Lancashire Holdings Limited

Annual Report & Accounts 2018

This is who we are

We are a provider of global specialty insurance and reinsurance products operating in Bermuda and London across three delivery platforms: rated company, Lloyd's and collateralised security.

Our focus is on short-tail, specialty (re)insurance risks within five general segments: Property, Energy, Marine, Aviation and Lloyd's.

Strategic report

Overview

Strategy

Performance

Governance

Financial statements

Additional information

At Lancashire, we recognise the value of hard work and that the combined talents of our people are critical to maximising risk-adjusted returns across the cycle.

Working together and supporting our policyholders is what ensures that our three core businesses can be more than the sum of their parts.

Return on equity KPI
2.4%
2017: -5.9%

Combined ratio KPI
92.2%
2017: 124.9%

Profit (Loss) after tax
$37.5m
2017: $-71.1m

Total investment return KPI
0.8%
2017: 2.5%

Dividend yield KPI
4.5%
2017: 1.6%

Total shareholder return KPI
-12.7%
2017: 9.4%

Focused
Responsive
Nimble

Property
Energy
Marine
Aviation
Lloyd’s

Structured to succeed

Lancashire Holdings Limited

Lancashire | Cathedral | Kinesis

Lancashire

Traditional company market rated (re) insurers operating in Bermuda and London. Underwriting high layers with higher deductibles to differentiate market position and drive lower attritional loss ratios. A lower number of large contracts and single exposures afford greater underwriting control. A consistent strategy and transparent risk appetite make Lancashire's rated (re)insurers important underwriters for key brokers in our area of expertise.

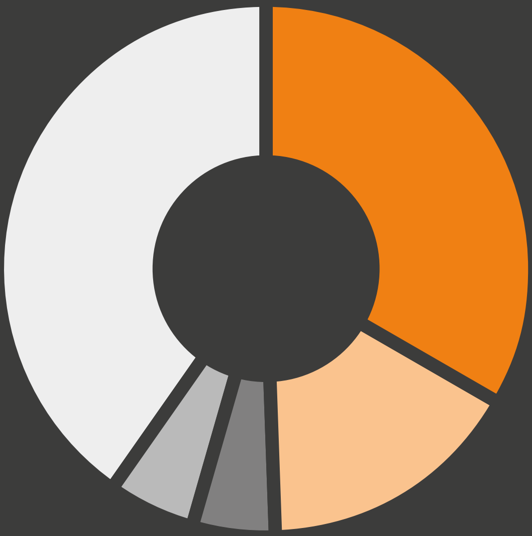
Cathedral

Cathedral gives the Group access to Lloyd's through Cathedral's managed Syndicates 2010 and 3010. The use of Lloyd's extensive network and infrastructure offers distribution advantages. Long-standing client relationships drive good understanding of underlying risks.

Kinesis

Kinesis focuses on third-party funded, fully collateralised reinsurance across different classes such as property catastrophe, aviation, marine, energy and terror. It has the ability to scale up opportunistically based on market dislocations, delivering speed to market advantage.

Specialty business lines



Gross premiums written by class

Property
33.6%

Lancashire covers property catastrophe excess of loss, terrorism, property political risk, property risk excess of loss, property retrocession and other property.

Marine
4.9%

Lancashire covers marine hull and total loss, marine builders' risk, marine excess of loss, marine P&I clubs, marine hull war and other marine.

Lloyd's
40.2%

Syndicates 2010 and 3010 cover property reinsurance, property direct and facultative, aviation and satellite, aviation deductible, marine cargo, marine hull, marine builders' risk, power and utilities, energy and terrorism.

Energy
16.1%

Lancashire covers worldwide offshore energy, Gulf of Mexico offshore energy, onshore energy, energy liabilities, construction energy and other energy.

Aviation
5.2%

Lancashire covers AV52, aviation deductible, aviation satellite and other aviation.

A single approach

Underwriting comes first

Maintaining the right balance between discipline and creativity is key for success. Underwriting discipline in challenging markets means we continue to focus on profitability and risk selection. We remain creative in being able to provide tailored insurance and reinsurance products and solutions to our core clients across the three platforms of our business. Providing protection against losses is the lifeblood of our business and the very reason our clients purchase (re)insurance coverage to manage their own risk profile and protect their lives and livelihoods, property and commercial interests.

Effectively balance risk and return

Balancing risk and return means not seeking top line growth for the sake of it in markets where we do not believe the right opportunities exist. We match our capital to the risks we are prepared to underwrite, not the other way around. We bring together all our disciplines to look at how different parts of our operations are working together. Then we stress test our business plans and gauge where we can be most effective without undue volatility.

Operate nimbly through the cycle

Our speed and agility in the way we manage volatility helps us underwrite our core portfolio profitably through the challenges of the cycle, yet seize opportunities when they present themselves. As capital continues to enter the (re)insurance market, the need to be nimble is more important than ever. This means being ready to deploy capital quickly when it is needed, and having the discipline to return it when it is not.

Dedicated team

One Group

We are one Group with three distinct (re)insurance platforms working together to maximise potential in the world of specialist risk. Our three platforms give the Lancashire Group more relevance in the market place, more broker relationships, more cross-selling and referral opportunities and more reinsurance purchasing power. Our collective strengths enable us to seek out and drive better performance for our clients, our employees and our investors.

Good communication

As one Group we value and nurture personal strengths but believe we are better together than we are alone. We look to build lasting relationships by listening and working with clients and colleagues to deliver meaningful results. We believe in open and honest communication whilst retaining the highest standards of professionalism and integrity.

Focused on quality

As one Group we seek to lead, not follow, on business and in day-to-day interactions. In volatile and harsh conditions, we operate nimbly to maximise returns for our shareholders. As new opportunities emerge in the future, our focused books will give us the ability to capitalise on opportunities and deliver our cross-cycle strategic goal of maximising risk-adjusted returns.

Diversified…

…across business sectors

A well-diversified portfolio across five core business segments as a base to trade across the cycle.

Gross premiums written by class

Segments	
Property	33.6%
Energy	16.1%
Marine	4.9%
Aviation	5.2%
Lloyd's	40.2%

…across geographical regions

We write a geographically diverse portfolio in order to manage overall risk exposures.

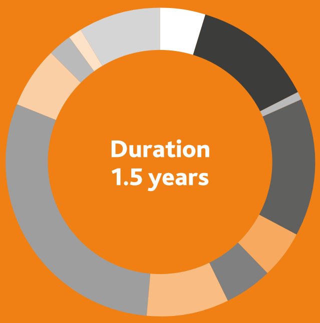
Gross premiums written by region

Geo zones	
U.S. and Canada	29.5%
Worldwide, including the U.S. and Canada	20.3%
Worldwide offshore	18.6%
Europe	8.0%
Far East	4.5%
Worldwide, excluding the U.S. and Canada	2.1%
Middle East	1.3%
Rest of world	15.7%

…asset allocation

We hedge our interest rate risk and aim to minimise the downside on our investment portfolio.

Investment asset allocation



Cash	4.8%
Short-term investments	12.9%
Fixed maturity funds	0.7%
Government debt	14.4%
Agency debt	5.1%
Agency MBS, CMBS	4.9%
Non-agency RMBS, ABS, CMBS	8.6%
Corporate bonds	29.9%
Bank loans	6.3%
Fixed maturity – at FVTPL	2.6%
Equity securities	1.3%
Hedge funds – at FVTPL	8.5%

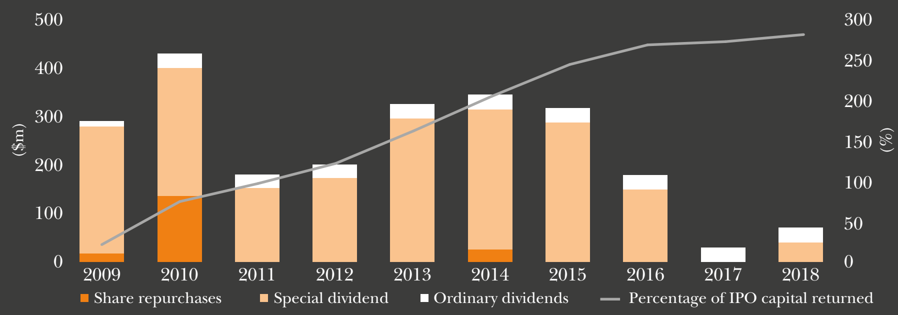
Total managed portfolio at 31 December 2018 $1,742.7m. Credit quality A+.

Returns across the cycle…

…producing a solid performance in volatile markets

Lancashire has one of the best performances and yet lower volatility in the London and Bermudian markets, and has a proven record of returning excess capital to shareholders over time.

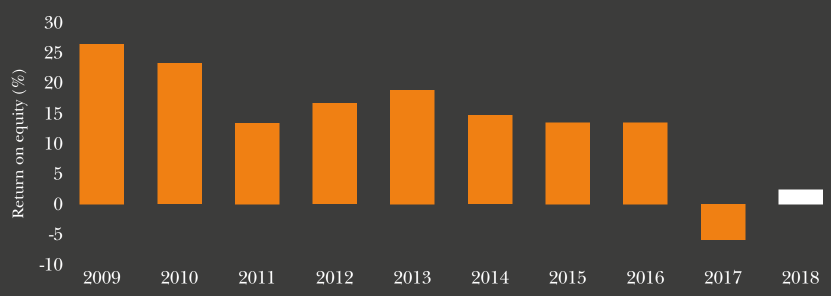
Proven record of active capital management



…maximising risk-adjusted returns

Our strategy is designed to cope with hard and soft markets, managing capital and exposures to maximise risk-adjusted returns across the cycle.

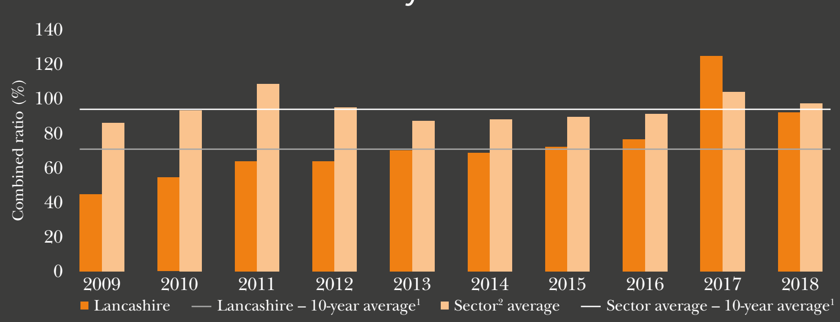
Return on equity – our record over ten years



…with experienced underwriters producing higher returns

Group management and our underwriters have decades of experience in rated companies, Lloyd's and collateralised markets.

Combined ratio – our record over ten years



1. Ten-year average based on 2009 to 2018 reporting periods. Lancashire ratios weighted by annual net premiums earned. Annual sector ratios are weighted by annual net premiums earned.
2. Sector includes Arch, Argo, Axis, Beazley, Everest, Hanover and Renaissance Re. The 2018 results for Greenlight, Hiscox and Third Point Re is not available at the time of the report.

Source: Company Reports

This is what we do

Managing risk and opportunity across the cycle

Peter Clarke
Non-Executive Chairman

How did the business perform during 2018?

Lancashire has generated a return on equity of 2.4 per cent for 2018, which, in view of the challenging loss environment for the second year in succession, reflects the Group's underwriting expertise and effective capital and risk management.

The understanding and management of risk are central to Lancashire's nimble business strategy. Lancashire's longer-term investors will appreciate that over the last few years the (re)insurance sector had witnessed an accumulation of capital and (until 2017) a relative lull in major catastrophe loss activity, which had tended to depress pricing across many of the Group's catastrophe-exposed and specialty product lines. In the face of this challenge, the business had sought to de-risk, cutting back on poorly priced business and increasing its reinsurance protections.

2018 witnessed a steadying of market conditions. In the Group's specialty and catastrophe lines it was reassuring to see evidence of modest improvements in premium rates and a return to underlying top line growth, once premiums are adjusted for the effects of multi-year contracts and the inwards reinstatement premiums resulting from the catastrophe losses in 2017. However, 2018 was another year marked by a relatively high frequency of market loss events, the details of which are addressed by Alex Maloney (see page 14) and Paul Gregory (see page 22). Once again, Lancashire was able to meet the (re)insurance needs of its clients within a robust framework of risk tolerances.

From the perspective of the Board, we were pleased that, within the context of a still challenging (albeit improved) pricing environment, and another year of notable losses to the market, the Group was able to generate a positive return and a respectable combined ratio of 92.2 per cent. Once again I would like to thank Alex, his management team and all our staff for their contributions and in showing the required discipline and expertise necessary for the achievement of a solid result in 2018 in what has been a challenging loss environment.

Please see my introduction to the Governance section of this report on page 48 for an account of the work of the Board and our governance arrangements for the 2018 year.

How do you expect strategy to develop in 2019?

I do not expect Lancashire's strategic priorities to change significantly in 2019. We will continue to focus on underwriting expertise and discipline, to effectively balance the equation of risk and return, and to operate nimbly through the cycle. However, we do hope to see continued improvement in general pricing and conditions, in particular in the specialty insurance lines which we underwrite, and we are cautiously hopeful of achieving managed organic growth in our specialty lines during 2019. Alex discusses these dynamics in greater detail in his review on page 14. We will continue to monitor the capital and human resources, the management and culture necessary for the business to develop these opportunities, all within an appropriate framework of risk management and tolerances. In his comments on page 14, Alex notes the Brexit planning, which has been carried out in 2018, and the Board will monitor developments during the coming year.

The Board has also decided to re-establish the Group's supervisory and tax domicile in Bermuda, and there is more discussion of this decision and the strategic opportunities it presents on page 48. For this reason the Company's 2019 AGM will be held in Bermuda, with a live shareholder video link from our London office. Details are set out in the Notice of the AGM.

What are the reasonable cross-cycle return expectations for Lancashire's investors?

As a Board we have debated how best to articulate the cross-cycle return target in a way that is helpful to investors and realistic, given the combination in recent years of the general trend towards lower investment returns and the low ebb in the insurance market pricing cycle in which we have found ourselves. Because conditions change over time, the Board does not consider that an absolute cross-cycle target is appropriate. Accordingly, you will see in this Annual Report and Accounts that we have stated our strategic aim as being to maximise risk-adjusted total return to shareholders over the long term. We do not rule out the prospect of a return to the higher returns seen in previous years, but we do consider that the revised strategic aim provides a more useful guide for investors.

Has Lancashire's dividend and capital management strategy changed?

Our dividend and capital management strategy has not changed, and although returns for 2018 were modest, we were pleased to be able to declare and pay a special dividend of $0.20 per common share in the final quarter of 2018 following the wind season. When taken together with the standard ordinary dividends, the aggregate of all dividends for the 2018 year amounts to $0.35 per common share. Lancashire's nimble capital management and dividend strategy is well understood by our shareholders and the dividend policy is set out on page 90 of this Annual Report and Accounts.

As a business we carefully consider the balance of risk and return when setting our capital levels, using capital for underwriting when the opportunity presents itself and returning capital when it is not needed. As we enter 2019, we believe that our capital resources are appropriate for the current market opportunity, but the Board will continue to adopt a flexible approach to capital management. An important tool within Lancashire's active capital management strategy is the flexibility afforded to us by shareholders during the last seven years to issue up to 15 per cent of Lancashire's shares on a non pre-emptive basis. As I have noted in previous years, the best opportunities in the insurance and reinsurance sectors typically arise following major loss events, and the flexibility to issue shares and raise capital quickly is a central pillar of our business strategy and will help the Group maximise underwriting opportunities for the business. Once again, the Company is seeking shareholder support for resolutions at the 2019 AGM allowing this capital management flexibility, and I would encourage all shareholders to vote in favour.

Peter Clarke
Non-Executive Chairman

"Lancashire offers its clients protection against damage arising from catastrophic or severe loss events. Our strategy is to monitor our risk exposures so as to maximise risk-adjusted returns across the insurance cycle."

Return on equity

2.4%

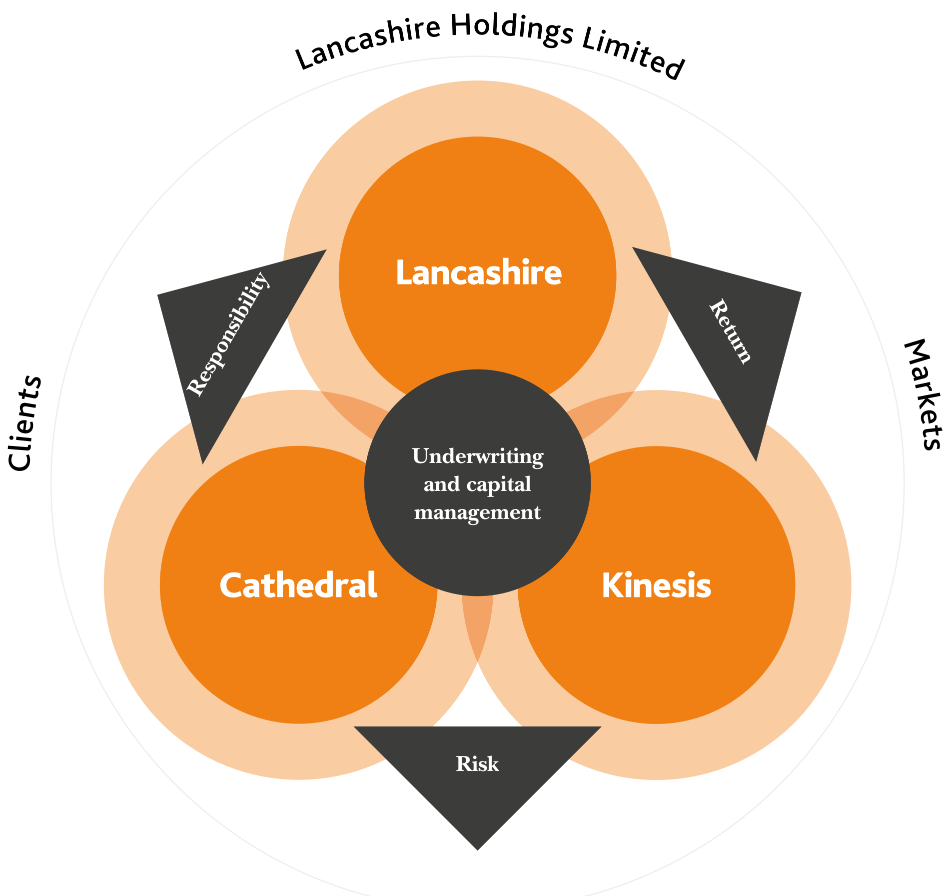
Dividend yield

4.5%

Three platforms provide options

We are one Group with three distinct (re)insurance platforms working together to maximise potential in the world of specialist risk. Three platforms give the Lancashire Group more relevance in the market place, more broker relationships, more cross-selling and referral opportunities and more reinsurance purchasing power. Our collective strengths enable us to seek out and drive better performance for our clients, our employees and our investors.

We leverage our deep underwriting expertise with efficient management of capital and resources across our three platforms to provide our clients and brokers with excellent solutions for their insurance and reinsurance needs. We always focus on the risk-adjusted return.



Our responsibility

We recognise that our responsibility as a company and as individuals reaches wider than our shareholders and our clients. We strive to be a good employer, a good corporate citizen and a responsible preserver of resources. Through the Lancashire Foundation, we make financial contributions and provide human support to a number of good causes in the places we operate around the world (for further details see pages 45 to 47).

Lancashire	Cathedral	Kinesis
Key strengths		
• Strong brand with clients and brokers • Recognised for significant capacity and leadership ability in well-defined business sectors • Proven track record of supplying capacity across the cycle with consistently high performance • A lean business operation allows us to remain nimble and make decisions efficiently • A stable core book of business and disciplined underwriting • Strong record of capital management actions to optimise and adjust capital and navigate market cycles • Experienced management team with proven ability	• Manages two active syndicates • Strong relationships with clients and brokers • Recognised for long-term consistency of relationships • Worldwide licensing maintained by Lloyd's allows Cathedral to write business worldwide with limited regulatory overheads • Use of the world's oldest insurance third-party capital, the Names, who provide support and capacity to Syndicate 2010 • Proven track record with more than five years as part of the Lancashire Group	• Experienced, fully dedicated management with strong relationships with clients, brokers and investors • Ability to leverage Group infrastructure, relationships and reputation with investors and clients • Highly specialised multi-class product with barriers to entry in terms of data and modelling expertise • Ability to raise and deploy capital quickly • Strong investor base since 2014 • Proven track record over five years
Goals		
• Maintain key client, broker and reinsurer relationships to ensure the continued flow of high quality business • Continue the use of reinsurance solutions to sustain the right risk-adjusted balance across the insurance market cycle • Retain 'underwriting comes first' culture and discipline without being tempted into innovation or diversification for its own sake • Provide profitable growth in areas experiencing an improved rating environment	• Maintain core portfolios in the syndicates • Continue to look for new opportunities for bolt-on business lines • Leverage the Group's balance sheet and cross-sell where opportunities arise	• Ensure product is correctly calibrated to meet clients' needs in terms of responding to events and providing capital relief • Deliver returns in line with expectations for modelled ranges given market losses and pricing • Continue to increase number of investors • Provide bespoke and flexible products to match investor and client appetite
Risks		
• Influx of new capacity and further development of broker facilities with less robust underwriting controls • Pressure on insurance rates across the market cycle • Widening terms and conditions being accepted by the insurance market without adequate pricing or exclusions	• Pressure on signings and participation given relatively small line sizes • Expanded burden of regulatory oversight or overlapping regulation from Lloyd's, the PRA and the FCA	• Increased competition from traditional and collateralised markets, with attempts to replicate the Kinesis product • Possible waning of investor interest in insurance allocations should interest rates begin to increase and yields return to capital markets • Resistance to complex reinsurance products amongst clients, given cheap availability of traditional products

Committed to underwriting excellence

Alex Maloney
Group Chief Executive Officer

"Fundamental to our strategy is our role as a responsible long-term business partner to our clients. We develop and retain underwriting expertise which is capable of appraising and pricing risk so as to provide the long-term support and assurance our clients require."

Did Lancashire's performance in 2018 meet your expectations?

We have generated a return on equity of 2.4 per cent and a combined ratio of 92.2 per cent in what was another year of significant loss activity. The third quarter witnessed another active wind season in both the U.S. and Pacific regions and the fourth quarter saw the occurrence of another series of wildfires in California. As well as causing tragic injury and loss of life, these catastrophic events also caused significant property damage and economic loss, which impacted the Group's property insurance and reinsurance books. There was also a series of devastating losses in the specialty markets, notably the occurrence of two of the largest historical losses in both the marine and construction markets. Paul Gregory discusses these events in more detail in his underwriting review on page 22. Such loss events are the lifeblood of our business and the very reason our clients purchase insurance and reinsurance coverage in order to manage their own risk profile and protect their lives and livelihoods, property and commercial interests. Fundamental to our strategy is our role as a responsible long-term business partner to our clients. We develop and retain underwriting expertise which is capable of appraising and pricing risk so as to provide the long-term support and assurance our clients require. In so doing, our aim is to maximise risk-adjusted returns to our investors across the insurance cycle.

So, in another challenging year, I am pleased to have served the needs of our clients whilst delivering a positive return to our shareholders. Our combined ratio for the year is testament to the professionalism and discipline of our underwriters and will, I believe, compare favourably to many other participants in the Lloyd's, London and international insurance markets. Most importantly, having navigated the challenges of another testing year Lancashire has the expertise, the capital, the commercial long-term relationships and the nimble business culture to succeed wherever we might find ourselves in the insurance pricing cycle.

Has the growth of the third-party reinsurance capital sector changed the nature of the insurance pricing cycle for good?

After the major catastrophe loss events of 2017, we watched the reinsurance markets with interest during the January 2018 renewal season, in particular to see whether the third-party capital, which has increasingly supported the reinsurance markets over recent years, would re-commit. In the event, this third-party capital did recommit and the pricing of property catastrophe and retrocessional reinsurance products improved marginally, but not materially. This last year we have seen another round of above-average loss activity, the effect of which has been to trap some of the collateral that supports third-party capital reinsurance products. Investors can only sustain losses and low returns for a limited period of time, so it was no surprise to me that the round of 1 January 2019 reinsurance renewals seems to have resulted in more limited availability of reinsurance capacity to the markets and a corresponding improvement in reinsurance pricing. So, whilst the wheel may turn slowly on occasions, I firmly believe that the (re)insurance business remains fundamentally cyclical in its nature. In 2018, in most lines of business, we saw a halt in pricing falls and some encouraging areas of stronger pricing. On balance, I think that the insurance and reinsurance markets have now moved off the bottom of the pricing cycle. Boards and regulators, in particular Lloyd's, are at last focusing on the need for each line of business to be underwritten on a sustainable basis. That is good for the markets and good for Lancashire, which is well positioned to provide relevant, properly priced underwriting capacity in the lines we underwrite.

The Board has also obtained regulatory approval for a change in the Group's supervisory and tax domicile and has re-established both back in Bermuda with effect from 1 January 2019. There is more discussion of this decision and the strategic opportunities it presents on page 48.

In which classes of business do you expect to see the greatest opportunity?

In last year's Annual Report and Accounts, I expressed the hope that in the specialty lines which we underwrite we might see a return in the wider market to the fundamentals of good underwriting. It was one of our priorities during 2018 to strengthen our specialty offering in a way that is complementary to those specialty classes in which we have specialised for many years. As Paul Gregory discusses in detail on page 22 we have been able to recruit new underwriting teams in the areas of downstream energy, power and aviation deductible insurance. This is part of our strategy that seeks to achieve incremental growth to our portfolio in lines that, whilst requiring specialist underwriting expertise, fit intuitively with what we already underwrite. In our property catastrophe lines, whilst we have seen some limited rating improvement, we do not yet see a significant growth opportunity for 2019 and we expect our exposures to be similar to 2018 and premium levels to improve marginally.

So, looking to 2019, I would expect to see some top line premium growth, but built on a combination of an improved pricing environment in our specialty lines in both renewal and new business and a continuing commitment to our property catastrophe reinsurance lines at similar levels of risk exposure, unless the loss environment should present well-priced new opportunities. In what we hope will be a more realistically and sustainably-priced market during 2019, we will continue to explore opportunities to recruit sector leading underwriters whose expertise might complement the specialty insurance and reinsurance lines in which the Group already participates.

What has changed in the risk environment during 2018?

Our first and foremost risk is our underwriting risk and the associated risk of exposure to fortuitous loss events, which we continue to monitor and control on a daily basis. Risk transfer is the product which we sell. Broadly speaking, our risks, risk tolerances and risk levels remained materially unchanged during 2018. On pages 33 to 39 Louise Wells, Group CRO, sets out in greater detail how the management and Board identify, monitor and control our risk universe so as to ensure the longer-term success and viability of our business. I would however make specific comment on two areas of risk.

During 2018 we have faced the challenge of Brexit in what has been an evolving and, at times, uncertain political and regulatory environment. As a Group we have benefited from the access afforded by Lloyd's Brussels as well as the ability of our principal Bermuda operating subsidiary, LICL, to underwrite reinsurance of most European risks due to the 'equivalent' status of Bermuda under the EU's Solvency II regime. These mechanisms have helped us protect the substantial majority of our income originating from EU-located risks. In this regard it should also be noted that such risks account for a relatively small amount of our total portfolio of business. We will continue to monitor developments and we see this as an area of both risk and opportunity.

Another area of increasing debate in the press has been that of climate change risk. For Lancashire, climate change can influence the assumptions which we make when underwriting any risk regarding the frequency, severity and location of loss events, and we think of it predominantly in terms of the management of our underwriting risk. Underwriting risk is the principal risk, and opportunity, for our business. This is not to downplay climate change as a potentially disruptive and systemic global risk in the medium to long-term, but it is to recognise climate change as a factor which can influence certain risks to, and opportunities for, our business, which we do have the expertise to assess and manage. Other factors which influence our principal underwriting risk include seismic or volcanic activity, political unrest and instability, secular changes in technology and oil price fluctuations, to name a few. We have the great benefit of employing experienced underwriters who are experts in risk appraisal and whose decisions are informed by powerful models and actuarial tools, which factor in thousands of assumptions including some that may be influenced by climate change projections. Climate change risk can also influence asset values within our investment portfolio or present reputational risk to our business in its management. Our conservative investment strategy factors in the exposure of the Group's investment portfolio to a whole range of risk scenarios which might impair the value of assets, and our management and Board remain committed to the prudent day-to-day management of the whole universe of risks which both challenge and present opportunities to our business. Lancashire has also for many years chosen to offset its own greenhouse gas emissions. Please see pages 43 and 44 of our engagement and sustainability report for further details.

Anything else?

I would like to thank all our staff across all our businesses in London and Bermuda, for having contributed to a solid performance delivering positive returns to our shareholders in what has been another challenging year. The skill and dedication of our people remain fundamental to our strategy and its successful delivery. As we start to navigate 2019, I look forward to leading our excellent team in meeting the challenges and developing the exciting opportunities which lie ahead in the coming year.

Alex Maloney
Group Chief Executive Officer

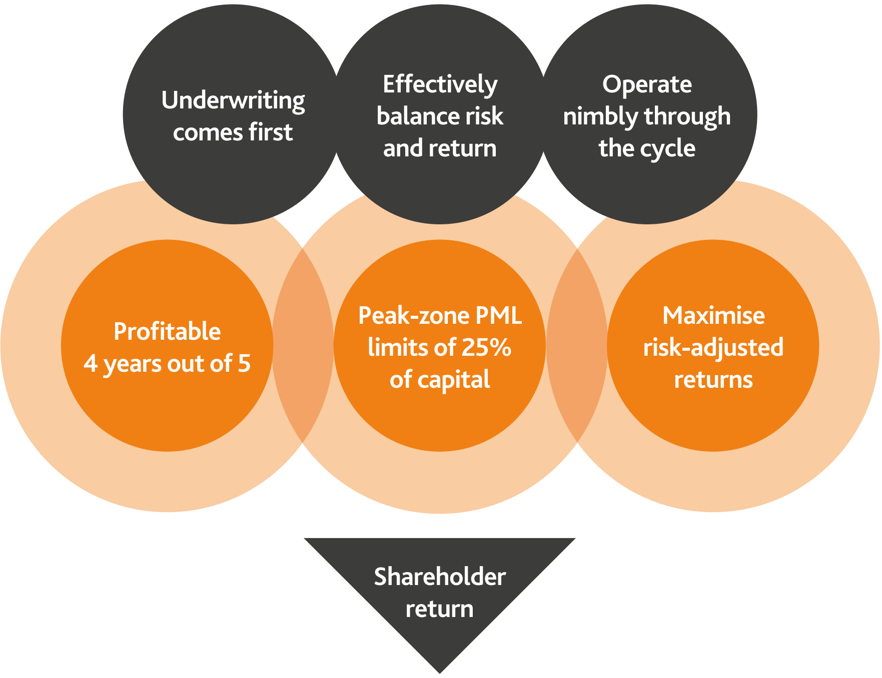
Our strategy

Our strategy

The Group executes its strategy by concentrating on three strategic priorities that enable the Group to meet its goal of maximising risk-adjusted returns for shareholders: underwriting comes first; effectively balance risk and return; and operate nimbly through the cycle. These strategic priorities enable the Group to serve clients and brokers with significant capacity across the cycle, not just in the core business the Group aims to renew every year, but also in times or in areas where capacity is scarce: the opportunistic part of the Group's portfolio. The Group maintains a lean structure and keeps overheads under strict control so that resources may be refocused quickly. The Group tests its assumptions and performance constantly through its structures, using its daily underwriting call or exception reporting to management, its fortnightly RRC meeting with all disciplines within the Group represented, and a series of supporting committees at management, Board and subsidiary board levels. The Group's risk function and internal audit team supply challenge and provide assurance to management and those boards through a continuous reporting process.

Our culture – the bedrock of our strategy

Lancashire encourages a culture of co-operation and respect based on open challenge. This can be seen clearly in the Lancashire companies' daily underwriting and marketing call where junior and senior underwriters debate the risks they want to write and their fit to the portfolio and market, and through post-underwriting reviews at Cathedral. It also characterises the Group-wide RRC which brings together underwriting, actuarial, modelling, finance, treasury, risk and operations to challenge the assumptions used in all areas of our business. The boards at both subsidiary and Group level oversee and monitor the culture of the business within the regular cycle of reporting and governance.



	Underwriting comes first	Effectively balance risk and return	Operate nimbly through the cycle
Description	We focus on maintaining our portfolio structure and our core clients, with the bulk of our exposures balanced towards significant events. We will grow in existing and new classes where favourable and improving market conditions exist. We use the principle of peer review throughout the Group, usually prior to underwriting business for LICL, LUK and Kinesis, the platforms that accept larger net exposures, and post-underwriting at Cathedral, with its smaller net exposures.	By bringing together all our disciplines – underwriting, actuarial, modelling, finance, treasury, risk and operations – at our fortnightly RRC meetings, we are able to look at how different parts of our operations are working together. We stress test our business plans and gauge where we can be most effective without undue volatility.	As capital continues to accumulate in the (re)insurance market, the need to be nimble is more important than ever. This means being ready to deploy capital quickly when it is needed, and having the discipline to return it when it is not.
Achievements	Successfully recruited new underwriting teams in downstream energy, power & utilities and aviation deductible during 2018. We have grown the funds raised and capital deployed from Kinesis investors and grown our client base for the second consecutive year.	We have increased our underwriting footprint and optimised our portfolios in areas where rating has improved whilst adding new complementary classes of business as the market conditions are now improving.	Lancashire renewed its 15 per cent disapplication of pre-emption rights at the 2018 AGM to assist potential future capital raises.
Performance	**Combined ratio** KPI **92.2%** A respectable combined ratio, even in a year where the global insurance industry sustained a significant level of natural catastrophe and risk losses, evidencing the continued focus on underwriting, superior risk selection and portfolio construction. **Gross premiums written** **$638.5m** With an improving rating environment in the majority of our classes, plus three new lines of business, premiums have grown year on year. We maintain the discipline to decline or restructure our participation on underpriced or poorly performing business but are willing to accept more risk if the market opportunity dictates.	**Return on equity** KPI **2.4%** A good result in the light of a challenging market and the incidence of natural catastrophe and risk losses in our major portfolios of business, helped by our improved outwards reinsurance programme. **Probable maximum loss** **$123.1m*** We continued to match our exposure to key catastrophe perils to the market opportunity, demonstrating our discipline and nimbleness. * 1 in 100 year Gulf of Mexico Hurricane expected net loss at 1 January 2019.	**Percentage of comprehensive income returned to shareholders** KPI **284.2%** Lancashire continues to exercise the discipline of maintaining sufficient capital headroom to support underwriting operations and take advantage of new opportunities as they emerge or returning capital to shareholders it cannot profitably use. **Dividend yield** KPI **4.5%** Current opportunities exist in the short-tail specialty insurance classes that, in general, require less capital than catastrophe exposed classes, so we grow in these areas but still provide modest capital returns. If opportunities exist in capital intensive product lines then capital will be retained to take advantage of these opportunities.
Associated strategic risk	The key risk in the current market phase is the loss of relevance to brokers and clients. With so much surplus capacity, insurers need to have a unique selling point. For the Group, that is found in its mixture of underwriting capacity, leadership capability, claims service and multiple balance sheet options.	The key issue for Lancashire is to continue to serve our clients and brokers with significant capacity, whilst ensuring that the portfolio is balanced. This means constantly reassessing our business mix, and testing key risk assumptions.	Lancashire has developed an expectation among its shareholders that it will produce a consistent return and pay ordinary dividends with special dividends only when it makes sense to do so. We believe our shareholders understand that in harder markets Lancashire will retain, and potentially even raise, capital to take full advantage of underwriting opportunities.

Maintained performance despite sizeable risk losses

Elaine Whelan
Group Chief Financial Officer

"Given the nature of our book and the loss events, we have performed as we would expect and have once again benefited from the additional reinsurance we have been buying. There is, however, a significant impact on our profitability for the year from these events."

What are your thoughts on the Company's performance in 2018?

2018 potentially had in excess of $80 billion of estimated global insured losses. While that's less than the $140 billion+ estimated last year, it's still significantly higher than average. It was again a year of accumulation, with no one, individually significant event driving the magnitude of the total insured loss. There were also a few sizeable risk losses in 2018 which contributed to the aggregate losses picked up by the industry. The types of losses that occurred are exactly the types of risks that Lancashire underwrites. We have therefore picked up losses across these events, recording a total net loss after reinsurance recoveries and reinstatement premiums of $119.3 million, with our equity pick up from our investment in Kinesis included in that number. Given the nature of our book and the loss events, we have performed as we would expect and have once again benefited from the additional reinsurance we have been buying. There is, however, a significant impact on our profitability for the year from these events. We have produced an RoE of 2.4 per cent – we are back in the black after 2017 and our RoE has improved by 8.3 per cent, however, pricing is still not where it needs to be to sustain the level of loss activity the industry is experiencing. We remain hopeful that the market reacts appropriately after two years of heavy losses.

Have you been affected by 'loss creep' on the 2017 catastrophe events?

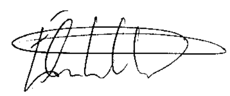
Reserving for the 2017 loss events was complicated. With such frequency of events there are amplifying effects that you don't see in an individual event – there can be more impacts from demand surge and the limited pool of resources available to adjust the losses, for example. We were aware of those potential effects while we were assessing our initial reserves, but I think it would be fair to say there was a bigger impact than perhaps we have seen historically. Assessing reinsurance recoveries is also more complicated with numerous events as compared to one event. However, we are generally fairly thorough and prudent in our initial reserving approach when there is a lack of cedant information. Our net loss after reinsurance recoveries and reinstatement premium, and including our equity pick up from our investment in Kinesis in relation to hurricanes Harvey, Irma, Maria, the two Mexican earthquakes plus the California wildfires, was $176.1 million at 31 December 2018, versus the initial $189.2 million at 31 December 2017. While there's still some way to go before the losses are fully settled, we're comfortable with the level of reserves which we are carrying across those events.

Did you make any changes in your reserving process for the 2018 catastrophe events?

Not really. While there are always lessons to be learned following loss events, our experience with the 2017 catastrophes proved our approach to be robust. There is a rigorous internal review process where we go through individual accounts to assess the potential loss and derive preliminary expectations from that. We would also have a view of the overall industry loss that would inform that expectation. Then the individual subsidiaries all have their own Reserve Committees who challenge the underlying estimates.

After two years of well above average loss levels, what does that mean for Lancashire's capital position?

We're very comfortable with the level of capital we are carrying. We always work out the business we want to write and then calculate the capital that would be needed to support that. We then add a buffer on top of that to ensure we have flexibility. We have carried excess buffers in recent years given the market conditions and that has served us well. We've also been buying more reinsurance in recent years and that helped us to better manage volatility, as well as our expected capital requirement. That means we have enough capital to underwrite the book that we want but also have some capital available to take advantage of any opportunities that may materialise.



Elaine Whelan
Group Chief Financial Officer

Financial highlights

	2018 $m	2017 $m	2016 $m	2015 $m	2014 $m
Gross premiums written	**638.5**	591.6	633.9	641.1	907.6
Net premiums written	**417.7**	398.0	458.7	481.7	742.8
Net premiums earned	**413.5**	427.9	488.1	567.1	715.6
Net insurance losses	**165.4**	335.4	142.5	155.7	226.5
Net underwriting profit (loss)	**121.7**	(23.1)	213.5	265.2	335.7
Net investment income	**34.7**	30.5	29.8	29.8	28.6
Net realised (losses) gains and impairments	**(5.1)**	9.1	(2.4)	(2.8)	(5.9)
Profit (loss) after tax[1]	**37.5**	(71.1)	153.8	181.1	229.3
Net change in unrealised gains/losses on investments	**(12.8)**	4.9	4.1	(11.3)	(2.1)
Comprehensive income (loss)[1]	**24.7**	(66.2)	157.9	169.8	227.2
Dividends[2]	**70.2**	29.9	178.9	317.5	321.0
Diluted earnings (loss) per share	**$0.19**	($0.36)	$0.76	$0.91	$1.16
Fully converted book value per share	**$5.26**	$5.48	$5.98	$6.07	$6.96
Return on equity	**2.4%**	(5.9%)	13.5%	10.9%	13.9%
Return on equity excluding warrant adjustments	**2.4%**	(5.9%)	13.5%	13.5%	14.7%
Net loss ratio	**40.0%**	78.4%	29.2%	27.5%	31.7%
Net acquisition cost ratio	**30.6%**	27.0%	27.1%	25.8%	21.4%
Expense ratio	**21.6%**	19.5%	20.2%	18.8%	15.6%
Combined ratio	**92.2%**	124.9%	76.5%	72.1%	68.7%
Accident year loss ratio	**70.0%**	94.2%	46.2%	46.0%	35.9%
Net total return on investments[3]	**0.8%**	2.5%	2.1%	0.7%	1.0%

1. Amounts are attributable to Lancashire and exclude non-controlling interest.
2. Dividends are included in the financial statement year in which they were recorded.
3. Net return on investments includes internal foreign exchange hedging.

Return on equity

$ A

Measurement

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

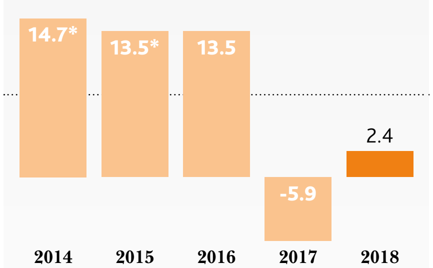
Aim

The Group's aim is to maximise risk-adjusted returns for our shareholders across the cycle.

Performance

2.4%

Given the significant catastrophe events of 2018 we were pleased to generate a positive RoE for the year.



Risk management

The stated aim is a long-term goal, acknowledging that management expects both high and low results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver of this pattern. We seek to align our variable remuneration to shareholders' interests by having an RoE component in this.

Please refer to the Directors' Remuneration Report on page 70 for further details.

* RoE including the impact of warrants was 10.9% in 2015 and 13.9% in 2014. The five-year average was 7.0%.

Combined ratio

A

Measurement

The combined ratio is the ratio of costs to net premiums earned and is a measure of an insurance company's operating performance. It is calculated as the sum of the loss ratio, the acquisition cost ratio and the expense ratio. These ratios are defined in our glossary.

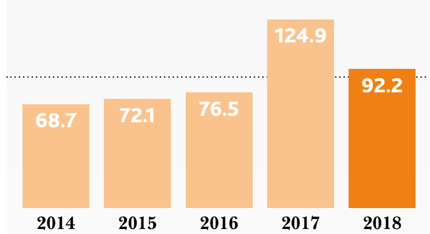
Aim

The Group aims to price its business to ensure that the combined ratio across the cycle is significantly less than 100 per cent.

Performance

92.2%

The combined ratio reflects the impact of a number of 2018 catastrophe events including hurricanes Michael and Florence, typhoons Jebi, Mangkhut and Trami and the California wildfires, as well as risk losses in our marine portfolio. Despite these events our focus on high quality underwriting allowed us to generate an underwriting profit for the year.



Risk management

The Group's underwriters assess likely losses, using models, 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. Peer reviews of risks are conducted through the daily underwriting call or peer review, depending on risk impact, enabling the Group to ensure careful risk selection, limits on concentration and appropriate portfolio diversification. The RRC then monitors performance at a portfolio level.

Total investment return

A

Measurement

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

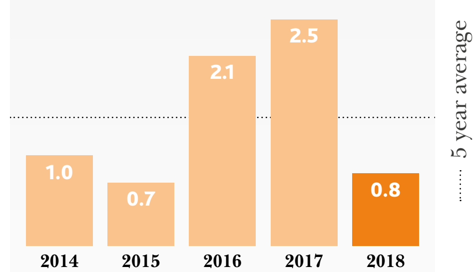
Aim

The Group's primary investment objectives are to preserve capital and provide adequate liquidity to support the Group's payment of claims and other obligations. Within this framework we aim for a degree of investment portfolio return.

Performance

0.8%

In 2018, the Group continued to manage its most significant investment risk, interest rate risk, via floating rate assets and risk assets. This helped to manage the risk on/risk off volatility and minimise losses in the rising rate environment.



Risk management

The investment strategy places an emphasis on the preservation of invested assets and provision of sufficient liquidity for the prompt payment of claims, in conjunction with providing a reasonably stable income stream. These objectives are reflected in the Group's investment guidelines and its relatively conservative asset allocation. Management reviews the composition, duration and asset allocation of the investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions.

Total shareholder return

$ A

Measurement

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

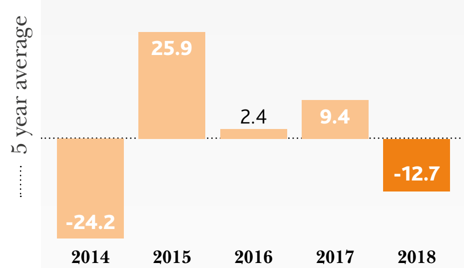
Aim

The Group's aim is to maximise RoE over the longer term and we would expect that to be reflected in our share price and multiple. This is a long-term goal, recognising that the cyclicality and volatility of both the insurance market and the financial markets in general will impact management's ability to maximise the RoE in the immediate term.

Performance

-12.7%

In line with the broader FTSE 250, our share price suffered through the year as investors shunned UK listed equities due to Brexit uncertainty. In part this was offset in TSR by our regular and special dividends through the year.



Risk management

The Lancashire remuneration structure and RSS ensure that staff are highly motivated and closely aligned to the Group's goals, and therefore with shareholders. Permanent staff are all eligible to receive RSS awards. The participation of employees in the RSS ensures that there is a strong focus on sustainable long-term shareholder value.

Comprehensive income returned to shareholders

A

Measurement

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

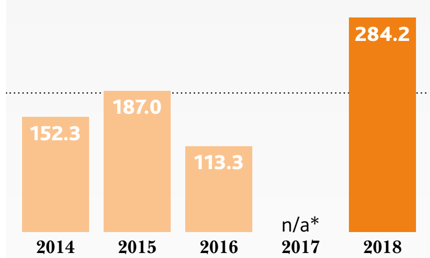
Aim

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

Performance

284.2%

We paid a small special dividend of $0.20 per share reflecting the capital benefits of enhancements to our reinsurance programme that enabled us to return more capital than we generated for 2018.



Risk management

Risk tolerances are set at a level that aims to prevent the Group incurring losses that would impair its ability to operate. The Group's key capital measure is its A.M. Best rating, and a minimum rating of A– is considered necessary to attract business. In 2018, Lancashire maintained its A rating.

* The Group made a comprehensive loss of $66.2 million during 2017. We paid annual ordinary dividends of $0.15 per share. Due to 2017 being n/a, the average is calculated over four years.

Dividend yield

A

Measurement

Dividend yield is measured by dividing the annual dividends per share by the share price on the last day of the given year.

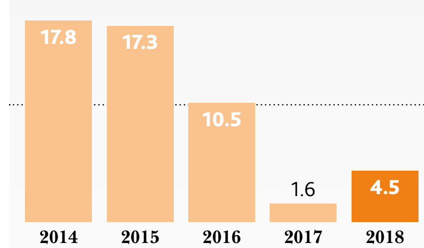
Aim

The Group aims to maintain a strong balance sheet whilst maximising risk-adjusted return for shareholders across the cycle. Lancashire's dividend yield demonstrates our ability to operate nimbly through the cycle through the active capital management that underpins our business model. We aim to pay annual ordinary dividends, and when we decide not to retain our profits as additional underwriting capital we return them to shareholders by way of special dividends.

Performance

4.5%

During 2018, we paid annual ordinary dividends of $0.15 per share and a special dividend of $0.20 per share.



Risk management

As capital continues to accumulate in the (re)insurance market, the need to be nimble is more important than ever. This means being ready to deploy capital quickly when it is needed and having the discipline to return it when it is not. The Group has to ensure that all shareholders understand that in harder markets the Group will want to retain, and potentially even raise, capital to take full advantage of underwriting opportunities.

$ *KPI linked to Executive Directors' remuneration. For more information see pages 70 to 89.*

A *Alternative Performance Measures (APM). For more information see page 167.*

Maintaining our discipline

Paul Gregory
Group Chief Underwriting Officer

"Given that pricing has finally started to move in a positive direction, it should come as no surprise that we have chosen now as the time to expand our footprint."

Following the record loss events of 2017 the direction of premium rate change, for the first time in five years, has moved positively. The RPIs for our portfolio for 2018 can be seen on page 26, which demonstrate this. It would be fair to argue that, given the size of losses incurred during 2017, a more positive rating environment could have been expected. However, our industry is driven by the basic principles of supply and demand and there was not enough of an imbalance to create a more dislocated market; albeit that the rating environment did improve.

The vast majority of losses in 2017 were natural catastrophe related. What these losses did was shine a light on the unprofitability of other product lines in the market, specifically the short-tail specialty insurance classes written in London. This unprofitability had been masked by profits made by natural catastrophe classes in a benign period for natural catastrophes losses. This ended in 2017.

This created an interesting dynamic as 2018 progressed. Whilst the RPIs for catastrophe business through the year were positive, the rate of increase slowed, whereas the opposite is true of the non-catastrophe lines, such as marine, aviation and to a lesser extent energy, which all gradually improved as the year elapsed.

Much of this improvement in the specialty insurance rating environment has been helped by Lloyd's conducting a thorough review of its performance and taking hard-line action with underperforming classes of business and syndicates for the 2019 business planning season. Put simply, Lloyd's wants to improve its underwriting profitability and is willing to cut back in underperforming areas to achieve this goal. Syndicates are cutting back or exiting unprofitable classes in order to gain business plan approval. This is an action we fully support as it fits our mantra of underwriting discipline and ultimately leads to a healthier and more robust market. This has meant that lines of business in which we operate are now seeing positive rate movement as there is less capacity and more focus on underwriting returns.

