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Gard Group

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Gard Group

SACP* Assessments				SACP*		Support		Ratings		
Anchor	a+	+	Modifiers	0	=	a+	+	0	=	Financial Strength Rating
Business Risk			ERM and Management	0		Liquidity	0	Group Support	0	A+/Stable/--
Strong			Holistic Analysis	0		Sovereign Risk	0	Gov't Support	0	
Financial Risk										
Extremely Strong										

*Stand-alone credit profile.
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

Rationale

Business Risk Profile: Strong

- Gard has a strong competitive position supported by significant barriers to entry in the protection and indemnity sector.
- Through its ownership of Gard Marine & Energy Ltd. (Gard M&E), Gard is also one of the largest marine insurers globally.
- Favorable brand recognition and diversification within the marine insurance sector.

Financial Risk Profile: Extremely Strong

- Extremely strong risk-based capital adequacy and wide capital base.
- Protection and indemnity (P&I) sector relatively volatile.
- Strong financial flexibility based on its ability to make unbudgeted supplementary calls and impose significant premium increases for its mutual business.

Other Factors

Gard's strong enterprise risk management (ERM) implies that it has the ability to appropriately manage its capital such that its capitalization continues to support the ratings.

Outlook: Stable

The stable outlook reflects our view that the group's earnings are likely to support its capital adequacy such that our assessment of its capital and earnings does not fall below strong. Furthermore, we expect the group to maintain its strong business risk profile through the strength of its brand.

Downside scenario

We do not expect to lower the ratings in the next two years. However, we could do so if the group's risk-based capital adequacy falls below the 'AA' (very strong) range, or if operating performance materially deteriorates below our expectations during the next two years. This could result from Gard suffering substantial investment losses outside its risk tolerance.

Upside scenario

We do not anticipate raising the ratings during the next two years. Gard already enjoys an extremely strong financial risk profile, our highest assessment, and a stronger business risk profile would require considerable diversification away from the marine sector.

Base-Case Scenario**Macroeconomic Assumptions**

- Global shipping companies will continue to face difficult operating conditions in 2018, characterized by fragile demand and chronic structural oversupply in the industry.
- Charter rates might finally be bottoming out in subsectors such as drybulk, container liner, and liquefied natural gas shipping. That said, they remain subdued and this, combined with the rising price of the oil-based fuel used to run ships (bunker fuel), will continue to constrain cash flow generation for most ship operators.
- Neither the IG pool structure nor the pool sharing methodology will change significantly.
- Increased capacity in the reinsurance markets will continue to have a positive impact on IG group reinsurance and retention protection premium and terms.
- Competition will continue to increase in the fixed premium business with all IG clubs now offering a fixed premium alternative in some form.

Company-Specific Assumptions

- Gard will retain its position as the largest IG club, as measured by gross written premium and total assets. We expect gross written premiums to be around \$770 million in FY2018 (assuming no deferred call rebate).
- A combined (loss and expense) ratio of 85% in FY2018, reflecting loss experience in 2016 to date. For FY2019-FY2020, we expect loss experience to normalize and for the combined ratio to revert to 95%-100%.
- We expect that investment profit will bolster Gard's FY2018 profit to about \$120 million, before reverting closer to historical norms of \$40 million-\$50 million in FY2019 and FY2020.
- We expect the group's risk-based capital to be managed at 'AAA' (extremely strong) using S&P Global Ratings' model over the next three years.

Key Metrics

	2019F	2018F	2017	2016	2015
Net Earned Premiums (\$ mil.)	610.0	620.0	617.2	727.5	804.7
Net Income (\$ mil.)	45.0	120.0	124.7	48.1	49.5
P/C Net Combined Ratio (%)	95-100	85.0	95.2	86.8	92.4
Net Investment Yield (%)	1.0	1.0	1.5	2.0	2.0
S&P Capital Adequacy	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Very Strong

Company Description

Gard P&I was established in Norway in 1907 as a marine mutual P&I club. Measured by size of gross premium calls, total assets, and free reserves, Gard P&I is the largest of the 13 global P&I clubs that make up the International Group of P&I clubs.

