BALANCE IS OUR FOCUS

lancashire
HOLDINGS LIMITED

Annual Report & Accounts 2016

STRATEGIC REPORT

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RETURN ON EQUITY

13.5%

(2015: 10.9%)*

COMBINED RATIO

76.5%

(2015: 72.1%)

PROFIT AFTER TAX

$153.8m

(2015: $181.1m)

TOTAL INVESTMENT RETURN

2.1%

(2015: 0.7%)

DIVIDEND YIELD

10.5%

(2015: 17.3%)

TOTAL SHAREHOLDER RETURN

2.4%

(2015: 25.9%)

* RoE excluding the impact of warrants was 13.5% in 2015, 14.7% in 2014, 18.9% in 2013 and 17.1% in 2012.

FOCUS ON *MAINTAINING BALANCE*

Lancashire is a provider of global specialty insurance and reinsurance products operating in Bermuda and London across three platforms: rated insurers, Lloyd's and collateralised security. The Group focuses on short-tail, mostly direct, specialty (re)insurance risks under five general categories: Property, Energy, Marine, Aviation and Lloyd's.

Markets continue to be difficult to navigate, yet we have again delivered strong returns by staying focused on balancing our risks to maximise returns while remaining ready for a change in market conditions. We are guided by our three consistent strategic maxims:

- underwriting comes first;
- effectively balance risk and return; and
- operate nimbly through the cycle.

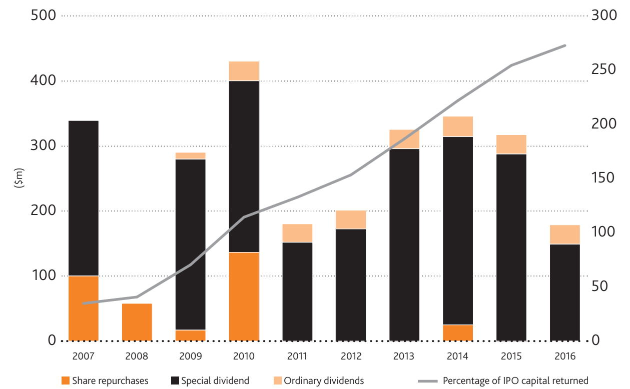
We manage the insurance cycle so we can continue to deliver greater value for our clients and shareholders.

OUR STRATEGY *IS BALANCED…*

… to produce a consistently high performance in volatile markets

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

PROVEN RECORD OF ACTIVE CAPITAL MANAGEMENT

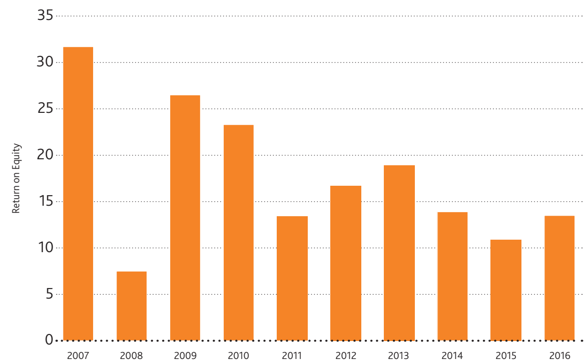


… to deliver superior returns across the cycle

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

(1) RoE including the impact of warrants.

TEN-YEAR RETURN ON EQUITY[1]



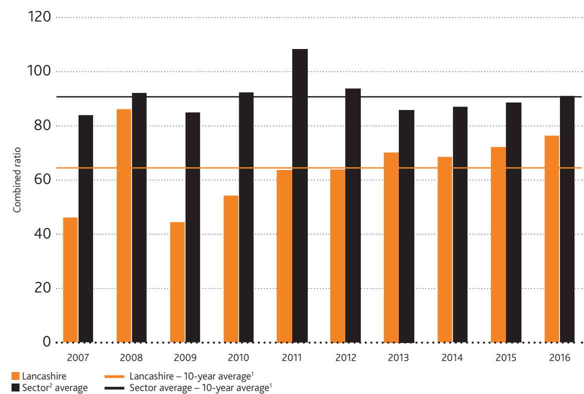
… by the experience of our underwriters, to produce higher returns across the cycle

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

(1) Ten-year average based on 2007 to 2016 reporting periods. Lancashire ratios weighted by annual net premiums earned. Annual sector ratios are weighted by annual net premiums earned.
(2) Sector includes Arch, Argo, Aspen, Axis, Beazley, Everest, Hanover, Hiscox, Novae, Renaissance Re and Validus. 2016 results for Hiscox and Novae not available at time of report.

Source: Company reports

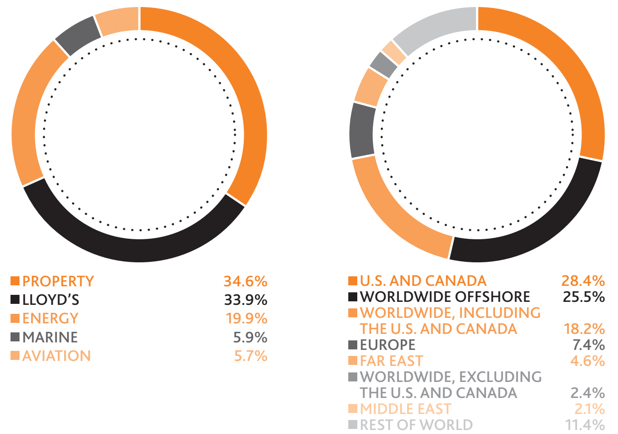
TEN-YEAR COMBINED RATIO



… across sectors and geographies

A well-diversified portfolio across multiple lines and geographies as a base to trade across the cycle.

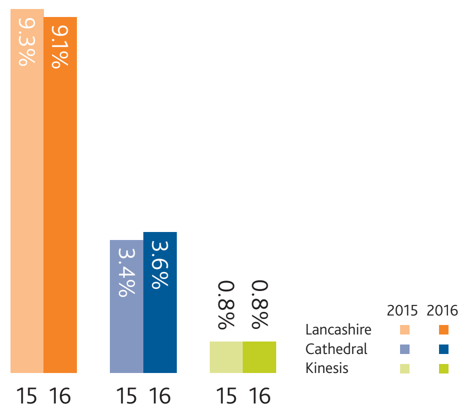
GROSS PREMIUMS WRITTEN BY CLASS AND REGION



… by diversification across our platforms and delivering on all three

Each of our platforms makes a positive contribution to the Group's RoE.

RETURN ON EQUITY BY PLATFORM

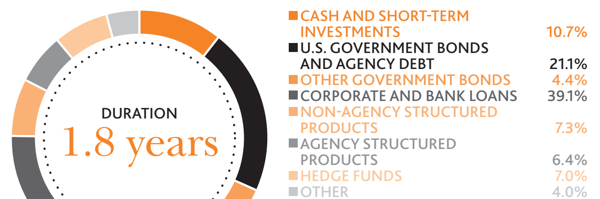


Note: 2015 RoE is excluding warrants.

… to protect our assets

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

INVESTMENT ASSET ALLOCATION



TOTAL PORTFOLIO AT 31 DECEMBER 2016	$1,840.5
CREDIT QUALITY	A+

DISCIPLINED UNDERWRITING
MAINTAINING BALANCE

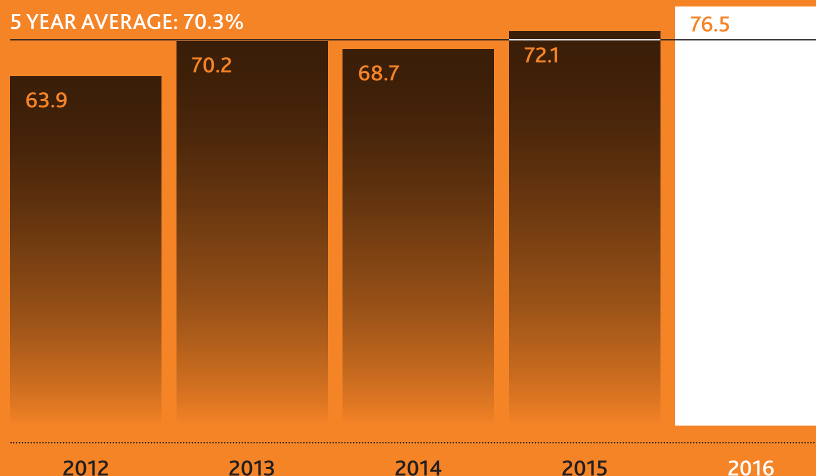
Maintaining the right balance between discipline and creativity is key for success. Underwriting discipline in challenging markets means we continue to focus on the profitability of our book, and therefore produce a market leading combined ratio. We remain creative in being able to provide tailored insurance and reinsurance products and solutions to our core clients across the three platforms of our business.

CONSISTENT COMBINED RATIO OUTPERFORMANCE

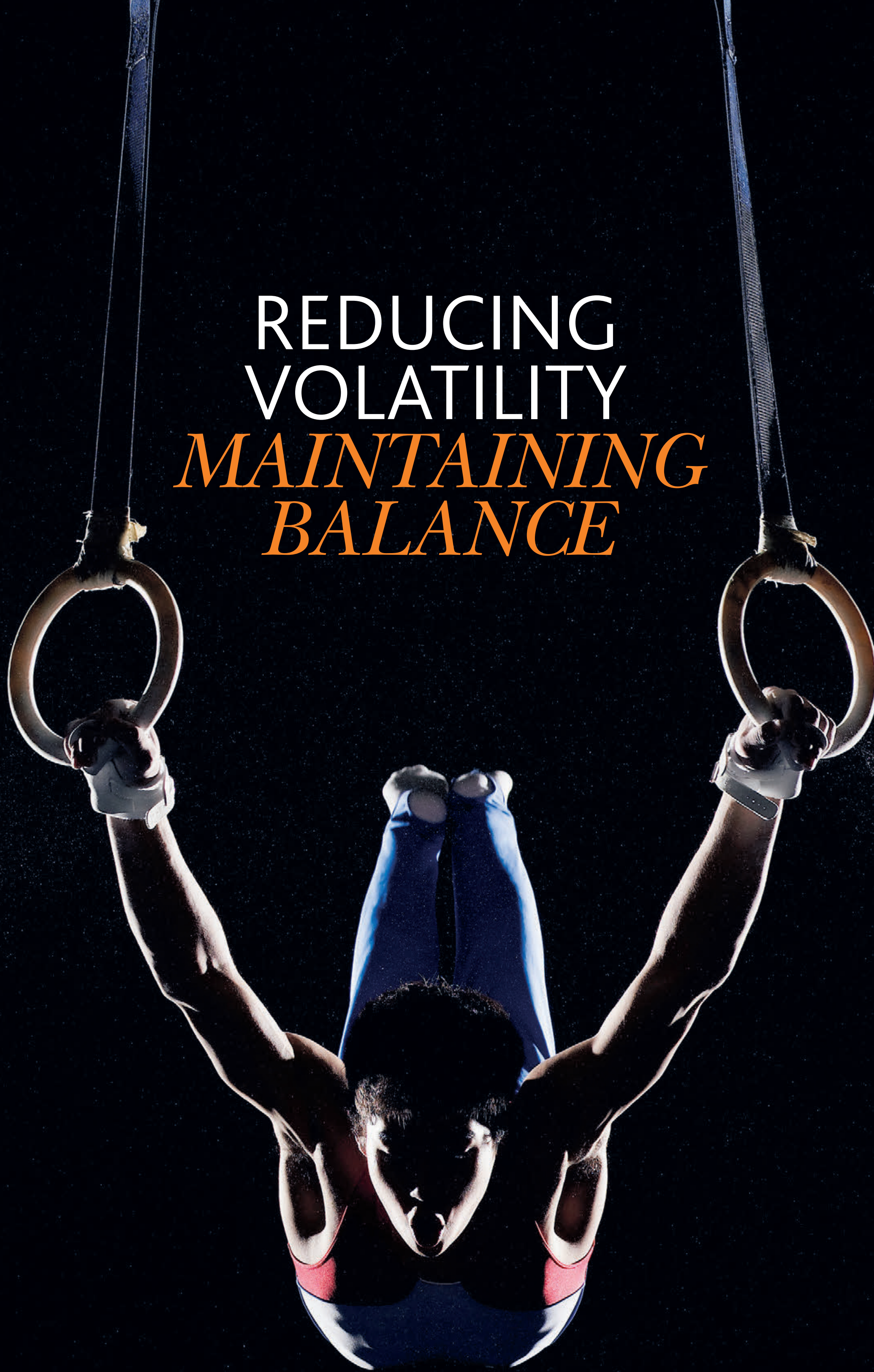
COMBINED RATIO

The Group's combined ratio has always been significantly below 100%, despite the softening market rates of recent years. The Group has consistently achieved combined ratios that have outperformed the market.

76.5%



REDUCING VOLATILITY *MAINTAINING BALANCE*



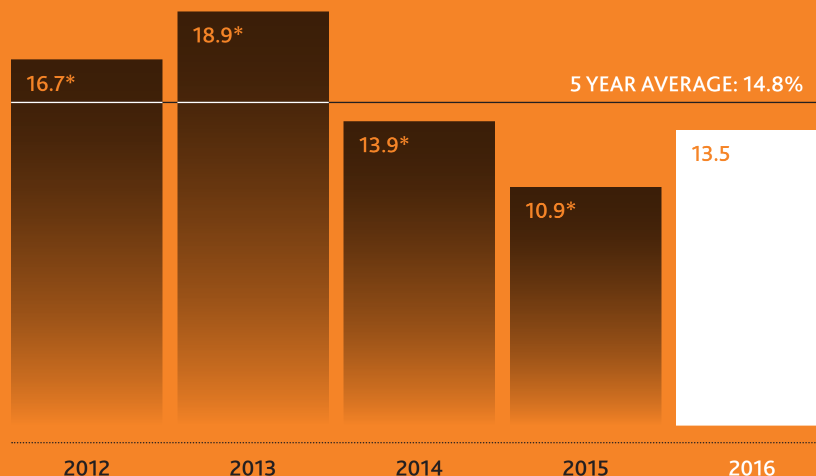
Balancing risk and return means not seeking top line growth for the sake of it in markets where we do not believe the right opportunities exist. We match our capital to the risk we are prepared to underwrite, not the other way around. We bring together all our disciplines to look at how different parts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

ATTRACTIVE RISK-ADJUSTED TOTAL RETURNS OVER THE LONG TERM

RETURN ON EQUITY

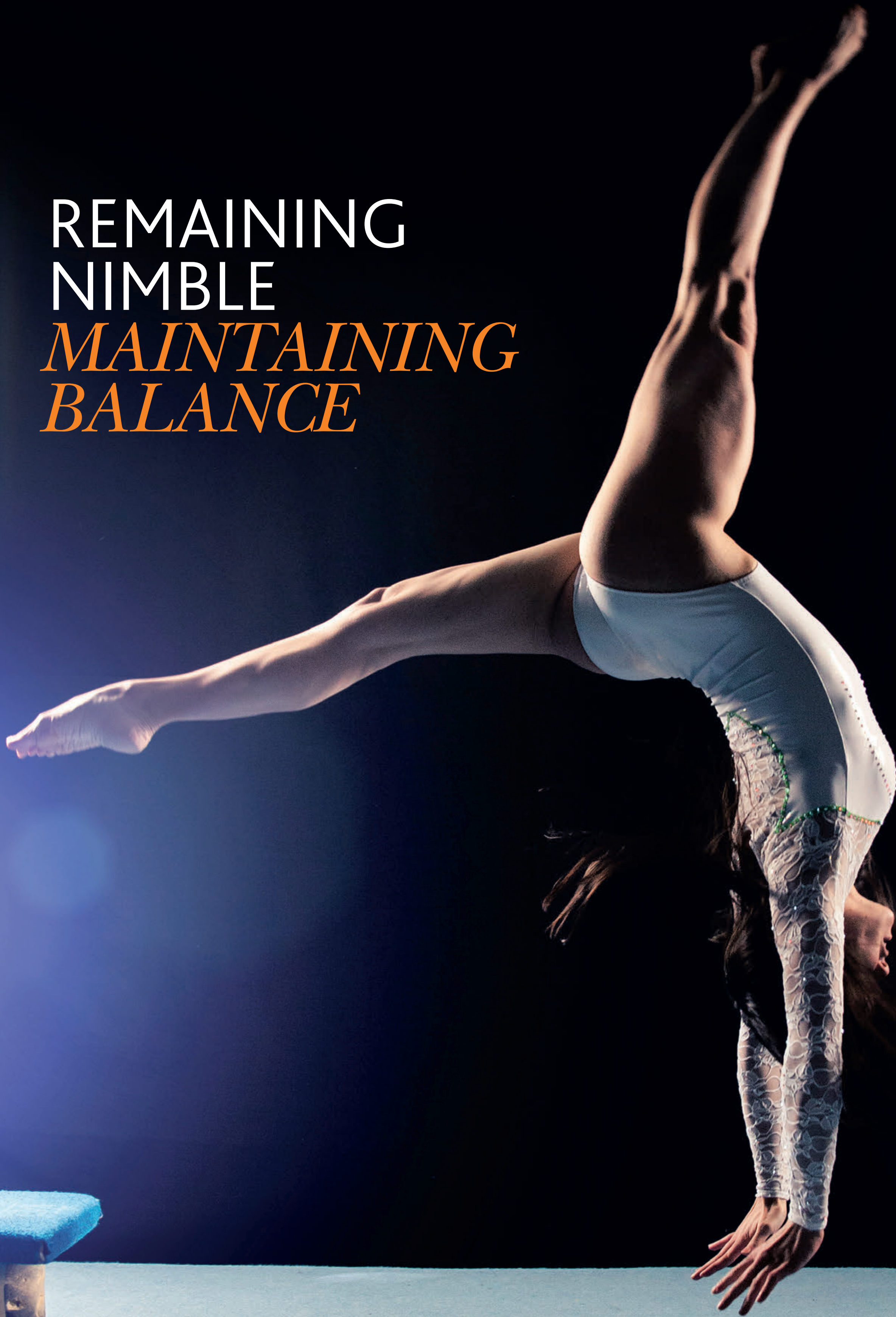
A strong result, despite a difficult market and the incidence of risk losses, helped by further enhancements in the Group's outwards reinsurance programme.

13.5%



* RoE excluding the impact of warrants was 13.5% in 2015, 14.7% in 2014, 18.9% in 2013 and 17.1% in 2012. The five year average was 15.5%.

REMAINING NIMBLE *MAINTAINING BALANCE*



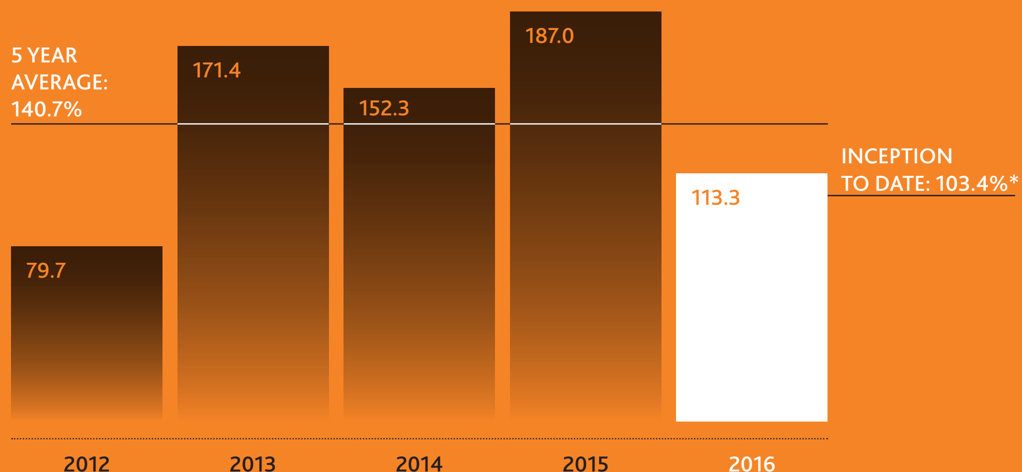
Our speed and agility in the way we manage volatility help us underwrite our core portfolio profitably through the challenges of the cycle, yet seize opportunities when they present themselves. As capital continues to enter the (re)insurance market, the need to be nimble is more important than ever.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

PROVEN OUTPERFORMANCE IN CHALLENGING TIMES

PERCENTAGE OF COMPREHENSIVE INCOME RETURNED TO SHAREHOLDERS

The Group continues to exercise the discipline of giving back capital it cannot profitably deploy, while maintaining sufficient headroom to take advantage of new opportunities as they emerge.

113.3%



* The inception to date percentage is calculated on a paid basis; including the final dividend of $0.10, the percentage increases to 104.2%.

ENSURING *BALANCE*

Lancashire's results, in a challenging market, are a testament to our steadfast maintenance of our core business and disciplined trimming of risk, as we prepare for the day the market hardens.

PETER CLARKE
Non-Executive Chairman

What were the challenges for the business during 2016?

The insurance business environment has remained difficult during 2016, as described elsewhere in this report. Against this background I congratulate our management team on an excellent set of results. The Board has debated long and hard about the implementation of strategy in these difficult insurance and investment market environments, and unexpected developments in the global political and economic spheres have added their own depth and colour to this complex picture. We are wholly supportive of Alex and his management team in seeking to maintain the Group's core book of business at this challenging point in the insurance cycle, whilst managing exposures through prudent underwriting and the strategic purchasing of reinsurance. This requires experience, discipline, patience and an acknowledgement that over the short to medium term the returns in our business may be lower than those that we have aimed to achieve over the full span of the insurance cycle.

Another challenge and opportunity for the Group during 2016 was the project to refresh our Lloyd's business. I explain the work that has been done in recruiting new independent Non-Executive Directors to the Board of CUL in my introduction to the Governance section of this Annual Report and Accounts (see page 43), and Alex has described the work that is being carried out in refreshing and refocusing the Cathedral management and underwriting teams in his review (see page 15).

Has Lancashire's dividend and capital management strategy changed?

I am pleased that Lancashire has declared ordinary and special dividends for the 2016 year amounting in total to $0.90 per common share. In the current environment the Board has decided to return slightly more than the comprehensive income for the year, whilst maintaining more than sufficient capital reserves to implement our current underwriting strategy. As a business we carefully consider the balance of risk and return when setting our capital levels, and this has enabled us to return earnings plus a little bit of our risk capital. An important element to this active capital management strategy is the flexibility afforded to us by shareholders during the last five years to issue up to 15 per cent of Lancashire's shares on a non pre-emptive basis. The best opportunities in the insurance and reinsurance sectors arise following major loss events, and the flexibility afforded by this mechanism (to issue shares and raise capital relatively quickly) is a central pillar of our business strategy, and will help Lancashire maximise underwriting opportunities for the business. Once again the Company is seeking shareholder support for resolutions at the 2017 AGM allowing this capital management flexibility, and I would encourage all shareholders to vote in favour.

Has the UK's Brexit vote affected Lancashire's business?

It is fair to say that the outcome of the UK Brexit referendum surprised many, and that there will remain areas of uncertainty for the next several years. Lancashire's earnings are predominantly in U.S. dollars, so the devaluation of Sterling in the wake of the vote had a beneficial outcome for our UK investors and was largely neutral for our international shareholders. In terms of business flows, the Group has a proportionately smaller exposure to European-situated risks and insurers than to other geographic areas. I remain confident that, whether through our London, Lloyd's or Bermuda offices, Lancashire will continue to have opportunities and a range of options to underwrite European risks for the foreseeable future. When there is clarity around what Brexit really means we will take any necessary actions.

> *"We are wholly supportive of Alex and his management team in seeking to maintain the Group's core book of business at this challenging point in the insurance cycle."*

What are Lancashire's expectations for 2017?

Lancashire's Board has considered the challenges of the current market. Within this context the Group has, since its inception to the end of 2016, generated compound annual RoE, excluding the impact of warrants, of 18.6 per cent which exceeds our stated long-term objective of generating a risk-adjusted RoE of 13 per cent in excess of the risk-free rate over the insurance cycle. The 'insurance cycle' is not difficult to understand in terms of its drivers and outputs, the flows of capital and the economic laws of supply and demand, but it is more difficult to define in terms of its expected or anticipated duration. What we know is that we are now at a point in the insurance cycle where an excess of capital and historically low investment returns mean that all disciplined insurers are operating on tighter margins and generating lower returns than they have done historically. The coming year will continue to be about implementing a core defensive strategy, ensuring that Lancashire is ready for the day when the market hardens. In this environment we expect Lancashire's returns for the near future to be lower than our stated cross-cycle objective.

Why is Lancashire proposing a change of auditors in 2017?

At Lancashire's 2017 AGM the Board will be proposing a resolution to our shareholders to appoint KPMG as our external auditors. EY have served as our external auditors since Lancashire's foundation in 2005. As part of our focus on strong corporate governance, the Board, led by the Audit Committee, conducted a rigorous tender process with several audit firms during the spring and summer of 2016 (see page 54 of the Audit Committee report for more detail). This has resulted in the recommendation to appoint KPMG as our auditors. I would like to thank all the participating audit firms for the time and resources devoted to the process and EY for their service over the years.

Peter Clarke
Non-Executive Chairman

GOVERNANCE STATEMENT

Lancashire strives to implement simple yet effective systems of corporate governance in a way that helps shape strategy, monitors its implementation, balances support and challenge for management and the business and embeds a positive and open corporate culture throughout the Group.

Total investment return

2.1%

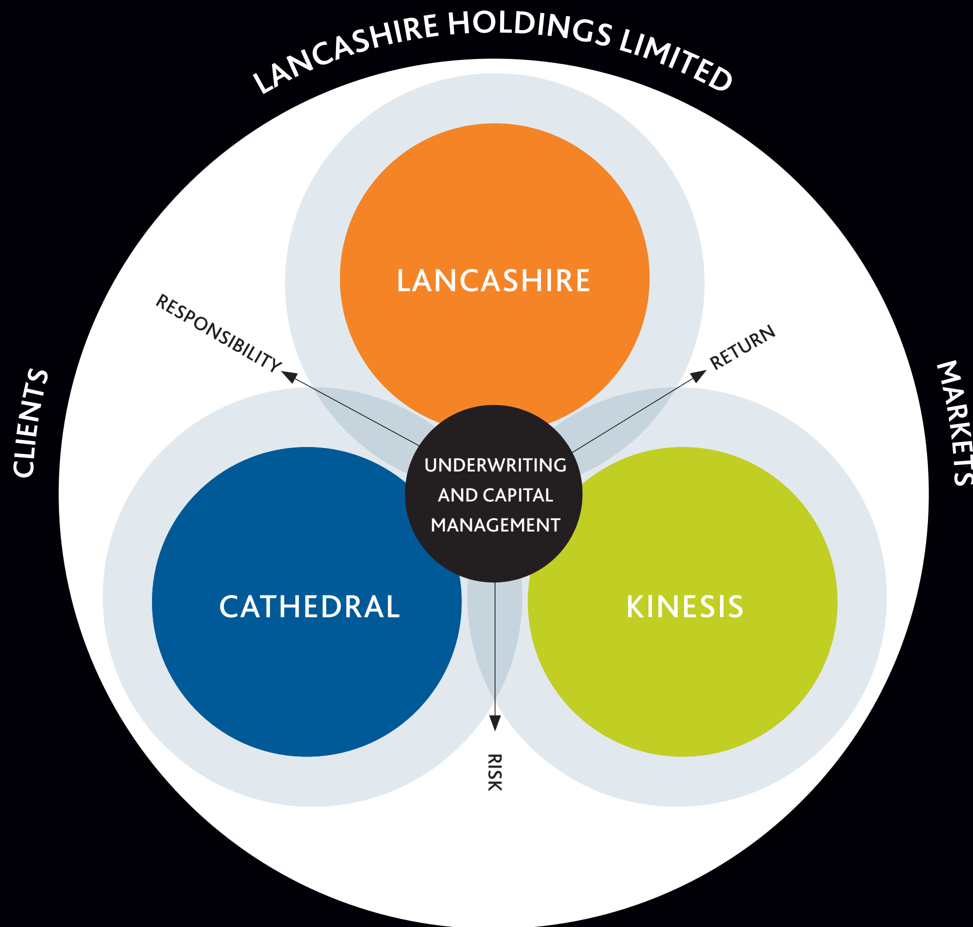
Dividend yield

10.5%

Read pages 20 and 21

THREE PLATFORMS *BALANCED BY ONE GOAL*

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



OUR RESPONSIBILITY

We recognise that our responsibility as a company and as individuals reaches wider than our shareholders and our clients. We strive to be a good employer, a good corporate citizen and a responsible preserver of resources. Through the Lancashire Foundation, we make financial contributions and provide human support to a number of good causes in the places we operate and around the world (for further details see pages 36 to 41).

	Lancashire	*Cathedral*	*Kinesis*
KEY STRENGTHS	• Strong brand with clients and brokers • Recognised for significant capacity and leadership ability in well-defined business sectors • Proven track record of supplying capacity across the cycle with consistently high performance • A lean business operation allows us to remain nimble and make decisions efficiently • A profitable core book of business and disciplined underwriting allows us to produce an excellent combined ratio • Strong record of capital management actions to optimise and adjust capital and navigate market cycles • Experienced management team with proven ability	• Manages two active syndicates • Strong relationships with clients and brokers • Recognised for long-term consistency of relationships • Efficient Lloyd's capital model allowing Cathedral greater premium leverage than for rated companies • Worldwide licensing maintained by Lloyd's allows Cathedral to write business worldwide with limited regulatory overheads • Use of world's oldest insurance third-party capital – the Names – who pay underwriting fees, costs and profit commission • Proven track record with more than three years under Lancashire ownership	• Experienced, fully dedicated management with strong relationships with clients, brokers and investors • Ability to leverage Group data, relationships and reputation with investors and clients • Highly specialised multi-class product with barriers to entry in terms of data and modeling expertise • Ability to raise and deploy capital quickly • Expanding investor base following a strong underwriting performance since the first capital raise in 2014 • Proven track record with Kinesis now in its fourth year
GOALS	• Maintain key client, broker and reinsurer relationships to ensure the continued flow of business • Continue the use of reinsurance solutions to uphold risk-adjusted balance in softening markets • Retain 'underwriting comes first' culture and discipline without being tempted into innovation or diversification for its own sake	• Maintain core portfolios in the syndicates in a climate of ever increasing competition • Continue to look for new opportunities for bolt on business lines in both syndicates • Leverage the Group's balance sheet and cross-sell where opportunities arise	• Ensure product is correctly calibrated to meet clients' needs in terms of responding to events and providing capital relief • Deliver returns in line with expectations for modeled ranges given market losses and pricing • Continue to increase investor club members • Provide bespoke and flexible products to match investor appetite
RISKS	• Influx of new capacity, and further development of broker facilities with less robust underwriting controls • Continuing rate pressures in softening markets • Widening terms and conditions being accepted by the insurance market without adequate pricing or exclusions	• Pressure on signings and participation given relatively small line sizes • Expanded burden of regulatory oversight or overlapping regulation from Lloyd's, the PRA and the FCA	• Increased competition from traditional and collateralised markets, with attempts to replicate the Kinesis product • Possible waning of investor interest in insurance allocations as interest rates begin to increase and yields return to capital markets • Resistance to complex reinsurance products amongst clients, given cheap availability of traditional products
RETURN	72.5% Lancashire Companies' combined ratio	83.7% Cathedral's combined ratio	0.8% Kinesis contribution to Group RoE

BALANCING *RISK AND REWARD*

Good underwriting remains paramount, as does our ability to act quickly and nimbly to changing conditions and our preparedness to closely match our capital to the opportunities available to us.

ALEX MALONEY
Group Chief Executive Officer

RETURN ON EQUITY
13.5%

COMBINED RATIO
76.5%

PROFIT AFTER TAX
$153.8m

Did Lancashire perform as you expected in 2016?

We've had a good set of results for 2016 with an RoE of 13.5 per cent and a combined ratio of 76.5 per cent. Whilst these figures are the product of our disciplined underwriting and risk selection, they do tend to mask a difficult trading environment. I have spoken regularly about the current over-supply of capital and the resulting imbalance which this generates, leading to downwards pressure on pricing and coverage terms within the international insurance and reinsurance markets. Those conditions persisted in 2016, influenced in part by another year of modest catastrophe losses across the insurance industry. There has been little sign of improvement as we enter 2017, other than some evidence of a slowing of the rate of decline in pricing, principally in the property catastrophe reinsurance lines.

Are these market conditions 'the new normal'?

I firmly believe that the insurance business is cyclical. We are now trading through what I consider to be a low point in the cycle. For a moment in early October 2016 the world watched as Hurricane Matthew caused devastation and tragic loss of life. It moved through the Caribbean to then skirt along the Florida coast and make landfall in South Carolina. As events developed the trajectory took the storm towards less densely populated areas. What might have been a major loss to the industry, in excess of those losses we have seen in recent years, in fact caused insured losses of a more attritional nature. There was erosion of earnings rather than serious capital impairment. However, Matthew illustrates that the market is operating at the very margins of profitability and that any material catastrophe loss could result in meaningful capital impairment. Macro-economic conditions and capital flows will change and catastrophe loss events will occur. Sooner or later the balance of capital and underwriting opportunity will readjust.

Has Lancashire's strategy changed in the face of the current market challenges?

Lancashire's strategy has remained constant, but our tactical implementation of strategy has changed over time, to rebalance the risk and return equation, to address current market conditions. Our strategy remains: to balance the risk that we assume against the potential return; to exercise our experience and be professional in our underwriting; and to demonstrate nimble capital management throughout the insurance cycle. During 2016 this meant that our underwriters worked hard to service the ongoing needs of our clients, whilst

> *"Our business is equipped with the right expertise and relationships, with our clients, their brokers and our capital providers, to remain a relevant and important provider of insurance and reinsurance solutions, wherever we find ourselves in the insurance cycle."*

showing discipline on both pricing and terms of coverage. On the other side of the equation, reinsurance can be an efficient form of capital management which allows us to maintain or reduce our aggregate risk exposures. This inevitably depresses returns in the current market, but I am confident that our tactical implementation of strategy will enable Lancashire to manage this stage of the cycle, protect its balance sheet, and meet the challenge of the next market moving event, when it does come. Our business is equipped with the right expertise and relationships, with our clients, their brokers and our capital providers, to remain a relevant and important provider of insurance and reinsurance solutions, wherever we find ourselves in the insurance cycle.

What are your plans for Lancashire's Lloyd's platform for the coming year?

In late December 2016 we welcomed Jon Barnes as the new designated Active Underwriter for Syndicate 2010, and last autumn we appointed John Spence as the Active Underwriter for Syndicate 3010. We have also appointed a further four new underwriters, Heather McKinlay as the CUL CFO, Emma Woolley as CUL's Director of Compliance and we have promoted Adam Beardon to the role of CUL CRO. Andrew McKee will join as the new CEO for our Lloyd's business in June 2017. I am particularly pleased to have attracted individuals of such high calibre, as it demonstrates Lancashire's ability not only to cultivate home grown talent but also to attract the very best people from across the industry. Peter Clarke has described the parallel work which has been carried out in renewing and refreshing the CUL Board (see page 43). Therefore, as we enter 2017, Cathedral continues to be a Lloyd's business not only with a reputation for its underwriting expertise, client service and ability to generate returns for its investors, but with a reinvigorated board, management and business team more closely aligned to Lancashire's thinking and strategic objectives. These changes have not come easily, but the work of rebuilding has begun to create a business with more open lines of communication, better integrated strategic thinking and improved management and governance.

Does Lancashire remain distinctive?

We are still different to our competitors. Lancashire has had some excellent results over many years, but my management team is not interested in accolades, rather in identifying the challenges of the present moment and doing what needs to be done quickly and effectively. Our headcount remains around 200 globally and that helps promote a very lean and nimble business culture. Without cutting corners we still have the ability to move very quickly to develop opportunities and/or address areas of risk. There is a 'can do' attitude amongst our employees who like our culture and working environment and the financial rewards and career opportunities that they can bring. I also believe that our business structure, with respected Lancashire (re)insurance operating companies in London and Bermuda, our Lloyd's platform and the Kinesis third-party capital management facility, gives us the ability to trade on at least equal terms with competitors who may operate far more complex and intrinsically costly businesses.

What are the biggest threats and opportunities for Lancashire?

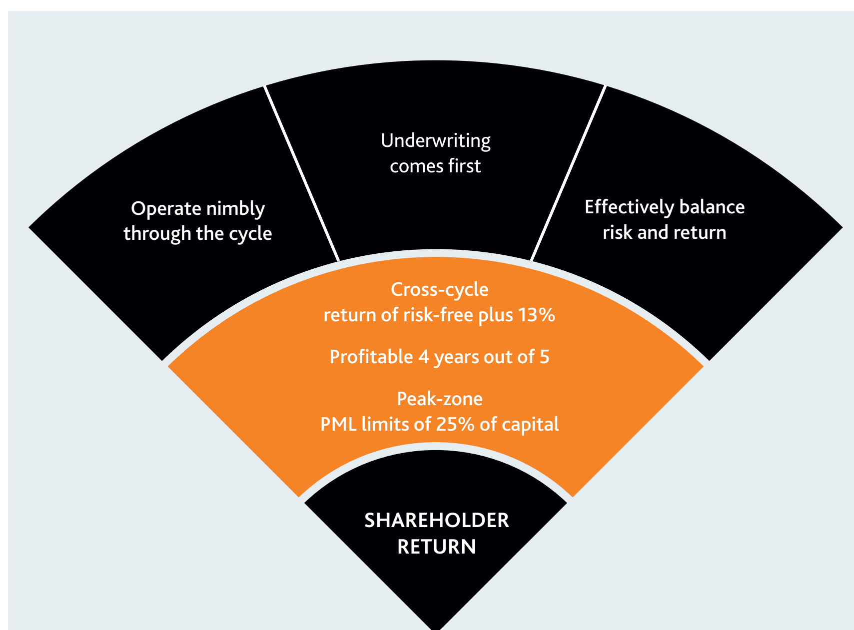
I have already spoken about the corrosive effect of excess capital in our sector. There has been much debate around the threat of 'disruptors' within the insurance industry, whether that is through alternative technologies, forms of distribution, underwriting or capital. Change in one form or another is a certainty, but I believe that Lancashire's commitment to offering bespoke, tailored specialty insurance products to our clients will help mitigate these threats. The ability to add value in a transaction and to service client requirements will remain central to our future success. To that end we will continue to service and protect our core book of business and seek to retain and reward all those people who are key to the success of our operations. This requires patience and discipline. The last couple of years have seen instances of insurance businesses effectively changing themselves through mergers and rationalisation of existing operations. That approach may buy time for some. However, the insurance industry cannot afford to operate on such tight margins over the longer term, in particular faced with the threat of a material upturn in global insured catastrophe losses, which will materialise sooner or later. Lancashire is ready for that moment of opportunity.

Alex Maloney
Group Chief Executive Officer

MAINTAINING *CONSISTENCY*

OUR STRATEGY

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



OUR CULTURE – THE BEDROCK OF OUR STRATEGY

Lancashire encourages a culture of cooperation and respect based on open challenge. This can be seen clearly in the LICL and LUK daily underwriting and marketing call where junior and senior underwriters debate the risks they want to write and their fit to the portfolio and market. It also characterises the Group-wide RRC which brings together underwriting, actuarial, modeling, finance, treasury, risk and operations to challenge the assumptions used in all areas of our business.

Description

UNDERWRITING 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.

EFFECTIVELY BALANCE RISK AND RETURN

By bringing together all our disciplines – underwriting, actuarial, modeling, finance, treasury, risk and operations – at our fortnightly RRC meetings, we are able to look at how different parts of our operations are working together. We stress test our business plans and gauge where we can be most effective without undue volatility.

OPERATE NIMBLY THROUGH THE CYCLE

As capital continues to accumulate in the (re)insurance market, the need to be nimble is more important than ever. This means being ready to deploy capital quickly when it is needed, and having the discipline to return it when it is not.

Achievements	*Performance*		*Associated strategic risks*
We have reduced our written premium and PMLs by turning down under-priced business, whilst retaining our core book. We have grown the number of Kinesis investors and the number of cedants to double figures. At 1 January 2017 Cathedral was successful in renewing its business, despite intense competition.	KPI **COMBINED RATIO** **76.5%** A market leading combined ratio, even in difficult markets, evidencing the continued focus on underwriting, superior risk selection and portfolio construction.	**GROSS PREMIUMS WRITTEN** **$633.9m** We focused on protecting our core portfolios, but maintained the discipline to decline or re-structure our participation on under-priced or poorly performing business.	The key risk in the current market phase is the loss of relevance to brokers and clients. With so much surplus capacity, insurers need to have a unique selling point. For the Group, that is found in its mixture of underwriting capacity, leadership capability, significant reinsurance expenditure and multiple balance sheet options.
We have had to reduce income in some areas of our business in response to a weakening market. However, we have been able to find substantial outwards reinsurance opportunities that allowed us to mitigate some of the effects of price reductions, and reduce our net exposures until the time is right for us to retain more risk.	KPI **RETURN ON EQUITY** **13.5%** A good result despite a challenging market and the incidence of risk losses, helped by our improved outwards reinsurance programme.	**PROBABLE MAXIMUM LOSS** **$157.5m*** We continued to reduce our exposure to key catastrophe perils as the market has become more competitive, demonstrating our discipline and nimbleness. * 1 in 100 year Gulf of Mexico Hurricane expected net loss at 1 January 2017.	The key issue for Lancashire is to continue to serve our clients and brokers with significant capacity, whilst ensuring that the portfolio is balanced. This means constantly re-assessing our business mix, and testing key risk assumptions.
Lancashire renewed its 15 per cent disapplication of pre-emption rights at the 2016 AGM to assist potential future capital raises.	KPI **PERCENTAGE OF COMPREHENSIVE INCOME RETURNED TO SHAREHOLDERS** **113.3%** Lancashire continues to exercise the discipline of giving back capital it cannot profitably deploy, but remains open to new opportunities.	KPI **DIVIDEND YIELD** **10.5%** Whilst buying back shares can be a part of right-sizing capital, special dividends allow the Group to make substantial capital adjustments when these are justified.	Lancashire has developed an expectation among its shareholders that it will produce a consistent return and pay ordinary dividends and special dividends when it makes sense to do so. All shareholders understand that in hard markets Lancashire will retain, and even raise, capital to take full advantage of underwriting opportunities.

KPI ***Read more on page 21***

Read about our Risk Management on page 31

MAINTAINING STRONG *PERFORMANCE*

ELAINE WHELAN
Group Chief Financial Officer

Both insurance and investment markets continue to be challenging, but we have remained patient and maintained our discipline. That has produced an RoE of 13.5 per cent, a combined ratio of 76.5 per cent and an investment return of 2.1 per cent: strong performance in a tough environment.

How has Lancashire maintained balance during 2016?

In the current phase of the cycle there are many factors to consider – it really is a bit of a balancing act. We want to have enough capital to be able to write the deals we think still look attractive, while managing broker and client relationships to decline those we do not. We don't want to carry too much capital, but in the current environment we are a little defensive and carry a bit more of a buffer than we typically would. There is a lot of uncertainty in the markets just now. That uncertainty also impacts our investment portfolio, but we continue to ignore the noise and invest for the longer term, protecting our capital and making tactical adjustments as necessary. On the expense side, we have always chosen to be leanly staffed so we are appropriately structured for all aspects of the cycle. With only two physical locations in Bermuda and London we are also better able to communicate and respond more quickly than some larger international companies might. It's a careful balance, but one that is paying off.

So how would you sum up 2016 performance?

