Hiscox Ltd Report and Accounts 2010

Contents

HISCOX

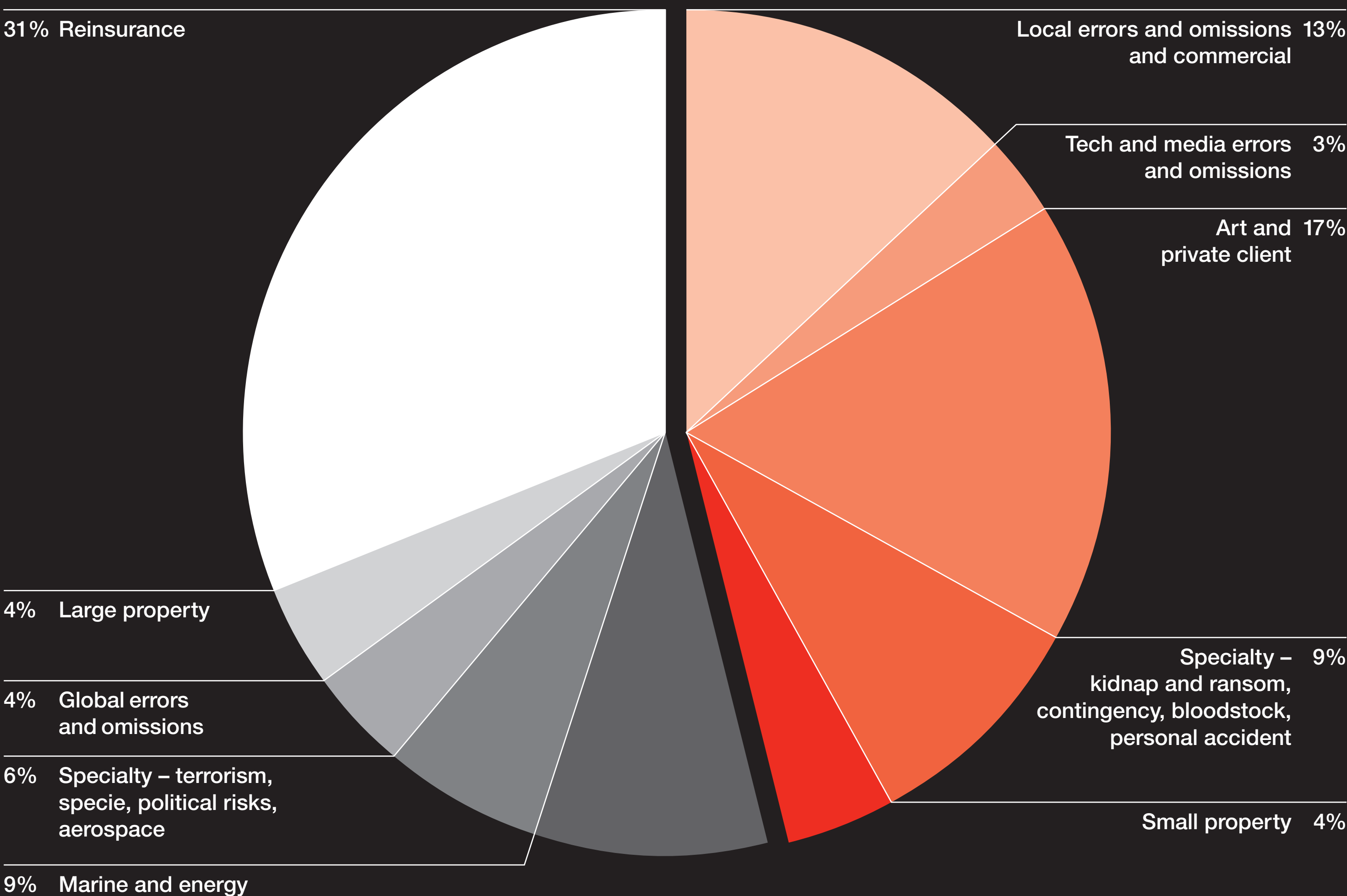
Our ambition is to be a highly respected specialist insurer with a diverse portfolio by product and geography. We believe that building balance between catastrophe-exposed business and less volatile local specialty business gives us opportunities for profitable growth throughout the insurance cycle.

Our strategy is:

- to use our underwriting expertise in London and Bermuda to write high-margin volatile or complex risks;
- to build our distribution in the UK, Europe and the US for our specialist retail products;
- to protect and nurture our distinctive culture and ethos by recruiting the best people, and by focusing on organic growth.

Strategic focus
Total Group controlled income for 2010

100% = £1,671m



Corporate highlights

Group key performance indicators

	2010	2009
Gross premiums written (£m)	**1,432.7**	1,435.4
Net premiums earned (£m)	**1,131.2**	1,098.1
Profit before tax (£m)	**211.4**	320.6
Profit after tax (£m)	**178.8**	280.5
Earnings per share (p)	**47.2**	75.2
Total dividend per share for year (p)	**16.5**	15.0
Net asset value per share (p)	**332.7**	299.2
Group combined ratio excluding foreign exchange (%)	**89.8**	82.2
Group combined ratio (%)	**89.3**	86.0
Return on equity (%)	**16.5**	30.1

Operational highlights

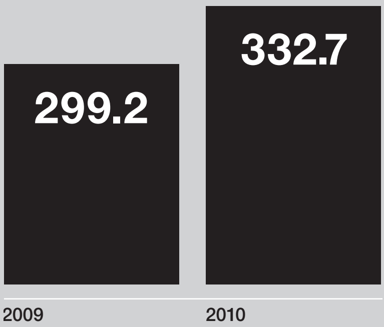
Hiscox London Market focused on margin over growth, reducing income by 13.6% and delivering profits of £121.4 million despite catastrophes.

Specialist retail businesses in the UK and Europe delivered good growth and doubled profits, again despite catastrophes.

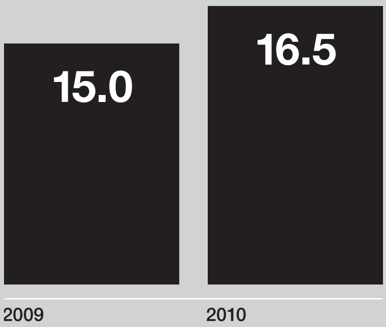
Rates still attractive in reinsurance and stable in other specialty lines.

The first 'direct from insurer' small business offering in the US launched with promising early results.

Net asset value p per share



Dividend p per share



3.6%
Investment return

Why invest in Hiscox?

We are a leading specialist insurer with:
- **balance that creates opportunity throughout the cycle;**
- **strong financial performance;**
- **a transparent approach to risk;**
- **specialist expertise that is valued by our customers.**

Our business
A balanced portfolio that creates opportunity throughout a cyclical market

Hiscox's strategy is to balance the more volatile catastrophe-exposed insurance and reinsurance with steady local specialty insurance. Our diversity by product and geography gives us great flexibility, particularly in a tough commercial environment. We are able to grow and shrink the catastrophe-exposed lines according to market conditions. Currently, rates for reinsurance, which makes up almost a third of our income, are healthy. When these rates are no longer favourable, we have the flexibility to shrink this side of the business. Our local specialty insurance business tends to be steadier throughout the insurance cycle and we have successfully grown our retail lines by 11.3% year-on-year over the last five years.

Our performance
Strong financial performance

Hiscox has a strong record of top-line growth with a focus on ROE. Performance highlights between 2006 and 2010 include:
- increased gross written premiums by 27.2% to over £1.4 billion
- healthy combined ratio averaging 85.0%
- delivered average ROE of 22.7%
- maintained a progressive dividend policy with compound growth of 13.3%.

Our expertise
A transparent approach to risk

The very business of insurance is managing risk. The understanding of risk is intrinsic to every level of decision-making in the Group. We devote a great deal of expertise to understanding the impact of global events and model these rigorously. We also draw on over 100 years of experience in insurance to assess these risks.

Catastrophes such as hurricanes and earthquakes could hit at any time, and naturally would have an impact on our business. Therefore twice a year, in our analysts' presentations and on our website, we publish estimates of what the Group's losses would be should such a catastrophe occur.

Our people
Specialist expertise that is valued by our customers

We are market leaders in many of our specialist areas and our customers value the expertise and cover we provide.

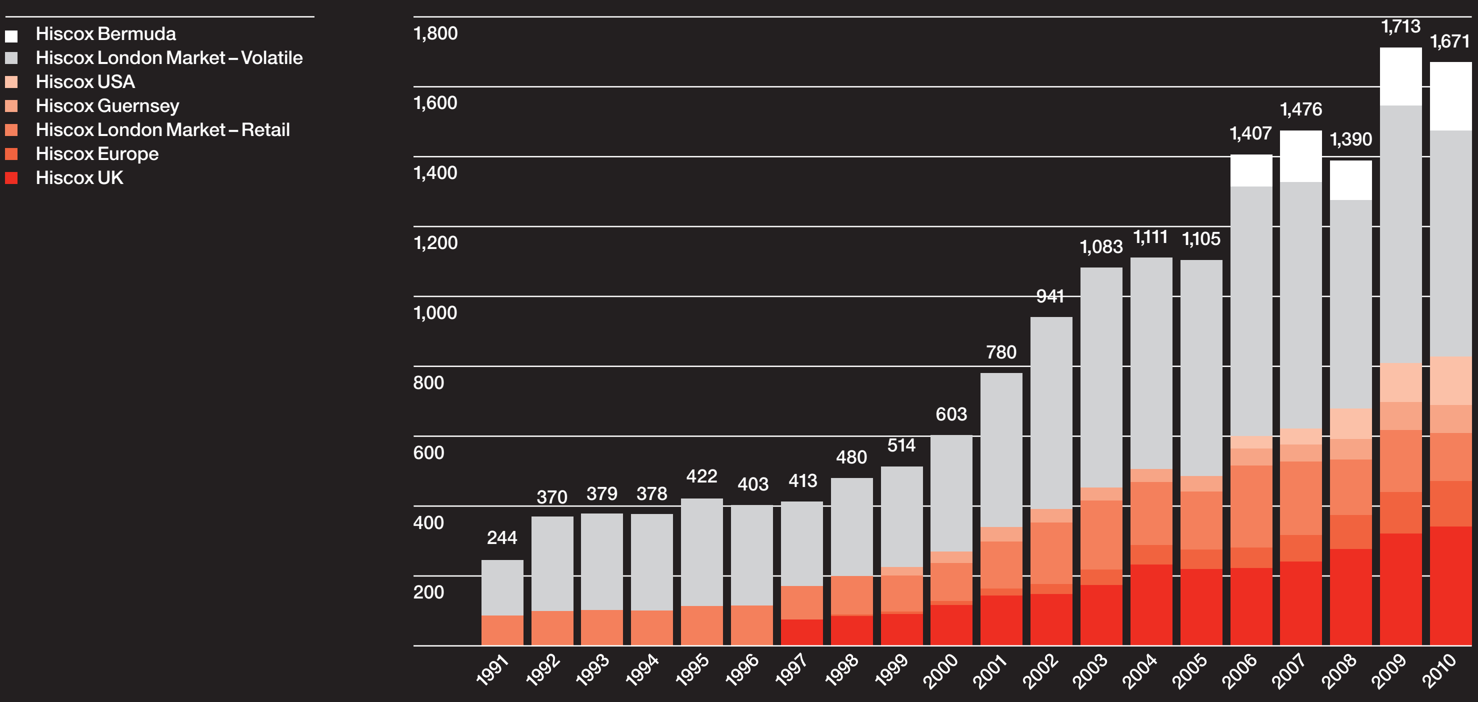
What our UK customers said:*
- 98% of business insurance customers were satisfied that we spoke to them in a clear way and avoided using financial jargon
- over 90% of our home insurance customers surveyed were satisfied with the way we settled their claim.

In Europe, a survey** of our brokers saw Hiscox rated the top insurer for superb service and the best claims service.

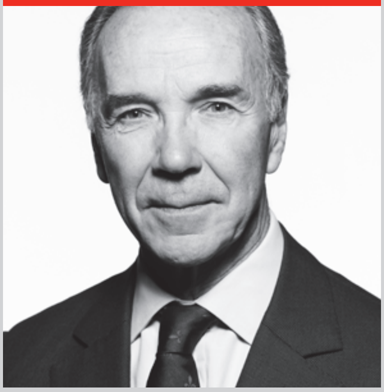
In 2010 Hiscox UK was awarded Specialist Insurance Provider of the Year by Spears Wealth Management and became a Which? recommended provider for home and contents insurance. On the commercial side, Hiscox UK won Best Small Business Insurance award for the second year running at the Start Your Business Awards 2010.

* Results from our monthly customer satisfaction survey for customers telephoning one of our UK-based contact centres.
** Results from a survey of 301 existing household/commercial brokers in Belgium, France, Germany and the Netherlands between November 2010 and January 2011.

Building a balanced business
Gross premiums written at 100% level (£m)



Chairman's statement



Robert Hiscox
Chairman

In our 2010 Interim Statement I said that a half-year profit of £97.2 million was a testament to the strength of our business given the unnatural number of natural catastrophes (and one massive oil spill) during the period. Well, Mother Nature has well and truly tested us further in the second half and a full-year pre-tax profit of £211.4 million is further strong evidence of the resilience of our business.

Our long-term strategy has been to build a balanced book of international businesses, retreating from any area when the competition gets foolish and advancing when we can charge the proper price. It seems an immutable rule of insurance that a big loss will hit the area of weakest rates, and this year has proved the rule. We were underweight in Chile, New Zealand and Australia, had declined a significant insured in the oil spill and had pruned our UK household book, as our view was that each area was under-rated for just the catastrophes which have occurred.

Results

The result for the year ending 31 December 2010 was a profit before tax of £211.4 million (2009: £320.6 million) on a gross written premium of £1,432.7 million (2009: £1,435.4 million). The combined ratio was 89.3% (2009: 86.0%). Earnings per share on profits after tax were 47.2p (2009: 75.2p) and net assets per share increased to 332.7p (2009: 299.2p). The return on equity was 16.5% (2009: 30.1%).

Dividend, balance sheet and capital management

The Board proposes to pay a final dividend of 11.5p (2009: 10.5p) on 21 June 2011 to shareholders on the register on 13 May 2011, making total dividends for the year of 16.5p (2009: 15.0p) an increase of 10%, in line with our policy of steady dividend growth. Subject to shareholder approval at the forthcoming Annual General Meeting, a scrip dividend alternative to the cash dividend is to be offered to shareholders and the Company's Dividend Access Plan will be suspended. The balance of profit retained helps to increase the net asset value per share which, combined with dividend growth, underpins the share price. Growth in net assets per share will inexorably drive the share price up whatever rating Mr Market puts on our shares or the sector.

New Directors

In December we appointed two distinguished and very experienced new Non Executive Directors, Richard Gillingwater and Robert (Bob) McMillan, to the Hiscox Ltd board. Richard Gillingwater is currently the Dean of Cass Business School and brings vital knowledge from his experience in the financial services sector. Richard has now been appointed Senior Independent Director replacing Andrea Rosen who was acting in the role following the death of Sir Mervyn Pedelty in January 2010. Bob McMillan has been a member of our US board since 2007 and his knowledge of retail insurance from his time with the Progressive Insurance Company has proved invaluable.

Courage and creativity

It takes courage to go against the herd, to pioneer in new areas, or to say no to major suppliers of business. In 1993, when Bronek Masojada joined, we were a simple underwriting agency. It would have been easy to remain so, solely managing syndicates in Lloyd's. It would have been easy to have expanded through Lloyd's only, or outside Lloyd's in the UK only; it would have been easy to accept business only from brokers. As it is, since 1993, we have raised the capital to go from agent to principal, formed insurance companies, opened offices in Bermuda, throughout the UK, Europe and the USA, expanded our distribution channels to include direct offerings, and moved our domicile to Bermuda. Our leading value is courage, and we will continue to develop the business in our own way while watching closely, but not following, the herd.

Our emphasis has always been on organic growth and start-ups which are tougher than the instant gratification of acquisitions, but mean that we build what we want. Investing is a word used by politicians to cover expenditure so I am reluctant to use it on our expansion in new areas, but new ventures take time to grow to profitability and I do consider them an excellent investment. We have written off the cost of building businesses against the profits of the day, and those businesses are now in many cases yielding a handsome return. Our UK and European regional offices are now an indispensable and profitable part of our distribution, and I believe our US offices will be so too when they reach critical mass. Our direct business in the UK now makes good money and has enormous growth potential. Our new direct offering in the US – the first direct commercial policy from an insurer – is in pre-marketing phase and showing promise.

The insurance cycle

General insurance is a great business as there is an insatiable and constantly growing demand for it. What drives rates up and down is supply of capital in the industry, combined with management weakness.

A small example of management weakness: the premium for piracy of ships in the Gulf of Aden can be calculated very roughly by relating the number of journeys through the Gulf to the number of successful kidnaps by pirates. We had built a rating for this and were trading successfully when the competition decided to under-cut our rates by about 50%. At the same time, the pirates doubled their demands. How can any management allow an underwriter to compete at a quarter of the rates of the established market? We have continued to quote the sensible rate which effectively leads to our doing less business. We will be back when our competitors realise their folly and withdraw from the market, as some already have.

Chairman's statement continued

Fortunately the reinsurance market is more disciplined as are many of the areas in which we specialise. We will not compete to hold market share but will underwrite selectively regardless of top line. There is talk that a major market loss is needed to turn the market, and it would appear that some competitors are hanging on to business at the wrong rate hoping that a big bang somewhere will enable them to increase the price. I personally hope that there continues to be a constant attrition of medium losses and no major event so that discipline has to be learnt the hard way.

Broker remuneration

The vast majority of our business comes from brokers and undoubtedly always will. Their job is a difficult one. They have to assess the risks of their diverse clients and transfer those risks to insurers at a reasonable price. Their definition of reasonable and ours will obviously sometimes conflict, and we must have the discipline to say no – sometimes not easy to do to a robust provider of business.

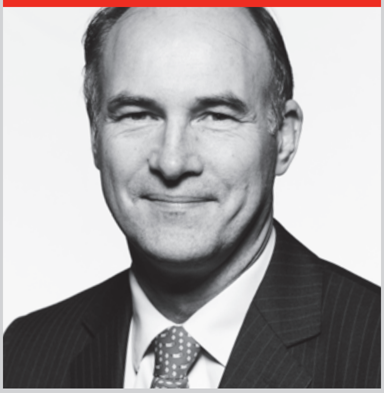
A deficiency in the insurance market has long been how the broker is remunerated. The clients should pay the broker, as they do their other advisers, for the advice given and the work done to transfer the risks. However, in our market, the insurer has traditionally paid the brokers through giving them a slice of the premium as brokerage or commission. This not only leads to obvious conflicts (the higher the premium, the bigger the pay; the placing of business with the highest payer of commission not the best insurer), but also made the clients believe that they got the services of brokers for nothing. As fees have properly grown to be the correct way to pay the broker, the broker fraternity have had to learn how to cost their services, and have been reluctant to charge the proper fee. They have also competed with each other to a ridiculous extent on fees. Not getting enough revenue as a result, they bring pressure on the insurers to make up the deficiency. This is a big issue at the moment, and I just hope that it will be resolved sensibly before a solution is imposed either by the law, or again by a crusading regulator.

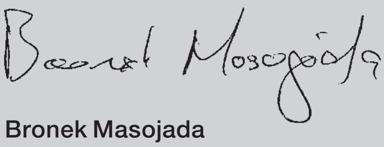
The future

We are building a business with a brand based on trust. We strive to offer flexible, intelligent underwriting backed by great service which people will want to buy for peace of mind, knowing they will be made good in times of loss, and definitely not because it is the cheapest in the market. But our brand has to be built on the behaviour of our people, and I am very grateful to them for their excellent work which led us to be voted the most trusted insurer in the UK. When I see the calibre of the staff throughout the Group, I am confident that the creativity and growth of the last decade will continue strongly over the next.

Robert Hiscox
Chairman
28 February 2011

Chief Executive's report





Bronek Masojada
Chief Executive

In 2010 Hiscox made a pre-tax profit of £211.4 million, a good result considering the low returns on offer in the investment markets and the large number of catastrophes the industry faced. This result reflects the diverse strengths of our businesses: Hiscox London Market and Hiscox Bermuda showed outstanding discipline in their risk selection, while our specialist retail businesses in the UK, Europe and Guernsey strengthened their market positions by focusing on quality products sold at a fair price with a fast and friendly claims service; our US business continues to build critical mass in a difficult market.

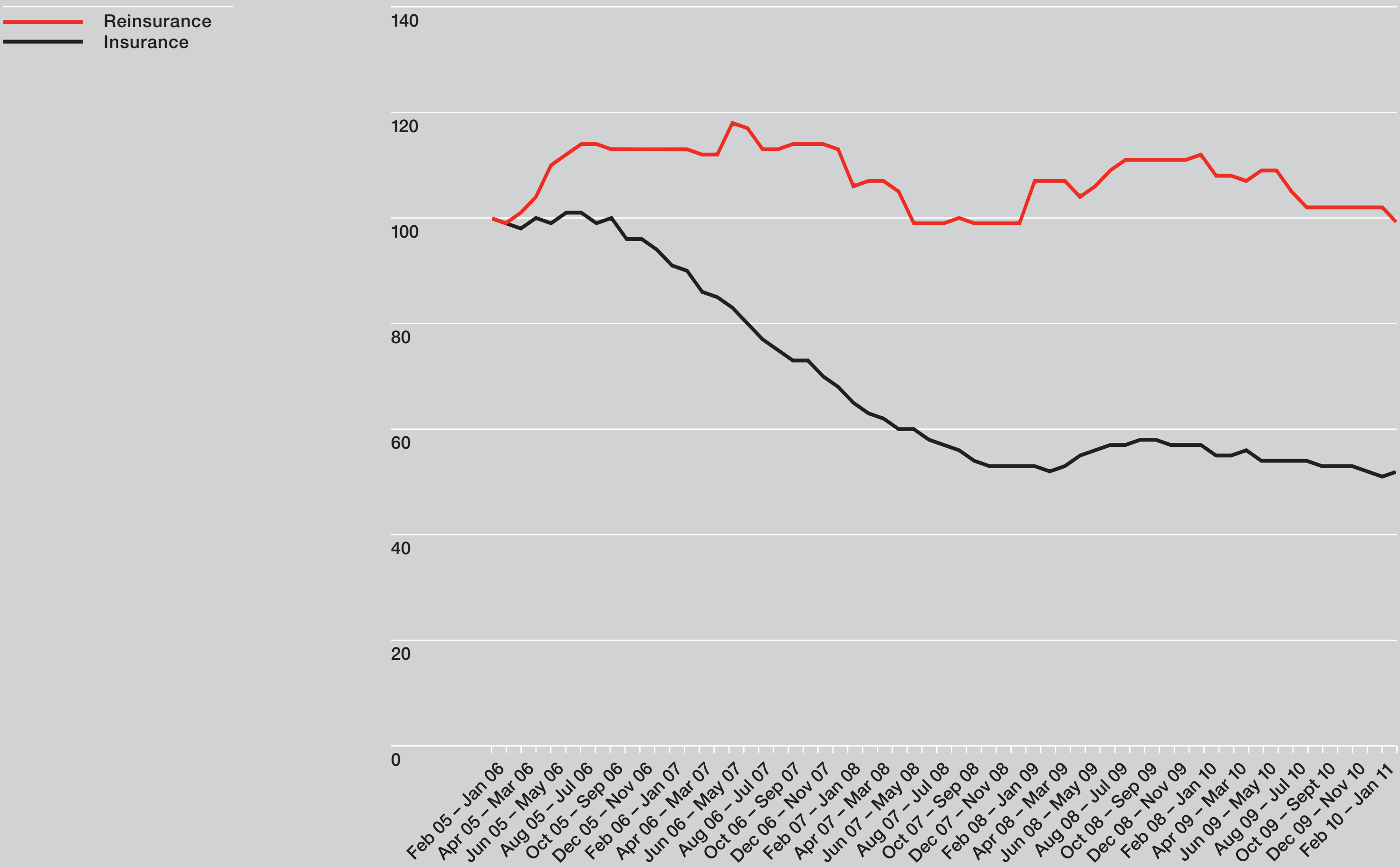
2011 will test the industry further as prices remain under pressure and investment returns diminish. Our long-term strategy of balance and diversification has built a business designed for these conditions. Hiscox always plans for profit throughout the cycle, so our London Market and Bermudian businesses will maintain the same excellent underwriting discipline they showed in 2010 and it will be the turn of our specialist retail businesses to drive the Group forward.

Hiscox London Market
Our London Market business has been the powerhouse of the Group. It delivered a pre-tax profit of £121.4 million (2009: £179.9 million). This result, though lower than 2009, was helped by some canny underwriting decisions, particularly around Deepwater Horizon and the Chilean earthquake. In each case disciplined underwriting, with a focus on margin over volume, led us to incur claims that were substantially below the market average. This discipline also led to a reduced premium income of £572.7 million (2009: £663.0 million), a trend that will continue in 2011.

The London Market business is managed through the following six product lines:

- **Reinsurance:** This remains our largest line of business, accounting for £234.9 million of premium income. This division took the brunt of Hiscox losses arising from Chile and New Zealand – amongst others – but the fact that it still made a profit shows the excellence of its people and portfolio. It enjoys a great reputation in the market, which has enabled it to attract substantial quota share reinsurance support from other syndicates and major European and global insurers. This allows us to play an influential role in the market while keeping within our risk appetite. The important January 1 renewals were largely within our expectations, with modest reductions in pricing. Margins remain attractive but this line of business

Hiscox Group rating index
Index level (%). 12-month rolling period



Chief Executive's report continued

Hiscox London Market

	2010 £m	2009 £m
Gross premiums written	**572.7**	663.0
Net premiums earned	**396.1**	453.3
Underwriting profit	**70.6**	136.0
Investment result	**39.1**	79.7
Foreign exchange	**11.7**	(35.8)
Profit before tax	**121.4**	179.9
Combined ratio	**79.7%**	78.8%
Combined ratio excluding foreign exchange	**81.8%**	71.0%

Hiscox UK

	2010 £m	2009 £m
Gross premiums written	**327.0**	304.0
Net premiums earned	**302.6**	261.0
Underwriting profit	**16.2**	7.3
Investment result	**12.4**	22.7
Foreign exchange	**0.2**	(0.9)
Profit before tax	**28.8**	29.1
Combined ratio	**94.6%**	97.9%
Combined ratio excluding foreign exchange	**94.7%**	97.6%

will shrink gradually as we trim our exposures in response to lower rates.

- **Property:** Our primary focus is catastrophe-exposed property risks of global companies, homeowners and small businesses. Property rates have been under pressure for some time and we have substantially reduced premium income to £95.7 million (2009: £137.4 million). Our experience is that good underwriting decisions like these, although painful to execute in the short-term, serve the business well over the long-term. We will return to serve customers with our previous risk appetite when our competitors, who have made this segment uneconomic, retreat nursing their losses, as they inevitably will. As regards our non-catastrophe-exposed activities, during the year we entered the mechanical equipment insurance market through a relationship with a respected underwriting team.

- **Marine and energy:** Good disciplined underwriting based on sound appreciation of the technical facts meant we had minimal exposure to those affected by the Deepwater Horizon loss. We have achieved good results in this sector and have the risk appetite to expand if rates rise during the course of 2011.

- **Specialty:** Our specialty lines benefit from operating in niche markets including personal accident, event cancellation and abandonment, terrorism, political risks and kidnap and ransom. Specialty continues to perform well and has enjoyed significant releases from reserves as recoveries were made on political risk claims.

- **Casualty:** This market, particularly US casualty, remains under pressure and so this line shrank during the year. We had expected to see some losses arising out of the global financial crisis but, so far, these have not materialised. We expect to remain a modest participant in this market for as long as rates remain at their current levels.

- **Aviation and aerospace:** Hiscox has had a long-standing participation in the insurance of satellites, both at launch and in orbit. Savvy technical ability meant that we were not involved in some of the major losses that affected this class during the year. We also welcomed to Hiscox a specialist aviation team, who came on board in the second half of the year. Our goal is to build a material business, but only when conditions are right.

Looking forward, we expect pricing in the London Market to remain challenging. Generally market prices are under pressure, so it is only through increasingly selective underwriting that we can retain business at attractive prices. We are convinced this is the right approach, even though it may mean that our premium income (and exposure) falls in the year ahead.

Hiscox UK and Europe

Our businesses in the UK and mainland Europe have a focus on art and private client insurance for wealthy individuals, property and liability insurance of small commercial enterprises, and on errors and omissions insurance for technology and media businesses. We market our products through brokers and direct to our customers. In the year we have seen continued growth while increasing our profitability. Total profit before tax for the year was £39.6 million (2009: £20.5 million) on total premium income of £454.7 million (2009: £421.0 million).

- **Hiscox UK:** Hiscox UK's premium income grew by 7.6% to £327.0 million (2009: £304.0 million) and the combined ratio improved to 94.6% (2009: 97.9%). Profits remained virtually flat at £28.8 million (2009: £29.1 million) despite total catastrophe losses of £28 million arising from the UK freezes in January and November/December and event cancellation losses arising from the Icelandic volcanic ash cloud. In addition, Hiscox UK experienced some recession-related errors and omission losses. This good performance shows the resilience of our business. The art and private client team deserves to be singled out for praise. In late 2009 they decided that on technical grounds prices were inadequate and implemented price rises of approximately 5% in a falling market. Their discipline was rewarded by a profitable result despite the many challenges of the year. Our commercial area achieved profits, albeit at lower levels than 2009. The direct business continues to expand with the top line growing by almost 20%. This business achieved a good level of profit in aggregate. In addition to the benefits of good underwriting, Hiscox UK has also seen the fruits of a sustained focus on expense ratio.

  We are positive about the future. We have entered a new underwriting partnership with Dual, an established MGA, where we have taken a 25% share of their existing book of business. We also expect to see our direct business continue to develop. We are cautious about our broker-generated business as we believe that the market will remain soft. The ability of Hiscox UK to withstand market pressures in 2010 shows the strength of our specialist market position and we are confident that it will continue to enhance the value of the Group going forward.

- **Hiscox Europe:** Hiscox Europe had a tremendous year and made a profit of €11.9 million (2009: €0.4 million). The top line grew by 11.5% to €146.7 million (2009: €131.6 million), and it achieved a combined ratio of 97.4% (2009: 114.6%). This improvement

Hiscox Europe

	2010 €m	2009 €m
Gross premiums written	**146.7**	131.6
Net premiums earned	**134.7**	123.2
Underwriting profit/(loss)	**6.2**	(15.8)
Investment result	**5.7**	16.2
Foreign exchange	**–**	–
Profit before tax	**11.9**	0.4
Combined ratio	**97.4%**	114.6%
Combined ratio excluding foreign exchange	**97.4%**	114.6%

Hiscox International

	2010 £m	2009 £m
Gross premiums written	**405.2**	351.4
Net premiums earned	**312.9**	277.5
Underwriting profit	**18.1**	59.5
Investment result	**27.6**	57.7
Foreign exchange	**(2.6)**	7.0
Profit before tax	**43.1**	124.2
Combined ratio	**97.3%**	76.3%
Combined ratio excluding foreign exchange	**96.4%**	78.6%

was driven by a number of factors. First, we have made progress in breaking down the silos separating country units, ensuring that lessons learned in one market are rapidly transferred to the others. Second, our creation of a pan-European service centre in Lisbon has allowed us to take advantage of pan-European economies of scale. Third, our decision to invest in the growth of our smaller commercial and technology businesses has paid off; and, fourth, the art and private client teams improved the quality of their book with the application of a more sophisticated pricing approach. We also created a new specialty line that sells kidnap and ransom and related products from our local offices to local brokers and experimented with a direct offering in France. In aggregate, these actions drove growth, improved the loss ratio and reduced the expense ratio. Hiscox Europe is, I believe, now in a position to become a sustainable contributor to the Group.

Hiscox International

Hiscox International comprises our businesses in Bermuda, Guernsey and the US. Aggregate premium written grew by 15.3% to £405.2 million (2009: £351.4 million), though profits dropped to £43.1 million (2009: £124.2 million).

- **Hiscox Bermuda:** Our Bermudian business, supported by a significant third-party quota share reinsurance, was able to grow its income by 15.6% to $303.8 million (2009: $262.9 million). After a relatively loss-free 2009, profits were hit by the Chilean and New Zealand earthquakes. During the year our healthcare team established itself as a sensible player in the market. In 2011 we expect to see pricing in the reinsurance market remain under pressure and as a result our Bermuda business will shrink.

- **Hiscox Guernsey:** The team showed great discipline in the piracy market, increasing prices in the face of increasing attacks, higher demands from pirates and the bizarre decision of some of our competitors to slash their prices. This inevitably led to a reduction in piracy revenues but Hiscox Guernsey remained overall flat. Our fine art business had a very good year with modest growth in premiums and increased profits. Our team in Guernsey also provides product leadership for kidnap and ransom across the Group, and their hard work during the year saw us consolidate our position as a worldwide leader in this field, with particular growth in Europe, the US and Latin America.

- **Hiscox USA:** Hiscox USA had a tough year. Premiums grew 22.4% to $198.3 million (2009: $162.1 million), but profitability was weak, in part due to some claims from long-standing large technology risks. In early 2009 we made a significant investment in the operation, believing that the financial crisis would allow us to recruit good people and that customers' concerns about financial stability would lead to a re-rating in the market. We were correct in our first assumption and are very pleased with the strength of talent we attracted, but the effective guarantee given by the government to some of the weaker players meant that rather than a market re-rating, prices actually fell further. Our philosophy of underwriting for profit over volume meant that in this challenging pricing environment we did not reach the scale we expected. In the middle of 2010 we took decisive action and adapted accordingly. We decided to focus our errors and omissions and property business through wholesale brokers only and to concentrate our specialist lines (kidnap and ransom, terrorism, construction, media and not-for-profit directors and officers) on major brokers in those niches. This led to the sale of our animal mortality business and the closure of our Boston office. These swift but necessary actions will allow us to keep focusing on building a quality business in what remains a very difficult market.

A milestone was the launch of our US direct commercial business. Our test site opened for business in November 2010, selling errors and omissions, commercial general liability and property owners' business to firms of zero to ten employees in 15 states. We expect to work on improving our processes and infrastructure during the first quarter of 2011 and once this is stable and working effectively we will support the business with a significant marketing investment. We expect that in time we will see a repeat of the success we enjoy in the UK.

Claims

It is only when a customer claims that you can live up to your brand promise. Our claims operations across the world were tested during 2010 and the team rose to the challenge. The year began with the challenges of Windstorm Xynthia and a freeze in the UK. It was followed by the earthquake in Chile and losses arising from the Icelandic volcanic ash cloud. The year continued with Deepwater Horizon, the New Zealand earthquake, riots in Thailand, the December freeze in the UK and, finally, the beginning of the Australian floods. Throughout this succession of calamities our claims teams have paid claims with the utmost efficiency and effectiveness. We strongly believe that a claim paid fairly and fast creates a competitive advantage, and judging by customer feedback we largely achieve this goal.

In my statement last year I expressed our concerns about the proposed Lloyd's Claims Scheme. Some of these seem to have been recognised now by others in the market and we hope that as Lloyd's finalises changes in 2011 it takes these concerns on board. We firmly believe that the need to provide a single point of notification for all claims, to differentiate between large and small claims and to provide a market-wide service for small claims must be recognised. Lloyd's claims handling, particularly on syndicated risks, is the cornerstone of its enviable reputation, so it is imperative that the market provides an effective unified solution.

Investments

During the year our investment portfolio, excluding derivatives, delivered a return of £98.8 million, a yield of 3.6% on an average portfolio of £2,717.5 million. The market was testing but on balance rewarded those prepared to take some measured risk. As a result our bond portfolio performed well, as our decision to maintain a healthy allocation to credit paid off. Our risk assets, a selection of equity and hedge funds, produced a good return but in aggregate under-performed their long only equity benchmark. The composition and benchmarking of risk assets will be a focus of attention in 2011. We expect market returns in the near term, particularly from bonds and cash, to remain low. However, we prefer to preserve the balance sheet, accepting the lower income on offer, rather than to stretch further for yield in credit, duration or structured products.

Operations and IT

As our specialist retail businesses have grown we have needed to increase the robustness of our processes. Last year, across the Group, we issued 370,000 policies and settled 40,000 claims. We rely on the efforts of many dedicated and professional operations and IT staff to deliver the services and infrastructure to do this effectively. Their high standards and those of our front line underwriters and claims handlers have helped us build the best reputation of any UK insurer, according to a 2010 consumer study by the Reputation Institute. The reduction in our expense ratios in the UK and Europe reflects the improving efficiency of our processes. Over a four-year period this has dropped by 6%, making a substantial contribution to profits.

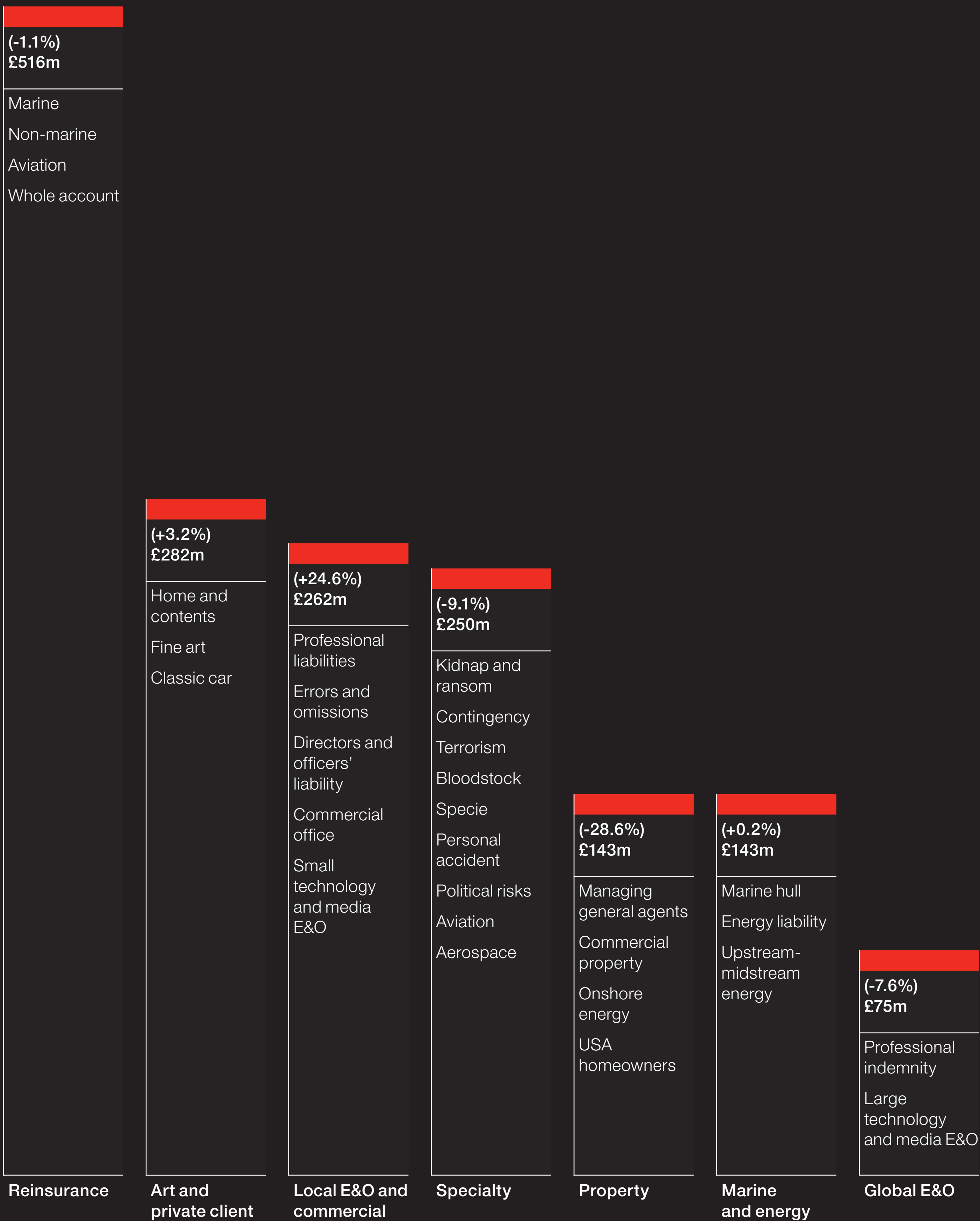
We can never be satisfied with how we are doing. During 2010 we conducted a 'lean' process review of a number of areas. In each case we identified significant improvements, whether in the timeliness of our underwriting reviews, the quality of our data or the cost of our service. The implementation of these recommendations will, over time, lead to continued improvements in our expense ratio.

