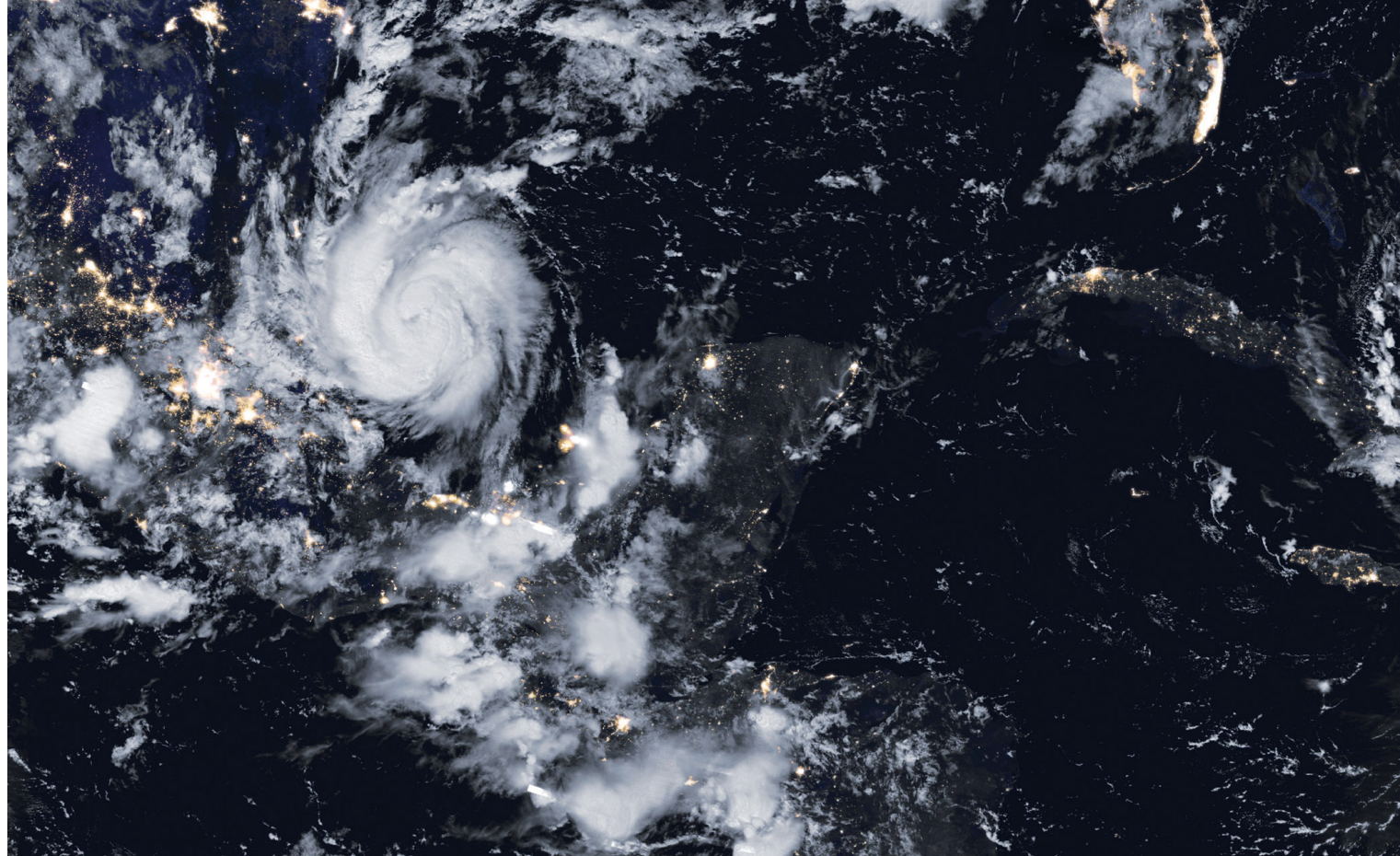


***Responsive in  
every environment***

Annual Report & Accounts 2017





## Strategic report

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### Return on equity

KPI

**-5.9%**

(2016: 13.5%)

### Combined ratio

KPI

**124.9%**

(2016: 76.5%)

### (Loss) Profit after tax

**\$-71.1m**

(2016: \$153.8m)

### Total investment return

KPI

**2.5%**

(2016: 2.1%)

### Dividend yield

KPI

**1.6%**

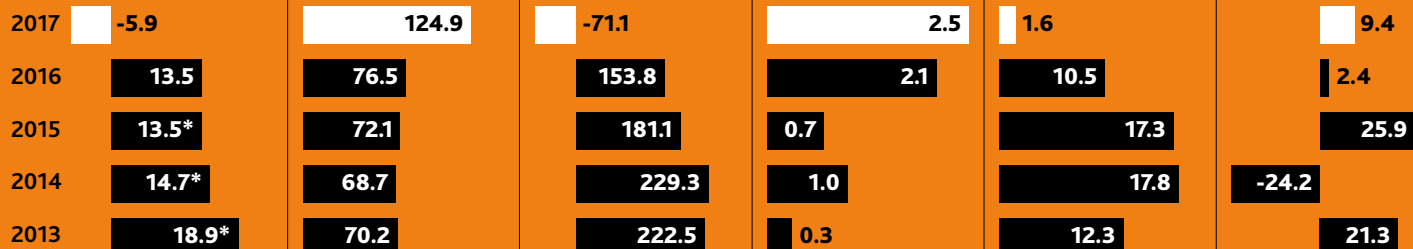
(2016: 10.5%)

### Total shareholder return

KPI

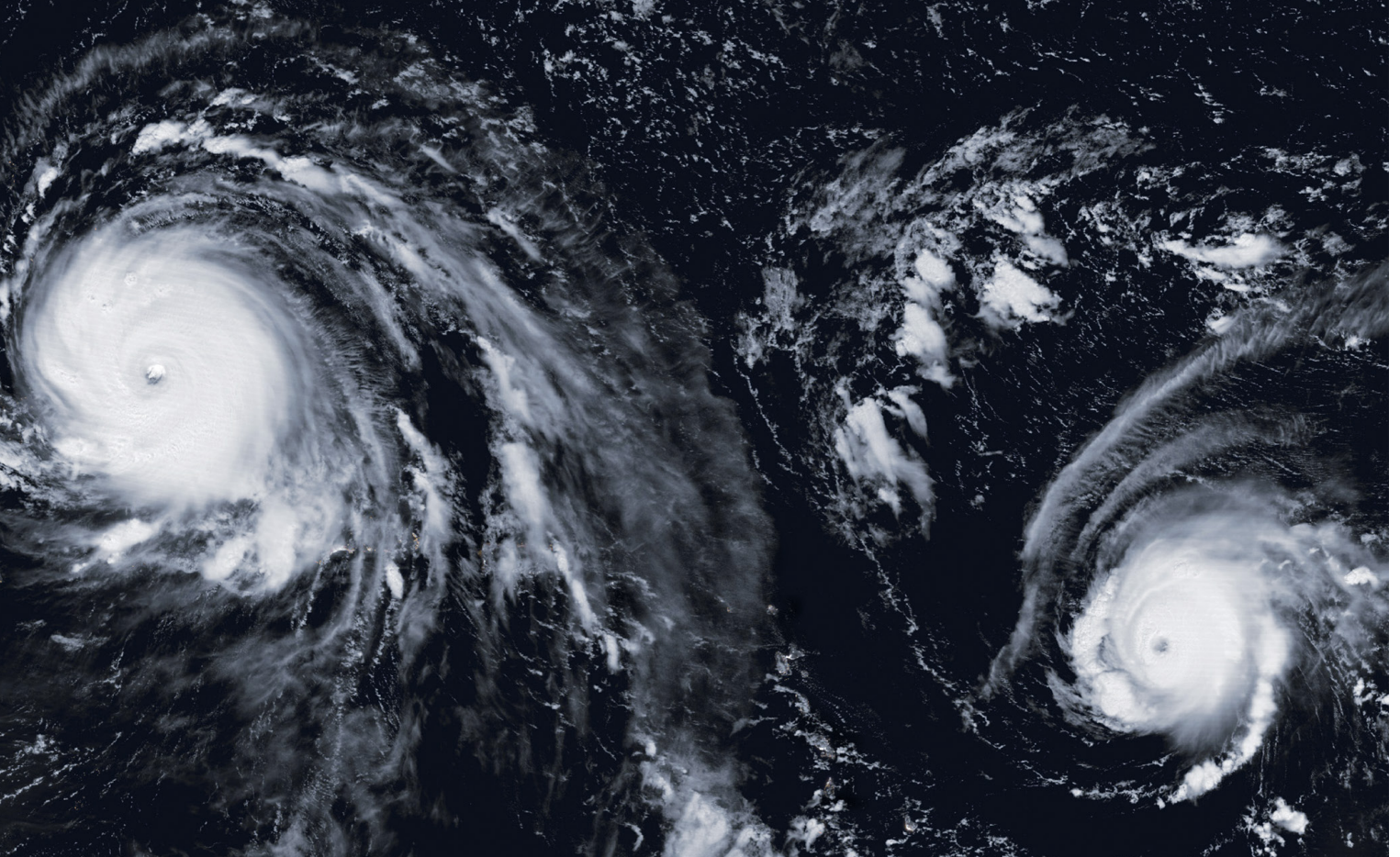
**9.4%**

(2016: 2.4%)



\* RoE including the impact of warrants was 10.9% in 2015, 13.9% in 2014 and 18.9% in 2013.





***The consistency and adaptability of our core principles enable us to deliver strong returns across the market cycle.***


***Whatever conditions the market brings, we are disciplined in the risks that we underwrite and manage, staying nimble to seize opportunities wherever they present themselves.***

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

The Group focuses on short-tail, mostly specialty (re)insurance risks under five general segments: Property, Energy, Marine, Aviation and Lloyd's.

Please refer to our glossary on pages 153 to 156 for key definitions.



An aerial photograph of a turbulent ocean surface, showing white foam and deep blue-green water. A vertical white line runs down the right side of the image, separating the text area from the right half of the image.

2017 has proven to be a challenging year but no matter what environment we find ourselves in, underwriting comes first. This focus on our core principle has allowed us to deliver sector-leading returns across the cycle.

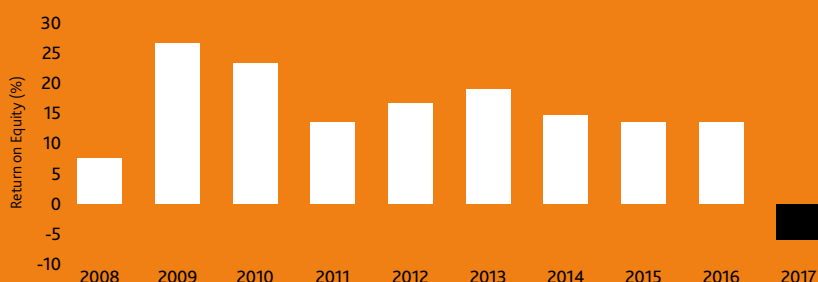
***We are  
guided by  
our core  
strategic  
principles***



## Our investment proposition: Underwriting comes first

### Delivering superior returns across the cycle and moderating downside risk

#### Ten-year Return on Equity<sup>1</sup>



#### Description

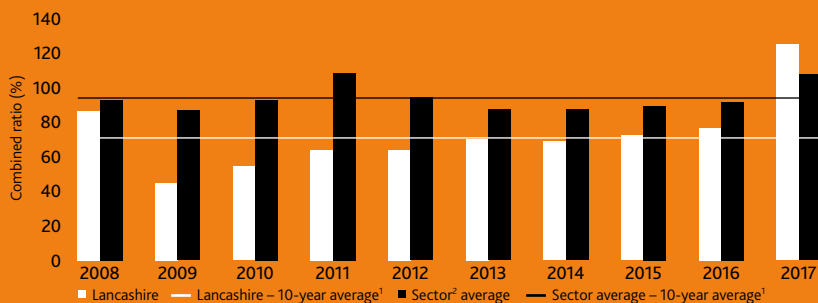
Our strategy is designed to cope with hard and soft markets, managing capital and exposures to maximise risk-adjusted returns across the cycle whilst moderating our exposures according to market conditions.

Our strategic cross-cycle aim is to be profitable four years out of five, acknowledging there will be years when we incur losses. 2017 is the first full year we have incurred a loss since inception.

(1) RoE excluding the impact of warrants.

### Experienced underwriters produce higher returns across the cycle

#### Ten-year combined ratio



#### Description


Group management and our underwriters have decades of experience in rated companies, Lloyd's and collateralised security markets. Across the cycle our combined ratio outperformed the sector average.

(1) Ten-year average based on 2008 to 2017 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, RenaissanceRe, Validus and XL Catlin. The 2017 result for Hiscox is not available at the time of the report.

Source: Company reports.





This year has shown why it is critical to balance risk and return and to understand the implications of over exposure in the market. The comprehensive risk management procedures our teams undertake every day allow us to strike the right balance of risk and return. In particular, we expect volatility in the occurrence of the catastrophe events to which our products respond.

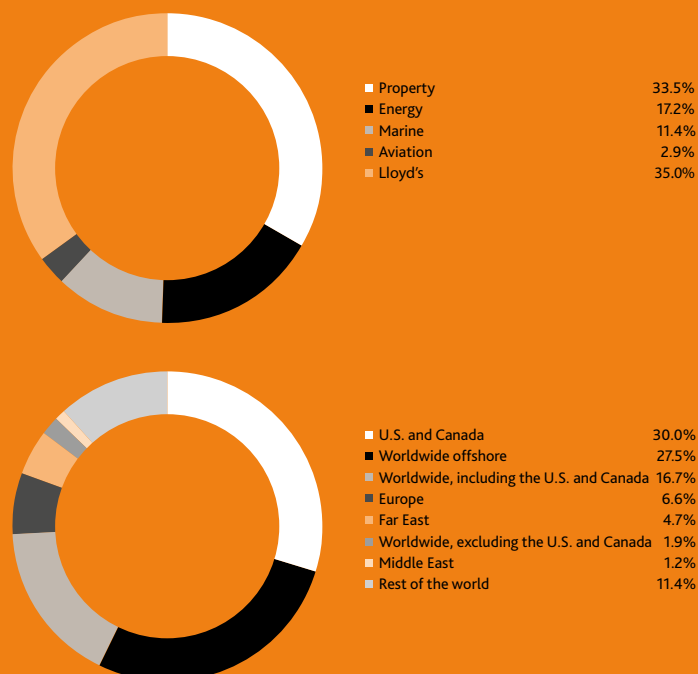
**We  
*navigate  
risk  
confidently***



## Our investment proposition: Effectively balance risk and return

### Managing our exposures across segments and geographies

#### Gross premiums written by class and region



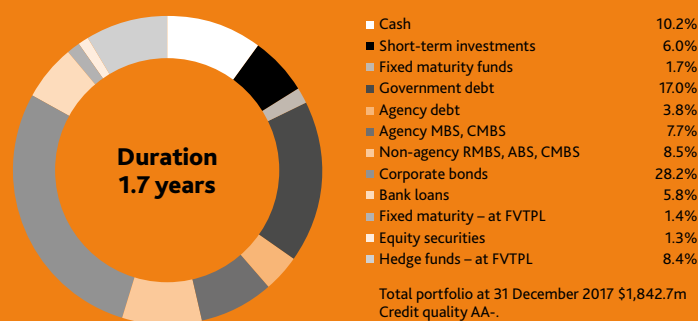
#### Description

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

During 2017, Lancashire has balanced the needs of its shareholders, wider stakeholders and importantly met the needs of its clients following the impact of the multiple catastrophe events.

### Protecting our assets


#### Investment asset allocation



#### Description

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





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In volatile and harsh conditions, we operate nimbly to achieve the maximum return for our shareholders across the market cycle. As new opportunities emerge in the future, our focused yet diversified books will give us the ability to capitalise on opportunities and deliver our cross-cycle strategic goal of maximising risk-adjusted returns across the cycle.

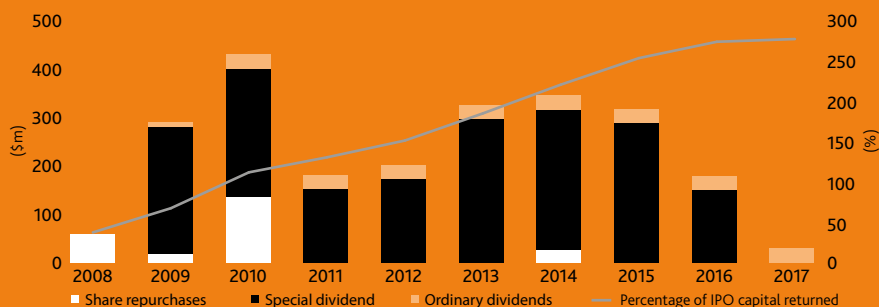
***We are  
able to  
react quickly  
to seize  
opportunities***



## Our investment proposition: Operating nimbly through the cycle

### Managing our capital proactively in volatile markets

#### Proven record of active capital management

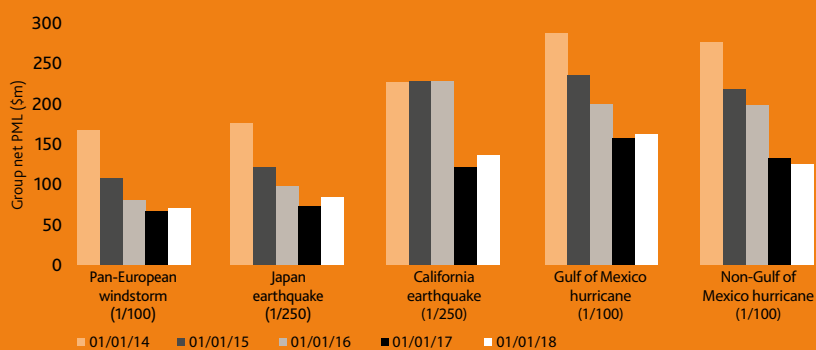


#### Description

Despite the difficult market and a significant number of catastrophe events in the year, Lancashire's capital base remains strong and positions us to remain relevant in the current market environment.

### Managing the cycle by reducing net exposures

#### Net PMLs by key catastrophe perils



#### Description

We continued to modify our exposure to key catastrophe perils as the market became more competitive, demonstrating our discipline and nimbleness across the market cycle.



# Responding to challenge

For Lancashire the recent catastrophe events have afforded a real world 'stress test' to our strategy and business model, and one which has validated our strategic decision to moderate our risk exposures during the softer part of the insurance cycle.

## How did Lancashire respond to the sequence of natural catastrophes during 2017?

One of the central challenges for any board or management team is to understand the principal factors which can stress a business. What are they, where do the risks and opportunities lie and how best to respond?

In recent years, Lancashire had faced the challenge of a relatively benign loss environment (subject to exceptions in certain lines of business) resulting in the accumulation of capital across the global (re)insurance sector and a gradual decline in premium rates. In general terms, the (re)insurance sector has tended to be paid less for the risks underwritten. Put simply, the business has been operating in the softer part of the (re)insurance cycle. Lancashire's strategic response has been to focus on maintaining market-leading underwriting and to carefully manage risk exposures, through the disciplined underwriting of inwards insurance and reinsurance risks and through careful planning and purchasing of outwards reinsurance protections.

Insurance (and reinsurance), as a product, is designed to help insured businesses plan for and respond to damage and disruption arising from fortuitous and unpredictable events, in particular natural catastrophes. Events such as hurricanes and earthquakes are the result of natural processes which are certain to occur as part of the cycles of nature. However, in the short term, their location, frequency and severity cannot be accurately predicted, although human ingenuity has produced probability models

which have enhanced our understanding of the risks and, combined with the benefits of practical underwriting experience, helped inform our commercial assumptions.

In the second half of 2017, we witnessed the occurrence of three major hurricanes: Harvey, Irma and Maria, two earthquakes in Mexico as well as wildfires in California. These catastrophes impacted upon areas of higher asset values and insurance market penetration, in particular in the U.S. and the Caribbean. For Lancashire, these recent catastrophe events have afforded a real world 'stress test' to our strategy and business model, and one which has validated our strategic decision to moderate our risk exposures during the softer part of the insurance cycle.

The Board was pleased at the way in which Lancashire proved itself capable of balancing the expectations of all its significant stakeholders in the face of the recent loss events. Most importantly, Lancashire has addressed the insurance needs of its clients within a transparent and robust risk framework. We have operated a business which has met the expectations of the Group's regulators whilst ensuring that, in a year which has seen a higher than usual sequence of natural catastrophe events, the Group's investors and capital providers have not been subject to outsize or unexpected losses. All this has been made possible through the contributions of our skilled employees. On behalf of the Board I would like to thank Alex, his management team and all our employees for a job well done.

Please see my introduction to the Governance Report on page 42 for an account of the work of the Board and our governance arrangements for the year.

## Will strategy change in 2018?

I do not expect Lancashire's strategic priorities to change in 2018. We will continue to focus on underwriting expertise and discipline, to effectively balance the equation of risk and return, and to operate nimbly through the cycle. What we do cautiously hope to see in this post-loss environment is an improvement in general pricing conditions, which may lead to greater opportunity in the underwriting space and a rebalancing of the risk and return equation. Alex discusses these dynamics in greater detail in his review on page 12. From a Board perspective our job is to ensure that we afford the business the capital and human resources necessary to develop any opportunities whilst ensuring that we establish and operate within appropriate risk tolerances. Predicting the future is never straightforward, but on the assumption that pricing improves and that the catastrophe loss environment is less extreme in 2018 than it proved to be in 2017, the Board would hope to see returns improving and more aligned with our cross-cycle expectations.





**Peter Clarke**  
Non-Executive Chairman

### Has Lancashire's dividend and capital management strategy changed?

The short answer is 'no', our dividend and capital management strategy has not changed. The dividend policy is set out on page 80 of this Annual Report and Accounts.

However, due to the exceptional loss environment during 2017 and our changing view of the (re)insurance markets, the Board decided not to pay an exceptional special dividend that our investors have enjoyed in recent years. Lancashire has however declared standard ordinary dividends for the 2017 year amounting in aggregate to \$0.15 per common share.

As a business we carefully consider the balance of risk and return when setting our capital levels. In previous years this approach enabled us to return capital that we did not need to support our underwriting. As we enter 2018, we believe there is a realistic prospect that the balance of risk and return will change in the current market. In the current fluid environment, the Board has decided to retain more of the Group's capital to best support our underwriting strategy and to position the business to take a lead in establishing improved pricing and terms of coverage following a period of market dislocation.

*"Predicting the future is never straightforward, but on the assumption that pricing improves and that the catastrophe loss environment is less extreme in 2018 ..., the Board would hope to see returns improving and more aligned with our cross-cycle expectations."*

**Dividend  
Yield**

**1.6%**

**Total investment  
return**

**2.5%**

An important element to Lancashire's active capital management strategy is the flexibility afforded to us by shareholders during the last six 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 typically arise following major loss events, and the flexibility to issue shares and raise capital quickly is a central pillar of our business strategy and will help Lancashire maximise underwriting opportunities for the business. Once again, the Company is seeking shareholder support for resolutions at the 2018 AGM allowing this capital management flexibility, and I would encourage all shareholders to vote in favour.

**Peter Clarke**  
Non-Executive Chairman

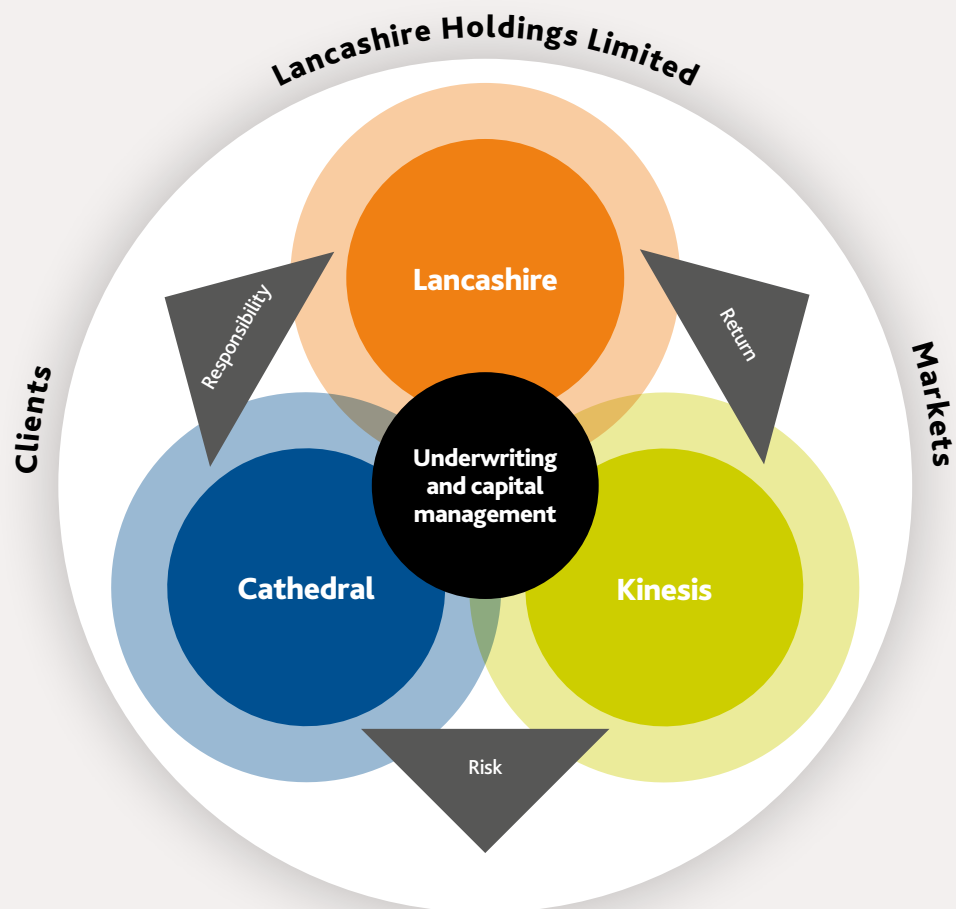


# Three platforms weathering all storms

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

## Our responsibility

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





	Lancashire Companies	Cathedral	Kinesis
Key strengths	<ul style="list-style-type: none"> <li>Strong brand with clients and brokers</li> <li>Recognised for significant capacity and leadership ability in well-defined business sectors</li> <li>Proven track record of supplying capacity across the cycle with consistently high performance</li> <li>A lean business operation allows us to remain nimble and make decisions efficiently</li> <li>A stable core book of business and disciplined underwriting</li> <li>Strong record of capital management actions to optimise and adjust capital and navigate market cycles</li> <li>Experienced management team with proven ability</li> </ul>	<ul style="list-style-type: none"> <li>Manages two active syndicates</li> <li>Strong relationships with clients and brokers</li> <li>Recognised for long-term consistency of relationships</li> <li>Efficient Lloyd's capital model allowing Cathedral greater premium leverage</li> <li>Worldwide licensing maintained by Lloyd's allows Cathedral to write business worldwide with limited regulatory overheads</li> <li>Use of world's oldest insurance third party capital, the Names, who provide support and capacity to Syndicate 2010</li> <li>Proven track record with more than four years as part of the Lancashire Group</li> </ul>	<ul style="list-style-type: none"> <li>Experienced, fully dedicated management with strong relationships with clients, brokers and investors</li> <li>Ability to leverage Group relationships and reputation with investors and clients</li> <li>Highly specialised multi-class product with barriers to entry in terms of data and modeling expertise</li> <li>Ability to raise and deploy capital quickly</li> <li>Strong investor base since 2014</li> <li>Proven track record with Kinesis now in its fifth year</li> </ul>
Goals	<ul style="list-style-type: none"> <li>Maintain key client, broker and reinsurer relationships to ensure the continued flow of business</li> <li>Continue the use of reinsurance solutions to uphold risk-adjusted balance across the insurance market cycle</li> <li>Retain 'underwriting comes first' culture and discipline without being tempted into innovation or diversification for its own sake</li> <li>Provide profitable growth in areas experiencing an improved rating environment</li> </ul>	<ul style="list-style-type: none"> <li>Maintain core portfolios in the syndicates</li> <li>Continue to look for new opportunities for bolt-on business lines in both syndicates</li> <li>Leverage the Group's balance sheet and cross-sell where opportunities arise</li> </ul>	<ul style="list-style-type: none"> <li>Ensure product is correctly calibrated to meet clients' needs in terms of responding to events and providing capital relief</li> <li>Deliver returns in line with expectations for modeled ranges given market losses and pricing</li> <li>Continue to increase number of investors</li> <li>Provide bespoke and flexible products to match investor and client appetite</li> </ul>
Risks	<ul style="list-style-type: none"> <li>Influx of new capacity and further development of broker facilities with less robust underwriting controls</li> <li>Pressure on insurance rates across the market cycle</li> <li>Widening terms and conditions being accepted by the insurance market without adequate pricing or exclusions</li> </ul>	<ul style="list-style-type: none"> <li>Pressure on signings and participation given relatively small line sizes</li> <li>Expanded burden of regulatory oversight or overlapping regulation from Lloyd's, the PRA and the FCA</li> </ul>	<ul style="list-style-type: none"> <li>Increased competition from traditional and collateralised markets, with attempts to replicate the Kinesis product</li> <li>Possible waning of investor interest in insurance allocations as interest rates begin to increase and yields return to capital markets</li> <li>Resistance to complex reinsurance products amongst clients, given cheap availability of traditional products</li> </ul>



# Responding to opportunity

We are strongly positioned, with the right expertise and good relationships with our clients, their brokers and our capital providers, to take the lead in establishing better-priced and more sustainable insurance and reinsurance markets and to remain a relevant and valued provider of insurance and reinsurance solutions.

## Did Lancashire perform as you expected in 2017?

Our results for 2017 have generated a return on equity of negative 5.9 per cent and a combined ratio of 124.9 per cent, which may at first sight seem lacklustre compared with Lancashire's performance in previous years. Whilst no CEO likes losing money, this is to be expected in what has been a significant year for catastrophe insurance losses across the market. On balance I am satisfied with this outcome during a year in which we had worked hard to moderate our risk exposures whilst remaining relevant to the needs of our policyholders and the expectations of our investors during the soft part of the market cycle.

The recent run of catastrophe losses, which regrettably caused much human suffering and property damage, has resulted in losses to the global insurance markets which are estimated to be in excess of \$100 billion, placing the 2017 year within the top three years for aggregate industry insured losses in recent history and ultimately could end up being the costliest on record. Over the last few years, I have spoken regularly about the oversupply of capital and the resulting imbalance which this has generated, leading to downwards pricing and pressure on coverage terms within the international insurance and reinsurance markets. Lancashire's response to those market conditions has been to demonstrate good inwards risk selection through underwriting discipline and to manage down its aggregate risk exposures through the judicious purchase of more and better-priced reinsurance coverage. We have bided our time for precisely the moment when there

would be a marked increase in major catastrophe losses. That moment came in 2017. Faced with the 2017 loss events, our combined ratio is indicative of the success of our strategy to moderate our risk exposures in what has been a lower-yield underwriting environment.

As we enter 2018, we find ourselves well positioned, with the right people and expertise and a robust balance sheet. We have strong relationships with our clients, their brokers and our capital providers. Lancashire stands ready to take the lead in establishing better-priced and more sustainable insurance and reinsurance markets and to remain a relevant and valued provider of insurance and reinsurance solutions.

## How do you view current market conditions?

After 25 years' experience as an underwriter, I firmly believe that the (re)insurance business is cyclical in its fundamentals. Due to an overabundance of capital and a protracted period of lower loss activity over a number of years, the beginning of 2017 marked a low point in the cycle of pricing and terms and conditions. Recent experience suggests to me that the market cannot continue to operate at the very margins of profitability. The 2017 catastrophe events should mark a point at which the balance of capital and underwriting opportunity will readjust, at least in the short to medium term. For the first time in several years I am cautiously optimistic that we will see a halt in the year-on-year decline in premium rates and a return to stronger underwriting discipline across the whole insurance and reinsurance sector.

***"For the first time in several years I am cautiously optimistic that we will see a halt in the year-on-year decline in premium rates and a return to stronger underwriting discipline across the whole insurance and reinsurance sector."***





**Alex Maloney**  
*Group Chief Executive Officer*

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

The early evidence suggests that pricing has started to improve, in particular in the U.S. property insurance and reinsurance lines, which have been directly affected by the recent losses. But I am also hopeful that a return to the fundamentals of good underwriting will extend to those other specialty lines which we underwrite. There is, at the very least, a likelihood that the decline in pricing will come to a halt and a reasonable prospect of improved and more sustainable pricing across many of our lines of business.

Paul Gregory, our Group CUO, sets out his view of the likely trends in our core lines of business on page 20 of this Annual Report and Accounts. I believe that a move to a market which is more realistically and sustainably priced is ultimately in the best interests not only of the (re)insurance sector itself but also of our clients, who value continuity and professionalism from their insurance and reinsurance partners. Price is not the sole determinant of value for our products.

### How is Lancashire different from other businesses?

We remain a business with a relatively small headcount of around 200 and we continue to pride ourselves on having a lean and nimble 'can do' business culture. During 2017, we implemented a reorganisation of our London office and, whilst that may seem a mundane step, it has helped us become even more joined-up between our businesses in London and Bermuda, our Cathedral Lloyd's platform and Kinesis, our third party reinsurance facility. We are a business with a very flat hierarchy and efficient lines of communication. We have the operating structure to respond quickly to the insurance and reinsurance needs of our clients and their brokers and to offer a level of underwriting and claims service, security and professionalism which often exceeds that of many of our larger competitors. We pride ourselves on doing what makes sense as disciplined underwriters. Rather than targeting growth or faddish diversification we have focused on management of the

Return on equity

**-5.9%**

Combined ratio

**124.9%**

Loss after tax

**\$71.1m**

(re)insurance cycle, if necessary refusing business and exposures which have been underpriced. This positions Lancashire well to develop the best opportunities, which should arise when we enter what I hope may become a more rewarding phase of the market cycle.

I would like to thank all our staff across the Group for having contributed to the successful negotiation of what has been a challenging phase of the (re)insurance market cycle. I know that the skill and dedication of our people is key to the success of Lancashire and I look forward to leading our excellent team as we develop the market opportunities and face the challenges which lie ahead in the coming year.

