Q4 2013 Earnings Call

Company Participants

- Alex Maloney, Group Chief Underwriting Officer
- Darren Redhead, Head of Lancashire Capital Management
- Elaine Whelan, Group CFO
- Peter Scales, CEO, Cathedral Capital
- Richard Brindle, Group CEO

Other Participants

- Angela Gu, Analyst
- Ben Cohen, Analyst
- Chris Hitchings, Analyst
- Frank Cawood, Analyst)
- Nick Johnson, Analyst
- Olivia Brindle, Analyst
- Tom Dorner, Analyst

Presentation

Operator

Good morning. Good afternoon and good evening, ladies and gentlemen. and welcome to today's Lancashire quarter 4 results conference call. (Operator Instructions) Just to remind you, this conference call is being recorded.

And now, I'm pleased to present Richard Brindle. Please begin.

Richard Brindle {BIO 1983776 <GO>}

Thank you very much. Just to introduce everybody else who's going to be on the call, I'm Richard Brindle, Chief Executive, Lancashire Group. I'll hand over after my remarks to Alex Maloney, who's the Group CUO. I'm also joined by Peter Scales, CEO of Cathedral Capital; Darren Redhead, CEO of Kinesis, our third-party capital management division; Elaine Whelan, our Group CFO; and Denise O'Donoghue, our Head of Investments and Treasury.

A year ago, we introduced the R-word, relevance, to our narrative. And events have unfolded more or less as we expected. Small, narrow, largely following carriers, are now under pressure as never before. They lack the clout to make brokers sit up and take notice and with non-traditional capital flowing into the cat space and larger carriers flexing their muscles in response, the outlook for them is bleak indeed.

Lancashire would never have fallen into this category, because we take big positions on the risks that we like, and lead a large majority of the business that we write. But I firmly believed at the start of last year that we had to find ways to make ourselves more relevant and muscular, if you will, in a very difficult market.

We have achieved this over the course of 2013, with the purchase of Cathedral and the strong start made by Kinesis. We now boast a strong bench of seasoned underwriters across the three platforms as I believe exists in the specialty London market. This depth enables us not only to combine our brands to the mutual advantage of the Group, but to find ways to cross-fertilize each other's underwriting activities and to add value to brokers and clients across our specialty world in ways we never could have done alone.

That said, we are now done on the M&A front for the foreseeable future and will concentrate now on deepening and enhancing the harmony and cohesion of the Group.

First and foremost, we will achieve this by sharing the same office space and we're all going to be on the same floor of the walkie-talkie, hopefully, by the late summer.

In our industry, different parts of group companies often simply don't talk to each other and examples of duplication, or even intra-group competition, which this spawns, are legion. We will not make this mistake.

Finally, we remain firmly committed to our strategy of giving money back to shareholders when we have nothing better to do with it and nothing that happened last year changes that philosophy in any respect.

And I now hand over to Alex.

Alex Maloney {BIO 16314494 <GO>}

Okay. Thank you, Richard. 2013 has certainly been a year of change for Lancashire, but our fundamental approach to the core of our business, the underwriting, has not changed. And in a softening market, and this is definitely a softening market, we think that our processes and people will help us to continue to outperform.

While it might be an exaggeration to say that we relish the prospect of a soft market, we do believe that strong underwriting franchises can differentiate themselves in soft markets when risk selection, portfolio management, analysis and discipline all come to the fore.

As a Group, we now have 40 underwriting staff with a real depth of experience across our business lines. We're working together well, referring opportunities and discussing markets together in regular forums and ad hoc.

Just the other day, Simon King on the Cathedral D&F team was able to refer a broker looking for terrorism cover to Simon Thurgood's team in London. At January 1, our (communal) underwriting office and Cathedral cooperated well to provide new layers for Cathedral property XL clients looking for additional limits.

We are working closely together on our plans to build out the Syndicate 3010 where we provide 100% of the capital. We will begin writing some specialty lines in 3010, including terrorism and energy, subject, of course, to Lloyds' approval.

Darren and Peter are going to speak about Kinesis and Cathedral, so I won't steal their thunder.

But we've had plenty going on at LICL and LUK too. We've seen very strong support from our brokers and clients in 2013 and continue on into the current year, and we'd like to thank them for that.

We've had a 36% increase in submissions to LICL and LUK, excluding the D&F line, which is now run off. This is a good indicator of support we get from our brokers and clients and the fact that we lead or have agreement-party status on 80% of our business written in 2013 shows why we're valuable.

We don't just supply capacity, but real expertise as well, and we've used that expertise well to grow in some areas where we see good opportunities. These are terrorism, political and obligor risks, energy liabilities and, of course, the build-out of our Bermuda property cat XL portfolio.

We stress the need to be nimble to manage the market and we think we achieved this at January 1 renewals. In fact, we were, for the first time, actually buyers of retro rather than sellers, with $100 million of limit purchased excess of an aggregate deductible.

We also bought some more reinsurance cover for our energy, marine and terrorism portfolios for 2014. So our risk adjusted net portfolio is looking in really good shape.

We've always said that straight property cat retro is opposed to lots of products for Lancashire. So two years after the serious losses, with rates plummeting, we've been winding down our retro into property cat XL. Indeed, comparing January 1, 2014, to the prior year, retro including Accordion, the reduction in down payment is from $66.7 million to $10.9 million whilst property cat XL has increased from $31.3 million to $64.8 million.

The property cat XL portfolio is well diversified geographically and includes some multi-year deals where we think this is appropriate on higher layers for clients with stable exposures. We have also written some low layers too, but these are for small limits.

When we look at our overall cat exposure, the reduction in inwards retro, the run-off of the D&F and the purchase of $100 million of aggregate retro cover, we believe this more than offsets the increase in property cat exposures.

Our terrorism portfolio is one of the leading London market books. We've already diversified our geographic locations, industries and attachment points. We continue to find low-risk profile opportunities all around the world. And although pricing is under pressure with 10% reductions becoming fairly common, we're seeing a great flow of business.

The uncertain future over TRIPRA is also stimulating more demand from US clients. This may carry over to our AV52 segment, where it is possible that US airlines may have to purchase from the private market in 2014. We won't know for several months, but this could be a welcome new premium pool, as existing AV52 rating is falling.

