LANCASHIRE HOLDINGS LIMITED

GROWTH IN FULLY CONVERTED BOOK VALUE PER SHARE, ADJUSTED FOR DIVIDENDS, OF 3.7% IN Q4 2013, 18.9% IN 2013
COMBINED RATIO OF 71.4% IN Q4 2013, 70.2% IN 2013
COMPLETION OF PURCHASE OF CATHEDRAL GROUP 7 NOVEMBER 2013
SPECIAL DIVIDEND OF $0.20 PER COMMON SHARE
FINAL ORDINARY DIVIDEND OF $0.10 PER COMMON SHARE
FULLY CONVERTED BOOK VALUE PER SHARE OF $7.50 AT 31 DECEMBER 2013

13 February 2014
London, UK

Lancashire Holdings Limited ("Lancashire" or "the Group") today announces its results for the fourth quarter of 2013 and the year ended 31 December 2013.

Financial highlights

	As at 31 Dec 2013	**As at 31 Dec 2012**
Fully converted book value per share	**$7.50**	**$7.83**
Return on equity* – Q4	**3.7%**	**3.1%**
Return on equity* – YTD	**18.9%**	**16.7%**
Operating return on average equity – Q4	**3.4%**	**2.8%**
Operating return on average equity – YTD	**12.5%**	**15.3%**
Special dividends per common share**	**$0.65**	**$1.95**

* Return on equity is defined as growth in fully converted book value per share, adjusted for dividends.
** See "Dividends" below for Record Date and Dividend Payment Date.

Financial highlights:

	Three months ended		**Year ended**	
	31 Dec 2013	**31 Dec 2012**	**31 Dec 2013**	**31 Dec 2012**
Highlights ($m)				
Gross premiums written	130.8	96.0	679.7	724.3
Net premiums written	128.3	100.7	557.6	576.1
Profit before tax	55.2	51.7	218.1	236.8
Profit after tax***	63.0	52.4	222.5	234.9
Comprehensive income***	60.2	48.4	190.0	252.7
Net operating profit***	51.5	43.6	184.2	220.3
Per share data				
Diluted earnings per share	$0.31	$0.28	$1.17	$1.29
Diluted earnings per share – operating	$0.25	$0.23	$0.97	$1.21
Financial ratios				
Total investment return	0.3%	0.3%	0.3%	3.1%
Net loss ratio	29.5%	41.3%	33.1%	29.9%
Combined ratio	71.4%	71.9%	70.2%	63.9%
Accident year loss ratio	34.6%	30.9%	36.1%	34.6%

*** These amounts are attributable to Lancashire and exclude non-controlling interests.

Richard Brindle, Group Chief Executive Officer, commented:

"I am pleased to report a strong close to an exciting year in Lancashire's history. RoE of 3.7% for the quarter and 18.9% for the full year are good results. The special dividend we have announced today reinforces our pledge that our commitment to capital management has not changed. But for Lancashire, 2013 has seen the most dramatic changes in our history. We have broadened our platforms, our core portfolio lines and our reinsurance purchasing capabilities, but without compromising our business model or our focus on underwriting.

There is a lot of gloom about the state of the market. But there is some truth in the old view that good underwriters prefer a soft market. In a hard market the benefits of superior risk selection and a focus on risk-adjusted return are cancelled out by the broad spread of strong pricing. In a soft market the strong underwriting franchises differentiate themselves. We can select the right clients and attachment points in a programme. We have a solid core portfolio but have the discipline to let go of under-priced, opportunistic business. And through the judicious use of reinsurance we can improve the risk-adjusted portfolio returns even when pricing is under pressure.

So whilst it might be an exaggeration to say that we relish the prospect of the coming year, we don't mind hard work, and we think our business model has evolved to cope very well with the softening market. And let's remember that although rates are undoubtedly coming down, they're doing so from what are historically high levels in much of our business.

There are also signs that the panic that affected some commentators who foresaw decimation of the traditional markets was overdone. Many of our clients understand the value of the superior policy features offered by traditional markets like reinstatements and multi-year capacity. They know that relationships are based on an understanding that claims are often a process of negotiation based on detailed policy understanding, which goes beyond the ability to model an output.

So for much of the portfolio there are real barriers to entry, based on product design which make rated capital a better fit for the client. But even in U.S. catastrophe reinsurance, where alternative capital has made the most inroads, it's not all one way traffic. For example, if we look at Cathedral's U.S. mutual portfolio where John Hamblin and Nick Destro's client relationships stretch back as far as twenty years, the penetration of alternative capital is close to, if not actually, zero.

Our own permanent vehicle for third party capital, Kinesis, has made a good start deploying over $252 million of limit at 1 January 2014. Darren Redhead's team has developed a bespoke product combining risk and catastrophe exposures, that offers real benefits to clients on tail risk mitigation. In addition, Lancashire Insurance Company Limited ("LICL") and Lancashire Insurance Company (UK) Limited ("LUK") continue to find new business opportunities such as energy liability, terrorism and obligors to complement the solid core portfolios in offshore energy, aviation and marine.

So we don't share the gloomy outlook. With our three platforms comprising our permanent reinsurance asset management business in Kinesis, our top-performing Lloyd's business in Cathedral and our leading specialist insurance and reinsurance businesses in Lancashire, together with our sound business model and outstanding team, we believe that we can navigate a course through this market, and indeed the next hard market when that comes."

Elaine Whelan, Group Chief Financial Officer, commented:

"Our acquisition of the Cathedral Group completed on 7 November 2013. Lancashire, as a combined group, produced a RoE of 3.7% for the quarter and 18.9% for the year. The quarter included two months of Cathedral's performance, but also our adjustments for acquisition accounting and contingent advisory fees. The one-off adjustments were largely offsetting, so the RoE for the quarter for Lancashire was approximately 3.2%, with Cathedral adding approximately 0.5%. As we highlighted in the third quarter, the Group also benefited from our equity issuance and hedging activities – these contributed approximately 6% to our RoE for the year.

Ignoring the one-off impacts, the Group had a reasonable quarter with no notable losses reported, and Cathedral's results were in line with prior year performance and expectations. Our investment portfolio produced a small positive return, driven by strong performance in our bank loan and emerging market debt portfolios.

We are continuing to re-balance our capital requirements as a combined Group and work on re-structuring our capital base is ongoing. A large part of that has already been completed, however, and we are therefore able to top up the special dividend we declared last quarter with a further special dividend, plus the related dividend equivalent payments, of approximately $43 million. With the special dividend declared in November, combined with our interim and final ordinary dividends for this financial year, we have now returned 88.4% of comprehensive income for the year and 93.3% of comprehensive income since inception. While pricing is declining in some areas of our portfolio, our overall outlook remains reasonable and we will continue to review opportunities as a combined group and refine our capital position accordingly."

Cathedral

The Cathedral acquisition completed on 7 November 2013. Results for Cathedral have been included in Lancashire's Group results, as the Lloyd's segment, from that date. For information only, our fourth quarter 2013 financial supplement includes proforma financial statements for Cathedral for the year ended 31 December 2013 by quarter and by underwriting segment.

Lancashire Renewal Price Index for major classes

Lancashire's Renewal Price Index ("RPI") is an internal methodology that management uses to track trends in premium rates on a portfolio of insurance and reinsurance contracts. The RPI is calculated on a per contract basis and reflects Lancashire's assessment of relative changes in price, terms, conditions and limits on like for like renewals only, and is weighted by premium volume (see "Note Regarding RPI Methodology" at the end of this announcement for further guidance). The RPI does not include new business and only covers business written by Lancashire, excluding the Lloyd's segment, to offer a consistent basis for analysis. The following RPIs are expressed as an approximate percentage of pricing achieved on similar contracts written in 2012:

Class	**Year 2013**	**Q4 2013**	**Q3 2013**	**Q2 2013**	**Q1 2013**
Aviation (AV52)	89%	86%	91%	94%	86%
Gulf of Mexico energy	97%	92%	91%	97%	96%
Worldwide offshore energy	97%	89%	94%	98%	99%
Marine	104%	97%	99%	100%	110%
Property retrocession and reinsurance	97%	98%	87%	98%	98%
Terrorism	95%	91%	97%	96%	96%
Combined	**97%**	**90%**	**92%**	**97%**	**98%**

Underwriting results

Gross premiums written

	Q4				YTD			
	2013 $m	**2012 $m**	**Change $m**	**Change %**	**2013 $m**	**2012 $m**	**Change $m**	**Change %**
Property	42.7	33.6	9.1	27.1	333.4	356.5	(23.1)	(6.5)
Energy	34.0	25.3	8.7	34.4	209.9	240.9	(31.0)	(12.9)
Marine	10.6	15.4	(4.8)	(31.2)	63.0	81.0	(18.0)	(22.2)
Aviation	19.0	21.7	(2.7)	(12.4)	48.9	45.9	3.0	6.5
Lloyd’s	24.5	-	24.5	-	24.5	-	24.5	-
Total	**130.8**	**96.0**	**34.8**	**36.3**	**679.7**	**724.3**	**(44.6)**	**(6.2)**

Gross premiums written increased by 36.3% in the fourth quarter of 2013 compared to the same period in 2012. In 2013 gross premiums written decreased by 6.2% compared to 2012. The Group’s five principal segments and the key market factors impacting them are discussed below.

Property gross premiums written increased by 27.1% for the quarter compared to the same period in 2012 and decreased by 6.5% in 2013 compared to 2012. We continued to see increased deal flow in the political and sovereign risk book in the fourth quarter along with some new opportunities in our terrorism book. For the year, the reduction in property premiums written is primarily due to the reduction of our property retrocession book and our decision to cease writing property direct and facultative business from 1 July 2012. For the year, these reductions have been somewhat offset by the writing of new business with core clients in the political and sovereign risk class, which also offset the non-renewal of long-term deals written in these classes in the previous year. While certain opportunistic property catastrophe deals written in 2012 were not renewed in 2013, as they were no longer required, the premium was largely replaced by new business as capital was redeployed from property retrocession and property direct and facultative. With this expansion, property catastrophe premiums year on year were therefore broadly flat.

Energy gross premiums written for the quarter increased by 34.4% compared to the same period in 2012 and decreased by 12.9% in 2013 compared to 2012. Although the fourth quarter is not a major renewal period for the energy book a few new business deals were written across the class resulting in an increase in premiums compared to the fourth quarter of 2012. The decrease in premiums for the year is mostly driven by the Gulf of Mexico book, where a number of deals that were written on a multi-year basis in the second quarter of 2012 are not up for renewal yet. During 2013 we continued the expansion of a new sub class – energy liabilities – with $8.8 million of new business premiums written this year.

Marine gross premiums written decreased by 31.2% for the quarter compared to the same period in 2012 and by 22.2% in 2013 compared to 2012. The decrease in both the quarter and year premium volumes across all the marine classes is primarily due to the timing of non-annual contract renewals.

Aviation gross premiums written decreased by 12.4% for the quarter compared to the same period in 2012 and increased by 6.5% in 2013 compared to 2012. Pricing and renewal rates remain under pressure in the AV52 class resulting in a reduction in premiums in both the fourth quarter and 2013 compared to the same periods of 2012. For the year these reductions are offset by new satellite premium written following our re-entry into the class in the third quarter of 2012.

The Lloyd’s segment includes premiums written by Cathedral from the date of acquisition. The fourth quarter is not a major renewal period for Cathedral. The largest contributor was the property direct and facultative line of business.

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Ceded reinsurance premiums increased by $7.2 million, or 153.2%, for the fourth quarter of 2013 and decreased by $26.1 million, or 17.6%, for the year ended 2013, in each case compared to the same periods in 2012. The fourth quarter is not a major renewal season for the Group's reinsurance programme and most of the spend in the quarter related to programme adjustments and facultative covers. The fourth quarter of 2013 also included $1.7 million of ceded premium for the new Lloyd's segment. The fourth quarter of 2012 included ceded reinstatement premium reductions relating to the Thailand flood losses.

Total cessions to the Accordion sidecar were $47.9 million in 2013 versus $64.8 million in 2012. The overall decrease in ceded reinsurance premiums for the year is therefore predominantly due to reduced cessions to the Accordion vehicles. The remainder of the decrease was driven by reduced reinstatement premiums on the Group's marine and energy cover plus reduced use of alternative covers given declining underlying exposures. Rate changes and a restructuring of our marine and energy cover in 2013 largely offset each other in premium terms, and while we did not renew our property programme the reduced spend on that was almost entirely offset by an increase in facultative covers purchased.

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Net premiums earned as a proportion of net premiums written were 135.3% in the fourth quarter of 2013 compared to 146.1% in the same period in 2012 and 101.9% in 2013, compared to 101.1% in 2012. The fourth quarter of 2013 includes a higher proportion of multi-year deals written in the political and sovereign risk and terrorism books than in the same period of 2012. Both years benefited from the lag in earnings from long-term contracts written in preceding years.

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The Group's net loss ratio for the fourth quarter of 2013 was 29.5% compared to 41.3% for the same period in 2012 and 33.1% for 2013 compared to 29.9% for 2012. The fourth quarter of 2013 includes the Lloyd's segment incurred losses from the date of acquisition. The fourth quarter 2013 net loss ratio was driven by a low level of reported losses somewhat offset by some adverse development in the energy line of business. This compared with the $44.5 million Sandy loss and $19.4 million adverse development on the Thailand flood loss, after reinsurance and reinstatement premiums, in the same period of 2012. Net losses attributable to the Lloyd's segment totalled $19.0 million of attritional losses. The Lloyd's segment's loss ratio for the period since the acquisition date was 47.7%.

The twelve months to 31 December 2013 were impacted by a number of energy losses and developments, the European hail and flood events, and adverse development on the Costa Concordia marine loss. The net loss to the Group from the European hail and floods, after reinsurance and reinstatement premiums, was $20.7 million. The net adverse development on the Costa Concordia marine loss in 2013 was $37.9 million, after reinsurance and reinstatement premium. In the twelve months to 31 December 2012 we recorded a total estimated net loss of $103.7 million, after reinsurance and reinstatement premium, in respect of the Costa Concordia and Sandy losses. At year end 2013, our total estimated net loss, after reinsurance and reinstatement premiums, for the Costa Concordia loss was $97.1 million and for the Sandy loss was $30.7 million.

Prior year favourable development for the fourth quarter was $8.2 million, compared to $15.1 million of adverse development for the fourth quarter of 2012. The fourth quarter of 2012 included adverse development of $19.4 million for the Thailand flood losses. Favourable development was $15.9 million for 2013, compared to $27.4 million for 2012, with 2013 impacted significantly by the adverse development on the Costa Concordia marine loss in the second quarter. Both years otherwise experienced releases due to lower than expected reported losses, with 2012 having exceptionally low reported losses.

The following tables show the impact of prior year development and large losses on the Group's loss ratio:

	Q4 2013		Year 2013	
	Losses $m	**Loss Ratio %**	**Losses $m**	**Loss Ratio %**
At 31 December	51.2	29.5	188.1	33.1
Absent Europe hail & flood	50.2	28.9	167.2	29.4
Absent Costa Concordia	51.0	29.4	154.6	27.0
Absent remaining prior year development	59.6	34.3	237.5	41.8
Adjusted losses and ratio	**58.4**	**33.6**	**183.1**	**32.0**

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

	Q4 2012		Year 2012	
	Losses $m	**Loss Ratio %**	**Losses $m**	**Loss Ratio %**
At 31 December	60.7	41.3	174.1	29.9
Absent Costa Concordia	60.7	41.3	128.3	21.5
Absent Sandy	14.7	10.1	128.1	22.0
Absent prior year development	45.6	31.0	201.5	34.6
Adjusted losses and ratio	**(0.4)**	**0.3**	**109.7**	**18.7**

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

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

	Q4		Year	
	2013 $m	**2012 $m**	**2013 $m**	**2012 $m**
Property	0.8	(25.7)	13.2	(36.0)
Energy	(2.9)	7.6	18.4	37.4
Marine	1.2	3.0	(23.4)	25.9
Aviation	-	-	(1.4)	0.1
Lloyd's	9.1	-	9.1	-
Total	**8.2**	**(15.1)**	**15.9**	**27.4**

Note: Positive numbers denote favourable development.

The accident year loss ratio for the fourth quarter of 2013 was 34.6% compared to 30.9% for the same period in 2012. The accident year loss ratio was 36.1% for 2013 compared to 34.6% for 2012. 2013 included 3.7% for the European hail and flood losses while the 2012 accident year loss ratio included 8.5% for the Costa Concordia loss and 7.8% for Sandy. Otherwise both years experienced relatively low levels of reported losses.

Excluding the impact of foreign exchange revaluations, previous accident years' ultimate losses developed as follows during 2013 and 2012:

	Year ended 31 Dec 2013 $m	**Year ended 31 Dec 2012 $m**
2006 accident year and prior	(0.7)	0.4
2007 accident year	(0.9)	2.3
2008 accident year	(4.1)	1.7
2009 accident year	2.0	7.1
2010 accident year	1.4	6.4
2011 accident year	(4.1)	9.5
2012 accident year	22.3	-
Total	**15.9**	**27.4**

Note: Positive numbers denote favourable development.

