

CHAUCER HOLDINGS PLC (“Chaucer”)

Preliminary results for the year ended 31 December 2009 (unaudited)

**Financial highlights**

- Profit before tax and foreign exchange on non-monetary items<sup>1</sup> of £75.3m (2008 loss £59.5m)
- Profit before tax of £42.0m (2008 loss £26.2m)
- Gross written premiums up 15.3% to £795.6m<sup>2</sup> (2008 £689.9m); up 5.4% on a constant currency basis
- Investment return of £53.3m (2008 loss £71.0m); a return on average funds of 4.3% (2008 negative 6.8%)
- Post-tax return on equity of 9.7% (2008 loss 7.0%)
- Final dividend of 2.7p recommended, making a total dividend of 4.0p (2008 5.5p)
- Undiluted earnings per share of 5.8p (2008 loss per share 6.0p)

**Underwriting performance**

- Underwriting profit of £45.8m before the impact of foreign exchange on non-monetary items<sup>1</sup> (2008 £33.0m)
- An average premium rate increase of 5.7% achieved across underwriting portfolio (2008 decrease 3.6%)
- Combined ratio of 93%<sup>2</sup> (2008 94%)
- Contribution of £5.9m from syndicate participation and management activities (2008 £4.4m)

**Business outlook**

- Underwriting will benefit from active management of diversified portfolio in 2010
- Forecast rate increases across our underwriting portfolio for 2010
- Targeting UK motor, aviation and selected specialist lines classes
- Syndicate 1084 capacity increased to £707m (2009 £634m) to take advantage of opportunities
- Group underwriting interests increased 7.5% to £623.3m in 2010 (2009 £580.0m)

Commenting on the results, Bob Stuchbery, Chief Executive Officer, said:

*“Our underwriting performed positively in 2009, with good results from our Property, Aviation, Energy and Specialist Lines Divisions. Our investment return was also particularly good following the dramatic change in the portfolio from 2008.*

*The outlook for the business remains encouraging despite the softening of rates across some classes of business. Our broad-based underwriting portfolio will enable us to take full advantage, especially with good opportunities for UK Motor and Aviation.*

*With a new management team and business strategy in place, I am confident of our ability to lead Chaucer to further success in 2010.”*

	2009	2008
	£m	£m
<b>Key financial information</b>		
Gross written premiums <sup>2</sup>	795.6	689.9
Net earned premiums <sup>2</sup>	672.6	538.4
Profit/(loss) before tax and foreign exchange on non-monetary items <sup>1</sup>	75.3	(59.5)
Foreign exchange on non-monetary items	(33.3)	33.3
Profit/(loss) before tax	42.0	(26.2)
Profit/(loss) attributable to equity holders	28.1	(19.0)
<b>Per share amounts</b>	<b>p</b>	<b>p</b>
Undiluted earnings/(loss) per share	5.8	(6.0)
Net tangible assets per ordinary share	55.5	62.5
Dividend	1.3	1.8
Interim	1.3	1.8
Final/Second interim	2.7	3.7
<b>Key business ratios</b>	<b>%</b>	<b>%</b>
Return on equity	9.7	(7.0)
Combined ratio <sup>2</sup>	93	94

<sup>1</sup> Under International Financial Reporting Standards, unearned premiums and deferred acquisition costs are carried at historic exchange rates, while the corresponding monetary items are translated at closing exchange rates

<sup>2</sup> Excluding consolidation adjustments, premiums written to reinsure to close non-Chaucer syndicates into Syndicate 1084, the impact of the increased ownership of in-house syndicates, following the reinsurance to close of third-party participations in the year in which the closure occurred and the impact of foreign exchange on non-monetary items on net earned premiums

Chaucer will hold an analysts' meeting at 9.30 a.m. today at Plantation Place, 30 Fenchurch Street, London, EC3M 3AD.

An audio webcast of the presentation to analysts will be available at [www.chaucerplc.com](http://www.chaucerplc.com) on Tuesday 9 March 2009.

#### Enquiries

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#### Notes to editors

Chaucer Holdings PLC is a diversified insurance group listed on the London Stock Exchange. Chaucer underwrites business at Lloyd's, the world's leading insurance and reinsurance market.

Chaucer deploys specialist underwriters in over 28 major insurance and reinsurance classes, balancing global marine, energy, non-marine and aviation with UK motor and nuclear.

Headquartered in London, Chaucer has international operations in Copenhagen, Houston and Singapore.

For more information on Chaucer, please visit [www.chaucerplc.com](http://www.chaucerplc.com)

## CHAIRMAN'S STATEMENT

Chaucer has confronted a set of extraordinary circumstances over the past 16 months. Despite this, I am pleased to report that stability has returned to Chaucer, with an encouraging financial performance and the establishment of a new Executive Management Team to lead the development of the business.

### Business results

Our pre-tax profit before the impact of foreign exchange on non-monetary items was £75.3m (2008 loss £59.5m). The reported profit before tax was £42.0m (2008 loss £26.2m). The return on post-tax equity was 9.7% (2008 loss 7.0%). Both underwriting and investments made positive contributions to profits.

In February 2009, the Group raised funds of £74.9m, net of expenses, to enable it to take advantage of good rating conditions in 2009, following the financial and insurance losses of 2008.

### Dividends

As previously announced, we intend to pay a total dividend of 4.0p per share for 2009, with the final dividend of 2.7p being payable on 28 May 2010 to shareholders on the register on 7 May 2010. In the absence of unforeseen circumstances, we also intend to pay a minimum total dividend of 4.0p per share for 2010.

### Board changes

On 16 December 2009, we announced a new Executive Management Team that saw Robert Stuchbery assume the role of Chief Executive Officer, Bruce Bartell the role of Chief Underwriting Officer and confirmed the appointment of Ken Curtis as Chief Finance Officer. I am convinced that Bob is the right person to lead the business, having been responsible for much of Chaucer's success over the past 20 years. In appointing these roles, the search considered both external and internal candidates, to ensure that we found the best individuals.

We have appointed John Fowle as Active Underwriter for Syndicate 1084 and, with effect from 1 April 2010, we have appointed Mauricio Carrillo as Finance Director of Chaucer Syndicates Limited, our Lloyd's managing agent.

All of these appointments reflect the strength of Chaucer's executive team and of its succession planning. This is a hugely experienced and proven leadership team that I believe has the capabilities required to continue Chaucer's development as a diversified Lloyd's insurance group.

We are seeking two additional non-executive directors for Chaucer Holdings PLC and three additional non-executive directors for Chaucer Syndicates Limited.

### Domicile

The Board will review a strategic options paper in the third quarter of 2010 before announcing any further actions. Amongst other matters, the paper will consider the future impact of the recently introduced claims equalisation reserves in the UK, other actions that our government proposes to reduce the effective tax rate for insurance activities and changes to Controlled Foreign Company rules worldwide. At present, the Group has significant unutilised tax losses, which means that re-domicile of the Group is primarily a strategic consideration from 2011 onwards.

### Business outlook

We are optimistic for 2010, believing that the strength in depth of our underwriting team and the broad diversity of our portfolio will enable us to take advantage of the current market conditions.

Martin Gilbert  
Chairman  
8 March 2010

## CHIEF EXECUTIVE OFFICER'S STATEMENT

In my first statement as Chief Executive Officer of Chaucer Holdings PLC, I wish to thank shareholders for their support during the past 16 months and for their ultimate vote of confidence in this business. It was a testing time but, as I have always believed and advocated, it has concluded with the right result, continued independence for this business. The challenge now is to restore our position as a leading Lloyd's organisation through hard work, diligence and commitment and to return the confidence shown by our shareholders. In my new role as CEO, I will provide the focus, direction and leadership that the business needs to achieve this.

I believe that, together with Bruce Bartell, Chief Underwriting Officer and Ken Curtis, Chief Finance Officer, we have the senior management team in place to respond to this challenge. With over 75 years of Lloyd's market experience as a team, we have expertise, management skills and the dedication required to secure the success of this business.

### **Financial results**

We are extremely pleased to be able to report a significantly improved business performance in 2009, against a challenging economic backdrop, with a pre-tax profit before the impact of foreign exchange on non-monetary items of £75.3m (2008 loss £59.5m). The reported profit before tax was £42.0m (2008 loss £26.2m).

Underwriting contributed a profit before investment income of £45.8m (2008 £33.0m), excluding the impact of foreign exchange on non-monetary items. It benefited from a quiet hurricane season, although aftershocks from the credit crunch and global recession understandably held back the headline result. Difficulties remain within the financial and professional liability markets and it was a challenging year for political risk and trade credit underwriting. The Group's combined ratio improved to 93% (2008 94%).

The Group's investment portfolio performed strongly, recording a return of £53.3m or 4.3% on average funds of £1.3bn (2008 loss £71.0m or loss of 6.8% on average funds of £1.0bn), with the value of equity and hedge fund holdings recovering as liquidity and confidence returned to the market.

### **Our strategy**

We are an independent business built on underwriting expertise, with an established, diversified and balanced portfolio.

We are committed to underwriting excellence and profitable cross-cycle growth. Over the last seven years, we have achieved an average annual return on equity of 19.0%, which includes the impact of the 2008 loss of £19.0m. We also have a strong track record of successful underwriting growth. Since our creation in 1998, we have increased our underwriting interests by over £500m to £623.3m in 2010. Having worked hard to build a strong Lloyd's underwriting franchise, we are committed to the Lloyd's platform. We currently manage four Lloyd's syndicates.

Our strategy is to build a leading diversified Lloyd's insurance group, one that delivers a market-leading return on capital to shareholders across the insurance cycle. We currently deploy specialist underwriters in over 28 major insurance and reinsurance classes, balancing global marine, energy, non-marine and aviation with UK motor and nuclear.

Underpinning our strategy is a focus on underwriting returns and strong capital management. We believe that this approach is the best way to deliver long-term stability and growth for the business and enduring value for shareholders.

#### *Achieving underwriting excellence*

To achieve our strategy, we aim to be a leading underwriter within each major class of business that we write.

At the forefront of the core skills required to achieve underwriting excellence, is the ability to select, motivate, manage and reward our underwriting teams. Our underwriting teams must also have the proven ability to outperform the insurance cycle. This requires both the maintenance of underwriting discipline throughout the cycle as well as the ability to respond rapidly to opportunities arising from major market events or individual accounts.

We measure the success of our underwriting teams through both quantitative and qualitative measures (including ultimate loss ratios, return on capital across the cycle, levels of client service provided and market knowledge and reputation).

Since 2006, we have significantly increased our underwriting capabilities, strengthening current teams and adding new teams in complementary underwriting areas. The total number of underwriters we employ has increased by over a third to 65. Throughout this process, we have sought to ensure that each new appointment supports our strategy of underwriting excellence and the target of being a leading underwriter within each chosen major class of business.

In line with our strategy, we recently announced the establishment of a new International Liability Division within Chaucer Syndicate 1084 and we are delighted with the appointment of Mark Lawrence as Head of International Liability to lead the new division. Mark is an acknowledged market leader for international liability business, with over 30 years of underwriting experience, and will join Chaucer ahead of the Division's formal launch in the final quarter of 2010.

#### *Building an international network*

Recognising that we need a stronger presence overseas, we are building an international network using our established presences in Denmark, Singapore and Houston. This will enable us to improve access to the highest quality business worldwide, diversifying our underwriting and improving portfolio management.

We are developing two models: underwriter-focused offices as in Denmark and Singapore, where our products and services are available through regional underwriting teams, and producer-focused offices, which will provide our underwriting teams in London with regional market knowledge, insight and assistance.

#### *Strengthening capital management*

Underpinning a focus on underwriting excellence, we require long-term capital security to protect the business against the impact of severe losses, such as the combination of hurricane Ike, financial market turbulence and the depreciation of sterling against the US dollar in 2008. This in turn reduces the requirement to seek additional capital funds after such events and enables us to plan the long-term development and to maintain the long-term value of the business with confidence.

In addition to cutting back marine and energy Gulf of Mexico exposures in advance of the 2009 hurricane season, which reduced our regulatory capital requirements, we injected new capital and entered into a capital backed quota share agreement in 2009 to strengthen our capital position.

In line with these steps, we intend to maintain a conservative investment strategy, with a focus on capital maintenance.

#### **Solvency Smart - building a better business**

Underpinning our strategy, the underwriting teams must have an efficient operational platform on which to excel. Our Solvency Smart Programme will help us to improve this.

We believe that Solvency II provides us with the opportunity to build a better business through improved strategic decision-making and operational and risk management, in addition to a business that complies with the EU directive.

Central to achieving this are the development of a business-wide internal model to lead and challenge strategic decision-making, notably for capital planning and allocation, and the strengthening of risk management. Taken together with the other changes that Solvency II will introduce, these transformations will significantly improve our business understanding and ability to manage it successfully.

The Solvency Smart Programme is demanding but critical to our building of a better business for the future. There are still two years of hard work ahead but, having observed the dedication with which the business has tackled the work to date to put the foundations in place, we are confident of overall programme success.

## **Business outlook for 2010**

The outlook for the business in 2010 remains encouraging despite the softening of rates across some classes of business. The business is well placed to benefit from the continued active management of our diversified underwriting portfolio.

After a quieter period for catastrophe losses, there will inevitably be some softening of rates, especially for North American property and catastrophe-exposed marine classes, although generally rates remain favourable.

The powerful Chilean earthquake of 27 February 2010 will cause significant international insurance and reinsurance losses. Our Property Division has sought to avoid Chilean treaty reinsurance programmes because of dissatisfaction over terms and conditions but will incur losses from other classes. The net effect of these losses will be contained within our annual catastrophe loss budget.

Energy premiums have responded to high offshore losses away from the Gulf of Mexico and a reinvigorated oil price, while aviation rates should also strengthen in 2010 following a year of heavy losses. Away from financial institutions, over-competitive pricing and a continued flow of new entrants continue to hinder the re-rating of the specialist lines market.

In UK motor, we forecast private car rate increases of approximately 14%, in response to unacceptable returns in 2009, and improvements in the fleet market following several years of fierce competition.

Our broad-based underwriting portfolio will enable us to take full advantage of these market conditions. Overall, we forecast a marginal increase in premium rates for our portfolio in 2010 and we are targeting those classes, including UK motor and aviation, which offer the best opportunities within this.

Our total underwriting interests for 2010 are £623.3m, an increase of £43.3m or 7.5% on the 2009 total of £580.0m.

The current underwriting year has started positively with premium income in line with budget.

It is worth noting that we also entered 2010 with net unearned premiums of £315.9m, an increase of £19.6m on the previous year, the majority of which we will earn this year. We wrote this business at healthy rates and, while we do not anticipate a further year of below average catastrophe losses, this reserve should yield a good return in 2010.

