Q2 2015 Earnings Call

Company Participants

- Alexander Maloney, Group Chief Executive Officer
- 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

- Andy D. Broadfield, Analyst
- Ben Cohen, Analyst
- Edward Morris, Analyst
- Fahad U. Changazi, Analyst
- Kamran Hossain, Analyst
- Nick Johnson, Analyst
- Olivia S. Brindle, Analyst
- Paris Hadjiantonis, Analyst
- Xinmei Wang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Greetings, and welcome to the Lancashire Holdings Limited second quarter 2015 results and 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.

I would now like to turn the conference over to your host, Alex Maloney. Thank you. You may now begin.

Alexander Maloney {BIO 16314494 <GO>}

Okay, thank you. Good morning, everyone. Good afternoon, everyone. Today on the call, we have Elaine Whelan, our Group CFO; Denise O'Donoghue, our Group CIO; Paul Gregory, Group Chief Underwriting Officer; and Peter Scales, the CEO of Cathedral.

I'm pleased to report we grew fully converted book value per share by 2.3% for the second quarter, with an excellent combined ratio of 78.2%. This brings our year-to-date growth in fully converted book value per share to 6.6%, excluding any impact of warrant exercises.

I'm delighted that we continue to show we can still increase value for Lancashire shareholders in this challenging market. Again, even with the last year's richest bank in the quarter, and our waiting for the energy class, which is by far the most challenging markets since the late 1990s, we continue to demonstrate that the Lancashire model can remain relevant in all we do.

Little was changed from the last time we reported. The market continues to be oversupplied with capital in all classes which we underwrite. In fact, the market is oversupplied with capital in all classes, so it doesn't matter which type of business you are in. The trend is the same.

As we have said before, you have to add value to suppliers in this market. As the market is going through a period of change, its members must adapt their strategies accordingly. Our strategy is a simple one which means we would provide our shareholders with access to insurance risk, which they pay us to adjust versus the opportunity we see. This is why we currently have the lowest amount of net risk on our balance sheet in our history and are purely driven by profit not by growth. We will enjoy the day we believe the market is right for us to grow the Lancashire businesses as this will mean we are in favorable waters. Until that day comes, we'll remain patient.

We will watch the outcome of the hurricane season with interest. I believe that any single loss that would change the market would need to be significant. I still believe in the insurance cycle and believe that the market will change when capital is impaired or returns elsewhere become more interesting, probably a combination of the both will be the catalyst.

Small companies will see if there's an opportunity to make more money for their shareholders than to try to overreach today. So you have to do all you can to preserve your capital for when the opportunity comes. We will continue to focus on underwriting and managing our capital, whether that be Lancashire, Cathedral, or Kinesis. It doesn't matter. The strategy is the same.

So we will continue working hard to enhance our broker and client relationships whilst all the time doing a better job we can for our shareholders.

I'll now hand over to Paul Gregory.

Paul Gregory {BIO 16314515 <GO>}

Thanks, Alex. Last quarter, we spoke about how the insurance lines are witnessing the same competitive pressures as the reinsurance lines have been experiencing for some time. It's fair to say that this trend continued through the second quarter.

Our response to such conditions has been to maintain underwriting discipline and focus on bottom line rather than top. This may not be particularly fashionable at the moment, but we remain convinced that our strategy remains correct. And we'll ultimately provide the required returns for our shareholders through the cycle.

Our top line premium reduction may seem dramatic, but once the impact of multi-years is stripped out, the year-on-year reduction is closer to 11%. Market conditions have slightly been in line with our expectation. They're those we've prepared for with this year's reinsurance strategy.

As has been well-publicized, the energy sector undoubtedly witnessed the most very competitive pressures this year. In the first quarter, we commented on the perfect storm created by the stock imbalance in demand and supply, and also the dangers of a low oil price, and the uptick in losses that historically tends to follow soft periods. This perfect storm intensified during the second quarter. And the prediction on loss activities currently play now as anticipated.

Conservatively, the losses in the upstream energy market year-to-date are now in excess of what we anticipate the market premiums to be at year end. As a significant participant in this market, we're obviously not immune from net pressures or indeed some of the losses. However, we have successfully avoided a number of these losses and defended our core portfolio. Fortunately, we have a degree of insulation from pricing pressure given the number of multi-year contracts put in place in 2014, which has impacted top line, but aided the bottom line.