The marine market continues to suffer from overcapacity and ill-discipline, and our portfolio shrank in 2013, though largely due to multi-year contracts written in 2012. Other than the international group, which is in payback for the (inaudible) on Costa Concordia marina, rating is unexciting so we're sticking to quality clients and niches like war and mortgagees' interest covers.

The political risk and especially the obligors' book is a bright spot, as growing investment and economic recovery are seeing a steady increase in deals.

We remain highly selective, binding less than 7% of the submissions we receive, but we've expanded the team this year and this is paying rewards.

The energy team continues to find new opportunities, with $8.8 million of excess liability business written in 2013.

James Flude has joined Lancashire London as Head of Energy and Marine, and he's already bringing us new clients and relationships.

Again, price is under pressure after four years of compound increases and a relatively light loss year. But with additional re-insurance limit purchased, we're happy that on a risk-adjusted basis, the portfolio continues to be in good shape.

A lot of attention has been given to the property cat arena, as new capital still continues to arrive. But it's worth remembering that LICL and LUK derive much of their profits from things like terrorism, political risk, AV52 and energy, and these markets continue to be the preserve of specialists.

Similarly, a lot of attention has been given to broker facilities, but we're already hearing that one of the major backers is pulling out. Again, as a market leader in most of our business, this really isn't a threat to us.

So all in all, we're in a good position for the market that faces us. We'll continue to target the cross-selling and leveraging our broker relationships that Cathedral and Kinesis bring to us. We'll continue to work on the portfolio optimization and the optionality that the three platforms give us.

I'll now hand over to Peter Scales.

Peter Scales {BIO 15393236 <GO>}

Ladies and gentlemen. good afternoon. My name's Pete Scales. I'm the CEO of Cathedral Group.

The timely completion of the acquisition of Cathedral by Lancashire means the contribution from Cathedral to the results we're presenting here is pretty immaterial. However, we thought it would be useful to give you a brief outline of last year's performance of the Cathedral Group, absent the transaction; a brief summary of the corporate actions we have taken so far to integrate the businesses; and a brief run-through of how we see the marketplace in the lines of business in which we trade.

Cathedral produced a combined ratio of 77% for last year. This includes releases from the run-off of early years and reflects the relatively benign underwriting years of 2012 and 2013.

In Lloyds' parlance, we closed the 2011 accounts on both syndicates profitably in what was a horrible year for frequency of loss. 2012 year of account is running among the best we have historically had, with the vast majority of exposure now off-risk; and 2013, although running at a slightly higher attrition rate than 2012, looks at this stage to be in very good shape, but still with substantial in-force exposure.

Since the deal was announced, we've been working hard with our new colleagues to streamline the capital side of the Cathedral Group, while maintaining focus on what was a tricky renewable season and developing some plans for the future.

The bulk of Cathedral's funds for its underwriting activities are now provided by Lancashire Group, and we've put in place a quota-share agreement to LICL from the Cathedral corporate member.

A number of the senior Cathedral staff now sit on the joint Executive Committee and are represented on Lancashire's Underwriting Risk Committee. Equally, we now have Lancashire representatives on the Cathedral Underwriting Board and on key committees, such as the Risk Management Committee.

Our central conclusion is that both businesses have very much in common, not least of which is the focal point is underwriting. Although this sounds rather obvious, we're both underwriting-driven businesses, supported by quality support teams that allow them to trade.

In terms of the operation of our trading models, although they're fundamentally different, both models are equally valid and have a loyal following from both client and broker. Therefore, the plan is to maintain both brands and both trading models, in order to offer different trading interfaces with our clients that we know work successfully.

The added value is that between us, we're already seeing that the relationships that existed in one business, be they clients or broker, have enabled us to bring in new business or trading leverage into the other, which were not obtainable on their own or before. This is a work in progress and something we're confident we can build on going forward, not just with Lancashire but also with Kinesis.

We're also planning to use Cathedral Syndicate 3010, our wholly-owned syndicate, as a build-out platform to encompass both existing Lancashire lines, probably starting with energy, where we can capture more Lloyds-style business and, in the long term, bring more market-leading underwriters who are attracted to the Cathedral corner shop model, overlaid with the opportunistic firepower of the wider Lancashire Group.

This is very attractive to underwriters as it gives them immediate clout and more offerings on to how effectively exploit an opportunity or market dislocation over and above their through-the-cycle trading position.

The marketplace, in the widest terms, is probably as challenged as it's been for the last 25 years. In December it was hard to see the bottom of where new and existing participants were willing to go in the hope of renewing or writing business. The combination of new entry and the charge into non-core areas from displaced existing markets trying to maintain top line set the scene for a potentially unattractive scenario.

Reality is that the process actually stabilized in the second half of December and what promised to be a rather frenetic yearend concluded in pretty orderly fashion.

However, in our two property lines the baseline for pricing, and terms on historical -- sorry. On an historical basis, we're not in a bad place, and still offer significant margin.

This is underscored on a net basis, where a small amount of planned gross income, lost during the renewal process, has been more than made up for by cost savings, and more effective cover being available for protecting our book on the reinsurance market.

The real story is that topline is slightly down on plan, but net income is up, with better protection and flat to lower gross aggregate exposure. The key to this is control of your business, inasmuch as you have control in any marketplace, which can only be done in the long term by having market leading underwriters in each class, coupled with a service that adds value and consistency to your client or broker.

Some broad numbers for you to get an idea where we're at at 1/1, and assuming the first half reinsurance and direct renewals follow broadly the same pattern.

Overall, our property treaty account saw gross income decline by about 7% over last year, which is in line with our business plan assumptions for 2014. Reinsurance costs, however, came in at well under plan. Costs are down around 20% with better lower cover. The result is that, although we have planned for a fall in our topline, net retained income is higher than we planned last year. Exposures are broadly flat and slightly down, both in terms of insured aggregates and on modelled-loss basis.