## **The Chaucer Team**

I wish to close by thanking all employees for their continued support and dedication under difficult circumstances over the past 16 months. I firmly believe that we will meet the challenge of 2010 with confidence, drawing on the skill and commitment that has been the hallmark of all of our achievements to date. We are an excellent business, which, with its strong underwriting focus, diverse business mix and healthy prospects, remains well placed for future success.

Robert Stuchbery  
Chief Executive Officer  
8 March 2010

## CHIEF UNDERWRITING OFFICER'S REPORT

It was a mixed year for insurance, as the gains from a quiet hurricane season and generally good underwriting conditions were countered by the impact of global turmoil and recession-related claims. Against this background, our underwriting performed well, recording a profit of £45.8m before the impact of foreign exchange on non-monetary items, with strong results from our Property, Energy and Aviation Divisions.

Gross written premiums, excluding reinsurance to close (RITC) premiums and consolidation adjustments, increased by 15.3% to £795.6m (2008 £689.9m), as we focused growth in those areas where rating levels were strongest. The blended rate increase for Syndicate 1084 reached 6%. Net earned premiums increased by 24.9% to £672.6m in 2009 (2008 £538.4m).

The Group's combined ratio improved to 93% (2008 94%). During 2009, the Group released net reserves of £31.8m relating to prior periods (2008 £74.1m), which reduced the combined ratio by 5% (2008 13%). The expense ratio decreased to 31% (2008 32%), benefiting from a foreign exchange gain of £1.8m (2008 £8.4m).

### *Events and outlook*

After heavy insured losses in 2008, there was a significant reduction in the magnitude and frequency of both man-made and natural catastrophe insured losses in 2009. The global bill for natural catastrophe insured losses was upwards of US\$20bn, headed by Windstorm Klaus, which caused damage of some US\$3.5bn in France and Spain in January 2009. This compares to an insured loss of approximately US\$20bn from Hurricane Katrina alone in 2005. The bill for man-made insured losses was approximately US\$4bn.

The property, energy and marine markets benefited from the calmest hurricane season in 12 years. However, despite a respite for Gulf of Mexico accounts, the offshore market as a whole no more than broke even after the November fire at the West Atlas rig in the Timor Sea, which may result in claims in excess of US\$700m.

Other major global property losses were also light. The early forecasts for 2010 predict a return to more typical levels of Atlantic hurricane activity, with an above average number of hurricanes expected to reach the US coastline.

The aviation market also suffered heavy losses of up to US\$2bn in 2009, the worst since 2001. The tragic loss of an Air France A330 over the Atlantic in June accounted for half of the total annual loss for the industry. There were also other major losses including the New York State Continental Airlines/Colgan loss in February and the Turkish Airlines crash in the Netherlands in the same month. The Group's Aviation Division focuses away from both major airlines and US-related liability exposures, avoiding significant exposure to these losses.

It was a challenging year for political risk and trade credit underwriting as heavy losses were experienced following the near collapse of Ukraine's banking sector and similar issues surfacing in Kazakhstan.

Following the generally positive market results of 2009, there is pressure on terms and conditions in a number of classes, albeit from rates that are predominantly healthy and at an all-time high in some cases.

UK motor rates will harden significantly in order to turn this sector to profitability. It has proved to be a difficult year for motor insurers as the impact of claims farming and recession-related claims have pushed losses beyond original estimates. In 2009, we began taking the appropriate action to address this, including major rate increases yielding in excess of 20% for some of our private car products.

Given the healthy underwriting results achieved across our non-motor divisions in 2009, increasing premium volumes for 2010 is reasonable, with approximately £45m of the overall increase of £73m in Syndicate 1084's capacity stemming from non-motor business. Despite a forecast flattening of rates in 2010, these areas continue to offer excellent profit potential.

## Divisional performance

The following table provides a summary of divisional level underwriting performance.

2009	UK	Marine	Energy	Aviation	Property	Specialist		In-house	Syndicate <sup>1</sup>	Run-off <sup>2</sup>	Total
	£m	£m	£m	£m	£m	Lines	Nuclear	total	participations	£m	£m
Gross written premiums <sup>3</sup>	158.6	152.7	150.6	42.2	183.8	72.8	15.7	776.4	18.7	0.5	795.6
Net earned premiums <sup>3</sup>	139.8	125.7	119.8	30.9	151.6	54.4	13.5	635.7	36.3	0.6	672.6
Underwriting profit/(loss) <sup>4</sup>	(12.2)	(0.9)	11.0	8.5	35.8	0.7	10.0	52.9	(10.3)	3.2	45.8
	%	%	%	%	%	%	%	%	%	%	%
Claims ratio <sup>5,3</sup>	83	70	51	39	46	68	15	61	94	n/a	62
Expense ratio <sup>5,3</sup>	26	31	40	34	31	31	11	31	35	n/a	31
Combined ratio <sup>5,3</sup>	109	101	91	73	77	99	26	92	129	n/a	93
<b>2008</b>											
Gross written premiums <sup>3</sup>	132.2	121.2	116.3	26.9	157.5	46.3	14.7	615.1	74.5	0.3	689.9
Net earned premiums <sup>3</sup>	118.1	94.9	79.1	23.3	122.0	41.4	12.0	490.8	48.0	(0.4)	538.4
Underwriting profit/(loss) <sup>4</sup>	(3.0)	9.3	(10.5)	2.7	8.9	7.5	9.1	24.0	(0.1)	9.1	33.0
	%	%	%	%	%	%	%	%	%	%	%
Claims ratio <sup>5,3</sup>	74	62	75	54	60	48	20	64	60	n/a	62
Expense ratio <sup>5,3</sup>	28	29	38	35	33	34	4	31	41	n/a	32
Combined ratio <sup>5,3</sup>	102	91	113	89	93	82	24	95	101	n/a	94

<sup>1</sup> Syndicate participations comprises the results of Chaucer participations on Syndicates 4000 and 4242.

<sup>2</sup> Run-off comprises the results of Syndicates 1204, 1224, 1229 and 1245 (excluding the initial impact of the RITC) which have reinsured to close into Syndicate 1084. The ratios are meaningless for this analysis and have been excluded accordingly.

<sup>3</sup> Excluding premiums written to reinsure to close non-Chaucer syndicates into Syndicate 1084, the impact of the increased ownership of in-house syndicates, following the RITC of third-party participations in the year in which the closure occurred and the impact of foreign exchange on non-monetary items. See Note 3 to the preliminary results for reconciliation of gross written premiums and net earned premiums to the Income Statement.

<sup>4</sup> Underwriting profit/(loss) is the sum of net earned premiums, net incurred claims and net expenses incurred in insurance activities.

<sup>5</sup> The claims ratio represents net claims incurred as a percentage of net earned premiums. The expense ratio represents expenses incurred in insurance activities as a percentage of net earned premiums. The combined ratio represents the sum of the claims and expense ratios.

## UK Division

It was another testing year for the UK motor market, as increased recession-related claims combined with the farming of bodily injury claims, caused Chaucer Insurance, our UK Division, to record an underwriting loss of £12.2m in 2009 (2008 loss £3m). The combined ratio rose to 109% (2008 102%) on a premium income of £158.6m (2008 £132.2m) as we strengthened reserves, in particular for significantly increased credit hire and multi claimant claims. Our pricing for 2010 reflects the impact of these increased claims and we forecast private car rate increases of approximately 14%.

While we have taken significant steps to reduce the amounts payable on credit hire claims and the detection of fraudulent claims, the number of claims including these elements grew more than forecast during 2009. The continued rise of claims farmers is a major problem for UK motor insurers, exacerbating the cost of third party bodily injury motor claims.

### *Private car, specialist motor and fleet*

Our motor portfolio is 100% UK-based and has two main components: personal lines and fleet. There are eight main personal lines motor products, including private car, motorcycle, motor trade, commercial vehicle and taxi. We write the majority of our fleet account through the Lloyd's broker market. The portfolio comprises mainly medium and small fleets, where price competition is less intense. Our fleets contain a mix of vehicles including private car, commercial vehicles, haulage and coaches.

We aim to write a broad range of UK motor insurance products, which we support with efficient administrative and claims services for customers. Although each product generally follows the insurance cycle, competitive pressures vary across products, supporting rate increases for individual products, without harming premium volumes. We use sophisticated capital allocation, premium pricing and performance monitoring techniques to manage our business.

Aggregators continue to take a greater share of the distribution of private motor products in the UK, advertising heavily to build share. Our products are available via intermediaries on the major aggregator sites. We have also established our *ChaucerDirect* consumer web site, which receives business enquiries from two aggregator sites and has two specifically designed private car products. Premiums from our direct channel grew as planned to

£3.0m in 2009. In 2010, we will increase both the number of aggregator sites employed and the number of products distributed.

The private car market saw sustained price increases in 2009, following similar rises in 2008 and 2007. This has enabled us to secure double-digit rate increases across a large element of our private car product portfolio. While private car volumes remained healthy, rate increases in 2009 reduced demand for our commercial vehicle and motor trade products. These markets remain weak. Within commercial vehicles, we have a successful agricultural motor account whose income reached £4.9m in 2009. We only launched this account in 2007.

The outlook for our market is positive and we forecast an increase of 14.1% in UK motor premium rates in 2010, with standard private car prices again expecting to benefit most. We believe that fleet prices will begin to recover in 2010, following five years of decline.

#### *Commercial liability*

In addition to motor insurance, the UK Division includes commercial products, which generated income in 2009 of £3.2m from UK employers and public liability insurance. We will launch a combined commercial product on our new technology platform in 2010.

#### **Marine Division**

The performance of the Marine Division was generally strong, with the exception of the Trade Credit book, which held back the overall result. The global economic downturn triggered significant claims for payment defaults in emerging economies, causing the Division to record an overall underwriting loss of £0.9m (2008 profit £9.3m) and the combined ratio rose to 101% (2008 91%). Premium income increased to £152.7m (2008 £121.2m).

#### *Hull, liability and war*

The pricing of the hull market continued to improve throughout the year, albeit at a modest rate. We expect this trend to continue in 2010. It is pleasing to note that we were able to acquire specifically targeted new business, resulting in healthy growth in the account.

Northern European insurers, traditionally an alternative to the London market, are readdressing recent losses through rate rises and reduced line sizes. We have significantly strengthened our distribution network to take advantage of favourable Scandinavian market conditions, appointing an experienced Marine Underwriter in our Copenhagen office. We have also added a specialist underwriter to our team in Singapore, to take advantage of opportunities in the South East Asian market.

The threat of piracy, particularly in the waters surrounding Somalia and Nigeria, continues. The risks to crews and vessels are our highest concern. We work with ship owners to mitigate this and support the escalation of an international naval maritime presence. We cover the risk of piracy almost exclusively in our war account to ensure that an adequate premium is charged.

#### *Marine excess of loss*

Our marine excess of loss account performed strongly, despite a late and difficult renewal season. We had only a limited exposure to the largest marine loss of the year, the fire at the West Atlas rig in the Timor Sea. This enabled us to achieve our 2009 targets, although income was down due to our near withdrawal from Gulf of Mexico damage energy policies.

Rates have remained stable since 2009 and we expect this to continue in 2010. The balance of our account will remain, although we expect global cargo exposures to fall as a consequence of the global downturn.

The outlook for 2010 is positive, with both the London and New York markets maintaining price discipline and opportunities arising in the international market. Together with our offices in Denmark and Singapore we will take advantage of these conditions.

#### *Political risk*

The global economic crisis impacted our trade credit account with emerging markets producing significant losses as payment defaults increased. Despite these losses, the recovery potential is promising and our expectation of long-term claims recoveries is high.

There are signs of trade volumes becoming re-established, although our clients remain cautious and risk averse. We believe that the underwriting environment has greatly improved and 2010 offers an opportunity to set

excellent terms. Demand for asset risk policies has increased as bank funding frequently requires this protection for asset purchases.

We expect exporters to continue to rely heavily on private market insurers to protect their sales contracts into emerging markets in 2010. We also believe that trade finance banks and commodity traders will continue to use our market to mitigate their cross-border trade risks. The outlook for 2010 is positive.

Political violence and terrorism rates softened as losses fell in 2009. The standard terrorism only product offered primarily in the US and Europe came under some pricing pressure and that is likely to be repeated this year. Underwriting conditions remain more favourable elsewhere in the world and accordingly we seek a broad geographic spread of risk. Strengthening our teams in London, Copenhagen and Singapore will help facilitate this.

#### *Cargo and specie*

The cargo market has stabilised, except for US risks, which are increasingly competitive. We reduced our US business in 2008 and continued with this policy in 2009, replacing the income with business from the Middle East and China. With many major development projects now on hold due to economic conditions, our project cargo account has slowed down, although there are signs that the book is beginning to recover. Overall, we have striven to remove less profitable business from the account in 2008 and 2009, which has improved the cargo account loss ratio.

The specie account continues to be profitable. Reductions are rare and accounts with large losses are generating correspondingly large rate rises. Throughout 2009, we increased the excess securities investment protection (SIPC) book as market capacity stretched and large rate rises followed. We trimmed our jewellers block and the cash in transit books, as more small thefts generally occur during a recession.

#### *Chaucer Singapore*

This provides us with dedicated capacity and local representation for Chaucer Syndicate 1084 in the Asian market. Since launching with an upstream energy focus in 2007, we have increased our offering with dedicated underwriters recruited for marine, power and utilities and specialist lines. We will continue to develop this strategy in 2010.

#### **Energy Division**

The Energy Division delivered good results in 2009, supported by the continued development of our overseas operations. Premium income increased to £150.6m (2008 £116.3m) and the combined ratio decreased to 91% (2008 113%).

We continued to de-risk our Gulf of Mexico account and, at the end of 2009, had no asset exposure to hurricanes beyond 30 June 2010. Current market conditions remain stable after a benign year and, going forward, we intend to manage our exposures on a selective basis, assuming hurricane exposure on a calendar year basis, following an annual review of direct and reinsurance market conditions.

While reinsurance rates have remained firm following the fire at the West Atlas rig in November in the Timor Sea, we are pleased that our reinsurers have recognised the strength of our account through their support for 2010.

Our London team continues to operate at the forefront of the Lloyd's market, with key senior underwriting appointments adding both diversification and niche underwriting products to the portfolio and furthering our lead position. Despite increased rating pressure we remain committed to maintaining a high-quality underwriting account. Further diversification of the account is important to this and so we have continued to develop our overseas operations in Singapore and Houston, as well as strengthening our position in the Norwegian market.