Solvency II

The European insurance industry is in the midst of a tremendous change driven by the introduction of a new regulatory framework called Solvency II. The framework has three essential elements called 'pillars': Pillar 1 covers the amount of capital we must hold; Pillar 2 focuses on governance and risk management; Pillar 3 on transparency and disclosure. As a Bermuda domiciled group we are in a slightly anomalous situation. We expect to apply Solvency II principles consistently across our Group, with the Bermuda Monetary Authority

Actively managed business mix

Total Group controlled premium December 2010: £1,671m
(Year-on-year change in original currency)



Chief Executive's report continued

(BMA) acting as our lead regulator, but with collaboration with the Financial Services Authority (FSA) and Lloyd's in the UK, and other regulators in other jurisdictions. The BMA has applied to the EU for approval as an 'equivalent regulator'– effectively that European supervisors can rely on its judgement – and it is making great progress on meeting the various tests which will be applied to it. Success in achieving equivalence will mean that Hiscox is able to apply a single consistent framework across the Group.

In many ways Solvency II is simply a formalisation of existing risk management systems used within our business. We have a well developed enterprise risk management approach which has been judged effective by some of the rating agencies. We have also been very transparent to shareholders on the underwriting risks we run. For many years we have published on our website and annual report our 'boxplot and whisker' chart which gives shareholders a clear view of the estimated losses we could suffer in the event of major catastrophes. At the moment we are assuming that Bermuda will achieve equivalence and that we will implement the Solvency II approach across the whole Group. We are therefore in constant communication with the BMA, the UK's FSA and Lloyd's of London on the path to implementing Solvency II within Hiscox.

The challenges of Solvency II arise from the fact that its rules are yet to be fully formulated, from the UK's well known tendency to 'gold plate' European Directives, and that the FSA itself is undergoing wrenching organisational and philosophical changes at the same time as Solvency II is being formulated and implemented. The challenges for all those involved in the process can be summed up by the fact that our application for approval under Solvency II is expected to reach 5,000 pages, and it is thought that the FSA will receive over 100 similar applications. One has to feel sorry for the teams who have to read and approve all the applications.

Achieving effective implementation of Solvency II is one of the Group's top priorities in 2011 and 2012.

People

Insurance is an industry where the decisions and actions by staff on the front line make a crucial difference to the performance of their businesses. We are lucky at Hiscox in having staff who not only enjoy this responsibility and the challenges which it brings, but who also make the right decisions for our business and its customers. Our exposure to Deepwater Horizon is minimal thanks to a single sound underwriting decision. Our US catastrophe-exposed property portfolio has shrunk thanks to a team exercising discipline. Our UK art and private client business has performed well despite some terrible weather and thanks to brave underwriting decisions going against the market trend. Our European art and private client business has improved the quality of its business thanks to co-ordinated actions over an extended period. Our claims teams make difficult decisions every day – whether resolving a coverage dispute between terrorism and property insurers without the client being adversely affected or dealing with many personal difficulties arising from the UK freeze. It is our ambition to ensure that Hiscox remains a place where the individual makes the difference no matter how much we grow – and with the quality and dedication of the staff who work for us across the globe I feel confident that this ethos will continue to be central to our business.

Outlook

The markets in which we operate have become progressively more challenging over the past three years, and we expect the trend of increasing competition and falling prices to continue. In this environment our strategy of building our retail businesses to balance the more volatile big-ticket businesses will come into its own. We will allow our big-ticket businesses in Bermuda and London to shrink as they focus on margin over volume, while at the same time we expect our specialist retail businesses to grow their revenue and profits. These specialist retail businesses offer products that are clearly distinct from those of their competitors; they have developed reputations for excellent standards of service and for paying claims fairly. This combination will stand our employees, customers and shareholders in good stead.

Bronek Masojada
Chief Executive
28 February 2011

The Hiscox Group has over 1,100 staff in 11 countries.

Bermuda
Hamilton

Europe
Amsterdam
Bordeaux
Brussels
Cologne
Dublin
Hamburg
Lisbon
Lyon
Madrid
Munich
Paris

Guernsey
St Peter Port

Latin American gateway
Miami

UK
Birmingham
Colchester
Glasgow
Leeds
London
Maidenhead
Manchester

USA
Armonk (New York)
Atlanta
Chicago
Kansas City (Missouri)
Los Angeles
New York City
San Francisco

Hiscox business structure

Hiscox London Market

Hiscox London Market

Russell Merrett
Managing Director

- Reinsurance
- Property
- Marine and energy
- Specialty
- Kidnap and ransom
- Terrorism
- Political risks
- Errors and omissions
- Aviation and aerospace

Hiscox International

Hiscox Bermuda

Charles Dupplin
Chief Executive Officer

- Global reinsurance
- Group capital support
- Healthcare insurance

Hiscox Guernsey

Steve Camm
Managing Director

- Fine art
- Kidnap and ransom
- Terrorism

Hiscox USA

Richard Watson
Chief Executive Officer

- Errors and omissions
- Directors and officers' liability
- Specialty
- Kidnap and ransom
- Terrorism
- Technology/media
- Direct to customer commercial business
- Property

Hiscox UK and Europe

Hiscox UK

Steve Langan
Managing Director

- Fine art
- High-value household
- Errors and omissions
- Directors and officers' liability
- Specialty commercial
- Technology/media
- Direct to customer household and commercial business

Hiscox Europe

Pierre-Olivier Desaulle
Managing Director

- Fine art
- High-value household
- Errors and omissions
- Directors and officers' liability
- Specialty commercial
- Technology/media
- Kidnap and ransom
- Terrorism
- Direct to customer commercial business

Hiscox distribution

Customers facing complex or unusual risks benefit greatly from the guidance of a broker or advisor which is why most specialist insurance is delivered through an intermediary. Although Hiscox has a multi-channel distribution strategy, the vast majority of our business comes from our broker partners around the world.

Hiscox has a strong history of going out to find good business, rather than waiting in London for it to come to us. Hiscox underwriters have always travelled the world to build long-lasting relationships with local brokers that showcase our unique expertise. Previously we brought that business back to London, but over the past 15 years we have benefited from building a local presence in a handful of key regional markets.

Our experience of having offices outside of London since 1995 has shown us that having a local presence brings several advantages. We develop better relationships with regional brokers, who appreciate our specialist knowledge, entrepreneurialism and desire to truly understand their clients' risks. We have better new business growth, because we see more submissions from these intermediaries than we would sitting in London. And our retention rate is higher, as this business tends not to move solely on price.

This strategy has worked: over the past ten years Hiscox UK has grown its broker business by 360%; 69% of this growth has been generated from brokers based outside of London.

We aim to grow our market share in Western Europe and the US – regions where we already operate and where we know there is a strong appetite for our products. When the opportunity has arisen to either acquire a good-quality book of regional business at an attractive price or to hire an excellent team of local underwriters we have opened an office, whether in Brussels, Munich, Armonk or Los Angeles. We now have 28 offices across the world, feeding us good new risks that help sustain our business.

In continental Europe brokers represent only 30% of our target market so we use a wider variety of distribution channels here. These include banks and composite insurers who are happy for us to cover their clients for their more specialist risks. This diverse choice allows clients to buy our products through their preferred sales channels and it has delivered steady growth over the past five years, including 11.5% in 2010.

Since 2005, Hiscox has established a network of offices across the US. Over 40% of the Group's revenues come from this market, mainly through Hiscox London Market, but our branches throughout the country have enabled us to capture smaller US corporate risks that are not seen in the London Market.

Hiscox also has an established direct to consumer business in the UK that it has built up since 2005 and newer direct businesses in the US and France. In all these regions we specialise in professional and general liability as well as buildings and office contents cover. We sell policies directly to professional services businesses with ten or fewer employees. These small firms tend to be uneconomic for brokers as they pay relatively little in premiums. Many have straightforward specialist needs so are better suited to getting their cover online. Hiscox UK has been a great success – it currently insures 38,000 small businesses with an average premium of £400 – and we have high hopes for our US and European direct operations. In the UK we also insure higher value household direct.

Hiscox aims to offer our products and expertise to new markets and customers via any route they would prefer.

Why our brand is so important

Hiscox has a very strong brand in the London insurance market, but until recently, was completely unknown to UK consumers. To build a successful direct insurance business it is fundamental that your target market is aware of and identifies with your brand, so five years ago we hired Steve Langan to help us. He has used the brand and marketing expertise he gained at Diageo and Coca-Cola to mastermind Hiscox UK's advertising and direct mail campaign. Many of you will have seen our distinctive adverts, either on TV, in newspapers or on billboards. They have helped transmit Hiscox's unique culture to a wider audience: bold, intelligent, freethinking, straightforward, responsible and with a passion for good customer service. Our consistent investment has paid off: our direct business grew by 22% last year. In 2010 we had the best reputation of any UK insurer, a consumer study by the Reputation Institute found. This is tangible proof that our marketing investment is helping us to build a brand that customers know and trust. What we have learnt in the UK is guiding our efforts in building our new direct operations in the US and in Europe.

People

1,164

Total number of staff at December 2010

The quality of our people has been a key ingredient in our success. Hiscox's reputation for innovation and dynamism has been built in large part on the energy, professionalism, commitment and expertise of our employees.

A good reputation takes a long time to build, but can be lost very quickly. We place a great emphasis on recruiting the best people, developing their skills and careers and ensuring that they are motivated. Some of the specific actions we take to fulfil each of these principles are described below.

The unique personality of Hiscox is expressed through our employees to our clients. We want customers to find us intelligent but not intellectual, bold but not arrogant, thought-provoking but not patronising, different while being straightforward, positive but not pushy, contemporary not stuffy, sophisticated but not superior.

1. Recruit the best

Hiscox aims to fill posts by recruiting internally, where possible. Because we strive to attract and retain the best people, we believe we have the ideal candidates for many jobs already working in the firm. We also want to stretch our people so they can reach their full potential. In 2010, 77 new appointments were either internal promotions or recommendations from current employees. When we do recruit talent from outside, we ensure that they go through a thorough assessment. Another source of talent to fill senior roles in the future is our graduate trainee and internship programme. In 2010, we nearly doubled our intake, recruiting 22 graduate trainees into the UK, one in Bermuda and three in France. One of our aims is to educate the brightest students about the vibrant career this industry can offer. The average number of candidates seen for each job filled in 2010 was five.

2. Develop excellence

Hiscox has a unique underwriting training programme developed by some of our very experienced underwriters. The training, which aims to reinforce Hiscox's underwriting standards, includes how to underwrite profitably across the cycle and the importance of learning the lessons of history when assessing risks. We also want to instil in our underwriters a restless curiosity, to challenge convention and not simply to accept a practice because that is the way it has always been done in the past. In 2010 Hiscox Europe instigated a programme of back-to-basics underwriting training with a specific focus on disciplined underwriting in challenging markets. This training helped achieve a 20% increase in new business submissions for our target areas in our commercial lines. Across the Group a total of 353 delegates completed our underwriting training programme in 2010.

3. Motivate

Having attracted and trained the best people we can find, it is then essential that we keep them motivated and ensure they thrive in their roles.

The Hiscox Partnership

Senior staff members who have made an important contribution to the Group's success may be appointed as a Hiscox Partner. The Hiscox Partnership, which numbers up to 5% of the total number of staff, is informed of all the strategic decisions and facts and figures of the Group, which enables them to influence the direction and performance of the Group. They also act as mentors to talented young people and ensure that we are operating in a way which is consistent with our values everywhere in the Group. In 2010, five new Partners were appointed.

Employee engagement survey

In September, Hiscox conducted its third global employee engagement survey. The survey, which was open to all permanent members of staff, looked at how committed employees feel to Hiscox, their managers, their teams and their role.

The idea behind it is simple: if employees feel very engaged they are more likely to stay and deliver their very best for the company. Being able to measure levels of commitment enables Hiscox to identify areas where it can improve performance and boost staff retention.

The survey is based on four key measurements:

- emotional commitment – the extent to which employees value, enjoy and believe in their work, in their manager, team and Hiscox;
- rational commitment – the extent to which employees believe Hiscox, their managers, and their teams have their best professional and development interests at heart;
- discretionary effort – employees' willingness to go above and beyond what is expected of them; and
- intention to stay.

The survey shows Hiscox enjoys high employee engagement as we rank between the 70th and 85th percentiles in all four areas against the global benchmark comprising 145 organisations across 67 countries.

Hiscox Partners

Stephen Ashwell	Global Head, Terrorism
David Astor	Chief Investment Officer
Reeva Bakhshi	Head of UK Direct
Rory Barker	Group Reinsurance Manager
Neil Bolton	Head of Non Marine Casualty, Hiscox London Market
Stuart Bridges	Chief Financial Officer
Amanda Brown	Group Human Resources Director
David Bruce	Deputy Managing Director, Hiscox London Market Head of Specialty, Hiscox London Market
Steve Camm	Managing Director, Hiscox Guernsey
Robert Childs	Chief Underwriting Officer
Paul Cooper	Finance Director, Hiscox UK
Robert Davies	Global Head, Kidnap and Ransom
Pierre-Olivier Desaulle	Managing Director, Hiscox Europe
Ed Donnelly	President, Hiscox USA
Charles Dupplin	Chief Executive Officer, Hiscox Bermuda Group Company Secretary
Michael Gould	Chief Operating Officer
Gary Head	Chief Underwriter, Hiscox UK
David Henderson	Branch Manager, Birmingham, Hiscox UK
Robert Hiscox	Chairman
Jason Jones	Group Compliance and Audit Director
Suzanne Kemble	Global Head, Media and Entertainment
Kevin Kerridge	Head of Direct, Hiscox USA
Ian King	Reinsurance Underwriter, Hiscox London Market
Steve Langan	Managing Director, Hiscox UK and Group Marketing Director
Paul Lawrence	Head of Property, Hiscox London Market
Ian Martin	Finance Director, Hiscox London Market
Bronek Masojada	Chief Executive
Russell Merrett	Managing Director, Hiscox London Market
Jeremy Pinchin	Group Claims Director
Steve Quick	Global Head, Broker Relations
Robert Read	Global Head, Fine Art
Christopher Sharpe	Chief Underwriter, Hiscox Bermuda
Damien Smith	Head of Non-Marine Treaty Reinsurance, Hiscox London Market
Nicholas Thomson	Retired Chief Underwriting Officer
Andrew Underwood	Head of Specialty, Hiscox USA
Gavin Watson	Chief Financial Officer, Hiscox USA
Richard Watson	Chief Executive Officer, Hiscox USA
Simon Williams	Head of Marine and Energy, Hiscox London Market

Group financial performance

89.3%
Combined ratio

Profit before tax for the year was £211.4 million (2009: £320.6 million), despite the large catastrophe losses and tougher investment markets experienced during the year. The Group recorded a post tax return on equity of 16.5% (2009: 30.1%) and earnings per share 47.2p (2009: 75.2p).

Net asset value per share grew by 11.2% to 332.7p (2009: 299.2p) supported in part by the continued strength of the US Dollar. The Group maintains a progressive dividend policy and total dividend per share rose by 10% to 16.5p (2009: 15.0p).

Gross premiums written of £1.4 billion were relatively flat compared to the prior year as we cut back in those lines where rates were weak and focused on areas where a greater return was expected.

The Group's overall underwriting performance was relatively strong despite the impact of the large catastrophe losses and we report a combined ratio including the impact of foreign exchange of 89.3% (2009: 86.0%).

Notwithstanding the challenge of the investment markets during the year, the Group's investments produced an annualised return of 3.6% (2009: 7.2%).

The underwriting performance for each operating segment is detailed below.

Hiscox London Market
Gross premiums written declined by 13.6% to £572.7 million (2009: £663.0 million) reflecting the cut back in those lines where rates are weak, in particular, the US property insurance lines and big-ticket professional indemnity.

Reinsurance purchased was higher than in the prior year as the segment benefited from a new quota share reinsurance arrangement which enabled an increase in underwriting capacity. Other reinsurance contracts which were renewed with commercial reinsurers during 2010 were on similar terms to the previous year and the quota share arrangement with Syndicate 6104 remained in place.

The net claims ratio deteriorated to 48.3%, from 38.8% in 2009, impacted by the losses on the Chile and New Zealand earthquakes together with the Australian floods. As a result, the combined ratio (excluding the impact of foreign currency movements) declined to 81.8% (2009: 71.0%). Profit before tax for the year was £121.4 million (2009: £179.9 million).

Hiscox UK and Europe
Gross written premiums rose by 8.0% to £454.7 million (2009: £421.0 million) reflecting growth in all core lines especially the professional and specialty commercial businesses.

The net claims ratio improved by 3.2% to 50.2% compared to the prior year ratio of 53.4% despite the UK freeze losses experienced in the earlier and latter parts of the year and Windstorm Xynthia in Europe.

Group key performance indicators

	2010					2009				
	London Market	UK and Europe	International	Corporate Centre	Total	London Market	UK and Europe	International	Corporate Centre	Total
Gross premiums written (£m)	**572.8**	**454.7**	**405.2**	**–**	**1,432.7**	663.0	421.0	351.4	–	1,435.4
Net premiums written (£m)	**389.6**	**428.0**	**314.0**	**–**	**1,131.6**	483.6	391.5	281.9	–	1,157.0
Net premiums earned (£m)	**396.1**	**422.2**	**312.9**	**–**	**1,131.2**	453.3	367.3	277.5	–	1,098.1
Investment result (£m)	**39.1**	**17.2**	**27.6**	**16.3**	**100.2**	79.7	36.9	57.7	8.9	183.2
Profit/(loss) before tax (£m)	**121.4**	**39.6**	**43.1**	**7.3**	**211.4**	179.9	20.5	124.2	(4.0)	320.6
Claims ratio (%)	**48.3**	**50.2**	**53.2**	**–**	**50.1**	38.8	53.4	33.0	–	41.8
Expense ratio (%)	**33.5**	**44.6**	**43.2**	**–**	**39.7**	32.2	49.9	45.6	–	40.4
Foreign exchange impact (%)	**(2.1)**	**0.5**	**0.9**	**–**	**(0.5)**	7.8	1.8	(2.3)	–	3.8
Combined ratio (%)	**79.7**	**95.3**	**97.3**	**–**	**89.3**	78.8	105.1	76.3	–	86.0

	2010	2009
Financial assets and cash* (£m)	**2,779.7**	2,660.6
Other assets (£m)	**1,211.2**	1,156.8
Total assets (£m)	**3,990.9**	3,817.4
Net assets (£m)	**1,266.1**	1,121.3
Net asset value per share (p)	**332.7**	299.2
Net tangible asset value per share (p)	**315.8**	285.7
Adjusted number of shares in issue (m)	**380.6**	374.8

*excluding derivative assets and catastrophe bonds.

£211.4m

Profit before tax

The combined ratio before the impact of foreign exchange improved by 8.5% to 94.8% from 103.3% in the prior year. This reflects not only the improved loss ratio but also benefits from the efficiencies achieved by the centralising of operations in Europe through the opening of the shared service centre.

As a result profit before tax for the year increased by 92.8% to £39.6 million (2009: £20.5 million).

Hiscox International

Gross premiums written increased 15.3% to £405.2 million (2009: £351.4 million). The rise was driven by Bermuda taking advantage of attractive reinsurance rates and a new quota share arrangement coupled with our continued expansion in the US. Gross premiums written in Guernsey remained stable due to disciplined underwriting on the more volatile piracy lines.

The net claims ratio was heavily impacted by the losses on the Chile and New Zealand earthquakes together with the Australian floods during the year and as such declined by 20.2% to 53.2% (2009: 33.0%). The impact on the combined ratio excluding foreign exchange was a deterioration of 17.8% to 96.4%.

Consequently profit before tax fell by 65.3% to £43.1 million (2009: £124.2 million).

Hiscox Corporate Centre

An investment result of £16.3 million (2009: £8.9 million) was recognised on those assets controlled centrally. Total expenses, including certain foreign exchange items, fell by 49.5% to £4.4 million (2009: £8.7 million). Foreign exchange gains of £8.4 million (2009: £10.3 million) include the foreign currency impact on certain intra-group loan balances. Profit before tax of £7.3 million (2009: £4.0 million loss) was recognised.

Cash and liquidity

The Group's primary source of liquidity is from premium income and investment income. These funds are used predominantly to pay claims, expenses, reinsurance costs, dividends and taxes, and to invest in more assets.

Total net cash inflows for the year were £75.9 million (2009: outflow £150.1 million). The inflow was mainly due to prompt settlement of premiums and reinsurance claims.

Net cash outflow from investing activities for the year was £22.2 million (2009: £11.7 million), primarily as a result of the purchase of tangible and intangible assets. The Group purchased the remaining shareholding in its associate company Blyth Valley Ltd, thereby obtaining control of the company. In addition, an investment was made in the US sister company of Blyth Valley Ltd, InsuranceBee Inc, a specialist errors and omissions insurance broker. The Group also disposed of its associate holding in HIM Capital Holdings Ltd during the year.

An area of increased investment for the Group during the year was on IT systems development. The Group embarked on several new enhancement projects including the web platform for the US direct business and a management information project aimed at improving the quality and efficiency of financial information provided to management, inherently aiding the implementation of the new Solvency II regime.

Net cash outflows from financing activities for the year were £172.9 million (2009: inflow £1.6 million). The outflow is due to the repayment of the borrowing facility and the payment of dividends.

The Group maintains relationships with a limited number of banks, whose credit status and ability to meet day-to-day banking requirements are monitored by the Group.

There were no impairments recorded against cash or cash equivalents and no issues regarding recoverability have been identified on these assets.

During the year, the Group secured a new revolving credit facility for a total of $750 million replacing the £350 million facility in place in the prior year. This may be drawn by way of cash or Letter of Credit or a combination of the two, providing the cash portion does not exceed $450 million. The facility may be drawn in any foreign currency that the Group requests. At 31 December 2010, $165 million had been drawn by way of Letter of Credit and £20 million by way of cash (2009: $225 million and $138 million respectively).

Solvency II

Solvency II is the new solvency regime for all insurers and reinsurers due to come into effect from 1 January 2013. It aims to create solvency requirements that are consistent across all member states and which better reflect the risks that insurers and reinsurers face.

The new regime is based on a three-pillar approach as follows:

Pillar 1 – Quantitative requirements
Pillar 2 – Government and risk management requirements
Pillar 3 – Disclosure and transparency requirements.

A working group has been established within Hiscox to lead the work on implementing the new rules and a comprehensive implementation plan is well underway. Many of Solvency II's qualitative requirements are already an integral part of the Group's risk management framework and an analysis has been done to identify those areas that require small incremental changes.

Full details of the requirements are continually developing and as such uncertainty remains over the full impact of the new regime. During the year, the Group made significant progress in achieving its objectives of implementing the three Pillars completing the QIS 5 exercise and enhancing existing corporate governance functions.

Group investments

The Group's invested assets increased over the year to £2.78 billion (2009: £2.66 billion) with the positive effect of good cashflow being partly offset by the decision to repay £138 million of Group borrowing during the period. The investment result, excluding derivatives, amounted to £98.8 million (2009: £182.8 million) equating to a return of 3.6% (2009: 7.2%).

In a year when investment markets were characterised by periods of 'risk on' or 'risk off', the outcome over the 12 months has favoured riskier assets. Volatility, however, remained a feature, with the general sense of optimism being punctuated by periods of doubt particularly in relation to the financial condition of certain Euro zone countries and fears of a slow down in Chinese growth. Faced with growing economic uncertainty in many developed countries, central bankers kept short-term interest rates at abnormally low levels and employed a variety of stimulatory tools, most noticeably quantitative easing, which drove government bond yields to the lowest level seen in recent times. The likelihood of a prolonged period of easier monetary policy encouraged investors to seek better returns away from cash and short-dated government bonds. Consequently the investment return, whilst not matching that of 2009, has comfortably exceeded our initial expectations.

With the broadly positive trends from 2009 continuing into 2010 there were very few shifts in the portfolio during the year. Cash was kept at a relatively low but prudent level, supported by significant holdings of government and government-backed bonds. Although mostly short in duration these provided superior income to cash and ensured that the liquidity and integrity of the balance sheet remained high. However, it was the allocations to non government bonds and risk assets that enhanced the portfolio's performance. Our risk assets exposure was maintained at around 5% throughout the year. It comprises a selection of long only equity funds and equity based hedge funds. The latter account for roughly 30% of this portfolio and are expected to deliver less exciting but more stable returns. When combined with the long only funds, the risk assets produced a satisfactory result in total.

The bond portfolios produced substantial profits for the Group and comfortably outperformed the relevant government bond benchmarks. This was due principally to the level of corporate debt exposure which, having been increased in 2009, was retained throughout the majority of 2010. In the core portfolios the bonds of investment grade corporates, where balance sheets have been conservatively managed in stark contrast to those of many over indebted countries, continued to be in high demand. Additionally, our opportunistic allocation to higher yielding and below investment grade securities produced another year of equity like returns. With further gains from these portfolios being made in the fourth quarter and the risk reward ratio no longer looking so attractive, we have taken profits in areas where further upside seems limited.

Bond markets have not been without risk and in consultation with our managers we have studiously avoided sovereign bonds from peripheral Europe and have only modest bank debt exposure to a few national champions in Spain and Italy. In contrast to our positive appetite for credit, duration in government bonds has been kept short. With hindsight this approach has been too cautious but the fourth quarter of the year has highlighted the perils of longer dated bonds. Whilst it was a profitable period for the portfolio overall the sudden sell off in government bonds in the last few weeks of the year is a salutary reminder of how quickly the pendulum can swing.

Going into 2011 therefore, there is little margin for error given our desire to avoid losing money in any 12-month reporting period. Indeed, with the possibility of interest rates rising from artificially low levels and further volatility likely in equity markets, the chances of an investment loss in 2011 are statistically greater than they have been recently for anything other than a cash-like portfolio. We are therefore more intent than usual on conserving capital rather than chasing yields, particularly in the absence of any compelling and appropriate opportunities. Few commentators expect official rates to rise in our main markets during 2011 but there are signs of inflationary pressures and a policy shift, or at least the expectation thereof, cannot be ruled out. The allocation to cash is therefore likely to drift higher and duration of the bond portfolios kept low relative to their benchmarks.

Given that returns from the bond portfolios are forecast to be lower than 2009 and 2010 and will provide a more limited cushion against the possibility of a weak equity market, our allocation to equities is set to remain around current levels. We do, however, believe they represent good value in the medium term and have a reasonable chance of providing a useful boost to the overall performance in 2011.

The impact of the financial crisis has not gone away. Economic recovery in the developed world and the outlook for Chinese growth are areas for concern, and doubts remain about solvency

Group investment performance

		31 December 2010			31 December 2009		
		Asset allocation %	**Return %**	**Return £000**	Asset allocation %	Return %	Return £000
Bonds	£	**18.5**	**2.7**		19.1	3.5	
	US$	**56.8**	**4.0**		58.6	9.2	
	Other	**6.9**	**2.8**		7.1	6.8	
Bonds total		**82.2**	**3.7**	**82,234**	84.8	7.7	152,954
Equities		**5.6**	**11.1**	**15,572**	5.0	20.7	26,360
Deposits and cash equivalents		**12.2**	**0.3**	**1,043**	10.2	0.8	3,455
Actual return			**3.6**	**98,849**		7.2	182,769
Group invested assets*				**£2,779.7m**			£2,660.6m

*excludes derivatives and investment in catastrophe bonds.

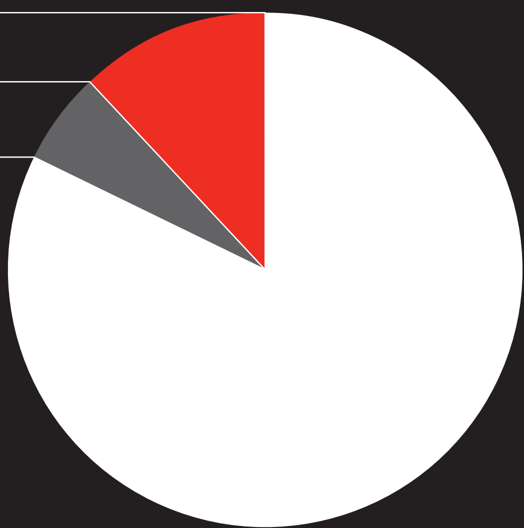
High quality and well diversified portfolio
Investment portfolio: £2,779.7m

Asset allocation

12.2% Cash

5.6% Risk assets

82.2% Bonds

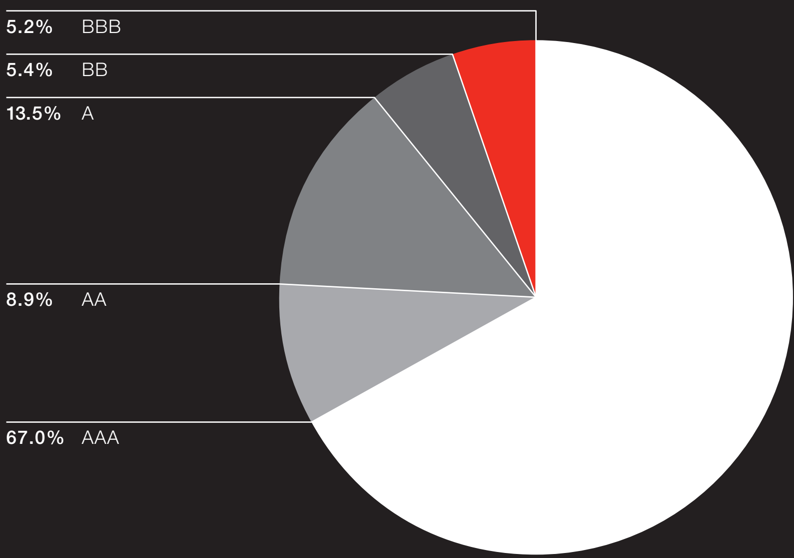


Group investments
continued

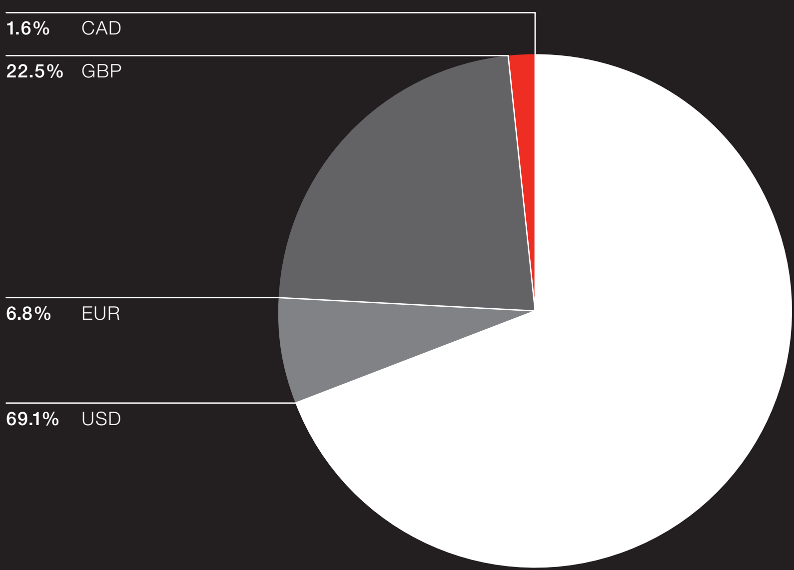
at a sovereign level in Europe and at a municipal level in the US. Having survived 2008 and prospered in the following two years, 2011 will be a year where the investment strategy is more defensively focused and mindful of our primary objective which is the preservation of capital to support the insurance business. This will leave us in a good position to take advantage of an investment world with higher interest rates and where the reward for taking risk is both greater and more apparent.

£2,779.7m
Invested assets

Bond credit quality



Bond currency split



Risk management

The core business of Hiscox is managing risk; as such the understanding of risk is intrinsic to every level of decision-making in the Group.

The risks associated with the core business of insurance and reinsurance represent some of the greater exposures, however the Group is exposed to a number of other risks and, as part of its risk management framework, the Group has systems and procedures to identify and manage them. These procedures are regularly reviewed and improved in the light of the evolving risk environment and best practice.

The Group's risk management framework, which extends to all aspects of risk including insurance, market, credit, operational, liquidity, reputational and strategic risks is headed by the Risk Committee of the Board, which advises the Board in relation to management of the Group's risk profile. The Group's risk appetite is set by the Board and cascaded through the Group's global operations as part of the business planning cycle and through the risk management framework, which encompasses the following committees:

- Group Underwriting Review
- Reinsurance Purchase Review Group
- Reinsurance Security Committee
- Cash Flow Review Group
- Broker Credit Committee
- Investment Committee
- Reserving Committees
- Business Continuity Committee.

Each committee is chaired by either the Chairman, Chief Executive Officer, Chief Financial Officer or Chief Underwriting Officer, apart from the Business Continuity Committee which is chaired by the Chief Operations Officer. Each committee has a specific remit, such as underwriting risk, reinsurance purchase, investment risk, claims reserving or business continuity. Senior management responsibilities are clearly defined together with reporting lines and the execution of delegated responsibilities is closely monitored by the Board and its committees. This monitoring, supported by financial and non-financial management information, assesses performance against agreed targets and objectives, as well as the risks to achieving these objectives and the effectiveness of the measures in place to manage these risks. In parallel with these direct risk management processes, there is a dedicated risk management function which, in conjunction with Internal Audit and the Group risk committees, monitors and reviews the effectiveness of risk management activities throughout the organisation and reports to the Risk Committee of the Board. These functions are organised centrally to assist in the integration of best practice throughout the Group. A range of risk management tools are used to assess and manage risk both at business unit level and on a Group-wide basis.

Major risks

The major risks that the Group faces are presented below categorised as either 'principal' or 'secondary'. Principal major risks represent the most pertinent risks to which the Group is currently exposed, and secondary major risks represent other material risks to which the Group is currently exposed, but not deemed critical at this stage. Detailed information relating to the 'principal risks' and uncertainties impacting the Group's financial statements is set out in note 3 to the financial statements.

Major risks: principal

Insurance risk: catastrophic and systemic insurance losses

The Group continues to underwrite significant risks in geographical regions that are prone to natural peril or which provide cover against other catastrophes, such as terrorism. This business remains a compelling proposition for the Group as it is capable of returning good margins over the medium to long-term as the occurrence of catastrophes average out. As with similar insurers, the Group's earnings are affected by unpredictable external events such as natural and other catastrophes, legal developments, social and economic change and the emergence of latent risks. Such events can create significant levels of underwriting losses.

The Group primarily manages exposure to these risks through a clearly defined risk appetite which dictates the business plan and is realised through disciplined underwriting, close and continuous monitoring of exposures and aggregations and a prudent and disciplined reinsurance purchase programme to limit losses from risk concentrations. The Group adapts its business plan, target products and reinsurance programme to produce a well-diversified book. This enables us to maximise expected risk/return on the portfolio as a whole and offset potential losses on more volatile accounts.

Of critical importance is the quality of our underwriting models and risk aggregation capability. Incentives ensure that underwriting staff make sound and objective judgements that are aligned with the Group's overall strategic objectives and risk appetite. Clear authority limits are also in place that are regularly reviewed and monitored. Policy wordings are reviewed regularly by specialists and legal experts in the light of legal developments to ensure that the Group's exposure is restricted, as far as possible, to those risks identified at the time of policy issuance. The modelling and monitoring tools are used both in the underwriting process and by independent risk specialists. They are used to design the insurance and reinsurance business plans and control the business underwritten to ensure that the risk profiles of contracts match the exposures for which the plans were devised.

Aggregation and modelling resources are shared across the Group. Subsidiaries and locations worldwide therefore employ the same sophisticated standard of modelling tools tailored to the characteristics of each specific market. The Group assesses realistic disaster

Risk management
continued

We adjust our business plan, target products and reinsurance programme to deliver a well-diversified book.

scenario projections on a subsidiary and consolidated basis in order to estimate the potential loss across all books of business following a range of specific events.

The Group also manages underwriting risk by purchasing reinsurance. Reinsurance protection such as excess of loss cover is purchased at an entity level and is also considered at an overall Group level to mitigate the effect of catastrophes and unexpected concentrations of risk. However, the scope and type of reinsurance protection purchased may change depending on the extent and competitiveness of cover available in the market. The purchase of reinsurance in turn exposes the Group to the risk that reinsurance protection against catastrophic and systemic insurance losses is inadequate or inappropriate. This risk is monitored and managed using similar modelling techniques to those described above, under the supervision of a dedicated Reinsurance Purchase Review Group.

Insurance risk: competition and the insurance cycle
In our markets, Hiscox competes against major international groups with similar offerings. At times, a minority of these groups may choose to underwrite for cash flow or market share purposes at prices that sometimes fall short of the break even technical price. The Group is firm in its resolve to reject business that is unlikely to generate underwriting profits. Accepting insurance risk below the technical price is detrimental to the industry's prospects, since it drives the prevailing rates in the market lower to the point where business failures occur, insurers' capital is destroyed, customers receive suboptimal service and the industry suffers from negative publicity. As capacity levels in the market fall, prices inevitably rise until the point where the cycle of irrational pricing may begin again. In common with all insurers, the Group is exposed to this price volatility. Prolonged periods of low premium rating levels or high levels of competition in the insurance markets are likely to have a negative impact on the Group's financial performance.

To manage this risk, Hiscox alters its appetite for the lines of business and the layers it writes in response to market conditions and the risk appetite of the Group. Pricing levels are monitored on a continuous basis, with detailed monthly reports grouping current prices with exposure and trends over the past 12 months. The Group's cycle management strategy and related modelling and monitoring are essential to ensure that it quickly identifies and controls any accumulating adverse effects of changes. As the Group frequently acts as the lead insurer in the complex co-insurance programmes required to cover significant high value assets, it has some ability to set market rates rather than follow them.

Mutualisation is a related risk arising from the phenomenon of pricing cycles in the industry. The Group is required to contribute towards the obligations of other financial institutions who fail. Syndicates 33 and 3624 contribute to the New Central Fund operated by the Council of Lloyd's, and in the UK certain Hiscox entities contribute to the Financial Services Compensation Scheme (FSCS). Insurance companies may be asked to contribute to the recent claims on the FSCS from the banking industry, currently funded by HM Treasury. Any such requests depend on the final level of claims from deposit holders (net of asset recoveries), the period of repayment demanded by HM Treasury and the ability of the banks to make such repayments. HM Treasury indicated that it will not demand any principal repayments for three years. The Group participates in many industry bodies, associations and task-force initiatives in order to monitor developments and influence their strategic direction. In particular, the continued involvement of the Group's executives in the reshaping of the Lloyd's market underscores that commitment.

Insurance risk: reserving
The Group establishes provisions for unpaid claims, defence costs and related expenses to cover its ultimate liability in respect of both reported claims and incurred but not reported (IBNR) claims. These provisions take into account both the Group's and the industry's experience of similar business, historical trends in reserving patterns, loss payments and pending levels of unpaid claims and awards, as well as any potential changes in historic rates arising from market or economic conditions. Details of the actuarial and statistical methods and assumptions used to calculate reserves are set out in note 26 to the financial statements. The provision estimates are subject to rigorous review and challenge by senior management from all areas of the business and the final provision is approved by the reserving committees. The provision is set above the expected or mean reserve requirement to minimise the risk that actual claims exceed the amount provided.

Investment (market) risk
The Group invests premiums and technical funds, which are held for the payment of future claims, and as such is exposed to investment risk. The Group's investment policy is designed to maximise returns within an overall risk appetite which stipulates a one in 100 year loss tolerance. Where appropriate the Board may seek to set aside additional capital to support the recommended asset allocation. The overriding philosophy with the Group's assets is not to lose money or to put at risk the Group's capacity to underwrite.

Technical funds are primarily invested in high quality bonds and cash. The high quality and short duration of these funds allows the Group to meet its aim of paying valid claims quickly. These funds are maintained in the currency of the insurance policy to reduce foreign exchange risk.

Emerging risk identification and control is a core part of risk management activity in relation to all aspects of our business, including underwriting, operations and strategy.

Due to the short-tail nature of the Group's insurance liabilities, the aim is not to match the duration of the assets and liabilities precisely. Benchmarks are instead set for the fixed income fund managers which approximate the payment profile of the claims as well as providing the managers with some flexibility to enhance returns.

A proportion of the Group's assets are allocated to riskier assets (risk assets), principally equities. Here, it is the Group's philosophy to take a long-term view in search of acceptable risk-adjusted returns. The proportion of the Group's funds invested in risk assets will depend on the outlook for investment and underwriting markets. An allocation within the risk assets is made to less volatile, absolute return strategies. This balances the desire to enhance returns against the need to ensure capital is available to support underwriting throughout any downturn in financial markets.

Foreign exchange risk
The US Dollar is the Group's largest underwriting currency. The Group's policy is to match US Dollar insurance liabilities with investments held in the same currency in order to minimise the effect of currency fluctuations. Whilst the Group's reporting currency is Sterling, a significant proportion of the Group's operational cost base is located in the US and Europe, and movements in foreign exchange rates may have a material adverse effect on its financial performance and position. In addition the capital base of the Bermuda, Guernsey and US insurance companies is in US Dollars. Where appropriate a percentage of the capital will be held in the currency matching that of the underlying business written. Net currency positions are closely monitored and currency hedging transactions are entered into where this is considered advantageous in the light of anticipated movements in exchange rates. Further details of the Group's investment profile and its management of currency risks are provided in notes 3 and 19 to the financial statements.

Liquidity risk
Liquidity risk is the risk of being unable to meet liabilities to customers or other creditors as they fall due, or the risk of incurring excessive costs in selling assets or having to raise finance in a very short period.

