Hiscox Ltd
Report and Accounts
2011

HISCOX

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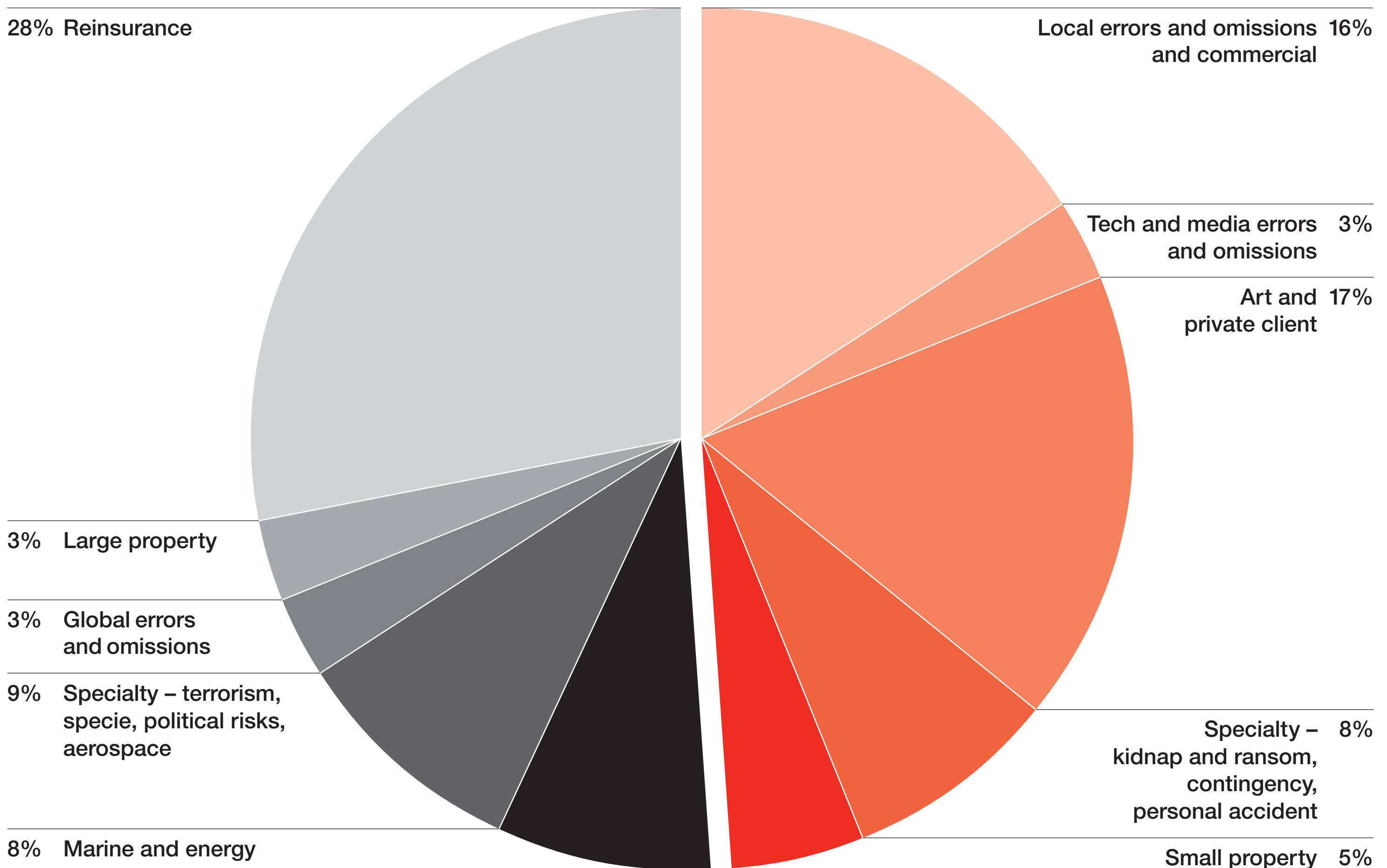
Our ambition is to be a highly respected specialist insurer with a diverse portfolio by product and geography. We believe that building balance between catastrophe-exposed business and less volatile local specialty business gives us opportunities for profitable growth throughout the insurance cycle.

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 2011

100% = £1,664m



Corporate highlights

Group key performance indicators

	2011	2010
Gross premiums written (£m)	**1,449.2**	1,432.7
Net premiums earned (£m)	**1,145.0**	1,131.2
Profit before tax (£m)	**17.3**	211.4
Profit after tax (£m)	**21.3**	178.8
Earnings per share (p)	**5.5**	47.2
Total dividend per share for year (p)	**17.0**	16.5
Net asset value per share (p)	**323.5**	332.7
Group combined ratio (%)	**99.5**	89.3
Group combined ratio excluding foreign exchange (%)	**99.3**	89.8
Return on equity (%)	**1.7**	16.5
Investment performance (%)	**0.9**	3.6

Operational highlights

- Robert Hiscox to step down from the Board in 2013
- UK retail business delivers good growth and another record profit of £49.0 million (2010: £28.8 million)
- Hiscox London Market achieved a profit of £57.6 million (2010: £121.4 million), offsetting catastrophe reinsurance losses with profits in international property, marine, and other specialist lines
- Rates are rising in reinsurance and slowly increasing in other specialty lines
- Hiscox USA is progressing well with 29% growth in core broker lines and over 6,000 policies sold by the direct business in the first year of operation

323.5
Net asset value p per share, 2011

17.0
Dividend p per share, 2011

£17.3m
Profit before tax

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 28% 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 7.5% 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 2007 and 2011 include:
- increased gross written premiums by 20.9% to over £1.4 billion
- healthy combined ratio averaging 87.1%
- delivered average ROE of 17.3%
- maintained a progressive dividend policy with compound growth of 9.1%.

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:*
- 99% of home insurance customers were satisfied that we answered their questions and provided the information they needed today
- 94% of our home insurance customers surveyed were satisfied with the service they received.

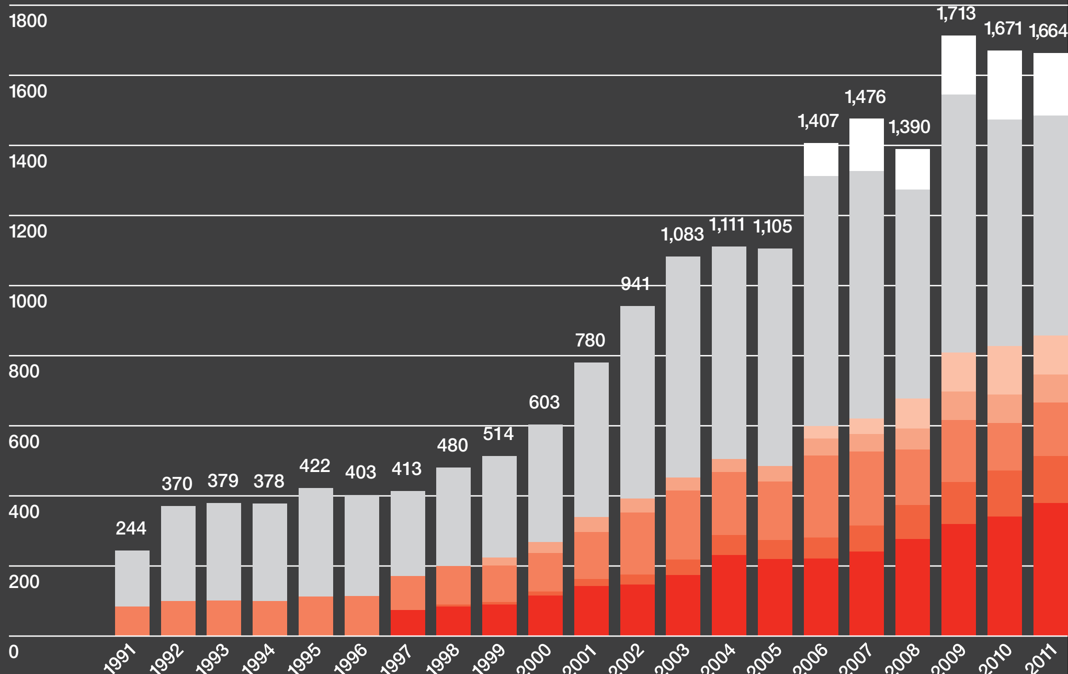
In Europe, a survey** of our brokers saw Hiscox rated as a leading high net worth insurance brand.

In 2011, Hiscox UK was awarded Commercial and Personal Lines Team of the Year at the Claim Awards ceremony. On the commercial side, Hiscox UK won Best Small Business Insurance award for the third year running at the Start Your Business Awards 2011.

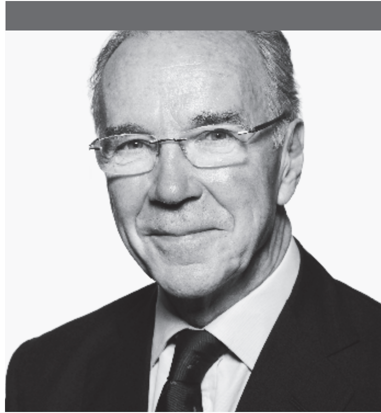
* Results from our monthly customer satisfaction survey for customers telephoning one of our UK-based contact centres.
** Results from a survey of 301 existing household/commercial brokers in Belgium, France, Germany and the Netherlands in January 2011.

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

- Hiscox Bermuda
- Hiscox London Market – Volatile
- Hiscox USA
- Hiscox Guernsey
- Hiscox London Market – Retail
- Hiscox Europe
- Hiscox UK



Chairman's statement



Robert Hiscox
Chairman

Again we have been well and truly tested by Mother Nature and a small profit is a good result in the circumstances. By any measurement, it was a phenomenally catastrophic year with definitely more economic damage caused by natural catastrophes than ever before, including in the second half of the year the major international loss from the Bangkok floods. We were able to absorb these considerable losses, despite much reduced investment returns, through the profits from our specialist books in the London Market, and the retail businesses in the UK, Europe and Guernsey. In particular, a £49.0 million profit from the UK business, the most mature of our retail accounts, demonstrates the potential for our similar accounts in Europe and the US. Our strategy of balance worked well.

Results

The result for the year ending 31 December 2011 was a profit before tax of £17.3 million (2010: £211.4 million) on a gross written premium income of £1,449.2 million (2010: £1,432.7 million). The combined ratio was 99.5% (2010: 89.3%). Earnings per share 5.5p (2010: 47.2p) and net assets per share 323.5p (2010: 332.7p). The return on equity was 1.7% (2010: 16.5%).

Dividend, balance sheet and capital management.

The Board proposes to pay a final dividend of 11.9p (2010: 11.5p) on 19 June 2012 to shareholders on the register on 11 May 2012, making total dividends for the year of 17.0p (2010: 16.5p) an increase of 3%, in line with our policy of steady dividend growth. A scrip dividend alternative to the cash dividend will continue to be offered to shareholders.

The market

As usual, the CEO Bronek Masojada will comment in detail on conditions in the general markets and the performance of our various businesses in them. I can see that rates are rising in many of our key areas, especially those which have suffered large losses, which bodes well for 2012. Some comment that the rises are not big enough but they suit me. If we get a great surge in rates, which happens only rarely and then after a major event following a lean period, prices go too high and start coming down almost immediately. In an ideal world rates would bump along at a level at which good underwriters could make money and the bad ones wither and die. Given that the insurance market is remorselessly cyclical, I like small rises which help margins for the good without encouraging foolishness in the bad.

There is still too much capacity in the insurance world, some of it new from hedge funds and the like. The reinsurance market is more stable than the insurance market as there are fewer well rated reinsurers and more disciplined adherence to catastrophe models. In the insurance market, we daily walk away from risks where uneducated capacity has plunged into the market at rates which can only lose them money. The curse of the industry is that we sell a product the cost of which is only discovered years later when the claims roll in. This breeds optimism, and nobody is more optimistic than the new entrant with no legacy problems (they think), but also no legacy book of business or experience. All existing business in the world is already placed with an insurer, and which broker is going to switch it to a new entrant unless they cut the price or widen the terms?

When I started underwriting (with unlimited liability for the first 21 years – and nothing could make an underwriter more conscious of risk than taking it with everything they own), there was no computer adding up aggregate liabilities. Premium income could be counted, but not the exposure, and claims come from exposure not income. Statistics and management information have improved enormously over the years, and every year I believe that management of our competitors will force commercial discipline on their underwriters, but some foolish underwriting continues. In Lloyd's, if rates are being cut foolishly, the Franchise Director moves in to test the business plan, and if necessary to stop it. I hope the discipline of Solvency II will similarly test the "we will beat whatever price the competition has quoted" underwriting that you even see advertised regularly.

Corporate governance

I have decided to step down as Chairman of the Board while I still feel near the top of my game and have informed my fellow Directors that I would like to retire from the Board this time next year when I will have just turned 70. My passion for the business remains undiminished, and I will be available if the new Chairman or others wish to draw on my 47 years of experience. The independent Directors have instituted a search from both within and without the company, and I know that they will find a suitable candidate to lead the Board for the next exciting era of the business.

There is no better fun than building a business. It has been an enormous privilege to lead Hiscox since 1970 when my father died and I am very grateful to those who have helped me to achieve what has been achieved so far. I have always aimed to employ people brighter than I am, and have always believed that a businessman should only be judged a success if the business thrives after he has gone. I am convinced that the current top executives prove that I have achieved my employment ambition, and I know that they have the talent and the drive to create a truly great business well into the future. Since before we became publicly quoted in 1993 we have had strong Non Executive Directors and I am grateful to them for their excellent advice on our strategy and tactics, and their robust challenge when they see the need. The regulator likes to see evidence of regular robust challenge, but it has to be said that challenge for its own sake is pointless, and if correct decisions are being made, calm

agreement can be found without artificial contrarian debate.

We first expanded from Lloyd's into the UK regions in 1989, then into Europe from 1993. We bought an ailing UK insurance company in 1996 which was on the regulator's monthly watch list and have turned it into a thriving company which made £49.2 million last year. We have built successful insurance companies in Guernsey and Bermuda, and have started an insurance company in the US which is growing to profitability. We have developed direct businesses in the UK, France and the US. We have grown from a Lloyd's syndicate to a truly international insurance business, headquartered in Bermuda.

We also have a very strong corporate ethical culture which has led us through some very stormy waters in our early days at Lloyd's when it went through its period of lack of integrity and appalling underwriting in the 1980s and 1990s. I was privileged to play an early part in regulation at Lloyd's when basic standards were being imposed, and a substantial part in the Reconstruction and Renewal of Lloyd's (together with Bronek Masojada who was on the McKinsey team), especially the Renewal through the introduction of Corporate Membership which created a renaissance of the UK insurance industry. With Solvency II the industry is now going through a massive assessment of the capital each business needs by codifying all the risks in great detail into a computer model, and I am glad that our massive housekeeping exercise has thrown up no surprises. Risk is our business and I have spent 47 years assessing it, and as I said before, 21 of them with unlimited liability.

The work we are doing should make us a safer business which brings me comfort as my family and I have a substantial percentage of our worth in Hiscox shares and as I get older I get more risk averse as I cannot make it again. We have always encouraged our staff to buy or hold shares in the company as we strongly believe that a feeling of ownership breeds responsibility, and I know that our investors like the fact that we have plenty of skin in the game.

The future

The general insurance market has had an excellent record for the last ten years despite enormous natural and man-made catastrophes (although it feels unrecognised with the ever increasing blanket of regulation with which we are smothered). It is an exciting business being in reality bookmaking as we quote odds on almost every conceivable event, loss or tragedy happening around the world. It is a fulfilling career as we enable private ownership and commercial endeavour to flourish through adversity. I think that the boring image, which could not be further from the truth, is dissipating, and we are attracting some extremely talented young people into our business which again bodes well for the future.

We have built a brand based on trust and service and have been rated as the most trusted insurer in the UK. The value of our brand depends on our integrity and our fair treatment of customers which acts as a sharp pencil in the small of the back of every member of staff to live up to the advertised standard. I would like to thank them all for carrying the flag so well.

Some key rates are rising, we are employing some brilliant talent, we have fledgling businesses poised for growth and profit, and our mature businesses have small market shares and enormous opportunities. I look forward to my final year as Chairman confident that the next era of the business will be rewarding to both shareholders and staff.

Robert Hiscox
27 February 2012

Chief Executive's report

Bronek Masojada
Chief Executive

As the Chairman has said, 2011 was a year dominated by natural catastrophes. Earthquakes, floods, tornadoes, hurricanes and a tsunami caused insured losses in excess of $100 billion making it one of the most expensive years on record for the industry. The fact that Hiscox made a profit of £17.3 million for the year (2010: £211.4 million) is a demonstration of the strength and resilience of our Group. The UK, Guernsey and European operations and several of our London Market divisions contributed strong profits, which offset the net £270 million (2010: £165 million) in catastrophe related claims reserved in our London and Bermuda reinsurance units, and the lower investment returns.

Our strategy of balance and diversification has therefore shown its value once again. We will continue, with ever greater effort, to grow our retail-focused businesses around the world and invest in our specialist businesses in London. This will further enhance our capacity to weather future catastrophes and provide attractive returns to shareholders.

Hiscox London Market

Our London Market business navigated its way through the thick of the storm in 2011 with amazing resilience thanks to its spread of business. Profits in international property, marine, and other specialist lines offset reinsurance losses allowing it to make an aggregate profit of £57.6 million (2010: £121.4 million). This is a fantastic achievement given the exposure it had to the global catastrophes of 2011. Revenues increased marginally to £585.4 million (2010: £572.7 million) showing yet again the truth of the mantra "profit is sanity: revenue vanity". Looking at each business line in turn:

- **Reinsurance:** Although underweight in most loss affected areas, this team was impacted by the many natural catastrophes in 2011. The team took advantage of distressed conditions following the events in the first half to expand their writings at the important mid-year renewals. They have also continued to build their partnerships with third-party providers of reinsurance support. The team retains their nerve and are optimistic about 2012.

- **Property:** Discipline over many years has seen our core property account shrink, but the result is good. The team have expanded their book into insuring non-catastrophe exposed contractors equipment for fire and theft and this is developing well. In 2012 they have seen upward pressure on rates, and business which had threatened 'never to

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

Reinsurance
Insurance

140
120
100
80
60
40
20
0

Feb 05 – Jan 06
Apr 05 – Mar 06
Jun 05 – May 06
Aug 05 – Jul 06
Oct 05 – Sep 06
Dec 05 – Nov 06
Feb 06 – Jan 07
Apr 06 – Mar 07
Jun 06 – May 07
Aug 06 – Jul 07
Oct 06 – Sep 07
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Dec 08 – Nov 09
Feb 09 – Jan 10
Apr 09 – Mar 10
Jun 09 – May 10
Aug 09 – Jul 10
Oct 09 – Sept 10
Dec 09 – Nov 10
Feb 10 – Jan 11
Apr 10 – Mar 11
Jun 10 – May 11
Aug 10 – Jul 11
Oct 10 – Sep 11
Dec 10 – Nov 11
Feb 11 – Jan 12

Hiscox London Market

	2011 £m	2010 £m
Gross premiums written	**585.4**	572.7
Net premiums earned	**418.8**	396.1
Underwriting profit	**50.3**	70.6
Investment result	**8.8**	39.1
Foreign exchange	**(1.5)**	11.7
Profit before tax	**57.6**	121.4
Combined ratio	**89.1%**	79.7%
Combined ratio excluding foreign exchange	**89.1%**	81.8%

Hiscox UK

	2011 £m	2010 £m
Gross premiums written	**367.1**	327.0
Net premiums earned	**325.2**	302.6
Underwriting profit	**41.5**	16.2
Investment result	**7.3**	12.4
Foreign exchange	**0.2**	0.2
Profit before tax	**49.0**	28.8
Combined ratio	**87.5%**	94.6%
Combined ratio excluding foreign exchange	**87.6%**	94.7%

come back to London', unless written at uneconomic prices, is returning from the US domestic market. This augurs well for the future. The division has also benefited from subrogation recoveries on property claims resulting from the events of 9/11.

- **Marine and energy:** This team suffered from the large Maersk Gryphon loss – a North Sea oil platform which was put out of production by poor weather – in the early part of the year, but discipline and its smart spread of business have allowed it to make a profit in the year. In 2012, we reserved $20 million net for the sinking of the Costa Concordia. We expect that this event will result in upward pressure on rates in the marine market.

- **Global response:** Our team has continued to serve clients around the world in the terrorism, kidnap and ransom, piracy and political risk areas. Piracy remains challenging as prices are inadequate for the risks being run and our book continues to shrink. The Arab Spring created repatriation losses but again the spread of business allowed the division to perform well in the year.

- **Specialty:** This division consists of the bloodstock, contingency, personal accident, specie, media and technology businesses written in the London Market. It had a very good year. The specie and technology accounts benefited from the settlement of some old claims which resulted in substantial releases from reserves. Our contingency team supported the Rugby World Cup organisers in New Zealand as they dealt with the impact of the Christchurch earthquakes on their seminal event, demonstrating our claims handling ability in such an unusual situation. During the course of the year we closed our bloodstock account as poor rating had caused it to shrink to a size where it was no longer viable.

- **Casualty:** This was once one of our biggest and most profitable lines, but relentless rate reductions and disciplined underwriting by the team has seen it shrink to less than a sixth of its cyclical high. The account remains profitable: we think that the suicidal competition in the 2012 renewal season will make a turn in pricing inevitable so we are investing in extending our capability in this area.

- **Aviation and space:** We have had a presence in the space market for many years and this business continues to perform well. Our aviation venture is now in its second year and we have established a small market presence with a reputation as a considered and disciplined participant.

Our London Market business is primarily conducted in London through Lloyd's with a focus on large internationally traded syndicated risks and on the specialist and the unusual.

Hiscox is a brand to be proud of, but we know in the global insurance market the continued high regard for the Lloyd's brand and the success of the market as whole is necessary for us to out-perform. We therefore believe in the value of the Lloyd's licenses, the need for a secure, well supervised market and the benefits of shared central services such as policy production, money collection and claims settlement and payment. Some of our competitors believe that they can gain individual advantage by performing many of these tasks themselves, independent of the market. We do not, as we believe that fragmentation will lead to poorer service to clients and brokers leading to an erosion of Lloyd's, and hence our own competitiveness. We are therefore supportive of efforts to improve the volume claims service which acts on behalf of the market and will continue to oppose efforts to fragment this community resource. We are also supportive of Lloyd's efforts to invest in upgrading the central market processing environment, but again with the concern that fragmentation must not be allowed. In all these matters we believe in holding Lloyd's and other central service providers to account, as if they do the job well, more business will flow to London and Lloyd's and we will win more than our fair share of the best business.

Hiscox UK and Europe

Our businesses in the UK and Europe focus on insuring higher net worth personal insurances and small businesses active in areas such as marketing, consulting and other office-based professional services. We market these products both through brokers and direct to the customer. The year saw continued growth, pushing premium income up 9.5% to £498.0 million (2010: £454.7 million). At the same time, we were able to increase our profits in this segment to £51.4 million (2010: £39.6 million), a fantastic result.

- **Hiscox UK:** Our UK business has become a powerhouse, achieving another record profit of £49.0 million (2010: £28.8 million) despite a big fall in investment income and the competitive market conditions which prevailed. It had substantial top-line growth of 12.3% to £367.1 million (2010: £327.0 million). This result was driven by a focus on disciplined underwriting and by the strength of the Hiscox brand. Most satisfying has been the performance of our high net worth team. They reaped the rewards of their efforts in 2009 and 2010 when, against prevailing market trends, they maintained discipline, increased prices marginally and as a result made a very healthy profit this year. Their nascent luxury motor account also made a good profit – a real achievement in its third year. The commercial business had a reasonable year, despite being challenged by claims arising from mistakes by some of the professionals we insure which have been revealed by the recession.

  We have worked for several years to build our distribution with a broader range of partners. In late 2010 we entered into

Chief Executive's report continued

Hiscox Europe

	2011 €m	2010 €m
Gross premiums written	151.4	146.7
Net premiums earned	143.8	134.7
Underwriting profit	4.1	6.2
Investment result	(0.1)	5.7
Foreign exchange	0.3	–
Profit before tax	4.3	11.9
Combined ratio	99.5%	97.4%
Combined ratio excluding foreign exchange	99.8%	97.4%

Hiscox International

	2011 £m	2010 £m
Gross premiums written	365.8	405.2
Net premiums earned	277.6	312.9
Underwriting profit	(92.7)	18.1
Investment result	6.3	27.6
Foreign exchange	(3.1)	(2.6)
Profit before tax	(89.5)	43.1
Combined ratio	133.9%	97.3%
Combined ratio excluding foreign exchange	132.8%	96.4%

an agreement with the Dual underwriting agency, for them to underwrite and market our products, and our business together has developed well. We have also created a specialist team to focus on Marsh, Aon and Willis, the three largest national brokers with whom we have strong Group relationships but with whom we do little business in the UK. Our business with them is growing slowly, but much remains to be done. We have also created new relationships with a number of independent brokers who have moved books of specialist business to us. We have won their support because our underwriters and operations staff respond to their requests for assistance faster than the competition and because of our reputation for paying valid claims fast and fairly. Not all of our underwriting partnerships have gone well, and at the end of 2011 we cancelled a household partnership which had not performed to our expectations. This will have a negative impact on Hiscox UK's 2012 top-line growth, but we expect that it will have a positive effect on profitability.