## Aviation Division

Our Aviation Division recorded an excellent result in 2009, with an underwriting profit of £8.5m (2008 £2.7m) on a premium income of £42.2m (2008 £26.9m). Our combined ratio remained low at 73% (2009 89%).

### *Hull and liability*

The airline market suffered heavy losses of up to US\$2bn in 2009, the worst since 2001. The tragic loss of Air France flight AF447 over the Atlantic on 1 June accounted for approximately half of the total. However, the Aviation Division avoided AF447 and the majority of other losses since we do not focus on either major airlines or US-related liability exposures.

The market saw some moderate rate increases at the start of 2009, which became more substantial following the Air France loss. Early indications for 2010 suggest that rates will continue to increase, although the strength of this rally remains uncertain.

In 2008, we broadened the spread of our airline involvements in anticipation of rate increases and continued this in 2009, adding more capacity as market conditions improved. The popularity of Lloyd's as an insurance market during this turbulent time has assisted with these efforts. We are cautious toward the major airlines and airline groups, since their buying power makes rates unattractive for us, although we expect to utilise part of our planned 20% capacity increase in 2010 for this area should airline rates become acceptable.

### *Refuellers and products*

Away from airlines, rates are generally flat, with increases on loss making accounts balancing modest reductions on clean accounts. Over-capacity continues to pressurise airport and product-related business.

## Property Division

The Property Division produced an outstanding result in 2009, as rating improvements within our portfolio and an absence of major US catastrophes combined with our avoidance of major losses worldwide. Gross premium income rose to £183.8m (2008 £157.5m) and our combined ratio reduced to 77% (2008 93%). The underwriting profit increased significantly to £35.8m (2008 £8.9m).

Although total market losses reduced, 2009 saw a high frequency of catastrophe losses around the world including Swiss hail losses, localised European floods, Australian Bush fires, European storm event Klaus, the Italian earthquake, regional hail and tornado losses in the US and Asian typhoons.

Our renewal portfolio achieved a healthy rate increase of 6.6% in 2009. While there was a positive start, a combination of over capacity and the weak global economic climate caused rate improvements to slow and then flatten in some areas in the second half of the year.

### *North American delegated authorities, facultative and treaty*

The results of our property direct and facultative accounts were excellent. Income and rates increased as we successfully implemented our shift to a US Fortune 2500 based account. However, rating improvements achieved came under pressure in the second half of 2009 as low loss activity and improved financial conditions encouraged the re-emergence of rate competition. In 2010, we shall continue to target opportunities that diversify our portfolio.

North American treaty catastrophe pricing responded positively to the effects of hurricane Ike and constrained balance sheets, both for primary carriers and reinsurance companies. As these constraints eased, upward price movements slowed. Loss activity was minor in 2009, with only regional hail and tornado events across the US and Canada.

North American delegated authority rates remained static in 2009 as initial price strengthening, in anticipation of a hardening market, subsided. There was strong competition from standard market carriers for surplus lines risks, but our core business, developed through long-established relationships, remained firm. The economic slowdown led to an increase in attritional losses and restricted growth but a dormant North Atlantic storm season had a positive impact on results.

### *International delegated authorities, facultative and treaty*

International catastrophe rates showed signs of improvement during the first quarter of 2009, driven by a combination of capital supply constraints and exchange rate fluctuations. This hardening peaked with the renewal of the Japanese portfolio, a key catastrophe territory, in the second quarter. Thereafter, strengthening capital markets and an absence of major losses caused rates to plateau and then to fall in less catastrophe-

exposed regions. Nevertheless, reductions were conservative and terms and conditions remained stable. Risk excess rates remained acceptable, with price movements reflecting exposure and claims records, and terms and conditions were generally unchanged.

It was a disappointing year for the international delegated authority account. Worldwide capacity for international property business remained high, but market conditions did not improve as anticipated despite generally low rating levels, poor attrition loss ratios and weak general economic problems. Following another benign wind season, the Caribbean account is now under pressure. Only the Australasian accounts saw consistent rate increases, although the UK, France and Ireland are now beginning to experience improvements.

#### *Engineering*

Engineering direct and facultative premiums declined in London due to the recessionary climate, but our market profile remained strong, buoyed by initiatives from our Singapore office. The economic downturn and additional market capacity reduced engineering treaty premiums as rates remained flat throughout 2009, and we do not anticipate improvements until the second half of 2010 at the earliest. Our wordings, deductibles and risk management controls remained strong in 2009, preventing recessionary pressures from materially affecting loss ratio estimates, which remain within original ultimate projections. The excess of loss portfolio did not suffer significant losses and rates remained stable.

#### *Chaucer Underwriting A/S*

Despite an unusual frequency of natural event catastrophes in 2009, the business we wrote from our Danish office performed satisfactorily.

Natural perils events were frequent throughout Europe in 2009, including windstorm Klaus in France, a severe hailstorm in Switzerland, windstorm Wolfgang in Austria and Czech Republic, summer hail-storms in Slovenia, Marmara flash flooding in Istanbul and the L'Aquila earthquake in Italy. Losses from such events eroded over three quarters of our catastrophe income.

Despite this unusual frequency, renewal rates have remained flat and in some cases even reduced, except for rates in Austria, Slovenia and Turkey. Over-capacity, caused by the absence of major losses outside Europe, and a continuing strengthening of insurer balance sheets, is the primary reason for this. In response, we have not increased our catastrophe aggregates in the main EU wind areas.

The worldwide life, accident and health catastrophe account continues to develop successfully. We have built a diversified book of international risks, actively quoting and leading an increasing number of risks within our portfolio. The market remains profitable but competitive following a nine-year absence of major losses.

#### **Specialist Lines Division**

This was a challenging year for the Specialist Lines Division, with the result affected by the global economic downturn. We recorded an underwriting profit of £0.7m (2008 £7.5m) and an increased combined ratio of 99% (2008 82%).

While not immune to market events, our disciplined underwriting approach did protect us from many of the major market losses that arose from the global economic crisis. This places us in a strong position to benefit from the favourable market conditions now beginning to emerge.

Outside of the financial institutions market, conditions are less encouraging as new entrants continue to add capacity to the market. Pricing is weakening, often to damagingly low levels, as competitors discount the inevitability of claims inflation in a number of classes. Having established high quality renewal accounts through strong long-term relationships in all our chosen sectors, we continue to pursue our commitment to rate integrity at the expense of growth.

#### *Financial institutions*

2009 saw the expected turnaround in rates for financial institutions as the impact of the banking crisis began to curb market appetite for this class. Not being involved with the major international banks ensured that we avoided many of the large market losses that arose and consequently we have been able to take advantage of the improving conditions from a position of strength. We expect that this trend will continue in 2010.

#### *Medical*

Our institutional healthcare account, which provides excess hospital liability coverage, continues to deliver prior year reserve releases and we remain confident in our pricing for 2009 and 2010. Concerns over the security of

certain major underwriters within this class provided us with the opportunity to write further business at the start of 2009. These concerns are now fading and aggressive new capacity has entered the market, limiting our opportunities for 2010.

#### *Errors and Omissions/Direct Casualty*

Our general casualty team are respected market leaders. In 2009, the team continued to build on these foundations. Our ambitions for 2010 are conservative, as the expected upturn in market conditions has yet to materialise but we are well positioned to take advantage of opportunities that may arise. In the meantime, we continue to enjoy strong market support and a stable distribution network, both of which continue to generate high quality income.

#### *Treaty*

Our international casualty treaty account made a strong start in 2009, developing an immediate leadership profile and securing a diverse account of target business. Conditions are testing as we entered 2010, with rating pressures driven by the continued weakness of direct business rates. We aim to consolidate our position in 2010.

Underwriting discipline and rate integrity remain key tenets of the Specialist Lines Division's philosophy. We will continue to target those classes and sectors where we can demonstrate market leading expertise and where we believe adequate and sustainable underwriting margins are available.

#### **Nuclear Division**

Nuclear Syndicate 1176 provides coverage across the nuclear fuel cycle, from raw uranium and nuclear fuel to the shipment and storage of waste, although most of the Syndicate's insurance exposures relate to power generation. The Syndicate also issues a limited liability policy with proven strict terms and restrictions. The Syndicate purchases excess of loss reinsurance to limit maximum exposure to a major incident to 200% of capacity.

The Syndicate, which had an underwriting capacity of £31.5m (2008 £27.5m), saw little change in net income during the period. The loss record remained favourable, supporting broadly stable rates across the portfolio. The combined ratio was 26% (2008 24%).

#### **Turnkey Solutions**

The Group's Turnkey Solutions Division provides a practical solution for investors that want a Lloyd's syndicate but do not wish to incur the additional costs of a standalone managing agency. This allows the new syndicate to focus on building the underwriting business.

Our Division works closely with the new syndicate team and investors to prepare the application to conduct business at Lloyd's and then to support the launch of the syndicate. We also provide the syndicate with managing agency and other services. Once the syndicate is live, our managing agency closely monitors its underwriting performance for investors.

Our total syndicate capacity under management during 2009 was £1,009.3m (2008 £839.5m) including £429.3m (2008 £319.7m) for third party capital providers. This generated a total income of £5.9m from syndicate management in the year (2008 £4.4m), included within Other Operating Income of £11.2m (2008 £9.2m).

#### *Syndicate 4242*

In addition to management services, we provide capital to support the underwriting capacity on US property catastrophe ICM Syndicate 4242.

Our share of the Syndicate's underwriting profit of £1.9m (2008 loss £0.9m) reflects significantly reduced weather-related losses in the US during 2009. We have an underwriting interest of £13.1m for the 2010 year of account (2009 £11.3m).

The following table provides a summary of our share of the underwriting performance of Syndicate 4242.

	2009	2008
	£m	£m
Gross written premiums	10.5	8.6
Net earned premiums <sup>1</sup>	4.8	5.1
Underwriting profit/(loss) (before investment return) <sup>1</sup>	1.9	(0.9)
	<b>%</b>	<b>%</b>
Claims ratio	(5)	67
Expense ratio	64	51
Combined ratio	59	118

<sup>1</sup> See 'Divisional performance' for definitions of the terms used in this table

#### *Syndicate 1274*

We underwrite on Syndicate 1274 through a £17.0m investment in Antares Holdings Limited, a Bermudian-based holding company established by industry investors to provide capital for the Syndicate. The Syndicate, which has an underwriting capacity of £200.0m for 2010 (2009 £165.2m), completed a satisfactory 2009.

In January 2010, we announced the successful novation of Antares Syndicate 1274 from our management to the new Antares Managing Agency. This follows some 15 months of work by our Turnkey Solutions Division with the Antares management team to develop and to obtain regulatory approval for the new managing agency. Antares is now a stronger and more valuable investment proposition as an integrated Lloyd's vehicle.

The success of Antares shows the strengths of our Turnkey Solutions Division, which helps investors to build successful syndicates and management agencies at Lloyd's, and we intend to develop further such ventures in the future.

#### *Syndicate 4000*

We provided the capital to support the 2008 and prior years of account for Syndicate 4000. The following provides a summary of the Syndicate's underwriting performance.

	2009	2008
	£m	£m
Gross written premiums	8.2	65.9
Net earned premiums <sup>1</sup>	31.5	42.9
Underwriting (loss)/profit (before investment return) <sup>1</sup>	(12.2)	0.8
	<b>%</b>	<b>%</b>
Claims ratio	108	59
Expense ratio	30	39
Combined ratio	138	98

<sup>1</sup> See 'Divisional performance' for definitions of the terms used in this table

While the 2006 and prior years continue to settle satisfactorily, the Syndicate has significant exposure to potential claims arising from difficulties within the financial and professional liability markets, with claims such as Stanford and Madoff now reaching the market from the credit crunch and subsequent economic turmoil.

These are complex events, where after each initial notification from policyholders and brokers, insurers instruct legal advisors to evaluate the validity and quantum of claims. The advice that the market is receiving from this evaluation process is causing it to adopt a more pessimistic view of emerging claims. While the ultimate loss resulting from these events cannot yet be accurately determined, based on all available information, we have booked an underwriting loss before investment return of £12.2m for premiums earned in 2009 (2008 profit of £0.8m). The Syndicate's net IBNR provisions amounted to £76.6m at 31 December 2009 (2008 £81.6m), which includes significant loadings retained as a buffer against possible future best estimate reserve deterioration.

## Underwriting outlook

The outlook for 2010 is positive. After a quiet period for both man-made and natural catastrophe losses, there will inevitably be some softening of rates, especially for North American property and catastrophe-exposed marine classes. In addition, while prices remain healthy, competition for the best business is increasing as underwriters seek to utilise surplus capacity and add diversity. We also expect property rates in non-critical catastrophe-exposed territories to come under pressure, following exceptionally good years.

Energy premiums have responded to high offshore losses away from the Gulf of Mexico and a reinvigorated oil price. Aviation rates should also strengthen in 2010 following a year of heavy airline losses and we have increased the capacity of our Aviation Division by 20% in response.

Within our Marine portfolio, political risk renewal rates have hardened in response to losses from the global economic downturn in 2009, with increases of between 10% and 25% for political risk and even steeper increases of 20% to 40% for trade credit.

Away from financial institutions, the specialist lines market remains soft, with competitive pricing and a flow of new entrants adding to capacity.

As the index shows, we forecast a marginal increase in premium rates for our underwriting portfolio in 2010.

Premium Rating Index	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2010 % Change
Marine	149	167	171	175	187	184	184	194	195	0.5
Energy	282	327	310	347	486	445	409	441	446	1.1
Aviation	175	171	168	164	160	148	146	155	162	4.5
International Property	169	166	154	148	155	148	140	146	145	(0.7)
North American Property	157	165	163	171	232	234	216	235	232	(1.3)
Specialist Lines	151	174	187	184	179	171	166	168	170	1.2
<b>Combined (excluding UK)</b>	<b>170</b>	<b>182</b>	<b>182</b>	<b>185</b>	<b>204</b>	<b>197</b>	<b>187</b>	<b>198</b>	<b>199</b>	<b>0.5</b>
UK	122	130	132	130	130	132	140	149	170	14.1
<b>Combined</b>	<b>152</b>	<b>156</b>	<b>157</b>	<b>158</b>	<b>181</b>	<b>175</b>	<b>169</b>	<b>179</b>	<b>183</b>	<b>2.2</b>

The index, which provides an overall measure of the financial terms of a policy, is based on Chaucer's internal assessment by reference not only to headline premium rates, but also to other financial aspects of cover, including policy deductibles, commissions and other relevant coverage amendments. The index for 2000 is 100. The 2010E index values are estimates. As nuclear insurance has historically been a non-cyclical business, there is no maintenance of an index.

