Q3 2013 Earnings Call

Company Participants

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

Other Participants

- Andreas Van Embden, Analyst
- Angela Gu, Analyst
- Ben Cohen, Analyst
- Chris Hitchings, Analyst
- Nick Johnson, Analyst
- Olivia Brindle, Analyst
- Thomas Fossard, Analyst
- Tom Dorner, Analyst

Presentation

Operator

Ladies and gentlemen. welcome the Lancashire Holdings Limited Q3 results analyst call. (Operator Instructions) Just to remind you, the call is being recorded.

I'm now pleased to hand over to today's presenters. Please go ahead, gentlemen.

Richard Brindle {BIO 1983776 <GO>}

Thanks very much. Welcome to the Lancashire earnings call. This is Richard Brindle, Group CEO. I'm joined by Alex Maloney, the Group CUO; Elaine Whelan, the Group CFO; by Darren Redhead, Chief Executive of Kinesis Capital Management, our new third-party capital division; and Denise O'Donoghue, who's Group Head of Treasury and Investments.

We entered 2013 as an excellent business with an industry-leading record in terms of both compound ROE and dividends. We faced, however, a difficult market and it has only grown more difficult during the year. It was clear to me that we needed to evolve in order to rise to the new challenges facing us, and that to stick doggedly to our original structure, to which we have been almost slavishly faithful now for seven years, would itself be somewhat perverse.

The first stage in this evolution came with the hiring of Darren Redhead and the setup of Kinesis, our new third-party capital division. Non-traditional capital is here to stay; it will ebb and flow with events, but it is here to stay.

So working with Goldman's patiently through the year, we now believe we can deploy a significant amount of third-party capital at and around 1.1, to support bespoke and original products which our clients want to buy. And this is, we believe, just the first step in creating something of real value to Lancashire shareholders.

The second stage is, of course, the purchase of Cathedral. We would not have gone into Lloyd's unless we could have found the right partner. Indeed, we have been critical of those who have bought syndicates simply for reasons of capital efficiency.

M&A only works, in my view, when yes, the numbers work, but when also the people work. And we have found that we have a good social fit with these guys. We share the same traders' mentally. We both look to lead most of our business and thus mitigate many of tough headwinds buffeting our industry, and we both prefer short-term business. We also get along very well with people and share the view that there is much that we can do together, both inside and outside Lloyd's.

These are both strategic investments, which will immediately increase our heft in the market with brokers and clients, and in time allow us to increase the ROE of the Group. To have done nothing this year was, in my view, not an option and we're all delighted with both the entrepreneurial spirit and the collegiate atmosphere of the enlarged Group.

And I'll now hand over to Alex.

Alex Maloney {BIO 16314494 <GO>}

Okay. Thank you, Richard. The Third Quarter (isn't) a particular busy one for Lancashire, and on the underwriting side at least that's fairly true this year. We managed to write a little bit more premium in the quarter, mostly in property cat and political and obligors' portfolios, but we've also had a couple of risk losses as well.

For property cat, we have continued our deliberate strategy to build out a broadly-based portfolio as our retro and D&F accounts run off. We've worked closely with the brokers and come up with ways to make our product more relevant. This can include putting a portion of our line on a multiyear basis while writing private layers using our substantial capacity.

We've been able to find business that fits our return parameters in Australasia, Europe and the US. Once again, we've been able to write post-loss capacity quickly to clients, this time after the unfortunate event in Canada.

The German hail and flood losses were manageable and should at least provide some relief from pricing pressure, even though they cannot be described as market changing.

Political risk business has been growing steadily over the last three years with the obligors' business the key to the growth. We've invested in people. We've added a couple of underwriters to our team, and this has paid off with a strong growth in submission volume although binding rates remain in single digits.

The obligors' business, it's hard to predict when we will get the deals through the door, but with resurgence of foreign direct investment around the world is creating opportunity and our underwriters are working hard with brokers and clients to develop that account.

Do bear in mind, when looking at the written premiums, these are often multiyear contracts, so the earnings pattern is different from the rest of our portfolio.

On the energy side, premiums were down in the quarter and year to date, but again, there were some multiyear impacts from accounts written in 2012 that aren't due for renewal yet.

Our core portfolio remains, clients are loyal to the Group, and organic growth in new projects and expanding facilities gives us a solid base. We've had a couple of biggish risk losses this year and these are the kind of events we expect and price for. So while individual losses are always disappointing, they are a part of our business and, overall, we're very pleased with the makeup of our energy book.