The majority of the Group's cash inflows and outflows are routine and can be forecast well in advance. The primary source of inflows is insurance premiums whilst outflows are to policyholders for claims made. Cash flow is forecast on rolling weekly, monthly and quarterly basis depending on the source, and, in the event of a major catastrophe, such forecasting may be up to three years in advance. Free cash is invested according to the Group's investment policy and cash requirements can normally be met through regular income streams (i.e. premiums or investment income), existing cash balances or realising investments that have reached maturity.

The Group's liquidity risk arises from large, unplanned cash demands and the principal source of risk is a major catastrophe resulting in a high value of claims. This could be exacerbated if a large portion of claims are funded pending recovery from a reinsurance partner. The Group plans for this risk through the following measures.

- Running stress tests to estimate the size and timing of claims that might be payable in the event of a number of major catastrophes all occurring within a short period of time. We also run scenario analyses which consider the impact on liquidity of a range of adverse events happening simultaneously; for example, an economic downturn and declining investment returns combined with unusual levels of insurance losses.

- Taking into account the stress and scenario analyses, we maintain extensive borrowing facilities. These are held with a diverse range of major international banks in order to minimise the risk of one or more being unable to honour their commitments.

- Our investment policy recognises that some investments may need to be realised before maturity or at short notice and hence a high proportion of investments must be held in liquid assets. This minimises the risk of loss in the event of having to sell assets quickly. Using these measures we believe the likelihood of being unable to meet our liabilities, or of incurring excessive costs in doing so, to be extremely remote.

Emerging risks
Given the nature of its activities, the Group is exposed to new and emerging risks. For example, a change in US legislation may result in unintended risks being underwritten, or may require us to cease business in certain US states.

Being able to identify and plan for unexpected events has become an increasingly important component of business cycle management. Emerging risk identification and control is therefore a core part of risk management activity in relation to all aspects of the business, including underwriting, operations and strategy. Significant efforts are made, including obtaining external expertise, to try to identify any threats to the Group either actual or potential.

The identification of emerging risks is a core agenda item in each Risk Committee. The Group takes all reasonable steps to minimise the likelihood and impact of such events and to be prepared for their occurrence.

Major risks: secondary
Insurance risk: binding authorities
Hiscox generates considerable premium income through agents to whom binding authority is given to accept risks on behalf of Hiscox Group carriers. All binding authorities are strictly controlled through tight underwriting guidelines

Risk management
continued

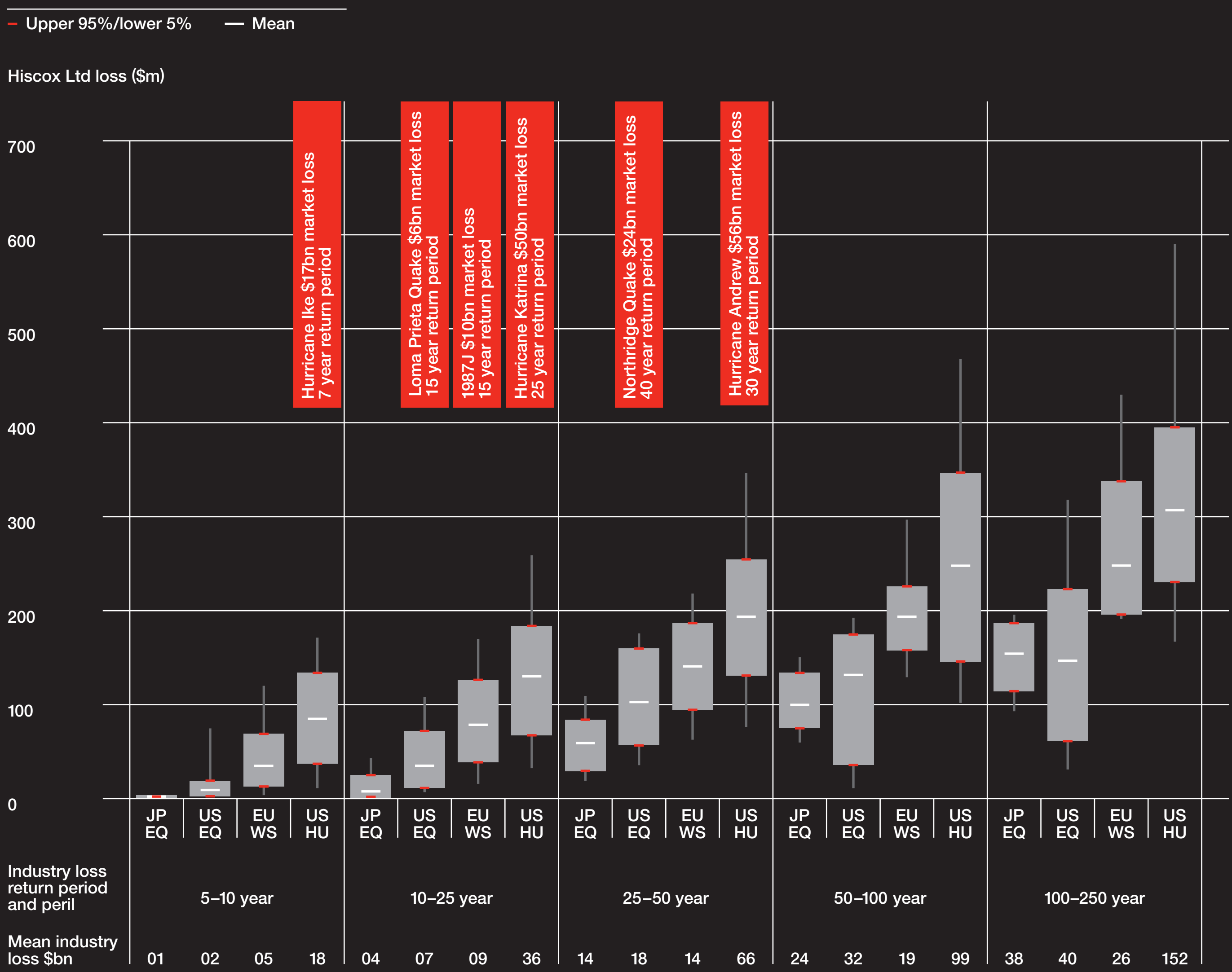
and limits and extensive vetting, monitoring, and auditing of compliance thereof. Agents to whom binding authorities are granted are regularly examined to ensure they meet the Group's minimum standards. These checks are performed by staff independent of the underwriting function and the process is overseen by a committee comprising both underwriters and non-underwriters from the senior management team and the Director of Compliance and Internal Audit.

Credit risk: reinsurance counterparties
The Group purchases reinsurance protection to limit its exposure to single claims and the aggregation of claims from catastrophic events. The Group places reinsurance with companies that it believes are strong financially and operationally. Credit exposures to these companies are closely managed by the Reinsurance Security Committee (RSC), which is chaired by the Chief Financial Officer. All reinsurers used must be approved by the RSC following an internal assessment of the company's financial strength, trading record, payment history, outlook and organisational structure, in addition to credit ratings granted by external agents. Approved reinsurers are monitored continuously to identify potential deteriorations as early as possible. Monitoring procedures include consideration of public information produced by reinsurers; the Group's experience of the reinsurers and their behaviour in the marketplace; and analysis from external consultants and from rating agencies. Credit limits are set for approved reinsurers both at a Hiscox Group level and for each underwriting subsidiary based on a defined risk appetite. The Group's experience of bad debts arising from its reinsurance arrangements has been minimal.

Strategic risk: Hiscox credit rating
The external ratings assigned to the Group and its subsidiaries are essential to maintaining profitability, particularly in relation to our reinsurance business and managing the costs of financing and access to capital. The Group has identified the key aspects of our business which are critical to maintaining our ratings. These are closely managed to minimise the risk of an event which might jeopardise any rating and to ensure that we respond appropriately to unforeseen external events. We maintain regular and open communication with our rating agencies to ensure that we continue to meet their expectations and that careful consideration is given to the potential impact on a rating of any significant decision.

Operational risk: business continuity
The Group has taken significant steps to minimise the impact of business interruption that could result from a major external event. A formal disaster recovery plan is in place for both workspace recovery and retrieval of communications, IT systems and data. In the event of a major event, these procedures will enable the Group to move the affected operations to alternative facilities within very short periods of time. The disaster recovery plan is tested regularly and includes disaster simulation tests. Employees of the Group are widely located throughout the UK, Europe, USA, Bermuda and Guernsey. This geographical dispersion reduces the Group's exposure to natural or terrorist events that could prevent access to premises or loss of staff. In the event of a loss of staff, for example as a result of a pandemic, a plan is in place to re-assign key responsibilities and transfer resources to ensure key business functions can continue to operate.

Boxplot and whisker diagram of Hiscox Ltd net loss (USD)



The chart above shows the variability in net loss the Group expects from individual losses of a given industry loss size.

The return period is the frequency at which an industry insured loss of a certain amount or greater is likely to occur. For example, an event with a return period of 20 years would be expected to occur on average five times in 100 years.

Corporate responsibility

At Hiscox several core values guide our business. These are: to challenge convention, to act with integrity at all times, to have respect for all our business partners, to have courage, to do everything to the highest quality and to excel in the service we provide. These values underpin a reputation we have earned for integrity and decent behaviour in everything we do, which we firmly believe is good for the morale of staff and for the results of the business.

Hiscox's commitment to responsible business practices is reflected in:

The environment

In 2010 Hiscox UK developed an environmental policy statement, laying out its commitment to measure its carbon footprint and to reduce that as far as it can. The policy encourages the business to operate more sustainably by: measuring our use of water, energy and other products in order to reduce their consumption over time; buying sustainably-sourced goods or energy-efficient products where we can; and minimising waste by recycling and reusing products as much as is feasible. It is intended that this policy and environmental best practice will be rolled out across the Group.

In 2009 Hiscox UK conducted an environmental audit of its operations and calculated its carbon footprint with the help of independent consultants Corporate Citizenship. In 2010 Hiscox UK undertook to encourage its employees to change their behaviour in an effort to become carbon neutral. The business generated significant cost and energy savings through increased recycling and more careful use of electricity, water and gas. They achieved a 13% decrease in overall waste sent to landfill, a 15% decrease in overall building energy use and a 12% reduction in water use. Overall, Hiscox UK reduced its carbon footprint by 6%; the balance of its (largely unavoidable) carbon emissions were offset through an investment in an African Energy Efficient Stove Project.

Our sustainability efforts have also been recognised by the City of London Corporation, which gave Hiscox's London office a Clean City Scheme gold award in 2010.

Hiscox is a founding member of ClimateWise, an insurance industry initiative that aims to reduce the long-term risk on the global economy and society from climate change. Hiscox supports the principles of ClimateWise and is encouraged by the actions taken by Lloyd's to assist the market to meet the majority of ClimateWise's principles.

The marketplace

Dealing with business partners

Hiscox regards insurance brokers as important stakeholders in our business, and we endeavour to have good relationships with them to create a competitive advantage in the marketplace. Clear communication is key in this and Hiscox regularly updates its partner brokers of new developments at Hiscox and in the insurance industry.

Dealing with investors

In keeping with its policy of open and transparent communication, Hiscox reports both its half and full year results to its investors via a series of presentations as well as ensuring all relevant Group financial information is available on its website. In addition, senior management and key employees meet investors and analysts throughout the year to explain and answer questions on the Group financial performance and business strategy.

Dealing with customers

Hiscox is dedicated to providing its customers with risk management advice to prevent distressing losses such as burglary and fire in the home. The Hiscox philosophy is that insurance is a promise to pay, so should a loss occur, it aims to fully support its customers and to pay their claims as soon as is possible.

The workplace

Culture

The Hiscox culture is underpinned by a set of core values that determine a standard of behaviour that is expected of all our employees. The Group recognises that through this conduct it is more likely to achieve business success and therefore create additional value for its shareholders. Hiscox strives for the highest standards of corporate governance while striving to remain, in essence, a non-bureaucratic organisation. An effective and firm system of internal controls ensures that risks are managed within acceptable limits, but not at the expense of innovation or speed of response.

The Group believes that it has got this balance right and, furthermore, that this is one of its greatest strengths. The Group's policies ensure that it continues to follow a best practice approach to managing its people and remains a fair and professional employer. In the unlikely event of an employee having a serious concern relating to the operations of the business, a whistleblowing policy explains to staff how they can confidentially raise their misgivings. Hiscox also subscribes to Public Concern at Work, which provides free legal advice to any employee with a concern about possible danger or malpractice in the workplace.

Hiscox wants to employ the best people and provide them with the means and the motivation to excel. This is achieved with fair rewards and by providing staff with an environment in which they can enjoy their work and reach their full potential. Hiscox recognises how important it is for employees to maintain a healthy work/life balance and it gives them the option of flexible and home working wherever possible.

Equal opportunities

Hiscox is committed to providing equal opportunities to all employees and potential employees in all aspects of employment,

£1.1m
Donated to charities

Hiscox UK
CarbonZero
Working with co2balance.com

Donor
team 2012

regardless of disability, sex, race, religion, sexual inclination or background.

Rewards and benefits
Hiscox encourages employees to share in the success of the Group through performance-related pay, bonus, savings-related share option schemes and executive share option schemes. Competitive benefits packages contain health and fitness perks and opportunities for flexible working and career breaks. Watson Wyatt benchmarks our salary packages against the financial services industry as a whole and against the Lloyd's market specifically (where applicable) and our salaries are also considered on a country-by-country basis.

Training and development
Hiscox is committed to training and developing its employees to help them maximise their potential. Each permanent member of staff is provided with a tailored personal development programme. Their training and development needs are reviewed twice a year, as well as their performance against clearly set objectives.

Communication and participation
Employees are kept informed of business developments through formal briefings, team meetings, intranet bulletins, video conferences and other more informal routes. Management takes these opportunities to listen to staff and involve them in taking the business forward. A monthly staff e-zine provides updates on issues and social events.

The community
Hiscox donated £1,109,000 to charities in 2010. The Group has maintained its involvement in its local communities with the strong support of its employees. In Bermuda, Hiscox supports the Bermuda Sunshine League, which is a transitional living facility for children removed from unstable living environments. It gives employees the opportunity to contribute time to children who require adult role models and some stability. In addition to $50,000 in donations to the not-for-profit organisation Habitat for Humanity, more than 60 employees from five locations in the USA participated in Habitat for Humanity 'builds', volunteering their time and labour for homes in various stages of completion. The Habitat for Humanity initiative gave Hiscox USA employees a chance to have a direct positive impact on their respective communities. Hiscox is a member of the Lloyd's Community programme, which supports local initiatives concerning education, training, enterprise and regeneration. In London, members of our staff help pupils at the Elizabeth Selby Infants School in Tower Hamlets through the Reading Partners' Scheme. Employees also mentor students at Morpeth School in Tower Hamlets.

Supporting the arts and sciences
The Group continues to support the Bermuda Masterworks Foundation, which aims to repatriate artworks by Bermudian artists or featuring Bermuda landscapes/seascapes. Hiscox has a three-year commitment to support the Whitechapel Art Gallery, in the East End of London. We sponsor the collections gallery at the Whitechapel, which is a touchstone for contemporary art internationally.

Hiscox is supporting The Royal Institution with a loan and corporate sponsorship. We are proud to support this independent charity which is the oldest independent research body in the world and has been dedicated to connecting people with the world of science for over 200 years.

The Hiscox Foundation
The Hiscox Foundation is a charity funded by an annual contribution from Hiscox to give donations to deserving causes. It gives priority to any charity in which a member of staff is involved, with the aim of encouraging and developing employees to become involved in charitable work. Hiscox staff continued their support of the Richard House Hospice and during 2010 raised over £29,500. The foundation has committed to support HART (Humanitarian Aid Relief Trust) over a three-year period. HART helps some of the poorest and most abused people in the world. More details of the charities Hiscox supports can be found on our website www.hiscox.com.

Hiscox has made a donation to the Team 2012 Fundraising Appeal, supporting Britain's athletes on their journey to success.

Insurance carriers

Syndicate 33
Hiscox can trace its origins in the Lloyd's Market to 1901. Today, Hiscox Syndicate 33 is one of the largest composite syndicates at Lloyd's, and has an A.M. Best syndicate rating of A (Excellent). Syndicate 33 underwrites a mixture of reinsurance, major property and energy business, as well as a range of specialty lines including contingency, technology and media risks among others. The business is mainly property-related short-tail business. Syndicate 33 trades through the Lloyd's worldwide licences and ratings. It also benefits from the Lloyd's brand. Lloyd's has an A (Excellent) rating from A.M. Best, an A+ (Strong) from Standard & Poor's, and an A+ (Strong) rating from Fitch.

The geographical and currency splits are shown to the right. One of the main advantages of trading through Lloyd's is the considerably lower capital ratios that are available due to the diversification of business written in Syndicate 33 and in Lloyd's as a whole. For 2011 Syndicate 33 has a capital requirement ratio of approximately 45% of Syndicate capacity. The size of the Syndicate is increased or reduced according to the strength of the insurance environment in its main classes. At present, Hiscox owns approximately 72.5% of the Syndicate, with the remainder owned by third-party Lloyd's Names. Hiscox receives a fee and a profit commission of approximately 17.5% of profit on the element it does not own.

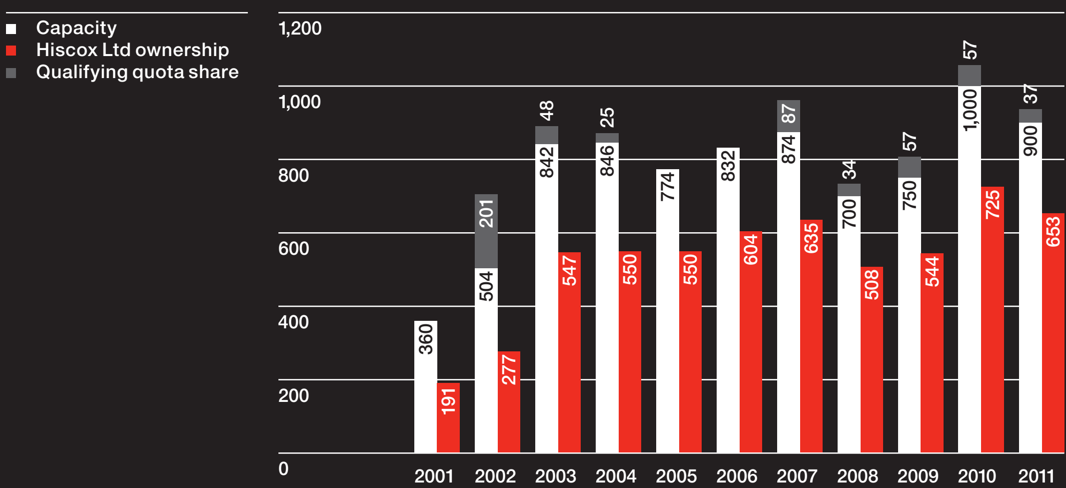
For the 2011 year of account, Syndicate 33's capacity has been reduced from £1 billion to £900 million, primarily to reflect the reduced appetite in certain business lines.

The chart below right shows the gross premiums written of Syndicate 33 for the last ten years.

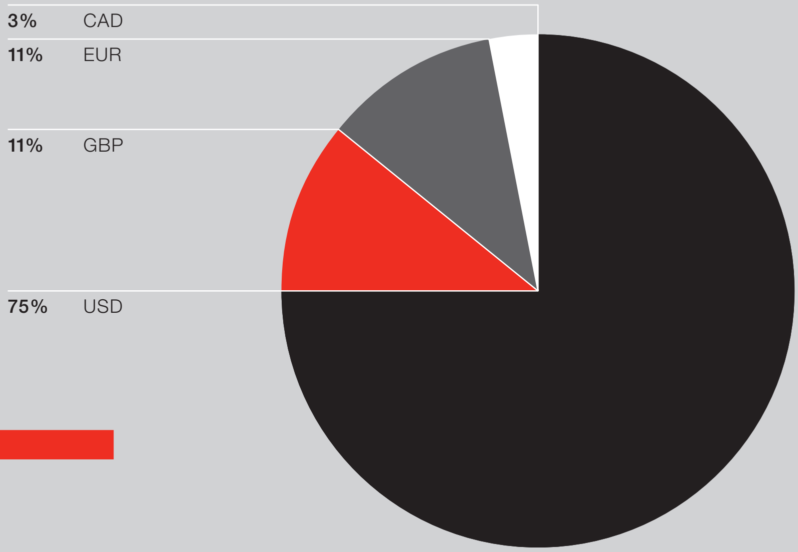
Syndicate 3624
Syndicate 3624 is a wholly owned syndicate which began underwriting for the 2009 year of account with an underwriting capacity of £150 million. Syndicate 3624 writes the US E&O account written through the Hiscox underwriting agency in Armonk, New York and a 50% quota share of Syndicate 33's TMT business written by Hiscox-owned underwriting agencies. Syndicate 3624 has a capital requirement ratio of 73% of syndicate capacity. Total underwriting capacity of Syndicate 3624 has been increased to £250 million for the 2011 year of account reflecting the focus on the expansion in the US.

Cougar Syndicate 6104
Cougar Syndicate 6104 was set up under a limited tenancy agreement for the 2008 year of account with an initial capacity of £34 million. It is wholly backed by external Names and takes a pure year of account quota share of Syndicate 33's international property catastrophe reinsurance account. The arrangement was extended for the 2010 year of account and Cougar Syndicate 6104's capacity was increased to £45 million. The Syndicate will continue for the 2011 year of account with a reduction in underwriting capacity to £37 million.

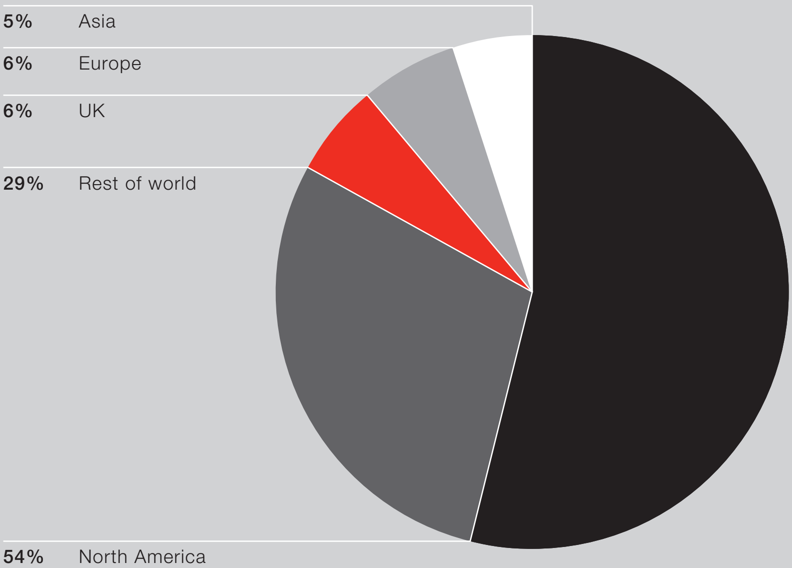
Syndicate 33
Capacity and Hiscox ownership (£m)



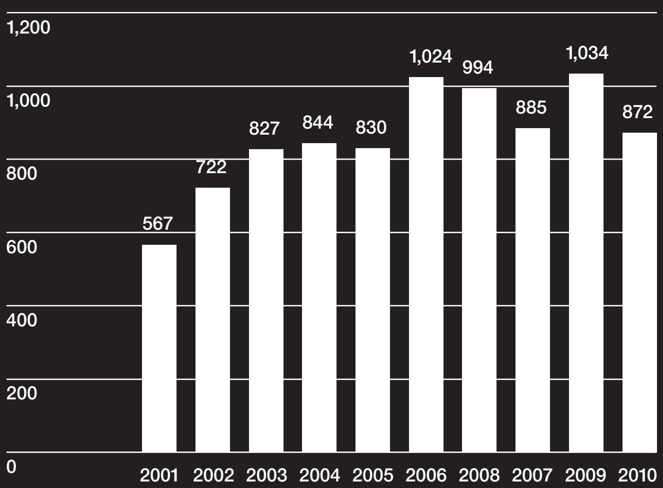
Syndicate 33
Gross premiums written currency split (%)



Syndicate 33
Gross premiums written geographical split (%)



Syndicate 33
Gross premiums written (£m)



Insurance carriers
continued

Hiscox Insurance Company
Hiscox purchased Hiscox Insurance Company Limited in 1996, in keeping with its aim of diversifying its activities outside of Lloyd's and writing a focused book of regional specialist risks. The Group has reshaped the Company's original portfolio to concentrate on high value household and smaller premium professional indemnity business.

Hiscox Insurance Company Limited has licences throughout Europe. It is the primary insurance vehicle used by the UK and mainland Europe offices for their business. The success of the reshaped portfolio can be seen in the chart below right.

Hiscox Insurance Company Limited has achieved average compound growth in gross premiums written of 13.8% from 1997 to 2010, despite discontinuing almost all of its original business. It has also significantly improved its combined ratio.

Hiscox Insurance Company Limited has an A.M. Best rating of A (Excellent), a Standard & Poor's rating of A (Strong) and an A (Strong) rating from Fitch.

At the end of 2010, net assets exceeded £197 million (2009: £172 million).

Hiscox Insurance Company (Guernsey)
Formed by Hiscox in 1998, Hiscox Insurance Company (Guernsey) Limited writes mainly kidnap and ransom and fine art insurance.

Hiscox Guernsey has an A.M. Best rating of A (Excellent) and an A (Strong) rating from Fitch. At the end of 2010, net assets exceeded $28 million (2009: $28 million).

Hiscox Insurance Company (Bermuda)
Formed by Hiscox in late 2005, Hiscox Insurance Company (Bermuda) Limited was set up as an expansion of the reinsurance operations of Hiscox and as an internal reinsurer of the Group. It recently employed a new team to underwrite healthcare insurance.

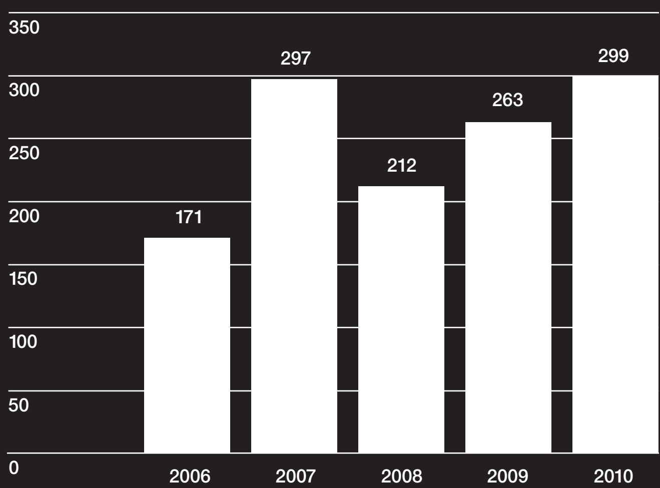
Hiscox Bermuda has an A.M. Best rating of A (Excellent) and an A (Strong) rating from Fitch. At the end of 2010, net assets exceeded $941 million (2009: $807 million).

Hiscox Insurance Company Inc.
Hiscox Insurance Company Inc. was acquired by the Group in 2007 through the purchase of the then parent holding company ALTOHA, Inc.

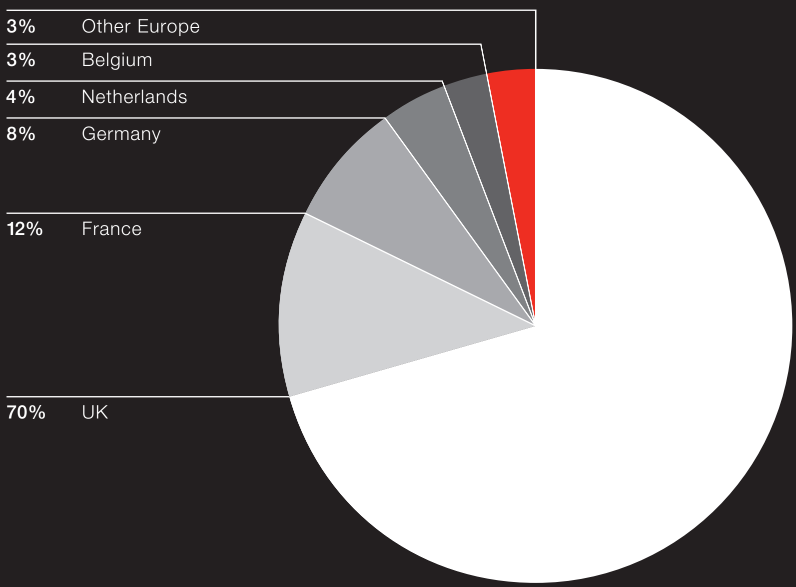
Hiscox Insurance Company Inc. is based in Chicago, Illinois and is an admitted insurance company with licences in all 50 US states and the District of Columbia. Its main business was animal mortality insurance for cattle and horses. These business lines were sold during the year and the Company wrote other property and liability coverage. From November 2010, the Company launched direct commercial business.

Hiscox Insurance Company Inc. is rated A (Excellent) by A.M. Best. At the end of 2010, net assets exceeded $58 million (2009: $56 million).

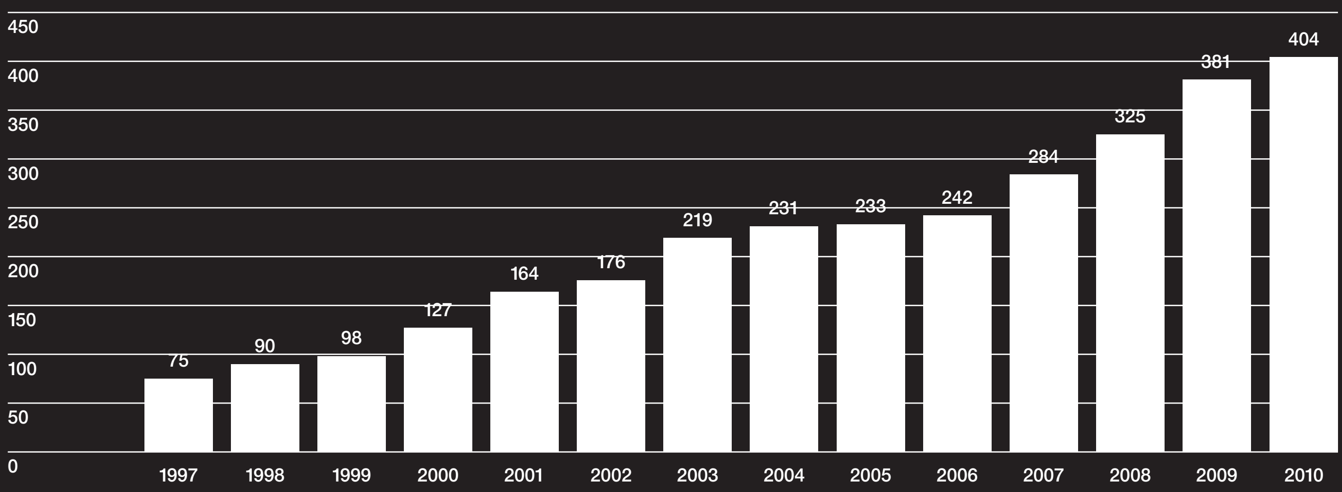
Hiscox Insurance Company (Bermuda) Limited
Gross premiums written ($m) External business



Hiscox Insurance Company Limited
Gross premiums written geographical split by origin (%)



Hiscox Insurance Company Limited
Gross premiums written (£m)



Board of Directors

Executive Directors

Robert Ralph Scrymgeour Hiscox
Chairman (Aged 68)

Robert Hiscox joined Hiscox in 1965 and has been Chairman of the main holding company of Hiscox since its incorporation in 1973. He was Deputy Chairman of Lloyd's between 1993 and 1995. He is a Non Executive Director of Grainger Trust plc, and AGICM Ltd.

Bronislaw Edmund Masojada
Chief Executive (Aged 49)

Bronek Masojada joined Hiscox in 1993. From 1989 to 1993 he was employed by McKinsey and Co. Bronek served as a Deputy Chairman of Lloyd's from 2001 to 2007. He was a Non Executive Director of Ins-sure Holdings Limited from 2002 to 2006 and is a past President of The Insurance Institute of London. He is Chairman of the Lloyd's Tercentenary Foundation, a charity which supports research in areas of interest to the insurance industry.

Stuart John Bridges
Chief Financial Officer (Aged 50)

Stuart Bridges joined Hiscox in 1999. He is a Chartered Accountant and has held posts in various financial service companies in the UK and US, including Henderson Global Investors. During the year he was Chairman of the Business Advisory Board of the Institute of Chartered Accountants in England and Wales, a member of the Financial Regulation and Taxation Committee of the Association of British Insurers and is Chairman of the Lloyd's Market Association Finance Committee.

Robert Simon Childs
Chief Underwriting Officer and Chairman of Hiscox USA (Aged 59)

Robert Childs joined Hiscox in 1986, served as the Active Underwriter of the Hiscox Lloyd's Syndicate 33 between 1993 and 2005, and is the Group's Chief Underwriting Officer. Robert was Chairman of the Lloyd's Market Association from January 2003 to May 2005. Robert is a Trustee of Enham (a charity for the disabled), Chairman of the Advisory Board of the School of Management of Royal Holloway University of London, and Chairman of The Bermuda Society.

Independent Non Executive Directors

Richard Gillingwater
Senior Independent Director (Aged 54)

Richard Gillingwater joined Hiscox in December 2010. He is Dean of Cass Business School. He spent a decade at Kleinwort Benson, before moving to and eventually becoming joint Head of Corporate Finance for BZW, a division of Barclays Bank. When that became Credit Suisse First Boston, he became Chairman of European Investment Banking. In 2003 he became Chief Executive and later Chairman of the Shareholder Executive which manages the UK Government's day-to-day relationships with government-owned businesses. He was awarded a CBE in the Queen's Birthday Honours List 2008 in recognition of his services to the financial services industry.

△○□

Secretary
Charles Dupplin

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Bermuda

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Bank of Bermuda – HSBC
6 Front Street
Hamilton HM 11
Bermuda

Stockbrokers
UBS Limited
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London EC2M 2PP
United Kingdom

Registrars
Capita Registrars (Jersey) Limited
PO Box 532
St Helier
Jersey JE4 5UW

△
Member of the Audit Committee

○
Member of the Conflict Committee

□
Member of the Remuneration and Nomination Committee

Chairman of Committee is highlighted in solid

Daniel Maurice Healy
Non Executive Director and Chairman of the Audit Committee (Aged 68)

Daniel Healy joined Hiscox in 2006. He was appointed Executive Vice President and Chief Financial Officer of North Fork Bancorporation in 1992 and a member of its Board of Directors in 2000. He was a partner with KPMG LLP before joining North Fork. He was the Managing Partner of the San José, California and Long Island, New York offices and held other positions in that firm during his tenure. He is Chairman of Herald National Bank and he holds Board positions with KBW, Inc. and Harlem RBI, a not-for-profit organisation. He is also a Senior Adviser to Permira Advisers LLC, an international private equity firm.

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Ernst Robert Jansen
Non Executive Director (Aged 62)

Ernst Jansen joined Hiscox in 2008. He held several Managing Director positions in the European chemical industry between 1980 and 1990. He was an Executive Director then Vice Chairman of Eureko B.V. between 1992 and 2007. Following retirement he became an adviser to the Executive Board and is a member of the Supervisory Board of a number of Eureko operating companies.

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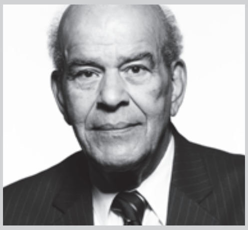

Dr James Austin Charles King
Non Executive Director and Chairman of the Conflict Committee (Aged 72)

Dr James King joined Hiscox in 2006. He chairs Keytech Limited, The Bermuda Telephone Company Ltd, Grotto Bay Properties Ltd and the Establishment Investment Trust, a UK listed company. He was Chairman of the Bank of N.T. Butterfield & Son Limited until 19 April 2007. He is a Director of Castle Harbour Limited. Dr King is a fellow of the Royal College of Surgeons, Canada and the American College of Surgeons.

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Robert McMillan
Non Executive Director (Aged 58)

Robert (Bob) McMillan joined the Hiscox Ltd Board in December 2010. He spent 24 years with the Progressive Insurance Corporation where he served in various positions including National Director of Product Development, then claims before becoming National Director of Marketing. He led Progressive's initiatives in multi-channel distribution, financial responsibility based rating, and immediate response claims. He has received two United States patents related to motor insurance pricing. He has lectured on business innovation at the University of Virginia's Darden School of Business and at the Harvard Business School. He has been a Non Executive Director of Hiscox Inc. since March 2007.

△○□

Andrea Sarah Rosen
Senior Independent Director (Jan 2010–Feb 2011) and Chairman of the Remuneration and Nomination Committee (Aged 56)

Andrea Rosen joined the Hiscox Ltd Board in 2006. She is a Director of Alberta Investment Management Corporation and a Director of Emera Inc. She was previously Vice Chair of TD Financial Group and President of TD Canada Trust from 2002 to 2005. Prior to this she held various positions within the TD Financial Group from 1994 to 2002, including Executive Vice President of TD Commercial Banking and Vice Chair of TD Securities. She was Vice President of Varity Corporation from 1991 to 1994 and held various positions with Wood Gundy Inc. from 1981 to 1990.

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Gunnar Stokholm
Non Executive Director (Aged 61)

Gunnar Stokholm joined Hiscox in 2008. He worked for Zurich Financial Services between 1995 and 2004, in a number of roles including CEO for Australia and Asian markets. He spent the majority of his career at Topdanmark Insurance and held the position of Managing Director of Topdanmark Holding from 1986 to 1995.

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Corporate governance

Overview and basis of reporting

Hiscox Ltd ('the Company') is the Bermudian domiciled holding company for the Group. The Company is listed on the London Stock Exchange's main market for listed securities. The corporate governance framework for companies registered in Bermuda is established by the Company's constitution together with Companies Act legislation.

During 2010, and up to the date of this report and accounts, the Group has complied with the provisions of the Combined Code in all material respects.

The Board of Directors

The Board comprises four Executive Directors and seven independent Non Executive Directors, including a Senior Independent Director. Biographical details for each member of the Board are provided on pages 32 to 33.

The Board continues to believe in the need for an Executive Chairman. The roles and activities of the Chairman and Chief Executive are distinct and separate. The Chairman is responsible for running an effective Board including oversight of corporate governance and overall strategy. The Chief Executive has responsibility for running the Group's business.

In accordance with the new UK Corporate Governance Code, all Directors are required to submit themselves for re-appointment at the Annual General Meeting of the Company. The appointment and removal of the Company Secretary is a matter for the Board as a whole. All Directors are entitled to seek independent professional advice at the Company's expense.

A copy of the advice is provided to the Company Secretary who will circulate it to all Directors.

The Board meets at least four times a year and operates within established Terms of Reference. It is supplied with appropriate and timely information to enable it to review business strategy, trading performance, business risks and opportunities. The Board of Hiscox Ltd met four times during the year. The Board considers all the Non Executive Directors to be independent within the meaning of the Combined Code and the new UK Corporate Governance Code as there are no relationships or circumstances which would interfere with the exercise of their independent judgement.

The Board's Terms of Reference include a Schedule of Matters Reserved for Board Decision, a copy of which can be found on the Group's website: www.hiscox.com.

The Board retains ultimate authority for high-level strategic and management decisions including: setting Group strategy, approving significant mergers or acquisitions, approving the financial statements, declaration of the interim dividend and recommendation of the final dividend, approving Group business plans and budgets, approving major new areas of business, approving capital raising, approving any bonus or rights issues of share capital, setting Group investment guidelines, approving the Directors' remuneration, approving significant expenditure or projects, and approving the issue of share options. The Board has, however, authorised the boards of the trading entities and business divisions to manage their respective operational affairs, to the extent that Company Board level approval is not required.

The Board's committees

The Board has appointed and authorised a number of committees to manage aspects of the Group's affairs. Each committee operates within established written terms of reference and each committee Chairman reports directly to the Board.

The Group Executive Committee

The Group Executive Committee, comprising the Executive Directors, meets monthly to raise and discuss topics such as Group strategy (subject always to Board approval), approval of senior appointments and remuneration (other than Board appointments), management of the Group's trading performance, mergers and acquisitions (which are not significant to the Group), significant issues raised by the London, European and US and executive groups and approval of exceptional spend within the limits established by the Board. The London, European and US executive groups provide strategic direction and are a forum for communicating important issues. Below these geographic executive groups, are the local management teams that drive the local businesses.

The Audit Committee

The Audit Committee of Hiscox Ltd is chaired by Daniel Healy and comprises Richard Gillingwater, Ernst Jansen, Dr James King, Bob McMillan, Andrea Rosen and Gunnar Stokholm. The Chairman of the Committee, Daniel Healy, is considered by the Board to have recent and relevant financial experience. The Audit Committee meets at least three times a year to assist the Board on matters of financial reporting, risk management and internal control. The Audit Committee monitors the scope, results and cost effectiveness of the internal and external audit functions, the independence and objectivity of the external auditors, and the nature and extent of non-audit work undertaken by the external auditors together with the level of related fees. The internal and external auditors have unrestricted access to the Audit Committee. All non-audit work undertaken by the Group's external auditors with fees greater than £50,000 must be pre-approved by the Audit Committee. KPMG has confirmed to the Audit Committee that in its opinion it remains independent. The Committee is satisfied that this is the case.

