# Q2 2012 Earnings Call

## Company Participants

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



## Other Participants

- Andreas Van Embden, Analyst
- Ben Cohen, Analyst
- Christopher Hitchings, Analyst
- Fahad Changazi, Analyst
- Nick Johnson, Analyst
- Ron Bobman, Analyst
- Thomas Fossard, Analyst

## Presentation

### Operator

Welcome to the Lancashire Holdings Limited Q2 results conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note that this conference is being recorded. I will now turn the call over to your host, Richard Brindle. Sir, you may begin.

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

Thank you very much. If I could just introduce my colleagues once again, Alex Maloney, Group Chief Underwriting Officer, and Elaine Whelan, Group Chief Financial Officer.

We have watched with bemusement as company after company has come out with bullish rating commentaries on the 1.6 and 1.7 US cat renewals. Whilst the business is by no means bad, if properly risk and model adjusted, the renewal terms were at best flat and probably slightly down in our view.

We continue to believe that the best priced cat business was available at 1.1 and 1.4 and so have approached the midyear renewals with some caution. Rates across the rest of our portfolio are broadly stable, as Alex will explain in more detail.

Having said all of this, we continue to find good pockets of opportunity and are moving determinedly into them, sometimes with the backing of third-party capital providers.

But broadly, we feel that this is a phase of the cycle that calls for further patience and discipline. And we eye the growth plans of some others in a gradually softening market with some suspicion.

We will see what happens in the wind season. But as Elaine will mention later, we remain strong believers in right-sizing our capital through special dividends. And you can expect that to continue.

I'll now hand over to Alex.

## Alex Maloney {BIO 16314494 <GO>}

Thank you, Richard. The Second Quarter started very well for Lancashire with an excellent performance on the Japanese and Asian renewals on the 1st of April.

The time and effort put into marketing, this commenced in November 2011 and included multiple trips to visit clients in Japan and working very closely with our brokers to shape a portfolio with the optimum risk and reward characteristics.

Overall, our wonderful premium written for the property cat ex of the loss line grew from $9.7 million to $41.8 million with Japanese cedents accounting for $36.3 million, including the Japanese interest abroad covers.

RPIs for this business range from 120% to 150%.

Including May and June, our Second Quarter property cat premiums drew from $18.9 million to $48.7 million, despite curtailing our Australian exposures due to weak pricing of a major program of the June renewals.

This in turn was partly offset by strong renewal terms on a major New Zealand client.

For the quarter, our retro premium also increased from $7.9 million to $21 million. And this includes reasonable retro returns on own account and the first Accordion renewal from 2011.

We rolled over the capital commitment for Accordion into the second year. And whilst we don't expect to renew every account, we do expect there to be both renewal and new opportunities as demand for worldwide cover remains healthy.

Sticking with the property arena, we reluctantly decided to close our direct and facultative property account and our onshore energy book in June. The decision was not taken lightly, and we're extremely grateful to our staff for their professionalism and hard work and for the brokers that supported us.

However, the bottom line was that the increased incidence of secondary cat power losses, be they be tornadoes in the US, floods in Thailand, or tsunamis in Japan, and the rising prevalence of contingent business interruption losses are very hard to model and quantify.

The inclusion of SRCC coverage for no additional premium along with a plethora of markets from the US domestics to Singapore to London, Europe, all write in a business we cannot see that the necessary changes to the product would be made to ensure its profitability.

On top of all this, the cost of reinsurance protections for D&F business have been climbing steeply. Our RPIs figure for the year to date of 108% for D&F may seem to question our decision. But this was only achieved through a decline in a host of inadequately priced business, which can be seen with our 42% reduction in premium for the year to date to just $21 million.

We have certainly been reducing our writings from 2007 with a peak of $150 million for D&F and onshore energy to just $62 million.

Over the same period, our property cat XL book has grown from $23 million to $100 million in written premium. So the rebalancing of our property exposures away from the insurance to the more disciplined reinsurance market has been a long-term project.

An additional benefit will be the reductions in critical year SPMLs. And the D&F account contributed heavily to the perimeter and tail risk for both wind and earthquake.

We've added a new underwriter to a reinsurance team in Bermuda. And we'll be actively looking for ways to deploy this P&L that is now going to be required for the D&F book.

On energy, we're pleased with the outcome of our busy Second Quarter. Premium was up 5% overall with a 65% increase in Gulf of Mexico income to $75 million, more than compensating the 23% reduction in worldwide income.

