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Q2 2011 Earnings Call

Company Participants

- Alex Maloney, Group Chief Underwriting Officer
- Elaine Whelan, Group CFO
- Neil McConachie, President
- Richard Brindle, CEO
- Unidentified Speaker, Unknown

Other Participants

- Adrienne Lim, Analyst
- Andreas Van Embden, Analyst
- Ben Cohen, Analyst
- Chris Hitchings, Analyst
- Marcus Barnard, Analyst
- Nick Pope, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Welcome to the Lancashire Holdings Ltd. Q2 results conference call. (Operator Instructions). Please note that this conference is being recorded. I will now turn the call over to your host, Group CEO Mr. Richard Brindle. Sir, you may begin.

Richard Brindle {BIO 1983776 <GO>}

Thank you, very much. Good morning, everybody.

We've heard much talk of how the one six [ph] and one seven [ph] U.S. property cat renewals were, quote-unquote, risk adjusted up 10% to 15%. All we can say is that none of the submissions we were shown when properly risk-adjusted for RMS Function 11 were anywhere near that.

Indeed, in many cases, they were substantial reductions. We anticipated this, to be quite honest. The industry is taking its time coming to grips with the new model. So we decided to embrace it early, let others use our valuable P&L from [ph] what they will in time come to regard as capital-inefficient renewals. And wait for the results and opportunities later in the year and into 2012. We non-renewed all our Florida domicile reinsurers.

However, we knew the pressure would grow on companies to adjust to the new reality. And even in the last few weeks we have seen sentiments start to change. Many companies are now talking about the model change and all its likely consequences. And even brokers are now saying that the change in and of itself, even without a major hurricane this season, will be enough to reduce capacity and force up prices.

Should there be a major loss, on the other hand, we could be looking at a sustained hard market, certainly across the property classes. And we stand ready, should that occur, to take the appropriate capital-raising actions and take a strong lead position in the ensuing marketplace.

Retro, however, is already distressed. And we have already deployed around 15% of the limits of Accordion on the new [ph] sidecar. We anticipate strong demand at and in the run-up to 1/1. And are working hard on marketing the associated products.

Our aversion to the diversification net [ph] approach to writing property cat has put us in good stead. Our natural catastrophe reserves are holding from Q1 and our exposures to the combined events of Q4 2010 and 2011 to date remain, I think, the lowest of comparable companies.

I will now hand over to Alex to discuss our underwriting in more detail. Thank you.

Alex Maloney {BIO 16314494 <GO>}

Okay. Thank you, Richard. I'll start with a view of our Second Quarter results, I'll highlight some key points. And I'll move on to our activity to the quarter and the rest of the year.

Half-year actual [ph] loss period, I'm happy to report that we've had limited exposure to the natural catastrophe events of the Second Quarter. And in general, we have experienced a low level of reported claims in this quarter. We did experience some losses in both New Zealand's third earthquake and severe tornadoes that affected the U.S. But in neither event is our loss expected to exceed $5 million.

Our net combined ratio of 41.2% for the Second Quarter is an excellent achievement for the Group, given the level of catastrophe losses, among [ph] which we believe indulges our businessman's [ph] approach to underwriting and exposure management.

We are now seeing the improvement in pricing, which I commented on during the First Quarter. We have sought to move quickly where we believe the opportunities arise, which are mainly through our reinsurance lines, being property cat and retro session.

Our renewal price index, which tracks business for broad distant [ph] similar renewable business, showed a 7% increase in pricing across our entire portfolio when compared to the First Quarter. Property reinsurance of offshore energy are showing the strongest rate increases for the Second Quarter, with 15%, with marine showing the weakest with a 1% reduction in pricing.

Some of the new business which we have written has much higher RPIs, heave [ph] even multiples of expiring pricing for lost effective business in the property cat life.

We have seen more opportunities in the Second Quarter with Japanese and New Zealand property cat business, both renewals and new business. Due to the drastically improved pricing, we are able to provide support to local companies.

In Japan, ceding companies have be -- (inaudible) responsible and orderly fashion. And included in the July 1 renewals of contracts which are extended on April 1. We have doubled the amount of Japanese cat XL premium that Lancashire writes. But we've only increased our exposure by 31% with the bulk of this increase on layers which are not affected by the Japanese earthquake.

The simplicity of our business model and the comparable small size of our portfolio have been positive assets from working on the transition of the RMS11 model change in service, aggregation, modeling. And pricing practices. Given the wide disparities between the principal models in terms of hazard frequency, amateur [ph] ability. And the impact of storm surge. And even exposure face to face, it is probable that some blending of the models will be the most acceptable final position.

It is not clear how quickly the industry as a whole will adapt to the model and its implications for increased capital charges for U.S. wind business. A one-in-100 wind PML has increased marginally to 16.3% for the Second Quarter over the First Quarter, which reflects the reducing effects of portfolio optimization and the increased effects of RMS11.

In our aviation and marine lines, our niche appetites have continued to serve us well, with steady performances in both despite weaker market conditions.

In terrorism, competition on price has led us to cut back in some areas. But we continue to find a decent flow of well-priced opportunities in our political risk and sovereign accounts.

The energy arena, whilst prices are not at the levels we would like or indeed expect to see, other [ph] than three large shop losses being Deepwater Horizon, Gryphon FPSO. And the oilsands loss, pricing has maintained in a positive trend. Much will depend on the outcome of the January 1 energy reinsurance renewals where [ph] the second year of losses to consider.

Our most positive development in the quarter has obviously been the swift initiation of our Accordion sidecar targeting the property retrocession market, where we foresee a -- that we foresee as potentially the most dissipated. Using a flexible adjusting time capsule model and working in conjunction with some of our existing investors who have supported Lancashire since the beginning, we've been able to build a vehicle that allows us to meet a market need. But without the risk of needing to deploy capital quickly to meet an ROE target.