The Remuneration and Nomination Committee

The Remuneration and Nomination Committee comprises Richard Gillingwater, Daniel Healy, Ernst Jansen, Dr James King, Bob McMillan, Andrea Rosen, Gunnar Stokholm and Dirk Stuurop and until his death Sir Mervyn Pedelty. It was chaired, until his death, by Sir Mervyn Pedelty, with Andrea Rosen as alternate, and is now chaired by Andrea Rosen. It meets a minimum of twice a year to deal with appointments to the Board and to recommend a framework of executive remuneration.

During the year, the Remuneration and Nomination Committee, considered the appointment of a Non Executive Director. A selection process was agreed by the Committee a recruitment consultancy was appointed and a detailed specification was prepared. It was agreed that Andrea Rosen (Acting Senior Independent Director) would represent the Committee in the selection process and she, as well as the Chairman, the Chief Executive Officer and the Group Human Resources Director, interviewed the shortlisted candidates.

The Board approved the appointment of Bob McMillan as a Non Executive Director. He has been a Non Executive Director of Hiscox Inc. since March 2007 and the Board consider that the knowledge and experience gained from this role, together with Bob's background in the insurance industry, are a significant benefit to the Board. Richard Gillingwater took over as Senior Independent Director from Acting Senior Independent Director, Andrea Rosen, on 28 February 2011.

The Directors' remuneration report is presented on pages 37 to 45.

The Conflicts Committee
The Group has a Conflicts Committee which comprises independent Non Executive Directors from within the Group, and is chaired by Dr James King. It meets as and when required. Conflicts of interest may arise from time to time because Syndicate 33, Syndicate 3624 and Syndicate 6104 are managed by a Hiscox-owned Lloyd's Managing Agency. 27.5% of the Names on Syndicate 33 are third-parties and 72.5% of Syndicate 33 is owned by a Hiscox Group company. 100% of Syndicate 3624 is owned by a Hiscox Group company. 100% of Syndicate 6104 is owned by third-parties. The Conflicts Committee serves to protect the interests of the third-party Syndicate Names. Should such a potential conflict of interest arise, there is a formal procedure to refer the matter to this Committee.

Risk Committees
There are a number of committees within the Group which have been established to oversee specific risk areas, including underwriting, reserving, reinsurance credit, liquidity, broker credit, business continuity and investments. A Group risk committee ensures that risk management activities are effective and integrated. These committees comprise Directors of the Company and its subsidiaries and relevant senior employees.

Performance evaluation
Periodically the Chairman reviews the performance of the Board as a whole. He meets with the Non Executive Directors separately and as a body to discuss a wide range of issues, including the performance of the Executive Directors. In addition the Non Executives periodically meet without the Chairman and Executive Directors to discuss a similarly wide range of issues concerning the company including as appropriate the performance of the Chairman and the Executive Directors. No major issues concerning Board performance have been raised during the year.

Meetings and attendance table

	Ltd Board	Audit Committee	Remuneration and Nomination Committee
Director	Attended	Attended	Attended
RRS Hiscox	4/4	n/a	n/a
BE Masojada	4/4	n/a	n/a
SJ Bridges	4/4	n/a	n/a
RS Childs	4/4	n/a	n/a
RD Gillingwater	0/0	0/0	0/0
DM Healy	4/4	3/3	3/3
ER Jansen	3/4	2/3	3/3
Dr J King	4/4	3/3	3/3
R McMillan	0/0	0/0	0/0
AS Rosen	4/4	3/3	3/3
G Stokholm	4/4	3/3	3/3

Corporate governance continued

The Chief Executive held one-to-one meetings with each of the Executive Directors to discuss their performance over the year and to set targets for the year ahead.

Shareholder communications

The Executive Directors communicate and meet directly with shareholders and analysts throughout each year, and do not limit this to the period following the release of financial results or other significant announcements.

Dirk Stuurop resigned as a Director of Hiscox Ltd on 19 August 2010 and did not attend the Annual General Meeting. All other Directors attended the Annual General Meeting in 2010.

The Company commissions independent research on feedback from shareholders and analysts on a regular basis following the Company's results announcements. This research together with the analysts' research notes are copied to the Non Executive Directors in full. The Chairman attends a number of meetings with shareholders as well as speaking at the analysts' presentations. In addition, any specific items covered in letters received from major shareholders are reported to the Board. Major shareholders are invited to request meetings with the Senior Independent Director and/or the other Non Executive Directors.

An alert service is available on www.hiscox.com to notify any stakeholder of new stock exchange announcements.

Accountability and internal control

The Directors are responsible for maintaining a sound system of internal control to safeguard the investment made by shareholders and the Company's assets, and for reviewing its effectiveness.

The risk management systems are set out in detail in the risk management report on pages 21 to 25.

The Board has reviewed the effectiveness of internal controls during 2010, including financial, operational and compliance controls. The Board confirms there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company, which has been in place throughout the year and up to the date of approval of the Annual Report and Accounts and accords with the guidance in the document 'Internal Control: Guidance for Directors on the Combined Code'. The head of each business area is responsible for implementing the risk management programme in their area of operations. The Risk function collates risk management information and works with the risk committees to monitor significant risks and movements, and review the relevant internal controls.

The Group also has an internal audit function which has direct access to the Audit Committee and reports to each meeting.

The Board acknowledges that it is neither possible, nor desirable, to eliminate risk completely. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The constant aim is to be fully aware of the risks to which the business is exposed and to manage these risks to acceptable levels.

Directors' remuneration report

This report sets out the remuneration policy for the Group's senior executives. This policy is consistent with the overall reward approach across the Group. The sections in this report entitled 'Annual cash incentives', 'Share incentive schemes', 'Remuneration of Executive Directors' and 'Pensions' have been audited by KPMG. The remainder of the report is unaudited.

Remuneration and Nomination Committee
The Remuneration and Nomination Committee meets at least twice a year. The members of the Committee for 2010 were Andrea Rosen (Chairman), Daniel Healy, Dr James King, Dirk Stuurop, Ernst Jansen, Gunnar Stokholm and Sir Mervyn Pedelty (until his death in January 2010 when Andrea took over as Chair).

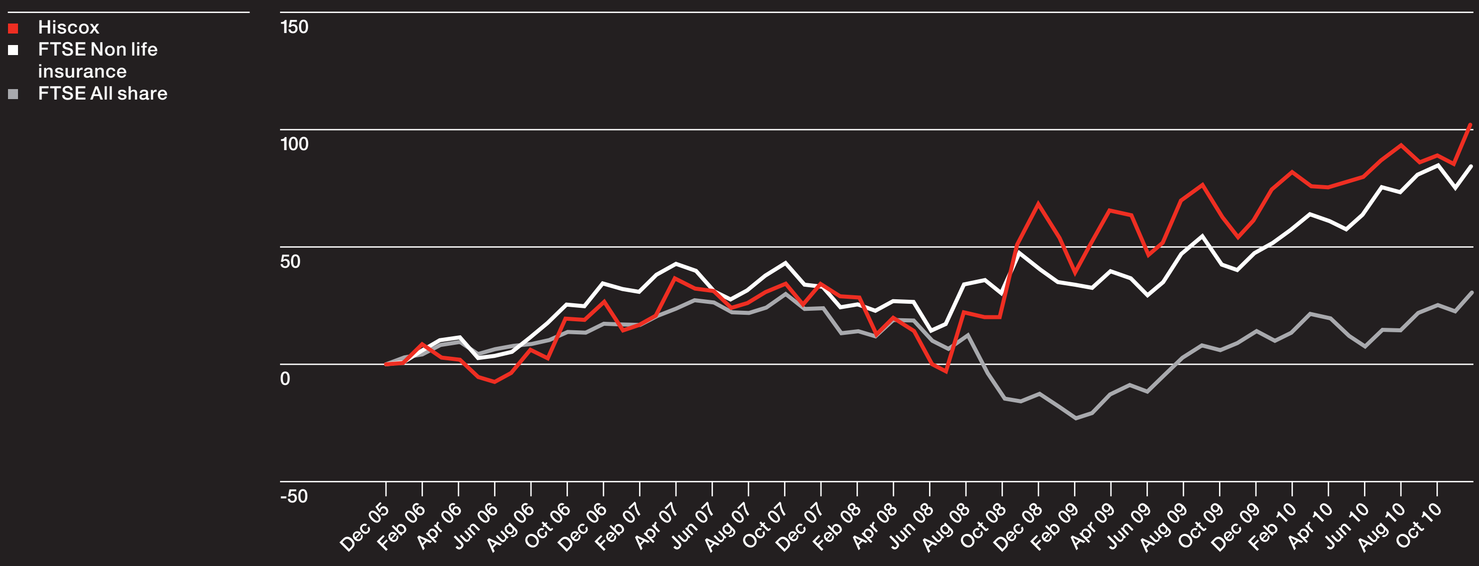
The primary purpose of the Committee is to determine:
- the overall remuneration strategy, policy and cost for the Group;
- the levels and make-up of remuneration for the four Executive Directors; and
- the award of sizeable bonuses to individuals other than the Executive Directors.

No member of the committee has any personal financial interest (other than as a shareholder) or conflicts of interest arising from cross directorships or day-to-day involvement in running the business. No Director plays any part in any discussion about his or her own remuneration.

The Committee is provided with data and has access to advice from Towers Watson, independent remuneration consultants. The Company also uses the Towers Watson compensation benchmarking reports.

Remuneration policy
The remuneration philosophy is to provide rewards that are competitive in every country in which Hiscox operates and that are consistent with our overall reward principles:
- competitive base pay;
- benefits which encourage health and security for the individual and his or her family but are not excessive and are consistent at all levels of the organisation;
- an annual bonus scheme which enables employees to earn attractive bonuses for generating good levels of return on equity;
- to encourage share ownership at all levels of the organisation and require it at senior levels; and
- contracts and notice periods that are in line with acceptable market practice but limit severance payments made on termination.

Total shareholder return (%)



Directors' remuneration report continued

As a business Hiscox is focused on generating strong returns on equity and long-term shareholder returns, therefore our reward structure is aligned with this.

The Remuneration and Nomination Committee regularly reviews our remuneration approach and, particularly in the context of the current remuneration environment, will do so again this year.

Remuneration elements

The elements of remuneration at Hiscox are: fixed reward (base salary, benefits and retirement benefits) and variable reward (annual cash incentives (bonuses) and share incentive schemes).

Fixed reward

Fixed reward is made up of base salary, benefits and retirement benefits.

Base salary

Base salaries are reviewed annually. The Remuneration and Nomination Committee takes into account inflation rate movements by country, market data provided by its own consultants, Towers Watson, and the competitive position of Hiscox salaries (based on the Towers Watson salary reports), in order to set the overall salary budget.

Individual salaries are set by taking into account all of the above as well as individual performance and skills.

When approving Executive Directors' salaries, the Remuneration and Nomination Committee takes into account rates of inflation, individual performance, and competitive positioning of salaries as informed by Towers Watson data and other publicly available reports.

The base salaries of the Executive Directors were not increased in 2010.

Benefits

Benefits are set within agreed principles but reflect normal practice for each country. Hiscox benefits include health insurance, life insurance and long-term disability schemes.

Retirement benefits

These also vary by local country practice. All open Hiscox retirement schemes are based on defined contributions.

Variable reward

Annual cash incentives (bonuses)

Hiscox's remuneration policy is underpinned by the belief that a reasonable portion of total remuneration should be attained through incentive awards, thereby linking rewards directly with performance. The expectation is that successful performance (company and individual) should enable employees to achieve upper quartile total remuneration.

Two bonus pools are operated: the Personal Performance Bonus (PPB) and the Profit Related Bonus (PRB). The PPB is only available to junior and mid-level staff and is based entirely on individual performance ratings. It is designed to ensure that employees in these roles continue to be motivated to perform and the benefit is up to 10% of relevant salaries.

All employees, including Executive Directors, are eligible for the Profit Related Bonus.
The PRB scheme is triggered when the business profits of the Group, based on the year's pre-tax operating result, exceed a return on equity (ROE) linked to the longer-term rate of return ('Hurdle Rate'). The minimum Hurdle Rate is currently set at a 10% pre-tax return on equity with the bonus pool comprising 15% of profits in excess of that. Bonus pools are then calculated for each major business division and line of business based on the performance of that division against the Hurdle Rate of return for the division's allocated equity. For the large premium business divisions the calculation is the same as for the Group (described above). Effective 2011 the small premium business divisions will have bonus pools calculated by taking 15% of total profits once the Hurdle Rate has been achieved.

The Hurdle Rate for the 2010 bonus was reviewed. On balance the conclusion was that the Hurdle Rate should remain unchanged for 2010.

From 2011 the Hurdle Rate will be reviewed by using a 'benchmark rate' which takes account of the medium-term, forward looking investment returns (specifically 1–3 year Gilt and Treasury yields, cash returns and the general investment environment). The Hurdle Rate will then be set at 5% above this benchmark rate. If the benchmark rate drops below zero or above 7.5% (suggesting a Hurdle Rate of below 5% or above 12.5%) we would review this approach. Based on this, the Hurdle Rate for 2011 has been set at 7.5%.

Once the overall bonus pool has been established, individual bonuses, including those for Executive Directors, are calculated based on the results of each business area and individual performance. The Remuneration and Nomination Committee determines the bonuses to be paid to the Executive Directors based on the performance of the Group and an assessment of individual performance. In this way, the bonus scheme aligns the interests of Executive Directors and employees with shareholders.

Executive Directors' cash incentives and ROE

	Pre-tax return on equity %	Average bonus as a percentage of salary %
2000	3	0
2001	(24)	0
2002	13	90
2003	30	202
2004	28	173
2005	19	54
2006	35	274
2007	36	372
2008	14	53
2009	34	287
2010	19	108

The payment of larger bonuses is normally deferred over a three-year period as follows (with receipt dependent on continued service).

Bonus of £50,000, €75,000, $100,000 and below	Entire bonus taken in cash in year one
Bonus above £50,000 and below £100,000 Bonus above €75,000 and below €150,000 Bonus above $100,000 and below $200,000	£50,000, €75,000, $100,000 taken in year one Balance of bonus split 50% in year two, and 50% in year three
Bonus above £100,000 Bonus above €150,000 Bonus above $200,000	50% of bonus taken in year one Balance of bonus split 50% in year two, and 50% in year three

Share ownership is encouraged amongst senior personnel by allowing the deferred element of the annual bonus to be used, without deferral for:
- payment of the exercise price on the exercise of share options;
- payment of tax on the exercise of performance shares;
- purchase of shares; and
- payment of debt due on share purchases.

The only exception to this is for US-based employees where, due to the implications of the US Internal Revenue Code, employees are not able to receive the deferred element of their bonuses early in order to purchase shares.

Early payment of deferred bonuses for reasons other than the above can only be made with the agreement of the Chief Executive, and the Remuneration and Nomination Committee in the case of Executive Directors.

Share Incentive Schemes

The Remuneration and Nomination Committee believes that employees should be encouraged to own Hiscox shares so that they are aligned with the long-term success of the Company. Hiscox operates a Performance Share Plan for senior managers, a UK Save as You Earn scheme and an International Save as You Earn scheme.

Performance Share Plan

Restricted share awards or nil cost option awards (depending on the appropriate practice by country) are made to Executive Directors and other senior managers at the discretion of the Remuneration and Nomination Committee. Awards under this plan were made in 2010 and the Remuneration and Nomination Committee has also agreed to make awards under this plan in 2011. The maximum annual award to an individual under the Performance Share Plan is a value of 200% of basic salary. The highest actual grant awarded in 2010 was 195% of basic salary.

Dividend payments

In order to better align senior managers with Total Shareholder Return, the concept which is applied to the Performance Share Plan awards is that the recipient is provided with the equivalent of the dividend either in shares or cash. This specifically works as follows:
- dividends (or amounts equal to dividends) on shares granted under the Performance Share Plan roll up in the form of shares between the grant and vesting;
- at the end of the performance period the employee would have options over the proportion of the share grant which vests by reference to the satisfaction of the applicable performance target as well as over the number of shares representing the 'rolled up' dividends on those shares; and
- for UK-based employees only, after vesting but before exercise, the employee would then receive 'shadow dividends' (i.e. amounts equal to dividends paid) on the total number of shares remaining under option. Up to a maximum of 200,000 shares under option per individual, these amounts would be paid in cash, twice yearly, at the same time as dividends are paid to shareholders, until the option is exercised (which could be for up to a further seven years, when the option expires). Above 200,000 shares under option, the 'shadow dividends' would be re-invested into shares within the trust. Executive Directors, however, would have the entire 'shadow dividend' re-invested in shares within an employee benefit trust.

Directors' remuneration report continued

Performance conditions
Performance conditions for the Performance Share Plan are as follows:

- 25% of the award vests if the Company achieves an average ROE of 10% post-tax for each of the three years;
- 100% vests if the average three-year return exceeds 17.5% post-tax; and
- vesting will occur on a straight-line basis between these points.

The Remuneration and Nomination Committee believes that using ROE as the long-term performance condition better aligns the interests of employees with shareholders as ROE best captures the efficiency with which the Company is using shareholder funds to generate earnings. The Remuneration and Nomination Committee believes that an average ROE performance requirement over the three-year period smoothes out any cyclical fluctuations in earnings and ensures that over any given period shareholders will receive a minimum return on equity before awards granted to employees will vest.

ROE has been calculated as profit after tax and goodwill amortisation divided by shareholders funds at the beginning of each year, excluding foreign currency items on economic hedges and intragroup borrowings.

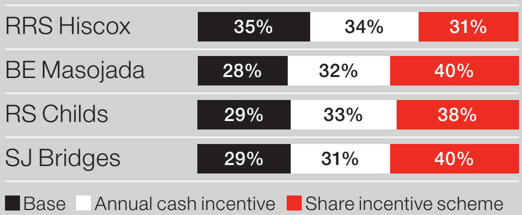
Save as You Earn
The sharesave scheme and international sharesave scheme are offered to all employees and currently have a 55% participation.

Shareholding guidelines
We strongly believe that senior managers within Hiscox should be aligned with Hiscox shareholders by owning a reasonable number of Hiscox shares.

Formal shareholding guidelines are in place which mean that within five years of becoming an Executive Director, Hiscox Partner (the top 5% of employees in the company) or a member of a subsidiary board, the employee will be expected to own Hiscox shares valued at 100% of salary for Hiscox Partners and members of subsidiary boards and 150% of salary for Executive Directors.

The table at the end of the remuneration report details Directors' interests in the long-term incentive plans.

Executive Director reward
Executive Directors' reward packages are consistent with the rest of the business. The actual compensation paid to the four Executive Directors in 2010 is outlined in the table below. Details of their contractual notice periods are contained in the table below right.



'Base' refers to base salary for the year.
'Annual cash incentive' is the annual amount allocated from the profit bonus pool.
'Share incentive scheme' is the estimated value at award of the Performance Share Plan awards made during the year.

Remuneration of Executive Directors

	2010 Basic salary £000	2010 Benefits £000	2010 Bonus £000	2010 Total £000	2009 Basic salary £000	2009 Benefits £000	2009 Bonus £000	2009 Total £000
RRS Hiscox	**310**	**2**	**300**	**612**	310	2	800	1,112
BE Masojada	**438**	**2**	**500**	**940**	436	2	1,250	1,688
RS Childs	**358**	**2**	**400**	**760**	356	73	1,250	1,679
SJ Bridges	**328**	**2**	**350**	**680**	326	2	800	1,128

External Non Executive Directorships

No external appointments may be accepted by an Executive Director where such appointment may give rise to a conflict of interest. The consent of the Chairman is required in any event. During the year, RRS Hiscox has been a Non Executive Director of Grainger Trust plc and was paid £35,000 for his services and of AGICM Ltd and was paid £10,000. During the year, RS Childs has been a Non Executive Director of HIM Capital Limited and HIM Capital Holdings Limited until resignation on 21 September 2010 and did not receive any payment for his services. SJ Bridges and BE Masojada did not hold any Non Executive Director positions during the year.

Service contract table

Director	Effective date of Hiscox Ltd contract	Unexpired term and notice period
RRS Hiscox	12 Dec 2006	12 months
BE Masojada	12 Dec 2006	6 months
RS Childs	12 Dec 2006	6 months
SJ Bridges	12 Dec 2006	6 months
R Gillingwater	1 Dec 2010	3 months
DM Healy	11 Oct 2006	3 months
ER Jansen	20 Nov 2008	3 months
Dr J King	11 Oct 2006	3 months
R McMillan	1 Dec 2010	3 months
AS Rosen	11 Oct 2006	3 months
G Stokholm	20 Nov 2008	3 months

Directors' remuneration report continued

Remuneration of Non Executive Directors

Non Executive Directors receive an annual fee in respect of their Board appointments together with additional compensation for their further duties in relation to Board committees. All amounts are denominated in US Dollars. The structure of the fees paid are detailed below.

The fees in relation to Hiscox Ltd for the year were:

	Hiscox Ltd Board $000	Committees $000	**Total 2010 $000**	Total 2009 $000
R Gillingwater	10	5	**15**	–
DM Healy	83	39	**122**	120
ER Jansen	83	29	**112**	110
Dr J King	83	34	**117**	115
R McMillan	10	3	**13**	–
Sir Mervyn Pedelty	6	2	**8**	130
AS Rosen	83	47	**130**	117
G Stokholm	83	34	**117**	110
DA Stuurop	53	17	**70**	110

Pensions

	Increase in accrued pension during the year £000	Transfer accrued annual pension at 31 Dec 10 £000	Transfer value of increase in accrued pension £000	Transfer value of accrued pension at 1 Jan 10 £000	Transfer value of accrued pension at 31 Dec 10 £000	Increase/(decrease) in transfer value of accrued benefit during the year £000
RRS Hiscox	7	238	16	4,701	5,056	355
BE Masojada	1	40	2	646	746	100
RS Childs	12	252	17	5,387	6,185	798
SJ Bridges	2	31	1	452	528	76

Share options

	Number of options at 1 January 2010	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2010**	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date
SJ Bridges	56,398	–	–	(56,398)	**–**	1.755	3.401	3-May-04	2-May-11
	180,341	–	–	(180,341)	**–**	1.252	3.401	19-Nov-05	18-Nov-12
	154,578	–	–	–	**154,578**	1.465	–	2-Apr-06	1-Apr-13
	154,578	–	–	–	**154,578**	1.514	–	13-Jul-07	12-Jul-14
	154,578	–	–	–	**154,578**	1.499	–	6-Apr-08	5-Apr-15
	700,473	–	–	(236,739)	**463,734**				
RS Childs	78,958	–	–	(78,958)	**–**	1.755	3.364	3-May-04	2-May-11
	206,104	–	–	–	**206,104**	1.252	–	19-Nov-05	18-Nov-12
	206,104	–	–	–	**206,104**	1.465	–	2-Apr-06	1-Apr-13
	206,103	–	–	–	**206,103**	1.514	–	13-Jul-07	12-Jul-14
	206,104	–	–	–	**206,104**	1.499	–	6-Apr-08	5-Apr-15
	903,373	–	–	(78,958)	**824,415**				
RRS Hiscox	56,398	–	–	(56,398)	**–**	1.755	3.688	3-May-04	2-May-11
	56,398	–	–	(56,398)	**–**				
BE Masojada	169,195	–	–	(169,195)	**–**	1.020	3.410	15-Jun-03	14-Jun-10
	78,958	–	–	(78,958)	**–**	1.755	3.410	3-May-04	2-May-11
	206,104	–	–	–	**206,104**	1.252	–	19-Nov-05	18-Nov-12
	206,104	–	–	–	**206,104**	1.465	–	2-Apr-06	1-Apr-13
	206,104	–	–	–	**206,104**	1.514	–	13-Jul-07	12-Jul-14
	206,104	–	–	–	**206,104**	1.499	–	6-Apr-08	5-Apr-15
	1,072,569	–	–	(248,153)	**824,416**				
Other employees	151,679	–	–	(151,679)	**–**	1.020	3.380-3.483	15-Jun-03	14-Jun-10
	244,742	–	–	(156,749)	**87,993**	1.755	3.363-3.600	3-May-04	2-May-11
	360,947	–	–	(267,338)	**93,609**	0.806	3.346-3.615	27-Sep-04	26-Sep-11
	621,433	–	–	(227,746)	**393,687**	1.252	3.363-3.600	19-Nov-05	18-Nov-12
	630,489	–	–	(145,181)	**485,308**	1.465	3.363-3.600	2-Apr-06	1-Apr-13
	1,138,410	–	(51,525)	(427,663)	**659,222**	1.514	3.360-3.585	13-Jul-07	12-Jul-14
	1,102,718	–	(46,371)	(405,572)	**650,775**	1.499	3.344-3.585	6-Apr-08	5-Apr-15
	4,250,418	–	(97,896)	(1,781,928)	**2,370,594**				
Total	6,983,231	–	(97,896)	(2,402,176)	**4,483,159**				

Directors' remuneration report continued

Share options

The interests of the Directors and employees under the UK and International Sharesave Schemes of the Group are set out below:

	Number of options at 1 January 2010	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2010**	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date
UK Sharesave Scheme									
SJ Bridges	4,256	–	–	(4,256)	**–**	2.220	3.340	01-May-10	31-Oct-10
	–	3,210	–	–	**3,210**	2.826	–	01-May-13	01-Nov-13
RRS Hiscox	4,907	–	–	–	**4,907**	1.956	–	01-Dec-11	31-May-12
RS Childs	–	3,210	–	–	**3,210**	2.826	–	01-May-13	01-Nov-13
BE Masojada	4,343	–	–	–	**4,343**	2.210	–	01-Dec-10	31-May-11
	–	3,107	–	–	**3,107**	2.896	–	01-Dec-13	31-May-14
Other employees	204,356	–	(6,298)	(198,058)	**–**	2.220	3.340-3.600	01-May-10	31-Oct-10
	134,699	–	(15,797)	(70,960)	**47,942**	2.210	3.415-3.618	01-Dec-10	31-May-11
	521,949	–	(36,626)	(4,440)	**480,883**	1.982	3.401-3.510	01-May-11	31-Oct-11
	347,784	–	(29,458)	(4,198)	**314,128**	1.956	3.412-3.599	01-Dec-11	31-May-12
	118,893	–	(8,085)	(1,294)	**109,514**	2.418	3.401-3.415	01-May-12	01-Nov-12
	90,241	–	(10,019)	–	**80,222**	2.752	–	01-Dec-12	31-May-13
	–	204,461	(14,957)	–	**189,504**	2.826	–	01-May-13	01-Nov-13
	–	131,239	(1,243)	–	**129,996**	2.896	–	01-Dec-13	31-May-14
Total	1,431,428	345,227	(122,483)	(283,206)	**1,370,966**				
International Sharesave Scheme									
RS Childs	4,147	–	–	(4,147)	**–**	2.220	3.340	01-May-10	31-Oct-10
Other employees	89,691	–	(9,371)	(80,320)	**–**	2.220	3.340-3.656	01-May-10	31-Oct-10
	7,363	–	(7,363)	–	**–**	2.220	–	01-Jul-10	31-Dec-10
	23,038	–	(1,190)	(10,264)	**11,584**	2.210	3.543-3.775	01-Dec-10	31-May-11
	161,130	–	(8,242)	–	**152,888**	1.982	–	01-May-11	31-Oct-11
	49,751	–	(2,840)	–	**46,911**	1.956	–	01-Dec-11	31-May-12
	54,438	–	(6,706)	–	**47,732**	2.418	–	01-May-12	01-Nov-12
	73,180	–	(2,825)	–	**70,355**	2.752	–	01-Dec-12	31-May-13
	–	89,254	(4,733)	–	**84,521**	2.826	–	01-May-13	01-Nov-13
	–	39,845	–	–	**39,845**	2.896	–	01-Dec-13	31-May-14
Total	462,738	129,099	(43,270)	(94,731)	**453,836**				

Performance Share Plan

	Number of awards at 1 January 2010	Number of awards granted	Number of awards lapsed	Number of awards exercised	**Number of awards at 31 December 2010**	Market price at date of exercise £	Date from which released
SJ Bridges	120,000	15,882	–	(135,882)	**–**	3.416	26-Mar-10
	110,000	–	–	–	**110,000**	–	07-Apr-11
	200,000	–	–	–	**200,000**	–	02-Apr-12
	–	150,000	–	–	**150,000**	–	07-Apr-13
RS Childs	150,000	19,852	–	(169,852)	**–**	3.366	26-Mar-10
	140,000	–	–	–	**140,000**	–	07-Apr-11
	225,000	–	–	–	**225,000**	–	02-Apr-12
	–	175,000	–	–	**175,000**	–	07-Apr-13
RRS Hiscox	80,000	10,588	–	–	**90,588**	–	26-Mar-10
	75,000	–	–	–	**75,000**	–	07-Apr-11
	50,000	–	–	–	**50,000**	–	02-Apr-12
	–	76,260	–	–	**76,260**	–	07-Apr-13
BE Masojada	200,000	26,470	–	(226,470)	**–**	3.381	26-Mar-10
	175,000	–	–	–	**175,000**	–	07-Apr-11
	275,000	–	–	–	**275,000**	–	02-Apr-12
	–	250,000	–	–	**250,000**	–	07-Apr-13
Other employees	909,580	–	–	(66,315)	**843,265**	3.371-3.414	12-Jan-09
	55,262	–	–	(55,262)	**–**	3.336	05-Oct-09
	2,026,500	266,180	(10,000)	(1,822,389)	**460,291**	3.325-3.660	26-Mar-10
	52,000	6,882	–	(58,882)	**–**	3.503-3.601	02-Oct-10
	1,553,000	–	(22,500)	–	**1,530,500**	–	07-Apr-11
	2,906,000	–	(70,000)	–	**2,836,000**	–	02-Apr-12
	–	3,095,096	(60,000)	–	**3,035,096**	–	07-Apr-13
Total	9,302,342	4,092,210	(162,500)	(2,535,052)	**10,697,000**		

Directors' report

The Directors have pleasure in submitting their Annual Report and financial statements for the year ended 31 December 2010.

Principal activity and business review

The Company is a holding company for subsidiaries involved in the business of insurance in Bermuda, the US, the UK, Guernsey and Europe. An analysis of the development and performance of the business and likely future development can be found within the Chief Executive's report on pages 5 to 11. A description of the major risks can be found in the risk management section on pages 21 to 25. In addition, note 3 to the financial statements provides a detailed discussion on the risks which are inherent to the Group's business and how those risks are managed. Details of the key financial performance indicators are given on page 1.

All information described above is incorporated by reference into this report and is deemed to form part of this report.

Financial results

The Group achieved a pre-tax profit for the year of £211.4 million (2009: £320.6 million). Detailed results for the year are shown in the consolidated income statement on page 49, and also within the Group financial performance section on pages 16 to 17.

Going concern

A review of the financial performance of the Group is set out on pages 16 to 17. The financial position of the Group, its cash flows and borrowing facilities are included therein. The Group has considerable financial resources and a well-balanced book of business.

After making enquiries, the Directors have an expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts.

Dividends

An interim dividend of 5.0p (net) per share (2009: 4.5p (net)) was paid on 28 September 2010 by Hiscox Ltd in respect of the year ended 31 December 2010. The Directors recommend the payment of a final dividend of 11.5p (net) per share (2009: second interim dividend 10.5p (net)). If approved this will be paid on 21 June 2011 to shareholders on the register at the close of business on 13 May 2011. The Directors propose that shareholders may elect to receive the final dividend in new ordinary shares, a 'scrip dividend', rather than cash. A resolution to approve the scrip dividend alternative will be put to shareholders at the Annual General Meeting. It is envisaged that the Company will suspend indefinitely the Company's Dividend Access Plan if the scrip dividend alternative is approved.

Share capital

Details of the structure of the Company's share capital and changes in the share capital during the year are disclosed in note 24 to the consolidated financial statements.

Directors

The names and details of the individuals who served as Directors of the Company during the year are set out on pages 32 to 33. Details of the Chairman's professional commitments are included in his biography.

In accordance with the new UK Corporate Governance Code all Directors will submit themselves for re-election at the Annual General Meeting of the Company.

Sir Mervyn Pedelty died in January 2010. Sir Mervyn had been the Chairman of the Remuneration and Nomination Committee and Senior Independent Director of Hiscox Ltd since redomicile. Andrea Rosen was subsequently appointed Chairman of the Remuneration and Nomination Committee and Acting Senior Independent Director. Dirk Stuurop resigned on 19 August 2010. Richard Gillingwater and Robert (Bob) McMillan were appointed on 1 December 2010. On 28 February 2011, Richard Gillingwater was appointed Senior Independent Director.

Political and charitable contributions

The Group made no political contributions during the year (2009: £nil). Charitable donations totalled £1,109,000 (2009: £1,171,000) of which £500,000 (2009: £1,000,000) was donated to the Hiscox Foundation, a UK registered charity. The policy of the Hiscox Foundation is to assist and improve education, the arts and independent living for disabled and disadvantaged members of society. Further information concerning the Group's charitable activities is contained in the report on corporate responsibility on page 27.

Major interests in shares

As at 28 February 2011, the Company has been notified of the following significant holdings of voting rights in its ordinary shares:

	Number of shares	% of total
Invesco Limited	53,447,456	14.04
Massachusetts Financial Services Company	19,620,700	5.15
Ruane, Cunniff & Goldfarb Inc.	19,410,231	5.10

A copy of the Company's Bye-Laws is available for inspection at the Company's registered office.

Annual General Meeting

The notice of the Annual General Meeting, to be held at the Elbow Beach Hotel, 60 South Shore Road, Paget PG04, Bermuda on 8 June 2011 at 10:00am (2:00pm (BST)), is contained in a separate circular to shareholders enclosed with this report.

By order of the Board
Charles Dupplin, Secretary
Wessex House, 45 Reid Street,
Hamilton HM12, Bermuda
28 February 2011

Directors' interests

	31 December 2010 5p Ordinary Shares number of shares beneficial	31 December 2009 5p Ordinary Shares number of shares beneficial
Executive Directors		
RRS Hiscox	**6,637,176**	6,600,196
BE Masojada	**3,504,517**	3,229,465
RS Childs	**1,991,272**	1,906,840
SJ Bridges	**1,149,438**	1,009,399
Non Executive Directors		
R Gillingwater	**–**	–
D Healy	**100,000**	55,000
E R Jansen	**20,698**	–
Dr J King	**–**	–
R McMillan	**–**	–
Sir Mervyn Pedelty	**–**	18,000
A Rosen	**24,116**	–
G Stokholm	**–**	–
DA Stuurop	**–**	50,000

Directors' responsibilities statement

The Board is responsible for ensuring the maintenance of proper accounting records which disclose with reasonable accuracy the financial position of the Company. It is required to ensure that the financial statements present a fair view for each financial period.

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, present fairly, in all material respects, the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Directors' report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

The Directors responsible for authorising the responsibility statement on behalf of the Board are the Chairman, RRS Hiscox and the Group Finance Director, SJ Bridges. The statements were approved for issue on 28 February 2011.

Independent auditors' report to the Board of Directors and the shareholders of Hiscox Ltd

We have audited the accompanying consolidated financial statements of Hiscox Ltd ('the Company') on pages 49 to 99 which comprise the consolidated balance sheet as at 31 December 2010, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In addition to our audit of the consolidated financial statements, the Directors have engaged us to audit the information in the Directors' remuneration report that is described as having been audited, which the Directors have decided to prepare (in addition to that required to be prepared) as if the Company were required to comply with the requirements of Schedule 8 to the UK Companies Act 2006 The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410).

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU and for such internal controls as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and, under the terms of our engagement letter, to audit the part of the Directors' remuneration report that is described as having been audited.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements and the part of the Directors' remuneration report to be audited are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements and the part of the Directors' remuneration report to be audited. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the consolidated financial statements and the part of the Directors' remuneration report to be audited, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the entity's preparation and fair presentation of the consolidated financial statements and the part of the Directors' remuneration report to be audited in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the part of the Directors' remuneration report to be audited.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review by those rules, and we report if it does not. We are not required by the terms of our engagement to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We also read the other information contained in the Report and Accounts and consider whether it is consistent with the audited consolidated financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

Opinion

In our opinion:

- the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at 31 December 2010, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and
- the part of the Directors' remuneration report which we were engaged to audit has been properly prepared in accordance with Schedule 8 to the UK Companies Act 2006 The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410), as if those requirements were to apply to the Company.

KPMG
Hamilton, Bermuda
28 February 2011

Consolidated income statement
For the year ended 31 December 2010

	Note	2010 Total £000	2009 Total £000
Income			
Gross premiums written	4	**1,432,674**	1,435,401
Outward reinsurance premiums		**(301,047)**	(278,378)
Net premiums written	4	**1,131,627**	1,157,023
Gross premiums earned		**1,435,118**	1,363,698
Premiums ceded to reinsurers		**(303,960)**	(265,596)
Net premiums earned	4	**1,131,158**	1,098,102
Investment result	7	**100,249**	183,165
Other revenues	9	**22,079**	19,498
Revenue		**1,253,486**	1,300,765
Expenses			
Claims and claim adjustment expenses, net of reinsurance	26.2	**(570,997)**	(463,218)
Expenses for the acquisition of insurance contracts	17	**(269,891)**	(256,634)
Operational expenses	9	**(206,403)**	(229,566)
Foreign exchange gains/(losses)	12	**15,484**	(25,554)
Total expenses		**(1,031,807)**	(974,972)
Results of operating activities		**221,679**	325,793
Finance costs	10	**(10,090)**	(5,293)
Share of (loss)/profit of associates after tax	16	**(223)**	118
Profit before tax		**211,366**	320,618
Tax expense	28	**(32,566)**	(40,121)
Profit for the year (all attributable to owners of the Company)		**178,800**	280,497
Earnings per share on profit attributable to owners of the Company			
Basic	31	**47.2p**	75.2p
Diluted	31	**45.4p**	72.3p

Consolidated statement of comprehensive income
For the year ended 31 December 2010, after tax

	Note	2010 Total £000	2009 Total £000
Profit for the year		**178,800**	280,497
Other comprehensive income			
Currency translation gains/(losses) (net of tax of £nil (2009: £nil))	12	**11,729**	(69,589)
Total other comprehensive income/(loss)		**11,729**	(69,589)
Total comprehensive income recognised for the year (all attributable to owners of the Company)		**190,529**	210,908

The notes on pages 53 to 99 are an integral part of these consolidated financial statements.

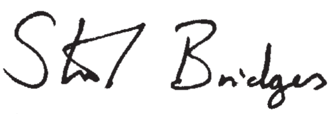
Consolidated balance sheet
At 31 December 2010

	Note	2010 £000	2009 £000
Assets			
Intangible assets	14	**64,108**	50,413
Property, plant and equipment	15	**19,742**	22,244
Investments in associates	16	**6,886**	7,318
Deferred tax	29	**14,077**	14,077
Deferred acquisition costs	17	**142,736**	141,505
Financial assets carried at fair value	19	**2,459,107**	2,413,300
Reinsurance assets	18, 26	**462,765**	420,126
Loans and receivables including insurance receivables	20	**485,414**	488,782
Cash and cash equivalents	23	**336,017**	259,647
Total assets		**3,990,852**	3,817,412
Equity and liabilities			
Shareholders' equity			
Share capital	24	**20,297**	20,158
Share premium	24	**15,800**	11,831
Contributed surplus	24	**245,005**	303,465
Currency translation reserve	25	**49,457**	37,728
Retained earnings	25	**935,555**	748,104
Total equity (all attributable to owners of the Company)		**1,266,114**	1,121,286
Employee retirement benefit obligations	30	**–**	–
Deferred tax	29	**45,421**	69,673
Insurance liabilities	26	**2,279,867**	2,122,351
Financial liabilities	19	**20,457**	138,539
Current tax		**29,995**	26,080
Trade and other payables	27	**348,998**	339,483
Total liabilities		**2,724,738**	2,696,126
Total equity and liabilities		**3,990,852**	3,817,412

The notes on pages 53 to 99 are an integral part of these consolidated financial statements.