Our US property reinsurance account, which is entirely made up of regional companies, was clearly the area where we expected to see the most competition, and we weren't disappointed. That said, our client relationship saw us through, and we've had no more turnover in the account than usual. In terms of clients won and lost, it's very much a typical renewal season. Signed shares in the business remain the same, again underscored by our relationships.

The international property treaty account saw single-digit reductions in pricing across most areas. This was offset, by some degree, by increases in the loss affected areas, such as Germany, Scandinavia, was less than the overall impact.

As regards our direct property account, December is a reasonably busy period for renewals of our delegated authority business, or binders. We saw single-digit rate increases on the US proportion of our book, and stable rates on the international segment. This has led to a small increase in our projected income over the same time last year.

For the open market book, written income is up a little over the same time last year. But you shouldn't really read anything into it at this stage, because of the vast bulk of the account were needed later in the year, when we expect things to become more competitive than they were at the yearend.

We have spent 12% less on our D&F reinsurance program, which now attaches much lower, and gives us greater, broader depth of cover than last year.

January is not a major renewal date for aviation reinsurance, but what we did renew, as much as expected with mid-single-digit reductions and generally a mixed bag.

Our contingency account is, by far, our smallest, and made up of non-appearance business in the rock and pop industry. Our account had a pretty torrid time last year, along with the rest of the market. As a result, this is one of the few areas we're actually seeing rates and deductibles meaningfully rise over the last couple of months. We're also seeing larger amounts of coverage being required towards increasing value.

On the cargo account, which is written in under Syndicate 3010, has grown during the last year, and will grow slightly more in 2014, reflecting the increase in the movements of goods across the world, as economies begin to recover. Rates remained pretty flat and market conditions, basically, continue to be oversubscribed.

Dealing in oversubscribed markets is nothing we haven't seen before; sadly, more than once for a few of us. But our business has experienced underwriters, who are a go-to pricing market in each line in which we trade. And we have a high quality track record through market cycles.

The market will continue to be more competitive until losses or alternative pursuits take not only capital but points of entry out of the marketplace. Until then, better businesses will continue to make good returns, and they're likely to be the ones standing next time the market changes and reap the rewards.

In summary, it's a traders' market where the best underwriting resource, the most effective capital backing will win; pretty much as usual.

Thank you. I'll now pass you over to Darren, please.

Darren Redhead {BIO 17995744 <GO>}

Thank you very much, Peter. Over the past few years, Lancashire's been actively involved with collateral vehicles for various products, energy and retro-sessionals, using various different structures.

We've evolved this good start to create a much more flexible, standalone, capital management vehicle, with its own special purpose insurer and reinsurer. Under the Kinesis banner, we have created a vehicle that remains loyal to the Lancashire brand of creating something different from the crowd.

We have created a vehicle that's different in three ways. Firstly, the way investors have access to the market on a kind of investors club. We have two fixed capital raises a year, and if funds are not deployed, they are returned to the investors; not left to sit on an account, almost being falsely used. Also, we have the ability to raise funds very quickly under a special draw, should the need arise.

Secondly, the business written, rather than just follow the crowd writing property catastrophe only, we have leveraged Lancashire's expertise in specialty lines, terrorism and energy; for example, packaging them up with property cat perils to create an individual product. Also, we have generated new business, not just ceding away our existing business.

Lastly, we have endeavored to give investors a balanced portfolio, so not to expose all their capital to one of them.

During 2013, a lot of hard work was done in investigating the landscape from a supply/demand point of view; something, I think, that is not done enough in this industry, especially in this type of market. Using these findings, we developed a concept for products that both appeal to potential clients and investors.

Last year, we targeted a potential limit of between $300 million to $500 million. To date, we have deployed just over $252 million. We look to be on target for the middle of our range, with our mid-year capital raise, which will, again, be specialty focused. We feel we could have raised more capital 1/1, but, in the present climate, held back to maintain our returns.

Collateralized reinsurance is here to stay, and is a major component under the reinsurance market. Indeed, it seems to have changed our industry, in how additional capital will be deployed in future after major events. It cannot be ignored, nor should it be; it should be embraced as an opportunity.

Lancashire now has a vehicle that is both market facing, developing its own business, and has the ability to raise funds quickly, to provide sizeable solutions for our clients.

Lastly, I'd like to thank all of those at Lancashire for their tremendous support and help over the past year in creating Kinesis.

I will hand over now to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Darren. Hi, everyone. Our results are on our website, as usual. We've added a couple of extra pages of Cathedral numbers to our financial supplement this time though. Some of those show historic numbers, to help you with your projections, and some are showing the impact of the income we picked up from Cathedral since the acquisition completed.

Our yearend financial statement also includes more disclosure in relation to acquisitions, and the resulting intangibles and the like. Going forward, Cathedral will be treated as a new segment, and it will have its own page in our segment breakout.

So there have been a lot of moving parts to this quarter, but the adjustments for acquisition accounting largely net off against each other.

As I said in our release, our return for the quarter was 3.7%, with about 3.2% of that from Lancashire standalone, and about 0.5% from Cathedral standalone. That brought us to a return for the year of 18.9%. Within that return, about 6.4% related to our equity issuance and foreign exchange hedging activities, in relation to the acquisition of Cathedral.

Our underlying performance for the quarter was reasonable. We didn't have any major cat events, but we did have some development and some prior year energy losses.

Overall, for Lancashire, development for the quarter was marginally adverse, but we did see some releases coming out of Cathedral from the annual review of their reserves. That amounted to $9.1 million. We had a net $8.2 million release on reserves in the quarter for the Group.

Just note that a small amount of Lancashire's adverse development related to the Thai flood losses. And that is mostly offset by foreign exchange, due to the way the Thai flood losses impact our reinsurance program. Adjusting for that, Lancashire's adverse development for the quarter would be favorable.

Similarly, if we adjust the reserve development for the year, for the FX impact of the Thai flood loss development, our 2011 accident year development would be slightly favorable.

On the premium side, Lancashire's premiums are broadly in line with the same quarter last year, with the increase for the Group, compared to last year, coming mostly from adding two months of Cathedral's business. Cathedral added $24.5 million to our topline. But bear in mind, the Fourth Quarter is not a major renewal period for them, and this only reflects two months' worth of premium.