2016 has been another year of attrition hurting the industry – a number of events have impacted the market, but none have been large enough either individually or collectively to drive any meaningful change in pricing, let alone a hardening of the market. We have continued to focus on both superior risk selection and our core clients' needs, while managing our exposures through reinsurance. We increased our reinsurance spend again this year, taking advantage of well-priced opportunities there. While there is undeniably a cost to that, we have reaped the benefits of increased recoveries this year, particularly on our energy book. On a risk-adjusted basis we are still able to produce an acceptable return, yet manage our downside risk. Our RoE for the year was 13.5 per cent and our combined ratio, excluding fee income, was 76.5 per cent. Including fee income our combined ratio was 72.3 per cent. Lancashire contributed 9.1 per cent to our RoE, with Cathedral and Kinesis contributing 3.6 per cent and 0.8 per cent respectively. In short, it's a strong performance in difficult markets.

Are the Group's three platforms performing in line with expectations?

The short answer is yes. The original Lancashire (London and Bermuda) platform continues to produce the majority of the Group's return. When we purchased Cathedral in November 2013, we said we expected it to contribute 2 to 3 per cent per annum to our RoE. Ignoring acquisition adjustments in the earlier years, it is actually exceeding those expectations. Kinesis is opportunity driven and could get to a size where it also

FINANCIAL HIGHLIGHTS

	2016 $m	2015 $m	2014 $m	2013 $m	2012 $m
Gross premiums written	**633.9**	641.1	907.6	679.7	724.3
Net premiums written	**458.7**	481.7	742.8	557.6	576.1
Net premiums earned	**488.1**	567.1	715.6	568.1	582.6
Net insurance losses	**142.5**	155.7	226.5	188.1	174.1
Net underwriting income	**213.5**	265.2	335.7	254.2	289.1
Net investment income	**29.8**	29.8	28.6	25.4	32.5
Net realised (losses) gains and impairments	**(2.4)**	(2.8)	(5.9)	12.6	11.8
Net operating profit	**144.0**	173.4	231.9	184.2	220.3
Profit after tax	**153.8**	181.1	229.3	222.5	234.9
Net change in unrealised gains/losses on investments	**4.1**	(11.3)	(2.1)	(32.5)	17.8
Comprehensive income	**157.9**	169.8	227.2	190.0	252.7
Dividends[1]	**178.9**	317.5	321.0	325.6	201.4
Diluted earnings per share	**$0.76**	$0.91	$1.16	$1.17	$1.29
Diluted operating earnings per share	**$0.71**	$0.87	$1.17	$0.97	$1.21
Fully converted book value per share	**$5.98**	$6.07	$6.96	$7.50	$7.83
Return on equity	**13.5%**	10.9%	13.9%	18.9%	16.7%
Return on equity excluding warrant adjustments	**13.5%**	13.5%	14.7%	18.9%	17.1%
Net loss ratio	**29.2%**	27.5%	31.7%	33.1%	29.9%
Net acquisition cost ratio	**27.1%**	25.8%	21.4%	22.1%	20.5%
Expense ratio	**20.2%**	18.8%	15.6%	15.0%	13.5%
Combined ratio	**76.5%**	72.1%	68.7%	70.2%	63.9%
Accident year loss ratio	**46.2%**	46.0%	35.9%	36.1%	34.6%
Net total return on investments[2]	**2.1%**	0.7%	1.0%	0.3%	3.1%

(1) Dividends are included in the financial statement year in which they were recorded.
(2) Net return on investments includes internal foreign exchange hedge.

contributes 2 to 3 per cent to our RoE, but that's a hard market contribution. We currently expect around 1.0 per cent, subject to loss performance and collateral releases. It is currently performing right in line with those expectations.

How have the departures of Cathedral employees impacted financial performance?

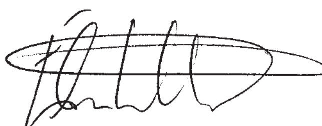
Well we haven't lost any business as a result of the departures, but did incur some costs early in 2016 – about $1.7 million. We've fully re-staffed now and expect the ongoing cost base for Cathedral to be pretty stable. There were a number of RSS awards granted to certain Cathedral employees on acquisition – a total of £18.7 million. A large portion of those have been, or will be, forfeited as individuals have left, or are leaving, prior to vesting. Of the original awards issued, only £6.4 million remain for future exercise. While the forfeits don't impact RoE there is a benefit to EPS and also simply an economic benefit from no longer having to settle those awards or the dividend equivalents on them.

How does the decline in Sterling impact the business?

As a U.S. dollar company, with about 60 to 70 per cent of our cost base in Sterling, we will see some benefit from the fall in Sterling. The extent of that obviously depends on how low Sterling falls and for how long. For the 2016 financial year, as compared to 2015, we have a saving of approximately $10.0 million in our operating expenses.

How has capital been managed in 2016?

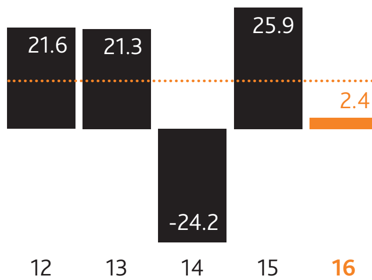
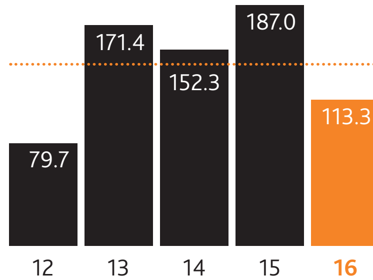
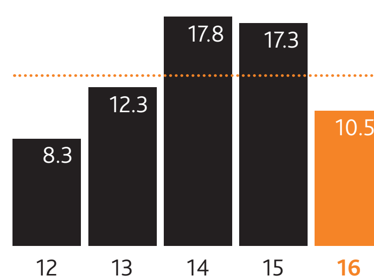
Our capital philosophy remains unchanged. We work out what business we want to write, and then we work out the capital we need to support that. We add a buffer and any excess beyond that buffer is returned to shareholders. As I mentioned, occasionally we will hold a little more of a buffer in times of market stress or where we think there may be an impact from other external factors that are out of our control. We are currently carrying a little more of a buffer than we typically would as we think 2017 is going to be an interesting year in a number of respects. Even with that buffer, we have returned a total of $178.9 million this year or 113.3 per cent of comprehensive income. That's a dividend yield of 10.5 per cent. Including the dividend declared on 15 February 2017, our capital return since inception stands at $2.7 billion or 104.2 per cent of comprehensive income.



Elaine Whelan
Group Chief Financial Officer

	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 the risk-free rate over the longer term.	The Group aims to price its business to ensure that the combined ratio in any year is significantly 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. Within this framework we aim for a degree of investment portfolio growth.
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 costs to net premiums earned and is a measure of an insurance company's operating performance. It is calculated as the sum of the loss ratio, the acquisition cost ratio and the expense ratio. These ratios are defined in our glossary.	Total investment return measures investment income and net realised and unrealised gains and losses produced by the Group's managed investment portfolio.
Performance	13.5%	76.5%	2.1%
5 year average*	12: 16.7*; 13: 18.9*; 14: 13.9*; 15: 10.9*; 16: 13.5	12: 63.9; 13: 70.2; 14: 68.7; 15: 72.1; 16: 76.5	12: 3.1; 13: 0.3; 14: 1.0; 15: 0.7; 16: 2.1
	Our market in 2016 remained in a soft phase. We recognise that whilst we have attained very high RoEs in the recent past, at this stage of the cycle we cannot expect to earn such high returns. But we continue to focus on getting the best risk-adjusted return for our shareholders. In 2016 we continued to buy more reinsurance and retrocession protection to reduce our exposures to protect our balance sheet for the eventual market turn.	Whilst the combined ratio in 2016 was above the five-year average, it was still an excellent result compared to some typical market combined ratios above the 90 per cent mark. In the context of a softening market and corresponding downward pressure on premiums, we would expect the combined ratio to increase.	In 2016, Lancashire continued to monitor risk-on/risk-off volatility and maintained the allocation to risk assets in the surplus portfolio as a hedge against the interest rate risk inherent in the significant fixed maturity allocation of the portfolio. However, given the liquidity and duration needs of the business, the composition of the core portfolio is unchanged.
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. We seek to align our variable remuneration to shareholders' interests by having an RoE component in this. Please refer to the Directors' Remuneration Report on page 69 for further details.	The Group's underwriters assess likely losses, using models, their experience and knowledge of past loss experience, industry trends and current circumstances. This allows them to estimate the premiums sufficient to meet likely losses and expenses. Peer reviews of risks are conducted through the daily underwriting call or peer review, depending on risk impact, enabling the Group to ensure careful risk selection, limits on concentration and appropriate portfolio diversification. The RRC then monitors performance at a portfolio level.	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.

* RoE excluding the impact of warrants was 13.5% in 2015, 14.7% in 2014, 18.9% in 2013 and 17.1% in 2012. The five-year average was 15.5%.

TOTAL SHAREHOLDER RETURN	PERCENTAGE OF COMPREHENSIVE INCOME RETURNED TO SHAREHOLDERS	DIVIDEND YIELD	
The Group's aim is to maximise RoE over the longer term and we would expect that to be reflected in our share price and multiple. This is a long-term goal, recognising that the cyclicality and volatility of both the insurance market and the financial markets in general will impact management's ability to maximise the share multiple in the immediate term.	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 Group aims to maintain a strong balance sheet whilst generating an attractive risk-adjusted return for shareholders. Lancashire's dividend yield demonstrates our ability to operate nimbly through the cycle through the active capital management that underpins our business model. We pay annual ordinary dividends, and when we cannot utilise our profits by retaining them as additional capital we return them to shareholders by way of special dividends.	*Aim*
Total shareholder return is measured in terms of the internal rate of return of the increase/decrease in share price in the period, measured in U.S. dollars and adjusted for dividends.	The percentage of comprehensive income returned to shareholders equals the total capital returned to shareholders through dividends and share repurchases paid in a given year, divided by the Group's comprehensive income.	Dividend yield is measured by dividing the annual dividends per share by the share price on the last day of the given year.	*Measurement*
2.4% 	113.3% 	10.5% 	*Performance* 5 year average
Volatility in the markets, continued insurance M&A activity and the UK Brexit vote have all impacted the U.S. dollar share price in 2016.	In view of the current market outlook Lancashire took the decision to return surplus capital to shareholders due to the lack of opportunities meeting internal hurdles outside the core book.	During 2016 we paid annual ordinary dividends of $0.15 per share and a special dividend of $0.75 per share.	
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. Permanent staff are all eligible to receive RSS awards. The participation of employees in the RSS ensures that there is a strong focus on sustainable long-term shareholder value.	Risk tolerances are set at a level that aims to prevent the Group incurring losses that would impair its ability to operate. The Group's key capital measure is its A.M. Best rating, and a minimum rating of A– is considered necessary to attract business. In 2016, Lancashire maintained its A rating.	As capital continues to accumulate in the (re)insurance market, the need to be nimble is more important than ever. This means being ready to deploy capital quickly when it is needed and having the discipline to return it when it is not. The Group has to ensure that all shareholders understand that in hard markets the Group will want to retain, and even raise, capital to take full advantage of underwriting opportunities.	*Risk management*

KPI linked to Executive Directors' remuneration. ***For more information see pages 61 to 79.***

BALANCING THE CYCLE *DELIVERING RETURNS*

PAUL GREGORY
Group Chief Underwriting Officer

2016 was a turbulent year. The volatility within the market and its softening conditions made for an environment that required careful navigation. The Lancashire Group has the underwriting teams, with the appropriate client and broker relationships, to balance these factors while delivering strong returns.

PROPERTY REINSURANCE

The trend of recent years continued in the reinsurance industry with an absence of significant monetary losses in the sector. Mother Nature was certainly not quiet, with earthquakes in Italy, New Zealand, Japan and Ecuador, hurricanes and storms in the U.S. and the Caribbean and wildfires in Canada. Whilst these events sadly led to loss of life, the financial impact to the industry was relatively modest, and certainly not at the levels required to change market conditions. None of the aforementioned events created industry losses in excess of $5 billion. This prolonged period of historically benign loss activity has meant that the property reinsurance market continues to be a challenging environment in which to operate. Despite a general realisation that macro-market margins are too tight to sustain any real uptick in loss frequency or severity, the levels of competitive pressure dictate that rates continue to fall, albeit the pace of change is certainly slowing. Notwithstanding these conditions, our portfolio of property reinsurance risk across the Group continues to perform well, acknowledging of course the benign loss environment. In these difficult trading conditions leveraging the strong client and broker relationships we have across the Group becomes even more important, so being better and more efficient with our Group offering will only benefit the underwriting result.

ENERGY

The ‘perfect storm’ of 2015 meant that the waters remained very choppy throughout 2016. The oil price stabilised somewhat and the retraction of demand was certainly less severe than the prior year. However, the demand and supply imbalance remained in 2016, hence the continuation of extremely challenging market conditions. In the space of 24 months, the premium into the upstream energy market has more than halved due to both rate reductions and demand slippage. The poor loss experience of 2015 continued through 2016 with a number of small to medium-sized losses as well as what could be the largest upstream energy loss since Deepwater Horizon in 2010. In summary, the last two years in the upstream energy market have been challenging, with premium haemorrhaging from the market and loss activity increasing in both frequency and severity. That said, the Group is fortunate to have relationships with strong and well-run companies, and as a result has been able to weather the storm. A continued focus on risk selection and being unconcerned about top line premium helps deliver underlying results that outperform the macro-market metrics. Energy has always been a core pillar of the Group’s strategy and will continue to be so. We understand and accept that the energy market is a volatile place but remain committed to both the market and, more importantly, our clients and their brokers. Together we will work through these tougher times and come out the other side stronger as a result.

TERRORISM, POLITICAL VIOLENCE AND POLITICAL RISKS

The world was a volatile place during 2016 with a continuation of uncertainty and instability across the globe. Sadly, the activity of certain terrorist groups shows no signs of ceasing and the world witnessed atrocities during 2016. These included numerous well publicised attacks across Europe in France, Germany and Belgium as well as a continuation of wars in various countries including Ukraine, Syria and Yemen. In addition to this, there have been the perceived seismic political events of Brexit and the U.S. elections which create a world of increased uncertainty. This creates challenges for underwriting the terrorism and political risk classes of business. However, the events of recent years have not created any significant losses to the insurance market, and therefore capacity has continued to enter the class, creating more competition. We accept that ultimately it is demand and supply that dictate market direction and unfortunately the market will not correct itself purely based upon the logic of being in a more unstable political environment. Given this, risk selection remains paramount and, as with other classes of business, we have built up a profitable core portfolio of business which is ours to defend and which is far easier than trying to build out a new portfolio in a challenging market. We continue to choose not to support broker facilities whereby we are required to 'give our pen away', something that we will continue to resist as long as possible in order to maintain our underwriting standards and therefore control the risk we put onto our consolidated balance sheet. The Group uses its ability to offer significant capacity across multiple platforms to ensure it is providing both clients and brokers with a fully rounded product and service which allows it to maintain its underwriting principles despite the many challenges the markets contain.

PROPERTY DIRECT & FACULTATIVE

Much like the property reinsurance portfolio, the direct property market has seen a number of small events impact the profitability of the class. The Canadian wildfires and Hurricane Matthew are the most obvious examples, but nothing sufficient to create a market dislocation and positive change to the rating environment. Therefore the property insurance market remains competitive, albeit different parts of the market are experiencing different levels of competition, and this is highlighted within our portfolio. The Group's portfolio is made up of two parts, commercial open market property risks and binders. The market conditions of this sector are predominantly driven by the demand and supply dynamics within the class, more so than any other external factors that you may see in other classes. Over the past few years the appetite of the insurance market for open market business has increased dramatically and consequently that part of the market has witnessed intense competitive pressures, driving rates downwards. This part of the Group's portfolio reduced through the course of 2016, as underwriting discipline was maintained and risks that no longer met the return hurdles were declined. Where possible, facultative reinsurance is used to modify the impact of market conditions and help the Group maintain long-standing client relationships, but this is not always possible. In contrast, the binder portfolio has been far less competitive and more stable and now forms a larger part of the overall portfolio as the rate reductions are far less severe and the long-standing nature of client relationships means there is less pressure on each risk. The dual impact of a reducing open market book and a consistent binder book creates a portfolio where, for the first time in many years, the binder percentage of the portfolio will be greater than the open market risks. This is expected in the softer part of the cycle and it demonstrates the value of the consistently performing binder book as it allows the Group to maintain its underwriting discipline on the open market risks. When the market environment changes this trend will likely reverse, but in the softer market this allows the portfolio to maintain its profitability.

MARINE

The cargo market can be seen as the barometer for world trade and if there is economic uncertainty then demand will be impacted. This has certainly been the case in recent years. Market conditions, as in all other lines of business, are competitive with a surplus of capacity. However, the core portfolio of business has been defended, rate reductions have been manageable, and the portfolio profitable. Without the pressure to grow top line income, the portfolio is stable and will ebb and flow with both the demand and rating environment. The hull, builders' risk and war portfolios are historically very stable portfolios of business that have changed very little since the inception of the Group. Much like the cargo portfolio, the size of this book will rise and fall in line with market conditions and, once again, the profitable portfolio of risks has been defended. Whilst market conditions remain as they are, the underwriting appetite will not change. Making an underwriting profit in marine classes is historically the exception rather than the rule, and we intend to remain the exception.

AVIATION

The Group underwrites both aviation insurance and reinsurance, and both markets are extremely challenging. During 2014 and 2015, losses to the aviation markets increased in frequency and severity. 2016 had fewer and less severe market losses. Rates continue to be under pressure but in some areas of the class it is starting to feel like the bottom may be getting close, albeit we are not there yet. In the aviation war market for example, the broker line slips that are so prevalent to the class no longer have the same levels of capacity available to them. That means that more risks have to come to the open market underwriters who tend to resist the trend for deteriorating pricing. It is small changes like this that can start to make a difference to the market dynamics. That said, like any other market, until such time as the demand and supply dynamic changes, the market conditions will not change fundamentally. So until this happens, we continue to focus on risk selection and protecting our portfolio of risks with appropriate reinsurance. Given the team we have throughout the Group, we certainly have the expertise to maximise any opportunity that may arise in the future.

STRIKING A *BALANCE*

HAYLEY JOHNSTON
Chief Underwriting Officer, LUK

SYLVAIN PERRIER
Chief Underwriting Officer, LICL

Striking a balance during a difficult year for underwriting.

BUSINESS ENVIRONMENT AND OUTLOOK

2016 was yet another difficult year for underwriting as we are now firmly in the soft phase of the underwriting cycle. Our strategy has remained unchanged as we are working to maintain our long-term profitable underwriting relationships whilst managing our outwards exposure through the purchase of well-priced, targeted reinsurance.

Our business model was always designed with the knowledge that we have to cater for all phases of the cycle. A solid return on equity and an excellent combined ratio have been achieved during 2016 and allowed us to return profits, based on our continued commitment to focusing first on our underwriting and our capital management.

Our outlook for 2017 is a continuation of current market trends. However, we expect to be able to continue to maintain our core book and consequently operate to a similar capital level as 2016, albeit with a bit more of a buffer than we normally carry given the current environment.

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 only covers business written by LICL and LUK, to offer a consistent basis for analysis. The calculation involves a degree of judgement in relation to the comparability of contracts and the assessment noted above. To enhance the RPI tool, the 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 the RPI 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.

PREMIUMS

Gross premiums written decreased by 1.1 per cent in 2016 compared to 2015. The Group's five principal segments, and the key market factors impacting them, are discussed below.

PROPERTY

Property gross premiums written increased by 11.3 per cent for the year ended 31 December 2016 compared to the year ended 31 December 2015. The majority of the increase was driven by new business in the political risk and property catastrophe excess of loss classes, partly offset by reductions due to the impact of non-annual policies in the political risk

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	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Aviation (AV52)	**37**	41	44	49	55	59	62	68	69	80	100
Gulf of Mexico offshore energy	**111**	118	125	136	140	140	139	137	64	80	100
Worldwide offshore energy	**70**	81	91	97	100	97	88	84	68	80	100
Marine	**72**	82	91	89	86	79	80	82	80	88	100
Property retrocession and reinsurance	**103**	117	132	152	157	131	121	127	86	97	100
Terrorism	**38**	43	48	52	55	57	60	66	71	86	100
Combined	**61**	68	76	81	84	83	81	83	76	86	100

UNDERWRITING RESULTS

	2016						2015					
	Property $m	**Energy $m**	**Marine $m**	**Aviation $m**	**Lloyd's $m**	**Total $m**	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m
Gross premiums written	**219.5**	**126.0**	**37.2**	**36.2**	**215.0**	**633.9**	197.2	112.0	47.6	36.6	247.7	641.1
Net premiums earned	**148.5**	**105.5**	**35.4**	**25.5**	**173.2**	**488.1**	171.3	126.5	37.7	33.4	198.2	567.1
Net loss ratio	**9.2%**	**39.3%**	**41.8%**	**(4.7)%**	**42.6%**	**29.2%**	10.6%	37.0%	13.8%	57.8%	33.4%	27.5%
Net acquisition cost ratio	**18.9%**	**45.1%**	**27.4%**	**30.6%**	**22.5%**	**27.1%**	18.4%	37.4%	34.2%	26.3%	23.0%	25.8%
Expense ratio	**–**	**–**	**–**	**–**	**–**	**20.2%**	–	–	–	–	–	18.8%
Combined ratio	**28.1%**	**84.4%**	**69.2%**	**25.9%**	**65.1%**	**76.5%**	29.0%	74.4%	48.0%	84.1%	56.4%	72.1%

and terrorism classes. Business flow in the political risk class is generally less predictable than other classes of business due to the lead time and specific nature of each deal. Rates continued to experience pressure in the property catastrophe excess of loss class.

ENERGY

Energy gross premiums written increased by 12.5 per cent for the year ended 31 December 2016 compared to the year ended 31 December 2015. The Gulf of Mexico book was responsible for most of the increase during 2016. Some new business was added in this class, but the vast majority of the increase was driven by the timing impact of multi-year deals plus the cancellation and replacement of certain contracts. The worldwide offshore book continued to experience price and exposure reductions due to the relatively low oil price, offset somewhat by the timing of renewal of non-annual deals.

MARINE

Marine gross premiums written decreased by 21.8 per cent for the year ended 31 December 2016 compared to the year ended 31 December 2015. The majority of the decrease across the class during 2016 was driven by the timing of non-annual renewals, together with a reduction in prior underwriting year risk-attaching business due to changes in the underlying exposure.

AVIATION

Aviation gross premiums written decreased by 1.1 per cent for the year ended 31 December 2016 compared to the year ended 31 December 2015. The decrease was mainly due to the timing of satellite launches on contracts written in previous years.

LLOYD'S

In the Lloyd's segment gross premiums written decreased by 13.2 per cent for the year ended 31 December 2016 compared to the year ended 31 December 2015. The decrease was primarily due to reductions across all lines of business, with rates continuing to come under pressure due to over-capacity in the market. In addition, the energy and marine cargo lines were both impacted by the low oil price. The decline in marine cargo premiums was due to the lower value of oil in transit. In the energy line, less oil production and exploration has reduced exposure.

CEDED

Ceded premiums increased by $15.8 million, or 9.9 per cent, for the year ended 31 December 2016 compared to the year ended 31 December 2015. Favourable conditions in the reinsurance market have generally allowed both Lancashire and Cathedral to buy more reinsurance limit, by adding new layers and attaching at lower loss levels for around the same outlay. The increased spend was largely due to higher cessions to various outwards facilities and additional reinstatement premiums.

EARNED

Net premiums earned as a proportion of net premiums written were 106.4 per cent for the year ended 31 December 2016, compared to 117.7 per cent for the year ended 31 December 2015. The reduced earnings percentage was due to an increase in longer tenor business written plus increased reinsurance spend.

LOSSES

The Group's net loss ratio was 29.2 per cent for the year ended 31 December 2016 compared to 27.5 per cent for the year ended 31 December 2015. The 2016 accident year loss ratio, including the impact of foreign exchange revaluations, was 46.2 per cent compared to 46.0 per cent for the year ended 31 December 2015. While there were no major losses in either 2016 or 2015, both years experienced a few mid-sized losses, primarily across the property and energy classes. Attritional losses for both years were otherwise low.

Prior year favourable development was $85.8 million for the year ended 31 December 2016 compared to favourable development of $107.7 million for the year ended 31 December 2015. Despite some adverse development on prior accident year marine and energy claims in 2016, the overall favourable development was primarily due to general IBNR releases across most lines of business due to a lack of reported claims. Experience in 2015 was similar in terms of releases, plus there was a further benefit of additional recoveries on the 2011 Thai flood losses.

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

Excluding the impact of foreign exchange revaluations, previous accident years' ultimate losses developed as follows during 2016 and 2015:

ULTIMATE LOSS DEVELOPMENT BY ACCIDENT YEAR

	2016 $m	2015 $m
2006 and prior accident years	**0.3**	1.6
2007 accident year	**(0.7)**	1.1
2008 accident year	**1.6**	(2.1)
2009 accident year	**(18.0)**	4.1
2010 accident year	**3.2**	(3.5)
2011 accident year	**9.9**	17.1
2012 accident year	**13.5**	10.8
2013 accident year	**(1.6)**	35.4
2014 accident year	**19.9**	43.2
2015 accident year	**57.7**	–
Total	**85.8**	107.7

Note: Positive numbers denote favourable development.

The ratio of IBNR to total net loss reserves was 34.6 per cent as at 31 December 2016 compared to 35.2 per cent as at 31 December 2015.

LOSS DEVELOPMENT BY CLASS

	2016 $m	2015 $m	2014 $m	2013 $m	2012 $m
Property	**36.6**	26.4	19.8	13.2	(36.0)
Energy	**17.3**	35.2	5.4	18.4	37.4
Marine	**1.9**	13.8	(9.7)	(23.4)	25.9
Aviation	**3.9**	2.9	0.9	(1.4)	0.1
Lloyd's	**26.1**	29.4	18.0	9.1	n/a
Total	**85.8**	107.7	34.4	15.9	27.4

Note: Positive numbers denote favourable development.

ACCIDENT YEAR LOSS RATIOS

	2016 %	2015 %	2014 %	2013 %	2012 %
Accident year loss ratio	**46.2**	35.7	27.0	28.5	27.9
Initial accident year loss ratio	**n/a**	46.0	35.9	36.1	34.6
Reduction in loss ratio post-accident year	**n/a**	10.3	8.9	7.6	6.7

Note: Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2016.

ACQUISITION COSTS

The acquisition cost ratio was 27.1 per cent for the year ended 31 December 2016 compared to 25.8 per cent for the year ended 31 December 2015. The increase was largely due to the additional reinsurance cover purchased in 2016 compared to 2015, in addition to higher profit commissions on some of our worldwide offshore business.

INVESTMENTS, LIQUIDITY AND CASH FLOW

Since inception, the primary objectives for our investment portfolio have been capital preservation and liquidity. Those objectives remain unchanged, and are more important than ever in today's volatile and reactive markets. As market volatility continues, we position our portfolio to limit downside risk in the event of market shocks. In 2016, our focus was on managing our interest rate risk, the largest risk to our predominantly fixed maturity portfolio. We continue to maintain a short duration, mostly fixed maturity portfolio and have been using our risk budget to add products to our portfolio to help mitigate a rise in interest rates. We produced a total investment return of 2.1 per cent compared to 0.7 per cent for the year ended 31 December 2015. Our average annual total investment return since inception is 2.9 per cent, and we have made a positive investment return in every year since inception, including 2008. Our portfolio mix illustrates our conservative philosophy, as shown in the table below. 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 112. As at 31 December 2016 and 2015 the managed portfolio was as follows:

	2016 **%**	2015 %
Fixed maturity securities	**81.4**	81.6
Cash and cash equivalents	**10.4**	9.6
Hedge funds	**7.0**	8.0
Equity securities	**1.2**	0.8
Total	**100.0**	100.0

PERFORMANCE

MANAGED INVESTMENT PORTFOLIO ALLOCATIONS

	2016 **%**	2015 %	2014 %	2013 %	2012 %
Cash	**10.4**	9.6	10.6	14.7	11.1
Short-term investments	**0.3**	1.1	1.4	9.8	5.4
Fixed maturity funds	**0.8**	0.6	0.7	1.1	–
Government debt	**20.3**	23.6	21.4	14.6	18.8
Agency debt	**4.4**	0.2	0.8	4.1	6.2
Agency MBS, CMBS	**6.4**	7.3	7.7	10.9	19.2
Non-agency RMBS, ABS, CMBS	**7.3**	8.4	11.0	8.4	5.3
Corporate bonds	**32.5**	33.2	31.7	29.7	32.2
Bank loans	**6.6**	5.9	5.8	4.5	1.8
Fixed maturity – at FVTPL	**2.8**	1.3	1.4	1.3	–
Equity securities	**1.2**	0.8	0.7	0.7	–
Hedge funds – at FVTPL	**7.0**	8.0	6.8	–	–
Other investments	**–**	–	–	0.2	–
Total	**100.0**	100.0	100.0	100.0	100.0

The composition, duration and asset allocation of the investment portfolio are reviewed on a regular basis in order to respond to changes in interest rates and other market conditions. If certain asset classes are anticipated to produce a higher return within management's risk tolerance an adjustment in asset allocation may be made. Conversely, if the risk profile is expected to move outside tolerance levels, adjustments may be made to reduce the risk in the portfolio. We try to be nimble in our investment strategy while putting our objective of capital preservation first and foremost. We believe in the application of common sense, and do not place much reliance on 'black box' approaches to investment selection.

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

INVESTMENT PERFORMANCE

Net investment income, excluding realised and unrealised gains and losses, was $29.8 million for the year ended 31 December 2016, consistent with 2015. Total investment return, including net investment income, net realised gains and losses, impairments and net change in unrealised gains and losses, was $38.4 million for the year ended 31 December 2016 compared to $14.4 million for 2015. For the year ended 31 December 2016, the investment portfolio returned 2.1 per cent. The fixed maturity portfolios performed reasonably well in 2016 primarily due to the narrowing of credit spreads which more than offset the slight increase in treasury yields during the year. Investment income was supported by strong returns from the Group's bank loans, equities and equity linked notes during 2016. For the year ended 31 December 2015, the investment portfolio returned 0.7 per cent, reflecting the increase in treasury yields and the widening of credit spreads.

LIQUIDITY

The Group 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, the Group's investment strategy places an emphasis on the preservation of invested assets and provision of sufficient liquidity for the prompt payment of claims in conjunction with providing a reasonably stable income stream.

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

CASH FLOW

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

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

In 2016, whilst lower than the prior year, our operating cash flow remained strong, driven by the Group's robust underwriting performance. A net positive cash inflow arose from operations during the year of $48.9 million (2015 – $98.1 million).

KEY INVESTMENT PORTFOLIO STATISTICS

	2016	2015	2014	2013	2012
Duration	**1.8 years**	1.5 years	1.5 years	1.0 year	1.8 years
Credit quality	**A+**	AA–	AA–	AA–	AA–
Market yield	**1.9%**	1.9%	1.5%	1.2%	1.1%
Book yield	**1.8%**	1.6%	1.5%	1.4%	1.8%

LANCASHIRE THIRD-PARTY CAPITAL MANAGEMENT

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

	2016 $m	2015 $m
Kinesis underwriting fees	**4.4**	5.6
Kinesis profit commission	**6.2**	7.3
Lloyd's fees & profit commission	**9.9**	7.0
Total other income	**20.5**	19.9
Share of profit of associate	**5.1**	4.1
Total third-party capital managed income	**25.6**	24.0

The reduction in Kinesis underwriting fees year on year is due to slightly less limit placed. The slightly lower Kinesis profit commission during the year ended 31 December 2016 compared to 2015 was due to the retention of a portion of the collateral held on the January 2015 underwriting cycle which is awaiting the confirmation of claims quantum. We anticipate receiving the remaining commission during the first quarter of 2017. The share of profit of associate reflects Lancashire's 10 per cent equity interest in the Kinesis vehicle.

The higher Lloyd's fees and profit commission during the year ended 31 December 2016 compared to 2015, was driven by the timing of profit commission on the 2014 year of account, together with profit commission on consortium business.

OTHER OPERATING EXPENSES

	2016 $m	2015 $m
Employee remuneration costs	**61.4**	64.3
Other operating expenses	**37.1**	42.3
Total	**98.5**	106.6

Employee remuneration costs for the year ended 31 December 2016 were $2.9 million lower compared to 2015. A higher compensation expense due to Cathedral staff departures was recorded in 2015. Otherwise 2016 benefited from the depreciation of Sterling in the second half of 2016.

Other operating expenses were $5.2 million lower for the year ended 31 December 2016 compared to the same period in 2015, primarily due to the depreciation in Sterling.

Equity based compensation expenses were $10.7 million for the year ended 31 December 2016 compared to $15.8 million for the year ended 31 December 2015. The decrease was primarily due to the lapsing of restricted share scheme awards of former employees of Cathedral on their departure from the Group.

CAPITAL MANAGEMENT

Lancashire has built a reputation for being one of the best known and most active proponents of capital management in the industry. Capital management is our most important area of focus after underwriting and it is our firm belief that 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. We have returned 104.2 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 and 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.

Maintaining a strong balance sheet will be the overriding factor in all capital management decisions. The Solvency II regulatory regime for (re)insurance in the EEA introduced a new basis for assessing regulatory capital requirements and became effective from 1 January 2016. The Group is more than adequately capitalised for supervisory and regulatory purposes under the Solvency II regime.

CAPITAL

As at 31 December 2016, total capital available to the Group was $1.528 billion, comprising shareholders' equity of $1.207 billion and $320.9 million of long-term debt. Tangible capital was $1.374 billion. Leverage was 21.0 per cent on total capital and 23.3 per cent on total tangible capital. Total capital and total tangible capital as at 31 December 2015 were $1.542 billion and $1.388 billion respectively.

DIVIDENDS

During 2016, the Lancashire Board declared a final dividend of $0.10 per common share in respect of the 2015 financial year, an interim dividend of $0.05 and a special dividend of $0.75 per common share in respect of 2016. With the final dividend in respect of 2016 of $0.10 per common share, total capital returns since inception amount to $2.7 billion, or 274.7 per cent of initial capital raised. The final dividend of $0.10 per common share has been declared and will be paid on 22 March 2017 to the shareholders of record on 24 February 2017.

NON PRE-EMPTIVE ISSUE OF SHARES

As part of the Group's flexible approach to capital management the Board has in recent years requested and received from shareholders authority to issue up to 15 per cent of its shares on a non pre-emptive basis. Lancashire believes that this ability to raise capital quickly is important in securing first mover advantage in the catastrophe insurance and reinsurance business in which it underwrites. The Board proposes to put similar requests for authority to shareholders in resolutions at the 2017 AGM to be held on 3 May 2017.

LETTERS OF CREDIT

Lancashire has a standard syndicated LOC facility which in total amounts to $300.0 million, with a $75.0 million loan sub-limit available for general corporate purposes. During 2016, Syndicate 2010 and Syndicate 3010 each had a catastrophe facility in place to assist in paying claims and gross funding of catastrophes. These facilities amounted to a combined $100.0 million with a total of $50.0 million available by way of LOCs and $50.0 million by way of RCFs. For 2017, this facility is in place for Syndicate 2010 only, providing in aggregate up to $80.0 million with a total of $40.0 million available by way of LOCs and $40.0 million by way of RCFs.

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

BALANCING *THE ELEMENTS OF ERM*

LOUISE WELLS
Group Chief Risk Officer

Balancing all the elements of ERM is essential if we are to emerge from this soft market ready to maximise any opportunities.

THE ONGOING BALANCING ACT

With the continued soft market in 2016 it has been even more important to ensure that we are balancing the risk we take on with the reward we receive for that risk. Our focus, therefore, has been on ensuring risk management remains inherent within our everyday processes and procedures; and that those processes and procedures continue to operate effectively and efficiently.

THIS YEAR'S ERM JOURNEY

Early in 2016 we completed the implementation of our new risk system, the 'Governance Portal', which has enhanced our quarterly risk and controls' affirmation process. In addition, Internal Audit now use the system to record all audit findings and link them to the relevant risk and control. The control affirmations have not identified any significant failings or weaknesses in our key controls or associated processes.

As at 31 December 2016, all Group entities were operating within their board-approved risk tolerances. No new risks have been identified and there have not been any material changes in our existing risks. Our risk preferences reduced during 2016 as a result of the market conditions, as we work to maintain our risk and return balance.

Our quarterly own risk solvency assessment reports prepared by the CRO to the main Board, known as ORSA reports, provide a timely analysis of current and potential risks, compared to risk tolerances, along with their associated capital requirements. The third annual ORSA report was reviewed, challenged and approved by the Board during the fourth quarter of 2016 and submitted to the PRA in line with supervisory requirements.

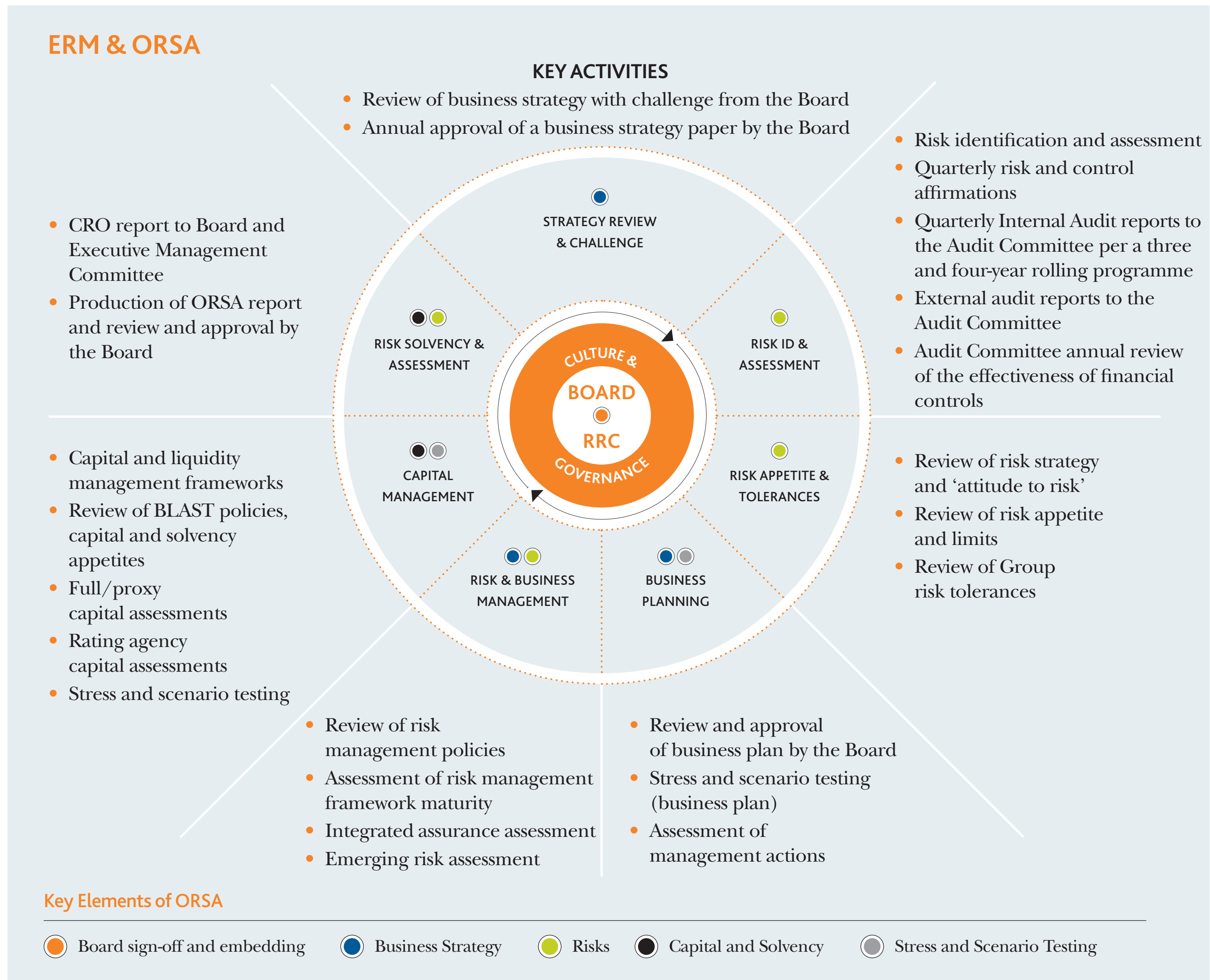
As a Lloyd's Managing Agent Cathedral falls within the Society of Lloyd's for Solvency II reporting, preparing ORSA reports for each syndicate. Cathedral has its own ERM framework to ensure adherence to Lloyd's minimum standards.

For the first time this year, the CRO reported to the Remuneration Committee regarding risk and remuneration, recognising the importance of the design of the remuneration structure in driving desired behaviours over both the short-term and the longer-term business planning periods.

LOOKING FORWARD AND MAINTAINING THE BALANCE

A detailed review of the ERM framework across the Group is planned for early 2017. This review will take into account how the existing framework has served us, current market best practice, and how the Group plans to operate going forward, with the aim of ensuring that the risk management framework meets the challenge of balancing the Group's risks and returns during the soft market and beyond.

The diagram below illustrates how we balance our ERM and ORSA activities. Our risk culture is driven from the top down via the Board and executive management to the business, with the RRC central to these processes.



RRC

The RRC, under the chairmanship of the Group CEO, is the key management tool for monitoring and challenging the assessment of risk on a continual basis. The RRC agenda is reviewed each year to ensure its activities remain appropriate and are aligned with the business cycle. The RRC reports its principal findings to the Board through the CRO's quarterly ORSA reports.

BLAST

We continue to challenge the assumptions used in BLAST and make changes where appropriate.

EMERGING RISK

As ever in 2016, the Group strove to foresee potential areas of new risk, or developments in existing risks that could threaten the Group. The political and economic outlook remains uncertain following the results of both the UK's referendum on leaving the European Union and the U.S. Presidential Election. Whilst we don't expect either to have a material impact on the Group, we continue to monitor the position. Cyber risk remains a hot topic and under scrutiny, both in our operating exposure and via our inwards insurance risk. Terrorism is an area of core business focus for the Group, and is well understood, but the continued increase in the diversity of targets and modes of attack from terrorist groups means we maintain a watch on developing trends.

RISK UNIVERSE

We continue to classify risks in three broad classes:

- Intrinsic Risk: 'Risk that stems from the inherent randomness and uncertainty that exists in the universe in which we operate and that is therefore fundamental to how we manage our business.' This is the risk we accept as inherent in the core functions of our business; so we recognise that by insuring fortuitous events we can suffer losses, and that within our investment portfolio we can see the value of investments fall. We cannot avoid these risks so we focus on the correlated operational risks and seek to mitigate them. So, for example, we know that by insuring the risk of earthquake we are exposed to the risk that losses exceed our plan. We model our portfolio using stochastic modeling to review actual and planned exposures to ensure they remain within tolerances. The correlated risks are that we might fail to design or maintain effective tolerances and limits, and fail to maintain exposures within such limits; or that we fail to keep accurate and timely records of our exposures. We then devise systems and processes to mitigate these risks, such as PML reconciliations, and RDS sign-offs, with review by the RRC and regular ORSA reports to the Board.
- Operational Risk: 'The potential for specific losses arising as a result of inadequate or failed internal processes, personnel, systems or (non-insurance) external events.' Risks that are operational in causation can be split into two sub-categories in terms of how they crystallise:
  - Independent: risks that have the potential to crystallise independently from intrinsic risk. For example, losses arising through the imposition of fines as a result of a regulatory breach, so unrelated to our core functions.
  - Correlated: risks that relate to the failure to effectively operate the processes designed to manage intrinsic risk, and which therefore have the potential to amplify its impact beyond that modeled. For example, increased reinsurer default losses arising through the use of non-approved counterparties.
- Other Risk: This is the non-financial category of risks such as reputational risk or communication risk which cannot necessarily be mitigated by holding capital since such risks may not have direct balance sheet implications. These are included within the risk register and are assessed and mitigated through scenario and stress testing.

