# Hiscox Ltd
Report and Accounts
2015

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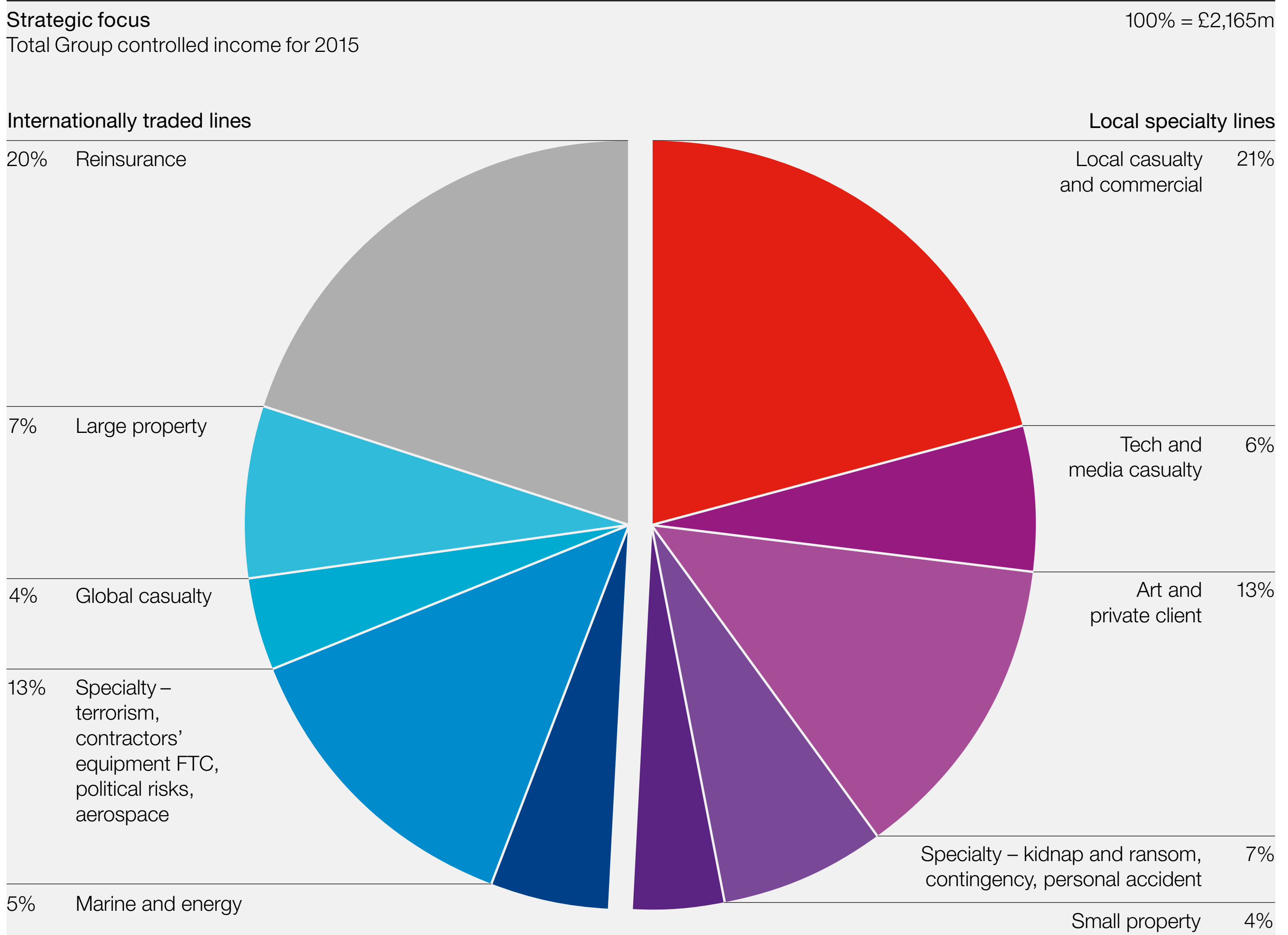
Cover image:
Ferrofluid from our 'elements of risk' series, challenging the opposing forces of nature and unseen threats in what we believe is a thought-provoking and beautiful way.

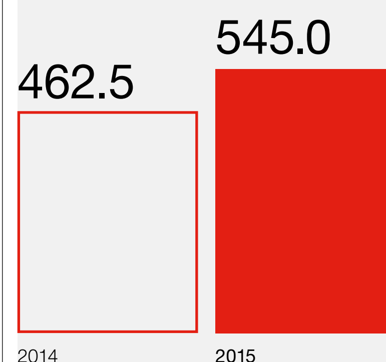
Our ambition is to be a respected specialist insurer with a diverse portfolio by product and geography. We believe that building balance between catastrophe-exposed business and less volatile local specialty business gives us opportunities for profitable growth throughout the insurance cycle.



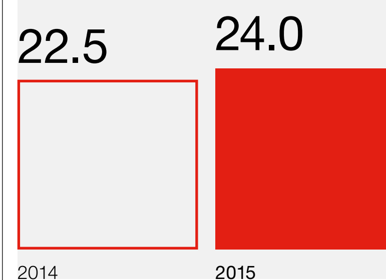
# Corporate highlights

| Group key performance indicators | 2015 | 2014 |
|---|---|---|
| Gross premiums written (£m) | **1,944.2** | 1,756.3 |
| Net premiums earned (£m) | **1,435.0** | 1,316.3 |
| Profit before tax (£m) | **216.1** | 231.1 |
| Profit after tax (£m) | **209.9** | 216.2 |
| Earnings per share (p) | **72.8** | 67.4 |
| Total ordinary dividend per share for year (p) | **24.0** | 22.5 |
| Special dividend (p) | **16.0** | 45.0 |
| Net asset value per share (p) | **545.0** | 462.5 |
| Group combined ratio (%) | **85.0** | 83.9 |
| Group combined ratio excluding foreign exchange (%) | **85.7** | 84.7 |
| Return on equity (%) | **16.0** | 17.1 |
| Investment return (%) | **1.0** | 1.8 |
| Reserve releases (£m) | **205.9** | 172.2 |

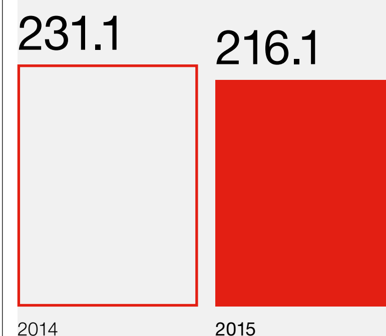
Net asset value p per share




Ordinary dividend p per share




Profit before tax (£m)




## Operational highlights

Strong premium growth of 10.7% from across the Group, with retail businesses now generating 50% of income.

Each division delivered good profits through careful risk selection, growth in profitable niches and an absence of natural catastrophes.

Investment in the Hiscox brand continues to deliver, with retail customers now exceeding 600,000.

Hiscox London Market continues to grow profitably, benefiting from new teams in complementary specialty lines.

Hiscox Re performing well with Kiskadee Investment Managers' AUM on track to reach US$1 billion in 2016 after its second year of operation.

A second interim dividend of 32.0p per share comprised a special dividend of 16.0p and a final dividend equivalent of 16.0p, bringing the year's total distribution to 40.0p. Going forward the Group will retain a greater proportion of earnings to fund the growth opportunities we see.

# The Hiscox Group has over 2,200 people in 14 countries

# Why invest in Hiscox?

Hiscox is a uniquely diversified insurer with a clear vision for the future. Our success is due to a strategy of building balance (illustrated below) which we have held for decades and has been proven to deliver in the short, medium and long term.

Our strategy is:

- to use our underwriting expertise in Bermuda and London to write high-margin volatile or complex risks;
- to build distribution 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.

Our three divisions covering reinsurance, London Market insurance, and retail insurance, provide the Group with a natural hedge against major catastrophes and market cycles in each of our businesses. Our operations span every continent and we are not overly reliant on any one of our divisions for the Group's overall profits.

A track record of profitable growth

Over the last five years the Hiscox Group has:

increased gross written premiums by 34.2% to

**£1.94bn**

delivered average combined ratio of

**87.4%**

posted average return on equity of

**14.2%**

achieved compound dividend growth of

**9.0%**

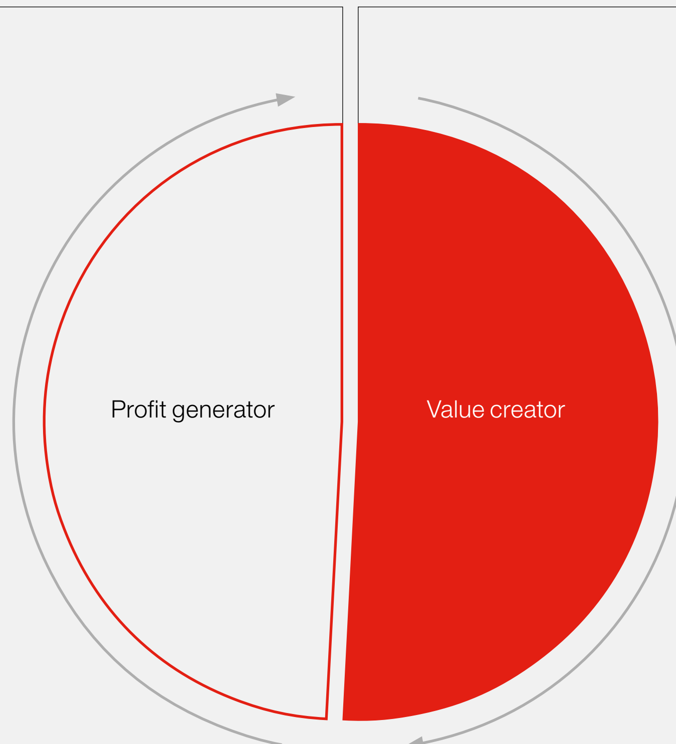
returned capital to shareholders of

**£815m**

A balanced business with a symbiotic relationship between catastrophe-exposed internationally traded lines, and less volatile local specialty business

Internationally traded lines

- Large premium, catastrophe exposed
- Shrinks and expands according to rates
- Excess profits allow investment in retail development




Local specialty lines

- Premium growth between 5–15% per annum
- Pays dividends
- Brand builds strong market position
- Profits act as additional capital

## A resilient business

Strong underwriting discipline, a diversified strategy and sound capital management lead to a lower risk profile for the Group.

Our divisions always underwrite for profit, not for market share, and we actively manage our business mix according to the conditions in each sector.

The Hiscox businesses maintain strong and stable credit ratings: A by A.M. Best and Standard & Poor's and A+ by Fitch. The Group has an increasingly diversified capital base and is in a strong position to take advantage of future growth opportunities.

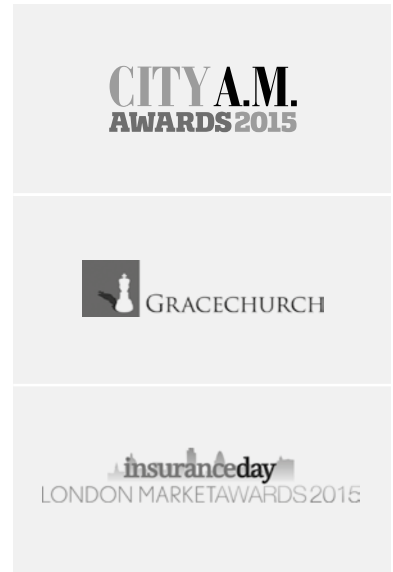
## Unique culture and strong brand

The excellence of our people has been a crucial factor in our continuing success. Their expertise, courage and dedication continue to drive our reputation for quality and professionalism. In return we strive to provide them with a working environment in which they can flourish. In our annual global employee engagement survey we looked at how connected employees feel to Hiscox, their managers, their teams and their role. Hiscox enjoys very high employee engagement, which averages in the top quartile of over 200 companies worldwide. Of our employees, 90% said they are proud to work for us, while 95% said they believed in our corporate values.

We are acknowledged market leaders in many of the sectors in which we operate, while our commitment to provide clients with quick responses, clear coverage and superb service is at the heart of everything we do. We have invested significantly in creating a powerful, differentiated brand that reflects our values and customer service ethos, with which our target clients identify. For example in DirectAsia, Thailand, brand awareness reached 37% in our first year of advertising, which is higher than expected.

## Specialist expertise that is valued by our customers

- In France, 96% of small business customers are satisfied with our services.
- In the USA, 97% of small business customers surveyed would recommend us.
- In the UK, 97% of Hiscox Home Insurance customers who have made a claim would recommend us.
- Our broker partners value our claims expertise, rating Hiscox number one in the Gracechurch London Claims Report for overall service quality.
- In 2015 we received industry accolades which included Insurance Company of the Year at the City A.M. Awards and the Hiscox London Market Directors and Officers' team being awarded Underwriting Team of the Year at the Insurance Day London Market Awards.




Focus on creating long-term shareholder value with a progressive dividend policy (%)

Hiscox
FTSE Non Life Insurance
FTSE All Share

200
180
160
140
120
100
80
60
40
20
0
-20

Dec 10, Mar 11, Jun 11, Sep 11, Dec 11, Mar 12, Jun 12, Sep 12, Dec 12, Mar 13, Jun 13, Sep 13, Dec 13, Mar 14, Jun 14, Sep 14, Dec 14, Mar 15, Jun 15, Sep 15, Dec 15

# Chairman's statement

**The Hiscox Group delivered a very healthy profit of £216.1 million (2014: £231.1 million) in 2015 with some help from a benevolent Mother Nature.**

Our industry has enjoyed a long period of reduced catastrophic activity. The effect has been to attract more capital, and thus competition resulting in reduced prices. This is more keenly felt on accounts that attract larger premiums. We are prepared for this; we have a proven strategy of balancing the bigger-ticket with the smaller retail business. Our diverse product range sold across a wide geographic area means we are well placed to thrive in this environment.

Our retail operations have grown profitably and now account for half the Group's income, reaping the rewards of our long-term investment in the Hiscox brand. Our London Market business has also had a strong year, exercising prudence and adding new teams in complementary specialty lines. Here we have benefited from the fallout from the recent M&A activity. Hiscox Re, with its focus on product development combined with technical strength and good underwriting, has done well, again delivering good profits. And Kiskadee, our insurance linked securities (ILS) business, is on track to reach US$1 billion of funds in 2016.

## Results

The result for the year ending 31 December 2015 was a very good profit before tax of £216.1 million (2014: £231.1 million). Gross written premium increased by 10.7% to £1,944.2 million (2014: £1,756.3 million). The combined ratio was 85.0% (2014: 83.9%). Earnings per share increased to 72.8p (2014: 67.4p) and the net asset value per share increased by 17.8% to 545.0p (2014: 462.5p). Return on equity was 16.0% (2014: 17.1%).

## Dividend and capital

The Board has declared a second interim dividend of 32.0p per share (to be paid on 7 April 2016 to shareholders on the register at 11 March 2016), which comprises a final dividend equivalent of 16.0p per share (2014: 15.0p), taking the total ordinary dividend per share for the year to 24.0p, an increase of 1.5p (2014: 22.5p) and; an additional return of capital of 16.0p per share (2014: 45.0p). On this occasion the Directors have decided not to offer a scrip alternative.

This is the fourth successive year we have been able to return additional capital to shareholders. As previously communicated to the market however, returning capital to shareholders is not a long-term strategy and going forward the focus will be on pursuing opportunities for profitable growth. The Group continues to maintain a progressive core dividend policy.

In 2015 we raised £275 million via a subordinated debt issue. As Tier 2 capital it will support our ratings and also give us capital flexibility underpinning our 2016 business plans and beyond. As an inaugural issue it was competitively priced and the support was flattering.

## Investments

After another challenging year for both bond and equity investment, characterised by low yields and volatility in many asset classes, we view our investment return of £33.7 million (2014: £56.4 million) to be satisfactory. This equates to a return of 1.0% (2014: 1.8%) of total assets under management.

Our retail operations have grown profitably and now account for half the Group's income, reaping the rewards of our long-term investment in the Hiscox brand.

It has never been our style to take excessive risk with our investment portfolio, particularly given the uncertainty and lack of liquidity which prevails in many investment markets. Our priority remains that of capital preservation over appreciation and whilst our portfolio of predominantly short-term bonds offers only modest upside, it reflects the nature of our liabilities and should limit the volatility of our portfolio overall. We have always been prepared to take some risk in the portfolio and we maintain an allocation to equity and hedge funds which we think is appropriate over the longer term despite more frequent outbreaks of short-term turbulence. The outlook for 2016 seems no clearer and we are planning for another year of similar returns.

## Cyber opportunity

Cyber attack is mainly about theft of data or malicious damage by electronic means. This can lead to a whole series of consequences from reputational damage to manufacturing plants breaking down, and worse. As such it is definitely the province of insurers, and shouldn't be left up to governments (as has been suggested). We have the underwriting expertise to address the issues and for over 15 years we have worked

hard to provide our customers with responsive cover. Cuthbert Heath, the great 20th century innovator of our industry, would have relished the challenge and so do we.

## Market stress test

We are actively seeking a consensus amongst peers as well as our regulators to ensure an effective response to a disaster hitting the London market. Post-World Trade Center, we responded to clients' needs, paying valid claims and writing more profitable business post-loss. We think it is necessary to organise a market stress test 'dry run' in 2016 to test the decision-making processes and speed of response of all relevant parties. This is essential if London is to maintain its pre-eminence in global specialty insurance.

## The Board

During 2015 a number of the original Hiscox Ltd Board retired; namely Dr James King, Andrea Rosen and Dan Healy, having each completed nine years' service (the point at which the UK Corporate Governance Code deems them not independent). Richard Gillingwater, who joined the Board in 2010, stood down due to his new commitments at Scottish and Southern Energy as well as Henderson Global Investors. They have served the business well and I would like to thank them all for their wisdom and guidance.

Two new members of the Board bring a wealth of retail financial services and marketing experience; Lynn Carter and Anne MacDonald support our focus on retail growth and brand building. In November we announced the appointment of our new Senior Independent Director and Chairman of the Remuneration Committee, Colin Keogh, who has had a long career in the financial services sector.

In August we said farewell to Stuart Bridges who left after 16 years as our Chief Financial Officer. Stuart made a significant contribution to the Group. He joined in 1999 when our gross written premium was £241 million and shareholder funds were £134 million. By the time he left our market cap had risen to £2.5 billion, and we delivered a total shareholder return of 16.1% per annum. Stuart played an important role in our growth, guiding our financial strategy through the challenges of overseas expansion, testing investment markets and increasing regulation. I would like to thank him for all he has achieved for Hiscox.

> I am proud and grateful for the talent and dedication our brand attracts.

## People

During the year we were very happy to celebrate 20 years of operating in France and Germany, as well as ten years in Spain, USA and Bermuda. Our European business has matured into a profitable and growing part of the company against a backdrop of economic difficulty. The US and Bermudian businesses are profitable and have grown substantially. When I am travelling to any of these locations I am struck by the enthusiasm of our people and their desire to do a great job. Across the Group, we work hard to maintain our culture and also encourage employee ownership. I am proud and grateful for the talent and dedication our brand attracts.

## Outlook

Although the result was in some part due to clement weather internationally, our strategy has once again proved itself in challenging conditions. For the best part of three decades we have sought to strike a balance between big-ticket wholesale exposures and smaller, less volatile retail risks; creating diversity in product, distribution and geography in order to grow despite market conditions. The Hiscox Group is now the only specialist insurer with established operations in all forms of insurance markets – from a direct-to-consumer offering, to a significant ILS fund management business and everything in between.

Treacherous currents and difficult headwinds will increasingly prevail in the years ahead and our experience tells us that catastrophes can occur at any time. As the operating environment gets tougher however, we believe our strategy will continue to give us profitable opportunities as we continue on our independent path with focus and discipline.

Robert Childs
29 February 2016

Robert Childs
Chairman

# Chief Executive's report

**It is pleasing to report a profit before tax of £216.1 million (2014: £231.1 million), a return on equity of 16.0% (2014: 17.1%) and premium growth of 10.7% to £1,944.2 million (2014: £1,756.3 million). Our good results are allowing us to pay a second interim dividend of 32.0p per share, which comprises a final dividend equivalent of 16.0p and a special dividend of 16.0p, bringing the year's total distribution to 40.0p. We do not expect the capital washing around our industry to go away in 2016, but we feel confident that the differentiated products in our retail businesses around the world will allow us to grow where margins are attractive, and we will use our retained earnings to fund the solvency capital this expansion requires.**

Our US business, entering its tenth year of operation in 2016, contributed significantly to the Group's growth in 2015, increasing premiums by 21.5% and delivering a healthy profit. Hiscox London Market demonstrated its adaptability with growth of 14.6% and good profits. Hiscox Re continued to evolve whilst making a material profit contribution, with Kiskadee, our insurance linked securities business, expected to manage US$1 billion by the end of 2016. Hiscox UK, Hiscox Europe and Hiscox Guernsey have all had a good year, with good progress shown in DirectAsia.

It was not a loss-free year for our industry, or Hiscox. We, like others, have benefited from the absence of major natural catastrophes. Our attritional claims were broadly in line with past years, and our skilled underwriting teams avoided material impact from some of the larger industry losses such as the explosions in Tianjin in China, tornado and freeze-related claims in the US, floods in the UK and mining-related collapses in South America. In total these cost us a modest £25.1 million.

## Hiscox Retail

Our specialist retail operations differentiate us from others in our sector who have grown out of London and Bermuda. The current competitive pressures have prompted many of them to try to replicate what we have achieved, but we have the considerable advantage of having begun this journey in 1989, with an initial focus on high net worth homes. Since then we have launched new lines of personal and commercial insurance, entered other countries, built great teams and invested heavily in our brand. Hiscox Retail now comprises half of the Group's gross written premium: £975.6 million in total (2014: £891.1 million). We began investing in commercial insurances for small- and medium-sized businesses in 1994; at £580.7 million it is now the single biggest segment in the Group.

In aggregate our retail businesses generated substantial profits: £73.3 million in 2015, slightly down on 2014's £78.1 million. This is due partly to our increased marketing expenditure which rose by £12.7 million to £44.5 million (2014: £31.8 million). These costs are taken to this year's profit and loss account, but their benefit accrues over many years; supporting not just our retail businesses, but the Group as a whole.

Hiscox Retail comprises Hiscox UK and Europe, and Hiscox International. I review them in turn below.

## Hiscox UK and Europe

This division provides personal and commercial lines cover. Personal lines include high-value households, fine art and collectibles and luxury motor. Commercial insurance is focused on

| Hiscox Retail | 2015 £m | 2014 £m |
|---|---|---|
| Gross premiums written | 975.6 | 891.1 |
| Net premiums earned | 870.4 | 790.7 |
| Underwriting profit | 64.3 | 57.3 |
| Investment result | 17.2 | 25.9 |
| Foreign exchange | (8.2) | (5.1) |
| Profit before tax | 73.3 | 78.1 |
| Combined ratio | 93.5% | 93.5% |
| Combined ratio excluding foreign exchange | 92.6% | 92.9% |

small- and medium-sized businesses, typically operating in white-collar industries. These products are distributed both via brokers, through a growing network of partnerships, and direct to the consumer.

Our retail businesses in the UK and Europe made profits of £64.9 million (2014: £73.3 million). Claims within the UK and European businesses were benign for the majority of the year which encouraged us to boost our marketing expenditure by £4 million above plan. This looked like a sensible decision until December when storms Desmond, Eva and Frank hit the UK. The impact of these events on our business is estimated at £10 million. Europe enjoyed a record year in Euro terms thanks to strong underlying performance, augmented by a single significant prior year release. Exchange rate movements mean that this performance is not reflected in our Sterling result.

*Hiscox UK and Ireland*
Hiscox UK and Ireland grew gross written premiums 1.9% to £443.3 million (2014: £435.0 million). Good growth across most lines offset a reduction of £23 million in income from commercial partnerships as we rebalanced the portfolio towards more profitable lines.

Brokers are our most important distribution channel, accounting for just under 80% of our UK business. We support them with disciplined, but creative, underwriting solutions and a focus on delivering good service via our network of offices in Birmingham, Colchester, Dublin, Glasgow, Leeds, London, Maidenhead, Manchester and York. The broker channel achieved good retention of 87% and grew by 7.6%.

During the year, we saw a six-fold increase in demand for our cyber and data insurance product for small businesses. We also acquired RH Classics, a leading classic car insurance specialist, which broadens our capabilities and gives us access to a new group of customers.

Our marketing reach means we receive many enquiries from customers whose needs are outside of our underwriting appetite. In 2016, we are creating a managing general agent to underwrite these risks on behalf of other insurers, providing them with a flow of business and us with fees and profit commission.

At the end of the year we celebrated the opening of our new office in York, on time and on budget. Housing over 250 employees, with room for further expansion, this is the hub of our direct-to-consumer operations and represents our high ambitions for this business. This office was off to a strong start on day one, as the team beat their sales targets and served our customers brilliantly; a testament to our motivated and talented people. However, we did have a heart-stopping moment in December when swathes of York flooded and water crept towards our office. Thanks to our dedicated staff, all of whom were

Bronek Masojada
Chief Executive

The atrium in the newly opened York office, featuring the 'Kholod' rocket; a product of post-Cold War co-operation between the United States and Russia.

able to get to the office on the worst affected day, and a cannily built overflow tank, we were able to provide uninterrupted service to all of our flood-affected customers.

We have for several years been progressively in-sourcing all of our direct customer sales and service functions and moving our direct business to a new IT platform. These projects are all now complete, and after such a sustained period of investing in infrastructure, the UK direct business will now focus on profitable growth, increasing scale and improving its expense ratio.

### *Hiscox Europe*

Hiscox Europe grew gross written premiums by 7.8% to €205.6 million (2014: €190.8 million) and achieved a combined ratio of 92.2% (2014: 94.1%), with a good performance in all product lines and from Spain, Germany and Benelux in particular.

During the year, Hiscox Specialty Commercial was launched in France and Germany. This suite of products broadens our liability and property offering to small businesses. We hope to replicate the success we have experienced in the UK and early signs have been very positive. Our cyber product in Germany and the Netherlands has also done particularly well, as demand grows and customer preparedness to buy increases. Alternative distribution, via broker schemes and partnerships with other organisations, is growing in importance. In Spain, participation in a number of contingency and personal accident managing general agencies is generating good growth.

Not everything went to plan. One of our priorities was to accelerate the growth of our Franco-German direct commercial business through a significant marketing investment. We achieved growth of over 20% to €5 million, but the returns were not commensurate with the cost. We have decided that the pan-European experiment did not work and will be pursuing a less ambitious path in 2016. A key part of this is transforming the direct business to one which can also support the broker and partnership channels, and is managed and led at a local level.

Our European Service Centre in Lisbon is operating well. It now performs up to 90% of transactions, representing a key step to reducing our European expense base.

Our European business offers opportunities for steady growth despite the Eurozone's travails. In 2016, we will explore opportunities in the classic car market, look to grow the commercial and partnership business, and continue to use segmentation to drive productivity and efficiency.

## Hiscox International

This division comprises Hiscox USA, Hiscox Guernsey and DirectAsia. Its revenues grew by 26.4% to £380.5 million (2014: £301.1 million) and it achieved a combined ratio of 97.9% (2014: 100.1%). Hiscox USA was the biggest contributor to the division's growth and profit improvement.


In 2016 we will launch an updated, comprehensive but simply-designed cyber product that reinforces our market position as a leading specialist insurer.


### *Hiscox USA*

Hiscox USA primarily underwrites small-to-middle market commercial risks through brokers, other insurers and directly to businesses (either online or over the telephone). It delivered another stellar performance in 2015, with gross written premiums increasing by 21.5% in local currency to US$446.6 million (2014: US$367.6 million), and a strong profit. This result was helped by a stable claims environment, discipline on commissions and good expense management.

Our core professional liability and small commercial products continue to drive growth. During the year the team honed its underwriting strategy in order to grow its footprint and retain its competitive edge in the directors and officers', technology errors and omissions (E&O) and general liability product lines. We also made good progress in entertainment, enhancing Hiscox One, the first integrated E&O, property and workers' compensation offering for entertainment professionals.

The cyber market in the US is experiencing rapid growth with many new market entrants. We believe the marketplace will ultimately favour those carriers that possess the most experience in servicing these risks. We have been underwriting US cyber for 15 years but will not rest on our laurels. In 2016 we will launch an updated, comprehensive but simply-designed cyber product that reinforces our market position as a leading specialist insurer.

Our direct-to-consumer operations continue to grow apace, with policies in force now numbering over 95,000. Direct and partnership small business insurance is now our single biggest US line of business, and marketing has been an important component of its success.

We are developing our brand around the strapline 'encourage courage'. To promote this we have sponsored the Tough Mudder fitness challenge across the US and created the Courageous Leaders web series. We hope that, in time, our US brand presence will match that of our UK business.

In 2016 we celebrate ten years of Hiscox USA. It has achieved critical mass, now provides the Group with a robust and sustainable profit stream, and has delivered 18% compound organic growth in the last five years. We have established teams of experts in key states, including an exploratory team in Dallas in 2015, and a growing brand. We will not stop there; we see real opportunities despite competitive markets, and will continue investing in new talent, IT and our brand in 2016.

### *Hiscox Guernsey*

Hiscox Guernsey comprises our Guernsey-based kidnap and ransom, private fine art and executive security underwriting operations with sales offices in London and Miami.

Across the globe, market conditions remain very competitive. Premiums decreased slightly by 1.9% to US$103.6 million (2014: US$105.6 million). A new team in Miami is driving growth, offsetting reductions elsewhere. An investment in IT is also paying off. Our business partners are increasingly looking for e-trading solutions, and our new platform delivers a more efficient process between producers, brokers and underwriters.

We have combined the different teams from across the Group that focus on special risks, including kidnap and ransom, private client fine art and executive security, into a single structure which is now branded Hiscox Special Risks. Led from Guernsey, the division will include teams in London, Munich, Paris, New York, Los Angeles and Miami. We believe that will allow us to provide better service and up-to-date products to corporate and personal customers in the increasingly volatile world in which we live.

### *DirectAsia*

In early 2014 Hiscox acquired DirectAsia, a direct-to-consumer business with operations in Singapore, Hong Kong and Thailand that sells predominantly motor insurance. The business is developing as expected.

Singapore performed solidly in a competitive pricing environment. Hong Kong made good progress too, despite the challenges of a small motor insurance market and low average premiums. We continue to make particularly good progress in Thailand, where we see strong growth potential and where our brand-building work has been well received. Investment in a new TV campaign, supported by print and social media marketing, has moved brand awareness to 37%, driving 500% growth in premium income.

DirectAsia has clear priorities, a strong plan, and a growing customer base. As anticipated, Hiscox's disciplined approach to underwriting and focus on brand-building has complemented the existing expertise within the team.

## Our London Market business remains a cornerstone of expertise, energy and profit within Hiscox.

### Hiscox London Market

Our London Market business delivered a strong profit of £59.9 million (2014: £62.6 million), and increased gross written premiums by 14.6% to £585.2 million (2014: £510.8 million). Much of this increase reflects exchange rate fluctuations, with premium growth being 8.5% on a constant currency basis. The business achieved a combined ratio of 85.7% (2014: 84.2%), a good result despite the impact of price reductions. Its biggest source of growth came through our partner White Oak, a specialist automotive and equipment underwriter. It contributed 5.0% of growth, while new products and teams delivered 4.2% and core London Market lines reduced by 0.7%.

The London Market remains competitive. Customers are getting used to lower prices and brokers are fighting to increase their declining margin. Our response is to continue improving our relationship with brokers, supporting facilities and quota-share agreements where we have the right degree of underwriting control and we see margin.

Hiscox London Market

| | 2015 £m | 2014 £m |
|---|---|---|
| Gross premiums written | 585.2 | 510.8 |
| Net premiums earned | 383.9 | 332.5 |
| Underwriting profit | 46.2 | 44.9 |
| Investment result | 7.0 | 8.7 |
| Foreign exchange | 6.7 | 9.0 |
| Profit before tax | 59.9 | 62.6 |
| Combined ratio | 85.7% | 84.2% |
| Combined ratio excluding foreign exchange | 87.8% | 87.2% |

# Chief Executive's report
continued

Hiscox London Market has also benefited from market dislocation resulting from M&A activity, as leading underwriting talent joins our ranks. This has allowed us to strengthen our existing cargo team and establish new teams in product recall and US general liability in London, and property in Miami.

Looking at each division in turn:

- Property: our property division includes US and international commercial property, power and mining risks, and US catastrophe exposed personal lines traded in the London Market.

  This area had another excellent year due to careful risk selection and a general lack of catastrophes. We focused on retaining small-ticket commercial and household business, written through binding authorities with long-standing US partners. Continuing pressure on big-ticket traded business meant the team needed to remain extremely disciplined as it dealt with market challenges and looked for new opportunities. The launch of flood cover for the newly deregulated US market is one example of such an opportunity. The private sector can offer wider terms and coverage than the government-backed National Flood Insurance Program, giving consumers a more accurately priced and responsive product. It is ironic that London Market firms have an appetite for flood exposure, whilst in the UK the government has pushed the domestic industry to create a mutualised and distorted approach to tackling this risk.

- Marine and energy: challenging trading conditions continue to depress the marine and energy market and our business in this sector shrank by 12.2%. Upstream energy was already under pressure but the substantial drop in the price of oil has further affected this account as pressure grows on clients' budgets. The team has actively reduced exposure where the margins are unreasonable. Our marine and energy liability business did well to maintain its position in 2015, mainly due to our increased appetite as market conditions held up. However given overall conditions, we expect existing marine and energy lines to reduce in future, except for cargo business which has been reinvigorated with some new hires.

- Casualty: this business grew by over 39% as a result of our investment in new talent and new lines of business over a number of years. During the year, the team launched a new cyber product that covers medium- to large-sized businesses for extortion threats and cyber breaches. The directors and officers' team won 'Underwriting Team of the Year' at the 2015 Insurance Day Awards. A new team was also brought on board to focus on US general liability.

- Aerospace and specialty: this division includes our aviation, space, contingency, terrorism, kidnap and ransom, political risks and personal accident business.

  Despite a series of aviation losses in recent years, including the Germanwings and Metrojet disasters in 2015, this market is under extreme pricing pressure. The team is navigating its way through turbulent conditions with opportunities seized in the more profitable manufacturers and airports business. Our political risks business has been hit by falling oil prices and political unrest in Ukraine, where we reserved claims for net £16 million at year end.

  Our terrorism business has felt the impact of facilities in the market where brokers are bundling risks together to make them easier to place. We participated where we saw margin and opportunity.

  The personal accident team recruited last year is making a strong impact, delivering profitable growth in a specialist line we are keen to lead. Similarly, our new product recall team has made a good start. Other lines, including contingency and kidnap and ransom, are holding steady and delivering strong profits driven by good risk selection.

- Alternative distribution: adapting to changes in distribution is key in the current environment. The role of the alternative distribution division is to facilitate innovation in the use of technology and specialist data to serve different markets. Its biggest business is the underwriting of specialist automotive and equipment, including extended warranty through White Oak. This business now represents 28% of our London Market income. Given its importance we increased our equity stake in White Oak from 10% to 30% in 2015, and continue to have representation on its Board.

## Hiscox Re

| | 2015 £m | 2014 £m |
|---|---|---|
| Gross premiums written | 383.4 | 354.3 |
| Net premiums earned | 180.7 | 193.0 |
| Underwriting profit | 84.5 | 93.6 |
| Investment result | 4.7 | 9.3 |
| Foreign exchange | 8.3 | 2.7 |
| Profit before tax | 97.5 | 105.6 |
| Combined ratio | 46.6% | 49.8% |
| Combined ratio excluding foreign exchange | 51.4% | 51.6% |

— Hiscox MGA: early in 2015, we acquired R&Q Marine Services, the mega-yacht and general marine leisure managing general agent. This furthers our capabilities to meet the needs of high net worth customers and acts as a vehicle through which we can act for Hiscox and other London-based carriers where the client's requirements exceed our risk appetite. We have re-branded the business Hiscox MGA and included within it our Miami-based terrorism and fine art teams. Our Miami offering has expanded to include property underwritten for Hiscox and others, and in 2016 we will include Middle East terrorism and a South of France-based yacht underwriter.

Our London Market business remains a cornerstone of expertise, energy and profit within Hiscox, but it is one player among many and so at times depends on the broader market's centrality and collaboration. We are supportive at a conceptual level of the London Market Group's (LMG) efforts to promote London and modernise its infrastructure. We are not idle bystanders; several of our Senior Executives serve on various committees that help shape the LMG's initiatives and in 2016 I will be joining a London Market Target Operating Model steering committee to drive a focus on implementing a few narrow priorities. I am delighted it will be chaired by Inga Beale, CEO of Lloyd's, as we believe that Lloyd's has the responsibility, financial resources, accountability and power to lead the London Market – not for its own benefit, but for the benefit of all.

### Hiscox Re

Hiscox Re largely comprises the Group's reinsurance businesses across the world and insurance linked security (ILS) activity.

Hiscox Re had an impressive year, delivering a 46.6% combined ratio (2014: 49.8%) as the team avoided some of the larger losses that impacted the market. The business grew by 8.2% to £383.4 million (2014: £354.3 million), 2.9% in local currency. Good growth in international, specialty and healthcare, along with income from Kiskadee, helped to offset the reductions in US property catastrophe reinsurance. We've experienced another year of low losses, a combination of fewer catastrophes and the team's strong risk selection. The benign claims environment continues to put pressure on rates. Last year's important 1/1 renewals saw rates fall by 12% and this year they fell again by 5%.

Our focus on product innovation is paying off, adding US$70 million in premium since the start of 2015. This includes new cyber products and takeout quota shares which either expand a client's original product or support an existing business when internal appetites are reached. Product development has evolved, it is about asking how we can help support clients' broad aims and responding from there.

We continue to leverage third-party capital through quota share arrangements (with other insurers) and through ILS activity (with capital markets investors). This gives us the ability to remain agile and relevant as we can offer larger lines and bespoke reinsurance solutions to a broad spectrum of clients.

In two years, our ILS business including our flagship Kiskadee Funds has grown to be a significant brand in the market. In 2015, we also launched Cardinal Re Ltd, a Bermuda-domiciled special purpose insurer designed to transform collateralised insurance and reinsurance risk into a security more suited for capital market investors. Kiskadee Investment Managers' assets under management are on track to reach US$1 billion in 2016.

### Claims

Claims are where all our promises to customers are tested. When faced with storms Desmond, Eva and Frank in the UK, our claims team responded with typical effectiveness. Staff from the new major and complex loss team visited those insureds who were most severely impacted by the storms, providing help with alternative accommodation and emergency payments. The October storms in the South of France proved to

# Chief Executive's report
continued

be equally destructive and the positive feedback from the claims management demonstrated that the Hiscox service and efficiency is provided consistently across our teams.

In the London Market, Hiscox was ranked number one by brokers in the 2015 Gracechurch annual survey of claims performance, for overall best service. Hiscox UK was awarded Personal Lines Claims Initiative of the Year at the Insurance Times' Claims Excellence Awards 2015, in recognition of our team's improvement of customer satisfaction from the already high level of 95% to 98% as part of our effort to create customers for life.

Reserve releases of £205.9 million were up from £172.2 million last year. This demonstrates our continued cautious approach to reserving, with the majority of the release coming from shorter tail lines and the earlier years of longer tail lines where we are confident that we will not be subject to any further claims development.

## Marketing

In 2015 we spent £44.5 million on marketing and brand-building activity across the Group (2014: £31.8 million). This was focused on our key retail businesses with incremental marketing investment accelerating the growth of our direct-to-consumer lines across the world. In the UK we have succeeded in establishing Hiscox as a retail brand. Our ongoing 'the small and the brave' small business campaign is maintaining brand awareness at a historic high of 76% and our home marketing has helped to deliver an 82% increase in new direct home customers. Our ambition is to replicate this in our other direct businesses. Our USA marketing campaign 'encourage courage' and our 'where happier matters' campaign in Asia are all steps towards this goal.

We continue to support the arts through corporate sponsorship such as Sculpture in the City, and on growing our presence in York to support wider activities that celebrate our new office and promote us as a major local employer.

## IT

As Hiscox grows, having an efficient reliable infrastructure is becoming ever more important. In early 2016 we reached the halfway point in the replacement of our UK retail systems with the launch of our new UK direct commercial platform. With all of our UK direct business now operating from this platform, we should see the same benefits across direct commercial that we saw when direct home migrated to the platform last year – sharper pricing, better customer responsiveness and greater efficiency. This £45 million, four-year programme remains broadly on track and work is well underway to adapt the system for the next phase, UK broker channel commercial.

We are also beginning the process of looking at system replacement in both the USA and mainland Europe, and we expect to make decisions on when and how to move to new operating platforms for these businesses during the course of 2016. In addition to these large projects, work has been undertaken to strengthen our cyber defences.

In 2015 we spent £44.5 million on marketing and brand-building activity across the Group.

Keeping our existing IT estate functional and operational is the less visible part of our IT team's work, but they have performed this task well.

## Investments

We have accepted in recent years that the contribution of investment income to the Group's profits is likely to be lower than that which prevailed before the financial crisis. As such we have set out our stall to accept what the market will reasonably give us from a conservative portfolio based around cash and short-term bonds with a small allocation to risk assets which over time should provide some extra growth. With the year now behind us it is clear that income from these asset classes was hard to come by and in that context our result for 2015 is acceptable. Our investments, before derivatives, made £33.7 million (2014: £56.4 million) equating to a return of 1.0% (2014: 1.8%). The outcome in recent years has been boosted by capital gains; from bonds in some years, equities in others and occasionally both. In 2015 there were few tailwinds and the bond returns of 0.9% were much closer to the yields on the underlying portfolios. Our risk assets portfolio delivered 4.0%, which is lower than of late but still represents a useful contribution to the overall result. It was another year where successful stock and sector selection made a difference and on the whole the funds that we are invested in avoided the energy, mining and mineral sectors which did most of the damage to the benchmark indices.

If 2015 was relatively benign in the insurance world, the same cannot be said for investments. Not only are we learning to live with structurally

lower interest rates but there is also a marked pick up in outbreaks of volatility. Who remembers the Swiss devaluation at the beginning of the year and the Greek crisis of the summer? These have now given way to the consequences of an unexpected decline in commodity prices and the reality of a slowing China transitioning from an economy driven by exports to one of domestic consumption. The cracks have been papered over by the support of central banks since the financial crisis but there is a growing feeling that they are reacting to events rather than anticipating them. With this volatility comes illiquidity and we are more aware than ever that we must be prepared, in the case of bonds, to hold what we own to maturity and in the case of equities to accept periods of negative returns. In an increasingly short-term world we need to take a long-term view. The early weeks of 2016 have seen sharp declines in equity prices as well as weakness in the higher-yielding areas of the bond market that we have avoided since 2011. Our priority as ever with the investment portfolio is to pay claims and support the business but we do have some dry powder should the current turmoil throw up some compelling opportunities.