The ratio of IBNR to total net loss reserves was 31.8% at 31 December 2013 compared to 28.1% at 31 December 2012.

Investments

Net investment income, was $6.7 million for the fourth quarter of 2013, a decrease of 16.3% from the fourth quarter of 2012. Net investment income was $25.4 million for 2013, a decrease of 21.8% compared to 2012. Average book yields over the quarter and year were lower than the same periods in 2012. Total investment return, including net investment income, net other investment income, net realised gains and losses, impairments and net change in unrealised gains and losses, was $6.6 million for the fourth quarter of 2013 compared to $7.1 million for the fourth quarter of 2012, and was $6.9 million for 2013 compared to $62.8 million for 2012. Treasury yields and credit spreads increased in the first half of 2013, which had a significantly detrimental impact on our portfolio, and in particular on our emerging market debt portfolio. However, the tail risk hedge implemented in the first half of the year softened the impact somewhat. In the second half of the year, strong returns in our bank loan and emerging market debt portfolios combined with significant credit spread narrowing in the rest of our fixed income portfolio, particularly in the fourth quarter, offset the losses of the first half of the year. Our portfolio therefore produced a marginally positive return for the year. In the corresponding periods of 2012 our portfolio benefited from significant credit spread tightening, particularly in the emerging market debt portfolio.

Currently 2.2% of the portfolio is allocated to the emerging market debt portfolio with an overall average credit quality of BBB. The corporate bond allocation represented 29.7% of managed invested assets at 31 December 2013 compared to 32.2% at 31 December 2012. At 31 December 2013 the Group's allocation to bank loans represented 4.5% of the portfolio. The allocation to bank loans, along with our tail risk hedge, is part of our interest rate risk management strategy to protect the fixed income portfolio from a significant increase in interest rates.

The managed portfolio was as follows:

	As at 31 Dec 2013	**As at 31 Dec 2012**
Fixed income securities	84.4%	88.9%
Cash and cash equivalents	14.7%	11.1%
Equity securities	0.7%	-
Other investments	0.2%	-
Total	**100.0%**	**100.0%**

Key investment portfolio statistics are:

	As at 31 Dec 2013	As at 31 Dec 2012
Duration	1.0 years	1.8 years
Credit quality	AA-	AA-
Book yield	1.4%	1.8%
Market yield	1.2%	1.1%

Lancashire Capital Management

The share of profit of associates of $0.5 million for the fourth quarter of 2013 and $9.2 million for 2013 reflects Lancashire's 20% equity interest in the Accordion vehicles and 16.9% interest in the Saltire vehicle. The share of profit of associates was $3.3 million for the fourth quarter of 2012 and $7.7 million for 2012 and related entirely to the Accordion vehicle.

Kinesis Capital Management Limited ("KCM") has now underwritten its first tranche of multi-class reinsurance agreements on behalf of Kinesis Reinsurance I Limited, incepting on or around 1 January 2014. All contracts are fully collateralised with combined aggregate limits of approximately $252 million. Lancashire contributed 10% of the capital raised by Kinesis Holdings I Limited.

Other operating expenses

Operating expenses consist of the following items:

	Q4		Year	
	2013 $m	**2012 $m**	**2013 $m**	**2012 $m**
Employee salaries and benefits	11.7	8.8	37.3	36.0
Employment taxes on equity compensation	2.0	(0.2)	4.2	10.9
Other operating expenses	13.4	7.3	36.2	31.5
Total Lancashire, excluding Lloyd's segment	**27.1**	**15.9**	**77.7**	**78.4**
Lloyd's segment	7.3	-	7.3	-
Total	**34.4**	**15.9**	**85.0**	**78.4**

Employee remuneration costs were $2.9 million higher in the fourth quarter of 2013 compared to the same period in the prior year as a result of the timing of variable compensation expense adjustments. The fourth quarter of 2012 included a reversal of employee national insurance accruals in relation to equity compensation exercises, given the actual timing of exercises versus expectations. The first quarter of 2012 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 with effect from 1 January 2012. Other operating expenses for the fourth quarter of 2013 included legal and advisory fees for the Cathedral acquisition and the structuring of Kinesis.

The Lloyd's segment includes $1.2 million of employee remunerations costs and $6.1 million of other operating expenses incurred since the acquisition date.

Equity based compensation was $4.9 million in the fourth quarter of 2013 compared to $3.9 million in the same period last year. For 2013 and 2012, the charge was $16.7 million and $16.4 million respectively. The equity based compensation charge is driven by the anticipated vesting level of the active awards based on current performance expectations.

Capital

At 31 December 2013, total capital available to Lancashire was $1.792 billion, comprising shareholders' equity of $1.460 billion and $332.3 million of long-term debt. Tangible capital was $1.615 billion. Leverage was 18.5% on total capital and 20.6% on total tangible capital. Total capital and total tangible capital at 31 December 2012 was $1.646 billion.

Dividends

The Lancashire Board declared the following dividends during 2013:

- A final dividend in respect of 2012 of $0.10 per common share;
- An interim dividend of $0.05 per common share; and
- A special dividend of $0.45 per common share.

Lancashire announces that its Board has declared the following dividend payments (collectively the "Dividends"):

> (i) a final dividend for 2013 of $0.10 per common share (approximately £0.06 per common share at the current exchange rate) amounting to an aggregate payment of approximately $18.1 million; and
>
> (ii) an additional special dividend for 2013 of $0.20 per common share (approximately £0.12 per common share at the current exchange rate) amounting to an aggregate payment of approximately $36.2 million.

The Dividends will result in an aggregate payment of approximately $54.3 million. The Dividends will be paid as a single payment in Pounds Sterling on 16 April 2014 (the "Dividend Payment Date") to shareholders of record on 21 March 2014 (the "Record Date") using the £ / $ spot market exchange rate at 12 noon London time on the Record Date.

Shareholders interested in participating in the dividend reinvestment plan ("DRIP") or other services including international payment, are encouraged to contact the Group's registrars, Capita Registrars, for more details at: http://www.capitaregistrars.com/shareholder.aspx

In addition to the dividend payment to shareholders, a dividend equivalent payment of approximately $8.7 million in aggregate will be paid on the Dividend Payment Date to holders of share warrants issued by the Company pursuant to the terms of the warrants.

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

Financial information

The consolidated financial statements set out below are audited. The audited Annual Report and Accounts are expected to be posted to shareholders no later than 10 March 2014 and will also be made available on the Group website.

Further details of our 2013 fourth quarter results can be obtained from our Financial Supplement. This can be accessed via our website www.lancashiregroup.com.

Analyst and Investor Earnings Conference Call

There will be an analyst and investor conference call at 1:00pm UK time / 8:00am EST on Thursday, 13 February 2014. The conference call will be hosted by Lancashire management.

The call can be accessed by dialling +44 (0) 203 139 4830 / + 1 718 873 9077 (Toll Free UK +44 (0) 808 237 0030 / Toll Free US + 1 866 928 7517) all with the confirmation code 67883608#. The call can also be accessed via webcast, please go to our website (www.lancashiregroup.com) to access.

A replay facility will be available for two weeks until Thursday, 27 February 2014. The dial in number for the replay facility is Toll +44 (0) 203 426 2807 or (Toll Free UK +44 (0) 808 237 0026 / Toll Free US +1 866 535 8030) with passcode 644986#. The replay facility will also be accessible at www.lancashiregroup.com

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

About Lancashire

Lancashire, through its UK and Bermuda-based operating subsidiaries, is a global provider of specialty insurance and reinsurance products. The Group companies carry the following ratings:

	Financial Strength Rating (1)	Financial Strength Outlook(1)	Long Term Issuer Rating (2)
A.M. Best	A (Excellent)	Stable	bbb
Standard & Poor's	A-	Stable	BBB
Moody's	A3	Stable	Baa2

(1)Financial Strength Rating and Financial Strength Outlook apply to Lancashire Insurance Company Limited and Lancashire Insurance Company (UK) Limited.

(2) Long Term Issuer Rating applies to Lancashire Holdings Limited.

NB: Cathedral benefits from Lloyd's ratings: A.M. Best: A (Excellent); Standard & Poor's: A+ (Strong); and Fitch: A+ (Strong).

Lancashire has capital in excess of $1.5 billion and its common shares trade on the premium segment of the Main Market of the London Stock Exchange under the ticker symbol LRE. Lancashire has its corporate headquarters and mailing address at Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, United Kingdom and its registered office at Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda.

For more information on Lancashire, visit the Company's website at www.lancashiregroup.com
Lancashire Insurance Company Limited is regulated by the Bermuda Monetary Authority in Bermuda.

Lancashire Insurance Company (UK) Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority in the UK.

Kinesis Capital Management Limited is regulated by the Bermuda Monetary Authority in Bermuda.

For more information on Lancashire’s subsidiary and Lloyd’s segment, Cathedral Capital Limited (“Cathedral”), visit Cathedral’s website at www.cathedralcapital.com

Cathedral Underwriting Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority in the UK.

NOTE REGARDING RPI METHODOLOGY

LANCASHIRE’S RENEWAL PRICE INDEX (“RPI”) IS AN INTERNAL METHODOLOGY THAT ITS MANAGEMENT USES TO TRACK TRENDS IN PREMIUM RATES OF A PORTFOLIO OF INSURANCE AND REINSURANCE CONTRACTS. THE RPI DOES NOT TAKE INTO ACCOUNT ANY BUSINESS OR CONTRACTS OF THE CATHEDRAL GROUP. THE RPI IS CALCULATED ON A PER CONTRACT BASIS AND REFLECTS LANCASHIRE’S ASSESSMENT OF RELATIVE CHANGES IN PRICE, TERMS, CONDITIONS AND LIMITS AND IS WEIGHTED BY PREMIUM VOLUME. THE CALCULATION INVOLVES A DEGREE OF JUDGEMENT IN RELATION TO COMPARABILITY OF CONTRACTS AND THE ASSESSMENT NOTED ABOVE. TO ENHANCE THE RPI METHODOLOGY, MANAGEMENT OF LANCASHIRE MAY REVISE THE METHODOLOGY AND ASSUMPTIONS UNDERLYING THE RPI, SO THE TRENDS IN PREMIUM RATES REFLECTED IN THE RPI MAY NOT BE COMPARABLE OVER TIME. CONSIDERATION IS ONLY GIVEN TO RENEWALS OF A COMPARABLE NATURE SO IT DOES NOT REFLECT EVERY CONTRACT IN LANCASHIRE'S PORTFOLIO. THE FUTURE PROFITABILITY OF THE PORTFOLIO OF CONTRACTS WITHIN THE RPI IS DEPENDENT UPON MANY FACTORS BESIDES THE TRENDS IN PREMIUM RATES.

NOTE REGARDING FORWARD-LOOKING STATEMENTS:

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

THESE FACTORS INCLUDE, BUT ARE NOT LIMITED TO: THE GROUP’S ABILITY TO INTEGRATE ITS BUSINESSES AND PERSONNEL, THE SUCCESSFUL RETENTION AND MOTIVATION OF THE GROUP’S KEY MANAGEMENT, THE INCREASED REGULATORY BURDEN FACING THE GROUP, THE NUMBER AND TYPE OF INSURANCE AND REINSURANCE CONTRACTS THAT THE GROUP WRITES OR MAY WRITE; THE PREMIUM RATES WHICH MAY BE AVAILABLE AT THE TIME OF SUCH RENEWALS WITHIN ITS TARGETED BUSINESS LINES; THE POSSIBLE LOW FREQUENCY OF LARGE EVENTS; POTENTIALLY UNUSUAL LOSS FREQUENCY; THE IMPACT THAT THE GROUP’S FUTURE OPERATING RESULTS, CAPITAL POSITION AND RATING AGENCY AND OTHER CONSIDERATIONS MAY HAVE ON THE EXECUTION OF ANY CAPITAL MANAGEMENT INITIATIVES OR DIVIDENDS; THE POSSIBILITY OF GREATER FREQUENCY OR SEVERITY OF CLAIMS AND LOSS ACTIVITY THAN THE GROUP’S 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 ITS LOSS LIMITATION METHODS; THE POTENTIAL LOSS OF KEY PERSONNEL; A DECLINE IN THE GROUP’S OPERATING SUBSIDIARIES’ RATING WITH A.M. BEST, STANDARD & POOR’S, MOODY’S OR OTHER RATING AGENCIES; INCREASED COMPETITION ON THE BASIS OF PRICING, CAPACITY, COVERAGE TERMS OR OTHER FACTORS; CYCLICAL DOWNTURNS 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 ITS INVESTMENT PORTFOLIO; CHANGES IN GOVERNMENTAL REGULATIONS OR TAX LAWS IN JURISDICTIONS WHERE THE GROUP CONDUCTS BUSINESS; ANY OF LANCASHIRE’S BERMUDIAN SUBSIDIARIES BECOMING SUBJECT TO INCOME TAXES IN THE UNITED STATES OR THE UNITED KINGDOM; THE INAPPLICABILITY TO THE GROUP OF SUITABLE EXCLUSIONS FROM THE NEW UK CFC REGIME; AND ANY CHANGE IN THE UK GOVERNMENT OR UK GOVERNMENT POLICY WHICH IMPACTS THE NEW CFC REGIME .

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2013

	Notes	2013 $m	2012 $m
Gross premiums written	3	**679.7**	724.3
Outwards reinsurance premiums	3	**(122.1)**	(148.2)
Net premiums written		**557.6**	576.1
Change in unearned premiums	3	**24.3**	3.8
Change in unearned premiums on premiums ceded	3	**(13.8)**	2.7
Net premiums earned		**568.1**	582.6
Net investment income	4	**25.4**	32.5
Net other investment income	4	**1.4**	0.7
Net realised gains (losses) and impairments	4	**12.6**	11.8
Share of profit of associates	17	**9.2**	7.7
Other income	27	**4.1**	–
Net foreign exchange gains		**21.8**	4.3
Total net revenue		**642.6**	639.6
Insurance losses and loss adjustment expenses	3, 13	**250.0**	216.9
Insurance losses and loss adjustment expenses recoverable	3, 13	**(61.9)**	(42.8)
Net insurance losses		**188.1**	174.1
Insurance acquisition expenses	3, 5	**135.1**	130.2
Insurance acquisition expenses ceded	3, 5	**(9.3)**	(10.8)
Other operating expenses	6, 7, 25	**85.0**	78.4
Equity based compensation	7	**16.7**	16.4
Total expenses		**415.6**	388.3
Results of operating activities		**227.0**	251.3
Financing costs	8	**8.9**	14.5
Profit before tax		**218.1**	236.8
Tax (credit) charge	9	**(3.8)**	1.9
Profit for the year		**221.9**	234.9
Profit (loss) for the year attributable to:			
Equity shareholders of LHL		**222.5**	234.9
Non-controlling interests		**(0.6)**	–
Profit for the year		**221.9**	234.9
Other comprehensive (loss) income to be reclassified to profit or loss in subsequent periods			
Net change in unrealised gains/losses on investments	4, 11	**(33.3)**	18.1
Tax provision on net change in unrealised gains/losses on investments	11	**0.8**	(0.3)
Other comprehensive (loss) income	11	**(32.5)**	17.8
Total comprehensive income for the year		**189.4**	252.7
Total comprehensive income (loss) attributable to:			
Equity shareholders of LHL		**190.0**	252.7
Non-controlling interests		**(0.6)**	–
Total comprehensive income for the year		**189.4**	252.7
Earnings per share			
Basic	26	**$1.31**	$1.47
Diluted	26	**$1.17**	$1.29

CONSOLIDATED BALANCE SHEET

As at 31 December 2013

	Notes	2013 $m	2012 $m
Assets			
Cash and cash equivalents	10, 22	**403.0**	295.8
Accrued interest receivable		**8.9**	9.3
Investments			
– Fixed income securities – available for sale	11, 22	**1,966.1**	1,874.5
– Fixed income securities – at fair value through profit or loss	11	**29.6**	–
– Equity securities – available for sale	11	**15.6**	–
– Other investments	11	**4.7**	0.1
Reinsurance assets			
– Unearned premiums on premiums ceded	12	**14.9**	11.5
– Reinsurance recoveries	13	**183.0**	73.0
– Other receivables	12	**10.8**	4.5
Deferred acquisition costs	15	**73.8**	68.0
Other receivables		**18.7**	2.7
Inwards premiums receivable from insureds and cedants	14	**288.4**	207.0
Corporation tax receivable		**5.6**	0.4
Deferred tax asset	16	**–**	7.3
Investment in associates	17	**64.7**	82.1
Property, plant and equipment	18	**2.8**	2.8
Intangible assets	2, 19	**177.2**	–
Total assets		**3,267.8**	2,639.0
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	13	**853.4**	537.4
– Unearned premiums	20	**442.1**	343.3
– Other payables	20, 21	**28.9**	23.5
Amounts payable to reinsurers	12, 21	**30.9**	30.6
Deferred acquisition costs ceded	15	**0.2**	0.8
Other payables	21	**80.7**	49.3
Deferred tax liability	16	**38.7**	–
Interest rate swap	22	**0.2**	8.0
Long-term debt	22	**332.3**	258.7
Total liabilities		**1,807.4**	1,251.6
Shareholders' equity			
Share capital	23	**92.7**	84.3
Own shares	23	**(36.8)**	(57.1)
Share premium		**192.2**	2.4
Contributed surplus		**645.7**	654.4
Accumulated other comprehensive income	11	**2.9**	35.4
Other reserves	24	**55.2**	57.1
Retained earnings		**507.8**	610.9
Total shareholders' equity attributable to equity shareholders of LHL		**1,459.7**	1,387.4
Non-controlling interests	27	**0.7**	–
Total shareholders' equity		**1,460.4**	1,387.4
Total liabilities and shareholders' equity		**3,267.8**	2,639.0

