Annual Report & Accounts 2013

lancashire
HOLDINGS LIMITED

THE POWER OF THREE

THE LANCASHIRE CONSTELLATION

In 2013 the Group has taken some significant strategic steps in response to changes in the market that are both cyclical and secular. We broadened the operating base by acquiring Cathedral, a top-performing Lloyd's business and set up a permanent reinsurance asset management business in Kinesis, and whilst the three business platforms have different capital structures, each is united by the ethos that underwriting comes first.

Like a constellation of stars, all three have a bright individual identity, but seen together the whole is greater than the sum of its parts.

LANCASHIRE

A leading specialist insurer and reinsurer with focused expertise in niche areas of business with an outstanding track record.

See p8

CATHEDRAL

Two Lloyd's syndicates with a track record of top tier performance in specialty short-tail lines, with a platform for profitable expansion.

See p10

KINESIS

A reinsurance asset management and underwriting entity, based in Bermuda, addressing the secular shift of asset allocation to reinsurance.

See p12

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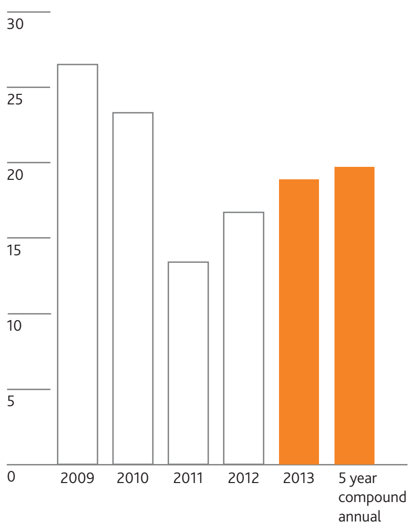
SUPERIOR RETURNS

Whilst broadening the base of our business, we have continued to produce strong returns.

KPI

RETURN ON EQUITY

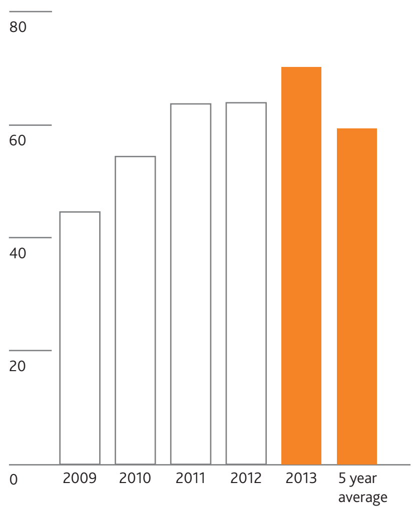
18.9%



KPI

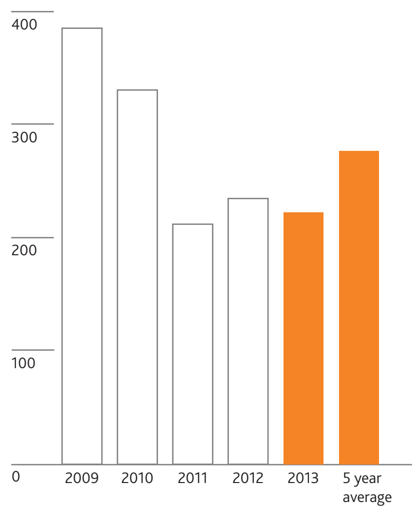
COMBINED RATIO

70.2%



PROFIT AFTER TAX

$222.5m

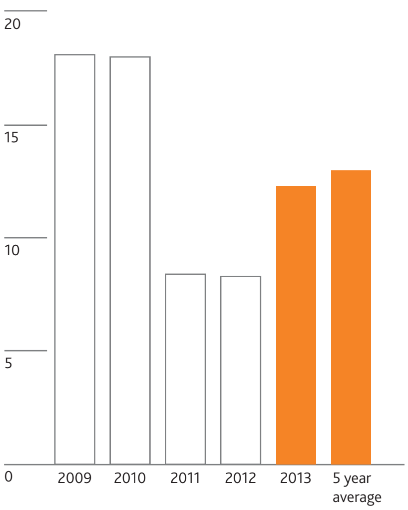


OPERATING HIGHLIGHTS

- Acquisition of Cathedral, giving access to a first-class Lloyd's business with global licences, strong rating and an efficient capital model.
- Continued focus on core Lancashire Bermuda and London businesses with strong development of political and sovereign risk and catastrophe excess of loss lines.
- Introduction of Kinesis to build out Lancashire's insurance management expertise.
- Attracted senior level employees and underwriters to Lancashire including the appointments of James Flude as head of Lancashire marine and energy and Darren Redhead as head of Kinesis as well as the Cathedral team of 62 people, including 14 underwriters.
- Continued record of special dividend payments, in addition to the regular ordinary dividends. Q3 special dividend paid of $94.5 million, and additional special dividend of approximately $42.0 million to be paid at the time of the final dividend.
- Approval of 15 per cent pre-emptive share allotment authority by a vote of over 96 per cent of shareholders at the 2013 AGM, enhancing the Group's financial flexibility.
- 2013 net loss ratio of 33.1 per cent. Accident year loss ratio of 36.1 per cent demonstrating continuing low attritional loss ratios in the Lancashire business.

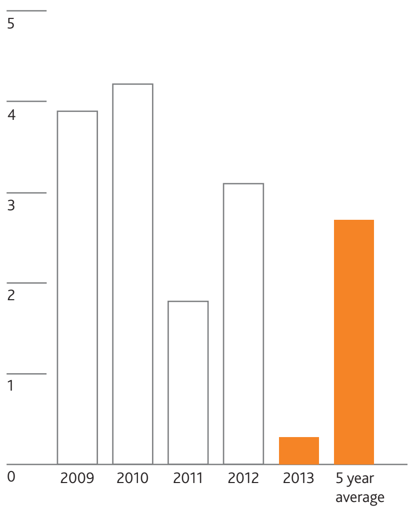
DIVIDEND YIELD

12.3%



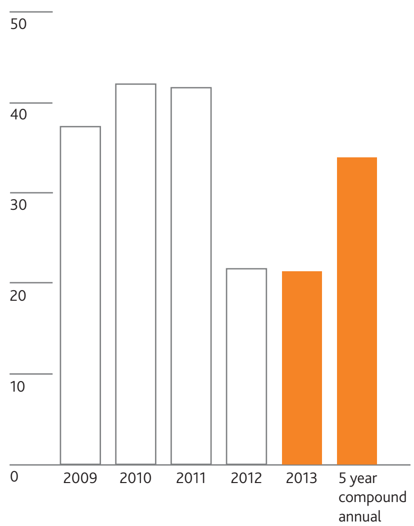
KPI TOTAL INVESTMENT RETURN

0.3%



KPI TOTAL SHAREHOLDER RETURN

21.3%



OVERVIEW

FINANCIAL HIGHLIGHTS

- Combined ratio of 70.2 per cent in spite of softening market conditions.
- Expense ratio of 15.0 per cent.
- Investment return of 0.3 per cent in challenging markets reflecting a desire to preserve capital versus reaching for yield.
- Successful placing of approximately 16.84 million new common shares amounting to an equity raise of 9.99 per cent of shares at a 3 per cent discount to closing. This was used to part fund the acquisition of Cathedral with the balance from own cash resources.
- Gross premiums written for the Group of $679.7 million with a contribution of $24.5 million from Cathedral from completion of the acquisition.
- Over $250 million of limit deployed by Kinesis from investors at 1 January 2014. A further special draw was also made in February 2014.

REMAINING RELEVANT

MARTIN THOMAS
NON-EXECUTIVE CHAIRMAN

"Having built on Lancashire's strengths, the Cathedral and Kinesis strategic business initiatives afford the Group a broader base, making us even better placed to serve our clients and investors."

STRONG GOVERNANCE FRAMEWORK

The Board's discussions and decisions are focused on maintaining the right strategy across the cycle.

See p56

CORPORATE RESPONSIBILITY

The Board has decided upon a policy to donate 1 per cent of our net profits to the Lancashire Foundation.

See p45

Dear shareholders,

STRATEGIC PLANNING – BUILDING A BROADER BASE

2013 saw a rapidly changing insurance market affected by the over supply of capital and some softening, in consequence, in the Group's traditional core business lines. The Board addressed the requirement of ensuring that the Company's strategy remained nimble and relevant. Responding to the challenges of these markets, the Company implemented the most extensive change to its business since its formation in 2005. The purchase of the Cathedral Group has for the first time provided Lancashire with an underwriting platform within the Lloyd's market, and further diversified our lines of insurance business. Towards the end of the year we saw the Kinesis third party capital facility successfully bring over $250 million of reinsurance capacity to the market to be deployed on January 2014 incepting business. This marked the next step in the natural development of our third party reinsurance strategy. We finished the year with three core platforms making Lancashire a broader, more diversified business, capable of remaining relevant to the requirements of our investors, stakeholders, brokers and clients.

2013 RESULTS

Lancashire delivered a very solid performance in a tough market. RoE for 2013 was 18.9 per cent and TSR was 21.3 per cent. On a like-for-like basis (excluding results from the Cathedral and Kinesis platforms) the Group's gross premiums written were down 9.5 per cent, reflecting our underwriting discipline in a softer market.

LANCASHIRE FOUNDATION

I take particular pleasure in the fact that in 2013 Lancashire boosted the grant to the Lancashire Foundation to 1 per cent of net profits, subject to a minimum of $2 million, marking the new keystone of our Corporate Responsibility.

CAPITAL MANAGEMENT

Effective capital management remains at the heart of Lancashire's strategy. As part of the Cathedral transaction LHL issued and placed 16,843,382 common shares amounting to 9.99 per cent of the issued common share capital immediately prior to the placing. These were admitted to trading on the LSE on 12 August 2013. This issue raised total net proceeds of approximately $198.2 million which was used to partially fund the acquisition of Cathedral.

The Board was pleased to declare ordinary and special dividends in respect of 2013 amounting in total to $0.80 per common share (see page 89 for further details). Once again I would like to thank our shareholders for affording the Group flexibility in its capital management capabilities. At the AGM held in May 2013 we asked for, and received, shareholder support to issue up to 15 per cent of the Company's shares on a non pre-emptive basis. In my letter to shareholders at the time I said, "The Company operates in a market that rewards the fastest to react, those who can play a role in benchmarking an adjusted pricing regime, as well as meeting brokers' needs for immediate capacity. In this way, first movers make the new market". That principle remains at the heart of Lancashire's nimble capital management strategy and the Company will be seeking shareholder support for a similar resolution at the 2014 AGM.

COMMUNICATION AND GOVERNANCE

Good communication and governance help the Board develop an effective commercial strategy. In 2013 the Board acted nimbly to articulate and implement the Company's strategic objectives. We have worked with our shareholders and wider stakeholders to ensure a transparent and straightforward articulation of our goals. I was particularly pleased with the overwhelming shareholder vote in favour of the Cathedral acquisition in September 2013. Please see page 61 for my more detailed summary of the work of the Board during 2013.

BOARD COMPOSITION PLANNING

2014 will be a year of change and development for the Board. In keeping with the requirement for ensuring independence of mind and relevance of skills, we have initiated a plan for refreshing the Board. In this context we say goodbye at the 2014 AGM to John Bishop and Ralf Oelssner, who are rotating off the Board after six and eight years' valuable service respectively. In addition, Neil McConachie, who joined the Board in 2005, and switched from Executive to Non-Executive Director in 2012, has decided to step down at the 2014 AGM. This will help preserve the right balance between independent and non-independent Directors. I would like to thank John, Ralf and Neil for their long years as valued colleagues and I wish them well for the future.

With the above changes in mind, at the time of our 2014 AGM, the role of Chair of the Audit Committee will be handed over to Samantha Hoe-Richardson, and the roles of Chair of the Remuneration Committee and Senior Independent Director will be handed over to Simon Fraser.

Our last two Non-Executive Board appointments have included one with a full-time external executive role, to bring some further operational experience to the Board, and one with a broad skill set drawn from experience in investment banking. These appointments have started a generational change in Board membership that will be executed across 2014 and will involve adding several new Non-Executive Directors to the Board.

APPRECIATION

I'd like to thank the Executive Directors for the contributions they made during 2013. We also welcome Peter Scales and the rest of the Cathedral staff, Darren Redhead of Kinesis and James Flude to the Lancashire Group.

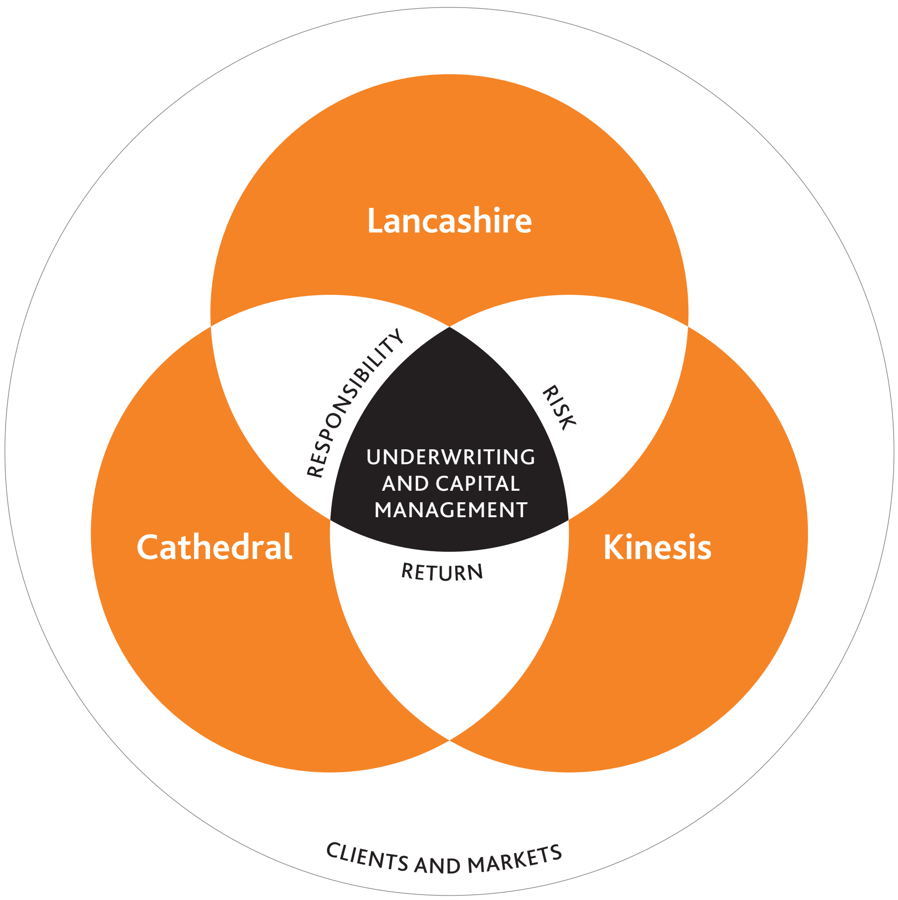
OUTLOOK FOR 2014

We enter 2014 as a more broadly based business. The coming year presents an exciting opportunity for the enlarged Group to further develop its strategy, building on its core skills and relationships across all underwriting channels.

MARTIN THOMAS
NON-EXECUTIVE CHAIRMAN

THE POWER OF THREE

Lancashire is a bigger, more varied business in 2013 with three different business platforms and balance sheets to serve our clients' and brokers' needs.



There has been a lot going on in 2013, both within Lancashire and within our marketplace. But our core principles remain unaltered. In fact, you can see those principles in action in all the decisions that we've made in 2013.

The Lancashire model has basically not changed since we were set up. It starts with an unrelenting focus on underwriting and how to optimise our portfolio. It demands that the returns we can obtain are weighed against the risks, and it requires us to operate nimbly by anticipating and reacting to the changes in our marketplace. By concentrating on the bottom line rather than the top line, and always aligning our interests with our shareholders, we ensure that the risk-adjusted return motivates our thinking about capital and risk management. We think that an emphasis on short-tail risks best suits these priorities, and that a lean operating structure ensures that information flows quickly through the organisation, and prevents sclerosis in decision making. We also believe that making sure we think about the responsibility we owe not just to shareholders, staff, brokers, clients and regulators, but also to the societies we operate in and to the broader world contributes to our long-term stability and success.

So in acquiring Cathedral and establishing Kinesis, Lancashire has endeavoured to ensure that the core elements of this business model are not compromised. The attraction in broadening the reach of Lancashire to encompass three different capital bases has not been allowed to override the proven success of the existing business model.

In February 2013, we announced the formation of the Lancashire Capital Management Division (LCM), and in March the appointment of Darren Redhead as its head, operating under the Kinesis name. One of the major issues in the reinsurance and retrocession world in 2013 has been the accelerating interest from capital markets in catastrophe risk, and the profusion of collateralised capital reinsurers and advisers. Lancashire has been working in this area since 2006 when our energy sidecar Sirocco was formed with a private equity group. Since then we have formed Accordion in 2011 and Saltire in 2012 to address needs in dislocated markets. But it is now apparent that client demand and investor interest allow for the creation of a more permanent capital markets solution, and that is what Kinesis aims to be.

In August 2013, Lancashire announced the proposed acquisition of Cathedral, which was completed in November 2013. This is the first acquisition that Lancashire has ever made. Cathedral is a top tier Lloyd's business that has been the sixth best performing syndicate in terms of combined ratio over the entire period 2005-2012. Whilst Cathedral writes similar classes of short-tail business to Lancashire, it has different niche emphases. In property, it writes a large reinsurance portfolio of U.S. mutual companies and a diversified international book, as well as direct property. In aviation, it focuses on reinsurance, and in marine on cargo. There is also a small contingency portfolio.

With the addition of Kinesis and Cathedral, Lancashire now has three platforms to access different kinds of capital, all with high-profile, experienced and established underwriters. They are able to provide brokers and clients with insurance, reinsurance and retrocession solutions for all types of risk transfer requirements.

Entity	Lancashire	Cathedral	Kinesis
Underwriting	Focus on short-tail classes in areas of expertise – property, energy, marine, aviation.	Focus on short-tail classes in areas of expertise – property, marine, aviation, contingency.	Focus on short-tail classes in areas of expertise – property, energy, marine, aviation.
Risk	Daily underwriting call and fortnightly RRC address risk at the micro and macro levels.	Underwriting peer review with exception reporting. Part of the RRC since acquisition.	Underwriting peer review with independent actuarial review.
Return	Compound annual RoE since inception of 19.2 per cent.	Combined ratio of 87 per cent in the period 2005-12 placing Cathedral sixth in the ranking of Lloyd's syndicates.	Overall strategy has a double digit target return for investors on an expected basis.
Responsibility	The Lancashire Group's commitment to its employees, shareholders, regulators, brokers and clients shows through in the longevity of its key staff, the core client relationships that it fosters, the cautious approach to investing and risk management and the contribution that the Lancashire Foundation makes to the societies in which the Group companies operate and to the wider world.		

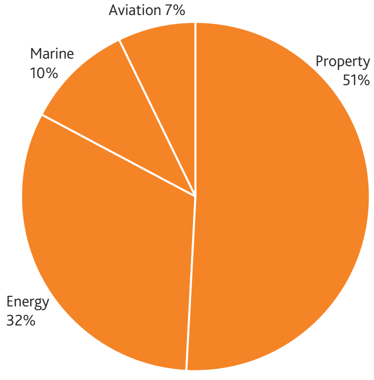
LANCASHIRE: WHERE UNDERWRITING COMES FIRST

"Lancashire provides a substantial part of the core portfolio as well as the ability to respond nimbly in post-loss situations."

PAUL GREGORY
CHIEF UNDERWRITING OFFICER, LUK

SYLVAIN PERRIER
CHIEF UNDERWRITING OFFICER, LICL

CLASSES OF BUSINESS*



TOTAL PORTFOLIO*

$655.2m

COMBINED RATIO*

68.9%

* Gross premiums written and the combined ratio for the Group's property, energy, marine and aviation segments for the year ended 31 December 2013, excluding the Lloyd's segment. Further details of the Group's segments can be found on pages 30 to 39.

Lancashire's role in the enlarged group is two-fold. As the traditional company market rated (re)insurer operating through its Bermuda and London subsidiaries, Lancashire provides a substantial part of the core portfolio as well as the ability to respond nimbly, for example in post-loss situations. LICL, as the holder of the majority of the Group's capital, facilitates the acceptance of larger risks, both on its own account and as a reinsurer of the direct writers in the Group at LUK and Cathedral. It writes the larger reinsurance and retrocession risks often for worldwide or super-regional cedants. LUK continues to write mostly direct insurance with a leading presence in the energy, terrorism, political and sovereign risk, marine hull and AV52 markets. Carrying substantial capital headroom (above both regulatory and rating agency requirements) allows the Lancashire operating companies to respond quickly to new opportunities. The daily underwriting call and the fortnightly RRC (see ERM section on page 40) ensure that the senior management of Lancashire is continually attuned to market developments, and receives an unfiltered view of the underwriting environment.

Deploying post-loss capacity in Canada and China in 2013, after the series of flooding losses, demonstrates the nimbleness of the response of which Lancashire is capable.

REVIEW OF THE YEAR AND OPERATIONAL HIGHLIGHTS

There is no doubt that the influx of new capital has put pressure on the reinsurance and retrocession areas in 2013. Whilst collateralised products do not suit all types of clients, there are commoditised sectors of the catastrophe reinsurance and retrocession markets, which are focused mostly on price, and this has led to strong competition in these segments. Fortunately, much of LICL's and LUK's business is not susceptible to this.

In terms of losses, there were some disappointments in 2013. Chief amongst these was the deterioration in the Costa Concordia claim where nearly $500 million was added to the cost to the insurance market of the removal of the wreck. However, the absence of any major hurricane or earthquake events affecting the portfolio meant that overall loss ratios were still very good.

FOCUS FOR THE FUTURE

At this stage of the cycle, LICL and LUK will focus first and foremost on their existing clients and brokers to protect their core portfolios. We know that the insurance market is cyclical, and that in times of abundant capital, pricing will come under pressure. So our key jobs are to service our clients and brokers, by giving prompt responses, deploying meaningful amounts of capital and making responsible innovations in coverage, such as offering multi-year deals. In the marine and aviation lines in particular we are not expecting many opportunities to develop the account other than in the renewal of the IGPIA account following the deterioration of the Costa Concordia loss.

Nonetheless, there will be opportunities to continue the expansion of the property catastrophe excess of loss account with the support of our brokers. We also expect our efforts with clients on the political and sovereign risk account to continue to bear fruit and we look forward to working with brokers, banks and obligors on our portfolio, which has grown to $66.4 million of gross premiums written in 2013.

The influx of capital markets capacity affects the reinsurance and retrocession risks that Lancashire takes on to its own balance sheet, by impacting pricing and the amount of available business. But it also affects the cost of the reinsurance and retrocession that Lancashire buys. New products and coverages are available, so we will increasingly focus on the outwards reinsurance opportunities available to LICL and LUK to enhance our portfolio's risk-adjusted return.

KEY STRENGTHS

- The ability to deploy substantial amounts of capacity with prompt decision making.
- The strong emphasis on risk selection at the micro end with the UMCC.
- The continual process of portfolio optimisation through the work of the RRC.
- The close working relationship between all functions – underwriting, actuarial, finance, operational, risk, legal and compliance – underpins the ability to react quickly and decisively when opportunities arise.

TARGETS

- Meet our cross-cycle return of the risk-free rate plus 13 per cent.
- Continue our service to brokers and clients by remaining relevant and responsive.
- We aim to maintain our submission volumes, which are a good indication of our continuing relevance and were up by 11 per cent in 2013.
- LICL and LUK deliberately do not give guidance on premiums. We believe that in a cyclical business top-line growth targets can be dangerous, and distort the focus on profitability.

ASSOCIATED RISKS

- Failure to adapt the business to the cycle.
- Failure to manage risk aggregations or understand exposures, such that inappropriate levels of risk are accepted.
- Solvency II increasing the burden of regulatory reporting.

Read our Group principal risks p42

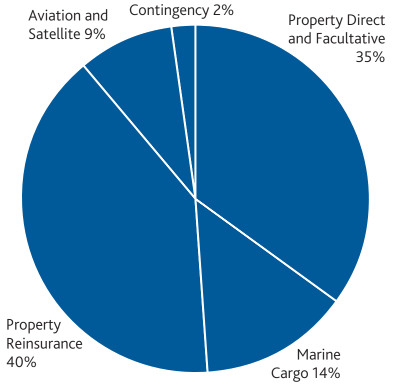
CATHEDRAL: OPENING UP THE LLOYD'S MARKET

"Cathedral's underwriters are market leaders in each area in which they trade and have produced more than a decade of profitable returns."

PETER SCALES
CHIEF EXECUTIVE OFFICER, CATHEDRAL

JOHN HAMBLIN
ACTIVE UNDERWRITER,
CATHEDRAL SYNDICATES 2010 AND 3010

CLASSES OF BUSINESS*



TOTAL PORTFOLIO*

$288.2m

COMBINED RATIO*

77.3%

* Gross premiums written and the combined ratio for Cathedral, the Group's Lloyd's segment, for the full year ended 31 December 2013. The Group's share of Cathedral's result from 7 November 2013 has been included in the Group's consolidated financial statements.

Cathedral adds a new unit to the Lancashire group that brings with it five classes of business. These mature underwriting portfolios, and experienced teams, dovetail well with the Lancashire areas of expertise. They also bring with them long-standing client and broker relationships and considerable expertise in terms of exposure, risk and reinsurance management.

The way that Cathedral underwrites its business is different, and therefore complementary, to Lancashire's model of writing larger direct, reinsurance and retrocessional risks in the non-Lloyd's environment. The Cathedral approach is based on greater populations of risk in portfolios of more modest individual line sizes, balancing exposure and dampening volatility through the judicious purchase of reinsurance. Cathedral will continue to trade in this way at Lloyd's under its own brand, but now with the benefit of the Lancashire Group's reputation and balance sheet. This gives greater ability to leverage positions, should opportunities present themselves.

Perhaps more importantly, Cathedral has always shared the Lancashire ethos that 'underwriting comes first'. With this simple premise in common, and with Lancashire's three trading platforms, there is a wide-ranging expertise in the short-tail insurance and reinsurance arenas that enables the Group to develop the most effective way to trade going forward.

The Group now has a significant presence in the short-tail specialist markets. In addition, the combination of Lancashire, Cathedral and Kinesis allows us to utilise our capital base efficiently, to both manage our exposures and achieve the best reward for the risks we take, however the market place moves. The industry landscape has changed markedly even in the last two years and will undoubtedly continue to do so. The scarcest resource in our industry is proven underwriters with a franchise, and of these we have more than our fair share.

RATIONALE FOR ACQUISITION AND KEY BENEFITS

The acquisition of Cathedral brings with it more lines of business that are sustainable through the cycle, plus a high-quality underwriting resource. It also brings the benefit of a Lloyd's platform, with worldwide licences in areas such as Canada and Brazil, where Lancashire sees opportunities in certain lines. Further, it brings Lloyd's high-quality security ratings that are acceptable to most counterparties worldwide.

The acquisition also allows the Group to improve Cathedral's capital structure and efficiency, making the acquisition accretive to RoE.

FOCUS FOR THE FUTURE

Cathedral has two syndicates under management at Lloyd's. The larger syndicate, Syndicate 2010, houses all the business lines, with the exception of cargo. Cargo was added in a separate syndicate, Syndicate 3010, in 2007. All lines of business are managed on the same basis in all regards, other than the ownership of the underwriting capacity.

Syndicate 2010 has 42.2 per cent of its capacity provided by third-party capital (Lloyd's Names) who pay a fee, profit commission and their share of the costs. The remainder is underwritten on the Cathedral balance sheet. Syndicate 3010 is wholly underwritten for the Cathedral balance sheet, and provides the logical platform to build out additional business in future.

Our goal is to continue to manage Syndicate 3010 under its existing business model, with the added benefits of being in the Lancashire Group. Over time, we will leverage Lancashire's expertise and market leading position in the energy and terrorism lines of business to develop those lines in the syndicate. We also aim to attract additional high-quality underwriters to further build out the syndicate.

KEY STRENGTHS

- Highly experienced underwriters with extensive cross-cycle experience.
- Relevant and responsive to brokers and clients with core books of relationship business.
- Focus on exposure management; both gross and net.
- Nimble and agile underwriting and management structure.
- Lloyd's worldwide licencing and rating.
- Third-party capital (Lloyd's Names) provide risk and expense sharing partners who remunerate Cathedral by way of fees and profit commission.

TARGETS

- Begin the process of building out the business lines written in Syndicate 3010.
- Co-locate to offices with our Lancashire colleagues, harmonising technology infrastructure in the process.
- Implement Cathedral's intended underwriting system upgrade during 2014.
- Maintain Cathedral's Solvency II preparedness and keep pace with Lloyd's expectations regarding its required minimum standards of governance, underwriting and risk management.

ASSOCIATED RISKS

- Inability to attract and retain suitable, high-quality underwriters to help build out Syndicate 3010.
- Failure to achieve Lloyd's approval to write new business in Syndicate 3010.

Read our Group principal risks p42

KINESIS: A STEP FORWARD IN THIRD-PARTY CAPITAL

"Kinesis is uniquely positioned to access the multi-class collateralised demand in the reinsurance market, while providing returns to investors that are uncorrelated to the broader financial markets."

DARREN REDHEAD
CHIEF EXECUTIVE OFFICER, KINESIS

OUR BERMUDA FOCUS

Lancashire has been present in Bermuda since its formation in 2005. One of its main underwriting hubs, LICL, has its headquarters there, and remains committed to the Bermuda market. Over the years, Bermuda has become a leading jurisdiction in the ILS space. It is therefore no surprise that in recent years Lancashire launched several Bermuda based insurance sidecars. In 2013 Lancashire reaffirmed its dedication to the island and to the ILS space by setting up KCML. KCML will focus on the management of third-party capital on behalf of Lancashire, by leveraging its existing deep relationship network and underwriting strength in the property catastrophe and specialty lines. With no other meaningful seller of multi-class collateralised capacity, a tremendous opportunity exists and can be optimally accessed by investors through Lancashire's newest platform located in Bermuda.

REVIEW OF THE YEAR

KCML was incorporated in Bermuda in June 2013. It currently acts as the underwriting manager to KRL, a special purpose insurer that underwrites multi-class reinsurance business on a fully collateralised basis on its own balance sheet.

Since then, having hired two full-time dedicated employees in Darren Redhead as CEO and Mathieu Marsan as Portfolio Manager, research and development has taken place to educate brokers, potential cedants and investors about multi-class reinsurance product possibilities. This led to a successful capital raising by KRL's parent company, KHL, with third-party investors enabling KRL to deploy over $250 million of limit for the 1 January 2014 underwriting cycle, followed by a special draw in February 2014.

At that size, KRL is among the largest of the new fully collateralised vehicles that came to the market in 2013, which sent a strong signal to the market that Lancashire would continue to embrace third-party capital as it always has. Lancashire has now centralised its existing ILS structures within its KCML brand and offers a broader range of insurance opportunities to its investors, providing a very low correlation to traditional financial markets. With more investors looking for insurance opportunities outside the property catastrophe world, Kinesis is very well positioned compared to its peers, to be able to attract new capital, and to grow this new venture successfully.

With property catastrophe reinsurance and retrocession rates declining, the increasing need for more bespoke capital relief solutions by cedants, and the almost non-existence of providers of multi-class fully collateralised reinsurance, the timing was perfect to launch the Kinesis vehicles and regroup all Lancashire's capital market activities under one banner. With a majority interest in KCML, Lancashire now owns shares in an insurance manager that has the flexibility to offer various products and grow opportunistically in times of market dislocation. This was also a way for Lancashire to demonstrate its dedication to third-party capital and that it will always continue to embrace it.

Lancashire has invested 10 per cent in KHL alongside investors in the first offering, and aims to do the same in future offerings. This allows Lancashire to align its interests with those of external investors, but also provides a way to profit from capital market opportunities and diversify its sources of revenues.

FOCUS FOR THE FUTURE

Kinesis intends to grow its asset base with its investor club, by continuing to look for attractive opportunities in the multi-class reinsurance space and selling limits yearly on each 1 January and 1 July underwriting cycle. It is also very well structured to be able to profit from market dislocations after large insurance loss events, by being able to deploy capacity rapidly via special draws. Assuming no loss events occur in 2014, Kinesis has plenty of opportunity for future growth in existing and other products.

KEY STRENGTHS

- Backed by Lancashire's excellent track record and reputation.
- Leveraging Lancashire's existing systems, data, relationships, infrastructure and processes.
- Fully dedicated team that writes risks on behalf of KRL, with its own underwriting committee.
- Able to generate superior returns by selling multi-class reinsurance covers where current supply is scarce.
- Diversifies investors' portfolios as limited correlation to traditional financial markets.
- Segregated cell structure enables a speedy response to new opportunities.

TARGETS

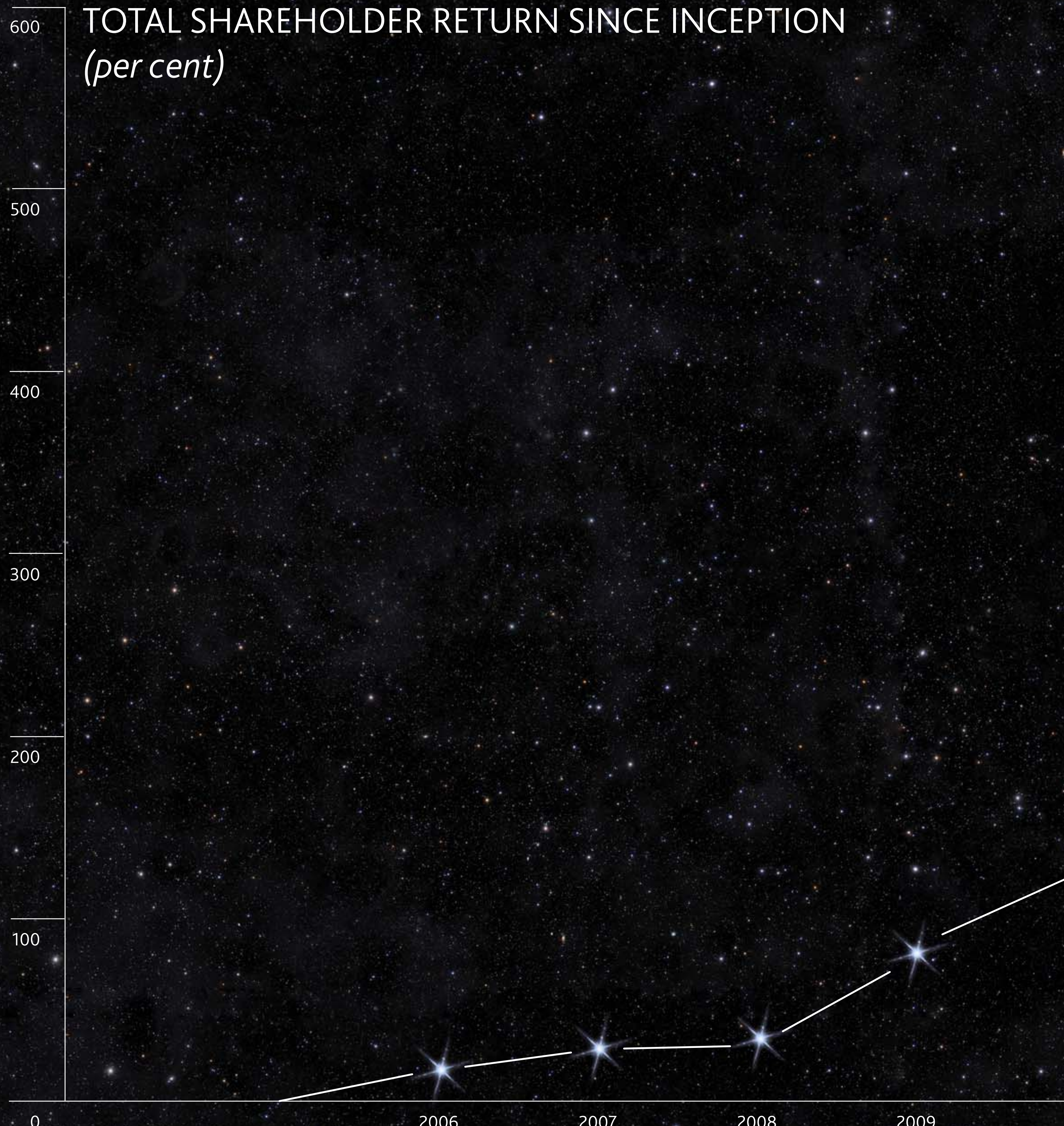
- Focus on multi-class fully collateralised reinsurance across different classes such as property catastrophe excess of loss, aviation, marine, energy and terrorism.
- Deploy capacity on 1 January and 1 July of every year, with potential 'special draws' during periods of market dislocation.
- Educate sophisticated reinsurance clients and design bespoke products for them which will ultimately add value to their usual reinsurance purchases.
- Target expected returns in the mid-teens, before fees.
- Focus on new products and ideas, such as parametric energy insurance solutions.

ASSOCIATED RISKS

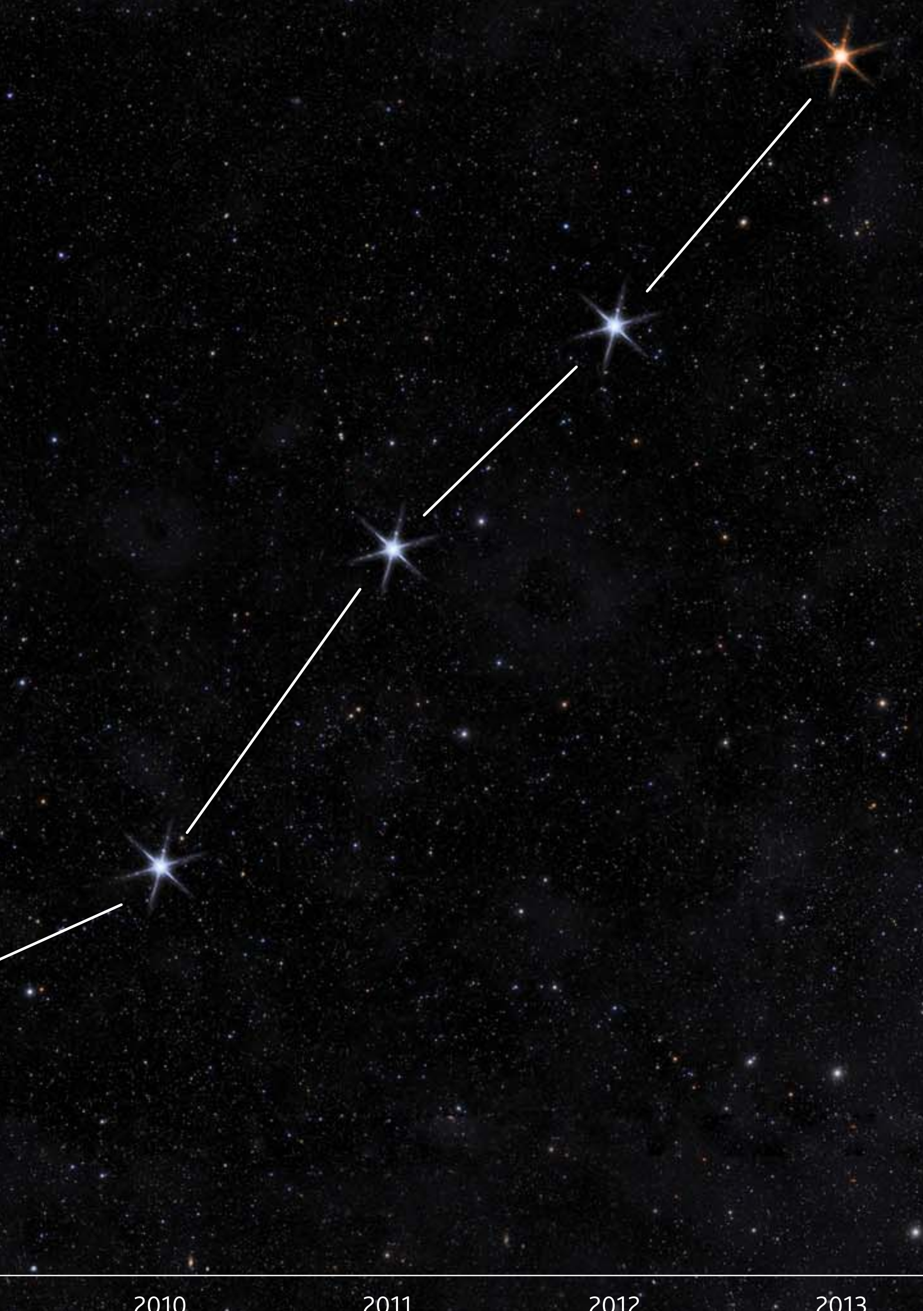
- Relatively short timeframe for investors to be able to access special draw opportunities.
- The insurance and reinsurance industry has historically been cyclical, so Kinesis could experience fluctuations in operating results due to competition and levels of underwriting capacity.
- Financial results can be volatile – Kinesis expects to have substantial exposure to unexpected losses arising from natural and man-made catastrophes.

Read our Group principal risks p42

TOTAL SHAREHOLDER RETURN SINCE INCEPTION
(per cent)



STRATEGY



IN THIS SECTION:

WHERE OPPORTUNITY MEETS ACTION

"Lancashire has reacted decisively to the opportunities and threats that presented themselves in 2013. Adding Cathedral and Kinesis to the existing LICL and LUK business means we can face the future with the right tools to navigate soft or hard markets."

RICHARD BRINDLE
CHIEF EXECUTIVE OFFICER

Dear shareholders,

SUMMARY OF 2013 PERFORMANCE

There were some major catastrophic events in 2013 that caused substantial loss of life, hardship and economic damage. The Bohol earthquake and typhoon Haiyan in the Philippines, the Balochistan earthquake in Pakistan and the widespread flooding in southwest China and western Canada are just a few examples. But the critical perils for the insurance industry in Europe, Japan and the U.S. were comparatively unscathed, and the North Atlantic hurricane season was the sixth quietest on record since 1950. For 2013, insured losses were below the recent 10 year (2003-2012) average.

In terms of risk losses, as opposed to natural catastrophes, there were some major losses in the areas in which Lancashire specialises, including the loss of satellites, oil rigs, terrorist attacks on property and a significant increase in the cost of removing the Costa Concordia wreck. Given all of this, we were pleased with a net loss ratio of 33.1 per cent, once again demonstrating the value of our risk selection processes and rigour. We have continued to build out our LICL and LUK teams with new underwriting hires in the property catastrophe excess of loss, political and sovereign risk, terrorism, marine and energy lines. We've seen a strong increase in submission flows in these lines and, allied to our new Kinesis and Cathedral brands, we believe that the Group is well placed to handle all stages of the market cycle. In everything we're doing, we're striving to make sure we can offer meaningful capacity to clients that keeps us relevant to the issues they face.

CATHEDRAL

The acquisition of Cathedral was a major step for Lancashire and was not undertaken lightly. Lancashire was not seeking an acquisition, but was trying to broaden its business lines to ensure it remained a relevant partner to its brokers and clients, even in a protracted soft market. Hence the development of satellite and obligors business at LUK and the building out of the property catastrophe excess of loss offering at LICL over the last couple of years. This growth has necessarily been slow going, although we are developing momentum in all of these lines.

Cathedral offered the opportunity to make a step-change in the Lancashire Group offering. We expect Cathedral to account for approximately one third of our gross premiums written in 2014. It operates in short-tail lines that Lancashire already knows well – property, aviation, marine – but it has some very niche areas of business so there is little duplication. The management team is heavily underwriter led, and the focus on underwriting is something very familiar within Lancashire's existing business. Financial incentives have been provided to retain key members of the Cathedral team over a three to five year period. However, the key to retaining these people will be their ability to continue shaping their business and integrating into the Lancashire platform. Members of the Cathedral team have begun attending the RRC, and a permanent representative has been appointed. This will ensure that the Group will keep its nimble ability to respond to challenges and opportunities across different balance sheets.