Fortunately, our approach over the past few years has meant that our specialty insurance lines have continued to deliver underwriting profits, even in a soft rating environment, as we had already made the hard decisions and exited classes of unprofitable business or trimmed back our exposure in classes we remain in. Therefore, any pricing improvement in these lines is beneficial to us as we come from a baseline of underwriting profitability. We have also been successful in securing business plan approval for both our syndicates in line with our expectations and this is a testament to the underwriting discipline we have shown in prior years.

Given that pricing has finally started to move in a positive direction, it should come as no surprise that we have chosen now as the time to expand our underwriting footprint. During 2018, we entered three new product lines, adding downstream energy, power and aviation deductible to our suite of product offerings.

All of these product lines are complementary to our existing offerings and fit our appetite for short-tail specialty insurance lines. Importantly, each of these product lines is now seeing positive rating environments so we believe that we are entering these lines at the right time and we will hopefully benefit as market conditions improve.

We have always been very clear that when the underwriting opportunity starts to improve we will be willing to underwrite more risk.

Entering these new classes at a time when market conditions are improving fits our underwriting philosophy exactly and the fact we can do this now is a result of our disciplined approach in the softer part of the cycle.

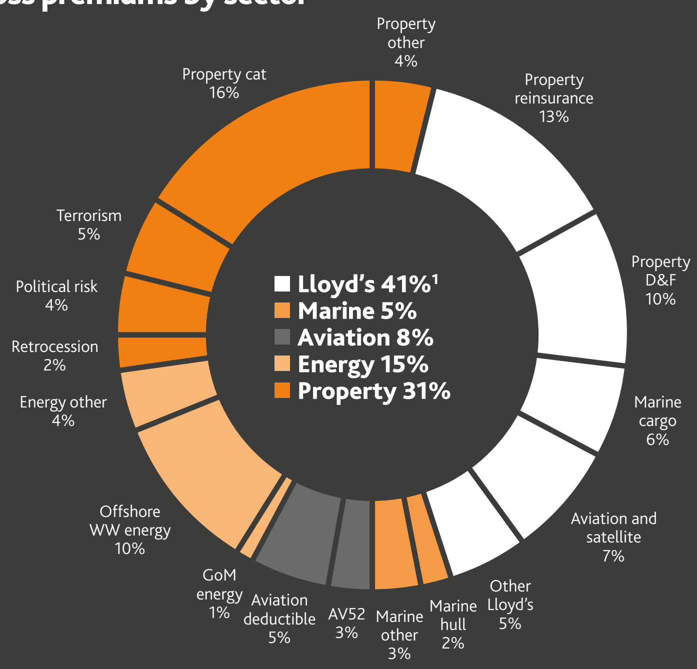
Whilst 2018 did not see the record losses of 2017, which turned out to be the costliest on record, it has once again been a very active year with loss quantum being significantly above historical averages, with a high frequency of losses from both natural catastrophe and man-made events.

We have seen tragic events such as wildfires in California, typhoons in Japan, the Philippines and China and hurricanes in the U.S.. These events have a devastating impact on the people in these areas with millions of people's lives terribly affected. Weather related events have deep and lasting impacts on local economies which further impacts these communities. For us and our industry, these events create insured losses. Whilst the claims we pay obviously impact underwriting profitability, we provide policies that allow those affected to help restore themselves after these events.

In addition to a continuation of natural catastrophe losses, 2018 has also seen a sharp increase in man-made losses, with significant loss activity on classes such as power, downstream energy and marine. Whilst rates have improved during 2018, all lines of business are coming from a relatively low point given numerous years of rate reductions so any frequency or severity of loss greatly challenges underwriting margins.

With this in mind we are very pleased that we have managed to deliver a combined ratio of 92.2 per cent in what has been a very challenging year given the amount of losses within our areas of specialism.

Gross premiums by sector



"We have always been very clear that when the underwriting opportunity starts to improve we will be willing to underwrite more risk."

1. Based on 2019 forecast of gross premiums written as of November 2018. Estimates could change without notice in response to several factors, including trading conditions.

Property reinsurance

2018 has once again been a very challenging year for this class of business. The loss events in Japan, the Philippines and the U.S. have not been as significant in terms of insured loss as 2017. However, they have been as frequent and of a level significant enough to impact underwriting profitability. Rating across the portfolio improved year on year, with 2018 RPIs shown on page 26, albeit with rate increases reducing as the renewal season progressed. Supply of capacity did not shrink and therefore the rate increases were dampened as market participants protected market share.

There was increased demand in some territories which allowed the Group to expand relationships with existing core clients and also develop new client relationships in an improved market. In particular, we were able to grow our footprint with our Japanese reinsurance clients and some of our U.S. reinsurance clients. So there remain opportunities in this market to grow prudently with rate increases on the existing portfolio and developing existing and new client relationships.

Looking ahead, the loss events of this year will most likely mean that property reinsurance pricing should remain at least stable through 2019. If there is dislocation in the market for retrocession capacity then this could impact the demand and supply dynamic and push rates further forward. The relatively immature ILS market faces a second year of losses that will trap and erode capital and produce another test of the product and the capital.

The Group, via our rated carriers, Lloyd's and Kinesis platforms, is uniquely placed to maximise any opportunity that manifests itself with the ability to offer clients and brokers a choice of platforms and products and additional capacity should the risk and return metrics allow.

Property direct & facultative (D&F)

Property D&F was another area of the business impacted by the loss events of 2017 and therefore was also challenged again during 2018 as natural catastrophe losses continued.

The rating environment improved during 2018, albeit the rate change across the portfolio was not uniform. Certain territories, such as the Caribbean, saw significant rate increases following the losses in 2017 and we took the opportunity to grow our exposure in these territories as the risk-adjusted pricing warranted additional exposure. In other areas of the portfolio, where rating marginally improved, we maintained risk appetite and renewed the core portfolio.

Having the flexibility to upscale risk in areas where the pricing improvement so justifies is a core strength of our underwriting. Equally, having the discipline to not force growth if the pricing does not warrant it is also a core underwriting principle.

With more loss events in 2018 impacting this market, plus a number of London market participants either exiting or reducing their exposure to the class, we anticipate continued modest pricing improvement through 2019 and have the platforms and people to access these opportunities wherever they present themselves.

Energy

In 2018, we saw the first green shoots of recovery in both the energy industry and the upstream energy insurance market. The higher and more stable oil price combined with our clients now being set up to run more efficiently in a lower oil price environment has meant that demand has stabilised and there are signs that demand may slowly improve as upstream energy clients look to gradually increase their operations. Alongside this, the pricing environment improved slightly with rates rising across the portfolio.

The last few years have been very challenging with rate reductions and a significant reduction in demand causing premiums in the upstream energy market to more than halve. Therefore, these positive signs during 2018 are very welcome. Fortunately, our energy book has remained profitable during this difficult period, albeit helped by the fact there has been less activity and therefore fewer claims; but we welcome the change in outlook and remain aware that an increase in client activity can also lead to an increase in loss activity.

We added two new product lines under the energy umbrella during 2018, namely downstream energy and power.

Downstream energy dovetails nicely with our current upstream offering as many of the clients are the same. We have been able to utilise our strong client relationships to access downstream business and prudently build out a portfolio during the year. The downstream market has succumbed to many large losses in 2018, most of which we have been able to avoid, allowing us to make an underwriting profit in the first year of operation, so this has helped push forward rate increases across this market and we expect this to continue into 2019.

Our power team joined in the middle of the year, so 2019 will be our first full year of underwriting. This class is another that has experienced a difficult few years with a number of losses and is a class under review at Lloyd's, meaning that some of our London market competitors are either withdrawing or cutting back. This has led to a positive rating movement which, as a new entrant, we can take advantage of.

"Having the flexibility to upscale risk in areas where the pricing improvement so justifies is a core strength of our underwriting. Equally, having the discipline to not force growth if the pricing does not warrant it is also a core underwriting principle."

> "The Group, via our rated carrier, Lloyd's and Kinesis platforms, is uniquely placed to maximise any opportunity that manifests itself with the ability to offer clients and brokers a choice of platforms and products and additional capacity should the risk and return metrics allow."

Marine

There have been many moving parts within the marine market during 2018.

The cargo market was already in a state of flux at the start of the year following a number of capacity withdrawals during 2017 which has led to improving rates. This trend continued during 2018, aided by the Lloyd's review of the class of business, leading to further withdrawals. Given we have cut back our cargo book during the years of softening we have now been growing our book as the rating environment has improved. For the first time in several years we are writing new business as it starts to pay more and the risk-reward balance makes more sense. Given further withdrawals from the class we anticipate the upward pricing movement to continue during 2019.

The hull market has historically been a very difficult line of business in which to make an underwriting profit. This was made even harder during 2018 which saw possibly the largest ever marine builders' risk loss in history. This loss impacted our marine portfolio given that we had a significant share of the risk. Whilst these losses are not good for underwriting profitability they are exactly the type of risks that we underwrite and why our clients buy our products. A loss of this size inevitably creates an underwriting loss for the class in 2018 albeit, even with this loss and other large losses in the past, our marine portfolio remains profitable since inception, which for marine underwriters is the exception rather than the rule. Much like cargo, marine hull has also been reviewed by Lloyd's and we have seen a number of markets withdraw from this class, so there is likely to be less capacity available in 2019. There remains global capacity for the product but like any market a reduction in capacity can only help stabilise and possibly improve market conditions for 2019.

Aviation

The aviation market is another market that has improved during the year with pricing slowly rising. We underwrite both direct and reinsurance product lines and both have seen small positive rate movements.

Our reinsurance portfolio continues to generate good underwriting margins and, whilst significantly smaller than it has been historically, is a recognised leader in the sphere, and is well positioned to expand as market conditions improve. As a result, we have been able to grow the portfolio gradually this year.

Our direct aviation portfolio covers war, hull and liability, AV52 and, more recently, aviation deductible. All these classes have been either in a stable or improving pricing environment during 2018. The decision to enter aviation deductible was a function of this improving market but also, because a large number of our existing aviation clients already buy this cover, it simply adds another aviation product to the range which we offer to our client base, further strengthening our relationships in this class.

Aviation has also seen a number of market participants withdraw during 2018, which we believe will help maintain positive rate movement through 2019 and we are very well placed to benefit from this continued better market.

Terrorism, political violence & political risk

The world continued to be a politically volatile place during 2018 with political issues such as Brexit and U.S. trade wars, as well as violence and civil unrest in areas such as Nigeria, Pakistan, Yemen and Afghanistan.

This global political and socio-economic climate certainly creates challenges for underwriting these classes of business, and risk selection remains absolutely crucial as years of softening rates mean that there is little margin to cater for any type of attritional losses.

We are fortunate to have a core portfolio of risks that have historically avoided attrition and therefore continue to deliver healthy underwriting profits. The rating environment has stabilised during the year. This is welcome following continued rate reductions in the terrorism class since we started writing it in 2006. There remains an abundance of capacity in this market given its historic profitability, so our aim will be to maintain our core portfolio in 2019 and grow in any areas that match our risk appetite. Over the past few years we have successfully grown in areas such as UK terrorism which goes some way towards replacing income lost to broker facilities, which has been a trend in this market for the past few years. To date we have refused to give up our underwriting pen as we continue to believe that underwriters selecting risks generates a superior underwriting return.

We are cautiously optimistic about 2019. We have a history of providing market leading returns in specialty insurance lines, even in softer market conditions, and now see markets that are slowly improving as we are expanding our footprint in these niche areas. Property catastrophe rates should remain stable following positive rate movement this year and any imbalance in the supply and demand dynamic of this market could help push rates further. With the rating environment looking more positive we feel that now is exactly the right time to grow. As ever we will only do this if the opportunity is there to do so but if it is we are uniquely placed with our platforms and people to maximise this opportunity.

Discipline in a challenging market

Hayley Johnston
Chief Underwriting Officer, LUK

James Irvine
Chief Underwriting Officer, LICL

Jon Barnes
Active Underwriter, Syndicate 2010

John Spence
Active Underwriter, Syndicate 3010

Renewal price index (RPI)

The Group's 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 the Group's assessment of relative changes in price, terms, conditions and limits on like-for-like renewals only, and is weighted by premium volume. The RPI does not include new business, to offer a consistent basis for analysis. The calculation involves a degree of judgement in relation to the comparability of contracts and the assessment noted above. To enhance the RPI tool, the Group 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 the RPI does not reflect every contract in the Group's portfolio. The future profitability of the portfolio of contracts within the RPI is dependent upon many factors besides the trends in premium rates. The following RPIs are expressed as an approximate percentage of pricing achieved on similar contracts written in the corresponding year, with our Lloyd's segment shown separately in order to aid comparability.

The following table summarises the RPI figures for the main business classes:

RPI Lancashire (excluding Lloyd's segment)

Class	2018	2017	2016	2015	2014
Aviation (AV52)	**99**	91	90	94	90
Gulf of Mexico offshore energy	**101**	93	94	94	92
Worldwide offshore energy	**103**	97	87	89	94
Marine	**98**	90	88	90	102
Property retrocession and reinsurance	**107**	95	88	89	87
Terrorism	**99**	96	88	90	93
Lancashire (excluding Lloyd's segment)[1]	**103**	94	89	90	94

1. The table above summarises the RPI figures for the main business classes, with the total incorporating all business classes.

RPI Lloyd's segment

Class	2018	2017	2016	2015	2014
Aviation	**104**	100	96	96	97
Energy	**103**	97	89	87	–
Marine	**105**	98	95	99	100
Property retrocession and reinsurance	**108**	96	94	91	89
Terrorism	**100**	92	96	90	95
Lloyd's segment[1]	**106**	97	94	93	94

1. The table above summarises the RPI figures for the main business classes, with the total incorporating all business classes.

Underwriting results

	2018						2017					
	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m
Gross premiums written	**214.6**	**103.0**	**31.1**	**33.0**	**256.8**	**638.5**	198.0	101.8	67.6	16.9	207.3	591.6
Net premiums earned	**131.9**	**75.9**	**21.5**	**17.8**	**166.4**	**413.5**	146.5	70.4	50.7	11.6	148.7	427.9
Net loss ratio	**34.0%**	**(27.1%)**	**102.3%**	**2.2%**	**71.4%**	**40.0%**	114.4%	15.8%	32.9%	(19.0%)	95.6%	78.4%
Net acquisition cost ratio	**23.9%**	**44.3%**	**55.8%**	**47.2%**	**24.6%**	**30.6%**	18.8%	44.0%	36.3%	27.6%	23.8%	27.0%
Expense ratio	**–**	**–**	**–**	**–**	**–**	**21.6%**	–	–	–	–	–	19.5%
Combined ratio	**57.9%**	**17.2%**	**158.1%**	**49.4%**	**96.0%**	**92.2%**	133.2%	59.8%	69.2%	8.6%	119.4%	124.9%

Premiums

Gross premiums written increased by 7.9 per cent in 2018 compared to 2017. The Group's five principal segments, and the key market factors impacting them, are discussed below.

Property

Property gross premiums written increased by 8.4 per cent for the year ended 31 December 2018 compared to the year ended 31 December 2017. The property segment experienced growth from new business and rate increases across most classes. However, that growth was significantly offset by reductions due to multi-year contracts not yet due to renew in the political risk and property catastrophe classes. In addition 2017 also included $7.0 million of reinstatement premiums in connection with hurricanes Harvey, Irma and Maria.

Energy

Energy gross premiums written increased by 1.2 per cent for the year ended 31 December 2018 compared to the year ended 31 December 2017. The increase for the year was due to some new business written in the onshore energy class, offset by multi-year contracts written in the Gulf of Mexico and offshore energy classes in 2017 that were not yet due to renew, plus the restructuring of an existing Gulf of Mexico multi-year deal.

Marine

Marine gross premiums written decreased by 54.0 per cent for the year ended 31 December 2018 compared to the year ended 31 December 2017. The decrease was due to a reduction in exposure on prior underwriting year risk-attaching business in the other marine class in addition to less pro-rata business written compared to the prior periods. The decrease for the year was further compounded by the timing of non-annual contract renewals.

Aviation

Aviation gross premiums written increased by 95.3 per cent for the year ended 31 December 2018 compared to the year ended 31 December 2017. The increase was mainly due to new business in the aviation deductible class due to the addition of a new underwriting team and the resulting new business introduced. There was also increased exposure on prior underwriting year risk-attaching business during the year.

Lloyd's

In the Lloyd's segment, gross premiums written increased by 23.9 per cent for the year ended 31 December 2018 compared to the year ended 31 December 2017. The increase was mainly due to new business in the aviation and energy classes due to the addition of new underwriting teams and the resulting new business introduced. There was also an increase in the property direct and facultative and marine classes, primarily due to improved rates, new business and negative adjustments made to prior underwriting year risk-attaching business in 2017. The increases were partially offset by reduced reinstatement premiums in the property reinsurance class.

Ceded

Ceded premiums increased by $27.2 million, or 14.0 per cent, for the year ended 31 December 2018 compared to the year ended 31 December 2017. The increase was due to a combination of additional cover purchased and rate increases, partially offset by the timing of some renewals.

Earned

Net premiums earned as a proportion of net premiums written were 99.0 per cent for the year ended 31 December 2018, compared to 107.5 per cent for the year ended 31 December 2017. The lower earnings ratio in 2018 compared to 2017 was impacted by the timing of gross premiums written in the year, with a higher proportion being written in the latter half of 2018 compared to the corresponding period in 2017.

Losses

2018 was characterised by an accumulation of losses as a result of exposures to a number of natural catastrophe events, including hurricanes Florence and Michael, typhoons Jebi, Mangkhut and Trami and the California wildfires. In addition, the Group also had exposure to loss events within its marine portfolio. As a result, the Group's net loss ratio was 40.0 per cent for the year ended 31 December 2018 compared to 78.4 per cent for the year ended 31 December 2017. The 2018 accident year loss ratio, including the impact of foreign exchange revaluations, was 70.0 per cent compared to 94.2 per cent for the year ended 31 December 2017.

Our net losses recorded for the year ended 31 December 2018 in relation to the loss events noted above was $104.9 million, excluding the impact of inwards and outwards reinstatement premiums and our share of losses from Kinesis. In the prior year, the total estimated net loss, excluding the impact of inwards and outwards reinstatement premiums and our share of losses from Kinesis, for the 2017 catastrophe losses on hurricanes Harvey, Irma and Maria, the two earthquakes in Mexico plus the California wildfires, was $181.8 million as at 31 December 2017 compared to $164.7 million as at 31 December 2018.

While reserves have been recorded, uncertainty exists on the eventual ultimate losses in relation to the hurricanes, typhoons, earthquakes and wildfires as loss information after these types of events can take some time to obtain. The Group's reserve estimates were derived from a combination of market data and assumptions, a limited number of provisional loss advices, limited client loss data and modelled loss projections. As additional information emerges, the Group's actual ultimate loss may vary, perhaps materially, from the current reported reserves. The final settlement of all claims is likely to take place over a considerable period of time.

There were no other significant net losses in either year.

Excluding the impact of foreign exchange evaluations, the table below shows the impact of current accident year catastrophe events on the Group's loss ratio for the year ended 31 December 2018:

	Losses $m	Loss ratio %
Reported loss ratio at 31 December 2018	**165.4**	**40.0**
Absent natural catastrophe events	**78.6**	**19.2**
Absent large marine losses	**147.3**	**34.7**
Absent all catastrophe events	**60.5**	**14.4**

Note: the table does not sum to a total due to the impact of reinstatement premiums.

As reported in the Group's results for the year ended 31 December 2017, excluding the impact of foreign exchange evaluations, the following table shows the impact of prior year catastrophe events on the Group's loss ratio:

	Losses $m	Loss ratio %
Reported loss ratio at 31 December 2017	335.4	78.4
Absent hurricane Harvey	287.6	67.7
Absent hurricane Irma	281.6	66.1
Absent hurricane Maria	300.0	70.5
Absent Mexico earthquakes	325.1	76.0
Absent California wildfires	300.9	70.4
Absent all catastrophe events	153.6	36.6

Note: the table does not sum to a total due to the impact of reinstatement premiums.

Prior year favourable development was $126.9 million for the year ended 31 December 2018 compared to $65.1 million for the year ended 31 December 2017. The favourable development in both 2018 and 2017 was primarily due to general IBNR releases across most lines of business due to a lack of reported claims. 2018 also included reductions on some prior accident year property and energy reserves. In 2017, the Group experienced some adverse development on prior accident year property and energy claims.

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

	2018 $m	2017 $m	2016 $m	2015 $m	2014 $m
Property	**46.5**	14.4	36.6	26.4	19.8
Energy	**55.0**	21.1	17.3	35.2	5.4
Marine	**12.1**	15.2	1.9	13.8	(9.7)
Aviation	**1.4**	3.0	3.9	2.9	0.9
Lloyd's	**11.9**	11.4	26.1	29.4	18.0
Total	**126.9**	65.1	85.8	107.7	34.4

Note: Positive numbers denote favourable development.

Excluding the impact of foreign exchange revaluations, previous accident years' ultimate losses developed as follows during 2018 and 2017:

Ultimate loss development by accident year

	2018 $m	2017 $m
2008 accident year and prior	**3.1**	0.1
2009 accident year	**23.9**	0.1
2010 accident year	**1.6**	1.8
2011 accident year	**4.7**	8.8
2012 accident year	**8.8**	5.0
2013 accident year	**3.5**	3.5
2014 accident year	**3.4**	9.2
2015 accident year	**6.6**	20.3
2016 accident year	**33.3**	16.3
2017 accident year	**38.0**	–
Total	**126.9**	65.1

Note: Positive numbers denote favourable development.

The ratio of IBNR to total net loss reserves was 39.3 per cent as at 31 December 2018 compared to 44.8 per cent as at 31 December 2017.

Accident year loss ratios

	2018 %	2017 %	2016 %	2015 %	2014 %
Accident year loss ratio	**70.0**	84.8	36.4	31.1	25.4
Initial accident year loss ratio	**n/a**	94.2	46.2	46.0	35.9
Change in loss ratio post-accident year	**n/a**	9.4	9.8	14.9	10.5

Note: Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2018.

Managed investment portfolio allocations

	2018 %	2017 %	2016 %	2015 %	2014 %
Cash	**4.8**	10.2	10.4	9.6	10.6
Short-term investments	**12.9**	6.0	0.3	1.1	1.4
Fixed maturity funds	**0.7**	1.7	0.8	0.6	0.7
Government debt	**14.4**	17.0	20.3	23.6	21.4
Agency debt	**5.1**	3.8	4.4	0.2	0.8
Agency MBS, CMBS	**4.9**	7.7	6.4	7.3	7.7
Non-agency RMBS, ABS, CMBS	**8.6**	8.5	7.3	8.4	11.0
Corporate bonds	**29.9**	28.2	32.5	33.2	31.7
Bank loans	**6.3**	5.8	6.6	5.9	5.8
Fixed maturity – at FVTPL	**2.6**	1.4	2.8	1.3	1.4
Equity securities	**1.3**	1.3	1.2	0.8	0.7
Hedge funds – at FVTPL	**8.5**	8.4	7.0	8.0	6.8
Total	**100.0**	100.0	100.0	100.0	100.0

Acquisition costs

The acquisition cost ratio was 30.6 per cent for the year ended 31 December 2018 compared to 27.0 per cent for the year ended 31 December 2017. The increase was largely due to higher outwards reinstatement premiums in 2018 compared to 2017, in addition to higher profit commissions on some of our property and energy classes.

Investments, liquidity and cash flow

Since inception, the primary objectives for our investment portfolio have been capital preservation and liquidity. Those objectives remain unchanged, and are more important than ever in today's volatile and reactive markets. As market volatility continues, we position our portfolio to limit downside risk in the event of market shocks. In 2018, our focus has been on managing our interest rate risk, the largest risk to our predominantly fixed maturity portfolio. We continue to maintain a short duration fixed maturity portfolio and have been using our risk budget to add products to our portfolio to help mitigate a rise in rates.

Our portfolio mix illustrates our conservative philosophy, as shown in the table adjacent. With the composition regulated by the Group's investment guidelines, we have three investment portfolio categories: 'core', 'core plus' and 'surplus'. The core and core plus portfolios contain at least enough funds required to meet near-term obligations and cash flow needs following an extreme event. Assets in excess of those required to be held in the core and core plus portfolios may be held in any of the three categories, which are discussed further on page 120.

The composition, duration and asset allocation of the investment portfolio are reviewed on a regular basis in order to respond to changes in interest rates and other market conditions. If certain asset classes are anticipated to produce a higher return within management's risk tolerance, an adjustment in asset allocation may be made. Conversely, if the risk profile is expected to move outside of tolerance levels, adjustments may be made to reduce the risk in the portfolio. We try to be nimble in our investment strategy while putting our objective of capital preservation first and foremost.

We believe in the application of common sense, and do not place much reliance on 'black box' approaches to investment selection.

Investments are, however, inherently unpredictable and there are risks associated with any investment strategy decisions. Recent market history has been tumultuous and we remain ever watchful. We will continue to monitor the economic environment closely.

Investment performance

Net investment income excluding realised and unrealised gains and losses was $34.7 million for the year ended 31 December 2018, an increase of 13.8 per cent compared to 2017. Total investment return, including net investment income, net realised gains and losses, impairments and net change in unrealised gains and losses, was a gain of $12.5 million for the year ended 31 December 2018 compared to a gain of $45.7 million for 2017.

The investment portfolio returned 0.8 per cent in 2018 driven by positive returns on the Group's standard fixed maturity portfolios as coupon returns more than offset the increase in treasury yields and widening of credit spreads that took place in 2018. Returns on the fixed maturity mandates outweighed the small losses on the equities, hedge funds and bank loans during the year. Despite the increase in treasury yields in 2017, the investment portfolio produced a return of 2.5 per cent due to the narrowing of credit spreads, coupon income and strong returns in the Group's equities, hedge funds, bank loans and principal protected notes.

Our average annual total investment return since inception is 2.7 per cent, and we have made a positive investment return in every year since inception, including 2008.

Liquidity

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

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

Cash flow

The Group's cash inflows are primarily derived from net premiums received, from losses recovered from reinsurers, from net investment income, including dividends and other returns from its associates, and any capital raising activities performed in a given year including the issuance of debt. Excess funds are invested in the investment portfolio, which primarily consists of high-quality, highly liquid fixed maturity securities of short duration. Other cash inflows result from the sale and redemption of investments.

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

Key investment portfolio statistics

	2018	2017	2016	2015	2014
Duration	**1.5 years**	1.7 years	1.8 years	1.5 years	1.5 years
Credit quality	**A+**	AA-	A+	AA-	AA-
Market yield	**3.1 %**	2.1 %	1.9 %	1.9 %	1.5 %
Book yield	**2.7 %**	2.0 %	1.8 %	1.6 %	1.5 %

Lancashire third-party capital management

The total contribution from third-party capital activities consists of the following items:

	2018 $m	2017 $m
Kinesis underwriting fees	**6.6**	5.8
Kinesis profit commission	**–**	5.9
Lloyd's managing agency fees & profit commission	**5.8**	5.5
Total other income	**12.4**	17.2
Share of loss of associate	**(7.1)**	(9.4)
Total third-party capital managed income	**5.3**	7.8

The Kinesis profit commission is driven by the timing of loss experience, settlement of claims and collateral release and therefore varies from period to period. Following the significant catastrophe activity during the second half of 2017, and resulting loss experience, there was no recognition during 2018 of any profit commission for the 2017 underwriting cycles. The higher Kinesis underwriting fees in 2018 reflect the higher level of premiums under management compared to 2017. The share of loss of associate reflects Lancashire's ten per cent equity interest in the Kinesis vehicle. The losses for both 2018 and 2017 were driven by the catastrophe activity in each respective year. The Lloyd's fees and profit commission is driven by the relative profitability of the underwriting years impacting each period.

Other operating expenses

	2018 $m	2017 $m
Employee remuneration costs	**49.0**	40.2
Other operating expenses	**40.2**	43.4
Total	**89.2**	83.6

Employee remuneration costs for the year ended 31 December 2018 were $8.8 million higher than the same period in 2017. The increase was primarily due to increased headcount following the recruitment of new underwriters and underwriting teams and an increase in the variable compensation element of employee remuneration costs compared to 2017, given the relative performance.

Other operating expenses were $3.2 million lower for the year ended 31 December 2018 compared to the same period in 2017 primarily due to lower consulting fees incurred in the Lloyd's segment.

Equity based compensation expenses were $7.9 million for the year ended 31 December 2018 compared to a credit of $0.4 million for the year ended 31 December 2017. The equity based compensation charge was driven by anticipated vesting levels of active awards based on current performance expectations. Lower equity based compensation charges were recorded during 2017 due to incorporating losses incurred during the second half of 2017 into the performance estimates combined with the lapsing of awards of former Cathedral employees on departure from the Group.

Capital management

Lancashire has built a reputation for being one of the best known and most active proponents of capital management in the industry. Capital management is our most important area of focus after underwriting and it is our firm belief that proactive and flexible capital management is crucial in helping to generate a superior risk-adjusted return over time. With our focus on maximising risk-adjusted shareholder return across the cycle we will return capital where this offers the best returns for our shareholders. We have returned 109.9 per cent of comprehensive income (loss) generated via dividends or share repurchases since inception.

The Group actively reviews the level and composition of capital on an ongoing basis. Internal methods have been developed to review the profitability of classes of business and their estimated capital requirements plus the capital requirements of the combination of a wide range of other risk categories. The key aim of the capital management process is to maintain a strong balance sheet, whilst:

- maintaining sufficient capital 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, regulatory and rating agency requirements.

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

Capital raising can include debt or equity, and returns of capital may be made through dividends, share repurchases, a redemption of debt or any combination thereof. All capital actions require approval by the Board of Directors. The retention of earnings generated also leads to an increase in capital.

The composition of capital is driven by management's appetite for leverage, amongst other factors, including the cost and availability of different types of capital. Maintaining a strong balance sheet will be the overriding factor in all capital management decisions.

Capital

As at 31 December 2018, total capital available to the Group was $1.391 billion, comprising shareholders' equity of $1.067 billion and $324.3 million of long-term debt. Tangible capital was $1.238 billion. Leverage was 23.3 per cent on total capital and 26.2 per cent on total tangible capital. Total capital and total tangible capital as at 31 December 2017 were $1.433 billion and $1.279 billion respectively.

Dividends

During 2018, the Lancashire Board declared a final dividend of $0.10 per common share in respect of the 2017 financial year and an interim dividend of $0.05 and a special dividend of $0.20 per common share in respect of 2018. With the final dividend in respect of 2018 of $0.10 per common share, total capital returns since inception amount to $2.8 billion, or 285.0 per cent of initial capital raised. The final dividend of $0.10 per common share will be paid on 27 March 2019 to the shareholders of record on 22 February 2019.

Non pre-emptive issue of shares

As part of the Group's flexible approach to capital management the Board has in recent years requested and received from shareholders authority to issue up to 15 per cent of its shares on a non pre-emptive basis. Lancashire believes that this ability to raise capital quickly is important in securing first mover advantage in the catastrophe insurance and reinsurance business which it underwrites. The Board proposes to put a similar request for authority to shareholders in a resolution at the 2019 AGM to be held on 1 May 2019.

Letters of credit

Lancashire has a standard syndicated LOC facility which in total amounts to $300.0 million, with a $75.0 million loan sub-limit available for general corporate purposes. Syndicate 2010 has a catastrophe facility in place to assist in paying claims and the gross funding of catastrophes. Up to $80.0 million can be utilised by way of an LOC or an RCF to assist Syndicate 2010's gross funding requirements.

There was no outstanding debt under the above facilities at any reporting date. There are no off-balance sheet forms of capital.

Working together

Louise Wells
Group Chief Risk Officer

As a short-tail, specialty (re)insurer risk management is key to our success; balancing the risk we take on with the return we receive for that risk is critical. Understanding the risks to the business and the current, and potential, impact on our business model gives us the ability to adapt as necessary to deliver on our strategic priorities. Ensuring we have continuous and consistent risk management embedded across the Group through the RMF is a key focus.

Risk strategy

Our risk strategy is the starting point for the development and evolution of our RMF and is therefore refreshed on an annual basis in line with the regular development of our framework and the annual review of the business and capital strategy. Our risk strategy must be aligned with our business and capital strategy to ensure the capital resources held are matched to the risk profile of the Group and that the balance between risk and return is considered as part of all key business decisions.

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, which can be subdivided into the core risk of underwriting and non-core risk of reserving and includes the Group's risk exposures to natural catastrophes including wind storms, wildfires and other loss events linked to climate change trends.

The Group has formulated, and keeps under review, a risk appetite which is set by the Board of Directors. The Group's appetite for risk will vary marginally from time to time to reflect the potential risks and returns that present themselves. However, protecting the Group's capital and maximising risk-adjusted returns for investors 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 modelled 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 Board and individual entity boards of directors review actual risk levels versus tolerances, emerging risks and any risk learning events at least quarterly. In addition, on at least a monthly basis, management assesses our modelled potential losses against risk tolerances to ensure that risk levels are managed in accordance with them.

ERM framework

The Group subscribes to a 'three lines of defence' model, the front line being risk ownership by business managers. 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 respective risk registers, which are a direct input into the subsidiary capital models. The second line comprises the risk management team, which is responsible for risk oversight. Within this, the Group 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 Board and the boards of the individual operating entities. The Group CRO ultimately has the right to report directly to the Group and entity regulators if she feels that management is not appropriately addressing areas of concern. Cathedral's CRO provides formal reports to the CUL Board and its RCCC. The third line of defence is the internal audit function, which works very closely with the business and the risk management team in providing risk assurance.

We continue to perform a quarterly risk and controls affirmation process whereby the operation of all key controls is affirmed by the control operators and then reviewed and signed off by the risk owners. In addition, the risk owners are required to affirm their risks remain appropriately documented and scored. The output from this process is reported to the RRC and the Group and operating subsidiary audit and risk committees or boards of directors as appropriate.

As at 31 December 2018, all Group entities were operating within their board-approved risk tolerances. No significant new risks have been identified and there have not been any material changes in our existing risks.

ERM & ORSA

Key activities

- Review of business strategy with challenge from the Board
- Annual approval of a business strategy paper by the Board

- Group CRO report to Board and Executive Management Committee
- Production of ORSA report and review and approval by the Board

- Risk identification and assessment
- Quarterly risk and control affirmations
- Quarterly internal audit reports to the Audit Committee per a three- and four-year rolling programme
- External audit reports to the Audit Committee
- Audit Committee annual review of the effectiveness of financial controls

- Capital and liquidity management frameworks
- Review of BLAST policies, capital and solvency appetites
- Full/proxy capital assessments
- Rating agency capital assessments
- Stress and scenario testing

- Review of risk strategy and 'attitude to risk'
- Review of risk appetite and limits
- Review of Group risk tolerances
- Management, Board and subsidiary board approval of risk tolerances

- Review of risk management policies
- Assessment of risk management framework maturity
- Integrated assurance assessment
- Emerging risk assessment

- Review and approval of business plan by the Board
- Stress and scenario testing (business plan)
- Assessment of management actions

Key elements of ORSA

- Board sign-off and embedding
- Business strategy
- Risks
- Capital and solvency
- Stress and scenario testing

Our quarterly ORSA reports prepared by the Group CRO to the main Board provide a timely analysis of current and potential risks, compared against risk tolerances, along with their associated capital requirements. Key areas of focus in 2018 included Brexit, climate change and the continued soft market conditions.

The 2019 annual ORSA report will be presented to the Board for review, challenge and approval during the first quarter of 2019. This will be a transitional ORSA as we move from the PRA's group supervision to the BMA's, which was effective 1 January 2019.

As a Lloyd's managing agent, CUL falls within the Society of Lloyd's for Solvency II reporting, preparing ORSA reports for each syndicate. Cathedral has its own ERM framework to ensure adherence to Lloyd's minimum standards.

In November 2018, the Group CRO reported to the Remuneration Committee regarding risk and remuneration, recognising the importance of the design of the remuneration structure in driving desired behaviours over both the short-term and the longer-term business planning periods. In addition, the Group Solvency II Staff policy underwent its annual review by the Remuneration Committee.

The diagram above illustrates how we balance our ERM and ORSA activities. Our risk culture is driven from the top down via the Board and executive management to the business, with the RRC central to these processes. The primary role of the Group CRO is to facilitate the effective operation of ERM and the ORSA process throughout the Group at all levels. The role includes, but is not limited to, the following responsibilities:

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

RRC

The RRC, under the chairmanship of the Group CEO, is the key management tool for monitoring and challenging the assessment of risk on a regular basis. It seeks to optimise risk-adjusted returns and facilitate the appropriate use of BLAST, 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 co-ordinating and overseeing ERM activities within the risk profile, appetites and tolerances set by the Group and individual entity boards of directors. The RRC includes the Group CEO, members from the finance, actuarial, modelling, operations, treasury and underwriting functions and both the Group CRO and Cathedral CRO. The Group CRO reports on the RRC's activities to the Group and individual entity boards of directors and, via the Cathedral CRO, the RCCC of Cathedral. Through the Group CRO the RRC considers recommendations to the Board and its Committees with regard to the adoption of formal risk tolerances.

Capital models

We continue to challenge the assumptions used in the individual capital models and make changes where appropriate.

Emerging risk

The identification and assessment of emerging risk occurs throughout the Group from individual departments to management and executive committees to the boards of directors and sub-committees of the boards. The risk department maintains an emerging risk register, which is provided to the Board and entity boards of directors each quarter, and is therefore subject to an iterative process of review and oversight. Emerging risks, by their nature, are difficult to quantify, however during 2018 the Group strove to foresee potential areas of new risk, or developments in existing risks and to assess how those risks could impact the Group. In addition, during 2018 CUL implemented an emerging risk working group, the output from which is included in the CUL CRO's report to the Cathedral RCCC and the Group's emerging risk register. Emerging risks considered in 2018 included Brexit, geo-political instability and U.S. tax reform.

Risk universe

We continue to classify risks in three broad classes: (a) Intrinsic Risk: 'Risk that stems from the inherent randomness and uncertainty that exists in the universe in which we operate and that is therefore fundamental to how we manage our business'. This can be core or non-core; (b) Operational Risk: which can be independent or correlated; and (c) Other Risk: the non-financial category of risks which cannot necessarily be mitigated by holding capital since such risks may not have direct balance sheet implications.

The Board evaluated the risks disclosed, alongside other factors, in the assessment of the Group's viability and prospects as set out in the going concern and viability statement in the Directors' Report at page 93.

Risk universe

Type	Category	Description
Intrinsic Core	Underwriting Investment	Intrinsic risks representing the potential to generate a return as well as a loss. In these areas, the Group promotes informed risk-taking that considers the risk and return equation in all major decisions, with the intention of maximising risk-adjusted return on equity. We recognise that by insuring fortuitous events we can suffer losses, and that within our investment portfolio we can see the value of investments fall. We cannot avoid these risks so we focus on the correlated operational risks and seek to mitigate them. For example, we know that by insuring the risk of earthquake we are exposed to the risk that losses exceed our plan. We model our portfolio using stochastic modelling to review actual and planned exposures to ensure they remain within tolerances. The correlated risks are that we might fail to design or maintain effective tolerances and limits, and fail to maintain exposures within such limits; or that we fail to keep accurate and timely records of our exposures. We then devise systems and processes to mitigate these risks, such as PML reconciliations, and RDS sign-offs, with review by the RRC and regular ORSA reports to the Board, which also considers and approves formal risk tolerances.
Intrinsic Non-core	Reserving (Re)Insurance counterparty Liquidity	Intrinsic risks to which we are inevitably exposed as a result of conducting our day-to-day business operations yet offer no direct potential for return. They are quantified insofar as practicable for the purposes of capital and risk management and avoided or minimised insofar as is economically justifiable.
Operational	Operational	These are risks arising as a result of inadequate or failed internal processes, personnel, systems or (non-insurance) external events. They have the potential either to magnify the adverse impacts of intrinsic risks, for example increased reinsurer default losses arising through the use of non-approved counterparties; or to crystallise separately in their own right, for example losses arising through the imposition of fines as a result of a regulatory breach, so unrelated to our core functions.
Other	Strategic Group Emerging	These are risks for which quantitative assessment is difficult but for which a structured approach is still required to ensure that their potential impact is considered and mitigated insofar as is practicable. These are included within the risk register and are assessed and mitigated through scenario and stress testing.

Balancing our risks and opportunities

As described under our review of the risk universe on page 35, our classification of risks as Intrinsic Core and Intrinsic Non-core, Operational and Other helps us to focus on our management and mitigation of those risks. Further details concerning these risks can be found on pages 111 to 133. Within the capital models, insurance risk accounts for over 80 per cent of the allocated risk capital, so this is clearly the principal area where we stringently apply controls and reviews. For example, we place a large number of controls around monitoring risk levels across the business. However, we understand that even risks that do not generate a capital charge under an economic capital model can pose serious threats to the execution of the business plan and strategy, and therefore need to be monitored and tested. For example, we spend a lot of time looking at the implications of emerging capital and the evolution of the market cycle. In addition, the Group continues to consider and adapt to the risks and opportunities arising from climate change through the analysis of the associated physical, transitional and liability risks. As part of our overall risk mitigation strategy we perform detailed stress and scenario testing to stress the financial stability of the Group. This process is aligned to our business planning and ORSA processes and time horizons. The selected tests are aligned to our key risk areas and include capital (rating agency and regulatory), underwriting and investment related stress tests at a minimum.

Intrinsic risk: Core

Type	Mitigation
Underwriting: Losses in our classes are hard to predict in particular as to the specifics of timing and quantum of catastrophe loss events. Additionally, we write lines of business that are subject to accumulations, including accumulations of individual risk losses arising from a single event such as several property catastrophe excess of loss programmes being affected by a windstorm or earthquake, and accumulations between business lines such as a 9/11 type event impacting both the terrorism and AV52 portfolios. Losses can also exceed expectations in terms of both frequency and severity. We recognise that through climate change trends, and other influencing factors, weather-related incidences or other actual catastrophe loss events these may increase losses in frequency, severity and clustering so, although we model losses, for example using the RMS and AIR stochastic models, we know that these projections can and will be wrong in many instances. Trend: Stable.	Modelling: We apply loads to, and stress test, stochastic models and develop alternative views of losses using exposure damage ratios. We review our assumptions periodically to ensure they remain appropriate. We also back test our portfolio against historic events to assess potential losses. RRC: The RRC considers accumulations, clashes and parameterisation of losses and models. Capital: We set our internal capital requirements at a level that allows for buffers above accumulations of extreme events and the Board approves risk tolerances at least annually and considers capital requirements on at least a quarterly basis. Reinsurance: We buy reinsurance to manage our exposure and protect our balance sheet. The structure of our programme was reviewed for 2019 to ensure it remained aligned to our strategy and risk profile.
Investment: We need to hold sufficient assets in readiness to pay claims, but the markets and products in which we invest can suffer volatility and losses. As a short-tail insurer, we are able to hold the majority of assets in low-duration securities such as fixed maturities. However, this creates an additional source of risk in the current environment, where there is a considerable risk from changes in the Federal Reserve policy where rates may increase further or start to reduce as the preferred term and interest rate is achieved. In addition, there is increased credit risk in the U.S. economy as it reaches the later stages of the credit cycle. We model our investment portfolios and use various stress scenarios to see what kinds of losses we could expect under a range of outcomes. Trend: Stable.	Investment strategy: Our strategy is that investment income is not expected to be a significant driver of our returns. Our primary focus remains on underwriting as the engine of profits. Investment strategy, including investment risk tolerances, is approved annually and monitored on a quarterly basis by the Investment Committee and Board. A detailed strategic asset allocation study is performed biannually. IRRC: The IRRC forms an integral part of our risk management framework, meeting at least quarterly and reporting to the RRC. External advisers: Lancashire's Board and management recognise that the Group's principal expertise lies in underwriting so we use the services of internationally recognised investment managers who are experts in their fields.

Intrinsic risk: Non-core

Type	Mitigation
Reserving: Because we do not know the amount of losses we are going to incur at the outset of a contract, we have to make estimates of the reserves we need to hold to pay claims. If these reserves are inadequate and claims exceed them, this may have an impact on earnings, or indeed capital. Independent reserve reviews by external actuaries look at the overall levels of expected losses, as well as individual large events, including benchmarking analyses to provide assurance over the level of reserves booked. Trend: Stable. Our processes and controls remain the same as in previous periods.	Short-tail business: Lancashire's focus is on short-tail lines of business where losses are usually known within, or shortly after, the policy period with a reasonable degree of certainty. Experience data: We have access to a lot of data, both our own and from the industry as a whole, about losses and loss trends. Actuarial and statistical data are used to set estimates of future losses, and these are reviewed by underwriters, claims staff and actuaries to ensure that they reflect the actual experience of the business. External review: Insurers typically facilitate an independent review by external actuaries of their loss reserves. Lancashire retains the services of one of the leading industry experts, and our appetite is defined so as to set reserves within a range of reasonable estimates based on both internal and external review. The external auditors, KPMG, also carry out an actuarial review of reserve adequacy. The Audit Committee of the Board, with the benefit of management and the actuarial and audit reports, reviews reserve adequacy at its quarterly meetings.

Type	Mitigation
(Re)Insurance and intermediary counterparty: Almost all the insurance policies which we write are brought to us by brokers, who act as intermediaries between us and the client, and handle the transaction of payments of claims and premiums on our behalf. This exposes us to the risk of mishandling by, or failure of, the broker concerned. In order to make our portfolio as efficient as possible, we buy reinsurance to protect against severity, frequency and accumulation of losses. Again, this exposes us to the risk that our counterparties may have the inability or unwillingness to pay us in the event of a loss. Trend: Stable.	Counterparty credit limits: The Broker Vetting Committee is responsible for the broker vetting approval process and monitoring credit risk in relation to brokers. In addition, the Group conducts broker business using non-risk transfer TOBAs. This mitigates the risk due to non-payment by brokers and intermediaries as monies are held in separated client accounts. We use counterparty credit limits, seek to deal with reputable reinsurers that meet our minimum rating standards, and use collateral agreements where appropriate. The operating entities of the Group that contract for reinsurance separately maintain and report their own counterparty credit limits at the entity level. The RSC is responsible for approving counterparties and monitoring aggregate limits.
Liquidity: In order to satisfy claims payments we need to ensure that sufficient assets are held in a readily realisable form. This includes holding liquid assets for the modelled payout of loss reserves, as well as ensuring that we can meet claims payments in relatively extreme events. Trend: Stable.	Portfolio management: The Group maintains liquidity in excess of the Board-agreed tolerances. This is achieved through the maintenance of a highly liquid portfolio with short duration and high creditworthiness. We monitor this through the use of stress tests and mitigate risks through the quality of the investments themselves.

Operational

Type

These are risks arising as a result of inadequate or failed internal processes, personnel, systems or (non-insurance) external events. They have the potential either to magnify the adverse impacts of intrinsic risks or crystallise separately in their own right. This can encompass IT availability, where the failure of an IT system, such as our underwriting system, could impact our ability to maintain accurate and up-to-date records of our exposures. If correlated with an insurance loss this could cause us to breach insurance risk tolerances. It could also encompass IT integrity, where an unauthorised intruder could alter data in our systems, or introduce a bug that would corrupt the system.

Trend: Stable compared to prior period but elevated through the project to develop our systems to enable us to further improve the functionality of Group IT finance systems, to enhance management of financial reporting risk and to ensure future compliance with IFRS 17.

Mitigation

Capacity: We mitigate IT availability risk by adding redundancy to the capacity we need and using backups of data including off-site storage that we test regularly.

Testing and access: We mitigate the integrity risk by using independent external penetration tests, and by restricting access to key systems to only those people who are qualified and need to use them.

Personnel: We mitigate the risks associated with staff retention and key-man risk through a combination of resource planning processes and controls. Examples include targeted retention packages, documented position descriptions and employment contracts, resource monitoring and the provision of appropriate compensation and training schemes. The Board regularly reviews succession planning arrangements and remuneration structures, and in addition the Group CRO reports annually to the Remuneration Committee on risk and remuneration including Solvency II remuneration requirements.

Other – Brexit

Type

These are risks for which quantitative assessment is difficult but for which a structured approach is still required to ensure that their potential impact is considered and mitigated insofar as practicable. They include categories such as Strategic, Group, Regulatory and Emerging Risks. A key focus during 2018 has been on the uncertainties arising as a result of Brexit and the lack of clarity on the political direction of the Brexit negotiations.

Trend: On balance risk levels remain stable. The impact of Brexit is not considered to be a significant risk to the Group given the Group's current operations, trading profile and the solutions that have been put in place. The Group has developed a clear strategy as a result of the UK's proposed withdrawal from the EU, which is currently scheduled to take effect on 29 March 2019. In the event that the UK and the EU27 conclude a withdrawal agreement prior to 29 March 2019 then there will be a 21 month period wherein access to the single market will continue seamlessly until 31 December 2020 for UK insurers. After that date it is anticipated that a free trade agreement will be implemented.

Notwithstanding this, the Group has actively sought a solution in the event of no agreement as at 29 March 2019, a so called 'hard' Brexit, and to that end it is proposed that a significant proportion of LUK's existing EU27 business could be written via Lloyd's Brussels, utilising CUL, which has Lloyd's approval for this arrangement, subject to ongoing approval by Lloyd's and any additional approvals of the Belgian regulatory authorities that may be required in relation to the operation of Lloyd's Brussels. The Group may also consider additional contingency planning depending on the likely level of continuing market access as the political situation develops, including transferring new and renewal EU27 business to LICL, a Bermuda domiciled company. Bermuda is a Solvency II equivalent jurisdiction to the EU and as a result a significant amount of EU27 (re)insurance business could be written by LICL. Moreover, it is the Group's understanding that even under the World Trade Organization's General Agreement on Trade and Services (GATS) rules (depending on each individual EU member state's commitment to grant access to third-party countries) there is likely to be an ability for LUK to continue underwriting certain classes of business in the EU27. The Group also notes the moves by France, Germany, the Republic of Ireland and several other EU countries to ensure contract certainty in relation to legacy business in the event of a 'hard' Brexit scenario; and expects that these moves are likely to be replicated across the EU27.