In UK motor, we forecast rate increases of 14.1% in excess of claims inflation in 2010. Increases for personal lines motor business will lead this, although the fleet market should also improve in 2010, following several years of fierce competition. We have increased the underwriting capacity of our UK Division by 10% to accommodate the rate increases levied for 2010.

There are also opportunities arising in specific specialist lines accounts, most notably for financial institutions, where rates have strengthened following the recent financial turmoil.

Overall, we have increased the capacity of Syndicate 1084 by £73.0m to £707.0m for 2010 (2009 £634.0m). In addition to Group capital, the Syndicate receives support from Flagstone Re, through an £82.1m capital provision quota-share (2009 £50.6m), and Labuan Re, through a £32.0m limited tenancy agreement (2009 £32.0m). The capacity of Nuclear Syndicate 1176 is £31.7m for 2010 (2009 £31.5m), of which our share is £17.4m (2009 £17.4m). Our participation on managed Syndicate 4242 has increased to £13.1m (2009 £11.3m).

Our total underwriting interests are £623.3m, an increase of £43.3m or 7.5% on the 2009 total of £580.0m.

Bruce Bartell  
Chief Underwriting Officer  
8 March 2010

## FINANCIAL REPORT

The financial performance of the Group improved significantly in 2009, with a profit before tax of £42.0m (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 £33.0m), 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 £71.0m). 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 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 result was improved by £33.3m. This mismatch of translation of assets and liabilities unwound in 2009, decreasing the reported profit by £33.3m. The magnitude of this figure resulted from a sudden significant swing in the US dollar, which coincided with the year-end. 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.

The table below summarises the results for the year.

	2009	2008
	£m	£m
<b>Key financial data</b>		
Gross written premiums <sup>1</sup>	796.3	741.0
Net earned premiums <sup>1</sup>	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)
<b>Per share amounts</b>	<b>p</b>	<b>p</b>
Basic earnings/(loss) per share	5.8	(6.0)
Interim dividend	1.3	1.8
Final dividend/second interim dividend	2.7	3.7
<b>Key business ratios</b>	<b>%</b>	<b>%</b>
Combined ratio <sup>2</sup>	93	94
Post tax return on equity	9.7	(7.0)

<sup>1</sup> 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.

<sup>2</sup> 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.

## **Taxation**

The Group's tax charge is £13.9m (2008 credit £7.3m). The tax charge is 33.1% (2008 27.9%). This is high 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 will 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.

## **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 £634.0m for 2009, an increase of £189.0m or 42.5% on the 2008 capacity of £445.0m.

### *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 £580.0m), with regulatory capital requirements of £336.5m or 47.7% (2009 48.1%), against a Lloyd's minimum of 40.0%. The Group deposits the capital as FAL. The table below shows the FAL composition for 2010.

	Year of account	
	2010	2009 <sup>3</sup>
	£m	£m
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%
	£m	£m
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 credit <sup>2</sup> :		
Group economic interest	51.0	56.0
Capital provision quota share reinsurer	55.9	35.6
Credits from Lloyd's for undistributed profits	61.7	-
	475.3 <sup>1</sup>	450.6 <sup>1</sup>

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> 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.

## Gearing

In addition to equity, the Group has debt capital of £40.3m (2008 £45.1m) and a £51.0m (2008 £56.0m) letter of credit facility deposited as FAL to support the underwriting capital.

The Group's debt capital comprises a €12.0m (£10.2m) 30-year loan note issued in 2004 and a US\$50.0m (£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 £5.0m of collateral (2008 £37.5m, including £5.0m of collateral) producing net debt of £38.9m (2008 £63.6m) and gearing of 12.3% (2008 28.2%).

The following table provides a gearing summary.

	2009	2008
	£m	£m
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

## 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 £899.0m) and capital buffer and working capital funds of £81.4m (2008 £39.8m). The following table provides an analysis of investments, cash and deposits held at 31 December 2009 and the net investment return for the period.

	31 December 2009			31 December 2008		
	Value £m	Return £m	Return %	Value £m	Return £m	Return %
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
	<u>1,336.5</u>	<u>53.8</u>	<u>4.3</u>	<u>1,202.5<sup>1</sup></u>	<u>(70.7)</u>	<u>(6.8)</u>
Investment expenses		(0.5)			(0.3)	
Net investment return		<u>53.3</u>			<u>(71.0)</u>	
<b>Asset allocation</b>	<b>%</b>			<b>%</b>		
Equities	-			-		
Hedge funds	3			13		
Absolute return bond funds	-			28		
Bonds	56			21		
Cash and deposits	41			38		
	<u>100</u>			<u>100</u>		

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

### 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.

The following table provides a summary of hedge fund investments including strategy, return and valuation at 31 December 2009.

	Return £m	Return %	Valuation £m
Fund of funds	5.0	13.9	25.9
Equity long short	1.8	15.8	-
Fixed income	7.9	33.9	11.6
	<u>14.7</u>	<u>20.9</u>	<u>37.5</u>

### Bonds

The portfolio performed well during 2009, recording a return of 4.2% (2008 loss 2.0%).

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

	AAA <sup>1</sup>	AA	A	BBB	Other	Credit rating Total
	£m	£m	£m	£m	£m	£m
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

<sup>1</sup> AAA rated corporates include government guaranteed securities

Securitised securities breakdown further as follows:

	AAA	AA	A	BBB	Other	Credit rating Total
	£m	£m	£m	£m	£m	£m
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

#### *Cash and deposits*

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

#### **Investment portfolio outlook**

As previously disclosed, the Group intends to maintain 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.

#### **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\$ funds deposited as FAL, the quota share reinsurance is supported by US\$ deposits. This provides a hedge against FAL requirements changing because of changes in the US\$ 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 because shareholders' funds increased.

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%).

The table below provides analysis of year-end reinsurance debtor security.

Reinsurance rating bands (Standard & Poor's or equivalent) <sup>1</sup>	2009	2008
	%	%
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 <sup>2</sup>	1.3	0.6
	100.0	100.0

<sup>1</sup> Ratings as at 31 December 2009 and 2008 respectively

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

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). The following table provides a breakdown of reserve releases by division.

Division	2009	2008
	£m	£m
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

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.

Ken Curtis  
Chief Finance Officer  
8 March 2010

Chaucer Holdings PLC  
Consolidated Income Statement (unaudited)  
For the year ended 31 December 2009

	Notes	2009 £m	2008 £m
Gross written premiums	3	796.3	741.0
Change in provision for gross unearned premiums	14	(27.0)	(57.8)
<b>Gross earned premiums</b>		<u>769.3</u>	<u>683.2</u>
Outward reinsurance premiums		(170.8)	(137.8)
Change in provision for unearned premiums – reinsurers’ share	14	7.8	1.8
<b>Net earned premiums</b>	3	<u>606.3</u>	<u>547.2</u>
Net investment return	4	53.3	(71.0)
Other operating income	5	11.2	9.2
<b>Total revenue from operations</b>		<u>670.8</u>	<u>485.4</u>
Gross claims paid	14	(416.8)	(324.4)
Movement in gross technical provisions		(74.3)	(158.3)
<b>Gross claims incurred</b>		<u>(491.1)</u>	<u>(482.7)</u>
Reinsurers’ share of gross claims paid	14	86.3	71.9
Movement in reinsurers’ share of technical provisions		15.1	46.4
<b>Reinsurers’ share of claims incurred</b>		<u>101.4</u>	<u>118.3</u>
<b>Net claims incurred</b>		<u>(389.7)</u>	<u>(364.4)</u>
Expenses incurred in insurance activities	6	(198.3)	(132.6)
Other operating expenses	7	(36.7)	(18.4)
<b>Total operating charges</b>		<u>(624.7)</u>	<u>(515.4)</u>
<b>Profit/(loss) from operations</b>		46.1	(30.0)
Finance costs		(4.1)	(4.0)
Other income from sale of subsidiary		-	14.7
Goodwill written off		-	(6.9)
<b>Profit/(loss) before tax</b>		<u>42.0</u>	<u>(26.2)</u>
Income tax (expense)/credit	8	(13.9)	7.3
<b>Profit/(loss) for the year</b>		<u>28.1</u>	<u>(18.9)</u>
Attributable to:			
Equity holders of the parent		28.1	(19.0)
Minority interest		-	0.1
		<u>28.1</u>	<u>(18.9)</u>
<b>Earnings/(losses) per share</b>	9		
Basic		5.8p	(6.0)p
Diluted		<u>5.8p</u>	<u>(6.0)p</u>

All of the operations of the Group are continuing.

Chaucer Holdings PLC  
 Consolidated Statement of Comprehensive Income (unaudited)  
 For the year ended 31 December 2009

	Notes	2009 £m	2008 £m
<b>Profit/(loss) for the year</b>		28.1	(18.9)
<b>Other comprehensive income/(expense)</b>			
Defined benefit pension scheme: actuarial losses for the year		(5.0)	(8.6)
Deferred tax credit in respect of actuarial losses	10	1.4	2.4
<b>Other comprehensive income/(expense) for the year, net of tax</b>		<u>(3.6)</u>	<u>(6.2)</u>
<b>Total comprehensive income/(expense) for the year, net of tax</b>		<u>24.5</u>	<u>(25.1)</u>
Attributable to:			
Equity holders of the parent		24.5	(25.2)
Minority interest		-	0.1
		<u>24.5</u>	<u>(25.1)</u>

## Chaucer Holdings PLC

Consolidated Statement of Changes in Equity (unaudited)

For the year ended 31 December 2009

	Notes	Called up share capital £m	Own shares £m	Share premium account £m	Equity element of convertible loan £m	Bonus reserve £m	Warrant reserve £m	Retained earnings £m	Minority interest £m	Total equity £m
At 1 January 2009		87.0	(31.5)	66.0	-	20.8	-	83.2	-	225.5
Total comprehensive income		-	-	-	-	-	-	24.5	-	24.5
Shares issued		50.0	-	24.9	-	-	-	-	-	74.9
Dividends paid	17	-	-	-	-	-	-	(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
<b>At 31 December 2009</b>	<b>13</b>	<b>137.0</b>	<b>(28.3)</b>	<b>90.9</b>	<b>-</b>	<b>27.3</b>	<b>-</b>	<b>89.8</b>	<b>-</b>	<b>316.7</b>
At 1 January 2008		86.3	(11.8)	65.7	0.1	16.0	1.9	124.0	0.4	282.6
Total comprehensive income		-	-	-	-	-	-	(25.2)	0.1	(25.1)
Shares issued		0.7	-	0.3	-	-	-	-	-	1.0
Dividends paid	17	-	-	-	-	-	-	(17.2)	-	(17.2)
Investments in own shares		-	(20.6)	-	-	0.5	-	-	-	(20.1)
Share option costs		-	-	-	-	0.1	-	-	-	0.1
Share incentive plan costs		-	-	-	-	0.4	-	-	-	0.4
Cost of shares and share options exercise		-	0.9	-	-	(0.8)	-	(0.4)	-	(0.3)
Bonus costs deferred share bonus plan		-	-	-	-	4.6	-	-	-	4.6
Minority interest in dividends declared by subsidiary		-	-	-	-	-	-	-	(0.2)	(0.2)
Sale of subsidiary		-	-	-	-	-	-	-	(0.3)	(0.3)
Warrant expiration		-	-	-	-	-	(1.9)	1.9	-	-
Conversion of loan stock		-	-	-	(0.1)	-	-	0.1	-	-
<b>At 31 December 2008</b>	<b>13</b>	<b>87.0</b>	<b>(31.5)</b>	<b>66.0</b>	<b>-</b>	<b>20.8</b>	<b>-</b>	<b>83.2</b>	<b>-</b>	<b>225.5</b>

Chaucer Holdings PLC  
Consolidated Balance Sheet (unaudited)  
At 31 December 2009

	Notes	2009 £m	2008 £m
<b>Assets</b>			
Intangible assets		32.1	32.1
Tangible fixed assets		7.9	8.7
Reinsurers' share of technical provisions	14	340.5	339.7
Deferred income tax	10	17.0	21.3
Current tax		0.4	-
Deferred acquisition costs		82.3	76.5
Prepayments and accrued income		15.4	3.5
Trade and other receivables		207.0	259.1
Financial assets	11	851.8	798.7
Cash and cash equivalents	12	501.7	420.8
<b>Total assets</b>		<u>2,056.1</u>	<u>1,960.4</u>
<b>Equity</b>			
	13		
Share capital		137.0	87.0
Own shares		(28.3)	(31.5)
Share premium account		90.9	66.0
Bonus reserve		27.3	20.8
Retained earnings		89.8	83.2
<b>Total equity</b>		<u>316.7</u>	<u>225.5</u>
<b>Liabilities</b>			
Subordinated debt		40.3	45.1
Employee benefits provision		14.2	9.4
Technical provisions	14	1,532.3	1,508.9
Current tax		-	4.8
Accruals and deferred income		12.0	12.7
Trade and other payables		140.6	154.0
<b>Total liabilities</b>		<u>1,739.4</u>	<u>1,734.9</u>
<b>Total equity and liabilities</b>		<u>2,056.1</u>	<u>1,960.4</u>
Net asset value per ordinary share	15	61.7p	72.9p
Net tangible asset value per ordinary share	15	<u>55.5p</u>	<u>62.5p</u>

**Chaucer Holdings PLC**  
**Consolidated Statement of Cash Flows (unaudited)**  
**For the year ended 31 December 2009**

	Notes	2009 £m	2008 £m
<b>Operating activities</b>			
Cash generated from operations	16	54.5	328.2
Interest paid		(4.1)	(4.1)
Return on financial assets		23.0	(53.5)
Tax paid		(13.4)	(19.9)
<b>Net cash flows from operating activities</b>		<u>60.0</u>	<u>250.7</u>
<b>Investing activities</b>			
Net cash acquired upon acquisition of subsidiary		-	16.6
Purchases less sales of financial assets		(22.8)	9.6
Purchase of tangible fixed assets		(1.1)	(1.0)
Purchase of own shares		-	(20.1)
Sale of subsidiary		-	15.3
Cash received on share option exercise		0.4	-
<b>Net cash flows from investing activities</b>		<u>(23.5)</u>	<u>20.4</u>
<b>Financing activities</b>			
Shares issued, net of expenses		74.9	-
Dividends paid	17	(18.6)	(17.3)
<b>Net cash flows from financing activities</b>		<u>56.3</u>	<u>(17.3)</u>
<b>Net increase in cash and cash equivalents</b>		92.8	253.8
Cash and cash equivalents at 1 January		420.8	179.0
Effect of changes in rates of exchange		(11.9)	(12.0)
<b>Cash and cash equivalents at 31 December</b>	12	<u>501.7</u>	<u>420.8</u>

# Chaucer Holdings PLC

## Notes to the Consolidated Financial Statements

### For the year ended 31 December 2009

#### 1. Accounting policies

Chaucer Holdings PLC, the ultimate holding company of the Group, is a public limited company registered in England and Wales. Its subsidiaries are private limited companies.

