Q3 2015 Earnings Call

Company Participants

- Alexander Maloney, Group Chief Executive Officer & Executive Director
- Elaine Whelan, Group Chief Financial Officer & CEO-Lancashire Insurance Company Limited
- Paul Gregory, Group Chief Underwriting Officer & CEO-Lancashire Insurance Company (UK) Limted
- Peter David Scales, Chief Executive Officer & Director

Other Participants

- Andreas van Embden, Analyst
- Ben Cohen, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Nick Johnson, Analyst
- Paris Hadjiantonis, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Greetings and welcome to the Lancashire Holdings Limited Third Quarter 2015 Results Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Alex Maloney, CEO. Thank you, sir. You may begin.

Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you. Good morning, good afternoon, everyone. Thank you for dialing in to our third quarter conference call. Today, we have myself, Paul Gregory, CUO; Elaine Whelan, CFO; Pete Scales, CEO of our Cathedral business; Darren Redhead, CEO of Kinesis; and Denise O'Donoghue, CIO.

I'm pleased to report we grew fully converted book value per share by 2.6% for the third quarter, with an excellent combined ratio of 70.2%. This brings our year-to-date growth in fully converted book value per share to 9.3%, excluding any impact of warrant exercises.

So, I'm delighted that we continue to show that we can increase value for Lancashire's shareholders in this challenging market.

This quarter, we have been tested on both sides of our balance sheet. We've experienced losses, most notably the Tianjin port explosion, and we have witnessed the volatility in investment markets. So, I believe our results demonstrate that we have the correct underwriting and investment strategy for the current trading conditions.

We do not believe the Tianjin loss or this quarter's investment losses will change the immediate outlook for the industry but yet again, take more dollars out of the system. So as time goes by, we believe that smaller historical losses will have a more volatile effect on the industry's earnings. There really is little margin left in most classes of business, with zero in some even in a cat-free year. So, it feels like we are near the bottom of the market.

This market reminds me of the trade (02:03) conditions we witnessed in the late 1990s which skirted the bottom of the market until the events of 9/11 unfolded. There will need to be a catalyst for change, and capital will have to be impaired before real change happens. Again, even with the losses we sustained in this quarter, we continue to demonstrate Lancashire's ability to trade through the current market conditions and provide an acceptable return for our shareholders.

We observe with interest some of the different strategies being deployed by others to try and mitigate the current conditions. Most, we do not subscribe to, so we fix our own strategy and underwrite our way through this stage of the cycle.

We look forward to the day when we can play a different tune. But until that day comes, we stay committed and focused to doing the best jobs for our shareholders, clients, and brokers.

I'll now hand over to Paul Gregory.

Paul Gregory {BIO 16314515 <GO>}

Thanks, Alex. In the absence of any significant loss events, the softening market conditions have continued through the third quarter and expect to continue through the remainder of 2015.

It's fair to say that the pace of change of softening is less drastic, but the direction of travel remains the same. There have been a number of loss events in the quarter, but none of the quantum to bring about any market change in any class of business. However, the attrition continues.

For us, the year-to-date and third quarter combined ratio in the low 70%, once again, demonstrates the quality of our underlying portfolio. And the Group has escaped any material impact from the most talked about losses in the quarter.

Our underwriting team continues to underwrite in a disciplined manner, focusing on underwriting profitability and not top line income. This strategy applies across all three platforms of the Group, and we're fortunate to have an underwriting bench strength that is most rated by making sensible underwriting decisions, and we've demonstrated an ability to continue to deliver underwriting profit through all stages of the cycle.

Our top-line written premiums are once again impacted by both the energy segment and some non-annual contracts, particularly this quarter in the marine portfolio. The Cathedral book is less lumpy and performs as expected with far less dramatic premium reductions which broadly track the rate reductions in their classes of business.

We've spoken openly about the drastic premium deterioration in the upstream energy market over previous quarters, and both the demand and rating environment continues to be challenging.