KINESIS

Kinesis has marked a real step forward in Lancashire's commitment to an approach to insurance management that complements its existing business. Over the last three years, with Accordion and Saltire, and prior to this with Sirocco, Lancashire has learnt a lot about the three key areas of the collateralised market. These are investor appetites, the technicalities of renewing and rolling over collateralised contracts, and which kinds of contract fit best on collateralised balance sheets. The worldwide retrocession exposures that form part of the core Kinesis products are very capital intensive when written on a rated balance sheet, so there's a natural division between the kind of business that fits LICL and LUK versus Kinesis. We deployed over $250 million of capacity at 1 January 2014, with a special draw in February and the potential for additional demand during the course of the year. Under the leadership of Darren Redhead, we are well positioned to source deals and match them to investors' requirements. The Group will benefit tangibly from underwriting fees and contingent profit commissions which will accrue to KCML. But there will be intangible benefits also from the broadening of the client pool and the wider conversations with brokers.

RISK MANAGEMENT

Lancashire has made some good progress in the risk management sphere in 2013. We have installed a new automated risk management system which is integrated with our internal audit system and will enable us to have a holistic view of our performance against our targets in these areas. The RRC continues to operate well and we've added some new areas for it to oversee, including reinsurance aggregations and Kinesis and Cathedral integration. With their large line strategy, LICL and LUK continue to use the UMCC to keep a close watch on the development of their portfolios, whilst Cathedral with its smaller line structure and extensive reinsurance protection relies on a post-binding review. We will continue to recognise the unique features of the different operating models of our businesses and tailor the risk management environments appropriately.

PEOPLE, VALUES AND CULTURE

Lancashire believes very strongly in the idea of responsible business. This encompasses how we treat our employees and how we impact the societies we work in and the broader world. We try to provide a stimulating and challenging work environment, and we're delighted to have attracted people of the calibre of the Cathedral team. We're similarly really pleased with the good cultural fit between the Cathedral and Lancashire teams in the early stages of our integration. In mid 2014 we anticipate moving into common office space so we will all be under one roof. Cathedral people are already sitting on key committees such as the Foundation's Donations Committee. The Foundation itself has donated a record amount of $3.5 million to good causes in London, Bermuda and right around the world, and 72 of our colleagues have spent one or more days doing good in the community.

MARKET AND REGULATORY REVIEW

The two big talking points of 2013 have been the continuing influx of new capital into the reinsurance industry, mostly into collateralised catastrophe capacity, and the return of broker facilities to the insurance space. The new reinsurance capacity does put pressure on rates and signings (the percentage of the offered capacity that a client accepts), but with the addition of Cathedral, Lancashire will also be a substantial buyer of reinsurance so there will be some compensating benefits in price reductions. As for broker facilities, these really threaten following markets who don't offer any value added – they don't set the terms, negotiate the contract or settle the claims. Lancashire is protected by its status as a lead underwriter with substantial capacity; indeed LICL and LUK lead or hold agreement party status on 80 per cent of their business by premium volume. Similarly in key business areas such as the U.S.

mutual portfolio and the aviation reinsurance account, Cathedral are recognised as an established lead with very long-standing relationships.

In 2013, the long-awaited application date for the Solvency II regime was announced as 1 January 2016. This will have a number of impacts on Lancashire, not least that the UK's PRA will then become our Group Supervisor. There will also be a considerable increase in the amount and frequency of our regulatory reporting. However, we have had a Solvency II plan in place for the last couple of years, and we are content that we will be ready to comply fully with the new requirements. We are fortunate that we regard a constant understanding and awareness of our resources and exposures, and the threats and opportunities in our model, as business as usual.

STRATEGY – POWER OF THREE

We have made a significant strategic shift in 2013 to support our goal of generating an attractive risk-adjusted return over time. We have broadened the Lancashire base to include a Lloyd's platform and a more permanent capital markets unit to add to the rated company model. I believe this is a real signal of our commitment to be able to offer our clients access to all kinds of risk transfer solutions. But in doing this we have continued to observe our strategic priorities:

– Underwriting always comes first: at both Kinesis and Cathedral the management teams are led by underwriters. Indeed Cathedral brings 14 front-line underwriters to the Group.

– Effectively balance risk and return: the integration of the underwriting and actuarial teams at LICL is reflected in the work performed for KCML, and also the close link between the Cathedral exposure and aggregation team with the underwriters. Cathedral is already represented on the RRC, which is the key forum for considering strategic risk and return.

– Operate nimbly through the cycle: Lancashire again demonstrated through its response after the Canadian and Chinese floods the ability to be a first responder and go-to market for brokers. Similarly, Cathedral has been flexing exposures both up and down in New Zealand and Chile through the direct and facultative portfolio in response to changing circumstances.

Overall, a combined ratio of 70.2 per cent with a net loss ratio of 33.1 per cent demonstrate the efficacy of our business model in a relatively soft part of the market cycle.

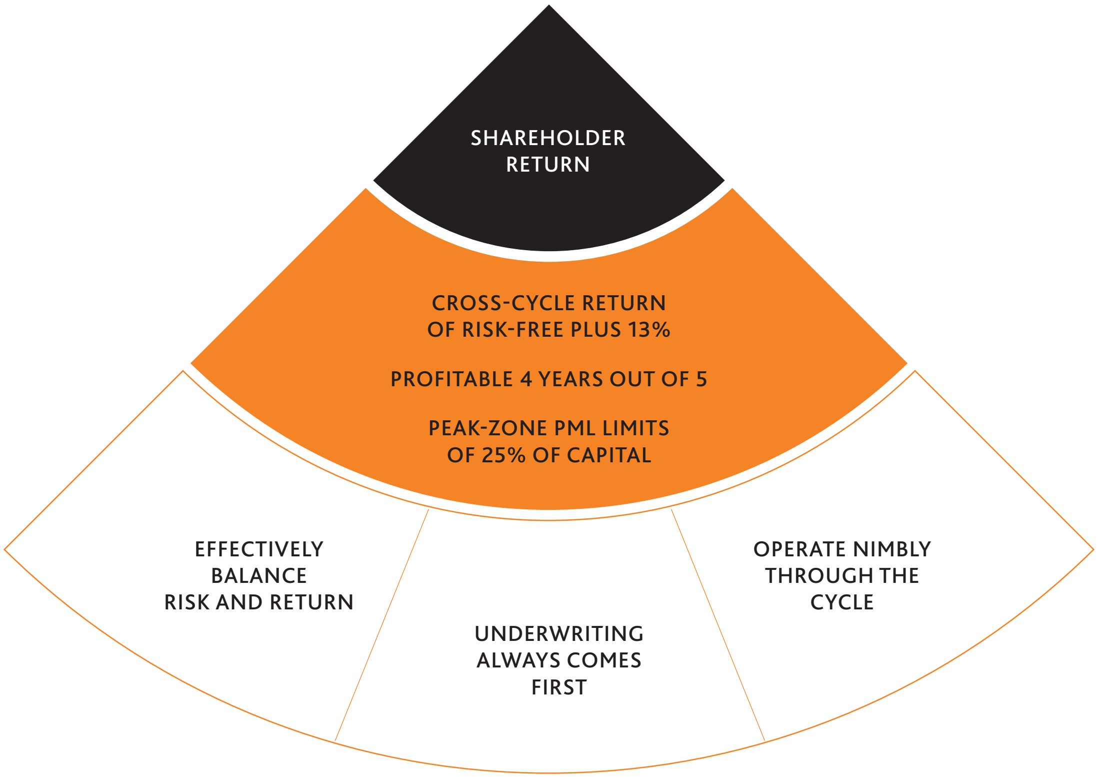
OUTLOOK

With abundant capacity and in the absence of market changing losses, we expect pricing, especially in the catastrophe exposed reinsurance lines, to continue to come under pressure. As our record over the last eight years shows, we do have good margins in our portfolio, so price reductions present a challenge, but not an existential threat to our business model. There will be areas that we can continue to develop, including political and sovereign risk, and property catastrophe excess of loss. Within Cathedral we have plans to build out some lines utilising our existing expertise and to consider new niches, all of which will benefit from both the efficient Lloyd's capital model, and from the excellent broker footfall. To do all this we will need to work hard with our colleagues in Cathedral and the Lloyd's market to understand how we can best deploy our underwriting and management expertise. For Kinesis, once the hubbub of 1 January dies down, we will continue to research and develop the products that are best suited to a collateralised balance sheet and our investors' appetite. We are confident that the three pillars of the Lancashire business model give us a strong platform to weather the market cycle, and to continue to deliver on our targets.

RICHARD BRINDLE
CHIEF EXECUTIVE OFFICER

STICKING TO OUR CORE STRATEGY

"A lot has happened to Lancashire in 2013, but our fundamental strategy has not changed. We aim to get the best risk-adjusted return in the current market through a focus on underwriting and remaining nimble."



OUR CULTURE

RISK MEETS REWARD

See p48

CREATIVITY MEETS DISCIPLINE

See p53

STRENGTH MEETS AGILITY

See p51

The core of executing Lancashire's strategy to provide an attractive risk-adjusted return to shareholders is found in the continual balancing of risk and reward. We analyse risk constantly when our underwriters make decisions on accepting individual (re)insurance contracts and, for example, through our RRC and IRRC looking at optimising our portfolios, reducing risk and/or enhancing returns. We therefore have to be alive to all kinds of opportunities and threats to our business, balancing the creativity to find solutions to new kinds of risks that fit our portfolio with the discipline to stick to what we know and not chase growth for its own sake. In order to keep the confidence of our stakeholders – clients, brokers, shareholders, debtholders, staff, regulators and rating agencies – we have to safeguard our financial strength through a strong ERM function and actuarial analysis, but balance this with the agility to move quickly and decisively when there are new opportunities.

A YEAR OF ACTION!

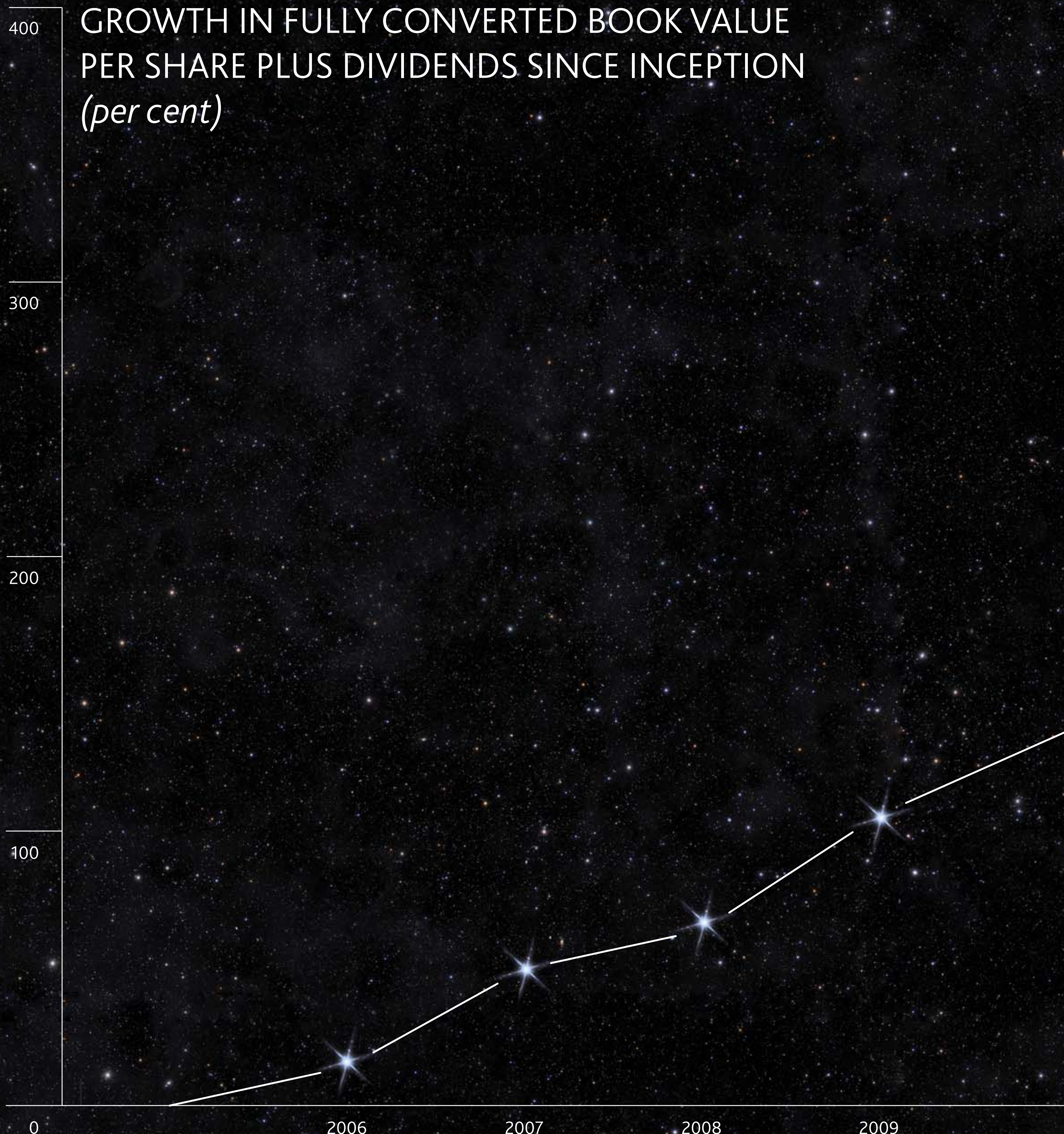
Strategic priority	*Description*	*Achievements in 2013*
UNDERWRITING ALWAYS COMES FIRST	We focus on maintaining our portfolio structure, with the bulk of our exposures balanced towards market moving events, and a strong commitment to core clients. We use the principle of peer review throughout the Group, usually pre-underwriting for LICL, LUK and Kinesis, the platforms that accept larger net exposures, and post-underwriting at Cathedral, with its much smaller net exposures.	With the addition of 14 underwriters at Cathedral and two at Kinesis, the total underwriting bench strength of the Lancashire Group has nearly doubled to 35. The ability to offer clients a rated company, Lloyd's or collateralised capacity enhances our relevance to brokers.
EFFECTIVELY BALANCE RISK AND RETURN	We continue to develop and improve BLAST and other tools to help us understand the drivers of profitability in our portfolio and to understand the kind of events that can impact our earnings or balance sheet. We continue to refine our risk on/risk off analysis on our investments and look for a balance there too.	The acquisition of Cathedral gives the Group access to their aggregate exposure damage ratio calculation methodology, which has been developed in-house over the last 13 years. This offers a robust alternative view of insurance risk to challenge the stochastic models and enhances our ability to think creatively about risk and reward.
OPERATE NIMBLY THROUGH THE CYCLE	There is a continual process of matching capital to opportunities with a commitment to scale the portfolio down as well as up. We can now use multiple balance sheet strategies to respond to opportunities most efficiently and maintain our relevance to clients through all phases of the cycle.	Lancashire has demonstrated capital management in a number of ways in 2013: raising equity, paying ordinary and special dividends, raising capital for Kinesis and managing the acquisition of Cathedral. All of this leaves the Group with a flexible underwriting platform, a solid investment portfolio, an efficient capital mix and a premium valuation.

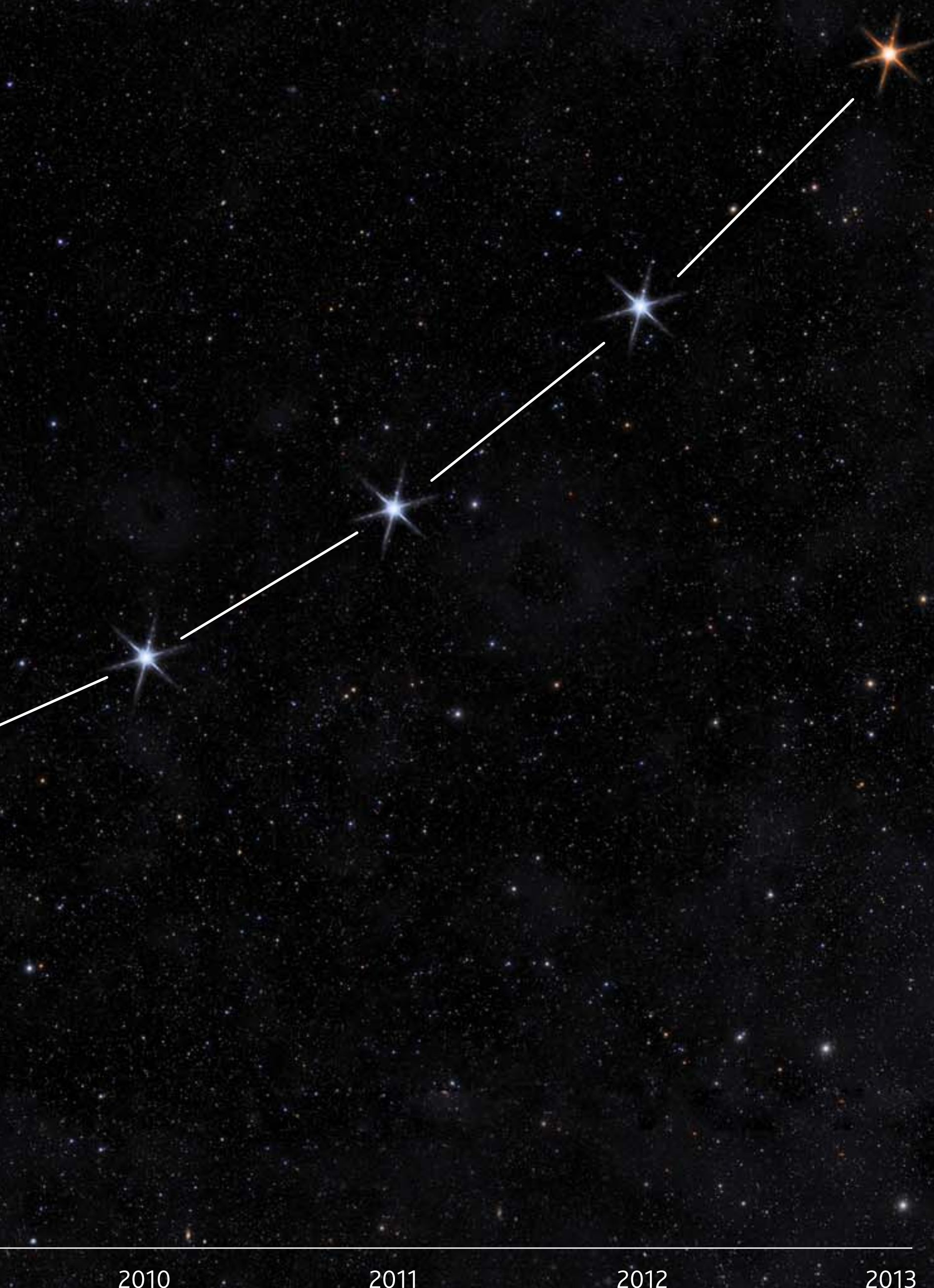
Performance KPI		*Associated strategic risks*
COMBINED RATIO 70.2% Low combined ratio, even in a difficult market, highlights our primary focus on underwriting and risk selection.	**GROSS PREMIUMS WRITTEN** $679.7m We continued to focus on niche areas with good pockets of opportunity, primarily in the energy liability, sovereign obligors and satellite classes. Cathedral premiums contributed $24.5 million from the date of acquisition.	The key risk for underwriting will come in managing the underwriting aggregation and correlation between the three platforms. A lot of work was undertaken during the due diligence process on Cathedral and is on-going since the acquisition to ensure that exposures are correctly aggregated.
KPI **RETURN ON EQUITY** 18.9% Our careful risk selection, opportunistic purchase of Cathedral and active capital management produced returns above our cross-cycle aim for the fifth year in a row and consistent with our inception-to-date compound annual RoE of 19.2 per cent.	**PROBABLE MAXIMUM LOSS AS A PERCENTAGE OF TANGIBLE CAPITAL**(1) 17.8% A focus on underwriting, together with the effective use of third-party capital and opportunistic reinsurance purchases, has kept our loss exposures well within tolerances while maximising our capital efficiency.	In a softening market it can be difficult to strike the right balance between keeping the discipline to let go of under-priced business, and maintaining relationships with core brokers and clients. We also need to ensure that our outwards reinsurance programme is properly calibrated to our inwards portfolio to maximise our risk-adjusted return.
KPI **PERCENTAGE OF PROFIT RETURNED TO SHAREHOLDERS** 146.3% $325.6 million in dividends paid in 2013 – a direct result of our focus on pro-active and flexible capital and cycle management.	**CAPITAL ACTIONS** $198.2m $198.2 million equity raised, net of expenses, with the opportunity to expand our footprint and purchase Cathedral.	With a larger balance sheet and an enlarged product line to manage, understanding the risk correlations and drivers of capital requirements, and assessing the opportunities for deployment of capital in the business will be a key challenge in 2014. Maintaining the discipline of capital management remains central to the operating philosophy.

(1) Estimate based on 1 in 100 wind loss at 1 January 2014 before income tax and net of reinstatement premiums and outward reinsurance.

Read our Group principal risks p42

GROWTH IN FULLY CONVERTED BOOK VALUE PER SHARE PLUS DIVIDENDS SINCE INCEPTION *(per cent)*





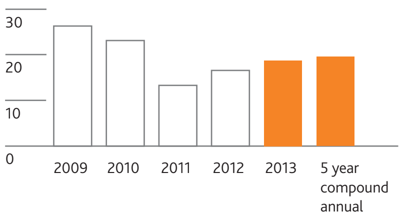
PERFORMANCE

IN THIS SECTION:

KPI DR

RETURN ON EQUITY

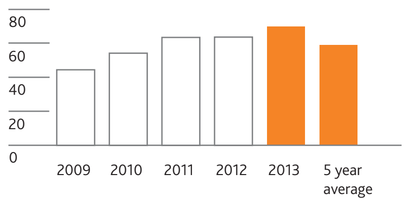
18.9%



KPI

COMBINED RATIO

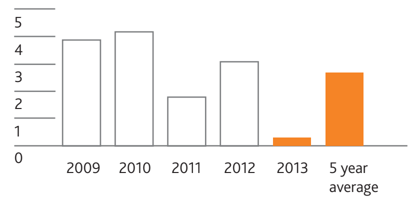
70.2%



KPI

TOTAL INVESTMENT RETURN

0.3%

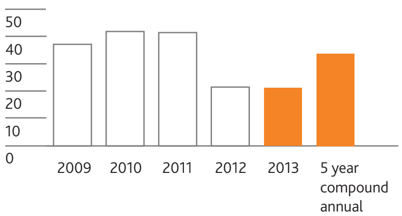


	Return on equity	Combined ratio	Total investment return
Aim	The Group's aim is to provide shareholders with a risk-adjusted return on equity of 13 per cent in excess of a risk-free rate over the insurance cycle.	The Group aims to price its business to ensure that the combined ratio in any year is less than 100 per cent.	The Group's primary investment objectives are to preserve capital and provide adequate liquidity to support the Group's payment of claims and other obligations.
Measurement	The return on equity is measured by management as the internal rate of return of the increase in fully converted book value per share in the period, adjusted for dividends.	The combined ratio is the ratio of total costs to total net earned premium and is a measure of an insurance company's operating performance. It is calculated as the sum of the loss ratio, the acquisition cost ratio and the expense ratio.	Total investment return measures investment income and net realised and unrealised gains and losses produced by the Group's managed investment portfolio.
Risk management	The stated aim is a long-term goal, acknowledging that management expects both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver of this pattern. Management monitors these peaks and troughs – adjusting the Group's portfolio using BLAST to make the most effective use of available capital and seeking to maximise the risk-adjusted return.	The Group's underwriters assess likely losses, using tools such as BLAST and BAM and catastrophe models, and their experience and knowledge of past loss experience, industry trends and current circumstances. This allows them to estimate the premiums sufficient to meet likely losses and expenses. 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.	The investment strategy places an emphasis on the preservation of invested assets and provision of sufficient liquidity for the prompt payment of claims, in conjunction with providing a reasonably stable income stream. These objectives are reflected in the Group's investment guidelines and its conservative asset allocation. Management reviews the composition, duration and asset allocation of the investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. In the current volatile investment markets, a specific focus is on minimising downside risk from a rising rate environment.

KPI DR

TOTAL SHAREHOLDER RETURN

21.3%



The Group's aim is to provide an attractive risk-adjusted return to shareholders over the insurance cycle. 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 share multiple in the immediate term.

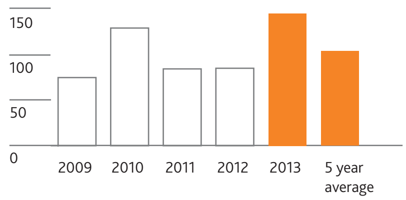
Total shareholder return is measured in terms of the internal rate of return of the increase in share price in the period, measured in U.S. dollars and adjusted for dividends.

The Lancashire remuneration structure and share scheme ensure that staff are highly motivated and closely aligned to the Group's goals, and therefore with shareholders. All permanent staff at Lancashire and Cathedral will be eligible to receive RSS awards for which TSR is an element of the vesting criteria. The participation of employees in the RSS ensures that there is a strong focus on sustainable long-term shareholder value.

KPI

PERCENTAGE OF PROFIT RETURNED TO SHAREHOLDERS

146.3%



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

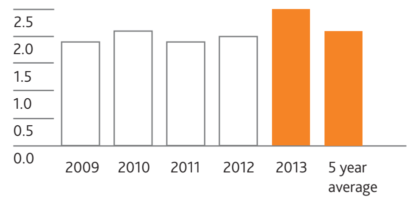
The percentage of profit returned to shareholders equals the total capital returned to shareholders through dividends and share repurchases paid in a given year, divided by the Group's profit after tax.

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

KPI

DONATIONS MADE TO THE LANCASHIRE FOUNDATION*

$2.5m



* Incl. dividends received on Lancashire warrants, donated at inception.

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

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

The Lancashire Foundation is a charity registered in England and Wales (registration number 1149184). The charity's trustees are Group employees as well as one LICL non-executive board member, and the day-to-day operations of the Foundation are supervised by the Foundation's Donations Committee. The Committee consists of Group employees and one LICL non-executive board member and operates within specific criteria set for the Foundation's charitable giving. The charities supported provide regular updates on how the funds donated are spent. Further information on the Lancashire Foundation can be found on pages 46 to 47.

DR *KPI linked to Executive Directors' remuneration. For more information see pages 74 to 75.*

DELIVERING VALUE

ELAINE WHELAN
GROUP CHIEF FINANCIAL OFFICER

"While an acquisition may seem out of character for Lancashire, our market has been clearly changed by the impact of third-party capital. We therefore took the opportunity to adapt and augment our business model by purchasing a mature, tried and tested, Lloyd's platform with excellent historic underwriting performance. With an unwavering focus on risk-adjusted return and capital management, we believe the transaction will allow us to compete in any market, to enhance our capital base and to continue to produce superior risk-adjusted returns across the cycle."

With competition in the market increasing, we reduced our premium income and sought a more sustainable cross-cycle business model via our acquisition of Cathedral. While there were no major loss events impacting the industry in 2013, we did experience significant deterioration in the Costa Concordia loss in the first half of the year. Investment markets have again been volatile and reactive to Federal Reserve commentary in respect of the tapering of their monetary stimulus, the U.S. Government shut-down and other news flows around the world. In spite of that challenging business environment, we produced a profit after tax of $222.5 million, comprehensive income of $190.0 million, a combined ratio of 70.2 per cent and a RoE of 18.9 per cent. We have now generated an annual compound return of 19.2 per cent since inception.

CATHEDRAL ACQUISITION

We partially funded our acquisition of the Cathedral Group with an equity issuance of 9.99% of our share capital. The issuance saw strong shareholder support with a minimal discount to our share price. Given our trading multiple, the equity raise boosted our RoE for the year. We included 2 months of Cathedral's performance in our results and various other aspects around the acquisition combined to enhance our return for the year, with an overall impact of 6.9 per cent of RoE.

PREMIUMS

Our gross premiums written were $679.7 million, a reduction of $44.6 million or 6.2 per cent compared to 2012. The reduction came largely from three lines of business: property retrocession, property direct and facultative, which LICL and LUK exited on 1 July 2012, and Gulf of Mexico offshore energy. As rates and terms and conditions in property retrocession worsened this year, we significantly reduced our book. However, $25.8 million of the $43.6 million reduction in property retrocession premiums for the year qualified for 100 per cent cession to the Accordion sidecar and therefore had no impact on a net written basis. The Gulf of Mexico premium reduction is predominantly due to business that was written on a multi-year basis in 2012 and those contracts not being up for renewal yet. Offsetting these reductions somewhat, we saw some expansion in our property catastrophe excess of loss and political risk books.

LOSSES

The Group's net loss ratio for the year was 33.1 per cent with an accident year ratio of 36.1 per cent. There were no major insured loss events this year, although we were impacted to a degree by the

2013 FINANCIAL PERFORMANCE

FINANCIAL HIGHLIGHTS

	2009 $m	2010 $m	2011 $m	2012 $m	**2013 $m**
Gross premiums written	627.8	689.1	632.3	724.3	**679.7**
Net premiums written	577.1	649.9	565.1	576.1	**557.6**
Net premiums earned	594.7	614.2	574.5	582.6	**568.1**
Net insurance losses	98.7	165.7	182.3	174.1	**188.1**
Net underwriting income	390.0	342.2	208.8	289.1	**254.2**
Net investment income	56.0	53.4	43.2	32.5	**25.4**
Net realised gains (losses) and impairments	23.8	33.2	8.6	11.8	**12.6**
Net operating profit	364.7	306.5	219.0	220.3	**184.2**
Profit after tax	385.4	330.8	212.2	234.9	**222.5**
Change in net unrealised gains/losses on investments	2.8	(2.2)	(10.6)	17.8	**(32.5)**
Comprehensive income	388.2	328.6	201.6	252.7	**190.0**
Dividends	273.5	294.2	180.4	201.4	**325.6**
Diluted earnings per share	$2.05	$1.86	$1.20	$1.29	**$1.17**
Diluted operating earnings per share	$1.94	$1.73	$1.23	$1.21	**$0.97**
Fully converted book value per share	$7.41	$7.57	$7.62	$7.83	**$7.50**
Return on equity	26.5%	23.3%	13.4%	16.7%	**18.9%**
Net loss ratio	16.6%	27.0%	31.7%	29.9%	**33.1%**
Net acquisition cost ratio	17.8%	17.3%	19.6%	20.5%	**22.1%**
Expense ratio	10.2%	10.1%	12.4%	13.5%	**15.0%**
Combined ratio	44.6%	54.4%	63.7%	63.9%	**70.2%**
Accident year loss ratio	27.2%	42.9%	59.3%	34.6%	**36.1%**
Net total return on investments	3.9%	4.2%	1.8%	3.1%	**0.3%**

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

European hail and flood losses and also one sizeable energy loss. While on an accident year basis we otherwise had relatively low reported losses, we saw a significant deterioration in prior year losses, driven primarily by the late development in the first half of the year of the Costa Concordia loss. However, with other general prior year reserve releases, plus settlements in our favour on some ILW contracts, net prior year development for the year was favourable.

INVESTMENTS

We produced a total return for the year of 0.3 per cent. Investment markets prove to be ever more challenging and in 2013, with the potential tapering of monetary stimulus by the Federal Reserve; the U.S. Government shutdown and debt ceiling negotiations; and the ongoing conflict in Syria – amongst other mixed news flows – we saw significant volatility with yields on the 10-year treasury bond increasing by 127 basis points over the year. Nevertheless, our focus on liquidity and capital preservation has not changed and we have continued to manage our interest rate risk. Over the course of the year we have added assets that are less susceptible to an eventual interest rate rise to our investment portfolio and also put in place a tail risk hedge. The same themes will continue into 2014.

CAPITAL

During the year we returned $325.6 million of capital, or 171.4 per cent of comprehensive income, by way of dividends paid to shareholders. Our capital return from inception, including dividends declared on 12 February 2014, now stands at $1.9 billion. Following our acquisition of the Cathedral Group, our total tangible capital at the end of the year was $1.615 billion. While our work to integrate the acquisition is ongoing, there has been no change in our capital philosophy. As ever, we will adjust our capital position to match business opportunities and to generate a superior risk-adjusted return for our shareholders.

ELAINE WHELAN
GROUP CHIEF FINANCIAL OFFICER

STRONG PERFORMANCE

ALEX MALONEY
GROUP CHIEF UNDERWRITING OFFICER

"In a difficult year for underwriting, Lancashire still achieved a combined ratio of 70.2 per cent."

BUSINESS ENVIRONMENT AND OUTLOOK

2013 was a difficult year for underwriting, with rapidly developing competition from new capital sources and a lack of major losses to drive new opportunities.

In 2013 we saw declining prices across many of our classes with the exception of our marine book which has been buoyed by pricing stability, and in some cases small increases, following the tragic loss of the Costa Concordia in 2012. However, with the continued inflow of capital from traditional and non-traditional sources, capacity has remained high and, absent any other events, we expect there to be continued pressure on prices through 2014.

However, the market outlook in our core lines of business varies from stable to under pressure with some decent pockets of opportunity. Lancashire will continue to focus on servicing its core insurance and reinsurance clients, who make up the majority of our portfolio, whilst looking for opportunistic areas of dislocation, or new demand, to leverage the Lancashire and Cathedral brands. With the ever growing flow of alternative funds into our market place, we launched Kinesis as a market facing vehicle providing unique collateralised products for the 2014 reinsurance renewal seasons.

The Group's emphasis on risk selection helps us to produce superior results across the cycle. Given our positioning following the acquisition of the Cathedral Group and the launch of Kinesis, we believe there is still plenty of good business available.

RENEWAL PRICE INDEX (RPI)

Lancashire'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 Lancashire'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 and covers business written by LICL and LUK only, to offer a consistent basis for analysis. The calculation involves a degree of judgement in relation to comparability of contracts and the assessment noted above.
To enhance the RPI tool, the management of Lancashire may revise the methodology and assumptions underlying the RPI, so the trends in premium rates reflected in the RPI may not be comparable over time. Consideration is only given to renewals of a comparable nature so it does not reflect every contract in Lancashire's portfolio. The future profitability of the portfolio of contracts within the RPI is dependent upon many factors besides the trends in premium rates.

The following table summarises the RPI figures for the main business classes, excluding the Lloyd's segment, using 2006 as the base year:

RPI

Class	2006	2007	2008	2009	2010	2011	2012	**2013**
Aviation (AV52)	100	80	69	68	62	59	55	**49**
Gulf of Mexico offshore energy	100	80	64	137	139	140	140	**136**
Worldwide offshore energy	100	80	68	84	88	97	100	**97**
Marine	100	88	80	82	80	79	86	**89**
Property retrocession and reinsurance	100	97	86	127	121	131	157	**152**
Terrorism	100	86	71	66	60	57	55	**52**
Combined	100	86	76	83	81	83	84	**81**

UNDERWRITING RESULTS

	2013						2012				
	Property $m	**Energy $m**	**Marine $m**	**Aviation $m**	**Lloyd's $m**	**Total $m**	Property $m	Energy $m	Marine $m	Aviation $m	Total $m
Gross premiums written	**333.4**	**209.9**	**63.0**	**48.9**	**24.5**	**679.7**	356.5	240.9	81.0	45.9	724.3
Net premiums earned	**218.8**	**203.1**	**61.7**	**44.7**	**39.8**	**568.1**	279.1	207.8	53.3	42.4	582.6
Net loss ratio	**13.8%**	**26.5%**	**105.3%**	**44.7%**	**47.7%**	**33.1%**	40.4%	12.9%	61.2%	4.7%	29.9%
Net acquisition cost ratio	**13.4%**	**27.7%**	**34.8%**	**22.6%**	**21.6%**	**22.1%**	12.2%	25.0%	43.3%	24.3%	20.5%
Expense ratio	**–**	**–**	**–**	**–**	**–**	**15.0%**	–	–	–	–	13.5%
Combined ratio	**27.2%**	**54.2%**	**140.1%**	**67.3%**	**69.3%**	**70.2%**	52.6%	37.9%	104.5%	29.0%	63.9%

PREMIUMS

Gross premiums written decreased by 6.2 per cent compared to 2012. The Group's five principal segments, the key market factors impacting them and their outlook are discussed in detail at the bottom of pages 30 through to 37, with the Lloyd's segment discussed on page 38.

Ceded premiums decreased by $26.1 million, or 17.6 per cent, for the year ended 31 December 2013 compared to the year ended 31 December 2012. Cessions to the Accordion sidecar were $47.9 million in 2013 versus $64.8 million in 2012. The overall decrease for the year is therefore predominantly due to reduced cessions to the Accordion vehicles. The remainder of the decrease was driven by reduced reinstatement premiums on the Group's marine and energy cover plus reduced use of alternative covers given declining underlying exposures. Rate changes and a restructuring of our marine and energy cover in 2013 largely offset each other in premium terms and while we did not renew our property programme the reduced spend on that was almost entirely offset by an increase in facultative covers purchased. 2013 also includes $1.7 million of ceded premium for the Lloyd's segment.

Net premiums earned as a proportion of net premiums written were 101.9 per cent for the year ended 31 December 2013, compared to 101.1 per cent in 2012. Both years benefited from the lag in earnings from multi-year contracts written in preceding years.

LOSSES

The Group's net loss ratio was 33.1 per cent for the year ended 31 December 2013 compared to 29.9 per cent for 2012. The 12 months to 31 December 2013 were impacted by a number of energy losses and developments, the European hail and flood events, and adverse development on the Costa Concordia marine loss. The net loss to the Group from the European hail and floods, after reinsurance and reinstatement premiums, was $20.7 million. The net adverse development on the Costa Concordia loss in 2013 was $37.9 million, after reinsurance and reinstatement premium. In the 12 months to 31 December 2012 we recorded a total estimated net loss of $103.7 million, after reinsurance and reinstatement premium, in respect of the Costa Concordia and Sandy losses. Our total estimated net loss, after reinsurance and reinstatement premiums, for the Costa Concordia loss is now $97.1 million and for the Sandy loss is now $30.7 million. 2013 also includes $19.0 million of net losses for the Lloyd's segment, representing a loss ratio of 47.7 per cent for that segment from acquisition.

Net prior year reserve releases were $15.9 million for the year ended 31 December 2013 compared to $27.4 million for 2012, with 2013 impacted significantly by the adverse development on the Costa Concordia loss. Both years otherwise experienced releases due to lower than expected reported losses.

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

FOR THE YEAR ENDED 31 DECEMBER 2013

	Losses $m	Loss ratio %
At 31 December 2013	188.1	33.1
Absent Europe hail and flood	167.2	29.4
Absent Costa Concordia	154.6	27.0
Absent remaining prior year development	237.5	41.8
Adjusted losses and ratio	**183.1**	**32.0**

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

FOR THE YEAR ENDED 31 DECEMBER 2012

	Losses $m	Loss ratio %
At 31 December 2013	174.1	29.9
Absent Costa Concordia	128.3	21.5
Absent Sandy	128.1	22.0
Absent prior year development	201.5	34.6
Adjusted losses and ratio	**109.7**	**18.7**

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

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

LOSS DEVELOPMENT BY CLASS

	2009 $m	2010 $m	2011 $m	2012 $m	**2013 $m**
Property	44.4	28.8	63.5	(36.0)	**13.2**
Energy	9.3	47.6	57.3	37.4	**18.4**
Marine	6.1	17.7	28.6	25.9	**(23.4)**
Aviation	3.7	6.0	5.9	0.1	**(1.4)**
Lloyd's	n/a	n/a	n/a	n/a	**9.1**
Total	**63.5**	**100.1**	**155.3**	**27.4**	**15.9**

Note: Positive numbers denote favourable development.

PROPERTY

MARKET REVIEW AND OUTLOOK

Absent a market changing event, we believe that competition from third-party capital providers in the property reinsurance and retrocession markets will continue to weaken pricing and terms and conditions. Whilst we continue to look for well-priced, opportunistic deals in niche areas of the regional retrocession market, our focus through 2014 will be to build out further our property catastrophe excess of loss book.

Political risk business has been growing steadily over the last three years with sovereign obligors the key to growth. Although it is difficult to predict the timing of new business in this class, we expect to see further deal flow during 2014 as an increase in foreign direct investment globally creates new opportunities.

These deals tend to be written on a multi-year basis and earn out over a longer period than the majority of our portfolio. Our terrorism and political violence programme saw a predominantly flat market in 2013, despite pressure on pricing. The uncertainty over the future of TRIPRA is driving some increased interest from U.S. buyers and we expect to maintain current premium volumes in 2014.

2013 gross premiums written decreased by 6.5 per cent compared to 2012. The reduction is primarily due to the reduction of our property retrocession book and our decision to cease writing property direct and facultative business from 1 July 2012. These reductions have been somewhat offset by the writing of new business with core clients in the political and sovereign obligors risk class, which also

ACCIDENT YEAR LOSS RATIOS

	2009	2010	2011	2012	**2013**
Accident year loss ratio	10.8%	29.3%	54.0%	31.4%	**36.1%**
Initial accident year loss ratio	27.2%	42.9%	59.3%	34.6%	**n/a**
Change in loss ratio post accident year	16.4%	13.6%	5.3%	3.2%	**n/a**

Note: Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2013.

The year to date accident year loss ratio, including the impact of foreign exchange revaluations, was 36.1 per cent compared to 34.6 per cent for the 12 months to 31 December 2012. 2013 included 3.7 per cent for the European hail and flood losses while the 2012 accident year loss ratio included 8.5 per cent for the Costa Concordia loss and 7.8 per cent for Sandy.

ULTIMATE LOSS DEVELOPMENT BY ACCIDENT YEAR

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

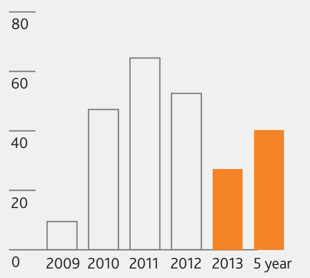
Note: Positive numbers denote favourable development.

offset the non-renewal of long-term deals written in these classes in the previous year. While certain opportunistic property catastrophe excess of loss deals written in 2012 were not renewed in 2013 as they were no longer required, the premium was largely replaced by new business and property catastrophe excess of loss premiums year on year were therefore broadly flat.

2013 losses were $82.5 million lower than 2012. In 2013 the net loss from the European hail and flood events was $20.7 million, after reinstatement premium, contributing 9.6 per cent to the 2013 property combined ratio. 2012 losses included $44.5 million, after reinstatement premium, from Sandy contributing 16.3 per cent to the 2012 property combined ratio.

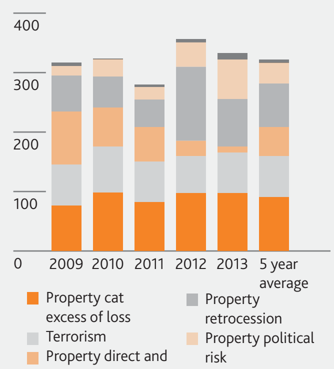
COMBINED RATIO

27.2%



GROSS PREMIUMS WRITTEN

$333.4m



ACQUISITION COSTS

The year to date accident acquisition cost ratio was 22.1 per cent compared to 20.5 per cent for the 12 months to 31 December 2012. The increase was largely due to changes in business mix as Lancashire earned less property premiums as a percentage of the total premiums when compared to the year ended 31 December 2012. The property line of business historically has had the lowest overall acquisition cost ratio for Lancashire.

INVESTMENTS, LIQUIDITY AND CASH FLOW

Since inception, our 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 market shocks. In 2013 our focus has been on managing our interest rate risk, the largest risk to our predominantly fixed income portfolio. We implemented a tail risk hedge over approximately half our portfolio and have been using our risk budget to add products to our portfolio to help mitigate a rise in rates. We produced a total investment return of 0.3 per cent (2012 – 3.1 per cent) for the year. Our average annual total investment return since inception is 3.6 per cent, and we have made a positive investment return in every year since inception, including 2008.

Our portfolio mix illustrates our philosophy, as shown in the table on page 33. With the composition regulated by the Group's investment guidelines we have three investment portfolio categories: 'core', 'core plus' and 'surplus'. The core portfolio contains at least enough funds required to meet near-term obligations and cash flow needs following an extreme event. Assets in excess of those required to be held in the core portfolio may be held in any of the three portfolio categories, which are discussed further on page 118. As at 31 December 2013 and 2012 the managed portfolio was as follows:

	2012 %	2013 %
Fixed income securities	88.9	**84.4**
Cash and cash equivalents	11.1	**14.7**
Equity securities	–	**0.7**
Other investments	–	**0.2**
Total	100.0	**100.0**

PERFORMANCE

ENERGY

MARKET REVIEW AND OUTLOOK

After another light year for Gulf of Mexico storms in 2013, energy pricing in the Gulf of Mexico remains under pressure. Reductions in deepwater rates are less than for shallow water, as the larger limits required by insureds help to maintain market discipline, and we expect demand from deepwater clients to remain stable. Worldwide offshore energy remains profitable for Lancashire as a class. Our core portfolio clients remain loyal, and organic growth from new projects and expanding facilities gives us a solid base for 2014. The energy liabilities class is still experiencing a positive rating trend and we expect to continue the considered expansion of this new class.

