S&P Global Ratings

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Shipowners' Mutual Protection & Indemnity Association (Luxembourg)

Primary Credit Analyst:
Charles-Marie Delpuech, London (44) 20-7176-7967; charles-marie.delpuech@spglobal.com

Secondary Contact:
Tufan Basarir, CFA, London (44) 20-7176-7126; tufan.basarir@spglobal.com

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Shipowners' Mutual Protection & Indemnity Association (Luxembourg)

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								
Financial Risk		Holistic Analysis	0	Sovereign Risk	0	Gov't Support	0	
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

- Membership of Shipowners' Mutual Protection and Indemnity Association (Luxembourg) (SMP, or the club) in the International Group (IG) of Protection and Indemnity (P&I) clubs provides market access.
- Leading position in the P&I insurance market for smaller ships.
- Stable and consistently positive underwriting records that compare well with those of IG peers.
- Geographically diverse, accepting risks across the globe.
- Specialized in a single product line, like many of its IG peers.

Financial Risk Profile: Strong

- Capital position is a key strength for the rating, with capital adequacy likely to remain in excess of the 'AAA' level.
- Despite SMP's strong underwriting performance being attractive to competitors, its dominant market position and competitive advantages in its specialized segment allow the club to defend its position and grow profitably.
- SMP is exposed to fluctuations in the frequency and severity of claims in the P&I market, although less so than its IG peers.
- High exposure to risky assets and a relatively small capital base contribute to the potential for capital volatility.

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Other Factors

- We combine these factors to derive our anchor for SMP of 'a'. This is the higher of two possible anchors; we chose the higher option to reflect our expectations that the club will continue to show lower underwriting volatility than its P&I peers. The higher anchor also reflects the resilience of the club's business risk profile to increased competition in the small ship P&I market sector.

Outlook: Stable

The stable outlook reflects our view that SMP's capital adequacy, as measured by our risk-based model, will exceed our requirements for the 'AAA' level for the next three years. We also expect the club to continue to underwrite profitably during this period. That said, in line with peers, we anticipate that economic conditions and competitive pressures may continue to slow SMP's growth rate.

Downside scenario

We may lower the rating on SMP if we were to see a deterioration in its competitive position, demonstrated by a period of poor underwriting results or a sizable reduction in its market share. We could also lower the rating if the club's prospective capital adequacy were to fall below our capital requirements for the 'AAA' level, as per our risk-based capital model.

Upside scenario

We consider a positive rating action to be unlikely over the next two years. We expect the rating to be constrained by SMP's size and its relative lack of diversification compared with global insurance players.

Base-Case Scenario

Macroeconomic Assumptions

- Significant competition will remain in the small ship P&I market for at least the next two years.
- The fixed-premium business will see increased competition.
- Global shipping companies will continue to face difficult operating conditions over the coming year, characterized by fragile demand and chronic structural oversupply in the industry.
- There will be no significant changes to the IG pool structure or pool-sharing methodology.
- Increased capacity in reinsurance markets will continue to have a positive impact on IG group reinsurance and retention protection premiums and terms.
- Investment yields will remain subdued and returns uncertain.

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Company-Specific Assumptions

- SMP will maintain its dominant position in the small ship P&I market.
- Capital adequacy will remain at the 'AAA' level.
- Growth in gross premiums will remain flat in the financial years ending December 2018 and 2019, assuming constant exchange rates.
- Operating performance will remain stable over the next two years, with SMP continuing to produce at least breakeven underwriting results.
- Pre-tax profits will be at least $20 million for financial 2017, based on strong investment returns, then will reduce to at least $10 million for both financial 2018 and financial 2019.

Key Metrics

	--Year-end Dec. 31--				--Year-end Feb. 20--
	2018f	**2017f**	**2016**	**2015***	**2015**
Gross premiums written (mil. $)	~220	~220	228.6	228.6	251.2
Net income (mil. $)	~10	~23	14.7	(20.9)	1.5
Net combined ratio (%)	99	99	98.5	98.1	94.4
S&P Global Ratings capital adequacy	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong

*The year-end 2015 financial statement figures do not reflect a full year but the period from Feb. 20, 2015 to Dec. 31, 2015. f--Forecast. Forecasts are on a full-year basis.

