FINAL

Bloomberg Transcript

# Q2 2013 Earnings Call

## Company Participants

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

## Other Participants

- Andreas Van Embden, Analyst
- Angela Gu, Analyst
- Ben Cohen, Analyst
- Chris Hitchings, Analyst
- Maciej Wasilewicz, Analyst
- Nick Johnson, Analyst
- Thomas Fossard, Analyst
- Tom Dorner, Analyst
- William Hardcastle, Analyst

## Presentation

### Operator

Good afternoon. Welcome to the Lancashire Holdings Limited Q2 results conference call. Throughout today's call all participants will be in listen-only mode and afterwards there shall be a question and answer session.

I'd just like to remind you at this time this conference call is being recorded. And it is with great pleasure to present Richard Brindle, please begin your meeting.

### Richard Brindle {BIO 1983776 <GO>}

Good afternoon, everybody. Good morning. Could I introduce myself, Chief Executive Officer; Alex Maloney, Group Chief Underwriting Officer; Elaine Whelan, Group Chief Financial Officer; and Denise O'Donoghue, Head of Treasury & Investments.

This has been quite a quarter. I think it is fair to say a degree of panic has set in in some quarters, spooked by the softening rating environment, the influx of third party capital and the wholly unhelpful re-emergence of full follow broker facilities, written by Berkshire et al.

FINAL

All of the developments are challenging, of course they are, but they're also reasons to be cheerful. As Alex will stress, our specialty insurance lines, to which we are strongly weighted, are highly sticky and we have moved to increase our marketing efforts with clients and brokers over the quarter.

Our clients greatly value our deep understanding and knowledge of their businesses. And in many cases view the emergence of this new wave of would-be underwriters, backed by non-traditional capital, with deep suspicion. Claims are often messy and they need to know that their insurers will pay valid claims promptly and with good grace. We are already hearing stories of litigation in the third party capital space and this can only mushroom if there are large and atypical losses.

We have also recruited two highly regarded and experienced individuals to our underwriting team in James Flude and Paul (Russell) over the course of this quarter. And they will help us retain quality business and seek out new opportunities in their respective areas.

We are pretty much out of D&F and Retro for reasons Alex will explain but we are achieving good growth in our property cat book written in Bermuda, as we intensify our marketing efforts in that arena. Much of the US business in particular is still well priced.

The incorporation of Kinesis underscores our calibrated commitment to embracing this new source of capital without undermining our core business as we believe some are doing.

We have made an impressive start to building out our team in the shape of Darren Redhead and Mathieu Marsan. We are working hard both with brokers and investors, along with our advisors Goldman Sachs, to create products and match them to their respective appetite. And we will take our time to build up this side of our business.

We believe that those who are good stewards of third party capital will benefit come the next big event, when others who have perhaps been too keen to raise and deploy third party capital may find themselves mired in difficulties at such a time.

Also worth remembering, third party capital offers us benefits as well as challenges. It makes it easy for us to make savings on our own outwards reinsurance.

And finally we see no reason to panic over the (full follow) facilities. We have seen them come and we have seen them go, and as many of my peers have commented, they have rarely, if ever, gone well. So we must be philosophical and wait for people to learn those lessons anew. There are already signs that the high-water mark for such facilities may have been passed. And with that I'll hand over to Alex Maloney.

Bloomberg Transcript

**Alex Maloney** {BIO 16314494 <GO>}

FINAL

Right, okay, thank you, Richard. Aside from Costa Concordia deterioration, the underwriting result for the quarter has been a good one with a net loss ratio of 30.2%. There is no disguising that markets are under pressure, with pricing down across most of our business areas. But our robust underwriting process allows us to navigate our way through softening markets and our Renewal Price Index of 97% for the quarter is a testament to this. So far, most of the pressure we have seen has been on pricing with little significant impact on terms and conditions.

Inevitably there's a lot of discussion about third party capital, but again let's remember that around two-thirds of Lancashire's portfolio comes from specialty lines. Whilst reinsurance is seeing increased levels of penetration from collateralized markets, there are a number of factors that inhibit this in the direct lines.

Firstly, there are no broadly accepted models for exposure, severity or frequency in lines like Energy, Terrorism, Marine or AV52.

Second, the (coverage in claims) are complex and our clients want to know that they have counter parties who understand the business and can respond to their needs.

Third, the clients don't want parameter risk, they want a product that responds directly to their exposure.

And lastly they often need features like reinstatements or periods longer than 12 months that don't fit well with a collateralized product.

We have very loyal clients and brokers who understand the value of a relationship and we believe all these factors make for a very solid (core) portfolio.

On the third party capital side, no one can deny the impact this is having on the property, reinsurance and retro markets. 73% of the limits that citizens in Florida bought this year were collateralized. Cat bond issuance is at record levels and the proliferation of the new ILS and ILW shops is bewildering.

We've taken the opportunity to build out our core cat, property cat portfolio, replacing some of the aggregate and PML previously taken up by our retrocession and D&F lines. At the same time, the R&D phase of our capital management products, that uses our direct lines' expertise to combine elemental and non-elemental coverages, is progressing well.

Nearly two-thirds of the reduction in our half-year premium of $90.9 million has been in the Property area. We are coming out of retro as expected in response to the reducing rates and expanding coverages, as the memory of 2010 and 2011 losses fades. We have now run off our D&F portfolio, aside from a few exposures which support other business lines. This has also had the benefit of reducing our reinsurance spend as we no longer need to purchase the per-risk protection on the D&F. And we chose not to renew one ILW bought last year, so reducing PMLs it was no longer efficient to purchase.