The consolidated financial statements were approved by the Board of Directors on 12 February 2014 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 2013

	Notes	Share capital $m	Own shares $m	Share premium $m	Contributed surplus $m	Accumulated other comprehensive income $m	Other reserves $m	Retained earnings $m	Shareholders' equity attributable to equity shareholders of LHL $m	Non-controlling interests $m	Total shareholders' equity $m
Balance as at 31 December 2011		84.3	(83.0)	2.4	660.5	17.6	67.6	577.4	1,326.8	–	1,326.8
Total comprehensive income for the year	11	–	–	–	–	17.8	–	234.9	252.7	–	252.7
Distributed by trust	23	–	33.2	–	(41.9)	–	–	–	(8.7)	–	(8.7)
Shares donated to trust	23, 27	–	(18.4)	–	18.4	–	–	–	–	–	–
Dividends on common shares	23	–	–	–	–	–	–	(168.6)	(168.6)	–	(168.6)
Dividend equivalents on warrants	24	–	–	–	–	–	–	(32.8)	(32.8)	–	(32.8)
Warrant exercises – Founder	24	–	11.1	–	(3.4)	–	(7.7)	–	–	–	–
Equity based compensation – tax	9	–	–	–	–	–	1.6	–	1.6	–	1.6
Equity based compensation – exercises	7, 23, 24	–	–	–	20.8	–	(20.8)	–	–	–	–
Equity based compensation – expense	7	–	–	–	–	–	16.4	–	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	–	1,387.4
Total comprehensive income for the year	11	**–**	**–**	**–**	**–**	**(32.5)**	**–**	**222.5**	**190.0**	**(0.6)**	**189.4**
Issue of shares	23	**8.4**	**–**	**189.8**	**–**	**–**	**–**	**–**	**198.2**	**–**	**198.2**
Issue of shares to non-controlling interests	27	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**1.3**	**1.3**
Distributed by trust	23	**–**	**30.1**	**–**	**(38.7)**	**–**	**–**	**–**	**(8.6)**	**–**	**(8.6)**
Shares donated to trust	23, 27	**–**	**(12.8)**	**–**	**12.8**	**–**	**–**	**–**	**–**	**–**	**–**
Dividends on common shares	23	**–**	**–**	**–**	**–**	**–**	**–**	**(276.7)**	**(276.7)**	**–**	**(276.7)**
Dividend equivalents on warrants	24	**–**	**–**	**–**	**–**	**–**	**–**	**(48.9)**	**(48.9)**	**–**	**(48.9)**
Warrant exercises – Founder	24	**–**	**3.0**	**–**	**(1.1)**	**–**	**(1.9)**	**–**	**–**	**–**	**–**
Equity based compensation – tax	9	**–**	**–**	**–**		**–**	**1.6**	**–**	**1.6**	**–**	**1.6**
Equity based compensation – exercises	7, 23, 24	**–**	**–**	**–**	**18.3**	**–**	**(18.3)**	**–**	**–**	**–**	**–**
Equity based compensation – expense	7	**–**	**–**	**–**		**–**	**16.7**	**–**	**16.7**	**–**	**16.7**
Balance as at 31 December 2013		**92.7**	**(36.8)**	**192.2**	**645.7**	**2.9**	**55.2**	**507.8**	**1,459.7**	**0.7**	**1,460.4**

STATEMENT OF CONSOLIDATED CASH FLOWS
For the year ended 31 December 2013

	Notes	2013 $m	2012 $m
Cash flows from operating activities			
Profit before tax		**218.1**	236.8
Tax paid		**(0.4)**	(1.2)
Depreciation	6	**1.4**	2.8
Amortisation of intangible asset	19	**13.2**	–
Interest expense on long-term debt	8	**13.2**	7.2
Interest and dividend income		**(43.9)**	(48.4)
Net amortisation of fixed income securities		**12.9**	11.8
Equity based compensation	7	**16.7**	16.4
Foreign exchange (gains) losses		**(11.8)**	(7.1)
Share of profit of associates	17	**(9.2)**	(7.7)
Net other investment income	4	**(1.4)**	(0.7)
Net realised (gains) losses and impairments	4	**(12.6)**	(11.8)
Net unrealised (gains) losses on interest rate swaps		**(7.8)**	1.9
Loss on disposal of intangible asset		**–**	2.9
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		**(26.1)**	(17.7)
– Other assets and liabilities		**5.4**	8.1
Net cash flows from operating activities		**167.7**	193.3
Cash flows from (used in) investing activities			
Interest and dividends received		**44.4**	49.1
Net purchase of property, plant and equipment		**(0.1)**	(0.2)
Purchase and development of intangible asset		**–**	(1.7)
Investment in associates		**26.6**	(23.6)
Acquisition of subsidiaries, net of cash acquired	2	**(227.2)**	–
Purchase of fixed income securities		**(1,282.7)**	(1,681.8)
Proceeds on maturity and disposal of fixed income securities		**1,521.0**	1,541.4
Proceeds on disposal of equity securities		**0.2**	–
Net settlement of other investments		**4.8**	(3.2)
Net cash flows from (used in) investing activities		**87.0**	(120.0)
Cash flows used in financing activities			
Interest paid		**(12.0)**	(5.5)
Proceeds from issue of shares, net of share issue costs	23	**198.2**	–
Issuance of long-term debt		**–**	130.0
Dividends paid	23	**(325.6)**	(201.4)
Distributions by trust		**(8.6)**	(8.7)
Issue of shares to non-controlling interests	27	**1.3**	–
Net cash flows used in financing activities		**(146.7)**	(85.6)
Net increase (decrease) in cash and cash equivalents		**108.0**	(12.3)
Cash and cash equivalents at beginning of year		**295.8**	311.8
Effect of exchange rate fluctuations on cash and cash equivalents		**(0.8)**	(3.7)
Cash and cash equivalents at end of year	10	**403.0**	295.8

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 issued 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 or fair value through profit or loss. The new standard, the effective date of which remains open, 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.

IFRS 13, Fair Value Measurement, is effective for annual periods beginning 1 January 2013 and is to be applied prospectively. The standard establishes a single source of guidance under IFRS for fair value measurement and introduces disclosures to help users to better assess the valuation techniques and inputs used to measure fair value. The standard requires the Group to provide disclosures about judgements made and inputs used in fair value measurements and the sensitivity of those measurements. The adoption of the standard did not have a material impact on the Group's results.

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 105 and also in the risk disclosures section from page 115. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 105.

Estimates are also 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 105 and 106 and in note 11. Management judgement is applied in determining impairment charges. The estimation of the fair value of equity based compensation awards granted is discussed in note 7.

Intangible assets are recognised on the acquisition of a subsidiary. The fair value of intangible assets arising from the acquisition of a subsidiary is largely based on the estimated expected cash flows of the business acquired and contractual rights of that business. The Group determines whether indefinite life intangible assets are impaired at least on an annual basis. This requires an estimation of the recoverable amount of the CGU to which the intangible asset is allocated. The assumptions made by management in performing impairment tests of intangible assets are subject to estimation uncertainty. Details of the key assumptions used in the estimation of the recoverable amounts of the CGU are contained in note 19.

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. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. Intercompany balances, profits and transactions are eliminated.

Subsidiaries' accounting policies are generally consistent with the Group's accounting policies. Where they differ, adjustments are made on consolidation to bring accounting policies in line.

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 of each of the Group's consolidated entities is the currency of the primary economic environment in which operations are conducted. The consolidated financial statements are 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.

The results and financial position of the Group companies that have a functional currency different from the group presentation currency are translated into the presentation currency as follows:

- assets and liabilities are translated at period end exchange rates;
- income and expenses for each statement of comprehensive income item are translated at average exchange rates for the reporting period where this is determined to be a reasonable approximation of the actual transaction rates; and
- resulting exchange differences are recognised in other comprehensive income as a separate component of equity.

BUSINESS COMBINATIONS

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the fair value of consideration transferred at the acquisition date. On acquisition of a business the Group assesses the financial assets acquired and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions at the acquisition date. Unpaid loss reserves and loss reserves recoverable assumed through a business combination are initially measured at fair value, using an applicable risk-free discount rate and having regard to the expected settlement dates of the claims. Unearned premiums and unearned premiums ceded acquired through a business combination are initially measured in accordance with the Group's existing accounting policies. The difference between the acquired amount and the fair value of these assets and liabilities is recognised as a separately identifiable intangible asset and recorded as the value of in-force business. Other identifiable assets acquired and liabilities and contingent liabilities assumed, which meet the conditions for recognition under IFRS 3, Business Combinations, are recognised at their fair value at the acquisition date. The excess of the fair value of consideration transferred over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. Costs directly related to an acquisition are expensed in the consolidated statement of comprehensive income when incurred.

INTANGIBLE ASSETS

The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite depending on the nature of the asset. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Intangible assets with indefinite useful lives are tested for impairment annually at the CGU level by comparing the net present value of the future earnings stream of the CGU to the carrying value of the intangible asset and the related net assets. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether the indefinite life assessment continues to be supportable.

GOODWILL

Goodwill is deemed to have an indefinite life and, after initial recognition, is measured at cost less any accumulated impairment losses. Goodwill is tested for impairment annually, or when events or changes in circumstance indicate that it might be impaired.

SYNDICATE PARTICIPATION RIGHTS

Syndicate participation rights purchased in a business combination are initially measured at fair value and are subsequently measured at cost less any impairment. Syndicate participation rights are considered to have an indefinite life as they will provide benefits over an indefinite future period and are therefore not subject to an annual amortisation charge. The value of the syndicate participation rights is reviewed for impairment annually.

VALUE OF IN-FORCE BUSINESS

The value of in-force business acquired in a business combination is initially recognised as the difference between the fair value of the net unearned premiums acquired and the measurement of the net unearned premiums acquired using the Group's existing accounting policies. The value of in-force business has a finite useful life and subsequent to initial recognition it is carried at cost less accumulated amortisation and is amortised over the remaining life of the acquired insurance contracts. The portion of the value of in-force business which replaces the deferred acquisition costs carried on Cathedral's historical balance sheet is amortised in the net acquisition costs in the statement of comprehensive income. The remaining amortisation is charged to other operating expenses.

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 later of a contract's binding or inception date. 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 incepts, or the period in which the contract is bound if later. 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 successful 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 incepts, or the period in which the contract is bound if later. The provision for reinsurers' share of unearned premiums represents that part of reinsurance premiums ceded which are estimated to be earned in future financial periods. Unearned reinsurance commissions are recognised as a liability using the same principles.

Any amounts recoverable from reinsurers are estimated using the same methodology as the underlying losses. The Group monitors the 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 portion of the Group's business is in classes with high attachment points of coverage, including property catastrophe excess of loss. 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.

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 and equity securities are quoted investments that are classified as available for sale or fair value through profit or loss and are carried at estimated fair value. The classification is determined at the time of initial purchase and depends on the category of investment. Fixed income investments in principal protected equity linked notes are designated as at fair value through profit or loss.

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. Changes in estimated fair value of investments classified as at fair value through profit or loss are recognised 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. Dividends on equity securities are recorded as revenue on the date the dividends become payable to the holders of record.

The Group reviews the carrying value of its available for sale investments for evidence of impairment. An investment is impaired if its carrying value exceeds the estimated fair value and there is objective evidence of impairment to the asset. Such evidence would include a prolonged decline in estimated fair value below cost or amortised cost, where other factors, such as expected cash flows, do not support a recovery in value. If an impairment is deemed appropriate, the difference between cost or amortised cost and estimated fair value is removed from accumulated other comprehensive income in shareholders' equity and charged to current period income. Impairment losses on fixed income securities may be subsequently reversed through income while impairment losses on equity securities are not 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 currently 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.

OTHER INCOME

Managing agent's fees and commissions and underwriting service fees are recognised in line with services provided. Contingent profit commissions are recognised when it is virtually certain that they will be realised.

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	20% to 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 for 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 all temporary differences between the assets and liabilities in the consolidated balance sheet and their tax base, except when the deferred tax liability arises from the initial recognition of goodwill. 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 capital resources held are matched to the risk profile of the Group and 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, generally on a modeled basis, that the Group and its entities are prepared to expose to certain risks.

The 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 LHL 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 RRC 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 and includes representation from Cathedral. The CRO attends the meetings and reports on the RRC's activities to the Group and individual entity Boards of Directors and the Risk Committee of Cathedral.

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 are 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 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 and the Risk Committee of Cathedral. The CRO ultimately has the right to report directly to the Group and entity regulators if he feels that management is not appropriately addressing areas of concern.

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 calculates projected financial outcomes for each insurance class, as well as the overall portfolio including diversification credit. Diversification credit 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 to 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, plus the Group's Lloyd's segment via the Cathedral Group, are deemed to be the Group's five 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, reviewed and updated on an ongoing basis;
- BLAST is used to measure occurrence risks, aggregate risks and correlations between classes and other non-insurance risks, and the outputs and assumptions are reviewed periodically by the RRC;
- 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;
- risk levels versus tolerances are monitored on a regular basis;
- a daily underwriting call is held for LICL and LUK to peer review insurance proposals, opportunities and emerging risks;
- a daily post-binding review process with exception reporting to management based on underwriting authority operates at Cathedral;
- 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. The Group's associates bear exposure to catastrophe losses and any significant loss event could potentially result in impairment in the value of the Group's investment in associates.

The Group's exposures to certain peak zone elemental losses, as a percentage of tangible 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 associates is included in the figures below.

		100 year return period estimated net loss		250 year return period estimated net loss	
As at 31 December 2013		**$m**	**% of tangible capital**	**$m**	**% of tangible capital**
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	**307.6**	**19.0**	**440.2**	**27.3**
Pan-European	Windstorm	**210.7**	**13.0**	**319.3**	**19.8**
Japan	Earthquake	**154.8**	**9.6**	**266.9**	**16.5**
Japan	Typhoon	**132.9**	**8.2**	**249.0**	**15.4**
California	Earthquake	**130.6**	**8.1**	**239.0**	**14.8**
Pacific North West	Earthquake	**49.4**	**3.1**	**176.4**	**10.9**

(1) Landing hurricane from Florida to Texas.

		100 year return period estimated net loss		250 year return period estimated net loss	
As at 31 December 2012		$m	% of capital	$m	% of capital
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	324.4	19.7	462.5	28.1
Pan-European	Windstorm	191.9	11.7	257.8	15.7
Japan	Earthquake	158.4	9.6	288.2	17.5
Japan	Typhoon	164.2	10.0	369.9	22.5
California	Earthquake	106.7	6.5	263.9	16.0
Pacific North West	Earthquake	34.9	2.1	191.1	11.6

(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:

	2013		2012	
	$m	**%**	$m	%
Worldwide offshore	**253.3**	**37.3**	309.1	42.7
Worldwide, including the U.S. and Canada[1]	**151.0**	**22.2**	176.8	24.5
U.S. and Canada	**101.5**	**14.9**	87.0	12.0
Far East	**39.9**	**5.9**	41.4	5.7
Europe	**38.4**	**5.6**	39.3	5.4
Worldwide, excluding the U.S. and Canada[2]	**19.4**	**2.9**	25.5	3.5
Middle East	**16.7**	**2.5**	8.1	1.1
Rest of world	**59.5**	**8.7**	37.1	5.1
Total	**679.7**	**100.0**	724.3	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 business segment are provided below:

	2013		2012	
	$m	%	$m	%
Property	**333.4**	**49.0**	356.5	49.2
Energy	**209.9**	**30.9**	240.9	33.3
Marine	**63.0**	**9.3**	81.0	11.2
Aviation	**48.9**	**7.2**	45.9	6.3
Lloyd's	**24.5**	**3.6**	–	–
Total	**679.7**	**100.0**	724.3	100.0

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

I. PROPERTY

Gross premiums written, for the year:

	2013 $m	2012 $m
Property catastrophe excess of loss	**97.5**	96.8
Property retrocession	**80.8**	124.4
Terrorism	**67.8**	62.9
Property political risk	**66.4**	41.1
Property direct and facultative	**10.0**	25.6
Other property	**10.9**	5.7
Total	**333.4**	356.5

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.

