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Q4 2010 Earnings Call

Company Participants

- Alex Maloney, Group Chief Underwriting Officer
- Elaine Whelan, Group CFO
- Richard Brindle, CEO

Other Participants

- Adrienne Lim, Analyst
- Ben Cohen, Analyst
- Chris Hitchings, Analyst
- Fahad Changazi, Analyst
- Nick Pope, Analyst
- Thomas Fossard, Analyst
- Tom Dorner, Analyst

Presentation

Operator

Good day, ladies and gentlemen. and welcome to today's Lancashire Holdings Q4 2010 conference call. For your information, this call is being recorded. I would now like to turn the call over to your host today, Mr. Richard Brindle. Please go ahead.

Richard Brindle {BIO 1983776 <GO>}

Thank you very much. Good morning. Good afternoon. This is Richard Brindle, Group CEO of the Lancashire Group. I'd also like to introduce Elaine Whelan, Group Chief Financial Officer; and Alex Maloney, Group Chief Underwriting Officer. Also on the call is Group President Neil McConachie, although he's not planning to speak today, but he's around if needed.

So I'll start, and then I'll hand over to Alex.

Whilst we are, obviously, pleased with our 2010 results, the market as a whole, as referenced in my comments last time out, faces a very challenging 2011. Key things to look for in our view are risk selection, the willingness to reduce top line premiums, keeping expenses under tight control, right-sizing capital to the underwriting opportunities available, and avoiding the temptation to bet too much on what is still a fragile economic recovery by adding too much risk to the investment portfolio.

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We believe we tick all these boxes. Our daily underwriting call ensures the first and second of these. Our expenses are around the lowest for comparable companies. We have led the way in right-sizing capital, and encouragingly, we see more willingness now across London and Bermuda to do this as well. And our investments, whilst we may add a small equity segment, remain decidedly on the cautious side of the street.

All of these strategies fall, of course, under the umbrella of knowing how to manage the cycle. I believe the industry as a whole is less reckless than in past cycles, due in no small part to most of us being public companies, with all the scrutiny and accountability that brings with it. But we still see irresponsible rate slashing in certain quarters, and companies committed to growth strategies in a softening market, which simply makes no sense.

For all the gloom and doom, there are bright spots for companies with a nimbleness to react quickly. Marine retro is one area. More spectacularly so was the recent demand for backups from Australasian carriers reeling from the recent string of cat losses down under.

We strongly disagreed with the original pricing and, indeed, with that of the original backups purchased in December and January. But the February pricing was excellent, and we were able to react within the very tight timeframe set by the cedents to write some highly attractive deals. New companies offered the immediate access enjoyed by our underwriters to the most senior managers, which in turn enabled us to do this.

To conclude, this will be a tough year for all of us. We are seeing accident year combined ratios nudge towards and beyond 100%, and investment markets offer no profits at a positive return this year. We also believe short durations on both sides of the balance sheet are prudent, given the massive uncertainty in the world over inflation and interest rates.

So underwriting excellence, low expenses, and a nimble eye offer the best chance of traveling safely though these waters.

I will now hand over to Alex Maloney.

Alex Maloney {BIO 16314494 <GO>}

Okay; thank you, Richard. Good afternoon, ladies and gentlemen. I'm going to start with my view about 2010 results, and then I'll highlight some key points of that; and then I'll move on to our 2011 outlook.

2010 was a very active year. The insurance and reinsurance industry has been challenged by cat losses in each of the four quarters. In quarter 1, we had the Chilean earthquake; quarter 2, we had Deepwater Horizon; quarter 3, we had the New Zealand earthquake; and then to finish the year in quarter 4, we had the flood losses in Australia. We believe that our losses from each of these events have been within management's expectations,

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and we expect little exposure from either the New Zealand earthquake or the flood losses in Australia.

Our loss estimate from the Chile earthquake has reduced from our original estimate, as we have now obtained better information from our clients. It now appears we were a bit conservative with our first estimate. Our net loss ratio of 27%, coupled with a combined ratio of 54.4% for 2010 is an excellent achievement, and a testament to our disciplined underwriting.