Gard P&I (Bermuda) Ltd. underwrites the majority of direct insurance business, with the rest written by its subsidiary Assuranceforeningen Gard (AF Gard), domiciled in Norway. The members of Gard P&I (Bermuda) Ltd. are also members of AF Gard and vice versa. All members of the two associations exercise membership rights through Gard P&I (Bermuda) Ltd. as the parent company in accordance with the group structure. In AF Gard's articles of association, Gard P&I (Bermuda) Ltd. can exercise membership rights on behalf of the entire membership of AF Gard, which means that Gard P&I (Bermuda) Ltd. governs and controls AF Gard's business activities. The Bermudian association assumes 25% of AF Gard's risk via a quota share reinsurance arrangement, while AF Gard assumes 2% of the risks incurred in relation to members directly entered into the Bermudian association.

Gard Marine & Energy Ltd. is a wholly owned subsidiary of Gard P&I (Bermuda) Ltd. and underwrites direct marine and energy risks. Gard Reinsurance Co. Ltd. (Gard Re), a Bermuda-based captive reinsurer, was established in 2010. Both Gard P&I (Bermuda) Ltd. and Gard Marine & Energy Ltd. cede about 50% of their retained business (after external reinsurance) to Gard Re. A further subsidiary, Gard Marine & Energy Europe, in turn cedes 70% of its business to Gard Marine & Energy.

Business Risk Profile: Strong

Insurance industry and country risk: Globally diverse insurance operations limited by high product risk

We consider Gard's industry and country risk to be intermediate, reflecting our assessment of the global marine P&I sector. For the purposes of our industry and country risk analysis, we view Gard's marine business as global P&I. In our opinion, the risk profiles of the two industries are similar.

We assess country risk as low. This reflects the fact that P&I insurers' exposures are heavily weighted to developed markets, most of which present low country risk. Since we do not anticipate any significant shift in the P&I sector's weighting to developed markets with low country risk, it is unlikely that we would need to revise our view of the sector's country risk. We believe the domicile of a P&I insurer has relatively little impact on the aggregate industry and country risks it faces and therefore we do not differentiate by domicile.

Our industry risk score is moderate. Although we see profitability and product risk as negative, these factors are offset by the sector's operational barriers to entry.

Shipowners' earnings have been relatively stable over the last 12 months, though still at historically low levels. The world fleet grew by 4% in 2016, however we expect vessel numbers to fall because fewer new vessels are being delivered.

One of the key strengths of the global marine P&I sector is the IG, which provides the sector with a high barrier to entry. A weakening of the IG's position in the marine market would probably lead us to revise our view of industry risk and change our overall view of industry and country risk to moderate.

The mutual marine sector is less focused on profitability than other sectors and is more exposed to high-risk assets than other non-life insurers, which increases earnings volatility. The size and frequency of claims are also unpredictable, increasing product risk.

Despite an improvement in underwriting profitability over the last four years, and in our short-term forecasts, we continue to view the global P&I insurance sector's profitability as negative. Our view reflects the inherent volatility in operating results and still significant reliance on investment returns to bolster earnings. We view as a negative the potential for product risks to trigger earnings volatility. The nature of the business is such that it is susceptible to the random size and frequency of claims, as reflected in the high year-on-year variation in combined ratios. We consider the barriers to entry for the global P&I insurance sector to be positive. This assessment incorporates regulatory and operational barriers; we view the former as low and the latter as high.

We do not expect our assessment of country and industry risk to change over the next two years.

Table 1

Gard Group Competitive Position					
\$ 000s	Fiscal year end Feb. 20				
	2017	2016	2015	2014	2013
Gross premiums written	734,561	873,941	953,277	923,863	853,494

Table 1

Gard Group Competitive Position (cont.)					
\$ 000s	Fiscal year end Feb. 20				
	2017	2016	2015	2014	2013
Change in Gross Premiums Written (%)	(15.94)	(8.32)	3.18	8.24	2.85
Net premiums written	586,154	702,890	797,026	738,684	678,263
Change in Net Premiums Written (%)	(16.61)	(11.81)	7.90	8.91	2.72
P/C: reinsurance utilization - premiums written (%)	20.20	19.57	16.39	20.04	20.53

Competitive position: The leading player within the IG pool and supported by its diversification into the M&E business

Gard has a strong competitive position, in our view, mainly stemming from its leading position within the International Group of Protection and Indemnity Clubs (IG), a group of 13 mutual marine clubs providing P&I insurance cover to more than 90% of world shipping. Members operate within the framework of the IG Agreement (IGA) and benefit from a substantial excess-of-loss reinsurance program and the pooling of risks. The IG's dominance of the P&I market is the key factor in our assessment of the operational barriers to entry. Historically, non-IG players and fixed-premium providers have had limited success in the sector.