#### Basis of preparation

The consolidated financial statements to be included in the Annual Report have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). IFRS comprises standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC). The disclosure requirements of section 435 of the Companies Act 2006 have been included in note 18.

The consolidated financial statements have been prepared on the historical cost basis, except for the revaluation of financial assets held at fair value through profit and loss, long term assets and liabilities at amortised cost using the effective interest rate method and pension liabilities which are determined by actuarial analysis.

The accounting policies adopted are consistent with those of the previous financial year, except for the adoption of the following new standards or interpretations as of 1 January 2009, which have not had any effect on the financial position or performance of the Group:

#### IAS 1 (Revised) Presentation of Financial Statements

The revised standard separates owner and non-owner changes in equity. The Group has introduced a Consolidated Statement of Changes in Equity, which includes only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, this standard introduces a Consolidated Statement of Comprehensive Income, which presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present two statements.

#### IFRS 7 (Amended) Financial Instruments: Disclosures

The amended standard requires additional disclosure about fair value measurement and liquidity risk. Fair value measurements are disclosed by source of inputs using a three-level hierarchy for each class of financial instrument. In addition, a reconciliation between the beginning and ending balance for Level 3 fair value measurements is now required, as well as significant transfers between Level 1 and Level 2 fair value measurements. The amendments also clarify the requirements for liquidity risk disclosures.

#### IFRS 8 Operating Segments

This standard requires disclosure of information about the Group's operating segments and replaces the requirement to determine primary (business) and secondary (geographical) reporting segments of the Group. The Group has determined that the operating segments are the same as the business segments previously identified under IAS 14 Segment Reporting. Additional disclosures about each of these segments are shown in Note 3.

#### IAS 23 (Revised) Borrowing Costs

The standard has been revised to require capitalisation of borrowing costs on qualifying assets and the Group has amended its accounting policy accordingly. In accordance with the transitional requirements of the standard, this has been adopted as a prospective change. Therefore borrowing costs will be capitalised on qualifying assets with a commencement date on or after 1 January 2009. No such borrowing costs have been incurred to date and no changes have been made for borrowing costs incurred prior to this date.

The Group has also adopted the following standards, amendments to standards and interpretations, which are effective for periods starting on or after the dates below, with no significant impacts on the financial statements of the Group:

- Amendment to IFRS 2 Share-based Payment (1 January 2009)
- Amendment to IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (1 January 2009)
- Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation (1 January 2009)
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items (1 July 2009)
- Amendments to IFRIC 9 Reassessment of Embedded Derivatives and IAS 39 Financial Instruments: Recognition and Measurement – Embedded Derivatives (30 June 2009)
- IFRIC 13 Customer Loyalty Programmes (1 July 2008)
- Amendment to IFRIC 14 Prepayments of a Minimum Funding Requirement (1 January 2011)
- IFRIC 15 Agreements for the Construction of Real Estate (1 January 2009)
- IFRIC 16 Hedges of a Net Investment in a Foreign Operation (1 October 2008)
- IFRIC 17 Distributions of Non-cash Assets to Owners (1 July 2009)

- IFRIC 18 Transfers of Assets from Customers (1 July 2009)
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (1 July 2010)

There are a number of new standards, interpretations and changes in existing standards issued by the IASB which are not yet effective (and in some cases had not yet been endorsed by the EU), that have not been adopted by the Group. The impact of the adoption of these standards and interpretations is not expected to be material on the financial statements of the Group.

The consolidated financial statements include the accounts of the parent and each subsidiary where the parent owns, directly or indirectly, over 50% of the voting rights, or over which it has control of their operating and financial policies.

Consolidation includes elimination of all inter-company transactions and balances.

#### **Business combinations**

Acquisitions of businesses are accounted for using the purchase method of accounting. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred at the date of exchange plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date. The excess of the cost of acquisition over the fair value of the net assets acquired is recorded as goodwill. If the cost of the acquisition is less than the fair value of the assets acquired the difference is recognised directly in the income statement.

#### **Foreign currency translation**

The consolidated financial statements are presented in sterling, which is the functional currency of most companies within the Group, being the currency of the primary economic environment of those companies.

Monetary items are translated at period end rates and any exchange differences arising from the change in rates of exchange are recognised in the income statement.

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, including deferred acquisition costs and unearned premiums, are recorded in sterling at monthly average rates prevailing at the time of the transaction.

The averages of the monthly average rates during each financial year were as follows:

	2009	2008
US Dollars	1.57	1.85
Canadian Dollars	1.78	1.96
Euros	1.12	1.26

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

#### **Underwriting transactions**

The results for all classes of business in respect of participations on syndicates managed by the Group are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premium, net of reinsurance as follows:

- (i) Premiums written comprise the premiums on contracts incepting in the financial year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums due but not yet receivable or notified, less allowance for cancellations.
- (ii) Reinsurance premiums and any related reinsurance recoveries are accounted for in the same accounting period as the premiums and claims for the related direct or inwards reinsurance business.
- (iii) Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date.
- (iv) Acquisition costs, which represent commission and other related expenses, are deferred over the period in which the related policies are earned.
- (v) Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from prior years. Where applicable, deductions are made for salvage and other recoveries.

- (vi) Outstanding claims represent the estimated ultimate cost of settling all claims (including direct and indirect claims settlement costs) arising from events that have occurred up to the balance sheet date, including provision for claims incurred but not reported, less any amounts paid in respect of those claims. Outstanding claims are reduced by anticipated salvage and other recoveries. The ultimate cost of outstanding claims is estimated by using a range of actuarial projection methods. The primary sensitivity in these methods is the assumption that experience is indicative of the outcome of current business and, where past experience is insufficient, that market benchmarks are representative of the relevant syndicate's own underwriting. Significant delays can be experienced in the notification and settlement of certain claims and, accordingly, the ultimate cost of such claims cannot be known with certainty at the balance sheet date. In particular, estimates of technical provisions inevitably contain inherent uncertainties because significant periods of time may elapse between the occurrence of an insured loss, the reporting of that claim to the syndicate and the syndicate's payment of the claim and the receipt of reinsurance recoveries. While the Directors consider that the estimate of outstanding claims is fairly calculated, on the basis of the information currently available to them, the ultimate liability remains inherently uncertain and may change as a result of subsequent information and events which may result in the eventual cost of settling these liabilities being higher or lower than the amount calculated.
- (vii) Reserves are set based upon an expectation that there will not be a subsequent release or deficit. In arriving at this estimate, allowance is made for the inherent uncertainty involved in the setting of reserves.
- (viii) Liability adequacy test: at each reporting date an assessment is made to determine whether recognised insurance liabilities are adequate. If that assessment shows that the carrying amount of insurance liabilities (less related acquisition costs) is inadequate in the light of estimated future cash flows, the entire deficiency is recognised in the income statement via the provision of an unexpired risk reserve. The provision for unexpired risks is included within technical provisions in the balance sheet.

### **Participation in Nuclear Pools**

The Group, through its interests in Syndicate 1176, participates on business underwritten by Nuclear Risk Insurers Limited (NRI). In addition to insuring UK based nuclear risks, NRI participates on reinsurance programmes of similar overseas nuclear pools. As part of these arrangements, NRI reinsures a portion of its business with the overseas pools and accepts inwards reinsurance on a reciprocal basis. NRI accounts to its members on a basis net of the inter-pool reciprocal reinsurance recoveries.

NRI maintains its underwriting accounts on a three-year basis and, on closure of an account after three years, it transfers the liabilities to the next open year of account by means of a portfolio transfer. Syndicate 1176 pays and receives a proportion of this portfolio transfer between its closing and next open year of account. The difference to the syndicate between the amount paid to close one year of account and that received by the following year of account is due to the different proportions of the NRI pool written by the syndicate for each year of account and is treated as an additional or return premium. The Group's financial statements include its share of these transactions, on an annually accounted basis.

### **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. Dividend income is recognised when the shareholder's right to receive payment is established. Interest income is recognised as it accrues and is calculated by using the effective interest rate method.

### **Other operating income**

Other operating income comprises retained underwriting agency fees, management fees and underwriting profit commissions. Underwriting agency fees are brought into account in the year to which they relate. Profit commissions expected to arise on closure of a Lloyd's year of account in respect of the managed syndicates are recognised as earned on an annual basis to match the related underwriting profits. Profit commissions due after more than one year are held at fair value, which is the discounted present value of the nominal amount expected to be received.

### **Net expenses incurred in insurance activities**

Expenses incurred in insurance activities are recognised on an accruals basis. These comprise the Group's share of syndicate operating expenses, acquisition costs and the costs of membership of Lloyd's and other expenses attributable to the Group's underwriting, stated net of contributions from quota share reinsurers.

### **Other operating expenses**

Operating expenses are recognised on an accruals basis. They comprise Group operating expenses such as remuneration, office and administrative costs.

### **Borrowing costs**

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, form part of the cost of that asset and are therefore capitalised.

## **Taxation**

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

The tax currently payable is based on taxable income for the year. Taxable profit differs from net profit as reported in the income statement 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 Group's liability for current tax is calculated using tax rates applicable at the balance sheet date.

Deferred income tax is generally provided in full, on temporary differences arising between the tax bases of assets and liabilities and the carrying value in the consolidated financial statements. However, if deferred income tax arises from the initial recognition of goodwill for which amortisation is not deductible for tax purposes, or the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates enacted, or substantively enacted, at the balance sheet date and expected to apply when the related tax is affected.

The deferred tax resulting from the recognition of actuarial losses for the year on the defined benefit pension scheme is recorded in the Statement of Comprehensive Income.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be used.

Deferred income tax is provided on the temporary differences arising on investments in subsidiaries, except where the Group controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset only where there is a legal right of offset and the deferred taxes relate to the same fiscal authority.

## **Leases**

Costs in respect of operating leases are charged on a straight-line basis over the lease term. Leasing agreements, which transfer to the Group substantially all the benefits and risks of ownership of an asset, are treated as if the asset has been purchased outright. The assets are included in tangible assets and the capital element of the leasing commitments is shown as obligations under finance leases. The lease rentals are treated as consisting of capital and interest elements.

The capital element is applied to reduce the outstanding obligations and the interest element charged against profit in proportion to the reducing capital element outstanding. Assets held under finance leases are depreciated over the shorter of the lease term and their useful life.

## **Dividends**

Dividends are recognised as a liability and deducted from equity when they are approved by the Group'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.

## **Syndicate participations**

Syndicate participations represent an aggregation of the proportion of assets and liabilities of each syndicate in which the Group participates. Those assets are held subject to the individual syndicate trust funds and the Group cannot obtain or use them until such time as each syndicate underwriting year is closed and profits are distributed, or an advance profit release is made.

## **Cash and cash equivalents**

Cash and cash equivalents on the balance sheet represent cash balances and money market deposits lodged with banks and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Investments with an original maturity date of less than three months are treated as cash equivalents.

## **Financial assets**

All investments 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 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 fair value of unquoted hedge fund investments is determined from net asset values provided by independent third-party fund administrators. Whilst many hedge funds operate in specialist markets, the securities in which they invest are predominantly listed or exchange traded; such securities can therefore be priced consistently with normal market practices for the valuation of listed securities.

If funds hold unquoted assets they are typically valued with reference to listed securities of a similar nature or by using pricing models that are reviewed and approved by an independent pricing specialist. The value of underlying assets valued in such a way is relatively small and the potential impact on Group results that could arise from pricing errors is considered to be immaterial in the context of the total investment portfolio.

Management considers 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 that is consistent with the adoption of fair value through profit and loss.

All purchases and sales of financial assets 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 income statement in the period in which they arise.

#### **Derivative financial instruments**

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates. The Group uses foreign exchange forward contracts to manage these exposures. The Group 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 income statement. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models, as appropriate.

#### **Tangible fixed assets**

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

Buildings	25 years	straight line
Lease improvements	20%	per annum
Furniture, office fixtures and fittings	8-20%	per annum
Computer equipment	33%	per annum

#### **Intangible assets**

Intangible assets comprise goodwill and auction costs arising on the purchase of syndicate capacity.

Goodwill is the excess of the cost of acquired businesses over the fair value of the net assets acquired and is deemed to have an indefinite useful life, since, in the current business strategy, the Group will benefit from the activities of the managing agency for as long as it carries on doing business.

Auction costs are the costs incurred in purchasing additional capacity on the syndicates currently managed by Chaucer Syndicates Limited. The capacity purchased is deemed to have an indefinite useful economic life represented by participation rights to membership on each syndicate, since it is deemed that the benefits from that capacity have no foreseeable limit.

Both goodwill and auction costs are recognised on the balance sheet at cost less any impairment.

Both goodwill and auction costs are tested annually for impairment. Where there is any reduction in the carrying amount for either, this would be recognised in the income statement during the period in which the reduction is determined.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts, subject to being tested for impairment at that date.

#### **Impairment of assets**

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an indefinite life is tested for impairment annually, and whenever there is an indication that the asset may be impaired.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in the income statement immediately.

Except for goodwill, where impairment losses cannot be reversed, where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount will not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of the impairment loss is recognised in the income statement immediately.

### **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 income statement.

### **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**

Provisions are recognised when the Group has a present legal or constructive obligation as a result 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 Group, 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: pensions**

The Group operates a single pension scheme with both a defined benefits and, from December 2001, a defined contribution section.

Payments to the defined contribution section are charged as expenses as they fall due. Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution schemes where the Group's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit scheme.

Contributions in respect of the defined benefits section are paid in accordance with the recommendations of independent actuaries. The costs of providing benefits under this section are determined using the projected unit credit method, with full actuarial valuations being carried out at least every three years (or sooner if significant changes in the assumptions surrounding the valuation of the scheme's assets and liabilities require it) and updates being carried out every six months. These costs are recognised in the income statement based on the valuation prepared by independent actuaries.

Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside profit or loss and presented in the Statement of Comprehensive Income. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The amount recognised in the balance sheet represents the present value of the defined benefit obligations and is reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

#### **Employee benefits: shares**

The Group grants shares to its employees under a number of shares 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 income statement.

#### **Employee benefits: share options**

The Group grants share options to its 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 Group's estimate of shares that will eventually vest.

