UNDERWRITING
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OPERATE NIMBLY
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lancashire
INSURANCE COMPANY LIMITED

Financial statements 31 December 2017

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Independent Auditor's Report

To the Shareholder and Board of Directors of Lancashire Insurance Company Limited

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Lancashire Insurance Company Limited (the "Company"), which comprise the balance sheet as at December 31, 2017, the statements of comprehensive (loss) income, changes in shareholder's equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at December 31, 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Bermuda and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company'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 management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

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

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As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG Audit Limited

KPMG Audit Limited
Hamilton, Bermuda
February 8, 2018

STATEMENT OF COMPREHENSIVE (LOSS) INCOME

For the year ended 31 December 2017

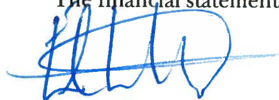
	Notes	**2017 $m**	2016 $m
Gross premiums written	2	**277.9**	313.9
Outwards reinsurance premiums	2	**(52.6)**	(49.1)
Net premiums written		**225.3**	264.8
Change in unearned premiums	2	**18.9**	8.4
Change in unearned premiums on premiums ceded	2	**0.5**	3.6
Net premiums earned		**244.7**	276.8
Net investment income	3	**24.2**	23.3
Net other investment income	3	**1.2**	6.9
Net realised gains (losses) and impairments	3	**8.3**	(1.7)
Other (losses) income	16	**(47.1)**	29.3
Net foreign exchange gains (losses)		**2.5**	(3.5)
Total net revenue		**233.8**	331.1
Insurance losses and loss adjustment expenses	2, 11	**272.1**	59.0
Insurance losses and loss adjustment expenses recoverable	2, 11	**(86.2)**	(1.1)
Net insurance losses		**185.9**	57.9
Insurance acquisition expenses	2, 4	**76.5**	84.5
Insurance acquisition expenses ceded	2, 4	**(2.3)**	(1.1)
Other operating expenses	5, 6, 15	**20.4**	21.7
Equity based compensation	6, 16	**0.8**	3.5
Total expenses		**281.3**	166.5
Results of operating activities		**(47.5)**	164.6
Financing costs		**1.1**	1.5
(Loss) profit for the year attributable to equity shareholder		**(48.6)**	163.1
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Net change in unrealised gains/losses on investments	3, 9	**6.2**	3.3
Other comprehensive income	9	**6.2**	3.3
Total comprehensive (loss) income for the year		**(42.4)**	166.4

BALANCE SHEET

As at 31 December 2017

	Notes	2017 $m	2016 $m
Assets			
Cash and cash equivalents	8, 13	**156.2**	126.6
Accrued interest receivable		**4.6**	5.0
Investments	9, 10, 13	**1,288.0**	1,269.8
Inwards premiums receivable from insureds and cedants	12	**77.0**	75.9
Reinsurance assets			
– Unearned premiums on premiums ceded		**6.3**	5.8
– Reinsurance recoveries	11	**87.7**	1.8
Other receivables	12	**28.2**	60.4
Property, plant and equipment		**0.3**	0.5
Deferred acquisition costs		**59.3**	56.9
Total assets		**1,707.6**	1,602.7
Liabilities			
Insurance contracts			
– Losses and loss adjustment expenses	11	**499.4**	338.1
– Unearned premiums		**193.7**	212.6
– Other payables		**30.8**	5.2
Amounts payable to reinsurers		**5.9**	0.9
Deferred acquisition costs ceded		**0.6**	0.2
Other payables		**45.9**	37.0
Total liabilities		**776.3**	594.0
Shareholder's equity			
Share capital	14	**1.0**	1.0
Contributed surplus	16	**840.5**	840.5
Accumulated other comprehensive loss	9	**(0.1)**	(6.3)
Retained earnings		**89.9**	173.5
Total shareholder's equity attributable to equity shareholder		**931.3**	1,008.7
Total liabilities and shareholder's equity		**1,707.6**	1,602.7

The financial statements were approved by the Board of Directors on 8 February 2018 and signed on its behalf by:



Elaine Whelan

Director/Chief Executive Officer

Jennifer Wilson

Director/Chief Financial Officer

STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY

For the year ended 31 December 2017

	Notes	Share capital $m	Contributed surplus $m	Accumulated other comprehensive loss $m	Retained earnings $m	Total shareholder's equity $m
Balance as at 31 December 2015		1.0	798.7	(9.6)	210.4	1,000.5
Total comprehensive income for the year		—	—	3.3	163.1	166.4
Dividend	14	—	—	—	(200.0)	(200.0)
Shareholder contribution	16	—	41.8	—	—	41.8
Balance as at 31 December 2016		1.0	840.5	(6.3)	173.5	1,008.7
Total comprehensive (loss) income for the year		**—**	**—**	**6.2**	**(48.6)**	**(42.4)**
Dividend	14	**—**	**—**	**—**	**(35.0)**	**(35.0)**
Balance as at 31 December 2017		**1.0**	**840.5**	**(0.1)**	**89.9**	**931.3**

STATEMENT OF CASH FLOWS

For the year ended 31 December 2017

	Notes	**2017 $m**	2016 $m
Cash flows from operating activities			
(Loss) profit		**(48.6)**	163.1
Depreciation	5	**0.3**	0.1
Interest and dividend income		**(29.6)**	(30.8)
Net amortisation of fixed maturity securities		**2.0**	4.0
Foreign exchange losses		**0.1**	5.8
Net other investment income	3	**(1.2)**	(6.9)
Net realised (gains) losses and impairments	3	**(8.3)**	1.7
Changes in operational assets and liabilities			
– Insurance and reinsurance contracts		**76.6**	(37.2)
– Other assets and liabilities		**66.7**	(4.2)
Net cash flows from operating activities		**58.0**	95.6
Cash flows from investing activities			
Interest and dividends received		**30.0**	30.5
Purchase of property, plant and equipment		**(0.1)**	(0.3)
Purchase of investments		**(1,088.1)**	(967.5)
Proceeds on sale of investments		**1,086.6**	1,012.8
Net cash flows from investing activities		**28.4**	75.5
Cash flows used in financing activities			
Dividends paid		**(60.5)**	(235.0)
Contribution to contributed surplus	16	**—**	41.8
Net cash flows used in financing activities		**(60.5)**	(193.2)
Net increase (decrease) in cash and cash equivalents		**25.9**	(22.1)
Cash and cash equivalents at beginning of year		**126.6**	149.6
Effect of exchange rate fluctuations on cash and cash equivalents		**3.7**	(0.9)
Cash and cash equivalents at end of year	8	**156.2**	126.6

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basis of preparation and significant accounting policies adopted in the preparation of these financial statements are set out below.

BASIS OF PREPARATION

The Company's financial statements are prepared in accordance with accounting principles generally accepted under IFRS.

In accordance with IFRS 10, Consolidated and Separate Financial Statements, the Company does not need to present consolidated financial statements if it meets certain criteria. The Company meets all of the requirements and has elected to prepare separate financial statements. According, the Company's structured entity, the Orange Fund, is carried at fair value in the balance sheet at 31 December 2017. In the course of preparing the financial statements, no judgements have been made in the process of applying the Company'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 financial statements.

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 Company's management determines appropriate measurement bases, to provide the most useful information to users of the financial statements, using their judgement and considering U.S. GAAP.

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

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

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 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 Company 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 Company. The Company 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 financial statements.

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

USE OF ESTIMATES

The preparation of financial statements in conformity with IFRS requires the Company 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 pages 8 and 9 and also in the risk disclosures section from page 17. Estimates in relation to losses and loss adjustment expenses recoverable are discussed on page 8.

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 9 and 10 and in note 9. Management judgement is applied in determining impairment charges.

FOREIGN CURRENCY TRANSLATION

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

Foreign currency transactions are recorded in the functional currency 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 statement of comprehensive (loss) income. Non-monetary assets and liabilities carried at historical cost and denominated in a foreign currency are translated at historic rates. Non-monetary assets and liabilities carried at estimated fair value and denominated in a foreign currency are translated at the exchange rate at the date the estimated fair value was determined, with resulting exchange differences recorded in accumulated other comprehensive loss in shareholder’s equity.

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 Company 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 Company 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 Company’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 Company’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 Company 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 Company'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 Company'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 Company, 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 Company 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 Company'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 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 Company'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 Company'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 Company'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 shareholder's 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 Company 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 shareholder's 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 Company 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 shareholder's 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 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 current period profit or loss. The Company 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 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 Company has transferred substantially all of the risks and rewards of ownership or the liability is discharged, cancelled or expired.

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 cent per annum
Office furniture and equipment	33 per cent per annum
Leasehold improvements	20 per cent 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 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 income on a straight-line basis over the lease term.

EMPLOYEE BENEFITS

EQUITY COMPENSATION PLANS

LHL, LICL's parent, 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.

PENSIONS

The Company operates a defined contribution plan. On payment of contributions to the plan there is no further obligation for the Company. Contributions are recognised as employee benefits in the statement of comprehensive (loss) income in the period when the services are rendered.

RISK DISCLOSURES: INTRODUCTION

The Company 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 Company is insurance risk.

The primary objective of the Company's ERM framework is to ensure that the capital resources held are matched to the risk profile of the Company and that the balance between risk and return is considered as part of all key business decisions. The Company has formulated, and keeps under review, a risk appetite which is set by the Board of Directors. The Company's appetite for risk will vary marginally from time to time to reflect the potential risks and returns that present themselves. However, protecting the Company's capital and providing investors with a superior risk-adjusted return over the long term are constants. The risk appetite of the Company 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 Company and an operating entity level. Risk tolerances represent the maximum amount of capital, generally on a modeled basis, that the Company and its entities are prepared to expose to certain risks.