**Alex Maloney**  
*Group Chief Executive Officer*



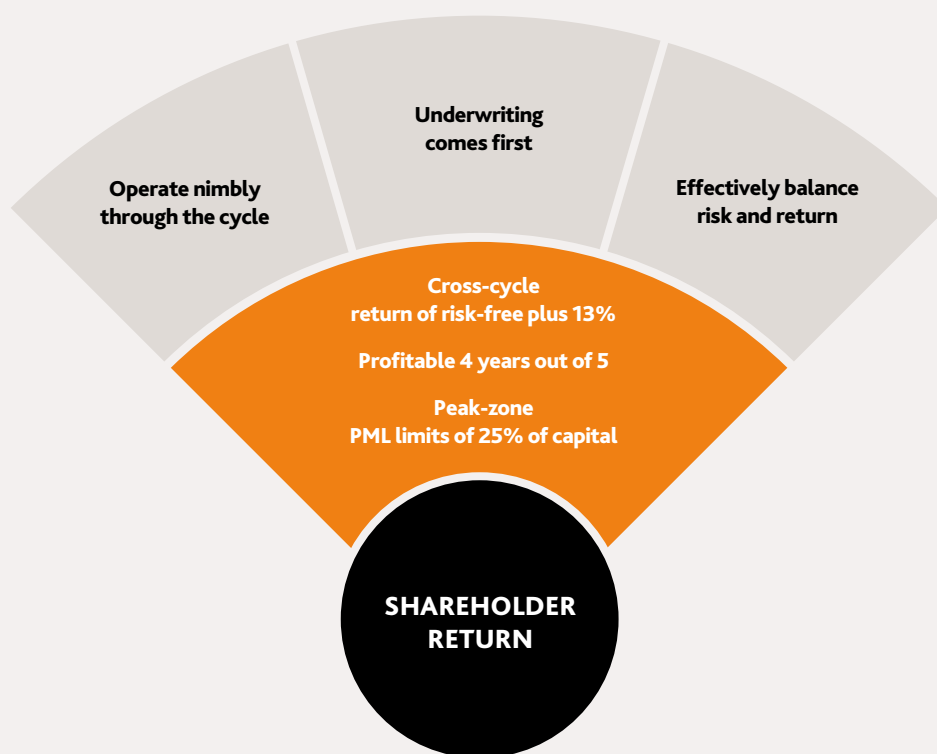
# Our strategy

## Our strategy

The Group executes its strategy by concentrating on three strategic priorities that enable the Group to meet its goal of maximising risk-adjusted returns for shareholders: underwriting comes first; effectively balance risk and return; and operate nimbly through the cycle. These strategic priorities enable the Group to serve clients and brokers with significant

capacity across the cycle, not just in the core business the Group aims to renew every year, but also in times or in areas where capacity is scarce: the opportunistic part of the Group's portfolio. The Group maintains a lean structure and keeps overheads under strict control so that resources may be refocused quickly. The Group tests its assumptions and performance constantly through its 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 provide 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 co-operation 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	<b>Underwriting comes first</b>	<b>Effectively balance risk and return</b>	<b>Operate nimbly through the cycle</b>
	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 prior to underwriting business for LIL, LUK and Kinesis, the platforms that accept larger net exposures, and post-underwriting at Cathedral, with its much smaller net exposures.	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.	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	We have reduced our written premium and PMLs by turning down underpriced business, whilst retaining our core book.  We have grown the number of Kinesis investors and the number of cedants to double figures.  Cathedral was successful in renewing its business, despite intense competition.	We have had to reduce income in some areas of our business in response to a weakening market in the first half of 2017. 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.	Lancashire renewed its 15 per cent disapplication of pre-emption rights at the 2017 AGM to assist potential future capital raises.
Performance	<b>Combined ratio</b> <b>124.9%</b>  A respectable combined ratio, even in a year where the global insurance industry sustained a significant level of catastrophe losses, evidencing the continued focus on underwriting, superior risk selection and portfolio construction.  <b>Gross premiums written</b> <b>\$591.6m</b>  We focused on protecting our core portfolios, but maintained the discipline to decline or restructure our participation on underpriced or poorly performing business.	<b>Return on equity</b> <b>-5.9%</b>  A good result despite a challenging market and the incidence of catastrophe risk losses in our major portfolios of business, helped by our improved outwards reinsurance programme.  <b>Probable maximum loss</b> <b>\$161.8m*</b>  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 2018.	<b>Ordinary dividends paid</b> <b>\$29.9m</b>  Lancashire continues to exercise the discipline of maintaining sufficient capital headroom to support underwriting operations and take advantage of new opportunities as they emerge or returning capital to shareholders it cannot profitably use.  <b>Dividend yield</b> <b>1.6%</b>  Capital is retained following loss events to take advantage of any underwriting opportunities that may follow.
Associated strategic risks	The key risk in the current market phase is the loss of relevance to brokers and clients. With so much surplus capacity, insurers need to have a unique selling point. For the Group, that is found in its mixture of underwriting capacity, leadership capability, claims service and multiple balance sheet options.	The key issue for Lancashire is to continue to serve our clients and brokers with significant capacity, whilst ensuring that the portfolio is balanced. This means constantly reassessing our business mix, and testing key risk assumptions.	Lancashire has developed an expectation among its shareholders that it will produce a consistent return and pay ordinary dividends with special dividends only when it makes sense to do so. All shareholders understand that in harder markets Lancashire will retain, and potentially even raise, capital to take full advantage of underwriting opportunities.



# Strong performance in challenging conditions



**Elaine Whelan**  
Group Chief Financial Officer

In 2017, we carried a little bit more of a capital buffer than we typically would – a bit of an insurance policy given the market conditions we were dealing with. That strategy served us well and our balance sheet remains strong.

## **Lancashire produced a loss for the year. What drove that?**

There were a number of significant and costly catastrophe events in 2017 – Hurricanes Harvey, Irma and Maria, two Mexican earthquakes plus the Californian wildfires being the larger events and the ones with the most impact on Lancashire's performance. We have therefore produced a return on equity of negative 5.9 per cent and a comprehensive loss of \$66.2 million. Given the nature of our book, and that 2017 could end up being one of the costliest natural catastrophe years on record, we are actually pretty pleased with the way our book performed. Our loss experience across these events was very much in line with expectations. Overall, for these events we have recorded a net loss after recoveries and reinstatement premiums of \$189.2 million, with our equity pick-up from our investment in Kinesis also included in that number. Looking forward to 2018 we do expect to benefit from the post-loss improved pricing environment.

## **How does the Group establish reserves for such significant events?**

It's quite an involved process. Our CUOs and Active Underwriters work with our claims and actuarial teams to establish which lines of business are impacted. There is then a detailed review on an account-by-account basis by our underwriting teams, in conjunction with claims, to identify the individual accounts which may be exposed. With a combination of experience, history and feedback from the brokers and clients themselves, they put together a preliminary estimate of loss per client. The gross loss is then fed through our various reinsurance programmes to get to a net loss position. This goes through a rigorous internal review process and we overlay our view of the industry loss size. Lastly, all of this is provided to the Reserve Committee who review and challenge the underlying estimates.



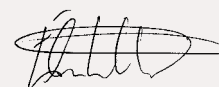
***"Given the nature of our book, and that 2017 could end up being one of the costliest natural catastrophe years on record, we are actually pretty pleased with the way our book performed."***

#### **What does that mean for Lancashire's capital position?**

We always work out the business we want to write and then we work out the capital we need to support that. We add a buffer on top of that and typically any excess is returned to shareholders. In 2017, we carried a little bit more of a capital buffer than we typically would – a bit of an insurance policy given the market conditions we were dealing with. That strategy served us well and our balance sheet remains strong. Given current expectations of post-loss pricing, we expect to fully utilise our current capital base. As a result, we did not declare a special dividend in 2017. Depending on loss activity in 2018, a better rating environment should lead to better returns.

#### **Have the events had any impact on the Group's strategy?**

In short, no. Our goal has always been to maximise risk-adjusted returns for our shareholders across the cycle. Our strategy remains to manage the cycle appropriately and match our capital to the underwriting opportunity. Over the last few years we have reduced our top line and bought more reinsurance as the market softened. In 2018 we expect to be able to take advantage of the post-loss pricing environment.



**Elaine Whelan**  
Group Chief Financial Officer

#### **Financial highlights**

	2017 \$m	2016 \$m	2015 \$m	2014 \$m	2013 \$m
Gross premiums written	591.6	633.9	641.1	907.6	679.7
Net premiums written	398.0	458.7	481.7	742.8	557.6
Net premiums earned	427.9	488.1	567.1	715.6	568.1
Net insurance losses	335.4	142.5	155.7	226.5	188.1
Net underwriting (loss) income	(23.1)	213.5	265.2	335.7	254.2
Net investment income	30.5	29.8	29.8	28.6	25.4
Net realised gains (losses) and impairments	9.1	(2.4)	(2.8)	(5.9)	12.6
Net operating (loss) profit	(86.0)	144.0	173.4	231.9	184.2
(Loss) profit after tax	(71.1)	153.8	181.1	229.3	222.5
Net change in unrealised gains/losses on investments	4.9	4.1	(11.3)	(2.1)	(32.5)
Comprehensive (loss) income	(66.2)	157.9	169.8	227.2	190.0
Dividends <sup>1</sup>	29.9	178.9	317.5	321.0	325.6
Diluted (loss) earnings per share	(\$0.36)	\$0.76	\$0.91	\$1.16	\$1.17
Diluted operating (loss) earnings per share	(\$0.43)	\$0.71	\$0.87	\$1.17	\$0.97
Fully converted book value per share	\$5.48	\$5.98	\$6.07	\$6.96	\$7.50
Return on equity	(5.9%)	13.5%	10.9%	13.9%	18.9%
Return on equity excluding warrant adjustments	(5.9%)	13.5%	13.5%	14.7%	18.9%
Net loss ratio	78.4%	29.2%	27.5%	31.7%	33.1%
Net acquisition cost ratio	27.0%	27.1%	25.8%	21.4%	22.1%
Expense ratio	19.5%	20.2%	18.8%	15.6%	15.0%
Combined ratio	124.9%	76.5%	72.1%	68.7%	70.2%
Accident year loss ratio	94.2%	46.2%	46.0%	35.9%	36.1%
Net total return on investments <sup>2</sup>	2.5%	2.1%	0.7%	1.0%	0.3%

(1) Dividends are included in the financial statement year in which they were recorded.

(2) Net return on investments includes internal foreign exchange hedge.

## Key performance indicators

### Return on equity

\$

Measurement

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

### Combined ratio

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

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

Aim

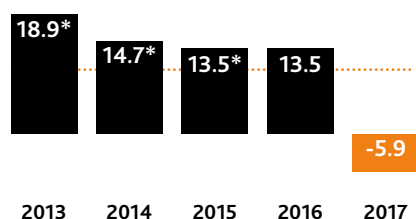
The Group's aim is to provide shareholders with a risk-adjusted return on equity of 13 per cent in excess of the risk-free rate over the longer term.

The Group aims to price its business to ensure that the combined ratio across the cycle 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 return.

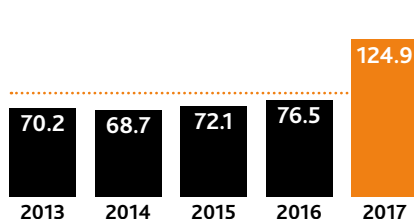
Performance

**-5.9%**



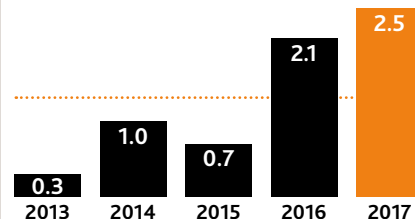
A significant level of loss activity in 2017 has resulted in a negative RoE for the year for the first time since we began underwriting in 2006.

**124.9%**



In 2017, we witnessed the occurrence of three major hurricanes (Harvey, Irma and Maria), two earthquakes in Mexico as well as wildfires in California. The high combined ratio in 2017 reflects the impact of these losses. Whilst there was a higher than usual sequence of catastrophe loss events in 2017 the impact of these was not outside or unexpected for the Group or its stakeholders.

**2.5%**



In 2017, 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.

Risk management

The stated aim is a long-term goal, acknowledging that management expects both higher and lower results in the shorter term. The cyclical 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 a RoE component in this.

Please refer to the Directors' Remuneration Report on page 60 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 including the impact of warrants was 10.9% in 2015, 13.9% in 2014 and 18.9% in 2013. The five-year average was 10.3%.



## Total shareholder return

\$

Measurement

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

## Percentage of comprehensive income returned to shareholders

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

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

Aim

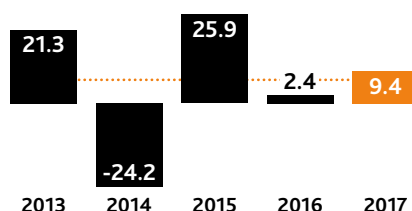
The Group's aim is to maximise RoE over the longer term and we would expect that to be reflected in our share price and multiple. This is a long-term goal, recognising that the cyclicality and volatility of both the insurance market and the financial markets in general will impact management's ability 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 proactive 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 aim to pay annual ordinary dividends, and when we decide not to retain our profits as additional underwriting capital we return them to shareholders by way of special dividends.

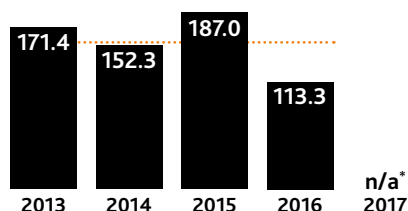
Performance

9.4%



The share price benefited from an uptick towards the end of the year due to positive expectations for the (re)insurance market following the run of catastrophe losses.

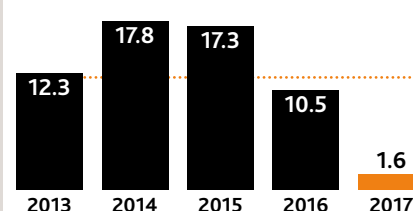
n/a\*



Following the costly catastrophe events in 2017, Lancashire took the decision not to pay a special dividend in order to retain capital to support potential business opportunities in the post-loss market.

\* The Group made a comprehensive loss of \$66.2 million during 2017. We paid annual ordinary dividends of \$0.15 per share. Due to 2017 being n/a, the average is calculated over 4 years.

1.6%



During 2017, we paid annual ordinary dividends of \$0.15 per share.

Risk management

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

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 2017, 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 harder markets the Group will want to retain, and potentially even raise, capital to take full advantage of underwriting opportunities.

# *Adapting to the cycle*

We have always been very candid about our underwriting approach. Our aim as underwriters has always been to find the appropriate balance between risk and return. This underwriting philosophy has never changed since our formation, however it does mean that at each stage of the market cycle our underwriting tactics change.

In recent years we have been able to ignore the pressure for top-line premium growth, focusing on maintaining a core portfolio of risks and protecting this portfolio with tailored, and increasingly more comprehensive, reinsurance products. When the price you receive for the risk reduces, the amount of risk you take should also reduce.

Rates in almost all of our product lines have been declining year-on-year making it more and more difficult to produce acceptable underwriting margins. We, like all of our peers, have clearly benefited from what has been a benign period over a number of years for natural catastrophe insured loss events. However, in non-natural catastrophe exposed lines we have also been able to continue to deliver underwriting margins, which the broader market has struggled to achieve, through disciplined underwriting and superior risk selection. The benign loss environment in natural catastrophe exposed lines has certainly masked rating deficiency elsewhere. So despite soft market conditions we were still able to achieve sector-leading underwriting results across our underwriting platforms by maintaining underwriting discipline.

The benign natural catastrophe environment was never going to continue forever, and the broader market was able to hide behind the profits generated by catastrophe business throughout this benign period. At some point this was going to end, and in the third quarter of 2017 this benign loss environment came to an abrupt halt with the three land-falling hurricanes, namely Harvey, Irma and Maria, as well as Mexico experiencing two major earthquakes. These losses were promptly followed by a fourth, if rather less significant, hurricane (Nate) and some of the costliest wildfires ever seen in California. In addition to these there were also major flood events in South East Asia and devastating mudslides in Columbia.

Mother Nature has certainly reminded our industry of the devastation and cost she can deliver. Every time there are catastrophe losses there seems to be something 'unique' about the loss or losses. By now we should realise the next loss or run of losses will always be different from the last.

First, these losses are devastating from a human perspective with millions of people's lives impacted by these cruel events. Second, the broader economic impact of these events, particularly in areas such as the Caribbean, are also incredibly damaging with lasting implications for these local economies. Third, the impact to our industry has been significant. It is likely that when the final bill is added up 2017 will be only the third year on record with natural catastrophe insured losses in excess of \$100 billion and quite possibly the costliest in history, and in any year this is a true test for the industry.

As a Group we have always had significant exposure to natural catastrophe risk across all of our platforms via a number of our reinsurance and insurance product lines. These events are a real test of our risk management capabilities as they are at the heart of our major product lines. When there are losses of this frequency and magnitude we obviously expect to incur losses across all of our platforms. At our inception one of our strategic objectives was to make an underwriting profit four years in every five, therefore acknowledging that there will be years where we will make an underwriting loss. We have been able to achieve an underwriting profit every year for the past 11 years, so whilst this year will be the first exception to this, in the context of our original target we have performed remarkably well.





**Paul Gregory**  
Group Chief Underwriting Officer

***"Mother Nature has certainly reminded our industry of the devastation and cost she can deliver. Every time there are catastrophe losses there seems to be something 'unique' about the loss or losses. By now we should realise the next loss or run of losses will always be different from the last."***

Part of our disciplined underwriting strategy over the past few years has been to ensure that when we experience loss events such as those in 2017, we perform in line with our various stakeholders' expectations and remain in a position to be responsive to our clients' and brokers' needs. First, we need to be able to pay our clients' claims expeditiously. Second, we need to be in a position to continue to provide these clients with ongoing support. Third, we want the underwriting platforms to be in a robust position to broaden our underwriting appetite and client base should the market conditions dictate.

I am very pleased that after experiencing these events we have achieved these aims and remain in a position to respond appropriately to our clients' current and future needs. As much as we have been prepared to narrow our portfolio in soft market conditions, we are equally prepared to broaden our portfolio in improving market conditions.

So as we look forward into 2018 we are very well positioned as a Group to service and support our existing clients and portfolio. We have the platforms and the people to ensure we maximise whatever underwriting opportunities manifest themselves.

### **Property Reinsurance**

2017 certainly bucked the recent trend of benign loss years. The market received a stark reminder of the havoc and cost that Mother Nature can deliver. All of the various hurricane, flood, fire and earthquake events of 2017 tested the global reinsurance and retrocession markets. It was not just the quantum of these losses but the frequency. After a number of years of rate reductions and broadening terms and conditions these losses come at a time that really tests the robustness of the market. Thus far it looks like the market will be able to respond to these losses as our customers would expect with claims being paid, however the dynamics of the market are now likely to change, albeit not to the extent we would like to see.

The structure of the reinsurance market in recent years has subtly changed, with the growth of ILS funds in the sector, predominantly into the retrocession space. It is fair to say that the 2017 losses are the first true test for a lot of this 'new' capacity and much like traditional rated paper there will be some that respond better than others. There is no doubt that retrocession pricing is going up, whether that be rated paper or ILS paper. This will flow through to the property reinsurance market as retrocessional costs increase.

There will of course be differentiation, with loss-impacted territories and clients sharing more of the cost burden than those territories and clients that were not loss impacted.

No one can predict exactly how much better the market will be in 2018 for these classes of business but what we do know is the softening has currently stopped and pricing is improving. The extent to which it does is very much dependent upon both the development pattern of the losses, and as always the dynamic between demand and supply.

As a Group we are very well placed to access all sectors of the reinsurance market so will be able to maximise whatever opportunity there is. We have the option of both rated paper, either company market or Lloyd's, and collateralised products via Kinesis, providing our clients with the full suite of reinsurance options. We have an established position and reputation in the property reinsurance market with deep broker and client relationships to benefit from any improved market conditions. As always the Group will look to take risk that is appropriate to the opportunity.

### Property Direct & Facultative

Much like the property reinsurance market the story for the direct property market in 2017 was dominated by the significant natural catastrophe events. Years of relatively benign conditions had led to increased competition in this sector, which inevitably had led to rating pressure across all elements of the portfolio, albeit more so for the open market business than the more stable binder business. As in other sectors of the market this pricing pressure had taken the margin from the portfolio. As a result, when events with the frequency and severity of those experienced in 2017 occur, the underwriting results will be in the red.

The D&F portfolio within the Group is primarily written from our Lloyd's platform and much like other lines of business this has shrunk as market conditions softened. The portfolio has de-risked in certain territories as rates and conditions became unsustainable. Given the 2017 industry loss events this has justified the decision as the losses incurred to the Group would have undoubtedly been larger if risk levels had not been reduced.

Following the losses there is likely to be positive rating movement during 2018 on our existing Direct & Facultative portfolio and also the opportunity to grow in areas where in recent years we have shrunk, for example Mexico and the Caribbean. We expect this to be predominantly within the open market D&F sphere as the binder book is traditionally a more stable portfolio although this will also benefit from better rating conditions. The extent of any growth will obviously be dictated by the extent of the opportunity as we look to balance risk and return appropriately.

### Energy

The 'perfect storm' of a low oil price and historically high levels of upstream energy market capacity witnessed during 2015 and 2016 continued in 2017, albeit with an oil price that was far more stable and a client base whose necessary cost cutting had largely been achieved. The stabilisation of the oil price meant that the demand side of the equation held up during 2017. Whilst the upstream energy market did not see a huge uptick in demand there were not any further reductions and there are a few early signs of some demand coming back into the system with a small number of construction projects coming to market and a number of our clients gradually increasing activity.

With the supply dynamic unchanged, i.e. historically high levels of market capacity, there was still pressure on rates as competition for a much reduced pot of premium continued amongst markets. The Group's strategy has been to maintain our core portfolio of profitable business as rates are now approaching levels last seen in the late 1990s and, considering that in 2012 rates were not far from historical highs, this shows how steep the fall in energy rates has been in the space of only a few years.

2017, however, was relatively benign for the upstream energy market in terms of significant claims although some prior year major losses did develop negatively, highlighting the volatility of the class. This benign loss year has helped mask the underlying weakness of energy rates and any return to a 'normalised' loss year would likely render the current rating environment unsustainable from a macro-market perspective. Whilst the natural catastrophe

events of 2017 have not directly impacted the upstream energy market they are large enough to alter the direction of the energy reinsurance market, which will filter through to the direct market as reinsurance costs increase. With this dynamic in place we fully expect market conditions to improve during 2018. The Group has access to energy business from both the Lancashire Companies and Lloyd's platforms, which primarily will focus on servicing existing clients' needs. However, should market conditions dictate, we have the people and the platforms to grow our energy portfolio further.

***"Following the losses there is likely to be positive rating movement during 2018 on our existing Direct & Facultative portfolio and also the opportunity to grow in areas where in recent years we have shrunk, for example Mexico and the Caribbean."***



*"The Group is able to offer significant capacity across multiple platforms to ensure we are providing both clients and brokers with fully rounded products and services, which allows us to maintain our underwriting principles despite the many challenges the market contains."*

### Marine

The marine market was relatively stable during 2017 with rates across areas of our marine portfolios remaining reasonably static.

Within the cargo market a number of London market participants exited the class during 2017, which aided this stability. The natural catastrophe events later in the year also impacted the cargo market given the exposure that this portfolio has to these kinds of events. Fortunately for us our portfolio performed admirably given the make-up of the book which has been deliberately designed to try to mitigate natural catastrophe exposures where possible. We expect these loss events to improve the cargo market during 2018 with rates reacting positively.

Outside of cargo, our hull, builders' risk and ancillary marine products portfolio performed steadily and we maintained our position on all our key accounts. This portfolio has been our most stable since our inception with our risk appetite clearly defined, which has allowed us to deliver sector-leading results for what is a notoriously difficult area to generate underwriting returns. Whilst the natural catastrophe events of 2017 have no direct impact on the insurance lines we write it will impact the broader reinsurance market so we expect stability in this market to continue through 2018.

### Aviation

The aviation market, much like the marine market, has historically been a difficult place to deliver respectable underwriting returns. Fortunately as a Group we have consistently been able to do this across all of our platforms. In a soft but more stable market in 2017 we continued to deliver underwriting profits. We access both the direct and reinsurance market across the Group's platforms so have excellent visibility of the entire sector.

Throughout the year there were a few green shoots of hope that the market had found a more viable level, particularly in the direct lines such as war. Market capacity has yet to retract, however, so as always until the demand/supply dynamic alters there is unlikely to be any material improvement

in market conditions. That said there has been a general recognition within the market, most notably post the natural catastrophe events of the third quarter of 2017, that the softening needs to stop. The rating environment for the broader market has now stabilised, much like other non-catastrophe lines, although it is still not at a level to sustain any quantum of normalised loss levels. We are confident that, at the very least, this stability of market conditions will continue through 2018.

### Terrorism, Political Violence & Political Risks

As in recent years the world continued to be a volatile place during 2017. There were numerous terrorist attacks across the globe in cities including London, Manchester, Barcelona, Paris and Stockholm as well as ongoing wars and civil disruption in many countries including Syria, Libya, Afghanistan, Iraq and Yemen. In addition, we have seen political tensions escalate between North Korea and the U.S. with the sabre-rattling intensifying. Despite these terrorism events and wars being horrific from a loss of life perspective, the impact on the insurance market has been minimal as they have created very few actual insured losses.

This global political and socio-economic climate certainly creates challenges for underwriting these classes of business, and risk selection remains absolutely crucial as years of softening rates means that there is little margin to cater for any type of attritional losses. Given this, and as with other classes of business, we have built up a profitable core portfolio of business, which in the softer market we have successfully retained. If the significant loss events of 2017 lead to a broader hard market then our leadership capabilities in these classes would allow us to develop our portfolio quickly and we have the appetite to do so.

The Group is able to offer significant capacity across multiple platforms to ensure we are providing both clients and brokers with fully rounded products and service which allows us to maintain our underwriting principles despite the many challenges the market contains.

## Ready to deliver, in all conditions



**Hayley Johnson**  
*Chief Underwriting Officer, LUK*



**Sylvain Perrier**  
*Chief Underwriting Officer, LICL*



**Jon Barnes**  
*Active Underwriter, Syndicate 2010*



**John Spence**  
*Active Underwriter, Syndicate 3010*

### Business environment and outlook

2017 was characterised by a significant level of loss activity. With the occurrence of hurricanes Harvey, Irma and Maria, the Mexican earthquakes and the California wildfires, the industry has incurred substantial losses.

At Lancashire we pride ourselves on understanding the insurance cycle. These events have shown the value of our priorities. Our discipline means that we prioritise the appropriate risk selection for all stages of the cycle.

Our outlook for 2018 is more positive than it has been for some time. We expect to put our capital to work to take advantage of improving market conditions and will be paying our standard ordinary dividend, in line with our stated dividend policy.

### 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, 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 LICL and LUK's portfolio. The future profitability of the portfolio of contracts within the RPI is dependent upon many factors besides the trends in premium rates.



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

### RPI

Class	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Aviation (AV52)	34	37	41	44	49	55	59	62	68	69	80	100
Gulf of Mexico offshore energy	103	111	118	125	136	140	140	139	137	64	80	100
Worldwide offshore energy	68	70	81	91	97	100	97	88	84	68	80	100
Marine	65	72	82	91	89	86	79	80	82	80	88	100
Property retrocession and reinsurance	98	103	117	132	152	157	131	121	127	86	97	100
Terrorism	36	38	43	48	52	55	57	60	66	71	86	100
Combined	57	61	68	76	81	84	83	81	83	76	86	100

### Underwriting results

	2017						2016					
	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	198.0	101.8	67.6	16.9	207.3	591.6	219.5	126.0	37.2	36.2	215.0	633.9
Net premiums earned	146.5	70.4	50.7	11.6	148.7	427.9	148.5	105.5	35.4	25.5	173.2	488.1
Net loss ratio	114.4%	15.8%	32.9%	(19.0)%	95.6%	78.4%	9.2%	39.3%	41.8%	(4.7)%	42.6%	29.2%
Net acquisition cost ratio	18.8%	44.0%	36.3%	27.6%	23.8%	27.0%	18.9%	45.1%	27.4%	30.6%	22.5%	27.1%
Expense ratio	—	—	—	—	—	19.5%	—	—	—	—	—	20.2%
Combined ratio	133.2%	59.8%	69.2%	8.6%	119.4%	124.9%	28.1%	84.4%	69.2%	25.9%	65.1%	76.5%

### Premiums

Gross premiums written decreased by 6.7 per cent in 2017 compared to 2016. Gross premiums earned decreased by 6.9 per cent in 2017 compared to 2016. The Group's five principal segments, and the key market factors impacting them, are discussed below.

### Property

Property gross premiums written decreased by 9.8 per cent for the year ended 31 December 2017 compared to the year ended 31 December 2016. The decrease was primarily due to multi-year contracts in the property catastrophe, political risk and terrorism classes which were written in 2016 that are not yet due to renew. This reduction was partly offset by new business written in the political risk book. Business flow in the political risk class is generally less predictable than other classes due to the specific nature of each deal. We also saw some new business written in the property catastrophe book and \$7.0 million of reinstatement premiums in connection with hurricanes Harvey, Irma and Maria.

### Energy

Energy gross premiums written decreased by 19.2 per cent for the year ended 31 December 2017 compared to the year ended 31 December 2016. The decrease for the year was mainly due to exposure reductions on prior underwriting year risk-attaching business in the worldwide offshore book, which can include exposure such as construction projects that have been delayed or cancelled, plus the timing of renewal of non-annual deals in the worldwide offshore book.

### Marine

Marine gross premiums written increased by 81.7 per cent for the year ended 31 December 2017 compared to the year ended 31 December 2016. The majority of the increase was due to new pro-rata business plus the timing of non-annual renewals and an increase in prior underwriting year risk-attaching business due to changes in the underlying exposure.

### Aviation

Aviation gross premiums written decreased by 53.3 per cent for the year ended 31 December 2017 compared to the year ended 31 December 2016. This was due to exposure reductions on prior underwriting year risk-attaching business

in the AV52 book. In addition, there were premium reductions year on year in the satellite book following the de-risking of this book during 2017.

### Lloyd's

In the Lloyd's segment gross premiums written decreased by 3.6 per cent for the year ended 31 December 2017 compared to the year ended 31 December 2016. The decrease was driven primarily by continued rating pressure on the energy book. This decrease was partly offset by an increase in reinstatement premiums in connection with hurricanes Harvey, Irma, and Maria.

### Ceded

Ceded reinsurance premiums increased by \$18.4 million, or 10.5 per cent, for the year ended 31 December 2017 compared to the year ended 31 December 2016. The increase was due to additional limit purchased plus reinstatement premiums in connection with hurricanes Harvey, Irma, and Maria.

### Earned

Net premiums earned as a proportion of net premiums written were 107.5 per cent for the year ended 31 December 2017, compared to 106.4 per cent for the year ended 31 December 2016. The earnings ratios were relatively stable on an annual basis.

## Losses

2017 was characterised by significant catastrophe activity, in the form of hurricanes Harvey, Irma and Maria, the two earthquakes in Mexico and the California wildfires. As a result, the Group's net loss ratio was 78.4 per cent for the year ended 31 December 2017 compared to 29.2 per cent for the year ended 31 December 2016. The 2017 accident year loss ratio, including the impact of foreign exchange revaluations, was 94.2 per cent compared to 46.2 per cent for the year ended 31 December 2016.

Our net losses recorded for the year ended 31 December 2017 in relation to the catastrophe events noted above was \$181.8 million, excluding the impact of inwards and outwards reinstatement premiums and our share of losses from Kinesis. While reserves have been recorded, significant uncertainty exists on the eventual ultimate losses in relation to the hurricanes, earthquakes and wildfires as loss information after these types of events can take some time to obtain. The Group's reserve estimates were derived from a combination of market data and assumptions, a limited number of provisional loss advices, limited client loss data and modeled loss projections. As additional information emerges, the Group's actual ultimate loss may vary, perhaps materially, from the current reported reserves. The final settlement of all claims is likely to take place over a considerable period of time.

While there were no other significant net losses in either of 2017 and 2016, both years experienced a few small to mid-sized losses, primarily across the property and energy classes.

Prior year favourable development was \$65.1 million for the year ended 31 December 2017 compared to \$85.8 million for the year ended 31 December 2016. Despite some adverse development on a prior accident year property and energy claims, we saw overall favourable development primarily due to general IBNR releases across most lines of business due to a lack of reported claims. Experience in 2016 was similar in terms of releases, offset partially by some adverse development on prior accident year energy and marine claims.

Excluding the impact of foreign exchange evaluations, the table below shows the impact of current accident year catastrophe events on the Group's loss ratio for the year ended 31 December 2017:

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

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

Excluding the impact of foreign exchange revaluations, previous accident years' ultimate losses developed as follows during 2017 and 2016:

## Ultimate loss development by accident year

	2017 \$m	2016 \$m
2007 accident year and prior	0.6	(0.4)
2008 accident year	(0.5)	1.6
2009 accident year	0.1	(18.0)
2010 accident year	1.8	3.2
2011 accident year	8.8	9.9
2012 accident year	5.0	13.5
2013 accident year	3.5	(1.6)
2014 accident year	9.2	19.9
2015 accident year	20.3	57.7
2016 accident year	16.3	—
<b>Total</b>	<b>65.1</b>	<b>85.8</b>

Note: Positive numbers denote favourable development.

The ratio of IBNR to total net loss reserves was 44.8 per cent as at 31 December 2017 compared to 34.6 per cent as at 31 December 2016.

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

## Loss development by class

	2017 \$m	2016 \$m	2015 \$m	2014 \$m	2013 \$m
Property	14.4	36.6	26.4	19.8	13.2
Energy	21.1	17.3	35.2	5.4	18.4
Marine	15.2	1.9	13.8	(9.7)	(23.4)
Aviation	3.0	3.9	2.9	0.9	(1.4)
Lloyd's	11.4	26.1	29.4	18.0	9.1
<b>Total</b>	<b>65.1</b>	<b>85.8</b>	<b>107.7</b>	<b>34.4</b>	<b>15.9</b>

Note: Positive numbers denote favourable development.

## Accident year loss ratios

	2017 %	2016 %	2015 %	2014 %	2013 %
Accident year loss ratio	94.2	43.5	32.4	25.9	28.1
Initial accident year loss ratio	n/a	46.2	46.0	35.9	36.1
Change in loss ratio post accident year	n/a	2.7	13.6	10.0	8.0

Note: Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2017.



### Acquisition costs

The acquisition cost ratio was 27.0 per cent for the year ended 31 December 2017 compared to 27.1 per cent for the year ended 31 December 2016. The acquisition cost ratio is relatively stable on an annual basis.

### 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 2017, our focus has been on managing our interest rate risk, the largest risk to our predominantly fixed maturity portfolio. We continue to maintain a short-duration fixed maturity portfolio and have been using our risk budget to add products to our portfolio to help mitigate a rise in rates.

Our portfolio mix illustrates our conservative philosophy, as shown in the table 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 categories, which are discussed further on page 110.