RISK UNIVERSE

Type	Category	Description
Intrinsic Core	Underwriting Investment	Intrinsic risks representing the potential to generate a return as well as a loss. In these areas, the Group promotes informed risk taking that considers the risk and return equation in all major decisions, with the intention of maximising risk-adjusted return on equity.
Intrinsic Non-core	Reserving (Re)Insurance counterparty Liquidity	Intrinsic risks to which we are inevitably exposed as a result of conducting our day-to-day business operations yet offer no direct potential for return. They are quantified insofar as practicable for the purposes of capital and risk management and avoided or minimised insofar as is economically justifiable.
Operational	Operational	These are risks arising as a result of inadequate or failed internal processes, personnel, systems or (non-insurance) external events. They have the potential either to magnify the adverse impacts of intrinsic risks or to crystallise separately in their own right.
Other	Strategic Group Emerging	These are risks for which quantitative assessment is difficult but for which a structured approach is still required to ensure that their potential impact is considered and mitigated insofar as is practicable.

BALANCING OUR *RISKS AND OPPORTUNITIES*

As described under our review of the Risk Universe, our classification of risks as Intrinsic Core and Intrinsic Non-Core, Operational and Other helps us to focus on our management and mitigation of those risks. Further details concerning these risks can be found on pages 101 to 128. Within BLAST, insurance risk accounts for over 80 per cent of the allocated risk capital, so this is clearly the principal area where we stringently apply controls and reviews. For example, we place a large number of controls around monitoring risk levels across the business. However, we understand that even risks that do not generate a capital charge under an economic capital model can pose serious threats to the execution of the business plan and strategy, and therefore need to be monitored and tested. For example, we spend a lot of time looking at the implications of emerging capital and the evolution of the market cycle.

INTRINSIC RISK: CORE	
TYPE	**MITIGATION**
Underwriting: Losses in our classes are hard to predict in particular as to the specifics of timing and quantum of catastrophe loss events. Additionally, we write lines of business that are subject to accumulations, including accumulations of individual risk losses arising from a single event such as several property catastrophe excess of loss programmes being affected by a windstorm or earthquake, and accumulations between business lines such as a 9/11 type event impacting both the terrorism and AV52 portfolios. Losses can also exceed expectations in terms of both frequency and severity. So, although we model losses, for example using the RMS and AIR stochastic models, we know that these projections can and will be wrong in many instances.	Modeling: We apply loads to, and stress test, stochastic models and develop alternative views of losses using exposure damage ratios. RRC: The RRC considers accumulations, clashes and parameterisation of losses and models. Capital: We set our internal capital requirements at a level that allows for buffers above accumulations of extreme events and the Board considers capital requirements on at least a quarterly basis.
Investment: We need to hold sufficient assets in readiness to pay claims, but the markets and products in which we invest can suffer volatility and losses. As a short-tail insurer, we are able to hold the majority of assets in low duration securities such as fixed income bonds. However, this creates an additional source of risk in the current environment, where there is a considerable risk from changes to interest rates as quantitative easing programmes may begin to taper or be increased. We model our investment portfolios and use various stress scenarios to see what kinds of losses we could expect under a range of outcomes.	Investment strategy: Our strategy is that investment income is not expected to be a significant driver of our returns. Our primary focus remains on underwriting as the engine of profits. Investment strategy is approved annually and monitored on a quarterly basis by the Investment Committee and Board. IRRC: The IRRC forms an integral part of our risk management framework, meeting at least quarterly and reporting to the RRC. External advisers: Lancashire's Board and management recognise that the Group's principal expertise lies in underwriting so we use the services of internationally recognised investment managers who are experts in their fields.

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

INTRINSIC RISK: NON-CORE CONTINUED

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

OPERATIONAL

TYPE	MITIGATION
These are risks arising as a result of inadequate or failed internal processes, personnel, systems or (non-insurance) external events. They have the potential either to magnify the adverse impacts of intrinsic risks or crystallise separately in their own right. This can encompass IT availability, where the failure of an IT system, such as our underwriting system, could impact our ability to maintain accurate and up-to-date records of our exposure. If correlated with an insurance loss this could cause us to breach insurance risk tolerances. It could also encompass IT integrity, where an unauthorised intruder could alter data in our systems, or introduce a bug that would corrupt the system.	Capacity: We mitigate IT availability risk by adding redundancy to the capacity we need and using backups of data including off-site storage that we test regularly. Testing and access: We mitigate the integrity risk by using independent external penetration tests, and by restricting access to key systems to only those people who are qualified and need to use them. Personnel: We mitigate the risks associated with staff retention and key-man risk through a combination of resource planning processes and controls. Examples include targeted retention packages, documented position descriptions and employment contracts, resource monitoring and the provision of appropriate compensation and training schemes. The Board regularly reviews succession planning arrangements and remuneration structures.

OTHER

TYPE	MITIGATION
These are risks for which quantitative assessment is difficult but for which a structured approach is still required to ensure that their potential impact is considered and mitigated insofar as practicable. They include categories such as Strategic, Group and Emerging Risks.	Qualitative approach: These risks require a qualitative approach, engaging staff in appropriate discussions about sources of risk, and then thinking about possible outcomes. The Group Executive Committee and the RRC consider these issues, and the ORSA reports made by the CRO to the Board include standing items on Emerging Risk.

SUPPORTING COMMUNITIES – *OUR RESPONSIBILITY TO OTHERS*

WHY CORPORATE RESPONSIBILITY IS IMPORTANT TO LANCASHIRE

Corporate responsibility is an integral part of Lancashire's approach to its business. We recognise the need to balance our commitment to our shareholders, employees and more immediate stakeholders with a responsibility to support the wider communities whether within our neighbouring areas or further afield. The Lancashire Foundation, our charitable grant making body, is the cornerstone of our support. The channelling of the talents and energy of our staff in helping others in this way helps benefit and build Lancashire's business and a positive culture.

OUR APPROACH

Lancashire tries to improve society and our environment using such tools as donations by the Foundation and the allocation of staff charity days to work on local improvement projects. We limit the negative impact of our carbon footprint through mitigation strategies and offsets. As well as the direct benefits, we believe that Lancashire reaps indirect benefits in terms of its attraction as an ethical and compassionate employer, and the positive and long lasting team-building benefits of the activities undertaken. In terms of governance, the Board sets the policy for corporate donations to the Foundation and reviews reports on its activities. The day-to-day activities of the Foundation are delegated to a Donations Committee comprised of staff members from across our operating platforms, which monitors and reports on the activities of the charities to which donations are made and brings a mixture of passion and pragmatism to our charitable giving. The Board also sets the policy for the operation of the HR function, and the environmental impact of the business.

Lancashire has a relatively low headcount (fewer than 200 employees globally), all of whom are remunerated on a basis which comfortably exceeds UK minimum wage requirements. In the ancillary services and limited supply chains used by the Group, Lancashire seeks to receive assurance that its service providers pay a living wage. Concerns over human rights issues with insureds and potential clients are addressed as part of the underwriting process. During 2016, the Board approved a statement addressing modern slavery and human trafficking concerns, which is published on the Lancashire website. The Board has recently reviewed the statement on slavery and human trafficking and concluded that it remains fit for purpose.

WE FOCUS ON THE FOLLOWING FOUR AREAS:

COMMUNITY

$17.4m

donated by the Lancashire Foundation since inception

See page 37

ENVIRONMENT

100%

of our 2016 CO_2 emissions offset

See page 39

MARKETPLACE

100%

of our employees are eligible for RSS awards

See page 40

WORKPLACE

10

different countries represented by our workforce

See page 41

COMMUNITY

We remain strongly committed to engaging with our local communities in Bermuda and the UK, including those that are near to our London office, and we continue to support local initiatives and activities, through partnerships with schools, local government and local businesses.

OUR APPROACH

We support our communities through the Foundation by making donations to locally based charities and through our staff charity day release programmes and charity leave. We believe that our mixture of financial support and voluntary engagement provides greater satisfaction for our staff and greater value to our charities. In 2016, 79 of our staff members across the Group participated in one or more of the volunteering opportunities offered by Lancashire. In Bermuda we continue to sponsor a morning fresh fruit programme for primary school children, and have from time to time held staff raffles, bake sales and other fundraising efforts.

OUR FOCUS AREAS

We focus on victims of disasters and those who are disadvantaged and excluded whether through lack of opportunity, lack of resources, or just in need of a helping hand. As our business is in part based on insuring against natural disasters we know very well how disruptive they can be, so the largest Foundation donation is to MSF, who provide immediate aid in crisis situations (both natural and man-made) right across the globe. The Foundation has made significant financial commitments to charities that support families in crisis (Family Centre) and children with autism (Tomorrow's Voices) in Bermuda, and charities supporting ex-offenders throughout the UK (St Giles Trust), and a poverty relief programme in the Philippines (ICM). But we also support them in other ways, for instance renovating premises for Tomorrow's Voices, mentoring staff members for St Giles Trust and sending volunteers on week-long service missions to support some of the poorest communities in the Philippines with ICM.

We also make donations to charities suggested by staff and indeed by clients and brokers. In 2016, we supported Back Up Trust, Batten Disease Family Association, Skiing with Heroes, National Brain Appeal, Prostate Cancer Research Centre, Action Medical Research, Udaan India Foundation and SCARS, all at the suggestion of our business partners, helping to build the sense of an insurance community in Bermuda and London.

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 release programmes for staff to give back to the communities in which they live and around the world. In addition, staff are entitled to up to a week's annual charity leave on completion of three years' permanent employment with the Group, which they can spend with a charity of their choice or with an existing Foundation-supported entity. The Lancashire Foundation also operates a charity matching scheme to support individual staff members' charitable initiatives. During 2016 such matched funds from the Foundation amounted to $27,373 and supported 13 charities.

CORPORATE RESPONSIBILITY IN ACTION

School Home Support

School Home Support (SHS) is an education charity. It works to ensure children are in school and ready to learn. SHS works with schools, local authorities and other children's settings to provide personalised support to children and families, tackling the underlying barriers to a successful education to improve the life chances of children.

SHS has also developed an innovative new 'early help' programme that supports both children and parents during transition from home or nursery into primary school and from primary to secondary school. Part of the work involves raising aspirations and helping parents and children understand the link between doing well at school and future employment.

On 19 October 2016, Lancashire took part in an SHS Aspiration Session to introduce the idea of employment in the City of London to a small group of ten year old children from a primary school in south London, providing an insight into the corporate environment. SHS Aspiration Sessions are designed to raise ambitions for future employment and to overcome any misconceptions and fears that children (and their parents) have around working within a corporate environment.

"It was really helpful for the children to hear what the Lancashire employees' jobs involve on a daily basis and what it is like to be working for the Lancashire Group. I would also like to take this opportunity to thank them for answering all of the children's and adults' questions. They were extremely patient with us and gave explanations that the children could really understand."

Tracy, SHS Practitioner

"Thank you for the amazing trip and I thoroughly enjoyed it and definitely enjoyed looking at London's amazing architecture. I would love to visit the building again and hope your company does well in the future. I loved the gift as well."

Boy – aged ten

"Thank you for making our trip unforgettable. I know that I want to visit Lancashire Insurance Group again because of how you made it enjoyable and interesting. Plus you gave an amazing gift bag. You made me start to think more about my future. Thank you."

Girl – aged ten

Paul Russell and Louise Byrne with the primary school children who took part in the School Home Support Aspiration Session.

CORPORATE RESPONSIBILITY IN ACTION

Project Transform

Every year, since 2010, six to eight employees from across the Group volunteer to travel to the Philippines and work alongside ICM for a week providing aid and support to those living in ultra-poverty. The 2016 Project Transform volunteers have reflected on their experience and summarised their thoughts below:

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members of staff have volunteered to participate in ICM's Project Transform in the Philippines since 2010.

"The Project Transform trip is well known amongst Lancashire employees as the experiences of previous participants are shared with such enthusiasm. However, being part of the trip first hand is another thing entirely.

The communities we visited, in spite of having so many limitations in terms of food, shelter and opportunity, were incredibly friendly, positive and determined, and exceptionally humbling to be around. The tireless and selfless work of the ICM staff was also eye-opening, and there is a real focus not just at making improvements for people within the communities in the short term, but also at creating an overall environment in which long-term progress can be made – through education, cooperation and ongoing support.

We returned from the trip feeling honoured to have been selected, and hopeful that our individual and combined contributions helped improve, in some way, the lives of people less privileged than ourselves."

The 2016 Project Transform team pictured from left to right – Mark Carvalho, Alannah Brown, Edward Pycraft, Caroline Palmer, Chris Sharkey, Vikram Singh, Andrew Kemp and Richard Lopez.

ENVIRONMENT

Despite a small increase in reporting scope, total emissions for 2016 have decreased by 9.0 per cent compared to 2015, with emissions per full-time employee (FTE) falling by 12.2 per cent.

With operations in London and Bermuda, and with clients and brokers around the globe, the Lancashire Group incurs the bulk of its carbon footprint as a result of airline travel, which is offset through an organised programme. The Group operates out of two offices, at 20 Fenchurch Street, London, and in Bermuda. The Group is also responsible for an apartment in Bermuda, which is used for temporary accommodation, for which data has been collected and reported for the first time this year.

Types of Emissions	Activity	**2016 tCO_2e**	2015 tCO_2e
Direct (Scope 1)	Gas (kWh)	**90.5**	60.4
	Refrigerant	**0.0**	0.0
Indirect (Scope 2)	Electricity (kWh)	**488.5**	590.2
Indirect (Scope 3)	Business Travel (km)	**1,624.3**	1,754.4
	Additional Upstream Activities	**308.7**	346.6
	Other	**50.3**	63.7
Gross emissions		**2,562.3**	2,815.3
Gross emissions tCO_2e per FTE		**12.9**	14.7
Carbon Credits		**(2,563)**	(2,816)
Net emission after offset		**-**	-

OUR APPROACH

The figures in this report are calculated over a 12-month period from 1 January 2016 to 31 December 2016. Lancashire uses the number of full-time employees (FTE) as its intensity metric, which this year shows a decrease of 12.2 per cent to 12.9 tCO_2e per FTE, compared to 14.7 tCO_2e per FTE in 2015.

Where data was not available for 2016, values have been extrapolated by using available data or calculated using industry benchmarks.

OUR FOCUS AREAS

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 Greenhouse Gas (GHG) emissions including Scope 1, 2 and 3. Calculations performed follow the ISO-14064-1:2006 standard and give absolute and intensity factors for the Group's emissions.

The Group's UK operations recently achieved BREEAM excellence for the offices at 20 Fenchurch Street, which has supported an overall improvement in environmental performance.

Therefore, results show that GHG emissions in the year were 2,562.3 tonnes of CO_2e, comprised of direct emissions (Scope 1) amounting to 90.5 tonnes of CO_2e, and indirect emissions (Scope 2) amounting to 488.5 tonnes of CO_2e. The source of other indirect emissions (Scope 3) comprised 1,983.3 tonnes of CO_2e. Scope 2 emissions decreased by 17.2 per cent compared with 2015 due to a 7.2 per cent reduction in overall consumption and the decarbonisation of the UK power grid. Scope 3 emissions have also decreased compared with 2015 due to a reduction in air travel, most notably domestic and short haul flights. Scope 1 emissions have increased by 49.8 per cent due to 2016 being a colder year than 2015, resulting in an increase in gas usage at the Fenchurch Street office.

Lancashire has purchased carbon credits to reduce its gross GHG emissions by 2,562.3 tonnes, offsetting its total carbon emissions and remaining carbon neutral.

The Group has chosen to offset its carbon emissions with Carbon Clear by buying credits in a project to supply low-smoke cooking stoves to communities in the Darfur region of Sudan. These offsetting proposals were discussed and agreed with the Group's CEO.

MARKETPLACE

We continue to help the development of our marketplace by making employees available to sit on market committees, boards and working groups. In 2016, our employees have given talks at industry conferences, investor days and symposia, and market education programmes. As noted on page 37, we also donate to many of the causes supported by our industry partners through the Foundation.

OUR APPROACH

We believe the most important thing we can do is to make the talents of our people available, and we do this happily. We also engage actively with our regulators in Bermuda and London, and the Cathedral team is active within the Lloyd's market. With our clients and their brokers, we are happy to welcome them to our offices, but we also travel to see them and their businesses all around the world.

OUR FOCUS AREAS

Regulators: we recognise the need to engage closely with our regulators at the PRA, FCA, BMA and at Lloyd's and seek to be transparent in all our dealings with them.

Clients: we strive to offer clear, fairly priced and useful products that meet their needs across our range of underwriting operations.

Brokers: we are fully committed to supporting a 'broker market' and prize our broker relationships very highly, right across the Group.

Investors: we continue to work hard at investor relations and have an active programme of engagement with investors around the globe.

WORKPLACE

We strive to attract and retain excellent employees who drive our appetite to outperform. Every company says it, but we truly believe that the talents of our people and our unique culture set us apart from our competitors.

Recruiting the right people for the Group 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.

The Group promotes an inclusive environment that recognises and values diversity as key to enhancing individual development and maximising business effectiveness. One way in which we seek to increase diversity, and promote the values of the Group, is through our 'Respect in the Workplace' training sessions which are given to all new employees during their induction. The training sessions aim to highlight their responsibilities in preventing discrimination in the workplace and in fostering a positive and productive working environment.

Compulsory training is provided to new permanent staff and fixed term contract staff in relation to a number of topics as follows:

- Tax/Regulatory Operating Guidelines;
- Disclosure (including share dealing);
- Inspections;
- Financial Crime;
- ERM; and
- Communications etiquette.

Other training may be held on an ad hoc, one-off or refresher basis.

CORPORATE RESPONSIBILITY IN ACTION

Internship Programme

In 2014, both the Group and the Foundation jointly sponsored two internship positions for Bermuda resident college graduates. These graduates were afforded the opportunity to spend two years working and learning about insurance in the Group's London office and completed their placements during 2016. One of these graduates is now a full-time employee within Lancashire and the other has obtained a role at another market insurer in Bermuda. The Group is pleased to confirm that we have welcomed one further graduate in the summer of 2016.

Andrew Fleming, Intern

"The opportunities afforded to me in being selected for the Lancashire Foundation Graduate Development Programme have thus far proven themselves to be boundless. Through Lancashire Group's international presence, I am able to both grasp a firm understanding of how the Bermuda market functions, as well as explore the dynamic London market – all while building the skills that I will need to be successful in the (re)insurance industry. This, combined with a company culture that encourages questions and champions open communication, has made it both incredibly easy and interesting to learn about the different aspects of the business. Indeed, though underwriting comes first at Lancashire, the exposure to the greater picture that the rotation in the Lancashire Foundation Graduate Development Programme offers, provides a sound foundation from which I can launch my career and a future that is geared towards success."

The training is designed to ensure that all personnel who are employed by the Group are provided with the skills, knowledge and expertise appropriate to their responsibilities.

Among the full-time staff, the turnover for the Group for 2016 was 20.1 per cent (an increase from 8.9 per cent in 2015), and as at 31 December 2016, 13.1 per cent of the workforce was composed of third-party contractors, an increase from 3.5 per cent in 2015. The relatively high rate of staff turnover and third-party contractors was driven principally by changes in our Lloyd's platform, where there was a process of refreshment and renewal implemented during the year (see the CEO statement and Chairman's governance introductory statement on pages 14 and 42 for further discussion).

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

OUR FOCUS AREAS

Our focus in 2016 has been to maintain the success of our employees through ongoing training and coaching – provided both internally and externally. During 2016 almost 32 per cent of our employees undertook formal training supported by the Group. We continue to measure our employees' success through attainment of personal performance metrics as well as performance within the Group's values framework. We are delighted that during 2016 approximately 9.6 per cent of our employees were promoted within the Group supported by the training and development opportunities provided. An area for further development during 2017 will be greater standardisation of the appraisal and training frameworks across the Group.

EMBRACING DIVERSITY

We are committed to being an equal opportunities employer. The Group is currently represented by employees from ten different nations. The gender split of males to females (see page 56) within the Group is 61/39 per cent respectively.

Recruiting the right people for the Group is a high priority for the business and we promote the value of having a diverse workforce. We base all recruitment decisions on the ability of our prospective employees to do the job, without consideration to race, age, gender, sexual orientation, disability, beliefs, or background.

CORPORATE RESPONSIBILITY IN ACTION

Bermuda Zoological Society

The Bermuda Zoological Society ('BZS') is the support charity for the Bermuda Aquarium, Museum & Zoo ('BAMZ'). Their mission statement is: *"The shared mission of BAMZ and the BZS is to inspire appreciation and care of island environments. We fulfill our mission through our animal habitat exhibits, which focus on species from oceanic islands, as well as related environmental education, conservation projects and research programmes."*

On 16 September 2016 Bermuda staff spent their annual day of giving on Trunk Island, the BZS living classroom and nature reserve. In 2015, BZS purchased a 2.4 acre lot on the island and have spent considerable time creating a comprehensive restoration plan under the guidance of Dr David Wingate. He is a well known Bermudian ornithologist, naturalist and conservationist and under his direction the staff culled invasive species as well as performed general landscaping tasks.

"Trunk Island provides numerous and unique educational opportunities for Bermuda school students and the community. However, it does require significant people power to maintain and improve the island. We at the Bermuda Zoological Society could not do it without the support of our corporate community. The Lancashire Group has been a major supporter of this project and we are very grateful for everything that they have helped us with. We look forward to working with them in the future and showing the many improvements that they helped to make happen!"

Dr Ian Walker, Principal Curator

"Thank you to the Lancashire Group for their support of Trunk Island. You accomplished a lot and kept our staff and volunteers busy with your enthusiasm and commitment. Please come back again!"

Joanne Chrisnall, Volunteer Co-ordinator

Lancashire Bermuda staff at their annual day of giving on Trunk Island.

GOOD GOVERNANCE AND *A POSITIVE CULTURE*

PETER CLARKE
Non-Executive Chairman

Governance, when done well, helps facilitate clear communication, constructive challenge and debate and creative strategic decision making. It cultivates a positive, open and balanced culture throughout our business.

In my opening statement I discussed those areas in which our business and Board addressed the challenges of 2016 within the context of our strategic objectives. The following section focuses on the formal work carried out by the Board and its Committees in exercising effective oversight, taking decisions and providing support and constructive challenge to the business.

How does the Board set and monitor the governance objectives for the Group?

By virtue of its premium listing on the LSE, Lancashire measures its corporate governance compliance against the requirements of the UK Corporate Governance Code published by the UK FRC. The FCA requires each company with a premium listing to 'comply or explain' against the Code (i.e. to disclose how it has complied with Code provisions or, if the Code provisions have not been complied with, provide an explanation for the non-compliance). The Group monitors its compliance with the Code on at least a quarterly basis, and in this corporate governance section and throughout this Annual Report and Accounts for the 2016 financial year, areas of corporate governance compliance are explained by reference to the Code. The Company also monitors its compliance with applicable corporate governance requirements under Bermuda law and regulations. In 2016 the PRA became the Group supervisor in accordance with the requirements of the UK's Solvency II regime.

I am pleased to be able to report that there are no areas of material non-compliance with the Code. As a Board and business we seek to use the formal consideration of governance and regulatory requirements not merely as a 'box ticking' exercise, but as useful tools for the structuring of agendas and the consideration of matters of risk and opportunity that are of real commercial and strategic benefit to the Group.

Is the Board effective in shaping a positive corporate culture?

Lancashire strives to implement simple yet effective systems of corporate governance in a way that helps shape strategy, monitors its implementation, balances support and challenge for management and the business and embeds a positive and open corporate culture throughout the Group.

Good strategic debate and decision-making remain central to the work of any board. At Lancashire we are fortunate in having a nimble strategy and a simple 'flat' structure with a total employee headcount at 31 December 2016 of 198. This means that all our Directors have regular opportunities to meet with both the members of our management team and other employees within the business. That helps inform our Board's active understanding of the business, its needs and challenges.

Further to the requirements of Solvency II, UK regulated insurers are required to prepare an ORSA report. Both the management team and the Board have engaged fully with the ORSA process, and use it as a tool to help deepen our understanding of our business, better understand the risks and opportunities facing it and to refine and focus Lancashire's strategic thinking and priorities.

During 2016 our Board once again used the services of Lintstock Limited (a third-party provider of board evaluation services) in facilitating a review of the effectiveness of our Board, its Committees and our Directors. A summary report was discussed by the full Board and I am pleased to report the conclusion that the Board and each of its Committees are considered to have a balance of skills and perspectives that serve the Group effectively and enable them to meet the challenges of the business. As a Board we have also gained useful insights and identified various areas for training and learning during the coming year. I would like to thank all of our Directors for their hard work during the year.

What changes have there been to the Board and governance teams during 2016?

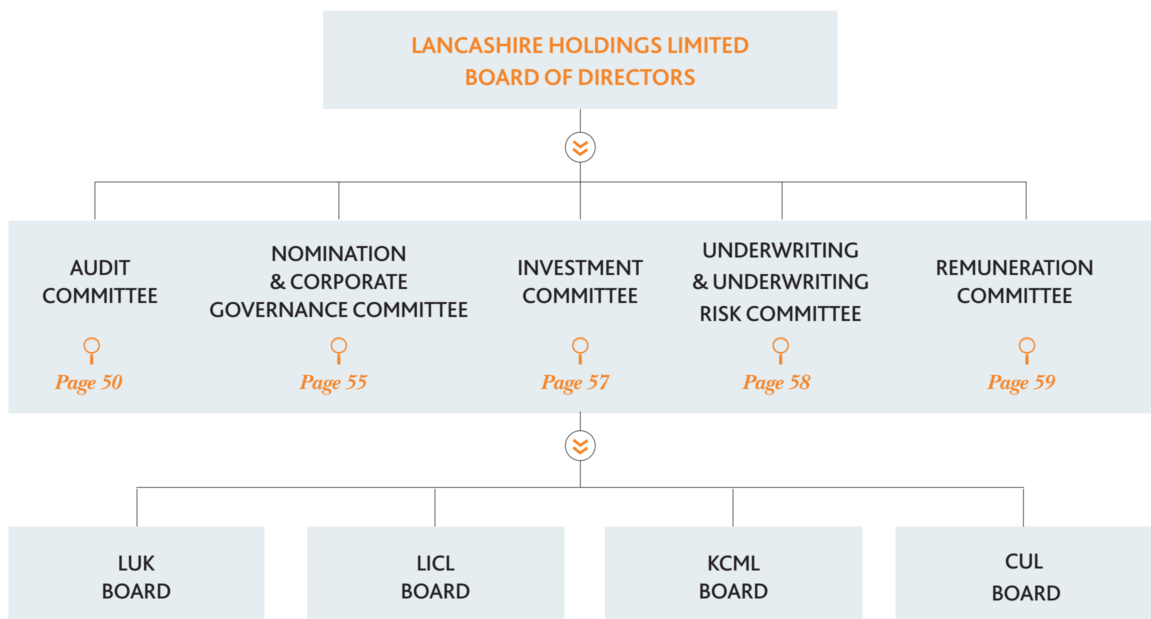
At our AGM in 2016 I became LHL Chairman in planned succession to Martin Thomas. Martin had served in that role since 2006, soon after the Company's formation. In July 2016 Emma Duncan stepped down as a Non-Executive Director after six years' service on the Board. Both Martin and Emma have contributed to Lancashire's success as a respected international specialty insurer and reinsurer and an established member of the FTSE 250 with a track record of generating superior returns for its investors. Our good wishes and thanks go to them. We have also been fortunate to have recruited Robert Lusardi and Michael Dawson to our Board. They bring a wealth of underwriting and insurance industry experience to our Board.

On our subsidiary boards, 2016 witnessed a changing of the guard at CUL. Tony South (the CUL Chairman), Robin Oakes and Elvin Patrick have left the CUL Board after many years' service and we were delighted to welcome Nick Davenport and Lance Gibbins as new independent Non-Executive Directors of CUL. Simon Fraser, the Group's Senior Independent Non-Executive Director, also joined the CUL Board. In February 2017, Nick will assume the role of CUL Chairman from Tony Minns, who has decided to step down having served as a CUL Non-Executive Director for many years, and latterly as CUL Chairman.

Following Martin's departure, Steve Smart assumed the Chairmanship on the LUK Board and we also welcome Adrian Colosso as a valued member of that Board. Samantha Hoe-Richardson, Chairman of the Group's Audit Committee, also joined the LUK Board as a Non-Executive Director.

Peter Clarke
Non-Executive Chairman

OUR GOVERNANCE STRUCTURE



A WELL-BALANCED *BOARD*

Peter Clarke
Non-Executive Chairman

Peter Clarke was Group Chief Executive of Man Group plc between April 2007 and February 2013. In 1993 Mr Clarke joined Man Group plc, a leading global provider of alternative investment products and solutions as well as one of the world's largest futures brokers. He was appointed to the board in 1997 and served in a variety of roles, including Head of Corporate Finance and Corporate Affairs and Group Company Secretary, before becoming the Group Finance Director in 2000. During this period he was responsible for investing in and developing one of the leading providers of third-party capital insurance and reinsurance products. In November 2005, he was given the additional title of Group Deputy CEO. Mr Clarke is currently the Chairman of the National Teaching Awards Trust and a Non-Executive Director of AXA Investment Managers S.A., RWC Partners Limited and Lombard Odier Asset Management. He is a member of the Treasury Committee of King's College London. Mr Clarke took a first in Law at Queens' College, Cambridge and is a qualified solicitor, having practised at Slaughter and May, and has experience in the investment banking industry, working at Morgan Grenfell and Citibank.

Alex Maloney
Chief Executive Officer

Alex Maloney joined Lancashire in December 2005 and was appointed Group Chief Executive Officer in April 2014. On joining, Mr Maloney was responsible for establishing and building the energy underwriting team and account and, in May 2009, was appointed Group Chief Underwriting Officer. Since November 2010 Mr Maloney has served as a member of the Board and was appointed Chief Executive Officer of Lancashire Insurance Company (UK) Limited in 2012. Mr Maloney also serves as a Director of Cathedral Underwriting Limited and has been closely involved in the development of the Group's Lloyd's strategy. Mr Maloney has over 20 years' underwriting experience and has also worked in the New York and Bermuda markets.

Elaine Whelan
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 predominantly (re)insurance and captive insurance clients. Ms Whelan graduated from the University of Strathclyde in 1994 with a BA in Accounting and Economics and gained her Chartered Accountancy qualification from the Institute of Chartered Accountants of Scotland in 1997.

Michael Dawson
Non-Executive Director

Michael Dawson has more than 35 years' experience in the insurance industry, having started his career at Lloyd's in 1979. He joined Cox Insurance in 1986 where he was the Chief Executive from 1995 to 2002. In 1991, Mr Dawson formed and became the underwriter of Cox's and subsequently Chaucer's specialist nuclear syndicate 1176. Between 2005 and 2008 Mr Dawson was appointed Chief Executive of Goshawk Insurance Holdings PLC and its subsidiary Rosemont Re, a Bermuda reinsurer. Mr Dawson served on the Council of Lloyd's from 1998 to 2001 and on the Lloyd's Market Board from 1998 to 2002. He is a Non-Executive Director of Pool Re (Nuclear) Limited and Deputy Chairman of the management committee of Nuclear Risk Insurers Limited.

Simon Fraser

Senior Independent 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 LSE issues. Mr Fraser has an MA degree in modern history from the University of St Andrews. He is also a Non-Executive Director of Legal and General Investment Management (Holdings) Limited and Senior Independent Director of Derwent London plc, where he chairs the Remuneration Committee and sits on the Audit and Nominations Committees. Mr Fraser also serves as a Non-Executive Director of Cathedral Underwriting Limited.

Samantha Hoe-Richardson

Non-Executive Director

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

Robert Lusardi

Non-Executive Director

Robert Lusardi is currently a private investor and has spent his career as a senior executive in the financial services industry. From 1980 until 1998 he was an investment banker with Lehman Brothers, ultimately as Managing Director in charge of the insurance and asset management practices. From 1998 until 2005 he was a member of the Executive Management Board of XL Group plc, first as Group CFO then as CEO of one of their three operating/reporting segments; from 2005 until 2010 he was an EVP of White Mountains (an insurance merchant bank) and CEO of certain subsidiaries; and from 2010 to 2015 he was CEO of PremieRe Holdings LLC. He has been a director of a number of insurance related entities including Symetra Financial Corporation, Primus Guaranty Ltd., OneBeacon Insurance Group Ltd., Esurance Inc., Delos Inc. and FSA International Ltd. He is also on the board of Oxford University's 501(c)3 charitable organisation. He received his BA and MA degrees in Engineering and Economics from Oxford University and his MBA from Harvard University.

Tom Milligan

Non-Executive Director

Tom Milligan was Co-Chief Executive Officer of Ariel Re Holdings Ltd., until his retirement in 2015. He began his career in the City in 1991 with Guy Carpenter & Co. and worked in both London and Bermuda as an insurance intermediary and underwriter. In 2005, Mr Milligan joined Goldman Sachs Group Inc. to start the GS Reinsurance Group's non-life activities. As a Managing Director of Goldman Sachs, Mr Milligan served as Chief Underwriting Officer of Arrow Capital Re in Bermuda, before starting Goldman Sachs-owned Lloyd's Syndicate 1910 in 2008 and serving as Active Underwriter until 2012. In 2012, Mr Milligan led Goldman Sachs' purchase of Ariel Re and served as Co-CEO from April 2012 until July 2014. During 2013, Mr Milligan played a leading role in the spin-off of GS Reinsurance Group into Global Atlantic Financial Group ('GAFG'), before managing the sale of the Ariel businesses from GAFG to BTG Pactual in 2014. He is also a Non-Executive Director of Managing Agency Partners Limited. Mr Milligan graduated from Durham University in 1991.

Christopher Head

Company Secretary

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

HIGHLIGHTS OF *THE BOARD'S YEAR*

FEBRUARY / Q1 MEETING

- In light of Martin Thomas's planned retirement as a Director and Chairman of the Board at the conclusion of the 2016 AGM, the Board decided to appoint Peter Clarke as his successor. The Board approved the appointment of Simon Fraser as a Non-Executive Director of CUL.
- The Board reviewed and approved the Group's 2016 business plan that had been updated in light of the 1 January renewals and then current market conditions.
- Following its quarterly review of capital management, the Board declared a final ordinary dividend of $0.10 per common share in respect of the year ended 31 December 2015.
- The Board reviewed the Group's 2016 framework for executive remuneration.
- The Board approved the Group's Annual Report on Remuneration, as set out in the second part of the Directors' Remuneration Report for the year ended 31 December 2015, for presentation to shareholders for approval at the 2016 AGM.
- The Board approved the Annual Report and Accounts 2015.

APRIL / Q2 MEETING

- The Board approved the Solvency II opening submissions as at 1 January 2016 for submission to the PRA.
- The Board reviewed and adopted the Group's 2016 investment strategy.
- The Board received an annual investor relations presentation from the Group's corporate brokers.
- The Company's 2016 AGM was held at its Head Office on 4 May 2016. All resolutions were duly passed.

JUNE / BOARD STRATEGY DAY

- The objective of the 2016 strategy day was to consider the key decisions to be made in the preparation of the Group's three-year strategic plan. The agenda for the day included:
  - review of the current strategy, including the underwriting, investment and capital management strategies;
  - a presentation on the London and International specialty and reinsurance markets;
  - consideration of the business's resourcing and training needs;
  - review of the emerging and strategic risks identified during the past 12 months; and
  - discussion of the strategic themes and options for the business.

JULY / Q3 MEETING

- The Board approved the appointment of Robert Lusardi as a Non-Executive Director and acknowledged the retirement of Emma Duncan.
- The Board approved the Group's 2016 reforecast business plan in light of market conditions and expectations following the 1 July renewals and actual experience to 30 June.
- The Board declared an interim dividend of $0.05 per common share.
- The Board approved and adopted the Group's three-year strategic plan, including the Group's risk, and capital and solvency appetites.
- The Board approved and adopted the three-year strategy and business plan for the Cathedral group of companies.
- The Board approved and adopted the Company's ERM strategic objectives and plan.
- The Board received and approved a recommendation from the Audit Committee that a recommendation be made to shareholders for approval at the 2017 AGM to appoint KPMG as the Company's external auditors.
- The Board approved and adopted a Group-Wide Share Dealing Policy and a revised Group Share Dealing Code following the implementation of the Market Abuse Regulation in July 2016.
- The Board approved and adopted an updated division of responsibilities between the Chairman and the CEO together with an updated statement on the representation of women on the Board, on executive committees and in senior management, which is published on the Group's website.
- The Board approved amendments to the Group's investment portfolio guidelines.
- The Board approved the change of the Group's corporate brokers to Morgan Stanley and received a presentation from their team on the current market conditions and outlook, particularly in light of the Brexit vote.

NOVEMBER / Q4 MEETING

- The Board declared a special dividend for 2016 of $0.75 per common share.
- The Board approved and adopted the Group's 2017 business plan.
- The Board approved the appointment of Michael Dawson as a Non-Executive Director.
- The Board approved and adopted the Group's updated succession plan.
- The annual performance evaluation of the Board and its Committees and individual Directors was commissioned, to be facilitated by Lintstock Limited.
- The Board approved the appointment of Samantha Hoe-Richardson as a Non-Executive Director of LUK.

DECEMBER

- The Board approved the Group ORSA report for submission to the PRA.

BOARD *COMMITTEES*

BOARD AND COMMITTEE ADMINISTRATION

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

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

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

The Board also meets to discuss strategic planning matters outside the formal meeting schedule. A Board strategy day was held in June 2016.

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

THE DIRECTORS

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

Michael Dawson, Simon Fraser, Samantha Hoe-Richardson, Robert Lusardi and Tom Milligan are independent, as each is independent in character and judgement and has no relationship or circumstance likely to affect his or her independence. Peter Clarke was independent upon his appointment as Chairman on 4 May 2016. At the Board meeting held on 15 February 2017, further to a recommendation by the Nomination and Corporate Governance Committee, the Board affirmed its judgement that five of the eight members of the Board are independent Non-Executive Directors. Therefore, in the Board's judgement, the Board 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.

During 2016 the Board noted Alex Maloney's acquisition of an interest in a Lloyd's Nameco (further details of which are set out on page 154), and the resultant alignment with the Names on Syndicate 2010.

In accordance with the provisions of the Code, all the Directors of the Company are submitting themselves for re-election at the 2017 AGM.

INFORMATION AND TRAINING

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

BOARD PERFORMANCE EVALUATION

A formal performance evaluation of the Board, its Committees and individual Directors is undertaken on an annual basis and the process is initiated by the Nomination and Corporate Governance Committee. The aim of this work is to assess the effectiveness of the Board and its Committees in terms of performance, composition, supporting processes and management of the Group, as well as to review each Director's performance, training and development needs. The 2014 performance evaluation was conducted internally, whilst in 2015 and 2016 the evaluations were facilitated by Lintstock Limited, a London-based corporate advisory firm with no other connection to the Group.

The 2016 evaluation process involved each Director as well as the Company Secretary, the Group CRO and the Group General Counsel completing a confidential online questionnaire designed by Lintstock and with input from the LHL Chairman and the Chairmen of each of the relevant Committees. Responses to the completed questionnaires were collated by Lintstock, who then prepared a suite of summary reports that were discussed in draft with the Chairman before being distributed to each of the Directors.

In February 2017, the Lintstock performance evaluation reports were discussed at meetings of the Nomination and Corporate Governance Committee and the Board, and each of the other Committees discussed the report pertinent to its own operation and performance. The Board discussions were led by the Chairman and focused on such matters as strategic oversight, succession planning, Board composition and training.

In summary, in the Board's consideration of the 2016 evaluation reports, the Board concluded that it operates effectively and has a good blend of insurance, financial and regulatory expertise. All Non-Executive Directors are committed to the continued success of the Group and to making the Board and its Committees work effectively. Attendance at Board meetings was found to be excellent. The CEO and the CFO, the Company's Executive Directors, were also found to be operating effectively.

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

The evaluation process proved a useful learning exercise. Amongst the principal themes identified, the Board considered the attributes required in future Non-Executive appointments, and agreed on the need to ensure sufficient time for the discussion and exploration of strategy and to continue to develop the understanding of the views of shareholders. A number of areas in which to optimise the focus of Board and Committee meetings were also identified for action.

The Board will continue to review its procedures, training requirements, effectiveness and development during 2017.

The Chairman's performance appraisal was conducted by the Senior Independent Director, who consulted with the Non-Executive Directors with input from the Executive Directors during November 2016. The discussion and feedback was extremely positive regarding all aspects of the Chairman's performance. Particular mention was made of the time he spends with the business and his support of the senior executives. It was noted that the Chairman also attends (at the invitation of the relevant Committee Chairman) meetings of those Committees of which he is not an appointed member, thus tracking the detail of Committees' decision-making, as well as providing strategic and high level leadership to the Board.

At the end of the year, the Chairman met with the CEO, and the CEO met with the CFO, to conduct a performance appraisal in respect of 2016 and to set targets for 2017. The results of these performance evaluations were discussed by the Chairman and the Non-Executive Directors and are reported in the Directors' Remuneration Report commencing on page 61.

	Original date of appointment to Board	Board	Audit Committee	Nomination and Corporate Governance Committee	Investment Committee	Underwriting and Underwriting Risk Committee	Remuneration Committee
Non-Executive Directors							
Peter Clarke[1]	9 June 2014	5/5	2/2	2/2	4/4	–	4/4
Michael Dawson	3 November 2016	1/1	–	0/0	–	0/0	0/0
Simon Fraser	5 November 2013	5/5	5/5	–	–	–	4/4
Samantha Hoe-Richardson[2]	20 February 2013	5/5	5/5	4/4	–	–	2/2
Robert Lusardi	8 July 2016	3/3	2/2	–	2/2	–	2/2
Tom Milligan[3]	3 February 2015	5/5	1/1	2/2	4/4	4/4	–
Executive Directors							
Alex Maloney	5 November 2010	5/5	–	–	–	4/4	–
Elaine Whelan	1 January 2013	5/5	–	–	4/4	–	–

(1) Peter Clarke resigned as a member of the Audit Committee, and was appointed as Chairman and a member of the Nomination and Corporate Governance Committee, with effect from his appointment as Chairman of the Board on 4 May 2016.

(2) Samantha Hoe-Richardson served as a member of the Remuneration Committee from 4 May 2016 to 3 November 2016.

(3) Tom Milligan served as a member of the Audit Committee from 4 May 2016 to 8 July 2016. He was appointed as a member of the Nomination and Corporate Governance Committee with effect from 8 July 2016.

RELATIONS WITH SHAREHOLDERS

During 2016, the Group's Head of Investor Relations, usually accompanied by one or more of the CEO, the CUO, the CFO, the Chairman or a senior member of the underwriting team, made presentations to major shareholders, analysts and the investor community. Formal reports of these meetings were provided to the Board on at least a quarterly basis.

Conference calls with shareholders and analysts hosted by senior management are held quarterly following the announcement of the Group's quarterly 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 expected to be available to meet with shareholders at the Company's 2017 AGM.

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

ENTERPRISE RISK MANAGEMENT

The Board is responsible for setting the Group's risk appetites, defining its risk tolerances, and monitoring and ensuring compliance with those risk tolerances. During 2016, the Board carried out a robust assessment of the principal risks affecting the Group's business model, future performance, solvency and liquidity.

Further discussion of the risks affecting the Group and the policies in place to manage them can be found in the risk disclosures section on pages 101 to 128.

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. During 2016 the Directors participated in a number of training sessions addressing the Board's obligations under Solvency II and, in particular, with regard to the review and approval of the Group ORSA and solvency and risk regulatory reporting requirements. The Board considers that a supportive ERM culture, established at the Board and embedded throughout the business, is of key importance. The facilitating and embedding of ERM and helping the Group to improve its ERM practices is a major responsibility assigned to the CRO. The CRO's remuneration is subject to annual review by the Remuneration Committee.

