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The financial performance of the Group improved significantly in 2009, with a profit before tax of £42m (2008 loss £26.2m).

The result illustrates the strengths of the Group's diversified underwriting strategy. Losses were sustained in certain classes but overall underwriting contributed a profit before investment income of £45.8m (2008 £33m), excluding the impact of foreign exchange on non-monetary items.

The Group's investment portfolio performed strongly, recording a return of £53.3m (2008 loss £71m). The value of equity and hedge fund holdings recovered as liquidity and confidence returned to the market.

The Group raised funds in February to enable it to take advantage of good rating conditions in 2009, following the financial and insurance losses of 2008. In 2009, gross written premiums, excluding RITC premiums and consolidation adjustments, increased by 15.3% to £795.6m (2008 £689.9m), the result of premium income increases across all divisions. Net earned premiums, excluding RITC premiums, the impact of foreign exchange on non-monetary items and consolidation adjustments, increased by 24.9% to £672.6m in 2009 (2008 £538.4m).

The Group combined ratio improved to 93% (2008 94%). During 2009, the Group released net reserves of £31.8m relating to prior periods (2008 £74.1m) reducing the combined ratio by 5% (2008 13%).

The expense ratio decreased to 31% (2008 32%). The ratio included a foreign exchange gain of £1.8m (2008 £8.4m) and professional fees of £2.8m relating to corporate finance costs in the first half of the year.

**"The Group's
investment portfolio
performed strongly,
recording a return
of £53.3m"**

The treatment of non-monetary assets and liabilities under IFRS has materially distorted the Group's performance in 2009 and 2008. Following the significant strengthening of the US dollar against sterling in the second half of 2008, the reported result was improved by £33.3m.

The magnitude of this figure resulted from a sudden significant swing in the US dollar, which coincided with the 2008 year-end. This mismatch of translation of assets and liabilities unwound in 2009, decreasing the reported profit by £33.3m.

Although the Group does not expect a repeat on this scale, it is still the case that each one cent movement in the year-end exchange rate will impact the reported profit before tax by more than £1m.

Table 4 summarises the results for the year.



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Chief Finance
Officer

Taxation

The Group's tax charge is £13.9m (2008 credit £7.3m). The tax charge is 33.1% (2008 27.9%). This is in excess of the standard rate because of the disallowed corporate finance costs and the tax treatment of the cost of shares awarded under the deferred bonus scheme, whereby the ultimate tax deduction is determined by the value of the shares at vesting. The estimated value of the deduction during the period to vesting is determined by the market price of the shares. A fall in the market price of the shares is reflected by a charge against the deferred tax asset, resulting in a current tax charge in the income statement. Under IFRS, the fact that the

share price has fallen is not reflected by a reduction in the before tax charge in the income statement but will be shown as an adjustment in equity at the time of vesting.

The introduction of claims equalisation reserves will enable the Group to defer corporation tax due on profits generated from certain classes of business, including property, marine, aviation and nuclear. This will reduce the corporation tax payable over the coming years. The Group estimates a reduction in the tax payable in 2010 of £9.8m. This represents a timing difference and might reverse in the future. The benefit of claims equalisation reserves may fall if the Group chooses to redomicile.

Dividends

At the time of the capital raising, the Group announced a commitment to a dividend policy of a minimum of 4.0 pence per ordinary share for both 2009 and 2010, in the absence of unforeseen circumstances. In accordance with this policy, the Group paid an interim dividend of 1.3p per share (2008 interim dividend 1.8p) on 1 October 2009. The Group intends to pay a final dividend of 2.7p (2008 second interim dividend 3.7p), making a total annual distribution of 4.0p (2008 5.5p). The dividend is payable on 28 May 2010 to shareholders on the register on 7 May 2010.

	2009 £m	2008 £m
Table 4 Key financial data		
Gross written premiums ¹	796.3	741.0
Net earned premiums ¹	606.3	547.2
Total revenue from operations	670.8	485.4
Total operating charges	(624.7)	(515.4)
Profit/(loss) from operations	46.1	(30.0)
Profit/(loss) before tax and foreign exchange on non-monetary items	75.3	(59.5)
Foreign exchange (loss)/gain on non-monetary items	(33.3)	33.3
Profit/(loss) before tax	42.0	(26.2)
Profit/(loss) after tax attributable to equity holders	28.1	(19.0)
Per share amounts		
	p	p
Basic earnings/(loss) per share	5.8	(6.0)
Interim dividend	1.3	1.8
Final dividend/second interim dividend	2.7	3.7
Key business ratios		
	%	%
Combined ratio ²	93	94
Post tax return on equity	9.7	(7.0)