The Board of Directors is responsible for setting and monitoring the Company's risk appetite and tolerances. All risk tolerances are subject to at least an annual review and consideration by the respective boards of directors. The Board 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 Company's risk-based capital approach to decision making is its economic capital model, BLAST, which is based on the widely accepted economic capital modeling tool, ReMetrica. Management uses BLAST primarily for monitoring its insurance risks. However, BLAST is also used to monitor other risks including market, credit and operational risks.

BLAST produces data in the form of a stochastic distribution for all classes, including non-elemental classes. The distribution includes the mean outcome and the result at various return periods, including very remote events. BLAST calculates projected financial outcomes for each insurance class, as well as the overall portfolio including diversification credit. Diversification credit arises as individual risks are generally not strongly correlated and are unlikely to all produce profits or losses at the same time. BLAST also measures the Company'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 Company seeks to achieve an improved risk-adjusted return over time.

BLAST is used in strategic underwriting decisions, as part of the Company'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 Company writes, or is considering writing, as well as the overall resulting financial impact to the Company. BLAST output, covering all of the risk Companys to which the Company 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 below.

A. INSURANCE RISK

The Company underwrites worldwide, predominantly short-tail, insurance and reinsurance contracts that transfer insurance risk, including risks exposed to both natural and man-made catastrophes. The Company'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 Company'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 Company's risk-adjusted RoE targets.

The Company 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 Company are Property, Energy, Marine and Aviation. The level of insurance risk tolerance per peril is set by the respective Boards of Directors at both the LHL and entity level.

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

- the Company has a rolling three-year strategic plan that helps establish the over-riding business goals that the Board of Directors aims to achieve;
- a detailed business plan is produced annually, which includes expected premiums and combined ratios by class and considers risk-adjusted profitability, capital usage and requirements. The plan is approved by the Board of Directors and is monitored, reviewed and updated on an ongoing basis;
- BLAST and SHARP 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 Company 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 to peer review insurance proposals, opportunities and emerging risks;
- 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 Company; 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 Company'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 Company'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 Company's loss experience. The North American and Japanese wind seasons are typically June to November and the European wind season November to March. The Company 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 Company's exposures to certain peak zone elemental losses, as a percentage of capital are shown below. Net loss estimates are before income tax and net of reinstatement premiums and outwards reinsurance.

		100 year return period estimated net loss		**250 year return period estimated net loss**	
As at 31 December 2017		**$m**	**% of capital**	**$m**	**% of capital**
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	**93.3**	**10.0**	**151.2**	**16.2**
Non-Gulf of Mexico – U.S.	Hurricane	**87.8**	**9.4**	**230.3**	**24.7**
California	Earthquake	**52.5**	**5.6**	**118.3**	**12.7**
Pan-European	Windstorm	**42.7**	**4.6**	**62.6**	**6.7**
Japan	Typhoon	**37.3**	**4.0**	**41.8**	**4.5**
Japan	Earthquake	**21.9**	**2.4**	**50.3**	**5.4**
Pacific North West	Earthquake	**16.8**	**1.8**	**40.8**	**4.4**

(1) Landing hurricane from Florida to Texas.

		100 year return period estimated net loss		250 year return period estimated net loss	
As at 31 December 2016		$m	% of capital	$m	% of capital
Zones	**Perils**				
Gulf of Mexico[1]	Hurricane	110.0	10.9	170.9	16.9
Non-Gulf of Mexico – U.S.	Hurricane	107.9	10.7	259.4	25.7
California	Earthquake	54.4	5.4	102.0	10.1
Pan-European	Windstorm	35.8	3.5	55.5	5.5
Japan	Typhoon	34.2	3.4	43.4	4.3
Japan	Earthquake	24.6	2.4	83.6	8.3
Pacific North West	Earthquake	13.5	1.3	42.0	4.2

(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	%
Worldwide offshore	**96.2**	**34.6**	96.4	30.7
U.S. and Canada	**82.5**	**29.7**	81.2	25.9
Worldwide, including the U.S. and Canada[1]	**30.7**	**11.0**	43.6	13.9
Europe	**17.1**	**6.2**	21.6	6.9
Far East	**15.9**	**5.7**	18.5	5.9
Worldwide, excluding the U.S. and Canada[2]	**5.3**	**1.9**	8.9	2.8
Middle East	**3.5**	**1.3**	8.9	2.8
Rest of world	**26.7**	**9.6**	34.8	11.1
Total	**277.9**	**100.0**	313.9	100.0

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

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

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

	2017		2016	
	$m	%	$m	%
Property	**176.5**	**63.5**	194.4	61.9
Energy	**49.0**	**17.6**	70.9	22.6
Marine	**47.8**	**17.2**	26.7	8.5
Aviation	**4.6**	**1.7**	21.9	7.0
Total	**277.9**	**100.0**	313.9	100.0

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

I. PROPERTY

Gross premiums written, for the year:

	2017 $m	2016 $m
Property catastrophe excess of loss	**103.1**	99.2
Property political risk	**22.5**	34.3
Terrorism	**21.4**	27.0
Property risk excess of loss	**12.9**	11.3
Property retrocession	**9.9**	12.7
Other property	**6.7**	9.9
Total	**176.5**	194.4

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

Property political risk cover is written either ground-up or on an excess of loss basis. Coverage that the Company 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 Company does not provide cover against purely private obligor credit risk.

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

Property 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 Company 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 Company's appetite and exposure guidelines for large losses are set out on page 12 and 13.

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 Company's worldwide exposure to large risk losses. Reinsurance is typically purchased on an excess of loss basis, however ILWs or quota share arrangements may be entered into.

II. ENERGY

Gross premiums written, for the year:

	2017 $m	2016 $m
Worldwide offshore energy	**31.9**	48.1
Gulf of Mexico offshore energy	**12.2**	10.4
Energy liabilities	**2.3**	2.8
Construction energy	**(1.4)**	3.3
Other energy	**4.0**	6.3
Total	**49.0**	70.9

Energy risks are written mostly on a direct basis and may be ground-up or for primary or excess layers on either a first loss or full value basis. Worldwide offshore energy policies are typically package policies which may include physical damage, business interruption and third-party liability sections. Coverage can include fire and explosion and elemental risks. Individual assets covered can be high-value and are therefore mostly written on a subscription basis, meaning that coverage is placed with multiple 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 Company's appetite and exposure guidelines to large losses are set out on page 12 and 13.

The Company 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.

III. MARINE

Gross premiums written, for the year:

	2017 $m	2016 $m
Marine hull and total loss	**11.4**	8.0
Marine excess of loss	**10.6**	—
Marine P&I clubs	**10.0**	8.3
Marine builders' risk	**9.2**	5.8
Marine hull war	**4.6**	2.8
Other marine	**2.0**	1.8
Total	**47.8**	26.7

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 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 Company of Protection and Indemnity Clubs and covers marine liabilities. Marine builders' risk covers the building of ocean- going vessels in specialised yards worldwide and their testing and commissioning. Marine hull war is mostly direct insurance of loss of vessels from war, piracy or terrorist attack, with a very limited amount of facultative reinsurance.

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

IV. AVIATION

Gross premiums written, for the year:

	2017 $m	2016 $m
AV52	**8.7**	14.6
Aviation satellite	**(4.5)**	5.0
Other aviation	**0.4**	2.3
Total	**4.6**	21.9

AV52 is written on a risk attaching excess of loss basis and provides coverage for third-party liability, excluding own passenger liability, resulting from acts of war or hijack of aircraft. Cover excludes countries whose governments provide a backstop coverage, but does, 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 Company 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 Company, 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 Company of its obligations to policyholders. Under the Company'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 Company'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 Company regularly reviews its catastrophe and other exposures and may purchase reinsurance in order to reduce the Company's net exposure to a large natural catastrophe loss and/or to reduce net exposures to other large losses. The Company 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 Company will retain some losses, as the cover purchased is unlikely to transfer the totality of the Company's exposure. Any loss amount which exceeds the programme would be retained by the Company. 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 Company, particularly given the nature of the business written.

Under IFRS, 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 Company'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 Company's internal actuaries review the reserving assumptions and methodologies on a quarterly basis with loss estimates being subject to a semi-annual corroborative review by independent actuaries. This independent review is presented to the Board. The Company has also established a Reserve Committee which has 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 Company expects to write the large majority of programmes on a direct excess of loss basis. The Company 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 Company, 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 Company'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 Company 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 Company is notified of changes to loss estimates.

As at 31 December 2017, management's estimates for IBNR represented 47.1 per cent of total net loss reserves (31 December 2016 – 32.6 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 Company was not made aware by the balance sheet date.

B. MARKET RISK

The Company is at risk of loss due to movements in market factors. The main risks include insurance risk, investment risk and currency risk.

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

I. INSURANCE RISK

The Company 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 Company's risk appetite;
- changes in regulation including capital, governance or licensing requirements;
- changes in 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 Company 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 Company 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 to discuss, inter alia, market conditions and opportunities;
- 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 documented meetings with regulators.

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

II. INVESTMENT RISK

Movements in investments resulting from changes in interest and inflation rates and currency exchange rates, amongst other factors, may lead to an adverse impact on the value of the Company's investment portfolio. Investment guidelines are established by the Investment Committee of the LHL Board of Directors to manage this risk. The LICL Board of Directors reviews and adopts these guidelines as appropriate. Investment guidelines set parameters within which the Company'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, the LHL Board of Directors and LICL Board of Directors.

The Company's fixed maturity portfolios are managed by five external investment managers. The Company 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 Company 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 Company 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 Company endeavours to limit losses in risk-on, risk-off, and interest rate hike scenarios. The Company 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 Company also monitors the portfolio impact of more severe disaster scenarios consisting of extreme shocks.