Our direct business continues to go from strength to strength and is now a £65 million business. Both our commercial and personal lines units achieved excellent profits in 2011. We have added a new travel product to our personal lines offering and expect to follow with more choices of cover during 2012.

Building the direct business requires us to spend significant amounts on our marketing which offers very tangible benefits to the whole Group and in 2011 we were short-listed as one of the five best brands in the UK at the Marketing Society Awards alongside household names such as John Lewis and British Airways. It is a real achievement for our UK team to have created such a recognisable brand when we operate in what is thought of as a grey industry.

Hiscox Europe: Although its profits fell to £2.4 million (2010: £10.8 million), 2011 is Europe's third successive year of overall profitability. Most of the profit fall was due to a decline in investment income and a single large reserve. Hiscox Europe is now at the same stage of development as the UK business in 2001 and as its scale grows I expect that profits will grow. The top line was flat at £130.9 million (2010: £127.6 million), though this masks some changes in its business mix. Our art and private client business shrank, as expected, as the impact of underwriting actions taken in 2010 fed through. This decline was offset by growth in the commercial area where our specialist kidnap and ransom, media, technology and related products performed well, as have our partnerships with other financial institutions.

Despite the economic challenges that Europe faced, and will no doubt face in 2012, we are continuing to invest on the continent. For the past two years we have been building a direct business in France focusing on small commercial lines. In 2012 we will be supporting this direct business with an expanded marketing campaign – in fact our first French television commercial aired in January. Early responses have been positive, and if all goes well we hope to build a direct business to match that in the UK.

Hiscox International

Hiscox International has suffered most visibly from the catastrophe losses in 2011. It swung to a loss of £89.5 million (2010: profit of £43.1 million) and its premiums shrank 9.7% to £365.8 million (2010: £405.2 million). As trends in each business unit within the division vary materially I comment on each separately below:

Hiscox Bermuda: The focus of our business in Bermuda is overwhelmingly on catastrophe reinsurance so in a year like 2011 it is not surprising that the unit suffered a big loss. Hiscox Bermuda's disciplined underwriting saw its written premiums reducing by 9.5% to £177.7 million (2010: £196.4 million). It is the nature of reinsurance to be volatile but on average the results are very attractive. Since we created our business in Bermuda in 2006 it has achieved an aggregate combined ratio, including 2011, of around 80% – a very respectable result.

Hiscox USA: The US has made good progress in 2011. Its revenue fell by 15.5% to £108.3 million (2010: £128.2 million) which was mainly due to the withdrawal from two lines of business at the end of 2010 and the transfer of our large technology and media portfolios to Hiscox London Market. It saw strong growth of 29.0% in our core areas of kidnap and ransom, construction, terrorism, media and professional lines and we believe this progress will continue. Our network of offices across the US has been crucial in helping us attract business.

2011 also saw the launch of our US direct commercial offering aimed at start ups and small businesses. We have been building the brand in the US through traditional and digital marketing. We have been using social media in the form of a branded entertainment web TV series called Leap Year, aimed at budding entrepreneurs which has been watched by over four million viewers. The series won a coveted Digital Luminary award for branded entertainment in the company of brands like Yahoo and NASA. We have also entered into marketing partnerships with GEICO and other major insurers, a real testament to the quality of the products we have on offer. We sold over 6,000 policies direct to consumers by the end of the year. The trend remains positive and we will continue to invest further in this fledgling business in 2012.

- **Hiscox Guernsey:** This business underwrites kidnap and ransom, piracy, fine art and terrorism and continues to be a star performer. Its revenues declined marginally to £79.8 million (2010: £80.6 million) despite a very disciplined underwriting approach towards piracy. The team made a profit despite suffering a large fine art loss when a painting was being transported from the auction house to a client. This team is concentrating on expanding its distribution and expects to strengthen this in several territories in 2012.

Claims

Insurance is basically a promise to pay. Claims are where that promise is tested. In 2011 our UK claims team dealt professionally with the welter of claims resulting from the severe winter freezes, while our Bermuda and London Market claims teams have been at the forefront of adjusting and paying claims arising from the string of natural catastrophes. It is pleasing to see that during all of this they kept their promise with prompt and fair payment of valid claims with a smile.

In 2011 we released £199 million (2010: £133 million) from prior years' reserves. We have benefited from some legal victories, most prominently in our long running litigation over subrogation from the World Trade Center, and from some large technology and professional liability cases. At the end of 2011 our actuarial analysis shows that we continue to hold the same size margin above best estimate as at the end of 2010.

In the UK we took the big step of insourcing all of the claims from our direct to consumer business, recruiting a small number of staff from our outsource partner and expanding the services which we offer to claimants. Our claims service remains one of the best in the industry and in 2011 we were awarded Post Magazine's Commercial Lines and Personal Lines claims team of the year. We continue to invest in claims and a priority in 2012 will be Europe. The challenge is to use our skills on a pan European basis as the individual operations remain quite small.

Investments

2011 was a challenging year for our investments. This is not a surprise given the continuing volatility and uncertainty in world financial markets. We achieved a total return of £25.9 million before derivatives with a yield of 0.9% (2010: £98.8 million, 3.6%).

We started the year concerned about a possible increase in interest rates but happy to take some credit risk and we positioned the bond portfolios accordingly. The stance on duration in particular proved to be too cautious in light of the flight to quality that took place in Government bond markets in the second half. Additionally, in some cases, our non government bonds incurred mark to market losses. However, we have the resilience to hold these through periods of market turbulence as we will eventually realise value for them as they move to maturity.

We took advantage of some of the market weakness in the summer to increase our equity weighting slightly. Again, we believe we have a strong enough balance sheet to withstand the volatility that inevitably comes with owning shares and are prepared to do so as long as we can see value in the longer-term.

Looking forward we expect investment returns to remain depressed. We are not tempted by the range of products which may offer higher apparent returns but would rather accept what the market has to offer from conventional sources.

Operations and IT

Great underwriting only delivers value to customers if supported by excellent operations. During the year we continued to improve our operational capabilities. In Hiscox London Market we re-engineered our processes so that all risk details are entered into our systems within 48 hours of binding, providing us with real underwriting insight and control benefits. Across our European and UK businesses we improved the quality of our data leading to more timely and accurate customer documentation. In Hiscox UK we introduced sophisticated capacity planning tools to ensure that we had the resources in place to meet spikes in demand. Our quality, as perceived by our customers, is measured using Net Promoter scores and we are now receiving industry-leading scores. In the US our new service centre, which supports the direct business, is also getting very positive customer reviews.

All this operational improvement has been mirrored in improvements in our IT performance. The IT team re-organised themselves during the year to match our business unit structure, allowing for more interaction between teams and greater accountability to the business for delivering specific projects. As a result, we have seen a higher number of projects being completed more efficiently and to a higher standard.

Our leadership

Robert's announcement that he intends to retire as Chairman in 12 months' time marks a watershed for the Group. Robert joined Hiscox in 1965 and took over its leadership in 1970 when we had two small boxes at Lloyd's and controlled premium income of just over £2 million. We now have controlled premiums of £1,664 million and operate from 27 locations in 11 countries. During this time Robert has steered Hiscox through the many challenges such as 9/11 which have occasionally shaken the industry to its foundations. He has also served the Lloyd's marketplace with distinction in a number of roles during its toughest times. He was a member of the Rowland Taskforce in 1991 and was Deputy Chairman of Lloyd's during its turbulent years of Reconstruction and Renewal from 1993–1995. He has done all of this with drive, energy, perspicacity, determination, iconoclasm, wit and aplomb. We will not be losing Robert's guidance as in 2013 he will remain with the business as Honorary President.

Chief Executive's report continued

A huge part of Robert's success has been formed around his ability to recruit great people and he has given them the freedom to build their businesses. One of the most important of these hires was Nicholas Thomson who will be standing down as a Non Executive of our UK based subsidiary boards shortly. Nick joined Robert in 1973, becoming Underwriter of Syndicate 33 from 1976 until 1993 and Director of Underwriting from 1993 until 2001. Nick served as a Hiscox plc Board Director from 1993 until 2001. He has also always served on our UK based subsidiary boards, moving to a Non Executive position in 2001. Nick's contribution to our underwriting culture has been immense and we will miss the grenades of underwriting and business insight that he rolled down the boardroom table with unfailing regularity.

Strong experienced Non Executives have also been of huge value to the Group. Foremost amongst these has been Anthony Howland-Jackson who will also be standing down shortly. After a distinguished career in broking, Anthony joined the Board of Hiscox plc and our UK based subsidiaries in 1997. He served as Senior Independent Director on the Board of Hiscox plc standing down from this Board when we re-domiciled to Bermuda in 2006. Since then he has continued to serve as a Non Executive Director of our UK based businesses. Anthony's well timed questions caused us to re-assess many of our more fanciful ideas and his words of advice were always listened to.

The Board has initiated a selection process to find a successor to Robert. This process is being led by the Chairman of the Remuneration and Nomination Committee, Andrea Rosen, supported by our Senior Independent Director, Richard Gillingwater, and with input from all Hiscox Ltd Non Executive Directors who form the Committee. The Remuneration and Nomination Committee have appointed a leading search firm as advisers and we will make an announcement on succession in due course.

People

We are always working to attract the most talented people to work here, to retain them and to help them to develop. Robert has led by example in this and we seek to live up to his standards. In 2011 both Hiscox London Market and Hiscox UK achieved Chartered Insurer status. This reflects the investment we have put into ensuring our staff achieve industry qualifications which we then back up with internal training and development programs.

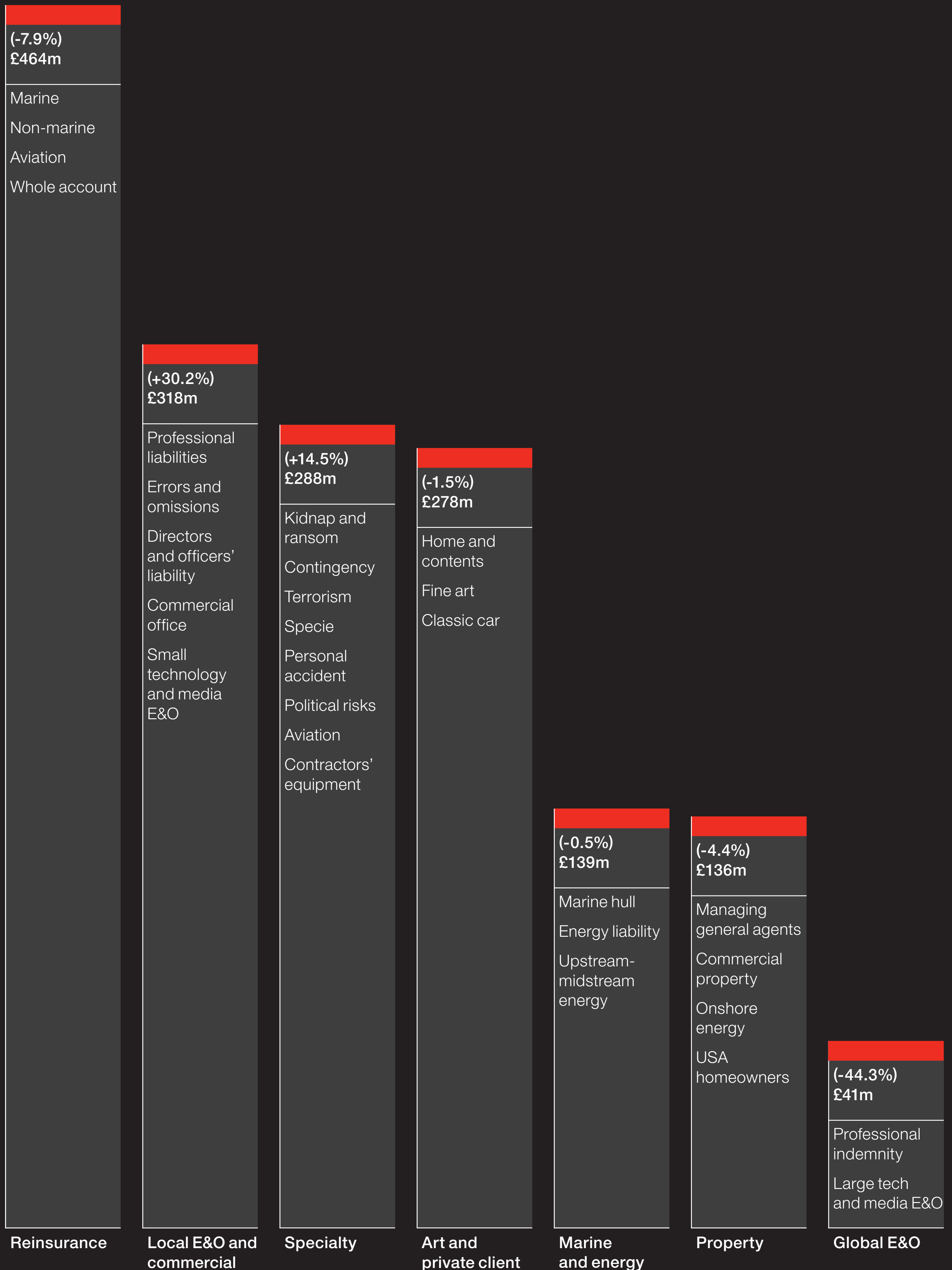
We really believe the quality of our staff is a competitive advantage in the industry, and the resilience of our result this year reflects their individual contributions on a risk-by-risk and day-by-day basis. I thank them all.

Outlook

We have seen substantial rises in rates for catastrophe reinsurance in loss affected territories such as Japan, New Zealand and Australia, but areas which were already well rated, such as the United States, have seen more modest increases. Unfortunately, catastrophe reinsurance in areas which continue to need price rises such as Europe have remained flat. In non catastrophe areas the trends are more mixed. European insurance pricing remains reasonable in our lines, and in the UK there is some downward pressure in commercial insurance, whilst personal lines are flat albeit at healthy levels. In the US we are seeing modest upward pressure.

In this environment we believe that we can thrive. The UK will continue with its consumer and brand led expansion; Europe will focus on driving growth in current product areas and current territories, developing greater scale and with that improved profitability; the US will continue to drive for scale in current areas and build on the exciting possibilities of its direct business; The London Market, Bermuda and Guernsey insurance businesses will take advantage of areas with rate increases, expanding judiciously in property related lines but continuing to shrink in casualty; overall Reinsurance is even better rated than in previous years and unless the world turns upside down, should return to its usual profitability. I feel excited as I see these plans coming together and am confident the profits they generate will benefit shareholders and staff.

Bronek Masojada
27 February 2012


Actively managed business mix
Total Group controlled premium December 2011: £1,664m
(Year-on-year change in original currency)
(-7.9%)
£464m
Marine
Non-marine
Aviation
Whole account
Reinsurance
(+30.2%)
£318m
Professional liabilities
Errors and omissions
Directors and officers' liability
Commercial office
Small technology and media E&O
Local E&O and commercial
(+14.5%)
£288m
Kidnap and ransom
Contingency
Terrorism
Specie
Personal accident
Political risks
Aviation
Contractors' equipment
Specialty
(-1.5%)
£278m
Home and contents
Fine art
Classic car
Art and private client
(-0.5%)
£139m
Marine hull
Energy liability
Upstream-midstream energy
Marine and energy
(-4.4%)
£136m
Managing general agents
Commercial property
Onshore energy
USA homeowners
Property
(-44.3%)
£41m
Professional indemnity
Large tech and media E&O
Global E&O

The Hiscox Group has over 1,250 staff in 11 countries.

Bermuda
Hamilton

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

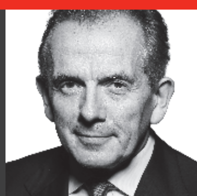
Guernsey
St Peter Port

Latin American gateway
Miami

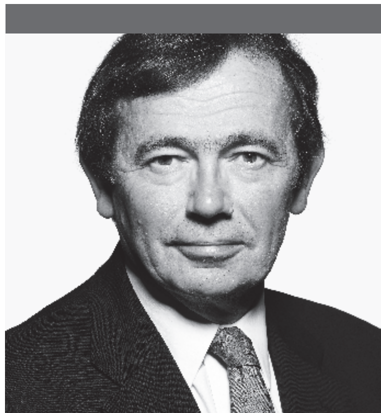
UK
Birmingham
Colchester
Glasgow
Leeds
London
Maidenhead
Manchester

USA
Atlanta
Chicago
Los Angeles
New York City
San Francisco
White Plains (New York)

Hiscox business structure

Division	Business		Head	Lines of business
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; property; specialty; kidnap and ransom; terrorism; technology/media; direct to customer commercial business
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

Reinsurance



Robert Childs
Chief Underwriting Officer

Robert Childs, Chief Underwriting Officer, explains more about Hiscox's biggest line of business.

How does reinsurance work?
Just as companies buy insurance to cover potential risks to their business, insurance companies themselves also buy insurance (known as reinsurance) to transfer some of their own risk. Reinsurance is a remarkably flexible financial tool that insurers use to manage the downside risk of their insurance portfolios. It can help insurers absorb large losses and reduce volatility in what can be a very unpredictable industry. It can also act as additional capital, allowing insurers to take on more risk when they see the time is right.

Hiscox is an insurer, so we buy reinsurance to help mitigate our own risk. We are also a reinsurer that sells cover to other insurers. Reinsurance is our largest line of business, accounting for 28% of our Group premium income in 2011. We underwrite it in both Bermuda and London.

How would you describe Hiscox's reinsurance business?
Most of our business is property reinsurance but we also underwrite a small amount of marine, personal accident and casualty reinsurance. We focus on 'short-tail' risks, where claims occurrence and development are more immediate and are therefore more easily quantifiable, giving us greater certainty.

The majority of our reinsurance premiums come from contracts that cover insurers' catastrophic exposures, including hurricane, wind, earthquake or flood. We also provide reinsurance against individual risks, most often fire or explosion, which are also known as risk excess contracts. For example, we may provide reinsurance for a client's losses between $10 million and $20 million 'any one risk' as part of an overall programme that provides a total of $150 million in coverage for a single event. The advantage for us is that our potential loss is strictly defined – if the client's loss exceeds $20 million by any amount, we'll only pay the $10 million for which we are responsible in that programme. This kind of underwriting needs specialist knowledge to get under the skin of how each client underwrites their own risks. We do that by having very experienced underwriters who build good relationships with their clients. It helps that we are underwriters of both insurance and reinsurance. We are able to approach reinsurance with the knowledge gained as a buyer as well as a seller.

Another substantial area of reinsurance underwriting for us is in contracts called 'pro-rata treaties', where we participate in a proportional share of an insurer's premiums and losses. This form of reinsurance often acts as a capital substitute, where clients transfer risk through the purchase of reinsurance to free up capital. Pro-rata treaties also offer us the chance to put our capacity behind specialist insurers writing in classes or territories which we could not otherwise access.

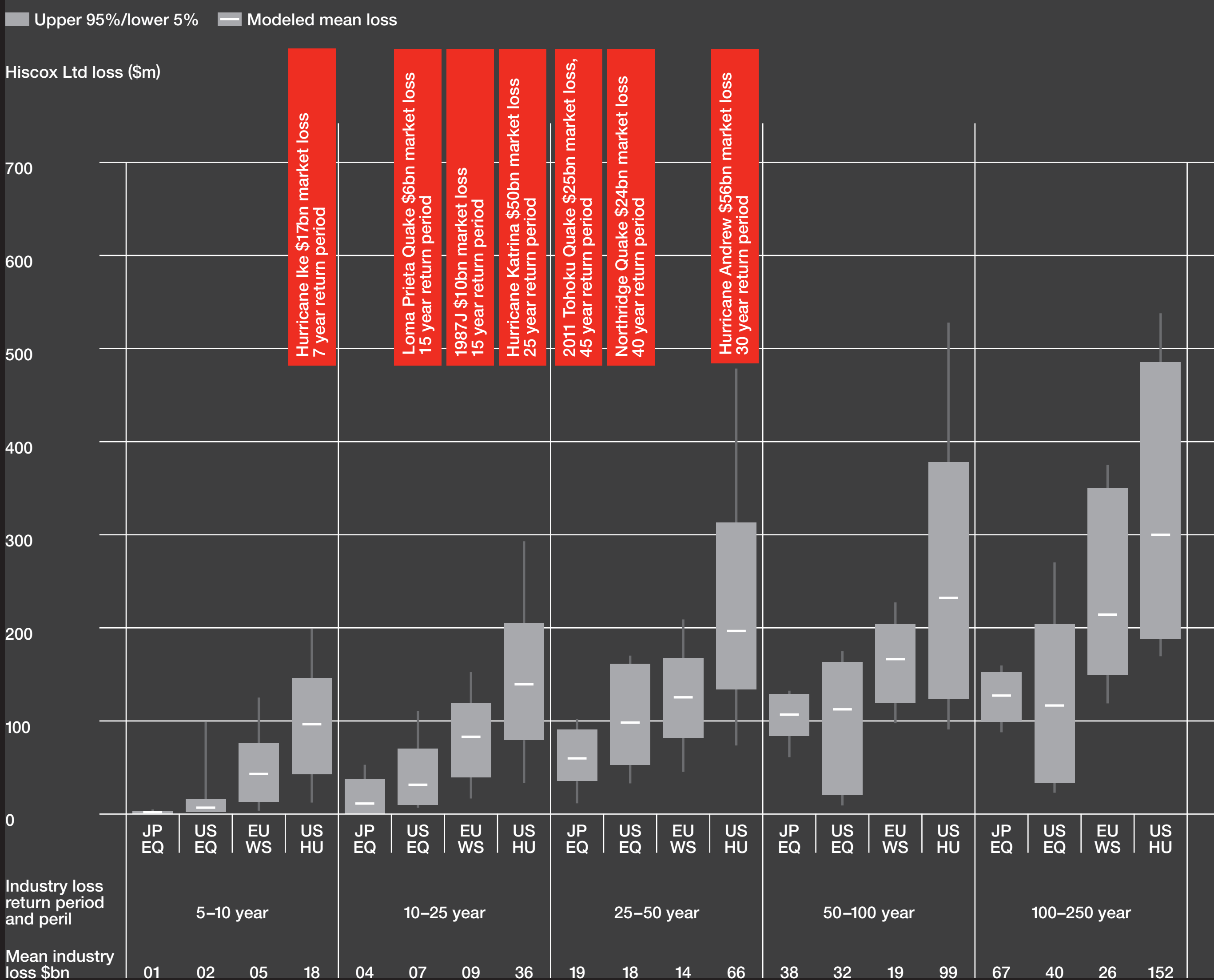
We also write reinsurance on behalf of other (insurance and reinsurance) companies who have entrusted capital to us, and in return we receive an underwriting fee and can earn a profit commission on that business. It's a good arrangement: it provides us with extra capacity, which we can use to increase our footprint in the market and to grasp new opportunities. But, in the event of a loss, our downside is limited.

Hiscox has been underwriting reinsurance since the 1970s, and a number of the Group's senior management were reinsurance underwriters, so it is a strong part of our corporate DNA.

How do you use catastrophe models in your business?
Catastrophe models can help reinsurers estimate potential losses. We were early-adopters of models as for decades we have held the belief that analysis and science is the route to profitable underwriting. The first model we used was back in the early 1980s – long before they became common in the industry. It was developed by my predecessor and was based on in-house research and used portable computers with a bus-ticket printer!

We have come a long way since then and much of the raw modeling is done using models created by specialist companies. We have a team of around 20 modelers who use our own research to modify the models supplied by the likes of Risk Management Solutions (RMS) and AIR Worldwide. Through our many years of underwriting reinsurance we have developed a huge database, which contains information not only on our own insurance losses but other peoples' as well. This empirical database and methodology is a good foil to the pure modeled approach.

We know that a mathematical model needs an underwriter to use common sense to interpret it. We have some of the best and most experienced around. Our customised models, our experienced underwriters and our backroom team of scientists are the foundations for what generates our 'Hiscox view of risk'.



This chart shows a modeled range of net loss the Group might expect from any one castastrophe event.
The white line between the bars depicts the modelled mean loss.

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.

JP EQ – Japanese earthquake, US EQ – United States earthquake, EU WS – European windstorm, US HU – United States hurricane

Reinsurance continued

The Hiscox view has often been more conservative than that produced by the industry catastrophe models because of the tweaks and fine-tuning we have made to them ourselves. The latest version of the RMS model, the incoming RMS 11, has caused projected US hurricane losses to rise significantly, more in line with our original view.

Can you explain what the Hiscox view of risk is?
Essentially it's our view of the underlying exposures we have on our book. It reflects the underwriting risk appetite defined by the Group's executive management. The view is formulated by our Catastrophe Management Team, which I chair, and which comprises the head of modeling, our climate science research manager and a number of our senior underwriters. We calculate our accumulated exposure to potential major disasters, such as a US hurricane or a Japanese earthquake, by running our numbers through our customised catastrophe models. That process produces a very specific loss number that we expect our underwriters' books to not exceed in a major catastrophe.

The Hiscox view of risk underpins the pricing models our underwriters use and informs their view on which risks to take.

We consolidate what our teams in London and Bermuda have written and measure that against our pre-defined risk appetite. Our modeling team updates the data on a regular basis and if the number is out of line with the pre-agreed risk appetite then we will manage our exposures accordingly.