The significant barriers to entry within P&I insurance support Gard's strong competitive position. Gard is the largest and most widely respected of the 13 IG clubs. It has a P&I market share of about 17.2%, as measured by gross premiums. Members' owned tonnage was 220.2 million gross register tonnage (grt) as of August 2017. Through its ownership of Gard Marine & Energy Ltd. (Gard M&E), Gard is also one of the largest marine insurers globally.

Marine markets will likely remain soft over FY2018-2019, reflecting in part the difficulties of the shipping sector as a whole. Gard's premium base fell from GWP of \$874 million in FY2016 to \$824 million in FY2017. In addition to this natural decline, the Club's strong capital position has allowed it to waiving the deferred call for mutual members, reducing premium by \$90 million.

In the February 2017 renewals, rates were up 0.7%. Tonnage was up modestly by 1 million grt, however insured values were down 10%, in part as two significant accounts were not renewed. Tonnage continued to grow modestly in the first half (H1) of FY2018. Consequently half year 2018 GWP was \$372 million, 14% down on H1 2017. This is a significant decline, but in line with the marine sector and also reflective of Gard's continued underwriting discipline (as evidenced in the 77% combined ratio for H1 2018). Assuming no call waiver, we anticipate that net earned premiums for FY2018 will be around \$620 million. While nominally higher than the \$617 million of FY2017, the latter figure was unnaturally depressed by the waiver of the deferred call and on a like-for-like basis our assumption would be equivalent to a 15% fall in NEP. We expect broadly flat and then modestly growing premiums in FY2019 and FY2020, respectively.

Financial Risk Profile: Extremely Strong

Capital and earnings: Outperforming rivals, and the capital base is solid

Gard's capitalization is now securely established at over \$1 billion (\$1.152 billion at August 2017). Moreover, with the

shrinkage of premium in 2017, the strain on Gard's capital base has diminished and consequently its capital surplus over the 'AAA' threshold on our model has increased. We expect premiums to be lower again in 2018 and Gard plans to increase capital in line with business growth when such growth returns. Even allowing for Gard maintaining its recent habit of reduced deferred calls, we expect the capital base to remain above \$1 billion over our three-year rating horizon.

In FY2017 the group reported a combined ratio of 83% on estimated call basis, similar to 2016. The combined ratio for P&I was 75%, and for Marine & Energy it was 103%. This result was a combination of good risk selection and a better-than-expected claims environment. Gard did not call the final installment of the year's premiums. This amounted to \$89 million. Deducting this from premiums raises the combined ratio to 95%. Nevertheless, Gard's recent performance compares favorably to its peers within the IG.

Gard's combined ratio as of HY 2018 was 77%. With strong investment returns adding up to a H1 profit of \$148 million. Even conservative assumptions for H2 2018 should see a triple-digit profit for the year as a whole (prior to any premium deferral). Looking further forward, we envisage that combined ratios and investment returns will revert to recent norms and that combined ratios in the high 90s (comparing favorably to a peer average of around 100%) will lead to annual profits of \$40 million-\$50 million.

Table 2

Gard Group Capitalization Statistics					
	Fiscal year end Feb. 20				
\$ 000s	2017	2016	2015	2014	2013
Common shareholders' equity	1,134,863	1,017,160	969,053	944,587	895,255
Change in common shareholders' equity (%)	11.57	4.96	2.59	5.51	8.37
Total reported capital	1,134,863	1,017,160	969,053	944,587	895,255
Change in total capital (reported) (%)	12	5	3	6	8

Table 3

Gard Group Earnings Statistics					
	Fiscal year end Feb. 20				
\$ 000s	2016	2015	2014	2013	2012
Total revenue	654,647	771,064	851,186	755,839	706,434
EBIT adjusted	66,063	155,416	77,128	6,253	-16,449
EBITDA adjusted	69,017	158,972	83,040	6,253	-16,449
Net income (attributable to all shareholders)	124,748	48,109	49,480	44,307	69,175
Return on revenue (%)	10.09	20.16	9.06	0.83	(2.33)
Return on shareholders' equity (reported) (%)	11.59	4.84	5.17	4.82	8.04
P/C: net loss ratio (%)	79.89	73.16	78.40	88.17	88.09
P/C: net combined ratio (%)	95.18	86.83	92.37	101.75	106.07

Risk position: Well-managed, but with above average exposure to high-risk assets

While marine P&I can be a volatile business line, we see Gard's strong track record of producing stable and profitable technical returns as positive.

