1. ACCOUNTING POLICIES

Basis of accounting

The accounts have been prepared under the historical cost convention, as modified by the revaluation of investments, and in accordance with applicable UK law and accounting standards. The balance sheet has been prepared in accordance with Schedule 1 of The Regulations 2008 (SI2008/410). No profit or loss account is presented for the Company as permitted by Section 408 of the Companies Act 2006. The profit dealt with in the accounts of the parent company was £19.6m (2008 £0.2m). The Company has taken advantage of the exemption available under FRS 1 (revised) and not prepared a cash flow statement. The Company has taken advantage of the exemption available under FRS 29 Financial instruments: Disclosure and Presentation to not disclose certain information on the Company's financial instruments as this information is incorporated within the Group accounts that include the relevant disclosures.

Financial assets

All investments (excluding shares in group undertakings) are classified as fair value through profit and loss and are measured at fair value. The fair value of quoted financial investments is based on current bid prices. Unquoted equity investments are initially carried at cost as the best estimate of fair value and are adjusted thereafter whenever events or changes in circumstances indicate that the carrying amount may not approximate to fair value. The fair value of an unquoted equity security is calculated using the most appropriate valuation technique, such as reference to current fair values of another instrument that is substantially the same, discounted cash flow analysis or option pricing models.

The Directors consider the fair value through profit and loss option to be appropriate as financial assets are managed and their performance evaluated on a fair value basis, in accordance with a documented investment strategy and information is provided internally on that basis to key management personnel. In addition, investment risk is assessed on a total return basis, which is consistent with the adoption of fair value through profit and loss.

All purchases and sales of investments are accounted for at trade date. Investments are initially recognised at fair value and derecognised when sold. Realised and unrealised gains and losses arising from the change in fair value are included in the profit and loss account in the period in which they arise.

Derivative financial instruments

The Company's activities expose it primarily to the financial risks of changes in foreign currency exchange rates. The Company uses foreign exchange forward contracts to hedge these exposures. The Company does not use derivative financial instruments for speculative purposes.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value are recognised immediately in the profit and loss account.

Other income

Other income comprises rental income and management rebate fees receivable from investment managers. Income is booked when the Company's right to receive payment is established.

Investment return

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment management fees. The Company recognises dividend income on establishment of the shareholders' right to receive payment. Interest income is recognised as it accrues and is calculated by using the effective interest rate method.

Expenses

Expenses are accounted for on an accruals basis and charged to the profit and loss account as incurred.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable income for the year. Taxable profit differs from net profit as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates applicable at the balance sheet date.

Deferred tax is generally provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax is not provided on un-remitted earnings of subsidiaries and associates where there is no commitment to remit these earnings. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Dividends

Dividends are recognised as a liability and deducted from equity when they are approved by the Company's shareholders. Interim dividends are deducted from equity when they are paid. Dividends declared after the balance sheet date but before the financial statements are authorised are not recognised but are disclosed in the notes to the financial statements.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation. Depreciation is calculated to write off the cost of tangible fixed assets over the estimated useful lives as follows:

Buildings	25 years	Straight line

Foreign currency translation

The functional currency used in the financial statements is sterling, being the currency of the primary economic environment of the Company. The financial statements are presented in sterling being the presentation currency for the Company.

Monetary items are translated at period end rates, any exchange differences arising from the change in rates of exchange are recognised in the profit and loss account.

Translation differences arising on non-monetary investments held at fair value through profit or loss are reported as part of the fair value gain or loss on those investments.

Transactions and non-monetary assets and liabilities in foreign currencies are recorded in sterling at monthly average rates prevailing at the time of the transaction.

The rates of exchange used to translate monetary balances at the year end in foreign currencies into sterling are as follows:

	2009	2008
US Dollars	1.61	1.44
Canadian Dollars	1.69	1.77
Euros	1.13	1.03

Long-term assets and liabilities

Where assets and liabilities are payable or recoverable in more than one year, they are initially recognised at their fair value, which is the discounted nominal value of the asset or liability. The unwinding of the related discount is subsequently recognised in the profit and loss account.