As at 31 December 2017 and 2016 the managed portfolio was as follows:

	2017 %	2016 %
Fixed maturity securities	<b>80.1</b>	81.4
Cash and cash equivalents	<b>10.2</b>	10.4
Hedge funds	<b>8.4</b>	7.0
Equity securities	<b>1.3</b>	1.2
<b>Total</b>	<b>100.0</b>	100.0

### Managed investment portfolio allocations

	2017 %	2016 %	2015 %	2014 %	2013 %
Cash	<b>10.2</b>	10.4	9.6	10.6	14.7
Short-term investments	<b>6.0</b>	0.3	1.1	1.4	9.8
Fixed maturity funds	<b>1.7</b>	0.8	0.6	0.7	1.1
Government debt	<b>17.0</b>	20.3	23.6	21.4	14.6
Agency debt	<b>3.8</b>	4.4	0.2	0.8	4.1
Agency MBS, CMBS	<b>7.7</b>	6.4	7.3	7.7	10.9
Non-agency RMBS, ABS, CMBS	<b>8.5</b>	7.3	8.4	11.0	8.4
Corporate bonds	<b>28.2</b>	32.5	33.2	31.7	29.7
Bank loans	<b>5.8</b>	6.6	5.9	5.8	4.5
Fixed maturity – at FVTPL	<b>1.4</b>	2.8	1.3	1.4	1.3
Equity securities	<b>1.3</b>	1.2	0.8	0.7	0.7
Hedge funds – at FVTPL	<b>8.4</b>	7.0	8.0	6.8	—
Other investments	<b>—</b>	—	—	—	0.2
<b>Total</b>	<b>100.0</b>	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 of tolerance levels, adjustments may be made to reduce the risk in the portfolio. We try to be nimble in our investment strategy while putting our objective of capital preservation first and foremost.

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

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

### Investment performance

Net investment income excluding realised and unrealised gains and losses, was \$30.5 million for the year ended 31 December 2017, an increase of 2.3 per cent compared to 2016. Total investment return, including net investment income, net realised gains and losses, impairments and net change

in unrealised gains and losses, was a gain of \$45.7 million for the year ended 31 December 2017 compared to a gain of \$38.4 million for 2016.

Despite the increase in treasury yields in 2017, the investment portfolio produced a return of 2.5 per cent due to the narrowing of credit spreads, coupon income and strong returns in the Group's risk-asset portfolios. In 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. The 2016 returns were also supported by strong performance from the Group's bank loans, equities and equity-linked notes.

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.

### Liquidity

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

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

### Cash flow

The Group's cash inflows are primarily derived from net premiums received, from losses recovered from reinsurers, from net investment income, including dividends and net income from managed third party capital, 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 and the distribution of dividends.

### Key investment portfolio statistics

	2017	2016	2015	2014	2013
Duration	<b>1.7 years</b>	1.8 years	1.5 years	1.5 years	1.0 year
Credit quality	<b>AA-</b>	A+	AA-	AA-	AA-
Market yield	<b>2.1%</b>	1.9%	1.9%	1.5%	1.2%
Book yield	<b>2.0%</b>	1.8%	1.6%	1.5%	1.4%



### Lancashire third party capital management

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

	2017 \$m	2016 \$m
Kinesis underwriting fees	5.8	4.4
Kinesis profit commission	5.9	6.2
Lloyd's managing agency fees & profit commission	5.5	9.9
<b>Total other income</b>	<b>17.2</b>	<b>20.5</b>
Share of (loss) profit of associate	(9.4)	5.1
<b>Total net third party capital managed income</b>	<b>7.8</b>	<b>25.6</b>

The increase in Kinesis underwriting fees during 2017 was due to more limit being placed compared to 2016. The Kinesis profit commission was driven by the timing of loss experience and collateral release and therefore varies from year to year. The share of (loss) profit of associate reflects Lancashire's 10 per cent equity interest in KHL. The overall loss for 2017 was entirely driven by the significant catastrophe activity during the second half of 2017. The reduction in Lloyd's fees and profit commission was driven by the relative profitability of the underwriting years impacting each period.

### Other operating expenses

	2017 \$m	2016 \$m
Employee remuneration costs	40.2	61.4
Other operating expenses	43.4	37.1
<b>Total</b>	<b>83.6</b>	<b>98.5</b>

Employee remuneration costs for the year ended 31 December 2017 were \$21.2 million lower than the same period in 2016, primarily driven by lower variable compensation due to the catastrophe activity in the year.

Other operating expenses were \$6.3 million higher for the year ended 31 December 2017 compared to the same period in 2016, primarily due to increased software costs, placement fees for the Kinesis vehicle plus higher consulting costs.

The equity-based compensation credit of \$0.4 million for the year ended 31 December 2017, compared to an expense of \$10.7 million for the year ended 31 December 2016, was due to incorporating losses incurred during the second half of 2017 into performance estimates, combined with the lapsing of awards of former Cathedral employees on their departure from the Group. The equity-based compensation charge was driven by the anticipated vesting level of the active awards based on current performance expectations.

### Capital management

Lancashire has built a reputation for being one of the best known and most active proponents of capital management in the industry. Capital management is our most important area of focus after underwriting and it is our firm belief that proactive and flexible capital management is crucial in helping to maximise risk-adjusted return over time. With that focus we will return capital where this offers the best returns for our shareholders. We have returned 108.1 per cent of comprehensive income generated via dividends or share repurchases since inception.

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

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

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

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

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

### **Capital**

As at 31 December 2017, total capital available to the Group was \$1.433 billion, comprising shareholders' equity of \$1.107 billion and \$326.3 million of long-term debt. Tangible capital was \$1.279 billion. Leverage was 22.8 per cent on total capital and 25.5 per cent on total tangible capital. Total capital and total tangible capital as at 31 December 2016 were \$1.528 billion and \$1.374 billion respectively.

### **Dividends**

During 2017, the Lancashire Board declared a final dividend of \$0.10 per common share in respect of the 2016 financial year and an interim dividend of \$0.05 per common share in respect of 2017. With the final dividend in respect of 2017 of \$0.10 per common share, total capital returns since inception amount to \$2.7 billion, or 277.8 per cent of initial capital raised. The final dividend of \$0.10 per common share will be paid on 21 March 2018 to the shareholders of record on 23 February 2018.

### **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 a similar request for authority to shareholders in a resolution at the 2018 AGM to be held on 2 May 2018.

### **Letters of credit**

Lancashire has a standard syndicated LOC facility which in total amounts to \$300.0 million, with a \$75.0 million loan sub-limit available for general corporate purposes. Syndicate 2010 has an \$80.0 million catastrophe facility in place to assist in paying claims and gross funding of catastrophes. Furthermore, a \$130.0 million syndicated uncollateralised facility is available for utilisation by LICL and guaranteed by LHL for Funds at Lloyd's purposes.

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



# Navigating our environment

Consistent Enterprise Risk Management is the key to being ready to respond in all environments.



**Louise Wells**  
Group Chief Risk Officer

## Maintaining the balance

The first eight months of 2017 were all about maintaining the balance of the risk we were taking on with the return we were receiving for that risk. It was pleasing therefore, that post hurricanes Harvey, Irma and Maria, the Mexican earthquakes and California wildfires we remained inside our Board-approved risk appetite and tolerances. Following these events our risk management processes did not change; our risk appetite was reviewed with the changing environment in mind, however no adjustments to tolerances were required.

## Risk strategy

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

The Group is exposed to risks from several sources. These include insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk. The primary risk to the Group is insurance risk, which can be subdivided into the core risk of underwriting and non-core risk of reserving.

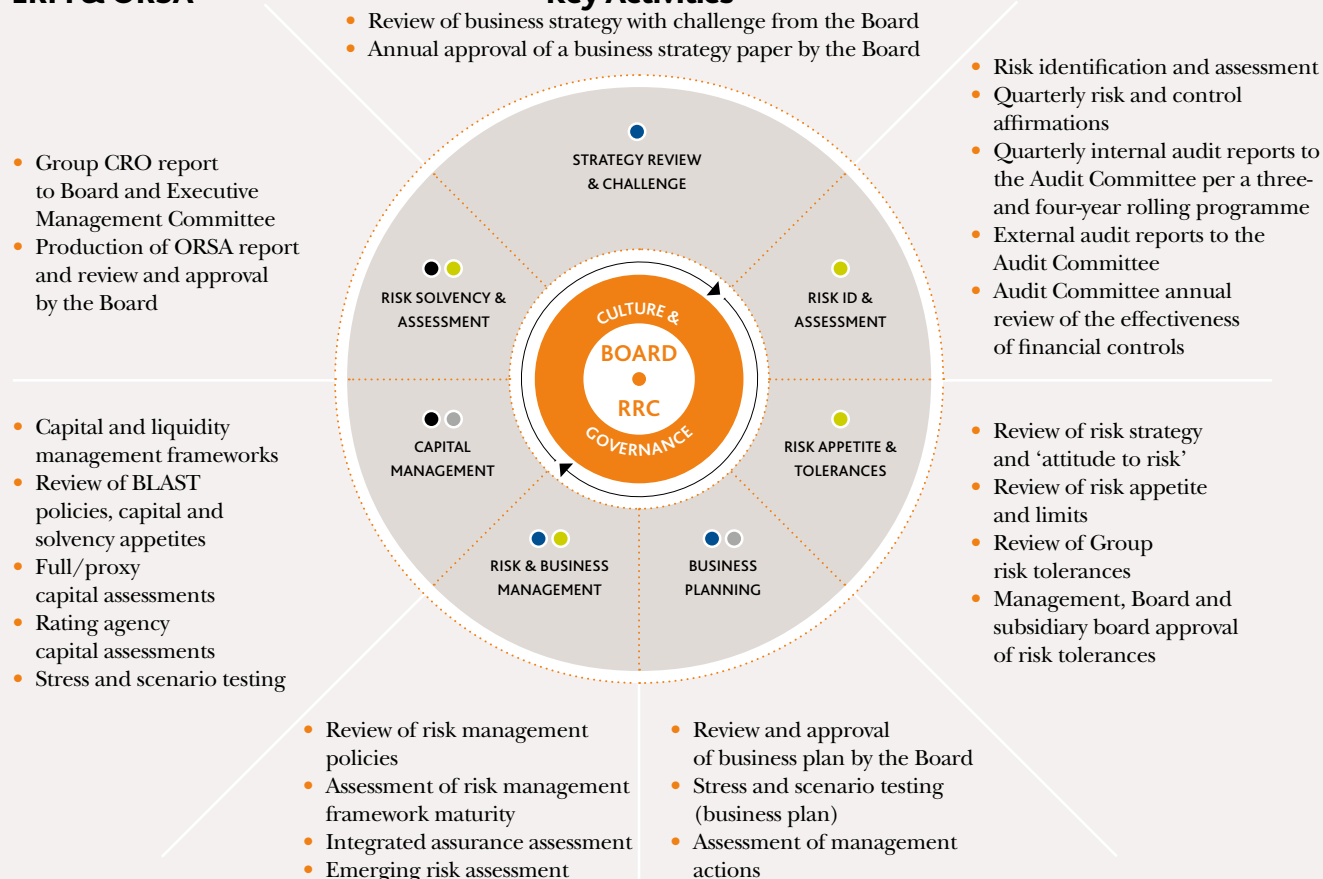
The Group has formulated, and keeps under review, a risk appetite which is set by the Board of Directors. The Group's appetite for risk will vary marginally from time to time to reflect the potential risks and return that present themselves. However, protecting the Group's capital and maximising risk-adjusted returns for investors over the long term are constants. The risk appetite of the Group is central to how the business is run and permeates into the risk appetites that the individual operating entity boards of directors have adopted. These risk appetites are expressed through detailed risk tolerances at both a Group and an operating entity level. Risk tolerances represent the maximum amount of capital, generally on a 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 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 to ensure that risk levels are managed in accordance with them.

## ERM framework

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

We continue to perform a quarterly risk and controls affirmation process whereby the operation of all key controls is affirmed by the control operators and then reviewed and signed off by the risk owners. In addition, the risk owners are required to affirm their risks remain appropriately documented and scored. During 2017 this process was expanded to include all individual operating entities including the syndicates. The output from this process is reported to the RRC and the Group and operating subsidiary audit committees or boards of directors as appropriate.

**ERM & ORSA****Key Activities****Key Elements of ORSA**

● Board sign-off and embedding   
 ● Business Strategy   
 ● Risks   
 ● Capital and Solvency   
 ● Stress and Scenario testing

As at 31 December 2017, all Group entities were operating within their board-approved risk tolerances. No significant new risks have been identified and there have not been any material changes in our existing risks.

Our quarterly ORSA reports prepared by the Group CRO to the main Board provide a timely analysis of current and potential risks, compared against risk tolerances, along with their associated capital requirements. The 2018 annual ORSA report will be presented to the Board for review, challenge and approval during Q1 2018 and then submitted to the PRA in line with supervisory requirements.

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

In November 2017, the Group CRO reported to the Remuneration Committee regarding risk and remuneration, recognising the importance of the design of the remuneration structure in driving desired behaviours over both the short-term and the longer-term business planning periods. In addition, a Group Solvency II Staff policy was reviewed, challenged and approved by the Remuneration Committee.

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

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



- to provide timely, accurate, reliable, factual, objective and accessible information and analysis to guide, coach and support decision making.

## RRC

The RRC, under the chairmanship of the Group CEO, is the key management tool for monitoring and challenging the assessment of risk on a continual basis. It 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 co-ordinating and overseeing ERM activities within the risk profile, appetites and tolerances set by the Group and individual entity boards of directors. The RRC includes the Group CEO, members from the finance, actuarial, modeling, operations, treasury and underwriting functions and both the Group CRO and Cathedral CRO. The Group CRO reports on the RRC's activities to the Group

and individual entity boards of directors and, via the Cathedral CRO, the Risk, Capital and Compliance Committee of Cathedral. Through the Group CRO the RRC considers recommendations to the Board and its Committees with regard to the adoption of formal risk tolerances.

## Capital models

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

## Emerging risk

The identification and assessment of emerging risk occurs throughout the Group from individual departments to management and executive committees to the boards of directors and sub-committees of the boards. The risk department maintains an emerging risk register, which is provided to the Board and entity boards of directors each quarter, and is therefore subject to an iterative process of review and oversight. Emerging risks, by their nature, are difficult to quantify, however during 2017 the Group strove to

foresee potential areas of new risk, or developments in existing risks and to assess how those risks could impact the Group.

## Risk universe

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

The Board evaluated the risks disclosed, alongside other factors, in the assessment of the Group's viability and prospects as set out in the going concern and viability statement in the Directors' Report at page 83.

## Risk universe

Type	Category	Description
Intrinsic Core	<b>Underwriting</b>	Intrinsic risks representing the potential to generate a return as well as a loss.
	<b>Investment</b>	In these areas, the Group promotes informed risk-taking that considers the risk and return equation in all major decisions, with the intention of maximising risk-adjusted return on equity.
		We recognise that by insuring fortuitous events we can suffer losses, and that within our investment portfolio we can see the value of investments fall. We cannot avoid these risks so we focus on the correlated operational risks and seek to mitigate them. For example, we know that by insuring the risk of earthquake we are exposed to the risk that losses exceed our plan. We model our portfolio using stochastic 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, which also considers and approves formal risk tolerances.
Intrinsic Non-core	<b>Reserving</b>	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.
	<b>(Re)Insurance counterparty Liquidity</b>	They are quantified insofar as practicable for the purposes of capital and risk management and avoided or minimised insofar as is economically justifiable.
Operational	<b>Operational</b>	These are risks arising as a result of inadequate or failed internal processes, personnel, systems or (non-insurance) external events.  They have the potential either to magnify the adverse impacts of intrinsic risks, for example increased reinsurer default losses arising through the use of non-approved counterparties; or to crystallise separately in their own right, for example losses arising through the imposition of fines as a result of a regulatory breach, so unrelated to our core functions.
Other	<b>Strategic</b>	These are risks for which quantitative assessment is difficult but for which a structured approach is still required to ensure that their potential impact is considered and mitigated insofar as is practicable. These are included within the risk register and are assessed and mitigated through scenario and stress testing.
	<b>Group Emerging</b>	

# 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 100 to 125. Within the capital models, insurance risk accounts for over 80 per cent of the allocated risk capital, so this is clearly the principal area where we stringently apply controls and reviews. For example, we place a large number of controls around monitoring risk levels across the business. However, we understand that even risks that do not generate a capital charge under an economic capital model can pose serious threats to the execution of the business plan and strategy, and therefore need to be monitored and tested. For example, we spend a lot of time looking at the implications of emerging capital and the evolution of the market cycle.

## INTRINSIC RISK: CORE

### TYPE

**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.

**Movement since 2016:** Decreased due to reduced retentions and further contraction to core book reducing aggregate exposure.

**Investment:** We need to hold sufficient assets in readiness to pay claims, but the markets and products in which we invest can suffer volatility and losses. As a short-tail insurer, we are able to hold the majority of assets in low-duration securities such as fixed maturities. However, this creates an additional source of risk in the current environment, where there is a considerable risk from changes 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.

**Movement since 2016:** No material change.

### MITIGATION

**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 approves risk tolerances at least annually and considers capital requirements on at least a quarterly basis.

**Investment strategy:** Our strategy is that investment income is not expected to be a significant driver of our returns. Our primary focus remains on underwriting as the engine of profits. Investment strategy, including investment risk tolerances, is approved annually and monitored on a quarterly basis by the Investment Committee and Board.

**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

**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.

**Movement since 2016:** No material change. Our processes and controls remain the same as in previous periods.

### MITIGATION

**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

### TYPE

**(Re)Insurance and intermediary counterparty:** Almost all the insurance policies which we write are brought to us by brokers, who act as intermediaries between us and the client, and handle the transaction of payments of claims and premiums on our behalf. This exposes us to the risk of mishandling by, or failure of, the broker concerned. In order to make our portfolio as efficient as possible, we buy reinsurance to protect against severity, frequency and accumulation of losses. Again, this exposes us to the risk that our counterparties may have the inability or unwillingness to pay us in the event of a loss.

**Movement since 2016:** No material change.

**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.

**Movement since 2016:** No material change.

### MITIGATION

**Counterparty credit limits:** The Broker Vetting Committee is responsible for the broker vetting approval process and monitoring credit risk in relation to brokers. In addition, the Group conducts broker business using non-risk transfer TOBAs. This mitigates the risk due to non-payment by brokers and intermediaries as monies are held in separated client accounts. We use counterparty credit limits, seek to deal with reputable reinsurers that meet our minimum rating standards, and use collateral agreements where appropriate. The operating entities of the Group that contract for reinsurance separately maintain and report their own counterparty credit limits at the entity level. The RSC is responsible for approving counterparties and monitoring aggregate limits.

**Portfolio management:** The Group maintains liquidity in excess of the Board-agreed tolerances. This is achieved through the maintenance of a highly liquid portfolio with short duration and high creditworthiness. We monitor this through the use of stress tests and mitigate risks through the quality of the investments themselves.

## OPERATIONAL

### TYPE

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

**Movement since 2016:** Increasing as we commence our project to develop our systems to enable us to further improve the functionality of Group IT Finance systems, to enhance management of financial reporting risk and to ensure compliance with IFRS 17 which comes into effect in 2021.

### MITIGATION

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

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

**Personnel:** We mitigate the risks associated with staff retention and key-man risk through a combination of resource planning processes and controls. Examples include targeted retention packages, documented position descriptions and employment contracts, resource monitoring and the provision of appropriate compensation and training schemes. The Board regularly reviews succession planning arrangements and remuneration structures.

## OTHER

### TYPE

These are risks for which quantitative assessment is difficult but for which a structured approach is still required to ensure that their potential impact is considered and mitigated insofar as practicable. They include categories such as Strategic, Group and Emerging Risks.

**Movement since 2016:** On balance no material change. The impact of Brexit is not considered to be a significant risk to the Group given the Group's current operations and trading profile. We will keep U.S. tax reform under review but do not at present consider that it will materially adversely impact the Group's operations.

### MITIGATION

**Qualitative approach:** These risks require a qualitative approach, engaging staff in appropriate discussions about sources of risk, and then thinking about possible outcomes. The Group Executive Management Committee and the RRC consider these issues, and the ORSA reports made by the Group CRO to the Board include standing items on Emerging Risk.



# Our responsibility to others and the environment

## 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 community and the environment, whether within our neighbouring areas or further afield. The work of The Lancashire Foundation is fundamental to the Group’s corporate responsibility programme.

## 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 off setting. 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. For more

information about the day-to-day management of the Foundation and how it operates see pages 37 and 38. The Board also sets the policy for the operation of the HR function, and oversees the management of the environmental impact of the business.

Lancashire has a relatively low headcount (204 employees globally), all of whom are remunerated on a basis which comfortably exceeds UK minimum wage requirements. In particular, the Group’s UK operation is an accredited Living Wage employer by the Living Wage Foundation. 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. The Board has recently reviewed and modified the statement on slavery and human trafficking made on behalf of all companies within the Group and considers that it remains fit for purpose. This statement is published on the Company’s website. The Chairman’s statement on the Group’s diversity policy has also been debated by the Board during the year and is posted on the Company’s website.

## We focus on the following four areas:

Community	Environment	Marketplace	Workplace
<b>\$18.5m</b>	<b>100%</b>	<b>100%</b>	<b>12</b>
donated by the Lancashire Foundation since inception	of our 2017 CO <sub>2</sub> emissions offset	of our permanent employees are eligible for RSS awards	different nations represented by our employees
See page	See page	See page	See page
<b>37</b>	<b>39</b>	<b>39</b>	<b>40</b>

## The Lancashire Foundation

# Committed to supporting communities

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.



**Michael Connor**  
*Chairman of the Trustees of  
The Lancashire Foundation*

### Can you explain what The Lancashire Foundation is and define its purpose?

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

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

In 2017, 131 of our staff across the Group participated in charity volunteer days, mentoring opportunities or fundraising events. The Foundation also operates a charity matching scheme to support individual staff members' charitable initiatives. During 2017 matched funds from the Foundation amounted to £16,785 and supported 12 charities.

### This sounds simple, but how does it work in practice?

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

The majority of charities we supported in 2017 were as a result of staff suggestions and support. In addition, the Foundation also supported charities suggested by clients and brokers which, for 2017, included Batten Disease Family Association, Skiing with Heroes, Edinburgh Global Partnerships, Starlight Foundation, The Brain Tumour Charity, World Vision – Hurricane Relief and Richard House Children's Hospice.

Taking the second aspect of staff giving, we actively encourage support by staff. This takes

a number of forms, for example: carrying out volunteering work that directly benefits the charity, like our annual volunteering trip to the Philippines to support the work of ICM with the ultra-poor; providing mentoring support to staff at St Giles Trust, many of whom are ex-offenders; or participating in fundraising events like marathons. During the year the Foundation carried out a number of presentations to remind staff what the Foundation aims to do and how they can support it.

### How is the Foundation staffed to support this work?

We don't employ staff; all the work is carried out on a voluntary basis by the existing staff of the Lancashire Group. As I mentioned earlier, a key aspect is ensuring that the Foundation reflects what engages our staff, so funding applications received from charities are analysed and challenged by the Foundation's Donations Committee, which is comprised of staff from across the UK and Bermuda platforms.

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

We are lucky with the quality and commitment of the people involved in the Foundation. It does not seem right to highlight certain individuals involved in the Foundation's work as all of them are

## The Lancashire Foundation



**Clockwise from left: Louise Wells, Chris Wilkinson, Louise Byrne, Derek Stapley and Robert Kennedy**

committed and talented, however I am very grateful for the insight and support of my fellow trustees, Derek Stapley and Louise Wells, the Chair of our Donations Committee, Chris Wilkinson, Robert Kennedy, who lends his considerable financial skills to the Foundation's budgeting and forecasting and Louise Byrne, whose organisational skills keep the whole show on the road!

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

***"It was very pleasing that the Foundation was shortlisted for an award at the 2017 Charity Times Awards in the Corporate Community Local Involvement category."***

**We've not really talked about charities. Can you give me a flavour of who you support?**

Of course. The Foundation looks to support charities around the world but with an emphasis on charities where we can see a demonstrable positive impact on the communities they serve and which operate in effective, transparent and sustainable ways to deliver the programmes they provide.

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

It was very pleasing that the Foundation was shortlisted for an award at the 2017 Charity Times Awards in the Corporate Community Local Involvement category, which is a tribute to our advocate for St Giles, John Cadman (the Group's General Counsel), and a number of our staff who act as mentors and give up their spare time to support selected St Giles' staff as they develop their careers.

**What kind of relationships do you look to cultivate with the charities you support?**

Put simply – open and transparent. The advocate system allows us to get close to our charities and foster the deep, multi-year relationships we hope to develop with most of the charities we support.

Annually, where we have multi-year relationships, the advocates are expected to review and reflect on the performance of the charity they advocate with the Donations Committee to ensure that the Committee is happy to recommend a renewal of the grant for the next year to the Trustees. Both quantitative and qualitative data will be reviewed as part of this process.

**What is the relationship like between the Foundation and Lancashire Holdings Limited?**

A very supportive one. The Foundation has been very lucky to receive an annual donation from LHL to support its activities and at the Foundation's inception it was granted warrants which have been converted into shares. We currently hold 330,713 shares in LHL. In this way we have aligned the Foundation to the Group and can share in its success, and leverage that success to causes and communities that do not often receive such material rewards. Ideally through our work we can develop something approaching a virtuous circle as a grant maker, but this remains a work in progress.



## Environment

Despite a small increase in reporting scope, total emissions for 2017 have decreased by 4.3 per cent compared to 2016, with emissions per full-time employee (FTE) falling by 7.0 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; in London and Bermuda. The Group is also responsible for an apartment in Bermuda which is used for temporary visitor accommodation.

### Our approach

The figures in this report are calculated over a 12-month period from 1 January 2017 to 31 December 2017. Emissions are calculated by converting consumption data into tonnes of carbon equivalent (tCO<sub>2</sub>e) using the DEFRA 2017 greenhouse gas reporting: conversion factors. Lancashire uses the number of FTE as its intensity metric, which this year shows a decrease of 7.0 per cent to 12.0 tCO<sub>2</sub>e per FTE, compared to 12.9 tCO<sub>2</sub>e per FTE in 2016.

Where data was not available for 2017, 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 the activities and facilities for which it is responsible and reported on all 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.

In 2017, the Group's UK operations achieved BREEAM excellence for its London offices at 20 Fenchurch Street, which has supported an overall improvement in environmental performance.

Therefore, results show that GHG emissions in the year were 2,453.3 tCO<sub>2</sub>e, comprised of direct emissions (Scope 1) amounting to 70.9 tCO<sub>2</sub>e, and indirect emissions (Scope 2) amounting to 418.0 tCO<sub>2</sub>e. The source of other indirect emissions (Scope 3) comprised 1,964.4 tCO<sub>2</sub>e. Scope 1 emissions have decreased by 21.7 per cent. Scope 2 emissions have decreased by 14.4 per cent compared with 2016 due to the decarbonisation of the UK power grid. Scope 3 emissions have also decreased compared with 2016 due, in part, to a reduction in airline travel, most notably short haul flights.

Emissions from water (Scope 3) have also decreased by 72.2 per cent compared with 2016. This was due to a water leakage at the Bermuda office during 2016, which was subsequently rectified in 2017.

Lancashire has purchased carbon credits to reduce its gross GHG emissions by 2,453.3 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 the Wind Power Generation Project in India. These offsetting proposals were discussed and agreed with the Group CEO.

## Marketplace

We continue to help the development of our marketplace by making employees available to sit on market committees, boards and working groups. During 2017, our employees gave 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 it is important to make our people available to the markets in which we operate, 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

**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.

**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.

Types of Emissions	Activity	2017 tCO <sub>2</sub> e	2016 tCO <sub>2</sub> e
Direct (Scope 1)	Gas ( <i>measured in kWh</i> )	70.9	90.5
	Refrigerant ( <i>measured in kg</i> )	0.0	0.0
Indirect Energy (Scope 2)	Electricity ( <i>measured in kWh</i> )	418.0	488.5
Indirect Other (Scope 3)	Business Travel ( <i>measured in miles and GBP</i> )	1,619.5	1,624.3
	Additional Upstream Activities <sup>1</sup> ( <i>measured in kWh, litres, miles and spend</i> )	299.7	308.7
	Water ( <i>measured in m<sup>3</sup></i> )	7.2	25.9
	Waste ( <i>measured in kg</i> )	4.4	1.7
	Paper ( <i>measured in reams</i> )	6.9	5.5
	Hotels ( <i>measured in hotel nights</i> )	26.7	17.2
<b>Gross Emissions (tCO<sub>2</sub>e)</b>		<b>2,453.3</b>	<b>2,562.3</b>
<b>Gross Emissions per FTE (tCO<sub>2</sub>e/FTE)</b>		<b>12.0</b>	<b>12.9</b>
<b>Carbon Credits</b>		<b>2,454</b>	<b>2,563</b>
<b>Total Net Emissions after offset (tCO<sub>2</sub>e)</b>		<b>0.0</b>	<b>0.0</b>

(1) Additional Upstream Activities include Well-to-Tank and Transmission & Distribution emissions. These are emissions associated with the upstream processes of extracting, refining, and transporting raw fuel to our business.



Corporate responsibility in action

## Relay for Life

For the past four years the Bermuda office has participated in the Relay for Life event put on by Bermuda Cancer and Health Centre. This event is part of the Global Relay for Life which is a 24-hour fundraiser that brings communities together in the fight against cancer. We walk to remember those we have lost, celebrate those who have survived, encourage those who are still fighting and give thanks to all caregivers. In 2017, Lancashire's 'Team Tango' was made up of over 100 staff, family and friends. In 2017 our team raised over \$25,000 and over the four years we have raised over \$75,000. These funds have been used to bring radiation therapy to Bermuda so patients can be treated locally rather than having to travel overseas.

## Workplace

We strive to attract and retain excellent employees who drive our appetite to outperform so as to ensure that the talents of our people and our unique culture continue to set us apart from our competitors. Matching the skills, aspirations and values of new recruits to both the role and the values of Lancashire remains a high priority for our business.

### Our approach – promoting a positive and diverse culture

The Group promotes an inclusive environment that recognises and values diversity as key to enhancing individual development and maximising business effectiveness. As an equal opportunities employer, we will not tolerate discrimination of any kind in any aspect of employment, including in job advertisements, recruitment, training, promotion, compensation, benefits, advancement and career development. The Group is also committed to a working environment that is free from any form of bullying or harassment.

Our proactive measures to achieve a diverse, vibrant and positive business culture include

our 'Respect in the Workplace/ Communications Etiquette' 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.

The Group values having a diverse workforce and bases all recruitment decisions on the ability of prospective employees to do the job, without consideration to race, age, gender, sexual orientation, disability, beliefs, background (except as may be pertinent to the requirements of a role, such as educational qualifications or prior employment experience) or nationality.

The Group is currently represented by employees from 12 different nations. The gender split of males to females (see page 56) within the Group is 60/40 per cent respectively.

Lancashire respects, supports and 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.

### Staff training and professional development

The Group encourages continuous personal and professional development for all of its employees, whether through individual external training, professional qualifications, performance coaching or 'lunch and learn' sessions.

Individual training and personal development needs are discussed on a regular and ongoing basis by managers and their team members, including as part of the formal performance appraisal process.

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
- Respect in the Workplace/ Communications Etiquette.

Other training may be held on an ad hoc, one-off or refresher basis. 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. Quarterly updates regarding attendance at these compulsory training sessions are provided to the Board for information purposes.

### Employee turnover and third party contractors

Among the Group's employees, the turnover for 2017 was 16.2 per cent (a decrease from 20.1 per cent in 2016), and as at 31 December 2017, 10.1 per cent of the workforce was composed of third party contractors, a decrease from 11.6 per cent in 2016. The rate of staff turnover and third party contractors was driven principally by changes in our Lloyd's platform, where there continued to be a process of refreshment and renewal implemented during 2017.

### Our focus areas

Our focus in 2017 has been to maintain the success of our employees through ongoing training and coaching, provided both internally and externally. During 2017 approximately 67 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 can confirm that during 2017 3.4 per cent of our employees were promoted within the Group, supported by the training and development opportunities provided. An area for continuing development during 2018 will be greater standardisation of the appraisal and training frameworks across the Group.

### Internship programme – Corporate responsibility in action

Since 2014, the Group and the Foundation have jointly sponsored an internship programme for Bermuda resident college graduates. These graduates are afforded the opportunity to spend two years working and learning about insurance in the Group's London office. The first two-year placement completed during 2016 and one of these graduates is now a permanent employee within Lancashire and the other has obtained a role at another market insurer in Bermuda. The Group has since welcomed two further graduates during 2016 and 2017, respectively.

## 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 2017 Project Transform volunteers have reflected on their experience and summarised their thoughts:

*"The members of the 2017 Project Transform team were very grateful to have been selected to travel to the Philippines and work with ICM."*

*We each applied to be part of the team due to the positive feedback shared by previous team members. The team were keen to help people*

*less fortunate than ourselves, as well as better understand some of the challenges ICM is trying to overcome locally.*

*During the project week we had the opportunity to see how ICM are trying to reach and educate as many people as possible. Our work included building projects and delivering educational talks within various communities.*

**"Ultimately ICM gives people hope for the future."**

*We loved spending time and interacting with the communities we visited and could see first-hand that lives have clearly been changed by the work of ICM. The week with ICM was a humbling experience which made us all see the world a little differently. Ultimately ICM gives people hope for the future."*



The Lancashire 2017 Project Transform team – Steven Hartley, Shirley Donovan, Susan Blasetti, Mathew Churm, Samantha Cobb, Sean Pitcher, Louise Cowin and Harry London.

# 56

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





# Responsive governance



**Peter Clarke**  
*Non-Executive Chairman*

Responsive governance requires clear communication, constructive challenge and debate and creative strategic thinking. A diverse range of perspectives and experience helps build a responsive culture, which serves and balances the expectations of a broad range of stakeholders.

In my opening statement I discussed the way in which our business and Board responded to the strategic challenges of 2017 as the year progressed. The following section focuses on the work carried out by the Board and its Committees in exercising effective oversight, taking decisions and providing responsive challenge and support to the business.

## **How does the Board structure and monitor the governance objectives for the business?**

As a premium-listed company 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.

