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Global Broking Centre | Marine & Energy

P&I Q2 Financial Bulletin

2019

Empower Results®

P&I Q2 Financial Bulletin

Following the recent round of May board meetings, 10 of the 13 International Group P&I Clubs have released their latest financial results for the year ending February 2019. As expected, these results are less positive than what we have seen in prior years. Most notably, there has been a significant increase in combined ratios and, for the first time in many years, most clubs are showing a dip in free reserves.

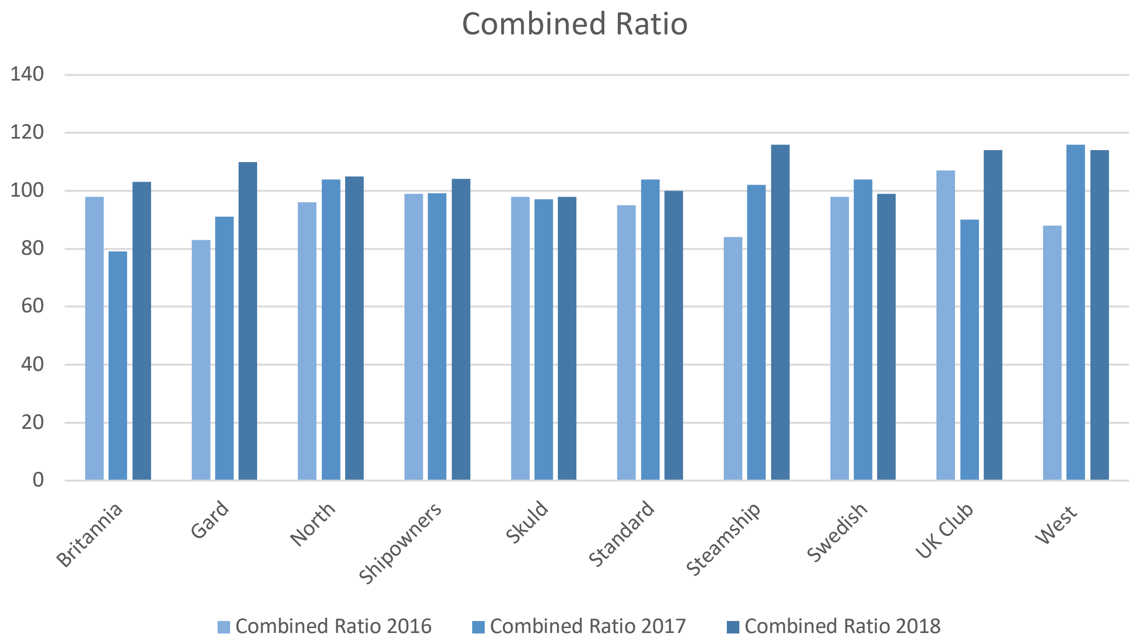
As this results season draws to a close, we take the opportunity to summarise the clubs' results and explore some of the factors driving the latest announcements in more detail.

At the time of writing, the American Club, London Club and Japan Club are all yet to announce their results; we will therefore comment on these at a later stage.

Combined ratios

Combined ratio is the measure of a club's underwriting performance, calculated using incurred claims plus expenses / premium less reinsurance. Most clubs have seen an increase in their combined ratio for 2018 policy year, with 8 of the 10 clubs reviewed reporting a financial year combined ratio of 100% or above. On average, across the group of 10 clubs reviewed, combined ratios have increased from 98.6% for the 2017 year to 106.3% for the 2018 year. However, with some clubs still to announce, these results may deteriorate further. In addition, it is worth noting that the announced results reflect a 'financial year' combined ratio, which allows for releases from back years; on a 'policy year' basis we would expect these results to be higher.

Skuld, the Swedish Club and the Standard Club are the only clubs that delivered a financial year combined ratio result at breakeven or better, with combined ratios at 98%, 99% and 100% respectively. For Skuld this is the 16th consecutive year of positive underwriting results.