2011 was a very costly year for natural catastrophes. How did Hiscox fare?
Natural catastrophes in 2011 cost Hiscox around £270 million, yet despite this we made a profit. This is largely due to our long held strategy of balancing the bigger volatile business, such as reinsurance, with smaller steadier insurance business.

Most of the catastrophic events that led to reinsurance claims occurred outside the USA in 2011. We had believed that in a number of these regions the catastrophe perils were not adequately rated. We had some exposure and suffered losses but because of this rate inadequacy we wrote less exposure and our losses were smaller than they could have been.

How do you hedge the reinsurance bets you've taken?
Primarily, our strategy of balance helps to offset the volatility of our higher margin business against the less volatile, and lower margin insurance business. We also purchase reinsurance cover to reduce our own peak exposures.

Within the reinsurance account itself we are able to achieve some balance between the principal zones of exposure by peril, those are the wind and earthquake in USA and Japan and wind in Europe. Further balance can be gained by adding in other territories but only when adequately compensated.

As we achieve diversification in the risks we write across the Group as a whole, we do not have to seek diversification in the reinsurance account per se. In reinsurance, diversification can become 'worsification' if you are not careful. It can dilute the quality and longer-term profitability of your business if you take on uncorrelated, but inadequately priced risk. Successful reinsurance underwriting is about making sure you take on risk at the right price and has a lot of similarities with investment management. We require to be paid adequately for risk.

We have also been innovative over the years in finding ways to expand our gross capacity without necessarily increasing our retained exposures. We have used financial instruments that allow investors to take on the risk and returns of the business we write. For example, we were the first Lloyd's business to create a sidecar, when we created Panther Re in 2006. We were also the first in Lloyd's to issue a catastrophe bond. We haven't returned to that market since then, because the terms on offer haven't been as attractive as in the traditional reinsurance market.

What plans do you have for 2012?
We try to play the cycle intelligently. It's fairly simple to say: if prices go down you write less business, but if they go up you write more; it's not always so easy to do. With the upheaval in the market we see plenty of opportunities for us in the year ahead and we have the financial muscle and the underwriting know-how to maximise those opportunities profitably for our shareholders.

People

1,254
Total number of staff at December 2011

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 2011, 154 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 2011, we recruited 19 graduate trainees an increase of 20% on 2010. One of our aims is to educate the brightest students about the vibrant career this industry can offer. We received 1,089 applications for these graduate roles globally, an average of 57 applications for every role.

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. Across the Group a total of 296 delegates completed our underwriting training programme in 2011. Hiscox London Market and Hiscox UK recently achieved Chartered Insurer status as the high standards and professionalism of our staff were recognised by The Chartered Insurance Institute (CII).

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 2011, six new Partners were appointed.

Employee engagement survey
In September, Hiscox conducted its fourth 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 average in the top 80th percentile when compared with 127 companies based around the world. Particularly pleasing was our 'intent to stay' score which is in the 90th percentile.

Group financial performance

£17.3m
Profit before tax

99.5%
Combined ratio

Profit before tax for the year was £17.3 million (2010: £211.4 million), despite reserving £270 million (2010: £165 million) for catastrophe losses and the volatile investment markets experienced during the year. The Group recorded a post tax return on equity of 1.7% (2010: 16.5%) and earnings per share were 5.5p (2010: 47.2p).

Net asset value per share reduced by 2.8% to 323.5p (2010: 332.7p) driven by smaller profits and the dividend payments made during the year. The Group continues to maintain a progressive dividend policy and total dividend per share rose by 3% to 17.0p (2010: 16.5p).

Gross premiums written of £1.45 billion were up 1.2% compared to the prior year. Strong growth in the local errors and omissions business and specialty lines were offset by reductions in reinsurance and large technology and media lines. The Group's combined ratio including foreign exchange was 99.5% (2010: 89.3%) due to reserves of £270 million (2010: £165 million) for the large amount of catastrophes during 2011.

This has been a challenging year in the investment markets, with the Group's investments producing a return of 0.9% (2010: 3.6%).

The underwriting performance for each operating segment is detailed below.

Hiscox London Market
Gross premiums written increased slightly by 2.2% to £585.4 million (2010: £572.7 million), with growth in specialty lines offset by reductions in reinsurance and large technology and media lines.

Reinsurance purchased was at a similar level to the prior year at 29.4% of gross premiums written (2010: 32.0%). The quota share arrangement with Syndicate 6104 remained in place.

The net claims ratio deteriorated to 56.6% (2010: 48.3%), due to a high number of catastrophe events including; Australian floods, Japanese earthquake and the resulting tsunami, two further earthquakes in New Zealand, the US tornados in Alabama and Joplin, and the Thailand floods.

As a result, the combined ratio (excluding the impact of foreign currency movements) worsened to 89.1% (2010: 81.8%). Profit before tax for the year was £57.6 million (2010: £121.4 million).

Hiscox UK and Europe
Gross premiums written rose by 9.5% to £498.0 million (2010: £454.7 million). Gross premiums written for the UK increased by 12.3% mainly due to good growth in the professional and specialty commercial lines of business. Europe remained broadly constant year to year with gross premiums written of £130.9 million (2010: £127.6 million).

The net claims ratio improved by 3.9% to 46.3% compared to the prior year ratio of 50.2%, where one specific larger loss in Europe was balanced by a better claims experience in the UK. The combined ratio before the impact of foreign exchange improved to 91.0% from 94.8% in the prior year reflecting the improved claims experience during the year.

As a result profit before tax for the year increased by 30.0% to £51.5 million (2010: £39.6 million).

Hiscox International
Gross premiums written decreased 9.7% to £365.8 million (2010: £405.2 million). The US reduced premiums by 15.5%, reflecting changes made in 2010, where we exited our inland marine and animal mortality business, and transferred our large technology and media businesses to Hiscox London Market. Bermuda also saw their premium reduce by 9.5% due to a disciplined underwriting approach. Gross premiums written in Guernsey were steady as they continued to underwrite cautiously in piracy lines.

The net claims ratio was heavily impacted by the catastrophe losses on the Australian floods, Japanese earthquake and the resulting tsunami, two further earthquakes in New Zealand, the US tornados in Alabama and Joplin, Hurricane Irene, and the floods in Thailand. The net claims ratio therefore declined to 89.9% (2010: 53.2%). The impact on the combined ratio excluding foreign exchange was a deterioration of 36.4% to 132.8% (2010: 96.4%).

As a result, the loss before tax was £89.5 million (2010: profit £43.1 million).

Hiscox Corporate Centre
Operational expenses, decreased slightly to £12.3 million (2010: £12.8 million). Foreign exchange gains of £12.4 million (2010: £8.4 million) include foreign currency impacts on certain intragroup positions. The loss before tax was £2.3 million (2010: profit £7.3 million) driven by a much reduced investment return as a result of market turmoil.

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. During the year there were additional rebates of tax.

Total net cash inflows for the year were £179.1 million (2010: inflow £75.9 million). The inflow was mainly due to prompt settlement of premiums and reinsurance recoveries. Net cash outflow from investing activities for the year was £11.8 million (2010: £22.2 million), primarily as a result of the development of IT systems recorded within intangible assets, a continued area of increased investment for the Group during the year. Projects included a management information project aimed at improving the quality and efficiency of financial

Group key performance indicators

	2011					2010				
	London Market	UK and Europe	International	Corporate Centre	Total	London Market	UK and Europe	International	Corporate Centre	Total
Gross premiums written (£m)	**585.4**	**498.0**	**365.8**	**–**	**1,449.2**	572.8	454.7	405.2	–	1,432.7
Net premiums written (£m)	**413.4**	**472.6**	**288.0**	**–**	**1,174.0**	389.6	428.0	314.0	–	1,131.6
Net premiums earned (£m)	**418.8**	**448.6**	**277.6**	**–**	**1,145.0**	396.1	422.2	312.9	–	1,131.2
Investment result (£m)	**8.8**	**7.2**	**6.3**	**2.2**	**24.5**	39.1	17.2	27.6	16.3	100.2
Profit/(loss) before tax (£m)	**57.6**	**51.5**	**(89.5)**	**(2.3)**	**17.3**	121.4	39.6	43.1	7.3	211.4
Claims ratio (%)	**56.6**	**46.3**	**89.9**	**–**	**60.2**	48.3	50.2	53.2	–	50.1
Expense ratio (%)	**32.5**	**44.7**	**42.9**	**–**	**39.1**	33.5	44.6	43.2	–	39.7
Foreign exchange impact (%)	**–**	**–**	**1.1**	**–**	**0.2**	(2.1)	0.5	0.9	–	(0.5)
Combined ratio (%)	**89.1**	**91.0**	**133.9**	**–**	**99.5**	79.7	95.3	97.3	–	89.3

	2011	2010
Financial assets and cash* (£m)	**2,873.4**	2,779.7
Other assets (£m)	**1,349.3**	1,211.2
Total assets (£m)	**4,222.7**	3,990.9
Net assets (£m)	**1,255.9**	1,266.1
Net asset value per share (p)	**323.5**	332.7
Net tangible asset value per share (p)	**306.1**	315.8
Adjusted number of shares in issue (m)	**388.2**	380.6

*excluding derivative assets and catastrophe bonds.

information provided to management, under the Solvency II regime.

Net cash outflows from financing activities for the year were £67.3 million (2010: outflow £172.9 million). The outflow is due to payment of dividends to shareholders and the full repayment of the cash borrowing facility outstanding at 2010 of £20 million.

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. The Group has no direct exposure to sovereign debt in Portugal, Ireland, Italy, Greece or Spain.

At 31 December 2011, $340 million had been drawn by way of Letter of Credit against the Group's $750 million revolving credit facility, with no cash drawings outstanding (2010: $165 million and £20 million respectively).

Solvency II

Solvency II is the new solvency regime for all European insurers and reinsurers. It aims to create solvency requirements that are consistent across all European member states which better reflect the risks that insurers and reinsurers face.

The Group is working with the Financial Services Authority (FSA) towards approval of our internal model for our FSA regulated entities. This work is progressing as planned.

The Group also submitted its Solvency II final application pack to Lloyd's in December on behalf of its syndicates. This pack included information around our readiness for the Solvency II regime. It is currently anticipated that the Group's capital model will be used to set capital requirements, for the syndicates that the Group manages, in 2013.

The Bermuda Monetary Authority (BMA) has begun supervising the Group, under the new Group Supervisory Framework. This will include the first full statutory submission for 2011 which is to be filed by the end of May 2012. The BMA continues to work towards Solvency II equivalence.

Group investments

The Group's invested assets at 31 December 2011 totalled £2.87 billion (2010: £2.78 billion). Cash flow remained healthy and the £75 million of Group borrowing that was outstanding at the half year was repaid before year end. The investment result, excluding derivatives, amounted to £25.9 million (2010: £98.8 million) equating to a return of 0.9% (2010: 3.6%).

£2,873.4m

Invested assets

Investment income in 2011 was forecast to be much reduced from that achieved in 2009 and 2010 and some volatility was to be expected. As it turned out, after a reasonably bright start, investment markets succumbed to a bout of significant turbulence, reminiscent of the latter part of 2008. Investors like certainty, not the indecisiveness served up by politicians in America over raising the debt ceiling and in Europe over the Eurozone crisis. The reality that Greece might default and the loss by the US of its AAA status finally sapped investors' appetite for risk and triggered a flight to quality. The main beneficiaries of the ensuing risk aversion included the US, UK and German government bond markets. Additionally, with the threat of recession growing, the Federal Reserve and the Bank of England responded with increased monetary stimulus adding further pressure to the downward trend in treasury and gilt yields. Riskier assets, by contrast, including corporate bonds and equities, were shunned by investors with prices marked down amidst a growing lack of liquidity. The performance of Eurozone sovereign bonds diverged dramatically.

The second half of the year therefore proved to be particularly challenging. Unlike the previous two years our fixed income portfolios generally delivered subdued returns and underperformed their government bond benchmarks. Effectively, the widening of corporate credit spreads offset the rally in the prices of our short dated government securities. Bank bonds in particular came under stress as worries of capital shortfalls and an interbank funding crisis grew. At 31 December 2011 approximately 10% of our bond portfolio was invested in bank debt. The vast majority of these are the senior debt of banks deemed to be strategically important to their national economies. We have limited exposure to banks in the troubled parts of the Eurozone, being a total of £7.5 million issued by Santander of Spain and Intesa of Italy. Given the heightened level of concern the list of approved institutions with which we may place cash has been reviewed and reduced. Cash is also invested in money market funds which are considered to be significant in scale, well diversified and managed by substantial organisations.

Our allocation to risk assets delivered a negative return. Whilst the portfolio of funds performed relatively well in difficult markets, beating a negative benchmark is never entirely satisfactory. Additional resource has been devoted to the selection of our long only and hedge fund managers and a number of changes have been made to their composition. On the whole the long only funds outperformed but some of our hedge funds had a disappointing year by their recent standards. Although volatile, over time we expect our risk assets to contribute to the growth of the Group's net asset value.

There were few tactical shifts during the year. Cash was managed to prudent levels with further ample liquidity available from our holdings in short dated government bonds and undrawn credit facilities. The credit quality of the bond portfolio remained high. We maintained our aversion to the sovereign debt of Greece, Ireland, Italy, Portugal and Spain and view our US government securities as being no more likely to default at AA+ than they were at AAA. Given a desire not to lose money in a 12-month period, the low interest rate environment continues to restrict the amount of risk that we might otherwise take. However, we did take advantage of the sharp market sell off in August and increased equity exposure by approximately £30 million which benefited the return for the year. The high yield bonds, bank loans and structured securities that were bought during the 2007/2008 crisis were sold. These were largely acquired on a buy and hold basis and have comfortably delivered the returns that we hoped for. Valuations are no longer as compelling as they were in this sector.

In 2011 there was an opportunity cost to not holding more and longer dated government bonds but the objective of preserving the balance sheet has been achieved. As we go into 2012 we expect global economic growth to be patchy and generally subdued with short-term interest rates in our main markets being kept at low levels throughout the year. Longer dated bond yields could be susceptible to any signs of economic improvement and the likelihood of another government bond rally of significant scale is much reduced. Duration therefore is likely to remain short relative to our liabilities. Along with cash we continue to see treasuries, gilts and bunds as essential for liquidity, rather than as great investments. Indeed, we would rather lend to quality companies than heavily indebted sovereigns and still view an allocation to investment grade corporate bonds as a sensible way to pick up some extra yield. Returns from equities have a good chance of beating that of cash and government bonds but further bouts of volatility are inevitable and we will manage our exposure in the light of valuations and our overall risk appetite. There are higher yields available for those that are willing to give up their liquidity and take more risk; indeed monetary policy is designed to encourage this behaviour. However, we have seen this end badly before and remain inclined to take what is reasonably on offer which currently implies another year of relatively low returns. Discretion is likely to be the better part of valour.

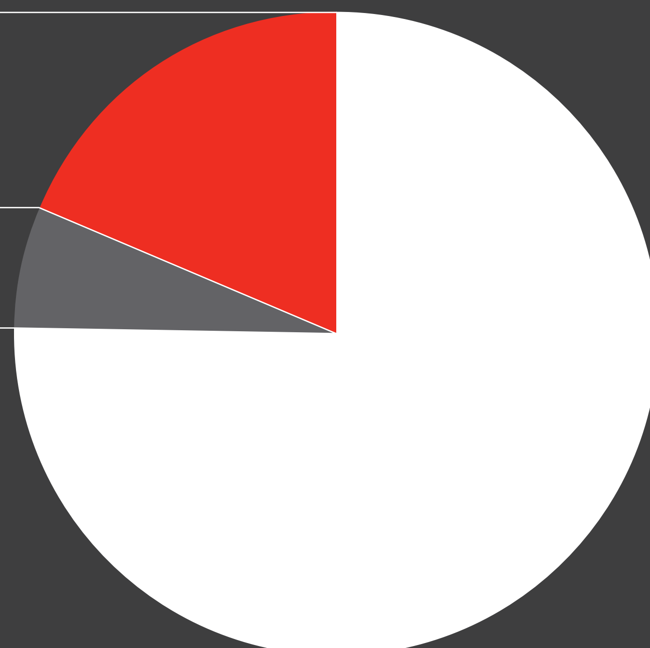
Group investment performance

		31 December 2011			31 December 2010		
		Asset allocation %	**Return %**	**Return £000**	Asset allocation %	Return %	Return £000
Bonds	£	**14.2**	**1.6**		18.5	2.7	
	US$	**52.5**	**1.0**		56.8	4.0	
	Other	**8.8**	**1.9**		6.9	2.8	
Bonds total		**75.5**	**1.3**	**29,933**	82.2	3.7	82,234
Equities		**6.0**	**(3.8)**	**(5,935)**	5.6	11.1	15,572
Deposits and cash equivalents		**18.5**	**0.4**	**1,944**	12.2	0.3	1,043
Actual return			**0.9**	**25,942**		3.6	98,849
Group invested assets*				**£2,873.4m**			£2,779.7m

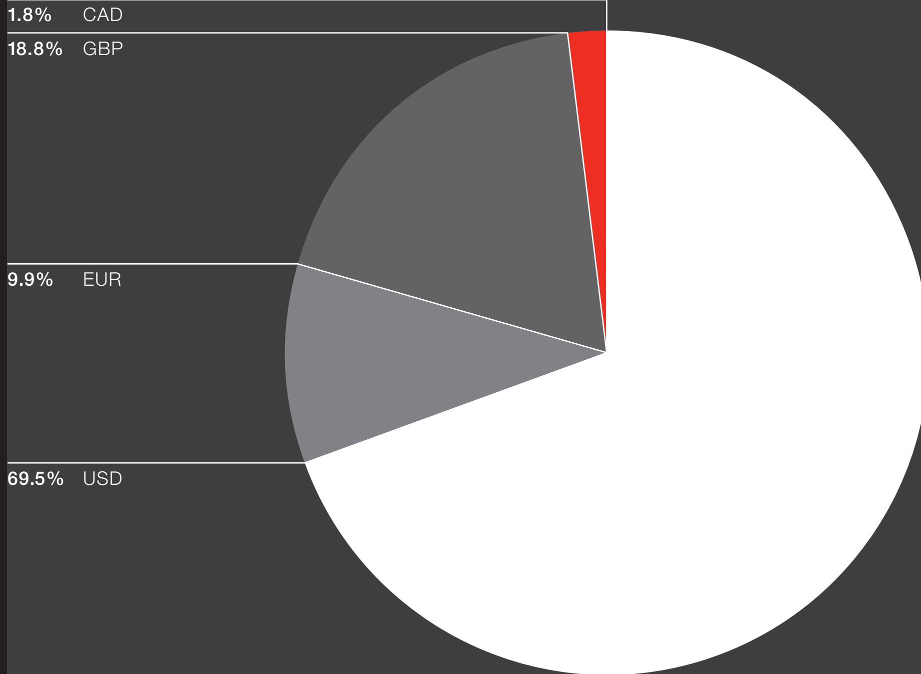
*excludes derivatives and investment in catastrophe bonds.

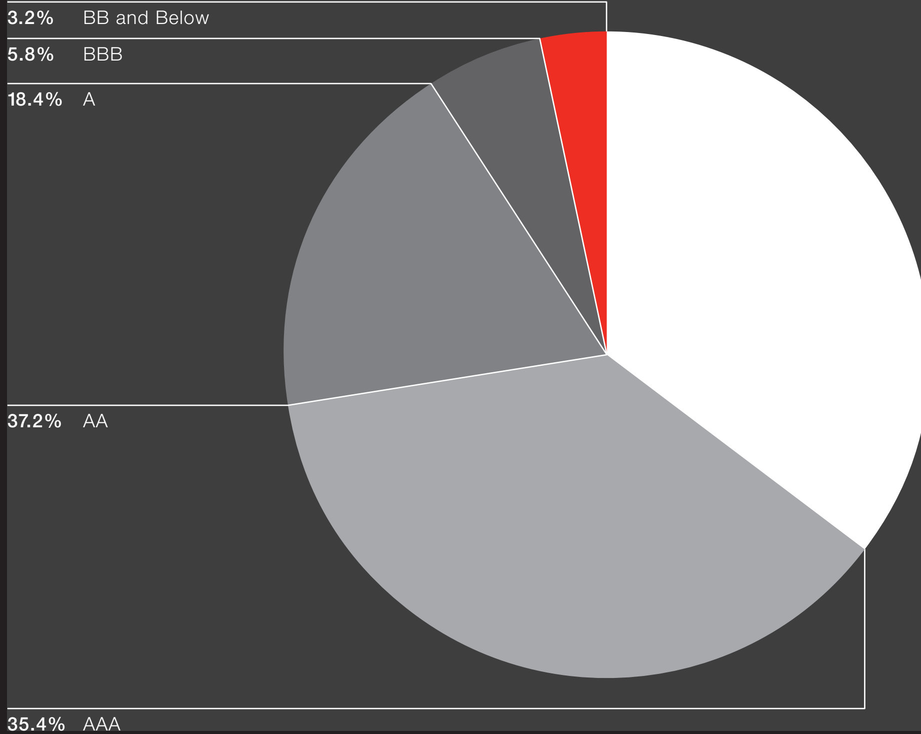
High quality and well diversified portfolio
Investment portfolio: £2,873.4m

Asset allocation



Group investments
continued





Risk management

Our core business is to take risk and our strategy is to maximise return on equity within a defined 'risk appetite'. It is therefore essential that we understand the significant exposures we face to manage the business well. It is also important that our knowledge of those risks underpins every important decision we make across the Group.

The risks from our core business of insurance and reinsurance represent many of our most significant exposures. We are also exposed to a number of other risks: investment, credit, operational, liquidity, and strategic. To identify and manage these we have developed a risk management framework, which we regularly review and improve in the light of the changing risk environment and evolving best practice on risk management.

The Group risk management framework
The Risk Committee of the Board advises our Directors on how to best manage the Group's risk profile. Our risk appetite is set by the Board and fed through to our divisions through the risk management framework, which is made up of a number of committees, including:

- Group Underwriting Review
- Reserving Committees
- Cash Flow Review Group
- Reinsurance Security Committee
- Broker Credit Committee
- Investment Committee
- Operational Risk Committee.

One of our Executive Directors – either the Chairman, Chief Executive Officer, Chief Financial Officer or Chief Underwriting Officer – chairs each of these committees, apart from the Operational Risk Committee, which is chaired by the Chief Operations Officer.

The responsibilities of our senior management are clearly defined, as are our reporting lines, and where responsibilities are delegated the Board and its committees closely monitor their activity, aided by financial and non-financial management information.

This monitoring assesses the level of risk being taken by the Group in pursuing its objectives, and to ensure that this level of risk remains within the parameters set by the Board.

A dedicated team reports to the Risk Committee of the Board which monitors and reviews the risk profile and the effectiveness of our risk management activities. This team has a wide range of tools to measure risks and is organised centrally so we can share best practice on managing risks across the Group.

Major risks
The major risks facing the Group are designated as being either of 'principal' or 'secondary' importance. Principal risks are those viewed to be potentially the most damaging for the Group, while secondary risks are not deemed to be critical at this stage. Certain of these risks arise from financial instruments held by the Group and are also discussed in note 3 to the consolidated financial statements.

Principal risks

What is the risk?	Why do we have it?	How is it managed?
Catastrophic and systemic insurance losses		
We insure individual customers, businesses and other insurers for damage caused by a range of catastrophes, both natural (e.g.hurricanes, earthquakes) and man-made (such as terrorism), which can cause heavy underwriting losses that could have a material impact on the Group's earnings.	Though volatile and potentially costly, this business is compelling for us, as it is capable of earning good margins over the medium to long-term.	— Hiscox has a well diversified portfolio by product and geography to help balance any catastrophe exposure. — We have a clearly defined appetite for underwriting risk, which dictates our business plan. To ensure that our risk appetite is not exceeded we maintain disciplined underwriting, regularly monitor our exposures to, and aggregations of risk in particular places closely and buy reinsurance to limit our losses from disasters. We adapt our business plan, target products and reinsurance programme to ensure our book of business is well diversified. This enables us to maximise the expected risk return profile on the whole portfolio and offset potential losses on more volatile accounts. — The quality of our underwriting models and our capability to accurately measure our aggregate exposure are key to managing this risk. Our underwriters are given incentives to make sound decisions that are aligned with the Group's overall strategic objectives and risk appetite. Clear limits are also placed on their authority. We regularly review our policy wordings in the light of legal developments to ensure the Group's exposure is restricted, as far as possible, to those risks identified in the policy at the time it was issued. Both our underwriting staff and independent risk specialists use

Principal risks continued

What is the risk?	Why do we have it?	How is it managed?
Catastrophic and systemic insurance losses continued		our modeling and monitoring tools to design the insurance and reinsurance business plans and to ensure that the exposures we underwrite match expectations. We share our risk aggregation and modeling resources across the Group to ensure everyone uses the same modeling tools (tailored to their specific market). We run stress and scenario tests for a range of specific events for each of our business units as well as the Group as a whole, so we can estimate our potential losses from a major catastrophe. — We buy reinsurance to mitigate the effect of catastrophes and unexpected concentrations of risk. We buy protection both for our business carriers and the Group as a whole. The scope and type of reinsurance protection we buy may change from year to year depending on the extent and competitiveness of cover available in the market. The Group is exposed to the risk that the reinsurance protection it has bought is inadequate or inappropriate, but this is monitored and managed using modeling techniques, under the supervision of a dedicated Reinsurance Purchase Group.
Competition and the insurance cycle		
Hiscox competes against major international insurance and reinsurance groups. At times, some of these groups may choose to underwrite risks at prices that fall below the breakeven technical price. Prolonged periods when premium levels are low or when competition is intense are likely to have a negative impact on the Group's financial performance.	We operate in open, aggressively competitive markets in which barriers to entry for new players are low and where competitors may choose to differentiate themselves by undercutting their rivals. As a result, capacity levels in these markets will rise and fall, causing prices to go up and down, creating volatile market cycles.	— We are firmly resolved to reject business that is unlikely to generate underwriting profits. Accepting risks below their technical price is detrimental to the industry's prospects since it drives the prevailing market rates down to a point where underwriting losses mount, insurers' capital is destroyed causing some businesses to fail, customers to receive poor service and the industry to suffer negative publicity. Hiscox incentivises underwriters on return on equity which rewards staff for profit not revenue. — Our appetite for certain lines of business changes according to the prevailing market conditions and the risk appetite of the Group. We regularly monitor pricing levels, producing detailed monthly reports grouping current prices with exposure and trends over the past 12 months. Thus we ensure that we quickly identify and control developing problems created by adverse changes in market conditions. — We frequently act as the lead insurer in the co-insurance programmes required to cover significant high value assets, so we have some ability to set market rates rather than follow them.
Reserving for insurance risks		
We make financial provisions for unpaid claims, defence costs and related expenses to cover our ultimate liability both from reported claims and from 'incurred but not reported' (IBNR) claims. There is the possibility that we do not make sufficient provision for our exposures, which could affect the Group's earnings, capital and possibly even its survival.	As an insurance company we are required to hold claims reserves.	— The provisions we make to pay claims reflect both our own experience – and that of the industry – 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 consolidated financial statements. — Our provision estimates are subject to rigorous review by senior management from all areas of the business including independent actuaries. The final provision is approved by the relevant boards on the recommendation of dedicated reserving committees. — The provisions we make are set above the expected or 'mean reserve' requirement to reduce the risk that actual claims exceed the amount that has been set aside.

