Planning for sustainable growth

"As we enter 2021, our capital resources and risk appetites are matched to the current exciting market opportunity."

Peter Clarke
Non-Executive Chairman

The best buildings sit on solid foundations. In recent years, through the softer part of the market cycle, our Board and management team have focused on the fundamental strategic buildings blocks of strong underwriting and technical skills, a core client base, rigorous risk and capital management, engaged shareholders, nimble governance, good regulatory relationships and a healthy corporate culture. We have made the necessary preparations to build our business in what we expect to be a better priced and more sustainable market.

How did the business perform in 2020?

This last year has posed exceptional challenges in the areas of health and stability to individuals, societies and to the global economy and commerce. Our thoughts go out to those whose lives and livelihoods have been impacted and to those key workers whose service has helped sustain us all. Much of the Board's focus has been on monitoring the operational and strategic impacts of the pandemic on our business. I would like to thank Alex and all our team for the resilience demonstrated by the Group's operation and performance. The Group has faced a number of challenges this year. These related not only to the COVID-19 pandemic but also included a run of natural catastrophe losses, that were broadly in line with our expectations for such events, and a series of medium-sized risk losses above our usual expectations for attritional losses. The combined ratio of 107.8% represents the Group's strong risk management in this exceptional year. Lancashire has generated a positive Change in FCBVS of 10.2% for 2020, which is a reflection of the Group's active and strategic capital management, operational performance and the contribution of the June 2020 equity raise, which places the business in a strong capital position to take full advantage of the improvements in the pricing environment.

What were the strategic priorities for the Board during the year?

The single most important area of focus for the Board has been discussion with the management team around the strategic commercial opportunities that started to develop compellingly as insurance market pricing strengthened during the year. This has shaped our capital management decisions, and in particular our engagement with our shareholders which resulted in our decision to launch our equity placing in June 2020.

The business has actively developed improved and new opportunities both in growing our existing lines of business and in adding new lines, as Alex and Paul discuss elsewhere in this Annual Report and Accounts. The decision to develop a greater level of casualty underwriting expertise marks a strategic development for Lancashire, which has traditionally had a focus on shorter-tail property and specialty lines. The Board is comfortable with the plans to develop casualty capability and expertise within the business.

Equity capital raised in 2020

$340.3m

What were the other principal areas of Board focus during the year?

Our Board has discussed issues of sustainability, in particular concerning the understanding and management of climate change risks. Our business has always had a strong and purposeful focus on its insurance liability exposures to weather-related events, such as windstorms, floods and wildfires, which are sensitive to climate change trends. The Board and management team have taken steps to broaden the formal oversight, strategic understanding, risk management and forward-looking scenario testing of climate change risk and opportunity. We have taken further steps on the journey to implement the recommendations of the TCFD, in particular in starting to utilise tools for the understanding of climate change risk on the Group's investment portfolio. We have also debated societal changes, including the emergence of the Black Lives Matter movement, and we reaffirm the Group's commitment to building a business which will continue to encourage and reap the benefits of an open, honest and diverse culture. For the second year running we will be reporting by reference to the United Nations Principles for Sustainable Development.

How have the capital requirements of the business changed?

The Board reviews the capital requirements of the business on a quarterly basis and considers the Group's capital headroom under several measures. Natalie Kershaw, who became our Group CFO in March 2020, has helped the Board deepen and develop its understanding of the capital requirements of the business and has also reformulated and refreshed the Group's business planning processes.

In early 2020, we were comfortable that our capital at that point was well matched to the Group's underwriting exposures. However, management's view of the rapidly improving underwriting environment prompted our decision in June to initiate a dialogue with our major shareholders and we subsequently raised fresh equity capital. This initiative was not driven by the need to 'fill a balance sheet hole', but instead to take advantage of the exciting underwriting opportunities which management and the Board believe will develop during 2021 and beyond. The Board paid close regard to the guidance issued by the Pre-Emption Group and the Lancashire shares issued in June 2020 were priced at a level which both maximised participation from our existing shareholders and raised the capital needed for the growth opportunities which we believe lie ahead. We would like to thank our investors for their support in this exercise and in providing the risk capital necessary to develop the exciting strategic market opportunity.

How has the Group changed the reporting measures used in the Annual Report and Accounts?

In previous years we have used the term RoE to describe the Group's growth in fully converted book value per share adjusted for dividends. This has been, and remains, one of the key measures of our overall financial performance, as well as being reflective of our capital management strategy. Further to constructive discussion with our auditors, KPMG LLP, on the use of Alternative Performance Measures (APMs) used in our financial reporting, and on recommendation from Natalie Kershaw, we have decided that the use of the term 'Change in FCBVS' to describe this key performance measure will aid clarity. Our finance team has also ensured that this report contains the necessary inputs and information for our stakeholders to understand this and our other APMs.

How did the Board and business address the challenges of the COVID-19 pandemic?

Following the 2019 year end meetings in February 2020, at which the Board discussed the potential impacts of COVID-19, the global pandemic developed rapidly causing a series of government directed restrictions on travel and national lockdowns. The Board closely monitored the operational and strategic impacts of the pandemic on our business and we were very impressed with the resilience shown by our operations in both London and Bermuda, which adeptly moved to a combination of home and office-based working during the year. A true reflection of our 'nimble' culture was the ability of the business to grow its top-line premium income in a strengthening market, even whilst adapting to a new way of working. The Group did not need to use furlough or other government relief schemes and there was measured net growth in headcount to equip the business to meet the growth opportunity.

The Board also focused on COVID-19 as a liability issue for the business and we monitored the rigorous reserving process which was conducted at an early stage of the pandemic and reviewed regularly throughout the year. As we report later, our COVID-19 reserve has been established on a prudent basis and has not deteriorated materially throughout the year. Whilst the pandemic is ongoing and its full effects remain uncertain, we are comfortable that the Group has strong processes in place to monitor potential exposures. This sense of assurance also relates to the series of natural catastrophe and risk losses which impacted the markets in the third and fourth quarters of 2020, where the Board has engaged constructively with our management and is satisfied that the Group's exposures to these losses have been well understood and reserved for.

In terms of the operation of our governance, we acted quickly to facilitate the virtual operation of our 2020 AGM and the Board itself has used a combination of virtual and in-person meetings during the course of the year.

How has the Board's dividend strategy changed?

Our dividend and capital management strategy has not changed. The Group paid its usual interim dividend during 2020 and proposes to make a final ordinary dividend distribution subject to a shareholder vote at the April 2021 AGM. Details are set out in the Notice of the AGM. In view of the expected improvement in (re)insurance pricing the Board has decided to retain most of the Group's current capital in order to develop this opportunity. Accordingly, the Board has decided not to declare a special dividend in respect of the 2020 financial year.

Assuming shareholder approval, the aggregate of all dividends for the 2020 year will amount to $0.15 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 105 of this Annual Report and Accounts.

Peter Clarke
Non-Executive Chairman