IFRS 2 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 income statement reflect only the share grants made after 7 November 2002 that had not vested before 1 January 2005.

At each balance sheet date, the Group 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 income statement 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 investment 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 loans are recognised initially at fair value, net of transaction costs incurred. The loans are subsequently stated at amortised cost; any difference between the initial carrying amount and the redemption value is recognised in the income statement over the expected period of the borrowings using the effective interest rate method.

### **Critical accounting estimates and judgements in applying accounting policies**

The preparation of the financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances.

The most critical accounting estimate made by the Group is the estimate of the ultimate claims liability under insurance contracts underwritten. The estimation of the liability considers historical data, with most relevance given to recent data, of claims experience in each particular account.

Other areas where the Directors have applied significant judgement are as follows:

- The decision to value the financial assets at fair value through profit and loss, based on the considerations described in the relevant accounting policy above, has impacted the final determination of the profit/(loss) for the year, as the methods and assumptions required by this classification differ substantially from other options available to the Directors.
- In valuing the tax charge for the year and in particular the deferred tax asset associated to losses available to the Group, the Directors have taken into consideration the changes to tax regulations during the year and the availability of potential future profits.
- The bonus payable to staff and Directors is based on a formulaic approach applicable to the profit before tax for the year. As a consequence, the uncertainties and assumptions affecting the valuation of insurance liabilities and investments, described above, have a material impact on the calculation of the bonus. In addition, the Directors have applied judgement in areas that have a significant impact on the recognition and deferral of the bonus charge, such as the estimate of when the long term elements of the bonus will be paid and an estimate of whether the conditions affecting the allocation of matching shares will be met.

The income statement adjusts and recognises any subsequent adjustments for inadequacies or surpluses.

## 2. Development of projections of insurance liabilities

The development of projections of insurance liabilities over time provides a measure of the Group's ability to estimate the ultimate value of claims. The following tables illustrate how the Group's share of total gross and net ultimate claims for each underwriting year has changed at successive year-ends.

Estimated gross ultimate claims <sup>1,2</sup> (All figures in £m)	2001 & prior	2002	2003	2004	2005	2006	2007 <sup>3</sup>	2008	2009	Corporate and other	Total
										adjustments <sup>4</sup>	
At end of year	1,811.7	232.7	262.7	314.5	508.3	308.5	444.2	662.0	460.0		
One year later	1,807.4	195.8	267.8	366.5	523.1	339.0	432.3	714.1			
Two years later	1,842.0	188.2	238.0	345.7	533.8	303.1	441.1				
Three years later	1,844.4	186.2	227.0	342.1	508.8	291.0					
Four years later	1,848.8	179.2	227.3	326.2	491.1						
Five years later	1,831.8	174.4	228.4	318.2							
Six years later	1,825.3	172.6	226.2								
Seven years later	1,823.1	174.0									
Eight years later	1,822.5										
<b>Total ultimate losses at 31 December 2009</b>	<b>1,822.5</b>	<b>174.0</b>	<b>226.2</b>	<b>318.2</b>	<b>491.1</b>	<b>291.0</b>	<b>441.1</b>	<b>714.1</b>	<b>460.0</b>		<b>4,938.2</b>
Less accumulated payments	(1,732.8)	(158.2)	(200.3)	(270.3)	(425.9)	(194.4)	(203.5)	(255.3)	(44.8)		(3,485.5)
Unearned portion of ultimate losses	-	-	-	-	-	(0.5)	(5.5)	(28.8)	(233.9)		(268.7)
Claims handling provision	0.4	0.2	0.2	0.7	1.0	1.7	2.4	6.4	4.7		17.7
<b>Total outstanding claims at 31 December 2009 on a 100% basis</b>	<b>90.1</b>	<b>16.0</b>	<b>26.1</b>	<b>48.6</b>	<b>66.2</b>	<b>97.8</b>	<b>234.5</b>	<b>436.4</b>	<b>186.0</b>		<b>1,201.7</b>
Less unaligned share	(0.3)	(0.2)	(0.4)	(3.5)	(0.8)	(0.8)	(2.4)	(11.1)	(13.4)		(32.9)
Other corporate adjustments	-	-	-	-	-	-	-	-	-	(0.1)	(0.1)
<b>Total outstanding claims at 31 December 2009</b>	<b>89.8</b>	<b>15.8</b>	<b>25.7</b>	<b>45.1</b>	<b>65.4</b>	<b>97.0</b>	<b>232.1</b>	<b>425.3</b>	<b>172.6</b>	<b>(0.1)</b>	<b>1,168.7</b>

  

Estimated net ultimate claims <sup>1,2</sup> (All figures in £m)	2001 & prior	2002	2003	2004	2005	2006	2007 <sup>3</sup>	2008	2009	Corporate and other	Total
										adjustments <sup>4</sup>	
At end of year	1,175.3	191.6	224.3	247.9	318.3	282.7	390.4	532.3	414.0		
One year later	1,161.4	162.5	204.1	243.2	315.1	302.3	370.0	557.6			
Two years later	1,156.8	155.8	180.4	229.7	326.3	269.5	373.3				
Three years later	1,156.3	154.9	170.2	219.3	305.7	260.1					
Four years later	1,141.8	150.2	169.8	213.6	291.8						
Five years later	1,140.9	147.5	170.2	209.7							
Six years later	1,139.1	144.4	168.4								
Seven years later	1,139.5	144.2									
Eight years later	1,139.0										
<b>Total ultimate losses at 31 December 2009</b>	<b>1,139.0</b>	<b>144.2</b>	<b>168.4</b>	<b>209.7</b>	<b>291.8</b>	<b>260.1</b>	<b>373.3</b>	<b>557.6</b>	<b>414.0</b>		<b>3,558.1</b>
Less accumulated payments	(1,084.2)	(134.6)	(152.4)	(180.2)	(235.7)	(179.4)	(187.5)	(219.3)	(40.8)		(2,414.1)
Unearned portion of ultimate losses	-	-	-	-	-	(0.5)	(5.3)	(25.7)	(210.3)		(241.8)
Claims handling provision	0.4	0.1	0.2	0.6	1.0	1.7	2.4	6.4	4.7		17.5
Bad debt provision	2.6	0.4	0.2	0.4	0.1	0.2	0.6	1.4	0.2		6.1
<b>Total outstanding claims at 31 December 2009 on a 100% basis</b>	<b>57.8</b>	<b>10.1</b>	<b>16.4</b>	<b>30.5</b>	<b>57.2</b>	<b>82.1</b>	<b>183.5</b>	<b>320.4</b>	<b>167.8</b>		<b>925.8</b>
Less unaligned share	(0.3)	(0.2)	(0.4)	(3.5)	(0.8)	(0.8)	(2.0)	(2.9)	(12.3)		(23.2)
Less quota share reinsurance	-	-	-	-	-	-	-	-	-	(26.7)	(26.7)
<b>Total outstanding claims at 31 December 2009</b>	<b>57.5</b>	<b>9.9</b>	<b>16.0</b>	<b>27.0</b>	<b>56.4</b>	<b>81.3</b>	<b>181.5</b>	<b>317.5</b>	<b>155.5</b>	<b>(26.7)</b>	<b>875.9</b>

## 2. Development of projections of insurance liabilities (continued)

- 1 Ultimate claims and accumulated claims payments as at each year-end converted at 31 December 2009 exchange rates for this analysis.
- 2 The figures above include ultimate claims and accumulated payments for Syndicates 15, 17, 396, 587, 1096, 1204, 1224, 1229, and 1245, which closed into Syndicate 1084 at various points in time. The Group typically strengthens reserves on closure, although for the purposes of this analysis, deems this strengthening to have occurred when these syndicates commenced operations.
- 3 From 2007, the results include the impact of claims reserves of Syndicate 4000 and Syndicate 4242. The Group initially includes these at 100% level before their removal on the 'unaligned share' line.
- 4 Corporate and other adjustments include the effect of quota share agreements held at the corporate level.

The total provision releases from prior years on which the Group participated on a 100% basis amounted to £39.0m (2008 £81m) net of reinsurance in the table above. This largely arises because of the Group's reserving philosophy, which may include the addition of risk loadings to actuarial best estimate reserves where sufficient uncertainty exists, especially in the earlier years of an underwriting year's development. This practice gives rise to the potential for subsequent releases, which, in 2009, mainly arose in the Marine, Energy, Aviation, Property and Specialist Divisions (2008 Motor, Property, and Specialist Lines Divisions, and Syndicate 4000).

The Group's share of the releases above is £31.8m (2008 £74.1m), after taking into account the change in participation in different years of account, the impact of foreign exchange and the application of earning patterns.

### 3. Segmental information

The Board of Directors, the Chief Decision Maker, monitors the operating results of each of the divisions below for the purpose of making decisions about resource allocation and performance assessment.

Segment performance is measured differently from operating profit or loss in the consolidated financial statements, as a result of the exclusion from divisional results of the foreign exchange impact on non monetary assets and liabilities. The exclusion is necessary in order to eliminate the volatility in our results created by the imbalance in the valuation of non-monetary balance sheet items (translated at historic rates) and the translation of monetary balances at closing rates.

In addition, the divisional analysis excludes the effect of premiums and reserves relating to the reinsurance to close (RITC) of third party syndicates into Syndicate 1084 and the Group's increased ownership of the RITC of Syndicates 1084 and 1176 following the closure of their 2006 years of accounts.

Details about the divisions referred to below are as follows:

- **UK** – The division specialises in the private car and fleet market, supplying high quality and flexible motor insurance solutions to policyholders countrywide. Both standard and non-standard private car business is available from a source of approximately 3,000 non-Lloyd's brokers and intermediaries. In addition, the division writes specialist classes including commercial vehicle, taxi, motorcycle, motor trade and classic/specialist vehicles, along with other UK small commercial products.
- **Marine** – The division underwrites a conventional marine account that encompasses hull, excess of loss, liability, cargo and specie. It also underwrites political risk, war and satellite business.
- **Energy** – The division underwrites a broad energy portfolio encompassing exploration & production, construction, liabilities, downstream and renewables. The coverage offered includes physical damage, business interruption, control of well, seepage and pollution and liabilities. The division also writes energy insurance through the Group's offices in Singapore and Denmark.
- **Aviation** – The division underwrites a worldwide aviation account including coverage in the following areas: Aircraft (including airline), hull and liability, Aircraft hull deductible, Contingent hull and liability for banks and leasing companies, Products liability, Airport liability, Non-owned aircraft liability.
- **Property** - The division underwrites a worldwide direct, facultative and treaty property account, which incorporates homeowners, commercial, auto and industrial business. The division writes this through binding authorities and on an open market basis at the Box at Lloyd's.

The property treaty account comprises mainly catastrophe and per risk excess acceptances, with a small amount of proportional treaty and reinsurance assumed business. The account primarily protects indigenous writers but also contains a worldwide element.

In addition, the division includes a non-marine reinsurance book through Chaucer Underwriting A/S, based in Copenhagen, Denmark.

- **Specialist Lines** – The division comprises financial institutions and professional indemnity, institutional healthcare, miscellaneous short tail and general casualty and claims made. The financial institutions and professional indemnity account focuses on small to medium sized institutions worldwide, with business domiciled in the United Kingdom and Europe providing 40% of forecast premium income. The Division also has a leading position in the underwriting of liability exposures for healthcare institutions.
- **Nuclear** – The division, which underwrites through Nuclear Syndicate 1176, is a leading insurer of nuclear risk. The Syndicate provides coverage across the nuclear fuel cycle, from raw uranium and nuclear fuel to the shipment and storage of waste, although most of the Syndicate's insurance exposures relate to power generation at nuclear power stations. In addition to providing coverage for physical damage loss to civil nuclear power stations, the Syndicate provides a limited liability policy with proven strict terms and restrictions.

The following table is used to calculate the loss ratios disclosed in the Divisional Performance section of this Report.