Response from brokers and clients has been very favorable. And we are encouraged by the aggregate we were able to deploy at mid-year.

We have decided not to pursue the opening of our office in Brazil at this time due to the heavy burden of administration and management time. We will find other ways to access the business that we like.

Listening to our crystal ball, there are a number of ways the market could now develop. We certainly believe that any significant cat loss in the second half of 2011 would be enough to harden the property and energy markets, both direct and reinsurance. What size of loss would catalyze the market would be a wider -- to provide a wider market movement is subject to much debate.

From management's point of view, we are seeing encouraging market conditions in many of our core areas. And we have testified [ph] that our risk levels adequately reflect the current state of the market with plenty of options to expand them appropriately should further hardening occur.

I'll now pass it over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Hi, everyone. Our results are laid out on our website as usual.

With minimal exposure to the Second Quarter cats, we produced a return on equity of 6.1% for the quarter, bringing us to 6.5% for the year so far. We were also pleased this quarter to be able to reduce our reserves for the Chilean earthquake by $10 million. And we have launched a pine [ph] down very slightly by a few million.

We have now compounded hooligan retch [ph] value per share at 19.9%. As Alex said, we also got off to a great start with our Accordion sidecar vehicle and signed [ph] a handful of deals in the June and July video periods [ph]. After reducing retro writings last quarter, given the then tightening terms and conditions, we're satisfied that the retro market has now turned and we fully expect that it will continue to improve, with the best opportunities to deploy our capital being at 1/1.

The capital drawdown feature of the vehicle makes it particularly attractive. We're under no pressure to use the commitments we have from our investors, unless the opportunities we see satisfy our requirements. The vehicle millet [ph] rises with capital if we can make good use of it and the ability to write larger lines on retros than we might otherwise have done.

There are a few other things to note for the quarter. Partially [ph] premiums are a little over 10% down on the Second Quarter of last year. And they were 17% down on the half year. As I reminded everyone last quarter, we did a number of multi-year deals last year within the property and energy classes, $30.3 million and $33.4 million, respectively, with the property impact mostly in the First Quarter and the energy impact mostly in the Second Quarter.

Also, as I just mentioned, the trim back our [ph] retro group a good deal at 1/1, with those reductions offset a little bit trying to alteration [ph] backups we did and reinstatement periods [ph] in relation to Japan. And then the deals we did this quarter for Accordion.

Terror and political risk are notably behind the prior year, due to a combination of multi-year deal renewal timing and a high degree of caution in those markets in general, given the state of the world.

The energy line is also worthy of a mention. The Gulf of Mexico was the line most impacted by the multi-year deals last year, post Deepwater Horizon. While the pricing has been mostly flat this year, it's still very attractive for priced business. And we've had good new business flow there with a few more deals being done on a multi-year basis.

In the offshore volt bright line [ph], we've seen some rate exposure in TCs [ph] there.

So there are the main drivers for the changes in our book. Worth pointing out, though, that in late 2010, early 2011, we would have expected to be much farther behind 2010 than we currently are. As Alex has indicated, our outlook is much more positive now.

On reserves, as I mentioned, we brought our Chilean reserves down by $10 million. And have had small, largely offsetting movements in our Japanese and Christchurch reserves, the book for $2 million for each of the tornadoes and the New Zealand earthquake. And also there [ph] the cautionary line of $22.5 million for energy industry loss warranties in relation to Gryphon.

Present [ph] was the 14 production storage and offloading vessels in the North Sea that suffered storm damage in the First Quarter. Our ILWs would be triggered if the Gryphon loss is in excess of $1 billion. It's not there yet. But it's getting closer so we've put up a cautionary reserve.

Total prior accident year reserve that we see is for $46.1 million. Aside from Chile, we also had a $9.2 million release under our political risk line due to a lack of any reported claims there.

Investment income was behind the prior year, primarily due to lower yields due to shorter durations. However, markets have continued to be volatile with a significant drop in Treasury yields in the quarter.

Economic data continues to be mixed. But we performed reasonably well, returning 1.1% for the quarter, which we can credit to our short duration positioning, plus our diversification into emerging-market debt, tips [ph]. And equities.

Our allocation to emerging markets is at 7.3% under the total of 3.6% in equity. Reallocations are really a part of a risk management strategy. But, as always, we'll adjust our portfolio as the world around us changes.

On G&A, our ratio does look like it's creeping up a little. This is largely due to our restricted stock payments, started in 2008 and are [ph] beginning today. We incur national insurance and payroll tax on that. But we do have an offset in our tax season [ph] in both the income statement and in equity. The net impact on ROE is pretty minimal. But it does lead to a inflated-looking G&A ratio.

Lastly on the capital front, our underwriting outlook is more positive than it has been for a while. A lot hinges on what happens over the year's wind season. But we currently think we will have enough good underwriting opportunities to effectively use lines of capital. If the wind doesn't blow, we may be able to return capital in the Fourth Quarter. But it will be less than last year's special dividend. And even without another cat loss, we expect pricing improvements.

But we think we're probably one more event away from a broad market turn. And should that happen, we could be more likely to raise capital than return it. As ever, we will adjust our capital up or down depending on where the market goes.

And I'll now hand over to Neil.

Neil McConachie {BIO 7540962 <GO>}

Thanks, Elaine.

Okay, we issued two other press releases this morning, other than our earnings release. One release announces that Lancashire Holdings plans to move tax residence from Bermuda to the UK and the other announces that Lancashire will call a special general meeting.

I'll talk about the tax residence announcement shortly. But first touch briefly on the special general meeting. The special general meeting includes two proposals, one of which is related to the move and tax residence, which I will cover in a minute. But the other one is a request that shareholders grant authority for the Company to issue up to 10% of its share capital on a non-preemptive basis, or in simple terms to increase its share capital by 10% within a few days without having to do a rights issue, which can take perhaps six to eight weeks.