Our renewal price index, which measures renewable business underwritten by the Group, tells a story which should be familiar across the industry. All prices are declining, apart from offshore energy. Our only notable area of expansion in 2010 was across the energy portfolio, where we benefited from new opportunities following the Deepwater Horizon loss, coupled with an upswing in rating for this class.

We continue to build our portfolio of sovereign risks, and we're now an established market in this class. We remain totally focused on the risks which are politically triggered, and we do not write risks which, although appear to have political triggers, are in fact trade credit risks.

In 2010, we spent a considerable amount of time optimizing our portfolio to further improve the risk-adjusted return potential from underwriting. This is something we have embraced further when planning our strategy for 2011. We reduced our 1 in 100 PML for Windstorm by 22% in 2010, and reduced our 1 in 250 earthquake PML by 27%, which we feel was prudent in the current pricing environment.

We have no problem reflecting our underwriting exposures with the market, as we have done this year, but we see no reason to take additional risk onto our balance sheet until the rating environment improves.

We are comfortable with our portfolio of insurance and reinsurance risks, and reinsurance risks at this challenging stage of cycle, and we believe we can achieve a respectable return for the Group in 2011, and we don't foresee material changes in this portfolio.

I'll now move on to some views on 2011. The January 1 reinsurance renewals; our portfolio was in line with the commentary from the larger (broker) houses. Our proxy cat portfolio saw reductions of around 5% to 7.5%.

We reduced the number of clients which we offer retro coverage to, as we feel that retro for Lancashire is more of a post-loss product, and therefore reduced that client base by 50%, whilst retaining some key relationships. We await any opportunities which may arise from the forthcoming RMS model change, which may mean clients needing to purchase additional coverage.

As Richard said, we constantly track catastrophe losses to see if there's any ability to underwrite any backup coverage where required.

As one of the leading writers of energy business, we see opportunities for us to growth this line of business. We have seen the rating environment flatten out since Deepwater Horizon, but we are still seeing positive rate increases across the book outside of the Gulf of Mexico win book, which is flat, following a loss-free year.

Our outlook across D&F property portfolio remains weak for 2011. We see aggressive competition from the US domestic market, and we see no opportunity to grow this book. But we will look to a new -- (our core book).

Our terrorism portfolio will continue to come under rating pressure, but our sovereign risk portfolio will continue to grow with banks being restrained with the amount of capital they have to retain on their balance sheet.

Our marine portfolio will be relatively flat, but we will see growth in some of the large value of new buildings which will join the cruise ship fleet in the next 24 months.

Lastly, we have renewed our main reinsurance program at January 1, and obtained reductions in all classes outside of offshore energy, where we've had a substantial rise. On a like-for-like basis, our reinsurance spend remains flat year on year, although we did purchase some additional coverage to protect risk losses, and that was due to the attractiveness of pricing.

I'll hand over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Alex. Hi, everyone. Our results are laid out in our website as usual. We've had an excellent Fourth Quarter to round off 2010 though, with probably two more things point out that impacted our results.

The first is our loss ratio of negative 6.1%. I think we said of our negative 0.8% loss ratio for Q4 2009 not to expect that to be sustainable. Please don't take this year's Fourth Quarter negative loss ratio as indicative of a trend. It's not.

We have minimal exposure to the New Zealand earthquake and the Queensland floods, so have insignificant amounts in our reserves for those catastrophic loss events. We were also able to bring our reserves for the Chilean earthquake down a bit more this quarter by GBP6.8 million net.

Combining our lack of exposure to the major cats that impacted the industry in the quarter, the low level of reported losses in general, and some fairly strong prior year releases, the result has been very favorable for Lancashire. The prior year releases were largely driven by lower than expected reported losses, which was actually the case for our prior accident years and also the 2010 accident year, where we released some earlier quarters' IBNR in the Fourth Quarter.

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Of the GBP21.8 million prior accident year reserves release, GBP20.7 million of that was in relation to IBNR. As a short-tailed company, if there's nothing reported coming through, we have to release those reserves pretty quickly.