Mitigation

Qualitative approach: These risks require a qualitative approach, engaging staff in appropriate discussions about sources of risk, and then thinking about possible outcomes. The Group Executive Management Committee and the RRC consider these issues, and the quarterly ORSA reports made by the Group CRO to the Board include standing items on these risk areas. A Brexit update including proposed solutions and the status of such was included each quarter during the year.

Working to support our stakeholders

The Group values its relations with, and works to support, its stakeholders to ensure the success of the business.

Our stakeholders

Our approach to stakeholder engagement

Since its foundation in 2005, the Lancashire Group has focused on fostering relations with a broad range of stakeholders, in particular our shareholders and our people, who support our business and our policyholders who rely on the (re)insurance products we sell. These 'core' stakeholders are shown at the heart of the diagram but at any one time the Group's relationship with certain of its other stakeholders can come to the forefront and be of key importance. Therefore, our stakeholder diagram is fluid in nature.

Responding to the debate

There has been recent debate around the importance of such stakeholder engagement in relation to UK listed companies. Although the Company is incorporated in Bermuda and therefore not subject to UK Companies Act requirements, the Board has paid, and continues to pay, close attention to the latest developments in English law and governance expectations, specifically, the duties falling upon boards of UK incorporated companies under section 172 of the Companies Act 2006 and the changes introduced to the UK Corporate Governance Code in 2018, which place a greater focus on businesses to demonstrably pay regard to the interests of a broad group of stakeholders. Our engagement with our stakeholders is essential to the formation and delivery

“Our employees are the lifeblood of the organisation and the Group therefore strives to attract and retain excellent individuals who share our drive and appetite to outperform.”

of Lancashire’s business strategy. The Board and the business have for many years prioritised underwriting excellence and a nimble culture of capital management to serve the best interests of our core stakeholders and ultimately benefit a broader group of stakeholders.

Our people

Culture

Our employees are the lifeblood of the organisation and the Group therefore strives to attract and retain excellent individuals who share our drive and appetite to outperform. Matching the skills, aspirations and values of new recruits to those of the business remains a key priority. We believe the talents of our people and our distinctive culture continue to set us apart from our competitors.

Lancashire offers a rewarding environment within which to work, both in terms of the support and opportunities given to employees to enable them to excel in their role and the competitive and attractive compensation and reward structures. To further enhance the link between our people and the performance of the business, all of our permanent employees are eligible to receive RSS awards, therefore giving them the opportunity to share in the growth and success of the Group and ultimately become shareholders.

Diversity and inclusion

The Group promotes an inclusive, collegiate and positive environment that recognises and values diversity as key to enhancing individual development and maximising business effectiveness (see in this regard the Nomination and Corporate Governance Committee report on pages 63 and 64). As an equal opportunities employer, we do not tolerate discrimination of any kind in any aspect of employment. For example, all decisions relating to recruitment, assessment and promotion are based on the ability of the individual to do the job, without consideration to race, age, gender, sexual orientation, disability, beliefs, background (except as may be pertinent to the requirements of a role, such as educational qualifications or prior employment experience) or nationality. Our workforce is represented by employees from 13 different nations and the gender split of males to females (see page 64) is 61/39 per cent respectively. The Group is also committed to providing a working environment that is free from any form of bullying or harassment.

We expect our staff to conduct themselves in a professional manner which is reflective of the Group’s core values. All new employees are required to attend our ‘Respect in the Workplace/ Communications Etiquette’ training sessions as part of their induction. The training sessions aim to highlight employees’ responsibilities in ensuring that there is no discrimination in the workplace and in fostering a positive and productive working environment.

Lancashire respects, supports and complies with all relevant local Bermudian and UK legal requirements to which it is subject, in particular with respect to rights of freedom of association, collective bargaining and working time regulations.

	2018	2017
Number of employees (UK and Bermuda)	**218**	204
Percentage of female employees	**39%**	40%
Percentage of women on the LHL Board	**28.6%***	25%
Percentage of women on the Group executive committee	**37.5%**	33.3%
Percentage of women in senior management positions	**29.4%**	26.3%
Number of different nations represented by our employees	**13**	12
Percentage of the workforce composed of third-party contractors	**6.9%**	3.8%
Group employee turnover (annual)	**13.8%**	16.2%
Percentage of employees who undertook training during the year	**65.6%**	67%
Percentage of permanent employees eligible for RSS awards	**100%**	100%
Accredited London Living Wage employer	**Yes**	Yes

* At the time of approval of this Annual Report and Accounts, the percentage of women on the LHL Board stands at 37.5%.

Training and development

The Group encourages continuous personal and professional development for all of its employees, through internal and external training, professional qualifications, internships and secondments, performance coaching, and 'lunch and learn' sessions. During 2018, approximately 65.6 per cent of our employees undertook some form of training supported by the Group. As ever, we encourage all our employees to take advantage of the training opportunities offered. Individual training and personal development needs are discussed on a regular and ongoing basis by managers and their team members, and are assessed as part of the formal appraisal process, where principally each of our employee's success is measured through the attainment of personal performance metrics as well as performance within the Group's values framework. We can confirm that during 2018 3.2 per cent of our employees were promoted within the Group, supported by the training and development opportunities afforded to them.

The Group also delivers compulsory training to all new permanent staff and fixed-term contract staff which covers a range of important topics, including; Tax/Regulatory Operating Guidelines, Disclosure (including share dealing), Inspections, Financial Crime, ERM and Respect in the Workplace/Communications Etiquette. Other training may be held on an ad hoc, one-off or refresher basis according to an individual's requirements. The training is designed to ensure that all personnel who are employed by the Group are provided with the skills, knowledge and expertise appropriate to their role and responsibilities within the business. There is an expectation that all new staff members will have completed their compulsory training during the first six months of joining the business. Quarterly updates regarding attendance at these compulsory training sessions are provided to the Board for information purposes.

Engagement

The Group benefits from having a relatively small headcount (218 employees globally), which allows its staff members to interact easily between departments and to access members of the senior management team including the CEOs at both Group and subsidiary level. Lancashire also encourages a high level of engagement between its workforce and the Board. There are regular opportunities for each of the Directors and staff members to interact at all levels across the organisation in a particular year, and such engagement is encouraged both at the level of the Group's subsidiary boards and the main Board of the Company. This occurs at board dinners (to which UK and Bermuda staff members are routinely invited), interaction with senior employees as part of quarterly activities, semi-formal lunches, 'town hall' quarterly update meetings, periodic attendance at the daily underwriting call and annual attendance at the AGM. Furthermore, both Simon Fraser and Samantha Hoe-Richardson are Non-Executive Directors on the subsidiary boards of CUL and LUK, respectively, and in that capacity each has the opportunity to meet and engage with a range of staff members within those businesses. Please see page 49 for the Chairman's comments on the Board's plans for workforce engagement during 2019.

Our employees also continue to contribute towards the development of our marketplace through their involvement with market committees, boards and working groups. During 2018, our employees actively participated in industry conferences, investor days and symposia, and market education programmes. As noted on page 46, we also donate to many of the causes supported by our industry partners through the Lancashire Foundation.

Shareholders

As a premium-listed company on the LSE, Lancashire understands the importance of its obligations to shareholders. We work hard to foster good investor relations and pride ourselves on having an active programme of engagement with our diverse shareholder community around the world.

Lancashire values the views of all of its shareholders and maintains open and transparent communication channels with them and certain of the leading shareholders advisory services. This is led by our Group Head of Investor Relations, in collaboration with members of the Board and the executive team, and is achieved through a structured programme of meetings, presentations and periodic consultation initiatives. These can cover a range of topics including the Group's financial performance and business strategy, the environment and the executive remuneration policy.

The Board meets regularly with the Group's corporate brokers to seek their feedback on investor priorities as well as Lancashire's performance and perception amongst investors within the broader insurance sector. To learn more about the Board's engagement and relationship with its shareholders, please see page 57 of this Annual Report and Accounts.

Policyholders

Policyholders are central to our business, so understanding and serving their commercial requirements is at the forefront of everything we do. Through our range of underwriting platforms, we strive to offer clear, fairly-priced and useful products that continue to meet our policyholders' insurance and reinsurance needs across the cycle. In the event of a loss occurring, we remain responsive in order to provide our policyholders with ongoing support and seek to pay their claims as expeditiously as possible, knowing the importance of providing an excellent service. We place the highest value on the relationships we have built over the years with our existing policyholders and work hard at creating a lasting impression with new ones. To this end, we are happy to welcome both our policyholders and their brokers to our offices, but we also travel to see them and their businesses around the world.

A more detailed account of the work we do in meeting the needs of our policyholders can be found in the underwriting review and business review sections of this Annual Report and Accounts on pages 22 to 25 and pages 26 to 32, respectively.

Brokers

We are fully committed to supporting a ‘broker market’ and to maintaining a strong working relationship with the largest global broking firms, as well as individual brokers. The Group depends on brokers to distribute its products and actively assesses these relationships to ensure that it continues to be viewed as a trusted partner and provider of solutions for their clients’ (re)insurance needs.

Communities and society, including the Lancashire Foundation

Lancashire is strongly committed to giving back to the communities within which it operates, both locally in the UK and Bermuda and also further afield. The business seeks to help those who are in distress or at a disadvantage, through continued support of local initiatives and activities, volunteering days, mentoring opportunities and fundraising events, to name a few. We utilise the talent and energy of our staff in helping others, positively impacting society and creating a more sustainable environment. In turn, this stimulates a positive culture amongst staff and promotes Lancashire as an ethical and compassionate employer. These goals are primarily achieved through the work of the Lancashire Foundation. To learn more about the Lancashire Foundation and the charities it supports, refer to pages 45 to 47.

The Group and the Foundation have jointly sponsored an internship programme for Bermuda resident college graduates since 2014. These graduates are afforded the opportunity to work and learn about insurance in the Group’s London office.

The Board keeps itself informed of the activities of the Lancashire Foundation through regular reporting and meetings with the Foundation’s Trustees. A staff survey completed in 2018 confirmed that across all our platforms the Foundation’s work was seen as a vitally important part of the Group. The Board also sets the policy for donations to the Lancashire Foundation.

Environment

The Group is committed to managing the environmental impact of its business. We continue to measure our carbon footprint with a view to minimising its negative impact through mitigation strategies and by offsetting 100 per cent of our greenhouse gas (GHG) emissions, as reported in the table below, to remain carbon neutral. The Group also recognises the challenges posed by climate change and considers its impact as part of the risk management and strategic planning process (please refer to the Chief Executive’s review on page 15 and the section on principal risks from page 36 to 39 for further details).

With operations in London and Bermuda, and with clients and brokers around the globe, the Lancashire Group incurs the bulk of its carbon footprint as a result of airline travel.

Emissions are collated over a 12-month period from 1 January 2018 to 31 December 2018 and are calculated by converting consumption data into tonnes of carbon equivalent (tCO_2e) using the DEFRA 2018 GHG reporting conversion factors.

Using an operational control approach, Lancashire has assessed its boundaries to identify all the activities and facilities for which it is responsible. Subsequently, we have reported 100 per cent of our Scope 1 and 2 footprint, along with areas of our Scope 3 footprint with high levels of operational control, as detailed below. Calculations performed follow the ISO 14064-1:2006 standard, giving absolute and intensity factors for the Group’s emissions. Lancashire uses the number of full-time employees (FTE) as its intensity metric. Where data was not available for 2018, values have been extrapolated by using available data or calculated using industry benchmarks.

The following table sets out the Group’s carbon footprint for the current and prior reporting period, broken down by emission source.

The Group’s UK operations have been awarded BREEAM excellence for their London offices at 20 Fenchurch Street, which has supported an overall improvement in environmental performance.

Total emissions for 2018 have decreased by 13.2 per cent compared to 2017, with emissions per FTE falling by 18.8 per cent compared to 2017.

Types of Emissions	Activity	2018[1] tCO_2e	2017[1] tCO_2e
Direct (Scope 1)	Gas *(measured in kWh)*	**60.1**	**70.9**
	Refrigerant *(measured in kg)*	**0.0**	**0.0**
Indirect Energy (Scope 2)	Electricity *(measured in kWh)*	**319.9**	**418.0**
Indirect Other (Scope 3)	Business Travel *(measured in miles and spend)*	**1,457.2**	**1,619.5**
	Additional Upstream Activities[2] *(measured in kWh, litres, miles and spend)*	**246.4**	**299.7**
	Water *(measured in m^3)*	**12.9**	**7.2**
	Waste *(measured in kg)*	**3.7**	**4.4**
	Paper *(measured in reams)*	**5.6**	**6.9**
	Hotels *(measured in hotel nights)*	**24.0**	**26.7**
Gross Emissions (tCO_2e)		**2,129.8**	**2,453.3**
Gross Emissions per FTE (tCO_2e/FTE)		**9.8**	**12.0**
Carbon Credits		**2,130**	**2,454**
Total Net Emissions after offset (tCO_2e)		**0.0**	**0.0**

1. Please note: all numbers quoted have been rounded to one decimal place.
2. Additional Upstream Activities include Well-to-Tank and Transmission & Distribution emissions. These are emissions associated with the upstream processes of extracting, refining and transporting raw fuel and the emissions associated with the electrical energy lost during transmission to our business.

Results show that GHG emissions in the year were 2,129.8 tCO_2e, comprised of direct emissions (Scope 1) amounting to 60.1 tCO_2e, and indirect emissions (Scope 2) amounting to 319.9 tCO_2e. The source of other indirect emissions (Scope 3) comprised 1,749.8 tCO_2e. Scope 1 emissions have decreased by 15.3 per cent due to a decrease in natural gas consumption. Scope 2 emissions have decreased by 23.5 per cent compared with 2017 due to the continuing decarbonisation of the UK grid mix, alongside a reduction in consumption year on year. Scope 3 emissions have also decreased compared with 2017 due, primarily, to a reduction in air mileage year on year.

The Group has fully offset its 2018 GHG emissions through an organised programme with EcoAct by purchasing credits in the Wind Power Generation project in India. These offsetting proposals were discussed and agreed with the Group CEO.

Government and regulators

In an industry that is subject to strict regulatory supervision and oversight, we recognise the need to work closely and openly with all relevant regulatory bodies. We place great importance on the relationships we have with our regulators and engage actively with them, whether that is through meetings, reporting or routine regulatory reviews. In particular and to provide an example, members of senior management and the Chairman of the Board held regular dialogue with the PRA during 2018 as part of the discussions relating to the relocation of the Group's regulatory supervision to Bermuda. The Board is also kept apprised of communications with regulators and supervisors and, together with management, monitors changes in regulatory and supervisory requirements closely.

In addition, the Group maintains proactive relationships with relevant tax authorities, including HMRC, in order to achieve compliance with all its tax obligations. This requires us to keep abreast of developments in tax legislation and to work with the tax authorities to manage our tax risk.

Rating agencies

Lancashire maintains a positive relationship with three major rating agencies: A.M. Best, S&P and Moody's. These rating agencies assess and rate the creditworthiness and claims-paying ability of the Group's insurance subsidiaries, LICL and LUK, based upon established criteria. The syndicates benefit from Lloyd's current ratings. We are proud of the ratings which we have been assigned by each of these rating agencies and we engage with them on the following bases: annually, for our rating review; quarterly, to discuss our results for the period; and on an ad hoc basis as events dictate including after significant industry loss events or a series of loss events. These ratings allow the Group to write business successfully in all major global insurance markets and to comply with reinsurance contracts under which the Group is reinsured, as well as its credit facilities which support underwriting obligations.

Service providers, including suppliers and contractors

The Group contracts with a number of third parties for the provision of important services to help run its business. Having developed excellent relationships with its service providers, Lancashire is able to work collaboratively with them. This helps us to respond to technological advances and to develop internal systems and infrastructure to operate efficiently.

For all employers within the ancillary services and limited supply chains used by the Group, Lancashire seeks to receive assurance that its service providers pay a living wage. In particular, the Group's UK operation is an accredited Living Wage employer by the Living Wage Foundation.

"In an industry that is subject to strict regulatory supervision and oversight, we recognise the need to work closely and openly with all relevant regulatory bodies."

The Group operates a policy of paying its service providers in accordance with the individual payment terms agreed. The Group's UK subsidiary, LUK, complies with its statutory reporting duty for payment practices and performance in relation to qualifying contracts on a half-yearly basis.

As a service provider in our own right, Lancashire has its own responsibilities to those within its limited supply chain. Any concerns arising over the human rights records of insureds and potential clients would be considered as part of the underwriting process.

Lenders

The Group has in place a number of long-term debt and financing arrangements with lenders which help to support and fund its underwriting operations and to comply with regulatory capital requirements. The Group's solid relationships with its lenders allow it the flexibility to respond to changing business and economic conditions and to raise capital, when required, to execute its strategy. We routinely publish financial information for the benefit of all our capital providers, including our lenders.

Further details of our long-term debt and financing arrangements are set out in note 18 to the consolidated financial statements from page 153 to 155.

The Lancashire Foundation

The Lancashire Foundation, our charitable grant-making body, is the cornerstone of our community support. The channelling of the talents and energy of our staff in helping others in this way helps benefit and build Lancashire's business and a positive culture.

The Foundation is a key component not just of our community activity, but also of our corporate persona.

The Foundation is funded by regular donations from the Company and retains a shareholding in the Company and therefore benefits from any dividends paid. This creates a direct link between the success of the Company and the resources available to the Foundation, serving as an additional motivation for our people, as the Foundation is able to support more of the causes that are suggested by employees. In this way we have aligned the Foundation to the Lancashire Group and can share in its success, and leverage that success to causes and communities that do not often receive such material rewards.

Major donations, such as those made to MSF, which operates in crisis relief around the world, and ICM, which works with the poorest of poor in the Philippines, complement Lancashire's own insurance and reinsurance business by seeking to provide support to those afflicted by unexpected events and extreme poverty in areas where there is no insurance to protect people and their property.

Other charities supported during 2018 include:

- Action on Addiction
- Cancer Research UK
- Child Bereavement UK
- Kiva Microfunds
- Knowledge Quest
- Medical Detection Dogs
- Rise2Shine
- St Giles Trust
- The Family Centre
- Tomorrow's Voices
- Victor Scott (Fruit for Schools)
- Warwick Academy
- Windreach Bermuda
- Women 4 Women

"The Lancashire Foundation started working with Médecins Sans Frontières in 2008. In the past ten years, the Foundation has provided funding totalling an incredible £3,207,497. Thanks to this long-term partnership we have been able to provide humanitarian support and emergency medical aid in some of the hardest to reach areas in the world, saving the lives of victims of war, epidemics and those affected by deliberate exclusion from healthcare and neglect. On behalf of MSF staff working around the world, we are so grateful for the Foundation's commitment to our work."

Vickie Hawkins, Executive Director, MSF UK

Michael Connor
Chairman of the Trustees of the Lancashire Foundation

What is the Lancashire Foundation?

The Foundation is a registered charity in England and Wales (number 1149184) and its purpose is to act as the focal point for the Lancashire Group's corporate social responsibility activities.

These activities can be divided into two main streams: giving money in the form of grants to selected charities and, equally as important, encouraging our staff to give of themselves by supporting the Foundation's work through volunteering. We do this by providing day release programmes for staff to give back to the communities in which they live and around the world. In addition, staff are entitled to up to a week's annual charity leave on completion of three years' permanent employment with the Group.

In 2018, 118 of our staff across the Group participated in charity volunteer days, mentoring opportunities or fundraising events. The Foundation also operates a charity matching scheme to support individual staff members' charitable initiatives. During 2018, matched funds from the Foundation amounted to £15,747 and supported 15 charities.

What does the Foundation do?

As a charity closely linked to the Lancashire Group, we strive to ensure that the charities we support reflect the issues and concerns of our staff, whether from personal experience or through the demonstrably positive impact that they have on those in need. We underpin this with a set of objectives to inform our giving with a focus on charities operating in the fields of poverty relief, removing barriers to social exclusion, supporting medical research and humanitarian relief.

The majority of charities we supported in 2018 were as a result of staff suggestions and support. In addition, the Foundation also supported charities suggested by clients and brokers which, for 2018, included The Lord Mayor's Appeal, Great Britain Wheelchair Rugby and Brooks Development Trust.

Taking the second aspect of staff giving, we actively encourage support by staff. This takes a number of forms, for example: carrying out volunteering work that directly benefits the charity, like our annual volunteering trip to the Philippines to support the work of ICM with the ultra-poor; providing mentoring support to staff at St Giles Trust, many of whom are ex-offenders; or participating in fundraising events, such as marathons.

What is the Foundation's link to staff?

We are lucky with the quality and commitment of the people involved in the Foundation as all the work is carried out on a voluntary basis by the existing staff of the Lancashire Group. As mentioned earlier, a key aspect is ensuring that the Foundation reflects what engages our staff, so funding applications received from charities are analysed and challenged by the Foundation's Donations Committee, which is comprised of staff from across the UK and Bermuda platforms.

The Trustees of the Foundation review the recommendations for funding received from the Donations Committee and release funds as appropriate. The Trustees also set the strategic direction of the Foundation and ensure it is meeting all of its governance and compliance requirements.

However, it does not stop there. We have a wider pool of advocates to draw upon, namely staff members who act as the Foundation's 'eyes and ears' in relation to specific charities. This really allows both the Donations Committee and the Trustees to obtain comfort that we have close liaison with our charity partners and that questions and issues can typically be resolved quickly.

What tangible evidence is there of the impact of the Foundation?

From an internal perspective we were very pleased that the 2018 staff survey confirmed that across all our platforms the Foundation's work was seen as a key indicator of Lancashire operating at its best.

The Foundation looks to support charities around the world but with an emphasis on charities where we can see a demonstrable positive impact on the communities they serve and which operate in effective, transparent and sustainable ways to deliver the programmes they provide. Annually, where we have multi-year relationships, the advocates are expected to review and reflect on the performance of the charity they advocate with the Donations Committee to ensure that the Committee is happy to recommend a renewal of the grant for the next year to the Trustees. Both quantitative and qualitative data will be reviewed as part of this process. The advocate system allows us to get close to our charities and foster the deep, multi-year relationships we hope to develop with most of the charities we support.

Through our flagship or cornerstone relationships we can see this: for example, the work of MSF really needs little introduction but they have an ability to react nimbly to multiple international humanitarian crises and to continue to shine a light on issues once the news cycle has moved on. More locally, the Family Centre in Bermuda provides early intervention services for children on the island suffering from family-based problems such as abuse and neglect, and St Giles Trust in the UK looks to break the bleak cycle of re-offending through a variety of means, one of which is its model of using ex-offenders trained to act as peer advisers to support those released from prison.

The Foundation in action

The 2018 Project Transform team

Project Transform

"Seven members of staff from across the Group were chosen to join the 2018 Project Transform trip. We all volunteered after listening to the stories and feedback from the previous year's team and wanted to experience for ourselves the amazing work that Project Transform does with ICM. Whilst we had a good idea what the trip involved it wasn't until we were on the ground that we could fully appreciate the extraordinary work that ICM does to help the ultra-poor.

The week involved building toilets for two families, a basic need that we all take for granted. We visited communities for house to house visits with the local pastor and provided health and livelihood lessons to help improve lives. We also visited the family academy where local volunteers help mothers to become their children's first teachers and prepare their children for school.

The poverty we saw in the Philippines was heart breaking. To see how these ultra-poor communities live and survive was devastating, but with ICM's help there is a hope for these people. We thank Lancashire for giving us this amazing opportunity – anyone can give money to a charity but being able to volunteer and give our time to help was so much more rewarding. The 2018 team bonded over the shared experience, something we'll never forget."

Vauxhall City Farm

Vauxhall City Farm

"Lancashire Insurance has been a long standing supporter of the farm, not only through annual monetary donations, which supports the staff at the farm to run many of our programmes with young people and vulnerable adults, helping us to meet our aims and objectives, but also in person.

For the last six years a team from Lancashire Insurance has come to the farm for a day each year, to get stuck in and help out. From hedge trimming, allotment clearing, digging out spent soil from old enclosures and helping us shift a tonne of woodchip (literally), to getting creative in using donated building site materials, to create sun and rain shelters for our animals!

While the team changes over time, some Lancashire staff have been coming to these corporate volunteer days for several years in a row and it is wonderful for us to see their involvement in the farm, and the enjoyment they seem to be getting from supporting our charity but also from actively seeing the real impact their money and time is making.

We couldn't do what we do without their support!"

Team Tango – Bermuda

Relay for Life

"The Bermuda Relay for Life cancer fundraiser took place on May 18-19 and we had a huge team of almost 100 staff, family and friends participating in the 24 hour event. Team Tango (the LICL team) has currently raised $20,491! This year's event raised over $350,000.

The Bermuda Cancer and Health Centre recently celebrated the one year anniversary of the Radiation Therapy Unit. It is a state-of-the-art-facility and allows patients to receive their treatment (which takes a maximum of 15 minutes) on the island. Many patients have been able to continue working at least part time during their treatment which allows them to feel less like a patient, and of course they are able to live at home and be surrounded by family, friends, pets, etc rather than having to be off island. Approximately 130 patients were treated in the first year and many of these people had full health care that would have allowed them to travel overseas for treatment but they have chosen to stay on island and be treated by Dr. Fosker and his team. This facility also treats the uninsured and the under-insured with no cost to the patient. This is what our ongoing fundraising supports."

Engaged governance and a dynamic culture

Peter Clarke
Non-Executive Chairman

"Lancashire's dynamic and successful business culture is based on a common understanding of strategic goals across the Board and the business fostered by effective, direct and reciprocal communication."

In my opening statement, I discussed the way in which our business and Board responded to the strategic challenges of 2018. The following section focuses on the work carried out by the Board and its Committees in providing responsive challenge and support to the business in the articulation and delivery of strategy and in exercising effective oversight.

How does the Board manage and implement the governance arrangements for the Group?

Lancashire is a premium-listed company on the LSE, which measures its corporate governance compliance against the requirements of the UK Corporate Governance Code published by the UK FRC. The FCA requires each company with a premium listing to 'comply or explain' against the Code (i.e. to disclose how it has complied with Code provisions or, if the Code provisions have not been complied with, provide an explanation for the non-compliance). The Group monitors its compliance with the Code on at least a quarterly basis.

In this corporate governance section and throughout the Annual Report and Accounts for the 2018 financial year, areas of corporate governance compliance are explained by reference to the Code. The Company also monitors its compliance with applicable corporate governance requirements under both Bermuda law and regulations and, during 2018, with the requirements of the PRA and the UK's Solvency II regime.

Once again I am pleased to report that, in the judgement of the Board, the Company has complied with the principles and provisions as set out in the Code throughout the year ended 31 December 2018. The Board and business seek to ensure that the formal consideration of governance and regulatory requirements are used as a proactive and constructive exercise to foster the dynamic and successful business culture which has been a hallmark of the Group's success over many years.

How has the Board managed its Group regulatory status during the year?

In 2012, the Company established its head office and conducted the majority of its Board business in the UK. Prior to this it was in Bermuda. Between 2016 and 2018, the PRA has operated as the Group's supervisory regulator and the Group has been subject to the requirements of the UK's Solvency II regime. During 2018, the Board held detailed discussions about the most suitable Group insurance supervisory and tax domicile for the Company and initiated engagement with the PRA, the BMA and the UK's HMRC, further to which it was agreed that, with effect from 1 January 2019, the Company should re-establish its Group supervisory and tax domiciles in Bermuda. This will not affect the regulation of the Group's UK insurance entities, which will continue to be regulated by the PRA, and the FCA, and in the case of CUL and Syndicates 2010 and 3010, Lloyd's. On balance the Board felt that the transition of Group supervision to Bermuda and the BMA would assist in ensuring a continuing strategic focus on the growth and development opportunities in the U.S. specialty and catastrophe markets.

In the light of changes to the UK Corporate Governance Code how does the Board expect to develop Lancashire's stakeholder engagement in promoting the success of the business?

The FRC published a revised UK Corporate Governance Code during 2018, and our Board has been tracking these developments principally through the work of our Nomination and Corporate Governance Committee (see page 63 for the Committee report). Whilst we will be taking steps during 2019 to track and implement the upcoming requirements of the revised Code, we anticipate that the Board and business are well placed to meet the expectations articulated in the Code with regard to stakeholder engagement. Indeed, it is my view that the Company already has, and will continue to operate, a strong culture of proactive and constructive stakeholder engagement. Readers will note a more detailed account of the way in which the Company engages with its stakeholders in the engagement and sustainability section of this report on pages 40 to 44.

In the area of 'workforce' engagement, the Board plans to address the expectations of the revised UK Code during 2019 by making arrangements for the direct involvement of one or more of our Non-Executive Directors in current 'town hall' staff meetings which, for a number of years, Alex Maloney has held on a quarterly basis with all our staff in the UK and Bermuda. I will be attending some of these sessions during 2019 and the Board will also be exploring other ways and means to facilitate constructive two-way feedback between the Board and the Group's employees. In this regard I would also add that we have the great advantage of having an employee headcount of a little over 200 people, so all our employees are known personally by our Group CEO or the other members of the Group's executive management team and most of our Non-Executive Directors have regular opportunities to meet members of staff both as part of the formal business of the Board and informally outside Board meetings.

How has Board membership and succession planning evolved during the year?

At the end of the first quarter of 2018, Tom Milligan stepped down from our Board, after having completed three years' service, to explore other opportunities in the insurance sector. I would like to thank Tom for his contribution to our business and insight as a member of our Board and wish him well for the future. After careful consideration of a diverse range of candidates, I was delighted that in July 2018 we were able to confirm the appointment of Sally Williams as a Non-Executive Director, who joined us in January 2019. In the light of Sally's recent employment as a senior executive and director within the Marsh Group, a global insurance brokerage which provides certain services to the Group, each of our Directors met individually with Sally prior to her appointment. The Board gave careful consideration to the question of Sally's independence of character and judgement in the light of her employment with an organisation which has had regular business dealings with the wider Group and its subsidiaries and which requires special consideration under the terms of the UK Corporate Governance Code (see page 55 for further details). I am delighted to report that after a detailed and thorough discussion the Board was unanimous in deciding that it should exercise its discretion to determine that Sally Williams should be considered independent on her appointment. I look forward to working with Sally in the coming years. In particular, Sally's experience (see page 51 for details) will help make her a valuable new member of our Audit Committee.

Are the Board and its Committees operating effectively?

During 2018 our Board once again carried out a review of its effectiveness, which was facilitated by Lintstock Ltd. A summary report was discussed by the full Board and we concluded that the Board, its members and each of its Committees have a balance of experience and talents that serves the Group well and have the culture and competencies necessary to meet the strategic challenges of the business effectively. I have throughout 2018 continued to meet regularly with the chairs of each of our principal subsidiary boards and our performance evaluation also concluded that the relationship between the main Lancashire Board and the subsidiary boards continues to operate effectively.

We have identified various strategic areas of focus and enhancements to the ways we operate and have identified certain specific areas for training and learning during the coming year (see page 56 for further details). I would like to thank all of our Directors, our management team and all our employees for their hard work during the year.

Peter Clarke
Non-Executive Chairman

A balanced board

Peter Clarke B I N R
Non-Executive Chairman

Date of appointment to the Board:
9 June 2014
Board meeting attendance: 5/5
Skills, experience and qualifications:
Peter Clarke was Group Chief Executive of Man Group plc between April 2007 and February 2013. In 1993, Mr Clarke joined Man Group plc, a leading global provider of alternative investment products and solutions as well as one of the world's largest futures brokers. He was appointed to the board in 1997 and served in a variety of roles, including Head of Corporate Finance and Corporate Affairs and Group Company Secretary, before becoming the Group Finance Director in 2000. During this period he was responsible for investing in and developing one of the leading providers of third-party capital insurance and reinsurance products. In November 2005, he was given the additional title of Group Deputy CEO. Mr Clarke has previously served as the Chairman of the National Teaching Awards Trust. Mr Clarke took a first in Law at Queens' College, Cambridge and is a qualified solicitor, having practised at Slaughter and May, and has experience in the investment banking industry, working at Morgan Grenfell and Citibank.

External appointments/Other roles:
Mr Clarke is currently a Non-Executive Director of RWC Partners Limited, Lombard Odier Asset Management and Sainsbury's Bank plc. He is a member of the Treasury Committee of King's College London.

Alex Maloney B U
Chief Executive Officer

Date of appointment to the Board:
5 November 2010
Board meeting attendance: 5/5
Skills, experience and qualifications:
Alex Maloney joined Lancashire in December 2005 and was appointed Group Chief Executive Officer in April 2014. On joining, Mr Maloney was responsible for establishing and building the energy underwriting team and account and, in May 2009, was appointed Group Chief Underwriting Officer. Since November 2010, Mr Maloney has served as a member of the Board. Mr Maloney has also been closely involved in the development of the Group's Lloyd's strategy. Mr Maloney has over 20 years' underwriting experience and has also worked in the New York and Bermuda markets.

Elaine Whelan B I
Chief Financial Officer

Date of appointment to the Board:
1 January 2013
Board meeting attendance: 5/5
Skills, experience and qualifications:
Elaine Whelan joined Lancashire in March 2006 and leads both the Group finance function and the Bermuda subsidiary, reporting to the Group Chief Executive Officer. Ms Whelan was previously Chief Accounting Officer of Zurich Insurance Company, Bermuda Branch. Prior to joining Zurich, Ms Whelan was an Audit Manager at PricewaterhouseCoopers, Bermuda, where she managed a portfolio of predominantly (re)insurance and captive insurance clients. Ms Whelan graduated from the University of Strathclyde in 1994 with a BA in Accounting and Economics and gained her Chartered Accountancy qualification from the Institute of Chartered Accountants of Scotland in 1997.

Michael Dawson B N R U
Non-Executive Director

Date of appointment to the Board:
3 November 2016
Board meeting attendance: 5/5
Skills, experience and qualifications:
Michael Dawson has more than 35 years' experience in the insurance industry, having started his career at Lloyd's in 1979. He joined Cox Insurance in 1986 where he was the Chief Executive from 1995 to 2002. In 1991, Mr Dawson formed and became the underwriter of Cox's and subsequently Chaucer's specialist nuclear syndicate 1176. Between 2005 and 2008, Mr Dawson was appointed Chief Executive of Goshawk Insurance Holdings PLC and its subsidiary Rosemont Re, a Bermuda reinsurer. Mr Dawson served on the Council of Lloyd's from 1998 to 2001 and on the Lloyd's Market Board from 1998 to 2002.

External appointments/Other roles:
Mr Dawson is a Non-Executive Director of Pool Re (Nuclear) Limited and Deputy Chairman of the management committee of Nuclear Risk Insurers Limited.

Board and Committee membership key

Chair
B Board of Directors
A Audit Committee
I Investment Committee
N Nomination and Corporate Governance Committee
R Remuneration Committee
U Underwriting and Underwriting Risk Committee

* Tom Milligan retired as a Non-Executive Director with effect from 31 March 2018. He attended the Board and Committee meetings for the fourth quarter 2017.

Simon Fraser B A R

Senior Independent Non-Executive Director

Date of appointment to the Board: 5 November 2013

Board meeting attendance: 5/5

Skills, experience and qualifications:

Simon Fraser was Head of Corporate Broking at Merrill Lynch and subsequently Bank of America Merrill Lynch until his retirement in 2011. He began his career in the City in 1986 with BZW and joined Merrill Lynch in 1997. He led initial public offerings, rights issues, placings, demergers and mergers and acquisitions transactions during his career and advised many UK companies on stock market and LSE issues. Mr Fraser has an MA degree in Modern History from the University of St Andrews.

External appointments/ Other roles:

Mr Fraser is also a Non-Executive Director of Legal and General Investment Management (Holdings) Limited and Senior Independent Director of Derwent London plc, where he sits on the Remuneration, Audit and Nominations Committees. Mr Fraser also serves as a Non-Executive Director of CUL.

Samantha Hoe-Richardson B A N

Non-Executive Director

Date of appointment to the Board: 20 February 2013

Board meeting attendance: 5/5

Skills, experience and qualifications:

Samantha Hoe-Richardson has been Chairman of the Audit Committee since 2014. She was Head of Environment & Sustainability for Network Rail and prior to that Head of Environment for Anglo American plc, one of the world's leading mining and natural resources companies. She was also a director and founder of Anglo American Zimele Green Fund (Pty) Ltd, which supports entrepreneurs in South Africa. Prior to her role with Anglo American, Ms Hoe-Richardson worked in investment banking and audit and she holds a masters degree in Nuclear and Electrical Engineering from the University of Cambridge. She also has a Chartered Accountancy qualification.

External appointments/ Other roles:

Ms Hoe-Richardson is a Non-Executive Director of Unum Ltd and Unum European Holding Company Ltd. Unum is one of the UK's leading employee benefits providers through the workplace. Ms Hoe-Richardson is also a Non-Executive Director of LUK.

Robert Lusardi B A I R

Non-Executive Director

Date of appointment to the Board: 8 July 2016

Board meeting attendance: 5/5

Skills, experience and qualifications:

Robert Lusardi spent the first phase of his career as a senior investment banker specialising in the insurance and asset management industries. From 1998 until 2005 he was a member of the Executive Management Board of XL Group plc, first as Group CFO then as a segment CEO; from 2005 until 2010 he was an EVP of White Mountains (an insurance merchant bank) and CEO of certain subsidiaries; and from 2010 to 2015 he was CEO of PremieRe Holdings LLC (a private insurance entity). He has been a director of ten insurance-related entities. He received his BA and MA degrees in Engineering and Economics from Oxford University and his MBA from Harvard University.

External appointments/ Other roles:

Mr Lusardi is currently a private investor and has spent his career as a senior executive in the financial services industry. He is also on the boards of Symetra Financial Holdings, Inc., a life insurer, and Oxford University's 501(c)3 charitable organisation.

Sally Williams B A N

Non-Executive Director

Date of appointment to the Board: 14 January 2019

Board meeting attendance: N/A

Skills, experience and qualifications:

Sally Williams joined the Marsh Group in 2015 where she served on the board of Marsh Ltd as a director with responsibility for Risk and Governance acting as the main business interface for Marsh Ltd with the FCA. She resigned from her directorships at Marsh with effect from 21 December 2018 and assumed her Non-Executive Directorship of LHL on 14 January 2019.

Ms Williams joined Marsh from National Australia Bank and previously held senior risk positions with Aviva. Ms Williams is a chartered accountant and spent the first 15 years of her career with PricewaterhouseCoopers (PwC), where she was a director specialising in financial services risk management and regulatory relationships. She also undertook a two year secondment from PwC to the Supervision and Surveillance Department at the Bank of England.

External appointments/ Other roles:

Ms Williams is a Non-Executive Director of OneFamily, where she is a member of the Audit Committee, Risk Committee and Nominations Committee.

Christopher Head

Company Secretary

Board meeting attendance: N/A

Skills, experience and qualifications:

Christopher Head joined Lancashire in September 2010. He was appointed Company Secretary of LHL in 2012 and advises on issues of corporate governance and generally on legal affairs for the Group. He also advises on the structuring of Lancashire's third-party capital underwriting initiatives which have included the Accordion and Kinesis facilities. Prior to joining Lancashire, he was in-house Counsel with the Imagine Insurance Group, advising specifically on the structuring of reinsurance transactions. He transferred to Max at Lloyd's in 2008 as Lloyd's and London Counsel. Between 1998 and 2006, Mr Head was Legal Counsel at KWELM Management Services Limited, where he managed an intensive programme of reinsurance arbitration and litigation for insolvent members of the HS Weavers underwriting pool. Mr Head is a qualified solicitor having worked until 1998 at Barlow Lyde & Gilbert in the Reinsurance and International Risk Team. Mr Head has a History MA and legal qualification from Cambridge University.

Our focus during 2018

Strategy and Capital Management

February 2018

- Discussion of strategic underwriter recruitment and development initiatives which during the year resulted in the addition of a power team, an onshore energy underwriter and aviation deductible business (see page 23);
- Discussion and approval of the Group's 2018 business plan that had been updated in light of the 1 January 2018 renewals and market conditions; and
- Capital management review and declaration of a final ordinary dividend of $0.10 per common share in respect of the year ended 31 December 2017.

May 2018

- Review and approval of the Group's UK tax strategy for the year ended 31 December 2018;
- Review and approval of modifications to the Group's investment strategy for 2018/2019;
- Review and discussion of the Group's capital support structures and options; and
- Dedicated strategy sessions (see case study – focus on strategy).

July 2018

- Consideration and approval of the Group's three-year (2018-2021) strategic plan (see case study – focus on strategy);
- Consideration and approval of the Group's 2018 reforecast business plan in light of actual experience to 30 June 2018;
- Consideration and approval of a modification to the description of the Group's strategic RoE target key performance indicator (see page 11); and
- Capital management review and declaration of an interim dividend of $0.05 per common share.

October 2018

- Consideration and approval of the Group's 2019 business plan; and
- Capital management review and declaration of a special dividend of $0.20 per common share.

Case Study – Focus on strategy

The objective of the 2018 strategy sessions held in May 2018 was to consider the key decisions to be made in the preparation of the Group's three-year strategic plan. The issues discussed included:

- review of the current strategy;
- consideration of its continued relevance and the views of shareholders;
- review of the Group's underwriting lines of business and potential options and opportunities;
- consideration of areas of opportunity in particular in international and specialty markets;
- analysis of the structures and tools used within the third-party reinsurance capital sector and related strategic opportunities;
- review of the Group's investment strategy and options;
- consideration of the Group's regulatory domicile and its interaction with strategic initiatives; and
- review of the business's resourcing and training needs.

At its July 2018 meetings the Board approved the Group's three-year strategic plan including the Group's risk appetites and capital and solvency appetites.

Risk

February 2018

- Review and approval of the revised anti-money laundering and financial crime, whistleblowing and conflicts of interest policies and procedures;
- Approval of the updated UK and U.S. regulatory and tax operating guidelines for the Group;
- Review and approval of the revised underwriting exposure risk tolerances (see page 33); and
- Consideration of risk reports from the Group CRO.

May 2018

- Review and approval of the Solvency II submissions as at 31 December 2017 for submission to the PRA;
- Review and approval of the revised sanctions policy and procedures; and
- Consideration of risk reports from the Group CRO.

July 2018

- Consideration of risk reports from the Group CRO; and
- Review and approval of the Group's risk, capital and solvency appetites as part of strategic planning.

October 2018

- Consideration of risk reports from the Group CRO including special focus on Brexit planning and climate change risk management.

Succession and Remuneration

February 2018

- Consideration and approval of a range of changes and appointments to the boards and management teams of the operating businesses within the Group;
- Review and approval of the Group's 2018 framework for executive remuneration; and
- Approval of the Directors' Remuneration Report within the 2017 Annual Report and Accounts, for approval by shareholders at the 2018 AGM.

May 2018

- Review and approval of the Group's succession plan and talent management and development programme for 2018/2019; and
- Consideration and approval of a range of changes and appointments to the boards and management teams of the operating businesses within the Group.

July 2018

- Consideration and approval in principle of the appointment of Sally Williams as a Non-Executive Director of LHL to take effect during January 2019 further to a determination that she should be considered to be independent in character and judgement (see page 55); and
- Consideration and approval of a range of changes and appointments to the boards and management teams of the operating businesses within the Group.

October 2018

- Consideration and approval of a modified Group Solvency II Identified Staff Remuneration policy;
- Consideration and approval of a resolution to issue up to 600,000 common shares in satisfaction of obligations under the RSS; and
- Consideration and approval of a range of changes and appointments to the boards and management teams of the operating businesses within the Group.

Financial Reporting and Controls

February 2018

- Review and approval of the fourth quarter 2017 financial supplement; and
- Approval of the 2017 Annual Report and Accounts further to the report from the Audit Committee.

May 2018

- Review and approval of the first quarter 2018 financial supplement; and
- Discussion of the 2017 audit process and review of KPMG's 2018 audit plan.

July 2018

- Review and approval upon recommendation by the Audit Committee of the interim consolidated financial statements; and
- Review and approval of the second quarter 2018 financial supplement.

October 2018

- Approval of a press release in respect of the Group's preliminary loss estimates from marine account losses and the U.S. and Pacific windstorm losses; and
- Review and approval of the third quarter 2018 financial supplement.

Stakeholder Engagement and Corporate Governance Matters

February 2018

- Review and approval of the Group's disclosure procedures;
- Review and approval of an updated diversity policy statement, further to a recommendation from the Nomination and Corporate Governance Committee;
- Review and approval of an updated policy statement on anti-slavery and human trafficking;
- Formal consideration of the independence of all Non-Executive Directors prior to the 2018 AGM;
- Discussion of the 2017 year end Board and Committee performance appraisal feedback and recommendations; and
- Consideration and approval of the draft 2018 AGM notice and the matters to be put to shareholders.

May 2018

- Review and approval of a modification to the Investment Committee Terms of Reference;
- Discussion of a presentation from the Group's corporate brokers;
- Approval of the appointment of a new Trustee to the Lancashire Foundation; and
- The Company's 2018 AGM was held at its London office on 2 May 2018. All resolutions were duly passed and approved by shareholders.

July 2018

- Discussion of the PRA's 'Dear CEO' letter concerning a request to all boards operating within the insurance industry to explain the management of "soft market" risks;
- Review and discussion of the Group's regulatory supervision options; and
- Review and approval of an updated diversity policy statement, further to a recommendation from the Nomination and Corporate Governance Committee.

October 2018

- Consideration and approval of the process for the annual performance evaluation of the Board and its Committees and individual Directors, to be facilitated by Lintstock; and
- Consideration and approval of a special purpose committee to facilitate the migration of Group insurance supervision and tax domicile to Bermuda to take effect on 1 January 2019.

December 2018

- Review and approval by the migration special purpose committee of revised UK and U.S. tax and regulatory operating guidelines to be used by the Group with effect from 1 January 2019.

Board Committees

Board and Committee administration

The Board of Directors is responsible for the leadership and control and the long-term success of Lancashire's business. The Board has reserved a number of matters for its decision, including responsibility for setting the Group's values and standards, and approval of the Group's strategic aims and objectives. The Board has delegated certain matters to Committees of the Board, as described below. Copies of the Schedule of Board-Reserved Matters and Terms of Reference of the Board Committees are available on the Company's website at www.lancashiregroup.com.

The Board has approved and adopted a formal division of responsibilities between the Chairman and the CEO. The Chairman is responsible for the leadership and management of the Board and for providing appropriate support and advice to the CEO. The CEO is responsible for the management of the Group's business and for the development of the Group's strategy and commercial objectives. The CEO is responsible, along with the executive team, for implementing the Board's decisions.

The Board and its Committees meet on at least a quarterly basis. At the regular quarterly Board meetings, the Directors review all areas of the Group's business and receive reports from management on underwriting, reserving, finance, investments, capital management, internal audit, risk, legal and regulatory developments, compliance and other matters affecting the Group. Management provides the Board with the information necessary for it to fulfil its responsibilities. In addition, presentations are made by external advisers such as the independent actuary, the investment managers, the external auditors, the remuneration consultants and the corporate brokers. The Board Committees are authorised to seek independent professional advice at the Company's expense.

The Board also meets to discuss strategic planning matters in addition to the customary schedule of quarterly meetings. A dedicated Board strategic planning day was held in May 2018.

The Chairman holds regular meetings with the Non-Executive Directors, without the Executive Directors present, to discuss a broad range of matters affecting the Group.

The Directors

Appointments to the Board are made on merit, against objective criteria and with due regard for the benefits of diversity on the Board, including gender. The Board considers all of the Non-Executive Directors to be independent within the meaning of the Code.

Michael Dawson, Simon Fraser, Samantha Hoe-Richardson and Robert Lusardi are independent, as each is independent in character and judgement and has no relationship or circumstance likely to affect his or her independence. Peter Clarke was independent upon his appointment as Chairman on 4 May 2016.

In relation to the determination of independence of Sally Williams, in a Board meeting held on 10 July 2018, the Directors considered that, by virtue of her directorships of Marsh Limited and certain other subsidiaries within the Marsh Group and her employment as a senior executive of the Marsh Group, these were circumstances which for purposes of the Code should be considered to be a 'material business relationship' requiring special consideration within the context of the determination of a Director's independence. The Board concluded that it was appropriate for the Directors to use their discretion in the light of these facts to determine whether Sally Williams was indeed independent in character and judgement. After lengthy and detailed discussion of these matters the Directors concluded that there was no question in their minds but that, subject to the service of her notice of resignation from the Marsh Group, which was confirmed on 19 July 2018, Sally Williams was to be considered as and would continue to be independent in character and judgement in her role as a Director of the Company. Sally Williams assumed her role as a Director of the Company on 14 January 2019.

At the Board meeting held on 13 February 2019, further to a recommendation by the Nomination and Corporate Governance Committee, the Board affirmed its judgement that five of the eight members of the Board are independent Non-Executive Directors. Therefore, in the Board's judgement, the Board's composition complies with the Code requirement that at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent.

In accordance with the provisions of the Company's Bye-laws and the Code, all the Directors are subject to re-election annually at each AGM.

Information and training

On appointment, the Directors receive written information regarding their responsibilities as Directors and information about the Group. An induction process is tailored for each new Director in the light of his or her existing skill set and knowledge of the Group, and includes meeting with senior management and visiting the Group's operations. Information and advice regarding the Company's official listing, legal and regulatory obligations and on the Group's compliance with the requirements of the Code is also provided on a regular basis. An analysis of the Group's compliance with the Code is collated and summarised in quarterly reports together with a more general summary of corporate governance developments, which are prepared by the Group's legal and compliance department for consideration by the Nomination and Corporate Governance Committee. The Directors have access to the Company Secretary who is responsible for advising the Board on all legal and governance matters. The Directors also have access to the Group General Counsel and independent professional advice as required. Regular sessions are held between the Board and management as part of the Company's quarterly Board meetings, during which in-depth presentations covering areas of the Group's business are made. During these presentations the Directors have the opportunity to consider, challenge and help shape the Group's commercial strategy. The Directors are also encouraged to seek supplementary know-how training suitable to their roles offered by the many external providers of training pertinent to governance and in particular the roles of non-executive directors and to consider their training needs and priorities as part of the year end performance evaluation for the Board and Committees.