Shares in group undertakings

Shares in group undertakings are stated at cost less provision for any impairment in value.

Convertible loan stock

The convertible loan is split on initial recognition into financial liability and equity components. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows, discounted at the rate of interest applied at the time by the market to instruments of comparable credit status and providing substantially the same cash flows on the same terms, but without the conversion option. The equity component on initial recognition is the difference between the original proceeds of the convertible loan and the present value of the liability component and is recognised in equity.

Issue costs are apportioned between the liability and equity components of the convertible loan notes based on their relative fair values at the date of issue.

The financial liability component is subsequently recognised at amortised cost over the life of the liability.

The interest expense on the liability component recognised in the income statement is calculated by applying the prevailing market interest rate for similar non-convertible debt at the time the instrument was issued to the liability component of the instrument. The difference between this amount and the interest paid is added to the carrying amount of the convertible loan note.

Provisions and contingencies

The Company recognises provisions when it has a present legal or constructive obligation because of past events and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. Where a reimbursement is expected, this is recognised only when it is virtually certain that the reimbursement will take place and of the amount to be reimbursed.

Contingent liabilities are liabilities that represent a possible obligation arising from a past event whose existence is dependent on one or more uncertain future events not within the control of the Company, or a present obligation where it is not probable that an outflow will be required for settlement of the obligation.

Contingent liabilities are not disclosed where the likelihood of the uncertain future event is remote, unless the disclosure of the contingent liability adds clarity to the financial statements.

Contingent assets, which relate to possible assets and depend on the outcome of uncertain future events, are not recognised. Such an asset is disclosed only where the inflow of economic benefit is probable.

Employee benefits: shares

The Company grants shares to its subsidiaries employees under a number of share schemes. The shares granted are measured at fair value at the date of the grant and are expensed on a straight-line basis over the vesting period, based on the terms of the share schemes. The expense is recorded against a bonus reserve in equity.

When the shares necessary to satisfy the benefit are purchased, they are recorded as own shares within equity, at their acquisition cost. These shares are held in a separately administered trust fund and deducted from equity.

If the vesting options are exercised by the employee and the shares leave the trust, own shares and the bonus reserve are reduced by the number of vesting shares valued at acquisition cost. If there is any difference between the acquisition cost and the fair value used at the date of setting the bonus reserve, it will be adjusted to retained earnings.

In accordance with the rules of the schemes, certain shares attract matching shares, if certain performance conditions are met. The number of matching shares and the fair values are determined through stochastic models that estimate the probabilities of the performance conditions being met. The cost of matching shares is amortised over the same period of time as the original shares. The assumptions behind the determination of matching shares and their fair values are reassessed, when applicable, at the end of each accounting period and the impact of any change is recorded in the profit and loss account.

Employee benefits: share options

The Company grants share options to its subsidiaries' employees under a number of option schemes. The share options granted are measured at fair value at the date of the grant and are expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares that will eventually vest.

FRS 20 Share-based Payment does not require share options granted before 7 November 2002 to be fair-valued, or those granted after 7 November 2002 that had vested as at 1 January 2005 to be expensed. Therefore, the costs recognised in the profit and loss account reflect only the share grants made after 7 November 2002 that had not vested before 1 January 2005.

At each balance sheet date, the Company revises its estimate of the number of share options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the profit and loss account and a corresponding adjustment to equity over the remaining vesting period. The proceeds received, net of any directly attributable transaction costs, are credited either to share capital (nominal value) and share premium, if shares are issued, or to investments in own shares, if shares are purchased, when the share options are exercised. If shares are purchased in the market to settle the share options then any difference between the exercise price, the fair value of the share options and the cost of the shares issued, is taken to retained earnings.

