Aon Risk Solutions
Global Broking Centre | Marine & Energy

P&I Bulletin
June 2021

Empower Results®

Financial Update

Following the recent round of board meetings, most of the International Group clubs (excluding the American Club and Japan Club) have now released their financial results for the 2020 policy year, with a marked deterioration in technical underwriting results across the group and, for some, a reduction in capital. In our latest bulletin, we take the opportunity to reflect on these results and comment on what they may indicate moving forward for the P&I market and our clients.

By way of background, prior to the 2021 renewal cycle, the International Group clubs had identified some challenges for the 2019 and anticipated 2020 policy year performance primarily driven by three key themes. The impact of:

1. Premium erosion, driven by a lack of general increases and churn over the preceding five years.

2. Increased volatility within the pool, with 2020 trending to be the highest pool year in a decade.

3. COVID-19 on claims and premium returns.

These themes have played out in the 2020 results, with the average combined ratio across the group rising from 117% in the prior year to 122% - some way above the breakeven target of 100%. On the higher end of the scale this year, both the West of England and the UK P&I Club have reported significant underwriting losses, with combined ratios of 139.8% (up from 107%) and 149.6% (up from 121%), respectively. These results will sit well outside each club’s acceptable range. In the case of the West of England, we believe this result represents an estimated USD 80 million loss; for the UK Club, an estimated USD 110 million loss before investment gains. These clubs and others in the International Group have identified the ‘one off’ elements of COVID-19 and high pool claims as major contributing factors to their 2020 performance. West of England and the UK Club are by no means outliers, with six of the IG Clubs (including London, Standard, Steamship and Swedish) also reporting combined ratios at 120% or higher and all clubs above 100%.

Diversification

Clubs that have diversified seem to have fared better this year, seeing profits from their non-mutual/commercial operations, such as hull and energy business, subsidising their P&I results overall. The largest club in the International Group, Gard, posted a P&I combined ratio of 112%, which, when combined with the positive results from its commercial lines, is reduced to 104% overall. Whilst still a technical underwriting loss, when coupled with a strong investment gain, Gard was able to deliver an impressive USD 68 million surplus for the year.

Skuld also saw a similar theme with an overall 108% combined ratio, which, when coupled with a 9.8% investment return, resulted in a positive USD 25 million surplus for the 2020 year. Nevertheless, Skuld saw a reduction in capital overall due to a set aside for potential Norwegian tax obligations. Whilst not a diversified club in the sense of those previously mentioned, The Shipowners Club who specialise in smaller tonnage, also posted a strong result with the lowest combined ratio in the International Group at 101% and an overall surplus after investment gains of USD 39.1 million.

Despite negative underwriting results for the group overall, following a rallying in the investment markets at the end of 2020/early 2021, most IG clubs have delivered a strong investment performance. Gard managed a USD 112 million investment gain, and Britannia, North, Shipowners, Skuld, Steamship, and UK all delivered investment gains in excess of USD 50 million each. In some but not all cases, these investment returns were enough to offset underwriting losses, with Britannia, North, Gard, Shipowners and Swedish all seeing an increase in free reserves as at 20th Feb 2021.

Overall, the increase in combined ratio across the group to an average of 122%, and in some cases a reduction in capital, highlight the challenges the clubs are facing. The shift relates to bringing the technical underwriting results back closer to a sustainable position and, in most cases, clubs' heavy reliance on investment income this year. S&P recognised this vulnerability in the latter part of 2020, moving Standard, Gard, UK and North onto a negative outlook. Whilst these results are certainly not to be celebrated, they do reinforce the importance of the significantly stronger capital position the clubs have built up over the last decade. Despite some clubs taking a reduction in capital, many remain comfortably above S&P's AAA capital adequacy model. They, therefore, can sustain a number of challenging years without undermining the core financial strength of the club.

Future outlook

What do these results mean moving forward? It was anticipated that we would see a deterioration of the clubs' results for 2020, which has certainly been the case. These results may even trigger a further S&P review with more clubs in the group looking at a potential negative outlook to their S&P rating. We have already seen this with the West of England joining those previously mentioned - their outlook recently changed from stable to negative. Whilst not wishing to talk up the market, undoubtedly, there is a strong chance we will see P&I rates continuing to rise over the coming years. A process began last year with some clubs taking a firm line on their general increase. This surely will impact their results positively moving forward, providing clubs can maintain pricing discipline when it comes to the temptation of new tonnage and opportunities for growth.

Claims

We hope that, with the global COVID-19 vaccine rollout and strong risk management protocols within the shipping industry, the negative impact of COVID-19 on the club results will be largely behind us. It has, however, been a challenging start to the 2021 year insofar as large P&I claims. The Ever Given incident was a very well-publicised grounding taking place in the Suez Canal in March 2021. Whilst we understand that negotiations are ongoing, there have been extremely large demands from the SCA, and this claim could well be significant. Very sadly, on top of this, there was also the tragic capsizing of the Seacor Power off the coast of Louisiana, the A Symphony collision, the Naga 7 Jack up capsizing/wreck removal, the tragic sinking of the Papaa 305 accommodation barge, and the X-press Pearl containership fire. It is too early to predict how the 2021 year will develop. Still, all of these incidents point toward likely continued challenges for the clubs driven by large losses and further potential pressure on the group reinsurance.

