards and related sale of 217,716 resultant shares to cover tax liabilities; and
- 6 March – gift of 66,710 shares to charitable foundation.

(3) Includes 100,000 shares owned by his spouse, Amanda Maloney, which she acquired on 13 August from Alex Maloney for no consideration. Alex Maloney conducted the following transactions in the Company's shares during 2012:
- 27 February – exercise of 63,750 RSS awards and 6,375 ERSS awards and related sale of 36,538 resultant shares to cover tax liabilities.

(4) Includes 144,975 shares owned by his spouse, Lorraine McConachie, which she acquired on 20 March from Neil McConachie for no consideration. Neil McConachie conducted the following transactions in the Company's shares during 2012:
- 1 March – exercise of 99,375 RSS awards, 9,938 ERSS awards and 35,662 deferred bonus RSS awards.

(5) Robert Spass conducted the following transactions in the Company's shares during 2012:
- 29 February – cashless exercise of 275,000 Founder warrants resulting in the acquisition of 163,648 shares
- 23 March – sold 82,000 shares at a price of $12.02 realising $985,640; and
- 27 March – sold 81,648 shares at a price of $12.49 realising $1,020,110.

(6) Includes 2,600 shares owned by her spouse, Kilian Whelan.

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 6,367,182 ordinary and performance warrants and 46,260 Founder warrants and Robert Spass is the beneficial owner of 809,135 Founder warrants.

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

Transaction in own shares

The Company did not repurchase any of its own common shares during 2011 and 2012.

The Group's current repurchase programme had 16,860,242 common shares remaining to be purchased at 31 December 2012 (approximately $209.2 million at the 31 December 2012 share price). Further details of the share repurchase authority and programme are set out in note 21 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 56 to 66.

Substantial shareholders

As at 20 February 2013 the Company was aware of the following interests of 3% or more in the Company's issued share capital:

Name	Number of shares as at 20 February 2013	% of shares in issue
Standard Life Investments Ltd	11,448,655	7.0%
Legal & General Group Plc	9,285,144	5.7%
Invesco Limited	8,096,000	5.0%
William Blair & Company, LLC	7,989,826	4.9%
BlackRock, Inc.	7,865,350	4.8%
HSBC Holdings plc	5,539,179	3.4%
Alken Luxembourg Sàrl	5,377,707	3.3%

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. 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 2011 the Board of Directors approved a cash donation of $1,250,000 (2011 – $1,250,000) to the Lancashire Foundation, payable in respect of 2012.

Lancashire established the Lancashire Foundation as 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. During 2012 the assets of the Lancashire Foundation were transferred to the Lancashire Foundation charitable trust established in England and Wales and registered with the Charity Commission.

A summary of the work of the Lancashire Foundation during 2012 can be found in the Corporate Responsibility section on pages 36 to 41.

The Group did not make any political donations or expenditure during 2012.

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 80 to 103 of the consolidated financial statements. The Group's use of derivative financial instruments can be found on pages 93 to 96.

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 General Meeting
The notice of the 2013 AGM, to be held on 1 May 2013 at the Company's head office, Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, UK, is contained in a separate circular to shareholders enclosed with 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 23 to 33 sets out details of the Group's financial performance, capital management, business environment and outlook. In addition, starting on page 80 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 2013 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.

Christopher Head, Company Secretary
20 February 2013

Directors' remuneration report

Remuneration Committee Chairman's letter

Dear Shareholder,

I am pleased to present the Directors' remuneration report for 2012, for which we seek shareholders' support at our AGM in London on 1 May 2013.

As a company incorporated in Bermuda, Lancashire is not bound by UK law or regulation to the same extent that it applies to UK incorporated companies in the area of Directors' remuneration. However, 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 UK corporate governance standards and best practices to the appropriate extent, taking into account the Company's size and the nature of its business.

Lancashire's goal is to reward its employees fairly and responsibly, by providing an appropriate balance between fixed and variable remuneration, linked to the achievement of suitably challenging Group and individual performance measures. The Lancashire Group has delivered strong results for 2012. Executives' bonus targets set at the beginning of 2012 for Company financial performance were achieved. Executive Directors' 2012 bonuses paid out between 143 per cent and 146 per cent of target. For full details of Executive Directors' bonuses see page 61.

During the year, effective 30 June 2012, Neil McConachie relinquished his executive responsibilities. He continues to serve on the Board as a Non-Executive Director. While he did not receive an exit payment, he was entitled to be considered for a pro-rated bonus for the proportion of the 2012 performance year he worked as an executive. His existing RSS awards will continue to vest, subject to the satisfaction of certain performance criteria, by virtue of his continuing service on the Board.

The following changes take effect in 2013:

- Elaine Whelan, our Group CFO, was appointed as an Executive Director on 1 January 2013. Her salary is $500,000, bonus target 150 per cent of salary and RSS award 116,087 shares. Ms Whelan's remuneration is in line with the median of her CFO executive director peers.
- Alex Maloney's target compensation has been restructured in order to ensure it remains competitive with, and comparable to, peers. While his target remuneration has remained broadly flat, his base salary has increased from $408,000 to $500,000. His RSS opportunity has been reduced accordingly. Mr Maloney took on additional responsibilities in 2012 for risk management and as the LUK CEO, and his previous base salary was at the lowest percentile of his CUO executive director peers. This was not aligned with the senior executive remuneration framework, which states that base salaries should be around the median of peer companies.
- Following a salary freeze in 2012, Richard Brindle's base salary was increased by 3 per cent to $1,112,400, in line with the general staff salary increase.
- Long-term incentive award metrics have been modified from an equal weighting between RoE and TSR, to 75 per cent based on RoE and 25 per cent based on TSR, due to a need to increase the emphasis on RoE through what is a challenging time for the Lloyd's market and our peer companies. We are confident that continued delivery of outstanding levels of RoE will provide superior stock market returns.

I hope shareholders will be supportive of the resolution at the forthcoming AGM, which approves the adoption of this remuneration report.

William Spiegel, LHL Remuneration Committee Chairman

Remuneration policy report

The Board reviews and approves annually the framework for remuneration of Executive Directors and certain senior executives, based on a recommendation from the Remuneration Committee.

The Remuneration Committee takes into account levels of pay elsewhere in the Group when determining the pay levels for Executive Directors and senior executives. The remuneration policy for all staff is, in principle, the same as that for Executive Directors in that all employees are offered similarly structured packages, with participation in the same annual bonus and long-term incentive plan (RSS). For senior executives a higher proportion of their compensation package is subject to performance pay and share-based remuneration. This ensures that there is a strong link between remuneration, Company performance and the interests of shareholders.

Where necessary the Remuneration Committee will liaise with the Company's major institutional shareholders in relation to any significant change to remuneration policy, to ensure that any changes are likely to be fully supported by shareholders.

2013 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 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 changes in responsibility or position occur. In determining appropriate levels of salary increases the Remuneration Committee considers the level of salary increases in the workforce generally.

The 2013 Executive Directors' salaries are as outlined on page 56.

Annual bonus

Bonuses, earned in respect of 2013, and payable in 2014, will be based on a clear split between the Company's financial performance and personal performance on a 75:25 basis for the CEO and CUO, and on a 70:30 basis for the CFO.

Financial performance for 2013 will have two components:

(i) Absolute financial performance against the Company's Board approved 2013 target. 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 2013 defined peer group is stated in the table on page 65. Should one of these companies undergo extensive change in capital size or market focus the Remuneration Committee will consider whether they should remain in the peer group.

Personal performance will be based upon individual achievement of clearly articulated objectives created at the beginning of each fiscal year.

The level of bonus for 2013 will be capped at 400 per cent, 350 per cent and 300 per cent of base salary for the Executive Directors – the CEO, CUO and CFO 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 per cent RoE for 100 per cent of target, with a minimum of 9 per cent RoE for 25 per cent of target, and a maximum of 19 per cent RoE for 200 per cent of target payout. Bonus payments will be made when all the peer group have reported their results and bonuses can be finalised.

A portion of each Executive Director's bonus may be paid in shares. Similar to the 2012 bonus, for the 2013 bonus 25 per cent of the bonus earned will be paid in RSS awards of which 33 per cent vests 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 a material misstatement in the Company's financial statements, an error in the calculation of any performance conditions or if the Executive ceased to be a Director or employee due to 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. These are exercisable over a period of up to ten years from the date of grant. RSS are released to the employee after three years, subject to the satisfaction of certain performance conditions and continued employment. The purpose of awards under the RSS is to motivate and retain members of staff and align them with the long-term performance goals of the Company and therefore its shareholders. The Executive Directors are eligible to receive share awards under the RSS at the discretion of the Remuneration Committee. The RSS is operated by reference to bands, decided upon by the Remuneration Committee, which state the minimum and maximum limits for awards which Executive Directors are entitled to expect each year. No RSS award to an Executive Director has been made outside these limits. Awards are made each year following the announcement of the Company's results.

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

The Remuneration Committee has considered carefully the grant levels and performance conditions for awards in 2013. For Executive Directors, RSS awards for 2013 will be 220,709 for the CEO, 131,969 for the CUO and 116,087 for the CFO with the actual number of shares received subject to satisfaction of time and performance conditions as set out below.

For RSS awards to be granted in 2014, which will reflect 2013 performance, 75 per cent of each award is based on the Company's RoE, measured over the three financial years of the performance period. 25 per cent of this part of the award will vest only 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 per cent. 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 per cent. Vesting will take place on a straight-line basis between 25 per cent and 100 per cent for RoE performance.

For the other 25 per cent 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 65) over the three year performance period. 25 per cent of this part of the award will vest if the Company's TSR is equal to the company whose TSR is ranked at the median. All of this part of the award will vest if the Company's TSR is equal to or above the company whose TSR is ranked at the upper quartile. Vesting will take place on a straight-line between 25 per cent and 100 per cent for TSR performance between median and upper quartile.

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

RSS awards are subject to clawback in the event of the discovery of a material misstatement in the Company's financial statements, an error in calculation of any performance conditions or if the Executive ceased to be a Director or employee due to gross misconduct.

Pension

Executive Directors receive pension contributions from the Company under defined contribution pension plans. The Group CEO and the CUO receive a 10 per cent base salary contribution to a UK defined contribution pension plan in respect of their salary and employment with the Company's UK operations. The CFO receives a Company contribution of 10 per cent of base salary (split 90 per cent LICL and 10 per cent LHL – see page 59 for details of this contract split). Details of the pension contributions made to Executive Directors in 2012 are set out on page 61.

Other benefits

Other benefits for Executive Directors comprise medical, dental, vision, life insurance coverage and gym membership, as well as an expatriate housing allowance for the CFO.

Share ownership guidelines

A policy for formal shareholding guidelines was introduced in 2012. This requires the CEO to build and maintain a shareholding in the Company worth two times annual salary and for the CUO and CFO to build and maintain a shareholding of one times annual salary. To the extent that existing shareholdings are below the guideline threshold, senior executives will be expected to retain shares or interests in shares of no less than 50 per cent of the net of taxes value that vests under the RSS, including bonus deferral.

The Remuneration Committee has considered whether any element of the current remuneration policy could conceivably encourage executives to take inappropriate risks and has concluded that that is not the case, given the following:

- There is an appropriate balance between fixed and variable pay, and therefore 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 any one particular metric;
- There is a high level of share ownership amongst executives meaning that there is a strong focus on sustainable long-term shareholder value. There is a formal policy requiring senior executives to build and maintain significant shareholdings; and

– Since 2012 the Company has had the power to claw back bonuses (including deferred annual bonus) and long-term incentive payments made to Executive Directors in the event of material misstatements in the Company's financial statements, error in the calculation of any performance condition or the Executive ceased to be a Director and/or employee due to gross misconduct.

Service contracts for Executive Directors
Details of the service contracts of the Executive Directors are shown in the table below.

Name of Director	Date of contract	Notice period from the Company (months)	Notice period from the Director (months)	Termination payment
Richard Brindle	10 December 2008(i)	6	6	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.
Alex Maloney	1 January 2009			
Elaine Whelan	1 March 2006(ii)			
Neil McConachie(iii)	1 February 2006			

(i) Richard Brindle's service contract was amended on 1 January 2012 to take effect under English law following Lancashire's move of head office from Bermuda to London.

(ii) Elaine Whelan has a split service contract due to her LHL Director appointment, with her contract comprising 90 per cent LICL and 10 per cent LHL (which reflects her LHL Director responsibilities appropriately).

(iii) Neil McConachie left as an employee on 30 June 2012 but has remained on the Board as a Non-Executive Director.

Broader policy on payments to departing executives
A pro-rata bonus may also become payable for the proportion of the financial year the executive works (with no bonus payable in respect of any period on garden leave). Any share-based awards under the RSS will be determined based upon the relevant plan rules and dependent on the circumstances at the time. In a good leaver situation RSS awards will still be subject to any performance conditions and, may be scaled back pro rata for the proportion of the service period completed.

Terms of appointment for Non-Executive Directors
The Non-Executive Directors serve subject to the Company's Bye-laws and under letters of appointment. They are appointed subject to re-election at the AGM and are also 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 for up to six years, although the Board may invite a Non-Executive Director to serve for an additional period. Their letters of appointment are available for inspection at the AGMs. The Company encourages share ownership by the Non-Executive 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.