Our other lines also come under pressure. From the general view, we've been in an overpopulated market that was fallen further in pressure by the insurance and reinsurance lines, albeit terms and conditions were not pushed too hard. The first time in a while, there were some reinsurance accounts that needed re-pricing, given the original pricing was deemed too aggressive. However, these were very much in the minority, and it's far too early to describe this as a trend.

Our reinsurance strategy is starting to bear fruit. We've been utilizing a hungry, facultative reinsurance market in a number of insurance lines, which have helped dampen some of the mid-sized losses we experienced in the quarter. We remain convinced that now is the time when you should provide more reinsurance and not less.

Despite a relatively noisy quarter with risk losses, the underwriting changed across the group, but still, we are able to produce a respectable combined ratio of 75.1% year-to-date. It is our belief if we continue to focus on underwriting, then the group will continue to deliver market-leading underwriting results and appropriate returns to the market we are in.

I'll now pass over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Paul. Hi, everyone. Our results are in our website as usual. We had a few risk losses in the quarter but also some favorable development on prior accident year reserves. Underwriting performance was reasonable overall, with a net loss ratio of 34.9%.

As Alex said, after adjusting for the impact of warrant exercises, we produced an ROE of 2.3% for the quarter, bringing us to a healthy 6.6% for the six months to June 30. There are now less than 600,000 warrants remaining to be exercised before their expiry in December. Any further impact on ROE will be negligible.

Our ROE of 2.3% breaks down as a 0.6% contribution from Cathedral, 0.2% from Kinesis, and 1.5% from Lancashire. For the year-to-date, Cathedral has contributed 1.2% to ROE, Kinesis 0.4%, and the balance of 5% coming from the original Lancashire platforms. Looking at our top-line premiums written, as for last quarter, there is a significant reduction compared to last year. That is very much driven by the multi-year deals that we wrote in 2014.

If you recall, we've been talking for several quarters now about the multi-year policies we wrote in our property cat and energy books last year. In the first half last year, we wrote $96.2 million of non-annual term contract in the property cat and energy offshore books. Those contracts are not due to renew yet, so there's a significant drop off in premiums written.

We do still have the benefit of the earnings those deals coming to in the current year, with the advantage of stronger pricing in those prior year contracts, and therefore, some protection from the current pricing conditions. We've included an analysis of gross earned premium by segment in our press release this quarter. So you can see that the reductions in earned are much lesser than written.

So all in, we said last year, that ignoring the lines of business are tend to be characterized by non-annual contracts. We were up $120 million of multi-year deals across our property cat and energy offshore lines, about 30% to 35% of our earnings in 2014 and about 45% of that we'll earn this year, but the majority of the rest earning in 2016.

We also saw reductions in our terrorism and political risk books. But both of those typically have longer term contract and business could be lumpy, so the reduction isn't indicative of any particular trend there.

However, if you continue to see pricing pressure across our lines of business over the rest of the year and expect our Q3 and Q4 premiums to come off a bit from last year's levels, with about 60% to 65% of our business written in the first half of the year, there'll be smaller impact.

Our net premiums, they're earned at around 14% at the half year and are expected to be around the same level of reduction for the full year.

On the ceded side, spend this quarter is broadly in line with Q2 last year. But as we restructured our program at 1/1, the spend this quarter mostly relates to new cover that we bought, including some new political risk cover. For the year-to-date for the same expenses last year, we have significantly improved our cover.

Our acquisition cost ratio looks a little high again this quarter. Some of that is due to changes in business mix, but the rest is due to changes in our reinsurance program. Also for the year-to-date ratio and with the Q1 2014 acquisition costs, we're impacted significantly by the Accordion vehicle, as we see $6.7 million of profit commission on the commutation of our quota share. Profit commissions from Kinesis are inputted in other income and did not impact our acquisition cost ratio. If we included our third party capital fees in profit commissions, our acquisition cost ratio would be 24.1%. However, with changes in business mix, I would now expect to see that ratio in the 25% to 26% range for the year.

On losses as I mentioned, there's a lot of an activity in risk losses this quarter, but nothing unexpected. There are no cat events to speak of. But we had one mid-sized energy loss and a couple of satellite losses. Their accident year ratio has somewhat elevated due to that at 59.4% for the quarter.

Otherwise, we have some favorable development in prior accident years, with the vast majority of that coming from the 2013 and 2014 accident years as you might expect. There were no specific drivers of the releases this quarter, just general IBNR releases, which are always nice to have.

