Hiscox Ltd Report and Accounts 2012

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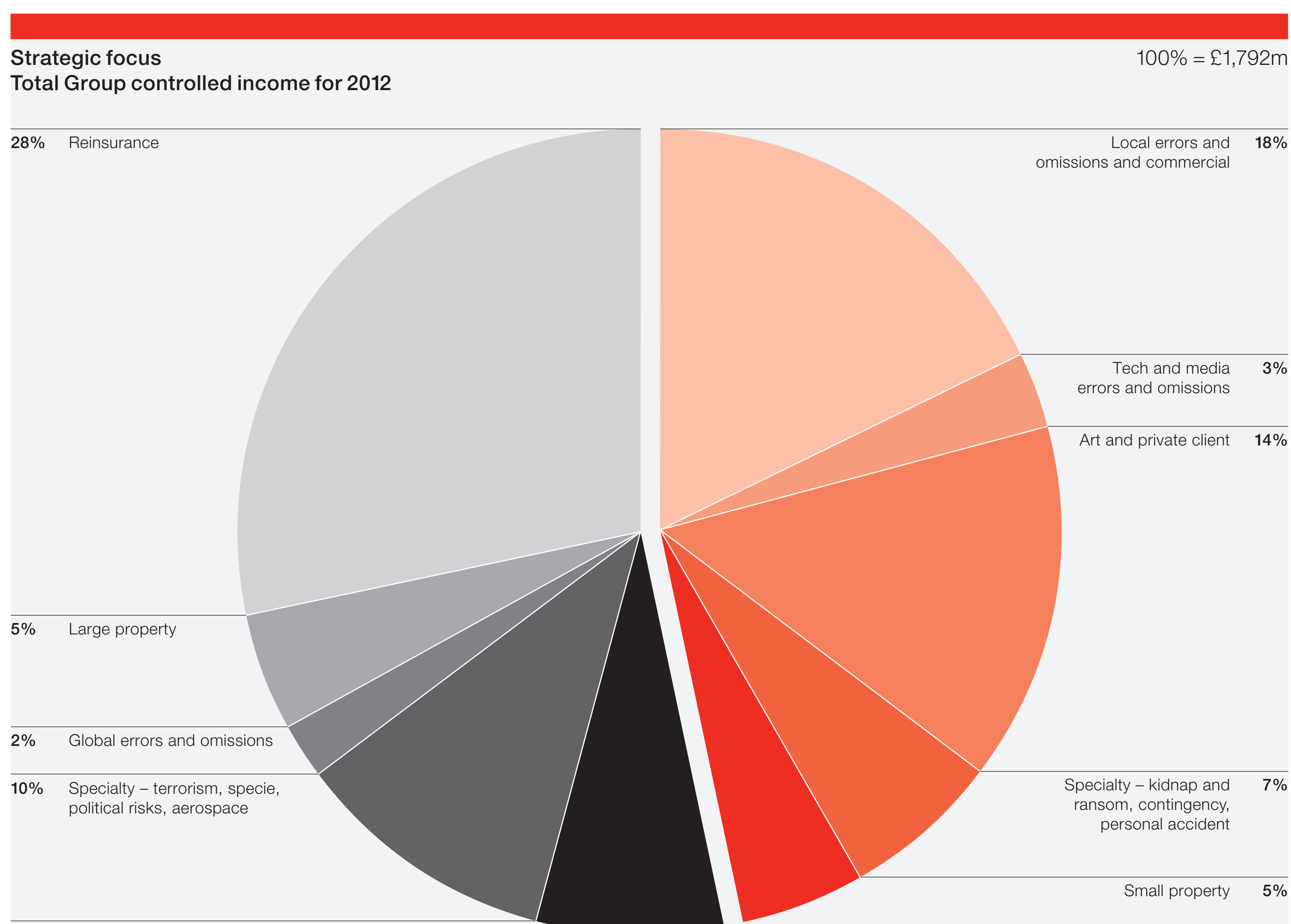
Our ambition is to be a highly respected specialist insurer with a diverse portfolio by product and geography. We believe that building balance between catastrophe-exposed business and less volatile local specialty business gives us opportunities for profitable growth throughout the insurance cycle.

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.



Corporate highlights

Group key performance indicators

	2012	2011
Gross premiums written (£m)	**1,565.8**	1,449.2
Net premiums earned (£m)	**1,198.6**	1,145.0
Profit before tax (£m)	**217.1**	17.3
Profit after tax (£m)	**207.8**	21.3
Earnings per share (p)	**53.1**	5.5
Total dividend per share for year (p)	**18.0**	17.0
Net asset value per share (p)	**349.7**	323.5
Group combined ratio (%)	**85.5**	99.5
Group combined ratio excluding foreign exchange (%)	**84.6**	99.3
Return on equity (%)	**16.9**	1.7
Investment return (%)	**3.1**	0.9
Reserve releases (£m)	**152**	199

Capital return

Capital return of £200 million (50.0p per share including final dividend) by way of B share scheme

Final dividend equivalent of 12.0p taking total dividend for the year to 18.0p, an increase of 5.9% (2011: 17.0p)

Additional special distribution of 38.0p per share (approximately £150 million) combined with share consolidation

Operational highlights

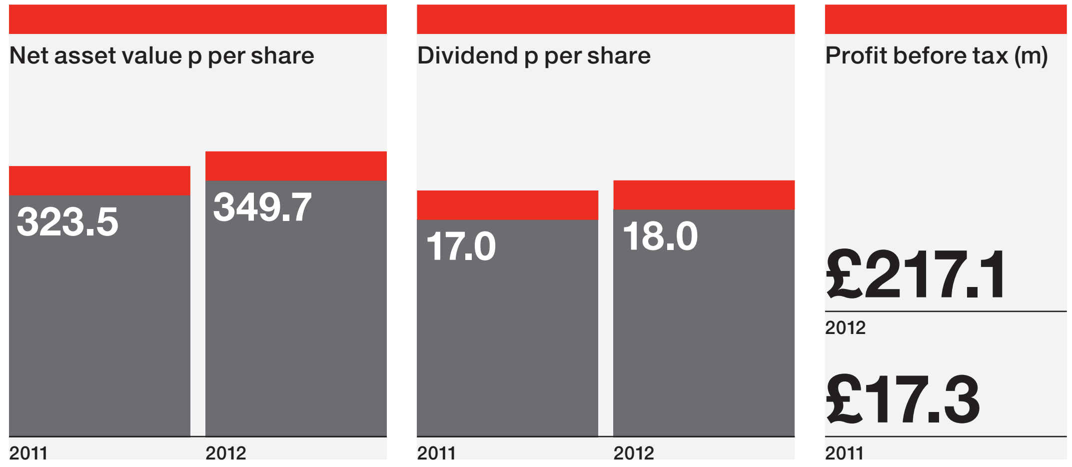
Robert Childs replaces Robert Hiscox as Chairman on 26 February 2013; Richard Watson now Chief Underwriting Officer

Hiscox London Market profit of £121.9 million (2011: £57.6 million) with contributions across all lines

Hiscox Bermuda delivered a pleasing profit despite Superstorm Sandy

UK retail business delivers another good profit of £45.2 million (2011: £49.0 million)

Hiscox USA revenues grew by 32.6% to $230.5 million. US Direct business increased by over 200% to nearly $10.0 million gross premiums written with strong continued growth prospects



Why invest in Hiscox?

8.0%
Increase in gross premiums written

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 8.9% 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 2008 and 2012 include:
- increased gross written premiums by 36.5% to over £1.5 billion;
- healthy combined ratio averaging 87.3%;
- delivered average ROE of 14.9%;
- maintained a progressive dividend policy with compound growth of 9.0%;
- returned additional £150 million of capital.

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:*
- 97% 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.

Hiscox was awarded 'Best small business insurer' as voted for by Start your Business magazine. As well as the Customer Care award at The British Insurance Awards 2012, for putting our customers at the heart of our business and moving against the tide by bringing our direct household claims back in-house.

Hiscox won Company of the Year at the 2012 London Market Awards, recognising the strength of the business over the previous 18 months. Robert Hiscox was presented with a lifetime achievement award at both the 2012 London Market Awards and the 2012 Insurance Insider awards.

* 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, 1 January 2012 – 31 December 2012.

The quality of our people has been a key ingredient in our success

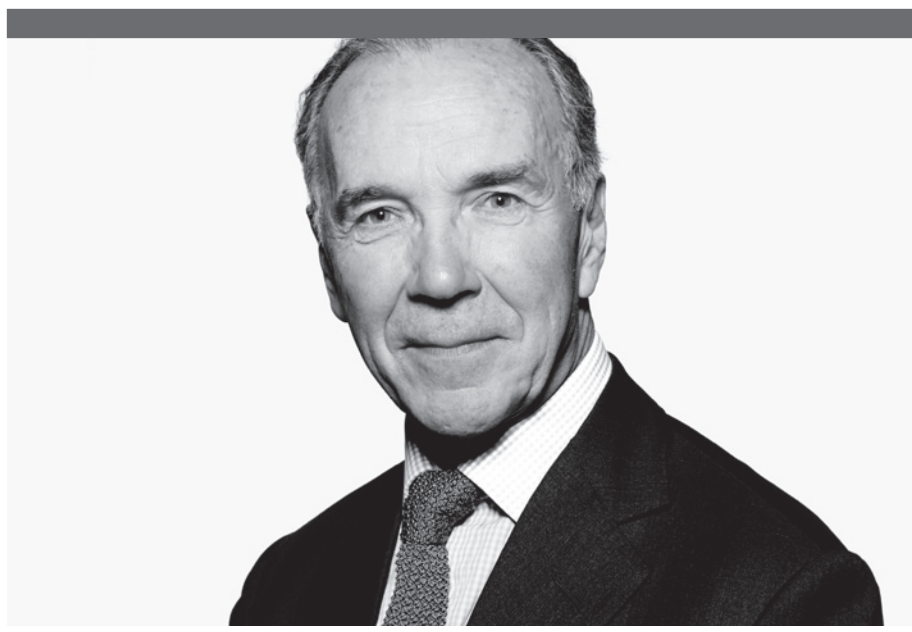
Hiscox's reputation for innovation and dynamism has been built in large part on the energy, professionalism, commitment and expertise of our employees.

In September, Hiscox conducted its fifth global employee engagement survey. Open to all permanent members of staff, it looks at how committed employees feel to Hiscox, their managers, their teams and their role. In 2012 our survey shows Hiscox enjoys high employee engagement as we average in the top 85th percentile when compared with 127 companies based around the world. Particularly pleasing was our 'intent to stay' score which was in the in the 95th percentile.

Hiscox Spain gained recognition for Best Workplace 2012 as awarded by Great Place to Work.

Chairman's statement

It is a nostalgic moment to be writing my last Chairman's report, and pleasing to be able to announce a solid profit. The year had its catastrophic moments, but as we grow bigger and more balanced, we can absorb Mother Nature's punches and the vicissitudes of accidents and criminal acts with greater ease.



Robert Hiscox
Chairman

Since I announced last year that I would be stepping down as Chairman, I have been asked to look back over my years in the insurance world and have enjoyed the memories of growing the business from days of buccaneering in a lawless market place, through the Lloyd's crisis and recently through stronger and stricter strait-jackets of rules and regulations. But I get greater pleasure from looking forward at the future opportunities for this business as it moves into its next era. I would not be stepping down if I were not absolutely sure that the business is in great shape and the next generation are more than qualified to take it to the next level.

Results

The result for the year ending 31 December 2012 was a profit before tax of £217.1 million (2011: £17.3 million) on a gross written premium income of £1,565.8 million (2011: £1,449.2 million). The combined ratio was 85.5% (2011: 99.5%). Earnings per share were 53.1p (2011: 5.5p) and the net assets per share rose to 349.7p (2011: 323.5p). The return on equity was 16.9% (2011: 1.7%).

Dividend, balance sheet and capital management

The Board has reviewed the capital requirements of the Group for the coming year and has proposed that a special distribution of 38.0p per share (amounting to approximately £150 million), should be made. This will reduce capital levels close to those of the 2012 opening balance sheet, effectively distributing all of this year's profit to shareholders which will have a favourable impact on both the Group premium to capital gearing ratio and return on capital, whilst still providing sufficient headroom above existing internal and external capital needs. This proposed return of capital will be made by way of a B share scheme and will be combined with a share consolidation.

In addition, a sum of 12.0p per share will be paid instead of a final dividend for the year ended 31 December 2012 as part of the B share scheme. This amount, together with the interim dividend of 6.0p per share, represents a total dividend for 2012 equal to 18.0p per share (2011: 17.0p), an increase of 5.9%, in line with our policy of progressive dividend growth. As a result of this amount being paid as part of the B share scheme, a scrip dividend alternative will not be offered to shareholders.

Full details of the proposed return of capital and final dividend equivalent will be set out in a circular expected to be despatched to Hiscox shareholders on or around 26 February 2013.

The business

As ever, Bronek will comment in detail in his following report on the various business activities. I would like to comment on the current state of the business that I have helped develop over the last 48 years and its future opportunities.

The basic underwriting strategy

When I stopped underwriting for our Lloyd's Syndicate in 1988, the 'retail' account of relatively simple insurance business was 50% of the portfolio, the balance being internationally traded reinsurance and large insurance business. That balance remains roughly the same to this day, albeit over a larger and more diverse Group.

We have created insurance companies in the UK, Guernsey and the US to underwrite the simpler business, and one in Bermuda to augment our strong reinsurance presence. We have the huge advantage of all our underwriters being able to use one of our local companies if suitable or Lloyd's with its great brand, financial strength and worldwide licences.

Catastrophe and internationally traded business

The core profit earner remains our founding London Market business. I believe that London will retain its prominence in the world of internationally traded business, and that Lloyd's will be the strongest magnet in that market.

The catastrophe and major loss business currently looks very volatile with international political unrest and more disturbed weather patterns. This is an opportunity for us as it keeps demand up and the weaker competitors away.

Bermuda is a great addition to our involvement in that business and they and London work

We have made a very good profit despite the second costliest storm on record and a challenging investment market

in parallel to widen the distribution and to grow diversified accounts.

We will continue to study the alternative risk transfer methods that are being developed and use them or write them, depending on the price levels.

The London Market division also writes a successful balancing book of non-catastrophe business in London and through other offices worldwide.

Retail insurance business

The accounts that we call 'retail' business are very close to my heart as when I underwrote at the box, I built up those accounts leaving the larger risks to my partner Nicholas Thomson. I always thought that the retail accounts were worth building up for their stability. In 1988 we set about widening our distribution to non-Lloyd's brokers and into Europe, and later in 1996 we bought an insurance company to take the retail account. We paid £28 million for the company (including a £6 million premium over assets) which seemed a high price, and I remember being warned by our investment banker that we were betting the bank. It is highly satisfactory to see the UK and European businesses make a profit of nearly £50 million this year. A pretty good investment.

The growing retail accounts are very important to us as they give stability to our profitability and add real value as steady profits are rated at a greater multiple. We have invested heavily into them both in terms of money and effort as we believe them to be core to our building a balanced and steadily more valuable business.

Overseas expansion

We first expanded the retail account into Europe, starting in 1993, and it has taken time to reach critical size. It is easy to see Europe as one geographical area when it is immensely different in the business practices in each country despite 38 years of efforts to create a single market. We are winning there and the next few years should see a steady increase in profitability.

Next we set up our Guernsey operation which has been a huge success and will remain a hub for some of our accounts.

Bermuda followed and that too has been very successful. Robert Childs, who is due to take over from me as Chairman, set up the Bermuda company, and proceeded shortly afterwards to open our US offices. We have made a big commitment to the US and I am very excited at the possibilities.

We are well aware of the graveyard of businesses which have expanded overseas, so having expanded in the sophisticated (but battered) economies of Europe and the US, we will consider any expansion east or to other emerging economies with great caution. It will happen when the right opportunity arises.

Marketing

I have always firmly believed that if you are good at what you do you should make every effort to spread that good news to potential clients. I think our marketing has done just that and I must congratulate Steve Langan who heads our UK retail side and masterminds our worldwide marketing. It has made us stand out from the crowd, has given us standards to live up to, has pulled in a great amount of business and has been a very good investment.

IT

I bore my colleagues by banging on that we should be an IT company with insurance attached, not an insurance company which uses IT. We are good at underwriting which we have done overall successfully for 112 years, but the next era will be dominated by IT, from an increasing competitive advantage from management information, especially in calculating underwriting rates, to distribution of policies. The company with the best IT and the ability to use it well will win.

Investments

Investment income has contributed on average 50% of our profits in the past, but today's low interest rates make that impossible in the near future without phenomenal risk taking. The low returns from the bulk of our portfolio of Government bonds give little protection against the potential volatility from any risk assets we own. David Astor, our Chief Investment Officer, works tirelessly to eke extra yield without undue risk and has nearly hit that 50% this year despite difficult conditions.

Insurance politics

The year has seen us conquer the burden of Solvency II and I think achieve greater harmony with our regulator, freeing us up to get on with making money. The financial burden of the implementation of Solvency II on us and the industry has been considerable. After 48 years of assessing risks, which is what underwriting is, it was surreal to have a one size fits all model for assessing the risks in the business inflicted on us in minute detail by actuarially driven regulators, combined with corporate governance diktats imposing huge expectations on non-executive directors combined with an extra layer of risk assessment staffing.

The FSA is about to be split in two into prudential and conduct supervision under the Bank of England with the duty to ensure we are able to pay claims when they fall due. I could wish that we had one regulator to form a relationship with and not two as there is always a fear of duplication or of something falling between the two stools, but we are where we are. We need effective regulation as the whole industry suffers when an insurer misbehaves or becomes insolvent. The FSA has taken virtually all self-regulation away from our industry which means that by definition we are invigilated and regulated by people with little or no trading experience in our business. We need good regulation,

Chairman's statement continued

The future looks as exciting as the past has been for me

and to help the regulator I wish that all entities involved in general insurance, from the ABI, the International Underwriters Association, the Chartered Insurance Association and Lloyd's, would form a General Insurance Body to be a strong lobby and, to an extent, a self-regulating body. We in the industry know when a competitor is going to go bust as we trade against them and see the folly; we ought to have a system of warning the regulator. And we desperately need a strong lobby to fight for us in the corridors of power. For instance, when a very senior politician starts attacking the insurance industry for its performance over flood damage, someone needs to hit back very hard with the truth.

The next era

I set out to run an honest business, to choose the best people to help me run the business, and to pick honest and careful clients who we would treat with great integrity and efficiency. The ability to pick the right people is to me the most important talent in all of life. My first major delegation was to Nicholas Thomson who was a brilliant underwriter and we owe him a huge debt of gratitude for the strong underwriting discipline he instilled. The next major delegation was to Bronek Masojada who joined in 1993 as Managing Director to help run the company and took the reins as CEO in 2000. Like an Oscar winner I would like to mention a whole host of others who have been indispensable, especially Alec Foster who handled our Lloyd's members in the early days and invested all our money so wisely, but space does not permit.

We have spent the last era building businesses both inside and outside Lloyd's and I believe we have developed some very strong future profit generators to add to our existing international and retail businesses. I hand over to Robert Childs (who has done incredibly valuable work at Hiscox for 26 years) and the top team with a happy heart. I have had fantastic fun building the business, and it will be just as enjoyable watching the success in the next era.

Robert Hiscox
25 February 2013

Chief Executive's report

Fires, storms and floods are the everyday experience of insurance companies. 2011 was exceptional in its severity so in comparison 2012 felt like a more normal loss experience, despite it being the third most expensive year on record for major catastrophes. We dealt with record flood activity in the UK, Superstorm Sandy in the US, fine art thefts in Europe, fires in substantial

Bronek Masojada
Chief Executive

properties across the world and the sinking of Costa Concordia. A profit of £217.1 million (2011: £17.3 million) and return on equity of 16.9% (2011: 1.7%) is therefore a good result and was driven by a combination of good underwriting performance and an excellent (for current market conditions) investment return. Our aim is to make good profits in years such as 2012, small profits in poor years (as we saw in 2011) and exceptional profits in very low loss frequency years.

Our strategy remains to build balance and diversification within the business. We saw good growth in the London Market, Bermuda and particularly the United States. Profits flowed from our London Market, UK, Bermuda and Guernsey businesses, offsetting the ongoing investment in the United States.

Hiscox London Market
Hiscox London Market business remains a powerhouse. Exceptional underwriting and a well-diversified portfolio have delivered a profit of £121.9 million (2011: £57.6 million) with every division contributing. Gross premium income grew by 9.3% to £640.0 million (2011: £585.4 million). The business achieved a combined ratio of 75.5% (2011: 89.1%) despite Superstorm Sandy and some large individual claims such as Costa Concordia. I review each division in turn below.

- **Reinsurance:** The many catastrophes of 2011 provided significant opportunities in 2012 as rates doubled in some loss affected areas. We increased market share in Japan and maintained a good position in other territories. The team delivered a very strong result despite the impact of Superstorm Sandy which we reserved for the Group as a whole at a net £90 million.

  We continue to underwrite catastrophe business in London and Bermuda on behalf of third-parties. It is a profitable use of our expertise and gives our partners valuable diversification. For several years we have been underwriting a book on behalf of Aviva and this quota share arrangement came to an end in 2012. Aviva has been a good partner, and whilst we are sorry to see the end of the relationship, we have more than replaced their support with capital from other sources – a testament to our team's reputation and track record.

  Market conditions remained attractive at the important 1 January renewals, with rates flat to positive in the key North American territories and softening in international markets. Overall reinsurance rates are still healthy.

- **Property:** Our property division delivered a good profit. It grew strongly in US small commercial, personal and onshore energy lines and was only marginally affected by Superstorm Sandy. The fire, theft and collision insurance book performed less well. This business tends to be less catastrophe exposed and so should be a source of stable profits within the division. We will be working hard to achieve this in 2013.

- **Global response:** The global response team serves clients around the world, covering personnel and property for kidnap and ransom, terrorism, war and political violence risks. 2012 proved to be calmer than 2011 and this has produced a strong result. The market in which we operate requires a high degree of service and responsiveness, and our team continues to deliver to the highest standards, maintaining our market-leading position. The world remains a volatile place, and companies are increasingly looking to protect their assets. We have the expertise and are well placed to help.

- **Marine and energy:** The team had a good year with profits and growth in offshore energy more than offsetting the Costa Concordia loss which is expected to settle at net $20 million. To the wider industry this loss has deteriorated, mainly due to the rising costs of removing the wreck. As the world becomes more environmentally conscious this type of expense will continue to increase, and we expect this to be reflected in future premiums for marine liability and related risks. In addition our offshore energy team has performed exceptionally well.

  Marine liability insurance is one of the oldest risks in the London Market and is proving to be at the cutting edge of modernisation

Chief Executive's report continued

Hiscox London Market

	2012 £m	2011 £m
Gross premiums written	**640.0**	585.4
Net premiums earned	**419.0**	418.8
Underwriting profit	**105.1**	50.3
Investment result	**27.0**	8.8
Foreign exchange	**(10.2)**	(1.5)
Profit before tax	**121.9**	57.6
Combined ratio	**75.5%**	89.1%
Combined ratio excluding foreign exchange	**73.1%**	89.1%

Hiscox UK

	2012 £m	2011 £m
Gross premiums written	**375.2**	367.1
Net premiums earned	**351.3**	325.2
Underwriting profit	**31.2**	41.5
Investment result	**14.6**	7.3
Foreign exchange	**(0.6)**	0.2
Profit before tax	**45.2**	49.0
Combined ratio	**92.1%**	87.5%
Combined ratio excluding foreign exchange	**91.9%**	87.6%

for Hiscox. We have given retail brokers the ability to place smaller risks quickly and cost effectively directly with us online and this investment in e-trading has delivered modest premiums in 2012 which we expect to grow in 2013. We will also be looking to trade in this manner in other lines of business.

- **Casualty:** The casualty market remains a challenging place and we continue to reduce our lines as the rates on offer remain inadequate. We do, however, believe that ultimately economic sanity will prevail and the market will inevitably harden. In preparation, during the course of 2012 we recruited several senior staff to build on our existing team. The division has performed well at the bottom line, as we have benefited from releases in prior years – demonstrating our prudent approach to reserving.

- **Aviation and space:** Both lines continue to make steady profitable progress. Pricing in the aviation market remains challenging, but our risk selection and hence loss experience have remained exemplary, so results are very acceptable for our second year of underwriting this class of business. There has been increased launch activity in the space market leading to slightly higher volumes. As the global economy continues to depend on more support from extraterrestrial services, we believe this business will grow steadily over time.

Our London Market business has a global remit. It makes use of the Lloyd's brand name and licences to write business located around the world. Lloyd's is making steady progress to enhance its own licence network, and we at Hiscox are supportive of all efforts to expand the range of licences the market has for both reinsurance and insurance. We are particularly supportive of licensing which allows us to trade from London without the costs of teams on the ground. In 2012 we saw the benefit of doing this with the significant expansion of our Japanese and Thai reinsurance exposures, and the insurance support we were able to give the New Zealand economy to enable the rebuilding of Christchurch. All of this business was underwritten from London, backed by extensive visits to local clients and brokers. We hope that as regulators get more parochial they will remember the benefits of accessing global expertise and capital, and will not restrict our ability to trade in this way.

Hiscox UK and Hiscox Europe

In 1987 we took our first step into UK retail business (or local specialty insurance) moving into Continental Europe in 1993. By 2012 our businesses had expanded materially, writing premium income of £507.5 million (2011: £498.0 million) and delivering a profit of £49.1 million (2011: £51.5 million). There is plenty of room to grow in these markets and I remain confident that we have the products, expertise and brand to continue to expand.

- **Hiscox UK:** Our UK business made another excellent profit of £45.2 million (2011: £49.0 million) despite spending more on marketing and paying record flood losses. The business benefited from a good investment return and good underwriting. Growth in commercial product lines offset the cancellation of two high net worth underwriting partnerships, resulting in an increase in revenues of 2.2% to £375.2 million (2011: £367.1 million). The progress in our core lines is set out below:

The high net worth business delivered a strong profit despite the largest single loss in its history – a London house fire. Premium income shrank slightly, reflecting the previously announced withdrawal from two partnerships which did not live up to expectations. We also experienced the greatest level of flood activity in our history, paying claims to the value of £14 million in flood and storm losses. You only find out the worth of your insurer when you make a claim so it is pleasing that during this busy year our team lived up to its reputation for excellence, winning 'The British Insurance Awards Customer Care' accolade. In the competitive luxury motor market we reached maturity with a second year of profit, our service and brand setting the team apart.

Our professions, specialty commercial, and technology lines have made good progress. We launched five new professional indemnity products during the year specifically for the unique risks professions such as facilities managers and interior and garden designers face. These products have sold well, filling a real customer need. Recession-related claims have not been as severe as we had expected.