Name	Position	Date of letter of appointment
Martin Thomas	Non-Executive Chairman, Chairman of Nomination and Corporate Governance Committee	16 April 2007(i)
John Bishop	Non-Executive Director, Chairman of Audit Committee	19 March 2008
Emma Duncan	Non-Executive Director	17 September 2010
Samantha Hoe-Richardson	Non-Executive Director	20 February 2013
Neil McConachie	Non-Executive Director	5 July 2012(ii)
Ralf Oelssner	Non-Executive Director, Senior Independent Director	31 July 2007(iii)
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) Effective date of appointment as a Non-Executive Director 1 July 2012.

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

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 2013 AGM.

Policy on external appointments for Executive Directors
The Board may allow Executive Directors to accept external appointments, provided time and commitment are not excessive.

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

2012 Implementation report

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 (Chairman)

The Remuneration Committee's responsibilities are contained in its 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 certain senior executives. The Committee is also responsible for approving employment contracts for certain senior executives, including the CRO and Head of Internal Audit.

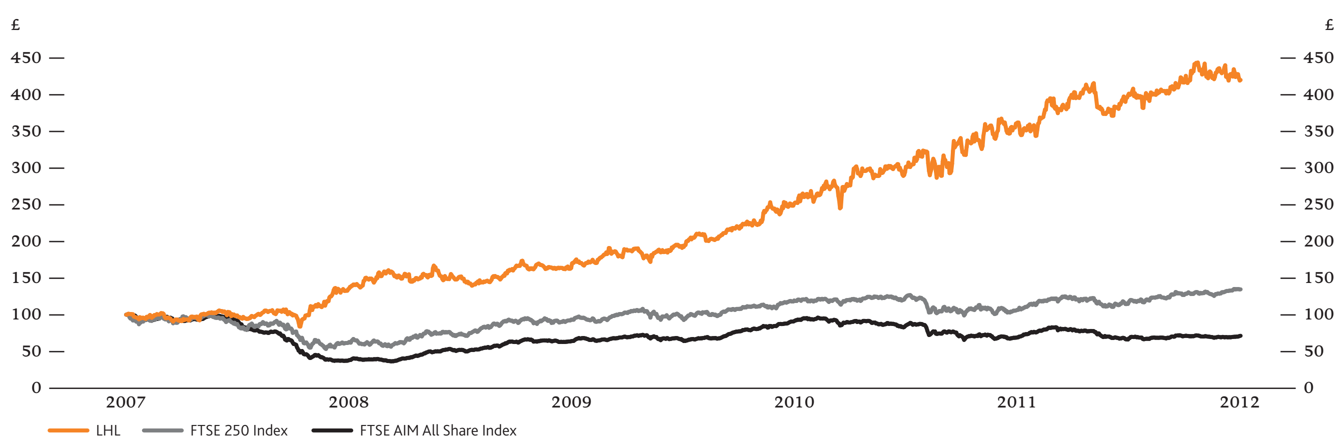
Remuneration Committee adviser

During 2012 NBS (a brand of Aon Hewitt Limited) was the independent adviser to the Remuneration Committee. Neither NBS nor any other part of Aon Hewitt Limited provided other services to the Company during the year. NBS advised the Remuneration Committee on market trends, data for remuneration for Executive Directors and members of senior management, and on the structure of the remuneration policy. Note that NBS adheres to the Remuneration Consultants' Group voluntary Code of Conduct in relation to executive remuneration consulting in the UK.

Meetings of the Remuneration Committee may also be attended by other Directors including the CEO, CUO and CFO, but such attendance is by invitation only. No Director is involved in deciding his or her own remuneration.

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.

Total Shareholder Return



Source: Thomson Reuters

This graph shows the value, by 31 December 2012, of £100 invested in LHL on 31 December 2007, compared with the value of £100 invested in the FTSE 250 Index and the FTSE AIM All Share Index, on a daily basis.

Directors' emoluments

Directors' emoluments in U.S. dollars for the year ended 31 December 2012:

Director	Base salary/fees	Other	Benefits(vii) (viii)	Pension(vii)	Annual bonus Cash(ix)	RSS	Total 2012 emoluments	Total 2011 emoluments
Non-Executive Directors								
John Bishop(i)	175,000	21,000	–	–	–	–	196,000	196,000
Emma Duncan	175,000	–	–	–	–	–	175,000	175,000
Neil McConachie(ii)	87,500	–	–	–	–	–	87,500	–
Ralf Oelssner(iii)	175,000	64,000	–	–	–	–	239,000	235,000
Robert Spass	175,000	–	–	–	–	–	175,000	175,000
William Spiegel	175,000	–	–	–	–	–	175,000	175,000
Martin Thomas(iv)	325,000	100,000	–	–	–	–	425,000	425,000
Executive Directors								
Richard Brindle(v)(vii)	1,080,845	–	18,891	108,085	2,367,711	789,237	4,364,769	4,391,452
Alex Maloney(vi)(vii)	353,651	–	9,073	96,005	772,026	257,342	1,488,097	1,418,802
Neil McConachie(ii)(vii)	186,816	–	56,949	18,682	326,009	108,670	697,126	2,032,885

(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. This agreement expired on 20 December 2012.

(ii) Neil McConachie transferred from Bermuda to London effective 1 April 2012 and, effective 30 June 2012, left as an employee, relinquishing his executive responsibilities and became a Non-Executive Director receiving a fee of $175,000 per annum effective 1 July 2012.

(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) Martin Thomas also receives a fee of $100,000 per annum for his position as non-executive Chairman of LUK.

(v) Richard Brindle's U.S. dollar salary from LHL and LISL in respect of his employment is paid in sterling.

(vi) Alex Maloney's base salary and pension have been adjusted to reflect his UK salary sacrifice pension contributions.

(vii) Some amounts were paid in pounds sterling and converted at average exchange rates for the year.

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

(ix) See 2012 Annual Bonus payments below.

Exit payment to Neil McConachie

Neil McConachie left the Company as an employee on 30 June 2012, relinquishing his executive responsibilities. He did not receive an exit payment and was entitled to be considered for a pro-rated bonus for the proportion of the 2012 performance year he worked as an executive.

He is able to exercise existing RSS awards when they have vested, subject to performance conditions being met, provided he remains a Non-Executive Director.

2012 Annual Bonus payments

As detailed in the Policy Report, each Executive Director participates in the annual incentive plan, in which performance is measured over a single financial year. For the year under review, the performance conditions that applied to the bonus were as follows:

For 2012 the Lancashire Group delivered strong results. Bonus targets were set at the beginning of 2012 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 158.75 per cent of target as RoE was 16.7 per cent against a target of 12.1 per cent and the relative component against the results of peer companies was at the 63.9th percentile (128.23 per cent payout). For the personal element of Executive Directors' bonus opportunity, the payout ranged from 133 per cent to 145 per cent of target.

Cash awards were made up of 75 per cent of total bonus award. 25 per cent of total bonus award has been paid in deferred 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 2014.

Vesting of the 2010 RSS award

The 2010 RSS awards vested at 99 per cent in accordance with the performance conditions on page 64.

Governance

Directors' warrants and RSS awards

(a) Founder warrants

Name	Warrants held at 1 January 2012	Warrants exercised during the year	Warrants sold during the year	Warrants held at 31 December 2012	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 2012	Warrants exercised during the year	Warrants sold during the year	Warrants held at 31 December 2012	Exercise price(iii)	Date from which first exercisable(i)	Expiry date
Richard Brindle							
16/12/2005	3,718,912	–	–	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	5,625,217	–	–	5,625,217			

(c) Performance vesting ordinary warrants(ii)

Name	Warrants held at 1 January 2012	Warrants exercised during the year	Warrants sold during the year	Warrants held at 31 December 2012	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			

(i) The time-vesting ordinary warrants vested 25 per cent on issuance on the admission of the Company's shares to trading on AIM on 16 December 2005. 25 per cent 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 per cent on 31 December 2007, 40 per cent on 31 December 2008 and 40 per cent 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.

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

- 16 December 2005 – £3.21

Dividends paid to Executive Directors on warrants

	Founder Warrants £	Time Vesting Ordinary Warrants £	Performance Vesting Ordinary Warrants £	Total £
Richard Brindle				
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
Final dividend of $0.10 (£0.0636) paid 18 April 2012	2,940	357,486	47,152	407,578
Interim dividend of $0.05 (£0.0316) paid 26 September 2012	1,460	177,586	23,424	202,470
Special dividend of $0.90 (£0.5605) paid 19 December 2012	25,931	3,153,148	415,899	3,594,978
Neil McConachie(i)				
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 Neil McConachie's warrants had been exercised by 15 November 2011.

(d) Awards under the RSS

Name	Awards held at 1 January 2012	Awards granted during the year	Awards exercised during the year	Awards lapsed during the year	Awards held at 31 December 2012	Vesting date(iv)
Richard Brindle						
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)
2011 deferred bonus	–	65,123	–	–	65,123	(iv)
2012 performance award(iv)	–	240,263	–	–	240,263	(iv)
Total	1,297,527	305,386	417,848	–	1,185,065	
Alex Maloney						
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)
2011 deferred bonus	–	13,454	–	–	13,454	(iv)
2012 performance award(iv)	–	187,165	–	–	187,165	(iv)
Total	443,678	200,619	70,125	–	574,172	
Neil McConachie						
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)
2011 deferred bonus	–	25,886	–	–	25,886	(iv)
2012 performance award(iv)	–	146,833	–	–	146,833	(iv)
Total	637,222	172,719	144,975	–	664,966	

(i) The market value of the common shares on the dates of grant were 19 May 2009 £5.10, 5 November 2009 £5.20, 25 March 2010 £4.86, 4 March 2011 £6.19, 28 February 2012 £7.90 and 5 March 2012 £7.58.

(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 65 for a list of comparator companies for each grant year), over a three-year performance period. 25 per cent of this half of the award vests for median performance by the Company, rising to 100 per cent 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 per cent of this half of the award will vest if average annual RoE over the performance period exceeds the criteria set out in the table on page 65, 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 on page 65. Between these two points vesting will take place on a straight-line basis from 25 per cent to 100 per cent for RoE performance.

TSR Targets for RSS

	2009	2010	2011	2012	2013*
100%	75th percentile	75th percentile	75th percentile	75th percentile	75th percentile
25%	= median	= median	= median	= median	= median
Nil	< median	< median	< median	< median	< median

RoE Targets for RSS

	2009	2010	2011	2012	2013*
100%	13 week Tr + 18%	13 week Tr + 18%	13 week Tr + 15%	13 week Tr +15%	13 week Tr +15%
25%	13 week Tr + 8%	13 week Tr + 8%	13 week Tr + 6%	13 week Tr + 6%	13 week Tr + 6%
Nil	<13 week Tr + 8%	<13 week Tr + 8%	<13 week Tr + 6%	<13 week Tr + 6%	<13 week Tr + 6%

* From 2013 onwards the split of targets has changed from 50 per cent/50 per cent to 75 per cent RoE and 25 per cent TSR.

Comparator companies (selected by Remuneration Committee)	2009 awards	2010 awards	2011 awards	2012 awards	2013 awards
Amlin plc	X	X	X	X	X
Arch Capital	X				
Argo Limited(v)				X	X
Aspen Insurance Holdings Limited	X		X	X	X
Axis Capital Holdings Limited	X	X	X	X	X
Beazley plc		X	X	X	X
Brit Insurance Holding N.V.		X			
Catlin Group Ltd.		X	X	X	X
Endurance Specialty Holdings Ltd.	X	X	X	X	X
Flagstone Reinsurance Holdings Limited(vi)	X	X	X	X	
Hiscox Ltd.	X	X	X	X	X
IPC	X				
Montpelier Re Holdings Ltd.	X	X	X	X	X
Partner Re	X				
Platinum	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 Bermuda 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 per cent to 100 per cent vesting – see table.

(iv) The vesting dates are subject to being out of a close period and, for the 2009 to 2012 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; and
- 2012 – first open period following the release of the Company's 2014 year end results.

(v) Argo was used as a comparator company for Q4 2012 only.

(vi) Flagstone was acquired by Validus with effect from 30 November 2012 and so was used as a comparator company for 2012 up to 30 September 2012.

The market value of the common shares as at 31 December 2012 was £7.755 and the range during the year was £6.725 to £8.810.

Total shareholdings of Executive Directors

	Number of Ordinary Shares							
	At 1 January 2012	At 31 December 2012						
Name of Director	Legally owned	Legally owned	Subject to deferral under the RSS	Subject to performance conditions under the RSS	Vested awards under other share-based plans	Total	Shareholding guideline requirement	Shareholding guideline achieved?
Richard Brindle	724,600	858,022	257,061	928,004	6,413,442	8,456,529	171,425	Yes
Alex Maloney	157,828	191,415	54,559	519,613	–	765,587	32,381	Yes
Elaine Whelan	43,887	44,087	21,487	246,982	–	312,556	15,278	Yes

Statement of shareholder voting at the AGM

At the 2012 AGM the Directors' Remuneration Report received the following votes from shareholders:

	Total number of votes	% of votes cast
For	83,190,496	85.9
Against	4,328,173	4.5
Abstentions	9,353,392	9.6
Total	**96,872,061**	**100.0**

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

William Spiegel, LHL Remuneration Committee Chairman
20 February 2013

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.