### Capital management

At the start of 2015 we returned £192 million of capital to shareholders. We have today announced that we will be returning 16.0p per share in addition to our normal dividend. Cumulative dividends and capital returns since 2012 will then total £750 million. This year we are retaining a greater proportion of our earnings so that we can fund the growth that we can foresee in our retail business.

In 2015 we completed a subordinated debt issue which raised £275 million of debt. This counts towards Tier 2 capital for rating agency purposes. We have used the proceeds of the bond issue to reduce the drawn portion of our Group Letter of Credit from US$529.5 million to US$71.9 million. We have reduced our Group Letter of Credit to US$500 million and will regard it as a standby facility to be utilised in the event of a rapid hardening of the market following a large event or to provide short-term capital flexibility in response to other events such as exchange rate movements. In our experience, responding rapidly to market dislocations is key to success and the Letter of Credit will give us the flexibility to do so, whilst having a low cost when undrawn.

Solvency II came into effect on 1 January 2016. Hiscox's Lloyd's business received internal model approval as part of the Lloyd's internal model approval process. Our UK carrier is operating using the standard formula. At a Group level we have both our own Hiscox economic capital model and, as a Bermuda-domiciled and regulated Group, the Bermuda Solvency Capital Requirement. Our available Group capital resources remain comfortably above our regulatory requirement.

The Board is committed to being well capitalised relative to regulatory capital models, but also has to meet clients' expectations as to rating. Our goal is to be a mid-point of the 'A' range on Standard & Poor's or 'A' on A.M. Best. This gives us protection from the minimum level we need to trade in the most credit-sensitive parts of our business. The capital requirements for this level of rating are more conservative than the regulatory requirements, hence the comfortable buffer held.

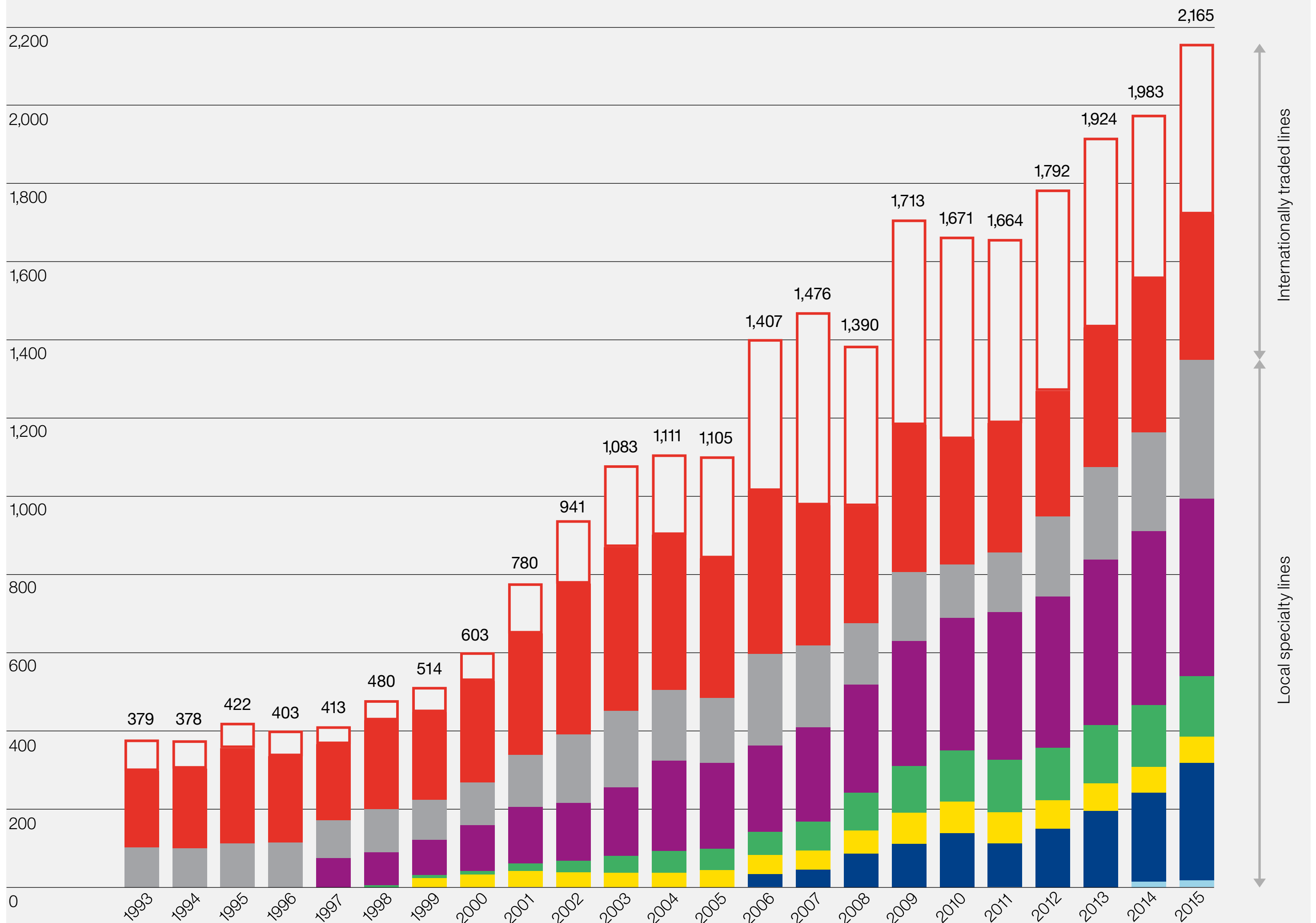
In 2015 good sector selection, good underwriting and good fortune delivered good results for shareholders.

### Outlook

In 2015 good sector selection, good underwriting and good fortune delivered good results for shareholders. We cannot count on good fortune at every turn, so in 2016 we will focus on sector selection, disciplined underwriting, marketing to drive profitable growth, and expense discipline. Our bigger-ticket businesses are more likely to retreat, with growth coming from our new teams and in specialty retail across the world. To this we will add a focus on efficiency as we reap the benefits of investments made in the UK, scale economies in the US, and expense discipline elsewhere. Our breadth of capability will set us apart in what will be a challenging environment.

Bronek Masojada
29 February 2016

# Building a balanced business



# Executive Committee

**Amanda Brown**
Group Human Resources Director

Amanda joined Hiscox in 2006 as Group Human Resources Director. Prior to joining the Group, Amanda worked for Mars, PepsiCo and Whitbread in senior human resources roles in Europe and internationally. Previous roles include: Compensation and Benefits Director for PepsiCo's restaurants division in Europe and Africa; Group Compensation and Benefits Director for hotel and restaurant company Whitbread; and Human Resources Director for Marriott Hotels in the UK. Amanda began her career at Mars Confectionery where she joined as an English graduate from Reading University.

**Pierre-Olivier Desaulle**
Managing Director, Hiscox Europe

Pierre-Olivier joined Hiscox in 2000 from MMC Marsh & McLennan Companies. He started his career at Marsh in strategy consulting, joining insurance broker Marsh France in 1993 where he held various senior management roles in strategic planning, personal lines and professional insurance. As Managing Director of Hiscox France, he grew the French business into the largest and most profitable operation for Hiscox Europe and in 2009 was appointed Managing Director of Hiscox Europe. He has led Europe to profitable growth with the development of professional insurance and distribution beyond the broker channel in partnerships and direct.

**Steve Langan**
Chief Executive Officer,
Hiscox Insurance Company
Chief Marketing Officer
Chief Executive Officer,
DirectAsia Group

Steve joined Hiscox in 2005 after a highly successful marketing and management career with Diageo, Coca-Cola, Nestlé, Bass Brewers and Scottish & Newcastle across the UK, Europe and South America. He has been at the forefront of developing the Hiscox brand globally, including the development of its first television advertising campaign in 2006 and the successful launch of the brand in the USA, Europe and (under the DirectAsia brand) in Singapore, Hong Kong and Thailand. Since 2013, Steve has led the UK and Ireland and Europe businesses as a combined entity and in 2014 he also became CEO of the DirectAsia Group post-acquisition. Steve became a Fellow of the Marketing Society in 2012 and is a Freeman of the City of London.

**Paul Lawrence**
Chief Underwriting Officer,
Hiscox London Market and Joint
Active Underwriter Syndicate 33

Since joining Hiscox in 1992, Paul has underwritten a broad range of business lines including fine art, high-value household, personal accident, contingency and property. Paul was appointed to the Hiscox Partnership in 2005, and was made Divisional Head of Property of Hiscox London Market in 2007. In April 2013, Paul was promoted to Chief Underwriting Officer, Hiscox London Market, and Joint Active Underwriter of Syndicate 33. Before joining Hiscox, Paul worked as an underwriting assistant for C P Attenborough Syndicate 144 at Lloyd's and for broker E W Payne.

**Bronek Masojada**
Group Chief Executive Officer

Bronek 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 and was Chairman of the Lloyd's Tercentenary Research Foundation from 2008 to 2014. He is a past President of The Insurance Institute of London and a Past Master of The Worshipful Company of Insurers. He is currently a member of the Board of the Association of British Insurers and a Non Executive Director of Pool Re.

**Jeremy Pinchin**
Chief Executive Officer, Hiscox Re
Group Company Secretary
Group Claims Director

Jeremy joined in 2005 as Hiscox's first Claims Director, responsible for co-ordinating and developing claims services across the Group. Jeremy came from Lloyd's of London where he was the first Head of Claims following the creation of the Franchise Team, and was responsible for the market's first co-ordinated claims strategy and Claims Management Principles. He joined Lloyd's as a consultant in early 2002 to head up a team co-ordinating the market's management of its exposure to the losses arising from September 11th. Jeremy trained as a solicitor, who served as General Counsel, and later, Board member of Sedgwick Group, the international insurance broker now part of Marsh. In 2012 Jeremy moved to Bermuda and became Chief Executive Officer of Hiscox Re and the Group Company Secretary.

**Ben Walter**
Chief Executive Officer, Hiscox USA

Ben is Chief Executive Officer for Hiscox USA. Ben joined Hiscox in early 2011 as US Chief Operating Officer and served in that post until April 2012 when he assumed his current role. He previously held the position of Managing Director at asset manager BlackRock, which he joined via its acquisition of Barclays Global Investors. Prior to that, he was a Director with Gap Inc. and a consultant for the Boston Consulting Group.

**Richard Watson**
Group Chief Underwriting Officer

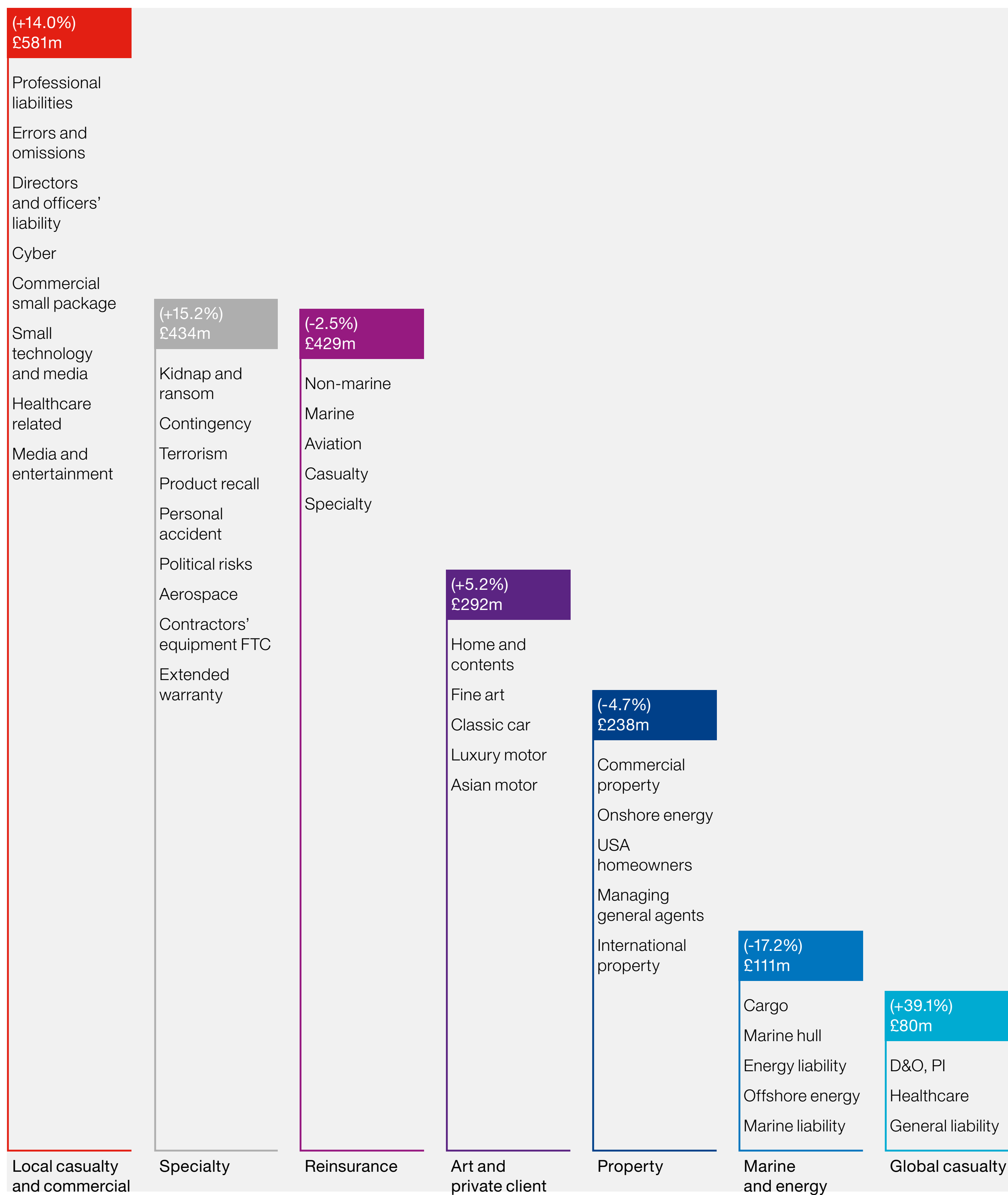
Richard joined Hiscox in 1986, having previously worked for Sedgwick's and Hogg Robinson. In 2005, he was appointed Managing Director of Hiscox Global Markets, the largest division of Hiscox by premium income, and was the Underwriter of Syndicate 33 from 2006 to 2009. In 2009, Richard moved to New York and served as the Chief Executive Officer for Hiscox USA for three years. He returned to London in 2012 to become Chief Underwriting Officer for the Hiscox Group.

**John Worth**
Interim Group Chief Financial Officer

John was previously Chief Financial Officer of a US-listed insurer/reinsurer. Prior to this, John held a number of senior financial roles within insurance and banking at Barclays, Ernst & Young, Prudential and Price Waterhouse, where he qualified as a chartered accountant. He has worked extensively in the US and the Far East, having previously been based in both the Caribbean and Japan.

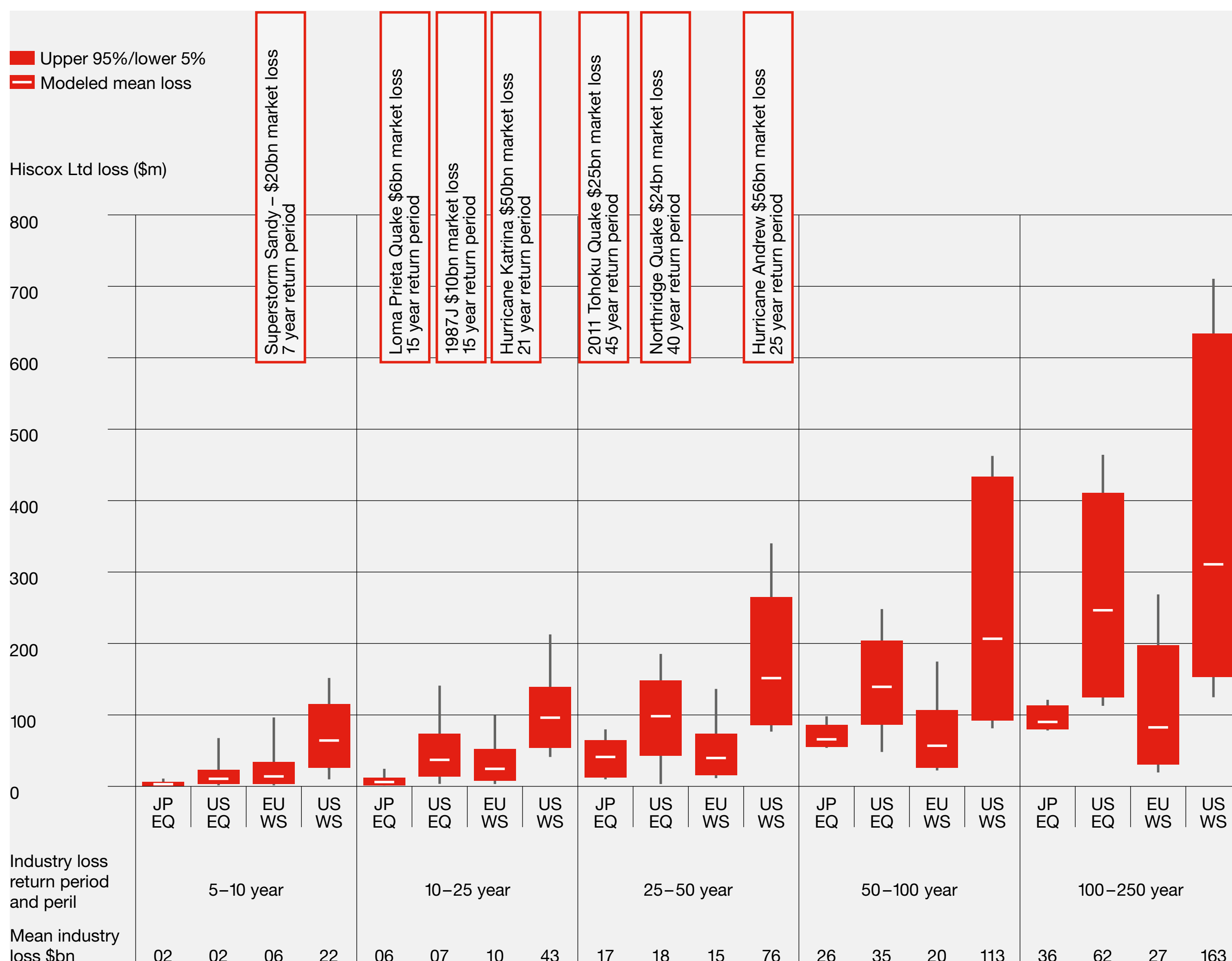
# Actively managed business mix

Total Group controlled premium 2015: £2,165m
(Period-on-period in local currency)



# Actively managed key underwriting exposures

Boxplot and whisker diagram of Hiscox Ltd net loss ($m) for certain modeled losses
January 2016




This chart shows a modeled range of net loss the Group might expect from any one catastrophe 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 2016 and industry data. Given the nature of the risks underwritten, the loss estimates may be materially different from 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 | 667 | 112 | 29.7 | 5.0 | 0.2 | 50 | 240 |
| Gulf of Mexico windstorm | 1,268 | 213 | 56.4 | 9.5 | 0.2 | 107 | 80 |
| Florida windstorm | 778 | 147 | 34.6 | 6.5 | 0.1 | 125 | 100 |
| European windstorm | 504 | 81 | 22.4 | 3.6 | 0.3 | 30 | 200 |
| San Francisco earthquake | 1,002 | 146 | 44.6 | 6.5 | 0.3 | 50 | 110 |

# Capital

## 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, once again as a result of our strong performance in 2015 the Board has reviewed the Group's capital level and proposed that a second interim dividend of 32p per share (approximately £91 million), should be made. This comprises a special dividend of 16.0p and a final dividend equivalent of 16.0p, bringing the year's total distribution to 40.0p. This return of capital will align the Group's available capital with the rating agencies' minimum capital requirements to remain in the A range. The impact of this distribution and how it compares to the Group's capital requirements is presented in the chart on page 21.

## Capital requirements

The Group monitors its capital requirements based on both external risk measures, set by regulators and the rating 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 Group level is given below.

The Group continues to identify opportunities for profitable growth and has made changes to its capital structure during 2015 accordingly. In particular, it issued £275 million of 30-year fixed to floating rate callable subordinated notes, which are publicly-traded debt instruments. This debt issue was performed in order to diversify the Group's sources of capital and reduce the size of the Letter of Credit (LOC) facilities used to provide additional funding. The additional funding available at Group level from revolving credit and LOC facilities comprised $500 million at 31 December 2015 (2014: $875 million), of which $71.9 million was drawn at 31 December 2015 (2014: $441.5 million). The debt issued was hybrid in nature. This means while it does not count towards capital as measured by shareholders' equity, it does count towards regulatory and rating agency capital requirements.

Management compares the capital requirements of the Group against its available capital. Available capital is defined by the Group as the total of shareholders' equity and subordinated debt. At 31 December 2015 available capital was £1,804 million (2014: £1,454 million), comprising shareholders' equity of £1,529 million (2014: £1,454 million) and subordinated debt of £275 million (2014: £nil).

### *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.

A.M. Best, Standard & Poor's and Fitch 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. Finally, Hiscox's own assessment of capital requirements arising from Fitch's Prism Factor-Based Model places the Group's capital in the 'very strong' range, comfortably above that necessary to maintain the current Fitch A rating. Projections indicate a reasonable level of flexibility would be maintained following the £91 million second interim dividend. The rating agency requirements shown in the chart on page 21 are consistent with our own internal projections of rating agency capital requirements based upon the Group's 2015 consolidated financial statements.

### *Group regulators*

As a Bermudian-registered holding company, the Bermuda Monetary Authority (BMA) is the Group's regulator under the Bermuda Group Supervisory Framework. The BMA requires the Group to monitor its Group solvency capital requirement under which the Group provides a solvency return in accordance the Group Solvency Self Assessment framework (GSSA) including an assessment of the Group's Bermuda Solvency Capital Requirement (BSCR).

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 Capital Model (GCM) which, together with the BSCR, forms part of the BMA's annual solvency assessment. The GCM provides a holistic view of the Group capital requirements and draws upon the Group's key underlying risk models. The proposed return of capital will leave the Group with a comfortable surplus above Hiscox's latest internal projections of both the BSCR and GSSA.

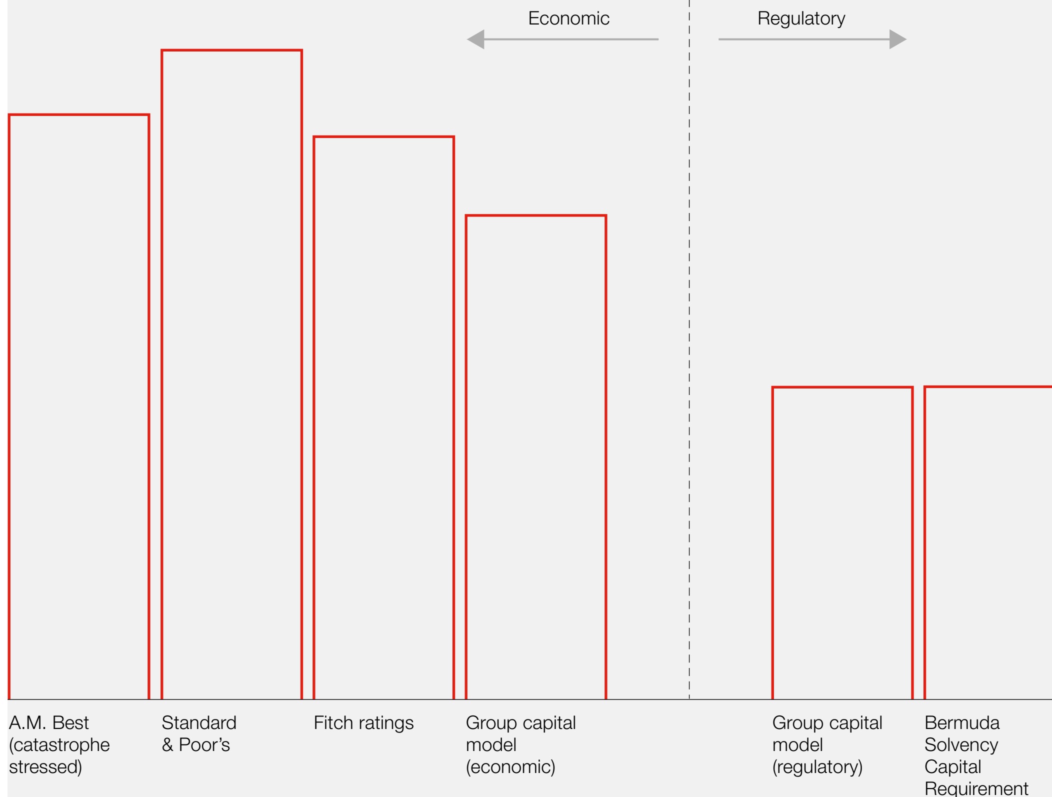
The Solvency II regime came into force in Europe on 1 January 2016. In addition, the European Commission has proposed that Bermuda be granted equivalence with Solvency II. This recommendation needs to be adopted by the European Parliament during 2016. The Group does not expect these new regimes to impact its capital requirements materially.

*Internal capital requirements*
The Group sets risk limits and tolerances which reflect the amount of risk it is willing to accept as a business. As part of good risk management, our current exposure by the key risk types is monitored against these pre-defined measures throughout the year. The largest driver of our capital is underwriting risk; the Group manages the underwriting portfolio so that in a 1 in 200 aggregate bad year it will lose no more than 12.5% of core capital plus 100% of buffer capital (£100 million) with an allowance for expected investment income. This underwriting risk limit definition has not changed since last year. A market loss at this remote return period would be very big indeed and would be expected to bring about positive market changes. The Group would be well positioned in the resulting strong market with capital in excess of £1 billion in addition to its LOC facilities and its now well-developed reinsurance partnerships. After the payment of the second interim dividend on 7 April 2016, the available capital will reduce to approximately £1.71 billion, comfortably meeting the current regulatory, rating agency and internal capital requirements. 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

£1.80bn available capital

£1.71bn available capital (post return)




Rating agency assessments shown are internal Hiscox projections of the agency capital requirements on the basis of projected 2015 year end results.
Hiscox uses the internally developed Group Capital Model to assess its own capital needs on both a trading (economic) and purely regulatory basis.
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.
The available capital figure comprises shareholders' equity and subordinated debt.

# Group financial performance

**Profit before tax for the year was £216.1 million (2014: £231.1 million). This continues a theme for the past three years of a lack of major catastrophe activity. The investment return reduced to 1.0% (2014: 1.8%), whilst lower than the previous year, they have again outperformed their benchmarks. Foreign exchange gains in 2015 were £15.2 million (2014: £5.0 million) with the US Dollar strengthening balanced by a weakening Euro for a second year. The Group recorded a post-tax return on equity of 16.0% (2014: 17.1%) and earnings per share were 72.8p (2014: 67.4p).**

Net asset value per share increased by 17.8% to 545.0p (2014: 462.5p), with net tangible asset value at 500.0p (2014: 428.8p).

The Board has declared a second interim dividend of 32.0p per share (to be paid on 7 April 2016 to shareholders on the register at 11 March 2016), comprised of: a final dividend equivalent of 16.0p per share (2014: 15.0p), taking the total ordinary dividend per share for the year to 24.0p, an increase of 6.7% (2014: 22.5p) and; an additional return of capital of 16.0p per share (2014: 45.0p). This is the fourth successive year we have been able to return additional capital to shareholders. Our focus will continue to be on identifying opportunities for profitable growth; returning capital to shareholders is not a long-term strategy. The Group continues to maintain a progressive dividend policy. Above and beyond this, shareholders should expect capital to be invested in the business for future growth rather than returned to shareholders. Gross premiums written of £1.94 billion were up 10.7% year-on-year. Strong growth has continued for most areas of the business, with Hiscox Retail comprising over 50% of the total gross premiums written. The Group's combined ratio including foreign exchange fluctuations was 85.0% (2014: 83.9%).

The underwriting performance for each operating segment is detailed as follows.

## Hiscox Retail

Hiscox Retail accounts for 50% of the Group's gross premiums written at £975.6 million (2014: £891.1 million). Gross premiums written for the UK were up slightly by 1.9% at £443.3 million (2014: £435.0 million). Europe's gross premiums written fell slightly by 2.1% to £151.8 million (2014: £155.1 million), yet up 7.8% in currency terms. The US again had strong growth, up 32.0%, with the professions and direct business lines contributing well to that growth. Guernsey's gross premiums written was up 5.1% year-on-year at £67.8 million. A full year of ownership of DirectAsia contributing £18.2 million of premium income.

The net claims ratio has remained steady at 38.6% (2014: 40.9%). The expense ratio has seen an uptick of 2.0% to 54.0%, as we invest more heavily in marketing spend, an additional £12.7 million for 2015, and IT development. The net combined ratio remained at 93.5% (2014: 93.5%), which is a good turnout compared against the additional investment being made.

## Hiscox London Market

Gross premiums written increased by 14.6% to £585.2 million (2014: £510.8 million) driven by strong growth in the alternative distribution, casualty and specialty divisions. The quota share arrangements with Syndicate 6104 remained in place.

The net claims ratio remained constant at 47.1% (2014: 47.4%), with minimal impact from catastrophes. The combined ratio increased slightly to 85.7% (2014: 84.2%) with a 0.9% increase in the expense ratio. Profit before tax for the year remained stable at £59.9 million (2014: £62.6 million).

The Group raised £275 million through its first long-term subordinated debt offering.

## Hiscox Re

Gross premiums written increased by 8.2% to £383.4 million (2014: £354.3 million). Another year of minimal catastrophe activity, with the claims ratio remaining low at 26.0% (2014: 22.0%). A lower net expense ratio of 25.4% (2014: 29.6%) helped push the combined ratio down to 46.6% (2014: 49.8%).

## Hiscox Corporate Centre

The central investment portfolio returned a lower £6.5 million (2014: £12.2 million) during 2015, but follows two good years. Foreign exchange gains boosted the result by £8.3 million compared to a loss of £1.6 million in 2014. Overall, the loss before tax remained constant at £14.6 million (2014: £15.2 million).

## Cash and liquidity

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

During 2015, the Group once again returned excess capital to its shareholders of

## Group key performance indicators

| | 2015 | | | | | 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Hiscox Retail | Hiscox London Market | Hiscox Re | Corporate Centre | Total | Hiscox Retail | Hiscox London Market | Hiscox Re | Corporate Centre | Total |
| Gross premiums written (£m) | 975.6 | 585.2 | 383.4 | – | 1,944.2 | 891.1 | 510.9 | 354.3 | – | 1,756.3 |
| Net premiums written (£m) | 919.6 | 427.2 | 225.0 | – | 1,571.8 | 825.9 | 336.9 | 180.6 | – | 1,343.4 |
| Net premiums earned (£m) | 870.4 | 383.9 | 180.7 | – | 1,435.0 | 790.7 | 332.5 | 193.0 | – | 1,316.2 |
| Investment result (£m) | 17.2 | 7.0 | 4.7 | 6.5 | 35.4 | 25.9 | 8.7 | 9.4 | 12.2 | 56.2 |
| Profit/(loss) before tax (£m) | 73.3 | 59.9 | 97.5 | (14.6) | 216.1 | 78.1 | 62.6 | 105.6 | (15.2) | 231.1 |
| Claims ratio (%) | 38.6 | 47.1 | 26.0 | – | 39.6 | 40.9 | 47.4 | 22.0 | – | 39.8 |
| Expense ratio (%) | 54.0 | 40.7 | 25.4 | – | 46.1 | 52.0 | 39.8 | 29.6 | – | 44.9 |
| Foreign exchange impact (%) | 0.9 | (2.1) | (4.8) | – | (0.7) | 0.6 | (3.0) | (1.8) | – | (0.8) |
| Group combined ratio (%) | 93.5 | 85.7 | 46.6 | – | 85.0 | 93.5 | 84.2 | 49.8 | – | 83.9 |

| | 2015 | 2014 |
|---|---|---|
| Financial assets and cash† (£m) | 3,609.3 | 3,244.9 |
| Other assets (£m) | 1,694.7 | 1,734.2 |
| Total assets (£m) | 5,304.0 | 4,979.1 |
| Net assets (£m) | 1,528.8 | 1,454.2 |
| Net asset value per share (p) | 545.0 | 462.5 |
| Net tangible asset value per share (p) | 500.0 | 428.8 |
| Adjusted number of shares in issue (m) | 280.5 | 314.4 |

†Excluding derivative assets and insurance linked securities funds.

£142 million on top of a final dividend equivalent. The Employee Benefit Trust additionally purchased net £6.7 million of shares during the year into the Trust. In November, the Group raised £275 million through its first long-term debt offering, with part of these funds being utilised to set against Funds at Lloyd's and reduce our Letter of Credit borrowing.

Inflows for the year were £71.0 million (2014: inflow of £93.0 million). The Group paid £27.8 million of tax during the year compared to £62.6 million in 2014. The Group had cash outflows from investing activities of £59.7 million (2014: outflow of £43.6 million), incorporating the purchase of Hiscox MGA. Continued investment in IT architecture remains, and we completed the build of our new York building. Marketing expenses increased significantly to £44.5 million in the year (2014: £31.8 million).

During the year, the Group successfully issued £275 million of long-term debt at attractive rates of interest. The issuance, which was well received by the markets, counts towards our Tier 2 rating agency and regulatory capital requirements and means that we have been able to substantially repay the Group's drawn-down Letter of Credit, with just $71.9 million (2014: $441.5 million) remaining drawn as at 31 December 2015. It is our intention to fully repay this amount to leave $500 million undrawn on an on-going basis.

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

# Group investments

**The Group's invested assets at 31 December 2015 totaled £3.61 billion (2014: £3.25 billion). Allowing for the £209 million that was returned to shareholders by way of dividend and capital distribution and the proceeds of the £275 million bond issue raised towards the end of the year, assets under management grew by approximately £300 million during the year. The investment result, excluding derivatives, amounted to £33.7 million (2014: £56.4 million) equating to a return of 1.0% (2014: 1.8%). It has been a challenging year for both bond and equity investors and in that context we view the return as perfectly acceptable.**

With central bank activity driving down government bond yields in recent years, we chose to accept the lower returns on offer rather than hunting for yield in longer duration or lower credit quality securities or by straying into non-traditional asset classes. Once again in 2015 our priority was capital preservation over appreciation. Whilst the ECB's quantitative easing programme provided a supportive investment background for much of the first half of the year, the headwinds latterly have been much more severe. Sentiment can turn very quickly and no sooner had the summer worries about Greece been allayed, than markets were taken by surprise by the Chinese decision in August to devalue their currency. From a position where growth was gaining traction in the likes of the USA and the UK and on a recovery path in Japan and Europe, there was suddenly concern that a slowdown in China would derail the global economy. This sparked a sharp sell-off in equity markets and a surge in volatility. Despite a rally in October, major equity indices declined during the second half. In fixed income markets the notable event was the Federal Reserve's decision in December to increase US interest rates for the first time in nine years. This prompted an increase in yields generally but more particularly in the US bond markets. Returns from the bond portfolios since June, therefore, whilst positive, did not keep pace with the first half.

Predictably, the impact of the increase in the Federal funds rate was greatest in the US Dollar bond market and particularly at the short end of the yield curve. US Dollar bonds now account for 70.7% of our fixed income assets and, given the nature of our liabilities, are focused on a short duration. Our investment returns are therefore sensitive to price movements there. With two-year US government bond yields increasing markedly from 0.5% to over 1%, the Dollar benchmark which most of our managers are measured against delivered a negative return in the final quarter. A further challenge for bond investors in the latter half of 2015 has been a widening in credit spreads. Whilst this has been most pronounced in the energy and materials sector and the high-yield market, where the portfolios have very little exposure, there has been a knock-on effect for credit markets more broadly. It has been a similar story in Sterling although yields did not rise as much given that expectations of a rate increase by the Bank of England receded into the second half of 2016. The Sterling returns, therefore, having lagged those denominated in Dollars for much of the year, caught up in the second half.

## Group investment performance

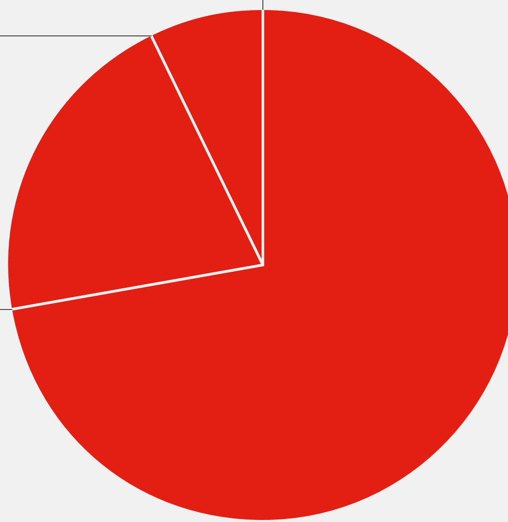
| | | 31 December 2015 | | | 31 December 2014 | | |
|---|---|---|---|---|---|---|---|
| | | Asset allocation % | Return % | Return £000 | Asset allocation % | Return % | Return £000 |
| Bonds | £ | 12.3 | 1.1 | | 15.1 | 2.1 | |
| | US$ | 51.2 | 0.9 | | 52.6 | 1.2 | |
| | Other | 8.9 | 0.6 | | 10.1 | 1.9 | |
| Bonds total | | 72.4 | 0.9 | 21,585 | 77.8 | 1.5 | 36,714 |
| Equities | | 7.2 | 4.0 | 10,410 | 7.8 | 7.6 | 17,604 |
| Deposits and cash equivalents | | 20.4 | 0.4 | 1,685 | 14.4 | 0.4 | 2,037 |
| Actual return | | | 1.0 | 33,680 | | 1.8 | 56,355 |
| Group invested assets | | | | £3,609m | | | £3,245m |

Before fees, derivative positions and investments in insurance linked funds.

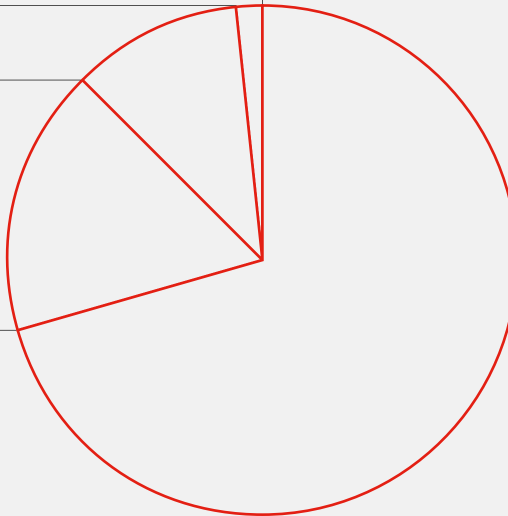
## High-quality, conservative portfolio

Investment portfolio: £3.609 billion as at 31 December 2015

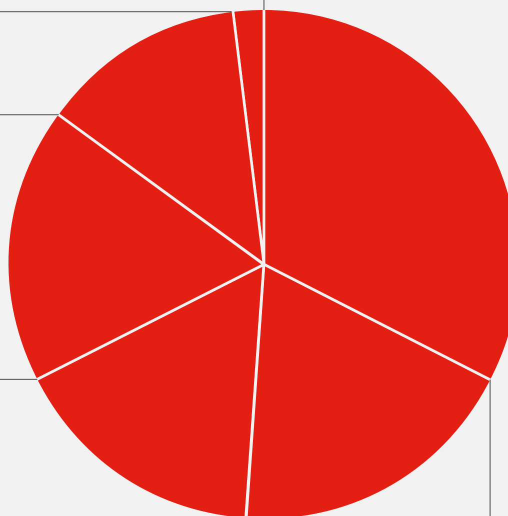
### Asset allocation




### Bond currency split




### Bond credit quality



# Group investments continued

The Euro component generated a small positive result which was in fact better than forecast given the negative yields on offer from cash and sovereign bond markets at the outset of the year. For the year as a whole the allocation to credit has added some value and enabled our portfolios to beat the benchmark by a small margin with a return of 0.9%.

We have enjoyed good performance from our risk assets allocation in the previous three years and maintained our weighting there in 2015. Over the long term we believe that they will outperform bonds and, whilst not cheap, offer acceptable value relative to fixed income markets that have been boosted by central bank liquidity. We do not, however, expect the outsized gains that have been produced on occasion since the financial crisis to be repeated in the near term. Indeed bouts of volatility (such as that currently being experienced) will produce some periods of negative or very low return. At a benchmark level, this was the case in 2015 where most markets delivered relatively poor results (a small positive for the S&P 500 in the US and the UK's FTSE All Share). The better gains, mainly in Europe and Japan, were partly offset by the weaker Euro and Yen. It is therefore very pleasing that the range of actively managed funds have contributed +4.0%, a significant outperformance to the benchmarks which in aggregate were negative. The main contribution to our risk assets performance lay within our UK equity fund allocation where the managers by and large avoided the mining and commodity sectors which clearly had an annus horribilis. Our UK funds delivered 6.8% whilst our global equity and hedge funds made more modest positive returns.

Last year produced a number of surprises, primarily in the currency and commodity sectors. Looking forward the impact of these developments is still being felt and worries now abound over the prospects for economic growth and corporate health. This is currently most apparent in equities, whilst in the bond markets a flight to safety has caused government bond yield to fall sharply and credit spreads to widen. However there are some grounds for optimism, as the US economy seems to have momentum, with the Federal Reserve still planning to raise interest rates, and the UK data is relatively robust. Additionally Europe and Japan will likely benefit from an ongoing supply of liquidity from their central banks.

Cash balances at the end of the year were higher than normal.

Our primary investment objective is that of not losing money in a calendar year but we also seek to maximise our return, subject to a prudent risk appetite. In a world of low but potentially rising interest rates, skittish equity markets and with reduced liquidity in many asset classes, achieving this balance is increasingly challenging. A small positive is that we began the year with our bond portfolios on higher yields than of late. Duration is short with credit quality focused on the investment-grade market and we remain well positioned to take advantage of higher interest rates as and when they come. Volatility often produces opportunity, but we think that any allocations to less traditional asset classes such as emerging market bonds and high yield are premature at this stage. In the meantime we are planning for another year of investment return not dissimilar to that of the last three years. The majority of our risk appetite is reflected in our allocation to equity and hedge funds. We believe that this remains appropriate in the longer term although short-term performance is likely to be volatile. We have the capacity to take more risk in the investment portfolio but not at any price.

Cash balances at the end of the year were higher than normal, largely reflecting the fact that the proceeds of the bond issue received at the end of last year were held in cash or near cash over the year-end. Subject to market conditions, these will be invested broadly in line with our overall asset allocation during the first quarter of 2016.