1 This includes the initial impacts of both the RITC of Run off Syndicates 1204, 1224, 1229 and 1245 and of the increased ownership of in-house syndicates following the RITC of third-party participations, in the year in which the closure occurs

2 Combined ratios exclude the initial impacts of both the RITC of Run off Syndicates 1204, 1224, 1229 and 1245 and of the increased ownership of in-house syndicates following the RITC of third-party participations, in the year in which the closure occurs. The ratios also exclude the impact of foreign exchange on non-monetary items

£74.9m

Capital raised to support business development and strengthen balance sheet

£82.1m

Capital provision quota-share support obtained for Syndicate 1084

£81.4m

Capital buffer and working capital

Capital management

The Group's capital management activities seek to ensure the continued availability of adequate capital across the insurance cycle and to achieve a balance between reasonable funding costs and an appropriate balance sheet structure. In addition to the permanent capital provided by shareholders' funds, the Group employs letters of credit, quota-share arrangements and debt as additional solvency capital to support underwriting.

Group capital comprises regulatory capital deposited as Funds at Lloyd's (FAL) and a capital buffer to protect the underwriting capacity of the business against the impact of severe (but not extreme) loss events. This reduces the Group's requirement to seek additional capital funds after such events. This provides underwriting flexibility and helps maintain the long-term value of the business.

At 31 December 2009, the Group's economic capital was £417.9m, comprising £336.5m of FAL and £81.4m of capital buffer and working capital.

The capital raising in February strengthened the capital position. In addition, the Group entered into a capital backed quota share agreement in 2009 to increase the buffer. The quota share support has increased for 2010 in order to support growth and maintain an appropriate balance between risk, reward and capital. At the year-end, the total of net tangible assets and subordinated debt represented 144% of the Group's ICA requirements for 2010. In addition, available funds, including letters of credit, represented 124% of the Group's FAL requirement. The Group continues to keep this balance under review.

Capital raising

In February 2009, the Group raised £74.9m, net of expenses, through a firm placing and placing and open offer, to support the development of the business and to strengthen the balance sheet. The Group deposited the proceeds as additional FAL to increase the underwriting capacity of Syndicate 1084 to £634m for 2009, an increase of £189m or 42.5% on the 2008 capacity of £445m.

	Year of account	
	2010 £m	2009 ³ £m
Table 5 Composition of Funds at Lloyd's		
Chaucer underwriting interests	623.3	580.0
Quota share	82.1	50.6
Overall premium limit	705.4	630.6
FAL ratio (average)	47.7 %	48.1 %
FAL requirement	336.5	303.2
Funding of open year of account losses	143.6	149.0
Total FAL requirement	480.1	452.2
FAL requirement satisfied by:		
Investments	218.8	243.2
Personal reserves	87.9	115.8
Letters of credit²		
Group economic interest	51.0	56.0
Capital provision quota share reinsurer	55.9	35.6
Credits from Lloyd's for undistributed profits	475.3 ¹	450.6 ¹

1 The difference between the FAL requirement and the assets held is due to the revaluation of the US dollar denominated assets at the balance sheet date. The Group's FAL requirement will be revalued by Lloyd's in April 2010 reflecting the year-end exchange rate, at which point an overall surplus is expected

2 The letters of credit include one for US\$60.4m (2009 US\$28.8m) provided by Flagstone Reassurance Suisse SA, a company registered in Switzerland, under the terms of a reinsurance agreement entered into by the Group and Flagstone in June 2009

3 The underwriting interests reported at 31 December 2008 were £484.4m. Subsequently the Group increased its interests in the 2009 underwriting year to £580m. The figures in the table above have been updated to reflect the increased underwriting interests

Reinsurance agreement

In November 2009, the Group concluded the second stage of a two year reinsurance agreement with Flagstone Re to provide £82.1m (2009 £50.6m) of underwriting capacity to Syndicate 1084 for the 2010 year of account.

Regulatory capital

The Group's total underwriting interests are £623.3m for 2010 (2009 £580m), with regulatory capital requirements of £336.5m or 47.7% (2009 48.1%), against a Lloyd's minimum of 40%. The Group deposits the capital as FAL. **Table 5** shows the FAL composition for 2010.

Gearing

In addition to equity, the Group has debt capital of £40.3m (2008 £45.1m) and a £51m (2008 £56m) letter of credit facility deposited as FAL to support the underwriting capital.