The IRRC meets quarterly to ensure that the Company'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:

	Core		Core plus		Surplus		Total	
As at 31 December 2017	$m	%	$m	%	$m	%	$m	%
– Short-term investments	**6.0**	**0.5**	**93.9**	**8.4**	**0.6**	**0.1**	**100.5**	**9.0**
– U.S. treasuries	**36.2**	**3.3**	**97.2**	**8.7**	**14.2**	**1.3**	**147.6**	**13.3**
– Other government bonds	**—**	**—**	**5.0**	**0.4**	**40.3**	**3.6**	**45.3**	**4.0**
– U.S. municipal bonds	**—**	**—**	**3.8**	**0.3**	**—**	**—**	**3.8**	**0.3**
– U.S. government agency debt	**6.9**	**0.6**	**33.7**	**3.0**	**17.0**	**1.5**	**57.6**	**5.1**
– Asset backed securities	**3.2**	**0.3**	**53.6**	**4.8**	**67.1**	**6.0**	**123.9**	**11.1**
– U.S. government agency mortgage backed securities	**1.0**	**0.1**	**21.7**	**2.0**	**107.3**	**9.7**	**130.0**	**11.8**
– Non-agency mortgage backed securities	**—**	**—**	**2.1**	**0.2**	**7.7**	**0.7**	**9.8**	**0.9**
– Non-agency commercial mortgage backed securities	**—**	**—**	**0.2**	**—**	**—**	**—**	**0.2**	**—**
– Bank loans	**—**	**—**	**—**	**—**	**106.7**	**9.6**	**106.7**	**9.6**
– Corporate bonds	**24.4**	**2.2**	**209.5**	**19.0**	**75.7**	**6.9**	**309.6**	**28.1**
– Fixed maturity funds	**20.3**	**1.8**	**8.1**	**0.7**	**22.2**	**2.0**	**50.6**	**4.5**
Total fixed maturity securities – AFS	**98.0**	**8.8**	**528.8**	**47.5**	**458.8**	**41.4**	**1,085.6**	**97.7**
Fixed maturity securities – at FVTPL	**—**	**—**	**—**	**—**	**25.7**	**2.3**	**25.7**	**2.3**
Total fixed maturity securities	**98.0**	**8.8**	**528.8**	**47.5**	**484.5**	**43.7**	**1,111.3**	**100.0**

	Core		Core plus		Surplus		Total	
As at 31 December 2016	$m	%	$m	%	$m	%	$m	%
– Short-term investments	—	—	0.3	—	4.0	0.4	4.3	0.4
– U.S. treasuries	30.5	2.7	135.2	12.1	21.0	1.9	186.7	16.7
– Other government bonds	0.5	—	28.7	2.6	14.4	1.3	43.6	3.9
– U.S. government agency debt	6.9	0.6	34.9	3.1	29.9	2.7	71.7	6.4
– Asset backed securities	6.4	0.6	68.1	6.1	26.4	2.4	100.9	9.1
– U.S. government agency mortgage backed securities	1.4	0.1	30.5	2.7	75.2	6.7	107.1	9.5
– Non-agency mortgage backed securities	—	—	7.1	0.6	1.9	0.2	9.0	0.8
– Non-agency commercial mortgage backed securities	2.4	0.2	2.9	0.3	3.7	0.3	9.0	0.8
– Bank loans	—	—	—	—	121.6	10.9	121.6	10.9
– Corporate bonds	19.3	1.7	251.4	22.3	144.4	12.9	415.1	36.9
Total fixed maturity securities – AFS	67.4	5.9	559.1	49.8	442.5	39.7	1,069.0	95.4
Fixed maturity securities – at FVTPL	—	—	—	—	51.6	4.6	51.6	4.6
Total fixed maturity securities	67.4	5.9	559.1	49.8	494.1	44.3	1,120.6	100.0

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[1] $m	Other government bonds $m	Total[2] $m
United States	**123.0**	**216.7**	**339.7**	**—**	**339.7**
Canada	**5.6**	**10.1**	**15.7**	**8.5**	**24.2**
Netherlands	**5.8**	**6.9**	**12.7**	**3.7**	**16.4**
United Kingdom	**8.0**	**6.8**	**14.8**	**1.2**	**16.0**
Germany	**3.9**	**3.0**	**6.9**	**8.2**	**15.1**
France	**8.6**	**2.1**	**10.7**	**2.2**	**12.9**
Japan	**7.4**	**1.7**	**9.1**	**—**	**9.1**
Australia	**6.5**	**—**	**6.5**	**1.0**	**7.5**
Luxembourg	**1.5**	**5.1**	**6.6**	**—**	**6.6**
Sweden	**1.8**	**—**	**1.8**	**3.3**	**5.1**
Switzerland	**2.8**	**2.3**	**5.1**	**—**	**5.1**
Denmark	**1.5**	**0.3**	**1.8**	**2.9**	**4.7**
India	**—**	**—**	**—**	**4.2**	**4.2**
China	**—**	**1.2**	**1.2**	**2.7**	**3.9**
Spain	**2.2**	**0.7**	**2.9**	**—**	**2.9**
Other	**4.7**	**1.8**	**6.5**	**7.4**	**13.9**
Total	**183.3**	**258.7**	**442.0**	**45.3**	**487.3**

(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[1] $m	Other government bonds $m	Total[2] $m
United States	129.5	308.8	438.3	—	438.3
United Kingdom	33.4	6.2	39.6	—	39.6
Netherlands	10.9	12.2	23.1	5.6	28.7
Canada	6.5	11.3	17.8	4.6	22.4
Germany	6.9	5.5	12.4	9.3	21.7
Australia	14.8	3.2	18.0	—	18.0
France	2.6	6.9	9.5	2.7	12.2
Luxembourg	1.8	6.4	8.2	—	8.2
Japan	7.4	—	7.4	—	7.4
Sweden	1.6	0.5	2.1	3.6	5.7
Norway	1.0	—	1.0	3.6	4.6
Hong Kong	—	4.0	4.0	—	4.0
Russian Federation	—	—	—	2.8	2.8
Switzerland	2.4	—	2.4	—	2.4
Spain	—	2.0	2.0	—	2.0
Other	1.3	1.2	2.5	11.4	13.9
Total	220.1	368.2	588.3	43.6	631.9

(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:

	2017		2016	
As at 31 December	$m	%	$m	%
Industrial	**236.9**	**53.6**	336.5	57.2
Financial	**183.3**	**41.5**	220.1	37.4
Utility	**21.8**	**4.9**	31.7	5.4
Total	**442.0**	**100.0**	588.3	100.0

The Company'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 Company's investment portfolio is mainly comprised of fixed maturity securities and cash and cash equivalents. The Company also has small equity and hedge fund portfolios. The estimated fair value of the Company's fixed maturity portfolio is generally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Company'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 Company's fixed maturity and derivative investment portfolio to interest rate movements is detailed below, assuming linear movements in interest rates:

	2017		2016	
As at 31 December	$m	%	$m	%
Immediate shift in yield (basis points)				
100	**(22.5)**	**(2.0)**	(22.1)	(2.0)
75	**(16.9)**	**(1.5)**	(16.6)	(1.5)
50	**(11.2)**	**(1.0)**	(11.0)	(1.0)
25	**(5.6)**	**(0.5)**	(5.5)	(0.5)
(25)	**5.5**	**0.5**	6.1	0.5
(50)	**11.1**	**1.0**	12.1	1.1
(75)	**16.6**	**1.5**	18.2	1.6
(100)	**22.2**	**2.0**	24.2	2.2

The Company mitigates interest rate risk on the investment portfolio by establishing and monitoring duration ranges in its investment guidelines. The Company 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	**2.0**	1.8
Core plus portfolio	**1.7**	1.8
Surplus portfolio[1]	**2.0**	2.2
Overall external portfolio[1]	**1.8**	2.0

(1) Including duration overlay.

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

In addition to duration management, the Company 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 Company's annual VaR calculations are as follows:

	2017		2016	
As at 31 December	**$m**	**% of shareholder's equity**	$m	% of shareholder's equity
99th percentile confidence level[1]	**26.8**	**2.9**	28.4	2.8

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

DERIVATIVE FINANCIAL INSTRUMENTS

The Company'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 Company may also use OTC or exchange-traded managed derivatives to mitigate interest rate risk and foreign currency exposures. The Company principally has exposure to derivatives related to the following types of risks: foreign currency risk, interest rate risk and credit risk.

The Company currently invests in the following derivative financial instruments:

a. Futures;

b. Options;

c. Forward foreign currency contracts; and

d. Swaps.