Bloomberg Transcript

FINAL

Bloomberg Transcript

We are finding opportunities to build out our core reinsurance product for the property cat book, and we have found opportunities worldwide. This is helping to improve the portfolio balance of the property cat book, and is (neither) binary as worldwide retro or there's not as much parameter risk as D&F.

For the Energy market, is roughly in balance as ever larger products continue to stretch capacity. Pricing has come up a little. But also we should think this in the context that the past four consecutive years of rate rises.

We continue to add to add to our team, as Richard mentioned, with a new head of Marine and Energy, James Flude, and he will join us in January and he will report to Paul Gregory, our London CUO. On the Marine side we have another new underwriter joining in September. The amount of excess capacity in this market continues to depress pricing. But our portfolio is effectively core. We always look for new opportunities and possibilities, but there's little to get excited about in the Marine area.

In terrorism our team is doing a fantastic job of marketing and servicing the account. We're writing more business volume and keeping premium levels pretty constant. We're up about 2% this quarter. It's too early to say what will happen with the (TRIA) renewal, but we are seeing a healthy flow of business from around the world.

In the political and obligor portfolios, we're delighted with our progress with submission volume up by one-third in the quarter, and premium up 15%. This is becoming an increasingly interesting area and we're building some good relationships with clients and brokers. Again, two junior underwriting staff were added to the terror and political risk team in the first half of the year, and they are enabling us to handle increased volume as well.

In Aviation, AV52, more products are pretty stable, with some pressure on pricing but a very consistent client base. But our satellite business is allowing us to grow, albeit with a modest line and income.

As you would expect in a softening market, Lancashire has been pulling back where appropriate. But perhaps we don't talk enough about our constant search for ways of developing our existing underwriting expertise in areas. We should note that new lines we've added over the last few years, such as obligors, satellite, our property proportional and energy liability, are projected to account for somewhere between 6% and 7% of our premium this year. So even in a tough market we can adapt and find new opportunities.

On the Second Quarter cats, we've contacted clients and brokers, but our exposures tend to be -- our exposure to the tragic floods in Alberta and Europe appear to be limited. At this stage, we're not expecting any significant loss. We've always said that the combined ratio is key to success in our specialty lines, and to have achieved a combined ratio of 58.8% for the first half-year we think is a major achievement.

Obviously this shows that Lancashire is proving it can navigate softer markets as well as hard markets. And with that, I'll hand over to Elaine.

FINAL

Bloomberg Transcript

## Elaine Whelan {BIO 17002364 <GO>}

Thanks, Alex. Hi, everyone. That's a combined ratio of 58.8% for the year to date, and that also happens to be our inception to this number.

So the results are laid out on our website as usual. While on an accident-year basis, we had very low reported losses, as Alex has mentioned. We were impacted by the late development of the Costa Concordia loss. But adverse development in itself wasn't a major surprise, the timing and magnitude were.

We also experienced some pretty hideous investment markets. Despite all that, we produced a 2% return on equity for the quarter. So pretty pleased with that, all things considered. Our ROE for the year is now 7%, strictly in line with this time last year.

We mentioned last quarter and Alex touched on it also that we were writing less retro and that theme continues. This quarter's Accordion contracts were not renewed, given the terms and conditions for that product. In fact, one contract written earlier in the year canceled this quarter, due to restructuring of the cedants reinsurance program.

So what we did right was mostly regional retro for our own book. It's worth noting that the Second Quarter last year also included some reinstatement premiums on our Thai flood losses.

In property cat, some of the JIA business that we picked up last year wasn't required this year, so we saw a reduction from that. We also saw a reduction in the Japanese book in general from movement in the yen. These reductions were somewhat offset by a tiny amount of business we wrote in Florida this year, just a couple of million dollars of premium.

As Alex also mentioned, in D&F, that book has now been run off so this is the last quarter you'll see any kind of significant reductions in premium from that. Any impacts going forward will be minimal.

The Gulf of Mexico book reduction is pretty much entirely driven by the impact of multi-year deals. If you recall this time last year, we told you we'd written some multi-year deals as clients were seeking to have certainty of cover. Rates were very good so we wrote a number of two-year and four-year contracts, and we saw some of those contracts cancel and replace this quarter as clients wanted to maintain certainty of capacity. The level of annual contract premium year on year is pretty consistent. The contracts that canceled and replaced had a minimal impact on earning streams.

Otherwise in premiums we commented on the movements in the Marine book in our press release, all driven by multi-year contracts. The Marine book can be a bit lumpy, but it's a much smaller proportion of our overall premiums.

For the rest of the year, I'd expect a slight reduction in Q3 and Q4 premiums, nothing major, as a majority of our book continues to be written in the first half of the year. We're likely to be a bit down in retro, up a bit in property cat, so largely offset.

So our losses, we had the deterioration in the Costa Concordia loss that occurred this quarter. We booked an additional $37.7 million for that after reinsurance, and including reinstatement premium. But we had some good news on the Gryphon (loss). With a settling below the $1 billion level, we released the reserve we'd been holding for some ILW contracts.

That, combined with some other general favorable developments, meant that while we had adverse development on prior years for the quarter as a result of the Costa development, the net adverse for the quarter was fairly small, at $9.6 million. And we remain net favorable for the year to date.

Otherwise there wasn't much happening in the loss side, with exceptionally low reported losses, and other prior large losses pretty stable. Our accident year loss ratio for the quarter was 22.6%.