### 3. Segmental information (continued)

Year ended 31 December 2009	UK £m	Marine £m	Energy £m	Aviation £m	Property £m	Specialist Lines £m	Nuclear £m	Syndicate Participations <sup>1</sup> £m	Run-off <sup>2</sup> £m	Total (excluding Other and Eliminations) £m	Eliminations £m	Other <sup>3</sup> £m	Total £m
Adjusted gross written premiums	158.6	152.7	150.6	42.2	183.8	72.8	15.7	18.7	0.5	795.6	0.6	-	796.2
RITC	-	-	-	-	-	-	0.1	-	-	0.1	-	-	0.1
<b>Unadjusted gross written premiums<sup>5</sup></b>	<b>158.6</b>	<b>152.7</b>	<b>150.6</b>	<b>42.2</b>	<b>183.8</b>	<b>72.8</b>	<b>15.8</b>	<b>18.7</b>	<b>0.5</b>	<b>795.7</b>	<b>0.6</b>	<b>-</b>	<b>796.3</b>
Adjusted net earned premiums <sup>2</sup>	139.8	125.7	119.8	30.9	151.6	54.4	13.5	36.3	0.6	672.6	0.6	(43.5)	629.7
RITC	-	-	-	-	-	-	0.1	-	-	0.1	-	-	0.1
Foreign exchange on non-monetary items	-	(5.2)	(7.4)	(1.1)	(6.8)	(1.8)	-	(2.4)	-	(24.7)	-	1.2	(23.5)
<b>Unadjusted net earned premiums<sup>5</sup></b>	<b>139.8</b>	<b>120.5</b>	<b>112.4</b>	<b>29.8</b>	<b>144.8</b>	<b>52.6</b>	<b>13.6</b>	<b>33.9</b>	<b>0.6</b>	<b>648.0</b>	<b>0.6</b>	<b>(42.3)</b>	<b>606.3</b>
Net investment return	4.8	6.5	8.9	2.1	10.4	4.6	0.4	1.1	6.9	45.7	-	7.6	53.3
Other operating income	-	-	-	-	-	-	-	-	-	-	(13.1)	24.3	11.2
<b>Total revenue from operations</b>	<b>144.6</b>	<b>127.0</b>	<b>121.3</b>	<b>31.9</b>	<b>155.2</b>	<b>57.2</b>	<b>14.0</b>	<b>35.0</b>	<b>7.5</b>	<b>693.7</b>	<b>(12.5)</b>	<b>(10.4)</b>	<b>670.8</b>
Adjusted net incurred claims	(116.4)	(87.9)	(61.1)	(12.0)	(69.2)	(36.9)	(2.0)	(34.0)	2.6	(416.9)	-	27.3	(389.6)
RITC	-	-	-	-	-	-	(0.1)	-	-	(0.1)	-	-	(0.1)
<b>Unadjusted net incurred claims<sup>5</sup></b>	<b>(116.4)</b>	<b>(87.9)</b>	<b>(61.1)</b>	<b>(12.0)</b>	<b>(69.2)</b>	<b>(36.9)</b>	<b>(2.1)</b>	<b>(34.0)</b>	<b>2.6</b>	<b>(417.0)</b>	<b>-</b>	<b>27.3</b>	<b>(389.7)</b>
<b>Adjusted net expenses incurred in insurance activities</b>													
Acquisition costs	(27.4)	(34.8)	(44.6)	(8.3)	(36.9)	(13.0)	(0.4)	(11.1)	-	(176.5)	-	11.8	(164.7)
Other expenses	(8.2)	(3.9)	(3.1)	(2.1)	(9.7)	(3.8)	(1.1)	(1.5)	-	(33.4)	3.9	5.7	(23.8)
Foreign exchange on non-monetary items	-	(3.0)	(2.5)	(0.9)	(1.5)	(2.0)	-	(0.6)	-	(10.5)	-	0.7	(9.8)
<b>Unadjusted net expenses incurred in insurance activities</b>	<b>(35.6)</b>	<b>(41.7)</b>	<b>(50.2)</b>	<b>(11.3)</b>	<b>(48.1)</b>	<b>(18.8)</b>	<b>(1.5)</b>	<b>(13.2)</b>	<b>-</b>	<b>(220.4)</b>	<b>3.9</b>	<b>18.2</b>	<b>(198.3)</b>
Recharges from managing agency <sup>4</sup>	(2.0)	(1.0)	(1.1)	(0.3)	(1.5)	(0.6)	(2.2)	(0.2)	-	(8.9)	8.3	0.6	-
Actual expenses transferred from managing agency	1.0	0.8	0.8	0.3	1.2	0.5	0.7	-	-	5.3	(5.3)	-	-
Other operating expenses	-	-	-	-	-	-	-	-	-	-	5.6	(42.3)	(36.7)
<b>Total operating charges</b>	<b>(153.0)</b>	<b>(129.8)</b>	<b>(111.6)</b>	<b>(23.3)</b>	<b>(117.6)</b>	<b>(55.8)</b>	<b>(5.1)</b>	<b>(47.4)</b>	<b>2.6</b>	<b>(641.0)</b>	<b>12.5</b>	<b>3.8</b>	<b>(624.7)</b>
<b>Profit/(loss) from operations</b>	<b>(8.4)</b>	<b>(2.8)</b>	<b>9.7</b>	<b>8.6</b>	<b>37.6</b>	<b>1.4</b>	<b>8.9</b>	<b>(12.4)</b>	<b>10.1</b>	<b>52.7</b>	<b>-</b>	<b>(6.6)</b>	<b>46.1</b>
Finance costs	-	-	-	-	-	-	-	-	-	-	-	(4.1)	(4.1)
<b>Profit/(loss) before tax</b>	<b>(8.4)</b>	<b>(2.8)</b>	<b>9.7</b>	<b>8.6</b>	<b>37.6</b>	<b>1.4</b>	<b>8.9</b>	<b>(12.4)</b>	<b>10.1</b>	<b>52.7</b>	<b>-</b>	<b>(10.7)</b>	<b>42.0</b>

### 3. Segmental information (continued)

Year ended 31 December 2008	UK £m	Marine £m	Energy £m	Aviation £m	Property £m	Specialist Lines £m	Nuclear £m	Syndicate Participations <sup>1</sup> £m	Run-off <sup>2</sup> £m	Total (excluding Other and Eliminations) £m	Eliminations £m	Other <sup>3</sup> £m	Total £m
Adjusted gross written premiums	132.2	121.2	116.3	26.9	157.5	46.3	14.7	74.5	0.3	689.9	1.4	-	691.3
RITC	0.9	1.1	0.4	0.2	0.7	1.4	(0.1)	-	45.1	49.7	-	-	49.7
<b>Unadjusted gross written premiums<sup>5</sup></b>	<b>133.1</b>	<b>122.3</b>	<b>116.7</b>	<b>27.1</b>	<b>158.2</b>	<b>47.7</b>	<b>14.6</b>	<b>74.5</b>	<b>45.4</b>	<b>739.6</b>	<b>1.4</b>	<b>-</b>	<b>741.0</b>
Adjusted net earned premiums <sup>2</sup>	118.1	94.9	79.1	23.3	122.0	41.4	12.0	48.0	(0.4)	538.4	1.4	(31.8)	508.0
RITC	0.9	1.1	0.4	0.2	0.7	1.4	(0.1)	-	45.1	49.7	-	-	49.7
Foreign exchange on non-monetary items	-	(2.2)	(2.4)	(0.7)	(2.5)	(1.6)	-	(1.8)	-	(11.2)	-	0.7	(10.5)
<b>Unadjusted net earned premiums<sup>5</sup></b>	<b>119.0</b>	<b>93.8</b>	<b>77.1</b>	<b>22.8</b>	<b>120.2</b>	<b>41.2</b>	<b>11.9</b>	<b>46.2</b>	<b>44.7</b>	<b>576.9</b>	<b>1.4</b>	<b>(31.1)</b>	<b>547.2</b>
Net investment return	(12.0)	(12.0)	(13.2)	(4.2)	(14.6)	(15.2)	1.5	3.5	(10.5)	(76.7)	-	5.7	(71.0)
Other operating income	-	-	-	-	-	-	-	-	-	-	(18.0)	27.2	9.2
<b>Total revenue from operations</b>	<b>107.0</b>	<b>81.8</b>	<b>63.9</b>	<b>18.6</b>	<b>105.6</b>	<b>26.0</b>	<b>13.4</b>	<b>49.7</b>	<b>34.2</b>	<b>500.2</b>	<b>(16.6)</b>	<b>1.8</b>	<b>485.4</b>
Adjusted net incurred claims	(87.9)	(58.5)	(59.2)	(12.5)	(73.2)	(19.9)	(2.4)	(28.6)	7.4	(334.8)	-	20.1	(314.7)
RITC	(0.9)	(1.1)	(0.4)	(0.2)	(0.7)	(1.4)	0.1	-	(45.1)	(49.7)	-	-	(49.7)
<b>Unadjusted net incurred claims<sup>5</sup></b>	<b>(88.8)</b>	<b>(59.6)</b>	<b>(59.6)</b>	<b>(12.7)</b>	<b>(73.9)</b>	<b>(21.3)</b>	<b>(2.3)</b>	<b>(28.6)</b>	<b>(37.7)</b>	<b>(384.5)</b>	<b>-</b>	<b>20.1</b>	<b>(364.4)</b>
<b>Adjusted net expenses incurred in insurance activities</b>													
Acquisition costs	(24.6)	(26.0)	(27.6)	(6.3)	(33.8)	(10.4)	(0.4)	(13.6)	-	(142.7)	1.1	7.8	(133.8)
Other expenses	(8.6)	(1.1)	(2.8)	(1.8)	(6.1)	(3.6)	(0.1)	(5.9)	2.1	(27.9)	1.3	(16.0)	(42.6)
Foreign exchange on non-monetary items	(0.1)	9.1	14.1	2.4	11.2	4.5	-	5.1	-	46.3	-	(2.5)	43.8
<b>Unadjusted net expenses incurred in insurance activities</b>	<b>(33.3)</b>	<b>(18.0)</b>	<b>(16.3)</b>	<b>(5.7)</b>	<b>(28.7)</b>	<b>(9.5)</b>	<b>(0.5)</b>	<b>(14.4)</b>	<b>2.1</b>	<b>(124.3)</b>	<b>2.4</b>	<b>(10.7)</b>	<b>(132.6)</b>
Recharges from managing agency <sup>4</sup>	(3.3)	(2.0)	(2.0)	(0.5)	(2.9)	(0.9)	(2.2)	(1.4)	-	(15.2)	15.2	-	-
Actual expenses transferred from managing agency	0.9	0.7	0.5	0.3	1.0	0.4	0.8	1.2	-	5.8	(5.8)	-	-
Other operating expenses	-	-	-	-	-	-	-	-	-	-	4.8	(23.2)	(18.4)
<b>Total operating charges</b>	<b>(124.5)</b>	<b>(78.9)</b>	<b>(77.4)</b>	<b>(18.6)</b>	<b>(104.5)</b>	<b>(31.3)</b>	<b>(4.2)</b>	<b>(43.2)</b>	<b>(35.6)</b>	<b>(518.2)</b>	<b>16.6</b>	<b>(13.8)</b>	<b>(515.4)</b>
<b>Profit/(loss) from operations</b>	<b>(17.5)</b>	<b>2.9</b>	<b>(13.5)</b>	<b>-</b>	<b>1.1</b>	<b>(5.3)</b>	<b>9.2</b>	<b>6.5</b>	<b>(1.4)</b>	<b>(18.0)</b>	<b>-</b>	<b>(12.0)</b>	<b>(30.0)</b>
Finance costs	-	-	-	-	-	-	-	-	-	-	-	(4.0)	(4.0)
Other income from sale of subsidiary	-	-	-	-	-	-	-	-	-	-	-	14.7	14.7
Goodwill write-off	-	-	-	-	-	-	-	-	-	-	-	(6.9)	(6.9)
<b>Profit/(loss) before tax</b>	<b>(17.5)</b>	<b>2.9</b>	<b>(13.5)</b>	<b>-</b>	<b>1.1</b>	<b>(5.3)</b>	<b>9.2</b>	<b>6.5</b>	<b>(1.4)</b>	<b>(18.0)</b>	<b>-</b>	<b>(8.2)</b>	<b>(26.2)</b>

### 3. Segmental information (continued)

- 1 'Syndicate Participations' comprises the results of Chaucer participations on Syndicates 4000 and 4242.
- 2 'Run-off' comprises the results of Syndicates 1204, 1224, 1229 and 1245 that have closed into Syndicate 1084.
- 3 'Other' represents other corporate income and expense items, and the capital provision reinsurance contracts in two of Chaucer's corporate members.
- 4 The elimination of net expenses incurred in insurance activities includes fees and profit commissions charged by the managing agency to overseas operations and a portion of the defined benefit pension scheme deficit from the managing agency to Syndicate 1084. The portion recharged represents the contributions. The recharges from managing agency include the profit commissions, managing agency fees and rent invoiced by the managing agency to Syndicates 1084 and 1176 during 2009 and 2008. Consolidation eliminates the Group's share of the related income and expenses. In addition, the actual expenses incurred by the managing agency (shown as actual expenses transferred from managing agency above) in managing the syndicates are reclassified as net expenses incurred in insurance activities from other operating expenses in each division. The eliminations column eradicates these transactions. The Group calculates expense ratios on the net expenses incurred in insurance activities figure including the consolidation adjustments and reclassifications explained above. This is in line with previous years' practices.
- 5 The unadjusted items in the divisional analysis represent the items calculated in accordance with IFRS.

#### 4. Net investment return

	2009 £m	2008 £m
<b>Investment return by type of fund</b>		
Funds at Lloyd's and other corporate funds	10.7	(0.4)
Syndicate funds	43.1	(70.3)
Investment expenses	(0.5)	(0.3)
	<u>53.3</u>	<u>(71.0)</u>

Net investment return is further analysed as follows:

##### Funds at Lloyd's and other corporate funds

Interest income	8.5	4.6
Dividend income	0.3	0.6
Movement in unrealised gains less losses	1.9	(5.6)
	<u>10.7</u>	<u>(0.4)</u>

##### Syndicate funds

Interest income	16.8	15.6
Dividend income	0.3	0.3
Realised and unrealised gains and losses	26.0	(86.2)
	<u>43.1</u>	<u>(70.3)</u>
Investment expenses	(0.5)	(0.3)
	<u>42.6</u>	<u>(70.6)</u>

**53.3**      **(71.0)**

#### 5. Other operating income

	2009 £m	2008 £m
Managing agency fees and profit commissions	8.7	6.8
Other income (including rental income and commissions earned by overseas subsidiary)	2.5	2.4
	<u>11.2</u>	<u>9.2</u>
<b>Analysis of managing agency fees and profit commissions</b>		
Managing agency fees	6.7	4.6
Profit commission	2.0	2.2
	<u>8.7</u>	<u>6.8</u>
<b>Analysis of managing agency fees and profit commissions by source of the income</b>		
In-house syndicates (non-aligned share)	2.8	2.4
Third party syndicates	5.8	4.3
Run-off syndicates	0.1	0.1
	<u>8.7</u>	<u>6.8</u>

#### 6. Expenses incurred in insurance activities

	2009 £m	2008 £m
Gross acquisition costs	173.6	155.6
Change in gross deferred acquisition costs	(5.6)	(15.9)
	<u>168.0</u>	<u>139.7</u>
Syndicate operating expenses	26.3	29.6
Foreign exchange losses/(gains)	12.6	(35.9)
Personal expenses	5.8	6.0
<b>Gross operating expenses</b>	<u>212.7</u>	<u>139.4</u>
Net contribution from quota share reinsurers	(14.4)	(6.8)
	<u>198.3</u>	<u>132.6</u>

## 7. Other operating expenses

	2009 £m	2008 £m
Other operating expenses includes:		
Bonus payable to directors and managers	14.2	7.4
Depreciation of owned assets	1.9	1.9
Operating leases	3.2	3.1
Professional fees	2.8	-

The bonus payable to executive directors and certain other senior staff links to the profits of the Group. Professional fees relate to corporate finance costs in the first half of 2009.

## 8. Income tax expense/(credit)

	2009 £m	2008 £m
UK corporation tax at 28% (2008 28.5%)	9.8	13.8
Adjustment in respect of prior years	(1.6)	1.5
<b>Current tax</b>	<b>8.2</b>	<b>15.3</b>
Deferred tax movement (Note 10)	5.7	(22.6)
<b>Total deferred tax</b>	<b>5.7</b>	<b>(22.6)</b>
<b>Income tax expense/(credit)</b>	<b>13.9</b>	<b>(7.3)</b>

The tax charge for the year is higher (2008 credit is lower) than that resulting from application of the standard rate of corporation tax in the UK of 28% (2008 28.5%). The following table reconciles the tax expense/(credit) for the year to the profit/(loss) per the Income Statement.