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

As at 31 December 2017	**Net realised losses $m**	**Net foreign exchange losses $m**
Treasury futures	**(0.7)**	**—**
Forward foreign currency contracts	**—**	**(2.5)**
Total	**(0.7)**	**(2.5)**

As at 31 December 2016	Net realised losses $m	Net foreign exchange losses $m
Treasury futures	(2.1)	—
Forward foreign currency contracts	—	(1.6)
Total	(2.1)	(1.6)

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

As at 31 December	2017 $m	2016 $m
Forward foreign currency contracts	**(0.2)**	(0.3)

A. FUTURES

The Company's investment guidelines permit the use of futures which provide the Company 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 Company 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 Company 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 Company had the following exposure to treasury futures:

	2017			2016		
As at 31 December	Notional long $m	Notional short $m	Net notional long (short) $m	Notional long $m	Notional short $m	Net notional long (short) $m
Treasury futures	**100.1**	**103.5**	**(3.4)**	76.4	104.1	(27.7)

B. OPTIONS

The Company'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 Company may enter into option contracts that are secured by holdings in the underlying securities or by other means which permit immediate satisfaction of the Company'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 Company 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 Company to credit, market and liquidity risks. Credit risk arises from the potential inability of counterparties to perform under the terms of the contract. The Company 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 Company 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 Company has the following open forward foreign currency contracts:

	2017			2016		
As at 31 December	**Notional long $m**	**Notional short $m**	**Net notional long (short) $m**	Notional long $m	Notional short $m	Net notional long (short) $m
Euro	**24.0**	**44.6**	**(20.6)**	—	0.6	(0.6)
Canadian Dollar	**—**	**10.9**	**(10.9)**	—	16.7	(16.7)
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**	—	—	—
British Pound	**14.7**	**4.0**	**10.7**	13.4	0.9	12.5
Total	**40.4**	**73.6**	**(33.2)**	13.4	20.9	(7.5)

D. SWAPS

The Company'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.

III. CURRENCY RISK

The Company underwrites from Bermuda, although risks are assumed on a worldwide basis. Risks assumed are predominantly denominated in U.S. dollars.

The Company is exposed to currency risk to the extent its assets are denominated in different currencies to its liabilities. The Company 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 Company 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 Company's main foreign currency exposure relates to its insurance obligations, cash holdings, investments, premiums receivable and dividends payable. The Company uses forward foreign currency contracts for the purposes of managing currency exposures. See page 25 for a listing of the Company's open forward foreign currency contracts.

The Company'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	92.4	1.1	29.0	10.0	23.7	156.2
Accrued interest receivable	4.6	—	—	—	—	4.6
Investments	1,216.8	4.2	66.5	—	0.5	1,288.0
Inwards premiums receivable from insureds and cedants	67.9	0.3	5.0	—	3.8	77.0
Reinsurance assets	94.0	—	—	—	—	94.0
Other receivables	30.3	(2.8)	—	—	0.7	28.2
Property, plant and equipment	0.3	—	—	—	—	0.3
Deferred acquisition costs	44.5	1.6	8.9	1.0	3.3	59.3
Total assets as at 31 December 2017	**1,550.8**	**4.4**	**109.4**	**11.0**	**32.0**	**1,707.6**

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	410.4	4.9	53.1	7.7	23.3	499.4
Unearned premiums	144.3	4.8	23.8	7.9	12.9	193.7
Insurance contracts – other payables	30.3	0.3	—	—	0.2	30.8
Amounts payable to reinsurers	5.8	—	—	—	0.1	5.9
Deferred acquisition costs ceded	0.6	—	—	—	—	0.6
Other payables	45.5	0.2	0.1	—	0.1	45.9
Total liabilities as at 31 December 2017	**636.9**	**10.2**	**77.0**	**15.6**	**36.6**	**776.3**

Assets	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Cash and cash equivalents	78.8	1.9	16.9	12.7	16.3	126.6
Accrued interest receivable	5.0	—	—	—	—	5.0
Investments	1,254.4	0.9	14.5	—	—	1,269.8
Inwards premiums receivable from insureds and cedants	63.3	0.8	5.5	—	6.3	75.9
Reinsurance assets	7.6	—	—	—	—	7.6
Other receivables	60.2	0.2	—	—	—	60.4
Property, plant and equipment	0.5	—	—	—	—	0.5
Deferred acquisition costs	44.4	1.4	6.1	0.8	4.2	56.9
Total assets as at 31 December 2016	1,514.2	5.2	43.0	13.5	26.8	1,602.7

Liabilities	U.S. $ $m	Sterling $m	Euro $m	Japanese Yen $m	Other $m	Total $m
Losses and loss adjustment expenses	273.6	4.3	24.1	17.5	18.6	338.1
Unearned premiums	165.5	4.6	21.7	6.7	14.1	212.6
Insurance contracts – other payables	5.0	—	—	—	0.2	5.2
Amounts payable to reinsurers	0.9	—	—	—	—	0.9
Deferred acquisition costs ceded	0.2	—	—	—	—	0.2
Other payables	35.5	1.5	0.1	—	(0.1)	37.0
Total liabilities as at 31 December 2016	480.7	10.4	45.9	24.2	32.8	594.0

The impact on net income of a proportional foreign exchange movement of 10.0 per cent up and 10.0 per cent down against the U.S. dollar at the year end spot rates would be an increase or decrease of $5.2 million (2016 – $1.0 million).

C. LIQUIDITY RISK

Liquidity risk is the risk that cash may not be available to pay obligations when they are due without incurring an unreasonable cost. The Company's main exposures to liquidity risk are with respect to its insurance and investment activities. The Company is exposed if proceeds from financial assets are not sufficient to fund obligations arising from its insurance contracts. The Company can be exposed to daily calls on its available investment assets, principally to settle insurance claims and to fund trust accounts following a large catastrophe loss.

Exposures in relation to insurance activities are as follows:

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

Exposures in relation to investment activities are as follows:

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

The maturity dates of the Company'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	**24.5**	**181.7**	**15.0**	**221.2**
Between one and two years	**17.7**	**65.8**	**45.4**	**128.9**
Between two and three years	**28.6**	**85.3**	**27.5**	**141.4**
Between three and four years	**5.3**	**35.9**	**40.3**	**81.5**
Between four and five years	**12.0**	**43.0**	**46.5**	**101.5**
Over five years	**5.7**	**39.5**	**127.7**	**172.9**
Asset backed and mortgage backed securities	**4.2**	**77.6**	**182.1**	**263.9**
Total fixed maturity securities	**98.0**	**528.8**	**484.5**	**1,111.3**

As at 31 December 2016	Core $m	Core plus $m	Surplus $m	Total $m
Less than one year	16.1	119.7	47.2	183.0
Between one and two years	17.0	133.2	17.2	167.4
Between two and three years	8.6	97.9	30.9	137.4
Between three and four years	7.9	55.5	38.8	102.2
Between four and five years	3.8	29.1	72.0	104.9
Over five years	3.8	15.1	180.8	199.7
Asset backed and mortgage backed securities	10.2	108.6	107.2	226.0
Total fixed maturity securities	67.4	559.1	494.1	1,120.6

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

	Years until liability becomes due – undiscounted values				
As at 31 December 2017	**Less than one $m**	**One to three $m**	**Three to five $m**	**Over five $m**	**Total $m**
Losses and loss adjustment expenses	**235.0**	**165.7**	**56.7**	**42.0**	**499.4**
Insurance contracts – other payables	**30.7**	**0.1**	**—**	**—**	**30.8**
Amounts payable to reinsurers	**5.9**	**—**	**—**	**—**	**5.9**
Other payables	**45.9**	**—**	**—**	**—**	**45.9**
Total	**317.5**	**165.8**	**56.7**	**42.0**	**582.0**

	Years until liability becomes due – undiscounted values				
As at 31 December 2016	Less than one $m	One to three $m	Three to five $m	Over five $m	Total $m
Losses and loss adjustment expenses	121.9	126.2	50.0	40.0	338.1
Insurance contracts – other payables	5.1	0.1	—	—	5.2
Amounts payable to reinsurers	0.9	—	—	—	0.9
Other payables	37.0	—	—	—	37.0
Total	164.9	126.3	50.0	40.0	381.2

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

The Company 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 Company 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 Company 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 Company 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 Company'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. 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 shareholder's equity. The Company 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 Company has established relationships, and by rigorous cash collection procedures. The Company 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 16.

The table below presents an analysis of the Company's major exposures to counterparty credit risk, based on their rating. The table includes amounts due from policyholders and unsettled investment trades. The quality of these receivables is not graded but, based on management's historical experience, there is limited default risk associated with these amounts.

As at 31 December 2017	**Cash and fixed maturity securities $m**	**Inwards premiums receivable and other receivables $m**	**Reinsurance recoveries $m**
AAA	**292.5**	**—**	**—**
AA+, AA, AA-	**465.4**	**—**	**—**
A+, A, A-	**238.2**	**—**	**21.1**
BBB+, BBB, BBB-	**168.0**	**—**	**—**
Other [1]	**103.4**	**105.2**	**66.6**
Total	**1,267.5**	**105.2**	**87.7**

(1) Reinsurance recoveries classified as "other" are fully collateralised.

As at 31 December 2016	Cash and fixed maturity securities $m	Inwards premiums receivable and other receivables $m	Reinsurance recoveries $m
AAA	165.3	—	—
AA+, AA, AA-	482.7	—	—
A+, A, A-	295.5	42.7	1.8
BBB+, BBB, BBB-	188.9	—	—
Other	114.8	93.6	—
Total	1,247.2	136.3	1.8

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

	2017 $m	2016 $m
Less than 90 days past due	**3.8**	0.9
Between 91 and 180 days past due	**0.4**	—
Over 180 days past due	**0.2**	—
Total	**4.4**	0.9

No provisions have been made for impaired or irrecoverable balances and no amounts were released to the statement of comprehensive (loss) income in respect of bad debts in either 2017 or 2016.

E. OPERATIONAL RISK

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

In order to manage operational risks, the Company has implemented a robust governance framework. Policies and procedures are documented and identify the key risks and controls within processes. The Company'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 Company 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 Company 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 of and approval of the annual business plan by the Board of Directors;
- regular monitoring of actual versus planned results;
- periodic review and re-forecasting as market conditions change; and
- feedback to senior management via the daily UMCC and fortnightly RRC meetings.

II. CAPITAL MANAGEMENT RISK

The total capital of the Company as at 31 December 2017 is $931.3 million (31 December 2016 - $1,008.7 million). The Company's capital requirements vary with the insurance cycle.