Investments then, well we had a pretty turbulent quarter. We managed a small gain in the First Quarter, but with the markets reacting to the thought of Fed tapering sooner rather than later, we saw rates and spreads rise in the second half of the Second Quarter.

That obviously had an impact on us, given our fixed income focus, but our (moderation) helped a lot, as did the tail-risk hedging that we put on earlier in the year. With the benefit of hindsight, the timing of that trade now looks exceptional. The tail-risk hedge saved us about 30 basis points for the quarter and for the year to date.

Given the relative size of the portfolio, our EMD portfolio is a large contributor to our loss for the quarter. It was impacted by the movement in rates, but also by an outflow of funds, as investors (towed) back and liquidity dried up a bit.

Our EMD contributed almost 30 basis points of our net 60 basis points loss. EMD does tend to be a more volatile class, but we still like the fundamentals on a relative basis, and it also tends to rebound well after a sell-off. Since quarter-end, that portfolio is up almost 1.7%.

There's not much else to talk about in the quarter's numbers; they're pretty straightforward. As I mentioned last quarter, with our PMLs reducing, we don't have any great expectations of any changes in the market in the near term or any niches of opportunistic business. So while we continue to look for ways to enhance and diversify our business, absent any opportunities to do so, as I said last quarter, we don't need the level of capital we're carrying.

And I hand back to the Operator for questions.

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

# Questions And Answers

## Operator

(Operator Instructions) Nick Johnson, Numis Securities.

## Q - Nick Johnson {BIO 1774629 <GO>}

Just a couple of questions; one on property cat premium income, which is down in the quarter, despite the opportunities you refer to and I note the explanation there. I just wondered if you could give us a feel for the underlying growth, absent the end move, and should we expect to see stronger growth in the later quarters this year and January next year?

And the second question is on yen exposure. Could you just tell us what the proportion of the annual premium is yen denominated? Thank you.

## A - Richard Brindle {BIO 1983776 <GO>}

I think probably the first one's for Alex to talk about July 1 and beyond the property cat, and then for Elaine to answer the yen question.

## A - Alex Maloney {BIO 16314494 <GO>}

Yes, probably when we're talking about growth opportunities with property cat, we're probably talking about July 1. Our book has grown at July 1 from about $15 million to about $20 million, so not a huge amount in dollars, but quite a good percentage.

We have said on previous calls that a lot of our insurance lines are quite mature, but our property cat book is not mature. There's still a lot of areas of the world where we don't have any aggregate deployed. There's lots of opportunities there.

Obviously, we are picking our way through the market. We still believe property cat is a very well-priced product. You're not seeing the huge reductions in world-wide property cat that you're seeing, particularly in Florida, where you're seeing the cat -- the collateralized market stepping in there and doing things that we wouldn't.

So I would expect to see some modest growth in our property cat book for the next couple of years really. I still think there's lot of business we can write.

## Q - Nick Johnson {BIO 1774629 <GO>}

Thank you.

## A - Elaine Whelan {BIO 17002364 <GO>}

In terms of the yen exposure, last year there was probably about a quarter of our property cat business was Japanese business. For the quarter so far -- for the Second Quarter rather, there's probably about two-thirds of the property cat (inaudible) in there is

FINAL

Japanese book and that's where most of our yen exposure sits obviously, in the property cat book.

## Q - Nick Johnson {BIO 1774629 <GO>}

Okay. Great. Thanks very much indeed.

## Operator

Tom Dorner, Citigroup.

## Q - Tom Dorner {BIO 15847486 <GO>}

The first question I have is on -- in the past you talked quite frequently about having a core client base that's something like 70% of your business and I wondered whether you could say something about how they're being impacted by -- are they being offered a lot of business from alternative capital and could you say, maybe, whether some of the business that you shed in the first and Second Quarter relates to what you have referred to as core clients?

Then the second question I had was on the growth in property cat. I just wondered, you made a valid point that two-thirds of your business is sticky specialty business. But if you're growing in property cat, can you really offer a stickier or a more differentiated product there or is that not really part of the plan? Is it not really that meaningful for the Group overall? Thanks.

## A - Richard Brindle {BIO 1983776 <GO>}

I think it's interesting, Tom, how the property cat market is changing. I'll let Alex talk about the core clients, the first question, second; but on the property cat, there are three camps, if you like. There are companies who are going crazy, as I referenced earlier on, about third party capital and almost putting that ahead of their core business, if you like.

Then there are those, the kind of flat-earthers, if you like, who are just pretending it's not happening and hoping it will go away. Then there's companies like ours, somewhere in the middle, which is saying, look, this stuff is real and we need to adapt to ensure that we remain relevant. I think I've heard the adjective, relevant, used more this year than any other adjective in connection with our sector.

So in terms of property cat, that probably means you need to be able to offer decent line sizes, which we can; you need to be able to be prepared to offer a minority of your capacity on a multi-year basis, which we can; and you need to be prepared to not just rely on the subscription market, but strike bilateral deals with clients.

So we've really ramped up our marketing in that area. We'd never really done this before; we've been fairly passive, waiting for certain niche opportunities to come along. We're now on the front foot with a very joined-up marketing campaign.

Bloomberg Transcript

FINAL

Bloomberg Transcript

One of our guys is on the road right now and looking to really strike some decent relationships, which will be core relationships, by their very nature. Because if you're not just relying on a small subscription market lying on the bottom of a slip, but writing a decent-sized line bilaterally between Lancashire and the client, maybe with some of that capacity tied in for two or three years, most of it one year, that obviously gives you incumbency and a good sticky position to hold onto in future years.