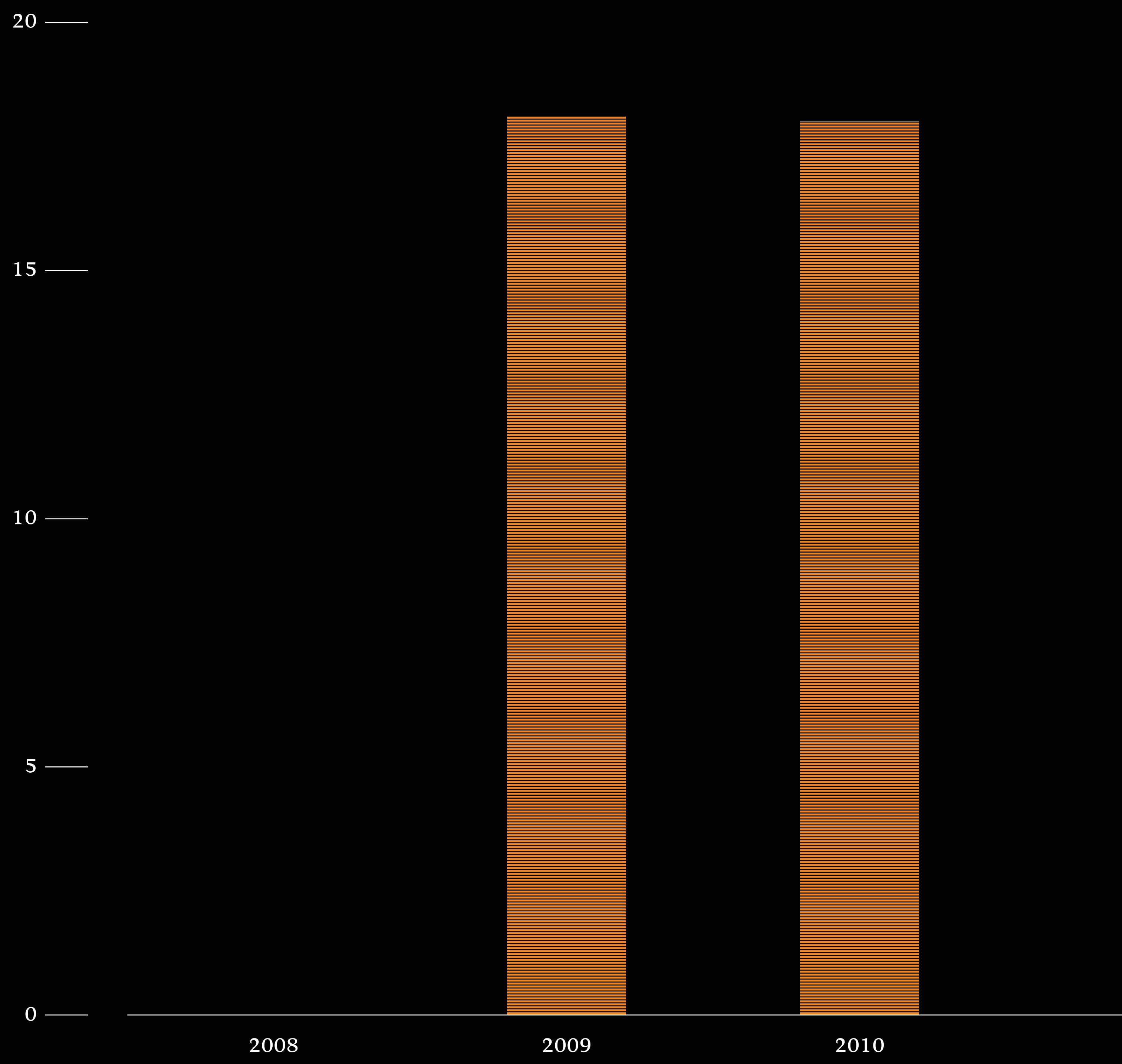
The Directors have elected to include the remuneration information contained in this Annual Report, although as a Company incorporated in Bermuda, Lancashire is not bound by UK law or regulation to the same extent that it applies to UK incorporated companies in the area of Directors' remuneration. As an LSE listed company with a premium listing the Company adopts a comply or explain approach with respect to the requirements of the UK Corporate Governance Code, and to this end the Company reports on both corporate governance and remuneration matters to optimise shareholder transparency. 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 Chief Financial Officer, Elaine Whelan and this statement is made to the best of their knowledge and belief.

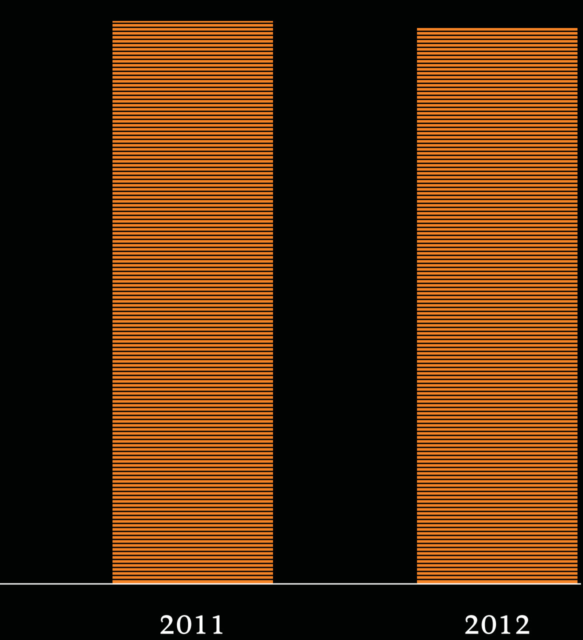
20 February 2013

Dividend yield *(per cent)*



Financial statements

Our aim to provide an attractive risk-adjusted total shareholder return is not a temporary goal. This is our aim for the long term and our patient approach continues to deliver year-on-year shareholder return.



Financial statements

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 2012 which comprise the consolidated balance sheet as at 31 December 2012, consolidated statement of comprehensive income, consolidated statement of changes in shareholders' equity and the statement of consolidated cash flows for the year then ended and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is International Financial Reporting Standards as adopted by the European Union.

This report is made solely to the Group's shareholders, in accordance with our engagement letter dated 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 67, 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 2012 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

20 February 2013

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 2012

	Notes	2012 $m	2011 $m
Gross premiums written	2	724.3	632.3
Outwards reinsurance premiums	2	(148.2)	(67.2)
Net premiums written		**576.1**	**565.1**
Change in unearned premiums	2	3.8	3.5
Change in unearned premiums on premiums ceded	2	2.7	5.9
Net premiums earned		**582.6**	**574.5**
Net investment income	3	32.5	43.2
Net other investment income (losses)	3	0.7	(0.5)
Net realised gains (losses) and impairments	3	11.8	8.6
Share of profit of associates	16	7.7	0.9
Net foreign exchange gains (losses)		4.3	(9.4)
Total net revenue		**639.6**	**617.3**
Insurance losses and loss adjustment expenses	2, 12	216.9	225.3
Insurance losses and loss adjustment expenses recoverable	2, 12	(42.8)	(43.0)
Net insurance losses		**174.1**	**182.3**
Insurance acquisition expenses	2, 4	130.2	114.2
Insurance acquisition expenses ceded	2, 4	(10.8)	(1.8)
Other operating expenses	5, 6, 23	78.4	71.0
Equity based compensation	6	16.4	18.8
Total expenses		**388.3**	**384.5**
Results of operating activities		**251.3**	**232.8**
Financing costs	7	14.5	14.2
Profit before tax		**236.8**	**218.6**
Tax charge	8	1.9	6.4
Profit for the year attributable to equity shareholders		**234.9**	**212.2**
Net change in unrealised gains/losses on investments	3, 10	18.1	(10.5)
Tax provision on net change in unrealised gains/losses on investments	10	(0.3)	(0.1)
Other comprehensive income (loss)	10	**17.8**	**(10.6)**
Total comprehensive income attributable to equity shareholders		**252.7**	**201.6**
Earnings per share			
Basic	24	$1.47	$1.38
Diluted	24	$1.29	$1.20

Consolidated balance sheet
As at 31 December 2012

	Notes	2012 $m	2011 $m
Assets			
Cash and cash equivalents	9, 20	295.8	311.8
Accrued interest receivable		9.3	10.0
Investments			
– Fixed income securities	10, 20	1,874.5	1,714.0
– Other investments	10	0.1	(0.6)
Reinsurance assets			
– Unearned premiums on premiums ceded	11	11.5	8.8
– Reinsurance recoveries	12	73.0	69.7
– Other receivables	11	4.5	6.2
Deferred acquisition costs	14	68.0	61.4
Other receivables		2.7	48.6
Inwards premiums receivable from insureds and cedants	13	207.0	212.1
Deferred tax asset	15	7.3	8.2
Corporation tax receivable		0.4	–
Investment in associates	16	82.1	50.9
Property, plant and equipment	17	2.8	5.3
Intangible asset		–	1.2
Total assets		**2,639.0**	**2,507.6**
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	12	537.4	571.2
– Unearned premiums	18	343.3	347.1
– Other payables	18, 19	23.5	23.5
Amounts payable to reinsurers	11, 19	30.6	17.8
Deferred acquisition costs ceded	14	0.8	0.7
Other payables	19	49.3	85.2
Corporation tax payable		–	1.2
Interest rate swap	20	8.0	6.1
Long-term debt	20	258.7	128.0
Total liabilities		**1,251.6**	**1,180.8**
Shareholders' equity			
Share capital	21	84.3	84.3
Own shares	21	(57.1)	(83.0)
Share premium		2.4	2.4
Contributed surplus		654.4	660.5
Accumulated other comprehensive income	10	35.4	17.6
Other reserves	22	57.1	67.6
Retained earnings		610.9	577.4
Total shareholders' equity attributable to equity shareholders		**1,387.4**	**1,326.8**
Total liabilities and shareholders' equity		**2,639.0**	**2,507.6**

The consolidated financial statements were approved by the Board of Directors on 20 February 2013 and signed on its behalf by:

Martin Thomas
Director/Chairman

Elaine Whelan
Director/CFO

Consolidated statement of changes in shareholders' equity
For the year ended 31 December 2012

	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 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	21	–	33.7	–	(38.2)	–	–	–	(4.5)
Shares donated to trust	21, 25	–	(15.4)	–	15.4	–	–	–	–
Dividends on common shares	21	–	–	–	–	–	–	(147.7)	(147.7)
Dividend equivalents on warrants	21	–	–	–	–	–	–	(32.7)	(32.7)
Warrant exercises – founder	21	–	5.6	–	(1.1)	–	(4.5)	–	–
Equity based compensation – tax	8	–	–	–	–	–	4.4	–	4.4
Equity based compensation – exercises	6, 21, 22	–	–	–	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**
Total comprehensive income for the year	10	–	–	–	–	17.8	–	234.9	252.7
Distributed by trust	21	–	33.2	–	(41.9)	–	–	–	(8.7)
Shares donated to trust	21, 25	–	(18.4)	–	18.4	–	–	–	–
Dividends on common shares	21	–	–	–	–	–	–	(168.6)	(168.6)
Dividend equivalents on warrants	21	–	–	–	–	–	–	(32.8)	(32.8)
Warrant exercises – founder	21	–	11.1	–	(3.4)	–	(7.7)	–	–
Equity based compensation – tax	8	–	–	–	–	–	1.6	–	1.6
Equity based compensation – exercises	6, 21, 22	–	–	–	20.8	–	(20.8)	–	–
Equity based compensation – expense	6	–	–	–	–	–	16.4	–	16.4
Balance as at 31 December 2012		**84.3**	**(57.1)**	**2.4**	**654.4**	**35.4**	**57.1**	**610.9**	**1,387.4**

Financial statements

Statement of consolidated cash flows
For the year ended 31 December 2012

	Notes	2012 $m	2011 $m
Cash flows from operating activities			
Profit before tax		236.8	218.6
Tax paid		(1.2)	(9.7)
Depreciation	5	2.8	2.9
Interest expense on long-term debt	7	7.2	5.6
Interest and dividend income		(48.4)	(56.2)
Net amortisation of fixed income securities		11.8	8.7
Equity based compensation	6	16.4	18.8
Foreign exchange (gains) losses		(7.1)	11.5
Share of profit of associate	16	(7.7)	(0.9)
Net other investment (income) losses	3	(0.7)	0.5
Net realised (gains) losses and impairments	3	(11.8)	(8.6)
Net unrealised losses on interest rate swaps		1.9	5.4
Loss on disposal of intangible asset		2.9	–
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		(17.7)	38.2
– Other assets and liabilities		8.1	22.9
Net cash flows from operating activities		**193.3**	**257.7**
Cash flows used in investing activities			
Interest and dividends received		49.1	59.6
Net purchase of property, plant and equipment		(0.2)	(0.6)
Purchase and development of intangible asset		(1.7)	(1.2)
Investment in associates	16	(23.6)	(50.0)
Purchase of fixed income securities		(1,681.8)	(1,944.5)
Purchase of equity securities		–	(87.4)
Proceeds on maturity and disposal of fixed income securities		1,541.4	1,939.0
Proceeds on disposal of equity securities		–	80.2
Net settlement of other investments		(3.2)	1.1
Net cash flows used in investing activities		**(120.0)**	**(3.8)**
Cash flows used in financing activities			
Interest paid		(5.5)	(5.6)
Issuance of long-term debt		130.0	–
Dividends paid	21	(201.4)	(444.4)
Distributions by trust		(8.7)	(4.5)
Net cash flows used in financing activities		**(85.6)**	**(454.5)**
Net decrease in cash and cash equivalents		**(12.3)**	**(200.6)**
Cash and cash equivalents at beginning of year		311.8	512.5
Effect of exchange rate fluctuations on cash and cash equivalents		(3.7)	(0.1)
Cash and cash equivalents at end of year	9	**295.8**	**311.8**

Accounting policies
For the year ended 31 December 2012

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, 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 reclassification of fixed income securities from available for sale to estimated fair value through profit or loss and a reclassification 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 will be effective from 1 January 2014 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 77 and also in the risk disclosures section from page 86. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 77.