Our investment portfolio, including our currency hedging, is flat for the quarter. There was a significant amount of volatility in the quarter, so we were pleased not to have a negative return in driving in our strong performance in the first quarter. While our main fixed income portfolio was impacted by rising treasury yields in the quarter, our bank loan portfolio performed very well and offset our losses elsewhere in our portfolio. We're happy with our positioning and are hedging against interest rate hikes.

As I mentioned last quarter, we have more risk assets in our portfolio now than we've had in recent years, so we will change in our investment strategy, and we don't intend to add much more. The risk assets we've added are generally lower volatility and are there to address our interest rate risk. Those state pretty short duration this year and start increasing through the expected fed rate hikes. Our reserve duration is around the two-year mark, but we wouldn't increase our asset duration much beyond that.

On KCM, the 2015 underwriting fees are earned in line with the underlying risk profile. So you see most of that coming over the third quarter. As there are no losses in the 1/1/15 underwriting cycle, profit commissions could be just under $7 million, but the earliest we would receive that would be Q1 2016.

Our G&A includes KCM's expenses. Our G&A ratio looks a little high again this quarter, and that's in part due to reduced earnings. As you see, the actual dollar spend is down thean last year. In Q2 2014, we have Richard's retirement package impact plus the amortization of the finite life intangible asset created in the acquisition of Cathedral. The foundation also received the donation of $2 million of Q2 2014, which wasn't required this year as they have sufficient funds to meet their goals.

Lastly, in general, there's a bit more movement in our G&A quarter-on-quarter now than that they used to be, as Cathedral's bonus accruals are linked to the profit. So that will move around a bit over the year. But over the rest of the year, our G&A ratio should trend around the same levels last year, possibly slightly lower.

Finishing off on capital, with the business we expect to write, we're still comfortable at the $1.4 billion to $1.45 billion level. So nothing happened to change the market this year. We'll likely return the earnings at the end of the year.

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

Q&A

Operator

Thank you. We'll now be conducting a question-and-answer session. Thank you. Our first question is from the line of Kamran Hossain with RBC. Please go ahead with your questions.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. I have three questions, if I may. First question, I guess, it comes back to the point that Elaine just made on capital, she you said, $1.4 billion to $1.5 billion is kind of the level of capital that you need to run the business. Is that a minimum level of capital, or is there something that depends on kind of do any kind of credit ratings run on the minimum level of capital? That's question one.

Second question, just on multi-year deals. Are there any that we should think about for the remaining two quarters in this year that were kind of risk in loans14:18) that won't be seen in the rest of this year?

And the third question is, some comments on profit amounts of the property cat reinsurance market, do you think any model changes from AIR, do you think – will they have any impact on ILS pricing? Thanks very much, and sorry it's three.

A - Alexander Maloney {BIO 16314494 <GO>}

Sure, okay. Well, obviously, the first two for Elaine, but I'll answer the third one. I think at the moment, trying to apply logic to the current market is difficult. So I'm not sure any kind of model change will really affect pricing. What we have seen for some of the cat loans and some of the ILS deals that there has been a bit of peak in demand, which flattened that market out, and I think there is now. It appears you are reasonably close to the bottom of the market, if there is a bottom to any market, and we have seen some deals repriced in the last kind of six weeks, which we haven't seen for a long time. So that's where that comment comes from. I think that's consistent with what other carriers have said. But, as I said, at the moment, trying to look at any kind of model change being linked to pricing is probably hard to see in today's market.

A - Elaine Whelan {BIO 17002364 <GO>}

Okay, on the capital side, the reason we didn't say that we're at a minimum level, I think we're at level, we were comfortable with this -- what we became. They're a mix of business that we've got and we have de-risked quite a bit and P&Ls are our biggest capital driver. So if we de-risk for more, and I'm sure we're keeping our capitals only a bit more, but we are happy with the business mix, that we've got more in returns with us producing.

And on the multi-years, that's really mostly the property count and the energy boosts are impacted by that, and they tend to be Q1 and Q2 books of business. So that there will be much less impact in Q3 and Q4. We do get some multi-year contracts across particular risk areas and some of them are in lines of business that are – the bigger impact to this one in the first half of the year.