COMMITTEES

The Board has established Audit, Investment, Nomination and Corporate Governance, Underwriting and Underwriting Risk and Remuneration 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' Terms of Reference were reviewed by the Board during 2016 and were considered to be in line with current best practice. The Committees are generally scheduled to meet quarterly, although additional meetings are arranged as business requirements dictate. The composition of the Committees as at 31 December 2016 was as set out in the table appearing above. A report from each of the Committees is set out from page 50 to page 60.

AUDIT *COMMITTEE*

'The essential features of the Audit Committee's relationship with the Board, with the executive management and with internal and external auditors are a frank, open working relationship and a high level of mutual respect.'
(FRC – Guidance on Audit Committees)

COMMITTEE MEMBERSHIP

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

	Meetings attended
Samantha Hoe-Richardson (Chairman)	5/5
Peter Clarke[1]	2/2
Simon Fraser	5/5
Robert Lusardi[2]	2/2
Tom Milligan[3]	1/1

(1) Peter Clarke resigned as a member of the Audit Committee with effect from his appointment as Chairman of the Board on 4 May 2016.
(2) Robert Lusardi was appointed as a member of the Audit Committee with effect from 8 July 2016.
(3) Tom Milligan served as a member of the Audit Committee from 4 May 2016 to 8 July 2016.

PRINCIPAL RESPONSIBILITIES OF THE COMMITTEE

- Monitors the integrity of the Group's consolidated financial statements and any other formal announcement relating to the Group's financial performance. Reports to the Board on significant financial reporting issues and judgements contained in 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.
- Monitors developments in the Solvency II regulatory regime.
- Oversees the relationship with the Group's external auditors and is responsible for assessing annually their independence and objectivity, taking into account the relevant professional and regulatory requirements.
- Makes a recommendation to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the Group's external auditors.
- Monitors and reviews the effectiveness of the Group's Internal Audit function in the context of the Group's overall risk management system.
- Reviews the adequacy and effectiveness of the Group's internal financial controls and internal control and risk management systems (including financial, operational and compliance controls).
- Reviews for adequacy and security the Group's 'whistleblowing' arrangements, procedures for detecting fraud and systems and controls for the prevention of bribery and money laundering.

HOW THE COMMITTEE DISCHARGED ITS RESPONSIBILITIES DURING 2016

FINANCIAL REPORTING

COMMITTEE RESPONSIBILITY	COMMITTEE ACTIVITIES
Monitors the integrity of the Group's consolidated financial statements and any other formal announcement relating to the Group's financial performance. Reports to the Board on significant financial reporting issues and judgements contained in the financial statements.	At each quarterly meeting the Committee reviews the Company's quarterly financial statements for the purposes of recommending their approval by the Board. 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 receives quarterly reports from management on: – developments in accounting and financial reporting requirements; – any new and/or significant accounting treatments/transactions in the quarter; and – loss reserving (see page 143 for further details). An annual paper is also presented to the Committee that details the areas of judgement or estimation in the financial statements (see accounting policies page 95 for the details of these areas). The Committee also considers quarterly reports on the financial statements from the external auditors, including an interim review results report and a year-end audit results report. These are discussed with the external auditors at the Committee's meetings. Of the areas of judgement or estimation considered by the Committee in 2016, those that were considered significant were loss reserving and the valuation of intangible assets. These are explained in further detail on page 54. In accordance with auditing guidance, the external auditors' report includes revenue recognition through the estimation of premium revenues as an area of risk. The Audit Committee considered this and concluded that for Lancashire revenue recognition is straightforward and low risk. While some premiums are subject to estimation, revenues are unlikely to be materially different from initial estimates, particularly on a consolidated Group basis.
Reviews the content of the Annual Report and Accounts and advises the Board on whether, taken as a whole, it is fair, balanced and understandable.	The Chairman of the Committee reviews early drafts of the Annual Report and Accounts to keep appraised of its key themes and messages and to raise any issues early in the process. The Committee reviewed the 2016 Annual Report and Accounts at the February 2017 Audit Committee meeting and advised the Board that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

SOLVENCY II

COMMITTEE RESPONSIBILITY	COMMITTEE ACTIVITIES
Monitors developments in the Solvency II regulatory regime.	A quarterly report was provided during 2016 to the Committee by the CRO detailing the Group's Solvency II activities and how the Group was meeting the requirements of the new regime. The comprehensive training programme to ensure that all Board members are able to discharge their Solvency II responsibilities was continued through 2016 and will be sustained in 2017.

EXTERNAL AUDIT

COMMITTEE RESPONSIBILITY	COMMITTEE ACTIVITIES
Oversees the relationship with the Group's external auditors and is responsible for assessing annually their independence and objectivity, taking into account the relevant professional and regulatory requirements, specifically including: – An annual assessment of the qualifications, expertise and resources of the external auditors and the effectiveness of the external audit process.	The Committee reviews reports from the external auditors at each quarterly Committee meeting including the annual audit plan and an ongoing assessment of the effective performance of the audit compared to the plan. The Committee Chairman conducts informal meetings with the auditors and the CFO prior to, during, and after the quarterly results. The Committee meets in executive session with the external auditors without management present to discuss any particular concerns or sensitivities about the audit process, and with management without the external auditors present to obtain feedback on the audit process. During 2016, an assessment of the effectiveness of the external audit process was led by the Committee Chairman with input from the Company's senior management and the external auditors. The review enabled the Audit Committee to determine that the external audit process was effective and to note some minor development areas for future audits.
– The implementation of a policy on the supply of non-audit services to ensure that the provision of non-audit services by the external auditors does not impair their independence and objectivity.	The Committee has approved and adopted a non-audit services policy that is reviewed on an annual basis and was last updated in October 2016. The policy, which stipulates rules around approvals required for various types of non-audit services, can be found on the Company's website. During 2016, EY provided non-audit services in relation to UK taxation. Fees for non-audit services provided in 2016 totalled $0.1 million representing 3.7 per cent of total fees paid to EY. The Committee gave careful consideration to the nature of the non-audit services provided and the level of fees charged, and has determined that they would not affect the independence and objectivity of EY as auditors.
– Makes a recommendation to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the Company's external auditors.	It was disclosed in the Annual Report and Accounts 2015 that the contract for the provision of external audit services commencing in the financial year 2017 would be put out to tender during 2016 and a recommendation would be made to shareholders at the 2017 AGM. Details of the external audit tender process and the results thereof are disclosed on page 54.

INTERNAL AUDIT

COMMITTEE RESPONSIBILITY	COMMITTEE ACTIVITIES
Monitors and reviews the effectiveness of the Group's Internal Audit function in the context of the Group's overall risk management system.	The Group's Internal Audit function reports directly to the Committee. Each year the Head of Internal Audit presents an audit plan to the Committee for consideration and approval. The highest rated Lancashire and Kinesis risks are considered for audit annually, moderate risks every two years and the lowest risks every three years. The highest rated Cathedral risks are considered for audit biannually, moderate risks every three years and the lowest risks every four years. The findings of each internal audit are reported to the Committee at the quarterly meetings. The Committee has a responsibility to ensure the timely implementation of agreed management actions and to review the status of these at its meetings. The Committee meets in executive session with the Head of Internal Audit on at least an annual basis. During 2016, the Committee reviewed and approved an updated Internal Audit Charter. This can be viewed on the Company's website. An assessment of the effectiveness of the Internal Audit function was conducted by the CRO, with a report issued to the Committee. The Committee discussed the report and its findings with the CRO and the Head of Internal Audit and noted that no significant issues were raised. The Committee concluded that the Internal Audit function is operating effectively and efficiently in the context of the Group's overall risk management system, and is adequately resourced.

INTERNAL CONTROLS AND RISK MANAGEMENT SYSTEMS

COMMITTEE RESPONSIBILITY	COMMITTEE ACTIVITIES
Reviews the adequacy and effectiveness of the Group's internal financial controls and internal control and risk management systems (including financial, operational and compliance controls).	The Board has ultimate responsibility for maintaining a robust framework of internal controls and risk management and for overseeing and ensuring the effectiveness of the Group's risk management and internal control systems, and has delegated the monitoring and review of this framework to the Committee. 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 receives an annual paper detailing the effectiveness of the Company's internal controls, which is reviewed and discussed by the Committee. This paper covers all material controls including financial, operating and compliance controls. In 2016, the Committee was satisfied that the Company's internal control framework was operating effectively.
Reviews for adequacy and security the Group's 'whistleblowing' arrangements, procedures for detecting fraud and systems and controls for the prevention of bribery and money laundering.	During 2016, the Committee reviewed and recommended the adoption by the Board of updated policies and procedures for anti-money laundering, bribery and financial crime, conflicts of interest and whistleblowing. The Committee regularly reviews the Company's procedures for detecting fraud. There were no instances of whistleblower reporting or financial crime recorded during the year. The Committee also keeps under review the adequacy and effectiveness of the Company's legal and compliance function.

EXTERNAL AUDIT TENDER PROCESS

It was disclosed to shareholders in the Annual Report and Accounts 2015 that a competitive external audit tender process would be undertaken during 2016. EY have been the Group's external auditors since the Group's formation in 2005 and the provision of external audit services has not been subject to a tender since then. Angus Millar has been the lead audit partner since 2012.

EY was amongst the firms that were invited to participate in the external audit tender process, which was as follows:

- The Audit Committee approved a detailed project plan and approach.
- After an initial high level consideration of seven firms, including three mid-tier organisations, the process was narrowed down to three firms. It was considered that none of the mid-tier firms had the breadth of insurance expertise necessary across the UK and Bermuda to be considered further.
- A formal invitation to tender letter and request for information questionnaire ('RIQ') was sent to the three firms.
- Following meetings with management and the Chairman of the Audit Committee and scoring of the RIQ responses, the Audit Committee agreed to reduce the number of firms to two for the final part of the process. These firms were issued with a request for proposal ('RFP').
- Both firms had meetings with members of the Audit Committee and various members of the Group's management and were scored across a number of requirements.
- Responses to the RFPs were received from the tendering firms, and also scored.
- Presentations were made by the tendering firms to the selection panel, which included members of the Audit Committee.
- Following the presentations and a review of the firms' scores a decision was made by the Audit Committee to recommend to the Board the appointment of KPMG as external auditors.
- The Board of Directors discussed the recommendation and approved the proposal to recommend the appointment of KPMG by shareholders at the 2017 AGM.

2016 AREAS FOR FOCUSED INQUIRIES

In addition to the regular cycle of activities, the Audit Committee also initiated a number of focused inquiries into specific areas during the year. A specialist from the Group senior management team was invited to present a topic to the Committee to increase the Committee's understanding and facilitate discussion and challenge within specific areas. During 2016 areas covered were:

- Review of the Group's IT architecture and key risks and controls.
- The application of judgements within the loss reserving process.
- A review of manual intervention in finance processes.

SIGNIFICANT AREAS OF JUDGEMENT OR ESTIMATION

LOSS RESERVES AND EXPENSES

As detailed on pages 143 to 145 of the consolidated financial statements, the estimation of ultimate loss reserves is a complex actuarial process that incorporates a significant amount of judgement. The Committee considers the adequacy of the Group's loss reserves at each Audit Committee meeting, for which purpose it receives quarterly reports from the Group's Reserving Actuary. EY conduct a high level review of the Group's loss reserves as part of their first and third quarter review procedures. The Reserving Actuary, independent actuary and EY present a comparison of Lancashire's reserves to their own best estimates at the second and fourth quarter Audit Committee meetings. During 2016, the Committee focused its discussions around the Group's loss reserves on: the range of reasonable actuarial estimates and the divergence of the Group's estimates to the external actuarial estimates; current and prior year loss development including 'back-testing' of the Group's prior year reserves; and reserving for each insurance operating subsidiary. Having reviewed and challenged these areas, the Committee concurred with management's valuation of the Group's loss reserves and the relevant disclosures around loss reserving in the Group's consolidated financial statements.

INTANGIBLE ASSET VALUATION

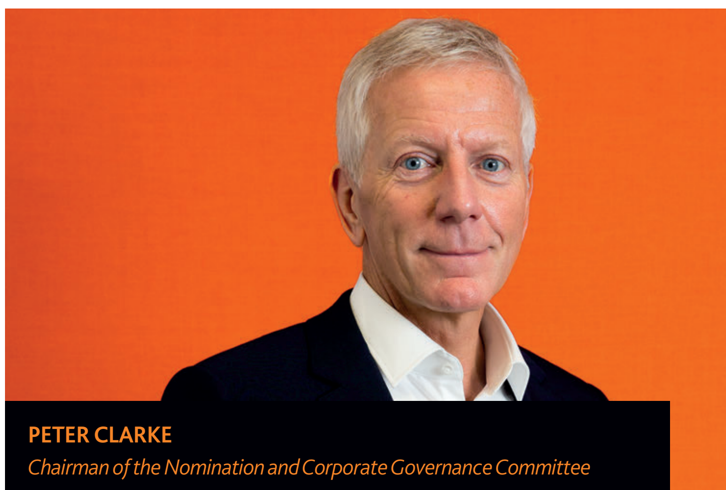
The Company has two indefinite life intangible assets following the acquisition of Cathedral – goodwill and syndicate participation rights. Intangible assets with indefinite useful lives are subject to an impairment review at least annually or sooner if there is an indication of impairment. Some of the key inputs in the impairment review are based on management judgement and/or estimation (see page 97 of the consolidated financial statements for further details). These inputs are reviewed by the Audit Committee annually and are considered reasonable. The Audit Committee also considers the Company's internal stress tests and what stress scenarios would have to occur to indicate an impairment of its intangible assets. As a result of these considerations the Audit Committee agreed with management and EY that there was no impairment of the Company's intangible assets.

PRIORITIES FOR 2017

The Committee's key priorities for 2017 are:

- To achieve a smooth transition of external auditors and a constructive and productive relationship with KPMG in that role.
- To ensure the continued effectiveness of the Group's control environment and the integrity of external financial reporting.
- To monitor the preparation by the Group for the implementation of IFRS 17 following confirmation by the IASB of the 1 January 2021 effective date.

NOMINATION AND *CORPORATE GOVERNANCE COMMITTEE*



PETER CLARKE
Chairman of the Nomination and Corporate Governance Committee

The focus of the Committee during 2016 has been on succession planning and consideration of the balance of skills, experience, independence and knowledge on the Board and talent management across the business.

COMMITTEE MEMBERSHIP

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

	Meetings attended
Peter Clarke[1] (Chairman)	2/2
Michael Dawson[2]	0/0
Samantha Hoe-Richardson	4/4
Tom Milligan[3]	2/2
Martin Thomas[1]	2/2
Emma Duncan[3]	2/2

(1) Martin Thomas retired as a member of the Nomination and Corporate Governance Committee as of his retirement from the Board on 4 May 2016. Peter Clarke succeeded Martin Thomas as Chairman of the Committee.
(2) Michael Dawson was appointed as a member of the Nomination and Corporate Governance Committee with effect from 3 November 2016.
(3) Emma Duncan retired as a member of the Nomination and Corporate Governance Committee with effect from 8 July 2016. Tom Milligan succeeded Emma Duncan as a member of the Committee.

PRINCIPAL RESPONSIBILITIES OF THE COMMITTEE

- 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 of Directors by shareholders.
- Reviews the Company's corporate governance arrangements and compliance with the Code.
- Makes recommendations to the Board concerning the charitable and corporate social responsibility activities of the Company and donations to the Lancashire Foundation.

HOW THE COMMITTEE DISCHARGED ITS RESPONSIBILITIES DURING 2016

BOARD COMPOSITION AND APPOINTMENT OF NON-EXECUTIVE DIRECTORS

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

In this regard, the Eliot Partnership, a global insurance executive search firm with no other connection to the Group, were engaged. They identified a number of potential candidates. The Committee recommended the appointments of Robert Lusardi and Michael Dawson as Non-Executive Directors.

The Committee recommended to the Board the various changes to the composition of the Board Committees which were made during the year.

SUCCESSION PLANNING

The Committee reviewed the Company's succession plan for Executive Directors and other senior executives, taking into account the Company's risk environment and strategic objectives, as well as the anticipated demands of the business. A particular area of focus during 2016 was the continued buildout of the Group's talent management and development programme to ensure it is aligned with the overarching business strategy.

APPOINTMENT OF DIRECTORS TO SUBSIDIARY BOARDS AND SENIOR EXECUTIVE POSITIONS

The Committee monitored the composition of subsidiary Boards during 2016, reviewing in particular the appointments of Simon Fraser, Lance Gibbins and Nicholas Davenport as Non-Executive Directors of CUL, the appointment of Beverley Todd as the Non-Executive Director and Chair of LICL, and the appointments of Adrian Colosso and Samantha Hoe-Richardson as Non-Executive Directors of LUK. The Committee also reviewed the appointments of Heather McKinlay to the role of CUL CFO, Marion Madden as interim Managing Director of CUL and Andrew McKee, who will be joining the Group as the permanent CUL CEO in June 2017.

CORPORATE GOVERNANCE

The Committee keeps under review the Company's corporate governance, particularly compliance with the Code, and is responsible for making recommendations to the Board concerning the process for conducting and facilitating the annual performance evaluation of the Board, its Committees and the individual Directors – see page 48.

During 2016, the Committee recommended the approval by the Board of a revised Group Share Dealing Code and new Policy following the implementation of the Market Abuse Regulation in July 2016.

The Committee also recommended the approval by the Board of an updated protocol for the division of responsibilities and roles of the Chairman and Group CEO and the responsibilities and reporting lines of the CEOs 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 Lord Davies' reports, 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 Group employees. These statistics are shown opposite.

The Committee also reviewed and approved the Chairman's statement on Slavery and Human Trafficking which is posted on the Company's website.

THE LANCASHIRE FOUNDATION

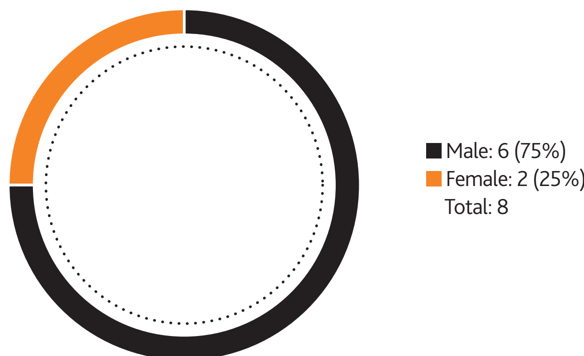
The Committee is responsible for monitoring and making recommendations to the Board in relation to the Company's charitable giving policy and the operation of, and reporting requirements for, the Lancashire Foundation. The Committee held a meeting with the Trustees of the Lancashire Foundation during the autumn of 2016 to receive a report on its charitable activities and to discuss the ways in which the Foundation engages with employees throughout the Group.

PRIORITIES FOR 2017

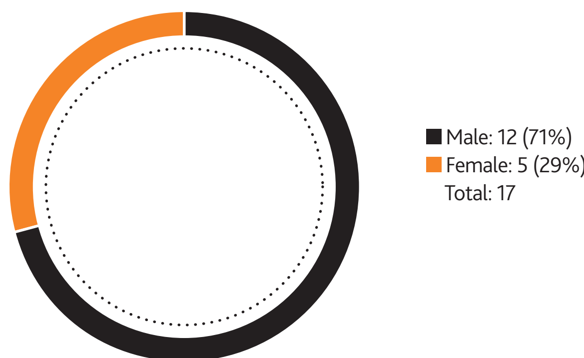
The Committee's key priorities for 2017 are:

- To continue to review succession planning for Directors and senior executives and to support management in the development of the talent pipeline.
- To review the outcomes of the 2016 annual performance evaluation of the Committees' performance, the composition of the Board, and agree and monitor any necessary actions.
- To continue its focus on corporate governance requirements, regulatory developments and compliance with the Code.

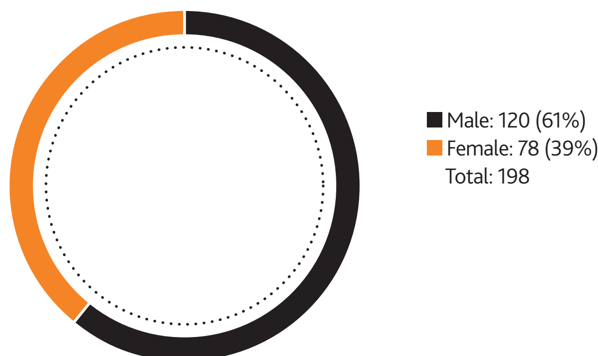
LHL BOARD MEMBERS



GROUP MANAGEMENT EXCLUDING LHL NON-EXECUTIVE DIRECTORS



OVERALL GROUP EMPLOYEES



INVESTMENT *COMMITTEE*

PETER CLARKE
Chairman of the Investment Committee

Our investment philosophy is to preserve capital and to ensure liquidity in our investments to complement our underwriting operations and service the needs of our clients.

COMMITTEE MEMBERSHIP

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

	Meetings attended
Peter Clarke (Chairman)	4/4
Robert Lusardi[1]	2/2
Tom Milligan	4/4
Denise O'Donoghue	4/4
Elaine Whelan	4/4
Emma Duncan[2]	2/2

(1) Robert Lusardi was appointed as a member of the Investment Committee with effect from 8 July 2016.
(2) Emma Duncan retired as a member of the Investment Committee with effect from 8 July 2016.

PRINCIPAL RESPONSIBILITIES OF THE COMMITTEE

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

HOW THE COMMITTEE DISCHARGED ITS RESPONSIBILITIES DURING 2016

The Committee regularly discussed and kept under review macro-economic and global political developments during the year, in particular the effects of the UK Brexit vote and the U.S. election on investment strategy and performance. The Committee also considered regular reports on the performance of the Group's investment portfolios, including asset allocation and compliance with pre-defined guidelines and tolerances; and recommended amendments to portfolio investment guidelines to the Board.

During the second quarter of 2016, the Committee undertook a strategic asset allocation analysis and recommended the 2016/2017 investment strategy to the Board. During the fourth quarter of 2016, the Committee approved the appointment of a new hedge fund adviser.

PRIORITIES FOR 2017

The Committee's key priorities for 2017 are:

- To maintain a continued focus on the preservation of capital, the maintenance of liquidity and the mitigation of interest rate risk.
- The continued management of the risk-on/risk-off balance in the portfolio in anticipation of gradually increasing interest rates and inflationary practices in the U.S., while also protecting the portfolio in risk-off environments.

UNDERWRITING AND *UNDERWRITING RISK COMMITTEE*

ALEX MALONEY
Chairman of the Underwriting and Underwriting Risk Committee

The Committee provides a forum for discussing the state of the insurance and reinsurance sectors in which the Group operates, and determining and monitoring the Group's risk tolerances through the insurance cycle.

COMMITTEE MEMBERSHIP

During 2016 the Underwriting and Underwriting Risk Committee comprised one Executive Director (the Group CEO) and two Non-Executive Directors together with the Group CUO, the CUO of LICL, the CUO and Reinsurance Manager of LUK, the Active Underwriters for Syndicates 2010 and 3010, and the Head of Capital Modeling (who are not Directors).

	Meetings attended
Alex Maloney (Chairman)	4/4
Michael Dawson[1]	0/0
Paul Gregory[2]	3/4
Hayley Johnston	4/4
Tom Milligan	4/4
Sylvain Perrier	4/4
Ben Readdy	4/4
John Spence[3]	1/1
Richard Williams[4]	2/3

(1) Michael Dawson was appointed as a member of the Underwriting and Underwriting Risk Committee with effect from 3 November 2016.
(2) Paul Gregory was unable to attend the July 2016 Committee meeting due to planned medical leave of absence.
(3) John Spence was appointed as a member of the Underwriting and Underwriting Risk Committee with effect from 1 November 2016.
(4) Richard Williams was appointed as a member of the Underwriting and Underwriting Risk Committee with effect from 28 April 2016.

PRINCIPAL RESPONSIBILITIES OF THE COMMITTEE

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

HOW THE COMMITTEE DISCHARGED ITS RESPONSIBILITIES DURING 2016

Underwriting risk is the key risk faced by the Group, and the Committee is actively engaged in the development of strategy and underwriting risk tolerances, which are approved by the Board. The Committee also monitors underwriting performance on a quarterly basis. Lancashire continues to prioritise good risk selection first and foremost, and the Committee has been supportive of management's strategic priority of servicing the insurance requirements of a core group of existing clients and their brokers. During 2016 the Group achieved greater efficiencies in the structuring and pricing of outwards reinsurance protections, thereby helping to effectively manage peak risk exposures across the business. The Committee monitored the restructuring of the underwriting teams within Cathedral, including the appointments of the Active Underwriters of Syndicates 2010 and 3010 and the recruitment of new underwriters within Cathedral during the year. The Committee also received regular reports on the progress made in the development of the Kinesis platform during 2016. The Committee also received quarterly reports of significant claims and reserve developments.

During 2016, 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 Committee and Board place great importance on the management of the Company's capital so as to match capital to the underwriting requirements of the business.

A more detailed analysis of the Group's underwriting performance appears in the Business review section of this Annual Report and Accounts on pages 24 to 30.

PRIORITIES FOR 2017

The Committee's key priorities for 2017 are:

- To continue to monitor the development of a forward-looking and disciplined underwriting strategy appropriate for the Group's three underwriting platforms, within a framework of appropriate risk tolerances.
- To work actively with management in the identification, analysis and consideration of such new underwriters and/or lines of business as may complement or enhance existing underwriting strategy.

REMUNERATION *COMMITTEE*

SIMON FRASER
Chairman of the Remuneration Committee

The Committee seeks to implement a Remuneration Policy which ensures that financial rewards are appropriately linked to performance, and that there is a balance which avoids the incentivisation of excessive risk taking or a culture of short-termism.

COMMITTEE MEMBERSHIP

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

	Meetings attended
Simon Fraser (Chairman)	4/4
Peter Clarke	4/4
Michael Dawson[1]	0/0
Robert Lusardi[2]	2/2
Emma Duncan[3]	2/2
Samantha Hoe-Richardson[1]	2/2

(1) Samantha Hoe-Richardson was appointed as a member of the Remuneration Committee on an interim basis with effect from 4 May 2016. Michael Dawson succeeded Samantha Hoe-Richardson as a member of the Committee with effect from 3 November 2016.
(2) Robert Lusardi was appointed as a member of the Remuneration Committee with effect from 8 July 2016.
(3) Emma Duncan retired as a member of the Remuneration Committee with effect from 8 July 2016.

PRINCIPAL RESPONSIBILITIES OF THE COMMITTEE

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

HOW THE COMMITTEE DISCHARGED ITS RESPONSIBILITIES DURING 2016

During 2016, the Committee reviewed the Group incentive packages to ensure that remuneration was structured appropriately to promote the long-term success of the Company. The Committee also reviewed the RSS structure for Executive Directors to ensure that the performance metrics continue to align the interests of the Company with its investors and management. The Committee considered the salary and bonus awards for 2016 for Executive Directors and other designated senior executives. The Committee also approved the grant of awards under the Company's RSS.

The Committee reviewed Executive Directors' shareholdings in the context of the Company's share ownership guidelines for senior/key executives and modified the guidelines to introduce a minimum qualifying holding for all Executive Directors of not less than 200 per cent of salary, thereby further increasing the alignment with shareholders.

In accordance with UK company best practices the Committee also reviewed the policy for Executive Directors' remuneration which has a three-year life, with a view to making a policy recommendation to shareholders at the 2017 AGM. The Committee considers the existing policy (last approved in 2014) fit for purpose but has proposed certain minor amendments to the policy to improve its clarity and operation. The Committee also reviewed the terms of the ten-year RSS rules governing the award of long-term incentives which are due for renewal at the 2017 AGM. No material amendments to the terms of the RSS rules are proposed, although certain clarificatory changes are proposed including the introduction of more formal provisions for the use of holding periods for specified awards. The Committee also initiated a consultation exercise prior to the year end including significant shareholders and certain of the proxy advisory services to receive feedback specifically in relation to the Group's policy for Executive Director remuneration, the renewal of the RSS rules and the metrics to be used for the operation of Executive Director remuneration during 2017. Further details regarding the policy for Executive Director remuneration and the RSS rules are given in the Directors' Remuneration Report and the Annual Report on Remuneration, for which the Committee is responsible, and which can be found on pages 61 to 79.

During 2016, the Committee undertook a review of, and recommended changes to, the companies comprising the Company's peer group for comparator purposes in light of recent M&A activity. A list of peer companies is on page 76.

PRIORITIES FOR 2017

The Committee's key priorities for 2017 are:

- To review the ongoing appropriateness and relevance of the Group's remuneration structures.
- To review arrangements for remuneration across the wider Group with a view to further aligning the processes for appraisal, objective setting and remuneration across the Lloyd's and non-Lloyd's platforms.

ANNUAL STATEMENT

Dear Shareholder,

I am pleased to present the 2016 Directors' Remuneration Report to shareholders.

Lancashire's Directors' Remuneration Policy was first put to shareholders and approved at the 2014 AGM. The Policy has served us well and, in accordance with the practice for UK companies, we will be submitting our Directors' Remuneration Policy for reapproval at the 2017 AGM. Proposed changes are few in number and largely ensure greater clarity and address administrative details. No material changes are proposed to the policy. A copy of the policy proposed for approval at the 2017 AGM is set out on pages 63 to 68.

REMUNERATION AND STRATEGY

The Group's goal continues to be 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 and Accounts, our strategy focuses on the effective operation of the business necessary to maximise long-term RoE and the delivery of superior total shareholder returns on a risk-adjusted basis over the course of the insurance cycle. Our Remuneration Policy and the way it is implemented are closely aligned to this strategy.

Against this background the Board has debated at length during this last year the issues raised by the global macro-economic environment, the current trend towards lower investment returns generally and the particular challenges to the insurance industry as a whole. The Board and management believe that the insurance industry is cyclical in its fundamental characteristics. Therefore, at the current low point in the insurance cycle the Group must prioritise achieving acceptable, but more modest, returns. This means moderating overall risk levels through underwriting discipline and prudent reinsurance planning, whilst ensuring that the business continues to service the needs of its core clients and brokers. The Board considers that such measures are important to ensure the continuing relevance of the business to its clients, shareholders and other stakeholders, and to position the business well for the time when market conditions turn.

PROPOSAL TO RENEW THE RESTRICTED SHARE SCHEME AT THE 2017 AGM

Lancashire's long-term incentive scheme, the RSS, is due to expire in 2018 and therefore shareholder approval will be sought for a replacement scheme at the 2017 AGM. The replacement RSS rules will have substantially the same terms as the existing scheme. There are some minor changes to bring the new rules more in line with current best practice including the extension of the clawback period for awards to three years post vesting; and a change to determine the value of shares subject to an award from the beginning of the financial year to a period of five trading days immediately prior to the date of such award.

Lancashire will continue the practice of paying dividend equivalents on vested RSS awards (structured as nil cost options) up until the date of exercise of awards. The Company is very active in its capital management – often paying very significant dividends which can lead to a reduction in the share price.

PERFORMANCE OUTCOME FOR 2016

The Group has delivered very solid results in a market which remained challenging during 2016 (see the performance review of this report on pages 72 to 75).

Against a continuing background of difficult market conditions there was a decrease in total remuneration of 11.1 per cent for the CEO and 13.5 per cent for the CFO between 2015 and 2016 (see the comparison table for single figure remuneration on page 71). This movement is consistent with an RoE of 13.5 per cent for 2016 compared to 10.9 per cent for 2015 (13.5 per cent on a warrant adjusted basis) and a total shareholder return of 2.4 per cent for the year compared to 25.9 per cent for 2015, which affected vesting levels on the 2014 RSS awards (see below and page 74 for further details).

Executive Directors' annual bonus performance targets set at the beginning of 2016 for personal and financial performance were stretching, and given the Company's 2016 performance were achieved at above target level (and at 63 per cent of maximum bonus for the CEO and the CFO), subject to final confirmation of peer group performance data. The potential percentage of maximum bonus for both the CEO and CFO could rise to 78 per cent should the Company performance be ranked at or above the upper quartile against peers.

In relation to long-term incentives, the 2014 Performance RSS awards were 75 per cent based on absolute RoE targets and 25 per cent on relative TSR against specified peer group companies over the three-year period to 31 December 2016. Our TSR performance (in U.S. dollars) over this period ranked the Company below the median of the designated peer group of 11 companies, resulting in 0 per cent vesting for the TSR component.

Our average RoE performance, adjusted for warrants, over this three-year performance period was 13.9 per cent against a threshold target of the 13-week Treasury bill rate plus 6 per cent and a maximum pay-out of the 13-week Treasury bill rate plus 15 per cent, resulting in 89.8 per cent of the RoE component of the 2014 Performance RSS awards vesting. Overall, the 2014 Performance RSS awards vested at 67.4 per cent. This compared to the overall 75 per cent vesting of the 2013 Performance RSS awards due to 100 per cent vesting of the RoE portion of those awards and 0 per cent vesting of the TSR portion of the awards, which we reported last year.

The total remuneration received by our current Executive Directors in 2016 was lower than that received in 2015 (see page 71 for the comparison data). In the current difficult underwriting environment total remuneration for the Executive Directors is lower than in many previous years, as demonstrated by the chart of Total Remuneration History for the CEO on page 78. The Committee believes in setting challenging performance criteria and having a significant proportion of the overall package linked to Company performance. However, the Committee also continues to recognise the need to ensure that Executive Directors are appropriately remunerated and incentivised even in the more challenging phases of the insurance cycle, as at present.

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

The like-for-like employee costs for the Group were $72.1 million in 2016 compared with $80.1 million in 2015 (see page 78 for further detail). A majority of our employment costs are in Sterling and this reduction is driven principally by the fall in value of Sterling against the U.S. dollar.

Overall, in light of the annual and three-year performance delivered, the Committee is satisfied that there has been a robust link between performance and reward for Executive Directors.

APPLICATION OF REMUNERATION POLICY FOR 2017

As mentioned above, the Remuneration Committee has reviewed the policy approved by shareholders and believes it remains fit for purpose, subject to certain minor changes. The policy changes include the introduction of a two-year holding period on long-term incentive awards and a strengthening of share ownership guidelines whereby a 200 per cent of salary guideline will apply to all Executive Directors and not just the CEO. Both these changes provide greater long-term alignment with our shareholder base.

After careful deliberation and consultation with our major shareholders and the major shareholder advisory groups, the Board has decided to modify the way in which the Company implements the Remuneration Policy for 2017. In setting annual bonus targets the Board has decided to create a more formal linkage between performance targets and the investment return environment. In relation to longer-term RSS awards the Board has set targets by reference to appropriate expectations for growth in fully converted book value per share plus dividends, an important metric for our shareholders and within the investment community for property and casualty companies. Relative total shareholder return will continue to account for 25 per cent of the award. Further details are set out on pages 69 to 71 of this report.

The final section of this report is the Annual Report on Remuneration which provides detailed disclosure on how the policy will be implemented for 2017 and how Directors have been paid in relation to 2016.

The disclosures provide our shareholders with the information necessary to form a judgement as to the link between Company performance and how the Executive Directors are paid. This Annual Statement together with the Annual Report on Remuneration will be subject to an advisory vote and I hope that you will be able to support the resolution at the forthcoming AGM. Additionally, the proposed new Remuneration Policy for 2017–2020 and the revised RSS rules will both be put forward at the 2017 AGM for a binding vote. The Committee is committed to maintaining an open and constructive dialogue with our shareholders on remuneration matters and I welcome any feedback you may have.

Simon Fraser
Chairman of the Remuneration Committee

DIRECTORS' REMUNERATION POLICY SECTION

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

The Company's first Remuneration Policy was approved by shareholders at the 2014 AGM. That policy had a three-year life and will expire at the 2017 AGM.

During the year, the Committee completed a review of executive remuneration which sought to ensure continued alignment with the Company's strategy and take account of good and developing practice. The revised Remuneration Policy for the Company's Directors is set out in this report and will be put forward for shareholder approval at the AGM on 3 May 2017. If the policy is approved, it will take effect immediately following the 2017 AGM and it is intended to apply for a period of three years from the 2017 AGM. The revised Remuneration Policy contains details of the Company's policy to govern future payments that will be made to Directors. If approved, all remuneration and loss of office payments made after 3 May 2017 will only be made if they are consistent with the approved Remuneration Policy. Full details of how the Company will implement the revised Remuneration Policy in 2017 is provided in the Annual Report on Remuneration section starting on page 69.

The Annual Report on Remuneration also details the remuneration paid to Directors in respect of the 2016 financial year in accordance with the policy approved at the 2014 AGM.

The revised Remuneration Policy has been developed taking into account the principles of the Code and the views of our major shareholders.

GOVERNANCE AND APPROACH

The Company's proposed 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 proposed 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 proposed Remuneration Policy could conceivably encourage Executive Directors to take inappropriate risks and have concluded that this is not the case, given the following:

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

HOW THE VIEWS OF SHAREHOLDERS ARE TAKEN INTO ACCOUNT

The Committee Chairman and, where appropriate, the Company Chairman, consult with major investors and representative bodies on any significant remuneration proposal relating to Executive Directors. Views of shareholders at the AGM, and feedback received at other times, will be considered by the Committee.

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

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

The Company does not consult with employees on Executive Directors' remuneration. However, as noted above, the Committee is made aware of pay structures across the wider Group when setting the Remuneration Policy for Executive Directors.

CHANGES MADE TO THE POLICY

Following the review of the remuneration arrangements for Executive Directors, some changes were introduced to the policy to reflect changes in best practice and to provide a limited amount of additional flexibility.

As mentioned above, the most material policy changes include the introduction of a two-year holding period on long-term incentive awards and a strengthening of share ownership guidelines.

REMUNERATION POLICY TABLE

Base Salary

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

Benefits

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

Pension

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

Annual Bonus[1,2]

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

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

REMUNERATION POLICY TABLE CONTINUED

Share Ownership Guidelines[4]

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

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

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

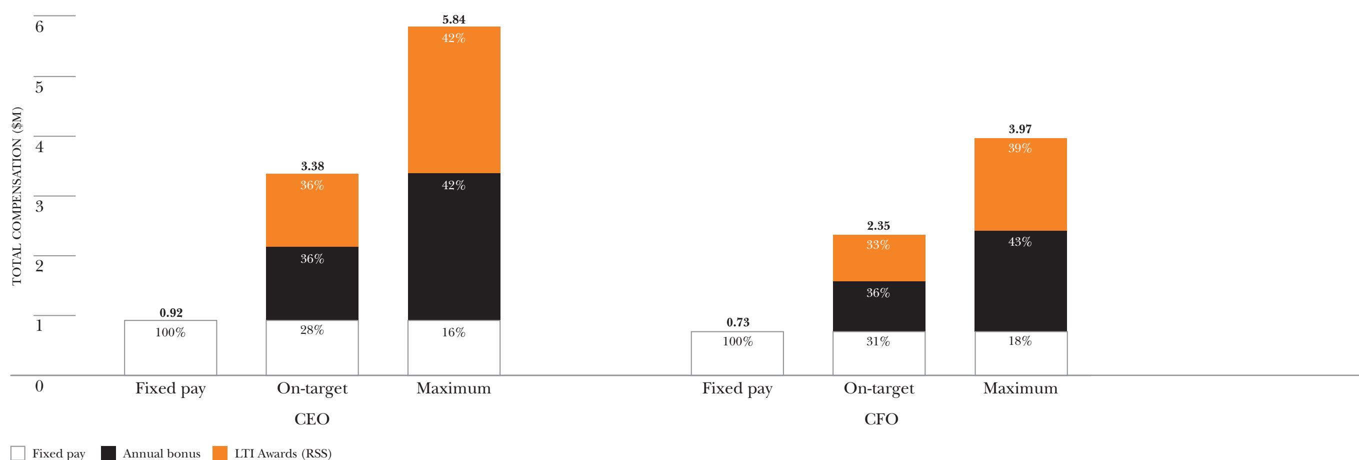
(2) All historic awards that were granted under any current or previous share scheme operated by the Company that remain outstanding remain eligible to vest based on their original award terms and this provision forms part of the policy.

(3) Performance measures: these may include the performance indicators shown on pages 20 to 21 or others described within the Annual Report and Accounts Glossary commencing on page 156 or any other measure that supports the achievement of the Company's short to long-term objectives.

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

ILLUSTRATIONS OF ANNUAL APPLICATION OF REMUNERATION POLICY

The charts below show the potential total remuneration opportunities for the Executive Directors in 2017 at different levels of performance under the proposed policy, if it is approved by shareholders at the 2017 AGM.



Fixed pay = 2017 Salary + Actual Value of 2016 Benefits + 2017 Pension Contribution.

On-target = Fixed Pay + Target Bonus (being half the Maximum Bonus Opportunity) + Target Value of 2017 RSS grant (assuming 50 per cent vesting with face values of grant).

Maximum = Fixed Pay + Maximum Bonus Opportunity + Maximum Value of 2017 RSS grant (assuming 100 per cent vesting with the face values of grant).

No account has been taken of any share price growth or dividend equivalent accruals.

APPROACH TO RECRUITMENT REMUNERATION

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

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

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

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

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

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

SERVICE CONTRACTS AND LOSS OF OFFICE PAYMENT POLICY FOR EXECUTIVE DIRECTORS

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

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

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

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

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

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

LEAVER ON ARRANGED TERMS OR GOOD LEAVER

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

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

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

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

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

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

TERMS OF APPOINTMENT FOR NON-EXECUTIVE DIRECTORS

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

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

LEGACY ARRANGEMENTS

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

For the avoidance of doubt, this includes all awards granted under the 2008 RSS rules in accordance with the Policy approved at the 2014 AGM and to employees of the Company who are not Directors at the date of grant. Outstanding RSS awards that remain unvested or unexercised at the date of this report (including for current Executive Directors as detailed on page 75 of the Annual Report on Remuneration), remain eligible for vesting or exercise based on their original award terms.

The Policy approved by shareholders at the 2014 AGM ('current policy') will continue to apply until this proposed Policy is approved at the 2017 AGM. If this proposed Policy is not approved at the 2017 AGM, the current policy will continue to apply in accordance with its terms.

ANNUAL REPORT ON REMUNERATION

This Annual Report on Remuneration together with the Chairman's Statement, as detailed on pages 61 and 62, will be subject to an advisory vote at the 2017 AGM. The information on page 71 with respect to Directors' emoluments and onwards through page 79 has been audited by EY.

IMPLEMENTATION OF REMUNERATION POLICY FOR 2017

In relation to the Policy described in the previous section, the following section sets out additional disclosure on the expected application of the Policy for 2017.

BASE SALARY AND FEES

Executive Directors

Increases and resulting salaries effective from 1 January 2017 are set out below:

- CEO – salary increased by 3 per cent to $819,545.
- CFO – salary increased by 3 per cent to $562,755.
- For 2017, increases of 3 per cent are in line with the salary increases across the general workforce population.

Non-Executive Directors

The Chairman's and Non-Executive Directors' fees are as follows for 2017:

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

Other Fees

- Samantha Hoe-Richardson is a Non-Executive Director of LUK in which capacity she will receive a fee of £50,000 per annum.
- Simon Fraser is a Non-Executive Director of CUL in which capacity he will receive a fee of $80,000 per annum.

ANNUAL BONUS

For 2017, the CEO will have a target bonus of 150 per cent of salary and, therefore, a maximum opportunity of 300 per cent of salary. This is within the approved policy limit and it is in line with last year's opportunity and represents a maximum bonus opportunity which is 100 per cent of salary less than the set policy limit. The CFO's target bonus opportunity will be in line with the policy at 150 per cent of salary (maximum 300 per cent).