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 77 and 78 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 per cent 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 creditworthiness 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 programmes 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.

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 represent 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 the Group's risk appetite and tolerances whereas the individual entity Boards of Directors 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. 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.

Risk and Return Committee

The RRC seeks to optimise risk-adjusted return and facilitate the appropriate use of the internal model, including considering its effectiveness. It ensures that all key areas of risk are discussed according to a schedule that covers fortnightly, monthly, quarterly, semi-annual and annual reviews. The committee meets fortnightly and is responsible for coordinating and overseeing ERM activities within the risk profile, appetites and tolerances set by the Group and individual entity Boards of Directors. The RRC includes members from the finance, actuarial, underwriting and operations functions. The CRO attends the meetings and reports on the RRC's activities to the Group and individual entity Boards of Directors.

Chief Risk Officer

The primary role of the CRO is to facilitate the effective operation of ERM throughout the Group at all levels. The role includes but is not limited to the following responsibilities:

- drive ERM culture, ownership and execution on three levels; Board, executive management, and operationally within the business;
- facilitate the identification, assessment and evaluation of existing and emerging risks by management and the Board;
- ensure that these risks are given due consideration and embedded within management's and the Board's oversight and decision making process;
- be consulted, and opine on, policy in areas such as, but not limited to, underwriting, claims, investments, operations and capital management; and
- provide timely, accurate, reliable, factual, objective and accessible information and analysis to guide, coach and support decision making.

Responsibility for the management of individual risks has been assigned to, and may form part of the performance objectives of, the risk owners within the business. Risk owners ensure that these risks and controls are consistent with their day-to-day processes and the entries made in the Group and individual entity 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 Group and the individual operating entities in this regard.

Internal audit

Internal audit plays a key role in the Group's ERM 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 other 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. 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, taking account of inwards business and all major reinsurance purchases. 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, insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk, 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, and broader economic cycle impacts 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 and desired levels of profitability consistent with the Group's risk-adjusted RoE targets.

The Group considers insurance risk at an individual contract level, at a sector level, a geographic level and at an aggregate portfolio level. This ensures 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 peril 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 predetermined normal maximum line structure;
- each underwriter has a clearly defined limit of underwriting authority;

- the Group and individual operating entities have predetermined tolerances on probabilistic and deterministic losses of capital for certain single events and aggregate losses over a period of time;
- risk levels versus tolerances are monitored on a regular basis;
- a daily underwriting 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 model 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 and to improve risk-adjusted RoE as modeled in BLAST.

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, droughts, floods and tornadoes, from risk losses throughout the year and from war, terrorism and political risk and other events. ARL bears 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. The exposure to catastrophe losses that would result in an impairment in the investment in AHL is included in the figures below.

As at 31 December 2012		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	324.4	19.7	462.5	28.1
Japan	Typhoon	164.2	10.0	369.9	22.5
Japan	Earthquake	158.4	9.6	288.2	17.5
California	Earthquake	106.7	6.5	263.9	16.0
Pan-European	Windstorm	191.9	11.7	257.8	15.7
Pacific North West	Earthquake	34.9	2.1	191.1	11.6

(1) Landing hurricane from Florida to Texas.

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	Typhoon	108.5	7.5	235.0	16.2
Japan	Earthquake	165.4	11.4	260.0	17.9
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.

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:

	2012 $m	2012 %	2011 $m	2011 %
Worldwide offshore	309.1	42.7	284.3	45.0
Worldwide, including the U.S. and Canada(1)	176.8	24.5	119.4	18.9
U.S. and Canada	87.0	12.0	84.2	13.3
Far East	41.4	5.7	26.2	4.1
Europe	39.3	5.4	31.5	5.0
Worldwide, excluding the U.S. and Canada(2)	25.5	3.5	26.3	4.2
Middle East	8.1	1.1	8.5	1.3
Rest of world	37.1	5.1	51.9	8.2
Total	**724.3**	**100.0**	**632.3**	**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:

	2012 $m	2012 %	2011 $m	2011 %
Property	356.5	49.2	279.8	44.2
Energy	240.9	33.3	229.0	36.2
Marine	81.0	11.2	76.4	12.1
Aviation	45.9	6.3	47.1	7.5
Total	**724.3**	**100.0**	**632.3**	**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:

	2012 $m	2011 $m
Property retrocession	124.4	46.8
Property catastrophe excess of loss	96.8	82.0
Terrorism	62.9	68.4
Property political risk	41.1	20.4
Property direct and facultative	25.6	57.5
Other property	5.7	4.7
Total	**356.5**	**279.8**

Property retrocession is written on an excess of loss basis through treaty arrangements and covers elemental risks. Cover may be on a worldwide or regional basis and may cover specific risks or all catastrophe perils. Coverage may be given on a UNL basis meaning that loss payments are linked directly to the ceding company's own loss, or on an ILW basis meaning that loss payments are linked to the overall insured loss as measured by independent third-party loss index providers.

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 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 political risk cover is written either ground-up or on an excess of loss basis. Coverage that the Group provides in the political risk book is split between confiscation perils coverage and sovereign/quasi-sovereign obligor coverage. Confiscation perils coverage protects against CEND (Confiscation, Expropriation, Nationalisation, Deprivation) and may be extended to include other perils. Sovereign/quasi-sovereign obligors coverage protects against the non-payment or non-honouring of an obligation by a sovereign or quasi-sovereign entity. Cover is provided to medium to large commercial and industrial clients as well as bank and commodity trading clients. The Group does not cover against private obligor credit risk.

During 2012 the decision was taken to exit the property direct and facultative market due to declining pricing and weak policy wording. A small number of risks will continue to be written with modest lines to support client relationships in other classes of business. 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.

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 remaining 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 81 and 82.

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, however ILWs or quota share arrangements, such as with ARL, may be entered into.

ii. Energy

Gross premiums written, for the year:

	2012 $m	2011 $m
Worldwide offshore energy	148.9	140.3
Gulf of Mexico offshore energy	65.5	60.7
Construction energy	17.9	10.5
Onshore energy	5.6	8.6
Energy excess of loss	0.8	5.2
Other energy	2.2	3.7
Total	**240.9**	**229.0**

Energy risks are written mostly on a direct basis and may be ground-up or for primary or excess layers on either a first loss or full value basis. Worldwide offshore energy policies are typically package policies which may include physical damage, business interruption and third-party liability sections. Coverage can include fire and explosion and elemental risks. Individual assets covered can be high-value and are therefore mostly written on a subscription basis, meaning that coverage is placed with multiple underwriters.

Gulf of Mexico offshore energy programmes cover elemental and non-elemental risks. Most policies have sub-limits on coverage for elemental losses. These programmes are exposed to Gulf of Mexico windstorms. 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 81 and 82.

Construction energy contracts generally cover all risks of platform and drilling units under construction at yards and offshore, during towing and installation. Onshore construction contracts are generally not written.

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. Coverage is given on the same basis as the property direct and facultative market and, as with that portfolio, is now largely in run-off.

Energy excess of loss currently consists of excess of loss and ILW 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. Reinsurance may be purchased on a facultative or treaty basis.

iii. Marine
Gross premiums written, for the year:

	2012 $m	2011 $m
Marine hull and total loss	28.9	23.8
Marine hull war	18.8	17.7
Marine builders risk	16.4	20.0
Marine P&I clubs	10.6	11.0
Other marine	6.3	3.9
Total	**81.0**	**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 and their testing and commissioning. 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 programmes 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:

	2012 $m	2011 $m
AV52	36.8	39.6
Other aviation	9.1	7.5
Total	**45.9**	**47.1**

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, as well as the satellite launch and orbit market which the Group re-entered in the third quarter of 2012.

The Group does not presently write general aviation hull and liability business.

Reinsurance may be purchased to mitigate exposures to an AV52 event loss. Reinsurance is typically purchased on a treaty 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, and to improve the modeled risk-adjusted RoE 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 RRC has defined limits by reinsurer by rating and with an aggregate exposure to a rating band. The RRC considers reinsurers that are not rated or do not fall within the predefined rating categories on a case-by-case basis, and would usually require collateral to be posted to support such obligations. There are specific guidelines for these collateralised contracts. The RRC monitors the creditworthiness of its reinsurers on an ongoing basis and formally reviews the Group's reinsurance arrangements at least quarterly.

Reinsurance protection is typically purchased on an excess of loss basis, however it may also include ILW 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. Reinsurance may also be purchased to optimise the risk-adjusted return of the underwriting portfolio. The structure varies between types of peril and sub-class. 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 programme would be retained by the Group. Some parts of the reinsurance programme 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 Reserve Committees at the operating entity level, which have responsibility for the review of large claims and IBNR levels, 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 programmes 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 or regulations 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 risks, such as the majority of risks underwritten by the Group, are reported more promptly 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 contracts, which make up the majority of the Group's 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, an initial estimated loss and loss expense ratio is generally used. This is 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. Due to 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 as well as regulatory directives, 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 2012 management's estimates for IBNR represented 28.1 per cent of total net loss reserves (2011 – 33.5 per cent). The majority of the estimate relates to potential claims on non-elemental risks where timing delays in insured or cedant reporting may mean losses could have occurred which the Group were not made aware of by the balance sheet date.

B. Market risk
The Group is at risk of loss due to movements in market factors. 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;
- failure to maintain broker and client relationships, leading to a limited or substandard choice of risks inconsistent with the Group's risk appetite; and
- changes in regulation including capital, governance or licensing requirements.

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;
- holds a quarterly Underwriting and Underwriting Risk Committee meeting to review underwriting strategy;
- holds a fortnightly RRC meeting to monitor estimated exposures to peak zone elemental losses and RDS; and
- holds ongoing documented meetings with regulators.

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 and currency exchange 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, currency, maturity, sectors, geographical, sovereign and issuer exposures. Compliance with guidelines is monitored on a monthly basis. Any adjustments to the investment guidelines are approved by the Investment Risk and Return Committee and the Board of Directors.

The Group's fixed income portfolios are managed by four external investment managers. The Group held a small allocation of equities for a short period of time in 2011. The equity portfolio was liquidated 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 subset 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 subset 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 is slightly longer than the core or core plus portfolio, while maintaining a focus on high quality assets.

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

The Group endeavours to maintain a market neutral investment portfolio in order to minimise losses during periods of heightened volatility. These scenarios represent what could, and most likely will occur (albeit not in the exact form of our chosen scenario). The Group also monitors the portfolio impact of more severe disaster scenarios consisting of extreme shocks.

The Investment Risk and Return Committee meets at least quarterly to ensure that the Group's strategic and tactical investment actions are consistent with investment risk preferences, appetite and risk and return objectives. The Investment Risk and Return Committee also helps further develop the risk tolerances to be incorporated into the ERM framework.