We've been successfully maintaining our position on core clients, but unless you want to grow your top line and exposure in a falling market, there's no way you can prevent top-line shrinkage in these market conditions, simply maintaining the status quo results in significant premium reductions. We accept this because ultimately this is a sensible decision to take, even if, as a Group, we're weighted to the energy sector, given our market-leading position in that class.

We anticipate energy market conditions to remain challenging into 2016, albeit losses in the sector this year will give the market pause for thought, so we do expect the pace of change to slow a little.

There are a small number of high-premium marine accounts (05:14) the third quarter which accounts for almost all the premium reduction in this class of business. So, we'll see the benefit of these contracts renewing in the fourth quarter and beyond.

Premium reductions elsewhere are simply a sign of market conditions and disciplined underwriting. The positive remains as a significant buyer of reinsurance across the Group, we're able to pay the reinsurance programs allow us to appropriately balance risk and return. And at 1/1, we will view our reinsurance requirements once again.

It would be refreshing to sit here today and be in a position to explain the numerous opportunities we can exploit. But until market conditions change, our focus remains on defending the core book and underwriting discipline will remain.

It may now seem a somewhat boring story, and it feels we've been preaching this for rather a long time, but we believe that in these market conditions, patience is a virtue. And we'll wait to exploit any such opportunities swiftly when they do arrive, and we have the underwriting platforms to adjust that.

In the meantime, our cycle management on the underwriting side allows us to expedite our capital management strategy by returning earnings via a special dividend announced today.

I'll now pass over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Paul. Hi, everyone. Our results are on our website, as usual. We had another quiet quarter in the last one and again, had some favorable developments on prior accident year reserves. Underwriting performance is, therefore, pretty strong with a net loss ratio of 26.4%.

In an incredibly volatile quarter for investments, we had a small investment loss, but that was well contained at less than 20 basis points. So as Alex said, overall ROE for the quarter is a decent 2.6% (06:49) after adjusting for the impact of warrants.

Cathedral and Kinesis contributed 0.9% and 0.5%, respectively, to the ROE for the quarter and 2.3% and 0.9% to the year-to-date.

As Paul mentioned, there was a reduction, again, in gross premiums written this quarter compared to last year. As before, that was primarily driven by the multi-year deals that we wrote in 2014. The majority of our book is written in the first half of the year. The reduction caused by prior year multi-year contracts is less pronounced this quarter than in prior quarters. About $30 million of multi-year contracts were written in Q3 2014 that weren't up for renewal this quarter.

For the year-to-date, approximately $184 million of multi-year contracts written in 2014 are not yet due to renew. We still have the benefit of the earnings (07:43), and you'll see in the press release the reduction in our gross premiums earned is much less than in written.

If you recall, I said last quarter that ignoring the lines of business that tend to be characterized by non-annual contracts, we wrote about $120 million of multi-year deals across the property cat and energy offshore lines. About 30% to 35% of that earned in 2014 and about 45% of that will earn this year with the majority of the rest earning in 2016. Multi-year deals in our terrorism and political risk books are more typical of those lines of business with deal flow being more unpredictable in the political risk book in particular.

For the fourth quarter, I'd expect we'll see a bit more pressure on premiums, but as it's our lowest volume quarter, there'll be less of an impact. As in prior years, we don't give top-line guidance but we should have less of an impact in 2016 for the multi-year deals. There will still be some earnings coming through 2014 deals but our top line will be more stable compared to this year.

While we expect pricing pressure to continue, there are always bits and pieces of new business and other opportunities out there. We also recently hired a few more underwriters and so we expect a little more business to come our way from them. On acquisition costs, I noted last quarter that I expect to see that ratio in the 25% to 26%

range due to changes in business mix and changes in our reinsurance program. The current quarter and year-to-date ratios are in line with that.

On losses, as I mentioned, we were very light on losses this quarter. There were no cat events to speak of, but we did have a few smaller current accident year losses come through so our accident year ratio is slightly elevated due to that at 47.2% for the quarter, although there is still nothing (09:28) of any great significance in there.