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 industry insured loss as measured by independent third-party loss index providers.

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. The term of these contracts is often multi-year reflecting the term of the underlying exposures. 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 term of these contracts is often multi-year reflecting the term of the underlying exposures. The Group does not provide cover against purely private obligor credit risk.

A small number of property direct and facultative risks continue to be written with modest lines mostly 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. 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 110 and 111.

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 may be entered into.

II. ENERGY

Gross premiums written, for the year:

	2013 $m	2012 $m
Worldwide offshore energy	**149.2**	148.9
Gulf of Mexico offshore energy	**34.4**	65.4
Construction energy	**12.9**	17.9
Energy liabilities	**8.8**	0.1
Other energy	**4.6**	8.6
Total	**209.9**	240.9

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 110 and 111.

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.

The Group started writing energy liability business on a stand-alone basis in the fourth quarter of 2012. Unlike the liability contained within the energy packages that Lancashire writes, stand-alone energy liability is written on an excess of loss basis only. Coverage is worldwide and provides coverage for all kinds of damages and loss to third parties. Coverage is generally restricted to offshore assets.

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:

	2013 $m	2012 $m
Marine hull and total loss	**24.8**	28.9
Marine hull war	**15.0**	18.8
Marine P&I clubs	**10.7**	10.6
Marine builders risk	**10.3**	16.4
Other marine	**2.2**	6.3
Total	**63.0**	81.0

With the exception of the marine P&I clubs, where excess layers are written, most policies are written on a ground-up basis. Marine hull and total loss is generally written on a direct basis and covers marine risks on a worldwide basis, primarily for physical damage. Marine hull war is direct insurance of loss of vessels from war, piracy or terrorist attack. Marine P&I clubs is mostly the reinsurance of the International Group of Protection and Indemnity Clubs and covers marine liabilities. Marine builders risk covers the building of ocean going vessels in specialised yards worldwide and their testing and commissioning.

The largest expected exposure in the marine class is from physical loss rather than from elemental loss events, although there is exposure to elemental perils.

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 a treaty excess of loss basis.

IV. AVIATION

Gross premiums written, for the year:

	2013 $m	2012 $m
AV52	**26.5**	36.8
Aviation satellite	**16.8**	5.6
Other aviation	**5.6**	3.5
Total	**48.9**	45.9

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.

The Group re-entered the aviation satellite launch and orbit market in the third quarter of 2012. Cover is written on an full value, primary or excess of loss basis and can provide cover for satellite launch, satellite in-orbit or both satellite launch and in-orbit. Coverage for in-orbit can be provided on an annual or multi-year basis and both launch and in-orbit can cover loss of earnings as well as physical damage.

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.

V. LLOYD'S

Gross premiums written, for the period from 7 November 2013, the date of acquisition, to 31 December 2013:

	2013 $m
Property direct and facultative	**13.0**
Marine cargo	**5.0**
Property reinsurance	**3.4**
Aviation and satellite	**2.6**
Contingency	**0.5**
Total	**24.5**

Property direct and facultative is a worldwide book of largely commercial property business, written both in the open market and under delegated authorities. The account spans small individual locations to Fortune 500 accounts but with a bias towards small to medium sized risks. Policies are generally provided both for non-elemental and elemental perils, although not all risks include both elemental and non-elemental coverage. Coverage is generally written on a full value, primary or excess of loss basis, although the very largest accounts are currently seldom written at the primary level.

Marine cargo is an international account and is written either on a direct basis or by way of reinsurance. It covers the (re)insurance of commodities or goods in transit. Typically, transit cover is provided on an all-risks basis for marine perils for the full value of the goods concerned, although higher value or capacity business may be written on a layered basis. Static cover is also provided for losses to cargo, from both elemental and non-elemental causes, whilst static at points along its route. In addition, the cargo account can include specie and fine art, vault risks, artwork on exhibition and marine war business relating to cargo in transit.

Property reinsurance predominantly includes property catastrophe excess of loss, per risk excess of loss and property retrocession lines of business. Property catastrophe excess of loss and per risk excess of loss provide protection for elemental and non-elemental risks and are written on an excess of loss treaty basis within the U.S. and internationally. The U.S. property catastrophe excess of loss book is particularly focused on regional clients. Property retrocession is written on an excess of loss basis through treaty arrangements. It provides coverage for elemental risks when sold on a catastrophe basis and both elemental and non-elemental risks when sold on a per risk retrocession basis. Protection is generally given on a regional basis and may cover specific property risks or all catastrophe perils. It is also generally written on an UNL basis, meaning loss payments are linked to the ceding company's own loss.

Aviation and satellite includes aviation reinsurance and aviation satellite lines of business. Aviation reinsurance provides excess of loss catastrophe cover to the insurers of the world's major airlines and aircraft and aircraft manufacturers. This includes cover for the aircraft themselves as well as losses arising from passenger and third party liability claims against airlines and/or manufacturers. A significant part of the aviation satellite account is written through Satec, a specialist underwriting agency, to which underwriting authority is delegated. Satellite insurance is purchased by launch operators, satellite manufacturers and satellite operators to protect against launch or deployment failure or subsequent failure in orbit. Policies are typically written for launch plus one year in orbit. Thereafter orbit cover is normally provided on an annual basis.

Contingency focuses on the sports, leisure and entertainment industries, with a significant emphasis on the music industry. It provides coverage for non-appearance and event cancellation. Generally business is written on a full value basis.

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 but, from time to time, quota share arrangements may be entered into. Reinsurance may be purchased on a facultative or treaty 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. 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 to transfer the totality of the Group's exposure. 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 semi-annual 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 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 and their loss adjusters 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 , reinsurers or vendor binding authorities.

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 or binding authority holder 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 2013 management's estimates for IBNR represented 31.8 per cent of total net loss reserves (2012 – 28.1 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 was 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, binding authority 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 for LICL and LUK to discuss, inter alia, market conditions and opportunities;
- reviews all new and renewal business post-underwriting for Cathedral;
- 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 regular 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 IRRC and the Board of Directors.

The Group's fixed income portfolios are managed by five external investment managers. The Group also has a small equity portfolio. 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 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 for this portion of assets are capital preservation and providing liquidity to meet insurance and other near-term obligations. In addition to cash managed internally, funds held in the investment portfolio 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, fixed income funds 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.

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, principal protected equity linked notes, derivative instruments, cash and cash equivalents and 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 currently endeavours to maintain a relatively market neutral investment portfolio in order to minimise losses during periods of heightened volatility. The Group models various periods of significant stress in order to better understand the investment portfolio's risks and exposures. These scenarios represent what could, and most likely will occur (albeit not in the exact form of the scenarios, which are based on historic periods of volatility). The Group also monitors the portfolio impact of more severe disaster scenarios consisting of extreme shocks.

The IRRC meets at least quarterly to ensure that the Group's strategic and tactical investment actions are consistent with investment risk preferences, appetite, risk and return objectives and tolerances. The IRRC 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:

As at 31 December 2013	Core		Core plus		Surplus		Total	
	$m	%	$m	%	$m	%	$m	%
– Short-term investments	**145.4**	**7.3**	**75.8**	**3.8**	**9.8**	**0.5**	**231.0**	**11.6**
– Fixed income funds	**26.3**	**1.3**	**–**	**–**	**–**	**–**	**26.3**	**1.3**
– U.S. treasuries	**98.7**	**4.9**	**53.1**	**2.7**	**65.5**	**3.3**	**217.3**	**10.9**
– Other government bonds	**45.5**	**2.3**	**13.6**	**0.7**	**48.8**	**2.4**	**107.9**	**5.4**
– U.S. municipal bonds	**2.3**	**0.1**	**3.4**	**0.2**	**15.7**	**0.8**	**21.4**	**1.1**
– U.S. government agency debt	**11.0**	**0.5**	**3.5**	**0.2**	**83.7**	**4.2**	**98.2**	**4.9**
– Asset backed securities	**66.6**	**3.3**	**30.6**	**1.5**	**54.2**	**2.7**	**151.4**	**7.5**
– U.S. government agency mortgage backed securities	**39.3**	**2.0**	**71.3**	**3.6**	**141.4**	**7.0**	**252.0**	**12.6**
– Non-agency mortgage backed securities	**3.8**	**0.2**	**1.8**	**0.1**	**3.2**	**0.2**	**8.8**	**0.5**
– Agency commercial mortgage backed securities	**1.6**	**0.1**	**0.9**	**–**	**1.7**	**0.1**	**4.2**	**0.2**
– Non-agency commercial mortgage backed securities	**7.1**	**0.4**	**11.8**	**0.6**	**19.0**	**0.9**	**37.9**	**1.9**
– Bank loans	**–**	**–**	**–**	**–**	**107.8**	**5.4**	**107.8**	**5.4**
– Corporate bonds	**271.7**	**13.6**	**173.4**	**8.7**	**256.8**	**12.9**	**701.9**	**35.2**
Total fixed income securities – available for sale	**719.3**	**36.0**	**439.2**	**22.1**	**807.6**	**40.4**	**1,966.1**	**98.5**
Fixed income securities – at fair value through profit or loss	**–**	**–**	**–**	**–**	**29.6**	**1.5**	**29.6**	**1.5**
Total fixed income securities	**719.3**	**36.0**	**439.2**	**22.1**	**837.2**	**41.9**	**1,995.7**	**100.0**

As at 31 December 2012	Core		Core plus		Surplus		Total	
	$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

Corporate bonds, fixed income securities at fair value through profit or loss, bank loans and other government bonds by country are as follows:

As at 31 December 2013	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	121.3	331.4	452.7	–	452.7
Canada	53.8	16.0	69.8	26.1	95.9
United Kingdom	41.3	52.2	93.5	0.4	93.9
Australia	22.9	9.7	32.6	10.0	42.6
France	7.4	24.4	31.8	6.6	38.4
Germany	3.8	13.3	17.1	15.3	32.4
Norway	29.0	0.8	29.8	2.0	31.8
Netherlands	14.1	10.9	25.0	5.8	30.8
Sweden	19.8	–	19.8	1.3	21.1
Switzerland	11.7	4.2	15.9	–	15.9
Belgium	–	7.4	7.4	–	7.4
Supranationals	7.2	–	7.2	–	7.2
Japan	2.6	2.6	5.2	–	5.2
Emerging market corporates	4.8	11.3	16.1	–	16.1
Emerging market sovereign	–	–	–	9.9	9.9
Emerging market agency	–	–	–	26.9	26.9
Other	4.0	11.4	15.4	3.6	19.0
Total	**343.7**	**495.6**	**839.3**	**107.9**	**947.2**

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

The sector allocation of the corporate bonds, fixed income securities at fair value through profit or loss and bank loans is as follows is as follows:

	2013		2012	
As at 31 December	**$m**	**%**	$m	%
Industrial	**452.8**	**53.9**	379.9	53.0
Financial	**336.5**	**40.1**	297.9	41.5
Utility	**42.8**	**5.1**	37.8	5.3
Supranationals	**7.2**	**0.9**	1.4	0.2
Total	**839.3**	**100.0**	717.0	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 fixed income funds are overseas deposits held by Syndicate 2010 and Syndicate 3010 in trust for the benefit of the policyholders in those overseas jurisdictions. They consist of high quality, short duration fixed income securities. The Group also has a small equity portfolio. 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:

	2013		2012	
As at 31 December	**$m**	**%**	$m	%
Immediate shift in yield (basis points)				
100	**(23.3)**	**(1.2)**	(40.9)	(2.2)
75	**(18.3)**	**(0.9)**	(30.6)	(1.6)
50	**(12.7)**	**(0.6)**	(20.4)	(1.1)
25	**(6.6)**	**(0.3)**	(10.2)	(0.5)
(25)	**6.8**	**0.3**	8.5	0.5
(50)	**14.0**	**0.7**	17.1	0.9
(75)	**21.3**	**1.1**	25.6	1.4
(100)	**28.9**	**1.4**	34.1	1.8

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 and swaptions 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	**2013 years**	2012 years
Core portfolio	**1.2**	1.5
Core plus portfolio	**1.2**	1.5
Surplus portfolio	**1.9**	2.4
Overall portfolio	**1.1**	1.9

The overall duration for fixed income, managed cash and cash equivalents and certain derivatives is 1.0 years (2012 – 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 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 an annual VaR at the 99th percentile confidence level. The annual VaR, at the 99th percentile confidence level, measures the minimum amount the assets should be expected to lose over a one year time horizon, under normal conditions, 1 per cent of the time. The current VaR tolerance is 8.0 per cent of shareholders' equity, plus the coupon on the investment portfolio, using the annual VaR at the 99th percentile confidence level.

The Group's annual VaR calculations are as follows:

	2013		2012	
As at 31 December	$m	% of shareholder's equity	$m	% of shareholder's equity
99th percentile confidence level	32.6	2.2	37.9	2.7

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 2013	Net other investment income $m	Net realised gains (losses) $m	Net foreign exchange gains (losses) $m	Financing costs $m
Eurodollar futures	–	0.3	–	–
Treasury futures	–	4.8	–	–
Forward foreign currency contracts	–	–	12.0	–
Interest rate swaps – investments	(0.1)	(0.3)	–	–
Interest rate swaps – debt	–	–	–	5.2
Credit default swaps	(0.3)	0.2	–	–
Swaptions	2.2	–	–	–
Total	1.8	5.0	12.0	5.2

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)

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

As at 31 December	2013 Other investments $m	2013 Other receivables $m	2013 Interest rate swaps $m	2012 Other investments $m	2012 Interest rate swaps $m
Forward foreign currency contracts	–	0.1	–	–	–
Interest rate swaps – investments	(0.1)	–	–	–	–
Interest rate swaps – debt	–	–	(0.2)	–	(8.0)
Swaptions	4.9	–	–	–	–
Credit default swaps	(0.1)	–	–	0.1	–
Total	**4.7**	**0.1**	**(0.2)**	0.1	(8.0)

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 2013 and 2012.

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 2013 the net notional short exposure to treasury futures is $5.7 million (2012 – $56.2 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 2013 and 2012. 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 as at 31 December 2013 and 2012.

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 as at 31 December 2013 and 2012.

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:

	2013			2012		
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
Australian Dollar	10.5	28.5	(18.0)	–	12.5	(12.5)
British Pound	–	9.4	(9.4)	0.1	3.9	(3.8)
Brazilian Real	3.9	6.6	(2.7)	–	3.3	(3.3)
Chinese Renminbi	0.3	0.3	–	3.4	3.4	–
Canadian Dollar	0.5	–	0.5	0.3	22.2	(21.9)
Malaysian Ringgit	3.9	–	3.9	–	–	–
Euro	52.6	24.5	28.1	1.9	19.1	(17.2)
Other(1)	0.3	0.3	–	–	0.3	(0.3)
Total	72.0	69.6	2.4	5.7	64.7	(59.0)

(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. 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 held in the investment portfolio is not material as at 31 December 2013 and 2012. The notional amount of interest rate swaps held internally for the purposes of hedging the interest rate exposure on the Group's subordinated loan notes as at 31 December 2013 is $259.8 million (31 December 2012 - $128.7 million)

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 2013, the maximum amount of loss the Group could incur on its open credit default swaps was the notional value of $4.1 million (2012 – $11.5 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 the 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. To reduce the impact of a significant increase in interest rates, swaptions with a gross notional value of $2.0 billion are held in the investment portfolio as at 31 December 2013. The estimated fair value of these instruments is $4.9 million as at 31 December 2013 (31 December 2012 – $nil). These instruments reduce the duration of the investment portfolio by 0.3 years as at 31 December 2013.

III. DEBT RISK

The Group has issued long-term debt as described in note 22. The LHL issued 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%

The interest rate swaps expire on 15 December 2020, therefore the Group currently has no interest rate risk on the LHL issued 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.

On the acquisition of Cathedral, the Group assumed subordinated loan notes as described in note 22. As at 31 December 2013 the Group has not hedged the interest rates on these floating rate notes and is therefore exposed to interest rate risk on this long-term debt. An increase of 100 basis points on the EURIBOR and LIBOR three month deposit rates would result in an increase in the interest expense on long term debt for the Group of approximately $0.8 million on an annual basis.