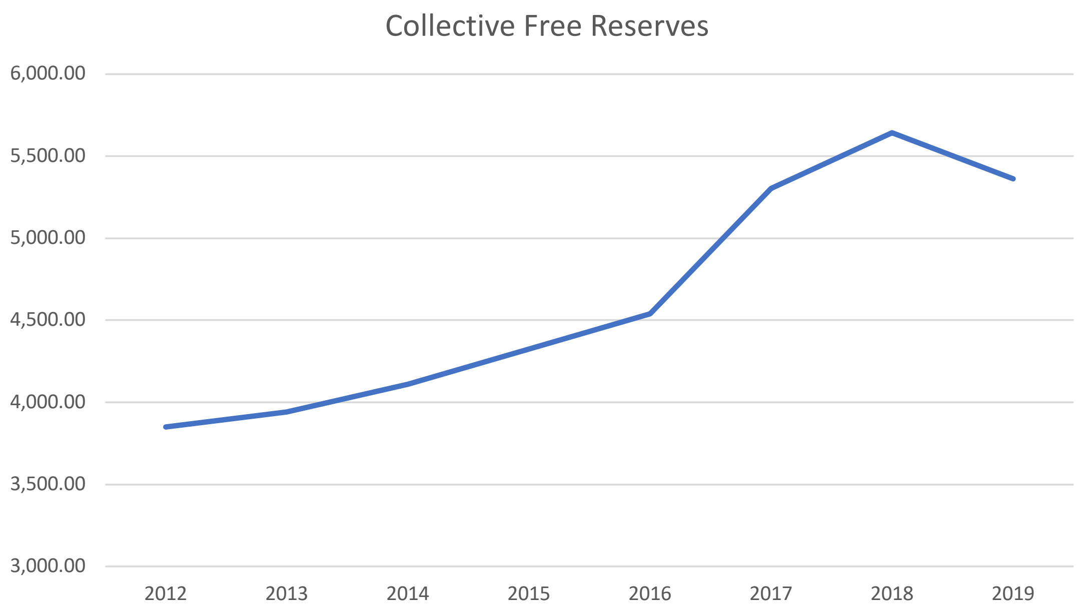


Free reserves

** Britannia's Free Reserves include Boudicca assets

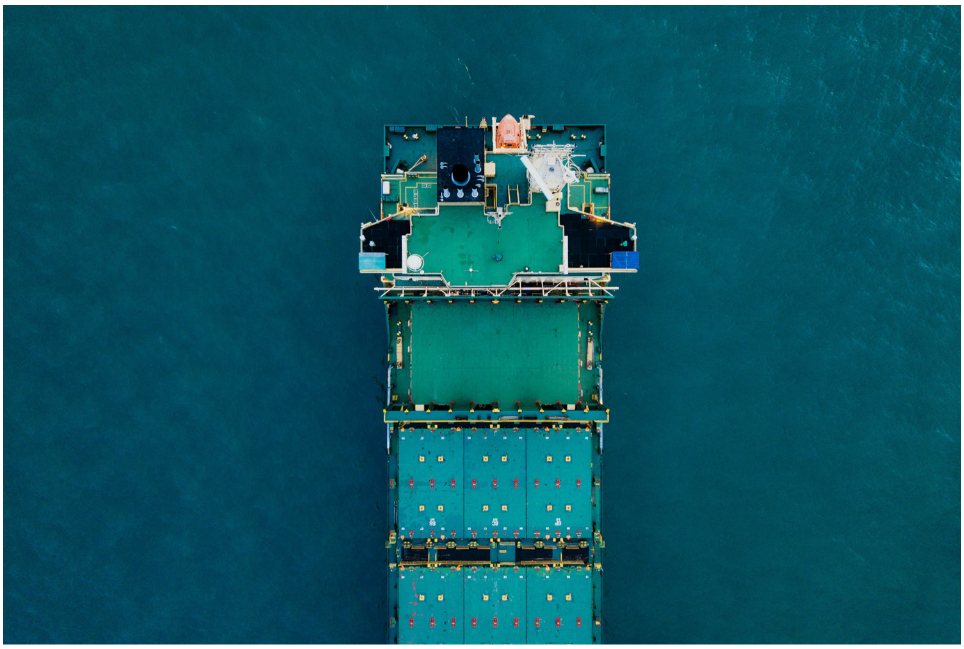
As you will note from the graph above, all clubs, with the exception of Skuld and North, have seen a reduction in free reserves from the 2017/2018 policy year, with the total reduction in free reserve across the 10 clubs reviewed standing at USD 285.1 million. This figure includes investment losses from two clubs that report at year-end (31st Dec), and will have likely since recovered somewhat, and a USD 40 million loss from Gard, resulting from the termination of a contract with a software vendor.

Ultimately, a strong capital position and financial integrity are essential cornerstones of a stable and successful P&I club. However, whilst a dip in free reserves highlights the issue of rising combined ratios, most of the clubs remain 'capital rich' and, comparatively, free reserves are still at very high levels, in most cases well in excess of AAA capital adequacy requirements. This is demonstrated below, where we show the development of free reserves across the International Group. As indicated, whilst there has been a dip in free reserve, in reality the drop reduces capital to 2017 levels, which, at the time, was at a record high.