So I think we've just changed the way we trade on the property cat space and I think -- actually we haven't really updated the stats yet, but I think it will be entirely justifiable, come 1-1, to actually call a lot of this new property cat business core business for the reasons I've described.

Think about the property space holistically, if you will, with us. We used to access it via property cat retro and D&F. We took the decision last year, as you know, with great regret because we employed some great people on the D&F team. I'm pleased to say they've all got new jobs, which is great news, because we don't like laying people off unless we really have to.

But the business class made no sense at all. It took up a huge amount of our time; it presented to us with a great deal of parameter risk and not much premium and we found, in the case of some large losses we had, that the clients really didn't seem to show any loyalty at all.

A commodity if you will. I know that sounds surprising, but our experience with D&F was that it really wasn't very sticky business at all. Retro is obviously not sticky. Retro is obviously a commodity. We have always said to you it's a post-loss product. We wrote the hell out of the market in 2006 and 2007. We also came in post some of the more recent losses for a period of time, but now it's time to get out.

It's the -- everything's against you, not just the pricing, but the terms and conditions, it's a sort of multiplier effect, and you need to have the strength of conviction just to get off it.

Then, so we've really -- we're moving our Property exposures to the most sticky part of that sector, which is property cat, which, despite third party capital incursion, remains a very structured market where relationships are extremely important and we feel very comfortable operating in that space.

Don't think of it as a huge expansion of our Property underwriting, but more as a repositioning of it into the property cat space and away from D&F and retro.

Alex, maybe you could talk about the core client question?

## A - Alex Maloney {BIO 16314494 <GO>}

We use the word core a lot, about our insurance portfolio, and if you look at different parts of our book, our Marine book is probably as core as you can get because we can't

FINAL

find any (other) business. After nearly eight years of trading, most of our insurance business we think is core, particularly in a market like this.

As Richard said, in the property cat world, most big clients still want to deal with insurance companies and people that understand their business. Just the pure nature of what we do is -- large claims are always complex and some of the collateralized options are fine, but when you start getting into grey areas, I think lots of clients would much -- would much rather be sitting opposite you on a table and negotiating a claim as opposed to negotiating with a fund.

So I think as Richard said, we're doubling up our marketing efforts; we are fighting back, if you like. But third party capital is making our lives difficult in the reinsurance area, because it's putting a lot of pressure on pricing and again, that's why we're so weighted to insurance lines where third party capital either won't be able to get into our market or it's going to find it very difficult accessing things like Energy and Marine.

So we're quite confident. If you look at our model, even in a challenging environment we can still add some value and maintain some good returns.

## Q - Tom Dorner {BIO 15847486 <GO>}

Thanks.

## Operator

Maciej Wasilewicz, Morgan Stanley.

## Q - Maciej Wasilewicz {BIO 16462204 <GO>}

Actually, Tom asked a similar question to what I was going to ask, but I think there's a slightly different angle I wanted to get at. If you look at the repositioning that you're doing in the prop cat space, I guess -- I can understand your arguments about the business being adequately priced, even if margins have come down and also being relatively good compared to the retro and the D&F that you used to do in the current environment.

The question I have is about timing. If we think about where prop cat was six months or twelve months ago, I would imagine that you'd have said at that time it was in a better place than it is now, plus the trajectory of that line seems to be heading in the wrong direction as well.

I'm just wondering whether or not -- what caused the timing to be now rather than previously to go into this line. If it was a good line, why didn't you do it a year ago when probably you would have got better margins?

And on a more positive note, on the dividend, if I read between the lines of what you're saying, it doesn't sound like you're going to massively expand your property catastrophe; you're saying that there's not actually that many opportunities in the market.

Bloomberg Transcript

FINAL

Do you think we can essentially just take your annual income from this year and assume that the vast bulk of it -- absent any huge loss or absent any unexpected opportunity, the vast bulk of that could come back to shareholders next year? That's my question.

## A - Richard Brindle {BIO 1983776 <GO>}

I'll ask Elaine to answer the second question. I think -- you ask a very good question about timing. I think there's two answers to that. The first is that, like I said a moment ago, there's only a certain amount of risk we want to take and a certain level of PML we want to run for the peak property perils. And until last year, it was distributed between D&F, property cat and retro.

Obviously, given the fact we're now pretty much out of retro and the D&F has all but run off now, we have to maintain some positivity in this market and we are happy to write the US peak perils but we're now really only accessing them through one supply chain, if you will. So I think that explains why we have done what we've done.

We certainly haven't done it heedless to price and we're still very selective but where we like business, there's nothing to stop us taking a decent line and striking a bilateral deal with the client. But in the aggregate, our risk levels are lower now than they were last year for the property perils.

So Elaine, maybe you could talk about the dividend?

## A - Elaine Whelan {BIO 17002364 <GO>}

Yes, sure. On those PMLs, they're probably just replacing PML that is running off now as opposed to bringing them down significantly more.

But I think you mentioned last quarter that the current outlook, we were comfortable with the balance sheet -- with capital, rather, at the $1.4 billion to $1.5 billion level, but towards the lower end of that would be where we were happy. Our outlook hasn't changed and, until such time that anything changes, then that view holds. So assuming that that's the case, then, yes, we'd be returning earnings later on in the year.

## Q - Maciej Wasilewicz {BIO 16462204 <GO>}

Thank you.

## Operator

William Hardcastle, BofA Merrill Lynch.