# Risk management

**Our core business is to take risk and our strategy is to maximise return on equity within a defined risk appetite. Our continuing success depends on how well we understand and manage the significant exposures we face, and this risk knowledge informs every important operating decision the Group makes.**

The Board sets the Group's risk strategy, appetite and framework. Each of the business units must operate within the limits set by the Board and these are monitored both locally and centrally, by risk type and in the aggregate.

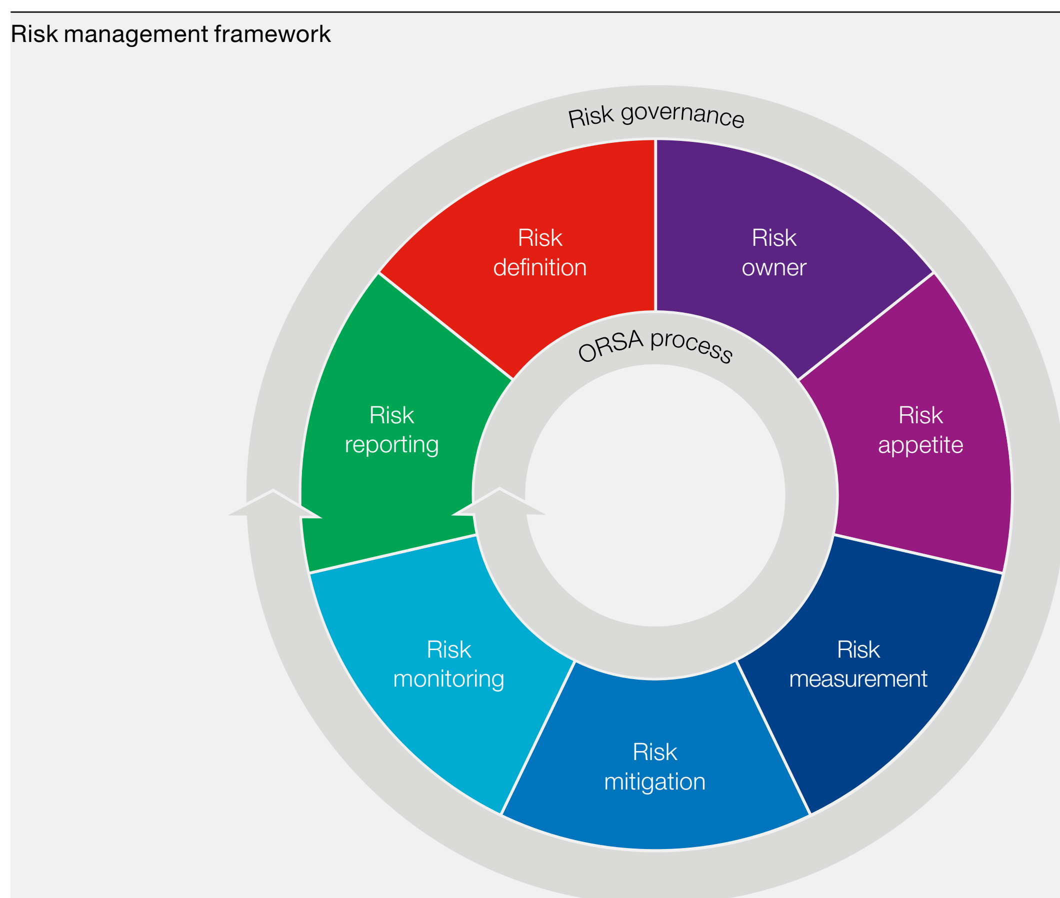
The risk management framework includes several Group-wide and local forums focusing on specific risk types such as underwriting, reserving, investments, liquidity and credit. Hiscox's risk management framework is illustrated in the diagram below.

The Risk Committee of the Board oversees the risk management framework, the development and operational implementation of Hiscox's risk management policies and procedures and advises the Board on how best to manage the Group's risk profile. The Risk Committee monitors and reviews the risk profile, the effectiveness of our risk management activities and our adherence to the agreed risk appetite and parameters.

The framework is supported by a central risk team that reports to the Risk Committee of the Board. This team monitors and reviews the risk profile and the effectiveness of our risk management activities.

Our continuing success depends on how well we understand and manage the significant exposures we face.

Risk management framework



# Risk management
continued

We operate three lines of defence in co-ordinating duties, roles and responsibilities to manage the full range of risks to which we are exposed. These risks include: underwriting risk, reserve risk, investment risk, FX risk, reinsurance credit risk, broker credit risk, operational risk and aggregate risk.

## Risk strategy

Key aspects of our risk strategy are:

- maintaining underwriting discipline when writing high-margin, volatile and complex risks;
- seeking balance and diversity to generate opportunities throughout the cycle;
- taking a transparent approach to risk in the decision-making process.

This will enable us to effectively capture the upside of the risks we pursue as well as managing the downside of the risks we are exposed to.

## Risk appetite

Our risk appetite sets out the nature, type and degree of risk the Group is prepared to take to meet its overall objectives. It forms the basis of the real-time exposure management we undertake, and is monitored throughout the year, and might be increased or reduced according to a number of factors.

## Risk management framework process

We evaluate risks both individually and in aggregate, which enables us to evaluate how different risks interact to determine where correlations and concentrations may occur, and allows us to pursue our strategic objective of seeking balance and diversity.

To assess and manage these exposures we have developed a risk management framework, which we regularly review and enhance in light of the changing risk environment and evolving best practice on risk management and governance. It is designed to enable innovative and disciplined underwriting, and operates as a continuous process that is embedded in the Group's culture.

### Three lines of defence

| 1. First line of defence *Own the risk* | 2. Second line of defence *Challenge, track and assess* | 3. Third line of defence *Independent assurance* |
|---|---|---|
| The first line of defence is responsible for the ownership and management of risks on a day-to-day basis in order to achieve the Group objectives. The first line of defence consists of individual risk owners at an operational level. | The second line of defence provides oversight, challenge and support to the first line of defence. A dedicated risk team is responsible for this and reports to the Risk Committee of the Board and the Chief Executive Officer. | The third line of defence consists of independent assurance to the Board, ensuring that risks are being managed in line with the policies and processes in place, to the agreed limits set by the Board and that the stated controls are in place operating effectively. |

Hiscox Own Risk and Solvency Assessment (ORSA) process

The Board approves Group risk policies and procedures, which address every aspect of risk, identification, appetite, measurement, mitigation, monitoring, reporting and governance. Their objective is to protect the Group's shareholders, policyholders and other stakeholders from negative events.

The Group's exposures are monitored locally and centrally, by risk type and in the aggregate, to assess the level of risk being taken by the Group, and ensure that this remains within the parameters set by the Board.

The risk team has a wide range of tools at its disposal to monitor risks, ensure risk remains within the appetite set by the Board and share best practice on managing risks across the Group.

The tools include:
- risk and control register;
- key risk indicators;
- critical risk monitoring;
- audit reports;
- Own Risk and Solvency Assessment (ORSA);
- risk and capital models;
- risk profiles;
- risk dashboards;
- specific risk reviews;
- stress and scenario testing.

The information on risk management these tools provide is reported to the Risk Committee and to the Board where necessary.

# Risk management
continued

## Principal risks

| What is the risk? | Why do we have it? | How is it managed? |
|---|---|---|
| **Strategic risk** | | |
| *Insurance cycle*<br>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.<br>**Remuneration:** Hiscox incentivises underwriters on return on equity, rewarding staff for profit not revenue.<br>**Risk appetite:** our appetite for certain lines of business changes according to market conditions and the risk appetite of the Group.<br>**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.<br>**Lead insurer:** we frequently act as the lead insurer in the coinsurance programmes required to cover significant high-value assets, so we have some ability to set market rates rather than follow them. |
| *Hiscox credit rating*<br>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.<br>**Communication:** regular and open communication with the major credit rating agencies helps to ensure we continue to meet their expectations. |
| *Emerging risks*<br>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. |

| What is the risk? | Why do we have it? | How is it managed? |
|---|---|---|
| Insurance risk – underwriting | | |
| *Catastrophic and systemic insurance losses*<br>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.<br>— 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 the 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.<br>— Underwriting discipline: underwriters are incentivised to make sound decisions that are aligned with the 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.<br>— 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.<br>— 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.<br>— 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. |
| *Binding authorities*<br>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. |

Principal risks continued

| What is the risk? | Why do we have it? | How is it managed? |
|---|---|---|
| **Insurance risk – reserving**<br><br>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 in 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.<br>– **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. |
| **Market risk – investment risk**<br><br>*Asset value*<br>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.<br>– **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.<br>– **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.<br>– **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.<br>– **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.<br>– **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.<br>– **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. |

| What is the risk? | Why do we have it? | How is it managed? |
|---|---|---|
| Market risk – investment risk continued<br><br>*Liquidity*<br>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.<br>— 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.<br>— 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.<br>— 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.<br>— 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.<br>— 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. |
| Market risk – FX risk<br><br>*Foreign exchange risk*<br>Our reporting currency is Sterling, but a significant proportion of our underwriting activity 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.<br>— 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. |

# Risk management
continued

## Principal risks continued

| What is the risk? | Why do we have it? | How is it managed? |
|---|---|---|
| **Credit risk – reinsurance**<br><br>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 Group Credit Committee, based on an assessment of financial strength, trading record, payment history, outlook, organisational structure, plus its external credit ratings.<br>– **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 consultants and from rating agencies.<br>– **Guidelines:** we set guidelines for exposure to each of our approved reinsurers. |
| **Credit risk – brokers**<br><br>Broker credit risk is the risk of loss due to exposure to intermediary brokers, i.e. the policyholder pays the broker but the broker fails to pass the premium to us, or we pay a claim to the broker but the broker fails to pass the payment to the policyholder. | The vast majority of our business is written through brokers (i.e. premiums and claims, paid and received), though there are direct books of business in the UK, US, Europe and Asia. We face credit risk where we transfer money to, and receive money from brokers. | – **Careful selection:** we follow the same careful selection, monitoring and guidelines process for broker credit risk as reinsurance credit risk.<br>– **Payments:** for large losses, we pay the policyholders directly to remove broker credit risk on these material transactions. |
| **Operational risk**<br><br>*Regulatory change*<br>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. | – **Monitoring:** we constantly monitor new regulation and review our internal arrangements operating under the guidance of the Group CFO. |
| *Cyber security*<br>Cyber security risk specifically relates to threats from globally connected networks such as the internet. It differs from the exposure posed by underwriting cyber risks, which is considered an insurance risk and can result in derivative impacts including loss of profit and legal, regulatory and reputational consequences. | We operate in a world where the volume of sensitive data and the number of connected devices and applications have increased exponentially. In parallel, the threat environment is constantly evolving as cyber attacks become increasingly frequent and sophisticated. Cyber risk is an integral part of what we do. As such, it is managed as a business risk, not an IT responsibility. | – **Strategy:** our cyber security risk strategy combines industry standard perimeter security with data-centric protection for specific highly confidential information.<br>– **Risk management:** we have dedicated IT security resources which provide advice on security design and standards, establishing appropriate system protection, embedding of security within IT practices and management of incidents.<br>– **Controls:** we constantly deploy and evolve systems, policies and procedures to mitigate internal and external threats to the IT infrastructure.<br>– **Stress testing and scenario analysis:** our stress testing and scenario analysis considers the impact and likelihood of information security exposures, including cyber security risks, to assess the effect on the business and discuss management actions.<br>– **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. |

# Corporate responsibility

**At Hiscox our core values include challenging convention, to have courage, to provide quality products, to excel in the service we provide and be human in our approach. 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 practice is reflected in:

## The environment

In the last year we have further strengthened structures to ensure climate change issues are integrated in our risk management governance. Climate change is factored into our business decisions in order to ensure we are responding effectively and appropriately to the challenges it poses.

Hiscox is a founding member of ClimateWise, which aims to leverage the insurance industry's expertise to understand, communicate and act on the risks associated with climate change. Hiscox is independently assessed against a commitment to six key principles: risk analysis, public policy, influencing our customers, investment strategies, managing our own impact and reporting on our direct emissions. More information on ClimateWise and the work Hiscox is doing here is available at www.climatewise.org.uk.

We believe in identifying, then minimising the environmental impact of our business activities, including the direct impact of our own business operations. We seek to reduce the amount of waste our activities produce, and the amount of resources we consume. We are committed to reducing our carbon footprint, and for the business to operate more sustainably. This includes 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 where we can. In 2015 Hiscox committed to six new targets for a real-term reduction in carbon emissions of 20% by 2020 relative to 2014.

We believe in identifying, then minimising the environmental impact of our business activities.

Hiscox global scope 1 and 2 GHG (greenhouse gas) emissions per full-time employee decreased from 1.20 in 2014 to 1.17 in 2015, reflecting a rise in occupied floor space. Global scope 3 GHG emissions per full-time employee also decreased, due largely to an 8% reduction in business travel since 2014.

The chart below depicts our global carbon emissions year-on-year since 2013.

### GHG emissions

| | *Year 2013 Global | *Year 2014 Global | **Year 2015 Global** |
|---|---|---|---|
| Scope 1 – company car use, onsite gas, combustion and refrigerant loss | 478.25 | 446.17 | **592.97** |
| Scope 2 – purchased electricity | 1,629.68 | 1,916.30 | **2,031.53** |
| Total (scope 1 and 2) | 2,107.93 | 2,362.47 | **2,624.50** |
| Total tonnes $CO_{2e}$ per FTE (Scope 1 and 2) | 1.27 | 1.20 | **1.17** |
| Scope 3 – air, rail, and personal car business travel | 3,588.06 | 4,906.32 | **4,538.07** |
| Total (all scopes 1, 2 and 3) | 5,695.99 | 7,268.79 | **7,162.57** |
| Tonnes $CO_{2e}$ per FTE (all scopes 1, 2 and 3) | 3.44 | 3.68 | **3.18** |

*The 2014 baseline has been re-stated. This is as a result of more accurate actual data available where estimates were previously used. This was for the following locations: Guernsey (Electricity and Gas), Hong Kong (Electricity), Glasgow (Gas), Dublin (Gas).

# Corporate responsibility continued

Hiscox Group operations will continue to offset the emissions we are not able to reduce, currently through our support of the award-winning climate and sustainable development experts, ClimateCare. Its LifeStraw Carbon for Water project provides simple gravity-fed water filters for 4.5 million people in Western Kenya, minimising exposure to water-borne diseases. This project also cuts carbon emissions by reducing the need to boil water to make it safe to drink.

The Hiscox London office received a Gold with Special Commendation Award at the 2015 Clean City Awards, as well as a Bronze Award in the Mayor of London's Business Energy Challenge 2015. Hiscox remains a member of the Carbon Disclosure Project (CDP), an initiative that provides a global system for companies to measure, disclose, manage and share vital environmental information.

## The marketplace

In 2015, Hiscox UK was awarded Insurance Company of the Year at the City A.M. Awards, Hiscox London Market's directors and officers' team was awarded Underwriting Team of the Year at the Insurance Day London Market Awards, and Hiscox USA was recognised in the Top 100 Small Business Influencer Awards.

Insurance brokers are important stakeholders in our business, and we wish to build strong relationships with them to create a competitive advantage in the marketplace. Hiscox UK has instigated a 'superb service' ethos, developing a greater understanding of individual brokers' needs. Hiscox UK and Hiscox London Market have Chartered Insurer status from the Chartered Insurance Institute, which recognises the professionalism and expertise of staff and helps to attract business partners looking to work with high-quality insurers.

### *Dealing with investors*

We have a policy of open and transparent communication with our shareholders. 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. Senior management and key employees also regularly meet investors and analysts throughout the year to explain and answer questions on our financial performance and business strategy.

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

### *Dealing with customers*

Our ethos of outstanding customer service has earned Hiscox a reputation as an insurer whose word can be trusted, which sets us apart in our industry. Our belief is that insurance is a promise to pay, so should a loss occur we aim to fully support our customers, and to pay every valid claim as soon as possible. This approach was recognised at the Insurance Times Claims Excellence Awards, where Hiscox UK's property claims team was awarded Personal Lines Claims Initiative of the Year.

## The workplace

### *Culture*

The Hiscox culture is underpinned by a set of core values that determine a standard of behaviour that we expect all our employees to follow. We firmly believe that, through high standards of conduct, we are more likely to achieve business success and, therefore, create additional value for shareholders. We aim to have 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 a speedy response. We believe that we have the balance right and, furthermore, that this is one of our greatest strengths. We seek to follow the best practices in managing our people and to be a fair and professional employer. Hiscox aims to maintain a culture that encourages employees to raise any concerns relating to malpractice or wrongdoing without threat of unfair treatment as a result. If an employee has a serious concern relating to the operation of the business, we have a whistleblowing policy that enables that person to confidentially raise their misgivings with the Group Compliance and Audit Director, Chief Executive or Chairman. Employees also have the option to raise a concern with the Chairman of the Audit Committee. 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 to 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.

In 2015, all Hiscox website content was reviewed specifically for raising the profile of company governance, human resources and environmental transparency.

*Inclusion*
Senior management believes that being successful at Hiscox should be purely down to talent, personal values and effort. 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. To support this, in 2015 we focused on gender with the launch of a new Women in Leadership programme in order to help more women become Hiscox leaders. Being a more inclusive business will bring a broader range of opinions and ideas to decision-making.

*Rewards and benefits*
We encourage our employees to share in the Group's success through performance-related pay: bonus, savings-related share option schemes and executive share option schemes. We also offer competitive benefits packages, which contain health and fitness perks and opportunities for flexible working and career breaks. We benchmark 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. We listen to the views of our people and involve all in new ideas to take forward the business.

The community
Hiscox Bermuda has pursued a wide range of community initiatives. It continued its support of the Hiscox 11-and-under youth cricket league, and is the lead sponsor of Reef Watch, a citizen-science initiative for coral reef conservation. Employees play an active role in the Keep Bermuda Beautiful's 'Adopt an Area' programme, participate in YouthNet's Reading Mentoring programme, and, with the Eliza Dolittle Society, helped prepare and serve Thanksgiving dinner to around 200 members of the community. It also makes a number of donations to groups that support the island's youth and families: Chain Reaction, The Family Center, The Bermuda Sloop Foundation, The Women's Resource Center and the BSMART Foundation. Its donation to Project 100 supported disabled adults in assisted living facilities, while its donation to the National Museum of Bermuda has assisted with the much-needed repairs from hurricanes in 2014 and 2015.

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.

Hiscox USA is dedicated to serving those charities local to its offices that aid and improve education, medical science, advancement of the arts and culture, and provide services to disadvantaged and vulnerable members of society. The Hiscox Foundation USA matched donations and pledged money for hours volunteered by Hiscox employees with partner charities throughout the US – The Children's Restoration Network in Atlanta, Friends of Karen in New York, Word of Honor in Chesapeake, VA, the Greater Chicago Food Depository, the LA Children's Hospital and Mission Graduates in San Francisco. The Hiscox Foundation USA continues to support the Parris Foundation, an organisation dedicated to helping disenfranchised communities by teaching children about science, technology, engineering and mathematics.

Hiscox Germany has chosen to support two refugee projects: one in Bavaria and the other in Syria, through the United Nations High Commissioner for Refugees (UNHCR).

In Colchester, employees raised £15,000 for the Tom Bowdidge Foundation. This included £5,000 raised through their participation in the Colchester Half Marathon and over £3,000 at a Charity Golf Day.

In York, employees have already raised over £5,000 through a series of activities for their two chosen charities: York Mind and Snappy.

In London, Hiscox worked with The Brokerage Citylink during the summer of 2015, participating for the second time in The City of London Business Traineeship Programme, which offered four young students from inner London the chance to work in the business for eight weeks. The scheme helps inner-city school leavers gain experience of working in a big City firm, as well as to learn extra social and professional skills to help them get a job at the end. The scheme was once again a success, with one intern still working with us into next year during her gap year.

# Corporate responsibility continued

For more detail on corporate responsibility see hiscoxgroup.com

*Supporting the arts, science and technology*

Hiscox continues to support the arts, science and technology, through its work with the Royal Academy Schools, providing a bursary for two second-year students, and with the City of London's Sculpture in the City project, designed to transform the local landscape with unique and well-known pieces of modern sculpture. Hiscox employees volunteered to work with students from Bethnal Green Academy and other local schools to bring the sculptures to life. Hiscox is a founding benefactor of the Public Catalogue Foundation, which was created to catalogue all oil paintings in public ownership in the UK. 2015 was the final year of Hiscox's support of the Royal Institution (RI), the oldest independent research body in the world, dedicated to connecting people with the world of science for over 200 years. Hiscox has for the past five years been title sponsor of the Sunday Times Hiscox Tech Track 100, charting the fastest growing private technology, telecoms and digital media companies. Hiscox Germany continues to support promising young artists, along with Hamburg's renowned Academy of Fine Art, presenting a €7,500 prize to the best young artist selected by a jury of well-known art experts.

*The Hiscox Foundation*

The Hiscox Foundation is a charity, funded by an annual contribution from the Group, which gives priority to any charity in which an employee is involved. The Foundation contributed over £29,000 during the year to the fundraising totals of Hiscox employees and continues to support the Humanitarian Aid Relief Trust (HART) and Richard House Children's Hospice. HART helps some of the poorest and most abused people in the world. Richard House Children's Hospice provides care and support to children and young people who have a life-limiting or life-threatening health condition.

# 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, property and energy business, as well as a range of specialty lines including contingency and terrorism risks among others.

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 AA- (Very strong) rating from Fitch.

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.

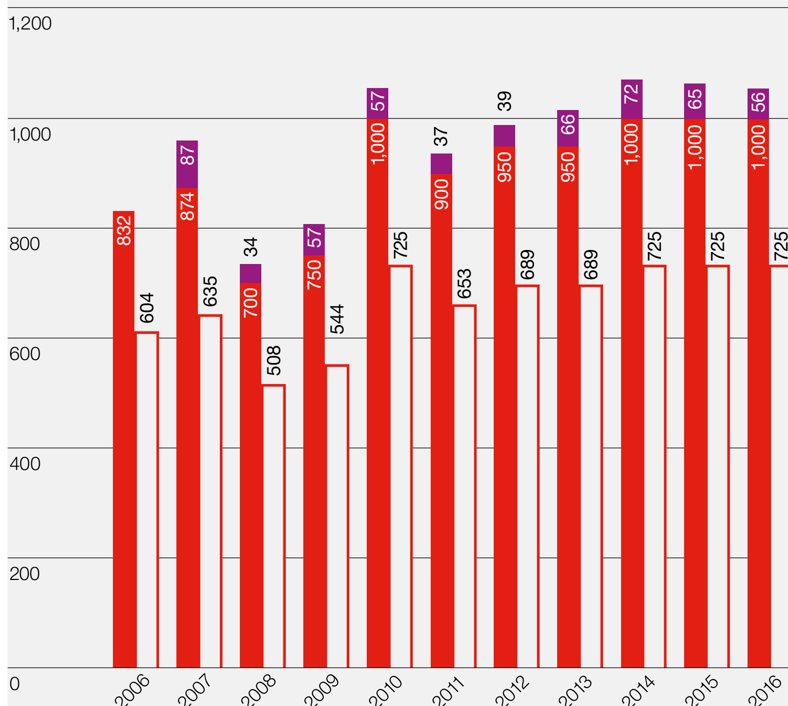
At present, Hiscox owns approximately 72.5% of the Syndicate, with the remainder owned by third-party Lloyd's Names. Hiscox receives a fee and a profit commission of approximately 20% of profit on the element it does not own. For the 2016 year of account, Syndicate 33's capacity has remained at £1 billion.

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

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.

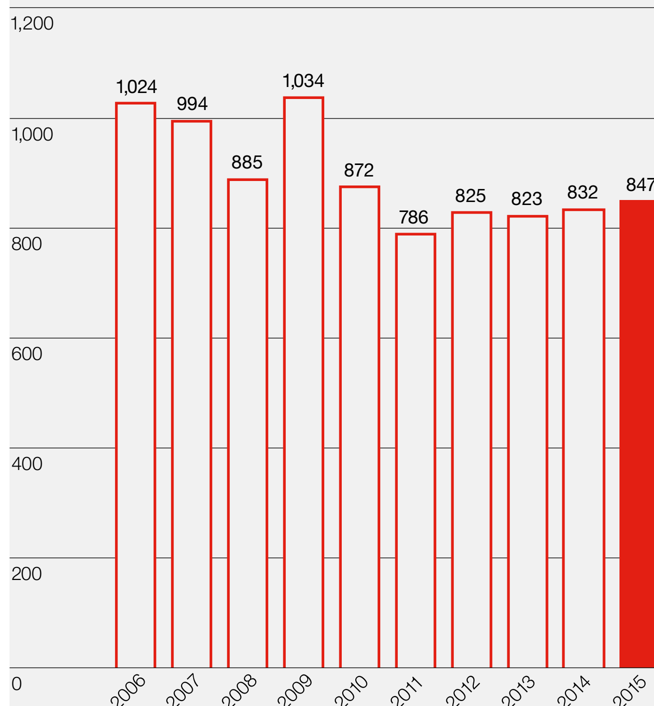
**Syndicate 33**
Capacity and Hiscox ownership (£m)

- Capacity
- Hiscox Ltd ownership
- Qualifying quota share*




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

**Syndicate 33**
Gross premiums written (£m)



# Insurance carriers
continued

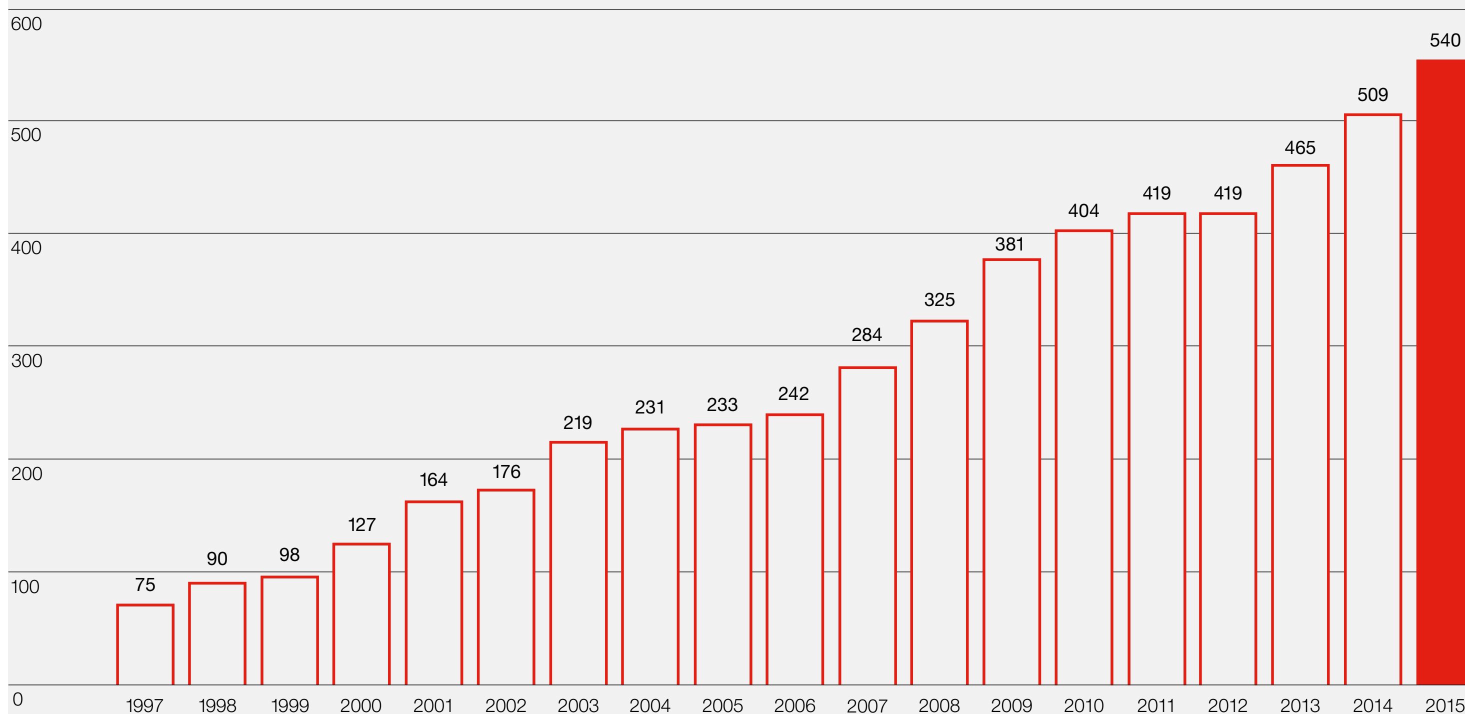
## Syndicate 3624
Syndicate 3624 is a wholly-owned Syndicate which began underwriting for the 2009 year of account. The Syndicate has a diversified portfolio of worldwide risks including FTC (fire, theft and collision), auto extended warranty, E&O, property, construction, technology and media, healthcare and aviation.

The diversification of the Syndicate from both an exposure and a geographical perspective means the Syndicate is well balanced to grow in a controlled way. Total underwriting capacity of Syndicate 3624 has increased to £400 million for the 2016 year of account.

## Syndicate 6104
Syndicate 6104 was set up under a limited tenancy agreement for the 2008 year of account. It is wholly backed by external Names and takes a pure year of account quota share of Syndicate 33's property catastrophe reinsurance account. The arrangement has been extended through to the 2016 year of account and Syndicate 6104's capacity was decreased to £56 million, from £65 million. Syndicate 6104 pays an overrider and profit commission to Syndicate 33.

## 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. Hiscox Insurance Company Limited has achieved average compound growth in gross premiums written of 11.6% from 1997 to 2015, 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



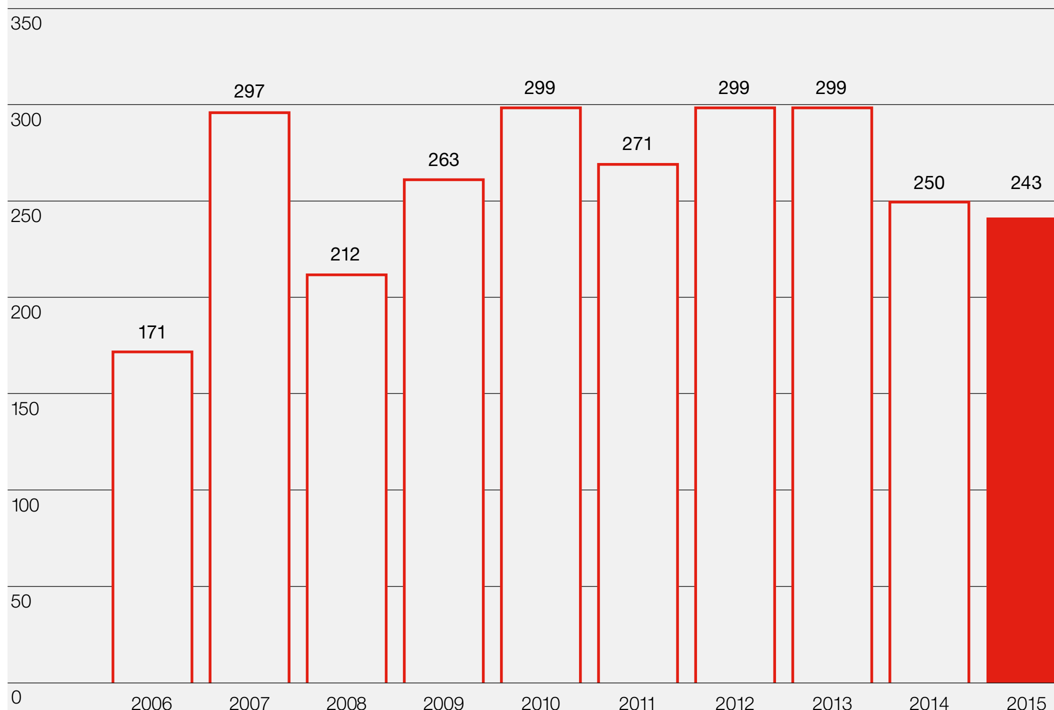
& Poor's rating of A (Strong) and an A+ (Strong) rating from Fitch. At the end of 2015, net assets exceeded £269 million (2014: £243 million).

### 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 2015, net assets exceeded $15 million (2014: $8 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 2015, net assets exceeded $848 million (2014: $895 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. In 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 2015, net assets exceeded $66 million (2014: $60 million).

### DirectAsia
In March 2014, the Group acquired Direct Asia Insurance (Holdings) Pte Ltd ('DirectAsia'). DirectAsia underwrites through subsidiaries in Singapore and Hong Kong, and an agency in Thailand. Its primary business is motor insurance, with ancillary lines in travel, personal accident and healthcare. At the end of 2015, the insurance company subsidiaries have net assets exceeding SGD$15 million (2014: SGD$16 million) and HK$125 million (2014: HK$134 million).



# Board of Directors

**Secretary**
Jeremy Pinchin

**Registered office**
Wessex House
45 Reid Street
Hamilton HM 12
Bermuda

Registered number
38877

**Auditors**
KPMG Audit Limited
Crown House
4 Par-la-Ville Road
Hamilton HM 08
Bermuda

**Solicitors**
Appleby
Canon's Court
22 Victoria Street
PO Box HM 1179
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**
Capita Registrars (Jersey) Limited
PO Box 532
St Helier
Jersey JE4 5UW

△ Member of the Audit Committee

○ Member of the Conflicts Committee

□ Member of the Remuneration Committee

⬡ Member of the Nominations Committee

Chairman of Committee is highlighted in solid.

*Effective date of Hiscox Ltd contract

## Chairman

**Robert Simon Childs**
Non Executive Chairman (Aged 64)
*26 February 2013**

⬢

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.

## Executive Directors

**Bronislaw Edmund Masojada**
Chief Executive (Aged 54)
*12 December 2006**

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 and was Chairman of the Lloyd's Tercentenary Research Foundation from 2008 to 2014. He is a past President of The Insurance Institute of London and immediate Past Master of The Worshipful Company of Insurers. He is currently a member of the Board of the Association of British Insurers.

**Richard Colin Watson**
Chief Underwriting Officer (Aged 52)
*16 May 2013**

Richard Watson joined Hiscox in 1986, having previously worked for Sedgwick's and Hogg Robinson. In 2005, he was appointed Managing Director of Hiscox Global Markets, the largest division of Hiscox by premium income, and was the Underwriter of Syndicate 33 from 2006 to 2009. In 2009, Richard moved to New York and served as the Chief Executive Officer for Hiscox USA for three years. He returned to London in 2012 and became Chief Underwriting Officer for the Hiscox Group. He is a Non Executive Director of White Oak Underwriting Agency Limited.

## Independent Non Executive Directors

**Lynn Carter**
Independent Non Executive Director
(Aged 59)
*20 May 2015**

△○□⬡

Lynn Carter joined Hiscox in May 2015. Lynn has 38 years' experience in the banking industry, most recently as President of Capital One Bank. Prior to Capital One, Lynn was President of Bank of America's Small Business Banking division, a $2.1 billion revenue business, with oversight of 110,000 business clients and 2,000 employees. Dividing her time between California and Connecticut, Lynn currently serves on the private board of American Express Centurion Bank, Phoenix House Foundation and Bankwork$ Advisory Board.

**Caroline Foulger**
Independent Non Executive Director and Chairman of the Audit Committee
(Aged 55)
*01 January 2013**

▲○□⬡

Caroline Foulger joined Hiscox in January 2013 having retired from a partnership at PwC on December 31, 2012. Until May 2012, Caroline led PwC's Insurance and Reinsurance practice in Bermuda. 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. Caroline is the Chair of the Board of the Bermuda Business Development Agency and a Non Executive Director of the Bank of N.T. Butterfield & Son Limited and Catalina Holdings (Bermuda) Ltd.

**Ernst Robert Jansen**
Independent Non Executive Director and Chairman of the Conflicts Committee
(Aged 67)
*20 November 2008**

△●□⬡

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.

**Colin Keogh**
Senior Independent Director and Chairman of the Remuneration Committee
(Aged 62)
*19 November 2015**

△○■⬡

Colin Keogh joined Hiscox in November 2015. Colin has spent his career in financial services, principally at Close Brothers Group plc, where he worked for 24 years and was CEO from 2002 until 2009. Colin currently holds directorships at London-listed Virgin Money Holdings (UK) plc and is Chairman for a specialist financial services business Premium Credit Limited.

**Anne MacDonald**
Independent Non Executive Director
(Aged 60)
*20 May 2015**

△○□⬡

Anne MacDonald joined Hiscox in May 2015. Anne has held the position of Chief Marketing Officer at four different Fortune 100 companies, marketing some of the most recognisable corporate names in the world – from Citigroup and Travelers to Macy's and PepsiCo. With an MBA from Bath University, Anne currently serves on the Board of Rentrak Corporation, the NASDAQ-listed global digital media measurement and research company serving the entertainment and advertising industries.

**Robert McMillan**
Independent Non Executive Director
(Aged 63)
*01 December 2010**

△○□⬡

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.

**Gunnar Stokholm**
Independent Non Executive Director
(Aged 67)
*20 November 2008**

△○□⬡

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.

# Hiscox Partners

'Hiscox Partner' is an honorary title given to employees who make significant contributions to the development and profitability of the Group.

The Hiscox Partnership numbers up to 5% of the total staff. A Partner's contribution can be in a variety of ways: through the leadership or development of an important area or line of business, or through technical and operational expertise that benefits the business significantly. Most have taken a risk in their careers and many have made personal sacrifices for Hiscox, whether it be moving into an unproven or new area for the Group or relocating themselves and their families. The Partners are the leaders of our business and individually and collectively influence our Group's development and success.

Along with the opportunity to shape the future of the Group comes responsibility. We expect Hiscox Partners to act as proprietors of the business, bringing attention to areas where they feel that Hiscox is not pursuing the correct course – not only in top-level strategy, but also day-to-day business behaviour in every area. Partners are expected to encourage and exemplify the Hiscox values and lead at all levels.

Hiscox Partners

| Name | Job title |
|---|---|
| David Astor | Chief Investment Officer, Hiscox Group |
| David Bailey | SVP, Southwest Regional Executive, Hiscox USA |
| Reeva Bakhshi | Chief Financial Officer, Hiscox Re |
| Rory Barker | Group Head of Outwards Reinsurance |
| Helen Bennett | HR Director, Hiscox UK and Europe |
| Neil Bolton | Head of Casualty, Hiscox London Market |
| Amanda Brown* | Group Human Resources Director |
| Steve Camm | Chief Underwriting Officer, Hiscox Special Risks |
| Rob Caton | Head of Underwriting Risk and Reinsurance |
| Robert Childs | Non Executive Chairman |
| Robert Davies | Chief Executive Officer, Hiscox Special Risks |
| Pierre-Olivier Desaulle* | Managing Director, Hiscox Europe |
| Robert Dietrich | Managing Director, Hiscox Germany |
| Ross Dingwall | Managing Director, Hiscox UK and Ireland Broker |
| Adam Edelstein | Chief Operating Officer, Hiscox USA |
| Guy Ellis | Head of Marine and Aviation Reinsurance, Hiscox Re |
| Stéphane Flaquet | Chief Information Officer, Hiscox Group |
| Sam Franks | Regional Manager Birmingham, Hiscox UK and Ireland |
| Robert Gadaleta | SVP, Southeast Regional Executive, Hiscox USA |
| Nicole Goodwin | Chief Underwriting Officer, Hiscox USA |
| Justin Gott | Head of Art and Private Client, Hiscox UK and Ireland |
| Peter Gower | Marine Liability Line Underwriter, Hiscox London Market |
| Gary Head | Managing Director of Alternative Distribution, Hiscox UK and Ireland |
| Robert Hiscox | Honorary President |
| Michael Jedraszak | Chief Investment Officer, Hiscox Re Insurance Linked Strategies |
| Jason Jones | Group Compliance and Audit Director |
| Suzanne Kemble | Group Head of Media, Entertainment and Events |
| Kevin Kerridge | EVP, Small Business Direct and Partnerships, Hiscox USA |
| Markus Klopfer | Munich Branch Office Manager, Hiscox Europe |
| Lorraine Kolega | Head of HR, Hiscox USA |
| Michael Krefta | Chief Underwriting Officer, Hiscox Re and Joint Active Underwriter, Syndicate 33 |
| Steve Langan* | CEO Hiscox Insurance Company, CEO of DirectAsia Group, Chief Marketing Officer |
| Paul Lawrence* | Chief Underwriting Officer, Hiscox London Market and Joint Active Underwriter Syndicate 33 |
| Ben Love | Head of Business Development, Hiscox Re |
| Kate Markham | Managing Director, Hiscox UK Direct |

**Hiscox Partners** continued

| Name | Job title |
|---|---|
| Ian Martin | Finance Director, Hiscox London Market |
| Bronek Masojada* | Group Chief Executive Officer |
| Steve McGerr | Head of Direct Commercial, Hiscox UK and Ireland |
| Stuart Middleton | Chief Underwriting Officer, Hiscox Europe |
| Alan Millard | Chief Operating Officer, Hiscox UK |
| Simon Morgan | Divisional Head of Property, Hiscox London Market |
| Joanne Musselle | Chief Underwriting Officer, Hiscox UK |
| Kylie O'Connor | Group Head of Communications |
| James Pilgrim-Morris | Head of Professional Indemnity Claims, Hiscox UK and Hiscox London Market |
| Jeremy Pinchin* | Chief Executive Officer – Hiscox Re, Group Company Secretary, Group Claims Director, Chief Executive Officer – Hiscox Bermuda |
| Derrick Potton | Head of Professions and Specialty Commercial, Hiscox UK |
| Tony Rai | Head of London Market Claims |
| Charles Rawlins | Energy Line Underwriter, Hiscox London Market |
| Robert Read | Global Head, Art and Private Clients |
| Joanne Richardson | Practice Leader, Media and Entertainment, Hiscox USA |
| Georgina Roberts | Head of HR, Hiscox London Market |
| Adam Rushin | Director of Operations, Hiscox London Market |
| Brett Sadoff | Head of Field, Hiscox USA |
| Kalpana Shah | Group Chief Actuary |
| David Slevin | Divisional Head of Aerospace and Specialty, Hiscox London Market |
| Damien Smith | Director of Underwriting, Hiscox Bermuda, Hiscox Re |
| Bevis Tetlow | Head of North American Underwriting Bermuda, Hiscox Re |
| Bob Thaker | Managing Director, DirectAsia |
| Ian Thompson | Head of Casualty, Hiscox Re |
| Nicholas Thomson | Retired Chief Underwriting Officer |
| Lee Turner | National Schemes Sales Manager, Hiscox UK and Ireland |
| Andrew Underwood | Group Head of Underwriting Management and Review |
| Annabel Venner | Global Brand Director, Hiscox Group |
| Ben Walter* | Chief Executive Officer, Hiscox USA |
| Chris Warrior | Head of Management Liability, Hiscox London Market |
| Gavin Watson | Chief Financial Officer, Hiscox USA |
| Richard Watson* | Chief Underwriting Officer, Hiscox Group |
| Gareth Wharton | Chief Technology Officer, Hiscox Group |
| Simon Williams | Head of Marine and Energy, Hiscox London Market |

*Hiscox Executive Committee

# Corporate governance

## Overview and basis of reporting

Hiscox Ltd ('the Company') is the Bermuda incorporated holding company for the Group. The Company has a premium listing on the London Stock Exchange. The corporate governance framework for the Company is derived from its constitution together with Bermuda Companies Act legislation. The Listing Rules require the Company to report against the UK Corporate Governance Code published in September 2014 (the Code). During 2015, and up to the date of this Report and Accounts, the Group has complied with the provisions of the Code in all material respects.