On the marine side, there was no significant activity in the quarter, but the (part backing) of the Costa Concordia went according to plan. By the time we speak to you next, our new Head of Marine and Energy, a guy called James Flude, will be on board and that will definitely give us new opportunities and ideas on how to take these portfolios forward.

Terrorism continues to a (buyer slot) for us, despite the pressure on pricing. We're attracting an excellent flow of submissions from a wide range of brokers and clients, and we're trying to be responsive about how we deploy our capital.

Pricing for some high flood areas is insufficient, in our view, but there are many benign areas where we can find layers that work well for us. The uncertainly over the future of TRIPRA is certainly driving some increased interest from US buyers, and we actually bound $1 million of new premium from there this quarter.

Looking at 1.1 there will obviously be pressure on pricing as the simple laws of supply and demand suggests. It's at times like this we look at our UMCC our daily underwriting call. This is such a valuable tool in helping us think about how we deploy capacity and keep our management fully involved in, and aware of, what's really happening in the market.

So while we can't see that this market is a lot to get excited about, we're confident we can navigate it well and meet our targets.

The careful expansion of our underwriting team, and the strong focus on our marketing over the course of the year is paying off; submission numbers are up by more than 25%

to the quarter, despite the loss of D&F from our portfolio this year.

We are well prepared for the future and will continue to search for, and find, opportunities to grow the core portfolio and find new niches for deployment.

I'll now hand over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Alex. Hi, everyone. Our results are on our website as usual. I'd just like to point out that we haven't made any changes yet to our supplement for the acquisition of Cathedral. We haven't actually paid for them yet, but we will definitely provide some Cathedral information, going forward, so look out for that next quarter.

It's been a bit of an unusual quarter for Lancashire, with the pending acquisition of the Cathedral book. Our return for the quarter was 7.4%, taking us to 14.7% for the year.

A large portion of our return for this quarter was driven by our equity issuance for our purchase of Cathedral. With our strong multiple, issuing just under 10% of equity gave us quite a boost in our ROE. Just under 5% of our return for the quarter comes from that. (Funding partnerships backed with equity) meant that we were able to maintain headroom through (the wind season) to make sure we were ready and able to respond to any major events. There were none, but it was important to have that comfort.

I'll come on to capital later, but continuing with the results, we had a very large foreign exchange gain this quarter. That was also entirely related to the Cathedral acquisition and drove a little over 1% of our ROE for the quarter.

As we had an obligation to pay in sterling, we retained the proceeds from our equity issuance in sterling and we also put some currency forwards in place for the balance of the purchase price.

With the movement in sterling against the dollar and preventative action we've ended up with a significant accounting gain in the quarter, although we were economically hedged for our commitment.

Rates have moved marginally since the end of the quarter so we're probably looking at a foreign exchange loss of about $2.5 million since then.

As we should be completing in the very near future, we expect to lock in a gain in the region of $15 million for the full-year numbers, provided rates don't move too much before we complete.

Without getting too complicated, the offset to the gain in the hedge will come in, in the Fourth Quarter in our acquisition accounting when we bring on Cathedral's balance sheet.

That does mean there will be an FX loss in the region of $2.5 million for the Fourth Quarter in relation to the acquisition.

Otherwise for the quarter obviously no large loss event, but as Alex mentioned, we did have some European hail and flood losses. There was also one reasonably big energy loss in the quarter; we were impacted by that too. And we saw a little bit of adverse development in the Hurricane Ike claim. There are still a few claims left from Hurricane Ike, but that's pretty well done now.

Our attritional losses have been so low for so long that their entry this quarter may seem surprising, but these losses are entirely within our expectations and do happen from time to time. A net loss ratio of 56.4% is still a pretty good result.

On the (PPM) side, Alex has mentioned the success we've had with the political and sovereign risk book. Just bear in mind again, they do tend to be longer tenor deals, so while they're well priced, they will take a while to earn out. We'll obviously get the benefit of that good pricing earning out over the next few years.

Alex also mentioned we're expanding in property cat also, and retro is a development that we find attractive. The Accordion vehicles are now in run-off as we didn't see any particularly attractive opportunities to roll that capital over.

For the Fourth Quarter of this year, I'd expect our premiums to be broadly in line with the Fourth Quarter last year, but we'll also be picking up a couple of months of Cathedral income. Much like us, Fourth Quarter isn't a major one for Cathedral, but we will add a bit more to our top line from them.