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

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

The Company 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. 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 LHL's shareholders with an RoE of 13.0 per cent in excess of a risk-free rate over the longer term. The return is generated within a broad framework of risk parameters. The return is measured by management in terms of the IRR of the increase in FCBVS in the period adjusted for dividends accrued. This aim is a long-term goal, acknowledging that management expects both higher and lower results in the shorter term. The cyclicality and volatility of the insurance market is expected to be the largest driver of this pattern. Management monitors these peaks and troughs – adjusting the Company's portfolio to make the most effective use of available capital and seeking to maximise the risk-adjusted return.

The primary source of capital used by the Company is equity shareholder's funds. The Company's ability to pay dividends and make capital distributions to LHL is subject to the legal and regulatory restrictions of the jurisdictions in which they operate.

The Company 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. The Company's capital requirement is calculated using the BSCR standard formula model. For the years ended 31 December 2017 and 2016 the Company was more than adequately capitalised under the BMA regulatory regime.

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 Company is a provider of global specialty insurance and reinsurance products. The Company was incorporated under the laws of Bermuda on 28 October 2005 and is authorised by the BMA as a Class 4 general insurer under The Insurance Act 1978 and related Regulations ('the Act'). The registered office of the Company is Power House, 7 Par-La-Ville Road, Hamilton HM 11, Bermuda. The Company is a wholly owned subsidiary of LHL, a company listed on the LSE, with a secondary listing on the BSX. As such it is required to prepare its annual audited financial information in accordance with Section 4.1 of the Disclosure and Transparency Rules and the Listing Rules, both issued by the Financial Conduct Authority, in addition to the Bermuda Companies Act 1981.

2. SEGMENTAL REPORTING

Management and the Board of Directors review the Company's business primarily by its four principal segments: Property, Energy, Marine and Aviation. These segments are therefore deemed to be the Company'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 13 to 15. 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 Company's country of domicile.

2. SEGMENTAL REPORTING CONTINUED

REVENUE AND EXPENSE BY OPERATING SEGMENT

For the year ended 31 December 2017	Property $m	Energy $m	Marine $m	Aviation $m	Total $m
Gross premiums written by geographic area					
Worldwide offshore	**0.1**	**46.9**	**49.2**	**—**	**96.2**
U.S. and Canada	**79.9**	**2.6**	**—**	**—**	**82.5**
Worldwide, including the U.S. and Canada[1]	**27.6**	**(0.4)**	**(1.1)**	**4.6**	**30.7**
Europe	**17.1**	**—**	**—**	**—**	**17.1**
Far East	**15.9**	**—**	**—**	**—**	**15.9**
Worldwide, excluding the U.S. and Canada[2]	**5.2**	**0.1**	**—**	**—**	**5.3**
Middle East	**3.5**	**—**	**—**	**—**	**3.5**
Rest of world	**27.2**	**(0.2)**	**(0.3)**	**—**	**26.7**
Total	**176.5**	**49.0**	**47.8**	**4.6**	**277.9**
Outwards reinsurance premiums	**(50.3)**	**(0.1)**	**(2.2)**	**—**	**(52.6)**
Change in unearned premiums	**12.6**	**7.7**	**(4.6)**	**3.2**	**18.9**
Change in unearned premiums on premiums ceded	**0.5**	**—**	**—**	**—**	**0.5**
Net premiums earned	**139.3**	**56.6**	**41.0**	**7.8**	**244.7**
Insurance losses and loss adjustment expenses	**(252.7)**	**(8.6)**	**(12.7)**	**1.9**	**(272.1)**
Insurance losses and loss adjustment expenses recoverable	**86.2**	**—**	**—**	**—**	**86.2**
Insurance acquisition expenses	**(31.7)**	**(25.4)**	**(16.8)**	**(2.6)**	**(76.5)**
Insurance acquisition expenses ceded	**2.2**	**—**	**0.1**	**—**	**2.3**
Net underwriting (loss) profit	**(56.7)**	**22.6**	**11.6**	**7.1**	**(15.4)**
Net unallocated income and expenses					**(33.2)**
Loss before tax					**(48.6)**
Net loss ratio	**119.5%**	**15.2%**	**31.0%**	**(24.4%)**	**76.0%**
Net acquisition cost ratio	**21.2%**	**44.9%**	**40.7%**	**33.3%**	**30.3%**
Expense ratio	**—**	**—**	**—**	**—**	**8.3%**
Combined ratio	**140.7%**	**60.1%**	**71.7%**	**8.9%**	**114.6%**

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

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

REVENUE AND EXPENSE BY OPERATING SEGMENT

For the year ended 31 December 2016	Property $m	Energy $m	Marine $m	Aviation $m	Total $m
Gross premiums written by geographic area					
Worldwide offshore	0.7	69.2	26.3	0.2	96.4
U.S. and Canada	81.4	(0.2)	—	—	81.2
Worldwide, including the U.S. and Canada[1]	20.1	1.8	—	21.7	43.6
Europe	21.6	—	—	—	21.6
Far East	18.5	—	—	—	18.5
Worldwide, excluding the U.S. and Canada[2]	8.8	0.1	—	—	8.9
Middle East	8.9	—	—	—	8.9
Rest of world	34.4	—	0.4	—	34.8
Total	194.4	70.9	26.7	21.9	313.9
Outwards reinsurance premiums	(47.1)	(0.2)	(1.8)	—	(49.1)
Change in unearned premiums	(12.7)	15.3	5.0	0.8	8.4
Change in unearned premiums on premiums ceded	3.6	—	—	—	3.6
Net premiums earned	138.2	86.0	29.9	22.7	276.8
Insurance losses and loss adjustment expenses	(12.6)	(35.9)	(11.4)	0.9	(59.0)
Insurance losses and loss adjustment expenses recoverable	0.5	0.5	0.1	—	1.1
Insurance acquisition expenses	(30.7)	(37.0)	(9.3)	(7.5)	(84.5)
Insurance acquisition expenses ceded	0.9	0.1	0.1	—	1.1
Net underwriting profit	96.3	13.7	9.4	16.1	135.5
Net unallocated income and expenses					27.6
Profit before tax					163.1
Net loss ratio	8.8%	41.2%	37.8%	(4.0%)	20.9%
Net acquisition cost ratio	21.6%	42.9%	30.8%	33.0%	30.1%
Expense ratio	—	—	—	—	7.8%
Combined ratio	30.4%	84.1%	68.6%	29.0%	58.8%

(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 Company is as follows:

For the year ended 31 December 2017	Net investment income and net other investment income[1] $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
Fixed maturity securities – AFS	**23.4**	**(2.9)**	**2.8**	**23.3**	**5.7**	**29.0**
Fixed maturity securities – at FVTPL	**(1.0)**	**2.4**	**—**	**1.4**	**—**	**1.4**
Equity securities – AFS	**—**	**—**	**3.4**	**3.4**	**—**	**3.4**
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	**0.8**	**—**	**—**	**0.8**	**0.1**	**0.9**
Total investment return	**25.4**	**8.3**	**6.2**	**39.9**	**3.2**	**43.1**

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

For the year ended 31 December 2016	Net investment income and net other investment income[1] $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
Fixed maturity securities – AFS	22.9	1.2	3.5	27.6	(0.3)	27.3
Fixed maturity securities – at FVTPL	1.2	—	—	1.2	—	1.2
Equity securities – AFS	—	—	(0.2)	(0.2)	—	(0.2)
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	0.4	—	—	0.4	0.1	0.5
Total investment return	30.2	(1.7)	3.3	31.8	(0.4)	31.4

(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 held by the Company.

Refer to page 24 in the risk disclosures section for the estimated fair values of the Company'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 $4.0 million (2016 – $3.8 million) of investment management, accounting and custodian fees.

4. NET INSURANCE ACQUISITION EXPENSES

	2017 $m	2016 $m
Insurance acquisition expenses	**78.9**	79.3
Changes in deferred insurance acquisition expenses	**(2.4)**	5.2
Insurance acquisition expenses ceded	**(2.7)**	(1.3)
Changes in deferred insurance acquisition expenses ceded	**0.4**	0.2
Total net insurance acquisition expenses	**74.2**	83.4

5. RESULTS OF OPERATING ACTIVITIES

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

	2017 $m	2016 $m
Depreciation on owned assets	**0.3**	0.1
Operating lease charges	**1.2**	1.2
Auditors' remuneration	**0.2**	0.2
Total	**1.7**	1.5

Fees paid to the Company's auditors for non-audit services were negligible for the years ended 31 December 2017 and 2016.

6. EMPLOYEE BENEFITS

	2017 $m	2016 $m
Wages and salaries	**7.5**	7.1
Pension costs	**0.6**	0.6
Bonus and other benefits	**2.9**	5.3
Total cash compensation	**11.0**	13.0
RSS – performance	**(0.5)**	2.6
RSS – ordinary	**0.7**	0.3
RSS – bonus deferral	**0.6**	0.6
Total equity based compensation	**0.8**	3.5
Total employee benefits	**11.8**	16.5

7. TAX CHARGE

BERMUDA

The Company has 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 STATES

The Company does not consider itself to be engaged in trade or business in the U.S. and, accordingly, does not expect to be subject to U.S. taxation on its income and capital gains.

8. CASH AND CASH EQUIVALENTS

	2017 $m	2016 $m
Cash at bank and in hand	**71.0**	61.5
Cash equivalents	**85.2**	65.1
Total cash and cash equivalents	**156.2**	126.6

Cash equivalents have an original maturity of three months or less. The carrying amount of these assets approximates their fair value. Refer to note 13 for the cash and cash equivalent balances on deposit as collateral.

