

Corporate Governance Report

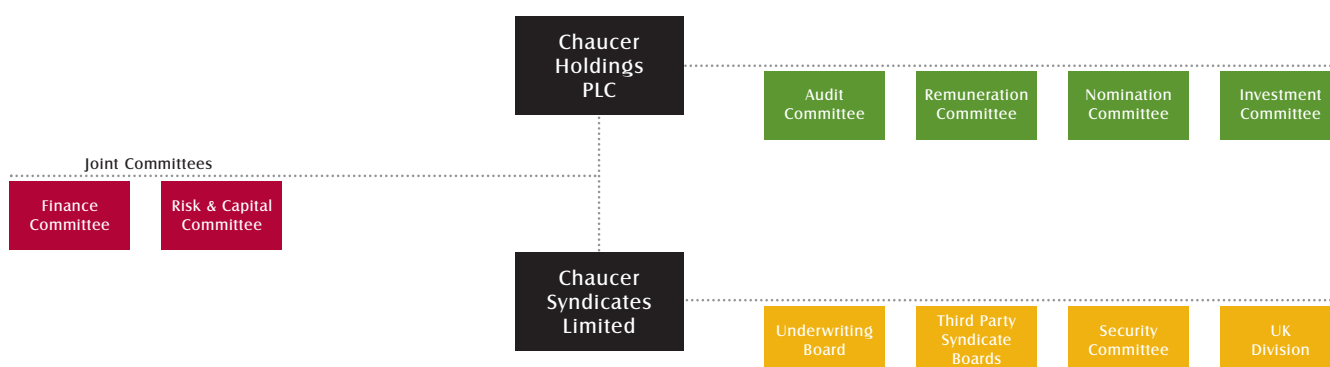
Set out below are statements on how the Company (Chaucer Holdings PLC or CHP) has applied the Main and Supporting Principles of the Combined Code (which is available at www.frc.org.uk). The Company complied with the provisions of the Code throughout the year, except as indicated below.

The Company is a listed holding company with one main trading subsidiary, Chaucer Syndicates Limited (CSL), a regulated Lloyd's managing agent first incorporated in 1922. As outlined below, the Company's Board determines major strategic and Group management decisions, while the CSL Board determines matters regarding Lloyd's and FSA regulation and day-to-day operations.

COMMITTEE STRUCTURE

To assist it in the discharge of its corporate governance responsibilities, the Company's Board has established three Committees; Audit, Remuneration and Nomination. The Terms of Reference of those Committees are available on the Company's website and their operation is set out below. In addition to these Committees, the Company's Board and the CSL Board have established the committee structure set out below.

Pages 47 and 52 outline the structure and responsibilities of those committees.



THE BOARD, DIRECTORS AND INDEPENDENCE

The Board of Directors comprises the Chairman, three executive and two non-executive directors (NEDs). The Nomination Committee considered in November 2009 the number of directors and their breadth of business experience and skills and concluded that they were appropriate for the Group's operations, except that additional independent NEDs should be recruited. The balance and experience of the Directors ensure that no individual or small group of individuals are in a position to dominate the Board's decisions.

The Chairman is mainly responsible for the running of the Board; he ensures that all Directors receive sufficient, timely and relevant information on financial, business and corporate issues. Papers for meetings are circulated a week in advance. The Chief Executive Officer's responsibilities focus on co-ordinating the Company's business and implementing Group strategy. All Directors are able to take independent professional advice relevant to their duties if necessary.

The Board met 18 times in 2009. It is scheduled to meet seven times during 2010. The higher number of meetings during 2009 was consequent to the extended offer period between 27 January and 29 June 2009 and the Firm Placing and Placing and Open Offer at the start of 2009.

The Board is responsible for overall Group strategy, acquisition and divestment policy, approval of major capital expenditure projects and consideration of significant financing matters. It approves the Group risk policy for development and implementation by the Risk & Capital Committee, which monitors the exposure to key business risks and the systems in place to achieve this in accordance with the Turnbull Guidance. The Board reviews the strategic direction of individual trading subsidiaries, their annual budgets, current trading, progress towards achievement of those budgets and capital expenditure programmes. The Board also considers environmental and employee issues and key appointments. In accordance with the Code, all Directors submit themselves for re-election at least once every three years.

The table below shows the members of the Board during 2009, the number of meetings held and individual member attendance during the year.

