

The Global 2019 Protection And Indemnity Renewal: Who Will Blink First?

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Key Takeaways

- S&P Global Ratings expects that the trend of protection and indemnity clubs making no general increases will continue at the 2019 renewal season due to their strong capitalization.
- However, the clubs' margins are increasingly squeezed and, in our view, general increases will return at the 2020 renewal, although at a subdued level.
- We anticipate that roughly half of the international group clubs will return premium to members in 2019.
- In this context, we expect the next 12 months to be relatively quiet in terms of rating actions, with the sector's robust capitalization providing some breathing room despite narrowing margins.

PRIMARY CREDIT ANALYST

Robert J Greensted
London
+ 44 20 7176 7095
robert.greensted
@spglobal.com

SECONDARY CONTACTS

Ali Karakuyu
London
(44) 20-7176-7301
ali.karakuyu
@spglobal.com

Mark D Nicholson
London
(44) 20-7176-7991
mark.nicholson
@spglobal.com

The chance of protection and indemnity (P&I) clubs hiking up their premiums may be slim this year and next, but if one of the marine insurers jumps then others could follow. However, asking for a general increase when clubs are well capitalized but the shipping industry faces challenges would evoke a negative sentiment and in our view, is unlikely until the 2020 renewal season. In this article, S&P Global Ratings will lay out its expectations for the 2019 renewal, the likelihood of clubs returning premium to members, and our forecasts for full-year profits and capital adequacy.

For the international group (IG) of 13 P&I clubs, October marks the beginning of the renewal period for their mutual business that incept on Feb. 20, 2019. During October, most clubs traditionally announce the level of general (premium) increase that members can expect to be quoted to renew their policies. Historically most clubs record an increase just below the level they announce, however it provides a solid indication of whether a club's renewing premium can be expected to grow or shrink in the next year.

Capitalization Is Strong, Margins Are Narrowing

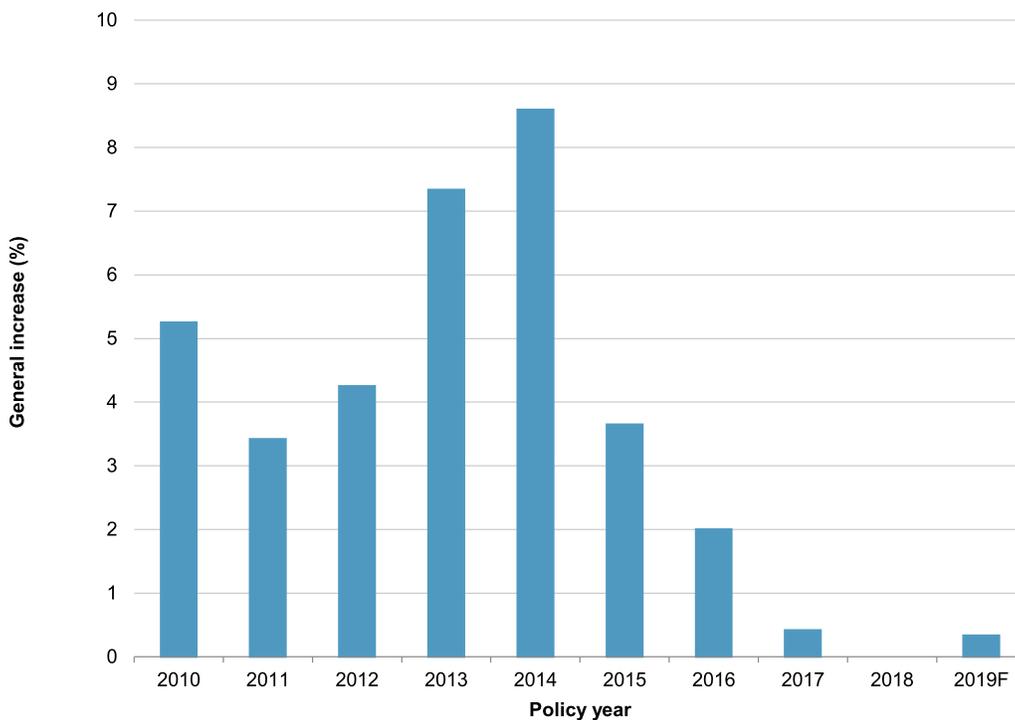
The renewal for the year 2018/2019 (starting in October 2017) saw a zero general increase across the board for P&I clubs. In the year before that, only one club asked for an increase, and that was

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only for 5%. The last year to see a material rise in premium was the renewal of the 2014 policy year when all 13 clubs asked for increases, which averaged just under 9%. The lack of significant increases in recent years reflects the IG clubs' strength of capital; their combined free reserves rose to \$5.6 billion in 2018 from \$4.3 billion in 2014. The increase in capital has resulted from improved underwriting performance after 2014, with the clubs benefiting from previous large general increases; comparatively subdued levels of claims to the pool system (that is, claims in excess of \$10 million); and robust returns from the equity market. However, in recent years, IG clubs' underwriting margins have narrowed, with the simple average of combined ratios moving to 101% at year-end 2018 from close to 93% in 2015.