## Q - William Hardcastle {BIO 16346311 <GO>}

The question has almost been answered but just to -- can I just clarify? With the premium trajectory declining, also PML reductions, if I consider the capital requirement year on year should it not be lower and so -- or is the property cat increase sufficient to offset that? I assume not.

Bloomberg Transcript

## A - Richard Brindle {BIO 1983776 <GO>}

Elaine, that's probably one for you.

## A - Elaine Whelan {BIO 17002364 <GO>}

Just to be clear that I understand your question, you want to know why our capital isn't lower given that we're replacing PML, right?

## Q - William Hardcastle {BIO 16346311 <GO>}

The required capital year on year.

## A - Elaine Whelan {BIO 17002364 <GO>}

Yes. The way that we look at capital is to work out what we think that we need for the market that's ahead of us and then to put a bit of headroom on top of that. So we're never going to shave it down to just the absolute required amount, so we're always going to have that little bit of cushion there so that when something does happen, we can respond to that.

## Q - William Hardcastle {BIO 16346311 <GO>}

Sure. So if I understand that correctly, perhaps the required capital, year on year, does go down but maybe you increase your headroom. Is that fair?

## A - Elaine Whelan {BIO 17002364 <GO>}

Yes. And we tend to carry a bit of extra headroom through wind season as well, just given that's where a lot of our risk sits.

## Q - William Hardcastle {BIO 16346311 <GO>}

Okay. Great. Thanks.

## A - Richard Brindle {BIO 1983776 <GO>}

I think it's important on that, Will, that you don't look at this as a sort of ever-declining story. I think we really have reached a -- Alex, perhaps you could talk a bit about portfolio optimization, but we feel we really have the best portfolio we've ever had now and we feel pretty confident we can ride this one out now if there are two or three more years of soft market conditions. Alex, maybe you just talk about that a bit?

## A - Alex Maloney {BIO 16314494 <GO>}

Yes, I think that's right. Every year, we've tried to improve the portfolio we have and I think the biggest decision of last year was about the D&F account. We spend an awful amount of time looking at capital needs, looking at the market and, as Richard said, we are pretty comfortable where we are at the moment.

FINAL

Bloomberg Transcript

FINAL

As I keep saying, I do think there's areas where we can grow into. Obviously, we always get the question about why are you growing now. But if you look at where the margins are at, I'm sure we're not at the bottom of the property cat market, unfortunately. So we think the margins are still good. We constantly use that word nimble but we are trying to be as nimble as we can. There will be reinsurance purchasing opportunities which hopefully should be a very capital-efficient purchase for us.

So I think it's very easy to talk yourself into everything's depressing, everything's going down, where's this all going to go, but I think that for us that have been in the market for a long period of time, this is just a market cycle like any other cycle. Pricing is coming off but we still think we can navigate through the market quite well.

## Operator

Ben Cohen, Canaccord.

## Q - Ben Cohen {BIO 1541726 <GO>}

Could I ask two things? On this issue of your cat appetite, which has come down as you rebalance the book. Do you think that you will be able to take that back to the recent peaks that you have had or is there just not the breadth of opportunity or the margin indeed to make that worthwhile?

And the second thing was on the profit on associates which I guess is from the third party capital stuff that you're running, can you give any updated guidance? I guess Accordion is now running off and now you've got the new plans with the new vehicle. Is there anything you can say in terms of how you see that revenue line developing? Thank you.

## A - Richard Brindle {BIO 1983776 <GO>}

Let me take the first one and Elaine the second one. I think it's important to always admit that we're not perfect and we don't always get things right. I think with D&F, sadly, despite the great people we employed, we never -- we didn't really get that right.

I think it was a very difficult class of business to get right. There are one or two companies who are extremely good at it but most people are struggling at the moment, I think. You've got unmodeled perils in there. You've got BI, CBI, SLCC, yes, it's tough. There are people who can make money out of it but frankly we weren't one of them.

I think on the property cat account we were just too negative. The perils -- or the US perils are the best priced in the world. We really weren't doing any serious marketing of either brokers or clients and we've changed all that now. And like any other new arena, you find opportunities. Now that we're on the road, our name is in brokers' minds, we're flexible, like I said, about doing bilateral deals with clients, incorporating elements of multi-year exposure, these are all things that get you to the top table and it's definitely true now that we're seeing opportunities that we simply wouldn't have seen six months ago.

Bloomberg Transcript

So as to where we'll end up, will we end up back where we used to be in terms of PMLs? I don't know but you certainly shouldn't regard this as an ever-shrinking business. I think we've repositioned ourselves and we feel good about that and we will write plenty of good business.

And Elaine, on the associates, profits on associates, please?

## A - Elaine Whelan {BIO 17002364 <GO>}

Yes, I guess most of our focus now is on -- we mentioned it in our press release, is on developing Kinesis and working through that. So for -- Saltire was a one-year vehicle anyway. Accordion is pretty well in run-off, if nothing else happens in the retro market. So that premium will run off.

We're still -- the PC flow will still come through in subsequent years and in terms of Kinesis as we build that up, if you look at that, (inaudible) with underwriting fees and with Property commissions, we could get to the position in a few years' time where we're adding 2% or 3% to our ROE and then building from that going forward. But it's a process of building that out and that will take a bit of time.

## 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. Just looking at the year-by-year run-off, tt looks like the Gryphon release was probably almost as much as your Costa Concordia top-up. Can you confirm that or give me some steer as to what the Gryphon item was?

Secondly, the Costa Concordia loss, have you based that on the latest $1.7 billion estimate or have you tried to go beyond that? And can you give us some feel or, if it's simply that you participated more on the higher layers, can I get some feel on that?

