

# Building on strong foundations

"We have laid robust foundations for an exciting period of growth as we enter a better priced 'harder market' in 2021."



Alex Maloney  
Group Chief Executive Officer

In a challenging year we have both strengthened and broadened our underwriting teams and our client and investor relationships.

## How did the business perform in 2020?

The fundamental requirement for any good building is a strong foundation. So, despite the challenges we have faced during the year, I am pleased and excited at the progress we have made to optimise the underwriting opportunity which now lies ahead. The Group's combined ratio of 107.8% and profit after tax of \$4.2 million represent a resilient outcome in an exceptional year in which we faced the challenges of the COVID-19 pandemic as well as a series of natural catastrophe and specialty risk losses that have challenged our profitability. However, in this context, the positive Change in the Group's FCBVS of 10.2% for 2020 demonstrates how we have grown our capital base to build out our business in anticipation of a materially better pricing environment.

## What were the impacts of the COVID-19 pandemic on the Group?

As the first lockdown began in March 2020, we were obliged to require all our colleagues to work from home. It is a credit to all our workforce that we were able to adapt so quickly to the changed working environment. Particular thanks must go to our IT team, who dealt rapidly and responsively with the changed requirements to ensure that we were all well-supported working from our homes. It is also testament to the strength of communication between our underwriters and our brokers that we were not only able to carry on servicing the needs of our clients as usual, but also to grow our revenues and underwriting footprint. Whilst the full impacts of the pandemic remain uncertain, there is now cause for hope of a return to a more usual level of 'normality' through the various vaccination and testing initiatives which are now gaining traction. The London and international property and specialty markets are 'people businesses', and whilst the last year has shown us that remote engagement has been a workable solution for Lancashire, I look forward to the time when we can re-establish the face-to-face contact which helps reinforce the relationships of trust and good faith on which our market depends.

As Peter noted earlier, we have carried out a rigorous appraisal of the Group's exposures to COVID-19 losses. The short-tail property and specialty policies which we typically underwrite tend to respond to first party physical damage. So, whilst we expect to have some peripheral exposures, we cautiously expect that we have not assumed material COVID-19 exposure through direct consumer, mortgage business and business interruption coverages. Whilst COVID-19 and its related losses are ongoing and a level of uncertainty remains, I have been pleased with the thoroughness of our reserving process and the relatively modest changes in our ultimate COVID-19 reserves as the year progressed.

## How is the business positioned for the future?

Lancashire is entering a period of real opportunity. Since I became Group CEO, I have talked about my understanding of insurance as a cyclical business which is inherently subject to cycles of changing capital, supply and demand and pricing. During the recent years of the

Combined ratio

107.8%



'soft market cycle', we saw a steady accumulation and inflow of new capital within the insurance space which led to year-on-year price reductions. Lancashire prioritised the discipline of insisting on the right technical price for risks and serving our core clients, which resulted in a managed reduction of our top line and the corresponding risk capital needed by our business. But we are now reaping the rewards of that discipline as we enter an improved part of the insurance cycle.

The last year has been an important transitional year in which we have built up our underwriting expertise in our existing classes and in new business lines. We have added and developed expertise in accident and health, specialty reinsurance and casualty reinsurance. On our existing underwriting portfolio, whilst we have seen variations in pricing improvements, we have seen a strongly improving pricing trend illustrated by the Group's cross-class RPIs, which show a like-for-like improvement in insurance pricing of 112% for the full year, on a risk adjusted basis. I spend a lot of my time talking to our core investors about Lancashire's strategy and management of the cycle. So, I was excited to have the opportunity to speak to many of them at the time of our equity placement in June 2020. We were able to raise \$340.3 million of new capital to fund future growth. That capital augments our already robust capital base and remains at our disposal to develop existing new underwriting opportunities as we enter 2021.

### How has the Group's risk appetite changed?

As Lancashire is able to underwrite better priced insurance and reinsurance risk on our inwards book of business, we have also seen a corresponding increase in the cost of our outwards reinsurance policies, which has led us to adjust the structure of the Group's suite of reinsurance protections. In simple terms, we expect the anticipated increase in the Group's premium income in 2021 to result in increased exposures. This is consistent with our long-term strategy of retaining more, better-priced, risk in the 'harder' part of the insurance cycle by putting more of our own risk capital to work on more favourable terms.

### How do you ensure the sustainability of Lancashire's business and strategy?

The issue of sustainability has always been a part of our business model and, as such, should not be over thought. Our core purpose and strategy are to provide risk solutions to our clients who face the challenges of an uncertain world. To do that sustainably over time we have operated a business and a culture with the skills and ability to manage our risk exposure, our pricing and our capital. We help our clients mutualise risk between themselves and with our investors and other capital providers, and that brings with it broader benefits and commercial resilience for the wider society.

Through the work of the Lancashire Foundation, we have a strong history of support for those in society who need our help, and a good record of personal staff commitment of both time and money across the Group. During 2020, the Foundation worked with several partner charities to alleviate the social disruption and harm caused by the COVID-19 pandemic, as well as funding various programmes which support those less able to manage the catastrophic impacts of climate change. The Foundation's activities included a 'London to Bermuda exercise challenge', which helped keep us all active and also raised money for good causes during the autumn. A more detailed report of the work of the Foundation can be found on page 55.

### How does the business address the challenges of climate change?

Since Lancashire's formation in 2005, we have monitored and controlled our exposures to a range of natural catastrophe and weather-related risks. There is now a strong scientific consensus that climate change is a risk factor which drives many of those catastrophe events that can impact our business. We have the underwriting and actuarial modelling skills to understand and price these risks. Moreover, we can usually adapt our view of exposure to these risks and price for them on a very nimble basis. We have also started to evaluate the resilience of our investment portfolio to climate change sensitivities; see the Investment Committee report on page 76 for details. So, whilst we are taking steps to enhance our climate change risk understanding and management and in addressing the requirements of the TCFD, on which we report on pages 58 to 61, we have a head start in having a long tradition of appraising, pricing and exposure management for weather-related natural catastrophe risks.

For many years Lancashire has been a risk partner of businesses operating in the energy sector across the world, including oil, gas, nuclear and other renewables. The risk solutions which we provide to the energy sector help deliver the wider social benefits of safer operations in a properly regulated environment with access to capital resources to quickly repair and remediate damage in the event of accidents or catastrophic failure. We share with our clients the journey required by the necessary transition away from carbon-based forms of energy. But there are no simple solutions to both meet global energy demand and reduce carbon emissions and we remain committed to supporting our clients across the energy sector as they address these challenges.

### Why is Lancashire building an underwriting capability in the casualty reinsurance classes?

Our management team has debated for many years whether the Group should develop expertise in casualty. Although we have had over some years limited ancillary casualty exposures on several of our existing lines of business, such as energy and marine, the Group has traditionally underwritten a predominantly short-tail book of business. In 2020, we identified an opportunity to start underwriting casualty reinsurance as a new class within our Bermuda platform. Our initial plans are modest, and we expect the top-line contribution in the initial years to be small relative to our established books of business. Our new casualty reinsurance class, which is to be underwritten on a proportional and excess of loss basis, will strengthen and broaden our product offering and enable us to deepen relationships with some of our existing property and specialty reinsured clients, who may also be seeking casualty reinsurance protection. So, this should not be seen as a fundamental change of strategy or direction, but indicative of our intention to broaden our expertise and relationships and to develop a wider range of strategic opportunities whilst more favourable market conditions allow.



**Alex Maloney**  
Group Chief Executive Officer