No expense is recognised for share options that do not ultimately vest, except for share options where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance and/or service conditions are satisfied.

Where the terms of a share option are modified, the minimum expense recognised is the expense as if the terms had not been modified. An additional expense is recognised for any modification which increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee, as measured at the date of modification.

Where a share option is cancelled, it is treated as if it had vested on the date of cancellation and any expense not yet recognised for the award is recognised immediately. However, if a new share option is substituted for the cancelled share option, and designated as a replacement share option on the date that it is granted, the cancelled and new share options are treated as if they were a modification of the original share option, as described in the previous paragraph.

Subordinated debt

The long-term loan is recognised initially at fair value, net of transaction costs incurred. The loan is subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest rate method.

2. DIVIDENDS

	2009 £m	2008 £m
Final dividend for the year ended		
31 December 2007: 3.5p per ordinary share, paid on 27 June 2008	-	11.6
Interim dividends for the year ended		
31 December 2009: 1.3p per ordinary share, paid on 1 October 2009	6.8	-
31 December 2008: 3.7p per ordinary share, paid on 13 March 2009	11.8	-
31 December 2008: 1.8p per ordinary share, paid on 1 October 2008	-	5.7
	18.6	17.3

A final dividend in respect of the 2009 financial year of 2.7p per share, amounting to a total of £14.6m is to be proposed at the Annual General Meeting on 19 May 2010. These financial statements do not recognise the 2009 final dividend.

The total dividend in respect of the 2009 financial year, including the interim paid and the final dividend recommended, is 4.0p per share (2008 5.5p).

3. TANGIBLE ASSETS

	Land and buildings £m
Cost	
At 1 January and 31 December 2009	5.9
Accumulated depreciation	
At 1 January 2009	(1.8)
Charge	(0.3)
At 31 December 2009	(2.1)
Net book amount at 31 December 2009	3.8
Net book amount at 31 December 2008	4.1

The property included under land and buildings is subject to a first and only legal charge to Lloyds TSB Bank plc (the Bank) in respect of a £51.0m letter of credit (2008 £56.0m) provided by the Bank as part of the Company's Funds at Lloyd's.

4. SHARES IN GROUP UNDERTAKINGS

	2009 £m	2008 £m
At 1 January	39.4	39.7
Disposals	-	(0.3)
At 31 December	39.4	39.4

The following were the main subsidiary undertakings at 31 December 2009 (unless otherwise stated):

Company	Activity	Class of share held	Proportion of shares and voting rights held (%)
Aberdeen Underwriting Advisers Limited	Dormant subsidiary	Ordinary	100
ALIT Insurance Holdings Limited	Holding company[1]	Ordinary	100
ALIT Underwriting Limited	Holding company	Ordinary	100
ALIT (No. 1) Limited	Corporate member of Lloyd's	Ordinary	100
ALIT (No. 2) Limited	Corporate member of Lloyd's	Ordinary	100
ALIT (No. 3) Limited	Corporate member of Lloyd's	Ordinary	100
ALIT (No. 4) Limited	Corporate member of Lloyd's	Ordinary	100
ALIT (No. 5) Limited	Corporate member of Lloyd's	Ordinary	100
CH 1997 Limited	Holding company	Ordinary	100
Chaucer Consortium Underwriting Limited	Insurance intermediary	Ordinary	100
Chaucer Corporate Capital Limited	Corporate member of Lloyd's[1]	Ordinary	100
Chaucer Dedicated Limited	Corporate member of Lloyd's	Ordinary	100
Chaucer Freeholds Limited	Property company[1]	Ordinary	100
Chaucer GmbH	Service company	Ordinary	90
Chaucer Insurance Services Limited	Insurance intermediary	Ordinary	100
Chaucer Singapore PTE Limited	Service company	Ordinary	100
Chaucer Syndicates Limited	Lloyd's managing agent	Ordinary	100
Chaucer Syndicate Services Limited	Dormant subsidiary	Ordinary	100
Chaucer Underwriting A/S	Service company	Ordinary	100
Hayward Brick Stuchbery Holdings Limited	Holding company[1]	Ordinary	100
Insurance4Cargo Services Limited	Service company	Ordinary	100
Chaucer Corporate Capital (No.2) Limited	Corporate member of Lloyd's[1]	Ordinary	100
Chaucer Corporate Capital (No.3) Limited	Corporate member of Lloyd's[1,2]	Ordinary	100