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

Financial Performance (75 per cent)

The Company's most important financial KPI is RoE, which is the core indicator of the delivery of our strategic priorities of ensuring underwriting comes first, effectively balancing risk and return and managing capital nimbly through the insurance cycle (see the strategic overview on pages 16 and 17 of this report). Further to consultation with the Company's major shareholders, the Company has decided both to simplify the measure for the financial performance element of the annual bonus targets and to create a more formal linkage between performance targets and the investment return environment. Accordingly, for 2017, the financial component is to be based on the performance of the Group's RoE, measured as the internal rate of return of the change in FCBVS plus accrued dividends.

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

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

There shall be linear interpolation between these points. The Board considers that these target ranges are appropriately challenging, given the current difficult insurance market conditions, and will help to ensure a strong and more formulaic link between remuneration for the Executive Directors and the Company's financial performance, the strategy and risk profile of the business and the investment return environment, without encouraging excessive risk taking. In future years, the Committee would not normally expect to set vesting points below the levels outlined above and, when appropriate, will set higher targets.

Personal Performance (25 per cent)
This element of the bonus plan is based upon the individual achievement of clearly articulated objectives created at the beginning of each year. The table below sets out a broad summary of the 2017 personal objectives for each Executive Director.

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

The personal targets are broadly common among the Executive Directors, with variances being attributable to the specifics of their respective roles. Specific granular areas for personal development within the set broad personal objectives are discussed between the Chairman and the Executive Directors and agreed by the Committee. As part of the 2017 annual performance reviews each Executive Director will receive a performance rating which will determine the level of personal performance bonus pay-out for which each Executive Director will be eligible.

RESTRICTED SHARE SCHEME

Performance Conditions
For Executive Directors, 2017 RSS awards are subject to a range based on (i) average annual growth in FCBVS plus accrued dividends and (ii) relative TSR performance conditions, both measured by reference to a period ending on 31 December 2019. These metrics aim to provide an appropriate focus on the Company's underlying financial performance and cycle management, and in the case of relative TSR to provide an objective reward for stock market performance measured against the Company's peers.

Weighting
For 2017, the TSR/RoE weighting is 25 per cent on TSR and 75 per cent on average annual growth in FCBVS plus accrued dividends.

Target ranges
The average annual growth in FCBVS plus accrued dividends target range for 2017 awards is:

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

None of the award will vest if average annual growth in FCBVS plus accrued dividends 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.

The Board and Committee consider that the stretch target represents exceptional performance, given current challenging market conditions. The target range closely aligns the longer-term remuneration of our Executive Directors with strong performance, the implementation of the business strategy and the interests of our shareholders, but is not so stretching as to encourage excessive risk taking.

The TSR target for 2017 awards is as follows:

The Group's TSR is compared against a comparator group comprising 11 peer companies as disclosed on page 76.

- 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 of the award will vest for upper quartile and above performance.

Vesting will be on a proportionate basis for performance between median and upper quartiles.

Award levels
2017 RSS award levels are as follows:

- CEO – shares to the value of $2,458,636 (being 300 per cent of salary)
- CFO – shares to the value of $1,547,577 (being 275 per cent of salary)

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

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

SINGLE FIGURE ON REMUNERATION

The following table presents the Executive Directors' emoluments in U.S. dollars in respect of the years ended 31 December 2016 and 31 December 2015.

Executive Directors		Salary $	Pension $	Taxable Benefits[1] $	Annual Bonus[5,6] $	Long-Term Incentives (RSS)[2,3] $	Total[4] $
Alex Maloney[4], CEO	**2016**	**810,266**	**81,027**	**20,127**	**1,510,554**	**1,003,429**	**3,425,403**
	2015	770,955	77,096	19,785	1,668,165	1,316,789	3,852,790
Elaine Whelan[4], CFO	**2016**	**547,423**	**54,636**	**114,445**	**1,037,248**	**831,184**	**2,584,936**
	2015	530,224	55,880	98,273	1,145,474	1,158,324	2,988,175

(1) Benefits comprise Bermudian payroll taxes, social insurance, medical, dental and vision coverage and housing and other allowances paid by the Company for expatriates (as is the case for the CFO), but exclude UK National Insurance contributions. Taxable benefits for Elaine Whelan for 2015 have been adjusted to reflect final actual benefits.

(2) For 2016, the long-term incentive values are based on the 2014 RSS awards which vest at 67.4 per cent on 16 February 2017 and are based on a three-year performance period that ended on 31 December 2016. The values are based on the share price at 31 December 2016 and include the value of dividends accrued on vested shares.

(3) For 2015, the long-term incentive values were based on the 2013 RSS awards which vested at 75 per cent on 18 February 2016 and were based on a three-year performance period that ended on 31 December 2015. The values are re-presented from the 2015 Annual Report and Accounts based on the share price at the vesting date, 18 February 2016, and include the value of dividends accrued on vested shares.

(4) Some amounts were paid in Sterling and converted at the average exchange rate of 1.3777 for the year as they are set in U.S. dollars.

(5) For 2016, the Lancashire Group delivered solid results in a challenging market. Bonus targets were set at the beginning of 2016 and based on a clear split between Company financial performance and personal performance on a 75:25 basis. Company financial performance had two components, absolute financial performance and relative financial performance weighted 60:40 respectively. The absolute component paid out at 131.25 per cent of target as the RoE was 13.5 per cent against a target level of 11 per cent and the relative component is provisionally cited at 58.33 per cent (with an estimated 50 per cent of maximum pay-out) 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 will be 75 per cent of the maximum for the CEO and 75 per cent of the maximum for the CFO. For full details of Executive Directors' bonuses and the associated performance delivered see pages 72 and 73. 25 per cent of Executive Directors' annual bonus is deferred into the long-term incentive scheme without performance conditions, vesting at 33.33 per cent over a three-year period.

(6) Annual bonus figures for Alex Maloney and Elaine Whelan for 2015 have been re-presented to reflect final relative performance data which was used to calculate the bonus figures and were finalised after all peer data was released in 2016, after the 2015 Directors' Remuneration Report was published for circulation. For 2015, the relative component had been provisionally stated to pay out at 50 per cent of the maximum, however after final results of all peers were released, this element paid out at 158 per cent of target (being 72 per cent of the maximum).

NON-EXECUTIVE DIRECTORS' FEES

Current Non-Executive Directors		Fee $	Other $	Total $
Peter Clarke[1]	**2016**	**290,769**	**–**	**290,769**
	2015	175,000	–	175,000
Michael Dawson[2]	**2016**	**28,269**	**–**	**28,269**
	2015	–	–	–
Simon Fraser[3]	**2016**	**175,000**	**66,974**	**241,974**
	2015	175,000	–	175,000
Samantha Hoe-Richardson[4]	**2016**	**175,000**	**13,350**	**188,350**
	2015	175,000	–	175,000
Robert Lusardi[5]	**2016**	**84,808**	**–**	**84,808**
	2015	–	–	–
Tom Milligan[6]	**2016**	**175,000**	**–**	**175,000**
	2015	158,958	–	158,958
Former Non-Executive Directors				
Emma Duncan[7]	**2016**	**91,538**	**–**	**91,538**
	2015	175,000	–	175,000
Martin Thomas[8]	**2016**	**111,250**	**34,375**	**145,625**
	2015	325,000	100,000	425,000

(1) Peter Clarke was appointed as a Non-Executive Director with effect from 9 June 2014 and as LHL Chairman with effect from 4 May 2016 and his 2016 fees are proportionally pro-rated for the year.

(2) Michael Dawson was appointed as a Non-Executive Director with effect from 3 November 2016 and his 2016 fees are proportionally pro-rated for the year.

(3) Simon Fraser was additionally appointed as a Non-Executive Director of CUL with effect from 29 February 2016 and his 2016 fees are proportionally pro-rated for the year.

(4) Samantha Hoe-Richardson was additionally appointed as a Non-Executive Director of LUK with effect from 18 October 2016 and her 2016 fees are proportionally pro-rated for the year.

(5) Robert Lusardi was appointed as a Non-Executive Director with effect from 8 July 2016 and his 2016 fees are proportionally pro-rated for the year.

(6) Tom Milligan was appointed as a Non-Executive Director with effect from 3 February 2015 and his 2015 fees were proportionally pro-rated for the year.

(7) Emma Duncan retired from the Board on 8 July 2016 and her 2016 fees are proportionally pro-rated for the year.

(8) Martin Thomas retired from the Board on 4 May 2016 and his 2016 fees are proportionally pro-rated for the year.

2017 ANNUAL BONUS PAYMENTS IN RESPECT OF 2016 PERFORMANCE

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

The target value of bonus was 150 per cent of salary for the CEO and CFO respectively, and the maximum payable was two times the target value. The RoE is 13.5 per cent.

FINANCIAL PERFORMANCE

75 per cent of the 2016 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%) %	Threshold %	Target %	Max %	Actual performance %	% payout
Absolute RoE	60	7	11	19	13.5	131.3 of target
Relative RoE	40	50	N/A	75	58.3	100.0 of target
Total	100 (75 per cent of Total Bonus)					118.8 of target payable in respect of Company performance

For 2016, the Lancashire Group delivered solid results in a difficult market. The absolute component paid out at 131.3 per cent of target as the RoE was 13.5 per cent against a target of 11 per cent. The relative component against the results of peer companies is provisionally stated at median performance (100 per cent pay-out of target, and 50 per cent of the maximum) pending the final audited results of peer companies needed in order to calculate the final bonus payable. Any changes to the bonus numbers reported will be re-presented in the 2017 Directors' Remuneration Report as final numbers.

PERSONAL PERFORMANCE

25 per cent of the 2016 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 2016 personal objectives for each Executive Director.

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

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

During the 2016 annual performance reviews of each Executive Director, a performance rating was assigned to determine the level of bonus pay-out for which each Executive Director was eligible.

As expected for a solid performance year in a challenging market, the Executive Directors each achieved a strong performance rating against their objectives. For the 2016 performance against personal objectives the following ratings were determined following a process for the evaluation of performance of the Executive Directors against the agreed personal targets and discussion and agreement of the outcomes with the Chairman and members of the Board. The outcomes are expressed as a percentage of the maximum award for personal performance: CEO – 75 per cent, and CFO – 75 per cent.

A table of performance measures and total 2016 bonus achievement is set out below:

Executive Director	Financial performance (max % of total bonus) %	Personal performance (max % of total bonus) %	Bonus % of maximum awarded %	Total[1] bonus value $	Value of bonus paid in cash (75 per cent of total bonus) $	Value of bonus deferred into RSS awards (25 per cent of total bonus)[1] $
Alex Maloney	75	25	63	1,510,554	1,132,915	377,639
Elaine Whelan	75	25	63	1,037,248	777,936	259,312

(1) 25 per cent of total bonus award will be deferred into RSS awards with one third vesting annually, each year, over a three-year period with the first third becoming exercisable in February 2018, subject to the Company not being in a closed period. These awards vest on the relevant dates subject to continued employment only.

LONG-TERM SHARE AWARDS WITH PERFORMANCE PERIODS ENDING IN THE YEAR – 2014 RSS AWARD

The 2014 RSS awards were based on a three-year performance period ending on 31 December 2016 and vest following the determination of financial results by the Board. The tables below set out the achievement against the performance conditions attached to the award, resulting in aggregate vesting of 67.4 per cent, and the actual number of awards vesting (with their estimated value).

	TSR (relative to a comparator group of 11 companies) (relevant to 25% of the 2014 RSS awards)		Average annual RoE (over three years in excess of 13-week Treasury Bill Rate) (relevant to 75% of the 2014 RSS awards)	
Performance level	**Performance required**	**% vesting**	**Performance required (%)**	**% vesting**
Below threshold	Below median	0	Below 6	0
Threshold	Median	25	6	25
Stretch or above	Upper quartile or above	100	15 or above	100
Actual achieved	Below median	0	13.9	89.8

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

Executive Director	Number of shares at grant	Number of shares to lapse	Number of shares to vest	Dividend accrual on vested shares value[2] $	Value of shares including dividend accrual[1] $
Alex Maloney	124,333	40,532	83,801	287,256	1,003,429
Elaine Whelan	102,989	33,573	69,416	237,947	831,184

(1) The value of the vested shares is based on the 2014 RSS awards which vest at 67.4 per cent on 16 February 2017 and are based on a three-year performance period that ended on 31 December 2016. The values are provisionally based on the average share price of the last quarter of 2016 (being $8.55 based on the exchange rate of 1.2422). The vested awards are subject to the claw-back provision set out on page 65.

(2) Dividends accrue on awards at the record date of a dividend payment and upon exercise the cash value of the accrued dividends is paid to the employee on the number of vested awards net of tax required.

SCHEME INTERESTS AWARDED DURING THE YEAR

The table below sets out the performance RSS awards that were granted as nil-cost options on 18 February 2016.

Executive Director	Grant date[2]	Number of awards granted during the year	Face value of awards granted during the year[1,3] $	% vesting at threshold performance
Alex Maloney	18-Feb-2016	219,254	1,940,398	25
Elaine Whelan	18-Feb-2016	157,104	1,390,370	25

(1) The share price on the date of performance awards grant was $8.85 when the RSS share awards were granted as nil-cost options. The awards were based on the share price as at 31 December 2015 (being $9.31, based on the exchange rate of 1.4826).

(2) These awards are due to vest subject to performance conditions being met at the end of the performance period ending 31 December 2018 and becoming exercisable in the first open period following the release of the Company's 2018 year-end results after the meeting of the Board in February 2019.

(3) The exercise share price is determined once an award has vested on the basis of the share price on the date an award is exercised.

LOSS OF OFFICE PAYMENTS

There were no loss of office payments during the 2016 year.

DETAILS OF ALL OUTSTANDING SHARE AWARDS

In addition to awards made during the 2016 financial year, the table below sets out details of all outstanding RSS awards held by Executive Directors.

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

		Grant date[1]	Exercise price	Awards held at 1-Jan-16	Awards granted during the year	Awards vested during the year	Awards lapsed during the year	Awards exercised during the year	Awards held at 31-Dec-16	End of performance period
Alex Maloney, Group CEO	Performance RSS[2,3]	28-Feb-13	–	131,969	–	98,976	32,993	98,976	–	31-Dec-15
	Deferred Bonus RSS[4]	5-Mar-13	–	5,848	–	5,848	–	5,848	–	
	Performance RSS[2,3]	19-Feb-14	–	124,333	–	–	–	–	124,333	31-Dec-16
	Deferred Bonus RSS[4]	5-Mar-14	–	19,620	–	9,810	–	9,810	9,810	
	Performance RSS[2,3]	12-Feb-15	–	244,208	–	–	–	–	244,208	31-Dec-17
	Deferred Bonus RSS[4]	20-Mar-15	–	41,929	–	13,976	–	13,976	27,953	
	Performance RSS[2,3]	18-Feb-16	–	–	219,254	–	–	–	219,254	31-Dec-18
	Deferred Bonus RSS[4]	11-Mar-16	–	–	56,224	–	–	–	56,224	
Total				**567,907**	**275,478**	**128,610**	**32,993**	**128,610**	**681,782**	
Elaine Whelan, Group CFO & LICL CEO	Performance RSS[2,3]	28-Feb-13	–	116,087	–	87,065	29,022	87,065	–	31-Dec-15
	Deferred Bonus RSS[4]	5-Mar-13	–	5,040	–	5,040	–	5,040	–	
	Performance RSS[2,3]	19-Feb-14	–	102,989	–	–	–	–	102,989	31-Dec-16
	Deferred Bonus RSS[4]	5-Mar-14	–	15,971	–	7,985	–	7,985	7,986	
	Performance RSS[2,3]	12-Feb-15	–	168,149	–	–	–	–	168,149	31-Dec-17
	Deferred Bonus RSS[4]	20-Mar-15	–	29,540	–	9,847	–	9,847	19,693	
	Performance RSS[2,3]	18-Feb-16	–	–	157,104	–	–	–	157,104	31-Dec-18
	Deferred Bonus RSS[4]	11-Mar-16	–	–	38,607	–	–	–	38,607	
Total				**437,776**	**195,711**	**109,937**	**29,022**	**109,937**	**494,528**	

(1) The market values of the common shares on the dates of grant were:

- 28 February 2013 £9.09
- 5 March 2013 £9.08
- 19 February 2014 £7.34
- 5 March 2014 £7.26
- 12 February 2015 £6.36
- 20 March 2015 £6.30
- 18 February 2016 £6.17
- 11 March 2016 £5.37

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

- 25 per cent of each award is subject to a performance condition measuring the TSR performance of the Company against the TSR performance of a select group of comparator companies (see page 76 for a list of comparator companies for each grant year), over a three-year performance period. 25 per cent of this part of the award vests for median performance by the Company, rising to 100 per cent vesting of this part of the award for upper quartile performance by the Company or better (with proportionate vesting between these two points).
- The other 75 per cent of each award is subject to a performance condition based on average annual RoE over a three-year performance period. 25 per cent of this part of the award will vest if average annual RoE over the performance period exceeds the criteria set out in the table on page 76, 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 76. Between these two points vesting will take place on a straight-line basis from 25 per cent to 100 per cent for RoE performance.

(3) The vesting dates of the RSS performance awards are subject to being out of a closed period and are as follows:

- 2014 – 16 February 2017;
- 2015 – first open period following the release of the Company's 2017 year-end results; and
- 2016 – first open period following the release of the Company's 2018 year-end results.

(4) The vesting dates of the RSS Deferred Bonus awards are subject to being out of a closed period and, for the 2013 to 2016 Deferred Bonus awards, are as follows:

- 2013 – vest 33.33 per cent over a three-year period at the first open period following the release of the Company's year-end results for 2013, 2014 and 2015;
- 2014 – vest 33.33 per cent over a three-year period at the first open period following the release of the Company's year-end results for 2014, 2015 and 2016;
- 2015 – vest 33.33 per cent over a three-year period at the first open period following the release of the Company's year-end results for 2015, 2016 and 2017; and
- 2016 – vest 33.33 per cent over a three-year period at the first open period following the release of the Company's year-end results for 2016, 2017 and 2018.

TSR TARGETS FOR RSS (25 PER CENT WEIGHTING)

	2013	2014	2015	2016	2017
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 (75 PER CENT WEIGHTING)

	2013	2014	2015	2016	2017*
100%	RFRoR + 15%	RFRoR +15%	RFRoR +15%	RFRoR +15%	13%
25%	RFRoR + 6%	RFRoR + 6%	RFRoR + 6%	RFRoR + 6%	6%
Nil	< RFRoR + 6%	< RFRoR + 6%	< RFRoR + 6%	< RFRoR + 6%	< 6%

* Average annual growth in FCBVS plus accrued dividends.

Peer Companies	2013 awards	2014 awards	2015 awards	2016 awards	2017 awards
Amlin plc[1]	X	X	X	–	–
Arch Capital Group Limited[2, 4]	–	–	–	X	X
Argo Group International Holdings, Ltd.	X	X	X	X	X
Aspen Insurance Holdings Limited	X	X	X	X	X
Axis Capital Holdings Limited	X	X	X	X	X
Beazley plc	X	X	X	X	X
Catlin Group Ltd.[3]	X	X	–	–	–
Endurance Specialty Holdings Ltd.[4,7]	X	X	X	X	–
Everest Re Group, Ltd.[5]	–	–	X	X	X
The Hanover Insurance Group[6]	–	–	X	X	X
Hiscox Ltd.	X	X	X	X	X
Montpelier Re Holdings Ltd.[7]	X	X	–	–	–
Novae Group plc[8]	–	–	X	X	X
Renaissance Re Holdings Ltd.	X	X	X	X	X
Validus Holdings Ltd.	X	X	X	X	X

(1) Mitsui Sumitomo Insurance Company acquired Amlin plc. on 1 February 2016. Accordingly, the Committee decided to use Amlin plc as a comparator company up to 30 June 2015 and it was replaced with Everest Re Group, Ltd with effect from 1 July 2015.

(2) Arch Capital Group Limited was added to the peer group of companies with effect from 1 October 2016 as a replacement for Endurance Specialty Holdings Ltd.

(3) Catlin Group Ltd. was acquired by the XL Group with effect from 1 May 2015 and so was used as a comparator company up to 31 December 2014 and was replaced by Novae Group plc.

(4) Sompo Holdings Inc. announced on 5 October 2016 that it intended to acquire Endurance Specialty Holdings Ltd ('Endurance'). The transaction subsequently achieved shareholder approval. Accordingly, the Committee decided to use Arch Capital Group Limited as a comparator company with effect from 1 October 2016 as a replacement for Endurance.

(5) Everest Re Group, Ltd. was added to the peer group of companies with effect from 1 July 2015 as a replacement for Amlin plc.

(6) The Hanover Insurance Group was added to the peer group of companies with effect from 1 January 2015 as a replacement for Montpelier Re Holdings Ltd.

(7) Montpelier Re Holdings Ltd. was acquired by Endurance with effect from 31 July 2015 and so was used as a comparator company up to 31 December 2014 and was replaced by The Hanover Insurance Group.

(8) Novae Group plc was added to the peer group of companies with effect from 1 January 2015 as a replacement for Catlin Group Ltd.

DIRECTORS' SHAREHOLDINGS AND SHARE INTERESTS

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

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

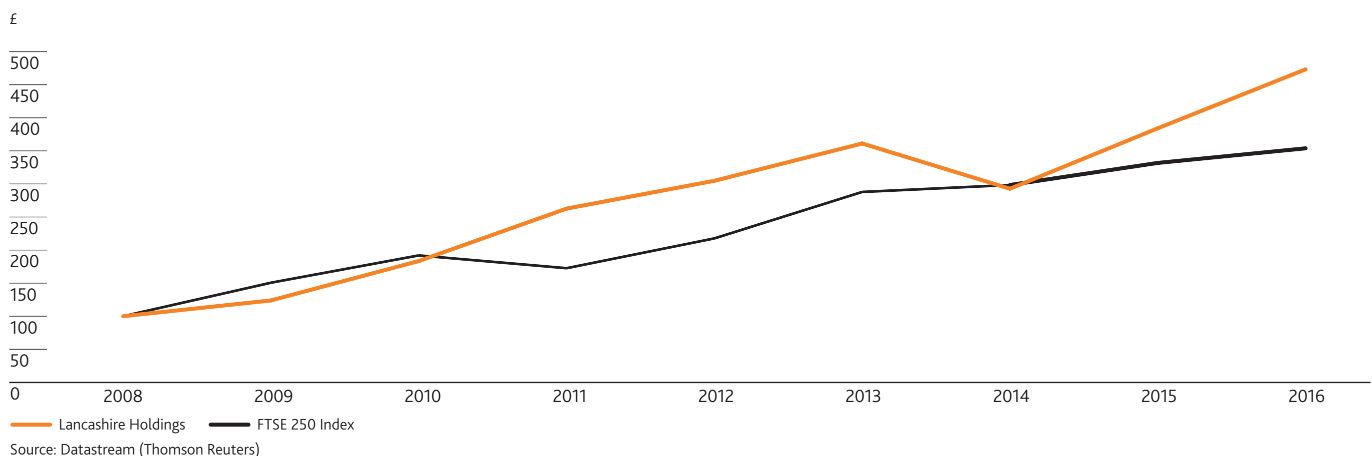
	Number of Ordinary Shares						
	As at 1 January 2016	As at 31 December 2016					
Directors	Legally owned	Legally owned	Subject to deferral under the RSS	Subject to performance conditions under the RSS	Vested but unexercised awards under other share-based plans	Total	Shareholding guideline achieved?
Alex Maloney	382,008	**513,512**	**93,987**	**587,795**	–	**1,195,294**	**Yes**
Elaine Whelan	287,169	**428,976**	**66,286**	**428,242**	–	**923,504**	**Yes**
Peter Clarke	–	**14,000**	**N/A**	**N/A**	**N/A**	**14,000**	**N/A**
Michael Dawson	N/A	–	**N/A**	**N/A**	**N/A**	–	**N/A**
Simon Fraser	1,000	**1,000**	**N/A**	**N/A**	**N/A**	**1,000**	**N/A**
Samantha Hoe-Richardson	3,947	**3,947**	**N/A**	**N/A**	**N/A**	**3,947**	**N/A**
Robert Lusardi	N/A	**3,000**	**N/A**	**N/A**	**N/A**	**3,000**	**N/A**
Tom Milligan	1,000	**1,000**	**N/A**	**N/A**	**N/A**	**1,000**	**N/A**
Former Non-Executive Directors							
Emma Duncan	–	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Martin Thomas	6,950	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**

Note: 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.

PERFORMANCE GRAPH

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

TOTAL SHAREHOLDER RETURN



Source: Datastream (Thomson Reuters)

This graph shows the value, by 31 December 2016, of £100 invested in LHL on 31 December 2008 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year ends.

GOVERNANCE

TOTAL REMUNERATION HISTORY FOR CEO

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

	2009	2010	2011	2012	2013	Richard Brindle 2014[1]	Alex Maloney 2014[2]	2015	**2016**
Total remuneration ($000s)	7,244	9,945	9,623	10,460	10,175	10,072	2,405	3,853[4]	**3,425**
Annual bonus (%)	68	94	73	73	80	80	73	72[4]	**63**
LTI vesting (%)	N/A	99.6	100	99	100	61[3]	50	75	**67**

(1) Richard Brindle was the CEO from 2005 until he retired from the Group and as a Director on 30 April 2014.

(2) Alex Maloney was appointed CEO effective 1 May 2014, after the retirement of Mr Brindle. For the purposes of this table his numbers have been pro-rated to account for only his time in office as CEO for 2014.

(3) Mr Brindle was afforded good leaver status and all RSS award interests were vested upon his departure, using estimated TSR and RoE values at the time of his retirement. The amounts in the table above reflect all awards which vested in 2014. Further particulars of the vesting were reported in the Group's 2014 Annual Report and Accounts.

(4) Alex Maloney's 2015 total remuneration and annual bonus percentage have been re-presented in the above table to reflect changes made after the publication of the 2015 Annual Report and Accounts. These changes are primarily due to the disclosed relative RoE performance which impacted his annual bonus figure for 2015 and the re-presentation of his LTI award vesting and dividend accrual value at the vesting date, as disclosed on page 71.

The table above shows the total remuneration figure for the former CEO during each of the relevant financial years; the current CEO is reflected since his appointment to the position on 1 May 2014. The total remuneration figure includes the annual bonus and LTI awards which vested based on performance in those years. The annual bonus and LTI percentages show the 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 CEO from the preceding year and the average percentage change in respect of the employees of the Group taken as a whole.

	Year on year change CEO[2] %	**Average year on year change employees[1,3] %**
Base salary	5	10
Benefits	4	9
Bonus	-9	12

(1) Employee numbers were calculated on a per permanent employee headcount basis for the years ending 31 December 2016 and 31 December 2015, adjusted for any joiners and leavers during this period.

(2) The underlying salary increase from 2015 to 2016 for the CEO was 3 per cent. However some amounts were paid in Sterling and converted at the average exchange rate of 1.3777 for the year, which has resulted in the overall 5 per cent base salary year on year change above.

(3) The underlying salary increase from 2015 to 2016 for the general workforce population was 3 per cent. The 10 per cent increase reflects staff promotions and other adjustments made during the year.

RELATIVE IMPORTANCE OF THE SPEND ON PAY

The following table sets out the percentage change in dividends and overall spend on pay in the year ended 31 December 2016 compared to the year ended 31 December 2015.

	2016 $m	2015 $m	Percentage change %
Employee remuneration costs	**72.1**	80.1	-10
Dividends	**178.9**	317.5	-44

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, with the exception of Peter Clarke who is the Chairman of the Board):

Remuneration Committee Members	Position	Comments
Simon Fraser	LHL Remuneration Committee Chairman	Attended 4 of a potential maximum meetings of 4 in 2016
Peter Clarke	Member from 4 November 2014	Attended 4 of a potential maximum meetings of 4 in 2016
Michael Dawson	Member from 3 November 2016	Attended 0 of a potential maximum meetings of 0 in 2016
Robert Lusardi	Member from 8 July 2016	Attended 2 of a potential maximum meetings of 2 in 2016
Emma Duncan	Member from 5 November 2010 Retired on 8 July 2016	Attended 2 of a potential maximum meetings of 2 in 2016
Samantha Hoe-Richardson	Member on an interim basis from 4 May 2016 to 3 November 2016	Attended 2 of a potential maximum meetings of 2 in 2016

The Remuneration Committee's responsibilities are contained in its Terms of Reference, a copy of which is available on the Company's website. These responsibilities include determining the framework for the remuneration, including pension arrangements, for all Executive Directors, the Chairman and senior executives. The Committee is also responsible for approving employment contracts for senior executives.

REMUNERATION COMMITTEE ADVISER

The Remuneration Committee is advised by 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 broking services to the Group.

The primary role of NBS is to provide independent and objective advice and support to the Committee's Chairman and members. In order to manage any possible conflict of interest, 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 ended 31 December 2016 were $159,473 (2015 – $132,330). Fees are predominantly charged on a 'time spent' basis.

ENGAGEMENT WITH SHAREHOLDERS

Details of votes cast for and against the resolution to approve last year's Remuneration Report are shown below along with the votes to approve the outgoing policy which have been restated below; any matters discussed with shareholders during the year are provided in the Implementation of Remuneration Policy for 2017 section of the report starting on page 69.

	Vote to approve 2015 Annual Report on Remuneration		2014 AGM Vote to approve outgoing Remuneration Policy	
	Total number of votes	**% of votes cast**	Total number of votes	% of votes cast
For	**139,168,062**	**96.1**	132,963,855	90.1
Against	**5,670,010**	**3.9**	14,530,236	9.9
Total	**144,838,072**	**100.0**	147,494,091	100.0
Abstentions	**4,450,849**		554,388	

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

Simon Fraser
LHL Remuneration Committee Chairman

15 February 2017

GOVERNANCE

OVERVIEW OF THE GROUP

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

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

PRINCIPAL ACTIVITIES

The Company's principal activity, through its wholly owned subsidiaries, is the provision of global specialty insurance and reinsurance products. On 7 November 2013, the Company completed the acquisition of CCL, an established Lloyd's insurance group, and in June 2013 established Kinesis, a third-party capital and underwriting management facility, to complement the Group's longstanding specialty insurance activities. An analysis of the Group's business performance can be found in the Business review on pages 24 to 30.

DIVIDENDS

For the year ended 31 December 2016, the following dividends were declared:

- an interim dividend of $0.05 per common share was declared on 26 July 2016 and paid on 31 August 2016 in pounds sterling at the pound/U.S. dollar exchange rate of 1.3159 or £0.0380 per common share;
- a special dividend of $0.75 per common share was declared on 2 November 2016 and paid on 14 December 2016 in pounds sterling at the pound/U.S. dollar exchange rate of 1.2417 or £0.6040 per common share; and
- a final dividend of $0.10 per common share was declared on 15 February 2017 to be paid on 22 March 2017 in pounds sterling at the pound/U.S. dollar exchange rate on the record date of 24 February 2017 or approximately £0.08 per common share.

DIVIDEND POLICY

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

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

CURRENT DIRECTORS

- Peter Clarke (Non-Executive Chairman) (appointed Chairman effective 4 May 2016)
- Michael Dawson (Non-Executive Director) (appointed effective 3 November 2016)
- Simon Fraser (Senior Independent Non-Executive Director)
- Samantha Hoe-Richardson (Non-Executive Director)
- Robert Lusardi (Non-Executive Director) (appointed effective 8 July 2016)
- Alex Maloney (Chief Executive Officer)
- Tom Milligan (Non-Executive Director)
- Elaine Whelan (Chief Financial Officer)

DIRECTORS WHO RETIRED DURING THE YEAR

- Martin Thomas (Non-Executive Chairman) (retired effective 4 May 2016)
- Emma Duncan (Non-Executive Director) (retired effective 8 July 2016)

DIRECTORS' INTERESTS

The Directors' beneficial interests in the Company's common shares as at 31 December 2016 and 2015 including interests held by family members were as follows:

Directors	Common shares held as at 31 December 2016	Common shares held as at 31 December 2015
Peter Clarke[1]	**14,000**	–
Michael Dawson	**–**	–
Simon Fraser	**1,000**	1,000
Samantha Hoe-Richardson	**3,947**	3,947
Robert Lusardi[2]	**3,000**	–
Alex Maloney[3]	**513,512**	382,008
Tom Milligan	**1,000**	1,000
Elaine Whelan[4]	**428,976**	287,169

Former Non-Executive Directors		
Emma Duncan	**N/A**	–
Martin Thomas	**N/A**	6,950

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

(1) Peter Clarke conducted the following transactions in the Company's shares during 2016:
- 1 March – purchase of 14,000 shares at a price of £5.52 costing £77,241.

(2) Robert Lusardi conducted the following transactions in the Company's shares during 2016:
- 30 December – purchase of 3,000 shares at a price of $8.60 costing $25,800.

(3) Includes 100,000 shares owned by his spouse, Amanda Maloney. Alex Maloney conducted the following transactions in the Company's shares during 2016:
- 1 March – purchase of 44,553 shares at a price of £5.60 costing £249,497.
- 5 May – purchase of 18,955 shares at a price of £5.27 costing £99,798.
- 13 September – exercise of 98,976 RSS awards and 29,634 deferred bonus RSS awards and related sale of 60,614 shares to cover tax liabilities, at a price of £6.50 realising £394,032.

(4) Includes 11,590 shares owned by her spouse, Kilian Whelan. Elaine Whelan conducted the following transactions in the Company's shares during 2016:
- 1 March – purchase of 29,500 shares at a price of £5.61 costing £165,569.
- 3 March – purchase of 8,990 shares at a price of £5.55 costing £49,912 by Kilian Whelan.
- 9 May – exercise of 87,065 RSS awards and 22,872 deferred bonus RSS awards and related sale of 6,620 shares on 9 and 10 May to cover tax liabilities, at a price of £5.55 realising £36,745.

TRANSACTIONS IN OWN SHARES

The Company did not repurchase any of its own common shares during 2016 or 2015.

The Group's current repurchase programme has 20,134,191 common shares remaining to be purchased as at 31 December 2016 (approximately $172.7 million at the 31 December 2016 share price). The purpose of the Company's repurchase programme is to acquire shares to use in the future towards satisfying its obligations under its RSS awards. Further details of the share repurchase authority and programme are set out in note 18 to the consolidated financial statements on page 150. The repurchase programme is subject to renewal at the 2017 AGM in an amount of up to 10 per cent of the then issued common share capital.

DIRECTORS' REMUNERATION

Details of the Directors' remuneration are set out in the Directors' Remuneration Report on pages 61 to 79.

SUBSTANTIAL SHAREHOLDERS

As at 15 February 2017, 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 15 February 2017	% of shares in issue
Invesco Limited	39,964,120	20.0
Woodford Investment Management Ltd	31,558,488	15.8
Setanta Asset Management Limited	15,223,868	7.6
Vidacos Nominees Ltd	10,342,300	5.2
BlackRock, Inc.	8,976,004	4.5
Dimensional Fund Advisors LP	8,097.268	4.1
Franklin Mutual Advisers, LLC	7,856,956	3.9
Troy Asset Management Limited	6,842,393	3.4

CORPORATE GOVERNANCE – COMPLIANCE STATEMENT

The Company's compliance with the Code is summarised in the Corporate Governance section of this Report on pages 47 to 49.

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 June 2016 the Company made a cash donation of $300,110 to the Lancashire Foundation.

The Foundation owns 330,713 common shares in the Company and during the 2016 calendar year received dividends of £236,010 declared on those shares.

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 two senior employees and a subsidiary Non-Executive Director. The Trustees make donations following recommendations made by the Company's Donations Committee consisting of some of the Group's employees.

A summary of the work of the Lancashire Foundation during 2016 can be found in the Corporate Responsibility section on pages 36 to 41.

The Group did not make any political donations or expenditure during 2016 or 2015.

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 page 39.

EMPLOYEES

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

CREDITOR PAYMENT POLICY

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

FINANCIAL INSTRUMENTS AND RISK EXPOSURES

Information regarding the Group's risk exposures is included in the ERM report on pages 31 to 33 and in the risk disclosures section on pages 101 to 128 of the consolidated financial statements. The Group's use of derivative financial instruments can be found on pages 116 to 118.

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 certain aspects relating to the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, the Group's management determines appropriate measurement bases, to provide the most useful information to users of the consolidated financial statements, using their judgement and considering U.S. GAAP.

ANNUAL GENERAL MEETING

The notice of the 2017 AGM, to be held on 3 May 2017 at the Company's head office, 29th Floor, 20 Fenchurch Street, London EC3M 3BY, UK, is contained in a separate circular to shareholders which is made available to shareholders at the same time as this Annual Report and Accounts. The notice of the AGM is also available on the Company's website.

ELECTRONIC AND WEB COMMUNICATIONS

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

GOING CONCERN AND VIABILITY STATEMENT

The Business review section on pages 24 to 30 sets out details of the Group's financial performance, capital management, business environment and outlook. In addition, further discussion of the principal risks and material uncertainties affecting the Group can be found on pages 34 and 35. Starting on page 101, the risk disclosures section of the consolidated financial statements sets out the principal risks to which the Group is exposed, including insurance, market, liquidity, credit, operational and strategic, together with the Group's policies for monitoring, managing and mitigating its exposures to these risks. The Board considers annually and on a rolling basis a three-year strategic plan for the business which the Company progressively implements. A three-year plan period aligns to the short-tail nature of the Group's liabilities and the agility in the business model, allowing the Group to adapt capital and solvency quickly in response to market cycles, events and opportunities. This is consistent with the outlook period in the Group's ORSA report. The three-year strategic plan was last approved by the Board on 26 July 2016. The Board receives quarterly reports from the CRO and sets and approves risk tolerances for the business. The Board approved the Group's 2016 ORSA report on 8 December 2016.

During 2016, and in particular in the preparation of the 2016 ORSA report, the Board carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. As part of this assessment the business plan was stressed for a number of scenarios and the impact on capital (on both an IFRS and Solvency II basis) evaluated. The Directors believe that the Group is well placed to manage its business risks successfully, having taken into account the current economic outlook. Accordingly, the Board believes that, taking into account the Group's current position, and subject to the principal risks faced by the business, the Group will be able to continue in operation and to meet its liabilities as they fall due for the period up to 31 December 2018, being the period considered under the Group's current three-year strategic plan.

The Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 31 December 2018. Accordingly, the Board has adopted and continues to consider appropriate the going concern basis in preparing the Annual Report and Accounts.

AUDITORS

Resolutions will be proposed at the Company's 2017 AGM to appoint KPMG as the Company's auditors and to authorise the Directors to set the auditors' remuneration.

During 2016 the Company completed an audit tender process and, as a result, the Board decided to recommend to shareholders that KPMG be appointed as the Company's auditors at the 2017 AGM. EY have served as the Company's auditors since 2005. See page 54 for further details of the audit tender process.

DISCLOSURE OF INFORMATION TO THE AUDITORS

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

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

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

Christopher Head
Company Secretary

15 February 2017

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

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that year. The consolidated financial statements have been prepared in accordance with IFRS. Where IFRS is silent, as it is in respect of certain aspects relating to 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 accounting 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 Group's 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 Group will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group, and enable them to ensure that the consolidated financial statements comply with applicable laws and regulations. They are also responsible for 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 and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy; and
3. the Strategy and the Business review sections of this Annual Report and Accounts include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that the Group faces.

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

By order of the Board

15 February 2017

OUR OPINION ON THE CONSOLIDATED FINANCIAL STATEMENTS

In our opinion the consolidated financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2016 and of its profit for the year then ended; and
- have been properly prepared in accordance with IFRSs as adopted by the European Union.

WHAT WE HAVE AUDITED

We have audited the consolidated financial statements of LHL for the year ended 31 December 2016 which comprise:

- the consolidated balance sheet as at 31 December 2016;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in shareholders' equity for the year then ended;
- the statement of consolidated cash flows for the year then ended; and
- the accounting policies, the risk disclosures, and the related notes to the accounts 1 to 24.

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.

OVERVIEW OF OUR AUDIT APPROACH	
Risks of material misstatement	– Valuation of loss reserves – Goodwill and intangible assets – Revenue recognition – premium estimates
Audit scope	– We performed an audit of the complete financial information of 4 components – The components where we performed full or specific audit procedures accounted for 100 per cent of profit before tax, 100 per cent of gross premiums written and 100 per cent of insurance contract liabilities
Materiality	Overall Group materiality of $7.5 million, which represents 5 per cent of profit before tax

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT AND RESPONSE TO THOSE RISKS

We identified the risks of material misstatement described below as those that had the greatest effect on our overall audit strategy, the allocation of resources in the audit and the direction of the efforts of the audit team. These risks are consistent with those identified during the 2015 audit. In addressing these risks, we have performed the procedures below which were designed in the context of the consolidated financial statements as a whole and, consequently, we do not express any opinion on these individual areas.

VALUATION OF LOSS RESERVES ($679.8 MILLION GROSS, $543.1 MILLION NET; 2015: $671.0 MILLION GROSS, $587.1 MILLION NET)

Refer to page 50 (Audit Committee report), page 98 (accounting policies), page 109 (risk disclosures), and page 143 (disclosures)

Risk	Response	What we concluded to the Audit Committee
The valuation of loss reserves 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 the ultimate amount paid varying materially from the amount estimated at this reporting date.	We understood, assessed and tested the design and operational effectiveness of the key controls in the Group's reserving process, including the review and approval of the reserves, and controls over the extraction of data from the appropriate sources. Supported by our actuarial specialists, we evaluated management's methodology against market practice and challenged management's assumptions and their assessment of major sensitivities, based on our market knowledge and industry data where available. The main areas of judgement include the level of reserves held for specific losses, the loss development patterns selected and the initial expected loss ratios. Using management's data, we independently re-projected the loss and loss adjustment expense reserves for LUK, LICL, and Cathedral on both a gross and net basis, investigating significant differences between our projections and management's booked reserves. Using our own re-projection we then considered whether the loss and loss adjustment expense reserves held at the year end fall within a reasonable range of possible estimates. We considered the results of the third-party actuarial review of the loss and loss adjustment reserves as at the reporting date, presented to the Audit Committee, again specifically to identify and understand any significant differences in projections. In light of our work outlined above, we considered the adequacy of disclosures of the judgements and uncertainties being made by the Directors in the insurance risk note on page 103 and note 12 related to losses and loss adjustment expenses.	Taken as a whole, we consider that managements judgements in the areas highlighted are reasonable based on the information available at the date of this report. Consistent with the prior period, the Group's booked reserves lie within what we consider to be a reasonable range of estimates. In addition we consider that the disclosures made are satisfactory, and they provide information that assists in understanding the uncertainty inherent in the valuation of loss reserves.

GOODWILL AND INTANGIBLE ASSETS ($153.8 MILLION; 2015: $153.8 MILLION)

Refer to page 50 (Audit Committee report), page 97 (accounting policy) and page 146 (disclosures)

Risk	Response	What we concluded to the Audit Committee
We considered the risk that the goodwill and intangible assets arising from the Cathedral acquisition may be impaired. In testing for impairment, judgement is applied by management in deriving: – the forecast cash flows; and – the pre-tax discount rate applied to those cash flows.	Management's impairment assessment of the recorded value of goodwill and the syndicate participation rights was performed as at 30 September 2016. We evaluated and challenged this assessment, including: – validating that the base cash flows used were consistent with the three year forecast approved by the Board; – reading the three year plan, assessing back testing performed by management to support the robustness of the forecast process and having regard to market conditions; – considering whether the pre-tax discount rate applied was appropriate by assessing the cost of capital for the Group and comparable businesses, and the sensitivity of the impairment assessment to changes in the pre-tax discount rate; and – assessing whether long term growth assumptions were consistent with economic and industry forecasts; and – assessing the sensitivity analysis performed by management, and performing our own stress tests of the pre-tax discount rate, forecast cash flows, and long term growth rate assumptions in isolation and in combination to consider reasonably possible alternative scenarios. We considered management's assessment as to whether there were any impairment indicators during the final quarter of the year, which included a comparison of expected 1 January 2017 business to be written as per the three year plan against the actual business subsequently written.	We agreed with the conclusions of management's assessment at 30 September 2016, that the recoverable amounts exceeded the recorded values with headroom remaining when key assumptions were stressed for what we consider to be cautious assumptions, and that as a result, no impairment of the goodwill and indefinite lived intangible assets was required. We also agreed with management's assessment that no impairment triggers occurred in the final quarter of the year.