What is the risk?	Why do we have it?	How is it managed?
Investment risk		
The premiums and technical funds we hold for the payment of future claims are inevitably exposed to investment risk.	We invest the cash we receive from our clients and the capital on our balance sheet until it might be needed to be paid as claims.	— We have a conservative investment policy: our overriding concern is to not lose money or to put at risk the Group's capacity to underwrite. Our policy is designed to maximise returns within an overall risk appetite. — Technical funds – those funds held for reserves – are invested primarily 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, as far as possible, are maintained in the currency of the original premiums for which they are set aside to reduce foreign exchange risk. — As many of our insurance and reinsurance liabilities have short time spans, we do not aim to match exactly the duration of our assets and liabilities. Our fixed income fund managers are set benchmarks that approximate the payment profile of our claims while still providing them with some flexibility to enhance returns. — A proportion of the Group's assets are allocated to riskier assets, principally equities. For these assets we take a long-term view so we can achieve the best risk-adjusted returns. The proportion of funds we invest in risk assets will depend on the outlook for investment and underwriting markets. We make an allocation to less volatile, absolute return strategies within our risk assets, so as to balance our desire to maximise returns with the need to ensure capital is available to support our underwriting throughout any downturn in financial markets. — Investment risk also encompasses the risk of default of counterparties, which is primarily with issuers of bonds in which we invest. Our third-party investment managers are issued guidelines as to the type and nature of bonds in which to invest.
Liquidity risk		
That we are unable to meet our liabilities to customers or other creditors when they fall due. Also the risk that we incur excessive costs by selling assets or raising finance in a very short time to meet our obligations.	We provide cover against a range of catastrophes, so if one occurs we may be faced with large, unplanned cash demands. This situation could be exacerbated if we have to fund a large portion of claims pending recovery from our reinsurers.	— We believe the likelihood that we may be unable to meet our liabilities, or that we incur excessive costs in doing so, is extremely remote, because of our range of risk management measures. — Most of our cash inflows and outflows are routine and can be forecast well in advance. Our primary source of inflows is insurance premiums while our outflows are largely expenses and payments to policyholders through claims. We forecast our cash flow for the week, month, quarter or up to two years ahead, depending on the source. Free cash is invested according to the Group's investment policy and our cash requirements can normally be met through our regular income streams: premiums, investment income, existing cash balances or by realising investments that have reached maturity. — We run stress tests to estimate the impact of a major catastrophe on our cash position in order to identify any potential issues. We also run scenario analyses that consider the impact on our liquidity should a number of adverse events occur simultaneously, such as an economic downturn and declining investment returns combined with unusually high insurance losses. — We maintain extensive borrowing facilities. These arrangements have been made with a range of major international banks so as to minimise the risk of one or more of the institutions being unable to honour their commitments to us. — Our investment policy recognises the demands created by our underwriting strategy, so that some investments may need to be realised before maturity or at short notice. Hence a high proportion of our investments are in liquid assets, which reduces our risk of making losses because we may have to sell assets quickly.

Risk management
continued

Principal risks continued

What is the risk?	Why do we have it?	How is it managed?
Regulatory change		
The insurance industry is undergoing a period of unprecedented regulatory change, which may impact the capital we are required to hold.	Insurance is a regulated industry. While regulations typically evolve on an ongoing basis, there may be times where the regulatory landscape undergoes a significant shift. We are currently facing such a situation.	— We currently have a dedicated team assessing and developing new internal arrangements compliant with new regulations, operating under the guidance of the Group CFO.

Major risks: secondary

What is the risk?	Why do we have it?	How is it managed?
Insurance risk: binding authorities		
Hiscox generates considerable premium income through agents to whom binding authority is given to underwrite insurance policies on our behalf. Agents may underwrite business outside of our normal guidelines.	Binding authorities give the Group access to a greater volume of business.	— All binding authorities we grant are closely controlled through tight underwriting guidelines. We vet all our agents prior to appointment and monitor and audit them regularly. — Agents are frequently audited to ensure they meet our standards.
Credit risk: reinsurance counterparties		
We buy reinsurance to protect us from large single claims as well as the aggregate effect of many claims resulting from catastrophes. The risk is that our reinsurers are unable to meet their obligations to us, which would put a strain on our earnings and capital.	We cover clients against a range of catastrophes and protect ourselves through reinsurance. We face credit risk where we seek to recover sums from other reinsurers.	— We buy reinsurance only from companies that we believe to be strong. Our credit exposures to these companies are closely monitored. Every reinsurer we use must be approved by a dedicated Reinsurance Security Committee, based on an assessment of its financial strength, trading record, payment history, outlook, organisational structure, plus its external credit ratings. Approved reinsurers are monitored continuously, so that we are able to identify quickly any potential problems. The committee considers public information, experience of the companies concerned, their behaviour in the marketplace and analysis from external consultants and from rating agencies. — We set guidelines for exposure to each of our approved reinsurers.

Major risks: secondary continued

What is the risk?	Why do we have it?	How is it managed?
Investment risk: foreign exchange risk		
Our reporting currency is Sterling, but a significant proportion of our operational costs are located in the US and Europe. In addition the capital bases of our insurance companies in Bermuda, Guernsey and US are in US Dollars. Therefore, movements in foreign exchange rates may have a material adverse effect on our financial performance and position.	We are an international insurance and reinsurance group that operates in numerous markets around the world.	— As the US Dollar is the Group's largest underwriting currency, our policy is to match our US Dollar insurance liabilities with investments held in that currency so we can minimise any losses from currency fluctuations. — We will hold a percentage of our capital in the matching currency of that part of our underlying business, where it is deemed appropriate. We closely monitor our net currency positions and will enter into currency hedges if we anticipate adverse 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 consolidated financial statements.
Strategic risk: Hiscox credit rating		
The external ratings assigned to the Group and its subsidiaries are essential to our profitability, particularly for our reinsurance business, and to manage our financing costs and access to capital. A reduction in these external ratings may impact the Group's ability to generate business and/or access finance.	The business in which we operate is determined largely by financial strength ratings issued by the major credit rating agencies.	— We have identified the key aspects of our business that are critical to maintaining our ratings. These are closely managed to minimise the risk of an event that might jeopardise our ratings and to ensure that we respond appropriately to unforeseen events. — We have regular and open communication with the major credit rating agencies to ensure that we continue to meet their expectations and that the potential impact on our ratings is given careful consideration before we make any significant business or strategic decision.
Operational risk: IT continuity		
We are unable to transact with intermediaries and customers due to an IT failure.	Like every other business we are reliant on data and computer systems in order to go about our everyday business.	— We have a formal disaster recovery plan in place that deals with both workspace recovery and the retrieval of communications, IT systems and data if a major problem occurred. These procedures would enable us to move the affected operations to alternative facilities very quickly. The disaster recovery plan is tested regularly and includes disaster simulation tests.
Emerging risks		
We are exposed to new and emerging risks, primarily through legal or political decisions. For example, a change in US legislation may result in exposures being included within our coverage that had not been intended by our underwriters, or may require us to cease business in certain US states.	Our business is taking risk, which by its nature, is inherently uncertain.	— Identifying, planning for and controlling emerging risks is an important part of our risk management activity across all aspects of our business, including underwriting, operations and strategy. We make a significant effort to try to identify material emerging threats to the Group. It is a core responsibility of each of our risk committees and we believe we take all reasonable steps to minimise the likelihood and impact of emerging risks and to prepare for them in case they occur.

Corporate responsibility

£0.5m
Donated to charities

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

It is our policy to have a responsible approach to identifying, and then minimising, the environmental impacts of our business activities and those that arise from our ownership and occupation of office premises. In doing so, we seek to reduce to a minimum the amount of waste our activities produce, and the amount of resources we consume. Hiscox aims to be a responsible business, respecting the environment and reducing our carbon footprint and has made commitments both to our shareholders and our staff.

During 2010 we launched an environmental policy in Hiscox UK, outlining our commitment to measure our carbon footprint and to reduce it as far as we can. During 2012 we will be building on this good work by rolling it out across the Group. 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.

For the second year in a row Hiscox UK was carbon neutral. We conducted an environmental audit of our UK operations and calculated our carbon footprint with the help of independent consultants Corporate Citizenship. We generated significant cost and energy savings through increased recycling and more careful use of electricity, water and gas. Overall, Hiscox UK reduced our carbon footprint by 6% in 2009 and 7% in 2010. The balance of our carbon emissions were offset through an investment in an African Energy Efficient Stove Project in Kenya.

This project is focused on providing energy efficient stoves for families in villages throughout the area, replacing inefficient open fires. Energy efficient stoves significantly reduce the amount of firewood required and therefore carbon emissions. The stoves more than halve the amount of smoke from firewood, benefiting the families health and are approximately 70% more efficient than an open fire as each stove will save over 15 tonnes of fuel over the lifetime of the stove. These stoves themselves go directly to families, and we have provided 242 so far. For more information, please go to www.hiscox.com.

Our sustainability efforts have also been recognised by the City of London Corporation. In 2011, for a third year in a row, our London office received a Clean City Scheme Gold award.

Hiscox Bermuda was awarded the Greenrock Green Workplace award in 2011. Greenrock Green Workplace Awards (GWAs) is an environmental competition bringing together businesses of all sizes that share the same vision of a greener workplace. It awarded seven companies and individuals for their environmental practices.

Hiscox is a founding member of ClimateWise, a collaborative insurance initiative through which members aim to work together to respond to the myriad of risks and opportunities of climate change.

The marketplace

Dealing with business partners

We regard 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. Hiscox UK and Hiscox London Market recently achieved Chartered Insurer status from The Chartered Insurance Institute, recognising the professionalism and expertise of staff and making it easier to build relationships with like minded business partners.

Dealing with investors

In keeping with our policy of open and transparent communication, Hiscox reports both its half and full year results to investors via a series of presentations as well as ensuring all relevant Group financial information is available on the corporate 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. Similarly, when a small business client is sued, our expert claims staff bring to bear years of expertise to defend the client or resolve the situation swiftly. The Hiscox philosophy is that insurance is a promise to pay, so should a loss occur, we aim to fully support our customers and to pay their claims as soon as 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 we are more likely to achieve business success and therefore create additional value for shareholders. Hiscox aims for the highest

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

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 we have got this balance right and, furthermore, that this is one of our greatest strengths. The Group's policies ensure that we continue to follow a best practice approach to managing people and remain 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, 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. Towers Watson 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 our 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.

The community
Hiscox donated £533,000 to charities in 2011. The Group has maintained its involvement in its local communities with the strong support of its employees. In Bermuda, Hiscox supports the Centre Against Abuse which provides shelter, support and tools to those involved in relationship abuse. We assist in the furnishing of the safe house for battered women and their children. Hiscox also supports The Women's Resource Centre by funding the Centre's 24 hour hotline. Other support was provided to the Bermuda Senior Islanders' Centre (a senior citizens social group), and Big Brothers and Big Sisters of Bermuda (a one-to-one mentoring programme). Hiscox USA doubled its donations to $100,000 supporting a variety of charities across the US and helped to organise events where employees volunteered their time. These charities included; City Year (New York), Make-A-Wish (San Francisco) and the Children's Restoration Network (Atlanta). 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 Cambridge Heath Sixth Form.

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 renewed 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 (RI) with a loan and corporate sponsorship. The RI 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. During 2011 Hiscox also supported two students of The Royal Academy of Art in London with a bursary.

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 2011 raised over £28,500. The foundation has supported HART (Humanitarian Aid Relief Trust) with a further £30,000 during 2011. 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.

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 and 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.

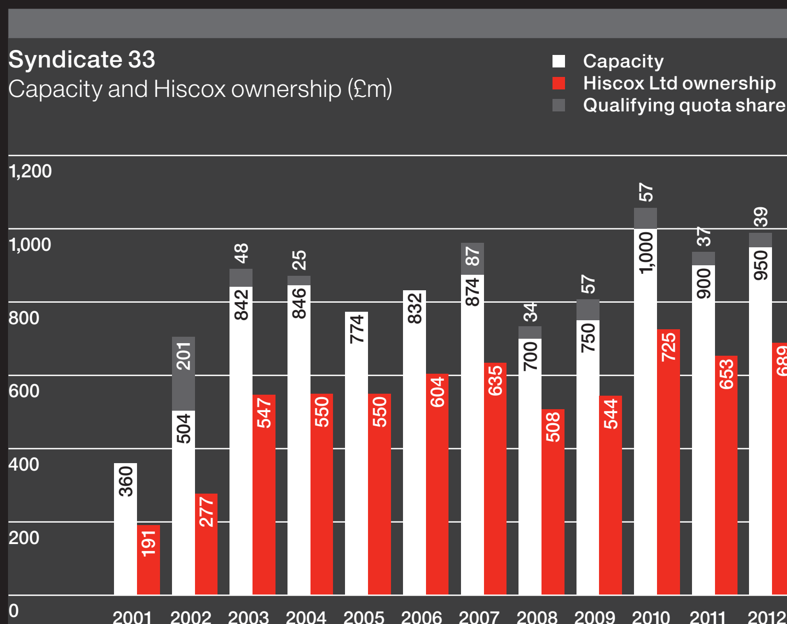
The geographical and currency splits are shown to the right. One of the main advantages of trading through Lloyd's is the considerably lower capital ratios that are available due to the diversification of business written in Syndicate 33 and in Lloyd's as a whole. For 2012 Syndicate 33 has a capital requirement ratio of approximately 34% 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 2012 year of account, Syndicate 33's capacity has been increased to £950 million from £900 million. The chart below right shows the gross premiums written of Syndicate 33 for the last 11 years.

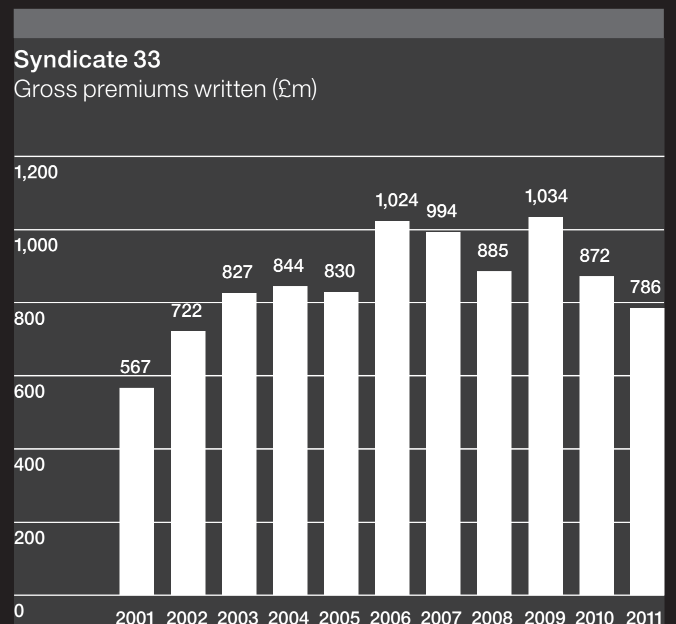
Syndicate 3624

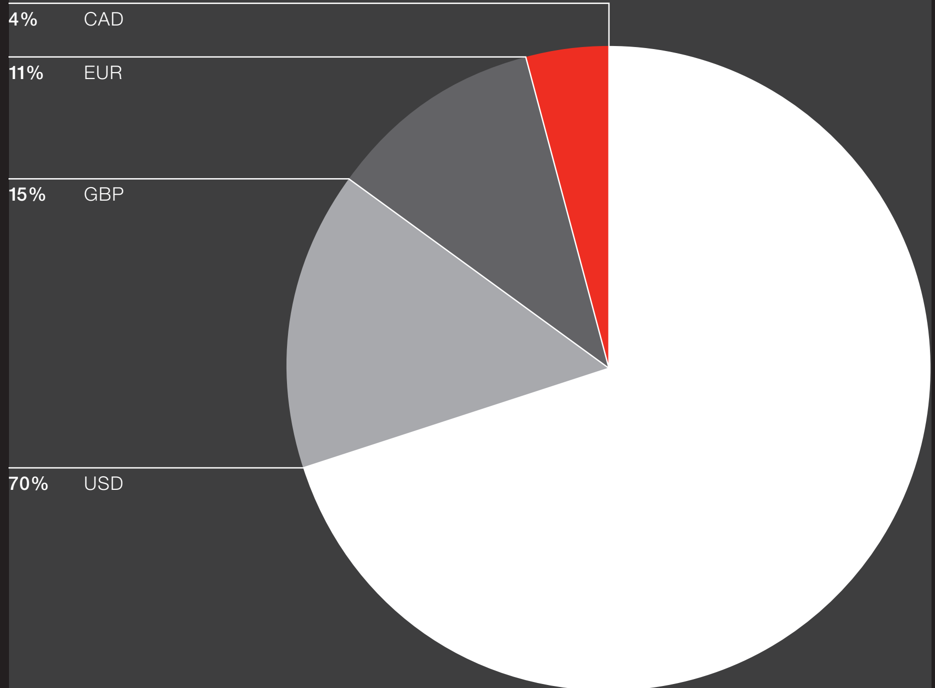
Syndicate 3624 is a wholly owned syndicate which began underwriting for the 2009 year of account with an underwriting capacity of £150 million. The syndicate has a diversified portfolio of worldwide risks including E&O, property, construction, technology and media, healthcare, aviation and events. The diversification of the syndicate from both an exposure and geographical perspective means the syndicate is well balanced to grow in a controlled way. The syndicate is primarily exposed to short tail liability risks. Syndicate 3624 has a capital requirement ratio of 55% of syndicate capacity. Total underwriting capacity of Syndicate 3624 remained flat at £250 million for the 2012 year of account.

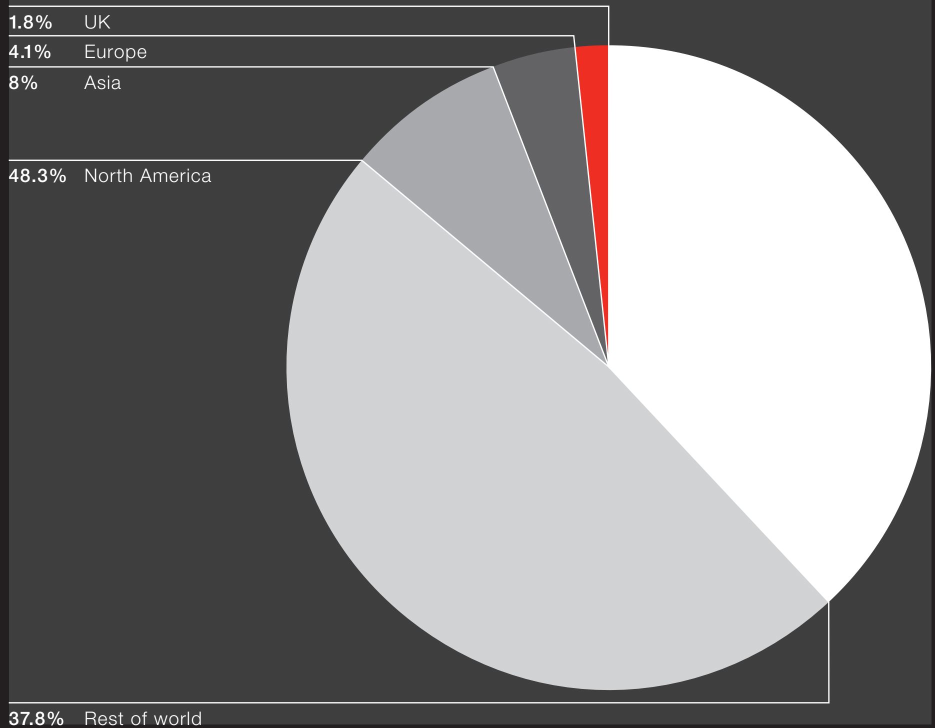
Cougar Syndicate 6104

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 has been extended through to the 2012 year of account and Cougar Syndicate 6104's capacity was increased to £39 million, from £37 million.

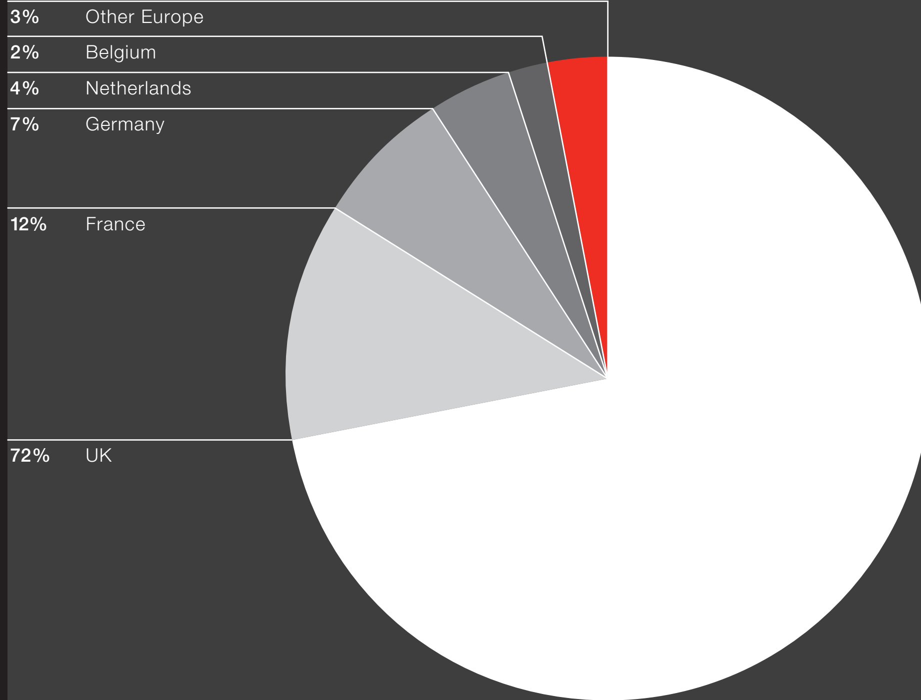


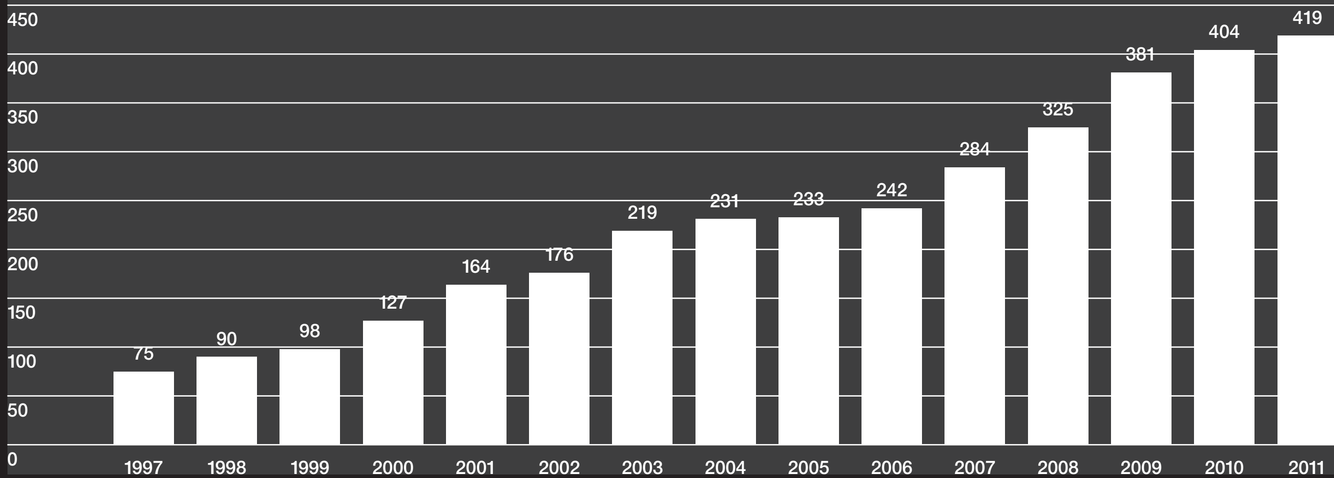



Syndicate 33
Gross premiums written currency split (%)
4% CAD
11% EUR
15% GBP
70% USD


Syndicate 33
Gross premiums written geographical split (%)
1.8% UK
4.1% Europe
8% Asia
48.3% North America
37.8% Rest of world

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 commercial 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 portfolio can be seen in the chart below left.