## The Board of Directors

As at the date of this Report, the Board comprises the Non Executive Chairman, two Executive Directors, and seven independent Non Executive Directors, including a Senior Independent Director. Biographical details for each member of the Board are provided on pages 42 to 43. The Nominations Committee monitors the composition of the Board and considers its diversity, balance of skills, experience, independence and knowledge to ensure that it remains appropriate. The composition of the Board was also reviewed as part of the Board evaluation described on pages 47 and 49.

There is a formal induction process for new Directors and induction training was provided to Lynn Carter, Anne MacDonald and Colin Keogh during the year. The needs of a new Director joining the Board are assessed and appropriate training arranged. Existing Directors are provided with the opportunity to attend training sessions. During the year Directors received briefings on capital modeling and cyber risk. Directors' training requirements were also assessed as part of the Board evaluation described on pages 47 and 49. 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.

Colin Keogh was appointed by the Board on 19 November 2015 and, in accordance with the Company's Bye-Laws, will seek re-appointment at the Annual General Meeting. In accordance with the Code the remaining Directors will also submit themselves for re-appointment. The external commitments of the Chairman and the Executive Directors are disclosed in their profiles on page 42. 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 respect of the 2015 financial year and adjustments were made to their remuneration as described in the annual report on remuneration on page 67. Whilst the Board acknowledges the value that knowledge and experience of the organisation can bring, it also recognises the need to progressively refresh Board 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 a particularly rigorous review.

The Board meets at least four times a year and operates within established Terms of Reference.

Daniel Healy, Dr James King and Andrea Rosen all left the Board during the year, having been appointed in 2006 when the Group re-domiciled in Bermuda. In accordance with the criteria set out in the Code these Directors would potentially have ceased to be independent had they continued to serve beyond nine years. Dr King retired from the Board and did not seek re-appointment at the 2015 Annual General Meeting. Andrea Rosen and Daniel Healy both left the Board on reaching nine years' service in October 2015. In addition, Richard Gillingwater decided to step down from the Board in order to pursue other commitments and did not seek re-appointment at the 2015 Annual General Meeting. Pending the appointment of a new permanent Senior Independent Director and Chair of the Remuneration Committee, Mr Healy, and later Mr Stokholm, assumed these roles on an interim basis. Details of the severance terms for each of the departing Non Executive Directors were posted on the Company's website from the day following their departure. Lynn Carter, Anne MacDonald and Colin Keogh, whose profiles are set out on page 43 of the Annual Report, all joined the Board during the year. Details of the Board succession planning arrangements are set out below in the section describing the Nominations Committee.

All Directors are entitled to seek independent professional advice at the Company's expense.

A copy of any such advice would be provided to the Company Secretary who would then circulate it to all Directors. The appointment and removal of the Company Secretary is a matter for the Board as a whole. As part of the internal Board evaluation conducted during the year Directors were asked whether they had sufficient access to the advice and services of the Company Secretary and there were no negative responses received. 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. As part of the Board evaluation Directors were asked about the quality of information provided to the Board and no concerns were raised. The Board of Hiscox Ltd held four scheduled meetings during 2015. The Code does not require the independence or otherwise of a Non Executive Chairman to be considered subsequent to their appointment. The Board considers all other Non Executive Directors to be independent within the meaning of the 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.hiscoxgroup.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 the annual Hiscox Partners' meeting held during the year. 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 interim dividends and recommendation of the final dividend, approving Group business plans and budgets, approving major new areas of business, approving capital raising, approving any bonus issues 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 awards. The Board has appointed an Executive Committee (described on page 49) and authorised the boards of the trading entities and business divisions to manage their respective operational affairs, to the extent that Board or Executive Committee 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 Audit Committee

The Audit Committee of Hiscox Ltd comprises Lynn Carter, Caroline Foulger, Ernst Jansen, Colin Keogh, Anne MacDonald, Bob McMillan and Gunnar Stokholm. Caroline Foulger is considered by the Board to have recent and relevant financial experience and was appointed Chair of the Audit Committee with effect from 1 January 2016. At that date more than three years had elapsed since her retirement as a partner of PwC. The Committee operates according to Terms of Reference published on the Group's website and meets at least three times a year to assist the Board on matters of financial reporting, risk management and internal control and to determine the external auditor's fees. The 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 Audit Committee receives reports from the auditors who also attend meetings of the Committee to report on the status of their audit and any findings. This allows the Committee to monitor the effectiveness of the auditors during the year.

The Board has appointed and authorised a number of committees to manage aspects of the Group's affairs.

It was reported last year that the Board had accepted the advice of the Committee with regard to the requirement for FTSE 350 companies to put the external audit out to tender and the audit of the Group was duly put out to tender for the first time, at the end of 2014. (Further details of this process are provided on page 52.) In accordance with the recommendation of the Committee, PwC will be proposed for appointment as auditors at the next Annual General Meeting. Caroline Foulger played no part in the audit tender process and absented herself from all meetings of the Committee at which this topic was discussed. The internal and external auditors have unrestricted access to the Committee. All non-audit work undertaken by the Group's external auditors with fees greater than £50,000 must be pre-approved by the Committee. KPMG has confirmed to the Committee that in its opinion it remains independent. The Committee is satisfied that this is the case. In respect of the 2015 financial year the Committee reported to the Board on how it had discharged its responsibilities and provided advice to the Board on how the Annual Report and Accounts were fair, balanced and understandable and provided the information necessary for shareholders to assess the Company's position and performance, business model and strategy. The arrangements by which staff may, in confidence, raise concerns about possible improprieties are described in the corporate responsibility statement on page 35. The internal audit function reviewed these arrangements during the year and reported on their findings to the Audit Committee. Further information on the activities of the Committee is included in the Audit Committee report on page 51.

## The Remuneration Committee

The Remuneration Committee comprises Lynn Carter, Caroline Foulger, Ernst Jansen, Colin Keogh, Anne MacDonald, Bob McMillan and Gunnar Stokholm. It is chaired by Colin Keogh. The Committee operates according to Terms of Reference published on the Group's website and generally meets three times a year. The Remuneration Committee takes care to recognise and manage conflicts of interest when receiving views from Executive Directors or senior management or consulting the Chief Executive about its proposals. No Executive is permitted to be present when the Committee discusses his or her remuneration. The Committee's role in remuneration is described in the remuneration policy report on page 55. The remuneration policy applicable to the Executive Directors is described on pages 56 to 59. The overall aim is to attract and retain high-calibre individuals and incentivise them to deliver long-term success for the Company. Executive Directors are subject to malus and clawback provisions in relation to their remuneration and the circumstances in which these would apply are described on page 61.

## The Nominations Committee

The Nominations Committee comprises Lynn Carter, Robert Childs, Caroline Foulger, Ernst Jansen, Colin Keogh, Anne MacDonald, Bob McMillan and Gunnar Stokholm. It is chaired by Robert Childs. It operates according to Terms of Reference published on the Group's website and meets as and when the Chairman determines appropriate, but at least once a year.

The Committee's role 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 Group believes that opportunity should be limited only by an individual's ability and drive. The Committee considers diversity, including gender diversity, when recommending appointments to the Board. The Committee has a policy in place to ensure that the candidate pool for each new appointment includes at least one female but does not consider it appropriate to set quotas for diversity. As referred to earlier in this report three Non Executive Directors who had served for nine years, or were approaching nine years' service, retired from the Board during 2015. With this in mind early in 2014 the external search consultancy firm, Egon Zehnder, was commissioned by the Committee to identify suitable independent non executive candidates. Other than undertaking search assignments Egon Zehnder has no connection to the Group. The qualities and experience specified by the Committee in the search briefs were aimed at balancing the existing skills, experience, independence and knowledge on the Board. Each candidate was interviewed by the Chairman, the Chief Executive and the Group Human Resources Director. As a result of the search a shortlist was produced and from that shortlist two candidates, Anne MacDonald and Lynn Carter, were nominated by the Committee. In February 2015 the Board agreed to recommend their appointment to shareholders and a separate resolution for each appointment was duly passed at the 2015 Annual General Meeting.

In February 2015 the external search consultancy firm, Sam Allen Associates, was commissioned to identify suitable candidates for the role of Senior Independent Director. Other than undertaking search assignments and insuring their business with Hiscox, Sam Allen Associates have no connection to the Group. Again the search brief was aimed at balancing the existing skills, experience, independence and knowledge on the Board. A shortlist of five potential candidates was produced and each was interviewed by the Chairman and the Group Human Resources Director. Two of the candidates were then interviewed by the Chief Executive and for a second time by the Chairman. Colin Keogh was then nominated by the Committee and appointed by the Board in November 2015. His biographical details are set out on page 43 and the reasons why the Board believed Colin Keogh should be appointed will be stated in the circular which will accompany the notice of the 2016 Annual General Meeting.

The Nominations Committee's role is to monitor the structure, size and composition of the Hiscox Ltd Board.

The Committee also has a role in considering the succession planning for Executive Directors and senior managers, and a remit to make recommendations on the succession planning for the Chairman and the Chief Executive and other members of the senior management group. During the year Stuart Bridges resigned as Chief Financial Officer in order to take up an alternative role outside the Group and left the Board on 31 August 2015. Details of the severance terms for Mr Bridges were posted on the Company's website from 1 September 2015 until publication of this Annual Report and are set out on page 68. The Committee approved a role specification and has instituted a process to find a new Chief Financial Officer.

The external search consultancy firm, JCA, has been commissioned to advise the Committee. The search has taken account of both internal and external candidates. Other than undertaking search assignments JCA have no connection to the Group. The Committee will take external advice as appropriate.

### The Investment Committee

The Investment Committee has oversight of the Group's investments and comprises Lynn Carter, Robert Childs, Caroline Foulger, Ernst Jansen, Colin Keogh, Anne MacDonald, Bob McMillan, Gunnar Stokholm, the Chief Executive and the Chief Financial Officer and is chaired by Robert Childs.

### The Conflicts Committee

The Group has a Conflicts Committee which comprises Lynn Carter, Caroline Foulger, Ernst Jansen, Colin Keogh, Anne MacDonald, Bob McMillan and Gunnar Stokholm and is chaired by Ernst Jansen. 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 Committee serves to protect the interests of the third-party Syndicate Names. There is also potential for similar conflicts to arise as a result of the Group's insurance linked securities (ILS) activity and the Committee serves to protect the interests of the external investors in the Kiskadee Select and Kiskadee Diversified funds.

### The Risk Committee

The Risk Committee of the Board oversees the risk management framework and advises the Board on how best to manage the Group's risk profile. The Committee normally meets three times per year. The Committee comprises Lynn Carter, Robert Childs, Caroline Foulger, Ernst Jansen, Colin Keogh, Anne MacDonald, Bob McMillan and Gunnar Stokholm. It is chaired by Caroline Foulger. The risk management framework is described in the risk management section on pages 27 to 34.

### The Executive Committee

The Executive Committee was established as a Committee of the Board in February 2015. It comprises Senior Executives, as listed on page 17, and will normally meet every six weeks. It makes recommendations to the Board and approves various matters (some of which may also require Board approval). The Committee approves senior appointments and remuneration outside the scope of the Remuneration Committee or Nominations Committee, approves operational policy, takes decisions on annual budgets and business plans, mergers and acquisitions, considers significant issues raised by management and approves exceptional spend within the limits established by the Board. Below this there are local management teams that drive the local businesses.

### Performance evaluation

The Code requires an externally facilitated Board evaluation to be undertaken every three years and this last took place in 2014. In 2015 an internal evaluation was conducted. The evaluation included a review of Board composition and whether there was an appropriate balance of skills, experience, independence and knowledge and whether the Board worked together as a unit. 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. As part of the Board evaluation Directors were asked whether additional information is required to support decision-making. The findings of the evaluation were discussed by the Board as a whole.

In addition to the internal evaluation of the Board, the then interim Senior Independent Director, Mr Stokholm, met with the other Non Executive Directors without the Chairman present to appraise the performance of the Chairman. During the year, the Non Executives also periodically met without the Executive Directors to discuss a wide range of issues concerning the Company. The Chairman held one-to-one meetings with each of the Non Executive Directors during the year to review their performance including their attendance, contribution and preparation for meetings and to discuss any training and development needs. No issues arose which would prevent the Chairman from recommending the re-appointment of a Non Executive Director. The Chairman met with the Chief Executive and the Chief Executive met with each of the Executive Directors, to discuss their performance over the year and to set targets for the year ahead.

### Shareholder communications

During the year the Company has engaged with its largest shareholders on the audit tender process and on the proposed renewal of its Performance Share Plan. The views expressed by shareholders have been reported back to the Board through its committees. Further details on the renewal of the Plan are set out on page 54. 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 2015. The Company commissions independent research on feedback from shareholders and analysts on a regular basis following the Company's results announcements. This research, together with the analysts' research notes, are copied to the Non Executive Directors in full. The Chairman attends a number of meetings with shareholders and analysts.

In addition, any specific items covered in letters received from major shareholders are reported to the Board. The then acting Senior Independent Director, Daniel Healy, wrote

to major shareholders in February 2015 to consult them on the audit tender process and to offer to meet with them. Major shareholders have also been consulted on the renewal of the Company's Performance Share Plan, approval of which will be considered at the next Annual General Meeting. 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.hiscoxgroup.com to notify any stakeholder of new stock exchange announcements.

### Accountability and internal control

The principal risks facing the organisation are described on pages 30 to 34 together with an explanation of how they are managed or mitigated. Risk is at the heart of any insurance organisation and the management of risk is fundamental to the success of its business model. The Group is subject to regulatory requirements aimed at ensuring its continuing solvency and has established arrangements to assess and manage its principal risks continually. Risk and solvency assessments are conducted and the Group is required to assess the capital resources necessary to achieve its strategic business objectives over the coming year whilst remaining solvent given its risk profile. This includes a forward-looking assessment which considers the business plan over a three-year time horizon.

The Group has a dedicated risk team led by the Chief Risk Officer which reports to both the Risk Committee of the main Board and to those of the relevant subsidiary boards. At each of its meetings during the year the Risk Committee reviews and discusses a risk dashboard and critical risk tracker which monitors the most significant risks. A critical risk is one which materially threatens financial strength and therefore requires regular focus. The Risk Committee also engages in focused reviews. Stress tests and reverse-stress tests (scenarios which could potentially give rise to business failure) are undertaken and these are reported to the Risk Committee. In the light of these arrangements the Directors are satisfied that a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity has been carried out during the year. The internal audit function carries out a rolling programme of reviews aimed at ensuring complete coverage of the Group's operations over a three-year period. The findings of internal audit reviews and the ratings given are reported to the Audit Committee. Taken together these activities enable the Board to monitor the Group's risk management and internal control systems.

Each year the internal audit function reviews the internal audit universe and updates it to reflect changes in the Group's operations including new business units and divisions. There is also an annual review of the Group's compliance with the governance requirements emanating from its regulators and the Code. The findings and overall rating from this review are reported to the Board through its Audit Committee. For the year ended 31 December 2015 the review resulted in a satisfactory rating.

Notwithstanding the uncertainties arising from the risks summarised on pages 30 to 34 there is a statement at page 73 which confirms that for the 2015 financial year the Directors considered it appropriate to adopt the going concern basis of accounting. For the reasons explained above the prospects of the Company are assessed over a longer period than the 12 months required by the Code. The Group calculates and projects forward the capital requirements of its regulators and those of the rating agencies to ensure that it will continue to meet any applicable solvency requirements and achieve the ratings it feels are necessary to conduct its business profitably. Whilst the Board has no reason to believe the Group's business model will not be viable over a longer period, the period over which the Board considers it possible to form reasonable expectations as to its position, is the three years to 31 December 2018. This corresponds to the forward-looking element of the Group's regulatory solvency assessments and allows reliance to be placed on the output from those assessments as well as the other arrangements described above. On the basis of its robust assessment of the principal risks and on the assumption that they can continue to be managed or mitigated as described and taking account of the most recent solvency assessments, together with the results of the stress tests and focused risk reviews, the Board has a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 31 December 2018.

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 Board confirms there is an ongoing process for identifying, evaluating and managing the principal 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.

# Audit Committee report

## Financial reporting

The primary role of the Audit Committee in relation to financial reporting is to monitor the integrity of the financial statements of the Company and any formal announcements relating to the Company's financial performance and review significant financial reporting judgements contained in them. In carrying out its role the Committee reviewed with both management and the external auditor the appropriateness of the half-year and annual financial statements, concentrating on, amongst other matters:

- the quality and acceptability of accounting policies and practices;
- the clarity of the disclosures and compliance with financial reporting standards and relevant financial and governance reporting requirements;
- material areas in which significant judgements have been applied or there has been discussion with the external auditor; and
- any correspondence from third parties in relation to our financial reporting.

To aid the review, the Committee considered the report of the key judgements in the financial statements from the Chief Financial Officer as well as reports from the external auditor on the outcomes of their annual audit and their half-year review. The Committee is supportive of KPMG in displaying the necessary professional scepticism their role requires. The primary areas of judgement considered by the Committee in relation to the 2015 Annual Report and Accounts were:

### *i) Reserving for insurance losses*

As set out in our significant accounting policies on page 89, the reserving for losses, in particular losses incurred but not reported, is the most critical estimate in the Company's consolidated balance sheet. The Chief Actuary presented a Group reserving report to the Committee and the Committee reviewed the approach taken by management when making their selection of reserving estimates and is satisfied with the judgements taken and the reporting and disclosure of the estimates.

### *ii) The carrying value of deferred tax arising from losses in foreign subsidiaries*

As fully explained in note 2.21, a deferred tax asset has been established relating to operating losses arising in foreign subsidiaries. The recoverability of this asset is dependent upon the future profitability of these subsidiaries. The Committee has reviewed the methodology used by management to assess the projected profitability and the carrying amount of the deferred tax asset and is satisfied with the methodology.

### *iii) The valuation of the investment portfolio*

The Group reports its assets at fair value. As discussed in note 2.21, during periods of economic stress, the resulting diminished liquidity means estimating fair value involves a higher level of judgement. The Committee has evaluated the process which management has used to estimate the fair value of the investment portfolio and is satisfied with their conclusions.

### *iv) Accounting for the defined benefit scheme*

As explained in note 2.15, the Group recognises the present value of the defined benefit obligation less the fair value of plan assets at the balance sheet date. The Audit Committee has reviewed the report of the key judgements in the financial statements from the Chief Financial Officer and is satisfied that the assumptions used to measure the deficit are reasonable.

### *v) Kiskadee deconsolidation*

As discussed in note 2.3(a), due to significant inflows into the Kiskadee vehicles during 2015, the direct interest held by the Group fell to a level where it was deemed prudent to reassess the original decision to consolidate the vehicles in 2013. The Audit Committee has reviewed the report of the key judgements including the variability of returns and other significant qualitative factors and is satisfied with the conclusion reached that the Group does not meet the criteria for consolidation of the Kiskadee vehicles as from 1 July 2015.

## UK Corporate Governance Code

In accordance with the 2014 UK Corporate Governance Code the Board requested that the Committee advise on whether it believes the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy. The Committee has provided such advice to the Board.

## External auditor

The external auditors are invited to attend all meetings of the Committee and it is the responsibility of the Committee to monitor their performance, objectivity and independence. The Committee discusses and agrees the scope of the audit plan for the full year and the review plan for the interim statement with the auditors. The Audit Committee receives reports from external auditors at regular intervals during the audit process including in relation to the judgements outlined above.

# Audit Committee report
continued

The external auditors provide reports at each Committee meeting on topics such as the control environment, key accounting matters and mandatory communications. The Committee also received a comprehensive presentation from the auditors demonstrating to its satisfaction how their independence and objectivity is maintained when providing non-audit services. Any contracts with the auditors, KPMG, for non-audit services in excess of £50,000 must be approved by the Committee in advance. Approval will not be given for any contract which may impair the auditor's independence or objectivity. During the year the value of non-audit services provided by KPMG amounted to £144,000 (2014: £88,000). There were no circumstances where KPMG was engaged to provide services which might have led to a conflict of interests, nor does the Audit Committee consider the quantum of the fees impacts the independence of the auditors. During the year the Non Executive Directors met with the external and internal auditors without the Executive Directors present so as to provide a forum to raise any matters of concern in confidence.

## Internal audit

The Group Compliance and Audit Director is invited to attend all meetings of the Committee. It is the responsibility of the Audit Committee to monitor and review the effectiveness of the Group's internal audit function and to consider reports prepared by internal audit on the effectiveness of systems of internal control. An internal Board and Committee evaluation was conducted during the year, the scope of which included the Audit Committee.

## Audit tender

It was disclosed in last year's report that a tender process was underway for the audit of the Group. KPMG had served as auditors of the Group since it was admitted to the main market of the London Stock Exchange in 1997. The audit had not been subject to a tender process in the past and as previously reported, in view of the length of their tenure, it was decided that KPMG should not participate. Having taken this decision the Committee discussed the effectiveness of the current external audit process in the context of what would be required from a new external auditor. The process which was undertaken can be summarised as follows.

- The Committee agreed a list of attributes required in the prospective auditors.
- A request for proposal (RFP) was prepared, specifying the areas to be covered in the tenders.
- The prospective candidates (including one mid-tier firm) were interviewed by the then Chairman of the Audit Committee, with the then Chief Financial Officer accompanying him to the initial meetings.
- As a result of those interviews two firms were invited to submit a tender. It became apparent that it would not be possible to identify a suitable mid-tier firm with sufficient global coverage and experience.
- The Company's major shareholders were consulted and invited to provide input to the process.
- Both firms were given access to data and the opportunity to meet with senior executives.
- The Committee received presentations from each of the candidates.
- The Committee then met to discuss the presentations and arrive at a recommendation.

The recommendation, which has been accepted by the Board, is that PwC be proposed for appointment in place of the Company's present auditors at this year's Annual General Meeting. Daniel Healy retired as the Chairman of the Audit Committee in October 2015 and I was appointed to succeed him with effect from 1 January 2016. As a former partner of PwC I played no part in the audit tender process and absented myself from all meetings of the Audit Committee and the Board at which this topic was discussed.

Chairman of the Audit Committee
Caroline Foulger

### Meetings and attendance table

| Director | Board Attended | Audit Committee Attended | Remuneration Committee Attended | Nominations Committee Attended |
|---|---|---|---|---|
| RS Childs | 4/4 | N/A | N/A | 4/4 |
| BE Masojada | 4/4 | N/A | N/A | N/A |
| RC Watson | 4/4 | N/A | N/A | N/A |
| LA Carter | 2/2 | 2/2 | 2/2 | 2/2 |
| C Foulger | 4/4 | 4/4 | 4/4 | 4/4 |
| ER Jansen | 4/4 | 4/4 | 4/4 | 4/4 |
| A MacDonald | 2/2 | 2/2 | 2/2 | 2/2 |
| R McMillan | 4/4 | 4/4 | 4/4 | 4/4 |
| G Stokholm | 4/4 | 4/4 | 4/4 | 4/4 |

In addition to the scheduled meetings referred to above separate Audit Committee meetings were held on 26 February and 19 May 2015 to facilitate the audit tender process. Those members of the Audit Committee listed above attended the meetings with the exception of C Foulger who absented herself. See above for details of the audit tender process. LA Carter and A MacDonald were appointed as Directors on 20 May 2015. C Keogh was appointed by the Board at its final meeting of 2015 and has therefore not been included in the above table.

# Letter to shareholders

Dear Shareholder

Last year we responded to shareholder feedback by making certain refinements to the way in which we operate the remuneration policy. Consistent with evolving best practice, the Committee capped annual bonuses and variable pay under the recruitment policy, introduced new clawback provisions and added a holding period to future performance share awards. These changes were disclosed in last year's report and received strong support from our shareholders at the 2015 AGM.

The remuneration policy is next due for renewal at the 2017 AGM and the Committee will undertake an appropriate review in preparation for this.

In the following pages the Hiscox remuneration policy report and the annual remuneration report are presented. Although the remuneration policy is not being changed, it has been re-produced for ease of reference.

At Hiscox our aim is to make strong shareholder returns across the cycle and consistently grow dividends and net asset value per share. Our core business is to take risk and our strategy is to maximise return on equity within a defined risk appetite. We believe that a simple and consistent remuneration approach with strong, transparent alignment to these business objectives is an important part of achieving sustainable strong performance.

## Aligning our remuneration to business results

The main elements of our remuneration structure are unchanged.

- **Annual incentive scheme:** in order for Executive Directors to receive a payment under this scheme, the Company must achieve a pre-tax return on equity for the year in excess of a pre-established Hurdle Rate. If the Hurdle Rate is not met, we simply do not pay bonuses to the Directors. In other words, like shareholders, we are focused on results, not inputs or effort or other measures often used to justify bonus payments. Once the Hurdle Rate is achieved the aggregate size of the bonus pool is calculated based on the level of profits delivered and the Executive Directors' bonuses are paid from this pool.

- **Long-term Performance Share Plan (PSP):** the vesting of share grants is also linked to achieving a pre-established Hurdle Rate. This ensures that all shares granted under the plan vest only to the extent that Hiscox has delivered the minimum three-year post-tax return on equity reflected in the agreed hurdle.

- **Executive shareholdings** at Hiscox are extensive and meaningful. Hiscox encourages all employees to have a stake in the business and shareholding guidelines apply to senior managers. We are pleased that the personal Hiscox shareholdings of the Executive Directors far exceed these guidelines. With such a considerable amount of their personal wealth invested in Hiscox shares, we believe the Directors are indeed aligned with our shareholders and thus focused on net asset growth, total shareholder return and risk management. As at the year end, the Chief Executive had a holding equivalent to over 55 times his base salary.

## 2015 results and remuneration outcomes

In 2015 Hiscox has delivered a post-tax ROE of 16.0% compared with a 2014 result of 17.1%. Profit before tax declined by 6.5% to £216 million and NAV per share increased by 17.8%. We have announced a second interim dividend of 32.0p per share which comprises a final dividend equivalent

# Letter to shareholders
continued

of 16p per share and an additional return of capital of 16p per share. These are good results in a competitive market and the remuneration of Executive Directors reflects this performance.

- **Salary review:** the Executive Directors' salaries will be reviewed in April 2016 and are expected to be in line with the overall UK-based employee increases.

- **Annual incentives:** the approach taken to set Executive Director incentive awards for 2015 is described in the annual remuneration report. In summary, the Executive Directors' bonuses are based on the above hurdle pre-tax ROE result of 16.5% and the profit performance of the Group. Given the satisfactory individual performance of Bronek Masojada and Richard Watson in 2015, the Committee sees no reason why they should not receive a bonus which reflects these results. The Committee also reviews profit and ROE results from prior years as a check that the bonuses are appropriate.

  Bronek Masojada's bonus for 2015 reflects a strong set of results but has been decreased to reflect the year-on-year movement in profit.

  Richard Watson has been awarded a bonus of £900,000. This award is primarily due to the strong underwriting performance across the Group which has been a major part of the 2015 results. It also reflects Richard's broadening contribution to the Group and to the Board, having been in the role for three years.

  As part of Stuart Bridges' departure terms we agreed to pay him a bonus to reflect the proportion of the year he worked. Stuart's bonus payment of £475,000 takes account of the profit outcome and is pro-rated based on eight months' service in 2015. Further details on Stuart's exit arrangements were published on 1 September 2015 and are set out in the annual remuneration report.

- **Performance Share Plan:** I am delighted to say that over the past three years (2013/14/15) Hiscox has delivered an average post-tax ROE of 17.5%. As a result, the 2013 performance share plan grant has vested in full.

### Renewal of the Hiscox Performance Share Plan

Since the current PSP was adopted in December 2006, it has been a highly effective means of driving both performance and behaviours consistent with our strategic goals. This plan will expire during 2016, at the end of its ten-year term.

During the year the Company has engaged with its major shareholders concerning the renewal of the Plan and a resolution will be put to shareholders at the forthcoming Annual General Meeting. The key features of how the Plan will be operated will remain unchanged. The Remuneration Committee is confident that the renewed Plan will continue to align management rewards with the delivery of strong returns within a defined risk appetite and I hope that shareholders will therefore support this approach.

The Committee is confident that our remuneration practices continue to provide strong shareholder alignment and incentivise Directors appropriately for the delivery of absolute performance. The Executive Director remuneration for 2015 reflects that approach.

Colin Keogh
Chairman of Remuneration Committee

# Remuneration policy report

A core function of the Remuneration Committee's role is to determine:
- the overall remuneration strategy, policy and cost for the Group;
- the levels and make-up of remuneration for the Executive Directors;
- the award of sizeable bonuses to individuals other than the Executive Directors; and
- the awards and operation of the Company's share plans, including the Performance Share Plan.

The Company's intended forward-looking remuneration policy for Board members is set out on pages 56 to 63. The remuneration policy set out in this report took effect from 15 May 2014.

The policy is unchanged from that approved by shareholders in 2014, however, as disclosed in last year's remuneration report, certain additional restrictions have been applied to how the policy will be operated in practice.

From January 2015 we have operated the following restrictions to our remuneration policy:

- **Annual bonuses will be capped**
  From the year ended 31 December 2015 the cap on the annual bonus which can be earned by the CEO and CFO for any one year will be 400% of salary. The cap for the Chief Underwriting Officer will be 500% of salary, reflecting the commercial nature of the role.

- **Regular variable pay on recruitment to be capped**
  The maximum level of regular variable pay on recruitment of an Executive Director will be in line with the maximum for the annual bonus and the maximum for the current Performance Share Plan (PSP) (which is limited to 200% of salary in respect of any one financial year). As announced to shareholders prior to the AGM in 2014, our intention will always be to put externally hired Executive Directors on a remuneration package which is consistent with our overall remuneration policy. Discretion may be exercised under the policy to transition an individual into our structure, however the maximum level of variable pay (excluding buy-outs) would now be subject to the cap set out above.

- **New clawback arrangements**
  In addition to the existing malus provisions, all future bonus (including the deferred element) and PSP awards will be subject to clawback provisions that will apply for up to two years after the end of the relevant performance period. As with our existing malus provisions the Remuneration Committee would have the ability to apply clawback in the event of a retrospective material restatement of the results, or gross misconduct leading to the Company suffering significant reputational or financial damage.

- **Addition of holding period for PSP**
  For PSP awards granted from 2015 onwards, any shares which vest based on performance at the end of the three-year performance period will have to be retained (net of any taxes) by Executive Directors for a further two years.

## Future policy table
### Executive Director remuneration

| Element | Purpose and link to strategy | Operation |
|---|---|---|
| Base salary | Base salary, benefits and retirement benefits represent fixed payments for undertaking the role.<br><br>Fixed pay elements enable the Company to be competitive in the recruitment market when looking to employ individuals of the calibre required by the business. | Base salary is normally reviewed annually taking into account a range of factors including inflation rate movements by country, relevant market data and the competitive position of Hiscox salaries by role.<br><br>Individual salaries are set by taking into account the above information as well as the individual's experience, performance and skills, increases to salary levels across the wider Group and overall business performance.<br><br>By exception an individual's salary may be amended outside of the annual review process. |
| Retirement benefits | | These vary by local country practice but all open Hiscox retirement schemes are based on defined contributions. This approach will be generally maintained for any new appointments other than in specific scenarios (e.g. local market practice dictates other terms).<br><br>For current Executive Directors, a cash allowance (which is currently 10% of salary, less an offset for the employer's National Insurance contribution) is provided in lieu of the standard employer pension contribution.<br><br>Selected Board members retain legacy interests in closed defined benefit schemes. However, there is no entitlement to any further accrual under these plans. |
| Other benefits | | Benefits are set within agreed principles but reflect normal practice for each country. Hiscox benefits include, but are not limited to, health insurance, life insurance, long-term disability schemes and participation in all-employee share plans such as the Sharesave Scheme.<br><br>For new hires and changes in role, the Committee may provide reasonable additional benefits based on the circumstances (e.g. travel allowance and relocation expenses). |
| Annual incentive | To reward for performance against key objectives and achievement of financial results over the financial year.<br><br>Provides a direct link between reward and performance.<br><br>To provide competitive compensation packages. | Executive Directors participate in profit-related bonus pools.<br><br>Bonus pools are calculated at a business unit level and for the Group as a whole on the basis of Group financial results.<br><br>For 2016, the bonus pool will be funded by a set percentage of profits on achievement of a Hurdle Rate of ROE. The bonus for 2015 was determined on a similar basis. Further detail is set out on page 65.<br><br>For Executive Directors, individual allocations from the pool are determined by the Remuneration Committee based on a judgement of various factors including:<br>— size of the Group bonus pool;<br>— results of business area (where relevant); and<br>— individual performance.<br><br>Amounts are paid in accordance with the bonus deferral mechanism described below.<br><br>Bonus awards are non-pensionable. |

| Maximum potential value | Performance metrics | Application to broader employee population |
| --- | --- | --- |
| The salaries for current Executive Directors are set out on page 64.<br><br>Executive Directors' salary increases will normally be in line with overall employee salary increases in the relevant location.<br><br>Increases above this level may be considered in other circumstances as appropriate (e.g. address market competitiveness, development in the role, or a change in role size, scope or responsibility). | Individual and business performance is taken into account when setting salary levels. | Process for review of salaries is consistent for all employees. |
| Set at an appropriate level by reference to the local market practice. | None. | Executive Directors' benefits are determined on a basis consistent with all employees. |
| Set at an appropriate level by reference to local market practice and reflecting individual and family circumstances. | | |
| The Company has a robust track record of paying bonuses which are proportionate to financial results, see page 65 of this report for further details. Where performance is deemed to be below a pre-determined hurdle, payouts will be nil.<br><br>The total of individual bonuses paid to Executive Directors for a year will not normally exceed 15% of the total pool.<br><br>If the number of Executive Directors increased in the future, this percentage would be adjusted as required. | Performance is measured over one financial year.<br><br>Bonus pools are determined based on financial performance, therefore this is the main determinant of overall bonus payouts.<br><br>A hurdle of financial performance is set annually.<br><br>Performance above this hurdle is rewarded and where performance falls below this hurdle, payouts will be nil. | The operation of the annual incentive is consistent for employees across the Group.<br><br>Bonuses for more junior employees are calculated using a more formulaic approach. Further details are set out on page 65. |

## Future policy table
### Executive Director remuneration

<table>
<tr><th>Element</th><th>Purpose and link to strategy</th><th>Operation</th></tr>
<tr><td>Bonus deferral</td><td>Retention of employees.<br><br>Facilitate and encourage share ownership in order to align senior employees with Hiscox shareholders.</td><td>Larger bonuses are deferred over a three-year period and paid subject to continuing service as explained in the table below.<br><br>Deferral points are determined based on the currency in which the Executive Director’s salary is paid and are normally as follows:
<table>
<tr><td>Bonus of £50,000, €75,000, $100,000 and below</td><td>Paid shortly after the end of the financial year in which the bonus was achieved.</td></tr>
<tr><td>Bonus above £50,000 and below £100,000<br>Bonus above €75,000 and below €150,000<br>Bonus above $100,000 and below $200,000</td><td>£50,000, €75,000, $100,000 paid shortly after the end of the financial year in which the bonus was achieved.<br>Balance of bonus split 50% to be paid after year two (i.e. 24 months after the start of the bonus year), and 50% after year three (i.e. 36 months after the start of the bonus year).</td></tr>
<tr><td>Bonus above £100,000, €150,000, $200,000</td><td>50% of bonus paid shortly after the end of the financial year.<br>Balance of bonus split 50% to be paid after year two, and 50% after year three.</td></tr>
</table>
Participants are able (subject to any local tax/legal/regulatory restrictions) to draw deferred bonuses early for the following reasons:<br>– payment of the exercise price on the exercise of employee share options;<br>– payment of tax on share awards (e.g. on exercise of performance shares);<br>– purchase of shares; and<br>– payment of debt due on share purchases.<br><br>The Remuneration Committee can agree to early payment of deferred bonuses to Executive Directors on an exceptional basis at their discretion.<br><br>Deferred awards are subject to a malus provision. Further details on the malus provision are set out on page 61 of this report.</td></tr>
<tr><td>Performance Share Plan (PSP)</td><td>To motivate and reward for the delivery of long-term objectives in line with business strategy.<br><br>To encourage share ownership amongst participants and align interests with shareholders.<br><br>To provide competitive compensation packages for senior employees.</td><td>Awards are granted under the Performance Share Plan, originally implemented in 2006. Awards are governed by the rules of this plan.<br><br>Share awards (typically structured as either contingent awards or nil cost options) are made to Executive Directors and other senior employees at the discretion of the Remuneration Committee.<br><br>Awards normally vest after a three-year period subject to the achievement of performance conditions.<br><br>Awards are generally subject to continued employment however, awards may vest to leavers in certain scenarios (e.g. ‘good’ leaver circumstances).<br><br>Dividends (or equivalents) may accrue on vested shares prior to release. Further details on this are set out on page 61. Unvested awards are subject to a malus provision. Further details on the malus provision are set out on page 61 of this report. The PSP rules also enable the Company to grant market value options, however there are currently no plans to use this for regular awards.</td></tr>
<tr><td>Shareholding guidelines</td><td>To ensure Executive Directors are aligned with shareholder interests.</td><td>Within five years of becoming an Executive Director, individuals will normally be expected to own Hiscox shares valued at 150% of salary.</td></tr>
</table>

| Maximum potential value | Performance metrics | Application to broader employee population |
|---|---|---|
| N/A | N/A | Approach is consistent for all employees across the Group who are awarded a sizeable bonus. |
| Maximum annual grant of up to 200% of salary in respect of any one financial year. | The performance conditions for awards are set to align with the long-term objectives of the Company.<br><br>The Committee reviews the targets prior to each grant to ensure that they remain appropriate.<br><br>Currently, the performance measures are linked to the achievement of ROE performance over an agreed hurdle, during the performance period. Details of targets for awards to be granted in 2016 are set out on page 67.<br><br>For delivery of the threshold hurdle, up to 25% of the relevant award will vest. For full vesting, the stretch hurdle needs to be met in full. Usually, there will be straight-line vesting for performance between the threshold and stretch hurdle.<br><br>Under the plan rules the Committee is able to modify performance criteria for outstanding awards on the occurrence of certain events (e.g. major disposal), provided that such adjustment is fair and reasonable and the adjusted condition is no more difficult to satisfy. | Participation in this Plan is restricted to Executive Directors and other senior individuals.<br><br>The approach is consistent for all participants under the Plan. |
| N/A | N/A | Executive Directors are required to hold more shares than other senior managers. |

# Remuneration policy report continued

The Committee may make minor changes to this remuneration policy to aid in its operation or implementation without seeking shareholder approval (e.g. for regulatory or administrative purposes), provided that any such change is not to the material advantage of Directors. For the avoidance of doubt, the Committee may continue to operate the PSP in accordance with the rules (e.g. the treatment of awards in the context of a change of control or other forms of corporate restructure).

## Notes to the policy table

### *Performance measure targets and target setting*

The performance targets for the annual bonus and share plan awards to Executive Directors are intended to be closely aligned with the Company's short-term and long-term objectives. The intention is to provide a direct link between reward levels and performance. The Company operates a bonus pool approach for the annual incentive. This ensures that both individual bonus levels and overall spend are commensurate with the performance of the Company. The Committee applies judgement based on a range of factors (as described in the table on pages 56 to 59) to ensure that outcomes for Executive Directors are based on performance in-the-round rather than based on a formulaic outcome. The profit pool approach currently used ensures that overall bonus amounts are aligned to the performance of the Company and remain appropriate and affordable.

The PSP performance measures are intended to motivate and reward to deliver long-term Company success. The Committee considers performance metrics and targets prior to the grant of each to ensure that these remain suitable and relevant. Recent awards have been based on ROE performance – a key indicator of the Company's long-term success.

| Non Executive Director remuneration<br>Approach |
|---|
| General approach |
| The total aggregate fees payable are set within the limit specified by the Company's Bye-laws. The fees paid are determined by reference to the skills and experience required by the Company as well as the time commitment associated with the role. The decision-making process is informed by appropriate market data. Non Executive Directors are not eligible for participation in the Company's incentive plans. Travel and other reasonable expenses incurred in the course of performing their duties are reimbursed to Non Executive Directors. Non Executive Directors are included on the directors and officers' indemnity insurance. |
| Chairman |
| The Chairman typically receives an all-inclusive fee in respect of the role. In addition to his fees the Chairman may be provided with incidental benefits (e.g. private healthcare and life assurance). The remuneration of the Chairman is determined by the Committee. |
| Non Executive Directors |
| Non Executive Directors receive an annual fee in respect of their Board appointments together with additional compensation for further duties (e.g. Board Committee membership and chairmanship). The fees for the Non Executive Directors (excluding the Chairman) are determined by the Chairman. |

The current fees payable to Non Executive Directors are set out on page 67.

*Dividend equivalents*
As part of our objective to align senior managers with total shareholder return, the recipient of the PSP award is provided with the equivalent of the dividend either in shares or cash. Dividends (or amounts equal to dividends) on shares granted under the PSP roll up in the form of shares between the grant and vesting.

Where awards are granted in the form of nil-cost options, at the end of the performance period the employee would have an option 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. Participants in selected jurisdictions (subject to tax/legal/regulatory restrictions) after vesting but before exercise, may receive amounts equal to dividends paid on the total number of shares that have vested.

*Legacy arrangements*
The Committee may continue to satisfy remuneration payments and payments for loss of office (including the exercise of any discretions available to the Committee in connection with such payments) where the terms of the payment were agreed before the policy came into effect or at a time when the relevant individual was not a Director of the Company and, in the opinion of the Committee, the payment was not in consideration for the individual becoming a Director of the Company. For these purposes, such payments include the Committee satisfying awards of variable remuneration.