9. INVESTMENTS

As at 31 December 2017	Cost or amortised cost $m	Unrealised gains $m	Unrealised losses $m	Estimated fair value $m
Fixed maturity securities – AFS				
– Short-term investments	**100.7**	**—**	**(0.2)**	**100.5**
– U.S. treasuries	**148.8**	**—**	**(1.2)**	**147.6**
– Other government bonds	**45.6**	**0.1**	**(0.4)**	**45.3**
– U.S municipal bonds	**3.7**	**0.1**	**—**	**3.8**
– U.S. government agency debt	**58.3**	**—**	**(0.7)**	**57.6**
– Asset backed securities	**119.8**	**4.4**	**(0.3)**	**123.9**
– U.S. government agency mortgage backed securities	**131.5**	**0.4**	**(1.9)**	**130.0**
– Non-agency mortgage backed securities	**9.8**	**0.1**	**(0.1)**	**9.8**
– Non-agency commercial mortgage backed securities	**0.2**	**—**	**—**	**0.2**
– Bank loans	**106.5**	**0.8**	**(0.6)**	**106.7**
– Corporate bonds	**309.5**	**1.7**	**(1.6)**	**309.6**
– Fixed maturity funds	**50.6**	**—**	**—**	**50.6**
Total fixed maturity securities – AFS	**1,085.0**	**7.6**	**(7.0)**	**1,085.6**
Fixed maturity securities – at FVTPL	**25.7**	**—**	**—**	**25.7**
Equity securities – AFS	**20.0**	**3.2**	**—**	**23.2**
Hedge funds – at FVTPL	**144.6**	**9.8**	**(0.4)**	**154.0**
Other investments	**—**	**—**	**(0.5)**	**(0.5)**
Total investments	**1,275.3**	**20.6**	**(7.9)**	**1,288.0**

As at 31 December 2016	Cost or amortised cost $m	Unrealised gains $m	Unrealised losses $m	Estimated fair value $m
Fixed maturity securities – AFS				
– Short-term investments	4.3	—	—	4.3
– U.S. treasuries	188.3	0.1	(1.7)	186.7
– Other government bonds	44.0	0.1	(0.5)	43.6
– U.S. government agency debt	73.0	—	(1.3)	71.7
– Asset backed securities	101.6	0.2	(0.9)	100.9
– U.S. government agency mortgage backed securities	108.4	0.6	(1.9)	107.1
– Non-agency mortgage backed securities	9.2	0.1	(0.3)	9.0
– Non-agency commercial mortgage backed securities	9.0	—	—	9.0
– Bank loans	120.8	1.4	(0.6)	121.6
– Corporate bonds	417.0	1.2	(3.1)	415.1
Total fixed maturity securities – AFS	1,075.6	3.7	(10.3)	1,069.0
Fixed maturity securities – at FVTPL	50.5	1.1	—	51.6
Equity securities – AFS	20.0	—	(0.2)	19.8
Hedge funds – at FVTPL	122.5	7.4	(0.5)	129.4
Total investments	1,268.6	12.2	(11.0)	1,269.8

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

	2017 $m	2016 $m
Unrealised gains	**10.8**	3.7
Unrealised losses	**(7.0)**	(10.5)
Net unrealised foreign exchange (gains) losses on fixed maturity securities – AFS	**(3.9)**	0.5
Accumulated other comprehensive loss	**(0.1)**	(6.3)

Fixed maturity securities are presented in the risk disclosures section on page 20. Refer to note 13 for the investment balances in trusts in favour of policyholders and ceding companies and on deposit as collateral.

The Company determines the estimated fair value of each individual security utilising the highest level inputs available. Prices for the Company'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 Company 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 Company'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 Company, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The Company determines securities classified as Level (i) to include highly liquid U.S. treasuries, certain highly liquid short-term investments and quoted equity securities.

LEVEL (II)

Level (ii) investments are securities with quoted prices in active markets for similar assets or liabilities or securities valued using other valuation techniques for which all significant inputs are based on observable market data. Instruments included in Level (ii) are valued via independent external sources using modeled or other valuation methods. Such methods are typically industry accepted standard and include:

- broker-dealer quotes;
- pricing models or matrix pricing;
- present values;
- future cash flows;
- yield curves;
- interest rates;
- prepayment speeds; and
- default rates.

Other similar quoted instruments or market transactions may be used.

The Company determines securities classified as Level (ii) to include short-term and fixed maturity investments and certain derivatives such as:

- Non-U.S. government bonds;
- U.S. municipal bonds;
- 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 Company classifies hedge funds as Level (iii) assets as the valuation technique incorporates both observable and unobservable inputs.

The estimated fair values of the Company'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 Company's knowledge of the underlying investments and the size of the Company's investment therein, we would not anticipate any material variance between estimated valuations and the final NAVs reported by the administrators.

The Company 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 Company's investment holdings is as follows:

As at 31 December 2017	Level (i) $m	Level (ii) $m	Level (iii) $m	Total $m
Fixed maturity securities – AFS				
– Short-term investments	**100.0**	**0.5**	**—**	**100.5**
– U.S. treasuries	**147.6**	**—**	**—**	**147.6**
– Other government bonds	**—**	**45.3**	**—**	**45.3**
– U.S. municipal bonds	**—**	**3.8**	**—**	**3.8**
– U.S. government agency debt	**—**	**57.6**	**—**	**57.6**
– Asset backed securities	**—**	**123.9**	**—**	**123.9**
– U.S. government agency mortgage backed securities	**—**	**130.0**	**—**	**130.0**
– Non-agency mortgage backed securities	**—**	**9.8**	**—**	**9.8**
– Non-agency commercial mortgage backed securities	**—**	**0.2**	**—**	**0.2**
– Bank loans	**—**	**106.7**	**—**	**106.7**
– Corporate bonds	**—**	**309.6**	**—**	**309.6**
– Fixed maturity funds	**2.6**	**48.0**		**50.6**
Total fixed maturity securities – AFS	**250.2**	**835.4**	**—**	**1,085.6**
Fixed maturity securities – at FVTPL	**—**	**25.7**	**—**	**25.7**
Equity securities – AFS	**23.2**	**—**	**—**	**23.2**
Hedge funds – at FVTPL	**—**	**—**	**154.0**	**154.0**
Other investments	**—**	**(0.5)**	**—**	**(0.5)**
Total investments	**273.4**	**860.6**	**154.0**	**1,288.0**

As at 31 December 2016	Level (i) $m	Level (ii) $m	Level (iii) $m	Total $m
Fixed maturity securities – AFS				
– Short-term investments	4.0	0.3	—	4.3
– U.S. treasuries	186.7	—	—	186.7
– Other government bonds	—	43.6	—	43.6
– U.S. government agency debt	—	71.7	—	71.7
– Asset backed securities	—	100.9	—	100.9
– U.S. government agency mortgage backed securities	—	107.1	—	107.1
– Non-agency mortgage backed securities	—	9.0	—	9.0
– Non-agency commercial mortgage backed securities	—	9.0	—	9.0
– Bank loans	—	121.6	—	121.6
– Corporate bonds	—	415.1	—	415.1
Total fixed maturity securities – AFS	190.7	878.3	—	1,069.0
Fixed maturity securities – at FVTPL	—	51.6	—	51.6
Equity securities – AFS	19.8	—	—	19.8
Hedge funds – at FVTPL	—	—	129.4	129.4
Total investments	210.5	929.9	129.4	1,269.8

There have been no transfers between Levels (i) and (ii), therefore no reconciliations have been presented.

The table below analyses the movements in hedge funds classified as Level (iii) investments:

	Hedge funds $m
As at 31 December 2015	156.0
Sales	(30.3)
Total net realised and unrealised gains recognised in profit or loss	3.7
As at 31 December 2016	129.4
Purchases	**149.7**
Sales	**(136.5)**
Total net realised and unrealised gains recognised in profit or loss	**11.4**
As at 31 December 2017	**154.0**

10. INTERESTS IN UNCONSOLIDATED STRUCTURED ENTITIES

As part of its investment activities, the Company invests in unconsolidated structured entities. As at 31 December 2017, the Company's total interest in unconsolidated structured entities was $468.5 million (31 December 2016 – $355.4 million). The Company does not sponsor any of the unconsolidated structured entities.

A summary of the Company's interest in unconsolidated structured entities is as follows:

As at 31 December	2017 $m	2016 $m
Fixed maturity securities		
– Asset backed securities	**123.9**	100.9
– U.S. government agency mortgage backed securities	**130.0**	107.1
– Non-agency mortgage backed securities	**9.8**	9.0
– Non-agency commercial mortgage backed securities	**0.2**	9.0
– Fixed maturity funds	**50.6**	—
Total fixed maturity securities	**314.5**	226.0
Investment funds		
– Hedge funds	**154.0**	129.4
Total investment funds	**154.0**	129.4
Total interest in unconsolidated structured entities	**468.5**	355.4

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 fixed maturity funds holds high-quality cash equivalents, short-term investments, U.S treasuries, other government bonds, asset-backed securities, U.S. government agency mortgage backed securities, non-agency mortgage backed securities, non-agency commercial mortgage backed securities and corporate bonds. 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 Company's operations.

The risk that the Company 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 balance sheet in that fair value is determined by market supply and demand. This is in turn driven by investor evaluation of the credit risk of the structure and changes in term structure of interest rates which change investors' expectation of the cash flows associated with the instrument and, therefore, its value in the market. Risk management disclosure for these financial instruments and other investments is provided on pages 19 to 30. 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 Company holds as at 31 December 2017 and 31 December 2016. Generally, default rates would have to increase substantially from their current level before the Company would suffer a loss and this assessment is made prior to investing and regularly through the holding period for the security. The Company has not provided any other financial or other support in addition to that described above as at the reporting date, and there is no intention to provide support in relation to any other unconsolidated structured entities in the foreseeable future.