2013 gross premiums written decreased by 12.9 per cent compared to 2012. The decrease in premiums for the year is mostly driven by the Gulf of Mexico book, where a number of deals that were written on a multi-year basis in the second quarter of 2012 are not up for renewal yet. During 2013 we continued the expansion of a new sub-class – energy liabilities – with $8.8 million of new business premiums written this year.

MANAGED INVESTMENT PORTFOLIO ALLOCATIONS

	2009 %	2010 %	2011 %	2012 %	**2013 %**
Cash	7.1	21.9	13.2	11.1	**14.7**
Short-term investments	14.2	0.5	4.0	5.4	**9.8**
Fixed income funds	–	–	–	–	**1.1**
Government debt	16.2	22.4	27.2	18.8	**14.6**
Agency debt	5.6	1.6	4.2	6.2	**4.1**
Agency MBS, CMBS	23.8	15.3	13.2	19.2	**10.9**
Non-agency RMBS, ABS, CMBS	–	2.9	5.8	5.3	**8.4**
FDIC corporate bonds	9.5	4.3	2.5	–	**–**
Corporate bonds	23.6	31.1	29.9	32.2	**29.7**
Bank loans	–	–	–	1.8	**4.5**
Fixed income at fair value through profit and loss	–	–	–	–	**1.3**
Equity securities	–	–	–	–	**0.7**
Other investments	–	–	–	–	**0.2**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The Group continues to hold an emerging market debt portfolio. Currently 2.2 per cent of the portfolio is allocated to emerging markets with an overall average credit quality of BBB compared to 4.5 per cent and an overall credit quality of BBB at 31 December 2012. The corporate bond allocation represented 29.7 per cent of managed invested assets at 31 December 2013 compared to 32.2 per cent at 31 December 2012. At 31 December 2013 the Group's allocation to bank loans represented 4.5 per cent of the portfolio compared to 1.8 per cent at 31 December 2012. As noted previously, along with our tail risk hedge, the allocation to bank loans is part of our interest rate risk management strategy.

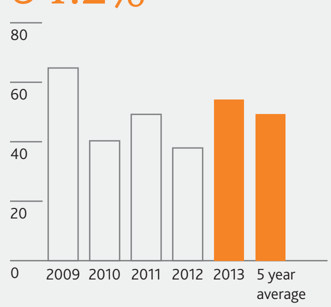
Cathedral's investment portfolio was integrated with the Group's portfolio on acquisition. The overall combined portfolio characteristics did not materially change, given Cathedral's investment portfolio was very similar to Lancashire's with high credit quality and short duration fixed income securities. While the portfolio added a small allocation to equities (0.7 per cent), this is in line with the Group's focus on reducing interest rate risk.

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

2013 results were impacted by a number of small to medium sized losses on our energy lines plus a single large deterioration on a prior year event. While individual losses are always disappointing, they are part of our business, and overall we're very pleased with the make up of our energy book. In 2012 there were no major losses experienced on our energy lines.

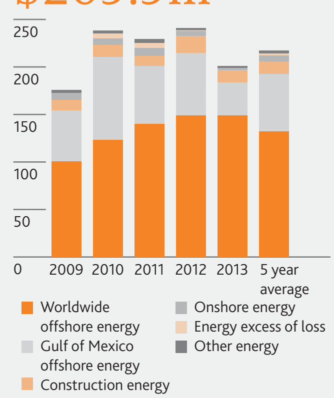
COMBINED RATIO

54.2%



GROSS PREMIUMS WRITTEN

$209.9m



management's risk tolerance an adjustment in asset allocation may be made. Conversely, if the risk profile is expected to move outside of tolerance levels, adjustments may be made to reduce the risk in the portfolio. We try to be nimble in our investment strategy while putting our objective of capital preservation first and foremost. We believe in the application of common sense, and do not place much reliance on 'black box' approaches to investment selection.

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

INVESTMENT PERFORMANCE

Net investment income excluding realised and unrealised gains and losses, was $25.4 million for the year ended 31 December 2013, a decrease of 21.8 per cent compared to 2012. Average book yields over the year ended 31 December 2013 were lower than the same period in 2012.

Total investment return, including net investment income, net realised gains and losses, impairments and net change in unrealised gains and losses was $6.9 million for the year ended 31 December 2013 compared to $62.8 million for 2012. Treasury yields and credit spreads increased in the first half of 2013, which had a significant detrimental impact on our portfolio, and in particular on our emerging market debt portfolio. However, the tail risk hedge implemented in the first half of the year softened the impact somewhat. In the second half of the year, strong returns in our bank loan and emerging market debt portfolios combined with significant credit spread narrowing in the rest of our fixed income portfolio, offset the losses of the first half of the year. Our portfolio therefore produced a marginally positive return for the year. In 2012, our portfolio benefited from significant credit spread tightening, particularly in the emerging market debt portfolio.

LIQUIDITY

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

PERFORMANCE

KEY INVESTMENT PORTFOLIO STATISTICS

	2009	2010	2011	2012	**2013**
Duration	2.3 years	2.2 years	1.8 years	1.8 years	**1.0 years**
Credit quality	AA+	AA	AA–	AA–	**AA-**
Market yield	2.2%	1.9%	1.5%	1.1%	**1.2%**
Book yield	2.8%	2.4%	1.9%	1.8%	**1.4%**

MARINE

MARKET REVIEW AND OUTLOOK

The Costa Concordia loss resulted in substantial increases in P&I rates but across the rest of the marine market ample capacity remains and is maintaining the downward pressure on pricing. Although we do see some attractive niche opportunities, our marine portfolio now largely consists of core clients. Therefore we do not expect any major growth in our portfolio in 2014, but will continue to work with our existing clients and focus on underwriting high value accounts such as cruise vessels and liquid natural gas carriers. We are also working actively to find new opportunities, especially in our preferred niches such as marine war, mortgagees' interest insurance and mortgagees' additional perils.

2013 gross premiums written decreased by 22.2 per cent compared to 2012. The decrease was a result of reduced premium volumes across all the marine classes, primarily due to the timing of non-annual contract renewals.

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

CASH FLOW

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

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

In 2013, cash flow was again strong, driven by the Group's robust underwriting performance. A net positive cash inflow arose from operations during the year of $167.7 million (2012 – $193.3 million). We have generated positive operating cash flows in each year of operation since inception.

In relation to the acquisition of Cathedral, the issue of new common shares resulted in a net cash inflow of $198.2 million. On completion of the acquisition, the total cash consideration paid, net of Cathedral cash acquired, was $227.2 million.

OTHER OPERATING EXPENSES

Employee remuneration costs, excluding the Lloyd's segment, were $5.4 million lower for the year ended 31 December 2013 compared to the same period in the prior year. In 2012, employee remuneration included a one-off national insurance charge of $6.9 million, incurred as a result of the Group's tax residency move to the UK with effect from 1 January 2012. Other operating expenses for 2013 included legal fees for the Cathedral acquisition and Kinesis structuring. The Lloyd's segment includes $1.2 million of employee remunerations costs and $6.1 million of other operating expenses incurred since the acquisition date, 7 November 2013.

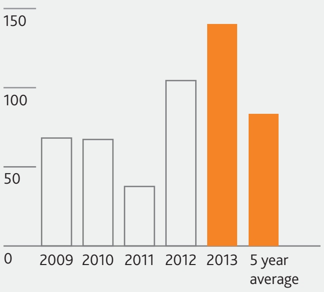
OTHER OPERATING EXPENSES

	2012 $m	**2013 $m**
Employee salaries and benefits	36.0	**37.3**
Employment taxes on equity compensation	10.9	**4.2**
Other operating expenses	31.5	**36.2**
Total Lancashire, excluding Lloyd's segment	78.4	**77.7**
Lloyd's segment	–	**7.3**
Total	78.4	**85.0**

2013 losses were impacted by adverse development on the Costa Concordia marine loss of $37.9 million, after reinsurance and reinstatement premiums, which contributed 60.0 per cent to the marine combined ratio for the year ended 31 December 2013. For the year ended 31 December 2012 Lancashire recorded a loss of $59.2 million, net of reinsurance and reinstatement premiums for this event, which contributed 59.7 per cent of the marine combined ratio for the year ended 31 December 2012.

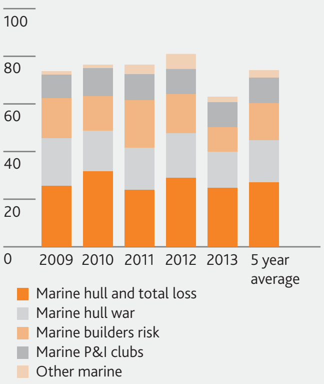
COMBINED RATIO

140.1%



GROSS PREMIUMS WRITTEN

$63.0m



Equity based compensation was $16.7 million for the year ended 31 December 2013 and $16.4 million for the year ended 31 December 2012.

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 second most important area of focus after underwriting and it is our firm belief that pro-active and flexible capital management is crucial in helping to generate a superior risk-adjusted return over time. With our focus on maximising shareholder return we will return capital where this offers the best returns for our shareholders. Including dividends declared in February 2014, we have returned 93.3 per cent of comprehensive income generated via dividends or share repurchases since inception.

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

- maintaining sufficient capital 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 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.

As noted on page 3, in 2013 the Group issued 16,843,382 new common shares to help fund the acquisition of the Cathedral Group. The shares issued represented approximately 9.99 per cent of the issued common share capital of Lancashire immediately prior to the placing.

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

Maintaining a strong balance sheet will be the overriding factor in all capital management decisions.

CAPITAL

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

AVIATION

MARKET REVIEW AND OUTLOOK

Rating on our core product of AV52 remains under pressure as clients continue to seek savings, in part to mitigate the cost pressures on other areas of their business. Many clients buy the coverage only because it is mandated by law or regulation, and perceive the risk as very remote. There was some small additional capacity entering the market over 2012 and 2013, but the existing capacity is already more than required for most risks, exacerbating the competitive pressure on pricing. In the absence of losses we expect pressure on pricing to continue, albeit the line remains very profitable.

There were fewer satellite launches in 2013 than 2012 but we continue to see a good showing of business from the main brokers. Losses have been sparse so rating is under some pressure, but reductions are not excessive and we continue to see this as a good complementary area of business.

2013 gross premiums written increased by 6.5 per cent compared to 2012 with reductions in AV52 more than offset by new satellite premium written following our re-entry into the class in the third quarter of 2012.

ASSOCIATES

For the year ended 31 December 2013, the equity pick-up on the Group's investments in Accordion and Saltire was $9.2 million and reflects Lancashire's 20.0 per cent equity interest in the Accordion vehicle and 16.9 per cent interest in the Saltire vehicle. Kinesis and third-party capital are discussed on page 39.

DIVIDENDS

During 2013 the Lancashire Board declared an interim dividend of $0.05, special dividends of $1.05 and $0.45, and a final dividend in respect of 2012 of $0.10 per common share. With the 2014 special dividend of $0.20 per common share and a final dividend in respect of 2013 of $0.10 per common share, total capital returns since inception amount to $1.9 billion, or 193.0 per cent of initial capital raised. The final dividend of $0.10 per common share and 2014 special dividend of $0.20 per common share have been declared and will be paid on 16 April 2014 to the shareholders of record on 21 March 2014.

NON PRE-EMPTIVE ISSUE OF SHARES

As part of Lancashire's flexible approach to capital management the Board has in recent years requested and received from shareholders authority to issue up to 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 2014 Annual General Meeting to be held on 30 April 2014.

REPURCHASE PROGRAMME

No shares were repurchased during the years ended 31 December 2013 and 2012. The Group's current authorised share repurchase programme permits a maximum of 16,860,242 shares to be repurchased, of which all remained available as at 31 December 2013.

The Board will be proposing at the 2014 Annual General Meeting, to be held on 30 April 2014, that shareholders approve a renewal of the repurchase programme with such authority to expire on the conclusion of the 2015 Annual General Meeting or, if earlier, 15 months from the date the resolution approving the repurchase programme is passed.

LETTERS OF CREDIT

Lancashire has standard LOC facilities which in total amount to $750.0 million, with a $75.0 million loan sub-limit available for general corporate purposes. Syndicate 2010 and Syndicate 3010 each have a catastrophe facility in place to assist in paying claims and gross funding of catastrophes. These facilities amount to a combined $100.0 million with a total of $60.0 million available by way of LOCs.

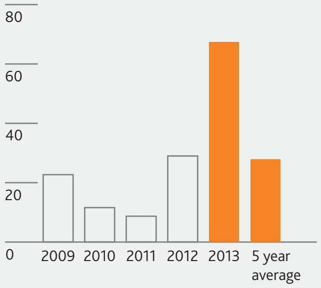
There was no outstanding debt under the above facilities at any reporting date. There are no off-balance sheet forms of capital.

Maintaining a strong balance sheet will be the overriding factor in all capital management decisions.

2013 losses increased over 2012 although neither year experienced any significant insured losses. The loss charge primarily relates to an attritional IBNR allocation and some limited satellite losses.

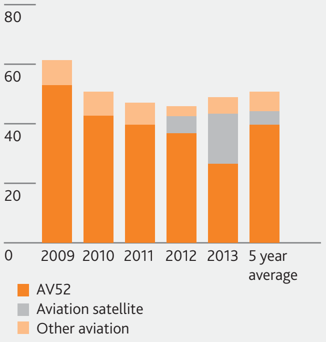
COMBINED RATIO

67.3%



GROSS PREMIUMS WRITTEN

$48.9m



CATHEDRAL

A top-tier Lloyd's business, with strong relationships in niche markets, which shares the Group's focus on underwriting.

Cathedral, the Group's Lloyd's segment, is an established specialty (re)insurance provider that operates exclusively in the Lloyd's (re)insurance market and writes insurance and reinsurance business in property reinsurance, property direct and facultative, aviation and satellite, marine cargo and contingency classes. Operating within the Lloyd's framework, Cathedral benefits from Lloyd's recognised status as the world's specialist (re)insurance market, its high-quality security rating, worldwide licences and attractive capital regime. Cathedral is London based and operates as an Integrated Lloyd's Vehicle which comprises a managing agent and two syndicates, Syndicate 2010 and Syndicate 3010. For the 2013 year of account, Cathedral owned 57.8 per cent of the capacity on Syndicate 2010 and 100 per cent of the capacity on Syndicate 3010. The remaining capacity, 42.2 per cent, on Syndicate 2010 is owned by Lloyd's Names, from which Cathedral receives ancillary income in the form of annual fees and profit commissions for the underwriting services it provides. For the 2013 year of account, Syndicate 2010 and Syndicate 3010 had underwriting capacity of £350.0 million and £30.0 million respectively.

Within Syndicate 2010 and Syndicate 3010 Cathedral writes five main classes of business. Each of these is discussed briefly below and further on pages 114 and 115.

The property reinsurance business is made up largely of international catastrophe and risk excess business with a U.S. focus and a core book of small clients. This line of business is expected to see increased pressure on price, terms and conditions in 2014.

The property direct and facultative business is a worldwide short-tail book with a U.S. bias, focusing on small and mid-sized businesses. Historically 90 per cent of lines written are under $5.0 million. Premiums in this class are expected to remain stable in 2014, however, Cathedral will look to grow this business should favourable conditions present themselves.

Cathedral is one of the major aviation reinsurance leaders worldwide and writes satellite business primarily through SATEC, a relationship held for over 15 years. The aviation and satellite line of business is expected to continue to see downward pressure on rates in 2014 as the benign loss period continues.

In 2013 the marine cargo class of business comprised over 90 per cent of Syndicate 3010's business and is written both direct and by way of reinsurance. Pure marine cargo business represents 82 per cent of this class with specie, fine art and war making up the remainder. Premium in this class of business is expected to remain stable in 2014.

The contingency class of business focuses primarily on music cancellation. There are some signs that following a spate of large losses relating to the music industry in recent years, conditions in this line of business may improve in 2014.

Results for the year ended 31 December 2013 for the Group include Cathedral results from 7 November 2013, the date the acquisition completed. For this limited period, Cathedral did not write a significant amount of premium, incur any large losses or produce unusual investment returns. Cathedral's key financial information for the period 7 November 2013 to 31 December 2013 is included on page 39. Full year financial information for Cathedral is presented on page 39 for informational purposes only.

	For the period 7 November 2013 to 31 December 2013 $m	Full year 2013 $m
Gross premiums written	**24.5**	288.2
Net premiums written	**22.8**	222.3
Net premiums earned	**39.8**	224.6
Net insurance losses	**19.0**	90.3
Net underwriting income	**12.2**	82.3
Net investment income	**0.6**	7.1
Net realised gains (losses) and impairments	**(0.1)**	(0.8)
Net operating profit	**5.0**	46.8
Profit after tax	**6.4**	37.7
Change in unrealised gains/losses on investments	**0.3**	0.3
Comprehensive income	**6.7**	38.0
Net loss ratio	**47.7%**	40.2%
Net acquisition cost ratio	**21.6%**	23.2%
Expense ratio	**15.8%**	13.9%
Combined ratio	**85.1%**	77.3%
Net total return on investments	**0.3%**	1.0%

KINESIS AND THIRD-PARTY CAPITAL

Following the success of Accordion and Saltire, Kinesis was launched in June 2013 and represents a further development of Lancashire's strategy to build partnerships with capital market participants. It will give the Group the opportunity to leverage its underwriting expertise whilst affording flexibility in the management and deployment of its own capital.

In early 2013 Accordion was able to take advantage of the remaining favourable property retrocession rates and assumed further property retrocession risks from LICL. Accordion deployed $185.0 million of limit at the 1 January 2013 renewals and reinsured $47.9 million of premiums ceded from LICL. Saltire, a market facing vehicle selling a multi-class ultimate net loss aggregate reinsurance product, provided the Group with $1.2 million in underwriting fee income in 2013.

With the development of Kinesis in 2013, Accordion and Saltire have effectively been placed in run-off. At 1 January 2014 Kinesis deployed $252.5 million of limits including net premiums written of approximately $56.2 million in Kinesis Re.

Going forward, the Group is expected to benefit from the management of Kinesis through underwriting fees and contingent profit commissions as well as the equity pick up on the Group's investment in Kinesis Holdings.

ENTERPRISE RISK MANAGEMENT

ERM for Lancashire is a part of "business as usual". This means that we embed prudent and proportional controls and systems of governance in all areas of our operations. We expect all our colleagues to contribute to risk management, starting with our Boards at Group and operating entity level. With the addition of Kinesis and Cathedral during 2013 we have to recognise that different operational structures require nuances of approach to ERM; but we do not compromise our core principles of establishing clear risk appetites, setting clear boundaries with tolerances, and requiring clear ownership through documented processes, procedures and risk registers.

ERM DEVELOPMENTS

Over the last eighteen months we have continued to embed our risk governance and strategy even further into our operating structure. This was done in two specific ways.

- firstly we decided not to have a separate ERM strategy, but rather to incorporate ERM within the overall business strategy. This reflects the fact that we regard an embedded ERM strategy as a key part of our organisational DNA;
- secondly we decided that as the Solvency II requirement is that the Board as a whole should be responsible for the risk function, a separate Board risk committee was inappropriate for our business model. The whole Board and the subsidiary Boards now receive the CRO's risk report.

The Omnibus II agreement to enact the necessary legislation to implement the Solvency II capital regime for Europe's (re)insurers was finally passed in November 2013. The outstanding points of contention that this agreement addressed did not have any significant impact on Lancashire as they dealt more with issues related to long-term and life policies. What has become clearer is the timeline under which the various provisions for reporting under Solvency II will be implemented by our UK regulator, the PRA.

We expect the PRA to become our Group Supervisor once Solvency II takes effect on 1 January 2016, and are continuing discussions with them to ensure we are prepared. The regulatory reporting burden will increase so we are finalising our plan to ensure we have all the necessary elements to make the returns promptly and accurately. This includes an assessment of the resources we require and the fit between our existing data, systems and procedures and Solvency II requirements. We have performed a test run of the Solvency Capital Requirement for LUK and have developed our pro-forma Own Risk and Solvency Assessment report and framework with the associated policy and procedure. Cathedral has already obtained the Lloyd's "green light" status for Solvency II preparedness, and is also well positioned to comply.

RISK MANAGEMENT STRUCTURE

The decisions to make the full Board responsible for risk management, and to present the CRO's report to the full Board places the central responsibility for risk management clearly at the very top of the governance structure of the Group. It also means we get the benefit of our Board members' experience of other industries' and other (re)insurers' approaches to risk management.

As we develop the Solvency II processes within Lancashire the Boards at Group and operating entity level will be responsible for overseeing the ORSA processes and leading the challenge on risk assumptions.

The ERM policy is designed to ensure that Lancashire is managed in accordance with its risk profile and risk appetite. Lancashire has described its risk profile in two ways; a cross-cycle RoE of the risk-free rate plus 13 per cent and to be profitable in four years out of five. This gives measures of both the desired level of return and the tolerance to volatility. The profile is supported by the risk appetite which describes the tolerance to certain kinds of risk – insurance (including reserving risk), market, liquidity, credit, operational, strategic – which is articulated through risk tolerances which are agreed by the Board annually. This ensures that the Group's capital and resources are aligned with the risk levels, and that there is continual compliance with rating agency, regulatory and our own assessment of capital requirements.

The Lancashire risk structure comprising the Board, RRC, CRO, risk owners and Internal Audit ensures that there is appropriate expertise and challenge throughout the organisation. As an example we can look at the Group's principal source of risk, insurance risk.

The process for handling this begins with our underwriters, operating within specified underwriting authorities matched to their level of experience and seniority. The underwriters are then subject to peer review, either before quoting at LICL and LUK through the UMCC, after quoting at Cathedral or with actuarial review at Kinesis. At an aggregate level the Boards approve risk tolerances that limit the absolute amount of risk for a given peril that the Group and subsidiaries can accept. This is monitored at the RRC which not only reviews changes in key risk levels against tolerances, but also challenges the basis for aggregating exposures and calculating RDS. The Internal Audit function reviews underwriting annually as a key risk, and the CRO regularly attends the UMCC and RRC. The risk register details the key underwriting risks and controls and is affirmed by the CUO for completeness and accuracy at operating entity and Group level.

The risk register has been updated in 2013 both through risk owners being challenged by the CRO on absolute and relative risk scoring, and through the RRC reviewing individual elements of the risk assumptions. The CRO has reviewed the Cathedral ERM and risk registers, which are appropriate to the Lloyd's environment, and the Kinesis risk register.

BLAST

BLAST is our capital model which we use to assess our risk levels and correlations. We continually look at improvements to BLAST and incorporate changes as required. Model changes are defined as one of four categories. Within each of these categories of change, there is a definition of major and minor change, based on the qualitative and quantitative significance.

TYPE 1 CHANGE – RISK PROFILE

A material change to Lancashire's risk profile not requiring a change in model design.

TYPE 2 CHANGE – PARAMETERISATION

A change in the assessment of risk, without a material change in the underlying risk profile: for example a change in one of the vendor stochastic models we use to assess and aggregate catastrophe risk, such as the change from RMS version 11 to 13.

TYPE 3 CHANGE – MODEL DESIGN

A change to the design or architecture of the model: for example adding a new reinsurance programme or loss module in ReMetrica which is the calculation engine of BLAST.

TYPE 4 CHANGE – GOVERNANCE/CONTROLS

A change to the control framework in which the model is operated.

All material assumptions in BLAST requiring expert judgement are discussed and signed off at the RRC on at least an annual basis. Any significant changes to the design or approach also have to be agreed at the RRC and, where appropriate, detailed to the Board for approval.

BLAST DEVELOPMENT AREAS IN 2013

There has been a lot of work on specific issues: from the modeling of outwards ILW recoveries to determine parameter risk to incorporating the change in the RMS U.S. windstorm model in version 13. As we did with Accordion we have also incorporated Lancashire's investment in Saltire into the model and will include Kinesis in 2014. Some examples of other work are:

- more work has been performed on the control environment of assumption sign off, reconciliations and IT governance. These are linked to the ArcLogics risk management system to enhance the monitoring of controls.
- we have also reassessed the non-modeled and under-modeled risks. There have been a number of losses over 2011 and 2012 in territories and for perils where the model data is limited; tornadoes and wildfires in the U.S., hailstorms in Europe, flooding in Thailand. We calibrate models against actual events and consider adjustments.

PRINCIPAL RISKS AND UNCERTAINTIES

We are a risk-taking business. Balancing risk and reward is at the heart of our business. We analyse and quantify our risks and have a system of controls through which we seek to limit and mitigate our risks.

Type	*What is the risk?*	*Why do we take the risk?*
INSURANCE RISK	Outsized losses from a single event or an accumulation of events. We incur significant exposures both to individual risks, such as oil rigs or cruise liners, and to accumulations of risks from perils such as hurricanes, windstorms or terrorist attacks. A major loss or sequence of losses could cause material damage to our earnings or, indeed, to our balance sheet.	Although there is the potential for 'shock' losses, we believe that the risk-adjusted return we can earn from these kinds of exposures fits our risk appetite and provides good margins across the insurance cycle.

How do we monitor and mitigate the risk?

Risk appetites and tolerances: The Boards set risk appetites which are then expressed through tolerances for the maximum amount of exposure that the Company is willing to accept for a given loss scenario, for example, a hurricane in the U.S., the sinking of a major ship, or a terrorist attack. We set these tolerances at extreme loss levels, such as 100 year and 250 year return periods, so they take account of very serious events and we monitor them through the RRC and operating entity Boards.

Modeling and accumulation studies: We spend a lot of time analysing correlations and accumulations of risk, to try to understand what sort of losses we could be exposed to. The RRC has a key role in this, by questioning the underlying assumptions and regularly reviewing items such as the RDS that we use for looking at worst-case risk losses. Cathedral brings some interesting new views on accumulation analysis for property catastrophe excess of loss which will challenge and add to our understanding.

Stress testing: We conduct stress tests as part of our annual business planning to see what earnings and capital implications there would be in the case of a single extremely large loss or an unusual accumulation of losses. This helps us to think about extreme scenarios and how we can mitigate exposure to them.

Reinsurance: We use reinsurance to mitigate our potential exposures to either unexpected frequency or severity of losses. The availability and cost of reinsurance can change dramatically through the cycle, but in 2013 capacity was plentiful, which allowed us to buy some new cover. With the addition of Cathedral, the Lancashire Group has become a significant buyer of reinsurance for 2014.

Underwriting process: We believe that the best control for underwriting exposures lies in the selection of risk. That is where the underwriting review process – through the UMCC at LICL/LUK and the review process at Cathedral and Kinesis – is such an important risk management tool.

Further discussion of the risks affecting Lancashire and the policies in place to manage them can be found in the risk disclosures section on pages 108 to 133.

Type	What is the risk?	Why do we take the risk?
CAPITAL MANAGEMENT RISK	Insufficient capital to maintain regulatory or rating agency requirements, or to execute the business plan. Capital can be depleted by insured loss events or investment losses. Inaccurate or ineffective capital modeling or changes to capital models can result in insufficient capital being held. There can be a number of competing capital requirements, including the rating agencies, regulators, debt covenants and our own tolerances.	Lancashire believes that an active capital management policy is a key component of its strategy to produce attractive risk-adjusted returns across the cycle. Clients, brokers, regulators and rating agencies all consider capital strength in evaluating insurers, and shareholders and analysts focus on RoE, so this is important on many fronts.

How do we monitor and mitigate the risk?

Capital modeling: We use our own internal capital model, BLAST, to assess our capital needs and allocate capital to all our risk categories. We are fortunate that our simple operating structure and systems allow us to run the capital model on a very frequent basis so that it can be used to assist in assessing all kinds of decisions – from how much surplus capital is available to return to shareholders, to the benefits of buying a specific reinsurance programme. This enables us to be nimble in our capital planning and to respond quickly to events and opportunities.

Business planning: Lancashire uses a formal and detailed business planning process to predict its capital requirements. This process begins in the third quarter of each year and culminates in a business plan that is approved by the Boards in the first quarter. It is also subject to review and updating as required, usually in the middle of each year.

Investor relations: We recognise that an active capital management strategy requires us to communicate clearly with our shareholders and to maintain the tools to raise new capital, as well as return it, as dictated by the cycle. In the last 18 months Lancashire has raised equity and debt capital and secured a pre-emption dispensation supported by over 96 per cent of shareholders. We travel extensively to meet existing, former and potential shareholders and hold presentations for analysts and investors.

ORSA: As part of the Solvency II regime, companies will be required to undertake a detailed assessment of their own view of their capital requirements – the ORSA. Lancashire has already set up a framework for this and drafted a report. This will become a key element in the Board and management's assessment of capital over the next two years.

Type	What is the risk?	Why do we take the risk?
INVESTMENT RISK	Investment risk is a key concern for insurers, as the funds that they invest are subject to potential loss or impairment, due to market volatility. There is also the risk that investments are too illiquid and are therefore not available to pay claims when they become due.	We hold the premiums we receive from clients and the capital we raise from the markets for the payment of future claims and expenses. Lancashire's strategy is to focus on preservation of capital before seeking superior returns.

How do we monitor and mitigate the risk?

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. So our investment strategy has been to remain largely neutral to both risk on and risk off markets. We do not reach for yield and use realistic loss and disaster scenarios to model our portfolio and concentrate on the divergence between the possible market scenarios.

Investment Risk and Return Committee: the IRRC forms an integral part of our risk management framework, meeting at least twice a quarter and reporting to the RRC. The IRRC monitors the realistic loss and disaster scenarios and considers new portfolio options and tools. In 2013 it promoted the use of swaptions to mitigate the exposure to interest rate risk, as the global economy improved. The IRRC takes direction from the Investment Committee of the Board and is chaired by the CFO.

External advisers: Lancashire's Board and management recognise that the Company's principal expertise lies in underwriting, so we use the services of internationally recognised investment managers who are experts in their fields. The managers are given detailed investment guidelines, and their performance is measured against pre-defined benchmarks.

Type	What is the risk?	Why do we take the risk?
RESERVE RISK	Insufficient reserves held to pay for losses that can impact, in extreme cases, earnings and capital, and lead to a loss of confidence in the competence of Lancashire by key stakeholders.	Regulators and simple financial prudence require that insurers hold reserves against the cost of claims, including actual losses, incurred but not reported claims and future claims on our policies. By their nature, claims can develop in unexpected ways.

How do we monitor and mitigate the risk?

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. This makes the process of reserve setting easier than in some complex casualty businesses where claims trends may be slow to materialise.

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 is 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. The RRC has a standing item to review these 'loss picks' annually, and a quarterly Reserve Committee reviews all significant individual claims.

External review: Insurers are required to conduct an independent, external review of their loss reserves. Lancashire retains the services of one of the leading industry experts, and our appetite is defined as to set reserves within a range of reasonable estimates based on both internal and external review. In addition, our auditors conduct their own review of loss reserves and both the auditors and external actuaries report their findings directly to the Board.

BALANCING RISK, RETURN AND RESPONSIBILITY

WHY CORPORATE RESPONSIBILITY IS IMPORTANT TO LANCASHIRE

Responsibility is one of the key qualities that underpins Lancashire's business strategy, and this is recognised not only at Board level, but throughout the Group. We always think about the responsibility we bear to shareholders to be prudent stewards of their capital, and to our clients to offer them a clear and comprehensive product at a fair price. We are conscious of the fact that when disasters strike, be they natural or man made, insurance and reinsurance is one of the key services that allows countries, economies, businesses and individuals to rebuild and renew. The role we play is an important one, and we always seek to ensure that we put risk and reward considerations at the heart of what we do.

The responsibility also extends to our roles as an employer and as a corporate citizen of the countries and societies where we operate, and through the donations of the Lancashire Foundation and the time of our staff, we also aim to make an impact right around the world. We believe that this makes Lancashire an organisation that can attract and retain good people, and create a workplace environment that aspires to a spirit of excellence and pride in doing well and doing good at the same time.

As in all areas, we believe that governance, and setting clear parameters for how decisions are made are important. Corporate responsibility governance starts with the full Board which sets group CR policy and receives and discusses periodic reports on the activities of the Foundation, and the HR function as well as environmental impact. As a UK registered charity the Foundation has four trustees and operates under the provisions of relevant UK law. The Foundation has a Donations Committee of employees and non-executives who review all applications and vote on donations, and then monitor outcomes, and review the status of each donation annually.

OUR APPROACH

We regard corporate responsibility as a key part of our business approach. We think about the impacts that we make in both a positive sense – such as enabling businesses to plan with confidence by having a strong insurance partner – and in a negative sense – such as our carbon emissions. We think a clear commitment to being a responsible corporate citizen has direct benefits to Lancashire, in attracting and retaining the best people, and fostering strong relationships with stakeholders.

LIVING BY OUR VALUES

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

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

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

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

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

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

PERFORMANCE

COMMUNITY
$11.0m
donated through the Lancashire Foundation since inception.

ENVIRONMENT
100%
of CO_2 emissions offset.

MARKETPLACE
8,000
kids helped by the summer appeal co-ordinated by Lancashire in 2013.

WORKPLACE
100%
of employees eligible for shares.

COMMUNITY

We support a number of organisations in the communities within which we operate, both in London and Bermuda, but we also look to the wider world where our passion and commitment can make a real difference.

INTRODUCTION

There is a growing sense in the insurance market of an insurance community that can combine a commitment to excellence in providing a crucial support for trade and business, with a determination to influence our local and global societies for the better. This can be seen most dramatically in the expansion of the Summer Appeal that Lancashire again led in 2013, but is also seen in many of our other activities.

OUR APPROACH

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

OUR FOCUS AREAS

Given the nature of our work in understanding risk and responsibility we focus our community work on two areas.

As an employer we need a specially trained workforce and we understand the importance of access to education. But we also understand that, for many, education is a luxury which comes after the need to access the basic necessities of safety, food and lodging. As a business that employs highly-educated citizens of countries from all around the world we believe that providing access to the basic needs, including education, brings benefits to us all.

A key role for Lancashire has become our co-ordination and leading role in the fundraising for the Summer Appeal. In 2013 Lancashire staff prepared the fundraising materials, distributed them, and lobbied others in the insurance and broader financial community to donate funds to provide summer programmes for London's disadvantaged kids during the school holidays. Working closely with other companies in London and the Lloyd's market, over £300,000 was raised.

As part of continually reviewing our charitable partnerships and, as well as continuing our work with long-standing partners like Médecins Sans Frontières in disaster relief and ICM in poverty reduction and education, we have added a significant new relationship in 2013. This is with St. Giles Trust, a charity based in London that works with ex-offenders. This has already engaged strong support from staff in the London offices volunteering to work as mentors.

THE LANCASHIRE FOUNDATION

The Foundation is a key component not just of our community activity, but also of our corporate persona. It helps to define Lancashire as an employer and as a business, and it shares and helps to expound our values. The Foundation is funded by an annual donation from the Company which the Board agreed in 2013 to set at $2 million or 1 per cent of net profits, whichever is greater. The Foundation retains the 648,143 warrants that were part of its initial funding and continues to benefit from the special and ordinary dividends, so there are direct links between the success of the Company and the resources of the Foundation. This serves as an additional motivation for our people, as the Foundation is able to support more of the causes that are suggested by employees. Donations in 2013 were made to Childreach, TOFS UK, Sick Children's Trust, Noah's Ark Children's Hospice, Richard House Children's Hospice, Medical Detection Dogs, Windreach Bermuda, Bermuda Foundation for Insurance Studies, Pandan Bay Institute, KnowledgeQuest, Adult Education School, Sudden Adult Death Syndrome, Eliza DoLittle Foundation, Cancer Research, ERuDeF and Fareshare, all of which were nominated by employees.

Major donations were made to MSF, which operates in crisis relief around the world, ICM which works with the poorest of the poor in the Philippines, the Family Centre which provides critical support to families in Bermuda and also St. Giles Trust which provides routes out of re-offending in the UK.

The first two of these charities supported disaster relief in 2013, complementing Lancashire's own catastrophe insurance and reinsurance business. The latter two work on improving quality of life in the cities where we are located, which makes them better, safer places to live and work.

The Foundation's Donations Committee meets quarterly to review reports from the charities we already support and to consider new donations or initiatives. Every charity has a designated advocate on the Committee who is responsible for keeping up to date with their activities, needs and progress. But, as in all other areas within Lancashire, the Committee is ready to respond nimbly, making quick decisions to provide support when disaster strikes; our partnership with ICM led directly to our enabling them to provide vital support in the aftermath of Typhoon Haiyan with a swift donation of £100,000.

The list of staff-suggested charities that the Foundation is able to support continues to grow. For example, in 2013 a grant of £50,000 enabled Islamic Help to build a new Orphans Home in Tanzania, that was named Lancashire House, and was opened by the former President of Tanzania Mr Ali Hassan Mwinyi. Ten children have moved in with their care-giver and have started to attend a nearby school. The charity was suggested to the Donations Committee by our Deputy CIO, Gohir Rashid, who is involved with the charity and has made his own donation. He will be visiting next year and will provide us with an update and feedback.

St. Giles Trust (SGT) is a new relationship for the Lancashire Foundation, but one where the Company recognises the potential to make a big difference. SGT supports male and female offenders aged over 15 and their families. The aim is to help them realise their true potential and avoid re-offending, and so to contribute to a safer and more productive society. SGT works with some of the most marginalised people in society struggling with issues such as homelessness, unemployment, addiction and discrimination. Their programme is centred around using ex-offenders to mentor and guide those coming back into society after custody, through its Peer Adviser Programme. Indeed 45 per cent of their staff are ex-offenders, making SGT one of the largest single employers of ex-offenders in the UK.

SGT shares Lancashire's focus on measuring outcomes and through a study facilitated by Pro Bono Economics they were able to demonstrate that their 'Through the Gates' programme for prison leavers who served less than 12 months delivered £10 in savings to the taxpayer for every £1 spent on the service.

EMPLOYEE ENGAGEMENT

We recognise that the energy and talents of the people of Lancashire can make a difference in a number of ways, and that our charitable partnerships offer a valuable way to channel these generous instincts. We provide day and week release programmes for staff to give back to the communities in which they live and around the world. In addition, staff are entitled to a week's charity leave on completion of three years' service with the Company. The following are some examples of the varied ways in which they have chosen to give back:

In March, a group assisted the Bermuda National Trust to remove invasive plants from the 7.5 acre Vesey Nature Reserve. The Executive Director of the Bermuda National Trust commented, "It is always great to see our corporates in Bermuda doing their part to give back to our island home, and your Corporate Days of Giving are truly appreciated."

In July, a group working with Habitat for Humanity of Bermuda, participated in a 'Three Homes in Three Days' event, a community improvement initiative to restore homes. The Executive Director of Habitat for Humanity was very appreciative, saying, "Marked differences were made in our community over these three days, and none of it would have been possible without Lancashire's efforts."

In December Lancashire staff served a Christmas Lunch at AGE UK's Appian Court in London. This is just a part of the regular visits and support that Lancashire provides. The centre provides a daily hot meal, healthcare advice and social events for older people. Through our financial support the centre has been able to purchase a range of new kitchen equipment, including a new industrial fridge, meaning that their own limited funding can be used instead to ensure the longevity of the centre. However, whilst the financial support is greatly appreciated, it is apparent that the most valuable aid comes from the regular visits by our staff to the centre, to assist with social events. Many of Bow's service users have little or no family, so the chance to enjoy the company of others is truly appreciated.

RISK MEETS REWARD

INTERNATIONAL CARE MINISTRIES

Teamwork is important at Lancashire, so for the last four years we've sent six volunteers each year to work as a team with ICM in the Philippines on a building project to improve the quality of life of the poorest of the poor. In 2013 the team built toilets for slum dwellers. The experience of working together in an environment that is both physically and emotionally tough is one that all the participants have cited as something that improves their relationships with colleagues across the Group. There are risks in volunteering for this trip, as the numerous vaccinations make clear, but the reward is a real feeling of accomplishment.

"Lancashire's investment in the lives of the poorest in the Philippines is such a gift to the ICM family. Not only does it encourage the poor who directly benefit from your support, but you are also energising the Filipinos who work for ICM, as your gift enables them to do their job more efficiently and with greater impact.

We feel a kinship with Lancashire because, like you, ICM believes in focusing its resources on the key areas of delivery. You can be confident that the work you are accomplishing in the Philippines through ICM is consistent with your core values of effectiveness, efficiency and excellence.

By equipping men and women to serve with your donation of vehicles, food shipments and medical supplies, you are giving them the dignity and joy of being a part of the solution to the challenges of poverty. Your donation towards the food alone has provided 8.1 million meals in the past twelve months.

Thank you for coming alongside ICM with your financial and volunteer support. Knowing that there are people around the world who stand with us in our work is as important as the physical donations. Thank you."

DAVID SUTHERLAND,
CHAIRMAN OF THE BOARD, ICM

MÉDICINES SAN FRONTIÈRES

"Lancashire Insurance is one of MSF UK's largest and most committed donors. The support we receive year after year has been absolutely vital for our teams, in order to respond immediately to crises and emergencies around the world.

The Democratic Republic of Congo (DRC) is just one of the countries Lancashire supported last year. It remains one of MSF's largest programmes due to decades of violence, displacement and epidemics which continue to plague the population. As the pressure mounts we are overwhelmed by the compassion shown by Lancashire employees for our patients living in crisis across the world specifically in Myanmar, DRC, Central African Republic and Syria.

The need to remain impartial and neutral is growing increasingly important, especially in places like South Sudan and Central African Republic, both currently gripped in conflicts. As always it is civilians and the most vulnerable who suffer the most. Because of Lancashire's support, we are able to work in contexts where others cannot, reaching the populations most in need. Thank you."

HANNAH RICHARDSON,
MAJOR GIFTS MANAGER

ENVIRONMENT

Our focus on our clients means we have to travel around the world to see them, and that creates the bulk of our carbon footprint. But we always seek to minimise travel, for instance combining trips to see clients with visits to see investors.

INTRODUCTION

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

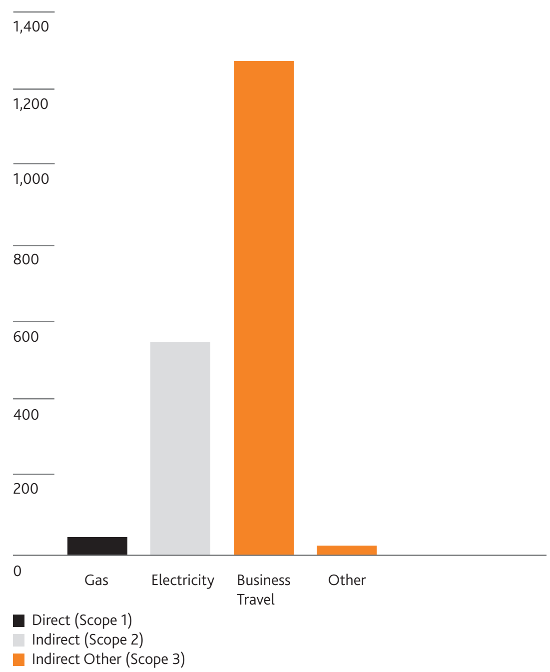
OUR APPROACH

In previous years Lancashire has submitted its carbon reporting for the period 1 October through to 30 September. In keeping abreast of the mandatory carbon reporting guidelines introduced in 2013, as of 2014 Lancashire will report its carbon footprint to align with the financial year.

For the sake of completeness, the carbon figures for the previous reporting period have been recalculated to give an accurate figure for the 12 months from 1 January 2012 to 31 December 2012 to align with the financial accounts for that year.