The direct business continues to propel the brand. We increased our marketing spend in the year by £4 million and returned to TV with an advertising campaign that promotes our ethos of trust, honesty and fair customer service. An unexpected outcome has been the strength with which our broker partners have identified with this message, reinforcing our relationships. The direct household products have been held back by challenges within our online platform hampering our flexibility in pricing. We are investing in 2013 and beyond to address this. Our commercial products continue to move ahead despite an increasingly competitive market. Again the brand and our service reputation are real differentiators. Competitors can copy our wordings, but these more intangible elements are real protective moats to our business.

In 2013 Hiscox UK has a big agenda. Distribution for the insurance market has evolved over the years; it is no longer as black and white as broker versus direct. We are launching a tied agency to address

gaps in our current model, working direct and in partnership with specialist commercial brokers who don't have in-house private client expertise but who want to offer a Hiscox Home Insurance policy to their clients. We also announced our plans to open a multi-function office in York during 2013, with progressive in-sourcing of some of our direct customer service centres. We have had effective relationships with our outsourcing partners for over a decade, but we feel that the next stage in our journey requires greater control over critical aspects of our customer service.

Hiscox Europe: Our European business has reached its fourth consecutive year of profitability. Revenues have grown by 5.9% to €160.4 million (2011: €151.4 million), though only 1.1% to £132.3 million when looked at in sterling. Profits grew to £3.9 million (2011: £2.4 million) despite increased marketing spend to support our French direct business. The combined ratio rose to 100.9% (2011: 100.5%), with improved investment returns driving the profit. Combined ratios and returns on equity are being challenged by the European economy and issues of scale.

The combined ratio challenges have come from two fronts. First we have seen some recession-related claims: jewellery thefts in public places, aggressive home invasions, and some large fine art thefts. The second is our expense ratio. This is driven by increased marketing expenditure to support the growing direct business in France, and also an increasing focus on smaller ticket business. This business is attractive from a loss ratio perspective, but initially it does drive up operating cost. We will be working in 2013 to re-engineer our business to bring this ratio down.

We continue to see opportunity in Europe. Partnerships with major financial institutions have performed well and are expanding from their commercial focus to high net worth personal lines. We also expect in time to see the broader brand benefit from our direct activities. We were on French TV for the first time ever in 2012. This supported our small direct business, and is also, reflecting our UK experience, driving brand recognition and perception in the broker channel. We will be launching a direct business in Germany in 2013, and I am confident that, in time, the German and French business will replicate the success we enjoy in the UK.

Hiscox Europe

	2012 £m	2011 £m
Gross premiums written	132.3	130.9
Net premiums earned	125.6	123.4
Underwriting profit	1.8	2.7
Investment result	3.1	(0.1)
Foreign exchange	(1.0)	(0.2)
Profit before tax	3.9	2.4
Combined ratio	100.9%	100.5%
Combined ratio excluding foreign exchange	100.2%	100.4%

Hiscox International

	2012 £m	2011 £m
Gross premiums written	418.3	365.8
Net premiums earned	302.7	277.6
Underwriting profit	30.3	(92.7)
Investment result	29.2	6.3
Foreign exchange	3.1	(3.1)
Profit before tax	62.6	(89.5)
Combined ratio	89.2%	133.9%
Combined ratio excluding foreign exchange	90.2%	132.8%

Hiscox International

Hiscox international comprises our activities in Bermuda, Guernsey and the United States. In aggregate they had a good year, though obviously not as positive as it might have been without Superstorm Sandy which materially impacted both our Bermudian and United States businesses. Each of the three business's progress is discussed below.

Hiscox Bermuda: Our main focus in Bermuda is on reinsurance with an emerging presence in healthcare. Revenues grew by 11.5% to $318.1 million (2011: $285.2 million). Profits grew substantially despite the cost of Superstorm Sandy. This performance reflects strong growth in the reinsurance business with a focus on areas like Japan, Thailand and Australia which were particularly affected by natural catastrophes in 2011. Healthcare made steady progress.

The reinsurance market is evolving and we must change with it. New forms of capital are entering the industry, selling collateralised policies or buying catastrophe bonds issued by cedents like Hiscox, in competition with traditional markets. For a number of years we have invested in a small portfolio of catastrophe bonds issued by cedents. In 2012 we invested in a fund managed by Third Point Reinsurance Investment Management Ltd and took a stake in the firm. After all, a catastrophe bond is no more than a reinsurance contract and a bond investment linked together. We will also be ceding tailored portfolios of catastrophe reinsurance exposure to the fund. We need to adapt as the market adapts and this helps us to do so.

Hiscox Guernsey: This business underwrites kidnap and ransom, piracy, fine art, terrorism and personal accident insurance. It delivered a very good profit even though revenues declined by 8.5% to £73.0 million (2011: £79.8 million). This is due to a disciplined approach to underwriting piracy and business that was previously signed in three-year deals to take advantage of good terms, prices and conditions. The team continues to concentrate on expanding its distribution into new territories.

Hiscox USA: Our US business made excellent progress during the year. Revenues grew by 32.6% to reach $230.5 million (2011: $173.8 million), with strong growth across every office and in every product. The business was performing well ahead of plan at the bottom line until Superstorm Sandy. We suffered losses on our construction account with most other areas escaping relatively unscathed. As they mature our professional liability accounts are developing well – a reflection of early prudent reserving. During the year we launched 'Hiscox One', a one-stop modular insurance cover for film and television productions. It is the first integrated product on the market and has been received well. The direct business continued to expand, reaching almost $10 million in premium income (2011: $3 million) with some exciting prospects in store for 2013. We will continue to market the products online in 2013, and test brand advertising on billboards, specialist publications and other print media in Austin

and San Diego, with the aim to accelerate growth in these key markets.

The US business is on track and we continue to invest in driving it to success. Our ambition is that the broker channel business will be profitable in 2013, assuming a normal loss year. The ongoing marketing investment in the direct business will hold back profitability in the short-term, but as we grow in knowledge and experience in the US we anticipate more rapid success.

Claims

When you sell insurance, claims are something you anticipate and plan for and at Hiscox we pride ourselves on settling our clients' claims swiftly and fairly. As highlighted at the start of my report we had a busy year. Costa Concordia and Superstorm Sandy hit the headlines, but there was lots of other activity. 2012 was a year of dramatic weather in the UK and Hiscox UK received 1,500 storm and flood claims with related claims paid of £14 million, nearly five times the previous year.

Handling claims well requires a balance of thorough process and controls as well as an ability to deal with claimants and their brokers. During the year we completed the implementation of a new claims management solution for Hiscox London Market which has transformed the way we do claims in that area, leading to better decision making, enhanced productivity and improved indemnity costs. In a 2012 independent survey of claims brokers we continued to score favourably for broker satisfaction and, with the enhancements in service that the new system will allow, we are hopeful that our perception in the market will improve further in the year ahead. In our UK and European businesses, customer satisfaction with our claims handling has continued to improve, and effective claims handling continues to set us apart in the market.

Hiscox's cautious reserving philosophy is again reflected in reserve releases of £152 million, down from releases of £199 million in 2011.

Operations and IT

The key ingredients for a successful insurer are capital, good people and effective IT. IT is a significant expenditure for the Group and is likely to increase in the short- to medium-term with the objective of improving distribution and service. In 2012 we developed a Group IT strategy, providing a clear roadmap for activity over the next five years.

The day-to-day delivery of services to brokers, customers and within the Group is continually improving. As the company grows, we can never be satisfied and will continue to look at ways to improve processes and minimise expenses. We have undertaken various lean management initiatives across the Group in 2012 including: improving how we operate our small commercial insurance lines in Europe, introducing a client-focused underwriting centre in the US and significantly increasing the amount of time underwriters spend on broker activity in the UK through the creation of virtual teams aligned to each UK region. Each of these steps has progressively improved service reliability and predictability. In 2013 the focus will be on using the momentum of 2012 to maintain service whilst reducing cost.

Investments

Hiscox's focus on property-related insurance means that our invested assets, when measured relative to our premium income, are lower than the industry average. Despite this, investment income has historically accounted for about 50% of our profits. We began the year with cautious expectations, given the low interest rate environment and our view that a lot could have gone wrong during the year. However, our worst fears were not realised and, with a fair wind from central banks, the investment result exceeded our expectations – and accounted for 42.6% of our profits, only just below the longer-term average. We achieved a total return of £92.7 million before derivatives equating to a yield of 3.1% (2011: £25.9 million, 0.9%).

Our asset allocation changed little during the year. In the bond portfolios, duration was kept short and a healthy weighting towards non government bonds was maintained. We made some alterations to the selection of equity and hedge fund managers but our overall exposure remained constant at around 6% of assets. With the words and actions of central bankers reassuring investors that interest rates would be kept low and a financial upheaval, particularly in Europe, would not be tolerated, a 'risk on' mentality eventually prevailed. This served us well as non government bonds and equities were much in demand. Our bond portfolios all beat their benchmarks and benefited from the narrowing of credit spreads and, unlike the previous year, there was not much opportunity cost to being short duration. The risk assets portfolio produced particularly strong returns both in absolute terms and relative to market indices.

Whilst the investment world may look a safer place in 2013, plenty of uncertainty still exists and the portfolio is cautiously positioned overall, both from a duration and credit quality standpoint. After such a favourable period for bonds, the yield to maturity of our portfolios has declined over the year and our expectation of returns from them in 2013 is therefore correspondingly reduced. We do, however, retain an appetite for sensible risk, hence our continued allocation to equities. We feel they offer a better risk-reward ratio than exists in the higher yielding bond and structured credit strategies where we continue to resist temptation.

Capital management

We announced today a special distribution of approximately £150 million, equal to 38p per share, which is on top of the final dividend equivalent of 12p. This takes our total capital back to approximately the level at the start of 2012.

A lot of detailed analysis has been done to support this decision, but in essence we feel that we started the year in a strong capital position, and looking forward we can see that our prospective profits will generate enough capital to support our growth so that there was no need to retain our after-tax profits for the year.

Our leadership and our people

As announced 12 months ago Robert Hiscox steps down as Chairman with the presentation of these results. Robert's record of successful leadership is unparalleled in the insurance industry and his contribution has rightly been recognised publicly over the year. When Robert took the reins at Hiscox in 1970 annual revenues amounted to £2.3 million; this has grown to £1.6 billion in 2012. Robert has accepted the role of Honorary President and we look forward to his ongoing sage counsel.

The Board undertook a thorough selection process in recruiting Robert's successor. I am delighted that they have chosen Robert Childs, our Chief Underwriter who has been with us for 26 years. This decision has been greeted very warmly within Hiscox and the industry.

There is a great benefit to having someone who knows the detail of our business in the role of Chairman. The greatest risk to the prosperity of our business is the success of its underwriting. In insurance the premiums are visible whilst the risks only become visible when the claims occur – when it is too late to change course. As the banks have shown, even the most sophisticated systems cannot adequately surface some critical risks on a timely basis. As Chairman, Robert Childs will have the enormous advantage of understanding where the risks lie, which ones are easy to measure and monitor and which will rely on judgement and feel. He also has the experience of dealing with a huge industry loss and knows that reacting in the right way is often the determinant of success in these tough situations.

Beyond the more visible Chairman's succession, we have made some other senior executive moves. In June Richard Watson returned from the US, where he served as Chief Executive, to become Deputy Chief Underwriter and he now succeeds Robert Childs as Group Chief Underwriter. Richard made a major contribution to shaping our US business, setting it on a successful path. His experience managing the London Market business and a more retail environment in the US makes him well placed to oversee our underwriting culture. Ben Walter replaced Richard Watson as Chief Executive of Hiscox USA. Ben joined us two years ago as Chief Operating Officer of Hiscox USA from the fund management industry. Gary Head, the Chief Underwriter of Hiscox UK, has moved to the US to serve as its Chief Underwriter. Charles Dupplin returned to the UK from Bermuda where he served as Chief Executive of Hiscox Bermuda, and Group Company Secretary. He will continue as Head of M&A and Special Projects, a role he had in Bermuda, but which received less attention with his other responsibilities. Jeremy Pinchin has succeeded Charles as CEO of Hiscox Bermuda and Company Secretary, whilst remaining Group Head of Claims. All of these moves have entailed personal challenges for the individuals and their families and I am grateful for the sacrifices they have made to help us build our business.

The broad Hiscox team make their contributions in many roles, geographies and disciplines. It is the dedication to excellence that builds our reputation as a Group. Our excellent marketing can deliver the message, but I am always personally gratified to be complimented on a claim paid well, a risk well underwritten or a recruitment process thoughtfully handled. These are all the result of individual decisions well executed – the personal standards of each person involved shining through. Our many staff deserve our thanks and it is great that their efforts have been justly rewarded in good performance.

Outlook

As I said at the start of my statement, 2012 was a more normal year for the global industry after the challenges of 2011. That means that we do not expect material upward or downward pressure in pricing. Reinsurance pricing is up slightly in areas closest to recent losses – in the US East Coast, Japan and parts of Asia. In the US domestic market there are reports of slight upward movement in some areas for the second year in a row. Parts of the UK are very competitive, whilst others are benign, so our aggregate expectation is for a stable pricing environment where good risk selection, good underwriting and good service will be rewarded. Investment returns will likely trend down, reflecting the broader financial market.

Looking further ahead than 12 months I believe we have the ability to materially grow the size of our business within the classes and geographies in which we currently operate. In our most developed retail market, the UK high net worth area, we still have only single digit market share, so the opportunity here is significant, not to mention the opportunities in other territories. Our retail commercial market share is even smaller, and our direct businesses have just begun. In our internationally traded businesses we are a smallish player other than in a few very specific segments, so again we have the opportunity to grow and develop. Expansion of our geographic footprint could also create new opportunities.

As I enter my twentieth year at Hiscox, I remain enthusiastic and optimistic for the opportunities ahead. I remain impatient and unsatisfied that we have not captured more of them already – a trait I have had bred into me by Robert Hiscox – and I am sure that with a steady determined focus on winning clients one at a time we will continue to grow our business profitably to the satisfaction of clients, staff and shareholders.

Bronek Masojada
25 February 2013

The Hiscox Group has over 1,400 staff in 11 countries.

Bermuda
Hamilton

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

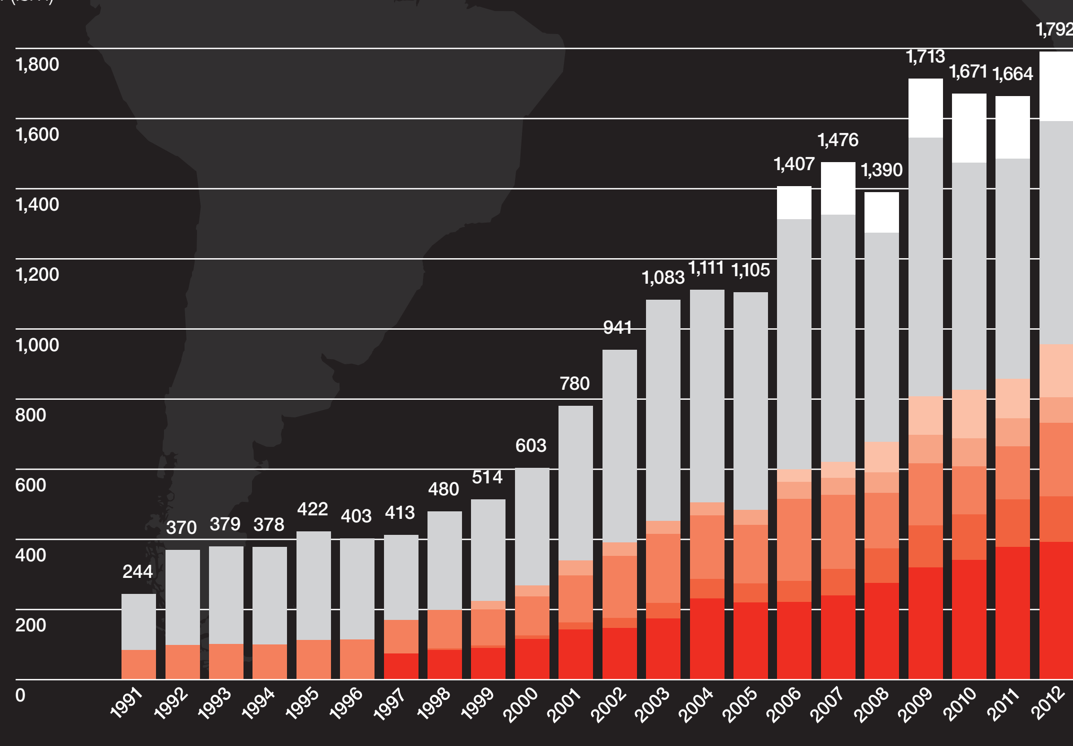
Guernsey
St Peter Port

Latin American gateway
Miami

UK
Birmingham
Colchester
Glasgow
Leeds
London
Maidenhead
Manchester
York

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

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



Hiscox business structure

Hiscox London Market

Hiscox London Market

Russell Merrett, Managing Director

Reinsurance; property; marine and energy; specialty; kidnap and ransom; terrorism; political risks; errors and omissions; aviation and aerospace

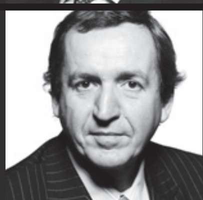
Hiscox International

Hiscox Bermuda

Jeremy Pinchin, Chief Executive Officer

Global reinsurance; Group capital support; healthcare insurance

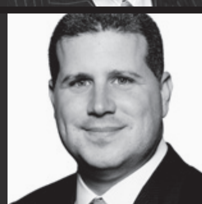
Hiscox Guernsey



Steve Camm, Managing Director

Fine art; kidnap and ransom; terrorism

Hiscox USA



Ben Walter, 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

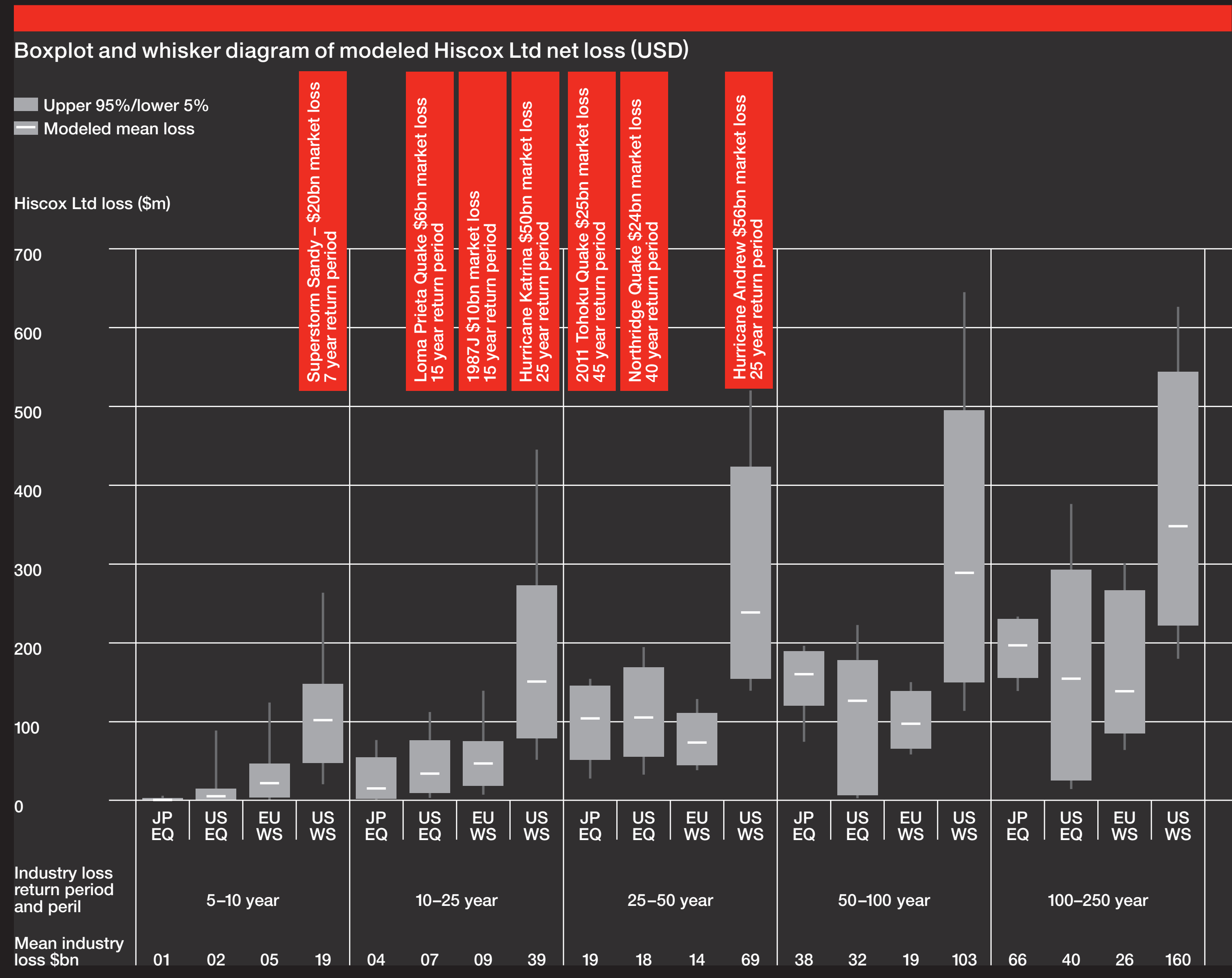
Fine art; high-value household; errors and omissions; directors and officers' liability; specialty commercial; technology/media; kidnap and ransom; terrorism; direct to customer commercial business

Actively managed business mix

Total Group controlled premium December 2012: £1,792m
(Year-on-year change in original currency)

Division	Change	Premium	Lines
Reinsurance	(+8.3%)	£503m	Non-marine; Marine; Aviation; Whole account
Local E&O and commercial	(+19.0%)	£377m	Professional liabilities; Errors and omissions; Directors and officers' liability; Commercial office; Small technology and media E&O
Specialty	(+7.6%)	£307m	Kidnap and ransom; Contingency; Terrorism; Specie; Personal accident; Political risks; Aviation; Contractors' equipment
Art and private client	(-6.8%)	£255m	Home and contents; Fine art; Classic car
Property	(+28.8%)	£175m	Managing general agents; Commercial property; Onshore energy; USA homeowners
Marine and energy	(-3.8%)	£135m	Marine hull; Energy liability; Upstream-midstream energy
Global E&O	(-3.4%)	£40m	Professional indemnity; Large tech and media E&O

Actively managed key underwriting exposures



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 modeled 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 WS – United States windstorm

Realistic disaster scenarios, Hiscox Ltd

The table below presents selected realistic disaster scenarios based on our book of business in force at 1 January 2013 and industry data. Given the nature of the risks underwritten, the loss estimates may be materially different than those that arise 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	405	211	18.0	9.4	0.4	50	240
Gulf of Mexico windstorm	805	185	35.8	8.2	0.2	107	80
Florida windstorm	589	136	26.2	6.1	0.1	125	100
European windstorm	483	173	21.5	7.7	0.6	30	200
San Francisco earthquake	632	156	28.1	6.9	0.3	50	110

Capital

£150m
Additional special distribution

Capital management
Hiscox believes in managing its capital. The Board monitors the capital strength of the Group and ensures its insurance carriers are suitably capitalised for regulatory and ratings purposes, taking into account future needs including growth where opportunities arise. As discussed in the Chairman's statement, as a result of our strong performance in 2012, the Board has reviewed the Group's capital level and proposed that a special distribution of 38.0p per share (approximately £150 million), should be made. A further amount of 12.0p per share is proposed instead of payment of a final dividend. This return of capital will align the Group's available capital with its risk appetite and ensure a surplus is maintained above the rating agencies' minimum capital requirements to remain in the A range, the most restrictive of the Group's external capital assessments.

The impact of this distribution and how it compares to the Group's capital requirements is presented in the chart below right.

Capital requirements
The Group monitors its capital requirements based on both external risk measures, set by regulators and the ratings agencies, and its own internal guidelines of risk appetite. A full description of the requirements set by the regulators for the most significant insurance carriers is included in note 3.3 to the financial statements. A brief explanation of the primary internal and external capital constraints at a Group level is given below.

Management compares the capital requirements of the Group against its available capital. Available capital is defined by the Group as shareholders' equity which was £1,378 million at 31 December 2012 (2011: £1,256 million). Debt or preference shares are not defined as available capital by the Group as they do not absorb losses, should they occur, ahead of or alongside ordinary shareholders.

However, the Group can source additional funding through a revolving credit and Letter of Credit facility. Additional funding from these sources comprised $875 million at 31 December 2012 (2011: $750 million).

Rating agencies
The ability of the Group to attract business, particularly reinsurance, is dependent upon the maintenance of appropriate financial strength ratings from the leading rating agencies, Standard & Poor's, A.M. Best and Fitch. These ratings are assigned individually to the insurance carriers of the Group, but capital adequacy is also monitored by the rating agencies at the consolidated Group level.

Both A.M. Best and Standard & Poor's have shared their capital models with management. These models calculate a capital adequacy score by measuring available capital, after making various balance sheet adjustments, as a proportion of required capital which incorporates charges for premium, reserve, investment and catastrophe risk. Management's interpretation of A.M. Best's 'Best Capital Adequacy Ratio' (BCAR) model indicates the Group has a healthy surplus above the minimum capital required to maintain the carriers' A ratings. On a similar basis the Standard & Poor's modeled result indicates a surplus in excess of the mid-point of the required A range with additional headroom above the minimum requirement. Projections indicate a reasonable level of flexibility would be maintained following the £150 million special distribution.

The rating agency capital requirements shown in the chart below are based on the Group's own internal projections of the requirements based upon its 2013 business plan. The A.M. Best capital requirements stated are also consistent with the latest assessment received from A.M. Best in November 2012, which also took into consideration the 2013 business plan.

Group regulators
As a Bermudian registered holding company, the Bermuda Monetary Authority (BMA) has been assessed as the Group's regulator under the Bermuda Group Supervisory Framework. During 2011, the BMA introduced proposals for a group solvency capital requirement under which the Group provides a solvency return in accordance

the Group Solvency Self Assessment framework (GSSA) including assessment of the Group's Bermuda Solvency Capital Requirement (BSCR). At this time the legislation for these requirements is still in draft form, with a proposed implementation date of 1 January 2014. Nevertheless, the Group continues to monitor its compliance with these requirements ahead of this implementation date.

The BSCR model applies factors to premium, reserves and assets/liabilities to determine the minimum capital required to remain solvent throughout the year.

The GSSA is based on Hiscox's own internally assessed capital requirements and is informed by the Group's Economic Capital Model (ECM), which together with the BSCR forms part of the BMA's annual solvency assessment. The ECM combines factor-based risk charges with stochastically modeled elements. It is a forward-looking model for which primary inputs are derived from the following year's business plan, in respect of expected levels of premium, exposure and underwriting losses (both catastrophe and non-catastrophe).