" That's it. Thanks very much. "

Operator

Our next question comes from the line of Ben Cohen with Canaccord Genuity. Please go ahead with your questions.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi. Can I just ask us to -- on the impact of kind of price declines on profitability looking forward. Firstly, just you mentioned that the underlying top line decline was about 11%. Can we sort of read that into the impact on the sort of the profitability of the business that you're writing on an underlying basis. And similar area, I think previously, you've said this sort of attritional loss ratio should be in the kind of mid 30s to high 30s. I might have missed this in your comment, Elaine, but could you maybe just talk about how would you see that progressing over the next 12 months? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

So just on the profitability one before I hand over to Elaine. I think that – let's be very straight about it. Any reduction in pricing is going to affect your profitability. We have seen on individual accounts, we have seen opportunities to buy some 17:38 of reinsurance or look at things a different way. And there's different ways to skin the cat, if you like, but it will always affect your profitability. But the way we think about the market and business here, it's all about profit, we're not interested in growth for growth's sake. We're trying to maintain the best business we can. But beyond the no illusions, yeah, of course, if pricing goes down, it affects your ability to make money. But as I said, there are -- and we have seen opportunities to take the original deals, transform them with some practice at our reinsurance, and then actually you end up with a better position, or in some cases, just the same position that you would have had last year, absent the rate reduction.

Q - Ben Cohen {BIO 1541726 <GO>}

Right. Right.

A - Elaine Whelan {BIO 17002364 <GO>}

On the loss ratio side, guidance that you gave in the past, I think that that is still valid. Obviously, the movements towards the end of this year, and of the arrival for next year, if there's further pricing impact, then that might change. But at the moment, mid to high 30s I think is still pretty reasonable. We have had a slight uptick in these losses this quarter, but I would see that as (18:49) in a timing type thing. The satellite losses we've had really are attritional, and if I back out inthe energy losses we've had for the year-to-date, we get into something that's looks kind of like mid to high 30s for attrition. So also in line with the expectations.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Great. Thanks very much.

Operator

Our next question is from the line of Edward Morris with JPMorgan. Please go ahead with your questions.

Q - Edward Morris {BIO 16274236 <GO>}

Hi, everybody. Two questions, if I may. The first is on sort of pricing and demand that was ready within the energy book. I'm sort of interested in how quickly you're seeing some demand sort of adjust to what's going on with the oil price. Do you think if the oil price sort of says where it is today, you will see a further reduction in demand and in pricing assuming there's kind of no losses, of course. And then the second question again is on multi-year deals. I think I commented there that around about 20% of what was written in 2014 will end through in 2016. And you mentioned in a statement some of the contracts have been renegotiated. So I just want to know can all of them be renegotiated, and what determines where they will be? Thanks.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. I think the first one is clearly Paul and number two is probably a combination of the loan drop .

A - Paul Gregory {BIO 16314515 <GO>}

Hi, Edward. Yeah, a good question on energy. I think what we've seen this year that the impact in the market has been dramatic, quite frankly. And I think when you get to the end of this year, the premium base within the market,given the combination of rate reductions and demand shortfall, will about a 40% reduction in premium to the upstream market. So it's pretty significant. So I think if the oil price remains where it is, then you've seen buyers adjust their demand within one year. And absent any further losses, obviously (20:45) you'll see further pricing pressure, not to the same degree you're seeing this year in 2016. So, I think the demand part of it, (20:54) oil price remains where it is has been dealt with, but I do think that you could see some further pricing pressure albeit not at the same levels you've seen this year going into 2016.

A - Elaine Whelan {BIO 17002364 <GO>}

On the multi-year deals, yes, someone can be renegotiated. It's pretty much a commercial discussion, and while they might be renegotiated for a price reduction, they still got the benefit of the earnings steam coming off of that. So we still got

that business locked in and which we're pretty happy with.

A - Paul Gregory {BIO 16314515 <GO>}

Not yet. And on that, Edward, hits. The multi-year deals we entered into their new clients, any new client we've had since our inception pretty much, and is a handful of clients. And as happens, we will always have commercial discussions with these clients. And if we can come to a mutually agreeable renegotiation, and that's what we do, but it is mutually agreeable.

A - Alexander Maloney {BIO 16314494 <GO>}

But just on that, just to be clear, if we run multi-year policy, we won't renegotiate for the period that we've already agreed to. So i.e., if we're one year into a three-year deal, we won't come back to the table to negotiate the next two years just because the markets got softer, and equally if the market got harder, we wouldn't renegotiate that. It's obviously a fair deal on both sides, but sometmies...

Q - Edward Morris {BIO 16274236 <GO>}

Yeah.