SOURCES OF EMISSIONS

1,884.7 tCO_2e



	2013-2014	2012-2013	2006-2007
Tonnes CO_2e	**S1, S2, S3**	S1, S2, S3	S1, S2, S3
Gross emissions	**89,510**	91,390	31,120
Exported renewable electricity reduction	**(18)**	(15)	0
Offsets	**(5,000)**	0	0
Woodland carbon units	**(100)**	0	0
Net emissions	**84,392**	91,375	31,120

Types of Emissions	Activity	tCO_2e
Direct (Scope 1)	Gas (kWh)	43.88
Indirect energy (Scope 2)	Electricity (kWh)	547.61
Indirect other (Scope 3)	Business travel (km)	1,270.65
	Other	22.57
TOTAL EMISSIONS (tCO_2e)		1,884.71
Intensity metric: Staff number – 165 FTE		
TOTAL EMISSIONS (tCO_2e) Staff number – FTE		11.4

The figures in this report calculate the full 12 months from 1 January 2013 to 31 December 2013. In response to the requirement to report at least one 'intensity ratio', Lancashire has elected to use the number of full-time employees (FTE) as its intensity metric and has determined an intensity ratio of 11 tCO_2e per FTE.

OUR FOCUS AREAS

This report details our greenhouse gas (GHG) emissions for the 12 months ending 31 December 2013. Using an operational control approach, Lancashire assessed its boundaries to identify all of the activities and facilities for which it is responsible and reported on all of the material GHG emissions including Scope 1, 2 and 3. Relevant activity data was identified and collected and provided to independent consultant, Carbon Clear. The validity and completeness of the data was checked by Carbon Clear to calculate the GHG emissions for the Lancashire Group. The calculations performed follow the ISO-14064-1:2006 standard and give absolute and intensity factors for the Group's emissions. Lancashire has purchased carbon credits to reduce its gross GHG emissions by 1,885 tonnes. The credits are certified to the Verified Carbon Standard (VCS) and the Gold Standard (GS).

The results show that GHG emissions in the period were 1,885 tonnes of CO_2e, comprised of direct emissions (Scope 1) amounting to 44 tonnes of CO_2e or 2 per cent of the total, and indirect emissions (Scope 2) amounting to 548 tonnes of CO_2e or 29 per cent of the total. The source of other indirect emissions (Scope 3) comprised 69 per cent of total emissions or 1,293 tonnes of CO_2e.

The Company has chosen to offset its carbon emissions with Carbon Clear by contributing towards a unique small-scale hydropower project in India, and a cook stove efficiency project in Sudan aimed at alleviating energy poverty and increasing the health of women and children. With Lancashire Group continuing to offset all gross emissions using quality carbon credits, net GHG emissions in this reporting period amounts to zero tonnes of CO_2e. The Group is pleased to announce it is again carbon neutral and dedicated to exploring initiatives that ensure we limit emissions, and positively manage our footprint.

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

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

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

MARKETPLACE

Lancashire devotes substantial resources, working in partnership with others in the insurance and financial world, to galvanise support for the causes that we feel passionate about.

INTRODUCTION

With the acquisition of Cathedral and the development of Kinesis, Lancashire has a bigger footprint and more ways to impact and influence the marketplace. We are fortunate that our new colleagues at Cathedral hold important positions within the Lloyd's market including the Council and the Lloyd's Charities Trust. These will inevitably enhance our ability to provide leadership within our industry. We continue to encourage staff to serve on market committees and boards, including a dozen IUA committees such as the Solvency II, Legal, Compliance and Energy committees.

OUR APPROACH

We continue to travel to meet our stakeholders and ensure that we communicate appropriately with them, and we also invite them to visit us in our offices in London and Bermuda.

OUR FOCUS AREAS

Clients: Our clients are the bedrock of our business so we seek always to offer them transparent and useful products that are priced fairly in relation to their risk. Having new platforms from which to offer them (re)insurance in Cathedral and Kinesis can only help to broaden and deepen our relationships with them.

Brokers: We continue our commitment to work as a broker market and we've been pleased with the expansion of our broker relationships in 2013, especially in the reinsurance realm. By combining with Cathedral, the Lancashire Group is now a significant buyer of reinsurance, which also enhances these relationships.

Investors: We had a lot of contact with our shareholders in 2013 as we explained to them the reasons behind major corporate actions. The strong support for the disapplication of pre-emption rights, the launch of Kinesis and the acquisition of Cathedral testify to the effectiveness of our communication strategy. We prepared and distributed materials explaining the transactions, and were particularly pleased with the response to the presentation to shareholders and analysts on the Cathedral deal. One asset manager described the presentation as a model for others to follow.

STRENGTH MEETS AGILITY

INTERNSHIP PROGRAMME

Following a meeting with Mr Michael Fahy, the Bermuda Minister for Home Affairs, the Company and the Lancashire Foundation are jointly sponsoring two two-year internship positions for Bermuda resident college graduates to be spent working and learning in the Lancashire London office. The two-year term is a major commitment and demonstrates the Group's determination to give back to Bermuda. This serves to help meet the need identified by the Bermuda government to improve the provision of skills training and entry level positions for young Bermudians in the international business sector, and builds on the Foundation's existing commitment to Sandys 360's elementary school support.

This demonstrates the strength and support that Lancashire offers to the local economy, along with developing the underwriters of the future.

WORKPLACE

PERFORMANCE

WORKPLACE

We continue to strive to attract excellent employees who drive our appetite to outperform.

INTRODUCTION

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

OUR APPROACH

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

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

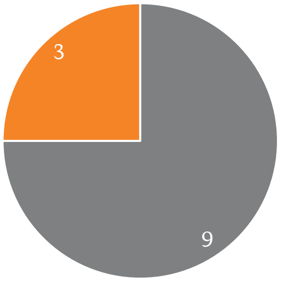
OUR FOCUS AREAS

Our focus in 2013 has been to maintain the success of our employees through ongoing training and coaching – provided both internally and externally. We have continued to deliver the Management Development Programme and we measure our employees' success through attainment of personal performance metrics as well as performance within the Lancashire Values framework. The Lancashire Values set out how we want our employees to carry out their roles within the Company while helping to shape our culture and meeting our business needs.

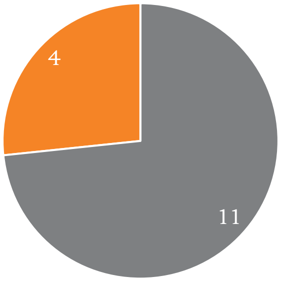
Whilst as a service business Lancashire has little direct exposure to abuses or infringements of human rights, this is an area where Lancashire wants to do more. We are therefore engaged with Anti-Slavery, a charity working in the slavery and forced labour area, and are in discussions with other insurance market participants about how we can further contribute.

BOARD, MANAGEMENT AND EMPLOYEE GENDER DIVERSITY

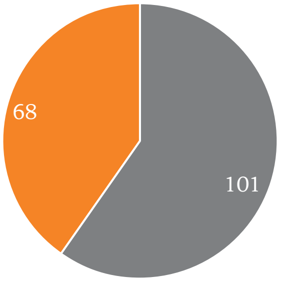
LHL Board members



Group management excluding LHL Non-Executive Board members



Overall Lancashire Group employees



Male Female

DIVERSITY

We are committed to being an equal opportunities employer. The Lancashire Group is currently represented by employees from 16 different nations. There is a 60/40 split of males to females (see page 52) that work in the Group. New staff receive equal opportunities training during their induction, and refresher training sessions for all staff are, again, planned for 2014. We promote the value of having a diverse workforce. We have recently supported the 'Ban the Box' campaign, an initiative from Business in the Community to give ex-offenders better employment opportunities by calling for the removal of tick boxes from employment application forms that ask about criminal convictions.

TRAINING AND DEVELOPMENT

We believe in nurturing the talent of our people and supporting internal career progression. This aids in succession planning and is also a key retention tool. In addition to providing informal training throughout the year, the global Management Development Programme was continued in 2013 and a similar programme was offered to staff. There are plans for both programmes to continue in 2014.

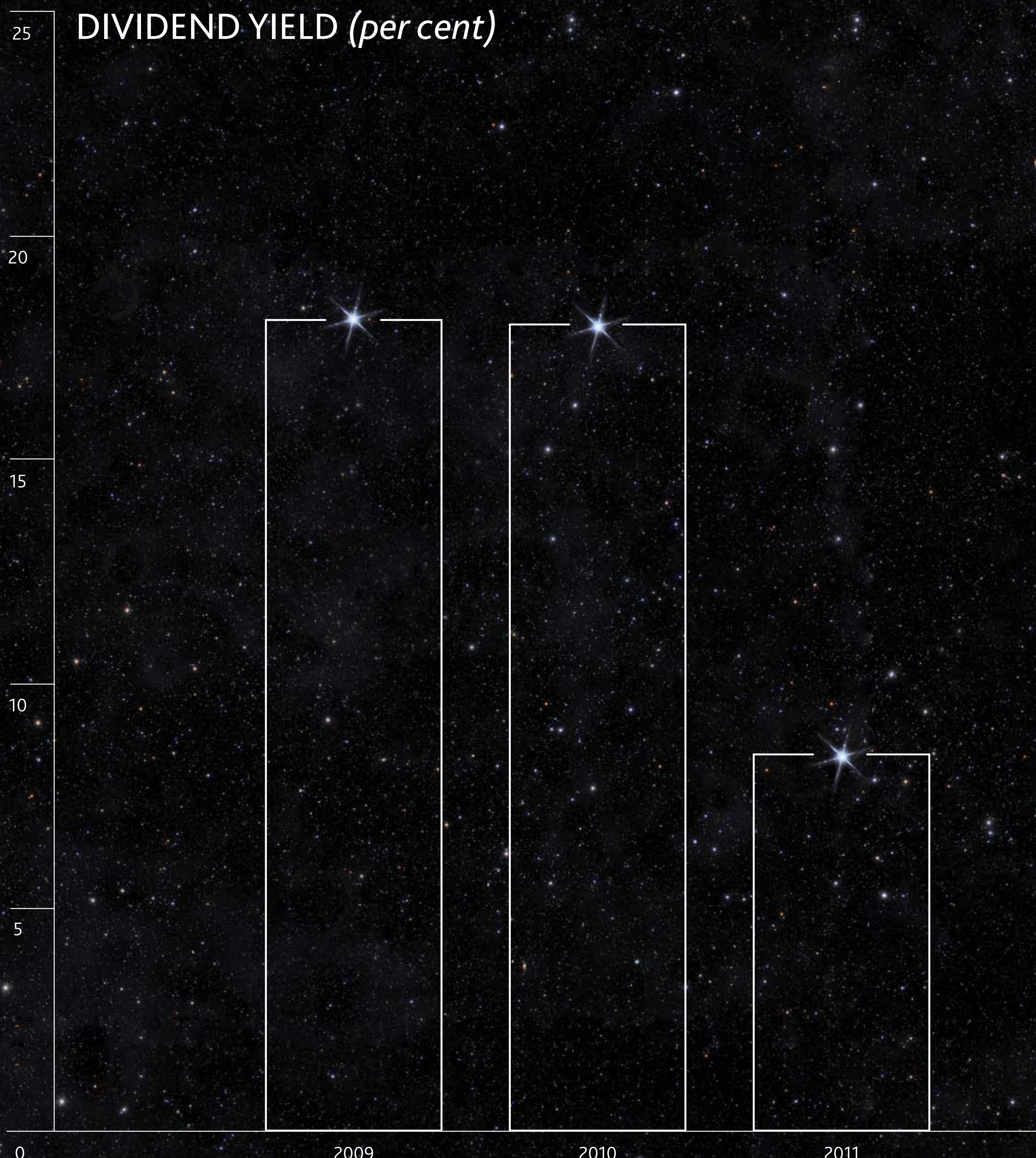
REWARDING OUR EMPLOYEES

Our voluntary staff turnover rate is currently 5.9 per cent, which is within the normal and healthy range we would expect. However, we still strive to reward our employees competitively and want to add something a bit different to value and, therefore, retain our people. We believe that we have some key differentiated benefits that help attract people and keep them motivated. We want everyone to benefit from the success of the business and have a shared ownership scheme providing free Company shares to staff, which vest depending upon the performance of the Group. Our Company has been financially successful since its inception and our staff have benefited from this.

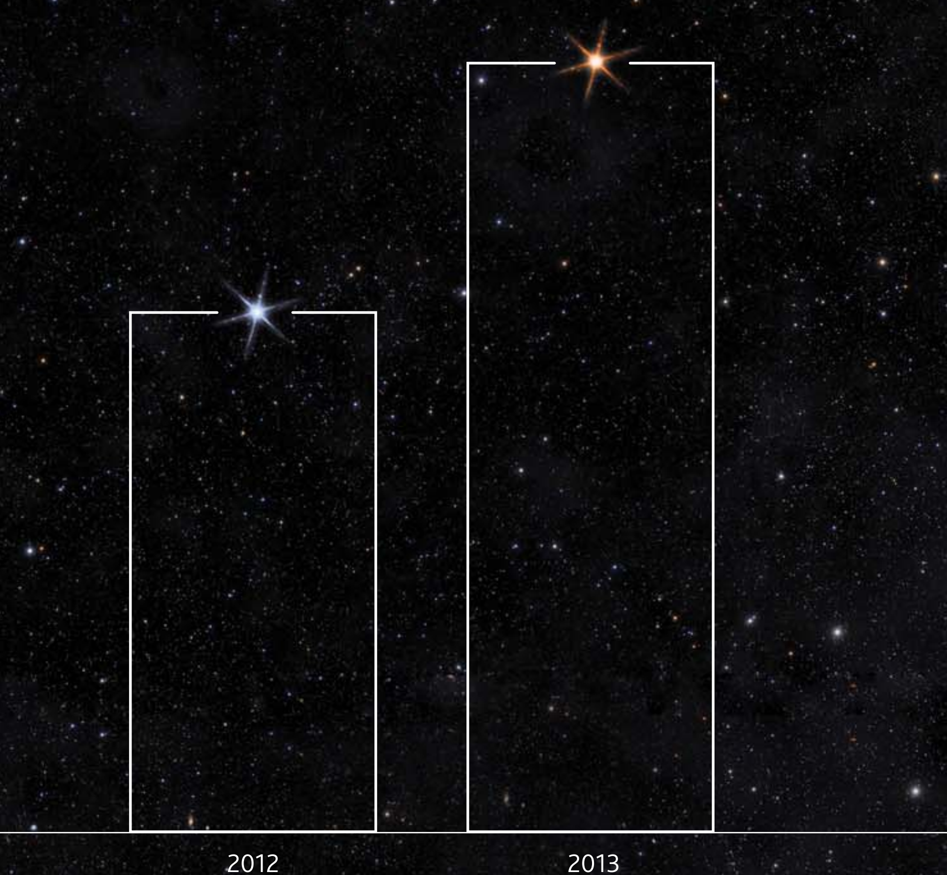
CREATIVITY MEETS DISCIPLINE

COMPANY SHARE SCHEME

Everyone in the Group has the right either to be awarded shares under the employee share scheme at Lancashire and Cathedral, or to buy shares at Kinesis. This creates a shared ownership culture where everyone has a vested interest in the long-term success of the Company, and also supports staff engagement. It further aligns staff, management and shareholder interests. So we ally the discipline of having a forward looking component to the variable remuneration to the creativity of our staff in finding solutions for our clients.


DIVIDEND YIELD (per cent)
25
20
15
10
5
0
2009
2010
2011

GOVERNANCE



IN THIS SECTION:

UNITED APPROACH

"The Board is well equipped to articulate and communicate a unified group strategy, so as to facilitate the dynamic operation of our three operating platforms."

In my opening statement (see page 4) I gave an overview of the work done by the Company during 2013 to broaden our underwriting platform. This work in implementing strategy involves careful preparation and detailed consideration of those matters which are central to the success of the business. In this section we give an account of the work done by the Board and its Committees in developing an effective strategy.

OUR GOALS – GOOD GOVERNANCE AND CLEAR COMMUNICATION

Lancashire seeks to achieve the highest standards of corporate governance. The Company, by virtue of its premium listing on the LSE, measures its corporate governance compliance against the requirements of the UK Corporate Governance Code published by the UK Financial Reporting Council. The FCA requires companies with a premium listing to 'comply or explain' against the Code (i.e. to disclose how they have complied with Code provisions or, if the Code provisions have not been complied with, provide an explanation for the non-compliance). The Company monitors its compliance with the Code, and in this Corporate Governance section and throughout this Annual Report for the 2013 financial year, areas of corporate governance compliance and non-compliance are explained by reference to the Code. The Company also monitors its compliance with applicable corporate governance requirements under Bermuda law. I am pleased to report that there are no areas of material non-compliance with either the Code or Bermuda law. We take care over, and pride in, our governance arrangements, not for their own sake, but because when done well they enhance the strategic planning and commercial performance of the Company and enhance the transparency of the Company's communication with its shareholders and wider stakeholders.

We operate a streamlined governance structure (see diagram on page 57). All Board members are customarily invited to attend the Underwriting and Underwriting Risk Committee sessions, which ensures a good understanding of our core business. The subsidiary Boards report to the LHL Board and Committees, and the main Board relies heavily on the work of the Committees so as to ensure as much time and space as possible within its business for wider-ranging strategic discussion.

CONTRIBUTION, CHANGE AND RENEWAL – MAINTAINING AN EFFECTIVE BOARD

Since its foundation in 2005, the Company has benefited from the expertise and commitment of a team of directors who have served the needs of our business well and helped deliver exceptional results over this period. Balanced against these benefits of continuity is the need to ensure that the Board is able to benefit periodically from fresh insights and perspectives. In its discussion of the outcomes of the 2012 Board evaluation, the Board as a whole resolved to address the need to refresh and renew its membership. The first fruit of this process was the appointment of Samantha Hoe-Richardson (which we were able to report on in the 2012 Annual Report), and the Board considered and confirmed the appointment of Simon Fraser (see discussion on pages 61 and 62) towards the end of the year. As part of this process of renewal and as mentioned in my introduction (see page 5) John Bishop, Ralf Oelssner and Neil McConachie have agreed to step down from the Board with effect from the 2014 AGM, when their names will not be put to shareholders for re-election. I would like to thank them all for their valued contributions to the Board over many years and for their wise counsel and insight. I wish them well for the future.

I conducted the 2013 performance appraisal of the Board and all its Committees (see page 62 for further details). That process was stimulating and fruitful, and I am pleased to report that the Board had a balance of skills and perspectives which served the Company effectively, across the year. Lancashire also remains committed to ensuring that our Board continues to deliver the benefits of experience from a diverse range of perspectives and backgrounds. To this end, we have initiated a plan for refreshing the Board, and plan to add several new Non-Executive Directors to the Board across 2014.

MARTIN THOMAS
CHAIRMAN

OUR GOVERNANCE STRUCTURE

Group Board

LANCASHIRE HOLDINGS LIMITED BOARD OF DIRECTORS

Group Committees

AUDIT COMMITTEE	NOMINATION & CORPORATE GOVERNANCE COMMITTEE	INVESTMENT COMMITTEE	REMUNERATION COMMITTEE	UNDERWRITING AND UNDERWRITING RISK COMMITTEE
See p64	*See p66*	*See p68*	*See p70*	*See p69*

Operational Boards

LUK BOARD	LICL BOARD	KCML BOARD	CCL BOARD

ONE TEAM


MARTIN THOMAS (AGE 50), NON-EXECUTIVE CHAIRMAN


RICHARD BRINDLE (AGE 51), CHIEF EXECUTIVE OFFICER


JOHN BISHOP (AGE 68), NON-EXECUTIVE DIRECTOR


EMMA DUNCAN (AGE 54), NON-EXECUTIVE DIRECTOR


SIMON FRASER (AGE 50), NON-EXECUTIVE DIRECTOR


SAMANTHA HOE-RICHARDSON (AGE 43), NON-EXECUTIVE DIRECTOR


NEIL MCCONACHIE (AGE 41), NON-EXECUTIVE DIRECTOR


RALF OELSSNER (AGE 69), SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR


ROBERT SPASS (AGE 57), NON-EXECUTIVE DIRECTOR


WILLIAM SPIEGEL (AGE 51), NON-EXECUTIVE DIRECTOR


ALEX MALONEY (AGE 40), CHIEF UNDERWRITING OFFICER


ELAINE WHELAN (AGE 39), CHIEF FINANCIAL OFFICER


CHRISTOPHER HEAD (AGE 47), COMPANY SECRETARY

MARTIN THOMAS (AGE 50), NON-EXECUTIVE CHAIRMAN

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

RICHARD BRINDLE (AGE 51), CHIEF EXECUTIVE OFFICER

Richard Brindle was the driving force behind the establishment of Lancashire in late 2005. He has been instrumental in ensuring an innovative and rigorous approach to underwriting, which has produced a series of financial results for Lancashire consistently to the top of its insurance peer group. He has also prioritised a keen focus on Lancashire's corporate social responsibilities and is proud of Lancashire's record in establishing and developing the Lancashire Foundation, which gives valuable support to a number of local and international charities, including MSF, ICM and St. Giles Trust.

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

JOHN BISHOP (AGE 68), NON-EXECUTIVE DIRECTOR

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

EMMA DUNCAN (AGE 54), NON-EXECUTIVE DIRECTOR

Emma Duncan is the Deputy Editor of The Economist. She has also held several other posts on the magazine, including Britain Editor and Asia Editor. She has covered the media business, the Middle East, home affairs, agriculture, commodities and the transport industry and has served as Delhi correspondent, covering India, Pakistan, Bangladesh and Sri Lanka. She has written special reports for the magazine on Saudia Arabia and the Gulf states, India, Pakistan and the food industry. Ms Duncan appears regularly on television and radio programmes. She has written widely on a freelance basis, for publications such as The Times, The Sunday Times, The Daily Telegraph, Vogue and Cosmopolitan. She has an honours degree in politics, philosophy and economics from Oxford University and started her career as a researcher and reporter at Independent Television News.

SIMON FRASER (AGE 50), NON-EXECUTIVE DIRECTOR

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 London Stock Exchange issues. Mr Fraser has an MA degree in modern history from St Andrews University. He is also a Non-Executive Director of Derwent London plc where he chairs the Remuneration Committee and sits on the Audit and Nominations Committees.

SAMANTHA HOE-RICHARDSON (AGE 43), NON-EXECUTIVE DIRECTOR

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

NEIL MCCONACHIE (AGE 41), NON-EXECUTIVE DIRECTOR

Neil McConachie worked at the Lancashire Group from February 2006 to June 2012 and during that time held the roles of CFO, COO, CRO and President. He also served as an executive member of the Board of Directors. Mr McConachie was previously Senior Vice President, Treasurer and Chief Accounting Officer of Montpelier Re Holdings Ltd. He has had extensive involvement in debt and equity capital markets transactions, including the initial public offerings of Lancashire and Montpelier. Prior to joining Montpelier, Mr McConachie worked for PricewaterhouseCoopers in London and Bermuda and at Stockton Holdings Limited. Mr McConachie has a BA in Accounting and Finance from Heriot-Watt University and an MBA from Edinburgh Business School.

RALF OELSSNER (AGE 69), SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR

Ralf Oelssner was Senior Vice President Corporate Insurance for Lufthansa German Airlines until 31 October 2007. In 1979, he was appointed Director of Corporate Insurance, and in 1990 was appointed Managing Director of Lufthansa's in-house broker. Mr Oelssner became a member of the executive board of the captive insurance and reinsurance companies of Lufthansa in 2000 and served as chairman of the Lufthansa sub-committee of the International Air Transport Association ('IATA') in 1982 and 1983 and as chairman of the IATA Risk & Insurance Managers' Panel in 2001 and 2002. He was chairman and president of Airline Mutual Insurance, Bermuda from its foundation in May 1986 until its dissolution in March 2007. He was President of the German Risk Managers' Association for 10 years and holds an MA in Economics from Cologne University.

ROBERT SPASS (AGE 57), NON-EXECUTIVE DIRECTOR

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

WILLIAM SPIEGEL (AGE 51), NON-EXECUTIVE DIRECTOR

William Spiegel is a founding partner and head of the financial services investing activities of Pine Brook Road Partners, LLC, a private equity firm. He has 23 years of private equity experience, including more than 11 years of financial services investment experience. Mr Spiegel was with The Cypress Group from its inception in 1994 until 2006. Prior to joining Cypress, Mr Spiegel worked in the Merchant Banking Group of Lehman Brothers. He has served on the board of directors of 17 companies, four of which have been publicly traded. Mr Spiegel currently serves on the board of directors of six Pine Brook portfolio companies, AloStar Bank of Commerce, Aurigen Capital Limited, Essent Group Ltd., Global Atlantic Financial Group, Green Bancorp, Inc., Syndicate Holding Corp. and Third Point Reinsurance Ltd. Mr Siegel holds a BSc in Economics from the London School of Economics, an MA in Economics from the University of Western Ontario and an MBA from the University of Chicago.

ALEX MALONEY (AGE 40), CHIEF UNDERWRITING OFFICER

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

ELAINE WHELAN (AGE 39), CHIEF FINANCIAL OFFICER

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

CHRISTOPHER HEAD (AGE 47), COMPANY SECRETARY

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

BOARD AND COMMITTEE ADMINISTRATION

The Board has overall responsibility for the leadership and control and the long-term success of Lancashire's business. The Board has reserved a number of matters for its decision, including responsibility for the overall management of the Group and approval of the Group's long-term objectives and commercial strategy. The Board has delegated certain matters to the Committees described below. The Committees report to the Board. A copy of the Schedule of Reserved Matters to the Board for its decision, and the Terms of Reference of the Board's main Committees can be found on Lancashire's website at www.lancashiregroup.com. During the latter part of 2013 the Board instigated a review of its Schedule of Reserved Matters as well as the Terms of Reference for most of the Board Committees in light of the guidance published recently by the ICSA, and will consider the results of that review and whether to refresh these documents during 2014.

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

In addition, the Non-Executive Directors meet periodically without the Executive Directors present to discuss a broad range of issues concerning the Company.

MEETING ATTENDANCE SCHEDULE

The Board and Committee attendance record during 2013 of the Directors who held office during the year is detailed below. The table reflects the number of meetings attended and the number of meetings held during the period the Director was a member of the Board or Committee.

	Board	Audit Committee	Nomination and Corporate Governance Committee	Remuneration Committee	Investment Committee	Underwriting and Underwriting Risk Committee
Non-Executive Directors						
John Bishop	7/8	4/4	–	–	–	4/4
Emma Duncan	8/8	–	–	5/6	4/4	–
Simon Fraser	1/1	–	–	1/1	–	–
Samantha Hoe-Richardson	8/8	2/2	–	–	–	–
Neil McConachie	8/8	–	–	–	6/6	–
Ralf Oelssner	8/8	4/4	4/4	6/6	–	4/4
Robert Spass*	5/8	1/2	–	–	3/6	–
William Spiegel*	6/8	–	4/4	5/5	4/6	–
Martin Thomas	8/8	–	4/4	–	–	–
Executive Directors						
Richard Brindle	7/8	–	–	–	2/4	4/4
Alex Maloney	7/8	–	–	–	–	4/4
Elaine Whelan	7/8	–	–	–	4/4	–

* Robert Spass and William Spiegel are resident in the U.S. Robert Spass attended three out of four and William Spiegel attended all of the main quarterly Board and Committee meetings. Due to the need to adhere to strict Group tax and regulatory operating guidelines Directors are unable to participate in Board and Committee meetings while they are in the U.S.

THE DIRECTORS

Appointments to the Board are made on merit, against objective criteria and with due regard for the benefits of diversity on the Board, including gender. The Board considers all of the Non-Executive Directors, except for Neil McConachie, to be independent within the meaning of the Code. Mr McConachie served as President and Executive Director until 30 June 2012 when he relinquished his executive role. He has served as a Non-Executive Director since 1 July 2012.

Emma Duncan, Samantha Hoe-Richardson, Ralf Oelssner and William Spiegel are independent, as each is independent in character and judgement and has no relationship or circumstance likely to affect

GOVERNANCE

his or her independence. Simon Fraser (who was appointed to the Board on 5 November 2013), was formerly an employee with Merrill Lynch during a period when it provided corporate brokerage services to the Company. Noting that under the Code this fact is one which is to be treated as being of special relevance to the determination of a director's independence, each of the Directors had the opportunity to engage with Mr Fraser prior to his appointment and, following that process, the Board determined at its meeting on 5 November 2013 that Mr Fraser is independent in character and judgement. The Board has in previous years determined that both John Bishop and Robert Spass are independent in character and judgement, notwithstanding the existence of circumstances requiring special consideration under the Code. These matters have been previously disclosed and discussed in the Company's 2010, 2011 and 2012 Annual Reports. Ralf Oelssner is the Senior Independent Director. Martin Thomas was independent upon his appointment as Chairman on 1 May 2007. At the Board meeting held on 12 February 2014, further to a recommendation by the Nomination and Corporate Governance Committee, the Board affirmed its judgement that seven of the 12 members of the Board are independent Non-Executive Directors. Therefore in the Board's judgement the Board composition complies with the Code requirement that at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent.

In accordance with the provisions of the Code, all Directors are subject to annual election by shareholders. Shareholders are asked to note that Robert Spass, William Spiegel and Martin Thomas will each have served as Non-Executive Directors for more than six years. Notwithstanding these periods of service, the Board is of the view that these Directors continue to offer valuable service to the Company. Ralf Oelssner and John Bishop, after serving the Board for eight and six years respectively, and Neil McConachie will not be standing for re-election, but the Board proposes to recommend the re-election of all the remaining Directors at the 2014 AGM.

INFORMATION AND TRAINING

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

An analysis of the Company's compliance with the Code is collated and summarised in quarterly reports together with a more general summary of corporate governance developments which are prepared by the Company's Legal and Compliance department for consideration by the Nomination and Corporate Governance Committee. The Directors have access to the Company Secretary who is responsible for advising the Board on all legal and governance matters. The Directors also have access to independent professional advice as required. Regular sessions are held between the Board and management as part of the Company's quarterly Board meetings, during which in-depth presentations covering areas of the Group's business are made. During these presentations the Directors have the opportunity to learn about, challenge, and help shape the Company's commercial strategy.

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 in the Nomination and Corporate Governance Committee. The aim of this work is to assess the effectiveness of the Board and its Committees in terms of performance, composition, supporting processes and management of the Group, as well as to review each Director's performance, training and development needs. The 2012 performance evaluation was facilitated by external consultants, whilst in 2013 the evaluation was conducted internally.

During 2013, it was decided that the evaluation process would be led by the Company Chairman, who conducted a series of meetings with each of the Directors to appraise and discuss their individual performances and to ascertain their views on the effectiveness of the Board and its Committees, the contribution of each of the individual Directors, and the management of the Company.

The 2013 evaluation included an in-depth interview with each Director to discuss a broad range of topics, but with a particular focus on the effectiveness of the Board, its Committees, each Director, and succession planning for executive management and the Board.

On completion of the interviews, the Chairman reported to the Nomination and Corporate Governance Committee and the Board.

In summary, the 2013 evaluation discussions found that the Board 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 Company and to making the Board and its Committees work effectively. Attendance at Board meetings is good. The CEO and Executive Directors are also operating effectively.

Appropriate infrastructure, processes and governance mechanisms are in place to support the effective performance of the Board and its Committees. The Board is considered to manage risk effectively. The number of Directors on the Board is considered to be appropriate and the Board Committees are considered to have an appropriate balance of skills and to function effectively. The Board will continue to review its procedures, training requirements, effectiveness and development in 2014. As part of its risk management strategy, and to ensure thorough preparedness for the anticipated requirements of Solvency II, the Board has decided to create a working group for the consideration and preparation of the ORSA for the Group.

The Chairman's performance appraisal was convened by the Senior Independent Director, who consulted with the Non-Executive Directors with input from the Executive Directors during July 2013. The Chairman's performance was found to be effective.

At the end of the year, the Chairman met the CEO, and the CEO met each of the other Executive Directors, to conduct a performance appraisal in respect of 2013 and to set targets for 2014.

RELATIONS WITH SHAREHOLDERS

During 2013, the Group's Head of Investor Relations, usually accompanied by one or more of the CEO, the CUO, the CFO, the CRO, 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.

Conference calls with shareholders and analysts hosted by senior management are held quarterly following the announcement of the Company's financial results. The CEO, CUO and 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 Head of Investor Relations. All of the Directors are available to meet with shareholders at the Company's AGM.

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

ENTERPRISE RISK MANAGEMENT

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

Further discussion of the risks affecting Lancashire and the policies in place to manage them can be found in the risk disclosures section on pages 108 to 133.

COMMITTEES

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

The composition of the Committees as at 31 December 2013 was as set out in the table appearing on page 61. A report from each of the Committees is set out from page 64 through to page 70.

AUDIT COMMITTEE

"The Audit Committee engages actively with management and the Company's auditors to give the Board and our broader stakeholders assurance on the quality and integrity of the Company's financial statements, reports and financial controls. As I come to the end of my tenure as Audit Committee Chairman, I would like to thank the Committee members and all those staff who contribute to the Committee's work, and to wish them well for the future."

- John Bishop – Chairman

- Simon Fraser (appointed effective 12 November 2013)
- Samantha Hoe-Richardson (appointed effective 1 May 2013)
- Ralf Oelssner
- Robert Spass (resigned effective 4 July 2013)

- Monitors the integrity of the Company's financial statements and reports to the Board on significant issues considered in relation to the financial statements.
- 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.
- Reviews the adequacy and effectiveness of the Company's internal financial controls and internal control and risk management systems.
- Reviews for adequacy and effectiveness the Company's 'whistleblowing' arrangements, procedures for detecting fraud and systems and controls for the prevention of bribery and money laundering.
- Monitors and reviews the effectiveness of the Group's Internal Audit function in the context of the Group's overall risk management system.
- Oversees the relationship with the Group's external auditors, including the effectiveness of the external audit process, the implementation of a policy on the supply of non-audit services and makes a recommendation to the Board on the terms of the shareholder resolution regarding appointment and removal of the Company's external auditors.

The Audit Committee comprises four independent Non-Executive Directors and is chaired by John Bishop, a qualified actuary, whom the Board considers to have recent and relevant financial experience (see Mr Bishop's biography on page 59). The internal and external auditors have the right of direct access to the Committee.

FINANCIAL REPORTING

The Committee reviews at its quarterly meetings the Company's financial statements for purposes of recommending their approval by the Board. As part of this review process the Committee considers the adequacy of the Company's loss reserves, for which purpose it receives reports from management and from Towers Watson as Lancashire's independent actuarial consultant. The Committee also considers quarterly reports on the financial statements from the external auditors, including an interim review report and a year-end audit results report. These are discussed with the external auditors at the Committee's meetings. The Committee receives regular reports from management on developments in accounting and financial reporting requirements. The Committee also monitors the activities of the Company's Disclosure Committee and reviews the Company's quarterly financial press releases, which it recommends to the Board for approval.

The Committee is responsible for assessing the independence and objectivity of the external auditors, taking into account relevant professional and regulatory requirements and the Company's relationship with the auditors as a whole, including the provision of non-audit services. The Audit Committee has approved and adopted a policy to ensure that the provision of non-audit services by the external auditors does not impair their independence and objectivity. The policy is reviewed on an annual basis and was updated in October 2013. During 2013, Ernst & Young LLP (E&Y) provided non-audit services in relation to Solvency II, capital management projects and the acquisition of Cathedral. Fees for non-audit services provided in 2013 totalled

GOVERNANCE

$811,514 (being $796,332 for advice on the Cathedral acquisition and restructuring, and $15,182 for Solvency II consulting) representing 62.8 per cent of total audit fees. The Committee gave careful consideration to the nature of the non-audit services performed by E&Y, noting that, whilst the fees were relatively high as a percentage of total fees in comparison to prior years, most of the additional work had been provided in relation to the acquisition of the Cathedral Group. Within this context the Committee considered the work to have been customary and in keeping with good practice. The Committee accordingly determined that, given the nature of the work performed, the non-audit fees charged were not likely to affect the independence and objectivity of E&Y as auditors.

The Committee assesses annually the qualifications, expertise and resources of the auditors, and the effectiveness of the audit process. This includes the practice of the Committee Chairman conducting informal meetings with the auditors and the CFO prior to, during and after the audits, and periodically meeting with the Chief Operating Officer and the Group Head of Internal Audit. The Committee meets in executive session with the external auditors and with management at least twice per annum.

The Audit Committee has recommended to the Board the reappointment of E&Y. E&Y have been the Group's external auditors since 2005. When making its recommendation to the Board, the Committee considered and had regard to E&Y's length of tenure and any non-audit services performed during the year, and continues to be satisfied with E&Y's performance, independence and objectivity, level of fees charged, compliance with ethical standards, and audit partner rotation policy.

The Committee considers that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable.

The primary areas of judgement considered by the Audit Committee in relation to the 31 December 2013 financial statements were loss reserving and the Cathedral integration, discussed below.

LOSS RESERVING

The Group Chief Actuary and the Head of Capital Modeling provide quarterly reports to the Committee on loss reserve developments and attend each quarterly Audit Committee meeting. Towers Watson provides the Company with semi-annual analyses of loss and loss adjustment expense liabilities, and discuss their findings with the Audit Committee. E&Y actuaries independently estimate the Group's reserves and report to the Committee on their findings during the course of the annual audit. E&Y also review and discuss with management on a quarterly basis any unusual or significant events and transactions occurring during the period under review that affected the loss reserves balance, as well as the development of any significant prior year claims. E&Y present their findings to the Committee in their quarterly and interim review reports.

CATHEDRAL INTEGRATION AND YEAR-END REPORTING

Management provided the Audit Committee with comprehensive reports regarding the Cathedral financial integration including commentary on technical acquisition accounting reporting requirements and related accounting estimates and judgements. Cathedral's auditors, Mazars, resigned at the time of the acquisition and E&Y were appointed auditors for all the Cathedral Group companies. E&Y discussed with the Committee the preparation of the consolidated financial statements and integration planning, including resources. Towers Watson provides Cathedral with actuarial consulting services and will provide Lancashire with year-end Cathedral consolidation support.

The Cathedral transaction was discussed by management with the Group's rating agencies prior to and subsequent to the acquisition, in order to address any issues or concerns. Lancashire's 2014 reporting deadlines will be tighter than at 2013 year end and the Committee will keep resources and IT requirements under continued review.

INTERNAL CONTROLS AND RISK MANAGEMENT SYSTEMS

The Board is responsible for maintaining a robust framework of internal control and risk management and for overseeing and ensuring the effectiveness of the Group's risk management and internal control systems. The Board has assigned responsibility to the Committee for reviewing the adequacy and effectiveness of the Group's internal financial controls and internal control and financial risk management systems (including financial, operational and compliance controls). The system of internal control 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 monitors developments in the Solvency II regime and the progress made within the Group in readiness for its implementation.

COMPLIANCE, WHISTLEBLOWING AND FRAUD

The Committee reviewed and recommended the adoption by the Board of updated policies and procedures on anti-money laundering, bribery and financial crime, conflicts of interest and whistleblowing. The Committee regularly reviews the Company's procedures for detecting fraud. The Committee also keeps under review the adequacy and effectiveness of the Company's legal and compliance function.

INTERNAL AUDIT

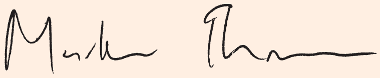
The Group's Internal Audit function reports directly to the Audit Committee. Each year the Head of Internal Audit presents an audit plan to the Audit Committee for consideration and approval. The key objective of Internal Audit is to audit on at least an annual basis those areas of the Group's business that are deemed to pose the greatest risk to the achievement of the Group's business objectives, and to audit all other areas of the Group's operations at least once every three years. The findings of each internal audit are reported to the Audit Committee which has a responsibility to ensure the timely implementation of agreed management actions and to review the status of these at each of its meetings. During 2013, the Committee reviewed and approved an updated Internal Audit charter and received a report from the Head of Internal Audit on her assessment of Lancashire's governance, risk and control framework, together with an analysis of themes and trends from the work of Internal Audit and their impact on Lancashire's risk profile. The Committee also received a report from management on its annual review of the implementation of the internal audit programme, to ensure its efficiency and appropriate standing and the effectiveness of the Internal Audit function and activities. The Committee concluded that the internal audit programme is operating effectively and efficiently in the context of the Group's overall risk management system and is adequately resourced. During 2013 the Company appointed KPMG as internal audit co-source partner, to provide specialist assistance to the Internal Audit department.

PRIORITIES FOR 2014

The priorities for the Audit Committee for the coming year will be to ensure the maintenance of the robust framework of internal controls and risk management suited to the requirements of the enlarged Group and the challenges of the developing regulatory environment.

NOMINATION AND CORPORATE GOVERNANCE COMMITTEE

"The Committee operates to ensure that the Board and management have the necessary range of skills, knowledge, experience and diversity to provide a fresh and independent perspective, effective leadership of the Company and the delivery of its strategic objectives, all within the appropriate governance framework."



– Martin Thomas – Chairman

– Ralf Oelssner
– William Spiegel

- Reviews the structure, size and composition (including the skills, knowledge, 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 by shareholders of Directors.
- Reviews the Company's corporate governance arrangements and compliance.

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

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One of the Committee's responsibilities is to identify, and nominate for the approval of the Board, candidates to fill Board vacancies as and when they arise. During 2013, the Committee considered a range of options for identifying potential candidates for appointment to the Board. As part of that process, the Company engaged Egon Zehnder (an independent executive search practice, with no connections to the Lancashire Group) who identified a number of potential candidates. The Committee also considered candidates identified from contacts within the Company. At its meeting in November 2013, the Committee considered the appointment of Simon Fraser to the Board. In its discussion, the Committee recognised Mr Fraser's prior role (until his retirement in 2011) as Head of Corporate Broking at Merrill Lynch and subsequently Bank of America Merrill Lynch, which provided services as corporate broker to the Company until January 2012. The Committee found Mr Fraser to be well qualified to serve on the Board of the Company and, after careful deliberation, satisfied itself on the question of Mr Fraser's independence. The Committee recommended that the Board also give particular consideration to the matter of Mr Fraser's independence in light of his former association with the Company. At a meeting of the Board held on 5 November 2013, the Directors determined Mr Fraser to be independent in character and judgement, notwithstanding his prior role at Merrill Lynch and Bank of America Merrill Lynch. Accordingly, the Board approved the appointment of Simon Fraser as a Non-Executive Director (see his biography on page 59).

The Committee recommended changes to the composition of the Board Committees during the year. It also reviewed the composition of the boards and board committees of the Cathedral Group of companies and made recommendations to the Board in this regard.

The Committee also recommended the approval and adoption by the Board of the Company's 2013 succession plan.

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 its individual Directors – see page 62.

During 2013, the Committee recommended the adoption by the Board of revised Terms of Reference for the Investment Committee and the Underwriting and Underwriting Risk Committee. It also recommended the approval by the Board of an amended Schedule of Reserved Matters and an updated protocol for the division of responsibilities and roles of the Chairman and CEO and the responsibilities and reporting lines of the chief executive officers of Group subsidiaries.

The Committee recommended approval by the Board of an updated statement on the representation of women on the Board, on executive committees and in senior management. This is published on the Company's website. In the context of the Davies Report, the Committee recognises the benefits that a broad diversity of skills, experience and gender, amongst other factors, brings to enhance Board performance, but considers that quotas are not the best option for achieving diversity.

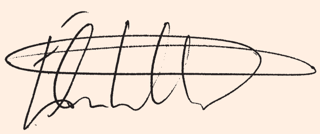
The Committee considered statistics relevant to the gender composition of the Board, Group management excluding Non-Executive Directors, and overall Lancashire Group employees. These statistics are shown in the Corporate Responsibility section on page 52.

PRIORITIES FOR 2014

The priority for the Nomination and Corporate Governance Committee for the coming year will be a focus on succession planning, to ensure that the Board continues to benefit from the skills and expertise of a diverse and independent team of Non-Executive Directors able to contribute to the work of an effective Board capable of developing a successful strategy for the benefit of the Group and its shareholders.

INVESTMENT COMMITTEE

"Our philosophy is one of capital preservation and liquidity, with a focus on minimising the downside risk in the investment portfolio."



- Elaine Whelan – Chairman (appointed effective 19 February 2013)

- Richard Brindle (resigned effective 1 May 2013)
- Emma Duncan (resigned effective 1 May 2013)
- Neil McConachie
- Robert Spass
- William Spiegel
- Denise O'Donoghue (not a Director, Head of Investments & Treasury)

- Recommends investment strategies, guidelines and policies for the Board of the Company and operating entities to approve annually.
- Recommends and sets risk asset definitions and risk tolerance levels for management to operate within.
- Recommends the appointment of investment managers to manage the Group's investments.
- Monitors the performance of the investment strategies against pre-defined benchmarks.
- Establishes and monitors compliance with investment operating guidelines relating to guidelines and internal controls.