In this corporate governance section and throughout the Annual Report and Accounts for the 2017 financial year, areas of corporate governance compliance are explained by reference to the Code. The Company also monitors its compliance with applicable corporate governance requirements under both Bermuda law and regulations and, as

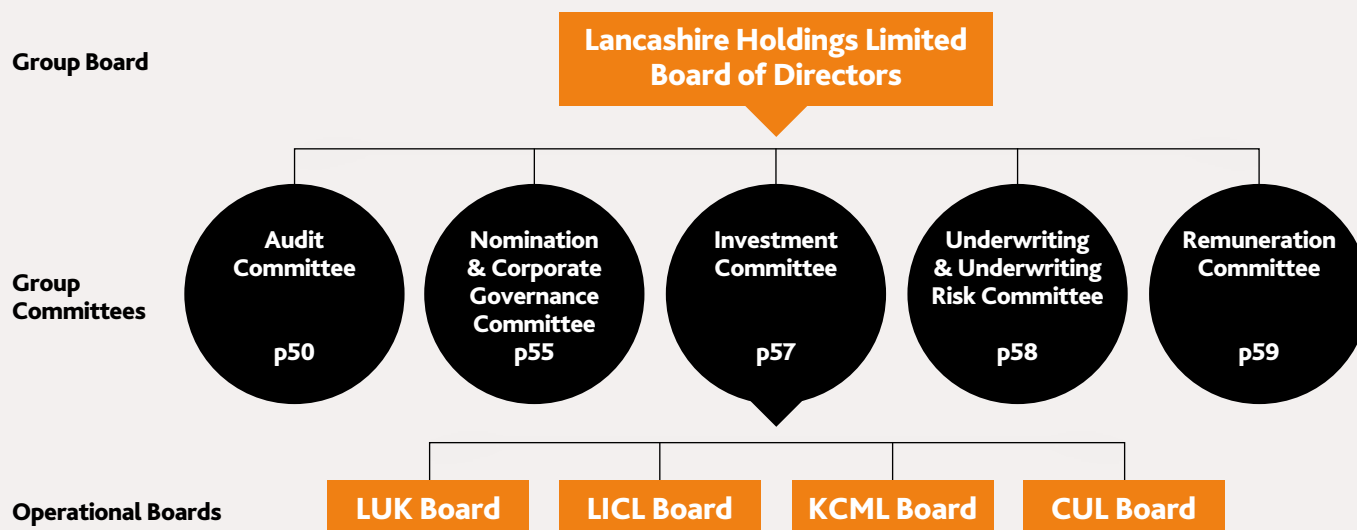
an insurance operation subject to UK group supervision by the PRA, in accordance with the requirements of the UK's Solvency II regime.

I am pleased to be able to report that the Board considers that the Company has complied with the principles and provisions as set out in the Code throughout the year ended 31 December 2017. The Board and business seek to ensure that the formal consideration of governance and regulatory requirements does not become a sterile exercise but is used to best advantage as a framework to inform the strategic and commercial matters which are so central to the nimble and responsive operation of the Group.

## **How does the Board have regard to the interests of Lancashire's stakeholders in promoting the success of the business?**

Over the last year or so the governance debate within the UK has concentrated strongly on the requirement for boards to focus on a broad group of stakeholders. Our Board has for many years taken what might be described as a holistic view to the operation of its business. Our strategic focus upon excellence in underwriting encompasses the importance which we attach to two of our most important stakeholder groups: our policyholders and our staff. It is paramount that the (re)insurance products we offer meet the needs of our clients and their

## Our governance structure



brokers and that Lancashire is viewed as a trusted partner and provider of solutions. Similarly, we spend time as a Board carefully considering the staff resources across the Group and in particular the succession planning for Board and senior roles. Given our relatively small headcount each of our Directors has regular opportunities to meet employees at all levels across the business. In particular, we meet frequently with senior employees in both London and Bermuda as part of our quarterly activities.

All of our staff have the opportunity to meet our Directors both at the AGM and at semi-formal lunches for employees and Directors held periodically in both London and Bermuda.

I am personally involved in the programme of dialogue which Alex and our management team conducts with our regulators, in particular the PRA, Lloyd's and the BMA, and those conversations are routinely reported back to our full Board. The business also prides itself on its engagement with the communities in which it operates, both through staff outreach programmes and through the operation of the Lancashire Foundation, which reports to the Board on its activities. Please see pages 36 to 41 of this Annual Report and Accounts for further details.

We also pride ourselves on engaging regularly with our shareholder community, not only through the regular programme of meetings organised by our management team, but also through periodic initiatives to consult with our shareholders. In particular, Simon Fraser led a consultation with our principal shareholders on the remuneration policy and implementation issues in advance of the 2017 AGM. As a Board we also meet regularly with our corporate brokers to seek their feedback on investor priorities as well as Lancashire's performance and perception amongst investors within the broader insurance sector.

### Are the Board and its Committees operating effectively?

During 2017 our Board once again carried out a review of its effectiveness which I led, facilitated by our Company Secretary (see page 48 for further details). A summary report was discussed by the full Board and we concluded that the Board, its members and each of its Committees have a balance of experience and talents that serves the Group well and have the culture and competencies necessary to meet the strategic challenges of the business effectively as we enter 2018. I have made it my practice to meet regularly with the chairs of each of our principal subsidiary boards and our review concluded that the relationship between the main

Lancashire Board and the subsidiary boards continues to operate effectively.

We have also gained useful insights and identified various areas for enhancements to the ways we operate and considered areas for training and learning during the coming year. I would like to thank all of our Directors, our management team and all employees for their hard work during the year.

**Peter Clarke**  
Non-Executive Chairman

# A 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 City Year 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 previously served as the Chairman of the National Teaching Awards Trust. Mr Clarke took a first in Law at Queens' College, Cambridge and is a qualified solicitor, having practised at Slaughter and May, and has experience in the investment banking industry, working at Morgan Grenfell and Citibank.



**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 sits on the Remuneration, 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 since 2014 has been Chairman of the Audit Committee. She is also a Non-Executive Director of Unum Ltd and Unum European Holding Company Ltd. Unum is one of the UK's leading employee benefits providers through the workplace. She also chairs their Audit Committees. Prior to this, she was Head of Environment & Sustainability and formerly Head of Environment for Anglo American plc, one of the world's leading mining and natural resources companies. She was also a director and founder of Anglo American Zimele Green Fund (Pty) Ltd, which supports entrepreneurs in South Africa. Prior to her role with Anglo American, Ms Hoe-Richardson worked in investment banking and audit and she holds a masters degree in nuclear and electrical engineering from the University of Cambridge. She also has a Chartered Accountancy qualification. Ms Hoe-Richardson is also a Non-Executive Director of LUK.



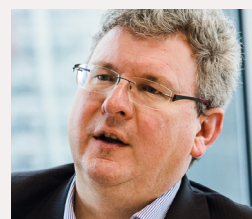
**Robert Lusardi**  
**Non-Executive Director**

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 (a private insurance entity). 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. In 2005, Mr Milligan joined Goldman Sachs Group Inc. to start the GS Reinsurance Group's non-life activities. Mr Milligan served as Chief Underwriting Officer of Arrow Capital Re and started Goldman Sachs-owned Lloyd's Syndicate 1910 in 2008, 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 and Non-Executive Chairman of Beat Capital Partners Ltd. 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

- The Board approved the appointment of Andrew McKee as a Director and CEO of CUL, subject to Lloyd's and relevant regulatory approvals. The Board also approved the appointment of Nicholas Davenport as Chairman of the Board of Directors of CUL;
- 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 2016;
- The Board approved the Group's 2017 business plan that had been updated in light of the 1 January 2017 renewals and market conditions;
- The Board approved updated UK and U.S. regulatory and tax operating guidelines for the Group;
- The Board approved the core objectives of the Lancashire Foundation for adoption by the Trustees of the Foundation;
- The Board approved the Group's 2017 framework for executive remuneration;
- The Board approved the Directors' Remuneration Policy and the Annual Report on Remuneration, as set out in the Directors' Remuneration Report for the year ended 31 December 2016, for presentation to shareholders for approval at the 2017 AGM;
- The Board approved the LHL 2017 RSS rules for presentation to shareholders for approval at the 2017 AGM; and
- The Board approved the Annual Report and Accounts 2016.

## March/Solvency II training

- Solvency II training was provided to the Non-Executive Directors as part of the structured programme delivered between 2015 and 2017.

## May/Q2 meeting

- The Board approved the Group's UK tax strategy for the year ended 31 December 2017;
- The Board approved the Solvency II submissions as at 31 December 2016 for submission to the PRA;
- The Board approved the appointment of Robert Lusardi as Chairman of the Investment Committee;
- The Board received a presentation from the Group's corporate brokers; and
- The Company's 2017 AGM was held at its Head Office on 3 May 2017. All resolutions were duly passed and approved by shareholders.

## June/Board strategy session

The objective of the 2017 strategy session was to consider the key decisions to be made in the preparation of the Group's three-year strategic plan. The agenda included:

- review of the current strategy; consideration of its continued relevance and the views of shareholders;
- review of the Group's underwriting lines of business and potential opportunities;
- presentations on the London and international specialty and reinsurance markets and alternative capital in the reinsurance market;
- consideration of soft market challenges and potential hard market issues;
- review of the business's resourcing and training needs; and
- discussion of the strategic themes and options for the business.

## July/Q3 meeting

- The Board approved the Group's three-year strategic plan, including the Group's risk appetite and capital and solvency appetite;
- The Board approved the Group's 2017 reforecast business plan in light of actual experience to 30 June 2017 and market conditions and expectations following the 1 July 2017 renewals;
- The Board declared an interim dividend of \$0.05 per common share;
- The Board approved the Group's updated ERM strategic objectives and plan;
- The Board approved amended and restated Terms of Reference of the Audit Committee;
- The Board approved an updated division of responsibilities between the Chairman and the CEO together with an amended Schedule of Board Reserved Matters, which is published on the Group's website; and
- The Board received a presentation on the fixed maturity market from one of the Group's investment managers.

## October/Q3 loss events

- The Board approved the publication of a press release in respect of the Group's preliminary loss estimates from hurricanes Harvey, Irma and Maria and the Mexican earthquakes.

## November/Q4 meeting

- The Board approved the Group's 2018 business plan;
- The Board discussed its policy on diversity;
- The Board approved a Group Solvency II Identified Staff Remuneration policy; and
- The annual performance evaluation of the Board and its Committees and individual Directors was commissioned, to be facilitated by the Company Secretary.

# Board Committees

## Board and Committee administration

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

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

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

The Board also meets to discuss strategic planning matters outside the formal meeting schedule. A Board strategic planning session was held in June 2017.

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 14 February 2018, 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.

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



## Information and training

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

## Board performance evaluation

A formal performance evaluation of the Board, its Committees and individual Directors is undertaken on an annual basis and the process is initiated by the Nomination and Corporate Governance Committee. The aim of this work is to assess the effectiveness of the Board and its Committees in terms of performance and risk oversight, strategic development, composition, supporting processes and management of the Group. The evaluation is forward-looking in terms of identifying the strategic priorities as well as considering performance, training and development needs for the Directors within the context of the work of each Committee and that of the Board. The 2015 and 2016 performance evaluations were facilitated by Lintstock Limited, a London-based corporate advisory firm with no other connection to the Group,

whilst the 2017 evaluation was conducted internally and facilitated by the Company Secretary and the Chairman.

The 2017 evaluation process involved each Director as well as the Company Secretary, the Group CRO, Group General Counsel and other members of senior management completing a questionnaire designed by the LHL Chairman and the Company Secretary with input from the Chairs of each of the relevant Committees. Responses to the completed questionnaires were collated by the Company Secretary, who prepared a suite of summary reports that were discussed in draft with the Board Chairman and Committee Chairs before being distributed to each of the Directors.

In February 2018, the performance evaluation reports were discussed at meetings of the Nomination and Corporate Governance Committee and the Board, and each of the other Committees discussed the report pertinent to its own operation and performance. The Board discussions were led by the Chairman and focused on such matters as strategic oversight, succession planning, Board composition and training and priorities for 2018.

In summary, in the Board's consideration of the 2017 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.

It was noted in the evaluation process that, in what had been a year involving significant material losses, the Board and Committee oversight of underwriting strategy and risk tolerances had operated effectively and within expectations. Engagement between

the Board and the wider body of staff is considered to be generally strong and beneficial to the operation of the business. Looking ahead, the Board and Committees will, during the course of 2018, seek to ensure that the Group holds sufficient capital and utilises capital tools to ensure that the business is well-placed to be a leading (re)insurance market participant in what may become a more dynamic underwriting environment than has been the case in recent years. In this regard the Board expects to monitor any changes to the rating agency and regulatory capital models. The Board also highlighted a number of themes which will inform the business of the Board during 2018 including the attributes required in future non-executive appointments, the benefits of a broad diversity on our Board and in our business and the ongoing need to ensure a strong succession plan to meet the requirements of the business. A number of practical steps to optimise the focus of Board and Committee meetings were also identified for action.

The Board will continue to review its procedures, training requirements, effectiveness and development during 2018.

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 2017. The discussion and feedback was positive regarding all aspects of the Chairman's performance. Particular reference was made to the strong lines of communication which have been fostered with the Chairs of the subsidiary boards 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.

Following the year end, the Chairman met with the CEO, and the CEO met with the CFO, to conduct a performance appraisal in respect of 2017 and to set targets for 2018. 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 60.

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

(1) Robert Lusardi is resident in the U.S. Due to unforeseen circumstances, he was unable to attend the meeting of the Audit Committee held in London on 21 July 2017. He was able to follow proceedings for information purposes via telephone conference. However, pursuant to the Group's strict tax and regulatory operating guidelines, he did not participate in the meeting.

### Relations with shareholders

During 2017, the Group's Head of Investor Relations, usually accompanied by one or more of the Group CEO, the Group CUO, the Group CFO, the Chairman or a senior member of the underwriting team, made presentations to major shareholders, analysts and the investor community. Formal reports of these meetings were provided to the Board on at least a quarterly basis. The Chairman of the Remuneration Committee conducted a consultation with the significant shareholders of the Group with regard to remuneration policy and practice in advance of the 2017 AGM.

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

Shareholders are invited to request meetings with the Chairman, the Senior Independent Director and/or the other Non-Executive Directors by contacting the Head of Investor Relations. All of the Directors are expected to be available to meet with shareholders at the Company's 2018 AGM.

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

### Enterprise Risk Management

The Board is responsible for setting the Group's risk appetites, defining its risk tolerances, and setting and monitoring the Company's risk management and internal control systems including compliance with risk tolerances. During 2017 the Board carried out a robust assessment of the principal risks affecting the Group's business model, future performance, solvency and liquidity and the operation of internal control systems.

Further discussion of the risks affecting the Group and the policies in place to manage them can be found in the ERM section of this report on pages 31 to 35 and in the risk disclosures section on pages 100 to 125.

Each of the Committees is responsible for various elements of risk (see the various Committee reports from page 50 to page 59 for further detail). The Group 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 Group CRO provides regular reports to the Group and subsidiary boards covering, amongst other things, actual risk levels against tolerances, emerging risks, any lessons learned from risk events and assurance provided over key risks. During 2017, the Directors participated in a number of training sessions addressing the Board's obligations under Solvency II and, in particular, with regard to the review and approval of the Solvency II submissions as at 31 December 2016 for submission to the

PRA. The Board considers that a supportive ERM culture, established at the Board and embedded throughout the business, is of key importance. The facilitating and embedding of ERM and helping the Group to improve its ERM practices are a major responsibility assigned to the Group CRO. The Group CRO's remuneration is subject to annual review by the Remuneration Committee. The Board is satisfied that the Company's risk management and internal control systems have operated effectively for the year under review.

### Committees

The Board has established Audit, Investment, Nomination and Corporate Governance, 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. The Committees' Terms of Reference were reviewed by the Board during 2017 and were considered to be in line with current best practice. The Committees are generally scheduled to meet quarterly, although additional meetings and information updates are arranged as business requirements dictate. Director attendance of the 2017 Board and Committee meetings is set out in the table appearing above. A report from each of the Committees is set out from page 50 to page 59.

# Audit Committee



**Samantha Hoe-Richardson**  
*Chairman of the Audit Committee*

During 2017 the focus of the Committee has been on the adequacy of the Group's loss reserves, as well as the transition of external auditors and the continued integrity of external financial reporting.

## 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)	4/4
Simon Fraser	4/4
Robert Lusardi <sup>1</sup>	3/4

(1) Robert Lusardi is resident in the U.S. Due to unforeseen circumstances, he was unable to attend the meeting of the Audit Committee held in London on 21 July 2017. He was able to follow proceedings for information purposes via telephone conference. However, pursuant to the Group's strict tax and regulatory operating guidelines, he did not participate in the meeting.

## Principal responsibilities of the Committee

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



## How the Committee discharged its responsibilities during 2017

### FINANCIAL REPORTING

#### COMMITTEE RESPONSIBILITY

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

#### COMMITTEE ACTIVITIES

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

- developments in accounting and financial reporting requirements;
- any new and/or significant accounting treatments/transactions in the quarter;
- the activities of LHL's subsidiary companies, including consideration of any risk issues; and
- loss reserving (see page 140 for further details).

An annual paper is presented by management to the Committee that details the areas of significant judgement and estimation in the preparation of the consolidated financial statements. (See accounting policies (page 94) for the details of these areas.) The Committee also receives quarterly reports on the consolidated financial statements from the external auditors, including an interim review report and a year-end full audit report. These are discussed with the external auditors at the Committee's meetings. With respect to the areas of judgement and estimation in the preparation of the consolidated financial statements, those that were considered by the Committee to be significant during 2017 were the estimation of ultimate loss reserves and the valuation of intangible assets. These are explained in detail on page 54. KPMG considered the valuation of intangible assets to be an elevated audit risk but not a significant audit risk. This was based on various factors, including the historic levels of headroom in the impairment testing and sensitivity analysis performed. In accordance with auditing guidance, KPMG's year-end audit report identified revenue recognition through the estimation of premium revenues as an area of significant risk. The Audit Committee considered this and concluded that, whilst some premiums are subject to estimation, revenues are unlikely to be materially different from initial estimates, particularly on a consolidated Group basis.

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

The Chairman of the Committee reviewed the early drafts of the 2017 Annual Report and Accounts in order to keep apprised of its key themes and messages. The Committee reviewed the final draft of the Annual Report and Accounts at the February 2018 Audit Committee meeting together with the external auditors' report. The Committee advised the Board that, in its view, the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

## EXTERNAL AUDIT

### COMMITTEE RESPONSIBILITY

Oversees the relationship with the Group's external auditors, approves their remuneration and terms of engagement, and assesses annually their independence and objectivity taking into account relevant legal, regulatory and professional requirements and the Group's relationship with the external auditors as a whole. This includes an annual assessment of the qualifications, expertise and resources, and independence of the external auditors and the effectiveness of the external audit process.

The development and implementation of a formal policy on the provision of non-audit services by the external auditors, taking into consideration any threats to the independence and objectivity of the external auditors.

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

### COMMITTEE ACTIVITIES

The Committee approves the annual external audit plan and receives reports from the external auditors at each quarterly Committee meeting, including an ongoing assessment of the effective performance of the audit compared to the plan. The Committee Chairman conducts informal meetings with the external auditors and the CFO prior to, during, and after the review of the quarterly results. The Committee meets quarterly in executive session with the external auditors to discuss any issues arising from the audit, and with management to obtain feedback on the audit process. The Committee conducted an assessment of the qualifications, expertise and resources, and independence of KPMG prior to recommending its appointment as external auditor in 2017. A further review was conducted in February 2018 and the Committee concluded that the external auditors are independent and objective. Due to the appointment of KPMG as new external auditors in 2017, the formal assessment of the effectiveness of the external audit process was minimal and focused on the effectiveness of the facilitation of the external audit process by Lancashire's staff. It is proposed to undertake a thorough review of KPMG's effectiveness through their first year of providing external audit services for the financial year ending 31 December 2017 during the first quarter of 2018.

The Committee has approved and adopted a formal non-audit services policy that is reviewed on an annual basis and was last updated in October 2017. The policy, which stipulates the approvals required for various types of non-audit services that may be provided by the external auditors, is on the Group's website. During 2017, KPMG provided non-audit services in relation to specified work over the distributable reserves and pre-appointment procedures on the first quarter 2017 earnings release. Fees for non-audit services provided in 2017 totalled \$20,000. The Committee gave careful consideration to the nature of the non-audit services provided and the level of fees charged, and has determined that they do not affect the independence and objectivity of KPMG as auditors.

It was disclosed in the 2016 Annual Report and Accounts that, following a competitive external audit tender process undertaken during the year, it was proposed to recommend the appointment of KPMG as external auditors by shareholders at the 2017 AGM. The recommendation was approved by shareholders and KPMG were appointed as external auditors with effect from the conclusion of the 2017 AGM. The lead audit partner is Rees Aronson. The Committee worked with KPMG during 2017 to achieve a smooth transition of external auditors and recommended to the Board the re-appointment of KPMG as external auditors at the 2018 AGM.

## INTERNAL AUDIT

### COMMITTEE RESPONSIBILITY

Monitors and reviews the effectiveness of the Group's internal audit function in the overall context of the Group's risk management system.

### COMMITTEE ACTIVITIES

The Group's internal audit function reports directly to the Committee. Each year, the Head of Internal Audit presents an annual internal audit strategy and plan to the Committee for consideration and approval. In general, the most significant business risks and controls are usually considered for audit annually whilst less critical risks are audited periodically as part of a flexible multi-year programme. The findings of each audit are reported to the Committee at the quarterly meetings and the Committee reviews the actions taken by management to implement the recommendations of internal audit. The Committee meets in executive session with the Head of Internal Audit on at least an annual basis.

During 2017, the Committee reviewed and approved an updated Internal Audit Charter. This can be viewed on the Group's website. The Group CRO undertook an annual review of the implementation of the internal audit programme during 2017 to ensure its continued efficiency and appropriate standing within the Company and the effectiveness of the internal audit function. The Committee discussed the report and its findings with the Group CRO and the Head of Internal Audit and concluded that the internal audit function is operating effectively in the overall context of the Group's risk management system.

## INTERNAL CONTROLS AND RISK MANAGEMENT SYSTEMS

### COMMITTEE RESPONSIBILITY

Reviews the adequacy and effectiveness of the Group's internal financial controls systems that identify, assess, manage and monitor financial risks, and other internal control and risk management systems; and reviews and approves the statements to be included in the Annual Report and Accounts concerning internal control, risk management and the viability statement.

### COMMITTEE ACTIVITIES

The Board has ultimate responsibility for ensuring the maintenance by the Group of a robust framework of internal control and risk management systems, and has delegated the monitoring and review of these systems to the Committee. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The Committee receives from the Head of Internal Audit an annual assessment of the Group's governance, risk and control framework together with an analysis of themes and trends from the internal audit work and their impact on the Group's risk profile. In 2017, the Committee and Board were satisfied that the governance, risk and control framework remains effective and appropriate for the Lancashire Group.

Reviews for adequacy and security the Group's compliance, 'whistleblowing' and fraud controls.

During 2017, the Committee conducted an annual review of the Group's policies and procedures relevant to financial controls and recommended the adoption by the Board of updated policies and procedures in respect of anti-money laundering, bribery and financial crime (including fraud), conflicts of interest and whistleblowing. There were no suspicious transaction or whistleblowing reports made during the year (whether arising from suspected money laundering activity or knowledge of, suspicion or concern relating to suspected acts of bribery or any other type of financial crime, dishonesty or impropriety). The Committee also keeps under review the adequacy and effectiveness of the Group's legal and compliance function.



**Significant areas of judgement or estimation****Loss reserves and expenses**

As detailed on pages 140 to 142 of the consolidated financial statements, the estimation of ultimate loss reserves is a complex actuarial process that incorporates a significant amount of judgement. The Committee considers the adequacy of the Group's loss reserves at each Audit Committee meeting, for which purpose it receives quarterly reports from the Group's Reserving Actuary. KPMG conduct a high-level review of the Group's loss reserves as part of their first and third quarter review procedures. The external independent actuary and KPMG present a comparison of Lancashire's booked reserves to their own best estimates at the second and fourth quarter Audit Committee meetings. Following the loss events in the third quarter of 2017, the Committee met with the Group's Reserving Actuary and KPMG's actuarial partner to review the adequacy of the Group's loss reserves. Management provided the Board with an analysis detailing how the loss ranges for each event were determined, and how they were challenged and supported. During 2017, 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 Group has two indefinite life intangible assets following the acquisition of Cathedral – goodwill and syndicate participation rights. Intangible assets with indefinite useful lives are subject to an impairment review at least annually, or sooner if there is an indication of impairment. Some of the key inputs in the impairment review are based on management judgement and/or estimation (see page 95 of the consolidated financial statements for further details). These inputs are reviewed by the Audit Committee annually and are considered reasonable. The Audit Committee also considers the Group's internal stress tests and what stress scenarios would have to occur to indicate an impairment of its intangible assets. As a result of these considerations the Audit Committee agreed with management and KPMG that there was no impairment of the Group's intangible assets.

**Priorities for 2018**

The Committee's key priorities for 2018 are:

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

**IFRS 17, Insurance Contracts**

During 2017 the International Accounting Standards Board issued IFRS 17, which will be mandatorily effective for annual reporting periods beginning on or after 1 January 2021. Management is in the pre-planning stage for this project and during 2017 it engaged Ernst & Young LLP to assist in the preparation of an initial operational impact assessment. KPMG provided the Audit Committee with preliminary training on IFRS 17 in the fourth quarter of 2017. During 2018 the Committee will continue to monitor the preparation by the Group for the implementation of IFRS 17.

# Nomination and Corporate Governance Committee



**Peter Clarke**  
*Chairman of the Nomination and Corporate Governance Committee*

During 2018, the Committee will continue to monitor governance developments, in particular the anticipated changes to the UK Corporate Governance Code, to ensure that the Group maintains its flexible and proactive culture to best serve the strategic needs of our 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 (Chairman)	4/4
Michael Dawson	4/4
Samantha Hoe-Richardson	4/4
Tom Milligan	4/4

## Principal responsibilities of the Committee

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

## How the Committee discharged its responsibilities during 2017

### Board composition

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

In this regard, the Committee engaged external executive search firms, which have no other connection to the Group. They identified a number of potential candidates, although no additional appointments were made to the Board during the year. In accordance with the provisions of the Code, all of the Directors are subject to annual election by shareholders. All of the Directors were re-elected by shareholders at the 2017 AGM.

The Committee recommended to the Board the appointment of Robert Lusardi as Chairman of the Investment Committee 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 and requirements of the business. One notable development to the succession plan was the introduction of a risk-weighted traffic light system to provide a 'dashboard' indication of areas in which succession risk is considered to be lower or more elevated. The Committee has continued to focus in its dialogue with management on the delivery of training and support and the development of talent across the Group. In 2017, there were further positive developments in the management of the Cathedral operations as well as a number of planned promotions within the underwriting teams.

### Subsidiary boards

The Committee monitored the composition of subsidiary boards during 2017 and recommended appointments to the boards of LICL, KCML and CUL. The Committee also recommended the appointment of Nicholas Davenport as Chairman of the Board of CUL in succession to Tony Minns.

### 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 2017, the Committee recommended the approval and adoption by the Board of an amended Schedule of Reserved Matters, and an amended and restated Terms of Reference of the Audit Committee. Copies of these documents are available on the Company's website.

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 considered statistics relevant to the gender composition of the Board, Group management excluding LHL Non-Executive Directors, and overall Group employees. These statistics are shown opposite. The Committee also reviewed comparative pay data by gender within the Lancashire Group. The Committee recommended approval by the Board of an updated diversity policy, which is posted on the Company's website. The Board remains of the view that the skills and experience needed to take the business of the Company forward are of paramount importance in selecting Board members, members of executive committees and senior management or, indeed, any role within the business. The Committee and Board recognise that there is increasingly an expectation within society, in particular as a result of the work of the Hampton-Alexander Review, that businesses should adopt a fixed percentage target for

gender diversity. Accordingly the Board has modified its previously stated position so as to adopt a goal for the representation of women on the Board of LHL and the principal management executive committee of 33 per cent by 2020. The Board does not view the new goal as a 'black line' but rather a flexible target against which the business should measure its performance and strategy. Identifying 'the best person for the job' remains paramount in identifying the right candidate. Lancashire's approach to recruitment and in particular ensuring the benefits of a broad diversity throughout the business is discussed further on page 40 in the discussion of the workplace culture.

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

### The Lancashire Foundation

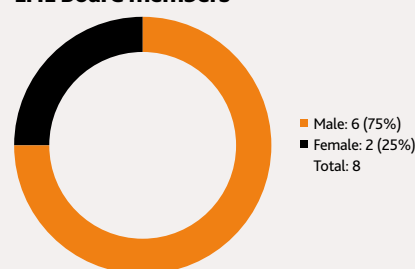
The Committee is responsible for monitoring and making recommendations to the Board in relation to the Company's charitable giving policy and the operation of, and reporting requirements for, the Lancashire Foundation. During 2017, the Committee received a report on the Foundation, including its objectives, governance, investment strategy, donations policy and charitable activities, and considered the ways in which the Foundation engages with employees throughout the Group. The Committee made a recommendation to the Board that during 2018, due to the Group's financial performance in what was a year impacted by significant catastrophe losses, there should not be a donation from the Group to the Foundation. It was, however, noted by the Committee and the Board that the Foundation had sufficient assets to implement its plans and to meeting its spending commitments over the next three years.

### Priorities for 2018

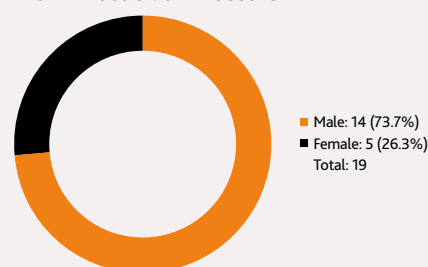
The Committee's key priorities for 2018 are:

- To continue to develop the succession plans for Directors and senior executives, in line with the Group's strategic objectives, and to support management in the development of the talent pipeline;
- To review the outcome of the 2017 performance evaluation process as it relates to the Committee and the composition of the Board, and to agree and monitor any required actions; and
- To continue the Committee's focus on corporate governance requirements, regulatory developments and compliance with the Code, specifically in light of the anticipated changes to the Code which have been tabled for industry consultation during 2018.

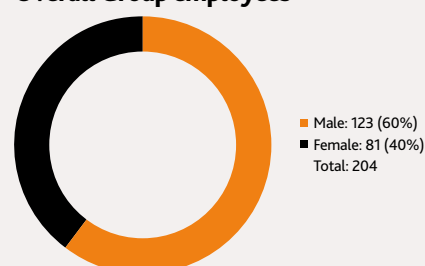
### LHL Board members



### Group management excluding LHL Non-Executive Directors



### Overall Group employees





# Investment Committee



**Robert Lusardi**  
Chairman of  
the Investment Committee

## Committee membership

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

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

(1) Peter Clarke stepped down as Chairman of the Investment Committee with effect from 3 May 2017 and was succeeded by Robert Lusardi.

Our investment philosophy is to preserve capital and to ensure liquidity in our investments while ensuring appropriate connectivity with, and support for, the Group's underwriting operations. The Group's strategy has been to remain relatively short in duration over the course of 2017 and into 2018 in anticipation of rising interest rates.

## 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; and
- Establishes and monitors compliance with investment operating guidelines relating to the custody of investments and the related internal controls.

## How the Committee discharged its responsibilities during 2017

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

The Committee focused in its discussions on the investment strategy priorities of preserving capital, ensuring the appropriate balance of risk assets and affording sufficient liquidity in the investment portfolio. These questions of investment strategy were all framed within the context of the Board's objective of ensuring appropriate connectivity with, and support for, the Group's underwriting operations.

The Committee also recommended to the Board and the boards of certain subsidiaries the appointment of a new investment manager to manage cash and cash equivalents on a Group platform.

The Committee received presentations from two of the portfolio investment managers during the year. During the fourth quarter of 2017, the Committee considered the impact on the portfolio of the payment of claims arising from the large loss events of late 2017, noting in particular that, in what had been a significant year for catastrophe losses, the portfolio had performed well in meeting the liquidity requirements of the business.

## Priorities for 2018

The Committee's key priorities for 2018 are:

- To maintain a continued focus on the preservation of capital, the maintenance of liquidity and the management of interest rate and other emerging investment risks; and
- A review of the asset allocation strategy taking into account a rising interest rate environment, market valuations, expected returns, and the current state of insurance underwriting markets.

# Underwriting and Underwriting Risk Committee



**Alex Maloney**  
Chairman of the Underwriting and Underwriting Risk Committee

## Committee membership

During 2017, 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 Deputy Group Chief Actuary (who are not Directors).

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

- (1) Jon Barnes was appointed as a member of the Underwriting and Underwriting Risk Committee with effect from 15 February 2017.
- (2) John Spence was unable to attend the 25 July 2017 meeting of the Underwriting and Underwriting Risk Committee.
- (3) Richard Williams retired as a member of the Underwriting and Underwriting Risk Committee with effect from 15 February 2017.

The Committee provides a forum for discussing the trends in the pricing and coverage terms for the market sectors in which we operate. The losses to the market in 2017 have demonstrated the value of the work which our underwriters, management and the Committee perform in managing our risk exposures through the insurance cycle.

## Principal responsibilities of the Committee

- Reviews 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; and
- Monitors underwriting risk and its consistency with the Group's risk profile and risk appetite.

## How the Committee discharged its responsibilities during 2017

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

The Committee also monitors underwriting performance on a quarterly basis. Good risk selection remains at the heart of the Group's strategy, in particular in the recent soft phase of the market cycle. The Committee also reviewed management reports on the structuring and pricing of the outwards reinsurance protections purchased across the Group. The Committee received quarterly update reports from the Active Underwriters of Syndicates 2010 and 3010, the Chief Underwriting Officers for LUK and LICL and the CEO of KCML during 2017.

The Committee also received quarterly reports of significant claims and related developments.

The Committee enhanced the reporting of new business options developed or considered by management during the course of 2017, which afforded scope for fruitful debate on risk and opportunities.

During 2017, the Committee meetings were open to attendance by all of 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 in all parts of the underwriting cycle.

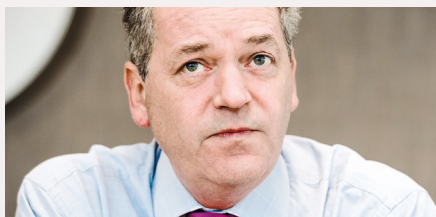
A more detailed analysis of the Group's underwriting performance appears in the Business Review section of this Annual Report and Accounts on pages 24 to 30.

## Priorities for 2018

The Committee's key priorities for 2018 are:

- To continue to monitor the development of a forward-looking and disciplined underwriting strategy appropriate for the Group's underwriting platforms, within a framework of appropriate risk tolerances; and
- 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*

## Committee membership

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

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

## Principal responsibilities of the Committee

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

The Committee seeks to implement a Remuneration Policy which ensures the retention of our most valued staff whilst affording linkage between remuneration and appropriate targets for company and personal performance. We seek to achieve a balance that avoids the incentivisation of excessive risk-taking or a culture of short-termism.

## How the Committee discharged its responsibilities during 2017

During 2017, the Committee reviewed the Group incentive packages to ensure that remuneration is structured appropriately to promote the long-term success of the Company. The Committee also reviewed the RSS structure for Executive Directors to ensure that the performance metrics continue to align the interests of the Company with its investors and management. The Committee considered the salary and bonus awards for 2017 for Executive Directors and other designated senior executives. The Committee also approved the grant of awards under the Company's RSS.

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

The Committee also reviewed the policy for Executive Directors' remuneration, which has a three-year life following its approval by shareholders at the 2017 AGM. The Committee considers the policy fit for purpose and does not propose any amendments at the 2018 AGM.

During 2017, the Committee recommended the approval and adoption by the Board of a Group Solvency II Identified Staff Remuneration policy. The Committee noted progress made during the year

on the alignment of remuneration practices across the Group and that further such alignment measures will be implemented by the management team during 2018.

The Committee also recommended changes to the companies comprising the Company's peer group for comparator purposes in light of recent M&A activity.