Board member	Number of Board meetings attended (total 18)	
B P Bartell (appointed 23 June 2009)	5	(maximum possible 5)
K D Curtis (appointed 16 December 2009)	0	(maximum possible 0)
R V Deutsch (appointed 26 August 2009)	4	(maximum possible 4)
C D Forbes (resigned 30 June 2009)	14	(maximum possible 14)
M J Gilbert (Chairman)	18	(maximum possible 18)
E H Gilmour (retired 31 December 2009)	18	(maximum possible 18)
M C Graham (resigned 24 June 2009)	14	(maximum possible 14)
R T Scholes	18	(maximum possible 18)
R A Stuchbery	18	(maximum possible 18)

In addition to these meetings, an executive committee of the Board held a number of meetings to deal largely with matters delegated to it regarding the operation of the Company's share schemes.

The Board of Directors considers that Messrs Deutsch and Scholes are independent of management, as was Mr Forbes until his resignation. Mr Scholes is the Senior Independent Director.

During the year, the Company was not compliant with the Code in that at least half the Board, excluding the Chairman, did not comprise of independent NEDs. The Nomination Committee decided to resolve this issue once the uncertainty created by the takeover approaches at the start of the year and by the subsequent changes in the composition of the Board had been resolved. Subsequently, the Company fell out of the FTSE 350 in December 2009, so will in the future be compliant. However, the intention to appoint new independent NEDs remains.

The Board considers that the requirement of the Code to evaluate the Board, all Committees and all Directors every year to be too onerous for a company of Chaucer's size. During the year, Executive Directors were subject to individual performance evaluations and a self-assessment questionnaire was completed covering the performance of the Board, the Audit Committee and the Remuneration Committee. A similar questionnaire was completed in 2010 for the Nomination Committee, this being delayed to allow for a review of the process used for the appointment of directors. Formal performance evaluations were not concluded in 2009 for the NEDs.

AUDIT COMMITTEE

The Audit Committee Report, which follows this report, includes details of its membership, activities and responsibilities.

NOMINATION COMMITTEE

During the year, the Committee considered and made recommendations to the Board in a number of areas. These included the appointments of Messrs Bartell, Curtis and Deutsch as Directors and their re-appointment at the 2010 AGM, the independence of the NEDs, the time requirements of the NEDs (concluding that they continue to devote sufficient time to their duties) and the size, structure and composition of the Board.

The Committee was particularly engaged in the composition of the Board during the year. In February 2009, the Committee engaged specialist consultants to identify potential candidates for various Board positions. That process was delayed by the extended offer period, which ceased only on 29 June 2009. At that point, the Committee determined a number of Board changes which were announced. The search for two additional independent NEDs was half-completed with the appointment of Robert Deutsch in August; Robert had stepped down from that role on 31 December 2008 due to a conflict of interest which had subsequently ceased. The Committee's search for a new Chief Executive Officer and Chief Finance Officer was completed in December 2009 with the appointments of Robert Stuchbery and Ken Curtis, with Bruce Bartell stepping up to Chief Underwriting Officer. Whilst that search had taken somewhat longer than expected, the Committee determined it was important to consider both external and internal candidates to ensure the best individuals were appointed. The Committee was pleased to confirm those internal appointments, which reflected the strength of Chaucer's executive team and of its succession planning. The appointment of John Fowle as Active Underwriter, at the same time, and Mauricio Carrillo as CSL Finance Director in April 2010 are similarly reflective.

The Committee continues to seek further independent NEDs.

The Committee has access to independent professional advice and is entitled to seek any information it requires from any employee.

Details of Committee members and the number of meetings attended in 2009 are as follows:

Committee member	Number of Committee meetings attended (total 5)	
M J Gilbert (Chairman)	5	(maximum possible 5)
R V Deutsch (appointed 26 August 2009)	4	(maximum possible 4)
C D Forbes (resigned 30 June 2009)	1	(maximum possible 1)
R T Scholes	5	(maximum possible 5)

In addition to the formal meetings held, members of the Committee discussed the matters delegated to it by the Board on other occasions during the year.

REMUNERATION COMMITTEE

Details of the Remuneration Committee are included in the Directors' Remuneration Report.