REVENUE RECOGNITION – PREMIUM ESTIMATES

Refer to page 50 (Audit Committee report) and page 97 (accounting policy)

Risk	Response	What we concluded to the Audit Committee
For certain contracts written, premium revenues are initially recognised based on estimates of ultimate premiums. This occurs for contracts where pricing is based on variables which are not known with certainty at the point of binding the contract. Subsequent adjustments to those estimates, which arise as updated information relating to those pricing variables becomes available, are recorded in the period in which they are determined. These estimates are judgemental and therefore could result in misstatements of revenue recognised in the consolidated financial statements.	We evaluated and tested the key controls over the premium estimation process, which include the periodic review by management of estimated premiums, taking into account any third-party information received from intermediaries or insureds. For a sample of policies we verified the year end estimated premium income, including considering the basis of estimation and corroborating evidence such as information from brokers. We have analysed the development, during the period, of estimates recognised as at 31 December 2016 to identify if there is any indication of management bias.	Based on the results of the procedures performed we have concluded that the premium estimates are recorded in line with applicable accounting standards.

THE SCOPE OF OUR AUDIT

TAILORING THE SCOPE

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each component within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent Internal Audit results when assessing the level of work to be performed at each component.

In assessing the risk of material misstatement to the consolidated financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the consolidated financial statements, we performed an audit of the complete financial information ('full scope audit') of all components of the group being LUK, LICL, Cathedral and Group except for the investment in associate for which we performed specified procedures.

Full scope audit procedures were performed over 100 per cent (2015: 100 per cent) of gross written premiums and insurance contract liabilities, and 97 per cent (2015: 98 per cent) of profit before tax. Specified audit procedures were performed over the remaining 3 per cent (2015: 2 per cent) of profit before tax.

CHANGES FROM THE PRIOR YEAR

There have been no material scoping changes from the prior year.

INVOLVEMENT WITH COMPONENT TEAMS

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit team, or by component auditors from other EY global network firms operating under our instruction.

The primary audit team, comprising both London and Bermuda members, visited all of the full scope components. These visits involved discussing the audit approach with the component team and any issues arising from their work, meeting with local management, and reviewing key audit working papers on the Group risk areas. The primary audit team interacted regularly with the component teams where appropriate during various stages of the audit, reviewed key working papers and were responsible for the scope and direction of the audit process. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the consolidated financial statements.

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality in planning and performing our audit, in evaluating the effect of identified misstatements on our audit and in forming our audit opinion.

MATERIALITY

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be $7.5 million (2015: $8.6 million), which is approximately 5 per cent (2015: approximately 5 per cent) of profit before tax. The decrease in materiality from the prior period is due to the reduced profit before tax for the current period.

PERFORMANCE MATERIALITY

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50 per cent (2015: 50 per cent) of our planning materiality, namely $3.8 million (2015: $4.3 million).

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was $3.8 million to $1.9 million (2015: $4.3 million to $2.4 million).

REPORTING THRESHOLD

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of $0.5 million (2015: $0.5 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

In forming our opinion, we evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in the light of other relevant qualitative considerations.

SCOPE OF THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the consolidated financial statements sufficient to give reasonable assurance that the consolidated 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 consolidated 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 consolidated 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.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Statement of Directors' Responsibilities set out on page 84, 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.

The Company has also instructed us to audit the section of the 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.

This report is made solely to the Company's members, as a body, in accordance with our engagement letter dated 7 August 2015. 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.

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

ISAs (UK and Ireland) reporting	We are required to report to you if, in our opinion, financial and non-financial information in the Annual Report and Accounts is: – materially inconsistent with the information in the audited consolidated 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 – otherwise misleading. In particular, we are required to report whether we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the Directors' statement that they consider that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy; and whether the Annual Report and Accounts appropriately addresses those matters that we communicated to the Audit Committee that we consider should have been disclosed.	We have no exceptions to report.
Listing Rules review requirements	We are required to review: – the Directors' statement in relation to going concern and longer-term viability, set out on page 83; and – the part of the Corporate Governance Statement relating to the Company's compliance with the provisions of the UK Corporate Governance Code specified for review.	We have no exceptions to report.

STATEMENT ON THE DIRECTORS' ASSESSMENT OF THE PRINCIPAL RISKS THAT WOULD THREATEN THE SOLVENCY OR LIQUIDITY OF THE ENTITY		
ISAs (UK and Ireland) reporting	We are required to give a statement as to whether we have anything material to add or to draw attention to in relation to: – the Directors' confirmation in the Annual Report and Accounts that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity; – the disclosures in the Annual Report and Accounts that describe those risks and explain how they are being managed or mitigated; – the Directors' statement in the Annual Report and Accounts about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the consolidated financial statements; and – the Directors' explanation in the Annual Report and Accounts as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or draw attention to.

Ernst & Young LLP
London

15 February 2017

(1) The maintenance and integrity of the Lancashire Holdings Limited website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the consolidated financial statements since they were initially presented on the website.
(2) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

	Notes	2016 $m	2015 $m
Gross premiums written	2	**633.9**	641.1
Outwards reinsurance premiums	2	**(175.2)**	(159.4)
Net premiums written		**458.7**	481.7
Change in unearned premiums	2	**25.7**	79.9
Change in unearned premiums on premiums ceded	2	**3.7**	5.5
Net premiums earned		**488.1**	567.1
Net investment income	3	**29.8**	29.8
Net other investment income (losses)	3	**6.9**	(1.3)
Net realised (losses) gains and impairments	3	**(2.4)**	(2.8)
Share of profit of associate	15	**5.1**	4.1
Other income	22	**20.5**	19.9
Net foreign exchange gains (losses)		**4.4**	(2.4)
Total net revenue		**552.4**	614.4
Insurance losses and loss adjustment expenses	2, 12	**212.2**	177.5
Insurance losses and loss adjustment expenses recoverable	2, 12	**(69.7)**	(21.8)
Net insurance losses		**142.5**	155.7
Insurance acquisition expenses	2, 4	**135.1**	148.2
Insurance acquisition expenses ceded	2, 4	**(3.0)**	(2.0)
Other operating expenses	5, 6, 20	**98.5**	106.6
Equity based compensation	6	**10.7**	15.8
Total expenses		**383.8**	424.3
Results of operating activities		**168.6**	190.1
Financing costs	7	**18.2**	18.4
Profit before tax		**150.4**	171.7
Tax credit	8	**3.9**	10.0
Profit for the year		**154.3**	181.7
Profit for the year attributable to:			
Equity shareholders of LHL		**153.8**	181.1
Non-controlling interests		**0.5**	0.6
Profit for the year		**154.3**	181.7
Other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods			
Net change in unrealised gains/losses on investments	3, 10	**4.1**	(11.6)
Tax provision on net change in unrealised gains/losses on investments	10	**–**	0.3
Other comprehensive income (loss)		**4.1**	(11.3)
Total comprehensive income for the year		**158.4**	170.4
Total comprehensive income attributable to:			
Equity shareholders of LHL		**157.9**	169.8
Non-controlling interests		**0.5**	0.6
Total comprehensive income for the year		**158.4**	170.4
Earnings per share			
Basic	21	**$0.77**	$0.93
Diluted	21	**$0.76**	$0.91

CONSOLIDATED BALANCE SHEET

As at 31 December 2016

	Notes	2016 $m	2015 $m
Assets			
Cash and cash equivalents	9, 17	**308.8**	291.8
Accrued interest receivable		**6.6**	6.5
Investments	10, 11, 17	**1,648.4**	1,773.3
Inwards premiums receivable from insureds and cedants	13	**270.0**	253.7
Reinsurance assets			
– Unearned premiums on premiums ceded		**33.9**	30.2
– Reinsurance recoveries	12	**136.7**	83.9
– Other receivables	13	**16.5**	2.7
Other receivables	13	**43.6**	37.8
Corporation tax receivable		**1.1**	–
Investment in associate	11, 15	**49.7**	47.5
Property, plant and equipment		**5.3**	7.2
Deferred acquisition costs		**81.5**	87.2
Intangible assets	16	**153.8**	153.8
Total assets		**2,755.9**	2,775.6
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	12	**679.8**	671.0
– Unearned premiums		**373.5**	399.2
– Other payables		**37.4**	36.2
Amounts payable to reinsurers		**52.7**	26.6
Deferred acquisition costs ceded		**0.4**	0.3
Other payables		**61.0**	67.0
Corporation tax payable		**–**	1.8
Deferred tax liability	14	**18.7**	25.6
Interest rate swap	17	**3.7**	4.8
Long-term debt	17	**320.9**	322.3
Total liabilities		**1,548.1**	1,554.8
Shareholders' equity			
Share capital	18	**100.7**	100.7
Own shares	18	**(23.2)**	(30.4)
Other reserves	19	**881.6**	880.8
Accumulated other comprehensive loss	10	**(6.4)**	(10.5)
Retained earnings		**254.6**	279.7
Total shareholders' equity attributable to equity shareholders of LHL		**1,207.3**	1,220.3
Non-controlling interests	22	**0.5**	0.5
Total shareholders' equity		**1,207.8**	1,220.8
Total liabilities and shareholders' equity		**2,755.9**	2,775.6

The consolidated financial statements were approved by the Board of Directors on 15 February 2017 and signed on its behalf by:

Alex Maloney
Director/CEO

Elaine Whelan
Director/CFO

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the year ended 31 December 2016

	Notes	Share capital $m	Own shares $m	Other reserves $m	Accumulated other comprehensive loss $m	Retained earnings $m	Shareholders' equity attributable to equity shareholders of LHL $m	Non-controlling interests $m	Total shareholders' equity $m
Balance as at 31 December 2014		96.1	(43.3)	887.1	0.8	416.1	1,356.8	0.5	1,357.3
Total comprehensive income for the year		–	–	–	(11.3)	181.1	169.8	0.6	170.4
Shares purchased by trust	18, 19, 22, 23	0.5	(9.3)	8.8	–	–	–	–	–
Distributed by trust	18, 19	–	12.5	(17.2)	–	–	(4.7)	–	(4.7)
Dividends on common shares	18	–	–	–	–	(316.0)	(316.0)	–	(316.0)
Dividend equivalents on warrants	18, 19	–	–	–	–	(1.5)	(1.5)	–	(1.5)
Dividends paid to minority interest holders	22	–	–	–	–	–	–	(0.6)	(0.6)
Warrant exercises	18, 19, 23	4.1	9.7	(13.8)	–	–	–	–	–
Equity based compensation – tax	8, 19	–	–	0.1	–	–	0.1	–	0.1
Equity based compensation – expense	6, 19	–	–	15.8	–	–	15.8	–	15.8
Balance as at 31 December 2015		100.7	(30.4)	880.8	(10.5)	279.7	1,220.3	0.5	1,220.8
Total comprehensive income for the year		**–**	**–**	**–**	**4.1**	**153.8**	**157.9**	**0.5**	**158.4**
Shares donated to trust	18, 19, 22	**–**	**0.6**	**(0.6)**	**–**	**–**	**–**	**–**	**–**
Distributed by trust	18, 19	**–**	**6.6**	**(9.5)**	**–**	**–**	**(2.9)**	**–**	**(2.9)**
Dividends on common shares	18	**–**	**–**	**–**	**–**	**(178.9)**	**(178.9)**	**–**	**(178.9)**
Dividends paid to minority interest holders	22	**–**	**–**	**–**	**–**	**–**	**–**	**(0.5)**	**(0.5)**
Equity based compensation – expense	19	**–**	**–**	**10.9**	**–**	**–**	**10.9**	**–**	**10.9**
Balance as at 31 December 2016		**100.7**	**(23.2)**	**881.6**	**(6.4)**	**254.6**	**1,207.3**	**0.5**	**1,207.8**

STATEMENT OF CONSOLIDATED CASH FLOWS

For the year ended 31 December 2016

	Notes	2016 $m	2015 $m
Cash flows from operating activities			
Profit before tax		**150.4**	171.7
Tax (paid) refunded		**(1.3)**	4.4
Depreciation	5	**2.3**	1.9
Interest expense on long-term debt	7	**15.6**	15.1
Interest and dividend income		**(38.5)**	(40.9)
Net amortisation of fixed maturity securities		**5.0**	8.1
Equity based compensation	6	**10.7**	15.8
Foreign exchange (gains) losses		**(2.3)**	10.8
Share of profit of associate	15	**(5.1)**	(4.1)
Net other investment (income) losses	3	**(6.9)**	1.3
Net realised losses (gains) and impairments	3	**2.4**	2.8
Net unrealised gains on interest rate swaps		**(1.1)**	(0.1)
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		**(71.7)**	(71.0)
– Other assets and liabilities		**(10.6)**	(17.7)
Net cash flows from operating activities		**48.9**	98.1
Cash flows from investing activities			
Interest and dividends received		**38.4**	42.1
Purchase of property, plant and equipment		**(0.4)**	–
Investment in associate	22	**2.9**	9.3
Purchase of investments		**(1,214.0)**	(990.8)
Proceeds on sale of investments		**1,341.8**	1,173.5
Net cash flows from investing activities		**168.7**	234.1
Cash flows used in financing activities			
Interest paid		**(15.4)**	(15.2)
Dividends paid	18	**(178.9)**	(317.5)
Dividends paid to minority interest holders		**(0.5)**	(0.6)
Distributions by trust		**(2.9)**	(4.7)
Net cash flows used in financing activities		**(197.7)**	(338.0)
Net increase (decrease) in cash and cash equivalents		**19.9**	(5.8)
Cash and cash equivalents at beginning of year		**291.8**	303.5
Effect of exchange rate fluctuations on cash and cash equivalents		**(2.9)**	(5.9)
Cash and cash equivalents at end of year	9	**308.8**	291.8

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basis of preparation, consolidation principles and significant accounting policies adopted in the preparation of these 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 certain aspects relating to the measurement of insurance products, the IFRS framework allows reference to another comprehensive body of accounting principles. In such instances, the Group's management determines appropriate measurement bases, to provide the most useful information to users of the consolidated financial statements, using their judgement and considering U.S. GAAP.

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 in 2016 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. These will be addressed in IFRS 17, previously referred to as IFRS 4 Phase II, which will include a number of significant changes regarding the measurement and disclosure of insurance contracts both in terms of liability measurement and profit recognition. IFRS 17 is expected to be issued in the first half of 2017 with an effective date of 1 January 2021. The Group will continue to assess the potential impact 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 maturity securities, equity securities and hedge funds as AFS or FVTPL. The new standard is effective for annual periods beginning on or after 1 January 2018, although it has been deferred for insurers to 1 January 2021 to align with the implementation date of IFRS 17. IFRS 9 is not expected to have a material impact on the results and disclosures reported in the consolidated financial statements.

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 98 and also in the risk disclosures section from page 109. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 98.

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 98 and 99 and in note 10. Management judgement is applied in determining impairment charges. The estimation of the fair value of equity based compensation awards granted is discussed in note 6.

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 the 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 assets are 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 16.

BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at and for the year ended 31 December 2016. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. Intercompany balances, profits and transactions are eliminated. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

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

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

ASSOCIATE

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

FOREIGN CURRENCY TRANSLATION

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

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

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 their useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Intangible assets with indefinite useful lives are tested for impairment at least annually at the CGU level by comparing the net present value of the future earnings stream of the CGU to the carrying value of the intangible asset. Such intangible assets are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether the indefinite life assessment continues to be supportable.

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 circumstances 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 accumulated impairment losses. 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 at least annually, or when events or changes in circumstances indicate that it might be impaired.

INSURANCE CONTRACTS

CLASSIFICATION

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

PREMIUMS AND ACQUISITION COSTS

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

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

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

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

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

OUTWARDS REINSURANCE

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

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

LOSSES

Losses comprise losses and loss adjustment expenses paid in the period and changes in the provision for outstanding losses and ACR, including the provision for IBNR and related expenses. Losses and loss adjustment expenses are charged to 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 the Group's 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 maturity and equity securities are quoted or unquoted investments that are classified as AFS or at FVTPL and are carried at estimated fair value. The classification of the Group's financial assets is determined at the time of initial purchase and depends on the nature of the investment. A financial asset is classified at FVTPL if it is managed and evaluated on a fair value basis and if acquired principally for the purpose of selling in the short term, or if it forms part of a portfolio of financial assets in which there is evidence of short-term profit taking. Equity securities classified as AFS are those that are neither classified as held for trading nor designated at FVTPL. Fixed maturity securities classified as AFS are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in market conditions.

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

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

Investments are derecognised when the Group has transferred substantially all of the risks and rewards of ownership. On derecognition of an AFS investment, previously recorded unrealised gains and losses are removed from accumulated other comprehensive income (loss) in shareholders' equity and included in current period income. Realised gains and losses are included in income in the period in which they arise.

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

The Group regularly reviews the carrying value of its AFS investments for evidence of impairment. 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 (loss) in shareholders' equity and charged to current period income. Impairment losses on fixed maturity 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 not currently hold any derivatives classified as hedging instruments. For discounted cash flow techniques, estimated future cash flows are based on management's best estimates and the discount rate used is an appropriate market rate.

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

OTHER INCOME

Fees and profit commissions are recognised in line with services provided. Contingent profit commissions due on open years of account 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 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 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 other reserves.

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 when the services are rendered.

TAX

Income tax represents the sum of the tax currently payable and any deferred tax. The tax payable is calculated based on taxable profit for the period using tax rates and tax laws enacted or substantively enacted at the year end reporting date and any adjustments to tax payable in respect of prior periods. Taxable profit for the period can differ from that reported in the consolidated statement of comprehensive income due to non-taxable income and certain items which are not tax deductible or which are deferred to subsequent periods. Tax provisions on the net change in unrealised gains/losses on investments classified as AFS are recognised in other comprehensive income or (loss).

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

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

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

OWN SHARES

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

RISK DISCLOSURES: INTRODUCTION

The Group is exposed to risks from several sources. 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 Board and individual entity boards of directors review actual risk levels versus tolerances, emerging risks and any risk learning events at least quarterly. In addition, on at least a monthly basis, management reviews the output from SHARP in order to assess 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 BLAST, including considering its effectiveness. It ensures that all key areas of risk are discussed according to a schedule that covers fortnightly, monthly, quarterly, semi-annual and annual reviews. The RRC meets fortnightly and is responsible for 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 the Group CEO and members from the finance, actuarial and underwriting functions. 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:

- overall management of the risk management system;
- drive ERM culture, ownership and execution on three levels: Board, executive management, and operationally within the business;
- facilitate the identification, assessment, evaluation and management 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.

The Group subscribes to a 'three lines of defence' model, the front line being risk ownership by business managers. Responsibility for the management of individual risks has been assigned to, and may form part of the performance objectives of, the risk owners within the business. Risk owners ensure that these risks and controls are consistent with their day-to-day processes and the entries made in the Group risk registers, which are a direct input into BLAST. The second line comprises the Risk Management team which is responsible for risk oversight. Within this, the CRO provides regular reports to the business outlining the status of the Group's ERM activities and strategy, as well as formal reports to the Boards of Directors of the Group and the individual operating entities in this regard and is a member of the Risk Committee of Cathedral. The CRO ultimately has the right to report directly to the Group and entity regulators if they feel that management is not appropriately addressing areas of concern. Cathedral's CRO provides formal reports to the CUL Board and Risk Committee. The third line of defence is Internal Audit who work very closely with the business and the Risk Management team in providing risk assurance.

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 and the consistency of their operation. Internal Audit's roles and responsibilities are clearly defined through the Internal Audit Charter. The Head of Internal Audit reports directly to the Chairman of the Group Audit Committee. The CRO has input to the scope of each audit and receives a copy of each internal audit report. The CRO 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 Lancashire Companies' risk-based capital approach to decision making is their 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, reforecasting 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 to which the Group is exposed, is reviewed, including the anticipated loss curves, combined ratios and risk-adjusted profitability, to determine profitability and risk tolerance headroom by class.

BLAST covers the risks for LICL, LUK and Kinesis but does not cover Cathedral's risk. Due to the particular requirements of Lloyd's regulations, Cathedral has its own internal model which is vetted by Lloyd's as part of its own capital and solvency regulations. To formulate an overall Group view of risk, exposures from Cathedral are combined with LICL, LUK and Kinesis.

The six primary risk categories, insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk, are discussed in detail on pages 103 to 128.

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 four principal classes of business for the Group, excluding the Lloyd's segment, are Property, Energy, Marine and Aviation. These classes, plus the Group's Lloyd's segment, are deemed to be the Group's five operating segments. The level of insurance risk tolerance per peril is set by the respective Boards of Directors at both the LHL and individual entity level.

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

- the Group has a rolling three-year strategic plan that helps establish the 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;
- for Cathedral, the Syndicate business forecast and business plan are subject to review and approval by Lloyd's;
- BLAST, SHARP and Cathedral's internal models are used to measure occurrence risks, aggregate risks and correlations between classes and other non-insurance risks, and the outputs and assumptions from BLAST and SHARP 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 associate bears exposure to catastrophe losses and any significant loss event could potentially result in impairment in the value of the Group's investment in associate.

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

		100 year return period estimated net loss		250 year return period estimated net loss	
As at 31 December 2016		**$m**	**% of tangible capital**	**$m**	**% of tangible capital**
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	**176.7**	**12.9**	**259.0**	**18.8**
Non-Gulf of Mexico – U.S.	Hurricane	**156.1**	**11.4**	**326.1**	**23.7**
California	Earthquake	**87.0**	**6.3**	**145.8**	**10.6**
Pan-European	Windstorm	**69.0**	**5.0**	**115.7**	**8.4**
Japan	Typhoon	**48.7**	**3.5**	**67.3**	**4.9**
Japan	Earthquake	**48.6**	**3.5**	**114.3**	**8.3**
Pacific North West	Earthquake	**27.6**	**2.0**	**65.7**	**4.8**

(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 2015		$m	% of tangible capital	$m	% of tangible capital
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	231.6	16.7	347.2	25.0
Non-Gulf of Mexico – U.S.	Hurricane	236.2	17.0	457.4	32.9
California	Earthquake	157.7	11.4	250.8	18.1
Pan-European	Windstorm	92.2	6.6	145.6	10.5
Japan	Typhoon	47.7	3.4	69.3	5.0
Japan	Earthquake	72.1	5.2	121.2	8.7
Pacific North West	Earthquake	37.1	2.7	98.5	7.1

(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:

	2016		2015	
	$m	**%**	$m	%
U.S. and Canada	**179.7**	**28.4**	176.1	27.5
Worldwide offshore	**161.1**	**25.5**	153.2	23.9
Worldwide, including the U.S. and Canada[1]	**115.6**	**18.2**	135.6	21.2
Europe	**46.9**	**7.4**	48.9	7.6
Far East	**29.2**	**4.6**	31.2	4.9
Worldwide, excluding the U.S. and Canada[2]	**15.4**	**2.4**	18.2	2.8
Middle East	**13.5**	**2.1**	8.0	1.2
Rest of world	**72.5**	**11.4**	69.9	10.9
Total	**633.9**	**100.0**	641.1	100.0

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

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

	2016		2015	
	$m	%	$m	%
Property	**219.5**	**34.6**	197.2	30.8
Lloyd’s	**215.0**	**33.9**	247.7	38.6
Energy	**126.0**	**19.9**	112.0	17.5
Marine	**37.2**	**5.9**	47.6	7.4
Aviation	**36.2**	**5.7**	36.6	5.7
Total	**633.9**	**100.0**	641.1	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:

	2016 $m	2015 $m
Property catastrophe excess of loss	**99.8**	90.6
Property political risk	**44.1**	33.3
Terrorism	**41.1**	43.8
Property retrocession	**12.8**	13.6
Property risk excess of loss	**11.3**	10.0
Other property	**10.4**	5.9
Total	**219.5**	197.2

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

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

Property 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.

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

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 103 and 104.

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. LLOYD'S

Gross premiums written, for the year:

	2016 $m	2015 $m
Property reinsurance	**88.6**	92.9
Property direct and facultative	**56.1**	66.2
Aviation and satellite	**24.3**	28.5
Marine cargo	**21.2**	29.6
Energy	**14.9**	20.1
Terrorism	**6.3**	6.0
Contingency	**3.6**	4.4
Total	**215.0**	247.7

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

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

Aviation and satellite includes aviation reinsurance, aviation war, general aviation 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. Aviation war covers loss or damage to aviation assets from war, terrorism and similar causes. General aviation covers fixed wing and rotor wing aircraft, typically with 50 passenger seats or less, and covers both commercial and private clients. A significant part of the 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.

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

Energy risks are written mostly on a direct basis and may be ground-up or for primary or excess layers on either a first loss or full value basis. Worldwide offshore energy policies are typically package policies which may include physical damage, well control, business interruption and third-party liability sections. Coverage can include fire and explosion and elemental risks. Individual assets covered can be high-value and are therefore mostly written on a subscription basis, meaning that coverage is placed with multiple risk carriers. Construction energy contracts generally cover all risks of platforms, FPSO and drilling units under construction at yard and offshore, during towing and installation. Onshore construction contracts are generally not written.

Terrorism business can be written either ground-up or for primary or excess layers, with cover provided for U.S. and worldwide property risks, but typically excluding nuclear, chemical, biological and cyber coverage in most territories. Cover is generally provided to medium to large commercial and industrial enterprises. Policies are typically written for scheduled locations and exposure is controlled by setting limits on aggregate exposure within a 'blast zone' radius. The term of these contracts may be multi-year, reflecting the term of the underlying exposures. Reinsurance may be purchased on a facultative or treaty 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 exposure to large risk losses including large natural catastrophe losses in the U.S., Canada and worldwide with certain exclusions. Reinsurance may also be purchased to mitigate an accumulation of smaller, attritional losses. Reinsurance may be purchased on a facultative, excess of loss treaty or proportional treaty basis.

III. ENERGY

Gross premiums written, for the year:

	2016 $m	2015 $m
Worldwide offshore energy	**88.7**	92.8
Gulf of Mexico offshore energy	**20.1**	6.1
Construction energy	**4.8**	2.8
Energy liabilities	**3.5**	3.3
Other energy	**8.9**	7.0
Total	**126.0**	112.0

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

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 103 and 104.

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

The Group writes energy liability business on a stand-alone basis. 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.

IV. MARINE

Gross premiums written, for the year:

	2016 $m	2015 $m
Marine hull and total loss	**13.1**	19.9
Marine builders' risk	**8.7**	6.5
Marine P&I clubs	**8.4**	13.0
Marine hull war	**4.1**	6.0
Other marine	**2.9**	2.2
Total	**37.2**	47.6

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

The largest expected exposure in the marine class is from physical loss rather than from elemental loss events, although there is exposure to elemental perils and to the costs for removal of wreck.

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.

V. AVIATION

Gross premiums written, for the year:

	2016 $m	2015 $m
AV52	**24.0**	23.5
Aviation satellite	**9.8**	12.2
Other aviation	**2.4**	0.9
Total	**36.2**	36.6

AV52 is written on a risk attaching excess of loss basis and provides coverage for third-party liability, excluding own passenger liability, resulting from acts of war or hijack of aircraft. Cover excludes countries whose governments provide a backstop coverage, but does, since 2014, include some U.S. commercial airlines.

Aviation satellite 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.

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

REINSURANCE

The Group, in the normal course of business and in accordance with its risk management practices, seeks to reduce certain types of loss that may arise from events that could cause unfavourable underwriting results, and to improve the modeled risk-adjusted RoE by entering into reinsurance arrangements. Reinsurance does not relieve the Group of its obligations to policyholders. Under the Group's reinsurance security policy, reinsurers are assessed and approved as appropriate security based on their financial strength ratings, amongst other factors. The RSC considers reinsurers that are not rated or do not fall within the predefined rating categories on a case-by-case basis, and would usually require collateral to be posted to support such obligations. There are specific guidelines for these collateralised contracts. The RSC monitors 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. The mix of reinsurance cover is dependent on the specific loss mitigation requirements, market conditions and available capacity. Reinsurance may also be purchased to optimise the risk-adjusted return of the underwriting portfolio. The structure varies between types of peril and sub-class. The Group regularly reviews its catastrophe and other exposures and may purchase reinsurance in order to reduce the Group's net exposure to a large natural catastrophe loss and/or to reduce net exposures to other large losses. The Group can purchase both facultative and treaty reinsurance with varying cover and attachment points. The reinsurance coverage is not intended to be available to meet all potential loss circumstances. The Group will retain some losses, as the cover purchased is unlikely to transfer the totality of the Group's exposure. Any loss amount which exceeds the programme would be retained by the Group. Some parts of the reinsurance programme have limited reinstatements, therefore the number of claims which may be recovered from second or subsequent losses in those particular circumstances is limited.

INSURANCE LIABILITIES

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

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

Losses and loss adjustment expenses are maintained to cover the Group's estimated liability for both reported and unreported claims. Reserving methodologies that calculate a point estimate for the ultimate losses are utilised, 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. 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.

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 2016, management's estimates for IBNR represented 34.6 per cent of total net loss reserves (31 December 2015 – 35.2 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 of which the Group was not made aware by the balance sheet date.

B. MARKET RISK

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

i. Insurance risk;

ii. Investment risk;

iii. Debt risk; and

iv. Currency risk.

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

I. INSURANCE RISK

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

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

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

- reviews and amends underwriting plans and outlook as necessary;
- reduces exposure to market sectors where conditions have reached unattractive levels;
- purchases appropriate, cost-effective reinsurance cover to mitigate exposures;
- closely monitors changes in rates and terms and conditions;
- ensures through continuous capital management that it does not allow surplus capital to drive underwriting appetite;
- holds a daily underwriting meeting for LICL and LUK to discuss, inter alia, market conditions and opportunities;
- reviews all new and renewal business post-underwriting for Cathedral;
- 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 RDSs; and
- holds regular meetings with regulators.

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

II. INVESTMENT RISK

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

The Group's fixed maturity portfolios are managed by four external investment managers. The Group also has a diversified low volatility portfolio of multi-strategy hedge funds, and 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 maturity securities, fixed maturity 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 the 'surplus' portfolios. The core plus portfolio is invested in fixed maturity securities and cash and cash equivalents. The surplus portfolio is invested in fixed maturity securities, principal protected equity linked notes, derivative instruments, cash and cash equivalents, equity securities and hedge funds. In general, the duration of the surplus portfolio is slightly longer than the core or core plus portfolio, 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 tolerance levels, adjustments may be made to reduce the risks in the portfolio.

The investment portfolio is currently structured to perform better in a risk-on environment in order to mitigate the impact of a potential rise in interest rates. The Group endeavours to limit losses in risk-on, risk-off and interest rate hike scenarios. The Group models various periods of significant stress in order to better understand the investment portfolio's risks and exposures. The scenarios represent what could and most likely will occur (albeit not in the exact form of the scenarios, which are based on historic periods of volatility). The Group also monitors the portfolio impact of more severe disaster scenarios consisting of extreme shocks.

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

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

As at 31 December 2016	Core		Core plus		Surplus		Total	
	$m	%	$m	%	$m	%	$m	%
– Short-term investments	–	–	1.3	0.1	4.0	0.3	5.3	0.4
– Fixed maturity funds	14.5	1.0	–	–	–	–	14.5	1.0
– U.S. treasuries	120.6	8.1	158.2	10.6	26.7	1.8	305.5	20.5
– Other government bonds	15.6	1.0	36.3	2.4	14.7	1.0	66.6	4.4
– U.S. municipal bonds	0.6	–	–	–	0.5	–	1.1	–
– U.S. government agency debt	17.1	1.2	34.9	2.3	29.9	2.0	81.9	5.5
– Asset backed securities	13.4	0.9	69.9	4.7	26.9	1.8	110.2	7.4
– U.S. government agency mortgage backed securities	10.3	0.7	30.5	2.0	77.5	5.2	118.3	7.9
– Non-agency mortgage backed securities	4.5	0.3	7.9	0.5	1.9	0.1	14.3	0.9
– Non-agency commercial mortgage backed securities	3.0	0.2	2.9	0.2	3.7	0.2	9.6	0.6
– Bank loans	–	–	–	–	121.6	8.1	121.6	8.1
– Corporate bonds	151.6	10.1	292.3	19.5	153.4	10.2	597.3	39.8
Total fixed maturity securities – AFS	351.2	23.5	634.2	42.3	460.8	30.7	1,446.2	96.5
Fixed maturity securities – at FVTPL	–	–	–	–	51.6	3.5	51.6	3.5
Total fixed maturity securities	351.2	23.5	634.2	42.3	512.4	34.2	1,497.8	100.0

As at 31 December 2015	Core		Core plus		Surplus		Total	
	$m	%	$m	%	$m	%	$m	%
– Short-term investments	7.5	0.5	13.1	0.8	–	–	20.6	1.3
– Fixed maturity funds	11.4	0.7	–	–	–	–	11.4	0.7
– U.S. treasuries	178.4	11.1	157.5	9.8	57.4	3.6	393.3	24.5
– Other government bonds	24.4	1.5	22.6	1.4	18.4	1.2	65.4	4.1
– U.S. municipal bonds	0.6	–	–	–	4.6	0.3	5.2	0.3
– U.S. government agency debt	2.9	0.2	1.0	–	–	–	3.9	0.2
– Asset backed securities	16.1	1.0	66.3	4.1	31.5	2.0	113.9	7.1
– U.S. government agency mortgage backed securities	20.2	1.3	39.0	2.4	84.6	5.3	143.8	9.0
– Non-agency mortgage backed securities	5.5	0.3	12.1	0.8	4.2	0.3	21.8	1.4
– Non-agency commercial mortgage backed securities	4.1	0.3	11.5	0.7	13.2	0.8	28.8	1.8
– Bank loans	–	–	–	–	115.0	7.2	115.0	7.2
– Corporate bonds	182.4	11.4	278.9	17.4	192.5	12.0	653.8	40.8
Total fixed maturity securities – AFS	453.5	28.3	602.0	37.4	521.4	32.7	1,576.9	98.4
Fixed maturity securities – at FVTPL	–	–	–	–	24.8	1.6	24.8	1.6
Total fixed maturity securities	453.5	28.3	602.0	37.4	546.2	34.3	1,601.7	100.0

Bank loans, corporate bonds, fixed maturity securities at FVTPL and other government bonds by country are as follows:

As at 31 December 2016	Financials $m	Other industries $m	Total[1] $m	Other government bonds $m	Total[2] $m
United States	**168.9**	**388.2**	**557.1**	**–**	**557.1**
United Kingdom	**41.5**	**10.3**	**51.8**	**2.0**	**53.8**
Canada	**13.9**	**13.2**	**27.1**	**15.5**	**42.6**
Netherlands	**16.4**	**17.7**	**34.1**	**7.4**	**41.5**
Germany	**8.7**	**8.3**	**17.0**	**12.9**	**29.9**
Australia	**23.4**	**4.0**	**27.4**	**–**	**27.4**
France	**5.0**	**9.3**	**14.3**	**4.2**	**18.5**
Sweden	**6.6**	**0.5**	**7.1**	**4.2**	**11.3**
Japan	**9.6**	**–**	**9.6**	**–**	**9.6**
Luxembourg	**1.8**	**7.1**	**8.9**	**–**	**8.9**
Norway	**1.0**	**–**	**1.0**	**5.3**	**6.3**
Hong Kong	**–**	**4.8**	**4.8**	**–**	**4.8**
Switzerland	**2.8**	**1.5**	**4.3**	**–**	**4.3**
Russian Federation	**–**	**–**	**–**	**2.8**	**2.8**
Denmark	**–**	**–**	**–**	**2.4**	**2.4**
Other	**1.8**	**4.2**	**6.0**	**9.9**	**15.9**
Total	**301.4**	**469.1**	**770.5**	**66.6**	**837.1**

(1) Includes bank loans, corporate bonds and fixed maturity securities at FVTPL.
(2) Includes bank loans, corporate bonds, fixed maturity securities at FVTPL and other government bonds.

As at 31 December 2015	Financials $m	Other industries $m	Total[1] $m	Other government bonds $m	Total[2] $m
United States	126.6	372.9	499.5	–	499.5
United Kingdom	48.8	27.7	76.5	1.0	77.5
Canada	19.4	15.3	34.7	13.8	48.5
Netherlands	19.2	10.5	29.7	7.5	37.2
Australia	26.8	5.7	32.5	4.2	36.7
France	14.2	8.4	22.6	7.8	30.4
Germany	5.2	13.2	18.4	10.8	29.2
Japan	15.4	5.1	20.5	–	20.5
Norway	8.0	0.7	8.7	5.3	14.0
Switzerland	11.2	2.1	13.3	–	13.3
Sweden	12.2	0.1	12.3	0.2	12.5
Luxembourg	–	11.8	11.8	–	11.8
Hong Kong	–	4.8	4.8	–	4.8
Mexico	–	1.0	1.0	3.5	4.5
Russian Federation	–	–	–	3.4	3.4
Other	2.0	5.3	7.3	7.9	15.2
Total	309.0	484.6	793.6	65.4	859.0

(1) Includes bank loans, corporate bonds and fixed maturity securities at FVTPL.
(2) Includes bank loans, corporate bonds, fixed maturity securities at FVTPL and other government bonds.

The sector allocation of bank loans, corporate bonds and fixed maturity securities at FVTPL is as follows:

As at 31 December	2016 $m	2016 %	2015 $m	2015 %
Industrial	**425.4**	**55.2**	457.9	57.7
Financial	**300.9**	**39.1**	308.5	38.9
Utility	**43.7**	**5.7**	26.7	3.4
Supranationals	**0.5**	**–**	0.5	–
Total	**770.5**	**100.0**	793.6	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 maturity securities and cash and cash equivalents. The fixed maturity 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 maturity securities. The Group also has small equity and hedge fund portfolios. The estimated fair value of the Group's fixed maturity portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's fixed maturity securities would tend to rise and vice versa.

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

As at 31 December	2016 $m	2016 %	2015 $m	2015 %
Immediate shift in yield (basis points)				
100	**(28.7)**	**(1.9)**	(25.5)	(1.6)
75	**(21.6)**	**(1.4)**	(19.1)	(1.2)
50	**(14.4)**	**(1.0)**	(12.7)	(0.8)
25	**(7.2)**	**(0.5)**	(6.4)	(0.4)
(25)	**7.8**	**0.5**	6.8	0.4
(50)	**15.6**	**1.0**	13.5	0.8
(75)	**23.4**	**1.6**	20.3	1.3
(100)	**31.2**	**2.1**	27.1	1.7

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 total durations of the externally managed portfolios which are comprised of fixed maturity, cash and cash equivalents and certain derivatives, are as follows:

As at 31 December	2016 years	2015 years
Core portfolio	**1.6**	1.7
Core plus portfolio	**1.8**	1.7
Surplus portfolio[1]	**2.2**	1.3
Overall external portfolio[1]	**1.9**	1.6

(1) Including duration overlay.

The overall duration for fixed maturity, managed cash and cash equivalents and certain derivatives is 1.8 years (2015 – 1.5 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 standard market pricing models. These security valuations serve as the input to many risk analytics, including full valuation risk analyses, as well as parametric methods that rely on option adjusted risk sensitivities to approximate the risk and return profiles of the portfolio.

The principal VaR measure that is produced is an annual VaR at the 99th percentile confidence level. Under normal conditions, the portfolio is not expected to lose more than the VaR metric listed in the table below, 99 per cent of the time over a one-year time horizon.

The Group's annual VaR calculations are as follows:

As at 31 December	2016 $m	2016 % of shareholders' equity	2015 $m	2015 % of shareholders' equity
99th percentile confidence level[1]	**33.3**	**2.8**	28.9	2.4

(1) Including the impact of internal foreign exchange hedges.

DERIVATIVE FINANCIAL INSTRUMENTS

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

The Group currently invests in the following derivative financial instruments:

a. Futures;
b. Options;
c. Forward foreign currency contracts; and
d. Swaps.

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

As at 31 December 2016	Net realised (losses) $m	Net foreign exchange (losses) $m	Financing (losses) $m
Treasury futures	**(2.1)**	–	–
Forward foreign currency contracts	–	**(1.8)**	–
Interest rate swaps	–	–	**(1.0)**
Total	**(2.1)**	**(1.8)**	**(1.0)**

As at 31 December 2015	Net realised (losses) $m	Net foreign exchange gains $m	Financing (losses) $m
Treasury futures	(1.4)	–	–
Forward foreign currency contracts	–	3.6	–
Interest rate swaps	–	–	(2.5)
Total	(1.4)	3.6	(2.5)

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

	2016			2015		
As at 31 December	Other receivables $m	Other payables $m	Interest rate swaps $m	Other receivables $m	Other payables $m	Interest rate swaps $m
Forward foreign currency contracts	**0.6**	**(0.6)**	**–**	1.6	(0.7)	–
Interest rate swaps	**–**	**–**	**(3.7)**	–	–	(4.8)
Total	**0.6**	**(0.6)**	**(3.7)**	1.6	(0.7)	(4.8)

A. FUTURES

The Group's investment guidelines permit the use of futures which provide the Group with participation in market movements, determined by the underlying instrument on which the futures contract is based, without holding the instrument itself or the individual securities. This approach allows the Group more efficient and less costly access to the exposure than would be available by the exclusive use of individual fixed maturity and money market securities. Exchange-traded futures contracts may also be used as substitutes for ownership of the physical securities.

All futures contracts are held on a non-leveraged basis. An initial margin is provided, which is a deposit of cash and/or securities in an amount equal to a prescribed percentage of the contract value. The fair value of futures contracts is estimated daily and the margin is adjusted accordingly with unrealised gains and/or losses settled daily in cash and/or securities. A realised gain or loss is recognised when the contract is closed.

Futures contracts expose the Group to market risk to the extent that adverse changes occur in the estimated fair values of the underlying securities. Exchange-traded futures are, however, subject to a number of safeguards to ensure that obligations are met. These include the use of clearing houses (thus reducing counterparty credit risk), the posting of margins and the daily settlement of unrealised gains and losses. The amount of credit risk is therefore considered low. The investment guidelines restrict the maximum notional futures position as a percentage of the investment portfolio's estimated fair value.

As at 31 December, the Group had the following exposure to treasury futures:

	2016			2015		
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
Treasury futures	**76.4**	**104.1**	**(27.7)**	56.1	152.5	(96.4)
Total	**76.4**	**104.1**	**(27.7)**	56.1	152.5	(96.4)

B. 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 $nil as at 31 December 2016 and 2015.

The investment guidelines also restrict the maximum notional options exposure as a percentage of the investment portfolio's estimated fair value.

C. FORWARD FOREIGN CURRENCY CONTRACTS

A forward foreign currency contract is a commitment to purchase or sell a foreign currency at a future date, at a defined rate. The Group may utilise forward foreign currency contracts to gain exposure to a certain currency or market rate or manage the impact of fluctuations in foreign currencies on the value of its foreign currency denominated investments, debt 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:

	2016			2015		
As at 31 December	Notional long $m	Notional short $m	Net notional long (short) $m	Notional long $m	Notional short $m	Net notional long (short) $m
Canadian dollar	–	**29.8**	**(29.8)**	–	21.4	(21.4)
Swedish Krona	–	**2.7**	**(2.7)**	–	–	–
Euro	–	**0.6**	**(0.6)**	28.9	15.9	13.0
Australian Dollar	–	–	–	7.1	17.8	(10.7)
Japanese Yen	–	–	–	5.9	7.4	(1.5)
Malaysian Ringgit	**2.7**	–	**2.7**	3.0	–	3.0
British Pound	**13.4**	**0.9**	**12.5**	10.4	8.6	1.8
Total	**16.1**	**34.0**	**(17.9)**	55.3	71.1	(15.8)

D. SWAPS

The Group's investment guidelines permit the use of interest rate swaps and credit default swaps which are traded primarily OTC.

