Q3 2017 Earnings Call

Company Participants

- Alexander Maloney, Group Chief Executive Officer & Executive Director
- Darren Redhead, Chief Executive Officer
- Elaine Whelan, Executive Director, Group Chief Financial Officer and Chief Eexecutive Officer, Lancashire Insurance Company Limited
- Paul Gregory, Group Chief Underwriting Officer and Chief Executive Officer, Lancashire Insurance Company (UK) Limited

Other Participants

- Andreas Evert Cornelis van Embden, Analyst
- Ben Cohen, Analyst
- Faizan Lakhani, Analyst
- Joanna T. Parsons, Analyst
- Jonny Urwin, Analyst
- Nick Johnson, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen, and welcome to the Lancashire Holdings Limited Third Quarter 2017 Results Conference Call. For your information, today's conference is being recorded.

At this time, I'd turn the call over to your host for today Mr. Alex Maloney, Chief Executive Officer. Please go ahead, sir.

Alexander Maloney {BIO 16314494 <GO>}

Okay, thank you. Good afternoon, everyone. Clearly, the third quarter 2017 will go down in the history books as one of the most active we have seen for natural catastrophes in recent history. The current estimates of claims for these events is not unprecedented, nor are multiple cat events in a calendar year, but the short period of time between each event is something we haven't witnessed before. This will add to the complexity in calculating the final quantum of losses and then the resultant market reaction.

These loss events have been a true test for the Lancashire business model across all three of our underwriting platforms. We haven't been tested with a meaningful cat event since 2012 with Superstorm Sandy, and this is our first meaningful cat year since we purchased Cathedral in 2013. So I am pleased that we have performed so well in the face of multiple cat losses in product lines which we are relevant in. We have minimum erosion of our capital, are in excellent shape for the next stage of the cycle.

We have said many times that our focus is not of one quarter, but a longer time horizon. So although our quarter is negative and this is the first time we've had a negative quarter since 2008, we believe that our full year result will be well within our expectation when accounting for the aggregate of cat losses we have suffered. So for us, our focus is all about the outlook for 2018.

There are always differences in the way losses are distributed across markets and these events are no different. We would expect carriers with cat exposed insurance portfolios to have more exposure to these events than just pure reinsurers as we do. But equally, we see a big opportunity in these same lines of business and expect to start being able to re-write under-priced business which we have currently refused to underwrite throughout 2018 and 2019.

We have the capital to underwrite the immediate opportunity, but as we have said many times, we have always matched our capital needs to the underwriting opportunity. Therefore, if the underwriting opportunity is better than we are currently thinking, we will pull one of the many levers we have to grow materially at that time, but we will stay disciplined. As our view of risk hasn't changed, we don't believe the probability of cat events has changed up or down in the short term, and we will continue to have our own view of risk, not just a model view of risk.

So I am delighted we finally have a different story to tell, but I am more delighted with us passing another test of our business model in difficult circumstances. There are no guarantees in this business and its transition to the next phase of the cycle is probably more complex than previously cycles. But I will guarantee across Lancashire, Cathedral and Kinesis platforms, we'll maximize the opportunity.

I'll now pass over to Paul Gregory.

Paul Gregory {BIO 16314515 <GO>}

Thanks, Alex. We've spoken to many quarters of how the benign natural catastrophe environment is certainly not going to continue indefinitely, and during the third quarter, this benign loss run came to an abrupt halt. We previously witnessed natural catastrophes such as those experienced over the past few months, but the occurrence of Harvey, Irma, Maria and the two Mexican earthquakes in such a short timeframe was certainly something new. As ever, Mother Nature always seems to bring us the unexpected, something different to what's come before.

These events are a good test of both our risk management and our underwriting strategy. Across all of our underwriting platforms, we have exposure to natural catastrophe risks. So when we experience events such as these, we will undoubtedly have losses which negatively impact our underwriting performance. This is clearly demonstrated by this quarter's underwriting metrics.

Whilst we expect to be impacted with losses, our key objective is to ensure that our losses are in line with both our own and our stakeholders' expectations, and I am pleased to say that we've been successful in achieving these goals.

This is important for a number of reasons. Firstly, we are in a great position to service our clients' needs, whether this is paying clients, offering backup or new capacity. Secondly, we are well positioned to access any post loss opportunity that may manifest itself and this can be both for the existing and new clients. We've been very candid about our approach to underwriting over the past few years, which has been to manage risk and return appropriately, which is in a softening market has meant being disciplined with our inwards underwriting whilst managing risk levels with appropriately structured reinsurance. Both of these tactics has served us well for these loss events.