We asked for this back in May at our AGM and we did not receive the necessary 75% approval from those who voted. We got 69%. Our shareholders have granted such authority in prior years. And we believe that this is a recognition of our core strength of nimbleness in capital management.

However, what we saw is that only 44% of shareholders voted at the recent AGM. It was only very narrowly defeated. We do think this is essential so that Lancashire can move faster, take advantage of opportunities. And we are putting this resolution back to shareholders and strongly encourage everyone to support it.

Okay, the other press release is that we plan to move tax residence to the UK, although we do not plan to move an incorporated domicile. I'm going to give a short story on this first. And then I've got a slightly longer version.

Okay, the short story on the real-world implication is as follows. Number one, this move will result in no change to the corporation tax bill for Lancashire's book. Lancashire Bermuda is currently subject to Bermuda corporation tax at a rate of zero. And after this move, Lancashire Bermuda will continue to be subject to Bermuda corporation tax at a rate of zero. Lancashire UK has always paid UK tax and will continue to pay UK tax. But most of our profits are generated by Lancashire Bermuda and that isn't expected to change.

Number two, we have already received written confirmation from HMRC that Lancashire meets the test for the temporary-period exemption and that the approval lasts from January 1, 2012, until December 31, 2014. So it is in writing that we receive the exemption.

Number three, there is a good chance, in our opinion, that by the end of 2014, if not sooner, there will be legislation in place that will offer qualifying companies a permanent exemption. This is not guaranteed. But the evidence points to strong cross-party support in the UK for CFC reform, which is what we're talking about here. And we wish HMRC the very best in getting this done.

Number four, if for some reason permanent exemptions do not come through before the end of 2014 and before the end of our current exemption, Lancashire will move back to Bermuda. And this means that there will again be no change in our corporation tax position.

The key thread running through all of this is that Lancashire Bermuda, which is where most of our profits are generated, should continue to have the Bermuda tax rate of zero at all times now and in the future.

Okay, I'm giving a slightly longer, dollar version. But I think this is a subject that has got a lot of interest. So, first of all, in case there is any confusion, tax residence is effectively the location of where the company is managed, which drives the tax jurisdiction under which it falls. Domicile is where the company is registered and incorporated. And to date, Lancashire Holdings has been tax resident and domiciled in the same country.

For the first time since inception, Lancashire Holdings can become tax resident in the UK with no impact on its UK corporation tax position. This change is because the UK 2011 Finance Act, which received royal assent on July 19, permits the profits of qualifying UK-controlled foreign corporations to be temporarily exempt from UK corporation tax. There are certain qualifying conditions. But as I said, we have received confirmation from HMRC a few days ago that we meet the test for the exemption.

Moving tax residence itself does not require any shareholder approval. However, the ability to hold Board meetings in the UK will require shareholder approval. And that's why we're asking for that simple approval via the SGM that I just mentioned, which will make that simple change to our current bylaws.

Assuming we receive shareholder approval to hold Board meetings in the UK, at this time we plan to move Lancashire Holdings back to residence at the start of 2012 and receive the exemption for three years. Our existing UK and Bermuda insuring subsidiary will continue to be resident and domiciled in the UK and Bermuda as they currently are and taxed as they currently are.

We anticipate several benefits from moving tax residence of Lancashire Holdings, including the ability to act more nimbly in making Group decisions, onshore in the UK; to also reduce operational and frictional costs by holding Board and shareholder meetings in the UK; and also to recruit Group-level management and directors from a larger UK talent pool.

Again, importantly, as I said earlier, the act of moving tax residence will not impact Lancashire's corporation tax bill. Profits from Lancashire Bermuda are not currently subject to UK taxes. And that will remain exactly the same. It will also have no impact on our Group structure, nor the amount of business written in our Bermuda office, or the fact that our Bermuda company is and will remain a crucial part of the Lancashire group.

The move does recognize, though, that for Lancashire the fact is that London is the hub for most of our classes of business and the residence of a number of our management.

Lastly, there is also the possibility of obtaining a permanent exemption. At the end of June 2011, a more specific consultation paper was introduced to the plans [ph] for discussion with the business community further about putting in place permanent exemptions, which may be more generous than under the current CFC to his regime.

The timing or ultimate outcome of that is not known at this time. It's possible it doesn't come to fruition, although we are hopeful that it will and our personal view is it's got a high chance.

If we get to the end of three years and the permanent exemption is not available, then we are highly likely to move back to Bermuda. And we'll just carry on operating as we have done since inception. And that would be absolutely fine if that were the case.

The final point to clarify is that the exemptions can be obtained without change to incorporated domicile. It is not needed to change domicile. There are, at the moment, limited business reasons for Lancashire to move its domicile. And we therefore plan for Lancashire Holdings to remain domiciled in Bermuda.

I'm sure there will be a few questions. But I'll leave it for now. We'll hand back to the operator. I'm happy to take your questions. Thank you.

Questions And Answers

Operator

(Operator Instructions). Ben Cohen.

Q - Ben Cohen {BIO 1541726 <GO>}

Could I ask two things, please? Firstly, on your PMLs and the increase in the Second Quarter, what is your appetite to increase those still further?

And the second question was with regards to -- I think there is going to be -- is it a new version of RMS for Europe introduced next year? Have you got any sort of further forward in your thoughts as to how that might impact pricing and demand for the January renewals? Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Thanks, Ben. I'll do the first one and probably double-tag the second one with Alex.

Before I start with that, I'd just like to stress that -- one thing we didn't really bring out in our prepared remarks was that the RPIs for the Accordion business are far better than the numbers Alex referred to for the real [ph] preferred, if you like. And the RPIs to business gains of Accordion are somewhere between 150% and 300%, which reflects the basic diversification [ph] of the retro market. So I just wanted to make that clear.