Lancashire also continued to build out its property, political and sovereign risk books. As I mentioned last quarter, these are longer tenure deals, they'll take a while to earn out, although they do provide the benefit of that income stream earning out over the coming years.

Alex and Pete have talked a good bit about the 1/1 renewals. As you all know, we don't provide premium guidance. But that said, if you take a look at the quarterly statement for 2013 for Cathedral that we added to our supplement, you can get a decent idea of what the Cathedral book will look like next year. Prices may be (off), but it's a very stable book and business model.

For the Lancashire book, we expect to continue to expand our property cat, and political and sovereign risk books, but our retro book will be drastically cut back. We only wrote $10.9 million of retro growth premiums at the 1/1 renewals, compared to $67.6 million at 1/1, 2013.

Just to remind you that $47.9 million of our 2013 retro gross premium was from Accordion qualifying contract, that were 100% ceded, due to a knock-on impact on our level of outward premium in 2014.

Otherwise, while we expect some pricing pressure, our energy, marine and aviation books should be fairly stable, as we renew the core clients, and hopefully add on a few new bits and pieces too.

As far as the rest of the Outward program goes, including Accordion, both Lancashire and Cathedral are looking at a similar dollar spend in 2013, for a better program.

On investments, we, again, managed to produce a small positive return on our portfolio this quarter. And that brought us to a positive return for the year.

Our bank loan and emerging market debt portfolios did well. And our fixed income portfolio benefited from the significant spread narrowing in the quarter, despite the rise in treasury yields.

We're continuing to work on bringing our emerging market debt portfolio in, given the volatility EMD is experiencing at the moment. We're also adding more to our backlog portfolio, and we have put a small amount into an equity-linked note. We're looking at other products too, to diversify our portfolio and help manage our interest rate risk.

Kinesis has obviously had a successful start, and over the coming year, we will earn underwriting fees of about $5 million on the capital called to date in 2014. Future capital calls will generate further underwriting fees.

On the capital calls to date and the book we have built, the profit commission could be in the region of $9 million, depending on the loss activity. The earliest recognition of that profit commission though would be in the First Quarter of 2015. But remember, we also have the benefit from our 10% investment in Kinesis and the equity pickup of that.

Also, Accordion and Saltire are now essentially in run-off and we expect profit commissions of about $9.6 million from them in the First Quarter of 2014.

G&A was obviously higher this quarter with the cost for legal and advisory services in relation to the Cathedral. There were some other one-offs and timing impacts too and we split out our operating expenses a bit more than normal this quarter.

Lastly and probably the bit everyone's interested the most is capital. We're topping up last quarter's special dividend with a further special dividend of $0.20, plus our regular final dividend of $0.10. In dollar terms, all in, that's about $64 billion. That's returning just under 90% of comprehensive income for the year and just over 90% of comprehensive income since inception.

We continue to work on integrating Cathedral and managing our P&L as a combined Group, but we have accomplished a lot already, which is why we're returning a bit more capital now.

We do want to make sure we have sufficient capital to grow and develop over the coming year and will spend some more time further refining our processes over the rest of this year.

But all that aside, and in the absence of a market changing event, there's been no change in our expectation that we will around $1.6 billion in tangible capital to support our current book and our growth expectations for 2014 and beyond.

If we continue with the market we're in, I'd be expecting us to return most, if not all, of our earnings at the end of 2014 or into early 2015.

With that, I'll hand over to the operator for questions.

Questions And Answers

Operator

(Operator Instructions) Tom Dorner, Citi.

Q - Tom Dorner {BIO 15847486 <GO>}

So two questions from me please. The first, I just wanted to confirm, Elaine, that you said that you expect your capital requirement to be somewhere in the region of $1.6 billion of tangible capital.

But asking -- looking forward, are there any factors that might reduce that? I wonder if you can comment on rating agencies and now that you've integrated Cathedral, is there potential that that might come down at all.

Then the second question I had was on the -- so the strong combined ratio from Cathedral, the 77% that Peter mentioned, can you give us a sense how much of that was reserve releases; you mentioned $9 million in Q4 I think, but for the year as a whole? And should we still be looking at a mid-80% combined ratio for that business? Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Sure . $1.6 billion tangible, that's what we felt that we need for 2014. And it's obviously pretty early on in the year, it depends what happens during the year as to what we think we need at the end of the year.

We've spent a lot of time working with Cathedral, working through our P&Ls; we've got a pretty comfort level there with what we've got on there. The same with rating agencies; we think we've got a good understanding of their expectations of us as well.

I think if pricing continues to come off or there's any kind of shock then we might want to bring our capital down a little bit more. But at the moment, we still think there's enough good business out there for us to be able to write that $1.6 billion. So if nothing changes then I think that's a fairly stable level for us, in that $1.5 billion to $1.6 billion range. I think as Lancashire standalone we're in the $1.4 billion to $1.5 billion range.

As far as reserve releases go, Cathedral probably had somewhere in the region of about $20 million of releases over the course of the year, if you take out one-offs and other kind of funny items, if you like. So I would use that as a rough frame of reference. We, obviously, don't have a lot of history of looking at Cathedral's numbers on accident-year basis, but I think that that's a reasonable starting point.

Q - Tom Dorner {BIO 15847486 <GO>}

Okay. Thanks.

Operator

Ben Cohen, Canaccord Genuity.

Q - Ben Cohen {BIO 1541726 <GO>}

I had -- there were two things that I wanted to ask. The first one was on the build-out of Syndicate 3 -- 3010, in terms of trying to write more of the Lancashire business on that. Where are you with approval from Lloyds? And what would your plan be for this year on that side?

And also as a subset, if you could quantify or give some guidance in terms of the capital efficiency that you would get out of that, that would be very helpful.

The second thing was really just a clarification in terms of how you're accounting for Cathedral. I think there was reference to the Lloyds' year of accounts in terms of 2012 and 2013 being very good.

In terms of what you reported for 2013 for the full year, is that -- that is basically an accident-year view of 2013 is it, so we're already getting that. It's not that these good years later than 2011 are going to come out later. Maybe you could just clarify where that stands with the comments about 2011 and having closed off that year? Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

Yes, I'll start. On that one, Ben -- it's Alex here. I'll talk to you about what our plan for 3010 is and then Peter Scales can talk about capital needs in Lloyds.