Now, we're moving into a market that will be moving in the opposite direction. But we will look to match risk and return. As the opportunity gets better, we are more than willing to increase our risk levels as the reward for that risk improves.

At this juncture, the market is still in a state of flux. There's no real business flow, with limited renewals on new business at this time of year and there's currently not a lot of traction. This will change the move towards 1/1 and beyond. There are a number of dynamics between now and 1/1 that have yet to play out, and depending upon how they go will determine the extent of the opportunity in 2018 and beyond. However, we do believe as we move from today through 2018 the underwriting environment will get progressively better.

For example, we would expect all natural catastrophe at both business lines to see rate increases. The larger of these increases will obviously be on loss impacted product lines and regions.

For non-elemental lines, we certainly expect to see no further downward rating pressure as we move into 2018, but hope to see lines reset to levels that allow for an appropriate underwriting margin. The too long the benign loss environment for natural catastrophe business has marked the lack of underlying profitability of other classes and we're now seeing the natural catastrophe losses date of alliance, but also need to start contributing to positive rate movement.

There's no doubt in our minds that we likely move into a better market and it's a market that should improve from an underwriting perspective. The implications of these losses manifest themselves and the realization that year's of rate reductions and softening terms and conditions have eroded the markets earnings to a point at which they are no longer sustainable.

Whilst the extent of the opportunity or exactly where these opportunities will appear still remains unclear, we are fortunate that in the group we have both the platforms and the people to maximize whatever opportunity there is.

In our history, we've demonstrated many times our nimbleness to generate superior underwriting returns in dissipated markets and are well positioned to do exactly the same this time around.

I will now pass over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Paul. Hi, everyone. The third quarter results are clearly significantly impacted by the hurricanes and earthquakes that occurred during the quarter. We recorded a net loss after recoveries of reinstatement premiums of $165 million of those events, with a pickup of Kinesis (07:24)

Our ROE for the quarter was negative 10.4%, getting us to negative 5.1% for the year-to-date. Our combined ratio is 213.3% for the quarter and 126.4% year-to-date. Given that 2017 could end up being one of the costliest natural catastrophe years on record, we are pretty pleased with the way our business performed. Additional reinsurance (07:47) over the last few years has paid off. We had also carried more excess capital to this year as we normally do (07:54)

Our balance sheet has therefore been well protected impacted (07:57) by hurricanes and earthquakes. We have sufficient capital to take advantage of the post loss opportunities that we currently expect.

Our gross premiums written have increased (08:08) this quarter. Total reinstatement premiums from Hurricane Harvey, Irma and Maria and the Mexican earthquakes is $17 million. Otherwise, we had some plans for this quarter for the timing of multi-year and non-annual deals in addition to the premiums coming through of prior year risk-attaching business.

The fourth quarter isn't a major renewal period for us, particularly the property lines of business. We are, however, already seeing evidence of rates increasing in both hurricanes and earthquakes. We expect that momentum to continue earn revenue (08:36)

We don't subjectively give top line guidance and there's quite a bit of uncertainty in terms of (08:46) Although it's fair to say we expect (08:51) opportunities here for some time.

Ceded premiums increased this quarter. Total reinstatements from Hurricane Harvey, Irma and Maria and the two Mexican earthquakes for $12.7 million. As I said in the last earnings call, the second quarter we had extended some covers and revenues (09:08) renewed this quarter. We also purchased also an additional covers (09:12) this quarter.

With the higher reinstatement premiums this quarter, I would expect (09:15) be a bit higher than last year and the impact of the reinstatement (09:24) the risk-attaching business and reinstatement premium and the timing of the reinsurance renewals are likely to increase in our net earned premiums this quarter.

On losses, we have broken the impact of the major event pause in the (09:36) in the press release. At a net loss in Harvey of $51.1 million contributing 9.9% total (09:42) loss ratio for the quarter, $57.5 million of Irma, contributing 46.1%, $33.6 million of Maria contributing 28.9% and $11.6 million of the Mexican earthquakes contributing 9.8%.

We did have a few other losses this quarter I would characterize (10:03) attrition, but not significant enough in dollar terms to speak of. That has been the case in previous quarters this year through (10:10) higher than we have been guiding.