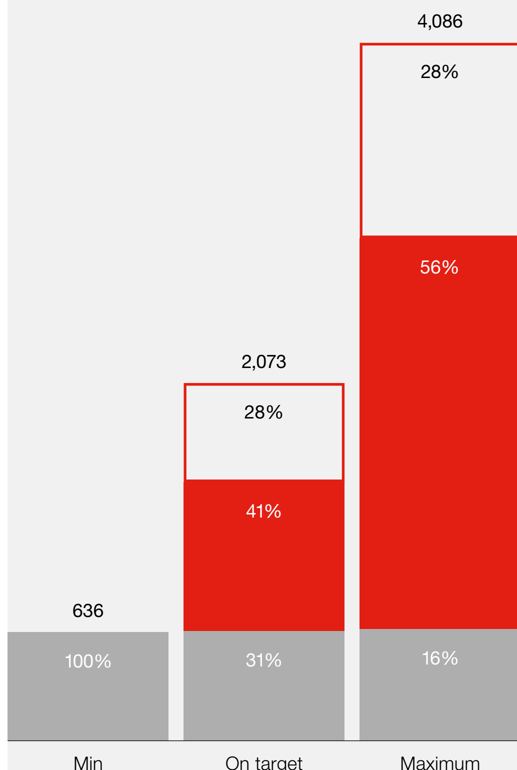
*Malus provision*
In respect of unvested compensation, specifically deferred bonuses and unvested performance share awards, granted following the introduction of this policy report, the Committee may, in its absolute discretion, determine at any time prior to the vesting of an award to reduce, cancel or impose further conditions in the following circumstances:
- a retrospective material restatement of the audited financial results of the Group for a prior period error in accordance with IAS 8;
- actions of gross misconduct, including fraud, by the participant or their team leading to the Company suffering significant reputational or financial damage.

This provision was introduced in 2014, and will apply to future grants.

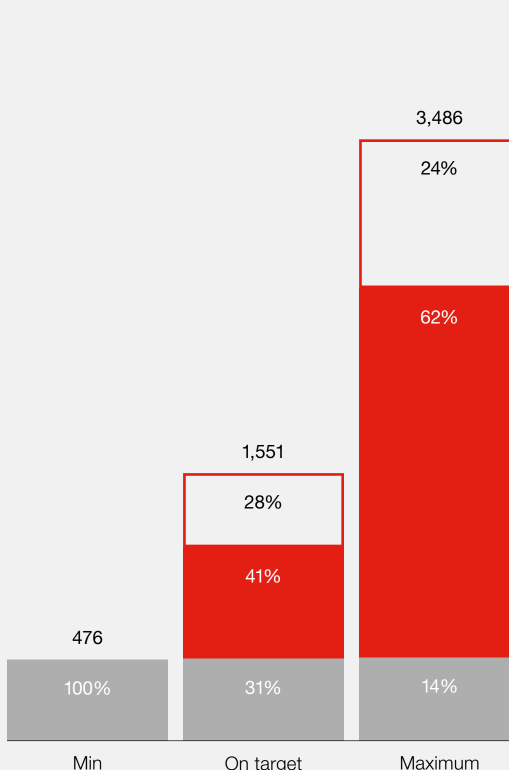
Illustration of application of the remuneration policy (£000s)

Long-term variable remuneration
Annual variable remuneration
Fixed remuneration

Chief Executive




Chief Underwriting Officer



The charts on page 61 have been compiled using the following assumptions.

**Fixed remuneration**

Fixed reward (i.e. base salary, benefits and retirement benefit).
- Salary with effect from 1 April 2015.
- Benefits as received during 2015, as disclosed in the Executive Director remuneration table on page 64.
- Retirement benefit as received during 2015, as disclosed in the Executive Director remuneration table on page 64.

**Variable remuneration**

Assumptions have been made in respect of the annual incentive and the PSP for the purpose of these illustrations.
- **Annual incentive**: the amounts shown in the scenarios are for illustration only. In practice the award would be determined based on a range of performance factors, and therefore vary depending on the circumstances. The maximum award reflects the incentive caps described at the beginning of this report.
- **PSP:** scenario analysis assumes awards are granted at the maximum level set out in the policy table on page 59. In practice, award levels are determined annually and are not necessarily granted at the plan maximum every year.

*Performance scenarios*

**Below target performance**
Fixed reward only

**On target performance**
Fixed reward *plus* variable pay for the purpose of illustration as follows.
- **Annual incentive:** assume a bonus equivalent to 150% of salary.
- **PSP:** assume vesting of 50% of the maximum award.

**Above target performance**
Fixed reward *plus* variable pay for the purpose of illustration as follows.
- **Annual incentive:** maximum bonus equivalent to 400% of salary for the CEO and 500% of salary for the CUO.
- **PSP:** assumes vesting of 100% of the maximum award.

## Recruitment policy

A new hire will ordinarily be remunerated in accordance with the policy described in the table on the previous pages. In order to define the remuneration for an incoming Executive Director, the Committee will take account of:

- prevailing competitive pay levels for the role;
- experience and skills of the candidate;
- awards (shares or earned bonuses) and other elements which will be forfeited by the candidate;
- transition implications on initial appointment.

The Committee will always aim to provide a remuneration package which is consistent with the overall Hiscox approach.

A 'buy-out' payment/award may be necessary in respect of arrangements forfeited on joining the Company. The size and structure of any such buy-out arrangement will take account of relevant factors in respect of the forfeited terms including potential value, time horizons and any performance conditions which apply. Where relevant, the Committee will review the likelihood of achievement of performance conditions based on the track record of payments and relevant performance of the candidate's current employer within the testing period. The objective of the Committee will be to suitably limit any buy-out to the commercial value forfeited by the individual.

On initial appointment (including interim Director appointments) the Committee recognises that there may be a need to offer more bespoke arrangements in order to facilitate recruitment. In such circumstances, the Committee may opt to vary the approach set out in the policy as it considers appropriate and necessary at the time. The exact structure of any such awards, including the mode of delivery (e.g. cash or shares), the timeframe for payment or vesting, and the detail of performance measures and targets (if any) would be tailored as appropriate but would remain consistent with the overall Hiscox approach to pay. In all circumstances, any movement from the ongoing policy would only be considered where there is a strong commercial rationale to do so and where the Committee felt this was in the best interests of the Company and shareholders. The Company would seek to clearly disclose and explain any such arrangements to shareholders as appropriate.

On the appointment of a new Chairman or Non Executive Director, the fees will normally be consistent with the policy. Fees to Non Executives will not include share options or other performance-related elements.

## Service contracts

It is the Company's policy that Executive Directors should have service contracts with an indefinite term which can be terminated by the Company by giving notice not exceeding 12 months or the Director by giving notice of six months.

Non Executive Directors are appointed for a three-year term, which is renewable, with three months' notice on either side, no contractual termination payments being due and subject to retirement pursuant to the Bye-laws at the Annual General Meeting. The contract for the Chairman is subject to a six-month notice provision on either side.

## Policy on payment for loss of office

Subject to the execution of an appropriate general release of claims an Executive Director may receive on termination of employment by the Company:

### *1. Notice period of 12 months*

Executive to remain on the payroll but may be placed on gardening leave for the duration of the notice period (or until they leave early by mutual agreement, whichever is sooner). During this period they will be paid as normal, therefore this will include base pay, pension contributions (or benefits allowance as appropriate) and other benefits (e.g. healthcare).

### *2. Bonus payment for the financial year of exit*

The Committee may pay a bonus calculated in line with the normal bonus scheme timings and performance metrics. The bonus amount would normally be pro-rated depending on the proportion of the financial year which has been completed by the time of the termination date.

### *3. Release of any deferred bonuses*

All outstanding bonuses deferred from the annual incentive scheme will normally be paid in full.

### *4. Unvested Performance Share Plan (PSP) awards*

Treatment would be in accordance with the plan rules and relevant grant documentation. The intended approach is summarised below:

- awards will vest in line with the normal scheme vesting date (unless the Committee determines otherwise). Awards vest to the extent that the relevant performance target is considered to have been met;
- the award will normally be pro-rated to reflect the period which has elapsed from the commencement of the award to the date of termination unless the Committee determines otherwise.

If the departing Executive Director does not sign a release of claims, they would normally be entitled to payments defined under point 1 only. In the event that the Executive is dismissed for gross misconduct, they would forfeit any payments under UK employment law. In the event of a voluntary resignation to join another company, no payments would normally be made other than remaining on the payroll, with associated benefits during the contractual notice period of six months.

## Consideration of shareholder views

Hiscox regularly discusses remuneration policy matters with a selection of shareholders.

The Remuneration Committee takes into consideration the range of views expressed in making its decisions.

# Annual report on remuneration 2015

This report explains how the remuneration policy was implemented for the financial year ending 31 December 2015 and how it will be applied for the 2016 financial year. KPMG has been engaged to audit the report to the extent that would be required by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2013, being the sections in the annual report on remuneration 2015 below entitled 'Executive Director remuneration', 'details of pension entitlements', 'Non Executive Director remuneration', 'payments for loss of office and payments to past Directors' and 'Directors' shareholding and share interest'.

## Executive Director remuneration

The table below sets out the remuneration received by current and past Executive Directors for the financial years ending 31 December 2015 and 31 December 2014.

| | Year | Salary[1] £ | Benefits[2] £ | Bonus[3] £ | Long-term incentives[4] £ | Retirement benefits £ | Total remuneration £ |
|---|---|---|---|---|---|---|---|
| BE Masojada<br>Chief Executive | **2015**<br>2014 | **572,500**<br>558,750 | **8,926**<br>8,237 | **900,000**<br>1,000,000 | **1,880,231**<br>1,512,756 | **52,043**<br>50,792 | **3,413,700**<br>3,130,535 |
| RC Watson<br>Chief Underwriting Officer | **2015**<br>2014 | **427,500**<br>415,000 | **7,362**<br>6,899 | **900,000**<br>800,000 | **1,343,024**<br>1,080,543 | **38,862**<br>37,729 | **2,716,748**<br>2,340,171 |
| SJ Bridges[5]<br>Former Chief Financial Officer | **2015**<br>2014 | **282,083**<br>415,000 | **4,692**<br>6,899 | **475,000**<br>750,000 | **–**<br>1,080,543 | **25,643**<br>37,729 | **787,418**<br>2,290,171 |

[1] Salaries are reviewed from 1 April, further detail on April 2015 increase can be found below.
[2] Benefits for Executive Directors include cover under the Company healthcare scheme, life insurance, income protection insurance and critical illness policies as well as gym membership and a Christmas gift hamper.
[3] A proportion of the bonus amount is deferred as set out on page 58 of the policy report.
[4] 2015 long-term incentives relate to performance share awards granted in 2013 where the performance period ends on 31 December 2015. The award is due to vest on 2 April 2016. The amount also includes dividend equivalents accrued on this award. For the purpose of this table the performance share award has been valued based on the average share price during the three-month period to 31 December 2015 of 990.92p. The 2014 long-term incentive award relates to performance share awards granted in 2012 where the performance period ends on 31 December 2014. The amount also includes dividend equivalents accrued on this award. For the purpose of this table the performance share award has been valued based on the share price on 19 March 2015 of 805.00p.
[5] SJ Bridges' appointment as an Executive Director ceased on 31 August 2015. The 2015 amounts shown above are pro-rated based on eight months' service.

## Additional notes to the Executive Director remuneration table

### *Salary*

The annual base salaries for current and past Executive Directors are as follows:

| | £ |
|---|---|
| BE Masojada | 575,000 |
| RC Watson | 430,000 |
| SJ Bridges (left 31 August 2015) | 425,000 |

Executive Director salaries increased by 2% as part of the annual April 2015 review. This was less than the overall UK-based employee salary increase of 3%. Salaries will next be reviewed as part of the annual April 2016 review and are expected to be in line with the overall UK-based employee salary increases.

## Bonus

Hiscox's approach to remuneration is underpinned by the belief that a reasonable portion of total remuneration should be attained through incentive awards, thereby linking rewards directly with performance.

In line with the remuneration policy, the Executive Directors, along with other employees across the Group, participated in the 2015 profit-related bonus pools. These pools were calculated at a business unit level and for the Group as a whole on the basis of a set percentage of profits on achievement of a return on allocated equity hurdle ('Hurdle Rate'). The Hurdle Rate is set annually by using an investment benchmark rate which takes account of one-to-three year gilt and treasury yields, cash returns and the general investment environment. The return on equity Hurdle Rate for the 2015 financial year was set at 7%, which was 5% above the investment benchmark rate.

Individual employee profit bonuses were determined based on the results of the relevant business area, individual performance and the size of the relevant bonus pool. The Remuneration Committee determined the profit bonuses to be paid to the Executive Directors based on judgement regarding the performance of the Group and an assessment of individual performance.

Junior and mid-level employees also participated in a Personal Performance Bonus Scheme. Awards under this scheme are 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. For the avoidance of doubt, Executive Directors did not participate in the Personal Performance Bonus Scheme.

In setting the 2015 bonus payments for the Executive Directors the Remuneration Committee took account of the following:

- the Hurdle Rate for the 2015 financial year was set at 7%. The 2015 pre-tax ROE was 16.5% which meant that the bonus hurdle had been met and a bonus pool was generated in respect of 2015;
- the achievement of satisfactory individual performance which meant that the Executive Directors could participate fully in the bonus pool;
- the size of the overall bonus pool (which is calculated based on profit, as described in the remuneration policy) and the number and level of employees eligible for a bonus in the year. The Hiscox remuneration philosophy is that junior bonuses are more formulaic, whereas bonuses for senior participants may vary significantly depending on the size of the overall pool. As ROE and profit achievement drive the size of the overall bonus pool, they are key determinants in bonus levels for Executive Directors;
- ROE and profit results from prior years are used as a check that bonuses are appropriate. The 2015 bonus for Bronek Masojada reduced by 10% compared with a year-on-year profit decline of 6.5%. Richard Watson's bonus took account of the strong underwriting performance across the Group and his broadening contribution now that he has been in his role for three years. The table below shows the ROE performance compared with aggregate Executive Director bonus payments over the past ten years. This table is included to demonstrate to shareholders that appropriate bonus decisions are being made reflecting the varying shareholder outcomes. As can be seen from the table, the bonuses vary significantly with performance from year to year.

### Executive Directors' cash incentives and ROE

| | Pre-tax return on equity % | Average bonus as a percentage of salary % |
|---|---|---|
| 2006 | 35 | 274 |
| 2007 | 36 | 372 |
| 2008 | 14 | 53 |
| 2009 | 34 | 287 |
| 2010 | 19 | 108 |
| 2011 | 1 | 0 |
| 2012 | 18 | 183 |
| 2013 | 20 | 209 |
| 2014 | 18 | 181 |
| 2015 | 17 | 176* |

*SJ Bridges' bonus and salary have been annualised.

In line with the remuneration policy, 50% of the 2015 bonus will be deferred over a period of two years. Receipt of these deferred amounts is normally subject to continued service.

## Bonus awards for the 2016 financial year

The bonus return on equity Hurdle Rate has been reviewed as described above and will remain unchanged for the 2016 financial year at 7%.

## Long-term incentives

### *Performance Share Plan (PSP) awards where the performance period ends with the 2015 financial year*

Executive Directors were granted awards under the PSP in 2013 for the three-year performance period 1 January 2013 to 31 December 2015. The performance conditions for this award were set at the start of the performance period and are as follows:

| | Required average post-tax ROE over the three-year performance period % | Proportion of PSP vesting % |
|---|---|---|
| Minimum threshold vesting | 7 | 25 |
| Maximum vesting | 14.5 | 100 |
| Straight-line vesting between these points | | |

Based on the three-year average return on equity of 17.5%, the awards ending with the 2015 performance year will vest at 100% on 2 April 2016. Executive Directors will also receive dividend equivalents in the form of additional awards based on dividends paid during the three-year performance period. The estimated value of these awards is covered in the Executive Director remuneration table on page 64.

### *PSP awards granted during the 2015 financial year*

On 13 April 2015 the Executive Directors were granted awards under the PSP as follows:

| | Number of awards granted | Market price at date of grant £ | Market value at date of grant £ |
|---|---|---|---|
| BE Masojada | 130,000 | 8.85 | 1,150,500 |
| RC Watson | 97,200 | 8.85 | 860,220 |

The performance conditions for this award are as follows:

| | Required average post-tax ROE over the three-year performance period % | Proportion of PSP vesting % |
|---|---|---|
| Minimum threshold vesting | 7 | 25 |
| Maximum vesting | 14.5 | 100 |
| Straight-line vesting between these points | | |

As noted in last year's remuneration report, Executive Directors will be required to retain any shares vesting (net of tax charges) at the end of the performance periods for a further two years (i.e. five years post the start of the performance period).

## PSP awards to be granted during 2016

In the coming year, the Committee intends to grant awards to Executive Directors and the performance conditions and targets will be unchanged from the 2015 awards.

## Details of pension entitlements

All open Hiscox retirement schemes are based on defined contributions.

BE Masojada, RC Watson and SJ Bridges hold lifetime allowance protection certificates and have therefore opted out of the Company pension scheme. They receive a 10% cash allowance (less an offset for the employer's UK National Insurance liability) in lieu of the standard employer pension contribution. The value of this benefit is shown in the Executive Director remuneration table on page 64.

The table below details the legacy entitlements from the defined benefit pension plan. There are no further accruals under this plan.

### Pensions

| | Normal retirement age | Increase in accrued pension during the year £000 | Transfer accrued annual pension at 31 Dec 15 £000 | Transfer value of increase in accrued pension £000 | Transfer value of accrued pension at 31 Dec 14 £000 | Transfer value of accrued pension at 31 Dec 15 £000 | Increase/ (decrease) in transfer value of accrued benefit during the year £000 |
|---|---|---|---|---|---|---|---|
| BE Masojada | 60 | 2 | 50 | – | 1,563 | 1,612 | 49 |
| RC Watson | 60 | 6 | 153 | – | 4,757 | 4,905 | 148 |
| SJ Bridges[1] | 60 | 1 | 37 | – | 976 | 995 | 19 |

[1]SJ Bridges ceased to be an Executive Director with effect from 31/8/2015.
The change in value over the period 01/01/2015 to 31/12/2015 is for information purposes only.

## Non Executive Director remuneration

The table below sets out the remuneration received by the Non Executive Directors for the financial years ending 31 December 2015 and 31 December 2014.

| | 2015 | | | | | 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Ltd Board fee £ | Ltd Committee fees £ | Subsidiary Board fees £ | Benefits £ | Total Hiscox fees £ | Ltd Board fee £ | Ltd Committee fees £ | Subsidiary Board fees £ | Benefits £ | Total Hiscox fees £ |
| RS Childs | 140,000 | – | 140,000 | 6,524 | 286,524 | 137,500 | – | 137,500 | 2,730 | 277,730 |
| L Carter[1] | 33,791 | 13,677 | – | – | 47,468 | – | – | – | – | – |
| RD Gillingwater[1] | 25,057 | 10,504 | – | – | 35,561 | 50,364 | 32,834 | – | – | 83,198 |
| C Foulger | 54,938 | 26,815 | 65,706 | – | 147,459 | 50,364 | 21,276 | 54,476 | – | 126,116 |
| DM Healy[1] | 46,521 | 24,277 | – | – | 70,798 | 50,364 | 25,485 | – | – | 75,849 |
| ER Jansen | 54,938 | 24,248 | – | – | 79,186 | 50,364 | 19,417 | – | – | 69,781 |
| Dr J King[1] | 21,260 | 9,871 | 17,577 | – | 48,708 | 50,364 | 22,451 | 38,228 | – | 111,043 |
| A MacDonald[1] | 33,791 | 13,677 | – | – | 47,468 | – | – | – | – | – |
| R McMillan | 54,938 | 22,237 | 52,322 | – | 129,497 | 50,364 | 19,417 | 47,330 | – | 117,111 |
| AS Rosen[1] | 42,709 | 17,287 | – | – | 59,996 | 50,364 | 22,660 | – | – | 73,024 |
| G Stokholm | 54,938 | 23,849 | 64,967 | – | 143,754 | 50,364 | 20,014 | 56,447 | – | 126,825 |
| C Keogh[1] | 7,628 | 3,198 | – | – | 10,826 | – | – | – | – | – |

2015 fees that are paid in US Dollars have been converted to Great British Pounds using an exchange rate of 1.529.
2014 fees that are paid in US Dollars have been converted to Great British Pounds using an exchange rate of 1.648.
[1]The 2015 amounts are pro-rated in relation to remuneration paid for service in these roles.

Non Executive Director fees were reviewed in January 2015. RS Childs' fee increased by 1.8% and the other Non Executive Director fees increased by an average of 2.3% due to an increase in the Ltd Board and Ltd Remuneration Committee membership fee.

# Annual report on remuneration 2015 continued

## Payments for loss of office and payments to past Directors

SJ Bridges stepped down as Chief Financial Officer and an Executive Director of Hiscox Ltd with effect from 31 August 2015. Upon leaving employment his salary and benefits ceased immediately. In recognition of his 18 years' tenure and contribution to the strong performance of the Company, the Remuneration Committee agreed to release outstanding deferred bonuses earned and disclosed in previous years of £587,500. His bonus for the 2015 financial year was pro-rated to 31 August 2015 and will be paid after the conclusion of the financial year, based on financial results. All unvested PSP share awards (235,000) lapsed on termination of employment. His outstanding options under the HMRC-approved all-employee Sharesave Scheme have been dealt with in accordance with the rules of the scheme.

## Directors' shareholding and share interests

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, the Director will be expected to own Hiscox shares valued at 150% of salary. The holdings of our Executive Directors far exceed the shareholding guidelines.

Directors

| | 31 December 2015 6.5p* ordinary shares number of shares beneficial | 31 December 2014 6p* ordinary shares number of shares beneficial |
|---|---|---|
| **Executive Directors** | | |
| BE Masojada | 3,006,378 | 3,477,214 |
| RC Watson | 751,397 | 921,888 |
| **Non Executive Directors** | | |
| L Carter | – | N/A |
| RS Childs | 1,511,866 | 1,718,031 |
| C Foulger | 7,832 | 8,900 |
| ER Jansen | 79,457 | 79,678 |
| C Keogh | 5,528 | N/A |
| A MacDonald | 4,953 | N/A |
| R McMillan | – | – |
| G Stokholm | – | – |

*Following the share capital consolidation on 26 March 2015, the nominal value of the ordinary shares changed from 6p to 6.5p.

### Performance Share Plan

The interests of Directors under the Performance Share Plan are set out below:

| | Number of awards at 1 January 2015 | Number of awards granted | Number of awards adjusted | Number of awards lapsed | Number of awards exercised | **Number of awards at 31 December 2015** | Market price at date of exercise £ | Date from which released |
|---|---|---|---|---|---|---|---|---|
| BE Masojada | 101,715 | – | – | – | (101,715) | **–** | 8.377 | 07-Apr-14 |
| | 175,000 | 12,920 | – | – | (187,920) | **–** | 8.313-8.376 | 19-Mar-15 |
| | 175,000 | – | – | – | – | **175,000** | – | 02-Apr-16 |
| | 156,000 | – | – | – | – | **156,000** | – | 17-Mar-17 |
| | – | 130,000 | – | – | – | **130,000** | – | 13-Apr-18 |
| RC Watson | 125,000 | 9,229 | – | – | (134,229) | **–** | 8.107 | 19-Mar-15 |
| | 125,000 | – | – | – | – | **125,000** | – | 02-Apr-16 |
| | 110,000 | – | – | – | – | **110,000** | – | 17-Mar-17 |
| | – | 97,200 | – | – | – | **97,200** | – | 13-Apr-18 |
| RS Childs | 72,653 | | – | – | (72,653) | **–** | 9.277 | 07-Apr-14 |
| | 125,000 | 9,229 | – | – | (134,229) | **–** | 9.277 | 19-Mar-15 |
| SJ Bridges | 121,934 | – | – | – | (121,934) | **–** | 8.565-8.787 | 07-Apr-11 |
| | 188,709 | – | – | – | (188,709) | **–** | 8.565 | 02-Apr-12 |
| | 65,040 | – | – | – | (65,040) | **–** | 8.565 | 07-Apr-13 |
| | 72,653 | – | – | – | (72,653) | **–** | 8.565 | 07-Apr-14 |
| | 125,000 | 9,229 | – | – | (134,229) | **–** | 8.565 | 19-Mar-15 |
| | 125,000 | – | – | (125,000) | – | **–** | – | 02-Apr-16 |
| | 110,000 | – | – | (110,000) | – | **–** | – | 17-Mar-17 |
| Total | 1,973,704 | 267,807 | – | (235,000) | (1,213,311) | **793,200** | | |

### Share options

The interests of Executive Directors under the Sharesave Schemes are set out below:

| | Number of options at 1 January 2015 | Number of options granted | Number of options lapsed | Number of options exercised | **Number of options at 31 December 2015** | Exercise price £ | Market price at date of exercise £ | Date from which exercisable | Expiry date |
|---|---|---|---|---|---|---|---|---|---|
| BE Masojada | 1,744 | – | – | – | **1,744** | 5.160 | – | 01-Dec-16 | 31-May-17 |
| | 1,649 | – | – | – | **1,649** | 5.456 | – | 01-Jun-17 | 30-Nov-17 |
| RC Watson | 3,299 | – | – | – | **3,299** | 5.456 | – | 01-Jun-17 | 30-Nov-17 |
| SJ Bridges | 2,017 | – | (2,017) | – | **–** | 4.460 | – | 01-May-16 | 31-Oct-16 |
| | 1,649 | – | (1,649) | – | **–** | 5.456 | – | 01-Jun-17 | 30-Nov-17 |
| Total | 10,358 | – | (3,666) | – | **6,692** | | | | |

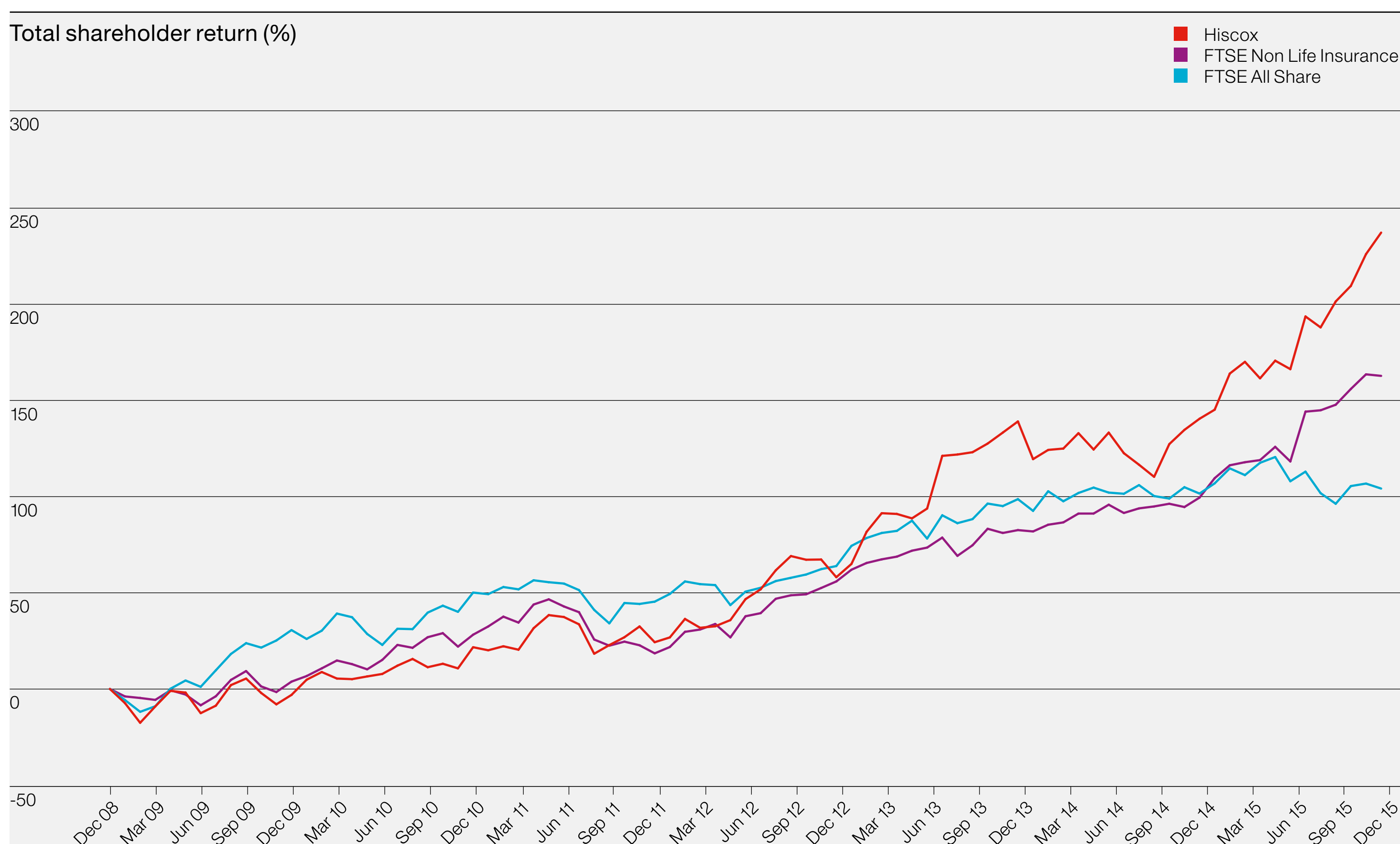
# Annual report on remuneration 2015 continued

## 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 held directorships on the Board of the Association of British Insurers, Bajka Investments (Pty) Ltd and Heptagon Assets Ltd. He was appointed a Director of Pool Reinsurance Company Limited on 21 May 2015. He was not remunerated for his services. Prior to stepping down from the Board, SJ Bridges held directorships on the Board of Caledonia Investments plc and did not retain a fee for his services. RC Watson held a directorship at White Oak Underwriting Agency Limited and was a Board Member of Lloyd's Members Association. He was not remunerated for his services.

## Performance graph and table

The graph below shows the total shareholder return of the Group against the FTSE All Share and FTSE Non Life Insurance indices. These reference points have been shown to assess performance against reference points from the general market and industry peers.



## Table of historic data

The table below shows the single total remuneration figure for the Chief Executive for the past seven years.

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | **2015** |
|---|---|---|---|---|---|---|---|
| CEO single figure of remuneration (£) | 2,536,943 | 1,759,123 | 1,509,248 | 1,938,759 | 2,341,737 | 3,130,535 | **3,413,700** |
| Annual bonus as % of salary[1] | 286 | 114 | – | 186 | 204 | 177 | **157** |
| PSP vesting as % of maximum opportunity | 100 | 100 | 85 | 39 | 53 | 100 | **100** |

[1]Prior to 2015, the annual bonus plan was operated on an uncapped basis. Subsequently, the outcomes for prior years and for 2015 are shown as a percentage of salary, in order to facilitate comparison. For 2015, the bonus for the CEO was capped at 400% of salary, and therefore the outcome for the year represented 39% of the maximum opportunity.

## Percentage change in remuneration of Director undertaking the role of Chief Executive

The table below shows the percentage change in base salary, benefits and annual bonus of the Chief Executive between the 2014 and 2015 financial years. We have chosen UK-based employees as the comparator group for base salary and benefits as this is where the Chief Executive is based and this allows for the closest comparison in terms of salary increases which take into account country inflation and the benefits package provided. For bonus we have used Group-wide employees as the comparator. The change is based on employees who were employed and eligible for a salary review and bonus in both financial years.

| | % Change 2014 to 2015 | |
|---|---|---|
| | CEO | Employee |
| Base salary | 2 | 3 |
| Benefits (including retirement benefits) | 3 | 6 |
| Bonus | (10) | (2) |

## Relative importance of the spend on pay

The chart below shows the relative movement in profit, shareholder returns and employee remuneration for the 2015 and prior financial year. Shareholder return for the year incorporates the distribution made on behalf of that year. Employee remuneration includes salary, benefits, bonus, long-term incentives and retirement benefits.

# Annual report on remuneration 2015
continued

## Membership of the Remuneration Committee

The Committee members at 31 December 2015 were C Foulger, ER Jansen, R McMillan, G Stokholm, LA Carter (20 May), A MacDonald (20 May), C Keogh – Chairman (19 November). R Gillingwater stepped down on 20 May along with Dr J King. DM Healy and AS Rosen left on 11 October.

No Director or Committee member was involved in determining their own remuneration during the year.

## External advisors

The Committee received independent advice from Deloitte, an independent firm of remuneration consultants appointed by the Committee. Deloitte is a founder member of the Remuneration Consultants Group and, as such, voluntarily operates under its code of conduct in relation to executive remuneration consulting in the UK. During the year, Deloitte's executive compensation advisory practice advised the Committee on developments in market practice, corporate governance and institutional investor views and on the development of the Company's incentive arrangements. Total fees for advice provided to the Committee during the year were £28,500. The Committee is satisfied that the advice they have received has been objective and independent. During the year Deloitte also provided other HR consulting services.

## Statement of shareholder voting

At the last AGM, the Directors' annual report on remuneration received the following votes from shareholders:

| | Annual report on remuneration |
|---|---|
| For | 211,895,120 |
| % | 99.25 |
| Against | 1,599,015 |
| % | 0.75 |
| Withheld | 1,620,487 |
| Total votes cast | 213,494,135 |

# Directors' report

**The Directors have pleasure in submitting their Annual Report and consolidated financial statements for the year ended 31 December 2015.**

## Management report

The Company is a holding company for subsidiaries involved in the business of insurance and reinsurance in Bermuda, the US, the UK, Guernsey, Europe and Asia. The information that fulfils the requirements of the management report as referred to in Disclosure and Transparency Rule 4, including additional explanation of amounts included in the financial statements and the branches of the Group in different countries, can be found on pages 8 to 15, 27 to 34 and 83 to 131. The key performance indicators are shown on page 2. Details of the use of financial instruments are set out in note 21 to the consolidated financial statements. An analysis of the development and performance of the business during the financial year, its position at the end of the year, any important events since the end of the year and the likely future development can be found within the Chief Executive's report on pages 8 to 15. The Chief Executive's report also describes the main trends and factors likely to affect the future development, performance and position of the Company's business and includes a description of the Company's strategy and business model. The Company's strategy is also described on page 1. A description of the principal risks and uncertainties and how they are managed or mitigated can be found in the risk management section on pages 27 to 34. In addition, note 3 to the consolidated financial statements provides a detailed explanation of the principal risks which are inherent to the Group's business and how those risks are managed. The confirmation required by C.2.1 of the UK Corporate Governance Code can be found on page 50.

## Corporate responsibility

Information on environmental, employee and community issues including details of the Company's policies are set out in the corporate responsibility statement on pages 35 to 38. This also includes disclosure of greenhouse gas emissions.

## Corporate governance statement

The information that fulfils the requirements of the corporate governance statement as referred to in Disclosure and Transparency Rule 7.2 can be found on pages 46 to 50 and in this report.

## Diversity

The composition of the Board and the Senior Executive structure are described on pages 42 and 43 and page 17 respectively. The role of a Hiscox Partner is described on page 44. The percentage of persons of each gender who were (i) Hiscox Partners and (ii) employees of the Hiscox Group, excluding the Board, is set out in the following table.

| | Male % | Female % |
|---|---|---|
| Hiscox Partners | 79.7 | 20.3 |
| Employees | 52.5 | 47.5 |

## Financial results

The Group achieved a pre-tax profit for the year of £216.1 million (2014: £231.1 million). Detailed results for the year are shown in the consolidated income statement on page 79, and also within the Group financial performance section on pages 22 and 23.

## Going concern

A review of the financial performance of the Group is set out on pages 22 and 23. 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, a period of at least 12 months from the date of this report. For this reason they continue to adopt the going concern basis in preparing the consolidated financial statements.

## Viability

The statement required to be included in the Annual Report under C.2.2 of the UK Corporate Governance Code can be found on page 50.

## Dividends

An interim dividend of 8.0p (net) per ordinary 6.5p share (2014: 7.5p (net), per ordinary 6p share) was paid on 16 September 2015 in respect of the year ended 31 December 2015. The Company has declared a second interim dividend of 32.0p which will be paid on 7 April 2016 to shareholders on the register at 11 March 2016. This includes a special dividend of 16p per share as well as an amount in place of a final dividend of 16p (2015: 15p). As the dividend includes a special distribution the Directors have decided not to offer a scrip alternative.

# Directors' report
continued

## Bye-laws
The Company's Bye-laws contain no specific provisions relating to their amendment and any such amendments are governed by Bermuda Company Law and subject to the approval of shareholders in a general meeting. A copy of the Company's Bye-laws is available for inspection at the Company's registered office.

## 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. The ordinary shares of 6.5p each are the only class of shares presently in issue and carry voting rights. There is power under Bye-law 45 of the Company's Bye-laws for voting rights to be suspended if calls on shares are unpaid. However, there are no nil or partly paid shares in issue on which calls could be made. The Bye-laws also allow the Company to investigate interests in its shares and apply restrictions including suspending voting rights where information is not provided. No such restrictions are presently in place. The Company was authorised by shareholders at the 2015 Annual General Meeting to purchase in the market up to 10% of the Company's issued ordinary shares. No shares have been bought back under this authority as at the date of this report.

## Directors
The following individuals were Directors at the start of the year and served until the dates shown against their names: Stuart Bridges (31 August 2015); Richard Gillingwater (20 May 2015); Daniel Healy (11 October 2015); Dr James King (20 May 2015); and Andrea Rosen (11 October 2015). The names and details of the other individuals who served as Directors of the Company during the year and up to the date of this report are set out on pages 42 to 43. Details of the Chairman's professional commitments are included in his biography on page 42 and there were no changes during the year. The Bye-laws of the Company govern the appointment and replacement of Directors. Mr Colin Keogh who was appointed by the Board as Senior Independent Director on 19 November 2015 will submit himself for appointment by shareholders at the Annual General Meeting. In accordance with the UK Corporate Governance Code, all other Directors will submit themselves for re-appointment at the Annual General Meeting.

Biographical details of the Directors and the reasons why the Board believe they should be appointed or re-appointed will be set out in the circular which will accompany the notice of Annual General Meeting.

## Political and charitable contributions
The Group made no political contributions during the year (2014: £nil). Information concerning the Group's charitable activities is contained in the report on corporate responsibility on page 37.

## Major interests in shares
As at the year end, the Company had been notified of the following interests of 5% or more of voting rights in its ordinary shares:

| | Number† of shares | % of issued share capital as at 31 December* 2015 |
|---|---|---|
| Invesco Limited[1] | 37,662,240 | 13.23 |
| Massachusetts Financial Services Company[1] | 27,742,612 | 9.75 |

*Per RNS announcement there were 284,677,469 shares in issue (excluding Treasury shares) as at 31 December 2015.
†Adjusted for consolidation on 26 March 2015.
[1]Indirect holdings.

Any acquisitions or disposals of major shareholdings notified to the Company in accordance with Disclosure and Transparency Rule 5.1 are announced and those announcements are available on the Company's website, www.hiscoxgroup.com.

## Power of Directors
The powers given to the Directors are contained in the Company's Bye-laws and are subject to relevant legislation and, in certain circumstances (including in relation to the issuing and buying back by the Company of its shares), approval by shareholders in a general meeting. At the Annual General Meeting in 2015 the Directors were granted authorities to allot and issue shares and to make market purchases of shares and intend to seek renewal of these authorities in 2016.

## Disclosure under LR 9.8.4
The information that fulfils the reporting requirements relating to the following matters can be found at the pages identified below.

| | |
|---|---|
| Details of long-term incentive schemes | Annual report on remuneration (page 58) |
| Allotment of shares for cash pursuant to employee share schemes | Note 24 to the consolidated financial statements on employee share schemes (page 117) |

# Directors' report
continued

## Annual General Meeting

The notice of the Annual General Meeting, to be held on 19 May 2016, will be contained in a separate circular to be sent to shareholders. The deadline for submission of proxies is 48 hours before the meeting.

By order of the Board
Jeremy Pinchin, Secretary,
Wessex House, 45 Reid Street
Hamilton HM 12, Bermuda
29 February 2016

# 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 and the Chief Executive. The statements were approved for issue on 29 February 2016.

The Directors consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's and the Group's position and performance, business model and strategy.

# Financial summary

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# Independent auditor's report to the Board of Directors and the shareholders of Hiscox Ltd

## Report on the consolidated financial statements and annual report on remuneration 2015

We have audited the accompanying consolidated financial statements of Hiscox Ltd ('the Company') on pages 79 to 131 which comprise the consolidated balance sheet as at 31 December 2015, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows 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 annual report on remuneration 2015 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 Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410) made under the United Kingdom's Companies Act 2006.

## Management's responsibility

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 and the annual report on remuneration 2015 that are free from material misstatement whether due to fraud or error.

## Auditor's 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 annual report on remuneration 2015 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 annual report on remuneration 2015 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 annual report on remuneration 2015 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 annual report on remuneration 2015 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 annual report on remuneration 2015 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 annual report on remuneration 2015 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 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 2015, 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 annual report on remuneration 2015 which we were engaged to audit has been properly prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410) made under the United Kingdom's Companies Act 2006 as if those requirements were to apply to the Company.

## Report on other legal and regulatory requirements

Under the United Kingdom's Listing Rules we are required to review the part of the corporate governance statement on pages 46 to 50 relating to the Company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code. We have nothing to report in respect to this responsibility.

## Report on other matters

In addition to our audit of the consolidated financial statements and part of the annual report on remuneration 2015, the Directors have engaged us to review their going concern and longer-term viability statement on pages 50 and 73 that has been prepared by the Directors to comply with the Company's requirements under the Listing Rules of the United Kingdom's Financial Conduct Authority. We have nothing to report in respect to this responsibility.

**KPMG Audit Limited**
**Hamilton, Bermuda**
29 February 2016

# Consolidated income statement
# For the year ended 31 December 2015

| | Note | 2015 Total £000 | 2014 Total £000 |
|---|---|---|---|
| **Income** | | | |
| Gross premiums written | 4 | **1,944,220** | 1,756,260 |
| Outward reinsurance premiums | | **(372,376)** | (412,850) |
| Net premiums written | 4 | **1,571,844** | 1,343,410 |
| Gross premiums earned | | **1,828,334** | 1,674,982 |
| Premiums ceded to reinsurers | | **(393,318)** | (358,723) |
| Net premiums earned | 4 | **1,435,016** | 1,316,259 |
| Investment result | 7 | **35,381** | 56,212 |
| Other revenues | 9 | **17,156** | 19,956 |
| Revenue | | **1,487,553** | 1,392,427 |
| **Expenses** | | | |
| Claims and claim adjustment expenses | 26.2 | **(685,897)** | (645,145) |
| Reinsurance recoveries | 26.2 | **113,444** | 113,477 |
| Claims and claim adjustment expenses, net of reinsurance | 26.2 | **(572,453)** | (531,668) |
| Expenses for the acquisition of insurance contracts | 17 | **(344,283)** | (318,616) |
| Operational expenses | 9 | **(361,215)** | (310,853) |
| Net foreign exchange gains | 12 | **15,153** | 4,974 |
| Total expenses | | **(1,262,798)** | (1,156,163) |
| Results of operating activities | | **224,755** | 236,264 |
| Finance costs | 10 | **(9,662)** | (6,418) |
| Share of profit from associates after tax | 16 | **1,007** | 1,229 |
| **Profit before tax** | | **216,100** | 231,075 |
| Tax expense | 28 | **(6,205)** | (14,923) |
| **Profit for the year (all attributable to owners of the Company)** | | **209,895** | 216,152 |
| Earnings per share on profit attributable to owners of the Company | | | |
| Basic | 31 | **72.8p** | 67.4p |
| Diluted | 31 | **70.5p** | 64.5p |

# Consolidated statement of comprehensive income
# For the year ended 31 December 2015

| | 2015 Total £000 | 2014 Total £000 |
|---|---|---|
| Profit for the year | **209,895** | 216,152 |
| **Other comprehensive income** | | |
| Items never reclassified to profit or loss: | | |
| Remeasurements of the net defined benefit obligation | **28,236** | (22,759) |
| Income tax relating to components of other comprehensive income | **(6,762)** | 5,470 |
| | **21,474** | (17,289) |
| Items that may be reclassified subsequently to profit or loss: | | |
| Exchange differences on translating foreign operations | **34,478** | 34,019 |
| Income tax relating to components of other comprehensive income | **–** | – |
| | **34,478** | 34,019 |
| **Other comprehensive income net of tax** | **55,952** | 16,730 |
| **Total comprehensive income for the year (all attributable to owners of the Company)** | **265,847** | 232,882 |

The notes on pages 83 to 131 are an integral part of these consolidated financial statements.