The proposed return of capital will leave the Group with a comfortable surplus above Hiscox's internal projections of both the BSCR and GSSA for the 2013 business plan.

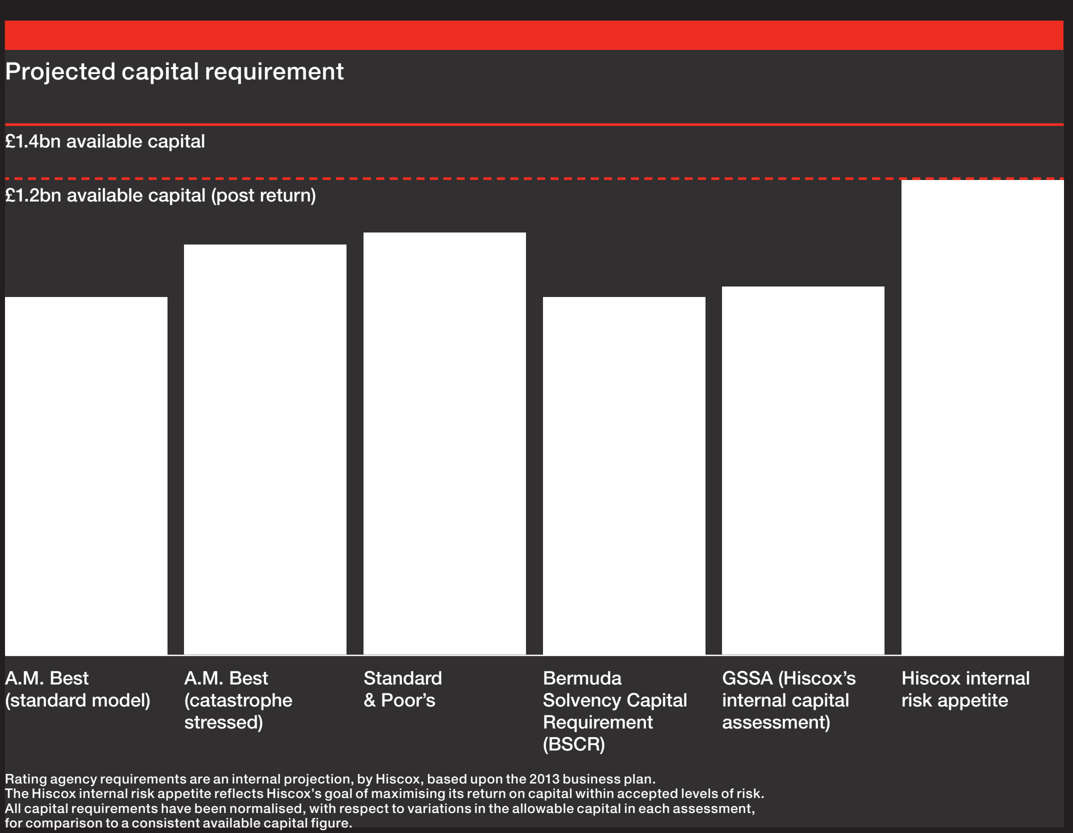
Internal capital requirements
The chief determinant of our capital requirement in 2013 is our own internal risk appetite which is more restrictive than any external measure.

The Group manages the underwriting portfolio so that in a 1 in 250 aggregate bad year it would lose no more than 15% of the Group's core capital plus assigned buffer capital (currently £100 million). A market loss at this remote return period would be very big indeed and would certainly bring about positive market changes. The Group would be well positioned in the resulting strong market with capital in the order of £1 billion in addition to its LOC facilities and its now well-developed reinsurance partnerships.

If the return of capital is approved by the shareholders on 28 March, the available capital will reduce to approximately £1,228 million, comfortably exceeding current regulatory and rating agency requirements. This level of capital would be in line with the Group's stated risk appetite for 2013.

The Board believes that this level of capital gives sufficient flexibility to achieve its desired business growth whilst maintaining the Group's current capital strength.

Projected capital requirement



Rating agency requirements are an internal projection, by Hiscox, based upon the 2013 business plan.
The Hiscox internal risk appetite reflects Hiscox's goal of maximising its return on capital within accepted levels of risk.
All capital requirements have been normalised, with respect to variations in the allowable capital in each assessment, for comparison to a consistent available capital figure.

Group financial performance

£217.1m
Profit before tax

85.5%
Combined ratio

Profit before tax for the year was £217.1 million (2011: £17.3 million), including a solid investment return of 3.1% (2011: 0.9%) and despite Superstorm Sandy losses of £90 million. The Group recorded a post-tax return on equity of 16.9% (2011: 1.7%) and earnings per share were 53.1p (2011: 5.5p).

Net asset value per share increased by 8.1% to 349.7p (2011: 323.5p). The Group continues to maintain a progressive dividend policy and total dividend per share rose by 5.9% to 18.0p (2011: 17.0p), subject to shareholder approval of the final dividend equivalent. Following a review of the Group's capital position, it is proposed to make a further special distribution, subject to shareholder approval, through the B share scheme of 38.0p per share.

Gross premiums written of £1.56 billion were up 8.0% year-on-year. Strong growth in the property, reinsurance, aviation and local E&O and commercial lines were offset in part by a decline in art and private clients. The Group's combined ratio including foreign exchange was 85.5% (2011: 99.5%).

This has been a good year for the Group in the investment markets, with the Group's investments producing a return of 3.1% (2011: 0.9%). All asset classes outstripped their benchmarks.

The underwriting performance for each operating segment is detailed on the next page.

Hiscox London Market

Gross premiums written increased by 9.3% to £640.0 million (2011: £585.4 million), with strong growth in the property division along with the aviation and reinsurance accounts.

Reinsurance purchased was at a similar level to the prior year at 27.8% of gross premiums written (2011: 29.4%). The quota share arrangement with Syndicate 6104 and others remained in place and are increasing in 2013.

The net claims ratio improved to 40.3% (2011: 56.6%), with much less catastrophe impact in the year. Superstorm Sandy and Costa Concordia being the two larger events of note compared to an over-active 2011.

As a result, the combined ratio improved greatly to 75.5% (2011: 89.1%). Profit before tax for the year was £121.9 million (2011: £57.6 million).

Hiscox UK and Europe

Gross premiums written rose by 1.9% to £507.5 million (2011: £498.0 million). Gross premiums written for the UK increased by 2.2% with a reduction in the art and private client lines offset by gains in professional and specialty commercial. Europe remained broadly constant year-on-year with gross premiums written of £132.3 million (2011: £130.9 million), being a 1.1% increase. In underlying currency terms, Europe fared better with an increase of 5.9%.

The net claims ratio remained constant at 47.2% (2011: 46.3%). Two specific losses in the year contributed to the small decline. The combined ratio declined to 94.4% (2011: 91.0%), in part due to a slight increase in the expense ratio as we increased the marketing spend in both UK and Europe for the year.

As a result, profit before tax for the year was slightly down at £49.1 million (2011: £51.5 million).

Hiscox International

Gross premiums written increased 14.3% to £418.3 million (2011: £365.8 million) largely driven by the US. The US increased premiums by 32.6%, driven in the main from the specialty lines, but all areas contributed. The Direct division grew by 223% from a small base. Bermuda also saw their premium increase by 13.0% to £200.7 million (2011: £177.7 million). Gross premiums written in Guernsey decreased as less piracy and multi-year policies were written.

The net claims ratio improved significantly to 46.0% (2011: 89.9%) with only Superstorm Sandy as a larger event during the year compared to the multiple catastrophe events in 2011. The impact on the combined ratio was an improvement of 44.7% to 89.2% (2011: 133.9%).

As a result, the profit before tax was £62.6 million (2011: loss of £89.5 million).

Hiscox Corporate Centre

Investments performed well during the year with a return of £18.5 million (2011: £2.2 million). This was offset in part by operational expenses increasing to £17.3 million (2011: £12.3 million) and foreign exchange losses of £11.5 million (2011: gain £12.4 million). The losses on foreign exchange were as a result of holding US Dollar assets. The loss before tax was £16.5 million (2011: loss £2.3 million).

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 £150.6 million (2011: inflow £179.1 million). The inflow was mainly due to prompt settlement of premiums and reinsurance recoveries, along with amounts recovered on tax. Net cash outflow from investing activities, being comparable to the prior year, was £13.7 million (2011: £11.8 million). The Group continues to invest in its IT infrastructure and the development of projects such as a management information project aimed at improving the quality and efficiency of information provision. Marketing expenses increased to £26 million in the year.

Net cash outflows from financing activities for the year were £60.8 million (2011: outflow

Group key performance indicators

	2012					2011				
	London Market	UK and Europe	International	Corporate Centre	Total	London Market	UK and Europe	International	Corporate Centre	Total
Gross premiums written (£m)	**640.0**	**507.5**	**418.3**	**-**	**1,565.8**	585.4	498.0	365.8	–	1,449.2
Net premiums written (£m)	**462.4**	**479.9**	**325.8**	**-**	**1,268.1**	413.4	472.6	288.0	–	1,174.0
Net premiums earned (£m)	**419.0**	**476.9**	**302.7**	**-**	**1,198.6**	418.8	448.6	277.6	–	1,145.0
Investment result (£m)	**27.0**	**17.7**	**29.2**	**18.5**	**92.4**	8.8	7.2	6.3	2.2	24.5
Profit/(loss) before tax (£m)	**121.9**	**49.1**	**62.6**	**(16.5)**	**217.1**	57.6	51.5	(89.5)	(2.3)	17.3
Claims ratio (%)	**40.3**	**47.2**	**46.0**	**-**	**44.1**	56.6	46.3	89.9	–	60.2
Expense ratio (%)	**32.8**	**46.9**	**44.2**	**-**	**40.5**	32.5	44.7	42.9	–	39.1
Foreign exchange impact (%)	**2.4**	**0.3**	**(1.0)**	**-**	**0.9**	–	–	1.1	–	0.2
Combined ratio (%)	**75.5**	**94.4**	**89.2**	**-**	**85.5**	89.1	91.0	133.9	–	99.5

	2012	2011
Financial assets and cash* (£m)	**3,055.8**	2,873.4
Other assets (£m)	**1,330.5**	1,349.3
Total assets (£m)	**4,386.3**	4,222.7
Net assets (£m)	**1,378.4**	1,255.9
Net asset value per share (p)	**349.7**	323.5
Net tangible asset value per share (p)	**332.0**	306.1
Adjusted number of shares in issue (m)	**394.2**	388.2

*excluding derivative assets, insurance linked fund and catastrophe bonds.

£67.3 million). The outflow is due to payment of dividends to shareholders, with less scrip dividends having been taken up in the year.

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. The bank facility was renegotiated during the year up to $875 million. There was no cash drawn down on the banking facility during the year.

At 31 December 2012, $308 million (2011: $340 million) had been drawn by way of Letter of Credit against this facility.

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.

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 implementation of the new regime remains uncertain, with a probable delay at least until 2015. The Group continues to monitor developments within Europe, and is confident of being well placed against the new requirements when they come into force.

The Bermuda Monetary Authority (BMA) has begun supervising the Group, under the new Group Supervisory Framework. The new framework places a regulatory capital requirement upon the Group for the first time. Testing of the new standards was undertaken during 2012 in which the Group had sufficient capital to meet requirements. The BMA continues to work towards Solvency II equivalence.

Group investments

The Group's invested assets at 31 December 2012 totaled £3.06 billion (2011: £2.87 billion). Continued positive cash flow accounted for the increase in assets under management during the year. The investment result, excluding derivatives, amounted to £92.7 million (2011: £25.9 million) equating to a return of 3.1% (2011: 0.9%).

£3.06bn
Invested assets

We approached 2012 with a good degree of scepticism and in the knowledge that events in the Eurozone, together with concerns over the potential for the US and Chinese economies to disappoint, could lead to a modest and volatile investment return. In the event these fears proved to be unfounded and nearly all asset classes appreciated in value as central bankers rode to the rescue, ensuring there was ample liquidity where necessary and pursuing monetary policy designed to keep interest rates artificially low along much of the yield curve. This support from their central banks enabled politicians to kick various cans down the road. Indeed, when there was a deadline for a political decision to be made, America did its best to alarm markets before averting the worst impact of the much heralded fiscal cliff. The 'do whatever it takes' and open-ended nature of the language accompanying various official statements in the latter half of the year provided fresh impetus to the equity rally and further compressed yields in bond markets. Against this background the Group's investment return comfortably exceeded initial expectations.

With a healthy allocation to non government bonds, the fixed income portfolios beat their benchmarks and generated much better returns than last year as they benefited from both the marked narrowing of spreads that occurred across a broad credit spectrum and, to a lesser degree, a further small decline in government bond yields. Mortgage backed securities ('MBS'), mostly concentrated in the US Dollar portfolios, provided the main source of outperformance. The Federal Reserve added agency MBS to the list of bonds that they would purchase in significant quantities, whilst non agency MBS made further gains, given their attractive yields and a background of a generally improving US housing market. The proportion of the portfolio invested in this area has declined steadily in recent years with principal repayments at par. However, following the strong recovery in prices of the underlying bonds, some outright sales were made, further reducing the overall exposure. Corporate bonds, in general, did well but the bank debt, where we remained focused on the national champions and the senior part of their capital structure, outperformed following the reduction in 'tail risk' engendered by the central banks. The margin of outperformance in the other currency portfolios was less but all of the managers did well, largely due to their credit exposure.

The allocation to risk assets, which was maintained at approximately 6% of invested assets throughout the year, made a solid contribution to returns. The changes that have been made to the selection of funds that we invest in has borne fruit and the blend of long only and equity based hedge funds returned 14.8%, with both categories exceeding their respective benchmarks.

Group investment performance

		31 December 2012			31 December 2011		
		Asset allocation %	Return %	Return £000	Asset allocation %	Return %	Return £000
Bonds	£	13.2	2.2		14.2	1.6	
	US$	49.0	3.2		52.5	1.0	
	Other	9.6	2.2		8.8	1.9	
Bonds total		71.8	2.8	62,579	75.5	1.3	29,933
Equities		6.2	14.8	26,974	6.0	(3.8)	(5,935)
Deposits and cash equivalents		22.0	0.5	3,137	18.5	0.4	1,944
Actual return			3.1	92,690		0.9	25,942
Group invested assets*				£3,055.8m			£2,873.4m

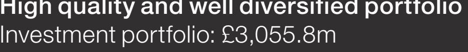
*excludes derivatives and investment in insurance linked fund and in catastrophe bonds.

There were no dramatic tactical shifts during the year, with surplus liquidity being invested in line with the asset allocation that prevailed at the end of 2012. We have not dropped our guard in matters of credit and the quality of our bond portfolios remains high with over 90% of securities rated single A or better. Sovereign bonds whose price depends largely on the prospect of support from the ECB were absent from our portfolio throughout the year. Conservative levels of cash were maintained for the payment of claims and general corporate purposes, with further liquidity being available from lines of credit which remained available and undrawn for cash purposes throughout the year. Cash continues to be invested with a focus on safety rather than yield.

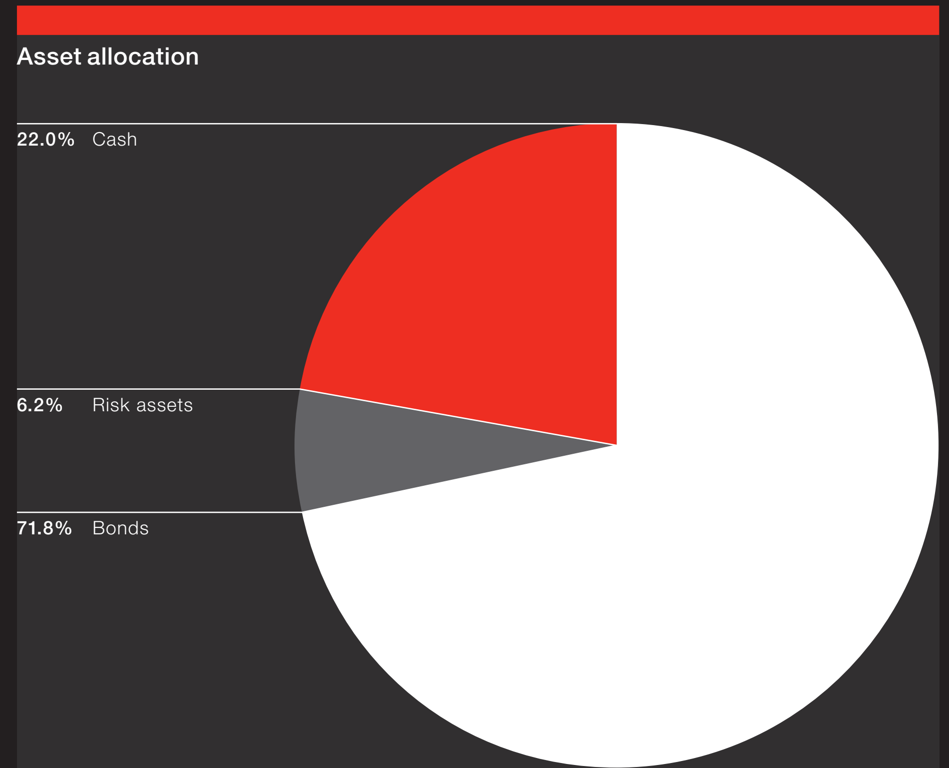
Whilst there are some grounds, looking ahead, to believe that economic activity is set to improve and the risks of a financial mishap are reduced, we still think that, on balance, it is a time for caution. The effects of financial repression have meant that the yields of the bond portfolios have declined over the year and there is little scope for further capital gain. Stretching for yield is an option but there is not much to be gained from taking duration risk and much to be lost when interest rates rise. On credit, we are wary of straying back into below investment grade securities at levels which may look relatively attractive in the short-term, but have limited upside and will perform more like equities when the tide turns. We are however prepared to take a modest amount of selective risk in order to avoid having a portfolio that is condemned to producing little by way of return. This is currently concentrated in the equity allocation where, even after recent gains, they represent a likely source of excess returns over time. Volatility in equity markets remains but so does their reasonable valuation and attraction relative to other assets. Given the above, our sights for the investment return in 2013 are set fairly low.

In summary, the investment objective is to maximise investment returns within an overall risk appetite and giving due regard to prevailing financial, economic and market conditions. The overriding concern is not to lose money in any 12-month period. Balancing these desires is becoming increasingly challenging in the current environment as the chances of losing money, given even a modest appetite for risk, are increasing. The portfolio therefore is constructed principally bearing in mind the need to pay claims and to provide capital for underwriting in all market conditions rather than to produce more yield from artificially overpriced assets. In order to allow some measured risk to be taken within the portfolio the Board has, in recent years, set aside capital against the possibility of a negative result from the investment portfolio in any one year and this continues to be the case for 2013. This gives us the ability to withstand volatility in markets but also the capacity to take advantage of any opportunities that may be thrown up by market dislocations.

High quality and well diversified portfolio
Investment portfolio: £3,055.8m

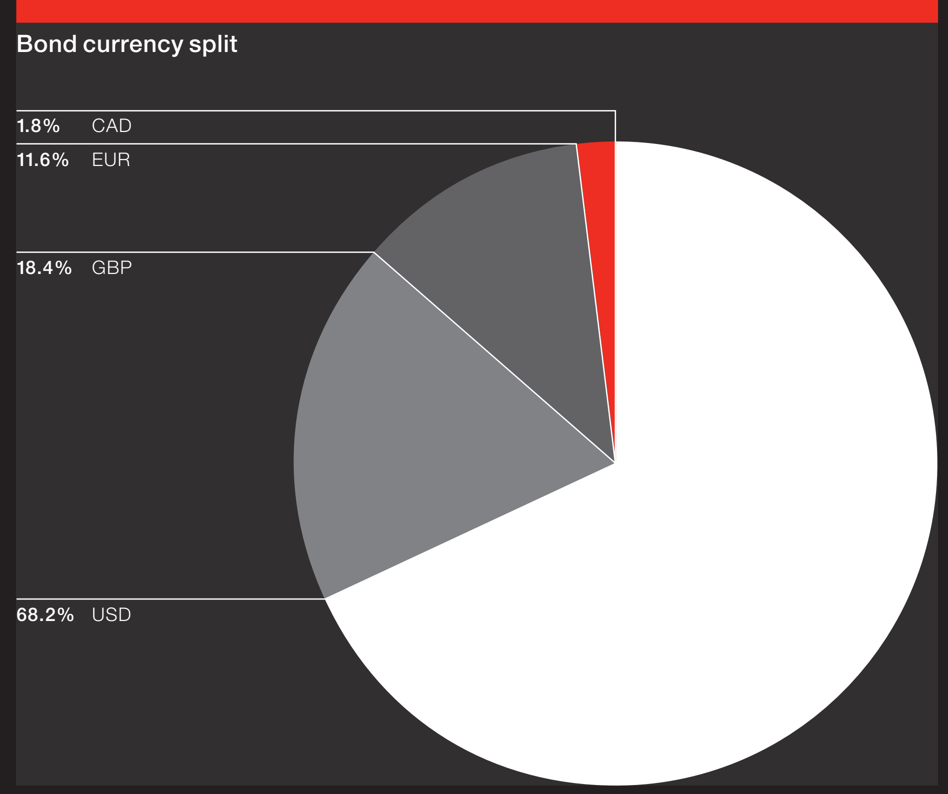


Asset allocation

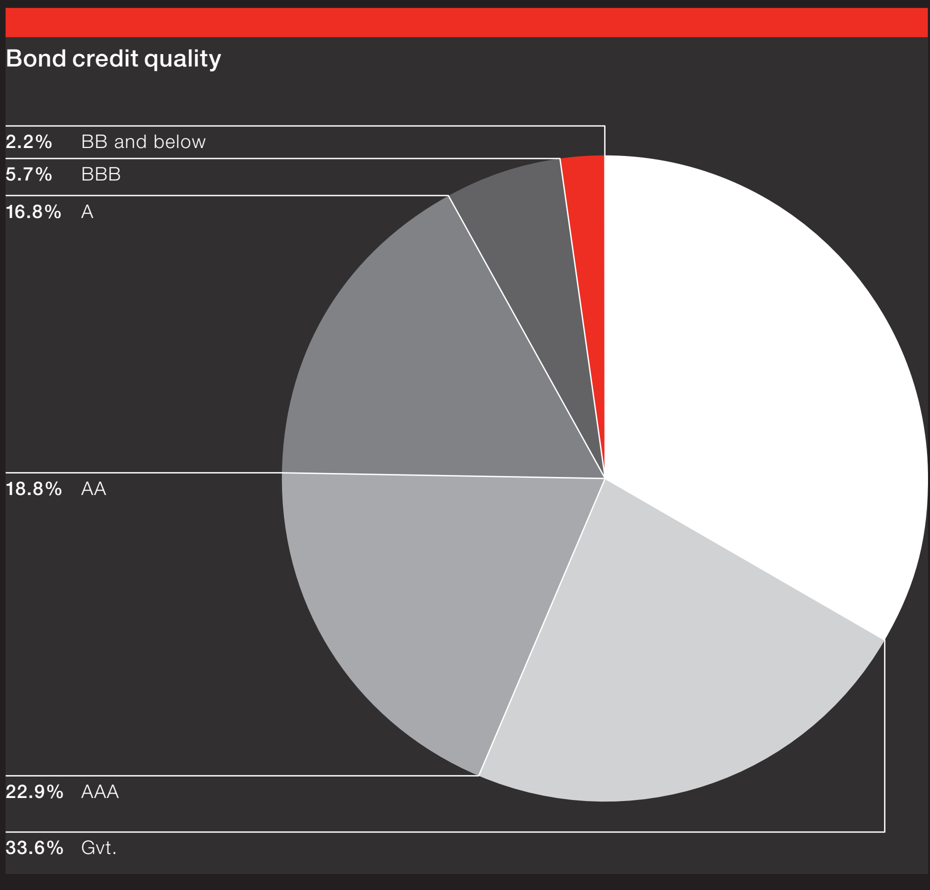


Group investments
continued

Bond currency split



Bond credit quality



Risk management

Our core business is to take risk and our strategy is to maximise return on equity within a defined risk appetite. Our ongoing success depends on how well we understand and manage the significant exposures we face. It is therefore crucial 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. Our risk management framework is designed to oversee a culture of innovative and prudent underwriting.

The Group risk management framework
The Risk Committee of the Board advises our Directors on how best to 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 ensures 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.	— **Diversified portfolio:** Hiscox has a well-diversified portfolio by product and geography to help balance any catastrophe exposure. — **Risk appetite:** We clearly define our risk appetite for underwriting risk, which dictates our business plan. To ensure that we do not exceed our risk appetite, we monitor our exposures closely and take mitigating actions to maintain business plan. This enables us to maximise the expected risk return profile on the whole portfolio and offset the potential losses on more volatile accounts. — **Underwriting discipline:** Underwriters are incentivised to make sound decisions that are aligned with Group's overall strategic objectives and risk appetite. Clear limits are placed on their underwriting authority. Policy wordings are regularly reviewed 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 of issue. — **Modeling:** We have tailored our modeling resources to assist insurance and reinsurance plans and ensure that the exposure we write matches expectations. The risk aggregation and modeling resources are shared across the Group to ensure everyone uses the same modeling tools.

Principal risks continued

What is the risk?	Why do we have it?	How is it managed?
Catastrophic and systemic insurance losses continued		**Stress and scenario testing:** 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. **Reinsurance:** We buy reinsurance for our business carriers and the Group as a whole, to mitigate the effect of catastrophes and unexpected concentrations in risk. The scope and type of 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, supervised by 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.	**Pricing discipline:** 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 as it can drive 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. **Remuneration:** Hiscox incentivises underwriters on return on equity, rewarding staff for profit not revenue. **Risk appetite:** Our appetite for certain lines of business changes according to market conditions and the risk appetite of the Group. **Monitoring:** We regularly monitor pricing levels, producing detailed monthly reports grouping current prices with exposure and trends over the past 12 months. This ensures that we quickly identify and control any problems created by adverse changes in market conditions. **Lead insurer:** 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.	**Historical data and actuarial analysis:** The provisions we make to pay claims reflect our own experience and the industry's view 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 on note 26 to the consolidated financial statements. The provisions we make are set above the actuarial mid-point to reduce the risk that actual claims exceed the amount that has been set aside. **Senior management and board approval:** 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.

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.	— **Conservative 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. — **Currency matching:** 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. — **Duration:** 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. — **Benchmarks:** 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. — **Equities:** A proportion of the Group's assets is 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. — **Guidelines:** 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 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 quickly 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.	— **Risk management:** 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 risk management measures. — **Forecasting:** 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. — **Cash:** Available 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. — **Stress tests:** We run tests to estimate the impact of a major catastrophe on our cash position in order to identify potential issues. We also run scenario analysis that considers 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. — **Credit:** We maintain extensive borrowing facilities. These arrangements have been made with a range of major international banks to minimise the risk of one or more of the institutions being unable to honour their commitments to us. — **Liquid assets:** 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.