As I said last quarter, that's mostly driven by Cathedral. But it doesn't change our view of maybe think attrition fit (10:20). Otherwise, in the quarter, we continued to see prior year's stability and at least (10:24) $19.9 million of prior accident years (10:27)

Investment returns 0.6% for the quarter, all of our asset classes have positive contributions to return again. Most of the return continues to come from our fixed securities portfolio as the (10:43)

Our G&A ratio has decreased significantly this quarter as we have (10:50) catastrophes department performance as we just wave (10:54)compensation grew. Our stock compensation costs also reduced for the same reason and we recorded a credit for the quarter. Larger tax credit this quarter is also due to the impact of the events.

We entered into an LOC agreement during the quarter to fund (11:06) Cathedral. The LOC was issued in early October and will give us greater flexibility to manage our capital at Lloyd's (11:15)

Lastly, on capital, accumulation of loss events this quarter and our expectation (11:22) particularly on loss of capital gain (11:26). We expect to be able to fully utilize our current capital base. We are therefore not declaring a special dividend, although we do expect to continue to pay our interim and final audit ordinary dividends. As ever, we will monitor underwriting opportunities and adjust our capital accordingly, whether that's a capital return or capital raise.

With that, I am going to hand over to the operator for questions.

Q&A

Operator

Thank you very much, ma'am. Today's first question is coming from Jonny Urwin calling in from UBS. Please go ahead. Your line is open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi, guys. Thanks for taking my question. Where do we start? I guess, firstly, just thinking a bit about the broader pricing environment. I mean it doesn't sound like you guys are expecting a sort of broad based market turn across all lines and geographies, or maybe you are, I don't know. Please if you can update us there? I mean it sounds like you're sort of thinking about more localized rate hardening.

And in which lines do you see most opportunity here from price increases? And I guess, importantly, how long do you expect this to last given I guess third-party capital (12:52) is likely to come back with a (12:54) so that will be the first area.

And then I suspect you're not going to answer this, but – I mean, what sort of growth do you think the current balance sheet could fund this? Interesting commentary around you got enough capital to fuel the immediate opportunity, but I am just trying to contemplate that. I know it's difficult, but any color will be great? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay, Jonny, so I'll start and others will chip in. So I'll say what Elaine always says, we don't give top line guidance – one is shorter way. I think look, we are probably more confident than what you would say we are about the pricing environment for a number of different reasons. I think what these losses highlight is everything we've said for a long time now that in most classes of business there is very little margin. And let's be honest about it, what was keeping everyone's ROEs at a sensible level was the lack of CAT activity, which has now been completely wiped out.

So I think there's another factor as well. We just haven't had significant CAT losses for a period of time, so it should focus everyone's attention on the real risks that they are assuming and why they were assuming those risks for a certain yield. So we believe all case both businesses going up, we've seen that already.

But we actually do believe non-CAT lines will have rate increases to varying different degrees as well, and we think the momentum will build as time goes by. So 1/1 is the first big test. And lots of reinsurance gets renewed at 1/1 and obviously that's a key factor.

The ILS question mark is something that we could debate for hours quite frankly. We have Darren sitting on the call. But from what we know, there isn't a lot of intent (14:50) in that world and we don't believe that capital can raise (14:53) back to the market quick enough for 1/1. So that's going to create dislocation at 1/1. And then most of the CAT business renews next year.

So I suppose in a nutshell we are more confident than what you think we are or maybe the commentary is. We do have the capital to expand. So when we talk about what we currently have there is (15:16) expansion in now. But if the market gets really interesting and things get more dislocated than what we think, we've always said we will deploy as much capital as we feel we should do if we're getting paid for it.

So if the market gets really exciting, things can move quite quickly. And all of that capital models like everyone else who has run off CAT really, so if you start running a lot of CAT business, you are going to need more capital quite quickly. And we've always said that we would be as nimble with capital on the way up as we have been on the way down.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks. Thanks for that. So, I guess it sounds like the immediate opportunity is 1/1 and then you can fund growth there. And then you might have to reappraise ahead of 1/6 if you're going to load up on Florida...?

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah, exactly. That's exactly where we're at. So we are looking at 1/1 and that's – this market is (16:08) We're in November and nothing is even being created really for 1/1. So the next eight weeks is going to be incredibly busy and interesting. And then we will reassess where we are at after 1/1 and then go from there.