You can see in our supplement that there's really not much left in the tank for 2006 and 2007. A little over half of the 2008 reserve balance remaining relates to Hurricane Ike claims, so there's not much just left in those older years.

On that, net development and the Hurricane Ike reserves in the Fourth Quarter was GBP3.1 million, with GBP1 million for the year, so those reserve estimates are fairly mature now.

Last thing to note in reserves is that now that we have five years of our own history behind us, we'll endeavor to conduct a reserve study at some stage in 2011, and incorporate more of our own experience into our loss expectations.

The second major item of note is that we had a small loss in investments for this quarter. For the year, our investment portfolio has performed reasonably well with a return of 4.2%, and we generated 1.6% for the second half of 2010. We lost some money in the Fourth Quarter though, 0.4% which, as you all know, doesn't sit well with us.

Our aim with investments has always been capital preservation and not to lose money. To put it in perspective, this is only the Second Quarter since inception that we've had a negative return on investments. An increase in treasury yields from mid-November through the end of the year was pretty dramatic and unexpected, but we still don't like it.

We have a conservative portfolio structure to minimize any downside, but with a fixed income on the portfolio, we didn't have the benefit of a strong equity performance in the quarter to offset that, as some of our peers would have done. Bear in mind, those same peers have lost money in more volatile times when we have had a steady performance.

That said, it's a different world now, and we look to see if there are ways we can be sure we don't lose any money in investment market shocks or surprises without adding significant risk and volatility into our investment portfolio.

A couple of other things I'd just like to touch on for the quarter. I'm looking into 2011. Premiums and capital; premiums for the quarter are marginally down on the prior year. Most lines saw reductions in volume due to declining prices. Exceptions, as Alex noted, were offshore energy and sovereign obligors. Also, as we previously stated in premiums, we did a few multi-year deals in 2010, early in the year, about $75 million or so. That needs to be factored into expectations for 2011 top line, along with the RPI expectations across our book that Alex has touched on.

On the capital front, we didn't buy back any shares in Q4. We adjusted our capital level quite significantly via our special dividend, and we are comfortable that our current capital level sets us up well for the opportunities available in 2011.

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At our current multiple, the distinction between using dividends versus share repurchases, return capital becomes less clear cut. But we like share repurchases. It's a tool we've used a lot in the past, and we're seeking new authorization for our repurchase program at our AGM, and we can continue this in our tool belt.

We've given back a lot of capital in 2010 and, as Richard mentioned, we've also found it encouraging to see more of other market companies more actively managing their capital during this soft cycle, with similar promises of capital returns.

As always, we will monitor our capital throughout the year, taking advantage of underwriting capital opportunities as they present themselves, including keeping an eye on the debt markets amongst other available products. It would be nice to increase our leverage, but we're under no pressure to do so, and wouldn't do so unless the conditions were right.

And with that I'll hand back to the operator for any questions. Thanks.

Questions And Answers

Operator

(Operator Instructions) Fahad Changazi, UBS.

Q - Fahad Changazi {BIO 15216120 <GO>}

Can I just follow up on the capital comments? First of all on the gearing; in the past, you said you'd be comfortable with 15% to 20% leverage. Is that still the case?

And the second thing on that, given you have enough capital for your business plans, if you did do any gearing, would that be affording you more capital flexibility in terms of capital return?

And finally, when you mention the right conditions for increasing leverage, what are they?

Thanks.

A - Richard Brindle {BIO 1983776 <GO>}

Okay. Thanks, Fahad. Those are all for Elaine.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Fahad. I think 15% to 20% is still the range that we would be comfortable increasing our debt leverage to if we were given the opportunity. The conditions that I was referring to really depend on the price that we see the debt at. Rates are increasing a little bit just now, which compared to rates over history isn't that bad, but they were cheaper earlier on, or late in 2010. They may cheapen up a little bit again.

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It would very much depend on what we thought the conditions were for underwriting. The cost of debt has to give us the opportunity to go after some good business, or enhance our ROE in some manner. So we balance all that when we're looking at it.