The consolidated Group financial statements were approved by the Board of Directors on 28 February 2011 and signed on its behalf by:

RRS Hiscox
Chairman



SJ Bridges
Chief Financial Officer

Consolidated statement of changes in equity

	Note	Share capital £000	Share premium £000	Contributed surplus £000	Currency translation reserve £000	Retained earnings £000	Total £000
Balance at 1 January 2009		20,067	9,418	352,078	107,317	462,146	951,026
Total recognised comprehensive income/(expense) for the year (all attributable to owners of the Company)		–	–	–	(69,589)	280,497	210,908
Employee share options:							
Equity settled share based payments	24	–	–	–	–	5,260	5,260
Proceeds from shares issued	24	91	2,413	–	–	–	2,504
Deferred tax		–	–	–	–	201	201
Dividends paid to owners of the Company	32	–	–	(48,613)	–	–	(48,613)
Balance at 31 December 2009		20,158	11,831	303,465	37,728	748,104	1,121,286
Total recognised comprehensive income/(expense) for the year (all attributable to owners of the Company)		**–**	**–**	**–**	**11,729**	**178,800**	**190,529**
Employee share options:							
Equity settled share based payments		**–**	**–**	**–**	**–**	**9,000**	**9,000**
Proceeds from shares issued	24	**139**	**3,969**	**–**	**–**	**–**	**4,108**
Deferred tax	29	**–**	**–**	**–**	**–**	**(349)**	**(349)**
Dividends paid to owners of the Company	32	**–**	**–**	**(58,460)**	**–**	**–**	**(58,460)**
Balance at 31 December 2010		**20,297**	**15,800**	**245,005**	**49,457**	**935,555**	**1,266,114**

The notes on pages 53 to 99 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows
For the year ended 31 December 2010

	Note	2010 £000	2009 £000
Profit before tax		**211,366**	320,618
Adjustments for:			
Interest and equity dividend income		**(61,606)**	(78,298)
Interest expense		**10,090**	5,293
Net fair value gains on financial assets		**(25,672)**	(87,692)
Depreciation and amortisation	14, 15	**7,065**	6,046
Charges in respect of share based payments	9, 24	**8,047**	5,260
Other non-cash movements		**1,323**	(975)
Effect of exchange rate fluctuations on cash presented separately		**(508)**	30,844
Changes in operational assets and liabilities:			
Insurance and reinsurance contracts		**141,646**	(58,366)
Financial assets carried at fair value		**(2,527)**	(338,556)
Financial liabilities carried at fair value		**82**	(52,533)
Other assets and liabilities		**(23,704)**	36,560
Cash flows from operations		**265,602**	(211,799)
Interest received		**60,332**	74,584
Equity dividends received		**1,274**	3,714
Interest paid		**(4,628)**	(5,066)
Current tax paid		**(51,580)**	(1,463)
Net cash flows from operating activities		**271,000**	(140,030)
Cash flows from the acquisition of subsidiaries	33	**(3,662)**	–
Cash flows from the sale and purchase of associates	16	**468**	–
Cash flows from the purchase of property, plant and equipment		**(3,462)**	(8,802)
Cash flows from the purchase of intangible assets		**(15,591)**	(2,911)
Net cash flows from investing activities		**(22,247)**	(11,713)
Proceeds from the issue of ordinary shares	24	**4,108**	2,504
Dividends paid to owners of the Company	32	**(58,460)**	(48,613)
Net (repayments)/receipts of borrowings		**(118,539)**	47,721
Net cash flows from financing activities		**(172,891)**	1,612
Net increase/(decrease) in cash and cash equivalents		**75,862**	(150,131)
Cash and cash equivalents at 1 January		**259,647**	440,622
Net increase/(decrease) in cash and cash equivalents		**75,862**	(150,131)
Effect of exchange rate fluctuations on cash and cash equivalents		**508**	(30,844)
Cash and cash equivalents at 31 December	23	**336,017**	259,647

The purchase, maturity and disposal of financial assets is part of the Group's insurance activities and is therefore classified as an operating cash flow. The purchase, maturity and disposal of derivative contracts is also classified as an operating cash flow.

Included within cash and cash equivalents held by the Group are balances totalling £63,447,000 (2009: £31,607,000) not available for immediate use by the Group outside of the Lloyd's syndicate within which they are held.

The notes on pages 53 to 99 are an integral part of these consolidated financial statements.

Notes to the consolidated financial statements

1 General information
The Hiscox Group, which is headquartered in Hamilton, Bermuda, comprises Hiscox Ltd (the parent Company, referred to herein as the 'Company') and its subsidiaries (collectively, the 'Hiscox Group' or the 'Group'). For the period under review the Group provided insurance and reinsurance services to its clients worldwide. It has operations in Bermuda, the UK, Europe, and the US and employs over 1,100 people.

The Company is registered and domiciled in Bermuda and on 12 December 2006 its ordinary shares were listed on the London Stock Exchange. As such it is required to prepare its annual audited financial information in accordance with Section 4.1 of the Disclosure and Transparency Rules and the Listing Rules, both issued by the Financial Services Authority (FSA), in addition to the Bermuda Companies Act 1981. The first two pronouncements issued by the FSA require the Group to prepare financial statements which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes 1 to 39 in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The consolidated financial statements for the year ended 31 December 2010 include all of the Group's subsidiary companies and the Group's interest in associates. All amounts relate to continuing operations.

The financial statements were approved for issue by the Board of Directors on 28 February 2011.

2 Significant accounting policies
The principal accounting policies applied in the preparation of these consolidated Group financial statements are set out below. The most critical individual components of these financial statements that involve the highest degree of judgement or significant assumptions and estimations are identified at note 2.22.

2.1 Statement of compliance
The consolidated financial statements have been prepared in accordance with IFRS as adopted by the European Union and in accordance with the provisions of the Bermuda Companies Act 1981.

Since 2002, the standards adopted by the International Accounting Standards Board (IASB) have been referred to as IFRS. The standards from prior years continue to bear the title 'International Accounting Standards' (IAS). Insofar as a particular standard is not explicitly referred to, the two terms are used in these financial statements synonymously. Compliance with IFRS includes the adoption of interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

In March 2004, the IASB issued IFRS 4 Insurance Contracts which specifies the financial reporting for insurance contracts by an insurer. The standard is only the first phase in the IASB's insurance contract project and as such is only a stepping stone to Phase II, introducing limited improvements to accounting for insurance contracts. Accordingly, to the extent that IFRS 4 does not specify the recognition or measurement of insurance contracts, transactions reported in these consolidated financial statements have been prepared in accordance with another comprehensive body of accounting principles for insurance contracts, namely accounting principles generally accepted in the UK.

In July 2010 the IASB published an exposure draft for Phase II of the Insurance Contracts project. The exposure draft was open for comment until 30 November 2010 and the IASB aim to issue a final standard by mid 2011.

The exposure draft proposes a number of significant changes to the measurement of insurance contracts and as such adoption of a final standard in a form similar to the exposure draft will likely have a significant impact on the results of the Group. As yet, there is no effective date agreed for a new standard however transitional provisions propose that it should be applied retrospectively with opening differences accounted for in equity.

The Group is generally supportive of the proposed measurement principles for short duration contracts however we have submitted a comment letter to the IASB outlining our concerns and issues with some of the definitions and detail included within the exposure draft. We continue to monitor the progress of the project.

In April 2010, the IASB published an exposure draft containing proposals on recognition, presentation and disclosure of defined benefit plans as currently defined by IAS 19. The exposure draft was open to comment until September 2010 and it is expected that a finalised standard will be issued during the first quarter of 2011.

The exposure draft proposes that the defined employee benefit cost is recognised immediately and removes the option of the corridor method which the Group currently applies. In addition, the exposure draft proposes that companies present the defined employee benefit cost as follows:
- service costs within employment expenses;
- net interest income or expense within finance costs;
- remeasurement within other comprehensive income.

The effective date for the new standard has not been determined however retrospective application will be required. Should IAS 19 be amended to reflect the proposed changes, the Group will no longer be permitted to apply the corridor approach and as such, should the proposals be included within the new standard, we expect there to be an impact to the financial position of the Group.

2.2 Basis of preparation
The financial statements are presented in Pounds Sterling and are rounded to the nearest thousand unless otherwise stated. They are compiled on a going concern basis and prepared on the historical cost basis except that pension scheme assets included in the measurement of the employee retirement benefit obligation, and certain financial instruments including derivative instruments are measured at fair value. Employee retirement benefit obligations are determined using actuarial analysis. The balance sheet of the Group is presented in order of increasing liquidity.

The accounting policies have been applied consistently by all Group entities, to all periods presented, solely for the purpose of producing the consolidated Group financial statements.

The Group elected to apply the transitional arrangements contained in IFRS 4 that permitted the disclosure of only five years of data in claims development tables, in the year ended 31 December 2005 which was the year of adoption. The number of years of data presented was increased from nine in the prior year, to the maximum of ten in the current financial year.

Notes to the consolidated financial statements
continued

2 Significant accounting policies continued
2.2 Basis of preparation continued

The Group has financial assets and cash of over £2.78 billion. The portfolio is predominantly invested in liquid short-dated bonds and cash to ensure significant liquidity to the Group and to reduce risk from the financial markets. In addition the Group has significant borrowing facilities in place.

The Group writes a balanced book of insurance and reinsurance business spread by product and geography. The Directors believe that the Group is well placed to manage its business risk and continue to trade successfully.

A review of the financial performance of the Group is set out on pages 16 to 17. The financial position of the Group, its cash flows and borrowing facilities are included therein. In addition, note 3 to the financial statements provides a detailed discussion on the risks which are inherent to the Group's business and how those risks are managed.

The Directors have an expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The Group has adopted, for the first time, the following new and amended Standards and Interpretations issued by the IASB and endorsed by the EU as of 1 January 2010.

IFRS 3 (Revised) Business Combinations and IAS 27 (Amended) Consolidated and Separate Financial Statements (endorsed)
The revised standards were issued in January 2008 and are applicable for accounting periods commencing on or after 1 July 2009. IFRS 3 incorporates a number of changes in accounting for business combinations which will impact the amount of goodwill recognised and the results reported in the period of the combination and future reporting periods. IAS 27 requires that a change in the ownership interest of a subsidiary, provided that control is maintained, to be accounted for as an equity transaction. As such, a transaction of this nature will no longer give rise to goodwill nor gain or loss. Adoption of this standard had no impact on previous acquisitions or the financial position of the Group.

In April 2010, the IASB issued its annual amendments to International Financial Reporting Standards. Such amendments remove inconsistencies and clarify wording and unless otherwise stated are effective for financial years beginning on or after 1 January 2010. The Group adopted the revisions where applicable with no impact to the financial statements.

The following standards and interpretations have been issued but are not yet effective.

In October 2009 the IASB issued an Amendment to IAS 32 Financial Instruments Disclosure and Presentations, Classification of Rights Issues. The amendment changes the definition of a financial liability in order to classify rights issues as equity instruments in cases where such rights are given pro rata to all of the existing owners of the same class of an entity's non derivative equity instruments. The amendment is effective for annual periods beginning on or after 1 February 2010. Adoption of this standard will have no impact on the financial position of the Group.

The amendment to IFRIC 14, The Limit on a Defined Benefit Asset, Minimum Funding Requirements is effective for annual periods beginning on or after 1 January 2011. The amendment provides guidance on assessing the recoverable amount of a net pension asset in a defined benefit scheme and permits an entity to treat the prepayment of a minimum funding requirement as an asset. Adoption of this standard will have no impact on the financial position of the Group.

IAS 24 Related Party Disclosure (Amendment) is effective for annual periods beginning on or after 1 January 2011. The amendment clarifies the definition of a related party in order to simplify the identification of such relationships and to eliminate inconsistencies in application. Adoption of this standard will have no impact on the financial position of the Group.

2.3 Basis of consolidation
(a) Subsidiaries
Subsidiaries are those entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Generally this occurs when the Group obtains a shareholding of more than half of the voting rights of an entity. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. Management also exercise significant judgement about any actual or perceived control acquired indirectly, through normal commercial dealings with entities of a special purpose nature. The Group does not undertake any such arrangements with such entities where control of that entity would be acquired. The consolidated financial statements include the assets, liabilities and results of the Group up to 31 December each year. The financial statements of subsidiaries are included in the consolidated financial statements only from the date that control commences until the date that control ceases.

Hiscox Dedicated Corporate Member Limited underwrites as a corporate member of Lloyd's on the main Syndicates managed by Hiscox Syndicates Limited (the 'main managed Syndicates' numbered 33 and, 3624). In view of the several but not joint liability of underwriting members at Lloyd's for the transactions of syndicates in which they participate, the Group's attributable share of the transactions, assets and liabilities of these Syndicates has been included in the financial statements. The Group manages the underwriting of, but does not participate as a member of, Syndicate 6104 at Lloyd's which provides reinsurance to Syndicate 33 on a normal commercial basis. Consequently, aside from the receipt of managing agency fees, defined profit commissions as appropriate and interest arising on effective assets included within the experience account, the Group has no share in the assets, liabilities or transactions of Syndicate 6104, nor is it controlled. The position and performance of that Syndicate is therefore not included in the Group's financial statements.

The Group uses the acquisition method of accounting to account for the acquisition of subsidiaries. At the date of acquisition, the Group recognises the identifiable assets acquired and liabilities assumed as part of the overall business combination transaction at their acquisition date fair value. Recognition of these items is subject to the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements. The Group may also recognise intangible items not previously recognised by the acquired entity such as customer relationships.

(b) Associates
Associates are those entities in which the Group has significant influence but not control over the financial and operating policies. Significant influence is generally identified with a shareholding of between 20% and 50% of an entity's voting rights. The consolidated financial statements

2 Significant accounting policies continued
2.3 Basis of consolidation continued
(b) Associates *continued*

include the Group's share of the total recognised gains and losses of associates on an equity accounted basis from the date that significant influence commences until the date that significant influence ceases. The Group's share of its associates' post-acquisition profits or losses after tax is recognised in the income statement for each period, and its share of the movement in the associates' net assets is reflected in the investments' carrying values in the balance sheet. When the Group's share of losses equals or exceeds the carrying amount of the associate, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

(c) Transactions eliminated on consolidation
Intragroup balances, transactions and any unrealised gains arising from intragroup transactions are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. In accordance with IAS 21, foreign currency gains and losses on intragroup monetary assets and liabilities may not fully eliminate on consolidation when the intragroup monetary item concerned is transacted between two Group entities that have different functional currencies. Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the entity. Unrealised gains arising from transactions with associates are eliminated against the investment in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

2.4 Foreign currency translation
(a) Functional and presentational currency
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The functional currency of all individual entities in the Group is deemed to be Sterling with the exception of the entities operating in France, Germany, the Netherlands and Belgium whose functional currency is Euros, those subsidiary entities operating from the US and Bermuda whose functional currency is US Dollars, Hiscox Insurance Company (Guernsey) Limited and Syndicate 3624 whose functional currency is also US Dollars.

(b) Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the retranslation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as IAS 39 effective net investment hedges or when the underlying balance is deemed to form part of the Group's net investment in a subsidiary operation and is unlikely to be settled in the foreseeable future. Non-monetary items carried at historical cost are translated in the balance sheet at the exchange rate prevailing on the original transaction date. Non-monetary items measured at fair value are translated using the exchange rate ruling when the fair value was determined.

(c) Group companies
The results and financial position of all the Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:
- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the date of the transactions); and
- all resulting exchange differences are recognised as a separate component of equity.

When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as the foreign entity's assets and liabilities and are translated at the closing rate.

2.5 Property, plant and equipment
Property, plant and equipment are stated at historical cost less depreciation and any impairment loss. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance items are charged to the income statement during the financial period in which they are incurred.

Land and artwork assets are not depreciated as they are deemed to have indefinite useful economic lives. The cost of leasehold improvements is amortised over the unexpired term of the underlying lease or the estimated useful life of the asset, whichever is shorter. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts, less their residual values, over their estimated useful lives. The rates applied are as follows:

— buildings	50 years
— vehicles	3 years
— leasehold improvements including fixtures and fittings	10–15 years
— furniture, fittings and equipment	3–15 years

The assets' residual values and useful lives are reviewed at each balance sheet date and adjusted if appropriate.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

2.6 Intangible assets
(a) Goodwill
Goodwill represents amounts arising on acquisition of subsidiaries and associates. In respect of acquisitions that have occurred since 1 January 2004, goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets and contingent liabilities assured of the acquired subsidiary or associate at the acquisition date.

In respect of acquisitions prior to this date, goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous generally accepted accounting principles.

Goodwill on acquisition of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Goodwill is not amortised but is tested annually for impairment and carried at cost less accumulated impairment losses.

Notes to the consolidated financial statements continued

2 Significant accounting policies continued
2.6 Intangible assets continued
(a) Goodwill *continued*

The impairment review process examines whether or not the carrying value of the goodwill attributable to individual cash generating units exceeds its recoverable amount. Any excess of goodwill over the recoverable amount arising from the review process indicates impairment. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

(b) Syndicate capacity
The cost of purchasing the Group's participation in the Lloyd's insurance syndicates is not amortised but is tested annually for impairment and is carried at cost less accumulated impairment losses. Having considered the future prospects of the London insurance market, the Board believes that the Group's ownership of syndicate capacity will provide economic benefits over an indefinite number of future periods.

(c) State authorisation licences
State authorisation licences acquired in business combinations are recognised initially at their fair value. The asset is not amortised, as the Board considers that economic benefits will accrue to the Group over an indefinite number of future periods, but is tested annually for impairment, and any accumulated impairment losses recognised are deducted from the historical cost amount to produce the net balance sheet carrying amount.

(d) Rights to customer contractual relationships
Costs directly attributable to securing the intangible rights to customer contractual relationships are recognised as an intangible asset where they can be identified separately and measured reliably and it is probable that they will be recovered by directly related future profits. These costs are amortised on a straight-line basis over the useful economic life which is deemed to be 20 years and are carried at cost less accumulated amortisation and impairment losses.

(e) Computer software
Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring into use the specific software. These costs are amortised over the expected useful life of the software of between three and five years on a straight-line basis.

Internally developed computer software is only capitalised when it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group and the cost of the asset can be measured reliably. Amortisation of internally developed computer software begins when the software is available for use and is allocated on a straight-line basis over the expected useful life of the asset. The useful life of the asset is reviewed annually and if different from previous estimates is changed accordingly with the change being accounted for as a change in accounting estimates in accordance with IAS 8.

2.7 Financial assets including loans and receivables
The Group has classified financial assets as a) financial assets designated at fair value through profit or loss, and b) loans and receivables. Management determines the classification of its financial investments at initial recognition. The decision by the Group to designate all financial investments, comprising debt and fixed income securities, equities and shares in unit trusts and deposits with credit institutions, at fair value through profit or loss reflects the fact that the investment portfolios are managed, and their performance evaluated, on a fair value basis. Regular way purchases and sales of investments are accounted for at the date of trade.

Financial assets are initially recognised at fair value. Subsequent to initial recognition financial assets are measured as described below.

Financial assets are de-recognised when the right to receive cash flows from them expires or where they have been transferred and the Group has also transferred substantially all risks and rewards of ownership.

Fair value for securities quoted in active markets is the bid price exclusive of transaction costs. For instruments where no active market exists, fair value is determined by referring to recent transactions and other valuation factors including the discounted value of expected future cash flows. Fair value changes are recognised immediately within the investment result line in the income statement. An analysis of fair values of financial instruments and further details as to how they are measured are provided in note 22.

(a) Financial assets at fair value through profit or loss
A financial asset is classified into this category at inception if it is managed and evaluated on a fair value basis in accordance with documented strategy, if acquired principally for the purpose of selling in the short-term, or if it forms part of a portfolio of financial assets in which there is evidence of short-term profit taking.

(b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. Receivables arising from insurance contracts are included in this category and are reviewed for impairment as part of the impairment review of loans and receivables. Loans and receivables are carried at amortised cost less any provision for impairment in value.

2.8 Cash and cash equivalents
The Group has classified cash deposits and short-term highly liquid investments as cash and cash equivalents. These assets are readily convertible into known amounts of cash and are subject to inconsequential changes in value. Cash equivalents are financial investments with less than three months to maturity at the date of acquisition.

2.9 Impairment of assets
Assets that have an indefinite useful life are not subject to amortisation and are tested annually or whenever there is an indication of impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

(a) Non-financial assets
Objective factors that are considered when determining whether a non-financial asset (such as goodwill, an intangible asset or item of property, plant and equipment) or group of non-financial assets may be impaired include, but are not limited to, the following:
- adverse economic, regulatory or environmental conditions that may restrict future cash flows and asset usage and/or recoverability;
- the likelihood of accelerated obsolescence arising from the development of new technologies and products; and
- the disintegration of the active market(s) to which the asset is related.

(b) Financial assets
Objective factors that are considered when determining whether a financial asset or group of financial assets may be impaired include, but are not limited to, the following:
- negative rating agency announcements in respect of investment issuers, reinsurers and debtors;

2 Significant accounting policies continued
2.9 Impairment of assets continued
(b) Financial assets *continued*

- significant reported financial difficulties of investment issuers, reinsurers and debtors;
- actual breaches of credit terms such as persistent late payments or actual default;
- the disintegration of the active market(s) in which a particular asset is traded or deployed;
- adverse economic or regulatory conditions that may restrict future cash flows and asset recoverability; and
- the withdrawal of any guarantee from statutory funds or sovereign agencies implicitly supporting the asset.

(c) Impairment loss
An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods. A reversal of an impairment loss is recognised as income immediately. Impairment losses recognised in respect of goodwill are not subsequently reversed.

2.10 Derivative financial instruments
Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently valued at their fair value at each balance sheet date. Fair values are obtained from quoted market values and, if these are not available, valuation techniques including option pricing models as appropriate. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. For derivatives not formally designated as a hedging instrument, fair value changes are recognised immediately in the income statement. Changes in the value of derivatives and other financial instruments formally designated as hedges of net investments in foreign operations are recognised in the currency translation reserve to the extent they are effective; gains or losses relating to the ineffective portion of the hedging instruments are recognised immediately in the consolidated income statement.

The Group had no derivative instruments designated for hedge accounting during the current and prior financial year (see note 2.17).

2.11 Own shares
Where any Group company purchases the parent Company's equity share capital (own shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's owners on consolidation. Where such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity attributable to the Company's owners, net of any directly attributable incremental transaction costs and the related tax effects.

2.12 Revenue
Revenue comprises insurance and reinsurance premiums earned on the rendering of insurance protection, net of reinsurance, together with profit commission, investment returns, agency fees and other income inclusive of fair value movements on derivative instruments not formally designated for hedge accounting treatment. The Group's share of the results of associates is reported separately. The accounting policies for insurance premiums are outlined below. Profit commission, investment income and other sources of income are recognised on an accruals basis net of any discounts and amounts such as sales-based taxes collected on behalf of third-parties. Profit commission is calculated and accrued based on the results of the managed syndicate.

2.13 Insurance contracts
(a) Classification
The Group issues short-term casualty and property insurance contracts that transfer significant insurance risk. Such contracts may also transfer a limited level of financial risk.

(b) Recognition and measurement
Gross premiums written comprise premiums on business incepting in the financial year together with adjustments to estimates of premiums written in prior accounting periods. Estimates are included for pipeline premiums and an allowance is also made for cancellations. Premiums are stated before the deduction of brokerage and commission but net of taxes and duties levied. Premiums are recognised as revenue (premiums earned) proportionally over the period of coverage. The portion of premium received on in-force contracts that relates to unexpired risks at the balance sheet date is reported as the unearned premium liability.

Claims and associated expenses are charged to profit or loss as incurred based on the estimated liability for compensation owed to contract holders or third-parties damaged by the contract holders. They include direct and indirect claims settlement costs and arise from events that have occurred up to the balance sheet date even if they have not yet been reported to the Group. The Group does not discount its liabilities for unpaid claims. Liabilities for unpaid claims are estimated using the input of assessments for individual cases reported to the Group and statistical analysis for the claims incurred but not reported, and an estimate of the expected ultimate cost of more complex claims that may be affected by external factors e.g. court decisions.

(c) Deferred acquisition costs (DAC)
Commissions and other direct and indirect costs that vary with and are related to securing new contracts and renewing existing contracts are capitalised as deferred acquisition costs. All other costs are recognised as expenses when incurred. DAC are amortised over the terms of the insurance contracts as the related premium is earned.

(d) Liability adequacy tests
At each balance sheet date, liability adequacy tests are performed by each segment of the Group to ensure the adequacy of the contract liabilities net of related DAC. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss initially by writing-off DAC and by subsequently establishing a provision for losses arising from liability adequacy tests ('the unexpired risk provision'). Any DAC written-off as a result of this test cannot subsequently be reinstated.

(e) Outwards reinsurance contracts held
Contracts entered into by the Group, with reinsurers, under which the Group is compensated for losses on one or more insurance or reinsurance contracts and that meet the classification requirements for insurance contracts, are classified as insurance contracts held. Contracts that do not meet these classification requirements are classified as financial assets.

The benefits to which the Group is entitled under outwards reinsurance contracts are

Notes to the consolidated financial statements continued

2 Significant accounting policies continued
2.13 Insurance contracts continued
(e) Outwards reinsurance contracts held *continued*

recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within loans and receivables) as well as longer-term receivables (classified as reinsurance assets) that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts.

Reinsurance liabilities primarily comprise premiums payable for 'outwards' reinsurance contracts. These amounts are recognised in profit or loss proportionally over the period of the contract. Receivables and payables are recognised when due.

The Group assesses its reinsurance assets on a regular basis and, if there is objective evidence, after initial recognition, of an impairment in value, the Group reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises the impairment loss in the income statement.

(f) Receivables and payables related to insurance contracts
Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

If there is objective evidence that the insurance receivable is impaired, the Group reduces the carrying amount of the insurance receivable accordingly and recognises the impairment loss in profit or loss.

(g) Salvage and subrogation reimbursements
Some insurance contracts permit the Group to sell property acquired in settling a claim (i.e. salvage). The Group may also have the right to pursue third-parties for payment of some or all costs (i.e. subrogation). Estimates of salvage recoveries are included as an allowance in the measurement of the insurance liability for claims and salvage property is recognised in other assets when the liability is settled. The allowance is the amount that can reasonably be recovered from the disposal of the property.

Subrogation reimbursements are also considered as an allowance in the measurement of the insurance liability for claims and are recognised in other assets when the liability is settled. The allowance is the assessment of the amount that can be recovered from the action against the liable third-party.

2.14 Deferred tax
Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, if the deferred income tax arises from 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 recognised. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled. Deferred tax assets are recognised to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising on investments in subsidiaries and associates, 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.

2.15 Employee benefits
(a) Pension obligations
The Group operated both defined contribution and defined benefit pension schemes during the year under review. The defined benefit scheme closed to future accrual with effect from 31 December 2006 and active members were offered membership of the defined contribution scheme from 1 January 2007.

A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity and has no further obligation beyond the agreed contribution rate. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a contractual basis. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

The amount recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. Plan assets exclude any insurance contracts issued by the Group. To the extent that a surplus emerges on the defined benefit obligation, it is only recognisable on the asset side of the balance sheet when it is probable that future economic benefits will be recovered by the scheme sponsor in the form of refunds or reduced future contributions.

Actuarial gains and losses are only recognised when the net cumulative unrecognised actuarial gains and losses for each individual plan at the end of the previous accounting period exceeds 10% of the higher of the defined benefit obligation and the fair value of the plan assets at that date. Such actuarial gains or losses falling outside of this 10% corridor are charged or credited to income over the employees' expected average remaining working lives. Past service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

(b) Other long-term employee benefits
The Group provides sabbatical leave to employees on completion of a minimum service period of ten years. The present value of the expected costs of these benefits is accrued over the period of employment. In determining this liability, consideration is given to future increases in salary levels, experience with employee departures and periods of service.

(c) Share based compensation
The Group operates a number of equity settled share based employee compensation plans. These include both the approved and unapproved share option schemes, and the Group's performance share plans, outlined in the Directors' remuneration report together with the Group's Save as You Earn (SAYE) schemes.

The fair value of the employee services received, measured at grant date, in exchange for the grant of the awards is recognised as an expense with the corresponding credit being recorded in retained earnings within equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the awards granted, excluding the impact of any non-market vesting conditions

2 Significant accounting policies continued
2.15 Employee benefits continued
(c) Share based compensation *continued*

(e.g. profitability or net asset growth targets). Non-market vesting conditions are included in assumptions about the number of awards that are expected to become exercisable. At each balance sheet date, the Group revises its estimates of the number of awards 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.

When the terms and conditions of an equity settled share based employee compensation plan are modified, and the expense to be recognised increases as a result of the modification, then the increase is recognised evenly over the remaining vesting period. When a modification reduces the expense to be recognised, there is no adjustment recognised and the pre-modification expense continues to be applied. The proceeds received net of any directly attributable transaction costs are credited to share capital and share premium when the options are exercised.

In accordance with the transitional arrangements of IFRS 2 only share based awards granted or modified after 7 November 2002, but not yet vested at the date of adoption of IFRS, are included in the calculations.

(d) Termination benefits
Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

(e) Profit sharing and bonus plans
The Group recognises a liability and an expense for bonuses and profit sharing, based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a provision where a contractual obligation to employees exists or where there is a past practice that has created a constructive obligation.

(f) Accumulating compensation benefits
The Group recognises a liability and an expense for accumulating compensation benefits (e.g. holiday entitlement), based on the additional amount that the Group expects to pay as a result of the unused entitlement accumulated at the balance sheet date.

2.16 Financial liabilities
All borrowings drawn after 6 May 2008 are now measured at amortised cost at each balance sheet date thereafter using the effective interest method. Any difference between the remeasured amortised cost carrying amount and the ultimate redemption amount is recognised in the income statement over the period of the borrowings.

Up to 6 May 2008 (when all existing borrowings were repaid in full), borrowings were measured at fair value at each balance sheet date using observable market interest rate data for similar instruments, with all changes in value from one accounting period to the next reflected in the income statement unless they formed part of a designated hedge accounting relationship in which case certain changes in value were recognised directly in equity, (see notes 2.17 and 19).

2.17 Net investment hedge accounting
In order to qualify for hedge accounting, the Group is required to document in advance the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an on-going basis. This effectiveness testing is re-performed at each period end to ensure that the hedge remains highly effective.

The Group hedged elements of its net investment in certain foreign entities through foreign currency borrowings that qualified for hedge accounting from 3 January 2007 until their replacement on 6 May 2008; accordingly gains or losses on retranslation are recognised in equity to the extent that the hedge relationship was effective during this period. Accumulated gains or losses will be recycled to the income statement only when the foreign operation is disposed of. The ineffective portion of any hedge is recognised immediately in the income statement.

2.18 Finance costs
Finance costs consist of interest charges accruing on the Group's borrowings and bank overdrafts together with commission fees charged in respect of Letters of Credit. Arrangement fees in respect of financing arrangements are charged over the life of the related facilities.

2.19 Provisions
The Group is subject to various insurance-related assessments and guarantee fund levies. Provisions are recognised where there is a present obligation (legal or constructive) as a result of a past event that can be measured reliably and it is probable that an outflow of economic benefits will be required to settle that obligation.

2.20 Leases
(a) Hiscox as lessee
Leases in which significantly all of the risks and rewards of ownership are transferred to the Group are classified as finance leases. At the commencement of the lease term, finance leases are recognised as assets and liabilities at the lower of the fair value of the asset and the present value of the minimum lease payments. The minimum lease payments are apportioned between finance charges and repayments of the outstanding liability, finance charges being charged to each period of the lease term so as to produce a constant rate of interest on the outstanding balance of the liability. All other leases are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(b) Hiscox as lessor
Rental income from operating leases is recognised on a straight-line basis over the term of the relevant contractual agreement.

2.21 Dividend distribution
Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved.

2.22 Use of critical estimates, judgements and assumptions
The preparation of financial statements requires the use of significant estimates, judgements and assumptions. The Directors consider the accounting policies for determining insurance liabilities, the valuation of investments, the valuation of retirement benefit scheme obligations and the determination of deferred tax assets and liabilities as being most critical to an understanding of the Group's result and position.

The most critical estimate included within the Group's balance sheet is the estimate for losses incurred but not reported. The total estimate as at 31 December 2010 is £904 million (2009: £749 million) and is included within total insurance liabilities on the balance sheet.

Notes to the consolidated financial statements continued

2 Significant accounting policies continued
2.22 Use of critical estimates, judgements and assumptions continued

Estimates of losses incurred but not reported are continually evaluated based on entity specific historical experience and contemporaneous developments observed in the wider industry when relevant, and are also updated for expectations of prospective future developments. Although the possibility exists for material changes in estimates to have a critical impact on the Group's reported performance and financial position, it is anticipated that the scale and diversity of the Group's portfolio of insurance business considerably lessens the likelihood of this occurring. The overall reserving risk is discussed in more detail in note 3.1 and the procedures used in estimating the cost of settling insured losses at the balance sheet date including losses incurred but not reported are detailed in note 26.

The Group carries its financial investments at fair value through profit or loss with fair value determined using published price quotations in the most active financial markets in which the assets trade. During periods of economic distress and diminished liquidity, the ability to obtain quoted bid prices may be reduced and as such a greater degree of judgement is required in obtaining the most reliable source of valuation. Note 3.2 to the financial statements discusses the reliability of the Group's fair values.

With regard to employee retirement benefit scheme obligations, the amounts disclosed in these consolidated financial statements are sensitive to judgemental assumptions regarding mortality, inflation, investment returns and interest rates on corporate bonds, many of which have been subject to specific recent volatility. This complex set of economic variables may be expected to influence the liability obligation element of the reported net balance amount to a greater extent than the reported value of the scheme assets element. For example, if the recent cuts in official UK interest rates are replicated with lower yields emerging in UK corporate bond indices, a significant uplift may occur in the reported net scheme deficit through the reduced effect of discounting outweighing any expected appreciation in asset values. A sensitivity analysis is given at note 30.

Legislation concerning the determination of taxation assets and liabilities is complex and continually evolving. In preparing the Group's financial statements, the Directors estimate taxation assets and liabilities after taking appropriate professional advice. The determination and finalisation of agreed taxation assets and liabilities may not occur until several years after the balance sheet date and consequently the final amounts payable or receivable may differ from those presently recorded in these financial statements.

2.23 Reporting of additional performance measures
The Directors consider that the claims ratio, expense ratio and combined ratio measures reported in respect of operating segments and the Group overall at note 4 provide useful information regarding the underlying performance of the Group's businesses. These measures are widely recognised by the insurance industry and are consistent with internal performance measures reviewed by senior management including the chief operating decision maker. However, these three measures are not defined within the IFRS framework and body of standards and interpretations and therefore may not be directly comparable with similarly titled additional performance measures reported by other companies. Net asset value per share and return on equity measures, disclosed at notes 5 and 6, are likewise considered to be additional performance measures.

3 Management of risk
The Group's overall appetite for accepting and managing varying classes of risk is defined by the Group's Board. The Board has developed a governance framework and has set Group wide risk management policies and procedures which include risk identification, risk management and mitigation and risk reporting. The objective of these policies and procedures is to protect the Group's shareholders, policyholders and other stakeholders from negative events that could hinder the Group's delivery of its contractual obligations and its achievement of sustainable profitable economic and social performance.

The Board exercises oversight of the development and operational implementation of its risk management policies and procedures, and ongoing compliance therewith, partially through its own enquiries but primarily through a dedicated internal audit function, which has operational independence, clear terms of reference influenced by the Board's Non Executive Directors and a clear upwards reporting structure back into the Board. The Group, in common with the non-life insurance industry generally, is fundamentally driven by a desire to originate, retain and service insurance contracts to maturity. The Group's cash flows are funded mainly through advance premium collections and the timing of such premium inflows is reasonably predictable. In addition, the majority of material cash outflows are typically triggered by the occurrence of insured events non-correlated to financial markets, and not by the inclination or will of policyholders.

The principal sources of risk relevant to the Group's operations and its financial statements fall into two broad categories: insurance risk and financial risk both of which are described in notes 3.1 and 3.2 below. The Group also actively manages its capital risks as detailed in note 3.3.

Additional unaudited information is also provided in the corporate governance and risk management sections of this Report and Accounts.

3.1 Insurance risk
The predominant risk to which the Group is exposed is insurance risk which is assumed through the underwriting process. Insurance risk can be sub-categorised into i) underwriting risk including the risk of catastrophe and systemic insurance losses and the insurance competition and cycle, and ii) reserving risk.

i) Underwriting risk
The Board sets the Group's underwriting strategy for accepting and managing underwriting risk, seeking to exploit identified opportunities in the light of other relevant anticipated market conditions. Specific underwriting objectives such as aggregation limits, reinsurance protection thresholds, geographical disaster event risk exposures and line of business diversification parameters are prepared and reviewed by the Chief Underwriting Officer in order to translate the Board's summarised underwriting strategy into specific measurable actions and targets. These actions and targets are reviewed and approved by the Board in advance of each underwriting year. The Board continually reviews its underwriting strategy throughout each underwriting year in light of the evolving market pricing and loss conditions and as opportunities present themselves. The Group's underwriters and management consider underwriting risk at an individual contract level, and also from a portfolio perspective where the risks assumed in similar classes of policies are aggregated and the exposure evaluated in light of historical portfolio experience and prospective factors. To assist with the process of pricing and managing underwriting risk

3 Management of risk continued
3.1 Insurance risk continued
***i) Underwriting risk** continued*

the Group routinely performs a wide range of activities including the following:
- regularly updating the Group's risk models;
- documenting, monitoring and reporting on the Group's strategy to manage risk;
- developing systems that facilitate the identification of emerging issues promptly;
- utilising sophisticated computer modelling tools to simulate catastrophes and measure the resultant potential losses before and after reinsurance;
- monitoring legal developments and amending the wording of policies when necessary;
- regularly aggregating risk exposures across individual underwriting portfolios and known accumulations of risk;
- examining the aggregated exposures in advance of underwriting further large risks; and
- developing processes that continually factor market intelligence into the pricing process.

The delegation of underwriting authority to specific individuals, both internally and externally, is subject to regular review. All underwriting staff and binding agencies are set strict parameters in relation to the levels and types of business they can underwrite, based on individual levels of experience and competence. These parameters cover areas such as the maximum sums insured per insurance contract, maximum gross written premiums and maximum aggregated exposures per geographical zone and risk class. Monthly meetings are held between the Chief Underwriting Officer and a specialist central analysis and review team in order to monitor claim development patterns and discuss individual underwriting issues as they arise. The Chief Underwriting Officer also holds weekly video conference meetings with this team to discuss interim underwriting matters.

The Group's insurance contracts include provisions to contain losses such as the ability to impose deductibles and demand reinstatement premiums in certain cases. In addition, in order to manage the Group's exposure to repeated catastrophic events, relevant policies frequently contain payment limits to cap the maximum amount payable from these insured events over the contract period.

The Group also manages underwriting risk by purchasing reinsurance. Reinsurance protection such as excess of loss cover is purchased at an entity level and is also considered at an overall Group level to mitigate the effect of catastrophes and unexpected concentrations of risk. However, the scope and type of reinsurance protection purchased may change depending on the extent and competitiveness of cover available in the market.

The Board requires all underwriters to operate within an overall Group appetite for individual events. This defines the maximum exposure that the Group is prepared to retain on its own account for any one potential catastrophe event or disaster. The Group's underwriting risk appetite seeks to ensure that it should not lose more than one year's profit plus 15% of core capital as a result of a 1 in 250 bad underwriting year.

The Group compiles estimates of losses arising from realistic disaster events using statistical models alongside input from its underwriters. These require significant management judgement. Realistic disaster scenarios are extreme hypothetical events selected to represent major events occurring in areas with large insured values. They also reflect the areas that represent significant exposures for Hiscox. The selection of realistic disaster scenario events is adjusted each year and they are not therefore necessarily directly comparable from one year to the next. The events are extreme and as yet untested, and as such these estimates may prove inadequate as a result of incorrect assumptions, model deficiencies, or losses from unmodelled risks. This means that should a realistic disaster actually eventuate, the Group's final ultimate losses could materially differ from those estimates modelled by management. The Group's estimated exposure to certain industry events is summarised below. These estimates have been made using modelled assumptions and management judgement and given the nature of risks underwritten may be materially different from actual losses suffered depending on the size and nature of the event.

	Gross loss US$m	Net loss US$m	Gross loss as a % of total equity	Net loss as a % of total equity	Net loss as % of insurance industry loss	Industry loss size US$bn	Return period years
Japan earthquake	331	202	16.7	10.2	0.4	50	240
Gulf of Mexico windstorm	790	212	39.7	10.7	0.2	107	80
Florida windstorm	645	173	32.4	8.7	0.1	125	100
European windstorm	507	225	25.5	11.3	0.8	30	200
San Francisco earthquake	638	197	32.1	9.9	0.4	50	110

Overleaf is a summary of the gross and net insurance liabilities for each category split by country of risk.