All subsidiary companies are registered in England and Wales except for Chaucer GmbH, Chaucer Underwriting A/S and Chaucer Singapore PTE Limited, which are registered in Germany, Denmark and Singapore respectively.

[1] These companies are direct holdings of the main parent company. All the other entities are indirect subsidiaries.

[2] Certain transactions took place in 2008 relating to the Group's purchase and subsequent sale of Pembroke JV Limited. Full details of these transactions were disclosed in the 2008 Annual Report.

5. FINANCIAL ASSETS

	Cost	2009 Fair value	Cost	2008 Fair value
	£m	£m	£m	£m
Funds at Lloyd's and other corporate funds				
Equities	3.2	2.1	3.2	2.5
Absolute return bond funds	-	-	172.3	168.7
Bonds	225.5	216.7	1.6	1.6
Other[1]	17.0	17.0	17.0	17.0
	238.1	235.8	194.1	189.8

1 In 2007, the Company invested £15m for a 13.7% shareholding of Antares Holdings Limited (Antares), a Bermudian based holding company established by Lightyear Capital LLC), a private equity firm focused on financial services investments. In November 2007, Antares issued the Company with an additional £2m shares in exchange for Managing Agent services to be provided in 2008 and 2009

Antares sponsors Antares Syndicate 1274, which begun underwriting for the 2008 year of account with an underwriting capacity of £135m. Chaucer Syndicates Limited, a subsidiary undertaking, managed the Syndicate until 31 December 2009

At the end of 2009, the investment in Antares remained unlisted on an active market. Accordingly, the Company has valued it by reference to the Company's share of net assets and future income discounted at an appropriate rate of return

The Company deposits Funds at Lloyd's (FAL) to support the Group's underwriting operations, based on the assessment of risk associated with those operations. The access to those funds is restricted and they are not available for any other purpose.

The movements in FAL held as fixed assets were as follows:

	2009 £m	2008 £m
At 1 January	172.8	118.8
Additional funds	44.1	59.6
Realised losses	(0.6)	-
Unrealised gains/(losses)	2.5	(5.6)
At 31 December	218.8	172.8

6. DEBTORS

	2009 £m	2008 £m
Amounts falling due within one year		
Amounts owed by group undertakings	82.3	47.7
Prepayments and accrued income	4.4	1.0
	86.7	48.7
Amounts falling due after one year		
Amounts owed by group undertakings	1.5	2.3

During 2004, Chaucer Holdings PLC granted a £1.5m subordinated loan to Chaucer Syndicates Limited, a subsidiary undertaking. Under the terms of the agreement, the loan generates interest at a rate of 1.0% above the Three Month Interbank Sterling rate and a one-year notice period is required before any repayment is made. The repayment is subject to Lloyd's approval.

During 2008, Chaucer Holdings PLC granted an additional subordinated loan of £0.2m to Chaucer Insurance Services Limited, a subsidiary undertaking, following the initial grant of a subordinated loan of £0.6m in 2007. In 2009, the subordinated loan was repaid as agreed by both parties.

7. CASH AT BANK AND IN HAND

	2009 £m	2008 £m
Funds at Lloyd's	87.9	90.9
Other funds	8.5	12.3
	96.4	103.2

The Company deposits Funds at Lloyd's to support the Group's underwriting operations, based on the assessment of risk associated with those operations. Lloyd's restricts access to those funds, preventing their use for any other purpose.