Company Description

SMP provides P&I (in essence liability cover), legal assistance, and defense cover for its members. The club has been based and regulated in Luxembourg since 1976 and was previously based in the U.K. SMP is managed by its wholly owned subsidiary The Shipowners' Protection Ltd. The club operates two main branches outside Luxembourg--London and Singapore--while its run-off Canadian branch closed in 2014. The club has a global presence, over 6,500 members, and nearly 33,000 vessels entered.

SMP, having previously operated as a reinsured member, became a full member of the International Group (IG)--a group of 13 clubs providing P&I cover to more than 90% of world shipping--in 1999. The club operates within the framework of the IG. Members benefit from a substantial joint excess-of-loss reinsurance program and the pooling of high-value claims among the 13 clubs. While a significant majority of the club's membership is entered on a pooled basis, the club has a substantial and growing non-pooled or fixed-premium membership (around 30% of gross premiums written).

Within the IG, SMP, whose primary focus is on smaller and specialist vessels, occupies a unique position. Many of these members do not require the high levels of insurance cover that apply to owners of large vessels (such as tankers or container ships) and therefore prefer the stability of a fixed-premium membership that SMP also offers. The club is one of the smallest within the IG in terms of tonnage insured. However, SMP comfortably insures the greatest number of members.

SMP's main regions of operation are Southeast and East Asia. Europe (including the U.K.) and Central and South America are also large markets for the club, along with India, Middle East, and Australasia.

The club launched a new initiative in 2015 called Claims, Technical, Risk and Legal (CTRL) to provide legal and technical solutions aimed at small vessel owners. This service is open to members and non-member clients.

Business Risk Profile: Strong

We regard SMP's business risk profile as strong, reflecting its predominant position in the small ship P&I market, which is evident from its stable and consistently positive underwriting results of recent years.

Insurance industry and country risk: Global coverage, potential earnings volatility

For the purposes of our industry and country risk analysis, we view SMP's small ship P&I business as "Global P&I". In our opinion, the risk profiles are similar although slightly different.

We assess insurance industry and country risk for SMP as intermediate, reflecting that for the global marine P&I sector. Like its peers, SMP typically writes marine P&I business in multiple countries around the world, resulting in broad geographic diversification and a low overall country risk assessment. Our industry risk assessment is moderate, although we see profitability and product risk as negative. These factors are offset by the sector's operational barriers to entry.

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, increasing earnings volatility. Therefore, we view profitability as negative. The size and frequency of claims are also unpredictable, increasing product risk.

Table 1

Shipowners' Mutual Industry And Country Risk

Insurance sector	IICRA	Business mix (%)
Global P&I	Intermediate risk	100

P&I--Protection and indemnity. IICRA--Insurance industry and country risk assessment.

Competitive position: Clear outperformance of peers and dominant market position

In our opinion, SMP has a strong competitive position. The club has consistently performed better than its peers on average, and benefits from its dominant position in its chosen sector, the small ship P&I market. We also note the club's wide geographic spread of members in many different markets.

We consider SMP's strong competitive position to be demonstrated by its stable operating performance. SMP's combined (loss and expense) ratio was 98.5% in December 2016. The combined ratio over the past five years has averaged 97%--which is slightly better than P&I clubs on average. We believe that the club has achieved these results through robust discipline over the quality of its book, a reputation for service excellence in its small ship market, and a clear strategic focus on underwriting profitability.

In recent years, SMP has imposed general increases in premium rates that were much lower than the majority of IG clubs. For the February 2017 renewal, the club decided not to apply a general increase in premium rates for the third year in a row. Unlike many of its IG peers, the club has not passed any increased costs of the IG reinsurance arrangement on to its members. We believe this has earned SMP considerable goodwill from both intermediaries and its members, while also acting as a defensive measure against competitors.

In our base-case scenario, we expect SMP's gross premium to reduce by 4% in December 2017 and then to stabilize for the two following years. We expect SMP to continue facing competition over the next two years as other IG clubs look to expand into the small ship market, and new competitors offering small ship fixed-premium insurance look to build their market share. However, despite increased price competition, SMP has largely managed to maintain its client base, shown by over 95% retention rates, while sustaining its tonnage and number of members and vessels in the past couple of years. We also believe that SMP's relationship with key brokers has contributed to the resilience of its market position over time, despite the unusually large member base for a P&I club.