# Consolidated balance sheet
# At 31 December 2015

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| **Assets** | | | |
| Intangible assets | 14 | 126,222 | 105,946 |
| Property, plant and equipment | 15 | 46,509 | 29,497 |
| Investments in associates | 16 | 13,525 | 10,670 |
| Deferred tax | 29 | 35,147 | 33,490 |
| Deferred acquisition costs | 17 | 271,517 | 230,373 |
| Financial assets carried at fair value | 19 | 2,921,585 | 2,828,847 |
| Reinsurance assets | 18, 26 | 538,810 | 525,345 |
| Loans and receivables including insurance receivables | 20 | 619,563 | 556,259 |
| Current tax asset | | 3,243 | 8,031 |
| Cash and cash equivalents | 23 | 727,880 | 650,651 |
| Total assets | | 5,304,001 | 4,979,109 |
| **Equity and liabilities** | | | |
| Shareholders' equity | | | |
| Share capital | 24 | 19,030 | 19,913 |
| Share premium | 24 | 15,231 | 10,417 |
| Contributed surplus | 24 | 89,864 | 89,864 |
| Currency translation reserve | 25 | 91,178 | 56,700 |
| Retained earnings | 25 | 1,312,660 | 1,276,446 |
| Equity attributable to owners of the Company | | 1,527,963 | 1,453,340 |
| Non-controlling interest | | 866 | 866 |
| Total equity | | 1,528,829 | 1,454,206 |
| Employee retirement benefit obligations | 30 | 75 | 32,166 |
| Deferred tax | 29 | 29,814 | 26,390 |
| Insurance liabilities | 26 | 3,048,362 | 2,835,199 |
| Financial liabilities | 19 | 275,679 | 7,109 |
| Current tax | | 4,884 | 32,379 |
| Trade and other payables | 27 | 416,358 | 591,660 |
| Total liabilities | | 3,775,172 | 3,524,903 |
| Total equity and liabilities | | 5,304,001 | 4,979,109 |

The notes on pages 83 to 131 are an integral part of these consolidated financial statements.

The consolidated financial statements were approved by the Board of Directors on 29 February 2016 and signed on its behalf by:

RS Childs
Chairman

BE Masojada
Chief Executive Officer

# Consolidated statement of changes in equity

| | Note | Share capital £000 | Share premium £000 | Contributed surplus £000 | Currency translation reserve £000 | Retained earnings £000 | Equity attributable to owners of the Company £000 | Non-controlling interest £000 | Total equity £000 |
|---|---|---|---|---|---|---|---|---|---|
| Balance at 1 January 2014 | | 20,854 | 4,953 | 89,864 | 22,681 | 1,271,109 | 1,409,461 | – | 1,409,461 |
| Profit for the year (all attributable to owners of the Company) | | – | – | – | – | 216,152 | 216,152 | – | 216,152 |
| Other comprehensive income/(expense) net of tax (all attributable to owners of the Company) | | – | – | – | 34,019 | (17,289) | 16,730 | – | 16,730 |
| Employee share options: | | | | | | | | | |
| Equity settled share-based payments | | – | – | – | – | 14,439 | 14,439 | – | 14,439 |
| Proceeds from shares issued | 24 | 74 | 2,669 | – | – | – | 2,743 | – | 2,743 |
| Deferred and current tax on employee share options | 29 | – | – | – | – | 1,874 | 1,874 | – | 1,874 |
| C/D Share Scheme: | | | | | | | | | |
| Return of capital, special distribution | | – | (35) | – | – | (126,049) | (126,084) | – | (126,084) |
| Final dividend equivalent | 32 | – | – | – | – | (49,728) | (49,728) | – | (49,728) |
| Share consolidation and sub-division | | (1,032) | 1,032 | – | – | – | – | – | – |
| Shares purchased by Trust | 24 | – | – | – | – | (10,593) | (10,593) | – | (10,593) |
| Acquisition of DirectAsia | | – | – | – | – | – | – | 866 | 866 |
| Shares issued in relation to Scrip Dividend | 24, 32 | 17 | 1,798 | – | – | – | 1,815 | – | 1,815 |
| Dividends paid to owners of the Company | 32 | – | – | – | – | (23,469) | (23,469) | – | (23,469) |
| Balance at 31 December 2014 | | 19,913 | 10,417 | 89,864 | 56,700 | 1,276,446 | 1,453,340 | 866 | 1,454,206 |
| Profit for the year (all attributable to owners of the Company) | | – | – | – | – | 209,895 | 209,895 | – | 209,895 |
| Other comprehensive income net of tax (all attributable to owners of the Company) | | – | – | – | 34,478 | 21,474 | 55,952 | – | 55,952 |
| Employee share options: | | | | | | | | | |
| Equity settled share-based payments | | – | – | – | – | 17,726 | 17,726 | – | 17,726 |
| Proceeds from shares issued | 24 | 29 | 1,400 | – | – | – | 1,429 | – | 1,429 |
| Deferred and current tax on employee share options | 29 | – | – | – | – | 5,761 | 5,761 | – | 5,761 |
| E/F Share Scheme: | | | | | | | | | |
| Return of capital, special distribution | 32 | – | (32) | – | – | (141,422) | (141,454) | – | (141,454) |
| Final dividend equivalent | 32 | – | – | – | – | (48,105) | (48,105) | – | (48,105) |
| Share consolidation and sub-division | | (930) | 930 | – | – | – | – | – | – |
| Shares purchased by Trust | | – | – | – | – | (6,712) | (6,712) | – | (6,712) |
| Shares issued in relation to Scrip Dividend | 24, 32 | 18 | 2,516 | – | – | – | 2,534 | – | 2,534 |
| Dividends paid to owners of the Company | 32 | – | – | – | – | (22,403) | (22,403) | – | (22,403) |
| Balance at 31 December 2015 | | 19,030 | 15,231 | 89,864 | 91,178 | 1,312,660 | 1,527,963 | 866 | 1,528,829 |

The notes on pages 83 to 131 are an integral part of these consolidated financial statements.

# Consolidated statement of cash flows
# For the year ended 31 December 2015

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Profit before tax | | 216,100 | 231,075 |
| Adjustments for: | | | |
| Interest and equity dividend income | | (40,951) | (45,146) |
| Interest expense | | 9,662 | 6,418 |
| Net fair value losses/(gains) on financial assets | | 8,538 | (12,121) |
| Depreciation, amortisation and impairment | 14, 15 | 22,734 | 12,857 |
| Charges in respect of share-based payments | 9, 24 | 17,726 | 14,439 |
| Other non-cash movements | | (782) | (497) |
| Effect of exchange rate fluctuations on cash presented separately | | (971) | 6,740 |
| Changes in operational assets and liabilities: | | | |
| Insurance and reinsurance contracts | | 47,125 | 174,158 |
| Financial assets carried at fair value | | (43,374) | (171,076) |
| Financial liabilities carried at fair value | | (7,093) | 6,880 |
| Other assets and liabilities | | 56,877 | (27,943) |
| Cash paid to the defined benefit pension scheme | | – | (200) |
| Interest received | | 40,768 | 43,292 |
| Equity dividends received | | 1,027 | 1,702 |
| Interest paid | | (8,453) | (5,990) |
| Current tax paid | | (27,757) | (62,563) |
| Cash derecognised on derecognition of Kiskadee Funds | | (342,655) | – |
| Cash flows from subscriptions received in advance | | 123,000 | 169,928 |
| **Net cash flows from operating activities** | | 71,521 | 341,953 |
| Cash flows from the sale and purchase of subsidiaries | 33 | (7,375) | (2,627) |
| Cash flows from the sale and purchase of associates | 16 | (2,089) | (1,687) |
| Cash flows from the purchase of property, plant and equipment | | (19,272) | (11,727) |
| Cash flows from the purchase of intangible assets | | (30,952) | (27,580) |
| **Net cash flows from investing activities** | | (59,688) | (43,621) |
| Proceeds from the issue of ordinary shares | 24 | 1,429 | 2,743 |
| Shares repurchased | 24 | (6,712) | (10,593) |
| Proceeds from long-term debt issue, net of fees | | 273,909 | – |
| Distributions made to owners of the Company | 24, 32 | (209,428) | (197,466) |
| **Net cash flows from financing activities** | | 59,198 | (205,316) |
| **Net increase in cash and cash equivalents** | | 71,031 | 93,016 |
| Cash and cash equivalents at 1 January | | 650,651 | 564,375 |
| Net increase in cash and cash equivalents | | 71,031 | 93,016 |
| Effect of exchange rate fluctuations on cash and cash equivalents | | 6,198 | (6,740) |
| **Cash and cash equivalents at 31 December** | 23 | 727,880 | 650,651 |

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 £125,626,000 (2014: £142,617,000) not available for immediate use by the Group outside of the Lloyd's syndicate within which they are held. Additionally £172,000,000 (2014: £nil) is pledged cash against Funds at Lloyd's. At December 2014 cash and cash equivalents included £169,928,000 for subscriptions received in advance by the Kiskadee Diversified and Select Funds that remained uninvested at that time.

The notes on pages 83 to 131 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, Asia and the US with over 2,200 staff.

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 Conduct Authority (FCA), in addition to the Bermuda Companies Act 1981. These two pronouncements issued by the FCA 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 statement of cash flows and the related notes 1 to 37 in accordance with a recognised set of Generally Accepted Accounting Principles (GAAP).

The consolidated financial statements for the year ended 31 December 2015 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 29 February 2016.

## 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 2.21.

### 2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (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).

The Group currently applies IFRS 4 Insurance Contracts which specifies the financial reporting for insurance contracts. The standard was issued by the IASB as the first phase in their project to develop a comprehensive standard 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.

### 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 £3.6 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 22 to 23. 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 insurance and financial 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.

Except as described below and overleaf, the accounting policies adopted are consistent with those of the previous financial year.

### Changes in accounting policies

A number of new standards, amendments to standards and interpretations, as adopted by the European Union, are effective for annual periods beginning on or after 1 January 2015. They have been applied in preparing these consolidated financial statements. There were no new standards, amendments or interpretations that had a material impact on the Group.

The amendments included minor changes to the following standards:

IAS 19: Defined Benefit Plans: Employee Contributions
Annual Improvements to IFRSs 2010 – 2012 Cycle
- IFRS 2: Share-based Payments
- IFRS 3: Business Combinations
- IFRS 8: Operating Segments
- IFRS 13: Fair Value Measurement
- IAS 16: Property, Plant and Equipment
- IAS 24: Related Party Disclosures
- IAS 38: Intangible Assets

Annual Improvements to IFRSs 2011 – 2013 Cycle
- IFRS 13: Fair Value Measurement

The following new standards, amendments to standards and interpretations are effective for annual periods beginning on or after 1 January 2016 and have not been applied in preparing these financial statements.

- IFRS 4 Phase II will replace IFRS Phase I and is expected to include a number of significant changes to the measurement of insurance contracts and as such adoption of a final standard will likely have a significant impact on the results of the Group. In addition,

# Notes to the consolidated financial statements continued

## 2 Significant accounting policies continued
## 2.2 Basis of preparation continued
## Changes in accounting policies continued

the IASB has stated they will allow approximately three full years from the date of any final standard to actual implementation, therefore 2020 is likely to be the earliest date for the adoption of a new standard.

- IFRS 9: Financial Instruments; Classification and Measurement. The new standard is effective for annual periods beginning on or after 1 January 2018, although it is likely to be deferred for insurers to better align with the implementation date of IFRS 4 Phase II. A full impact analysis is expected to be completed at least 12 months prior to the effective date of the standard.

## 2.3 Basis of consolidation

*(a) Subsidiaries*

Subsidiaries are those entities controlled by the Group. Control exists when the Group has power over an entity, exposure or rights to variable returns from its involvement with the investee and ability to use its power to affect those returns. 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 2015, HDCM owned 72.5% of Syndicate 33 (2014: 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 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 Kiskadee Diversified Fund and Kiskadee Select Fund ('Kiskadee Funds') were launched in 2014 to provide investment opportunities to institutional investors in property catastrophe reinsurance and insurance-linked strategies. The Group made an initial investment of £30.2 million in the Kiskadee Funds. The Kiskadee Funds are managed by Kiskadee Investment Managers Ltd which is a wholly owned subsidiary of the Group. All of the Kiskadee Funds' exposures to reinsurance risk are fronted by the Group into two Bermuda Licensed Special Purpose Insurers ('SPI'), Kiskadee Reinsurance 1 Ltd and Kiskadee Reinsurance 2 Ltd which have been collateralised by the Kiskadee Funds.

Following a significant inflow of capital from third-party investors during 2015, the Group has determined that it no longer meets the criteria for consolidation of the Kiskadee Funds and SPIs from 1 July 2015 as defined in IFRS 10. Significant judgements and assumptions made in determining this are disclosed in Note 2.21.

As a result, from that date the assets and liabilities of the Kiskadee Funds as well as the two SPIs have been derecognised at their carrying amounts and the Group's investment in the Kiskadee Funds is recognised as a financial asset measured at fair value through profit and loss. Below is a table disclosing the impact to the consolidated financial statement following the deconsolidation on 1 July 2015:

| | £000 |
|---|---|
| Total assets no longer recognised in the consolidated balance sheet | (303,397) |
| Total liabilities no longer recognised in the consolidated balance sheet | 267,154 |
| Total currency translation reserve no longer recognised in the balance sheet | (248) |
| Investment in ILS Fund recognised in the consolidated balance sheet | 35,362 |
| Loss recognised in other revenues in the consolidated income statement | (1,129) |

In accordance with IFRS 12 the Group is disclosing its interest in the unconsolidated Kiskadee Funds and SPIs.

As at 31 December 2015, the Group recognised a financial asset at fair value of £40.0 million in relation to its investment in the Kiskadee Funds (note 19). In assessing the maximum exposure to loss from its interest in the Kiskadee Funds and SPIs, the Group has determined it is no greater than the fair value recognised as at the balance sheet date.

In addition to the return on the financial asset, the Group also receives fee income through Kiskadee Investment Managers Ltd and Hiscox Insurance Company (Bermuda) Ltd, both wholly owned subsidiaries, under normal commercial terms.

The Group is exposed to credit risk associated with reinsurance recoverables on risks fronted for the Kiskadee SPIs. Note 3.2(d) discusses how the Group manages credit risk associated with reinsurance assets.

The operations of the Kiskadee Funds and SPIs are financed through the issuance of preference shares to external investors. The Group does not intend to provide any further financial support to the Kiskadee Funds or SPIs.

*(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 losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

## 2 Significant accounting policies continued

### 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. Functional currencies of entities operating in Asia include US Dollars, Hong Kong Dollars, Singapore Dollars and Thai Baht.

*(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 acquiring entity's assets and liabilities and are translated at the rate at acquisition. For each business combination, the Group measures any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

### 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 20–50 years
- vehicles 3 years
- leasehold improvements including fixtures and fittings 10–15 years
- furniture, fittings and equipment 3–15 years

The assets' residual values and useful lives are reviewed at each balance sheet date and adjusted if appropriate. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

### 2.6 Intangible assets

*(a) Goodwill*

Goodwill represents amounts arising on acquisition of subsidiaries and associates. In respect of acquisitions that have occurred since 1 January 2004, goodwill represents the excess of the 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 1 January 2004, 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) US 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 licences 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.

# Notes to the consolidated financial statements continued

## 2 Significant accounting policies continued
## 2.6 Intangible assets continued

*(d) Rights to customer contractual relationships*
Costs directly attributable to securing the intangible rights to customer contractual relationships are recognised as an intangible asset where they can be identified separately and measured reliably and it is probable that they will be recovered by directly related future profits. These costs are amortised on a straight-line basis over the useful economic life which is deemed to be between ten and 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 ten 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 and liabilities 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 and liabilities are initially recognised at fair value. Subsequent to initial recognition financial assets and liabilities are measured as described below.

Financial assets are derecognised 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 a 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.

*(c) Long-term debt*
All borrowings are initially recognised at fair value. Subsequent to initial recognition, borrowings are measured at amortised cost. Any difference between the value recognised at initial recognition and the ultimate redemption amount is recognised in the income statement over the period to redemption using the effective interest method.

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

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

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

*(b) Financial assets*
Objective factors that are considered when determining whether a financial asset or group of financial assets may be impaired include, but are not limited to, the following:
- negative rating agency announcements in respect of investment issuers, reinsurers and debtors;
- significant reported financial difficulties of investment issuers, reinsurers and debtors;
- actual breaches of credit terms such as persistent late payments or actual default;
- the disintegration of the active market(s) in which a particular asset is traded or deployed;
- adverse economic or regulatory conditions that may restrict future cash flows and asset recoverability; and
- the withdrawal of any guarantee from statutory funds or sovereign agencies implicitly supporting the asset.

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

Where an impairment loss subsequently reverses, the carrying amount of the asset

is increased to the revised estimate of its recoverable amount, but only to the extent 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 2.16).

### 2.11 Own shares

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

### 2.12 Revenue

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

### 2.13 Insurance contracts

#### *(a) Classification*

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

#### *(b) Recognition and measurement*

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

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

#### *(c) Deferred acquisition costs (DAC)*

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

#### *(d) Liability adequacy tests*

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

#### *(e) Outwards reinsurance contracts held*

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

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

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

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

#### *(f) Receivables and payables related to insurance contracts*

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders. If there is objective evidence that the insurance receivable is impaired, the Group reduces the carrying amount of the insurance receivable accordingly and recognises the impairment loss in the income statement.

# Notes to the consolidated financial statements continued

## 2 Significant accounting policies continued
## 2.13 Insurance contracts continued

*(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. Plan assets exclude any insurance contracts issued by the Group. The calculation of the defined benefit obligation is performed annually by a qualified actuary using the projected unit method. As the plan is closed to all future benefit accrual, each participant's benefits under the plan are based on their service to the date of closure or earlier leaving, their final pensionable earnings at the measurement date and the service cost is the expected administration cost during the year. Past service costs are recognised immediately in income.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income. The Group determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognised in profit or loss through operating expenses.

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.

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

*(c) Share-based compensation*
The Group operates a number of equity settled share-based employee compensation plans. These include both the approved and unapproved share option schemes, and the Group's Performance Share Plans, outlined in the Directors' remuneration report together with the Group's Save as You Earn (SAYE) schemes. The fair value of the employee services received, measured at grant date, in exchange for the grant of the awards is recognised as an expense, with the corresponding credit being recorded in retained earnings within equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the awards granted, excluding the impact of any non-market vesting conditions (e.g. profitability or net asset growth targets). Non-market vesting conditions are included in assumptions about the number of awards that are expected to become exercisable. At each balance sheet date, the Group revises its estimates of the number of awards that are expected to vest.

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

*(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

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

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 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 ongoing 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.

### 2.17 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.

### 2.18 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.

### 2.19 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.

### 2.20 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.

### 2.21 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 gross estimate as at 31 December 2015 is £1,214 million (2014: £1,143 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, where available. 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.

As shown in note 30, following the triennial valuation for December 2014 having updated the experience data, this has significantly reduced the scheme obligations and the deficit recorded.

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.

# Notes to the consolidated financial statements continued

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

As at 1 July 2015 the Group has determined that it no longer meets the criteria for consolidation of the Kiskadee Funds and Kiskadee Special Purpose Insurers ('SPI') as defined in IFRS 10. The Group considered the following factors to determine whether it is acting as an agent or a principal:
- the power the Group has over the Kiskadee Funds and the ability to direct relevant activities;
- rights to variable returns from the Group's involvement with the Kiskadee Funds; and
- the ability to use that power to affect the amount of the Group's returns.

The fee income and the Group's direct investment exposes it to variability of returns from the activities of the Kiskadee Funds and SPIs without creating exposure that is of such significance that it indicates that the Group is acting as a principal. The Group considered additional factors including the purpose of the design of the structure, the business model, and a broad range of qualitative factors in determining whether the Kiskadee Funds and SPIs still met the criteria for consolidation.

As a result of this analysis the Group determined, from 1 July 2015 its exposure to variability of returns together with its decision-making authority within restricted parameters indicates that the Group is acting as an agent and will no longer consolidate the Kiskadee Funds and SPIs.

### 2.22 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 through the Risk Committee and ongoing compliance therewith, 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, 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 and tax risks as detailed in note 3.4. 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 and risk appetite seeking to exploit identified opportunities in the light of other relevant anticipated market conditions.

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 12.5% of core capital plus 100% of buffer capital (£100 million) with an allowance for expected investment income, as a result of a 1 in 200 bad underwriting year.

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 team in order to monitor claim development patterns and discuss individual underwriting issues as they arise.

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 19, are extreme hypothetical events selected to represent major events occurring in areas with large insured values.

They also reflect the areas that represent significant exposures for Hiscox. The selection of realistic disaster scenario events is adjusted each year and they are not therefore necessarily directly comparable from one year to the next. The events are extreme and as yet untested, and as such these estimates may prove inadequate as a result of incorrect assumptions, model deficiencies, or losses from unmodeled risks. This means that should a realistic disaster actually eventuate, the Group's final ultimate losses could materially differ from those estimates modeled by management.

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

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

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

**Estimated concentration of gross and net insurance liabilities on balance sheet by territory coverage of premium written 31 December 2015**

| | | 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 | 1,862 | 20,491 | 149,818 | 402,266 | 17,326 | 16,522 | 608,285 |
| | Net | 1,417 | 9,697 | 146,085 | 380,556 | 15,253 | 16,034 | 569,042 |
| Europe | Gross | 4,363 | 541 | 99,021 | 151,092 | 29,858 | 39,997 | 324,872 |
| | Net | 1,605 | 517 | 81,714 | 147,163 | 28,117 | 30,147 | 289,263 |
| United States | Gross | 136,736 | 116,605 | 183,496 | 341,409 | 126,116 | 69,582 | 973,944 |
| | Net | 73,337 | 59,796 | 100,114 | 337,142 | 113,146 | 62,385 | 745,920 |
| Other territories | Gross | 70,755 | 38,507 | 53,837 | 23,954 | 24,134 | 110,332 | 321,519 |
| | Net | 51,118 | 30,016 | 40,864 | 22,177 | 17,018 | 95,885 | 257,078 |
| Multiple territory coverage | Gross | 268,951 | 174,603 | 108,119 | 49,584 | 134,655 | 83,830 | 819,742 |
| | Net | 206,090 | 148,558 | 58,686 | 48,492 | 121,576 | 64,847 | 648,249 |
| **Total** | **Gross** | **482,667** | **350,747** | **594,291** | **968,305** | **332,089** | **320,263** | **3,048,362** |
| | **Net** | **333,567** | **248,584** | **427,463** | **935,530** | **295,110** | **269,298** | **2,509,552** |

Estimated concentration of gross and net insurance liabilities on balance sheet by territory coverage of premium written 31 December 2014

| | | 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 | 1,062 | 19,258 | 138,727 | 361,541 | 5,030 | 19,808 | 545,426 |
| | Net | 597 | 12,984 | 117,505 | 347,246 | 4,911 | 13,459 | 496,702 |
| Europe | Gross | 6,847 | 3,437 | 86,757 | 145,288 | 24,905 | 26,059 | 293,293 |
| | Net | 4,257 | 2,931 | 74,997 | 144,173 | 23,724 | 24,169 | 274,251 |
| United States | Gross | 140,396 | 83,686 | 159,758 | 322,116 | 75,562 | 28,031 | 809,549 |
| | Net | 75,508 | 34,341 | 85,594 | 309,998 | 68,715 | 24,120 | 598,276 |
| Other territories | Gross | 88,526 | 33,361 | 52,401 | 22,519 | 19,310 | 108,143 | 324,260 |
| | Net | 70,028 | 26,600 | 37,373 | 22,491 | 15,490 | 86,725 | 258,707 |
| Multiple territory coverage | Gross | 278,842 | 219,939 | 94,604 | 41,639 | 141,497 | 86,150 | 862,671 |
| | Net | 218,032 | 177,820 | 61,043 | 41,089 | 120,861 | 63,073 | 681,918 |
| Total | Gross | 515,673 | 359,681 | 532,247 | 893,103 | 266,304 | 268,191 | 2,835,199 |
| | Net | 368,422 | 254,676 | 376,512 | 864,997 | 233,701 | 211,546 | 2,309,854 |

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

# Notes to the consolidated financial statements continued

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

The estimated liquidity profile to settle the gross 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 are 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) 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

## 3 Management of risk continued
### 3.1 Insurance risk continued
#### *i) Underwriting risk continued*
#### *Casualty insurance risks continued*

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.

#### *ii) 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 Group's provision estimates are subject to rigorous review by senior management from all areas of the business including independent actuaries. The final provision is approved by the relevant boards on the recommendation of dedicated reserving committees.

The 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.

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 funds, 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 2015, the Group holds asset-backed and mortgage-backed fixed income instruments in its investment portfolio, but 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 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 relatively small and controlled proportion of the overall investment portfolio and the equity and unit trust holdings involved are diversified over a number of companies and industries. The fair value of equity assets in the Group's balance sheet at 31 December 2015 was £260 million (2014: £253 million). These may be analysed as follows:

| Nature of equity and unit trust holdings | 2015 % weighting | 2014 % weighting |
|---|---|---|
| Directly held equity securities | 3 | 4 |
| Units held in funds – traditional long only | 68 | 64 |
| Units held in funds – long and short and special strategies | 29 | 32 |
| **Geographic focus** | | |
| Specific UK mandates | 42 | 47 |
| Global mandates | 58 | 53 |

3 Management of risk continued
3.2 Financial risk continued
*(b) Equity price risk continued*

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. 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. A 10% downward correction in equity prices at 31 December 2015 would have been expected to reduce Group equity and profit after tax for the year by approximately £23.8 million (2014: £22.6 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 31 December 2015 was £2,615 million (2014: £2,526 million). These may be analysed below as follows:

| Nature of debt and fixed income holdings | 2015 % weighting | 2014 % weighting |
|---|---|---|
| Government issued bonds and instruments | 33 | 30 |
| Agency and government supported debt | 12 | 12 |
| Asset-backed securities | 8 | 9 |
| Mortgage-backed instruments – agency | 3 | 4 |
| Mortgage-backed instruments – non-agency | 2 | 2 |
| Mortgage-backed instruments – commercial | 3 | 6 |
| Corporate bonds | 37 | 34 |
| Lloyd's deposits and bond funds | 2 | 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 Group equity and profit after tax for the year might have been expected to decrease by approximately £42 million (2014: £36 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 2015, no amounts were outstanding on the Group's borrowing facility (2014: £nil). At 31 December 2015, the Group had long-term debt of £275 million (2014: £nil) being fixed-to-floating rate notes, as explained in note 19. The floating rate becomes effective from November 2025. 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 34.

*(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, but collateral may be requested to be held against these 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 Credit 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 as well as detailed analysis from a dedicated in-house security consultant. 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.

The Group also mitigates counterparty credit risk by concentrating debt and fixed income investments in high-quality instruments, including a particular emphasis on government bonds issued mainly by North American countries and the European Union. The Group has no exposure to sovereign debt in Spain, Italy, Ireland, Greece or Portugal.

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 2015 | Note | AAA £000 | AA £000 | A £000 | Other/ non-rated £000 | Total £000 |
|---|---|---|---|---|---|---|
| Debt and fixed income securities | 19 | 603,086 | 1,160,692 | 460,922 | 390,314 | 2,615,014 |
| Deposits with credit institutions | 19 | – | 555 | 5,963 | 166 | 6,684 |
| Reinsurance assets | 18 | 116,637 | 141,751 | 256,655 | 23,767 | 538,810 |
| Cash and cash equivalents | 23 | 96,917 | 32,994 | 593,286 | 4,683 | 727,880 |
| Total | | 816,640 | 1,335,992 | 1,316,826 | 418,930 | 3,888,388 |
| Amounts attributable to largest single counterparty | | 117,973 | 578,741 | 109,060 | 15,712 | |

| As at 31 December 2014 | Note | AAA £000 | AA £000 | A £000 | Other/ non-rated £000 | Total £000 |
|---|---|---|---|---|---|---|
| Debt and fixed income securities | 19 | 726,822 | 999,298 | 508,734 | 291,325 | 2,526,179 |
| Deposits with credit institutions | 19 | – | 3,482 | 19,296 | 3,607 | 26,385 |
| Reinsurance assets | 18 | 53,960 | 182,558 | 262,520 | 26,307 | 525,345 |
| Cash and cash equivalents | 23 | 64,260 | 5,050 | 577,834 | 3,507 | 650,651 |
| Total | | 845,042 | 1,190,388 | 1,368,384 | 324,746 | 3,728,560 |
| Amounts attributable to largest single counterparty | | 164,004 | 335,676 | 256,758 | 12,475 | |

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.

The largest counterparty exposure within the AAA rating at 31 December 2015 and 2014 is the German government. For the AA rating it is with the US Treasury at both 31 December 2015 and 2014. A significant proportion of other/non-rated assets are rated BBB and BB at both 31 December 2015 and 2014.

At 31 December 2015 and 2014 the Group held no material debt or fixed income assets that were past due or impaired beyond their reported fair values. For the current period and prior period, the Group did not experience any material defaults on debt securities.

The Group's AAA rated reinsurance assets include fully collateralised positions at 31 December 2015 and 2014.

## 3 Management of risk continued
## 3.2 Financial risk continued

### *(e) Liquidity risk*

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

A significant proportion of the Group's investments 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 | **2015 Total £000** | 2014 Total £000 |
|---|---|---|---|---|---|
| Less than one year | 517,306 | – | 727,880 | **1,245,186** | 1,170,663 |
| Between one and two years | 832,087 | 4,713 | – | **836,800** | 534,990 |
| Between two and five years | 920,271 | 1,971 | – | **922,242** | 1,073,685 |
| Over five years | 345,350 | – | – | **345,350** | 423,877 |
| Total | 2,615,014 | 6,684 | 727,880 | **3,349,578** | 3,203,215 |

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 time frame within one year of the balance sheet date.

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

| Average contractual maturity analysed by denominational currency of investments as at 31 December | **2015 Years** | 2014 Years |
|---|---|---|
| Pound Sterling | **2.93** | 2.76 |
| US Dollar | **4.50** | 6.43 |
| Euro | **2.75** | 2.33 |
| Canadian Dollar | **1.96** | 1.86 |

The following is an analysis by liability type of the estimated timing of net cash flows based on the gross 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 gross 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 | 2015 Total £000 |
|---|---|---|---|---|---|
| Reinsurance inwards | 155,994 | 85,991 | 90,317 | 38,090 | 370,392 |
| Property – marine and major assets | 114,808 | 70,342 | 76,013 | 26,668 | 287,831 |
| Property – other assets | 135,034 | 68,120 | 26,522 | 7,193 | 236,869 |
| Casualty – professional indemnity | 184,651 | 197,953 | 236,258 | 103,787 | 722,649 |
| Casualty – other risks | 65,715 | 55,198 | 105,009 | 48,427 | 274,349 |
| Other* | 82,253 | 24,953 | 24,113 | 14,687 | 146,006 |
| Total | 738,455 | 502,557 | 558,232 | 238,852 | 2,038,096 |

| Liquidity requirements to settle estimated profile of gross 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 | 2014 Total £000 |
|---|---|---|---|---|---|
| Reinsurance inwards | 191,910 | 97,723 | 100,567 | 34,388 | 424,588 |
| Property – marine and major assets | 107,393 | 66,886 | 82,311 | 31,201 | 287,791 |
| Property – other assets | 112,656 | 69,626 | 30,995 | 8,005 | 221,282 |
| Casualty – professional indemnity | 174,795 | 183,608 | 230,863 | 97,287 | 686,553 |
| Casualty – other risks | 52,043 | 42,786 | 77,173 | 38,224 | 210,226 |
| Other* | 68,528 | 23,630 | 25,389 | 19,877 | 137,424 |
| Total | 707,325 | 484,259 | 547,298 | 228,982 | 1,967,864 |

*Includes a diverse mix of certain specialty lines such as kidnap and ransom, terrorism 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 21 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:

- structural foreign exchange risk through consolidation of net investments in subsidiaries with different functional currencies within the Group results; and
- 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 operations 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 and Asian operations. The Group's risk appetite permits the acceptance of structural foreign exchange movements within defined aggregate limits and exchange rate parameters which are monitored centrally. Exchange rate derivatives are used when appropriate to shield the Group against significant movements outside of a defined range.

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

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

Operational foreign exchange risk is controlled within the Group's individual entities. The assets of the Group's overseas operations are generally invested in the same currencies as their underlying insurance and investment liabilities, intended to produce 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 on pages 98 and 99 are net non-monetary liabilities of £218 million (2014: £197 million) which are denominated in foreign currencies.

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

As a result of the accounting treatment for non-monetary items, the Group may also experience volatility in its income statement during a period when movements in foreign exchange rates fluctuate significantly. In accordance with IFRS, non-monetary items are recorded at original transaction rates and are not remeasured at the reporting date. These items include unearned premiums, deferred acquisition costs and reinsurers' share of unearned premiums. Consequently, a mismatch arises in the income statement between the amount of premium recognised at historical transaction rates, and the related claims which are retranslated using currency rates in force at the reporting date. The Group considers this to be a timing issue which can cause significant volatility in the income statement. 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 2015 | Sterling £000 | US Dollar £000 | Euro £000 | Other £000 | Total £000 |
|---|---|---|---|---|---|
| Intangible assets | 118,408 | 7,220 | – | 594 | 126,222 |
| Property, plant and equipment | 39,278 | 4,787 | 1,250 | 1,194 | 46,509 |
| Investments in associates | 13,019 | – | 506 | – | 13,525 |
| Deferred tax | – | 34,224 | 923 | – | 35,147 |
| Deferred acquisition costs | 63,972 | 171,023 | 29,873 | 6,649 | 271,517 |
| Financial assets carried at fair value | 579,508 | 2,013,688 | 287,284 | 41,105 | 2,921,585 |
| Reinsurance assets | 61,527 | 420,967 | 31,869 | 24,447 | 538,810 |
| Loans and receivables including insurance receivables | 203,551 | 355,008 | 40,425 | 20,579 | 619,563 |
| Current tax asset | – | – | 3,194 | 49 | 3,243 |
| Cash and cash equivalents | 378,126 | 204,419 | 80,088 | 65,247 | 727,880 |
| Total assets | 1,457,389 | 3,211,336 | 475,412 | 159,864 | 5,304,001 |

| | Sterling £000 | US Dollar £000 | Euro £000 | Other £000 | Total £000 |
|---|---|---|---|---|---|
| Employee retirement benefit obligations | 75 | – | – | – | 75 |
| Deferred tax | 29,814 | – | – | – | 29,814 |
| Insurance liabilities | 719,518 | 1,904,441 | 325,508 | 98,895 | 3,048,362 |
| Financial liabilities | 275,679 | – | – | – | 275,679 |
| Current tax | 4,582 | – | 302 | – | 4,884 |
| Trade and other payables | 166,723 | 221,704 | 2,275 | 25,656 | 416,358 |
| Total liabilities | 1,196,391 | 2,126,145 | 328,085 | 124,551 | 3,775,172 |

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

| As at 31 December 2014 | Sterling £000 | US Dollar £000 | Euro £000 | Other £000 | Total £000 |
|---|---|---|---|---|---|
| Intangible assets | 95,542 | 7,259 | – | 3,145 | 105,946 |
| Property, plant and equipment | 23,145 | 4,456 | 886 | 1,010 | 29,497 |
| Investments in associates | 10,125 | – | 545 | – | 10,670 |
| Deferred tax | – | 32,250 | 1,240 | – | 33,490 |
| Deferred acquisition costs | 62,792 | 132,742 | 29,467 | 5,372 | 230,373 |
| Financial assets carried at fair value | 653,160 | 1,846,260 | 295,219 | 34,208 | 2,828,847 |
| Reinsurance assets | 55,790 | 406,073 | 40,534 | 22,948 | 525,345 |
| Loans and receivables including insurance receivables | 179,638 | 311,111 | 40,802 | 24,708 | 556,259 |
| Current tax asset | – | – | 7,981 | 50 | 8,031 |
| Cash and cash equivalents | 130,829 | 355,229 | 87,500 | 77,093 | 650,651 |
| Total assets | 1,211,021 | 3,095,380 | 504,174 | 168,534 | 4,979,109 |

| | Sterling £000 | US Dollar £000 | Euro £000 | Other £000 | Total £000 |
|---|---|---|---|---|---|
| Employee retirement benefit obligations | 32,166 | – | – | – | 32,166 |
| Deferred tax | 26,390 | – | – | – | 26,390 |
| Insurance liabilities | 675,086 | 1,695,425 | 356,092 | 108,596 | 2,835,199 |
| Financial liabilities | – | 7,033 | – | 76 | 7,109 |
| Current tax | 31,455 | – | 924 | – | 32,379 |
| Trade and other payables | 143,528 | 409,741 | 14,342 | 24,049 | 591,660 |
| Total liabilities | 908,625 | 2,112,199 | 371,358 | 132,721 | 3,524,903 |

*Sensitivity analysis*

As at 31 December 2015, the Group used closing rates of exchange of £1:€1.36 and £1:$1.47 (2014: £1:€1.28 and £1:$1.56). 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 2015 | Effect on equity after tax £m | Effect on profit before tax £m |
|---|---|---|
| Strengthening of US Dollar | 114.8 | 47.5 |
| Weakening of US Dollar | (93.3) | (38.3) |
| Strengthening of Euro | 17.6 | 19.9 |
| Weakening of Euro | (14.4) | (16.3) |

# Notes to the consolidated financial statements continued

## 3 Management of risk continued
## 3.2 Financial risk continued

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

The sensitivity analysis does 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, long-term 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 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.

*Gearing*
The Group currently utilises 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 of $500 million 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 $228 million. This facility was reduced to $500 million from $875 million in December 2015 by the Company's subsidiary Hiscox plc with the maximum cash portion reduced from $400 million. The Letter of Credit availability period ends on 31 December 2015. This enables the Group to utilise the Letter of Credit as Funds at Lloyd's to support underwriting on the 2015, 2016 and 2017 years of account. The revolving credit facility has a maximum three-year contractual period for repayment. At 31 December 2015 US$71.9 million was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and there were no cash drawings (2014: $441.5 million and £nil million respectively) to support general trading activities. The Group will be renegotiating this facility in 2016;
- £275 million of fixed-to-floating rate subordinated notes that are classified as Tier 2 debt. This was raised in November 2015 and matures in 2045. The debt is rated BBB- by Standard & Poor's and Fitch;
- 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 £65 million for the 2015 year of account (2014 year of account: £72 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.

The funds raised through Letters of Credit and loan facilities have been applied to support both the 2015 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 significant 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, A+ (Strong) from Standard & Poor's and AA- (Very strong) from Fitch.

*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 seeks to maintain its cost of capital levels and its debt to overall equity ratios in line with others in the non-life insurance industry.

## 3 Management of risk continued
### 3.3 Capital risk management continued

*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). The BMA's new regulatory capital requirements became effective on 1 January 2013. The Group had sufficient capital at all times throughout the year to meet these requirements.

The Solvency II regime came into force in the UK on 1 January 2016. This requires insurance companies to calculate their capital requirements using either an internal model or a standard formula. Hiscox Insurance Company Limited uses the standard formula to calculate its regulatory capital requirement. Its risk profile is sufficiently well represented by the standard formula not to warrant going through the internal model approval process. Hiscox's Lloyd's operations use the internal model that has been built to meet the requirements of the Solvency II regime which came into force on 1 January 2016. The model is concentrated specifically on the particular product lines, market conditions and risk appetite of each risk carrier.

For Syndicate 33 and Syndicate 3624, internal model results are uplifted by Lloyd's to identify the capital required to hold the A rating. Capital models are used more widely across the Group to monitor exposure to key risk types, inform decision-making and measure ROE across different segments of the business. In addition to the Solvency II requirements, the EU Insurance Groups Directive of 1998, as amended by the Financial Groups 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 and Asia, its subsidiaries underwriting insurance business are required to operate within broadly similar risk-based externally imposed capital requirements when accepting business.

### 3.4 Tax risk
The Group is subject to income taxes levied by the various jurisdictions in which the Group operates, and the division of taxing rights between these jurisdictions results in the Group tax expense and effective rate of income tax disclosed in these financial statements. Due to the Group's operating model, there is an unquantifiable risk that this division of taxing rights could be altered materially, either by a change to the tax residence, or permanent establishment profile, of Hiscox Ltd or its principal subsidiaries; or due to the re-pricing or re-characterisation for tax purposes of transactions between members of the Group, under local transfer pricing or related tax legislation. The Group seeks to manage this risk by:
- maintaining appropriate internal policies and controls over its operations worldwide;
- monitoring compliance with these policies on an ongoing basis;
- adhering to internationally recognised best practice in determining the appropriate division of profits between taxing jurisdictions.

## 4 Operating segments
The Group's operating segment reporting follows the organisational structure and management's internal reporting systems, which form the basis for assessing the financial reporting performance of, and allocation of resource to each business segment. The Group's four primary business segments are identified as follows:
- Hiscox Retail brings together the results of the UK and Europe, and Hiscox International being the USA, Guernsey and Asia retail business divisions. Hiscox UK and Europe underwrite European personal and commercial lines of business through Hiscox Insurance Company Limited, together with the fine art and non-US household insurance business written through Syndicate 33. In addition, the UK includes elements of specialty and international employees and officers' insurance written by Syndicate 3624. Hiscox International comprises the specialty and fine art lines written through Hiscox Insurance Company (Guernsey) Limited, and the motor business written via DirectAsia, together with US commercial, property and specialty business written by Syndicate 3624 and Hiscox Insurance Company Inc. via the Hiscox USA business division.
- Hiscox London Market comprises the internationally traded insurance business written by the Group's London-based underwriters via Syndicate 33, including lines in property, marine and energy, casualty and other specialty insurance lines. In addition, the segment includes elements of business written by Syndicate 3624 being auto physical damage, auto extended warranty and aviation business.
- Hiscox Re is the reinsurance division of the Hiscox Group, combining the underwriting platforms in Bermuda, London and Paris. The segment comprises the performance of Hiscox Insurance Company (Bermuda) Limited, excluding the internal quota share arrangements, with the reinsurance contracts written by Syndicate 33. In addition, the healthcare and casualty reinsurance contracts written in the Bermuda hub on Syndicate capacity are included. The segment also captures the performance and fee income of the Kiskadee Funds as described in note 2.3.
- 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 these can be found in note 13. Corporate Centre forms a reportable segment due to its investment activities which earn significant external returns.