A - Alexander Maloney {BIO 16314494 <GO>}

...they get -- sometimes we will add another year to the policy or the client will sign a new three-year deal and that's where you see the changes as well.

Q - Edward Morris {BIO 16274236 <GO>}

I see. Okay. That's great. It's very clear. Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah. One more thing on the multi-years, if you look at our net (22:29) to net newswritten last year, the ratio there is a little bit under 100%. I would expect the ratio for this year to be quite a bit above 100% given the multi-year earnings coming through.

Q - Edward Morris {BIO 16274236 <GO>}

Yeah. Okay. Great. Thank you.

Operator

Thank you. Our next question is from the line of Andy Broadfield with Barclays. Please go ahead with your questions.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Yeah. Hi, good afternoon. Three questions from me, please. Could you just give the aggregate number for the two satellite and energy loss together, it's been just as strong back at the underlying (23:13) holder. I fully understand that slump in. I just kind of want to understand what those lumps are and in size. The second question is, the multi-year deals, whether they protect, they immunize you this year, and to some extent, will be next year, of course the immunization goes away when you have to renegotiate or redo that. I was just wondering what you think the likely hit is at that stepdown. That reflects to the earnings as well, over the course of next couple of years, assuming nothing dramatically changes in the market. Are you able to give us a sense of how much that might impact profitability?

And then, the third question is really a little more strategic, given what we're seeing going on in the market, and I'm sure you had lots of thinking time about this, but what value do you think Lancashire has as standalone versus part of another organization in some shape or form? And what are you doing about those potential opportunities?

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. And this – we'll do it in reverse order. I'll do the last one and then a brief comment on the multi-year deals, and then we go for now. I think your last question is a good question. It's kind of obvious question, what do you do in a market like this? Everything is getting difficult, margin is going down. You don't really see ads (24:39) on a big event or a change in the investment world, what's going to change for Lancashire. I think what people understand is, it's all about the shareholders we have.

So we have some fantastic shareholders that have been long-term holders of blanks. They've built up (24:56) with us. Obviously the senior management team and obviously (25:01) have worked with the shareholders and explaining what their strategy is. And they are very comfortable with what we're doing. They understand the market cycle. They obviously want us to preserve their capital when things are difficult, and add returns as with everyone else is, will always be judged on what return you can get elsewhere in the world. So we'll be – the whole insurance community will sit here and moan about the current market and how terrible it is and it is the worst market we've seen in 10 years, but we're still very confident that we can work our way through and particularly come up with an extensible dividend yields for our shareholders absent a big event.

So it's a good question, it's a right question to ask. We're still completely relevant in everything we do. Relevant is very different to size. If you talk about, are we better in a bigger company? I'll be totally honest to you, I don't really buy the bigger respect of thing. I would say that I personally see no evidence of any of the companies that have got together to be so sort of super companies getting a bigger market share. On the back of it, if anything, I think they get a smaller market share. I don't think one plus one equals two.

So and equally I think there are a lot of particularly big deals have been done seem to be just a cost-cutting exercise. No one is going to buy Lancashire to cut the cost because we've always been on our costs. So I really don't think if we were a part of the bigger company, it would give us a better opportunity. I don't believe it will give us a bigger market share. It would enable us to cut our costs because our costs are about lean as soon as you can get. So I still think we're much better the way are.

On the multi-year thing, it's very hard to predict what clients will do. Some clients like a multi-year policy. Some clients prefer to have their chances every year in the market. I think -- so I don't think we can give you any guidance on how many multi-year deals we'll be writing in two years' time. What I would say, the general message is that when we're selling multi-year, we're obviously very careful what clients we sell multi-year to, and they're our core clients. And then equally dependent on where you are in the cycle, obviously you don't want to get two years down the line in a difficult market and sell the majority of your book on a multi-year basis, and then next year, there's a big event and you miss the opportunity. So there'll always be a limit to the amount of multi-year deals we will sell, and we'll always be very aware of where we are in a pricing cycle when we sell those deals. So it's very difficult and I – I personally I don't think we should give you any guidance in that because we don't know ourselves.

A - Elaine Whelan {BIO 17002364 <GO>}

And on the...

A - Paul Gregory {BIO 16314515 <GO>}

Sorry.

A - Elaine Whelan {BIO 17002364 <GO>}

On the satellite and the energy claims, we don't really give specific numbers on individual claims, but overall, the net impact of the satellite and energy claims we've or the individual ones you've taught about for this quarter is around about the $25 million mark. And that's (28:17) on some of our satellite cover.