Hiscox Insurance Company Limited has achieved average compound growth in gross premiums written of 13.1% from 1997 to 2011, 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 2011, net assets exceeded £224 million (2010: £197 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 2011, net assets exceeded $11 million (2010: $28 million), having distributed $20 million in dividends during the year.

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.

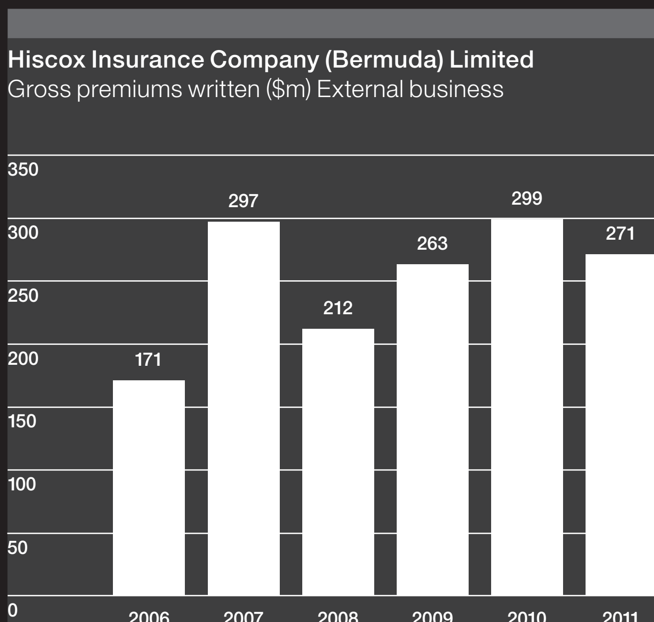
Hiscox Bermuda has an A.M. Best rating of A (Excellent) and an A (Strong) rating from Fitch. At the end of 2011, net assets exceeded $846 million (2010: $941 million).

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 is property and liability cover sold through insurance brokers. From November 2010, the Company launched a direct commercial business.

Hiscox Insurance Company Inc. is rated A (Excellent) by A.M. Best. At the end of 2011, net assets exceeded $58 million (2010: $58 million).



Board of Directors

Executive Directors

Robert Ralph Scrymgeour Hiscox
Chairman (Aged 69)

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 was a Non Executive Director of AGICM Ltd until July 2011 and Grainger Trust plc until February 2012. Robert was appointed High Sheriff of Wiltshire in March 2011.

Bronislaw Edmund Masojada
Chief Executive
(Aged 50)

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 51)

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 a member of the Financial Regulation and Taxation Committee of the Association of British Insurers, a member of the audit committee of the Institute of Chartered Accountants in England and Wales and Chairman of the Lloyd's Market Association Finance Committee.

Robert Simon Childs
Chief Underwriting Officer and Chairman of Hiscox USA
(Aged 60)

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. In 2012 Robert joined the Council of Lloyd's. He is Active Underwriter of Lloyd's Syndicate 3624. Robert was Chairman of the Lloyd's Market Association from January 2003 to May 2005. He 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 55)

△○□

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. Richard is a Non Executive Director of SSE plc and Non Executive Chairman of CDC Group plc.

Secretary
Charles Dupplin

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Bermuda

Registered number
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Hamilton HM 08
Bermuda

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Appleby
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HMEX Bermuda

Bankers
HSBC Bank Bermuda
Limited
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 69)

▲○□

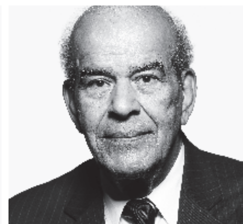
Daniel Healy joined Hiscox in 2006. He was appointed Executive Vice President and Chief Financial Officer of North Fork Bancorporation in 1992 and a member of its Board of Directors in 2000. He was a partner with KPMG LLP before joining North Fork. He was the Managing Partner of the San José, California and Long Island, New York offices and held other positions in that firm during his tenure. He is Chief Executive Officer of Bond Street Holdings Inc and Florida Community Bank, a subsidiary and holds a Board position with KBW, Inc.. He is also a Senior Adviser to Permira Advisers LLC, an international private equity firm. He was previously Chairman of Herald National Bank.

Ernst Robert Jansen
Non Executive Director (Aged 63)

△○□

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. (now Achmea BV) between 1992 and 2007 and following retirement he became an adviser to the Executive Board. He is also a Non Executive Director of Friends Provident International Limited.

Dr James Austin Charles King
Non Executive Director and Chairman of the Conflict Committee (Aged 73)



△●□

Dr James King joined Hiscox in 2006. He chairs Keytech Limited, The Bermuda Telephone Company Ltd and Grotto Bay Properties Ltd. He was Chairman of the Bank of N.T. Butterfield & Son Limited until 19 April 2007 and the Establishment Investment Trust, a UK listed company until August 2011. 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.

Robert McMillan
Non Executive Director (Aged 59)

△○□

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 57)

△○■

Andrea Rosen joined the Hiscox Ltd Board in 2006. She is a Director of Alberta Investment Management Corporation, Emera Inc. and Manulife Financial Corporation. 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.

Gunnar Stokholm
Non Executive Director (Aged 62)

△○□

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.

Corporate governance

Overview and basis of reporting

Hiscox Ltd ('the Company') is the Bermudian domiciled holding company for the Group. The Company has a premium listing on the London Stock Exchange. The corporate governance framework for companies registered in Bermuda is established by the Company's constitution together with Companies Act legislation. During 2011, and up to the date of this report and accounts, the Group has complied with the provisions of the UK Corporate Governance Code (formerly 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 34 to 35.

In order to ensure that the composition of the Board remains appropriate the Remuneration and Nomination Committee monitors the composition of the Board and is required to consider the balance of skills and experience before any appointment is made. The balance of skills and experience is also reviewed as part of the Board evaluation process as described on page 38. 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 and meets periodically with the Senior Independent Director. The Chief Executive has responsibility for running the Group's business.

In accordance with the UK Corporate Governance Code, all Directors submit themselves for re-appointment at the Annual General Meeting of the Company. The external commitments of the Directors are disclosed in their profiles on pages 34 to 35. Non Executive Directors are appointed for a specified term. Their terms of appointment state that their continuation in office is contingent upon their satisfactory performance and prescribe the time commitment required of them in order to discharge their duties. The terms also state that appropriate preparation time is required ahead of each meeting. A review of the remuneration of the Non Executive Directors, which does not include performance-related elements, was carried out during the year. All Directors received briefings at every Board meeting cycle on how the Company is addressing changes in solvency regulation. Directors' training was also assessed as part of the performance evaluation described on page 38. 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 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. Aside of the opportunity which the Non Executive Directors have to challenge and contribute to the development of strategy in the regular Board meetings the Non Executive Directors also attended the annual Hiscox Partners' meeting.

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 including financial reporting, internal control and risk management. 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 management and approval of exceptional spend within the limits established by the Board. Below this there are 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

Meetings and attendance table

Director	Ltd Board Attended	Audit Committee Attended	Remuneration and nomination Committee 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	4/4	3/3	2/2
DM Healy	4/4	3/3	2/2
ER Jansen	4/4	3/3	2/2
Dr J King	4/4	3/3	2/2
R McMillan	3/4	2/3	1/2
AS Rosen	4/4	3/3	2/2
G Stokholm	4/4	2/3	2/2

Chairman of the Committee, Daniel Healy, is considered by the Board to have recent and relevant financial experience. It operates according to Terms of Reference published on the Group's website. 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 and Gunnar Stokholm. It is chaired by Andrea Rosen. It operates according to Terms of Reference published on the Group's website and generally meets three times a year.

The Committee's role in remuneration is described in the Directors' remuneration report presented on pages 39 to 46.

The Committee's role in nomination is to monitor the structure, size and composition of the Hiscox Ltd Board and when Board vacancies arise, to nominate, for approval by the Board, appropriate candidates to fill those roles. The Committee also has a role to consider the succession planning for executive directors and senior managers; and has a particular remit to make recommendations on the succession planning for Chairman and the Chief Executive. When considering candidates for Board roles, the Committee will ensure that an appropriate process is followed to ensure that an objective review of the skills, background and time available is undertaken. The Committee will take external advice as appropriate.

For the most recent appointment (of the Senior Independent Director) a recruitment consultancy was appointed and the acting Senior Independent Director represented the Committee in the selection process. The Chairman, the Chief Executive Officer and the Group Human Resources Director then interviewed the shortlisted candidates.

In 2011, a particular consideration for the Remuneration and Nomination Committee has been the succession of Robert Hiscox as Chairman of Hiscox Ltd. A selection process has been put in place, a job and person specification has been prepared and the search firm Egon Zehnder has been appointed to advise the Committee throughout that process. A decision is expected to be made and announced during 2012.

During the year the Chairman reported to the Board a change in his commitments following his appointment as High Sheriff of Wiltshire.

Corporate governance continued

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

An externally facilitated board evaluation process was conducted during the year. This included a review of the culture and dynamics of the Board, the interaction of the Board with its Committees, the information provided to the Board, and the performance of the Chairman. Each Director was interviewed and asked to complete a questionnaire. The findings of the evaluation were then discussed by the Board as a whole. In addition the Non Executives periodically meet without the Chairman and Executive Directors to discuss a wide range of issues concerning the Company including as appropriate the performance of the Chairman and the Executive Directors. Such a meeting was held after the external evaluation exercise. While no major issues concerning Board performance were raised during the year a number of improvements were suggested around Board information and minute taking, and Board visits to Hiscox operations.

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. All Directors attended the Annual General Meeting in 2011.

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 23 to 27.

The Board has reviewed the effectiveness of its risk management and internal controls during 2011, 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: Revised 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 and generally meets three times a year. The members of the Committee for 2011 were Andrea Rosen (Chairman), Richard Gillingwater, Daniel Healy, Ernst Jansen, Dr James King, Bob McMillan and Gunnar Stokholm.

The Committee's role in remuneration 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.

The Committee's role in nomination is outlined on page 37.

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;
- annual bonus scheme which enables employees to earn attractive bonuses for generating good levels of return on equity;
- 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.

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.

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 2011.

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.

The Group operates two different types of bonus pools: the Personal Performance Bonus pools (PPB) and the Profit Related Bonus pools. 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 their roles well, irrespective of overall Group performance. The benefit is up to 10% of relevant salaries.

Directors' remuneration report continued

All employees, including Executive Directors, participate in profit related bonus pools. These pools are calculated at a business unit level and for the Group as a whole on the basis of a set percentage of profits in excess of a return on allocated equity hurdle ('Hurdle Rate'). The Hurdle Rate is currently set at a 7.5%. In the case of Bermuda, the London Market and Guernsey business units the pool is 15% of profits in excess of the Hurdle Rate return on allocated equity. In the case of the UK and Europe, the bonus pool is 15% of profits from the ground up, but this is only released when the business unit's return on allocated equity exceeds the Hurdle Rate. For businesses in the development phase, such as our US business, bonuses are awarded on achievement of budgets agreed at the beginning of the year.

A portion of each business unit's pool is available to pay bonuses for corporate centre staff, including the Executive Directors. There are also controls in place to ensure that as the Executives seek to maximise the Group's return on equity that Hiscox does not exceed the risk appetite set by the Board.

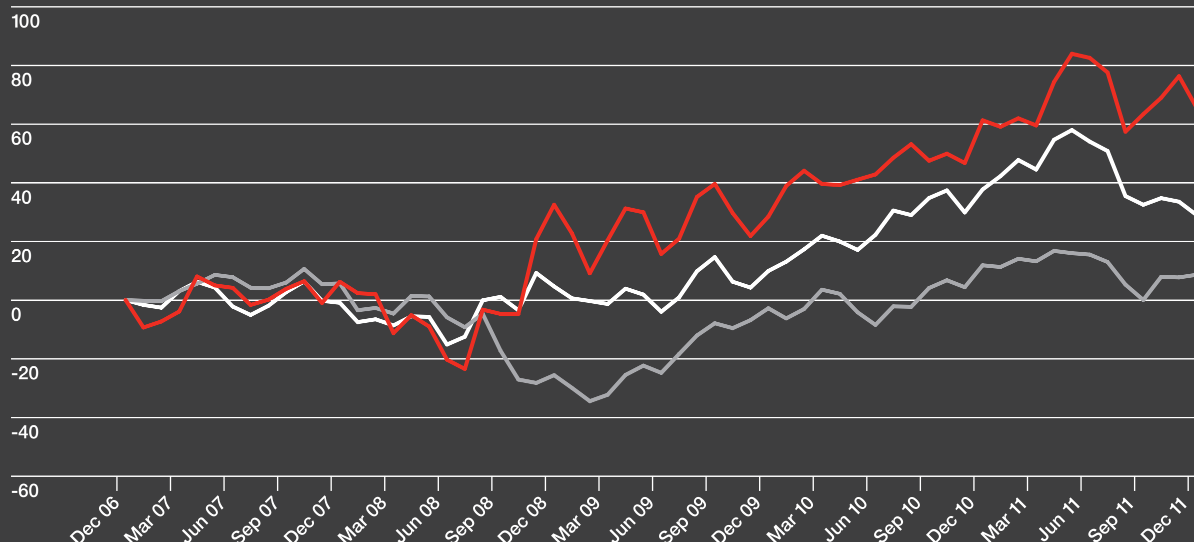
Once the bonus pools have been established individual bonuses are determined based on the results of the relevant business area, individual performance and the size of the relevant bonus pool. The Remuneration and Nomination Committee determines the bonuses to be paid to the Executive Directors based 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.

The Hurdle Rate is reviewed annually by using a benchmark which takes account of the medium-term forward looking investment returns (specifically the 1–3 year Gilt and Treasury yields, cash returns and the general investment environment). The Hurdle Rate is set at 5% above this benchmark rate. If the benchmark rate dropped to zero, or exceeded 7.5% (suggesting a Hurdle Rate of 5% or above 12.5%) we would review this approach. Based on the approach the Hurdle Rate for 2011 was set at 7.5%.

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
2011	1	0

Total shareholder return (%)



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 2011 and the Remuneration and Nomination Committee has also agreed to make awards under this plan in 2012. 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 2011 was 152% 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.

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 shareholder 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

Directors' remuneration report continued

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 2011 is outlined in the table below. Details of their contractual notice periods are contained in the table below.

	Base	Share incentive scheme
RRS Hiscox	49%	51%
BE Masojada	38%	62%
RS Childs	41%	59%
SJ Bridges	39%	61%

'Base' refers to base salary for the year.
'Share incentive scheme' is the estimated value at award of the Performance Share Plan awards made during the year.

Remuneration of Executive Directors

	2011 Basic salary £000	2011 Benefits £000	2011 Bonus £000	2011 Total £000	2010 Basic salary £000	2010 Benefits £000	2010 Bonus £000	2010 Total £000
RRS Hiscox	**302**	**1**	**–**	**303**	310	2	300	612
BE Masojada	**438**	**2**	**–**	**440**	438	2	500	940
RS Childs	**358**	**2**	**–**	**360**	358	2	400	760
SJ Bridges	**328**	**2**	**–**	**330**	328	2	350	680

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 £40,000 for his services and of AGICM Ltd and was paid £5,000, for the period until his resignation on 12 July 2011. RS Childs, 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

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 is detailed below.

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

	Hiscox Ltd Board $000	Committees $000	**Total 2011 $000**	Total 2010 $000
R Gillingwater	83	45	**128**	15
DM Healy	83	40	**123**	122
ER Jansen	83	30	**113**	112
Dr J King	83	35	**118**	117
R McMillan	83	30	**113**	13
AS Rosen	83	39	**122**	130
G Stokholm	83	36	**119**	117

Pensions

	Increase in accrued pension during the year £000	Transfer accrued annual pension at 31 Dec 11 £000	Transfer value of increase in accrued pension £000	Transfer value of accrued pension at 1 Jan 11 £000	Transfer value of accrued pension at 31 Dec 11 £000	Increase/ (decrease) in transfer value of accrued benefit during the year £000
RRS Hiscox	12	250	–	5,056	5,727	671
BE Masojada	3	43	–	746	1,269	523
RS Childs	(5)	247	–	6,185	7,828	1,643
SJ Bridges	2	33	–	528	745	217

Share options

	Number of options at 1 January 2011	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2011**	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date
SJ Bridges	154,578	–	–	–	**154,578**	1.465	–	02-Apr-06	01-Apr-13
	154,578	–	–	–	**154,578**	1.514	–	13-Jul-07	12-Jul-14
	154,578	–	–	–	**154,578**	1.499	–	06-Apr-08	05-Apr-15
	463,734	–	–	–	**463,734**				
RS Childs	206,104	–	–	–	**206,104**	1.252	–	19-Nov-05	18-Nov-12
	206,104	–	–	–	**206,104**	1.465	–	02-Apr-06	01-Apr-13
	206,103	–	–	–	**206,103**	1.514	–	13-Jul-07	12-Jul-14
	206,104	–	–	–	**206,104**	1.499	–	06-Apr-08	05-Apr-15
	824,415	–	–	–	**824,415**				
BE Masojada	206,104	–	–	–	**206,104**	1.252	–	19-Nov-05	18-Nov-12
	206,104	–	–	–	**206,104**	1.465	–	02-Apr-06	01-Apr-13
	206,104	–	–	–	**206,104**	1.514	–	13-Jul-07	12-Jul-14
	206,104	–	–	–	**206,104**	1.499	–	06-Apr-08	05-Apr-15
	824,416	–	–	–	**824,416**				
Other employees	87,993	–	–	(87,993)	**–**	1.755	3.773-4.006	03-May-04	02-May-11
	93,609	–	–	(93,609)	**–**	0.806	3.545-3.999	27-Sep-04	26-Sep-11
	393,687	–	–	(159,730)	**233,957**	1.252	3.852-3.930	19-Nov-05	18-Nov-12
	485,308	–	–	(216,408)	**268,900**	1.465	3.738-4.243	02-Apr-06	01-Apr-13
	659,222	–	–	(195,798)	**463,424**	1.514	3.738-4.107	13-Jul-07	12-Jul-14
	650,775	–	–	(175,188)	**475,587**	1.499	3.752-3.880	06-Apr-08	05-Apr-15
	2,370,594	–	–	(928,726)	**1,441,868**				
Total	4,483,159	–	–	(928,726)	**3,554,433**				

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 2011	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2011**	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date
UK Sharesave Scheme									
SJ Bridges	3,210	–	–	–	**3,210**	2.826	–	01-May-13	31-Oct-13
RRS Hiscox	4,907	–	–	(4,907)	**–**	1.956	3.884	01-Dec-11	31-May-12
RS Childs	3,210	–	–	–	**3,210**	2.826	–	01-May-13	31-Oct-13
BE Masojada	4,343	–	–	(4,343)	**–**	2.210	3.824	01-Dec-10	31-May-11
	3,107	–	–	–	**3,107**	2.896	–	01-Dec-13	31-May-14
Other employees	47,942	–	(2,606)	(45,336)	**–**	2.210	3.500-4.199	01-Dec-10	31-May-11
	480,883	–	(10,946)	(460,251)	**9,686**	1.982	3.666-4.220	01-May-11	31-Oct-11
	314,128	–	(17,036)	(264,707)	**32,385**	1.956	3.699-4.198	01-Dec-11	31-May-12
	109,514	–	(13,905)	(2,284)	**93,325**	2.418	3.820	01-May-12	31-Oct-12
	80,222	–	(13,156)	(557)	**66,509**	2.752	4.221	01-Dec-12	31-May-13
	189,504	–	(30,701)	(4,029)	**154,774**	2.826	3.490-4.198	01-May-13	31-Oct-13
	129,996	–	(18,203)	–	**111,793**	2.896	–	01-Dec-13	31-May-14
	–	292,265	(145,928)	–	**146,337**	3.077	–	01-May-14	31-Oct-14
	–	448,213	(253)	–	**447,960**	2.843	–	01-Dec-14	31-May-15
Total	1,370,966	740,478	(252,734)	(786,414)	**1,072,296**				
International Sharesave Scheme									
Other employees	11,584	–	(11,584)	–	**–**	2.210	–	01-Dec-10	31-May-11
	152,888	–	(15,754)	(137,134)	**–**	1.982	3.666-4.137	01-May-11	31-Oct-11
	46,911	–	–	(22,329)	**24,582**	1.956	3.703-3.884	01-Dec-11	31-May-12
	47,732	–	–	–	**47,732**	2.418	–	01-May-12	31-Oct-12
	70,355	–	–	–	**70,355**	2.752	–	01-Dec-12	31-May-13
	84,521	–	–	–	**84,521**	2.826	–	01-May-13	31-Oct-13
	39,845	–	–	–	**39,845**	2.896	–	01-Dec-13	31-May-14
	–	61,258	–	–	**61,258**	3.077	–	01-May-14	31-Oct-14
	–	109,693	–	–	**109,693**	2.843	–	01-Dec-14	31-May-15
Total	453,836	170,951	(27,338)	(159,463)	**437,986**				

Performance Share Plan

	Number of awards at 1 January 2011	Number of awards granted	Number of awards lapsed	Number of awards exercised	**Number of awards at 31 December 2011**	Market price at date of exercise £	Date from which released
SJ Bridges	110,000	11,934	–	–	**121,934**	–	07-Apr-11
	200,000	–	–	–	**200,000**	–	02-Apr-12
	150,000	–	–	–	**150,000**	–	07-Apr-13
	–	125,000	–	–	**125,000**	–	07-Apr-14
RS Childs	140,000	15,189	–	(155,189)	**–**	3.96	07-Apr-11
	225,000	–	–	–	**225,000**	–	02-Apr-12
	175,000	–	–	–	**175,000**	–	07-Apr-13
	–	125,000	–	–	**125,000**	–	07-Apr-14
RRS Hiscox	90,588	–	–	–	**90,588**	–	26-Mar-10
	75,000	8,137	–	–	**83,137**	–	07-Apr-11
	50,000	–	–	–	**50,000**	–	02-Apr-12
	76,260	–	–	–	**76,260**	–	07-Apr-13
	–	75,000	–	–	**75,000**	–	07-Apr-14
BE Masojada	175,000	18,986	–	–	**193,986**	–	07-Apr-11
	275,000	–	–	–	**275,000**	–	02-Apr-12
	250,000	–	–	–	**250,000**	–	07-Apr-13
	–	175,000	–	–	**175,000**	–	07-Apr-14
Other employees	843,265	–	–	(238,942)	**604,323**	3.49-4.12	12-Jan-09
	460,291	–	–	(195,329)	**264,962**	3.75-3.85	26-Mar-10
	1,530,500	173,548	(7,500)	(1,012,667)	**683,881**	3.50-4.25	07-Apr-11
	2,836,000	–	(94,500)	–	**2,741,500**	–	02-Apr-12
	3,035,096	–	(192,856)	–	**2,842,240**	–	07-Apr-13
	–	2,943,000	(135,000)	–	**2,808,000**	–	07-Apr-14
Total	10,697,000	3,670,794	(429,856)	(1,602,127)	**12,335,811**		

Directors' report

The Directors have pleasure in submitting their Annual Report and consolidated financial statements for the year ended 31 December 2011.

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, its position at the end of the year, and the likely future development can be found within the Chief Executive's report on pages 6 to 12. A description of the major risks can be found in the risk management section on pages 23 to 27. In addition, note 3 to the consolidated 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 2.

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 £17.3 million (2010: £211.4 million). Detailed results for the year are shown in the consolidated income statement on page 51, and also within the Group financial performance section on pages 18 to 19.

Going concern
A review of the financial performance of the Group is set out on pages 18 to 19. 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 consolidated financial statements.

Dividends
An interim dividend of 5.1p (net) per share (2010: 5.0p (net)) was paid on 21 September 2011 by Hiscox Ltd in respect of the year ended 31 December 2011. The Directors recommend the payment of a final dividend of 11.9p (net) per share (2010: 11.5p (net)). If approved this will be paid on 19 June 2012 to shareholders on the register at the close of business on 11 May 2012. As in the previous year the Directors propose that shareholders may elect to receive the final dividend in new ordinary shares, a scrip dividend rather than cash.

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 34 to 35. Details of the Chairman's professional commitments are included in his biography.

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

Political and charitable contributions
The Group made no political contributions during the year (2010: £nil). Charitable donations totalled £533,000 (2010: £1,109,000) of which £250,000 (2010: £500,000) 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 pages 28 and 29.