Interest rate swaps are used to manage interest rate exposure, portfolio duration or 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 2016 and 2015. Through the use of interest rate swaps, the Group has fixed the interest rate on Lancashire's subordinated loan notes until December 2020. These swaps were entered into in two separate tranches to extend the maturity of the swaps, the first of which expired in 2016. As at 31 December 2016 the notional amount of interest rate swaps held for hedging purposes was $122.3 million (31 December 2015 – $246.4 million).

III. DEBT RISK

The Group has issued long-term debt as described in note 17. 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 on the LHL debt 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 until 2020 the Group has no cash flow 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 17. The Group is subject to interest rate risk on the coupon payment of 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 $0.7 million on an annual basis.

IV. CURRENCY RISK

The Group underwrites from two locations, Bermuda and London, although risks are assumed on a worldwide basis. Risks assumed are predominantly denominated in U.S. dollars.

The Group is exposed to currency risk to the extent its assets are denominated in different currencies to its liabilities. The Group is also exposed to non-retranslation risk on non-monetary assets such as unearned premiums and deferred acquisition costs. Exchange gains and losses can impact income.

The Group hedges monetary non-U.S. dollar liabilities primarily with non-U.S. dollar assets, but may also use derivatives to mitigate foreign currency exposures. The Group's main foreign currency exposure relates to its insurance obligations, cash holdings, investments, premiums receivable, dividends payable and the euro denominated subordinated loan notes discussed in note 17. See page 118 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	201.0	15.9	25.0	14.0	52.9	308.8
Accrued interest receivable	6.6	–	–	–	–	6.6
Investments	1,593.9	14.8	27.4	–	12.3	1,648.4
Inwards premiums receivable from insureds and cedants	235.4	8.4	17.1	2.7	6.4	270.0
Reinsurance assets	177.3	5.3	3.5	0.3	0.7	187.1
Other receivables	41.1	1.9	–	–	0.6	43.6
Corporation tax receivable	–	1.1	–	–	–	1.1
Investment in associate	49.7	–	–	–	–	49.7
Property, plant and equipment	0.6	4.7	–	–	–	5.3
Deferred acquisition costs	60.8	6.5	7.4	0.7	6.1	81.5
Intangible assets	153.8	–	–	–	–	153.8
Total assets as at 31 December 2016	**2,520.2**	**58.6**	**80.4**	**17.7**	**79.0**	**2,755.9**

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	548.8	34.1	41.1	20.1	35.7	679.8
Unearned premiums	287.7	19.8	34.6	7.4	24.0	373.5
Insurance contracts – other payables	27.0	5.6	3.0	–	1.8	37.4
Amounts payable to reinsurers	51.4	0.9	0.4	–	–	52.7
Deferred acquisition costs ceded	0.4	–	–	–	–	0.4
Other payables	31.0	29.9	–	–	0.1	61.0
Deferred tax liability	7.8	10.9	–	–	–	18.7
Interest rate swap	1.5	–	2.2	–	–	3.7
Long-term debt	283.3	–	37.6	–	–	320.9
Total liabilities as at 31 December 2016	**1,238.9**	**101.2**	**118.9**	**27.5**	**61.6**	**1,548.1**

Assets	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Cash and cash equivalents	190.8	40.3	17.8	18.5	24.4	291.8
Accrued interest receivable	6.5	–	–	–	–	6.5
Investments	1,706.3	17.0	32.0	–	18.0	1,773.3
Inwards premiums receivable from insureds and cedants	204.4	15.4	23.5	–	10.4	253.7
Reinsurance assets	106.1	7.2	2.7	–	0.8	116.8
Other receivables	35.5	1.8	–	–	0.5	37.8
Investment in associate	47.5	–	–	–	–	47.5
Property, plant and equipment	0.5	6.7	–	–	–	7.2
Deferred acquisition costs	68.4	5.6	7.1	0.4	5.7	87.2
Intangible assets	153.8	–	–	–	–	153.8
Total assets as at 31 December 2015	2,519.8	94.0	83.1	18.9	59.8	2,775.6

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	529.3	43.5	47.4	20.9	29.9	671.0
Unearned premiums	318.5	19.2	34.6	3.7	23.2	399.2
Insurance contracts – other payables	27.0	3.8	3.0	0.3	2.1	36.2
Amounts payable to reinsurers	24.0	1.8	0.6	–	0.2	26.6
Deferred acquisition costs ceded	0.3	–	–	–	–	0.3
Other payables	31.7	35.2	0.1	–	–	67.0
Corporation tax payable	0.8	1.0	–	–	–	1.8
Deferred tax liability	16.7	8.9	–	–	–	25.6
Interest rate swap	2.3	–	2.5	–	–	4.8
Long-term debt	284.4	–	37.9	–	–	322.3
Total liabilities as at 31 December 2015	1,235.0	113.4	126.1	24.9	55.4	1,554.8

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 $1.5 million (2015 – $2.6 million).

The Group uses forward foreign currency contracts for the purposes of managing currency exposures. See page 118 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 to settle insurance claims and to fund trust accounts following a large catastrophe loss.

Exposures in relation to insurance activities are as follows:

- large catastrophic events, or multiple medium-sized events in quick succession, resulting in a requirement to pay a large value of claims within a relatively short time frame;
- failure of insureds or cedants to meet their contractual obligations with respect to the payment of premiums in a timely manner; and
- failure of reinsurers to meet their contractual obligations with respect to the payment of claims in a timely manner.

Exposures in relation to investment activities are as follows:

- adverse market movements and/or a duration mismatch to obligations, resulting in investments being disposed of at a significant realised loss; and
- an inability to liquidate investments due to market conditions.

The maturity dates of the Group's fixed maturity portfolio are as follows:

As at 31 December 2016	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	75.7	128.1	47.8	251.6
Between one and two years	108.7	164.0	20.4	293.1
Between two and three years	71.7	116.1	32.4	220.2
Between three and four years	26.3	62.8	42.9	132.0
Between four and five years	13.8	35.8	75.6	125.2
Over five years	23.8	16.2	183.3	223.3
Asset backed and mortgage backed securities	31.2	111.2	110.0	252.4
Total fixed maturity securities	**351.2**	**634.2**	**512.4**	**1,497.8**

As at 31 December 2015	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	58.0	93.0	24.5	175.5
Between one and two years	185.3	190.7	70.3	446.3
Between two and three years	96.6	102.8	35.9	235.3
Between three and four years	25.1	28.3	53.3	106.7
Between four and five years	21.3	46.5	96.2	164.0
Over five years	21.3	11.8	132.5	165.6
Asset backed and mortgage backed securities	45.9	128.9	133.5	308.3
Total fixed maturity securities	453.5	602.0	546.2	1,601.7

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

As at 31 December 2016	Years until liability becomes due – undiscounted values					
	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	**679.8**	**269.0**	**255.2**	**90.6**	**65.0**	**679.8**
Insurance contracts – other payables	**37.4**	**34.4**	**3.0**	**–**	**–**	**37.4**
Amounts payable to reinsurers	**52.7**	**52.7**	**–**	**–**	**–**	**52.7**
Other payables	**61.0**	**61.0**	**–**	**–**	**–**	**61.0**
Interest rate swap	**3.7**	**1.6**	**1.8**	**0.3**	**–**	**3.7**
Long-term debt	**320.9**	**14.0**	**34.6**	**36.8**	**496.5**	**581.9**
Total	**1,155.5**	**432.7**	**294.6**	**127.7**	**561.5**	**1,416.5**

As at 31 December 2015	Years until liability becomes due – undiscounted values					
	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	671.0	269.5	246.4	88.6	66.5	671.0
Insurance contracts – other payables	36.2	33.1	3.1	–	–	36.2
Amounts payable to reinsurers	26.6	26.6	–	–	–	26.6
Other payables	67.0	67.0	–	–	–	67.0
Interest rate swap	4.8	2.0	2.3	0.5	–	4.8
Long-term debt	322.3	14.0	33.8	36.5	521.3	605.6
Total	1,127.9	412.2	285.6	125.6	587.8	1,411.2

Actual maturities of the above may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. While the estimation of the ultimate liability for losses and loss adjustment expenses is complex and incorporates a significant amount of judgement, the timing of payment of losses and loss adjustment expenses is also uncertain and cannot be predicted as simply as for other financial liabilities. Actuarial and statistical techniques, past experience and management's judgement have been used to determine a likely settlement pattern.

The Group manages its liquidity risks via its investment strategy to hold high quality, 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 outlook and reallocates assets as deemed necessary.

D. CREDIT RISK

Credit risk is the risk that a counterparty may fail to pay, or repay, a debt or obligation. The Group is exposed to credit risk on its fixed maturity investment portfolio and derivative instruments, its inwards premiums receivable from insureds and cedants, and on any amounts recoverable from reinsurers.

Credit risk on the fixed maturity portfolio is mitigated through the Group's policy to invest in instruments of high credit quality issuers and to limit the amounts of credit exposure with respect to particular ratings categories and any one issuer. Securities rated below an S&P or equivalent rating of BBB-/Baa3 may comprise no more than 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 maturity securities issued by the U.S. government and government agencies and other highly rated governments.

Credit risk on exchange-traded derivative instruments is mitigated by the use of clearing houses to reduce counterparty credit risk, requiring the posting of margins and settling of unrealised gains and losses daily. Credit risk on OTC derivatives is mitigated by monitoring the creditworthiness of the counterparties and by requiring collateral amounts exceeding predetermined thresholds to be posted for positions which have accrued gains.

Credit risk on inwards premiums receivable from insureds and cedants is managed by conducting business with reputable broking organisations, with whom the Group has established relationships, and by rigorous cash collection procedures. The Group also has a broker approval process in place. Binding authorities are subject to standard market controls including credit control. Credit risk from reinsurance recoverables is primarily managed by the review and approval of reinsurer security, as discussed on page 109.

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 2016	Cash and fixed maturity securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	**221.6**	**–**	**–**
AA+, AA, AA-	**735.8**	**–**	**2.6**
A+, A, A-	**502.5**	**84.5**	**126.4**
BBB+, BBB, BBB-	**231.7**	**–**	**–**
Other[1]	**115.0**	**245.6**	**7.7**
Total	**1,806.6**	**330.1**	**136.7**

(1) Reinsurance recoveries classified as 'other' include $5.6 million of reserves that are fully collateralised.

As at 31 December 2015	Cash and fixed maturity securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	302.8	–	–
AA+, AA, AA-	744.0	–	–
A+, A, A-	502.2	81.3	77.5
BBB+, BBB, BBB-	232.0	–	–
Other[1]	112.5	212.9	6.4
Total	1,893.5	294.2	83.9

(1) Reinsurance recoveries classified as 'other' include $1.5 million of reserves that are fully collateralised.

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

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

	2016 $m	2015 $m
Less than 90 days past due	**12.3**	16.1
Between 91 and 180 days past due	**5.9**	5.6
Over 180 days past due	**16.1**	6.4
Total	**34.3**	28.1

Provisions of $1.0 million (2015 – $2.2 million) have been made for impaired or irrecoverable balances and $1.2 million (2015 – $1.0 million charge) was released to the consolidated statement of comprehensive income in respect of bad debts. No provisions have been made against balances recoverable from reinsurers.

E. OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes or systems. The Group and its subsidiaries have identified and evaluated their key operational risks and these are incorporated in the risk registers and modeled directly within BLAST. The Group has also established, and monitors compliance with, internal operational risk tolerances. The RRC reviews operational risk on at least an annual basis and operational risk is covered in the CRO's quarterly ORSA report to the LHL Board and entity boards and in the Cathedral Risk Committee reporting.

In order to manage operational risks, the Group has implemented a robust governance framework. Policies and procedures are documented and identify the key risks and controls within processes. The Group's Internal Audit function provides independent feedback with regard to the accuracy and completeness of key risks and controls, and independently verifies the effective operation of these through substantive testing. All higher risk areas are subject to an annual audit while compliance with tax operating guidelines is audited quarterly. Frequency of audits for all other areas varies from quarterly at the most frequent to a minimum of once every four years, on a rotational basis.

F. STRATEGIC RISK

The Group has identified several strategic risks. These include:

- the risks that either the poor execution of the business plan or an inappropriate business plan in itself results in a strategy that fails to adequately reflect the trading environment, resulting in an inability to optimise performance, including reputational risk;
- the risks of the failure to maintain adequate capital, accessing capital at an inflated cost or the inability to access capital. This includes unanticipated changes in vendor, regulatory and/or rating agency models that could result in an increase in capital requirements or a change in the type of capital required; and
- the risks of succession planning, staff retention and key man risks.

I. BUSINESS PLAN RISK

The Group addresses the risks associated with the planning and execution of the business plan through a combination of the following:

- an iterative annual forward-looking business planning process with cross departmental involvement;
- evaluation and approval of the annual business plan by the Board of Directors;
- regular monitoring of actual versus planned results;
- periodic review and re-forecasting as market conditions change; and
- feedback to senior management via the daily UMCC and fortnightly RRC meetings.

II. CAPITAL MANAGEMENT RISK

The total capital of the Group is as follows:

As at 31 December	2016 $m	2015 $m
Shareholders' equity	**1,207.3**	1,220.3
Long-term debt	**320.9**	322.3
Total capital	**1,528.2**	1,542.6
Intangible assets	**(153.8)**	(153.8)
Total tangible capital	**1,374.4**	1,388.8

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

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

The Group reviews the level and composition of capital on an ongoing basis with a view to:

- maintaining sufficient capital for underwriting opportunities and to meet obligations to policyholders;
- maximising the risk-adjusted return to shareholders within predetermined risk tolerances;
- maintaining adequate financial strength ratings; and
- meeting internal and regulatory capital requirements.

Capital is increased or returned as appropriate. The retention of earnings generated leads to an increase in capital. Capital raising can include debt or equity and returns of capital may be made through dividends, share repurchases, a redemption of debt or any combination thereof. Other capital management tools and products available to the Group may also be utilised. All capital actions require approval by the Board of Directors.

Internal methods have been developed to review the profitability of classes of business and their estimated capital requirements plus the capital requirements of the combination of a wide range of other risk categories. These approaches are used by management in decision making.

The Group's aim is to provide its shareholders with an RoE of 13.0 per cent in excess of a risk-free rate over the longer term. 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
31 December 2014	13.9	18.9	375.3
31 December 2015	10.9	18.6	449.1
31 December 2016	13.5	18.4	541.1

(1) The returns shown are for the period from 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
31 December 2014	13.9	17.7	363.8
31 December 2015	10.9	17.5	437.5
31 December 2016	13.2	17.4	529.2

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

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.

On 1 January 2016 Solvency II, a regulatory regime for (re)insurers domiciled in the EEA, came into effect, with the PRA as the Group's supervisor. Solvency II introduces a new basis for assessing capital and solvency, comprising a market-consistent economic balance sheet and an SCR, using either an internal model or the standard formula. Both the Group and LUK calculate their SCR using the standard formula. As the Group's long-term debt is excluded from Solvency II capital ('own funds') both the Group's and LUK's Solvency II own funds are comprised entirely of Tier 1 items for the year ended 31 December 2016. Tier 1 capital is the highest quality capital under Solvency II with the greatest loss absorbing capacity, comprising share capital and retained earnings. For the year ended 31 December 2016 the Group and LUK were more than adequately capitalised under the Solvency II regime.

LICL is regulated by the BMA and is required to monitor its solvency capital requirement under the BMA's regulatory framework, which is considered equivalent to the Solvency II regime. LICL's capital requirement is calculated using the BSCR. For the year ended 31 December 2016 LICL was more than adequately capitalised under the BMA regulatory regime.

The Group's underwriting capacity in its Lloyd's syndicates must be supported by providing a deposit in the form of cash, securities or LOCs, which are referred to as FAL. The capital framework at Lloyd's requires each managing agent to calculate the capital requirement for each syndicate they manage. Solvency II internal models are used to determine capital requirements for Syndicate 2010 and Syndicate 3010 based on the uSCR. Lloyd's has the discretion to take into account other factors at syndicate or member level to uplift the calculated uSCR. This may include perceived deficiencies in the internal model result as well as the need to maintain Lloyd's overall security rating. Currently, as a minimum, Lloyd's applies a 35.0 per cent uplift to each syndicate's uSCR to arrive at the ECA.

Lloyd's then uses each syndicate's ECA as a basis for determining member level capital requirements, which is backed by FAL. For the 2017 calendar year the Group's corporate member's FAL requirement was set at 75.6 per cent (2016 – 56.8 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 increase was primarily driven by a change in model version and the depreciation of Sterling during the second half of 2016. The Group has met its FAL requirement of £209.4 million as at 31 December 2016 (31 December 2015 – £157.3 million).

For the years ended 31 December 2016 and 2015 the capital requirements of all the Group's regulatory jurisdictions were met.

III. RETENTION RISK

Risks associated with succession planning, staff retention and key man risks are mitigated through a combination of resource planning processes and controls, including:

- the identification of key personnel with appropriate succession plans;
- the identification of key team profit generators and function holders with targeted retention packages;
- documented recruitment procedures, position descriptions and employment contracts;
- resource monitoring and the provision of appropriate compensation, including equity based compensation which vests over a defined time horizon; and
- training schemes.

1. GENERAL INFORMATION

The Group is a provider of global specialty insurance and reinsurance products with operations in London and Bermuda. LHL was incorporated under the laws of Bermuda on 12 October 2005. On 16 March 2009, LHL was added to the official list and its common shares were admitted to trading on the main market of the LSE; previously LHL's shares were listed on AIM, a subsidiary market of the LSE. Since 21 May 2007, LHL's shares have had a secondary listing on the BSX. LHL's registered office is Power House, 7 Par-la-Ville Road, Hamilton HM 11, Bermuda. LHL's head office is Level 29, 20 Fenchurch Street, London, EC3M 3BY, United Kingdom.

The consolidated financial statements for the year ended 31 December 2016 include the Company's subsidiary companies, the Company's interest in associate, and the Group's share of the Syndicates' assets and liabilities and income and expenses. A full listing of the Group's related parties can be found in note 22.

2. SEGMENTAL REPORTING

Management and the Board of Directors review the Group's business primarily by its five principal segments: Property, Energy, Marine, Aviation and Lloyd's. These segments are therefore deemed to be the Group's operating segments for the purposes of segmental reporting. Further sub-classes of business are underwritten within each operating segment. The nature of these individual sub-classes is discussed further in the risk disclosures section on pages 105 to 108. Operating segment performance is measured by the net underwriting profit or loss and the combined ratio.

All amounts reported are transactions with external parties and associates. There are no inter-segmental transactions and there are no significant insurance or reinsurance contracts that insure or reinsure risks in Bermuda, the Group's country of domicile.

2. SEGMENTAL REPORTING CONTINUED

REVENUE AND EXPENSE BY OPERATING SEGMENT

For the year ended 31 December 2016	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m
Gross premiums written by geographic area						
U.S. and Canada	84.0	0.4	–	–	95.3	179.7
Worldwide offshore	0.9	123.4	36.6	0.2	–	161.1
Worldwide, including the U.S. and Canada[1]	23.5	2.0	–	36.0	54.1	115.6
Europe	27.7	–	–	–	19.2	46.9
Far East	20.0	–	–	–	9.2	29.2
Worldwide, excluding the U.S. and Canada[2]	9.4	0.1	–	–	5.9	15.4
Middle East	11.5	–	–	–	2.0	13.5
Rest of world	42.5	0.1	0.6	–	29.3	72.5
Total	219.5	126.0	37.2	36.2	215.0	633.9
Outwards reinsurance premiums	(62.2)	(40.2)	(8.3)	(9.5)	(55.0)	(175.2)
Change in unearned premiums	(15.0)	20.9	6.6	0.6	12.6	25.7
Change in unearned premiums on premiums ceded	6.2	(1.2)	(0.1)	(1.8)	0.6	3.7
Net premiums earned	148.5	105.5	35.4	25.5	173.2	488.1
Insurance losses and loss adjustment expenses	(14.6)	(91.3)	(15.1)	1.1	(92.3)	(212.2)
Insurance losses and loss adjustment expenses recoverable	0.9	49.8	0.3	0.1	18.6	69.7
Insurance acquisition expenses	(29.4)	(48.2)	(10.2)	(8.1)	(39.2)	(135.1)
Insurance acquisition expenses ceded	1.4	0.6	0.5	0.3	0.2	3.0
Net underwriting profit	106.8	16.4	10.9	18.9	60.5	213.5
Net unallocated income and expenses						(63.1)
Profit before tax						150.4
Net loss ratio	9.2%	39.3%	41.8%	(4.7%)	42.6%	29.2%
Net acquisition cost ratio	18.9%	45.1%	27.4%	30.6%	22.5%	27.1%
Expense ratio	–	–	–	–	–	20.2%
Combined ratio	28.1%	84.4%	69.2%	25.9%	65.1%	76.5%

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

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

REVENUE AND EXPENSE BY OPERATING SEGMENT

For the year ended 31 December 2015	Property $m	Energy $m	Marine $m	Aviation $m	Lloyd's $m	Total $m
Gross premiums written by geographic area						
U.S. and Canada	74.3	1.2	–	–	100.6	176.1
Worldwide offshore	0.2	106.2	46.8	–	–	153.2
Worldwide, including the U.S. and Canada[1]	23.0	3.9	–	36.6	72.1	135.6
Europe	24.2	(0.1)	–	–	24.8	48.9
Far East	23.2	(0.1)	–	–	8.1	31.2
Worldwide, excluding the U.S. and Canada[2]	10.4	–	–	–	7.8	18.2
Middle East	7.3	–	–	–	0.7	8.0
Rest of world	34.6	0.9	0.8	–	33.6	69.9
Total	197.2	112.0	47.6	36.6	247.7	641.1
Outwards reinsurance premiums	(51.4)	(30.6)	(11.9)	(14.2)	(51.3)	(159.4)
Change in unearned premiums	19.6	48.6	1.9	6.4	3.4	79.9
Change in unearned premiums on premiums ceded	5.9	(3.5)	0.1	4.6	(1.6)	5.5
Net premiums earned	171.3	126.5	37.7	33.4	198.2	567.1
Insurance losses and loss adjustment expenses	(33.0)	(47.5)	(5.2)	(26.8)	(65.0)	(177.5)
Insurance losses and loss adjustment expenses recoverable	14.8	0.7	–	7.5	(1.2)	21.8
Insurance acquisition expenses	(32.4)	(48.0)	(13.2)	(8.9)	(45.7)	(148.2)
Insurance acquisition expenses ceded	0.8	0.7	0.3	0.1	0.1	2.0
Net underwriting profit	121.5	32.4	19.6	5.3	86.4	265.2
Net unallocated income and expenses						(93.5)
Profit before tax						171.7
Net loss ratio	10.6%	37.0%	13.8%	57.8%	33.4%	27.5%
Net acquisition cost ratio	18.4%	37.4%	34.2%	26.3%	23.0%	25.8%
Expense ratio	–	–	–	–	–	18.8%
Combined ratio	29.0%	74.4%	48.0%	84.1%	56.4%	72.1%

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

3. INVESTMENT RETURN

The total investment return for the Group is as follows:

For the year ended 31 December 2016	Net investment income and net other investment income (losses)[1] $m	Net realised (losses) gains and impairments $m	Net change in unrealised gains/losses on AFS $m	Total investment return excluding foreign exchange $m	Net foreign exchange losses $m	Total investment return including foreign exchange $m
Fixed maturity securities – AFS	**28.4**	**1.8**	**3.7**	**33.9**	**(0.5)**	**33.4**
Fixed maturity securities – at FVTPL	**1.2**	**–**	**–**	**1.2**	**–**	**1.2**
Equity securities – AFS	**0.3**	**(1.3)**	**0.4**	**(0.6)**	**–**	**(0.6)**
Hedge funds – at FVTPL	**4.3**	**(0.8)**	**–**	**3.5**	**–**	**3.5**
Other investments	**1.4**	**(2.1)**	**–**	**(0.7)**	**(0.2)**	**(0.9)**
Cash and cash equivalents	**1.1**	**–**	**–**	**1.1**	**(0.9)**	**0.2**
Total investment return	**36.7**	**(2.4)**	**4.1**	**38.4**	**(1.6)**	**36.8**

(1) Net unrealised gains/(losses) on our FVTPL investments are included within net investment income and net other investment income.

For the year ended 31 December 2015	Net investment income and net other investment income (losses)[1] $m	Net realised (losses) gains and impairments $m	Net change in unrealised gains/losses on AFS $m	Total investment return excluding foreign exchange $m	Net foreign exchange (losses) gains $m	Total investment return including foreign exchange $m
Fixed maturity securities – AFS	28.8	(1.8)	(11.4)	15.6	(9.2)	6.4
Fixed maturity securities – at FVTPL	(1.3)	2.7	–	1.4	–	1.4
Equity securities – AFS	0.4	(0.7)	(0.2)	(0.5)	–	(0.5)
Hedge funds – at FVTPL	–	(1.6)	–	(1.6)	–	(1.6)
Other investments	–	(1.4)	–	(1.4)	2.1	0.7
Cash and cash equivalents	0.6	–	–	0.6	(0.3)	0.3
Total investment return	28.5	(2.8)	(11.6)	14.1	(7.4)	6.7

(1) Net unrealised gains/(losses) on our FVTPL investments are included within net investment income and net other investment income.

Net realised (losses) gains and impairments include impairment losses of $3.5 million (2015 – $2.4 million) recognised on fixed maturity securities and $0.4 million (2015 – $0.5 million) recognised on equity securities held by the Group.

Refer to pages 116 and 117 in the risk disclosures section for the estimated fair values of the Group's derivative instruments. Realised gains and losses on futures and options contracts are included in net realised (losses) gains and impairments.

Included in investment income is $4.5 million (2015 – $3.2 million) of investment management, accounting and custodian fees.

4. NET INSURANCE ACQUISITION EXPENSES

	2016 $m	2015 $m
Insurance acquisition expenses	**129.4**	130.8
Changes in deferred insurance acquisition expenses	**5.7**	17.4
Insurance acquisition expenses ceded	**(3.1)**	(2.2)
Changes in deferred insurance acquisition expenses ceded	**0.1**	0.2
Total net insurance acquisition expenses	**132.1**	146.2

5. RESULTS OF OPERATING ACTIVITIES

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

	2016 $m	2015 $m
Depreciation on owned assets	**2.3**	1.9
Operating lease charges	**2.3**	3.4
Auditors' remuneration		
– Group audit fees	**1.8**	1.8
– Other services	**0.1**	0.1
Total	**6.5**	7.2

During 2016 and 2015, EY provided non-audit services in relation to taxation services. All fees paid to the Group's auditors for non-audit services are approved by the Group's Audit Committee.

6. EMPLOYEE BENEFITS

	2016 $m	2015 $m
Wages and salaries	**27.1**	30.4
Pension costs	**3.1**	3.1
Bonus and other benefits	**31.2**	30.8
Total cash compensation	**61.4**	64.3
RSS – performance[1]	**8.3**	7.3
RSS – ordinary	**1.2**	–
RSS – bonus deferral	**2.0**	2.1
RSS – Cathedral acquisition grant	**(0.8)**	6.4
Total equity based compensation	**10.7**	15.8
Total employee benefits	**72.1**	80.1

(1) Previously the performance RSS options were referred to as ordinary RSS options. The terminology has been updated as RSS options without performance criteria for vesting were issued for the first time in 2016 and are referred to as ordinary RSS options.

EQUITY BASED COMPENSATION

The Group's equity based compensation scheme is its RSS. Previously the Group also authorised and issued warrants at its formation in 2005 and 2006. These were all exercised during 2015 and expired on 16 December 2015.

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.

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 2016 and 2015:

Assumptions	2016	2015
Dividend yield	**–**	–
Expected volatility[1]	**22.2%**	19.5%
Risk-free interest rate[2]	**0.5%**	0.7%
Expected average life of options	**3 years**	3 years
Share price	**$8.85**	$9.87

(1) The expected volatility of LHL and comparator companies' share prices are calculated based on the movement in the share prices over a period prior to the grant date, equal in length to the expected life of the award.
(2) The risk-free interest rate is consistent with three-year UK government bond yields on the date of grant.

The calculation of the equity based compensation expense assumes forfeitures due to employee turnover of 10.0 per cent per annum prior to vesting, with subsequent adjustments to reflect actual experience.

6. EMPLOYEE BENEFITS CONTINUED

RSS – PERFORMANCE

The performance RSS options vest after a three-year period and are dependent on certain performance criteria. A maximum of 75.0 per cent of the performance RSS options will vest only on the achievement of an RoE in excess of a required amount. A maximum of 25.0 per cent of the performance RSS options will vest only on the achievement of a 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-employee restricted stock	Total number of restricted stock
Outstanding as at 31 December 2014	3,154,216	221,833	3,376,049
Granted	1,529,507	–	1,529,507
Exercised	(662,345)	(128,839)	(791,184)
Forfeited	(223,893)	–	(223,893)
Lapsed	(525,348)	(92,994)	(618,342)
Outstanding as at 31 December 2015	3,272,137	–	3,272,137
Granted	**886,916**	**–**	**886,916**
Exercised	**(499,296)**	**–**	**(499,296)**
Forfeited	**(72,024)**	**–**	**(72,024)**
Lapsed	**(224,576)**	**–**	**(224,576)**
Outstanding as at 31 December 2016	**3,363,157**	**–**	**3,363,157**
Exercisable as at 31 December 2015	956,911	–	956,911
Exercisable as at 31 December 2016	**226,863**	**–**	**226,863**

	2016			2015		
	Employee restricted stock	**Non-employee restricted stock**	**Total restricted stock**	Employee restricted stock	Non-employee restricted stock	Total restricted stock
Weighted average remaining contractual life	**8.0 years**	**–**	**8.0 years**	7.9 years	–	7.9 years
Weighted average fair value at date of grant during the year	**$7.60**	**–**	**$7.60**	$8.72	–	$8.72
Weighted average share price at date of exercise during the year	**$8.27**	**–**	**$8.27**	$9.98	$9.86	$9.97

RSS – ORDINARY

The ordinary RSS options were issued for the first time in 2016 and vest three years from the date of grant and do not have associated performance criteria for vesting. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise. These awards will become exercisable in the first open period following the release of the Company's 2018 year-end results after the Board meeting in February 2019.

	Total number of restricted stock
Granted	**688,714**
Forfeited	**(91,194)**
Outstanding as at 31 December 2016	**597,520**

	2016 Total restricted stock
Weighted average remaining contractual life	**9.1 years**
Weighted average fair value at date of grant during the year	**$8.85**

RSS – BONUS DEFERRAL

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

	Number of employee restricted stock	Number of non-employee restricted stock	Total number of restricted stock
Outstanding as at 31 December 2014	363,610	13,738	377,348
Granted	268,738	–	268,738
Exercised	(170,844)	(11,183)	(182,027)
Forfeited	(26,229)	–	(26,229)
Outstanding as at 31 December 2015	435,275	2,555	437,830
Granted	**270,752**	**–**	**270,752**
Exercised	**(180,737)**	**–**	**(180,737)**
Forfeited	**(1,727)**	**–**	**(1,727)**
Outstanding as at 31 December 2016	**523,563**	**2,555**	**526,118**
Exercisable as at 31 December 2015	60,882	–	60,882
Exercisable as at 31 December 2016	**80,576**	**2,555**	**83,131**

	2016			2015		
	Employee restricted stock	**Non-employee restricted stock**	**Total restricted stock**	Employee restricted stock	Non-employee restricted stock	Total restricted stock
Weighted average remaining contractual life	**8.5 years**	**0.1 years**	**8.5 years**	8.0 years	1.1 years	8.0 years
Weighted average fair value at date of grant during the year	**$7.72**	**–**	**$7.72**	$9.69	–	$9.69
Weighted average share price at date of exercise during the year	**$8.24**	**–**	**$8.24**	$10.08	$9.96	$10.08

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 first tranche of awards are exercisable in 2017.

	Total number of restricted stock
Outstanding as at 31 December 2015	2,307,157
Forfeited	**(950,907)**
Outstanding as at 31 December 2016	**1,356,250**

	Total restricted stock
Weighted average remaining contractual life	**6.9 years**
Weighted average fair value at date of grant	**$13.01**

MANAGEMENT WARRANTS

During the year ended 31 December 2015 all of the remaining management team ordinary and performance warrants were exercised as follows:

	Number exercised	Weighted average exercise price	Fair value of warrants granted
Management team performance warrants	559,182	$4.72	$2.62
Management team ordinary warrants	117,480	$3.62	$2.62

7. FINANCING COSTS

	2016 $m	2015 $m
Interest expense on long-term debt	**15.6**	15.1
Net losses on interest rate swaps	**1.0**	2.5
Other financing costs	**1.6**	0.8
Total	**18.2**	18.4

Refer to note 17 for details of long-term debt and financing arrangements.

8. TAX

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 31 March 2035. At the present time no such taxes are levied in Bermuda.

UNITED KINGDOM

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

	2016 $m	2015 $m
Corporation tax charge for the period	**2.7**	2.3
Adjustments in respect of prior period corporation tax	**(2.4)**	(0.4)
Deferred tax credit for the period	**(4.0)**	(7.9)
Tax rate change adjustment	**(0.8)**	(0.8)
Adjustments in respect of prior period deferred tax	**0.6**	(3.2)
Total tax credit	**(3.9)**	(10.0)

Tax reconciliation[1]	2016 $m	2015 $m
Profit before tax	**150.4**	171.7
UK corporation tax at 20.0% (2015 – 20.3%)	**30.1**	34.8
Non-taxable income	**(34.4)**	(41.1)
Adjustments in respect of prior period	**(1.8)**	(3.6)
Differences related to equity based compensation	**0.6**	0.4
Other expense permanent differences	**3.1**	1.7
Tax rate change adjustment	**(0.8)**	(0.8)
Unused tax losses not recognised for deferred tax	**0.6**	–
Utilisation of tax losses previously unrecognised for deferred tax	**(1.3)**	(1.4)
Total tax credit	**(3.9)**	(10.0)

(1) All tax reconciling balances have been classified as recurring items.

Due to the different taxpaying jurisdictions throughout the Group, the current tax credit as a percentage of the Group's profit before tax is 2.6 per cent (2015 – 5.8 per cent). Non-taxable income relates to profits of companies within the Group that are non-tax resident in the UK, intra-group dividends and the share of profit of associate.

For the years ended 31 December, the following tax movements were recognised in other reserves relating to tax deductions for equity based compensation award exercises and temporary differences in respect of unexercised awards where the estimated market value varies from the cumulative expense at the reporting date.

	2016 $m	2015 $m
Deferred tax credit	–	(0.1)
Total tax credit in other reserves	–	(0.1)

Refer to note 10 for details of the tax expense related to the net change in unrealised gains/losses on investments that is included in accumulated other comprehensive loss within shareholders' equity.

9. CASH AND CASH EQUIVALENTS

	2016 $m	2015 $m
Cash at bank and in hand	**122.4**	131.7
Cash equivalents	**186.4**	160.1
Total cash and cash equivalents	**308.8**	291.8

Cash equivalents have an original maturity of three months or less. The carrying amount of these assets approximates their fair value. Refer to note 17 for the cash and cash equivalent balances on deposit as collateral.

10. INVESTMENTS

As at 31 December 2016	Cost or amortised cost $m	Unrealised gains $m	Unrealised losses $m	Estimated fair value $m
Fixed maturity securities – AFS				
– Short-term investments	**5.3**	**–**	**–**	**5.3**
– Fixed maturity funds	**14.5**	**–**	**–**	**14.5**
– U.S. treasuries	**307.8**	**0.1**	**(2.4)**	**305.5**
– Other government bonds	**67.6**	**0.1**	**(1.1)**	**66.6**
– U.S. municipal bonds	**1.0**	**0.1**	**–**	**1.1**
– U.S. government agency debt	**83.2**	**–**	**(1.3)**	**81.9**
– Asset backed securities	**111.1**	**0.3**	**(1.2)**	**110.2**
– U.S. government agency mortgage backed securities	**119.8**	**0.7**	**(2.2)**	**118.3**
– Non-agency mortgage backed securities	**14.6**	**0.1**	**(0.4)**	**14.3**
– Non-agency commercial mortgage backed securities	**9.7**	**–**	**(0.1)**	**9.6**
– Bank loans	**120.8**	**1.4**	**(0.6)**	**121.6**
– Corporate bonds	**600.2**	**1.7**	**(4.6)**	**597.3**
Total fixed maturity securities – AFS	**1,455.6**	**4.5**	**(13.9)**	**1,446.2**
Fixed maturity securities – at FVTPL	**50.5**	**1.1**	**–**	**51.6**
Equity securities – AFS	**20.8**	**0.8**	**(0.4)**	**21.2**
Hedge funds – at FVTPL	**122.5**	**7.4**	**(0.5)**	**129.4**
Total investments	**1,649.4**	**13.8**	**(14.8)**	**1,648.4**

10. INVESTMENTS CONTINUED

As at 31 December 2015	Cost or amortised cost $m	Unrealised gains $m	Unrealised losses $m	Estimated fair value $m
Fixed maturity securities – AFS				
– Short-term investments	20.6	–	–	20.6
– Fixed maturity funds	13.9	–	(2.5)	11.4
– U.S. treasuries	394.9	0.2	(1.8)	393.3
– Other government bonds	70.0	0.3	(4.9)	65.4
– U.S. municipal bonds	5.0	0.2	–	5.2
– U.S. government agency debt	3.9	–	–	3.9
– Asset backed securities	115.2	0.1	(1.4)	113.9
– U.S. government agency mortgage backed securities	144.0	1.7	(1.9)	143.8
– Non-agency mortgage backed securities	22.1	0.3	(0.6)	21.8
– Non-agency commercial mortgage backed securities	28.8	0.1	(0.1)	28.8
– Bank loans	119.9	0.2	(5.1)	115.0
– Corporate bonds	659.4	1.4	(7.0)	653.8
Total fixed maturity securities – AFS	1,597.7	4.5	(25.3)	1,576.9
Fixed maturity securities – at FVTPL	24.9	–	(0.1)	24.8
Equity securities – AFS	15.8	1.6	(1.8)	15.6
Hedge funds – at FVTPL	153.6	5.3	(2.9)	156.0
Total investments	1,792.0	11.4	(30.1)	1,773.3

Accumulated other comprehensive loss is in relation to the Group's AFS fixed maturity and equity securities and is as follows:

	2016 $m	2015 $m
Unrealised gains	**5.3**	6.1
Unrealised losses	**(14.3)**	(27.1)
Net unrealised foreign exchange losses on fixed maturity securities – AFS	**2.5**	10.4
Tax provision	**0.1**	0.1
Accumulated other comprehensive loss	**(6.4)**	(10.5)

Fixed maturity securities are presented in the risk disclosures section on page 122. Refer to note 17 for the investment balances in trusts in favour of ceding companies and on deposit as collateral.

The Group determines the estimated fair value of each individual security utilising the highest level inputs available. Prices for the Group's investment portfolio are provided by a third-party investment accounting firm whose pricing processes and the controls thereon are subject to an annual audit on both the operation and the effectiveness of those controls. The audit reports are available to clients of the firm and the report is reviewed annually by management. In accordance with their pricing policy, various recognised reputable pricing sources are used including broker-dealers and pricing vendors. The pricing sources use bid prices where available, otherwise indicative prices are quoted based on observable market trade data. The prices provided are compared to the investment managers' pricing. The Group has not made any adjustments to any pricing provided by independent pricing services or its third-party investment managers for either year ending 31 December.

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

LEVEL (I)

Level (i) investments are securities with quoted prices in active markets. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The Group determines securities classified as Level (i) to include highly liquid U.S. treasuries, certain highly liquid short-term investments and quoted equity securities.

LEVEL (II)

Level (ii) investments are securities with quoted prices in active markets for similar assets or liabilities or securities valued using other valuation techniques for which all significant inputs are based on observable market data. Instruments included in Level (ii) are valued via independent external sources using 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 and certain derivatives such as:

- Fixed maturity funds;
- 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;
- Non-agency commercial mortgage backed securities;
- Bank loans;
- Corporate bonds; and
- OTC derivatives, such as options, forward foreign exchange contracts, interest rate swaps and credit default swaps.

10. INVESTMENTS CONTINUED

LEVEL (III)

Level (iii) investments are securities for which valuation techniques are not based on observable market data. The Group classifies hedge funds as Level (iii) assets as the valuation technique incorporates both observable and unobservable inputs.

The estimated fair values of the Group's hedge funds are determined using a combination of the most recent NAVs provided by each fund's independent administrator and the estimated performance provided by each hedge fund manager. Independent administrators provide monthly reported NAVs with up to a one-month delay in valuation. The most recent NAV available for each hedge fund is adjusted for the estimated performance, as provided by the fund manager, between the NAV date and the reporting date. Historically estimated fair values incorporating these performance estimates have not been significantly different from subsequent NAVs. Given the Group's knowledge of the underlying investments and the size of the Group's investment therein, we would not anticipate any material variance between estimated valuations and the final NAVs reported by the administrators.

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

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

As at 31 December 2016	Level (i) $m	Level (ii) $m	Level (iii) $m	Total $m
Fixed maturity securities – AFS				
– Short-term investments	**4.0**	**1.3**	**–**	**5.3**
– Fixed maturity funds	**–**	**14.5**	**–**	**14.5**
– U.S. treasuries	**305.5**	**–**	**–**	**305.5**
– Other government bonds	**–**	**66.6**	**–**	**66.6**
– U.S. municipal bonds	**–**	**1.1**	**–**	**1.1**
– U.S. government agency debt	**–**	**81.9**	**–**	**81.9**
– Asset backed securities	**–**	**110.2**	**–**	**110.2**
– U.S. government agency mortgage backed securities	**–**	**118.3**	**–**	**118.3**
– Non-agency mortgage backed securities	**–**	**14.3**	**–**	**14.3**
– Non-agency commercial mortgage backed securities	**–**	**9.6**	**–**	**9.6**
– Bank loans	**–**	**121.6**	**–**	**121.6**
– Corporate bonds	**–**	**597.3**	**–**	**597.3**
Total fixed maturity securities – AFS	**309.5**	**1,136.7**	**–**	**1,446.2**
Fixed maturity securities – at FVTPL	**–**	**51.6**	**–**	**51.6**
Equity securities – AFS	**21.2**	**–**	**–**	**21.2**
Hedge funds – at FVTPL	**–**	**–**	**129.4**	**129.4**
Total investments	**330.7**	**1,188.3**	**129.4**	**1,648.4**

As at 31 December 2015	Level (i) $m	Level (ii) $m	Level (iii) $m	Total $m
Fixed maturity securities – AFS				
– Short-term investments	10.9	9.7	–	20.6
– Fixed maturity funds	–	11.4	–	11.4
– U.S. treasuries	393.3	–	–	393.3
– Other government bonds	–	65.4	–	65.4
– U.S. municipal bonds	–	5.2	–	5.2
– U.S. government agency debt	–	3.9	–	3.9
– Asset backed securities	–	113.9	–	113.9
– U.S. government agency mortgage backed securities	–	143.8	–	143.8
– Non-agency mortgage backed securities	–	21.8	–	21.8
– Non-agency commercial mortgage backed securities	–	28.8	–	28.8
– Bank loans	–	115.0	–	115.0
– Corporate bonds	–	653.8	–	653.8
Total fixed maturity securities – AFS	404.2	1,172.7	–	1,576.9
Fixed maturity securities – at FVTPL	–	24.8	–	24.8
Equity securities – AFS	15.6	–	–	15.6
Hedge funds – at FVTPL	–	–	156.0	156.0
Total investments	419.8	1,197.5	156.0	1,773.3

There have been no transfers between Levels (i) and (ii), therefore no reconciliations have been presented.