We renewed a couple of significant multiyear wind contracts in the Gulf of Mexico, maintaining the strong pricing of the last current years with 100% RPI.

Organic growth continues as our clients are expanding operations around the globe. And although price increases have slowed, we're still in positive territory with an RPI of 103%.

For the first half of 2012, our total energy premium is up 21% to $198 million.

For marine, we saw a 68% increase in the quarter to $16 million of income with RPIs of 135% for hull and 148% for wall. This was driven almost entirely by the renewal of the Carnival program, the owners of the Costa Concordia.

It seems possible that this loss, including liabilities, will escalate. So we have added $20 million to our reserves, as we indicated was possible last quarter. Outside this one account, pricing has been flat on the direct side, although reinsurance pricing has increased.

We've hired a new senior underwriter for this portfolio, who replaced our former underwriter this quarter. And he is reviewing the book thoroughly to identify new profitable opportunities.

On aviation, our premium fell by 8% to $12 million. And our RPI was 97%. But this is not a significant quarter.

We continue to like our niche products of AV52 and believe that this risk rule balance is acceptable.

For terrorism, it was a fairly flat quarter with premium growth down 6% to $19 million and our RPI of 98%. We continue to believe that risk selection is key, given the level of sometimes naive competition.

Our line size and intensive marketing efforts allow us to play a key role in structuring accounts with our brokers so we can find attachment points that allow us to tailor our participation to our appetites.

A cautious approach to political risks, both expropriation and obligors business is based on careful consideration of a wide range of factors. We use multiple resources, including well-deferred specialists and investment advisors.

(Attributing of) our income to $17 million in the quarter is evident of our slow-burn approach to this (class) as paying dividends. Individual account premiums for this line tend to be large. And our binding ratio is low, so just 22% for year to date.

So the quarter-by-quarter figures can be affected by small numbers of risks. So but, we are happy with this line of business and look forward to growing it modestly.

The market outlook is far from clear, but it certainly seems our original prediction for the year that the most attractive markets would be retro and the cat markets at 1.1 and 1.4 has proven correct.

The rebuilding of capital by both insurers and reinsurers in a cat-free first half year will produce pressures on pricing absent an event in the second half.

We continue to see the market as patchy, with some areas performing better than others, despite suffering some significant individual losses in our book of D&F price (putting) into runoff and the Costa Concordia loss, we've returned an acceptable ROE for the quarter and the year so far.

With the increased interest in the insurance sector from capital markets, we have come by some new outward reinsurance opportunities. And we've been able to buy reinsurance on an IOW and collateralized basis that supported our writings in Japan, the US, and worldwide.

We believe that a more proactive approach to such opportunities has allowed us to get our portfolio in the best risk-adjusted shape it has been since we began underwriting.

The market will be challenging, and if there's no event in the second half of the year, but Lancashire's continued to show that, even with losses in major lines, it has the discipline and underwriting focus to try successfully through all kinds of market conditions.

I'll now pass over to Elaine.

## Elaine Whelan {BIO 17002364 <GO>}

Thanks, Alex. Hi, everyone. Our results are laid out on our Website, as usual. We've achieved a return of 3.6% for the quarter, bringing us to 7.1% for the year so far. Our combined ratio for the quarter was a healthy 60.7%.

Where there was again a refreshing lack of major catastrophe losses in the quarter, the tornado activity in the US continued and with a net loss in one D&F account of $16.7 million.

As Alex said, on Costa Concordia, we mentioned on last quarter's call that we had some marine and energy IOWs, which would be triggered if the energy loss with an excess of $1 billion.

It got there this quarter unfortunately. So there was therefore (total) exposure there of $20 million.

The total development and the cost of loss was $24.6 million for the quarter net of reinsurance and reinstatement premiums.

Otherwise, in losses, we saw a little bit of development on prior-year cat, not much but around $9.7 million across the New Zealand and Japanese quakes and the Thai flood with most of that coming from the Christchurch, New Zealand, quake.

We had fully reserved exposures to one large Japanese client last year but only saw a couple of million dollars of development on our Japanese reserves.

The Thai flood development came mostly from one retro client and was reinsured by Accordion.

The reinstatement was retained by Lancashire, though, which actually resulted in the net impact from that loss being minimal to the Group.