On PMLs, Ben, we are constrained, as we always have been, by the (technical difficulty) stated tolerances to capital for the various zones of the world. And nothing is going to change.

We will probably be closer to those numbers, in a harder market or in a softer market, than we have seen. We've -- for example, the Gulf wind number, which is 25% of capital, we were -- and had a 24.9% throughout 2006, 2007. And early 2008. But it's now down in the mid-teens.

You could expect to see that go back up, absolutely right. But it would never exceed 35%. We're not going to change those at any point in the cycle. And if we need to write more business and remain with the 25% -- within the 25%, we have to raise more capital. It is as simple as that.

Having said that, obviously we have come in, post event, in that I hope you'll agree that proper Lancashire (technical difficulty), particularly in Japan where I'd also like to pay tribute to our Japanese clients, by the way. They, as always, did the right thing. The market showed faith in them by extending most of the covers pro rata from one quarter one seven on the promise which was, of course, redeemed that they would come back to us and pay proper post-loss pricing, one seven, which they did. And we also took the opportunity to send a donation to the Japanese Red Cross and to mention that to all our clients as a (technical difficulty) for the ongoing tragedy in northeastern Japan.

But the Japanese number went up. Our tolerance for Japan is 20%. And we're fairly close to that now. We have a lot of tolerance for Australasian. We've always, I think as you know, (technical difficulty) Australasian business. We do not subscribe -- we do not worship at the altar of diversification. And that, frankly, serves in very good stead. But post-loss, we've seen some massive rises. And 400% to 500% RPIs. And as you'd expect us to do, we've taken advantage of a lot of those. I forget the number now. But I think the low teens, the capital for Australasian now is something like that, maybe up to 15%.

So, on the European RMS, I mean, feel free to jump in, Alex, I think the effects on us will be minimal. But you may want to add to that.

A - Alex Maloney {BIO 16314494 <GO>}

I think, as we've seen in Florida, when you've got any model change, people are going to try their different speeds in the market. And it's very much subject to the market conditions at the time, i.e., you get the model change and we're in a very hard market, yes, I think you're going to see a real change and good opportunities.

For Lancashire, if the market is flattish, it pretty much won't make a huge amount of difference, needless to say [ph].

Operator

Adrienne Lim, Morgan Stanley.

Q - Adrienne Lim {BIO 16537674 <GO>}

I just had one very quick question. In terms of the Japan renewals that were pushed back to July, can you give us an idea of how big the quantum of premiums that were pushed back to July really were?

A - Richard Brindle {BIO 1983776 <GO>}

Yes, most of it was (technical difficulty) diversity [ph]. I'm trying to think if -- there's actually only the big one. That was 1/7. All the other cooperatives were 1/7.

I mean, it's important to just note we don't write sort of normal Japanese. But we don't write the pro ratas which got absolutely hammered. We don't write the lower layers. Our portfolio is more or less geared towards the big close fine [ph] event; however as was [ph] indicated in our loss number, which is pretty small, frankly.

And we certainly learned lessons on our loss, by the way, because half of our losses were from one D&F account, a railway account. And we certainly learned from that and are implementing some changes in our underwriting as a result. In other words, it doesn't make sense to write big non-peak cap-exposed D&F lines because there isn't enough money in them. And they can give you quite a nasty surprise.

But having said that, I think you would agree that our overall loss was below most of our peers. We doubled our Japanese premium this year. But remained faithful to that underwriting philosophy. However, overall, I would say RPIs are probably of the order of 160% to 180%, something like that.

Q - Adrienne Lim {BIO 16537674 <GO>}

I'm just trying to get a sense of the quantum of the premium number, just in terms of forecasting Q3 and the seasonality there.

A - Richard Brindle {BIO 1983776 <GO>}

It's not that (multiple speakers). For us, it went from $7 million to $15 million, something (multiple speakers)

Operator

Chris Hitchings, KBW.

Q - Chris Hitchings {BIO 2034501 <GO>}

A couple of things. Just talk me through the reserve release number, which was obviously significantly higher than -- almost as high as the First Quarter, which itself had a specific exceptional element to it. You've mentioned a $10 million release from Chile. And -- but are there any other, like specifically, specific elements in that prior-year reserve release?

I think Elaine also talked about releasing Japan. Obviously, that wouldn't go into your prior year. So I'm really trying to see where are we in terms of a forecasting basis going on. I know this is very difficult. But I'm just trying to get a handle on that.

Secondly, just on accounting query, presumably all premium written by Accordion goes into gross and comes out in the reinsurance ceded line.

Thirdly, on NZ3, you crowed so much about how much you'd massively written additional cover in Antipodies -- in the Antipodies after NZ2. I'm surprised you have almost nothing from NZ3. Can you give us some idea of where you are exposed on these and things like that?

And the fourth of my three questions, just -- now that Gryphon is going to cost you something like $50 million, are there any issues that you feel about energy aggregates and the protections on this account which we need to be aware of going forward? Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Chris, thanks for that. Elaine, feel free to give Chris the specifics on the reserves. And also please answer the Accordion question. I will knit into the New Zealand question. And Alex can do Gryphon.

A - Elaine Whelan {BIO 17002364 <GO>}

Okay, sure. For the quarter, it was $46.1 million of releases. And as you know, $10 million was from Chile where we got some good news from the recent [ph]. It was at $9.3 million in our applicable [ph] risk account. And generally if there aren't any claims in on that account, then we release the reserve to prior year. And we typically do that at this time of year each year.

And it's just a bigger number than normal because we had been expanding that line in the last year or so. And we had a little bit coming through from the reserves that [ph] we had in the First Quarter. And $5 million or so. And you won't really see much from that going forward.