INVESTMENT COMMITTEE

From 11 February 2009, the operation of the Investment Committee was suspended and all material investment matters were discussed at the CHP Board and CSL Board where appropriate. In March 2010, the Investment Committee was re-established but material investment matters continue to be reserved for consideration by the CHP Board. The CSL Board continues to be informed of, and discusses investment matters as appropriate.

The CSL Treasurer and investment advisers attend meetings as appropriate.

ACCOUNTABILITY AND AUDIT

Financial reporting

The Company presented its financial position and prospects during the year in a number of ways to ensure shareholders and potential shareholders could make a balanced and informed assessment about their investment. This included:

- Annual Report and Accounts, prepared in accordance with International Financial Reporting Standards, which includes a Chief Underwriting Officer's Report, a Financial Report and statements on directors' responsibilities and going concern;
- Half-year Report and Accounts;
- Interim Management Statements;
- Announcements regarding developments which may affect the share price of the Company as and when necessary; and
- Syndicate Annual Report and Accounts filed with Lloyd's, which are also public documents.

The CHP Board approved these reports before publication, following their review and recommendation by the appropriate Board Committees, including the Audit Committee and Finance Committee.

Internal controls and risk management

Chaucer is committed to high standards of corporate governance and has complied throughout the year with the principles set out in the Turnbull Guidance for Internal Control.

The CHP Board acknowledges that they are responsible for the Group's system of internal control and for reviewing its effectiveness. The Risk Management Framework (RMF, which is described in detail below) and other internal controls are designed to manage, rather than eliminate, the risk of failure to achieve the Group's strategic objectives and can only provide reasonable, but not absolute, assurance against material misstatement or loss.

The CHP Board has conducted an annual review of the effectiveness of the Group's systems of internal controls (including the RMF) in addition to other reviews and procedures that are ongoing throughout the year. The annual review was conducted by the Risk Officer and reported to the CSL Board and the Audit Committee on behalf of CHP. An annual Internal Audit is conducted on the work of the Risk Management Function to provide further comfort.

During 2009, there has been much focus on Solvency II planning and implementation. Within Chaucer's Solvency Smart Programme, the Company seeks to enhance certain elements of the RMF, such as areas of risk and capital modelling and the measurement and effective management of the aggregated risk appetite of the Group.

Following the significant investment losses incurred largely during September and October 2008, the Risk Officer was commissioned to review the operations of the Investment Committee, the Risk & Capital Committee and the related components of the RMF. The Risk Officer's recommendations were considered by the CHP and CSL Boards and the Audit, Investment and Risk & Capital Committees. Whilst it was recognised that the events in the global financial markets were exceptional, a number of the Risk Officer's recommendations have been accepted and implemented.

In addition, the investment portfolio has been substantially de-risked and current financial markets support, at least in the short-term, significant holdings of cash, cash equivalents, government bonds and government guaranteed bonds. Asset allocation benchmarks shall continue to be reviewed regularly.

Investment advisers to the CHP Board consist of Mercer Investment Consulting and Paul Berriman. Mr Berriman is currently an Executive Director of Oxford Investment Partners, a fund management company set up to manage the investment portfolios of a number of Oxford colleges. Prior to this he was the Chief Executive of Deutsche Asset Management in the UK, with responsibility for over £50bn of assets managed on behalf of pension funds, insurance companies and high net worth individuals, and was formerly Global Head of Fixed Income at the same organisation.

RISK GOVERNANCE

Risk governance is operated through the following structure of Boards, Committees and departments:

Chaucer Holdings PLC

The CHP Board is ultimately responsible for setting risk strategy and risk appetite, for overseeing the management of risk and for ensuring the adequacy and efficacy of capital to support the risks across the business.

Chaucer Syndicates Limited

The CSL Board is responsible for supporting the CHP Board in the management of risk to defined risk appetite or risk tolerance levels and is primarily focused on the management of risks faced by our Lloyd's managing agent and all managed syndicates, including third-party management syndicates.

Risk & Capital Committee

To fulfil the above risk governance roles effectively, the CHP and CSL Boards have delegated the oversight of the management of risks to a Risk & Capital Committee (RCC), which is responsible for the implementation of risk policy across the business.

The RCC oversees the development of on-going risk identification, risk assessment and mitigation strategies and the overall operation of the RMF.

The membership of the RCC and its work regarding capital management is described on page 52.

The Risk Assurance Group

The Risk Assurance Group (RAG), headed by the Risk Officer, who is also a CSL Director, supports the Boards and the RCC by working in partnership with the business to build effective risk management processes.