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 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.	– **Vetting and auditing:** 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.	– **Careful selection:** We buy reinsurance only from companies that we believe to be strong. Every reinsurer we use must be approved by a dedicated Reinsurance Security Committee, based on an assessment of financial strength, trading record, payment history, outlook, organisational structure, plus its external credit ratings. – **Monitoring:** Our credit exposures to these companies are closely monitored. The companies are continuously monitored so that we are able to identify 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. – **Guidelines:** 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 underwriting activities is 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.	— **Currency matching:** 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 to 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. — **Currency hedging:** 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.	— **Careful management:** 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, or change in strategy, that might jeopardise our ratings. — **Communication:** Regular and open communication with the major credit rating agencies helps to ensure we continue to meet their expectations.
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.	— **Disaster recovery planning:** A formal disaster recovery plan is in place to deal with workspace recovery and the retrieval of communications, IT systems and data should a major problem occur. These procedures would enable us to move the affected operations to alternative facilities quickly. The plan is tested regularly and includes 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.	— **Risk assessment:** 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 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

£0.8m
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 the amount of waste our activities produce, and the amount of resources we consume. We have made commitments to our shareholders and staff to reduce our carbon footprint. Our environmental policy encourages the business to operate more sustainably by: measuring our use of water, energy and other products in order to reduce consumption over time; buying sustainably-sourced or energy-efficient products where we can; and minimising waste by recycling products as much as is feasible. We generate significant cost and energy savings primarily through careful use of electricity, water and gas.

For the third year in a row, Hiscox UK has been carbon neutral. Our carbon footprint has improved by approximately 5% in comparison to the last audited year. The balance of our carbon emissions is offset through an investment in an African Energy Efficient Stove Project in Kenya. Replacing open fires with energy efficient stoves in villages throughout the area results in reduced firewood and therefore carbon emissions. The stoves more than halve the amount of smoke from firewood, benefiting family health. For more information, please go to www.hiscox.com.

Our sustainability efforts have also been recognised by the City of London Corporation. The London office was recently awarded Platinum in the Clean City Award scheme.

Hiscox Bermuda received the Greenrock Green Workplace award for the second year in a row. Greenrock Green Workplace Awards (GWAs) is an environmental competition bringing together businesses of all sizes that share the same vision of a greener workplace.

Hiscox is also a founding member of ClimateWise which aims to leverage the insurance industry's expertise to understand, communicate and act on climate change risk. Members commit to six key principles and are independently reviewed against these annually. These principles span risk analysis, public policy, influencing our customers, investment and managing our direct emissions. In the most recent independent review, Hiscox was recognised as being one of the most improved performers.

The marketplace

Hiscox won Company of the Year at the 2012 London Market Awards, recognising the strength of the business over the previous 18 months. Robert Hiscox was presented with a lifetime achievement award at both the London Market Awards and the Insurance Insider awards in 2012.

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 and Hiscox regularly updates partner brokers on new developments at Hiscox and in the insurance industry. Hiscox UK has instigated a 'superb service' ethos, developing a greater understanding of what works for individual brokers and thereby building strong relationships. Hiscox UK and Hiscox London Market have 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. Hiscox was awarded 'Best Small Business Insurer' by Start your Business magazine. Other accolades include the Customer Care Award from The British Insurance Awards 2012, for putting our customers at the heart of the business and moving against the tide by bringing direct household claims back in-house.

The workplace

Hiscox Spain gained recognition for Best Workplace 2012 as awarded by Great Place to Work.

Culture

The Hiscox culture is underpinned by a set of core values that determine a standard

Whitechapel Gallery

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 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 the 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 take these opportunities to listen to staff and involve them in taking the business forward.

The community
Hiscox donated £768,000 to charities in 2012. In 2012 Hiscox Bermuda continued to support Centre Against Abuse which provides shelter, support and tools to those affected by abuse. Hiscox also supports the Women's Resource Centre providing services related to the empowerment of women. Other charities include YouthNet, a school-based mentoring programme, and The Eliza Dolittle Society Bermuda which helps feed Bermuda's hungry. Other support was provided to Kaleidoscope Arts Foundation, dedicated to teaching art to children, Friends of Hospice's Agape House which is Bermuda's only in-patient palliative care facility and SCARS (Saving Children and Revealing Secrets) whose mission is to reduce the risk of child abuse. Hiscox USA also gives priority to charitable endeavours and staff are actively involved in the San Francisco Make-A-Wish Foundation. Staff also volunteered time and money to aid victims of Superstorm Sandy. Dozens of Hiscox USA employees participated in charity bike rides in California and Pennsylvania, raising over $25,000 for cancer research and prevention as part of the Livestrong initiative. In London, staff supported pupils at the Elizabeth Selby Infants School in Tower Hamlets through the Reading Partners' Scheme and have volunteered in the gardens of Richard House Children's Hospice. In Colchester, staff raised £23,000 for Headway.

Supporting the arts, science and technology
Hiscox continues to sponsor the Whitechapel Gallery's collections programme and was a major sponsor of the 2012 Serpentine Gallery Pavilion in Kensington Gardens. For the second year running, Hiscox supplied a bursary for two students of The Royal Academy of Art in London. Hiscox continues to support the Bermuda Masterworks Foundation, which aims to repatriate artworks by Bermudian artists or featuring Bermuda landscapes/seascapes. Hiscox supports 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. In September 2012 Hiscox became the title sponsor of The Sunday Times Hiscox Tech Track 100, charting the fastest growing private technology, telecoms and digital media companies.

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. The foundation has supported the Humanitarian Aid Relief Trust with a further £30,000. HART helps some of the poorest and most abused people in the world.

For more detail on corporate responsibility see hiscox.com

Insurance carriers

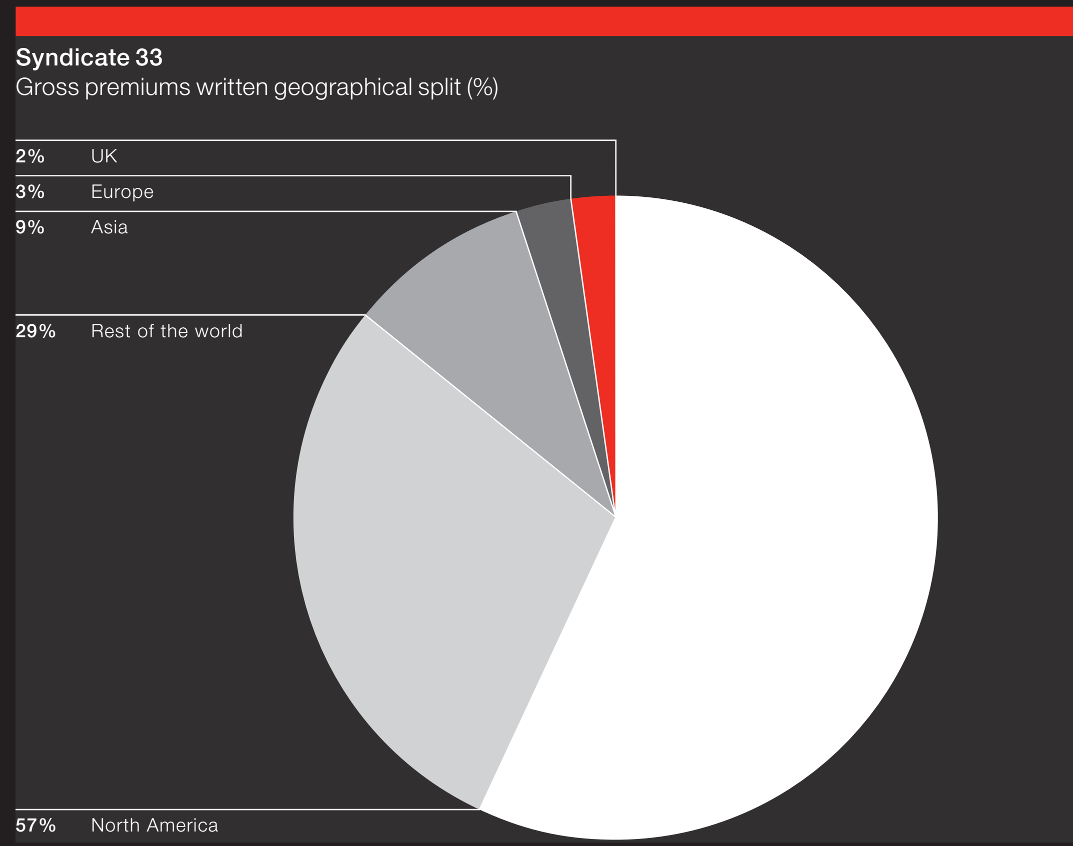
Syndicate 33
Hiscox can trace its origins in the Lloyd's Market to 1901. Today, Hiscox Syndicate 33 is one of the largest composite syndicates at Lloyd's, and has an A.M. Best syndicate rating of A (Excellent). Syndicate 33 underwrites a mixture of reinsurance, major property and energy business, as 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.

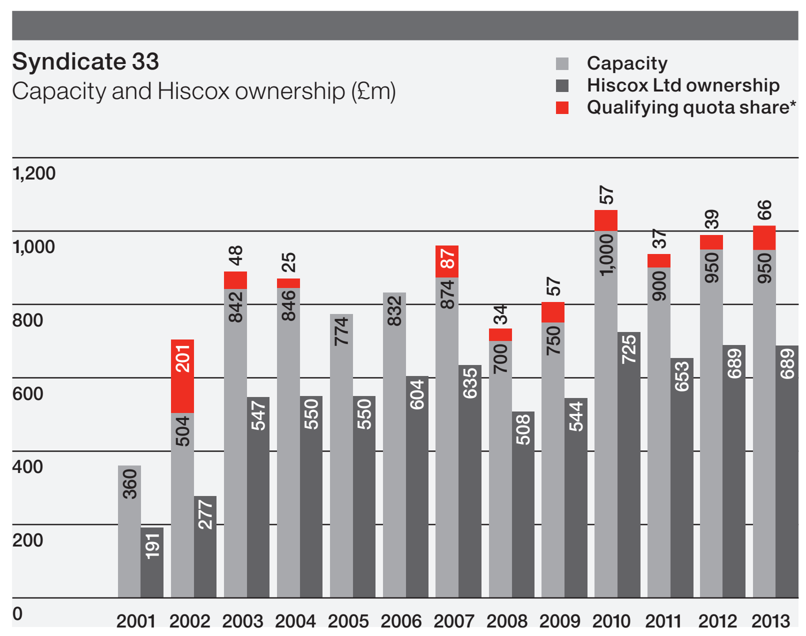
The geographical and currency splits are shown below. One of the main advantages of trading through Lloyd's is the considerably lower capital ratios that are available due to the diversification of business written in Syndicate 33 and in Lloyd's as a whole. The size of the Syndicate is increased or reduced 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 20% of profit on the element it does not own. For the 2013 year of account, Syndicate 33's capacity has remained flat at £950 million. The chart right shows the gross premiums written of Syndicate 33 for the last 12 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. Total underwriting capacity of Syndicate 3624 remained flat at £250 million for the 2013 year of account.

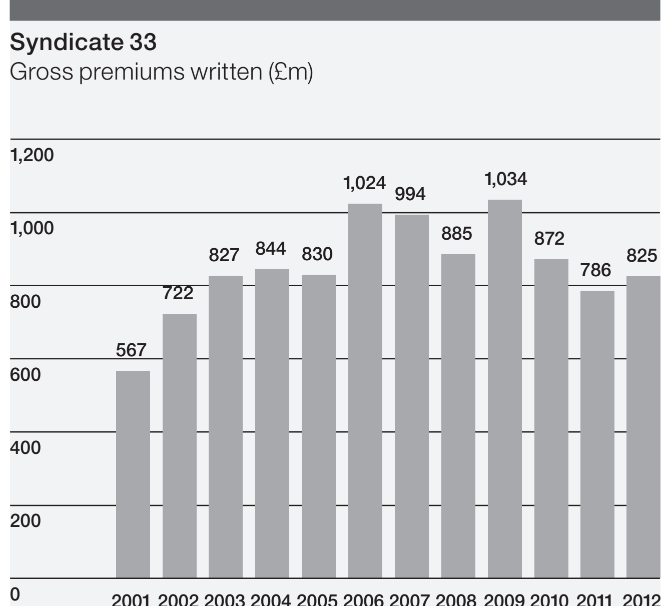
Syndicate 6104
Syndicate 6104 was set up under a limited tenancy agreement for the 2008 year of account with an initial capacity of £34 million. It is wholly backed by external Names and takes a pure year of account quota share of Syndicate 33's international property catastrophe reinsurance account. The arrangement has been extended through to the 2013 year of account and Syndicate 6104's capacity was increased to £66 million, from £39 million. Syndicate 6104 pays an overrider and profit commission to Syndicate 33.

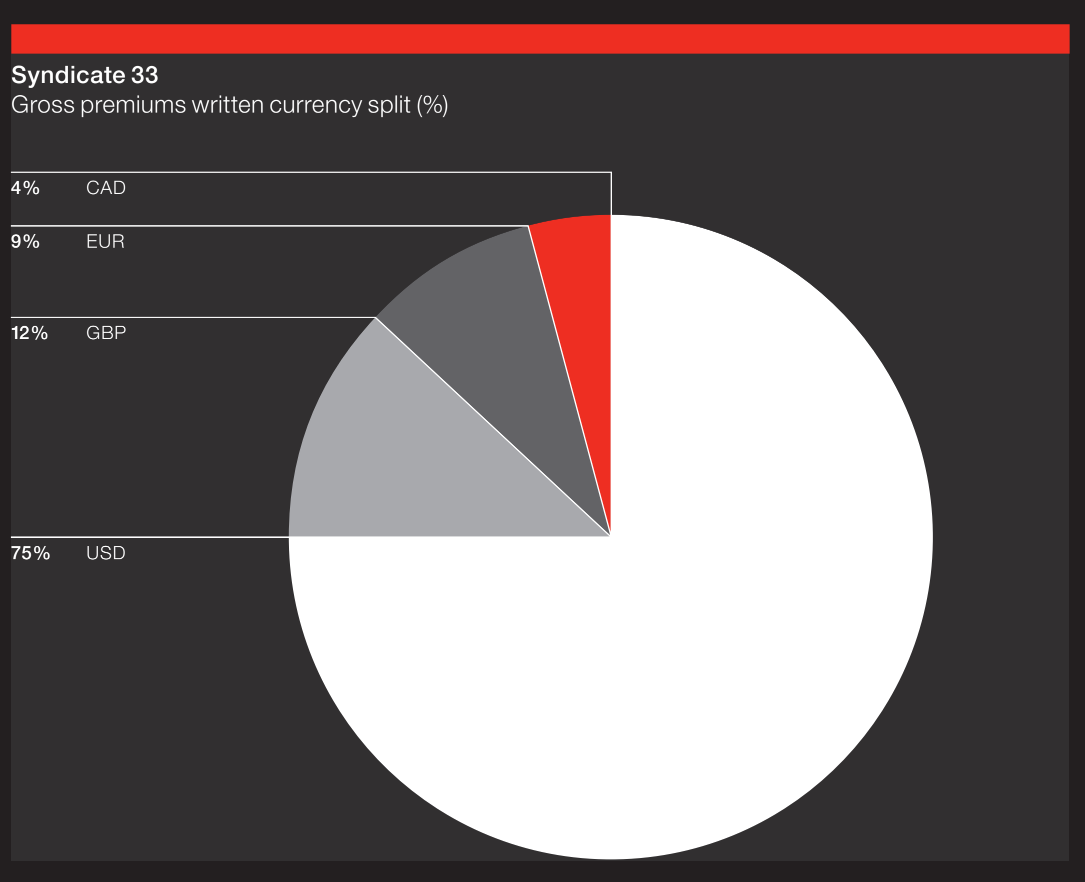
Syndicate 33
Gross premiums written geographical split (%)





*Quota share reinsurance policies, which Lloyd's allows in certain circumstances, that enable a syndicate to write gross premium in excess of its capacity.





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 right.

Hiscox Insurance Company Limited has achieved average compound growth in gross premiums written of 12.2% from 1997 to 2012, 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 2012, net assets exceeded £240 million (2011: £214 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 2012, net assets exceeded $12 million (2011: $11 million).

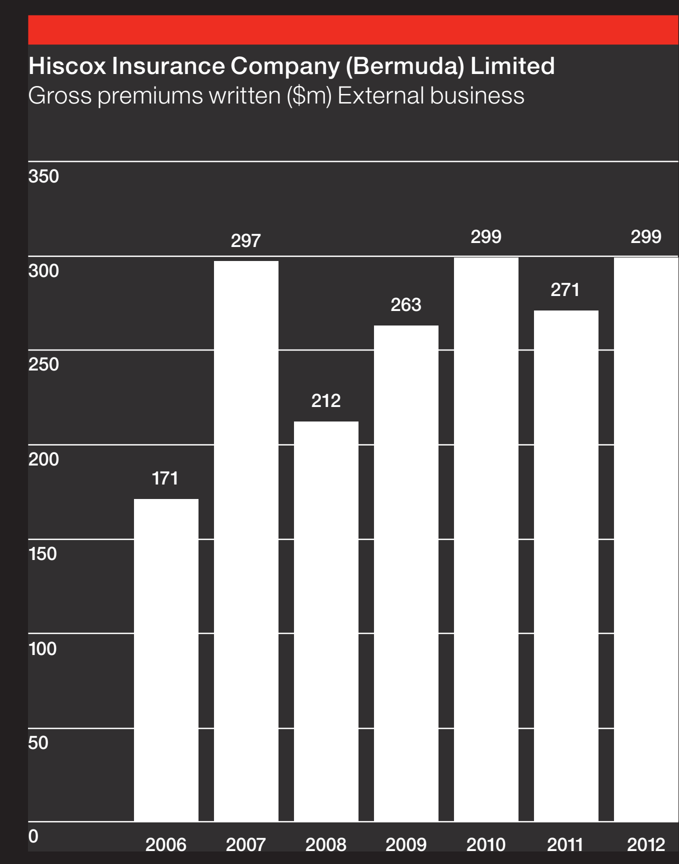
Hiscox Insurance Company (Bermuda)
Formed by Hiscox in late 2005, Hiscox Insurance Company (Bermuda) Limited was set up as an expansion of the reinsurance operations of Hiscox and as an internal reinsurer of the Group.

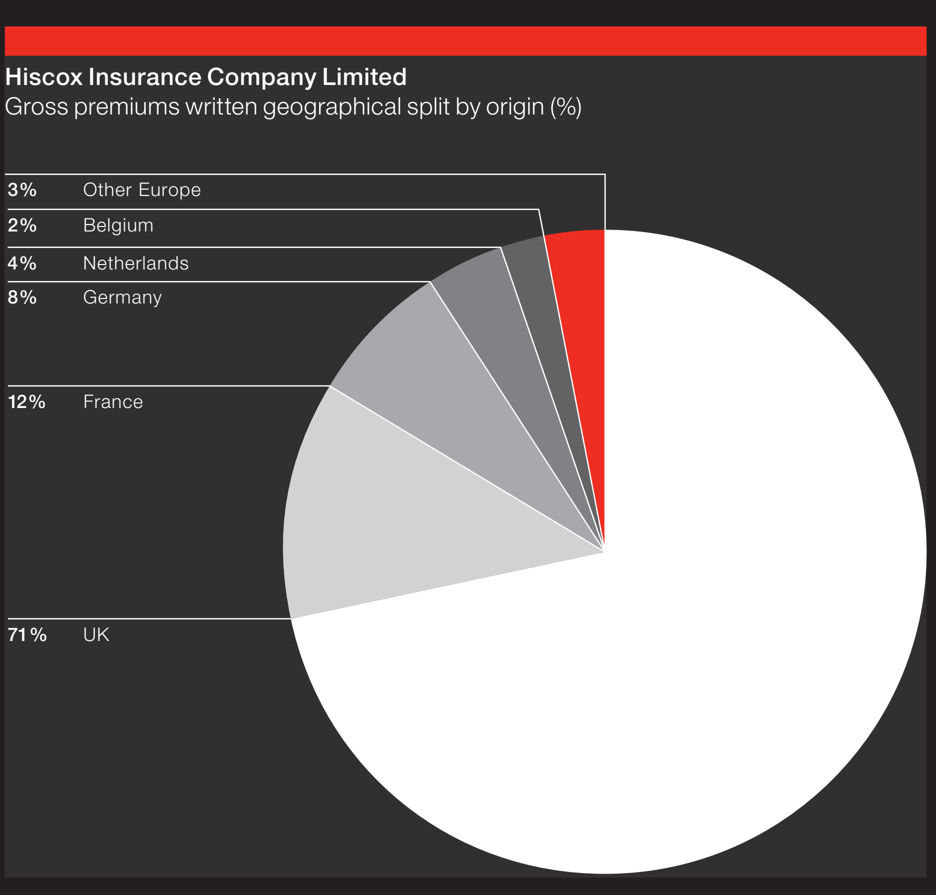
Hiscox Bermuda has an A.M. Best rating of A (Excellent) and an A+ (Strong) rating from Fitch. At the end of 2012, net assets exceeded $1,019 million (2011: $846 million).

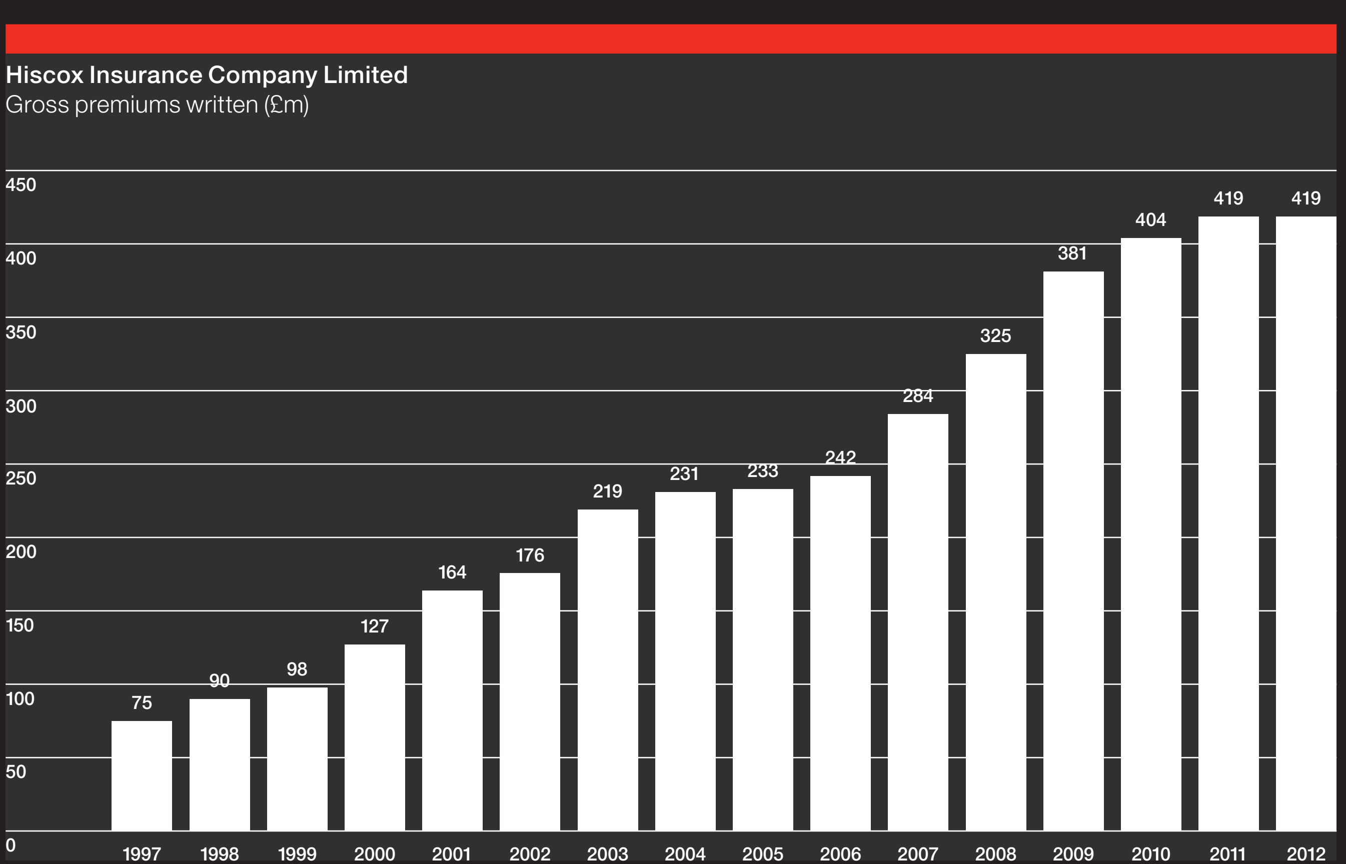
Hiscox Insurance Company Inc.
Hiscox Insurance Company Inc. was acquired by the Group in 2007 through the purchase of the then parent holding company ALTOHA, Inc.

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 2012, net assets exceeded $56 million (2011: $58 million).




Hiscox Insurance Company Limited
Gross premiums written geographical split by origin (%)
3% Other Europe
2% Belgium
4% Netherlands
8% Germany
12% France
71% UK


Hiscox Insurance Company Limited
Gross premiums written (£m)
450
400
350
300
250
200
150
100
50
0
75
90
98
127
164
176
219
231
233
242
284
325
381
404
419
419
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

Board of Directors

Executive Directors

Robert Ralph Scrymgeour Hiscox
Chairman, stepping down 2013 (Aged 70)

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.

Bronislaw Edmund Masojada
Chief Executive (Aged 51)

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 a member of the Board of the Association of British Insurers and the Junior Warden of the Worshipful Company of Insurers. Bronek 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 52)

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 Prudential Financial 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. He is a Non Executive Director of Caledonia Investments plc.

Robert Simon Childs
Chief Underwriting Officer, Chairman designate (Aged 61)

Robert Childs joined Hiscox in 1986, served as the Active Underwriter of the Hiscox Lloyd's Syndicate 33 between 1993 and 2005, and was the Group's Chief Underwriting Officer until February 2013. In 2012 Robert joined the Council of Lloyd's. 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), former 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

Caroline Foulger
Non Executive Director (Aged 52)

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Caroline Foulger joined Hiscox in January 2013. Until May 2012, Caroline led Pricewaterhouse-Coopers' (PwC) Insurance and Reinsurance team in Bermuda, and was Head of the PwC Bermuda Government and Public Sector Practice. Caroline is a Fellow of the Institute of Chartered Accountants in England and Wales, a member of the Institute of Chartered Accountants of Bermuda and a member of the Institute of Directors.