As at 31 December 2017 the Company has a commitment of $100.0 million (31 December 2016 – $50.0 million) in respect of two credit facility funds. The Company, 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 Company'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 two credit facility funds is $100.0 million and as at 31 December 2017 there have been no defaults under this facility.

11. LOSSES AND LOSS ADJUSTMENT EXPENSES

	Losses and loss adjustment expenses $m	Reinsurance recoveries $m	Net losses and loss adjustment expenses $m
As at 31 December 2015	364.0	(0.9)	363.1
Net incurred losses for:			
Prior years	(54.8)	(0.4)	(55.2)
Current year	113.8	(0.7)	113.1
Exchange adjustments	3.8	—	3.8
Incurred losses and loss adjustment expenses	62.8	(1.1)	61.7
Net paid losses for:			
Prior years	75.1	(0.1)	75.0
Current year	13.6	(0.1)	13.5
Paid losses and loss adjustment expenses	88.7	(0.2)	88.5
As at 31 December 2016	338.1	(1.8)	336.3
Net incurred losses for:			
Prior years	**(46.9)**	**—**	**(46.9)**
Current year	**319.0**	**(86.2)**	**232.8**
Exchange adjustments	**11.6**	**(0.1)**	**11.5**
Incurred losses and loss adjustment expenses	**283.7**	**(86.3)**	**197.4**
Net paid losses for:			
Prior years	**110.9**	**(0.1)**	**110.8**
Current year	**11.5**	**(0.3)**	**11.2**
Paid losses and loss adjustment expenses	**122.4**	**(0.4)**	**122.0**
As at 31 December 2017	**499.4**	**(87.7)**	**411.7**

Further information on the calculation of loss reserves and the risks associated with them is provided in the risk disclosures section from pages 16 and 17. 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 Company's loss reserves. The Company believes that the loss reserves established are adequate, however a 20.0 per cent increase in estimated losses would lead to a $99.9 million (2016 – $67.6 million) increase in gross loss reserves. There was no change to the Company'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	
As at 31 December	**$m**	**%**	$m	%
Outstanding losses	**154.1**	**30.8**	194.9	57.7
Additional case reserves	**66.8**	**13.4**	32.6	9.6
Losses incurred but not reported	**278.5**	**55.8**	110.6	32.7
Total	**499.4**	**100.0**	338.1	100.0

The Company'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 Company's ability to estimate the ultimate value of its insurance liabilities. The Company began writing insurance and reinsurance business in December 2005.

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
Gross losses												
Estimate of ultimate liability[1]												
At end of accident year	218.6	394.6	141.1	238.8	309.7	191.9	153.3	117.8	143.7	112.7	319.9	
One year later	150.4	366.0	92.5	169.3	311.5	230.4	133.9	84.5	99.8	96.5		
Two years later	122.4	326.3	61.9	166.2	301.5	234.5	111.7	73.9	91.0			
Three years later	114.5	298.7	55.6	166.3	308.4	228.4	116.5	70.0				
Four years later	101.1	297.0	54.4	159.9	309.2	218.2	114.8					
Five years later	98.3	306.0	52.7	163.8	300.9	213.8						
Six years later	99.7	302.8	51.5	163.5	299.4							
Seven years later	100.5	306.3	68.7	163.9								
Eight years later	99.7	306.3	69.1									
Nine years later	101.1	306.6										
Ten years later	100.3											
Current estimate of cumulative liability	**100.3**	**306.6**	**69.1**	**163.9**	**299.4**	**213.8**	**114.8**	**70.0**	**91.0**	**96.5**	**319.9**	**1,845.3**
Paid	**(96.8)**	**(298.2)**	**(47.9)**	**(157.2)**	**(281.1)**	**(184.7)**	**(102.8)**	**(60.4)**	**(68.7)**	**(36.6)**	**(11.5)**	**(1,345.9)**
Total gross liability	**3.5**	**8.4**	**21.2**	**6.7**	**18.3**	**29.1**	**12.0**	**9.6**	**22.3**	**59.9**	**308.4**	**499.4**

(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
Reinsurance recoveries												
Estimate of ultimate recovery[1]												
At end of accident year	2.0	24.7	0.4	—	—	13.4	—	—	0.1	0.7	86.1	
One year later	1.9	27.2	0.3	—	17.8	64.9	—	—	0.2	0.7		
Two years later	1.3	21.4	0.1	—	17.8	70.0	—	—	0.2			
Three years later	1.2	20.4	—	—	10.8	69.9	0.1	—				
Four years later	1.1	19.8	—	—	10.9	69.9	0.1					
Five years later	1.0	22.5	—	—	10.7	69.9						
Six years later	1.0	22.1	—	—	10.8							
Seven years later	1.0	22.8	—	—								
Eight years later	1.0	23.2	—									
Nine years later	1.0	23.3										
Ten years later	1.0											
Current estimate of cumulative recovery	**1.0**	**23.3**	—	—	**10.8**	**69.9**	**0.1**	—	**0.2**	**0.7**	**86.1**	**192.1**
Paid	**(1.0)**	**(22.0)**	—	—	**(10.8)**	**(69.9)**	**(0.1)**	—	**(0.2)**	**(0.1)**	**(0.3)**	**(104.4)**
Total reinsurance recoveries	—	**1.3**	—	—	—	—	—	—	—	**0.6**	**85.8**	**87.7**

(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
Net losses												
Estimate of ultimate liability[1]												
At end of accident year	216.6	369.9	140.7	238.8	309.7	178.5	153.3	117.8	143.6	112.0	233.8	
One year later	148.5	338.8	92.2	169.3	293.7	165.5	133.9	84.5	99.6	95.8		
Two years later	121.1	304.9	61.8	166.2	283.7	164.5	111.7	73.9	90.8			
Three years later	113.3	278.3	55.6	166.3	297.6	158.5	116.4	70.0				
Four years later	100.0	277.2	54.4	159.9	298.3	148.3	114.7					
Five years later	97.3	283.5	52.7	163.8	290.2	143.9						
Six years later	98.7	280.7	51.5	163.5	288.6							
Seven years later	99.5	283.5	68.7	163.9								
Eight years later	98.7	283.1	69.1									
Nine years later	100.1	283.3										
Ten years later	99.3											
Current estimate of cumulative liability	**99.3**	**283.3**	**69.1**	**163.9**	**288.6**	**143.9**	**114.7**	**70.0**	**90.8**	**95.8**	**233.8**	**1,653.2**
Paid	**(95.8)**	**(276.2)**	**(47.9)**	**(157.2)**	**(270.3)**	**(114.8)**	**(102.7)**	**(60.4)**	**(68.5)**	**(36.5)**	**(11.2)**	**(1,241.5)**
Total net liability	**3.5**	**7.1**	**21.2**	**6.7**	**18.3**	**29.1**	**12.0**	**9.6**	**22.3**	**59.3**	**222.6**	**411.7**

(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	**0.7**	(1.3)
2008 accident year	**(0.3)**	0.5
2009 accident year	**(0.4)**	(17.1)
2010 accident year	**0.7**	1.1
2011 accident year	**7.7**	10.2
2012 accident year	**4.4**	10.3
2013 accident year	**2.1**	(4.3)
2014 accident year	**4.7**	11.2
2015 accident year	**9.7**	44.6
2016 accident year	**17.6**	—
Total favourable development	**46.9**	55.2

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

	Harvey $m	Irma $m	Maria $m	California wildfires $m
Change in insurance losses and loss adjustment expenses	**38.7**	**40.8**	**43.6**	**65.0**
Change in insurance losses and loss adjustment expenses recoverable	**(6.2)**	**(10.1)**	**(21.3)**	**(41.4)**
Change in reinstatement premiums	**(1.9)**	**(2.1)**	**(2.2)**	**0.5**
Net ultimate losses as at 31 December 2017	**30.6**	**28.6**	**20.1**	**24.1**

12. INSURANCE, REINSURANCE AND OTHER RECEIVABLES

All receivables are considered current other than $46.7 million (31 December 2016 – $50.6 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 Company's receivables.

13. FINANCING ARRANGEMENTS

LETTERS OF CREDIT

As the Company is a non-admitted insurer or reinsurer 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**	29.3

LOCs are required to be fully collateralised.

The Company, along with its parent company, have the following facilities in place as at 31 December 2017 and 2016:

- 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
- a $350.0 million syndicated collateralised credit facility with a $75.0 million loan sub-limit that has been in place since 5 April 2012 and was replaced on 24 March 2016 by the $300.0 million syndicated collateralised credit facility. There was no outstanding debt under this facility as at 31 December 2016.

The existing facility is available for the issue of LOCs to ceding companies. The facility is also available for the Company to issue LOCs to LUK to collateralise certain insurance balances.

The terms of the $300.0 million syndicated collateralised 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 LHL 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 2010 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 Company was in compliance with all covenants under these facilities.

TRUSTS AND RESTRICTED BALANCES

The Company 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, the Company 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, the Company had been granted authorised or trusteed reinsurer status in all states. The MBRT is subject to the rules and regulations of the aforementioned states and the respective deed of trust. These rules and regulations include minimum capital funding requirements, investment guidelines, capital distribution restrictions and regulatory reporting requirements.

In 2013 the Company entered into a QST agreement with CCL 1998. See note 16 for further details. Under this agreement the Company is required to provide 85 per cent of the required FAL to support the underwriting capacity of Syndicate 2010 and Syndicate 3010. FAL are restricted in their use and are only drawn down to pay cash calls to Syndicate 2010 and Syndicate 3010. FAL requirements are formally assessed twice a year and any funds surplus to requirements may be released at this time.