Our Thai flood losses are still within our originally reported range of $24 million to $28 million.

We're still carrying some cost reserves on our IOWs in relation to Gryphon. But we'd hope for some kind of update in this before the end of the year.

Our prior-year releases this quarter were $22.9 million, versus $46.1 million for Q2 2011.

Q2 2011 had a couple of one-off items in those releases, hence the particularly high level. And so, this quarter's release may seem in the hindsight, though, in the independent reserve study we have conducted in the First Quarter of last year, we're now incorporating for the (inaudible)fees in the reserving.

We reviewed the data against industry benchmarks and found both showed faster reporting patterns. We adjusted accordingly, and this led to release of about $12 million across prior years.

The rest of the reserve that we see have no real specifics, simply better (loss emergence) than expected.

Going forward, we'll continue to incorporate our own experience in to our (loss base) as we generate more history.

Alex has discussed (inaudible) at length. So I'll just add, on a gross written basis, we're about 35% ahead of Q2 last year with the vast majority of that coming from the property cat and retro books. And Alex explained what drove that.

In the energy book, we saw a fair bit of activity in multiyear deals again this year as clients look for some certainty in cover.

In Q2 2011, we wrote about $31.2 million in multiyear deals in the Gulf of Mexico book with two two-year terms.

In the Q2 2012 Gulf book, we extended several of the Q2 2011 multiyear contract effectively extending and replacing existing prior underwriting year multiyear deals.

The net increase in gross written premium for those deals was $10.3 million and had a minimal impact in expected earnings in 2012.

The total of $48.4 million in multiyear deals in the Gulf book and of that $39.3 million of that is deferred into subsequent year's earnings with most of that coming in, in 2013 and 2014.

Last point on premiums and our retro book, about one-third of that premium qualified for (inaudible) to Accordion. The rest was a combination of reinstatement premiums in relation to Thai floods and deals which did not qualify for Accordion that we retained on our own balance sheet. So that's $7 million of our ceded premium this quarter related to Accordion in line with the prior-year level.

We also got some more opportunistic IOWs cover in both Japanese and US loss events and expanded our marine and energy cover for in the cost of loss.

We make an advantage of opportunistic deals here and there. We shouldn't really see too much more in terms of reinsurance purchases for the rest of the year now.

So as for last quarter, for the year to date, with increased gross written and increased ceded, on a net and an earned basis, we're fairly in line with the prior year.

Back on Accordion for a moment, as previously announced, we've rolled over the investment for another year with our investment partners. We expect to see continued, albeit lightly reduced amounts at 1.1 and therefore expect to be able to utilize the vehicle further then.

However(most of the cash) put to work at that date will really depend to the degree of what happens this wind season.

The small loss in our share we show this quarter is just the impact of Thai flood losses, as I mentioned. To date, though, we've recorded $2.4 million in terms of our extra pickup in the vehicle.

Our acquisition cost ratio looks a little high again this quarter. But again, this isn't really indicative of an underlying trend, just down to some adjustments that routinely happen on a risk (inaudible) business. There've just been a few more than normal this quarter.

G&A, however, is back to a more normal level after the one-off adjustment for national insurance on employee compensation that we discussed last quarter.

On investments, our market mutual approach appears to be working well and has registered a total return for the quarter of 0.6%.

We're happy that, given the ongoing almost daily volatility in the market, as we stated in our press release, we've got emerging market debt holdings (in LL). This isn't going to be a reflection of our thinking in emerging markets and the ability to produce good returns. It is more driven by the knock-on impact on (EMD) of the heightened concerns about the state of Europe.

As previously, we continue to have no exposure to European peripheral sovereign debt. And our (inaudible) portfolio (inaudible) published with our quarterly results on our Website.

Lastly, on capital, capital levels, and change of special dividend this year, I guess everyone is used to the way that we look at this now and is expecting us to say it's too early to tell. It is too early to tell. But that said, if there are no market-changing events this year, we'd expect to continue in our current (NO) of being disciplined, spending our time optimizing our portfolio, and generating the best risk-adjusted return that we can.

That means we'd be likely to maintain year-end capital levels at similar levels to the prior year and return 2012 profit generated to our shareholders.

With that (much) capital, there are still some (inaudible) of business and that could generate good returns from them.

(inaudible) major events, we would anticipate using all of our capital and possibly even using more.