As in prior years, we don't give top line guidance but base it on our outlook (as mentioned) over the last few quarters.

We may buy a little bit of regional business, but the retro premium will drop off significantly. Remember, though, that the Accordion qualifying contracts of $47.7 million of the total premium written, near 100% ceded to the sidecar.

So though top line will come off steeply, the impact in net earnings will be substantially less.

Otherwise, the (inaudible) might ease off a little, but much of the rest of our book of core business looks fairly stable and we'll continue to build out our property cat book.

Cathedral's book is mainly core, but we expect their premium levels to be fairly consistent with prior years too. We're anticipating that new business opportunities will make up for declining prices.

Lastly, while it won't impact our top line we will have the benefit of our investment in Kinesis as the business offering ramps up.

Back to the current quarter. We had another turbulent quarter with our investment portfolio (build up we've done in) a quarter. But I'm pleased we managed to produce a positive return and are now flat for the year to cover the loss in the Second Quarter.

We're also in positive territory for the Fourth Quarter so far. It's been tough to make money in investments this year, but our tail-risk hedging served us well, as has our bank loan portfolio.

We brought our emerging market debt portfolio in a little, down to about 3% of our portfolio and are adding to our (back line).

With a little more liquidity in the (energy) portfolio, we thought it was a good time to realize some of the gains this quarter. The asset class has been a strong performer for us, and still adds yield. But we see less room for (inaudible) going forward. That combined with volatility (inaudible) means we may shave it just a little bit more.

We're looking at other investment products that would help us address our interest rate risk and get us a bit more yield without necessarily adding a whole lot of risk. That won't be a significant portion of the portfolio by any stretch of the imagination. (Keep teetering) round the edges but no major changes.

Cathedral's portfolio is also very similar to ours, so more of the same there.

So lastly on capital. You have seen in our release that we're declaring a special dividend of about $94.5 million. That represents about three-quarters of our comprehensive income for the year to date.

We indicated earlier this year we would be likely to pay out earnings if there was a change of outlook. That was before our acquisition of Cathedral and although our outlook hasn't changed, nor has our dividend policy. We're not returning any more than that just now, as we'd like to see how the January renewals pan out.

We're also working with our colleagues at Cathedral to integrate the two businesses and streamline their capital base. And we need to see where our P&Ls are as a combined risk after the January renewals.

We have indicated previously that, in the current market, we expect our capital level to be around ($1.1 billion). With the addition of the Cathedral book I'd expect that to be around $1.6 billion or so in tangible capital. That will obviously change if combined market conditions change.

To emphasize there's no change in our dividend policy (at all). We will continue to do what we've always done, which is work out what we want to write and match our capital to that. In a harder market we'd obviously retain more capital to write more business.

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

Questions And Answers

Operator

(Operator Instructions) (Chris Roberts, Barclays).

Q - Tom Dorner {BIO 15847486 <GO>}

It's actually Tom Dorner, Citi. I have two questions which I think are both for Elaine. The first is in the statement you say that you're rebalancing your capital requirements after the acquisition, or that you're in the process of doing that. Can you just explain what that means?

Then the second question is about capital return; I appreciate you can't give a definitive answer, but you have alluded to the fact that you've paid an unusually low proportion of your earnings out this time for a number of reasons that make sense. But going forward, if the market conditions don't change, should we see you reverting back to the 93% level that you say you've paid out since inception? Thanks.

A - Elaine Whelan {BIO 17002364 <GO>}

Yes. Sure, thanks. I think on the capital return side I think maybe we should just keep this in perspective, we've just paid out 75% of our earnings, so I don't think that that's a small (part) of capital.

We do think that we need some time, and this leads us into your other question, we need some time just to go through our portfolios and (mark them up in) our combined P&L and working through the Lloyd's environment and extracting excess capital from the Cathedral balance sheet there.

So that all takes a number of weeks, maybe a couple of months. And with that perspective as well, we haven't actually paid Cathedral yet, still haven't completed yet, so we need some time to do all that.

So we felt it was prudent to return about three quarters of our earnings at this stage while we wait and see how that comes out. If there are opportunities to add more business into Cathedral then we will take advantage of that at this stage too.

So there's a lot of moving parts and, as I said, our dividend policy hasn't changed. If we work out what we want write and we've got money left over, then we'll return that.