8. CREDITORS

	2009 £m	2008 £m
Amounts falling due within one year		
Amounts due to group undertakings	154.2	158.9
Amount due to PXRE Holdings Limited	-	0.5
Accruals and deferred income	0.1	0.1
Other creditors	0.8	1.0
	155.1	160.5
Amounts falling due after one year		
Amount due to PXRE Holdings Limited	2.9	2.9

The amounts payable to PXRE Holdings Limited are in relation to the expected utilisation of tax losses purchased as part of the acquisition of Chaucer Corporate Capital (No.2) Limited (formally PXRE Limited) in 2005. The liability with PXRE Holdings Limited is expected to be settled in 2011 (£0.6m) and 2012 (£2.3m).

9. SUBORDINATED DEBT

	2009 £m	2008 £m
Debt in Euros	10.2	11.3
Debt in US Dollars	30.1	33.8
	40.3	45.1

On 16 November 2004, the Company issued a €12m floating rate subordinated 30-year note. The Company, subject to meeting certain conditions, has the option to full or partial redemption of the note on any future interest payment date at its principal amount plus any accrued interest.

Interest is paid semi-annually each year up to the date of redemption and the cost of borrowing is tied to the European Inter bank offer rate (Euribor) plus an agreed margin of 3.75%.

The Company reports the financial liability of this note at amortised cost using an effective interest rate of 4.9% (2008 6.8%) as follows:

	2009 £m
Balance at 1 January 2009	11.3
Interest charges in the year	0.6
Interest paid during the year	(0.7)
Foreign exchange adjustments	(1.0)
Balance at 31 December 2009	**10.2**

On 21 September 2006, the Company issued a US$50m floating rate unsecured subordinated 30-year note, which pays interest quarterly in arrears up to the date of redemption and the cost of borrowing is tied to the US Dollar 3-month LIBOR plus an agreed margin of 3.1%. There is the option for full or partial redemption of the note on any interest payment date on or after the relevant date falling in December 2011.

The Company reports the financial liability of this note at amortised cost using an effective interest rate of 3.5% (2008 4.7%), as follows:

	2009 £m
Balance at 1 January 2009	33.8
Interest charges in the year	1.3
Interest paid during the year	(1.4)
Foreign exchange adjustments	(3.6)
Balance at 31 December 2009	**30.1**

10. CONTINGENT LIABILITIES AND CONTINGENT ASSETS

The Company has entered into a deed of covenant in respect of certain of the corporate member subsidiaries to meet each subsidiary's obligations to Lloyd's. These refer to the obligation to deposit Funds at Lloyds (FAL) to support the Group's underwriting activities.

The Group currently underwrites at Lloyd's for the 2010 year of account at an average economic capital assessment of 47.7% (2009 year of account 48.1%) whereby FAL must be deposited to this proportion of the Group's overall premium limit (OPL) for that year. A fixed and floating charge over the investments and other assets of the Company in favour of Lloyd's secures the total guarantee given by the Company under the deeds of covenant (subject to limited exceptions).

Lloyd's has the right to retain income on charged investments, although it is not expected that Lloyd's would exercise the right unless it considers there to be a risk that one or more of the covenants might need to be called and, if called, might not be honoured in full.

Liability under each deed of covenant is limited to a fixed monetary amount. However, in the event of default by a corporate member, caused by the total value of investments falling below the total of all amounts covenanted, then Lloyd's may enforce the charge provisions within the deed of covenant and appropriate a share of the Company's Funds at Lloyd's. This share may be greater than the corporate member's proportion of FAL to support the total OPL of the Group.