Otherwise, we had some more favorable development on prior accident years with the vast majority of that coming from the 2013 and 2014 accident years. Again, there were no specific drivers of the releases this quarter, just general IBNR releases with a lack of anything reported which is always nice to have.

As I mentioned, our investment portfolio, including our currency hedging, had a small loss for the quarter. The markets had another quarter of significant volatility, so we're pleased our portfolio performed relatively well, supporting our strategy of a small allocation to low-volatility risk assets.

With the risk-off quarter, the losses in the risk assets were offset somewhat by positive returns in our standard fixed-income portfolios as reduction in yields offset the widening credit spreads. With the rebound in markets in October, our portfolio has also recouped – already recouped the third quarter loss. For the immediate future, we continue to focus on interest rate risk and are happy with our current positioning situation and hedging against Fed rate hikes whenever they finally come.

On KCM, as the 2015 underwriting fees are earned in line with the underlying risk profile, most of that came in over the third quarter with about $1.5 million due to earn in Q4. If there are no losses in the 1-1-15 underwriting cycle, profit commissions could be just under $7 million but the earliest we'd receive that would be Q1 2016.

Just a reminder that KCM's expenses are included in Lancashire's G&A. So like the last quarter, our G&A ratio looks a little high again. And that's in part due to reduced earnings as you see the actual dollar spend is down on last year. There's a bit more movement in our G&A quarter-on-quarter now than they used to be as Cathedral's warrant accrued are linked to their profit. So, that will be varying a bit over the year.

But for the full year, I'd expect the dollar spend to be broadly in line with last year once the amortization of our finite life and tangible assets are backed out. The movement in our stock compensation expense is due to vesting and performance assumptions, and it can move around a bit quarter-on-quarter.

Our financing expenses this quarter were impacted by the mark-to-market of our interest rate swaps. Ignoring movements in that, the financing costs tend to be around $4 million a quarter. Finishing off on capital, as you will have noted in our press release, we're declaring a dividend of $0.95 per share. That comes to about $188 million which is clearly greater than earnings. For 2016, we expect a continuation of current market trends and further ability to enhance our reinsurance program.

As a result, we're able to trim capital back a little further to around the $1.35 billion to $1.4 billion level. That's just a little lower than previous guidance, reflecting the strength of our core book. It's unlikely that we'll do a further special dividend after year end, but we'll wait and see how the renewal season goes.

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

Q&A

Operator

Thank you. The floor is now open for questions. Our first question today is coming from Kamran Hossain of RBC Capital Markets. Please proceed with your question.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, afternoon. I've just got one question. Basically, in your statement, you referred to a number of midsize losses which I understand probably include things like Tianjin. Would it be possible just to kind of quantify how much this kind of collection of midsize losses added to your combined ratio, or how much it was in monetary terms? Just because, I guess, when I adjust for the reserve release, your underlying looks fairly weak. So just any kind of help on that would be really, really helpful. Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

So, you'll touch that one?

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah, sure. Hi. We've had a few things that haven't been significant enough for us to really strip out, and Tianjin is one of them. There were some other property losses in there as well. If you back out both of those, then you get to around about our kind of attritional run rate around about the 34% mark.

Similarly, on the year-to-date basis, we've had a few energy losses and some satellite losses and some property losses. None of them have more than a 5% impact on our loss ratio, but when you take them out collectively, again, you get back to kind of around about our 34% attritional rate. So, I think that rate that we've been talking about for the last little while is still appropriate and will be into next year (14:10) pricing as well.

Q - Kamran Hossain {BIO 17666412 <GO>}

I mean just on that, I guess now that the premium base has fallen fairly significantly year-on-year, is it worth kind of reconsidering the threshold for what is an attrition loss and what's not? Just so that when we look at the numbers, it seems a little bit easier to compare them versus peers?

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah. I think if you had anything that was of significance in there that we felt it was worthwhile splitting out and doing it, we'd back that out. But, as I say, there's a number of smaller losses. And when you add them up together, they come to a bit more of a meaningful number in terms of our attritional rate, but none of them are individually significant.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay, perfect. Thanks very much.