Major interests in shares
As at 24 February 2012, the Company had been notified of the following interests of five per cent or more of voting rights in its ordinary shares:

	Number of shares	% of total*
Invesco Limited	54,031,056	13.91
Massachusetts Financial Services Company	19,620,700	5.05

*Based on voting rights of 388,420,033 as at 24 February 2012.

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 Fairmont Hamilton Princess Hotel, 76 Pitts Bay Road, Pembroke HM 08, Bermuda on 30 May 2012 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
27 February 2012

Directors' report
continued

Directors' interests

	31 December 2011 5p Ordinary Shares number of shares beneficial	31 December 2010 5p Ordinary Shares number of shares beneficial
Executive Directors		
RRS Hiscox	**4,944,068**	6,637,176
BE Masojada	**3,496,077**	3,504,517
RS Childs	**2,104,316**	1,991,272
SJ Bridges	**1,112,152**	1,149,438
Non Executive Directors		
R Gillingwater	**–**	–
D Healy	**100,000**	100,000
E R Jansen	**53,231**	20,698
Dr J King	**–**	–
R McMillan	**–**	–
A Rosen	**43,525**	24,116
G Stokholm	**–**	–

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 Chief Financial Officer, SJ Bridges. The statements were approved for issue on 27 February 2012.

Financial summary

Group key performance indicators

	2011	2010
Gross premiums written (£m)	**1,449.2**	1,432.7
Net premiums earned (£m)	**1,145.0**	1,131.2
Profit before tax (£m)	**17.3**	211.4
Profit after tax (£m)	**21.3**	178.8
Earnings per share (p)	**5.5**	47.2
Total dividend per share for year (p)	**17.0**	16.5
Net asset value per share (p)	**323.5**	332.7
Group combined ratio (%)	**99.5**	89.3
Group combined ratio excluding foreign exchange (%)	**99.3**	89.8
Return on equity (%)	**1.7**	16.5
Investment return (%)	**0.9**	3.6

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 51 to 103 which comprise the consolidated balance sheet as at 31 December 2011, 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 control 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 from 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 control 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 policies 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 UK Corporate Governance 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 2011, 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
27 February 2012

Consolidated income statement
For the year ended 31 December 2011

	Note	2011 Total £000	2010 Total £000
Income			
Gross premiums written	4	**1,449,219**	1,432,674
Outward reinsurance premiums		**(275,208)**	(301,047)
Net premiums written	4	**1,174,011**	1,131,627
Gross premiums earned		**1,428,954**	1,435,118
Premiums ceded to reinsurers		**(283,947)**	(303,960)
Net premiums earned	4	**1,145,007**	1,131,158
Investment result	7	**24,495**	100,249
Other revenues	9	**17,322**	22,079
Revenue		**1,186,824**	1,253,486
Expenses			
Claims and claim adjustment expenses, net of reinsurance	26.2	**(697,898)**	(570,997)
Expenses for the acquisition of insurance contracts	17	**(269,792)**	(269,891)
Operational expenses	9	**(203,204)**	(206,403)
Foreign exchange gains	12	**7,816**	15,484
Total expenses		**(1,163,078)**	(1,031,807)
Results of operating activities		**23,746**	221,679
Finance costs	10	**(6,698)**	(10,090)
Share of profit/(loss) of associates after tax	16	**223**	(223)
Profit before tax		**17,271**	211,366
Tax credit/(expense)	28	**4,001**	(32,566)
Profit for the year (all attributable to owners of the Company)		**21,272**	178,800
Earnings per share on profit attributable to owners of the Company			
Basic	31	**5.5p**	47.2p
Diluted	31	**5.3p**	45.4p

Consolidated statement of comprehensive income
For the year ended 31 December 2011, after tax

	Note	2011 Total £000	2010 Total £000
Profit for the year		**21,272**	178,800
Other comprehensive income			
Currency translation gains (net of tax of £nil (2010: £nil))	12	**11,060**	11,729
Total other comprehensive income		**11,060**	11,729
Total comprehensive income recognised for the year (all attributable to owners of the Company)		**32,332**	190,529

The notes on pages 55 to 103 are an integral part of these consolidated financial statements.

Consolidated balance sheet
At 31 December 2011

	Note	**2011 £000**	2010 £000
Assets			
Intangible assets	14	**67,552**	64,108
Property, plant and equipment	15	**18,155**	19,742
Investments in associates	16	**6,380**	6,886
Deferred tax	29	**25,748**	14,077
Deferred acquisition costs	17	**150,050**	142,736
Financial assets carried at fair value	19	**2,368,636**	2,459,107
Reinsurance assets	18, 26	**492,515**	462,765
Loans and receivables including insurance receivables	20	**507,722**	485,414
Current tax asset		**69,436**	–
Cash and cash equivalents	23	**516,547**	336,017
Total assets		**4,222,741**	3,990,852
Equity and liabilities			
Shareholders' equity			
Share capital	24	**20,563**	20,297
Share premium	24	**32,086**	15,800
Contributed surplus	24	**245,005**	245,005
Currency translation reserve	25	**60,517**	49,457
Retained earnings	25	**897,728**	935,555
Total equity (all attributable to owners of the Company)		**1,255,899**	1,266,114
Employee retirement benefit obligations	30	**–**	–
Deferred tax	29	**152,447**	45,421
Insurance liabilities	26	**2,500,260**	2,279,867
Financial liabilities	19	**–**	20,457
Current tax		**–**	29,995
Trade and other payables	27	**314,135**	348,998
Total liabilities		**2,966,842**	2,724,738
Total equity and liabilities		**4,222,741**	3,990,852

The notes on pages 55 to 103 are an integral part of these consolidated financial statements.

The consolidated Group financial statements were approved by the Board of Directors on 27 February 2012 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 2010		20,158	11,831	303,465	37,728	748,104	1,121,286
Total recognised comprehensive income 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
Total recognised comprehensive income for the year (all attributable to owners of the Company)		**–**	**–**	**–**	**11,060**	**21,272**	**32,332**
Employee share options:							
Equity settled share based payments		**–**	**–**	**–**	**–**	**8,677**	**8,677**
Proceeds from shares issued	24	**91**	**3,124**	**–**	**–**	**–**	**3,215**
Deferred tax	29	**–**	**–**	**–**	**–**	**(3,927)**	**(3,927)**
Scrip dividends	24, 32	**175**	**13,162**	**–**	**–**	**–**	**13,337**
Dividends paid to owners of the Company	32	**–**	**–**	**–**	**–**	**(63,849)**	**(63,849)**
Balance at 31 December 2011		**20,563**	**32,086**	**245,005**	**60,517**	**897,728**	**1,255,899**

The notes on pages 55 to 103 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows
For the year ended 31 December 2011

	Note	2011 £000	2010 £000
Profit before tax		**17,271**	211,366
Adjustments for:			
Interest and equity dividend income		**(50,333)**	(61,606)
Interest expense		**6,698**	10,090
Net fair value gains/(losses) on financial assets		**30,878**	(25,672)
Depreciation and amortisation	14, 15	**8,098**	7,065
Charges in respect of share based payments	9, 24	**8,677**	8,047
Other non-cash movements		**(1,070)**	1,323
Effect of exchange rate fluctuations on cash presented separately		**(1,451)**	(508)
Changes in operational assets and liabilities:			
Insurance and reinsurance contracts		**138,667**	141,646
Financial assets carried at fair value		**78,501**	(2,527)
Financial liabilities carried at fair value		**(457)**	82
Other assets and liabilities		**(18,888)**	(23,704)
Cash flows from operations		**216,591**	265,602
Interest received		**50,244**	60,332
Equity dividends received		**1,531**	1,274
Interest paid		**(6,163)**	(4,628)
Current tax paid		**(4,003)**	(51,580)
Net cash flows from operating activities		**258,200**	271,000
Cash flows from the acquisition of subsidiaries	33	**–**	(3,662)
Cash flows from the sale and purchase of associates	16	**729**	468
Cash flows from the purchase of property, plant and equipment		**(2,561)**	(3,462)
Cash flows from the purchase of intangible assets		**(9,992)**	(15,591)
Net cash flows from investing activities		**(11,824)**	(22,247)
Proceeds from the issue of ordinary shares	24	**3,215**	4,108
Dividends paid to owners of the Company	32	**(50,512)**	(58,460)
Net (repayments)/receipts of borrowings		**(20,000)**	(118,539)
Net cash flows from financing activities		**(67,297)**	(172,891)
Net increase in cash and cash equivalents		**179,079**	75,862
Cash and cash equivalents at 1 January		**336,017**	259,647
Net increase in cash and cash equivalents		**179,079**	75,862
Effect of exchange rate fluctuations on cash and cash equivalents		**1,451**	508
Cash and cash equivalents at 31 December	23	**516,547**	336,017

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 £77,203,000 (2010: £63,447,000) not available for immediate use by the Group outside of the Lloyd's syndicate within which they are held.

The notes on pages 55 to 103 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 1,250 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 38 in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The consolidated financial statements for the year ended 31 December 2011 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 27 February 2012.

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 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.

In February 2012, the IASB extended its timeline for either re-exposing or issuing a staff draft on the insurance contracts project to the second half of 2012. The ultimate timeline for a final standard will depend on whether the IASB issues a new exposure draft before issuing a standard. While the IASB has not indicated an effective date for a final standard, 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.

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 has financial assets and cash of over £2.87 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 18 to 19. 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

2 Significant accounting policies continued
2.2 Basis of preparation continued

and Interpretations issued by the IASB and endorsed by the EU as of 1 January 2011.

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.

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.

Early adoption of SI 2008/489, disclosure requirements for auditors remuneration, has occurred. The amendments are intended to align the classification of non-audit services for the purposes of disclosure in the financial statements with the classification of non-audit services under the UK Auditing Practice Board's Ethical Standards. The disclosure for 2010 has been restated to conform to the current year presentation.

Adoption of the above had no material effect on the financial performance or position of the Group.

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2011, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements except for IFRS 9 and IAS 19.

Defined Benefit Plans – Amendments to IAS 19 is due to be in effect from 1 January 2013. The amendments require immediate recognition of actuarial gains and losses in other comprehensive income and to eliminate the corridor method that the Group currently operates. The principal amendment is the requirement to calculate net interest income or expense using the discount rate used to measure the defined benefit asset or liability.

IFRS 9 Financial Instruments is due to be effective from 1 January 2015. The standard contains two primary measurement categories for financial assets of amortised cost and fair value. Financial assets are classified in to one of these two categories on initial recognition. A financial asset is measured at amortised cost if the following conditions are met: it is held where the objective is to hold the asset in order to collect contractual cash flows; and, its contractual terms give rise on specified dates to cash flows that are solely payment of principal and interest on the principal outstanding. All other financial assets are to be classified at fair value.

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 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.

2 Significant accounting policies continued
2.3 Basis of consolidation continued
(c) Transactions eliminated on consolidation *continued*

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 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 assumed 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.

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.

Notes to the consolidated financial statements continued

2 Significant accounting policies continued
2.6 Intangible assets continued

(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;
- 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 Significant accounting policies continued

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 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

2 Significant accounting policies continued
2.13 Insurance contracts continued
(g) Salvage and subrogation reimbursements *continued*

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 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 (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

2 Significant accounting policies continued
2.15 Employee benefits continued
(d) Termination benefits *continued*

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 are measured at amortised cost at each balance sheet date 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.

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 2011 is £964 million (2010: £904 million) and is included within total insurance liabilities on the balance sheet.

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 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

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

estimate taxation assets and liabilities after taking appropriate professional advice. To the extent that taxable losses carried forward by the Group exceed taxable temporary differences relating to the same taxation authority and taxable entity which will result in amounts against which the losses can be utilised, the Group uses estimates of probable future taxable profits available to determine whether recognition of a deferred tax asset is appropriate. 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 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 modeling 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

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

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 unmodeled risks. This means that should a realistic disaster actually eventuate, the Group's final ultimate losses could materially differ from those estimates modeled by management. The Group's estimated exposure to certain industry events is summarised below. These estimates have been made using modeled 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	230	122	11.9	6.3	0.2	50	240
Gulf of Mexico windstorm	759	185	39.2	9.6	0.2	107	80
Florida windstorm	477	110	24.7	5.7	0.1	125	100
European windstorm	456	208	23.6	10.8	0.7	30	200
San Francisco earthquake	519	139	26.8	7.2	0.3	50	110

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

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

Estimated concentration of gross and net insurance liabilities on balance sheet by territory coverage of premium written 31 December 2011

		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	16,985	16,339	136,379	319,209	12,548	30,079	531,539
	Net	13,575	4,366	134,889	280,220	7,683	19,251	459,984
Europe	Gross	14,383	4,893	68,600	98,754	12,547	39,627	238,804
	Net	11,843	4,618	62,324	93,435	10,168	33,591	215,979
United States	Gross	246,957	53,306	81,804	237,744	46,446	26,260	692,517
	Net	171,255	23,107	33,393	220,686	39,423	20,453	508,317
Other territories	Gross	122,281	37,026	19,877	27,574	3,579	63,769	274,106
	Net	91,606	32,901	12,764	24,278	3,095	44,314	208,958
Multiple territory coverage	Gross	370,228	172,933	61,808	3,435	88,278	66,612	763,294
	Net	307,442	128,813	31,625	3,358	86,776	56,493	614,507
Total	**Gross**	**770,834**	**284,497**	**368,468**	**686,716**	**163,398**	**226,347**	**2,500,260**
	Net	**595,721**	**193,805**	**274,995**	**621,977**	**147,145**	**174,102**	**2,007,745**

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

*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 2011, 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. The Group has no direct exposure to sovereign debt in Portugal, Ireland, Italy, Greece or Spain. Note 3.2d shows the Group's positions at 31 December 2011 for government issued, government supported and bank debt exposures. The Group did not experience any material defaults on debt securities during the year.

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 2011 was £173 million (2010: £155 million). These may be analysed as follows:

Nature of equity and unit trust holdings	**2011 % weighting**	2010 % weighting
Directly held equity securities	**3**	2
Units held in funds – traditional long only	**73**	69
Units held in funds – long and short and special strategies	**24**	29
Geographic focus		
Specific UK mandates	**39**	44
Global mandates	**61**	56

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 2011 would have been expected to reduce Group equity and profit after tax for the year by approximately £15.0 million (2010: £13.1 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 rise, the fair value of the Group's debt and fixed income investments would tend to fall 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.

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

The fair value of debt and fixed income assets in the Group's balance sheet at 31 December 2011 was £2,171 million (2010: £2,285 million). These may be analysed as follows:

Nature of debt and fixed income holdings	2011 % weighting	2010 % weighting
Government issued bonds and instruments	**23**	22
Agency and government supported debt	**25**	31
Asset backed securities	**11**	8
Mortgage backed instruments – agency	**6**	4
Mortgage backed instruments – non-agency	**5**	6
Corporate bonds	**27**	27
Lloyd's and money market deposits	**3**	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 £38 million (2010: decrease of £28 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 modeling 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 2011, no amounts were outstanding on the Group's borrowing facility (2010: £20 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.

Notes to the consolidated financial statements
continued

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 highly liquid instruments, including a particular emphasis on government bonds issued mainly by North American countries and the European Union, excluding those from Portugal, Greece, Ireland, Italy and Spain.

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 2011	Note	AAA £000	AA £000	A £000	Other/ non-rated £000	Total £000
Debt and fixed income securities	19	**767,709**	**808,076**	**400,257**	**194,546**	**2,170,588**
Deposits with credit institutions	19	**2,500**	**–**	**10,088**	**260**	**12,848**
Catastrophe bonds		**–**	**–**	**–**	**11,639**	**11,639**
Reinsurance assets	18	**27,682**	**181,862**	**262,709**	**20,262**	**492,515**
Cash and cash equivalents	23	**157,395**	**41,094**	**316,843**	**1,215**	**516,547**
Total		**955,286**	**1,031,032**	**989,897**	**227,922**	**3,204,137**
Amounts attributable to largest single counterparty		**211,465**	**267,442**	**54,235**	**13,216**	

As at 31 December 2010	Note	AAA £000	AA £000	A £000	Other/ non-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	

The largest counterparty exposure within AAA rating at 31 December 2011 is with the UK Treasury, and for AA rating is with the US Treasury. During the year, the US Treasury was downgraded from AAA to AA, which led to the significant shift from AAA to AA assets in the above table. At 31 December 2010, the largest counterparty exposure within AAA rating was the US Treasury. Catastrophe bonds included within 'other/not rated' are rated BB and B. A significant proportion of 'other/not rated' reinsurance assets at 31 December 2011 and 31 December 2010 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 2011 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 (2010: £nil). For the current period and prior period, the Group did not experience any material defaults on debt securities.

Within the fixed income portfolios, which include debt securities, deposits with credit institutions and cash equivalent assets, there are exposures to a range of government borrowers, on either a direct or guaranteed basis, and banking institutions. The Group, together with its investment managers, closely manages its geographical exposures across government issued and supported debt.

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

The positions at 31 December 2011 in respect of government issued and supported debt are shown in the table below. The Group has no direct government exposure to Portugal, Italy, Ireland, Greece or Spain.

	Government issued £000	Government supported £000	Total £000
United States of America	302,605	269,048	571,653
United Kingdom	208,235	81,699	289,934
Australia	–	13,975	13,975
Belgium	–	1,537	1,537
Canada	–	58,380	58,380
Denmark	–	5,158	5,158
Finland	6,380	3,985	10,365
France	4,015	16,533	20,548
Germany	92,414	36,205	128,619
Netherlands	–	24,539	24,539
Norway	–	6,035	6,035
New Zealand	–	584	584
Supranationals	–	30,135	30,135
South Korea	2,833	–	2,833
Sweden	2,307	3,494	5,801
Other	338	141	479
Total	619,127	551,448	1,170,575

Included above are £1,049m in relation to holdings in debt securities and £122m held as cash equivalents, having a maturity of less than three months at the time of purchase. Of the amount held as cash equivalents, £88m is held in UK Treasury bills and £26m is held in a UK Government bond.

Additionally, the geographical location and credit quality of individual bank borrowers are closely monitored. An analysis of the Group's exposure to bank counterparties by country and credit rating is detailed below as at 31 December 2011. Bank debt held by the Group is mostly senior unsecured and covered bonds. The subordinated bonds are all classed as lower tier 2 capital.

	Senior						Subordinated			
	AAA £000	AA £000	A £000	BBB £000	B £000	Sub-total £000	A £000	BBB £000	Sub-total £000	Sub-total £000
United States of America	–	–	73,615	2,723	–	76,338	–	1,372	1,372	77,710
United Kingdom	319	8,505	23,912	–	–	32,736	3,327	1,148	4,475	37,211
Australia	–	7,314	295	–	–	7,609	–	–	–	7,609
Belgium	–	–	3,429	–	–	3,429	–	–	–	3,429
Canada	1,241	12,240	7,840	604	–	21,925	2,884	–	2,884	24,809
Denmark	–	–	1,544	–	–	1,544	–	–	–	1,544
Finland	–	1,518	–	–	–	1,518	–	–	–	1,518
France	3,889	4,750	7,573	–	–	16,212	712	–	712	16,924
Germany	–	–	3,720	–	–	3,720	–	–	–	3,720
Italy	–	–	–	4,294	–	4,294	–	319	319	4,613
Netherlands	2,329	7,348	6,415	–	–	16,092	691	–	691	16,783
Norway	130	–	378	–	1,431	1,939	–	–	–	1,939
New Zealand	–	2,768	–	–	–	2,768	–	–	–	2,768
Spain	928	–	1,920	–	–	2,848	–	–	–	2,848
Sweden	–	6,359	4,733	–	–	11,092	–	–	–	11,092
Switzerland	–	–	11,597	–	–	11,597	–	–	–	11,597
Other	–	–	594	429	–	1,023	–	–	–	1,023
Total	8,836	50,802	147,565	8,050	1,431	216,684	7,614	2,839	10,453	227,137

Included in the bank debt table above, are £222m in relation to holdings in debt securities and £5m held as cash equivalents.

Notes to the consolidated financial statements
continued

3 Management of risk continued
3.2 Financial risk continued

(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.

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	**2011 Total £000**	2010 Total £000
Less than one year	560,520	2,760	2,373	516,547	**1,082,200**	825,186
Between one and two years	473,904	10,088	3,686	–	**487,678**	816,842
Between two and five years	816,665	–	5,580	–	**822,245**	654,638
Over five years	265,897	–	–	–	**265,897**	290,083
Sub-total	2,116,986	12,848	11,639	516,547	**2,658,020**	2,586,749
Other non-dated instruments	53,602	–	–	–	**53,602**	53,513
Total	2,170,588	12,848	11,639	516,547	**2,711,622**	2,640,262

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.

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.

Average contractual maturity analysed by denominational currency of investments	**2011 Years**	2010 Years
Pound Sterling	**2.26**	1.89
US Dollar	**5.64**	4.83
Euro	**1.45**	3.82
Canadian Dollar	**4.01**	2.24

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

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	**2011 Total £000**
Reinsurance inwards	**230,546**	**110,980**	**73,170**	**37,288**	**451,984**
Property – marine and major assets	**80,386**	**38,146**	**32,185**	**5,040**	**155,757**
Property – other assets	**98,334**	**25,568**	**16,954**	**819**	**141,675**
Casualty – professional indemnity	**150,017**	**124,183**	**230,161**	**17,353**	**521,714**
Casualty – other risks	**60,093**	**32,768**	**37,042**	**5,350**	**135,253**
Other*	**51,250**	**13,536**	**14,241**	**4,333**	**83,360**
Total	**670,626**	**345,181**	**403,753**	**70,183**	**1,489,743**

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

*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.

(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 £169 million (2010: £142 million) which are denominated in foreign currencies.

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

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 are provided in note 12.

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

As at 31 December 2011	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Intangible assets	61,244	6,308	–	–	67,552
Property, plant and equipment	9,623	7,692	840	–	18,155
Investments in associates	5,726	66	588	–	6,380
Deferred tax	–	23,555	2,193	–	25,748
Deferred acquisition costs	51,693	70,969	23,183	4,205	150,050
Financial assets carried at fair value	511,306	1,601,720	215,795	39,815	2,368,636
Reinsurance assets	69,576	373,469	38,502	10,968	492,515
Loans and receivables including insurance receivables	145,876	226,133	125,488	10,225	507,722
Current tax asset	62,654	3,385	3,397	–	69,436
Cash and cash equivalents	235,090	117,577	91,922	71,958	516,547
Total assets	1,152,788	2,430,874	501,908	137,171	4,222,741

	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Employee retirement benefit obligations	–	–	–	–	–
Deferred tax	152,447	–	–	–	152,447
Insurance liabilities	617,082	1,458,367	294,780	130,031	2,500,260
Financial liabilities	–	–	–	–	–
Trade and other payables	93,544	156,673	53,802	10,116	314,135
Total liabilities	863,073	1,615,040	348,582	140,147	2,966,842

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

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

	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

Sensitivity analysis
As at 31 December 2011, the Group used closing rates of exchange of £1:€1.19 and £1:$1.54 (2010: £1:€1.17 and £1:$1.57). 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 2011	Effect on equity after tax £m	Effect on profit before tax £m
Strengthening of US Dollar	**93.2**	**25.5**
Weakening of US Dollar	**(73.4)**	**(18.0)**
Strengthening of Euro	**14.5**	**19.8**
Weakening of Euro	**(11.9)**	**(16.2)**

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 modeling 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 ended 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 2011 US$340 million was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and there were no cash drawings (2010: $165 million and £20 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 a capacity of £37 million for the 2011 year of account (2010 year of account: £45 million). This Syndicate is wholly backed by external members and takes pure years 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 2011 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 all relate directly to ROE, this concept is embedded in the workings and culture

3 Management of risk continued
3.3 Capital risk management continued

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 modeling 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 modeling 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 and Syndicate 3624, 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 modeling, have produced a capital ratio below that suggested under the previous risk-based capital regime. Another key area of capital modeling 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 modeling 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 modeling 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.

During 2011, the Bermuda Monetary Authority (BMA) introduced a group solvency capital requirement. A dry-run of the impact of these new requirements was conducted by the BMA, over groups which they have regulatory oversight. The Hiscox Group participated in this assessment and found that the capital requirements fairly reflected the risks contained within the Group. The capital requirements necessary to maintain a financial strength of an A rating will continue to be the main determinate of capital strategy for the Group.

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, and the larger TMT business written by Hiscox Insurance Company Limited. In addition, it excludes 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.
- **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 2011					Year to 31 December 2010				
	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	585,441	498,006	365,772	–	1,449,219	572,748	454,692	405,234	–	1,432,674
Net premiums written	413,390	472,608	288,013	–	1,174,011	389,581	428,032	314,014	–	1,131,627
Net premiums earned	418,764	448,594	277,649	–	1,145,007	396,096	422,180	312,882	–	1,131,158
Investment result*	8,782	7,248	6,313	2,152	24,495	39,068	17,244	27,624	16,313	100,249
Other revenues	9,858	3,938	3,311	215	17,322	12,054	3,671	5,836	518	22,079
Revenue	437,404	459,780	287,273	2,367	1,186,824	447,218	443,095	346,342	16,831	1,253,486
Claims and claim adjustment expenses, net of reinsurance	(238,026)	(207,018)	(252,854)	–	(697,898)	(195,570)	(213,001)	(162,426)	–	(570,997)
Expenses for the acquisition of insurance contracts	(99,257)	(106,300)	(64,235)	–	(269,792)	(92,832)	(99,069)	(77,990)	–	(269,891)
Operational expenses	(39,685)	(94,985)	(56,229)	(12,305)	(203,204)	(44,733)	(89,440)	(59,419)	(12,811)	(206,403)
Foreign exchange gains/(losses)	(1,507)	(25)	(3,097)	12,445	7,816	11,669	(1,972)	(2,610)	8,397	15,484
Total expenses	(378,475)	(408,328)	(376,415)	140	(1,163,078)	(321,466)	(403,482)	(302,445)	(4,414)	(1,031,807)
Results of operating activities	58,929	51,452	(89,142)	2,507	23,746	125,752	39,613	43,897	12,417	221,679
Finance costs	(1,308)	–	(399)	(4,991)	(6,698)	(4,392)	(9)	(433)	(5,256)	(10,090)
Share of (loss)/profit of associates after tax	–	–	65	158	223	–	–	(323)	100	(223)
Profit before tax	57,621	51,452	(89,476)	(2,326)	17,271	121,360	39,604	43,141	7,261	211,366

*Interest revenues included total £48,802,000 (2010: £60,332,000).