Q - Tom Dorner {BIO 15847486 <GO>}

Can I ask on the extraction of capital from Lloyd's, I think at the time of the deal you made it sound like this was going to be a relatively straightforward process. Is that what you're finding? I appreciate it's still early days, but are you anticipating it to be more complicated than you first thought, or is this sort of in line?

A - Elaine Whelan {BIO 17002364 <GO>}

It's not complicated; it's just that there's a process to go through with Lloyd's, and then there's the timeframe in which that occurs. So it will be towards the end of this month before we start to extract any excess funds, so that doesn't quite fit in terms of our normal signing of dividend declarations.

Q - Tom Dorner {BIO 15847486 <GO>}

Thank you.

Operator

Thomas Fossard, HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

I've got two questions on my side, mainly relating to Q3 (European cat) losses. So first one would be, on the energy loss, could you be a bit more precise on how much you have reserved for the loss in Q3?

And second question would be on the German (hail), could you help us to understand why, in Q2, you did not capture any losses from the German floods where, in fact, you've been exposed to German hail? So what is the difference in terms of exposure in your (treaty), just to better understand where you stand currently regarding European cat? Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

Right, okay. Thomas, it's Alex Maloney here. On the energy loss, the main loss we had in the quarter was a drilling rig, offshore in Angola, we are reserved for about $24 million which gives that market share of about 7% of the limits available.

So that kind of fits in with our portfolio. It's a bog standard loss that you should expect for a portfolio of our size; it's a core client. Their record's very good; it's definitely an account we'll continue with, so that's just run of the mill really.

And I think your question around the German hail and flood losses, we have reserves, or limits that we had available for the contracts exposed. But where we were writing accounts of the stock lost, once these (storm events happened) we reserved all of our layers so that's why you're seeing differential in timing of one with reserves.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thanks, Alex. That's very clear, thanks.

Operator

Ben Cohen, Canaccord Genuity.

Q - Ben Cohen {BIO 1541726 <GO>}

I have two questions on premiums being written. Firstly, on the property reinsurance side, I think you indicated that there was more demand for multiyear deals. I was just wondering how you weigh that; I guess it's a sign of pricing declining. What is your appetite overall, and do you think there will be similar property growth in the Fourth Quarter, or was that weighted to the Third Quarter?

And the second question was on the political risk side, it sounded like you were saying that you've only bound a small amount of that business; maybe I've misheard. Could you maybe say something about how big you see that becoming and over what sort of time period? Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

Okay, Ben, it's Alex again. On the first question, we think it's fair to say things like multiyear and policies with reinstatements are tools, somewhat, to keep us competitive compared to some of the third-party capital guys. So we are looking for ways to work with our brokers to offer things that some of the funds can't offer. So the multiyear play will only be for a percentage of our line, and we're seeing orders coming from clients on a different basis.

Some really like multiyear; most of the big traditional players that we're looking to build here are going to be long-term clients for the Group anyway, so it doesn't really make any difference. So we would see that continuing for the near future at least.

On the political risk side, the political risk book and the property cat book, the reason you're seeing growth in those two lines is that they are not mature portfolios for Lancashire at this moment in time. It's fair to say, on the reinsurance portfolio, we've probably got two or three years of hard work to target all of our core clients and to build our capacity on those programs.

But then on the political risk and sovereign side, as we said in our comments, you do quote a huge amount of deals; our hit ratio's probably only about 10%, but again, that's not a mature book and you're writing multiyear contracts. So again, it will probably take us two or three years for our earnings to catch up with our risk (inaudible).

A - Richard Brindle {BIO 1983776 <GO>}

I'd just add on the property cat side, Alex, this is Richard, that don't forget, we don't have the D&F any more and the retro's pretty much run off. So the only point of the property spectrum that we're accessing is the property cat book, and we do think the pricing there is the least volatile area of the property world, and, therefore, the best area to concentrate our capacity.

We correctly predicted there's some really big reductions around on stuff like retro, ILWs, (inaudible), and we will definitely be buyers of those products rather than sellers.

We did write property cat in the past in a rather opportunistic manner and we will still do that, like the way we went into New Zealand after the earthquakes and Japan, and to a little more limited extent, Canada. We'll carry on doing that, but what we didn't have was a decent underlying core portfolio.

We've worked extremely hard this year to build that, with great success, so that is something of a growth story for us and we think the property cat business is still pretty well rated.