So based on that, about $20-odd million or so, had cross line, really nothing specific, general kind of reserve releases. Probably a little higher than our run rate. And the $20 million. And the First Quarter was $50 million of releases. And $37 million of that was entirely from the reserve study.

Q - Chris Hitchings {BIO 2034501 <GO>}

But there is no specific element from the reserve study coming in in the Second Quarter?

A - Elaine Whelan {BIO 17002364 <GO>}

Little bit, about $5 million from that. But that's all.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay. And secondly, surely release from the Japan quake in the First Quarter wouldn't be accounted as a reserve release because it's not a prior year, is it?

A - Elaine Whelan {BIO 17002364 <GO>}

Right, it's just a reduction in our accident-year number.

Q - Chris Hitchings {BIO 2034501 <GO>}

Yes, yes, fine. So, okay, fine because you said from the First Quarter just there, fine. So $20 million is a reasonable sort of ongoing thing. And there's probably about 20 of exceptionals.

A - Elaine Whelan {BIO 17002364 <GO>}

Yes, roughly. I think $20 million ongoing is a little higher than we'd expect for EBIT at this quarter.

Q - Chris Hitchings {BIO 2034501 <GO>}

That's helpful, thanks. In the Accordion?

A - Elaine Whelan {BIO 17002364 <GO>}

(multiple speakers) on the accounting question, you're exactly right. It comes in in the gross (inaudible) line.

Q - Chris Hitchings {BIO 2034501 <GO>}

And what was the actual number in Q2?

A - Elaine Whelan {BIO 17002364 <GO>}

We had just a little under $8 million worth of premium (multiple speakers) out.

A - Richard Brindle {BIO 1983776 <GO>}

Chris, on New Zealand 3, Alex, correct me if I'm wrong here, I think we have minimal exposure. We -- again even the (technical difficulty) we wrote, Chris, I think with one exception, we tried to avoid the low-down layers. And the magnitude of New Zealand 3 is not such that it will affect the high layers. (multiple speakers) give him enough upside?

Q - Chris Hitchings {BIO 2034501 <GO>}

I'm just trying to -- so what kind of event are you exposed? Sort of really mega cat in Australia and New Zealand, or --

A - Richard Brindle {BIO 1983776 <GO>}

Yes, I mean, we've -- even despite recent ratings [ph], we retain massive skepticism particular about our Australian friends and some (inaudible), for example, we're on the top layer.

We haven't dived down the risk section, Chris, to take advantage. We carried on rising pretty high levels. And in New Zealand similarly, it's going to have to be a major earthquake in one of the big cities in New Zealand for us to get tagged.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay, fine. Certainly your comment on pricing, you're the only person I've yet come across who reckons that Antipodean and Asian reinsurance rate have reached attractive levels, assuming you're talking about very, very specific areas of the business?

A - Richard Brindle {BIO 1983776 <GO>}

Yes, we're talking principally about New Zealand and, to some extent, about Australia. But I would also remark to you, Chris, that without getting into names, it is pretty strange when you see companies publicly announcing they're putting out Australasia when the rate raising is certainly the highest level any of us can remember. That seems to be very odd move. And Alex, can you do Gryphon, please?

A - Alex Maloney {BIO 16314494 <GO>}

Yes, sure. Just a few key points on Gryphon, Chris.

We -- the ILWs that we write attach at $1 billion. Currently, the Gryphon energy loss is sub-$1 billion. So our reserve is very precautionary. Even if it goes above $1 billion, the way we write our energy account, if we're looking at a $1 billion loss to Lancashire, on top of a $50 million net, that would be well within management expectations for such an event.

It might be (inaudible) to change anything. We think that it's the kind of loss we would expect in our energy book. It is -- everyone should remember -- it still was 50% bigger than Deepwater Horizon from a physical damage point of view. So it's a very large loss.

The ILW reserve is precautionary. We are hopeful that it won't touch $1 billion. But even if it does, we're happy with the number.

Q - Chris Hitchings {BIO 2034501 <GO>}

And there is no plan to change your reinsurance buying as a result of that?

A - Alex Maloney {BIO 16314494 <GO>}

No.

Q - Chris Hitchings {BIO 2034501 <GO>}

No. Okay. Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

(multiple speakers) it's worth remembering that the ILWs we wrote last year, which may or may not get tagged by Gryphon -- and that's -- it's going to have to be at the very top end of the loss range for us to get tagged, by the way. So as Alex rightly says, our reserves are very conservative and precautionary.

But we wrote them optimistically following probably a 300%, 250% rise in ILW raising following Deepwater Horizon. So it's unfortunate we get tagged. But it was very (inaudible) what we did (multiple speakers)

Q - Chris Hitchings {BIO 2034501 <GO>}

No, no, no, please. There's no criticism. I'm just wondering.

A - Richard Brindle {BIO 1983776 <GO>}

(multiple speakers) absolutely. Thank you.

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Operator

Frank Hayward [ph], Frank Hayward Associates [ph].

Q - Unidentified Participant

Good morning, ladies and gentlemen. Again, congratulations on the very markably boring results. We like boring when it comes to insurance.

I have a couple of questions. Also with Elaine, congratulations on the low duration of your portfolio. I think we, like Lancashire, would like to see this very steady low variation [ph] invested returns rather than basically reaching for yield. So congratulations on keeping the portfolio in that low risk range.

A - Elaine Whelan {BIO 17002364 <GO>}

Thanks, Frank.

Q - Unidentified Participant

Yes, regarding, let's see, Tokyo earthquake risk. I was reading Munich Re's report recently. And they make a big -- they seem to have great authority in the geological area. They seem to think that the risk of a quake near Tokyo has been increased by the massive earthquakes that occurred north of there. So I don't know if that's something you've taken into consideration in writing the earthquake risk [ph] in that region?