So we are -- we haven't actually gone to Lloyds officially yet to talk to them, so obviously everything I say is subject to Lloyds' approval. But we are going to look to try and write energy and terrorism within Syndicate 3010. That's our plan. We should be going to Lloyds in the next month or so. Then obviously that will enable us to see a slightly different type of business than we see outside of Lloyds.

We are going to underwrite that business the same way we would anyway, so we don't see any changes there. But you can't deny that Lloyds has got a good brand and there's a lot of brokers that continually place business in Lloyds and it just gives us -- it's the beauty of doing the Cathedral deal, it just gives us another platform, another option, to write business in a place that's highly capital efficient.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay.

A - Peter Scales {BIO 15393236 <GO>}

So in terms of the capital, Syndicate 3010 at the moment is monoline, but kind of gets lost in the wash in that the capital charge at Lloyds sits on the Cathedral corporate member. So clearly, the Group's share of the 58% of the larger syndicate and the 100% of 3010, as a blended number, is about 59%.

As 3010 builds up there is some credit within the Lloyds black box-type model, and it's more diverse I would suspect that there will be a mixture of, locally at 3010, some credit for diversity and widening of the book. But again, there will be some notional lows for a small while as they're new books to Lloyds.

So what does that mean in the wash? The answer is we can't be definitive at the moment, but I'd be surprised given the scale of it immediately it would affect massively the Lloyds capital requirements that we have in place, is a short version.

So there will be a -- we will keep you updated once we're into Lloyds, we've rounded the offering out, and it's approved and up and running. That would be something we'd certainly like to mention at a future call when we're up and we know exactly what we're talking about.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay.

A - Elaine Whelan {BIO 17002364 <GO>}

And I'll take your second question, Ben. We converted the Lloyds' basis of accounting into GAAP accounting for our purpose -- our reporting purposes. We've actually given you a breakout in our supplements.

So if you go to our loss reserve pages there by accident year, what we've picked up from Cathedral on an accident-year basis, very much like ours; there's not an awful lot left on the overall year. It's a pretty short tail book, so there shouldn't be any massive surprises there in how you see the numbers.

Their reserving process is pretty similar to our as well; it's attritional loss ratios. Then for larger stuff and cat, it's reserving to best estimate, to the extent that they develop favorably then, that's always good news. Sometimes it goes the other way.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. So it's really more an accounting, how they would account into Lloyds, rather than any changes you would expect?

A - Elaine Whelan {BIO 17002364 <GO>}

Yes. We can look at that in both years.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thanks.

Operator

Angela Gu, UBS.

Q - Angela Gu {BIO 18078706 <GO>}

I have two questions please. The first one is on reinsurance protection. I think you talked about how your reinsurance purchase behavior has changed, because retro is now more attractive as a buyer. So I was just wondering if you can clarify you attachment point. Is this a stop-loss, aggregate or do you buy protection per event, that will be really helpful?

The second one is for Elaine, I just want to ask whether you're still maintaining your attritional loss ratio guidance for Lancashire core at 22%? And would you give us some guidance of Cathedral's attritional loss ratio please? Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

Okay, Angela, it's Alex here. Just to give you a flavor of the way we're thinking about the market, in that obviously everyone can get hung up on prices going down but, equally, that means our reinsurance costs are going down as well.

We have taken the opportunity to buy more reinsurance, so we're actually spending more money as rates go down to get a much broader cover.

On the non-marine cat account, we have protected that in the past. We think it's like ILWs, which you saw in Hurricane Sandy, but we've now decided to buy some retro, which is on an aggregate basis. We've got $100 million aggregate retention and we've got $100 million of cover in excess of that. So that we think provides some really good protection.

We've also purchased more reinsurance on our energy book, our marine book and our terrorism book as well, and every program that we've purchased this year has reduced in price by varying degrees.

And if you look at the retro, we think, compared to what we paid for the retro this year versus what we would have paid for it 12 months ago, it's materially different, obviously in our favor.

So that's not to say we're done with reinsurance purchasing for the year. We're constantly looking at everything. We're constantly looking at opportunities. But it's fair to say that Lancashire has the most reinsurance protection that we've ever had in our history.

Q - Angela Gu {BIO 18078706 <GO>}

Just to clarify, so you say it's $100 million on XL -- sorry, if you have an industry loss -- sorry, if you have a loss of $200 million you, basically, will pay the first $100 million and the second $100 would be covered?

A - Alex Maloney {BIO 16314494 <GO>}

Yes. That's correct, but it is an aggregate so it's not on each and every deductible.

Q - Angela Gu {BIO 18078706 <GO>}

Okay. Thanks.

A - Elaine Whelan {BIO 17002364 <GO>}

Then on your second question, Angela, I think after we had had our reserves study done, we're indicating that our attritional ratio had probably gone from the 25%, knock off a few points for that, call it 22%/23%. I think with the addition of Cathedral into the Lancashire book that probably brings (it) back up a bit, so back up at that kind of 25% level.

I think, given where we are in terms of placing and the renewal book that we've seen, I think we should RPI-adjust that, which probably nudges it up a little bit higher, and that should be a good start point for you.

Q - Angela Gu {BIO 18078706 <GO>}

So you have 25% attritional alteration for Group or for the core -- the Lancashire business?

A - Elaine Whelan {BIO 17002364 <GO>}

That was across the Group.

Q - Angela Gu {BIO 18078706 <GO>}

Oh, a ross the Group, okay, thank you.

Operator

Nick Johnson, Numis Securities.

Q - Nick Johnson {BIO 1774629 <GO>}

Two questions already answered, but since I'm here, can I just ask what the expected clean return is for Kinesis, if there are no losses this year?

A - Darren Redhead {BIO 17995744 <GO>}

I'll take that. Gross of fees, the clean return will be around 28%/29%.

Q - Nick Johnson {BIO 1774629 <GO>}

Great, thank you very much.

Operator

Chris Hitchings, KBW.