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

	Core		Core plus		Surplus		Total	
As at 31 December 2012	$m	%	$m	%	$m	%	$m	%
– Short-term investments	24.4	1.3	88.9	4.7	1.5	0.1	114.8	6.1
– U.S. treasuries	97.8	5.2	52.5	2.8	64.6	3.5	214.9	11.5
– Other government bonds	5.5	0.3	11.9	0.6	133.5	7.1	150.9	8.0
– U.S. municipal bonds	2.7	0.1	9.2	0.5	16.7	0.9	28.6	1.5
– U.S. government agency debt	8.1	0.4	16.8	0.9	106.7	5.7	131.6	7.0
– Asset backed securities	18.1	1.0	32.6	1.7	23.2	1.2	73.9	3.9
– U.S. government agency mortgage backed securities	48.0	2.6	127.3	6.8	227.8	12.1	403.1	21.5
– Non-agency mortgage backed securities	1.9	0.1	2.3	0.1	4.3	0.3	8.5	0.5
– Agency commercial mortgage backed securities	–	–	1.2	0.1	0.4	–	1.6	0.1
– Non-agency commercial mortgage backed securities	1.1	0.1	5.1	0.3	23.4	1.2	29.6	1.6
– Bank loans	–	–	–	–	37.4	2.0	37.4	2.0
– Corporate bonds	142.3	7.6	264.1	14.1	273.2	14.6	679.6	36.3
Total fixed income securities	**349.9**	**18.7**	**611.9**	**32.6**	**912.7**	**48.7**	**1,874.5**	**100.0**

As at 31 December 2011	Core $m	Core %	Core plus $m	Core plus %	Surplus $m	Surplus %	Total $m	Total %
– 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**

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

As at 31 December 2012	Financials $m	Other industries $m	Total corporate bonds and bank loans $m	Other government bonds $m	Total corporate bonds, bank loans and other government bonds $m
United States	137.6	290.9	428.5	–	428.5
Canada	67.1	15.0	82.1	28.6	110.7
United Kingdom	9.6	32.0	41.6	8.3	49.9
Australia	9.8	12.2	22.0	16.0	38.0
Norway	30.8	–	30.8	2.1	32.9
France	1.5	21.8	23.3	1.8	25.1
Netherlands	7.5	5.5	13.0	2.8	15.8
Switzerland	8.0	6.9	14.9	–	14.9
Sweden	14.4	–	14.4	–	14.4
Belgium	–	9.7	9.7	–	9.7
Denmark	–	–	–	9.0	9.0
Germany	–	4.9	4.9	1.8	6.7
Spain	2.7	1.2	3.9	2.3	6.2
Supranationals	1.4	–	1.4	–	1.4
Emerging market corporates	6.4	9.6	16.0	–	16.0
Emerging market sovereign	–	–	–	30.4	30.4
Emerging market agency	–	–	–	47.8	47.8
Other	2.5	8.0	10.5	–	10.5
Total	**299.3**	**417.7**	**717.0**	**150.9**	**867.9**

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**

The sector allocation of the corporate bonds and bank loans is as follows:

	2012		2011	
As at 31 December	$m	%	$m	%
Financial	297.9	41.5	238.8	37.3
Financial – FDIC guaranteed	–	–	49.2	7.7
Industrial	379.9	53.0	277.5	43.4
Utility	37.8	5.3	43.2	6.8
Foreign agencies	–	–	29.5	4.6
Supranationals	1.4	0.2	1.5	0.2
Total	**717.0**	**100.0**	**639.7**	**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.

The Group's investment portfolio is mainly comprised of fixed income securities and cash and cash equivalents. The Group has no exposure to valuation risk from equity 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:

	2012		2011	
As at 31 December	$m	%	$m	%
Immediate shift in yield (basis points)				
100	(40.9)	(2.2)	(36.2)	(2.1)
75	(30.6)	(1.6)	(27.1)	(1.6)
50	(20.4)	(1.1)	(18.1)	(1.1)
25	(10.2)	(0.5)	(9.0)	(0.5)
(25)	8.5	0.5	8.7	0.5
(50)	17.1	0.9	17.3	1.0
(75)	25.6	1.4	26.0	1.5
(100)	34.1	1.8	34.6	2.0

The Group mitigates interest rate risk on the investment portfolio by establishing and monitoring duration ranges in its investment guidelines. The Group may manage duration through the use of interest rate futures from time to time. 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	2012 years	2011 years
Core portfolio	1.5	1.3
Core plus portfolio	1.5	1.2
Surplus portfolio	2.4	2.8
Overall portfolio	**1.9**	**2.0**

The overall duration for fixed income, managed cash and cash equivalents and certain derivatives is 1.8 years (2011 – 1.8 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 VaR 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 per cent of the time. The current VaR tolerance is 4.0 per cent of shareholders' equity, using the 90 day VaR at the 95th percentile confidence level.

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

	2012		2011	
As at 31 December	$m	%	$m	%
95th percentile confidence level	13.4	1.0	18.5	1.4
99th percentile confidence level	19.0	1.4	26.1	2.0

Derivative financial instruments

The Group's investment guidelines permit the investment managers to utilise exchange-traded futures and options contracts, and OTC instruments including interest rate swaps, credit default swaps, interest rate swaptions and forward foreign currency contracts. 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 2012	Net other investment income $m	Net realised gains (losses) $m	Net foreign exchange gains (losses) $m	Financing costs $m
Eurodollar futures	–	0.2	–	–
Treasury futures	–	(1.7)	–	–
Forward foreign currency contracts	–	–	(2.8)	–
Interest rate swaps – investments	0.2	–	–	–
Interest rate swaps – debt	–	–	–	(4.1)
Credit default swaps	0.5	(0.1)	–	–
Total	**0.7**	**(1.6)**	**2.8**	**(4.1)**

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)**

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

	2012			2011		
As at 31 December	Other investments $m	Other assets $m	Interest rate swap $m	Other investments $m	Other assets $m	Interest rate swap $m
Forward foreign currency contracts	–	–	–	0.1	0.2	–
Interest rate swaps – investments	–	–	–	(0.2)	–	–
Interest rate swaps – debt	–	–	(8.0)	–	–	(6.1)
Credit default swaps	0.1	–	–	(0.5)	–	–
Total	**0.1**	**–**	**(8.0)**	**(0.6)**	**0.2**	**(6.1)**

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 creditworthiness of the counterparty is monitored and collateral may be required on open positions.

The Group did not hold any TBA positions as at 31 December 2012 and 2011.

b. Futures
The Group's investment guidelines permit the use of futures which 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 counterparty 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.

As at 31 December 2012 the net notional short exposure to treasury futures is $56.2 million (2011 – $0.6 million).

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 2012 and 2011. The contracts currently held by the Group will expire in 2014 and 2015.

The sensitivity of the Group's Eurodollar futures position to interest rate movements is not material at 31 December 2012 and 2011.

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 predetermined future date. 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 notional amount of options is not material at 31 December 2012 and 2011.

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 counterparties 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 counterparty 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:

	2012			2011		
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
Canadian Dollar	0.3	22.2	(21.9)	0.3	21.8	(21.5)
Euro	1.9	19.1	(17.2)	0.6	12.0	(11.4)
Australian Dollar	–	12.5	(12.5)	–	10.7	(10.7)
British Pound	0.1	3.9	(3.8)	–	1.3	(1.3)
Brazilian Real	–	3.3	(3.3)	5.3	9.2	(3.9)
Mexican Peso	–	0.2	(0.2)	3.5	3.6	(0.1)
South African Rand	–	0.1	(0.1)	4.8	4.9	(0.1)
Chinese Renminbi	3.4	3.4	–	5.6	5.6	–
Japanese Yen	–	–	–	24.3	0.3	24.0
Russian Ruble	–	–	–	4.5	4.5	–
Turkish Lira	–	–	–	3.5	3.5	–
Indonesian Rupiah	–	–	–	3.4	3.4	–
Malaysian Ringgit	–	–	–	2.4	2.4	–
Other(1)	–	–	–	8.7	8.7	–
Total	**5.7**	**64.7**	**(59.0)**	**66.9**	**91.9**	**(25.0)**

(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 counterparty's inability to perform. Swaps are recorded at estimated fair value at the end of each period with unrealised gains and losses recorded in the consolidated statement of comprehensive income.

Interest rate 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. 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 counterparty 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 counterparty credit quality and a maximum notional exposure to interest rate swaps as a percentage of the investment portfolio's estimated fair value. The notional amount of interest rate swaps is not material at 31 December 2012 and 2011.

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. As at 31 December 2012, the maximum amount of loss the Group could incur on its open credit default swaps was the notional value of $11.5 million (2011 – $20.8 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, as a purchaser of a swaption, is subject to the credit risk of the counterparty 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. The notional amount of swaptions is not material at 31 December 2012 and 2011.

iii. Debt risk
The Group has issued long-term debt as described in note 20. The subordinated loan notes due in 2035 bear interest at a floating rate that is reset on a quarterly basis, plus a fixed margin of 3.70 per cent. The Group is subject to interest rate risk on the coupon payments of these subordinated loan notes. 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. Therefore the Group currently has no interest rate risk on the subordinated loan notes due in 2035.

The senior unsecured notes maturing 1 October 2022 bear interest at a fixed rate of 5.70 per cent and therefore the Group is not exposed to interest rate risk on this long-term debt.

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 a small exposure to foreign currencies through its EMD investment portfolio. These positions may not be hedged depending on the currency outlook. See page 95 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	123.4	8.9	93.7	59.0	10.8	295.8
Accrued interest receivable	9.2	–	0.1	–	–	9.3
Fixed income securities	1,813.6	3.8	17.0	–	40.1	1,874.5
Other investments	0.1	–	–	–	–	0.1
Reinsurance assets	87.8	–	–	1.2	–	89.0
Deferred acquisition costs	53.2	1.2	6.7	1.3	5.6	68.0
Other receivables	2.5	0.6	–	–	–	3.1
Inwards premiums receivable from insureds and cedants	168.3	2.4	20.4	2.9	13.0	207.0
Deferred tax asset	–	7.3	–	–	–	7.3
Investment in associates	82.1	–	–	–	–	82.1
Property, plant and equipment	1.7	1.1	–	–	–	2.8
Total assets as at 31 December 2012	**2,341.9**	**25.3**	**137.9**	**64.4**	**69.5**	**2,639.0**

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	336.8	6.7	67.0	110.1	16.8	537.4
Unearned premiums	271.7	6.4	31.2	12.1	21.9	343.3
Insurance contracts – other payables	19.4	0.1	2.0	–	2.0	23.5
Amounts payable to reinsurers	30.6	–	–	–	–	30.6
Deferred acquisition costs ceded	0.6	–	–	0.2	–	0.8
Other payables	35.1	12.4	1.8	–	–	49.3
Interest rate swap	5.6	–	2.4	–	–	8.0
Long-term debt	227.0	–	31.7	–	–	258.7
Total liabilities as at 31 December 2012	**926.8**	**25.6**	**136.1**	**122.4**	**40.7**	**1,251.6**

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**

The impact on net income of a proportional foreign exchange movement of 10 per cent up and 10 per cent down against the U.S. dollar at the year end spot rates would be an increase or decrease of $2.0 million (2011 – $4.2 million).

The 31 December 2012 losses and loss adjustment expenses include the equivalent of $55.4 million (2011 – $57.1 million) of Japanese Yen denominated insurance liabilities that are contained within the Group's outwards reinsurance programme which limits the Group's net liability to $30.0 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 2012	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	89.7	174.6	47.4	311.7
Between one and two years	98.5	127.9	80.1	306.5
Between two and three years	39.7	44.6	59.2	143.5
Between three and four years	10.0	24.1	66.5	100.6
Between four and five years	36.6	55.5	185.4	277.5
Over five years	6.3	16.7	195.0	218.0
Asset backed and mortgage backed securities	69.1	168.5	279.1	516.7
Total fixed income securities	**349.9**	**611.9**	**912.7**	**1,874.5**

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**

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

	Years until liability becomes due – undiscounted values					
As at 31 December 2012	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	537.4	243.0	193.1	59.7	41.6	537.4
Insurance contracts – other payables	23.5	18.2	4.8	0.5	–	23.5
Amounts payable to reinsurers	30.6	30.6	–	–	–	30.6
Other payables	49.3	49.3	–	–	–	49.3
Interest rate swap	8.0	2.6	4.6	0.8	–	8.0
Long-term debt	258.7	10.6	25.1	25.1	383.5	444.3
Total	**907.5**	**354.3**	**227.6**	**86.1**	**425.1**	**1,093.1**

	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**

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 20. 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 aims to ensure 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 reallocates assets as deemed necessary.

D. Credit risk

Credit risk is the risk that a counterparty 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 per cent of shareholders' equity. In addition, no one issuer, with the exception of U.S. government and agency securities, other G10 government guaranteed securities (excluding Italy) and Australian sovereign debt, should exceed 5 per cent of shareholders' equity. The Group is therefore not exposed to any significant credit concentration risk on its investment portfolio, except for fixed income securities issued by the 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 counterparty credit risk, require the posting of margins and settle unrealised gains and losses daily. Credit risk on OTC derivatives is mitigated by monitoring the creditworthiness of the counterparties 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 RRC, as discussed on page 86. Reinsurance recoverables from ARL are fully collateralised by $238.4 million of funds held in a collateral account consisting of cash and cash equivalents and fixed income securities which are of high quality and short duration.

The table below presents an analysis of the Group's major exposures to counterparty 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 2012	Other investments $m	Cash and fixed income securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	–	425.5	–	–
AA+, AA, AA-	–	901.7	–	–
A+, A, A-	–	579.2	4.5	55.3
BBB+, BBB, BBB-	0.1	189.0	–	–
Other(1)	–	74.9	209.7	17.7
Total	**0.1**	**2,170.3**	**214.2**	**73.0**

(1) Reinsurance recoveries classified as "other" relate to contracts with ARL and are fully collateralised.

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**

The counterparty 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:

	2012 $m	2011 $m
Less than 90 days past due	5.2	10.5
Between 91 and 180 days past due	0.2	0.3
Over 180 days past due	–	0.1
Total	**5.4**	**10.9**

Provisions of $0.5 million (2011 – $0.8 million) have been made for impaired or irrecoverable balances and $0.8 million was released from (2011 – $0.3 million 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. The RRC reviews operational risk on a quarterly basis.