Board performance evaluation

A formal performance evaluation of the Board, its Committees and individual Directors is undertaken on an annual basis and the process is initiated by the Nomination and Corporate Governance Committee. The aim of this work is to assess the effectiveness of the Board and its Committees in terms of performance and risk oversight, strategic development, composition, supporting processes and management of the Group. The evaluation is forward-looking in terms of identifying the strategic priorities as well as considering performance, training and development needs for the Directors within the context of the work of each Committee and that of the Board. The 2017 evaluation was conducted internally and facilitated by the Company Secretary and the Chairman and the 2018 performance evaluation process was facilitated by Lintstock Limited, a London-based corporate advisory firm with no other connection to the Group.

The 2018 evaluation process involved each Director as well as the Company Secretary, the Group CRO, Group General Counsel and other members of senior management completing a questionnaire designed, in consultation with Lintstock, by the LHL Chairman and the Company Secretary with input from the Chairs of each of the relevant Committees. Responses to the completed questionnaires were collated by Lintstock, which then held a series of individual interviews with each of the Directors, the Company Secretary, the Group General Counsel and the Group CRO to explore emerging themes. Lintstock then prepared a suite of anonymised summary reports that were discussed in draft with the Board Chairman and Committee Chairs before being distributed to each of the Directors.

In February 2019, the performance evaluation reports were discussed at meetings of the Nomination and Corporate Governance Committee and the Board, and each of the other Committees discussed the report pertinent to its own operation and performance. The Board discussions were led by the Chairman and focused on such matters as strategic oversight, succession planning, Board composition and training and priorities for 2019.

In summary, in the Board's consideration of the 2018 evaluation reports, the Board concluded that it operates effectively and has a good blend of insurance, financial and regulatory expertise. All Non-Executive Directors are committed to the continued success of the Group and to making the Board and its Committees work effectively. Attendance at Board meetings was found to be excellent. The Group CEO and the Group CFO, the Company's Executive Directors, were also found to be operating effectively.

Appropriate infrastructure, processes and governance mechanisms are in place to support the effective performance of the Board and its Committees. The Board is considered to manage risk effectively. The number of Directors on the Board is considered to be appropriate.

It was noted in the evaluation process that, in what had been another challenging year for the (re)insurance markets, the Board and Committee oversight of underwriting strategy and risk tolerances had operated effectively and within expectations. Engagement between the Board and the wider body of staff is considered to be generally strong and beneficial to the operation of the business. It was concluded that the Board discussion around the regulatory and tax domicile for the Group had been well focused and effective and had resulted in the implementation of the decision to move Group management and supervision to Bermuda in a timely manner. Looking ahead, the Board and Committees will, during the course of 2019, seek to ensure that the Group holds sufficient capital and utilises capital tools to ensure that the business is well-placed to be a leading (re)insurance market. The Board is also committed to underwriting those specialty insurance lines in which the business has expertise and to support management in the identification of new and complementary underwriting classes with a view to achieving controlled organic premium growth where this makes sense. The Board also highlighted a number of themes which will inform the business of the Board during 2019 including the attributes required for a future non-executive appointment to the Board and the ongoing need to ensure a strong succession plan to meet the requirements of the business. A number of practical steps to optimise the focus of Board and Committee meetings were also identified for action.

The Board will continue to review its procedures, training requirements, effectiveness and development during 2019.

The Chairman's performance appraisal was conducted by the Senior Independent Director, who consulted with the Non-Executive Directors with input from the Executive Directors during July 2018. The discussion and feedback were positive regarding the Chairman's performance. Particular reference was made to the strong lines of communication which the Chairman has fostered with the Chairs of the subsidiary boards and the executive team. The Chairman's insight and strategic and high-level leadership of the Board were also noted.

Following the year end, the Chairman met with the Group CEO, and the Group CEO met with the Group CFO, to conduct a performance appraisal in respect of 2018 and to set targets for 2019. The results of these performance evaluations were discussed by the Chairman and the Non-Executive Directors and are reported in the Directors' Remuneration Report commencing on page 70.

Relations with shareholders

During 2018, the Group's Head of Investor Relations, usually accompanied by one or more of the Group CEO, the Group CUO, the Group CFO, the Chairman or a senior member of the underwriting team, made presentations to major shareholders, analysts and the investor community. Formal reports of these meetings were provided to the Board on at least a quarterly basis. During the year the Board oversaw the transition to the appointment of a new Head of Investor Relations. Jelena Bjelanovic assumed that role in October 2018 and made her first presentation to the Board at the third quarter 2018 Board meeting.

The Chairman of the Remuneration Committee conducted a consultation with the significant shareholders of the Group with regard to remuneration policy and practice in advance of the production of the Directors' Remuneration Report in the 2017 Annual Report and Accounts and the 2018 AGM and again during January 2019, to seek feedback on the Group's implementation of remuneration policy.

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

Shareholders are invited to request meetings with the Chairman, the Senior Independent Director and/or the other Non-Executive Directors by contacting the Group Head of Investor Relations. All of the Directors are expected to be available to meet with shareholders at the Company's 2019 AGM.

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

Enterprise Risk Management

The Board is responsible for setting the Group's risk appetites, defining its risk tolerances, and setting and monitoring the Company's risk management and internal control systems including compliance with risk tolerances. During 2018 the Board carried out a robust assessment of the principal risks affecting the Group's business model, future performance, solvency and liquidity and the operation of internal control systems.

Further discussion of the risks affecting the Group and the policies in place to manage them can be found in the ERM section of this report on pages 33 to 39 and in the risk disclosures section on pages 111 to 133.

Each of the Committees is responsible for various elements of risk (see the various Committee reports from page 58 to page 69 for further detail). The Group CRO reports directly to the Group and subsidiary boards and facilitates the identification, evaluation, quantification and control of risks at a Group and subsidiary level. The Group CRO provides regular reports to the Group and subsidiary boards covering, amongst other things, actual risk levels against tolerances, emerging risks, any lessons learned from risk events and assurance provided over key risks. During 2018, the Directors participated in a number of training sessions addressing the Board's obligations under Solvency II and, in particular, with regard to the review and approval of the Solvency II submissions as at 31 December 2017 for submission to the PRA. The Board considers that a supportive ERM culture, established at the Board and embedded throughout the business, is of key importance. The facilitating and embedding of ERM and helping the Group to improve its ERM practices are a major responsibility assigned to the Group CRO. The Group CRO's remuneration is subject to annual review by the Remuneration Committee. The Board is satisfied that the Company's risk management and internal control systems have operated effectively for the year under review.

Committees

The Board has established Audit, Investment, Nomination and Corporate Governance, Remuneration, and Underwriting and Underwriting Risk Committees. Each of the Committees has written Terms of Reference, which are reviewed regularly and are available on the Company's website. The Committees' Terms of Reference were reviewed by the Board during 2018 and were considered to be in line with current best practice. The Committees are generally scheduled to meet quarterly, although additional meetings and information updates are arranged as business requirements dictate. Director attendance at the 2018 Board meetings is set out on pages 50 to 51. A report from each of the Committees, which covers Committee attendance, is set out from page 58 to page 69.

Audit Committee

Samantha Hoe-Richardson
Chairman of the Audit Committee

"During 2018, the focus of the Committee has been on the adequacy of the Group's loss reserves, as well as monitoring the effectiveness of both the external auditors and the internal audit programme and ensuring the continued integrity of the Group's financial reporting. In particular, the Committee has monitored the Group's preparations for the implementation of the IFRS 17 ('Insurance Contracts') accounting standard."

Committee membership

The Audit Committee comprises four independent Non-Executive Directors and is chaired by Samantha Hoe-Richardson, a qualified accountant. The Board considers that the four independent Non-Executive Directors all have recent and relevant financial experience. The Audit Committee as a whole has competence in the specialty insurance and reinsurance sectors. The internal and external auditors have the right of direct access to the Audit Committee. The Audit Committee's detailed Terms of Reference are available on the Group's website.

	Meetings attended
Samantha Hoe-Richardson (Chairman)	4/4
Simon Fraser	4/4
Robert Lusardi	4/4
Sally Williams[1]	n/a

1. Sally Williams was appointed as a member of the Audit Committee with effect from 12 February 2019.

Principal responsibilities of the Committee

- Financial reporting: monitors the integrity of the consolidated financial statements of the Group and any other formal statements relating to its financial performance, including the annual Solvency II Group reporting requirements. Reviews and reports to the Board on significant financial reporting issues and judgements that those statements contain. Reviews the Annual Report and Accounts and advises the Board on whether, taken as a whole, it is fair, balanced and understandable;
- External audit: oversees the relationship with the external auditors and is responsible for the annual assessment of their independence and objectivity. Makes a recommendation to the Board, to be put to shareholders for approval at the AGM, for the appointment of the Company's external auditors;
- Internal audit: monitors and reviews the effectiveness of the Group's internal audit function ensuring it has unrestricted scope, the necessary resources and access to information to enable it to fulfil its mandate in accordance with appropriate professional standards; and
- Internal controls and risk management systems: oversight of internal controls and risk management systems. Reviews the Group's 'whistleblowing' and other systems and controls for the prevention of fraud, bribery and money laundering.

How the Committee discharged its responsibilities during 2018

Financial reporting

Committee responsibility

Monitors the integrity of the Group's consolidated financial statements, including its annual and half-yearly reports, annual Solvency II Group Pillar 3 reports, interim management statements and any other formal statements relating to the Group's financial performance. Reports to the Board on significant financial reporting issues and judgements contained in the consolidated financial statements.

Committee activities

At each quarterly meeting the Committee reviews the Group's quarterly consolidated financial statements for the purposes of recommending their approval by the Board. The Group's annual Solvency II Pillar 3 reports were reviewed at the April 2018 Audit Committee meeting prior to recommendation of their approval at the May 2018 Board meeting. The Committee also monitors the activities of the Company's Disclosure Committee and reviews the Group's quarterly financial press releases, which it recommends to the Board for approval. The Committee receives quarterly reports from management on:

- developments in accounting and financial reporting requirements;
- any new and/or significant accounting treatments/transactions in the quarter;
- the activities of LHL's subsidiary companies, including consideration of any risk issues;
- loss reserving (see page 107 for further details);
- the progress of the Group's IFRS 9 and IFRS 17 implementation project and the related enhancements to the Group's finance IT framework and move to a common Group general ledger; and
- the Committee also receives quarterly reports on the consolidated financial statements from the external auditors, including an interim review report and a year-end full audit report. These are discussed with the external auditors at the Committee meetings.

Judgements and estimation in the consolidated financial statements

An annual paper is presented by management to the Committee that details the areas of judgement and estimation in the preparation of the consolidated financial statements (see accounting policies (page 105) for the details of these areas). Of these, the most significant area of estimation and judgement considered by the Committee during 2018 was the estimation of ultimate loss reserves. The Audit Committee's quarterly review of the adequacy of the loss reserves is explained in detail on page 62.

The Group has two indefinite life intangible assets following the acquisition of Cathedral – goodwill and syndicate participation rights. Intangible assets with indefinite useful lives are subject to an impairment review at least annually, or sooner if there is an indication of impairment. Some of the key inputs in the impairment review are based on management judgement and/or estimation (see page 105 of the consolidated financial statements for further details). These inputs are reviewed by the Audit Committee annually and are considered reasonable. The Audit Committee also considers the Group's internal stress tests and what stress scenarios would have to occur to indicate an impairment of its intangible assets. As a result of these considerations the Audit Committee agreed with management and KPMG that there was no impairment of the Group's intangible assets.

In accordance with auditing guidance, KPMG's year-end audit report identified revenue recognition through the estimation of premium revenues as an area of significant risk. The Audit Committee considered this and concluded that, whilst some premiums are subject to estimation, revenues are unlikely to be materially different from initial estimates, particularly on a consolidated Group basis.

Reviews the content of the Annual Report and Accounts and advises the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

The Chairman of the Committee reviewed the early drafts of the 2018 Annual Report and Accounts in order to keep apprised of its key themes and messages. The Committee reviewed the final draft of the Annual Report and Accounts at the February 2019 Audit Committee meeting together with the external auditor's report. The Committee advised the Board that, in its view, the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

External audit

Committee responsibility	Committee activities
Oversees the relationship with the Group's external auditors, approves their remuneration and terms of engagement, and assesses annually their independence and objectivity taking into account relevant legal, regulatory and professional requirements and the Group's relationship with the external auditors as a whole. This includes an annual assessment of the qualifications, expertise and resources, and independence of the external auditors and the effectiveness of the external audit process.	The Committee approves the annual external audit plan and receives reports from the external auditors at each quarterly Committee meeting, including an ongoing assessment of the effective performance of the audit compared to the plan. The Committee Chairman conducts informal meetings with the external auditors and the Group CFO prior to, during, and after the review of the quarterly results. The Committee meets quarterly in executive session with the external auditors to discuss any issues arising from the audit, and with management to obtain feedback on the audit process. Following the completion of KPMG's first year of provision of external audit services for the financial year ending 31 December 2017, the Committee Chairman led a thorough and formal review process to consider the effectiveness of the external audit process. This sought constructive feedback from stakeholders across the organisation and included an assessment of the qualifications, expertise and resources, and independence of KPMG. The results of the review were discussed at the April 2018 meeting, where it was concluded that the external audit process was operating effectively both with respect to the service provided by KPMG and management's support of the audit process. Areas of the audit process identified as benefiting from further development included the overall audit planning process and more effective communication between KPMG and the Group finance team. At its February 2019 meeting, the Committee discussed with KPMG an Audit Quality Review (AQR) report produced by the FRC on KPMG's 2017 audit of the Group. The Committee discussed areas for process enhancements with KPMG in relation to the FRC AQR findings. It was the Committee's view that the issues raised by the FRC were procedural rather than substantive in nature. A further review of auditor independence was conducted in February 2019 and the Committee concluded that the external auditors are independent and objective.
The development and implementation of a formal policy on the provision of non-audit services by the external auditors, taking into consideration any threats to the independence and objectivity of the external auditors.	The Committee has approved and adopted a formal non-audit services policy that is reviewed on an annual basis and was last reviewed and approved in October 2018. The policy, which stipulates the approvals required for various types of non-audit services that may be provided by the external auditors, is on the Group's website. During 2018, KPMG provided non-audit services in relation to U.S. tax advisory work. Fees for non-audit services provided in 2018 totalled $15,000. The Committee gave careful consideration to the nature of the non-audit services provided and the level of fees charged, and has determined that they do not affect the independence and objectivity of KPMG as auditors.
Makes a recommendation to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment or removal of the Group's external auditors.	Following a competitive external audit tender process undertaken during 2016, the appointment of KPMG as external auditors was first approved by shareholders at the 2017 AGM. Accordingly, the 2018 financial year was the second financial year in which KPMG acted as the Company's external auditors, following KPMG's re-appointment at the 2018 AGM further to a recommendation from the Committee and the full Board. The lead audit partner is Rees Aronson. The Committee and the Board are recommending the re-appointment of KPMG as external auditors at the 2019 AGM. The Committee has noted the reports from the Kingman review regarding the role of the FRC and related proposals for reform, and the UK Competition and Markets Authority report concerning the market for audit services, and will continue to monitor these, and related, developments.

Internal audit

Committee responsibility	Committee activities
Monitors and reviews the effectiveness of the Group's internal audit function in the overall context of the Group's risk management system.	The Group's internal audit function reports directly to the Committee. Each year, the Group Head of Internal Audit presents an annual internal audit strategy and plan to the Committee for consideration and approval. In general, the most significant business risks and controls are usually considered for audit annually whilst less critical risks are audited periodically as part of a flexible multi-year programme. The findings of each audit are reported to the Committee at the quarterly meetings and the Committee reviews the actions taken by management to implement the recommendations of internal audit. The Committee meets in executive session with the Group Head of Internal Audit usually on a quarterly basis. During 2018, the Committee reviewed and approved an updated Internal Audit Charter. This can be viewed on the Group's website. The Group CRO undertook an annual review of the implementation of the internal audit programme during 2018 to ensure its continued efficiency and appropriate standing within the Group and the effectiveness of the internal audit function. The Committee discussed the report and its findings with the Group CRO and the Group Head of Internal Audit and concluded that the internal audit function is operating effectively in the overall context of the Group's risk management system. The Committee Chairman oversaw the process for the appointment of a new Group Head of Internal Audit and the transitional internal audit management arrangements. Samantha Churchill joined the Group as the new Group Head of Internal Audit during January 2019.

Internal controls and risk management systems

Committee responsibility	Committee activities
Reviews the adequacy and effectiveness of the Group's internal financial controls systems that identify, assess, manage and monitor financial risks, and other internal control and risk management systems; and reviews and approves the statements to be included in the Annual Report and Accounts concerning internal control, risk management and the viability statement.	The Board has ultimate responsibility for ensuring the maintenance by the Group of a robust framework of internal control and risk management systems, and has delegated the monitoring and review of these systems to the Committee. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The Committee receives from the Group CRO periodic reports detailing results of the quarterly risk and control affirmation review. The Committee receives from the Group Head of Internal Audit an annual assessment of the Group's governance, risk and control framework together with an analysis of themes and trends from the internal audit work and their impact on the Group's risk profile. In 2018, the Committee and Board were satisfied that the governance, risk and control framework remains effective and appropriate for the Lancashire Group.
Reviews for adequacy and security the Group's compliance, 'whistleblowing' and fraud controls.	During 2018, the Committee conducted an annual review of the Group's policies and procedures relevant to financial controls and recommended the adoption by the Board of updated policies and procedures in respect of anti-money laundering, bribery and financial crime (including fraud), conflicts of interest and whistleblowing. There were no suspicious transactions or whistleblowing reports made during the year (whether arising from suspected money laundering activity or knowledge of, suspicion or concern relating to suspected acts of bribery or any other type of financial crime, dishonesty or impropriety). The Committee also keeps under review the adequacy and effectiveness of the Group's legal and compliance function.

Significant area of judgement or estimation

Loss reserves and expenses

As detailed on pages 117 to 118 of the consolidated financial statements, the estimation of ultimate loss reserves is a complex actuarial process that incorporates a significant amount of judgement. The Committee considers the adequacy of the Group's loss reserves at each Audit Committee meeting, for which purpose it receives quarterly reports from the Group's Reserving Actuary. KPMG conduct a high-level review of the Group's loss reserves as part of their first and third quarter review procedures. The Committee also receives estimates of the Group's ultimate loss reserves from an external independent actuary and from KPMG and compares these third-party estimates to those of the Group at its second and fourth quarter Audit Committee meetings. During 2018, the Committee focused its discussions around the Group's loss reserves on: the range of reasonable actuarial estimates and the difference between the Group's and the independent review from external actuaries (these differences being viewed by management, the external third parties and the Committee to be within a reasonable actuarial range); current and prior year loss development including 'back-testing' of the Group's prior year reserves; and reserving for each insurance operating subsidiary. Having reviewed and challenged these areas, the Committee concurred with management's valuation of the Group's loss reserves and the relevant disclosures around loss reserving in the Group's consolidated financial statements.

Priorities for 2019

The Committee's key priorities for 2019 are:

- To ensure the continued effectiveness of the Group's control environment, the operation of the business's financial reporting systems and the integrity of external financial reporting; and
- To continue to monitor the preparation by the Group for the implementation of IFRS 9 and IFRS 17.

IFRS 17, Insurance Contracts

In 2017 the IASB issued IFRS 17 ('Insurance Contracts'), which was to be mandatorily effective for annual reporting periods beginning on or after 1 January 2021. However, at its board meeting on 14 November 2018, the IASB tentatively decided to propose an amendment of the IFRS 17 effective date to reporting periods beginning on or after 1 January 2022.
If the proposed deferral of IFRS 17 is accepted, the implementation of IFRS 9 ('Financial Instruments: Classification and Measurement'), will also be deferred to this date for companies whose prominent activity is the issuance of insurance contracts. During 2018, the Committee monitored on a quarterly basis the preparation by the Group for the implementation of IFRS 9 and IFRS 17. This project encompasses changes to the Group's finance IT framework and general ledger, as well as the presentation of the Group's financial statements on an IFRS 9 and IFRS 17 basis. The prospective deferral of the implementation date for the standard has not had a significant impact on the Group's implementation project timetable.

Nomination and Corporate Governance Committee

Peter Clarke
Chairman of the Nomination and Corporate Governance Committee

"During 2019, the Committee will keep under review the Group's corporate governance reporting to ensure that the Company is able to discharge effectively its governance responsibilities under the 2018 Code."

Committee membership

A majority of the members of the Nomination and Corporate Governance Committee are independent Non-Executive Directors. The Committee Chairman is Peter Clarke, who is the Chairman of the Board.

	Meetings attended
Peter Clarke (Chairman)	4/4
Michael Dawson	4/4
Samantha Hoe-Richardson	4/4
Tom Milligan[1]	1/1
Sally Williams[2]	n/a

1. Tom Milligan retired as a member of the Nomination and Corporate Governance Committee with effect from 31 March 2018.
2. Sally Williams was appointed as a member of the Nomination and Corporate Governance Committee with effect from 12 February 2019.

Principal responsibilities of the Committee

- Reviews the structure, size and composition (including the skills, knowledge, independence, experience and diversity) of the Board;
- Considers succession planning for Directors and other senior executives;
- Nominates candidates to fill Board vacancies;
- Makes recommendations to the Board concerning Non-Executive Director independence, membership of Committees, suitable candidates for the role of Senior Independent Director, and the re-election of Directors by shareholders;
- Reviews the Company's corporate governance arrangements and compliance with the Code; and
- Makes recommendations to the Board concerning the charitable and corporate social responsibility activities of the Company and donations to the Lancashire Foundation.

How the Committee discharged its responsibilities during 2018

Board composition

The Committee reviewed the composition of the Board to ensure that the balance of skills, knowledge, independence, experience and diversity continues to be appropriate for the Group's business to meet its strategic objectives. The Committee also considered whether any additional skills and experience were needed to complement those already on the Board.

In this regard, the Committee engaged the Eliot Partnership, an executive search firm that has no other connection to the Group. They identified a number of potential candidates, including Sally Williams, who in July 2018 was appointed as a Non-Executive Director of the Company which took effect on 14 January 2019. In this regard, please see page 55 for a discussion relating to the Board process followed on the determination of the independence of Sally Williams. In accordance with the provisions of the Code, all of the Directors are subject to annual (re)election by shareholders. With the exception of Tom Milligan, who retired from the Board on 31 March 2018, all of the Directors were re-elected by shareholders at the 2018 AGM.

Succession planning

The Committee reviewed and recommended the approval and adoption by the Board of the Company's succession plan and talent management and development programme 2018/2019. The Committee also continued to focus in its dialogue with management on training and development initiatives for key employees across the Group. During 2018, there were a number of planned promotions within the risk management, modelling and actuarial, and underwriting teams.

Subsidiary boards

The Committee monitored the composition of subsidiary boards during 2018 and recommended appointments to the boards of CUL, LICL and KCML. The Committee also recommended the appointment of Simon Fraser as Chairman of the CUL Remuneration and Nomination Committee.

Corporate governance

The Committee keeps under review the Company's corporate governance, particularly compliance with the Code, and is responsible for making recommendations to the Board concerning the process for conducting and facilitating the annual performance evaluation of the Board, its Committees and the individual Directors (see page 56).

During 2018, the Committee noted the publication by the FRC of the 2018 Code and reviewed with management the detailed changes made to the Code. The Committee will review the Company's compliance with the 2018 Code from the beginning of 2019 for the purpose of reporting in the Company's 2019 Annual Report and Accounts.

During 2018, the Company continued the practice of the Group CEO holding 'town hall' meetings with employees following the announcement of the Company's quarterly results. The Committee has discussed plans for certain of these meetings to be attended by the Chairman of the Board or another Non-Executive Director during 2019 and to further enhance arrangements for engagement between the Directors and members of the workforce.

During 2018, the Committee recommended the approval and adoption by the Board of amended and restated Terms of Reference of the Investment Committee, a copy of which is posted on the Company's website.

The Committee considered statistics relevant to the gender composition of the Board, Group management excluding LHL Non-Executive Directors, and overall Group employees. These statistics are shown opposite. The Committee also reviewed 2018 comparative pay data by gender within the Lancashire Group.

The Committee recommended approval by the Board of an updated diversity policy, which is posted on the Company's website. The Board remains of the view that the skills and experience needed to take the business of the Company forward are of paramount importance in selecting Board members and employees.

Lancashire's approach to recruitment and ensuring the benefits of a broad diversity throughout the business is discussed further on page 41 in the discussion of the workplace culture.

During 2018, the Committee recommended the approval by the Board of an updated Anti-Slavery and Human Trafficking statement, a copy of which is posted on the Company's website.

The Lancashire Foundation

The Committee is responsible for monitoring and making recommendations to the Board in relation to the Company's charitable giving policy and the operation of, and reporting requirements for, the Lancashire Foundation. During 2018, the Committee received a report on the Foundation, including its objectives, governance, approach to funding for 2018 and beyond, investment strategy, donations policy and charitable activities, and considered the ways in which the Foundation engages with employees throughout the Group. The Committee made a recommendation to the Board that the Company make a donation to the Foundation of $0.5 million for 2019.

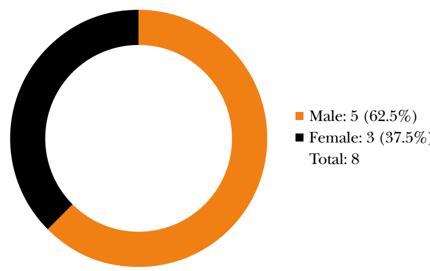
The Committee recommended the appointment by the Board of Emma Hill (a LUK Terrorism, War & Political Risks underwriter) as a Trustee of the Foundation. The Committee also recommended the approval by the Board of some amendments to the Foundation's Trust Deed.

Priorities for 2019

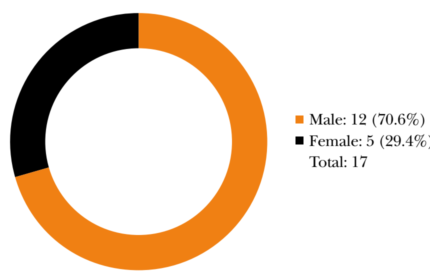
The Committee's key priorities for 2019 are:

- To ensure that the Company is able to discharge effectively its governance responsibilities under the 2018 Code;
- To continue to develop the succession plans for Directors and senior executives, in line with the Group's strategic objectives, and to support management in the development of the talent pipeline; and
- To monitor the Company's progress on gender diversity and other diversities.

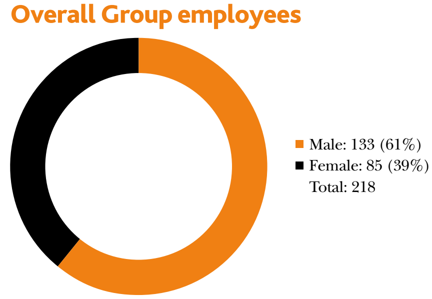
LHL Board members



Group management excluding LHL Non-Executive Directors



Overall Group employees



The gender composition data reflecting LHL Board members is reported as at the date of this Annual Report and Accounts. The gender split of males to females on the LHL Board as at 31 December 2018 was five males (71.4 per cent)/two females (28.6 per cent). All other gender composition data is shown as at 31 December 2018.

Investment Committee

Robert Lusardi
Chairman of the Investment Committee

"Returns on Lancashire's investment portfolio are an integral part of the income generated for our shareholders. Our investment philosophy is designed to complement and support our underwriting strategy, reflect the current market conditions and include liquidity constraints based on PMLs and potential claim exposures. During 2018, the Group continued to maintain a defensive short duration profile during a year in which we have seen rising interest rates. We also seek to hold a diversified portfolio to manage and mitigate the effect of interest rate risk."

Committee membership

During 2018, the Terms of Reference of the Investment Committee were amended to provide that the Committee shall comprise at least two Non-Executive Directors (one of whom may be the Chairman of the Board) and the Group CFO and/or the Group CIO. Any Executive Director may also serve on the Committee. The Terms of Reference are posted on the Company's website.

The Investment Committee comprises one independent Non-Executive Director, the Chairman of the Board, one Executive Director (the Group CFO) and the Group CIO (who is not a Director).

	Meetings attended
Robert Lusardi (Chairman)	4/4
Peter Clarke	4/4
Tom Milligan[1]	1/1
Elaine Whelan	4/4
Denise O'Donoghue	4/4

1. Tom Milligan retired as a member of the Investment Committee with effect from 31 March 2018.

Principal responsibilities of the Committee

- Recommends investment strategies, guidelines and policies to the Board and other members of the Group to approve annually;
- Recommends and sets risk asset definitions and risk tolerance levels;
- Recommends to the relevant boards the appointment of investment managers to manage the Group's investments;
- Monitors the performance of investment strategies within the risk framework; and
- Establishes and monitors compliance with investment operating guidelines relating to the custody of investments and the related internal controls.

How the Committee discharged its responsibilities during 2018

The Committee regularly discussed and kept under review macro-economic, capital markets and global political developments during the year, in particular fiscal and political developments in the U.S. and the ongoing impact of the UK's Brexit negotiations on investment strategy and performance. The Committee also considered regular reports on the performance of the Group's investment portfolios, including asset allocation and compliance with pre-defined guidelines and tolerances; and recommended amendments to portfolio investment guidelines to the Board and operating boards of LICL, LUK and CUL. During the year the Committee received presentations from Goldman Sachs and PIMCO on the state of the investment markets and the Group's portfolio structure and performance.

The Committee's discussion of the investment strategy has been framed within the context of the Board's objective of ensuring appropriate connectivity with, and support for, the Group's underwriting operations. The Committee continued to prioritise the preservation of capital and seeks to ensure an appropriate balance between risk assets and core assets. The Committee aims to provide sufficient liquidity in the investment portfolio to meet the potential payout patterns on the Group's insurance business, and during the year the Committee modified the Group's liquidity rule to ensure that it appropriately recognises historic payout patterns.

The Committee also considered potential adjustments to the investment strategy in light of the decision to move the Company's group insurance regulatory supervision and tax residence from the UK to Bermuda.

Priorities for 2019

The Committee's key priorities for 2019 are:

- To maintain a continued focus on a diversified portfolio, the preservation of capital, the maintenance of liquidity and the management of interest rate and other investment risks; and
- To continue to review the asset allocation strategy in light of the decision to move the Company's group insurance regulatory supervision and tax residence from the UK to Bermuda.

Underwriting and Underwriting Risk Committee

Alex Maloney
Group Chief Executive Officer and Chairman of the Underwriting and Underwriting Risk Committee

"The Committee provides a forum for discussing the Group's underwriting performance and developments in market pricing and coverage trends within the insurance and reinsurance lines in which we operate. The Committee's work in engaging with our underwriters and managers is an important discipline in helping manage the Group's (re)insurance risk exposures and in identifying areas of opportunity through the insurance cycle."

Committee membership

During 2018, the Underwriting and Underwriting Risk Committee comprised one Executive Director (the Group CEO) and one Non-Executive Director together with the Group CUO, the CUO of LICL, the CUO and Reinsurance Manager of LUK, the Active Underwriters for Syndicates 2010 and 3010, and the Deputy Group Chief Actuary (who are not Directors).

	Meetings attended
Alex Maloney (Chairman)	4/4
Jon Barnes	4/4
Michael Dawson	4/4
Paul Gregory	4/4
Hayley Johnston	4/4
Sylvain Perrier[1]	4/4
Ben Readdy	4/4
John Spence	4/4
James Irvine[2]	1/1
Tom Milligan[3]	1/1

1. Sylvain Perrier retired as a member of the Underwriting and Underwriting Risk Committee with effect from 31 December 2018.
2. James Irvine was appointed as a member of the Underwriting and Underwriting Risk Committee with effect from 30 October 2018.
3. Tom Milligan retired as a member of the Underwriting and Underwriting Risk Committee with effect from 31 March 2018.

Principal responsibilities of the Committee

- Reviews Group underwriting strategy including consideration of new lines of business;
- Oversees the development of, and adherence to, underwriting guidelines by operating company CUOs;
- Reviews underwriting performance;
- Reviews significant changes in underwriting rules and policies;
- Establishes, reviews and maintains strict underwriting criteria and limits; and
- Monitors underwriting risk and its consistency with the Group's risk profile and risk appetite.

How the Committee discharged its responsibilities during 2018

The Committee is actively engaged in the development of strategy and the formal underwriting risk tolerances, which are reviewed by the Committee and approved by the Board. Underwriting risk is the key risk faced by the Group. Specifically, the Committee receives quarterly risk data, tracking movements in the Group's exposures to modelled PMLs and RDSs.

The Committee monitors underwriting performance on a quarterly basis, and seeks to ensure that good risk selection and disciplined underwriting remain at the heart of the Group's underwriting strategy. The Committee reviewed management reports on the structuring and pricing of the outwards reinsurance protections purchased across the Group. The Committee received quarterly update reports from the Active Underwriters of Syndicates 2010 and 3010, the CUOs for LUK and LICL and the CEO of KCML during 2018. The Committee also received quarterly reports of significant claims and related developments.

Regarding business development opportunities, the Committee reviewed and approved management plans for the recruitment of underwriters in onshore energy, power and aviation deductible lines of business as well as approving underwriting parameters for participating in transactional liability risk, underwritten on an agency basis.

During 2018, the Committee meetings were open to attendance by all of the Board members and provided a useful forum for the discussion of underwriting performance, the approval and management of risk tolerances and the development of strategic underwriting initiatives. The Committee and Board seek to match the Company's capital to the underwriting requirements of the business in all parts of the underwriting cycle.

A more detailed analysis of the Group's underwriting performance appears in the business review section of this Annual Report and Accounts on pages 26 to 32.

Priorities for 2019

The Committee's key priorities for 2019 are:

- To continue to monitor the development and implementation of a forward-looking and disciplined underwriting strategy appropriate for the Group's underwriting platforms, within a framework of appropriate risk tolerances;
- To work actively with management in the identification, analysis and consideration of new underwriters and/or lines of business, with a particular focus on the managed development of growth in the U.S. specialty and catastrophe lines which are complementary to the Group's underwriting portfolio; and
- To continue to foster a nimble and responsive underwriting culture, capable of responding to the needs of clients, investors, employees and other stakeholders.

Remuneration Committee

Simon Fraser
Chairman of the Remuneration Committee

"The Committee seeks to support the recruitment and retention of the best people for our business. This requires achieving a balance between the need to ensure attractive and fair remuneration outcomes, which are linked to appropriately challenging yet realistic targets for Company and personal performance, and the need to avoid structures which might incentivise excessive risk-taking or a culture of short-termism."

Committee membership

The Remuneration Committee comprises three independent Non-Executive Directors and the Chairman of the Board.

	Meetings attended
Simon Fraser (Chairman)	4/4
Peter Clarke	4/4
Michael Dawson	4/4
Robert Lusardi	4/4

Principal responsibilities of the Committee

- Sets the remuneration policy for, and determines the total individual remuneration packages, including pension arrangements of, the Company's Chairman, the Executive Directors, Company Secretary and other designated senior executives, to deliver long-term benefits to the Group;
- Agrees personal objectives for each Executive Director and the related performance and pay-out metrics for the performance element of the annual bonus;
- Determines each year whether awards will be made under the Group's RSS and, if so, the overall amount of such awards, the individual awards to Executive Directors and other designated senior executives, and the performance targets to be used;
- Ensures that contractual terms on termination or retirement, and any payments made, are fair to the individual and the Company; and
- Oversees any major changes in employee benefit structures throughout the Group.

How the Committee discharged its responsibilities during 2018

During 2018, the Committee reviewed the Group incentive packages to ensure that remuneration is structured appropriately to promote the long-term success of the Company. The Committee also reviewed the RSS structure for Executive Directors to ensure that the performance metrics continue to align the interests of the Company with its investors and management. The Committee considered the salary and bonus awards for 2018 for Executive Directors and other designated senior executives. The Committee also approved the grant of awards under the Company's RSS.

The Committee reviewed Executive Directors' shareholdings in the context of the Company's share ownership guidelines for senior/key executives and discussed revisions to the guidelines to reflect more recent changes to the composition of the senior management team.

The Committee also reviewed the policy for Executive Directors' remuneration, which has a three-year life following its approval by shareholders at the 2017 AGM. The Committee considers the policy fit for purpose and does not propose any amendments at the 2019 AGM.

During 2018, the Committee recommended the approval and adoption by the Board of modifications to the Group Solvency II Identified Staff Remuneration policy principally to reflect changes within the staff population. The Committee continued to monitor progress made during the year on the alignment of remuneration practices across the Group.

The Committee also recommended changes to the companies comprising the Company's peer group for comparator purposes in light of recent M&A activity, albeit that with effect from the 2018 RSS awards the Group has decided to move away from a peer group approach in favour of absolute targets for both TSR and growth (see page 79 for further details).

The Committee considered a number of proposals relating to the treatment of RSS awards held by departing employees.

The Directors' Remuneration Policy and the Annual Report on Remuneration, for which the Committee is responsible, can be found on pages 70 to 89. The report contains a summary of the debate which has been had within the Committee and the Board on the alignment of remuneration and Group performance both in the current year and over a longer timeframe. It should be noted that following a shareholder consultation at the beginning of 2018, the Committee recommended a modification in the methodology for measurement of financial performance in the 2018 three-year RSS awards. The Committee noted and discussed the minority shareholder vote against the Annual Report on Remuneration at the 2018 AGM and, following a further consultation with shareholders at the beginning of 2019, the Committee has recommended to the Board the continued use of the measurement methodology for the 2019 three-year RSS awards (see page 79 for further details).

Priorities for 2019

The Committee does not expect any change to the implementation of its policy in 2019. The Committee's key priorities for 2019 are:

- To review the ongoing appropriateness and relevance of the Group's remuneration structures, ensuring that they are in line with the Group's business strategy, risk profile, objectives, risk management practices and long-term interests;
- To ensure that remuneration across the wider Group meets the staffing needs and staff retention requirements of the business; and
- To conduct a full review of the 2017 Directors' Remuneration Policy, with any changes being put to shareholders for consideration at the 2020 AGM. As part of this review, the Committee will work with its independent advisers to keep abreast of compensation levels amongst the Group's Bermudian and other peers, and the latest compensation issues and market practices.

Annual statement

Dear Shareholder,

I am pleased to present the 2018 Directors' Remuneration Report to shareholders.

Shareholder engagement

Lancashire's Directors' Remuneration Policy was approved by shareholders at the May 2017 AGM. There were no changes to the Policy proposed at the 2018 AGM. At our 2018 AGM we received support from in excess of 80 per cent of shareholders that voted for our Annual Report on Remuneration. On behalf of the Committee I contacted various shareholders and proxy advisory agencies, both before and/or after the 2018 AGM vote, to explain and discuss the Committee's reasoning for the changes implemented in 2018. The Committee has debated the appropriate remuneration structures to be used in 2019 in some detail and (as I set out below) we have decided to follow the same structure for the remuneration of our Executive Directors as was used in 2018.

Remuneration and strategy

The Group's goal continues to be to reward its employees fairly and responsibly by providing an appropriate balance between fixed remuneration and variable remuneration linked to the achievement of suitably challenging Group and individual performance measures.

There is a strong link between the Remuneration Policy and the business strategy. As highlighted elsewhere in this Annual Report and Accounts, our strategy focuses on the effective operation of the business necessary to maximise long-term RoE and the delivery of superior total shareholder returns on a risk-adjusted basis over the course of the insurance cycle. Our Remuneration Policy and the way it is implemented are closely aligned to this strategy.

The Board and management continue to believe that the insurance industry is cyclical in its fundamental characteristics. The Board's priorities at the current point in the pricing cycle are to achieve acceptable returns whilst moderating overall risk levels through underwriting discipline and prudent reinsurance planning and to ensure that throughout the softer part of the market cycle the business has continued to service the needs of its core clients and brokers.

Performance outcomes for 2018 – another challenging year

The Group has produced an RoE of 2.4 per cent (see the strategy and performance reviews of this report on pages 16 to 21).

The Board and Committee were satisfied that in light of 2018 market loss events this performance represents an acceptable outcome for the year. Whilst this has been a year in which higher than average catastrophe loss activity has been experienced, the business has generated positive annual earnings and the Group remains vibrant and well-capitalised. The business is well-positioned to compete in the market as we enter 2019 in what we expect to be an improving phase of the insurance cycle. Our strategy is to continue exploring opportunities for organic growth, where this makes sense, whilst ensuring a rigorous focus on the balanced management of risk and reward.

Against the background described above there has been a decrease in total remuneration of 26 per cent for the CEO and 20 per cent for the CFO between 2017 and 2018 (see the comparison table for single figure remuneration on page 80). This movement is largely driven by an RoE of 2.4 per cent for 2018 and the negative 5.9 per cent for 2017, which taken together severely impacted the vesting levels on the 2016 RSS awards (see below and page 83 for further details).

The Executive Directors' annual bonus performance targets set at the beginning of 2018 for personal and financial performance were stretching. The financial element which made up 75 per cent of the annual bonus opportunity resulted in no annual bonus for that element given the Company's 2018 low return (as a result of the above average catastrophe loss environment). The Board did however consider that both the Executive Directors had performed strongly in managing risk within the business and in positioning the Group well for what we hope will be a better rating environment in 2019, therefore a bonus was awarded for the personal component in respect of 2018 performance. In summary, annual bonuses for our Executive Directors were achieved substantially below target level at 19 per cent of maximum bonus for both the CEO and the CFO (see page 82 for further details).

In relation to long-term incentives for Executive Directors and other senior management, the 2016 Performance RSS awards were 75 per cent based on absolute RoE targets and 25 per cent on relative TSR against specified peer group companies over the three-year period to 31 December 2018. Our TSR performance (in U.S. dollars) over this period ranked the Company below the median of the designated peer group of 11 companies, resulting in 0 per cent vesting for the TSR component.

Our average RoE performance over this three-year performance period was 3.3 per cent against a threshold target of the 13-week Treasury bill rate plus 6 per cent and a maximum pay out of the 13-week Treasury bill rate plus 15 per cent, resulting in 0 per cent of the RoE component of the 2016 Performance RSS awards vesting. Therefore overall, the 2016 Performance RSS awards vested at 0 per cent. This compared with the overall 22.5 per cent vesting of the 2015 Performance RSS awards due to 30.1 per cent vesting of the RoE portion of those awards and 0 per cent vesting of the TSR portion of the awards, which we reported last year.

The total remuneration received by our Executive Directors in 2018 was accordingly lower than that received in 2017 (see page 80 for the comparison data), as demonstrated by the table of Total Remuneration History for the CEO on page 88.

The Committee believes in setting challenging performance criteria and having a significant proportion of the overall package linked to Company performance. However, the Committee also continues to recognise the need to ensure that Executive Directors are appropriately remunerated and incentivised even in the more challenging phases of the insurance cycle, as at present.

It is also important that the Committee and the Board ensure that Executive Director compensation is structured in such a way as to discourage excessive risk to the business.

Overall, in light of the annual and three-year performance delivered, the Committee is satisfied that there has been a robust link between performance and reward for Executive Directors, albeit that the Group's performance has been substantially impacted by a series of above average catastrophe loss events to the global insurance markets, which are beyond the power of our Executive Directors to control, but which have been appropriately planned for. Lancashire will continue to ensure that there remains appropriate alignment between executive remuneration and Company performance, not only in loss-affected years, but also in those future years when the Group hopes to produce results more in line with its cross-cycle return expectations.

Application of Remuneration Policy for 2019

The Remuneration Committee has reviewed the 2017 Directors' Remuneration Policy approved by shareholders and considers it to remain fit for purpose. The Remuneration Committee will be conducting a full review of the Policy in 2019, with any changes being put to shareholders for consideration at the 2020 AGM. The planned review will take into account changes introduced as a result of the FRC's revised 2018 UK Corporate Governance Code.

The final section of this report is the Annual Report on Remuneration, which provides detailed disclosure on how the Policy will be implemented for 2019 and how Directors have been paid in relation to 2018. The Board has decided to apply the targets for the annual bonus on substantially the same basis as agreed for 2018. In deciding to implement the three-year RSS awards for Executive Directors for 2019 on the same basis as the 2018 RSS awards, I wrote to our major shareholders and a number of the leading proxy voting advisory services and held a number of meetings to seek comments on our plans and the feedback given was largely supportive.

There has been some discussion within the investor community regarding post-employment holding periods for Executive Directors, which the Committee has discussed. The Committee does not propose to change the current policy at present, but will further debate this matter during the year and as part of the Remuneration Policy review, which is to take place in advance of the shareholder policy vote in 2020. The Committee notes that the current structure of the RSS awards requires a two-year holding period post vesting for awards held by Executive Directors. Should an Executive Director leave the business on agreed terms as a 'good leaver' it will ordinarily be a requirement that RSS awards vesting after the date of departure should be held for a period of two years post vesting. Accordingly, the Committee notes that in a managed exit for an Executive Director there is already a degree of post-employment shareholder alignment under the current arrangements.

The disclosures provide our shareholders with the information necessary to form a judgement as to the link between Company performance and how the Executive Directors are paid. This Annual Statement together with the Annual Report on Remuneration will be subject to an advisory vote and I hope that you will be able to support the resolution at the forthcoming AGM. The Committee is committed to maintaining an open and constructive dialogue with our shareholders on remuneration matters and I welcome any feedback you may have.

Simon Fraser
Chairman of the Remuneration Committee

Directors' Remuneration Policy section

As a company incorporated in Bermuda, Lancashire is not bound by UK law or regulation in the area of Directors' remuneration to the same extent that it applies to UK incorporated companies. However, by virtue of the Company's premium listing on the LSE, and for the purposes of explaining its compliance against the requirements of the Code, the Board is committed to providing full information on Directors' remuneration to shareholders. In particular, the Committee has discussed the changes to the Code during 2018 for implementation during 2019, in particular with regard to the responsibilities of the Remuneration Committee and Board concerning the review and cognisance of workforce remuneration structures and the mechanisms for employees' engagement and feedback.

The Company's Remuneration Policy was approved by shareholders at the 2017 AGM and is effective for a period of three years from the 2017 AGM until the AGM in 2020 (or until amended by a decision of shareholders). The 2017 Remuneration Policy was developed taking into account the principles of the Code and the views of our major shareholders. As noted earlier, the Committee will be conducting a full review of the Remuneration Policy in 2019, with any changes put to shareholders for consideration at the 2020 AGM.

The 2017 Remuneration Policy contains details of the Company's policy to govern future payments that will be made to Directors.

The Annual Report on Remuneration also details the remuneration paid to Directors in respect of the 2018 financial year in accordance with the shareholder approved Policy.

Governance and approach

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

The Remuneration Committee and the Board have again considered whether any element of the Remuneration Policy could conceivably encourage Executive Directors to take inappropriate risks and have concluded that this is not the case, given the following:

- there is an appropriate balance between fixed and variable pay, and therefore Executive Directors are not required to earn performance-related pay to meet their day-to-day living expenses;
- there is a blend of short-term and long-term performance metrics with an appropriate mix of performance conditions, meaning that there is no undue focus on any one particular metric;
- there is a high level of share ownership amongst Executive Directors, meaning that there is a strong focus on sustainable long-term shareholder value; and
- the Company has the power to claw back bonuses (including the deferred element of the annual bonus) and long-term incentive payments made to Executive Directors in the event of material misstatements in the Group's consolidated financial statements, errors in the calculation of any performance condition, or the Executive Director ceasing to be a Director and/or employee due to gross misconduct.

How the views of shareholders are taken into account

The Committee Chairman and, where appropriate, the Company Chairman, consult with major investors and representative bodies on any significant remuneration proposal relating to Executive Directors. Views of shareholders at the AGM, and feedback received at other times, will be considered by the Committee. In January 2019 the Committee Chairman conducted a consultation on behalf of the Committee with various shareholders and proxy advisory agencies to seek feedback on the Committee's plans to implement the Remuneration Policy for the Executive Directors for 2019 without any material changes to the approach adopted in 2018. Feedback received was supportive of that approach.

How the views of employees are taken into account

The Remuneration Committee takes into account levels of pay elsewhere in the Group when determining the pay levels for Executive Directors. The Remuneration Policy for all staff is, in principle, broadly the same as that for Executive Directors in that any of the Group's employees may be offered similarly structured packages, with participation in annual bonus and long-term incentive plans, although award types (restricted cash, restricted stock or performance shares) and size may vary between different categories of staff. For Executive Directors, with higher remuneration levels, a higher proportion of the compensation package is subject to performance pay, share-based remuneration and deferral. This ensures that there is a strong link between remuneration, Company performance and the interests of shareholders.

Reflecting good practice in this area, Executive Directors' pension provision is no more generous than the pension contributions made to employees in the Group (in percentage of salary terms).

The Company does not consult with employees on Executive Directors' remuneration. However, as noted above, the Committee is made aware of pay structures across the wider Group when setting the Remuneration Policy for Executive Directors. The Committee also reviews and approves the size of any annual bonus pot to be distributed amongst the staff population and the allocation of RSS awards, and its practice in this regard is well aligned with the expectations introduced within the revised Code.

Remuneration Policy table

Base salary	
Purpose and link to strategy	Helps recruit, motivate and retain high-calibre Executive Directors by offering salaries at market competitive levels. Reflects individual experience and role.
Operation	Normally reviewed annually and fixed for 12 months, typically effective from 1 January. Positioning and annual increases influenced by: • role, experience and performance; • change in broader workforce salary; • changes to the size and complexity of the business; and • changes in responsibility or position. Salaries are benchmarked periodically against insurance company peers in the UK, U.S. and in Bermuda.
Opportunity	No maximum.

Benefits	
Purpose and link to strategy	Market competitive structure to support recruitment and retention. Medical cover aims to ensure minimal business interruption as a result of illness.
Operation	Executive Directors' benefits may include healthcare, dental, vision, gym membership and life insurance. Other additional benefits may be offered from time to time that the Committee considers appropriate based on the Executive Director's circumstances. Executive Directors who are expatriates or are required to relocate may be eligible for a housing allowance or other relocation-related expenses. Any reasonable business-related expense can be reimbursed, including any personal tax thereon if such expense is determined to be a taxable benefit.
Opportunity	No maximum.