Q - Ben Cohen {BIO 1541726 <GO>}

Right. Thank you very much.

Operator

Angela Gu, UBS.

Q - Angela Gu {BIO 18078706 <GO>}

I have two questions, please. The first one is on underwriting, underlying and loss ratio. I want to know to what extent is this affected by one-offs, and are you seeing any deterioration in underlying margins due to loss frequency going up or any lower rates in any particular lines?

And I remember you saying the normal run rate should be 22%, so this quarter looks very high comparing to that. Are you still maintaining the 22% guidance?

And also, second question is on your growth expectations for the combined Group for next year. Are you changing your business mix to where it's more property lines, going forward? And what does this mean for your capital requirement, given this is a capital-intensive line? Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Probably the first one's for Elaine and the second one, Alex and Elaine, I guess.

A - Elaine Whelan {BIO 17002364 <GO>}

Yes. I missed a part of your question, Angela, so bear with me and please follow up if I'm not answering what you're looking for. I think, for us, the 22% guidance that we've given is still pretty relevant. Obviously, when we acquire Cathedral, then that will nudge up a little bit, not massively, just given that their book is slightly more attritional in nature than ours, but for Lancashire (side) (inaudible) pretty appropriate.

If you back out the $25 million to $30 million of energy loss that we had this quarter, then you're getting back to that level anyway.

In terms of growth expectations, Alex can chip in here (a bit), but we've talked about (ratio) and a lot of that will be coming off next year. We won't be writing any Accordion business next year; that will be $47.7 million worth.

A lot of the stuff that we've written this year, we won't write again next year and we are fully out of the D&F business now. Also, the Cathedral book is pretty stable, and so if you look at their financials for the last couple of years, you can pretty well (work) out what they're going to be like.

And in terms of business mix, Cathedral is more property-focused than us, so you'll see a movement towards property. And in terms of capital needs, as I mentioned, I think the acquisition takes us from about the $1.4 billion level to $1.6 billion or so in tangible capital (inaudible).

A - Alex Maloney {BIO 16314494 <GO>}

Yes, I agree. I think people have to understand that an energy account is volatile and it is exposed to large losses, so that will obviously make the loss ratios volatile.

But as I said, the loss we had is run-of-the-mill loss; it's nothing out of the ordinary. And as Elaine says, with our acquisition of Cathedral, we'll definitely be more property-weighted. But as Richard says, we believe that's a more than adequately priced line of business. And on the capital needs, I'm not even going to pretend to work out the capital needs, but people should remember, we don't even actually own Cathedral at this moment in time, so there will be quite a few changes coming in the future.

Q - Angela Gu {BIO 18078706 <GO>}

Thank you.

Operator

Chris Hitchings, KBW.

Q - Chris Hitchings {BIO 2034501 <GO>}

A couple of issues. (First of all) just in the statement, Elaine referred to the quarter being a very average one. That was a quarter of average cat or pre average cat losses, and does that mean that you consider 90.8% as an average combined ratio we should expect? That probably wasn't a serious question.

Second question is probably on the prior year provisions. Can you tell us a little bit more about this Ike claim?

You've also had, through this year, a number of provisions on the 2006, 2007, 2008 years which are also all years in which you released a lot of reserves, going back. Is there an extent to which you need to have another look at the IBNR for these years before you rule off the accounts, i.e., should we anticipate something in the Fourth Quarter?

And a technical question; are you likely to report Cathedral as a separate segment, going forward? This is just a spreadsheet construction question. Thanks.

A - Elaine Whelan {BIO 17002364 <GO>}

That was a pretty bad line, Chris, so you said a little bit about (inaudible) (the microphone), but let me see if I can tackle what you said.

In terms of combined ratio expectations, I think was your first one, our inception to date, combined ratio is under 60%. We have had quarters in there where it's been higher. We have had quarters where it's been very low, so I don't have anything in terms of combined ratio expectations.

Then I think your second question -- I'm not even going to try your third one, but I think your second question was on the 2007 and 2008 years (inaudible). We did have a study carried out, but we had enough experience of our own (inaudible) and adjusted our reserves accordingly.

We were trying a little bit too much there because we were using industry (patterns and factors). We are happy now that we're using our own experience to work out our losses, and on large events, (we thought) what was best estimate, but best estimate will always be wrong.