Q - Chris Hitchings {BIO 2034501 <GO>}

Couple of things. Can you give us just, Elaine, a little bit more help about the other operating expenses that are actually one-offs? You've mentioned that there's an element of fees earned at commissions to do with the Cathedral deal in there, and you've mentioned that there's some timing issues on that. I'm just trying to get an idea of what your clean cost ratio, going forward, is?

Second question; if I'm looking at your reserve movements, am I presuming that the $9.1 million from Cathedral is all in the 2012 accident year in the other schedule? But if so, I'm surprised that 2011 development has gone from plus 4.4% at nine months, to minus 4.1% at the year, which is odd really if that's all down to movements in the Thai baht, or whatever you suggested it was? Thanks.

A - Elaine Whelan {BIO 17002364 <GO>}

Sure. I think as a general rule you can probably knock about $5 million of our G&A and about $5 million off of Cathedral's G&A to get a run-rate to take out those costs (inaudible) the acquisition.

Q - Chris Hitchings {BIO 2034501 <GO>}

So $10 million in all?

A - Elaine Whelan {BIO 17002364 <GO>}

Yes. About that. We've had some other stuff in our numbers, which is driven by timing of exercises on a good compensation. We accrued for it. It's hard to work out when people are actually going to exercise, so that one's always going to be a bit lumpy, which is why we stripped that one out this time round. I think that that should give you enough to be able to work out a decent run-rate.

On the reserve movements, the Cathedral development has been spread across a number of years. 2011 was where we saw the development of the energy claim, so that's why you're seeing that one being impacted.

Q - Chris Hitchings {BIO 2034501 <GO>}

Sorry, this is the development of which energy claim?

A - Elaine Whelan {BIO 17002364 <GO>}

We are not able to talk about specific claims, unfortunately.

Q - Chris Hitchings {BIO 2034501 <GO>}

So that was an $8 million adverse development in the Fourth Quarter -- sorry, positive development in the Fourth Quarter?

A - Elaine Whelan {BIO 17002364 <GO>}

Yes.

Q - Chris Hitchings {BIO 2034501 <GO>}

But if it's the one you referred to at the 9-month stage, I thought that was in the nine month figures. Or that was certainly the indication.

A - Elaine Whelan {BIO 17002364 <GO>}

We had some development last quarter on the same claim; we had some more development in this quarter. We've now reserved everything.

Q - Chris Hitchings {BIO 2034501 <GO>}

So it's adverse development?

A - Elaine Whelan {BIO 17002364 <GO>}

Correct.

Q - Chris Hitchings {BIO 2034501 <GO>}

But there was a release in the Third Quarter wasn't there?

A - Elaine Whelan {BIO 17002364 <GO>}

On this specific claim that I'm talking about, I think we were still negative for 2011 at the end of last quarter.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay, fine. So that's the adverse development. But you've allocated the $9.1 million from Cathedral across the years, or is it reasonable to presume the vast bulk of it is 2012?

A - Elaine Whelan {BIO 17002364 <GO>}

In the later years, yes, for sure.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay, fine. Thank you.

Operator

Olivia Brindle, Deutsche Bank.

Q - Olivia Brindle {BIO 17273762 <GO>}

I've got a couple of questions. First of all, if we think ahead to the April and June/July renewals, we've been hearing a lot that's when we start to find out where the floor in the market is perhaps on the pricing side. Would just be interested to get your thoughts on that, albeit it's quite early in the year?

Secondly, partly related to that is what are your expectation, at this stage, for top line growth across the Group as a whole in light of the expectation for the midyear renewals, but also what you've seen in January?

Then thirdly on the capital release from Cathedral. I'm just wondering if you could give a bit more clarity on that. You've said that a lot of this has already been completed, so does that include the ($35 million) of funds at Lloyds that you previously referred to? Or what else does that include.

And related to that, should we expect any more big movements on this over 2014? Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Let me talk a bit about the first, and I'll do this with Alex about expectations for the year, Olivia.

I think Peter said in his remarks, and I concur with him, at one stage in Q4 we were fearing and anticipating a kind of meltdown, and that didn't really happen.

There were various things that happened, which you'll probably get to hear about over time, which stiffened the resolve of some of the more entrenched players such as ourselves.

And there was something, I think it's fair to say, of a fight back by the rated markets against the encroachment of certain type of third-party cover. Not the type that Darren's deploying, which is behind bespoke products, which are cat/non-cat, but genuinely new products to the market, but behind all this money was piling into the cat space.

And I think that one held up better than we had feared, both from a pricing point of view and from a signings point of view.

I think where the squeeze is really going to be felt is on the smaller following outfits. Obviously, Cathedral you could say are relatively small, but they, don't forget they lead a huge amount of their business, and they held up just as well as we did on signings. The squeeze more is on the small following carriers who, nothing against them as individuals, obviously, but it's hard to see their relevance, my favorite word, in the current market.

So it's simple math. If you have non-traditional capital taking a slice of the pie, the leadership contenders like ourselves holding onto what we've got and possibly taking a bit more, the mathematics (still) happens to the rest.

In terms of the year, so I think we come into the year with a slightly stiffened resolve and stiffened backbone. I think an awful lot of -- John Hamblin, who's the active underwriter at Cathedral, talks very persuasively about how a lot of his clients on the regional book and the US have no desire to deal with third-party capital at all; they are extremely appreciative of, not only the product, but the people offering their product. And we would echo that in our book, although our book is different.

So I think overall we're in the downwards pricing environment. There's no point pretending we're not, but I think our fears of some sort of meltdown are now behind us.

I think what we will see more of, is verticalization. And that is something which we will be in a good position to resist as lead market. But again, I think you will see the following markets under pressure to offer the same policy for a lower price. We've all seen that before, and we know how that movie ends, but that's starting to rear its head again.

But there are positives signs. Some of these big follow facilities, as you've probably picked up on the grapevine, are being unwound. I think it's in the public domain about what's happened with Berkshire Hathaway and the energy deals. That -- we applaud that decision by Berkshire, they're sensible people. I was a bit surprised they did it in the first place, but I applaud their decision; those sort of facilities don't help at all.