The Group's debt capital comprises a €12m (£10.2m) 30-year loan note issued in 2004 and US\$50m (£30.1m) of 30 year subordinated debt raised in September 2006 (sterling equivalents are on an amortised cost basis). These arrangements provide the Group with

balance sheet gearing to enhance returns for shareholders. The total financial gearing, including loan notes, uncollateralised letters of credit and subordinated debt, was £86.3m (2008 £96.1m) or 27.2% of shareholders' funds (2008 42.6%).

At 31 December 2009, the Group held cash resources outside of syndicates and FAL of £52.4m, including £5m of collateral (2008 £37.5m, including £5m of collateral), producing net debt of £38.9m (2008 £63.6m) and gearing of 12.3% (2008 28.2%).

Table 6 provides a gearing summary.

Investment portfolio performance

The Group achieved an investment return of £53.3m (4.3% return on average funds) in 2009.

Financial investments (excluding the investment in Antares), cash and deposits totalled £1.3bn at 31 December 2009 (2008 £1.2bn). These supported FAL of £306.7m (2008 £263.7m), syndicate technical reserves of £948.4m (2008 £899m) and capital buffer and working capital funds of £81.4m (2008 £39.8m).

£53.3m

Investment return achieved
(4.3% return on average funds)

£1,336.5m

Record funds under management
at the year end

£306.7m

Funds at Lloyd's

	2009 £m	2008 £m
Table 6 Gearing summary		
Debt		
On balance sheet	40.3	45.1
Off balance sheet (letters of credit)	51.0	56.0
Cash held outside Lloyd's	(5.0)	(5.0)
Free cash resources	(47.4)	(32.5)
Total net debt	38.9	63.6
Shareholder equity	316.7	225.5
	%	%
Gross gearing	27.2	42.6
Net gearing	12.3	28.2

Table 7 provides an analysis of investments, cash and deposits held at 31 December 2009 and of the net investment return for the period.

Hedge funds

The Group redeemed hedge funds with a total value of £118.9m during 2009. These redemptions continued to settle at favourable prices and in accordance with forecasts. At 31 December 2009, hedge fund participations comprised 3% of the Group's investment portfolio. This will fall to less than 1% of the portfolio during the second quarter of 2010 as redemptions continue.

Table 8 provides a summary of hedge fund investments by strategy, return and valuation at 31 December 2009.

Bonds

The portfolio performed well during 2009, recording a return of 4.2% (2008 loss 2%).

The average duration of the bond portfolio at 31 December 2009 was 1.8 years (31 December 2008 1.0 year) and the weighted average yield to maturity was 2.6% (31 December 2008 4.3%).

In October 2009, the Group allocated £330m of redeemed hedge fund participations and existing cash balances to three newly appointed fixed income managers, increasing the allocation to investment grade credit. The average credit rating of the fixed income portfolio is AA. The allocation to sub-investment grade securities is less than 1% of the fixed income portfolio and consists primarily of mortgage-backed securities that were downgraded during 2009.

As **table 9** shows, at the end of 2009, the majority of Group holdings were in investment grade bonds.

Securitised securities breakdown further as shown in **table 10**.

Cash and deposits

Cash returns remain poor because of continued record low interest rates.

Investment portfolio outlook

As previously disclosed, the Group intends to continue with a conservative investment strategy, with a focus on capital maintenance, and forecasts only modest investment returns in 2010. The Group expects that the performance of the current investment portfolio will remain robust through most economic scenarios, including a double dip recession and growth with inflation environments.

	31 December 2009			31 December 2008		
	Value £m	Return £m	Return %	Value £m	Return £m	Return %
Table 7 Investment portfolio						
Equities	4.6	0.3	5.3	6.0	(31.9)	(38.7)
Hedge funds	37.5	14.7	20.9	154.7	(30.4)	(27.0)
Absolute return bond funds	-	9.4	2.9	332.6	(17.3)	(4.5)
Bonds	749.6	24.0	4.2	248.1	(3.5)	(2.0)
Cash and deposits	544.8	5.4	0.9	461.1	12.4	4.3
	1,336.5	53.8	4.3	1,202.5¹	(70.7)	(6.8)
Investment expenses		(0.5)			(0.3)	
Net investment return		53.3			(71.0)	

	31 December 2009	31 December 2008
Asset allocation	%	%
Equities	-	-
Hedge funds	3	13
Absolute return bond funds	-	28
Bonds	56	21
Cash and deposits	41	38
	100	100

¹ These financial assets were held at 31 December 2008, prior to the capacity increase in the 2009 year of account following the capital raising

Foreign currency management

With approximately a fifth of premium income currently generated from UK motor insurance, the Group has less gross foreign currency exposures than many Lloyd's entities, although it still writes substantial amounts of business in foreign currency, the majority of which is in US dollars. US and Canadian dollar insurance liabilities are matched by assets held in the same currencies. The Group monitors exposures arising from retained profits and losses in major foreign currencies quarterly and manages with currency purchases and sales as appropriate.