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, investments, premiums receivable, dividends payable and the euro denominated subordinated loan notes long-term debt liabilities discussed in note 22. 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 124 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 are as follows:

Assets	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Cash and cash equivalents	227.6	63.8	44.9	39.4	27.3	403.0
Accrued interest receivable	8.7	0.1	0.1	–	–	8.9
Fixed income securities – available for sale	1,862.3	25.5	45.9	–	32.4	1,966.1
Fixed income securities – at fair value through profit or loss	29.6	–	–	–	–	29.6
Equity securities – available for sale	1.0	14.3	–	–	0.3	15.6
Other investments	4.7	–	–	–	–	4.7
Reinsurance assets	170.3	34.6	2.3	0.3	1.2	208.7
Deferred acquisition costs	57.4	2.2	7.1	0.8	6.3	73.8
Other receivables	8.7	10.0	–	–	–	18.7
Inwards premiums receivable from insureds and cedants	232.1	18.0	26.7	0.6	11.0	288.4
Corporation tax receivable	–	5.6	–	–	–	5.6
Investment in associates	64.7	–	–	–	–	64.7
Property, plant and equipment	1.0	1.8	–	–	–	2.8
Intangible assets	177.2	–	–	–	–	177.2
Total assets as at 31 December 2013	**2,845.3**	**175.9**	**127.0**	**41.1**	**78.5**	**3,267.8**

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	569.9	74.1	91.1	77.7	40.6	853.4
Unearned premiums	348.4	22.8	35.3	7.4	28.2	442.1
Insurance contracts – other payables	24.2	0.1	2.6	–	2.0	28.9
Amounts payable to reinsurers	25.3	5.2	0.3	–	0.1	30.9
Deferred acquisition costs ceded	0.1	–	–	0.1	–	0.2
Other payables	47.7	32.9	0.1	–	–	80.7
Deferred tax liability	19.4	17.2	–	–	2.1	38.7
Interest rate swap	(1.4)	–	1.6	–	–	0.2
Long-term debt	284.4	–	47.9	–	–	332.3
Total liabilities as at 31 December 2013	**1,318.0**	**152.3**	**178.9**	**85.2**	**73.0**	**1,807.4**

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 – available for sale	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	0.2	–	–	–	2.7
Inwards premiums receivable from insureds and cedants	168.3	2.4	20.4	2.9	13.0	207.0
Corporation tax receivable	–	0.4	–	–	–	0.4
Deferred tax asset	–	7.3	–	–	–	7.3
Investment in associate	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

The impact on net income of a proportional foreign exchange movement of 10.0 per cent up and 10.0 per cent down against the U.S. dollar at the year end spot rates would be an increase or decrease of $2.3 million (2012 – $2.0 million).

The 31 December 2013 losses and loss adjustment expenses include the equivalent of $57.2 million (2012 – $55.4 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.

The Group uses forward foreign currency contracts for the purposes of managing currency exposures. See page 124 for details of the Group's open forward foreign currency contracts.

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 2013	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	265.9	153.2	56.7	475.8
Between one and two years	162.2	68.7	101.5	332.4
Between two and three years	123.4	30.2	57.6	211.2
Between three and four years	30.7	34.3	153.5	218.5
Between four and five years	15.1	23.2	54.3	92.6
Over five years	3.6	13.2	194.1	210.9
Asset backed and mortgage backed securities	118.4	116.4	219.5	454.3
Total fixed income securities	**719.3**	**439.2**	**837.2**	**1,995.7**

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

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

	Years until liability becomes due – undiscounted values					
As at 31 December 2013	**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	**853.4**	**381.2**	**312.4**	**96.7**	**63.1**	**853.4**
Insurance contracts – other payables	**28.9**	**26.6**	**1.5**	**0.8**	**–**	**28.9**
Amounts payable to reinsurers	**30.9**	**30.9**	**–**	**–**	**–**	**30.9**
Other payables	**80.7**	**80.7**	**–**	**–**	**–**	**80.7**
Interest rate swap	**0.2**	**2.5**	**3.5**	**(1.2)**	**(4.6)**	**0.2**
Long-term debt	**332.3**	**13.3**	**34.0**	**41.8**	**629.7**	**718.8**
Total	**1,326.4**	**535.2**	**351.4**	**138.1**	**688.2**	**1,712.9**

	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

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 22. 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 10.0 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 5.0 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 and other highly rated governments.

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 have accrued gains 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. Binding authorities are subject to standard market controls including credit control. Credit risk from reinsurance recoverables is primarily managed by the review and approval of reinsurer security by the RRC, as discussed on page 108. Reinsurance recoverables from ARL are fully collateralised by $175.0 million of funds 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 2013	Other investments $m	Cash and fixed income securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	**–**	**568.8**	–	–
AA+, AA, AA-	**–**	**865.9**	–	–
A+, A, A-	**4.9**	**665.8**	**97.0**	**148.1**
BBB+, BBB, BBB-	**(0.2)**	**186.8**	**–**	**0.3**
Other(1)	**–**	**111.4**	**220.9**	**34.6**
Total	**4.7**	**2,398.7**	**317.9**	**183.0**

(1) Reinsurance recoveries classified as "other" include $33.2 million of reserves that are fully collateralised; $26.8 million of these are with ARL.

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 in the amount of $17.7 million classified as "other" are fully collateralised with ARL.

The two counterparties to the Group's long-term debt interest rate swaps are currently rated A+ and A- by S&P respectively.

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

	2013 $m	2012 $m
Less than 90 days past due	**13.5**	5.2
Between 91 and 180 days past due	**2.2**	0.2
Over 180 days past due	**3.6**	–
Total	**19.3**	5.4

Provisions of $0.2 million (2012 – $0.5 million) have been made for impaired or irrecoverable balances and $0.3 million (2012 – $0.8 million) was released from 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. The internal audit plan for 2014 will be modified to incorporate the higher risk areas within Cathedral's operations.

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 acquisition of Cathedral adds further risk to the execution and appropriateness of the Group's business plan;
- 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. It also includes the failure by the Group to integrate Cathedral's operations effectively or the failure to maximise earnings and capital efficiency from the acquisition; and
- the Group has identified succession planning, staff retention and key man risks as strategic risks. With the acquisition of Cathedral and the importance of their underwriting team's business relationships and knowledge of their book of business, retention of key personnel at Cathedral is now included in strategic risks.

The Group has elevated the relevant risk scores in its risk register to reflect the issues inherent in the integration of Cathedral into the Group's financial reporting.

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 forward-looking business planning process with cross departmental involvement , including the Cathedral team;
- regular integration and business development meetings with the Cathedral management and underwriting teams;
- 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 and fortnightly Cathedral integration meetings.

II. CAPITAL MANAGEMENT RISK

The total capital of the Group is as follows:

As at 31 December	2013 $m	2012 $m
Shareholders' equity	**1,459.7**	1,387.4
Long-term debt	**332.3**	258.7
Total capital	**1,792.0**	1,646.1
Intangible assets	**(177.2)**	–
Total tangible capital	**1,614.8**	1,646.1

Risks associated with the effectiveness of the Group's capital management, including enhancing Cathedral's capital base, are mitigated as follows:

- regular monitoring of current regulatory and rating agency capital requirements;
- regular discussion with the Cathedral management team regarding Lloyd's capital requirements and the impact of the acquisition thereon;
- oversight of capital requirements by the Board of Directors;
- ability to purchase sufficient, cost effective reinsurance;
- maintaining contact with vendors, regulators and rating agencies in order to stay abreast of upcoming developments; and
- participation in industry groups such as the International Underwriters Association, the Association of Bermuda Insurers and Reinsurers and the Lloyd's Market Association.

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 risk-adjusted 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. These approaches are used by management in decision making. The acquisition of Cathedral has brought new tools and ideas to the Group to view profitability and exposures. The operating entities also conduct capital requirement assessments under internal measures and local regulatory requirements. Refer to note 29 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 13.0 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
31 December 2013	18.9	19.2	308.0

(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	231.3
31 December 2013	18.9	17.9	296.6

(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;
- the provision of retention packages to key members of the Cathedral team;
- 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 with operations in the United Kingdom, Bermuda and Canada. 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. LHL's head office is at Level 11, Vitro, 60 Fenchurch Street, London, EC3M 4AD, United Kingdom.

The consolidated financial statements for the year ended 31 December 2013 include the Group's subsidiary companies, the Group's interest in associates, and the Group's share of syndicate assets and liabilities and income and expenses. A full listing of the Group's related parties can be found in note 27.

2. BUSINESS COMBINATIONS

On 7 November 2013, LHL acquired the entire issued share capital of Cathedral together with manager and investor loan notes and preference shares issued by CCIL and CCL respectively. Cathedral is an established (re)insurance provider that operates exclusively in the Lloyd's insurance market and writes insurance and reinsurance business in property direct and facultative, property reinsurance, marine cargo, aviation and satellite and contingency classes.

The acquisition was funded through a combination of internally available cash resources, loan notes issued to certain sellers, and the net proceeds of the placing of 16,843,382 new common shares in LHL. The consideration for the issued share capital was $230.4 million and consideration paid for the outstanding loan notes and preference shares was $185.7 million. The consideration of $416.1 million was settled in cash of $422.0 million plus issued loan notes of $3.6 million, less amounts due to the Group from Cathedral in the amount of $9.5 million. On the date of acquisition, RSS were also issued to certain Cathedral employees. See note 7 for further details of the RSS issued. The acquisition has enabled the Group to benefit from direct participation in Lloyd's, the world's leading specialist insurance market.

Acquired assets and liabilities of Cathedral and the excess of the Group's consideration paid over the interest in the net fair value of assets acquired in aggregate, at the acquisition date, were as follows:

	Notes	$m
Assets		
Cash and cash equivalents	10, 22	**194.8**
Accrued interest receivable		**2.4**
Investments		
– Fixed income securities – available for sale	11, 22	**401.9**
– Equity securities – available for sale	11	**15.3**
Reinsurance assets		
– Unearned premiums on premiums ceded	12	**17.2**
– Reinsurance recoveries	13	**107.3**
– Other receivables	12	**13.7**
Other receivables		**12.2**
Inwards premiums receivable from insureds and cedants	14	**90.7**
Property, plant and equipment	18	**1.3**
Intangible assets		
– Value of in-force business	19	**36.6**
– Syndicate participation rights	19	**82.6**
Total assets		**976.0**
Liabilities		
Insurance contracts		
– Losses and loss adjustment expenses	13	**331.5**
– Unearned premiums	20	**123.1**
– Other payables	20, 21	**6.3**
Amounts payable to reinsurers	12, 21	**22.0**
Other payables	21	**30.7**
Corporation tax payable		**0.7**
Deferred tax liability		**46.6**
Long-term debt	22, 27	**255.9**
Total liabilities		**816.8**
Net assets acquired at fair value		**159.2**

2. BUSINESS COMBINATIONS CONTINUED

	Notes	$m
Total consideration paid for the entire issued share capital of Cathedral		**230.4**
Net assets acquired at fair value		**159.2**
Excess of total consideration over net fair value of assets acquired allocated to goodwill	19	**71.2**

Intangible assets recognised on the acquisition of Cathedral relate to syndicate participation rights and the value of in-force business. These are discussed further in note 19. The goodwill recognised arose from the premium paid for strengthening the Group's market position and acquiring a skilled workforce with an existing book of business and long standing business relationships. The goodwill is not deductible for tax purposes.

Directly attributable acquisition costs of $5.8 million have been expensed and are included within other operating expenses in the consolidated statement of comprehensive income for the year ending 31 December 2013.

Also included are the Group's share of Cathedral's earned premium, net of reinsurance, of $39.8 million and profit after tax of $6.4 million from the date of acquisition.

Had the acquisition taken place on 1 January 2013, earned premium and profit after tax, included in the consolidated statement of comprehensive income on a pro-forma basis for the Group, would have been approximately $752.9 million and $252.7 million respectively. This summary does not include any possible synergies from the acquisition nor any actions taken by management subsequent to the acquisition. The information is provided for illustrative purposes only and is not necessarily indicative of the future results of the combined companies.

3. SEGMENTAL REPORTING

Management and the Board of Directors review the Group's business primarily by its five principal segments: Property, Energy, Marine, Aviation and Lloyd's. These segments 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 112 to 115. 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. Results included in the Lloyd's segment are from the date of completion of the Cathedral acquisition.

REVENUE AND EXPENSE BY OPERATING SEGMENT

For the year ended 31 December 2013	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m
Gross premium written by geographical region						
Worldwide offshore	–	191.9	61.3	0.1	–	253.3
Worldwide, including the U.S. and Canada[1]	85.4	7.2	0.9	48.8	8.7	151.0
U.S. and Canada	84.9	6.5	–	–	10.1	101.5
Far East	39.1	0.3	–	–	0.5	39.9
Europe	36.4	0.4	0.1	–	1.5	38.4
Worldwide, excluding the U.S. and Canada[2]	18.7	0.4	–	–	0.3	19.4
Middle East	16.5	0.2	–	–	–	16.7
Rest of world	52.4	3.0	0.7	–	3.4	59.5
Total	333.4	209.9	63.0	48.9	24.5	679.7
Outwards reinsurance premiums	(66.9)	(38.5)	(11.2)	(3.8)	(1.7)	(122.1)
Change in unearned premiums	(39.9)	27.8	9.9	(0.4)	26.9	24.3
Change in unearned premiums ceded	(7.8)	3.9	–	–	(9.9)	(13.8)
Net premiums earned	218.8	203.1	61.7	44.7	39.8	568.1
Insurance losses and loss adjustment expenses	(47.1)	(63.2)	(99.2)	(20.0)	(20.5)	(250.0)
Insurance losses and loss adjustment expenses recoverable	16.9	9.3	34.2	–	1.5	61.9
Insurance acquisition expenses	(37.8)	(56.9)	(21.7)	(10.1)	(8.6)	(135.1)
Insurance acquisition expenses ceded	8.4	0.7	0.2	–	–	9.3
Net underwriting profit	159.2	93.0	(24.8)	14.6	12.2	254.2
Net unallocated income and expenses						(36.1)
Profit before tax						218.1
Net loss ratio	13.8%	26.5%	105.3%	44.7%	47.7%	33.1%
Net acquisition cost ratio	13.4%	27.7%	34.8%	22.6%	21.6%	22.1%
Expense ratio	–	–	–	–	–	15.0%
Combined ratio	27.2%	54.2%	140.1%	67.3%	69.3%	70.2%

(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. SEGMENTAL REPORTING CONTINUED

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.

4. INVESTMENT RETURN

The total investment return for the Group is as follows:

For the year ended 31 December 2013	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 – available for sale	**24.5**	**7.6**	**(33.8)**	**(1.7)**	**(3.1)**	**(4.8)**
Fixed income securities – at fair value through profit or loss	**(0.4)**	**–**	**–**	**(0.4)**	**–**	**(0.4)**
Equity securities – available for sale	**0.1**	**–**	**0.5**	**0.6**	**–**	**0.6**
Other investments	**1.8**	**5.0**	**–**	**6.8**	**2.6**	**9.4**
Cash and cash equivalents	**0.8**	**–**	**–**	**0.8**	**(0.1)**	**0.7**
Total investment return	**26.8**	**12.6**	**(33.3)**	**6.1**	**(0.6)**	**5.5**

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 – available for sale	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

Net realised gains (losses) and impairments includes impairment losses of $nil (2012 – $0.3 million) recognised on fixed income securities held by the Group.

Refer to page 122 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 $5.5 million (2012 – $4.0 million) of investment management, accounting and custodian fees.

5. NET INSURANCE ACQUISITION EXPENSES

	2013 $m	2012 $m
Insurance acquisition expenses	**120.8**	136.8
Amortisation of value of in-force business acquired	**8.5**	–
Changes in deferred insurance acquisition expenses	**5.8**	(6.6)
Insurance acquisition expenses ceded	**(8.7)**	(10.9)
Changes in deferred insurance acquisition expenses ceded	**(0.6)**	0.1
Total net insurance acquisition expenses	**125.8**	119.4

A portion of the amortisation expense relating to the value of in-force business acquired has been allocated to insurance acquisition expenses, in line with the run-off profile of that business.

6. RESULTS OF OPERATING ACTIVITIES

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

	2013 $m	2012 $m
Depreciation on owned assets	**1.4**	2.8
Operating lease charges	**2.4**	2.3
Amortisation of value of in-force business	**13.2**	–
Auditors' remuneration		
– Group audit fees	**1.3**	1.1
– Other services	**0.3**	0.3
Total	**18.6**	6.5

In addition to the auditors' remuneration above, $0.5 million of fees were paid to the Group's auditor during the year ended 31 December 2013 in relation to their work performed in their role as Reporting Accountant for LHL's share issuance on 7 August 2013. The share issuance is discussed further in note 23. These fees are included in the Group's consolidated balance sheet as a deduction to share premium. All fees paid to the Group's auditor for tax advice and other services are approved by the Group's Audit Committee.

7. EMPLOYEE BENEFITS

	2013 $m	2012 $m
Wages and salaries	**19.8**	19.1
Pension costs	**1.8**	1.9
Bonus and other benefits	**21.1**	25.9
Total cash compensation	**42.7**	46.9
RSS – ordinary	**13.9**	12.0
RSS – bonus deferral	**2.8**	4.2
LTIP	**–**	0.2
Total equity based compensation	**16.7**	16.4
Total employee benefits	**59.4**	63.3

EQUITY BASED COMPENSATION

The Group's primary equity based compensation scheme is its RSS. Previously the Group also issued options to employees pursuant to an LTIP, which has been closed to further issues, and also authorised and issued warrants at its formation in 2005 and 2006. Further details of the warrants can be found in note 24.