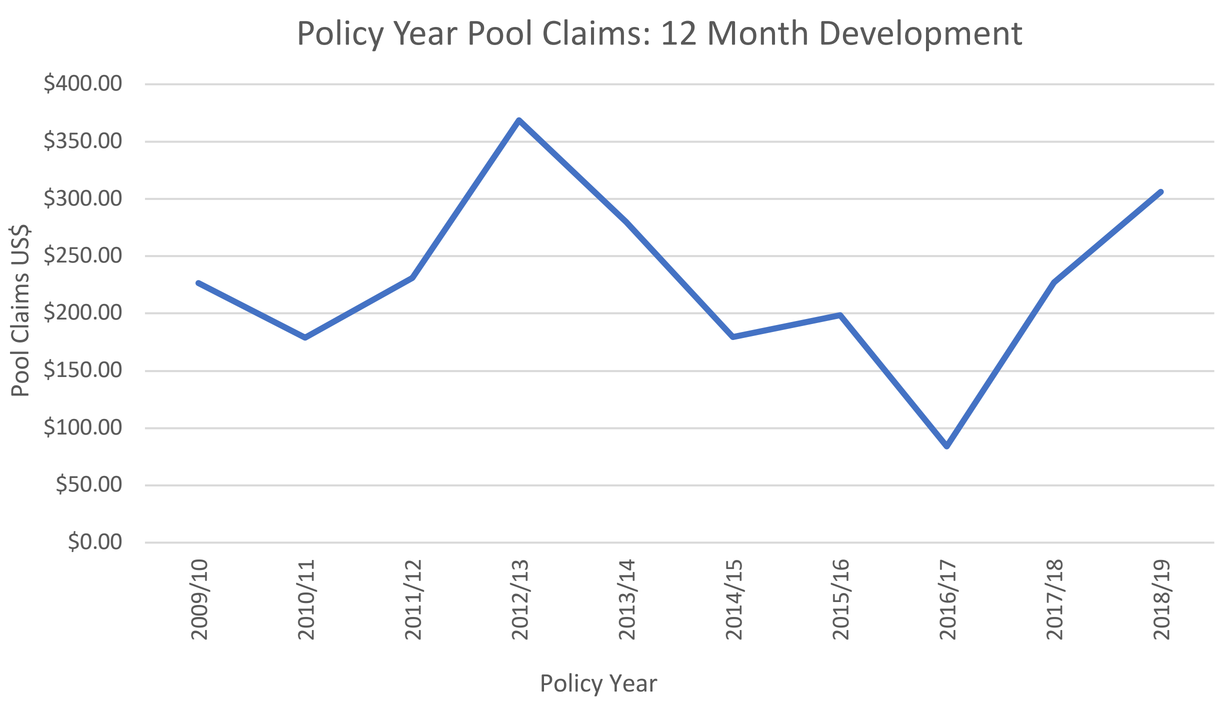
*2019 results include the American, London and Japan at 'current' reserve levels, prior to announcement of results.

Are these latest results a sign of: an escalating claims environment; a one off unfortunate year; poor investment performance or perhaps a result of premium erosion, driven by a lack of general increases and the effects of the 'churn'?



Pool claims

The 2018 policy year has seen a combination of at least some of these factors and one of the most prevalent appears to be an active pool year. Pool claims are those claims shared amongst the International Group clubs, between each club's USD 10m retention and USD 100m reinsurance attachment point. In fact, 2018 is the most active year since 2012, with over 20 claims notified to the pool so far. In 2018, the headlines for marine casualties were dominated by vessel fires, particularly the SSL Kolkata, Iron Chieftain, Maersk Honam, Sincerity Ace and Yantian Express, all of which are likely to impact the pool. Other notable claims include the MSC Zoe and the collision between Sea Centurion and Antea. The chart below sets out details of the last 10 years of pool claims. Whilst the pool limits and structure have changed over the last decade, it's clear that, after 12 months of development, the 2018 year-to-date has been more active than any other year, with the exception of 2012.



Large claims are often random and difficult to predict and therefore it is challenging to argue that a trend for major claims is becoming more frequent. However, clubs are reporting that large claims are becoming more expensive, driven in part by more complex salvage operations. Conversely, whilst large claims appear to be becoming costlier, the frequency of claims in total appears to still be falling. This is a positive sign and likely a result of a safer, newer world fleet, better trained crew, new technology and undoubtedly more sophisticated member risk management.