A - Richard Brindle {BIO 1983776 <GO>}

This came up -- thank you for your kind words, by the way -- this came up at our Board meeting yesterday. I just want to emphasize we are not meteorologists. We are not seismologists. We are not volcanologists, or any other sort of ologist, for that matter.

And if every insurance company starts telling you that they have a handle on what's going to happen around the world in terms of natural peril, I would urge you to be very, very alarmed.

Q - Unidentified Participant

I think those are very difficult to predict. I do think that --

A - Richard Brindle {BIO 1983776 <GO>}

Impossible.

Q - Unidentified Participant

Yes, earthquakes do seem to have a tackle [ph] pattern; they seem to come in groups and then they seem to die down and be abnormally low for an extended period. And then you see it again. So, that is, I think, a phenomenon just in general.

Okay, well, that's good. I just didn't know. And again I think you know your risk is in very intelligent. And of course, I guess, you've gotten some very good rates on that business.

A - Richard Brindle {BIO 1983776 <GO>}

Yes. Thank you, Frank.

Q - Unidentified Participant

Again, congratulations, gentlemen, and again remarkably boring results. So (inaudible) luck.

A - Richard Brindle {BIO 1983776 <GO>}

Yes, no we like boring too. Thanks for your kind words, Frank.

Operator

Andreas Van Embden, JPMorgan.

Q - Andreas Van Embden {BIO 1795530 <GO>}

Hello. Good afternoon. Just two questions. First of all, on your Gulf of Mexico energy book. You mention in the press release that you're seeing a reasonable level of new business coming through. Could you maybe indicate what you expect -- how you expect demand to develop in the second half of the year and into 2012? Do you see an acceleration or momentum of demand?

And secondly, I read your interesting comments on adjusted pricing in Florida. Could you also comment, maybe, on your U.S. property cat risks outside of Florida? How is the risk-adjusted pricing developing there? Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Those are probably both for Alex. Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

Yes, sure. Gulf of Mexico energy, we have written some new business this year. It's important to note that any new business that we write in the Gulf of Mexico very much fits our deepwater strategy.

There's lots of business in the Gulf of Mexico that we get offered of which we don't write. Obviously, because we only write deepwater assets, there's a finite number of assets you can write in the Gulf of Mexico. So it wouldn't be as simple as us subbing out that book, et cetera, if the right to nickel [ph] stayed the same.

What you will see in the Gulf as the drilling moratorium has now been lifted and people start drilling wells in the Gulf of Mexico, you will see more activity. You will see more drill ships, et cetera, going in the Gulf of Mexico. So yes, we can definitely -- we will see more opportunities next year. Very, very difficult to estimate at the moment. But yes, we will see opportunity.

I think Florida, as Richard mentioned earlier, if you look at individual accounts and you look at (multiple speakers) environment, Niobrara -- for instance, RMS11 and you see the individual category [ph] charge, that's important to know. At Lancashire when we look at any cat business, we look at that account on an individual basis. We don't look at that account based on what it would look like once it is diversified in that portfolio.

So just on an account-versus-account basis, if you look at what happens to the capital charge year on year. And then you look at the quoted rate increases in the market, we believe -- once you factor in the capital charge, we believe that those renewals were actually reductions, not 10% or 15% rate increases.

They were 10% or 15% rate increases. But the capital charge may have been up 25% or 30%, which is why we exited a lot of that business this year.

A - Richard Brindle {BIO 1983776 <GO>}

But the question, Alex, is more about non-Florida. And I think the answer -- what (multiple speakers) true, non-Florida, I think -- we don't write nationwide. So the only other area we've really looked at recently would be Northeast, which has been okay. There's been a couple of disappointing (inaudible) where we had to reduce our lines. It's a bit different.

In Florida, it's really a commodity play. There's a lot of pretty flimsy companies, to be quite honest with you. We don't have any real relationship with any of the Florida domiciles, reinsurers; in fact, we don't write any of them anymore.

The Northeast is different; you've got a lot of very strong, reputable companies who have been around forever. And they are long-term core clients of ours. But we had to reduce lines on a couple of them because the terms were pretty difficult.

But overall, I would say much closer to flat, whereas Florida was definitely down in our view. And I'm just bemused, as I said in my prepared remarks, that the industry as a whole is telling (technical difficulty) that it was 10 to 15 points up because I can assure you it wasn't.

Operator

(Operator Instructions). Marcus Barnard, Oriel Securities.

Q - Marcus Barnard {BIO 2103471 <GO>}

Can you just remind me how having a sidecar like Accordion benefits shareholders? I mean, do you get a profit share or percentage of revenue or commission or dividends or what? How does it enhance earnings per share or book value, return on equity, or capital? Can you just remind me what the mechanism is?

A - Richard Brindle {BIO 1983776 <GO>}

Yes, it's -- well, there is a number of advantages, to be honest with you. First of all, there is first-mover advantage, the fact that we were, I think, the second company to come out with sidecar, post all of the Q1 [ph] events, gave us the ability to make the market, if you like.

Retro's a fairly sparsely populated landscape. It's not that quality cat that everybody likes. So there's not many people writing retro right now.

And that gave us the opportunity to pitch our tent at the attachment points, which we would (inaudible) in fact charge a lot more money, as referenced earlier.

The cycles in energy provides a bigger growth line, as Alex mentioned in his remarks, which obviously means you have more ability to drive the deal. You know, if you're offering $50 million top [ph] line rather than a $10 million line, then you're obviously going to going to have more credibility in the eyes of the client. Very different broker relationships, which is terribly important to us too.

And then on the economics, we get both a profit commission and overall (inaudible) commission, which is -- if the vehicle runs clean or reasonably clean, it is quite a lot of money. So it's pretty attractive when you put it all together.