As at and for the years ended 31 December 2017 and 2016, the Company was in compliance with all covenants under its trust facilities.

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:

As at 31 December	2017 Cash and cash equivalents $m	2017 Fixed maturity securities $m	2017 Total $m	2016 Cash and cash equivalents $m	2016 Fixed maturity securities $m	2016 Total $m
In trust in favour of affiliates	**—**	**244.0**	**244.0**	3.7	285.6	289.3
MBRT accounts	**50.7**	**132.4**	**183.1**	5.6	35.1	40.7
FAL	**18.2**	**90.6**	**108.8**	11.7	217.4	229.1
In favour of LOCs	**5.4**	**35.7**	**41.1**	6.2	29.4	35.6
In trust accounts for policyholders	**0.8**	**15.6**	**16.4**	3.6	12.6	16.2
In favour of derivative contracts	**0.9**	**0.3**	**1.2**	0.7	0.3	1.0
Total (1)	**76.0**	**518.6**	**594.6**	31.5	580.4	611.9

(1) These balances exclude accrued interest.

14. SHARE CAPITAL

Authorised ordinary shares of $0.50 each	Number	$m
As at 31 December 2017 and 2016	1,000,000	1.0

Allocated, called up and fully paid	Number	$m
As at 31 December 2017 and 2016	**1,000,000**	**1.0**

DIVIDENDS

The Board of Directors have authorised the following dividends:

Date	$m
31 October 2016	200.0
26 October 2017	**35.0**

15. COMMITMENTS AND CONTINGENCIES

A. LEASE COMMITMENTS

The Company has payment obligations in respect of operating leases for certain items of office equipment and office space. Operating lease expenses for the year were $1.2 million (2016 – $1.2 million).

Future minimum lease payments under non-cancellable operating leases are as follows:

	2017 $m	2016 $m
Due in less than one year	**1.1**	1.1
Due between one and five years	**—**	1.1
Total	**1.1**	2.2

B. CREDIT FACILITY FUND

At as 31 December 2017 the Company has a commitment of $100.0 million (31 December 2016 – $50.0 million) relating to two credit facility funds (refer to note 10).

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.

16. RELATED PARTY DISCLOSURES

KEY MANAGEMENT COMPENSATION

Remuneration for key management was as follows:

For the year ended 31 December	2017 $m	2016 $m
Short-term compensation	**3.4**	3.2
Equity based compensation	**0.2**	2.1
Total	**3.6**	5.3

TRANSACTIONS WITH AFFILIATES

The Company conducts business with its parent company and other Group subsidiaries. This includes providing services, including professional and administrative support services, to related entities within the Group. Service agreements are in place to allow corresponding expenses to be re-allocated to the relevant entity with a mark-up to reflect commercial terms. Net other (losses) income in the statement of comprehensive (loss) income includes income of $2.1 million (2016 – $2.1 million) relating to such transactions with LHL and its subsidiaries.

During the year ended 31 December 2016 LHL contributed cash and fixed income securities of $41.8 million to the Company . This transaction is reflected in contributed surplus. There were no such transactions in 2017.

LHL's equity based compensation scheme is its RSS. LHL has issued RSS to certain LICL employees. LHL charges the Company for equity based compensation granted. Charges are based on the underlying estimated fair values and vesting conditions, adjusted by actions taken by LHL's Remuneration Committee as required. Refer to note 6 for the equity based compensation expense included in the statement of comprehensive (loss) income.

The Company has entered into a QST agreement with LUK. Under this agreement LUK cedes a share of all its business written or assumed. The following balances and transactions with LUK under the QST are included in the Company's financial statements:

Balance sheet	2017 $m	2016 $m
Assets		
Deferred acquisition costs	**46.6**	44.4
Inwards premium receivable from insureds and cedants	**4.3**	8.5
Liabilities		
Losses and loss adjustment expenses	**167.6**	213.8
Unearned premiums	**113.1**	131.1
Other payables	**28.5**	1.3

Statement of comprehensive (loss) income	2017 $m	2016 $m
Gross premiums written	**123.3**	145.8
Change in unearned premiums	**18.1**	26.0
Insurance losses and loss adjustment expenses	**43.2**	55.8
Insurance acquisition expenses	**56.5**	63.6

The Company holds $245.3 million (31 December 2016 – $290.8 million) of cash and cash equivalents, fixed income securities and accrued interest in trust for the benefit of LUK in relation to the QST agreement.

In 2013 the Company entered into a QST agreement with CCL 1998. Under this agreement CCL 1998 cedes 85.0 per cent of its financial result, which includes both insurance and non-insurance balances, to the Company from 1 January 2014. Net other (losses) income in the statement of comprehensive (loss) income includes a loss of $49.2 million (2016 – $27.2 million income) relating to the QST agreement. As at 31 December 2017, other payables includes $33.9 million (31 December 2016 – $42.7 million other receivables)relating to the QST agreement. The Company is required to provide 85.0 per cent of the required FAL to support the underwriting activities of Syndicates 2010 and Syndicate 3010. The Company holds $109.2 million (31 December 2016 – $230.0 million) of cash and cash equivalents and fixed income securities in FAL in relation to the QST agreement. On 3 October 2017 the Company put in place a $130.0 million syndicated uncollateralised facility for FAL purposes. See note 13 for further details.

TRANSACTIONS WITH SUBSIDIARY OF AFFILIATE

During 2017, the Company entered into an reinsurance agreement with Kinesis Re Limited. The following balances are included in the Company's financial statements:

Balance sheet	2017 $m
Assets	
Reinsurance recoveries	**22.1**

Statement of comprehensive (loss) income	2017 $m
Outwards reinsurance premiums	**3.8**
Insurance losses and loss adjustment expenses recoverable	**22.1**
Insurance acquisition expenses ceded	**0.1**

17. SUBSEQUENT EVENTS

On 8 February 2018 the Board of Directors authorised the payment of a dividend of $60.0 million.

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

AHL
Accordion Holdings Limited

A.M. Best Company (A.M. Best)
A.M. Best is a full-service credit rating organisation dedicated to serving the financial services industries, focusing on the insurance sector

ARL
Accordion Reinsurance Limited

Board of Directors
Unless otherwise stated, refers to the Company's Board of Directors

Best Lancashire Assessment of Solvency over Time (BLAST)
The Company's economic internal capital model

BMA
Bermuda Monetary Authority

BSCR
Bermuda Solvency and Capital Return

BSX
Bermuda Stock Exchange

CCL 1998
Cathedral Capital (1998) Limited, the Lloyd's corporate member of the Group

The Company
Lancashire Insurance Company 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

Combined ratio
Ratio, in per cent, of the sum of net insurance losses, net acquisition expenses and other operating expenses to net premiums earned

CRO
Chief Risk Officer

Deferred acquisition costs
Costs incurred for the acquisition or the renewal of insurance policies (e.g. brokerage and premium taxes) which are deferred and amortised over the term of the insurance contracts to which they relate

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

ERM
Enterprise Risk Management

Excess of loss
Reinsurance or insurance that indemnifies the reinsured or insured against all or a specified portion of losses on an underlying insurance policy in excess of a specified amount

Expense ratio
Ratio, in per cent, of other operating expenses to net premiums earned

Facultative reinsurance
A reinsurance risk that is placed by means of a separately negotiated contract as opposed to one that is ceded under a reinsurance treaty

FAL
Funds at Lloyd's

Fully converted book value per share (FCBVS)
Calculated by dividing the value of the total shareholders' equity plus the proceeds that would be received from the exercise of all dilutive equity compensation awards by the sum of all shares, including equity compensation awards, assuming all are exercised

FVTPL
Fair value through profit or loss

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

Gross premiums written
Amounts payable by the insured, excluding any taxes or duties levied on the premium, including any brokerage and commission deducted by intermediaries

the Group
LHL and its subsidiaries

IFRS
International Financial Reporting Standard(s)

Industry loss warranty (ILW)
A type of reinsurance or derivative contract through which one party will purchase protection based on the total loss arising from an event to the entire insurance industry rather than their own losses.

Incurred but not reported (IBNR)
These are anticipated or likely losses that may result from insured events which have taken place, but for which no losses have yet been reported. IBNR also includes a reserve for possible adverse development of previously reported losses

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

LHL
Lancashire Holdings Limited

LIBOR
London Interbank Offered Rate

LICL
Lancashire Insurance Company Limited

LOC
Letter of credit

Losses
Demand by an insured for indemnity under an insurance contract

LUK
Lancashire Insurance Company (UK) Limited

MBRT
Multi-beneficiary reinsurance trust

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 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

Pro-rata/proportional
Reinsurance or insurance where the reinsured or insured shares a proportional part of the original premiums and losses of the reinsured or insured

QST
Quota Share Treaty

Retrocession
The reinsurance of the reinsurance account

Return on Equity (RoE)
The IRR of the change in FCBVS in the period plus accrued dividends

RDS
Realistic Disaster Scenarios

RRC
Risk and Return Committee

RSC
Reinsurance Security Committee

RSS
Restricted share scheme

SHARP
Lancashire's in house aggregation system

Syndicate 2010
Lloyd's Syndicate 2010 managed by CUL, a subsidiary of CCL

Syndicate 3010
Lloyd's Syndicate 3010 managed by CUL, a subsidiary of CCL

TBAs
Mortgage backed "to be announced" securities

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

Unearned premiums
The portion of premium income that is attributable to periods after the balance sheet date is deferred and amortised to future accounting periods

UMCC
Underwriting and Marketing Conference Call

UNL
Ultimate net loss