The Investment Committee comprises three Non-Executive Directors (two of whom are independent), one Executive Director and the Group Head of Investments and Treasury. It is responsible for recommending investment strategies, guidelines and policies for approval by the Board and for recommending and setting risk asset definitions and risk tolerance levels for management to operate within. The Committee is also responsible for recommending the appointment of investment managers for the Group's investments and for monitoring the performance of the investment strategies against set benchmarks.

During 2013, the Investment Committee recommended to the Board the adoption of the 2013 investment strategy, including the implementation of a tail-risk hedging strategy to protect the fixed income portfolio from a significant increase in interest rates. The Investment Committee also considered regular reports on investment performance, asset allocation and compliance with pre-defined guidelines and tolerances. The Investment Committee also considered and approved proposals for investment risk tolerances.

PRIORITIES FOR 2014

For the coming year the Investment Committee will continue to focus upon the appropriate balance of risk and return in the implementation of the Group's investment strategy, preserving capital and managing its interest rate risk. It will review new possible risk asset products to help it accomplish those goals. The integration and hedging of the Cathedral cash and investment portfolio will also be a major point of focus.

UNDERWRITING AND UNDERWRITING RISK COMMITTEE

"Underwriting is at the heart of our business and the Committee is a key tool in setting the right risk appetites and monitoring the Company's underwriting performance against the risk tolerances."

– Alex Maloney – Chairman

– John Bishop
– Richard Brindle
– Ralf Oelssner
– Ben Readdy (not a Director, Head of Capital Modeling)
– Paul Gregory (not a Director, CUO LUK)
– Sylvain Perrier (not a Director, CUO LICL)

– Oversees the development of and adherence to underwriting guidelines by operating company CUOs.

– Formulates Group underwriting strategy.

– Reviews underwriting performance.

– Reviews significant changes in underwriting rules and policy.

– Establishes, reviews and maintains strict underwriting criteria and limits.

– Monitors underwriting risk and its consistency with Lancashire's risk profile and risk appetite.

The Underwriting and Underwriting Risk Committee comprises two independent Non-Executive Directors, two Executive Directors, the CUOs of each of the operating subsidiaries (Paul Gregory and Sylvain Perrier) and the Head of Modeling (Ben Readdy). Underwriting risk is one of the key risks faced by the Company, and the Committee is actively engaged in the development of strategy and underwriting risk tolerances, which are approved by the Board. During 2013, the Committee meetings were open to attendance by all the Board members and provided a useful forum for the discussion of underwriting performance, risk tolerances and strategic initiatives. The Terms of Reference of the Underwriting and Underwriting Risk Committee were revised in July 2013 and include: formulating underwriting strategy, overseeing the development of and adherence to the Group's underwriting guidelines, establishing, reviewing and maintaining strict underwriting criteria and limits, and monitoring underwriting risk and its consistency with the Company's risk profile and risk appetite.

A more detailed analysis of the Lancashire underwriting performance appears in the Business Review section of this Annual Report at pages 28 to 39.

PRIORITIES FOR 2014

For the coming year the Underwriting and Underwriting Risk Committee will continue to monitor the development of a dynamic and nimble underwriting strategy appropriate for the Group's three underwriting platforms, within a framework of appropriate risk tolerances.

REMUNERATION COMMITTEE

"The Committee's primary objective is to ensure the alignment of the interests of the Company's owners with its senior executives by structuring remuneration policy so as to afford financial rewards that are closely linked to performance."

– William Spiegel – Chairman

– Emma Duncan
– Simon Fraser (appointed effective 12 November 2013)
– Ralf Oelssner

– Responsible for setting the remuneration policy for all Executive Directors and the Company's Chairman.

– Recommends and monitors the level and structure of remuneration for senior management.

– Determines each year whether awards will be made under the Company's restricted share scheme and, if so, the overall amount of such awards, the individual awards to Executive Directors, Company Secretary and other designated senior executives, and the performance targets to be used.

– Determines the policy for, and scope of, pension arrangements for each Executive Director and other designated senior executives.

– Ensures that contractual terms on termination, and any payments made, are fair to the individual and the Company.

– Oversees any major changes in employee benefit structures throughout the Group.

The Remuneration Committee comprises four independent Non-Executive Directors. It is responsible for setting the remuneration policy for all Executive Directors and the Company's Chairman, including pension rights and any compensation payments. The objective of such policy is to attract, retain and motivate executive management of the quality required to run the Company successfully, having regard to the views of shareholders and other stakeholders. The Remuneration Committee also recommends and monitors the level and structure of remuneration for senior management. The Committee has adopted and monitors share ownership guidelines for the Group's senior and key executives. During 2013, the Committee reviewed the policy to be put to shareholders at the 2014 AGM and approved the grant of RSS awards in relation to the Cathedral acquisition.

The Directors' Remuneration Policy and the Annual Report on Remuneration for which the Committee is responsible can be found on pages 72 to 88.

PRIORITIES FOR 2014

For the coming year the Remuneration Committee will remain focused on ensuring the continuation of the close alignment of the Group's remuneration structures and the Group's financial performance with due regard to the dangers of excessive risk-taking.

GOVERNANCE

ANNUAL STATEMENT

Dear Shareholder,

I am pleased to present the Directors' Remuneration Report for 2013, for which we seek shareholders' support at our AGM in London on 30 April 2014.

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 London Stock Exchange and, for the purposes of explaining its compliance against the requirements of the UK Corporate Governance Code, the Board is committed to providing full information on Directors' remuneration to shareholders. In 2013 new regulations were introduced in the UK which require details of Directors' remuneration to be reported in a different format and for there to be two votes in relation to the Remuneration Report; one binding vote approving the policy and one advisory vote approving what has been paid to Executive Directors for the year under review. The Company intends to comply with the requirements of the UK regulations.

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

There is a strong link between the remuneration policy and the business strategy. As highlighted at the front of this Annual Report, our strategy focuses on the effective operation of the business necessary to maximize long-term and sustainable Return on Equity and the delivery of superior total shareholder returns. Our remuneration policy reflects this strategy, with the annual bonus focused on Return on Equity and the long-term incentive being based on Return on Equity and relative Total Shareholder Return.

The Lancashire Group has delivered strong results for 2013. Executive Directors' performance targets set at the beginning of 2013 for financial performance were stretching, but nevertheless were achieved at an above target level (but below the maximum bonus level). Executive Directors' 2013 bonuses paid out between 154 per cent and 159 per cent of target. For full details of Executive Directors' bonuses and the associated performance delivered see page 80.

In relation to long-term incentives, performance has been similarly strong, with 100 per cent of RSS awards granted in 2011 (and covering the performance period of the three financial years 2011-2013) vesting. Our TSR performance (in USD) over this period was 109.25 per cent compared to 59.39 per cent for the FTSE 250 Index.

Overall, in light of the strong performance delivered once again, the Committee is satisfied that there has been a robust link between performance and reward.

The Directors' Remuneration Policy describes our remuneration policy for Executive Directors for the next three years and there will be a binding shareholder vote on the policy under resolution 2, which is being proposed at the 2014 AGM.

The final section, the Annual Report on Remuneration, provides detailed disclosure on how the policy will be implemented for 2014 and how Directors have been paid in relation to 2013. The disclosures provide shareholders with the information necessary to form a judgement as to the link between Company performance and how the Executive Directors are paid. This section will be subject to an advisory shareholder vote under resolution 3, which is being proposed at the 2014 AGM.

I hope that you will be able to support both resolutions to approve the level of remuneration paid during 2013 and the Committee's policy for the future, at the forthcoming AGM.

WILLIAM SPIEGEL
Chairman of the Remuneration Committee

DIRECTORS' REMUNERATION POLICY SECTION

GOVERNANCE AND APPROACH

This part of the Directors' Remuneration Report sets out the Remuneration Policy for the Company. The policy has been developed taking into account the principles of the UK Corporate Governance Code and the views of our major shareholders. As it is the Company's first Policy Report under the new reporting regime, it will be put forward for a binding vote at the 2014 AGM. The policy will be effective from the date of the AGM and will apply for the next three years until the 2017 AGM.

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 considered whether any element of the current Remuneration Policy could conceivably encourage Executive Directors to take inappropriate risks and have concluded that that 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 maintain their day-to-day living expenses;
- there is a blend of short-term and long-term performance metrics with an appropriate mix of performance conditions, meaning that there is no undue focus on any one particular metric;
- there is a high level of share ownership amongst 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 Company's financial statements, error 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, will consult with major investors and representative bodies on any significant remuneration proposal relating to Executive Directors. The Committee Chairman consulted with major shareholders and the Association of British Insurers ('ABI') in December 2013 and January 2014 upon proposals for the Directors' Remuneration Policy. Views of shareholders at the AGM and feedback received at other times will be considered by the Committee.

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, the same as that for Executive Directors in that all employees are offered similarly structured packages, with participation in annual bonus and long-term incentive plans. 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.

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.

FUTURE 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	Reviewed annually and fixed for 12 months, effective from 1 January. Positioning and annual increases influenced by: – role, experience and performance; – change in broader workforce salary; and – changes in responsibility or position. Salaries are benchmarked periodically against insurance company peers in the UK 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 are entitled to healthcare, dental, vision, gym membership and life insurance. Executive Directors who are expatriates may be eligible for a housing allowance or other relocation-related expenses.
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 where contributions would exceed HMRC pension limits in the UK. 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% of base salary.

FUTURE POLICY TABLE CONTINUED

Annual Bonus[1,2]

Purpose and Link to Strategy	Rewards the achievement of financial and personal targets.
Operation	Bonus targets (percentage of salary) are based on mechanistic calculations for 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, based upon input from the CEO, will have the ability to override the results of any mechanistic bonus calculation to either increase or decrease the amount payable (subject to the cap) to ensure a robust link between reward and performance. At least 25% of each Executive Director's bonus is automatically deferred into shares as nil cost options over three years, with one third vesting each subsequent year. A dividend equivalent 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. If Lancashire's comprehensive income in the relevant full financial year should be negative, there will be no pay-out possible under the Relative Financial Performance element (details of the bonus metrics are included on page 78 of the Annual Report on Remuneration). 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	Bonus for achieving target level of performance as a percentage of salary is: – CEO – 200% – CUO – 175% – CFO – 150% Maximum opportunity is two times target.
Performance Metrics	**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, combined ratio, investment return or any other financial KPI[3]. A sliding scale of targets applies for financial performance targets. Bonus is earned on an incremental basis once a predetermined threshold level is achieved. 25% 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. The weightings applying 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 have a higher weighting than the personal element.

Long Term Incentives (LTI)	
Purpose and Link to Strategy	Rewards Executive Directors for achieving superior returns for shareholders over a longer-term timeframe. Enables Executive Directors to build a meaningful shareholding over time and align goals with shareholders.
Operation[2,3]	RSS awards are made annually in the form of nil cost options 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 at 1 January in the year of grant unless the Committee at its discretion determines otherwise. The Remuneration 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 equivalent provision operates enabling dividends to be accrued (in cash or shares) on RSS awards up to the point of exercise.
Opportunity	Award levels are determined primarily by seniority. A maximum individual grant limit of 350% of salary applies.
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[1]. If more than one measure is used, the Committee will review the weightings between the measures chosen and the target ranges prior to each LTIP 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% vesting at threshold performance. For TSR, none of this part of the award will vest below median ranking and full vesting will require upper quartile performance or better. Awards vest on a proportionate basis for performance between the median and upper quartiles.

Share Ownership Guidelines

Under the guidelines, the CEO is expected to maintain a qualifying interest (defined as beneficially owned shares or rights over shares calculated on the basis of the net of tax value) equivalent in value to no less than two times salary over time. For other Executive Directors the threshold is one times salary. Until such time as the guideline threshold is achieved Executive Directors are required to retain no less than 50% of the net of tax value of awards that vest under the RSS.

Chairman and Non-Executive Directors' (NEDs) 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 fee for his responsibilities as Chairman and also receives a separate fee for his position as Chairman of LUK. 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.
Opportunity	No maximum.

Notes

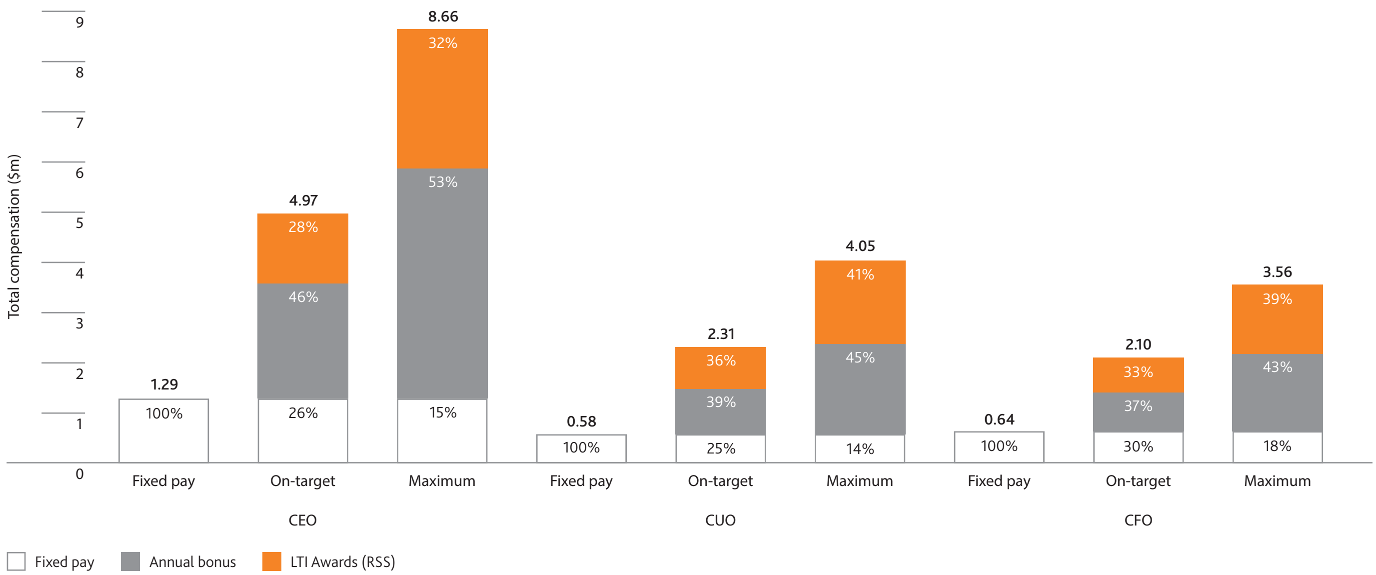
1 The Committee will operate the annual bonus plan and RSS according to their respective rules and in accordance with the Listing Rules. The Committee, consistent with normal market practice, retains discretion over a number of areas relating to the operation and administration of these plans and this discretion forms part of this policy.

2 All historic awards that were granted under any current or previous share schemes operated by the Company but remain outstanding remain eligible to vest based on their original award terms and this provision forms part of the policy.

3 Performance Measures: Return on Equity, which is measured as the internal rate of return of the increase in fully converted book value per share adjusted for dividends, seeks to provide shareholders with a risk-adjusted return on equity in excess of appropriate hurdles over the insurance cycle. The Combined Ratio focuses management on operating performance by considering the total costs to total net earned premiums. Profit is also a key metric and ultimately is measured by returns to shareholders. Total Shareholder Return looks to provide shareholders with an attractive risk-adjusted return over the long term. Other key measures are set out in the Glossary commencing on page 169.

ILLUSTRATIONS OF ANNUAL APPLICATION OF REMUNERATION POLICY

The charts below show the potential total remuneration opportunities for the Executive Directors in 2014 at different levels of performance under the policy subject to shareholders' approval.



Fixed pay = Salary + Value of Benefits + Pension Contribution

On-target = Fixed Pay + Target Bonus (being half the Maximum Bonus Opportunity) + Expected Value of 2014 RSS grant (assuming 50 per cent vesting with face values of 243 per cent, 323 per cent and 267 per cent of salary for the CEO, CUO and CFO respectively).

Maximum = Fixed Pay + Maximum Bonus Opportunity + Expected Value of 2014 RSS grant (assuming 100 per cent vesting with values of 243 per cent, 323 per cent and 267 per cent of salary for the CEO, CUO and CFO respectively).

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 annual bonus and LTI potential would be in line with the Policy. 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, 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.

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. No Executive Director has a contractual right to a bonus for any period of notice not worked.

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

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 shares will remain exercisable. Unvested deferred bonus shares 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. The Committee has discretion to permit such unvested awards to vest early rather than continue on the normal vesting timetable and also retains discretion, acting fairly and reasonably, as to whether or not to apply (or to apply to a lesser extent) the pro-rata reduction to the bonus shares where it feels the reduction would be inappropriate.

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 vesting period.

Depending upon circumstances, the Committee may consider other payments in respect of 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. The Company encourages share ownership by the Non-Executive Chairman and Non-Executive Directors, and Non-Executive Directors who do not own shares are encouraged to use a proportion of their fees to buy shares in the Company and retain such shareholdings for their remaining periods of office.

In accordance with best practice under the Code, the Board proposes to submit the Directors individually for re-election by the shareholders at the 2014 AGM. Mr Bishop, Mr Oelssner and Mr McConachie are to retire from the Board and will not be proposed for re-election.

ANNUAL REPORT ON REMUNERATION

The Annual Report on Remuneration will be put to an advisory shareholder vote at the 2014 AGM. The information on pages 79 with respect to Directors' Emoluments and onwards through page 88 has been audited.

IMPLEMENTATION OF REMUNERATION POLICY FOR 2014

In relation to the Policy described in the previous section, the following table sets out additional disclosure on the expected application of the Policy for 2014.

BASE SALARY AND FEES

Executive Directors

Increases and resulting salaries effective from 1 January 2014 are set out below:

- CEO – salary increased by 3 per cent to $1,145,773.
- CUO – salary increased by 3 per cent to $515,000.
- CFO – salary increased by 3 per cent to $515,000.

Non-Executives

- The fee for the Chairman is $325,000 per annum and the additional fee for the Chairman of LUK is $100,000.
- The Non-Executive Director fee is $175,000 per annum.

ANNUAL BONUS

For 2014 the target and maximum bonus opportunities are those set out in the Policy Report. Bonus is based as to 75 per cent on financial performance and 25 per cent on personal performance.

Financial Performance

For 2014, the financial component comprises two parts – 60 per cent of this element is based on the performance of the Group's absolute RoE (measured as the internal rate of return of the change in the fully converted book value per share (or 'FCBVS') plus dividends accrued) and 40 per cent is based on the Group's relative RoE performance against appropriate peer companies (peer companies can be located on page 84).

- Absolute RoE:
  A sliding scale range of RoE targets is set with 25 per cent of bonus payable if the threshold level of increase in RoE is achieved (being 9 per cent), rising to 100 per cent of bonus target being payable for target growth in RoE of 12 per cent and 200 per cent of bonus target being payable for achieving the maximum RoE growth target of 19 per cent or higher. There is linear interpolation between these points.
- Relative RoE:
  Relative performance will be measured against the identified comparator group of companies which can be seen on page 84. Vesting will be based on performance against a sliding scale with no vesting for below median performance, 25 per cent payable for achieving a median ranking, and up to 100 per cent for upper quartile or better. Vesting for performance in between the median and upper quartiles is determined on a proportionate basis.

Personal Performance

This element of the bonus plan is based upon individual achievement of clearly articulated objectives created at the beginning of each year. The Committee has chosen not to disclose the personal performance objectives in advance as it considers them to be commercially sensitive. There will be broad disclosure retrospectively in the 2014 Annual Report on Remuneration.

RESTRICTED SHARE SCHEME

Performance Conditions

2014 RSS awards are subject to RoE and relative TSR performance conditions. These metrics were chosen as RoE provides a focus on the Company's underlying financial performance and cycle management, and relative TSR provides an objective reward for stock market performance against the Company's peers.

Weighting

For 2014, the TSR/RoE weighting is 25 per cent on TSR and 75 per cent on RoE.

Target ranges

RoE target range for 2014 awards:

- threshold – average RoE compared to the 13 week Treasury bill rate +6 per cent;
- maximum – average RoE compared to the 13 week Treasury bill rate +15 per cent; and
- none of the award will vest if RoE 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.

TSR target for 2014 awards:

Lancashire's TSR is compared against a comparator group comprising 11 peer companies as disclosed on page 84.

- 0 per cent will vest for a below median ranking;
- 25 per cent of the award will vest if Lancashire's performance is at the median; and
- 100 per cent will vest for upper quartile and above performance.
- vesting will be on a proportionate basis for performance between median and upper quartile.

Award levels

2014 RSS award levels are as follows:

- CEO – 207,938 shares (243 per cent of salary);
- CUO – 124,333 shares (323 per cent of salary); and
- CFO – 102,989 shares (267 per cent of salary).

The number of shares awarded was determined based on the share price at 1 January 2014.

DIRECTORS' EMOLUMENTS

The following table presents the Executive Directors' emoluments in U.S. Dollars in respect of the year ended 31 December 2013.

Executive Directors		Salary $	Pension $	Taxable Benefits[1,7] $	Annual Bonus[8] $	Long-Term Incentives (RSS)[2,3] $	Total[4] $
Richard Brindle, CEO	2013	1,110,226	111,023	29,476	3,541,067	5,383,381	10,175,173
	2012	1,080,845	108,085	18,891	3,156,948	6,094,987	10,459,756
Alex Maloney[5], CUO	2013	453,534	86,830	13,279	1,366,703	4,065,805	5,986,151
	2012	353,651	96,005	9,073	1,029,368	1,564,380	3,052,477
Elaine Whelan[4,6], CFO	2013	499,865	50,000	69,431	1,158,675	1,399,685	3,177,656

1 Benefits comprise Bermudian payroll taxes, medical, dental and vision coverage, air travel and housing and other allowances paid by the Company for expatriates, but exclude UK National Insurance contributions.

2 For 2013, the long-term incentive values are based on the 2011 RSS awards which vest at 100% on 13 February 2014 and are based on a performance period that ended on 31 December 2013.

3 For 2012, the RSS values are based on the 2010 RSS awards which vested at 99% on 21 February 2013 and were based on a performance period that ended on 31 December 2012.

4 Some amounts were paid in pounds sterling and converted at the average exchange rate for the year (1.5627).

5 Alex Maloney's base salary and pension reflect his UK salary sacrifice pension contributions arrangement.

6 Elaine Whelan was appointed an Executive Director effective 1 January 2013 and therefore 2012 figures for when she did not provide qualifying services have not been reported.

7 For 2013, the benefits totals were significantly increased due to the medical underwriting process being completed and Executives coverage being increased to the qualified maximum entitlement.

8 For 2013 the Lancashire Group delivered strong results. Bonus targets were set at the beginning of 2013 and based on a clear split between Company financial performance and personal performance on a 75:25 (70:30 for the CFO) basis. Company financial performance had two components, absolute financial performance and relative financial performance weighted 60:40 respectively. The absolute component paid out at 198.57 per cent of target as RoE was 18.9 per cent against a budget of 12.1 per cent and the relative component is provisionally cited at 57 per cent pending the final audited results of peer companies needed in order to calculate the final bonus payable. For the personal element of Executive Directors' bonus opportunity the pay-out ranged from 68 per cent to 74 per cent of the maximum.

TOTAL PENSION ENTITLEMENTS

During the year under review the Executive Directors received either a cash supplement in lieu of pension or a contribution to the Company's defined contribution scheme. The level of contribution is shown in the table of Directors' emoluments.

2014 ANNUAL BONUS PAYMENTS IN RESPECT OF 2013 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.

FINANCIAL PERFORMANCE

The target value of bonus was 200 per cent, 175 per cent and 150 per cent of salary for the CEO, CUO and CFO respectively, and the maximum payable was two times the target value.

75 per cent (70 per cent for the CFO) of the 2013 bonus was based on Company performance conditions and the extent to which they were achieved is as follows:

Performance Measures	Weighting (of total Company element of 75%/70%)	Threshold	Target	Max	Actual performance	% vesting
Absolute RoE	**60%**	**9%**	**12%**	**19%**	**18.9%**	**198.57% of Target**
Relative RoE	**40%**	**25%**	**50%**	**90%**	**57%**	**109.25% of Target**
Total	**100% (75%/70% of Total Bonus)**					**182.64% of Target payable in respect of Company performance**

For 2013 the Lancashire Group delivered another year of strong results. The absolute component paid out at 198.57 per cent of target as RoE was 18.9 per cent against a target of 12.1 per cent and the relative component against the results of peer companies is provisionally stated at the 57th per centile (109.25 per cent pay out) pending the final audited results of peer companies needed in order to calculate the final bonus payable.

PERSONAL PERFORMANCE

25 per cent (30 per cent for the CFO) of the 2013 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 2013 personal objectives for each Executive Director.

Executive Director	Personal Performance
Richard Brindle	Effective management of the Senior Executive team and Group. Development of the general business strategy. Contribution aligned to the Lancashire Values.
Alex Maloney	Effective leadership and management of the underwriting function and the UK office. Development of the general business strategy. Contribution aligned to the Lancashire 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 Values.

The personal targets were broadly common among all three Executive Directors, with variances being attributable to the specifics of their respective roles and the perceived need for areas of personal development within their fields of expertise to be emphasised.

During the 2013 annual performance reviews of each Executive Director, a performance rating was assigned to determine the level of bonus pay-out each Executive Director was eligible for. As expected for a strong performance year, the Executive Directors each achieved high performance ratings against their objectives. For the 2013 performance against personal objectives the following ratings were determined, expressed as a percentage of the maximum award for personal performance: CEO – 74 per cent, CUO – 68 per cent, and CFO – 68 per cent.

A table of performance measures and total 2013 bonus achievement is set out below:

Executive Director	Financial Performance (max % of total bonus)	Personal Performance (max % of total bonus)	Bonus % of Maximum awarded for 2013	Total Bonus Value	Value of Bonus paid in cash (75% of total bonus)	Value of Bonus deferred into RSS (25% of total bonus)[1]
Richard Brindle	75%	25%	80%	$3,541,067	$2,655,800	$885,267
Alex Maloney	75%	25%	78%	$1,366,703	$1,025,027	$341,676
Elaine Whelan	70%	30%	77%	$1,158,675	$869,006	$289,669

1 25% of total bonus award will be deferred into Lancashire shares with one third vesting annually, each year, over a three-year period with the first third becoming exercisable in February 2015, subject to the Company being in an 'open period'. These awards vest on the relevant dates subject to continued employment only.

LONG-TERM SHARE AWARDS WITH PERFORMANCE PERIODS ENDING IN THE YEAR – 2011 RSS AWARD

The 2011 RSS awards vested on 31 December 2013. The tables below set out the achievement against the performance conditions attached to the award, resulting in aggregate vesting of 100% per cent, and the actual number of awards vesting (with their estimated value).

	TSR (relative to a comparator group of 11 companies)		Average annual RoE (over 3 years in excess of 13 Week Treasury Bill Rate)	
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	1st ranking above upper quartile	100%	16.1%	100%

Details of the performance RSS awards granted 24 February 2011 with a performance period of 1 January 2011 – 31 December 2013 vesting for each Director, based on the above vesting, are shown in the table below:

Executive	Number of shares at grant	Number of shares to vest	Number of shares to lapse	Sub-total	Dividend accrual on vested shares value[2] ($)	Value[1] $
Richard Brindle	312,741	312,741	–	312,741	1,200,720	5,383,381
Alex Maloney	236,198	236,198	–	236,198	906,845	4,065,805
Elaine Whelan	81,313	81,313	–	81,313	312,189	1,399,685

1 The value of the vested shares is based on the share price on the date of vesting, being $13.3742 (based on the exchange rate of 1.6491) on 31 December 2013. The vested awards are subject to the clawback provision set out on page 75.

2 Dividends accrue on awards at the 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.

SCHEME INTERESTS AWARDED DURING THE YEAR

The table below sets out the performance RSS share awards that were granted as nil-cost options on 28 February 2013.

Executive	Grant Date[2]	Number of awards granted during the year	Face value of awards granted during the year[1]	% vesting at threshold performance
Richard Brindle	28 February 2013	220,709	$3,000,097	25%
Alex Maloney	28 February 2013	131,969	$1,793,855	25%
Elaine Whelan	28 February 2013	116,087	$1,577,971	25%

1 The share price on the date of performance awards grant was $13.593, when the RSS share 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 2015 and becoming exercisable after the meeting of the Board in February 2016.

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.

DETAILS OF ALL OUTSTANDING SHARE AWARDS

In addition to awards made during the 2013 financial year, the table below sets out details of all outstanding RSS awards held by Directors.

PERFORMANCE AND DEFERRED BONUS AWARDS UNDER THE NIL COST OPTION RESTRICTED SHARE SCHEME (RSS)

		Grant Date[1]	Awards held at 1 January 2013	Awards granted during the year	Awards vested during the Year	Awards lapsed during the year	Awards exercised during the year	Awards held at 31 December 2013	End of performance period
Richard Brindle, Group CEO	Performance RSS[2,3]	25 March 2010	375,000	**–**	**371,250**	**3,750**	**371,250**	**–**	31 Dec 2012
	Performance RSS[2,3]	24 February 2011	312,741	**–**	**–**	**–**	**–**	**312,741**	31 Dec 2013
	Deferred Bonus RSS[5]	4 March 2011	191,938	**–**	**191,938**	**–**	**191,938**	**–**	–
	Performance RSS[2,3]	28 February 2012	240,263	**–**	**–**	**–**	**–**	**240,263**	31 Dec 2014
	Deferred Bonus RSS[4]	5 March 2012	65,123	**–**	**21,709**	**–**	**21,709**	**43,414**	–
	Performance RSS[2,3]	28 February 2013	–	**220,709**	**–**	**–**	**–**	**220,709**	31 Dec 2015
	Deferred Bonus RSS[4]	5 March 2013	–	**56,584**	**–**	**–**	**–**	**56,584**	–
Total			1,185,065	**277,293**	**584,897**	**3,750**	**584,897**	**873,711**	
Alex Maloney, Group CUO & LUK CEO	Performance RSS[2,3]	25 March 2010	96,250	**–**	**95,287**	**963**	**95,287**	**–**	31 Dec 2012
	Performance RSS[2,3]	24 February 2011	236,198	**–**	**–**	**–**	**–**	**236,198**	31 Dec 2013
	Deferred Bonus RSS[5]	4 March 2011	41,105	**–**	**41,105**	**–**	**41,105**	**–**	–
	Performance RSS[2,3]	28 February 2012	187,165	**–**	**–**	**–**	**–**	**187,165**	31 Dec 2014
	Deferred Bonus RSS[4]	5 March 2012	13,454	**–**	**4,485**	**–**	**4,485**	**8,969**	–
	Performance RSS[2,3]	28 February 2013	–	**131,969**	**–**	**–**	**–**	**131,969**	31 Dec 2015
	Deferred Bonus RSS[4]	5 March 2013	–	**17,543**	**–**	**–**	**–**	**17,543**	–
Total			574,172	**149,512**	**140,877**	**963**	**140,877**	**581,844**	

		Grant Date[1]	Awards held at 1 January 2013	Awards granted during the year	Awards vested during the Year	Awards lapsed during the year	Awards exercised during the year	Awards held at 31 December 2013	End of performance period
Elaine Whelan, Group CFO & LICL CEO	Performance RSS[2,3]	25 March 2010	92,083	–	**91,162**	**921**	**45,581**	**45,581**	31 Dec 2012
	Performance RSS[2,3]	24 February 2011	81,313	–	–	–	–	**81,313**	31 Dec 2013
	Deferred Bonus RSS[6]	24 February 2011	6,010	–	**3,005**	–	**3,005**	**3,005**	–
	Performance RSS[2,3]	28 February 2012	48,586	–	–	–	–	**48,586**	31 Dec 2014
	Deferred Bonus RSS[4]	5 March 2012	15,477	–	**5,159**	–	**2,580**	**12,897**	–
	Performance RSS – Interim[2,3]	4 May 2012	25,000	–	–	–	–	**25,000**	31 Dec 2014
	Performance RSS[2,3]	28 February 2013	–	**116,087**	–	–	–	**116,087**	31 Dec 2015
	Deferred Bonus RSS[4]	5 March 2013	–	**15,120**	–	–	–	**15,120**	–
Total			268,469	**131,207**	**99,326**	**921**	**51,166**	**347,589**	
Neil McConachie, Non-Executive Director[7]	Performance RSS	25 March 2010	152,500	–	**150,975**	**1,525**	**150,975**	–	31 Dec 2012
	Performance RSS	24 February 2011	261,994	–	–	–	–	**261,994**	31 Dec 2013
	Deferred Bonus RSS[5]	4 March 2011	77,753	–	**77,753**	–	**77,753**	–	–
	Performance RSS[7]	28 February 2012	146,833	–	–	–	–	**146,833**	31 Dec 2014
	Deferred Bonus RSS[4]	5 March 2012	25,886	–	**8,629**	–	**8,629**	**17,257**	–
	Deferred Bonus RSS[4]	5 March 2013	–	**7,664**	–	–	–	**7,664**	–
Total			664,966	**7,664**	**237,357**	**1,525**	**237,357**	**433,748**	

1 The market values of the common shares on the dates of grant were:
- 25 March 2010 £4.86
- 24 February 2011 £6.00
- 4 March 2011 £6.19
- 28 February 2012 £7.90
- 5 March 2012 £7.58
- 4 May 2012 £7.99
- 28 February 2013 £9.09
- 5 March 2013 £9.08

2 The vesting of the RSS performance awards prior to 2013 grants is subject to two performance conditions as follows:
- Half of each award is subject to a performance condition measuring the TSR performance of the Company against the TSR performance of a select group of comparator companies (see page 84 for a list of comparator companies for each grant year), over a three-year performance period. 25% of this half of the award vests for median performance by the Company, rising to 100% vesting of this half of the award for upper quartile performance by the Company or better (with proportionate vesting between these two points).
- The other half of each award is subject to a performance condition based on average annual RoE over a three-year performance period. 25% of this half of the award will vest if average annual RoE over the performance period exceeds the criteria set out in the table on page 84, 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 84. Between these two points vesting will take place on a straight-line basis from 25% to 100% for RoE performance.

The vesting of the RSS performance awards for 2013 grants is subject to two performance conditions as follows:
- 25% 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 84 for a list of comparator companies for each grant year), over a three-year performance period. 25% of this half of the award vests for median performance by the Company, rising to 100% vesting of this half of the award for upper quartile performance by the Company or better (with proportionate vesting between these two points).
- The other 75% of each award is subject to a performance condition based on average annual RoE over a three-year performance period. 25% of this half of the award will vest if average annual RoE over the performance period exceeds the criteria set out in the table on page 84, 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 84. Between these two points vesting will take place on a straight-line basis from 25% to 100% for RoE performance.

3 The vesting dates of the RSS mainstream awards are subject to being out of a close period and, for the 2010 to 2013 performance awards, are as follows:
- 2010 – first open period following the release of the Company's 2012 year-end results;
- 2011 – first open period following the release of the Company's 2013 year-end results;
- 2012 – first open period following the release of the Company's 2014 year-end results; and
- 2013 – first open period following the release of the Company's 2015 year-end results.

4 The vesting dates of the RSS Deferred Bonus awards are subject to being out of a close period and, for the 2012 to 2013 Deferred Bonus awards, are as follows:
- 2012 – vest 33.33% over a three year period at the first open period following the release of the Company's year-end results 2012, 2013 and 2014; and
- 2013 – vest 33.33% over a three year period at the first open period following the release of the Company's year-end results 2013, 2014 and 2015.

5 The 4 March 2011 Deferred Bonus award was an additional bonus deferral for staff who at the time fell under the remit of the LHL Remuneration Committee; they were not subject to performance conditions and vested 100% at 1 January 2013 and were exercisable in the first open period following the release of the Company's 2012 year end results.

6 The Deferred Bonus award to Elaine Whelan on 24 February 2011 was awarded when her position was outside the remit of the LHL Remuneration Committee and therefore vested 50% over two years at 100% per tranche on 1 January 2012 and 1 January 2013 with no performance conditions to be met.

7 Neil McConachie was an Executive Director in 2012, the above awards were made in relation to his 2012 performance as an Executive Director. No awards have been made to Mr McConachie in his capacity as a Non-Executive Director. At its meeting held on 4 February 2014, the Remuneration Committee decided that in light of Neil McConachie's decision to resign from the Board at the 2014 AGM, it was appropriate to afford him 'good leaver' status for all vested and unvested RSS awards, subject to a non-compete requirement, to vest on the usual vesting date with no pro-rata calculation applied.

TSR TARGETS FOR RSS

	2010	2011	2012	2013*	2014*
100%	75th percentile	75th percentile	75th percentile	75th percentile	75th percentile
25%	= median	= median	= median	= median	= median
Nil	< median	< median	< median	< median	< median

ROE TARGETS FOR RSS

	2010	2011	2012	2013*	2014*
100%	13 week Tr + 18%	13 week Tr + 15%	13 week Tr + 15%	13 week Tr +15%	13 week Tr +15%
25%	13 week Tr + 8%	13 week Tr + 6%	13 week Tr + 6%	13 week Tr + 6%	13 week Tr +6 %
Nil	<13 week Tr + 8%	<13 week Tr + 6%	<13 week Tr + 6%	<13 week Tr + 6%	<13 week Tr +6 %

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

Peer Companies	2010 awards	2011 awards	2012 awards	2013 awards	2014 awards
Amlin plc	X	X	X	X	X
Argo Limited[1]			X	X	X
Aspen Insurance Holdings Limited		X	X	X	X
Axis Capital Holdings Limited	X	X	X	X	X
Beazley plc	X	X	X	X	X
Brit Insurance Holding N.V.	X				
Catlin Group Ltd.	X	X	X	X	X
Endurance Specialty Holdings Ltd.	X	X	X	X	X
Flagstone Reinsurance Holdings Limited[2]	X	X	X		
Hiscox Ltd.	X	X	X	X	X
Montpelier Re Holdings Ltd.	X	X	X	X	X
RenaissanceRe Holdings Ltd.	X	X	X	X	X
Validus Holdings Ltd.	X	X	X	X	X

1 Argo was used as a comparator company from the fourth quarter of 2012.

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

GOVERNANCE

DIRECTORS' SHAREHOLDINGS AND SHARE INTERESTS

A policy for formal shareholding guidelines was introduced in 2012. This requires the CEO to build and maintain a shareholding in the Company worth two times annual salary and for the CUO and CFO to build and maintain a shareholding of one times annual salary as set out in the Policy Report.

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

	Number of Ordinary Shares							
	At 1 January 2013	At 31 December 2013						
	Legally owned	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 requirement	Shareholding guideline achieved?*
Richard Brindle	858,022	858,022	99,998	773,713	6,413,442	8,145,175	179,031	Yes
Alex Maloney	191,415	191,415	26,512	555,332	–	773,259	41,633	Yes
Elaine Whelan	44,087	94,225	31,022	316,567	–	441,814	40,235	Yes
John Bishop	4,807	–	N/A	N/A	N/A	–	N/A	N/A
Emma Duncan	–	–	N/A	N/A	N/A	–	N/A	N/A
Simon Fraser	–	–	N/A	N/A	N/A	–	N/A	N/A
Samantha Hoe-Richardson	–	3,947	N/A	N/A	N/A	3,947	N/A	N/A
Neil McConachie	144,975	–	24,921	408,827	–	433,748	N/A	N/A
Ralf Oelssner	–	–	N/A	N/A	N/A	–	N/A	N/A
Robert Spass	–	153,679	N/A	N/A	N/A	153,679	N/A	N/A
William Spiegel	–	–	N/A	N/A	N/A	–	N/A	N/A
Martin Thomas	6,950	6,950	N/A	N/A	N/A	6,950	N/A	N/A

* For the purpose of the shareholding guideline, legally owned shares are counted together with the net of tax value of deferred bonus and vested (but unexercised) long-term incentive awards.

Warrants over the Company's shares were awarded to the Company's founders and management prior to the admission of the Company's shares to trading on AIM. Details of Richard Brindle's awards, which were granted on 16 December 2005, are set out as below. Other Executive Directors had exercised their warrants prior to 2012.

Warrants held at 1 January 2013[2]	Warrants exercised during the year	Warrants sold during the year	Warrants held at 31 December 2013	Exercise price	Date from which first exercisable[1]	Expiry date
46,260	–	–	46,260	$5.00	16/12/2005	16/12/2015
3,718,912	–	–	3,718,912	$5.00	16/12/2005	16/12/2015
288,843	–	–	288,843	$5.00	31/12/2007	16/12/2015
1,906,305	–	–	1,906,305	$3.90	16/12/2008	16/12/2015
47,155	–	–	47,155	$3.90	31/12/2008	16/12/2015
405,967	–	–	405,967	$2.60	31/12/2009	16/12/2015
6,413,442	–	–	6,413,442			

1 There is a contractual obligation to make a dividend equivalent payment on each vested warrant. The value of dividend equivalents paid in respect of the above warrants to Richard Brindle in 2013 was £6,822,340 (2012 – £4,205,026).

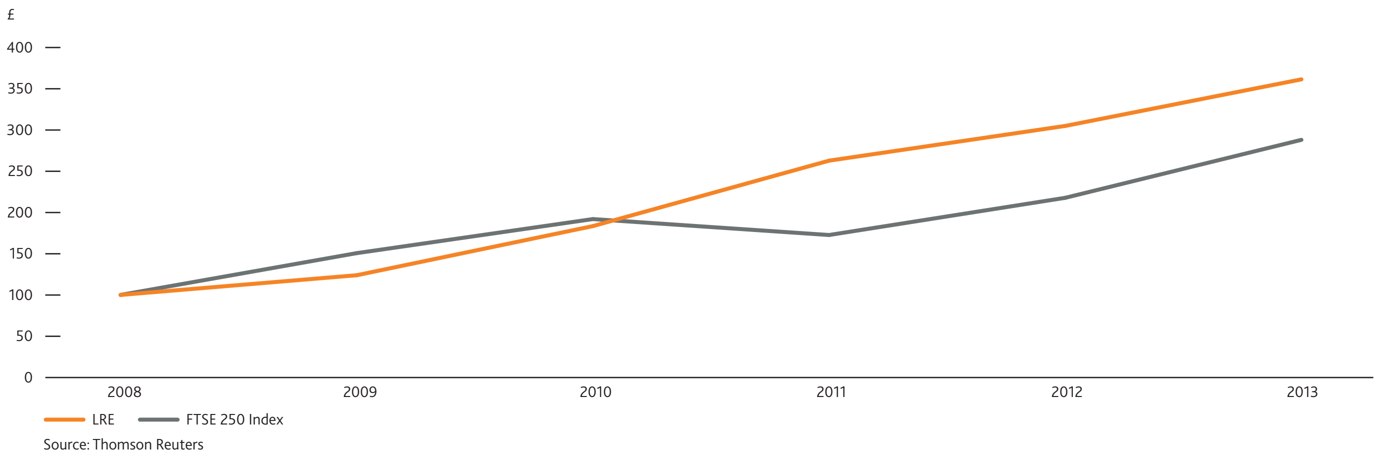
2 The market value of the common shares on 16 December 2005, the date of warrant grant, was £3.21.

GOVERNANCE

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



This graph shows the value, by 31 December 2013, of £100 invested in Lancashire Holdings Limited 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 remuneration for the CEO over the last five years with the annual bonus paid as a percentage of the maximum and the percentage of long-term share awards vesting in the year.

	2009	2010	2011	2012	**2013**
Total remuneration ($000s)	7,244	9,945	9,623	10,460	**10,175**
Annual bonus (%)	68	94	73	73	**80**
LTI vesting (%)	N/A	99.57	100	99	**100**

The table above shows the total remuneration figure for the CEO during each of those financial years. 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 pay-out 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 Chief Executive from the preceding year and the average percentage change in respect of the employees of the Company taken as a whole.

	Year on Year Change (%) CEO	Year on Year Change (%) Employees[2]
Base Salary	3%	6%
Benefits[1]	11%	12%
Bonus	23%	11%

1 For 2013, the CEO's benefit totals were significantly increased compared to 2012 due to the medical underwriting process being completed and Executives' coverage being increased to the qualified maximum entitlement.

2 Employee numbers were calculated on a per head count as at 31 December 2012 and 31 December 2013 basis.

GOVERNANCE

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 ending 31 December 2013 compared to the year ending 31 December 2012. This demonstrates that the shareholders have benefited to a greater extent than the employees in terms of compensations paid. The reduction in employee remuneration costs is mainly attributed to company restructuring, resulting in staff population changes.