And in terms of what we would use it for, it would be a case of either seeing good underwriting opportunities there, whether it would be a chance to increase and improve our ROE, either by retiring some existing debt or making a capital return, or any kind of combination of those.

Q - Fahad Changazi {BIO 15216120 <GO>}

Okay. Thank you.

Operator

Ben Cohen, Collins Stewart.

Q - Ben Cohen {BIO 1541726 <GO>}

Two things, please. Firstly on the energy book, with the price movements that you saw in January, I just wonder the scope as you see it to actually continue to grow in 2011 across what you're writing.

And the second thing I wanted to ask was, you referenced that you would be looking at doing your reserves more on your own basis, I guess, with a review in 2011. Do you think that would be likely to see lower loss ratio picks given the surpluses that have been coming out on when you've had cat losses in your book? Could you give a bit of color as to what that would involve?

Thanks.

A - Richard Brindle {BIO 1983776 <GO>}

Okay. Thanks, Ben. So probably the first one for Alex, and the second one for Elaine, please.

A - Alex Maloney {BIO 16314494 <GO>}

Right, okay. Yes, good question, Ben. I think, just to give you some numbers, straight after Deepwater Horizon, we were seeing rate increases of probably 20%. That was from a base which was minus 10%, so (30%) rates between -- straight after Deepwater Horizon. That has flattened out to probably between 5% and 10% rate increases at this moment in time.

As you know, our market is driven by capacity really, not by losses. We haven't seen a major withdrawal of energy capacity this year, so I think if we can stay at the current rate and levels, we can definitely grow our book, we may see a situation where the rate levels come off towards the end of the year.

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But coupled with that, there will be some opportunities. We are seeing areas where some clients are buying bigger limits. It's definitely not wholesale across the book, but it very much depends on the client's attitude.

So to summarize that, I think we can grow our energy income. It's just a factor of quantum. But keeping with the Lancashire theme, if those opportunities don't arise, we won't grow the book; simple as that.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Ben. On the second one, on reserves, it's a little bit too early to give any clear guidance at this stage. What we will be doing is putting less weight on industry benchmarks and a little bit more weight on our own data.

I would expect on balance that our loss (specs) would come down a little on some lines; perhaps not all of them. It depends on the quality of data that we have to merge in there.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you very much. And sorry, when would you expect to do this?

A - Elaine Whelan {BIO 17002364 <GO>}

We're going to do it this year at some point; probably in the March to June timeframe, but no guarantees on that.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you very much.

Operator

Chris Hitchings, KBW.

Q - Chris Hitchings {BIO 2034501 <GO>}

A couple of things. Can you just put me a little bit -- give us a little bit more color behind what you referred to right at the start, Richard, on writing Australian back-ups;? Where are you doing it and at what time, and what kind of coverages?

Secondly, Elaine had a reference to share buyback that happened in the Fourth Quarter, and with the share price where it is, it's sort of dividends are a better tool. Can you give us some idea? Your share price has gone up a bit more in the First Quarter. Is really the current share price the price at which share buybacks really aren't something you're going to look at?

A - Richard Brindle {BIO 1983776 <GO>}

Okay, Chris, I'll take the first one and ask Elaine to talk about the buybacks.

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Well as you know, the story started with the New Zealand earthquake, and then there was flooding in December, and then there was further flooding in January. We can debate how many events that is. It's still not resolved. Some cedents actually had the ability to elect at their discretion to deem how many events may be constituted by a period of flooding.

But suffice it to say, we didn't write the original business. That's why we have little or nothing on the New Zealand earthquake and on the December floods.

What you then saw was companies coming to market in December/January. I'd rather not talk about the names of the companies, but they came to market at that time to buy backups to the original cat programs they'd taken out at July 1, which is the traditional renewal date for Australasian business. Obviously, they were looking at potentially having burnt their first flare and their reinstatement, and possibly their second reinstatement, so they were under pressure to prove they had plenty of cover. But the first round of backups were still predicated off the original pricing.