A - Paul Gregory {BIO 16314515 <GO>}

And one things always worth remembering, Jonny, if you think back to 8/6, the opportunity at 1/1, there was a big opportunity in retro, but property CAT took a little bit of a while to catch up and it was more of a Q2 opportunity. So you've got back there as well. We definitely have the belief that as you move through 2018, the underwriting environment will get progressively better.

Q - Jonny Urwin {BIO 17445508 <GO>}

Very helpful. Thanks guys.

Operator

We'll now go to Ben Cohen calling in from Investec. Please go ahead.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi guys. Thanks for taking my questions. I just had I guess really three questions actually. Firstly, if you do need to sort of to fund additional growth, I was just wondering how you would sort of prioritize between the different instruments that you would have in front of you between I guess equity and debt and doing more on the Kinesis side?

The second question was on the Cathedral loss ratio. I appreciate your comment that you feel primary insurance would have had more of a hit than reinsurers to this event. But is there anything in terms of the coverage that it has – the mix of each business that you've learned that you will look to do differently? And maybe you could also just comment on the particular opportunities for Cathedral in a Lloyd's context?

And the third question is really I guess in terms of your outlook for an ROE for the business. I guess in better years you had achieved kind of high teens or even higher

ROEs. Those have slipped to kind of what sort of low teens. What's your outlook with the view that you have of the market environment at the moment? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. So I'll start on two – sorry, I'll start on the Lloyd's piece and then Paul can come in and then Elaine will talk about capital and then she will tell you that we don't give any guidance on ROE. So what I am trying to say on – so if you look at our Lloyd's business and where our losses have fell, there's nothing outside of our expectation.

So our risk management worked. We picked up the losses we would expect to. Reinsurance, repurchase and exactly where we thought it would be. But you have to remember that we have effectively had like six losses. So for most people that write an insurance book, say, a property D&F book, and if you're writing a Lloyd's type treaty book, this loss is much worse than, say, $175 billion loss.

So you've got lots of sideways, multiple retentions and that's where most of our loss is coming from. So there is nothing there that surprises me. But we would think that the two segments of the market, if you like, that have been the most heavily affected is any moment the Lloyd platform, the riots, the typical Lloyd's treaty book, D&F portfolio and maybe even a cargo portfolio and typically a lot of the Lloyd's business. And Lloyd's will be heavily, heavily impaired. But these run of losses – and then if you look at the third-party capital space where both guys are writing retro at low level because they need to get the rates on line for the collateral to make the numbers work, those guys will be heavily impaired as well.

So we would think Lloyd's and third-party capital funds particularly in the retro space are going to be the people with the most impairment. But there's nothing for us at a syndicate level that has surprised us. But these losses are pretty hard to digest because you've just said you effectively had six losses. But do you want to talk about the rate and what that means for us going forward?

A - Paul Gregory {BIO 16314515 <GO>}

Yeah. I mean, say – to add to this point, there's actually the non-marine treaty portfolio within syndicate 2010 and undoubtedly the portfolio business is going to see rate rises as we move through 2018.

There has been a number of loss (20:26) impacted accounts there and loss (20:30) of impacted regions. So we are definitely going to see some premium there. I think more importantly is the D&F portfolio.

I think there are going to be lots of opportunity in D&F. And one thing that's worth noting there is the Cathedral D&F portfolio over the past few years has been de-risked quite a lot. So there is a lot of room for us to grow there when opportunities manifest themselves.

So we are pretty bullish on the D&F market and what opportunities we have as a group. And as we said in the commentary, we got both the platform and the people to access all of those opportunities.

A - Alexander Maloney {BIO 16314494 <GO>}

And then, Ben – sorry, just one other thing without sort of having got the competition I suppose. One thing that we all hearing lots of examples of really sloppy underwriting in a soft market (21:21) with lots of examples of PMLs for parts of the Caribbean are horribly wrong.

So there will be risk management failures elsewhere, which is another reason why we think particularly for the D&F space there will be a big opportunity, because I just can't believe that a number of carriers will continue to write the amount of CAT exposure that they currently have or thought they had. And that's going to come back to the market and we will be able to re-price that business to some extent. We will be able to write that business, so that's why we are quite bullish on the D&F market.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

And in terms of funding extra growth, we do still have headroom. We did have extra capital coming into this year. So we don't have any immediate need to – we are quite happy to use our hedging, first of all, in terms of any extra funding, how we prioritize that. We don't really have much appetite for additional debt at the moment.