The following charges are included within the consolidated income statement:

	Year to 31 December 2011					Year to 31 December 2010				
	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	1,325	1,488	1,226	106	4,145	455	2,155	1,932	63	4,605
Amortisation of intangible assets	1,198	1,250	1,499	6	3,953	1,212	845	403	–	2,460

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.

100% ratio analysis	London Market (2011)	UK and Europe (2011)	International (2011)	Corporate Centre (2011)	Total (2011)	London Market (2010)	UK and Europe (2010)	International (2010)	Corporate Centre (2010)	Total (2010)
					Year to 31 December 2011					Year to 31 December 2010
Claims ratio (%)	**56.6**	**46.3**	**89.9**	**–**	**60.2**	48.3	50.2	53.2	–	50.1
Expense ratio (%)	**32.5**	**44.7**	**42.9**	**–**	**39.1**	33.5	44.6	43.2	–	39.7
Combined ratio excluding foreign exchange impact (%)	**89.1**	**91.0**	**132.8**	**–**	**99.3**	81.8	94.8	96.4	–	89.8
Foreign exchange impact (%)	**–**	**–**	**1.1**	**–**	**0.2**	(2.1)	0.5	0.9	–	(0.5)
Combined ratio (%)	**89.1**	**91.0**	**133.9**	**–**	**99.5**	79.7	95.3	97.3	–	89.3
Combined ratio excluding non-monetary foreign exchange impact (%)	**90.0**	**90.9**	**133.9**	**–**	**99.9**	79.7	95.3	97.3	–	89.3

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:

	London Market £000 (2011)	UK and Europe £000 (2011)	International £000 (2011)	Corporate Centre £000 (2011)	London Market £000 (2010)	UK and Europe £000 (2010)	International £000 (2010)	Corporate Centre £000 (2010)
				Year to 31 December 2011				Year to 31 December 2010
At 100% level (note 4b) 1% change in claims or expense ratio	**5,555**	**4,637**	**2,831**	**–**	5,459	4,388	3,223	–
At Group level 1% change in claims or expense ratio	**4,188**	**4,486**	**2,776**	**–**	3,961	4,222	3,129	–

(b) 100% operating result by segment

	London Market £000 (2011)	UK and Europe £000 (2011)	International £000 (2011)	Corporate Centre £000 (2011)	Total £000 (2011)	London Market £000 (2010)	UK and Europe £000 (2010)	International £000 (2010)	Corporate Centre £000 (2010)	Total £000 (2010)
					Year to 31 December 2011					Year to 31 December 2010
Gross premiums written	**779,261**	**514,075**	**370,168**	**–**	**1,663,504**	782,523	472,247	416,103	–	1,670,873
Net premiums written	**543,696**	**487,609**	**292,640**	**–**	**1,323,945**	524,658	443,693	321,236	–	1,289,587
Net premiums earned	**555,533**	**463,706**	**283,138**	**–**	**1,302,377**	545,945	438,773	322,341	–	1,307,059
Investment result	**12,024**	**7,399**	**6,503**	**2,152**	**28,078**	53,870	17,848	28,572	16,313	116,603
Other revenues	**1,553**	**3,380**	**1,990**	**215**	**7,138**	–	3,029	4,393	518	7,940
Claims and claim adjustment expenses, net of reinsurance	**(314,517)**	**(214,609)**	**(254,627)**	**–**	**(783,753)**	(263,610)	(220,101)	(171,347)	–	(655,058)
Expenses for the acquisition of insurance contracts	**(130,593)**	**(111,624)**	**(65,127)**	**–**	**(307,344)**	(127,202)	(105,394)	(78,611)	–	(311,207)
Operational expenses	**(50,182)**	**(95,946)**	**(56,245)**	**(12,305)**	**(214,678)**	(55,873)	(90,489)	(60,755)	(12,811)	(219,928)
Foreign exchange gains/(losses)	**72**	**90**	**(3,103)**	**12,445**	**9,504**	11,272	(1,983)	(2,892)	8,397	14,794
Results of operating activities	**73,890**	**52,396**	**(87,471)**	**2,507**	**41,322**	164,402	41,683	41,701	12,417	260,203

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 2011	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Intragroup items and eliminations £000	Total £000
Intangible assets	**36,758**	**5,389**	**15,257**	**10,148**	**–**	**67,552**
Deferred acquisition costs	**44,868**	**46,903**	**56,072**	**–**	**2,207**	**150,050**
Financial assets	**896,702**	**333,553**	**869,891**	**51,661**	**223,209**	**2,375,016**
Reinsurance assets	**808,304**	**219,167**	**112,914**	**–**	**(647,870)**	**492,515**
Other assets	**472,942**	**353,634**	**407,817**	**1,029,800**	**(1,126,585)**	**1,137,608**
Total assets	**2,259,574**	**958,646**	**1,461,951**	**1,091,609**	**(1,549,039)**	**4,222,741**
Insurance liabilities	**1,299,104**	**550,201**	**782,405**	**–**	**(131,450)**	**2,500,260**
Other liabilities	**863,907**	**257,816**	**73,180**	**119,381**	**(847,702)**	**466,582**
Total liabilities	**2,163,011**	**808,017**	**855,585**	**119,381**	**(979,152)**	**2,966,842**
Capital expenditure	**1,532**	**4,527**	**3,605**	**392**	**–**	**10,056**

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	–	15,997

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.

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

Gross premium revenues earned from external parties	Year to 31 December 2011					Year to 31 December 2010				
	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	**24,360**	**274,108**	**11,925**	**–**	**310,393**	28,534	285,350	27,360	–	341,244
Europe	**27,829**	**145,270**	**27,677**	**–**	**200,776**	27,459	127,639	35,658	–	190,756
United States	**306,114**	**22,127**	**194,116**	**–**	**522,357**	361,192	8,557	219,210	–	588,959
Rest of World	**235,273**	**32,807**	**127,348**	**–**	**395,428**	176,527	28,757	108,875	–	314,159
	593,576	**474,312**	**361,066**	**–**	**1,428,954**	593,712	450,303	391,103	–	1,435,118

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

	2011		2010	
	Net asset value (total equity) £000	Net asset value per share pence	Net asset value (total equity) £000	Net asset value per share pence
Net asset value	**1,255,899**	**323.5**	1,266,114	332.7
Net tangible asset value	**1,188,347**	**306.1**	1,202,006	315.8

The net asset value per share is based on 388,233,074 shares (2010: 380,613,336 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

	2011 £000	2010 £000
Profit for the year (all attributable to owners of the Company)	**21,272**	178,800
Opening shareholders' equity	**1,266,114**	1,121,286
Adjusted for the time weighted impact of capital distributions and issuance of shares	**(14,025)**	(34,820)
Adjusted opening shareholders' equity	**1,252,089**	1,086,466
Annualised return on equity (%)	**1.7**	16.5

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

	Note	2011 £000	2010 £000
Investment income including interest receivable		**50,333**	61,606
Net realised gains on financial investments at fair value through profit or loss		**5,040**	12,971
Net fair value (losses)/gains on financial investments at fair value through profit or loss		**(29,431)**	24,272
Investment result – financial assets	8	**25,942**	98,849
Fair value (losses)/gains on derivative financial instruments	21	**(1,447)**	1,400
Total result		**24,495**	100,249

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:

	2011 %	2010 %
Sterling	**1.0**	3.6
US Dollar	**0.6**	3.8
Other	**1.6**	2.3

(b) Investment return

	London Market		UK and Europe		International		Corporate Centre		2011 Total	
	£000	%	£000	%	£000	%	£000	%	£000	%
Debt and fixed income securities	9,477	1.1	7,642	1.8	10,846	1.6	1,968	0.9	29,933	1.3
Equities and shares in unit trusts	–	–	(1,168)	(2.4)	(4,392)	(9.3)	(375)	(0.9)	(5,935)	(3.8)
Deposits with credit institutions/ cash and cash equivalents	225	0.4	725	1.0	868	0.4	126	0.2	1,944	0.4
	9,702	1.1	7,199	1.3	7,322	0.8	1,719	0.5	25,942	0.9

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

	London Market		UK and Europe		International		Corporate Centre		2010 Total	
	£000	%	£000	%	£000	%	£000	%	£000	%
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

9 Other revenues and operational expenses

	2011 £000	2010 £000
Agency related income	**6,769**	6,816
Profit commission	**7,383**	10,616
Other underwriting income – catastrophe bonds	**1,006**	1,280
Other income	**2,164**	3,367
Other revenues	**17,322**	22,079
Wages and salaries	**69,185**	80,359
Social security cost	**12,930**	13,689
Pension cost – defined contribution	**5,724**	5,209
Pension cost – defined benefit	**1,700**	1,700
Share based payments	**8,677**	8,047
Other expenses	**73,575**	74,668
Marketing expenses	**19,955**	11,863
Investment expenses	**3,360**	3,803
Depreciation and amortisation	**8,098**	7,065
Operational expenses	**203,204**	206,403

10 Finance costs

	Note	2011 £000	2010 £000
Interest and expenses associated with bank borrowings		**1,960**	3,117
Interest and charges associated with Letters of Credit	35	**3,933**	3,216
Interest charges on experience account		**804**	3,748
Interest charges arising on finance leases	36	**1**	9
		6,698	10,090

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	2011 £000	Restated 2010 £000
Amounts receivable by the auditor and associates in respect of:		
1. The auditing of accounts of any associate of the Group	**908**	848
2. Audit-related assurance services	**77**	74
3. Taxation compliance services	**8**	3
4. All taxation advisory services not falling within part 3	**–**	–
5. Internal audit services	**–**	–
6. All assurance services not falling within parts 1 to 5	**55**	–
7. All services relating to corporate finance transactions entered into, or proposed to be entered into, by or on behalf of the Group or any of its associates not falling within parts 1 to 6	**–**	–
8. All non-audit services not falling in parts 2 to 7*	**–**	10
Total auditors' remuneration expense	**1,048**	935

*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 for the year include the following amounts:

	2011 £000	2010 £000
Exchange gains recognised in the consolidated income statement	**7,816**	15,484
Exchange gains classified as a separate component of equity	**11,060**	11,729
Overall impact of foreign exchange related items on net assets	**18,876**	27,213

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.

	2011 £000	2010 £000
Opening balance sheet impact of non retranslation of non-monetary items	**(1,251)**	(3,207)
Gain included within profit representing the non retranslation of non-monetary items	**3,395**	1,956
Closing balance sheet impact of non retranslation of non-monetary items	**2,144**	(1,251)

13 Foreign currency items on economic hedges and intragroup borrowings

The Group has loan arrangements, denominated in US Dollars and Euros, in place between certain Group companies. In most cases, as one party to each arrangement has a functional currency other than the US Dollar or the Euro, 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 2011	**Consolidated income statement 2011 £000**	**Consolidated other comprehensive income 2011 £000**	**Total impact on equity 2011 £000**
Unrealised translation (losses)/gains on intragroup borrowings	**(4,540)**	**4,540**	**–**
Total (losses)/gains recognised	**(4,540)**	**4,540**	**–**

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)	–

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

14 Intangible assets

	Goodwill £000	Syndicate capacity £000	State authorisation licences £000	Software and development costs £000	Other £000	Total £000
At 1 January 2010						
Cost	10,405	24,505	6,308	8,029	5,337	54,584
Accumulated amortisation and impairment	(2,430)	–	–	(661)	(1,080)	(4,171)
Net book amount	7,975	24,505	6,308	7,368	4,257	50,413
Year ended 31 December 2010						
Opening net book amount	7,975	24,505	6,308	7,368	4,257	50,413
Other additions	–	–	–	11,510	4,645	16,155
Amortisation charges	–	–	–	(2,196)	(264)	(2,460)
Closing net book amount	7,975	24,505	6,308	16,682	8,638	64,108
At 31 December 2010						
Cost	10,405	24,505	6,308	19,539	9,982	70,739
Accumulated amortisation and impairment	(2,430)	–	–	(2,857)	(1,344)	(6,631)
Net book amount	7,975	24,505	6,308	16,682	8,638	64,108
Year ended 31 December 2011						
Opening net book amount	**7,975**	**24,505**	**6,308**	**16,682**	**8,638**	**64,108**
Other additions	**–**	**–**	**–**	**7,397**	**–**	**7,397**
Amortisation charges	**–**	**–**	**–**	**(3,634)**	**(319)**	**(3,953)**
Closing net book amount	**7,975**	**24,505**	**6,308**	**20,445**	**8,319**	**67,552**
At 31 December 2011						
Cost	**10,405**	**24,505**	**6,308**	**26,936**	**9,982**	**78,136**
Accumulated amortisation and impairment	**(2,430)**	**–**	**–**	**(6,491)**	**(1,663)**	**(10,584)**
Net book amount	**7,975**	**24,505**	**6,308**	**20,445**	**8,319**	**67,552**

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 4.8% (2010: 2.5%) 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 2011 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. The results of that testing show that no impairment is due.

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. The results of this testing show that no impairment is due.

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. No impairment is due as at 31 December 2011.

The amortisation charge for the year includes £3,634,000 (2010: £2,196,000) 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 2011 was £20,446,000 (2010: £16,684,000). There are no charges for impairment during the current or prior financial year.

At 31 December 2011 there were £8,873,000 of assets under development on which no amortisation has been charged (2010: £4,817,000).

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 2010					
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
Year ended 31 December 2011					
Opening net book amount	**5,764**	**2,176**	**108**	**11,694**	**19,742**
Additions	**–**	**584**	**–**	**2,075**	**2,659**
Disposals	**–**	**(21)**	**(58)**	**(186)**	**(265)**
Depreciation charge	**(82)**	**(292)**	**–**	**(3,771)**	**(4,145)**
Foreign exchange movements	**60**	**40**	**–**	**64**	**164**
Closing net book amount	**5,742**	**2,487**	**50**	**9,876**	**18,155**
At 31 December 2011					
Cost	**6,164**	**3,765**	**142**	**45,560**	**55,631**
Accumulated depreciation	**(422)**	**(1,278)**	**(92)**	**(35,684)**	**(37,476)**
Net book amount	**5,742**	**2,487**	**50**	**9,876**	**18,155**

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

Assets with a net book value of £nil were held under finance leases (2010: £99,000). The total depreciation charge for the year in respect of assets held under finance leases was £4,000 (2010: £24,000) and is included in other expenses.

At 31 December 2011 there were no assets under development upon which no depreciation has yet been charged (2010: £nil).

16 Investments in associates

	2011 £000	2010 £000
Year ended 31 December		
At beginning of year	**6,886**	7,318
Additions during the year	**–**	318
Disposals during the year	**(729)**	(527)
Share of post-tax profit/(loss) recognised for the period	**223**	(223)
At end of year	**6,380**	6,886

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
2011					
Associates incorporated in the UK	**from 25% to 37%**	**5,984**	**3,294**	**5,041**	**198**
Associates incorporated in Europe	**25%**	**900**	**386**	**1,341**	**15**
Associates incorporated in the USA	**25%**	**691**	**645**	**116**	**(894)**
Total at the end of 2011		**7,575**	**4,325**	**6,498**	**(681)**

	% 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)

On 23 March 2011, the Group sold its holding in Plexstar Insurance Services Ltd, resulting in a loss of £33,000. Further consideration is due to be received during 2012, estimated to be £200,000.

During 2010, the Group disposed of its 40% holding in HIM Capital Holdings Ltd recognising a gain of £458,000. Also in December 2010, the Group increased its holding in Blyth Valley Ltd to 100% as referred to in note 33. The company was 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

	2011			2010		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance deferred at 1 January	**142,736**	**(17,048)**	**125,688**	141,505	(17,584)	123,921
Acquisition costs incurred in relation to insurance contracts written	**321,699**	**(43,186)**	**278,513**	318,876	(47,218)	271,658
Acquisition costs expensed to the income statement	**(314,385)**	**44,593**	**(269,792)**	(317,645)	47,754	(269,891)
Balance deferred at 31 December	**150,050**	**(15,641)**	**134,409**	142,736	(17,048)	125,688

The deferred amount of insurance contract acquisition costs attributable to reinsurers of £15,641,000 (2010: £17,048,000) 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:

	2011 £000	2010 £000
Within one year	**126,847**	124,822
After one year	**7,562**	866
	134,409	125,688

18 Reinsurance assets

	Note	2011 £000	2010 £000
Reinsurers' share of insurance liabilities		**493,422**	463,724
Provision for non-recovery and impairment		**(907)**	(959)
Reinsurance assets	26	**492,515**	462,765

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

	2011 £000	2010 £000
Within one year	**265,525**	236,541
After one year	**226,990**	226,224
	492,515	462,765

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 £52,000 (2010: gain of £4,487,000) in respect of previously 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	2011 Fair value £000	2010 Fair value £000
Debt and fixed income securities		**2,170,588**	2,284,513
Equities and shares in unit trusts		**173,432**	154,862
Deposits with credit institutions		**12,848**	4,280
Total investments		**2,356,868**	2,443,655
Catastrophe bonds		**11,639**	15,452
Derivative financial instruments	21	**129**	–
Total financial assets carried at fair value		**2,368,636**	2,459,107

	Note	2011 Fair value £000	2010 Fair value £000
Borrowings from credit institutions carried at amortised cost*		**–**	20,000
Derivative financial instruments	21	**–**	457
Total financial liabilities		**–**	20,457

*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 £11.6 million (2010: £15.5 million), comprising of 16 catastrophe bonds (2010: 13) with credit ratings of BB and B. 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 entire amount of the Group's borrowings from December 2010, all being Pound Sterling, was repaid during the year and there is no amount outstanding at 31 December 2011.

19 Financial assets and liabilities continued

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

	2011 £000	2010 £000
Debt and fixed income securities		
Sterling	**408,328**	514,726
US Dollars	**1,508,234**	1,578,075
Euro and other currencies	**254,026**	191,712
	2,170,588	2,284,513
Equities and shares in unit trusts		
Sterling	**90,303**	80,226
US Dollars	**81,620**	61,565
Euro and other currencies	**1,509**	13,071
	173,432	154,862
Deposits with credit institutions		
Sterling	**12,588**	3,755
US Dollars	**260**	525
Euro and other currencies	**–**	–
	12,848	4,280
Total investments	**2,356,868**	2,443,655

20 Loans and receivables including insurance receivables

	2011 £000	2010 £000
Gross receivables arising from insurance and reinsurance contracts	**429,676**	412,524
Provision for impairment	**(956)**	(1,041)
Net receivables arising from insurance and reinsurance contracts	**428,720**	411,483
Due from contract holders, brokers, agents and intermediaries	**299,879**	298,214
Due from reinsurance operations	**128,841**	113,269
	428,720	411,483
Prepayments and accrued income	**8,387**	7,656
Other loans and receivables:		
Net profit commission receivable	**13,792**	15,276
Accrued interest	**10,149**	11,888
Share of Syndicates other debtors' balances	**19,726**	23,230
Other debtors including related party amounts	**26,948**	15,881
Total loans and receivables including insurance receivables	**507,722**	485,414

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

	2011 £000	2010 £000
Within one year	**499,805**	474,010
After one year	**7,917**	11,404
	507,722	485,414

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 gain of £85,000 (2010: loss of £86,000) for the impairment of receivables during the year ended 31 December 2011.

21 Derivative financial instruments

The Group entered into both exchange-traded and over the counter derivative contracts for a number of purposes during 2011. 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 2011 all mature within one year of the balance sheet date and are detailed below:

31 December 2011 **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	**22,552**	**12,662**	**12,533**	**129**

31 December 2011 **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**
Interest rate futures contracts	**37,156**	**–**	**–**	**–**

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

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 loss on these forward contracts of £84,000 (2010: gain of £1,522,000) as included in note 7. The opposite exchange gain 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 £1,796,000 (2010: £117,000) as included in note 7.

Equity index futures

During the year, the Group purchased a number of equity index futures in order to hedge equity market exposure pending the acquisition of shares in unit trusts. All contracts were exchange traded and the Group made a profit of £433,000 (2010: £nil) as included in note 7.

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 2011	**Level 1 £000**	**Level 2 £000**	**Level 3 £000**	**Total £000**
Financial assets				
Debt and fixed income securities	**500,672**	**1,669,916**	**–**	**2,170,588**
Equities and shares in unit trusts	**–**	**162,806**	**10,626**	**173,432**
Deposits with credit institutions	**12,848**	**–**	**–**	**12,848**
Catastrophe bonds	**–**	**11,639**	**–**	**11,639**
Derivative instrument assets	**–**	**129**	**–**	**129**
Total	**513,520**	**1,844,490**	**10,626**	**2,368,636**

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

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.

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 2011	**Equities and shares in unit trusts £000**	**Deposits with credit institutions £000**	**Derivative financial instruments £000**	**Total £000**
Balance at 1 January	**6,926**	**–**	**–**	**6,926**
Total gains or losses through profit or loss*	**1,242**	**–**	**–**	**1,242**
Purchases	**3,002**	**–**	**–**	**3,002**
Settlements	**(544)**	**–**	**–**	**(544)**
Closing balance	**10,626**	**–**	**–**	**10,626**

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

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
Settlements	–	–	–	–
Closing balance	6,926	–	–	6,926

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

23 Cash and cash equivalents

	2011 £000	2010 £000
Cash at bank and in hand	**258,927**	260,710
Short-term bank deposits	**257,620**	75,307
	516,547	336,017

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

24 Share capital

Group	31 December 2011 Share capital £000	31 December 2011 Number of shares	31 December 2010 Share capital £000	31 December 2010 Number of shares
Issued share capital	**20,563**	**411,256,520**	20,297	405,943,169

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	Note	Ordinary share capital £000	Share premium £000	Contributed surplus £000
At 1 January 2010		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
Employee share option scheme – proceeds from shares issued		91	3,124	–
Scrip dividends		175	13,162	–
Dividends to owners of the Company	32	–	–	–
At 31 December 2011		**20,563**	**32,086**	**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) 2011	Number of 5p ordinary shares in issue (thousands) 2010
At 1 January	**405,943**	403,149
Employee share option scheme – ordinary shares issued	**1,811**	2,794
Scrip dividends	**3,503**	–
At 31 December	**411,257**	405,943

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 £8,677,000 (2010: £8,047,000). This comprises charges of £8,361,000 (2010: £7,619,000) in respect of performance share plan awards and £316,000 (2010: £428,000) 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	2011	2010
Annual risk free rates of return and discount rates (%)	**0.9-1.9**	1.8-2.0
Long-term dividend yield (%)	**4.24-4.59**	3.9-4.14
Expected life of options (years)	**3.25**	3.25
Implied volatility of share price (%)	**29**	29-30
Weighted average share price (p)	**397.0**	340.4

The weighted average fair value of each share option granted during the year was 89.9p (2010: 81.5p). The weighted average fair value of each performance share plan award granted during the year was 397.0p (2010: 340.4p).