Chart 1

Subdued General Increases Since 2014



F--S&P Global Ratings forecast. Source: Aon UK Ltd.

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S&P Global Ratings' Renewal Expectations

Deteriorating results and underwriting profitability would normally result in general increases from the majority of the clubs. However, we expect that at the 2019 renewal, only one club will ask for a general increase and that it will be relatively small. We note however, that in the case of the 2018 and 2019 renewal periods, it may come down to which club is the "first to blink." If one of the first clubs to announce its position were to ask for a general increase, other clubs might follow suit, even if they would not otherwise have done. Clubs hesitate to take this action because of their robust capital positions. We expect 10 out of the 13 clubs to report capital levels above our 'AAA' level under our risk-based model at year-end; many have a comfortable surplus above the

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'AAA' level. Holding significant levels of capital while the shipping sector is still suffering from low freight rates and oversupply, makes asking for general increases difficult. This is particularly because many P&I brokers have made their expectation of a zero general increase very clear. We expect the majority of clubs will have to wait until the 2020 renewal before general increases will be acceptable to their members. Even then, we would anticipate the level of increase to be small and likely not sufficient to make up for some under-pricing in the sector.

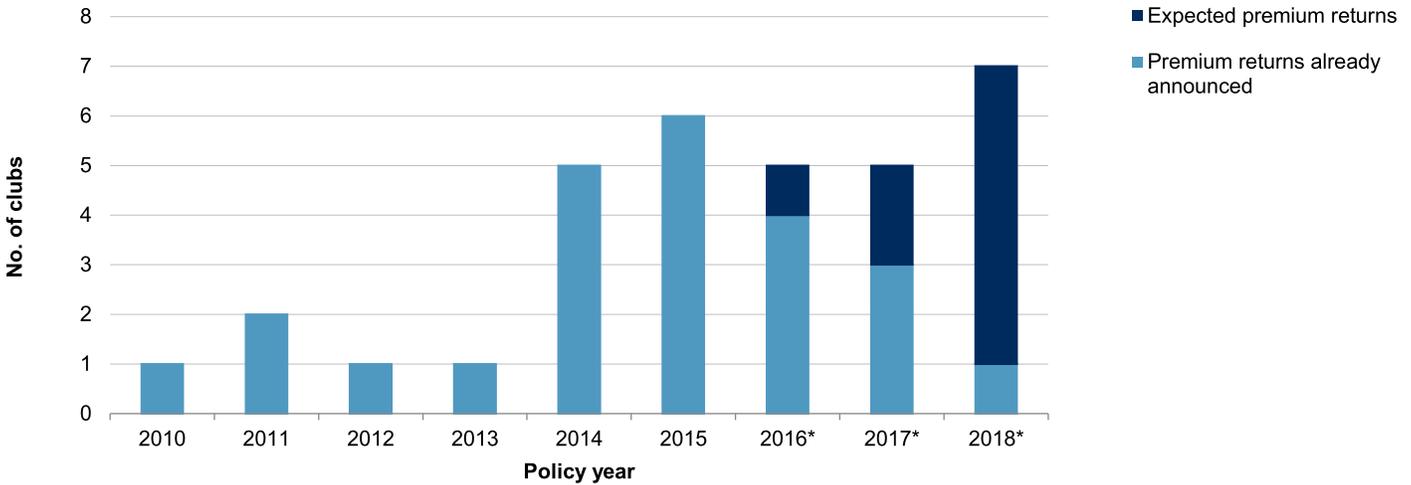
In our opinion, pricing is now below required levels and investment returns are likely to be subdued (increasing U.S. interest rates are eroding the value of many clubs' bond portfolios). In this context, we expect the current year to bring meagre earnings, with many clubs only just breaking even. The total of our analysts' expectations for individual clubs for 2018/2019 is a profit for the IG group of just over \$105 million, with unrealized losses significantly dragging down results.