And we've always felt, Chris, that Australasian cat business is incredibly cheap. You do have so many different types of natural catastrophes, sadly, in Australia, and they happen pretty much annually. So if you're writing a first layer (of 40 on line), 1 at 100, it's just not enough money. And if you're writing a second layer at 25 online, 1 at 100, that's not enough either.

So we declined the backup, the first round of backups, if you will, and then, of course, the Brisbane and the -- I forget the name of the town, Tamaranga, something like that, very close by -- another, potentially two events occurred. And you then have a situation where the Australian regulator was saying to companies that had then to demonstrate that they had at least two tranches of cover in place from that time forward until the expiry date of June 30. And at that point -- and they gave them a pretty limited period of time to put that cover in place.

So we had a period, the week before last, where there was a 48 hour period where various companies had to buy these backups. The brokers, I think, did a fantastic job, because in one case they had to arrange 100s of millions of dollars of cover overnight.

The price -- we led the way on pricing with a couple of other companies and pushed it -- I don't wish to sound like I'm gloating here, but we pushed it to very good pricing levels, and it was interesting in that a lot of the companies that had paid the original losses were either unable or unwilling to write backups, which frankly made a nonsense of the original pricing; and we felt it was a further vindication of our own flexibility in our model that we can come together and get everybody from myself, to Alex, to our Chief Actuary, to our Chief Risk Officer, to the underwriters in question, to bear down on this sort of opportunity when it presents itself, and we were able to turn it all around within about 24 hours. So it was a good vindication of the way that we trade I think.

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Q - Chris Hitchings {BIO 2034501 <GO>}

Excellent.

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A - Richard Brindle {BIO 1983776 <GO>}

Thank you. Then, Elaine, on buybacks, please.

A - Elaine Whelan {BIO 17002364 <GO>}

I guess we decided to do the large special dividend in Q4, so we didn't need to do too much in terms of capital adjustment there. We still like buying back shares, and the level that we like to buy back to is typically up to about 1.1 times book, as that's generally accretive in a pretty short timeframe.

Over that, I think we can generate a better ROE of our underwriting opportunities. And we're also waiting to see what's happening in the energy market. And that will dictate the level and speed that we buy back shares at over the coming time up until (end of) season.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay. But at the moment -- so the decision not to buy back shares in Fourth Quarter was nothing to do with the fact that your share price was more than 1.1 times book?

A - Elaine Whelan {BIO 17002364 <GO>}

That had a factor in the decision, but because we'd done the size of special dividend that we had done, then we didn't really need to buy back any more shares to get our capital to the level that we wanted it to be at.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay. Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

I think, Chris, once you get above 1.1 times NAV, the math just don't work.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay. Thanks.

Operator

Tom Dorner, Oriel Securities.

Q - Tom Dorner {BIO 15847486 <GO>}

Two quick questions. The first is on the timing of any broader improvement in the energy market. I just wondered if you have any more sense of when you're expecting to see it change. The reason I ask is because I think some of your competitors are implying that it might not be until 2012 that you get broader improvements. So if you have a feel, or maybe it's too early to say, but that would be helpful.

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Then the second question was again on capital levels. I remember at the beginning of 2010 you said that all other things being equal. you'd intend the balance sheet to be the same size at the end of the year as it was at the beginning. Is it safe to assume that's the case for 2011 also, provided that nothing else changes?

Thanks.

A - Richard Brindle {BIO 1983776 <GO>}

The first one for Alex, second for Elaine, please.

A - Alex Maloney {BIO 16314494 <GO>}

Two separate things, Tom. I think if people are talking about improvements in rating, that only happens when capacity shrinks, so I don't think we're going to see that this year. We may see that next year, but it depends on the loss pattern. The energy account can be volatile, and my own view is that for people that write trackers for the market, I'm not sure how much volume -- how much profitability there is for some people with the increased reinsurance costs.

So I don't think pricing is going to change until the capacity changes really. I think what you're referring to in 2012 is that after Deepwater Horizon, there was a lot of discussion about what the US Government was going to do in the Gulf of Mexico and what the requirements will be. And I probably agree with them in that who knows how long it will take before any decisions are made on what clients need to purchase in the Gulf.