Obviously, taking that blindly following capacity out of the energy market is very helpful for us. We continue to get a greater and greater distribution and share of the energy and political violence business. Our sovereign book is profiting from the upturn in world economies.

So I'll hand over to Alex to perhaps give you his expectations, but I think there's plenty of reasons for optimism, at the moment, for our book and for the nature of our leadership profile.

A - Alex Maloney {BIO 16314494 <GO>}

I think that Richard's covered most of it, but what I would say as a big sort of overlay to -- before we get too depressed about reductions, you know you have to look at the underlying rating of the business.

So if you just pick two big areas for Lancashire and the Cathedral Group, it's property cat and energy. If you look at where you are in property cat writing, we're definitely -- the market's move quickly, which has spooked people, but you're definitely not at the late 1990s quite yet.

We think you're about 30% off the peak in 2006. And we think you'd have to go at least another 30% down before you'd even got close to the late 1990s. So you've got -- you've always got to keep an eye on where relative rating is.

If you look at the energy market, the energy market is now giving reductions. But again, if you look at where you are, you're coming off historic highs. The capacity has grown in that market, but the beauty of the energy market is the risks have grown with the capacity, so people are not killing each other for business and that portfolio is controlled in the London market as well.

If you look at things like marine, the reason why marine is so difficult is there's too many people that can write marine around the world and the capacity far outstrips the need. So if you look at the biggest cruise ship in the world, it's about $1.5 billion; probably 98% of the world's tonnage is sub-$100 million. So you can just never do anything in that market. The beauty of energy is it's pretty well matched to the capacity.

So I think in a nutshell, if you look at what the Group does and the majority of the income we write, we feel -- we still think we're in pretty good shape.

If you look at the areas where we write where the rates have come off, like AV52 and terror, those rates have probably halved since we started writing them, but we never paid a loss. So I think that's why we cautiously optimistic about the market.

As Richard said earlier, it's an opportunity for us to -- the good underwriters should differentiate themselves and we think adding Cathedral to that group just gives us more options.

A - Richard Brindle {BIO 1983776 <GO>}

So then the question probably best for you, Elaine, on top line growth, and then -- I can't remember what the third one was.

A - Elaine Whelan {BIO 17002364 <GO>}

Capital release from (multiple speakers).

A - Richard Brindle {BIO 1983776 <GO>}

Capital releases.

A - Elaine Whelan {BIO 17002364 <GO>}

Olivia, I think if you look at our energy, marine and aviation lines of business they're broadly flat to last year. We might lose a little bit in pricing, but we should get some back in new business.

The big movement is obviously going to be in retro, where, as I said, we wrote about $10.9 million at 1/1, we're not going to write an awful lot more over the course of the rest of the year, so that one's going to come up a little bit.

We will grow our property account line though, so you can see some expansion there.

In terms of Cathedral we've got that page in our supplement. The book is fairly stable. Again, you might lose something in pricing, but they should make that back up in new business and some of the growth that we might see through 3010. So most of the growth you will see will be in our property cat line and everything else is fairly flat with retro down.

In terms of the capital release, probably a simple way to look at what we've done is that we paid for Cathedral with the equity issuance, and a comprehensive income. The dividends that we've been able to return have been capital release from that.

It's a little simplistic, but it's there or thereabouts. There's obviously a lot of moving parts to that, but we have done that style restructuring. We've put in place a quota share over to LICL, as Pete mentioned. So that's largely done.

What we're going to spend the rest of the year doing is just refining some of our modeling assumptions.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay, so on the top line you're basically saying flattish to maybe sort of up 1%/2% something like that perhaps? And on the capital release no sort of big movements that we should expect?

A - Elaine Whelan {BIO 17002364 <GO>}

No, not until we get to the end of the year and then, obviously, we'll have an assessment of the market at that point. But if nothing else changes, then we might return all of our earnings at the end of the year, we'll see what happens then; for most of the book flattish, property cat up, retro down.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay. Great; thank you.

Operator

(Frank Cawood), Frank Cawood Associates.

Q - Frank Cawood {BIO 18585522 <GO>}

Congratulations Richard and Peter Scales on what appears to be a very smooth integration of your two businesses.

A - Richard Brindle {BIO 1983776 <GO>}

Thank you, Frank.

A - Peter Scales {BIO 15393236 <GO>}

Thank you.

Q - Frank Cawood {BIO 18585522 <GO>}

And I'd like to address first question to Richard, and then I have a couple of quick questions for Elaine.

Richard, would you comment on what appears, to me, to be an enormous de-risking of your business since Lancashire's inception? It seems particularly with this $100 million re-insurance over $100 million, that's just typical of what you've been doing in the last few years, so could you comment on that?

A - Richard Brindle {BIO 1983776 <GO>}

With pleasure, Frank. I think I've said to you before that one of the absurdities of the insurance market is that people -- most companies write the least business and rates are highest, and the most business and the rates are lowest, which if you talk to somebody outside of our cozy little world just will gape at you open mouthed.

And obviously, we can't be entirely binary. We're not Berkshire Hathaway who can come and write $1 billion one day and nothing the next. We have core relationships with brokers and clients which are vital to our ongoing success.

But with that caveat in mind, we do try to de-risk when rates are coming down. And we think that -- I read these plans -- without singling anybody out, I read these plans about people diving into new lines of business and opening new offices and this, that and the other against the backdrop of the market we're in and, like I said earlier, we've all seen how that movie ends.

So yes, we are de-risking. We've gone from sellers to purchasers of retro and we're pleased that we've done that. We've taken the opportunity to buy more cover on the non-elemental book, and we think that's exactly the right thing to be doing at this point in the cycle, Frank.

Q - Frank Cawood {BIO 18585522 <GO>}

Good; thank you, Richard. And Elaine, I have a couple of questions for you.

Again, the duration of the portfolio at one year is extraordinarily low and I, personally, think that's a very good idea, because of trying to reach for yield in such a low interest rate environment. Also, there's the potential protection in case your rates should move up materially in the next year, or in the years ahead. So could you comment on that, and then I've got a couple of other quick questions.

A - Elaine Whelan {BIO 17002364 <GO>}

Sure, yes. It's low intentionally, (and managed at a) fairly duration. We put on a tail risk hedge earlier on this year and that kept our duration low as well.