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 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 an annual audit while compliance with tax operating guidelines is audited quarterly. Frequency of audits for all other areas varies from quarterly at the most frequent to a minimum of once every three years, on a rotational basis.

F. Strategic risk

The Group has identified several strategic risks. These include the risks that either the poor execution of the business plan or 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, including reputational risk. 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 UMCC.

ii. Capital management risk

The total capital of the Group is as follows:

As at 31 December	2012 $m	2011 $m
Shareholders' equity	1,387.4	1,326.8
Long-term debt	258.7	128.0
Total capital	**1,646.1**	**1,454.8**

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 predetermined 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 use these approaches in decision making. The operating entities also conduct capital requirement assessments under internal measures and local regulatory requirements. Refer to note 27 for a discussion of the regulatory capital requirements of the Group's operating entities.

The Group's aim is to provide its shareholders with an RoE of 13 per cent 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
31 December 2012	16.7	19.2	242.7

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

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

	Annual return %	Compound annual return %	Inception to date return %
31 December 2005[(1)]	(3.4)	n/a	(3.4)
31 December 2006	13.0	9.2	9.2
31 December 2007	26.9	17.8	40.8
31 December 2008	6.4	14.3	52.7
31 December 2009	26.4	17.1	94.6
31 December 2010	23.2	18.2	141.1
31 December 2011	13.3	17.7	179.9
31 December 2012	16.6	17.7	231.27

(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. 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 HMRC.

LHL has six subsidiaries, all wholly owned: LICL, LIHL, LIMSL, LISL, LMSCL and SML. 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 2012 held the following licence or authorisation 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
LMSCL	16 May 2012	None	Support services
SML	30 October 2012	BMA	Insurance management services

2. Segmental reporting

Management and the Board of Directors review the Group's business primarily by its four principal classes: Property, Energy, Marine and Aviation. These classes are therefore deemed to be the Group's operating segments for the purposes of segment reporting. Further sub-classes of business are underwritten within each operating segment. The nature of these individual sub-classes is discussed further in the risk disclosures section on pages 83 to 85. 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.

Revenue and expense by operating segment

For the year ended 31 December 2012	Property $m	Energy $m	Marine $m	Aviation $m	Total $m
Gross premium written by geographical region					
Worldwide offshore	–	229.4	79.7	–	309.1
Worldwide, including the U.S. and Canada(1)	124.5	5.8	0.6	45.9	176.8
U.S. and Canada	84.5	2.5	–	–	87.0
Far East	40.5	0.9	–	–	41.4
Europe	39.1	0.1	0.1	–	39.3
Worldwide, excluding the U.S. and Canada(2)	24.4	1.1	–	–	25.5
Middle East	7.8	0.3	–	–	8.1
Rest of world	35.7	0.8	0.6	–	37.1
Total	**356.5**	**240.9**	**81.0**	**45.9**	**724.3**
Outwards reinsurance premiums	(97.1)	(26.7)	(20.5)	(3.9)	(148.2)
Change in unearned premiums	18.7	(8.1)	(7.2)	0.4	3.8
Change in unearned premiums ceded	1.0	1.7	–	–	2.7
Net premiums earned	**279.1**	**207.8**	**53.3**	**42.4**	**582.6**
Insurance losses and loss adjustment expenses	(109.1)	(24.0)	(81.8)	(2.0)	(216.9)
Insurance losses and loss adjustment expenses recoverable	(3.6)	(2.8)	49.2	–	42.8
Insurance acquisition expenses	(44.0)	(52.5)	(23.3)	(10.4)	(130.2)
Insurance acquisition expenses ceded	10.0	0.5	0.2	0.1	10.8
Net underwriting profit	**132.4**	**129.0**	**(2.4)**	**30.1**	**289.1**
Net unallocated income and expenses					(52.3)
Profit before tax					**236.8**
Net loss ratio	40.4%	12.9%	61.2%	4.7%	29.9%
Net acquisition cost ratio	12.2%	25.0%	43.3%	24.3%	20.5%
Expense ratio	–	–	–	–	13.5%
Combined ratio	**52.6%**	**37.9%**	**104.5%**	**29.0%**	**63.9%**

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

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

2. Segmental reporting continued

Revenue and expense by operating segment

For the year ended 31 December 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
Far East	25.9	0.2	0.1	–	26.2
Europe	30.2	0.6	0.7	–	31.5
Worldwide, excluding the U.S. and Canada(2)	25.8	0.5	–	–	26.3
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 and loss adjustment expenses 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.

3. Investment return

The total investment return for the Group is as follows:

For the year ended 31 December 2012	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	32.2	13.4	18.1	63.7	0.7	64.4
Other investments	0.7	(1.6)	–	(0.9)	(1.7)	(2.6)
Cash and cash equivalents	0.3	–	–	0.3	–	0.3
Total investment return	**33.2**	**11.8**	**18.1**	**63.1**	**(1.0)**	**62.1**

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**

Net realised gains (losses) and impairments includes impairment losses of $0.3 million (2011 – $0.3 million) recognised on fixed income securities held by the Group.

Refer to page 93 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 $4.0 million (2011 – $4.3 million) of investment management, accounting and custodian fees.

4. Net insurance acquisition expenses

	2012 $m	2011 $m
Insurance acquisition expenses	136.8	114.4
Changes in deferred insurance acquisition expenses	(6.6)	(0.2)
Insurance acquisition expenses ceded	(10.9)	(2.4)
Changes in deferred insurance acquisition expenses ceded	0.1	0.6
Total net insurance acquisition expenses	**119.4**	**112.4**

5. Results of operating activities

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

	2012 $m	2011 $m
Depreciation on owned assets	2.8	2.9
Operating lease charges	2.3	1.8
Auditors' remuneration		
– Group audit fees	1.1	1.3
– Other services	0.3	0.1
Total	**6.5**	**6.1**

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

6. Employee benefits

	2012 $m	2011 $m
Wages and salaries	19.1	19.3
Pension costs	1.9	1.8
Bonus and other benefits	25.9	19.7
Total cash compensation	**46.9**	**40.8**
RSS – ordinary	12.0	10.6
RSS – bonus deferral	4.2	4.1
LTIP	0.2	4.1
Total equity based compensation	**16.4**	**18.8**
Total employee benefits	**63.3**	**59.6**

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 22.

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 programme to a nil-cost options programme. 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 2012 and 2011:

Assumptions	2012	2011
Dividend yield	0.0%	0.0%
Expected volatility(1)	23.7% – 24.2%	22.1% – 24.9%
Risk-free interest rate(2)	0.50% – 0.53%	0.96% – 1.49%
Expected average life of options	3 years	3 years
Share price	$12.56 – $12.91	$9.67 – $11.14

(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.

The calculation of the equity based compensation expense assumes forfeitures due to employee turnover of 10% per annum prior to vesting, with subsequent adjustments to reflect actual experience.

RSS – ordinary

The ordinary RSS options vest after a three-year period and are dependent on certain performance criteria. A maximum of 50 per cent 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 predefined comparator group. A maximum of 50 per cent 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 of employee restricted stock	Number of Non-Executive Director restricted stock	Total number of restricted stock
Outstanding as at 31 December 2010	**5,905,445**	**–**	**5,905,445**
Granted	1,955,830	–	1,955,830
Exercised	(1,500,995)	–	(1,500,995)
Lapsed	(7,223)	–	(7,223)
Forfeited	(124,220)	–	(124,220)
Outstanding as at 31 December 2011	**6,228,837**	**–**	**6,228,837**
Granted	1,518,767	–	1,518,767
Exercised	(2,091,161)	–	(2,091,161)
Forfeited	(180,293)	–	(180,293)
Reclassified(1)	(561,327)	561,327	–
Outstanding as at 31 December 2012	**4,914,823**	**561,327**	**5,476,150**
Exercisable as at 31 December 2012	**1,915,163**	**–**	**1,915,163**

(1) On 30 June 2012 Neil McConachie relinquished his executive role but continued as a Board member in a non-executive capacity. His RSS options are shown separately from employee RSS options in the table above.

	2012			2011
	Employee restricted stock	Non-Executive Director restricted stock	Total restricted stock	Total restricted stock
Weighted average remaining contractual life	8.0 years	8.2 years	8.1 years	8.1 years
Weighted average fair value at date of grant during the year	$9.99	$9.98	$9.99	$7.98
Weighted average share price at date of exercise during the year	$12.24	–	$12.24	$10.53

Financial statements

6. Employee benefits continued

RSS – bonus deferral

The bonus deferral RSS options vesting periods range from one to three 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 of employee restricted stock	Number of Non-Executive Director restricted stock	Total number of restricted stock
Outstanding as at 31 December 2010	**371,834**	**–**	**371,834**
Granted	549,738	–	549,738
Forfeited	(4,417)	–	(4,417)
Outstanding as at 31 December 2011	**917,155**	**–**	**917,155**
Granted	234,454	–	234,454
Exercised	(386,542)	–	(386,542)
Forfeited	(4,085)	–	(4,085)
Reclassified[(1)]	(103,639)	103,639	–
Outstanding as at 31 December 2012	**657,343**	**103,639**	**760,982**
Exercisable as at 31 December 2012	**36,694**	**–**	**36,694**

(1) On 30 June 2012 Neil McConachie relinquished his executive role but continued as a Board member in a non-executive capacity. His RSS options are shown separately from employee RSS options in the table above.

	2012			2011
	Employee restricted stock	Non-Executive Director restricted stock	Total restricted stock	Total restricted stock
Weighted average remaining contractual life	8.3 years	8.4 years	8.3 years	8.8 years
Weighted average fair value at date of grant during the year	$12.31	$12.16	$12.30	$10.01
Weighted average share price at date of exercise during the year	$12.24	–	$12.24	–

LTIP

The LTIP plan was closed on 4 January 2008. All LTIP options will expire ten years from the date of grant. 25 per cent 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 2010	**1,783,163**	**$2.88**
Exercised	(1,379,379)	$2.53
Forfeited	(66,720)	$2.32
Outstanding as at 31 December 2011	**337,064**	**$2.11**
Exercised	(203,228)	$2.17
Forfeited	–	–
Outstanding and exercisable as at 31 December 2012	**133,836**	**$0.98**

	2012	2011
Weighted average remaining contractual life	4.5 years	5.5 years
Weighted average share price at date of exercise during the year	$12.27	$10.61

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	$	£	2012 $m	2011 $m
14 February 2008	1.10	0.56	–	0.1
4 November 2009	1.30	0.79	–	0.5
19 March 2010	0.10	0.07	–	0.1
3 September 2010	0.05	0.03	–	0.1
10 December 2010	1.40	0.89	–	2.5
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
16 March 2012	0.10	0.06	–	–
31 August 2012	0.05	0.03	–	–
30 November 2012	0.90	0.56	0.2	–
Total			**0.2**	**4.0**

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 2010	**10,034,795**	**$4.72**
Exercised	(1,169,766)	$4.62
Sale to external buyer	(2,350,000)	$5.00
Outstanding as at 31 December 2011	**6,515,029**	**$4.65**
Exercised	(330,630)	$4.84
Outstanding and exercisable as at 31 December 2012	**6,184,399**	**$4.64**

	2012	2011
Weighted average remaining contractual life	3.0 years	4.0 years
Weighted average share price at date of exercise during the year	$13.03	$10.80

Refer to note 25 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.

6. Employee benefits continued

Performance warrants granted and outstanding are:

	Number	Weighted average exercise price
Outstanding as at 31 December 2010	**1,344,810**	**$3.62**
Exercised	(417,494)	$3.61
Outstanding as at 31 December 2011	**927,316**	**$3.62**
Exercised	(67,871)	$3.63
Outstanding and exercisable as at 31 December 2012	**859,445**	**$3.62**

	2012	2011
Weighted average remaining contractual life	3.0 years	4.0 years
Weighted average share price at date of exercise during the year	$13.52	$11.09

Refer to note 22 for further disclosure on non-management warrants outstanding.

7. Financing costs

	2012 $m	2011 $m
Interest expense on long-term debt	7.2	5.6
Net losses on interest rate swaps	4.1	7.4
Other financing costs	3.2	1.2
Total	**14.5**	**14.2**

Refer to note 20 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

LHL and the UK subsidiaries are subject to normal UK corporation tax on all their taxable profits.

Tax charge	2012 $m	2011 $m
Current tax charge for the period	1.1	6.0
Adjustments in respect of prior period corporation tax	(0.3)	(0.1)
Deferred tax charge for the period	0.7	0.5
Adjustments in respect of prior period deferred tax	0.4	–
Total tax charge	**1.9**	**6.4**

Tax reconciliation	2012 $m	2011 $m
Profit before tax	236.8	218.6
Less loss (profit) not subject to tax	2.8	(196.6)
Profits subject to tax	**239.6**	**22.0**
UK corporation tax at 24.5% (26.5%)	58.7	5.8
Non-taxable income	(73.6)	–
Adjustments in respect of prior period	0.1	(0.1)
Differences related to equity based compensation	1.6	(0.1)
Other expense permanent differences	9.0	0.1
Tax rate change adjustment	0.6	0.7
Unused tax losses not recognised for deferred tax	5.5	–
Total tax charge	**1.9**	**6.4**

Due to the different taxpaying jurisdictions throughout the Group the current tax charge as a percentage of the Group's profit before tax is 0.8 per cent (2011 – 2.9 per cent). Following the move of its tax residency to the UK on 1 January 2012, the ultimate parent undertaking's profits before tax are included within profits subject to tax for the first time in 2012. Dividend income from its subsidiary companies is, however, exempt from UK corporation tax and therefore appears as a reconciling item as non-taxable income.