There is no mechanism for the Company to quantify its exposure in this regard and the Directors consider that the possibility of having this appropriation is remote

Where the Group reduces its participation on a syndicate, it pays a reinsurance to close premium to other Lloyd's Members to assume its ongoing liabilities. The nature of this arrangement is that of reinsurance such that the Group retains liability in the event of failure of these Lloyd's Members and the Lloyd's chain of security. There is no mechanism for the Group to quantify its exposure in this regard and the Directors consider that the possibility of having to assume these liabilities is remote.

11. SHARE OPTIONS

The Company grants share options to Directors and employees in accordance with the terms of the various share option schemes, as described in the Directors' Remuneration Report. The share options are exercisable three, five, seven or ten years from grant date or on satisfaction of the conditions of the option grant. The movements in the number of shares outstanding and the weighted average exercise price are as follows:

	2009 Weighted average exercise price per share Pence	2009 Share options Thousands	2008 Weighted average exercise price per share Pence	2008 Share options Thousands
Outstanding at 1 January	47.2	8,531	49.3	7,567
Share options granted	39.1	4,671	49.0	3,163
Share options exercised	32.5	(813)	42.4	(874)
Forfeited	46.8	(2,538)	70.7	(1,079)
Expired	46.2	(182)	51.0	(246)
Outstanding at 31 December	**42.5**	**9,669**	47.2	8,531
Exercisable at 31 December	45.1	4,234	45.7	4,455

The share options outstanding at 31 December 2009 had a weighted average remaining contractual life of 3.4 years (2008 3.7 years).

The Company estimates the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. The inputs into the Black-Scholes model for valuing the share options granted in the year are as follows:

	2009 £m	2008 £m
Weighted average share price	50.0p	58.0p
Weighted average exercise price	39.0p	49.0p
Volatility	46.38%	42.96%
Weighted average expected life	4.0 years	4.0 years
Risk-free rate	3.90%	4.68%
Dividend yield	9.95%	9.14%

Expected volatility was determined by calculating the historical volatility of the Company's share price over the previous three years on a weighted average basis. The expected life used in the model is the Company's current best estimate for the effects of non-transferability, exercise restrictions, future market conditions and behavioural considerations.

During the year the Company recognised total expenses of £0.7m (2008 £0.1m) relating to share options granted.

All existing share options, issued after 7 November 2002 and not vested at 1 January 2005, have been valued as required by FRS 20 Share-based Payment.

Share options outstanding at 31 December 2009 have the following expiry dates and exercise prices:

	Date of grant	Exercise price Pence[1]	Exercise period	2009	2008
Chaucer Holdings PLC Approved Savings Related Share Options Scheme	10-02	25.8	11/09-05/10	16,507	88,748
	10-03	31.3	11/08-05/09	-	93,178
	10-03	31.3	11/10-05/11	26,789	25,416
	10-04	34.7	11/09-05/10	47,590	218,526
	10-05	41.6	11/08-05/09	-	198,261
	10-05	41.6	11/10-05/11	146,441	181,576
	10-06	54.7	11/09-05/10	204,363	231,560
	10-06	54.7	11/11-05-12	69,389	145,293
	10-07	74.9	11/10-05/11	27,400	43,254
	10-07	74.9	11/12-05/13	12,998	21,688
	10-08	46.5	11/11-05/12	510,573	1,582,699
	10-08	46.5	11/13-05/14	439,553	1,536,855
	10-09	38.5	11/12-05/13	2,460,684	-
	10-09	38.5	11/14-05/15	1,741,556	-
				5,703,843	4,367,054
Chaucer Holdings PLC Share Option Scheme (Performance related)	07-00	55.0	07/03-07/10	110,674	105,000
	09-00	61.2	09/03-09/10	84,321	120,000
	05-01	61.2	05/04-05/11	564,967	512,500
	10-02	32.3	10/05-10/12	1,106,922	1,221,467
	10-03	42.4	10/06-10/13	148,895	170,294
	10-04	39.6	10/07-10/14	782,002	923,299
				2,797,781	3,052,560
Chaucer Holdings PLC Approved Share Option Scheme (Performance related)	05-01	61.2	05/04-05/11	547,049	472,500
	10-01	49.8	10/04-10/11	68,513	65,000
	10-02	32.3	10/05-10/12	91,702	87,000
	05-03	32.0	05/06-05/13	-	50,000
	10-03	42.4	10/06-10/13	205,219	194,697
	10-04	39.6	10/07-10/14	254,776	241,713
				1,167,259	1,110,910
				9,668,883	8,530,524