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

The Directors' Remuneration Policy and the Annual Report on Remuneration, for which the Committee is responsible, can be found on pages 60 to 79. The report contains a summary of the debate which has been had within the Committee and the Board on the alignment of remuneration and Group performance both in the current year and over a longer time frame.

## Priorities for 2018

The Committee's key priorities for 2018 are:

- To review the ongoing appropriateness and relevance of the Group's remuneration structures, ensuring that they are in line with the Group's business strategy, risk profile, objectives, risk management practices and long-term interests; and
- 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 2017 Directors' Remuneration Report to shareholders.

### Shareholder decisions at the 2017 AGM

Lancashire's Directors' Remuneration Policy was approved by shareholders at the May 2017 AGM. There were minor (largely housekeeping) changes to the Policy, which had previously been approved by shareholders in 2014. Shareholders also approved a set of revised rules for Lancashire's long-term incentive RSS. The replacement 2017 RSS rules have substantially the same terms as the previous scheme, but incorporated some minor changes to bring the new rules more in line with current best practice. The new 2017 RSS rules took effect from the 2017 AGM.

### Remuneration and strategy

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

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

As I reported in the 2016 Annual Report and Accounts, the Board and management believe that the insurance industry is cyclical in its fundamental characteristics. At the low point in the insurance cycle, which we witnessed throughout 2016 and the first half of 2017, the Board has sought to prioritise achieving acceptable, but more modest, returns whilst moderating overall risk levels through underwriting discipline and prudent reinsurance planning. Of equal importance has been the need to ensure that throughout the softer part of the market cycle the business has continued to service the needs of its core clients and brokers. The Board has prioritised the need 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.

### Performance outcomes for 2017 – A challenging year

On account of the severe year for insured losses, due to the sequence of major natural catastrophe losses which occurred during 2017, the Group has produced an RoE of negative 5.9 per cent, which is the only negative full year annual RoE since the Group's foundation in 2005 (see the strategy and performance reviews of this Annual Report and Accounts on pages 12 to 41).

Notwithstanding this, the Board and Committee were, on balance, satisfied with the outcomes in light of these events. Whilst the annual earnings have been impacted in comparison with previous years, there has not been a significant impairment to capital even in the

face of the number of loss events. The business is well-positioned to compete in the market as we enter 2018 in what we expect to be an improving phase of the insurance cycle. This is in no small amount down to the work and planning of our management team in delivering a portfolio of business which was better able to respond to the challenge of a series of severe loss events notwithstanding the softer rating environment in which the Group and the whole (re)insurance sector have been operating in recent years.

Against the background described above there has been a decrease in total remuneration of 49 per cent for the CEO and 47 per cent for the CFO between 2016 and 2017 (see the comparison table for single figure remuneration on page 70). This movement is driven by an RoE of negative 5.9 per cent for 2017 compared with 13.5 per cent for 2016, which affected vesting levels on the 2015 RSS awards (see below and page 73 for further details).

Executive Directors' annual bonus performance targets set at the beginning of 2017 for personal and financial performance were stretching, and given the Company's 2017 lower return in comparison with previous years (as a result of the severe catastrophe loss environment) resulted in no annual bonus in relation to the financial element which made up 75 per cent of the annual bonus opportunity. The Board did however consider that both the Executive Directors had performed strongly in managing risk within the business and in positioning the Group well for what we hope will be a better rating environment in 2018 and 2019, therefore a bonus was awarded for the personal component in respect of 2017 performance. In summary, annual bonuses for our Executive Directors were achieved substantially below target level at only 17 per cent of maximum bonus for the CEO and 18 per cent of maximum bonus for the CFO (see page 72 for further details).

In relation to long-term incentives, the 2015 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 2017. Our TSR performance (in U.S. dollars) over this period ranked the Company below the median of the designated peer group of 11 companies, resulting in 0 per cent vesting for the TSR component.

Our average RoE performance over this three-year performance period was 7.0 per cent against a threshold target of the 13-week Treasury bill rate plus 6 per cent and a maximum payout of the 13-week Treasury bill rate plus 15 per cent, resulting in 30.1 per cent of the RoE component of the 2015 Performance RSS awards vesting. Overall, the 2015 Performance RSS awards vested at 22.5 per cent. This compared with the overall 67.4 per cent vesting of the 2014 Performance RSS awards due to 89.8 per cent vesting of the RoE portion of those awards and 0 per cent vesting of the TSR portion of the awards, which we reported last year.

The total remuneration received by our Executive Directors in 2017 was accordingly significantly lower than that received in 2016 (see page 70 for the comparison data) and significantly lower than in many previous years, as demonstrated by the table 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 as to discourage excessive risk to the business.

The like-for-like employee costs for the Group were \$39.8 million in 2017 compared with \$72.1 million in 2016 (see page 78 for further detail). This 45 per cent decrease in employee costs is primarily attributed to the decrease in annual bonus and long-term incentive award grants.

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. However, in the context of the steep decline in Executive Director remuneration for 2017, when compared with previous years, it is recognised by our Executive Directors that in a significant loss-making year (due to higher than normal natural catastrophe losses) it is appropriate for their remuneration outcomes to be aligned with the fortunes of our shareholders. In the insurance sector, which is powerfully cyclical, Lancashire will continue to ensure that there remains appropriate alignment between executive remuneration and Company performance not only in loss-affected years, but also in those future years when the Group hopes to produce results more in line with its cross-cycle return target.

#### **Application of Remuneration Policy for 2018**

The Remuneration Committee has reviewed the 2017 Directors' Remuneration Policy approved by shareholders and considers it to remain fit for purpose.

The Board has decided to apply the targets for the annual bonus on substantially the same basis as agreed for 2017. For the three-year longer-term RSS incentive awards, the Committee has decided to modify the structure for the 2018 awards, whilst remaining within the bounds of our overarching shareholder-approved Policy.

The loss-making year of 2017 has had a very negative impact on the long-term RSS awards made in 2015, and is also expected to have a similar impact on the 2016 and 2017 RSS awards as we have used a rolling three-year average return to calculate the Company's performance. In fact the Board believes that management's performance in each of these years has been excellent and the financial results have been strong, given the market backdrop in 2015 and 2016 and the natural catastrophe frequency in 2017. Nevertheless, the impact of the 2017 year is expected to result in much lower levels of vesting of the long-term RSS awards granted in all these three years for senior management than the Board believes is warranted.

The Committee has decided that the best way to avoid one loss-making year having too big an impact on a series of RSS awards in the future is to separate the financial element of the award into three annual tranches. The RSS awards will still only vest after the three-year period, and the two-year subsequent holding period of course remains in place. We believe that this will help to create long-term value for our senior people in the future and avoid the problem of a big natural catastrophe year overly impacting the shares element of our remuneration structure. This will improve the retention value of the long-term incentive awards.

The Committee will also be able to exercise downwards discretion at the end of an award period if it feels that the Executive Directors have not managed the business well, including in a loss-making year falling within the performance period of an RSS award.

In addition, for our long-term RSS award TSR calculation, we are moving to an absolute TSR with a challenging threshold from the relative TSR calculation used in previous years. This is due to the radical reduction in the number of quoted peers which the Company now has as a result of M&A both in the UK and Bermuda. The Committee believes this has left the Company with no really relevant competitor group in the quoted sector and leads to unhelpful volatility in this part of the award. Further details are set out on pages 69 and 70 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 2018 and how Directors have been paid in relation to 2017.

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

**Simon Fraser**  
*Chairman of the Remuneration Committee*

### Directors' Remuneration Policy section

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

The Company's Remuneration Policy was approved by shareholders at the 2017 AGM and is effective for a period of three years from the 2017 AGM until the AGM in 2020 (or until amended by a decision of shareholders). The 2017 Remuneration Policy was developed taking into account the principles of the Code and the views of our major shareholders.

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

The Annual Report on Remuneration also details the remuneration paid to Directors in respect of the 2017 financial year in accordance with the shareholder-approved Policy.

### Governance and approach

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

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

- there is an appropriate balance between fixed and variable pay, and therefore Executive Directors are not required to earn performance-related pay to meet their day-to-day living expenses;
- there is a blend of short-term and long-term performance metrics with an appropriate mix of performance conditions, meaning that there is no undue focus on any one particular metric;
- there is a high level of share ownership amongst Executive Directors, meaning that there is a strong focus on sustainable long-term shareholder value; and

- the Company has the power to clawback 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 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.



## 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: <ul style="list-style-type: none"> <li>• role, experience and performance;</li> <li>• change in broader workforce salary;</li> <li>• changes to the size and complexity of the business; and</li> <li>• changes in responsibility or position.</li> </ul> Salaries are benchmarked periodically against insurance company peers in the UK, U.S. and in Bermuda.
Opportunity	No maximum.

### Benefits

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

### Pension

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

### Annual Bonus<sup>1,2</sup>

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 clawback if the consolidated 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	<p>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.</p> <p>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.</p>
Performance Metrics	<p>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.</p> <p><b>Financial Performance</b></p> <p>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<sup>3</sup>.</p> <p>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.</p> <p><b>Personal Performance</b></p> <p>Personal performance is based upon achievement of clearly articulated objectives. A performance rating is attributed to participating Executive Directors, which determines the payout for this part of the bonus.</p>
<b>Long Term Incentives (LTI)</b>	
Purpose and Link to Strategy	<p>Rewards Executive Directors for achieving superior returns for shareholders over a longer time frame.</p> <p>Enables Executive Directors to build a meaningful shareholding over time and align goals with shareholders.</p>
Operation <sup>2,3</sup>	<p>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.</p> <p>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.</p> <p>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.</p> <p>Awards are subject to clawback if there is a material misstatement in the Company's consolidated 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.</p> <p>A dividend equivalent provision operates enabling dividends to be accrued (in cash or shares) on RSS awards up to the point of exercise.</p> <p>The Committee has the discretion, in exceptional circumstances, to settle an award made to Executive Directors in cash.</p> <p>A two-year post-vesting holding period applies to awards made to Executive Directors since 2016.</p>
Opportunity	<p>Award levels are determined primarily by seniority. A maximum individual grant limit of 350 per cent of salary applies.</p> <p>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.</p>
Performance Metrics	<p>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.</p> <p>These may include measures such as TSR, RoE/BVS, Company profitability, or any other relevant financial measures.</p> <p>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.</p> <p>A sliding scale of targets applies for financial metrics with no more than 25 per cent vesting for threshold performance.</p> <p>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.</p>

## Remuneration Policy table continued

### Share Ownership Guidelines<sup>4</sup>

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

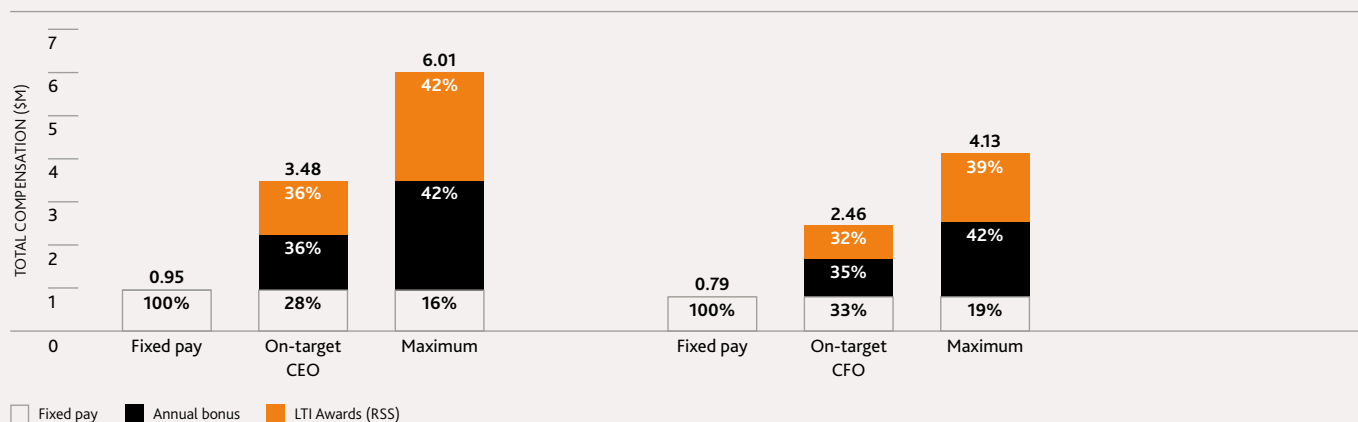
### Chairman and Non-Executive Directors' fees

Purpose and Link to Strategy	Helps recruit, motivate and retain a Chairman and Non-Executive Directors of a high calibre by offering a market competitive fee level.
Operation	<p>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.</p> <p>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.</p> <p>Any reasonable business-related expenses (including any personal tax payable) can be reimbursed.</p>
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 18 to 19 or others described within the Annual Report and Accounts Glossary commencing on page 153 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 2018 at different levels of performance under the Directors' Remuneration Policy.



Fixed pay = 2018 Salary + Actual Value of 2017 Benefits + 2018 Pension Contribution.

On-target = Fixed Pay + Target Bonus (being half the Maximum Bonus Opportunity) + Target Value of 2018 RSS grant (assuming 50 per cent vesting with face values of grant).

Maximum = Fixed Pay + Maximum Bonus Opportunity + Maximum Value of 2018 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 the current Policy which was subsequently approved by shareholders at the 2017 AGM, and to employees of the Company who are not Directors at the date of grant. Outstanding RSS awards that remain unvested or unexercised at the date of this report (including for current Executive Directors as detailed on page 74 of the Annual Report on Remuneration) remain eligible for vesting or exercise based on their original award terms.

## Annual Report on Remuneration

This Annual Report on Remuneration together with the Chairman's Statement, as detailed on pages 60 and 61, will be subject to an advisory vote at the 2018 AGM. The information on page 70 with respect to Directors' emoluments and onwards through page 79 has been audited by KPMG.

### Implementation of Remuneration Policy for 2018

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 2018.

#### Base salary and fees

##### *Executive Directors*

Increases and resulting salaries effective from 1 January 2018 are set out below:

- CEO – salary increased by 3 per cent to \$844,135.
- CFO – salary increased by 3 per cent to \$579,640.
- For 2018, increases of 3 per cent are in line with the salary increases for Group employees.

##### *Non-Executive Directors*

The Chairman's and Non-Executive Directors' fees are as follows for 2018:

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

##### *Other Fees*

- Samantha Hoe-Richardson is a Non-Executive Director of LUK in which capacity she will receive a fee of \$64,500 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 2018, the CEO and CFO will have a target bonus of 150 per cent of salary and, therefore, a maximum opportunity of 300 per cent of salary. This is within the approved policy limit and 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 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 14 and 15 of this Annual Report and Accounts). For 2018, the financial component for annual bonus is to be based on the performance of the Group's RoE, measured as the internal rate of return of the change in FCBVS plus accrued dividends.

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

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

There shall be linear interpolation between these points. The Board considers that these target ranges are appropriately challenging, given the current insurance market conditions, and will help to ensure a strong link between remuneration for the Executive Directors and the Company's financial performance, the strategy and risk profile of the business and the investment return environment, without encouraging excessive risk-taking. In future years, the Committee would not normally expect to set reference 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 2018 personal objectives for each Executive Director.

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

The personal targets 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 2018 annual performance reviews, each Executive Director will receive a performance rating which will determine the level of personal performance bonus payout for which each Executive Director will be eligible.

### Restricted Share Scheme

#### Performance Conditions

For Executive Directors, 2018 RSS awards are subject to a range based on (i) annual growth in FCBVS plus accrued dividends and (ii) absolute TSR performance conditions, both measured by reference to a period ending on 31 December 2020. These metrics aim to provide an appropriate focus on the Company's underlying financial performance and cycle management, and in the case of absolute TSR to provide an objective reward for delivering value to shareholders.

#### Weighting

For 2018, the weighting is 85 per cent on annual growth in FCBVS plus accrued dividends and 15 per cent on absolute TSR.

#### Target ranges

The annual growth in FCBVS plus accrued dividends target range for 2018 awards is:

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

Within the three-year performance period each of the separate financial years will be treated as a separate element, each one contributing one-third to the overall outcome of the vesting of this element of the RSS award. In each year performance will be measured against the target range to determine the ultimate level of vesting in respect of one-third of the RSS award. Vesting will only occur after completion of the full three-year performance period, and continued employment of the Executive Director at the time of vesting. This change in the 2018 RSS award is intended to ensure that any single year which is significantly affected by catastrophe losses does not substantially diminish the long-term incentive and retention value of all subsisting RSS awards. Please see the Chairman's Statement on pages 60 and 61 for a further discussion of the rationale for the changes to the 2018 RSS awards.

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

The Board and Committee consider that the maximum target represents exceptional performance, particularly in light of the challenging market conditions and significant insured loss environment experienced in 2017. 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.

#### Overriding downwards discretion

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

The TSR target range for 2018 awards is:

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

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

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

## Shareholder consultation in respect of 2018 RSS awards

The Chairman of the Remuneration Committee consulted with a number of major shareholders before the Committee and Board approved these changes. The Board considers that these developments improve long-term alignment between Executive Directors and the Company's shareholders.

## Award levels

2018 RSS award levels are as follows:

- CEO – shares to the value of \$2,532,405 (being 300 per cent of salary)
- CFO – shares to the value of \$1,594,010 (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 2017 and 31 December 2016.

Executive Directors		Salary \$	Pension \$	Taxable Benefits <sup>1</sup> \$	Annual Bonus <sup>5,6</sup> \$	Long-Term Incentives (RSS) <sup>2,3</sup> \$	Total <sup>4</sup> \$
Alex Maloney <sup>4</sup> , CEO	2017	811,311	81,227	21,910	420,000	601,925	1,936,373
	2016	810,266	81,027	20,127	1,825,627	1,063,364	3,800,411
Elaine Whelan <sup>4</sup> , CFO	2017	562,268	56,275	155,960	310,000	414,458	1,498,961
	2016	547,423	54,636	114,445	1,253,598	880,831	2,850,933

- (1) Benefits comprise Bermudian payroll taxes, social insurance, medical, dental and vision coverage and housing and other allowances paid by the Company for expatriates (as is the case for the CFO), but exclude UK National Insurance contributions.
- (2) For 2017, the long-term incentive values are based on the 2015 RSS awards which vest at 22.5 per cent on 15 February 2018 and are based on a three-year performance period that ended on 31 December 2017. The values are based on the average share price for the last quarter of 2017 and include the value of dividends accrued on vested shares.
- (3) For 2016, the long-term incentive values were based on the 2014 RSS awards which vested at 67.4 per cent on 16 February 2017 and were based on a three-year performance period that ended on 31 December 2016. The values are re-presented from the 2016 Annual Report and Accounts based on the share price at the vesting date, 16 February 2017, 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 1.2806 for the year as they are set in U.S. dollars.
- (5) Bonus targets were set at the beginning of 2017 and based on a clear split between Company financial performance and personal performance on a 75:25 basis. Company financial performance is based on absolute financial performance against the RFRoR. The Company financial performance component paid out at 0 per cent of target as the RoE was negative 5.9 per cent against a target level of RFRoR +8 per cent. The personal element of Executive Directors' bonus opportunity was the only bonus element to payout; however this element was also paid out at a modified rate considering the significant loss year experienced. Final bonus payout to Executive Directors will be 17 per cent of the maximum for the CEO and 18 per cent of the maximum for the CFO. For full details of Executive Directors' bonuses and the associated performance delivered see pages 71 and 72. 25 per cent of Executive Directors' annual bonus is deferred into RSS awards without performance conditions, vesting at 33.3 per cent over a three-year period.
- (6) Annual bonus figures for the Executive Directors for 2016 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 2017, after the 2016 Directors' Remuneration Report was published. For 2016, 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 188 per cent of target (with final bonus payout being 76 per cent of the maximum for the CEO and CFO).

## Non-Executive Directors' fees

		Fee \$	Other \$	Total \$
<b>Current Non-Executive Directors</b>				
Peter Clarke <sup>1</sup>	2017	350,000	–	350,000
	2016	290,769	–	290,769
Michael Dawson <sup>2</sup>	2017	175,000	–	175,000
	2016	28,269	–	28,269
Simon Fraser <sup>3</sup>	2017	175,000	80,000	255,000
	2016	175,000	66,974	241,974
Samantha Hoe-Richardson <sup>4</sup>	2017	175,000	64,500	239,500
	2016	175,000	13,350	188,350
Robert Lusardi <sup>5</sup>	2017	175,000	–	175,000
	2016	84,808	–	84,808
Tom Milligan <sup>6</sup>	2017	175,000	–	175,000
	2016	175,000	–	175,000
<b>Former Non-Executive Directors</b>				
Emma Duncan <sup>7</sup>	2017	–	–	–
	2016	91,538	–	91,538
Martin Thomas <sup>8</sup>	2017	–	–	–
	2016	111,250	34,375	145,625

(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 were 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 were 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 were 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 were 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 were proportionally pro-rated for the year.

(6) Tom Milligan was appointed as a Non-Executive Director with effect from 3 February 2015.

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

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

## 2018 annual bonus payments in respect of 2017 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 negative 5.9 per cent.



## Directors' Remuneration Report continued

### Financial performance

75 per cent of the 2017 bonus was based on Company performance conditions and the extent to which these were achieved is as follows:

Performance Measure	Financial Performance Weighting (of total bonus) %	Threshold %	Target %	Max %	Actual performance %	% payout
Absolute RoE	75	RFRoR +6%	RFRoR +8%	RFRoR +14%	-5.9	0% of target payable in respect of Company performance

In 2017 there was a higher than average frequency and severity of material natural catastrophe losses which resulted in the Lancashire Group delivering the lowest financial return since its inception in 2005. Bonus targets were set at the beginning of 2017 and based on a clear split between Company financial performance and personal performance on a 75:25 basis. The Company financial performance component did not payout at all (i.e. zero per cent of target) as RoE was negative 5.9 per cent against a target level of RFRoR +8 per cent and a threshold of RFRoR +6 per cent.

### Personal performance

25 per cent of the 2017 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 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 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 2017 annual performance reviews of each Executive Director, a performance rating was assigned to determine the level of bonus payout for which each Executive Director was eligible; however this element was paid out at a modified rate considering the significant loss year experienced.

Notwithstanding the financial performance of the Group in what was a significant year for catastrophe loss activity (in this regard please see the strategy and performance sections on pages 12 to 41 of this Annual Report and Accounts) the Executive Directors each achieved a strong performance rating against their objectives, in particular in delivering an underwriting portfolio which operated in such a way as to moderate loss exposures through a combination of underwriting discipline and a carefully structured reinsurance programme. The leadership of the Executive Directors in delivering a team of employees with strong professional skills at all levels throughout the Group is considered by the Board to position the business well for the challenges and opportunities which lie ahead. For the 2017 performance against personal objectives, the ratings were determined following a process for the evaluation of performance of the Executive Directors against the agreed personal targets and discussion and agreement of the outcomes with the Chairman and members of the Board. The outcomes are expressed as a percentage of the maximum award as illustrated in the table below.

A table of performance measures and total 2017 bonus achievement is set out below:

Executive Director	Financial performance (max % of total bonus) %	Personal performance (max % of total bonus) %	Bonus % of maximum awarded %	Total bonus value <sup>1</sup> \$	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) <sup>1</sup> \$
Alex Maloney	75	25	17	420,000	315,000	105,000
Elaine Whelan	75	25	18	310,000	232,500	77,500

- (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 2019, 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 – 2015 RSS awards

The 2015 RSS awards were based on a three-year performance period ending on 31 December 2017 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 22.5 per cent, and the actual number of awards vesting (with their estimated value).

Performance level	TSR (relative to a comparator group of 11 companies) (relevant to 25% of the 2015 RSS awards)		Average annual RoE (over three years in excess of 13-week Treasury bill rate) (relevant to 75% of the 2015 RSS awards)	
	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	7.0	30.1

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 <sup>2</sup> \$	Value of shares including dividend accrual <sup>1</sup> \$
Alex Maloney	244,208	189,261	54,947	129,799	601,925
Elaine Whelan	168,149	130,315	37,834	89,373	414,458

- (1) The value of the vested shares is based on the 2015 RSS awards which vest at 22.5 per cent on 15 February 2018 and are based on a three-year performance period that ended on 31 December 2017. The values are provisionally based on the average share price of the last quarter of 2017 (being \$8.59 based on the exchange rate of 1.242). The values will be re-presented in 2018 with the value at the vesting date. The vested awards are subject to the clawback provision set out on page 64.
- (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 14 March 2017.

Executive Director	Grant date <sup>2</sup>	Number of awards granted during the year	Face value of awards granted during the year <sup>1,3</sup> \$	% vesting at threshold performance
Alex Maloney	14-Mar-2017	286,666	2,458,640	25
Elaine Whelan	14-Mar-2017	180,441	1,547,583	25

- (1) The awards were based on the five-day average closing share price prior to the award date, being £7.02 (a share price of \$8.57 based on the exchange rate of 1.2214) and the awards were granted as nil-cost options.
- (2) These awards are due to vest subject to performance conditions being met at the end of the performance period ending 31 December 2019 and become exercisable in the first open period following the release of the Company's 2019 year-end results after the meeting of the Board in February 2020.
- (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 2017 year.

**Details of all outstanding share awards**

In addition to awards made during the 2017 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 <sup>1</sup>	Exercise price	Awards held at 1-Jan-17	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-17	End of performance period
Alex Maloney, Group CEO	Performance RSS <sup>2,3</sup>	19-Feb-14	–	124,333	–	83,801	40,532	83,801	–	31-Dec-16
	Deferred Bonus RSS <sup>4</sup>	5-Mar-14	–	9,810	–	9,810	–	9,810	–	
	Performance RSS <sup>2,3</sup>	12-Feb-15	–	244,208	–	–	–	–	244,208	31-Dec-17
	Deferred Bonus RSS <sup>4</sup>	20-Mar-15	–	27,953	–	13,977	–	13,977	13,976	
	Performance RSS <sup>2,3</sup>	18-Feb-16	–	219,254	–	–	–	–	219,254	31-Dec-18
	Deferred Bonus RSS <sup>4</sup>	11-Mar-16	–	56,224	–	18,741	–	18,741	37,483	
	Performance RSS <sup>2,3</sup>	14-Mar-17	–	–	286,666	–	–	–	286,666	31-Dec-19
	Deferred Bonus RSS <sup>4</sup>	14-Mar-17	–	–	53,215	–	–	–	53,215	
<b>Total</b>				<b>681,782</b>	<b>339,881</b>	<b>126,329</b>	<b>40,532</b>	<b>126,329</b>	<b>854,802</b>	
Elaine Whelan, Group CFO & LICL CEO	Performance RSS <sup>2,3</sup>	19-Feb-14	–	102,989	–	69,416	33,573	69,416	–	31-Dec-16
	Deferred Bonus RSS <sup>4</sup>	5-Mar-14	–	7,986	–	7,986	–	7,986	–	
	Performance RSS <sup>2,3</sup>	12-Feb-15	–	168,149	–	–	–	–	168,149	31-Dec-17
	Deferred Bonus RSS <sup>4</sup>	20-Mar-15	–	19,693	–	9,846	–	9,846	9,847	
	Performance RSS <sup>2,3</sup>	18-Feb-16	–	157,104	–	–	–	–	157,104	31-Dec-18
	Deferred Bonus RSS <sup>4</sup>	11-Mar-16	–	38,607	–	12,869	–	12,869	25,738	
	Performance RSS <sup>2,3</sup>	14-Mar-17	–	–	180,441	–	–	–	180,441	31-Dec-19
	Deferred Bonus RSS <sup>4</sup>	14-Mar-17	–	–	36,541	–	–	–	36,541	
<b>Total</b>				<b>494,528</b>	<b>216,982</b>	<b>100,117</b>	<b>33,573</b>	<b>100,117</b>	<b>577,820</b>	

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

- 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
- 14 March 2017 £7.02

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

- 25 per cent of each award is subject to a performance condition measuring the TSR performance of the Company against the TSR performance of a select group of comparator companies (see page 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 75, 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 75. 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 – 15 February 2018;
- 2016 – first open period following the release of the Company's 2018 year-end results; and
- 2017 – first open period following the release of the Company's 2019 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 2014 to 2017 Deferred Bonus awards, are as follows:

- 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;
- 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; and
- 2017 – 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 2017, 2018 and 2019.



**Relative TSR targets for RSS (25 per cent weighting)**

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

**RoE targets for RSS (75 per cent weighting)**

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

\* Average annual growth in FCBVS plus accrued dividends.

**Absolute TSR targets for RSS (15 per cent weighting)**

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

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

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

\* See page 69 and 70 for the vesting methodology to be applied for the 2018 RSS awards.

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

Peer Companies <sup>11</sup>	2014 awards	2015 awards	2016 awards	2017 awards
Amlin plc <sup>1</sup>	X	X	–	–
Arch Capital Group Limited <sup>2, 4</sup>	–	–	X	X
Argo Group International Holdings, Ltd.	X	X	X	X
Aspen Insurance Holdings Limited	X	X	X	X
Axis Capital Holdings Limited	X	X	X	X
Beazley plc	X	X	X	X
Catlin Group Ltd. <sup>3</sup>	X	–	–	–
Endurance Specialty Holdings Ltd. <sup>4, 7</sup>	X	X	X	–
Everest Re Group, Ltd. <sup>5</sup>	–	X	X	X
The Hanover Insurance Group <sup>6</sup>	–	X	X	X
Hiscox Ltd.	X	X	X	X
Montpelier Re Holdings Ltd. <sup>7</sup>	X	–	–	–
Novae Group plc <sup>8, 9</sup>	–	X	X	X
Renaissance Re Holdings Ltd.	X	X	X	X
Validus Holdings Ltd. <sup>10</sup>	X	X	X	X
XL Group Ltd <sup>9</sup>	–	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 Ltd. with effect from 1 May 2015 and so was used as a comparator company up to 31 December 2014 and was replaced by Novae Group plc.
- (4) Sampo 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.
- (9) Novae Group plc was acquired by Axis Capital Holdings Limited with effect from 2 October 2017 and so was used as a comparator company up to 30 June 2017 and was replaced by XL Group Ltd as of 1 July 2017.
- (10) American International Group, Inc. announced on 22 January 2018 that it is set to acquire Validus Holdings Ltd.; a replacement within the peer group of companies effective 1 January 2018 has not yet been identified but consideration of this has been initiated.
- (11) For 2018 RSS awards the Board adopted a range of absolute TSR targets. See page 70 for further details.

## Directors' shareholdings and share interests

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

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

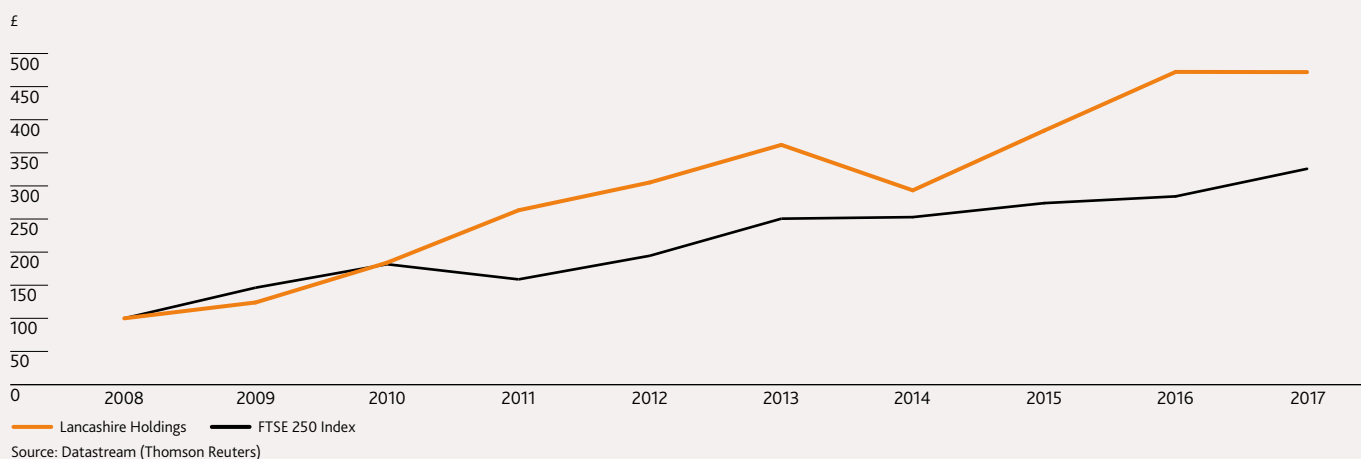
		Number of Common Shares					
		Total as at 1 January 2017		As at 31 December 2017			
Directors		Legally owned	Subject to deferral under the RSS	Subject to performance conditions under the RSS	Vested but unexercised awards under other share-based plans	Total	Shareholding guideline achieved?
Alex Maloney	1,195,294	580,302	104,674	750,128	N/A	1,435,104	Yes
Elaine Whelan	923,504	524,370	72,126	505,694	N/A	1,102,190	Yes
Peter Clarke	14,000	44,000	N/A	N/A	N/A	44,000	N/A
Michael Dawson	–	7,200	N/A	N/A	N/A	7,200	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	3,000	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

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

## Performance graph

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

### TOTAL SHAREHOLDER RETURN



This graph shows the value, by 31 December 2017, of £100 invested in LHL on 31 December 2008 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year ends.



### Total Remuneration History for CEO

The table below sets out the total single figure remuneration for the CEOs over the last nine 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 <sup>1</sup>	Alex Maloney 2014 <sup>2</sup>	2015	2016	2017
Total remuneration (\$'000s)	7,244	9,945	9,623	10,460	10,175	10,072	2,405	3,853	3,800 <sup>4</sup>	1,936
Annual bonus (%)	68	94	73	73	80	80	73	72	76 <sup>4</sup>	17
LTI vesting (%)	N/A	99.6	100	99	100	61 <sup>3</sup>	50	75	67	22.5

- (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 2016 total remuneration and annual bonus percentage have been re-presented in the above table to reflect changes made after the publication of the 2016 Annual Report and Accounts. These changes are primarily due to the disclosed relative RoE performance which impacted his annual bonus figure for 2016 and the re-presentation of his LTI award vesting and dividend accrual value at the vesting date, as disclosed on page 70.

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

### Percentage change in CEO remuneration

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

	Year-on-year change CEO <sup>2</sup> %	Average year-on-year change employees <sup>1,3</sup> %
Base salary	0	8
Benefits	2	8
Bonus	(77)	(79)

- (1) Employee numbers were calculated on a per permanent employee headcount basis for the years ending 31 December 2017 and 31 December 2016, adjusted for any joiners and leavers during this period.
- (2) The underlying salary increase from 2016 to 2017 for the CEO was 3 per cent. However some amounts were paid in Sterling and converted at the average exchange rate of 1.2806 for the year, which has resulted in the overall 0 per cent base salary year-on-year change above.
- (3) The underlying salary increase from 2016 to 2017 for Group employees was 3 per cent. The 8 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 2017 compared with the year ended 31 December 2016.