Gard has material exposure to high-risk assets. The level of market risk in its balance sheet is high compared with non-life insurance industry norms. Market risk stems from high-risk assets such as equities and real estate funds. These exposures create potential volatility in its capital and earnings. That said, the group has managed this well in recent years, demonstrating its strong ERM.

As of February 2017, bonds accounted for 59% of the group's total invested assets, equities 18%, and real estate 4%, which is broadly in line with its strategic asset allocation. We expect the asset mix to remain broadly similar to the current level over the next two years. The portfolio is well spread by sector and obligor. The portfolio returned a positive ROL of 3.7% in the year to February 2017 and 3.7% in H1 FY2018.

Gard matches liabilities by currency and duration. The average duration of Gard's bond portfolio, at about three years, is consistent with the company's estimate of the duration of the respective underlying liabilities, which is two years for the P&I business and one-and-a-half years for M&E.

Gard significantly reduced its exposure to its defined benefit pension scheme in December 2015 by closing it to accrual for the great majority of members and transferring paid-up contributions to a specialist life provider. We view this positively as it has reduced balance sheet volatility.

Table 4

Gard Group Risk Position	Fiscal year end Feb. 20				
	2016	2015	2014	2013	2012
\$ 000s					
Total invested assets	2,503,090	2,355,546	2,239,374	2,220,853	2,055,696
Cash and short term investments (%)	11.55	9.87	7.33	10.39	7.00
Bonds (%)	42.10	46.77	57.64	55.34	61.84
Equity investments (%)	37.38	37.90	33.23	30.66	25.78
Real Estate (%)	1.11	1.07	1.30	1.59	2.02
Other investments (%)	7.86	4.39	0.50	2.03	3.37

Financial flexibility: Unlimited call options

Financial flexibility (defined as the ability to source capital relative to capital requirements) remains strong, based on the club's ability to collect unlimited additional premiums (by making unbudgeted supplementary calls) from members on open policy years or impose significant premium increases at renewal. However, the club's financial flexibility is not quite as strong as for some of its peers because this ability applies only to the P&I club's mutual members (accounting for about 57% of total premium), and not to Gard M&E policyholders or fixed premium P&I business.

Other Assessments

Enterprise risk management: We view risk management culture and models as positive

We assess Gard's ERM as strong overall, and we believe it is highly unlikely that Gard will experience losses outside of its risk tolerances. We consider ERM to be of high importance because the club is exposed to potential earnings volatility from investment risk and potential exposure to large losses, notably in its non-mutual business. The major factors supporting the overall strong ERM assessment are our positive views of risk management culture, risk models,

strategic risk management, and controls for material risks (insurance, reserving, and investments). Gard's strong ERM implies that it has the ability to appropriately manage its capital such that its capitalization continues to support the ratings.

Management and Governance: Cost-effective access to legal, technical, and administrative capabilities, and a focus on meeting members' needs

Gard's management and governance is satisfactory, in our opinion. The group has cost-effective access to world-class legal, technical, and administrative capabilities. This enables it to assist members and clients in the marine industries to manage risk and its consequences.

Liquidity: Strong, supported by a liquid portfolio

Our view of the group's liquidity reflects the strength of the liquidity sources available to it. The main source is a liquid asset portfolio of \$2 billion, but the group also has a committed funding line of \$40 million. Were claims to increase in size or frequency, we would consider the group well positioned to meet any liquidity needs that may arise, largely because of the generally very strong credit quality of its bond portfolio.

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Insurance - General: A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models, Jan. 24, 2011
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of December 5, 2017)

Operating Company Covered By This Report

Gard P&I (Bermuda) Ltd.

Financial Strength Rating

Local Currency

A+/Stable/--

Counterparty Credit Rating

Local Currency

A+/Stable/--

Domicile

Bermuda

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