So we'd be looking at either equity or reinsurance whether that's to Kinesis or to external parties. And whichever way we go, really depends on the size of the opportunity that we are seeing.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay.

A - Elaine Whelan {BIO 17002364 <GO>}

We don't give any guidance on ROE.

Q - Ben Cohen {BIO 1541726 <GO>}

Right. Okay. Worth a try. Thanks very much.

A - Elaine Whelan {BIO 17002364 <GO>}

Joking aside, we are expecting to see the increase in a (22:41) better market. It's just very hard to see at this stage how much better that's going to be.

Q - Ben Cohen {BIO 1541726 <GO>}

Sure. Thank you. Thanks very much.

Operator

Thank you very much, Mr. Cohen. We'll now go to Andreas Van Embden calling in from Peel Hunt. Please go ahead.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

Hello, good afternoon. I just wanted to hear your thoughts on what's going on within Kinesis. Obviously, there has been big losses. I just wanted to listen to your thoughts of how much capital will be trapped within Kinesis and for how long a time?

Also, what are your inflow expectations? Are you thinking about attracting new money or are you going to wait until the capital has freed up to reinvest? And are there any changes in your views on what the potential is for assets under management taking sort of a three year view and where you see the opportunities in retro today? Thanks.

A - Darren Redhead {BIO 17995744 <GO>}

Thank you, Andreas. This is Darren. Regarding trapped capital in (23:56), just to refresh your memory, we structured Kinesis slightly different in that we raise the money annually. Yes, we will have trapped funds as all funds will be played in the retro space, quite significant amounts. It's going to be over a big proportion of your actual capital raised and all the funds in the area we will have to have substantial capital raises for 2018. We raise the money on an annual basis, so our investors are used to that.

Regarding looking to increasing the number of investors, we will be looking at our investors to increase the assets under management for 2018. I'm not going to give a guidance. It's all going to depend, as we all have said earlier, regarding of how good the opportunities will be. It will be price dependent. Yes, there will be growth in Kinesis, but it will be in relation to where we think the opportunities will be. Priority will be given to our existing customers and we'll look to renew those portfolios with increases with the amounts deployed and in pricing, but then look at new accounts as well.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

(25:02)

A - Darren Redhead {BIO 17995744 <GO>}

Sorry?

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

So if I understand it correctly, existing customers can reload immediately...

A - Darren Redhead {BIO 17995744 <GO>}

Yes.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

...into the funds or are you going to setup a new fund alongside the old fund?

A - Darren Redhead {BIO 17995744 <GO>}

It will be – we raised – the new fund is new every year. Kinesis has a new fund every year, so 2018.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

Okay. So the 2017 fund will just run off and the 2018 fund will be a new fund running alongside it?

A - Darren Redhead {BIO 17995744 <GO>}

Correct. And we've deliberately done that every year because one of our thoughts has always been trapped funds will happen. It's the product we sell as claims. We have done so to promise to pay paper (25:45). We sell you a dollar for dollar trust fund. And the customer won't release those funds until he is happy that he knows he is in quantum of amount. So that's why we've set Kinesis up as a new fund every year, unlike all of our peers who are continuous funds. And not speaking for them, but they will have to raise funds in their existing structures or set up separate managed accounts.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

Okay. So you've got that flexibility to re-acquire quickly?

A - Darren Redhead {BIO 17995744 <GO>}

Yes.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

All right, very clear. Thank you.

A - Darren Redhead {BIO 17995744 <GO>}

Thank you.

Operator

Thank you (26:22) We'll now go to Mr. Jonny Urwin coming in from – with a follow-up question from UBS. Please go ahead sir.

Q - Jonny Urwin {BIO 17445508 <GO>}

Yes. Hi. Just a couple more please. So just going back to Kinesis. I mean when will you give us sort of some commentary around the potential for the 2018 limit? I know you don't really give too much disclosure around those limits. It seems to be kept quiet. I mean you've also in the past you mentioned that you would limit your Lancashire's investment in the funds to about 10% on a $1 billion limit. Is that still the case or in this market would you think about allocating more?

And then secondly just thinking a bit about your retro program. And obviously it seems to have worked pretty well through these losses. Can you give us any commentary around the gross to net on the losses and how much was offset by retro and also how much – how are you thinking this program for next year given potential price increases, what are you thinking there and how much cover will you buy, will you trim it perhaps?