Pension	
Purpose and link to strategy	Contribution towards funding post-retirement lifestyle.
Operation	The Company operates a defined contribution pension scheme (via outsourced pension providers) or cash-in-lieu of pension. There is a salary sacrifice structure in the UK. There is the opportunity for additional voluntary contributions to be made by individuals, if elected.
Opportunity	Company contribution is currently 10 per cent of base salary.

Annual bonus[1,2]	
Purpose and link to strategy	Rewards the achievement of financial and personal targets.
Operation	The annual bonus is based on financial and personal performance. The precise weightings may differ each year, although there will be a greater focus on financial as opposed to personal performance. The Committee will have the ability to override the bonus outcome by either increasing or decreasing the amount payable (subject to the cap) to ensure a robust link between reward and performance. At least 25 per cent of each Executive Director's bonus is automatically deferred into shares as nil-cost options or conditional awards over three years, with one-third vesting each subsequent year. A dividend equivalence provision operates enabling dividends to be accrued (in cash or shares) on unvested deferred bonus shares in the form of nil-cost options up to the point of exercise. The bonus is subject to clawback if the financial statements of the Company were materially misstated or an error occurred in assessing the performance conditions on bonus and/or if the Executive ceased to be a Director or employee due to gross misconduct.

Opportunity	The maximum bonus for Executive Directors for achieving target level of performance as a percentage of salary is 200 per cent of salary. Maximum opportunity is two times target. Note: The Committee may set bonus opportunities less than the amounts set out above – see Implementation of Policy section of the Annual Report on Remuneration.
Performance metrics	The weightings that apply to the bonus measures and the degree of stretch in objectives may vary each year depending on the business aims and the broader economic or industry environment at the start of the relevant year. For Executive Directors, the financial component will be at least 75 per cent of the overall opportunity, and no more than 25 per cent will be based on personal or strategic objectives. **Financial performance** The financial component is based on the Company's key financial measures of performance. For any year, these may include RoE, growth in BVS, profit, comprehensive income, combined ratio, investment return or any other financial KPI[3]. Typically, a sliding scale of targets applies for financial performance targets. Bonus is earned on an incremental basis once a predetermined threshold level is achieved. Up to 25 per cent of the total bonus opportunity is payable for achieving threshold/median, rising to maximum bonus for stretch/upper quartile performance. The degree of stretch in targets may vary each year depending on the business aims and the broader economic or industry environment at the start of the relevant year. **Personal performance** Personal performance is based upon achievement of clearly articulated objectives. A performance rating is attributed to participating Executive Directors, which determines the payout for this part of the bonus.
Long Term Incentives (LTI)	
Purpose and link to strategy	Rewards Executive Directors for achieving superior returns for shareholders over a longer time frame. Enables Executive Directors to build a meaningful shareholding over time and align goals with shareholders.
Operation[2,3]	RSS awards are normally made annually in the form of nil-cost options (or conditional awards) with vesting dependent on the achievement of performance conditions over at least three financial years, commencing with the year of grant. This three-year period is longer than the typical pattern of loss reserve development on the Group's insurance business, which is approximately two years. The number of awards will normally be determined by reference to the share price around the time of grant unless the Committee, at its discretion, determines otherwise. The Committee considers carefully the quantum of awards each year to ensure that they are competitive in light of peer practice and the targets set. Awards are subject to clawback if there is a material misstatement in the Company's financial statements, an error in the calculation of any performance conditions or if the Executive Director ceases to be a Director or employee due to gross misconduct. A dividend equivalence provision operates enabling dividends to be accrued (in cash or shares) on RSS awards up to the point of exercise. The Committee has the discretion, in exceptional circumstances, to settle an award made to Executive Directors in cash. A two-year post-vesting holding period applies to awards made to Executive Directors since 2016.
Opportunity	Award levels are determined primarily by seniority. A maximum individual grant limit of 350 per cent of salary applies. Note: The Committee may set the normal level of award at less than the percentage set out above – see Implementation of Remuneration Policy section of the Annual Report on Remuneration.
Performance metrics	Awards vest at the end of a three-year performance period based on performance measures reflecting the long-term strategy of the business at the time of grant. These may include measures such as TSR, RoE/BVS, Company profitability, or any other relevant financial measures. If more than one measure is used, the Committee will review the weightings between the measures chosen and the target ranges prior to each LTI grant to ensure that the overall balance and level of stretch remains appropriate. A sliding scale of targets applies for financial metrics with no more than 25 per cent vesting for threshold performance. For TSR, none of this part of the award will vest below median ranking or achievement of an index. No more than 25 per cent of this part of the award will vest for achieving median or index.

Remuneration Policy table continued

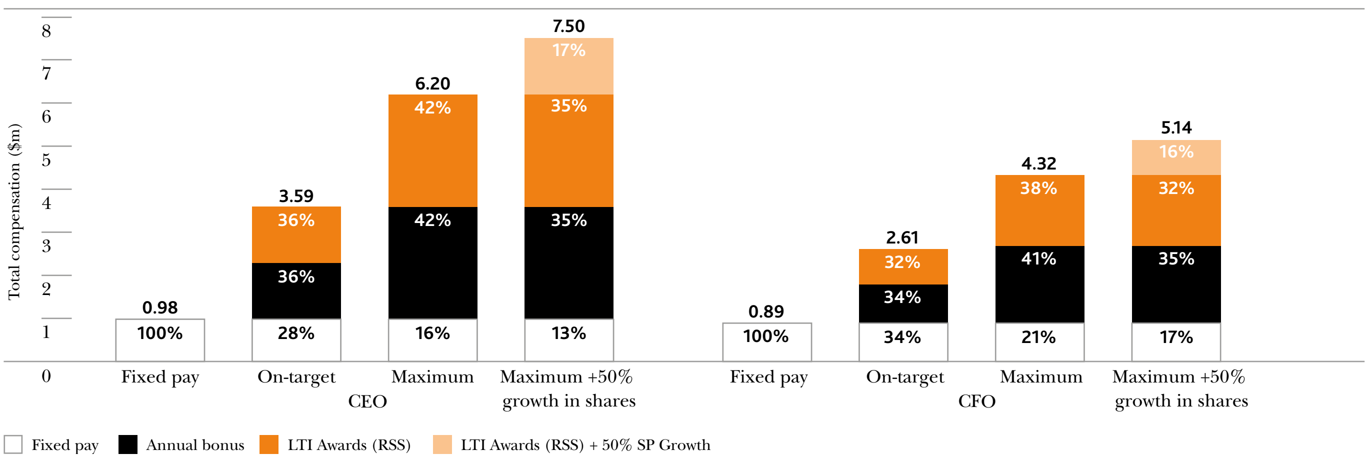
Share ownership guidelines[4]
Under the guidelines, Executive Directors are expected to maintain an interest equivalent in value to no less than two times salary over time. Until such time as the guideline threshold is achieved Executive Directors are required to retain no less than 50 per cent of the net of tax value of awards that vest under the RSS.

Chairman and Non-Executive Directors' fees	
Purpose and link to strategy	Helps recruit, motivate and retain a Chairman and Non-Executive Directors of a high calibre by offering a market competitive fee level.
Operation	The Chairman is paid a single fee for his responsibilities as Chairman. The level of these fees is reviewed periodically by the Committee and the CEO by reference to broadly comparable businesses in terms of size and operations. In general, the Non-Executive Directors are paid a single fee for all responsibilities, although supplemental fees may be payable where additional responsibilities are undertaken, including a Non-Executive Director role on a subsidiary board. Any reasonable business-related expenses (including any personal tax payable) can be reimbursed.
Opportunity	No maximum.

1. The Committee operates the annual bonus plan and RSS according to their respective rules and in accordance with the Listing Rules. The Committee, consistent with normal market practice, retains discretion over a number of areas relating to the operation and administration of these plans and this discretion forms part of this policy.
2. All historical awards that were granted under any current or previous share scheme operated by the Company that remain outstanding remain eligible to vest based on their original award terms and this provision forms part of the policy.
3. Performance measures: these may include the performance indicators shown on pages 20 to 21 or others described within the Annual Report and Accounts Glossary commencing on page 162 or any other measure that supports the achievement of the Company's short to long-term objectives.
4. Share ownership interest equivalent is defined as wholly owned shares or the net of taxes value of RSS awards which have vested but are unexercised and the net of tax value of deferred bonus RSS awards. Shares include those owned by persons closely associated with the relevant Executive Director.

Illustrations of annual application of Remuneration Policy

The charts below show the potential total remuneration opportunities for the Executive Directors in 2019 at different levels of performance under the Directors' Remuneration Policy.



Fixed pay = 2019 Salary + Actual Value of 2018 Benefits + 2019 Pension Contribution.

On-target = Fixed Pay + Target Bonus (being half the Maximum Bonus Opportunity) + Target Value of 2019 RSS grant (assuming 50 per cent vesting with face values of grant).

Maximum = Fixed Pay + Maximum Bonus Opportunity + Maximum Value of 2019 RSS grant (assuming 100 per cent vesting with the face values of grant).

Maximum + 50% growth over performance period = Fixed Pay + Maximum Bonus Opportunity + Maximum Value of 2019 RSS grant + 50% share price appreciation (assuming 100 per cent vesting with the face values of grant).

Approach to recruitment remuneration

The remuneration package for a new Executive Director would be set in accordance with the terms of the Company's prevailing approved Remuneration Policy at the time of appointment and take into account the skills and experience of the individual, the market rate for a candidate of that experience and the importance of securing the relevant individual.

Salary would be provided at such a level as is required to attract the most appropriate candidate. The Committee retains the flexibility to set base salary for a newly appointed Executive Director below the mid-market level and allow them to progress quickly to or around mid-market level once expertise and performance have been proven. This decision would take into account all relevant factors noted above.

The annual bonus and LTI potential would be in line with the Policy. Depending on the timing of the appointment, the Committee may deem it appropriate to set different bonus performance measures for the performance year during which he or she became an Executive Director. The Committee may grant an LTI award to an executive shortly after joining, up to the plan limits set out in the Remuneration Policy table (assuming the Company is not in a closed period).

In addition, the Committee may offer additional cash and/or share-based elements to replace deferred or incentive pay forfeited by an Executive leaving a previous employer. It would seek to ensure, where possible, that these awards would be consistent with awards forfeited in terms of vesting periods (which may be less than three years), expected value and performance conditions.

For an internal Executive Director appointment, any variable pay element awarded in respect of the prior role may be allowed to pay out according to its terms, adjusted as relevant to take into account the appointment. In addition, any other ongoing remuneration obligations existing prior to appointment may continue.

The Committee may agree that the Company will meet certain relocation expenses as appropriate and is able to provide expatriate benefits including housing, a relocation allowance, assignment-related costs or tax equalisation.

Service contracts and loss of office payment policy for Executive Directors

Executive Directors have service contracts with six-month notice periods. In the event of termination, the Executive Directors' contracts provide for compensation up to a maximum of base salary plus the value of benefits to which the Executive Directors are contractually entitled for the unexpired portion of the notice period. The Company may pay statutory claims. No Executive Director has a contractual right to a bonus for any period of notice not worked.

The service contract for a new appointment will be on similar terms as existing Executive Directors, with the facility to include a notice period of no more than 12 months from either party.

The Company seeks to apply the principle of mitigation in the payment of compensation on the termination of the service contract of any Executive Director. There are no special provisions in the service contracts for payments to Executive Directors on a change of control of the Company.

In the event of an exit of an Executive Director, the overriding principle will be to honour contractual remuneration entitlements and determine, on an equitable basis, the appropriate treatment of deferred and performance-linked elements of the package, taking account of the circumstances. Failure will not be rewarded.

Depending on the leaver classification, an Executive Director may be eligible for certain payments or benefits continuation after cessation of employment.

If an Executive Director resigns or is summarily dismissed, salary, pension and benefits will cease on the last day of employment and there will be no further payments.

Leaver on arranged terms or good leaver

If an Executive Director leaves on agreed terms, including compassionate circumstances, there may be payments after cessation of employment. Salary, pension and benefits will be paid up to the length of the agreed notice period or agreed period of gardening leave.

Subject to performance, a bonus may be payable at the discretion of the Committee pro-rata for the portion of the financial year worked.

Vested but unexercised deferred bonus RSS awards will remain exercisable. Unvested deferred bonus RSS awards will ordinarily vest in full, relative to the normal vesting period. All such vested awards must be exercised within 12 months of the vesting date.

Vested but unexercised RSS awards may remain exercisable for 12 months. Unvested awards may vest on the normal vesting date unless the Committee determines that such awards shall instead vest at the time of cessation. Unvested awards will only vest to the extent that the performance conditions have been satisfied (over the full or curtailed period as relevant). A pro-rata reduction in the size of awards may apply, based upon the period of time after the grant date and ending on the date of cessation of employment relative to the three-year or other relevant vesting period.

The Committee has discretion to permit unvested RSS awards to vest early rather than continue on the normal vesting timetable and also retains discretion as to whether or not to apply (or to apply to a lesser extent) the pro-rata reduction to the RSS awards where it feels the reduction would be inappropriate.

Depending upon circumstances, the Committee may consider other payments in respect of any claims in connection with a termination of employment where deemed appropriate, including an unfair dismissal award, outplacement support and assistance with legal fees.

Terms of appointment for Non-Executive Directors

The Non-Executive Directors serve subject to the Company's Bye-laws and under letters of appointment. They are appointed subject to re-election at the AGM and are also terminable by either party on six months' notice except in the event of earlier termination in accordance with the Bye-laws. The Non-Executive Directors are typically expected to serve for up to six years, although the Board may invite a Non-Executive Director to serve for an additional period. Their letters of appointment are available for inspection at the Company's registered office and at each AGM.

In accordance with best practice under the Code, the Board ordinarily submits the Directors individually for re-election by the shareholders at each AGM.

Legacy arrangements

In approving the Policy, authority is given to the Company for the duration of the Policy to honour commitments paid, promised to be paid or awarded to: (i) current or former Directors prior to the date of this Policy being approved (provided that such payments or promises were consistent with any Remuneration Policy of the Company which was approved by shareholders and was in effect at the time they were made); or (ii) to an individual (who subsequently is appointed as a Director of the Company) at a time when the relevant individual was not a Director of the Company and, in the opinion of the Committee, was not paid, promised to be paid or awarded as financial consideration of that individual becoming a Director of the Company, even where such commitments are inconsistent with the provisions of the revised Policy.

For the avoidance of doubt, this includes all awards granted under the 2008 RSS rules in accordance with the Policy approved at the 2014 AGM and the current Policy which was approved by shareholders at the 2017 AGM, and to employees of the Company who are not Directors at the date of grant. Outstanding RSS awards that remain unvested or unexercised at the date of this report (including for current Executive Directors as detailed on page 84 of the Annual Report on Remuneration) remain eligible for vesting or exercise based on their original award terms.

Annual Report on Remuneration

This Annual Report on Remuneration together with the Chairman's Statement, as detailed on pages 70 and 71, will be subject to an advisory vote at the 2019 AGM. The following sections in respect of Directors' emoluments have been audited by KPMG:

- Single figure of remuneration.
- Non-Executive Directors' fees.
- 2019 annual bonus payment in respect of 2018 performance.
- Long-term share awards with performance periods ending in the year – 2016 RSS award.
- Scheme interests awarded during the year.
- Loss of office payments.
- Performance and deferred bonus awards under the RSS.
- Directors' shareholdings and share interests.

Implementation of Remuneration Policy for 2019

In relation to the Policy described in the previous section, the following section sets out additional disclosure on the expected application of the Policy for 2019.

Base salary and fees

Executive Directors

Increases and resulting salaries effective from 1 January 2019 are set out below:

- CEO – salary increased by 3 per cent to $869,460.
- CFO – salary increased by 3 per cent to $597,030.

For 2019, increases of 3 per cent are in line with the standard salary increases for Group employees.

Non-Executive Directors

The Chairman's and Non-Executive Directors' fees are as follows for 2019:

- The fee for the Chairman (Peter Clarke) will remain at $350,000 per annum.
- The Non-Executive Director fee will remain at $175,000 per annum.

Other fees

- Samantha Hoe-Richardson is a Non-Executive Director of LUK in which capacity she will receive a fee of $67,099 per annum.
- Simon Fraser is a Non-Executive Director of CUL in which capacity he will receive a fee of $80,000 per annum.

Annual bonus

For 2019, the CEO and CFO will have a target bonus of 150 per cent of salary and, therefore, a maximum opportunity of 300 per cent of salary. This is within the approved policy limit and is in line with last year's opportunity and represents a maximum bonus opportunity which is 100 per cent of salary less than the set policy limit.

The financial and personal portions of the annual bonus will remain unchanged with 75 per cent on financial performance and 25 per cent on personal performance.

Financial performance (75 per cent)

The Company's most important financial KPI is RoE, which is the core indicator of the delivery of its strategic priorities of ensuring underwriting comes first, effectively balancing risk and return and managing capital nimbly through the insurance cycle (see the strategic overview on pages 16 and 17 of this Annual Report and Accounts). For 2019, the financial component for annual bonus is to be based on the performance of the Group's RoE, measured as the internal rate of return of the change in FCBVS plus accrued dividends.

A sliding scale range of RoE targets has been set by reference to the Risk Free Rate of Return as follows:

- 25 per cent of target bonus shall be payable at a threshold level of RoE equal to RFRoR + 6 per cent (0 per cent will be payable below this threshold).
- 50 per cent of target bonus shall be payable at a level of RoE equal to RFRoR + 7 per cent.
- 100 per cent of target bonus shall be payable at a level of RoE equal to RFRoR + 8 per cent.
- 200 per cent of target bonus shall be payable at a level of RoE equal to RFRoR + 14 per cent.

There shall be linear interpolation between these points. The Board considers that these target ranges are appropriately challenging, given the current insurance market conditions, and will help to ensure a strong link between remuneration for the Executive Directors and the Company's financial performance, the strategy and risk profile of the business and the investment return environment, without encouraging excessive risk-taking.

Personal performance (25 per cent)
This element of the bonus plan is based upon the individual achievement of clearly articulated objectives created at the beginning of each year. The table below sets out a broad summary of the 2019 personal objectives for each Executive Director.

Executive Director	Personal performance
Alex Maloney	Effective leadership and management of the senior executive team and Group. Development of the general business strategy. Contribution aligned to the Lancashire Group Values.
Elaine Whelan	Effective leadership and management of the finance function and the Bermuda office. Development of the general business strategy. Contribution aligned to the Lancashire Group Values.

The personal targets are broadly common among the Executive Directors, with variances being attributable to the specifics of their respective roles. Specific granular areas for personal development within the set broad personal objectives are discussed between the Chairman and the Executive Directors and agreed by the Committee. As part of the 2019 annual performance reviews, each Executive Director will receive a performance rating which will determine the level of personal performance bonus payout for which each Executive Director will be eligible.

Restricted Share Scheme

Performance conditions

For Executive Directors, 2019 RSS awards are subject to a range based on (i) annual growth in FCBVS plus accrued dividends and (ii) absolute TSR performance conditions, both measured by reference to a period ending on 31 December 2021. These metrics aim to provide an appropriate focus on the Company's underlying financial performance and cycle management, and in the case of absolute TSR to provide an objective reward for delivering value to shareholders.

Weighting
For 2019, the weighting is 85 per cent on annual growth in FCBVS plus accrued dividends and 15 per cent on absolute TSR.

Target ranges
The annual growth in FCBVS plus accrued dividends target range for 2019 awards is:

- threshold – 6 per cent; and
- maximum – 13 per cent.

Within the three-year performance period each of the separate financial years will be treated as a separate element, each one contributing one-third to the overall outcome of the vesting of this element of the RSS award. In each year performance will be measured against the target range to determine the ultimate level of vesting in respect of one-third of the RSS award. Vesting will only occur after completion of the full three-year performance period, and continued employment of the Executive Director at the time of vesting.

The relevant element of the RSS award will not vest if annual growth in FCBVS plus accrued dividends is below threshold, 25 per cent of the relevant element of the RSS award will vest at threshold, and 100 per cent of the relevant element of the RSS award will vest at maximum. Performance between threshold and maximum is determined on a straight-line basis.

Overriding downwards discretion
If any year produces a return that the Committee believes is significantly worse than competitors and reflects poor management decisions, the Remuneration Committee will use its discretion to determine that no part (or a lesser part) of the RSS award accrued over the full three-year period shall vest.

The TSR target range for 2019 awards is:

- threshold – 8 per cent compound annual growth; and
- maximum – 12 per cent compound annual growth.

Absolute TSR will be measured over the full three-year performance period rather than looking at each year separately.

None of the award will vest if TSR is below threshold, 25 per cent of the award will vest at threshold, and 100 per cent of the award will vest at maximum. Performance between threshold and maximum is determined on a straight-line basis.

Award levels

2019 RSS award levels are as follows:

- CEO – shares to the value of $2,608,380 (being 300 per cent of salary).
- CFO – shares to the value of $1,641,833 (being 275 per cent of salary).

The number of shares awarded shall be determined based on the closing average share price for a period of five trading days immediately prior to the date of the award.

Post-vesting holding period

For RSS awards made in 2016 or subsequent years, Executive Directors are expected to hold vested RSS awards (or the resultant net of tax shares) which had a performance period of at least three years, for a further period of not less than two years following vesting.

Single figure of remuneration

The following table presents the Executive Directors' emoluments in U.S. dollars in respect of the years ended 31 December 2018 and 31 December 2017.

Executive Directors		Salary $	Pension $	Taxable benefits[1] $	Annual bonus[5] $	Long-Term Incentives (RSS)[2,3] $	Total[4] $
Alex Maloney[4], CEO	**2018**	846,910	84,691	24,879	474,826	0	1,431,306
	2017	811,311	81,227	21,910	420,000	608,696	1,943,144
Elaine Whelan[4,6], CFO	**2018**	579,967	57,795	234,144	326,048	0	1,197,954
	2017	562,268	56,275	155,960	310,000	419,120	1,503,623

1. Benefits comprise Bermudian payroll taxes, social insurance, medical, dental and vision coverage and housing and other allowances paid by the Company for expatriates (as is the case for the CFO), but exclude UK National Insurance contributions.
2. For 2018, the long-term incentive values are based on the 2016 RSS awards which vest at 0 per cent on 14 February 2019 and are based on a three-year performance period that ended on 31 December 2018.
3. For 2017, the long-term incentive values were based on the 2015 RSS awards which vested at 22.5 per cent on 15 February 2018 and were based on a three-year performance period that ended on 31 December 2017. The values are re-presented from the 2017 Annual Report and Accounts based on the share price at the vesting date, 15 February 2018 ($8.397), and include the value of dividends accrued on vested shares.
4. Some amounts were paid in Sterling and converted at the average exchange rate of 1.3420 for the year as they are set in U.S. dollars.
5. Bonus targets were set at the beginning of 2018 and are based on a clear split between Company financial performance and personal performance on a 75:25 basis. Company financial performance is based on absolute financial performance against the RFRoR. The Company financial performance component paid out at 0 per cent of target as the RoE was 2.4 per cent against a target level of RFRoR +8 per cent. The personal element of Executive Directors' bonus opportunity was the only bonus element to pay out. Final bonus payout to Executive Directors will be 19 per cent of the maximum for the CEO and 19 per cent of the maximum for the CFO. For full details of Executive Directors' bonuses and the associated performance delivered see pages 81 and 82. 25 per cent of Executive Directors' annual bonus is deferred into RSS awards without performance conditions, vesting at 33.3 per cent per year over a three-year period.
6. For Elaine Whelan, the increase in taxable benefits from 2017 to 2018 is a result of changes in the Bermuda payroll tax regime.

Non-Executive Directors' fees

Current Non-Executive Directors		Fee $	Other $	Total $
Peter Clarke	**2018**	**350,000**	**–**	**350,000**
	2017	350,000	–	350,000
Michael Dawson	**2018**	**175,000**	**–**	**175,000**
	2017	175,000	–	175,000
Simon Fraser	**2018**	**175,000**	**80,000**	**255,000**
	2017	175,000	80,000	255,000
Samantha Hoe-Richardson[3]	**2018**	**175,000**	**67,099**	**242,099**
	2017	175,000	64,500	239,500
Robert Lusardi	**2018**	**175,000**	**–**	**175,000**
	2017	175,000	–	175,000
Sally Williams[2]	**2018**	**–**	**–**	**–**
	2017	–	–	–

Former Non-Executive Directors				
Tom Milligan[1]	**2018**	**43,750**	**–**	**43,750**
	2017	175,000	–	175,000

1. Tom Milligan was appointed as a Non-Executive Director with effect from 3 February 2015 and retired effective 31 March 2018. His 2018 fees were proportionally pro-rated for the year.
2. Sally Williams was appointed on 10 July 2018 as a Non-Executive Director and her appointment took effect on 14 January 2019.
3. Samantha Hoe-Richardson is remunerated in GBP for her LUK Non-Executive Director fee and this is converted to USD at the average annual FX rate of 1.3420 for 2018 (1.2900 was used for 2017).

2019 annual bonus payments in respect of 2018 performance

As detailed in the Policy Report, each Executive Director participates in the annual bonus plan, under which performance is measured over a single financial year.

The target value of bonus was 150 per cent of salary for the CEO and CFO, and the maximum payable was two times the target value. The RoE is 2.4 per cent.

Financial performance

75 per cent of the 2018 bonus was based on Company performance conditions and the extent to which these were achieved is as follows:

Performance Measure	Financial Performance Weighting (of total bonus) %	Threshold %	Target %	Max %	Actual performance %	% payout
Absolute RoE	75	RFRoR +6%	RFRoR +8%	RFRoR +14%	2.4	0% of target payable in respect of Company performance

In 2018 natural catastrophe losses occurred at above average frequency and financial returns were below the lower threshold targets. Bonus targets were set at the beginning of 2018 and based on a clear split between Company financial performance and personal performance on a 75:25 basis. The Company financial performance component paid out at 0 per cent of target as RoE was 2.4 per cent against a target level of RFRoR +8 per cent and a threshold of RFRoR +6 per cent.

Personal performance

25 per cent of the 2018 bonus was based on performance against clearly defined personal objectives set at the start of the year.

The table below sets out a summary of the 2018 personal objectives for each Executive Director.

Executive Director	Personal performance
Alex Maloney	Effective leadership and management of the senior executive team and Group. Development of the general business strategy. Contribution aligned to the Lancashire Group Values.
Elaine Whelan	Effective leadership and management of the finance function and the Bermuda office. Development of the general business strategy. Contribution aligned to the Lancashire Group Values.

The personal targets were broadly common among the Executive Directors, with variances being attributable to the specifics of their respective roles and performance targets relating to areas of personal development.

During the 2018 annual performance reviews of each Executive Director, a performance rating was assigned to determine the level of bonus payout for which each Executive Director was eligible.

Notwithstanding the financial performance of the Group in what was a higher than average year for catastrophe loss activity (in this regard please see the strategy and performance sections on pages 16 to 21 of this Annual Report and Accounts), the Executive Directors each achieved a strong performance rating against their objectives, in particular in delivering an underwriting portfolio which operated in such a way as to moderate loss exposures through a combination of underwriting discipline and a carefully structured reinsurance programme. The leadership of the Executive Directors in delivering a team of employees with strong professional skills at all levels throughout the Group and in particular the recruitment of new underwriting teams during the year (see pages 22 to 25 for further details) is considered by the Board to position the business well for the challenges and opportunities which lie ahead. For the 2018 performance against personal objectives, the ratings were determined following a process for the evaluation of performance of the Executive Directors against the agreed personal targets and discussion and agreement of the outcomes with the Chairman and members of the Board. The outcomes are expressed as a percentage of the maximum award as illustrated in the table below.

A table of performance measures and total 2018 bonus achievement is set out below:

Executive Director	Financial performance (max % of total bonus) %	Personal performance (max % of total bonus) %	Bonus % of maximum awarded %	Total bonus value[1] $	Value of bonus paid in cash (75 per cent of total bonus) $	Value of bonus deferred into RSS awards (25 per cent of total bonus)[1] $
Alex Maloney	75	25	19	474,826	356,119	118,707
Elaine Whelan	75	25	19	326,048	244,536	81,512

1. 25 per cent of total bonus award will be deferred into RSS awards with one third vesting annually, each year, over a three-year period with the first third becoming exercisable in February 2020, subject to the Company not being in a closed period. These awards vest on the relevant dates subject to continued employment only.

Long-term share awards with performance periods ending in the year – 2016 RSS award

The 2016 RSS awards were based on a three-year performance period ending on 31 December 2018 and vest following the determination of financial results by the Board. The tables below set out the achievement against the performance conditions attached to the award, resulting in aggregate vesting of 0 per cent, and the actual number of awards vesting.

	TSR (relative to a comparator group of 11 companies) (relevant to 25% of the 2016 RSS awards)		Average annual RoE (over three years in excess of 13-week Treasury bill rate) (relevant to 75% of the 2016 RSS awards)	
Performance level	Performance required	% vesting	Performance required (%)	% vesting
Below threshold	Below median	0	Below 6	0
Threshold	Median	25	6	25
Stretch or above	Upper quartile or above	100	15 or above	100
Actual achieved	Below median	0	2.4	0

Details of the vesting for each Executive Director, based on the above, are shown in the table below:

Executive Director	Number of shares at grant	Number of shares to lapse	Number of shares to vest	Dividend accrual on vested shares value[2] $	Value of shares including dividend accrual[1] $
Alex Maloney	219,254	219,254	0	0	0
Elaine Whelan	157,104	157,104	0	0	0

1. The value of the vested shares is based on the 2016 RSS awards which vest at 0 per cent on 14 February 2019 and are based on a three-year performance period that ended on 31 December 2018.
2. Dividends accrue on awards at the record date of a dividend payment and upon exercise the cash value of the accrued dividends is paid to the employee on the number of vested awards net of tax required.

Scheme interests awarded during the year

The table below sets out the performance RSS awards that were granted as nil-cost options on 23 February 2018.

Executive Director	Grant date[2]	Number of awards granted during the year	Face value of awards granted during the year[1,3] $	% vesting at threshold performance
Alex Maloney	23-Feb-2018	315,762	2,532,876	25
Elaine Whelan	23-Feb-2018	198,755	1,594,308	25

1. The awards were based on the five-day average closing share price prior to the award date, being £5.74 (a share price of $8.02 based on the exchange rate of 1.3982) and the awards were granted as nil-cost options.
2. These awards are due to vest subject to performance conditions being met at the end of the performance period ending 31 December 2020 and becoming exercisable in the first open period following the release of the Company's 2020 year-end results after the meeting of the Board in February 2021.
3. The exercise share price is determined once an award has vested on the basis of the share price on the date an award is exercised.

Loss of office payments

There were no loss of office payments during the 2018 year.

Details of all outstanding share awards

In addition to awards made during the 2018 financial year, the table below sets out details of all outstanding RSS awards held by Executive Directors.

Performance and deferred bonus awards under the RSS

		Grant date[1]	Exercise price	Awards held at 1-Jan-18	Awards granted during the year	Awards vested during the year	Awards lapsed during the year	Awards exercised during the year	Awards held at 31-Dec-18	End of performance period
Alex Maloney, Group CEO	Performance RSS[2,3]	12-Feb-15	–	244,208	–	**54,947**	**189,261**	**54,947**	–	31-Dec-17
	Deferred Bonus RSS[4]	20-Mar-15	–	13,976	–	**13,976**	–	**13,976**	–	
	Performance RSS[2,3]	18-Feb-16	–	219,254	–	–	–	–	**219,254**	31-Dec-18
	Deferred Bonus RSS[4]	11-Mar-16	–	37,483	–	**18,742**	–	**18,742**	**18,741**	
	Performance RSS[2,3]	14-Mar-17	–	286,666	–	–	–	–	**286,666**	31-Dec-19
	Deferred Bonus RSS[4]	14-Mar-17	–	53,215	–	**17,738**	–	**17,738**	**35,477**	
	Performance RSS[3,5]	23-Feb-18	–	–	**315,762**	–	–	–	**315,762**	31-Dec-20
	Deferred Bonus RSS[4]	23-Feb-18	–	–	**13,090**	–	–	–	**13,090**	
Total				**854,802**	**328,852**	**105,403**	**189,261**	**105,403**	**888,990**	
Elaine Whelan, Group CFO & LICL CEO	Performance RSS[2,3]	12-Feb-15	–	168,149	–	**37,834**	**130,315**	**37,834**	–	31-Dec-17
	Deferred Bonus RSS[4]	20-Mar-15	–	9,847	–	**9,847**	–	**9,847**	–	
	Performance RSS[2,3]	18-Feb-16	–	157,104	–	–	–	–	**157,104**	31-Dec-18
	Deferred Bonus RSS[4]	11-Mar-16	–	25,738	–	**12,869**	–	**12,869**	**12,869**	
	Performance RSS[2,3]	14-Mar-17	–	180,441	–	–	–	–	**180,441**	31-Dec-19
	Deferred Bonus RSS[4]	14-Mar-17	–	36,541	–	**12,180**	–	**12,180**	**24,361**	
	Performance RSS[3,5]	23-Feb-18	–	–	**198,755**	–	–	–	**198,755**	31-Dec-20
	Deferred Bonus RSS[4]	23-Feb-18	–	–	**9,663**	–	–	–	**9,663**	
Total				**577,820**	**208,418**	**72,730**	**130,315**	**72,730**	**583,193**	

1. The market values of the common shares on the dates of grant were:
   - 12 February 2015 £6.36
   - 20 March 2015 £6.30
   - 18 February 2016 £6.17
   - 11 March 2016 £5.37
   - 14 March 2017 £7.02
   - 23 February 2018 £5.69
2. The vesting of the RSS performance awards above is subject to two performance conditions as follows:
   - 25 per cent of each award is subject to a performance condition measuring the TSR performance of the Company against the TSR performance of a select group of comparator companies (see page 86 for a list of comparator companies for each grant year), over a three-year performance period. 25 per cent of this part of the award vests for median performance by the Company, rising to 100 per cent vesting of this part of the award for upper quartile performance by the Company or better (with proportionate vesting between these two points).
   - The other 75 per cent of each award is subject to a performance condition based on average annual RoE over a three-year performance period. 25 per cent of this part of the award will vest if average annual RoE over the performance period exceeds the criteria set out in the table on page 85, whilst all of this part of the award will vest if the Company's average RoE is equal to the more stringent criteria set out in the table on page 85. Between these two points vesting will take place on a straight-line basis from 25 per cent to 100 per cent for RoE performance.
3. The vesting dates of the RSS performance awards are subject to being out of a closed period and are as follows:
   - 2015 – 15 February 2018;
   - 2016 – 14 February 2019;
   - 2017 – first open period following the release of the Company's 2019 year-end results; and
   - 2018 – first open period following the release of the Company's 2020 year-end results.
4. The vesting dates of the RSS Deferred Bonus awards are subject to being out of a closed period and, for the 2015 to 2018 Deferred Bonus awards, are as follows:
   - 2015 – vest 33.33 per cent per year over a three-year period at the first open period following the release of the Company's year-end results for 2015, 2016 and 2017;
   - 2016 – vest 33.33 per cent per year over a three-year period at the first open period following the release of the Company's year-end results for 2016, 2017 and 2018;
   - 2017 – vest 33.33 per cent per year over a three-year period at the first open period following the release of the Company's year-end results for 2017, 2018 and 2019; and
   - 2018 – vest 33.33 per cent per year over a three-year period at the first open period following the release of the Company's year-end results for 2018, 2019 and 2020.
5. The vesting of the RSS performance awards above is subject to two performance conditions as follows:
   - 15 per cent of each award is subject to a performance condition measuring the absolute TSR performance of the Company over a three-year performance period. 25 per cent of this part of the award vests for threshold (8 per cent compound annual growth) performance by the Company, rising to 100 per cent vesting of this part of the award for maximum performance (12 per cent compound annual growth) by the Company or better. Performance between threshold and maximum is determined on a straight-line basis.
   - The other 85 per cent of each award is subject to a performance condition based on the annual growth in FCBVS plus accrued dividends over a three-year performance period. 25 per cent of this part of the award will vest if annual growth in FCBVS plus accrued dividends over the performance period exceeds the criteria set out in the table on page 85, whilst all of this part of the award will vest if the Company's annual growth in FCBVS plus accrued dividends is equal to the more stringent criteria set out in the table on page 85. Between these two points vesting will take place on a straight-line basis. Within the three-year performance period each of the separate financial years will be treated as a separate element, each one contributing one-third to the overall outcome of the vesting of this element of the RSS award. Details of this calculation method were disclosed on page 69 of the 2017 Annual Report and Accounts.

Relative TSR targets for RSS (25 per cent weighting)

	2014	2015	2016	2017
100%	75th percentile	75th percentile	75th percentile	75th percentile
25%	= median	= median	= median	= median
Nil	< median	< median	< median	< median

RoE targets for RSS (75 per cent weighting)

	2014	2015	2016	2017*
100%	RFRoR +15%	RFRoR +15%	RFRoR +15%	13%
25%	RFRoR + 6%	RFRoR + 6%	RFRoR + 6%	6%
Nil	< RFRoR + 6%	< RFRoR + 6%	< RFRoR + 6%	< 6%

* Average annual growth in FCBVS plus accrued dividends.

Absolute TSR targets for RSS (15 per cent weighting)

	2018*	2019*
100%	12%	12%
25%	8%	8%
Nil	< 8%	< 8%

Annual growth in FCBVS plus accrued dividends targets for RSS (85 per cent weighting)

	2018*	2019*
100%	13%	13%
25%	6%	6%
Nil	< 6%	< 6%

* See pages 79 and 80 for the vesting methodology to be applied for the 2018 and onwards RSS awards.

Historical Peer Group Data for 2017 and prior RSS awards (relative TSR element)

Peer Companies [13]	2014 awards	2015 awards	2016 awards	2017 awards
Amlin plc[1,6]	X	X	–	–
Arch Capital Group Limited[2, 5]	–	–	X	X
Argo Group International Holdings, Ltd.	X	X	X	X
Aspen Insurance Holdings Limited[3]	X	X	X	X
Axis Capital Holdings Limited	X	X	X	X
Beazley plc	X	X	X	X
Catlin Group Ltd.[4]	X	–	–	–
Endurance Specialty Holdings Ltd.[5,8]	X	X	X	–
Everest Re Group, Ltd.[6]	–	X	X	X
Greenlight Capital Re, Ltd.[11]	–	–	X	X
The Hanover Insurance Group[7]	–	X	X	X
Hiscox Ltd.	X	X	X	X
Montpelier Re Holdings Ltd.[7,8]	X	–	–	–
Novae Group plc[9,10]	–	X	X	X
Renaissance Re Holdings Ltd.	X	X	X	X
Third Point Reinsurance Ltd. [12]	–	–	X	X
Validus Holdings Ltd. [11]	X	X	X	X
XL Group Ltd[10,12]	–	X	X	X

1. Mitsui Sumitomo Insurance Company acquired Amlin plc on 1 February 2016. Accordingly, the Committee decided to use Amlin plc as a comparator company up to 30 June 2015 and it was replaced with Everest Re Group, Ltd with effect from 1 July 2015.
2. Arch Capital Group Limited was added to the peer group of companies with effect from 1 October 2016 as a replacement for Endurance Specialty Holdings Ltd.
3. Apollo Funds announced on 28 August 2018 that it intended to acquire all outstanding common shares of Aspen Insurance Holdings Limited ('Aspen'). The transaction is due to close in the first half of 2019, subject to approval by regulators, Aspen shareholders and the satisfaction of other customary closing conditions. As a result of this announcement, Aspen ceased to be in the comparator peer group from 30 June 2018.
4. Catlin Group Ltd. was acquired by the XL Group Ltd. with effect from 1 May 2015 and so was used as a comparator company up to 31 December 2014 and was replaced by Novae Group plc.
5. Sompo Holdings Inc. announced on 5 October 2016 that it intended to acquire Endurance Specialty Holdings Ltd. ('Endurance'). The transaction subsequently achieved shareholder approval. Accordingly, the Committee decided to use Arch Capital Group Limited as a comparator company with effect from 1 October 2016 as a replacement for Endurance.
6. Everest Re Group, Ltd. was added to the peer group of companies with effect from 1 July 2015 as a replacement for Amlin plc.
7. The Hanover Insurance Group was added to the peer group of companies with effect from 1 January 2015 as a replacement for Montpelier Re Holdings Ltd.
8. Montpelier Re Holdings Ltd. was acquired by Endurance with effect from 31 July 2015 and so was used as a comparator company up to 31 December 2014 and was replaced by The Hanover Insurance Group.
9. Novae Group plc was added to the peer group of companies with effect from 1 January 2015 as a replacement for Catlin Group Ltd.
10. Novae Group plc was acquired by Axis Capital Holdings Limited with effect from 2 October 2017 and so was used as a comparator company up to 30 June 2017 and was replaced by XL Group Ltd as of 1 July 2017.
11. American International Group, Inc. announced on 22 January 2018 that it intended to acquire Validus Holdings Ltd ('Validus'). Accordingly, the Committee decided to use Greenlight Capital Re, Ltd as a comparator company with effect from 1 January 2018 as a replacement for Validus.
12. AXA announced on 5 March 2018 that it had entered into an agreement to acquire 100% of XL Group Ltd, which was approved by XL Group Ltd's common shareholders on 6 June 2018. Accordingly, the Committee decided to use Third Point Reinsurance Ltd as a comparator company with effect from 1 January 2018 as a replacement for XL Group Ltd.
13. For 2018 and onwards RSS awards the Board adopted a range of absolute TSR targets. See page 85 for further details.

Directors' shareholdings and share interests

Formal shareholding guidelines were first introduced in 2012 and have subsequently been modified. The guidelines require the CEO and CFO to build and maintain a shareholding in the Company worth two times annual salary as set out in the Policy Report.

Details of the Directors' interests in shares are shown in the table below.

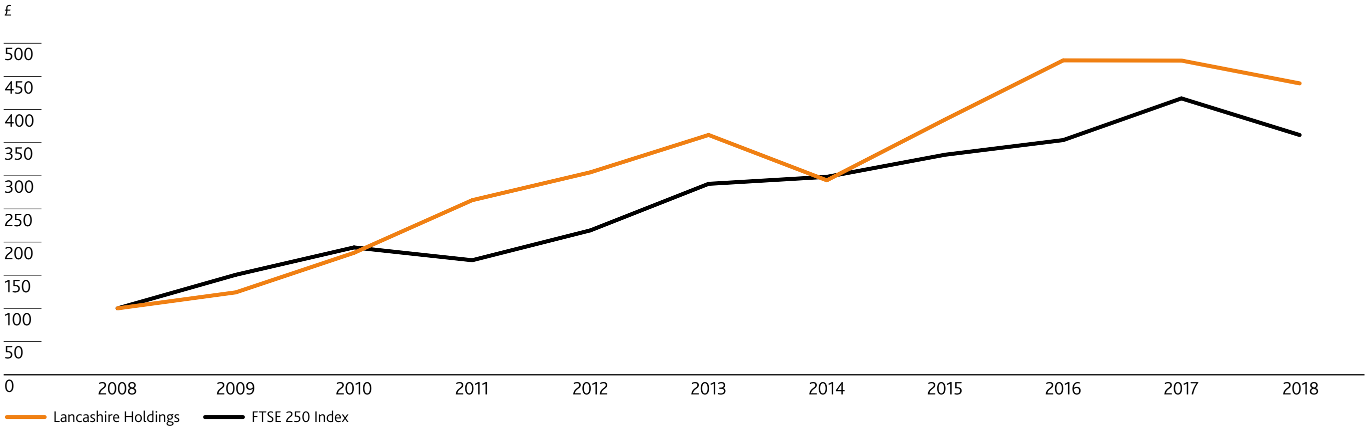
	Number of Common Shares						
	Total as at 1 January 2018	As at 31 December 2018					
Directors		Legally owned	Subject to deferral under the RSS	Subject to performance conditions under the RSS	Vested but unexercised awards under other share-based plans	Total	Shareholding guideline achieved?
Alex Maloney	1,435,104	**657,724**	**67,308**	**821,682**	**N/A**	**1,546,714**	**Yes**
Elaine Whelan	1,102,190	**627,169**	**46,893**	**536,300**	**N/A**	**1,210,362**	**Yes**
Peter Clarke	44,000	**60,000**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Michael Dawson	7,200	**11,000**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Simon Fraser	1,000	**1,000**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Samantha Hoe-Richardson	3,947	**5,356**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Robert Lusardi	3,000	**8,000**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Sally Williams	–	**–**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**

Note: Share ownership interest equivalent is defined as wholly owned shares or the net of taxes value of RSS awards which have vested but are unexercised and the net of tax value of deferred bonus RSS awards. Shares include those owned by persons closely associated with the relevant Executive Director.

Performance graph

The following graph shows the Company's performance, measured by TSR, compared with the performance of the FTSE 250 Index. The Company's common shares commenced trading on the main market of the LSE on 16 March 2009 and the Company joined the FTSE 250 Index on 22 June 2009 and is currently a constituent of this.

TOTAL SHAREHOLDER RETURN



Source: Datastream (Thomson Reuters)

This graph shows the value, by 31 December 2018, of £100 invested in LHL on 31 December 2008 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year ends.

Total remuneration history for CEO

The table below sets out the total single figure of remuneration for the CEOs over the last ten years with the annual bonus paid as a percentage of the maximum and the percentage of long-term share awards vesting in each year.

	2009	2010	2011	2012	2013	2014[1]	2014[2]	2015	2016	2017	2018
Total remuneration ($000s)	7,244	9,945	9,623	10,460	10,175	10,072	2,405	3,853	3,800	1,943	**1,431**
Annual bonus (%)	68	94	73	73	80	80	73	72	76	17	**19**
LTI vesting (%)	N/A	99.6	100	99	100	61[1]	50	75	67	22.5[3]	**0**

1. Richard Brindle was the CEO from 2005 until he retired from the Group and as a Director on 30 April 2014. Mr Brindle was afforded good leaver status and all RSS award interests were vested upon his departure, using estimated TSR and RoE values at the time of his retirement. The amounts in the table above reflect all awards which vested in 2014. Further particulars of the vesting were reported in the Group's 2014 Annual Report and Accounts.
2. Alex Maloney was appointed CEO effective 1 May 2014, after the retirement of Mr Brindle. For the purposes of this table his numbers have been pro-rated to account for only his time in office as CEO for 2014.
3. For 2017, the long-term incentive values were based on the 2015 RSS awards which vested at 22.5 per cent on 15 February 2018 and were based on a three-year performance period that ended on 31 December 2017. The values are re-presented from the 2017 Annual Report and Accounts based on the share price at the vesting date, 15 February 2018 ($8.397), and include the value of dividends accrued on vested shares.

The table above shows the total remuneration figure for the former CEO during each of the relevant financial years; figures for the current CEO are shown since his appointment to the position on 1 May 2014. The total remuneration figure includes the annual bonus and LTI awards which vested based on performance in those years. The annual bonus and LTI percentages show the payout for each year as a percentage of the maximum.

Percentage change in CEO remuneration

The following table sets out the percentage change in the aggregate value of salary, benefits and bonus for the CEO from the preceding year and the average percentage change in respect of the employees of the Group taken as a whole.

	Year-on-year change CEO[2] %	Average year-on-year change employees[1,3] %
Base salary	4	5
Benefits	6	5
Bonus	13	33

1. Employee numbers were calculated on a per permanent employee headcount basis for the years ending 31 December 2018 and 31 December 2017, adjusted for any joiners and leavers during this period.
2. The underlying salary increase from 2017 to 2018 for the CEO was 3 per cent. However some amounts were paid in Sterling and converted at the average exchange rate of 1.3420 for the year, which has resulted in the overall 4 per cent base salary year-on-year change above.
3. The underlying salary increase from 2017 to 2018 for Group employees was a standard 3 per cent. The 5 per cent increase reflects staff promotions and other adjustments made during the year.

Relative importance of the spend on pay

The following table sets out the percentage change in dividends and overall spend on pay in the year ended 31 December 2018 compared with the year ended 31 December 2017.

	2018 $m	2017 $m	Percentage change %
Employee remuneration costs	**56.9**	39.8	43
Dividends	**70.2**	29.9	135

Committee members, attendees and advice

For Remuneration Committee membership and attendance at meetings through 2018, please refer to page 68 of this Annual Report and Accounts. The Remuneration Committee's responsibilities are contained in its Terms of Reference, a copy of which is available on the Company's website. These responsibilities include determining the framework for the remuneration, including pension arrangements, for all Executive Directors, the Chairman and senior executives. The Committee is also responsible for approving employment contracts for senior executives.

Remuneration Committee adviser

The Remuneration Committee is advised by the Executive Compensation practice at Aon plc. Aon was appointed by the Remuneration Committee in 2007. Aon has discussions with the Remuneration Committee Chairman regularly on Committee process and topics which are of particular relevance to the Company.

Aon ReInsurance Solutions (which is part of Aon but is a separate business division) provides reinsurance broking services to the Group.

The primary role of Aon is to provide independent and objective advice and support to the Committee's Chairman and members. In order to manage any possible conflict of interest, Aon operates as a distinct business within the Aon Group and there is a robust separation between the business activities and management of Aon and all other parts of the wider Aon Group. The Committee is satisfied that the advice that it receives is objective and independent. Aon is also a signatory to the Remuneration Consultants Group ('RCG') Code of Conduct which sets out guidelines for managing conflicts of interest, and has confirmed to the Committee its compliance with the RCG Code.

The total fees paid to Aon in respect of its services to the Committee for the year ended 31 December 2018 were $71,334 (2017 – $68,072). Fees are predominantly charged on a 'time spent' basis.