	2017 \$m	2016 \$m	Percentage change %
Employee remuneration costs	39.8	72.1	(45)
Dividends	29.9	178.9	(83)

### Committee members, attendees and advice

For Remuneration Committee membership and attendance at meetings through 2017, please refer to page 59 of this Annual Report and Accounts. The Remuneration Committee's responsibilities are contained in its Terms of Reference, a copy of which is available on the Company's website. These responsibilities include determining the framework for the remuneration, including pension arrangements, for all Executive Directors, the Chairman and senior executives. The Committee is also responsible for approving employment contracts for senior executives.

### Remuneration Committee adviser

The Remuneration Committee is advised by 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 from 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 2017 were \$68,072 (2016 – \$159,473). Fees are predominantly charged on a 'time spent' basis.

### Engagement with shareholders

Details of votes cast for and against the resolution to approve last year's Remuneration Report are shown below along with the votes to approve the 2017 Remuneration Policy which have been stated below; any matters discussed with shareholders during the year are provided in the Implementation of Remuneration Policy for 2018 section of the report starting on page 68.

	Vote to approve 2016 Annual Report on Remuneration		Vote to approve 2017-2019 Remuneration Policy	
	Total number of votes	% of votes cast	Total number of votes	% of votes cast
For	143,579,559	94.6	144,229,951	94.8
Against	8,228,480	5.4	7,870,777	5.2
Total	151,808,039	100.0	152,100,728	100.0
Abstentions	9,418,682		9,125,993	

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

**Simon Fraser**

*Chairman of the Remuneration Committee*

14 February 2018

### 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 2017, the following dividends were declared:

- an interim dividend of \$0.05 per common share was declared on 26 July 2017 and paid on 6 September 2017 in pounds sterling at the pound/U.S. dollar exchange rate of 1.2965 or £0.0386 per common share; and
- a final dividend of \$0.10 per common share was declared on 14 February 2018 to be paid on 21 March 2018 in pounds sterling at the pound/U.S. dollar exchange rate on the record date of 23 February 2018 or approximately £0.07 per common share.

### Dividend policy

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

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

### Current Directors

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



## Directors' interests

The Directors' beneficial interests in the Company's common shares as at 31 December 2017 and 2016 including interests held by family members were as follows:

Directors	Common shares held as at 31 December 2017	Common shares held as at 31 December 2016
Peter Clarke <sup>1</sup>	44,000	14,000
Michael Dawson <sup>2</sup>	7,200	–
Simon Fraser	1,000	1,000
Samantha Hoe-Richardson	3,947	3,947
Robert Lusardi	3,000	3,000
Alex Maloney <sup>3</sup>	580,302	513,512
Tom Milligan	1,000	1,000
Elaine Whelan <sup>4</sup>	524,370	428,976

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 2017:
  - 2 November – purchase of 30,000 shares at a price of £7.46 costing £223,791.
- (2) Michael Dawson conducted the following transactions in the Company's shares during 2017:
  - 28 February – purchase of 7,200 shares at a price of £6.93 costing £49,896.
- (3) Includes 100,000 shares owned by his spouse, Amanda Maloney. Alex Maloney conducted the following transactions in the Company's shares during 2017:
  - 29 March – exercise of 83,801 RSS awards and 42,528 deferred bonus RSS awards and related sale of 59,539 shares to cover tax liabilities, at a price of £6.72 realising £400,310.
- (4) Includes 11,590 shares owned by her spouse, Kilian Whelan. Elaine Whelan conducted the following transactions in the Company's shares during 2017:
  - 27 February – exercise of 69,416 RSS awards and 30,701 deferred bonus RSS awards and related sale of 4,723 shares to cover tax liabilities, at a price of £6.90 realising £32,606.

## Transactions in own shares

The Company did not repurchase any of its own common shares during 2017 or 2016.

The Group's current repurchase programme has 20,134,191 common shares remaining to be purchased as at 31 December 2017 (approximately \$172.7 million at the 31 December 2017 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 147. The repurchase programme is subject to renewal at the 2018 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 60 to 79.

## Substantial shareholders

As at 14 February 2018, 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 14 February 2018	% of shares in issue
Invesco Limited	36,515,214	18.1
Setanta Asset Management Limited	18,023,741	9.0
Wellington Management	11,359,428	5.6
Dimensional Fund Advisors LP	9,501,507	4.7
Frank W. Cawood	9,302,300	4.6
Franklin Mutual Advisers, LLC	7,639,246	3.8
The Vanguard Group, Inc	7,397,922	3.7
BlackRock, Inc.	6,990,810	3.5
Troy Asset Management Limited	6,864,893	3.4

**Corporate governance – compliance statement**

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

The Company confirms, in accordance with the principle of 'comply or explain', that the Board considers that the Company has complied with the principles and provisions as set out in the Code throughout the year ended 31 December 2017. With regard to the diversity policy for the Group and its implementation please see the report of the Nomination and Corporate Governance Committee, specifically page 56.

**Donations**

In June 2017 the Company made a cash donation of \$702,358 to the Lancashire Foundation.

The Foundation owns 330,713 common shares in the Company and during the 2017 calendar year received dividends of £39,090 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 2017 can be found in the Corporate Responsibility section on pages 36 to 41.

The Group did not make any political donations or expenditure during 2017 or 2016.

**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, bullying or harassment 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, including labour standards, working conditions and benefits, are available to all employees in the staff handbook, which is available on the Group's intranet and provided to all new staff during their induction.

**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 100 to 125 of the consolidated financial statements. The Group's use of derivative financial instruments can be found on pages 114 to 116.

**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 2018 AGM, to be held on 2 May 2018 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 100, 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 via a detailed three-year business plan considered by the Board at the November and February meetings. 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 2018 ORSA report. The three-year strategic plan was last approved by the Board in July 2017 and the detailed business plan was approved by the Board at the November 2017 meeting. The Board receives quarterly reports from the Group CRO and sets, approves and monitors risk tolerances for the business. The Board will receive the Group's 2018 ORSA report during the first quarter 2018 for review and challenge.

During 2017, 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 2020, being the period considered under the Group's current three-year business plan and the Group's 2018 ORSA report.

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 2020. 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 2018 AGM to re-appoint KPMG LLP as the Company's auditors and to authorise the Directors to set the auditors' remuneration.

### Disclosure of information to the auditors

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

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

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

**Christopher Head**  
Company Secretary

14 February 2018

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

14 February 2018



## 1 Our opinion is unmodified

We have audited the consolidated financial statements of Lancashire Holdings Limited ("the Group") for the year ended 31 December 2017 which comprise the consolidated balance sheet as at 31 December 2017, the consolidated statements of comprehensive (loss) income, changes in shareholders' equity and cash flows for the year then ended, and the related notes, including the accounting policies.

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 2017 and of its loss for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

## Basis for opinion

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

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

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

In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, were as follows:

**Valuation of gross and net insurance contract liabilities for losses and loss adjustment expenses (\$933.5m gross, \$649.4m net; 2016: \$679.8m gross, \$543.1m net)**

Refer to page 51 (Audit Committee report), page 97 (accounting policy) and pages 140 to 142 (financial disclosures)

Risk	Response
<p>The Group maintains reserves to cover the estimated ultimate cost of settling all losses and loss adjustment expenses arising from events which have occurred up to the balance sheet date, regardless of whether those losses have been reported to the Group.</p> <p><b>Subjective valuation</b></p> <p>The valuation of loss reserves is a complex process which requires the exercise of significant judgement. Key judgements relate to the assumptions applied in setting the estimates of both the gross and net liabilities that have been incurred but not reported, and assessing the evidence for the release or strengthening of provisions for claims.</p> <p>We also consider there to be greater judgement associated with reserves held for classes of business where losses tend to relate to low frequency high severity events, which limits the availability of historical loss data for use in calculating expected ultimate losses. For these classes in particular, there is a greater level of required judgement in estimating the initial expected loss ratios in the most recent underwriting years.</p>	<p>We have used our own actuarial specialists to assist us in performing our procedures in this area.</p> <p>Our procedures included:</p> <ul style="list-style-type: none"> <li>• <b>Methodology choice</b> Assessing and challenging the reserving methodology (on a gross basis and net of outwards reinsurance) based on our knowledge and understanding of the reserving policy within the Group. This has also involved comparing the Group's reserving methodology with industry practice and understanding the rationale for key differences.</li> <li>• <b>Historical experience</b> Challenging the quality of the Group's historical reserving estimates by monitoring the development of losses against initial estimates.</li> <li>• <b>Independent re-performance</b> Applying our own assumptions, across all classes of business, to perform re-projections on the insurance contract liabilities for loss and loss adjustment expenses on both a gross and net basis and comparing these to the Group's projected results. Where there were significant variances in the results, we have challenged the Group's assumptions. Our independent re-projections focussed on classes of business where losses tend to relate to low frequency high severity events.</li> <li>• <b>Benchmarking assumptions</b> Assessing and challenging the reserving assumptions by comparing the Group's loss experience to peers in the market, on a gross and net basis, including on a contract by contract basis for large loss and catastrophe events.</li> </ul>

## Premiums which are estimated or earned based on non-standard profiles, included in gross premiums written (2017: \$591.6m, 2016: \$633.9m)

Refer to page 51 (Audit Committee report), page 96 (accounting policy) and pages 102 to 106 (financial disclosures)

Risk	Response
<p><b>Subjective estimate</b></p> <p>Pricing for certain contracts is based on a best estimate of ultimate premiums as a result of premiums being based upon future events which are unknown at the balance sheet date. Judgement is involved in determining the ultimate estimates in order to establish the appropriate premium value and, ultimately, the cash to be received. As updated information is received over the life of the contract, adjustments are made to the premium recognised.</p> <p>There is also judgement required in determining the appropriate earnings profile to be applied to each contract, particularly where standard (straight line over the contract period) earning profiles are not applied.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> <li>• <b>Control operation</b> Testing the design, implementation and operating effectiveness of key controls over the periodic review of premium estimates booked.</li> <li>• <b>Historical comparisons</b> Performing procedures to understand the development of estimated premium income by comparing the Group's estimated premium income to actual premium income once received and verifying actual premium income back to source documentation for a sample of policies.</li> <li>• <b>Assessing application</b> Assessing the appropriateness of non-standard earnings profiles applied in the context of the type of contracts being written and practice across the market.</li> </ul>

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

Materiality for the consolidated financial statements as a whole was set at \$7.0 million, determined with reference to a benchmark of normalised profit before tax of \$139.2 million, of which it represents 5.0 per cent. This was computed by averaging the last five years of profit before tax to allow for fluctuations in the business cycle.

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

We subjected 8 of the 9 components, including the parent company, UK insurance company, Bermuda insurance company and Lloyd's operations to full scope audits for group reporting purposes. Including the audit of the consolidation adjustments our scope covered 100 per cent of gross premiums written, loss before tax and total assets.

The work on 7 of the 8 components was performed by component auditors and the other one, which was the parent company, was performed by the Group audit team. The Group audit team instructed the component auditors, based in the UK and Bermuda, as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group audit team approved the component materialities, which ranged from \$9,500 to \$3.8 million having regard to the size and risk profile of the various components across the Group. The Group audit team visited all component locations in Bermuda and the UK. Video and telephone conference meetings were also held with these component auditors. At these visits and meetings, the findings reported to the Group audit team were discussed in more detail, and any further work required by the Group audit team was then performed by the component auditors.

#### **4 We have nothing to report on going concern**

We are required to report to you if we have anything material to add or draw attention to in relation to the Directors' statement on page 83 of the Annual Report and Accounts on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group's use of that basis for a period of at least twelve months from the date of approval of the financial statements.

We have nothing to report in this respect.

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

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

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

#### **Directors' Remuneration Report**

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

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

#### **Disclosures of principal risks and longer-term viability**

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

- the Directors' confirmation within the going concern and viability statement on page 83 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Risk Disclosures describing these risks and explaining how they are being managed and mitigated; and
- the Directors' explanation in the going concern and viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

#### **Corporate governance disclosures**

We are required to report to you if:

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

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

We have nothing to report in these respects.



## 6 Respective responsibilities

### Directors' responsibilities

As explained more fully in their statement set out on page 84, the Directors are responsible for: the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union; such internal control as they determine is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

### Auditors' responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

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

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

### Rees Aronson

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

15 Canada Square  
London, E14 5GL

14 February 2018

## Consolidated statement of comprehensive (loss) income

For the year ended 31 December 2017

	Notes	2017 \$m	2016 \$m
Gross premiums written	2	591.6	633.9
Outwards reinsurance premiums	2	(193.6)	(175.2)
<b>Net premiums written</b>		<b>398.0</b>	<b>458.7</b>
Change in unearned premiums	2	22.6	25.7
Change in unearned premiums on premiums ceded	2	7.3	3.7
<b>Net premiums earned</b>		<b>427.9</b>	<b>488.1</b>
Net investment income	3	30.5	29.8
Net other investment income	3	1.2	6.9
Net realised gains (losses) and impairments	3	9.1	(2.4)
Share of (loss) profit of associate	15	(9.4)	5.1
Other income	22	17.2	20.5
Net foreign exchange gains		2.3	4.4
<b>Total net revenue</b>		<b>478.8</b>	<b>552.4</b>
Insurance losses and loss adjustment expenses	2, 12	538.0	212.2
Insurance losses and loss adjustment expenses recoverable	2, 12	(202.6)	(69.7)
<b>Net insurance losses</b>		<b>335.4</b>	<b>142.5</b>
Insurance acquisition expenses	2, 4	120.7	135.1
Insurance acquisition expenses ceded	2, 4	(5.1)	(3.0)
Other operating expenses	5, 6, 20	83.6	98.5
Equity based compensation	6	(0.4)	10.7
<b>Total expenses</b>		<b>534.2</b>	<b>383.8</b>
<b>Results of operating activities</b>		<b>(55.4)</b>	<b>168.6</b>
Financing costs	7	17.5	18.2
<b>(Loss) profit before tax</b>		<b>(72.9)</b>	<b>150.4</b>
Tax credit	8	2.3	3.9
<b>(Loss) profit for the year</b>		<b>(70.6)</b>	<b>154.3</b>
<b>(Loss) profit for the year attributable to:</b>			
Equity shareholders of LHL		(71.1)	153.8
Non-controlling interests		0.5	0.5
<b>(Loss) profit for the year</b>		<b>(70.6)</b>	<b>154.3</b>
<b>Other comprehensive income to be reclassified to profit or loss in subsequent periods</b>			
Net change in unrealised gains/losses on investments	3, 10	4.9	4.1
<b>Other comprehensive income</b>		<b>4.9</b>	<b>4.1</b>
<b>Total comprehensive (loss) income for the year</b>		<b>(65.7)</b>	<b>158.4</b>
<b>Total comprehensive (loss) income attributable to:</b>			
Equity shareholders of LHL		(66.2)	157.9
Non-controlling interests		0.5	0.5
<b>Total comprehensive (loss) income for the year</b>		<b>(65.7)</b>	<b>158.4</b>
<b>(Loss) earnings per share</b>			
Basic	21	(\$0.36)	\$0.77
Diluted	21	(\$0.36)	\$0.76

## Consolidated balance sheet

As at 31 December 2017

	Notes	2017 \$m	2016 \$m
<b>Assets</b>			
Cash and cash equivalents	9, 17	256.5	308.8
Accrued interest receivable		6.1	6.6
Investments	10, 11, 17	1,654.6	1,648.4
Inwards premiums receivable from insureds and cedants	13	297.9	270.0
Reinsurance assets			
– Unearned premiums on premiums ceded		41.2	33.9
– Reinsurance recoveries	12	284.1	136.7
– Other receivables	13	20.7	16.5
Other receivables	13	42.4	43.6
Corporation tax receivable		–	1.1
Investment in associate	11, 15	59.4	49.7
Property, plant and equipment		2.6	5.3
Deferred acquisition costs		76.7	81.5
Intangible assets	16	153.8	153.8
<b>Total assets</b>		<b>2,896.0</b>	<b>2,755.9</b>
<b>Liabilities</b>			
Insurance contracts			
– Losses and loss adjustment expenses	12	933.5	679.8
– Unearned premiums		350.9	373.5
– Other payables		40.7	37.4
Amounts payable to reinsurers		65.5	52.7
Deferred acquisition costs ceded		2.5	0.4
Other payables		48.0	61.0
Corporation tax payable		2.8	–
Deferred tax liability	14	16.5	18.7
Interest rate swap	17	2.0	3.7
Long-term debt	17	326.3	320.9
<b>Total liabilities</b>		<b>1,788.7</b>	<b>1,548.1</b>
<b>Shareholders' equity</b>			
Share capital	18	100.7	100.7
Own shares	18	(12.1)	(23.2)
Other reserves	19	866.2	881.6
Accumulated other comprehensive loss	10	(1.5)	(6.4)
Retained earnings		153.6	254.6
<b>Total shareholders' equity attributable to equity shareholders of LHL</b>		<b>1,106.9</b>	<b>1,207.3</b>
Non-controlling interests	22	0.4	0.5
<b>Total shareholders' equity</b>		<b>1,107.3</b>	<b>1,207.8</b>
<b>Total liabilities and shareholders' equity</b>		<b>2,896.0</b>	<b>2,755.9</b>

The consolidated financial statements were approved by the Board of Directors on 14 February 2018 and signed on its behalf by:

**Peter Clarke**  
Director/Chairman

**Elaine Whelan**  
Director/CFO

## Consolidated statement of changes in shareholders' equity

For the year ended 31 December 2017

	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
<b>Balance as at 31 December 2015</b>		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
<b>Balance as at 31 December 2016</b>		100.7	(23.2)	881.6	(6.4)	254.6	1,207.3	0.5	1,207.8
Total comprehensive (loss) for the year		—	—	—	4.9	(71.1)	(66.2)	0.5	(65.7)
Shares donated to trust	18, 19, 22	—	1.2	(1.2)	—	—	—	—	—
Distributed by trust	18, 19	—	9.9	(13.8)	—	—	(3.9)	—	(3.9)
Dividends on common shares	18	—	—	—	—	(29.9)	(29.9)	—	(29.9)
Dividends paid to minority interest holders	22	—	—	—	—	—	—	(0.6)	(0.6)
Equity based compensation – credit	19	—	—	(0.4)	—	—	(0.4)	—	(0.4)
<b>Balance as at 31 December 2017</b>		100.7	(12.1)	866.2	(1.5)	153.6	1,106.9	0.4	1,107.3



## Statement of consolidated cash flows

For the year ended 31 December 2017

	Notes	2017 \$m	2016 \$m
<b>Cash flows (used in) from operating activities</b>			
(Loss) profit before tax		(72.9)	150.4
Tax refunded (paid)		1.3	(1.3)
Depreciation	5	1.8	2.3
Interest expense on long-term debt	7	16.4	15.6
Interest and dividend income		(37.1)	(38.5)
Net amortisation of fixed maturity securities		2.8	5.0
Equity based compensation	6	(0.4)	10.7
Foreign exchange losses (gains)		9.4	(2.3)
Share of loss (profit) of associate	15	9.4	(5.1)
Net other investment income	3	(1.2)	(6.9)
Net realised (gains) losses and impairments	3	(9.1)	2.4
Net unrealised gains on interest rate swaps		(1.7)	(1.1)
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		52.0	(71.7)
– Other assets and liabilities		(9.4)	(10.6)
<b>Net cash flows (used in) from operating activities</b>		<b>(38.7)</b>	<b>48.9</b>
<b>Cash flows from investing activities</b>			
Interest and dividends received		37.6	38.4
Purchase of property, plant and equipment		(0.6)	(0.4)
Investment in associate	22	(19.1)	2.9
Purchase of investments		(1,196.1)	(1,214.0)
Proceeds on sale of investments		1,209.5	1,341.8
<b>Net cash flows from investing activities</b>		<b>31.3</b>	<b>168.7</b>
<b>Cash flows used in financing activities</b>			
Interest paid		(16.3)	(15.4)
Dividends paid	18	(29.9)	(178.9)
Dividends paid to minority interest holders		(0.6)	(0.5)
Distributions by trust		(3.9)	(2.9)
<b>Net cash flows used in financing activities</b>		<b>(50.7)</b>	<b>(197.7)</b>
<b>Net (decrease) increase in cash and cash equivalents</b>		<b>(58.1)</b>	<b>19.9</b>
Cash and cash equivalents at beginning of year		308.8	291.8
Effect of exchange rate fluctuations on cash and cash equivalents		5.8	(2.9)
<b>Cash and cash equivalents at end of year</b>	9	<b>256.5</b>	<b>308.8</b>

### 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. In the course of preparing the consolidated financial statements, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimations as noted in the 'Use of Estimates' section below, that have had a significant effect on amounts recognised in the consolidated financial statements.

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

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

IFRS 15, Revenue from Contracts with Customers, is effective for annual periods beginning on or after 1 January 2018. IFRS 15 will not have a material impact on the results and disclosures reported in the consolidated financial statements.

IFRS 17, Insurance Contracts, issued in May 2017, specifies the financial reporting for insurance contracts by an insurer. The new standard is effective for annual periods beginning on or after 1 January 2021 and will include a number of significant changes regarding the measurement and disclosure of insurance contracts both in terms of liability measurement and profit recognition. The Group will continue to assess the impact 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 until 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 96 and 97 and also in the risk disclosures section from page 108. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 96.

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 97 and 98 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 2017. 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 (loss) 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 (loss) 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 (loss) income in profit or loss. 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 the consolidated statement of comprehensive (loss) income in profit or loss.

### 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 loss in shareholders' equity. Changes in estimated fair value of investments classified at FVTPL are recognised in current period net other investment income.

Investments are derecognised when the Group has transferred substantially all of the risks and rewards of ownership. On derecognition of an AFS investment, previously recorded unrealised gains and losses are removed from accumulated other comprehensive loss in shareholders' equity and included in current period profit or loss. Realised gains and losses are included in net investment 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 loss in shareholders' equity and charged to current period profit or loss. Impairment losses on fixed maturity securities may be subsequently reversed through profit or loss while impairment losses on equity securities are not subsequently reversed through profit or loss.

#### **Derivative financial instruments**

Derivatives are classified as financial assets or liabilities at FVTPL and 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 are recognised in profit or loss. 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 are recognised in line with services provided. Profit commissions are recognised in line with the underlying performance. 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 (loss) income. Costs for repairs and maintenance are charged to profit or loss as incurred.

## Leases

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

## Employee benefits

### Equity compensation plans

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

At each balance sheet date, the Group revises its estimate of the number of RSS nil-cost options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated statement of comprehensive (loss) 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 (loss) 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 (loss) 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 (loss) income due to non-taxable income and certain items which are not tax deductible or which are deferred to subsequent periods.

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

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

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

## Own shares

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

### Risk disclosures: Introduction

The Group is exposed to risks from several sources. 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 framework is to ensure that the capital resources held are matched to the risk profile of the Group and that the balance between risk and return is considered as part of all key business decisions. The Group has formulated, and keeps under review, a risk appetite which is set by the Board of Directors. The Group's appetite for risk will vary marginally from time to time to reflect the potential risks and returns that present themselves. However, protecting the Group's capital and 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.

### 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 covers the risks for LICL, LUK and Kinesis but does not cover Cathedral's risks. 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.

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.

The six primary risk categories, insurance risk, market risk, liquidity risk, credit risk, operational risk and strategic risk, are discussed in detail on page 101 to 125.



## A. Insurance risk

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

The Group considers insurance risk at an individual contract level, at a segment level, a geographic level and at an aggregate portfolio level. This ensures 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, wildfires 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.

As at 31 December 2017		100 year return period estimated net loss		250 year return period estimated net loss	
		\$m	% of tangible capital	\$m	% of tangible capital
<b>Zones</b>	<b>Perils</b>				
Gulf of Mexico <sup>1</sup>	Hurricane	173.8	13.6	253.6	19.8
Non-Gulf of Mexico – U.S.	Hurricane	140.9	11.0	306.5	24.0
California	Earthquake	96.1	7.5	181.1	14.2
Pan-European	Windstorm	77.2	6.0	125.1	9.8
Japan	Typhoon	51.6	4.0	68.1	5.3
Japan	Earthquake	46.6	3.6	85.6	6.7
Pacific North West	Earthquake	33.1	2.6	79.6	6.2

(1) Landing hurricane from Florida to Texas.

As at 31 December 2016		100 year return period estimated net loss		250 year return period estimated net loss	
		\$m	% of tangible capital	\$m	% of tangible capital
<b>Zones</b>	<b>Perils</b>				
Gulf of Mexico <sup>1</sup>	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.

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:

	2017		2016	
	\$m	%	\$m	%
U.S. and Canada	177.6	30.0	179.7	28.4
Worldwide offshore	162.5	27.5	161.1	25.5
Worldwide, including the U.S. and Canada <sup>1</sup>	98.6	16.7	115.6	18.2
Europe	38.9	6.6	46.9	7.4
Far East	27.9	4.7	29.2	4.6
Worldwide, excluding the U.S. and Canada <sup>2</sup>	11.5	1.9	15.4	2.4
Middle East	6.9	1.2	13.5	2.1
Rest of world	67.7	11.4	72.5	11.4
<b>Total</b>	<b>591.6</b>	<b>100.0</b>	<b>633.9</b>	<b>100.0</b>

(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:

	2017		2016	
	\$m	%	\$m	%
Lloyd's	207.3	35.0	215.0	33.9
Property	198.0	33.5	219.5	34.6
Energy	101.8	17.2	126.0	19.9
Marine	67.6	11.4	37.2	5.9
Aviation	16.9	2.9	36.2	5.7
<b>Total</b>	<b>591.6</b>	<b>100.0</b>	<b>633.9</b>	<b>100.0</b>

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

### I. Lloyd's

Gross premiums written, for the year:

	2017 \$m	2016 \$m
Property reinsurance	88.5	88.6
Property direct and facultative	56.1	56.1
Aviation and satellite	25.0	24.3
Marine cargo	22.5	21.2
Energy	10.8	14.9
Terrorism	4.4	6.3
Other	—	3.6
<b>Total</b>	<b>207.3</b>	<b>215.0</b>

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.

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

## II. Property

Gross premiums written, for the year:

	2017 \$m	2016 \$m
Property catastrophe excess of loss	101.9	99.8
Terrorism	34.9	41.1
Property political risk	31.1	44.1
Property risk excess of loss	12.9	11.3
Property retrocession	10.0	12.8
Other property	7.2	10.4
<b>Total</b>	<b>198.0</b>	<b>219.5</b>

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

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

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

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

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



The Group is exposed to large natural catastrophe losses, such as windstorm and earthquake losses, primarily from assuming property catastrophe excess of loss and property retrocession portfolio risks. Exposure to such events is controlled and measured by setting limits on aggregate exposures in certain classes per geographic zone and through loss 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 101 and 102.

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

### III. Energy

Gross premiums written, for the year:

	2017 \$m	2016 \$m
Worldwide offshore energy	66.6	88.7
Gulf of Mexico offshore energy	24.4	20.1
Onshore energy	3.5	4.9
Energy liabilities	3.0	3.5
Construction energy	(1.1)	4.8
Other energy	5.4	4.0
<b>Total</b>	<b>101.8</b>	<b>126.0</b>

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 101 and 102.

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

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.

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.

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:

	2017 \$m	2016 \$m
Marine hull and total loss	20.0	13.1
Marine builders' risk	13.9	8.7
Marine excess of loss	13.4	–
Marine P&I clubs	10.1	8.4
Marine hull war	7.1	4.1
Other marine	3.1	2.9
<b>Total</b>	<b>67.6</b>	<b>37.2</b>

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 excess of loss is written on a treaty basis and covers ocean and inland marine risks. 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:

	2017 \$m	2016 \$m
AV52	16.8	24.0
Aviation satellite	(0.2)	9.8
Other aviation	0.3	2.4
<b>Total</b>	<b>16.9</b>	<b>36.2</b>

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. The Lancashire companies stopped writing new satellite business in 2016.

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 independent review by external actuaries. The results of the 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 2017, management's estimates for IBNR represented 44.8 per cent of total net loss reserves (31 December 2016 – 34.6 per cent). The majority of the estimate relates to the recent catastrophe events during the latter part of 2017, in addition to potential claims on non-elemental risks where timing delays in insured or cedant reporting may mean losses could have occurred of which the Group was not made aware by the balance sheet date.



## B. Market risk

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

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

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

### I. Insurance risk

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

- the advent or continuation of a soft market, which may result in a stabilisation or decline in premium rates and/or terms and conditions for certain lines, or across all lines;
- the actions and reactions of key competitors, which may directly result in volatility in premium volumes and rates, fee levels and other input costs;
- market events, including unusual inflation in rates, may result in a limit in the availability of cover, causing political intervention or national remedies;
- failure to maintain broker, binding authority and client relationships, leading to a limited or substandard choice of risks inconsistent with the Group's risk appetite;
- changes in regulation including capital, governance or licensing requirements;
- changes in the geopolitical environment including the UK's impending exit from the EU and the implications for business passporting within the EEA; and
- changes in U.S. tax legislation, which came into effect from 1 January 2018. The new rules introduce significant changes to the corporate tax regime. The most significant change to impact the global (re)insurance sector is the base erosion and anti-abuse tax. While the Lancashire Group has no U.S. affiliates, there may be wider implications as this provision will directly impact those foreign reinsurers that have significant intra-group reinsurance arrangements between U.S. and overseas affiliates.

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 five external investment managers. The Group also has a diversified low volatility multi-strategy portfolio of hedge funds, and a small equity portfolio. The performance of the managers is monitored on an ongoing basis.

Within the Group 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.

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

The investment portfolio is currently structured to perform 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 2017	Core		Core plus		Surplus		Total	
	\$m	%	\$m	%	\$m	%	\$m	%
– Short-term investments	8.8	0.6	98.7	6.7	3.6	0.2	111.1	7.5
– Fixed maturity funds	31.0	2.1	–	–	–	–	31.0	2.1
– U.S. treasuries	100.7	6.8	118.2	8.0	16.8	1.1	235.7	15.9
– Other government bonds	16.4	1.1	13.4	0.9	41.6	2.8	71.4	4.8
– U.S. municipal bonds	1.9	0.1	4.1	0.3	–	–	6.0	0.4
– U.S. government agency debt	17.1	1.2	34.5	2.3	18.9	1.3	70.5	4.8
– Asset backed securities	15.9	1.1	56.7	3.8	71.4	4.8	144.0	9.7
– U.S. government agency mortgage backed securities	8.4	0.6	22.4	1.5	110.2	7.6	141.0	9.7
– Non-agency mortgage backed securities	2.2	0.1	3.3	0.2	7.7	0.5	13.2	0.8
– Non-agency commercial mortgage backed securities	–	–	0.2	–	–	–	0.2	–
– Bank loans	–	–	–	–	106.7	7.2	106.7	7.2
– Corporate bonds	168.7	11.4	264.7	18.0	88.0	6.0	521.4	35.4
<b>Total fixed maturity securities – AFS</b>	<b>371.1</b>	<b>25.1</b>	<b>616.2</b>	<b>41.7</b>	<b>464.9</b>	<b>31.5</b>	<b>1,452.2</b>	<b>98.3</b>
Fixed maturity securities – at FVTPL	–	–	–	–	25.7	1.7	25.7	1.7
<b>Total fixed maturity securities</b>	<b>371.1</b>	<b>25.1</b>	<b>616.2</b>	<b>41.7</b>	<b>490.6</b>	<b>33.2</b>	<b>1,477.9</b>	<b>100.0</b>

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
<b>Total fixed maturity securities – AFS</b>	<b>351.2</b>	<b>23.5</b>	<b>634.2</b>	<b>42.3</b>	<b>460.8</b>	<b>30.7</b>	<b>1,446.2</b>	<b>96.5</b>
Fixed maturity securities – at FVTPL	–	–	–	–	51.6	3.5	51.6	3.5
<b>Total fixed maturity securities</b>	<b>351.2</b>	<b>23.5</b>	<b>634.2</b>	<b>42.3</b>	<b>512.4</b>	<b>34.2</b>	<b>1,497.8</b>	<b>100.0</b>

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

As at 31 December 2017	Financials \$m	Other industries \$m	Total <sup>1</sup> \$m	Other government bonds \$m	Total <sup>2</sup> \$m
United States	183.4	300.2	483.6	–	483.6
Canada	13.4	13.6	27.0	19.3	46.3
United Kingdom	15.5	12.3	27.8	2.0	29.8
Netherlands	9.6	10.4	20.0	6.3	26.3
Germany	5.2	5.7	10.9	13.9	24.8
France	15.0	3.5	18.5	5.1	23.6
Australia	14.5	0.2	14.7	1.0	15.7
Japan	12.6	2.6	15.2	–	15.2
Sweden	6.9	–	6.9	5.1	12.0
Luxembourg	1.5	5.3	6.8	–	6.8
Denmark	2.1	0.3	2.4	3.9	6.3
Switzerland	3.0	2.6	5.6	–	5.6
India	–	–	–	4.2	4.2
Spain	3.5	0.7	4.2	–	4.2
China	–	1.2	1.2	2.7	3.9
Other	5.9	3.1	9.0	7.9	16.9
<b>Total</b>	<b>292.1</b>	<b>361.7</b>	<b>653.8</b>	<b>71.4</b>	<b>725.2</b>

(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 2016	Financials \$m	Other industries \$m	Total <sup>1</sup> \$m	Other government bonds \$m	Total <sup>2</sup> \$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
<b>Total</b>	<b>301.4</b>	<b>469.1</b>	<b>770.5</b>	<b>66.6</b>	<b>837.1</b>

(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	2017		2016	
	\$m	%	\$m	%
Industrial	329.1	50.3	425.4	55.2
Financial	289.5	44.3	300.9	39.1
Utility	32.6	5.0	43.7	5.7
Supranationals	2.6	0.4	0.5	–
<b>Total</b>	<b>653.8</b>	<b>100.0</b>	<b>770.5</b>	<b>100.0</b>

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	2017		2016	
	\$m	%	\$m	%
<b>Immediate shift in yield (basis points)</b>				
100	(28.5)	(1.9)	(28.7)	(1.9)
75	(21.4)	(1.4)	(21.6)	(1.4)
50	(14.3)	(1.0)	(14.4)	(1.0)
25	(7.1)	(0.5)	(7.2)	(0.5)
(25)	7.2	0.5	7.8	0.5
(50)	14.4	1.0	15.6	1.0
(75)	21.6	1.5	23.4	1.6
(100)	28.8	1.9	31.2	2.1

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	2017 years	2016 years
Core portfolio	1.7	1.6
Core plus portfolio	1.7	1.8
Surplus portfolio <sup>1</sup>	2.0	2.2
<b>Overall external portfolio<sup>1</sup></b>	<b>1.8</b>	<b>1.9</b>

(1) Including duration overlay.

The overall duration for fixed maturity, managed cash and cash equivalents and certain derivatives is 1.7 years (2016 – 1.8 years).