A - Alexander Maloney {BIO 16314494 <GO>}

Sorry, Jonny. So we'll go to Darren in a minute. On our percentage of Kinesis, currently we have got no plans to increase our participation in Kinesis. And for us to write the type of products that Darren writes is incredibly capital inefficient for us, which is why we have booked Kinesis anyway. So for us, we could increase our participation, but at the moment we're not planning to and it's very much dependent on what happens in the market. And look, we will say this a lot and that will probably irritate lots of people, but the fact of the matter is this year everything will be incredibly late and it will be a very messy renewal season. So even we won't know till it's incredibly late in the day.

On our retro, as you know, we have bought more retro in the softer market in fairness to all the reinsurance market. One thing they have done this time versus the late 1990s was they didn't give away retention, yet they are competitive on price. But retentions was like that they weren't prepared to really negotiate on. So the reinsurance market I think was more disciplined in this cycle than the last.

For us, as a buyer, we've always thought of a long-term view. So we might be competitive on price, but we have never seen our reinsurers as people we are just going to give large claims to and walk away from. So we are pretty good hung for this. But we will pay the rate increases that we need to pay. We are not afraid to pay more for every insurance. The coverage is more important for us. But we would expect to be able to renew everything that we currently have.

We don't think any of our reinsurers, either (29:15) presented, are reinsurers with anything that should surprise them. We've managed their expectations. And when you go for these losses, I suppose my number one job is managing the expectation and I think we have managed our expectation with pretty much everyone, including our reinsurers.

And then the price will be what the price will be. But clearly, your point is the right one. If prices are going up, that clearly affects us when we're buying as well. But I'm pretty confident we'll get a fair deal from our reinsurance.

Regarding on the growth of Kinesis, again I'll repeat on Elaine's comment, we don't give any guidance on top line. But just if I'll answer around about where – we will look to raise and increase and we'll look to sell that. If we don't sell it and the price is on, we'll give it back to investors, as we always do. However, if we do sell it, we'll look to raise more and we'll raise capital. As a group, we'll foresee the opportunities.

Q - Jonny Urwin {BIO 17445508 <GO>}

All right. Thank you very much.

Operator

Thank you very much, sir. We'll now go to Mr. Frank Howard calling from Lancashire Holdings (30:25). Please go ahead, sir.

Yes. Congratulations, gentleman. I appreciate your candor here and I'm continued to be impressed. There's a lot of talk about risk management. But you've had, as you said, six events here, including three really big ones and things didn't snowball. So would you like to comment a little bit more about all the thoughts you've put into this and how – in general I think you've been pleased that it's well within your parameters?

A - Alexander Maloney {BIO 16314494 <GO>}

Sorry, Frank (30:57), what was that first point you've made?

Q - Operator

Yeah. So just a comment on your risk management. I think the way things are coming in, not extreme, but well within your parameters. Just a little more comment about all the thoughts that you've put into this.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Thanks. Paul?

A - Paul Gregory {BIO 16314515 <GO>}

Thanks for your comments, Frank (31:17). I think for us, what we've always tried to achieve here is a combination of factors. And one thing that these events will tell you or should tell everyone is that some of the modeling estimates and some of the modeled results will be very wrong. So to run your business based on models solely we think would be a mistake.

So my comment earlier about our own view of risk very much stands. So our view here is we have some very smart people that come around with models and come up with actuary numbers, but then we also have some sort of old-fashioned underwriters that will common sense a lot of those views as well. And then our business is not a black and white business and things can happen. So when you've got a good reinsurance program behind you as well, you would hope that would keep you within certain type of events.

But as you've said, this is a real test for us and everyone else and these losses are much harder to absorb than the straight $75 billion loss, because you're managing the sideways and the multiple retentions you have. So we are very pleased with the way we've come through that.

But as I said, our view of risk hasn't changed. We don't really get to focused on sea temperatures or new models from RMS saying that the hurricane frequency is coming down this year, but didn't really happen. So we will take our own views as always and manage our business accordingly.

Q - Operator

Thank you very much. That's very good.

Thank you very much, sir. We'll now go to Mr. Andreas van Embden also coming back with a follow-up question. Please go ahead, sir.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

Yeah. Thanks. Thank you very much. Just thinking about next year on increasing capacity and the capital requirements that attach to that. Lloyd's have been saying they have become a bit more flexible and that in Q4 a lot of syndicates can come in with revised budgets for 2018 and there seems to be more headroom to expand stand capacity. I just want to hear whether is this for Lancashire the right time to increase capacity materially through either Syndicate 2010 or 3010 and grow into possibly a hardening reinsurance market next year in a more capital efficient way? Thanks.