In the meantime, we've declared our usual small $0.05 interim dividend and have now returned capital of $1.3 billion since inception of 78.2% of total comprehensive income.

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

## Questions And Answers

### Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Ron Bobman from Capital Returns is online with a question.

### Q - Ron Bobman

Hi. Good morning. I didn't expect to be first, but I'm ready nonetheless. A little bit of help, in the prepared remarks, somebody referred to SRCC. I didn't know what that abbreviation meant. And I have got just a couple of more brief ones.

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

Okay. Sure. Alex, you want to take that one?

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

Yes. It just means strikes, riot, civil commotion cover.

### Q - Ron Bobman

Okay.

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

So that's something that tends to be in (property) D&F policies, particularly in the sort of current economic climate. Obviously, things getting difficult around the world, underwriters should be at least identifying that coverage and charging more for it. But they're not.

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

Exactly. And I think our point is that it's just thrown into the D&F policy without any separate charge, which is (inaudible) that market (inaudible).

## Q - Ron Bobman

It's almost like political risk cover that's making its way into sort of traditional D&F?

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

It's political damage cover following strikes, riots, civil commotion. It's not really political risk, but it's a subset of what you cover on a terrorism policy.

## Q - Ron Bobman

Okay.

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

But it's effectively thrown in for nothing.

## Q - Ron Bobman

Thanks. Then also, in the prepared remarks, I forgot your CFO's name. I'm sorry. But she referenced the reinstatement premium was retained by Lancashire associated with the Accordion loss. And I guess I think I understand that. But could you just explain?

I guess you sell a cover that's got a backup or reinstatement, but the Accordion vehicle doesn't offer a reinstatement. So Lancashire's keeping that sort of secondary premium and thus the related exposure. Is it sort of as simple as that?

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

Pretty much. Elaine, anything to add? That's pretty much it.

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

No. That's pretty much it, one-shot deal with Accordion.

## Q - Ron Bobman

Gotcha. And I guess all of the -- I mean, I -- actually, I should just speak to the other sort of side-car vehicles that have been set up. But for the most part, to the extent that they are single-shot entities or that's their business plan, that would be the way for the traditional insurer or reinsurer to offer cover that's got a reinstatement outside of the strict mandate of the side car? That would be sort of somewhat typical?

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

Yes. Sure. Yes.

## Q - Ron Bobman

Okay. My last question -- thanks for your patience -- Costa Concordia, as it relates to that event, are you at a limit now, or could there be future retro recoverables for you if it got worse, or are there just further exposures of loss creep further beyond where we are today? Thank you.

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

Yes.

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

Alex?

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

We -- I mean, that's a complicated loss because the removal of that vessel is going to be very difficult. And no one can probably predict that. But what I would say from our point of view, if there's any loss creep, we do have reinsurance for that. There will be some additional reinstatement premiums about -- we've got the IOW fully reserved. We have got a cautious reserve on it.

But what I would say is that that will take some time. It will be about the removal. But we have reinsurance on it. So it'll be minimal for Lancashire.

## Q - Ron Bobman

Okay. What is the cumulative Costa Concordia loss that you've booked so far? Then I'm done. Have a nice day. And best of luck. Hope it continues.

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

Just getting that number for you.

## Q - Ron Bobman

Or, roughly.

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

It's $44.6 million for the -- .

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

-- That's -- so, that's $45 million?

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

Yes.

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

Something like that.

## Q - Ron Bobman

$45 million. Thank you very much.

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

Thank you.

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

You're welcome.

## Operator

Ben Cohen from Canaccord Annuity is online with a question.

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

Hi there. Thanks very much. Could I ask a couple of things? Firstly, I was just wondering, Elaine, if you could give a little bit more guidance in terms of how you expect the premium to earn through. I know you made some reference in the individual divisional lines. But should we expect some underlying growth in earned premium in 2013 from the volume that you've put on in the Second Quarter?

The second thing I wanted to ask was, just looking at the loss ratio in marine, and maybe I've read this wrongly, but I presume that the Costa Concordia increase is in there. Obviously, you've got a reserve release as well, and you've got a sort of a positive claims ratio, if you like, so an underwriting profit.

So are there other positive kind of one-off items in there because the underlying result just looks extremely good if I'm understanding that right?

And the last thing I wanted to ask about was in terms of the shutting down the D&F book. I just wonder your confidence level around being able to find alternative uses for the capital that you had deployed there I guess when this business would otherwise come up for renewal in 2013. Thanks.