The RAG comprises Risk Management, Internal Audit and Compliance teams which, together, provide guidance, support and monitoring of risk management effectiveness across the business. Underwriting Risk Review is the most recent addition to the RAG and took place in mid 2009, providing additional technical underwriting assurance capabilities to the Group. The Internal Audit function liaises closely with the RAG but has an independent reporting line to the Audit Committee.

The main objectives of the RAG are as follows:

- Instil a culture of risk awareness and controlled risk taking throughout the business;
- Ensure internal and external risks to the Group are identified, consistently evaluated and clearly communicated;
- Act as a link between the RMF and optimal capital utilisation;
- Provide independent control environment assurance and advice;
- Facilitate positive regulatory relationships; and
- Ensure regulatory compliance requirements are met.

Risk Management

The Risk Management Team focuses primarily on the threat to the achievement of our stated business objectives through the operation of the RMF. Risk Management works in partnership with the business to facilitate the identification and assessment of key risks and ensure that appropriate mitigations and controls are in place and operate effectively.

Risk Management reports to the RCC monthly on risk exposure areas, performance of mitigations and controls and the overall development of the RMF.

Underwriting Risk Review

Underwriting Risk Review was established to provide the Board with the necessary assurance that the Underwriting Risk assumed by the syndicates under management is consistent with the business plan of each syndicate and that the associated processes and controls are effective and properly utilised.

The Department sits above the peer review process between Internal Audit and the business, seeking consistency of approach to the process and management of Underwriting Risk across all syndicates managed by CSL and attainment of levels commensurate with market best practice and the business plan of each syndicate.

Compliance

The Compliance function monitors regulatory compliance with Lloyd's, the FSA and international requirements and manages our exposure to regulatory risks. Compliance works in partnership with the business through a Compliance Committee, whose members include appointed representatives from key areas of the business.

Internal Audit

Reporting to the Audit Committee, the objective of the Internal Audit Team is to provide independent and objective assurance of business processes, procedures and governance through the evaluation of adequacy and effectiveness of controls. The team applies a targeted risk-based audit approach, focusing on those internal controls that most mitigate the risks faced by the business. The Audit Committee reviews and approves the annual Internal Audit Plan. The Internal Audit Team works closely with the RAG to coordinate risk-focused audit activity.

The Risk Management Framework

A risk management framework has been developed to ensure that risks are identified, assessed, managed and monitored.

Risk ownership

Responsibility for the day-to-day management of risks and the design and operation of risk mitigations and internal controls is assigned to an individual risk owner (usually a Director) but with the support of operational Boards and Committees across the business. The following table summarises the key risks arising from business activities, identifies the relevant risk-owning committee(s) and references where the Annual Report provides further discussion on the management of these risks.

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FSA classification	Risks	Risk owning Board or Committee	Risk discussion (Page)
Insurance	Underwriting	Underwriting Board	80
	Claims		82
	Reinsurance	Finance Committee	84
	Reserving		86
Credit	Reinsurers	Security Committee	93
	Intermediaries		93
	Investments	Investment Committee	89
Financial Market	Interest rate fluctuations	Investment Committee	90
	Currency fluctuations		91
	Investment fluctuations		89
Liquidity	Insurance calls on cash	Investment Committee	92
	Non-insurance calls on cash		92
Operational	People	Risk & Capital Committee	28
	Systems and processes		48
Group	Capital adequacy	Risk & Capital Committee	34
	Financial strength		36

Risk identification and risk assessment

Each risk owner is responsible for the identification of risk, with support from the Risk Management Team and the framework of risk owning committees.

Business risks are analysed in accordance with the principal risk categories defined by the FSA and each risk owner is responsible for the evaluation of risk in terms of impact and probability. Risk Management assists and challenges the risk owners in the assessment of risk.

The following table summarises the main risk categories facing the business.

