Committed to underwriting excellence

Alex Maloney
Group Chief Executive Officer

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Did Lancashire's performance in 2018 meet your expectations?

We have generated a return on equity of 2.4 per cent and a combined ratio of 92.2 per cent in what was another year of significant loss activity. The third quarter witnessed another active wind season in both the U.S. and Pacific regions and the fourth quarter saw the occurrence of another series of wildfires in California. As well as causing tragic injury and loss of life, these catastrophic events also caused significant property damage and economic loss, which impacted the Group's property insurance and reinsurance books. There was also a series of devastating losses in the specialty markets, notably the occurrence of two of the largest historical losses in both the marine and construction markets. Paul Gregory discusses these events in more detail in his underwriting review on page 22. Such loss events are the lifeblood of our business and the very reason our clients purchase insurance and reinsurance coverage in order to manage their own risk profile and protect their lives and livelihoods, property and commercial interests. Fundamental to our strategy is our role as a responsible long-term business partner to our clients. We develop and retain underwriting expertise which is capable of appraising and pricing risk so as to provide the long-term support and assurance our clients require. In so doing, our aim is to maximise risk-adjusted returns to our investors across the insurance cycle.

So, in another challenging year, I am pleased to have served the needs of our clients whilst delivering a positive return to our shareholders. Our combined ratio for the year is testament to the professionalism and discipline of our underwriters and will, I believe, compare favourably to many other participants in the Lloyd's, London and international insurance markets. Most importantly, having navigated the challenges of another testing year Lancashire has the expertise, the capital, the commercial long-term relationships and the nimble business culture to succeed wherever we might find ourselves in the insurance pricing cycle.

Has the growth of the third-party reinsurance capital sector changed the nature of the insurance pricing cycle for good?

After the major catastrophe loss events of 2017, we watched the reinsurance markets with interest during the January 2018 renewal season, in particular to see whether the third-party capital, which has increasingly supported the reinsurance markets over recent years, would re-commit. In the event, this third-party capital did recommit and the pricing of property catastrophe and retrocessional reinsurance products improved marginally, but not materially. This last year we have seen another round of above-average loss activity, the effect of which has been to trap some of the collateral that supports third-party capital reinsurance products. Investors can only sustain losses and low returns for a limited period of time, so it was no surprise to me that the round of 1 January 2019 reinsurance renewals seems to have resulted in more limited availability of reinsurance capacity to the markets and a corresponding improvement in reinsurance pricing. So, whilst the wheel may turn slowly on occasions, I firmly believe that the (re)insurance business remains fundamentally cyclical in its nature. In 2018, in most lines of business, we saw a halt in pricing falls and some encouraging areas of stronger pricing. On balance, I think that the insurance and reinsurance markets have now moved

off the bottom of the pricing cycle. Boards and regulators, in particular Lloyd's, are at last focusing on the need for each line of business to be underwritten on a sustainable basis. That is good for the markets and good for Lancashire, which is well positioned to provide relevant, properly priced underwriting capacity in the lines we underwrite.

The Board has also obtained regulatory approval for a change in the Group's supervisory and tax domicile and has re-established both back in Bermuda with effect from 1 January 2019. There is more discussion of this decision and the strategic opportunities it presents on page 48.

In which classes of business do you expect to see the greatest opportunity?

In last year's Annual Report and Accounts, I expressed the hope that in the specialty lines which we underwrite we might see a return in the wider market to the fundamentals of good underwriting. It was one of our priorities during 2018 to strengthen our specialty offering in a way that is complementary to those specialty classes in which we have specialised for many years. As Paul Gregory discusses in detail on page 22 we have been able to recruit new underwriting teams in the areas of downstream energy, power and aviation deductible insurance. This is part of our strategy that seeks to achieve incremental growth to our portfolio in lines that, whilst requiring specialist underwriting expertise, fit intuitively with what we already underwrite. In our property catastrophe lines, whilst we have seen some limited rating improvement, we do not yet see a significant growth opportunity for 2019 and we expect our exposures to be similar to 2018 and premium levels to improve marginally.

So, looking to 2019, I would expect to see some top line premium growth, but built on a combination of an improved pricing environment in our specialty lines in both renewal and new business and a continuing commitment to our property catastrophe reinsurance lines at similar levels of risk exposure, unless the loss environment should present well-priced new opportunities. In what we hope will be a more realistically and sustainably-priced market during 2019, we will continue to explore opportunities to recruit sector leading underwriters whose expertise might complement the specialty insurance and reinsurance lines in which the Group already participates.

What has changed in the risk environment during 2018?

Our first and foremost risk is our underwriting risk and the associated risk of exposure to fortuitous loss events, which we continue to monitor and control on a daily basis. Risk transfer is the product which we sell. Broadly speaking, our risks, risk tolerances and risk levels remained materially unchanged during 2018. On pages 33 to 39 Louise Wells, Group CRO, sets out in greater detail how the management and Board identify, monitor and control our risk universe so as to ensure the longer-term success and viability of our business. I would however make specific comment on two areas of risk.

During 2018 we have faced the challenge of Brexit in what has been an evolving and, at times, uncertain political and regulatory environment. As a Group we have benefited from the access afforded by Lloyd's Brussels as well as the ability of our principal Bermuda operating subsidiary, LICL, to underwrite reinsurance of most European risks due to the 'equivalent' status of Bermuda under the EU's Solvency II regime. These mechanisms have helped us protect the substantial majority of our income originating from EU-located risks. In this regard it should also be noted that such risks account for a relatively small amount of our total portfolio of business. We will continue to monitor developments and we see this as an area of both risk and opportunity.

Another area of increasing debate in the press has been that of climate change risk. For Lancashire, climate change can influence the assumptions which we make when underwriting any risk regarding the frequency, severity and location of loss events, and we think of it predominantly in terms of the management of our underwriting risk. Underwriting risk is the principal risk, and opportunity, for our business. This is not to downplay climate change as a potentially disruptive and systemic global risk in the medium to long-term, but it is to recognise climate change as a factor which can influence certain risks to, and opportunities for, our business, which we do have the expertise to assess and manage. Other factors which influence our principal underwriting risk include seismic or volcanic activity, political unrest and instability, secular changes in technology and oil price fluctuations, to name a few. We have the great benefit of employing experienced underwriters who are experts in risk appraisal and whose decisions are informed by powerful models and actuarial tools, which factor in thousands of assumptions including some that may be influenced by climate change projections. Climate change risk can also influence asset values within our investment portfolio or present reputational risk to our business in its management. Our conservative investment strategy factors in the exposure of the Group's investment portfolio to a whole range of risk scenarios which might impair the value of assets, and our management and Board remain committed to the prudent day-to-day management of the whole universe of risks which both challenge and present opportunities to our business. Lancashire has also for many years chosen to offset its own greenhouse gas emissions. Please see pages 43 and 44 of our engagement and sustainability report for further details.

Anything else?

I would like to thank all our staff across all our businesses in London and Bermuda, for having contributed to a solid performance delivering positive returns to our shareholders in what has been another challenging year. The skill and dedication of our people remain fundamental to our strategy and its successful delivery. As we start to navigate 2019, I look forward to leading our excellent team in meeting the challenges and developing the exciting opportunities which lie ahead in the coming year.

Alex Maloney
Group Chief Executive Officer