The Group holds two foreign currency denominated debt instruments. First, a US\$50m subordinated debt issue, which the Group matches with US\$50m deposited as FAL and second, a €12m loan note issue. In addition to Group US dollar funds deposited as FAL, the quota share reinsurance is supported by US dollar deposits. This provides a hedge against FAL requirements changing because of changes in the US dollar exchange rate.

Technical reserves

The Group entered 2010 with net unearned premiums of £315.9m, an increase of £19.6m on the previous year,

the majority of which the Group will earn this year.

Both gross and net loss reserves decreased as a proportion of shareholders' funds in 2009. This was due to reduced loss activity during the year, which resulted in a lower level of unsettled claim amounts at the balance sheet date and increased shareholders' funds.

The share of loss reserves due from reinsurers decreased during 2009 to £292.8m (2008 £299.8m). This amount represents 25.1% of gross loss reserves at 31 December 2009 (2008 25.6%).

	Return £m	Return %	Valuation £m
Table 8 Hedge fund performance			
Fund of funds	5.0	13.9	25.9
Equity long short	1.8	15.8	-
Fixed income	7.9	33.9	11.6
	14.7	20.9	37.5

	AAA ¹ £m	AA £m	A £m	BBB £m	Other £m	Credit rating Total £m
Table 9 Composition of bond holdings						
Governments	86.8	-	-	-	-	86.8
Securitised securities (see following table)	69.2	4.6	0.8	1.7	6.0	82.3
Supranational	10.6	-	-	-	-	10.6
Corporate	248.3	102.3	121.6	63.8	2.3	538.3
Agency	24.0	7.6	-	-	-	31.6
	438.9	114.5	122.4	65.5	8.3	749.6

1 AAA rated corporates include government guaranteed securities

	AAA £m	AA £m	A £m	BBB £m	Other £m	Credit rating Total £m
Table 10 Composition of securitised securities						
Asset backed securities	20.6	2.1	0.8	1.4	0.4	25.3
Commercial mortgage backed securities	23.8	-	-	-	-	23.8
Residential mortgage backed securities	24.8	2.5	-	0.3	5.6	33.2
	69.2	4.6	0.8	1.7	6.0	82.3

Table 11 provides analysis of year-end reinsurance debtor security.

The Group undertakes continual review of its exposure to reinsurance companies, with particular attention given to commutation opportunities in appropriate circumstances. The Group carried provisions for bad and doubtful reinsurance debts totalling 1.9% of the reinsurers' share of technical reserves due at 31 December 2009 (2008 1.9%).

The Group released £31.8m of loss reserves created in 2008 and prior years (2008 £74.1m). **Table 12** provides a breakdown of reserve releases by division.

The Group has strengthened UK motor reserves in response to significantly increased credit hire and multi-claimant costs.

Syndicate 4000 has significant exposure to potential claims arising from the credit crunch and subsequent financial turmoil. While the ultimate loss from these events cannot yet be accurately determined, the Group has strengthened reserves for its run off participations on the Syndicate, in accordance with its conservative approach and based on all available information and extensive third party professional advice.

The 2008 reserve releases reflected a one-off benefit of £11.8m from the removal of loadings that limited the credit taken for better than expected claims development in booked reserves. The Group ceased to apply this loading because, in practice, it was concentrated on short-tail business classes and, thus, represented a poor match to the underlying reserving risk. In addition, the release of Syndicate 4000 reserves in 2008 reflected good run off performance from 2006 and prior years.

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Chief Finance Officer
7 April 2010

	2009 %	2008 %
Table 11 Reinsurance rating bands (Standard & Poor's or equivalent)¹		
Lloyd's Syndicates (A+)	17.1	15.9
AAA	3.5	4.7
AA	26.9	45.8
A	50.8	31.1
BBB	0.3	0.3
Collateralised	0.1	1.6
Other ²	1.3	0.6
	100.0	100.0

1 Ratings as at 31 December 2009 and 2008 respectively

2 Other is net of offset (where appropriate) or post year-end commutations

	2009 £m	2008 £m
Table 12 Reserve releases		
UK	(2.2)	4.8
Marine	6.0	7.7
Energy	7.3	(6.7)
Aviation	4.7	1.7
Property	7.2	15.1
Specialist Lines	7.5	18.3
Nuclear	3.0	3.4
Syndicate 4000	(3.3)	24.5
Syndicate 4242	0.3	-
Run off	3.7	8.6
Quota-share provider's portion	(2.4)	(3.3)
	31.8	74.1