A - Alexander Maloney {BIO 16314494 <GO>}

So what you said, Andreas, is true. Lloyd's and the PRA from our experience have been very good through this whole process and we've had some very good conversations, and they have definitely told us that the flexibility is there based on the market opportunity. It obviously helps when – we've managed their expectations, so we've already had our business plans agreed for 2019 (34:19).

And again, from our point of view, there is no surprises and we do have the flexibility to change our view of the market. And very much like what we said earlier, on every class of business, including Kinesis, we will get through 1/1 and reassess where we're at. And if that means we have to put another business plan to Lloyds, that's what we will do if that's the right fit.

Property D&F is an area that we think is going to be a real opportunity and we write that through our Lloyd's 2010 platform. We don't write it anywhere else. So if we think that the current headroom we have at Syndicate 2010 is not sufficient, but we do have a lot of headroom in Syndicate 2010 on our current stand capacity, if we don't think that's enough, we will go to Lloyd's and ask them to approve another business plan. And we can currently see no reason why they wouldn't allow us to do that, because, as I said, we've passed our risk management test and that would be the natural home for that business.

Q - Andreas Evert Cornelis van Embden {BIO 1795530 <GO>}

Great. Thank you very much.

Operator

Thank you, sir. We'll now go to Joanna Parsons calling from Stockdale Securities. Please go ahead, ma'am.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Thank you very much. Just one quick question. Based on your current assumptions of what you think is going to happen to the rating environment for 2018 and therefore the capital that you require, do you factor in your calculations that you expect to pay a special dividend in 2018 on that basis?

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Joanna. And I guess, in terms of how we were thinking about a special dividend for next year is going to depend on how the rating environment progresses. If we think that we're continuing to see an improving market, then it's better for us to put the capital to work. And we will continue to pay our ordinary dividend and as ever, we'll look at matching our capital to underwriting if we need to keep the capital. So fundraising (36:24) will do that. And if we think that we have more than enough and we wanted to return profits, then we'll do that too.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Okay. But I was just wondering based on your current assumptions, because I obviously understand if the rating environment improves further than you anticipate, well, then clearly you want to take advantage of it. But based on your current view of the market, would you be expecting to pay a special dividend?

A - Elaine Whelan {BIO 17002364 <GO>}

We may do something small, but it's really early to call that.

A - Alexander Maloney {BIO 16314494 <GO>}

And then again, Joanna, well, even – I suppose even where we are today, our view of 1/1 will change a lot between now and 1/1. So our view of where we would be when we make that call on capital, which would be next November, who knows.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Okay. Thanks.

Operator

Thank you, Mrs. Parsons. We'll now go to Mr. Nick Johnson calling in from Numis Securities. Please go ahead, sir.

Q - Nick Johnson {BIO 1774629 <GO>}

Hello (37:19). Excuse me. Just picking up on the comment that you say you think that there should be a meaningful adjustment in pricing for all products that you sell. Just focusing on energy, because that's not affected, I just wonder if you could just talk through a bit more about what the dynamics will be or could be that would drive price increases in that segment?

A - Paul Gregory {BIO 16314515 <GO>}

Yeah, I'll take that, Nick. So one thing I would say is, there isn't much business flow on energy at the moment, but the business flow there is, is already seeing rate increases. At this juncture, they're not as large as you're seeing in the cat lines, but you are seeing rate increases. We are confident that those rate increases will increase and continue through 2018.

There's no doubt in my mind that when people get their reinsurance bills at 1/1 they will be more than they have been in the past. That is definitely a dynamic that's going to help push rates. And also remember, a big part of the energy market is Gulf of Mexico wind. Gulf of Mexico wind clashes directly with cat business in areas such as Florida.

It's going to be competing for capital. So if people redirect capacity to areas such as Florida property cat or Texas, for example, then you may see capacity come out, and you've got Mexico sector, and if capacity comes out, then in my view, rates only do one thing.

So there's a lot of moving parts, but what we've seen thus far is positive rate movement and our view is that, that will continue through 2018. The one thing I would just caveat all that with is demand with the oil price where it is, is obviously different to what it was back in the glory days when you had $100 oil.

So, rate increases are great, that's good. And ideally if the oil price went up as well, that would be even better. And it is also worth remembering the upstream, I mean, obviously we focus more on the upstream side, the upstream energy market has had a few losses over the past few years as well. So the margins aren't particularly great. So we're confident that rates are going in the right direction.