(inaudible) now our average duration's about two years. So when something does come to -- whether it's a negotiated settlement or whether something goes to litigation, then (inaudible). Overall, we would hope that things settle in our favor, but sometimes they go the other away; it's just how it works. I don't think there's any need for us to have a new reserve study done.

Q - Chris Hitchings {BIO 2034501 <GO>}

Right.

A - Elaine Whelan {BIO 17002364 <GO>}

Do you want to try your third question again?

Q - Chris Hitchings {BIO 2034501 <GO>}

Sorry, the third question was, will Cathedral be a separate segment in your future reporting?

A - Elaine Whelan {BIO 17002364 <GO>}

That's our intention, yes.

Q - Chris Hitchings {BIO 2034501 <GO>}

Just on this, on the reserve development there's been a series of adverse developments of $1 million, $2 million here or there on all three 2006, 2007 and 2008, and these are years you said you carry no IBNR for. Do you think you ought to?

A - Elaine Whelan {BIO 17002364 <GO>}

No. We've been expecting most of those years to have run off by now. There's just a couple of late things that have come through. When you're looking at things, there's a magnitude that we're talking about here, $1 million doesn't really make me want to put up extra reserves.

Q - Chris Hitchings {BIO 2034501 <GO>}

Okay. Thank you.

Operator

Olivia Brindle, Deutsche Bank.

Q - Olivia Brindle {BIO 17273762 <GO>}

A couple of questions from my side. First of all, just to follow up the property cat book, could you give a bit more detail on the type of new business you've been writing there by geography perhaps? Whether it's proportional excessive loss, how far down you've gone down the layers because I know you were saying that you might consider going a bit further down than you've gone in the past.

Secondly, to what extent do you think that you can make up some of the losses on the European side, and also in the energy business, from price increases next year? Or will the level of supply in those markets prevent a sufficient response?

The finally just, I guess, to get your thoughts on whether you're seeing that the market appetite for new alternative capital is peaking at all. Just thinking that we've seen quite a lot of issuance recently, sentiment on other asset classes seems to have improved, and pricing has come down. Are you sensing any slowdown there, or is there still quite a lot at this point in time? Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Right, I didn't get the second question. Sorry, Olivia it's a really bad line all of a sudden for some reason. The first question was loud and clear.

Like I said, we used to write property cat in a pretty opportunistic way; we weren't really part of the market. That's fine when you're in a harder market and there are opportunities coming along. But in the current market, to be at all relevant, and that's the word we've used throughout the year really, in order to be relevant in that segment you've got to be able to offer brokers lines through the program.

We still continue to weight our lines towards the top of programs, and as Alex said, we do offer a proportion of our line multiyear. You can't just sit there writing the top layers; you will get destroyed on signings if you try and do that. We're seeing, obviously we're not going to give names, but some companies are trying to do that and trying to resist any multiyear offerings, and they were just getting destroyed at signings.

It's different with the Cathedral book; that's very much of a personality-led business. (John) and his team have led this stuff for donkeys' years and that's a lot more sticky.

To your other point about the type of clients, it's the great and the good really. The sort of clients we've been getting purchase on now, both in Continental Europe, the UK, and North America, have been the marquee names. I think for us, as a mature business, to have those sorts of clients whose programs we need to be on, yes.

I'm afraid I didn't get the second question. Did you get that?

A - Elaine Whelan {BIO 17002364 <GO>}

The second question was on price increases after the losses in Europe, I think. Is that right?

Q - Olivia Brindle {BIO 17273762 <GO>}

Yes, on the European weather losses and also on the energy losses that you've had.

A - Richard Brindle {BIO 1983776 <GO>}

Alex?

A - Alex Maloney {BIO 16314494 <GO>}

Yes, I think we're definitely in the market now where (post-loss) opportunities are regionalized and they don't last very long. So we would say that the losses in Germany or Europe, etc., would probably just flatten out some of those renewals. I don't think there will be big price increases because you're just not seeing that across the board at the moment.

It's exactly the same with the energy account. That loss is a market loss of ($250 million to $300 million). That is just (nowhere) close to something that will move the market. That client will have to pay more next year, but you won't see any adjustment on the rest of the portfolio.

A - Richard Brindle {BIO 1983776 <GO>}

I think the third question was about third-party capital.

A - Darren Redhead {BIO 17995744 <GO>}

Yes, I think it was touching on -- Olivia, was it touching on the new issuances of sidecars and classes of business they're getting into?