In addition to duration management, the Group uses VaR on a monthly basis to measure potential losses in the estimated fair values of its cash and invested assets and to understand and monitor risk. The VaR calculation is performed using variance/covariance risk modeling to capture the cash flows and embedded optionality of the portfolio. Securities are valued individually using 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:

	2017		2016	
	\$m	% of shareholders' equity	\$m	% of shareholders' equity
As at 31 December				
99th percentile confidence level <sup>1</sup>	27.0	2.4	33.3	2.8

(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:

- Futures;
- Options;
- Forward foreign currency contracts; and
- Swaps.

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

	Net realised losses \$m	Net foreign exchange losses \$m	Financing losses \$m
As at 31 December 2017			
Treasury futures	(0.7)	—	—
Forward foreign currency contracts	—	(0.7)	—
Interest rate swaps	—	—	—
<b>Total</b>	<b>(0.7)</b>	<b>(0.7)</b>	<b>—</b>
As at 31 December 2016			
Treasury futures	(2.1)	—	—
Forward foreign currency contracts	—	(1.8)	—
Interest rate swaps	—	—	(1.0)
<b>Total</b>	<b>(2.1)</b>	<b>(1.8)</b>	<b>(1.0)</b>

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

	2017				2016		
	Other investments \$m	Other receivables \$m	Other payables \$m	Interest rate swaps \$m	Other receivables \$m	Other payables \$m	Interest rate swaps \$m
As at 31 December							
Forward foreign currency contracts	(0.5)	1.6	(0.1)	–	0.6	(0.6)	–
Interest rate swaps	–	–	–	(2.0)	–	–	(3.7)
<b>Total</b>	<b>(0.5)</b>	<b>1.6</b>	<b>(0.1)</b>	<b>(2.0)</b>	<b>0.6</b>	<b>(0.6)</b>	<b>(3.7)</b>

#### 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:

	2017			2016		
	Notional long \$m	Notional short \$m	Net notional long (short) \$m	Notional long \$m	Notional short \$m	Net notional long (short) \$m
As at 31 December						
Treasury futures	100.1	103.5	(3.4)	76.4	104.1	(27.7)
<b>Total</b>	<b>100.1</b>	<b>103.5</b>	<b>(3.4)</b>	<b>76.4</b>	<b>104.1</b>	<b>(27.7)</b>

#### 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 2017 and 2016.

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:

	2017			2016		
	Notional long \$m	Notional short \$m	Net notional long (short) \$m	Notional long \$m	Notional short \$m	Net notional long (short) \$m
<b>As at 31 December</b>						
Canadian Dollar	–	26.9	(26.9)	–	29.8	(29.8)
Euro	24.0	44.6	(20.6)	–	0.6	(0.6)
Australian Dollar	–	7.2	(7.2)	–	–	–
Japanese Yen	–	3.9	(3.9)	–	–	–
Swedish Krona	–	3.0	(3.0)	–	2.7	(2.7)
Mexican Peso	1.7	–	1.7	–	–	–
Malaysian Ringgit	4.9	–	4.9	2.7	–	2.7
British Pound	53.5	4.0	49.5	13.4	0.9	12.5
<b>Total</b>	<b>84.1</b>	<b>89.6</b>	<b>(5.5)</b>	<b>16.1</b>	<b>34.0</b>	<b>(17.9)</b>

### 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 2017 and 2016. Through the use of interest rate swaps, the Group has fixed the interest rate on Lancashire's subordinated loan notes until December 2020. As at 31 December 2017 the notional amount of interest rate swaps held for hedging purposes was \$125.8 million (31 December 2016 – \$122.3 million).



### III. Debt risk

The Group has issued long-term debt as described in note 17. The LHL subordinated loan notes due in 2035 bear interest at a floating rate that is reset on a quarterly basis, plus a fixed margin of 3.70 per cent. The Group is subject to interest rate risk on the coupon payments of these subordinated loan notes. The Group has mitigated the interest rate risk on the LHL debt by entering into interest rate swap contracts on the following loan notes:

	Maturity date	Interest hedged
Subordinated loan notes \$97.0 million	15 December 2035	100%
Subordinated loan notes €24.0 million	15 June 2035	100%

The interest rate swaps expire on 15 December 2020, therefore until 2020 the Group has no cash flow interest rate risk on the LHL subordinated loan notes due in 2035.

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

On the acquisition of Cathedral, the Group assumed subordinated loan notes as described in note 17. The Group is subject to cash flow 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 profit or loss.

The Group hedges monetary non-U.S. dollar liabilities primarily with non-U.S. dollar assets, but may also use derivatives to mitigate foreign currency exposures. The Group's main foreign currency exposure relates to its insurance obligations, cash holdings, investments, premiums receivable, dividends payable and the Euro denominated subordinated loan notes discussed in note 17. See page 116 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	158.1	16.9	33.6	11.7	36.2	256.5
Accrued interest receivable	6.1	–	–	–	–	6.1
Investments	1,538.2	20.8	82.1	–	13.5	1,654.6
Inwards premiums receivable from insureds and cedants	252.1	13.4	19.7	2.3	10.4	297.9
Reinsurance assets	331.9	6.1	6.1	–	1.9	346.0
Other receivables	39.3	2.5	–	–	0.6	42.4
Investment in associate	59.4	–	–	–	–	59.4
Property, plant and equipment	0.3	2.3	–	–	–	2.6
Deferred acquisition costs	55.2	6.5	9.4	0.9	4.7	76.7
Intangible assets	153.8	–	–	–	–	153.8
<b>Total assets as at 31 December 2017</b>	<b>2,594.4</b>	<b>68.5</b>	<b>150.9</b>	<b>14.9</b>	<b>67.3</b>	<b>2,896.0</b>

Liabilities	U.S. \$ \$m	Sterling \$m	Euro \$m	Japanese Yen \$m	Other \$m	Total \$m
Losses and loss adjustment expenses	773.5	38.5	72.9	8.6	40.0	933.5
Unearned premiums	259.7	20.7	37.9	8.6	24.0	350.9
Insurance contracts – other payables	30.4	5.8	2.6	–	1.9	40.7
Amounts payable to reinsurers	62.8	1.5	1.0	–	0.2	65.5
Deferred acquisition costs ceded	2.1	–	0.3	–	0.1	2.5
Other payables	30.8	16.4	0.7	–	0.1	48.0
Corporation tax payable	–	2.8	–	–	–	2.8
Deferred tax liability	7.8	8.7	–	–	–	16.5
Interest rate swap	0.2	–	1.8	–	–	2.0
Long-term debt	283.3	–	43.0	–	–	326.3
<b>Total liabilities as at 31 December 2017</b>	<b>1,450.6</b>	<b>94.4</b>	<b>160.2</b>	<b>17.2</b>	<b>66.3</b>	<b>1,788.7</b>

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
<b>Total assets as at 31 December 2016</b>	<b>2,520.2</b>	<b>58.6</b>	<b>80.4</b>	<b>17.7</b>	<b>79.0</b>	<b>2,755.9</b>

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
<b>Total liabilities as at 31 December 2016</b>	<b>1,238.9</b>	<b>101.2</b>	<b>118.9</b>	<b>27.5</b>	<b>61.6</b>	<b>1,548.1</b>

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 \$3.5 million (2016 – \$1.5 million).

The Group uses forward foreign currency contracts for the purposes of managing currency exposures. See page 116 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 or trust accounts;
- failure of insureds or cedants to meet their contractual obligations with respect to the payment of premiums in a timely manner; and
- failure of reinsurers to meet their contractual obligations with respect to the payment of claims in a timely manner.

Exposures in relation to investment activities are as follows:

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

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

As at 31 December 2017	Core \$m	Core plus \$m	Surplus \$m	Total \$m
Less than one year	89.5	211.0	12.6	313.1
Between one and two years	102.7	84.1	45.5	232.3
Between two and three years	95.6	103.1	27.2	225.9
Between three and four years	18.8	44.1	40.4	103.3
Between four and five years	27.3	49.4	48.9	125.6
Over five years	10.7	41.9	126.7	179.3
Asset backed and mortgage backed securities	26.5	82.6	189.3	298.4
<b>Total fixed maturity securities</b>	<b>371.1</b>	<b>616.2</b>	<b>490.6</b>	<b>1,477.9</b>

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
<b>Total fixed maturity securities</b>	<b>351.2</b>	<b>634.2</b>	<b>512.4</b>	<b>1,497.8</b>



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

As at 31 December 2017	Years until liability becomes due – undiscounted values					Total \$m
	Balance sheet \$m	Less than one \$m	One to three \$m	Three to five \$m	Over five \$m	
Losses and loss adjustment expenses	933.5	524.3	265.6	88.0	55.6	933.5
Insurance contracts – other payables	40.7	37.5	3.2	–	–	40.7
Amounts payable to reinsurers	65.5	65.5	–	–	–	65.5
Other payables	48.0	48.0	–	–	–	48.0
Interest rate swap	2.0	0.9	1.1	–	–	2.0
Long-term debt	326.3	15.1	36.2	167.6	354.8	573.7
<b>Total</b>	<b>1,416.0</b>	<b>691.3</b>	<b>306.1</b>	<b>255.6</b>	<b>410.4</b>	<b>1,663.4</b>

As at 31 December 2016	Years until liability becomes due – undiscounted values					Total \$m
	Balance sheet \$m	Less than one \$m	One to three \$m	Three to five \$m	Over five \$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
<b>Total</b>	<b>1,155.5</b>	<b>432.7</b>	<b>294.6</b>	<b>127.7</b>	<b>561.5</b>	<b>1,416.5</b>

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 107.

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.

	Cash and fixed maturity securities \$m	Inwards premiums receivable and other receivables \$m	Reinsurance recoveries \$m
<b>As at 31 December 2017</b>			
AAA	368.0	—	—
AA+, AA, AA-	621.8	—	2.7
A+, A, A-	403.7	69.5	177.0
BBB+, BBB, BBB-	237.3	—	—
Other <sup>1</sup>	103.6	291.5	104.4
<b>Total</b>	<b>1,734.4</b>	<b>361.0</b>	<b>284.1</b>

(1) Reinsurance recoveries classified as 'other' include \$93.6 million of reserves that are fully collateralised.

	Cash and fixed maturity securities \$m	Inwards premiums receivable and other receivables \$m	Reinsurance recoveries \$m
<b>As at 31 December 2016</b>			
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 <sup>1</sup>	115.0	245.6	7.7
<b>Total</b>	<b>1,806.6</b>	<b>330.1</b>	<b>136.7</b>

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

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

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

	2017 \$m	2016 \$m
Less than 90 days past due	15.3	12.3
Between 91 and 180 days past due	5.3	5.9
Over 180 days past due	14.0	16.1
<b>Total</b>	<b>34.6</b>	<b>34.3</b>

Provisions of \$2.4 million (2016 – \$1.0 million) have been made for impaired or irrecoverable balances and \$1.4 million (2016 – \$1.2 million release) was charged to the consolidated statement of comprehensive (loss) income in respect of bad debts.

### E. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes or systems. The Group and its subsidiaries have identified and evaluated their key operational risks and these are incorporated in the risk registers and modeled directly within the subsidiaries' capital models. The Group has also established, and monitors compliance with, internal operational risk tolerances. The RRC reviews operational risk on at least an annual basis and operational risk is covered in the Group CRO's quarterly ORSA report to the LHL Board and entity boards and in the Cathedral Risk, Capital and Compliance 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	2017 \$m	2016 \$m
Shareholders' equity	<b>1,106.9</b>	1,207.3
Long-term debt	<b>326.3</b>	320.9
<b>Total capital</b>	<b>1,433.2</b>	1,528.2
Intangible assets	<b>(153.8)</b>	(153.8)
<b>Total tangible capital</b>	<b>1,279.4</b>	1,374.4

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

- regular monitoring of current and prospective regulatory and rating agency capital requirements;
- regular discussion with the Cathedral management team regarding Lloyd's capital requirements;
- oversight of capital requirements by the Board of Directors;
- ability to purchase sufficient, cost effective reinsurance;
- maintaining contact with vendors, regulators and rating agencies in order to stay abreast of upcoming developments; and
- participation in industry groups such as the International Underwriting 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 cyclical 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 2016	13.5	18.4	541.1
<b>31 December 2017</b>	<b>(5.9)</b>	<b>17.7</b>	<b>608.2</b>

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

	Annual return %	Compound annual return %	Inception to date return %
31 December 2016	13.2	17.4	529.2
<b>31 December 2017</b>	<b>(6.8)</b>	<b>16.7</b>	<b>595.2</b>

The primary source of capital used by the Group is equity shareholders' funds and borrowings (note 17). 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.

Under Solvency II the basis for assessing capital and solvency comprises 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 years ended 31 December 2017 and 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 years ended 31 December 2017 and 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 standard formula model. For the years ended 31 December 2017 and 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 Economic Capital Assessment (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 2018 calendar year the Group's corporate member's FAL requirement was set at 66.5 per cent (2017 – 75.6 per cent) of underwriting capacity supported. The reduction was driven by a combination of factors including a change in categorisation of future reserves, improved reinsurance planning and actively reducing exposures to less profitable business. Further solvency adjustments are made to allow for open year profits and losses of the syndicates on which the corporate member participates. The Group has met its FAL requirement of £184.3 million as at 31 December 2017 (31 December 2016 – £209.4 million).

For the years ended 31 December 2017 and 2016 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 2017 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 103 to 106. Operating segment performance is measured by the net underwriting profit or loss and the combined ratio.

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

## Revenue and expense by operating segment

For the year ended 31 December 2017

	Property \$m	Energy \$m	Marine \$m	Aviation \$m	Lloyd's \$m	Total \$m
<b>Gross premiums written by geographic area</b>						
U.S. and Canada	80.0	4.7	—	—	92.9	177.6
Worldwide offshore	0.2	94.8	67.5	—	—	162.5
Worldwide, including the U.S. and Canada <sup>1</sup>	30.3	2.5	—	16.9	48.9	98.6
Europe	23.1	—	—	—	15.8	38.9
Far East	16.5	—	—	—	11.4	27.9
Worldwide, excluding the U.S. and Canada <sup>2</sup>	6.0	0.1	—	—	5.4	11.5
Middle East	5.3	—	—	—	1.6	6.9
Rest of world	36.6	(0.3)	0.1	—	31.3	67.7
<b>Total</b>	<b>198.0</b>	<b>101.8</b>	<b>67.6</b>	<b>16.9</b>	<b>207.3</b>	<b>591.6</b>
Outwards reinsurance premiums	(66.3)	(45.1)	(11.3)	(7.2)	(63.7)	(193.6)
Change in unearned premiums	11.6	7.5	(5.6)	4.4	4.7	22.6
Change in unearned premiums on premiums ceded	3.2	6.2	—	(2.5)	0.4	7.3
<b>Net premiums earned</b>	<b>146.5</b>	<b>70.4</b>	<b>50.7</b>	<b>11.6</b>	<b>148.7</b>	<b>427.9</b>
Insurance losses and loss adjustment expenses	(254.9)	(34.7)	(17.3)	1.6	(232.7)	(538.0)
Insurance losses and loss adjustment expenses recoverable	87.3	23.6	0.6	0.6	90.5	202.6
Insurance acquisition expenses	(30.2)	(32.4)	(19.0)	(3.3)	(35.8)	(120.7)
Insurance acquisition expenses ceded	2.6	1.4	0.6	0.1	0.4	5.1
<b>Net underwriting (loss) profit</b>	<b>(48.7)</b>	<b>28.3</b>	<b>15.6</b>	<b>10.6</b>	<b>(28.9)</b>	<b>(23.1)</b>
Net unallocated income and expenses						(49.8)
<b>(Loss) before tax</b>						<b>(72.9)</b>
Net loss ratio	114.4%	15.8%	32.9%	(19.0%)	95.6%	78.4%
Net acquisition cost ratio	18.8%	44.0%	36.3%	27.6%	23.8%	27.0%
Expense ratio	—	—	—	—	—	19.5%
<b>Combined ratio</b>	<b>133.2%</b>	<b>59.8%</b>	<b>69.2%</b>	<b>8.6%</b>	<b>119.4%</b>	<b>124.9%</b>

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

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

**2. Segmental reporting continued****Revenue and expense by operating segment**

For the year ended 31 December 2016

	Property \$m	Energy \$m	Marine \$m	Aviation \$m	Lloyd's \$m	Total \$m
<b>Gross premiums written by geographic area</b>						
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 <sup>1</sup>	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 <sup>2</sup>	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
<b>Total</b>	<b>219.5</b>	<b>126.0</b>	<b>37.2</b>	<b>36.2</b>	<b>215.0</b>	<b>633.9</b>
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
<b>Net premiums earned</b>	<b>148.5</b>	<b>105.5</b>	<b>35.4</b>	<b>25.5</b>	<b>173.2</b>	<b>488.1</b>
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
<b>Net underwriting profit</b>	<b>106.8</b>	<b>16.4</b>	<b>10.9</b>	<b>18.9</b>	<b>60.5</b>	<b>213.5</b>
Net unallocated income and expenses						(63.1)
<b>Profit before tax</b>						<b>150.4</b>
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%
<b>Combined ratio</b>	<b>28.1%</b>	<b>84.4%</b>	<b>69.2%</b>	<b>25.9%</b>	<b>65.1%</b>	<b>76.5%</b>

(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:

	Net investment income and net other investment income <sup>1</sup> \$m	Net realised gains (losses) and impairments \$m	Net change in unrealised gains/losses on AFS \$m	Total investment return excluding foreign exchange \$m	Net foreign exchange gains (losses) \$m	Total investment return including foreign exchange \$m
<b>For the year ended 31 December 2017</b>						
Fixed maturity securities – AFS	28.6	(2.9)	2.1	27.8	9.8	37.6
Fixed maturity securities – at FVTPL	(1.0)	2.4	–	1.4	–	1.4
Equity securities – AFS	–	0.8	2.8	3.6	–	3.6
Hedge funds – at FVTPL	1.1	9.5	–	10.6	–	10.6
Other investments	1.1	(0.7)	–	0.4	(2.6)	(2.2)
Cash and cash equivalents	1.9	–	–	1.9	0.5	2.4
<b>Total investment return</b>	<b>31.7</b>	<b>9.1</b>	<b>4.9</b>	<b>45.7</b>	<b>7.7</b>	<b>53.4</b>

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

	Net investment income and net other investment income <sup>1</sup> \$m	Net realised gains (losses) and impairments \$m	Net change in unrealised gains/losses on AFS \$m	Total investment return excluding foreign exchange \$m	Net foreign exchange gains (losses) \$m	Total investment return including foreign exchange \$m
<b>For the year ended 31 December 2016</b>						
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
<b>Total investment return</b>	<b>36.7</b>	<b>(2.4)</b>	<b>4.1</b>	<b>38.4</b>	<b>(1.6)</b>	<b>36.8</b>

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

Net realised gains (losses) and impairments includes impairment losses of \$1.3 million (2016 – \$3.5 million) recognised on fixed maturity securities and \$nil (2016 – \$0.4 million) recognised on equity securities held by the Group.

Refer to pages 114 to 115 in the risk disclosures section for the estimated fair values of the Group's derivative instruments. Realised gains and losses on futures and options contracts are included in net realised gains (losses) and impairments.

Included in net investment income and net other investment income is \$4.6 million (2016 – \$4.5 million) of investment management, accounting and custodian fees.

### 4. Net insurance acquisition expenses

	2017 \$m	2016 \$m
Insurance acquisition expenses	115.9	129.4
Changes in deferred insurance acquisition expenses	4.8	5.7
Insurance acquisition expenses ceded	(7.2)	(3.1)
Changes in deferred insurance acquisition expenses ceded	2.1	0.1
<b>Total net insurance acquisition expenses</b>	<b>115.6</b>	<b>132.1</b>



## 5. Results of operating activities

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

	2017 \$m	2016 \$m
Depreciation on owned assets	1.8	2.3
Operating lease charges	3.4	2.3
Auditors' remuneration		
– Group audit fees	1.8	1.8
– Other services	–	0.1
<b>Total</b>	<b>7.0</b>	<b>6.5</b>

During 2017, KPMG provided non-audit services in relation to specified work over the distributable reserves and pre-appointment procedures on the first quarter 2017 earnings release. Fees for non-audit services provided in 2017 totalled twenty thousand dollars. During 2016, 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

	2017 \$m	2016 \$m
Wages and salaries	27.6	27.1
Pension costs	2.5	3.1
Bonus and other benefits	10.1	31.2
<b>Total cash compensation</b>	<b>40.2</b>	<b>61.4</b>
RSS – performance	(1.9)	8.3
RSS – ordinary	2.9	1.2
RSS – bonus deferral	2.1	2.0
RSS – Cathedral acquisition grant	(3.5)	(0.8)
<b>Total equity based compensation</b>	<b>(0.4)</b>	<b>10.7</b>
<b>Total employee benefits</b>	<b>39.8</b>	<b>72.1</b>

### Equity based compensation

The Group's equity based compensation scheme is its RSS. All outstanding and future RSS grants have an exercise period of ten years from the grant date.

The fair value of any TSR component of the nil-cost options is estimated using a stochastic model. For all other components the Black-Scholes model is used to estimate the fair value.

The following table lists the assumptions used in the stochastic model for the RSS awards granted during the years ended 31 December 2017 and 2016:

Assumptions	2017	2016
Dividend yield	–	–
Expected volatility <sup>1</sup>	25.1%	22.2%
Risk-free interest rate <sup>2</sup>	0.1%	0.5%
Expected average life of options	3 years	3 years
Share price	\$8.60	\$8.85

(1) The expected volatility of LHL and comparator companies' share prices are calculated based on the movement in the share prices over a period prior to the grant date, equal in length to the expected life of the award.

(2) The risk-free interest rate is consistent with three-year UK government bond yields on the date of grant.

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

### RSS – Performance

The performance RSS options vest after a three-year period and are dependent on certain performance criteria. A maximum of 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.

	Total number of restricted stock
<b>Outstanding as at 31 December 2015</b>	3,272,137
Granted	886,916
Exercised	(499,296)
Forfeited	(72,024)
Lapsed	(224,576)
<b>Outstanding as at 31 December 2016</b>	3,363,157
Granted	1,018,933
Exercised	(509,524)
Forfeited	(156,461)
Lapsed	(257,894)
<b>Outstanding as at 31 December 2017</b>	3,458,211
Exercisable as at 31 December 2016	226,863
<b>Exercisable as at 31 December 2017</b>	249,112

	2017 Total restricted stock	2016 Total restricted stock
Weighted average remaining contractual life	7.8 years	8.0 years
Weighted average fair value at date of grant during the year	\$7.56	\$7.60
Weighted average share price at date of exercise during the year	\$8.82	\$8.27

### 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)
<b>Outstanding as at 31 December 2016</b>	597,520
Granted	699,251
Forfeited	(10,025)
<b>Outstanding as at 31 December 2017</b>	1,286,746

	2017 Total restricted stock	2016 Total restricted stock
Weighted average remaining contractual life	8.7 years	9.1 years
Weighted average fair value at date of grant during the year	\$8.49	\$8.85

**6. Employee benefits continued****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
<b>Outstanding as at 31 December 2015</b>	435,275	2,555	437,830
Granted	270,752	–	270,752
Exercised	(180,737)	–	(180,737)
Forfeited	(1,727)	–	(1,727)
<b>Outstanding as at 31 December 2016</b>	523,563	2,555	526,118
Granted	<b>244,523</b>	–	<b>244,523</b>
Exercised	<b>(220,448)</b>	–	<b>(220,448)</b>
Forfeited	–	<b>(2,555)</b>	<b>(2,555)</b>
<b>Outstanding as at 31 December 2017</b>	<b>547,638</b>	–	<b>547,638</b>
Exercisable as at 31 December 2016	80,576	2,555	83,131
<b>Exercisable as at 31 December 2017</b>	<b>78,295</b>	–	<b>78,295</b>

	2017			2016		
	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	<b>8.3 years</b>	–	<b>8.3 years</b>	8.5 years	0.1 years	8.5 years
Weighted average fair value at date of grant during the year	<b>\$8.58</b>	–	<b>\$8.58</b>	\$7.72	–	\$7.72
Weighted average share price at date of exercise during the year	<b>\$8.73</b>	–	<b>\$8.73</b>	\$8.24	–	\$8.24

**RSS – Cathedral acquisition**

The Cathedral acquisition RSS options vesting periods range from three to five years and are dependent on certain performance criteria. A maximum of 75.0 per cent of the Cathedral acquisition RSS options will vest on the achievement of a Cathedral combined ratio below a required amount. A maximum of 25.0 per cent of the Cathedral acquisition RSS options vest on the achievement of an LHL RoE in excess of a required amount. An amount equivalent to the dividends paid between the grant date and the exercise date accrues and is paid at the time of exercise. The first tranche of awards were exercisable in 2017.

	Total number of restricted stock
Outstanding as at 31 December 2015	2,307,157
Forfeited	(950,907)
<b>Outstanding as at 31 December 2016</b>	<b>1,356,250</b>
Exercised	<b>(400,166)</b>
Forfeited	<b>(556,768)</b>
Lapsed	<b>(29,838)</b>
<b>Outstanding as at 31 December 2017</b>	<b>369,478</b>
<b>Exercisable as at 31 December 2017</b>	<b>205,955</b>

	2017	2016
	Total restricted stock	Total restricted stock
Weighted average remaining contractual life	<b>5.9 years</b>	6.9 years
Weighted average fair value at date of grant	<b>\$13.01</b>	\$13.01

## 7. Financing costs

	2017 \$m	2016 \$m
Interest expense on long-term debt	16.4	15.6
Net losses on interest rate swaps	–	1.0
Other financing costs	1.1	1.6
<b>Total</b>	<b>17.5</b>	<b>18.2</b>

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.

	2017 \$m	2016 \$m
Corporation tax charge for the period	3.3	2.7
Adjustments in respect of prior period corporation tax	(2.3)	(2.4)
Deferred tax credit for the period	(4.1)	(4.0)
Tax rate change adjustment	(0.6)	(0.8)
Adjustments in respect of prior period deferred tax	1.4	0.6
<b>Total tax credit</b>	<b>(2.3)</b>	<b>(3.9)</b>

	2017 \$m	2016 \$m
<b>Tax reconciliation<sup>1</sup></b>		
<b>(Loss) profit before tax</b>	<b>(72.9)</b>	<b>150.4</b>
<b>Corporation tax at 19.3% (2016 – 20.0%)</b>	<b>(14.1)</b>	<b>30.1</b>
Non-taxable loss (income)	10.1	(34.4)
Adjustments in respect of prior period	(0.9)	(1.8)
Differences related to equity based compensation	(0.6)	0.6
Other expense permanent differences	3.8	3.1
Tax rate change adjustment	(0.6)	(0.8)
Unused tax losses not recognised for deferred tax	–	0.6
Utilisation of tax losses previously unrecognised for deferred tax	–	(1.3)
<b>Total tax credit</b>	<b>(2.3)</b>	<b>(3.9)</b>

(1) All tax reconciling balances have been classified as recurring items.

The current tax credit as a percentage of the Group's loss (2016 – profit) before tax is negative 3.2 per cent (2016 – 2.6 per cent). Non-taxable (loss) income relates to (losses) profits of companies within the Group that are non-tax resident in the UK and the share of (loss) profit of associate.

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**

	2017 \$m	2016 \$m
Cash at bank and in hand	107.0	122.4
Cash equivalents	149.5	186.4
<b>Total cash and cash equivalents</b>	<b>256.5</b>	<b>308.8</b>

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. Cash and cash equivalents includes managed cash of \$188.1 million (31 December 2016 – \$192.1 million).

**10. Investments**

As at 31 December 2017

	Cost or amortised cost \$m	Unrealised gains \$m	Unrealised losses \$m	Estimated fair value \$m
<b>Fixed maturity securities – AFS</b>				
– Short-term investments	111.2	–	(0.1)	111.1
– Fixed maturity funds	31.2	–	(0.2)	31.0
– U.S. treasuries	237.4	0.1	(1.8)	235.7
– Other government bonds	71.2	0.8	(0.6)	71.4
– U.S. municipal bonds	6.0	–	–	6.0
– U.S. government agency debt	71.2	–	(0.7)	70.5
– Asset backed securities	139.5	4.9	(0.4)	144.0
– U.S. government agency mortgage backed securities	142.4	0.4	(1.8)	141.0
– Non-agency mortgage backed securities	13.2	0.2	(0.2)	13.2
– Non-agency commercial mortgage backed securities	0.2	–	–	0.2
– Bank loans	106.5	0.8	(0.6)	106.7
– Corporate bonds	520.1	3.6	(2.3)	521.4
<b>Total fixed maturity securities – AFS</b>	<b>1,450.1</b>	<b>10.8</b>	<b>(8.7)</b>	<b>1,452.2</b>
Fixed maturity securities – at FVTPL	25.7	–	–	25.7
Equity securities – AFS	20.0	3.2	–	23.2
Hedge funds – at FVTPL	144.6	9.8	(0.4)	154.0
Other investments	–	–	(0.5)	(0.5)
<b>Total investments</b>	<b>1,640.4</b>	<b>23.8</b>	<b>(9.6)</b>	<b>1,654.6</b>



As at 31 December 2016

	Cost or amortised cost \$m	Unrealised gains \$m	Unrealised losses \$m	Estimated fair value \$m
<b>Fixed maturity securities – AFS</b>				
– 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
<b>Total fixed maturity securities – AFS</b>	<b>1,455.6</b>	<b>4.5</b>	<b>(13.9)</b>	<b>1,446.2</b>
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
<b>Total investments</b>	<b>1,649.4</b>	<b>13.8</b>	<b>(14.8)</b>	<b>1,648.4</b>

Accumulated other comprehensive loss is in relation to the Group's AFS fixed maturity and equity securities and is as follows:

	2017 \$m	2016 \$m
Unrealised gains	<b>14.0</b>	5.3
Unrealised losses	<b>(8.7)</b>	(14.3)
Net unrealised foreign exchange (gains) losses on fixed maturity securities – AFS	<b>(6.9)</b>	2.5
Tax provision	<b>0.1</b>	0.1
<b>Accumulated other comprehensive loss</b>	<b>(1.5)</b>	(6.4)

Fixed maturity securities are presented in the risk disclosures section on page 120. 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.

**10. Investments continued****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:

- Short-term investments;
- Fixed maturity funds;
- Other government bonds;
- U.S. municipal bonds;
- U.S. government agency debt;
- Asset backed securities;
- U.S. government agency mortgage backed securities;
- Non-agency mortgage backed securities;
- Non-agency commercial mortgage backed securities;
- Bank loans;
- Corporate bonds; and
- OTC derivatives, such as options, forward foreign exchange contracts, interest rate swaps and credit default swaps.

**Level (iii)**

Level (iii) investments are securities for which valuation techniques are not based on observable market data. The Group classifies hedge funds as Level (iii) assets as the valuation 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 2017	Level (i) \$m	Level (ii) \$m	Level (iii) \$m	Total \$m
<b>Fixed maturity securities – AFS</b>				
– Short-term investments	104.6	6.5	–	111.1
– Fixed maturity funds	–	31.0	–	31.0
– U.S. treasuries	235.7	–	–	235.7
– Other government bonds	–	71.4	–	71.4
– U.S. municipal bonds	–	6.0	–	6.0
– U.S. government agency debt	–	70.5	–	70.5
– Asset backed securities	–	144.0	–	144.0
– U.S. government agency mortgage backed securities	–	141.0	–	141.0
– Non-agency mortgage backed securities	–	13.2	–	13.2
– Non-agency commercial mortgage backed securities	–	0.2	–	0.2
– Bank loans	–	106.7	–	106.7
– Corporate bonds	–	521.4	–	521.4
<b>Total fixed maturity securities – AFS</b>	<b>340.3</b>	<b>1,111.9</b>	<b>–</b>	<b>1,452.2</b>
Fixed maturity securities – at FVTPL	–	25.7	–	25.7
Equity securities – AFS	23.2	–	–	23.2
Hedge funds – at FVTPL	–	–	154.0	154.0
Other investments	–	(0.5)	–	(0.5)
<b>Total investments</b>	<b>363.5</b>	<b>1,137.1</b>	<b>154.0</b>	<b>1,654.6</b>

**10. Investments continued**

As at 31 December 2016

	Level (i) \$m	Level (ii) \$m	Level (iii) \$m	Total \$m
<b>Fixed maturity securities – AFS</b>				
– 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
<b>Total fixed maturity securities – AFS</b>	<b>309.5</b>	<b>1,136.7</b>	<b>–</b>	<b>1,446.2</b>
Fixed maturity securities – at FVTPL	–	51.6	–	51.6
Equity securities – AFS	21.2	–	–	21.2
Hedge funds – at FVTPL	–	–	129.4	129.4
<b>Total investments</b>	<b>330.7</b>	<b>1,188.3</b>	<b>129.4</b>	<b>1,648.4</b>

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
<b>As at 31 December 2015</b>	<b>156.0</b>
Sales	(30.3)
Total net realised and unrealised gains recognised in profit or loss	3.7
<b>As at 31 December 2016</b>	<b>129.4</b>
Purchases	<b>149.7</b>
Sales	<b>(136.5)</b>
Total net realised and unrealised gains recognised in profit or loss	<b>11.4</b>
<b>As at 31 December 2017</b>	<b>154.0</b>

**11. Interests in structured entities****A. Consolidated structured entities**

The Group's two consolidated structured entities are the EBT and the Orange Fund.

- The Group provides capital contributions to the EBT to enable it to meet its obligations to employees under the equity based compensation plans. The Group has a contractual agreement which may require it to provide financial support to the EBT.
- The Orange Fund was opened during 2017 and holds short duration high-quality cash equivalents and fixed maturity securities, and Lancashire Group companies are the only investors in the Orange Fund. The primary objectives of the fund are to preserve capital and provide liquidity to support the Group's operations.

**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 2017, the Group's total interest in unconsolidated structured entities was \$511.8 million (31 December 2016 – \$431.5 million). The Group does not sponsor any of the unconsolidated structured entities.

A summary of the Group's interest in consolidated and unconsolidated structured entities is as follows:

As at 31 December 2017	Orange Fund \$m	Investments \$m	Interest in associate \$m	Total \$m
<b>Fixed maturity securities</b>				
– Asset backed securities	8.1	135.9	–	144.0
– U.S. government agency mortgage backed securities	3.1	137.9	–	141.0
– Non-agency mortgage backed securities	–	13.2	–	13.2
– Non-agency commercial mortgage backed securities	–	0.2	–	0.2
<b>Total fixed maturity securities</b>	<b>11.2</b>	<b>287.2</b>	<b>–</b>	<b>298.4</b>
<b>Investment funds</b>				
– Hedge funds	–	154.0	–	154.0
<b>Total investment funds</b>	<b>–</b>	<b>154.0</b>	<b>–</b>	<b>154.0</b>
<b>Specialised investment vehicles</b>				
– KHL (note 15)	–	–	59.4	59.4
<b>Total</b>	<b>11.2</b>	<b>441.2</b>	<b>59.4</b>	<b>511.8</b>

As at 31 December 2016	Investments \$m	Interest in associate \$m	Total \$m
<b>Fixed maturity securities</b>			
– 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
<b>Total fixed maturity securities</b>	<b>252.4</b>	<b>–</b>	<b>252.4</b>
<b>Investment funds</b>			
– Hedge funds	129.4	–	129.4
<b>Total investment funds</b>	<b>129.4</b>	<b>–</b>	<b>129.4</b>
<b>Specialised investment vehicles</b>			
– KHL (note 15)	–	49.7	49.7
<b>Total</b>	<b>381.8</b>	<b>49.7</b>	<b>431.5</b>

The fixed maturity structured entities are created to meet specific investment needs of borrowers and investors which cannot be met from standardised financial instruments available in the capital markets. As such, they provide liquidity to the borrowers in these markets and provide investors with an opportunity to diversify risk away from standard fixed maturity securities. Whilst individual securities may differ in structure, the principles of the instruments are broadly the same and it is appropriate to aggregate the investments into the categories detailed above.