In addition, we believe that the CTRL initiative (see "Company Description" section above), if implemented successfully, could further fortify the retention of members and channel potential new members into the club.

Our assessment of SMP's competitive position, like that of many of its peers, is hampered by its largely undiversified product range, with no other significant lines of business outside its core P&I offering. We believe this leaves the club exposed to the fortunes of one market.

Table 2

Shipowners' Mutual Competitive Position					
	--Year-end Dec. 31--		**--Year ended Feb. 20--**		
(Mil. $)	**2016**	**2015**	**2015**	**2014**	**2013**
Gross premiums written	229	229	251	244	227
Change in gross premiums written (%)	0.0	(9.0)	3.0	7.3	5.4
Net written premium	184	186	207	202	193
Change in net premiums written (%)	(0.8)	(10.2)	2.4	4.9	1.6
Reinsurance utilization (%)	19.3	18.7	17.6	17.2	15.3
Total tonnage (m gt)	25.4	24.6	23.5	23.6	21.9

Financial Risk Profile: Strong

Capital and earnings: Extremely strong capital adequacy and one of the strongest underwriting performances within IG

We regard SMP's capital and earnings as very strong, largely based on the club's capital adequacy. Its total adjusted capital (TAC) has exceeded our requirements at the 'AAA' level over the past six years, as measured by our risk-based capital model. Over 95% of TAC is made up of shareholder's funds, which have grown by 1.6x to $294 million in 2016 from $188 million in 2011.

Following a negative investment return of 3.5% in December 2015, investments recovered in December 2016, with a gain of $11.7 million that mainly came from the equity portfolio. This principally explains the $15 million increase in free reserves in 2016. As the global market continues to recover, we expect investment returns to be strong in 2017, exceeding 3.0%, and then to be at least 1.0% in 2018-2019.

In our base-case scenario, we expect SMP's capital adequacy to remain at least at the 'AAA' level over 2017-2019. We expect that SMP will continue to underwrite profitably over the next two years, recording combined ratios of at least 99%.

Table 3

Shipowners' Mutual Capital

	--Year-end Dec. 31--		--Year ended Feb. 20--		
(Mil. $)	**2016**	**2015**	**2015**	**2014**	**2013**
Total reported capital	294	279	300	299	276
Change in total capital (reported) (%)	5.3	(7.0)	0.5	8.4	17.4

Table 4

Shipowners' Mutual Earnings Statistics

	--Year-end Dec. 31--		--Year ended Feb. 20--		
(Mil. $)	**2016**	**2015**	**2015**	**2014**	**2013**
Total revenue	192.4	177.4	211.5	207.5	198.1
EBIT adjusted	10.8	9.2	19.9	8.6	19.8
EBITDA adjusted	10.8	9.2	19.9	8.6	19.8
Net income	14.7	(20.9)	1.5	23.2	40.9
Return on revenue (%)	5.6	5.2	9.4	4.2	10.0
Return on shareholders' equity (reported) (%)	5.1	(7.2)	0.5	8.1	16.0
Net expense ratio (%)	26.7	24.9	26.7	25.9	23.7
Net loss ratio (%)	71.8	73.2	67.7	73.0	71.6
Net combined ratio (%)	98.5	98.1	94.4	98.8	95.2

Risk position: Exposure to high-risk assets, but low retention reduces volatility

We view SMP's risk position as moderate chiefly because of the club's exposure to capital and earnings volatility through the unpredictable size and frequency of claims in the P&I sector and its 5% shared exposure to the IG pool.

The club has a relatively high-risk investment allocation compared to Western European non-life peers--26% of its investments are in equities. However, the club has negligible exposure to speculative-grade bonds and no exposure to real estate and alternative investments.

In 2015, SMP's exposure to foreign currency-asset liability mismatches, which we used to consider larger than peers, has largely reduced. SMP is now better protected against fluctuations in pounds sterling, euros, and Canadian dollars. This improves our view of SMP's risk position overall.

SMP has historically enjoyed lower underwriting volatility than its peers, which we largely attribute to a significant reinsurance program that allows for low retention levels.