Q - Olivia Brindle {BIO 17273762 <GO>}

Yes, just whether you're seeing demand from the investor side peak, given that there's been a lot of different opportunities coming to the market, and maybe the effectiveness is a little bit less than it was a little while back.

A - Richard Brindle {BIO 1983776 <GO>}

Okay. Darren's going to answer that one.

A - Darren Redhead {BIO 17995744 <GO>}

Yes, I'll answer that. There's probably been about half a dozen sidecars raising capital with us towards year end, but all those they have exclusively been property cat. Most of them have been cannibalizing existing portfolios. We're really (gaining money) out there but I'm not looking to cannibalize existing business and be multiclass. Hopefully, that answers that.

Q - Olivia Brindle {BIO 17273762 <GO>}

I was just thinking, sorry, at the market level whether this trend has peaked or we're still seeing, I guess, an increased pressure?

A - Darren Redhead {BIO 17995744 <GO>}

The collateralized market is $40 billion, $45 billion. Personally, I can see that going to $65 billion over the next 12 to 24 months. As continual growth, most exclusively property cat, which has been touched on before, is causing pricing in terms of issuance in property cat. Some of those (riders) maybe looking to other classes that could have knock-on effects within other markets.

A - Richard Brindle {BIO 1983776 <GO>}

It's important to stress, Olivia, that within Kinesis we are not in the market offering cat bonds for (HRLW) that sort of stuff. The market is awash with capacity, and frankly, we'd rather be buyers than sellers. We think that's a good arbitrage for us and we intend to take full advantage, and the products we're offering in Kinesis, or that Darren's offering in Kinesis, are very bespoke.

He spends a lot of time with each (cedent) looking at their book, seeing how we can offer something that's attractive to them; it has a cat component, and non-cat component, and it's pretty unusual. Most of the new money haven't really got their head around non-cat lines and there's not really much sign of them doing so. What that means is all this capital is driven into the place they find easy to occupy which is the easy collateralized stuff, like retro.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay, that's clear. Thank you.

Operator

Andreas Van Embden, JPMorgan.

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

Two questions, please; one on the energy book. Energy rates seem to have slipped further in the Third Quarter versus the Second Quarter, both in the Gulf of Mexico and in the international worldwide portfolio. Could you maybe just go through both portfolios and describe what's going on there with rates?

Also on energy, what is your ambition in energy liability? Is that in each area within the energy market you're seeking to accelerate your exposures?

The second question is really on your risk appetite, your PMLs. I think you've been derisking in the first half of the year and that derisking has stabilized in the Third Quarter. As you build up your property cat books, should I expect the PMLs of Lancashire to start to moving at the January 1 renewals? Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

Obviously, energy rates, when I talk energy rates I'm just talking upstream energy rates, not downstream, because we don't write downstream. We have seen a weakening in that market; we are seeing reductions for quality accounts with good records in the region of 7.5% to 10%. We still think the margin's down on that book.

We would estimate that if you looked at the whole worldwide book, you're probably, I don't know, 12.5 points off those (6) which is a reference point we use quite a lot. So most of our books (call), we're going to renew most accounts; we're not looking to change it dramatically. We still like the business and we don't thing the rating environment is at a level where we're going to come off wholesale business.

With the Gulf of Mexico, remember as well, the Gulf of Mexico cat business we only write the deepwater. We are the dominant player in deepwater for the Gulf of Mexico; we do not write the shelf. And in our experience, the rates this year have been close to as before for that business, whereas if you look at the shelf business there's been some reasonable sized reductions in that market.

We probably will expect to give some kind of no claims bonus or profit commissions on some of those cat deals next year, to secure them for another year. They've been highly profitable since Ike, and we like that business. So we don't think that market will be a blood bath by any means and, as I said, we are the dominant force in that market anyway.

On the energy liability class, as we've said before, we're already underwriting the clients and meeting the clients, understanding the clients on the physical damage side, so the liability side for those clients is not too difficult for us to get our heads around. We continue to (adopt) opportunities the brokers bring us where we can offer private (terms). We've done that a number of times, so that is a growth market for us.

I think we've written about between $6 million and $8 million of premium, so it's not massive; there's definitely room for growth in that book. And that market it flat this year after paying substantial rises after Deepwater Horizon, and we're not seeing any new capacity come into that market. So that book should continue to grow for us.

A - Richard Brindle {BIO 1983776 <GO>}

Then the question for PMLs is probably more for Elaine.