Risk category	Risk objective	Comments
Insurance	Optimise risk returns within appetite	Insurance risk is the dominant risk faced by the business as our core business activity is the evaluation and acceptance of underwriting risk for return
Credit	Minimise risk exposure while achieving optimal trade-off with insurance risk	We only use internally approved brokers and reinsurers that meet our quality assessment criteria
Financial Market	Optimise risk returns within appetite	Our portfolio comprises assets that are well diversified and liquid ¹ . We determine asset allocations according to set risk constraints
Liquidity	Minimise risk exposure	We maintain a strong cash flow position and highly liquid ¹ investments
Operational (including legal and regulatory risk)	Minimise risk exposure	We are committed to high standards of internal control that are regularly monitored and tested
Group	Minimise risk exposure	The risks associated with being part of a group are generally low, although the activities of managed syndicates and our overseas offices create exposure

¹ The residual hedge funds are not as liquid as other investment classes due to the existence of certain redemption restrictions

Risk monitoring and reporting

Risks are monitored through a combination of risk or control indicators, self-certification procedures and regular meetings between business representatives and Risk Management. Risk Management maintains a risk register and a log of issues, control failures or near misses, which encompasses existing, emerging and future risks and includes a materiality assessment of each item's potential exposure to the business.

Risk Management reports to the RCC and both Risk Management and the risk-owning committees report to the CSL Board. The Risk Officer also provides reports as required to the Audit Committee, such as an annual review of the effectiveness of the RMF. Risk information produced for the syndicate Individual Capital Assessment process also provides a key source of risk reporting for the Boards.

Managing the risk

Each risk owner is responsible for the effective operation of key controls and management of the risk, with support from the Risk Management Team.

Risk Management works with the risk owner to develop commercially focused action plans to achieve the required level of risk or control according to risk appetite. Risk Management also monitors actions taken, to ensure that the management of risk remains within the risk appetite or tolerance levels set and reports progress to the RCC.

The Scheme of Delegation, which sets out the decision-making authority levels for individuals, Committees and Boards across the business, determines where and at what level commercial decisions are taken.

Solvency II

From 2012, all syndicates managed by CSL will be subject to the rules and regulations of Solvency II, a European Union Directive that introduces legislation to improve the protection of policyholders through greater emphasis on enterprise-wide risk management and strengthened levels of insurance capital adequacy.

In 2008, the Company recognised that implementation of the Directive would provide an excellent opportunity for the Company to enhance its risk management activities through better-informed business decisions, improve efficiencies within its operations and further strengthen its risk-based capital modelling capabilities and capital management processes. Throughout 2009, the Company's Senior Management Team undertook a significant planning exercise to identify and design the enhancements its operations and RMF would require for this. This initiative, the Solvency Smart Programme, aims primarily to benefit the Company and its managed syndicates, while also ensuring regulatory compliance and approval of its internal model.

Since the final quarter of 2009, the Company has been working on the implementation of its Solvency Smart Programme. To demonstrate the importance attached to this initiative, the Company Chief Executive Officer is the Programme Sponsor. The Solvency Smart Programme Board comprises CHP and CSL Directors and selected senior management. The programme is divided into five core work-streams, with a CHP or CSL Director leading each stream.

The CSL Board has approved a substantial budget for Solvency Smart to ensure that the Company delivers on the enhancements required, while business continuity remains, as implementation of changes occurs during the next two years. The Company recognises that a programme of this scale, importance and complexity requires structured and skilful management. An experienced Senior Change and Programme Manager was recruited in November 2009 for the duration of the programme. The majority of programme resources are also now in place and work on implementation progresses well.

RELATIONS WITH SHAREHOLDERS

The Company encourages two-way communications with its institutional and private investors and responds quickly to all queries received. The Chief Executive Officer, the Chief Underwriting Officer and the Chief Finance Officer attended numerous meetings and maintained contact with analysts, brokers and institutional shareholders during the year. Subsequent to the announcement in March 2009 of the Company's 2008 results, the Company's stockbroker, Numis, canvassed the views of shareholders and reported to the Directors. All the Directors attended the AGM and the chairs of the Board Committees were available for questions. While the Chairman, Senior Independent Director and other NEDs do not have regular meetings with shareholders, they have expressed their willingness to do so if the shareholders so desire.

Following the departure of Chris Forbes, Richard Scholes was appointed Senior Independent Director on 26 August 2009.

GOING CONCERN BASIS

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chairman's Statement, Chief Executive Officer's Statement and Chief Underwriting Officer's Report on pages 4 to 23. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Financial Report on pages 32 to 38. In addition the Corporate Governance Report and Notes 2 and 3 to the consolidated financial statements include the Group's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities and its exposures to credit risk and liquidity risk.