Club Financials

Combined net ratio (CNR)

Club	2020	2021
UK Club	121%	150%
West of England	107%	140%
London Club	137%	137%
Steamship	99.8%	125%
Standard Club	143%	121%
Swedish Club	107%	120%
Britannia*	132%	117%
North of England	125%	114%
Skuld	110%	108%
Shipowners	105%	104%
Gard	114%	102%
Japan Club	108%	
American Club	106%	

**Estimated excluding movement in Boudica*

Free reserves

Club (USDm)	2020	2021
Gard	1,179	1,262
Britannia*	594	626
Steamship	515	511
UK Club	559	507
Skuld	466	459
North of England	443	450
Shipowners	340	379
Standard	393	360
West of England	338	291
Swedish Club	228	231
London	173	154
Japan Club	235	
American Club	54	

**Including Boudica*

Investment returns

Club (USDm)	2020	2021
Gard	118	113
North of England	70	65
Britannia*	87	59
UK Club	107	59
Steamship	67	54
Shipowners	48	50
Swedish Club	32	34
West of England	46	33
Skuld	55	63
London Club	41	16.7
Standard Club	69	32.8
American Club	15	
Japan Club	(4)	

Release Calls: Constantly on the Agenda

The subject of release calls is often the cause of friction and misunderstanding. The rationale of imposing release calls is to protect existing membership should owners choose to leave. It is common to have two-three open years in addition to the current in place should any of those years deteriorate, culminating in a call for additional premium. The club will want departing members to provide adequate security to meet that risk.

Given only one club - the American Club - has made additional calls in the past decade, it could be argued that release calls, at least for the better financially performing clubs, should be a thing of the past. Indeed Britannia took such a decision two years ago, only to change direction and reimpose them. The Shipowners Club is the only club not to levy release calls.

Do release calls accurately reflect the financial outlook for each open year? You need to go back to over a decade to witness the last time the clubs (save American Club) resorted to unbudgeted supplementary calls. Since the financial crash of 2008, the level of free reserves across the clubs has soared to record levels. Add in that there are clubs that have never made additional calls in their history, and it is easy to cast doubt on the necessity.

As mentioned in an earlier bulletin, the current crisis could have had serious consequences and demonstrates how fragile financial predictions can be. Still, the level of release calls spread over several years, we would suggest, does not reflect the risk of additional levy premiums. It is perhaps easy to understand why many see release calls as a pair of handcuffs, making leaving a club difficult.

Satisfying the release calls is far from straightforward. There are three methods. Firstly, to pay the release calls for all open years. This will mean the member will have no liability for any deterioration in any year. Given the present level of free reserves for most clubs and the accuracy in claims reserving in open years, that would seem a costly route. Secondly, cash could be paid into an escrow account in favour of the club reducing as each open year closes. The prospect of tying up capital for three to four years is not an attractive one. Lastly, and the option for most members is to post a bank guarantee. History will demonstrate this is the most cost-effective choice. In providing the guarantee, the bank must be acceptable to the club, and the initial education to the bank can take some explanation. It is easy to understand why the imposition of release calls is constantly on the agenda, and if they are justified, why are some at such high levels?

Release Calls

Club (%)	2017	2018	2019	2020	2021
America	Closed	20	20	20	20
Britannia	Closed	Nil	5	7.5	15
Gard	Closed	Nil	5	5	10
Japan	Closed	5	5	5	5
London	Closed	5	12.5	15	15
North	Closed	0	5	15	15
Shipowners	Closed	0	0	0	0
Skuld	Closed	7.5	10	15	15
Standard	Closed	Closed	0	6	12.5%
Steamship	Closed	Closed	10	10	10
Swedish	Closed	Closed	5	15	15
UK	Closed	5	10	15	20
West of England	Closed	Closed	0	15	15

**Excluding any unpaid supplementary calls*

Could Overspill be a Reality?

There has never been an overspill claim in the history of P&I. In recent times, only the tragic Costa Concordia loss at USD 1.4 billion has reached anywhere near the present insurance provision of USD 3.1 billion. However, we continue to see claims escalate in quantum from what would previously have been considered heavy but not excessive losses.

Wreck removal losses have led the way with a high of USD 860 million for a current claim which is second only to Costa Concordia in the list of largest all-time P&I losses.

An overspill claim will come into effect when all reinsurance placements are exhausted, hence the phrase ‘overspill’. Should such a claim occur, the loss would be spread amongst all 13 clubs calculated at 2.5% of the property limitation under the 1976 London Convention per vessel. On current entered tonnage, the limit is estimated to be in the region of USD 8 billion.

There is no risk of overspill claims where limitation applies; this would be the case for pollution, crew and passenger risks. If there were to be an unlimited P&I claim of such a magnitude, it would be spread across the group, with each club contributing in accordance with their limitation calculations.

In such dire circumstances, this financial burden would mean, at best, a severe hit to free reserves. The worst outcome would result in additional premiums by overspill calls on all members. It is worth noting that when a member leaves a club and decides to pay release calls, this does not exonerate them from overspill calls.

We have resisted any desire to be alarmist in these remarks, but it is a risk, albeit small, that is ever-present, and in the current climate we feel ought to be remembered.

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