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

## 4 Operating segments continued

### *(a) Profit before tax by segment*

| | Year to 31 December 2015 | | | | | Year to 31 December 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 |
| Gross premiums written | 975,635 | 585,173 | 383,412 | – | 1,944,220 | 891,115 | 510,825 | 354,320 | – | 1,756,260 |
| Net premiums written | 919,686 | 427,170 | 224,988 | – | 1,571,844 | 825,878 | 336,895 | 180,637 | – | 1,343,410 |
| Net premiums earned | 870,459 | 383,883 | 180,674 | – | 1,435,016 | 790,721 | 332,497 | 193,041 | – | 1,316,259 |
| Investment result | 17,225 | 6,977 | 4,664 | 6,515 | 35,381 | 25,934 | 8,719 | 9,348 | 12,211 | 56,212 |
| Other revenues | 9,004 | 7,520 | (149) | 781 | 17,156 | 6,643 | 6,283 | 6,777 | 253 | 19,956 |
| Revenue | 896,688 | 398,380 | 185,189 | 7,296 | 1,487,553 | 823,298 | 347,499 | 209,166 | 12,464 | 1,392,427 |
| Claims and claim adjustment expenses, net of reinsurance | (341,244) | (182,912) | (48,297) | – | (572,453) | (325,806) | (159,864) | (45,998) | – | (531,668) |
| Expenses for the acquisition of insurance contracts | (225,148) | (113,543) | (5,592) | – | (344,283) | (205,748) | (93,569) | (19,299) | – | (318,616) |
| Operational expenses | (249,454) | (49,014) | (40,694) | (22,053) | (361,215) | (209,213) | (40,597) | (39,623) | (21,420) | (310,853) |
| Foreign exchange gains/(losses) | (8,183) | 6,681 | 8,327 | 8,328 | 15,153 | (5,121) | 9,044 | 2,682 | (1,631) | 4,974 |
| Total expenses | (824,029) | (338,788) | (86,256) | (13,725) | (1,262,798) | (745,888) | (284,986) | (102,238) | (23,051) | (1,156,163) |
| Results of operating activities | 72,659 | 59,592 | 98,933 | (6,429) | 224,755 | 77,410 | 62,513 | 106,928 | (10,587) | 236,264 |
| Finance costs | – | (52) | (1,472) | (8,138) | (9,662) | – | (46) | (1,365) | (5,007) | (6,418) |
| Share of profit of associates after tax | 661 | 346 | – | – | 1,007 | 655 | 182 | – | 392 | 1,229 |
| **Profit before tax** | 73,320 | 59,886 | 97,461 | (14,567) | 216,100 | 78,065 | 62,649 | 105,563 | (15,202) | 231,075 |

The following charges are included within the consolidated income statement:

| | Year to 31 December 2015 | | | | | Year to 31 December 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 |
| Depreciation | 2,859 | 395 | 176 | 173 | 3,603 | 2,098 | 472 | 208 | 96 | 2,874 |
| Amortisation of intangible assets | 12,149 | 3,748 | 523 | 78 | 16,498 | 6,892 | 2,522 | 504 | 65 | 9,983 |
| Impairment of intangible assets | 2,633 | – | – | – | 2,633 | – | – | – | – | – |

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 2015 | | | | | Year to 31 December 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 100% ratio analysis | Hiscox Retail | Hiscox London Market | Hiscox Re | Corporate Centre | Total | Hiscox Retail | Hiscox London Market | Hiscox Re | Corporate Centre | Total |
| Claims ratio (%) | 38.6 | 47.1 | 26.0 | – | 39.6 | 40.9 | 47.4 | 22.0 | – | 39.8 |
| Expense ratio (%) | 54.0 | 40.7 | 25.4 | – | 46.1 | 52.0 | 39.8 | 29.6 | – | 44.9 |
| Combined ratio excluding foreign exchange impact (%) | 92.6 | 87.8 | 51.4 | – | 85.7 | 92.9 | 87.2 | 51.6 | – | 84.7 |
| Foreign exchange impact (%) | 0.9 | (2.1) | (4.8) | – | (0.7) | 0.6 | (3.0) | (1.8) | – | (0.8) |
| **Combined ratio (%)** | **93.5** | **85.7** | **46.6** | – | **85.0** | 93.5 | 84.2 | 49.8 | – | 83.9 |
| **Combined ratio excluding non-monetary foreign exchange impact (%)** | **93.5** | **85.9** | **46.8** | – | **85.1** | 93.1 | 86.1 | 49.8 | – | 84.5 |

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 2015 | | | | Year to 31 December 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 |
| At 100% level (note 4b) 1% change in claims or expense ratio | 8,891 | 4,852 | 2,067 | – | 8,089 | 4,273 | 2,293 | – |
| At Group level 1% change in claims or expense ratio | 8,705 | 3,839 | 1,807 | – | 7,907 | 3,325 | 1,930 | – |

## 4 Operating segments continued

### *(b) 100% operating result by segment*

| | Year to 31 December 2015 | | | | | Year to 31 December 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 |
| Gross premiums written | 998,088 | 729,175 | 437,777 | – | 2,165,040 | 914,372 | 647,094 | 421,599 | – | 1,983,065 |
| Net premiums written | 938,255 | 535,986 | 249,680 | – | 1,723,921 | 844,471 | 434,133 | 215,534 | – | 1,494,138 |
| Net premiums earned | 889,128 | 485,232 | 206,669 | – | 1,581,029 | 808,876 | 427,342 | 229,343 | – | 1,465,561 |
| Investment result | 17,420 | 9,338 | 5,465 | 6,515 | 38,738 | 26,191 | 11,722 | 10,364 | 12,211 | 60,488 |
| Other revenues | 3,873 | 1,421 | (3,993) | 781 | 2,082 | 2,618 | – | 1,136 | 253 | 4,007 |
| Claims and claim adjustment expenses, net of reinsurance | (343,290) | (228,701) | (53,787) | – | (625,778) | (330,554) | (202,670) | (50,434) | – | (583,658) |
| Expenses for the acquisition of insurance contracts | (230,341) | (138,624) | (6,322) | – | (375,287) | (211,407) | (120,417) | (23,760) | – | (355,584) |
| Operational expenses | (249,369) | (58,957) | (46,115) | (22,053) | (376,494) | (208,961) | (49,242) | (44,048) | (21,420) | (323,671) |
| Foreign exchange (losses)/gains | (8,154) | 10,092 | 9,893 | 8,328 | 20,159 | (5,196) | 12,713 | 4,080 | (1,631) | 9,966 |
| **Results of operating activities** | 79,267 | 79,801 | 111,810 | (6,429) | 264,449 | 81,567 | 79,448 | 126,681 | (10,587) | 277,109 |

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.

### *(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 2015 | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 |
|---|---|---|---|---|---|
| Intangible assets | 72,383 | 34,402 | 6,349 | 13,088 | 126,222 |
| Deferred acquisition costs | 160,105 | 87,726 | 23,686 | – | 271,517 |
| Financial assets | 720,742 | 773,134 | 1,108,327 | 332,907 | 2,935,110 |
| Reinsurance assets | 112,731 | 255,719 | 170,360 | – | 538,810 |
| Other assets | 608,139 | 182,842 | 285,330 | 356,031 | 1,432,342 |
| **Total assets** | 1,674,100 | 1,333,823 | 1,594,052 | 702,026 | 5,304,001 |
| Insurance liabilities | 1,338,798 | 1,178,445 | 531,119 | – | 3,048,362 |
| Other liabilities | 150,419 | 96,799 | 175,977 | 303,615 | 726,810 |
| **Total liabilities** | 1,489,217 | 1,275,244 | 707,096 | 303,615 | 3,775,172 |
| **Capital expenditure** | 34,430 | 2,579 | 1,195 | 12,700 | 50,904 |

| As at 31 December 2014 | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 |
|---|---|---|---|---|---|
| Intangible assets | 63,541 | 27,291 | 5,686 | 9,428 | 105,946 |
| Deferred acquisition costs | 141,039 | 69,052 | 20,282 | – | 230,373 |
| Financial assets | 690,683 | 743,475 | 1,163,449 | 241,910 | 2,839,517 |
| Reinsurance assets | 159,878 | 202,793 | 162,674 | – | 525,345 |
| Other assets | 543,787 | 157,626 | 516,230 | 60,285 | 1,277,928 |
| Total assets | 1,598,928 | 1,200,237 | 1,868,321 | 311,623 | 4,979,109 |
| Insurance liabilities | 1,258,729 | 1,015,742 | 560,728 | – | 2,835,199 |
| Other liabilities | 174,730 | 130,832 | 360,055 | 24,087 | 689,704 |
| Total liabilities | 1,433,459 | 1,146,574 | 920,783 | 24,087 | 3,524,903 |
| Capital expenditure | 20,914 | 3,137 | 519 | 14,692 | 39,262 |

## 4 Operating segments continued

### *(c) Segmental analysis of assets and liabilities continued*

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

### *(d) Geographical information*

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

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 2015 | | | | | Year to 31 December 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 | Hiscox Retail £000 | Hiscox London Market £000 | Hiscox Re £000 | Corporate Centre £000 | Total £000 |
| UK and Ireland | 371,860 | 3,712 | 1,947 | – | 377,519 | 345,281 | 7,608 | 2,471 | – | 355,360 |
| Europe | 192,605 | 15,129 | 10,620 | – | 218,354 | 190,999 | 17,757 | 14,198 | – | 222,954 |
| United States | 270,567 | 312,687 | 187,247 | – | 770,501 | 206,443 | 264,415 | 178,389 | – | 649,247 |
| Rest of World | 96,863 | 200,835 | 164,262 | – | 461,960 | 116,868 | 170,397 | 160,156 | – | 447,421 |
| | 931,895 | 532,363 | 364,076 | – | 1,828,334 | 859,591 | 460,177 | 355,214 | – | 1,674,982 |

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.

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

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | 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 | 1,528,829 | 545.0 | 1,454,206 | 462.5 |
| Net tangible asset value | 1,402,607 | 500.0 | 1,348,260 | 428.8 |

The net asset value per share is based on 280,516,658 shares (2014: 314,419,567 shares), being the shares in issue at 31 December, less those held in treasury and those held by the Group Employee Benefit Trust.

Net tangible assets comprise total equity excluding intangible assets.

## 6 Return on equity

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Profit for the year (all attributable to owners of the Company) | 209,895 | 216,152 |
| Opening shareholders' equity | 1,454,206 | 1,409,461 |
| Adjusted for the time-weighted impact of capital distributions and issuance of shares | (146,028) | (142,812) |
| Adjusted opening shareholders' equity | 1,308,178 | 1,266,649 |
| **Annualised return on equity (%)** | 16.0 | 17.1 |

## 7 Investment result

The total result for the Group before taxation comprises:

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Investment income including interest receivable | | 40,951 | 45,146 |
| Net realised gains/(losses) on financial investments at fair value through profit or loss | | 2,968 | (1,055) |
| Net fair value (losses)/gains on financial investments at fair value through profit or loss | | (10,239) | 12,264 |
| Investment result – financial assets | 8 | 33,680 | 56,355 |
| Net fair value gains/(losses) on derivative financial instruments | 21 | 1,701 | (143) |
| Total result | | 35,381 | 56,212 |

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:*

| | 2015 % | 2014 % |
|---|---|---|
| Sterling | 2.1 | 2.7 |
| US Dollar | 0.8 | 1.5 |
| Other | 0.6 | 1.5 |

*(b) Investment return*

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | £000 | % | £000 | % |
| Debt and fixed income securities | 21,585 | 0.9 | 36,714 | 1.5 |
| Equities and units in unit trusts | 10,410 | 4.0 | 17,604 | 7.6 |
| Deposits with credit institutions/cash and cash equivalents | 1,685 | 0.4 | 2,037 | 0.4 |
| | 33,680 | 1.0 | 56,355 | 1.8 |

## 9 Other revenues and operational expenses

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Agency-related income | 9,117 | 8,060 |
| Profit commission | 10,000 | 9,965 |
| Other underwriting income | (4,196) | 1,136 |
| Other income | 2,235 | 795 |
| Other revenues | 17,156 | 19,956 |
| Wages and salaries | 124,466 | 108,622 |
| Social security cost | 21,884 | 19,551 |
| Pension cost – defined contribution | 8,432 | 8,112 |
| Pension cost – defined benefit | 1,825 | 660 |
| Share-based payments | 17,726 | 14,439 |
| Marketing expenses | 44,499 | 31,829 |
| Investment expenses | 4,267 | 4,192 |
| Depreciation, amortisation and impairment | 22,734 | 12,857 |
| Other expenses | 115,382 | 110,591 |
| Operational expenses | 361,215 | 310,853 |

In accordance with IAS 32, any changes in the fair value of the third-party investment in Kiskadee Funds, classified as a financial liability, are recognised as fair value gains and losses through profit or loss. At the point of derecognition of the Funds at 1 July 2015, the Group recognised a loss of £6,374,000 which is included in other underwriting income above.

Wages and salaries have been shown net of transfers to acquisition and claims expenses.

## 10 Finance costs

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Interest charge associated with long-term debt | 19 | 1,754 | – |
| Interest and expenses associated with bank borrowings | | 2,156 | 1,931 |
| Interest and charges associated with Letters of Credit | 34 | 5,363 | 3,894 |
| Interest charges on experience account | | 389 | 593 |
| | | 9,662 | 6,418 |

## 11 Auditor's 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 | 2015 £000 | 2014 £000 |
|---|---|---|
| Amounts receivable by the auditor and associates in respect of: | | |
| The auditing of the accounts of any associate of the Group | 1,241 | 1,201 |
| All audit-related assurance services | 98 | 189 |
| All non-audit-related assurance services | 144 | 88 |
| | 1,483 | 1,478 |

The full audit fee payable for the Syndicate 33 audit has been included above, although an element of this is borne by the third-party participants in the Syndicate.

## 12 Net foreign exchange gains

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Exchange gains recognised in the consolidated income statement | 15,153 | 4,974 |
| Exchange gains classified as a separate component of equity | 34,478 | 34,019 |
| **Overall impact of foreign exchange-related items on net assets** | **49,631** | 38,993 |

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, whereas resulting claims are retranslated at the end of each period. The impact of this mismatch on the income statement is shown below.

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Opening balance sheet impact of non-retranslation of non-monetary items | 1,608 | (4,790) |
| Gain included within profit representing the non-retranslation of non-monetary items | 1,842 | 6,398 |
| **Closing balance sheet impact of non-retranslation of non-monetary items** | **3,450** | 1,608 |

## 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 losses/(gains) 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 2015 | Consolidated income statement 2015 £000 | Consolidated other comprehensive income 2015 £000 | Total impact on equity 2015 £000 |
|---|---|---|---|
| Unrealised translation (losses)/gains on intragroup borrowings | (1,888) | 1,888 | – |
| **Total (losses)/gains recognised** | **(1,888)** | **1,888** | – |

| Impact as at 31 December 2014 | Consolidated income statement 2014 £000 | Consolidated other comprehensive income 2014 £000 | Total impact on equity 2014 £000 |
|---|---|---|---|
| Unrealised translation gains/(losses) on intragroup borrowings | 677 | (677) | – |
| Total gains/(losses) recognised | 677 | (677) | – |

## 14 Intangible assets

| | Goodwill £000 | Syndicate capacity £000 | State authorisation licences £000 | Software and development costs £000 | Other £000 | Total £000 |
|---|---|---|---|---|---|---|
| At 1 January 2014 | | | | | | |
| Cost | 10,405 | 24,505 | 6,308 | 44,188 | 9,982 | 95,388 |
| Accumulated amortisation and impairment | (2,595) | – | – | (17,227) | (2,846) | (22,668) |
| Net book amount | 7,810 | 24,505 | 6,308 | 26,961 | 7,136 | 72,720 |
| Year ended 31 December 2014 | | | | | | |
| Opening net book amount | 7,810 | 24,505 | 6,308 | 26,961 | 7,136 | 72,720 |
| Acquisitions on purchase of subsidiary | 2,079 | – | – | 6,390 | 6,666 | 15,135 |
| Other additions | – | – | – | 19,551 | 8,523 | 28,074 |
| Amortisation charges | – | – | – | (8,947) | (1,036) | (9,983) |
| Impairment | – | – | – | – | – | – |
| Closing net book amount | 9,889 | 24,505 | 6,308 | 43,955 | 21,289 | 105,946 |
| At 31 December 2014 | | | | | | |
| Cost | 12,319 | 24,505 | 6,308 | 70,129 | 25,171 | 138,432 |
| Accumulated amortisation and impairment | (2,430) | – | – | (26,174) | (3,882) | (32,486) |
| Net book amount | 9,889 | 24,505 | 6,308 | 43,955 | 21,289 | 105,946 |
| **Year ended 31 December 2015** | | | | | | |
| Opening net book amount | **9,889** | **24,505** | **6,308** | **43,955** | **21,289** | **105,946** |
| Acquisitions on purchase of subsidiary (note 33) | **–** | **–** | **–** | **–** | **9,185** | **9,185** |
| Other additions | **–** | **–** | **–** | **20,141** | **10,127** | **30,268** |
| Amortisation charges | **–** | **–** | **–** | **(13,374)** | **(3,124)** | **(16,498)** |
| Impairment | **(2,154)** | **–** | **–** | **–** | **(479)** | **(2,633)** |
| Foreign exchange movements | **–** | **–** | **–** | **(46)** | **–** | **(46)** |
| Closing net book amount | **7,735** | **24,505** | **6,308** | **50,676** | **36,998** | **126,222** |
| **At 31 December 2015** | | | | | | |
| Cost | **10,165** | **24,505** | **6,308** | **90,205** | **43,902** | **175,085** |
| Accumulated amortisation and impairment | **(2,430)** | **–** | **–** | **(39,529)** | **(6,904)** | **(48,863)** |
| Net book amount | **7,735** | **24,505** | **6,308** | **50,676** | **36,998** | **126,222** |

Goodwill is allocated to the Group's cash generating units (CGUs) identified according to country of operation and business segment. £5,480,000 (2014: £5,480,000) is allocated to the Lloyd's corporate member entity CGU and £2,255,000 (2014: £4,409,000) is allocated to the Hiscox Retail 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 less cost to sell or value in use.

All intangible assets have a finite useful life except for the Syndicate capacity, goodwill and US state authorisation licences.

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, based on a weighted average cost of capital (WACC) for the Group of 6.4% (2014: 6.6%), 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.

In 2015, the £2,633,000 impairment recognised in the year for goodwill and other intangible assets is included in operational expenses in the consolidated income statement and relates to Hiscox Retail as a CGU. There was no impairment for 2014.

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 less costs to sell 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 2015 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.

## 14 Intangible assets continued

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 the WACC 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. These intangible assets are amortised on a straight-line basis over their useful economic life. At the end of each reporting period we assess whether there is any indication that customer contractual relationships may be impaired. Where indications of impairment are identified, the carrying value of customer contractual relationships is tested for impairment based on the recoverable amount which is considered to be the higher of the fair value less costs to sell 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 showed that £479,000 was due to be impaired (2014: £nil).

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 2015.

All of the software and development costs are internally generated.

At 31 December 2015 there were £20,478,000 of assets under development on which amortisation has yet to be charged (2014: £17,672,000).

## 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 2014 | | | | | |
| Cost | 3,834 | 4,820 | 120 | 40,253 | 49,027 |
| Accumulated depreciation | (400) | (2,238) | (59) | (26,111) | (28,808) |
| Net book amount | 3,434 | 2,582 | 61 | 14,142 | 20,219 |
| Year ended 31 December 2014 | | | | | |
| Opening net book amount | 3,434 | 2,582 | 61 | 14,142 | 20,219 |
| Additions | 6,947 | 302 | 38 | 3,901 | 11,188 |
| Acquired purchase of subsidiary | – | 179 | 1 | 590 | 770 |
| Disposals | – | – | – | (83) | (83) |
| Depreciation charge | (39) | (556) | (42) | (2,237) | (2,874) |
| Impairment | – | – | – | – | – |
| Foreign exchange movements | – | 121 | – | 156 | 277 |
| Closing net book amount | 10,342 | 2,628 | 58 | 16,469 | 29,497 |
| **At 31 December 2014** | | | | | |
| Cost | 10,781 | 5,573 | 159 | 44,932 | 61,445 |
| Accumulated depreciation | (439) | (2,945) | (101) | (28,463) | (31,948) |
| Net book amount | 10,342 | 2,628 | 58 | 16,469 | 29,497 |
| **Year ended 31 December 2015** | | | | | |
| Opening net book amount | **10,342** | **2,628** | **58** | **16,469** | **29,497** |
| Additions | **12,093** | **975** | **25** | **7,543** | **20,636** |
| Acquired purchase of subsidiary | **–** | **–** | **–** | **–** | **–** |
| Disposals | **–** | **(39)** | **(2)** | **(193)** | **(234)** |
| Depreciation charge | **(40)** | **(764)** | **(48)** | **(2,751)** | **(3,603)** |
| Impairment | **–** | **–** | **–** | **–** | **–** |
| Foreign exchange movements | **–** | **107** | **(1)** | **107** | **213** |
| Closing net book amount | **22,395** | **2,907** | **32** | **21,175** | **46,509** |
| **At 31 December 2015** | | | | | |
| Cost | **22,874** | **6,738** | **146** | **52,032** | **81,790** |
| Accumulated depreciation | **(479)** | **(3,831)** | **(114)** | **(30,857)** | **(35,281)** |
| Net book amount | **22,395** | **2,907** | **32** | **21,175** | **46,509** |

The Group's land and buildings assets relate to freehold property in the UK. There was no impairment charge during the year (2014: £nil). Assets with a net book value of £nil were held under finance leases (2014: £nil).

During 2014, £7,795,000 was recognised in the carrying line of land and buildings that were under construction. The Group moved into these premises in December 2015. There were no assets under construction at December 2015.

## 16 Investments in associates

| Year ended 31 December | 2015 £000 | 2014 £000 |
|---|---|---|
| At beginning of year | 10,670 | 7,754 |
| Additions during the year | 2,089 | 2,103 |
| Disposals during the year | – | (416) |
| Distributions received | (241) | – |
| Net profit from investments in associates | 1,007 | 1,229 |
| At end of year | 13,525 | 10,670 |

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

| | % interest held at 31 December | Assets £000 | Liabilities £000 | Revenues £000 | Profit after tax £000 |
|---|---|---|---|---|---|
| | | 100% results | | | |
| 2015 | | | | | |
| Associates incorporated in the UK | from 10% to 35% | 74,881 | 50,036 | 41,312 | 4,734 |
| Associates incorporated in Europe | from 10% to 49% | 1,969 | 1,454 | 2,616 | 207 |
| Total at the end of 2015 | | 76,850 | 51,490 | 43,928 | 4,941 |

| | % interest held at 31 December | Assets £000 | Liabilities £000 | Revenues £000 | Profit after tax £000 |
|---|---|---|---|---|---|
| | | 100% results | | | |
| 2014 | | | | | |
| Associates incorporated in the UK | from 10% to 35% | 76,176 | 52,281 | 38,089 | 4,086 |
| Associates incorporated in Europe | from 10% to 49% | 1,965 | 1,627 | 2,752 | 242 |
| Total at the end of 2014 | | 78,141 | 53,908 | 40,841 | 4,328 |

During 2015, the Group increased its holding in White Oak Underwriting Agency Limited to 29.8% for £2,089,000.

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

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Gross £000 | Reinsurance £000 | Net £000 | Gross £000 | Reinsurance £000 | Net £000 |
| Balance deferred at 1 January | 230,373 | (30,215) | 200,158 | 197,628 | (23,479) | 174,149 |
| Acquisition costs incurred in relation to insurance contracts written | 474,534 | (94,021) | 380,513 | 425,773 | (87,328) | 338,445 |
| Acquisition costs expensed to the income statement | (441,376) | 97,093 | (344,283) | (399,658) | 81,042 | (318,616) |
| Foreign exchange and other adjustments | 7,986 | (6,068) | 1,918 | 6,630 | (450) | 6,180 |
| Balance deferred at 31 December | 271,517 | (33,211) | 238,306 | 230,373 | (30,215) | 200,158 |

The deferred amount of insurance contract acquisition costs attributable to reinsurers of £33,211,000 (2014: £30,215,000) is not eligible for offset against the gross balance sheet asset and is included separately within trade and other payables (note 27).

Due to the deconsolidation of the Kiskadee Funds, note 2.3(a), the impact on reinsurance deferred acquisition costs is included in other adjustments.

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Within one year | 212,149 | 183,810 |
| After one year | 26,157 | 16,348 |
| | 238,306 | 200,158 |

## 18 Reinsurance assets

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Reinsurers' share of insurance liabilities | | **539,540** | 526,085 |
| Provision for non-recovery and impairment | | **(730)** | (740) |
| **Reinsurance assets** | 26 | **538,810** | 525,345 |

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

| | 2015 | 2014 |
|---|---|---|
| Within one year | **301,022** | 287,528 |
| After one year | **237,788** | 237,817 |
| | **538,810** | 525,345 |

Amounts due from reinsurers in respect of outstanding premiums and claims already paid by the Group are included in loans and receivables (note 20). The Group recognised a gain during the year of £10,000 (2014: gain of £41,000) in respect of previously impaired balances.

## 19 Financial assets and liabilities

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

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Debt and fixed income securities | | **2,615,014** | 2,526,179 |
| Equities and units in unit trusts | | **259,705** | 252,916 |
| Deposits with credit institutions | | **6,684** | 26,385 |
| Total investments | | **2,881,403** | 2,805,480 |
| Insurance linked funds | | **40,045** | 22,888 |
| Derivative financial instruments | 21 | **137** | 479 |
| **Total financial assets carried at fair value** | | **2,921,585** | 2,828,847 |

The effective maturity of the debt and fixed income securities due within and after one year are as follows:

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Within one year | **607,968** | 616,038 |
| After one year | **2,007,046** | 1,910,141 |
| | **2,615,014** | 2,526,179 |

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).

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Third-party investment in Kiskadee Funds | | **–** | 7,033 |
| Derivative financial instruments | 21 | **16** | 76 |
| **Total financial liabilities carried at fair value** | | **16** | 7,109 |

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Long-term debt | | **273,909** | – |
| Accrued interest on long-term debt | | **1,754** | – |
| **Total financial liabilities carried at amortised cost** | | **275,663** | – |

All of the financial liabilities carried at fair value are due within one year. All of the financial liabilities carried at amortised cost are due after one year.

Following a significant inflow of capital from third-party investors during 2015, the Group has determined that it no longer meets the criteria for consolidation of the Kiskadee Funds and SPIs from 1 July 2015 as defined in IFRS 10. As a result, from that date the assets and liabilities of the Kiskadee Funds as well as the two SPIs have been derecognised at their carrying amounts and the Group's investment in the Kiskadee Funds is recognised as a financial asset measured at fair value through profit and loss.

This investment is classified as insurance linked funds in the table above. The investment in the Funds was recognised at fair value on the date of deconsolidation at £35.4 million (refer to note 22). The Group recognised a gain of £2.2 million for the period from 1 July 2015 related to the Kiskadee Funds. No further subscriptions or redemptions were made into these funds by the Group in 2015.

At 31 December 2014, the Group had an investment in the Third Party Reinsurance Opportunities Fund which was classified as an insurance linked fund. These positions were redeemed during early 2015 as the contracts expired. No positions remain open at December 2015.

## 19 Financial assets and liabilities continued

On 24 November 2015, the Group issued £275.0 million 6.125% fixed-to-floating rate callable subordinated notes due 2045, with a first call date of 2025.

The notes bear interest from and including 24 November 2015 at a fixed rate of 6.125% per annum payable annually in arrears starting 24 November 2016 up until the first call date in November 2025, and thereafter at a floating rate of interest equal to three-month LIBOR plus 5.076% payable quarterly in arrears on each floating interest payment date. The Group is exposed to cash flow interest rate risk on its long-term debt.

On 25 November 2015 the notes were admitted for trading on the London Stock Exchange's regulated market. The notes were rated BBB- by S&P as well as by Fitch.

The fair value of the long-term debt is estimated as £275.7 million. The fair value measurement is classified within Level 1 of the fair value hierarchy. The fair value is estimated by reference to the actively traded value on the London Stock Exchange.

The interest accrued on the long-term debt was £1.75 million at the balance sheet date and is included in financial liabilities.

Note 10 includes details of the interest expense for the year included in financing costs.

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Debt and fixed income securities | | |
| Sterling | 443,902 | 490,440 |
| US Dollars | 1,848,684 | 1,707,643 |
| Euro and other currencies | 322,428 | 328,096 |
| | 2,615,014 | 2,526,179 |
| Equities and shares in unit trusts | | |
| Sterling | 134,888 | 137,179 |
| US Dollars | 124,817 | 115,737 |
| Euro and other currencies | – | – |
| | 259,705 | 252,916 |
| Deposits with credit institutions | | |
| Sterling | 1,089 | 25,507 |
| US Dollars | – | – |
| Euro and other currencies | 5,595 | 878 |
| | 6,684 | 26,385 |
| Total investments | 2,881,403 | 2,805,480 |

## 20 Loans and receivables including insurance receivables

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Gross receivables arising from insurance and reinsurance contracts | 538,652 | 482,641 |
| Provision for impairment | (2,175) | (2,131) |
| Net receivables arising from insurance and reinsurance contracts | 536,477 | 480,510 |
| Due from contract holders, brokers, agents and intermediaries | 405,284 | 349,955 |
| Due from reinsurance operations | 131,193 | 130,555 |
| | 536,477 | 480,510 |
| Prepayments and accrued income | 8,130 | 9,068 |
| Other loans and receivables: | | |
| Net profit commission receivable | 26,139 | 25,116 |
| Accrued interest | 8,637 | 9,448 |
| Share of Syndicates' other debtors' balances | 13,173 | 12,952 |
| Other debtors including related party amounts | 27,007 | 19,165 |
| Total loans and receivables including insurance receivables | 619,563 | 556,259 |

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Within one year | 598,317 | 534,921 |
| After one year | 21,246 | 21,338 |
| | 619,563 | 556,259 |

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 £44,000 (2014: loss of £849,000) for the impairment of receivables during the year ended 31 December 2015.

The carrying amounts disclosed above are reasonably approximate to the fair value at the reporting date.

## 21 Derivative financial instruments

The Group entered into both exchange-traded and over-the-counter derivative contracts for a number of purposes during 2015. 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 2015 all mature within one year of the balance sheet date and are detailed below:

| 31 December 2015<br>Derivative financial instruments 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 | 11,610 | 81 | (16) | 65 |
| Interest rate futures contracts | 31,031 | 56 | – | 56 |
| Credit default swaps | – | – | – | – |

The foreign exchange forward contracts are represented by gross fair value of assets and liabilities as detailed below:

| | | | |
|---|---|---|---|
| Gross fair value of assets | 12,765 | 367 | 13,132 |
| Gross fair value of liabilities | (12,684) | (383) | (13,067) |
| | 81 | (16) | 65 |

| 31 December 2014<br>Derivative financial instruments 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 | 25,875 | 479 | (76) | 403 |
| Interest rate futures contracts | 31,421 | – | – | – |
| Credit default swaps | 1,639 | – | – | – |

The foreign exchange forward contracts are represented by gross fair value of assets and liabilities as detailed below:

| | | | |
|---|---|---|---|
| Gross fair value of assets | 19,596 | 3,003 | 22,599 |
| Gross fair value of liabilities | (19,117) | (3,079) | (22,196) |
| | 479 | (76) | 403 |

## 21 Derivative financial instruments continued

### *Foreign exchange forward contracts*
During the current and prior year the Group entered into a series of conventional over-the-counter forward contracts in order to secure translation gains made on Euro, US Dollar and other non-Pound Sterling denominated monetary assets. The contracts require the Group to forward sell a fixed amount of the relevant currency for Pound Sterling at pre-agreed future exchange rates. The Group made a gain on these forward contracts of £1,940,000 (2014: gain of £1,941,000) as included in note 7. 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 £239,000 (2014: loss of £2,078,000) as included in note 7.

### *Equity index options*
The Group did not purchase equity options during 2015 or 2014.

## 22 Fair value measurements
In accordance with IFRS 13: Fair Value Measurement, the financial instruments carried at fair value, based on a three-level fair value hierarchy that reflects the significance of the inputs used in measuring the fair value, are provided below.

| As at 31 December 2015 | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Debt and fixed income securities | 836,950 | 1,778,064 | – | 2,615,014 |
| Equities and shares in unit trusts | – | 246,065 | 13,640 | 259,705 |
| Deposits with credit institutions | 6,684 | – | – | 6,684 |
| Insurance linked fund | – | – | 40,045 | 40,045 |
| Derivative instrument assets | – | 137 | – | 137 |
| **Total** | 843,634 | 2,024,266 | 53,685 | 2,921,585 |
| **Financial liabilities** | | | | |
| Derivative financial instruments | – | 16 | – | 16 |
| **Total** | – | 16 | – | 16 |

| As at 31 December 2014 | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Debt and fixed income securities | 682,940 | 1,843,239 | – | 2,526,179 |
| Equities and shares in unit trusts | – | 239,238 | 13,678 | 252,916 |
| Deposits with credit institutions | 26,385 | – | – | 26,385 |
| Insurance linked fund | – | – | 22,888 | 22,888 |
| Derivative instrument assets | – | 479 | – | 479 |
| Total | 709,325 | 2,082,956 | 36,566 | 2,828,847 |
| **Financial liabilities** | | | | |
| Third-party investment in Kiskadee Funds | – | – | 7,033 | 7,033 |
| Derivative financial instruments | – | 76 | – | 76 |
| Total | – | 76 | 7,033 | 7,109 |

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.

Investments in mutual funds, which are included in equities and shares in unit trusts, 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 certain government bonds, treasury bills, long-term debt and exchange-traded equities which are measured based on quoted prices in active markets. The fair value of the long-term debt that is carried at amortised cost, is estimated at £275.7 million and is considered as Level 1 in fair value hierarchy.

Level 2 of the hierarchy contains certain government bonds, US government agencies, corporate securities, asset backed securities and mortgage-backed securities. 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, unquoted equity securities and an insurance linked fund which have limited observable inputs on which to measure fair value. Unquoted equities are carried at fair value. The effect of changing one or more inputs used in the measurement of fair value of these instruments to another reasonably possible assumption would not be significant. At 31 December 2014, the Group had an investment in a third-party insurance linked fund that specialised in catastrophe reinsurance opportunities. The fund was partially redeemed in January 2015 with remaining redemption shares issued which paid out when the underwriting contracts expired on 30 June 2015. At 31 December 2015, the insurance linked funds of £40,045,000 represents the Group's investment in the Kiskadee Funds.

The fair value of the Kiskadee Funds is estimated to be the net asset value as at the balance sheet date. The net asset value is based on the fair value of the assets and liabilities in the Fund. The majority of the assets of the Fund are cash and cash equivalents. Significant inputs and assumptions in calculating the fair value of the assets and liabilities associated with reinsurance contracts written by the Kiskadee Funds include the amount and timing of claims payable in respect of claims incurred and periods of unexpired risk. The Group has considered changes in the net asset valuation of the Kiskadee Funds if reasonably different inputs and assumptions were used and has found no significant changes in the valuation.

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

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

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

| | Financial asset | | | Financial liability |
|---|---|---|---|---|
| **31 December 2015** | Equities and shares in unit trusts £000 | Insurance linked fund £000 | Total £000 | Third-party investment in Kiskadee Funds £000 |
| Balance at 1 January | 13,678 | 22,888 | 36,566 | 7,033 |
| Fair value gains or losses through profit or loss* | (230) | 2,189 | 1,959 | 6,374 |
| Foreign exchange gains | 283 | 2,959 | 3,242 | (3,968) |
| Purchases | 52 | – | 52 | 264,306 |
| Recognition/(derecognition) on deconsolidation | – | 35,362 | 35,362 | (273,745) |
| Settlements | (143) | (23,353) | (23,496) | – |
| **Closing balance** | 13,640 | 40,045 | 53,685 | – |
| **Unrealised gains and losses in the year on securities held at the end of the year** | (257) | 2,201 | 1,944 | – |

*Fair value gains/(losses) are included within the investment result in the income statement for equities and shares in unit trusts and through other income for the insurance linked fund.

| 31 December 2014 | Equities and shares in unit trusts £000 | Insurance linked fund £000 | Total £000 | Third-party investment in Kiskadee Funds £000 |
|---|---|---|---|---|
| Balance at 1 January | 14,064 | 19,917 | 33,981 | – |
| Fair value gains or losses through profit or loss* | 2,920 | 1,725 | 4,645 | 589 |
| Foreign exchange gains and losses | 284 | 1,246 | 1,530 | 408 |
| Purchases | 6 | – | 6 | 6,036 |
| Settlements | (3,596) | – | (3,596) | – |
| Closing balance | 13,678 | 22,888 | 36,566 | 7,033 |
| Unrealised gains and losses in the year on securities held at the end of the year | 3,204 | 2,971 | 6,175 | 589 |

*Fair value gains/(losses) are included within the investment result in the income statement for equities and shares in unit trusts and through other income for the insurance linked fund.

## 23 Cash and cash equivalents

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Cash at bank and in hand | **601,301** | 400,245 |
| Short-term deposits | **126,579** | 39,220 |
| Cash held by special purpose vehicles | **–** | 41,258 |
| Subscriptions received in advance | **–** | 169,928 |
| | **727,880** | 650,651 |

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.

Following a significant inflow of capital from third-party investors during 2015, the Group has determined that it no longer meets the criteria for consolidation of the Kiskadee Funds and SPIs from 1 July 2015 as defined in IFRS 10. As a result, since 1 July 2015 the Group no longer recognises any assets or liabilities held by these vehicles including the cash held by special purpose vehicles or the subscriptions received in advance as described below.

The cash held by special purpose vehicles consists of underlying interests held by the Kiskadee Funds which were consolidated by the Group at 31 December 2014, but in which the Group had an interest of less than 100%.

Subscriptions received in advance consist of cash received as at 31 December 2014 by the two Kiskadee Funds and not invested at the balance sheet date.

## 24 Share capital

| | 31 December 2015 | | 31 December 2014 | |
|---|---|---|---|---|
| Group | Share capital £000 | Number of shares 000 | Share capital £000 | Number of shares 000 |
| Authorised ordinary share capital of 6.5p (2014: 6p) | **240,000** | **3,692,308** | 40,000 | 666,667 |
| Issued ordinary share capital of 6.5p (2014: 6p) | **19,030** | **292,776** | 19,913 | 331,874 |

On 28 March 2013 the Company passed a special resolution to increase the authorised share capital by £200,000,000 (400,000,000 shares at a par value of 50.0p per share) to facilitate the capital distribution of the B Shares in 2013. There are no B Shares outstanding at 31 December 2014 or 2015 as all shares have been redeemed or cancelled.

At an Extraordinary General Meeting held on 25 March 2015 a resolution was passed to subdivide and consolidate the 400,000,000 unissued shares of par value of 50.0p each into shares of 6.5p each to rank pari passu with the ordinary shares in the capital of the Company.

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

| Changes in Group share capital and contributed surplus | Ordinary share capital £000 | Share premium £000 | Contributed surplus £000 | C Shares £000 | D Shares £000 | E Shares £000 | F Shares £000 |
|---|---|---|---|---|---|---|---|
| At 1 January 2014 | 20,854 | 4,953 | 89,864 | – | – | – | – |
| Employee share option scheme – proceeds from shares issued | 74 | 2,669 | – | – | – | – | – |
| Issue of C/D Shares | – | (35) | – | 128,988 | 46,824 | – | – |
| Redemption of C/D Shares | – | – | – | (128,988) | (46,824) | – | – |
| Share consolidation and subdivision | (1,032) | 1,032 | – | – | – | – | – |
| Scrip dividends to owners of the Company | 17 | 1,798 | – | – | – | – | – |
| At 31 December 2014 | 19,913 | 10,417 | 89,864 | – | – | – | – |
| Employee share option scheme – proceeds from shares issued | 29 | 1,400 | – | – | – | – | – |
| Issue of E/F Shares | – | (32) | – | – | – | 143,176 | 46,351 |
| Redemption of E/F Shares | – | – | – | – | – | (143,176) | (46,351) |
| Share consolidation and subdivision | (930) | 930 | – | – | – | – | – |
| Scrip dividends to owners of the Company | 18 | 2,516 | – | – | – | – | – |
| **At 31 December 2015** | **19,030** | **15,231** | **89,864** | **–** | **–** | **–** | **–** |

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

## E/F Share issue and return of capital

On 2 March 2015, Hiscox Ltd announced its intention to return approximately £192 million, or 60p per existing ordinary share, to shareholders. This comprised 45p per share in the form of a special distribution and a final dividend equivalent of 15p per share. This was also accompanied by a consolidation of the Company's existing ordinary share capital as described below. These proposals were approved by shareholders at an Extraordinary General Meeting held on 25 March 2015.

On 26 March 2015, E/F Shares were issued to existing shareholders on the basis of one E or F Share (at the election of the shareholder) for each existing ordinary share held. Each E Share entitled the shareholder to receive 60p in the form of a dividend payable on 2 April 2015. Each F Share would be purchased by UBS Limited for the same amount. Following its purchase of the F Shares, UBS Limited exercised a put option requiring the Company to buy the shares for 60p each.

There were no E/F Shares outstanding at 31 December 2015 as both classes of shares had been redeemed and cancelled by that date.

As a result of these arrangements total capital of £189,559,000 was returned to shareholders, of which £32,000 was charged against the share premium account and the remaining £189,527,000 charged against retained earnings. An additional £2,862,000 of E Shares were distributed to the Employee Benefit Trust. The amount is not reported as a distribution as the Trust forms part of the consolidated result.

In an effort to ensure that the net tangible asset value per share remained the same, pre and post the return of capital, a 88 for 100 share consolidation was also undertaken. This was accompanied by a separate issue of deferred shares which were subsequently cancelled in order to arrive at a new par value for the ordinary shares of 6.5p each. No deferred shares were in issue at 31 December 2015 as all shares had been redeemed and cancelled by that date.

During the year, the Group offered its shareholders the option of receiving a scrip dividend alternative to the interim 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.

The Company relies upon dividend streams from its subsidiary companies to provide the cash flow required for distributions to be made to shareholders. The ability of the subsidiaries to pay dividends is subject to regulatory restrictions within the jurisdiction from which they operate.