	2013 $m	2012 $m	Percentage change
Employee remuneration costs	**59.4**	63.3	-6.57%
Dividends	**325.6**	201.4	38.14%

COMMITTEE MEMBERS, ATTENDEES AND ADVICE

The Remuneration Committee comprised the following members during the year and to the date of this Report (all of whom are independent Non-Executive Directors):

Remuneration Committee Members	Position	Comments
William Spiegel	LHL Remuneration Committee Chairman	Independent; attended 5 of a potential maximum meetings of 5 in 2013
Emma Duncan	Member from 5 November 2010	Independent; attended 5 of a potential maximum meetings of 6 in 2013
Ralf Oelssner	Member from 9 December 2005	Independent; attended 6 of a potential maximum meetings of 6 in 2013
Simon Fraser	Member from 12 November 2013	Independent; attended 1 of a potential maximum meetings of 1 in 2013

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, including the CRO and Head of Internal Audit.

NON-EXECUTIVE DIRECTORS' FEES

Non-Executive Directors		Fee $	Other $	Total $
John Bishop[1]	**2013**	**175,000**	**–**	**175,000**
	2012	175,000	21,000	196,000
Emma Duncan	**2013**	**175,000**	**–**	**175,000**
	2012	175,000	–	175,000
Simon Fraser[2]	**2013**	**27,178**	**–**	**27,178**
	2012	–	–	–
Samantha Hoe-Richardson[2]	**2013**	**150,096**	**–**	**150,096**
	2012	–	–	–
Neil McConachie[3]	**2013**	**175,000**	**–**	**175,000**
	2012	87,500	697,126	784,626
Ralf Oelssner[4]	**2013**	**175,000**	**56,000**	**231,000**
	2012	175,000	64,000	239,000
Robert Spass	**2013**	**175,000**	**–**	**175,000**
	2012	175,000	–	175,000
William Spiegel	**2013**	**175,000**	**–**	**175,000**
	2012	175,000	–	175,000
Martin Thomas	**2013**	**325,000**	**100,000**	**425,000**
	2012	325,000	100,000	425,000

1 John Bishop had a Solvency II consultancy agreement with LUK from 12 July 2010 through 20 December 2012 where he was paid at a rate of $21,000 per annum.

2 Samantha Hoe-Richardson and Simon Fraser were appointed Non-Executive Directors with effect from 19 February 2013 and 5 November 2013 respectively.

3 Neil McConachie moved from being an Executive Director to a Non-Executive Director effective 1 July 2012. The compensation paid in respect of his Executive Director responsibilities in 2012 which were previously reported have been added to the above chart as 'Other' to give an accurate reflection of compensation received by Mr McConachie in 2012.

4 Ralf Oelssner receives a fee of $30,000 per annum for his LUK directorship plus an additional $2,000 for each Board and Committee Meeting (Risk, Audit and Remuneration) that he attends.

REMUNERATION COMMITTEE ADVISER

The Remuneration Committee is advised by New Bridge Street ('NBS'), a trading name of Aon Hewitt, being a subsidiary of Aon plc. NBS was appointed by the Remuneration Committee in 2007. NBS has discussions with the Remuneration Committee Chairman regularly on committee process and topics which are of particular relevance to the Company.

Aon Benfield (which is part of Aon but is a separate business division to Aon Hewitt) provides reinsurance brokering services to Lancashire.

The primary role of NBS is to provide independent and objective advice and support to the Committee's Chair and members. In order to manage any possible conflict of interest, NBS operates as a distinct business within the Aon Group and there is a robust separation between the business activities and management of NBS and all other parts of Aon Hewitt and the wider Aon Group. The Committee is satisfied that the advice that it receives is objective and independent. NBS 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 NBS in respect of its services to the Committee for the year ending 31 December 2013 were $174,004, 2012 $88,813. 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 and any matters discussed with shareholders during the year are provided in the Implementation Report on page 78.

	Total number of votes	% of votes cast
For	102,920,185	93.3
Against	7,403,309	6.7
Total	110,323,494	100.0
Abstentions	10,195,447	

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

WILLIAM SPIEGEL, LHL REMUNERATION COMMITTEE CHAIRMAN
12 February 2014

GOVERNANCE

OVERVIEW OF THE GROUP

Lancashire Holdings Limited (the Company) is a Bermuda incorporated company with operating subsidiaries in Bermuda and London. The Company's common shares were admitted to trading on AIM in December 2005 and were subsequently moved up to the Official List and to trading on the main market of the LSE on 16 March 2009. The shares have been included in the FTSE 250 index since 22 June 2009.

PRINCIPAL ACTIVITIES

The Company's principal activity, through its wholly owned subsidiaries, is the provision of global specialty insurance and reinsurance products. On 7 November 2013 the Company completed the acquisition of Cathedral Capital Limited, an established Lloyd's insurer, and in July set up Kinesis, a third-party capital facility, to complement Lancashire's longstanding specialty insurance activities. An analysis of the Group's business performance can be found in the Business review on pages 28 to 39.

DIVIDENDS

For the year ended 31 December 2013, the following dividends were declared:

- an interim dividend of $0.05 per common share and warrant was declared on 24 July 2013 and paid on 25 September 2013 in pounds sterling at the pound/U.S. dollar exchange rate of 1.5603 or £0.0320 per common share and warrant;
- a special dividend of $0.45 per common share and warrant was declared on 5 November 2013 and paid on 20 December 2013 in pounds sterling at the pound/U.S. dollar exchange rate of 1.6340 or £0.2754 per common share and warrant;
- a final dividend of $0.10 per common share and warrant was declared on 12 February 2014; and
- an additional special dividend of $0.20 per common share and warrant was declared on 12 February 2014.

Both the final dividend and the additional special dividend are to be paid on 16 April 2014 in pounds sterling at the pound/U.S. dollar exchange rate on the record date of 21 March 2014 or approximately £0.18 in the aggregate, per common share and warrant.

DIVIDEND POLICY

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

DIRECTORS

- John Bishop (Non-Executive Director)
- Richard Brindle (Chief Executive Officer)
- Emma Duncan (Non-Executive Director)
- Simon Fraser (Non-Executive Director) (appointed effective 5 November 2013)
- Samantha Hoe-Richardson (Non-Executive Director) (appointed effective 19 February 2013)
- Alex Maloney (Chief Underwriting Officer)
- Neil McConachie (Non-Executive Director)
- Ralf Oelssner (Senior Independent Non-Executive Director)
- Robert Spass (Non-Executive Director)
- William Spiegel (Non-Executive Director)
- Martin Thomas (Non-Executive Chairman)
- Elaine Whelan (Chief Financial Officer) (appointed effective 1 January 2013)

DIRECTORS' INTERESTS

The Directors' beneficial interests in the Company's common shares as at 31 December 2013 and 2012 including interests held by family members were as follows:

Director	**Common shares held at 31 December 2013**	Common shares held at 31 December 2012
John Bishop(1)	**–**	4,807
Richard Brindle(2)	**858,022**	858,022
Emma Duncan	**–**	–
Simon Fraser	**–**	–
Samantha Hoe-Richardson(3)	**3,947**	–
Alex Maloney(4)	**191,415**	191,415
Neil McConachie(5)	**–**	144,975
Ralf Oelssner	**–**	–
Robert Spass(6)	**153,679**	–
William Spiegel	**–**	–
Martin Thomas	**6,950**	6,950
Elaine Whelan(7)	**94,225**	44,087

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

(1) John Bishop conducted the following transactions in the Company's shares during 2013:
- 7 November – sold 4,807 shares at a price of £8.05 realising £38,696.

(2) Richard Brindle conducted the following transactions in the Company's shares during 2013:
- 10 May – exercise of 371,250 RSS awards and 213,647 deferred bonus RSS awards and sale of 584,897 shares at a price of £8.26 realising £4,833,004.

(3) Samantha Hoe-Richardson conducted the following transactions in the Company's shares during 2013:
- 9 August – purchase of 1,307 shares at a price of £7.65 costing £9,999;
- 30 September – purchase of 1,000 shares at a price of £7.54 costing £7,540; and
- 19 November – purchase of 1,640 shares at a price of £7.94 costing £13,020.

(4) Includes 100,000 shares owned by his spouse, Amanda Maloney. Alex Maloney conducted the following transactions in the Company's shares during 2013:
- 10 May – exercise of 95,287 RSS awards and 45,590 deferred bonus RSS awards and sale of 140,877 shares at a price of £8.26 realising £1,164,067.

(5) Lorraine McConachie conducted the following transactions in the Company's shares during 2013:
- 1 March – sold 44,975 shares at a price of £9.17 realising £412,421;
- 5 March – sold 25,000 shares at a price of £9.13 realising £228,250;
- 2 December – sold 35,000 shares at a price of £7.78 realising £272,230; and
- 11 December – sold 40,000 shares at a price of £7.70 realising £307,800.

Neil McConachie conducted the following transactions in the Company's shares during 2013:
- 12 December – exercise of 150,975 RSS awards and 86,382 deferred bonus RSS awards and between 12 and 17 December sale of 237,357 shares at an average price of £7.62 realising £1,808,209.

(6) Robert Spass conducted the following transactions in the Company's shares during 2013:
- 8 November – cashless exercise of 249,135 Founder warrants resulting in the acquisition of 153,679 shares.

(7) Includes 2,600 shares owned by her spouse, Kilian Whelan. Elaine Whelan conducted the following transactions in the Company's shares during 2013:
- 16 May – exercise of 45,581 RSS awards and 5,585 deferred bonus RSS awards and related sale of 1,028 shares to cover tax liabilities, at a price of £8.26 realising £8,486.

Certain of the Directors hold warrants over the Company's shares which were awarded prior to the Company's admission to AIM in December 2005 along with other warrants awarded to the Company's founders and employees as follows: Richard Brindle owns 6,367,182 ordinary and performance warrants and 46,260 Founder warrants and Robert Spass is the beneficial owner of 560,000 Founder warrants.

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

In September 2013 both Richard Brindle and Alex Maloney purchased shares in Kinesis Capital Management Limited, a company that is 87.43 per cent owned by LHL, with the balance of the shares owned by senior Lancashire and KCML employees. Mr Brindle, who owns 5.46 per cent, and Mr Maloney, who owns 1.09 per cent, purchased their shares on the same terms as LHL.

TRANSACTION IN OWN SHARES

The Company did not repurchase any of its own common shares during 2013 or 2012.

The Group's current repurchase programme had 16,860,242 common shares remaining to be purchased at 31 December 2013 (approximately $225.5 million at the 31 December 2013 share price). Further details of the share repurchase authority and programme are set out in note 23 to the consolidated financial statements on page 162.

DIRECTORS' REMUNERATION

Details of the Directors' remuneration are set out in the Directors' Remuneration Report on pages 71 to 88.

SUBSTANTIAL SHAREHOLDERS

As at 12 February 2014 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 12 February 2014	% of shares in issue
Invesco Limited	18,426,750	10.1
Standard Life Investments Ltd	15,681,694	8.6
Legal & General Group Plc	9,968,257	5.4
Franklin Mutual Advisers, LLC	9,772,203	5.3
BlackRock, Inc.	6,935,060	3.8
Alken Luxembourg S.A.	6,234,413	3.4
Norges Bank	5,581,469	3.1

CORPORATE GOVERNANCE – COMPLIANCE STATEMENT

The Company's compliance with the Code is summarised in the Corporate Governance section of this Report on pages 61 to 63. The Company confirms, in accordance with the principle of 'comply or explain', that there are no areas of material non-compliance with the Code.

DONATIONS

In November 2012 the Board of Directors approved a cash donation of $1,400,000 (2012 – $1,250,000) to the Lancashire Foundation, payable in respect of 2013.

Lancashire established the Lancashire Foundation as a Bermuda charitable trust in 2007, with the aim of creating a trust for the benefit of charitable causes in Bermuda, the UK and worldwide. During 2012 the assets of the Lancashire Foundation were transferred to the Lancashire Foundation charitable trust established in England and Wales and registered with the Charity Commission. The Lancashire Foundation's trustees are three senior employees and one former employee and make donations following recommendations made by the Company's Donations Committee consisting of Lancashire employees.

A summary of the work of the Lancashire Foundation during 2013 can be found in the Corporate Responsibility section on pages 45 to 53.

The Group did not make any political donations or expenditure during 2013 or 2012.

HEALTH AND SAFETY

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

GREENHOUSE GAS EMISSIONS

The Group's greenhouse gas emissions are detailed in the Corporate Responsibility section on pages 49 and 50.

EMPLOYEES

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

CREDITOR PAYMENT POLICY

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

FINANCIAL INSTRUMENTS AND RISK EXPOSURES

Information regarding the Group's risk exposure is included in the risk disclosures section on pages 108 to 133 of the consolidated financial statements. The Group's use of derivative financial instruments can be found on pages 122 to 125.

ACCOUNTING STANDARDS

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

ANNUAL GENERAL MEETING

The notice of the 2014 AGM, to be held on 30 April 2014 at the Company's head office, Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, UK, is contained in a separate circular to shareholders enclosed with this Annual Report & Accounts. The notice of the AGM is also available on the Company's website.

ELECTRONIC AND WEB COMMUNICATIONS

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

GOING CONCERN

The Business Review section on pages 28 to 39 sets out details of the Group's financial performance, capital management, business environment and outlook. In addition, further discussion of the principal risks and uncertainties affecting Lancashire can be found on pages 42 to 44 and starting on page 108, the risk disclosures section of the consolidated financial statements set out the major risks the Group is exposed to, including insurance, market, liquidity, credit, operational and strategic, together with the Group's policies for monitoring and controlling its exposures to these risks.

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

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

AUDITORS

Resolutions will be proposed at the Company's 2014 AGM to re-appoint Ernst & Young LLP as the Company's auditors and to authorise the Directors to set the auditors' remuneration. Ernst & Young have served as the Company's auditors since 2005.

DISCLOSURE OF INFORMATION TO THE AUDITORS

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

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

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

CHRISTOPHER HEAD, COMPANY SECRETARY
12 February 2014

The Directors are responsible for preparing 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 Company and the Group and of the profit or loss of the Group for that period. The consolidated financial statements have been prepared in accordance with IFRS. Where IFRS is silent, as it is in respect of the measurement of insurance products, U.S. GAAP is considered. Further detail on the basis of preparation is described in the consolidated financial statements. In preparing the consolidated financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the consolidated financial statements;
- provide additional disclosures where compliance with the specific requirements of IFRS are considered to be insufficient to enable users to understand the impact of particular transactions, events and conditions on the financial position and performance; and
- prepare the consolidated financial statements on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

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

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors confirm that to the best of their knowledge:

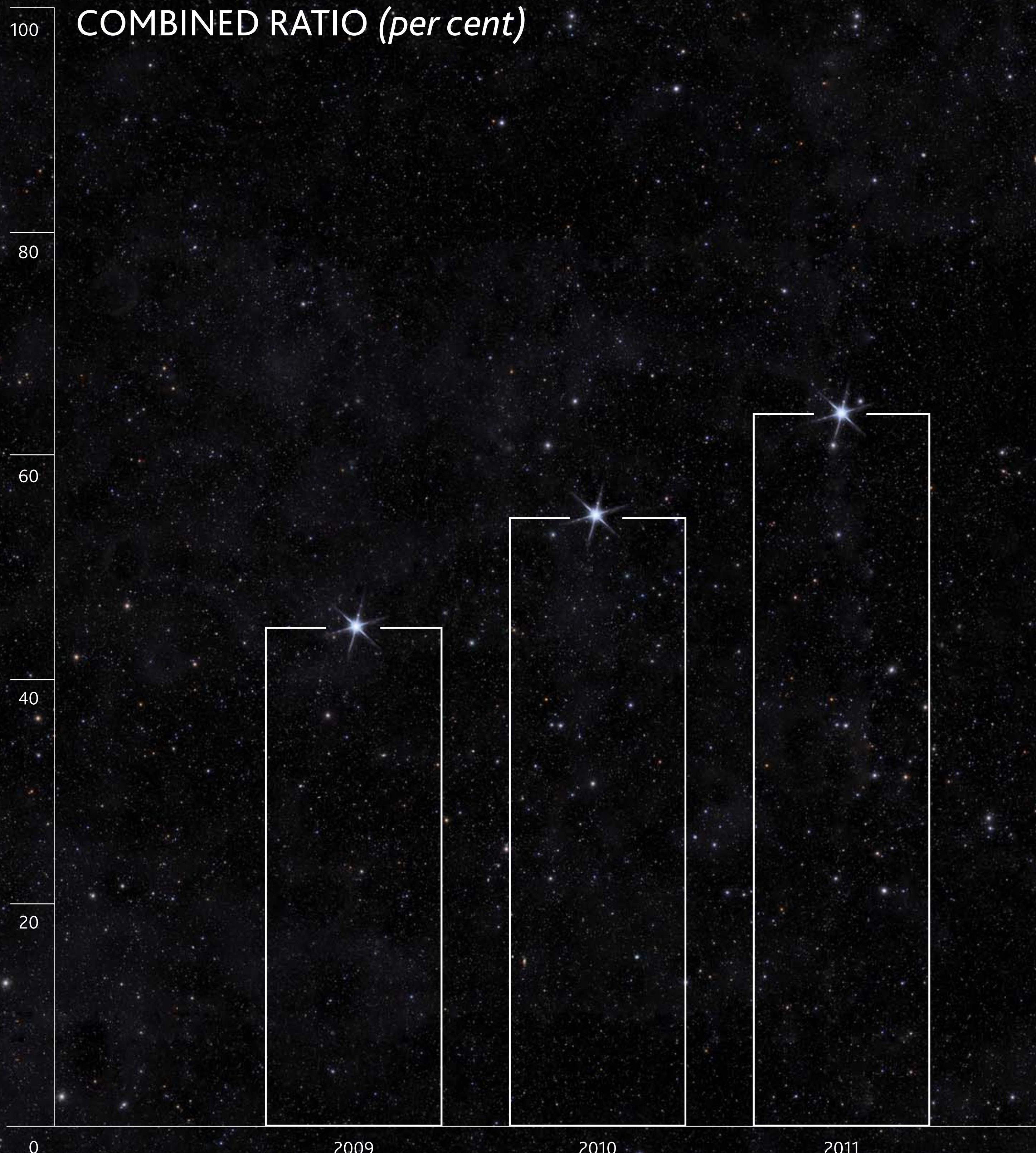
1. the consolidated financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position and profit of the Group;
2. the Board considers the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy; and
3. the Strategy and the Business review 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.

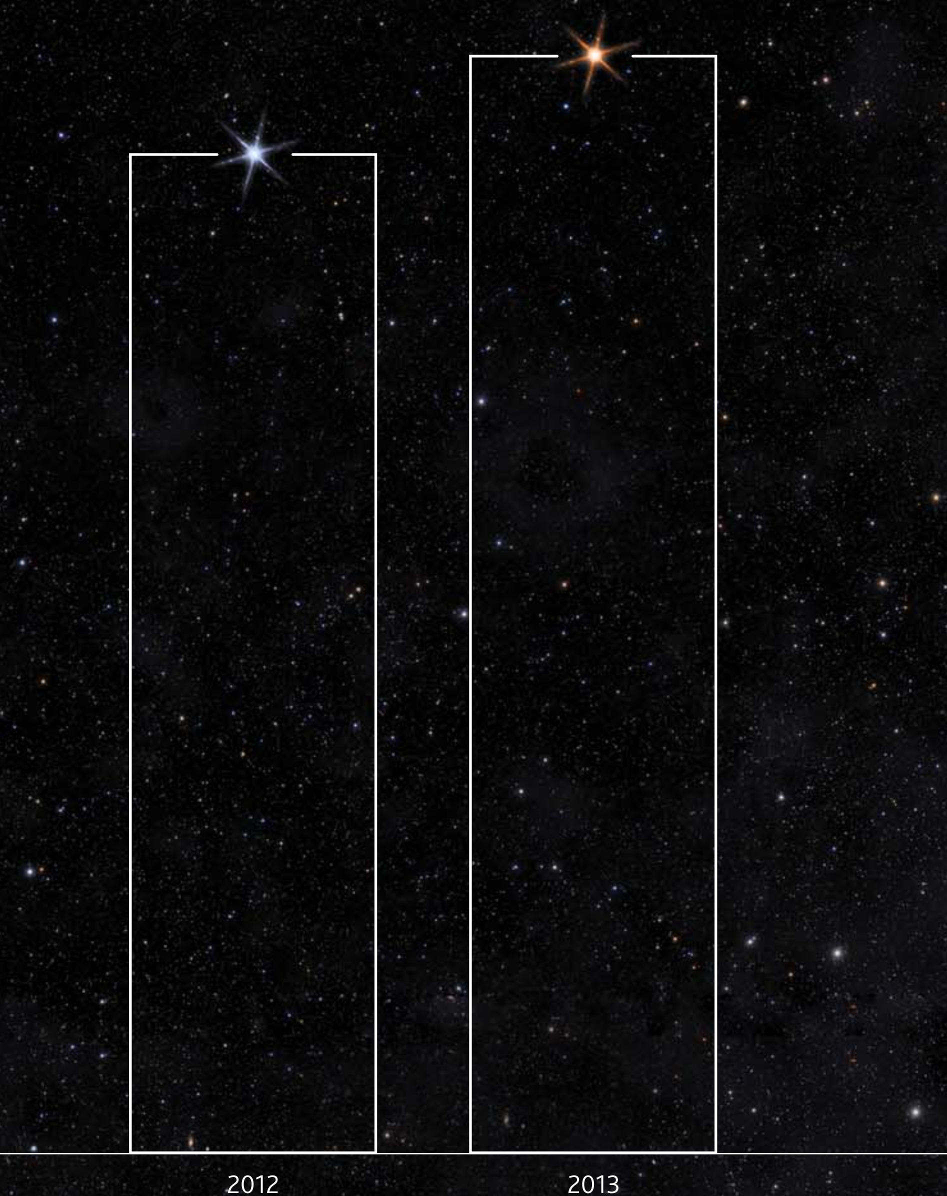
By order of the Board

12 February 2014

COMBINED RATIO *(per cent)*



FINANCIAL STATEMENTS



IN THIS SECTION:

We have audited the consolidated financial statements of Lancashire Holdings Limited and its subsidiaries (collectively "the Group") for the year ended 31 December 2013, which comprise the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated statement of cash flows, and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with our engagement letter dated 26 November 2013. 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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As explained more fully in the Directors' Responsibilities Statement set out on page 93, the Directors are responsible for the preparation of the consolidated financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the consolidated financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Notwithstanding the Company's incorporation in Bermuda, the Company has also instructed us to audit the section of Directors' Remuneration Report that has been described as audited and state whether it has been properly prepared in accordance with the basis of preparation described therein.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

OPINION ON FINANCIAL STATEMENTS

In our opinion the consolidated financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2013 and of its profit for the year then ended; and
- have been properly prepared in accordance with IFRSs as adopted by the European Union.

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

We identified the following risks that have had the greatest effect on the overall audit strategy ; the allocation of resources in the audit; and directing the efforts of the engagement team:

- value of insurance losses and loss adjustment expenses;
- the accounting for the acquisition of the Cathedral group; and
- revenue recognition, including the estimation of ultimate premiums.

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of identified misstatements on our audit and of uncorrected misstatements, if any, on the financial statements and in forming our opinion in the Audit Report.

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole. We determined materiality for the Group to be $10.0 million, which is approximately 5 per cent of pre-tax profit and is 0.7 per cent of equity. This provided a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timings and extent of further audit procedures.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement is that overall performance materiality (i.e. our tolerance for misstatement in an individual account or balance) for the Group should be 50 per cent of materiality, namely $5.0 million. Our objective in adopting this approach is to ensure that total uncorrected and undetected audit differences do not exceed our materiality of $10.0 million for the financial statements as whole.

We agreed with the Audit Committee that we would report to the Audit Committee all audit differences in excess of $0.5 million, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

AN OVERVIEW OF THE SCOPE OF OUR AUDIT

Following our assessment of the risk of material misstatement to the Group financial statements, our Group audit scope focused on the two insurance subsidiaries which are subject to a full scope audit for the year ended 31 December 2013. These two subsidiaries accounted for 96.4 per cent of the Group's gross premiums written, 89.9 per cent of the Group's net insurance losses for the year, and 95.2 per cent of the Group's results of operating activities.

The remaining operating location was the Cathedral Group, which was acquired on 7 November 2013 and was subject to a specific scope audit for the year ended 31 December 2013.

Audits of these locations are performed at a materiality level calculated by reference to a proportion of Group materiality appropriate to the relative scale of the business concerned.

The Group audit team follows a programme of planned site visits that is designed to ensure that the Group audit team visits each of the full scope locations at least once a year. This year, the Group audit team visited both of the full scope locations.

Our principal responses to the risks identified above were as follows:

- we challenged management's assumptions and estimates used in valuing the insurance losses and loss adjustment expenses;
- we considered the appropriateness of management's assumptions and estimates in relation to the acquisition accounting of the Cathedral Group during the year, including the fair value adjustments recognised on the acquisition date, and the valuation of intangible assets, challenging those assumptions and associated forecasts and estimates; and
- we carried out testing relating to controls over the estimation of premiums as well as substantive testing, analytical procedures and assessing whether the revenue recognition policies adopted complied with the stated accounting policy.

The Audit Committee's consideration of these judgements is set out on page 65.

OPINION ON OTHER MATTERS

In our opinion the part of the Directors' Remuneration Report that is described as having been audited has been properly prepared in accordance with the basis of preparation as described therein.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following:

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.

Under the Listing Rules we are required to review:

- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review.

ERNST & YOUNG LLP
London

12 February 2014

For the year ended 31 December 2013

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

As at 31 December 2013

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

The consolidated financial statements were approved by the Board of Directors on 12 February 2014 and signed on its behalf by:

MARTIN THOMAS
Director/Chairman

ELAINE WHELAN
Director/CFO

For the year ended 31 December 2013

	Notes	Share capital $m	Own shares $m	Share premium $m	Contributed surplus $m	Accumulated other comprehensive income $m	Other reserves $m	Retained earnings $m	Shareholders' equity attributable to equity shareholders of LHL $m	Non-controlling interests $m	Total shareholders' equity $m
Balance as at 31 December 2011		84.3	(83.0)	2.4	660.5	17.6	67.6	577.4	1,326.8	–	1,326.8
Total comprehensive income for the year	11	–	–	–	–	17.8	–	234.9	252.7	–	252.7
Distributed by trust	23	–	33.2	–	(41.9)	–	–	–	(8.7)	–	(8.7)
Shares donated to trust	23, 27	–	(18.4)	–	18.4	–	–	–	–	–	–
Dividends on common shares	23	–	–	–	–	–	–	(168.6)	(168.6)	–	(168.6)
Dividend equivalents on warrants	24	–	–	–	–	–	–	(32.8)	(32.8)	–	(32.8)
Warrant exercises – Founder	24	–	11.1	–	(3.4)	–	(7.7)	–	–	–	–
Equity based compensation – tax	9	–	–	–	–	–	1.6	–	1.6	–	1.6
Equity based compensation – exercises	7, 23, 24	–	–	–	20.8	–	(20.8)	–	–	–	–
Equity based compensation – expense	7	–	–	–	–	–	16.4	–	16.4	–	16.4
Balance as at 31 December 2012		84.3	(57.1)	2.4	654.4	35.4	57.1	610.9	1,387.4	–	1,387.4
Total comprehensive income for the year	11	**–**	**–**	**–**	**–**	**(32.5)**	**–**	**222.5**	**190.0**	**(0.6)**	**189.4**
Issue of shares	23	**8.4**	**–**	**189.8**	**–**	**–**	**–**	**–**	**198.2**	**–**	**198.2**
Issue of shares to non-controlling interests	27	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**1.3**	**1.3**
Distributed by trust	23	**–**	**30.1**	**–**	**(38.7)**	**–**	**–**	**–**	**(8.6)**	**–**	**(8.6)**
Shares donated to trust	23, 27	**–**	**(12.8)**	**–**	**12.8**	**–**	**–**	**–**	**–**	**–**	**–**
Dividends on common shares	23	**–**	**–**	**–**	**–**	**–**	**–**	**(276.7)**	**(276.7)**	**–**	**(276.7)**
Dividend equivalents on warrants	24	**–**	**–**	**–**	**–**	**–**	**–**	**(48.9)**	**(48.9)**	**–**	**(48.9)**
Warrant exercises – Founder	24	**–**	**3.0**	**–**	**(1.1)**	**–**	**(1.9)**	**–**	**–**	**–**	**–**
Equity based compensation – tax	9	**–**	**–**	**–**		**–**	**1.6**	**–**	**1.6**	**–**	**1.6**
Equity based compensation – exercises	7, 23, 24	**–**	**–**	**–**	**18.3**	**–**	**(18.3)**	**–**	**–**	**–**	**–**
Equity based compensation – expense	7	**–**	**–**	**–**		**–**	**16.7**	**–**	**16.7**	**–**	**16.7**
Balance as at 31 December 2013		**92.7**	**(36.8)**	**192.2**	**645.7**	**2.9**	**55.2**	**507.8**	**1,459.7**	**0.7**	**1,460.4**

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

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basis of preparation, consolidation principles and significant accounting policies adopted in the preparation of LHL and the Group's consolidated financial statements are set out below.

BASIS OF PREPARATION

The Group's consolidated financial statements are prepared in accordance with accounting principles generally accepted under IFRS as adopted by the European Union.

Where IFRS is silent, as it is in respect of the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, the Group determines appropriate measurement bases, to provide the most useful information to users of the consolidated financial statements, using their judgement and considering U.S. GAAP.

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

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

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

IFRS 9, Financial Instruments: Classification and Measurement, has been issued but is not yet effective, and therefore has not yet been adopted by the Group. The Group continues to apply IAS 39, Financial Instruments: Recognition and Measurement and classifies its fixed income and equity securities as available for sale or fair value through profit or loss. The new standard, the effective date of which remains open, is not expected to have a material impact on the results and disclosures reported in the consolidated financial statements. It will, however, result in a reclassification of fixed income securities from available for sale to estimated fair value through profit or loss and a reclassification of the net change in unrealised gains and losses on investments from accumulated other comprehensive income to profit or loss.

IFRS 10, Consolidated Financial Statements, issued in May 2011, redefines the principle of control and establishes control as the basis for determining which entities are consolidated in an entity's financial statements. IFRS 12, Disclosure of Involvement with Other Entities, was issued concurrently and sets out the disclosure requirements for consolidated financial statements. Both standards will be effective from 1 January 2014 and are not expected to have a material impact on the Group's results, although additional disclosures may be required.

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

The consolidated balance sheet of the Group is presented in order of decreasing liquidity.

USE OF ESTIMATES

The preparation of financial statements in conformity with IFRS requires the Group to make estimates and assumptions that affect the reported and disclosed amounts at the balance sheet date and the reported and disclosed amounts of revenues and expenses during the reporting period. Actual results may differ materially from the estimates made.

The most significant estimate made by management is in relation to losses and loss adjustment expenses. This is discussed on page 105 and also in the risk disclosures section from page 115. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 105.

Estimates are also made in determining the estimated fair value of certain financial instruments and equity compensation plans. The estimation of the fair value of financial instruments is discussed on pages 105 and 106 and in note 11. Management judgement is applied in determining impairment charges. The estimation of the fair value of equity based compensation awards granted is discussed in note 7.

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

BASIS OF CONSOLIDATION

The Group's consolidated financial statements include the assets, liabilities, shareholders' equity, revenues, expenses and cash flows of LHL and its subsidiaries. A subsidiary is an entity in which the Group owns, directly or indirectly, more than 50 per cent of the voting power of the entity or otherwise has the power to govern its operating and financial policies. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. Intercompany balances, profits and transactions are eliminated.

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

ASSOCIATES

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

FOREIGN CURRENCY TRANSLATION

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

Foreign currency transactions are recorded in the functional currency for each entity using the exchange rates prevailing at the dates of the transactions, or at the average rate for the period when this is a reasonable approximation. Monetary assets and liabilities denominated in foreign currencies are translated at period end exchange rates. The resulting exchange differences on translation are recorded in the consolidated statement of comprehensive income. Non-monetary assets and liabilities carried at historical cost denominated in a foreign currency are translated at historic rates. Non-monetary assets and liabilities carried at estimated fair value denominated in a foreign currency are translated at the exchange rate at the date the estimated fair value was determined, with resulting exchange differences recorded in accumulated other comprehensive income in shareholders' equity.

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

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

BUSINESS COMBINATIONS

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

INTANGIBLE ASSETS

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

GOODWILL

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

SYNDICATE PARTICIPATION RIGHTS

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

VALUE OF IN-FORCE BUSINESS

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

INSURANCE CONTRACTS

CLASSIFICATION

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Contracts that do not transfer significant insurance risk are accounted for as investment contracts. Insurance risk is transferred when an insurer agrees to compensate a policyholder if a specified uncertain future event adversely affects the policyholder.

PREMIUMS AND ACQUISITION COSTS

Premiums are first recognised as written at the later of a contract's binding or inception date. The Group writes both excess of loss and pro-rata (proportional) contracts. For the majority of excess of loss contracts, written premium is recorded based on the minimum and deposit or flat premium, as defined in the contract. Subsequent adjustments to the minimum and deposit premium are recognised in the period in which they are determined. For pro-rata contracts and excess of loss contracts where no deposit is specified in the contract, written premium is recognised based on estimates of ultimate premiums provided by the insureds or ceding companies. Initial estimates of written premium are recognised in the period in which the contract incepts, or the period in which the contract is bound if later. Subsequent adjustments, based on reports of actual premium by the insureds or ceding companies, or revisions in estimates, are recorded in the period in which they are determined.

Premiums are earned rateably over the term of the underlying risk period of the insurance contract, except where the period of risk differs significantly from the contract period. In these circumstances, premiums are recognised over the period of risk in proportion to the amount of insurance protection provided. The portion of the premium related to the unexpired portion of the risk period is reflected in unearned premiums.

Where contract terms require the reinstatement of coverage after an insured's or ceding company's loss, the estimated mandatory reinstatement premiums are recorded as written premiums when a specific loss event occurs. Reinstatement premiums are not recorded for losses included within the provision for IBNR which do not relate to a specific loss event.

Inwards premiums receivable from insureds and cedants are recorded net of commissions, brokerage, premium taxes and other levies on premiums, unless the contract specifies otherwise. These balances are reviewed for impairment, with any impairment loss recognised as an expense in the period in which it is determined.

Acquisition costs represent commissions, brokerage, profit commissions and other variable costs that relate directly to the successful securing of new contracts and the renewing of existing contracts. They are generally deferred over the period in which the related premiums are earned to the extent they are recoverable out of expected future revenue margins. All other acquisition costs are recognised as an expense when incurred.

OUTWARDS REINSURANCE

Outwards reinsurance premiums comprise the cost of reinsurance contracts entered into. Outwards reinsurance premiums are accounted for in the period in which the contract incepts, or the period in which the contract is bound if later. The provision for reinsurers' share of unearned premiums represents that part of reinsurance premiums ceded which are estimated to be earned in future financial periods. Unearned reinsurance commissions are recognised as a liability using the same principles.

Any amounts recoverable from reinsurers are estimated using the same methodology as the underlying losses. The Group monitors the creditworthiness of its reinsurers on an ongoing basis and assesses any reinsurance assets for impairment, with any impairment loss recognised as an expense in the period in which it is determined.

LOSSES

Losses comprise losses and loss adjustment expenses paid in the period and changes in the provision for outstanding losses, including the provision for IBNR and related expenses. Losses and loss adjustment expenses are charged to income as they are incurred.

A portion of the Group's business is in classes with high attachment points of coverage, including property catastrophe excess of loss. Reserving for losses in such programmes is inherently complicated in that losses in excess of the attachment level of the Group's policies are characterised by high severity and low frequency and other factors which could vary significantly as losses are settled. This limits the volume of industry loss experience available from which to reliably predict ultimate losses following a loss event.

Losses and loss adjustment expenses represent the estimated ultimate cost of settling all losses and loss adjustment expenses arising from events which have occurred up to the balance sheet date, including a provision for IBNR. The Group does not discount its liabilities for unpaid losses. Outstanding losses are initially set on the basis of reports of losses received from third parties. ACRs are determined where the Group's best estimate of the reported loss is greater than that reported. Estimated IBNR reserves may also consist of a provision for additional development in excess of losses reported by insureds or ceding companies, as well as a provision for losses which have occurred but which have not yet been reported by insureds or ceding companies. IBNR reserves are set on a best estimate basis and are estimated by management using various actuarial methods as well as a combination of own loss experience, historical insurance industry loss experience, underwriters' experience, estimates of pricing adequacy trends and management's professional judgement.

The estimation of the ultimate liability arising is a complex process which incorporates a significant amount of judgement. It is reasonably possible that uncertainties inherent in the reserving process, delays in insureds or ceding companies reporting losses to the Group, together with the potential for unforeseen adverse developments, could lead to a material change in losses and loss adjustment expenses.

LIABILITY ADEQUACY TESTS

At each balance sheet date, the Group performs a liability adequacy test using current best estimates of future cash outflows generated by its insurance contracts, plus any investment income thereon. If, as a result of these tests, the carrying amount of the Group's insurance liabilities is found to be inadequate, the deficiency is charged to income for the period, initially by writing off deferred acquisition costs and subsequently by establishing a provision.

FINANCIAL INSTRUMENTS

CASH AND CASH EQUIVALENTS

Cash and cash equivalents are carried in the consolidated balance sheet at amortised cost and include cash in hand, deposits held on call with banks and other short-term highly liquid investments with a maturity of three months or less at the date of purchase.
Carrying amounts approximate fair value due to the short-term nature and high liquidity of the instruments.

Interest income earned on cash and cash equivalents is recognised on the effective interest rate method. The carrying value of accrued interest income approximates estimated fair value due to its short-term nature and high liquidity.

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

Regular way purchases and sales of investments are recognised at estimated fair value including transaction costs on the trade date and are subsequently carried at estimated fair value. The estimated fair values of quoted investments are determined based on bid prices from recognised exchanges, broker-dealers, recognised indices or pricing vendors. Investments are derecognised when the Group has transferred substantially all of the risks and rewards of ownership. Realised gains and losses are included in income in the period in which they arise. Unrealised gains and losses from changes in estimated fair value of available for sale investments are included in accumulated other comprehensive income in shareholders' equity.

On derecognition of an investment, previously recorded unrealised gains and losses are removed from accumulated other comprehensive income in shareholders' equity and included in current period income. Changes in estimated fair value of investments classified as at fair value through profit or loss are recognised in current period income.

Amortisation and accretion of premiums and discounts on available for sale fixed income securities are calculated using the effective interest rate method and are recognised in current period net investment income. Interest income is recognised on the effective interest rate method. The carrying value of accrued interest income approximates estimated fair value due to its short-term nature and high liquidity. Dividends on equity securities are recorded as revenue on the date the dividends become payable to the holders of record.

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

DERIVATIVE FINANCIAL INSTRUMENTS
Derivatives are recognised at estimated fair value on the date a contract is entered into, the trade date, and are subsequently carried at estimated fair value. Derivative instruments with a positive estimated fair value are recorded as derivative financial assets and those with a negative estimated fair value are recorded as derivative financial liabilities.

Derivative financial instruments include exchange-traded future and option contracts, forward foreign currency contracts, interest rate swaps, credit default swaps and interest rate swaptions. They derive their value from the underlying instrument and are subject to the same risks as that underlying instrument, including liquidity, credit and market risk. Estimated fair values are based on exchange or broker-dealer quotations, where available, or discounted cash flow models, which incorporate the pricing of the underlying instrument, yield curves and other factors. Changes in the estimated fair value of instruments that do not qualify for hedge accounting are recognised in current period income. The Group does currently not hold any derivatives classified as hedging instruments. For discounted cash flow techniques, estimated future cash flows are based on management's best estimates and the discount rate used is an appropriate market rate.

Derivative financial assets and liabilities are offset and the net amount is reported in the consolidated balance sheet only to the extent there is a legally enforceable right of offset and there is an intention to settle on a net basis, or to realise the assets and liabilities simultaneously. Derivative financial assets and liabilities are derecognised when the Group has transferred substantially all of the risks and rewards of ownership or the liability is discharged, cancelled or expired.

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

LONG-TERM DEBT
Long-term debt is recognised initially at fair value, net of transaction costs incurred. Thereafter it is held at amortised cost, with the amortisation calculated using the effective interest rate method. Derecognition occurs when the obligation has been extinguished.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is carried at historical cost, less accumulated depreciation and any impairment in value. Depreciation is calculated to write off the cost over the estimated useful economic life on a straight-line basis as follows:

IT equipment	33% per annum
Office furniture and equipment	20% to 33% per annum
Leasehold improvements	20% per annum

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property, plant or equipment is derecognised on disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Gains and losses on the disposal of property, plant and equipment are determined by comparing proceeds with the carrying amount of the asset, and are included in the consolidated statement of comprehensive income. Costs for repairs and maintenance are charged to income as incurred.

LEASES

Rentals payable under operating leases are charged to income on a straight-line basis over the lease term.

EMPLOYEE BENEFITS

EQUITY COMPENSATION PLANS

The Group currently operates an RSS under which nil-cost options have been granted. The Group has also operated a management warrant plan and an LTIP option plan in the past. The fair value of the equity instruments granted is estimated on the date of grant. The estimated fair value is recognised as an expense pro-rata over the vesting period of the instrument, adjusted for the impact of any non-market vesting conditions. No adjustment to vesting assumptions is made in respect of market vesting conditions.

At each balance sheet date, the Group revises its estimate of the number of RSS nil-cost options, LTIP options and warrants that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated statement of comprehensive income, and a corresponding adjustment is made to other reserves in shareholders' equity over the remaining vesting period.

On exercise, the differences between the expense charged to the consolidated statement of comprehensive income and the actual cost to the Group, if any, is transferred to contributed surplus. Where new shares are issued, the proceeds received are credited to share capital and share premium.

PENSIONS

The Group operates a defined contribution plan. On payment of contributions to the plan there is no further obligation for the Group. Contributions are recognised as employee benefits in the consolidated statement of comprehensive income in the period to which they relate.

TAX

Income tax represents the sum of the tax currently payable and any deferred tax. The tax payable is calculated based on taxable profit for the period. Taxable profit for the period can differ from that reported in the consolidated statement of comprehensive income due to certain items which are not tax deductible or which are deferred to subsequent periods.

Deferred tax is recognised on all temporary differences between the assets and liabilities in the consolidated balance sheet and their tax base, except when the deferred tax liability arises from the initial recognition of goodwill. Deferred tax assets or liabilities are accounted for using the balance sheet liability method. Deferred tax assets are recognised to the extent that realising the related tax benefit through future taxable profits is likely.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

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

OWN SHARES

Own shares include shares repurchased under share repurchase authorisations and held in treasury plus shares repurchased and held in trust for the purposes of employee equity based compensation schemes. Own shares are deducted from shareholders' equity. No gain or loss is recognised on the purchase, sale, cancellation or issue of own shares and any consideration paid or received is recognised directly in equity.

RISK DISCLOSURES: INTRODUCTION

The Group is exposed to risks from several sources. These include insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk. The primary risk to the Group is insurance risk.

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

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

RISK AND RETURN COMMITTEE

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

CHIEF RISK OFFICER

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

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

Responsibility for the management of individual risks has been assigned to, and may form part of the performance objectives of, the risk owners within the business. Risk owners ensure that these risks and controls are consistent with their day-to-day processes and the entries made in the Group risk registers, which are a direct input into BLAST. The CRO provides regular reports to the business outlining the status of the Group's ERM activities and strategy, as well as formal reports to the Boards of Directors of the Group and the individual operating entities in this regard including the Risk Committee of Cathedral. The CRO ultimately has the right to report directly to the Group and entity regulators if he feels that management is not appropriately addressing areas of concern.

INTERNAL AUDIT

Internal Audit plays a key role in the Group's ERM by providing an independent opinion regarding the accuracy and completeness of risks, in addition to verification of the effectiveness of controls. Internal audit's roles and responsibilities are clearly defined through the Internal Audit Charter. The Head of Internal Audit reports directly to the Group Audit Committee. The CRO receives a copy of each internal audit report and considers the findings and agreed actions in the context of the risk appetites and tolerances, plus the risk policies and risk management strategy of each area. The integration of internal audit and ERM into the business helps facilitate the Group's protection of its assets and reputation.