1 As a result of the firm placing and placing and open offer in February 2009, the Company increased the number of existing share options by 5.4% and decreased the exercise price of all outstanding share options by 5.1%. The incremental fair value granted has no material impact on the results of the Company

The number of share options that were exercisable at the end of the year was 4,233,500 (2008 4,454,909).

12. SHARE-BASED PAYMENT

The Directors' Remuneration Report describes the features of the new long-term incentive scheme implemented by the Company in 2006. The scheme includes an element payable in shares, which has resulted in expenses during the year of £8.7m (2008 £4.6m). In accordance with the requirements of FRS 20 Share-based Payment, the recognition of those share related expenses resulted in the creation of a bonus reserve within equity.

The scheme will result in the grant of shares, some of which will attract matching shares if the Company's performance meets certain conditions in the future. For each share that attracts matching shares, the scheme allows the Company to grant:

- Up to one matching share on satisfaction of a market condition test, which compares the Company's growth in TSR to the growth in an index of comparator companies; and
- Up to one matching share on satisfaction of non-market condition tests, which compare the growth of net asset value per share with that of the UK retail price index.

The Company may grant proportional numbers of shares on partial satisfaction of the performance conditions.

The Company uses an actuarial model to estimate the number of shares required to match the market condition related shares. The model looked at the historic out-performance of the group of comparator companies to determine the distribution of probabilities of out-performance and applied a stochastic analysis to determine the expected number of matching shares.

The Company estimated the number of non-market condition related matching shares by comparing the internal and market growth forecasts for net assets per share and the UK retail price index at relevant future balance sheet dates. The Company bases the fair value of all the matching shares on estimated market values at the date of grant.

The Company grants shares issued under the scheme four months after the end of the year and the shares then vest three years after the grant date. Accordingly, the total cost of the shares will be amortised over a period of 52 months, which is the period from the beginning of the service period until the end of the vesting period. The Company has recognised twelve months' worth of costs in 2009. Costs associated with matching shares have also been amortised over the same period. Each individual Group company that contributes to the consolidated profit for the year recognises its share of the cost of the shares awarded.

The estimated value of shares due for grant and the associated costs (excluding national insurance costs) are as follows:

	Total cost £m	Cost recognised in 2009 £m	Cost recognised in 2008 £m
Shares granted in 2009			
Attracting matching shares	1.2	0.5	-
Not attracting matching shares	0.7	0.2	-
Matching shares: market condition	0.3	0.1	-
Matching shares: non-market condition	1.0	0.2	-
	3.2	1.0	-
Shares granted in 2008			
Adjustment to 2008 declared bonus[1]	0.6	0.3	-
Shares granted in 2007			
Attracting matching shares	3.1	0.5	0.5
Not attracting matching shares	7.1	1.6	1.6
Matching shares: market condition	0.8	0.2	0.2
Matching shares: non-market condition	2.1	0.5	0.5
Adjustment to 2007 declared bonus[1]	(2.2)	(0.1)	(0.7)
	10.9	2.7	2.1
Shares granted in 2006			
Attracting matching shares	1.9	0.4	0.4
Not attracting matching shares	11.2	2.5	2.7
Matching shares: market condition	0.6	0.2	0.1
Matching shares: non-market condition	2.6	0.6	0.6
2005 matching shares: market condition	0.4	-	0.1
2005 matching shares: non-market condition	0.5	-	0.1
Adjustment to 2005/06 declared bonus[1]	(0.1)	1.0	(1.5)
	17.1	4.7	2.5
	31.8	8.7	4.6