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Jeremy Pinchin

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Hamilton
HMEX Bermuda

Bankers
HSBC Bank Bermuda
Limited
6 Front Street
Hamilton HM 11
Bermuda

Stockbrokers
UBS Limited
1 Finsbury Avenue
London EC2M 2PP
United Kingdom

Registrars
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(Jersey)
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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

Richard Gillingwater
Senior Independent
Director (Aged 56)

△○□

Richard Gillingwater joined Hiscox in December 2010. He is a Non Executive Director and Chairman Designate of Henderson Group plc and a Non Executive Director of Wm Morrison Supermarkets PLC. He is currently Chairman of CDC Group plc. 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. In 2007 he became Dean of Cass Business School, retiring at the end of 2012. Richard is a Non Executive Director of SSE plc and Helical Bar plc.

Daniel Maurice Healy
Non Executive Director
and Chairman of the
Audit Committee
(Aged 70)

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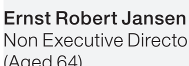
Daniel Healy joined Hiscox in 2006. He was appointed Executive Vice President and Chief Financial Officer of North Fork Bancorporation in 1992 and a member of its Board of Directors in 2000. He was a partner with KPMG LLP before joining North Fork. He was the Managing Partner of the San José, California and Long Island, New York offices and held other positions in that firm during his tenure. He holds Board positions at KBW Inc and Bond Street Holdings.



Ernst Robert Jansen
Non Executive Director
(Aged 64)

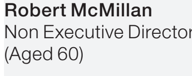
△○□

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 advisor to the Executive Board and is Director of two investment vehicles of Achmea.

Dr James Austin Charles King
Non Executive Director
and Chairman of the
Conflict Committee
(Aged 74)

△●□

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 60)

△○□

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
Non Executive Director
and Chairman of the
Remuneration and
Nomination Committee
(Aged 58)

△○■

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 63)

△○□

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, and for premium listed companies the UK Corporate Governance Code applies. During 2012, and up to the date of this Report and Accounts, the Group has complied with the provisions of the UK Corporate Governance Code in all material respects. It was announced during the year that Robert Childs would succeed Robert Hiscox as Chairman. Whilst Mr Hiscox remains Chairman at the date of this report it is clear that Mr Childs will not meet the independence criteria set out in the Code when he is appointed and this is explained below.

The Board of Directors

The Board comprises four Executive Directors, including an Executive Chairman, and eight 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, experience, independence and knowledge before any appointment is made and this is also reviewed as part of the Board evaluation process as described on page 38. There is an induction process for new Directors. 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 one Director submits theirself for appointment, and the remaining 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 in 2012 but did not result in any change. Robert Childs will not receive any further performance related remuneration once he is appointed as Non Executive Chairman. Directors received briefings on solvency regulation at two of the Board meetings held during the year. Directors' training was also assessed as part of the annual evaluation described on page 38. The appointment and removal of the Company Secretary is a matter for the Board as a whole. Whilst the Board acknowledges the value that knowledge and experience of the organisation can bring, it also recognises the need to progressively refresh its membership over time. Non Executive Directors will normally be expected to serve for six years. They may be invited to serve for longer, but service beyond nine years is unlikely. Any service beyond six years is subject to particularly rigorous review. 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 from 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 an annual meeting of senior staff. 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 is comprises the Executive Directors and, for the last four months of the year, the Deputy Group Chief Underwriting Officer. It 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 Caroline Foulger, Richard Gillingwater, Ernst Jansen, Dr James King, Bob McMillan, Andrea Rosen and Gunnar Stokholm. The Chairman of the Committee, Daniel Healy, is considered by the Board to have recent and relevant financial experience. 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 Caroline Foulger, 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 is mindful of the need for diversity, including gender diversity, in the selection process and in considering an appointment will ensure that the candidate pool includes at least one female. The Committee also has a role to consider succession planning for Executive Directors and senior managers; and has a particular remit to make recommendations on succession planning for the 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.

It was announced on 30 July 2012 that Robert Childs would succeed Robert Hiscox as Chairman. A job and person specification was prepared for the Chairman's role, and a thorough search of both internal and external candidates was conducted by the recruitment consultancy Egon Zehnder under the direction of the Committee. The successful candidate was already a Director of the Company and currently holds the position of Group Chief Underwriting Officer. As at the date of this report Robert Hiscox remains Chairman. However, it is clear that Robert Childs will not meet the independence criteria required by the UK Corporate Governance Code when he is appointed as Non Executive Chairman. Notwithstanding this it was felt that Robert Childs had the strength of character, the commercial experience and the detailed knowledge of the Group's business to make him an excellent Chairman. The Senior Independent Director represented the Committee throughout the selection process and consulted the Company's major shareholders prior to any decision being made. As well as Egon Zehnder, the Senior Independent Director, the Chairman of the Remuneration and Nomination Committee and the Chief Executive interviewed all shortlisted internal and external candidates.

In July 2012 the Remuneration and Nomination Committee became aware that Caroline Foulger was potentially available as a Non Executive Director and it was felt that she offered a rare combination of qualities, having been a partner in PricewaterhouseCoopers (PwC) for ten years and head of PwC's insurance and reinsurance practice in Bermuda. Following an evaluation of the balance of skills, experience, independence and knowledge on the Board it was concluded that her qualities would be complementary. Interviews were conducted by the Chairman, the Chairman of the Remuneration and Nomination Committee, the Chief Executive, the Chief Financial Officer, the Senior Independent Director and the Group Human Resources Director. It was concluded that the Company's interests would be served on this occasion by moving swiftly, and following nomination by the Committee, the Board approved the appointment with effect from 1 January 2013. Consequently no search firm was retained, nor was the position advertised.

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 internal Board and committee evaluation process was conducted during the year. This followed an externally facilitated review carried out in 2011. This year's evaluation included a review of Board composition and whether there was an appropriate balance of skills, experience, independence and knowledge. It also considered how diversity, including gender diversity, could be improved. Other areas covered were succession planning, Board meeting content and focus, the support to the Board, the quality and provision of information, the Non Executive Directors' input into the strategy and shareholder engagement. It was decided that no purpose would be served in assessing the performance of an outgoing Chairman in this year's evaluation. However, it is intended that the Chairman's performance will feature in future evaluations. The findings of the evaluation were 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. 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 2012.

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, is 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 2012, 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 generally meets three times a year. The members of the Committee for 2012 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 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 and Deloitte, independent remuneration consultants. The Company also uses the Towers Watson compensation benchmarking reports and other publicly available 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 but are not excessive and are applied at all levels of the organisation;
- 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 subject to an annual review.

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 the size and scope of a role, rates of salary increases elsewhere in the Group, individual and Group performance, and competitive positioning of salaries as informed by Towers Watson data and other publicly available reports.

In 2012 Executive Directors' salaries increased by an average of 5%, which was broadly in line with increases seen elsewhere in the Group. Between 2009 and 2011 there were no salary increases for any Executive Directors, compared with around 3% per annum for the Group. For the two years prior to 2009 the CEO received base salary increases below the average for the Group. We believe that it is important to note that, during this period from 2007 to 2012, the CEO had explicitly requested that his salary increases be eliminated or kept to a limited amount in order to set an example for the Company of compensation restraint. The Committee viewed this as an admirable stance and supported the CEO's position. However, we now believe that the impact over time of this position has resulted in a meaningful disparity between the CEO's actual salary and the appropriate level of base pay for the role.

A number of important changes will be made to senior executive roles in Hiscox in 2013. As already announced, Robert Hiscox will retire as Executive Chairman and a new Non Executive Chairman will be formally appointed. These changes will have an impact on the role of the Executive Directors and therefore the Remuneration Committee has taken the opportunity to review the base salaries of the CEO and CFO in the context of the consequential expansion of their leadership responsibilities.

In addition to the role changes described above, the Committee was also aware that the size and complexity of the Hiscox Group

has increased considerably over time, but that this was not fully reflected in the base salary progression due to the history described above. To inform the review the Committee undertook analysis of absolute and relative performance over the period. Over the past five years Hiscox has delivered a total shareholder return (TSR) of just under 100%, outperforming the FTSE 250 by just over 60% points and the FTSE non-life by just under 30% points. Over the past ten years Hiscox has delivered a TSR of just over 330%, outperforming the FTSE 250 by over 50% points and the FTSE non-life by 140% points. The Committee believes that this overwhelmingly illustrates that Bronek Masojada and Stuart Bridges have delivered excellent results to shareholders over a significant period of time.

As a result of this review the Committee has decided to increase Bronek Masojada's salary to £540,000 and Stuart Bridges' salary to £400,000 effective April 2013. The Committee recognises that these are unusual and significant increases which do not reflect past increases. The changes for 2013 are not intended to form a pattern for future increases.

It is important to note that the Executive Directors and the Remuneration Committee take the issue of pay discipline very seriously and firmly believe that while base pay should be set at a reasonable level, upper quartile total compensation should only be achieved as a result of superior returns to shareholders. This is demonstrated clearly by the fact that in three of the previous 12 years the Executive Directors did not receive any bonus payment because the pre-tax return on equity did not meet the agreed hurdle. The Committee does, however, take equally seriously, the need to retain high-performing executives by ensuring that their pay is competitive. The Committee has considered the costs involved in the event of needing to recruit new executives compared with the costs of increasing compensation to retain successful proven executives. Getting this balance right is clearly in the interests of shareholders.

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.

Stuart Bridges and Bronek Masojada hold Lifetime Allowance protection certificates and have therefore opted out of the pension scheme. They receive a 10% cash allowance (less an offset for the employer's National Insurance liability) in lieu of the standard employer pension contribution. Robert Childs and Robert Hiscox are in receipt of pensions from the closed defined benefit scheme and are entitled to no further pension provision.

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.

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 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 described above, the Hurdle Rate for 2012 was set at 7.5% and for 2013 will be set at 7.0%.

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, 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.

As can be seen from the following table the bonus pool and individual bonuses vary significantly with performance from year-to-year. In 2012 the performance of the business was very good in what remains a very challenging business environment. This resulted in a pre-tax return on equity of 18% and an average bonus of 183%. This contrasts with 2011, when no bonuses were earned by the Executive Directors.

Executive Directors' cash incentives and ROE

	Pre-tax return on equity %	Average bonus as a percentage of salary %
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
2012	18	183

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.

Meetings and attendance table

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

Directors' remuneration report continued

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 2012 and the Remuneration and Nomination Committee has also agreed to make awards under this plan in 2013. The maximum annual award to an individual under the Performance Share Plan is a value of 200% 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 that have vested.

Performance conditions
Performance conditions for the Performance Share Plan (PSP) 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. ROE encourages efficient use of capital, or its return to shareholders. In 2013 £150 million of capital will be returned, above normal progressive dividends.

The performance conditions for the PSP have been unchanged since 2007. For future awards to be made in 2013 and subsequent years the Committee has decided to align the approach to setting the PSP performance conditions with the method of setting the bonus hurdle. The benchmark rate will be set annually as described above under 'Annual cash incentives' (taking account of medium-term forward-looking investment returns) and the vesting threshold will be five percentage points above this.

As a result of these proposed changes the threshold rate below which none of the 2013 PSP award will vest will be a 7.0% post-tax return on equity over a three-year period. If this minimum threshold rate of return is reached or exceeded, then 25% of the PSP awards granted in 2013 will vest. The whole of the award will only vest if a 14.5% post-tax return on equity is achieved. The rate of vesting for performance above the threshold level of performance will remain unchanged and will be determined on a straight line sliding scale.

Save as You Earn
The sharesave scheme and international sharesave scheme are offered to all employees and currently have a 56% participation.

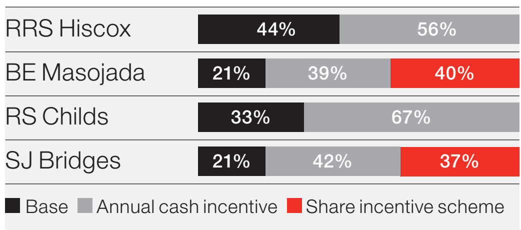
Shareholding guidelines
We strongly believe that senior managers within Hiscox should be aligned with Hiscox shareholders by owning a minimum number of Hiscox shares.

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

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

Executive Director reward

Executive Directors' reward packages are consistent with the rest of the business. The actual compensation paid to the four Executive Directors in 2012 is outlined in the table below. Details of their contractual notice periods are contained in the table opposite.

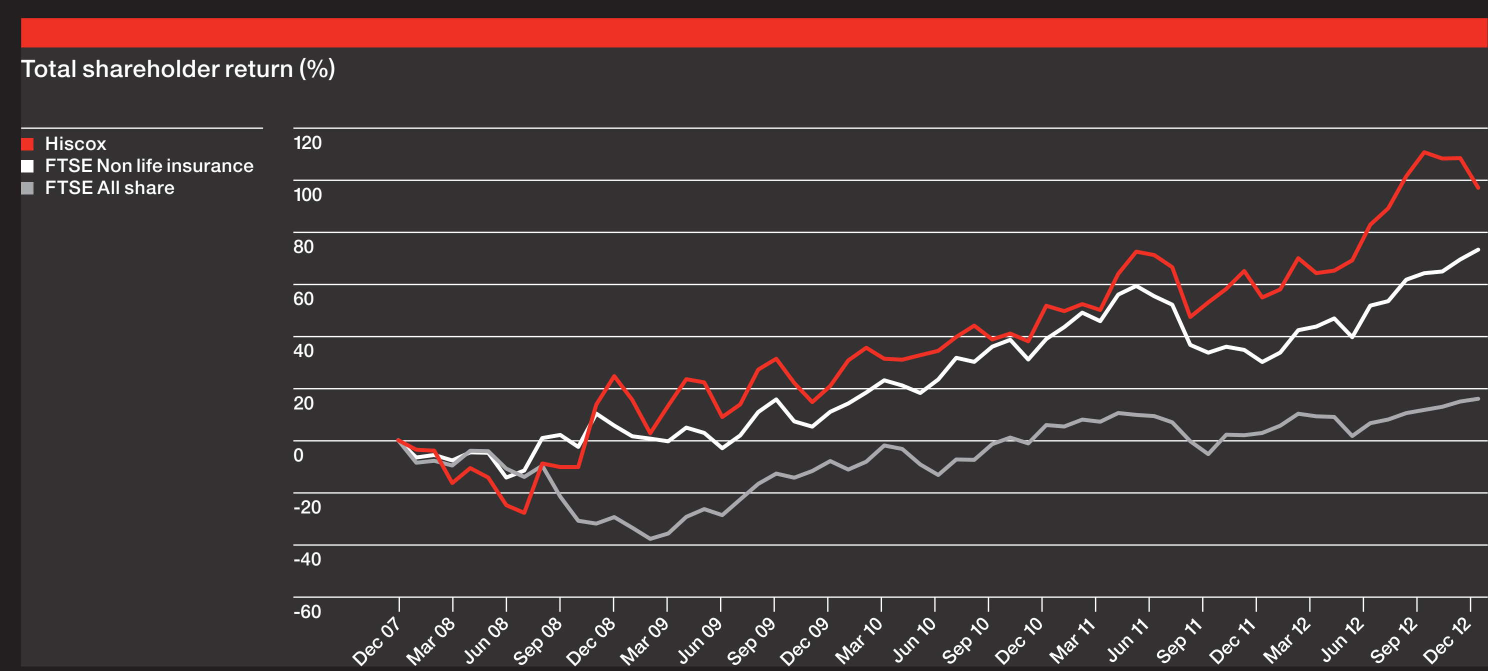


'Base' refers to base salary for the year.
'Annual cash incentive' is the annual amount allocated from the profit bonus pool.
'Share incentive scheme' is the estimated value at award of the Performance Share Plan awards made during the year.

Non Executive Director remuneration

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. The fees paid in 2012 are summarised in the table on page 44.

In 2013 Robert Childs will become Chairman of Hiscox Ltd. His appointment is as Non Executive Chairman and as such he will be paid a fee of £275,000 p.a. but will no longer be entitled to participate in the annual bonus scheme or receive grants under the Performance Share Plan. His outstanding Performance Share Plan grants from 2011 and 2012 will vest, in line with the scheme rules, in 2014 and 2015 respectively.



Remuneration of Executive Directors

	2012 Basic salary £000	2012 Benefits £000	2012 Bonus £000	2012 Total £000	2011 Basic salary £000	2011 Benefits £000	2011 Bonus £000	2011 Total £000
RRS Hiscox	311	2	400	713	302	1	–	303
BE Masojada	453	35	850	1,338	438	2	–	440
RS Childs	371	2	750	1,123	358	2	–	360
SJ Bridges	344	28	700	1,072	328	2	–	330
Total	1,479	67	2,700	4,246	1,426	7	–	1,433

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, BE Masojada has been a member of the Board of the Association of British Insurers and was not remunerated for his services. RRS Hiscox, RS Childs, and SJ Bridges did not hold any Non Executive Director positions during the year.

Directors' remuneration report continued

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

All amounts are denominated in US Dollars. The structure of the fees paid is detailed below. In 2013 Robert Childs will become Chairman of Hiscox Ltd. His appointment is as Non Executive Chairman and as such he will be paid a fee of £275,000 p.a. but will no longer be entitled to participate in the annual bonus scheme or receive grants under the Performance Share Plan. His outstanding Performance Share Plan grants from 2011 and 2012 will vest in line with the scheme rules in 2014 and 2015 respectively.

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

	Hiscox Ltd Board $000	Committees $000	**Total 2012 $000**	Total 2011 $000
R Gillingwater	83	47	**130**	128
DM Healy	83	42	**125**	123
ER Jansen	83	32	**115**	113
Dr J King	83	37	**120**	118
R McMillan	83	32	**115**	113
AS Rosen	83	42	**125**	122
G Stokholm	83	39	**122**	119

Pensions

	Increase in accrued pension during the year £000	Transfer accrued annual pension at 31 Dec 12 £000	Transfer value of increase in accrued pension £000	Transfer value of accrued pension at 1 Jan 12 £000	Transfer value of accrued pension at 31 Dec 12 £000	Increase/ (decrease) in transfer value of accrued benefit during the year £000
RRS Hiscox	12	262	–	5,727	5,582	(145)
BE Masojada	2	45	–	1,269	1,166	(103)
RS Childs	10	257	–	7,828	6,799	(1,029)
SJ Bridges	1	34	–	745	736	(9)

Share options

	Number of options at 1 January 2012	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2012**	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	4.052-4.053	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	–	–	(206,104)	**618,311**				
BE Masojada	206,104	–	–	(206,104)	**–**	1.252	4.070-4.135	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	–	–	(206,104)	**618,312**				
Other employees	233,957	–	–	(233,957)	**–**	1.252	4.214-4.879	19-Nov-05	18-Nov-12
	268,900	–	–	(64,097)	**204,803**	1.465	4.576-4.879	02-Apr-06	01-Apr-13
	463,424	–	–	(24,652)	**438,772**	1.514	3.795-4.718	13-Jul-07	12-Jul-14
	475,587	–	–	(26,977)	**448,610**	1.499	4.047	06-Apr-08	05-Apr-15
	1,441,868	–	–	(349,683)	**1,092,185**				
Total	3,554,433	–	–	(761,891)	**2,792,542**				

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 2012	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2012**	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	–	2,764	–	–	**2,764**	3.255	–	01-May-15	31-Oct-15
RS Childs	3,210	–	–	–	**3,210**	2.826	–	01-May-13	31-Oct-13
BE Masojada	3,107	–	–	–	**3,107**	2.896	–	01-Dec-13	31-May-14
Other employees	9,686	–	–	(9,686)	**–**	1.982	4.000-4.565	01-May-11	31-Oct-11
	32,385	–	–	(32,385)	**–**	1.956	4.000-4.243	01-Dec-11	31-May-12
	93,325	–	(1,513)	(91,812)	**–**	2.418	3.713-4.870	01-May-12	31-Oct-12
	66,509	–	(8,175)	(52,796)	**5,538**	2.752	4.673-4.826	01-Dec-12	31-May-13
	154,774	–	(17,491)	(3,053)	**134,230**	2.826	4.250-4.360	01-May-13	31-Oct-13
	111,793	–	(5,636)	(328)	**105,829**	2.896	4.360	01-Dec-13	31-May-14
	146,337	–	(7,117)	(2,324)	**136,896**	3.077	4.000-4.553	01-May-14	31-Oct-14
	447,960	–	(23,487)	(123)	**424,350**	2.843	4.360	01-Dec-14	31-May-15
	–	186,297	(3,534)	–	**182,763**	3.255	–	01-May-15	31-Oct-15
	–	164,122	(2,470)	–	**161,652**	3.642	–	01-Dec-15	31-May-16
Total	1,072,296	353,183	(69,423)	(192,507)	**1,163,549**				
International Sharesave Scheme									
Other employees	24,582	–	(16,789)	(7,793)	**–**	1.956	4.092-4.868	01-Dec-11	31-May-12
	47,732	–	(8,412)	(39,320)	**–**	2.418	3.713-4.250	01-May-12	31-Oct-12
	70,355	–	–	(51,020)	**19,335**	2.752	4.553-4.826	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
	–	73,507	–	–	**73,507**	3.127	–	01-May-15	31-Oct-15
	–	54,272	–	–	**54,272**	3.718	–	01-Dec-15	31-May-16
Total	437,986	127,779	(25,201)	(98,133)	**442,431**				

Performance Share Plan

	Number of awards at 1 January 2012	Number of awards granted	Number of awards lapsed	Number of awards exercised	**Number of awards at 31 December 2012**	Market price at date of exercise £	Date from which released
SJ Bridges	121,934	–	–	–	**121,934**	–	07-Apr-11
	200,000	18,709	(30,000)	–	**188,709**	–	02-Apr-12
	150,000	–	–	–	**150,000**	–	07-Apr-13
	125,000	–	–	–	**125,000**	–	07-Apr-14
	–	125,000	–	–	**125,000**	–	19-Mar-15
RS Childs	225,000	21,048	(33,750)	–	**212,298**	–	02-Apr-12
	175,000	–	–	–	**175,000**	–	07-Apr-13
	125,000	–	–	–	**125,000**	–	07-Apr-14
	–	125,000	–	–	**125,000**	–	19-Mar-15
RRS Hiscox	90,588	–	–	–	**90,588**	–	26-Mar-10
	83,137	–	–	–	**83,137**	–	07-Apr-11
	50,000	4,677	(7,500)	–	**47,177**	–	02-Apr-12
	76,260	–	–	–	**76,260**	–	07-Apr-13
	75,000	–	–	–	**75,000**	–	07-Apr-14
	–	75,000	–	–	**75,000**	–	19-Mar-15
BE Masojada	193,986	–	–	–	**193,986**	–	07-Apr-11
	275,000	25,725	(41,250)	–	**259,475**	–	02-Apr-12
	250,000	–	–	–	**250,000**	–	07-Apr-13
	175,000	–	–	–	**175,000**	–	07-Apr-14
	–	175,000	–	–	**175,000**	–	19-Mar-15
Other employees	604,323	–	–	(16,257)	**588,066**	4.090	12-Jan-09
	264,962	–	–	–	**264,962**	–	26-Mar-10
	683,881	–	–	(59,859)	**624,022**	3.971-4.204	07-Apr-11
	2,741,500	242,564	(537,451)	(1,180,375)	**1,266,238**	3.850-4.832	02-Apr-12
	2,842,240	–	(287,500)	–	**2,554,740**	–	07-Apr-13
	2,808,000	15,000	(233,500)	–	**2,589,500**	–	07-Apr-14
	–	3,018,700	(122,500)	–	**2,896,200**	–	19-Mar-15
Total	12,335,811	3,846,423	(1,293,451)	(1,256,491)	**13,632,292**		

Directors' report

The Directors have pleasure in submitting their Annual Report and consolidated financial statements for the year ended 31 December 2012.

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 7 to 11. 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. The information that fulfils the requirements of the corporate governance statement as referred to in Disclosure and Transparency Rule 7.2 can be found in the corporate governance statement on pages 36 to 38 and in this report.

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 £217.1 million (2011: £17.3 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 6.0p (net) per share (2011: 5.1p (net)) was paid on 19 September 2012 by Hiscox Ltd in respect of the year ended 31 December 2012. The Directors are recommending the return of capital to shareholders through an issue of B shares and this will be considered at an Extraordinary General Meeting to be held on 28 March 2013. It is proposed that in place of a final dividend, a sum equal to 12.0p per share will be payable to shareholders as part of the return of capital. (The final dividend for 2011 was 11.9p per share.)

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, as well as one additional Director, Caroline Foulger, who joined the Board on 1 January 2013, are set out on pages 34 to 35. Details of the Chairman's professional commitments are included in his biography. The bye-laws of the Company govern the appointment and replacement of Directors. It was announced on 30 July 2012 that Robert Hiscox would retire as Chairman in February 2013 and accordingly he will not be seeking re-appointment as a Director at the Annual General Meeting. Caroline Foulger will submit herself for appointment at that meeting and, in accordance with the UK Corporate Governance Code, all other Directors will submit themselves for re-appointment. The bye-laws may only be amended with the approval of shareholders in general meeting in accordance with relevant legislation.

Political and charitable contributions

The Group made no political contributions during the year (2011: £nil). Charitable donations totaled £768,000 (2011: £533,000) of which £500,000 (2011: £250,000) 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 22 February 2013, the Company had been notified of the following interests of 5% or more of voting rights in its ordinary shares:

	Number of shares	% of total*
Invesco Limited†	54,031,056	13.44
Massachusetts Financial Services Company†	39,800,146	10.09

*Based on voting rights of 394,387,209 as at 22 February 2013.
†Indirect holding.

A copy of the Company's bye-laws is available for inspection at the Company's registered office. The powers given to the Directors are contained in the Company's bye-laws and are subject to relevant legislation and, in certain circumstance (including in relation to the issuing and buying back by the Company of its shares), approval by shareholders in general meeting. At the Annual General Meeting in 2012 the Directors were granted authorities to allot and issue shares and to make market purchases of shares.

Directors' report continued

Annual General Meeting
The notice of the Annual General Meeting, to be held on 16 May 2013 at 10:00am (2:00pm (BST)), will be contained in a separate circular to be sent to shareholders. This will be despatched following the Extraordinary General Meeting to be held on 28 March 2013.

By order of the Board
Jeremy Pinchin, Secretary
Wessex House, 45 Reid Street,
Hamilton HM12, Bermuda
25 February 2013

Directors' interests

	31 December 2012 5p Ordinary Shares number of shares beneficial	31 December 2011 5p Ordinary Shares number of shares beneficial
Executive Directors		
RRS Hiscox	**5,135,534**	4,944,068
BE Masojada	**3,505,527**	3,496,077
RS Childs	**2,165,357**	2,104,316
SJ Bridges	**1,157,508**	1,112,152
Non Executive Directors		
R Gillingwater	**–**	–
D Healy	**100,000**	100,000
E R Jansen	**72,188**	53,231
Dr J King	**–**	–
R McMillan	**–**	–
A Rosen	**61,454**	43,525
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, RSS Hiscox and the Chief Financial Officer, SJ Bridges. The statements were approved for issue on 25 February 2013.