Operator

Thank you. Our next question is coming from Ben Cohen of Canaccord Genuity. Please proceed with your question.

Q - Ben Cohen {BIO 1541726 <GO>}

Oh, hi there. Can I ask two things? Firstly, on the Tianjin loss, relatively small, could you just give us some color in terms of what underwriting decisions led to you doing, I guess, quite a lot better than your peers on that?

And the second thing I wanted to ask was you've had, I guess now, three quarters of $30 million reserve releases each quarter, $90 million in total, so very material in the context of your overall profitability. Can you maybe talk to your confidence level in reserves, and maybe also just contrast the development in Cathedral where I think you've indicated before things are very conservatively reserved with the rest of the Lancashire Group? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Well, okay, Ben, I'll take the Tianjin one first and then I'll hand over to Elaine, and maybe we'll have some color from Pete as well about the Cathedral numbers. On the reserving, as a general statement, we are always conservative. It doesn't matter if it's Lancashire or Cathedral, anyway. That's the way we've always done it.

On the Tianjin loss, you're probably asking the worst person in the Company about Chinese underwriting because I think it just highlights how difficult it is to write some of these exposures in territories like China. And I think when we look at our loss numbers, we're delighted that we've got an immaterial loss. But they are based on very little data, and I would suggest that everyone in the market is based on very little data. And I think that's the difficulty of writing lots of business in territories such as China.

I think it also backs up our view of, if you had an office in Singapore, these are kind of the exposures you're handling every single day, and we've made a conscious decision not to do that. So, the Chinese loss is a good one for us because it sort of backs up our view of not underwriting area of the world where you've just got no information, but equally it's a global world with global clients, and we're always going to have some exposure to China. But I think that, for me, some major highlights how difficult it is to write territories such as that, and that's why we look quite good this quarter.

So, Elaine, do you want to answer the question about reserving?

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah, sure. Hi, Ben. I would be pretty reluctant to see that that's a trend that's developing and something you should factor in to your modeling going forward. Our reserve releases have been primarily across the years. They've been across 2011, 2012 and – sorry, 2013 and 2014.

2011 earlier this year, we managed to book in some more recoveries on our high spot losses, and that was quite nice to have that develop that way. In 2013 and 2014, we have reserve for them as we would do normally. We just haven't had the level of reported losses coming through on those years and in my view, that's a pretty nice problem to have.

Q - Ben Cohen {BIO 1541726 <GO>}

So, would that have been out of the sort of attritional loss ratio that you were booking in those years rather than out of sort of named single losses?

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah, yeah, exactly. There's no specific event development that's driving those releases.

Q - Ben Cohen {BIO 1541726 <GO>}

Right.

A - Peter David Scales {BIO 15393236 <GO>}

Hi, Ben. Peter. Also, I'll just give you the color on the Cathedral piece. Again, it's pretty much the same thing where basically, we've had three pretty benign years particularly on the property accounts and to a point (18:35) where you simply have a loss pick where you – simply nothing's happened to achieve a loss pick. If we haven't got a loss, we pay the money out. It just takes a while to unload, and that's just your combination of a number of years into the GAAP accounting as your earnings profile comes up.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. But presuming on that basis, we should still have a couple more years to run as you move through the Lloyd's accounting on 2013 and 2014. Would that be fair?

A - Peter David Scales {BIO 15393236 <GO>}

(19:09) I wouldn't bet any favorites, but there's nothing in there that I'm aware of at the moment in terms of loss profile. You're aware all the major market losses are. 2015, we started quite well. But again, as soon as you start seeing losses going into accounts, that will have an effect on the earnings.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you very much.

A - Peter David Scales {BIO 15393236 <GO>}

It's just we've always been fairly conservative people.

Operator

Are you ready to move on to the next question?

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah.

Operator

Our next question is coming from Andreas Van Embden of Peel Hunt. Please proceed with your question.