Table 5

Shipowners' Mutual Risk Position

	--Year-end Dec. 31--		--Year ended Feb. 20--		
(Mil. $)	**2016**	**2015**	**2015**	**2014**	**2013**
Total invested assets	646.5	635.9	628.5	640.4	585.2

Table 5

Shipowners' Mutual Risk Position (cont.)					
	--Year-end Dec. 31--		--Year ended Feb. 20--		
(Mil. $)	**2016**	**2015**	**2015**	**2014**	**2013**
Change in invested assets (%)	1.7	1.2	(1.9)	9.4	13.3
Net investment income	8.1	6.0	8.4	5.7	10.8
Realized capital gains/(losses)	(4.1)	1.1	21.3	12.6	22.7
Unrealized gains/(losses)	18.0	(14.1)	(14.2)	4.8	4.7
Net investment yield (%)	1.3	1.0	1.3	0.9	2.0
Net investment yield including realized capital gains/(losses) (%)	(1.0)	(1.3)	0.5	2.8	5.1
Net investment yield including investment gains/(losses) (%)	1.8	(3.5)	(1.7)	3.6	6.0
Investment portfolio composition (%)					
Cash and short-term investments (%)	18.1	17.2	19.4	13.6	8.8
Bonds (%)	56.3	58.7	57.7	62.4	65.7
Equity investments (%)	25.6	24.1	22.9	24.0	25.6

Financial flexibility: Limited need for capital

We view SMP's financial flexibility as adequate. Like its IG marine mutual peers, SMP has a legally enforceable right to collect unlimited additional premiums by making unbudgeted supplementary calls. However, we give lower weight to this unbudgeted call facility in our assessment of SMP than in that of its IG peers, given its small-vessel specialization and large fixed-premium facility.

Even if the club were to make such a call, in our view there could be operational challenges in its practical application. The sheer volume of members at the club could make a call a significant administrative and legal burden. The increase in the club's non-pooled member base also limits the credit we give for the unbudgeted call facility, as it reduces the number of members from whom SMP is able to collect additional calls. Positively, we do not expect these issues to affect the club over the ratings horizon due to the club's large excess capital position.

Other Assessments

Enterprise risk management: Improved ERM framework

We view SMP's enterprise risk management (ERM) as having low importance to the rating due to the club's monoline nature. We assess SMP's ERM as adequate, based on our neutral view of risk controls and risk management culture. The club has made significant progress in instilling an ERM framework and documenting its controls procedures. In October 2014, the club hired a chief risk officer and established a dedicated risk function. In 2015, the club further increased the alignment of strategic objectives, risk profile, risk appetite, and risk management through the own risk and solvency assessment process.

SMP has developed pricing tools that it uses extensively in its quoting procedures, and benefits from its large database and knowledge of the small ship sector.

Management and Governance: Strong strategic planning

Our view of SMP's management and governance as satisfactory reflects our opinion of the club's strong strategic planning process, implementation of strategy, and comprehensive operational standards for a club of its size. Management clearly has the market-leading expertise in its chosen segment.

The senior management team has been renewed over the past couple of years with a new CEO and a new CFO. This has not changed our view of the strength of the management team considering the successful and smooth transition phase.

Liquidity: Liquid investment portfolio

We regard the club's liquidity as exceptional, owing to the strength of its available liquidity sources, mainly premium income, and liquid asset portfolio. We believe the company is capable of managing unexpectedly large claims.

Accounting Considerations

The year-end 2015 financial statement figures do not reflect a full year but the period from Feb. 20, 2015 to Dec. 31, 2015.

The financial statements include payments and recoveries relating to the IG pooling agreement. As the pooling agreement provides a mutual reinsurance mechanism for the IG, we have treated the $16.7 million paid into the pool at year-end December 2016 as ceded reinsurance premiums, as opposed to gross claims incurred.

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: 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 18, 2017)	
Operating Company Covered By This Report	
Shipowners' Mutual Protection & Indemnity Association (Luxembourg)	
Financial Strength Rating	
Local Currency	A/Stable/--
Counterparty Credit Rating	
Local Currency	A/Stable/--
Domicile	Luxembourg

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Insurance Ratings Europe; insurance_interactive_europe@spglobal.com