Engagement with shareholders

Details of votes cast for and against the resolution to approve last year's Remuneration Report are shown below along with the votes to approve the 2017 Remuneration Policy which have been stated below; any matters discussed with shareholders during the year are provided in the Implementation of Remuneration Policy for 2019 section of the report starting on page 78.

	Vote to approve 2017 Annual Report on Remuneration (at the 2018 AGM)		Vote to approve 2017-2019 Remuneration Policy (at the 2017 AGM)	
	Total number of votes	% of votes cast	Total number of votes	% of votes cast
For	**135,967,463**	**80.6**	144,229,951	94.8
Against	**32,740,906**	**19.4**	7,870,777	5.2
Total	**168,708,369**	**100.0**	152,100,728	100.0
Abstentions	**205,726**		9,125,993	

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

Simon Fraser
Chairman of the Remuneration Committee

13 February 2019

Overview of the Group

Lancashire Holdings Limited is a Bermuda incorporated company (Registered Company No. 37415) with operating subsidiaries in Bermuda and London, and two syndicates at Lloyd's.

The Company's common shares were admitted to trading on AIM in December 2005 and were subsequently moved up to the Official List and to trading on the main market of the LSE on 16 March 2009. The shares have been included in the FTSE 250 Index since 22 June 2009 and have a premium listing on the LSE.

Principal activities

The Company's principal activity, through its wholly owned subsidiaries, is the provision of global specialty insurance and reinsurance products. On 7 November 2013, the Company completed the acquisition of CCL, an established Lloyd's insurance group, and in June 2013 established Kinesis, a third-party capital and underwriting management facility, to complement the Group's longstanding specialty insurance activities. An analysis of the Group's business performance can be found in the business review on pages 26 to 32.

Dividends

For the year ended 31 December 2018, the following dividends were declared:

- a final dividend of $0.10 per common share was declared on 14 February 2018 and paid on 21 March 2018 in pounds sterling at the pound/U.S. dollar exchange rate of 1.3985 or £0.0715 per common share;
- an interim dividend of $0.05 per common share was declared on 25 July 2018 and paid on 12 September 2018 in pounds sterling at the pound/U.S. dollar exchange rate of 1.2715 or £0.0393 per common share; and
- a special dividend of $0.20 per common share was declared on 31 October 2018 and paid on 12 December 2018 in pounds sterling at the pound/U.S. dollar exchange rate of 1.3030 or £0.1535 per common share.

Dividend policy

The Group intends to maintain a strong balance sheet at all times, while generating an attractive risk-adjusted total return for shareholders. We actively manage capital to achieve those aims. Capital management is expected to include the payment of a sustainable annual (interim and final) dividend, supplemented by special dividends from time to time. Dividends will be linked to past performance and future prospects.

Under most scenarios, the annual dividend is not expected to reduce from one year to the next. Special dividends are expected to vary substantially in size and in timing. The Board may cancel the payment of any dividend between declaration and payment for purposes of compliance with regulatory requirements or for exceptional business reasons.

Current Directors

- Peter Clarke (Non-Executive Chairman)
- Michael Dawson (Non-Executive Director)
- Simon Fraser (Senior Independent Non-Executive Director)
- Samantha Hoe-Richardson (Non-Executive Director)
- Robert Lusardi (Non-Executive Director)
- Alex Maloney (Chief Executive Officer)
- Elaine Whelan (Chief Financial Officer)
- Sally Williams (Non-Executive Director)

Directors' interests

The Directors' beneficial interests in the Company's common shares as at 31 December 2018 and 2017 including interests held by family members were as follows:

Directors	Common shares held as at 31 December 2018	Common shares held as at 31 December 2017
Peter Clarke[1]	**60,000**	44,000
Michael Dawson[2]	**11,000**	7,200
Simon Fraser	**1,000**	1,000
Samantha Hoe-Richardson[3]	**5,356**	3,947
Robert Lusardi[4]	**8,000**	3,000
Alex Maloney[5]	**657,724**	580,302
Elaine Whelan[6]	**627,169**	524,370
Sally Williams[7]	**–**	–

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

1. Peter Clarke conducted the following transactions in the Company's shares during 2018:
   - 16 February – purchase of 16,000 shares at a price of £5.67 costing £90,705.56.
2. Michael Dawson conducted the following transactions in the Company's shares during 2018:
   - 16 February – purchase of 3,800 shares at a price of £5.89 costing £22,363.
3. Samantha Hoe-Richardson conducted the following transactions in the Company's shares during 2018:
   - 19 February – purchase of 1,409 shares at a price of £5.68 costing £7,999.60.
4. Robert Lusardi conducted the following transactions in the Company's shares during 2018:
   - 20 February – purchase of 5,000 shares at a price of $7.89 costing $39,450.
5. Includes 155,722 shares owned by his spouse, Amanda Maloney. Alex Maloney conducted the following transactions in the Company's shares during 2018:
   - 15 February – exercise of 54,947 RSS awards and 50,456 deferred bonus RSS awards and related sale of 49,681 shares to cover tax liabilities, at a price of £6.08 realising £302,042.59. The balance of 55,722 shares was transferred to his spouse, Amanda Maloney.
   - 16 February – purchase of 21,700 shares at a price of £5.73 costing £124,341.
6. Includes 11,590 shares owned by her spouse, Kilian Whelan. Elaine Whelan conducted the following transactions in the Company's shares during 2018:
   - 15 February – exercise of 37,834 RSS awards and 34,896 deferred bonus RSS awards and related sale of 3,431 shares to cover tax liabilities, at a price of £6.08 realising £20,859.24.
   - 16 February – purchase of 20,000 shares at a price of £5.90 costing £117,900.
   - 20 February – purchase of 13,500 shares at a price of £5.58 costing £75,262.50.
7. Sally Williams was appointed to the Board with effect from 14 January 2019.

Transactions in own shares

The Company did not repurchase any of its own common shares during 2018 or 2017.

The Group's current repurchase programme has 20,134,192 common shares remaining to be purchased as at 31 December 2018 (approximately $172.7 million at the 31 December 2018 share price). Further details of the share repurchase authority and programme are set out in note 19 to the consolidated financial statements on page 156. The repurchase programme is subject to renewal at the 2019 AGM in an amount of up to 10 per cent of the then issued common share capital.

Directors' remuneration

Details of the Directors' remuneration are set out in the Directors' Remuneration Report on pages 70 to 89.

Substantial shareholders

As at 13 February 2019, the Company was aware of the following interests of 3 per cent or more in the Company's issued share capital:

Name	Number of shares as at 13 February 2019	% of shares in issue
Invesco Limited	32,247,491	15.97
Setanta Asset Management Limited	26,367,532	13.06
Franklin Mutual Advisers, LLC	12,222,897	6.05
Oppenheimer Funds	10,000,000	4.95
Frank W Cawood & Associates	9,302,300	4.61
Wellington Management	9,047,266	4.48
Dimensional Fund Advisors LP	8,414,981	4.17
BlackRock, Inc.	7,823,145	3.87
Vanguard Group	7,546,539	3.74
Troy Asset Management Limited	7,444,804	3.69

Corporate governance – compliance statement

The Company's compliance with the Code is summarised in the Corporate Governance section of this Report on pages 55 to 57.

The Board considers and the Company confirms, in accordance with the principle of 'comply or explain' that the Company has complied with the principles and provisions set out in the UK Corporate Governance Code throughout the year ended 31 December 2018.

Health and safety

The Group considers the health and safety of its employees to be a management responsibility equal to that of any other function.

The Group operates in compliance with health and safety legislative requirements in Bermuda and the UK.

Greenhouse gas emissions

The Group's greenhouse gas emissions are detailed in the engagement and sustainability section on page 43.

Employees

The Group is an equal opportunity employer, and does not tolerate unfair discrimination of any kind in any area of employment or corporate life. The Group believes that education and training for employees is a continuous process and employees are encouraged to discuss training needs with their managers. The Group's health and safety, equal opportunities, training and other policies are available to all employees in the staff handbook which is available on the Group's intranet.

Creditor payment policy

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

Financial instruments and risk exposures

Information regarding the Group's risk exposures is included in the ERM report on pages 33 to 39 and in the risk disclosures section on pages 111 to 133 of the consolidated financial statements. The Group's use of derivative financial instruments can be found on pages 124 to 125.

Accounting standards

The Group's consolidated financial statements are prepared on a going concern basis in accordance with accounting principles generally accepted under IFRS as adopted by the EU. Where IFRS is silent, as it is in respect of certain aspects relating to the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, the Group's management determines appropriate measurement bases, to provide the most useful information to users of the consolidated financial statements, using their judgement and considering U.S. GAAP.

Annual general meeting

The notice of the 2019 AGM, to be held on 1 May 2019 at the Company's head office, Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda, is contained in a separate circular to shareholders which is made available to shareholders at the same time as this Annual Report and Accounts. The notice of the AGM is also available on the Company's website.

Electronic and web communications

Provisions of the Bermuda Companies Act 1981 enable companies to communicate with shareholders by electronic and/or website communications. The Company will notify shareholders (either in writing or by other permitted means) when a relevant document or other information is placed on the website and a shareholder may request a hard copy version of the document or information.

Going concern and viability statement

The business review section on pages 26 to 32 sets out details of the Group's financial performance, capital management, business environment and outlook. In addition, further discussion of the principal risks and material uncertainties affecting the Group can be found on pages 36 to 39. Starting on page 111, the risk disclosures section of the consolidated financial statements sets out the principal risks to which the Group is exposed, including insurance, market, liquidity, credit, operational and strategic, together with the Group's policies for monitoring, managing and mitigating its exposures to these risks. The Board considers annually and on a rolling basis a three-year strategic plan for the business which the Company progressively implements. A three-year plan period aligns to the short-tail nature of the Group's liabilities and the agility in the business model, allowing the Group to adapt capital and solvency quickly in response to market cycles, events and opportunities. This is consistent with the outlook period in the Group's ORSA report. The three-year strategic plan was last approved by the Board on 25 July 2018. The Board receives quarterly reports from the Group CRO and sets, approves and monitors risk tolerances for the business.

During 2018, the Board carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. As part of this assessment the business plan was stressed for a number of severe but plausible scenarios and the impact on capital (on both an IFRS and Solvency II basis) evaluated. The Directors believe that the Group is well placed to manage its business risks successfully, having taken into account the current economic outlook. Accordingly, the Board believes that, taking into account the Group's current position, and subject to the principal risks faced by the business, the Group will be able to continue in operation and to meet its liabilities as they fall due for the period up to 31 December 2021, being the period considered under the Group's current three-year strategic plan.

The Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 31 December 2021. Accordingly, the Board has adopted and continues to consider appropriate the going concern basis in preparing the Annual Report and Accounts.

Auditors

Resolutions will be proposed at the Company's 2019 AGM to re-appoint KPMG as the Company's auditors and to authorise the Directors to set the auditor's remuneration.

Disclosure of information to the auditors

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

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

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

Christopher Head
Company Secretary

13 February 2019

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Accounts and the Group's consolidated financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that year. The consolidated financial statements have been prepared in accordance with IFRS as adopted by the EU. Where IFRS, as adopted by the EU, is silent, as it is in respect of certain aspects relating to the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, the Group's management 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. Further detail on the basis of preparation is described in the consolidated financial statements. In preparing the consolidated financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Group's consolidated financial statements;
- provide additional disclosures where compliance with the specific requirements of IFRS as adopted by the EU are considered to be insufficient to enable users to understand the impact of particular transactions, events and conditions on the financial position and performance;
- assess the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or to cease operations or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group, and enable them to ensure that the consolidated financial statements comply with applicable laws and regulations. They are also responsible for such internal control as they determine is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error, and also have general responsibility for safeguarding the assets of the Group and hence for taking reasonable steps for prevention and detection of fraud and other irregularities.

Directors' responsibility statement

The Directors confirm that to the best of their knowledge:

- the consolidated financial statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group;
- the Board considers the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; and
- the strategy and the business review sections of this Annual Report and Accounts include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that the Group faces.

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

By order of the Board

13 February 2019

1. Our opinion is unmodified

We have audited the consolidated financial statements of Lancashire Holdings Limited ('the Group') for the year ended 31 December 2018 which comprise the consolidated statement of comprehensive income (loss), the consolidated balance sheet, the consolidated statement of changes in shareholders' equity, the statement of consolidated cash flows, and the related notes, including the accounting policies on pages 104 to 110.

In our opinion the consolidated financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2018 and of its profit for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed entities. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the consolidated financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, were as follows:

Valuation of insurance contract liabilities for losses and loss adjustment expenses on a gross basis and net of outwards reinsurance

($915.0m gross, $592.1m net of outwards reinsurance, of which incurred but not reported represented $389.3m gross, $233.0m net of outwards reinsurance; (2017: $933.5m gross, $649.4m net of outwards reinsurance, of which incurred but not reported represented $446.6m gross, $155.8m net of outwards reinsurance).

Refer to page 62 (Audit Committee report), page 107 (accounting policy) and page 148 to 151 (financial disclosures).

Risk vs 2017: ◄ ►

Risk	Response
The Group maintains reserves to cover the estimated ultimate cost of settling all losses and loss adjustment expenses arising from events which have occurred up to the balance sheet date, regardless of whether those losses have been reported to the Group. **Subjective valuation** Insurance liabilities represent the single largest liability for the Group. Valuation of these liabilities is highly judgemental because it requires a number of assumptions to be made with high estimation uncertainty such as expected loss ratios, estimates of ultimate premium and of the frequency and severity of claims and, where appropriate, the discount rate for longer tail classes of business by territory and line of business. The determination and application of the methodology and performance of the calculations are also complex. These judgemental and complex calculations for insurance liabilities are also used to derive the valuation of the related reinsurance assets. A margin is added to the actuarial best estimate of insurance liabilities to make allowance for specific risks identified in assessment of the best estimate. The appropriate margin to recognise is a subjective judgement and estimate taken by the Directors, based on the perceived uncertainty and potential for volatility in the underlying claims. The effect of these matters is that, as part of our risk assessment, we determined that valuation of gross and net insurance contract liabilities for losses and loss adjustment expenses has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the consolidated financial statements as a whole, and possibly many times that amount. The consolidated financial statements (note 13) discloses the sensitivity estimated by the Group. **Completeness and accuracy of data** The valuation of insurance liabilities depends on complete and accurate data about the volume, amount and pattern of current and historical claims since they are often used to form expectations about future claims. If the data used in calculating the insurance liabilities, or for forming judgements over key assumptions, is not complete and accurate then material impacts on the valuation of insurance liabilities may arise.	We have used our own actuarial specialists to assist us in performing our procedures in this area. Our procedures included: • **Control operation** Tested the design and implementation of key controls around review and approval of reserves as well as completeness and accuracy of the data used in the reserving process. • **Methodology assessment** Assessed and challenged the reserving methodology (on a gross basis and net of outwards reinsurance) based on our knowledge and understanding of the reserving policy within the Group. This has also involved comparing the Group's reserving methodology with industry practice and understanding the rationale for key differences. • **Historical experience** Challenged the quality of the Group's historical reserving estimates by monitoring the development of losses against initial estimates. • **Independent re-performance** Applied our own assumptions, across all classes of business, to perform re-projections on the insurance contract liabilities for loss and loss adjustment expenses on both a gross and net basis and comparing these to the Group's projected results. Where there were significant variances in the results, we have challenged the Group's assumptions. Our independent re-projections focussed on classes of business where losses tend to relate to low frequency high severity events. • **Benchmarking of large losses** Assessed and challenged the reserving assumptions by comparing the Group's loss experience to peers in the market, on a gross and net basis, including on a contract by contract basis for large loss and catastrophe events. • **Data reconciliations** Checked the completeness and accuracy of the data used within the reserving process by reconciling the actuarial source data to their financial systems.

Valuation of premiums which are estimated, included in gross premiums written

(2018: $638.5m, 2017: $591.6m)

Refer to page 59 (Audit Committee report), pages 106 (accounting policy) and pages 134 and 135 (financial disclosures).

Risk vs 2017: ◄ ►

Risk	Response
Subjective valuation Pricing for certain contracts is based on a best estimate of ultimate premiums as a result of premiums being based upon the latest information received from third parties at the balance sheet date. Judgement is involved in determining the ultimate estimates in order to establish the appropriate premium value and, ultimately, the cash to be received. As updated information is received over the life of the contract, adjustments are made to the premium recognised. It should however be noted that it is only a portion of the total gross premiums written figures noted above that are subject to this valuation risk.	Our procedures included: • **Control operation** Tested the design and implementation of key controls over the periodic review of premium estimates booked. • **Historical experience** Performed procedures to understand the development of estimated premium income by comparing the Group's estimated premium income to actual premium income once received and checked actual premium income back to source documentation for a sample of policies.

We continue to perform procedures over policies that are still earning on non-standard earning profiles. However, as the Group's syndicates are now materially earning all 2018 incepted business on straight line earning profiles, we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the consolidated financial statements as a whole was set at $5.1 million (2017: $7.0 million), determined with reference to a benchmark of Group profit before tax normalised by averaging over the last five years due to fluctuations in the frequency and severity of catastrophe loss events, of which it represents 5 per cent (2017: 5 per cent).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding $0.25 million (2017: $0.3 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's 9 (2017: 9) reporting components, including the parent company, UK insurance company, Bermuda insurance company, UK service entity and Lloyd's operations, we subjected 5 (2017: 8) to full scope audits for Group purposes. Including the audit of the consolidation adjustments our scope covered 100 per cent (2017: 100 per cent) of gross premiums written, loss before tax and total assets.

The Group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back.

The Group team approved the component materialities, which ranged from $0.8m to $5.0m (2017: $9,500 to $3.8 million), having regard to the mix of size and risk profile of the Group across the components.

The Group team visited all component locations in Bermuda and the UK (2017: Bermuda and the UK). Video and telephone conference meetings were also held with these component auditors. At these visits and meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

4. We have nothing to report on going concern

The Directors have prepared the consolidated financial statements on the going concern basis as they do not intend to liquidate the Group or to cease their operations, and as they have concluded that the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a period of twelve months from the date of approval of the consolidated financial statements ('the going concern period').

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's business model, including the impact of Brexit, and analysed how those risks might affect the Group's financial resources or ability to continue operations over the going concern period. We evaluated those risks and concluded that they were not significant enough to require us to perform additional audit procedures.

Based on this work, we are required to report to you if we have anything material to add or draw attention to in relation to the Directors' statement in the accounting policies section to the consolidated financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group's use of that basis for a period of at least twelve months from the date of approval of the consolidated financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the Annual Report and Accounts

The Directors are responsible for the other information presented in the Annual Report and Accounts together with the consolidated financial statements. Our opinion on the consolidated financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the consolidated financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Directors' Remuneration Report

In addition to our audit of the consolidated financial statements, the Directors have engaged us to audit the information in the Directors' Remuneration Report that is described as having been audited, which the Directors have decided to prepare as if the Company was required to comply with the requirements of Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410) made under the UK Companies Act 2006.

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the UK Companies Act 2006, as if those requirements applied to the Company.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the Directors' confirmation within viability statement page 93 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks disclosures describing these risks and explaining how they are being managed and mitigated; and
- the Directors' explanation in the viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's longer-term viability.

Corporate governance disclosures

We are required to report to you if we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the Directors' statement that they consider that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or the section of the Annual Report and Accounts describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We are required to report to you if the Corporate Governance Statement does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 94, the Directors are responsible for: the preparation of the consolidated financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

7. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with section 90 of the Bermuda Companies Act 1981 and the terms of our engagement. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and the further matters we are required to state to them in accordance with the terms agreed with the Company and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Rees Aronson
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants

15 Canada Square
London, E14 5GL

13 February 2019

Consolidated statement of comprehensive income (loss)

For the year ended 31 December 2018

	Notes	2018 $m	2017 $m
Gross premiums written	2	**638.5**	591.6
Outwards reinsurance premiums	2	**(220.8)**	(193.6)
Net premiums written		**417.7**	398.0
Change in unearned premiums	2	**(19.7)**	22.6
Change in unearned premiums on premiums ceded	2	**15.5**	7.3
Net premiums earned		**413.5**	427.9
Net investment income	3	**34.7**	30.5
Net other investment (losses) income	3	**(4.2)**	1.2
Net realised (losses) gains and impairments	3	**(5.1)**	9.1
Share of loss of associate	16	**(7.1)**	(9.4)
Other income	5	**12.4**	17.2
Net foreign exchange (losses) gains		**(1.6)**	2.3
Total net revenue		**442.6**	478.8
Insurance losses and loss adjustment expenses	2, 13	**307.4**	538.0
Insurance losses and loss adjustment expenses recoverable	2, 13	**(142.0)**	(202.6)
Net insurance losses		**165.4**	335.4
Insurance acquisition expenses	2, 4	**131.0**	120.7
Insurance acquisition expenses ceded	2, 4	**(4.6)**	(5.1)
Other operating expenses	6, 7, 21	**89.2**	83.6
Equity based compensation	7	**7.9**	(0.4)
Total expenses		**388.9**	534.2
Results of operating activities		**53.7**	(55.4)
Financing costs	8	**20.1**	17.5
Profit (loss) before tax		**33.6**	(72.9)
Tax credit	9	**4.0**	2.3
Profit (loss) for the year		**37.6**	(70.6)
Profit (loss) for the year attributable to:			
Equity shareholders of LHL		**37.5**	(71.1)
Non-controlling interests		**0.1**	0.5
Profit (loss) for the year		**37.6**	(70.6)
Other comprehensive (loss) income to be reclassified to profit or loss in subsequent periods			
Net change in unrealised gains/losses on investments	3, 11	**(12.9)**	4.9
Tax provision on net change in unrealised gains/losses on investments	11	**0.1**	–
Other comprehensive (loss) income		**(12.8)**	4.9
Total comprehensive income (loss) for the year		**24.8**	(65.7)
Total comprehensive income (loss) attributable to:			
Equity shareholders of LHL		**24.7**	(66.2)
Non-controlling interests		**0.1**	0.5
Total comprehensive income (loss) for the year		**24.8**	(65.7)
Earnings (loss) per share			
Basic	22	**$0.19**	($0.36)
Diluted	22	**$0.19**	($0.36)

Consolidated balance sheet

As at 31 December 2018

	Notes	2018 $m	2017 $m
Assets			
Cash and cash equivalents	10, 18	**154.6**	256.5
Accrued interest receivable		**6.8**	6.1
Investments	11, 12, 18	**1,659.0**	1,654.6
Inwards premiums receivable from insureds and cedants	14	**318.1**	297.9
Reinsurance assets			
– Unearned premiums on premiums ceded		**56.7**	41.2
– Reinsurance recoveries	13	**322.9**	284.1
– Other receivables	14	**9.8**	20.7
Other receivables	14	**35.3**	42.4
Investment in associate	12, 16	**67.1**	59.4
Property, plant and equipment		**1.4**	2.6
Deferred acquisition costs		**74.2**	76.7
Intangible assets	17	**153.8**	153.8
Total assets		**2,859.7**	2,896.0
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	13	**915.0**	933.5
– Unearned premiums		**370.6**	350.9
– Other payables		**36.0**	40.7
Amounts payable to reinsurers		**81.3**	65.5
Deferred acquisition costs ceded		**7.1**	2.5
Other payables		**45.4**	48.0
Corporation tax payable		**0.9**	2.8
Deferred tax liability	15	**11.2**	16.5
Interest rate swap	18	**0.4**	2.0
Long-term debt	18	**324.3**	326.3
Total liabilities		**1,792.2**	1,788.7
Shareholders' equity			
Share capital	19	**101.0**	100.7
Own shares	19	**(9.4)**	(12.1)
Other reserves	20	**869.0**	866.2
Accumulated other comprehensive loss	11	**(14.3)**	(1.5)
Retained earnings		**120.9**	153.6
Total shareholders' equity attributable to equity shareholders of LHL		**1,067.2**	1,106.9
Non-controlling interests	23	**0.3**	0.4
Total shareholders' equity		**1,067.5**	1,107.3
Total liabilities and shareholders' equity		**2,859.7**	2,896.0

The consolidated financial statements were approved by the Board of Directors on 13 February 2019 and signed on its behalf by:

Peter Clarke
Director/Chairman

Elaine Whelan
Director/CFO

Consolidated statement of changes in shareholders' equity

For the year ended 31 December 2018

	Notes	Share capital $m	Own shares $m	Other reserves $m	Accumulated other comprehensive loss $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 2016		100.7	(23.2)	881.6	(6.4)	254.6	1,207.3	0.5	1,207.8
Total comprehensive loss for the year		–	–	–	4.9	(71.1)	(66.2)	0.5	(65.7)
Shares donated to the trust	19, 20, 23	–	1.2	(1.2)	–	–	–	–	–
Distributed by the trust	19, 20	–	9.9	(13.8)	–	–	(3.9)	–	(3.9)
Dividends on common shares	19	–	–	–	–	(29.9)	(29.9)	–	(29.9)
Dividends paid to minority interest holders	23	–	–	–	–	–	–	(0.6)	(0.6)
Equity based compensation – credit	20	–	–	(0.4)	–	–	(0.4)	–	(0.4)
Balance as at 31 December 2017		100.7	(12.1)	866.2	(1.5)	153.6	1,106.9	0.4	1,107.3
Total comprehensive income for the year		**–**	**–**	**–**	**(12.8)**	**37.5**	**24.7**	**0.1**	**24.8**
Shares purchased by the trust	19, 20, 23	**0.3**	**(4.6)**	**4.3**	**–**	**–**	**–**	**–**	**–**
Distributed by the trust	19, 20	**–**	**7.3**	**(9.9)**	**–**	**–**	**(2.6)**	**–**	**(2.6)**
Purchase of shares from non-controlling interest	20	**–**	**–**	**(0.1)**	**–**	**–**	**(0.1)**	**(0.2)**	**(0.3)**
Dividends on common shares	19	**–**	**–**	**–**	**–**	**(70.2)**	**(70.2)**	**–**	**(70.2)**
Equity based compensation – expense	20	**–**	**–**	**8.5**	**–**	**–**	**8.5**	**–**	**8.5**
Balance as at 31 December 2018		**101.0**	**(9.4)**	**869.0**	**(14.3)**	**120.9**	**1,067.2**	**0.3**	**1,067.5**

Statement of consolidated cash flows

For the year ended 31 December 2018

	Notes	2018 $m	2017 $m
Cash flows used in operating activities			
Profit (loss) before tax		**33.6**	(72.9)
Tax (paid) refunded		**(3.3)**	1.3
Depreciation	6	**1.4**	1.8
Interest expense on long-term debt	8	**18.1**	16.4
Interest and dividend income		**(36.6)**	(37.1)
Net amortisation of fixed maturity securities		**(0.6)**	2.8
Equity based compensation	7	**7.9**	(0.4)
Foreign exchange (gains) losses		**(4.3)**	9.4
Share of loss of associate	16	**7.1**	9.4
Net other investment loss (income)		**3.9**	(1.2)
Net realised losses (gains) and impairments	3	**5.1**	(9.1)
Net unrealised gains on interest rate swaps		**(1.6)**	(1.7)
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		**(51.5)**	52.0
– Other assets and liabilities		**18.3**	(9.4)
Net cash flows used in operating activities		**(2.5)**	(38.7)
Cash flows (used in) from investing activities			
Interest and dividends received		**35.9**	37.6
Purchase of property, plant and equipment		**(0.2)**	(0.6)
Investment in associate	23	**(14.8)**	(19.1)
Purchase of investments		**(1,143.1)**	(1,196.1)
Proceeds on sale of investments		**1,115.8**	1,209.5
Net cash flows (used in) from investing activities		**(6.4)**	31.3
Cash flows used in financing activities			
Interest paid		**(18.0)**	(16.3)
Dividends paid	19	**(70.2)**	(29.9)
Dividends paid to minority interest holders	23	**–**	(0.6)
Distributions by trust		**(2.6)**	(3.9)
Purchase of shares from non-controlling interest		**(0.3)**	–
Net cash flows used in financing activities		**(91.1)**	(50.7)
Net decrease in cash and cash equivalents		**(100.0)**	(58.1)
Cash and cash equivalents at beginning of year		**256.5**	308.8
Effect of exchange rate fluctuations on cash and cash equivalents		**(1.9)**	5.8
Cash and cash equivalents at end of year	10	**154.6**	256.5

Summary of significant accounting policies

The basis of preparation, use of estimates, consolidation principles and significant accounting policies adopted in the preparation of these consolidated financial statements are set out below.

Basis of preparation

The consolidated financial statements are prepared on a going concern basis in accordance with accounting principles generally accepted under IFRS as adopted by the EU.

Where IFRS is silent, as it is in respect of certain aspects relating to the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, the Group's management 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. In the course of preparing the consolidated financial statements, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimations as noted in the 'Use of Estimates' section below, that have had a significant effect on amounts recognised in the consolidated financial statements.

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

Changes in accounting standards

IFRS 15, Revenue from Contracts with Customers, was effective on 1 January 2018. The adoption of IFRS 15, using the cumulative effect approach, has not had a material impact on the results and disclosures reported in the consolidated financial statements for the year ended 31 December 2018 and is consistent with the Group's previous treatment of other income. While a number of other amended IFRS and IFRIC standards have become effective this year, none of these standards have had a material impact on the Group.

Future accounting changes

IFRS 17, Insurance Contracts, issued in May 2017, specifies the financial reporting for insurance contracts by an insurer. The new standard is currently effective for annual periods beginning on or after 1 January 2021. At its board meeting on 14 November 2018, the IASB tentatively decided to propose an amendment of the IFRS 17 effective date to reporting periods on or after 1 January 2022. The standard includes a number of significant changes regarding the measurement and disclosure of insurance contracts both in terms of liability measurement and profit recognition. The Group will continue to assess the impact that the new standard will have on its results and the presentation and disclosure requirements. IFRS 17 has not yet been endorsed by the EU.

IFRS 9, Financial Instruments: Classification and Measurement, is effective for annual periods beginning on or after 1 January 2018. The amendments to IFRS 4, Insurance Contracts, issued in 2016, provide a temporary exemption from applying IFRS 9. The Group qualifies for, and has elected to apply, the temporary exemption available to companies whose predominant activity is to issue insurance contracts. The exemption lasts until accounting periods beginning on or after 1 January 2022, subject to the proposed deferral of IFRS 17 as noted above, and addresses the accounting consequences of applying IFRS 9 to insurers prior to the adoption of IFRS 17, Insurance Contracts. IFRS 9 introduces new classification and measurement requirements for financial instruments, an expected credit loss impairment model that replaces the IAS 39 incurred loss model and new hedge accounting requirements. Applying the new requirements of IFRS 9, the Group currently anticipates that all investments held by the Group will be classified as at FVTPL (mandatory), because they are managed on a fair value basis. As a result all investments currently disclosed in Note 11 as AFS will be reclassified as at FVTPL (mandatory) with changes in unrealised gains (losses) currently recorded within other comprehensive (loss) income to be reclassified and recorded within net investment income in profit or (loss). The reclassification from AFS to FVTPL (mandatory) will not result in a change in the carrying value of the investments disclosed in Note 11 of the consolidated financial statements. Further implications from the change in classification from AFS to FVTPL (mandatory) will be that balances within accumulated other comprehensive loss will be reclassified to retained earnings on the date of transition.

IFRS 16, Leases, is effective for annual periods beginning on or after 1 January 2019 and replaces the existing lease standard IAS 17. IFRS 16 introduces a single on-balance sheet accounting model for both finance and operating leases. The adoption of the standard results in the recognition of a right-of-use asset and associated lease liability on the balance sheet. In addition, the current operating lease rental charges in the consolidated statement of comprehensive income (loss) will be replaced with a depreciation charge for the right-of-use asset and an interest expense for the lease liabilities. IFRS 16 will be adopted by the Group on 1 January 2019 using the fully retrospective transition approach. The estimated $1.8 million cumulative effect of adopting IFRS 16 will be recognised in the consolidated financial statements for the year ending 31 December 2019 as a credit to the opening balance of retained earnings as at 1 January 2018, with a re-statement of comparative information.

The consolidated balance sheet 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, both gross and net of outwards reinsurance recoverable. This is discussed on page 106 and 107 and also in the risk disclosures section from page 118.

Less significant estimates are made in determining the estimated fair value of certain financial instruments and management judgement is applied in determining impairment charges. The estimation of the fair value of financial instruments is discussed on pages 107 and 108 and in note 11.

Whilst not significant, estimates are also utilised in the valuation of intangible assets. The fair value of intangible assets recognised on the acquisition of a subsidiary is largely based on the estimated expected cash flows of the business acquired and the contractual rights of that business. The assumptions made by management in performing annual 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 17.

Consolidation principles

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at and for the year ended 31 December 2018. 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. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary.

The Group participates in two syndicates at Lloyd's, which are managed by the Group's managing agent subsidiary. In view of the several liability of underwriting members at Lloyd's, the Group recognises its proportion of all the transactions undertaken by the syndicates in which it participates within its consolidated statement of comprehensive income (loss). Similarly, the Group's proportion of the syndicates' assets and liabilities has been reflected in its consolidated balance sheet. This proportion is calculated by reference to the Group's participation as a percentage of each syndicate's total capacity for each year of account.

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.

Associate

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 or (loss) from such investments in its consolidated statement of comprehensive income (loss) for the period. Adjustments are made to associate accounting policies, where necessary, in order to be consistent with the Group's accounting policies.

Foreign currency

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

Foreign currency transactions are recorded in the functional currency for each entity using the exchange rates prevailing at the dates of the transactions, or at the average rate for the period when this is a reasonable approximation. Monetary assets and liabilities denominated in foreign currencies are revalued at period end exchange rates. The resulting exchange differences on revaluation are recorded in the consolidated statement of comprehensive income (loss) within net foreign exchanges (losses)gains. Non-monetary assets and liabilities denominated in a foreign currency are carried at historic rates. Non-monetary assets and liabilities carried at estimated fair value and denominated in a foreign currency are translated at the exchange rate at the date the estimated fair value was determined.

Intangible assets

The Group's intangible assets comprise syndicate participation rights and goodwill. The cost of syndicate participation rights and goodwill 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 their 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 at least 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 CGU and related intangible assets. Such intangible assets 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.

Syndicate participation rights and goodwill are considered to have an indefinite life.

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, premiums written are 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, premiums written are recognised based on estimates of ultimate premiums provided by the insureds or ceding companies. Initial estimates of premiums written 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 written 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 premiums written when a specific loss event occurs. Reinstatement premiums are not recorded for losses included within the provision for IBNR that 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 regularly 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 the 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 for 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 and ACR, including the provision for IBNR and related expenses. Losses and loss adjustment expenses are charged to profit or loss as they are incurred.

Losses and loss adjustment expenses represent the estimated ultimate cost of settling all insurance claims 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 reported losses received from third parties. ACR 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 the Group's own loss experience, historical insurance industry loss experience, underwriters' experience, estimates of pricing adequacy trends and management's professional judgement.

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.

The estimation of the ultimate loss and loss adjustment expense liability 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 estimated losses and loss adjustment expenses.

Liability adequacy tests

At each balance sheet date, the Group performs a liability adequacy test to determine if there is an overall excess of expected claims over unearned premiums for the period of unexpired risk by 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 maturity and equity securities include quoted and unquoted investments that are classified as either AFS or at FVTPL and are carried at estimated fair value. The classification of the Group's financial assets is determined at the time of initial purchase and depends on the nature of the investment. A financial asset is classified at FVTPL if it is managed and evaluated on a fair value basis and if acquired principally for the purpose of selling in the short term, or if it forms part of a portfolio of financial assets in which there is evidence of short-term profit taking. Equity securities classified as AFS are those that are neither classified as held for trading nor designated at FVTPL. Fixed maturity securities classified as AFS are those that are intended to be held for an indefinite period, the composition, duration and allocation of these investments are reviewed by management on a regular basis in order to respond to needs for liquidity, changes in interest rates and other market conditions. The Group has elected to carry certain fixed maturity securities at FVTPL upon initial recognition. This category includes instruments in which the cash flows are linked to the performance of an underlying pool of securities. Presentation of these securities in the FVTPL category is consistent with how management monitors and evaluates the performance of these securities.

The Group's hedge funds are unquoted investments classified at FVTPL and are carried at estimated fair value. Estimated fair values are determined using a combination of the most recent NAVs provided by each fund's independent administrator and the estimated performance provided by each hedge fund manager.

Regular way purchases and sales of investments are recognised at estimated fair value including, in the case of investments not carried at FVTPL, transaction costs attributable to the acquisition of that investment on the trade date and are subsequently carried at estimated fair value. The estimated fair values of quoted and unquoted investments are determined based on bid prices from recognised exchanges, broker-dealers, recognised indices or pricing vendors. Unrealised gains and losses from changes in the estimated fair value of AFS investments are included in accumulated other comprehensive loss in shareholders' equity. Changes in estimated fair value of investments classified at FVTPL are recognised in the consolidated statement of comprehensive income (loss) within net other investment (losses) income.

Investments are derecognised when the Group has transferred substantially all of the risks and rewards of ownership. On derecognition of an AFS investment, previously recorded unrealised gains and losses are recycled from accumulated other comprehensive loss in shareholders' equity and included in the consolidated statement of comprehensive income (loss) as a realised gain or loss within net realised (losses) gains and impairments.

Amortisation and accretion of premiums and discounts on AFS fixed maturity 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 income on the date the dividends become payable to the holders of record.

The Group regularly reviews the carrying value of its AFS investments for evidence of impairment. 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 loss in shareholders' equity and charged to current period profit or loss. Impairment losses on fixed maturity securities may be subsequently reversed through profit or loss while impairment losses on equity securities are not subsequently reversed through profit or loss.

Derivative financial instruments

Derivatives are classified as financial assets or liabilities at FVTPL. They are initially 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 derivative instruments are recognised in the consolidated statement of comprehensive income (loss) within net other investment(losses) income. The Group does not currently 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

Other income is measured based on the consideration specified in a contract and excludes amounts collected on behalf of third parties.

Nature of services

The table below details the type of services from which the Group derives its other income.

Services	Nature, timing of satisfaction of performance obligation and significant payment terms
Kinesis underwriting fees	The Group recognises underwriting fees over the underwriting cycle based on the underlying exposure of the covered contracts. Underwriting fees are received by or before the collateral funding date, which is prior to commencement of the underwriting cycle.
Kinesis profit commission	The Group recognises profit commission following the end of the underwriting cycle based on the underlying performance of the covered contracts and as collateral is released. Profit commissions may only be received once the profit commission hurdle has been met.
Lloyd's consortium management fees	The Group recognises consortium fees over the risk period based on the underlying exposure of the covered contracts. Consortium fees are received quarterly.
Lloyd's consortium profit commission	The Group recognises profit commission in line with the underlying performance of covered contracts once the year of account closes, which is also when the profit commissions are received.
Lloyd's managing agency fees	The Group recognises managing agency fees in line with services provided for each year of account. Managing agency fees are received quarterly.
Lloyd's managing agency profit commission	The Group recognises profit commission on open years of account when measurement is virtually certain. Profit commissions are received once the year of account closes.

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 (loss). Costs for repairs and maintenance are charged to profit or loss as incurred.

Leases

Rentals payable under operating leases are charged to profit or loss 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 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 that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, as equity based compensation expense (credit) in the consolidated statement of comprehensive income (loss), 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 (loss) and the actual cost to the Group, if any, is transferred to other reserves in shareholders' equity.

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 (loss) in the period when the services are rendered.

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 using tax rates and tax laws enacted or substantively enacted at the year end reporting date and any adjustments to tax payable in respect of prior periods. Taxable profit for the period can differ from that reported in the consolidated statement of comprehensive income (loss) due to non-taxable income and 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 and are reassessed each year for recognition.

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 differs from 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, classified into six primary risk categories. These are 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 framework is to ensure that the capital resources held are matched to the risk profile of the Group and that the balance between risk and return 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 for risk will vary marginally from time to time to reflect the potential risks and returns that present themselves. However, protecting the Group's capital and maximising risk-adjusted returns for investors 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 modelled 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 Board and individual entity boards of directors review actual risk levels versus tolerances, emerging risks and any risk learning events at least quarterly. In addition, on at least a monthly basis, management reviews the output from SHARP in order to assess modelled potential losses against risk tolerances and ensure that risk levels are managed in accordance with them.

Economic capital models

The Group maintains economic capital models at the LICL, LUK and syndicate levels. These models are primarily focused on insurance risks, however they are also used to model other risks including market, credit and operational risks. The syndicate models are vetted by Lloyd's as part of its own capital and solvency regulations.

The economic capital models produce data in the form of stochastic distributions for all classes, including non-elemental classes. The distributions include the mean outcome and the result at various return periods, including very remote events. Projected financial outcomes for each insurance class are calculated, 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.

The six primary risk categories are discussed in detail on pages 112 to 133.

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 segment level, a geographic level and at an aggregate portfolio level. This ensures that careful risk selection, limits on concentration and appropriate portfolio diversification are accomplished. The four principal classes of business for the Group, excluding the Lloyd's segment, are Property, Energy, Aviation and Marine. These classes, plus the Group's Lloyd's segment, are deemed to be the Group's five operating segments. The level of insurance risk tolerance per peril is set by the Board and the boards of directors at individual entity level.

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 overriding 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;
- for Cathedral, the syndicates' business forecast and business plan are subject to review and approval by Lloyd's;
- BLAST, SHARP and Cathedral's internal models are used to measure occurrence risks, aggregate risks and correlations between classes and other non-insurance risks;
- each authorised class has a predetermined normal maximum line structure;
- each underwriter has a clearly defined limit of underwriting authority;
- the Group and individual operating entities have predetermined tolerances on probabilistic and deterministic losses of capital for certain single events;
- 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 modelling 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.

Some of the Group's business provides coverage for natural catastrophes (e.g. hurricanes, earthquakes, wildfires and floods) and is subject to potential seasonal variation and the effects of climate change. 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 associate bears exposure to catastrophe losses and any significant loss event could potentially result in impairment in the value of the Group's investment in associate.

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 to the investment in associate is included in the figures below.

		100 year return period estimated net loss		250 year return period estimated net loss	
As at 31 December 2018		$m	% of tangible capital	$m	% of tangible capital
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	**163.2**	**13.2**	**242.8**	**19.6**
Non-Gulf of Mexico – U.S.	Hurricane	**110.2**	**8.9**	**241.6**	**19.5**
California	Earthquake	**78.0**	**6.3**	**129.5**	**10.5**
Pan-European	Windstorm	**70.7**	**5.7**	**118.0**	**9.5**
Japan	Earthquake	**45.0**	**3.6**	**81.2**	**6.6**
Japan	Typhoon	**36.3**	**2.9**	**49.1**	**4.0**
Pacific North West	Earthquake	**22.7**	**1.8**	**73.1**	**5.9**

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 2017		$m	% of tangible capital	$m	% of tangible capital
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	173.8	13.6	253.6	19.8
Non-Gulf of Mexico – U.S.	Hurricane	140.9	11.0	306.5	24.0
California	Earthquake	96.1	7.5	181.1	14.2
Pan-European	Windstorm	77.2	6.0	125.1	9.8
Japan	Earthquake	46.6	3.6	85.6	6.7
Japan	Typhoon	51.6	4.0	68.1	5.3
Pacific North West	Earthquake	33.1	2.6	79.6	6.2

1. Landing hurricane from Florida to Texas.

There can be no guarantee that the modelled assumptions and techniques deployed in calculating these figures are accurate. There could also be an unmodelled loss which exceeds these figures. In addition, any modelled loss scenario could cause a larger loss to capital than the modelled expectation.

Details of annual gross premiums written by geographic area of risks insured are provided below:

	2018		2017	
	$m	%	$m	%
U.S. and Canada	**188.2**	**29.5**	177.6	30.0
Worldwide, including the U.S. and Canada[1]	**129.8**	**20.3**	98.6	16.7
Worldwide offshore	**118.6**	**18.6**	162.5	27.5
Europe	**51.3**	**8.0**	38.9	6.6
Far East	**29.0**	**4.5**	27.9	4.7
Worldwide, excluding the U.S. and Canada[2]	**13.4**	**2.1**	11.5	1.9
Middle East	**8.2**	**1.3**	6.9	1.2
Rest of world	**100.0**	**15.7**	67.7	11.4
Total	**638.5**	**100.0**	591.6	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:

	2018		2017	
	$m	%	$m	%
Lloyd's	**256.8**	**40.2**	207.3	35.0
Property	**214.6**	**33.6**	198.0	33.5
Energy	**103.0**	**16.1**	101.8	17.2
Aviation	**33.0**	**5.2**	16.9	2.9
Marine	**31.1**	**4.9**	67.6	11.4
Total	**638.5**	**100.0**	591.6	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. Lloyd's

Gross premiums written, for the year:

	2018 $m	2017 $m
Property reinsurance	**82.3**	88.5
Property direct and facultative	**74.4**	56.1
Other aviation and satellite	**37.7**	25.0
Marine cargo	**31.9**	22.5
Energy	**19.0**	10.8
Aviation deductible	**6.4**	–
Terrorism	**5.1**	4.4
Total	**256.8**	207.3

Property reinsurance predominantly includes property catastrophe excess of loss, property per risk excess of loss and property retrocession lines of business. Property catastrophe excess of loss and property 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.

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.

Other aviation and satellite includes aviation reinsurance, aviation war, general aviation, airlines hull and liability and 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 whilst the airlines hull and liability line provides cover to the airlines directly. Both lines include cover for the aircraft themselves as well as losses arising from passenger and third-party liability claims against airlines and/or manufacturers. Aviation war covers loss or damage to aviation assets from war, terrorism and similar causes. General aviation covers fixed wing and rotor wing aircraft, typically with 50 passenger seats or less, and covers both commercial and private clients. A significant part of the 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.

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.

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, well control, 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 risk carriers. Construction energy contracts generally cover all risks of platforms, FPSO and drilling units under construction at yard and offshore, during towing and installation. Onshore construction contracts are generally not written. Power generation and utility business can be written either ground-up or on a primary or excess basis. The core composition of the portfolio is operational conventional thermal power generation, renewable energy and associated transmission & distribution assets. Midstream exposures encompass the onshore movements of electricity, oil, gas and water and can include treatment and processing plants. Risks associated with the processing or refining of oil or petroleum by-products are excluded. Our underwriting appetite targets well engineered and operated power and midstream opportunities, whilst carefully balancing the associated natural catastrophe and business interruption exposures.

Aviation deductible business is a specialist area with small individual limits normally up to $1.0 million and covers the deductible the airline would normally have for each and every loss under the terms of their airline policy.

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, biological and cyber 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 may be multi-year, reflecting the term of the underlying exposures.

Reinsurance may be purchased to reduce the exposure to large risk losses and large natural catastrophe losses in the U.S., Canada and worldwide with certain exclusions. Reinsurance may also be purchased to mitigate an accumulation of smaller, attritional losses. Reinsurance may be purchased on a facultative, excess of loss treaty or proportional treaty basis.

II. Property

Gross premiums written, for the year:

	2018 $m	2017 $m
Property catastrophe excess of loss	**103.7**	101.9
Terrorism	**41.3**	34.9
Property political risk	**35.4**	31.1
Property risk excess of loss	**15.0**	12.9
Property retrocession	**10.0**	10.0
Other property	**9.2**	7.2
Total	**214.6**	198.0

Property catastrophe excess of loss covers elemental risks and is written on an excess of loss treaty basis. The property catastrophe excess of loss portfolio is written within the U.S. and also internationally. Cover is offered for specific perils and regions or countries.

Terrorism business can be written either ground-up or for primary or excess layers, with cover provided for U.S. and worldwide property risks, but typically excluding nuclear, chemical, biological and cyber 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 and may have an element of life 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 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.

Property risk excess of loss is written on an excess of loss basis through UNL treaty arrangements, predominantly covering fire and allied perils in addition to natural catastrophe exposure. The portfolio is written on a worldwide basis, with particular focus on the U.S. market.

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.

The Group is exposed to large natural catastrophe losses, such as windstorm and earthquake losses, 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 modelling. The accuracy of the latter exposure analysis is limited by the quality of data and the effectiveness of the modelling. It is possible that a catastrophic event significantly exceeds the expected modelled event loss. The Group's appetite and exposure guidelines for large losses are set out on pages 112 and 113.

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.

III. Energy

Gross premiums written, for the year:

	2018 $m	2017 $m
Worldwide offshore energy	**63.8**	66.6
Onshore energy	**14.6**	3.5
Gulf of Mexico offshore energy	**10.6**	24.4
Construction energy	**4.1**	(1.1)
Energy liabilities	**3.1**	3.0
Other energy	**6.8**	5.4
Total	**103.0**	101.8

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 risk carriers.

Onshore energy risks can include onshore Gulf of Mexico and worldwide energy installations and are largely subject to the same loss events as the Gulf of Mexico offshore energy programmes.

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 modelling. The accuracy of this exposure analysis is limited by the quality of data and the effectiveness of the modelling. It is possible that a catastrophic event significantly exceeds the expected modelled event loss. The Group's appetite and exposure guidelines to large losses are set out on pages 112 and 113.

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 writes energy liability business on a standalone basis. Unlike the liability contained within the energy packages that Lancashire writes, standalone 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.

IV. Aviation

Gross premiums written, for the year:

	2018 $m	2017 $m
AV52	**19.4**	16.8
Aviation deductible	**11.1**	–
Other aviation	**2.5**	0.1
Total	**33.0**	16.9

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 countries whose governments provide a backstop coverage, but does include some U.S. commercial airlines.

Aviation deductible business is a specialist area with small individual limits normally up to $1.0 million and covers the deductible the airline would normally have for each and every loss under the terms of their airline policy.

Reinsurance may be purchased to mitigate exposures to an AV52 event loss. Reinsurance is typically purchased on a treaty excess of loss basis. Quota share reinsurance is typically used to reduce the Group's exposure to aviation deductible business.