1 The adjustments to previous year's bonuses refer to adjustments to the cost of matching shares previously calculated, due to the yearly update of the assumptions behind the calculations, such as number of shares in circulation and profit forecasts

13. SHARE CAPITAL

	2009 Shares Million	2009 Value £m	2008 Shares Million	2008 Value £m
Authorised				
Ordinary shares of 25p each	700.0	175.0	456.0	114.0
Called up, allotted and fully paid				
Ordinary shares of 25p each	548.1	137.0	348.1	87.0

The number of 25p ordinary shares called up, allotted and fully paid:

	Date	Share price Pence	Number	Ordinary share capital £m	Share premium £m
At 1 January 2009			348,092,039	87.0	66.0
Shares issued in respect of:					
Firm Placing and Placing and Open offer	25/02/09	40.0	199,999,606	50.0	24.9
At 31 December 2009			**548,091,645**	**137.0**	**90.9**

On 28 January 2009, the Group announced a firm placing and placing and open offer to raise £74.9m (net of £5.1m expenses), subject to approval at a General Meeting to be held on 13 February 2009. The General Meeting approved the increase in the authorised share capital to £175.0m from £114.0m and the planned share issue. The firm placing of 17,251,680 new ordinary shares and the open offer of up to 182,748,320 new ordinary shares was completed and the Group issued 199,999,606 new ordinary shares at 40 pence each. The total issued share capital of the Group is now 548,091,645 ordinary shares.

14. MOVEMENT IN EQUITY SHAREHOLDERS' FUNDS

	Called up share capital £m	Own shares £m	Share premium account £m	Bonus reserve £m	Retained earnings £m	Total equity £m
At 1 January 2009	87.0	(31.5)	66.0	20.8	36.7	179.0
Profit for the year	-	-	-	-	19.6	19.6
Shares issued	50.0	-	24.9	-	-	74.9
Dividends paid or declared	-	-	-	-	(18.6)	(18.6)
Investments in own shares	-	(0.3)	-	0.3	-	-
Share option costs	-	-	-	-	0.6	0.6
Vested shares		2.5	-	(2.9)	0.4	-
Cost of shares and share options exercise	-	1.0	-	(0.3)	(0.3)	0.4
Bonus costs deferred share bonus plan	-	-	-	9.4	-	9.4
At 31 December 2009	137.0	(28.3)	90.9	27.3	38.4	265.3

Share capital and share premium reflect the nominal value and premium elements of any issue of equity shares.

The own shares represent the shares held by employee trust schemes, of which the sole purpose is to hold shares of the Company for settlement of share awards. The number of shares held by the trust schemes at the end of 2009 was 35,133,044 (2008 38,913,554).

The bonus reserve contains the element of the bonus that is payable in shares or share options to senior members of staff in accordance with the terms of the deferred share benefit plan. The reserve mainly increases with the charge for the year for those elements and decreases when the shares or share options vest.

The reserve also contains an element of shares granted to employees in accordance with the terms of the Share Incentive Plan (SIP). The SIP represents an incentive of two free shares granted to employees who decided to buy one share. The movement in the year for SIP costs represents the cost of granting free shares to employees that purchase shares.

The cost of shares and share options exercise represents the sum of the market value of the granted shares when employees exercise share options, less both the exercise price and the fair value of the option previously expensed in accordance with FRS 20 Share-based Payment.

Retained earnings represent the accumulation of profits and losses up to the balance sheet date, after the distribution of dividends and other adjustments. The Company can distribute retained earnings of up to £38.7m (2008 £36.7m).

15. RELATED PARTY TRANSACTIONS

The Company has taken advantage of the exemption allowed by FRS 8 Related Party Disclosures not to disclose related party transactions with its subsidiaries.