A - Elaine Whelan {BIO 17002364 <GO>}

In terms of our own PMLs there's not really going to be much change in those. Remember we're coming off (a ratio) and D&F book, so we're just swapping in the capital there that we would use for those wins in the property cat base.

With the addition of Cathedral, I think our PMLs is about (200) percentage points, but we've got a bit of work to do ahead of us there in that, so.

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

So your PMLs going into next year without Cathedral, just the Lancashire book you expect them to be flat?

A - Elaine Whelan {BIO 17002364 <GO>}

Yes, no significant change in those.

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

All right. Thank you.

A - Richard Brindle {BIO 1983776 <GO>}

Just think about, Andreas, as exchange of a (PML) from the retro for the property cats which we believe is less volatile and better priced.

A - Alex Maloney {BIO 16314494 <GO>}

And we're quite underweight already. We're not right in our (peak) tolerances. We're being conservative already.

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

All right. So any extra risk coming on your book is really from the deal with Cathedral?

A - Richard Brindle {BIO 1983776 <GO>}

Yes. It'll be supported by additional capital, so yes, not making the business riskier. They buy a lot more reinsurance than we do. It's a different business model and on the principal of it ain't broke, don't fix it, we fully respect what they've built up over many years. And whilst we want to work together and have suggestions for each other as to how we can enhance our business, because no business is perfect, we think it's a very mature successful business and they have a very settled way of doing things which works well.

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

All right, very clear. Thank you.

Operator

Nick Johnson, Numis Securities.

Q - Nick Johnson {BIO 1774629 <GO>}

Just picking up on Richard's comment about the changing shape of the property cat book, in going lower down layers in some cases. I appreciate there's no crystal ball, but would it be reasonable to expect German hail type losses every year? Previously Lancashire's been a low attritional loss rate business with infrequent cat exposure. Are we going to see more losses in the middle ground? Could you really give us some guidance on how much you think about expected loss costs, going forward? Thanks.

A - Richard Brindle {BIO 1983776 <GO>}

(In general, no, it's) unusual thinking that a lot of the customers buy (aggregate) cover; we wrote some pretty modest lines and we got hit. But I don't think you should get alarmed every time there's some pretty minor event, we're going to get paying out. We don't think have any exposure to the St Jude's Day storm. We didn't have anything in Canada, did we Alex? Anything material?

So I think the German loss is a bit of an oddity, Nick, because of its structure and we'll stick with that stuff, because we expect to get some decent renewal terms. But no, logically, if we writing some dollars a bit further down, and again bear in mind most of our dollars remain on top layers, you're obviously going to be that much more exposed to medium sized events. But I think we've proved, over the course of this year, that it's not going to mean that you're -- we're not going to start picking up all these medium sized cat losses like a lot of our peers, it's still a good risk factor.

Q - Nick Johnson {BIO 1774629 <GO>}

Great. Thanks very much.

A - Richard Brindle {BIO 1983776 <GO>}

The point really is, Nick, as I said earlier if you just try and sit in a property cat market and write top layers only, you're going to get destroyed on signings, because that market has changed, (broken). The good news is that we worked incredibly hard this year on our relationships, and I think it's fair to say we've taken our relationships with all of the major reinsurance brokers to a new level. And we're now very often offered private deals where 8 or 10 trusted reinsurers are approached to do a certain deal and that's, if you like, stitched up and then the balance goes into the market.

And you can imagine if you're -- it's frankly a matter of being one of the haves, not one of the have-nots, because if you're one of the have-nots and you're hoovering up the scraps, then there's enormous pressure on both pricing and signings. So the way to trade in that market -- there are some clients who still buy in the old fashioned way, but increasingly you need to make sure you're at the top table, with flexibility and a decent line size and with the ability to be on the inside and get these private deals, because if you're on the outside it's pretty bleak right now.

And again, use this abundant capacity in a sort of retro space to, hopefully, mitigate of if not entirely neutralize the effects of the reduced pricing on the (inaudible) business.

Q - Nick Johnson {BIO 1774629 <GO>}

Okay. Thanks very much.

Operator

(Operator Instructions) Speakers, at this stage, it appears there are no further questions registered. I return the conference to you.

A - Richard Brindle {BIO 1983776 <GO>}

Thank you; that's all from us. All the best.

Operator

Ladies and gentlemen. this now concludes today's call. Thank you, all for attending. Participants, you may disconnect your lines now.