Third question, if I may, and I am, again, I'm trying to get some feel as to what future income might look like. Can you remind us if there are any multi-year deals impact on Q3, Q4? How much of the multi-years in 2012 will renew in 2014? And I'm starting with the view that if -- based on Elaine's guidance of small growth in the second half, you're going to be writing $640 million or so across written premium in full year '13.

I'm wondering where you -- if there's no change in markets, where you see that in full year '14. And because clearly we also note expense ratio's going up and there's an extent to which there must be a minimum efficient scale for Lancashire. Thanks.



FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

## A - Richard Brindle {BIO 1983776 <GO>}

All good questions. I'll take a stab. I can't give you the detail of the multi-year contracts. I'll defer to Elaine on that. In terms of the way you think about the business, like I say, I wouldn't be thinking about Lancashire from a gross written premium point of view as an ever declining story. I think we've got our portfolio now in the best shape we've ever had it.

We've sloughed off the D&F which didn't work for us, and frankly, unless you're seriously good at it, I think it's a class of business that it's very hard to make money out of. Everything, all the tailwinds -- all the headwinds are against you at the moment, and the retro, which is, frankly, goes to hell in a hand-basket extremely quickly in a certain point in the cycle.

That's all out of the numbers now, effectively, and we're really down to our core accounts. Then we have the growth story on the property cats, and then also on sovereign, satellite and, to some extent, the terror, the violence book.

So I think -- I don't know what Elaine would say about premium guidance, but I wouldn't think about it as an every-reducing story.

And on the expense ratio, yes of course maintaining a healthy G&A ratio in a soft market is a struggle, but please bear in mind, Chris, we're miles ahead of most of our peers. We are so tight on expenses. We only have 100 people. The only hiring we're doing now is underwriters. We're always open to hiring underwriters, and we frankly made four really good quality hires this year, in Darren and Mathieu on the Kinesis side, and then James and Paul on the Lancashire side.

So we're really good on expenses, so it's a perfectly valid question, but I think it's a more urgent question for others.

Elaine, do you want to add to any of that before we go to the first few questions?

## A - Elaine Whelan {BIO 17002364 <GO>}

Just that I think it's probably a bit on the early side to be giving 2014 guidance. I think that's probably something that we can cover after the next quarter once we're got a clearer picture on how the beginning of next year's going to look.

But $640 million, we've still got some D&F and some retro in the Q3 and Q4 last year, which probably won't be coming through. So that's just maybe a little high there. You might want to water that down just very slightly.

But we will, as always, look for opportunities around the market. And we'll give more color on that next time around.

## A - Richard Brindle {BIO 1983776 <GO>}

FINAL

And the first question about Gryphon and Costa?

## A - Elaine Whelan {BIO 17002364 <GO>}

On that one, Chris, I think if you try and get to a run rate of regular recoveries, if you look at where we were last time round it was a bit muddied with the Sandy recovery. This time it's a bit muddied with the Gryphon recovery.

But if I go back through and smooth out those anomalies, our run rate for the year to date is probably around about the $20 million mark.

## Q - Chris Hitchings {BIO 2034501 <GO>}

Sorry, is that $20 million per quarter?

## A - Elaine Whelan {BIO 17002364 <GO>}

For the year to date.

## Q - Chris Hitchings {BIO 2034501 <GO>}

Sorry, year to date.

## A - Elaine Whelan {BIO 17002364 <GO>}

Yes.

## Q - Chris Hitchings {BIO 2034501 <GO>}

So what was the Gryphon release then?

## A - Elaine Whelan {BIO 17002364 <GO>}

We don't tend to comment on specific claims and contracts, unfortunately. So you'll just have to work the numbers out there from the run rate that I've given you.

## Q - Chris Hitchings {BIO 2034501 <GO>}

Okay. And the basis of Costa Concordia?

## A - Elaine Whelan {BIO 17002364 <GO>}

We have booked to their latest reported number, and we've put a little bit of a buffer on top of that one. They do have some contingency in their numbers. We've put a little bit more on top of that as well, and we'll just watch and see what happens from here on in, but we're hopeful that it won't deteriorate any further. As I said, the size of the deterioration was a bit of a surprise, I think, for us and others in the market, and it's one that we're watching very closely.

## Q - Chris Hitchings {BIO 2034501 <GO>}

Bloomberg Transcript

Is there a cap at all on your contract, because these removal of wreck tend to be unlimited, don't they?

## A - Elaine Whelan {BIO 17002364 <GO>}

Our exposure now sits in the P&I club.

## Q - Chris Hitchings {BIO 2034501 <GO>}

Yes. Thank you.

## A - Richard Brindle {BIO 1983776 <GO>}

Like everybody else, Chris, it's an issue of concern for us. We put -- Elaine's a little bit modest -- we put quite a decent buffer ahead of the latest estimate; and of course within the estimate itself there's contingency.

But I think it's fair to say the market has gone from being relatively reactive, to being very, very proactive. All the major players are extremely engaged with the brokers and the international group now to ensure that this thing is wrapped up within a reasonable timeframe.

## Q - Chris Hitchings {BIO 2034501 <GO>}

Okay. Thank you.

## A - Elaine Whelan {BIO 17002364 <GO>}

You had one question left there, Chris, on multi-year contracts?

## Q - Chris Hitchings {BIO 2034501 <GO>}

On multi-years, yes, that's right.