Movements in the number of share options during the year and details of the balances outstanding at 31 December 2011 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

	2011 £000	2010 £000
Currency translation reserve at 31 December	**60,517**	49,457
Retained earnings at 31 December	**897,728**	935,555

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 2011 Hiscox Ltd held 22,836,487 shares in treasury (2010: 25,142,874). 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	2011 £000	2010 £000
Gross			
Claims reported and claim adjustment expenses		**938,498**	802,254
Claims incurred but not reported		**964,073**	904,150
Unearned premiums		**597,689**	573,463
Total insurance liabilities, gross		**2,500,260**	2,279,867
Recoverable from reinsurers			
Claims reported and claim adjustment expenses		**187,973**	131,697
Claims incurred but not reported		**224,855**	242,496
Unearned premiums		**79,687**	88,572
Total reinsurers' share of insurance liabilities	18	**492,515**	462,765
Net			
Claims reported and claim adjustment expenses		**750,525**	670,557
Claims incurred but not reported		**739,218**	661,654
Unearned premiums		**518,002**	484,891
Total insurance liabilities, net		**2,007,745**	1,817,102

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

	2011	2010
Within one year	**1,160,744**	1,008,399
After one year	**847,001**	808,703
	2,007,745	1,817,102

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 2011 and 2010 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 nine 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	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	**2011 £000**	**Total £000**
Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year	413,184	466,817	703,352	1,181,038	607,845	814,411	1,138,242	865,308	1,040,776	**1,342,851**	**8,573,824**
one year later	437,595	479,567	780,406	1,307,247	580,772	730,346	968,161	723,236	893,734	**–**	**6,901,064**
two years later	445,766	450,905	744,857	1,309,989	559,679	693,912	945,948	665,513	–	**–**	**5,816,569**
three years later	429,751	464,336	704,672	1,291,432	528,667	706,535	906,391	–	–	**–**	**5,031,784**
four years later	425,705	459,437	707,894	1,285,490	538,593	700,267	–	–	–	**–**	**4,117,386**
five years later	399,825	448,549	689,366	1,286,662	528,182	–	–	–	–	**–**	**3,352,584**
six years later	395,574	443,914	693,070	1,241,435	–	–	–	–	–	**–**	**2,773,993**
seven years later	397,049	433,538	674,175	–	–	–	–	–	–	**–**	**1,504,762**
eight years later	383,247	429,429	–	–	–	–	–	–	–	**–**	**812,676**
nine years later	384,727	–	–	–	–	–	–	–	–	**–**	**384,727**
Current estimate of cumulative claims	384,727	429,429	674,175	1,241,435	528,182	700,267	906,391	665,513	893,734	**1,342,851**	**7,766,704**
Cumulative payments to date	(337,051)	(419,839)	(617,994)	(1,167,039)	(455,780)	(570,177)	(714,342)	(473,533)	(435,502)	**(331,251)**	**(5,522,508)**
Liability recognised at 100% level	47,676	9,590	56,181	74,396	72,402	130,090	192,049	191,980	458,232	**1,011,600**	**2,244,196**
Liability recognised in respect of prior accident years at 100% level											**89,859**
Total gross liability to external parties at 100% level											**2,334,055**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2011.

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

Accident year	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	**2011 £000**	**Total £000**
Current estimate of cumulative claims	384,727	429,429	674,175	1,241,435	528,182	700,267	906,391	665,513	893,734	**1,342,851**	**7,766,704**
Less: attributable to external Names	(78,366)	(96,389)	(158,879)	(310,875)	(110,438)	(137,899)	(173,449)	(111,234)	(138,144)	**(198,129)**	**(1,513,802)**
Group's share of current ultimate claims estimate	306,361	333,040	515,296	930,560	417,744	562,368	732,942	554,279	755,590	**1,144,722**	**6,252,902**
Cumulative payments to date	(337,051)	(419,839)	(617,994)	(1,167,039)	(455,780)	(570,177)	(714,342)	(473,533)	(435,502)	**(331,251)**	**(5,522,508)**
Less: attributable to external Names	65,747	94,246	144,651	295,205	93,607	107,948	129,641	72,899	57,269	**42,423**	**1,103,636**
Group's share of cumulative payments	(271,304)	(325,593)	(473,343)	(871,834)	(362,173)	(462,229)	(584,701)	(400,634)	(378,233)	**(288,828)**	**(4,418,872)**
Liability for 2002 to 2011 accident years recognised on Group's balance sheet	35,057	7,447	41,953	58,726	55,571	100,139	148,241	153,645	377,357	**855,894**	**1,834,030**
Liability for accident years before 2002 recognised on Group's balance sheet											**68,541**
Total Group liability to external parties included in balance sheet – gross**											**1,902,571**

**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	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	**2011 £000**	**Total £000**
Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year	278,813	368,640	588,123	694,883	540,273	704,951	788,664	699,134	823,698	**1,040,657**	**6,527,836**
one year later	304,138	389,344	642,944	798,902	531,608	641,184	704,512	587,970	724,754	**–**	**5,325,356**
two years later	314,738	354,561	617,364	788,855	514,331	621,008	701,306	561,371	–	**–**	**4,473,534**
three years later	290,692	364,975	579,523	763,321	470,863	588,955	661,089	–	–	**–**	**3,719,418**
four years later	284,205	355,928	580,450	752,750	488,023	585,147	–	–	–	**–**	**3,046,503**
five years later	268,666	350,593	564,886	753,311	475,691	–	–	–	–	**–**	**2,413,147**
six years later	262,542	346,939	565,374	731,725	–	–	–	–	–	**–**	**1,906,580**
seven years later	268,143	335,507	549,172	–	–	–	–	–	–	**–**	**1,152,822**
eight years later	256,535	327,249	–	–	–	–	–	–	–	**–**	**583,784**
nine years later	266,886	–	–	–	–	–	–	–	–	**–**	**266,886**
Current estimate of cumulative claims	266,886	327,249	549,172	731,725	475,691	585,147	661,089	561,371	724,754	**1,040,657**	**5,923,741**
Cumulative payments to date	(206,430)	(320,079)	(486,977)	(665,968)	(405,032)	(467,043)	(537,004)	(411,187)	(378,092)	**(277,611)**	**(4,155,423)**
Liability recognised at 100% level	60,456	7,170	62,195	65,757	70,659	118,104	124,085	150,184	346,662	**763,046**	**1,768,318**
Liability recognised in respect of prior accident years at 100% level											**41,780**
Total net liability to external parties at 100% level											**1,810,098**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2011.

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

Accident year	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	**2011 £000**	**Total £000**
Current estimate of cumulative claims	266,886	327,249	549,172	731,725	475,691	585,147	661,089	561,371	724,754	**1,040,657**	**5,923,741**
Less: attributable to external Names	(52,080)	(71,829)	(129,973)	(175,292)	(99,258)	(119,202)	(123,113)	(90,647)	(103,540)	**(137,891)**	**(1,102,825)**
Group's share of current ultimate claims estimate	214,806	255,420	419,199	556,433	376,433	465,945	537,976	470,724	621,214	**902,766**	**4,820,916**
Cumulative payments to date	(206,430)	(320,079)	(486,977)	(665,968)	(405,032)	(467,043)	(537,004)	(411,187)	(378,092)	**(277,611)**	**(4,155,423)**
Less: attributable to external Names	35,729	70,171	113,766	160,728	82,118	90,238	93,316	61,793	51,086	**34,255**	**793,200**
Group's share of cumulative payments	(170,701)	(249,908)	(373,211)	(505,240)	(322,914)	(376,805)	(443,688)	(349,394)	(327,006)	**(243,356)**	**(3,362,223)**
Liability for 2002 to 2011 accident years recognised on Group's balance sheet	44,105	5,512	45,988	51,193	53,519	89,140	94,288	121,330	294,208	**659,410**	**1,458,693**
Liability for accident years before 2002 recognised on Group's balance sheet											**31,050**
Total Group liability to external parties included in the balance sheet – net**											**1,489,743**

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

26 Insurance liabilities and reinsurance assets continued

26.2 Movements in insurance claims liabilities and reinsurance claims assets

Year ended 31 December	2011 Gross £000	2011 Reinsurance £000	2011 Net £000	2010 Gross £000	2010 Reinsurance £000	2010 Net £000
Total at beginning of year	**(1,706,404)**	**374,193**	**(1,332,211)**	(1,549,323)	328,890	(1,220,433)
Claims and loss adjustment expenses for year	**(830,368)**	**132,470**	**(697,898)**	(733,074)	162,077	(570,997)
Cash paid for claims settled in the year	**650,510**	**(95,433)**	**555,077**	598,179	(120,088)	478,091
Exchange differences and other movements	**(16,309)**	**1,598**	**(14,711)**	(22,186)	3,314	(18,872)
Total at end of year	**(1,902,571)**	**412,828**	**(1,489,743)**	(1,706,404)	374,193	(1,332,211)
Claims reported and loss adjustment expenses	**(938,498)**	**187,973**	**(750,525)**	(802,254)	131,697	(670,557)
Claims incurred but not reported	**(964,073)**	**224,855**	**(739,218)**	(904,150)	242,496	(661,654)
Total at end of year	**(1,902,571)**	**412,828**	**(1,489,743)**	(1,706,404)	374,193	(1,332,211)

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

Year ended 31 December	2011 Gross £000	2011 Reinsurance £000	2011 Net £000	2010 Gross £000	2010 Reinsurance £000	2010 Net £000
Current year claims and loss adjustment expenses	**(1,126,667)**	**229,314**	**(897,353)**	(864,128)	160,277	(703,851)
Over/(under) provision in respect of prior year claims and loss adjustment expenses	**296,299**	**(96,844)**	**199,455**	131,054	1,800	132,854
Total claims and claim adjustment expenses	**(830,368)**	**132,470**	**(697,898)**	(733,074)	162,077	(570,997)

27 Trade and other payables

	Note	2011 £000	2010 £000
Creditors arising out of direct insurance operations		**58,346**	52,368
Creditors arising out of reinsurance operations		**152,866**	181,159
		211,212	233,527
Obligations under finance leases	36	**–**	45
Share of Syndicates other creditors' balances		**4,856**	4,887
Social security and other taxes payable		**10,640**	14,563
Other creditors		**14,939**	13,995
		30,435	33,490
Reinsurers' share of deferred acquisition costs	17	**15,641**	17,048
Accruals and deferred income		**56,847**	64,933
Total		**314,135**	348,998

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

	2011 £000	2010 £000
Within one year	**300,976**	338,541
After one year	**13,159**	10,457
	314,135	348,998

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:

	2011 £000	2010 £000
Current tax		
Expense for the year	**380**	58,228
Adjustments in respect of prior years	**(95,809)**	(1,062)
Total current tax (credit)/expense	**(95,429)**	57,166
Deferred tax		
Expense/(credit) for the year	**17,090**	(22,532)
Adjustments in respect of prior years	**77,992**	(691)
Effect of rate change	**(3,654)**	(1,377)
Total deferred tax expense/(credit)	**91,428**	(24,600)
Total tax (credited)/charged to the income statement	**(4,001)**	32,566

The standard rate of corporation tax in Bermuda is 0% whereas the effective rate of tax for the Group is -22.5% (2010: 15.4%). A reconciliation of the difference is provided below:

	2011 £000	2010 £000
Profit before tax	**17,271**	211,366
Tax calculated at the standard corporation tax rate applicable in Bermuda: 0% (2010: 0%)	**–**	–
Effects of Group entities subject to overseas tax at different rates	**21,620**	28,866
Impact of overseas tax rates on:		
Effect of rate change	**(3,654)**	(1,377)
Expenses not deductible for tax purposes	**11,665**	273
Tax losses for which no deferred tax asset is recognised	**(2,651)**	9,639
Other	**(1,435)**	396
Sch 23 FA 2003 deduction and share based payments	**(1,867)**	(1,803)
Non-taxable income	**(10,242)**	(2,839)
Overseas tax	**380**	1,164
Prior year tax adjustments	**(17,817)**	(1,753)
Tax (credit)/charge for the period	**(4,001)**	32,566

During 2011 the group's Lloyd's corporate member, Hiscox Dedicated Corporate Member Ltd, changed its tax filing position on the timing of the deduction for tax purposes of member-level reinsurance premiums. Consequently, a prior year current tax adjustment has arisen and results in a closing current tax debtor. Equally, deductions for member-level reinsurance premiums which were previously deferred for tax, and formed part of the deferred tax balance have been taken in earlier years, and no longer form part of the deferred tax balance. The effect of this change in current tax is a credit to the income statement of £81,287,000. The effect of this change in deferred tax is a charge to the income statement of £73,296,000. A permanent difference arises as a result of the difference in UK effective tax rate between the earlier and later years.

29 Deferred tax

Deferred tax assets	2011 £000	2010 £000
Trading losses in overseas entities	**25,748**	14,077

Net deferred tax liabilities	2011 £000	2010 £000
Deferred tax assets	**24,616**	14,968
Deferred tax liabilities	**(177,063)**	(60,389)
Total net deferred tax liability	**(152,447)**	(45,421)

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	2010 £000	Income statement (charge)/credit £000	Transfer from equity £000	2011 £000
Trading losses in overseas entities	14,077	11,671	–	**25,748**
Deferred tax assets	14,077	11,671	–	**25,748**

At 31 December	2010 £000	Income statement (charge)/credit £000	Transfer from equity £000	2011 £000
Tangible assets	1,366	1,248	–	**2,614**
Trading losses in UK entities	–	12,959	–	**12,959**
Trade and other payables	990	(465)	–	**525**
Intangible assets – Syndicate capacity	3,881	(537)	–	**3,344**
Reinsurance premiums	(5,376)	5,376	–	**–**
Other items	14,107	(5,006)	(3,927)	**5,174**
Total deferred tax assets	14,968	13,575	(3,927)	**24,616**

(b) Group deferred tax liabilities analysed by balance sheet headings

At 31 December	2010 £000	Income statement (charge)/credit £000	Transfer from equity £000	2011 £000
Investment in associated enterprises	(17)	11	–	**(6)**
Financial assets	(1,093)	75	–	**(1,018)**
Insurance contracts – equalisation provision*	(23,079)	(3,850)	–	**(26,929)**
Reinsurance premiums	–	(128,240)	–	**(128,240)**
Retirement benefit obligations	–	(610)	–	**(610)**
	(24,189)	(132,614)	–	**(156,803)**
Open years of account	(36,200)	15,940	–	**(20,260)**
Total deferred tax liabilities	(60,389)	(116,674)	–	**(177,063)**

*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 25%. The UK Government has indicated its intention to reduce UK tax rates year-on-year to 23% by the full year commencing April 2014, however at the balance sheet date, no such measures were substantially enacted.

Deferred tax assets of £25,748,000, relating to losses arising in overseas entities, which depend on the availability of future taxable profits in excess of profits arising from the reversal of other temporary differences are recognised above. Business projections indicate it is probable that sufficient future taxable income will be available against which to offset these recognised deferred tax assets within five years. £23,555,000 of the tax losses to which these assets relate will expire after 15 years or later; the balance of tax losses carried forward has no time limit.

The amount of deferred tax asset expected to be recovered after more than 12 months is £25,748,000.

The Group has not provided for deferred tax assets totalling £8,714,000 (2010: £18,216,000) including £8,713,000 (2010: £18,088,000) in relation to losses in overseas companies of £25,408,000 (2010: £51,769,000). 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 employer's expense for the defined contribution scheme is taken to the income statement.

The gross amount recognised in the Group balance sheet in respect of the defined benefit scheme is determined as follows:

	2011 £000	2010 £000
Present value of scheme obligations	**155,685**	146,737
Fair value of scheme assets	**(140,517)**	(144,056)
Deficit for funded plans	**15,168**	2,681
Unrecognised net actuarial losses	**(27,247)**	(12,310)
Unrecognised surplus deemed irrecoverable	**12,079**	9,629
Net amount recognised as a defined benefit obligation	**–**	–

30 Employee retirement benefit obligations continued

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.

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.

The Group sought legal confirmation, and we have confirmed that CPI revaluation in deferment is used for contracted out members from 1 January 2011. Contracted in members retain their link to RPI as well as for all pension in payment increases.

The effect of using the CPI to determine the scheme liabilities at 31 December 2011 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 triennial actuarial valuation at 31 December 2011 is currently being completed. 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	2011 £000	2010 £000
Equities	**91,758**	64,249
Debt and fixed income assets	**44,825**	75,918
Cash	**3,934**	3,889
	140,517	144,056

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	2011 £000	2010 £000
Current service cost		**533**	346
Interest cost		**7,705**	7,952
Expected return on scheme assets		**(8,988)**	(8,441)
Recognition of past service credit		**(3,037)**	–
Amortisation of net actuarial loss		**–**	323
Effect of deemed irrecoverability of surplus		**5,487**	1,520
Total included in staff costs	9	**1,700**	1,700

The actual return on scheme assets was a gain of £3,392,000 (2010: £14,516,000).

The movement in liability recognised in the Group's balance sheet is as follows:

	Notes	2011 £000	2010 £000
At beginning of year		**–**	–
Total expense charged in the income statement of the Group	9	**1,700**	1,700
Past service costs recognised in other creditors		**–**	–
Contributions paid		**(1,700)**	(1,700)
At end of year		**–**	–

30 Employee retirement benefit obligations continued

A reconciliation of the fair value of scheme assets is as follows:

	2011 £000	2010 £000
Opening fair value of scheme assets	**144,056**	118,391
Expected return on scheme assets	**8,988**	8,441
Difference between expected and actual return on scheme assets	**(5,596)**	6,075
Contributions by the employer	**1,700**	13,500
Settlements with scheme members	**–**	–
Benefits paid	**(8,098)**	(2,351)
Expenses paid	**(533)**	–
Closing fair value of scheme assets	**140,517**	144,056

A reconciliation of the present value of scheme obligations of the scheme is as follows:

	2011 £000	2010 £000
Opening present value of scheme obligations	**146,737**	140,676
Current service cost	**533**	346
Interest cost	**7,705**	7,952
Amendments	**(3,037)**	–
Actuarial losses/(gains)	**12,378**	114
Benefits paid from scheme	**(8,098)**	(2,351)
Settlements with scheme members	**–**	–
Expenses paid	**(533)**	–
Closing present value of scheme obligations	**155,685**	146,737

A summary of the scheme's recent experience is shown below:

	2011 £000	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	**(5,596)**	6,075	(3,678)	(18,107)	75	6,480	10,764

Additional memorandum information at the end of the current and previous six accounting periods is presented below:

	2011 £000	2010 £000	2009 £000	2008 £000	2007 £000	2006 £000	2005 £000
Present value of scheme obligations	**155,685**	146,737	140,676	101,615	106,793	137,461	137,533
Fair value of scheme assets	**(140,517)**	(144,056)	(118,391)	(115,166)	(127,576)	(133,660)	(101,409)
Present value of unfunded obligations/ (surplus scheme assets)	**15,168**	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:

	2011 years	2010 years
Male	**26.6**	24.5
Female	**27.8**	27.6

The average life expectancy in years of a pensioner retiring at 60, 15 years after the balance sheet date is as follows:

	2011 years	2010 years
Male	**27.7**	25.6
Female	**29.0**	28.6

Other principal actuarial assumptions are as follows:

	2011 %	2010 %
Discount rate	**4.90**	5.40
Expected return on scheme assets	**5.80**	6.40
Inflation assumption (RPI)	**3.10**	3.60
Inflation assumption (CPI)	**2.30**	–
Pension increases	**3.10**	3.60

30 Employee retirement benefit obligations continued

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 agreed to fund the £5.1 million deficit paying instalments over four years. During the year the Group made a third instalment of £1.7 million to the defined benefit scheme (2010: £1.7 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 2011 by approximately £1,396,000 (2010: £80,000), the Group considers that the most sensitive and judgemental assumptions are the discount rate and inflation.

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 2011 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%	**15,168**	**7,223**	**–**
Effect of an increase in inflation Use of CPI inflation assumption of 3.35%	**15,168**	**17,975**	**–**

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	2011	2010
Profit for the year attributable to the owners of the Company (£000)	**21,272**	178,800
Weighted average number of ordinary shares (thousands)	**383,602**	379,064
Basic earnings per share (pence per share)	**5.5p**	47.2p

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.

	2011	2010
Profit for the year attributable to the owners of the Company (£000)	**21,272**	178,800
Weighted average number of ordinary shares in issue (thousands)	**383,602**	379,064
Adjustments for share options (thousands)	**15,610**	14,662
Weighted average number of ordinary shares for diluted earnings per share (thousands)	**399,212**	393,726
Diluted earnings per share (pence per share)	**5.3p**	45.4p

Diluted earnings per share has been calculated after taking account of 15,029,986 (2010: 13,996,961) options and awards under employee share option and performance plan schemes and 579,518 (2010: 665,060) options under SAYE schemes.

32 Dividends paid to owners of the Company

	2011 £000	2010 £000
Interim dividend for the year ended:		
31 December 2011 of 5.1p (net) per share	**19,738**	–
31 December 2010 of 5.0p (net) per share	**–**	19,018
Final dividend for the year ended:		
31 December 2010 of 11.5p (net) per share	**44,111**	–
Second interim dividend for the year ended:		
31 December 2009 of 10.5p (net) per share	**–**	39,442
	63,849	58,460

Included in the final dividend for 2010 and the interim dividend for 2011, were scrip dividends to the value of £12,308,238 and £1,029,226 respectively.

Subject to shareholder approval at the forthcoming Annual General Meeting on 30 May 2012, 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

There were no acquisitions in the current year.

In 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 consolidated the results of Blyth Valley Ltd at 31 December 2011 and 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 during 2010, 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

On 23 March 2011, the Group sold its holding in Plexstar Insurance Services Ltd with a further consideration to be settled in 2012. On cash settlement, this recognised an initial loss of £33,000. Further consideration is due to be received during 2012, estimated to be £200,000.

During 2010, 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 subsidiary's obligations at Lloyd's. The total guarantee given under these deeds of covenant (subject to limitations) amounts to £15 million (2010: £15 million) in respect of Hiscox Ltd and $350 million (2010: $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) In the prior year, 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 US Dollar. At 31 December 2011 $340 million (2010: $165 million) was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and no cash drawings were outstanding (2010: £20 million).

(c) Hiscox Insurance Company Limited has arranged a Letter of Credit of £50,000 (2010: £50,000) with NatWest Bank plc to support its consortium activities with Lloyd's.

(d) The managed syndicates are subject to the New Central Fund annual contribution, which is an annual fee calculated on gross premiums written. This fee was 0.5% for 2011 and 2010. 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.

35 Contingencies and guarantees continued

(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. In 2009, Hiscox 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 Insurance Company (Bermuda) Limited. Letters of Credit under this facility totalling US$67,208,000 were issued with an effective date of 31 December 2011 (2010: US$89,110,000).

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 £326,000 (2010: £229,000).

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 £7,256,000 (2010: £7,171,000). Operating lease rental income for the year totalled £420,000 (2010: £635,000).

The aggregate minimum lease payments required by the Group under non-cancellable operating leases, over the expected lease terms, are as follows:

		2011 £000	2010 £000
No later than one year	Land and buildings	**7,359**	7,505
	Office equipment	**1**	28
Later than one year and no later than five years	Land and buildings	**25,239**	24,737
	Office equipment	**–**	1
Later than five years	Land and buildings	**22,106**	26,437
		54,705	58,708

The total future aggregate minimum lease rentals receivable by the Group as lessor under non-cancellable operating property leases are as follows:

	2011 £000	2010 £000
No later than one year	**373**	275
Later than one year and no later than five years	**246**	344
Later than five years	**–**	–
	619	619

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 £1,430 (2010: £8,806).

The finance lease obligations to which the Group is committed include the following minimum lease payments:

	2011 £000	2010 £000
Current liabilities due for settlement no later than one year	**–**	45
Non-current liabilities due for settlement after one year and no later than five years	**–**	–
	–	45
Less: future finance lease interest charges	**–**	(1)
	–	44

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 2011

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*	Reinsurance	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 at 31 December 2011 (2010: 54,560).

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 39 to 46. 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.

	2011 £000	2010 £000
Value of services provided by Hiscox Syndicates Limited to Syndicate 33	**32,276**	44,538
Amounts receivable from Syndicate 33 at 31 December excluding profit commission accrued	**22,426**	13,163

(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 2011 £000	Total 2010 £000
Gross premium income achieved through associates	**11,593**	13,228
Commission expense charged by associates	**2,679**	3,285
Amounts payable to associates at 31 December	**–**	–
Amounts receivable from associates at 31 December	**120**	–

Details of the Group's associates are given in note 16.

(c) Internal reinsurance arrangements

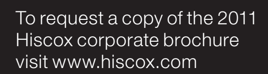
During the current and prior year, there were a number of reinsurance arrangements entered into in the normal course of trade between various Group companies.

The related results of these transactions have been eliminated on consolidation.

Five year summary

	2011 £000	2010 £000	2009 £000	2008† £000	2007 £000
Results					
Gross premiums written	**1,449,219**	1,432,674	1,435,401	1,147,364	1,198,949
Net premiums written	**1,174,011**	1,131,627	1,157,023	898,394	974,910
Net premiums earned	**1,145,007**	1,131,158	1,098,102	928,095	965,190
Profit before tax	**17,271**	211,366	320,618	105,180	237,199
Profit for the year after tax	**21,272**	178,800	280,497	70,808	191,248
Assets employed					
Intangible assets	**67,552**	64,108	50,413	48,557	40,452
Financial assets carried at fair value	**2,368,636**	2,459,107	2,413,300	2,081,772	1,747,827
Cash and cash equivalents	**516,547**	336,017	259,647	440,622	302,742
Insurance liabilities and reinsurance assets	**(2,007,745)**	(1,817,102)	(1,702,225)	(1,773,622)	(1,433,799)
Other net assets	**310,909**	223,984	100,151	153,697	167,082
Net assets	**1,255,899**	1,266,114	1,121,286	951,026	824,304
Net asset value per share (p)	**323.5**	332.7	299.2	258.1	209.5
Key statistics					
Basic earnings per share (p)	**5.5**	47.2	75.2	18.8	48.4
Diluted earnings per share (p)	**5.3**	45.4	72.3	18.1	46.8
Combined ratio (%)	**99.5**	89.3	86.0	75.3	84.4
Return on equity (%)	**1.7**	16.5	30.1	9.2	28.8
Dividends per share (p)	**17.00**	16.50	15.00	12.75	12.00
Share price – high* (p)	**424.70**	381.40	362.00	361.00	304.50
Share price – low* (p)	**340.50**	317.00	277.00	194.75	246.75

*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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Design: Browns
www.brownsdesign.com

Print: Pureprint
www.pureprint.com

Photography:
Portraits © John Ross and Matthew Septimus
Cover © NASA/GSFC/METI/ERSDAC/JAROS, and U.S./Japan ASTER Science Team

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Cover: Thailand floods, 2011

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