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

Hello, thank you. Yeah. I had a question about your risk appetite going into 2016. Obviously, you've bought more reinsurance this year. Your PMLs have been coming down. I just wanted to pick your brains on what plans you have for 1-1 and your risk appetite into 2016, please? Thanks.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. I'll start on that one, Andreas, and it might be Paul comes in on that one. I think every year, we go through the same process. And every year, when your budgeting and you're buying your reinsurance, you kind of decide how much risk you want to take. And obviously, as the market has got weaker, we've taken less risk because there's no reason to think about our view changes.

There's obviously a limit to how much you can buy reinsurance and take no risk but obviously, you'll have no return. So, there's a way to limit to that. I think if you look at what we've done on the capital side, that's very much borne out of two things. That's taking less risk and obviously, the efficiency of the reinsurance that we've been able to access.

So, I think there is a limit to how much we can do. We're currently renewing our reinsurance programs. We think that the reinsurance market is probably closer to the bottom as well. I don't think that market is going to be up massively as of 30th January, but we're always trying to match our risk appetite to our earnings, but we are a company that takes risk and we would love to take more risk quite frankly.

So, we will continue sort of trading our way through this stage of the cycle, and we believe this is the right thing you should do at this stage of the cycle. You should definitely not be taking any more risk, but we're looking forward to the day where we can take a lot more risk because that means the market's got better.

So, we do it every year. There's a limit to how much we can do. And obviously, there's a cost to buying reinsurance, and we were strong (21:52) what we can. But, yeah, we're constantly adjusting risk, even on individual deals. The market is at the level where even individual deals come in where we may adjust the risk, and we may try and transform that individual deal by buying some type of reinsurance or just trying to look at it a different way. So, you kind of have to work hard on everything to try and get you the best risk-adjusted return in this market, and we're very focused on that.

A - Paul Gregory {BIO 16314515 <GO>}

I think, as well – Andreas, hi. It's Paul. We have (22:25) got a good book of core business, and we absolutely want to be in a position, as we've said over the last three quarters, to defend that portfolio, and that's exactly what we've done this year. So, we have got some good business.

We want to keep that on the book where we're looking to keep that on the books. And as Alex rightly says, the way we can manage the risk we have to the balance sheet in various ways, some of which is strategy, some of which is (22:53), but we absolutely still want to keep our core portfolio of business in all our lines.

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

All right. Thank you very much.

Operator

Thank you. Our next question is coming from Jonny Urwin of UBS. Please proceed with your question.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi there. Thanks for taking my questions. I've got two. Firstly, on the capital base, I mean, obviously, it shrunk quite a lot over the last two years to three years, and I completely get why as you've pulled back the premium base and reinsured more. But I mean realistically, how low can that go? I mean how many more years of returning more than your earnings can you do if the cycle stays pretty depressed?

And then linked to that, my second question would be around M&A. I mean it's very sensible what you're doing in returning capital rather than just chasing risks that you shouldn't write. But I mean in terms of M&A, mostly people talk about you being on the receiving end, but what about smaller bolt-on acquisitions that give you access to some more resilient business in this cycle, if there are any? I mean at what point does that become more attractive, and you'd prefer to allocate capital to maybe some sort of smaller specialty lines or whatever, instead of giving it back to shareholders? Those are my questions. Thanks.

A - Alexander Maloney {BIO 16314494 <GO>}

Sure, okay. So, I'll start with question two, and then I'll go back up to Elaine for the capital question. I think, look, the M&A thing is incredibly fashionable at the moment. We would argue that we started it and we had very successful acquisition of Cathedral. But that was a very clean, well-run business and it's very easy to understand, and the results speak for themselves.

I think if I pretended that we're M&A experts, it would be naïve. And I think that buying companies now could be a very, very bad thing to do. You've got to look at why someone would be selling something now. You probably are buying something at the bottom of the market. If you did buy something that wasn't as clean as, say, a Cathedral, like very much like buying a house, you can look at the house and walk around it. But you don't really know what you've got till you bought it.