Notes to the consolidated financial statements
continued

3 Management of risk continued
3.1 Insurance risk continued

Estimated concentration of gross and net insurance liabilities on balance sheet by territory coverage of premium written 31 December 2010

		Types of insurance risk in the Group						
		Reinsurance inwards £000	Property – Marine and major assets £000	Property – Other assets £000	Casualty – Professional indemnity £000	Casualty – Other risks £000	Other* £000	Total £000
UK and Ireland	Gross	31,637	19,881	136,202	295,631	7,513	17,326	508,190
	Net	24,427	5,330	132,554	257,998	2,258	10,528	433,095
Europe	Gross	31,983	2,577	71,130	63,295	11,779	24,360	205,124
	Net	22,081	2,044	67,239	59,135	3,827	19,717	174,043
United States	Gross	181,963	18,706	104,422	267,698	39,355	20,776	632,920
	Net	116,634	16,339	58,361	248,849	22,837	16,720	479,740
Other territories	Gross	28,524	27,577	34,303	36,326	3,424	65,570	195,724
	Net	23,503	21,756	23,207	33,643	2,905	52,574	157,588
Multiple territory coverage	Gross	268,350	177,678	68,834	44,785	114,857	63,405	737,909
	Net	197,678	135,679	50,207	41,549	91,218	56,305	572,636
Total	**Gross**	542,457	246,419	414,891	707,735	176,928	191,437	2,279,867
	Net	384,323	181,148	331,568	641,174	123,045	155,844	1,817,102

Estimated concentration of gross and net insurance liabilities on balance sheet by territory coverage of premium written 31 December 2009

		Types of insurance risk in the Group						
		Reinsurance inwards £000	Property – Marine and major assets £000	Property – Other assets £000	Casualty – Professional indemnity £000	Casualty – Other risks £000	Other* £000	Total £000
UK and Ireland	Gross	29,001	16,993	133,166	247,222	15,345	14,716	456,443
	Net	26,579	8,425	129,114	213,181	10,767	9,639	397,705
Europe	Gross	23,650	5,367	74,121	53,557	10,549	22,992	190,236
	Net	21,531	3,659	69,606	49,691	8,886	20,625	173,998
United States	Gross	188,593	26,143	146,842	249,942	20,828	15,819	648,167
	Net	139,688	22,506	82,919	233,294	13,689	11,294	503,390
Other territories	Gross	35,915	23,506	43,488	49,656	17,317	68,013	237,895
	Net	34,407	16,910	32,924	49,254	6,453	57,932	197,880
Multiple territory coverage	Gross	139,843	162,116	48,190	12,689	127,781	98,991	589,610
	Net	80,558	124,264	37,713	11,289	87,186	88,242	429,252
Total	Gross	417,002	234,125	445,807	613,066	191,820	220,531	2,122,351
	Net	302,763	175,764	352,276	556,709	126,981	187,732	1,702,225

*Includes a diverse mix of certain specialty lines such as kidnap and ransom, terrorism, bloodstock and other risks which contain a mix of property and casualty exposures.

The estimated liquidity profile to settle these net claims liabilities is given in note 3.2 (e).

The specific insurance risks accepted by the Group fall broadly into the following main categories: reinsurance inwards, marine and major asset property, other property risks, professional indemnity casualty and casualty other insurance risks. These specific categories are defined for risk review purposes only as each contain risks specific to the nature of the cover provided. They are not exclusively aligned to any specific reportable segment in the Group's operational structure or the primary internal reports reviewed by the chief operating decision maker. The following describes the policies and procedures used to identify and measure the risks associated with each individual category of business.

Reinsurance inwards

The Group's reinsurance inwards acceptances are primarily focused on large commercial property, homeowner and marine and crop exposures held by other insurance companies predominantly in North America and other developed economies. This business is characterised more by large claims arising from individual events or catastrophes than the high-frequency, low-severity attritional losses associated with certain other business written by the Group. Multiple insured losses can periodically arise out of a single natural or man-made occurrence. The main circumstances that result in claims against the reinsurance inwards book are conventional catastrophes, such as earthquakes or storms, and other events including fires and explosions. The occurrence and impact of these events are very difficult to model over the short-term which complicates attempts to anticipate loss frequencies on an annual basis. In those years where there is a low incidence of severe catastrophes, loss frequencies on the reinsurance inwards book can be relatively low.

A significant proportion of the reinsurance inwards business provides cover on an excess of loss basis for individual events. The Group agrees to reimburse the cedant once their losses exceed a minimum level. Consequently the frequency and severity of reinsurance inwards claims is related not only to the number of significant insured events that occur but also to their individual magnitude. If numerous catastrophes occurred in any one year, but the cedant's individual loss on each was below the minimum stated, then the Group would have no liability under such contracts. Maximum gross line sizes and aggregate exposures are set for each type of programme.

The Group writes reinsurance risks for periods of mainly one year so that contracts can be assessed for pricing and terms and adjusted to reflect any changes in market conditions.

Property risks – marine and major assets

The Group directly underwrites a diverse range of property risks. The risk profile of the property covered under marine and major asset policies is different to that typically contained in the other classes of property (such as private households and contents insurance) covered by the Group.

Typical property covered by marine and other major property contracts include fixed and moveable assets such as ships and other vessels, cargo in transit, energy platforms and installations, pipelines, other subsea assets, satellites, commercial buildings and industrial plants and machinery. These assets are typically exposed to a blend of catastrophic and other large loss events and attritional claims arising from conventional hazards such as collision, flooding, fire and theft. Climatic changes may give rise to more frequent and severe extreme weather events (for example earthquakes, windstorms and river flooding etc.) and it may be expected that their frequency will increase over time.

For this reason the Group accepts major property insurance risks for periods of mainly one year so that each contract can be re-priced on renewal to reflect the continually evolving risk profile. The most significant risks covered for periods exceeding one year are certain specialist lines such as marine and offshore construction projects which can typically have building and assembling periods of between three and four years. These form a small proportion of the Group's overall portfolio.

Marine and major property contracts are normally underwritten by reference to the commercial replacement value of the property covered. The cost of repairing or rebuilding assets, of replacement or indemnity for contents and time taken to restart or resume operations to original levels for business interruption losses are the key factors that influence the level of claims under these policies. The Group's exposure to commodity price risk in relation to these types of insurance contracts is very limited, given the controlled extent of business interruption cover offered in the areas prone to losses of asset production.

Other property risks

The Group provides home and contents insurance, together with cover for art work, antiques, classic cars, jewellery, collectables and other assets. The Group also extends cover to reimburse certain policyholders when named insureds or insured assets are seized for kidnap and a ransom demand is subsequently met. Events which can generate claims on these contracts include burglary, kidnap, seizure of assets, acts of vandalism, fires, flooding and storm damage. Losses on most classes can be predicted with a greater degree of certainty as there is a rich history of actual loss experience data and the locations of the assets covered, and the individual levels of security taken by owners are relatively static from one year to the next. The losses associated with these contracts tend to be of a higher frequency and lower severity than the marine and other major property assets covered above.

The Group's home and contents insurance contracts are exposed to weather and climatic risks such as floods and windstorms and their consequences. As outlined earlier the frequency and severity of these losses do not lend themselves to accurate prediction over the short-term. Contract periods are therefore not normally more than one year at a time to enable risks to be regularly re-priced.

Contracts are underwritten by reference to the commercial replacement value of the properties and contents insured. Claims payment limits are always included to cap the amount payable on occurrence of the insured event.

Casualty insurance risks

The casualty underwriting strategy attempts to ensure that the underwritten risks are well diversified in terms of type and amount of potential hazard, industry and geography. However, the Group's exposure is more focused towards marine and professional and technological liability risks rather than human bodily injury risks, which are only accepted under limited circumstances. Claims typically arise from incidents such as errors and omissions attributed to the insured, professional negligence and specific losses suffered as a result of electronic or technological failure of software products and websites.

The provision of insurance to cover allegations made against individuals acting in the course of fiduciary or managerial responsibilities, including directors' and officers' insurance is one example of a casualty insurance risk. However the Group's specific exposure to this specific risk category is relatively limited. The Group's casualty insurance contracts mainly experience low severity attritional losses. By nature, some casualty losses may take longer to settle than the other categories of business.

The Group's pricing strategy for casualty insurance policies is typically based upon historical claim frequencies and average claim severities, adjusted for inflation and extrapolated forwards to incorporate projected changes in claims patterns. In determining the price of each policy an allowance is also made for acquisition and administration expenses, reinsurance costs, investment returns and the Group's cost of capital.

Reserving risk

The Group's procedures for estimating the outstanding costs of settling insured losses at the balance sheet date, including claims incurred but not yet reported, are detailed in note 26.

The majority of the Group's insurance risks are short tail and, based on historical claims experience, significant claims are normally notified and settled within 12 to 24 months of the insured event occurring. Those claims taking the longest time to develop and settle typically relate to casualty risks where legal complexities occasionally develop regarding the insured's alleged omissions or negligence. The length of time required to obtain definitive legal judgements and make eventual settlements exposes the Group to a degree of reserving risk in an inflationary environment.

The majority of the Group's casualty exposures are written on a claims made basis. However the final quantum of these claims may not be established for a number of years after the event. Consequently a significant proportion of the casualty insurance amounts reserved on the balance sheet may not be expected to settle within 24-months of the balance sheet date.

Notes to the consolidated financial statements
continued

3 Management of risk continued
3.1 Insurance risk continued
***Reserving risk** continued*

Certain marine and property insurance contracts such as those relating to subsea and other energy assets, and the related business interruption risks, can also take longer than normal to settle. This is because of the length of time required for detailed subsea surveys to be carried out and damage assessments agreed together with difficulties in predicting when the assets can be brought back into full production.

For the inwards reinsurance lines, there is often a time lag between the establishment and re-estimate of case reserves and reporting to the Group. The Group works closely with the reinsured to ensure timely reporting and also centrally analyses industry loss data to verify the reported reserves.

3.2 Financial risk
Overview
The Group is exposed to financial risk through its ownership of financial instruments including financial liabilities. These items collectively represent a significant element of the Group's net shareholder funds. The Group invests in financial assets in order to fund obligations arising from its insurance contracts and financial liabilities.

The key financial risk for the Group is that the proceeds from its financial assets and investment result generated thereon are not sufficient to fund the obligations. The most important entity and economic variables that could result in such an outcome relate to the reliability of fair value measures, equity price risk, interest rate risk, credit risk, liquidity risk and currency risk. The Group's policies and procedures for managing exposure to these specific categories of risk are detailed below.

(a) Reliability of fair values
The Group has elected to carry all financial investments at fair value through profit or loss as they are managed and evaluated on a fair value basis in accordance with a documented strategy. With the exception of unquoted equity investments, all of the financial investments held by the Group are available to trade in markets and the Group therefore seeks to determine fair value by reference to published prices or as derived by pricing vendors using observable quotations in the most active financial markets in which the assets trade. The fair value of financial assets is measured primarily with reference to their closing bid market prices at the balance sheet date. The ability to obtain quoted bid market prices may be reduced in periods of diminished liquidity. In addition, those quoted prices that may be available may represent an unrealistic proportion of market holdings or individual trade sizes that could not be readily available to the Group. In such instances fair values may be determined or partially supplemented using other observable market inputs such as prices provided by market makers such as dealers and brokers, and prices achieved in the most recent regular transaction of identical or closely related instruments occurring before the balance sheet date but updated for relevant perceived changes in market conditions.

At 31 December 2010, the Group holds asset-backed and mortgage-backed fixed income instruments in its investment portfolio however has minimal direct exposure to sub-prime asset classes. Together with the Group's investment managers, management continues to monitor the potential for any adverse development associated with this investment exposure through the analysis of relevant factors such as credit ratings, collateral, subordination levels and default rates in relation to the securities held.

Valuation of these securities will continue to be impacted by external market factors including default rates, rating agency actions, and liquidity. The Group will make adjustments to the investment portfolio as appropriate as part of its overall portfolio strategy, but its ability to mitigate its risk by selling or hedging its exposures may be limited by the market environment. The Group's future results may be impacted, both positively and negatively, by the valuation adjustments applied to these securities.

Note 22 provides an analysis of the measurement attributes of the Group's financial instruments.

(b) Equity price risk
The Group is exposed to equity price risk through its holdings of equity and unit trust investments. This is limited to a small and controlled proportion of the overall investment portfolio and the equity and unit trust holdings involved are well diversified over a number of companies and industries. The fair value of equity assets in the Group's balance sheet at 31 December 2010 was £155 million (2009: £134 million). These may be analysed as follows:

Nature of equity and unit trust holdings	2010 % weighting	2009 % weighting
Directly held equity securities	**2**	2
Units held in funds – traditional long only	**69**	68
Units held in funds – long and short and special strategies	**29**	30
Geographic focus		
Specific UK mandates	**44**	37
Global mandates	**56**	63

The allocation of equity risk is not heavily confined to any one market index so as to reduce the Group's exposure to individual sensitivities. A 10% downward correction in equity prices at 31 December 2010 would have been expected to reduce Group equity and profit after tax for the year by approximately £13.1 million (2009: £11.4 million) assuming that the only area impacted was equity financial assets. A 10% upward movement is estimated to have an equal but opposite effect.

(c) Interest rate risk
Fixed income investments represent a significant proportion of the Group's assets and the Board continually monitors investment strategy to minimise the risk of a fall in the portfolio's market value which could affect the amount of business that the Group is able to underwrite or its ability to settle claims as they fall due. The fair value of the Group's investment portfolio of debt and fixed income securities is normally inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's debt and fixed income investments would tend to rise and vice versa if credit spreads remained constant.

Debt and fixed income assets are predominantly invested in high quality corporate, government and asset backed bonds. The investments typically have relatively short durations and terms to maturity. The portfolio is managed to minimise the impact of interest rate risk on anticipated Group cash flows.

The Group may also from time to time, enter into interest rate future contracts in order to minimise the interest rate risk on specific longer duration portfolios.

The fair value of debt and fixed income assets in the Group's balance sheet at 31 December 2010 was £2,285 million (2009: £2,256 million). These may be analysed as follows:

3 Management of risk continued
3.2 Financial risk continued
(c) Interest rate risk *continued*

Nature of debt and fixed income holdings	**2010 % weighting**	2009 % weighting
Government issued bonds and instruments	**22**	28
Agency and government supported debt	**31**	28
Asset backed securities	**8**	6
Mortgage backed instruments – Agency	**4**	4
Mortgage backed instruments – Non-agency	**6**	6
Corporate bonds	**27**	26
Lloyd's and money market deposits	**2**	2

One method of assessing interest rate sensitivity is through the examination of duration-convexity factors in the underlying portfolio. Using a duration-convexity based sensitivity analysis, if market interest rates had risen by 100 basis points at the balance sheet date, the fair value might have been expected to decrease by £28 million (2009: decrease of £32 million) assuming that the only balance sheet area impacted was debt and fixed income financial assets.

Duration is the weighted average length of time required for an instrument's cash flow stream to be recovered, where the weightings involved are based on the discounted present values of each cash flow. A closely related concept, modified duration, measures the sensitivity of the instrument's price to a change in its yield to maturity. Convexity measures the sensitivity of modified duration to changes in the yield to maturity.

Using these three concepts, scenario modelling derives the above estimated impact on instruments' fair values for a 100 basis point change in the term structure of market interest rates.

Insurance contract liabilities are not directly sensitive to the level of market interest rates, as they are undiscounted and contractually non-interest-bearing. The Group's debt and fixed income assets are further detailed at note 19.

At 31 December 2010, £20 million was drawn on the Group's borrowing facility (2009: £138 million). The Group has no other significant borrowings or other assets or liabilities carrying interest rate risk, other than the facilities and Letters of Credit outlined in note 35.

(d) Credit risk
The Group has exposure to credit risk, which is the risk that a counterparty will suffer a deterioration in perceived financial strength or be unable to pay amounts in full when due.

The concentrations of credit risk exposures held by insurers may be expected to be greater than those associated with other industries, due to the specific nature of reinsurance markets and the extent of investments held in financial markets. In both markets, the Group interacts with a number of counterparties who are engaged in similar activities with similar customer profiles, and often in the same geographical areas and industry sectors. Consequently, as many of these counterparties are themselves exposed to similar economic characteristics, one single localised or macroeconomic change could severely disrupt the ability of a significant number of counterparties to meet the Group's agreed contractual terms and obligations.

Key areas of exposure to credit risk include:
- reinsurers' share of insurance liabilities;
- amounts due from reinsurers in respect of claims already paid;
- amounts due from insurance contract holders; and
- counterparty risk with respect to cash and cash equivalents, and investments including deposits, derivative transactions and catastrophe bonds.

The Group's maximum exposure to credit risk is represented by the carrying values of financial assets and reinsurance assets included in the consolidated balance sheet at any given point in time. The Group does not use credit derivatives or other products to mitigate maximum credit risk exposures on reinsurance assets. The Group structures the levels of credit risk accepted by placing limits on their exposure to a single counterparty, or groups of counterparties, and having regard to geographical locations. Such risks are subject to an annual or more frequent review. There is no significant concentration of credit risk with respect to loans and receivables, as the Group has a large number of internationally dispersed debtors with unrelated operations. Reinsurance is used to contain insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is therefore continually reviewed throughout the year.

The Group Reinsurance Security Committee assesses the creditworthiness of all reinsurers by reviewing credit grades provided by rating agencies and other publicly available financial information detailing their financial strength and performance. The financial analysis of reinsurers produces an assessment categorised by Standard & Poor's (S&P) rating (or equivalent when not available from S&P).

Despite the rigorous nature of this assessment exercise, and the resultant restricted range of reinsurance counterparties with acceptable strength and credit credentials that emerges therefrom, some degree of credit risk concentration remains inevitable.

The Committee considers the reputation of its reinsurance partners and also receives details of recent payment history and the status of any ongoing negotiations between Group companies and these third-parties. This information is used to update the reinsurance purchasing strategy. Individual operating units maintain records of the payment history for significant brokers and contract holders with whom they conduct regular business. The exposure to individual counterparties is also managed by other mechanisms, such as the right of offset where counterparties are both debtors and creditors of the Group. Management information reports detail provisions for impairment on loans and receivables and subsequent write-off. Exposures to individual intermediaries and groups of intermediaries are collected within the ongoing monitoring of the controls associated with regulatory solvency.

3 Management of risk continued
3.2 Financial risk continued
(d) Credit risk *continued*

The Group also mitigates credit counterparty risk by concentrating debt and fixed income investments in high-quality instruments, including a particular emphasis on government bonds issued mainly by European Union and North American countries.

An analysis of the Group's major exposures to counterparty credit risk excluding loans and receivables, based on Standard & Poor's or equivalent rating, is presented below:

As at 31 December 2010	Note	AAA £000	AA £000	A £000	Other/ not rated £000	Total £000
Debt and fixed income securities	19	**1,530,973**	**202,410**	**308,966**	**242,164**	**2,284,513**
Deposits with credit institutions	19	**3,819**	**207**	**–**	**254**	**4,280**
Catastrophe bonds		**–**	**–**	**–**	**15,452**	**15,452**
Reinsurance assets	18	**22,931**	**169,083**	**253,810**	**16,941**	**462,765**
Cash and cash equivalents	23	**35,874**	**137,223**	**160,382**	**2,538**	**336,017**
Total		**1,593,597**	**508,923**	**723,158**	**277,349**	**3,103,027**
Amounts attributable to largest single counterparty		**252,213**	**76,466**	**43,420**	**16,583**	

at 31 December 2009	Note	AAA £000	AA £000	A £000	Other/ not rated £000	Total £000
Debt and fixed income securities	19	1,555,636	198,001	256,120	245,980	2,255,737
Deposits with credit institutions	19	62	2,860	8,472	–	11,394
Catastrophe bonds		–	–	–	11,310	11,310
Derivative financial instruments	19, 21	–	–	–	1,018	1,018
Reinsurance assets	18	8,120	151,803	230,462	29,741	420,126
Cash and cash equivalents	23	27,456	136,214	93,999	1,978	259,647
Total		1,591,274	488,878	589,053	290,027	2,959,232
Amounts attributable to largest single counterparty		308,569	57,859	17,424	10,619	

The largest counterparty exposure within AAA rating is with the US Treasury. Catastrophe bonds included within 'other/not rated' are rated BB or above. A significant proportion of 'other/not rated' reinsurance assets at 31 December 2010 and 31 December 2009 are supported by Letter of Credit guarantees issued by financial institutions with Standard & Poor's or equivalent credit or financial strength ratings of A or better.

At 31 December 2010 the Group held no material debt and fixed income assets that were past due or impaired beyond their reported fair values, either for the current period under review or on a cumulative basis (2009: £nil). For the current period and prior period, the Group did not experience any material defaults on debt securities.

The available headroom of working capital is monitored through the use of a detailed Group cash flow forecast which is reviewed by management monthly or more frequently as required.

(e) Liquidity risk
The Group is exposed to daily calls on its available cash resources mainly from claims arising from insurance and reinsurance contracts. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Board sets limits on the minimum level of cash and maturing funds available to meet such calls and on the minimum level of borrowing facilities that should be in place to cover unexpected levels of claims and other cash demands.

A significant proportion of the Group's investments are in highly liquid assets which could be converted to cash in a prompt fashion and at minimal expense. The deposits with credit institutions largely comprise short-dated certificates for which an active market exists and which the Group can easily access. The Group's exposure to equities is concentrated on shares and funds that are traded on internationally recognised stock exchanges.

3 Management of risk continued
3.2 Financial risk continued
(e) Liquidity risk continued

The main focus of the investment portfolio is on high-quality short duration debt and fixed income securities, and cash. There are no significant holdings of investments with specific repricing dates. Notwithstanding the regular interest receipts and also the Group's ability to liquidate these securities and the majority of its other financial instrument assets for cash in a prompt and reasonable manner, the contractual maturity profile of the fair value of these securities at 31 December was as follows:

Fair values at balance sheet date analysed by contractual maturity	Debt and fixed income securities £000	Deposits with credit institutions £000	Catastrophe bonds £000	Cash and cash equivalents £000	**2010 Total £000**	2009 Total £000
Less than one year	484,885	525	3,759	336,017	**825,186**	733,946
Between one and two years	807,481	3,755	5,606	–	**816,842**	719,700
Between two and five years	648,551	–	6,087	–	**654,638**	672,198
Over five years	290,083	–	–	–	**290,083**	359,094
Sub-total	2,231,000	4,280	15,452	336,017	**2,586,749**	2,484,938
Other non-dated instruments	53,513	–	–	–	**53,513**	54,168
Total	2,284,513	4,280	15,452	336,017	**2,640,262**	2,539,106

The Group's equities and shares in unit trusts and other non-dated instruments have no contractual maturity terms but could also be liquidated in an orderly manner for cash in a prompt and reasonable timeframe within one year of the balance sheet date.

Average contractual maturity analysed by denominational currency of investments	**2010 Years**	2009 Years
Pound Sterling	**1.89**	1.52
US Dollar	**4.83**	4.89
Euro	**3.82**	3.21
Canadian Dollar	**2.24**	1.38

The following is an analysis by liability type of the estimated timing of net cash flows based on the net claims liabilities held. The Group does not discount claims liabilities. The estimated phasing of settlement is based on current estimates and historical trends and the actual timing of future settlement cash flows may differ materially from that disclosure below.

Liquidity requirements to settle estimated profile of net claim liabilities on balance sheet	Within one year £000	Between one and two years £000	Between two and five years £000	Over five years £000	**2010 Total £000**
Reinsurance inwards	161,531	91,515	85,066	36,512	**374,624**
Property – marine and major assets	29,233	17,715	17,753	1,720	**66,421**
Property – other assets	112,654	37,758	28,314	4,049	**182,775**
Casualty – professional indemnity	117,058	114,352	210,116	37,672	**479,198**
Casualty – other risks	66,493	44,187	37,681	9,487	**157,848**
Other*	39,831	11,339	14,114	6,061	**71,345**
Total	**526,800**	**316,866**	**393,044**	**95,501**	**1,332,211**

Liquidity requirements to settle estimated profile of net claim liabilities on balance sheet	Within one year £000	Between one and two years £000	Between two and five years £000	Over five years £000	2009 Total £000
Reinsurance inwards	86,533	61,120	52,478	13,529	213,660
Property – marine and major assets	54,426	33,557	34,163	10,194	132,340
Property – other assets	115,406	42,065	32,477	5,234	195,182
Casualty – professional indemnity	99,372	101,486	183,597	36,193	420,648
Casualty – other risks	55,636	37,247	34,243	8,301	135,427
Other*	56,342	30,266	27,088	9,480	123,176
Total	467,715	305,741	364,046	82,931	1,220,433

*Includes a diverse mix of certain specialty lines such as kidnap and ransom, terrorism, bloodstock and other risks which contain a mix of property and casualty exposures.

Details of the payment profile of the Group's borrowings, derivative instruments and other liabilities is given in notes 19 and 27.

3 Management of risk continued
3.2 Financial risk continued

(f) Currency risk

The Group operates internationally and its exposures to foreign exchange risk arise primarily with respect to the US Dollar, Pound Sterling and the Euro. These exposures may be classified in two main categories:

1) Structural foreign exchange risk through consolidation of net investments in subsidiaries with different functional currencies within the Group results; and
2) Operational foreign exchange risk through routinely entering into insurance, investment and operational contracts, as a Group of international insurance entities serving international communities, where rights and obligations are denominated in currencies other than each respective entity's functional currency.

The Group's exposure to structural foreign exchange risk primarily relates to the US Dollar net investments made in its domestic operation in Bermuda and its overseas operation in Guernsey and the US. Other structural exposures also arise on a smaller scale in relation to net investments made in European operations. The Group's risk appetite permits the acceptance of structural foreign exchange movements within defined aggregate limits and exchange rate parameters which are monitored centrally. Exchange rate derivatives are used when appropriate to shield the Group against significant movements outside of a defined range.

At a consolidated level, the Group is exposed to foreign exchange gains or losses on balances held between Group companies where one party to the transaction has a functional currency other than Pound Sterling. To the extent that such gains or losses are considered to relate to economic hedges and intragroup borrowings, they are disclosed separately in order for users of the financial statements to obtain a fuller understanding of the Group's financial performance (note 13).

The Group has the ability to draw on its current borrowing facility in any currency requested, enabling the Group to match its funding requirements with the relevant currency.

Operational foreign exchange risk is controlled within the Group's individual entities. The assets of the Group's overseas operations are generally invested in the same currencies as their underlying insurance and investment liabilities producing a natural hedge. Due attention is paid to local regulatory solvency and risk-based capital requirements.

Details of all foreign currency derivative contracts entered into with external parties are given in note 21. All foreign currency derivative transactions with external parties are managed centrally. Included in the tables below are net non-monetary liabilities of £142 million (2009: £240 million) which are denominated in foreign currencies.

As a result of the accounting treatment for non-monetary items, the Group may also experience volatility in its income statement during a period when movements in foreign exchange rates fluctuate significantly. In accordance with IFRS, non-monetary items are recorded at original transaction rates and are not remeasured at the reporting date. These items include unearned premiums, deferred acquisition costs and reinsurers' share of unearned premiums. Consequently, a mismatch arises in the income statement between the amount of premium recognised at historical transaction rates, and the related claims which are retranslated using currency rates in force at the reporting date. The Group considers this to be a timing issue which can cause significant volatility in the income statements. Further details of the impact of the accounting treatment is provided in note 12.

The currency profile of the Group's assets and liabilities is as follows:

As at 31 December 2010	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Intangible assets	57,800	6,308	–	–	64,108
Property, plant and equipment	11,379	7,710	653	–	19,742
Investments in associates	6,302	–	584	–	6,886
Deferred tax	–	14,077	–	–	14,077
Deferred acquisition costs	43,762	72,080	23,462	3,432	142,736
Financial assets carried at fair value	598,779	1,648,985	174,224	37,119	2,459,107
Reinsurance assets	57,680	360,902	32,927	11,256	462,765
Loans and receivables including insurance receivables	132,916	222,202	126,154	4,142	485,414
Cash and cash equivalents	135,457	121,807	54,828	23,925	336,017
Total assets	1,044,075	2,454,071	412,832	79,874	3,990,852

3 Management of risk continued
3.2 Financial risk continued
(f) Currency risk *continued*

	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Employee retirement benefit obligations	–	–	–	–	–
Deferred tax	**45,421**	–	–	–	**45,421**
Insurance liabilities	**545,358**	**1,417,667**	**268,833**	**48,009**	**2,279,867**
Financial liabilities	**20,457**	–	–	–	**20,457**
Current tax	**29,995**	–	–	–	**29,995**
Trade and other payables	**36,698**	**237,488**	**67,915**	**6,897**	**348,998**
Total liabilities	**677,929**	**1,655,155**	**336,748**	**54,906**	**2,724,738**

As at 31 December 2009	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Intangible assets	44,105	6,308	–	–	50,413
Property, plant and equipment	13,678	7,893	673	–	22,244
Investments in associates	6,728	–	590	–	7,318
Deferred tax	–	14,077	–	–	14,077
Deferred acquisition costs	42,376	71,678	23,125	4,326	141,505
Financial assets carried at fair value	580,797	1,623,276	166,629	42,598	2,413,300
Reinsurance assets	54,976	320,424	27,375	17,351	420,126
Loans and receivables including insurance receivables	127,361	259,539	88,480	13,402	488,782
Cash and cash equivalents	93,096	97,754	57,998	10,799	259,647
Total assets	963,117	2,400,949	364,870	88,476	3,817,412

	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Employee retirement benefit obligations	–	–	–	–	–
Deferred tax	69,673	–	–	–	69,673
Insurance liabilities	486,488	1,361,934	220,661	53,268	2,122,351
Financial liabilities	138,000	539	–	–	138,539
Current tax	26,080	–	–	–	26,080
Trade and other payables	142,659	149,005	42,766	5,053	339,483
Total liabilities	862,900	1,511,478	263,427	58,321	2,696,126

Sensitivity analysis

As at 31 December 2010, the Group used closing rates of exchange of £1:€1.17 and £1:$1.57 (2009: £1:€1.13 and £1:$1.61). The Group performs sensitivity analysis based on a 10% strengthening or weakening of Pound Sterling against the Euro and US Dollar. This analysis assumes that all other variables, in particular interest rates, remain constant and that the underlying valuation of assets and liabilities in their base currency is unchanged. The process of deriving the undernoted estimates takes account of the linear retranslation movements of foreign currency monetary assets and liabilities together with the impact on the retranslation of those Group entities with non-Sterling functional currency financial statements. During the year, the Group transacted in a number of over the counter forward currency derivative contracts. The impact of these contracts on the sensitivity analysis is negligible.

As at 31 December 2010	**Effect on equity after tax £m**	**Effect on profit before tax £m**
Strengthening of US Dollar	**91.0**	**38.5**
Weakening of US Dollar	**(71.9)**	**(28.9)**
Strengthening of Euro	**7.2**	**10.0**
Weakening of Euro	**(5.9)**	**(8.2)**

Notes to the consolidated financial statements continued

3 **Management of risk** continued
3.2 Financial risk continued

(g) Limitations of sensitivity analysis
The sensitivity information given in notes (a) to (f) above demonstrates the estimated impact of a change in a major input assumption while other assumptions remain unchanged. In reality, there are normally significant levels of correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results. The same limitations exist in respect to the retirement benefit scheme sensitivities presented at note 30 to these financial statements. Furthermore, estimates of sensitivity may become less reliable in unusual market conditions such as instances when risk-free interest rates fall towards zero.

The sensitivity analyses do not take into consideration that the Group's assets and liabilities are actively managed. Additionally, the financial position of the Group may vary at the time that any actual market movement occurs. For example, the Group's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action.

3.3 Capital risk management
The Group's primary objectives when managing its capital position are:
- to safeguard its ability to continue as a going concern, so that it can continue to provide long-term growth and progressive dividend returns for shareholders;
- to provide an adequate return to the Group's shareholders by pricing its insurance products and services commensurately with the level of risk;
- to maintain an efficient cost of capital;
- to comply with all regulatory requirements by a significant margin; and
- to maintain financial strength ratings of A in each of its insurance entities.

The Group sets the amount of capital required in its funding structure in proportion to risk. The Group then manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to obtain or maintain an optimal capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, assume debt, or sell assets to reduce debt.

The Group's activities are funded by a mixture of capital sources including issued equity share capital, retained earnings, Letters of Credit, bank debt and other third-party insurance capital.

The Board ensures that the use and allocation of capital are given a primary focus in all significant operational actions. With that in mind, the Group has developed and embedded sophisticated capital modelling tools within its business. These join together short-term and long-term business plans and link divisional aspirations with the Group's overall strategy. The models provide the basis of the allocation of capital to different businesses and business lines, as well as the regulatory and rating agency capital processes.

During the year the Group was in compliance with capital requirements imposed by regulators in each jurisdiction where the Group operates.

There were no changes in the Group's approach to capital risk management during the current or prior year under review.

Gearing
The Group currently utilises short-to medium-term gearing as an additional source of funds to maximise the opportunities from strong markets and to reduce the risk profile of the business when the rating environment shows a weaker model for the more volatile business. The Group's gearing is obtained from a number of sources, including:
- Letter of Credit and revolving credit facility – the Group's main facility was replaced during 2010 for a total of $750 million which may be drawn as cash (under a revolving credit facility), Letter of Credit or a combination thereof, providing that the cash portion does not exceed $450 million. This facility was secured during 2010 by the Company's subsidiary Hiscox plc. The Letter of Credit availability period ends on 31 December 2011. This enables the Group to utilise the Letter of Credit as Funds at Lloyd's to support underwriting on the 2010, 2011 and 2012 years of account. The revolving credit facility has a maximum three-year contractual period for repayment. At 31 December 2010 US$165 million was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and a further £20 million by way of cash (2009: $225 million and £138 million respectively) to support general trading activities;
- external Names – 27.5% of Syndicate 33's capacity is capitalised by third-parties paying a profit share of approximately 17.5%;
- Syndicate 6104 at Lloyd's – with an approximate capacity of £45 million for the 2010 year of account (2009 year of account: £43 million). This Syndicate is wholly backed by external members and takes a pure 2009 year of account quota share of Syndicate 33's international property catastrophe reinsurance account;
- gearing quota shares – historically the Group has used reinsurance capital to fund its capital requirement for short-term expansions in the volume of business underwritten by the Syndicate; and
- qualifying quota shares – these are reinsurance arrangements that allow the Group to increase the amount of premium it writes in hard markets.

The funds raised through Letters of Credit and loan facilities have been applied to support both the 2010 year of account for Syndicate 33 and the capital requirements of Hiscox Insurance Company (Bermuda) Limited.

Financial strength
The financial strength ratings of the Group's insurance company subsidiaries are outlined below:

	A.M. Best	Fitch	Standard & Poor's
Hiscox Insurance Company Limited	A (Excellent)	A	A (Strong)
Hiscox Insurance Company (Bermuda) Limited	A (Excellent)	A	–
Hiscox Insurance Company (Guernsey) Limited	A (Excellent)	A	–
Hiscox Insurance Company Inc.	A (Excellent)	–	–

Syndicate 33 benefits from an A.M. Best rating of A (Excellent). In addition, the Syndicate also benefits from the Lloyd's ratings of A (Excellent) from A.M. Best and A+ (Strong) from Standard & Poor's.

Capital performance
The Group's main capital performance measure is the achieved return on equity (ROE). This marker best aligns the aspirations of employees and shareholders. As variable remuneration, the vesting of options and longer-term investment plans

3 Management of risk continued
3.3 Capital risk management continued

all relate directly to ROE, this concept is embedded in the workings and culture of the Group. The Group maintains its cost of capital levels and its debt to overall equity ratios in line with others in the non-life insurance industry.

Capital modelling and regulation
The capital requirements of an insurance group are determined by its exposure to risk and the solvency criteria established by management and statutory regulations.

In 2005, the UK Financial Services Authority (FSA) and Lloyd's introduced a new capital regime that requires insurance companies to calculate their own capital requirements through Individual Capital Assessments (ICA). Hiscox Insurance Company Limited and Syndicate 33 maintain ICA models in accordance with this regime. The models are concentrated specifically on the particular product lines, market conditions and risk appetite of each entity. If the FSA considers an ICA to be inadequate, it can require the entity to maintain an increased capital safeguard. The Directors are also required to certify that the Group has complied, in all material aspects, with the provisions of the Interim Prudential Sourcebook: Insurers (IPRU(INS)), the Integrated Prudential Sourcebook for Insurers (INSPRU) and General Prudential Sourcebook (GENPRU) when completing the ICA return. The Group used its own integrated modelling expertise to produce the ICA calculations. The results mirrored those driving the existing internal capital setting process.

The Group's capital requirements are managed both centrally and at a regulated entity level. The assessed capital requirement for the business placed through Hiscox Insurance Company Limited, Hiscox Insurance Company (Bermuda) Limited, Hiscox Insurance Company (Guernsey) Limited and Hiscox Insurance Company Inc., is driven by the level of resources necessary to maintain both regulatory requirements and the capital necessary to maintain financial strength of an A rating.

For Syndicate 33, the ICA process produces a result that is uplifted by Lloyd's to identify the capital required to hold the A rating. The strong control and risk management environment, together with the sophistication of the modelling, have produced a capital ratio below that suggested under the previous risk-based capital regime. Another key area of capital modelling for Hiscox is to identify which insurance vehicle produces the best return on capital employed for the Group, given certain restraints from licences, reinsurance and the regulatory environment. This modelling takes into account transactional costs and tax, in addition to the necessary capital ratios. It proves the capital efficiency of Lloyd's, despite a tax disadvantage against offshore entities, and the cost advantage of processing smaller premium business outside of Lloyd's.

In addition to the ICA modelling process, the EU Insurance Group's Directive of 1998, as amended by the Financial Group's Directive (FGD), compels insurance companies that are members of a group to consider the solvency margin of their ultimate parent company. This consideration must refer to the surplus assets of the ultimate parent's related insurers, reinsurers, intermediate holding companies and other regulated entities.

The FGD has been applied in the UK through INSPRU and GENPRU. In accordance with these provisions, the parent company's solvency margin consideration became a minimum capital requirement for the Group from 31 December 2006 onwards. The Group complied with the requirement for the current and prior year.

In the Group's other geographical territories, including the US, its subsidiaries underwriting insurance business are required to operate within broadly similar risk-based externally imposed capital requirements when accepting business.

4 Operating segments
The Group's operating segments consist of four segments which recognise the differences between products and services, customer groupings and geographical areas. Financial information is used in this format by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The format is representative of the management structure of the segments.

The Group's four operating segments are:

- **London Market** comprises the results of Syndicate 33, excluding the results of the fine art, UK regional events coverage and non US household business which is included within the results of UK and Europe. It also includes the fire and aviation businesses from Syndicate 3624. In addition, it excludes the larger TMT business which is allocated to the International segment and an element of kidnap and ransom and terrorism included in UK and Europe.
- **UK and Europe** comprises the results of Hiscox Insurance Company Limited, the results of Syndicate 33's fine art, UK regional events coverage and non US household business, together with the income and expenses arising from the Group's retail agency activities in the UK and in continental Europe. In addition, it includes the European errors and omissions business from Syndicate 3624. It excludes the results of the larger retail TMT business written by Hiscox Insurance Company Limited. It also includes an element of kidnap and ransom and terrorism written in Syndicate 33.
- **International** comprises the results of Hiscox Insurance Company (Guernsey) Limited, Hiscox Insurance Company (Bermuda) Limited, Hiscox Inc., Hiscox Insurance Company Inc. and Syndicate 3624 excluding the European errors and omissions, fire and aviation business. It also includes the results of the larger TMT business written by Hiscox Insurance Company Limited and Syndicate 33.
- **Corporate Centre** comprises the investment return, finance costs and administrative costs associated with Group management activities. Corporate Centre also includes the majority of foreign currency items on economic hedges and intragroup borrowings. These relate to certain foreign currency items on economic hedges and intragroup borrowings, further details of which are given at note 13. Corporate Centre forms a reportable segment due to its investment activities which earn significant external coupon revenues.

All amounts reported below represent transactions with external parties only. In the normal course of trade, the Group's entities enter into various reinsurance arrangements with one another. The related results of these transactions are eliminated on consolidation and are not included within the results of the segments. This is consistent with the information used by the chief operating decision maker when evaluating the results of the Group. Performance is measured based on each reportable segment's profit before tax.

4 Operating segments continued

(a) Profit before tax by segment

	Year to 31 December 2010					Year to 31 December 2009				
	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000
Gross premiums written	572,748	454,692	405,234	–	1,432,674	663,034	420,982	351,385	–	1,435,401
Net premiums written	389,581	428,032	314,014	–	1,131,627	483,611	391,461	281,951	–	1,157,023
Net premiums earned	396,096	422,180	312,882	–	1,131,158	453,281	367,326	277,495	–	1,098,102
Investment result*	39,068	17,244	27,624	16,313	100,249	79,709	36,902	57,682	8,872	183,165
Other revenues	12,054	3,671	5,836	518	22,079	12,841	3,955	2,700	2	19,498
Revenue	447,218	443,095	346,342	16,831	1,253,486	545,831	408,183	337,877	8,874	1,300,765
Claims and claim adjustment expenses, net of reinsurance	(195,570)	(213,001)	(162,426)	–	(570,997)	(175,823)	(195,967)	(91,428)	–	(463,218)
Expenses for the acquisition of insurance contracts	(92,832)	(99,069)	(77,990)	–	(269,891)	(101,518)	(87,393)	(67,723)	–	(256,634)
Operational expenses	(44,733)	(89,440)	(59,419)	(12,811)	(206,403)	(52,178)	(97,193)	(61,128)	(19,067)	(229,566)
Foreign exchange gains/(losses)	11,669	(1,972)	(2,610)	8,397	15,484	(35,800)	(7,065)	6,989	10,322	(25,554)
Total expenses	(321,466)	(403,482)	(302,445)	(4,414)	(1,031,807)	(365,319)	(387,618)	(213,290)	(8,745)	(974,972)
Results of operating activities	125,752	39,613	43,897	12,417	221,679	180,512	20,565	124,587	129	325,793
Finance costs	(4,392)	(9)	(433)	(5,256)	(10,090)	(616)	(20)	(407)	(4,250)	(5,293)
Share of (loss)/profit of associates after tax	–	–	(323)	100	(223)	–	–	–	118	118
Profit before tax	121,360	39,604	43,141	7,261	211,366	179,896	20,545	124,180	(4,003)	320,618

*Interest revenues included total £60,332,000 (2009: £74,584,000).