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

Okay. Fine. So probably the first two for Elaine and the last one for Alex, and I can jump in if needed.

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

Thank you.

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

Okay. With respect to premiums, the vast majority of our contracts are 12-month premiums. Marine builders risk and energy construction and political risk tend to be the ones that are longer-term contracts. It's (kind of small dollars on them). Then the one that I was trying to reference today was in the Gulf of Mexico book because it got quite a lot of multiyear contracts in there or dollars on them anyway so that I said it was $48 million premium there, was $39 million of that deferred.

So they're mostly two-year deals, a couple of two-year deals in there. So you see -- what was it, half of that next year. It's a little less than half the following year and then the final little bit dribbling in, in 2015.

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

Okay.

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

On the marine loss with Costa Concordia, the IOWs are actually technically an energy contract. You'll see the IOW loss coming through in the energy line as opposed to marine line. So the marine line looks basically like (think it should) with that loss. And the energy line looks a little bit worse because of it.

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

Yes. And those are (IOWs) our marine and energy IOWs, as already said.

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

Right. Okay.

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

On D&F, according to my script, you'd have noted that we have been sort of deploying more capital into the reinsurance line anyway. So we're way off our peak of 2007 of how much D&F business we wrote. That market was weak. We will look to use that capital in the reinsurance lines if we can. Obviously, if we can't, we'll form part of any dividend or special dividend that we may do if the wind season (goes clean).

But as we've always said, we're not going to deploy capital into markets where we don't feel we're going to get adequate returns. And the human side of the D&F decision is always difficult when you're talking about Lancashire staff. But the technical side of the decision after us struggling with D&F for some time now was relatively easy. And we just feel that the reinsurance side of the business has just been much more disciplined, particularly around model change, than what the direct property market has been.

So we'll look to deploy it there. If for any reason we can't, that will just be excess capital that we can return to shareholders.

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

Okay. Thank you very much.

## Operator

Nick Johnson from Numis Securities is online with a question.

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

Good afternoon, all. Question on -- just wonder if you could elaborate a bit on the change in market conditions you described from the 1.1, 1.4 to 1.6 and 1.7. I just wondered if that is related to the regional differences and attitudes and pricing the different regions.

Obviously, a lot of the loss impacted accounts renewed earlier in the year versus the 1.6 and 1.7. Just wondered if that is a reason for the difference in sort of market conditions or whether there's been a genuine change in the pricing environment in the first half.

And sort of related to that, just wondering if you could discuss a bit about whether or not you're seeing significant signing down on attractive risks, whether there's been any change in that sort of behavior in the last six months. Thanks.

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

Yes.

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

Yes, go ahead.

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

I think your first point I think is more than anything -- yes, there was a lot of loss effect to business at the start of the year. But I think it's as simple as the same people are still at the party. I think we haven't seen people exit the insurance or reinsurance market.

And I think over a period of shorter three or six months, you see people starting to lose their nose a bit. So I think we've even seen it on the energy market. Conditions were better at 1.1 than what they were at 1.7.

So I think people lose their nose a bit. Brokers are very good at doing their jobs. And capacity hasn't changed enough. So I think there's a big element of that.

I think the sign-in question's a good one. We believe -- we don't write huge numbers of product lines. But the product lines that we write we believe were important enough with brokers and clients to maintain our sign-ins in this type of market.

So I think, if you're a smaller carrier or a smaller syndicate in Lloyd's, sign-ins are probably a big issue. They're not a massive issue for us because we're big enough and probably (ugly) enough to protect our sign-ins. But it's a good question in this type of market.



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

Yes, (inaudible) I agree with all of that. And I'd just add maybe the -- particularly the (inaudible) market in 1.6 with model change, it's an unusually muddy puddle in a muddy body of water to try and read RPIs through.

And I think it's fair to say that companies finessed or even avoided really looking at the implication of the model change and the knock-on effect on the capital required to write the business and therefore the charge to leave it on the portfolio, if you will, of writing those contracts and just really looked at the headline rates, which is not for us the true RPI.

So yes, the headline rates went up. And I think people were therefore able to present it as a positive market, but really it wasn't. So yes, we have indicated in our view that the first half of the year would show better opportunities.

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

Great. Thanks very much.

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

Thank you.