Financial summary

Group key performance indicators

	2012	2011
Gross premiums written (£m)	**1,565.8**	1,449.2
Net premiums earned (£m)	**1,198.6**	1,145.0
Profit before tax (£m)	**217.1**	17.3
Profit after tax (£m)	**207.8**	21.3
Earnings per share (p)	**53.1**	5.5
Total dividend per share for year (p)	**18.0**	17.0
Net asset value per share (p)	**349.7**	323.5
Group combined ratio (%)	**85.5**	99.5
Group combined ratio excluding foreign exchange (%)	**84.6**	99.3
Return on equity (%)	**16.9**	1.7
Investment return (%)	**3.1**	0.9
Reserve releases (£m)	**152**	199

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 2012, 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 2012, 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 Audit Limited
Hamilton, Bermuda
25 February 2013

Consolidated income statement
For the year ended 31 December 2012

	Note	2012 Total £000	2011 Total £000
Income			
Gross premiums written	4	**1,565,819**	1,449,219
Outward reinsurance premiums		**(297,679)**	(275,208)
Net premiums written	4	**1,268,140**	1,174,011
Gross premiums earned		**1,487,859**	1,428,954
Premiums ceded to reinsurers		**(289,238)**	(283,947)
Net premiums earned	4	**1,198,621**	1,145,007
Investment result	7	**92,424**	24,495
Other revenues	9	**13,930**	17,322
Revenue		**1,304,975**	1,186,824
Expenses			
Claims and claim adjustment expenses, net of reinsurance	26.2	**(538,826)**	(697,898)
Expenses for the acquisition of insurance contracts	17	**(283,615)**	(269,792)
Operational expenses	9	**(236,202)**	(203,204)
Foreign exchange (losses)/gains	12	**(20,173)**	7,816
Total expenses		**(1,078,816)**	(1,163,078)
Results of operating activities		**226,159**	23,746
Finance costs	10	**(8,605)**	(6,698)
Share of (loss)/profit of associates after tax	16	**(430)**	223
Profit before tax		**217,124**	17,271
Tax (expense)/credit	28	**(9,352)**	4,001
Profit for the year (all attributable to owners of the Company)		**207,772**	21,272
Earnings per share on profit attributable to owners of the Company			
Basic	31	**53.1p**	5.5p
Diluted	31	**50.9p**	5.3p

Consolidated statement of comprehensive income
For the year ended 31 December 2012, after tax

	Note	2012 Total £000	2011 Total £000
Profit for the year		**207,772**	21,272
Other comprehensive (loss)/income			
Currency translation (losses)/gains (net of tax of £nil (2011: £nil))	12	**(35,806)**	11,060
Total other comprehensive (loss)/income		**(35,806)**	11,060
Total comprehensive income recognised for the year (all attributable to owners of the Company)		**171,966**	32,332

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

Consolidated balance sheet
At 31 December 2012

	Note	2012 £000	2011 £000
Assets			
Intangible assets	14	**69,617**	67,552
Property, plant and equipment	15	**18,055**	18,155
Investments in associates	16	**9,054**	6,380
Deferred tax	29	**25,608**	25,748
Deferred acquisition costs	17	**166,041**	150,050
Financial assets carried at fair value	19	**2,406,269**	2,368,636
Reinsurance assets	18, 26	**540,389**	492,515
Loans and receivables including insurance receivables	20	**492,064**	507,722
Current tax asset		**1,513**	69,436
Cash and cash equivalents	23	**657,662**	516,547
Total assets		**4,386,272**	4,222,741
Equity and liabilities			
Shareholders' equity			
Share capital	24	**20,703**	20,563
Share premium	24	**41,313**	32,086
Contributed surplus	24	**245,005**	245,005
Currency translation reserve	25	**24,711**	60,517
Retained earnings	25	**1,046,652**	897,728
Total equity (all attributable to owners of the Company)		**1,378,384**	1,255,899
Employee retirement benefit obligations	30	**–**	–
Deferred tax	29	**138,362**	152,447
Insurance liabilities	26	**2,596,612**	2,500,260
Financial liabilities	19	**301**	–
Current tax		**6,998**	–
Trade and other payables	27	**265,615**	314,135
Total liabilities		**3,007,888**	2,966,842
Total equity and liabilities		**4,386,272**	4,222,741

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 25 February 2013 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 2011		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
Total recognised comprehensive income for the year (all attributable to owners of the Company)		**–**	**–**	**–**	**(35,806)**	**207,772**	**171,966**
Employee share options:							
Equity settled share based payments		**–**	**–**	**–**	**–**	**6,135**	**6,135**
Proceeds from shares issued	24	**52**	**1,649**	**–**	**–**	**–**	**1,701**
Deferred and current tax	29	**–**	**–**	**–**	**–**	**5,190**	**5,190**
Scrip dividends	24, 32	**88**	**7,578**	**–**	**–**	**–**	**7,666**
Dividends paid to owners of the Company	32	**–**	**–**	**–**	**–**	**(70,173)**	**(70,173)**
Balance at 31 December 2012		**20,703**	**41,313**	**245,005**	**24,711**	**1,046,652**	**1,378,384**

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 2012

	Note	2012 £000	2011 £000
Profit before tax		**217,124**	17,271
Adjustments for:			
Interest and equity dividend income		**(45,699)**	(50,333)
Interest expense		**8,605**	6,698
Net fair value (gains)/losses on financial assets		**(37,654)**	30,878
Depreciation, amortisation and impairment	14, 15	**7,833**	8,098
Charges in respect of share based payments	9, 24	**6,135**	8,677
Other non-cash movements		**1,239**	(1,070)
Effect of exchange rate fluctuations on cash presented separately		**9,481**	(1,451)
Changes in operational assets and liabilities:			
Insurance and reinsurance contracts		**(8,245)**	138,667
Financial assets carried at fair value		**(49,377)**	78,501
Financial liabilities carried at fair value		**301**	(457)
Other assets and liabilities		**12,850**	(18,888)
Cash flows from operations		**122,593**	216,591
Interest received		**51,743**	50,244
Equity dividends received		**1,631**	1,531
Interest paid		**(7,256)**	(6,163)
Current tax received/(paid)		**56,403**	(4,003)
Net cash flows from operating activities		**225,114**	258,200
Cash flows from the sale and purchase of associates	16	**(3,104)**	729
Cash flows from the purchase of property, plant and equipment		**(3,103)**	(2,561)
Cash flows from the purchase of intangible assets		**(7,505)**	(9,992)
Net cash flows from investing activities		**(13,712)**	(11,824)
Proceeds from the issue of ordinary shares	24	**1,701**	3,215
Dividends paid to owners of the Company	32	**(62,507)**	(50,512)
Net repayments of borrowings		**–**	(20,000)
Net cash flows from financing activities		**(60,806)**	(67,297)
Net increase in cash and cash equivalents		**150,596**	179,079
Cash and cash equivalents at 1 January		**516,547**	336,017
Net increase in cash and cash equivalents		**150,596**	179,079
Effect of exchange rate fluctuations on cash and cash equivalents		**(9,481)**	1,451
Cash and cash equivalents at 31 December	23	**657,662**	516,547

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 totaling £86,168,000 (2011: £77,203,000) 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 1,400 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 2012 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 25 February 2013.

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 was the first phase in the IASB's insurance contract project and as such is 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.

Since the original exposure draft, further amendments have been made to the proposals. As a result, the IASB has committed to re-exposing the draft during the first half of 2013. In addition, the IASB has also stated they will allow at least three full years from the date of any final standard to actual implementation, therefore 2018 is likely to be the earliest date for the adoption of a new standard.

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 £3.06 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. There were no new or amended Standards and Interpretations issued by the IASB and endorsed by the EU as of 1 January 2012 that had a material impact on the Group.

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these consolidated financial statements.

2 Significant accounting policies continued
2.2 Basis of preparation continued

IAS 19: Employee Benefits (2011) 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. In addition, net interest income or expense is required to be calculated using the discount rate used to measure the defined benefit asset or liability. The key impact of adopting the amendments to IAS 19 for the year ended 31 December 2012 would have been to recognise a liability of £16.9 million.

IFRS 9: Financial Instruments sets out the recognition and measurement requirements for financial instruments and some contracts to buy or sell non-financial items. The IASB has broken the project into three phases, classification and measurement, impairment methodology and hedge accounting. The IASB continues to add to the standard as it completes the various phases of its project and it will eventually form a complete replacement for IAS 39: Financial Instruments Recognition and Measurement.

IFRS 9 (2010): Financial Instruments: Classification and Measurement is due to be effective from 1 January 2015. Under the standard, a financial asset is measured at amortised cost if it is held within a business model whose objective is to hold assets to collect contractual cash flows and its cash flows are solely payments of principal and interest. All other financial assets are measured at fair value, with changes in fair value recognised in profit or loss, 'FVTPL', except for some equity investments for which changes in fair value are recognised in other comprehensive income.

An exposure draft containing amendments to the standard was released in November 2012. It introduces a third measurement category, under which a financial asset is required to be measured at fair value through other comprehensive income, 'FVOCI', if its cash flows are solely payments of principal and interest and are held in a business model in which assets are managed both in order to collect contractual cash flows and for sale. The existing option to measure an asset at FVTPL in order to reduce an accounting mismatch would be available for financial assets that would otherwise be mandatorily measured at FVOCI.

The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets.

IFRS 10: Consolidated Financial Statements is effective for annual periods beginning 1 January 2014, with retrospective application. It replaces the portion of IAS 27: Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. IFRS 10 revises the definition of 'control', the key factor in determining whether an entity is consolidated. The adoption of IFRS 10 is not expected to have an effect on the Group's consolidated financial statements.

IFRS 11: Joint Arrangements is effective for annual periods beginning 1 January 2014, with retrospective application. It replaces IAS 31: Interests in Joint Ventures and SIC-13: Jointly-Controlled Entities – Non-Monetary Contributions by Venturers. The standard clarifies the definition of a joint arrangement and uses the principle of control in IFRS 10 to define joint control. The standard is not expected to have a significant impact on the consolidated financial statements of the Group.

IFRS 12: Disclosure of Interests in Other Entities is effective for annual periods beginning 1 January 2014, with retrospective application. It includes all of the disclosures that were previously included in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28: Investment in Associates. A number of new disclosures are also required, including the judgements made by management in determining whether it controls an entity. The standard will impact the disclosures made by the Group in respect of its interests in subsidiaries, joint arrangements and associates on adoption.

As a result of the issuance of IFRS 10, IFRS 11 and IFRS 12, consequential amendments have been made to IAS 27 and IAS 28. IAS 27 now contains requirements only relating to separate financial statements, while the amendments to IAS 28 incorporate the accounting for joint ventures. Both standards are effective for annual periods beginning on or after 1 January 2014. The adoption of these standards is not expected to have an effect on the Group's consolidated financial statements.

IFRS 13: Fair Value Measurement is effective for annual periods beginning 1 January 2013 and is to be applied prospectively. The standard defines fair value, sets out in a single IFRS a framework for measuring fair value, and requires disclosures about fair value measurements. The standard will impact the disclosures in respect of fair value measurement on adoption.

IAS 1 (amended): Presentation of Financial Statements is effective for annual periods beginning 1 July 2012. The amendment will require a change in the presentation of items of other comprehensive income, requiring companies to group together items within other comprehensive income that may be reclassified to the profit or loss section of the income statement. Upon adoption, the amendment will result in changes to the presentation of the Group's other comprehensive income.

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 ('HDCM') 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). As at 31 December 2012, HDCM owned 72.5% of Syndicate 33 (2011: 72.5%). 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

2 Significant accounting policies continued
2.3 Basis of consolidation continued
(a) Subsidiaries *continued*

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. 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, Spain, Portugal, Ireland 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.

Notes to the consolidated financial statements
continued

2 Significant accounting policies continued

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 fair value of consideration 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 at least 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. This assumption is reviewed annually to determine whether the asset continues to have an indefinite life.

(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 due to the stability of the US insurance market. The licenses are 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. This assumption is reviewed annually to determine whether the asset continues to have an indefinite life.

(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.

2 Significant accounting policies continued
2.9 Impairment of assets continued

(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.

2.10 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

Notes to the consolidated financial statements continued

2 Significant accounting policies continued
2.13 Insurance contracts continued
(d) Liability adequacy tests *continued*

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 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.

2 Significant accounting policies continued
2.15 Employee benefits continued

(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 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 reperformed 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 2012

Notes to the consolidated financial statements continued

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

is £1,000 million (2011: £964 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 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, risk management and capital 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 premiums written and maximum aggregated exposures per geographical zone and risk class. Monthly meetings are held between the Chief Underwriting Officer and a specialist central analysis and review team in order to monitor claim development patterns and discuss individual underwriting issues as they arise. The Chief Underwriting Officer also holds weekly video conference meetings with this team to discuss interim underwriting matters.

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

The 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, shown on page 15, 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 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.

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

Notes to the consolidated financial statements
continued

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 2012

		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	**2,222**	**11,098**	**142,799**	**316,820**	**7,167**	**23,427**	**503,533**
	Net	**1,700**	**4,939**	**124,722**	**283,463**	**7,092**	**13,868**	**435,784**
Europe	Gross	**4,567**	**20,995**	**70,753**	**130,375**	**16,837**	**34,073**	**277,600**
	Net	**4,220**	**14,739**	**61,637**	**111,989**	**14,615**	**27,878**	**235,078**
United States	Gross	**286,305**	**88,501**	**131,387**	**291,391**	**34,715**	**20,602**	**852,901**
	Net	**141,113**	**46,615**	**76,376**	**270,016**	**30,428**	**17,767**	**582,315**
Other territories	Gross	**107,676**	**11,716**	**38,838**	**29,665**	**22,695**	**77,960**	**288,550**
	Net	**94,429**	**8,604**	**34,904**	**29,188**	**17,531**	**60,544**	**245,200**
Multiple territory coverage	Gross	**292,506**	**181,389**	**33,223**	**–**	**102,296**	**64,614**	**674,028**
	Net	**238,366**	**161,215**	**26,545**	**–**	**82,429**	**49,291**	**557,846**
Total	**Gross**	**693,276**	**313,699**	**417,000**	**768,251**	**183,710**	**220,676**	**2,596,612**
	Net	**479,828**	**236,112**	**324,184**	**694,656**	**152,095**	**169,348**	**2,056,223**

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

*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 contains 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 includes 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 repriced 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 artwork, 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 repriced.

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 and the insurance linked fund, 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 2012, 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 2012 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 2012 was £190 million (2011: £173 million). These may be analysed as follows:

Nature of equity and unit trust holdings	2012 % weighting	2011 % weighting
Directly held equity securities	**4**	3
Units held in funds – traditional long only	**69**	73
Units held in funds – long and short and special strategies	**27**	24
Geographic focus		
Specific UK mandates	**44**	39
Global mandates	**56**	61

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 2012 would have been expected to reduce Group equity and profit after tax for the year by approximately £16.7 million (2011: £15.0 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.

The fair value of debt and fixed income assets in the Group's balance sheet at

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

31 December 2012 was £2,195 million (2011: £2,171 million). These may be analysed as follows:

Nature of debt and fixed income holdings	2012 % weighting	2011 % weighting
Government issued bonds and instruments	**34**	23
Agency and government supported debt	**12**	25
Asset backed securities	**10**	11
Mortgage backed instruments – agency	**7**	6
Mortgage backed instruments – non-agency	**3**	5
Mortgage backed instruments – commercial	**3**	–
Corporate bonds	**27**	27
Lloyd's deposits and bond funds	**4**	3

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 £39 million (2011: decrease of £38 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 2012, no amounts were outstanding on the Group's borrowing facility (2011: £nil). 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 and obtaining collateral from unrated counterparties. Management information reports detail provisions for impairment on loans and receivables and subsequent write-off. Exposures to individual intermediaries and groups of intermediaries are collected within the ongoing monitoring of the controls associated with regulatory solvency.

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

The Group also mitigates counterparty credit 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 2012	**Note**	**AAA £000**	**AA £000**	**A £000**	**Other/ non-rated £000**	**Total £000**
Debt and fixed income securities	19	**816,153**	**834,671**	**369,528**	**174,514**	**2,194,866**
Deposits with credit institutions	19	**900**	**–**	**12,303**	**–**	**13,203**
Catastrophe bonds		**–**	**–**	**–**	**–**	**–**
Reinsurance assets	18	**16,714**	**153,440**	**340,711**	**29,524**	**540,389**
Cash and cash equivalents	23	**149,291**	**77,090**	**429,949**	**1,332**	**657,662**
Total		**983,058**	**1,065,201**	**1,152,491**	**205,370**	**3,406,120**
Amounts attributable to largest single counterparty		**209,847**	**489,070**	**106,502**	**5,398**	

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	

The largest counterparty exposure within the AAA rating at both 31 December 2012 and 2011 is with the UK Treasury, and for AA rating is with the US Treasury. On 22 February 2013, Moody's downgraded the UK's government bonds from Aaa to Aa1. Standard & Poor's maintain the AAA rating currently.

Catastrophe bonds included within 'other/non-rated' are rated BB and B. A significant proportion of 'other/non-rated' assets are rated BBB and BB at 31 December 2012 and 31 December 2011. The reinsurance assets classified as AAA rated include collateralised reinsurance arrangements.

At 31 December 2012 and 2011 the Group held no material debt or 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. 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.

An analysis of the Group's positions 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.

	31 December 2012			31 December 2011		
	Government issued £000	Government supported £000	Total £000	Government issued £000	Government supported £000	Total £000
United States of America	489,070	120,991	610,061	302,605	269,048	571,653
United Kingdom	209,847	23,083	232,930	208,235	81,699	289,934
Australia	–	8,921	8,921	–	13,975	13,975
Belgium	–	–	–	–	1,537	1,537
Canada	17,297	31,373	48,670	–	58,380	58,380
Denmark	–	4,384	4,384	–	5,158	5,158
Finland	7,003	2,197	9,200	6,380	3,985	10,365
France	6,551	1,531	8,082	4,015	16,533	20,548
Germany	109,871	51,806	161,677	92,414	36,205	128,619
Netherlands	–	12,329	12,329	–	24,539	24,539
New Zealand	–	–	–	–	584	584
Norway	3,118	–	3,118	–	6,035	6,035
Supranationals	–	25,645	25,645	–	30,135	30,135
South Korea	2,614	209	2,823	2,833	–	2,833
Sweden	2,191	1,133	3,324	2,307	3,494	5,801
Other	1,474	–	1,474	338	141	479
Total	849,036	283,602	1,132,638	619,127	551,448	1,170,575

Included above are £1,012 million (2011: £1,049 million) in relation to holdings in debt securities, £10 million (2011: £nil) held as deposits with credit institutions and £111 million (2011: £122 million) held as cash equivalents, having a maturity of less than three months at the time of purchase. Of the amount held as cash equivalents, £35 million (2011: £114 million) is held with the UK Government and £75 million (2011: £nil) with the US Treasury.

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. 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				
31 December 2012	AAA £000	AA £000	A £000	BBB £000	Sub-total £000	A £000	BBB £000	B £000	Sub-total £000	Total £000
United States of America	–	–	65,651	1,311	66,962	603	–	–	603	67,565
United Kingdom	10,632	4,375	12,948	–	27,955	303	894	1,394	2,591	30,546
Australia	1,102	7,829	–	–	8,931	–	–	–	–	8,931
Canada	12,066	4,973	15,090	–	32,129	1,828	823	–	2,651	34,780
Denmark	349	–	537	–	886	–	–	–	–	886
France	1,364	292	8,373	–	10,029	–	–	–	–	10,029
Germany	–	–	1,712	–	1,712	–	–	–	–	1,712
Netherlands	1,893	3,516	4,751	–	10,160	–	765	–	765	10,925
New Zealand	662	637	–	–	1,299	–	–	–	–	1,299
Norway	1,704	–	1,059	–	2,763	–	–	–	–	2,763
Spain	–	–	–	614	614	–	–	–	–	614
Sweden	1,853	6,723	6,432	–	15,008	–	–	–	–	15,008
Switzerland	–	–	8,833	–	8,833	–	–	–	–	8,833
Other	–	190	304	495	989	–	–	–	–	989
Total	31,625	28,535	125,690	2,420	188,270	2,734	2,482	1,394	6,610	194,880

Included in the bank debt table above, are £192 million in relation to holdings in debt securities and £3 million held as deposits with credit institutions.

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

	Senior						Subordinated			
31 December 2011	AAA £000	AA £000	A £000	BBB £000	B £000	Sub-total £000	A £000	BBB £000	Sub-total £000	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
New Zealand	–	2,768	–	–	–	2,768	–	–	–	2,768
Norway	130	–	378	–	1,431	1,939	–	–	–	1,939
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 table above, are £222 million in relation to holdings in debt securities and £5 million held as cash equivalents.

(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 is 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	Cash and cash equivalents £000	**2012 Total £000**	2011 Total £000
Less than one year	497,658	12,957	657,662	**1,168,277**	1,082,200
Between one and two years	468,475	–	–	**468,475**	487,678
Between two and five years	808,545	246	–	**808,791**	822,245
Over five years	349,761	–	–	**349,761**	265,897
Sub-total	2,124,439	13,203	657,662	**2,795,304**	2,658,020
Other non-dated instruments	70,427	–	–	**70,427**	53,602
Total	2,194,866	13,203	657,662	**2,865,731**	2,711,622

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.

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

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 as at 31 December	**2012 Years**	2011 Years
Pound Sterling	**1.58**	2.26
US Dollar	**5.97**	5.64
Euro	**2.08**	1.45
Canadian Dollar	**2.13**	4.01

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	**2012 Total £000**
Reinsurance inwards	**194,812**	**98,970**	**67,604**	**32,860**	**394,246**
Property – marine and major assets	**86,882**	**41,829**	**34,942**	**5,242**	**168,895**
Property – other assets	**99,599**	**26,896**	**18,414**	**1,052**	**145,961**
Casualty – professional indemnity	**160,302**	**124,411**	**256,700**	**17,838**	**559,251**
Casualty – other risks	**59,053**	**30,705**	**34,988**	**2,365**	**127,111**
Other*	**50,443**	**14,129**	**14,906**	**4,523**	**84,001**
Total	**651,091**	**336,940**	**427,554**	**63,880**	**1,479,465**

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

*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 are 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.

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

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 £181 million (2011: £169 million) which are denominated in foreign currencies.

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

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

As at 31 December 2012	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Intangible assets	63,309	6,308	–	–	69,617
Property, plant and equipment	10,372	6,537	1,146	–	18,055
Investments in associates	8,754	–	300	–	9,054
Deferred tax	–	23,809	1,799	–	25,608
Deferred acquisition costs	53,314	83,584	24,416	4,727	166,041
Financial assets carried at fair value	523,212	1,587,848	253,677	41,532	2,406,269
Reinsurance assets	67,136	410,944	52,038	10,271	540,389
Loans and receivables including insurance receivables	77,951	304,258	91,375	18,480	492,064
Current tax asset	–	107	1,406	–	1,513
Cash and cash equivalents	231,463	254,002	103,522	68,675	657,662
Total assets	1,035,511	2,677,397	529,679	143,685	4,386,272

	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Employee retirement benefit obligations	–	–	–	–	–
Deferred tax	138,362	–	–	–	138,362
Insurance liabilities	641,484	1,493,727	348,878	112,523	2,596,612
Financial liabilities	75	–	226	–	301
Current tax	6,615	–	383	–	6,998
Trade and other payables	71,794	156,618	31,765	5,438	265,615
Total liabilities	858,330	1,650,345	381,252	117,961	3,007,888

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

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

Sensitivity analysis

As at 31 December 2012, the Group used closing rates of exchange of £1:€1.23 and £1:$1.63 (2011: £1:€1.19 and £1:$1.54). 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 2012	**Effect on equity after tax £m**	**Effect on profit before tax £m**
Strengthening of US Dollar	**119.9**	**31.9**
Weakening of US Dollar	**(95.1)**	**(23.1)**
Strengthening of Euro	**14.1**	**19.2**
Weakening of Euro	**(11.6)**	**(15.7)**

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 2012 for a total of $875 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 $400 million. This facility was secured during 2012 by the Company's subsidiary Hiscox plc. The Letter of Credit availability period ends on 31 December 2013. This enables the Group to utilise the Letter of Credit as Funds at Lloyd's to support underwriting on the 2012, 2013 and 2014 years of account. The revolving credit facility has a maximum three-year contractual period for repayment. At 31 December 2012 US$308 million was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and there were no cash drawings (2011: $340 million and £nil 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 20%;
- Syndicate 6104 at Lloyd's – with a capacity of £39 million for the 2012 year of account (2011 year of account: £37 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 2012 year of account for Syndicates 33 and 3624 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 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.

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.

The Group's regulatory capital is supervised by the Bermuda Monetary Authority (BMA). For the last two years, the BMA has conducted impact assessments of the regulatory capital requirements for groups, in preparation for the requirements to become enforceable from the beginning of 2013. The Group had sufficient capital to meet the regulatory capital requirements during both of the impact assessments.

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 Hiscox's Lloyd's operations 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. The Group used its own integrated modeling expertise to produce the ICA calculations. The results mirrored those driving the existing internal capital setting process.

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 the Integrated Prudential Sourcebook for Insurers (INSPRU) and General Prudential Sourcebook (GENPRU). In accordance with these provisions, the parent company's solvency margin consideration became a minimum capital requirement for the Group from 31 December 2006 onwards. The Group complied with the requirement for the current and prior year.