The following charges are included within the consolidated income statement:

	Year to 31 December 2010					Year to 31 December 2009				
	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000
Depreciation	455	2,155	1,932	63	4,605	650	3,230	1,187	60	5,127
Amortisation of intangible assets	1,212	845	403	–	2,460	635	135	149	–	919

4 Operating segments continued
(a) Profit before tax by segment continued

The Group's wholly owned subsidiary, Hiscox Syndicates Limited, oversees the operation of Syndicate 33 at Lloyd's. The Group's percentage participation in Syndicate 33 can fluctuate from year to year and consequently, presentation of the results at the 100% level removes any distortions arising therefrom.

	Year to 31 December 2010					Year to 31 December 2009				
100% ratio analysis	London Market	UK and Europe	International	Corporate Centre	Total	London Market	UK and Europe	International	Corporate Centre	Total
Claims ratio (%)	**48.3**	**50.2**	**53.2**	**–**	**50.1**	38.8	53.4	33.0	–	41.8
Expense ratio (%)	**33.5**	**44.6**	**43.2**	**–**	**39.7**	32.2	49.9	45.6	–	40.4
Combined ratio excluding foreign exchange impact (%)	**81.8**	**94.8**	**96.4**	**–**	**89.8**	71.0	103.3	78.6	–	82.2
Foreign exchange impact (%)	**(2.1)**	**0.5**	**0.9**	**–**	**(0.5)**	7.8	1.8	(2.3)	–	3.8
Combined ratio (%)	**79.7**	**95.3**	**97.3**	**–**	**89.3**	78.8	105.1	76.3	–	86.0
Combined ratio excluding non-monetary foreign exchange impact (%)	**79.7**	**95.3**	**97.3**	**–**	**89.3**	71.5	103.9	76.3	–	81.7

The claims ratio is calculated as claims and claim adjustment expenses, net of reinsurance, as a proportion of net premiums earned. The expense ratio is calculated as the total of expenses for the acquisition of insurance contracts, and operational expenses as a proportion of net premiums earned. The foreign exchange impact ratio is calculated as the foreign exchange gains or losses as a proportion of net premiums earned. The combined ratio is the total of the claims, expenses and foreign exchange impact ratios. The combined ratio excluding non-monetary foreign exchange impact is calculated by adjusting the net premiums earned and the expenses for the acquisition of insurance contracts by the movement arising from retranslating net unearned premiums and net deferred acquisition costs at year end rates of exchange. All ratios are calculated using the 100% results.

Costs allocated to the Corporate Centre are non-underwriting related costs and are not included within the combined ratio. The impact on profit before tax of a 1% change in each component of the segmental combined ratios is:

	Year to 31 December 2010				Year to 31 December 2009			
	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	London Market £000	UK and Europe £000	International £000	Corporate Centre £000
At 100% level (note 4b) 1% change in claims or expense ratio	**5,459**	**4,388**	**3,223**	**–**	6,248	3,824	2,875	–
At Group level 1% change in claims or expense ratio	**3,961**	**4,222**	**3,129**	**–**	4,533	3,673	2,775	–

(b) 100% operating result by segment

	Year to 31 December 2010					Year to 31 December 2009				
	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000
Gross premiums written	**782,523**	**472,247**	**416,103**	**–**	**1,670,873**	914,072	440,064	359,297	–	1,713,433
Net premiums written	**524,658**	**443,693**	**321,236**	**–**	**1,289,587**	666,692	408,037	287,589	–	1,362,318
Net premiums earned	**545,945**	**438,773**	**322,341**	**–**	**1,307,059**	624,755	382,417	287,524	–	1,294,696
Investment result	**53,870**	**17,848**	**28,572**	**16,313**	**116,603**	109,803	38,395	59,214	8,872	216,284
Other revenues	**–**	**3,029**	**4,393**	**518**	**7,940**	–	2,716	677	2	3,395
Claims and claim adjustment expenses, net of reinsurance	**(263,610)**	**(220,101)**	**(171,347)**	**–**	**(655,058)**	(242,422)	(204,330)	(94,873)	–	(541,625)
Expenses for the acquisition of insurance contracts	**(127,202)**	**(105,394)**	**(78,611)**	**–**	**(311,207)**	(139,923)	(92,562)	(69,185)	–	(301,670)
Operational expenses	**(55,873)**	**(90,489)**	**(60,755)**	**(12,811)**	**(219,928)**	(61,054)	(97,948)	(62,040)	(19,067)	(240,109)
Foreign exchange gains/(losses)	**11,272**	**(1,983)**	**(2,892)**	**8,397**	**14,794**	(48,912)	(6,951)	6,678	10,322	(38,863)
Results of operating activities	**164,402**	**41,683**	**41,701**	**12,417**	**260,203**	242,247	21,737	127,995	129	392,108

Segment results at the 100% level presented above differ from those presented at the Group's share at note 4(a) solely as a result of the Group not owning 100% of the capacity of Syndicate 33 at Lloyd's.

4 Operating segments continued

(c) Segmental analysis of assets and liabilities

The segment assets and liabilities at 31 December and the capital expenditure for the year then ended are as follows:

Year to 31 December 2010

	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Intragroup items and eliminations £000	Total £000
Intangible assets	**32,995**	**5,524**	**15,441**	**10,148**	**–**	**64,108**
Deferred acquisition costs	**51,275**	**45,574**	**43,529**	**–**	**2,358**	**142,736**
Financial assets	**995,824**	**413,989**	**797,048**	**32,480**	**226,652**	**2,465,993**
Reinsurance assets	**660,057**	**185,625**	**85,778**	**–**	**(468,695)**	**462,765**
Other assets	**514,351**	**253,925**	**345,893**	**954,236**	**(1,213,155)**	**855,250**
Total assets	**2,254,502**	**904,637**	**1,287,689**	**996,864**	**(1,452,840)**	**3,990,852**
Insurance liabilities	**1,315,215**	**536,196**	**528,390**	**–**	**(99,934)**	**2,279,867**
Other liabilities	**811,866**	**208,759**	**194,115**	**139,015**	**(908,884)**	**444,871**
Total liabilities	**2,127,081**	**744,955**	**722,505**	**139,015**	**(1,008,818)**	**2,724,738**
Capital expenditure	**4,152**	**2,731**	**8,742**	**372**	**–**	**15,497**

Year to 31 December 2009

	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Intragroup items and eliminations £000	Total £000
Intangible assets	32,647	2,715	8,522	6,529	–	50,413
Deferred acquisition costs	59,741	44,735	36,453	–	576	141,505
Financial assets	1,161,612	365,268	604,927	75,118	213,693	2,420,618
Reinsurance assets	472,998	146,435	103,630	–	(302,937)	420,126
Other assets	369,751	235,075	294,113	925,940	(1,040,129)	784,750
Total assets	2,096,749	794,228	1,047,645	1,007,587	(1,128,797)	3,817,412
Insurance liabilities	1,326,719	482,577	384,186	–	(71,131)	2,122,351
Other liabilities	657,956	185,355	173,219	168,193	(610,948)	573,775
Total liabilities	1,984,675	667,932	557,405	168,193	(682,079)	2,696,126
Capital expenditure	1,539	2,245	6,962	275	–	11,021

Segment assets and liabilities primarily consist of operating assets and liabilities, which represent the majority of the balance sheet. Intragroup assets and liabilities that cross segments are presented under the separate category heading 'Intragroup items and eliminations'.

Capital expenditure comprises expenditure on intangible assets (note 14) other than goodwill, and additions to property, plant and equipment (note 15), but excluding assets acquired on business combinations.

(d) Geographical information

The Group's operational segments underwrite business domestically in Bermuda and from locations in the UK and Ireland, the US, Guernsey, France, Germany, Belgium, the Netherlands, Spain, Portugal and Austria.

The following table provides an analysis of the Group's gross premium revenues earned by material geographical location from external parties:

	Year to 31 December 2010					Year to 31 December 2009				
Gross premium revenues earned from external parties	**London Market £000**	**UK and Europe £000**	**International £000**	**Corporate Centre £000**	**Total £000**	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000
UK and Ireland	**28,534**	**285,350**	**27,360**	**–**	**341,244**	33,028	257,873	24,298	–	315,199
Europe	**27,459**	**127,639**	**35,658**	**–**	**190,756**	47,271	111,552	30,513	–	189,336
United States	**361,192**	**8,557**	**219,210**	**–**	**588,959**	324,757	4,440	190,738	–	519,935
Rest of World	**176,527**	**28,757**	**108,875**	**–**	**314,159**	224,878	23,337	91,013	–	339,228
	593,712	**450,303**	**391,103**	**–**	**1,435,118**	629,934	397,202	336,562	–	1,363,698

The Group's largest external policyholder contributed less than 2% of total gross Group premium revenues earned and the details thereof are not disclosed on the grounds of materiality.

4 Operating segments continued
(d) Geographical information continued

The Group has not reported geographical segmental details of non-current assets excluding financial instruments and including loans and receivables, rights and obligations under insurance and reinsurance contracts, investments in associates and subsidiaries as such details are not used by the chief operating decision maker to evaluate the performance of the Group.

5 Net asset value per share

	2010 Net asset value (total equity) £000	2010 Net asset value per share pence	2009 Net asset value (total equity) £000	2009 Net asset value per share pence
Net asset value	**1,266,114**	**332.7**	1,121,286	299.2
Net tangible asset value	**1,202,006**	**315.8**	1,070,873	285.7

The net asset value per share is based on 380,613,336 shares (2009: 374,819,025 shares), being the adjusted number of shares in issue at 31 December.

Net tangible assets comprise total equity excluding intangible assets.

6 Return on equity

	2010 £000	2009 £000
Profit for the year (all attributable to owners of the Company)	**178,800**	280,497
Opening shareholders' equity	**1,121,286**	951,026
Adjusted for the time weighted impact of capital distributions and issuance of shares	**(34,820)**	(20,429)
Adjusted opening shareholders' equity	**1,086,466**	930,597
Annualised return on equity (%)	**16.5**	30.1

7 Investment result
The total result for the Group before taxation comprises:

	Note	2010 £000	2009 £000
Investment income including interest receivable		**61,606**	75,740
Net realised gains on financial investments at fair value through profit or loss		**12,971**	19,733
Net fair value gains/(losses) on financial investments at fair value through profit or loss		**24,272**	87,296
Investment result – financial assets	8	**98,849**	182,769
Fair value gains/(losses) on derivative financial instruments	21	**1,400**	396
Total result		**100,249**	183,165

Investment expenses are presented within other expenses (note 9).

8 Analysis of return on financial investments
(a) The weighted average return on financial investments for the year by currency, based on monthly asset values, was:

	2010 %	2009 %
Sterling	**3.6**	4.2
US Dollar	**3.8**	8.5
Other	**2.3**	6.5

(b) Investment return

	London Market £000	London Market %	UK and Europe £000	UK and Europe %	International £000	International %	Corporate Centre £000	Corporate Centre %	2010 Total £000	2010 Total %
Debt and fixed income securities	39,464	4.2	9,586	2.6	22,078	3.6	11,106	4.7	82,234	3.7
Equities and shares in unit trusts	–	–	6,079	11.6	4,468	9.0	5,025	13.4	15,572	11.1
Deposits with credit institutions/cash and cash equivalents	138	0.3	500	0.8	218	0.1	187	0.4	1,043	0.3
	39,602	4.0	16,165	3.3	26,764	3.2	16,318	5.0	98,849	3.6

8 Analysis of return on financial investments continued
(b) Investment return continued

	London Market		UK and Europe		International		Corporate Centre		2009 Total	
	£000	%	£000	%	£000	%	£000	%	£000	%
Debt and fixed income securities	80,616	8.0	19,212	5.9	48,887	9.2	4,239	3.8	152,954	7.7
Equities and shares in unit trusts	–	–	14,769	28.5	7,668	17.5	3,923	12.3	26,360	20.7
Deposits with credit institutions/ cash and cash equivalents	285	0.7	954	1.4	1,210	0.4	1,006	3.3	3,455	0.8
	80,901	7.7	34,935	7.8	57,765	6.8	9,168	5.2	182,769	7.2

9 Other revenues and operational expenses

	2010 £000	2009 £000
Agency related income	**6,816**	6,651
Profit commission	**10,616**	12,248
Other underwriting income – catastrophe bonds	**1,280**	410
Other income	**3,367**	189
Other revenues	**22,079**	19,498
Wages and salaries	**80,359**	86,701
Social security cost	**13,689**	12,391
Pension cost – defined contribution	**5,209**	5,167
Pension cost – defined benefit	**1,700**	13,300
Share based payments	**8,047**	5,260
Other expenses	**74,668**	86,150
Marketing expenses	**11,863**	11,422
Investment expenses	**3,803**	3,129
Depreciation and amortisation	**7,065**	6,046
Operational expenses	**206,403**	229,566

10 Finance costs

	Note	2010 £000	2009 £000
Interest and expenses associated with bank borrowings		**3,117**	2,493
Interest and charges associated with Letters of Credit	35	**3,216**	2,780
Interest charges on experience account		**3,748**	–
Interest charges arising on finance leases	36	**9**	20
		10,090	5,293

11 Auditors' remuneration
Fees payable to the Group's main external auditors, KPMG, its member firms and its associates (exclusive of VAT) include the following amounts recorded in the consolidated income statement:

Group	2010 £000	2009 £000
Fees payable to the Company's auditors for the audit of the Group's consolidated financial statements	**181**	188
Fees payable to the Company's auditors and its associates for other services:		
The audit of subsidiaries pursuant to legislation	**645**	638
Other services pursuant to legislation	**96**	90
All other services*	**3**	185
	925	1,101
Fees in respect of the defined benefit pension scheme:		
Audit	**10**	11
Total auditors' remuneration expense	**935**	1,112

*Other fees relate primarily to corporate advisory and financial reporting consulting services. Non-audit services with fees greater than £50,000 must be pre-approved by the Audit Committee which is composed solely of independent Non Executive Directors.

11 Auditors' remuneration continued

The full audit fee payable for the Syndicate audit has been included above, although an element of this is borne by the third-party participants in the Syndicate.

12 Net foreign exchange gains/(losses)

The net foreign exchange gains/(losses) for the year include the following amounts:

	2010 £000	2009 £000
Exchange gains/(losses) recognised in the consolidated income statement	**15,484**	(25,554)
Exchange gains/(losses) classified as a separate component of equity	**11,729**	(69,589)
Overall impact of foreign exchange related items on net assets	**27,213**	(95,143)

The above excludes profit or losses on foreign exchange derivative financial instruments which are included within the investment result.

Net unearned premiums and deferred acquisition costs are treated as non-monetary items in accordance with IFRS. As a result, a foreign exchange mismatch arises caused by these items being earned at historical rates of exchange prevailing at the original transaction date whereby resulting claims are retranslated at the end of each period. The impact of this mismatch on the income statement is shown below.

	2010 £000	2009 £000
Opening balance sheet impact of non retranslation of non-monetary items	**(3,207)**	50,525
Gain/(loss) included within profit representing the non retranslation of non-monetary items	**1,956**	(53,732)
Closing balance sheet impact of non retranslation of non-monetary items	**(1,251)**	(3,207)

13 Foreign currency items on economic hedges and intragroup borrowings

The Group has loan arrangements, denominated in US Dollars, in place between certain Group companies. In most cases, as one party to each arrangement has a functional currency other than the US Dollar, foreign exchange losses arise which are not eliminated through the income statement on consolidation. Implicit offsetting gains are reflected instead on retranslation of the counterparty company's closing balance sheet through other comprehensive income and into the Group's currency translation reserve within equity.

Impact as at 31 December 2010	**Consolidated income statement 2010 £000**	**Consolidated other comprehensive income 2010 £000**	**Total impact on equity 2010 £000**
Unrealised translation gains/(losses) on intragroup borrowings	**1,846**	**(1,846)**	**–**
Total gains/(losses) recognised	**1,846**	**(1,846)**	**–**

Impact as at 31 December 2009	Consolidated income statement 2009 £000	Consolidated other comprehensive income 2009 £000	Total impact on equity 2009 £000
Realised gains on foreign currency derivative contracts used to manage retranslation risk associated with the net investment in Bermuda and Guernsey insurance operations	314	–	314
Retranslation loss on managed net investment in Bermuda and Guernsey insurance operations	–	(5,207)	(5,207)
Unrealised translation (losses)/gains on intragroup borrowings	(4,362)	4,362	–
Total losses recognised	(4,048)	(845)	(4,893)

The Group did not enter into any economic hedging derivative contracts during the current year.

14 Intangible assets

	Goodwill £000	Syndicate capacity £000	State authorisation licences £000	Other £000	Total £000
At 1 January 2009					
Cost	10,405	24,505	6,308	10,591	51,809
Accumulated amortisation and impairment	(2,430)	–	–	(822)	(3,252)
Net book amount	7,975	24,505	6,308	9,769	48,557
Year ended 31 December 2009					
Opening net book amount	7,975	24,505	6,308	9,769	48,557
Other additions	–	–	–	2,775	2,775
Amortisation charges	–	–	–	(919)	(919)
Closing net book amount	7,975	24,505	6,308	11,625	50,413
At 31 December 2009					
Cost	10,405	24,505	6,308	13,366	54,584
Accumulated amortisation and impairment	(2,430)	–	–	(1,741)	(4,171)
Net book amount	7,975	24,505	6,308	11,625	50,413
Year ended 31 December 2010					
Opening net book amount	**7,975**	**24,505**	**6,308**	**11,625**	**50,413**
Other additions	**–**	**–**	**–**	**16,155**	**16,155**
Amortisation charges	**–**	**–**	**–**	**(2,460)**	**(2,460)**
Closing net book amount	**7,975**	**24,505**	**6,308**	**25,320**	**64,108**
At 31 December 2010					
Cost	**10,405**	**24,505**	**6,308**	**29,521**	**70,739**
Accumulated amortisation and impairment	**(2,430)**	**–**	**–**	**(4,201)**	**(6,631)**
Net book amount	**7,975**	**24,505**	**6,308**	**25,320**	**64,108**

Goodwill is allocated to the Group's cash generating units (CGUs) identified according to country of operation and business segment. Goodwill is considered to have an indefinite life and as such is tested annually for impairment based on the recoverable amount which is considered to be the higher of the fair value or value in use. Accumulated amortisation and impairment of goodwill relates to the amortisation charged prior to the Group's adoption of IFRS.

Value in use is considered to be the best indication of the recoverable amount for goodwill. Value in use calculations are performed using cash flow projections based on financial forecasts covering a five-year period. A discount factor of 2.5% (2009: 1.8%) has been applied to the projections to determine the net present value. The outcome of the value in use calculation is measured against the carrying value of the asset and where the carrying value is in excess of the value in use, the asset is written down to this amount.

There were no impairments recognised in the current or prior year for goodwill.

The Group's intangible asset relating to Syndicate capacity has been allocated, for impairment testing purposes, to one individual CGU, being the active Lloyd's corporate member entity. The asset is tested annually for impairment based on its recoverable amount which is considered to be the higher of the asset's fair value or its value in use. The fair value of Syndicate capacity can be determined from the Lloyd's of London Syndicate capacity auctions. Based on the average open market price witnessed in the recent Autumn 2010 auction, the carrying value of Syndicate capacity recognised on the balance sheet is significantly below the market price.

As part of a business combination in 2007, the Group acquired insurance authorisation licences for 50 US states. This intangible asset has been allocated for impairment testing purposes to one individual CGU, being the Group's North American underwriting businesses. The carrying value of this asset is tested for impairment based on its fair value which reflects the total costs to acquire the licences in each state.

Other intangible assets relate to the costs of acquiring rights to customer contractual relationships with additions in the current and prior year relating to software licence and development costs. Customer contractual relationships are amortised on a straight line basis over the useful economic life.

14 Intangible assets continued

The carrying value of customer contractual relationships is tested annually for impairment based on the recoverable amount which is considered to be the higher of the fair value or value in use. The asset's value in use is considered to be the best indication of its recoverable amount. Value in use is calculated for customer contractual relationships in the same manner as described above for goodwill and the same discount rate used.

Capitalised software and development costs are amortised when the assets become available for use on a straight line basis over the expected useful life of the asset. The carrying value of software and development costs is reviewed for impairment on an ongoing basis by reference to the stage and expectation of a project.

The amortisation charge for the year includes £2,196,000 (2009: £660,000) relating to capitalised internally generated software costs and is included in other expenses in the income statement.

The net book value of capitalised internally generated software costs at 31 December 2010 was £16,684,000 (2009: £7,368,000). There are no charges for impairment during the current or prior financial year.

At 31 December 2010 there were £4,817,000 of assets under development on which no amortisation has been charged (2009: £nil).

15 Property, plant and equipment

	Land and buildings £000	Leasehold improvements £000	Vehicles £000	Furniture fittings and equipment and art £000	Total £000
At 1 January 2009					
Cost	2,985	1,700	968	40,413	46,066
Accumulated depreciation	(200)	(746)	(418)	(25,034)	(26,398)
Net book amount	2,785	954	550	15,379	19,668
Year ended 31 December 2009					
Opening net book amount	2,785	954	550	15,379	19,668
Additions	3,022	2,286	–	2,938	8,246
Disposals	–	(214)	(13)	(69)	(296)
Depreciation charge	(59)	(330)	(94)	(4,644)	(5,127)
Foreign exchange movements	–	(95)	(1)	(151)	(247)
Closing net book amount	5,748	2,601	442	13,453	22,244
At 31 December 2009					
Cost	6,007	3,807	940	42,732	53,486
Accumulated depreciation	(259)	(1,206)	(498)	(29,279)	(31,242)
Net book amount	5,748	2,601	442	13,453	22,244
Year ended 31 December 2010					
Opening net book amount	**5,748**	**2,601**	**442**	**13,453**	**22,244**
Additions	**20**	**828**	**46**	**2,568**	**3,462**
Disposals	**–**	**(808)**	**(333)**	**(395)**	**(1,536)**
Depreciation charge	**(81)**	**(510)**	**(47)**	**(3,967)**	**(4,605)**
Foreign exchange movements	**77**	**65**	**–**	**35**	**177**
Closing net book amount	**5,764**	**2,176**	**108**	**11,694**	**19,742**
At 31 December 2010					
Cost	**6,104**	**3,162**	**258**	**44,678**	**54,202**
Accumulated depreciation	**(340)**	**(986)**	**(150)**	**(32,984)**	**(34,460)**
Net book amount	**5,764**	**2,176**	**108**	**11,694**	**19,742**

The Group's land and buildings assets relate to freehold property in the UK and US.

Assets with a net book value of £99,000 were held under finance leases (2009: £398,000). The total depreciation charge for the year in respect of assets held under finance leases was £24,000 (2009: £56,000) and is included in other expenses.

At 31 December 2010 there were no assets under development upon which no depreciation has yet been charged (2009: £1,906,000).

16 Investments in associates

	2010 £000	2009 £000
Year ended 31 December		
At beginning of year	**7,318**	7,200
Additions during the year	**318**	–
Disposals during the year	**(527)**	–
Share of post-tax profit recognised for the period	**(223)**	118
At end of year	**6,886**	7,318

The Group's interests in its principal associates, all of which are unlisted, were as follows:

	% interest held at 31 December	100% results Assets £000	Liabilities £000	Revenues £000	Profit after tax £000
2010					
Associates incorporated in the UK	**From 25% to 49%**	**1,847**	**1,230**	**1,098**	**185**
Associates incorporated in Europe	**25%**	**455**	**284**	**326**	**20**
Associates incorporated in the USA	**25%**	**210**	**(1)**	**11**	**(1,756)**
Total at the end of 2010		**2,512**	**1,513**	**1,435**	**(1,551)**

	% interest held at 31 December	100% results Assets £000	Liabilities £000	Revenues £000	Profit after tax £000
2009					
Associates incorporated in the UK	From 25% to 49%	11,100	7,800	8,743	234
Associates incorporated in Europe	up to 25%	943	436	1,379	30
Total at the end of 2009		12,043	8,236	10,122	264

During the year, the Group disposed of its 40% holding in HIM Capital Holdings Ltd recognising a gain of £458,000.

On 17 December 2010, the Group increased its holding in Blyth Valley Ltd to 100% as referred to in note 33. The company is treated as a subsidiary of the Group from this date.

The equity interests held by the Group in respect of associates do not have quoted market prices and are not traded regularly in any active recognised market. The associates concerned have no material impact on the results or assets of the Group. No impairments were identified during the current or prior financial year under review.

17 Deferred acquisition costs

	2010 Gross £000	2010 Reinsurance £000	2010 Net £000	2009 Gross £000	2009 Reinsurance £000	2009 Net £000
Balance deferred at 1 January	**141,505**	**(17,584)**	**123,921**	131,130	(21,068)	110,062
Acquisition costs incurred in relation to insurance contracts written	**318,876**	**(47,218)**	**271,658**	312,705	(42,212)	270,493
Acquisition costs expensed to the income statement	**(317,645)**	**47,754**	**(269,891)**	(302,330)	45,696	(256,634)
Balance deferred at 31 December	**142,736**	**(17,048)**	**125,688**	141,505	(17,584)	123,921

The deferred amount of insurance contract acquisition costs attributable to reinsurers of £17,048,000 (2009: £17,584,000) is not eligible for offset against the gross balance sheet asset and is included separately within trade and other payables (note 27).

The amounts expected to be recovered before and after one year are estimated as follows:

	2010 £000	2009 £000
Within one year	**124,822**	123,921
After one year	**866**	–
	125,688	123,921

18 Reinsurance assets

	Note	2010 £000	2009 £000
Reinsurers' share of insurance liabilities		**463,724**	425,572
Provision for non-recovery and impairment		**(959)**	(5,446)
Reinsurance assets	26	**462,765**	420,126

The amounts expected to be recovered before and after one year, based on historical experience, are estimated as follows:

Within one year	**236,541**	217,278
After one year	**226,224**	202,848
	462,765	420,126

Amounts due from reinsurers in respect of outstanding premiums and claims already paid by the Group are included in loans and receivables (note 20). The Group recognised a gain during the year of £4,487,000 (2009: gain of £2,085,000) in respect of impaired balances.

19 Financial assets and liabilities

Financial assets are measured at their bid price values, with all changes from one accounting period to the next being recorded through the income statement.

	Note	2010 Fair value £000	2009 Fair value £000
Debt and fixed income securities		**2,284,513**	2,255,737
Equities and shares in unit trusts		**154,862**	133,841
Deposits with credit institutions		**4,280**	11,394
Total investments		**2,443,655**	2,400,972
Catastrophe bonds		**15,452**	11,310
Derivative financial instruments	21	**–**	1,018
Total financial assets carried at fair value		**2,459,107**	2,413,300

	Note	2010 Fair value £000	2009 Fair value £000
Borrowings from credit institutions carried at amortised cost*		**20,000**	138,000
Derivative financial instruments	21	**457**	539
Total financial liabilities		**20,457**	138,539

*The fair value of borrowings from credit institutions is not considered to be significantly different from the amortised cost.

An analysis of the credit risk and contractual maturity profiles of the Group's financial instruments is given in notes 3.2(d) and 3.2(e).

The Group's investment in catastrophe bonds consists of £15.5 million (2009: £11.3 million), comprising of 13 catastrophe bonds (2009: 12) with credit ratings of BB or above. The issuers of these securities have used the proceeds to collateralise certain catastrophe reinsurance obligations mainly in US and European wind and earthquake risks. The investment in these contracts is therefore at risk of loss, in whole or in part if a covered catastrophe occurs with the maximum loss being equal to the total investment.

The Group's borrowings from credit institutions at 31 December 2010 are denominated in Pound Sterling (2009: Pound Sterling). The entire amount from December 2009 was repaid during the year and the amount outstanding at 31 December 2010 is expected to be repaid in full within one year from the balance sheet date. The movement in fair value of derivative instrument liabilities includes settlements totalling £1,460,000 (2009: £49,838,000), realised gains of £1,371,000 (2009: £3,234,000) and unrealised losses of £457,000 (2009: £539,000).

Notes to the consolidated financial statements
continued

19 Financial assets and liabilities continued

Investments at 31 December are denominated in the following currencies at their fair value:

	2010 £000	2009 £000
Debt and fixed income securities		
Sterling	**514,726**	508,292
US Dollars	**1,578,075**	1,559,673
Euro and other currencies	**191,712**	187,772
	2,284,513	2,255,737
Equities and shares in unit trusts		
Sterling	**80,226**	60,549
US Dollars	**61,565**	51,914
Euro and other currencies	**13,071**	21,378
	154,862	133,841
Deposits with credit institutions		
Sterling	**3,755**	11,223
US Dollars	**525**	171
Euro and other currencies	**–**	–
	4,280	11,394
Total investments	**2,443,655**	2,400,972

20 Loans and receivables including insurance receivables

	2010 £000	2009 £000
Gross receivables arising from insurance and reinsurance contracts	**412,524**	413,449
Provision for impairment	**(1,041)**	(955)
Net receivables arising from insurance and reinsurance contracts	**411,483**	412,494
Due from contract holders, brokers, agents and intermediaries	**298,214**	270,593
Due from reinsurance operations	**113,269**	141,901
	411,483	412,494
Prepayments and accrued income	**7,656**	10,020
Other loans and receivables:		
Net profit commission receivable	**15,276**	17,758
Accrued interest	**11,888**	12,227
Share of Syndicate's other debtors' balances	**23,230**	20,273
Other debtors including related party amounts	**15,881**	16,010
Total loans and receivables including insurance receivables	**485,414**	488,782
The amounts expected to be recovered before and after one year are estimated as follows:		
Within one year	**474,010**	482,194
After one year	**11,404**	6,588
	485,414	488,782

There is no significant concentration of credit risk with respect to loans and receivables as the Group has a large number of internationally dispersed debtors. The Group has recognised a loss of £86,000 (2009: £395,000) for the impairment of receivables during the year ended 31 December 2010.

21 Derivative financial instruments

The Group entered into both exchange-traded and over the counter derivative contracts for a number of purposes during 2010. The Group had the right and intention to settle each contract on a net basis. The assets and liabilities of these contracts at 31 December 2010 all mature within one year of the balance sheet date and are detailed below:

31 December 2010 **Derivative financial instrument liabilities included on balance sheet**	**Gross contract notional amount £000**	**Fair value of assets £000**	**Fair value of liabilities £000**	**Net balance sheet position £000**
Foreign exchange forward contracts	**20,223**	**10,070**	**10,500**	**430**
Interest rate futures contracts	**64,407**	**16,557**	**16,582**	**25**
Credit default swaps	**25,398**	**–**	**2**	**2**
	110,028	**26,627**	**27,084**	**457**

31 December 2009 Derivative financial instrument assets included on balance sheet	Gross contract notional amount £000	Fair value of assets £000	Fair value of liabilities £000	Net balance sheet position £000
Foreign exchange forward contracts	50,105	180	7	173
Interest rate futures contracts	21,288	906	61	845
	71,393	1,086	68	1,018

Derivative financial instrument liabilities included on balance sheet	Gross contract notional amount US$000	Fair value of assets £000	Fair value of liabilities £000	Net balance sheet position £000
Event linked futures contracts	2,400	18	557	539

Foreign exchange forward contracts

During the current and prior year the Group entered into a series of conventional over the counter forward contracts in order to secure translation gains made on Euro, US Dollar and other non Pound Sterling denominated monetary assets. The contracts require the Group to forward sell a fixed amount of the relevant currency for Pound Sterling at pre-agreed future exchange rates. The Group made a gain on these forward contracts of £1,522,000 (2009: £769,000) as included in note 7. The opposite exchange loss is included within financial investments.

There was no initial purchase cost associated with these instruments.

Interest rate futures contracts

During the year the Group continued short selling a number of government bond futures and sovereign futures denominated in a range of currencies to informally hedge substantially all of the interest rate risk on specific long portfolios of the matching currencies denominated corporate bonds. All contracts are exchange traded and the Group made a loss on these futures contracts of £117,000 (2009: £78,000) as included in note 7.

Event-linked future contracts

In June 2008 the Group commenced trading event-linked future contracts which are transacted on the Chicago Climate Futures Exchange. The contracts have fixed maturity dates and are structured such that cash inflows are binary in nature and are triggered by the occurrence of specific natural events in specific geographical zones which cause pre-determined losses to the insurance industry in excess of a specified amount. The Group itself does not have to suffer losses to receive a payment once the industry loss strike amount on each contract has been reached. Consequently the contracts are not accounted for as insurance contracts in accordance with IFRS 4. The Group ceased trading in these instruments during the year, realising a loss on settlement of £5,000 (2009: £609,000).

Notes to the consolidated financial statements
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22 Fair value measurements

In accordance with the Amendments to IFRS 7 Financial Instruments: Disclosures, the fair value of financial instruments based on a three-level fair value hierarchy that reflects the significance of the inputs used in measuring the fair value is provided below.

As at 31 December 2010	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Debt and fixed income securities	516,528	1,767,985	–	2,284,513
Equities and shares in unit trusts	70	147,866	6,926	154,862
Deposits with credit institutions	4,280	–	–	4,280
Catastrophe bonds	–	15,452	–	15,452
Total	520,878	1,931,303	6,926	2,459,107
Financial liabilities				
Derivative financial instruments	–	457	–	457

As at 31 December 2009	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Debt and fixed income securities	627,702	1,628,035	–	2,255,737
Equities and shares in unit trusts	162	129,419	4,260	133,841
Deposits with credit institutions	11,394	–	–	11,394
Catastrophe bonds	–	11,310	–	11,310
Derivative financial instruments	–	1,018	–	1,018
Total	639,258	1,769,782	4,260	2,413,300
Financial liabilities				
Derivative financial instruments	–	539	–	539

The levels of the fair value hierarchy are defined by the standard as follows:

- Level 1 – fair values measured using quoted prices (unadjusted) in active markets for identical instruments;
- Level 2 – fair values measured using directly or indirectly observable inputs or other similar valuation techniques for which all significant inputs are based on observable market data;
- Level 3 – fair values measured using valuation techniques for which significant inputs are not based on market observable data.

The fair values of the Group's financial assets are based on prices provided by investment managers who obtain market data from numerous independent pricing services. The pricing services used by the investment manager obtain actual transaction prices for securities that have quoted prices in active markets. For those securities which are not actively traded, the pricing services use common market valuation pricing models. Observable inputs used in common market valuation pricing models include, but are not limited to, broker quotes, credit ratings, interest rates and yield curves, prepayment speeds, default rates and other such inputs which are available from market sources.

The fair values of the Group's investments in catastrophe bonds are based on quoted market prices or, where such prices are not available, by reference to broker or underwriter bid indications.

Investments in mutual funds comprise a portfolio of stock investments in trading entities which are invested in various quoted investments. The fair value of shares in unit trusts are based on the net asset value of the fund as reported by independent pricing sources or the fund manager.

Included within Level 1 of the fair value hierarchy are government bonds, Treasury bills and exchange traded equities which are measured based on quoted prices.

22 Fair value measurements continued

Level 2 of the hierarchy contains US Government Agencies, Corporate Securities, Asset Backed Securities and Mortgage Backed Securities and Catastrophe bonds. The fair value of these assets are based on the prices obtained from both investment managers and investment custodians as discussed above. The Group records the unadjusted price provided and validates the price through a number of methods including a comparison of the prices provided by the investment managers with the investment custodians and the valuation used by external parties to derive fair value. Quoted prices for US Government Agencies and Corporate Securities are based on a limited number of transactions for those securities and as such the Group considers these instruments to have similar characteristics to those instruments classified as Level 2. Also included within Level 2 are units held in traditional long funds and long and short special funds and over the counter derivatives, including event linked future contracts.

Level 3 contains investments in a limited partnership and unquoted equity securities which have limited observable inputs on which to measure fair value. Unquoted equities are carried at cost, which is deemed to be comparable to fair value. The effect of changing one or more inputs used in the measurement of fair value of these instruments to another reasonably possible assumption would not be significant and no further analysis has been performed.

In certain cases, the inputs used to measure the fair value of a financial instrument may fall into more than one level within the fair value hierarchy. In this instance, the fair value of the instrument in its entirety is classified based on the lowest level of input that is significant to the fair value measurement.

During the year, there were no transfers made between Level 1 and Level 2 of the fair value hierarchy.

The following table sets forth a reconciliation of opening and closing balances for financial instruments classified under Level 3 of the fair value hierarchy:

31 December 2010	**Equities and shares in unit trusts £000**	**Deposits with credit institutions £000**	**Derivative financial instruments £000**	**Total £000**
Balance at 1 January	**4,260**	**–**	**–**	**4,260**
Total gains or losses through profit or loss*	**842**	**–**	**–**	**842**
Purchases	**1,824**	**–**	**–**	**1,824**
Issues	**–**	**–**	**–**	**–**
Settlements	**–**	**–**	**–**	**–**
Transfer into Level 2	**–**	**–**	**–**	**–**
Closing balance	**6,926**	**–**	**–**	**6,926**

*Total gains/(losses) are included within the investment result in the income statement.

31 December 2009	Equities and shares in unit trusts £000	Deposits with credit institutions £000	Derivative financial instruments £000	Total £000
Balance at 1 January	539	5,877	40	6,456
Total gains or losses through profit or loss*	245	–	–	245
Purchases	3,353	–	–	3,353
Issues	123	–	–	123
Settlements	–	(5,877)	–	(5,877)
Transfer into Level 2	–	–	(40)	(40)
Closing balance	4,260	–	–	4,260

*Total gains/(losses) are included within the investment result in the income statement.

23 Cash and cash equivalents

	2010 £000	2009 £000
Cash at bank and in hand	**260,710**	166,780
Short-term bank deposits	**75,307**	92,867
	336,017	259,647

The Group holds its cash deposits with a well diversified range of banks and financial institutions.

24 Share capital

Group	Share capital £000 31 December 2010	Number of shares 31 December 2010	Share capital £000 31 December 2009	Number of shares 31 December 2009
Issued share capital	**20,297**	**405,943,169**	20,158	403,148,858

The amounts presented in the equity structure of the Group above relate to Hiscox Ltd, the legal parent Company.

Changes in Group share capital and contributed surplus	Ordinary share capital £000	Share premium £000	Contributed surplus £000
At 1 January 2009	20,067	9,418	352,078
Employee share option scheme – proceeds from shares issued	91	2,413	–
Dividends to owners of the Company	–	–	(48,613)
At 31 December 2009	20,158	11,831	303,465
Employee share option scheme – proceeds from shares issued	139	3,969	–
Dividends to owners of the Company	–	–	(58,460)
At 31 December 2010	**20,297**	**15,800**	**245,005**

In accordance with the reverse acquisition provisions of IFRS 3 Business Combinations, the amount of issued share capital included in the consolidated balance sheet reflects that of Hiscox plc, the Group's former legal parent company, up until the date of the reverse acquisition on 12 December 2006 together with that issued subsequently by Hiscox Ltd, the new legal parent, up until each respective balance sheet date.

Contributed surplus is a distributable reserve and arose on the reverse acquisition of Hiscox plc on 12 December 2006.

Equity structure of Hiscox Ltd	Number of 5p ordinary shares in issue (thousands) 2010	Number of 5p ordinary shares in issue (thousands) 2009
At 1 January	**403,149**	401,331
Employee share option scheme – ordinary shares issued	**2,794**	1,818
At 31 December	**405,943**	403,149

All issued shares are fully paid.

Share options and performance share plan awards
Performance share plan awards are granted to Directors and to senior employees. Up until 2005, share options were also granted. The exercise price of the granted options is equal to the closing mid-market price of the shares on the day before the date of the grant. No exercise price is attached to performance plan awards, although their attainment is conditional on the employee completing three years' service (the vesting period) and the Group achieving targeted levels of returns on equity. Share options are also conditional on the employee completing three years' service (the vesting period) or less under exceptional circumstances (death, disability, retirement or redundancy). The options are exercisable starting three years from the grant date only if the Group achieves its targets of return on equity; the options have a contractual option term of ten years. The Group has no legal or constructive obligation to re-purchase or settle the options in cash.

In accordance with IFRS 2 the Group recognises an expense for the fair value of share option and performance share plan award instruments issued to employees, over their vesting period through the income statement. The expense recognised in the consolidated income statement during the year was £8,047,000 (2009: £5,260,000). This comprises charges of £7,619,000 (2009: £4,972,000) in respect of performance share plan awards and £428,000 (2009: £288,000) in respect of share option awards. The Group has applied the principles outlined in the Black-Scholes option pricing model when determining the fair value of each share option instrument and discounted cash flow methodology in respect of performance share plan awards.

24 Share capital continued
Share options and performance share plan awards continued

The range of principal Group assumptions applied in determining the fair value of share based payment instruments granted during the year under review are:

Assumptions affecting inputs to fair value models	2010	2009
Annual risk free rates of return and discount rates (%)	**3.4-3.9**	1.4
Long-term dividend yield (%)	**3.9-4.14**	4.24
Expected life of options (years)	**3.25**	3.25
Implied volatility of share price (%)	**29-30**	31
Weighted average share price (p)	**340.4**	310.8

The weighted average fair value of each share option granted during the year was 81.5p (2009: 85.5p). The weighted average fair value of each performance share plan award granted during the year was 340.4p (2009: 308.0p).