And the Cathedral portfolio when we amalgamated that is very similar to ours, and probably slightly lower duration as they have pretty high cash balances. So we're quite happy with where that is and the bank loans were at play.

In terms of our interest rate risk, we're looking at other stuff around the edges there as well. And we'll look at stuff that doesn't add significant duration to our portfolio, gives us a bit of yield and does not add too much risk.

You might see that duration creep up a little bit, but it's not going to be significant.

Q - Frank Cawood {BIO 18585522 <GO>}

Great, well, a couple of other little quick questions here. On the -- you mentioned Accordion and Saltire are, in effect, in run-off and you're expecting perhaps a $9 million profit commission in Q1. If that's the case what about the remaining quarters of this year?

A - Elaine Whelan {BIO 17002364 <GO>}

Accordion and Saltire aren't writing any more business. Accordion was retro, which we're not really interested in any more. Saltire was kind of a one-year product, and Kinesis has obviously taken over from that as a longer-term vehicle.

So the profit commissions are coming in now, because the deals in those vehicles have run off.

Profit commission in Kinesis, the first time that we will see some of that will be First Quarter next year, just because the contracts have to run through a full year (final) term first, before us to see how they are, depending the loss activity on them. But we will get the underwriting fee from underwriting on behalf of Kinesis throughout this year.

Q - Frank Cawood {BIO 18585522 <GO>}

Yes, I guess my question is the profit commission expected from the run off of Accordion and Saltire would that rate of perhaps $9 million in the First Quarter, would that rate continue perhaps through the rest of the year?

A - Elaine Whelan {BIO 17002364 <GO>}

No. It's a one-time hit. That's -- the vehicles are done and that's the profit commission that we're getting at the end of the day.

Q - Frank Cawood {BIO 18585522 <GO>}

Okay, good; that makes it clear. Another interesting thing, I noticed it's kind of a level of interest, that with Cathedral there was apparently a long-term claim, which now apparently has been settled from the Michael Jackson Estate. So would that settlement be perhaps reflected in a release in the First Quarter?

A - Peter Scales {BIO 15393236 <GO>}

This is Peter. Broadly speaking, we always had a claims reserve. The net movement is virtually nothing to us; it's just basically something off the books. It financially virtually makes no impact.

Q - Frank Cawood {BIO 18585522 <GO>}

Okay, I just didn't know if perhaps -- since it was kind of a spurious claim anyway, if perhaps there might be some further movement in that.

Okay, well, thank you very much.

A - Elaine Whelan {BIO 17002364 <GO>}

Okay, Frank.

A - Richard Brindle {BIO 1983776 <GO>}

Thanks, Frank.

A - Peter Scales {BIO 15393236 <GO>}

Thank you.

Operator

Tom Dorner, Citigroup.

Q - Tom Dorner {BIO 15847486 <GO>}

I actually wanted to ask a similar question to the earlier one about fees within Lancashire Capital Management, because I think you said in the past you had expected to add 2% to 3% ROE over time. I just wanted to make sure I got the numbers right.

So on the Kinesis business its $5 million within this year and then another $9 million next year, and then a one-off benefit of about $10 million from Accordion and Saltire.

How do you get to the 2% to 3% over the next couple of years, is it driven by Kinesis? Or do you need to introduce other products to achieve that? Thanks.

A - Elaine Whelan {BIO 17002364 <GO>}

There are two elements to it; there's the underwriting fee and then there's the profit commission. There's always going to be a lag with that, which is why we said that, ultimately, we think it's going to get to 2% to 3% on our ROE, it does take a time for that to build up.

The $9 million is profit commission; the $5 million or so is underwriting fee, in terms of the capital that we've called and put to work right now. So it's $250 million of capital.

As that grows, those numbers increase, and that's where we're getting to the 2% to 3%. So it's not a 2014 play, we'll see it increase a little bit in 2015. It's you're really going to see it stabilize and start flowing through on it from 2016 onwards.

Q - Tom Dorner {BIO 15847486 <GO>}

But do you think you need to introduce new products to get there, or can you just scale up Kinesis to do it?

A - Darren Redhead {BIO 17995744 <GO>}

I'll take that, it's Darren here. There will be natural growth with the Kinesis multi-class product. But as I mentioned, we will be going for specialty products mid-year as well, so it will be product-driven over the next two to three years as we grow.

But one caveat I would say on that is if there is dislocation within the market, obviously, with the structure we've created it could expand dramatically over a very short period of time.

So it's -- if no loss activity, as Elaine's mentioned, it will be a two/three-year grow out to where we want to get to on the multi-class specialty products. But if there was a market dislocation we could potentially get there a lot quicker.

A - Richard Brindle {BIO 1983776 <GO>}

What we've created Tom, and I think we talked about this before with Goldman's our advisors, is a sort of investor club, and it took a bit of time. And Darren did a hell of a lot of work last year, as he mentioned in his script, identifying the supply, because that's not done often enough, and getting people really acquainted with our underwriting approach, and that paid dividends at 1/1.

We want to expand that investor club, but the concept is that we have an annual draw where we do the 1/1 book, which will be mainly the multi-class products, but we'll certainly look at other products; there may be property cap opportunities and stuff like that.

But then we can do what we call special draws through the year and we reckon that we can actually do a special draw within a week/10 day-period, which is very quick if you think about it. And that's because we've put in a lot of hard work in educating our investors, getting all the legal agreements signed and all of that stuff.

And you know what we're like; we're constantly on the lookout for market dislocations and niches. Sadly, there aren't very many, at the moment. But we're constantly on the lookout and this special draw feature should enable us to react extremely quickly to any dislocations.

Q - Tom Dorner {BIO 15847486 <GO>}

That's very helpful, thank you.

Operator

(Operator Instructions) We have no further questions registered, I hand the conference back to you.

A - Richard Brindle {BIO 1983776 <GO>}

Okay, just thanks, everybody, for dialing in and we'll see you next quarter.

FINAL

Operator

Ladies and gentlemen. this now concludes the conference. Thank you, all very much for attending. You may now disconnect. Have a nice day.

Bloomberg Transcript