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 2013 and 2012:

Assumptions	2013	2012
Dividend yield	**0.0%**	0.0%
Expected volatility(1)	**23.2%**	23.7% – 24.2%
Risk-free interest rate(2)	**0.40%**	0.50% – 0.53%
Expected average life of options	**3 years**	3 years
Share price	**$13.79**	$12.56 – $12.91

(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 3 year UK government bond yields on the date of grant.

The calculation of the equity based compensation expense assumes forfeitures due to employee turnover of 10.0 per cent 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 75.0 per cent of the ordinary RSS options will vest only on the achievement of an LHL RoE in excess of a required amount. A maximum of 25.0 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. For all RSS options issued in 2012 and earlier the performance criteria was split as 50.0 per cent relating to RoE and 50.0 per cent relating to TSR. 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 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
Granted	**1,236,971**	**–**	**1,236,971**
Exercised	**(1,443,649)**	**(150,975)**	**(1,594,624)**
Forfeited	**(369,810)**	**–**	**(369,810)**
Lapsed	**(17,574)**	**(1,525)**	**(19,099)**
Outstanding as at 31 December 2013	**4,320,761**	**408,827**	**4,729,588**
Exercisable as at 31 December 2013	**1,935,061**	**261,994**	**2,197,055**

(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.

7. EMPLOYEE BENEFITS CONTINUED

	2013			2012		
	Employee restricted stock	**Non-Executive Director restricted stock**	**Total restricted stock**	Employee restricted stock	Non-Executive Director restricted stock	Total restricted stock
Weighted average remaining contractual life	**7.9 years**	**7.5 years**	**7.9 years**	8.0 years	8.2 years	8.1 years
Weighted average fair value at date of grant during the year	**$11.80**	**–**	**$11.80**	$9.99	$9.98	$9.99
Weighted average share price at date of exercise during the year	**$12.80**	**$12.44**	**$12.76**	$12.24	–	$12.24

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 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
Granted	**179,633**	**7,664**	**187,297**
Exercised	**(470,410)**	**(86,382)**	**(556,792)**
Forfeited	**(11,345)**	**–**	**(11,345)**
Outstanding as at 31 December 2013	**355,221**	**24,921**	**380,142**
Exercisable as at 31 December 2013	**62,168**	**–**	**62,168**

(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.

	2013			2012		
	Employee restricted stock	**Non-Executive Director restricted stock**	**Total restricted stock**	Employee restricted stock	Non-Executive Director restricted stock	Total restricted stock
Weighted average remaining contractual life	**8.4 years**	**8.5 years**	**8.4 years**	8.3 years	8.4 years	8.3 years
Weighted average fair value at date of grant during the year	**$13.84**	**$12.71**	**$13.85**	$12.31	$12.16	$12.30
Weighted average share price at date of exercise during the year	**$12.59**	**$12.48**	**$12.57**	$12.24	–	$12.24

RSS – CATHEDRAL ACQUISITION

The Cathedral acquisition RSS options vesting periods range from three to five years and are dependent on certain performance criteria. A maximum of 75.0 per cent of the Cathedral acquisition RSS options will vest only on the achievement of a Cathedral combined ratio below a required amount. A maximum of 25.0 per cent of the Cathedral acquisition 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. The awards are not exercisable as at 31 December 2013.

	Total number of restricted stock
Granted	**2,307,157**
Outstanding as at 31 December 2013	**2,307,157**

	Total number of restricted stock
Weighted average remaining contractual life	**9.9 years**
Weighted average fair value at date of grant during the year	**$13.01**

LTIP

The LTIP plan was closed on 4 January 2008. 25.0 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. All outstanding LTIP options were exercised during the year.

	Number	Weighted average exercise price
Outstanding as at 31 December 2011	337,064	$2.11
Exercised	(203,228)	$2.17
Outstanding as at 31 December 2012	133,836	$0.98
Exercised	**(133,836)**	**$0.80**
Outstanding and exercisable as at 31 December 2013	**–**	**–**

	2013	2012
Weighted average remaining contractual life	**–**	4.5 years
Weighted average share price at date of exercise during the year	**$13.23**	$12.27

As approved by the Remuneration Committee on 18 November 2009, all option exercise prices were automatically adjusted on the dividend record date to neutralise the devaluing impact of dividend payments. The resulting charge to equity based compensation in the consolidated statement of comprehensive income for the year ended 31 December 2013 is $nil (31 December 2012 – $0.2 million). In all cases there is a net $nil impact to shareholders' equity.

7. EMPLOYEE BENEFITS CONTINUED

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 2011	6,515,029	$4.65
Exercised	(330,630)	$4.84
Outstanding and exercisable as at 31 December 2013 and 2012	**6,184,399**	**$4.64**

	2013	2012
Weighted average remaining contractual life	**2.0 years**	3.0 years
Weighted average share price at date of exercise during the year	–	$13.03

MANAGEMENT TEAM PERFORMANCE WARRANTS

Performance warrants were all fully vested by 31 December 2009. All performance warrants will expire ten years from the date of issue. Vesting was dependent on achieving certain performance criteria. The fair value of all warrants granted was $2.62 per warrant. The exercise price of warrants was automatically adjusted for dividends declared prior to their vesting dates.

Performance warrants granted and outstanding are:

	Number	Weighted average exercise price
Outstanding as at 31 December 2011	927,316	$3.62
Exercised	(67,871)	$3.63
Outstanding and exercisable as at 31 December 2013 and 2012	**859,445**	**$3.62**

	2013	2012
Weighted average remaining contractual life	**2.0 years**	3.0 years
Weighted average share price at date of exercise during the year	–	$13.52

Refer to note 24 for further disclosure on non-management warrants outstanding.

8. FINANCING COSTS

	2013 $m	2012 $m
Interest expense on long-term debt	**13.2**	7.2
Net (gains) losses on interest rate swaps	**(5.2)**	4.1
Other financing costs	**0.9**	3.2
Total	**8.9**	14.5

Refer to note 22 for details of long-term debt and financing arrangements.

9. 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 its UK subsidiaries are subject to normal UK corporation tax on all their taxable profits.

Tax charge	2013 $m	2012 $m
Corporation tax (credit) charge for the period	**(2.6)**	1.1
Adjustments in respect of prior period corporation tax	**(1.1)**	(0.3)
Deferred tax charge for the period	**3.8**	0.1
Tax rate change adjustment	**(2.9)**	0.6
Adjustments in respect of prior period deferred tax	**(1.0)**	0.4
Total tax (credit) charge	**(3.8)**	1.9

Tax reconciliation	2013 $m	2012 $m
Profit before tax	**218.1**	236.8
UK corporation tax at 23.25% (2012 – 24.5%)	**50.7**	58.0
Non-taxable income	**(51.0)**	(64.1)
Adjustments in respect of prior period	**(2.1)**	0.1
Differences related to equity based compensation	**0.1**	1.6
Other expense permanent differences	**1.4**	0.2
Tax rate change adjustment	**(2.9)**	0.6
Unused tax losses not recognised for deferred tax	**–**	5.5
Total tax (credit) charge	**(3.8)**	1.9

Due to the different taxpaying jurisdictions throughout the Group, the current tax charge as a percentage of the Group's profit before tax is negative 1.7 per cent (2012 – 0.8 per cent).

A corporation tax credit of $1.1 million (2012 – $1.4 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 16 for further details of tax credits included in other reserves.

Refer to note 11 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.

The UK corporation tax rate as at 31 December 2013 was 23.0 per cent (effective from 1 April 2013). Until 1 April 2013 the UK corporation tax rate of 24.0 per cent applied. On 17 July 2013 reductions to 21.0 per cent from 1 April 2014 and to 20.0 per cent from 1 April 2015 were enacted. These rates have been reflected in the closing deferred tax position on the balance sheet.

10. CASH AND CASH EQUIVALENTS

	2013 $m	2012 $m
Cash at bank and in hand	**297.2**	209.4
Cash equivalents	**105.8**	86.4
Total cash and cash equivalents	**403.0**	295.8

Cash equivalents have an original maturity of three months or less. The carrying amount of these assets approximates their fair value. Refer to note 22 for the cash and cash equivalent balances on deposit as collateral.

11. INVESTMENTS

As at 31 December 2013	Cost or amortised cost $m	Gross unrealised gain $m	Gross unrealised loss $m	Estimated fair value $m
Fixed income securities – available for sale				
– Short-term investments	**231.0**	**0.1**	**(0.1)**	**231.0**
– Fixed income funds	**26.4**	**0.4**	**(0.5)**	**26.3**
– U.S. treasuries	**218.5**	**0.1**	**(1.3)**	**217.3**
– Other government bonds	**111.1**	**0.8**	**(4.0)**	**107.9**
– U.S. municipal bonds	**21.3**	**0.3**	**(0.2)**	**21.4**
– U.S. government agency debt	**99.0**	**–**	**(0.8)**	**98.2**
– Asset backed securities	**150.4**	**1.1**	**(0.1)**	**151.4**
– U.S. government agency mortgage backed securities	**252.5**	**3.5**	**(4.0)**	**252.0**
– Non-agency mortgage backed securities	**8.7**	**0.1**	**–**	**8.8**
– Agency commercial mortgage backed securities	**4.1**	**0.1**	**–**	**4.2**
– Non-agency commercial mortgage backed securities	**36.9**	**1.0**	**–**	**37.9**
– Bank loans	**107.3**	**0.6**	**(0.1)**	**107.8**
– Corporate bonds	**698.0**	**6.0**	**(2.1)**	**701.9**
Total fixed income securities – available for sale	**1,965.2**	**14.1**	**(13.2)**	**1,966.1**
Fixed income securities – at fair value through profit or loss	**30.0**	**–**	**(0.4)**	**29.6**
Equity securities – available for sale	**15.1**	**0.8**	**(0.3)**	**15.6**
Other investments	**2.6**	**3.5**	**(1.4)**	**4.7**
Total investments	**2,012.9**	**18.4**	**(15.3)**	**2,016.0**

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 – available for sale				
– 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 – available for sale	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

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

	2013 $m	2012 $m
Gross unrealised gains	**14.9**	38.3
Gross unrealised losses	**(13.5)**	(2.1)
Net foreign exchange losses (gains)	**1.8**	0.3
Tax provision	**(0.3)**	(1.1)
Accumulated other comprehensive income	**2.9**	35.4

Fixed income maturities are presented in the risk disclosures section on page 128. Refer to note 22 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:

LEVEL (I)

Level (i) investments are 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 level (i) to include highly liquid U.S. treasuries, certain highly liquid short-term investments and quoted equity securities.

11. INVESTMENTS CONTINUED

LEVEL (II)

Level (ii) investments are 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 level (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 level (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;
- Bank loans;
- Corporate bonds; and
- OTC derivatives, including futures, options, forward foreign exchange contracts, interest rate swaps, credit default swaps and swaptions.

LEVEL (III)

Level (iii) investments are securities for which valuation techniques are not based on observable market data. During the years ended 31 December 2013 and 2012, the Group did not hold any level (iii) investments.

The Group determines whether transfers have occurred between levels of the fair value hierarchy by re-assessing the categorisation at the end of each reporting period based on the lowest level input that is significant to the fair value measurement as a whole.

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 2013	(i) $m	(ii) $m	Total $m
Fixed income securities – available for sale			
– Short-term investments	**153.5**	**77.5**	**231.0**
– Fixed income funds	**–**	**26.3**	**26.3**
– U.S. treasuries	**217.3**	**–**	**217.3**
– Other government bonds	**–**	**107.9**	**107.9**
– U.S. municipal bonds	**–**	**21.4**	**21.4**
– U.S. government agency debt	**–**	**98.2**	**98.2**
– Asset backed securities	**–**	**151.4**	**151.4**
– U.S. government agency mortgage backed securities	**–**	**252.0**	**252.0**
– Non-agency mortgage backed securities	**–**	**8.8**	**8.8**
– Agency commercial mortgage backed securities	**–**	**4.2**	**4.2**
– Non-agency commercial mortgage backed securities	**–**	**37.9**	**37.9**
– Bank loans	**–**	**107.8**	**107.8**
– Corporate bonds	**–**	**701.9**	**701.9**
Total fixed income securities – available for sale	**370.8**	**1,595.3**	**1,966.1**
Fixed income securities – at fair value through profit or loss	**–**	**29.6**	**29.6**
Equity securities – available for sale	**15.6**	**–**	**15.6**
Other investments	**–**	**4.7**	**4.7**
Total investments	**386.4**	**1,629.6**	**2,016.0**

11. INVESTMENTS CONTINUED

As at 31 December 2012	(i) $m	(ii) $m	Total $m
Fixed income securities – available for sale			
– 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 – available for sale	329.5	1,545.0	1,874.5
Other investments	–	0.1	0.1
Total investments	329.5	1,545.1	1,874.6

There have been no transfers between levels (i) and (ii) and no level (iii) investments have been held by the Group, therefore no reconciliations have been presented.

12. REINSURANCE ASSETS AND LIABILITIES

	Unearned premiums ceded $m	Amounts payable to reinsurers $m	Other receivables $m	Total $m
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)
Acquired in the Cathedral acquisition	**17.2**	**(22.0)**	**13.7**	**8.9**
Net deferral for prior years (1)	**(23.3)**	**–**	**–**	**(23.3)**
Net deferral for current year	**9.5**	**–**	**–**	**9.5**
Other	**–**	**21.7**	**(7.4)**	**14.3**
As at 31 December 2013	**14.9**	**(30.9)**	**10.8**	**(5.2)**

(1) Includes movement in deferral for reinsurance assets and liabilities acquired in the acquisition of Cathedral

13. 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 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
Assumed in the Cathedral acquisition	**331.5**	**(107.3)**	**224.2**
Net incurred losses for:			
Prior years	**41.9**	**(57.8)**	**(15.9)**
Current year	**208.1**	**(4.1)**	**204.0**
Exchange adjustments	**(13.6)**	**(0.7)**	**(14.3)**
Incurred losses and loss adjustment expenses	**236.4**	**(62.6)**	**173.8**
Net paid losses for:			
Prior years	**200.3**	**(59.8)**	**140.5**
Current year	**51.6**	**(0.1)**	**51.5**
Paid losses and loss adjustment expenses	**251.9**	**(59.9)**	**192.0**
As at 31 December 2013	**853.4**	**(183.0)**	**670.4**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from page 116. 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 the Group's loss reserves. The Group believes that the loss reserves established are adequate, however a 20.0 per cent increase in estimated losses would lead to a $170.7 million (2012 – $107.5 million) increase in gross loss reserves. The split of losses and loss adjustment expenses between notified outstanding losses, additional case reserves assessed by management and IBNR is shown below:

	2013		2012	
As at 31 December	**$m**	**%**	$m	%
Outstanding losses	**501.1**	**58.7**	306.2	57.0
Additional case reserves	**115.0**	**13.5**	98.3	18.3
Losses incurred but not reported	**237.3**	**27.8**	132.9	24.7
Total	**853.4**	**100.0**	537.4	100.0

The Group's reserve for unpaid losses and loss adjustment expenses as at 31 December 2013 and 2012 had an estimated duration of approximately two years.

13. LOSSES AND LOSS ADJUSTMENT EXPENSES CONTINUED

CLAIMS DEVELOPMENT

The development of insurance liabilities is indicative of the Group's ability to estimate the ultimate value of its insurance liabilities. The Group began writing insurance and reinsurance business in December 2005. With the acquisition of Cathedral, the group has assumed loss reserves relating to 2001 and subsequent years.

Accident year	2006 and prior $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	Total $m
Gross losses excluding Lloyd's segment									
Estimate of ultimate liability[1]									
At end of accident year	39.1	154.8	444.6	163.3	297.4	397.0	250.3	176.9	
One year later	34.7	131.2	417.4	107.8	209.4	371.9	290.9		
Two years later	32.0	103.5	377.5	73.1	204.2	362.3			
Three years later	27.6	94.8	345.1	66.0	204.4				
Four years later	27.2	83.5	340.8	64.7					
Five years later	24.4	81.0	346.9						
Six years later	24.0	81.7							
Seven years later	24.9								
Current estimate of cumulative liability excluding Lloyd's segment	**24.9**	**81.7**	**346.9**	**64.7**	**204.4**	**362.3**	**290.9**	**176.9**	**1,552.7**
Payments made	**(23.3)**	**(75.7)**	**(326.0)**	**(52.6)**	**(166.4)**	**(175.9)**	**(163.4)**	**(43.0)**	**(1,026.3)**
Total gross liability	**1.6**	**6.0**	**20.9**	**12.1**	**38.0**	**186.4**	**127.5**	**133.9**	**526.4**
Gross losses – Lloyd's segment									
Estimate of ultimate liability[1]									
At acquisition	35.1	6.8	7.8	24.1	30.8	83.5	66.2	77.2	331.5
Current estimate of cumulative liability – Lloyd's segment	**35.5**	**7.0**	**7.0**	**23.9**	**30.9**	**78.3**	**61.2**	**109.6**	**353.4**
Payments made	**(0.3)**	**(0.6)**	**(0.5)**	**(0.4)**	**(1.7)**	**(9.4)**	**(4.9)**	**(8.6)**	**(26.4)**
Total gross liability	**35.2**	**6.4**	**6.5**	**23.5**	**29.2**	**68.9**	**56.3**	**101.0**	**327.0**
Total Group gross liability	**36.8**	**12.4**	**27.4**	**35.6**	**67.2**	**255.3**	**183.8**	**234.9**	**853.4**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2013.