	2009 £m	2008 £m
Profit/(loss) before tax	42.0	(26.2)
Tax at 28% (2008 28.5%)	11.8	(7.5)
Effects of:		
Expense/(income) not deductible/(taxable) for tax purposes	0.9	(2.0)
Impact of share price reduction in deferred tax assets	3.0	-
Other temporary differences	(0.3)	0.8
Adjustment in respect of prior years	(1.6)	1.5
Unrealised loss on revaluation of investment	0.1	0.3
Utilisation of previously unrecognised tax losses	-	(0.4)
<b>Total income tax expense/(credit)</b>	<b>13.9</b>	<b>(7.3)</b>

Reductions in the share price in late 2008 and 2009 caused a reduction in the deferred tax asset arising from the amortisation of the cost of the deferred bonus scheme. The scheme includes an element that is payable in shares, which vest three years after the date of grant. The associated cost of those shares is amortised in the Income Statement until the vesting date and is valued at the grant value of those shares. For tax purposes, the deductible expense is calculated using the share price at the vesting date. This has resulted in an additional tax charge in the year of £3m (or 7% in relation to the profit before tax).

## 9. Earnings/losses per share

	Earnings £m	Number of shares Million	Earnings per share Pence
<b>Year ended 31 December 2009</b>			
Basic, based on net profit for year	28.1	480.4	5.8
Diluted, based on net profit for the year	28.1	484.7	5.8
	Loss £m	Number of shares Million	Loss per share Pence
<b>Year ended 31 December 2008</b>			
Basic, based on net loss for the year	(19.0)	317.3	(6.0)
Diluted, based on net loss for the year	(18.9)	326.8	(6.0) <sup>1</sup>

<sup>1</sup> The dilutive impact on shares is excluded when it decreases the loss per share in accordance with IAS 33 Earnings per share

The calculation of the profit/(loss) for the year for diluted earnings per share is as follows:

	2009 £m	2008 £m
Net profit/(loss) for the year	28.1	(19.0)
Add interest on convertible loan stock net of tax	-	0.1
	<b>28.1</b>	<b>(18.9)</b>

The calculation of the weighted average number of shares outstanding for basic and diluted earnings per share is as follows:

	2009 Million	2008 Million
Unadjusted weighted average for the year	517.4	346.1
Elimination of own shares held	(37.0)	(28.8)
<b>Adjusted basic weighted average</b>	<b>480.4</b>	<b>317.3</b>
Potentially dilutive shares from convertible debt	-	1.8
Potentially dilutive shares from share options	4.3	7.7
	<b>484.7</b>	<b>326.8</b>

Total potential shares outstanding at the balance sheet date that were not dilutive, as vesting conditions with regards to price have not been met yet, but could potentially dilute earnings per share in the future, were 2.7m (2008 1.7m).

## 10. Deferred income tax

	2009 £m	2008 £m
The movement in the deferred tax asset comprises:		
At 1 January	21.3	(6.4)
(Charged)/credited in respect of revenue	(5.7)	22.6
Tax credited to equity	1.4	2.4
Acquisition of subsidiary	-	2.7
<b>At 31 December</b>	<b>17.0</b>	<b>21.3</b>
The deferred tax asset at 31 December comprises:		
Underwriting results	11.4	4.9
Other tax losses carried forward	5.3	5.9
Deferred bonus payment	6.2	8.2
Other temporary differences	4.0	2.6
Claims equalisation reserves	(9.8)	-
Capital allowances greater than depreciation	(0.1)	(0.3)
	<b>17.0</b>	<b>21.3</b>

The deferred tax liability relating to claims equalisation reserves arises for the first time this year as a result of a change in legislation under the Finance Act 2009. For Lloyd's corporate members, the calculation of a claims equalisation reserves is purely a tax adjustment and has no impact on reserving for accounts purposes or for capital setting.

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 will fall if the Group chooses to redomicile.

The Directors believe that there will be sufficient future taxable profits in order to utilise the above tax losses, based on the Group's forecasts. There were no unrecognised tax losses at the year-end (2008 £nil).

## 11. Financial assets

### Financial assets at fair value through profit and loss

	Cost £m	2009 Fair value £m	Cost £m	2008 Fair value £m
<b>Funds at Lloyd's and other corporate funds</b>				
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
	228.7	218.8	177.1	172.8
Other <sup>1</sup>	17.0	17.0	17.0	17.0
	245.7	235.8	194.1	189.8
<b>Syndicate participations</b>				
Equities	4.5	2.5	5.9	3.5
Hedge funds <sup>2</sup>	32.5	37.5	192.9	154.7
Absolute return bond funds	-	-	170.8	163.9
Bonds	528.0	532.9	255.0	246.5
Overseas deposits <sup>3</sup>	43.1	43.1	40.3	40.3
	608.1	616.0	664.9	608.9
	853.8	851.8	859.0	798.7

<sup>1</sup> In 2007, the Group invested £15m for a 13.7% shareholding of Antares Holdings Limited (Antares), a Bermudian based holding company established by Lightyear Capital LLC (Lightyear), a private equity firm focused on financial services investments. In November 2007, Antares issued the Group with an additional £2m shares in exchange for the provision of managing agency services in 2008 and 2009.

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

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

<sup>2</sup> At the end of 2009, hedge funds with a total value of £37.5m remained unlisted on an active market. In accordance with stated accounting policies, the Group valued these based on net asset values provided by independent third party fund administrators, by reference to listed securities of a similar nature or by using pricing models which are reviewed and approved by an independent pricing specialist (as applicable).

<sup>3</sup> Overseas deposits represent monies kept in overseas funds managed by Lloyd's. The funds are required in order to protect policyholders in overseas markets and enable the Group to operate in those markets. The access to those funds is restricted and the Group cannot influence the investment strategy.

## 12. Cash and cash equivalents

	2009 £m	2008 £m
Funds at Lloyd's	87.9	90.9
<b>Other funds:</b>		
Corporate	55.3	39.8
Syndicate	358.5	290.1
	<b>501.7</b>	<b>420.8</b>

The balances above represent cash.

The Group deposits Funds at Lloyd's to support 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.

### 13. Movements in equity

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 Group 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).

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 cost of the granted shares when employees exercise share options, less both the exercise price and the fair value of the share options previously expensed in accordance with IFRS 2.

Retained earnings represent the accumulation of profits and losses up to the balance sheet date, after the distribution of dividends and other adjustments. The balance includes £24.7m (2008 £19.7m) of accumulated actuarial losses resulting from the valuation of the pension scheme liability. Retained earnings can be distributed up to the level of realised retained earnings of the parent (2009 £38.7m; 2008 £36.7m).

#### 14. Technical provisions

	Provision for unearned premiums £m	Outstanding claims £m	Total £m
<b>Gross</b>			
At 1 January 2009	336.2	1,172.7	1,508.9
Claims paid in the year	-	(416.8)	(416.8)
Net movement in the year	27.0	491.1	518.1
Exchange and other adjustments	0.4	(78.3)	(77.9)
<b>At 31 December 2009</b>	<b>363.6</b>	<b>1,168.7</b>	<b>1,532.3</b>
At 1 January 2008	249.4	729.0	978.4
Claims paid in the year	-	(324.4)	(324.4)
Net movement in the year	57.8	482.7	540.5
Exchange and other adjustments	29.0	285.4	314.4
At 31 December 2008	336.2	1,172.7	1,508.9
<b>Reinsurance</b>			
At 1 January 2009	39.9	299.8	339.7
Reinsurance recoveries in the year	-	(86.3)	(86.3)
Net movement in the year	7.8	101.4	109.2
Exchange and other adjustments	-	(22.1)	(22.1)
<b>At 31 December 2009</b>	<b>47.7</b>	<b>292.8</b>	<b>340.5</b>
At 1 January 2008	32.0	191.7	223.7
Reinsurance recoveries in the year	-	(71.9)	(71.9)
Net movement in the year	1.8	118.3	120.1
Exchange and other adjustments	6.1	61.7	67.8
At 31 December 2008	39.9	299.8	339.7
<b>Net at 31 December 2009</b>	<b>315.9</b>	<b>875.9</b>	<b>1,191.8</b>
Net at 31 December 2008	296.3	872.9	1,169.2

During the year, movements in the reserves in respect of prior periods amounted to a release of £31.8m (2008 £74.1m). This release includes £0.6m (2008 £10.3m) associated with variations in rates of exchange during the year.

## 2009 events

Included within the technical provisions as at 31 December 2009 are reserves for:

- the fraud relating to Bernard L Madoff Investment Securities LLC (“Madoff”);
- specific losses on the Political Risk Trade Credit account; and
- the West Atlas loss

### Madoff

Syndicate 4000 and, to a lesser extent, Syndicate 1084 have significant exposure to Madoff related losses. During 2009, several new claims notifications were received and changes to previous assumptions have been made, with a comprehensive “bottom-up” analysis being carried out on individual notifications and loss probabilities on a gross basis, along with an in-depth review of the reinsurance available by year of account and currency.

The events surrounding these claims are complex and require the involvement of legal advisors to evaluate the validity and quantum of claims. The advice that the market is receiving from this evaluation process is causing it to adopt a more pessimistic view of emerging claims. At this stage the ultimate loss resulting from these events cannot yet be accurately determined.

### Political Risk Trade Credit account (“PRTC”)

During the year the Group was notified of significant claims associated to default of banking credit contracts as a consequence of the worldwide banking credit crisis. The claims generally related to private banks not honouring their letter of credit (LOC) agreements or banks acting as obligor to an insured that was unable to deliver on their obligations.

There is uncertainty surrounding the quantum of future claims in respect of the worldwide credit crisis. The Group has performed extensive analysis of the exposures, and the level of salvage resulting from expected recovery actions. In addition, economic depression allowances have been introduced in the reserving methodology. Based on the information available to date, the Group believes that the level of reserves is appropriate.

### West Atlas loss

This loss relates to a fire at the West Atlas rig in the Timor Sea and is estimated at a total cost of US\$700m.

Syndicates 1084 and 4000 have exposures to the losses above, as summarised below:

	Syndicate 1084 £m	Syndicate 4000 £m	2009 Total £m
<b>Estimated ultimate gross loss</b>			
Madoff	11.3	47.9	59.2
PRTC (Specific Losses)	49.4	-	49.4
West Atlas	21.0	-	21.0
	<u>81.7</u>	<u>47.9</u>	<u>129.6</u>
<b>Estimated ultimate net loss (after reinstatement premiums and reinsurance)</b>			
Madoff	5.3	15.9	21.2
PRTC (Specific Losses)	33.9	-	33.9
West Atlas	12.2	-	12.2
	<u>51.4</u>	<u>15.9</u>	<u>67.3</u>
<b>Group share of estimated ultimate net loss (after reinstatement premiums and reinsurance)</b>			
Madoff	5.0	15.9	20.9
PRTC (Specific Losses)	32.1	-	32.1
West Atlas	11.3	-	11.3
	<u>48.4</u>	<u>15.9</u>	<u>64.3</u>

Figures are prepared at rates of exchange in place at the end of the year.

Other significant 2008 loss events reported last year, including Hurricane Ike, sub-prime losses and financial turmoil reserves, are not included in the above table as their development during 2009 has been in line with expectations.

## Reinsurance

The Group's reinsurance policies protecting the losses in the above table are predominantly with reinsurers rated A (strong) or better by Standard & Poor's, as analysed below:

Rating bands (as at 12 February 2010)	Madoff %	PRTC %	West Atlas %
<b>Syndicate 1084</b>			
Lloyd's syndicates (A+)	24.8	9.8	16.7
AA	55.0	45.0	41.1
A (excluding Lloyd's syndicates)	20.2	45.2	42.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Syndicate 4000</b>			
Lloyd's syndicates (A+)	16.2	-	-
AA	32.8	-	-
A (excluding Lloyd's syndicates)	51.0	-	-
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

## 15. Net asset value per ordinary share

The net asset value per ordinary share and net tangible asset value per ordinary share have been calculated on the equity balance and equity less intangible assets, respectively, and using the number of ordinary shares in issue at the year end, adjusted by own shares held, as shown below:

	2009	2008
Equity funds	£316.7m	£225.5m
Number of adjusted shares	513.0m	309.2m
<b>Net asset value per ordinary share</b>	<b>61.7p</b>	<b>72.9p</b>
Equity funds less intangible assets	£284.6m	£193.4m
Number of adjusted shares	513.0m	309.2m
<b>Net tangible asset value per ordinary share</b>	<b>55.5p</b>	<b>62.5p</b>
Number of shares in issue	548.1m	348.1m
Less own shares held	(35.1)m	(38.9)m
<b>Number of adjusted shares</b>	<b>513.0m</b>	<b>309.2m</b>

## 16. Reconciliation of profit/(loss) before tax to cash generated from operations

	2009 £m	2008 £m
Profit/(loss) before tax	42.0	(26.2)
Net investment return less finance costs	(49.2)	75.0
Depreciation of tangible fixed assets	1.9	1.9
Increase of technical provisions	23.4	415.9
Increase of reinsurers' share of technical provisions	(0.8)	(95.2)
Decrease/(increase) in other debtors	52.1	(60.4)
(Decrease)/increase in other creditors	(13.4)	13.5
Increase/(decrease) in accruals	(0.7)	(3.6)
Increase in deferred acquisition costs	(5.8)	(14.8)
(Increase)/decrease in prepayments	(11.9)	2.5
Decrease in employee benefits provision	(0.2)	(1.3)
Unrealised foreign exchange on cash and cash equivalents	11.9	12.0
Foreign exchange in subordinated debt	(4.8)	11.9
Increase in bonus provisions: charge to Income Statement	9.4	4.8
Sale of subsidiary	-	(14.7)
Goodwill written off	-	6.9
Share options cost	0.6	-
<b>Cash generated from operations</b>	<b>54.5</b>	<b>328.2</b>

## 17. Dividends

	2009 £m	2008 £m
<b>Final dividend for the year ended:</b>		
31 December 2007: 3.5p per ordinary share, paid on 27 June 2008	-	11.6
<b>Interim dividends for the year ended:</b>		
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
	<b>18.6</b>	<b>17.3</b>

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

## 18. Financial information and posting of accounts

The financial information set out above does not constitute the Company's statutory accounts for the year ended 31 December 2008 or 2009, but is derived from those accounts. Statutory accounts for 2008 have been delivered to the Registrar of Companies and those for 2009 will be delivered following the Company's Annual General Meeting. The auditors have reported on the 2008 accounts; their report was unqualified and did not contain statements under Section 237(2) or (3) of the Companies Act 1985. The auditors have not yet signed their report for the year ended 31 December 2009 but are expected to sign their opinion on 6 April 2010.

The audited Annual Report for 2009 is expected to be posted to shareholders by no later than 19 April 2010. Copies of the Report may be obtained from that date by writing to the Company Secretary, Chaucer PLC, Plantation Place, 30 Fenchurch Street, London, EC3M 3AD. The Annual General Meeting of the Company will be held at the same address at noon on 19 May 2010.

The Board approved the Preliminary Results on 5 March 2010.