So, we are very cautious about anything that we were to acquire today. That's not to say we wouldn't do it. And as you said, the kind of bolt-on smaller acquisitions are probably easier. But equally, we just haven't seen much that interests us. Most things that are up for sale do come to our door. (25:25).

There's lot of friendly bankers showing us stuff all the time. But for us, we just can't see any logical reason to do most of those deals, and the only thing we focus on here is trying to make money and trying to do the best thing for our shareholders. So, just getting bigger for the sake of it doesn't appeal to us.

Lots of the commentary about M&A, we don't agree with. We can still compete in the markets we're in. So, I really don't think it solves the problem. But absolutely, as we've always said, if there was better things to do with our capital that gave us a better return over time, we would much rather do that than keep constantly giving it back to shareholders. But equally, I think just showing the discipline that we won't spend the money if we can't find spend that money on something good that will add value over time, we just refuse to do it.

So, I think if there was interesting stuff, yes, we would buy stuff. Yes, we would bolt on stuff. We're not averse to doing that at all, but we're definitely not going to do it for the sake of it. But, look, we never say never. Something may come along. Something may surprise us that maybe something of interest, but it's pretty unlikely to be honest.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks.

A - Elaine Whelan {BIO 17002364 <GO>}

I hope none of the friendly bankers are listening in today.

A - Alexander Maloney {BIO 16314494 <GO>}

I've got lots of friendly bankers.

A - Elaine Whelan {BIO 17002364 <GO>}

On the capital side, we always go through the same processes there, as well. We look to see what we think we could underwrite, and then we reckon how much capital we need (26:58) we can get at doing that. It depends on the business (27:02) and the business mix.

And as Paul said earlier, we're pretty much at the point where we've got a really good core book, and I think things will be fairly stable going into next year with that core book. So, we're pretty comfortable at the level that we're at at the moment. And as for returning more than earnings, if we're fairly comfortable with where we are, then we would probably look to return earnings if there's no other opportunity to start next year. And I think at this stage, if we're giving back just our earnings, I think that's still a pretty attractive dividend yield.

Q - Jonny Urwin {BIO 17445508 <GO>}

I mean is there a point where you actually can't go any lower, like where you hit any rating agency restrictions or regulatory restrictions?

A - Elaine Whelan {BIO 17002364 <GO>}

Again, it's driven by business mix. So, a very easy way to reduce your capital is to reduce your exposure.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question is coming from Nick Johnson of Numis Securities. Please proceed with your question.

Q - Nick Johnson {BIO 1774629 <GO>}

Afternoon, all. Hello. A general question, really, on the balance of power between brokers and underwriters. Just (28:20) becoming harder to retain the core book without being obliged to write unattractive risk. Do you think it's still possible to be a truly discerning underwriter in this market, or are you facing (28:31)?

A - Operator

Excellent question.

A - Alexander Maloney {BIO 16314494 <GO>}

So, Nick, maybe you can come and sit in our office for a week and you can experience it for yourself. I think we spend a huge amount of time on planes and meeting clients for exactly the reason of trying to have direct relationships with those clients. And when I say direct, I mean it's just we love the broker network. It's a very cost-efficient way for us to access business around the world. But having – sort of spending lots of times with your core clients is incredibly valuable because you're absolutely right. The big brokers wield a lot of power, and you have to add value. And we've spoken about being relevant for quarters upon quarters now.

And I think that the big brokers are definitely hugely powerful in this market. And if you don't add value – and you can do that in many ways – they will abuse you, quite frankly, and you will end up writing facilities and (29:32) things that you probably shouldn't at this stage of the cycle. So it's a constant battle, and we constantly find ways to add value. And we think we can hold our own with the brokers, and we have a kind of a Rugby kind of relationship with the brokers. They come in and beat us up, then we beat them up, and then we go for a beer afterwards, and it seems to work quite well.

But I think you have to add value. You have to be in sort of the top tier of people that they want to deal with. Every broker, every big broking house comes in and says the same thing. They all say they've got too many underwriters on their books. They're all looking to cut down the amount of underwriters they want to deal with.