A - Paul Gregory {BIO 16314515 <GO>}

Okay. That's great. And actually, Elaine, if I can just extend Alex's comments around the one plus one doesn't equal two. I'm just thinking as much as anything for your book of business on the capital side, it may actually exceed two just because -- I'll look at your -- the degree to which you're reducing the risk exposures you talked about a lot, but your capital base, you're not reducing quite so fast. But as part of a larger investment business, that would be more possible I would've thought to you. So is that not party? You think you do not agree with that, or it's just not a consideration, Elaine?

A - Elaine Whelan {BIO 17002364 <GO>}

Not for this quarter. When we get to (29:11), and we'll do - we always do market how much we think we need to carry. And we will always carry a little bit hedging so that if any opportunities do come up, we can take advantage of that. So there'll always be a little bit of a buffer still in there.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay. Thanks.

Operator

Our next question is from the line of Nick Johnson with Numis Securities. Please go ahead with your question.

Q - Nick Johnson {BIO 1774629 <GO>}

Hi there. It's clearly very difficult underwriting environment with no obvious end in sight. Can you just comment on how its impacting staff morale, how you're managing the motivation, incentivisation, and retention of key staff, what you're seeing in that area? Thanks.

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah. Again, good question. Obviously, I would say this because I'm the boss, but I think what we have whether it's Lancashire, Cathedral, Kinesis, you know, I still think we offer incredible working environment for our staff.

We just had a board meeting in Bermuda, and we had a very good conversation with the RemCom (30:14) about paying people in a difficult market, and you know, our business is about people and we have to keep our best people. That's obviously not to say that everyone is going to get the same bonuses they got when our results were much better, but we are fully aware that we have to keep our best people. And without that, we run out of business.

So, you know, the board, the RemCom, they're very pragmatic about the difficult market we're in, and it's all about, you know, being patient and waiting for the next opportunity. But you can't take advantage of the opportunity if - when that time comes, you've got no staff. So I'm totally relaxed about that. You know, we'll communicate that to all our staff, there's no real issues about staff retention. Of course, we're always going to lose some people, and you know, some people will seek other opportunities, and we have some good people and they always get approached, which again is a good thing. But I'm pretty relaxed about it.

And equally, if you look around the market, Nick, as you know, it's pretty miserable out there, and I think smart people are aware that just by changing shops in this market doesn't really make a difference to your life, particularly for an underwriter. So I think we still got a good proposition for people to come and work at Lancashire and we are - we are talking to a number of individuals that -- the houses that have merged or acquired, and look, there's some pretty unhappy people out there, so I still think where we're at is quite good.

A - Paul Gregory {BIO 16314515 <GO>}

And I think, Nick, on the underwriting side, if you think about it, good underwriters actually prefer being in a house where they can make the right underwriting decisions. It can actually be quite self-destroying trying to grow your book in this market when rates are coming off. And we are not a management saying that's telling our underwriters to grow. So they've been able sit there and do the job that they want to do, which actually has improved in morale on the underwriting side. I think sometimes that gets missed.

Q - Nick Johnson {BIO 1774629 <GO>}

Okay. Thanks very much for the answers. Thank you.

Operator

Our next question is from the line of Olivia Brindle with Bank of America. Please go ahead with your question.

Q - Olivia S. Brindle {BIO 17273762 <GO>}

Hi, guys. Two questions from my side, please. And the first one, I was wondering if you could just talk a bit about what's happening in Cathedral, because premiums there were down 17%. And you mentioned pricing pressure, but I mean, it shouldn't be that much on that part of business, to be honest. And you mentioned there are new lines which that part of Lancashire started writing. So just wondering where exactly the quantum of decline is coming on, on that portfolio begin to get to understand that? And second question around your ROE, I was wondering if you had an updated sense as where you might end up for the year. Also thinking about your cross-cycle target of risk 3 plus 13%, I know that's a cross-cycle target, but is there – I guess, there is a growing possibility you may be sort of slightly below that this year, next year. And I'm wondering whether that would concern you at all, would you consider taking any additional actions to avert that? Or are you sort of happy to take that in one given year and just focus on the fact that it's cross cycle? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay, I think that's a combination of Pete and Elaine, let's bring Pete in and then Elaine can answer a few questions.