FINANCIAL STATEMENTS

Accident year	2006 and prior $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	Total $m
Reinsurance excluding Lloyd's segment									
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	108.2		
Two years later	–	4.0	43.1	0.7	24.1	52.2			
Three years later	–	3.5	40.9	0.7	24.5				
Four years later	–	3.3	38.1	0.7					
Five years later	–	3.1	39.2						
Six years later	–	3.2							
Seven years later	–								
Current estimate of cumulative recovery excluding Lloyd's segment	**–**	**3.2**	**39.2**	**0.7**	**24.5**	**52.2**	**108.2**	**–**	**228.0**
Payments made	**–**	**(3.2)**	**(36.8)**	**(0.6)**	**(22.8)**	**(12.7)**	**(70.9)**	**–**	**(147.0)**
Total gross recovery	**–**	**–**	**2.4**	**0.1**	**1.7**	**39.5**	**37.3**	**–**	**81.0**
Reinsurance – Lloyd's segment									
Estimate of ultimate liability[1]									
At acquisition	24.3	1.9	1.1	9.0	9.1	41.0	14.9	6.0	107.3
Current estimate of cumulative recovery – Lloyd's segment	**24.9**	**1.8**	**1.2**	**8.9**	**9.1**	**39.5**	**13.9**	**10.1**	**109.4**
Payments made	**(0.2)**	**–**	**(0.2)**	**0.1**	**(0.9)**	**(4.9)**	**(1.2)**	**(0.1)**	**(7.4)**
Total gross recovery	**24.7**	**1.8**	**1.0**	**9.0**	**8.2**	**34.6**	**12.7**	**10.0**	**102.0**
Total Group gross recovery	**24.7**	**1.8**	**3.4**	**9.1**	**9.9**	**74.1**	**50.0**	**10.0**	**183.0**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2013.

13. LOSSES AND LOSS ADJUSTMENT EXPENSES CONTINUED

Accident year	2006 and prior $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	Total $m
Net losses excluding Lloyd's segment									
Estimate of ultimate liability(1)									
At end of accident year	39.1	151.2	403.9	161.7	263.6	340.8	201.4	176.9	
One year later	34.7	125.0	370.3	106.5	185.8	319.3	182.7		
Two years later	32.0	99.5	334.4	72.4	180.1	310.1			
Three years later	27.6	91.3	304.2	65.3	179.9				
Four years later	27.2	80.2	302.7	64.0					
Five years later	24.4	77.9	307.7						
Six years later	24.0	78.5							
Seven years later	24.9								
Current estimate of cumulative liability excluding Lloyd's segment	**24.9**	**78.5**	**307.7**	**64.0**	**179.9**	**310.1**	**182.7**	**176.9**	**1,324.7**
Payments made	**(23.3)**	**(72.5)**	**(289.2)**	**(52.0)**	**(143.6)**	**(163.2)**	**(92.5)**	**(43.0)**	**(879.3)**
Total net liability	**1.6**	**6.0**	**18.5**	**12.0**	**36.3**	**146.9**	**90.2**	**133.9**	**445.4**
Net losses – Lloyd's segment									
Estimate of ultimate liability(1)									
At acquisition	10.8	4.9	6.7	15.1	21.7	42.5	51.3	71.2	224.2
Current estimate of cumulative liability – Lloyd's segment	**10.6**	**5.2**	**5.8**	**15.0**	**21.8**	**38.8**	**47.3**	**99.5**	**244.0**
Payments made	**(0.1)**	**(0.6)**	**(0.3)**	**(0.5)**	**(0.8)**	**(4.5)**	**(3.7)**	**(8.5)**	**(19.0)**
Total net liability	**10.5**	**4.6**	**5.5**	**14.5**	**21.0**	**34.3**	**43.6**	**91.0**	**225.0**
Total Group net liability	**12.1**	**10.6**	**24.0**	**26.5**	**57.3**	**181.2**	**133.8**	**224.9**	**670.4**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2013.

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:

	2013 $m	2012 $m
2006 accident year and prior	**(0.7)**	0.4
2007 accident year	**(0.9)**	2.3
2008 accident year	**(4.1)**	1.7
2009 accident year	**2.0**	7.1
2010 accident year	**1.4**	6.4
2011 accident year	**(4.1)**	9.5
2012 accident year	**22.3**	–
Total favourable development	**15.9**	27.4

The favourable prior year development in 2013 arose primarily from IBNR releases due to fewer than expected reported losses, a benefit from the settlement on our North East ILW in relation to Sandy and releases on the settlement of outstanding losses. This favourable development was offset to an extent by unfavourable development of $33.5 million after reinsurance, on the Costa Concordia marine loss. The favourable prior year development in 2012 arose primarily from IBNR releases due to fewer than expected reported losses.

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 $30.7 million. The 90th percentile of the loss distribution for this estimate is $36.2 million with the 95th percentile being $38.4 million. Significant uncertainty exists on the eventual ultimate loss.

During 2012 the Group was also impacted by significant losses in relation to the total loss of the Costa Concordia. Management's current best estimate of the ultimate net loss in relation to this event is $97.1 million. The 90th percentile of the loss distribution for this estimate is $102.6 million with the 95th percentile being $104.4 million. Significant uncertainty exists on the eventual ultimate loss in relation to this event.

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 $122.2 million. The 90th percentile of the loss distribution for this estimate is $130.9 million with the 95th percentile being $134.1 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	Costa Concordia $m	Japan $m
Net ultimate losses as at 31 December 2011	–	–	117.3
Change in insurance losses and loss adjustment expenses	46.0	92.8	3.7
Change in insurance losses and loss adjustment expenses recoverable	–	(47.0)	–
Change in reinstatement premium	(1.5)	13.4	(2.0)
Net ultimate losses as at 31 December 2012	44.5	59.2	119.0
Assumed in the Cathedral acquisition	**6.8**	**–**	**3.7**
Change in insurance losses and loss adjustment expenses	**3.4**	**67.7**	**(0.7)**
Change in insurance losses and loss adjustment expenses recoverable	**(23.6)**	**(34.2)**	**(0.5)**
Change in reinstatement premium	**(0.4)**	**4.4**	**0.7**
Net ultimate losses as at 31 December 2013	**30.7**	**97.1**	**122.2**

14. INSURANCE, REINSURANCE AND OTHER RECEIVABLES

All receivables are considered current other than $52.1 million (2012 – $37.2 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.

15. 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 2011	61.4	(0.7)	60.7
Net deferral during the year	136.8	(10.9)	125.9
(Expense) income for the year	(130.2)	10.8	(119.4)
As at 31 December 2012	68.0	(0.8)	67.2
Net deferral during the year	**132.4**	**(8.7)**	**123.7**
(Expense) income for the year	**(126.6)**	**9.3**	**(117.3)**
As at 31 December 2013	**73.8**	**(0.2)**	**73.6**

16. PROVISION FOR DEFERRED TAX

	2013 $m	2012 $m
Equity based compensation	**8.5**	9.5
Claims equalisation reserves	**(16.7)**	(2.2)
Syndicate underwriting profits	**(11.2)**	–
Syndicate participation rights	**(16.4)**	–
Other temporary differences	**(5.1)**	–
Tax losses carried forward	**2.2**	–
Net deferred tax (liability) asset	**(38.7)**	**7.3**

A deferred tax credit of $0.5 million (2012 – $0.2 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 Group 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 LHL, as at present, the related tax benefit is not expected to be realised through future taxable profits.

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

17. INVESTMENT IN ASSOCIATES

AHL

The Group holds a 20.0 per cent interest (31 December 2012 - 20.0 per cent) in the common shares of AHL, a company incorporated in Bermuda. AHL's operating subsidiary, ARL, is authorised as a Special Purpose Insurer by the BMA.

ARL assumed 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 2013, the Group's capital commitment in AHL was $17.2 million (31 December 2012 – $41.1 million). As at 31 December 2013 the carrying value of the Group's investment in AHL is $32.4 million (31 December 2012 – $49.7 million). The Group's share of comprehensive income for AHL for the period was $6.6 million (2012 – $7.7 million). Investments in associates are generally deemed non-current. Key financial information for AHL is as follows:

	2013 $m	2012 $m
Assets	**194.0**	272.5
Liabilities	**36.8**	26.0
Shareholders' equity	**157.2**	246.5
Gross premiums earned	**52.0**	66.6
Comprehensive income	**30.8**	36.7

Refer to note 27 for details of transactions between the Group, AHL and ARL.

SHL

The Group holds a 16.9 per cent interest (31 December 2012 - 20.0 per cent) 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. At 31 December 2013 the Group's capital commitment to SHL was $9.6 million. As at 31 December 2013 the carrying value of the Group's investment in SHL was $12.2 million (31 December 2012 – $32.4 million). The Group's share of comprehensive income for SHL for the period was $2.6 million (31 December 2012 – $nil). Key financial information for SHL is as follows:

	2013 $m	2012 $m
Assets	**75.8**	192.3
Liabilities	**3.5**	–
Shareholders' equity	**72.3**	192.3
Gross premiums earned	**24.8**	–
Comprehensive income	**15.5**	–

The Group has the power to participate in operational and financial policy decisions of SHL and SRL through the provision of essential technical information and has therefore classified its investment in SHL as an investment in associate. Refer to note 27 for details of transactions between the Group, SHL and SRL.

KHL

In 2013 the Group invested $20.1 million representing a 10.0 per cent interest in the common shares of KHL, a company incorporated in Bermuda. KHL's operating subsidiary, KRL, is authorised as a Special Purpose Insurer by the BMA. KRL is a market facing vehicle underwriting collateralised reinsurance products. KRL commenced writing insurance business on 1 January 2014. Financial information for the period from the date of incorporation, 4 June 2013 to 31 December 2013 is as follows:

	2013 $m
Assets	**201.2**
Shareholders' equity	**201.2**

The Group has the power to participate in operational and financial policy decisions of KHL and KRL through the provision of essential technical information and has therefore classified its investment in KHL as an investment in associate.

18. PROPERTY, PLANT AND EQUIPMENT

	2013 $m	2012 $m
Cost	**14.3**	12.9
Accumulated depreciation	**(11.5)**	(10.1)
Net book value	**2.8**	**2.8**

19. INTANGIBLE ASSETS

	Value of in-force business $m	Syndicate participation rights $m	Goodwill $m	Total $m
Acquired in the Cathedral acquisition	**36.6**	**82.6**	**71.2**	**190.4**
Cost as at 31 December 2013	**36.6**	**82.6**	**71.2**	**190.4**
Amortisation charge for the year	**(13.2)**	**–**	**–**	**(13.2)**
Accumulated amortisation at 31 December 2013	**(13.2)**	**–**	**–**	**(13.2)**
Net book value at 31 December 2013	**23.4**	**82.6**	**71.2**	**177.2**

Syndicate participation rights and goodwill are deemed to have indefinite life as they are expected to have value in use that does not diminish over the course of time. Consequently, the carrying value is not amortised but tested annually for impairment. The value of in-force business is amortised over the remaining life of the acquired insurance contracts, which is approximately one year.

For the purpose of impairment testing, intangible assets are allocated to the Group's CGU's, in accordance with the manner in which management operates and monitors the business. The syndicate participation rights and goodwill have therefore been allocated to the Lloyd's CGU.

When testing for impairment, the recoverable amount of the Lloyd's CGU is determined based on value in use. Value in use is calculated using projected cash flows based on the financial projections of the CGU. These are approved by management and cover a 3 year period. The most significant assumptions used to derive the projected cash flows include an assessment of business prospects, projected loss ratios, outwards reinsurance expenditure and investment return. A discount rate of 8.4 per cent has been used to discount the projected post tax cash flows, which reflects a combination of factors including the Group's expected cost of equity and cost of borrowing. The growth rate used to extrapolate the cash flows of the unit beyond the 3 year period is 2.0 per cent based on historical growth rates and management's best estimate of future growth rates.

The results of this exercise indicate that the recoverable amount exceeds the intangible asset's carrying value for both the syndicate participation rights and goodwill and would not be sensitive to reasonable possible changes in assumptions.

20. INSURANCE LIABILITIES

	Unearned premiums $m	Other payables $m	Total $m
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
Acquired in the Cathedral acquisition	**123.1**	**6.3**	**129.4**
Net deferral for prior years(1)	**(275.9)**	**–**	**(275.9)**
Net deferral for current year	**251.6**	**–**	**251.6**
Other	**–**	**(0.9)**	**(0.9)**
As at 31 December 2013	**442.1**	**28.9**	**471.0**

(1) Includes movement in deferral for insurance liabilities acquired in the Cathedral acquisition.

21. INSURANCE, REINSURANCE AND OTHER PAYABLES

	2013 $m	2012 $m
Other payables	**78.5**	47.4
Accrued interest payable	**2.2**	1.9
Total other payables	**80.7**	49.3
Insurance contracts – other payables	**28.9**	23.5
Amounts payable to reinsurers	**30.9**	30.6
Total payables	**140.5**	103.4

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.

22. LONG-TERM DEBT AND FINANCING ARRANGEMENTS

LONG-TERM DEBT

On 5 October 2012 the Group issued U.S. $130.0 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 floating rate subordinated loan notes. The U.S. dollar subordinated loan notes are repayable on 15 December 2035. Interest on the principal is based on a set margin, 3.70 per cent, above the three month 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. Interest on the principal is based on a set margin, 3.70 per cent, above the 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.

In 2013 the Group assumed loan notes, issued by CCHL and listed on the ISE, as part of the Cathedral acquisition. The loan notes acquired are set out as follows:

- €12.0 million floating rate subordinated loan note issued on 18 November 2004 and repayable on September 2034, paying interest quarterly based on a set margin, 3.75 per cent, above three month EURIBOR;
- $10.0 million floating rate subordinated note loan issued on 26 November 2004 and repayable in September 2034, paying interest quarterly based on a set margin, 3.75 per cent, above three month LIBOR;
- $25.0 million floating rate subordinated loan note issued on 13 May 2005 and repayable in June 2035, paying interest quarterly based on a set margin, 3.25 per cent, above three month LIBOR; and
- $25.0 million floating rate subordinated loan note issued on 18 November 2005 and repayable in December 2035, paying interest quarterly based on a set margin, 3.25 per cent, above three month LIBOR.

The Group has the option to redeem its senior unsecured notes and all of its subordinated loan notes, in whole or in part, prior to the respective maturity dates.

22. LONG-TERM DEBT AND FINANCING ARRANGEMENTS CONTINUED

The carrying values of the notes are shown below:

As at 31 December	2013 $m	2012 $m
Long-term debt $130.0 million	**130.0**	130.0
Long-term debt $97.0 million	**97.0**	97.0
Long-term debt €24.0 million	**33.0**	31.7
Long-term debt €12.0 million	**14.9**	n/a
Long-term debt $10.0 million	**10.0**	n/a
Long-term debt $25.0 million	**23.7**	n/a
Long-term debt $25.0 million	**23.7**	n/a
Carrying value	**332.3**	**258.7**

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 page 125.

The fair value of the long-term debt is estimated as $341.2 million (2012 – $252.9 million). The fair value measurement is classified within level (ii) of the fair value hierarchy. The fair value is estimated by reference to similar financial instruments quoted in active markets.

The interest accrued on the long-term debt was $2.2 million (2012 – $1.9 million) at the balance sheet date and is included in other payables.

Refer to note 8 for details of the interest expense for the year included in financing costs.

INTEREST RATE SWAPS

The Group hedges a portion of its floating rate borrowings using interest rate swaps to transfer floating to fixed rate. These instruments are held at estimated fair value. Refer to the risk disclosures section from page 124 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 $0.2 million. Further information is provided on pages 122 and 124. 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 $0.7 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 8 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 at 31 December 2013:

(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 as at 31 December 2013; 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 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 30.0 per cent, where the subordinated loan notes 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	2013 $m	2012 $m
Issued to third parties	**20.1**	17.2

LOCs are required to be fully collateralised.

SYNDICATE BANK FACILITIES

As at 31 December 2013, Syndicate 2010 had in place an $80.0 million catastrophe facility with Barclays Bank plc. The facility is available to assist in paying claims and the gross funding of catastrophes for Syndicate 2010. Up to $50.0 million can be utilised by way of an LOC to assist Syndicate 2010's gross funding requirements.

As at 31 December 2013, Syndicate 3010 had in place a $20.0 million catastrophe facility with Barclays Bank plc. The facility is available to assist in paying claims and the gross funding of catastrophes for Syndicate 3010. Up to $10.0 million can be utilised by way of an LOC to assist gross funding requirements of Syndicate 3010.

There are no balances outstanding under either of the syndicate bank facilities as at 31 December 2013. The syndicate bank facilities are not available to the Group other than through its participation on the syndicates it supports.

