Managing risk and opportunity across the cycle

Peter Clarke
Non-Executive Chairman

How did the business perform during 2018?

Lancashire has generated a return on equity of 2.4 per cent for 2018, which, in view of the challenging loss environment for the second year in succession, reflects the Group's underwriting expertise and effective capital and risk management.

The understanding and management of risk are central to Lancashire's nimble business strategy. Lancashire's longer-term investors will appreciate that over the last few years the (re)insurance sector had witnessed an accumulation of capital and (until 2017) a relative lull in major catastrophe loss activity, which had tended to depress pricing across many of the Group's catastrophe-exposed and specialty product lines. In the face of this challenge, the business had sought to de-risk, cutting back on poorly priced business and increasing its reinsurance protections.

2018 witnessed a steadying of market conditions. In the Group's specialty and catastrophe lines it was reassuring to see evidence of modest improvements in premium rates and a return to underlying top line growth, once premiums are adjusted for the effects of multi-year contracts and the inwards reinstatement premiums resulting from the catastrophe losses in 2017. However, 2018 was another year marked by a relatively high frequency of market loss events, the details of which are addressed by Alex Maloney (see page 14) and Paul Gregory (see page 22). Once again, Lancashire was able to meet the (re)insurance needs of its clients within a robust framework of risk tolerances.

From the perspective of the Board, we were pleased that, within the context of a still challenging (albeit improved) pricing environment, and another year of notable losses to the market, the Group was able to generate a positive return and a respectable combined ratio of 92.2 per cent. Once again I would like to thank Alex, his management team and all our staff for their contributions and in showing the required discipline and expertise necessary for the achievement of a solid result in 2018 in what has been a challenging loss environment.

Please see my introduction to the Governance section of this report on page 48 for an account of the work of the Board and our governance arrangements for the 2018 year.

How do you expect strategy to develop in 2019?

I do not expect Lancashire's strategic priorities to change significantly in 2019. We will continue to focus on underwriting expertise and discipline, to effectively balance the equation of risk and return, and to operate nimbly through the cycle. However, we do hope to see continued improvement in general pricing and conditions, in particular in the specialty insurance lines which we underwrite, and we are cautiously hopeful of achieving managed organic growth in our specialty lines during 2019. Alex discusses these dynamics in greater detail in his review on page 14. We will continue to monitor the capital and human resources, the management and culture necessary for the business to develop these opportunities,

all within an appropriate framework of risk management and tolerances. In his comments on page 14, Alex notes the Brexit planning, which has been carried out in 2018, and the Board will monitor developments during the coming year.

The Board has also decided to re-establish the Group's supervisory and tax domicile in Bermuda, and there is more discussion of this decision and the strategic opportunities it presents on page 48. For this reason the Company's 2019 AGM will be held in Bermuda, with a live shareholder video link from our London office. Details are set out in the Notice of the AGM.

What are the reasonable cross-cycle return expectations for Lancashire's investors?

As a Board we have debated how best to articulate the cross-cycle return target in a way that is helpful to investors and realistic, given the combination in recent years of the general trend towards lower investment returns and the low ebb in the insurance market pricing cycle in which we have found ourselves. Because conditions change over time, the Board does not consider that an absolute cross-cycle target is appropriate. Accordingly, you will see in this Annual Report and Accounts that we have stated our strategic aim as being to maximise risk-adjusted total return to shareholders over the long term. We do not rule out the prospect of a return to the higher returns seen in previous years, but we do consider that the revised strategic aim provides a more useful guide for investors.

Has Lancashire's dividend and capital management strategy changed?

Our dividend and capital management strategy has not changed, and although returns for 2018 were modest, we were pleased to be able to declare and pay a special dividend of $0.20 per common share in the final quarter of 2018 following the wind season. When taken together with the standard ordinary dividends, the aggregate of all dividends for the 2018 year amounts to $0.35 per common share. Lancashire's nimble capital management and dividend strategy is well understood by our shareholders and the dividend policy is set out on page 90 of this Annual Report and Accounts.

As a business we carefully consider the balance of risk and return when setting our capital levels, using capital for underwriting when the opportunity presents itself and returning capital when it is not needed. As we enter 2019, we believe that our capital resources are appropriate for the current market opportunity, but the Board will continue to adopt a flexible approach to capital management. An important tool within Lancashire's active capital management strategy is the flexibility afforded to us by shareholders during the last seven years to issue up to 15 per cent of Lancashire's shares on a non pre-emptive basis. As I have noted in previous years, the best opportunities in the insurance and reinsurance sectors typically arise following major loss events, and the flexibility to issue shares and raise capital quickly is a central pillar of our business strategy and will help the Group maximise underwriting opportunities for the business. Once again, the Company is seeking shareholder support for resolutions at the 2019 AGM allowing this capital management flexibility, and I would encourage all shareholders to vote in favour.

Peter Clarke
Non-Executive Chairman

"Lancashire offers its clients protection against damage arising from catastrophic or severe loss events. Our strategy is to monitor our risk exposures so as to maximise risk-adjusted returns across the insurance cycle."

Return on equity

2.4%

Dividend yield

4.5%