And until that happens, I don't think you'll see clients running out to buy lots of new coverage, because if they don't actually know what their insurance spend is going to be from coverage that they are mandated to purchase. So I think the real opportunities, if they are in the Gulf of Mexico for that kind of coverage, it will be 2012. And just to recap, rating is going to be a function of capacity.

A - Elaine Whelan {BIO 17002364 <GO>}

Let me take your second question there. With the large special that we did, we're at a level that we're comfortable with for what we see in 2011 at the moment. We're likely to be around the same level towards the end of the year, but it depends a lot on how 2011 actually unfolds, and what (inaudible) for 2012.

Q - Tom Dorner {BIO 15847486 <GO>}

Okay. Thanks.

Operator

Adrienne Lim, Morgan Stanley.

Q - Adrienne Lim {BIO 16537674 <GO>}

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I just wanted to ask a quick question. On your loss development by class, it looks like you've added $5.1 million in the property class. Can you just elaborate on what that relates to?

And also, just following up on these demands for energy liability post the OPA, what is your view on that now and in terms of what will come out from the US Government?

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A - Richard Brindle {BIO 1983776 <GO>}

Okay, Adrienne; thank you. That's the first one for Elaine; the second for Alex, please. I'm getting off pretty lightly today.

A - Elaine Whelan {BIO 17002364 <GO>}

The development you see in the property class is in relation to Hurricane Ike, and the movement between the property lines and our energy lines. For the quarter, we had net development of about $3.1 million on Ike; for the year, about $1 million there. So the overall reserve on Ike is pretty stable; it's just a movement between lines.

A - Alex Maloney {BIO 16314494 <GO>}

I think, again, probably two answers. The whole OPA discussion will be as long as a piece of string. We really don't know when the US Government will make a decision, but undoubtedly, that will create opportunities for us, because the guys that we insure on a day-to-day basis will have to buy more cover if that happens.

A general comment about energy liability coverage; as you would expect after any loss, we're always looking to see if there's opportunities. Energy liability coverage is something that we have looked at on an excess basis. Obviously, as you know, we do write some of that coverage within our package policies, but on an excess level, although that market has increased its rating for those clients, we still feel that the rating levels are not where they need to be. And I think rating levels are still going to have to go some way before Lancashire would seriously look at writing energy liability for some of the clients we currently have at the excess level. We just feel that there's still not enough dollars there to justify our capital.

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Q - Adrienne Lim {BIO 16537674 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Nick Pope, Jefferies.

Q - Nick Pope {BIO 16852956 <GO>}

A couple of quick questions. The first one is just to clarify; you talk about very little exposure to the Australia losses. I just wanted to check that that was all of the losses, including the ones that would possibly fall in the start of 2011. I understood you may have had some exposure in Brisbane, so I just wanted to check that your comments hold true for that as well.

And that's actually my only question. The others have been answered.

A - Richard Brindle {BIO 1983776 <GO>}

Okay, Nick; I'll take that. Yes. We can't entirely put it to bed yet, but it looks as if we will have nothing material on either the 2010 or the 2011 events in Australasia.

Q - Nick Pope {BIO 16852956 <GO>}

Great. Thanks very much.

Operator

Thomas Fossard, HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

Two questions on my side. The first one is, could you comment a bit on how you may have changed your reinsurance protection going into '11 during the renewal season, so, i.e., your own protection for your book?

Second question would be on the PML. Obviously, you've significantly decreased PML throughout '10. Could you give us a kind of hint to how we should expect this to change in '11? Should it be flat, or should we expect further decrease in PML?

A - Richard Brindle {BIO 1983776 <GO>}

Okay. Probably both of those for Alex, although I can chip in on the second part.

A - Alex Maloney {BIO 16314494 <GO>}

Yes, sure. Okay, I'll start. I think we'll just take the PML one first. Obviously, we've brought down our PML as we saw the opportunity decrease due to the rating levels. So I think it just gives you a good story on the way we think about reducing our portfolio, looking at where we thought opportunities are, and the fact that we are more than happy to reduce our exposures in a falling market.