So, you have to be relevant. You have to stay in that pack. Otherwise, you're adding no value in this market, and the brokers will hold too much power. So, I'm very comfortable we can still hold our own. I'm very comfortable we have great trading relationships with those brokers. And that you have to remember, as well, we can sit (30:32) about brokers, but they're under massive pressure themselves as well.

So, you're in an environment where everyone's under pressure. People frequently get upset. But as I said, unless you add value, you just may as well pack up and go home. We don't do anything where we can't add value or hold our own. But those discussions, we have every day in a very, very difficult market.

A - Paul Gregory {BIO 16314515 <GO>}

Hi, Nick. It's Paul. I think Alex's point around the clients is the key one. If you've got good relationships with your clients, and you've added value to them through a cycle, that's the most important thing there. As Alex said, brokers are incredibly important network to us, but our clients are ultimately our customers. And we spend a huge amount of time on all parts of the business over the last – or ever since we've been running as a business, spending time with those clients, working with them, providing them with products that work, and their clients, et cetera, et cetera. So if your relationships with your clients are strong, yes, you will get pressure from brokers. That's a natural part of the cycle, but those relationships will bear out that you will continue to see that business.

Q - Nick Johnson {BIO 1774629 <GO>}

Thank you very much. Yeah, very interesting. Thank you.

Operator

Our next question is coming from Paris Hadjiantonis of KBW. Please proceed with your question.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes. Hi, everybody. I just have one question for today. If you could actually give us an idea of what we should be expecting for attrition losses for next year, that would be really helpful. I mean you have been guiding for a normalized 34% this year, but I guess we saw the pressure in terms of margin that you have been seeing. I guess it would be natural to assume that that number is going to be a bit higher. Any comments? Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Paris. I think the 34% that we've been talking about is still relevant to our book of business. I think we'll wait and see what the pricing impact of the renewal book are next year and you might want to price adjust that. But otherwise, I don't really see any reason to change that. We have had a few midsize losses this year, but our attritional rate is still running about that level.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Fair enough. Thank you.

Operator

Thank you. Our next question is coming from Ben Cohen of Canaccord Genuity. Please proceed with your question.

Q - Ben Cohen {BIO 1541726 <GO>}

Thanks very much. I just had a follow-up on the ROE outlook for next year. I guess in the context of the price declines that you've seen that will be earning through maybe into 2016 and then weighing that against the capital return that you're planning to make in your fourth quarter, what is a reasonable ROE to be looking for? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

And on that Ben, we wouldn't give any hard guidance because you can bet your life our number would be wrong. Obviously, we don't think the environment will get any better next year, so we think it will weaken. But equally, if you look at our book of business and the reinsurance we can buy, we don't see any wild material changes. But obviously, there will be a price change and even on the price change side, it feels like things are slowing down a bit.

That's not to say that it will stop, but it does feel like we are getting to that stage of the cycle where even people that have been very aggressive are now slowing down because I think most people appreciate that we are close to the bottom of the cycle. So, I'm not sure we'll see some of the really aggressive stuff we've seen this year. So as I said, it will definitely come off a bit. I don't think it's going to be savage.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question is coming from Frank Cawood (34:38), a private investor. Please proceed with your question.

Hello, folks, and congratulations again on what I think is a remarkable quarter, all things considered especially I think to Elaine. Again, many thanks for the discipline on the portfolio there. And I think where some insurers maybe quite a few have actually had portfolio losses that have greatly impacted their balance sheet, it's really insignificant what we've experienced. So, congratulations in order there.

Elaine, I had a question. Again, when Lancashire was founded, there was a statement about ROE of 13% over the risk-free rate. Well, now, the risk free rate is approaching zero. There's some interesting (35:32) true risk-free rate if you consider the yield curve is actually below zero. So, I think it looks like you're within spitting distance of getting a respectable small double-digit return for the year. Could you comment on that as regarding the long-term goals? And I think personally, that's exceptional and remarkable in the current very soft environment that you would actually be tracking what you anticipate you would do over the whole cycle. So again, congratulations there. So, any comments there from Elaine?