Q - Marcus Barnard {BIO 2103471 <GO>}

Okay, on this profit and override commission, what sort of percentage of your pretax could it be?

A - Richard Brindle {BIO 1983776 <GO>}

Elaine, do you want to do that? But feel free to mention about the commission [ph], if you want to.

A - Elaine Whelan {BIO 17002364 <GO>}

Sure, yes, we got a 4% overrider on Accordion. And the profit commission is 13.5% on that.

So, you can write that out based off of the maximum capital you can have in there.

The other advantage that we have with Accordion is the fact that we have an equity interest in it as well. So we get a share of the profits along with the investors.

Q - Marcus Barnard {BIO 2103471 <GO>}

Okay, that is brilliant. Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

No problem. It's worth mentioning, Marcus, we equally deployed -- I think we can write something like $350 million of limit within the cycle. So you can do the math from that.

Q - Marcus Barnard {BIO 2103471 <GO>}

That's brilliant, thank you.

Operator

Ben Cohen, Collins Stewart.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi, I just wanted to follow up on two things. Firstly on energy, sort of after Gryphon, how much sort of further do you think the market will move and what is your -- how do you see your appetite for that business changing with the price increases?

And the second thing was on the votes that you are going to put to shareholders about the being able to raise capital without pre-emption rights, have you -- is this something you have already discussed with them in detail? And from where you stand, I mean, are you -- do you have a sort of a plan B that you would need to put into play if they turn you down again? Thanks.

A - Richard Brindle {BIO 1983776 <GO>}

Okay, first one for Alex (technical difficulty) want any of this?

A - Alex Maloney {BIO 16314494 <GO>}

Sure, okay, then. The energy market at the moment for claim and desirable business, you are probably seeing 5% to 10% rate increases for loss-affected accounts. It could be much bigger than that.

Obviously, when you look at our prime numbers, we've got a blend of loss-affected accounts and clean accounts, which gives you our overall RPI. But the general energy market for clean, core business will be 5% to 10%, which we think is funnily [ph] not enough. I see that continuing for the rest of the year, probably about 7% to 10%. The energy business is already renewed for the year. It's very dependent upon what happens in the Gulf of Mexico.

The key point is it is all about reinsurance. If the reinsurance market at January 1 takes some material changes to the way they underwrite the portfolio. And probably the biggest thing there would be if they demanded larger retentions from their clients, i.e., the underwriters, I think that could make a material effect to the energy market.

At that point, we would write more business and we would write a lot of business which we currently don't write. So our portfolio would expand, the numbers of clients would expand, if there was a material rise, i.e., something like 35% in the energy rate. We would then access a lot more business.

If the range of this market is relatively flat and nothing really changes, I think that the current level of rate increases will continue and that will mean that we will maintain our existing book.

We will -- you know, there's always going to be organic growth in our energy book because we are one of the largest writers of energy. There'll always be things like new assets, (inaudible) around the world. And opportunities for us that you won't see the material change in portfolio unless you see the material change in writing.

A - Neil McConachie {BIO 7540962 <GO>}

Hi, Ben, it's Neil. Okay, the unfortunate situation is that in the UK, there is certain shareholder (technical difficulty) that do not like preemption rights to be above 5%.

So the Company asks for preemption rights to be above 5%. Even though there's fantastically logical business reasons for doing so, they tell certain funds to vote against them. And unfortunately, there are certain funds in the UK that in their constitution or whatever have no choice but to go against it. So if an AGM comes out with this proposal for more than 5%, it will vote against it regardless if it's Lancashire or anyone else.

We only saw 44% of our shareholders base voting at the last AGM on this matter. We know that the great majority of our shareholders support this. And the total business stands for this. And that is the frustrating thing.

So that's the only -- 20% of our total shareholder base, right around 20, Actually voted against us. And we know some phoning around recently that there is a number of people that didn't vote for this. And said, I'm sorry, we should have voted, apologies, we'll come back and vote for it.

A - Unidentified Speaker

Somebody voted against and said, sorry (multiple speakers)

A - Neil McConachie {BIO 7540962 <GO>}

We did find somebody who accidentally voted against it. So we have got to a pretty high level of confidence that this is going to go through. And it's very frustrating that shareholder pressure just completely ignores the business (inaudible) and stand for it. But so be it. Nothing we can do about it.

A - Richard Brindle {BIO 1983776 <GO>}

I just will add then that if you look at the speed to market post-Katrina for the UK company (inaudible) U.S. company and permitted companies, it was startling how much slower it was in the UK because of the whole voting (inaudible) issue. The Board timetable.

As I said in the remarks, which are posted in the Chairman's remarks -- letter to (inaudible) that went out and not just the AGM, I urge you to read it. This is particularly irksome because it runs contrary to the entire DNA of Lancashire.

Right from the IPO, we write to every single meeting that all of us have with -- as investors. And Charlie spends -- he likes telling the market. Lancashire is nimble, we'll be first out of the blocks post an event to take advantage of the market conditions, that (inaudible) to take this as they (inaudible) top cycle and will push (inaudible) and have cycles. That's who we are.

And we would urge and frankly expect the vast majority of our shareholders to (inaudible) second time around as (inaudible) resolution because it's -- this 10% is a key part of the toolbox of what we do after a big event.

We probably do a rights issue as well. But we want to do a 10% immediately. And then we'll go to the rights issue. And then possibly we have companies already talking to us about providing us with (inaudible) capacity post an event because they think we have proved that we're very good at reacting post-loss to the market.

So we urge and expect shareholders to turn out and support this in large numbers, second time around, which I believe is on the 18th of next month.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay, super. Thanks for much for clarifying that.

A - Richard Brindle {BIO 1983776 <GO>}

Thanks a lot.

Operator

Nick Pope, Jefferies.

Q - Nick Pope {BIO 16852956 <GO>}

Yes. Good morning, guys. Thanks very much for a very clear presentation.