Obviously, a lot of people talk about reducing premiums, but I think reducing exposures is key. But obviously, this year, with model changes, etc., etc., and the amount of business that we're yet to renew, our PML will obviously move around this year.

I think a general comment is, as I said in my script, that we're not looking to put material amounts of new exposure on our balance sheet at this moment in time until rating levels increase.

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Moving on to your comment about reinsurance, just to be clear, January 1 we renew our main risk reinsurance program. We've done that this year, as I said. We obtained reductions across all classes of business outside of offshore energy, where we obviously posted a substantial rise, which is fair enough.

We did purchase two additional layers of cover this year; one to protect our property risk on our onshore energy book, and we also bought an additional limit which covers our marine and offshore energy book. It's something that we look at every year. We go through the renewal process. We get renewal prices.

And it would seem stupid, if you like, not to on one hand talk about a soft rating environment, but then on the other hand not look at soft rate prices in the reinsurance market. So we just felt two new layers were good value, so we purchased them this year. And that's basically about it.

A - Richard Brindle {BIO 1983776 <GO>}

I'd just add, Thomas, on the whole question about PMLs, and reinsurance, actually, on PMLs, the version 11 change with RMS is currently working its way through everybody's systems. We're not going to know the impact of that for a while, but it will clearly push up certain elemental PMLs. We don't know how much yet and, obviously, we'll assess that in the coming months.

But the fundamental point is, to which we remain very much committed, is that in terms of cycle management, as rates come down, you should write less business, so you can expect to see us unashamedly shrinking our top line this year.

And another corollary of a soft market is reinsurance becomes cheaper, so you should buy more reinsurance. You can expect us to -- we've already bought more, but we'll be looking at other opportunities through the year. And if they're compelling enough, we'll certainly buy them.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Can I ask just an additional question on your political risk portfolio? How are you potentially exposed to what we are currently experiencing, or seeing, in North Africa, or Middle East? Is that a big chunk of your exposure?

And behind that, is that creating potentially more demand, or we'll see the short term impact is that potentially we see claims before seeing rising demand?

A - Richard Brindle {BIO 1983776 <GO>}

Yes, I think there's no question this will increase demand. That hasn't really come to market yet, but I think a lot of companies will now look at the pretty uncertain world we operate in, and react accordingly.

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In terms of our exposures, I think, along with most of the major players in the political risk market, we have quite a lot of risks exposed in Egypt, mostly on the confiscation side. Our analysis is that whilst we shouldn't be complacent, we don't think any incoming Egyptian government is going to be any more or less inclined to start nationalizing the assets of foreign companies. We expect a business-friendly administration to emerge.

We have some sovereign exposure for the state oil company. Again, we would expect that company to continue to meet its obligations. If anything, we'll emerge with counterparties who are a lot more transparent and easier to do business with.

We've had a couple of physical damage losses in Egypt where a supermarket was burned down and there was a problem, I think, in a shopping mall, but these are not large events for us.

Looking across the region, our exposures in the other Maghreb countries are pretty low. Morocco, Tunisia, Libya; nothing big exposed there.

In the Gulf, we believe that the stability of the two countries where we do most business, which is the UAE, particularly Abu Dhabi within the UAE, and Qatar, we believe those countries are very stable. They have very small indigenous populations and large ex-pat workforces. The indigenous population are by and large extremely wealthy, and there seems to us close to no pressure within those countries for fuller forms of democracy to emerge.

Saudi is perhaps more complex. You've got a larger population there. We have some political risk exposures there; not massive. We'll continue to monitor them closely.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thanks.

Operator

Fahad Changazi, UBS.

Q - Fahad Changazi {BIO 15216120 <GO>}

Just two quick follow-up questions on energy. Alex mentioned that rates were up I believe 5% to 10% now, and expected to flatten out for the year. Is this for the entire energy segment or were you just referring to offshore energy?