The table below analyses the movements in hedge funds classified as Level (iii) investments:

	Hedge funds $m
As at 31 December 2014	152.1
Purchases	18.1
Sales	(12.9)
Total net realised and unrealised losses recognised in profit or loss	(1.3)
As at 31 December 2015	156.0
Sales	**(30.3)**
Total net realised and unrealised gains recognised in profit or loss	**3.7**
As at 31 December 2016	**129.4**

11. INTERESTS IN STRUCTURED ENTITIES

A. CONSOLIDATED STRUCTURED ENTITIES

The Group's only consolidated structured entity is the EBT. The Group provides capital contributions to the EBT to enable it to meet its obligations to employees under the equity based compensation plans. The Group has a contractual agreement which may require it to provide financial support to the EBT.

B. UNCONSOLIDATED STRUCTURED ENTITIES IN WHICH THE GROUP HAS AN INTEREST

As part of its investment activities, the Group invests in unconsolidated structured entities. As at 31 December 2016, the Group's total interest in unconsolidated structured entities was $431.5 million (31 December 2015 – $511.8 million). The Group does not sponsor any of the unconsolidated structured entities.

11. INTERESTS IN STRUCTURED ENTITIES CONTINUED

A summary of the Group's interest in unconsolidated structured entities is as follows:

As at 31 December 2016	Investments $m	Interest in associate $m	Total $m
Fixed maturity securities			
– Asset backed securities	**110.2**	**–**	**110.2**
– U.S. government agency mortgage backed securities	**118.3**	**–**	**118.3**
– Non-agency mortgage backed securities	**14.3**	**–**	**14.3**
– Non-agency commercial mortgage backed securities	**9.6**	**–**	**9.6**
Total fixed maturity securities	**252.4**	**–**	**252.4**
Investment funds			
– Hedge funds	**129.4**	**–**	**129.4**
Total investment funds	**129.4**	**–**	**129.4**
Specialised investment vehicles			
– KHL (see note 15)	**–**	**49.7**	**49.7**
Total	**381.8**	**49.7**	**431.5**

As at 31 December 2015	Investments $m	Interest in associate $m	Total $m
Fixed maturity securities			
– Asset backed securities	113.9	–	113.9
– U.S. government agency mortgage backed securities	143.8	–	143.8
– Non-agency mortgage backed securities	21.8	–	21.8
– Non-agency commercial mortgage backed securities	28.8	–	28.8
Total fixed maturity securities	308.3	–	308.3
Investment funds			
– Hedge funds	156.0	–	156.0
Total investment funds	156.0	–	156.0
Specialised investment vehicles			
– KHL (see note 15)	–	47.5	47.5
Total	464.3	47.5	511.8

The fixed maturity structured entities are created to meet specific investment needs of borrowers and investors which cannot be met from standardised financial instruments available in the capital markets. As such, they provide liquidity to the borrowers in these markets and provide investors with an opportunity to diversify risk away from standard fixed maturity securities. Whilst individual securities may differ in structure, the principles of the instruments are broadly the same and it is appropriate to aggregate the investments into the categories detailed above.

The risk that the Group faces in respect of the investments in structured entities is similar to the risk it faces in respect of other financial investments held on the consolidated balance sheet in that fair value is determined by market supply and demand. This is in turn driven by investor evaluation of the credit risk of the structure and changes in term structure of interest rates which change investors' expectation of the cash flows associated with the instrument and, therefore, its value in the market. Risk management disclosure for these financial instruments and other investments is provided on pages 112 to 124. The total assets of these structured entities are not considered meaningful for the purpose of understanding the related risks and therefore have not been presented.

The maximum exposure to loss in respect of these structured entities would be the carrying value of the instruments that the Group holds as at 31 December 2016 and 31 December 2015. Generally, default rates would have to increase substantially from their current level before the Group would suffer a loss and this assessment is made prior to investing and continually through the holding period for the security. The Group has not provided any other financial or other support in addition to that described above as at the reporting date, and there are no intentions to provide support in relation to any other unconsolidated structured entities in the foreseeable future.

As at 31 December 2016 the Group has a commitment of $50.0 million (31 December 2015 – $50.0 million) in respect of a credit facility fund. The Group, via the fund, provides collateral for revolving credit facilities purchased at a discount from financial institutions and is at risk for its portion of any defaults on those revolving credit facilities. The Group's proportionate share of these revolving credit facilities purchased by the fund as at 31 December 2016 is $37.5 million (31 December 2015 – $14.3 million), which currently remains unfunded. The maximum exposure to the credit facility fund is $50.0 million and as at 31 December 2016 there have been no defaults under this facility.

12. LOSSES AND LOSS ADJUSTMENT EXPENSES

	Losses and loss adjustment expenses $m	Reinsurance recoveries $m	Net losses and loss adjustment expenses $m
As at 31 December 2014	752.6	(112.4)	640.2
Net incurred losses for:			
Prior years	(101.4)	(6.3)	(107.7)
Current year	278.9	(15.5)	263.4
Exchange adjustments	4.9	0.8	5.7
Incurred losses and loss adjustment expenses	182.4	(21.0)	161.4
Net paid losses for:			
Prior years	210.0	(40.7)	169.3
Current year	54.0	(8.8)	45.2
Paid losses and loss adjustment expenses	264.0	(49.5)	214.5
As at 31 December 2015	671.0	(83.9)	587.1
Net incurred losses for:			
Prior years	**(89.7)**	**3.9**	**(85.8)**
Current year	**301.9**	**(73.6)**	**228.3**
Exchange adjustments	**(3.8)**	**1.4**	**(2.4)**
Incurred losses and loss adjustment expenses	**208.4**	**(68.3)**	**140.1**
Net paid losses for:			
Prior years	**139.4**	**(8.0)**	**131.4**
Current year	**60.2**	**(7.5)**	**52.7**
Paid losses and loss adjustment expenses	**199.6**	**(15.5)**	**184.1**
As at 31 December 2016	**679.8**	**(136.7)**	**543.1**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from page 109. 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 $136.0 million (2015 – $134.2 million) increase in gross loss reserves. There was no change to the Group's reserving methodology during the year. The split of losses and loss adjustment expenses between notified outstanding losses, ACRs assessed by management and IBNR is shown below:

	2016		2015	
As at 31 December	$m	%	$m	%
Outstanding losses	**328.1**	**48.3**	286.0	42.6
Additional case reserves	**144.5**	**21.3**	162.1	24.2
Losses incurred but not reported	**207.2**	**30.4**	222.9	33.2
Total	**679.8**	**100.0**	671.0	100.0

The Group's reserve for unpaid losses and loss adjustment expenses as at 31 December 2016 and 2015 had an estimated duration of approximately two years.

12. 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 in 2013, the Group assumed additional 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	2014 $m	2015 $m	2016 $m	Total $m
Gross Group losses												
Estimate of ultimate liability[1]												
At end of accident year	39.1	154.8	444.6	163.3	297.4	397.0	250.3	280.0	274.8	276.0	298.5	
One year later	34.7	131.2	417.4	107.8	209.4	371.9	350.4	259.8	226.7	214.6		
Two years later	32.0	103.5	377.5	73.1	204.2	447.0	338.8	224.0	206.0			
Three years later	27.6	94.8	345.1	66.0	235.8	450.4	326.9	224.4				
Four years later	27.2	83.5	340.8	89.1	229.4	460.0	313.3					
Five years later	24.4	81.0	355.6	81.7	231.4	450.7						
Six years later	24.0	87.6	350.9	72.9	229.8							
Seven years later	60.6	87.8	353.6	90.8								
Eight years later	58.6	86.6	352.5									
Nine years later	56.5	87.3										
Ten years later	55.1											
Current estimate of cumulative liability	**55.1**	**87.3**	**352.5**	**90.8**	**229.8**	**450.7**	**313.3**	**224.4**	**206.0**	**214.6**	**298.5**	**2,523.0**
Paid	**(31.1)**	**(81.6)**	**(340.7)**	**(60.8)**	**(211.0)**	**(349.0)**	**(257.5)**	**(185.1)**	**(158.6)**	**(107.6)**	**(60.2)**	**(1,843.2)**
Total Group gross liability	**24.0**	**5.7**	**11.8**	**30.0**	**18.8**	**101.7**	**55.8**	**39.3**	**47.4**	**107.0**	**238.3**	**679.8**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2016.

Accident year	2006 and prior $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	2014 $m	2015 $m	2016 $m	Total $m
Reinsurance												
Estimate of ultimate recovery[1]												
At end of accident year	–	3.6	40.7	1.6	33.8	56.2	48.9	9.9	17.8	15.3	73.1	
One year later	–	6.2	47.1	1.3	23.6	52.6	121.8	8.9	14.1	12.2		
Two years later	–	4.0	43.1	0.7	24.1	92.4	122.0	8.8	13.1			
Three years later	–	3.5	40.9	0.7	33.5	88.9	121.2	8.0				
Four years later	–	3.3	38.1	10.0	34.4	103.3	121.2					
Five years later	–	3.1	40.7	7.0	34.6	102.8						
Six years later	–	4.0	39.8	2.5	35.7							
Seven years later	25.1	4.1	40.4	2.5								
Eight years later	25.1	4.1	40.9									
Nine years later	24.7	4.1										
Ten years later	23.7											
Current estimate of cumulative recovery	**23.7**	**4.1**	**40.9**	**2.5**	**35.7**	**102.8**	**121.2**	**8.0**	**13.1**	**12.2**	**73.1**	**437.3**
Paid	**(3.2)**	**(3.7)**	**(39.1)**	**(0.2)**	**(33.0)**	**(73.0)**	**(116.4)**	**(6.9)**	**(7.9)**	**(9.7)**	**(7.5)**	**(300.6)**
Total Group gross recovery	**20.5**	**0.4**	**1.8**	**2.3**	**2.7**	**29.8**	**4.8**	**1.1**	**5.2**	**2.5**	**65.6**	**136.7**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2016.

Accident year	2006 and prior $m	2007 $m	2008 $m	2009 $m	2010 $m	2011 $m	2012 $m	2013 $m	2014 $m	2015 $m	2016 $m	Total $m
Net Group losses												
Estimate of ultimate liability[1]												
At end of accident year	39.1	151.2	403.9	161.7	263.6	340.8	201.4	270.1	257.0	260.7	225.4	
One year later	34.7	125.0	370.3	106.5	185.8	319.3	228.6	250.9	212.6	202.4		
Two years later	32.0	99.5	334.4	72.4	180.1	354.6	216.8	215.2	192.9			
Three years later	27.6	91.3	304.2	65.3	202.3	361.5	205.7	216.4				
Four years later	27.2	80.2	302.7	79.1	195.0	356.7	192.1					
Five years later	24.4	77.9	314.9	74.7	196.8	347.9						
Six years later	24.0	83.6	311.1	70.4	194.1							
Seven years later	35.5	83.7	313.2	88.3								
Eight years later	33.5	82.5	311.6									
Nine years later	31.8	83.2										
Ten years later	31.4											
Current estimate of cumulative liability	**31.4**	**83.2**	**311.6**	**88.3**	**194.1**	**347.9**	**192.1**	**216.4**	**192.9**	**202.4**	**225.4**	**2,085.7**
Paid	**(27.9)**	**(77.9)**	**(301.6)**	**(60.6)**	**(178.0)**	**(276.0)**	**(141.1)**	**(178.2)**	**(150.7)**	**(97.9)**	**(52.7)**	**(1,542.6)**
Total Group net liability	**3.5**	**5.3**	**10.0**	**27.7**	**16.1**	**71.9**	**51.0**	**38.2**	**42.2**	**104.5**	**172.7**	**543.1**

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2016.

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:

	2016 $m	2015 $m
2006 accident year and prior	**0.3**	1.6
2007 accident year	**(0.7)**	1.1
2008 accident year	**1.6**	(2.1)
2009 accident year	**(18.0)**	4.1
2010 accident year	**3.2**	(3.5)
2011 accident year	**9.9**	17.1
2012 accident year	**13.5**	10.8
2013 accident year	**(1.6)**	35.4
2014 accident year	**19.9**	43.2
2015 accident year	**57.7**	–
Total favourable development	**85.8**	107.7

Despite some adverse development on prior accident year marine and energy claims during the year ended 31 December 2016, the overall favourable development was primarily due to general IBNR releases across most lines of business due to a lack of reported claims. Experience during the year ended 31 December 2015 was similar in terms of releases, plus there was a further benefit of additional recoveries on the 2011 Thai flood losses.

13. INSURANCE, REINSURANCE AND OTHER RECEIVABLES

All receivables are considered current other than $58.4 million (31 December 2015 – $53.8 million) of inwards premiums receivable related to multi-year contracts. The carrying value approximates fair value due to the short-term nature of the receivables. There are no significant concentrations of credit risk within the Group's receivables.

14. PROVISION FOR DEFERRED TAX

	2016 $m	2015 $m
Equity based compensation	**(3.8)**	(4.6)
Claims equalisation reserves	**8.1**	14.6
Syndicate underwriting profits	**2.7**	3.3
Syndicate participation rights	**12.8**	13.6
Other temporary differences	**(0.9)**	0.6
Tax losses carried forward	**(0.2)**	(1.9)
Net deferred tax liability	**18.7**	25.6

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 2017 and subsequent years to utilise the deferred tax assets recognised when the underlying temporary differences reverse.

A deferred tax asset of $11.4 million (31 December 2015 – $14.1 million) has not been recognised in relation to unused tax losses carried forward in LHL, because at present the related tax benefit is not expected to be realised through future taxable profits.

Changes to the UK main rate of corporation tax have been enacted under the Finance Act 2015 and Finance Act 2016 reducing the rate to 19 per cent from 1 April 2017 and to 17 per cent from 1 April 2020.

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

15. INVESTMENT IN ASSOCIATE

The Group holds a 10.0 per cent interest in the preference shares of each segregated account of KHL, a company incorporated in Bermuda. KHL's operating subsidiary, KRL, is authorised by the BMA as a Special Purpose Insurer. KRL commenced writing insurance business on 1 January 2014. As at 31 December 2016, the carrying value of the Group's investment in KHL was $49.7 million (31 December 2015 – $47.5 million). The Group's share of comprehensive income for KHL for the period was $5.1 million (2015 – $4.1 million). Key financial information for KHL is as follows:

	2016 $m	2015 $m
Assets	**506.5**	495.0
Liabilities	**9.2**	19.4
Shareholders' equity	**497.3**	475.4
Gross premium earned	**54.2**	73.4
Comprehensive income	**51.1**	41.2

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

Refer to note 22 for details of transactions between the Group and its associate.

16. INTANGIBLE ASSETS

	Syndicate participation rights $m	Goodwill $m	Total $m
Net book value as at 31 December 2016 and 2015	**82.6**	**71.2**	**153.8**

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.

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 three year period. The most significant assumptions used to derive the projected cash flows include an assessment of business prospects, projected loss ratios, outwards reinsurance expenditure and investment returns. A pre-tax discount rate of 6.9 per cent (31 December 2015 – 6.8 per cent) has been used to discount the projected cash flows, which reflects a combination of factors including the Group's expected cost of equity and cost of

borrowing. The growth rate used to extrapolate the cash flows of the unit beyond the three-year period is 3.0 per cent (2015 – 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 assets' carrying value for both the syndicate participation rights and goodwill and would not be sensitive to any reasonably possible changes in assumptions. Therefore no impairment has been recognised during the years ended 31 December 2016 and 2015.

17. LONG-TERM DEBT AND FINANCING ARRANGEMENTS

LONG-TERM DEBT

On 5 October 2012, the Group issued $130.0 million 5.70 per cent senior unsecured notes due 2022 pursuant to a private offering to U.S. Qualified Institutional Buyers. Interest on the principal is payable semi-annually. The notes were listed and admitted to trading on the LSE on 16 October 2012.

On 15 December 2005, 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 CSX admitted to the official list the LHL 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 in September 2034, paying interest quarterly based on a set margin, 3.75 per cent, above the three-month EURIBOR;
- $10.0 million floating rate subordinated 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 the three-month LIBOR;
- $25.0 million floating rate subordinated loan note issued on 13 May 2005 and repayable in June 2035, paying interest quarterly based on a set margin, 3.25 per cent, above the three-month LIBOR; and
- $25.0 million floating rate subordinated loan note issued on 18 November 2005 and repayable in December 2035, paying interest quarterly based on a set margin, 3.25 per cent, above the three-month LIBOR.

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

The terms of the $130.0 million senior unsecured notes include standard default and cross-default provisions which require certain covenants to be adhered to. These include the following:

- a maximum debt to capital ratio of 30.0 per cent, where the subordinated loan notes are included as both total consolidated debt and total consolidated capital in this calculation.

There are no such covenants for either the $97.0 million and €24.0 million in aggregate floating rate subordinated loan notes or the loan note issued by CCHL.

As at all reporting dates the Group was in compliance with all covenants under these facilities.

The carrying values of the notes are shown below:

As at 31 December	**2016 $m**	2015 $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	**25.3**	26.2
Long-term debt €12.0 million	**11.2**	11.7
Long-term debt $10.0 million	**10.0**	10.0
Long-term debt $25.0 million	**23.7**	23.7
Long-term debt $25.0 million	**23.7**	23.7
Carrying value	**320.9**	322.3

The Group is exposed to cash flow interest rate risk and currency risk on its long-term debt. Further information is provided in the risk disclosures section on page 119.

17. LONG-TERM DEBT AND FINANCING ARRANGEMENTS CONTINUED

The fair value of the long-term debt is estimated as $354.8 million (31 December 2015 – $328.8 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 $2.0 million (31 December 2015 – $2.2 million) at the balance sheet date and is included in other payables.

Refer to note 7 for details of the interest expense for the year included in financing costs.

INTEREST RATE SWAPS

The Group hedges a portion of its floating rate borrowings using interest rate swaps to transfer floating to fixed rate. These instruments are held at estimated fair value. Refer to the risk disclosures section from page 118 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 a $3.7 million liability (31 December 2015 – $4.8 million liability). Further information is provided on pages 116 and 118. Cash settlements are completed on a quarterly basis and the total of the next cash settlements in the first quarter of 2017 on these instruments is $0.5 million. The net impact from cash settlements and changes in estimated fair value are included in financing costs.

The interest rate swaps are held at estimated fair value, priced using observable market inputs, and are therefore classified as Level (ii) securities in the fair value hierarchy.

Refer to note 7 for the net impact from cash settlement and changes in estimated fair value included in financing costs.

LETTERS OF CREDIT

As both LICL and LUK are non-admitted insurers or reinsurers throughout the U.S., the terms of certain contracts require them to provide LOCs to policyholders as collateral. The following LOCs have been issued:

As at 31 December	**2016 $m**	2015 $m
Issued to third parties	**29.4**	44.5

LOCs are required to be fully collateralised.

LHL and LICL had the following facilities in place:

- a $300.0 million syndicated collateralised credit facility with a $75.0 million loan sub-limit that has been in place since 24 March 2016 and will expire on 24 March 2021. There was no outstanding debt under this facility as at 31 December 2016; and
- a $350.0 million syndicated collateralised credit facility with a $75.0 million loan sub-limit that had been in place since 5 April 2012 and was replaced on 24 March 2016 by the $300.0 million syndicated collateralised credit facility. There was no outstanding debt under this facility as at 31 December 2015.

The existing facility is available for the issue of LOCs to ceding companies. The facility is also available for LICL to issue LOCs to LUK to collateralise certain insurance balances.

The terms of the $300.0 million syndicated collateralised credit facility include standard default and cross-default provisions that are broadly consistent with the previous facility, which require certain covenants to be adhered to. These include the following:

- an A.M. Best financial strength rating of at least B++;
- a maximum debt to capital ratio of 30.0 per cent, where the subordinated loan notes are excluded from this calculation;
- a maximum indebtedness regarding the subordinated loan notes of $250.0 million; and
- a maximum indebtedness regarding the Syndicate 2010 and 3010 catastrophe facilities of $150.0 million.

As at all reporting dates the Group was in compliance with all covenants under these facilities.

SYNDICATE BANK FACILITIES

As at 31 December 2016 and 2015, 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 $40.0 million can be utilised by way of an LOC and up to $40.0 million by way of an RCF to assist Syndicate 2010's gross funding requirements.

As at 31 December 2016 and 2015, Syndicate 3010 had in place a $40.0 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 $20.0 million can be utilised by way of an LOC and up to $20.0 million by way of an RCF to assist Syndicate 3010's gross funding requirements. This facility was not renewed for the 2017 year.

The total combined maximum borrowings available to Syndicate 2010 and Syndicate 3010 under these facilities are $100.0 million and the total combined maximum that can be utilised by way of an LOC is $50.0 million and by way of an RCF is $50.0 million to assist in both Syndicates' gross funding requirements. For 2017, this facility is in place for Syndicate 2010 only, providing in aggregate up to $80.0 million with a total of $40.0 million available by way of LOCs and $40.0 million by way of RCFs.

There are no balances outstanding under either of the Syndicate bank facilities as at 31 December 2016 or 2015. 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 and for the years ended 31 December 2016 and 2015, LICL had been granted authorised or trusteed reinsurer status in all states. The MBRT is subject to the rules and regulations of the aforementioned states and the respective deeds of trust. These rules and regulations include minimum capital funding requirements, investment guidelines, capital distribution restrictions and regulatory reporting requirements.

As at and for the years ended 31 December 2016 and 2015, the Group was in compliance with all covenants under its trust facilities.

The Group is required to hold a portion of its assets as FAL to support the underwriting capacities of Syndicate 2010 and Syndicate 3010. FAL are restricted in their use and are only drawn down to pay cash calls to Syndicates supported by the Group. FAL requirements are formally assessed twice a year and any funds surplus to requirements may be released at that time. See page 128 for more information regarding FAL requirements.

In addition to the FAL, certain cash and investments held by Syndicate 2010 and Syndicate 3010 are only available for paying the Syndicates' claims and expenses. See page 128 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:

	2016			2015		
As at 31 December	**Cash and cash equivalents $m**	**Fixed maturity securities $m**	**Equity securities $m**	Cash and cash equivalents $m	Fixed maturity securities $m	Equity securities $m
MBRT accounts	**5.6**	**35.1**	**–**	0.6	31.3	–
In trust accounts for policyholders	**3.7**	**21.4**	**–**	0.9	21.7	–
In favour of LOCs	**6.2**	**29.4**	**–**	7.4	43.4	–
In favour of derivative contracts	**3.8**	**0.3**	**–**	6.0	0.3	–
FAL	**13.5**	**254.1**	**1.4**	11.3	201.4	15.6
Syndicate accounts	**26.8**	**75.9**	**–**	9.4	85.8	–
Total	**59.6**	**416.2**	**1.4**	35.6	383.9	15.6

18. SHARE CAPITAL

Authorised ordinary shares of $0.50 each	Number	$m
As at 31 December 2016 and 2015	3,000,000,000	1,500

Allocated, called up and fully paid	Number	$m
As at 31 December 2014	192,112,598	96.1
Shares issued	9,229,320	4.6
As at 31 December 2016 and 2015	**201,341,918**	**100.7**

The new common shares issued during 2015 were to satisfy the exercises of warrants and to fund future RSS exercises.

Own shares	Number held in treasury	$m	Number held in trust	$m	Total number of own shares	$m
As at 31 December 2014	2,950,947	27.8	1,657,069	15.5	4,608,016	43.3
Shares distributed	(1,109,421)	(9.7)	(1,354,535)	(12.5)	(2,463,956)	(22.2)
Shares purchased by trust	–	–	1,000,000	9.3	1,000,000	9.3
As at 31 December 2015	1,841,526	18.1	1,302,534	12.3	3,144,060	30.4
Shares distributed	**–**	**–**	**(680,033)**	**(6.6)**	**(680,033)**	**(6.6)**
Shares donated to trust	**(426,468)**	**(4.1)**	**426,468**	**3.5**	**–**	**(0.6)**
As at 31 December 2016	**1,415,058**	**14.0**	**1,048,969**	**9.2**	**2,464,027**	**23.2**

The number of common shares in issue with voting rights (allocated share capital less shares held in treasury) as at 31 December 2016 was 199,926,860 (31 December 2015 – 199,500,392).

SHARE REPURCHASES

At the AGM held on 4 May 2016, LHL's shareholders approved a renewal of the Repurchase Programme authorising the repurchase of a maximum of 20,134,191 shares, with such authority to expire on the conclusion of the 2017 AGM or, if earlier, 15 months from the date the resolution approving the Repurchase Programme was passed.

During the year ended 31 December 2016, 426,468 shares (2015 – nil shares) were donated to the EBT at a market value of $3.5 million.

In 2016, the trustees of the EBT acquired nil shares (2015 – 1,000,000) in accordance with the terms of the trust and distributed 680,033 (2015 – 1,354,535). 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	20 Mar 2015	15 Apr 2015	19.8
Special	$0.50	20 Mar 2015	15 Apr 2015	99.2
Interim	$0.05	28 Aug 2015	25 Sep 2015	9.9
Special	$0.95	27 Nov 2015	18 Dec 2015	188.6
Final	$0.10	26 Feb 2016	23 Mar 2016	19.8
Interim	$0.05	5 Aug 2016	31 Aug 2016	10.0
Special	$0.75	18 Nov 2016	14 Dec 2016	149.1

19. OTHER RESERVES

Other reserves consist of the following:

	Contributed surplus $m	Equity based compensation $m	Total other reserves $m
As at 31 December 2014	838.4	48.7	887.1
Purchase of shares by trust	8.8	–	8.8
Distributed by trust	(17.2)	–	(17.2)
Warrant exercises	(4.2)	(9.6)	(13.8)
Equity based compensation – tax	–	0.1	0.1
Equity based compensation – exercises	13.8	(13.8)	–
Equity based compensation – expense	–	15.8	15.8
As at 31 December 2015	839.6	41.2	880.8
Shares donated to the trust	**(0.6)**	**–**	**(0.6)**
Distributed by trust	**(9.5)**	**–**	**(9.5)**
Equity based compensation – exercises	**10.0**	**(10.0)**	**–**
Equity based compensation – expense	**–**	**10.9**	**10.9**
As at 31 December 2016	**839.5**	**42.1**	**881.6**

Equity based compensation reserves represent the fair value, at the grant date, of all outstanding RSS options and management team ordinary and performance warrants, adjusted for any applicable performance conditions.

During the year ended 31 December 2015 all of the remaining Founder warrants were exercised and amounted to $39.4 million. The remaining number of warrants were exercised at a weighted average share price at date of exercise during 2015 of $9.98 as follows:

	Number of Founder warrants	Number of Lancashire Foundation warrants	Number of ordinary warrants
Exercised	15,032,679	648,143	2,350,000

FINANCIAL STATEMENTS

20. COMMITMENTS AND CONTINGENCIES

A. LEASE COMMITMENTS

The Group has payment obligations in respect of operating leases for certain items of office equipment and office space. Operating lease expenses for the year were $2.3 million (2015 – $3.4 million).

Future minimum lease payments under non-cancellable operating leases are as follows:

	2016 $m	2015 $m
Due in less than one year	**3.0**	1.1
Due between one and five years	**10.2**	12.7
Due in more than five years	**28.1**	36.6
Total	**41.3**	50.4

During 2014, the Group entered into a new lease agreement for larger office premises in the UK and assigned the leases in relation to the existing office premises in the UK to a third party who assumed responsibility for payments. Under the terms of the lease assignment the Group retains liability for lease payments in the event that the assignee and the assignee's guarantor fail to meet their obligations under the assignment agreements. The new lease agreement contains a break date of April 2029 and is guaranteed by the Group.

B. CREDIT FACILITY FUND

At as 31 December 2016 the Group has a commitment of $50.0 million (31 December 2015 – $50.0 million) relating to a credit facility fund (refer to note 11).

C. LEGAL PROCEEDINGS AND REGULATIONS

The Group operates in the insurance industry and is subject to legal proceedings in the normal course of business. While it is not practicable to estimate or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings (including litigation) will have a material effect on its results and financial position.

21. EARNINGS PER SHARE

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

	2016 $m	2015 $m
Profit for the year attributable to equity shareholders of LHL	**153.8**	181.1

	2016 Number of shares	2015 Number of shares
Basic weighted average number of shares	**198,565,378**	195,649,042
Dilutive effect of RSS	**2,901,049**	2,982,711
Diluted weighted average number of shares	**201,466,427**	198,631,753

Earnings per share	**2016**	2015
Basic	**$0.77**	$0.93
Diluted	**$0.76**	$0.91

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.

22. 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
KCML[2]	Insurance management services	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
CCHL	Investment company	United Kingdom
CCL	Holding company	United Kingdom
CCL 1998	Lloyd's corporate member	United Kingdom
CCL 1999	Non trading	United Kingdom
CCSL	Support services	United Kingdom
CUL	Lloyd's managing agent	United Kingdom
Associate		
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 below.
(2) 92.68 per cent owned by the Group.

The Group has issued subordinated loan notes via a trust vehicle – LHFT, refer to note 17. The Group effectively has 100.0 per cent of the voting rights in LHFT. These rights are subject to the property trustee's obligations to seek the approval of the holders of LHFT's preferred securities in case of default and other limited circumstances where the property trustee would enforce its rights. While the ability of the Group to influence the actions of LHFT is limited by the trust agreement, LHFT was set up by the Group with the sole purpose of issuing the subordinated loan notes, and is in essence controlled by the Group, and is therefore consolidated.

The EBT was established to assist in the administration of the Group's employee equity based compensation schemes. While the Group does not have legal ownership of the EBT and the ability of the Group to influence the actions of the EBT is limited by the trust deed, the EBT was set up by the Group with the sole purpose of assisting in the administration of these schemes, and is in essence controlled by the Group, and is therefore consolidated.

The Group has a Loan Facility Agreement (the 'Facility') with RBC Cees Trustee Limited, the trustee of the EBT. The Facility is an interest free revolving credit facility under which the trustee can request advances on demand, within the terms of the Facility, up to a maximum aggregate amount of $60.0 million. The Facility may only be used by the trustee for the purpose of achieving the objectives of the EBT. During the year ended 31 December 2016, the Group had made advances of $nil (2015 – $9.0 million) to the EBT under the terms of the Facility.

During the year ended 31 December 2016, the Group donated 426,468 treasury shares to the EBT at the prevailing market rate. The total value of the treasury share donation was $3.5 million. During the year ended 31 December 2015, the Group issued 1,000,000 shares to the EBT at a total par value of $0.5 million.

22. RELATED PARTY DISCLOSURES CONTINUED

LICL holds $290.8 million (31 December 2015 – $308.1 million) of cash and cash equivalents, fixed maturity securities and accrued interest in trust for the benefit of LUK relating to intra-group reinsurance agreements. LICL is required to provide 85.0 per cent of the required FAL to support the underwriting activities of Syndicate 2010 and 3010 and holds $230.0 million (31 December 2015 – $182.9 million) of cash and cash equivalents and fixed maturity securities in FAL in relation to intra-group reinsurance agreements.

The senior management team shareholding in KCML now represents a minority interest of 7.32 per cent. This investment represents the non-controlling interest listed in the Group's consolidated balance sheet. During the year ended 31 December 2016 dividends of $0.5 million (31 December 2015 – $0.6 million) were paid to minority interest holders.

As at 31 December 2016 and 2015, Mr Alex Maloney, a director of LHL, had a 1.156 per cent interest in KCML. During the year ended 31 December 2016 Mr Maloney received a dividend of $0.1 million (31 December 2015 – $0.1 million) in relation to his interest in KCML.

Mr Maloney and his spouse, acquired 100.0 per cent of the shares in Nameco on 7 November 2016. Nameco provides capacity to a number of Lloyd's syndicates including Syndicate 2010 which is managed by CUL. Nameco has provided $0.2 million of capacity to Syndicate 2010 for the 2017 year of account. Mr Maloney receives a proportionate share of the underwriting results of Syndicate 2010 to which he is contractually entitled through his participation.

KEY MANAGEMENT COMPENSATION

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

For the year ended 31 December	2016 $m	2015 $m
Short-term compensation	**3.2**	4.1
Equity based compensation	**3.3**	3.3
Directors' fees and expenses	**2.2**	1.9
Total	**8.7**	9.3

Non-Executive Directors do not receive any benefits in addition to their agreed fees and expenses and do not participate in any of the Group's incentive, performance or pension plans.

TRANSACTIONS WITH ASSOCIATE

In 2013, KCML entered into an underwriting services agreement with KRL and KHL to provide various services relating to underwriting, actuarial, premium payments and relevant deductions, acquisition expenses and receipt of claims. For the year ended 31 December 2016, the Group recognised $10.6 million (2015 – $12.9 million) of service fees and profit commissions in other income in relation to this agreement.

During 2016, the Group committed an additional $25.8 million (31 December 2015 – $23.5 million) of capital to KHL. During 2016, KHL returned $28.7 million (31 December 2015 – $32.8 million) of capital to the Group.

Refer to note 15 for further details on the Group's investment in associate.

23. NON-CASH TRANSACTIONS

The Group did not engage in any non-cash transactions during 2016. During 2015, the Group issued new common shares to satisfy future exercises of RSS in the amount of $4.6 million; refer to note 18 for further details.

24. SUBSEQUENT EVENTS

DIVIDEND

On 15 February 2017 the Board of Directors declared the payment of an ordinary dividend of $0.10 per common share to shareholders of record on 24 February 2017, with a settlement date of 22 March 2017. The ordinary dividend payable will be approximately $19.8 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.

ANNUAL GENERAL MEETING

The Company's AGM is scheduled for 3 May 2017. Notice of this year's AGM and the form of proxy accompany this Annual Report and Accounts. If you have any queries regarding the notice or return of the proxy please contact Chris Head, Company Secretary, at Lancashire Holdings Limited, 29th Floor, 20 Fenchurch Street, London EC3M 3BY, 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', 'can', 'likely', 'will', 'seeks', 'should' or, in each case, their negative or comparable terminology and similar statements are of a future or forward-looking nature. All forward-looking statements address matters that involve known and unknown risks and uncertainties. Accordingly, there are or will be important factors that could cause the actual results, performance or achievements of the Group to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

These factors include, but are not limited to: the Group's ability to integrate its business and personnel, the successful retention and motivation of the Group's key management, the increased regulatory burden facing the Group, the number and type of insurance and reinsurance contracts that the Group writes or the Group may write; the Group's ability to successfully implement its business strategy during 'soft' as well as 'hard' markets; the premium rates which may be available at the time of such renewals within its targeted business lines; the possible low frequency of large events; potentially unusual loss frequency; the impact that the Group's future operating results, capital position and rating agency and other considerations may have on the execution of any capital management initiatives or dividends; the possibility of greater frequency or severity of claims and loss activity than the Group's underwriting, reserving or investment practices have anticipated; the reliability of, and changes in assumptions to, catastrophe pricing, accumulation and estimated loss models; increased competition from existing alternative capital providers and insurance linked funds and collateralised special purpose insurers and the related demand and supply dynamics as contracts come up for renewal; the effectiveness of its loss limitation methods; the potential loss of key personnel; a decline in the Group's operating subsidiaries' rating with A.M.Best, 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 maturity investments; the impact of swings in market interest rates, currency exchange rates and securities prices; changes by central banks regarding the level of interest rates; the impact of inflation or deflation in relevant economies in which the Group operates; the effect, timing and other uncertainties surrounding future business combinations within the insurance and reinsurance industries; the impact of terrorist activity in the countries in which the Group writes risks; a rating downgrade of, or a market decline in, securities in its investment portfolio; changes in governmental regulations or tax laws in jurisdictions where the Group conducts business; Lancashire or its Bermudian subsidiaries becoming subject to income taxes in the United States or the Bermudian subsidiaries becoming subject to income taxes in the United Kingdom; the inapplicability to the Group of suitable exclusions from the UK CFC regime; any change in UK government policy which impacts the CFC regime or other tax changes; and the impact of the Brexit vote and future negotiations regarding the UK's relationship with the European Union in the recent in-or-out referendum on the Group's business, regulatory relationships, underwriting platforms or the industry generally.

Any estimates relating to loss events involve the exercise of considerable judgement and reflect a combination of ground-up evaluations, information available to date from brokers and insureds, market intelligence, initial and/or tentative loss reports and other sources. Judgements in relation to loss arising from natural catastrophe and man-made events are influenced by complex factors. The Group cautions as to the preliminary nature of the information used to prepare such estimates as subsequently available information may contribute to an increase in these types of losses.

These forward-looking statements speak only as at the date of this document. The Company expressly disclaims any obligation or undertaking (save as required to comply with any legal or regulatory obligations including the rules of the LSE) to disseminate any updates or revisions to any forward-looking statement to reflect any changes in the Group's expectations or circumstances on which any such statement is based. All subsequent written and oral forward-looking statements attributable to the Group or individuals acting on behalf of the Group are expressly qualified in their entirety by this paragraph. Prospective investors should specifically consider the factors identified in this document which could cause actual results to differ before making an investment decision.

ABS
Asset backed securities

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

ADDITIONAL CASE RESERVES (ACR)
Additional reserves deemed necessary by management

AFS
Available for sale

AGGREGATE
Accumulations of insurance loss exposures which result from underwriting multiple risks that are exposed to common causes of loss

AGM
Annual General Meeting

AIM
A sub-market of the LSE

AIR
AIR Worldwide

A.M. BEST COMPANY (A.M. BEST)
A.M. Best is a full-service credit rating organisation dedicated to serving the financial services industries, focusing on the insurance sector

BAM
Bathwater aggregate model

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

BSCR
Bermuda Solvency Capital Requirement

BSX
Bermuda Stock Exchange

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

CCHL
Cathedral Capital Holdings Limited

CCL
Cathedral Capital Limited

CCL 1998
Cathedral Capital (1998) Limited

CCL 1999
Cathedral Capital (1999) Limited

CCSL
Cathedral Capital Services Limited

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

CEND
Confiscation, Expropriation, Nationalisation and Deprivation

CEO
Chief Executive Officer

CFC
Controlled Foreign Company

CFO
Chief Financial Officer

CGU
Cash generating unit

CMBS
Commercial mortgage backed securities

THE CODE
UK Corporate Governance Code published by the UK FRC

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

CONSOLIDATED FINANCIAL STATEMENTS
Includes the independent auditors' report, consolidated primary statements, accounting policies, risk disclosures and related notes

CONSOLIDATED PRIMARY STATEMENTS
Includes the consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in shareholders' equity and the statement of consolidated cash flows

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

CRO
Chief Risk Officer

CSX
Cayman Islands Stock Exchange

CUL
Cathedral Underwriting Limited

CUO
Chief Underwriting Officer

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

DELEGATED AUTHORITIES
An arrangement under which a Managing Agent or (re)insurer delegates its authority to another to enter into contracts of insurance on their behalf.

DILUTED EARNINGS PER SHARE
Calculated by dividing the net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year plus the weighted average number of common shares that would be issued on the conversion of all potentially dilutive equity based compensation awards into common shares under the treasury stock method

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

DIRECTORS' FEES AND EXPENSES
Unless otherwise stated includes fees and expenses of all Directors across the Group

DURATION
Duration is the weighted average maturity of a security's cash flows, where the present values of the cash flows serve as the weights

The effect of the convexity, or sensitivity, of the portfolio's response to changes in interest rates is also factored in to the calculation

EARNINGS PER SHARE (EPS)
Calculated by dividing net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year, excluding treasury shares and shares held by the EBT

EBT
Lancashire Holdings Employee Benefit Trust

ECA
Economic Capital Assessment

EEA
European Economic Area

ERM
Enterprise Risk Management

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

EY
Ernst & Young LLP

FACULTATIVE REINSURANCE
A reinsurance risk that is placed by means of a separately negotiated contract as opposed to one that is ceded under a reinsurance treaty

FAL
Funds at Lloyd's

FCA
Financial Conduct Authority

FPSO
Floating production storage and offloading

FRC
Financial Reporting Council

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

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

FVTPL
Fair value through profit or loss

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

ICM
International Care Ministries

IFRIC
International Financial Reporting Interpretations Committee

IFRS
International Financial Reporting Standard(s)

INCURRED BUT NOT REPORTED (IBNR)
These are anticipated or likely losses that may result from insured events which have taken place, but for which no losses have yet been reported. IBNR also includes a reserve for possible adverse development of previously reported losses

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

INTERNAL AUDIT CHARTER
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

ISA
International Standards on Auditing (UK and Ireland)

ISE
Irish Stock Exchange

KCML
Kinesis Capital Management Limited

KCMMSL
KCM Marketing Services Limited

KHL
Kinesis Holdings I Limited

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

KPMG
KPMG LLP, a UK limited liability partnership

KRL (KINESIS RE)
Kinesis Reinsurance I Limited

LANCASHIRE COMPANIES
Refers to the Group excluding Cathedral and Kinesis

LANCASHIRE FOUNDATION OR FOUNDATION
The Lancashire Foundation is a charity registered in England and Wales

LHFT
Lancashire Holdings Financing Trust I Limited

LHL (THE COMPANY)
Lancashire Holdings Limited

LIBOR
London Interbank Offered Rate

LICL
Lancashire Insurance Company Limited

LIHL
Lancashire Insurance Holdings (UK) Limited

LIMSL
Lancashire Insurance Marketing Services Limited

LISL
Lancashire Insurance Services Limited

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

LLOYD'S
The Society of Lloyd's

LMSCL
Lancashire Management Services (Canada) Limited

LOC
Letter of credit

LOSSES
Demand by an insured for indemnity under an insurance contract

LSE
London Stock Exchange

LUK
Lancashire Insurance Company (UK) Limited

M&A
Mergers and acquisitions

MBRT
Multi-beneficiary reinsurance trust

MBS
Mortgage backed securities

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

MSF
Médecins Sans Frontières

NAMES
An individual member underwriting with unlimited liability. Since 6 March 2003 no person has been admitted as a new member to underwrite on an unlimited basis

NAMECO
Nameco (No. 801) Ltd

NAV
Net asset value

NBS
New Bridge Street (a trading name 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 after tax attributable to Lancashire excluding realised gains and losses, net of impairments, foreign exchange gains and losses and tax. Lancashire believes the reporting of net operating profit available helps the understanding of results by highlighting the underlying profitability of the Group's core insurance and reinsurance business

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 reinsurer or insurer shares a proportional part of the original premiums and losses of the reinsured or insured

RCF
Revolving credit facility

RDS
Realistic Disaster Scenarios

RETROCESSION
The reinsurance of a reinsurance account

RETURN ON EQUITY (RoE)
The IRR of the change in FCBVS in the period plus accrued dividends

RISK FREE RATE OF RETURN (RFRoR)
Being the 13-week U.S. Treasury bill rate, unless otherwise stated

RMBS
Residential mortgage backed securities

RMS
Risk Management Solutions

RPI
Renewal Price Index

RRC
Risk and Return Committee

RSC
Reinsurance Security 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

SCR
Solvency Capital Requirement

SHARP
Lancashire's in-house aggregation system

S&P GLOBAL RATINGS (S&P)
S&P Global Ratings is a worldwide insurance rating and information agency whose ratings are recognised as an ideal benchmark for assessing the financial strength of insurance related organisations

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

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

THE SYNDICATES
Syndicate 2010 and Syndicate 3010

TOBA
Terms of business agreements

TOTAL SHAREHOLDER RETURN (TSR)
The IRR of the increase/(decrease) in share price in the period, measured in U.S. dollars, adjusted for dividends

TREATY REINSURANCE
A reinsurance contract under which the reinsurer agrees to offer and to accept all risks of a certain size within a defined class

UK
United Kingdom

UMCC
Underwriting and Marketing Conference Call

UNEARNED PREMIUMS
The portion of premium income that is attributable to periods after the balance sheet date that is deferred and amortised to future accounting periods

UNL
Ultimate net loss

USCR
Ultimate solvency capital requirement

U.S. 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

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