A corporation tax credit of $1.4 million (2011 – $2.0 million) was recognised 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

	2012 $m	2011 $m
Cash at bank and in hand	209.4	122.9
Cash equivalents	86.4	188.9
Total cash and cash equivalents	**295.8**	**311.8**

Cash equivalents have an original maturity of three months or less. The carrying amount of these assets approximates their fair value. Refer to note 20 for the cash and cash equivalent balances on deposit as collateral.

10. Investments

As at 31 December 2012	Cost or amortised cost $m	Gross unrealised gain $m	Gross unrealised loss $m	Estimated fair value $m
Fixed income securities				
– Short-term investments	114.8	–	–	114.8
– U.S. treasuries	214.5	0.5	(0.1)	214.9
– Other government bonds	145.0	7.0	(1.1)	150.9
– U.S. municipal bonds	26.7	2.0	(0.1)	28.6
– U.S. government agency debt	130.4	1.2	–	131.6
– Asset backed securities	73.0	0.9	–	73.9
– U.S. government agency mortgage backed securities	394.1	9.2	(0.2)	403.1
– Non-agency mortgage backed securities	8.3	0.2	–	8.5
– Agency commercial mortgage backed securities	1.6	–	–	1.6
– Non-agency commercial mortgage backed securities	27.0	2.6	–	29.6
– Bank loans	37.4	0.1	(0.1)	37.4
– Corporate bonds	665.5	14.6	(0.5)	679.6
Total fixed income securities	**1,838.3**	**38.3**	**(2.1)**	**1,874.5**
Other investments	(0.2)	0.7	(0.4)	0.1
Total investments	**1,838.1**	**39.0**	**(2.5)**	**1,874.6**

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**

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

	2012 $m	2011 $m
Gross unrealised gains	38.3	26.7
Gross unrealised losses	(2.1)	(10.0)
Net foreign exchange losses (gains)	0.3	1.7
Tax provision	(1.1)	(0.8)
Accumulated other comprehensive income	**35.4**	**17.6**

Fixed income maturities are presented in the risk disclosures section on page 99. Refer to note 20 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.

10. Investments continued

Category (iii)

Category (iii) includes securities for which valuation techniques are not based on observable market data. During the years ended 31 December 2012 and 2011, 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.

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 2012	(i) $m	(ii) $m	Total $m
Fixed income securities			
– Short-term investments	114.6	0.2	114.8
– U.S. treasuries	214.9	–	214.9
– Other government bonds	–	150.9	150.9
– U.S. municipal bonds	–	28.6	28.6
– U.S. government agency debt	–	131.6	131.6
– Asset backed securities	–	73.9	73.9
– U.S. government agency mortgage backed securities	–	403.1	403.1
– Non-agency mortgage backed securities	–	8.5	8.5
– Agency commercial mortgage backed securities	–	1.6	1.6
– Non-agency commercial mortgage backed securities	–	29.6	29.6
– Bank loans	–	37.4	37.4
– Corporate bonds	–	679.6	679.6
Total fixed income securities	**329.5**	**1,545.0**	**1,874.5**
Other investments	–	0.1	0.1
Total investments	**329.5**	**1,545.1**	**1,874.6**

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**

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 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)**
Net deferral for prior years	(8.8)	–	–	(8.8)
Net deferral for current year	11.5	–	–	11.5
Other	–	(12.8)	(1.7)	(14.5)
As at 31 December 2012	**11.5**	**(30.6)**	**4.5**	**(14.6)**

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 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**
Net incurred losses for:			
Prior years	(33.5)	6.1	(27.4)
Current year	250.4	(48.9)	201.5
Exchange adjustments	(11.2)	–	(11.2)
Incurred losses and loss adjustment expenses	**205.7**	**(42.8)**	**162.9**
Net paid losses for:			
Prior years	134.4	(8.2)	126.2
Current year	105.1	(31.3)	73.8
Paid losses and loss adjustment expenses	**239.5**	**(39.5)**	**200.0**
As at 31 December 2012	**537.4**	**(73.0)**	**464.4**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from page 86. The risks associated with general insurance contracts are complex and do not readily lend themselves to meaningful sensitivity analysis. The impact of an unreported event could lead to a significant increase in our loss reserves. The Group believes that the loss reserves established are adequate, however a 20 per cent increase in estimated losses would lead to a $107.5 million (2011 – $114.2 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:

	2012		2011	
As at 31 December	$m	%	$m	%
Outstanding losses	306.2	57.0	276.7	48.4
Additional case reserves	98.3	18.3	123.9	21.7
Losses incurred but not reported	132.9	24.7	170.6	29.9
Total	**537.4**	**100.0**	**571.2**	**100.0**

The Group's reserve for unpaid losses and loss adjustment expenses as at 31 December 2012 and 2011 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	2012 $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	250.3	
One year later	34.7	131.2	417.4	107.8	209.4	371.9		
Two years later	32.0	103.5	377.5	73.1	204.2			
Three years later	27.6	94.8	345.1	66.0				
Four years later	27.2	83.5	340.8					
Five years later	24.4	81.0						
Six years later	24.0							
Current estimate of cumulative liability	**24.0**	**81.0**	**340.8**	**66.0**	**204.2**	**371.9**	**250.3**	**1,338.2**
Payments made	**(22.1)**	**(74.5)**	**(306.1)**	**(46.7)**	**(133.1)**	**(113.2)**	**(105.1)**	**(800.8)**
Total gross liability	**1.9**	**6.5**	**34.7**	**19.3**	**71.1**	**258.7**	**145.2**	**537.4**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2012.

Accident year	2006 $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m	Total $m
Reinsurance								
Estimate of ultimate recovery[1]								
At end of accident year	–	3.6	40.7	1.6	33.8	56.2	48.9	
One year later	–	6.2	47.1	1.3	23.6	52.6		
Two years later	–	4.0	43.1	0.7	24.1			
Three years later	–	3.5	40.9	0.7				
Four years later	–	3.3	38.1					
Five years later	–	3.1						
Six years later	–							
Current estimate of cumulative recovery	**–**	**3.1**	**38.1**	**0.7**	**24.1**	**52.6**	**48.9**	**167.5**
Payments made	**–**	**(3.1)**	**(33.7)**	**(0.7)**	**(22.6)**	**(3.1)**	**(31.3)**	**(94.5)**
Total gross recovery	**–**	**–**	**4.4**	**–**	**1.5**	**49.5**	**17.6**	**73.0**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2012.

12. Losses and loss adjustment expenses continued

Accident year	2006 $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $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	201.4	
One year later	34.7	125.0	370.3	106.5	185.8	319.3		
Two years later	32.0	99.5	334.4	72.4	180.1			
Three years later	27.6	91.3	304.2	65.3				
Four years later	27.2	80.2	302.7					
Five years later	24.4	77.9						
Six years later	24.0							
Current estimate of cumulative liability	**24.0**	**77.9**	**302.7**	**65.3**	**180.1**	**319.3**	**201.4**	**1,170.7**
Payments made	**(22.1)**	**(71.4)**	**(272.4)**	**(46.0)**	**(110.5)**	**(110.1)**	**(73.8)**	**(706.3)**
Total net liability	**1.9**	**6.5**	**30.3**	**19.3**	**69.6**	**209.2**	**127.6**	**464.4**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2012.

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:

	2012 $m	2011 $m
2006 accident year	0.4	2.9
2007 accident year	2.3	11.1
2008 accident year	1.7	29.8
2009 accident year	7.1	33.7
2010 accident year	6.4	77.8
2011 accident year	9.5	–
Total favourable development	**27.4**	**155.3**

The favourable prior year development in 2012 arose primarily from IBNR releases due to fewer than expected reported losses offset to an extent by unfavourable development on various outstanding case reserves and additional case reserves as a result of updated information received. 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.

During 2012 the Group was impacted by significant losses in relation to Sandy. Management's current best estimate of the ultimate net loss in relation to this event is $44.5 million. The 90th percentile of the loss distribution for this estimate is $53.3 million with the 95th percentile being $56.3 million. Significant uncertainty exists on the eventual ultimate loss.

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 $119.0 million. The 90th percentile of the loss distribution for this estimate is $131.5 million with the 95th percentile being $135.8 million. Significant uncertainty exists on the eventual ultimate losses in relation to this event.

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

	Sandy $m	Japan $m
Net ultimate losses as at 31 December 2010	**–**	**–**
Change in insurance losses and loss adjustment expenses	–	119.2
Change in insurance losses and loss adjustment expenses recoverable	–	–
Change in reinstatement premium	–	(1.9)
Net ultimate losses as at 31 December 2011	**–**	**117.3**
Change in insurance losses and loss adjustment expenses	46.0	3.7
Change in insurance losses and loss adjustment expenses recoverable	–	–
Change in reinstatement premium	(1.5)	(2.0)
Net ultimate losses as at 31 December 2012	**44.5**	**119.0**

13. Insurance, reinsurance and other receivables

All receivables are considered current other than $37.2 million (2011 – $28.0 million) of inwards premiums receivable related to multi-year contracts. The carrying value approximates fair value due to the short-term nature of the receivables. There are no significant concentrations of credit risk within the Group's receivables.

14. Deferred acquisition costs 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 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**
Net deferral during the year	136.8	(10.9)	125.9
Income (expense) for the year	(130.2)	10.8	(119.4)
As at 31 December 2012	**68.0**	**(0.8)**	**67.2**

15. Deferred tax asset

	2012 $m	2011 $m
Deferred tax assets (related to equity based compensation)	9.5	10.1
Deferred tax liabilities (related to claims equalisation reserves)	(2.2)	(1.9)
Net deferred tax asset	**7.3**	**8.2**

A deferred tax credit of $0.2 million (2011 – $2.4 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 2013 and subsequent years to utilise the deferred tax assets recognised when the underlying temporary differences reverse.

A deferred tax asset has not been recognised in relation to unused tax losses carried forward in the ultimate parent undertaking, as at present, the related tax benefit is not expected to be realised through future taxable profits.

The UK government has announced its intent to legislate to reduce the rate of corporation tax to 21.0 per cent with effect from 1 April 2014. It is estimated that the effect of these changes will be to reduce the company's deferred tax asset by approximately $0.6 million.

All deferred tax assets and liabilities are classified as non-current.

16. Investment in associates

AHL

The Group has a commitment of up to $50.0 million representing a 20 per cent 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. As at 31 December 2012 $41.1 million of the commitment had been called. As at 31 December 2012 the carrying value of the Group's investment in AHL is $49.7 million (31 December 2011 – $50.9 million). The Group's share of comprehensive income for AHL for the period was $7.7 million (2011 – $0.9 million). Investments in associates are generally deemed non-current. Key financial information for AHL is as follows:

	2012 $m	2011[(1)] $m
Assets	272.5	260.1
Liabilities	26.0	5.8
Shareholders' equity	246.5	39.1
Amounts advanced in respect of shares to be issued	–	215.2
Gross premiums earned	66.6	6.6
Comprehensive income	36.7	4.3

(1) From the date of incorporation, 1 June 2011, to 31 December 2011.

Refer to note 25 for details of transactions between the Group, AHL and ARL.

SHL

In 2012 the Group invested $32.4 million representing a 20 per cent interest in the common shares of SHL, a company incorporated in Bermuda. SHL's operating subsidiary, SRL, is authorised as a Special Purpose Insurer by the BMA. SRL is a market facing vehicle underwriting a combined exposure ultimate net loss aggregate reinsurance product. SRL commenced writing insurance business at 1 January 2013. Subsequent to year end $22.9 million of capital was returned by SHL to the Group. See note 28 for details. Financial information for the period from the date of incorporation, 29 October 2012, to 31 December 2012 is as follows:

	$m
Assets	192.3
Shareholders' equity	192.3

17. Property, plant and equipment

	2012 $m	2011 $m
Cost	12.9	12.6
Accumulated depreciation	(10.1)	(7.3)
Net book value	**2.8**	**5.3**

18. Insurance liabilities

	Unearned premiums $m	Other payables $m	Total $m
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**
Net deferral for prior years	(271.4)	–	(271.4)
Net deferral for current year	267.6	–	267.6
As at 31 December 2012	**343.3**	**23.5**	**366.8**

19. Insurance, reinsurance and other payables

	2012 $m	2011 $m
Other payables	47.4	84.9
Accrued interest payable	1.9	0.3
Total other payables	**49.3**	**85.2**
Insurance contracts – other payables	23.5	23.5
Amounts payable to reinsurers	30.6	17.8
Total payables	**103.4**	**126.5**

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.

20. Long-term debt and financing arrangements

Long-term debt

On 5 October 2012 the Group launched and priced an offering of U.S. $130 million 5.70 per cent senior unsecured notes due 2022 pursuant to a private offering to U.S. Qualified Institutional Buyers. Interest on the principal is payable semi-annually. The notes were listed and admitted to trading on the LSE on 16 October 2012.