V. Marine

Gross premiums written, for the year:

	2018 $m	2017 $m
Marine hull and total loss	**14.0**	20.0
Marine P&I clubs	**7.3**	10.1
Marine builders' risk	**6.0**	13.9
Marine hull war	**5.5**	7.1
Marine excess of loss	**(3.9)**	13.4
Other marine	**2.2**	3.1
Total	**31.1**	67.6

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 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. Marine hull war is mostly direct insurance of loss of vessels from war, piracy or terrorist attack, with a very limited amount of facultative reinsurance. Marine excess of loss is written on a treaty basis and covers ocean and inland marine risks.

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 and to the costs for removal of wrecks.

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.

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 modelled 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 RSC 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 RSC monitors the Group's 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. 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 and other 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 with varying cover and attachment points. The reinsurance coverage is not intended to be available to meet all potential loss circumstances. The Group will retain some losses, as the cover purchased is unlikely 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

The most significant judgement made by management is the estimation of losses and loss adjustment expenses. 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 GAAP, 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 of the Group's reserves are reported on an undiscounted basis.

Losses and loss adjustment expenses 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. This 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 independent review by external actuaries. The results of the independent review are 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, monitoring their development and approving any changes in reserving methodology and assumptions.

The extent to which the reserving process relies on management's judgement is dependent on a number of factors including 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 pro-rata basis. Generally, the Group writes most of its business on a direct excess of loss basis and the Group does not currently write a significant amount of long-tail business.

Insurance versus reinsurance

Loss reserve calculations, whether reserving for direct insurance business or for reinsurance classes, 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. The estimates and judgements relied on in making loss reserve calculations are based on a number of factors and may be revised as additional experience or other data becomes available. Loss reserve calculations are also reviewed as new or improved methodologies are developed and as laws or regulations change.

Furthermore, as a business operating within a broker market, 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 management's estimates 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. 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.

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 2018, management's estimates for IBNR represented 39.3 per cent of total net loss reserves (31 December 2017 – 44.8 per cent). The estimate relates to catastrophe events during recent years, in addition to potential claims on non-elemental risks where timing delays in insured or cedant reporting may mean losses could have occurred of which the Group was not made aware 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, including unusual inflation in rates, may result in a limit in the availability of cover, 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;
- changes in regulation including capital, governance or licensing requirements; and
- changes in the geopolitical environment including the UK's impending exit from the EU and the implications for business passporting within the EEA.

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 exposures;
- closely monitors changes in rates and terms and conditions;
- ensures through continuous capital management that it does not allow surplus capital to drive underwriting appetite;
- 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;
- reviews outputs 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 RDSs; and
- holds regular 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 asset classes, duration ranges, credit quality, currency, maturity, sectors, geographical, sovereign and issuer exposures. Compliance with guidelines is monitored on a monthly basis. Any adjustments to the investment guidelines are approved by the Investment Committee and the Board of Directors.

The Group's fixed maturity portfolios are managed by five external investment managers. The Group also has a diversified low volatility multi-strategy portfolio of hedge funds and a small equity portfolio. The performance of the managers is monitored on an ongoing basis.

Within the Group's investment guidelines are subsets of guidelines for the portion of funds required to meet near-term obligations and cash flow needs following an extreme event. These guidelines add 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 and core plus portfolios and the portfolio duration is matched to the duration of the insurance liabilities, within an agreed range. The core and core plus portfolios are invested in fixed maturity securities, fixed maturity funds and cash and cash equivalents. The combined core and core plus portfolios 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 and core plus portfolios are typically held in the surplus portfolio. The surplus portfolio is invested in fixed maturity securities, principal protected equity-linked notes, derivative instruments, cash and cash equivalents, equity securities and hedge funds. In general, the duration of the surplus portfolio is slightly longer than the core or core plus portfolio.

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

The investment portfolio is currently structured to perform similarly in risk-on and risk-off environments. The Group endeavours to limit losses in risk-on, risk-off and interest rate hike scenarios. The Group models various periods of significant stress in order to better understand the investment portfolio's risks and exposures. The 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 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 maturity portfolios is as follows:

As at 31 December 2018	Core $m	Core %	Core plus $m	Core plus %	Surplus $m	Surplus %	Total $m	Total %
– Short-term investments	**48.1**	**3.2**	**175.6**	**11.8**	**1.8**	**0.1**	**225.5**	**15.1**
– Fixed maturity funds	**11.4**	**0.8**	**–**	**–**	**–**	**–**	**11.4**	**0.8**
– U.S. treasuries	**69.6**	**4.7**	**113.1**	**7.6**	**3.9**	**0.3**	**186.6**	**12.6**
– Other government bonds	**15.9**	**1.0**	**29.5**	**2.0**	**13.3**	**0.9**	**58.7**	**3.9**
– U.S. municipal bonds	**1.0**	**0.1**	**4.4**	**0.3**	**–**	**–**	**5.4**	**0.4**
– U.S. government agency debt	**13.1**	**0.9**	**69.6**	**4.7**	**5.4**	**0.4**	**88.1**	**6.0**
– Asset backed securities	**16.5**	**1.1**	**62.2**	**4.2**	**50.6**	**3.4**	**129.3**	**8.7**
– U.S. government agency mortgage backed securities	**4.8**	**0.3**	**15.0**	**1.0**	**60.1**	**4.0**	**79.9**	**5.3**
– Non-agency mortgage backed securities	**3.8**	**0.3**	**10.4**	**0.7**	**6.9**	**0.5**	**21.1**	**1.5**
– Agency commercial mortgage backed securities	**–**	**–**	**1.9**	**0.1**	**3.3**	**0.2**	**5.2**	**0.3**
– Non-agency commercial mortgage backed securities	**0.4**	**–**	**–**	**–**	**0.1**	**–**	**0.5**	**–**
– Bank loans	**–**	**–**	**–**	**–**	**109.1**	**7.3**	**109.1**	**7.3**
– Corporate bonds	**200.1**	**13.5**	**277.9**	**18.7**	**43.6**	**2.9**	**521.6**	**35.1**
Total fixed maturity securities – AFS	**384.7**	**25.9**	**759.6**	**51.1**	**298.1**	**20.0**	**1,442.4**	**97.0**
Fixed maturity securities – at FVTPL	**–**	**–**	**–**	**–**	**45.0**	**3.0**	**45.0**	**3.0**
Total fixed maturity securities	**384.7**	**25.9**	**759.6**	**51.1**	**343.1**	**23.0**	**1,487.4**	**100.0**

As at 31 December 2017	Core $m	Core %	Core plus $m	Core plus %	Surplus $m	Surplus %	Total $m	Total %
– Short-term investments	8.8	0.6	98.7	6.7	3.6	0.2	111.1	7.5
– Fixed maturity funds	31.0	2.1	–	–	–	–	31.0	2.1
– U.S. treasuries	100.7	6.8	118.2	8.0	16.8	1.1	235.7	15.9
– Other government bonds	16.4	1.1	13.4	0.9	41.6	2.8	71.4	4.8
– U.S. municipal bonds	1.9	0.1	4.1	0.3	–	–	6.0	0.4
– U.S. government agency debt	17.1	1.2	34.5	2.3	18.9	1.3	70.5	4.8
– Asset backed securities	15.9	1.1	56.7	3.8	71.4	4.8	144.0	9.7
– U.S. government agency mortgage backed securities	8.4	0.6	22.4	1.5	110.2	7.6	141.0	9.7
– Non-agency mortgage backed securities	2.2	0.1	3.3	0.2	7.7	0.5	13.2	0.8
– Non-agency commercial mortgage backed securities	–	–	0.2	–	–	–	0.2	–
– Bank loans	–	–	–	–	106.7	7.2	106.7	7.2
– Corporate bonds	168.7	11.4	264.7	18.0	88.0	6.0	521.4	35.4
Total fixed maturity securities – AFS	371.1	25.1	616.2	41.7	464.9	31.5	1,452.2	98.3
Fixed maturity securities – at FVTPL	–	–	–	–	25.7	1.7	25.7	1.7
Total fixed maturity securities	371.1	25.1	616.2	41.7	490.6	33.2	1,477.9	100.0

Bank loans, corporate bonds, fixed maturity securities at FVTPL and other government bonds by country are as follows:

As at 31 December 2018	Financials $m	Other industries $m	Total[1] $m	Other government bonds $m	Total[2] $m
United States	171.7	295.7	467.4	–	467.4
United Kingdom	33.3	18.7	52.0	0.1	52.1
Canada	10.7	10.9	21.6	19.8	41.4
Japan	17.9	7.8	25.7	–	25.7
Netherlands	4.6	8.6	13.2	7.2	20.4
France	13.0	2.2	15.2	1.8	17.0
Switzerland	7.8	7.5	15.3	–	15.3
Germany	1.7	3.3	5.0	7.5	12.5
Spain	9.8	0.7	10.5	–	10.5
Sweden	4.1	–	4.1	6.1	10.2
Denmark	4.9	–	4.9	3.4	8.3
Supranational	7.0	–	7.0	–	7.0
Australia	6.8	–	6.8	–	6.8
Italy	1.5	3.5	5.0	–	5.0
Belgium	–	4.0	4.0	0.5	4.5
Other	5.2	12.8	18.0	12.3	30.3
Total	300.0	375.7	675.7	58.7	734.4

1. Includes bank loans, corporate bonds and fixed maturity securities at FVTPL.
2. Includes bank loans, corporate bonds, fixed maturity securities at FVTPL and other government bonds.

As at 31 December 2017	Financials $m	Other industries $m	Total[1] $m	Other government bonds $m	Total[2] $m
United States	183.4	300.2	483.6	–	483.6
Canada	13.4	13.6	27.0	19.3	46.3
United Kingdom	15.5	12.3	27.8	2.0	29.8
Netherlands	9.6	10.4	20.0	6.3	26.3
Germany	5.2	5.7	10.9	13.9	24.8
France	15.0	3.5	18.5	5.1	23.6
Australia	14.5	0.2	14.7	1.0	15.7
Japan	12.6	2.6	15.2	–	15.2
Sweden	6.9	–	6.9	5.1	12.0
Luxembourg	1.5	5.3	6.8	–	6.8
Denmark	2.1	0.3	2.4	3.9	6.3
Switzerland	3.0	2.6	5.6	–	5.6
India	–	–	–	4.2	4.2
Spain	3.5	0.7	4.2	–	4.2
China	–	1.2	1.2	2.7	3.9
Other	5.9	3.1	9.0	7.9	16.9
Total	292.1	361.7	653.8	71.4	725.2

1. Includes bank loans, corporate bonds and fixed maturity securities at FVTPL.
2. Includes bank loans, corporate bonds, fixed maturity securities at FVTPL and other government bonds.

The sector allocation of bank loans, corporate bonds and fixed maturity securities at FVTPL is as follows:

	2018		2017	
As at 31 December	$m	%	$m	%
Industrial	**344.8**	**51.0**	329.1	50.3
Financial	**293.0**	**43.4**	289.5	44.3
Utility	**30.9**	**4.6**	32.6	5.0
Supranationals	**7.0**	**1.0**	2.6	0.4
Total	**675.7**	**100.0**	653.8	100.0

The Group's net asset value is directly impacted by movements in the fair value of investments held. Values can be impacted by movements in interest rates, credit ratings, exchange rates, current economic environment and outlook.

The Group's investment portfolio is mainly comprised of fixed maturity securities and cash and cash equivalents. Fixed maturity funds are overseas deposits held by the syndicates in trust for the benefit of the policyholders in those overseas jurisdictions. They consist of high quality, short duration fixed maturity securities. The Group also has a hedge fund portfolio as well as a small equity portfolio. The estimated fair value of the Group's fixed maturity portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's fixed maturity securities would tend to rise and vice versa.

The sensitivity of the price of fixed maturity 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 maturity and derivative investment portfolio to interest rate movements is detailed below, assuming linear movements in interest rates:

	2018		2017	
As at 31 December	$m	%	$m	%
Immediate shift in yield (basis points)				
100	**(22.4)**	**(1.5)**	(28.5)	(1.9)
75	**(16.8)**	**(1.1)**	(21.4)	(1.4)
50	**(11.2)**	**(0.8)**	(14.3)	(1.0)
25	**(5.6)**	**(0.4)**	(7.1)	(0.5)
(25)	**6.4**	**0.4**	7.2	0.5
(50)	**12.7**	**0.9**	14.4	1.0
(75)	**19.1**	**1.3**	21.6	1.5
(100)	**25.5**	**1.7**	28.8	1.9

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 modelled 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 for the surplus portfolio is between one and five years.

The total durations of the externally managed portfolios, which are comprised of fixed maturity, cash and cash equivalents and certain derivatives, are as follows:

As at 31 December	2018 years	2017 years
Core portfolio	**1.8**	1.7
Core plus portfolio	**1.7**	1.7
Surplus portfolio[1]	**1.3**	2.0
Overall external portfolio[1]	**1.6**	1.8

1. Including duration overlay.

The overall duration for fixed maturity, managed cash and cash equivalents and certain derivatives is 1.5 years (2017 – 1.7 years).

In addition to duration management, the Group monitors VaR 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 modelling to capture the cash flows and embedded optionality of the portfolio. Securities are valued individually using standard market 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. Under normal conditions, the portfolio is not expected to lose more than the VaR metric listed in the table below, 99 per cent of the time over a one-year time horizon.

The Group's annual VaR calculations are as follows:

As at 31 December	2018 $m	2018 % of shareholders' equity	2017 $m	2017 % of shareholders' equity
99th percentile confidence level[1]	**26.0**	**2.4**	27.0	2.4

1. Including the impact of internal foreign exchange hedges.

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 OTC or exchange-traded 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. Futures;

b. Options;

c. Forward foreign currency contracts; and

d. Swaps.

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

As at 31 December 2018	Net realised losses $m	Net foreign exchange gains $m	Financing gains $m
Interest rate futures	**(1.0)**	–	–
Forward foreign currency contracts	–	**1.6**	–
Interest rate swaps	–	–	**0.9**
Total	**(1.0)**	**1.6**	**0.9**

As at 31 December 2017	Net realised losses $m	Net foreign exchange losses $m	Financing gains $m
Interest rate futures	(0.7)	–	–
Forward foreign currency contracts	–	(0.7)	–
Total	(0.7)	(0.7)	–

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

As at 31 December	2018 Other investments $m	2018 Other receivables $m	2018 Other payables $m	2018 Interest rate swaps $m	2017 Other investments $m	2017 Other receivables $m	2017 Other payables $m	2017 Interest rate swaps $m
Forward foreign currency contracts	**(0.3)**	**1.1**	**(1.0)**	–	(0.5)	1.6	(0.1)	–
Interest rate swaps	–	–	–	**(0.4)**	–	–	–	(2.0)
Total	**(0.3)**	**1.1**	**(1.0)**	**(0.4)**	(0.5)	1.6	(0.1)	(2.0)

A. 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 maturity 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.

The Group's exposure to interest rate futures are as follows:

	2018			2017		
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
Interest rate futures	**69.1**	**94.1**	**(25.0)**	100.1	103.5	(3.4)
Total	**69.1**	**94.1**	**(25.0)**	100.1	103.5	(3.4)

B. Options

The Group's investment guidelines permit the use of exchange-traded options on U.S. treasury futures and Euro dollar 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 $nil as at 31 December 2018 and 2017.

The investment guidelines also restrict the maximum notional options exposure as a percentage of the investment portfolio's estimated fair value.

C. 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, debt, insurance related currency exposures and/or expenses.

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:

	2018			2017		
As at 31 December	Notional long $m	Notional short $m	Net notional long (short) $m	Notional long $m	Notional short $m	Net notional long (short) $m
Canadian Dollar	**–**	**20.3**	**(20.3)**	–	26.9	(26.9)
Euro	**22.9**	**38.0**	**(15.1)**	24.0	44.6	(20.6)
Australian Dollar	**–**	**5.8**	**(5.8)**	–	7.2	(7.2)
Japanese Yen	**–**	**3.6**	**(3.6)**	–	3.9	(3.9)
Swedish Krona	**–**	**2.8**	**(2.8)**	–	3.0	(3.0)
Mexican Peso	**0.7**	**–**	**0.7**	1.7	–	1.7
Malaysian Ringgit	**3.9**	**–**	**3.9**	4.9	–	4.9
British Pound	**67.3**	**3.5**	**63.8**	53.5	4.0	49.5
Total	**94.8**	**74.0**	**20.8**	84.1	89.6	(5.5)

D. Swaps

The Group's investment guidelines permit the use of interest rate swaps and credit default swaps which are traded primarily OTC.

Interest rate swaps are used to manage interest rate exposure, portfolio duration or to 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 2018 and 2017. Through the use of interest rate swaps, the Group has fixed the interest rate on Lancashire's subordinated loan notes until December 2020. As at 31 December 2018 the notional amount of interest rate swaps held for hedging purposes was $124.5 million (31 December 2017 – $125.8 million).

The Group may utilise credit default swaps to add or reduce credit risk to an individual issuer, or a basket of issuers, without investing directly in their securities. The group did not hold any credit default swaps at 31 December 2018 or 31 December 2017.

III. Debt risk

The Group has issued long-term debt as described in note 18. The LHL 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 on the LHL subordinated loan notes by entering into interest rate swap contracts on the following loan notes:

	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 until 2020 the Group has a fixed interest rate on the LHL 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 cash flow interest rate risk on this long-term debt.

The Group is subject to interest rate risk on the coupon payments on Cathedral's long-term debt described in note 18. 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 $0.7 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 profit or loss.

The Group hedges monetary 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 discussed in note 18. The Group uses forward foreign currency contracts for the purposes of managing currency exposures. See page 126 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	86.0	15.2	19.4	9.0	25.0	154.6
Accrued interest receivable	6.6	0.1	0.1	–	–	6.8
Investments	1,546.0	18.0	69.8	–	25.2	1,659.0
Inwards premiums receivable from insureds and cedants	270.9	11.2	20.6	5.3	10.1	318.1
Reinsurance assets	361.1	13.6	12.1	–	2.6	389.4
Other receivables	26.7	8.2	–	–	0.4	35.3
Investment in associate	67.1	–	–	–	–	67.1
Property, plant and equipment	0.2	1.2	–	–	–	1.4
Deferred acquisition costs	48.4	8.0	11.6	1.0	5.2	74.2
Intangible assets	153.8	–	–	–	–	153.8
Total assets as at 31 December 2018	**2,566.8**	**75.5**	**133.6**	**15.3**	**68.5**	**2,859.7**

Liabilities	U.S.$ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	685.4	59.5	113.7	19.7	36.7	915.0
Unearned premiums	265.8	25.4	43.3	10.4	25.7	370.6
Insurance contracts – other payables	26.9	4.7	2.9	–	1.5	36.0
Amounts payable to reinsurers	75.8	2.8	2.5	–	0.2	81.3
Deferred acquisition costs ceded	4.7	–	2.1	–	0.3	7.1
Other payables	23.9	21.0	0.4	–	0.1	45.4
Corporation tax payable	–	0.9	–	–	–	0.9
Deferred tax liability	7.8	3.4	–	–	–	11.2
Interest rate swap	(0.8)	–	1.2	–	–	0.4
Long-term debt	284.4	–	39.9	–	–	324.3
Total liabilities as at 31 December 2018	**1,373.9**	**117.7**	**206.0**	**30.1**	**64.5**	**1,792.2**

Assets	U.S.$ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Cash and cash equivalents	158.1	16.9	33.6	11.7	36.2	256.5
Accrued interest receivable	6.1	–	–	–	–	6.1
Investments	1,538.2	20.8	82.1	–	13.5	1,654.6
Inwards premiums receivable from insureds and cedants	252.1	13.4	19.7	2.3	10.4	297.9
Reinsurance assets	331.9	6.1	6.1	–	1.9	346.0
Other receivables	39.3	2.5	–	–	0.6	42.4
Investment in associate	59.4	–	–	–	–	59.4
Property, plant and equipment	0.3	2.3	–	–	–	2.6
Deferred acquisition costs	55.2	6.5	9.4	0.9	4.7	76.7
Intangible assets	153.8	–	–	–	–	153.8
Total assets as at 31 December 2017	2,594.4	68.5	150.9	14.9	67.3	2,896.0

Liabilities	U.S.$ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	773.5	38.5	72.9	8.6	40.0	933.5
Unearned premiums	259.7	20.7	37.9	8.6	24.0	350.9
Insurance contracts – other payables	30.4	5.8	2.6	–	1.9	40.7
Amounts payable to reinsurers	62.8	1.5	1.0	–	0.2	65.5
Deferred acquisition costs ceded	2.1	–	0.3	–	0.1	2.5
Other payables	30.8	16.4	0.7	–	0.1	48.0
Corporation tax payable	–	2.8	–	–	–	2.8
Deferred tax liability	7.8	8.7	–	–	–	16.5
Interest rate swap	0.2	–	1.8	–	–	2.0
Long-term debt	283.3	–	43.0	–	–	326.3
Total liabilities as at 31 December 2017	1,450.6	94.4	160.2	17.2	66.3	1,788.7

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 $5.4 million (2017 – $3.5 million).

C. Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when they are due without incurring an unreasonable cost. The Group's main exposures to liquidity risk are with respect to its insurance and investment activities. The Group is exposed if proceeds from financial assets are not sufficient to fund obligations arising from its insurance contracts. The Group can be exposed to daily calls on its available investment assets, principally to settle insurance claims and to fund trust accounts following a large catastrophe loss.

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 or fund trust accounts;
- 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 maturity portfolio are as follows:

As at 31 December 2018	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	**100.2**	**245.3**	**11.9**	**357.4**
Between one and two years	**104.9**	**156.0**	**35.3**	**296.2**
Between two and three years	**76.2**	**89.1**	**20.5**	**185.8**
Between three and four years	**30.0**	**66.4**	**18.0**	**114.4**
Between four and five years	**34.4**	**75.3**	**28.4**	**138.1**
Over five years	**13.5**	**38.0**	**108.0**	**159.5**
Asset backed and mortgage backed securities	**25.5**	**89.5**	**121.0**	**236.0**
Total fixed maturity securities	**384.7**	**759.6**	**343.1**	**1,487.4**

As at 31 December 2017	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	89.5	211.0	12.6	313.1
Between one and two years	102.7	84.1	45.5	232.3
Between two and three years	95.6	103.1	27.2	225.9
Between three and four years	18.8	44.1	40.4	103.3
Between four and five years	27.3	49.4	48.9	125.6
Over five years	10.7	41.9	126.7	179.3
Asset backed and mortgage backed securities	26.5	82.6	189.3	298.4
Total fixed maturity securities	371.1	616.2	490.6	1,477.9

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

	Years until liability becomes due – undiscounted values					
As at 31 December 2018	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	**915.0**	**497.9**	**269.4**	**89.9**	**57.8**	**915.0**
Insurance contracts – other payables	**36.0**	**35.7**	**0.3**	**–**	**–**	**36.0**
Amounts payable to reinsurers	**81.3**	**81.3**	**–**	**–**	**–**	**81.3**
Other payables	**45.4**	**45.4**	**–**	**–**	**–**	**45.4**
Interest rate swap	**0.4**	**0.1**	**0.3**	**–**	**–**	**0.4**
Long-term debt[1]	**324.3**	**16.2**	**37.3**	**160.0**	**344.3**	**557.8**
Total	**1,402.4**	**676.6**	**307.3**	**249.9**	**402.1**	**1,635.9**

1. The maturity profile of long-term debt includes accrued interest.

As at 31 December 2017	Balance sheet $m	Less than one $m	One to three $m	Three to five $m	Over five $m	Total $m
		Years until liability becomes due – undiscounted values				
Losses and loss adjustment expenses	933.5	524.3	265.6	88.0	55.6	933.5
Insurance contracts – other payables	40.7	37.5	3.2	–	–	40.7
Amounts payable to reinsurers	65.5	65.5	–	–	–	65.5
Other payables	48.0	48.0	–	–	–	48.0
Interest rate swap	2.0	0.9	1.1	–	–	2.0
Long-term debt[1]	326.3	15.1	36.2	167.6	354.8	573.7
Total	1,416.0	691.3	306.1	255.6	410.4	1,663.4

1. The maturity profile of long-term debt includes accrued interest.

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. 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, liquid securities, sufficient to meet its insurance liabilities and other near-term liquidity requirements. The creation of the core and core plus portfolios with their 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 outlook 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 maturity 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 maturity 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 15.0 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 maturity 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 clearing houses to reduce counterparty credit risk, requiring the posting of margins and settling of unrealised gains and losses daily. Credit risk on OTC derivatives is mitigated by monitoring the creditworthiness of the counterparties and by requiring collateral amounts exceeding predetermined thresholds to be posted for positions which have accrued gains.

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, as discussed on page 117.

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 2018	Cash and fixed maturity securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	**335.9**	**–**	**–**
AA+, AA, AA-	**586.2**	**–**	**3.6**
A+, A, A-	**402.6**	**87.0**	**208.3**
BBB+, BBB, BBB-	**219.7**	**–**	**–**
Other[1]	**97.6**	**276.2**	**111.0**
Total	**1,642.0**	**363.2**	**322.9**

1. Reinsurance recoveries classified as 'other' include $100.5 million of reserves that are fully collateralised.

As at 31 December 2017	Cash and fixed maturity securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	368.0	–	–
AA+, AA, AA-	621.8	–	2.7
A+, A, A-	403.7	69.5	177.0
BBB+, BBB, BBB-	237.3	–	–
Other[1]	103.6	291.5	104.4
Total	1,734.4	361.0	284.1

1. Reinsurance recoveries classified as 'other' include $93.6 million of reserves that are fully collateralised.

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

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

	2018 $m	2017 $m
Less than 90 days past due	**8.5**	15.3
Between 91 and 180 days past due	**5.5**	5.3
Over 180 days past due	**8.4**	14.0
Total	**22.4**	34.6

Provisions of $2.9 million (2017 – $2.4 million) have been made for impaired or irrecoverable balances and $0.5 million (2017 – $1.4 million) was charged to the consolidated statement of comprehensive income (loss) in respect of bad debts.

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 modelled within the subsidiaries' capital models. The Group has also established, and monitors compliance with, internal operational risk tolerances. The RRC reviews operational risk on at least an annual basis and operational risk is covered in the Group CRO's quarterly ORSA report to the LHL Board and entity boards and in the Cathedral RCCC reporting.

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 four years, on a rotational basis.

F. Strategic risk

The Group has identified several strategic risks. These include:

- the risks that either the poor execution of the business plan or an inappropriate business plan in itself results in a strategy that fails to adequately reflect the trading environment, resulting in an inability to optimise performance, including reputational risk;
- the 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; and
- the risks of succession planning, staff retention and key man risks.

I. Business plan risk

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;
- evaluation 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 RRC meetings.

II. Capital management risk

The total capital of the Group is as follows:

As at 31 December	2018 $m	2017 $m
Shareholders' equity	**1,067.2**	1,106.9
Long-term debt	**324.3**	326.3
Total capital	**1,391.5**	1,433.2
Intangible assets	**(153.8)**	(153.8)
Total tangible capital	**1,237.7**	1,279.4

Risks associated with the effectiveness of the Group's capital management are mitigated as follows:

- regular monitoring of current and prospective regulatory and rating agency capital requirements;
- regular discussion with the Cathedral management team regarding Lloyd's capital requirements;
- 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 Group's aim is to maximise risk-adjusted returns for its shareholders across the 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 2018	**2.4**	**17.5**	**716.3**
31 December 2017	(5.9)	17.7	608.2

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

	Annual return %	Compound annual return %	Inception to date return %
31 December 2018	**0.5**	**16.4**	**701.1**
31 December 2017	(6.8)	16.7	595.2

The primary source of capital used by the Group is equity shareholders' funds and borrowings (note 18). 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.

Between 2014 and 2018 the PRA operated as the Group's Solvency II supervisor and the Group was subject to the requirements of the UK's Solvency II regime. Effective 1 January 2019, the Company will establish its Group supervisory and tax domiciles in Bermuda and therefore be supervised by the BMA. This change will not affect the Group's UK regulated insurance entities, which will continue to be regulated by the PRA and the FCA. Additionally, CUL is also regulated by Lloyd's.

Under Solvency II the basis for assessing capital and solvency comprises a market-consistent economic balance sheet and a SCR, using either an internal model or the standard formula. Both the Group and LUK calculate their SCR using the standard formula. The Group's and LUK's Solvency II own funds are primarily comprised of Tier 1 items for the years ended 31 December 2018 and 31 December 2017. Tier 1 capital is the highest quality capital under Solvency II with the greatest loss absorbing capacity, comprising share capital and retained earnings. For the years ended 31 December 2018 and 2017 the Group and LUK were more than adequately capitalised under the Solvency II regime.

LICL is regulated by the BMA and is required to monitor its solvency capital requirement under the BMA's regulatory framework, which has been assessed as equivalent to the Solvency II regime. LICL's capital requirement is calculated using the BSCR standard formula model. For the years ended 31 December 2018 and 2017, LICL was more than adequately capitalised under the BMA regulatory regime.

The Group's underwriting capacity in its Lloyd's syndicates 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. Solvency II internal models are used to determine capital requirements for Syndicate 2010 and Syndicate 3010 based on the uSCR. Lloyd's has the discretion to take into account other factors at syndicate or member level to uplift the calculated uSCR. This may include perceived deficiencies in the internal model result as well as the need to maintain Lloyd's overall security rating. Currently, as a minimum, Lloyd's applies a 35.0 per cent uplift to each syndicate's uSCR to arrive at the ECA.

Lloyd's then uses each syndicate's ECA as a basis for determining member level capital requirements, which is backed by FAL. For the 2019 calendar year the Group's corporate member's FAL requirement was set at 67.8 per cent (2018 – 66.5 per cent) of underwriting capacity supported. Further solvency adjustments are made to allow for open year profits and losses of the syndicates on which the corporate member participates. The Group has met its FAL requirement of £187.8 million as at 31 December 2018 (31 December 2017 – £184.3 million).

For the years ended 31 December 2018 and 2017 the capital requirements of all the Group's regulatory jurisdictions were met.

III. Retention risk

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 identification of key team profit generators and function holders with targeted retention packages;
- documented recruitment procedures, position descriptions and employment contracts;
- 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 London and Bermuda. 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 head office and registered office is Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda.

The consolidated financial statements for the year ended 31 December 2018 include the Company's subsidiary companies, the Company's investment in associate, and the Group's share of the syndicates' assets and liabilities and income and expenses. A full listing of the Group's related parties can be found in note 23.

2. 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 segmental 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 114 to 117. Operating segment performance is measured by the net underwriting profit or loss and the combined ratio.

All amounts reported are transactions with external parties and associates. There are no significant inter-segmental transactions and there are no significant insurance or reinsurance contracts that insure or reinsure risks in Bermuda, the Group's country of domicile.

Revenue and expense by operating segment

For the year ended 31 December 2018	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m
Gross premiums written by geographic area						
U.S. and Canada	78.9	1.8	–	–	107.5	188.2
Worldwide, including the U.S. and Canada[1]	30.7	6.5	–	32.9	59.7	129.8
Worldwide offshore	0.3	87.0	31.3	–	–	118.6
Europe	27.4	1.9	–	–	22.0	51.3
Far East	15.3	0.5	–	–	13.2	29.0
Worldwide, excluding the U.S. and Canada[2]	6.7	1.5	–	0.1	5.1	13.4
Middle East	4.4	2.3	–	–	1.5	8.2
Rest of world	50.9	1.5	(0.2)	–	47.8	100.0
Total	214.6	103.0	31.1	33.0	256.8	638.5
Outwards reinsurance premiums	(90.8)	(28.9)	(20.2)	(11.0)	(69.9)	(220.8)
Change in unearned premiums	(4.9)	7.9	10.6	(7.3)	(26.0)	(19.7)
Change in unearned premiums on premiums ceded	13.0	(6.1)	–	3.1	5.5	15.5
Net premiums earned	131.9	75.9	21.5	17.8	166.4	413.5
Insurance losses and loss adjustment expenses	(93.0)	22.0	(70.5)	(3.6)	(162.3)	(307.4)
Insurance losses and loss adjustment expenses recoverable	48.2	(1.4)	48.5	3.2	43.5	142.0
Insurance acquisition expenses	(34.8)	(34.1)	(11.4)	(9.4)	(41.3)	(131.0)
Insurance acquisition expenses ceded	3.3	0.5	(0.6)	1.0	0.4	4.6
Net underwriting profit (loss)	55.6	62.9	(12.5)	9.0	6.7	121.7
Net unallocated income and expenses						(88.1)
Profit before tax						33.6
Net loss ratio	34.0%	(27.1%)	102.3%	2.2%	71.4%	40.0%
Net acquisition cost ratio	23.9%	44.3%	55.8%	47.2%	24.6%	30.6%
Expense ratio	–	–	–	–	–	21.6%
Combined ratio	57.9%	17.2%	158.1%	49.4%	96.0%	92.2%

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.

Revenue and expense by operating segment

For the year ended 31 December 2017	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m
Gross premiums written by geographic area						
U.S. and Canada	80.0	4.7	–	–	92.9	177.6
Worldwide, including the U.S. and Canada[1]	30.3	2.5	–	16.9	48.9	98.6
Worldwide offshore	0.2	94.8	67.5	–	–	162.5
Europe	23.1	–	–	–	15.8	38.9
Far East	16.5	–	–	–	11.4	27.9
Worldwide, excluding the U.S. and Canada[2]	6.0	0.1	–	–	5.4	11.5
Middle East	5.3	–	–	–	1.6	6.9
Rest of world	36.6	(0.3)	0.1	–	31.3	67.7
Total	198.0	101.8	67.6	16.9	207.3	591.6
Outwards reinsurance premiums	(66.3)	(45.1)	(11.3)	(7.2)	(63.7)	(193.6)
Change in unearned premiums	11.6	7.5	(5.6)	4.4	4.7	22.6
Change in unearned premiums on premiums ceded	3.2	6.2	–	(2.5)	0.4	7.3
Net premiums earned	146.5	70.4	50.7	11.6	148.7	427.9
Insurance losses and loss adjustment expenses	(254.9)	(34.7)	(17.3)	1.6	(232.7)	(538.0)
Insurance losses and loss adjustment expenses recoverable	87.3	23.6	0.6	0.6	90.5	202.6
Insurance acquisition expenses	(30.2)	(32.4)	(19.0)	(3.3)	(35.8)	(120.7)
Insurance acquisition expenses ceded	2.6	1.4	0.6	0.1	0.4	5.1
Net underwriting (loss) profit	(48.7)	28.3	15.6	10.6	(28.9)	(23.1)
Net unallocated income and expenses						(49.8)
Loss before tax						(72.9)
Net loss ratio	114.4%	15.8%	32.9%	(19.0%)	95.6%	78.4%
Net acquisition cost ratio	18.8%	44.0%	36.3%	27.6%	23.8%	27.0%
Expense ratio	–	–	–	–	–	19.5%
Combined ratio	133.2%	59.8%	69.2%	8.6%	119.4%	124.9%

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.

3. Investment return

The total investment return for the Group is as follows:

For the year ended 31 December 2018	Net investment income and net other investment (losses) income[1] $m	Net realised (losses) gains and impairments $m	Net change in unrealised gains/losses on AFS[2] $m	Total investment return excluding foreign exchange $m	Net foreign exchange (losses) gains $m	Total investment return including foreign exchange $m
Fixed maturity securities – AFS	**31.8**	**(6.4)**	**(12.4)**	**13.0**	**(5.4)**	**7.6**
Fixed maturity securities – at FVTPL	**(0.7)**	**–**	**–**	**(0.7)**	**–**	**(0.7)**
Equity securities – AFS	**–**	**–**	**(0.5)**	**(0.5)**	**–**	**(0.5)**
Hedge funds – at FVTPL	**(4.7)**	**2.3**	**–**	**(2.4)**	**–**	**(2.4)**
Other investments	**1.2**	**(1.0)**	**–**	**0.2**	**3.8**	**4.0**
Cash and cash equivalents	**2.9**	**–**	**–**	**2.9**	**(0.3)**	**2.6**
Total investment return	**30.5**	**(5.1)**	**(12.9)**	**12.5**	**(1.9)**	**10.6**

1. Net unrealised gains/(losses) on our FVTPL investments are included within net investment income and net other investment income.
2. Applying IFRS 9, net change in unrealised gains /losses on AFS will be classified within net investment income and net other investment income.

For the year ended 31 December 2017	Net investment income and net other investment (losses) income[1] $m	Net realised (losses) gains and impairments $m	Net change in unrealised gains/losses on AFS[2] $m	Total investment return excluding foreign exchange $m	Net foreign exchange (losses) gains $m	Total investment return including foreign exchange $m
Fixed maturity securities – AFS	28.6	(2.9)	2.1	27.8	9.8	37.6
Fixed maturity securities – at FVTPL	(1.0)	2.4	–	1.4	–	1.4
Equity securities – AFS	–	0.8	2.8	3.6	–	3.6
Hedge funds – at FVTPL	1.1	9.5	–	10.6	–	10.6
Other investments	1.1	(0.7)	–	0.4	(2.6)	(2.2)
Cash and cash equivalents	1.9	–	–	1.9	0.5	2.4
Total investment return	31.7	9.1	4.9	45.7	7.7	53.4

1. Net unrealised gains/(losses) on our FVTPL investments are included within net investment income and net other investment income.
2. Applying IFRS 9, net change in unrealised gains /losses on AFS will be classified within net investment income and net other investment income.

Net realised (losses) gains and impairments includes impairment losses of $0.4 million (2017 – $1.3 million) recognised on fixed maturity securities.

Refer to pages 124 to 125 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(losses) gains and impairments.

Included in net investment income and net other investment income is $4.4 million (2017 – $4.6 million) of investment management, accounting and custodian fees.

4. Net insurance acquisition expenses

	2018 $m	2017 $m
Insurance acquisition expenses	**128.5**	115.9
Changes in deferred insurance acquisition expenses	**2.5**	4.8
Insurance acquisition expenses ceded	**(9.2)**	(7.2)
Changes in deferred insurance acquisition expenses ceded	**4.6**	2.1
Total net insurance acquisition expenses	**126.4**	115.6

5. Other income

	2018 $m	2017 $m
Kinesis underwriting fees	**6.6**	5.8
Kinesis profit commission	**–**	5.9
Lloyd’s managing agency fees	**1.2**	1.0
Lloyd’s consortium fees	**0.5**	0.2
Lloyd’s consortium profit commission	**1.4**	1.5
Lloyd’s profit commission	**2.7**	2.8
Total other income	**12.4**	17.2

As at 31 December 2018, contract assets in relation to other income amounted to $10.9 million (31 December 2017 – $9.0 million).

6. Results of operating activities

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

	2018 $m	2017 $m
Depreciation on owned assets	**1.4**	1.8
Operating lease charges	**3.4**	3.4
Auditor’s remuneration		
– Group audit fees	**1.7**	1.8
Total	**6.5**	7.0

During 2018, KPMG provided non-audit services in relation to specific U.S. taxation advisory work. Fees for non-audit services provided in 2018 totalled fifteen thousand dollars. During 2017, KPMG provided non-audit services in relation to specified work over distributable reserves and pre-appointment procedures on the first quarter of 2017 earnings release. Fees for non-audit services provided in 2017 totalled twenty thousand dollars.

7. Employee benefits

	2018 $m	2017 $m
Wages and salaries	**32.4**	27.6
Pension costs	**2.6**	2.5
Bonus and other benefits	**14.0**	10.1
Total cash compensation	**49.0**	40.2
RSS – performance	**1.5**	(1.9)
RSS – ordinary	**5.0**	2.9
RSS – bonus deferral	**1.0**	2.1
RSS – Cathedral acquisition grant	**0.4**	(3.5)
Total equity based compensation	**7.9**	(0.4)
Total employee benefits	**56.9**	39.8

7. Employee benefits continued

Equity based compensation

The Group's equity based compensation scheme is its RSS. All outstanding and future RSS grants have an exercise period of ten years from the grant 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 2018 and 2017:

Assumptions	2018	2017
Dividend yield	**–**	–
Expected volatility[1]	**24.1%**	25.1%
Risk-free interest rate[2]	**0.8%**	0.1%
Expected average life of options	**3 years**	3 years
Share price	**$7.95**	$8.60

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 three- 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 – performance

The performance RSS options vest after a three-year period and are dependent on certain performance criteria. A maximum of 85.0 per cent (2017 – 75.0 per cent) of the performance RSS options will vest only on the achievement of an RoE in excess of a required amount. A maximum of 15.0 per cent (2017 – 25.0 per cent) of the performance RSS options will vest only on the achievement of an absolute TSR in excess of a required amount. For the 2017 awards, TSR was determined on a relative basis of a predefined comparator group. 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.

	Total number of restricted stock
Outstanding as at 31 December 2016	3,363,157
Granted	1,018,933
Exercised	(509,524)
Forfeited	(156,461)
Lapsed	(257,894)
Outstanding as at 31 December 2017	3,458,211
Granted	**1,041,567**
Exercised	**(381,359)**
Forfeited	**(47,260)**
Lapsed	**(1,090,376)**
Outstanding as at 31 December 2018	**2,980,783**

Exercisable as at 31 December 2017	249,112
Exercisable as at 31 December 2018	**183,141**

	2018 Total restricted stock	2017 Total restricted stock
Weighted average remaining contractual life	**8.0 years**	7.8 years
Weighted average fair value at date of grant during the year	**$6.96**	$7.56
Weighted average share price at date of exercise during the year	**$8.14**	$8.82

RSS – ordinary

The ordinary RSS options were issued for the first time in 2016 and vest three years from the date of grant 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. These awards will become exercisable in the first open period following the release of the Company's 2018 year-end results after the Board meeting in February 2019.

	Total number of restricted stock
Outstanding as at 31 December 2016	597,520
Granted	699,251
Forfeited	(10,025)
Outstanding as at 31 December 2017	1,286,746
Granted	**1,018,951**
Forfeited	**(205,500)**
Outstanding as at 31 December 2018	**2,100,197**

	2018 Total restricted stock	2017 Total restricted stock
Weighted average remaining contractual life	**8.4 years**	8.7 years
Weighted average fair value at date of grant during the year	**$7.96**	$8.49

RSS – bonus deferral

The bonus deferral RSS options vesting periods range from one to three years from the date of grant 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.

	Total number of restricted stock
Outstanding as at 31 December 2016	526,118
Granted	244,523
Exercised	(220,448)
Forfeited	(2,555)
Outstanding as at 31 December 2017	547,638
Granted	**31,941**
Exercised	**(220,047)**
Forfeited	**(18,943)**
Outstanding as at 31 December 2018	**340,589**

Exercisable as at 31 December 2017	78,295
Exercisable as at 31 December 2018	**73,963**

	2018 Total restricted stock	2017 Total restricted stock
Weighted average remaining contractual life	**7.7 years**	8.3 years
Weighted average fair value at date of grant during the year	**$7.95**	$8.58
Weighted average share price at date of exercise during the year	**$8.25**	$8.73

7. Employee benefits continued

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 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 vest on the achievement of an LHL RoE in excess of a required amount. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise, pro-rata according to the number of RSS options that vest. The first tranche of awards were exercisable in 2017.

	Total number of restricted stock
Outstanding as at 31 December 2016	1,356,250
Exercised	(400,166)
Forfeited	(556,768)
Lapsed	(29,838)
Outstanding as at 31 December 2017	369,478
Exercised	**(199,370)**
Forfeited	**(1,850)**
Outstanding as at 31 December 2018	**168,258**

Exercisable as at 31 December 2017	205,955
Exercisable as at 31 December 2018	**168,258**

	2018 Total restricted stock	2017 Total restricted stock
Weighted average remaining contractual life	**4.9 years**	5.9 years
Weighted average fair value at date of grant	**$13.01**	$13.01
Weighted average share price at date of exercise during the year	**$7.99**	$8.84

8. Financing costs

	2018 $m	2017 $m
Interest expense on long-term debt	**18.1**	16.4
Net (gains) losses on interest rate swaps	**(0.9)**	–
Other financing costs	**2.9**	1.1
Total	**20.1**	17.5

Refer to note 18 for details of long-term debt and financing arrangements.

9. Tax

Bermuda

LHL, LICL, LUK and KCML have received an undertaking from the Bermuda government exempting them from all Bermuda local income, withholding and capital gains taxes until 31 March 2035. At the present time no such taxes are levied in Bermuda.

United Kingdom

LHL and its UK subsidiaries are subject to normal UK corporation tax on all their taxable profits. From 1 January 2019 LHL will cease to be a tax resident in the UK and subject to UK corporation tax.

	2018 $m	2017 $m
Corporation tax charge for the period	**2.9**	3.3
Adjustments in respect of prior period corporation tax	**(1.9)**	(2.3)
Deferred tax credit for the period	**(5.1)**	(4.1)
Tax rate change adjustment	**–**	(0.6)
Adjustments in respect of prior period deferred tax	**0.1**	1.4
Total tax credit	**(4.0)**	(2.3)

Tax reconciliation[1]	2018 $m	2017 $m
Profit (loss) before tax	**33.6**	(72.9)
Corporation tax at 19.0% (2017 – 19.3%)	**6.4**	(14.1)
Non-taxable (income) loss	**(13.3)**	10.1
Adjustments in respect of prior period	**(1.8)**	(0.9)
Differences related to equity based compensation	**0.4**	(0.6)
Other expense permanent differences	**4.3**	3.8
Tax rate change adjustment	**–**	(0.6)
Total tax credit	**(4.0)**	(2.3)

1. All tax reconciling balances have been classified as recurring items.

The current tax credit as a percentage of the Group's profit (2017 – loss) before tax is 11.9 per cent (2017 – negative 3.2 per cent). Non-taxable income (loss) relates to profits (losses) of companies within the Group that are non-tax resident in the UK and the share of loss of associate.

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 loss within shareholders' equity.

10. Cash and cash equivalents

	2018 $m	2017 $m
Cash at bank and in hand	**97.5**	107.0
Cash equivalents	**57.1**	149.5
Total cash and cash equivalents	**154.6**	256.5

Cash equivalents have an original maturity of three months or less. The carrying amount of these assets approximates their fair value. Refer to note 18 for the cash and cash equivalent balances on deposit as collateral. Cash and cash equivalents include managed cash of $83.7 million (31 December 2017 – $188.1 million).

11. Investments

As at 31 December 2018	Cost or amortised cost $m	Unrealised gains $m	Unrealised losses $m	Estimated fair value[1] $m
Fixed maturity securities – AFS				
– Short-term investments	**225.5**	**–**	**–**	**225.5**
– Fixed maturity funds	**11.4**	**–**	**–**	**11.4**
– U.S. treasuries	**187.5**	**0.3**	**(1.2)**	**186.6**
– Other government bonds	**59.8**	**0.1**	**(1.2)**	**58.7**
– U.S. municipal bonds	**5.4**	**–**	**–**	**5.4**
– U.S. government agency debt	**88.2**	**0.4**	**(0.5)**	**88.1**
– Asset backed securities	**131.1**	**1.0**	**(2.8)**	**129.3**
– U.S. government agency mortgage backed securities	**82.2**	**0.2**	**(2.5)**	**79.9**
– Non-agency mortgage backed securities	**21.3**	**–**	**(0.2)**	**21.1**
– Agency commercial mortgage backed securities	**5.3**	**–**	**(0.1)**	**5.2**
– Non-agency commercial mortgage backed securities	**0.5**	**–**	**–**	**0.5**
– Bank loans	**114.7**	**0.1**	**(5.7)**	**109.1**
– Corporate bonds	**528.8**	**1.0**	**(8.2)**	**521.6**
Total fixed maturity securities – AFS	**1,461.7**	**3.1**	**(22.4)**	**1,442.4**
Fixed maturity securities – at FVTPL	**45.7**	**–**	**(0.7)**	**45.0**
Equity securities – AFS	**20.0**	**2.7**	**–**	**22.7**
Hedge funds – at FVTPL	**143.0**	**9.3**	**(3.1)**	**149.2**
Other investments	**–**	**0.1**	**(0.4)**	**(0.3)**
Total investments	**1,670.4**	**15.2**	**(26.6)**	**1,659.0**

1. When IFRS 9, Financial Instruments: Classification and Measurement is implemented, all investments held above will be classified as at FVTPL (mandatory), with no resulting changes in the estimated fair value.

As at 31 December 2017	Cost or amortised cost $m	Unrealised gains $m	Unrealised losses $m	Estimated fair value[1] $m
Fixed maturity securities – AFS				
– Short-term investments	111.2	–	(0.1)	111.1
– Fixed maturity funds	31.2	–	(0.2)	31.0
– U.S. treasuries	237.4	0.1	(1.8)	235.7
– Other government bonds	71.2	0.8	(0.6)	71.4
– U.S. municipal bonds	6.0	–	–	6.0
– U.S. government agency debt	71.2	–	(0.7)	70.5
– Asset backed securities	139.5	4.9	(0.4)	144.0
– U.S. government agency mortgage backed securities	142.4	0.4	(1.8)	141.0
– Non-agency mortgage backed securities	13.2	0.2	(0.2)	13.2
– Non-agency commercial mortgage backed securities	0.2	–	–	0.2
– Bank loans	106.5	0.8	(0.6)	106.7
– Corporate bonds	520.1	3.6	(2.3)	521.4
Total fixed maturity securities – AFS	1,450.1	10.8	(8.7)	1,452.2
Fixed maturity securities – at FVTPL	25.7	–	–	25.7
Equity securities – AFS	20.0	3.2	–	23.2
Hedge funds – at FVTPL	144.6	9.8	(0.4)	154.0
Other investments	–	–	(0.5)	(0.5)
Total investments	1,640.4	23.8	(9.6)	1,654.6

1. When IFRS 9, Financial Instruments: Classification and Measurement is implemented, all investments held above will be classified as at FVTPL (mandatory), with no resulting changes in the estimated fair value.

Accumulated other comprehensive loss in relation to the Group's AFS fixed maturity and equity securities is as follows:

	2018 $m	2017 $m
Unrealised gains	**5.8**	14.0
Unrealised losses	**(22.4)**	(8.7)
Net unrealised foreign exchange losses (gains) on fixed maturity securities – AFS	**2.1**	(6.9)
Tax provision	**0.2**	0.1
Accumulated other comprehensive loss	**(14.3)**	(1.5)

Fixed maturity securities are presented in the risk disclosures section on page 129. Refer to note 18 for the investment balances in trusts in favour of ceding companies and on deposit as collateral.