And secondly, I think in the past, you've said that in terms of energy, of the overall book, it could be 40% to 50%. Is that still the case?

Thanks.

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A - Richard Brindle {BIO 1983776 <GO>}

Okay, Alex. Can you take those, please?

A - Alex Maloney {BIO 16314494 <GO>}

Yes, sure. Sorry, I should have clarified that. I was talking about offshore energy. Just as a flavor, onshore energy's still seeing some pretty heavy reductions. Some of those reductions are 20% to 25%. We don't write an awful lot of that business at all.

Then the other segment of energy is Gulf of Mexico coverage, wind coverage. That is flat from what we have seen so far following a clean season in the Gulf of Mexico.

Obviously, we're seeing 5% to 10% at the moment. Hopefully, that will hold up. People shouldn't forget that energy underwriters have got much more expensive reinsurance programs this year, so they do need to maintain their rates increases, but capacity is driven by -- sorry, ratings are driven by capacity the majority of the times and not by the market.

Sorry, the second question?

Q - Fahad Changazi {BIO 15216120 <GO>}

The energy segment constituting 40% to 50% of your overall potentially this year.

A - Alex Maloney {BIO 16314494 <GO>}

Yes. We don't have any hard numbers. When we look at the mix of our portfolio, obviously, that's going to be built around the profitability, so we don't actually have any hard numbers. And as we've done this year, and as you would expect, Lancashire will reflect the market. So if there was another big energy loss or the rating environment went up substantially, we could definitely write more business. We have definitely got the team of people to do it and the broker distribution base.

So we don't have any hard numbers. It could happen, but it will only happen on the back of opportunities.

Q - Fahad Changazi {BIO 15216120 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Ben Cohen, Collins Stewart.

Q - Ben Cohen {BIO 1541726 <GO>}

I just wanted to ask a follow-up on the retro business that you're writing this year. I think Richard commented that you'd pulled back quite a lot on property, and that sounded,

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even in the context of, I don't know, presumably a soft market, quite an aggressive cut to make. And against that, I think you were suggesting that there's good growth opportunities on the marine retro side, and I was wondering maybe you could also put that in the context of the embedded profitability on the new marine direct business that you're writing.

Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Yes, sure. The cut back, Ben, as you rightly say, has been on the property retro side. Normally, property retro is a pretty blunt instrument, and in a hard market all the right things happen. The additional coverages get cut back. You're really just reinsuring the property cat underwritings of the reassured. Obviously, the pricing gets very good.

What tends to happen during the cycle is that other coverages start creeping in; cat on D&F, pro rata; these sorts of things; per risk treaties; all get thrown in, and the pricing comes down. So if you look at the inflated effect of the increased coverage and the decreased rating, it actually can be a little bit startling how quickly terms can deteriorate.

So we have two or three relationship clients who we trust to do the right thing through the cycle, and we've stayed with them. But the rest we viewed as commodity rights, and we just were, as you say, quite aggressive in just dropping those.

By the opposite token, if you will, marine retro was concentrated in a relatively small number of hands prior to Deepwater Horizon. Those guys, obviously, were getting the loss from every which way, and there's been some consolidation in that area as well as companies being pressed by themselves and, in some cases, the Lloyd's authorities to buy more cover. So you've had exactly the opposite scenario going on. You've had decreased supply and the ability to drive better terms and conditions and pricing.

It probably, in most cases, won't be a long-term play for us. We'll see. But we were certainly achieving RPIs of 160%/170%, and it stacked up very well, to answer the earlier part of your question, with our direct writings. So again, it's the stuff that you can only do if you're set up to be nimble and to be able to react quickly to these opportunities.

Q - Ben Cohen {BIO 1541726 <GO>}

Thanks very much. Thank you.

Operator

(Operator Instructions) As there are no further questions in the queue, that will conclude today's Q&A session. I would now like to turn the call back to Mr. Richard Brindle for any additional or closing remarks.

A - Richard Brindle {BIO 1983776 <GO>}

Okay. Thanks. Nothing else to say. Thanks to everybody for dialing in.

Operator

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen.

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