## Operator

Christopher Hitchings from KBW is online with a question.

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

Thanks very much indeed, chaps. Two of my four questions have been dealt with. So I have two -- just two left.

On G&A expenses, you've got a number presumably of exceptional costs to do with resizing the business in 2012. You've notified the $7 million of NICs. There's presumably some costs of exit from D&F and the exit from Dubai.

And presumably, therefore, there's some lower ongoing cost. Could you give us some handle on how much you expect the G&A number to be down in 2013 as a result of all this, or help me in some way?

Second question, I think when you set your special dividend at the end of last year, you kind of retained some capital just in case things got more better than you thought in 2012.

Presumably, they haven't. So that capital is still there. Are we likely to reckon, however, therefore, that a special dividend this year, absent events, could well be at least or if not more than your retained profits because you've already got some buffer retained last year? Thanks.

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

Okay. Elaine, they're probably both for you.

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

Sure. Yes. There are some costs of closing down the D&F book and closing Dubai, which will end up on a net basis without too much of a differential there, though, because of the lost cost of employment cost from those people.

If you're trying to factor in your numbers for next year, I don't have a specific number to hand, but we lost three employees in Dubai, and we lost about nine or so in the -- on the D&F book and across various different departments in the organization. So if you sort of factor in an average cost there, you can come up with a reasonable working number on that one.

In terms of the special dividend, if nothing changes, then we will be giving back quite a lot of money. And it is -- it really is very, very early to call that, though. We got through a fairly detailed exercise in terms of working out our outlook for next year and how much capital we're going to need for that.

If our outlook is muddy, then we may do what we did this year and keep a little bit back to be able to use that. And if it clears a little bit, if we have a fairly strong view on how the market's going to listen to 2013, we may just decide to do a large one-shot next special dividend.

It's really a November decision. At the moment, looking forward, we don't see anything particularly exciting in the horizon that would mean that we need to increase our balance sheet size. And so, we looked kind of at least have it at the same level as last year.

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

Sorry. Can I come back just on that last thing? But the principle that I said that you in effect started 2012 with a bit of a buffer in case things got better and they didn't. So you're probably -- you've still got that buffer. That's fair, is it?

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

Well (that was, again), Chris, we used it really because we wrote quite a good deal of retro) business, while -- which is obviously capital intensive. And in fact, we're pleased that we held back some capital for 1.1 this year because they were good opportunities.

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

Okay.

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

Go ahead.

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

Sorry. I hadn't -- sorry, it sounded from what you're saying was that the market had panned out exactly as you thought. But no, that's fine. Thanks very much.

And on the G&A cost, I'm just -- I appreciate you don't want to give a forecast. But I'm just getting very lost as to what is -- you've got a $7 million exceptional anyway in the G&A for 2012, which is your NIC. You've presumably got some costs. And presumably, the employee costs won't be going out until the second half of the year.

So I clearly can work out what average costs of employing people are and what rentals on Dubai is. I was just wondering if you'd help me. I mean, are we talking about $10 million less or $20 million less in terms of G&A, or are there other things I should be worried about?

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

I think the dollar number that we have in there for this quarter, Chris, is a reasonable assumption for a run rate.

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

Okay.

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

There's some payments that have been made already. Some will lag out over the rest of the year.

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

Okay.

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

And -- .

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

-- Okay. Fine. Thanks.

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

You -- I mean, particularly important question as we go into potentially a tricky couple of years. If nothing big happens, then we'll recognize that margins could come under pressure, that you keep a very firm control of your G&A, although in hindsight, we probably allowed ourselves to get a little bit too bloated as an organization.

And we've taken some steps, which have been very painful on a personal level. But our headcount is now pretty much back down to 100 now. And I think that's probably where it should've been all along in hindsight.



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

Okay. Thank you.

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

Thanks.

## Operator

Thomas Fossard from HSBC is online with a question.

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

Yes. Good afternoon. I've got three question on my side, two on the D&F and one more as (in particular) about next year opportunities.

On the D&F side, could we -- could you please quantify the level of abnormal losses in (inaudible) D&F book in Q1 and Q2?

And second point relating to D&F book, could you quantify what is or what was or how much the D&F book was consuming in terms of Group P&L if I can say that?

And the last question would be on the next year opportunities. How do you view currently potential losses in the US on the crop business, agricultural business? Do you expect this to be a big loss for the market? And would you be ready to, I would say, deploy your (capacity) in that lines, or I mean, at this stage this is unlikely? Thank you.