ECONOMIC CAPITAL MODEL

The foundation of the Group's risk-based capital approach to decision making is its economic capital model, BLAST, which is based on the widely accepted economic capital modeling tool, ReMetrica. Management uses BLAST primarily for monitoring its insurance risks. However, BLAST is also used to monitor other risks including market, credit and operational risks.

BLAST produces data in the form of a stochastic distribution for all classes, including non-elemental classes. The distribution includes the mean outcome and the result at various return periods, including very remote events. BLAST calculates projected financial outcomes for each insurance class, as well as the overall portfolio including diversification credit. Diversification credit arises as individual risks are generally not strongly correlated and are unlikely to all produce profits or losses at the same time. BLAST also measures the Group's aggregate insurance exposures. It therefore helps senior management and the Board of Directors to determine the level of capital required to meet the combined risk from a wide range of categories. Assisted by BLAST, the Group seeks to achieve an improved risk-adjusted return over time.

BLAST is used in strategic underwriting decisions, as part of the Group's annual business planning process and to assist in portfolio optimisation, taking account of inwards business and all major reinsurance purchases. Management also utilises BLAST in assessing the impact of strategic decisions on individual classes of business that the Group writes, or is considering writing, as well as the overall resulting financial impact to the Group. BLAST output, covering all of the risk groups the Group is exposed to, is reviewed, including the anticipated loss curves, combined ratios and risk-adjusted profitability, to determine profitability and risk tolerance headroom by class.

The six primary risk categories, insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk, are discussed in detail below.

A. INSURANCE RISK

The Group underwrites worldwide, predominantly short-tail, insurance and reinsurance contracts that transfer insurance risk, including risks exposed to both natural and man-made catastrophes. The Group's exposure in connection with insurance contracts is, in the event of insured losses, whether premiums will be sufficient to cover the loss payments and expenses. Insurance and reinsurance markets are cyclical and premium rates and terms and conditions vary by line of business depending on market conditions and the stage of the cycle. Market conditions are impacted by capacity and recent loss events, and broader economic cycle impacts amongst other factors. The Group's underwriters assess likely losses using their experience and knowledge of past loss experience, industry trends and current circumstances. This allows them to estimate the premiums sufficient to meet likely losses and expenses and desired levels of profitability consistent with the Group's risk-adjusted RoE targets.

The Group considers insurance risk at an individual contract level, at a sector level, a geographic level and at an aggregate portfolio level. This ensures careful risk selection, limits on concentration and appropriate portfolio diversification are accomplished. The Group's four principal classes, or lines, are Property, Energy, Marine and Aviation. These classes, plus the Group's Lloyd's segment via the Cathedral Group, are deemed to be the Group's five operating segments. The level of insurance risk tolerance per peril is set by the Board of Directors.

A number of controls are deployed to manage the amount of insurance exposure assumed:

- the Group has a rolling three-year strategic plan that helps establish the over-riding business goals that the Board of Directors aims to achieve;
- a detailed business plan is produced annually which includes expected premiums and combined ratios by class and considers risk-adjusted profitability, capital usage and requirements. The plan is approved by the Board of Directors and is monitored, reviewed and updated on an ongoing basis;
- BLAST is used to measure occurrence risks, aggregate risks and correlations between classes and other non-insurance risks, and the outputs and assumptions are reviewed periodically by the RRC;
- each authorised class has a predetermined normal maximum line structure;
- each underwriter has a clearly defined limit of underwriting authority;
- the Group and individual operating entities have predetermined tolerances on probabilistic and deterministic losses of capital for certain single events;
- risk levels versus tolerances are monitored on a regular basis;
- a daily underwriting call is held for LICL and LUK to peer review insurance proposals, opportunities and emerging risks;
- a daily post-binding review process with exception reporting to management based on underwriting authority operates at Cathedral;
- sophisticated pricing and aggregation models are utilised in certain areas of the underwriting process, and are updated frequently;
- BLAST and other modeling tools are deployed to model catastrophes and resultant losses to the portfolio and the Group; and
- reinsurance may be purchased to mitigate both frequency and severity of losses on a treaty or facultative basis and to improve risk-adjusted RoE as modeled in BLAST.

Some of the Group's business provides coverage for natural catastrophes (e.g. hurricanes, earthquakes and floods) and is subject to potential seasonal variation. A proportion of the Group's business is exposed to large catastrophe losses in North America, Europe and Japan as a result of windstorms. The level of windstorm activity, and landfall thereof, during the North American, European and Japanese wind seasons may materially impact the Group's loss experience. The North American and Japanese wind seasons are typically June to November and the European wind season November to March. The Group also bears exposure to large losses arising from other non-seasonal natural catastrophes, such as earthquakes, tsunamis, droughts, floods and tornadoes, from risk losses throughout the year and from war, terrorism and political risk and other events. The Group's associates bear exposure to catastrophe losses and any significant loss event could potentially result in impairment in the value of the Group's investment in associates.

The Group's exposures to certain peak zone elemental losses, as a percentage of tangible capital, including long-term debt, are shown below. Net loss estimates are before income tax and net of reinstatement premiums and outwards reinsurance. The exposure to catastrophe losses that would result in an impairment in the investment in associates is included in the figures below.

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

(1) Landing hurricane from Florida to Texas.

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

(1) Landing hurricane from Florida to Texas.

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

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

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

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

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

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

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

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

I. PROPERTY

Gross premiums written, for the year:

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

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

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

Terrorism business can be written either ground-up or for primary or excess layers, with cover provided for U.S. and worldwide property risks, but typically excluding nuclear, chemical and biological coverage in most territories. Cover is generally provided to medium to large commercial and industrial enterprises. Policies are typically written for scheduled locations and exposure is controlled by setting limits on aggregate exposure within a 'blast zone' radius. The term of these contracts is often multi-year reflecting the term of the underlying exposures. Some national pools are also written, which may include nuclear, chemical and biological coverage.

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

A small number of property direct and facultative risks continue to be written with modest lines mostly to support client relationships in other classes of business. Cover is generally provided to medium to large commercial and industrial enterprises with high-value locations for non-elemental perils, including fire and explosion, and elemental (natural catastrophe) perils which can include flood, windstorm, earthquake, brush fire, tsunami and tornado.

The Group is exposed to large natural catastrophe losses, such as windstorm and earthquake loss, primarily from assuming property catastrophe excess of loss and property retrocession portfolio risks. Exposure to such events is controlled and measured by setting limits on aggregate exposures in certain classes per geographic zone and through loss modeling. The accuracy of the latter exposure analysis is limited by the quality of data and the effectiveness of the modeling. It is possible that a catastrophic event significantly exceeds the expected modeled event loss. The Group's appetite and exposure guidelines for large losses are set out on pages 110 and 111.

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

II. ENERGY

Gross premiums written, for the year:

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

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

Gulf of Mexico offshore energy programmes cover elemental and non-elemental risks. Most policies have sub-limits on coverage for elemental losses. These programmes are exposed to Gulf of Mexico windstorms. Exposure to such events is controlled and measured through loss modeling. The accuracy of this exposure analysis is limited by the quality of data and the effectiveness of the modeling. It is possible that a catastrophic event significantly exceeds the expected modeled event loss. The Group's appetite and exposure guidelines to large losses are set out on pages 110 and 111.

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

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

Reinsurance protection may be purchased to protect a portion of loss from elemental and non-elemental energy claims, and from the accumulation of smaller, attritional losses. Reinsurance is typically purchased on an excess of loss basis but, from time to time, quota share arrangements may be entered into. Reinsurance may be purchased on a facultative or treaty basis.

III. MARINE

Gross premiums written, for the year:

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

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

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

Reinsurance may be purchased to reduce the Group's exposure to both large risk losses and an accumulation of smaller, attritional losses. Reinsurance is typically purchased on a treaty excess of loss basis.

IV. AVIATION

Gross premiums written, for the year:

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

AV52 is written on a risk attaching excess of loss basis and provides coverage for third-party liability, excluding own passenger liability, resulting from acts of war or hijack of aircraft. Cover excludes U.S. commercial airlines and certain other countries whose governments provide a backstop coverage.

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

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

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

V. LLOYD'S

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

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

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

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

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

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

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

Reinsurance may be purchased to reduce the Group's exposure to both large risk losses and an accumulation of smaller, attritional losses. Reinsurance is typically purchased on an excess of loss basis but, from time to time, quota share arrangements may be entered into. Reinsurance may be purchased on a facultative or treaty basis.

REINSURANCE

The Group, in the normal course of business and in accordance with its risk management practices, seeks to reduce certain types of loss that may arise from events that could cause unfavourable underwriting results, and to improve the modeled risk-adjusted RoE by entering into reinsurance arrangements. Reinsurance does not relieve the Group of its obligations to policyholders. Under the Group's reinsurance security policy, reinsurers are assessed and approved as appropriate security based on their financial strength ratings, amongst other factors. The RRC has defined limits by reinsurer by rating. The RRC considers reinsurers that are not rated or do not fall within the predefined rating categories on a case-by-case basis, and would usually require collateral to be posted to support such obligations. There are specific guidelines for these collateralised contracts. The RRC monitors the creditworthiness of its reinsurers on an ongoing basis and formally reviews the Group's reinsurance arrangements at least quarterly.

Reinsurance protection is typically purchased on an excess of loss basis, however it may also include ILW covers or quota share arrangements, such as with ARL. The mix of reinsurance cover is dependent on the specific loss mitigation requirements, market conditions and available capacity. Reinsurance may also be purchased to optimise the risk-adjusted return of the underwriting portfolio. The structure varies between types of peril and sub-class. The Group regularly reviews its catastrophe exposures and may purchase reinsurance in order to reduce the Group's net exposure to a large natural catastrophe loss and/or to reduce net exposures to other large losses. The Group can purchase both facultative and treaty reinsurance. There is no guarantee that reinsurance coverage will be available to meet all potential loss circumstances, as it is possible that the cover purchased is not sufficient to transfer the totality of the Group's exposure. Any loss amount which exceeds the programme would be retained by the Group. Some parts of the reinsurance programme have limited reinstatements, therefore the number of claims which may be recovered from second or subsequent losses in those particular circumstances is limited.

INSURANCE LIABILITIES

For most insurance and reinsurance companies, the most significant judgement made by management is the estimation of loss and loss adjustment expense reserves. The estimation of the ultimate liability arising from claims made under insurance and reinsurance contracts is a critical estimate for the Group particularly given the nature of the business written.

Under generally accepted accounting principles, loss reserves are not permitted until the occurrence of an event which may give rise to a claim. As a result, only loss reserves applicable to losses incurred up to the reporting date are established, with no allowance for the provision of a contingency reserve to account for expected future losses or for the emergence of new types of latent claims. Claims arising from future events can be expected to require the establishment of substantial reserves from time to time. All reserves are reported on an undiscounted basis.

Loss and loss adjustment expense reserves are maintained to cover the Group's estimated liability for both reported and unreported claims. Reserving methodologies that calculate a point estimate for the ultimate losses are utilised, and then a range is developed around these point estimates. The point estimate represents management's best estimate of ultimate loss and loss adjustment expenses. The Group's internal actuaries review the reserving assumptions and methodologies on a quarterly basis with loss estimates being subject to a semi-annual corroborative review by independent actuaries, using U.S. generally accepted actuarial principles. This independent review is presented to the Group's Audit Committee. The Group has also established Reserve Committees at the operating entity level, which have responsibility for the review of large claims and IBNR levels, their development and any changes in reserving methodology and assumptions.

The extent of reliance on management's judgement in the reserving process differs as to whether the business is insurance or reinsurance, whether it is short-tail or long-tail and whether the business is written on an excess of loss or on a pro-rata basis. Over a typical annual period, the Group expects to write the large majority of programmes on a direct excess of loss basis. The Group does not currently write a significant amount of long-tail business.

INSURANCE VERSUS REINSURANCE

Loss reserve calculations for direct insurance business are not precise in that they deal with the inherent uncertainty of assumptions regarding future reporting and development patterns, frequency and severity trends, claims settlement practices, potential changes in the legal environment and other factors, such as inflation. These estimates and judgements are based on numerous factors and may be revised as additional experience or other data becomes available or reviewed as new or improved methodologies are developed or as current laws or regulations change.

Furthermore, as a broker market reinsurer, management must rely on loss information reported to brokers by other insurers and their loss adjusters who must estimate their own losses at the policy level, often based on incomplete and changing information. The information management receives varies by cedant and may include paid losses, estimated case reserves and an estimated provision for IBNR reserves. Additionally, reserving practices and the quality of data reporting may vary among ceding companies which adds further uncertainty to the estimation of the ultimate losses.

SHORT-TAIL VERSUS LONG-TAIL

In general, claims relating to short-tail risks, such as the majority of risks underwritten by the Group, are reported more promptly than those relating to long-tail risks, including the majority of casualty risks. However, the timeliness of reporting can be affected by such factors as the nature of the event causing the loss, the location of the loss, and whether the losses are from policies in force with insureds, primary insurers, reinsurers or vendor binding authorities.

EXCESS OF LOSS VERSUS PROPORTIONAL

For excess of loss contracts, which make up the majority of the Group's business, management are aided by the fact that each policy has a defined limit of liability arising from one event. Once that limit has been reached, there is no further exposure to additional losses from that policy for the same event. For proportional business, an initial estimated loss and loss expense ratio is generally used. This is based upon information provided by the insured or ceding company and/or their broker and management's historical experience of that treaty, if any, and the estimate is adjusted as actual experience becomes known.

TIME LAGS

There is a time lag inherent in reporting from the original claimant to the primary insurer or binding authority holder to the broker and then to the reinsurer. Also, the combination of low claims frequency and high severity makes the available data more volatile and less useful for predicting ultimate losses. In the case of proportional contracts, reliance is placed on an analysis of a contract's historical experience, industry information, and the professional judgement of underwriters in estimating reserves for these contracts. In addition, if available, reliance is placed partially on ultimate loss ratio forecasts as reported by insureds or cedants, which are normally subject to a quarterly or six-month lag.

UNCERTAINTY

As a result of the time lag described above, an estimation must be made of IBNR reserves, which consist of a provision for additional development in excess of the case reserves reported by insureds or ceding companies, as well as a provision for claims which have occurred but which have not yet been reported by insureds or ceding companies. Due to the degree of reliance that is necessarily placed on insureds or ceding companies for claims reporting, the associated time lag, the low frequency/high severity nature of much of the business that the Group underwrites, and the varying reserving practices among ceding companies, reserve estimates are highly dependent on management judgement and are therefore uncertain. During the loss settlement period, which may be years in duration, additional facts regarding individual claims and trends often will become known, and current laws and case law may change as well as regulatory directives, with a consequent impact on reserving. The claims count on the types of insurance and reinsurance that the Group writes, which are low frequency and high severity in nature, is generally low.

For certain catastrophic events there are greater uncertainties underlying the assumptions and associated estimated reserves for losses and loss adjustment expenses. Complexity resulting from problems such as policy coverage issues, multiple events affecting one geographic area and the resulting impact on claims adjusting (including the allocation of claims to the specific event and the effect of demand surge on the cost of building materials and labour) by, and communications from, insureds or ceding companies, can cause delays to the timing with which the Group is notified of changes to loss estimates.

As at 31 December 2013 management's estimates for IBNR represented 31.8 per cent of total net loss reserves (2012 – 28.1 per cent). The majority of the estimate relates to potential claims on non-elemental risks where timing delays in insured or cedant reporting may mean losses could have occurred which the Group was not made aware of by the balance sheet date.

B. MARKET RISK

The Group is at risk of loss due to movements in market factors. The main risks include:

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

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

I. INSURANCE RISK

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

- the advent or continuation of a soft market, which may result in a stabilisation or decline in premium rates and/or terms and conditions for certain lines, or across all lines;
- the actions and reactions of key competitors, which may directly result in volatility in premium volumes and rates, fee levels and other input costs;
- market events which may cause a limit in the availability of cover, including unusual inflation in rates, causing political intervention or national remedies;
- failure to maintain broker, binding authority and client relationships, leading to a limited or substandard choice of risks inconsistent with the Group's risk appetite; and
- changes in regulation including capital, governance or licensing requirements.

The most important method to mitigate insurance market risk is to maintain strict underwriting standards. The Group manages insurance market risk in numerous ways, including the following:

- reviews and amends underwriting plans and outlook as necessary;
- reduces exposure to market sectors where conditions have reached unattractive levels;
- purchases appropriate, cost-effective reinsurance cover to mitigate exposure;
- closely monitors changes in rates and terms and conditions;
- holds a daily underwriting meeting for LICL and LUK to discuss, inter alia, market conditions and opportunities;
- reviews all new and renewal business post-underwriting for Cathedral;
- regularly reviews output from BLAST to assess up-to-date profitability of classes and sectors;
- holds a quarterly Underwriting and Underwriting Risk Committee meeting to review underwriting strategy;
- holds a fortnightly RRC meeting to monitor estimated exposures to peak zone elemental losses and RDS; and
- holds regular documented meetings with regulators.

Insurance contract liabilities are not directly sensitive to the level of market interest rates, as they are undiscounted and contractually non-interest bearing.

II. INVESTMENT RISK

Movements in investments resulting from changes in interest and inflation rates and currency exchange rates, amongst other factors, may lead to an adverse impact on the value of the Group's investment portfolio. Investment guidelines are established by the Investment Committee of the Board of Directors to manage this risk. Investment guidelines set parameters within which the Group's external investment managers must operate. Important parameters include guidelines on permissible assets, duration ranges, credit quality, currency, maturity, sectors, geographical, sovereign and issuer exposures. Compliance with guidelines is monitored on a monthly basis. Any adjustments to the investment guidelines are approved by the IRRC and the Board of Directors.

The Group's fixed income portfolios are managed by five external investment managers. The Group also has a small equity portfolio. The performance of the managers is monitored on an ongoing basis.

Within the Group guidelines is a subset of guidelines for the portion of funds required to meet near-term obligations and cash flow needs following an extreme event. The subset of guidelines adds a further degree of requirements, including fewer allowable asset classes, higher credit quality, shorter duration and higher liquidity. The primary objectives for this portion of assets are capital preservation and providing liquidity to meet insurance and other near-term obligations. In addition to cash managed internally, funds held in the investment portfolio to cover this potential liability are designated as the 'core' portfolio and the portfolio duration is matched to the duration of the insurance liabilities, within an agreed range. The core portfolio is invested in fixed income securities, fixed income funds and cash and cash equivalents. The core portfolio may, at times, contain assets significantly in excess of those required to meet insurance liabilities or other defined funding needs.

Assets in excess of those required to be held in the core portfolio are typically held in the 'core plus' or 'surplus' portfolios. The core plus portfolio is invested in fixed income securities and cash and cash equivalents. The surplus portfolio is invested in fixed income securities, principal protected equity linked notes, derivative instruments, cash and cash equivalents and equity securities. The assets in the core plus and surplus portfolios are not matched to specific insurance liabilities. In general, the duration of the surplus portfolio is slightly longer than the core or core plus portfolio, while maintaining a focus on high quality assets.

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

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

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

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

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

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

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

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

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

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

As at 31 December	2013 $m	2013 %	2012 $m	2012 %
Industrial	**452.8**	**53.9**	379.9	53.0
Financial	**336.5**	**40.1**	297.9	41.5
Utility	**42.8**	**5.1**	37.8	5.3
Supranationals	**7.2**	**0.9**	1.4	0.2
Total	**839.3**	**100.0**	717.0	100.0

The Group's net asset value is directly impacted by movements in the value of investments held. Values can be impacted by movements in interest rates, credit ratings, exchange rates and economic environment and outlook.

The Group's investment portfolio is mainly comprised of fixed income securities and cash and cash equivalents. The fixed income funds are overseas deposits held by Syndicate 2010 and Syndicate 3010 in trust for the benefit of the policyholders in those overseas jurisdictions. They consist of high quality, short duration fixed income securities. The Group also has a small equity portfolio. The estimated fair value of the Group's fixed income portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's fixed income securities would tend to rise and vice versa.

The sensitivity of the price of fixed income securities, and certain derivatives, to movements in interest rates is indicated by their duration. The greater a security's duration, the greater its price volatility to movements in interest rates. The sensitivity of the Group's fixed income and derivative investment portfolio to interest rate movements is detailed below, assuming linear movements in interest rates:

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

The Group mitigates interest rate risk on the investment portfolio by establishing and monitoring duration ranges in its investment guidelines. The Group may manage duration through the use of interest rate futures and swaptions from time to time. The duration of the core portfolio is matched to the modeled duration of the insurance reserves, within a permitted range. The permitted duration range for the core plus portfolio is between zero and four years and the surplus portfolio is between one and five years.

The durations of the externally managed portfolios are as follows:

As at 31 December	2013 years	2012 years
Core portfolio	**1.2**	1.5
Core plus portfolio	**1.2**	1.5
Surplus portfolio	**1.9**	2.4
Overall portfolio	**1.1**	1.9

The overall duration for fixed income, managed cash and cash equivalents and certain derivatives is 1.0 years (2012 – 1.8 years).

In addition to duration management, the Group uses VaR on a monthly basis to measure potential losses in the estimated fair values of its cash and invested assets and to understand and monitor risk. The VaR calculation is performed using variance/covariance risk modeling to capture the cash flows and embedded optionality of the portfolio. Securities are valued individually using market standard pricing models. These security valuations serve as the input to many risk analytics, including full valuation risk analyses, as well as parametric methods that rely on option adjusted risk sensitivities to approximate the risk and return profiles of the portfolio.

The principal VaR measure that is produced is an annual VaR at the 99th percentile confidence level. The annual VaR, at the 99th percentile confidence level, measures the minimum amount the assets should be expected to lose over a one year time horizon, under normal conditions, 1 per cent of the time. The current VaR tolerance is 8.0 per cent of shareholders' equity, plus the coupon on the investment portfolio, using the annual VaR at the 99th percentile confidence level.

The Group's annual VaR calculations are as follows:

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

DERIVATIVE FINANCIAL INSTRUMENTS

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

The Group currently invests in the following derivative financial instruments:

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

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

As at 31 December 2013	**Net other investment income $m**	**Net realised gains (losses) $m**	**Net foreign exchange gains (losses) $m**	**Financing costs $m**
Eurodollar futures	**–**	**0.3**	**–**	**–**
Treasury futures	**–**	**4.8**	**–**	**–**
Forward foreign currency contracts	**–**	**–**	**12.0**	**–**
Interest rate swaps – investments	**(0.1)**	**(0.3)**	**–**	**–**
Interest rate swaps – debt	**–**	**–**	**–**	**5.2**
Credit default swaps	**(0.3)**	**0.2**	**–**	**–**
Swaptions	**2.2**	**–**	**–**	**–**
Total	**1.8**	**5.0**	**12.0**	**5.2**

As at 31 December 2012	Net other investment income $m	Net realised gains (losses) $m	Net foreign exchange gains (losses) $m	Financing costs $m
Eurodollar futures	–	0.2	–	–
Treasury futures	–	(1.7)	–	–
Forward foreign currency contracts	–	–	(2.8)	–
Interest rate swaps – investments	0.2	–	–	–
Interest rate swaps – debt	–	–	–	(4.1)
Credit default swaps	0.5	(0.1)	–	–
Total	0.7	(1.6)	(2.8)	(4.1)

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

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

A. TBAS

The TBA market is essentially a forward or delayed delivery market for mortgage backed securities issued by U.S. government agencies, where securities of a specific term and interest rate are bought or sold for future settlement on a 'to be announced' basis. TBAs are generally physically settled and classified as available for sale fixed income securities. Occasionally TBAs may be traded for net settlement. Such instruments are deemed to be derivative instruments. All TBAs classified as derivatives are held on a non-leveraged basis. The credit exposure is restricted to the differential between the settlement value of the forward purchase and the forward sale. The creditworthiness of the counterparty is monitored and collateral may be required on open positions.

The Group did not hold any TBA positions as at 31 December 2013 and 2012.

B. FUTURES

The Group's investment guidelines permit the use of futures which provide the Group with participation in market movements, determined by the underlying instrument on which the futures contract is based, without holding the instrument itself or the individual securities. This approach allows the Group more efficient and less costly access to the exposure than would be available by the exclusive use of individual fixed income and money market securities. Exchange-traded futures contracts may also be used as substitutes for ownership of the physical securities.

All futures contracts are held on a non-leveraged basis. An initial margin is provided, which is a deposit of cash and/or securities in an amount equal to a prescribed percentage of the contract value. The fair value of futures contracts is estimated daily and the margin is adjusted accordingly with unrealised gains and/or losses settled daily in cash and/or securities. A realised gain or loss is recognised when the contract is closed.

Futures contracts expose the Group to market risk to the extent that adverse changes occur in the estimated fair values of the underlying securities. Exchange-traded futures are, however, subject to a number of safeguards to ensure that obligations are met. These include the use of clearing houses (thus reducing counterparty credit risk), the posting of margins and the daily settlement of unrealised gains and losses. The amount of credit risk is therefore considered low. The investment guidelines restrict the maximum notional futures position as a percentage of the investment portfolio's estimated fair value.

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

A Eurodollar futures contract is an exposure to 3 month LIBOR, based on a commitment to a $1.0 million deposit. The estimated fair value is based on expectations of 3 month LIBOR, is determined using exchange-traded prices and was negligible as at 31 December 2013 and 2012. The contracts currently held by the Group will expire in 2014 and 2015.

The sensitivity of the Group's Eurodollar futures position to interest rate movements is not material as at 31 December 2013 and 2012.

C. OPTIONS

The Group's investment guidelines permit the use of exchange-traded options on U.S. treasury futures and Eurodollar futures, which are used to manage exposure to interest rate risk and also to hedge duration. Exchange-traded options are held on a similar basis to futures and are subject to similar safeguards. Options are contractual arrangements that give the purchaser the right, but not the obligation, to either buy or sell an instrument at a specific set price at a predetermined future date. The Group may enter into option contracts that are secured by holdings in the underlying securities or by other means which permit immediate satisfaction of the Group's obligations.
The notional amount of options is not material as at 31 December 2013 and 2012.

The investment guidelines also restrict the maximum notional options exposure as a percentage of the investment portfolio's estimated fair value.

D. FORWARD FOREIGN CURRENCY CONTRACTS

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

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

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

The Group has the following open forward foreign currency contracts:

	2013			2012		
As at 31 December	**Notional long $m**	**Notional short $m**	**Net notional long (short) $m**	Notional long $m	Notional short $m	Net notional long (short) $m
Australian Dollar	**10.5**	**28.5**	**(18.0)**	–	12.5	(12.5)
British Pound	**–**	**9.4**	**(9.4)**	0.1	3.9	(3.8)
Brazilian Real	**3.9**	**6.6**	**(2.7)**	–	3.3	(3.3)
Chinese Renminbi	**0.3**	**0.3**	**–**	3.4	3.4	–
Canadian Dollar	**0.5**	**–**	**0.5**	0.3	22.2	(21.9)
Malaysian Ringgit	**3.9**	**–**	**3.9**	–	–	–
Euro	**52.6**	**24.5**	**28.1**	1.9	19.1	(17.2)
Other(1)	**0.3**	**0.3**	**–**	–	0.3	(0.3)
Total	**72.0**	**69.6**	**2.4**	5.7	64.7	(59.0)

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

E. SWAPS

The Group's investment guidelines permit the use of interest rate swaps and credit default swaps which are primarily traded OTC. Swaps are recorded at estimated fair value at the end of each period with unrealised gains and losses recorded in the consolidated statement of comprehensive income.

Interest rate swaps are used to manage interest rate exposure, portfolio duration or capitalise on anticipated changes in interest rate volatility without investing directly in the underlying securities. Interest rate swap agreements entail the exchange of commitments to pay or receive interest, such as an exchange of floating rate payments for fixed rate payments, with respect to a notional amount of principal. These agreements involve elements of credit and market risk. Such risks include the possibility that there may not be a liquid market, that the counterparty may default on its obligation to perform, or that there may be unfavourable movements in interest rates. These risks are mitigated through defining a minimum counterparty credit quality and a maximum notional exposure to interest rate swaps as a percentage of the investment portfolio's estimated fair value. The notional amount of interest rate swaps held in the investment portfolio is not material as at 31 December 2013 and 2012. The notional amount of interest rate swaps held internally for the purposes of hedging the interest rate exposure on the Group's subordinated loan notes as at 31 December 2013 is $259.8 million (31 December 2012 – $128.7 million)

The Group uses credit default swaps as a way to add or reduce credit risk to an individual issuer, or a basket of issuers, without investing directly in their securities. As at 31 December 2013, the maximum amount of loss the Group could incur on its open credit default swaps was the notional value of $4.1 million (2012 – $11.5 million).

F. SWAPTIONS
The Group uses swaptions, options on interest rate swaps, to manage interest rate risk exposure and portfolio and yield curve duration. The Group, as the purchaser of a swaption, is subject to the credit risk of the counterparty but is only subject to market risk to the extent of the premium paid. As a swaption writer, the Group is not subject to credit risk but is subject to market risk, due to its obligation to make payments under the terms of the contract. These risks are mitigated through maximum allowable notional exposures as a percentage of the investment portfolio's estimated fair value. To reduce the impact of a significant increase in interest rates, swaptions with a gross notional value of $2.0 billion are held in the investment portfolio as at 31 December 2013. The estimated fair value of these instruments is $4.9 million as at 31 December 2013 (31 December 2012 – $nil). These instruments reduce the duration of the investment portfolio by 0.3 years as at 31 December 2013.

III. DEBT RISK
The Group has issued long-term debt as described in note 22. The LHL issued subordinated loan notes due in 2035 bear interest at a floating rate that is reset on a quarterly basis, plus a fixed margin of 3.70 per cent. The Group is subject to interest rate risk on the coupon payments of these subordinated loan notes. The Group has mitigated the interest rate risk by entering into interest rate swap contracts as follows:

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

The interest rate swaps expire on 15 December 2020, therefore the Group currently has no interest rate risk on the LHL issued subordinated loan notes due in 2035.

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

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

IV. CURRENCY RISK
The Group underwrites from two locations, Bermuda and London, although risks are assumed on a worldwide basis. Risks assumed are predominantly denominated in U.S. dollars.

The Group is exposed to currency risk to the extent its assets are denominated in different currencies to its liabilities. The Group is also exposed to non-retranslation risk on non-monetary assets such as unearned premiums and deferred acquisition costs. Exchange gains and losses can impact income.

The Group hedges non-U.S. dollar liabilities primarily with non-U.S. dollar assets, but may also use derivatives to mitigate foreign currency exposures. The Group's main foreign currency exposure relates to its insurance obligations, cash holdings, investments, premiums receivable, dividends payable and the euro denominated subordinated loan notes long-term debt liabilities discussed in note 22. The Group also has a small exposure to foreign currencies through its EMD investment portfolio. These positions may not be hedged depending on the currency outlook. See page 124 for a listing of the Group's open forward foreign currency contracts.

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

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

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

Assets	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Cash and cash equivalents	123.4	8.9	93.7	59.0	10.8	295.8
Accrued interest receivable	9.2	–	0.1	–	–	9.3
Fixed income securities – available for sale	1,813.6	3.8	17.0	–	40.1	1,874.5
Other investments	0.1	–	–	–	–	0.1
Reinsurance assets	87.8	–	–	1.2	–	89.0
Deferred acquisition costs	53.2	1.2	6.7	1.3	5.6	68.0
Other receivables	2.5	0.2	–	–	–	2.7
Inwards premiums receivable from insureds and cedants	168.3	2.4	20.4	2.9	13.0	207.0
Corporation tax receivable	–	0.4	–	–	–	0.4
Deferred tax asset	–	7.3	–	–	–	7.3
Investment in associate	82.1	–	–	–	–	82.1
Property, plant and equipment	1.7	1.1	–	–	–	2.8
Total assets as at 31 December 2012	2,341.9	25.3	137.9	64.4	69.5	2,639.0

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

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

The 31 December 2013 losses and loss adjustment expenses include the equivalent of $57.2 million (2012 – $55.4 million) of Japanese Yen denominated insurance liabilities that are contained within the Group's outwards reinsurance programme which limits the Group's net liability to $30.0 million. The Group has therefore not hedged the foreign currency exposure in relation to these losses.

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

C. LIQUIDITY RISK

Liquidity risk is the risk that cash may not be available to pay obligations when they are due without incurring an unreasonable cost. The Group's main exposures to liquidity risk are with respect to its insurance and investment activities. The Group is exposed if proceeds from financial assets are not sufficient to fund obligations arising from its insurance contracts. The Group can be exposed to daily calls on its available investment assets, principally from insurance claims.

Exposures in relation to insurance activities are as follows:

- large catastrophic events, or multiple medium-sized events in quick succession, resulting in a requirement to pay a large value of claims within a relatively short time frame;
- failure of insureds or cedants to meet their contractual obligations with respect to the payment of premiums in a timely manner; and
- failure of reinsurers to meet their contractual obligations with respect to the payment of claims in a timely manner.

Exposures in relation to investment activities are as follows:

- adverse market movements and/or a duration mismatch to obligations, resulting in investments being disposed of at a significant realised loss; and
- an inability to liquidate investments due to market conditions.

The maturity dates of the Group's fixed income portfolio are as follows:

As at 31 December 2013	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	265.9	153.2	56.7	475.8
Between one and two years	162.2	68.7	101.5	332.4
Between two and three years	123.4	30.2	57.6	211.2
Between three and four years	30.7	34.3	153.5	218.5
Between four and five years	15.1	23.2	54.3	92.6
Over five years	3.6	13.2	194.1	210.9
Asset backed and mortgage backed securities	118.4	116.4	219.5	454.3
Total fixed income securities	**719.3**	**439.2**	**837.2**	**1,995.7**

As at 31 December 2012	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	89.7	174.6	47.4	311.7
Between one and two years	98.5	127.9	80.1	306.5
Between two and three years	39.7	44.6	59.2	143.5
Between three and four years	10.0	24.1	66.5	100.6
Between four and five years	36.6	55.5	185.4	277.5
Over five years	6.3	16.7	195.0	218.0
Asset backed and mortgage backed securities	69.1	168.5	279.1	516.7
Total fixed income securities	349.9	611.9	912.7	1,874.5

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

		Years until liability becomes due – undiscounted values				
As at 31 December 2013	**Balance sheet $m**	**Less than one $m**	**One to three $m**	**Three to five $m**	**Over five $m**	**Total $m**
Losses and loss adjustment expenses	**853.4**	**381.2**	**312.4**	**96.7**	**63.1**	**853.4**
Insurance contracts – other payables	**28.9**	**26.6**	**1.5**	**0.8**	**–**	**28.9**
Amounts payable to reinsurers	**30.9**	**30.9**	**–**	**–**	**–**	**30.9**
Other payables	**80.7**	**80.7**	**–**	**–**	**–**	**80.7**
Interest rate swap	**0.2**	**2.5**	**3.5**	**(1.2)**	**(4.6)**	**0.2**
Long-term debt	**332.3**	**13.3**	**34.0**	**41.8**	**629.7**	**718.8**
Total	**1,326.4**	**535.2**	**351.4**	**138.1**	**688.2**	**1,712.9**

		Years until liability becomes due – undiscounted values				
As at 31 December 2012	Balance sheet $m	Less than one $m	One to three $m	Three to five $m	Over five $m	Total $m
Losses and loss adjustment expenses	537.4	243.0	193.1	59.7	41.6	537.4
Insurance contracts – other payables	23.5	18.2	4.8	0.5	–	23.5
Amounts payable to reinsurers	30.6	30.6	–	–	–	30.6
Other payables	49.3	49.3	–	–	–	49.3
Interest rate swap	8.0	2.6	4.6	0.8	–	8.0
Long-term debt	258.7	10.6	25.1	25.1	383.5	444.3
Total	907.5	354.3	227.6	86.1	425.1	1,093.1

Actual maturities of the above may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. The prepayment options for the Group's long-term debt are discussed in note 22. While the estimation of the ultimate liability for losses and loss adjustment expenses is complex and incorporates a significant amount of judgement, the timing of payment of losses and loss adjustment expenses is also uncertain and cannot be predicted as simply as for other financial liabilities. Actuarial and statistical techniques, past experience and management's judgement have been used to determine a likely settlement pattern.

The Group manages its liquidity risks via its investment strategy to hold high quality, highly liquid securities, sufficient to meet its insurance liabilities and other near-term liquidity requirements. The creation of the core portfolio with its subset of guidelines aims to ensure funds are readily available to meet potential insurance liabilities in an extreme event plus other near-term liquidity requirements. In addition, the Group has established asset allocation and maturity parameters within the investment guidelines such that the majority of the investments are in high quality assets which could be converted into cash promptly and at minimal expense. The Group monitors market changes and outlooks and reallocates assets as deemed necessary.

D. CREDIT RISK

Credit risk is the risk that a counterparty may fail to pay, or repay, a debt or obligation. The Group is exposed to credit risk on its fixed income investment portfolio and derivative instruments, its inwards premiums receivable from insureds and cedants, and on any amounts recoverable from reinsurers.

Credit risk on the fixed income portfolio is mitigated through the Group's policy to invest in instruments of high credit quality issuers and to limit the amounts of credit exposure with respect to particular ratings categories and any one issuer. Securities rated below an S&P or equivalent rating of BBB-/Baa3 may comprise no more than 10.0 per cent of shareholders' equity. In addition, no one issuer, with the exception of U.S. government and agency securities, other G10 government guaranteed securities (excluding Italy) and Australian sovereign debt, should exceed 5.0 per cent of shareholders' equity. The Group is therefore not exposed to any significant credit concentration risk on its investment portfolio, except for fixed income securities issued by the U.S. government and government agencies and other highly rated governments.

Credit risk on exchange-traded derivative instruments is mitigated by the use of exchange-traded instruments which use clearing houses to reduce counterparty credit risk, require the posting of margins and settle unrealised gains and losses daily. Credit risk on OTC derivatives is mitigated by monitoring the creditworthiness of the counterparties and by requiring collateral to be posted for positions which have accrued gains by amounts exceeding predetermined thresholds.

Credit risk on inwards premiums receivable from insureds and cedants is managed by conducting business with reputable broking organisations, with whom the Group has established relationships, and by rigorous cash collection procedures. The Group also has a broker approval process in place. Binding authorities are subject to standard market controls including credit control. Credit risk from reinsurance recoverables is primarily managed by the review and approval of reinsurer security by the RRC, as discussed on page 108. Reinsurance recoverables from ARL are fully collateralised by $175.0 million of funds consisting of cash and cash equivalents and fixed income securities which are of high quality and short duration.

The table below presents an analysis of the Group's major exposures to counterparty credit risk, based on their rating. The table includes amounts due from policyholders and unsettled investment trades. The quality of these receivables is not graded but, based on management's historical experience, there is limited default risk associated with these amounts.

As at 31 December 2013	Other investments $m	Cash and fixed income securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	–	**568.8**	–	–
AA+, AA, AA-	–	**865.9**	–	–
A+, A, A-	**4.9**	**665.8**	**97.0**	**148.1**
BBB+, BBB, BBB-	**(0.2)**	**186.8**	–	**0.3**
Other(1)	–	**111.4**	**220.9**	**34.6**
Total	**4.7**	**2,398.7**	**317.9**	**183.0**

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

As at 31 December 2012	Other investments $m	Cash and fixed income securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	–	425.5	–	–
AA+, AA, AA-	–	901.7	–	–
A+, A, A-	–	579.2	4.5	55.3
BBB+, BBB, BBB-	0.1	189.0	–	–
Other(1)	–	74.9	209.7	17.7
Total	0.1	2,170.3	214.2	73.0

(1) Reinsurance recoveries in the amount of $17.7 million classified as "other" are fully collateralised with ARL.

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

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

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

Provisions of $0.2 million (2012 – $0.5 million) have been made for impaired or irrecoverable balances and $0.3 million (2012 – $0.8 million) was released from the consolidated statement of comprehensive income in respect of bad debts. No provisions have been made against balances recoverable from reinsurers.

E. OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes or systems. The Group and its subsidiaries have identified and evaluated their key operational risks and these are incorporated in the risk registers and modeled directly within BLAST. The Group has also established, and monitors compliance with, internal operational risk tolerances. The RRC reviews operational risk on a quarterly basis.

In order to manage operational risks, the Group has implemented a robust governance framework. Policies and procedures are documented and identify the key risks and controls within processes. The Group's internal audit function provides independent feedback with regard to the accuracy and completeness of key risks and controls, and independently verifies the effective operation of these through substantive testing. All higher risk areas are subject to an annual audit while compliance with tax operating guidelines is audited quarterly. Frequency of audits for all other areas varies from quarterly at the most frequent to a minimum of once every three years, on a rotational basis. The internal audit plan for 2014 will be modified to incorporate the higher risk areas within Cathedral's operations.

F. STRATEGIC RISK

The Group has identified several strategic risks. These include:

- the risks that either the poor execution of the business plan or an inappropriate business plan in itself results in a strategy that fails to adequately reflect the trading environment, resulting in an inability to optimise performance, including reputational risk. The acquisition of Cathedral adds further risk to the execution and appropriateness of the Group's business plan;
- the Group has also identified risks of the failure to maintain adequate capital, accessing capital at an inflated cost or the inability to access capital. This includes unanticipated changes in vendor, regulatory and/or rating agency models that could result in an increase in capital requirements or a change in the type of capital required. It also includes the failure by the Group to integrate Cathedral's operations effectively or the failure to maximise earnings and capital efficiency from the acquisition; and
- the Group has identified succession planning, staff retention and key man risks as strategic risks. With the acquisition of Cathedral and the importance of their underwriting team's business relationships and knowledge of their book of business, retention of key personnel at Cathedral is now included in strategic risks.

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

I. BUSINESS PLAN RISKS

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

- an iterative annual forward-looking business planning process with cross departmental involvement , including the Cathedral team;
- regular integration and business development meetings with the Cathedral management and underwriting teams;
- evaluation of and approval of the annual business plan by the Board of Directors;
- regular monitoring of actual versus planned results;
- periodic review and re-forecasting as market conditions change; and
- feedback to senior management via the daily UMCC and fortnightly Cathedral integration meetings.

II. CAPITAL MANAGEMENT RISK

The total capital of the Group is as follows:

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

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

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

The Group reviews the level and composition of capital on an ongoing basis with a view to:

- maintaining sufficient capital for underwriting opportunities and to meet obligations to policyholders;
- maximising the risk-adjusted return to shareholders within predetermined risk tolerances;
- maintaining adequate financial strength ratings; and
- meeting internal and regulatory capital requirements.

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

Internal methods have been developed to review the profitability of classes of business and their estimated capital requirements plus the capital requirements of the combination of a wide range of other risk categories. These approaches are used by management in decision making. The acquisition of Cathedral has brought new tools and ideas to the Group to view profitability and exposures. The operating entities also conduct capital requirement assessments under internal measures and local regulatory requirements. Refer to note 29 for a discussion of the regulatory capital requirements of the Group's operating entities.

The Group's aim is to provide its shareholders with an RoE of 13.0 per cent in excess of a risk-free rate over the insurance cycle. The return is generated within a broad framework of risk parameters. The return is measured by management in terms of the IRR of the increase in FCBVS in the period adjusted for dividends accrued. This aim is a long-term goal, acknowledging that management expects both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver of this pattern. Management monitors these peaks and troughs – adjusting the Group's portfolio to make the most effective use of available capital and seeking to maximise the risk-adjusted return.

IRR achieved is as follows:

	Annual return %	Compound annual return %	Inception to date return %
31 December 2005[1]	(3.2)	n/a	(3.2)
31 December 2006	17.8	14.0	14.0
31 December 2007	31.4	22.4	50.3
31 December 2008	7.8	17.9	63.7
31 December 2009	26.5	19.8	105.8
31 December 2010	23.3	20.3	152.4
31 December 2011	13.4	19.5	191.2
31 December 2012	16.7	19.2	242.7
31 December 2013	18.9	19.2	308.0

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

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

	Annual return %	Compound annual return %	Inception to date return %
31 December 2005[1]	(3.4)	n/a	(3.4)
31 December 2006	13.0	9.2	9.2
31 December 2007	26.9	17.8	40.8
31 December 2008	6.4	14.3	52.7
31 December 2009	26.4	17.1	94.6
31 December 2010	23.2	18.2	141.1
31 December 2011	13.3	17.7	179.9
31 December 2012	16.6	17.7	231.3
31 December 2013	18.9	17.9	296.6

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

III. RETENTION RISKS

Risks associated with succession planning, staff retention and key man risks are mitigated through a combination of resource planning processes and controls, including:

- the identification of key personnel with appropriate succession plans;
- the provision of retention packages to key members of the Cathedral team;
- documented recruitment procedures, position descriptions and employment contracts; and
- resource monitoring and the provision of appropriate compensation, including equity based compensation which vests over a defined time horizon, and training schemes.