The risk that the Group faces in respect of the investments in structured entities is similar to the risk it faces in respect of other financial investments held on the consolidated balance sheet in that fair value is determined by market supply and demand. This is in turn driven by investor evaluation of the credit risk of the structure and changes in term structure of interest rates which change investors' expectation of the cash flows associated with the instrument and, therefore, its value in the market. Risk management disclosures for these financial instruments and other investments is provided on pages 110 to 121. 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 2017 and 31 December 2016. Generally, default rates would have to increase substantially from their current level before the Group would suffer a loss and this assessment is made prior to investing and regularly through the holding period for the security. The Group has not provided any other financial or other support in addition to that described above as at the reporting date, and there is no intention to provide support in relation to any other unconsolidated structured entities in the foreseeable future.



**11. Interests in structured entities continued**

As at 31 December 2017 the Group has a commitment of \$100.0 million (31 December 2016 – \$50.0 million) in respect of two credit facility funds. The Group, via the funds, provides collateral for revolving credit facilities purchased at a discount from financial institutions and is at risk for its portion of any defaults on those revolving credit facilities. The Group's proportionate share of these revolving credit facilities purchased by the funds as at 31 December 2017 is \$64.4 million (31 December 2016 – \$37.5 million), which currently remains unfunded. The maximum exposure to the credit facility funds is \$100.0 million and as at 31 December 2017 there have been no defaults under these facilities.

**12. Losses and loss adjustment expenses**

	Losses and loss adjustment expenses \$m	Reinsurance recoveries \$m	Net losses and loss adjustment expenses \$m
<b>As at 31 December 2015</b>	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)
<b>Incurred losses and loss adjustment expenses</b>	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
<b>Paid losses and loss adjustment expenses</b>	199.6	(15.5)	184.1
<b>As at 31 December 2016</b>	679.8	(136.7)	543.1
Net incurred losses for:			
Prior years	(40.1)	(25.0)	(65.1)
Current year	578.1	(177.6)	400.5
Exchange adjustments	18.8	(0.7)	18.1
<b>Incurred losses and loss adjustment expenses</b>	556.8	(203.3)	353.5
Net paid losses for:			
Prior years	231.1	(50.2)	180.9
Current year	72.0	(5.7)	66.3
<b>Paid losses and loss adjustment expenses</b>	303.1	(55.9)	247.2
<b>As at 31 December 2017</b>	933.5	(284.1)	649.4

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from page 107. 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 \$186.7 million (31 December 2016 – \$136.0 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:

	2017		2016	
	\$m	%	\$m	%
<b>As at 31 December</b>				
Outstanding losses	300.4	32.2	328.1	48.3
Additional case reserves	186.5	20.0	144.5	21.3
Losses incurred but not reported	446.6	47.8	207.2	30.4
<b>Total</b>	933.5	100.0	679.8	100.0

The Group's reserve for unpaid losses and loss adjustment expenses as at 31 December 2017 and 2016 had an estimated duration of approximately two years.

### Claims development

The development of insurance liabilities is indicative of the Group's ability to estimate the ultimate value of its insurance liabilities. The Group began writing insurance and reinsurance business in December 2005. With the acquisition of Cathedral in 2013, the Group assumed additional loss reserves relating to 2001 and subsequent years.

Accident year	2007 and prior \$m	2008 \$m	2009 \$m	2010 \$m	2011 \$m	2012 \$m	2013 \$m	2014 \$m	2015 \$m	2016 \$m	2017 \$m	Total \$m
<b>Gross Group losses</b>												
Estimate of ultimate liability <sup>1</sup>												
At end of accident year	228.6	444.6	163.3	297.4	397.0	250.3	280.0	274.8	276.0	298.5	580.1	
One year later	163.2	417.4	107.8	209.4	371.9	350.4	259.8	226.7	214.6	310.7		
Two years later	131.1	377.5	73.1	204.2	447.0	338.8	224.0	206.0	196.2			
Three years later	122.0	345.1	66.0	235.8	450.4	326.9	224.4	196.5				
Four years later	107.9	340.8	89.1	229.4	460.0	313.3	222.1					
Five years later	105.0	355.6	81.7	231.4	450.7	308.7						
Six years later	148.2	350.9	72.9	229.8	452.6							
Seven years later	146.4	353.6	90.8	229.6								
Eight years later	143.1	352.5	89.6									
Nine years later	142.4	353.1										
Ten years later	140.6											
<b>Current estimate of cumulative liability</b>	<b>140.6</b>	<b>353.1</b>	<b>89.6</b>	<b>229.6</b>	<b>452.6</b>	<b>308.7</b>	<b>222.1</b>	<b>196.5</b>	<b>196.2</b>	<b>310.7</b>	<b>580.1</b>	<b>3,079.8</b>
<b>Paid</b>	<b>(113.1)</b>	<b>(341.1)</b>	<b>(60.2)</b>	<b>(215.9)</b>	<b>(421.4)</b>	<b>(267.3)</b>	<b>(200.0)</b>	<b>(167.5)</b>	<b>(153.5)</b>	<b>(134.3)</b>	<b>(72.0)</b>	<b>(2,146.3)</b>
<b>Total Group gross liability</b>	<b>27.5</b>	<b>12.0</b>	<b>29.4</b>	<b>13.7</b>	<b>31.2</b>	<b>41.4</b>	<b>22.1</b>	<b>29.0</b>	<b>42.7</b>	<b>176.4</b>	<b>508.1</b>	<b>933.5</b>

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2017.

Accident year	2007 and prior \$m	2008 \$m	2009 \$m	2010 \$m	2011 \$m	2012 \$m	2013 \$m	2014 \$m	2015 \$m	2016 \$m	2017 \$m	Total \$m
<b>Reinsurance</b>												
Estimate of ultimate recovery <sup>1</sup>												
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	177.6	
One year later	6.2	47.1	1.3	23.6	52.6	121.8	8.9	14.1	12.2	98.5		
Two years later	4.0	43.1	0.7	24.1	92.4	122.0	8.8	13.1	12.6			
Three years later	3.5	40.9	0.7	33.5	88.9	121.2	8.0	11.5				
Four years later	3.3	38.1	10.0	34.4	103.3	121.2	8.0					
Five years later	3.1	40.7	7.0	34.6	102.8	121.2						
Six years later	29.1	39.8	2.5	35.7	106.1							
Seven years later	29.2	40.4	2.5	36.2								
Eight years later	28.8	40.9	1.3									
Nine years later	27.8	41.0										
Ten years later	26.6											
<b>Current estimate of cumulative recovery</b>	<b>26.6</b>	<b>41.0</b>	<b>1.3</b>	<b>36.2</b>	<b>106.1</b>	<b>121.2</b>	<b>8.0</b>	<b>11.5</b>	<b>12.6</b>	<b>98.5</b>	<b>177.6</b>	<b>640.6</b>
<b>Paid</b>	<b>(7.3)</b>	<b>(39.0)</b>	<b>0.5</b>	<b>(34.4)</b>	<b>(99.2)</b>	<b>(117.8)</b>	<b>(7.4)</b>	<b>(8.0)</b>	<b>(12.0)</b>	<b>(26.2)</b>	<b>(5.7)</b>	<b>(356.5)</b>
<b>Total Group gross recovery</b>	<b>19.3</b>	<b>2.0</b>	<b>1.8</b>	<b>1.8</b>	<b>6.9</b>	<b>3.4</b>	<b>0.6</b>	<b>3.5</b>	<b>0.6</b>	<b>72.3</b>	<b>171.9</b>	<b>284.1</b>

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2017.

**12. Losses and loss adjustment expenses continued**

Accident year	2007 and prior \$m	2008 \$m	2009 \$m	2010 \$m	2011 \$m	2012 \$m	2013 \$m	2014 \$m	2015 \$m	2016 \$m	2017 \$m	Total \$m
<b>Net Group losses</b>												
Estimate of ultimate liability <sup>1</sup>												
At end of accident year	225.0	403.9	161.7	263.6	340.8	201.4	270.1	257.0	260.7	225.4	402.5	
One year later	157.0	370.3	106.5	185.8	319.3	228.6	250.9	212.6	202.4	212.2		
Two years later	127.1	334.4	72.4	180.1	354.6	216.8	215.2	192.9	183.6			
Three years later	118.5	304.2	65.3	202.3	361.5	205.7	216.4	185.0				
Four years later	104.6	302.7	79.1	195.0	356.7	192.1	214.1					
Five years later	101.9	314.9	74.7	196.8	347.9	187.5						
Six years later	119.1	311.1	70.4	194.1	346.5							
Seven years later	117.2	313.2	88.3	193.4								
Eight years later	114.3	311.6	88.3									
Nine years later	114.6	312.1										
Ten years later	114.0											
<b>Current estimate of cumulative liability</b>	<b>114.0</b>	<b>312.1</b>	<b>88.3</b>	<b>193.4</b>	<b>346.5</b>	<b>187.5</b>	<b>214.1</b>	<b>185.0</b>	<b>183.6</b>	<b>212.2</b>	<b>402.5</b>	<b>2,439.2</b>
<b>Paid</b>	<b>(105.8)</b>	<b>(302.1)</b>	<b>(60.7)</b>	<b>(181.5)</b>	<b>(322.2)</b>	<b>(149.5)</b>	<b>(192.6)</b>	<b>(159.5)</b>	<b>(141.5)</b>	<b>(108.1)</b>	<b>(66.3)</b>	<b>(1,789.8)</b>
<b>Total Group net liability</b>	<b>8.2</b>	<b>10.0</b>	<b>27.6</b>	<b>11.9</b>	<b>24.3</b>	<b>38.0</b>	<b>21.5</b>	<b>25.5</b>	<b>42.1</b>	<b>104.1</b>	<b>336.2</b>	<b>649.4</b>

(1) Adjusted for revaluation of foreign currencies at the exchange rate as at 31 December 2017.

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:

	2017 \$m	2016 \$m
2007 accident year and prior	0.6	(0.4)
2008 accident year	(0.5)	1.6
2009 accident year	0.1	(18.0)
2010 accident year	1.8	3.2
2011 accident year	8.8	9.9
2012 accident year	5.0	13.5
2013 accident year	3.5	(1.6)
2014 accident year	9.2	19.9
2015 accident year	20.3	57.7
2016 accident year	16.3	–
<b>Total favourable development</b>	<b>65.1</b>	<b>85.8</b>

Despite some adverse development on prior accident year property and energy claims in 2017, 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 2016 was similar in terms of releases, offset partially by some adverse development on prior accident year energy and marine claims.

In September 2017, hurricanes Harvey, Irma and Maria made landfall in the Caribbean and U.S., causing significant damage and destruction to property. These events were followed by wildfires in California during October 2017 and December 2017. Management's current best estimates in relation to each of these events are shown in the table below.

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

	Harvey \$m	Irma \$m	Maria \$m	Combined California Wildfires \$m
Change in insurance losses and loss adjustment expenses	66.3	108.9	78.5	75.9
Change in insurance losses and loss adjustment expenses recoverable	(18.5)	(55.1)	(43.1)	(41.4)
Change in reinstatement premiums	(3.3)	(1.7)	(2.3)	(0.4)
<b>Net ultimate losses as at 31 December 2017</b>	<b>44.5</b>	<b>52.1</b>	<b>33.1</b>	<b>34.1</b>

### 13. Insurance, reinsurance and other receivables

All receivables are considered current other than \$53.7 million (31 December 2016 – \$58.4 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

	2017 \$m	2016 \$m
Equity based compensation	(2.9)	(3.8)
Claims equalisation reserves	8.3	8.1
Syndicate underwriting profits	0.1	2.7
Syndicate participation rights	12.7	12.8
Other temporary differences	(1.2)	(0.9)
Tax losses carried forward	(0.5)	(0.2)
<b>Net deferred tax liability</b>	<b>16.5</b>	<b>18.7</b>

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 \$10.9 million (31 December 2016 – \$11.4 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. For the years ended 31 December 2017 and 2016, the Group had no uncertain tax positions.

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 19.0 per cent from 1 April 2017 and to 17.0 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 2017, the carrying value of the Group's investment in KHL was \$59.4 million (31 December 2016 – \$49.7 million). The Group's share of comprehensive loss for KHL for the period was \$9.4 million (2016 – \$5.1 million income). Key financial information for KHL is as follows:

	2017 \$m	2016 \$m
Assets	736.4	506.5
Liabilities	141.9	9.2
Shareholders' equity	594.5	497.3
Gross premium earned	71.7	54.2
Comprehensive (loss) income	(94.3)	51.1

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
<b>Net book value as at 31 December 2017 and 2016</b>	<b>82.6</b>	<b>71.2</b>	<b>153.8</b>

Syndicate participation rights and goodwill are deemed to have an 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 6.2 per cent (2016 – 6.9 per cent) has been used to discount the projected cash flows, which reflects a combination of factors including the Group's expected cost of equity and cost of borrowing. The growth rate used to extrapolate the cash flows is 3.0 per cent (2016 – 3.0 per cent) based on historical growth rates and management's best estimate of future growth rates.

The results of this exercise indicate that the recoverable amount exceeds the intangible assets' carrying value for both the syndicate participation rights and the 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 2017 and 2016.

**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 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 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 notes issued by CCHL.

As at all reporting dates the Group was in compliance with all covenants under these facilities.

The carrying values of the notes are shown below:

As at 31 December	2017 \$m	2016 \$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	28.8	25.3
Long-term debt €12.0 million	13.1	11.2
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
<b>Carrying value</b>	<b>326.3</b>	<b>320.9</b>

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 117.

The fair value of the long-term debt is estimated as \$369.3 million (31 December 2016 – \$354.8 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 \$2.3 million (31 December 2016 – \$2.0 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 116 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 \$2.0 million (31 December 2016 – \$3.7 million). Further information is provided on pages 114 to 116. Cash settlements are completed on a quarterly basis and the total of the next cash settlements in the first quarter of 2018 on these instruments is \$0.3 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	2017 \$m	2016 \$m
Issued to third parties	31.0	29.4

LOCs are required to be fully collateralised.

**17. Long-term debt and financing arrangements continued**

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 2017 and 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.

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.

A \$130.0 million syndicated uncollateralised facility has been in place since 3 October 2017 and will expire on 31 December 2018. It is available for utilisation by LICL and guaranteed by LHL for FAL purposes. As at 31 December 2017 \$130.0 million of LOCs were issued under this facility.

The terms of the \$130.0 million syndicated uncollateralised facility includes standard default and cross-default provisions and require certain covenants to be adhered to. These include the following:

- an A.M. Best financial strength rating of at least B++;
- a maximum debt-to-capital ratio of 30.0 per cent, where the subordinated loan notes are excluded from this calculation;
- a maximum indebtedness regarding the subordinated loan notes of \$250.0 million; and
- maintenance of a minimum net worth requirement.

As at all reporting dates the Group was in compliance with all covenants under these facilities.

**Syndicate bank facilities**

As at 31 December 2017 and 2016, 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. For 2018, up to \$80.0 million can be utilised by way of an LOC or an RCF to assist Syndicate 2010's gross funding requirements.

As at 31 December 2016, Syndicate 3010 had in place a \$40.0 million catastrophe facility with Barclays Bank plc. The facility was available to assist in paying claims and the gross funding of catastrophes for Syndicate 3010. Up to \$20.0 million could 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.

There are no balances outstanding under either of the Syndicates' bank facilities as at 31 December 2017 or 2016. The Syndicates' 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 2017 and 2016, LICL had been granted authorised or trustee 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 2017 and 2016, 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 125 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 125 for more information regarding the 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:

	2017				2016			
	Cash and cash equivalents \$m	Fixed maturity securities \$m	Equity securities \$m	Total \$m	Cash and cash equivalents \$m	Fixed maturity securities \$m	Equity securities \$m	Total \$m
As at 31 December								
MBRT accounts	50.7	132.4	–	183.1	5.6	35.1	–	40.7
FAL	18.4	132.5	–	150.9	13.5	254.1	1.4	269.0
Syndicate accounts	21.0	78.3	–	99.3	26.8	75.9	–	102.7
In favour of LOCs	5.4	35.7	–	41.1	6.2	29.4	–	35.6
In trust accounts for policyholders	0.8	24.6	–	25.4	3.7	21.4	–	25.1
In favour of derivative contracts	3.0	0.3	–	3.3	3.8	0.3	–	4.1
<b>Total</b>	<b>99.3</b>	<b>403.8</b>	<b>–</b>	<b>503.1</b>	<b>59.6</b>	<b>416.2</b>	<b>1.4</b>	<b>477.2</b>

## 18. Share capital

Authorised common shares of \$0.50 each

	Number	\$m
As at 31 December 2017 and 2016	3,000,000,000	1,500

Allocated, called up and fully paid

	Number	\$m
As at 31 December 2017 and 2016	201,341,918	100.7

Own shares	Number held in treasury	\$m	Number held in trust	\$m	Total number of own shares	\$m
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
Shares distributed	–	–	(1,130,800)	(9.9)	(1,130,800)	(9.9)
Shares donated to trust	(1,415,058)	(14.0)	1,415,058	12.8	–	(1.2)
As at 31 December 2017	–	–	1,333,227	12.1	1,333,227	12.1

The number of common shares in issue with voting rights (allocated share capital less shares held in treasury) as at 31 December 2017 was 201,341,918 (31 December 2016 – 199,926,860).

### Share repurchases

At the AGM held on 3 May 2017, 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 2018 AGM or, if earlier, 15 months from the date the resolution approving the Repurchase Programme was passed. There were no share repurchases during either 2017 or 2016.

During the year ended 31 December 2017, 1,415,058 shares (2016 – 426,468 shares) were donated to the EBT at a market value of \$12.8 million (2016 – \$3.5 million).

In 2017, the trustees of the EBT distributed 1,130,800 shares (2016 – 680,033 shares). There were no unsettled balances in relation to EBT purchases at either balance sheet date.

**18. Share capital continued****Dividends**

The Board of Directors have authorised the following dividends:

Type	Per share amount	Record date	Payment date	\$m
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
Final	<b>\$0.10</b>	<b>24 Feb 2017</b>	<b>22 Mar 2017</b>	<b>19.9</b>
Interim	<b>\$0.05</b>	<b>11 Aug 2017</b>	<b>6 Sep 2017</b>	<b>10.0</b>

**19. Other reserves**

Other reserves consist of the following:

	Contributed surplus \$m	Equity based compensation \$m	Total other reserves \$m
<b>As at 31 December 2015</b>	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
<b>As at 31 December 2016</b>	839.5	42.1	881.6
Shares donated to the trust	(1.2)	–	(1.2)
Distributed by trust	(13.8)	–	(13.8)
Equity based compensation – exercises	14.6	(14.6)	–
Equity based compensation – expense	–	(0.4)	(0.4)
<b>As at 31 December 2017</b>	<b>839.1</b>	<b>27.1</b>	<b>866.2</b>

**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 \$3.4 million (2016 – \$2.3 million).

Future minimum lease payments under non-cancellable operating leases are as follows:

	2017 \$m	2016 \$m
Due in less than one year	<b>3.6</b>	3.0
Due between one and five years	<b>10.0</b>	10.2
Due in more than five years	<b>28.3</b>	28.1
<b>Total</b>	<b>41.9</b>	41.3

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 LHL.

**B. Credit facility fund**

At as 31 December 2017 the Group has a commitment of \$100.0 million (31 December 2016 – \$50.0 million) relating to two credit facility funds (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:

	2017 \$m	2016 \$m
(Loss) profit for the year attributable to equity shareholders of LHL	(71.1)	153.8

	2017 Number of shares	2016 Number of shares
Basic weighted average number of shares	199,723,434	198,565,378
Dilutive effect of RSS	1,780,368	2,901,049
<b>Diluted weighted average number of shares</b>	<b>201,503,802</b>	<b>201,466,427</b>

	2017	2016
(Loss) earnings per share		
Basic	(\$0.36)	\$0.77
Diluted	(\$0.36)	\$0.76

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
<b>Subsidiaries<sup>1</sup></b>		
LICL	General insurance business	Bermuda
KCML <sup>2</sup>	Insurance management services	Bermuda
ORANGE FUND	Investment fund	United States
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
<b>Associate</b>		
KHL	Holding company	Bermuda
<b>Other controlled entities</b>		
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) 92.7 per cent owned by the Group.



## 22. Related party disclosures continued

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 \$80.0 million. The Facility may only be used by the trustee for the purpose of achieving the objectives of the EBT. During the year ended 31 December 2017, the Group had made advances of \$6.0 million (2016 – \$nil) to the EBT under the terms of the Facility.

During the year ended 31 December 2017, the Group donated 1,415,058 treasury shares (2016 – 426,468) to the EBT at the prevailing market rate. The total value of the treasury share donation was \$12.8 million (2016 – \$3.5 million).

LICL holds \$245.3 million (31 December 2016 – \$290.8 million) of cash and cash equivalents, fixed maturity securities and accrued interest in trust for the benefit of LUK relating to intra-group reinsurance agreements. In addition, LICL is required to provide 85.0 per cent of the required FAL to support the underwriting activities of Syndicate 2010 and 3010 and holds \$109.2 million (31 December 2016 – \$230.0 million) of cash and cash equivalents and fixed maturity securities in FAL in relation to intra-group reinsurance agreements.

The senior management team shareholding in KCML represents a minority interest of 7.3 per cent. This investment represents the non-controlling interest listed in the Group's consolidated balance sheet. During the year ended 31 December 2017 dividends of \$0.6 million (31 December 2016 – \$0.5 million) were paid to minority interest holders.

As at 31 December 2017 and 2016, Mr Alex Maloney, a director of LHL, had a 1.2 per cent interest in KCML. During the year ended 31 December 2017 Mr Maloney received a dividend of \$0.1 million (31 December 2016 – \$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 2018 year of account (2017 year of account – \$0.2 million). Mr Maloney receives a proportionate share of the underwriting results of Syndicate 2010 to which he is contractually entitled through his participation.

### Key management compensation

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

For the year ended 31 December	2017 \$m	2016 \$m
Short-term compensation	2.9	3.2
Equity based compensation	0.2	3.3
Directors' fees and expenses	2.1	2.2
<b>Total</b>	<b>5.2</b>	<b>8.7</b>

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 2017, the Group recognised \$11.7 million (2016 – \$10.6 million) of service fees and profit commissions in other income in relation to this agreement.

During 2017, the Group committed an additional \$57.5 million (31 December 2016 – \$25.8 million) of capital to KHL. During 2017, KHL returned \$38.4 million (31 December 2016 – \$28.7 million) of capital to the Group.

Refer to note 15 for further details on the Group's investment in associate.

### Transactions with subsidiary of KHL

During 2017, the Group entered into a reinsurance agreement with KRL. The following balances are included in the Group's consolidated financial statements:

	2017 \$m
<b>Consolidated balance sheet</b>	
Reinsurance recoveries	22.1
<b>Consolidated statement of comprehensive (loss) income</b>	
Outwards reinsurance premiums	3.8
Insurance losses and loss adjustment expenses recoverable	22.1
Insurance acquisition expenses ceded	0.1

## 23. Subsequent events

### Dividend

On 14 February 2018 the Board of Directors declared the payment of an ordinary dividend of \$0.10 per common share to shareholders of record on 23 February 2018, with a settlement date of 21 March 2018. The ordinary dividend payable will be approximately \$20.0 million. An amount equivalent to the dividend accrues on all RSS options and is paid at the time of exercise, pro-rata according to the number of RSS options that vest.

### Annual General Meeting

The Company's AGM is scheduled for 2 May 2018. Notice of this year's AGM and forms of proxy and direction accompany this Annual Report. If you have any queries regarding the notice or return of the proxy please contact Chris Head, Company Secretary, 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](mailto: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](http://www.lancashiregroup.com). Please address any enquiries to [info@lancashiregroup.com](mailto:info@lancashiregroup.com).

### Note regarding forward-looking statements

Some of the statements in this document include forward-looking statements which reflect the Directors' current views with respect to financial performance, business strategy, plans and objectives of management for future operations (including development plans relating to the Group's products and services). These statements include forward-looking statements both with respect to the Group and the sectors and industries in which the Group operates. Statements containing the words "believes", "anticipates", "plans", "projects", "forecasts", "guidance", "intends", "expects", "estimates", "predicts", "may", "can", "likely", "will", "seeks", "should" or, in each case, their negative or comparable terminology and similar statements are of a future or forward-looking nature. All forward-looking statements address matters that involve known and unknown risks and uncertainties. Accordingly, there are or will be important factors that could cause the actual results, performance or achievements of the Group to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

These factors include, but are not limited to: the actual development of losses and expenses impacting estimates for hurricanes Harvey, Irma and Maria and the earthquakes in Mexico, that occurred in the third quarter of 2017 and the wildfires which impacted parts of California during 2017, the impact of complex and unique causation and coverage issues associated with attribution of losses to wind or flood damage or other perils such as fire or business interruption relating to such events; potential uncertainties relating to reinsurance recoveries, reinstatement premiums and other factors inherent in loss estimations, the Group's ability to integrate its business and personnel, the successful retention and motivation of the Group's key management, the increased regulatory burden facing the Group, the number and type of insurance and reinsurance contracts that the Group writes or the Group may write; the Group's ability to successfully implement its business strategy during 'soft' as well as 'hard' markets; the premium rates which may be available at the time of such renewals within its targeted business lines; the possible low frequency of large events; potentially unusual loss frequency; the impact that the Group's future operating results, capital position

and rating agency and other considerations may have on the execution of any capital management initiatives or dividends; the possibility of greater frequency or severity of claims and loss activity than the Group's underwriting, reserving or investment practices have anticipated; the reliability of, and changes in assumptions to, catastrophe pricing, accumulation and estimated loss models; increased competition from existing alternative capital providers and insurance-linked funds and collateralised special purpose insurers and the related demand and supply dynamics as contracts come up for renewal; the effectiveness of its loss limitation methods; the potential loss of key personnel; a decline in the Group's operating subsidiaries' rating with A.M.Best, S&P Global Ratings, Moody's or other rating agencies; increased competition on the basis of pricing, capacity, coverage terms or other factors; cyclical downturns of the industry; the impact of a deteriorating credit environment for issuers of fixed maturity investments; the impact of swings in market interest rates, currency exchange rates and securities prices; changes by central banks regarding the level of interest rates; the impact of inflation or deflation in relevant economies in which the Group operates; the effect, timing and other uncertainties surrounding future business combinations within the insurance and reinsurance industries; the impact of terrorist activity in the countries in which the Group writes risks; a rating downgrade of, or a market decline in, securities in its investment portfolio; changes in governmental regulations or tax laws in jurisdictions where the Group conducts business; Lancashire or its Bermudian subsidiaries becoming subject to income taxes in the United States or 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 'Brexit' (following the UK's notification to the European Council under Article 50 of the Treaty on European Union on 29 March 2017) and future negotiations regarding the UK's relationship with the European Union on the Group's business, regulatory relationships, underwriting platforms or the industry generally.

Any estimates relating to loss events involve the exercise of considerable judgement and reflect a combination of ground-up evaluations, information available to date from brokers and insureds, market intelligence, initial and/or tentative loss reports and other sources. Judgements in relation to loss arising from natural catastrophe and man-made events are influenced by complex factors. The Group cautions as to the preliminary nature of the information used to prepare such estimates as subsequently available information may contribute to an increase in these types of losses.

These forward-looking statements speak only as at the date of this document. The Company expressly disclaims any obligation or undertaking (save as required to comply with any legal or regulatory obligations including the rules of the LSE) to disseminate any updates or revisions to any forward-looking statement to reflect any changes in the Group's expectations or circumstances on which any such statement is based. All subsequent written and oral forward-looking statements attributable to the Group or individuals acting on behalf of the Group are expressly qualified in their entirety by this paragraph. Prospective investors should specifically consider the factors identified in this document which could cause actual results to differ before making an investment decision.

## Glossary

### ABS

Asset backed securities

### Accident year loss ratio

The accident year loss ratio is calculated using the accident year ultimate liability revalued at the current balance sheet date, divided by net premiums earned

### Active Underwriter

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

### Additional case reserves (ACR)

Additional reserves deemed necessary by management

### AFS

Available for sale

### Aggregate

Accumulations of insurance loss exposures which result from underwriting multiple risks that are exposed to common causes of loss

### AGM

Annual General Meeting

### AIM

A sub-market of the LSE

### AIR

AIR Worldwide

### A.M. Best Company (A.M. Best)

A.M. Best is a full-service credit rating organisation dedicated to serving the financial services industries, focusing on the insurance sector

### Best Lancashire Assessment of Solvency over Time (BLAST)

The Group's economic internal capital model

### BMA

Bermuda Monetary Authority

### Board of Directors, Board

Unless otherwise stated refers to the LHL Board of Directors

### Book value per share (BVS)

Calculated by dividing the value of the total shareholders' equity by the sum of all common voting shares outstanding

### BREEAM

Building Research Establishment Environmental Assessment Method

### BSCR

Bermuda Solvency Capital Requirement

### BSX

Bermuda Stock Exchange

### Cathedral; Cathedral Group

Refers to CCL and all direct and indirect subsidiaries of CCL

### CCHL

Cathedral Capital Holdings Limited

### CCL

Cathedral Capital Limited

### CCL 1998

Cathedral Capital (1998) Limited

### CCL 1999

Cathedral Capital (1999) Limited

### CCSL

Cathedral Capital Services Limited

### Ceded

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

### CEND

Confiscation, Expropriation, Nationalisation and Deprivation

### CEO

Chief Executive Officer

### 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

### D&F

Direct and facultative (re)insurance

### Deferred acquisition costs

Costs incurred for the acquisition or the renewal of insurance policies (e.g. brokerage and premium taxes) which are deferred and amortised over the term of the insurance contracts to which they relate

### DEFRA

Department for Environment, Food and Rural Affairs

**Delegated authorities**

Arrangements under which a Managing Agent or (re)insurer delegates its authority to another to enter into contracts of insurance on its behalf

**Diluted Earnings Per Share**

Calculated by dividing the net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year plus the weighted average number of common shares that would be issued on the conversion of all potentially dilutive equity based compensation awards into common shares under the treasury stock method

**Diluted Operating Earnings Per Share**

Calculated by dividing the net operating (loss) income for the year attributable to shareholders by the weighted average number of common shares outstanding during the year plus the weighted average number of common shares that would be issued on the conversion of all potentially dilutive equity based compensation awards into common shares under the treasury stock method

**Directors' fees and expenses**

Unless otherwise stated includes fees and expenses of all Directors across the Group

**Dividend yield**

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

**Duration**

Duration is the weighted average maturity of a security's cash flows, where the present values of the cash flows serve as the weights. The effect of the convexity, or sensitivity, of the portfolio's response to changes in interest rates is also factored in to the calculation

**Earnings per share (EPS)**

Calculated by dividing net profit for the year attributable to shareholders by the weighted average number of common shares outstanding during the year, excluding treasury shares and shares held by the EBT

**EBT**

Lancashire Holdings Employee Benefit Trust

**ECA**

Economic Capital Assessment

**EEA**

European Economic Area

**ERM**

Enterprise Risk Management

**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)

**FTE**

Full-Time Employee

**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

**GHG**

Greenhouse Gas

**Gross premiums written**

Amounts payable by the insured, excluding any taxes or duties levied on the premium, including any brokerage and commission deducted by intermediaries

**The Group or the Lancashire Group**

LHL and its subsidiaries

**ICM**

International Care Ministries

**IFRIC**

International Financial Reporting Interpretations Committee

**IFRS**

International Financial Reporting Standard(s)

**ILS**

Insurance Linked Securities

**Incurred but not reported (IBNR)**

These are anticipated or likely losses that may result from insured events which have taken place, but for which no losses have yet been reported. IBNR also includes a reserve for possible adverse development of previously reported losses

**Industry loss warranty (ILW)**

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



**Internal Audit Charter**

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

**LMSC**

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 (loss)/ profit**

(Loss)/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 an adjusted 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

**Orange Fund**

A Series of Payden Active Cash Management, LLC

**ORSA**

Own Risk and Solvency Assessment

**OTC**

Over the counter

**PML**

Probable maximum loss. The Group's exposure to certain peak zone elemental losses

**PRA**

Prudential Regulation Authority

**Pro-rata/proportional**

Reinsurance or insurance where the reinsurer or insurer shares a proportional part of the original premiums and losses of the reinsured or insured

**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

**S&P global ratings (S&P)**

S&P Global Ratings is a worldwide insurance rating and information agency whose ratings are recognised as an ideal benchmark for assessing the financial strength of insurance related organisations

**SATEC**

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

**SCR**

Solvency Capital Requirement

**SHARP**

Lancashire's in house aggregation system

**Syndicate 2010**

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

**Syndicate 3010**

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

**The syndicates**

Syndicate 2010 and 3010

**TOBA**

Terms of business agreements

**Total Investment Return**

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

**Total Shareholder Return (TSR)**

The IRR of the increase/(decrease) in share price in the period, measured in U.S. dollars, adjusted for dividends

**Treaty reinsurance**

A reinsurance contract under which the reinsurer agrees to offer and to accept all risks of a certain size within a defined class

**UK**

United Kingdom

**UMCC**

Underwriting and Marketing Conference Call

**Unearned premiums**

The portion of premium income that is attributable to periods after the balance sheet date that is deferred and amortised to future accounting periods

**UNL**

Ultimate net loss

**USCR**

Ultimate solvency capital requirement

**U.S.**

United States of America

**U.S. GAAP**

Accounting principles generally accepted in the United States

**Value at Risk (VaR)**

A measure of the risk of loss of a specific portfolio of financial assets

## Contact information

### Head office

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29<sup>th</sup> Floor  
20 Fenchurch Street  
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### Legal counsel to the Company

#### As to English and U.S. law:

Willkie Farr & Gallagher (UK) LLP  
City Point  
1 Ropemaker Street  
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#### As to Bermuda law:

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Clarendon House  
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Hamilton HM 11  
Bermuda

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15 Canada Square  
London E14 5GL  
United Kingdom

### Registrar

Link Market Services (Jersey) Limited  
12 Castle Street  
St Helier  
Jersey JE2 3RT  
Channel Islands

### Depository

Link Market Services Trustees Limited  
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*[www.lancashiregroup.com](http://www.lancashiregroup.com)*