I just have one question. And it's about moving your tax residency to the UK. And it's all sort of a thought process question because obviously you've received written confirmation of your exemption for three years already. I'm just wondering if you could put me through how do you get there given that around sort of 70% of your business is sourced from the London market. And now it looks like you'll be having some Board meetings in the UK. And a lot of the -- most of that senior management will now be leaving the UK. I just wondered how you came to get that exemption and what the thought process has been for HRMC allowing you to have that.

A - Alex Maloney {BIO 16314494 <GO>}

There's been a pretty (inaudible) population tax reform in the UK for, I think, some years now. And it started under the Labour government, previous administration, which has been picked up by the current coalition government.

So there's top party support for corporation tax reform. And it recognizes, I think, that we now operate in a global marketplace and there's UK companies that have subsidiaries overseas doing business, whether it's insurance or it's something else. It really has nothing to do with UK. And so the reform is trying to -- I don't know, just trying to make the corporation tax environment in the UK more competitive.

There are consultation papers. Very clear consultation papers came out on the HMRC website. And we encourage people to go and look at that. And the situation that we have is exactly that. We made the situated [ph] in London as well as Bermuda. And the rest are written to brokers in London -- but the rest are really international risks. And not UK (inaudible) risk. And much of it has nothing to do with UK.

I want to just -- I wanted to clarify maybe one thing. Many exemptions should (inaudible) our tax residence in Bermuda; most of them are U.S.-focused groups. A smaller number are UK-focused groups, which includes Lancashire. But also others like (inaudible) or Hardy or Omega and so on. And regardless if you are a U.S.-focused group or a UK-focused group, strict operating guidelines must be adhered to at all times.

And these require that important decisions have to be made outside the U.S. and outside the UK. And Board meetings have to be held outside the U.S. and the UK because, of course, important decisions are made by the Board as well.

If you do not make those decisions outside the U.S. or UK, the profits in that Bermuda subsidiary are at great risk of being taxed by those governments. And you know, we all know that management of a lot of companies in Bermuda do not actually live in Bermuda. They pop in and out when they need to be there. And we know that some of the members of management in Lancashire are based in the UK ostensibly because that's where most of our business is written.

You know, it does create a risk to all exempt insurance companies that fall into that description, not just Lancashire. Many, many companies in Bermuda that accidentally do something in the UK or the U.S. they are not meant to do, despite their best efforts. And you suddenly find their (inaudible) in Bermuda subsidiary no longer is getting the Bermuda tax rate applied to it, zero. They're suddenly getting U.S. or UK tax rate applied to it, which is much higher than zero.

So by Lancashire taking advantage of this legislation and being granted an extension, eliminating a very large risk of some higher Bermuda profits being in captured by the UK.

And so, yes, this makes life easier for us. But it's also eliminating an important risk that all exempt insurance companies do face and Lancashire now wants.

I would just add, the analogy is clearly without the nimbleness our underwriting capital management. We are the first company, we believe, to go into CHMLC, me and myself and Martin (inaudible), our Chairman, was first in the door. And we beat this grace period (inaudible) you saw last week. We try to be first out of the (inaudible) as we prepared to start.

Operator

Chris Hitchings, KBW.

Q - Chris Hitchings {BIO 2034501 <GO>}

Hi, folks, I am sorry to come back again. But I too am slightly concerned that poor Neil hadn't done any questions about his tax (inaudible).

Just one. I mean, you've answered the major one, I think. How much does Lancashire actually spend on flying people to Bermuda and back in a year? I wonder what is the actual cost savings. And I mean, I appreciate the risk and I appreciate these costs. But isn't it also dirty work element [ph] here isn't very helpful for Mr. Hawthorne that there is a company now saying now that we'll move back? Are there any political advantages to this? Might we be seeing arise Sir Richard?

A - Richard Brindle {BIO 1983776 <GO>}

Sir Richard would be really -- let me just cover that answer, Chris.

I think you know my personal belief in the unlikely event I was offered it, I would decline it. But, no, we are as a company (inaudible) apolitical here. But it's something, like Neil said, that has cross-party support.

We started on (inaudible) continue over the (inaudible). It makes sense for UK (inaudible) Plc has (inaudible). Of course it is. But this is really about -- as Neil said, this is about enabling the senior management, as Neil is moving back to the UK this year, this is about enabling us to merge the company quickly and nimbly from the UK. And as Neil rightly stresses, there remains a key risk that hangs over all exempt companies that we think we've been incredibly hard on our operating guidelines.

You know. I've flown to Dublin to do appraisals. And this is the thing. For 15 years, we've taken it extremely seriously. But the removal of this sort (inaudible) will make our lives easier. And we think it is less to do with (inaudible) our decision-making. And that has to help ROE which is the full (inaudible).

A - Unidentified Speaker

I think it will help ROE; it will definitely make decisions faster. Cost-wise, there's no significant costs to doing this. There's probably no significant cost savings either. It's more (inaudible) factor it will save and reducing the risk as well. (multiple speakers)

A - Richard Brindle {BIO 1983776 <GO>}

On the side cuff, Chris, just remind you that we remain, as far as we can tell (inaudible) in terms of G&A, we really are quite hard on ourselves about how we spend shareholders' money and we don't buy first-class seats from Bermuda like a lot of other companies, let alone, dare I say, having corporate jets. So we try to keep it as real as we can.

Q - Unidentified Participant

So it's not a meaningful figure, the cost of actually complying with that decision.

A - Unidentified Speaker

Now it is a cost.

A - Richard Brindle {BIO 1983776 <GO>}

We would hope it is positive for us (inaudible) over time.

Operator

(Operator Instructions). We have no further questions at this time.

A - Richard Brindle {BIO 1983776 <GO>}

Okay. Thank you, very much, everybody.