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 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' 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 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.

Level (ii)

Level (ii) investments are securities with quoted prices in active markets for similar assets or liabilities or securities valued using 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 modelled 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.

11. Investments continued

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

- Short-term investments;
- Fixed maturity funds;
- Other 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;
- Agency commercial mortgage backed securities;
- Non-agency commercial mortgage backed securities;
- Bank loans;
- Corporate bonds; and
- OTC derivatives, such as options, forward foreign exchange contracts, interest rate swaps and credit default swaps.

Level (iii)

Level (iii) investments are securities for which valuation techniques are not based on observable market data. The Group classifies hedge funds as Level (iii) assets as the valuation techniques incorporate both observable and unobservable inputs.

The estimated fair values of the Group's hedge funds are determined using a combination of the most recent NAVs provided by each fund's independent administrator and the estimated performance provided by each hedge fund manager. Independent administrators provide monthly reported NAVs with up to a one month delay in valuation. The most recent NAV available for each hedge fund is adjusted for the estimated performance, as provided by the fund manager, between the NAV date and the reporting date. Historically estimated fair values incorporating these performance estimates have not been significantly different from subsequent NAVs. Given the Group's knowledge of the underlying investments and the size of the Group's investment therein, we would not anticipate any material variance between estimated valuations and the final NAVs reported by the administrators.

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

As at 31 December 2018	Level (i) $m	Level (ii) $m	Level (iii) $m	Total $m
Fixed maturity securities – AFS				
– Short-term investments	**216.8**	**8.7**	**–**	**225.5**
– Fixed maturity funds	**–**	**11.4**	**–**	**11.4**
– U.S. treasuries	**186.6**	**–**	**–**	**186.6**
– Other government bonds	**–**	**58.7**	**–**	**58.7**
– U.S. municipal bonds	**–**	**5.4**	**–**	**5.4**
– U.S. government agency debt	**–**	**88.1**	**–**	**88.1**
– Asset backed securities	**–**	**129.3**	**–**	**129.3**
– U.S. government agency mortgage backed securities	**–**	**79.9**	**–**	**79.9**
– Non-agency mortgage backed securities	**–**	**21.1**	**–**	**21.1**
– Agency commercial mortgage backed securities	**–**	**5.2**	**–**	**5.2**
– Non-agency commercial mortgage backed securities	**–**	**0.5**	**–**	**0.5**
– Bank loans	**–**	**109.1**	**–**	**109.1**
– Corporate bonds	**–**	**521.6**	**–**	**521.6**
Total fixed maturity securities – AFS	**403.4**	**1,039.0**	**–**	**1,442.4**
Fixed maturity securities – at FVTPL	**–**	**45.0**	**–**	**45.0**
Equity securities – AFS	**22.7**	**–**	**–**	**22.7**
Hedge funds – at FVTPL	**–**	**–**	**149.2**	**149.2**
Other investments	**–**	**(0.3)**	**–**	**(0.3)**
Total investments	**426.1**	**1,083.7**	**149.2**	**1,659.0**

As at 31 December 2017	Level (i) $m	Level (ii) $m	Level (iii) $m	Total $m
Fixed maturity securities – AFS				
– Short-term investments	104.6	6.5	–	111.1
– Fixed maturity funds	–	31.0	–	31.0
– U.S. treasuries	235.7	–	–	235.7
– Other government bonds	–	71.4	–	71.4
– U.S. municipal bonds	–	6.0	–	6.0
– U.S. government agency debt	–	70.5	–	70.5
– Asset backed securities	–	144.0	–	144.0
– U.S. government agency mortgage backed securities	–	141.0	–	141.0
– Non-agency mortgage backed securities	–	13.2	–	13.2
– Non-agency commercial mortgage backed securities	–	0.2	–	0.2
– Bank loans	–	106.7	–	106.7
– Corporate bonds	–	521.4	–	521.4
Total fixed maturity securities – AFS	340.3	1,111.9	–	1,452.2
Fixed maturity securities – at FVTPL	–	25.7	–	25.7
Equity securities – AFS	23.2	–	–	23.2
Hedge funds – at FVTPL	–	–	154.0	154.0
Other investments	–	(0.5)	–	(0.5)
Total investments	363.5	1,137.1	154.0	1,654.6

There have been no transfers between Levels (i) and (ii).

11. Investments continued

The table below analyses the movements in investments classified as Level (iii) investments:

	Hedge funds $m
As at 31 December 2016	129.4
Purchases	149.7
Sales	(136.5)
Total net realised and unrealised gains recognised in profit or loss	11.4
As at 31 December 2017	154.0
Purchases	**17.6**
Sales	**(21.5)**
Total net realised and unrealised losses recognised in profit or loss	**(0.9)**
As at 31 December 2018	**149.2**

12. Interests in structured entities

Consolidated structured entities

The Group's two consolidated structured entities are the EBT and the Orange Fund.

- the Group provides capital contributions to the EBT to enable it to meet its obligations to employees under the equity based compensation plans. The Group has a contractual agreement which may require it to provide financial support to the EBT (see note 23).
- the Orange Fund was opened during 2017 and holds short duration high quality cash equivalents and fixed maturity securities. The Lancashire Group companies are the only investors in the Orange Fund. The primary objectives of the fund are to preserve capital and provide liquidity to support the Group's operations.

Unconsolidated structured entities in which the group has an interest

As part of its investment activities, the Group invests in unconsolidated structured entities. The Group does not sponsor any of the unconsolidated structured entities.

A summary of the Group's interest in consolidated and unconsolidated structured entities is as follows:

As at 31 December 2018	Orange Fund $m	Investments $m	Interest in associate $m	Total $m
Fixed maturity securities				
– Asset backed securities	**12.5**	**116.8**	**–**	**129.3**
– U.S. government agency mortgage backed securities	**–**	**79.9**	**–**	**79.9**
– Non-agency mortgage backed securities	**4.9**	**16.2**	**–**	**21.1**
– Agency commercial mortgage backed securities	**–**	**5.2**	**–**	**5.2**
– Non-agency commercial mortgage backed securities	**0.5**	**–**	**–**	**0.5**
Total fixed maturity securities	**17.9**	**218.1**	**–**	**236.0**
Investment funds				
– Hedge funds	**–**	**149.2**	**–**	**149.2**
Total investment funds	**–**	**149.2**	**–**	**149.2**
Specialised investment vehicles				
– KHL (note 16)	**–**	**–**	**67.1**	**67.1**
Total	**17.9**	**367.3**	**67.1**	**452.3**

As at 31 December 2017	Orange Fund $m	Investments $m	Interest in associate $m	Total $m
Fixed maturity securities				
– Asset backed securities	8.1	135.9	–	144.0
– U.S. government agency mortgage backed securities	3.1	137.9	–	141.0
– Non-agency mortgage backed securities	–	13.2	–	13.2
– Non-agency commercial mortgage backed securities	–	0.2	–	0.2
Total fixed maturity securities	11.2	287.2	–	298.4
Investment funds				
– Hedge funds	–	154.0	–	154.0
Total investment funds	–	154.0	–	154.0
Specialised investment vehicles				
– KHL (note 16)	–	–	59.4	59.4
Total	11.2	441.2	59.4	511.8

The fixed maturity structured entities are created to meet specific investment needs of borrowers and investors which cannot be met from standardised financial instruments available in the capital markets. As such, they provide liquidity to the borrowers in these markets and provide investors with an opportunity to diversify risk away from standard fixed maturity securities. Whilst individual securities may differ in structure, the principles of the instruments are broadly the same and it is appropriate to aggregate the investments into the categories detailed above.

The risk that the Group faces in respect of the investments in structured entities is similar to the risk it faces in respect of other financial investments held on the consolidated balance sheet in that fair value is determined by market supply and demand. This is in turn driven by investor evaluation of the credit risk of the structure and changes in term structure of interest rates which change investors' expectation of the cash flows associated with the instrument and, therefore, its value in the market. Risk management disclosures for these financial instruments and other investments is provided on pages 120 to 131. The total assets of these structured entities are not considered meaningful for the purpose of understanding the related risks and therefore have not been presented.

The maximum exposure to loss in respect of these structured entities would be the carrying value of the instruments that the Group holds as at 31 December 2018 and 31 December 2017. Generally, default rates would have to increase substantially from their current level before the Group would suffer a loss and this assessment is made prior to investing and regularly through the holding period for the security. The Group has not provided any other financial or other support in addition to that described above as at the reporting date, and there is no intention to provide support in relation to any other unconsolidated structured entities in the foreseeable future.

As at 31 December 2018 the Group has a commitment of $100.0 million (31 December 2017 – $100.0 million) in respect of two credit facility funds. The Group, via the funds, provides collateral for revolving credit facilities purchased at a discount from financial institutions and is at risk for its portion of any defaults on those revolving credit facilities. The Group's proportionate share of these revolving credit facilities purchased by the funds as at 31 December 2018 is $54.4 million (31 December 2017 – $64.4 million), which currently remains unfunded. The maximum exposure to the credit facility funds is $100.0 million and as at 31 December 2018 there have been no defaults under these facilities.

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 2016	679.8	(136.7)	543.1
Net incurred losses for:			
Prior years	(40.1)	(25.0)	(65.1)
Current year	578.1	(177.6)	400.5
Exchange adjustments	18.8	(0.7)	18.1
Incurred losses and loss adjustment expenses	556.8	(203.3)	353.5
Net paid losses for:			
Prior years	231.1	(50.2)	180.9
Current year	72.0	(5.7)	66.3
Paid losses and loss adjustment expenses	303.1	(55.9)	247.2
As at 31 December 2017	933.5	(284.1)	649.4
Net incurred losses for:			
Prior years	**(124.4)**	**(2.5)**	**(126.9)**
Current year	**431.8**	**(139.5)**	**292.3**
Exchange adjustments	**(7.2)**	**0.6**	**(6.6)**
Incurred losses and loss adjustment expenses	**300.2**	**(141.4)**	**158.8**
Net paid losses for:			
Prior years	**261.5**	**(99.1)**	**162.4**
Current year	**57.2**	**(3.5)**	**53.7**
Paid losses and loss adjustment expenses	**318.7**	**(102.6)**	**216.1**
As at 31 December 2018	**915.0**	**(322.9)**	**592.1**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from page 117. 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 $183.0 million (31 December 2017 – $186.7 million) increase in gross loss reserves. There was no change to the Group's reserving methodology during the year. The split of losses and loss adjustment expenses between notified outstanding losses, ACR assessed by management and IBNR is shown below:

	2018		2017	
As at 31 December	$m	%	$m	%
Outstanding losses	**315.2**	**34.4**	300.4	32.2
Additional case reserves	**210.5**	**23.0**	186.5	20.0
Losses incurred but not reported	**389.3**	**42.6**	446.6	47.8
Total	**915.0**	**100.0**	933.5	100.0

The Group's reserve for unpaid losses and loss adjustment expenses as at 31 December 2018 and 2017 had an estimated duration of approximately two years.

Claims development

The development of insurance liabilities is indicative of the Group's ability to estimate the ultimate value of its insurance liabilities. The Group began writing insurance and reinsurance business in December 2005. With the acquisition of Cathedral in 2013, the Group assumed additional loss reserves relating to 2001 and subsequent years.

Accident year	2008 and prior $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	2014 $m	2015 $m	2016 $m	2017 $m	2018 $m	Total $m
Gross Group losses												
Estimate of ultimate liability[1]												
At end of accident year	836.4	163.3	297.4	397.0	250.3	280.0	274.8	276.0	298.5	580.1	429.7	
One year later	548.5	107.8	209.4	371.9	350.4	259.8	226.7	214.6	310.7	547.1		
Two years later	499.5	73.1	204.2	447.0	338.8	224.0	206.0	196.2	274.4			
Three years later	453.0	66.0	235.8	450.4	326.9	224.4	196.5	189.6				
Four years later	445.8	89.1	229.4	460.0	313.3	222.1	193.4					
Five years later	503.8	81.7	231.4	450.7	308.7	218.4						
Six years later	497.3	72.9	229.8	452.6	299.5							
Seven years later	496.7	90.8	229.6	446.9								
Eight years later	494.9	89.6	228.3									
Nine years later	493.7	65.4										
Ten years later	487.3											
Current estimate of cumulative liability	**487.3**	**65.4**	**228.3**	**446.9**	**299.5**	**218.4**	**193.4**	**189.6**	**274.4**	**547.1**	**429.7**	**3,380.0**
Paid	**(455.2)**	**(61.9)**	**(217.7)**	**(424.4)**	**(270.3)**	**(202.4)**	**(172.0)**	**(161.2)**	**(181.0)**	**(261.7)**	**(57.2)**	**(2,465.0)**
Total Group gross liability	**32.1**	**3.5**	**10.6**	**22.5**	**29.2**	**16.0**	**21.4**	**28.4**	**93.4**	**285.4**	**372.5**	**915.0**

1. Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2018.

Accident year	2008 and prior $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	2014 $m	2015 $m	2016 $m	2017 $m	2018 $m	Total $m
Reinsurance												
Estimate of ultimate recovery[1]												
At end of accident year	50.5	1.6	33.8	56.2	48.9	9.9	17.8	15.3	73.1	177.6	139.3	
One year later	51.1	1.3	23.6	52.6	121.8	8.9	14.1	12.2	98.5	185.0		
Two years later	46.6	0.7	24.1	92.4	122.0	8.8	13.1	12.6	96.7			
Three years later	44.2	0.7	33.5	88.9	121.2	8.0	11.5	13.0				
Four years later	41.2	10.0	34.4	103.3	121.2	8.0	11.9					
Five years later	69.8	7.0	34.6	102.8	121.2	8.0						
Six years later	69.0	2.5	35.7	106.1	120.9							
Seven years later	69.2	2.5	36.2	105.4								
Eight years later	68.7	1.3	36.5									
Nine years later	67.6	1.1										
Ten years later	64.2											
Current estimate of cumulative recovery	**64.2**	**1.1**	**36.5**	**105.4**	**120.9**	**8.0**	**11.9**	**13.0**	**96.7**	**185.0**	**139.3**	**782.0**
Paid	**(46.8)**	**0.5**	**(35.1)**	**(101.6)**	**(117.9)**	**(7.5)**	**(8.4)**	**(12.6)**	**(49.4)**	**(76.8)**	**(3.5)**	**(459.1)**
Total Group gross recovery	**17.4**	**1.6**	**1.4**	**3.8**	**3.0**	**0.5**	**3.5**	**0.4**	**47.3**	**108.2**	**135.8**	**322.9**

1. Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2018.

13. Losses and loss adjustment expenses continued

Accident year	2008 and prior $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	2014 $m	2015 $m	2016 $m	2017 $m	2018 $m	Total $m
Net Group losses												
Estimate of ultimate liability[1]												
At end of accident year	785.9	161.7	263.6	340.8	201.4	270.1	257.0	260.7	225.4	402.5	290.4	
One year later	497.4	106.5	185.8	319.3	228.6	250.9	212.6	202.4	212.2	362.1		
Two years later	452.9	72.4	180.1	354.6	216.8	215.2	192.9	183.6	177.7			
Three years later	408.8	65.3	202.3	361.5	205.7	216.4	185.0	176.6				
Four years later	404.6	79.1	195.0	356.7	192.1	214.1	181.5					
Five years later	434.0	74.7	196.8	347.9	187.5	210.4						
Six years later	428.3	70.4	194.1	346.5	178.6							
Seven years later	427.5	88.3	193.4	341.5								
Eight years later	426.2	88.3	191.8									
Nine years later	426.1	64.3										
Ten years later	423.1											
Current estimate of cumulative liability	**423.1**	**64.3**	**191.8**	**341.5**	**178.6**	**210.4**	**181.5**	**176.6**	**177.7**	**362.1**	**290.4**	**2,598.0**
Paid	**(408.4)**	**(62.4)**	**(182.6)**	**(322.8)**	**(152.4)**	**(194.9)**	**(163.6)**	**(148.6)**	**(131.6)**	**(184.9)**	**(53.7)**	**(2,005.9)**
Total Group net liability	**14.7**	**1.9**	**9.2**	**18.7**	**26.2**	**15.5**	**17.9**	**28.0**	**46.1**	**177.2**	**236.7**	**592.1**

1. Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2018.

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:

	2018 $m	2017 $m
2008 accident year and prior	**3.1**	0.1
2009 accident year	**23.9**	0.1
2010 accident year	**1.6**	1.8
2011 accident year	**4.7**	8.8
2012 accident year	**8.8**	5.0
2013 accident year	**3.5**	3.5
2014 accident year	**3.4**	9.2
2015 accident year	**6.6**	20.3
2016 accident year	**33.3**	16.3
2017 accident year	**38.0**	–
Total favourable development	**126.9**	65.1

The favourable prior year development in both 2018 and 2017 was primarily due to general IBNR releases across most lines of business due to a lack of reported claims. 2018 also included reductions on some prior accident year property and energy reserves. In 2017, the Group experienced some adverse development on prior accident year property and energy claims.

There were no individually significant net loss events for the year ended 31 December 2018. In September 2017, hurricanes Harvey, Irma and Maria made landfall in the Caribbean and U.S., causing significant damage and destruction to property. These events were followed by wildfires in California during October 2017 and December 2017. Management's current best estimates in relation to each of these events are shown in the table below.

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

	Harvey $m	Irma $m	Maria $m	Combined 2017 California Wildfires $m
Change in insurance losses and loss adjustment expenses	66.3	108.9	78.5	75.9
Change in insurance losses and loss adjustment expenses recoverable	(18.5)	(55.1)	(43.1)	(41.4)
Change in reinstatement premiums	(3.3)	(1.7)	(2.3)	(0.4)
Net ultimate losses as at 31 December 2017	44.5	52.1	33.1	34.1
Change in insurance losses and loss adjustment expenses	**(23.8)**	**14.8**	**(1.2)**	**(13.1)**
Change in insurance losses and loss adjustment expenses recoverable	**3.7**	**(4.9)**	**(5.2)**	**6.0**
Change in reinstatement premiums	**1.4**	**0.1**	**0.8**	**(1.3)**
Net ultimate losses as at 31 December 2018	**25.8**	**62.1**	**27.5**	**25.7**

14. Insurance, reinsurance and other receivables

All receivables are considered current other than $54.1 million (31 December 2017 – $53.7 million) of inwards premiums receivable related to multi-year contracts. The carrying value approximates fair value due to the short-term nature of the receivables. There are no significant concentrations of credit risk within the Group's receivables.

15. Provision for deferred tax

	2018 $m	2017 $m
Equity based compensation	**(2.5)**	(2.9)
Claims equalisation reserves	**6.2**	8.3
Syndicate underwriting profits	**(3.6)**	0.1
Syndicate participation rights	**12.7**	12.7
Other temporary differences	**(1.6)**	(1.2)
Tax losses carried forward	**–**	(0.5)
Net deferred tax liability	**11.2**	16.5

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 2019 and subsequent years to utilise the deferred tax assets recognised when the underlying temporary differences reverse.

For the years ended 31 December 2018 and 2017, the Group had no uncertain tax positions.

Changes to the UK main rate of corporation tax have been enacted under the Finance Act 2016 reducing the rate to 17.0 per cent from 1 April 2020.

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

16. Investment in associate

The Group holds a 10.0 per cent interest in the preference shares of each segregated account of KHL, a company incorporated in Bermuda. KHL's operating subsidiary, KRL, is authorised by the BMA as a Special Purpose Insurer. KRL commenced writing insurance business on 1 January 2014. As at 31 December 2018, the carrying value of the Group's investment in KHL was $67.1 million (31 December 2017 – $59.4 million). The Group's share of comprehensive loss for KHL for the period was $7.1 million (2017 – $9.4 million). Key financial information for KHL is as follows:

	2018 $m	2017 $m
Assets	**905.2**	736.4
Liabilities	**234.2**	141.9
Shareholders' equity	**671.0**	594.5
Gross premium earned	**81.9**	71.7
Comprehensive loss	**(71.2)**	(94.3)

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

When IFRS 9, Financial Instruments: Classification and Measurement is implemented, KHL will continue to classify all its financial assets at FVTPL. There will therefore be no impact on the estimated fair value of the assets disclosed in the table above.

Refer to note 23 for details of transactions between the Group and its associate.

17. Intangible assets

	Syndicate participation rights $m	Goodwill $m	Total $m
Net book value as at 31 December 2018 and 2017	**82.6**	**71.2**	**153.8**

Indefinite life intangible assets are tested annually for impairment. For the purpose of impairment testing, the syndicate participation rights and goodwill have been allocated to the Lloyd's CGU.

The recoverable amount of the Lloyd's CGU is determined based on value in use. Value in use is calculated using projected cash flows of the Lloyd's CGU. These are approved by management and cover a three-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 returns. A pre-tax discount rate of 6.4 per cent (2017 – 6.2 per cent) has been used to discount the projected 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 is 3.0 per cent (2017 – 3.0 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 syndicate participation rights and the goodwill's carrying values and would not be sensitive to any reasonably possible changes in assumptions. No impairment has been recognised for the years ending 31 December 2018 and 2017.

18. Long-term debt and financing arrangements

Long-term debt

On 5 October 2012, LHL issued $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, LHL 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 CSX admitted to the official list the LHL U.S. dollar and Euro subordinated loan notes.

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 in September 2034, paying interest quarterly based on a set margin, 3.75 per cent, above the three-month EURIBOR;
- $10.0 million floating rate subordinated loan note issued on 26 November 2004 and repayable in September 2034, paying interest quarterly based on a set margin, 3.75 per cent, above the 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 the 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 the 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.

The terms of the $130.0 million senior unsecured notes include standard default and cross-default provisions which require certain covenants to be adhered to. These include a maximum debt to capital ratio of 30.0 per cent, where the subordinated loan notes are included as both total consolidated debt and total consolidated capital in this calculation.

There are no such covenants for either the $97.0 million and €24.0 million in aggregate floating rate subordinated loan notes or the loan notes issued by CCHL.

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

The carrying values of the notes are shown below:

As at 31 December	2018 $m	2017 $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	**27.5**	28.8
Long-term debt €12.0 million	**12.4**	13.1
Long-term debt $10.0 million	**10.0**	10.0
Long-term debt $25.0 million	**23.7**	23.7
Long-term debt $25.0 million	**23.7**	23.7
Carrying value	**324.3**	326.3

The Group is exposed to cash flow interest rate risk and currency risk on its long-term debt. Further information is provided in the risk disclosures section on pages 126 to 127.

The fair value of the long-term debt is estimated as $359.2 million (31 December 2017 – $369.3 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 $2.4 million (31 December 2017 – $2.3 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.

18. Long-term debt and financing arrangements continued

Interest rate swaps

The Group hedges a portion of its floating rate borrowings using interest rate swaps to transfer floating to fixed rate. These instruments are held at estimated fair value. Refer to the risk disclosures section from page 126 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 $0.4 million (31 December 2017 – $2.0 million). Further information is provided on pages 124 to 127. Cash settlements are completed on a quarterly basis and the total of the next cash settlements in the first quarter of 2019 on these instruments is $nil. The net impact from cash settlements and changes in estimated fair value are included in financing costs.

The interest rate swaps are held at estimated fair value, priced using observable market inputs, and are therefore classified as Level (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. The following LOCs have been issued:

As at 31 December	2018 $m	2017 $m
Issued to third parties	**30.2**	31.0

These LOCs are required to be fully collateralised.

LHL and LICL have a $300.0 million syndicated collateralised credit facility with a $75.0 million loan sub-limit that has been in place since 24 March 2016 which will expire on 24 March 2021. There was no outstanding debt under this facility as at 31 December 2018 and 2017.

The existing facility is available for the issue of LOCs to ceding companies. The facility is also available for LICL to issue LOCs to LUK to collateralise certain insurance balances.

The terms of the $300.0 million syndicated collateralised credit facility include standard default and cross-default provisions, which require certain covenants to be adhered to. These include the following:

- an A.M. Best financial strength rating of at least B++;
- a maximum debt to capital ratio of 30.0 per cent, where the subordinated loan notes are excluded from this calculation;
- a maximum indebtedness regarding the subordinated loan notes of $250.0 million; and
- a maximum indebtedness regarding the Syndicate 2010 and 3010 catastrophe facilities of $150.0 million.

A $130.0 million syndicated uncollateralised facility had been in place since 3 October 2017 and was cancelled during December 2018. It was available for utilisation by LICL and guaranteed by LHL for FAL purposes. As at 31 December 2018 $nil (31 December 2017 – $130.0 million) of LOCs were issued under this facility.

The terms of the $130.0 million syndicated uncollateralised facility included standard default and cross-default provisions and require certain covenants to be adhered to. These include the following:

- an A.M. Best financial strength rating of at least B++;
- a maximum debt to capital ratio of 30.0 per cent, where the subordinated loan notes are excluded from this calculation;
- a maximum indebtedness regarding the subordinated loan notes of $250.0 million; and
- maintenance of a minimum net worth requirement.

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

Syndicate bank facilities

As at 31 December 2018 and 2017, Syndicate 2010 had in place an $80.0 million catastrophe facility. The facility is available to assist in paying claims and the gross funding of catastrophes for Syndicate 2010. Up to $80.0 million can be utilised by way of an LOC or an RCF to assist Syndicate 2010's gross funding requirements.

There are no balances outstanding under the Syndicate bank facility as at 31 December 2018 or 2017. The Syndicate bank facility is 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 and for the years ended 31 December 2018 and 2017, LICL had been granted accredited or trusteed reinsurer status in all U.S. States. The MBRT is subject to the rules and regulations of the aforementioned states and the respective deeds 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 2018 and 2017, the Group was in compliance with all covenants under its trust facilities.

The Group is required to hold a portion of its assets as FAL to support the underwriting capacities 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 page 133 for more information regarding FAL requirements.

In addition to the FAL, certain cash and investments held by Syndicate 2010 and Syndicate 3010 are only available for paying the syndicates' claims and expenses. See page 133 for more information regarding the capital requirements for Syndicate 2010 and Syndicate 3010.

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

	2018			2017		
As at 31 December	Cash and cash equivalents $m	Fixed maturity securities $m	Total $m	Cash and cash equivalents $m	Fixed maturity securities $m	Total $m
MBRT accounts	**1.4**	**174.7**	**176.1**	50.7	132.4	183.1
FAL	**6.2**	**306.7**	**312.9**	18.4	132.5	150.9
Syndicate accounts	**15.9**	**90.4**	**106.3**	21.0	78.3	99.3
In favour of LOCs	**2.3**	**38.7**	**41.0**	5.4	35.7	41.1
In trust accounts for policyholders	**3.4**	**24.9**	**28.3**	0.8	24.6	25.4
In favour of derivative contracts	**1.4**	**–**	**1.4**	3.0	0.3	3.3
Total	**30.6**	**635.4**	**666.0**	99.3	403.8	503.1

19. Share capital

Authorised common shares of $0.50 each	Number	$m
As at 31 December 2018 and 2017	3,000,000,000	1,500

Allocated, called up and fully paid	Number	$m
As at 31 December 2017 and 2016	201,341,918	100.7
Shares issued	600,000	0.3
As at 31 December 2018	**201,941,918**	**101.0**

The new common shares issued during 2018 were to fund future RSS exercises.

Own shares	Number held in treasury	$m	Number held in trust	$m	Total number of own shares	$m
As at 31 December 2016	1,415,058	14.0	1,048,969	9.2	2,464,027	23.2
Shares distributed	–	–	(1,130,800)	(9.9)	(1,130,800)	(9.9)
Shares donated to trust	(1,415,058)	(14.0)	1,415,058	12.8	–	(1.2)
As at 31 December 2017	–	–	1,333,227	12.1	1,333,227	12.1
Shares distributed	**–**	**–**	**(800,776)**	**(7.3)**	**(800,776)**	**(7.3)**
Shares purchased by trust	**–**	**–**	**600,000**	**4.6**	**600,000**	**4.6**
As at 31 December 2018	**–**	**–**	**1,132,451**	**9.4**	**1,132,451**	**9.4**

The number of common shares in issue with voting rights (allocated share capital less shares held in treasury) as at 31 December 2018 was 201,941,918 (31 December 2017 – 201,341,918).

19. Share capital continued

Share repurchases

At the AGM held on 2 May 2018, LHL's shareholders approved a renewal of the Repurchase Programme authorising the repurchase of a maximum of 20,134,192 shares, with such authority to expire on the conclusion of the 2019 AGM or, if earlier, 15 months from the date the resolution approving the Repurchase Programme was passed. There were no share repurchases during either 2018 or 2017.

Dividends

The Board of Directors have authorised the following dividends:

Type	Per share amount	Record date	Payment date	$m
Final	$0.10	24 Feb 2017	22 Mar 2017	19.9
Interim	$0.05	11 Aug 2017	6 Sep 2017	10.0
Final	**$0.10**	**23 Feb 2018**	**21 Mar 2018**	**20.0**
Interim	**$0.05**	**17 Aug 2018**	**12 Sep 2018**	**10.1**
Special	**$0.20**	**9 Nov 2018**	**12 Dec 2018**	**40.1**

20. Other reserves

Other reserves consist of the following:

	Contributed surplus $m	Equity based compensation $m	Total other reserves $m
As at 31 December 2016	839.5	42.1	881.6
Shares donated to the trust	(1.2)	–	(1.2)
Distributed by the trust	(13.8)	–	(13.8)
Equity based compensation – exercises	14.6	(14.6)	–
Equity based compensation – credit	–	(0.4)	(0.4)
As at 31 December 2017	839.1	27.1	866.2
Shares purchased by the trust	**4.3**	–	**4.3**
Distributed by the trust	**(9.9)**	–	**(9.9)**
Purchase of shares from non-controlling interest	**(0.1)**	–	**(0.1)**
Equity based compensation – exercises	**10.3**	**(10.3)**	–
Equity based compensation – expense	–	**8.5**	**8.5**
As at 31 December 2018	**843.7**	**25.3**	**869.0**

21. Commitments and contingencies

Lease commitments

The Group has payment obligations in respect of operating leases for certain items of office equipment and office space. Operating lease expenses for the year were $3.4 million (2017 – $3.4 million).

Future minimum lease payments under non-cancellable operating leases are as follows:

	2018 $m	2017 $m
Due in less than one year	**3.5**	3.6
Due between one and five years	**13.9**	10.0
Due in more than five years	**24.4**	28.3
Total	**41.8**	41.9

During 2014, the Group entered into a new lease agreement for larger office premises in the UK and assigned the leases in relation to the existing office premises in the UK to a third party who assumed responsibility for payments. Under the terms of the lease assignment the Group retains liability for lease payments in the event that the assignee and the assignee's guarantor fail to meet their obligations under the assignment agreements. The new lease agreement contains a break date of April 2029 and a lease end date of April 2034. The lease is guaranteed by LHL.

In December 2018, the Group committed to a new five-year lease agreement for its existing office premises in Bermuda. The new lease agreement is effective 1 January 2019.

Credit facility fund

As at 31 December 2018 the Group has a commitment of $100.0 million (31 December 2017 – $100.0 million) relating to two credit facility funds (refer to note 12).

Legal proceedings and regulations

The Group operates in the insurance industry and is subject to legal proceedings in the normal course of business. While it is not practicable to estimate or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings (including litigation) will have a material effect on its results and financial position.

22. Earnings per share

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

	2018 $m	2017 $m
Profit (loss) for the year attributable to equity shareholders of LHL	**37.5**	(71.1)

	2018 Number of shares	2017 Number of shares
Basic weighted average number of shares	**200,655,440**	199,723,434
Dilutive effect of RSS	**1,960,322**	1,780,368
Diluted weighted average number of shares	**202,615,762**	201,503,802

Earnings (loss) per share	2018	2017
Basic	**$0.19**	($0.36)
Diluted[1]	**$0.19**	($0.36)

1. Diluted EPS excludes dilutive effect of RSS when in a loss making position.

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.

23. Related party disclosures

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

Name	Principal Business	Domicile
Subsidiaries[1]		
CCHL	Investment company	United Kingdom
CCL	Holding company	United Kingdom
CCL 1998	Lloyd's corporate member	United Kingdom
CCL 1999	Non trading	United Kingdom
CCSL	Dormant	United Kingdom
CUL	Lloyd's managing agent	United Kingdom
KCML[2]	Insurance management services	Bermuda
KCMMSL	Support services	United Kingdom
LICL	General insurance business	Bermuda
LIHL	Holding company	United Kingdom
LIMSL	Insurance mediation activities	United Kingdom
LISL	Support services	United Kingdom
LMSCL	Support services	Canada
LUK	General insurance business	United Kingdom
ORANGE FUND	Investment fund	United States
Associate		
KHL[3]	Holding company	Bermuda
Other controlled entities		
EBT	Trust	Jersey
LHFT	Trust	United States

1. Unless otherwise stated, the Group owns 100 per cent of the ordinary share capital and voting rights in its subsidiaries listed below.
2. 93.5 per cent (2017 – 92.7 per cent) owned by the Group.
3. 10.0 per cent interest in the preference shares of each segregated account of KHL.

The Group has issued subordinated loan notes via a trust vehicle – LHFT, refer to note 18. 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, and 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, and 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 trustee 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 amount of $80.0 million. The Facility may only be used by the trustee for the purpose of achieving the objectives of the EBT. During the year ended 31 December 2018, the Group had made advances of $1.5 million (2017 – $6.0 million) to the EBT under the terms of the Facility.

During the year ended 31 December 2018, the Group issued 600,000 shares to the EBT at a par value of $0.3 million and a total value of $4.6 million at the prevailing market rate. During the year ended 31 December 2017, the Group donated 1,415,058 treasury shares to the EBT at the prevailing market rate. The total value of the treasury share donation was $12.8 million.

LICL holds $191.9 million (31 December 2017 – $245.3 million) of cash and cash equivalents, fixed maturity securities and accrued interest in trust for the benefit of LUK relating to intra-group reinsurance agreements. In addition, LICL is required to provide 85.0 per cent of the required FAL to support the underwriting activities of Syndicate 2010 and 3010 and holds $267.9 million (31 December 2017 – $109.2 million) of cash and cash equivalents and fixed maturity securities in FAL in relation to intra-group reinsurance agreements.

The senior management team shareholding in KCML represents a minority interest of 6.5 per cent (2017 – 7.3 per cent). This investment represents the non-controlling interest listed in the Group's consolidated balance sheet. During the year ended 31 December 2018, dividends of $nil (31 December 2017 – $0.6 million) were paid to minority interest holders.

As at 31 December 2018 and 2017, Mr Alex Maloney, a director of LHL, had a 1.2 per cent interest in KCML. During the year ended 31 December 2018, Mr Maloney received a dividend of $nil (31 December 2017 – $0.1 million) in relation to his interest in KCML.

Mr Maloney and his spouse acquired 100.0 per cent of the shares in Nameco on 7 November 2016. Nameco provides capacity to a number of Lloyd's syndicates including Syndicate 2010 which is managed by CUL. Nameco has provided $0.2 million of capacity to Syndicate 2010 for the 2019 year of account (2018 year of account – $0.2 million). Mr Maloney receives a proportionate share of the underwriting results of Syndicate 2010 to which he is contractually entitled through his participation.

Key management compensation

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

For the year ended 31 December	2018 $m	2017 $m
Short-term compensation	**2.3**	2.9
Equity based compensation	**1.2**	0.2
Directors' fees and expenses	**1.9**	2.1
Total	**5.4**	5.2

Non-Executive Directors do not receive any benefits in addition to their agreed fees and expenses and do not participate in any of the Group's incentive, performance or pension plans.

Transactions with associate

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. For the year ended 31 December 2018, the Group recognised $6.6 million (2017 – $11.7 million) of service fees and profit commissions in other income (refer to note 5) in relation to this agreement.

During 2018, the Group committed an additional $35.8 million (31 December 2017 – $57.5 million) of capital to KHL. During 2018, KHL returned $21.0 million (31 December 2017 – $38.4 million) of capital to the Group.

Refer to note 16 for further details on the Group's investment in associate.

Transactions with subsidiary of KHL

During 2017, the Group entered into a reinsurance agreement with KRL, which was not renewed during 2018. All reinsurance recoveries due as at 31 December 2017 were fully settled during 2018. The following balances were included in the Group's consolidated financial statements for the year ended 31 December 2017:

Consolidated balance sheet	2017 $m
Reinsurance recoveries	22.1

Consolidated statement of comprehensive income (loss)	2017 $m
Outwards reinsurance premiums	3.8
Insurance losses and loss adjustment expenses recoverable	22.1
Insurance acquisition expenses ceded	0.1

24. Subsequent events

Dividend

On 13 February 2019, the Board of Directors declared the payment of an ordinary dividend of $0.10 per common share to shareholders of record on 22 February 2019, with a settlement date of 27 March 2019. The ordinary dividend payable will be approximately $20.1 million. An amount equivalent to the dividend accrues on all RSS awards and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

Annual General Meeting

The Company's AGM is scheduled for 1 May 2019 and is to be held at the Company's registered and head office at Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda. Notice of this year's AGM and forms of proxy and direction accompany this Annual Report. If you have any queries regarding the notice or return of the proxy please contact Chris Head, Company Secretary, using Tel: + 44 (0) 20 7264 4000 and email: chris.head@lancashiregroup.com.

Further information

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

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

Note regarding forward-looking statements

Some of the statements in this document include forward-looking statements which reflect the Directors' current views with respect to financial performance, business strategy, plans and objectives of management for future operations (including development plans relating to the Group's products and services). These statements include forward-looking statements both with respect to the Group and the sectors and industries in which the Group operates. Statements containing the words 'believes', 'anticipates', 'plans', 'projects', 'forecasts', 'guidance', 'intends', 'expects', 'estimates', 'predicts', 'may', 'can', 'likely', 'will', 'seeks', 'should' or, in each case, their negative or comparable terminology and similar statements are of a future or forward-looking nature. All forward-looking statements address matters that involve known and unknown risks and uncertainties. Accordingly, there are or will be 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 actual development of losses and expenses impacting estimates for the Californian wildfires and hurricane Michael which occurred in the fourth quarter of 2018, hurricane Florence, the typhoons and marine losses that occurred in the third quarter of 2018, hurricanes Harvey, Irma and Maria and the earthquakes in Mexico, that occurred in the third quarter of 2017 and the wildfires which impacted parts of California during 2017; the impact of complex and unique causation and coverage issues associated with attribution of losses to wind or flood damage or other perils such as fire or business interruption relating to such events; potential uncertainties relating to reinsurance recoveries, reinstatement premiums and other factors inherent in loss estimations; the Group's ability to integrate its business 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 the Group may write; the Group's ability to successfully implement its business strategy during 'soft' as well as 'hard' markets; 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; increased competition from existing alternative capital providers and insurance-linked funds and collateralised special purpose insurers, and the related demand and supply dynamics as contracts come up for renewal; 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, S&P Global Ratings, 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 maturity investments; the impact of swings in market interest rates, currency exchange rates and securities prices; changes by central banks regarding the level of interest rates; the impact of inflation or deflation in relevant economies in which the Group operates; the effect, timing and other uncertainties surrounding future business combinations within the insurance and reinsurance industries; the impact of terrorist activity in the countries in which the Group writes risks; 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; Lancashire or its Bermudian subsidiaries becoming subject to income taxes in the United States or in the United Kingdom; the impact of the change in tax residence on stakeholders of the Group; and the impact of 'Brexit' (following the UK's notification to the European Council under Article 50 of the Treaty on European Union on 29 March 2017) and future negotiations regarding the UK's relationship with the European Union on the Group's business, regulatory relationships, underwriting platforms or the industry generally.

Any estimates relating to loss events involve the exercise of considerable judgement and reflect a combination of ground-up evaluations, information available to date from brokers and insureds, market intelligence, initial and/or tentative loss reports and other sources. Judgements in relation to loss arising from natural catastrophe and man-made events are influenced by complex factors. The Group cautions as to the preliminary nature of the information used to prepare such estimates as subsequently available information may contribute to an increase in these types of losses.

These forward-looking statements speak only as at the date of this document. The Company expressly disclaims any obligation or undertaking (save as required to comply with any legal or regulatory obligations including the rules of the LSE) to disseminate any updates or revisions to any forward-looking statement to reflect any changes in the Group's expectations or circumstances on which any such statement is based. All subsequent written and oral forward-looking statements attributable to the Group or individuals acting on behalf of the Group are expressly qualified in their entirety by this paragraph. Prospective investors should specifically consider the factors identified in this document which could cause actual results to differ before making an investment decision.

Glossary

ABS
Asset backed securities

Accident year loss ratio
The accident year loss ratio is calculated using the accident year ultimate liability revalued at the current balance sheet date, divided by net premiums earned

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

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

AFS
Available for sale

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

AGM
Annual General Meeting

AIM
A sub-market of the LSE

AIR
AIR Worldwide

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

APM
Alternative performance measures

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

BMA
Bermuda Monetary Authority

Board of Directors; Board
Unless otherwise stated refers to the LHL Board of Directors

Book value per share (BVS)
Calculated by dividing the value of the total shareholders' equity by the sum of all common voting shares outstanding

BREEAM
Building Research Establishment Environmental Assessment Method

BSCR
Bermuda Solvency Capital Requirement

BSX
Bermuda Stock Exchange

Cathedral; Cathedral Group
Refers to CCL and all direct and indirect subsidiaries of CCL

CCHL
Cathedral Capital Holdings Limited

CCL
Cathedral Capital Limited

CCL 1998
Cathedral Capital (1998) Limited

CCL 1999
Cathedral Capital (1999) 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

CEND
Confiscation, Expropriation, Nationalisation and Deprivation

CEO
Chief Executive Officer

CFO
Chief Financial Officer

CGU
Cash generating unit

CIO
Chief Investment Officer

CMBS
Commercial mortgage backed securities

The Code
UK Corporate Governance Code published by the UK FRC

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

Consolidated financial statements
Includes the independent auditors report, consolidated primary statements, accounting policies, risk disclosures and related notes

Consolidated primary statements
Includes the consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in shareholders' equity and the statement of consolidated cash flows

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

CRO
Chief Risk Officer

CSX
Cayman Islands Stock Exchange

CUL
Cathedral Underwriting Limited

CUO
Chief Underwriting Officer

D&F
Direct and facultative (re)insurance

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

DEFRA
Department for Environment, Food and Rural Affairs

Delegated authorities
Arrangements under which a managing agent or (re)insurer delegates its authority to another to enter into contracts of insurance on its behalf

Diluted earnings per share
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

Directors' fees and expenses
Unless otherwise stated includes fees and expenses of all Directors across the Group

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

EEA
European Economic Area

ERM
Enterprise Risk Management

EU
European Union

EURIBOR
The Euro Interbank Offered Rate

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

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

FAL
Funds at Lloyd's

FCA
Financial Conduct Authority

FPSO
Floating production storage and offloading

FRC
Financial Reporting Council

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

FTE
Full-Time Employee

Fully converted book value per share (FCBVS)
Calculated based on the value of the total shareholders' equity attributable to the Group and dilutive restricted stock units as calculated under the treasury method, divided by the sum of all shares and dilutive restricted stock units, assuming all are exercised

FVTPL
Fair value through profit or loss

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

GHG
Greenhouse gas emissions covers carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFC), perfluorocarbons (PFC), nitrogen trifluoride (NF_3) and sulphur hexafluoride (SF_6)

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 or the Lancashire Group
LHL and its subsidiaries

ICM
International Care Ministries

IFRIC
International Financial Reporting Interpretations Committee

IFRS
International Financial Reporting Standard(s)

ILS
Insurance Linked Securities

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

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

Internal Audit Charter
A formal written document that sets out the mission, scope, responsibilities, authority, professional standards and the relationship with the external auditors and regulatory bodies of the internal audit function 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

ISA
International Standards on Auditing (UK)

ISE
Irish Stock Exchange

KCML
Kinesis Capital Management Limited

KCMMSL
KCM Marketing Services Limited

KHL
Kinesis Holdings I Limited

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

KPMG
KPMG LLP, a UK limited liability partnership

KPI
Key performance indicator

KRL (Kinesis Re)
Kinesis Reinsurance I Limited

Lancashire companies
Refers to the Group excluding Cathedral and Kinesis

Lancashire Foundation or Foundation
The Lancashire Foundation is a charity registered in England and Wales

LHFT
Lancashire Holdings Financing Trust I Limited

LHL (The Company)
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)

Lloyd's
The Society of Lloyd's

Lloyd's Brussels
Lloyd's Insurance Company SA, the insurer that Lloyd's has established in Brussels

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

LUK
Lancashire Insurance Company (UK) Limited

Managed cash
Managed cash includes both cash managed by external investment managers and non-operating cash managed internally

M&A
Mergers and acquisitions

MBRT
Multi-beneficiary reinsurance trust

MBS
Mortgage backed securities

Moody's investors services (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

MSF
Médecins Sans Frontières

Nameco
Nameco (No. 801) Ltd

Names
An individual member underwriting at Lloyd's with unlimited liability. Since 6 March 2003 no person has been admitted as a new member to underwrite on an unlimited basis

NAV
Net asset value

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

Net expense ratio
Ratio, in per cent, of other operating expenses, excluding restricted stock expenses, to net premiums earned

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

Net premiums earned
Net premiums earned is equal to net premium written less the change in unearned premiums and change in unearned premiums on premiums ceded

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

Official List
The official list of the UK Listing Authority

Orange Fund
A Series of Payden Active Cash Management, LLC

ORSA
Own Risk and Solvency Assessment

OTC
Over the counter

PML
Probable maximum loss. The Group's exposure to certain peak zone elemental losses

PRA
Prudential Regulation Authority

Pro-rata/proportional
Reinsurance or insurance where the reinsurer or insurer shares a proportional part of the original premiums and losses of the reinsured or insured

RCCC
Risk Capital and Compliance Committee

RCF
Revolving credit facility

RDS
Realistic Disaster Scenarios

Retrocession
The insurance of a reinsurance account

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

Risk Free Rate of Return (RFRoR)
Being the 13 week U.S. Treasury bill rate, unless otherwise stated

RMBS
Residential mortgage backed securities

RMF
Risk Management Framework

RMS
Risk Management Solutions

RPI
Renewal Price Index

RRC
Risk and Return Committee

RSC
Reinsurance Security Committee

RSS
Restricted share scheme

S&P Global Ratings (S&P)
S&P Global Ratings 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

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

SCR
Solvency Capital Requirement

SHARP
Lancashire's in house aggregation system

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

The syndicates
Syndicate 2010 and 3010

TOBA
Terms of business agreements

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

Total Shareholder Return (TSR)
The IRR of the increase/(decrease) 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

UK
United Kingdom

UMCC
Underwriting and Marketing Conference Call

Unearned premiums
The portion of premium income that is attributable to periods after the balance sheet date that is deferred and amortised to future accounting periods

UNL
Ultimate net loss

uSCR
Ultimate solvency capital requirement

U.S.
United States of America

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

Alternative Performance Measures ('APMs')

As is customary in the insurance industry, the Group also utilises certain non GAAP measures in order to evaluate, monitor and manage the business and to aid users' understanding of the Group. In compliance with the Guidelines on APMs of the European Securities and Markets Authority, we give information on APMs in the table below. This information has not been audited.

Management believes that the APMs included in the Annual Report and Accounts are important for understanding the Group's overall results of operations and may be helpful to investors and other interested parties who may benefit from having a consistent basis for comparison with other companies within the industry. However, these measures may not be comparable to similarly labelled measures used by companies inside or outside the insurance industry. In addition, the information contained herein should not be viewed as superior to, or a substitute for, the measures determined in accordance with the accounting principles used by the Group for its audited consolidated financial statements or in accordance with GAAP.

The following APMs included in the Annual Report and Accounts have not been prepared in accordance with the accounting principles used by the Group for its audited consolidated financial statements. Refer to pages 162 to 166 of the Glossary for definitions on each of the below APMs.

Below is an explanation of the APMs as well as information regarding their relevance:

APM	Relevance
Net loss ratio	This ratio gives an indication of the amount of claims expected to be paid out per $1.00 of net premium earned in the financial year.
Net acquisition cost ratio	This ratio gives an indication of the amount expected to be paid out to insurance brokers and other insurance intermediaries per $1.00 of net premium earned in the financial year.
Net expense ratio	This ratio gives an indication of the amount of operating expenses expected to be paid out per $1.00 of net premium earned in the financial year.
Combined ratio (KPI)	The Group aims to price its business to ensure that the combined ratio across the cycle is significantly less than 100 per cent.
Accident year loss ratio	This ratio shows the amount of claims expected to be paid out per $1.00 of net premium earned in an accident year.
Fully converted book value per share ('FCBVS') attributable to the Group	Shows the Group net asset value on a diluted per share basis for comparison to the market value per share.
Return on equity ('RoE') (KPI) (RoE is also sometimes referred to as the change in FCBVS adjusted for dividends)	The Group's aim is to maximise risk-adjusted returns for shareholders across the cycle.
Total investment return (KPI)	The Group's primary investment objectives are to preserve capital and provide adequate liquidity to support the Group's payment of claims and other obligations. Within this framework we aim for a degree of investment portfolio return.
Total shareholder return (KPI)	The Group's aim is to maximise RoE over the longer term and we would expect that to be reflected in our share price and multiple. This is a long-term goal, recognising that the cyclicality and volatility of both the insurance market and the financial markets in general will impact management's ability to maximise the RoE in the immediate term.
Comprehensive income returned to shareholders (KPI)	The Group aims to carry the right level of capital to match attractive underwriting opportunities, utilising an optimal mix of capital tools. Over time, through proactive and flexible capital management across the cycle, we aim to maximise risk-adjusted returns for shareholders.
Dividend yield (KPI)	The Group aims to maintain a strong balance sheet whilst maximising risk-adjusted return for shareholders across the cycle. Lancashire's dividend yield demonstrates our ability to operate nimbly through the cycle through the active capital management that underpins our business model. We aim to pay annual ordinary dividends, and when we decide not to retain our profits as additional underwriting capital we return them to shareholders by way of special dividends.

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