TRUSTS AND RESTRICTED BALANCES

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.

In 2012 LICL entered into an MBRT to collateralise its reinsurance liabilities associated with U.S. domiciled clients. As at 31 December 2013, LICL had been granted authorised or trusteed reinsurer status in 45 States (31 December 2012 – 1 State). The MBRT is subject to the rules and regulations of the aforementioned States 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 2013 and 2012 the Group was in compliance with all covenants under its trust facilities.

With the acquisition of Cathedral the Group is now required to hold a portion of its assets as FAL to support the underwriting capacity of Syndicate 2010 and Syndicate 3010. FAL are restricted in their use and are only drawn down to pay cash calls to syndicates supported by the Group. FAL requirements are formally assessed twice a year and any funds surplus to requirements may be released at that time. See note 29 for more information regarding FAL requirements.

In addition to the FAL, cash and investments held by Syndicate 2010 and Syndicate 3010 are only available for paying claims and expenses of the syndicate to their policyholders. See note 29 for more information regarding capital requirements for Syndicate 2010 and Syndicate 3010.

The following cash and cash equivalents and investment balances were held in trust, other collateral accounts in favour of third parties or are otherwise restricted:

	2013		2012	
As at 31 December	Cash and cash equivalents $m	Fixed income securities $m	Cash and cash equivalents $m	Fixed income securities $m
MBRT accounts	**1.0**	**20.0**	–	20.2
In various other trust accounts for policyholders	**3.8**	**9.7**	12.5	123.6
In favour of LOCs	**6.3**	**20.0**	3.3	17.0
In favour of derivative contracts	**0.7**	**0.8**	–	0.4
FAL	**11.1**	**159.7**	–	–
Syndicate accounts	**16.9**	**218.2**	–	–
Total	**39.8**	**428.4**	15.8	161.2

23. SHARE CAPITAL

Authorised ordinary shares of $0.50 each	Number	$m
As at 31 December 2013 and 2012	3,000,000	1,500.0

Allocated, called up and fully paid	Number	$m
As at 31 December 2012 and 2011	168,602,427	84.3
Shares issued	**16,843,382**	**8.4**
As at 31 December 2013	**185,445,809**	**92.7**

Own shares	Number held in treasury	$m	Number held in trust	$m	Total number of own shares	$m
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
Shares distributed	**(435,120)**	**(3.0)**	**(2,276,285)**	**(30.1)**	**(2,711,405)**	**(33.1)**
Shares donated to trust	**(1,862,138)**	**(13.1)**	**1,862,138**	**25.9**	**–**	**12.8**
As at 31 December 2013	**3,513,325**	**24.6**	**906,339**	**12.2**	**4,419,664**	**36.8**

The number of common shares in issue with voting rights (allocated share capital less shares held in treasury) as at 31 December 2013 was 181,932,484 (31 December 2012 – 162,791,844).

On 7 August 2013 LHL issued 16,843,382 new common shares. As a result of these shares being issued, a total of $203.5 million was raised, $8.4 million of which is included in share capital and $195.1 million of which is included in share premium, net of $5.3 million of offering expenses.

SHARE REPURCHASES

At the AGM held on 1 May 2013 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 2014 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 2013 the trustees of the EBT acquired nil shares (2012 – nil) in accordance with the terms of the trust and distributed 2,276,285 (2012 – 2,848,168). There were no unsettled balances in relation to EBT purchases at either balance sheet date.

DIVIDENDS

The Board of Directors have authorised the following dividends:

Type	Per share amount	Record date	Payment date	$m
Final	$0.10	16 Mar 2012	18 Apr 2012	19.2
Interim	$0.05	31 Aug 2012	26 Sep 2012	9.6
Special	$0.90	30 Nov 2012	19 Dec 2012	172.6
Final	$0.10	22 Mar 2013	17 Apr 2013	19.2
Special	$1.05	22 Mar 2013	17 Apr 2013	201.4
Interim	$0.05	23 Aug 2013	25 Sep 2013	10.5
Special	$0.45	29 Nov 2013	20 Dec 2013	94.5

24. 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 7. 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 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
Exercised	**(728,785)**	**–**	**–**
Outstanding and exercisable as at 31 December 2013	**19,074,787**	**648,143**	**2,350,000**
Weighted average exercise price as at 31 December 2013	**$5.00**	**$4.73**	**$5.00**

	2013	2012
Weighted average remaining contractual life	**2.0 years**	3.0 years
Weighted average share price at date of exercise during the year	**$12.17**	$12.47

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 7 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.

25. 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 $2.4 million (2012 – $2.3 million). Future minimum lease payments under non-cancellable operating leases are as follows:

	2013 $m	2012 $m
Due in less than one year	**2.9**	2.5
Due between one and five years	**6.9**	3.4
Total	**9.8**	**5.9**

26. EARNINGS PER SHARE

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

	2013 $m	2012 $m
Profit for the year attributable to equity shareholders of LHL	**222.5**	234.9

	2013 Number of shares	2012 Number of shares
Basic weighted average number of shares	**169,270,681**	159,575,802
Dilutive effect of RSS	**3,431,739**	4,278,094
Dilutive effect of LTIP	**–**	123,444
Dilutive effect of warrants	**17,788,368**	18,194,380
Diluted weighted average number of shares	**190,490,788**	**182,171,720**

Earnings per share	2013	2012
Basic	**$1.31**	$1.47
Diluted	**$1.17**	$1.29

26. EARNINGS PER SHARE CONTINUED

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.

27. RELATED PARTY DISCLOSURES

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

Name	Principal Business	Domicile
Subsidiaries[1]		
LICL	General insurance business	Bermuda
SML	Insurance management services	Bermuda
KCML[2]	Insurance management services	Bermuda
Lutine	Non trading	Bermuda
KCMMSL	Support services	United Kingdom
LIHL	Holding company	United Kingdom
LIMSL	Insurance mediation activities	United Kingdom
LISL	Support services	United Kingdom
LUK	General insurance business	United Kingdom
LMSCL	Support services	Canada
CCIL	Holding company	United Kingdom
CCHL	Investment company	United Kingdom
CCL	Holding company	United Kingdom
CCL 1998	Lloyd's corporate member	United Kingdom
CCL 1999	Non trading	United Kingdom
CCL 2000	Holding company	United Kingdom
CCML	Non trading	United Kingdom
CCSL	Support services	United Kingdom
CUL	Lloyd's managing agent	United Kingdom
Associates		
AHL	Holding company	Bermuda
AHL II	Holding company	Bermuda
SHL	Holding company	Bermuda
KHL	Holding company	Bermuda
Other controlled entities		
LHFT	Trust	United States
EBT	Trust	Jersey

(1) Unless otherwise stated, the Group owns 100 per cent of the ordinary share capital and voting rights in its subsidiaries listed.

(2) 87.43 per cent owned by the Group.

The Group has issued subordinated loan notes via a trust vehicle – LHFT, refer to note 22. The Group effectively has 100.0 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 $60.0 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 2013, the Group had made advances of $10.7 million (2012 – $10.3 million) to the EBT under the terms of the Facility.

During the year ended 31 December 2013 the Group donated 1,862,138 (2012 – 2,901,233) treasury shares to the EBT at the prevailing market rate. The total value of the treasury share donation was $25.9 million (2012 – $35.8 million).

LICL holds $302.8 million (2012 – $298.1 million) of cash and cash equivalents and fixed income securities in trust for the benefit of LUK relating to intra-group reinsurance agreements.

Through the business combination with Cathedral, discussed in note 2, LHL acquired fixed rate manager and investor loan notes of $123.4 million issued by CCIL and $62.3 million of preference shares issued by CCL. Subsequently, and prior to the year ended 31 December 2013, these loan notes and preference shares were redeemed by CCIL and CCL.

In 2013 members of the Group's senior management team contributed 12.57 per cent of the share capital in KCML. This investment represents the non-controlling interest listed in the Group's consolidated balance sheet.

KEY MANAGEMENT COMPENSATION

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

For the year ended 31 December	2013 $m	2012 $m
Short-term compensation	**8.1**	13.7
Equity based compensation	**6.7**	7.4
Directors' fees and expenses	**2.1**	1.7
Total	**16.9**	**22.8**

The Directors' fees and expenses includes $0.4 million (2012 – $0.4 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 LANCASHIRE FOUNDATION

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

Date	$m
7 November 2012	1.4
23 May 2013	1.4

27. RELATED PARTY DISCLOSURES CONTINUED

TRANSACTIONS WITH ASSOCIATES

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	2013 $m	2012 $m
Consolidated statement of comprehensive income		
Outwards reinsurance premiums	**47.9**	64.8
Insurance loss and loss adjustment expenses recoverable	**9.1**	17.7
Insurance acquisition expenses ceded	**7.1**	9.0
Consolidated balance sheet		
Reinsurance recoveries	**26.8**	17.7
Unearned premiums on premiums ceded	**–**	3.5
Amounts payable to reinsurers	**(5.5)**	(18.4)
Deferred acquisition costs ceded	**–**	(0.6)

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

In 2013 KCML entered into an underwriting services agreement with KRL and KHL 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 2013 the Group did not enter any financial transactions with KRL or KHL apart from its initial investment discussed in note 17. Contingent profit commission may be payable to KCML depending on the ultimate performance of KRL.

During 2012 SML entered into an 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. In 2013 the Group recognised $1.2 million (2012: $nil) of service fees in other income in relation to this agreement. Contingent profit commission may be payable to SML depending on the ultimate performance of SRL.

FINANCIAL STATEMENTS

28. NON-CASH TRANSACTIONS

TBAs classified as derivatives were settled net during the year with purchases and sales of $nil (2012 – $32.6 million) and $nil (2012 – $32.6 million) respectively.

29. 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 LICL and LUK, these regulatory restrictions are based principally on the amount of premiums written and reserves for losses and loss adjustment expenses, subject to overall minimum solvency requirements. LICL and LUK's statutory capital and surplus are 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 LICL and LUK is as follows:

	2013		2012	
As at 31 December	LICL $m	LUK £m	LICL $m	LUK £m
Statutory capital and surplus	**1,210.2**	**118.9**	1,293.8	115.3
Minimum required statutory capital and surplus	**235.5**	**23.9**	255.5	23.8

LICL is required to maintain a minimum liquidity ratio, whereby relevant assets, as defined in the regulations, must exceed 75.0 per cent of relevant liabilities. As at 31 December 2013 and 2012 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.

For LUK, various capital calculations are performed and an ICA is presented to the PRA. The PRA then considers the capital calculations and issues an ICG, reflecting the PRA's own view as to the level of capital required. The PRA considers that a decrease in an insurance company's capital below the level of its ICG represents a regulatory intervention point. As the Solvency II regime is adopted by the PRA the capital measures will change, but the principals and restrictions on capital release will remain.

The Group's underwriting capacity as a member of Lloyd's must be supported by providing a deposit in the form of cash, securities or LOCs, which are referred to as FAL. The capital framework at Lloyd's requires each managing agent to calculate the capital requirement for each syndicate they manage, a process known as ICA. Solvency II internal models and the uSCR have been used to determine capital requirements for Syndicate 2010 and Syndicate 3010. The uSCR of each syndicate at Lloyd's is regarded as the minimum regulatory capital requirement for the business. Lloyd's has the discretion to take into account other factors at member level to uplift the calculated uSCR, including the need to maintain the market's overall security rating. Any uplift by Lloyd's is added to the uSCR to produce the ECA.

Lloyd's then uses each syndicate's ECA as a basis for determining member level ECR. For the 2014 calendar year the Group's initial FAL requirement was set at 61.0 per cent of underwriting capacity supported. Further adjustments can be made by Lloyd's to allow for open year profits and losses of the syndicates on which the corporate member participates. The Group has sufficient capital to meet its FAL requirement of £115.1 million as at 31 December 2013 (31 December 2012 – $nil).

As at 31 December 2013 and 2012 the capital requirements of the regulatory jurisdictions were met.

30. SUBSEQUENT EVENTS

DIVIDEND

On 12 February 2014 the Board of Directors declared the payment of an ordinary dividend of $0.10 per common share and a special dividend of $0.20 per share to shareholders of record on 21 March 2014, with a settlement date of 16 April 2014. The ordinary dividend payable will be approximately $21.0 million and the special dividend payable will be approximately $42.0 million. An amount equivalent to the dividend accrues on all RSS options and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

RETURN OF CAPITAL FROM ASSOCIATE

Subsequent to 31 December 2013, SHL returned $12.2 million of capital to the Group and SRL paid a final profit commission to the Group in the amount of $2.9 million and was placed in to run-off.

ACTIVE UNDERWRITER
The individual at a Lloyd's syndicate with principal authority to accept insurance and reinsurance risk on behalf of the syndicate

ABS
Asset backed securities

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

AHL II
Accordion Holdings Limited II

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

BAM
Bathwater aggregate model

BEST LANCASHIRE ASSESSMENT OF SOLVENCY OVER TIME (BLAST)
The Group's economic capital model

BMA
Bermuda Monetary Authority

BOARD OF DIRECTORS
Unless otherwise stated refers to the LHL Board of Directors

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

CATHEDRAL; CATHEDRAL GROUP
Refers to CCL and all direct and indirect subsidiaries of CCL

CCHL
Cathedral Capital Holdings Limited

CCIL
Cathedral Capital (Investments) Limited

CCL
Cathedral Capital Limited

CCL 1998
Cathedral Capital (1998) Limited

CCL 1999
Cathedral Capital (1999) Limited

CCL 2000
Cathedral Capital (2000) Limited

CCML
Cathedral Capital Management Limited

CCSL
Cathedral Capital Services Limited

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

THE 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

COVERHOLDER AT LLOYD'S
A coverholder is a company or partnership authorised by a managing agent to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate managed by it in accordance with the terms of a binding authority

CEO
Chief Executive Officer

CFO
Chief Financial Officer

CFC
Controlled Foreign Company

CGU
Cash generating unit

CMBS
Commercial mortgage backed securities

CRO
Chief Risk Officer

CUL
Cathedral Underwriting Limited

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 EARNINGS PER SHARE (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

DIVIDEND YIELD
Calculated by dividing the annual dividends per share by the share price on the last day of the given year

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

ECA
Economic Capital Assessment

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

FCA
Financial Conduct Authority

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

FSMA
The Financial Services and Markets Act 2000 (as amended from time to time)

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

G10
Belgium, Canada, Germany, France, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States

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)

IGPIA
International group of protection and indemnity clubs association

ILS
Insurance linked securities

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

INTEGRATED LLOYD'S VEHICLE
A company which owns a corporate member of a syndicate and the managing agent of that syndicate

INTERNAL AUDIT CHARTER
Is a formal written document that sets out the mission, scope, responsibilities, authority, professional standards and the relationship with the external auditors / regulatory bodies of the internal audit function ("internal audit") with the company and its subsidiaries

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

IRRC
Investment Risk and Return Committee

ISE
Irish Stock Exchange

KCML
Kinesis Capital Management Limited

KCMMSL
KCM Marketing Services Limited (UK)

KHL (KINESIS HOLDINGS)
Kinesis Holdings I Limited

KINESIS
The Group's third party capital management division encompassing KCML, KCMMSL and the management of KHL and KRL

KRL (KINESIS RE)
Kinesis Reinsurance I Limited

LANCASHIRE
Refers to the Group excluding Cathedral and Kinesis

LANCASHIRE FOUNDATION OR 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

LIBOR
London Interbank Offered Rate

LICL
Lancashire Insurance Company Limited

LIHL
Lancashire Insurance Holdings (UK) Limited

LIMSL
Lancashire Insurance Marketing Services Limited

LISL
Lancashire Insurance Services Limited

LISTING RULES
The listing rules made by the FCA under part VI of FSMA (as amended from time to time)

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

LUTINE
Lutine Limited

MBRT
Multi-beneficiary reinsurance trust

MBS
Mortgage backed securities

MOODY'S
Moody's Corporation is the parent company of Moody's Investors Service, which provides credit ratings and research covering debt instruments and securities, and Moody's Analytics, which offers software, advisory services and research for credit and economic analysis and financial risk management.

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

ORSA
Own Risk and Solvency Assessment

OTC
Over the counter

PML
Probable maximum loss

PRA
Prudential Regulation Authority

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

Regular way purch

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
Residential mortgage backed securities

RMS
Risk Management Solutions

RRC
Risk and Return Committee

RSS
Restricted share scheme

SATEC
SATEC Underwriting, a privately owned Insurance Underwriting Agency operating at national and international level in specialty classes of business. SATEC Underwriting is a coverholder at Lloyd's

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

SYNDICATE 2010
Lloyd's Syndicate 2010, managed by CUL. The group provides capital to support 57.8 per cent of the stamp.

SYNDICATE 3010
Lloyd's Syndicate 3010, managed by CUL. The group provides capital to support 100.0 per cent of the stamp.

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

TRIPRA
Terrorism Risk Insurance Protection Act

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

USCR
Ultimate solvency capital requirement

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