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

Hi. As the guys have said already, the market is quite tricksy, which is overspilt from the reinsurance lines into most of the things. As Paul made a very good point earlier, the management brief, if you will, for the underwriters is just a trademark that you see in front of it. The response has been for the last two or three years that we look after our core books. The books that we have written are pretty much right on point in terms of how we solve (34:16) in terms of Lloyds business planning. We have bought more reinsurance, we have lower retentions. And the start of the year, oddly and bizarrely this year, is one of the best we've had in the property sectors throughout the biggest spaces.

The 2013 and 2014 account of following the usual good years get better, aid each other, (34:40) down quite well. So in terms of what you see, Lancashire (34:45) again, I'm never a fan of dissecting things, and so the quarterly or the half yearly basis, because the way the different things earn at different times and how the business mix has changed slightly. But broadly speaking, it's pretty much where we thought it was going forward, again reflecting out at this point. If we could get more teams at an added line or two of business in – for people who actually generally do control their marketplace, that's what we'd like to do. We're absolutely not in the business or sitting the underwriters down and telling them, this is your budget, we will need to increase your budget or hold your budget, we'll start to reflex in other shops.

So I'm not slightly surprised that you actually – it's a number with a space we're made comfortable with and don't think it sticks out, I mean what particular line of business were you surprise there's a drop often, Olivia?

Q - Olivia S. Brindle {BIO 17273762 <GO>}

Well, just I mean generally, you've sort of said it's a future pricing pressure, albeit you've grown some new lines of business. So I mean 17% is just quite a big quantum. And it is now roughly a third of the overall group premium. So for a bigger business which I guess I'd expect to be a bit more stable across time, a bit more sticky, it just surprised me that that was quite the number. I'd expect it to be making down, but not quite that much.

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah. I think if you look at the year-to-date numbers, Olivia, the decrease is about 12%, which is a bit more in line with that we've been seeing and we've been talking about. There's a little bit of lumpiness in the premiums in Q1, Q2, and in Cathedral's for this year. So to Pete's point, we can focus just specifically on one individual quarter. And I'd look at across the half year and where we end up for the full year.

Q - Olivia S. Brindle {BIO 17273762 <GO>}

Okay. So to sum up, for the full year, do you have a number in mind for where it should end up more or less in percent? Is it roughly 10%? Is that...

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah. I think we want to see some reductions in Q3 and Q4 as well, and I think that's the reason of low expectation to start with.

Q - Olivia S. Brindle {BIO 17273762 <GO>}

Okay.

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

Yeah. I have to confer with that. It's a tough market. You have your exposures down if you are looking up your net premium thing and you'd keep your core clients, people tend to forget about what the exposure piece is doing, both on net and gross basis. And so it's a - bet what Alex has aimed to, (37:13) just generally trading through it. We have traders who've been around a long time than we've navigated markets before. My view has always been let them go do it. And this is how they're choosing to do it.

Q - Olivia S. Brindle {BIO 17273762 <GO>}

Okay. Makes sense.

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

Okay.

Operator

Our next question is from the line of Paris Hadjiantonis with KBW. Please go ahead with your question.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes. Thank you very much. Just a couple of questions from my side as well. The first one on the reserve releases, you're saying that you're seeing reserve releases from pretty much every single underwriting class, and we can also see that in your disclosure, but I was wondering if you can talk about a bit about the reserve value per share that has changed a little? And then, if you could also talk about how much you have in your Thai flood reserves, I understand that there was a small release this quarter relating to that? Thanks very much.

A - Elaine Whelan {BIO 17002364 <GO>}

Just on the reserve releases. There hasn't been any change in our methodology. It's just the case of the fact that it's mostly 2013 and 2014 as the years coming through. And given the nature of our book from the reserve purchase, that nothing is reported in the after releases reserves. So there's no real change there. And on our Thai flood loss, we have seen some releases on that, both this quarter and last quarter, and that the remaining reserve on that is up $40 million.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Okay. Thank you.

Operator

Our next question is from the line of Xinmei Wang with Morgan Stanley. Please go ahead with your question.

Q - Xinmei Wang {BIO 17860767 <GO>}

Hi. It is Xinmei Wang from Morgan Stanley. Two questions for you. So the first one on Kinesis, can you comment on your outlook? So Kinesis sort of going into year 2015 and 2016 as well, whether you're seeing a standard of competition there? And how should us think about profit commission and underwriting fees going forward? That's my first question.