## A - Elaine Whelan {BIO 17002364 <GO>}

Not so much in the third and Fourth Quarter. The Marine book -- you do get some long-term ones in there, but as I said it's a very small part. It tends to be more in the Gulf of Mexico that we get those multi-year contracts. And they're largely done for the year.

## Q - Chris Hitchings {BIO 2034501 <GO>}

And are there any that you wrote in 2012 which will renew in 2014?

## A - Elaine Whelan {BIO 17002364 <GO>}

Not so much of a renewal in 2014, but sometimes they do cancel them and replace them for the same terms so they can continue to have that capacity.

## Q - Chris Hitchings {BIO 2034501 <GO>}

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

Okay. Thanks.

## Operator

Angela Gu, UBS.

## Q - Angela Gu {BIO 18078706 <GO>}

I have a couple of questions. The first one is it's quite interesting to see Lancashire entered a new subclass, energy liabilities, and written $5 million premium in Q2. Given Lancashire's short-tail focus, what's the rationale of entering liability class?

Could you give us some guidance of premium run rate that we expect from this class and the final capacity you want to achieve?

My second question is the (headline beat) today is driven by Lancashire's very low attritional loss ratio. Could we just double check the actual number of the attritional loss ratio and how you define it? What's the year-on-year change?

To what extent is the improvement due to your more refined current book as you exited from D&F and some other lines? How much is this sustainable, and given rates are softening in some classes, would we expect attritional loss ratio to deteriorate a little bit next year? Thank you.

## A - Richard Brindle {BIO 1983776 <GO>}

The first one's for Alex and the second one's for Elaine, please.

## A - Alex Maloney {BIO 16314494 <GO>}

Yes, sure. There has always been an element of energy liabilities written within the Energy portfolio anyway; that's the way the market has packaged the business up. But we have -- you're right in saying we have started to write some standalone energy liabilities.

What I would say is that we currently have a relationship with all the clients on the Property side, so for us to flip over and write some third party liabilities for the same client, that's not very difficult for us to do. We understand the clients; we understand what their operations are.

I think the biggest reason we got interested in the energy liability market was that post Deepwater Horizon and some other major Energy losses, that market has moved and it's now at all-time highs. It could probably do with going further to be fair, and I think if the market was harder, we could definitely write more business. So we've taken a cautious approach. We have picked our way through the market but the markets at all-time highs, which obviously appeals to Lancashire.

At the level we're writing, it's not really going to be a situation where a claim comes out the woodwork; it's going to be something on CNN. So we're quite comfortable about what that book of business does for us. If you look at reserving and the fact that we're a short-term carrier.

Quite frankly, we'd like to write more energy liability business, if there's opportunities out there we will write them. What people should always remember with energy liabilities is that American clients in particular will always buy a huge amount of cover, so there's a lot of value in the products. By us writing liability, that's helped us to maintain our signings on the Energy side, on the Property contracts as well.

And Again, I think the message for today is we are working a lot harder to maintain our position in the market and we're trying to look at any opportunity that will give us leverage with the brokers and clients. And energy liability is definitely one of those things.

## Q - Angela Gu {BIO 18078706 <GO>}

Thank you.

## A - Elaine Whelan {BIO 17002364 <GO>}

On the attritional loss ratio, I think if you look at how we've done this year, given that we've had very low reported losses, we haven't really had any exposure to any of the cats, so Europe, Alberta, the floods. What we've produced in terms of accident year loss ratio this year then is probably a pretty good way to look and see where you can get some guidance for an attritional loss ratio for us.

I think before we did a reserve study, we'd probably have said our attritional rate was about 25%. After we had that reserve study, we said you can probably knock a couple of points off of that, so in the 22%, 23% range is probably a good place to put your attritional losses.

## Q - Angela Gu {BIO 18078706 <GO>}

Do you expect that to be the same going forward?

## A - Elaine Whelan {BIO 17002364 <GO>}

We'd like to think so.

## Q - Angela Gu {BIO 18078706 <GO>}

Thank you.

## Operator

Thomas Fossard, HSBC.

## Q - Thomas Fossard {BIO 1941215 <GO>}

FINAL
Bloomberg Transcript

Just one question left on my side. Just going back to the TRIA business, if the TRIA was to be disbanded in a couple of months' time, how big could be the opportunity for you? What is your risk appetite to write this business currently? Could you tell us when you would expect, I would say, some clarification about is this to be renewed or not in the US? Thanks.

## A - Richard Brindle {BIO 1983776 <GO>}

That's one for Alex.

## A - Alex Maloney {BIO 16314494 <GO>}

I think just on risk appetite, there's a huge amount of business that we'd be interested in, I think; I'm not sure it would actually happen. I think people in our market are very good at looking for the next opportunity that sometimes doesn't arise. So we are monitoring it. We are talking to brokers and clients. We don't know yet and there's no clear guidance I think at the moment on when we will know if TRIA exists or not.

What I can assure you, if TRIA goes away and there's a market opportunity, we will be all over it because we like the (terror) book. There'll be lots of exposure that we'll be interested in and our risk appetite will be high.

## Operator

Nick Johnson, Numis Securities.

## Q - Nick Johnson {BIO 1774629 <GO>}

With Monte Carlo approaching, I just wondered what your early expectations are for movement in property cat rates at January next year.

## A - Richard Brindle {BIO 1983776 <GO>}

Alex?