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

Okay. Thanks, Thomas. And let me start on the crop business. And I'll hand over to Alex on the other bit. We did a market survey couple of weeks back, but I think it got even worse since then sadly. And yes, it looks pretty severe. And in certain states, it looks -- I think I read somewhere it's the driest summer since the '50s and the hottest since the 1890s. Obviously, our sympathies go to those who have to live through such a ghastly summer.

And yes, we think -- I think the comfort zone for underwriters in the past has always been because you -- the quality response on a revenue basis rather than a yield basis that, even if yields are depressed, to some extent, that's compensated for by the increased commodity in price due to the scarcity of the commodity, if that makes sense.

I think what we're seeing here is essentially such a big diminution of yield, much greater than 25% in several states from what we're hearing and possibly quite a bit worse than that, you wonder whether the resulting increase in price will be able to mitigate that fully.

So I think substantial losses are on the horizon. And we don't write much of this stuff, we actually write a total of $20 million of limit on the crop business, which we took down from $50 million the previous year. These are inadequate pricing in our view. And we're writing the very top layers, which have hardly if ever been affected even in the worst of conditions.

So we're pretty underweight on this stuff. And yes, as usual, if we seen a dislocated market next year, with people getting burnt and opportunities crystallizing, you can fully expect us to be in that space.

But I'll pass over to Alex for the D&F questions.

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

Sure. Okay, Thomas, I don't want to give you any exact numbers because I haven't got them in front of me. So I don't want to start guessing. What I would say about the D&F loss is, firstly, our decision to stop writing D&F wasn't just about losses. The fact that we can pick up losses on our book is what we do. We're more than happy to pay losses. It wasn't just the fact that we had a couple of losses on the D&F book.

One of the losses was a tornado. It was quite a big one. And that was I think the first big tornado loss we've picked up in nearly seven years of underwriting. So just want to make it clear it wasn't about the losses, but it did have a material effect on that subclass of business.

I think more interestingly, your question about capital -- again, I'm not looking to not answer your question. It's difficult to give you a number because the portfolio, the sort of diversification credits will move around when you take D&F out of our P&Ls. But what I would say is, when you look at the contribution to say our US Gulf of Mexico P&L D&F was pretty capital intensive versus the premium.

So again, even excluding the things we spoke about earlier, like SRCC and flood and tornado, all the model perils, just looking at the pure US, is this a good trade for your capital on the D&F book? The answer is no.

So we will get, as said, a bit of capital relief. And as I said earlier, we can use that in the reinsurance book for a better return on that capital, we will. And if not, we'll give it back to shareholders.

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

I think, just to sort of elaborate on that, Thomas, I think we've learned in hindsight that, probably the way you write D&F is pretty aggressively in a hard market and then fairly soon, maybe 18 months, two years into the hard market, you get out again.

We've had a number of major losses where the clients haven't stayed with the market, in one instance, a large loss in Thailand. The client stopped buying cat, having given the market, including most of our colleagues in the London market a substantial claim. That leaves a bitter taste (inaudible).

And I think in many ways, funnily enough, D&F shared some of the characteristics of retro in that it is somewhat of a commodity. There are exceptions to that. There are (some very low) accounts in our retro portfolio. But most of it is stuff that comes and goes according to peaks and troughs and supply and demand. And I think, in hindsight, we've learned that D&F behave in quite a similar way.

Property cat by contrast is a very mature market, relationships both (with brokers and cedents) very important, those conferences and the whole -- the rest of the (apparatus) of the market.

And if you treat your growth and clients with respect, which we always do, it's very possible to create a strong sort of through-cycle portfolio. I think Alex has described our property cat portfolio as not being mature yet, which I think is spot on. But with the recent strengthening of our team, we've got a major internal drive now to have a look at that account and see how we can further embed the client relationships.

Japan is a major push for us. You probably know that Japanese clients are extraordinarily honorable, particularly if you are there for them at a time of need. We've spend a lot of time on Japan, where we're hosting a cocktail party in Tokyo in November and Alex and I going out with other colleagues to personally sort of put the gloss on the relationships there, and you take that business is very much a building block of our core portfolio.