Premium erosion

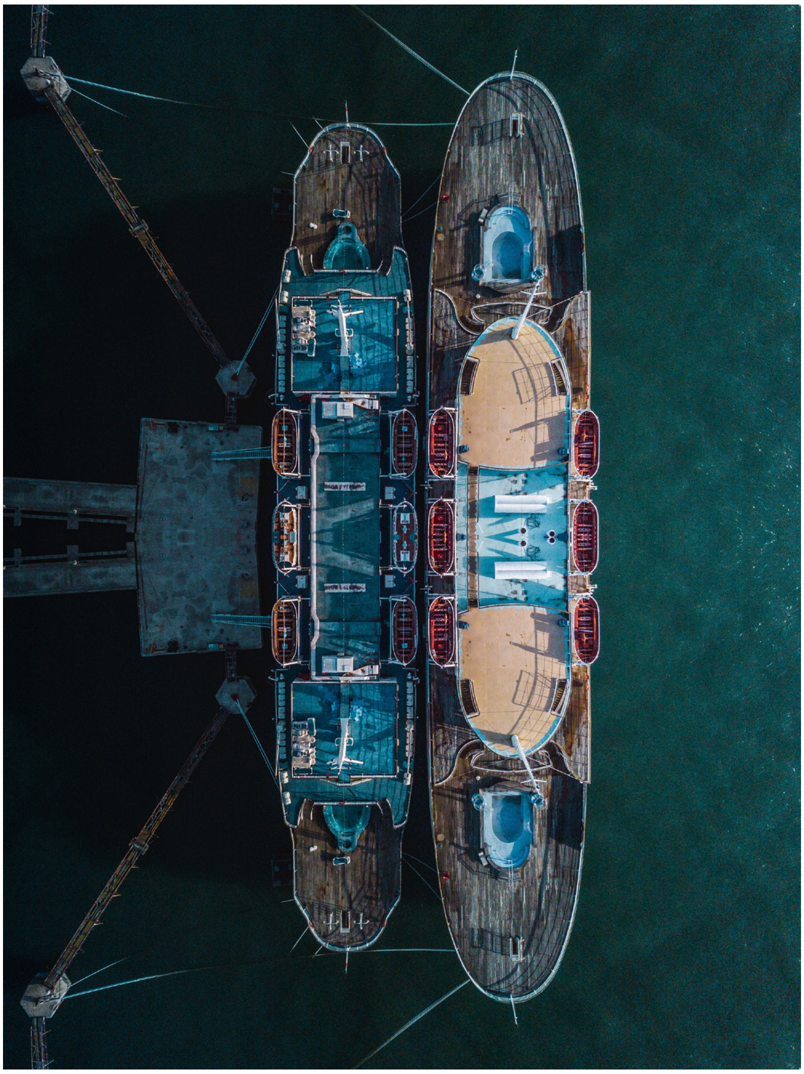
Over the preceding five years, whilst capital levels have grown, P&I premiums have generally been reducing, driven by a lack of general increases, impact of the ‘churn’ and fierce competition between the clubs, particularly for new or ‘free’ business.

There has, of course, been justification for the downward premium trend: the clubs are holding record levels of capital, combined ratios have largely been comfortably below 100% and investment income has been extremely favourable. As a result, the clubs were able to reduce premium levels overall for members with positive records at renewal, as well as quoting new tonnage at very competitive rates. Some clubs were also able to consistently return capital during this period or reduce deferred calls, which is certainly an endorsement for mutuality.

However, premium reductions are now impacting underwriting results, as demonstrated by the increase in combined ratios. When looking across the International Group, we believe that owned entered tonnage has grown by around 20% over the preceding five years, whilst premiums have reduced by about 20% over the same period.

Investment income

Whilst only a snapshot in time, 2018 delivered a less impressive investment performance than prior years. As we know, rising geopolitical concerns were impacting the equity markets in late 2018; while the situation improved in the late months of the policy year, this meant that investment results were down overall on prior years. Indeed, the Swedish Club, Shipowners, Gard and Britannia all delivered a negative investment result (-USD 5.9m, -USD29.7m, -USD3m and -USD 2.6m respectively). However, as referenced above, both the Swedish Club and Shipowners report their results on 31st Dec; therefore, the improvements in the equity markets in the early months of 2018 should have shifted this position somewhat. Of the clubs that delivered a positive result, the average return was just under 2%.



Conclusion

- Most International Group P&I clubs are indicating that the 2020 renewal will see a return to general increases.

- Rates per ton have reduced by just over 35% over the past five years and, as a result, many shipowners will have seen significant rate reductions over this period.

- As we have witnessed in the past, it's not a good idea for clubs to rely solely on investment income to subsidise underwriting performance.

- The 2018 combined ratio results were also impacted by a random but notably high pool claims year.

- Whilst rate reductions have been seen across the board, shipowners with stable fleets will not have seen the benefit of the 'churn', which we believe is a meaningful contributor to the downward premium trend.

- Clubs have collectively seen substantial growth in capital in recent years and, as a result, reserves are still, in most cases, well excess of capital requirements, which poses the question: will there be further capital returns in 2020?

- The past five years certainly has been a full endorsement to mutuality. Many clubs have returned significant capital and offered compounding rate reductions at a time where some of the shipping markets still faced a challenging environment. However, we suggest that that clubs with very strong capital positions should exercise some restraint and flexibility going forward. We question whether general increases are still relevant and indeed whether the excess capital position built up by the support of the International Group membership could be dispatched to moderate the desire for generalised rate increases in 2020.

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