And my second one is on the finance cost. So as if they decreased a lot quarter-on-quarter, and I understand there's kind of be a degree of volatility there each quarter, but is there sort of run rate we could be expecting on that going forward?

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Kinesis continues to be a product which we don't put our huge amount of competition for. But equally, cost is quite unique beyond we see (40:03) with some clients. So we're pretty much flat year-on-year, which in this market is an achievement. We are looking at this market products, which hopefully we can launch in the future. But as I said, we're going to be in flat and this market is a good result by any measure. And that one continues to a very good job for us.

Q - Xinmei Wang {BIO 17860767 <GO>}

Okay.

A - Elaine Whelan {BIO 17002364 <GO>}

Okay. On the financing cost, the volatility that you see there is driven by the interest rate swap. So as rates move around that mark tomarket and that's the move that you see because of underlying run rate at about $4 million for the interest expense on our debt and for other LOC costs, that kind of thing, but you will see some swings there as well it marks to market.

Q - Xinmei Wang {BIO 17860767 <GO>}

Okay. Great. Thank you very much.

Operator

Our next question is from the line of Ben Cohen with Canaccord Genuity. Please go ahead with your question.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi. I just wanted to follow up. I think it was a comment earlier in the call that you were talking to a number of different people in the market. I was just interested in terms of which of the areas where you would be looking to take new people on? Are these new classes? Is it kind of building out capacity in your existing lines? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

So obviously, we can't say what class is the business. But in general, we're always open to conversations wherever the market is. But I suppose with all the M&A, we hopefully see it as a big opportunity. But obviously, there's not many really good people in each class of business. And surprising enough, we're not the only company in the world thinking about taking advantage of the opportunity.

What I would say to you, Ben, is that it's only going to be in business use that we know and understand. It's highly unlikely, any of those things. We're not talking about a major play into casualty or something that is just not our bag. So we're not looking to change the shape of the company. We see ourselves as a specialty player. It will be in specialty classes.

Obviously, if you could find a team of people in products that we don't currently do, that's obviously, much more attractive than things we commonly do because we have enough people to do what we commonly do. And obviously, it would might be more capital efficient. So there's various conversations going on, but equally you always find good people. If they're ready to go, they're probably having three or four conversations at the same time. So it's not days, again, new people. But as I said more than anything, we're not trying to change the shape of the company and we're sticking to things that quite frankly we think we're good at and we can outperform. We wouldn't actually give guidance on the lines of mutual consent.

A - Paul Gregory {BIO 16314515 <GO>}

And the underlying case, it's all about the people. If we can get the right people to add value, then we'll do what we can to bring them to the business. Because ultimately it's - the results from Lancashire, historically, and Cathedral were being driven by having good people. And that will be our number one place.

Q - Ben Cohen {BIO 1541726 <GO>}

Right. Great. Thank you.

Operator

The next question is from the line of Fahad Changazi with Nomura Securities. Please go ahead with your questions.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Yeah. Hi, there. Sorry if it was covered earlier in the call, I've joined a bit late, but can I follow up on the Kinesis question and the ILS markets in general. We didn't have a lower issuance in Q2. Could you perhaps give us some flavor where you think ILS issuance could be heading in the next few quarters and if there's been any change in terms of what were the limits are for ILS, are the people are moving down or what's happening with yields or coupons, et cetera? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. I think I'll answer as best as I can. I think it's very difficult predicting what capacity will remain at market. Again for me, what's quite interesting is that if you look at some of the ILS markets, they're professional investors. And I think to all those people, it doesn't matter if they're investing in insurance or make sure it's trading, they're just looking for a return. And you could see an example where as the market gets weaker, the ILS guys are actually more disciplined than the right to paper, where we were a lot more emotional about this market than some of those guys. So I think as returns go down, it's unlikely you're gaining more capacity in that market. But we will know if there's a sort of a wall of capital that we'd love to be in insurance land if the yields were down.

So I think it's very difficult to predict. I think like all capital, whether it's traditional or ILS capital, there are some very small capital, there are some more naive capital, but I think it's just quite interesting trend that some of the funds are actually pulling back and some of the rights you guys own appears to be pulling back at all.

So we're right in say, I think in fairness to the funds in the ILS guys, I think the rest of us – for the rest of the traditional guys, we're a lot supplying the whole market on the arrival of third party capital, but that's just completely related to us quite frankly.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Okay. Thank you. That's useful. Thanks.

Operator

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

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you very much and we'll talk to you next quarter.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. And we thank you for your participation.