1. GENERAL INFORMATION

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

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

2. BUSINESS COMBINATIONS

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

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

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

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

2. BUSINESS COMBINATIONS CONTINUED

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

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

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

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

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

3. SEGMENTAL REPORTING

Management and the Board of Directors review the Group's business primarily by its five principal segments: Property, Energy, Marine, Aviation and Lloyd's. These segments are therefore deemed to be the Group's operating segments for the purposes of segment reporting. Further sub-classes of business are underwritten within each operating segment. The nature of these individual sub-classes is discussed further in the risk disclosures section on pages 112 to 115. Operating segment performance is measured by the net underwriting profit or loss and the combined ratio.

All amounts reported are transactions with external parties. There are no inter-segmental transactions and there are no significant insurance or reinsurance contracts that insure or reinsure risks in Bermuda, the Group's country of domicile. Results included in the Lloyd's segment are from the date of completion of the Cathedral acquisition.

REVENUE AND EXPENSE BY OPERATING SEGMENT

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

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

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

3. SEGMENTAL REPORTING CONTINUED

REVENUE AND EXPENSE BY OPERATING SEGMENT

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

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

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

4. INVESTMENT RETURN

The total investment return for the Group is as follows:

For the year ended 31 December 2013	Investment income and other investment income $m	Net realised gains (losses) and impairments $m	Net change in unrealised gains /losses $m	Total investment return excluding foreign exchange $m	Foreign exchange gains (losses) $m	Total investment return including foreign exchange $m
Fixed income securities – available for sale	**24.5**	**7.6**	**(33.8)**	**(1.7)**	**(3.1)**	**(4.8)**
Fixed income securities – at fair value through profit or loss	**(0.4)**	**–**	**–**	**(0.4)**	**–**	**(0.4)**
Equity securities – available for sale	**0.1**	**–**	**0.5**	**0.6**	**–**	**0.6**
Other investments	**1.8**	**5.0**	**–**	**6.8**	**2.6**	**9.4**
Cash and cash equivalents	**0.8**	**–**	**–**	**0.8**	**(0.1)**	**0.7**
Total investment return	**26.8**	**12.6**	**(33.3)**	**6.1**	**(0.6)**	**5.5**

For the year ended 31 December 2012	Investment income and other investment income $m	Net realised gains (losses) and impairments $m	Net change in unrealised gains /losses $m	Total investment return excluding foreign exchange $m	Foreign exchange gains (losses) $m	Total investment return including foreign exchange $m
Fixed income securities – available for sale	32.2	13.4	18.1	63.7	0.7	64.4
Other investments	0.7	(1.6)	–	(0.9)	(1.7)	(2.6)
Cash and cash equivalents	0.3	–	–	0.3	–	0.3
Total investment return	33.2	11.8	18.1	63.1	(1.0)	62.1

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

Refer to page 122 in the risk disclosures section for the estimated fair values of the Group's derivative instruments. Realised gains and losses on futures and options contracts are included in net realised gains (losses) and impairments. The net impact of TBAs is $nil for all reporting periods.

Included in investment income is $5.5 million (2012 – $4.0 million) of investment management, accounting and custodian fees.

5. NET INSURANCE ACQUISITION EXPENSES

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

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

6. RESULTS OF OPERATING ACTIVITIES

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

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

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

7. EMPLOYEE BENEFITS

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

EQUITY BASED COMPENSATION

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

RSS

On 22 December 2010, LHL's shareholders, in a Special General Meeting, voted in favour of the LHL Board's proposal to modify the existing RSS awards programme to a nil-cost options programme. The modification introduced an exercise period of ten years from the grant date for all outstanding and future RSS grants. Previously, all awards were automatically converted to shares on the vesting date.

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

The following table lists the assumptions used in the stochastic model for the RSS awards granted during the years ended 31 December 2013 and 2012:

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

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

(2) The risk-free interest rate is consistent with 3 year UK government bond yields on the date of grant.

The calculation of the equity based compensation expense assumes forfeitures due to employee turnover of 10.0 per cent per annum prior to vesting, with subsequent adjustments to reflect actual experience.

RSS – ORDINARY

The ordinary RSS options vest after a three-year period and are dependent on certain performance criteria. A maximum of 75.0 per cent of the ordinary RSS options will vest only on the achievement of an LHL RoE in excess of a required amount. A maximum of 25.0 per cent of the ordinary RSS options will vest only on the achievement of an LHL TSR in excess of the 75th percentile of the TSR of a predefined comparator group. For all RSS options issued in 2012 and earlier the performance criteria was split as 50.0 per cent relating to RoE and 50.0 per cent relating to TSR. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

	Number of employee restricted stock	Number of Non-Executive Director restricted stock	Total number of restricted stock
Outstanding as at 31 December 2011	6,228,837	–	6,228,837
Granted	1,518,767	–	1,518,767
Exercised	(2,091,161)	–	(2,091,161)
Forfeited	(180,293)	–	(180,293)
Reclassified(1)	(561,327)	561,327	–
Outstanding as at 31 December 2012	4,914,823	561,327	5,476,150
Granted	**1,236,971**	**–**	**1,236,971**
Exercised	**(1,443,649)**	**(150,975)**	**(1,594,624)**
Forfeited	**(369,810)**	**–**	**(369,810)**
Lapsed	**(17,574)**	**(1,525)**	**(19,099)**
Outstanding as at 31 December 2013	**4,320,761**	**408,827**	**4,729,588**
Exercisable as at 31 December 2013	**1,935,061**	**261,994**	**2,197,055**

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

7. EMPLOYEE BENEFITS CONTINUED

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

RSS – BONUS DEFERRAL

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

	Number of employee restricted stock	**Number of Non-Executive Director restricted stock**	**Total number of restricted stock**
Outstanding as at 31 December 2011	917,155	–	917,155
Granted	234,454	–	234,454
Exercised	(386,542)	–	(386,542)
Forfeited	(4,085)	–	(4,085)
Reclassified(1)	(103,639)	103,639	–
Outstanding as at 31 December 2012	657,343	103,639	760,982
Granted	**179,633**	**7,664**	**187,297**
Exercised	**(470,410)**	**(86,382)**	**(556,792)**
Forfeited	**(11,345)**	**–**	**(11,345)**
Outstanding as at 31 December 2013	**355,221**	**24,921**	**380,142**
Exercisable as at 31 December 2013	**62,168**	**–**	**62,168**

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

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

RSS – CATHEDRAL ACQUISITION

The Cathedral acquisition RSS options vesting periods range from three to five years and are dependent on certain performance criteria. A maximum of 75.0 per cent of the Cathedral acquisition RSS options will vest only on the achievement of a Cathedral combined ratio below a required amount. A maximum of 25.0 per cent of the Cathedral acquisition RSS options will vest only on the achievement of an LHL RoE in excess of a required amount. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise. The awards are not exercisable as at 31 December 2013.

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

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

LTIP

The LTIP plan was closed on 4 January 2008. 25.0 per cent of LTIP options vested on each of the first, second, third and fourth anniversary of the grant date. There were no associated performance criteria. All outstanding LTIP options were exercised during the year.

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

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

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

7. EMPLOYEE BENEFITS CONTINUED

MANAGEMENT TEAM ORDINARY WARRANTS

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

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

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

MANAGEMENT TEAM PERFORMANCE WARRANTS

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

Performance warrants granted and outstanding are:

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

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

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

8. FINANCING COSTS

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

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

FINANCIAL STATEMENTS

9. TAX CHARGE

BERMUDA

LHL, LICL and LUK have received an undertaking from the Bermuda government exempting them from all Bermuda local income, withholding and capital gains taxes until 28 March 2035. At the present time no such taxes are levied in Bermuda.

UNITED STATES

The Group does not consider itself to be engaged in trade or business in the U.S. and, accordingly, does not expect to be subject to U.S. taxation on its income or capital gains.

UNITED KINGDOM

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

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

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

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

A corporation tax credit of $1.1 million (2012 – $1.4 million) was recognised in other reserves which relates to tax deductions for equity based compensation award exercises in excess of the cumulative expense at the reporting date. Refer to note 16 for further details of tax credits included in other reserves.

Refer to note 11 for details of the tax expense related to the net change in unrealised gains/losses on investments that is included in accumulated other comprehensive income within shareholders' equity.

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

10. CASH AND CASH EQUIVALENTS

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

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

11. INVESTMENTS

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

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

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

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

Fixed income maturities are presented in the risk disclosures section on page 128. Refer to note 22 for the investment balances in trusts in favour of ceding companies and on deposit as collateral.

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

LEVEL (I)

Level (i) investments are securities with quoted prices in active markets. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The Group determines securities classified as level (i) to include highly liquid U.S. treasuries, certain highly liquid short-term investments and quoted equity securities.

11. INVESTMENTS CONTINUED

LEVEL (II)

Level (ii) investments are securities with quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data. Instruments included in level (ii) are valued via independent external sources using modeled or other valuation methods. Such methods are typically industry accepted standard and include:

- broker-dealer quotes;
- pricing models or matrix pricing;
- present values;
- future cash flows;
- yield curves;
- interest rates;
- prepayment speeds; and
- default rates.

Other similar quoted instruments or market transactions may be used.

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

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

LEVEL (III)

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

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

The Group determines the estimated fair value of each individual security utilising the highest level inputs available. Prices for the Group's investment portfolio are provided by a third-party investment accounting firm whose pricing processes, and the controls thereon, are subject to an annual audit on both the operation, and the effectiveness, of those controls. The audit reports are available to clients of the firm and the report is reviewed annually by management. In accordance with their pricing policy, various recognised reputable pricing sources are used including index providers, broker-dealers, and pricing vendors. The pricing sources use bid prices where available, otherwise indicative prices are quoted based on observable market trade data. The prices provided are compared to the investment managers' and custodian's pricing.

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

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

As at 31 December 2013	(i) $m	(ii) $m	Total $m
Fixed income securities – available for sale			
– Short-term investments	153.5	77.5	231.0
– Fixed income funds	–	26.3	26.3
– U.S. treasuries	217.3	–	217.3
– Other government bonds	–	107.9	107.9
– U.S. municipal bonds	–	21.4	21.4
– U.S. government agency debt	–	98.2	98.2
– Asset backed securities	–	151.4	151.4
– U.S. government agency mortgage backed securities	–	252.0	252.0
– Non-agency mortgage backed securities	–	8.8	8.8
– Agency commercial mortgage backed securities	–	4.2	4.2
– Non-agency commercial mortgage backed securities	–	37.9	37.9
– Bank loans	–	107.8	107.8
– Corporate bonds	–	701.9	701.9
Total fixed income securities – available for sale	370.8	1,595.3	1,966.1
Fixed income securities – at fair value through profit or loss	–	29.6	29.6
Equity securities – available for sale	15.6	–	15.6
Other investments	–	4.7	4.7
Total investments	386.4	1,629.6	2,016.0

11. INVESTMENTS CONTINUED

As at 31 December 2012	(i) $m	(ii) $m	Total $m
Fixed income securities – available for sale			
– Short-term investments	114.6	0.2	114.8
– U.S. treasuries	214.9	–	214.9
– Other government bonds	–	150.9	150.9
– U.S. municipal bonds	–	28.6	28.6
– U.S. government agency debt	–	131.6	131.6
– Asset backed securities	–	73.9	73.9
– U.S. government agency mortgage backed securities	–	403.1	403.1
– Non-agency mortgage backed securities	–	8.5	8.5
– Agency commercial mortgage backed securities	–	1.6	1.6
– Non-agency commercial mortgage backed securities	–	29.6	29.6
– Bank loans	–	37.4	37.4
– Corporate bonds	–	679.6	679.6
Total fixed income securities – available for sale	329.5	1,545.0	1,874.5
Other investments	–	0.1	0.1
Total investments	329.5	1,545.1	1,874.6

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

12. REINSURANCE ASSETS AND LIABILITIES

	Unearned premiums ceded $m	Amounts payable to reinsurers $m	Other receivables $m	Total $m
As at 31 December 2011	8.8	(17.8)	6.2	(2.8)
Net deferral for prior years	(8.8)	–	–	(8.8)
Net deferral for current year	11.5	–	–	11.5
Other	–	(12.8)	(1.7)	(14.5)
As at 31 December 2012	11.5	(30.6)	4.5	(14.6)
Acquired in the Cathedral acquisition	**17.2**	**(22.0)**	**13.7**	**8.9**
Net deferral for prior years (1)	**(23.3)**	**–**	**–**	**(23.3)**
Net deferral for current year	**9.5**	**–**	**–**	**9.5**
Other	**–**	**21.7**	**(7.4)**	**14.3**
As at 31 December 2013	**14.9**	**(30.9)**	**10.8**	**(5.2)**

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

13. LOSSES AND LOSS ADJUSTMENT EXPENSES

	Losses and loss adjustment expenses $m	Reinsurance recoveries $m	Net losses and loss adjustment expenses $m
As at 31 December 2011	571.2	(69.7)	501.5
Net incurred losses for:			
Prior years	(33.5)	6.1	(27.4)
Current year	250.4	(48.9)	201.5
Exchange adjustments	(11.2)	–	(11.2)
Incurred losses and loss adjustment expenses	205.7	(42.8)	162.9
Net paid losses for:			
Prior years	134.4	(8.2)	126.2
Current year	105.1	(31.3)	73.8
Paid losses and loss adjustment expenses	239.5	(39.5)	200.0
As at 31 December 2012	537.4	(73.0)	464.4
Assumed in the Cathedral acquisition	**331.5**	**(107.3)**	**224.2**
Net incurred losses for:			
Prior years	**41.9**	**(57.8)**	**(15.9)**
Current year	**208.1**	**(4.1)**	**204.0**
Exchange adjustments	**(13.6)**	**(0.7)**	**(14.3)**
Incurred losses and loss adjustment expenses	**236.4**	**(62.6)**	**173.8**
Net paid losses for:			
Prior years	**200.3**	**(59.8)**	**140.5**
Current year	**51.6**	**(0.1)**	**51.5**
Paid losses and loss adjustment expenses	**251.9**	**(59.9)**	**192.0**
As at 31 December 2013	**853.4**	**(183.0)**	**670.4**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from page 116. The risks associated with general insurance contracts are complex and do not readily lend themselves to meaningful sensitivity analysis. The impact of an unreported event could lead to a significant increase in the Group's loss reserves. The Group believes that the loss reserves established are adequate, however a 20.0 per cent increase in estimated losses would lead to a $170.7 million (2012 – $107.5 million) increase in gross loss reserves. The split of losses and loss adjustment expenses between notified outstanding losses, additional case reserves assessed by management and IBNR is shown below:

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

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

13. LOSSES AND LOSS ADJUSTMENT EXPENSES CONTINUED

CLAIMS DEVELOPMENT

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

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

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

Accident year	2006 and prior $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	Total $m
Reinsurance excluding Lloyd's segment									
Estimate of ultimate recovery(1)									
At end of accident year	–	3.6	40.7	1.6	33.8	56.2	48.9	–	
One year later	–	6.2	47.1	1.3	23.6	52.6	108.2		
Two years later	–	4.0	43.1	0.7	24.1	52.2			
Three years later	–	3.5	40.9	0.7	24.5				
Four years later	–	3.3	38.1	0.7					
Five years later	–	3.1	39.2						
Six years later	–	3.2							
Seven years later	–								
Current estimate of cumulative recovery excluding Lloyd's segment	**–**	**3.2**	**39.2**	**0.7**	**24.5**	**52.2**	**108.2**	**–**	**228.0**
Payments made	**–**	**(3.2)**	**(36.8)**	**(0.6)**	**(22.8)**	**(12.7)**	**(70.9)**	**–**	**(147.0)**
Total gross recovery	**–**	**–**	**2.4**	**0.1**	**1.7**	**39.5**	**37.3**	**–**	**81.0**
Reinsurance – Lloyd's segment									
Estimate of ultimate liability(1)									
At acquisition	24.3	1.9	1.1	9.0	9.1	41.0	14.9	6.0	107.3
Current estimate of cumulative recovery – Lloyd's segment	**24.9**	**1.8**	**1.2**	**8.9**	**9.1**	**39.5**	**13.9**	**10.1**	**109.4**
Payments made	**(0.2)**	**–**	**(0.2)**	**0.1**	**(0.9)**	**(4.9)**	**(1.2)**	**(0.1)**	**(7.4)**
Total gross recovery	**24.7**	**1.8**	**1.0**	**9.0**	**8.2**	**34.6**	**12.7**	**10.0**	**102.0**
Total Group gross recovery	**24.7**	**1.8**	**3.4**	**9.1**	**9.9**	**74.1**	**50.0**	**10.0**	**183.0**

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

13. LOSSES AND LOSS ADJUSTMENT EXPENSES CONTINUED

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

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

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

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

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

During 2012 the Group was impacted by significant losses in relation to Sandy. Management's current best estimate of the ultimate net loss in relation to this event is $30.7 million. The 90th percentile of the loss distribution for this estimate is $36.2 million with the 95th percentile being $38.4 million. Significant uncertainty exists on the eventual ultimate loss.

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

During 2011 the Group was impacted by significant losses in relation to the Japan Tohoku earthquake and following tsunami. Management's current best estimate of the ultimate net loss in relation to this event is $122.2 million. The 90th percentile of the loss distribution for this estimate is $130.9 million with the 95th percentile being $134.1 million. Significant uncertainty exists on the eventual ultimate losses in relation to this event.

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

	Sandy $m	Costa Concordia $m	Japan $m
Net ultimate losses as at 31 December 2011	–	–	117.3
Change in insurance losses and loss adjustment expenses	46.0	92.8	3.7
Change in insurance losses and loss adjustment expenses recoverable	–	(47.0)	–
Change in reinstatement premium	(1.5)	13.4	(2.0)
Net ultimate losses as at 31 December 2012	44.5	59.2	119.0
Assumed in the Cathedral acquisition	**6.8**	**–**	**3.7**
Change in insurance losses and loss adjustment expenses	**3.4**	**67.7**	**(0.7)**
Change in insurance losses and loss adjustment expenses recoverable	**(23.6)**	**(34.2)**	**(0.5)**
Change in reinstatement premium	**(0.4)**	**4.4**	**0.7**
Net ultimate losses as at 31 December 2013	**30.7**	**97.1**	**122.2**

14. INSURANCE, REINSURANCE AND OTHER RECEIVABLES

All receivables are considered current other than $52.1 million (2012 – $37.2 million) of inwards premiums receivable related to multi-year contracts. The carrying value approximates fair value due to the short-term nature of the receivables. There are no significant concentrations of credit risk within the Group's receivables.

15. DEFERRED ACQUISITION COSTS AND DEFERRED ACQUISITION COSTS CEDED

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

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

16. PROVISION FOR DEFERRED TAX

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

A deferred tax credit of $0.5 million (2012 – $0.2 million) was recognised in other reserves which relates to deferred tax credits for unexercised equity based compensation awards where the estimated market value is in excess of the cumulative expense at the reporting date.

Deferred tax assets are recognised to the extent that realising the related tax benefit through future taxable profits is likely. It is anticipated that sufficient taxable profits will be available within the Group in 2013 and subsequent years to utilise the deferred tax assets recognised when the underlying temporary differences reverse.

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

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

17. INVESTMENT IN ASSOCIATES

AHL

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

ARL assumed worldwide property retrocession risks from LICL. AHL is an unquoted investment and its shares do not trade on an active market. As at 31 December 2013, the Group's capital commitment in AHL was $17.2 million (31 December 2012 – $41.1 million). As at 31 December 2013 the carrying value of the Group's investment in AHL is $32.4 million (31 December 2012 – $49.7 million). The Group's share of comprehensive income for AHL for the period was $6.6 million (2012 – $7.7 million). Investments in associates are generally deemed non-current. Key financial information for AHL is as follows:

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

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

SHL

The Group holds a 16.9 per cent interest (31 December 2012 - 20.0 per cent) in the common shares of SHL, a company incorporated in Bermuda. SHL's operating subsidiary, SRL, is authorised as a Special Purpose Insurer by the BMA.

SRL is a market facing vehicle underwriting a combined exposure ultimate net loss aggregate reinsurance product. SRL commenced writing insurance business at 1 January 2013. At 31 December 2013 the Group's capital commitment to SHL was $9.6 million. As at 31 December 2013 the carrying value of the Group's investment in SHL was $12.2 million (31 December 2012 – $32.4 million). The Group's share of comprehensive income for SHL for the period was $2.6 million (31 December 2012 – $nil). Key financial information for SHL is as follows:

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

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

KHL

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

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

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

18. PROPERTY, PLANT AND EQUIPMENT

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

19. INTANGIBLE ASSETS

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

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

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

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

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

20. INSURANCE LIABILITIES

	Unearned premiums $m	Other payables $m	Total $m
As at 31 December 2011	347.1	23.5	370.6
Net deferral for prior years	(271.4)	–	(271.4)
Net deferral for current year	267.6	–	267.6
As at 31 December 2012	343.3	23.5	366.8
Acquired in the Cathedral acquisition	**123.1**	**6.3**	**129.4**
Net deferral for prior years[1]	**(275.9)**	**–**	**(275.9)**
Net deferral for current year	**251.6**	**–**	**251.6**
Other	**–**	**(0.9)**	**(0.9)**
As at 31 December 2013	**442.1**	**28.9**	**471.0**

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

21. INSURANCE, REINSURANCE AND OTHER PAYABLES

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

Other payables include unsettled investment trades, accrued interest and other accruals. Insurance payables relate to amounts due to policyholders for profit commission, return premiums and claims payable. All payables are considered current. The carrying value approximates fair value due to the short-term nature of the payables.

22. LONG-TERM DEBT AND FINANCING ARRANGEMENTS

LONG-TERM DEBT

On 5 October 2012 the Group issued U.S. $130.0 million 5.70 per cent senior unsecured notes due 2022 pursuant to a private offering to U.S. Qualified Institutional Buyers. Interest on the principal is payable semi-annually. The notes were listed and admitted to trading on the LSE on 16 October 2012.

On 15 December 2005 the Group issued $97.0 million and €24.0 million in aggregate principal amount of floating rate subordinated loan notes. The U.S. dollar subordinated loan notes are repayable on 15 December 2035. Interest on the principal is based on a set margin, 3.70 per cent, above the three month LIBOR rate and is payable quarterly. The loan notes were issued via a trust company. The Euro subordinated loan notes are repayable on 15 June 2035. Interest on the principal is based on a set margin, 3.70 per cent, above the EURIBOR rate and is payable quarterly. On 21 October 2011 the Cayman Islands Stock Exchange admitted to the official list the Group's U.S. dollar and Euro subordinated loan notes due 2035.

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

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

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

22. LONG-TERM DEBT AND FINANCING ARRANGEMENTS CONTINUED

The carrying values of the notes are shown below:

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

The Group is exposed to cash flow interest rate risk and currency risk on its long-term debt. Further information is provided in the risk disclosures section on page 125.

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

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

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

INTEREST RATE SWAPS

The Group hedges a portion of its floating rate borrowings using interest rate swaps to transfer floating to fixed rate. These instruments are held at estimated fair value. Refer to the risk disclosures section from page 124 for further details. The Group has the right to net settle these instruments.

The net fair value position owed by the Group on the swap agreements is $0.2 million. Further information is provided on pages 122 and 124. The Group has the right to net settle these instruments. Cash settlements are completed on a quarterly basis and the total of the next cash settlement on these instruments is $0.7 million. The net impact from cash settlement and changes in estimated fair value is included in financing costs.

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

Refer to note 8 for the net impact from cash settlement and changes in estimated fair value included in financing costs.

LETTERS OF CREDIT

As both LICL and LUK are non-admitted insurers or reinsurers throughout the U.S., the terms of certain contracts require them to provide LOCs to policyholders as collateral. LHL and LICL have the following facilities in place as at 31 December 2013:

(i) a $350.0 million syndicated collateralised credit facility with $75.0 million loan sub-limit that has been in place since 5 April 2012 and will expire on 5 April 2017. There was no outstanding debt under this facility as at 31 December 2013; and

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

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

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

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

(ii) a maximum debt to capital ratio of 30.0 per cent, where the subordinated loan notes are excluded from this calculation.

As at all reporting dates the Group was in compliance with all covenants under these facilities. The $400.0 million bi-lateral uncommitted LOC facility does not contain default provisions or covenants.

The following LOCs have been issued:

As at 31 December	2013 $m	2012 $m
Issued to third parties	**20.1**	17.2

LOCs are required to be fully collateralised.

SYNDICATE BANK FACILITIES

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

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

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

TRUSTS AND RESTRICTED BALANCES

The Group has several trust arrangements in place in favour of policyholders and ceding companies in order to comply with the security requirements of certain reinsurance contracts and/or the regulatory requirements of certain jurisdictions.

In 2012 LICL entered into an MBRT to collateralise its reinsurance liabilities associated with U.S. domiciled clients. As at 31 December 2013, LICL had been granted authorised or trusteed reinsurer status in 45 States (31 December 2012 – 1 State). The MBRT is subject to the rules and regulations of the aforementioned States and the respective deed of trust. These rules and regulations include minimum capital funding requirements, investment guidelines, capital distribution restrictions and regulatory reporting requirements.

As at and for the years ended 31 December 2013 and 2012 the Group was in compliance with all covenants under its trust facilities.

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

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

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

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

FINANCIAL STATEMENTS

23. SHARE CAPITAL

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

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

Own shares	Number held in treasury	$m	Number held in trust	$m	Total number of own shares	$m
As at 31 December 2011	10,513,326	69.2	1,267,421	13.8	11,780,747	83.0
Shares distributed	(1,801,510)	(11.1)	(2,848,168)	(33.2)	(4,649,678)	(44.3)
Shares donated to trust	(2,901,233)	(17.4)	2,901,233	35.8	–	18.4
As at 31 December 2012	5,810,583	40.7	1,320,486	16.4	7,131,069	57.1
Shares distributed	**(435,120)**	**(3.0)**	**(2,276,285)**	**(30.1)**	**(2,711,405)**	**(33.1)**
Shares donated to trust	**(1,862,138)**	**(13.1)**	**1,862,138**	**25.9**	**–**	**12.8**
As at 31 December 2013	**3,513,325**	**24.6**	**906,339**	**12.2**	**4,419,664**	**36.8**

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

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

SHARE REPURCHASES

At the AGM held on 1 May 2013 the Group's shareholders approved a renewal of the Repurchase Programme authorising the repurchase of a maximum of 16,860,242 shares, with such authority to expire on the conclusion of the 2014 AGM or, if earlier, fifteen months from the date the resolution approving the Repurchase Programme was passed.

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

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

DIVIDENDS

The Board of Directors have authorised the following dividends:

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

24. OTHER RESERVES

Other reserves represent the Group's restricted shares, options and warrants. Changes in the number of restricted shares, options and management warrants held by employees are disclosed in note 7. The changes in the number of warrants held by non-employees are as follows:

	Number of Founder warrants	Number of Lancashire Foundation warrants	Number of ordinary warrants
Outstanding at 31 December 2011	22,760,220	648,143	2,350,000
Exercised	(2,956,648)	–	–
Outstanding and exercisable as at 31 December 2012	19,803,572	648,143	2,350,000
Exercised	**(728,785)**	–	–
Outstanding and exercisable as at 31 December 2013	**19,074,787**	**648,143**	**2,350,000**
Weighted average exercise price as at 31 December 2013	**$5.00**	**$4.73**	**$5.00**

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

The fair value of all warrants granted was $2.62 per warrant. The exercise price of the Lancashire Foundation warrants was automatically adjusted for dividends declared prior to the vesting date. Refer to note 7 for further details. This did not apply to the Founder warrants as they were fully vested at the date of grant and exercisable upon issuance.

25. LEASE COMMITMENTS

The Group has payment obligations in respect of operating leases for certain items of office equipment and office space. Operating lease expenses for the year were $2.4 million (2012 – $2.3 million). Future minimum lease payments under non-cancellable operating leases are as follows:

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

26. EARNINGS PER SHARE

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

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

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

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

26. EARNINGS PER SHARE CONTINUED

Equity based compensation awards are only treated as dilutive when their conversion to common shares would decrease earnings per share or increase loss per share from continuing operations. Unvested restricted shares without performance criteria are therefore included in the number of potentially dilutive shares. Incremental shares from ordinary restricted share options where relevant performance criteria have not been met are not included in the calculation of dilutive shares. In addition, where options are antidilutive, they are not included in the number of potentially dilutive shares.

27. RELATED PARTY DISCLOSURES

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

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

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

(2) 87.43 per cent owned by the Group.

The Group has issued subordinated loan notes via a trust vehicle – LHFT, refer to note 22. The Group effectively has 100.0 per cent of the voting rights in LHFT. These rights are subject to the property trustee's obligations to seek the approval of the holders of LHFT's preferred securities in case of default and other limited circumstances where the property trustee would enforce its rights. While the ability of the Group to influence the actions of LHFT is limited by the trust agreement, LHFT was set up by the Group with the sole purpose of issuing the subordinated loan notes, is in essence controlled by the Group, and is therefore consolidated.

The EBT was established to assist in the administration of the Group's employee equity based compensation schemes. While the Group does not have legal ownership of the EBT and the ability of the Group to influence the actions of the EBT is limited by the trust deed, the EBT was set up by the Group with the sole purpose of assisting in the administration of these schemes, is in essence controlled by the Group, and is therefore consolidated.

The Group has a Loan Facility Agreement (the 'Facility') with RBC Cees Trustee Limited, the trustees of the EBT. The Facility is an interest free revolving credit facility under which the Trustee can request advances on demand, within the terms of the facility, up to a maximum aggregate of $60.0 million. The Facility may only be used by the Trustees for the purpose of achieving the objectives of the EBT. During the year ended 31 December 2013, the Group had made advances of $10.7 million (2012 – $10.3 million) to the EBT under the terms of the Facility.

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

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

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

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

KEY MANAGEMENT COMPENSATION

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

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

The Directors' fees and expenses includes $0.4 million (2012 – $0.4 million) paid to significant founding shareholders. Non-Executive Directors, with the exception of Neil McConachie, do not receive any benefits in addition to their agreed fees and expenses and do not participate in any of the Group's incentive, performance or pension plans. Neil McConachie left the company as an employee on 30 June 2012, relinquishing his executive responsibilities and became a Non-Executive Director effective 1 July 2012. He is able to exercise previously granted RSS awards when they have vested and subject to performance conditions being met, provided he remains a Non-Executive Director.

TRANSACTIONS WITH LANCASHIRE FOUNDATION

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

Date	$m
7 November 2012	1.4
23 May 2013	1.4

27. RELATED PARTY DISCLOSURES CONTINUED

TRANSACTIONS WITH ASSOCIATES

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

As at 31 December	2013 $m	2012 $m
Consolidated statement of comprehensive income		
Outwards reinsurance premiums	**47.9**	64.8
Insurance loss and loss adjustment expenses recoverable	**9.1**	17.7
Insurance acquisition expenses ceded	**7.1**	9.0
Consolidated balance sheet		
Reinsurance recoveries	**26.8**	17.7
Unearned premiums on premiums ceded	**–**	3.5
Amounts payable to reinsurers	**(5.5)**	(18.4)
Deferred acquisition costs ceded	**–**	(0.6)

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

In 2013 KCML entered into an underwriting services agreement with KRL and KHL to provide various services relating to underwriting, actuarial, premium payments and relevant deductions, acquisition expenses and receipt of claims. During the year ended 31 December 2013 the Group did not enter any financial transactions with KRL or KHL apart from its initial investment discussed in note 17. Contingent profit commission may be payable to KCML depending on the ultimate performance of KRL.

During 2012 SML entered into an underwriting services agreement with SRL and SHL to provide various services relating to underwriting, actuarial, premium payments and relevant deductions, acquisition expenses and receipt of claims. In 2013 the Group recognised $1.2 million (2012: $nil) of service fees in other income in relation to this agreement. Contingent profit commission may be payable to SML depending on the ultimate performance of SRL.

FINANCIAL STATEMENTS

28. NON-CASH TRANSACTIONS

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

29. STATUTORY REQUIREMENTS AND DIVIDEND RESTRICTIONS

The primary source of capital used by the Group is equity shareholders' funds and borrowings. As a holding company, LHL relies on dividends from its operating entities to provide the cash flow required for debt service and dividends to shareholders. The operating entities' ability to pay dividends and make capital distributions is subject to the legal and regulatory restrictions of the jurisdictions in which they operate.

For LICL and LUK, these regulatory restrictions are based principally on the amount of premiums written and reserves for losses and loss adjustment expenses, subject to overall minimum solvency requirements. LICL and LUK's statutory capital and surplus are different from shareholders' equity due to certain items that are capitalised under IFRS but expensed or have a different valuation basis for regulatory reporting, or are not admitted under insurance regulations.

Annual statutory capital and surplus reported to regulatory authorities by LICL and LUK is as follows:

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

LICL is required to maintain a minimum liquidity ratio, whereby relevant assets, as defined in the regulations, must exceed 75.0 per cent of relevant liabilities. As at 31 December 2013 and 2012 the liquidity ratio was met. LICL is also required to perform various capital calculations under the BMA's regulatory framework. An assessment is made of LICL's capital needs and a target capital amount is determined. The BMA may require a further capital loading on the target capital amount in certain circumstances. The BMA considers that a decrease in capital below the target level represents a regulatory intervention point.

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

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

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

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

30. SUBSEQUENT EVENTS

DIVIDEND

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

RETURN OF CAPITAL FROM ASSOCIATE

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

ANNUAL GENERAL MEETING

The Company's AGM is scheduled for 30 April 2014. Notice of this year's AGM and the form of proxy accompany this annual report. If you have any queries regarding the notice or return of the proxy please contact Chris Head, Company Secretary, at Lancashire Holdings Limited, Level 11, Vitro, 60 Fenchurch Street, London EC3M 4AD, United Kingdom, Tel: + 44 (0) 20 7264 4000 and email: chris.head@lancashiregroup.com.

FURTHER INFORMATION

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

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

NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements in this document include forward-looking statements which reflect the Directors' current views with respect to financial performance, business strategy, plans and objectives of management for future operations (including development plans relating to the Group's products and services). These statements include forward-looking statements both with respect to the Group and the sectors and industries in which the Group operates. Statements containing the words "believes", "anticipates", "plans", "projects", "forecasts", "guidance", "intends", "expects", "estimates", "predicts", "may", "will", "seeks", "should" or, in each case, their negative or comparable terminology and similar statements are of a future or forward-looking nature. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause the actual results, performance or achievements of the Group to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

These factors include, but are not limited to: the Group's ability to integrate its 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 premium rates which may be available at the time of such renewals within its targeted business lines; the possible low frequency of large events; potentially unusual loss frequency; the impact that the Group's future operating results, capital position and rating agency and other considerations may have on the execution of any capital management initiatives or dividends; the possibility of greater frequency or severity of claims and loss activity than the Group's underwriting, reserving or investment practices have anticipated; the reliability of, and changes in assumptions to, catastrophe pricing, accumulation and estimated loss models; the effectiveness of its loss limitation methods; the potential loss of key personnel; a decline in the Group's operating subsidiaries' rating with A.M.Best, Standard & Poor's, Moody's or other rating agencies; increased competition on the basis of pricing, capacity, coverage terms or other factors; cyclical downturns of the industry; the impact of a deteriorating credit environment for issuers of fixed income investments; the impact of swings in market interest rates and securities prices; a rating downgrade of, or a market decline in, securities in its investment portfolio; changes in governmental regulations or tax laws in jurisdictions where the Group conducts business; Lancashire or its Bermudian subsidiary becoming subject to income taxes in the United States or the Bermudian subsidiary becoming subject to income taxes in the United Kingdom; the inapplicability to the Group of suitable exclusions from the new UK CFC regime; any change in the UK government or the UK government policy which impacts the new CFC regime; and the negative impact in any material way of the change in tax residence of the Company on its stakeholders. Any estimates relating to loss events involve the exercise of considerable judgement and reflect a combination of ground-up evaluations, information available to date from brokers and insureds, market intelligence, initial and/or tentative loss reports and other sources. Judgements in relation to loss arising from natural catastrophe and man-made events are influenced by complex factors. 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 statements 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.

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

ABS
Asset backed securities

ADDITIONAL CASE RESERVES (ACR)
Additional reserves deemed necessary by management

AIM
A sub-market of the LSE

AIR
AIR Worldwide

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

AGM
Annual General Meeting

AHL
Accordion Holdings Limited

AHL II
Accordion Holdings II Limited

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

ARL (ACCORDION)
Accordion Reinsurance Limited

BAM
Bathwater aggregate model

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

BMA
Bermuda Monetary Authority

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

BOOK VALUE PER SHARE (BVS)
Calculated by dividing the value of the total shareholders' equity by the sum of all common voting shares outstanding

BSX
Bermuda Stock Exchange

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

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

CCHL
Cathedral Capital Holdings Limited

CCIL
Cathedral Capital (Investments) Limited

CCL
Cathedral Capital Limited

CCL 1998
Cathedral Capital (1998) Limited

CCL 1999
Cathedral Capital (1999) Limited

CCL 2000
Cathedral Capital (2000) Limited

CCML
Cathedral Capital Management Limited

CCSL
Cathedral Capital Services Limited

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

THE CODE
UK Corporate Governance Code published by the UK Financial Reporting Council

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

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

CEO
Chief Executive Officer

CFO
Chief Financial Officer

CFC
Controlled Foreign Company

CGU
Cash generating unit

CMBS
Commercial mortgage backed securities

CRO
Chief Risk Officer

CUL
Cathedral Underwriting Limited

CUO
Chief Underwriting Officer

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

DILUTED EARNINGS PER SHARE
Calculated by dividing the net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year plus the weighted average number of common shares that would be issued on the conversion of all potentially dilutive equity based compensation awards into common shares under the treasury stock method

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

DURATION
Duration is the weighted average maturity of a security's cash flows, where the present values of the cash flows serve as the weights.

The effect of the convexity, or sensitivity, of the portfolio's response to changes in interest rates is also factored in to the calculation

EARNINGS PER SHARE (EPS)
Calculated by dividing net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year, excluding treasury shares and shares held by the EBT

EBT
Lancashire Holdings Employee Benefit Trust

ECA
Economic Capital Assessment

ECR
Economic Capital Requirement

EMD
Emerging Market Debt

ERM
Enterprise Risk Management

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

EXPENSE RATIO
Ratio, in per cent, of other operating expenses to net premiums earned

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

FAL
Funds at Lloyd's

FCA
Financial Conduct Authority

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

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

FULLY CONVERTED BOOK VALUE PER SHARE (FCBVS)
Calculated by dividing the value of the total shareholders' equity plus the proceeds that would be received from the exercise of all dilutive equity compensation awards, by the sum of all shares, including equity compensation awards assuming all are exercised

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

GROSS PREMIUMS WRITTEN
Amounts payable by the insured, excluding any taxes or duties levied on the premium, including any brokerage and commission deducted by intermediaries

THE GROUP
LHL and its subsidiaries

HMRC
Her Majesty's Revenue & Customs

ICA
Individual capital assessment

ICG
Individual capital guidance

IFRIC
International Financial Reporting Interpretations Committee

IFRS
International Financial Reporting Standard(s)

IGPIA
International group of protection and indemnity clubs association

ILS
Insurance linked securities

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

INCURRED BUT NOT REPORTED (IBNR)
These are anticipated or likely losses that may result from insured events which have taken place, but for which no losses have yet been reported. IBNR also includes a reserve for possible adverse development of previously reported losses

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

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

INTERNATIONAL ACCOUNTING STANDARD(S) (IAS)
Standards, created by the IASB, for the preparation and presentation of financial statements

INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB)
An international panel of accounting experts responsible for developing IAS and IFRS

IRR
Internal rate of return

IRRC
Investment Risk and Return Committee

ISE
Irish Stock Exchange

KCML
Kinesis Capital Management Limited

KCMMSL
KCM Marketing Services Limited (UK)

KHL (KINESIS HOLDINGS)
Kinesis Holdings I Limited

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

KRL (KINESIS RE)
Kinesis Reinsurance I Limited

LANCASHIRE
Refers to the Group excluding Cathedral and Kinesis

LANCASHIRE FOUNDATION OR FOUNDATION
The Lancashire Foundation is a charity registered in England and Wales

LANCASHIRE UK GROUP OF COMPANIES
Includes LHL, LUK, LIHL, LISL and LIMSL

LHFT
Lancashire Holdings Financing Trust I

LHL
Lancashire Holdings Limited

LIBOR
London Interbank Offered Rate

LICL
Lancashire Insurance Company Limited

LIHL
Lancashire Insurance Holdings (UK) Limited

LIMSL
Lancashire Insurance Marketing Services Limited

LISL
Lancashire Insurance Services Limited

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

LMSCL
Lancashire Management Services (Canada) Limited

LOC
Letter of credit

LOSSES
Demand by an insured for indemnity under an insurance contract

LSE
London Stock Exchange

LTIP
Long-term incentive plan

LUK
Lancashire Insurance Company (UK) Limited

LUTINE
Lutine Limited

MBRT
Multi-beneficiary reinsurance trust

MBS
Mortgage backed securities

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

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

NET ACQUISITION COST RATIO
Ratio, in per cent, of net acquisition expenses to net premiums earned

NET LOSS RATIO
Ratio, in per cent, of net insurance losses to net premiums earned

NET OPERATING PROFIT
Profit before tax excluding realised gains and losses and foreign exchange gains and losses

NET PREMIUMS WRITTEN
Net premiums written is equal to gross premiums written less outwards reinsurance premiums written

ORSA
Own Risk and Solvency Assessment

OTC
Over the counter

PML
Probable maximum loss

PRA
Prudential Regulation Authority

PRO-RATA/PROPORTIONAL
Reinsurance or insurance where the reinsured or insured shares a proportional part of the original premiums and losses of the reinsured or insured

RETROCESSION
The reinsurance of a reinsurance account

RETURN ON EQUITY (ROE)
The IRR of the change in FCBVS in the period plus accrued dividends

RDS
Realistic Disaster Scenarios

RPI
Renewal Price Index

RMBS
Residential mortgage backed securities

RMS
Risk Management Solutions

RRC
Risk and Return Committee

RSS
Restricted share scheme

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

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

SHL
Saltire Holdings I Limited

SML
Saltire Management Limited

SRL
Saltire Re I Limited

STANDARD & POOR'S (S&P)
Standard & Poor's is a worldwide insurance rating and information agency whose ratings are recognised as an ideal benchmark for assessing the financial strength of insurance related organisations

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

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

TBAs
Mortgage backed "to be announced" securities

TOTAL SHAREHOLDER RETURN (TSR)
The IRR of the increase in share price, in the period, measured in U.S. dollars, adjusted for dividends

TREATY REINSURANCE
A reinsurance contract under which the reinsurer agrees to offer and to accept all risks of a certain size within a defined class

TRIPRA
Terrorism Risk Insurance Protection Act

UMCC
Underwriting and Marketing Conference Call

UNEARNED PREMIUMS
The portion of premium income that is attributable to periods after the balance sheet date that is deferred and amortised to future accounting periods

UNL
Ultimate net loss

USCR
Ultimate solvency capital requirement

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

VALUE AT RISK (VAR)
A measure of the risk of loss of a specific portfolio of financial assets

CONTACT INFORMATION

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

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

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

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

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

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

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

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

CATHEDRAL
Cathedral Capital Limited
Fitzwilliam House
10 St. Mary Axe
London EC3A 8BF
United Kingdom

Phone: + 44 (0) 20 7170 9000
Fax: + 44 (0) 20 7170 9001

KINESIS
Kinesis Capital Management Limited
Power House
7 Par-la-Ville Road
Hamilton HM 11
Bermuda

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

LEGAL COUNSEL TO THE COMPANY
AS TO ENGLISH AND U.S. LAW:
Willkie Farr & Gallagher (UK) LLP
CityPoint
1 Ropemaker Street
London EC2Y 9AW
United Kingdom

AS TO BERMUDA LAW:
Conyers Dill & Pearman Limited
Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

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

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

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

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