The Group has considerable financial resources together with contracts with a number of customers and suppliers across different geographic areas and industries. Consequently, the Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have formed a judgment at the time of approving the consolidated financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the consolidated financial statements.

CSL BOARD AND JOINT COMMITTEES

The FSA, which is responsible for regulation of the UK insurance industry (including Lloyd's Managing Agents) and Lloyd's, which is responsible for risk management within the market, regulate CSL. CSL is therefore obliged to comply with the extensive regulations and detailed codes of practice imposed by the FSA and Lloyd's. Consequently, it has developed a comprehensive system of monitoring, compliance, regulation, risk assessment and overseeing the management of the major risks faced by the business. The governance structure is regularly reviewed and adjusted to ensure a continued fit to business needs.

The following paragraphs outline the roles and responsibilities of individual boards and committees within the governance structure.

Underwriting Board

The Underwriting Board is chaired by the Chief Underwriting Officer; other members include the Active Underwriter of Syndicate 1084 and the heads of each underwriting division. It meets approximately monthly and reports to the CSL Board.

It has specific responsibility for setting and ensuring delivery of the underwriting strategy for Syndicates 1084 and 1176 and for monitoring all aspects of their underwriting performance. This includes reviewing and recommending the Syndicates' annual business plans to the CSL Board and monitoring actual performance against those plans. Its objective is to approve capital allocations for individual business classes and to optimise their return on capital employed.

Finance Committee

The Finance Committee is chaired by the Chief Finance Officer; other members include the Chief Executive Officer, the CSL Finance Director and the Group Actuary. It meets approximately monthly and is a joint committee of both the CHP and CSL Boards.

It has responsibility for monitoring the financial health of the Group. It also provides advice and commentary on all relevant material financial matters, including reserves and dividends. In particular, it has responsibility for the timely and accurate delivery of all financial reporting, developing and implementing policy in respect of cash flow management, credit control, expenses, tax, foreign exchange and capital management and assisting the Risk & Capital Committee in the identification and control of credit, liquidity and financial market, reserving and capital risks.

Risk & Capital Committee

The Risk & Capital Committee is chaired by the Chief Executive Officer; other members include the Chief Underwriting Officer, the Chief Finance Officer, the CSL Risk Officer and the Active Underwriter of Syndicate 1084. It meets approximately monthly and is a joint committee of both the CHP and CSL Boards.

It has responsibility for the development and implementation of Group risk policy and for ensuring that the risk policy is consistent with the expectations of capital providers and the limitations imposed by Lloyd's and the FSA. It also has responsibility for the oversight of risk management throughout the Group and for ensuring that the RMF and capital assessments are consistent with the requirements of Lloyd's and the FSA.

Third Party Management Committee/Syndicate Management Boards

The Third Party Management Committee (TPMC) was chaired by the CSL Director for Third Party Syndicates (TPS). During 2009, it met approximately monthly and reported to the CSL Board and, where appropriate, to capital providers.

It had responsibility for monitoring all aspects of the underwriting performance of each TPS. This included reviewing and recommending the Syndicates' annual business plans to the Expert Review Committee; setting business class capital allocations; ensuring the efficient operational management of each TPS and run off syndicate; ensuring that the risks to Chaucer of managing and being associated with TPS are being identified, assessed and appropriately managed.

Effective 1 January 2010, the TPMC and each Third Party Syndicate Operations Committee (SOC) were replaced by a Syndicate Management Board (SMB) for each TPS. Broadly speaking, the responsibilities of each SMB combine those of the old SOC and TPMC. Each SMB is chaired by the CSL Director for TPS and members include representatives from CSL and the relevant TPS.

Security Committee

The Security Committee is chaired by the Chief Finance Officer and other members include representatives from the underwriting, reinsurance, actuarial and finance departments. It meets approximately monthly and reports to the CSL Board. External consultants assist the Committee.

It has responsibility for managing the exposure to credit risk from reinsurers, brokers, cover-holders and other intermediary counterparties for the Group and managed syndicates.

UK Division Board

A UK Division Board, which is a continuation of the Motor Division Board, was established on 24 February 2009 to provide a forum for the development of the Group's business in the UK managed from Whitstable. Whilst that business continues to be dominated by motor underwriting, it also includes the Group's motor broking activities and development of other business lines.

Approved by the Board of Directors on 7 April 2010 and signed on its behalf by

David Turner

Company Secretary