A - Alexander Maloney {BIO 16314494 <GO>}

And also, Nick, remember that – one thing I've been annoying our underwriters with recently is, our insurance lines, I don't think are a good bellwether for the whole market. So our insurance lines, because of our underwriting discipline and we didn't force our underwriters to grow, are all below 100% combined. Whereas, lots of other people's insurance lines, they've been some very sensible carriers of about 100 combined. So I think the kind of rate we would need on our book to get to a better technical rate is less than what you would need overall.

And that's why we are more confident about some of the other product lines will just have to be re-rated, because people have just ignored – quite frankly people just ignored current rating levels for years. And we don't think they can ignore them anymore.

Q - Nick Johnson {BIO 1774629 <GO>}

Okay. Interesting. Thanks so much indeed. Thanks.

Operator

Thank you very much, Mr. Johnson. As we have no further question at this time, I'd turn the call back over to – oh, I'm very sorry, we have one last question coming in from Faizan Lakhani calling from Bernstein. Please go ahead. Faizan Lakhani, your line is open, could you please ask your question, sir?

Q - Faizan Lakhani {BIO 20034558 <GO>}

Hi. I just had a few quick question. You commented earlier that some of the models didn't correlate to what the actual experience was. Are you potentially looking to adjust your models or use different model vendors?

Secondly, are you seeing any sort of issues with claim surge, inflation in the nat cat hit areas? And finally, could you just provide a little bit of color on the midsized losses that you're seeing? I know you mentioned that they are within the variance, but at what lines are they coming under and are you potentially looking to re-underwriting any of them? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

So, a few of the models have been (41:34) changed. I think we were sufficiently cynical about some of the model (41:38) losses. In slight fairness to the model I see I think it depends how these losses fall. So in some parts of the world, the models will be more reliable than other parts of the world.

But as I said, we have our view of risk. And one of our sort of risk committees that we run every two weeks in this business has a mixture of people from actuaries to finance the underwriters and that's where we form our view of the risk levels that we want to take for our business.

So I don't think it has changed. I think it just highlights that the model doesn't give you the whole picture and you shouldn't be totally reliant on models. You need more than that to sufficiently manage your risk levels in volatile events such as cat losses. So it hasn't changed.

On the sort of claims inflation, I suppose we haven't seen that yet, but we are expecting to see that. What has changed about these loses? Because you've had so many events in such a short period of time, the data flow to the market, it's hard to remember because it doesn't happen often (42:51) but the data flow to the market seems to be a lot slower this time than in previous large cat events. But we do expect to see higher claims inflation I suppose.

The loss has just been expensed. But again, we haven't really turned to the market as a whole as great data at the moment and that's an opportunity, complication on working what the actual losses are. So we haven't seen that. The midsized losses Elaine you really get the question that (43:18).

A - Elaine Whelan {BIO 17002364 <GO>}

So, let me take a shot at that one. I think and we talked about some a bit of an attrition (43:24) but they are not big enough to be okay to get platform losses (43:27) coming through and we also get some of that losses (43:31) over the last while and just in general I think also the higher level of attrition. Does that answer your question?

Q - Faizan Lakhani {BIO 20034558 <GO>}

Yeah. And are you looking to potentially re-underwrite off the back of those very large attritional losses or are you quite happy with what it is and the type of book of business?

A - Elaine Whelan {BIO 17002364 <GO>}

No, this is all tied...

A - Paul Gregory {BIO 16314515 <GO>}

Yeah, there are no surprises in there. It's all as expected. It's just a quarter where we've got a couple of them really.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Okay. And just sorry, a very quick follow-up. Are you seeing anyone change term and conditions on the long side as being rate-changed across your portfolio? That's all.

A - Alexander Maloney {BIO 16314494 <GO>}

We haven't yet, but I'm absolutely sure you will see people. I think particularly for some of the – maybe some of the fund products or some of the retro deals I think that there will be an element of rate increase and an element of terms and conditions or coverage. As I said earlier in the call, some of the things we're hearing, there is a lot of sloppy soft market underwriting which gets exposed when you have losses such as this. So we think that will change, yes.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Okay. Thank you very much.

Operator

Thank you, sir. As we don't have any further questions, I'll turn the call back over to the organizing staff for any additional closing remarks. Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you for your time, thank you for your questions. And we'll update you at fourth quarter call. Thank you.