Providing risk solutions in a changing world

Alex Maloney
Group Chief Executive Officer

Our purpose as a business is to deliver bespoke risk solutions which help protect our clients in the face of uncertain loss events. It is therefore central to our strategy to develop and retain underwriters and other experts in risk management with the expertise to appraise and price risk properly and to ensure that we use our capital to support our business whilst delivering sustainable returns to our investors.

Did Lancashire perform as you expected in 2019?

We have generated a strong return on equity of 14.1% and a combined ratio of 80.9%. The return comes from a combination of underwriting and investment returns and represents a good outcome for our shareholders. For me, one of the most pleasing outcomes of these results is that they illustrate that the Lancashire Group has not been materially impacted by the catastrophe reserve deterioration on prior year losses, which has affected some in our industry.

Lancashire has the expertise, the capital, the commercial long-term relationships and the nimble business culture to succeed, and the results for 2019 are testament to the open, honest and sustainable approach we take to underwriting and risk management across the insurance cycle.

How was the Group impacted by the catastrophe losses which occurred in 2019?

With the occurrence during 2019 of typhoons Faxai and Hagibis in Japan and hurricane Dorian in the Caribbean and along the U.S. south-east coastline, we saw the tragic results of catastrophe loss activity. These events once again caused disruption to lives and livelihoods. There were also significant large aviation, energy and political risk losses during the year which have impacted those specialty lines which form a major part of our underwriting portfolio.

As a Group we established aggregate net loss reserves in respect of typhoons Faxai and Hagibis, and hurricane Dorian of $52.1 million. But the 2019 losses must be viewed within the context of the catastrophe losses of 2017 and 2018, which taken together produced the largest aggregate losses to the global insurance market in recent memory.

So, while in economic terms the 2019 losses should be considered relatively unremarkable, the fact that they amount to another sequence of mid-sized catastrophe losses serves to demonstrate the continuing need within the insurance industry for a re-rating of pricing in many traditional property and specialty lines.

What challenges and opportunities do you see over the coming year?

The pressure on insurance risk capital has been further heightened by the recent industry reappraisal of many of the reserving assumptions within the longer-tail casualty classes, and the need to strengthen reserves. Whilst Lancashire has not traditionally operated in the casualty space in any meaningful way, the combination of reserving and pricing pressure across international (re)insurance markets in short-tail catastrophe and specialty lines and in the longer-tail casualty classes has produced an appreciation across our sector that the products we sell need to be sufficiently priced to attract the risk capital on which our industry relies.

> **"During 2019, I was pleased to see controlled top-line growth in our premium income, which was a measured response to an improving market environment. As things stand, we believe the positive pricing trend is likely to continue in many of our core specialty and catastrophe lines in a move towards better pricing."**

Although we are still in the early stages of a necessary market correction, developments over the past year or so have illustrated once again that our industry is cyclical in nature and that the key to long-term sustainable success is to show underwriting discipline across that market cycle.

At Lancashire we have taken the difficult decision over the recent years of the soft market phase of the cycle to shrink our top-line income, which reflected the challenging pricing environment. During 2019, I was pleased to see controlled top-line growth in our premium income, which was a measured response to an improving market environment. As things stand, we believe the positive pricing trend is likely to continue in many of our core specialty and catastrophe lines in a move towards better pricing. However, this cautious optimism should be tempered by the knowledge that in many insurance and reinsurance classes pricing still sits below a level which we consider to be sustainable. So, in what remains a competitively priced market, there will be some opportunities for organic growth. It is central to our strategy to develop and retain underwriters and other experts in risk management with the expertise to appraise and price risk properly, to structure and manage our outwards reinsurance protections and to ensure that we use our capital to support our business whilst delivering sustainable returns to our investors.

Paul Gregory discusses the underwriting environment in more detail in his underwriting review on page 20.

How does climate change affect the longer-term prospects of the Group's business?

As a business we have a relatively small headcount of a little over 200 people and our own carbon footprint (which we offset through the purchase of carbon credits) is small relative to many listed businesses of our market capitalisation (see page 44). Perhaps even more important is the trend over the last three years of the increased frequency and severity of weather-related loss events, which I mentioned above. Such a trend will ultimately be understood and managed over longer time frames. What this illustrates is the value of our insurance and reinsurance products to our clients in managing their climate change risks and exposures, in particular through the catastrophe-exposed property insurance and reinsurance products which we underwrite. Our purpose as a business is to deliver bespoke risk solutions which help our clients manage the threats they face from unpredictable perils. It follows as a central pillar of our strategy and its operation that we monitor and manage our own risk exposures to both weather-related and other catastrophic loss events. Our investment portfolio is conservative in nature and has limited exposure to climate-related risk. As a business, we are a long-term partner of many clients operating in the oil and gas exploration and development sectors and within power generation and distribution. We recognise the potential environmental effects of carbon emissions, and in a global commercial and political environment, which currently remains reliant on carbon-based forms of energy production, we will work with our clients through a period of global energy transition to help manage their operational and catastrophe-exposure risks in a controlled and responsible way. We also insure many clients in the renewable energy sector, and in this regard please see Paul Gregory's introduction to the underwriting review on page 20. We have also decided to become signatories to the UN Principles for Sustainable Insurance (see pages 52 to 54). Our strategy is to respond nimbly to the demands of a changing world, and we believe this flexibility will help guarantee viability over the longer term.

How has the Group developed the Lancashire brand recently?

We have made a few name changes to our Lloyd's and reinsurance third-party capital management platforms. Our Lloyd's managing agent, Cathedral Underwriting Limited, has changed its name to Lancashire Syndicates Limited (LSL), and our third-party capital management operation, Kinesis Capital Management Limited, has changed its name to Lancashire Capital Management (LCM). There has been no change to the ownership or operation of these businesses. This helps clearly align the 'Lancashire' name and brand across all platforms within the Lancashire Group of companies.

Can you tell us about the developments in the Group executive team and business over the last year?

We announced in May 2019 that, after slightly more than 13 years of service at Lancashire, Elaine Whelan decided to retire from the Group and will step down as our Group CFO and from the LHL Board at the end of February 2020. Personally, I would like to thank Elaine for her years of support and advice to me and to our business. Elaine has been one of the architects of our successful strategy over many years, in particular in the area of our nimble capital management and the delivery of strong cross-cycle returns to our shareholders.

As we say farewell to Elaine, I am pleased to welcome Natalie Kershaw as Elaine's successor to the role of Group CFO and a member of the LHL Board (see page 49 for more details). During the year we have also seen the progression of other colleagues within the Group. Emma Woolley became CEO at LSL, John Cadman (our Group General Counsel) became CEO at LUK, and Hayley Johnston will become our Bermuda CEO at LICL, replacing Elaine in that role. James Flude will assume the role of our LUK CUO, replacing Hayley, subject to regulatory approval.

I would like to thank these and all our staff across our businesses in London and Bermuda, for having contributed to a strong performance for the year. I look forward to leading our excellent team in meeting the challenges and developing the opportunities in the year ahead, which has the potential to be a more interesting phase of the insurance and reinsurance market cycle.

Alex Maloney
Group Chief Executive Officer