And again to the underwriting team, it's remarkable to see that good discipline on your underwriting. And could you give us a little more detail? I was just fascinated with the detail about how – not only the brokers, but how you interface with your core clients in difficult environments. And I know that there's some anecdotal accounts about how sometimes that works which are very interesting. But if anyone – Paul or anyone else would like to comment on exactly how that has done, a little more detail there and perhaps what the area of the new team of underwriters going to be. Thanks a lot.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Frank (36:52). I appreciate the comments, and I completely agree with you on the risk-free rate. As far as our guidance is concerned compared to when we started, the risk-free rate was higher. But we were able to make higher returns, including on our investment portfolio at that point. We've obviously had some discussions about that internally over the last little while and the market that we're in as well. And we see no real reason to change that.

We've always said that we expect that we'll have lower years and we'll have higher years, and that's exactly where we are. We're compounding at over 18% since we started, so pretty happy with that. It's obviously been pretty tough in the last little while but maybe that the negative risk-free rate has been helping us there.

A - Paul Gregory {BIO 16314515 <GO>}

Hi, Frank (37:42).

Q - Operator

Yes.

A - Paul Gregory {BIO 16314515 <GO>}

Yeah. On the client interaction side, it's just good old-fashioned spending time with them quite honest. We take the time, as underwriters, to sit down with them, listen to them, understand their business, what drives their business – at different parts of the cycle, there are different things that drive their businesses – and then see what we can do within the realms of reasonableness to assist them wherever their business is at their point in the cycle.

It's quite easy really. It's just about spending time with them, being open with them, being honest with them in terms of what's happening in our business and what we can and can't do. And to be honest, we've been doing that ever since we started. At Cathedral, the team there have been doing that for 20-plus years. And it's as simple as that. It's not actually that difficult. It's not rocket science. But you just take the time out, and you spend time with them, and you understand their business (38:41).

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah. I mean I think – it's Alex (38:42), Frank. And also, it's about picking the right clients. There's lots of clients that come across our door that, quite frankly, we don't want to have a long-term relationship with and their buying habits don't suit the Company that we are. So, as Paul said, we're trying to have long-term relationships with clients. But sometimes, it's great for them, and sometimes it's great for us. And if you look at our old clients, the insurance market might be great for them, but their own businesses are under huge pressures. So, if we can partner through them through these difficult times, that pays dividends in the future.

If you look at the Cathedral book, the John Hamblin book, some of the stories of how John has responded to claims with some of his clients, that cemented that relationship for 20 years. So, it (39:30) from the market where it rises or decreases. But you just build that relationship over time, and you just got to make sure that, as an underwriter, you're backing the right clients effectively which is what we're trying to do, which is why we spend so much time talking about core clients and core relationships.

Q - Operator

Yes, I guess that's kind of what I'm thinking. Just remarkably after the big earthquake in Japan that I think the Lancashire was the very first insurer to actually send a payment, even before a claim had been made. So, just those types of things, I guess, over the years have really cemented that relationship.

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah, it's things like that. It's the last thing you want to do of any client when they're going through a very difficult period is sort of go in there heavy-handed. As the insurance company, you want to try and make it as easy as possible for them, and the experience is very much the same as when you buy your homeowners. The last thing you want when something bad has happened is a lot of hassle from your insurer. And if we can find ways to make that easier for our clients, hopefully, they remember that, and we build a long-term relationship.

Q - Operator

Great. Thank you, gentlemen. Keep up the good work.

A - Alexander Maloney {BIO 16314494 <GO>}

Thanks, Frank (40:41).

A - Elaine Whelan {BIO 17002364 <GO>}

Thanks, Frank (40:42).

Operator

Thank you. At this time, I will turn the floor back over to management for any additional or closing comments.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you for your questions, and we'll see you next quarter.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's teleconference. You may disconnect your lines at this time and have a wonderful day.