## Share repurchase

The Trustees of the Group's Employee Benefit Trust purchased Hiscox Ltd shares through the market during the period for £6,712,000 (2014: £10,593,000) to facilitate the settlement of vesting awards under the Group's Performance Share Plan. As the trust is consolidated into the Group financial results, these purchases have been accounted for in the same way as treasury shares and have been charged against retained earnings. The shares are held by the Trustees for the beneficiaries of the Trust.

| Equity structure of Hiscox Ltd | Note | Number of ordinary shares in issue (thousands) 2015 | Number of ordinary shares in issue (thousands) 2014 |
|---|---|---|---|
| At 1 January | | **331,874** | 371,215 |
| Employee share option scheme – ordinary shares issued | | **458** | 1,236 |
| Scrip dividends to owners of the Company | 32 | **274** | 271 |
| Share consolidation as a result of the special capital distribution | | **(39,830)** | (40,848) |
| **At 31 December** | | **292,776** | 331,874 |

Up until 26 March 2015, the Group issued 6p ordinary shares. From this date, new ordinary shares of 6.5p each exist. 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 £17,726,000 (2014: £14,439,000). This comprises charges of £17,136,000 (2014: £13,968,000) in respect of Performance Share Plan awards and £590,000 (2014: £471,000) 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.

# Notes to the consolidated financial statements
continued

## 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 | 2015 | 2014 |
|---|---|---|
| Annual risk-free rates of return and discount rates (%) | **0.76-0.82** | 1.09-1.32 |
| Long-term dividend yield (%) | **4.28** | 4.46 |
| Expected life of options (years) | **3.25** | 3.25 |
| Implied volatility of share price (%) | **19.4** | 20.5 |
| Weighted average share price (p) | **884.7** | 684.9 |

The weighted average fair value of each share option granted during the year was 156.7p (2014: 122.0p). The weighted average fair value of each Performance Share Plan award granted during the year was 885.0p (2014: 688.5p).

Movements in the number of share options and Performance Share Plan awards during the year and details of the balances outstanding at 31 December 2015 for the Executive Directors are shown in the Directors' remuneration report. The total number of options and Performance Share Plan awards outstanding is 11,005,621 (2014: 12,460,938) of which 2,043,465 are exercisable (2014: 3,723,170). The total number of SAYE options outstanding is 2,041,124 (2014: 2,013,508).

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Currency translation reserve at 31 December | **91,178** | 56,700 |
| Retained earnings at 31 December | **1,312,660** | 1,276,446 |

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.

The Group purchased its own shares during 2015 for a net amount of £6,712,000 and placed them in the Trust for future utilisation on vesting of Performance Share Plan awards (2014: £10,593,000).

At 31 December 2015 Hiscox Ltd held 8,098,190 shares in treasury (2014: 12,645,632). 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 | 2015 £000 | 2014 £000 |
|---|---|---|---|
| **Gross** | | | |
| Claims reported and claim adjustment expenses | | **824,397** | 825,017 |
| Claims incurred but not reported | | **1,213,699** | 1,142,847 |
| Unearned premiums | | **1,010,266** | 867,335 |
| **Total insurance liabilities, gross** | | **3,048,362** | 2,835,199 |
| **Recoverable from reinsurers** | | | |
| Claims reported and claim adjustment expenses | | **118,322** | 129,134 |
| Claims incurred but not reported | | **247,155** | 239,185 |
| Unearned premiums | | **173,333** | 157,026 |
| **Total reinsurers' share of insurance liabilities** | 18 | **538,810** | 525,345 |
| **Net** | | | |
| Claims reported and claim adjustment expenses | | **706,075** | 695,883 |
| Claims incurred but not reported | | **966,544** | 903,662 |
| Unearned premiums | | **836,933** | 710,309 |
| **Total insurance liabilities, net** | | **2,509,552** | 2,309,854 |

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Within one year | **1,330,074** | 1,222,114 |
| After one year | **1,179,478** | 1,087,740 |
| | **2,509,552** | 2,309,854 |

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 2015 and 2014 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. 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 | 2006 £000 | 2007 £000 | 2008 £000 | 2009 £000 | 2010 £000 | 2011 £000 | 2012 £000 | 2013 £000 | 2014 £000 | **2015 £000** | **Total £000** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year | 613,965 | 820,758 | 1,171,389 | 871,290 | 1,050,390 | 1,346,120 | 1,135,921 | 914,316 | 1,002,432 | **1,086,715** | **10,013,296** |
| one year later | 586,774 | 731,504 | 989,227 | 722,476 | 896,516 | 1,223,229 | 1,013,078 | 803,558 | 852,952 | **–** | **7,819,314** |
| two years later | 565,700 | 694,409 | 963,518 | 663,564 | 834,064 | 1,185,540 | 937,629 | 716,413 | – | **–** | **6,560,837** |
| three years later | 534,113 | 704,700 | 921,366 | 656,334 | 820,684 | 1,194,990 | 935,543 | – | – | **–** | **5,767,730** |
| four years later | 542,438 | 699,387 | 883,940 | 655,016 | 799,344 | 1,177,983 | – | – | – | **–** | **4,758,108** |
| five years later | 531,663 | 668,173 | 848,564 | 651,969 | 788,035 | – | – | – | – | **–** | **3,488,404** |
| six years later | 518,941 | 651,304 | 839,083 | 637,232 | – | – | – | – | – | **–** | **2,646,560** |
| seven years later | 513,482 | 634,993 | 826,272 | – | – | – | – | – | – | **–** | **1,974,747** |
| eight years later | 511,115 | 630,485 | – | – | – | – | – | – | – | **–** | **1,141,600** |
| nine years later | 509,517 | – | – | – | – | – | – | – | – | **–** | **509,517** |
| Current estimate of cumulative claims | 509,517 | 630,485 | 826,272 | 637,232 | 788,035 | 1,177,983 | 935,543 | 716,413 | 852,952 | **1,086,715** | **8,161,147** |
| Cumulative payments to date | (495,101) | (593,238) | (793,010) | (567,489) | (647,246) | (970,104) | (674,576) | (492,040) | (449,650) | **(221,461)** | **(5,903,915)** |
| Liability recognised at 100% level | 14,416 | 37,247 | 33,262 | 69,743 | 140,789 | 207,879 | 260,967 | 224,373 | 403,302 | **865,254** | **2,257,232** |
| Liability recognised in respect of prior accident years at 100% level | | | | | | | | | | | **116,296** |
| **Total gross liability to external parties at 100% level** | | | | | | | | | | | **2,373,528** |

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2015.

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

| Accident year | 2006 £000 | 2007 £000 | 2008 £000 | 2009 £000 | 2010 £000 | 2011 £000 | 2012 £000 | 2013 £000 | 2014 £000 | **2015 £000** | **Total £000** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Current estimate of cumulative claims | 509,517 | 630,485 | 826,272 | 637,232 | 788,035 | 1,177,983 | 935,543 | 716,413 | 852,952 | **1,086,715** | **8,161,147** |
| Less: attributable to external Names | (107,966) | (124,235) | (157,347) | (109,941) | (120,709) | (178,161) | (123,416) | (80,299) | (94,391) | **(129,160)** | **(1,225,625)** |
| Group's share of current ultimate claims estimate | 401,551 | 506,250 | 668,925 | 527,291 | 667,326 | 999,822 | 812,127 | 636,114 | 758,561 | **957,555** | **6,935,522** |
| Cumulative payments to date | (495,101) | (593,238) | (793,010) | (567,489) | (647,246) | (970,104) | (674,576) | (492,040) | (449,650) | **(221,461)** | **(5,903,915)** |
| Less: attributable to external Names | 104,367 | 116,544 | 151,987 | 98,428 | 97,773 | 143,032 | 91,978 | 49,728 | 45,632 | **17,696** | **917,165** |
| Group's share of cumulative payments | (390,734) | (476,694) | (641,023) | (469,061) | (549,473) | (827,072) | (582,598) | (442,312) | (404,018) | **(203,765)** | **(4,986,750)** |
| Liability for 2006 to 2015 accident years recognised on Group's balance sheet | 10,817 | 29,556 | 27,902 | 58,230 | 117,853 | 172,750 | 229,529 | 193,802 | 354,543 | **753,790** | **1,948,772** |
| Liability for accident years before 2006 recognised on Group's balance sheet | | | | | | | | | | | **89,324** |
| **Total Group liability to external parties included in balance sheet – gross**** | | | | | | | | | | | **2,038,096** |

**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 | 2006 £000 | 2007 £000 | 2008 £000 | 2009 £000 | 2010 £000 | 2011 £000 | 2012 £000 | 2013 £000 | 2014 £000 | 2015 £000 | Total £000 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Estimate of ultimate claims costs as adjusted for foreign exchange* at end of accident year | 547,475 | 716,600 | 816,672 | 721,233 | 833,980 | 1,043,574 | 830,401 | 796,559 | 827,058 | 888,780 | 8,022,332 |
| one year later | 539,615 | 650,572 | 729,073 | 602,776 | 734,104 | 969,415 | 731,379 | 704,190 | 722,306 | – | 6,383,430 |
| two years later | 522,043 | 627,838 | 724,013 | 576,104 | 692,095 | 928,640 | 678,036 | 632,967 | – | – | 5,381,736 |
| three years later | 479,118 | 598,170 | 680,906 | 577,334 | 675,455 | 925,491 | 655,337 | – | – | – | 4,591,811 |
| four years later | 493,795 | 595,009 | 645,733 | 570,022 | 658,476 | 920,449 | – | – | – | – | 3,883,484 |
| five years later | 480,198 | 567,690 | 638,019 | 565,730 | 655,457 | – | – | – | – | – | 2,907,094 |
| six years later | 473,881 | 563,220 | 630,606 | 553,901 | – | – | – | – | – | – | 2,221,608 |
| seven years later | 474,232 | 549,438 | 618,979 | – | – | – | – | – | – | – | 1,642,649 |
| eight years later | 471,817 | 546,300 | – | – | – | – | – | – | – | – | 1,018,117 |
| nine years later | 470,004 | – | – | – | – | – | – | – | – | – | 470,004 |
| Current estimate of cumulative claims | 470,004 | 546,300 | 618,979 | 553,901 | 655,457 | 920,449 | 655,337 | 632,967 | 722,306 | 888,780 | 6,664,480 |
| Cumulative payments to date | (468,372) | (514,985) | (594,754) | (489,224) | (524,814) | (783,148) | (467,934) | (427,117) | (369,309) | (175,735) | (4,815,392) |
| Liability recognised at 100% level | 1,632 | 31,315 | 24,225 | 64,677 | 130,643 | 137,301 | 187,403 | 205,850 | 352,997 | 713,045 | 1,849,088 |
| Liability recognised in respect of prior accident years at 100% level | | | | | | | | | | | 84,169 |
| **Total net liability to external parties at 100% level** | | | | | | | | | | | **1,933,257** |

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2015.

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

| Accident year | 2006 £000 | 2007 £000 | 2008 £000 | 2009 £000 | 2010 £000 | 2011 £000 | 2012 £000 | 2013 £000 | 2014 £000 | 2015 £000 | Total £000 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Current estimate of cumulative claims | 470,004 | 546,300 | 618,979 | 553,901 | 655,457 | 920,449 | 655,337 | 632,967 | 722,306 | 888,780 | 6,664,480 |
| Less: attributable to external Names | (99,367) | (107,475) | (109,892) | (87,871) | (89,266) | (127,761) | (71,176) | (65,478) | (75,387) | (97,318) | (930,991) |
| Group's share of current ultimate claims estimate | 370,637 | 438,825 | 509,087 | 466,030 | 566,191 | 792,688 | 584,161 | 567,489 | 646,919 | 791,462 | 5,733,489 |
| Cumulative payments to date | (468,372) | (514,985) | (594,754) | (489,224) | (524,814) | (783,148) | (467,934) | (427,117) | (369,309) | (175,735) | (4,815,392) |
| Less: attributable to external Names | 99,193 | 100,729 | 106,275 | 75,818 | 67,037 | 109,870 | 47,985 | 38,096 | 35,063 | 12,188 | 692,254 |
| Group's share of cumulative payments | (369,179) | (414,256) | (488,479) | (413,406) | (457,777) | (673,278) | (419,949) | (389,021) | (334,246) | (163,547) | (4,123,138) |
| Liability for 2006 to 2015 accident years recognised on Group's balance sheet | 1,458 | 24,569 | 20,608 | 52,624 | 108,414 | 119,410 | 164,212 | 178,468 | 312,673 | 627,915 | 1,610,351 |
| Liability for accident years before 2006 recognised on Group's balance sheet | | | | | | | | | | | 62,268 |
| **Total Group liability to external parties included in the balance sheet – net**** | | | | | | | | | | | **1,672,619** |

**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 | 2015 Gross £000 | 2015 Reinsurance £000 | 2015 Net £000 | 2014 Gross £000 | 2014 Reinsurance £000 | 2014 Net £000 |
|---|---|---|---|---|---|---|
| Total at beginning of year | (1,967,864) | 368,319 | (1,599,545) | (1,853,062) | 359,946 | (1,493,116) |
| Claims and claim adjustment expenses for year | (685,897) | 113,444 | (572,453) | (645,145) | 113,477 | (531,668) |
| Cash paid for claims settled in the year | 673,083 | (129,606) | 543,477 | 591,796 | (124,194) | 467,602 |
| Exchange differences and other movements | (57,418) | 13,320 | (44,098) | (61,453) | 19,090 | (42,363) |
| Total at end of year | (2,038,096) | 365,477 | (1,672,619) | (1,967,864) | 368,319 | (1,599,545) |
| Claims reported and claim adjustment expenses | (824,397) | 118,322 | (706,075) | (825,017) | 129,134 | (695,883) |
| Claims incurred but not reported | (1,213,699) | 247,155 | (966,544) | (1,142,847) | 239,185 | (903,662) |
| Total at end of year | (2,038,096) | 365,477 | (1,672,619) | (1,967,864) | 368,319 | (1,599,545) |

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

| Year ended 31 December | 2015 Gross £000 | 2015 Reinsurance £000 | 2015 Net £000 | 2014 Gross £000 | 2014 Reinsurance £000 | 2014 Net £000 |
|---|---|---|---|---|---|---|
| Current year claims and claim adjustment expenses | (943,824) | 165,507 | (778,317) | (845,086) | 141,189 | (703,897) |
| Over-provision in respect of prior year claims and claim adjustment expenses | 257,927 | (52,063) | 205,864 | 199,941 | (27,712) | 172,229 |
| Total claims and claim adjustment expenses | (685,897) | 113,444 | (572,453) | (645,145) | 113,477 | (531,668) |

A reconciliation of the unearned premium reserves is as follows:

| | 2015 Gross £000 | 2015 Reinsurance £000 | 2015 Net £000 | 2014 Gross £000 | 2014 Reinsurance £000 | 2014 Net £000 |
|---|---|---|---|---|---|---|
| Balance deferred at 1 January | 867,335 | (157,026) | 710,309 | 756,059 | (98,876) | 657,183 |
| Premiums written | 1,944,220 | (372,376) | 1,571,844 | 1,756,260 | (412,850) | 1,343,410 |
| Premiums earned through the income statement | (1,828,334) | 393,318 | (1,435,016) | (1,674,982) | 358,723 | (1,316,259) |
| Foreign exchange and other adjustments | 27,045 | (37,249) | (10,204) | 29,998 | (4,023) | 25,975 |
| Balance deferred at 31 December | 1,010,266 | (173,333) | 836,933 | 867,335 | (157,026) | 710,309 |

Due to the deconsolidation of the Kiskadee Funds, note 2.3(a), the impact on reinsurance unearned premium is included in other adjustments. The amounts expected to be recovered before and after one year, based on historical experience, are included in the first table to this note 26.

## 27 Trade and other payables

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Creditors arising out of direct insurance operations | | 20,208 | 11,969 |
| Creditors arising out of reinsurance operations | | 210,654 | 248,267 |
| | | 230,862 | 260,236 |
| Share of Syndicates' other creditors' balances | | 11,095 | 3,212 |
| Social security and other taxes payable | | 12,266 | 9,782 |
| Subscriptions received in advance | | – | 169,928 |
| Other creditors | | 11,654 | 11,968 |
| | | 35,015 | 194,890 |
| Reinsurers' share of deferred acquisition costs | 17 | 33,211 | 30,215 |
| Accruals and deferred income | | 117,270 | 106,319 |
| Total | | 416,358 | 591,660 |

## 27 Trade and other payables continued

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Within one year | **381,246** | 563,663 |
| After one year | **35,112** | 27,997 |
| | **416,358** | 591,660 |

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.

Subscriptions received in advance consisted of cash received as at 31 December 2014 by the two Kiskadee Funds and not yet invested at the balance sheet date, see note 23.

The carrying amounts disclosed above are reasonably approximate to the fair value at the reporting date.

## 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:

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Current tax | | |
| Expense for the year | **9,906** | 65,537 |
| Adjustments in respect of prior years | **(264)** | (3,365) |
| **Total current tax expense** | **9,642** | 62,172 |
| Deferred tax | | |
| Credit for the year | **(1,849)** | (45,633) |
| Adjustments in respect of prior years | **(490)** | (811) |
| Effect of rate change | **(1,098)** | (805) |
| **Total deferred tax credit** | **(3,437)** | (47,249) |
| **Total tax charged to the income statement** | **6,205** | 14,923 |

The standard rate of corporation tax in Bermuda is 0% whereas the effective rate of tax for the Group is 2.9% (2014: 6.5%). A reconciliation of the difference is provided below:

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Profit before tax | **216,100** | 231,075 |
| Tax calculated at the standard corporation tax rate applicable in Bermuda: 0% (2014: 0%) | **–** | – |
| Effects of Group entities subject to overseas tax at different rates | **2,688** | 14,703 |
| Impact of overseas tax rates on: | | |
| Effect of rate change | **(1,098)** | (805) |
| Expenses not deductible for tax purposes | **1,999** | 2,911 |
| Tax losses for which no deferred tax asset is recognised | **6,936** | 4,218 |
| Other | **(513)** | (972) |
| Adjustment for share-based payments | **260** | (64) |
| Non-taxable income | **(3,313)** | (892) |
| Prior year tax adjustments | **(754)** | (4,176) |
| **Tax charge for the period** | **6,205** | 14,923 |

The UK Finance Act 2015 introduced a new tax with effect from 1 April 2015, the Diverted Profits Tax (DPT), which in certain situations applies a tax of 25% on income which would not otherwise be chargeable to UK tax. The Group is currently in discussions with HMRC as to the scope of the new tax in the context of the Group's operations. No provision for DPT has been made in 2015.

## 29 Deferred tax

| Deferred reconciliation tax assets | 2015 £000 | 2014 £000 |
|---|---|---|
| Trading losses in overseas entities | **35,147** | 33,490 |

| Net deferred tax liabilities | 2015 £000 | 2014 £000 |
|---|---|---|
| Deferred tax assets | **29,193** | 33,804 |
| Deferred tax liabilities | **(59,007)** | (60,194) |
| **Total net deferred tax liability** | **(29,814)** | (26,390) |

Deferred tax assets and deferred tax liabilities relating to the same tax authority are presented net in the Group's balance sheet.

*(a) Group deferred tax assets analysed by balance sheet headings*

| | 2015 £000 | 2014 £000 |
|---|---|---|
| At 1 January | **33,490** | 32,123 |
| Income statement credit | **1,657** | 1,367 |
| Recognised in equity | **–** | – |
| At 31 December | **35,147** | 33,490 |

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

| At 31 December | 2014 £000 | Income statement (charge)/credit £000 | Recognised in equity £000 | 2015 £000 |
|---|---|---|---|---|
| Tangible assets | 1,080 | (345) | – | **735** |
| Trading losses in UK entities | 1,378 | (1,378) | – | **–** |
| Trade and other payables | 4,244 | (464) | – | **3,780** |
| Intangible assets – Syndicate capacity | 2,155 | (371) | – | **1,784** |
| Retirement benefit obligations | 5,580 | 2,075 | (6,762) | **893** |
| Reinsurance premiums | 13,675 | 784 | – | **14,459** |
| Other items | 5,692 | 292 | 1,558 | **7,542** |
| **Total deferred tax assets** | 33,804 | 593 | (5,204) | **29,193** |
| Financial assets | (3,940) | 3,135 | – | **(805)** |
| Insurance contracts – equalisation provision† | (30,333) | 77 | – | **(30,256)** |
| | (34,273) | 3,212 | – | **(31,061)** |
| Open years of account | (25,921) | (2,025) | – | **(27,946)** |
| **Total deferred tax liabilities** | (60,194) | 1,187 | – | **(59,007)** |
| **Net total deferred tax liabilities** | (26,390) | 1,780 | (5,204) | **(29,814)** |

†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 adjusted each year based on 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 UK 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. From 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. Finance Act 2012 repealed the legislation treating the equalisation provision as a tax deductible expense, and treats the existing equalisation provision as a receipt taxable over six years with effect from January 2016, when the current solvency regulations are replaced by Solvency II which does not require an equalisation provision. The Group has provided for the deferred tax liability on its claims equalisation provisions during the year.

Following changes to the future UK main rate of corporation tax introduced in the Finance Act 2015, the deferred tax on the Syndicates' open years of account is calculated with reference to the tax rate expected to be in force when those years close, and all other UK deferred income tax assets and liabilities are calculated at 18% for the year ended 31 December 2015 (2014: 20%).

Movements in deferred and current tax relating to tax deductions arising on employee share options are recognised in the statement of changes in equity to the extent that the movement exceeds the corresponding charge to the income statement. Movements in deferred tax relating to the employee retirement benefit obligation are recognised in the statement of changes in equity to the extent that the movement corresponds to actuarial gains and losses recognised in the statement of changes in equity. The total recognised in the statement of changes in equity is £1,001,000, comprising £5,204,000 deferred tax and £(4,203,000) current tax (2014: £3,668,000 deferred tax and £3,676,000 current tax).

Deferred tax assets of £35,147,000 (2014: £33,490,000), 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 timing 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 six years. £34,224,000 (2014: £32,250,000) of the tax losses to which these assets relate will expire after ten years or later; the balance of tax losses carried forward has no time limit. The Group has not provided for deferred tax assets totalling £20,474,000 (2014: £12,926,000) including £20,474,000 (2014: £12,926,000) in relation to losses in overseas companies of £72,016,000 (2014: £40,359,000). 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 £35,147,000 (2014: £33,490,000).

## 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. 61% of any scheme surplus or deficit is recharged to Syndicate 33. The full pension obligation of the Hiscox defined benefit pension scheme is recorded and the recovery from the third-party Names for their share of the Syndicate 33 recharge is shown as a separate asset.

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Present value of scheme obligations | 199,120 | 227,375 |
| Fair value of scheme assets | (199,045) | (195,209) |
| Deficit for funded plans | 75 | 32,166 |
| Effect of asset ceiling/onerous liability | – | – |
| **Net amount recognised as a defined benefit obligation** | 75 | 32,166 |

As the fair value of scheme obligations exceeds the present value of the scheme assets, the scheme reports a deficit.

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 2014, 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 are as follows:

| At 31 December | 2015 £000 | 2014 £000 |
|---|---|---|
| Managed fund pooled investment vehicles | | |
| UK equity funds | 70,871 | 81,163 |
| Emerging market equity funds | 7,515 | 8,340 |
| Global equity funds | 46,129 | 43,974 |
| Bond funds | 38,580 | 43,542 |
| US equities | 16,302 | 14,770 |
| Cash | 19,648 | 3,420 |
| | 199,045 | 195,209 |

All managed fund pooled investment vehicles and equity holdings have quoted prices in active markets.

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 total comprehensive income are as follows:

| | Note | 2015 £000 | 2014 £000 |
|---|---|---|---|
| Interest cost on defined benefit obligation | | 8,320 | 8,309 |
| Interest income on plan assets | | (7,118) | (8,589) |
| Interest expense on effect of onerous liability | | – | 496 |
| Net interest cost | | 1,202 | 216 |
| Administrative expenses and taxes | | 623 | 444 |
| Total expense recognised in operational expenses in the income statement | 9 | 1,825 | 660 |
| Remeasurements | | | |
| Effect of change in demographic assumptions | | (4,324) | – |
| Effect of change in financial assumptions | | (13,374) | 44,976 |
| Effect of experience adjustments | | (13,836) | – |
| Return on plan asset (excluding interest income) | | (2,382) | (6,587) |
| Changes in asset ceiling/onerous liability (excluding interest income) | | – | (11,049) |
| Remeasurement of third-party Names share of defined benefit obligation | | 5,680 | (4,581) |
| **Total remeasurement included in other comprehensive income** | | (28,236) | 22,759 |
| **Total defined (credit)/benefit charge recognised in comprehensive income** | | (26,411) | 23,419 |

## 30 Employee retirement benefit obligations continued

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Group defined benefit liabilities at beginning of the year | 32,166 | 4,366 |
| Third-party Names' share of liability | (5,422) | (731) |
| Net defined benefit liability at beginning of year | 26,744 | 3,635 |
| Defined benefit cost included in net income | 1,825 | 660 |
| Charge from third-party Names | (271) | (110) |
| Total remeasurement included in other comprehensive income | (28,236) | 22,759 |
| Employer contributions by Hiscox Group | – | (200) |
| Less contributions received by Hiscox Group from third-party Names | – | – |
| Net defined benefit liability at end of year | 62 | 26,744 |
| Third-party Names' share of liability | 13 | 5,422 |
| **Group defined benefit liability at end of year** | 75 | 32,166 |

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Opening fair value of scheme assets | 195,209 | 185,666 |
| Interest income | 7,118 | 8,589 |
| Cash flows | | |
| Contribution by the employer | – | 200 |
| Benefit payments | (5,041) | (5,389) |
| Administration expenses | (623) | (444) |
| Remeasurements | | |
| Return on plan assets (excluding interest income) | 2,382 | 6,587 |
| **Closing fair value of scheme assets** | 199,045 | 195,209 |

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Opening present value of scheme obligations | 227,375 | 179,479 |
| Interest expense | 8,320 | 8,309 |
| Cash flows | | |
| Benefit payments | (5,041) | (5,389) |
| Remeasurements | | |
| Changes in demographic assumptions | (4,324) | – |
| Changes in financial assumptions | (13,374) | 44,976 |
| Impact of experience adjustments | (13,836) | – |
| **Closing present value of scheme obligations** | 199,120 | 227,375 |

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

| | 2015 £000 | 2014 £000 | 2013 £000 | 2012 £000 | 2011 £000 | 2010 £000 | 2009 £000 |
|---|---|---|---|---|---|---|---|
| Present value of scheme obligations | 199,120 | 227,375 | 179,479 | 173,420 | 155,685 | 146,737 | 140,676 |
| Fair value of scheme assets | 199,045 | (195,209) | (185,666) | (156,513) | (140,517) | (144,056) | (118,391) |
| Present value of unfunded obligations/ (surplus scheme assets) | 75 | 32,166 | (6,187) | 16,907 | 15,168 | 2,681 | 22,285 |
| Effect of asset ceiling/onerous liability | – | – | 10,553 | – | – | – | – |
| Gross liability recognised on balance sheet | 75 | 32,166 | 4,366 | 16,907 | – | – | – |

Assumptions regarding future mortality experience are set based on professional advice, published statistics and actual experience.

## 30 Employee retirement benefit obligations continued

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

| | 2015 years | 2014 years |
|---|---|---|
| Male | **28.4** | 28.9 |
| Female | **29.6** | 30.3 |

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

| | 2015 years | 2014 years |
|---|---|---|
| Male | **29.7** | 30.3 |
| Female | **31.0** | 31.8 |

The weighted average duration of the defined benefit obligation at 31 December 2015 was 20.5 years.

Other principal actuarial assumptions are as follows:

| | 2015 % | 2014 % |
|---|---|---|
| Discount rate | **4.0** | 3.7 |
| Inflation assumption (RPI) | **3.1** | 3.0 |
| Inflation assumption (CPI) | **2.1** | 2.0 |
| Pension increases | **3.1** | 3.0 |

The scheme operates under UK trust law and the Trust is a separate legal entity from the Group. The scheme is governed by a board of trustees, comprised of member and employee trustees. The trustees are required by law to act in the best interests of scheme members and are responsible for setting certain policies together with the principal employer. The scheme is funded by the Group when required. Funding of the scheme is based on a separate actuarial valuation for funding purposes for which the assumptions may differ from the assumptions above. Funding requirements are formally set out in the statement of funding principles, schedule of contributions and recovery plan agreed between the trustees and the Company.

The triennial valuation carried out as at 31 December 2014 resulted in a surplus position of £8.6 million. The Group is therefore not required to currently make any contributions to the pension scheme.

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. For example, an additional one year of life expectancy for all scheme members would increase the scheme obligations by £5,712,000 at 31 December 2015 (2014: £6,987,000), and would increase the recorded net deficit on the balance sheet by £5,712,000 (2014: £6,987,000).

The most sensitive and judgemental assumptions are the discount rate and inflation. These are considered further below.

CPI revaluation 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 2015 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 4.25% | 75 | – | 75 |
| Use of discount rate of 3.75% | 75 | 10,561 | (10,486) |
| Effect of an increase in inflation | | | |
| Use of RPI inflation assumption of 3.35% | 75 | 4,341 | (4,266) |
| Use of RPI inflation assumption of 2.85% | 75 | – | 75 |

## 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* | 2015 | 2014 |
|---|---|---|
| Profit for the year attributable to the owners of the Company (£000) | **209,895** | 216,152 |
| Weighted average number of ordinary shares (thousands) | **288,209** | 320,554 |
| Basic earnings per share (pence per share) | **72.8p** | 67.4p |

## 31 Earnings per share continued

### *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.

| | 2015 | 2014 |
|---|---|---|
| Profit for the year attributable to the owners of the Company (£000) | **209,895** | 216,152 |
| Weighted average number of ordinary shares in issue (thousands) | **288,209** | 320,554 |
| Adjustments for share options (thousands) | **9,603** | 14,315 |
| Weighted average number of ordinary shares for diluted earnings per share (thousands) | **297,812** | 334,869 |
| Diluted earnings per share (pence per share) | **70.5p** | 64.5p |

Diluted earnings per share has been calculated after taking account of 8,872,744 (2014: 13,527,726) options and awards under employee share option and performance plan schemes and 730,477 (2014: 787,419) options under SAYE schemes.

## 32 Dividends paid to owners of the Company

| | 2015 £000 | 2014 £000 |
|---|---|---|
| Interim dividend for the year ended: | | |
| 31 December 2015 of 8.0p (net) per share | **22,403** | – |
| 31 December 2014 of 7.5p (net) per share | **–** | 23,469 |
| | **22,403** | 23,469 |

The final dividend equivalent for the year ended 31 December 2014 was paid as part of the E/F Share Scheme (2013: C/D Share Scheme), see note 24. 243,449,661 E and 77,251,864 F Shares of 60p each were issued, of which 15p per share was in lieu of a final dividend for 2014 of a cash value of £48,105,000. During 2014, the final dividend equivalent for the year ended 31 December 2013 was settled as 261,555,693 C and 93,647,894 D Shares of 50p each, of which 14p per share was issued in lieu of a final cash dividend of £49,728,000.

The interim dividends for 2015 and 2014 were either paid in cash or issued as a scrip dividend at the option of the shareholder. The interim dividend for the year ended 31 December 2015 was paid in cash of £20,202,000 (2014: £22,049,000) and 274,455 shares for the scrip dividend (2014: 270,917).

The Board has declared a second interim dividend of 32p per share to be paid on 7 April 2016 to shareholders on the register at 11 March 2016, comprised of a final dividend equivalent of 16p per share (2014: 15p), taking the total ordinary dividend per share for the year to 24p (2014: 22.5p), and a special dividend of a further 16p per share (2014: special distribution of 45p).

## 33 Business combinations

### *Hiscox MGA Ltd (Formerly R&Q Marine Services Ltd)*

On 27 February 2015, the Group acquired 100% of the share capital and voting rights of R&Q Marine Services Ltd for £9,250,000. Soon after the acquisition the company's name was changed to Hiscox MGA Ltd. The company is an underwriting agency specialising in yachts and the general marine leisure industry. They write a range of products, providing cover for super-yachts, small yachts, marina trades and yacht race cover. The acquisition will give Hiscox a platform within the yacht and marine leisure industry to underwrite to its existing Syndicate 33 on certain lines and to develop the MGA platform for the Group, providing opportunities for future growth.

### *Purchase consideration*

| | £000 |
|---|---|
| Initial cash consideration | **7,375** |
| Contingent consideration | **1,875** |
| Total purchase consideration | **9,250** |

The contingent consideration reflected above of £1,875,000 represents the current fair value estimate of the expected additional consideration that may be payable to the seller. The contingent consideration is payable based on Hiscox MGA Ltd exceeding certain revenue targets during the first year post the acquisition.

## 33 Business combinations continued

The assets and liabilities arising from the acquisition are as follows:

| | Acquiree's carrying amount £000 | Fair value and accounting policy adjustments £000 | Fair value £000 |
|---|---|---|---|
| Intangible assets | – | 9,185 | 9,185 |
| Other debtors | 299 | – | 299 |
| Cash and cash equivalents | 1,204 | – | 1,204 |
| **Total assets** | 1,503 | 9,185 | 10,688 |
| Net client account creditors | 1,295 | – | 1,295 |
| Other creditors | 143 | – | 143 |
| **Total liabilities** | 1,438 | – | 1,438 |
| **Net assets acquired** | 65 | 9,185 | 9,250 |

The intangible assets shown above is primarily from acquiring the rights to renew the existing book of business and the underwriter teams contacts and experience in the marine leisure field. The Group incurred acquisition-related costs of £72,000 on legal fees and due diligence costs. These costs have been included in administrative expenses. Hiscox MGA Ltd contributed a loss of £74,000 to the Group's profit before tax for the period between 27 February 2015 and 31 December 2015.

### *DirectAsia*

On 31 March 2014, the Group acquired 100% of the share capital and voting rights of Direct Asia Insurance (Holdings) Pte Ltd (DirectAsia) for US$24,575,000 (£14,804,000). In addition the Group purchased the outstanding debt of the company totaling US$31,750,000 (£19,127,000) from the previous owners. DirectAsia's primary business is motor insurance, with ancillary lines in travel, personal accident, healthcare and term life products sold as an agent. This acquisition provides the Group with a distribution platform in Asia, providing opportunities for future growth.

| | £000 |
|---|---|
| Total purchase consideration | 14,804 |
| Net asset acquired | (13,591) |
| Non-controlling interest | 866 |
| Goodwill | 2,079 |

The goodwill above was recognised on acquisition in relation to acquiring a skilled workforce who provide insight into operating in new territories, as included in note 14.

### *Associates*

During 2015, the Group increased its holding in White Oak Underwriting Agency Limited to 29.8% for £2,089,000. During 2014 the Group acquired a 10.6% stake in White Oak Underwriting Agency Limited (White Oak) for £1,700,000. White Oak specialises in auto extended warranty and auto physical damage business. Additionally, on 28 May 2014, the Group acquired a 10% stake in Carl Rieck GmbH, a German intermediary, for €500,000. Carl Rieck underwrites high net worth private clients, professional indemnity and specialist commercial business.

On 14 February 2014 the Group disposed of its 25% holding in Barta & Partner – Versicherungsmakler G.m.b.H, for €500,000. The investment previously had been fully impaired.

## 34 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 (HDCM), to meet the subsidiary's obligations at Lloyd's. The total guarantee given under these deeds of covenant (subject to limitations) amounts to £29 million (2014: £29 million) in respect of Hiscox Ltd supported by £30 million of investment securities (2014: £29 million) and US$423 million (2014: US$274 million) in respect of Hiscox Capital Ltd supported by US$401 million of investment securities (2014: US$262 million). 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. Additionally HDCM held £172 million of cash in favour of Lloyd's.

(b) Hiscox plc continued with its Letter of Credit and revolving credit facility with Lloyds Banking Group, as agent for a syndicate of banks, reduced to US$500 million (2014: US$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 US$228 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 2015 US$71.9 million (2014: US$441.5 million) was drawn by way of Letter of Credit to support the Funds at Lloyd's requirement and no cash drawings were outstanding (2014: £nil).

## 34 Contingencies and guarantees continued

(c) Hiscox Insurance Company Limited has arranged a Letter of Credit of £50,000 (2014: £50,000) with NatWest Bank plc to support its consortium activities with Lloyd's the arrangement is collateralised with cash of £50,000 (2014: £50,000).

(d) The Council of Lloyd's has the discretion to call a contribution of up to 3% of capacity if required from the managed Syndicates.

(e) As Hiscox Insurance Company (Bermuda) Limited (Hiscox Bermuda) is not an admitted insurer or reinsurer in the US, the terms of certain US insurance and reinsurance contracts require Hiscox Bermuda to provide Letters of Credit or other terms of collateral to clients. Hiscox Bermuda has in place a Letter of Credit Reimbursement and Pledge Agreement with Citibank for the provision of a Letter of Credit facility in favour of US ceding companies and other jurisdictions, and also Letter of Credit facility agreements with the Royal Bank of Scotland and Commerzbank AG. The agreements combined are a three-year secured facility that allowed Hiscox Bermuda to request the issuance of up to US$350 million in Letters of Credit (2014: US$350 million). Letters of Credit issued under these facilities are collateralised by US government and corporate securities of Hiscox Bermuda. Letters of Credit under this facility totaling US$81.1 million were issued with an effective date of 31 December 2015 (2014: US$98.7 million on a US$350 million facility) and these were collateralised by US government and corporate securities with a fair value of US$92.4 million (2014: US$115.6 million). In addition, Hiscox Bermuda holds US$403.5 million of restricted marketable securities collateralising reinsurance obligations.

## 35 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 £2,168,000 (2014: £1,976,000).

*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 £9,794,000 (2014: £9,031,000). Operating lease rental income for the year totaled £226,000 (2014: £595,000).

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

| | | 2015 £000 | 2014 £000 |
|---|---|---|---|
| No later than one year | Land and buildings | **8,951** | 9,082 |
| | Office equipment and other | **356** | 276 |
| Later than one year and no later than five years | Land and buildings | **29,801** | 30,080 |
| | Office equipment and other | **557** | 432 |
| Later than five years | Land and buildings | **25,205** | 15,161 |
| | | **64,870** | 55,031 |

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

| | 2015 £000 | 2014 £000 |
|---|---|---|
| No later than one year | **149** | 191 |
| Later than one year and no later than five years | **746** | – |
| Later than five years | **–** | – |
| | **895** | 191 |

*Obligations under finance leases*

There were no finance lease arrangements in place at 31 December 2015 or 31 December 2014.

Finance lease interest expense for the year was £nil (2014: £nil).

## 36 Principal subsidiary companies of Hiscox Ltd at 31 December 2015

| 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 Syndicates Limited | Lloyd's managing agent | Great Britain |
| Hiscox ASM Ltd | Insurance intermediary | 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 |
| Direct Asia Insurance (Holdings) Pte Ltd | Holding company | Singapore |
| Direct Asia Insurance (Singapore) Pte Limited | General insurance | Singapore |
| Direct Asia Insurance (Hong Kong) Limited | General insurance | Hong Kong |

*Held directly.
**Hiscox Holdings Limited held 38,030 shares in Hiscox Ltd at 31 December 2015 (2014: 43,216).

All companies are wholly owned. The proportion of voting rights of subsidiaries held is the same as the proportion of equity shares held.

## 37 Related-party transactions

Details of the remuneration of the Group's key personnel are shown in the annual report on remuneration 2015 on pages 64 to 72. 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*

Related-party balances between Group companies and Syndicate 33 are as follows.

| | Transactions in the income statement for the year ended | | Balances outstanding (payable) at | |
|---|---|---|---|---|
| | **31 December 2015 £000** | 31 December 2014 £000 | **31 December 2015 £000** | 31 December 2014 £000 |
| Hiscox Syndicates Limited | **42,496** | 42,368 | **54,211** | 55,623 |
| Hiscox Group insurance carriers | **19,181** | 33,576 | **58,960** | 55,070 |
| Hiscox Group insurance intermediaries | **6,425** | 5,365 | **(15,396)** | (13,920) |
| Other Hiscox Group companies | **–** | – | **(8,043)** | (9,381) |
| | **68,102** | 81,309 | **89,732** | 87,392 |

### *(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.

| | **2015 £000** | 2014 £000 |
|---|---|---|
| Gross premium income achieved through associates | **185,588** | 102,396 |
| Commission expense charged by associates | **15,538** | 9,099 |
| Amounts payable to associates at 31 December | **–** | 2,520 |
| Amounts receivable from associates at 31 December | **67,455** | 52,230 |

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

| | 2015 £000 | 2014 £000 | 2013 £000 | 2012 restated* £000 | 2011 £000 |
|---|---|---|---|---|---|
| **Results** | | | | | |
| Gross premiums written | **1,944,220** | 1,756,260 | 1,699,478 | 1,565,819 | 1,449,219 |
| Net premiums written | **1,571,844** | 1,343,410 | 1,371,114 | 1,268,140 | 1,174,011 |
| Net premiums earned | **1,435,016** | 1,316,259 | 1,283,311 | 1,198,621 | 1,145,007 |
| Profit before tax | **216,100** | 231,075 | 244,538 | 217,454 | 17,271 |
| Profit for the year after tax | **209,895** | 216,152 | 237,758 | 208,026 | 21,272 |
| **Assets employed** | | | | | |
| Intangible assets | **126,222** | 105,946 | 72,720 | 69,617 | 67,552 |
| Financial assets carried at fair value | **2,921,585** | 2,828,847 | 2,585,054 | 2,406,269 | 2,368,636 |
| Cash and cash equivalents | **727,880** | 650,651 | 564,375 | 657,662 | 516,547 |
| Insurance liabilities and reinsurance assets | **(2,509,552)** | (2,309,854) | (2,150,299) | (2,056,223) | (2,007,745) |
| Other net assets | **262,694** | 178,616 | 337,611 | 288,041 | 310,909 |
| **Net assets** | **1,528,829** | 1,454,206 | 1,409,461 | 1,365,366 | 1,255,899 |
| **Net asset value per share (p)** | **545.0** | 462.5 | 402.2 | 346.4 | 323.5 |
| **Key statistics** | | | | | |
| Basic earnings per share (p) | **72.8** | 67.4 | 66.3 | 53.1 | 5.5 |
| Diluted earnings per share (p) | **70.5** | 64.5 | 63.5 | 51.0 | 5.3 |
| Combined ratio (%) | **85.0** | 83.9 | 83.0 | 85.5 | 99.5 |
| Return on equity (%) | **16.0** | 17.1 | 19.3 | 17.1 | 1.7 |
| Dividends per share (p) | **24.0** | 22.5 | 21.0 | 18.0 | 17.0 |
| Share price – high† (p) | **1,059.0** | 735.0 | 695.0 | 489.4 | 424.7 |
| Share price – low† (p) | **707.5** | 624.5 | 453.6 | 369.3 | 340.5 |

*The 2012 results have been restated to reflect the revised pension accounting standard.
†Closing mid-market prices.

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