Movements in the number of share options during the year and details of the balances outstanding at 31 December 2010 are shown in the Directors' remuneration report.

The implied volatility assumption is based on historical data for periods of between five and ten years immediately preceding grant date.

For options issued after 1 January 2006 the assumptions regarding long-term dividend yield have been aligned to the progressive dividend policy announced during the 2005 Rights Issue.

25 Retained earnings and other reserves

	2010 £000	2009 £000
Currency translation reserve at 31 December	**49,457**	37,728
Retained earnings at 31 December	**935,555**	748,104

The currency translation reserve comprises qualifying net investment gains and losses and foreign exchange differences arising from the translation of the financial statements of, and investments in, foreign operations.

There were no transactions by the Company in its own shares during the year.

At 31 December 2010 Hiscox Ltd held 25,142,874 shares in treasury (2009: 28,142,874). Additional details are shown in note 37 to these financial statements in respect of additional Hiscox Ltd shares held by subsidiaries.

26 Insurance liabilities and reinsurance assets

	Note	2010 £000	2009 £000
Gross			
Claims reported and claim adjustment expenses		**802,254**	800,307
Claims incurred but not reported		**904,150**	749,016
Unearned premiums		**573,463**	573,028
Total insurance liabilities, gross		**2,279,867**	2,122,351
Recoverable from reinsurers			
Claims reported and claim adjustment expenses		**131,697**	173,987
Claims incurred but not reported		**242,496**	154,903
Unearned premiums		**88,572**	91,236
Total reinsurers' share of insurance liabilities	18	**462,765**	420,126
Net			
Claims reported and claim adjustment expenses		**670,557**	626,320
Claims incurred but not reported		**661,654**	594,113
Unearned premiums		**484,891**	481,792
Total insurance liabilities, net		**1,817,102**	1,702,225

The amounts expected to be recovered and settled before and after one year, based on historical experience, are estimated as follows:

Within one year	**1,008,399**	939,565
After one year	**808,703**	762,660
	1,817,102	1,702,225

Notes to the consolidated financial statements
continued

26 Insurance liabilities and reinsurance assets continued

The gross claims reported, the loss adjustment expenses liabilities and the liability for claims incurred but not reported are net of expected recoveries from salvage and subrogation. The amounts for salvage and subrogation at the end of 2010 and 2009 are not material.

26.1 Insurance contracts assumptions
(a) Process used to decide on assumptions
The risks associated with insurance contracts are complex and subject to a number of variables that complicate quantitative sensitivity analysis. Uncertainty over the timing and amount of future claim payments necessitate the holding of significant reserves for liabilities that may only emerge a number of accounting periods later.

For all risks, the Group uses several statistical methods to incorporate the various assumptions made into the ultimate cost of claims. There is close communication between the actuaries involved in the estimation process and the Group's underwriters to ensure that all parties are aware of material factors relating to outstanding claims reserves. Adjustments are made within the claims reserving methodologies to remove distortions in the historical claims development patterns from large or isolated claims not expected to re-occur in the future. An allowance is also made for the current rating and inflationary environment.

Outstanding claims reserves are actuarially estimated primarily using the Chain Ladder and Bornhuetter-Ferguson methods.

The Chain Ladder method may be applied to premiums, paid claims or incurred claims (i.e. paid claims plus case estimates). The basic technique involves the analysis of historical claims development factors and the selection of estimated development factors based on this historical pattern. Where losses in the earliest underwriting years or years of account have yet to fully develop an adjustment is made to the pattern to allow for further expected development. The selected development factors are then applied to cumulative claims data for each accident year to produce an estimated ultimate claims cost for each accident year.

The Chain Ladder method is adopted for mature classes of business where sufficient claims development data is available. This methodology produces optimal estimates when a large claims development history is available and the claims development patterns throughout the earliest years are stable. Chain Ladder techniques are less suitable in cases in which the insurer does not have developed claims history data for a particular class of business (e.g. in relation to more recent underwriting years or years of account). In these instances the Group's actuaries make reference to the Bornhuetter-Ferguson method.

The Bornhuetter-Ferguson method is based on the Chain Ladder approach but utilises estimated ultimate loss ratios. This method uses a combination of a benchmark or market-based estimate and an estimate based on claims experience. The former is based on a measure of exposure such as premiums; the latter is based on the paid or incurred claims to date. The two estimates are combined using a formula that gives more weight to the experience-based estimate as time passes. This technique has been used in situations in which developed claims experience was not available for the projection (recent accident years or new classes of business).

Catastrophe events which are expected to impact multiple business units in the Group are analysed by the central analysis team. They combine information from underwriters, the claims team and past experience of similar events to produce gross and net estimates of the ultimate loss cost to each part of the Group. These figures are then incorporated by the actuarial team into the quarterly reserving exercise. This process ensures that a consistent approach is taken across the Group.

In exceptional cases the required provision is calculated with reference to the actual exposures on individual policies. In addition, the reserves determined for the managed Syndicate are converted to annually accounted figures using earnings patterns that are consistent with those for the underlying Syndicate business.

The choice of selected results for each accident year of each class of business depends on an assessment of the technique that has been most appropriate to observed historical developments. This often means that different techniques or combinations of techniques have been selected for individual accident years or groups of accident years within the same class of business.

Estimates of ultimate claims are adjusted each reporting period to reflect emerging claims experience. Changes in expected claims may result in a reduction or an increase in the ultimate claim costs and a release or an increase in reserves in the period in which the change occurs

(b) Claims development tables
The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The Group analyses actual claims development compared with previous estimates on an accident year basis. This exercise is performed to include the liabilities of Syndicate 33 at the 100% level regardless of the Group's actual level of ownership, which has increased significantly over the last eight years. Analysis at the 100% level is required in order to avoid distortions arising from reinsurance to close arrangements which subsequently increase the Group's share of ultimate claims for each accident year, three years after the end of that accident year.

The top half of each table, on the following pages, illustrates how estimates of ultimate claim costs for each accident year have changed at successive year ends. The bottom half reconciles cumulative claim costs to the amounts still recognised as liabilities. A reconciliation of the liability at the 100% level to the Group's share, as included in the Group balance sheet, is also shown.

26 Insurance liabilities and reinsurance assets continued
26.1 Insurance contracts assumptions continued
(b) Claims development tables continued
Insurance claims and claim adjustment expenses reserves – gross at 100%

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	**2010 £000**	**Total £000**
Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year	701,387	410,797	463,733	698,820	1,170,170	604,706	809,548	1,127,349	860,395	**1,033,809**	**7,880,714**
one year later	680,601	435,108	476,153	774,979	1,294,900	577,680	726,072	959,350	719,421	**–**	**6,644,264**
two years later	755,321	443,259	447,650	739,639	1,297,603	556,641	689,800	937,465	–	**–**	**5,867,378**
three years later	779,918	427,233	460,941	699,397	1,279,163	525,823	702,980	–	–	**–**	**4,875,455**
four years later	823,545	423,050	456,291	702,505	1,273,288	536,077	–	–	–	**–**	**4,214,756**
five years later	819,846	398,472	445,561	684,260	1,274,625	–	–	–	–	**–**	**3,622,764**
six years later	817,655	394,252	440,956	688,004	–	–	–	–	–	**–**	**2,340,867**
seven years later	814,774	395,833	430,687	–	–	–	–	–	–	**–**	**1,641,294**
eight years later	823,678	382,319	–	–	–	–	–	–	–	**–**	**1,205,997**
nine years later	808,695	–	–	–	–	–	–	–	–	**–**	**808,695**
Current estimate of cumulative claims	808,695	382,319	430,687	688,004	1,274,625	536,077	702,980	937,465	719,421	**1,033,809**	**7,514,082**
Cumulative payments to date	(751,596)	(347,926)	(394,853)	(604,658)	(1,151,238)	(462,855)	(542,307)	(639,622)	(386,599)	**(182,971)**	**(5,464,625)**
Liability recognised at 100% level	57,099	34,393	35,834	83,346	123,387	73,222	160,673	297,843	332,822	**850,838**	**2,049,457**
Liability recognised in respect of prior accident years at 100% level											**84,784**
Total gross liability to external parties at 100% level											**2,134,241**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2010.

Reconciliation of 100% disclosures above to Group's share – gross

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	**2010 £000**	**Total £000**
Current estimate of cumulative claims	808,695	382,319	430,687	688,004	1,274,625	536,077	702,980	937,465	719,421	**1,033,809**	**7,514,082**
Less: attributable to external Names	(200,059)	(77,565)	(96,451)	(159,837)	(319,643)	(112,599)	(136,453)	(181,382)	(119,007)	**(172,924)**	**(1,575,920)**
Group's share of current ultimate claims estimate	608,636	304,754	334,236	528,167	954,982	423,478	566,527	756,083	600,414	**860,885**	**5,938,162**
Cumulative payments to date	(751,596)	(347,926)	(394,853)	(604,658)	(1,151,238)	(462,855)	(542,307)	(639,622)	(386,599)	**(182,971)**	**(5,464,625)**
Less: attributable to external Names	184,573	68,737	87,421	141,261	291,641	96,380	101,589	114,995	59,151	**20,732**	**1,166,480**
Group's share of cumulative payments	(567,023)	(279,189)	(307,432)	(463,397)	(859,597)	(366,475)	(440,718)	(524,627)	(327,448)	**(162,239)**	**(4,298,145)**
Liability for 2001 to 2010 accident years recognised on Group's balance sheet	41,613	25,565	26,804	64,770	95,385	57,003	125,809	231,456	272,966	**698,646**	**1,640,017**
Liability for accident years before 2001 recognised on Group's balance sheet											**66,387**
Total Group liability to external parties included in balance sheet – gross**											**1,706,404**

**This represents the claims element of the Group's insurance liabilities.

Notes to the consolidated financial statements
continued

26 Insurance liabilities and reinsurance assets continued
26.1 Insurance contracts assumptions continued
(b) Claims development tables continued

Insurance claims and claim adjustment expenses reserves – net at 100%

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	**2010 £000**	**Total £000**
Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year	337,866	277,174	366,197	584,744	689,688	537,157	700,937	782,336	695,595	**819,110**	**5,790,804**
one year later	380,010	302,447	386,549	638,962	792,534	528,737	637,695	698,849	585,504	**–**	**4,951,287**
two years later	453,049	312,897	351,754	613,606	782,878	511,509	617,910	695,742	–	**–**	**4,339,345**
three years later	492,745	288,586	362,671	575,449	757,545	468,059	585,996	–	–	**–**	**3,531,051**
four years later	481,424	282,392	353,744	576,344	747,108	485,738	–	–	–	**–**	**2,926,750**
five years later	466,500	267,860	348,549	561,005	747,855	–	–	–	–	**–**	**2,391,769**
six years later	459,225	261,703	344,902	561,577	–	–	–	–	–	**–**	**1,627,407**
seven years later	461,672	267,290	333,610	–	–	–	–	–	–	**–**	**1,062,572**
eight years later	461,216	255,949	–	–	–	–	–	–	–	**–**	**717,165**
nine years later	446,087	–	–	–	–	–	–	–	–	**–**	**446,087**
Current estimate of cumulative claims	446,087	255,949	333,610	561,577	747,855	485,738	585,996	695,742	585,504	**819,110**	**5,517,168**
Cumulative payments to date	(391,358)	(229,514)	(300,776)	(488,664)	(639,323)	(421,595)	(451,859)	(484,840)	(321,162)	**(173,650)**	**(3,902,741)**
Liability recognised at 100% level	54,729	26,435	32,834	72,913	108,532	64,143	134,137	210,902	264,342	**645,460**	**1,614,427**
Liability recognised in respect of prior accident years at 100% level											**37,001**
Total net liability to external parties at 100% level											**1,651,428**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2010.

Reconciliation of 100% disclosures above to Group's share – net

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	**2010 £000**	**Total £000**
Current estimate of cumulative claims	446,087	255,949	333,610	561,577	747,855	485,738	585,996	695,742	585,504	**819,110**	**5,517,168**
Less: attributable to external Names	(104,209)	(50,055)	(73,299)	(131,460)	(179,351)	(103,318)	(118,752)	(130,649)	(91,326)	**(123,011)**	**(1,105,430)**
Group's share of current ultimate claims estimate	341,878	205,894	260,311	430,117	568,504	382,420	467,244	565,093	494,178	**696,099**	**4,411,738**
Cumulative payments to date	(391,358)	(229,514)	(300,776)	(488,664)	(639,323)	(421,595)	(451,859)	(484,840)	(321,162)	**(173,650)**	**(3,902,741)**
Less: attributable to external Names	89,314	43,108	64,811	114,344	154,111	88,645	87,112	81,953	48,897	**22,793**	**795,088**
Group's share of cumulative payments	(302,044)	(186,406)	(235,965)	(374,320)	(485,212)	(332,950)	(364,747)	(402,887)	(272,265)	**(150,857)**	**(3,107,653)**
Liability for 2001 to 2010 accident years recognised on Group's balance sheet	39,834	19,488	24,346	55,797	83,292	49,470	102,497	162,206	221,913	**545,242**	**1,304,085**
Liability for accident years before 2001 recognised on Group's balance sheet											**28,126**
Total Group liability to external parties included in the balance sheet – net**											**1,332,211**

**This represents the claims element of the Group's insurance liabilities and reinsurance assets.

26.2 Movements in insurance claims liabilities and reinsurance claims assets

Year ended 31 December	2010 Gross £000	2010 Reinsurance £000	2010 Net £000	2009 Gross £000	2009 Reinsurance £000	2009 Net £000
Total at beginning of year	(1,549,323)	328,890	(1,220,433)	(1,767,728)	426,303	(1,341,425)
Claims and loss adjustment expenses for year	(733,074)	162,077	(570,997)	(508,238)	45,020	(463,218)
Cash paid for claims settled in the year	598,179	(120,088)	478,091	571,689	(110,924)	460,765
Exchange differences and other movements	(22,186)	3,314	(18,872)	154,954	(31,509)	123,445
Total at end of year	(1,706,404)	374,193	(1,332,211)	(1,549,323)	328,890	(1,220,433)
Claims reported and loss adjustment expenses	(802,254)	131,697	(670,557)	(800,307)	173,987	(626,320)
Claims incurred but not reported	(904,150)	242,496	(661,654)	(749,016)	154,903	(594,113)
Total at end of year	(1,706,404)	374,193	(1,332,211)	(1,549,323)	328,890	(1,220,433)

The insurance claims expense reported in the consolidated income statement is comprised as follows:

Year ended 31 December	2010 Gross £000	2010 Reinsurance £000	2010 Net £000	2009 Gross £000	2009 Reinsurance £000	2009 Net £000
Current year claims and loss adjustment expenses	(864,128)	160,277	(703,851)	(725,132)	122,538	(602,594)
(Under)/over provision in respect of prior year claims and loss adjustment expenses	131,054	1,800	132,854	216,894	(77,518)	139,376
Total claims and claim adjustment expenses	(733,074)	162,077	(570,997)	(508,238)	45,020	(463,218)

27 Trade and other payables

	Note	2010 £000	2009 £000
Creditors arising out of direct insurance operations		52,368	45,476
Creditors arising out of reinsurance operations		181,159	157,514
		233,527	202,990
Obligations under finance leases	36	45	393
Share of Syndicate's other creditors' balances		4,887	316
Social security and other taxes payable		14,563	15,424
Other creditors		13,995	20,448
		33,490	36,581
Reinsurers' share of deferred acquisition costs	17	17,048	17,584
Accruals and deferred income		64,933	82,328
Total		348,998	339,483

The amounts expected to be settled before and after one year are estimated as follows:		
Within one year	338,541	336,383
After one year	10,457	3,100
	348,998	339,483

The amounts expected to be settled after one year of the balance sheet date primarily relate to deferred bonuses and the Group's provision of sabbatical leave employee benefits.

Notes to the consolidated financial statements
continued

28 Tax expense

The Company and its subsidiaries are subject to enacted tax laws in the jurisdictions in which they are incorporated and domiciled.

The principal subsidiaries of the Company and the country in which they are incorporated are listed in note 37.

The amounts charged in the consolidated income statement comprise the following:

	2010 £000	2009 £000
Current tax		
Expense for the year	**58,228**	51,030
Adjustments in respect of prior years	**(1,062)**	2,345
Total current tax	**57,166**	53,375
Deferred tax		
Credit for the year	**(22,532)**	(14,146)
Adjustments in respect of prior years	**(691)**	892
Effect of rate change	**(1,377)**	–
Total deferred tax	**(24,600)**	(13,254)
Total tax charged to the income statement	**32,566**	40,121

The standard rate of corporation tax in Bermuda is 0% whereas the effective rate of tax for the Group is 15.4% (2009: 12.5%). A reconciliation of the difference is provided below:

	2010 £000	2009 £000
Profit before tax	**211,366**	320,618
Tax calculated at the standard corporation tax rate applicable in Bermuda: 0% (2009: 0%)	**–**	–
Effects of:		
Group entities subject to overseas tax at different rates	**28,866**	41,397
Impact of overseas tax rates on:		
Effect of rate change	**(1,377)**	–
Expenses not deductible for tax purposes	**273**	1,348
Tax losses for which no deferred tax asset is recognised	**9,639**	(130)
Other	**396**	(51)
Sch 23 FA 2003 deduction and share based payments	**(1,803)**	(2,974)
Non-taxable income	**(2,839)**	–
Overseas tax	**1,164**	(2,706)
Prior year tax adjustments	**(1,753)**	3,237
Tax charge for the period	**32,566**	40,121

29 Deferred tax

Deferred tax assets	2010 £000	2009 £000
Trading losses in overseas entities	**14,077**	14,077

The deferred tax asset relates to losses arising in overseas entities and is subject to overseas relief against future profits. Management considers it probable that taxable profits will arise in future in order to utilise the deferred tax asset.

Net deferred tax liabilities	2010 £000	2009 £000
Deferred tax assets	**14,968**	17,658
Deferred tax liabilities	**(60,389)**	(87,331)
Total net deferred tax liability	**(45,421)**	(69,673)

Deferred tax assets and deferred tax liabilities relating to the same tax authority are presented net in the Group's balance sheet.

29 Deferred tax continued

(a) Group deferred tax assets analysed by balance sheet headings

At 31 December	2009 £000	Income statement (charge)/credit £000	Transfer from equity £000	**2010 £000**
Trading losses in overseas entities	14,077	–	–	**14,077**
Deferred tax assets	14,077	–	–	**14,077**

At 31 December	2009 £000	Income statement (charge)/credit £000	Transfer from equity £000	**2010 £000**
Tangible assets	1,604	(238)	–	**1,366**
Trade and other payables	–	990	–	**990**
Retirement benefit obligations	1,310	(1,310)	–	**–**
Intangible assets – Syndicate capacity	4,230	(349)	–	**3,881**
Other items	10,514	(1,434)	(349)	**8,731**
Total deferred tax assets	17,658	(2,341)	(349)	**14,968**

(b) Group deferred tax liabilities analysed by balance sheet headings

At 31 December	2009 £000	Income statement (charge)/credit £000	Transfer from equity £000	**2010 £000**
Investment in associated enterprises	(17)	–	–	**(17)**
Financial assets	(453)	(640)	–	**(1,093)**
Insurance contracts – equalisation provision*	(16,973)	(6,106)	–	**(23,079)**
	(17,443)	(6,746)	–	**(24,189)**
Open years of account	(69,888)	33,688	–	**(36,200)**
Total deferred tax liabilities	(87,331)	26,942	–	**(60,389)**

*The solvency regulations in the UK require certain entities within the Group to establish an equalisation provision, to be utilised against abnormal levels of future losses in certain lines of business. The regulations prescribe that the provision is increased every year by an amount that is calculated as a percentage of net premiums written for those lines of business during the financial year subject to a maximum percentage. The amount of each annual increase is a deductible expense for tax purposes, and the equalisation provision is taxed when released. Equalisation provisions are not permitted under IFRS which therefore results in the temporary difference for tax purposes. Following a change in the legislation at the end of 2008, Lloyd's Corporate Members are also entitled to a tax deduction for claims equalisation losses although this is not a solvency requirement for Lloyd's. The Group has provided for the deferred tax liability on its Corporate Members' claims equalisation reserve during the year.

UK deferred income tax assets and liabilities are calculated at 27%. The UK Government has indicated its intention to reduce UK tax rates year-on-year to 24% by the full year commencing April 2014, however at the balance sheet date, no such measures were substantially enacted.

Deferred income tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Group has not provided for deferred tax assets totalling £18,216,000 (2009: £8,452,000) including £18,088,000 (2009: £8,488,000) in relation to losses in overseas companies of £51,769,000 (2009: £22,138,000). In accordance with IAS 12, all deferred tax assets and liabilities are classified as non-current.

30 Employee retirement benefit obligations

The Company's subsidiary, Hiscox plc, operates a defined benefit pension scheme based on final pensionable salary. The scheme closed to future accrual with effect from 31 December 2006 and active members were offered membership of a defined contribution scheme from 1 January 2007. The funds of the defined benefit scheme are controlled by the trustee and are held separately from those of the Group.

The gross amount recognised in the Group balance sheet in respect of the defined benefit scheme is determined as follows:

	2010 £000	2009 £000
Present value of scheme obligations	**146,737**	140,676
Fair value of scheme assets	**(144,056)**	(118,391)
Deficit for funded plans	**2,681**	22,285
Unrecognised net actuarial losses	**(12,310)**	(17,648)
Past service costs recognised in other creditors	**–**	(11,800)
Unrecognised surplus deemed irrecoverable	**9,629**	7,163
Net amount recognised as a defined benefit obligation	**–**	–

The unrecognised net actuarial losses are the net cumulative gains and losses on both the scheme's obligations and underlying assets.

As the fair value of scheme obligations exceeds the present value of the scheme assets, the scheme reports a deficit. The Group recognises actuarial gains and losses using the corridor method as defined in the Group's accounting policy. As a result of a court ruling in the prior year, past service costs of £11.8 million were recognised in respect of the equalisation of the scheme obligation for the period between May 1992 and May 1997. The requirement on the scheme to equalise is based on the Barber case in the early 1990s which established that it was unlawful under EU law for retirement ages for men and women to differ. The past service cost was recognised immediately.

Notes to the consolidated financial statements
continued

30 Employee retirement benefit obligations continued

On 8 July 2010, the UK Government announced its decision to replace the Retail Prices Index ('RPI') with the Consumer Prices Index ('CPI') as an inflation measure used to determine the minimum statutory increases to be applied to the revaluation of deferred pensions and to the increase of pensions in payment.

Based on the rules of the Group's defined benefit scheme, it is expected that CPI will be allowed to be used for revaluation in deferment but RPI should be used for increases in payment. The Group has sought legal confirmation that this impact is limited to contracted out members.

The effect of using the CPI to determine the scheme liabilities at 31 December 2010 does not have a significant effect on scheme liabilities.

The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit actuarial cost method. A formal full actuarial valuation is performed on a triennial basis, most recently at 31 December 2008, and updated at each intervening balance sheet date by the actuaries. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of AA rated corporate bonds that have terms to maturity that approximate to the terms of the related pension liability.

The scheme assets are invested as follows:

At 31 December	2010 £000	2009 £000
Equities	**64,249**	42,488
Debt and fixed income assets	**75,918**	65,935
Cash	**3,889**	9,968
	144,056	118,391

The majority of the scheme's debt and fixed income assets are held through the ownership of units in managed credit funds issued by Standard Life Assurance Limited which invest in a broad spread of high quality corporate bonds with derivatives used in controlled conditions to extend durations in some cases.

The amounts recognised in the Group's income statement are as follows:

	Notes	2010 £000	2009 £000
Current service cost		**346**	300
Interest cost		**7,952**	5,720
Expected return on scheme assets		**(8,441)**	(7,899)
Past service costs		**–**	11,800
Amortisation of net actuarial loss		**323**	–
Effect of deemed irrecoverability of surplus		**1,520**	3,379
Total included in staff costs	9	**1,700**	13,300

The actual return on scheme assets was a gain of £14,516,000 (2009: £4,221,000).

The movement in liability recognised in the Group's balance sheet is as follows:

	Notes	2010 £000	2009 £000
At beginning of year		**–**	–
Total expense charged in the income statement of the Group	9	**1,700**	13,300
Past service costs recognised in other creditors		**–**	(11,800)
Contributions paid		**(1,700)**	(1,500)
At end of year		**–**	–

A reconciliation of the fair value of scheme assets is as follows:

	2010 £000	2009 £000
Opening fair value of scheme assets	**118,391**	115,166
Expected return on scheme assets	**8,441**	7,899
Difference between expected and actual return on scheme assets	**6,075**	(3,678)
Contributions by the employer	**13,500**	1,500
Settlements with scheme members	**–**	–
Benefits paid	**(2,351)**	(2,496)
Closing fair value of scheme assets	**144,056**	118,391

30 Employee retirement benefit obligations continued

A reconciliation of the present value of scheme obligations of the scheme is as follows:

	2010 £000	2009 £000
Opening present value of scheme obligations	**140,676**	101,615
Current service cost	**346**	300
Interest cost	**7,952**	5,720
Actuarial losses/(gains)	**114**	23,737
Past service costs	**–**	11,800
Benefits paid from scheme	**(2,351)**	(2,496)
Settlements with scheme members	**–**	–
Closing present value of scheme obligations	**146,737**	140,676

A summary of the scheme's recent experience is shown below:

	2010 £000	2009 £000	2008 £000	2007 £000	2006 £000	2005 £000
Experience gains/(losses) on scheme obligations	**–**	–	–	2,783	(3,310)	(1,223)
Experience gains/(losses) on scheme assets	**6,075**	(3,678)	(18,107)	75	6,480	10,764

Additional memorandum information at the end of the current and previous five accounting periods is presented below:

	2010 £000	2009 £000	2008 £000	2007 £000	2006 £000	2005 £000
Present value of scheme obligations	**146,737**	140,676	101,615	106,793	137,461	137,533
Fair value of scheme assets	**(144,056)**	(118,391)	(115,166)	(127,576)	(133,660)	(101,409)
Present value of unfunded obligations/(surplus scheme assets)	**2,681**	22,285	(13,551)	(20,783)	3,801	36,124
Gross liability recognised on balance sheet	**–**	–	–	–	3,801	16,677

Assumptions regarding future mortality experience are set based on professional advice, published statistics and actual experience.

The average life expectancy in years of a pensioner retiring at age 60 on the balance sheet date is as follows:

	2010 years	2009 years
Male	**24.5**	24.5
Female	**27.6**	27.6

The average life expectancy in years of a pensioner retiring at 60, 15 years after the balance sheet date is as follows:

	2010 years	2009 years
Male	**25.6**	25.6
Female	**28.6**	28.6

Other principal actuarial assumptions are as follows:

	2010 %	2009 %
Discount rate	**5.40**	5.70
Expected return on scheme assets	**6.40**	6.50
Inflation assumption	**3.60**	3.90
Pension increases	**3.60**	3.90

The triennial valuation carried out as at 31 December 2008, resulted in a deficit position of £5.1 million and excludes the impact of the equalisation of scheme obligations. The cost of equalisation of scheme obligations of £11.8 million was recognised in 2009 and paid in full in 2010. The Group has agreed to fund the £5.1 million deficit paying instalments over four years. During the year the Group made a second instalment of £1.7 million to the defined benefit scheme (2009: £1.5 million). 61% of any scheme surplus or deficit calculated is recharged or refunded to Syndicate 33.

The expected return on scheme assets is based on historical data and management's expectations of long-term future returns. While management believes that the actuarial assumptions are appropriate, any significant changes to those could affect the balance sheet and income statement. Whilst an additional one year of life expectancy for all scheme members might be expected to reduce the present value of unfunded obligations at 31 December 2010 by approximately £80,000 (2009: £4 million), the Group considers that the most sensitive and judgemental assumptions are the discount rate and inflation.

30 Employee retirement benefit obligations continued

The Group has estimated the sensitivity of the net obligation recognised in the consolidated balance sheet to isolated changes in these assumptions at 31 December 2010 as follows:

	Present value of unfunded obligations before change in assumption £000	Present value of unfunded obligations after change £000	(Increase) /decrease in obligation recognised on balance sheet £000
Effect of a change in discount rate			
Use of discount rate of 5.15%	2,681	10,887	–
Effect of an increase in inflation			
Use of inflation assumption of 3.85%	2,681	5,946	–

31 Earnings per share

Basic earnings per share are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of shares in issue during the year, excluding ordinary shares held by the Group and held in treasury as own shares.

Basic	2010	2009
Profit for the year attributable to the owners of the Company (£000)	178,800	280,497
Weighted average number of ordinary shares (thousands)	379,064	372,848
Basic earnings per share (pence per share)	47.2p	75.2p

Diluted

Diluted earnings per share is calculated adjusting for the assumed conversion of all dilutive potential ordinary shares. The Company has one category of dilutive potential ordinary shares, share options and awards. For the share options, a calculation is made to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2010	2009
Profit for the year attributable to the owners of the Company (£000)	178,800	280,497
Weighted average number of ordinary shares in issue (thousands)	379,064	372,848
Adjustments for share options (thousands)	14,662	14,966
Weighted average number of ordinary shares for diluted earnings per share (thousands)	393,726	387,814
Diluted earnings per share (pence per share)	45.4p	72.3p

Diluted earnings per share has been calculated after taking account of 13,996,961 (2009: 14,345,744) options and awards under employee share option and performance plan schemes and 665,060 (2009: 619,870) options under SAYE schemes.

32 Dividends paid to owners of the Company

	2010 £000	2009 £000
Interim dividend for the year ended:		
31 December 2010 of 5.0p (net) per share	19,018	–
31 December 2009 of 4.5p (net) per share	–	16,834
Second interim dividend for the year ended:		
31 December 2009 of 10.5p (net) per share	39,442	–
Final dividend for the year ended:		
31 December 2008 of 8.5p (net) per share	–	31,779
	58,460	48,613

Subject to shareholder approval at the forthcoming Annual General Meeting on 8 June 2011, a scrip dividend alternative to a cash dividend is to be offered to the owners of the Company. These financial statements do not reflect this dividend as a distribution or liability in accordance with IAS 10 Events after the reporting period.

33 Acquisitions

On 15 December 2010, the group increased its 25.2% holding in Blyth Valley Ltd to 100%. Full control of the company was obtained and as such the Group have consolidated the results of Blyth Valley Ltd at 31 December 2010. Total cash consideration of £3,662,220 was paid representing net identifiable assets acquired of £243,000 and customer relationships not previously recognised by Blyth Valley Ltd of £3,619,000.

In addition, the Group acquired a 25% holding in InsuranceBee Inc for total consideration of $500,000 (£323,000). InsuranceBee Inc was, until the Group acquired 100% of Blyth Valley Ltd, the American sister company of Blyth Valley Ltd and is a specialist errors and omissions insurance broker.

34 Disposals

During the year, the Group disposed of its 40% holding in HIM Capital Holdings Limited recognising a gain on disposal of £458,000.

35 Contingencies and guarantees

The Group's subsidiaries are like most other insurers, continuously involved in legal proceedings, claims and litigation in the normal course of business.

The Group is subject to insurance solvency regulations in all the territories in which it issues insurance contracts. There are no contingencies associated with the Group's compliance or lack of compliance with these regulations.

The following guarantees have also been issued:

(a) Hiscox Ltd and Hiscox Capital Ltd have entered into deeds of covenant in respect of a subsidiary, Hiscox Dedicated Corporate Member Limited, to meet the subsidiaries obligations at Lloyd's. The total guarantee given under these deeds of covenant (subject to limitations) amounts to £15 million (2009: £15 million) in respect of Hiscox Ltd and $350 million (2009: $350 million) in respect of Hiscox Capital Ltd. The obligations in respect of this deed of covenant are secured by a fixed and floating charge over certain of the investments and other assets of the company in favour of Lloyd's. Lloyd's has a right to retain the income on the charged investments in circumstance where it considers there to be a risk that the covenant might need to be called and may be met in full.

(b) On 5 July 2010 Hiscox plc entered into a new Letter of Credit and revolving credit facility with Lloyds TSB Bank, for a total $750 million which may be drawn in cash (under a revolving credit facility), Letter of Credit or a combination thereof, providing that the cash portion does not exceed $450 million. In addition the terms also provide that upon request the facility may be drawn in a currency other than USD. At 31 December 2010 $165 million (2009: $225 million) was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and a further £20 million (2009: £138 million) by way of cash.

(c) Hiscox Insurance Company Limited has arranged a Letter of Credit of £50,000 (2009: £50,000) with NatWest Bank plc to support its consortium activities with Lloyd's.

(d) The managed syndicate is subject to the New Central Fund annual contribution, which is an annual fee calculated on gross premiums written. This fee was 0.5% for 2010 and 2009. In addition to this fee, the Council of Lloyd's has the discretion to call a further contribution of up to 3% of capacity if required.

(e) As Hiscox Insurance Company (Bermuda) Limited is not an admitted insurer or reinsurer in the US, the terms of certain US insurance and reinsurance contracts require Hiscox to provide Letters of Credit or other terms of collateral to clients. On 27 February 2009, Hiscox renegotiated its previous US$300 million facility and entered into a Letter of Credit Reimbursement and Pledge Agreement with Citibank for the provision of a Letter of Credit facility in favour of US ceding companies. The agreement was a three-year secured facility that allowed Hiscox to request the issuance of up to US$450 million in Letters of Credit. Letters of Credit issued under these facilities are collateralised by pledged US Government Securities of Hiscox Bermuda. Letters of Credit under this facility totalling US$89,110,000 were issued with an effective date of 31 December 2010 (2009: US$109,000,000).

36 Capital and lease commitments

Capital commitments

The Group's capital expenditure contracted for at the balance sheet date but not yet incurred for property, plant and equipment was £229,000 (2009: £614,000).

Operating lease commitments

The Group acts as both lessee and lessor in relation to various offices in the UK and overseas which are held under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights. The Group also has payment obligations in respect of operating leases for certain items of office equipment. Operating lease rental expenses for the year totalled £7,171,000 (2009: £5,656,000). Operating lease rental income for the year totalled £635,000 (2009: £468,000).

The aggregate minimum lease payments required by the Group under non-cancellable operating leases, over the expected lease terms, are as follows:

		2010 £000	2009 £000
No later than one year	Land and buildings	**7,505**	5,683
	Office equipment	**28**	177
Later than one year and no later than five years	Land and buildings	**24,737**	15,730
	Office equipment	**1**	457
Later than five years	Land and buildings	**26,437**	14,501
		58,708	36,548

The total future aggregate minimum lease rentals receivable by the Group as lessor under non-cancellable operating property leases are as follows:

	2010 £000	2009 £000
No later than one year	**275**	468
Later than one year and no later than five years	**344**	1,053
Later than five years	**–**	–
	619	1,521

Obligations under finance leases

It is the Group's policy to lease certain of its motor vehicles under finance lease arrangements. The leases have a typical term of three years and are on a fixed repayment basis with a final lump sum component at the end of each agreement should the Group decide to acquire ownership of the vehicle. Interest rates are fixed at the contract commencement date. The Group's obligations under leases are secured by the lessors' charges over the leased assets.

Finance lease interest expense for the year totalled £8,806 (2009: £20,000).

The finance lease obligations to which the Group is committed include the following minimum lease payments:

	2010 £000	2009 £000
Current liabilities due for settlement no later than one year	**45**	226
Non-current liabilities due for settlement after one year and no later than five years	**–**	177
	45	403
Less: future finance lease interest charges	**(1)**	(10)
	44	393

The present value of the minimum lease payments is not materially different to the currently disclosed obligation.

37 Principal subsidiary companies of Hiscox Ltd at 31 December 2010

Company	Nature of business	Country
Hiscox plc*	Holding company	Great Britain
Hiscox Insurance Company Limited	General insurance	Great Britain
Hiscox Insurance Company (Guernsey) Limited*	General insurance	Guernsey
Hiscox Holdings Inc.	Insurance holding company	USA (Delaware)
ALTOHA Inc.	Holding company	USA (Delaware)
Hiscox Insurance Company Inc.	General insurance	USA (Illinois)
Hiscox Inc.	Underwriting agent	USA (Delaware)
Hiscox Insurance Company (Bermuda) Limited*	General insurance and reinsurance	Bermuda
Hiscox Dedicated Corporate Member Limited	Lloyd's corporate Name	Great Britain
Hiscox Holdings Limited**	Insurance holding company	Great Britain
Hiscox Insurance Holdings Limited	Insurance holding company	Great Britain
Hiscox Syndicates Limited	Lloyd's managing agent	Great Britain
Hiscox Underwriting Group Services Limited	Service company	Great Britain
Hiscox Capital Ltd*	General insurance	Bermuda
Hiscox Underwriting Ltd	Underwriting agent	Great Britain
Hiscox Europe Underwriting Limited	Insurance intermediary	Great Britain

*Held directly.
**Hiscox Holdings Limited held 54,560 shares in Hiscox Ltd (2009: 54,560) at 31 December 2010.

All companies are wholly-owned. The proportion of voting rights of subsidiaries held is the same as the proportion of equity shares held.

38 Related-party transactions

Details of the remuneration of the Group's key personnel are shown in the Directors' remuneration report on pages 37 to 45. A number of the Group's key personnel hold insurance contracts with the Group, all of which are on normal commercial terms and are not material in nature.

The following transactions were conducted with related parties during the year.

(a) Syndicate 33 at Lloyd's

Hiscox Syndicates Limited, a wholly owned subsidiary of the Company, received management fees and profit commissions for providing a range of management services to Syndicate 33.

	2010 £000	2009 £000
Value of services provided by Hiscox Syndicates Limited to Syndicate 33	**44,538**	50,845
Amounts receivable from Syndicate 33 at 31 December excluding profit commission accrued	**13,163**	964

(b) Transactions with associates

Certain companies within the Group conduct insurance and other business with associates. These transactions arise in the normal course of obtaining insurance business through brokerages, and are based on arm's length arrangements.

	Total 2010 £000	Total 2009 £000
Gross premium income achieved through associates	**13,228**	18,530
Commission expense charged by associates	**3,285**	4,632
Amounts payable to associates at 31 December	**–**	–
Amounts receivable from associates at 31 December	**–**	–

Details of the Group's associates are given in note 16.

(c) Internal reinsurance arrangements

During the current and prior year, there were a number of reinsurance arrangements entered into in the normal course of trade between various Group companies.

The related results of these transactions have been eliminated on consolidation.

39 Subsequent events

Significant flooding in Queensland, Australia, dominated the end of 2010 and beginning of 2011. The Group has provided for £10 million in relation to the net losses which it believes were incurred pre 31 December 2010. The start of 2011 also saw a severe tropical cyclone, Yasi, make landfall in northern Queensland. On 22 February 2011, an earthquake measuring 6.3 on the Richter scale struck approximately ten kilometres south-east of Christchurch, New Zealand's second most populous city. The earthquake caused extensive damage in the Christchurch area and, although it is too early to assess, the Group expects to report losses of a similar or greater magnitude as those recorded for the September 2010 New Zealand earthquake. Losses relating to these events in 2011 are not included within the results for 2010.

Five year summary

	2010 £000	2009 £000	2008† £000	2007 £000	2006 £000
Results					
Gross premiums written	**1,432,674**	1,435,401	1,147,364	1,198,949	1,126,164
Net premiums written	**1,131,627**	1,157,023	898,394	974,910	975,397
Net premiums earned	**1,131,158**	1,098,102	928,095	965,190	888,828
Profit before tax	**211,366**	320,618	105,180	237,199	201,062
Profit for the year after tax	**178,800**	280,497	70,808	191,248	163,846
Assets employed					
Intangible assets	**64,108**	50,413	48,557	40,452	33,212
Financial assets carried at fair value	**2,459,107**	2,413,300	2,081,772	1,747,827	1,241,910
Cash and cash equivalents	**336,017**	259,647	440,622	302,742	502,871
Insurance liabilities and reinsurance assets	**(1,817,102)**	(1,702,225)	(1,773,622)	(1,433,799)	(1,291,329)
Other net assets	**223,984**	100,151	153,697	167,082	195,421
Net assets	**1,266,114**	1,121,286	951,026	824,304	682,085
Net asset value per share (p)	**332.7**	299.2	258.1	209.5	173.2
Key statistics					
Basic earnings per share (p)	**47.2**	75.2	18.8	48.4	41.7
Diluted earnings per share (p)	**45.4**	72.3	18.1	46.8	40.5
Combined ratio (%)	**89.3**	86.0	75.3	84.4	89.1
Return on equity (%)	**16.5**	30.1	9.2	28.8	28.9
Dividends per share (p)	**16.50**	15.00	12.75	12.00	10.00
Share price – high* (p)	**381.40**	362.00	361.00	304.50	280.25
Share price – low* (p)	**317.00**	277.00	194.75	246.75	193.75

*Closing mid market prices.
†As a result of a change in presentation, 2008 and later years included acquisition costs for the purchase of reinsurance contracts within expenses for the acquisition of insurance contracts. Earlier years include these costs within 'outward reinsurance premiums'.

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