And when you take that, you take other elements of a property cat account, you take the energy account, Gulf of Mexico account, you take a lot of our political risk, terror writings in London, there's probably a good $0.5 billion or a bit more than that of absolute core portfolio business, probably more like $550 million. Then the rest of the stuff is more opportunistic.

So we are -- we have to anticipate that we may go into a difficult market for a couple of years now. As I said earlier, we simply don't share the bullishness on US cat pricing and others, although we do still think it's a decent market for property cat as opposed to D&F and retro.

But this is where you have to define and be prepared to defend your core portfolio and believe in it through cycle profitability, which we do. Then, of course, you've got to the point of making it earlier with your G&A. You've got to keep your G&A under rigorous control.

And I've been around a long time. And also, at this point in the cycle, you start to see companies talking about growth and this, that, and the other. And you see the combined ratios hovering uncomfortably in the 90s or worse, and at a time when it's almost impossible to make any decent money out of investments, you wonder what the business proposition is there.

So we're big believers now in being very cautious and diligent, as I said at the top of the call, at a tricky time in the cycle and want to make sure we keep our (expenses) tight, our core portfolio well defended and well defined and wait for better opportunities to come around the corner.

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

Okay. Thanks.

## Operator

Andreas Van Embden from J.P. Morgan is online with a question.

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

Yes. Thank you. I just want to come back to the Accordion renewals, just two questions there. Has anything changed in the structure of the terms and conditions for the Accordion side car on the renewal?

And secondly, would Accordion write the same type of business next year as it has written in 2012? Thanks.

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

Okay. Elaine, please?

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

No changes. It's a rollover that we had factored in when we designed the vehicle. And in terms of what kind of business we write, again, if nothing else happens this year, we'd expect to renew a fair proportion of that book, but not all of it. There might be some new business opportunities. It depends what happens. And you look, for example, for the most part, I think we were there. The more distressed clients would fall out of that book and would renew whatever was left after that.

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

All right. And has Accordion in terms of the business plan you had at the beginning of the year, has that sort of, in terms of the capacity you've used, has that been more or less in line with what you were hoping for, a little bit less, or a little bit more?

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

Pretty well in line. It has the draw-down feature in the capital, which was very nice. It meant that we could decide when we wanted to use it and how much. And that meant that we could use a lot more of it at 1.1 when the rates were the best. And we're probably not going to use very much for the rest of this year until we get to 1.1 in 2013.

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

All right. Perfect. Thanks a lot.

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

Okay.

## Operator

(Operator Instructions) Fahad Changazi from Nomura is online with a question.

## Q - Fahad Changazi {BIO 15216120 <GO>}

Hi, hello there. Just a very quick question for Elaine, and apologies if I missed this already. But at the Q1 stage, you did give us guidance for net premium written and net premium earned I believe for the full year, given how strong Q1 was developing. Have you -- would you just reiterate the guidance or tell us if something's changed, given how strong H1 premiums have been? Thanks.

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

Yes, I mean, our gross is up. Gross written's up. Gross (CD's) up. But I think, overall, you can expect the same kind of level in terms of net written and net earned as we had in the prior year, so no real change to the guidance we gave last quarter on that.

## Q - Fahad Changazi {BIO 15216120 <GO>}

Okay. Thank you.

## Operator

Ben Cohen from Canaccord Annuity is online with a question.

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

Hi. I just wanted to follow up on the June and July renewals in the US. I'm not sure you've actually sort of said in terms of how active you were in the market. I guess you've indicated that it wasn't a market that you liked. But could you just remind us because I thought last year it wasn't a market that you liked either. Have you seen a big contraction, a small contraction? Can you just remind us from what level to help us think about the Third Quarter? Thanks.

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

Sure. I don't know, Alex, if you've got some figures. And if not, Ben, we can certainly get back to you with them. You're right. We didn't write the Floridian specialist so-called last year. We haven't written them this year. But we've also come off some non-Floridian specialist accounts. Have you got some details, Alex?

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

I haven't got them in front of me. But I think you're right, Richard. It's all about Florida really. And we're not a Florida player. So the Second Quarter for us or the year's renewals around 1.6 and not that material for us.

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

Well let's -- we'll get back to you, Ben, with something more specific on that.

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

Okay. Thanks.

## Operator

(Operator Instructions) We have no further questions at this time. I will now turn the call back to your host.

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

Okay. Many thanks, everybody, and a good summer. And we'll speak at -- we'll speak in November. Thank you very much.

## Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.