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

4 Operating segments

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

The Group's four operating segments are:

- **London Market** comprises the results of Syndicate 33, excluding the results of the fine art, UK regional events coverage and non US household business which is included within the results of UK and Europe. It also includes the fire and aviation businesses from Syndicate 3624, 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 on the following page 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 2012					Year to 31 December 2011				
	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	**640,042**	**507,522**	**418,255**	**–**	**1,565,819**	585,441	498,006	365,772	–	1,449,219
Net premiums written	**462,397**	**479,861**	**325,882**	**–**	**1,268,140**	413,390	472,608	288,013	–	1,174,011
Net premiums earned	**419,026**	**476,945**	**302,650**	**–**	**1,198,621**	418,764	448,594	277,649	–	1,145,007
Investment result*	**26,973**	**17,754**	**29,202**	**18,495**	**92,424**	8,782	7,248	6,313	2,152	24,495
Other revenues	**7,115**	**2,136**	**3,992**	**687**	**13,930**	9,858	3,938	3,311	215	17,322
Revenue	**453,114**	**496,835**	**335,844**	**19,182**	**1,304,975**	437,404	459,780	287,273	2,367	1,186,824
Claims and claim adjustment expenses, net of reinsurance	**(176,253)**	**(222,562)**	**(140,011)**	**–**	**(538,826)**	(238,026)	(207,018)	(252,854)	–	(697,898)
Expenses for the acquisition of insurance contracts	**(97,853)**	**(112,487)**	**(73,275)**	**–**	**(283,615)**	(99,257)	(106,300)	(64,235)	–	(269,792)
Operational expenses	**(45,606)**	**(111,074)**	**(62,233)**	**(17,289)**	**(236,202)**	(39,685)	(94,985)	(56,229)	(12,305)	(203,204)
Foreign exchange (losses)/gains	**(10,187)**	**(1,647)**	**3,113**	**(11,452)**	**(20,173)**	(1,507)	(25)	(3,097)	12,445	7,816
Total expenses	**(329,899)**	**(447,770)**	**(272,406)**	**(28,741)**	**(1,078,816)**	(378,475)	(408,328)	(376,415)	140	(1,163,078)
Results of operating activities	**123,215**	**49,065**	**63,438**	**(9,559)**	**226,159**	58,929	51,452	(89,142)	2,507	23,746
Finance costs	**(1,319)**	**–**	**(697)**	**(6,589)**	**(8,605)**	(1,308)	–	(399)	(4,991)	(6,698)
Share of (loss)/profit of associates after tax	**–**	**–**	**(64)**	**(366)**	**(430)**	–	–	65	158	223
Profit before tax	**121,896**	**49,065**	**62,677**	**(16,514)**	**217,124**	57,621	51,452	(89,476)	(2,326)	17,271

*Interest revenues included total £50,811,000 (2011: £48,802,000).

The following charges are included within the consolidated income statement:

	Year to 31 December 2012					Year to 31 December 2011				
	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	**720**	**442**	**1,012**	**83**	**2,257**	1,325	1,488	1,226	106	4,145
Amortisation of intangible assets	**1,532**	**1,896**	**1,527**	**30**	**4,985**	1,198	1,250	1,499	6	3,953

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

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

	Year to 31 December 2012					Year to 31 December 2011				
100% ratio analysis	London Market	UK and Europe	International	Corporate Centre	Total	London Market	UK and Europe	International	Corporate Centre	Total
Claims ratio (%)	**40.3**	**47.2**	**46.0**	**–**	**44.1**	56.6	46.3	89.9	–	60.2
Expense ratio (%)	**32.8**	**46.9**	**44.2**	**–**	**40.5**	32.5	44.7	42.9	–	39.1
Combined ratio excluding foreign exchange impact (%)	**73.1**	**94.1**	**90.2**	**–**	**84.6**	89.1	91.0	132.8	–	99.3
Foreign exchange impact (%)	**2.4**	**0.3**	**(1.0)**	**–**	**0.9**	–	–	1.1	–	0.2
Combined ratio (%)	**75.5**	**94.4**	**89.2**	**–**	**85.5**	89.1	91.0	133.9	–	99.5
Combined ratio excluding non-monetary foreign exchange impact (%)	**74.6**	**94.7**	**89.2**	**–**	**85.1**	90.0	90.9	133.9	–	99.9

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

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

	Year to 31 December 2012				Year to 31 December 2011			
	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	London Market £000	UK and Europe £000	International £000	Corporate Centre £000
At 100% level (note 4b) 1% change in claims or expense ratio	**5,496**	**4,895**	**3,072**	**–**	5,555	4,637	2,831	–
At Group level 1% change in claims or expense ratio	**4,190**	**4,769**	**3,027**	**–**	4,188	4,486	2,776	–

(b) 100% operating result by segment

	Year to 31 December 2012					Year to 31 December 2011				
	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	**844,330**	**523,405**	**424,189**	**–**	**1,791,924**	779,261	514,075	370,168	–	1,663,504
Net premiums written	**601,736**	**491,992**	**330,941**	**–**	**1,424,669**	543,696	487,609	292,640	–	1,323,945
Net premiums earned	**549,603**	**489,453**	**307,206**	**–**	**1,346,262**	555,533	463,706	283,138	–	1,302,377
Investment result	**36,842**	**18,283**	**29,590**	**18,495**	**103,210**	12,024	7,399	6,503	2,152	28,078
Other revenues	**–**	**2,097**	**2,453**	**687**	**5,237**	1,553	3,380	1,990	215	7,138
Claims and claim adjustment expenses, net of reinsurance	**(221,637)**	**(230,740)**	**(141,154)**	**–**	**(593,531)**	(314,517)	(214,609)	(254,627)	–	(783,753)
Expenses for the acquisition of insurance contracts	**(125,810)**	**(117,955)**	**(74,751)**	**–**	**(318,516)**	(130,593)	(111,624)	(65,127)	–	(307,344)
Operational expenses	**(54,091)**	**(111,810)**	**(61,162)**	**(17,289)**	**(244,352)**	(50,182)	(95,946)	(56,245)	(12,305)	(214,678)
Foreign exchange (losses)/gains	**(13,372)**	**(1,711)**	**3,138**	**(11,452)**	**(23,397)**	72	90	(3,103)	12,445	9,504
Results of operating activities	**171,535**	**47,617**	**65,320**	**(9,559)**	**274,913**	73,890	52,396	(87,471)	2,507	41,322

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.

Notes to the consolidated financial statements
continued

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:

As at 31 December 2012

	London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Intragroup items and eliminations £000	Total £000
Intangible assets	**33,215**	**10,469**	**15,779**	**10,154**	**–**	**69,617**
Deferred acquisition costs	**50,862**	**45,023**	**68,391**	**–**	**1,765**	**166,041**
Financial assets	**826,094**	**428,107**	**870,731**	**73,424**	**216,967**	**2,415,323**
Reinsurance assets	**886,937**	**230,013**	**275,825**	**–**	**(852,386)**	**540,389**
Other assets	**426,004**	**264,231**	**606,413**	**1,074,731**	**(1,176,477)**	**1,194,902**
Total assets	**2,223,112**	**977,843**	**1,837,139**	**1,158,309**	**(1,810,131)**	**4,386,272**
Insurance liabilities	**1,267,797**	**566,218**	**914,223**	**–**	**(151,626)**	**2,596,612**
Other liabilities	**926,709**	**222,193**	**72,923**	**193,282**	**(1,003,831)**	**411,276**
Total liabilities	**2,194,506**	**788,411**	**987,146**	**193,282**	**(1,155,457)**	**3,007,888**
Capital expenditure	**4,262**	**3,743**	**1,776**	**585**	**–**	**10,366**

As at 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

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 and 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 2012** London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000	Year to 31 December 2011 London Market £000	UK and Europe £000	International £000	Corporate Centre £000	Total £000
UK and Ireland	**19,774**	**287,673**	**12,431**	**–**	**319,878**	24,360	274,108	11,925	–	310,393
Europe	**6,922**	**167,970**	**22,828**	**–**	**197,720**	27,829	145,270	27,677	–	200,776
United States	**339,991**	**1,068**	**245,074**	**–**	**586,133**	306,114	22,127	194,116	–	522,357
Rest of World	**225,560**	**48,861**	**109,707**	**–**	**384,128**	235,273	32,807	127,348	–	395,428
	592,247	**505,572**	**390,040**	**–**	**1,487,859**	593,576	474,312	361,066	–	1,428,954

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

	2012		2011	
	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	**1,378,384**	**349.7**	1,255,899	323.5
Net tangible asset value	**1,308,767**	**332.0**	1,188,347	306.1

The net asset value per share is based on 394,200,249 shares (2011: 388,233,074 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

	2012 £000	2011 £000
Profit for the year (all attributable to owners of the Company)	**207,772**	21,272
Opening shareholders' equity	**1,255,899**	1,266,114
Adjusted for the time-weighted impact of capital distributions and issuance of shares	**(28,095)**	(14,025)
Adjusted opening shareholders' equity	**1,227,804**	1,252,089
Annualised return on equity (%)	**16.9**	1.7

7 Investment result

The total result for the Group before taxation comprises:

	Note	2012 £000	2011 £000
Investment income including interest receivable		**45,699**	50,333
Net realised gains on financial investments at fair value through profit or loss		**9,071**	5,040
Net fair value gains/(losses) on financial investments at fair value through profit or loss		**37,920**	(29,431)
Investment result – financial assets	8	**92,690**	25,942
Fair value losses on derivative financial instruments	21	**(266)**	(1,447)
Total result		**92,424**	24,495

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:

	2012 %	2011 %
Sterling	**3.6**	1.0
US Dollar	**3.2**	0.6
Other	**1.8**	1.6

(b) Investment return

	London Market		UK and Europe		International		Corporate Centre		2012 Total	
	£000	%	£000	%	£000	%	£000	%	£000	%
Debt and fixed income securities	**26,813**	**3.5**	**8,585**	**1.9**	**19,191**	**2.5**	**7,990**	**3.9**	**62,579**	**2.8**
Equities and shares in unit trusts	**–**	**–**	**8,288**	**13.8**	**8,580**	**14.0**	**10,106**	**16.6**	**26,974**	**14.8**
Deposits with credit institutions/ cash and cash equivalents	**242**	**0.2**	**796**	**0.7**	**1,700**	**0.6**	**399**	**0.4**	**3,137**	**0.5**
	27,055	3.1	17,669	2.8	29,471	2.7	18,495	5.1	92,690	3.1

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

	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

9 Other revenues and operational expenses

	2012 £000	2011 £000
Agency related income	**5,866**	6,769
Profit commission	**5,532**	7,383
Other underwriting income – catastrophe bonds	**1,123**	1,006
Other income	**1,409**	2,164
Other revenues	**13,930**	17,322
Wages and salaries	**88,294**	69,185
Social security cost	**15,299**	12,930
Pension cost – defined contribution	**6,117**	5,724
Pension cost – defined benefit	**1,800**	1,700
Share based payments	**6,135**	8,677
Marketing expenses	**26,251**	19,955
Investment expenses	**3,543**	3,360
Depreciation, amortisation and impairment	**7,833**	8,098
Other expenses	**80,930**	73,575
Operational expenses	**236,202**	203,204

10 Finance costs

	Note	2012 £000	2011 £000
Interest and expenses associated with bank borrowings		**2,703**	1,960
Interest and charges associated with Letters of Credit	35	**5,032**	3,933
Interest charges on experience account		**870**	804
Interest charges arising on finance leases	36	**–**	1
		8,605	6,698

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	2012 £000	2011 £000
Amounts receivable by the auditor and associates in respect of:		
The auditing of the accounts of any associate of the Group	**911**	908
All audit-related assurance services	**129**	132
Taxation compliance services	**–**	8
All non-audit-related assurance services	**21**	–
	1,061	1,048

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 (losses)/gains

The net foreign exchange gains for the year include the following amounts:

	2012 £000	2011 £000
Exchange (losses)/gains recognised in the consolidated income statement	**(20,173)**	7,816
Exchange (losses)/gains classified as a separate component of equity	**(35,806)**	11,060
Overall impact of foreign exchange related items on net assets	**(55,979)**	18,876

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.

	2012 £000	2011 £000
Opening balance sheet impact of non-retranslation of non-monetary items	**2,144**	(1,251)
(Loss)/gain included within profit representing the non-retranslation of non-monetary items	**(4,818)**	3,395
Closing balance sheet impact of non-retranslation of non-monetary items	**(2,674)**	2,144

13 Foreign currency items on 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 (gains)/losses arise which are not eliminated through the income statement on consolidation. Implicit offsetting gains/(losses) 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 2012	**Consolidated income statement 2012 £000**	**Consolidated other comprehensive income 2012 £000**	**Total impact on equity 2012 £000**
Unrealised translation gains/(losses) on intragroup borrowings	**891**	**(891)**	**–**
Total gains/(losses) recognised	**891**	**(891)**	**–**

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	–

14 Intangible assets

	Goodwill £000	Syndicate capacity £000	State authorisation licences £000	Software and development costs £000	Other £000	Total £000
At 1 January 2011						
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
Year ended 31 December 2012						
Opening net book amount	**7,975**	**24,505**	**6,308**	**20,445**	**8,319**	**67,552**
Other additions	**–**	**–**	**–**	**7,150**	**–**	**7,150**
Amortisation charges	**–**	**–**	**–**	**(4,302)**	**(683)**	**(4,985)**
Impairment	**(100)**	**–**	**–**	**–**	**–**	**(100)**
Closing net book amount	**7,875**	**24,505**	**6,308**	**23,293**	**7,636**	**69,617**
At 31 December 2012						
Cost	**10,405**	**24,505**	**6,308**	**34,086**	**9,982**	**85,286**
Accumulated amortisation and impairment	**(2,530)**	**–**	**–**	**(10,793)**	**(2,346)**	**(15,669)**
Net book amount	**7,875**	**24,505**	**6,308**	**23,293**	**7,636**	**69,617**

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.

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 6.7% (2011: 4.8%) has been applied to the projections to determine the net present value. The outcome of the value in use calculation is measured against the carrying value of the asset and, where the carrying value is in excess of the value in use, the asset is written down to this amount.

The £100,000 impairment recognised in the year for goodwill is included in operational expenses in the consolidated income statement (2011: £nil).

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 2012 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 value in use to the Group's US insurer. The value in use is calculated using a discounted projected cash flow based on business plans approved by management, and discounted at an appropriate rate. Key assumptions include new business growth, retention rates, market cycle and claims inflation. The results of that test show 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. These intangible assets are amortised on a straight-line basis over their 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 2012.

The amortisation charge for the year includes £4,302,000 (2011: £3,634,000) relating to capitalised internally generated software costs and is included in operational expenses in the consolidated income statement.

The net book value of capitalised internally generated software costs at 31 December 2012 was £23,293,000 (2011: £20,445,000). There are no charges for impairment during the current or prior financial year.

At 31 December 2012 there were £13,505,000 of assets under development on which no amortisation has been charged (2011: £8,873,000).

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 2011					
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
Year ended 31 December 2012					
Opening net book amount	**5,742**	**2,487**	**50**	**9,876**	**18,155**
Additions	**–**	**260**	**80**	**2,876**	**3,216**
Disposals	**–**	**–**	**(27)**	**(90)**	**(117)**
Depreciation charge	**(77)**	**(391)**	**(33)**	**(1,756)**	**(2,257)**
Impairment	**(491)**	**–**	**–**	**–**	**(491)**
Foreign exchange movements	**(170)**	**(138)**	**–**	**(143)**	**(451)**
Closing net book amount	**5,004**	**2,218**	**70**	**10,763**	**18,055**
At 31 December 2012					
Cost	**5,498**	**3,816**	**114**	**43,743**	**53,171**
Accumulated depreciation	**(494)**	**(1,598)**	**(44)**	**(32,980)**	**(35,116)**
Net book amount	**5,004**	**2,218**	**70**	**10,763**	**18,055**

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

The impairment charge of £491,000 in the year is included in operational expenses in the consolidated income statement (2011: £nil).

Assets with a net book value of £nil were held under finance leases (2011: £nil).

During the year no expenditure was recognised in the carrying value of property that is under the course of construction (2011: £nil).

16 Investments in associates

Year ended 31 December	2012 £000	2011 £000
At beginning of year	**6,380**	6,886
Additions during the year	**3,104**	–
Disposals during the year	**–**	(729)
Net (loss)/profit from investments in associates	**(430)**	223
At end of year	**9,054**	6,380

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

		100% results			
	% interest held at 31 December	Assets £000	Liabilities £000	Revenues £000	Profit after tax £000
2012					
Associates incorporated in the UK	**from 25% to 35%**	**67,773**	**52,720**	**14,987**	**661**
Associates incorporated in Europe	**from 25% to 49%**	**1,806**	**1,097**	**2,523**	**254**
Total at the end of 2012		**69,579**	**53,817**	**17,510**	**915**

		100% results			
	% interest held at 31 December	Assets £000	Liabilities £000	Revenues £000	Profit after tax £000
2011					
Associates incorporated in the UK	from 25% to 35%	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)

On 6 August 2012, the Group acquired a 25% holding in Lark (2012) Ltd, for total consideration of £3,104,000 as referred to in note 33. The company is treated as an associate from this date.

During 2012, the Group disposed of its holding in InsuranceBee, Inc. During 2011 the Group sold its holding in Plexstar Insurance Services Ltd.

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.

17 Deferred acquisition costs

	2012			2011		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance deferred at 1 January	**150,050**	**(15,641)**	**134,409**	142,736	(17,048)	125,688
Acquisition costs incurred in relation to insurance contracts written	**353,193**	**(53,077)**	**300,116**	320,529	(43,186)	277,343
Acquisition costs expensed to the income statement	**(333,758)**	**50,143**	**(283,615)**	(314,385)	44,593	(269,792)
Foreign exchange adjustment	**(3,444)**	**235**	**(3,209)**	1,170	–	1,170
Balance deferred at 31 December	**166,041**	**(18,340)**	**147,701**	150,050	(15,641)	134,409

The deferred amount of insurance contract acquisition costs attributable to reinsurers of £18,340,000 (2011: £15,641,000) 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:	2012 £000	2011 £000
Within one year	**137,754**	126,847
After one year	**9,947**	7,562
	147,701	134,409

18 Reinsurance assets

	Note	2012 £000	2011 £000
Reinsurers' share of insurance liabilities		**541,387**	493,422
Provision for non-recovery and impairment		**(998)**	(907)
Reinsurance assets	26	**540,389**	492,515

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

	2012 £000	2011 £000
Within one year	**286,532**	265,525
After one year	**253,857**	226,990
	540,389	492,515

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 loss during the year of £91,000 (2011: gain of £52,000) 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	2012 Fair value £000	2011 Fair value £000
Debt and fixed income securities		**2,194,866**	2,170,588
Equities and shares in unit trusts		**190,029**	173,432
Deposits with credit institutions		**13,203**	12,848
Total investments		**2,398,098**	2,356,868
Insurance linked fund		**8,098**	–
Catastrophe bonds		**–**	11,639
Derivative financial instruments	21	**73**	129
Total financial assets carried at fair value		**2,406,269**	2,368,636

	Note	2012 Fair value £000	2011 Fair value £000
Derivative financial instruments	21	**301**	–
Total financial liabilities		**301**	–

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).

On 27 December 2012, the Group invested $13.2 million into the Third Point Reinsurance Opportunities Fund ('the Fund'), representing a 32% non-voting interest holding, subject to a two-year initial lock-up period. The Group has committed to invest an additional $16.8 million into the Fund which is payable on demand. The Fund specialises in catastrophe reinsurance opportunities and is classified by the Group as an insurance linked fund.

The Group has entered into a quota share arrangement with Third Point Re Cat Ltd, a wholly-owned reinsurance entity of the Fund. No contracts have been ceded to the entity as of 31 December 2012.

The Group's investment in catastrophe bonds was dissolved during the year (2011: £11.6 million). 2011 comprised 16 catastrophe bonds with credit ratings of BB and B. The issuers of these securities used the proceeds to collateralise certain catastrophe reinsurance obligations mainly in US and European wind and earthquake risks.

19 Financial assets and liabilities continued

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

	2012 £000	2011 £000
Debt and fixed income securities		
Sterling	**404,769**	408,328
US Dollars	**1,496,748**	1,508,234
Euro and other currencies	**293,349**	254,026
	2,194,866	2,170,588
Equities and shares in unit trusts		
Sterling	**105,486**	90,303
US Dollars	**82,683**	81,620
Euro and other currencies	**1,860**	1,509
	190,029	173,432
Deposits with credit institutions		
Sterling	**12,957**	12,588
US Dollars	**246**	260
Euro and other currencies	**–**	–
	13,203	12,848
Total investments	**2,398,098**	2,356,868

20 Loans and receivables including insurance receivables

	2012 £000	2011 £000
Gross receivables arising from insurance and reinsurance contracts	**425,720**	429,676
Provision for impairment	**(986)**	(956)
Net receivables arising from insurance and reinsurance contracts	**424,734**	428,720
Due from contract holders, brokers, agents and intermediaries	**295,892**	299,879
Due from reinsurance operations	**128,842**	128,841
	424,734	428,720
Prepayments and accrued income	**10,345**	8,387
Other loans and receivables:		
Net profit commission receivable	**7,295**	13,792
Accrued interest	**9,120**	10,149
Share of Syndicates' other debtors' balances	**13,138**	19,726
Other debtors including related party amounts	**27,432**	26,948
Total loans and receivables including insurance receivables	**492,064**	507,722
The amounts expected to be recovered before and after one year are estimated as follows:		
Within one year	**476,930**	499,805
After one year	**15,134**	7,917
	492,064	507,722

There is no significant concentration of credit risk with respect to loans and receivables as the Group has a large number of internationally dispersed debtors. The Group has recognised a loss of £30,000 (2011: gain of £85,000) for the impairment of receivables during the year ended 31 December 2012.

21 Derivative financial instruments

The Group entered into both exchange-traded and over-the-counter derivative contracts for a number of purposes during 2012. 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 2012 all mature within one year of the balance sheet date and are detailed below:

31 December 2012 Derivative financial instrument 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	17,755	73	301	228
Interest rate futures contracts	36,655	–	–	–

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	–	–	–

All derivatives contracts settle within three months of the year end.

Foreign exchange forward contracts

During the current and prior year the Group entered into a series of conventional over-the-counter forward contracts in order to secure translation gains made on Euro, US Dollar and other non-Pound Sterling denominated monetary assets. The contracts require the Group to forward sell a fixed amount of the relevant currency for Pound Sterling at pre-agreed future exchange rates. The Group made a gain on these forward contracts of £71,000 (2011: loss of £84,000) as included in note 7. The opposite exchange loss is included within financial investments.

There was no initial purchase cost associated with these instruments.

Interest rate futures contracts

During the year the Group continued short selling a number of government bond futures and sovereign futures denominated in a range of currencies to informally hedge substantially all of the interest rate risk on specific long portfolios of the matching currencies denominated corporate bonds. All contracts are exchange traded and the Group made a loss on these futures contracts of £337,000 (2011: £1,796,000) as included in note 7.

Equity index futures

During the prior 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 as included in note 7.

No such futures were purchased in 2012.

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 2012	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Debt and fixed income securities	**718,393**	**1,476,473**	**–**	**2,194,866**
Equities and shares in unit trusts	**–**	**176,494**	**13,535**	**190,029**
Deposits with credit institutions	**13,203**	**–**	**–**	**13,203**
Catastrophe bonds	**–**	**–**	**–**	**–**
Insurance linked fund	**–**	**–**	**8,098**	**8,098**
Derivative instrument assets	**–**	**73**	**–**	**73**
Total	**731,596**	**1,653,040**	**21,633**	**2,406,269**
Financial liabilities				
Derivative financial instruments	**–**	**301**	**–**	**301**

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
Insurance linked fund	–	–	–	–
Derivative instrument assets	–	129	–	129
Total	513,520	1,844,490	10,626	2,368,636
Financial liabilities				
Derivative financial instruments	–	–	–	–

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 market observable 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 is 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 is 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 and an insurance linked fund 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 Group invested into the insurance linked fund in December 2012, which is subject to a two-year initial lock-up period. The fund specialises in catastrophe reinsurance opportunities. 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 significant 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 2012	**Equities and shares in unit trusts £000**	**Deposits with credit institutions £000**	**Insurance linked fund £000**	**Derivative financial instruments £000**	**Total £000**
Balance at 1 January	**10,626**	**–**	**–**	**–**	**10,626**
Total gains or losses through profit or loss*	**2,587**	**–**	**–**	**–**	**2,587**
Purchases	**322**	**–**	**8,098**	**–**	**8,420**
Settlements	**–**	**–**	**–**	**–**	**–**
Closing balance	**13,535**	**–**	**8,098**	**–**	**21,633**
Unrealised gains and losses in the year on securities held at the end of the year	**2,587**	**–**	**–**	**–**	**2,587**

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

31 December 2011	Equities and shares in unit trusts £000	Deposits with credit institutions £000	Insurance linked fund £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
Unrealised gains and losses in the year on securities held at the end of the year	1,242	–	–	–	1,242

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

23 Cash and cash equivalents

	2012 £000	2011 £000
Cash at bank and in hand	**428,454**	258,927
Short-term deposits	**229,208**	257,620
	657,662	516,547

The Group holds its cash deposits with a well-diversified range of banks and financial institutions. Cash includes overnight deposits. Short-term deposits include debt securities with an original maturity date of less than three months and money market funds.

24 Share capital

Group	31 December 2012 Share capital £000	31 December 2012 Number of shares	31 December 2011 Share capital £000	31 December 2011 Number of shares
Authorised	**40,000**	**800,000,000**	30,000	600,000,000
Issued share capital	**20,703**	**414,069,422**	20,563	411,256,520

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 2011		20,297	15,800	245,005
Employee share option scheme – proceeds from shares issued		91	3,124	–
Scrip dividends to owners of the Company	32	175	13,162	–
At 31 December 2011		20,563	32,086	245,005
Employee share option scheme – proceeds from shares issued		52	1,649	–
Scrip dividends to owners of the Company	32	88	7,578	–
At 31 December 2012		**20,703**	**41,313**	**245,005**

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

During the year, the Group offered its shareholders the option of receiving a scrip dividend alternative to the cash dividend. This resulted in the Company paying the shareholders, who opted for a scrip dividend, in shares of equal value to the cash dividend at a specified date. The full dividend was distributed from retained earnings and the new shares issued for the scrip dividend were reflected in share capital and share premium.

Equity structure of Hiscox Ltd	Note	Number of 5p ordinary shares in issue (thousands) 2012	Number of 5p ordinary shares in issue (thousands) 2011
At 1 January		**411,257**	405,943
Employee share option scheme – ordinary shares issued		**1,054**	1,811
Scrip dividends to owners of the Company	32	**1,758**	3,503
At 31 December		**414,069**	411,257

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 employees 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 repurchase 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 £6,135,000 (2011: £8,677,000). This comprises charges of £5,793,000 (2011: £8,361,000) in respect of performance share plan awards and £342,000 (2011: £316,000) 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	2012	2011
Annual risk-free rates of return and discount rates (%)	**0.27-0.55**	0.9-1.9
Long-term dividend yield (%)	**3.95-4.31**	4.24-4.59
Expected life of options (years)	**3.25**	3.25
Implied volatility of share price (%)	**28**	29
Weighted average share price (p)	**416.0**	397.0

The weighted average fair value of each share option granted during the year was 93.4p (2011: 89.9p). The weighted average fair value of each performance share plan award granted during the year was 414.0p (2011: 397.0p).