Better Risk Management Means Premium Returns For Members

Shipowners and charterers could be further buoyed by their clubs returning premium. We expect seven of the 13 clubs will announce further returns to members over the next six months. In our base-case scenario, we do not expect these returns to affect our views of these clubs' capital adequacy. Returns of premium have become increasingly commonplace in the sector in the past four years and while the amounts are generally modest, they have been welcomed by members. Many of the clubs returning premium are those who have built up significant capital buffers that they feel unable to use, either through taking on more underwriting risk or pushing into more adventurous investments. In our opinion, this demonstrates better risk management practices in the sector (along with learning the lessons of the financial crisis), with clubs taking capital management, risk/reward decisions, and defining their risk appetites much more seriously. We have not seen a club make any unbudgeted call since the 2010 policy year and expect that such calls will not be used in the next two to three years. Considering the rarity of such calls in recent years, and the resulting negative publicity that such a call would bring, we would likely review our assessment of any such club's competitive position as a result.

Chart 2

More Returns Of Premium Look Likely



*Clubs use different mechanisms to return premium to members. Some return premium on their most recent policy years, others on years that are closing. Source: Aon UK Ltd. Note: expected premium returns are based on S&P Global Ratings analyst forecasts.

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Our ratings on the P&I clubs have remained relatively stable over the last 12 months with no rating changes and only one outlook change (Swedish Club to a positive outlook). We expect that the next 12 months will again be relatively quiet in terms of rating actions largely due to the sector's robust capitalization providing most clubs with some breathing room despite narrowing margins.

Table 1

P&I Clubs - Rating Component Scores

| | Competitive Position | Business | | | Risk Position | Financial Risk Profile | Anchor | M&G | ERM | Liquidity | Financial Strength | |
|--|----------------------|---------------|--------------------|--------------|------------------|------------------------|--------|--------------|-------------|-----------|--------------------|---------|
| | | Risk Position | Capital & Earnings | | | | | | | | Rating | Outlook |
| Assuranceforeningen Gard - gjensidig - | Strong | Strong | Extremely Strong | Intermediate | Extremely Strong | a+ | Satis. | Strong | Strong | A+ | Stable | |
| The Britannia Steam Ship Insurance Association Ltd. | Strong | Strong | Very Strong | Intermediate | Very Strong | a | Satis. | Adequate | Exceptional | A | Stable | |
| The North of England Protecting & Indemnity Association Ltd. | Strong | Strong | Very Strong | Intermediate | Very Strong | a | Satis. | Adequate SRC | Strong | A | Stable | |
| Shipowners' Mutual Protection & Indemnity Association (Luxembourg) | Strong | Strong | Very Strong | Moderate | Strong | a | Satis. | Adequate | Exceptional | A | Stable | |
| Assuranceforeningen SKULD (Gjensidig) | Strong | Strong | Strong | Intermediate | Strong | a | Satis. | Adequate | Exceptional | A | Stable | |

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Table 1

P&I Clubs - Rating Component Scores (cont.)

| | Competitive Position | Business | | | Financial Risk Profile | Anchor | M&G | ERM | Liquidity | Financial Strength | |
|--|----------------------|---------------|--------------------|---------------|------------------------|--------|--------|--------------|-------------|--------------------|----------|
| | | Risk Position | Capital & Earnings | Risk Position | | | | | | Rating | Outlook |
| The Standard Club Europe Ltd. | Strong | Strong | Very Strong | Moderate | Strong | a | Satis. | Adequate SRC | Exceptional | A | Stable |
| Steamship Mutual Underwriting Association Ltd. | Strong | Strong | Very Strong | Moderate | Strong | a | Satis. | Adequate SRC | Exceptional | A | Stable |
| The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd. | Strong | Strong | Very Strong | Intermediate | Strong | a | Satis. | Adequate SRC | Exceptional | A | Stable |
| West of England Mutual Insurance Association (Luxembourg) | Adequate | Satis. | Very Strong | Moderate | Strong | a- | Fair | Adequate | Exceptional | A- | Stable |
| Sveriges Angfartygs Assurans Forening (The Swedish Club) | Adequate | Satis. | Strong | Moderate | Moderately Strong | bbb+ | Satis. | Adequate SRC | Exceptional | BBB+ | Positive |
| The Japan Ship Owners' Mutual Protection & Indemnity Association | Adequate | Satis. | Moderately Strong | Moderate | Upper Adequate | bbb+ | Fair | Adequate | Exceptional | BBB+ | Stable |
| The London Steam-Ship Owners' Mutual Insurance Assn. Ltd. | Less than Adequate | Fair | Moderately Strong | Moderate | Upper Adequate | bbb | Fair | Adequate | Exceptional | BBB | Stable |
| American Steamship Owners Mutual P&I Assoc. Inc. | Adequate | Satis. | Upper Adequate | Moderate | Less than Adequate | bbb- | Fair | Adequate | Exceptional | BBB- | Stable |

ERM--Enterprise risk management. M&G--Management and governance. Satis.--Satisfactory. SRC--Strong risk controls.

This report does not constitute a rating action.

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