## A - Alex Maloney {BIO 16314494 <GO>}

Yes, obviously it's all about the wind season. So if we go clean in the wind season, there will undoubtedly be more pressure on the property cat market. Saying that, I don't think it will be like some of the headline numbers that you've seen for some of the Florida business. As Richard mentioned earlier, retro we've been under huge pressure from the collateralized markets. That might actually create an opportunity for us to buy some retro, but undoubtedly, you will see pressure in the property cat area.

But I think, again, we would lean on relationships and we still think, even with a further reduction, we still think property cat's pretty well paid. So I would expect it to reduce. As usual, we will look for the best opportunities, and as we keep saying, there are -- there's probably lots of parts of the world where we could write more business; we think it's well priced. So we will still be interested in the market. We're definitely not at the point where we're saying property cat's at the bottom of the market.



FINAL
Bloomberg Transcript

FINAL

## A - Richard Brindle {BIO 1983776 <GO>}

No, far from it.

## Q - Nick Johnson {BIO 1774629 <GO>}

Great. Thanks a lot.

## A - Richard Brindle {BIO 1983776 <GO>}

It's been an interesting quarter, Nick, because I don't know, I feel a little -- I've always been very honest with you guys and if I think the markets looking lousy, I tell you. And in fact I -- my comments in some previous quarters have stood out from other companies who've been much more rosy-tinted.

But actually I think there are -- there've been some interesting developments over the course of the last quarter, I think. As I mentioned in my remarks at the top, there are signs of -- there is trouble in paradise you know, and these third party capital outfits, some of these funds are slashing the fees which they charge, they're slashing the rates, there's a multiplier effect there, they're not able to get profit commissions, so they're just getting basic fees.

And you start to think, well hang on, how does that work, and it confirms what I've always felt which is that in the long term -- some of these funds have come in and done a great job, to be honest with you. And good luck to them. But in the longer term, given they also have their own standalone expense base, which is harder and harder to service in a softer market, I think this stuff is going to migrate to traditional reinsurers, insurers like ourselves who have the infrastructure in place and can simply bolt-on a number of systems or a number of individuals to get you to where you need to be in terms of servicing the business.

So I think there's a structural issue there. I think there's -- some of the funds are great, they understand the products and they've been around for a long time, others frankly have no idea and we're starting to see litigation. I think if there's a difficult, messy atypical loss of some sort, you could see, frankly, a whole rash of litigation going on.

I think there's also been -- the brokers are fighting back, the traditional market is fighting back and without getting into names and so forth, these follow-on facilities I think were causing people to panic a bit three months ago. It now seems that the market's actually pushing back a bit and saying actually no, we're not sure this is the right way to go.

So the traditional market is far from done and dusted, albeit we are choosing to ride both tigers, we are very strong in the traditional space, but we're also very seized by the fact we must have a proper joined-up capability in the third party capital space and that's what we've done.

## Q - Nick Johnson {BIO 1774629 <GO>}

Great, that's very clear. Thank you.

Bloomberg Transcript

FINAL

Bloomberg Transcript

## Operator

Andreas Van Embden, JPMorgan.

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

Just continuing on this third party capital theme, maybe it's too soon, but could you possibly highlight the difference between the underwriting strategy that you may deploy within Kinesis Re and the underwriting strategy on your own balance sheet when it comes to property cat re-insurance or re-insurance in general? Thank you.

## A - Richard Brindle {BIO 1983776 <GO>}

There may come a point in the future at which both Companies will seek to operate within the same product lines and we have in place a very detailed and thoroughly vetted allocations policy which would come into effect at that time.

I have to say for the foreseeable future we don't even see that as being an issue because the intention is that Kinesis will offer a product that Lancashire simply has not and will not offer, which will be a hybrid cat/non-cat product, tailored to individual companies' reinsurance programs, acting in many ways as a wrap-around product.

We sold some with some success in Saltire and we think we can sell more in Kinesis. Darren and Mathieu, with obviously help from the Lancashire management, have spent a lot of time this year talking to brokers and clients about potential deals which will work for them. And obviously the other side of the conversation is the conversations with potential investors; the guys were on a road trip last week and we're starting to marry up the two.

Obviously it's tough to get people to make decisions in July, with the wind season, summer holidays and all that. But I think we're well positioned for Monte Carlo and we're well positioned for when people are starting to look in detail at their outwards in probably late September, to start having some pretty detailed conversations.

So we try to be as proactive as possible and marry up supply and demand, because it's tough raising capital, but it's also tough deploying capital, so you've got to make sure you get both sides of the house right.

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

All right, but in terms of the risks you'll be underwriting within Kinesis Re, is the team, the underwriting team within the fund, will they be part of your morning meeting, will they be picking up risks that Lancashire are seeing, or how will that -- from an operational standpoint, how is that going to work?

## A - Richard Brindle {BIO 1983776 <GO>}

No, as I said Andreas, for the foreseeable future, there'll be no crossover in what products the two companies write. They'll be separate underwriting teams, they won't be part of our daily conference call, it's a different company with a different business plan.

Of course we'll talk to each other and leverage relationships and expertise, but they're different businesses. If, at some point in the future, they do find themselves operating in the same space, we have a very strong allocations policy to ensure that there is no muddying of the waters.

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

All right. Thank you very much.

## A - Richard Brindle {BIO 1983776 <GO>}

You're welcome.

## Operator

As we have no further questions at this time, I'll return the conference to you.

## A - Richard Brindle {BIO 1983776 <GO>}

Okay, that's all really. Thanks everybody for dialing in and we'll talk to you in another three months time, thank you.

## Operator

This now concludes today's call, thank you for all attending, you may now disconnect your lines.

*This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.*

FINAL
Bloomberg Transcript