Movements in the number of share options during the year and details of the balances outstanding at 31 December 2012 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

	2012 £000	2011 £000
Currency translation reserve at 31 December	**24,711**	60,517
Retained earnings at 31 December	**1,046,652**	897,728

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 2012 Hiscox Ltd held 19,682,214 shares in treasury (2011: 22,836,487). 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	2012 £000	2011 £000
Gross			
Claims reported and claim adjustment expenses		**932,604**	938,498
Claims incurred but not reported		**1,000,300**	964,073
Unearned premiums		**663,708**	597,689
Total insurance liabilities, gross		**2,596,612**	2,500,260
Recoverable from reinsurers			
Claims reported and claim adjustment expenses		**192,311**	187,973
Claims incurred but not reported		**261,128**	224,855
Unearned premiums		**86,950**	79,687
Total reinsurers' share of insurance liabilities	18	**540,389**	492,515
Net			
Claims reported and claim adjustment expenses		**740,293**	750,525
Claims incurred but not reported		**739,172**	739,218
Unearned premiums		**576,758**	518,002
Total insurance liabilities, net		**2,056,223**	2,007,745

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

	2012	2011
Within one year	**1,190,613**	1,160,744
After one year	**865,610**	847,001
	2,056,223	2,007,745

Notes to the consolidated financial statements continued

26 Insurance liabilities and reinsurance assets continued

The gross claims reported, the claims 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 2012 and 2011 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 necessitates 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 reoccur 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	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	2011 £000	**2012 £000**	**Total £000**
Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year	451,232	677,420	1,132,098	586,952	785,828	1,089,977	830,500	999,343	1,305,556	**1,068,466**	**8,927,372**
one year later	462,982	750,898	1,252,403	560,426	700,297	924,155	691,660	858,866	1,177,441	**–**	**7,379,128**
two years later	435,298	716,648	1,254,360	539,926	664,529	901,688	635,020	805,499	–	**–**	**5,952,968**
three years later	448,028	678,079	1,236,690	509,990	677,008	864,069	628,871	–	–	**–**	**5,042,735**
four years later	442,618	681,010	1,231,059	519,672	670,233	828,996	–	–	–	**–**	**4,373,588**
five years later	432,405	663,389	1,232,155	509,716	641,088	–	–	–	–	**–**	**3,478,753**
six years later	427,914	666,685	1,188,963	496,764	–	–	–	–	–	**–**	**2,780,326**
seven years later	417,794	648,433	1,182,120	–	–	–	–	–	–	**–**	**2,248,347**
eight years later	413,874	638,611	–	–	–	–	–	–	–	**–**	**1,052,485**
nine years later	413,545	–	–	–	–	–	–	–	–	**–**	**413,545**
Current estimate of cumulative claims	413,545	638,611	1,182,120	496,764	641,088	828,996	628,871	805,499	1,177,441	**1,068,466**	**7,881,401**
Cumulative payments to date	(380,930)	(603,815)	(1,137,927)	(456,744)	(551,708)	(705,187)	(490,583)	(508,862)	(612,544)	**(211,444)**	**(5,659,744)**
Liability recognised at 100% level	32,615	34,796	44,193	40,020	89,380	123,809	138,288	296,637	564,897	**857,022**	**2,221,657**
Liability recognised in respect of prior accident years at 100% level											**107,975**
Total gross liability to external parties at 100% level											**2,329,632**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2012.

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

Accident year	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	2011 £000	**2012 £000**	**Total £000**
Current estimate of cumulative claims	413,545	638,611	1,182,120	496,764	641,088	828,996	628,871	805,499	1,177,441	**1,068,466**	**7,881,401**
Less: attributable to external Names	(92,227)	(149,455)	(297,239)	(104,031)	(124,512)	(158,706)	(104,563)	(122,246)	(167,408)	**(151,799)**	**(1,472,186)**
Group's share of current ultimate claims estimate	321,318	489,156	884,881	392,733	516,576	670,290	524,308	683,253	1,010,033	**916,667**	**6,409,215**
Cumulative payments to date	(380,930)	(603,815)	(1,137,927)	(456,744)	(551,708)	(705,187)	(490,583)	(508,862)	(612,544)	**(211,444)**	**(5,659,744)**
Less: attributable to external Names	83,632	140,725	286,497	94,183	105,597	131,908	81,998	69,254	86,192	**21,317**	**1,101,303**
Group's share of cumulative payments	(297,298)	(463,090)	(851,430)	(362,561)	(446,111)	(573,279)	(408,585)	(439,608)	(526,352)	**(190,127)**	**(4,558,441)**
Liability for 2003 to 2012 accident years recognised on Group's balance sheet	24,020	26,066	33,451	30,172	70,465	97,011	115,723	243,645	483,681	**726,540**	**1,850,774**
Liability for accident years before 2003 recognised on Group's balance sheet											**82,130**
Total Group liability to external parties included in balance sheet – gross**											**1,932,904**

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

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	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	2011 £000	**2012 £000**	**Total £000**
Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year	355,725	566,426	668,943	522,105	683,708	762,679	681,858	800,335	1,016,675	**790,001**	**6,848,455**
one year later	375,233	618,704	768,212	513,824	622,394	681,434	573,182	705,854	940,543	**–**	**5,799,380**
two years later	342,232	594,381	758,222	497,020	603,148	677,599	547,415	665,628	–	**–**	**4,685,645**
three years later	352,920	557,991	733,810	455,123	572,223	639,340	548,086	–	–	**–**	**3,859,493**
four years later	343,372	558,860	724,053	471,721	568,043	608,530	–	–	–	**–**	**3,274,579**
five years later	338,539	544,064	724,336	460,025	543,510	–	–	–	–	**–**	**2,610,474**
six years later	334,976	544,245	703,604	453,022	–	–	–	–	–	**–**	**2,035,847**
seven years later	323,900	528,724	695,163	–	–	–	–	–	–	**–**	**1,547,787**
eight years later	316,035	520,847	–	–	–	–	–	–	–	**–**	**836,882**
nine years later	321,250	–	–	–	–	–	–	–	–	**–**	**321,250**
Current estimate of cumulative claims	321,250	520,847	695,163	453,022	543,510	608,530	548,086	665,628	940,543	**790,001**	**6,086,580**
Cumulative payments to date	(313,107)	(487,971)	(644,541)	(420,041)	(471,241)	(508,311)	(422,048)	(445,819)	(502,022)	**(182,459)**	**(4,397,560)**
Liability recognised at 100% level	8,143	32,876	50,622	32,981	72,269	100,219	126,038	219,809	438,521	**607,542**	**1,689,020**
Liability recognised in respect of prior accident years at 100% level											**65,222**
Total net liability to external parties at 100% level											**1,754,242**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2012.

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

Accident year	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	2010 £000	2011 £000	**2012 £000**	**Total £000**
Current estimate of cumulative claims	321,250	520,847	695,163	453,022	543,510	608,530	548,086	665,628	940,543	**790,001**	**6,086,580**
Less: attributable to external Names	(70,288)	(122,336)	(167,281)	(94,653)	(106,623)	(109,893)	(86,099)	(90,474)	(121,073)	**(97,137)**	**(1,065,857)**
Group's share of current ultimate claims estimate	250,962	398,511	527,882	358,369	436,887	498,637	461,987	575,154	819,470	**692,864**	**5,020,723**
Cumulative payments to date	(313,107)	(487,971)	(644,541)	(420,041)	(471,241)	(508,311)	(422,048)	(445,819)	(502,022)	**(182,459)**	**(4,397,560)**
Less: attributable to external Names	68,282	113,935	154,537	86,235	90,960	87,609	64,676	58,138	65,136	**18,319**	**807,827**
Group's share of cumulative payments	(244,825)	(374,036)	(490,004)	(333,806)	(380,281)	(420,702)	(357,372)	(387,681)	(436,886)	**(164,140)**	**(3,589,733)**
Liability for 2003 to 2012 accident years recognised on Group's balance sheet	6,137	24,475	37,878	24,563	56,606	77,935	104,615	187,473	382,584	**528,724**	**1,430,990**
Liability for accident years before 2003 recognised on Group's balance sheet											**48,475**
Total Group liability to external parties included in the balance sheet – net**											**1,479,465**

**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	2012 Gross £000	2012 Reinsurance £000	2012 Net £000	2011 Gross £000	2011 Reinsurance £000	2011 Net £000
Total at beginning of year	**(1,902,571)**	**412,828**	**(1,489,743)**	(1,706,404)	374,193	(1,332,211)
Claims and claim adjustment expenses for year	**(719,792)**	**180,966**	**(538,826)**	(830,368)	132,470	(697,898)
Cash paid for claims settled in the year	**614,723**	**(124,685)**	**490,038**	650,510	(95,433)	555,077
Exchange differences and other movements	**74,736**	**(15,670)**	**59,066**	(16,309)	1,598	(14,711)
Total at end of year	**(1,932,904)**	**453,439**	**(1,479,465)**	(1,902,571)	412,828	(1,489,743)
Claims reported and claim adjustment expenses	**(932,604)**	**192,311**	**(740,293)**	(938,498)	187,973	(750,525)
Claims incurred but not reported	**(1,000,300)**	**261,128**	**(739,172)**	(964,073)	224,855	(739,218)
Total at end of year	**(1,932,904)**	**453,439**	**(1,479,465)**	(1,902,571)	412,828	(1,489,743)

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

Year ended 31 December	2012 Gross £000	2012 Reinsurance £000	2012 Net £000	2011 Gross £000	2011 Reinsurance £000	2011 Net £000
Current year claims and claim adjustment expenses	**(930,635)**	**239,912**	**(690,723)**	(1,126,667)	229,314	(897,353)
Over/(under) provision in respect of prior year claims and claim adjustment expenses	**210,843**	**(58,946)**	**151,897**	296,299	(96,844)	199,455
Total claims and claim adjustment expenses	**(719,792)**	**180,966**	**(538,826)**	(830,368)	132,470	(697,898)

27 Trade and other payables

	Note	2012 £000	2011 £000
Creditors arising out of direct insurance operations		**15,606**	58,346
Creditors arising out of reinsurance operations		**130,605**	152,866
		146,211	211,212
Share of Syndicates' other creditors' balances		**10,239**	4,856
Social security and other taxes payable		**8,649**	10,640
Other creditors		**9,037**	14,939
		27,925	30,435
Reinsurers' share of deferred acquisition costs	17	**18,340**	15,641
Accruals and deferred income		**73,139**	56,847
Total		**265,615**	314,135
The amounts expected to be settled before and after one year are estimated as follows:			
Within one year		**248,155**	300,976
After one year		**17,460**	13,159
		265,615	314,135

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.

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:

	2012 £000	2011 £000
Current tax		
Expense for the year	**15,751**	380
Adjustments in respect of prior years	**2,973**	(95,809)
Total current tax expense/(credit)	**18,724**	(95,429)
Deferred tax		
Expense for the year	**595**	17,090
Adjustments in respect of prior years	**2,912**	77,992
Effect of rate change	**(12,879)**	(3,654)
Total deferred tax (credit)/expense	**(9,372)**	91,428
Total tax charged/(credited) to the income statement	**9,352**	(4,001)

The standard rate of corporation tax in Bermuda is 0% whereas the effective rate of tax for the Group is 4.3% (2011: -22.5%). A reconciliation of the difference is provided below:

	2012 £000	2011 £000
Profit before tax	**217,124**	17,271
Tax calculated at the standard corporation tax rate applicable in Bermuda: 0% (2011: 0%)	**–**	–
Effects of Group entities subject to overseas tax at different rates	**31,594**	21,620
Impact of overseas tax rates on:		
Effect of rate change	**(12,879)**	(3,654)
Expenses not deductible for tax purposes	**1,734**	11,665
Tax losses for which no deferred tax asset is recognised	**6,752**	(2,651)
Other	**716**	(1,435)
Sch 23 FA 2003 deduction and share based payments	**(727)**	(1,867)
Non-taxable income	**(23,723)**	(10,242)
Overseas tax	**–**	380
Prior year tax adjustments	**5,885**	(17,817)
Tax charge/(credit) for the period	**9,352**	(4,001)

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 arose and resulted in a closing current tax debtor at 31 December 2012. Equally, deductions for member-level reinsurance premiums which were previously deferred for tax, and formed part of the deferred tax balance had been taken in earlier years, and no longer formed part of the deferred tax balance. The effect of this change in current tax was a credit to the income statement of £81,287,000. The effect of this change in deferred tax was 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. This rebate was received during 2011 and 2012.

29 Deferred tax

Deferred tax assets	2012 £000	2011 £000
Trading losses in overseas entities	**25,608**	25,748

Net deferred tax liabilities	2012 £000	2011 £000
Deferred tax assets	**11,370**	24,616
Deferred tax liabilities	**(149,732)**	(177,063)
Total net deferred tax liability	**(138,362)**	(152,447)

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	2011 £000	Income statement (charge)/credit £000	Transfer from equity £000	2012 £000
Trading losses in overseas entities	25,748	(140)	–	**25,608**
Deferred tax assets	25,748	(140)	–	**25,608**

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

At 31 December	2011 £000	Income statement (charge)/credit £000	Transfer from equity £000	2012 £000
Tangible assets	2,614	(955)	–	**1,659**
Trading losses in UK entities	12,959	(12,959)	–	**–**
Trade and other payables	525	510	–	**1,035**
Intangible assets – Syndicate capacity	3,344	(468)	–	**2,876**
Other items	5,174	(3,947)	4,573	**5,800**
Total deferred tax assets	24,616	(17,819)	4,573	**11,370**
Investment in associated enterprises	(6)	–	–	**(6)**
Financial assets	(1,018)	22	–	**(996)**
Insurance contracts – equalisation provision*	(26,929)	(4,103)	–	**(31,032)**
Reinsurance premiums	(128,240)	14,379	–	**(113,861)**
Retirement benefit obligations	(610)	521	–	**(89)**
	(156,803)	10,819	–	**(145,984)**
Open years of account	(20,260)	16,512	–	**(3,748)**
Total deferred tax liabilities	(177,063)	27,331	–	**(149,732)**
Net total deferred tax liabilities	(152,447)			**(138,362)**

*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 23% for the year ended 31 December 2012 (2011: 25%). The UK Government has indicated its intention to reduce UK tax rates to 21% by the full year commencing April 2014, however at the balance sheet date, no such measures were substantially enacted.

Movements in deferred and current tax relating to tax deductions arise on employee share options are recognised in the statement of change to equity to the extent that the movement exceeds the corresponding charge to the income statement. The total recognised in the statement of changes in equity is £5,190,000, comprising £4,573,000 deferred tax and £617,000 current tax (2011: £3,927,000 deferred tax).

Deferred tax assets of £25,608,000 (2011: £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. £23,809,000 (2011: £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 Group has not provided for deferred tax assets totalling £13,931,000 (2011: £8,714,000) including £13,841,000 (2011: £8,713,000) in relation to losses in overseas companies of £39,545,000 (2011: £25,408,000). In accordance with IAS 12, all deferred tax assets and liabilities are classified as non-current.

The amount of deferred tax asset expected to be recovered after more than 12 months is £25,608,000 (2011: £25,748,000).

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:

	2012 £000	2011 £000
Present value of scheme obligations	**173,420**	155,685
Fair value of scheme assets	**(156,513)**	(140,517)
Deficit for funded plans	**16,907**	15,168
Unrecognised net actuarial losses	**(32,991)**	(27,247)
Unrecognised surplus deemed irrecoverable	**16,084**	12,079
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.

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 2011, and updated at each intervening balance sheet date by the actuaries. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of AA rated corporate bonds that have terms to maturity that approximate to the terms of the related pension liability.

The scheme assets are invested as follows:

At 31 December	2012 £000	2011 £000
Equities	**105,644**	91,758
Debt and fixed income assets	**47,417**	44,825
Cash	**3,452**	3,934
	156,513	140,517

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:

	Note	2012 £000	2011 £000
Current service cost		**347**	533
Interest cost		**7,548**	7,705
Expected return on scheme assets		**(8,097)**	(8,988)
Recognition of past service credit		**–**	(3,037)
Amortisation of net actuarial loss		**1,034**	–
Effect of deemed irrecoverability of surplus		**968**	5,487
Total included in staff costs	9	**1,800**	1,700

The actual return on scheme assets was a gain of £17,807,000 (2011: £3,392,000).

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

	Note	2012 £000	2011 £000
At beginning of year		**–**	–
Total expense charged in the income statement of the Group	9	**1,800**	1,700
Contributions paid		**(1,800)**	(1,700)
At end of year		**–**	–

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

	2012 £000	2011 £000
Opening fair value of scheme assets	**140,517**	144,056
Expected return on scheme assets	**8,097**	8,988
Difference between expected and actual return on scheme assets	**9,710**	(5,596)
Contributions by the employer	**1,800**	1,700
Settlements with scheme members	**–**	–
Benefits paid	**(3,264)**	(8,098)
Expenses paid	**(347)**	(533)
Closing fair value of scheme assets	**156,513**	140,517

30 Employee retirement benefit obligations continued

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

	2012 £000	2011 £000
Opening present value of scheme obligations	**155,685**	146,737
Current service cost	**347**	533
Interest cost	**7,548**	7,705
Amendments	**–**	(3,037)
Actuarial losses/(gains)	**13,451**	12,378
Benefits paid from scheme	**(3,264)**	(8,098)
Settlements with scheme members	**–**	–
Expenses paid	**(347)**	(533)
Closing present value of scheme obligations	**173,420**	155,685

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

	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000	2007 £000	2006 £000
Experience gains/(losses) on scheme obligations	**4,372**	–	–	–	–	2,783	(3,310)
Experience gains/(losses) on scheme assets	**9,710**	(5,596)	6,075	(3,678)	(18,107)	75	6,480

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

	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000	2007 £000	2006 £000
Present value of scheme obligations	**173,420**	155,685	146,737	140,676	101,615	106,793	137,461
Fair value of scheme assets	**(156,513)**	(140,517)	(144,056)	(118,391)	(115,166)	(127,576)	(133,660)
Present value of unfunded obligations/ (surplus scheme assets)	**16,907**	15,168	2,681	22,285	(13,551)	(20,783)	3,801
Gross liability recognised on balance sheet	**–**	–	–	–	–	–	3,801

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:

	2012 years	2011 years
Male	**26.9**	26.6
Female	**28.3**	27.8

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

	2012 years	2011 years
Male	**28.3**	27.7
Female	**29.8**	29.0

Other principal actuarial assumptions are as follows:

	2012 %	2011 %
Discount rate	**4.5**	4.9
Expected return on scheme assets	**5.6**	5.8
Inflation assumption (RPI)	**2.9**	3.1
Inflation assumption (CPI)	**2.1**	2.3
Pension increases	**2.9**	3.1

The triennial valuation carried out as at 31 December 2011 resulted in a deficit position of £19.7 million. The Group agreed to fund the £19.7 million deficit paying instalments over five years. During the year the Group made its first instalment of £1.8 million to the defined benefit scheme (2011: £1.7 million) which included £0.2 million for the expenses of the pension fund (2011: £0.2 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 2012 by approximately £4,650,000 (2011: £1,396,000), the Group considers that the most sensitive and judgemental assumptions are the discount rate and inflation.

30 Employee retirement benefit obligations continued

CPI revalution in deferment is used for contracted-out members. Contracted-in members are linked to RPI as well as for all pension in payment increase.

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 2012 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 4.75%	**16,907**	**6,634**	**–**
Effect of an increase in inflation			
Use of RPI inflation assumption of 3.15%	**16,907**	**20,039**	**–**

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	2012	2011
Profit for the year attributable to the owners of the Company (£000)	**207,772**	21,272
Weighted average number of ordinary shares (thousands)	**391,592**	383,602
Basic earnings per share (pence per share)	**53.1p**	5.5p

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.

	2012	2011
Profit for the year attributable to the owners of the Company (£000)	**207,772**	21,272
Weighted average number of ordinary shares in issue (thousands)	**391,592**	383,602
Adjustments for share options (thousands)	**16,427**	15,610
Weighted average number of ordinary shares for diluted earnings per share (thousands)	**408,019**	399,212
Diluted earnings per share (pence per share)	**50.9p**	5.3p

Diluted earnings per share has been calculated after taking account of 15,915,875 (2011: 15,029,986) options and awards under employee share option and performance plan schemes and 510,925 (2011: 579,518) options under SAYE schemes.

32 Dividends paid to owners of the Company

	2012 £000	2011 £000
Interim dividend for the year ended:		
31 December 2012 of 6.0p (net) per share	**23,567**	–
31 December 2011 of 5.1p (net) per share	**–**	19,738
Final dividend for the year ended:		
31 December 2011 of 11.9p (net) per share	**46,606**	–
31 December 2010 of 11.5p (net) per share	**–**	44,111
	70,173	63,849

32 Dividends paid to owners of the Company continued

The final and interim dividends were either paid in cash or issued as a scrip dividend at the option of the shareholder. The final dividend for the year ended 31 December 2011 was paid in cash of £44,301,000 (2010: £31,803,000) and 562,194 shares for the scrip dividend (2010: 3,227,459).

The interim dividend for the year ended 31 December 2012 was paid in cash of £18,206,000 (2011: £18,709,000) and 1,196,214 shares for the scrip dividend (2011: 276,006).

Subject to shareholder approval at the forthcoming Extraordinary General Meeting on 28 March 2013, the Board proposes to pay 12p per ordinary share instead of a final dividend for the year ended 31 December 2012. Together with the interim dividend of 6p per ordinary share, this represents a total dividend for 2012 of 18p per ordinary share. In addition, the Board proposes to pay a special distribution of 38p per ordinary share. Such amounts will be paid by way of a B share scheme. A scrip dividend alternative will not be offered to shareholders.

33 Acquisitions
On 6 August 2012, the Group acquired a 25% holding in Lark (2012) Ltd, 'Lark', for total consideration of £3,104,000. Lark is a specialist UK insurance broker. The company is treated as an associate of the Group from this date. No goodwill arose on acquisition.

There were no acquisitions in the prior year.

34 Disposals
The Group disposed of its holding in InsuranceBee, Inc. for no consideration.

During 2011, the Group sold its holding in Plexstar Insurance Services Ltd.

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 (2011: £15 million) in respect of Hiscox Ltd and $350 million (2011: $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 circumstances where it considers there to be a risk that the covenant might need to be called.

(b) During 2012, Hiscox plc entered into a new Letter of Credit and revolving credit facility with Lloyds TSB Bank, for a total $875 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 $400 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 2012 $308 million (2011: $340 million) was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and no cash drawings were outstanding (2011: £nil).

(c) Hiscox Insurance Company Limited has arranged a Letter of Credit of £50,000 (2011: £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 2013 and 2012. In addition to this fee, the Council of Lloyd's has the discretion to call a further contribution of up to 3% of capacity if required.

(e) As Hiscox Insurance Company (Bermuda) Limited is not an admitted insurer or reinsurer in the US, the terms of certain US insurance and reinsurance contracts require Hiscox to provide Letters of Credit or other terms of collateral to clients. In 2012, Hiscox renegotiated its Letter of Credit Reimbursement and Pledge Agreement with Citibank for the provision of a Letter of Credit facility in favour of US ceding companies and other jurisdictions. In addition, Hiscox entered into new Letter of Credit facility agreements with the Royal Bank of Scotland and Commerzbank AG during 2012. The agreements combined are a three-year secured facility that allowed Hiscox to request the issuance of up to US$400 million in Letters of Credit. Letters of Credit issued under these facilities are collateralised by US Government and Corporate Securities of Hiscox Insurance Company (Bermuda) Limited. Letters of Credit under this facility totaling US$126,579,000 were issued with an effective date of 31 December 2012 (2011: US$68,759,000 on a US$450 million facility).

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, equipment and software development was £418,000 (2011: £326,000).

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 totaled £7,233,000 (2011: £7,256,000). Operating lease rental income for the year totaled £615,000 (2011: £420,000).

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

		2012 £000	2011 £000
No later than one year	Land and buildings	**7,482**	7,359
	Office equipment	**194**	1
Later than one year and no later than five years	Land and buildings	**25,967**	25,239
	Office equipment	**72**	–
Later than five years	Land and buildings	**18,101**	22,106
		51,816	54,705

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

	2012 £000	2011 £000
No later than one year	**584**	373
Later than one year and no later than five years	**613**	246
Later than five years	**–**	–
	1,197	619

Obligations under finance leases

There were no finance lease arrangements in place at 31 December 2012 or 31 December 2011.

Finance lease interest expense for the year was £nil (2011: £1,430).

37 Principal subsidiary companies of Hiscox Ltd at 31 December 2012

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 2012 (2011: 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

The following balances were outstanding (payable) at the year end to Syndicate 33 by Group companies.

	31 December 2012 £000	31 December 2011 £000
Hiscox Syndicates Limited	**21,102**	38,577
Hiscox Group insurance carriers	**1,836**	10,460
Hiscox Group insurance intermediaries	**(7,874)**	(14,845)
Other Hiscox Group companies	**(8,321)**	(7,581)
	6,743	26,611

The following amounts reflected in the income statement were transacted with Syndicate 33:

	31 December 2012 £000	31 December 2011 £000
Hiscox Syndicates Limited	**25,840**	32,276
Hiscox Group insurance carriers	**6,313**	3,556
Hiscox Group insurance intermediaries	**12,550**	14,133
	44,703	49,965

(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 2012 £000	Total 2011 £000
Gross premium income achieved through associates	**12,994**	11,593
Commission expense charged by associates	**3,286**	2,679
Amounts payable to associates at 31 December	**29**	–
Amounts receivable from associates at 31 December	**10,539**	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

	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
Results					
Gross premiums written	**1,565,819**	1,449,219	1,432,674	1,435,401	1,147,364
Net premiums written	**1,268,140**	1,174,011	1,131,627	1,157,023	898,394
Net premiums earned	**1,198,621**	1,145,007	1,131,158	1,098,102	928,095
Profit before tax	**217,124**	17,271	211,366	320,618	105,180
Profit for the year after tax	**207,772**	21,272	178,800	280,497	70,808
Assets employed					
Intangible assets	**69,617**	67,552	64,108	50,413	48,557
Financial assets carried at fair value	**2,406,269**	2,368,636	2,459,107	2,413,300	2,081,772
Cash and cash equivalents	**657,662**	516,547	336,017	259,647	440,622
Insurance liabilities and reinsurance assets	**(2,056,223)**	(2,007,745)	(1,817,102)	(1,702,225)	(1,773,622)
Other net assets	**301,059**	310,909	223,984	100,151	153,697
Net assets	**1,378,384**	1,255,899	1,266,114	1,121,286	951,026
Net asset value per share (p)	**349.7**	323.5	332.7	299.2	258.1
Key statistics					
Basic earnings per share (p)	**53.1**	5.5	47.2	75.2	18.8
Diluted earnings per share (p)	**50.9**	5.3	45.4	72.3	18.1
Combined ratio (%)	**85.5**	99.5	89.3	86.0	75.3
Return on equity (%)	**16.9**	1.7	16.5	30.1	9.2
Dividends per share (p)	**18.00**	17.00	16.50	15.00	12.75
Share price – high* (p)	**489.40**	424.70	381.40	362.00	361.00
Share price – low* (p)	**369.30**	340.50	317.00	277.00	194.75

*Closing mid-market prices.

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