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 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 per cent, 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 per cent, 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 due 2035.

The carrying values of the notes are shown below:

As at 31 December	2012 $m	2011 $m
Long-term debt $130.0 million	130.0	–
Long-term debt $97.0 million	97.0	97.0
Long-term debt €24.0 million	31.7	31.0
Carrying value	**258.7**	**128.0**

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 96 and 97.

The fair value of the long-term debt is estimated as $252.9 million (2011 – $108.4 million). The fair value is estimated by reference to similar financial instruments quoted in active markets.

The interest accrued on the long-term debt was $1.9 million (2011 – $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.

20. Long-term debt and financing arrangements continued

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 96 for further details. The Group has the right to net settle these instruments.

The net fair value position owed by the Group on the swap agreements is $8.0 million. Further information is provided on pages 93 and 96. 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 $0.6 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 2012:

(i) a $350.0 million syndicated collateralised credit facility with $75.0 million loan sub-limit that has been in place since 5 April 2012 and will expire on 5 April 2017. There was no outstanding debt under this facility at 31 December 2012; and

(ii) 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.

The Group's $200.0 million bi-lateral collateralised credit facility with Lloyds TSB Bank PLC and the Group's $200.0 million syndicated collateralised credit facility were terminated on 5 April 2012.

The terms of the $350.0 million LOC facility include standard default and cross-default provisions which require certain covenants to be adhered to. These include the following:

(i) an A.M. Best financial strength rating of at least B++; and

(ii) a maximum debt to capital ratio of 30 per cent, where the subordinated loan notes due in 2035 are 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	2012 $m	2011 $m
Issued to third parties	17.2	9.4

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.

On 5 December 2012 LICL was approved as a Trusteed Reinsurer in the state of New York and established an MBRT to collateralise its insurance and reinsurance liabilities associated with U.S. domiciled clients. The MBRT is subject to the rules and regulations of the state of New York and the respective deed of trust. These rules and regulations include minimum capital funding requirements, investment guidelines, capital distribution restrictions and regulatory reporting requirements.

As at and for the years ended 31 December 2012 and 2011 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:

	2012		2011	
As at 31 December	Cash and cash equivalents $m	Fixed income securities $m	Cash and cash equivalents $m	Fixed income securities $m
MBRT accounts	–	20.2	–	–
In various other trust accounts for policyholders	12.5	123.6	14.6	166.0
In favour of letters of credit	3.3	17.0	0.3	10.3
In favour of derivative contracts	–	0.4	0.9	0.5
Total	**15.8**	**161.2**	**15.8**	**176.8**

21. Share capital

Allocated, called up and fully paid	Number	$m
As at 31 December 2010, 2011 and 2012	**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 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**
Shares distributed	(1,801,510)	(11.1)	(2,848,168)	(33.2)	(4,649,678)	(44.3)
Shares donated to trust	(2,901,233)	(17.4)	2,901,233	35.8	–	18.4
As at 31 December 2012	**5,810,583**	**40.7**	**1,320,486**	**16.4**	**7,131,069**	**57.1**

The number of common shares in issue with voting rights (allocated share capital less shares held in treasury) as at 31 December 2012 was 162,791,844 (31 December 2011 – 158,089,101).

Share repurchases
At the AGM held on 3 May 2012 the Group's shareholders approved a renewal of the Repurchase Programme authorising the repurchase of a maximum of 16,860,242 shares, with such authority to expire on the conclusion of the 2013 AGM or, if earlier, fifteen months from the date the resolution approving the Repurchase Programme was passed.

The Group has not utilised its Repurchase Programme since 16 September 2010. As at all reporting periods the maximum number of shares under the Group's Repurchase Programme remained to be purchased and no amounts remained to be settled.

In 2012 the trustees of the EBT acquired nil shares (2011 – nil) in accordance with the terms of the trust and distributed 2,848,168 (2011 – 3,497,027). There were no unsettled balances in relation to EBT purchases at either balance sheet date.

21. Share capital continued

Dividends

The Board of Directors have authorised the following dividends:

Type	Per share amount	Record date	Payment date	$m
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	15 Dec 2011	152.0
Final	$0.10	16 Mar 2012	18 Apr 2012	19.2
Interim	$0.05	30 Aug 2012	26 Sep 2012	9.6
Special	$0.90	30 Nov 2012	19 Dec 2012	172.6

22. 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 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**
Exercised	(2,956,648)	–	–
Outstanding and exercisable as at 31 December 2012	**19,803,572**	**648,143**	**2,350,000**
Weighted average exercise price as at 31 December 2012	**$5.00**	**$4.73**	**$5.00**

	2012	2011
Weighted average remaining contractual life	3.0 years	4.0 years
Weighted average share price at date of exercise during the year	$12.47	$10.64

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

23. Lease commitments

The Group has payment obligations in respect of operating leases for certain items of office equipment and office space. Operating lease expenses for the year were $2.3 million (2011 – $1.8 million). Future minimum lease payments under non-cancellable operating leases are as follows:

	2012 $m	2011 $m
Due in less than one year	2.5	2.4
Due between one and five years	3.4	5.6
Total	**5.9**	**8.0**

24. Earnings per share

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

	2012 $m	2011 $m
Profit for the year attributable to equity shareholders	234.9	212.2

	2012 Number of shares	2011 Number of shares
Basic weighted average number of shares	159,575,802	154,339,421
Dilutive effect of RSS	4,278,094	5,088,005
Dilutive effect of LTIP	123,444	269,355
Dilutive effect of warrants	18,194,380	17,754,552
Diluted weighted average number of shares	**182,171,720**	**177,451,333**

Earnings per share	2012	2011
Basic	$1.47	$1.38
Diluted	$1.29	$1.20

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.

25. Related party disclosures

The consolidated financial statements include LHL and the entities listed below:

Name	Domicile
Subsidiaries	
LICL	Bermuda
SML	Bermuda
LIHL	United Kingdom
LUK	United Kingdom
LIMSL	United Kingdom
LISL	United Kingdom
LMSCL	Canada
LMEL	United Arab Emirates
Associates	
AHL	Bermuda
SHL	Bermuda
Other controlled entities	
LHFT	United States
EBT	Jersey

All subsidiaries are wholly owned, either directly or indirectly.

25. Related party disclosures continued

The Group has issued subordinated loan notes via a trust vehicle – LHFT, refer to note 21. The Group effectively has 100 per cent 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 2012, the Group had made advances of $10.3 million (2011 – $4.0 million) to the EBT under the terms of the Facility.

During the year ended 31 December 2012 the Group donated 2,901,233 (2011 – 4,028,423) treasury shares to the EBT at the prevailing market rate. The total value of the treasury share donation was $35.8 million (2011 – $40.8 million).

LICL holds $298.1 million (2011 – $311.5 million) of cash and cash equivalents and fixed income securities in trust for the benefit of LUK relating to intra-group reinsurance agreements.

In 2012 the Group completed the process of liquidating its LMEL subsidiary and ceased all LMEL operations.

Key management compensation

Remuneration for key management, the Group's Executive and Non-Executive Directors, was as follows:

For the year ended 31 December	2012 $m	2011 $m
Short-term compensation	13.7	7.8
Equity based compensation	7.4	6.0
Directors' fees and expenses	1.7	2.4
Total	**22.8**	**16.2**

The Directors' fees and expenses includes $0.4 million (2011 – $0.9 million) paid to significant founding shareholders. Non-Executive Directors, with the exception of Neil McConachie, 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. Neil McConachie left the company as an employee on 30 June 2012, relinquishing his executive responsibilities and became a Non-Executive Director effective 1 July 2012. He is able to exercise previously granted RSS awards when they have vested and subject to performance conditions being met, provided he remains a Non-Executive Director.

Transactions with a shareholder

During 2011 two of the Group's Executive Directors sold management team ordinary warrants to an external buyer who has a 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 Lancashire Foundation

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

Date	$m
3 November 2011	1.3
7 November 2012	1.4

Transactions with associates

On 18 January 2012, following the 1 January 2012 property retrocession renewals and resulting capital requirements in ARL, AHL returned previously called capital requirements to the Group in the amount of $14.9 million. Subsequently, $6.0 million of capital calls were made during the year, for a net return of capital from AHL for the period of $8.9 million (31 December 2011 – investment in AHL of $50.0 million).

In relation to transactions with ARL, the following amounts were included in the consolidated statement of comprehensive income and the consolidated balance sheet:

As at 31 December	2012 $m	2011 $m
Consolidated statement of comprehensive income		
Outwards reinsurance premiums	64.8	12.2
Insurance loss and loss adjustment expenses recoverable	17.7	–
Insurance acquisition expenses ceded	9.0	1.5
Consolidated balance sheet		
Reinsurance recoveries	17.7	–
Unearned premiums on premiums ceded	3.5	5.5
Amounts payable to reinsurers	(18.4)	(2.7)
Deferred acquisition costs ceded	(0.6)	(0.7)

Contingent profit commission may be payable to the Group depending on the ultimate performance of ARL.

During 2012 SML entered into and underwriting services agreement with SRL and SHL to provide various services relating to underwriting, actuarial, premium payments and relevant deductions, acquisition expenses and receipt of claims.

During the year ended 31 December 2012 the Group did not enter any financial transactions with SHL apart from its initial investment discussed in note 16. In late 2012 SML entered into an underwriting services agreement with SRL and SHL to provide various underwriting and related services.

26. Non-cash transactions

TBAs classified as derivatives were settled net during the year with purchases and sales of $32.6 million (2011 – $4.8 million) and $32.6 million (2011 – $4.8 million) respectively.

27. 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 shareholders' equity due to certain items that are capitalised under IFRS but expensed or have a different valuation basis for regulatory reporting, or are not admitted under insurance regulations.

Annual statutory capital and surplus reported to regulatory authorities by the primary operating entities is as follows:

	2012		2011	
As at 31 December	LICL $m	LUK £m	LICL $m	LUK £m
Statutory capital and surplus	1,293.8	115.3	1,132.2	145.1
Minimum required statutory capital and surplus	255.5	23.8	250.5	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 per cent of relevant liabilities. As at 31 December 2012 and 2011 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 2012 and 2011 the capital requirements of both regulatory jurisdictions were met.

28. Subsequent events

Dividend
On 20 February 2013 the Board of Directors declared the payment of an ordinary dividend of $0.10 per common share and a special dividend of $1.05 per share to shareholders of record on 22 March 2013, with a settlement date of 17 April 2013. The ordinary dividend payable will be approximately $19.1 million and the special dividend payable will be approximately $200.9 million. An amount equivalent to the dividend accrues on all RSS options and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

Return of capital from associate
On 5 February 2013 SHL returned previously called capital requirements to the Group in the amount of $22.9 million.

Shareholder information

Annual General Meeting

The Company's AGM is scheduled for 1 May 2013. 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 Chris Head, Company Secretary at Lancashire Holdings Limited, Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, United Kingdom, Tel: + 44 (0) 20 7264 4000 and email: chris.head@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 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; the effectiveness of our loss limitation methods; 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 for issuers of fixed income investments; the impact of swings in market interest rates and securities prices; 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 Bermudian subsidiary becoming subject to income taxes in the United Kingdom; the UK temporary period exemption under the CFC regime failing to remain in force for the period intended; the inapplicability to the Group of suitable exclusions from the new UK CFC regime; any change in the UK government or the UK government policy which impacts the new CFC regime; and the negative impact in any material way of the change in tax residence of the Company on its stakeholders. 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 are influenced by complex factors. We caution as to the preliminary nature of the information used to prepare such estimates as subsequently available information may contribute to an increase in these types of losses.

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

AIM
A sub-market of the LSE

AIR
AIR Worldwide

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 UK 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

CFC
Controlled Foreign Company

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

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

FPSO
Floating Production Storage and Offloading vessel

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

HMRC
Her Majesty's Revenue & Customs

ICA
Individual capital assessment

ICG
Individual capital guidance

IFRIC
International Financial Reporting Interpretations Committee

IFRS
International Financial Reporting Standard(s)

Industry loss warranty (ILW)
A type of reinsurance or derivative contract through which one party will purchase protection based on the total loss arising from an event to the entire insurance industry rather than their own losses.

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 charity registered in England and Wales

Lancashire UK group of companies
Includes LHL, LUK, LIHL, LISL and LIMSL

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 Marketing Services (Middle East) Limited

LMSCL
Lancashire Management Services (Canada) 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

MBRT
Multi-beneficiary reinsurance trust

NBS
New Bridge Street (a brand of Aon Hewitt Limited)

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 and 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

PML
Probable maximum loss

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

Retrocession
The reinsurance of the reinsurance account

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

RDS
Realistic Disaster Scenarios

RPI
Renewal Price Index

RMS
Risk Management Solutions

RRC
Risk and Return Committee

RSS
Restricted share scheme

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.

SHL
Saltire Holdings I Limited

SML
Saltire Management Limited

SRL
Saltire Re I Limited

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

UMCC
Underwriting and Marketing Conference Call

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

UNL
Ultimate net loss

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

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