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## Shipowners' Mutual Protection & Indemnity Association (Luxembourg)

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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			Holistic Analysis	0		Sovereign Risk	0	Gov't Support	0	

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

## Major Rating Factors

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>Membership of the International Group (IG) of protection and indemnity (P&amp;I) clubs provides market access.</li> <li>Leading and resilient position in the small ship P&amp;I insurance market.</li> <li>Well capitalized in excess of the 'AAA' level, with stable and consistently positive underwriting records that compare well with those of IG peers.</li> </ul>	<ul style="list-style-type: none"> <li>High competition from fixed premium players and the low-premium-rate environment are pressuring underwriting profitability and growth rate.</li> <li>Largely undiversified product range.</li> <li>Compared with IG peers, the unusually large number of members implies more reliance on broker relationships to retain the business.</li> </ul>

## Rationale

Our rating on Shipowners' Mutual Protection and Indemnity Association (Luxembourg) (SMP, or the club) is underpinned by the club's strong market position and stable track record of underwriting profitability. Its strong capitalization is also a supportive factor, while its relative lack of diversification (in common with P&I peers) and exposure to risky assets are credit weaknesses.

We think the club has sustained a dominant position in the small ship P&I market, where it has continued to grow and record stable and consistently positive underwriting results for the past five years. Resilience to increased competition in the small ship P&I market has allowed SMP to build a strong balance sheet. In our view, the club is sufficiently well

capitalized to manage potential fluctuations from its key risk exposures, namely equity and insurance risks. While high exposure to risky assets and a relatively small capital base may contribute to capital volatility, we think that the nature and size of the vessels that SMP insures and the security of its reinsurance programs limit underwriting volatility below that of most its P&I peers.

### **Outlook: Stable**

The stable outlook reflects our view that SMP's capital adequacy, as measured by our risk-based model, will remain above our requirements for the 'AAA' level for the next three years.

We also expect the club will maintain its competitive position, with sustained high retention levels and underwriting results marginally better than P&I peers' average 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 could 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 weaken below our 'AAA' level. However, this is unlikely to happen in the next three years based on our view of the club's current capital buffer.

### **Upside scenario**

We consider a positive rating action to be unlikely. Like most of its peers, the relative lack of diversity in SMP's earnings constrains our view of its competitive position.

## **Base-Case Scenario**

### **Macroeconomic Assumptions**

- Significant competition will remain in the small ship P&I market for at least the next two years.
- The global shipping industry is recovering but operating conditions over 2018 will continue to be difficult because, although improved, the supply condition remains fragile.
- There will be no significant changes to the IG pool structure or pool-sharing methodology.
- The pricing pressure in the reinsurance markets will continue to have a positive impact on IG group reinsurance premiums and terms.
- Investment yields will remain subdued and returns uncertain.

**Shipowners' Mutual Protection & Indemnity Association (Luxembourg) -- Key Metrics**

	Year-ended Feb. 20	Year-ended Dec. 31				
	2015A	2015A*	2016A	2017A	2018F	2019F
GPW (mil. \$)	251.2	228.6	228.6	217.8	~220	~220
Net income (mil. \$)	1.5	(20.9)	14.7	47.7	5-10	5-10
S&P Global Ratings' net combined ratio (%)	94.4	98.1	98.5	99	100-102	100-102
Return on shareholders' equity (reported; %)	0.5	(7.2)	5.1	15	~2	~2
Return on revenue (%)	9.4	5.2	5.6	6.3	~4	~4
Net investment yield (%)	1.3	1.0	1.3	1.5	~1.5	~1.5
Total reported capital (mil. \$)	300	279	294	342	~350	~350
Revenue (mil. \$)	212	177	192	185	~185	~185
S&P Global Ratings' capital adequacy	Extremely strong	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. A--Actual. F--Forecast. GPW--Gross premiums written. Forecast data represent S&P Global Ratings' base-case assumptions.

**Business Risk Profile: Strong Market Position In The Small And Specialist Ships Sector**

Within the IG--a group of 13 clubs providing P&I cover to more than 90% of world shipping--SMP occupies a unique position with a focus on the smaller and specialist vessels market where it has grown successfully over time. In addition to the traditional P&I market covered by the IG, SMP has a sizable fixed premium offering (about 30% of gross premiums written) that provides alternative solutions for its members. We view positively the diversification benefits for SMP but also recognize the competitive nature of the fixed premium market, which adds some pressure to its underwriting margins.

Like most of its peers, SMP's revenues have slightly reduced in the past couple of years because of the softening market trend. SMP has historically imposed general increases in premium rates that were much lower than the majority of IG clubs, and we expect price increases will remain limited in the next three years. While muted prices should help keeping members' retention at high levels (more than 95%), we anticipate that SMP's gross premium growth will be constrained as a result, with modest new business coming in over 2018-2020.

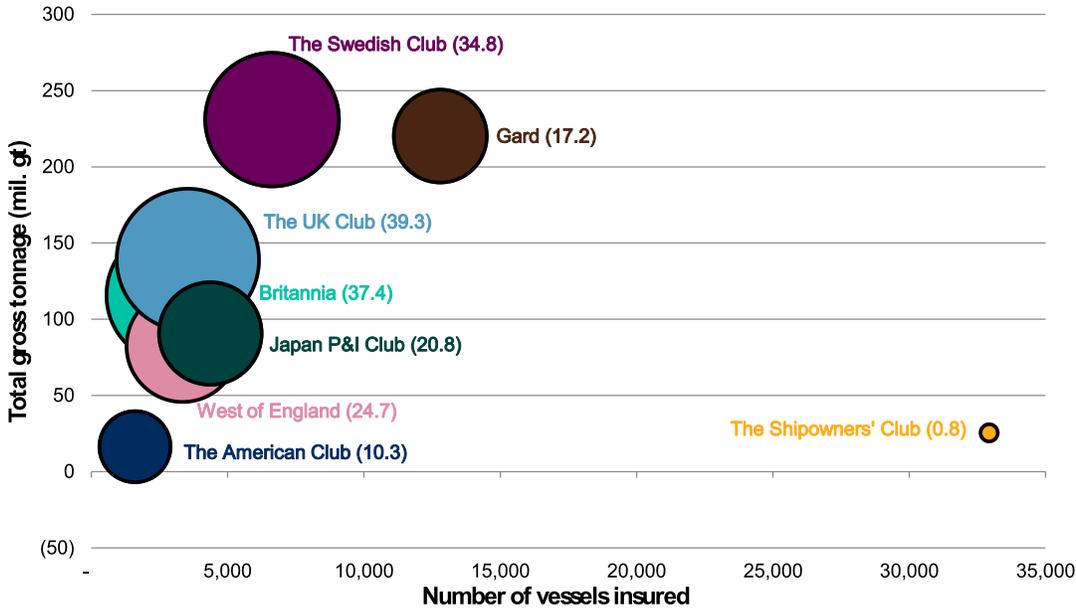
Despite these pressures, SMP's combined ratio over the past five years has averaged 97.9%, which is slightly better than P&I clubs on average. As SMP maintains discipline over the quality of its book and services, we expect

performance will continue to be marginally better than that of peers, on average.

The club's portfolio is well diversified with a global presence, over 6,500 members, and nearly 33,000 vessels entered. However, with no other significant lines of business outside its core P&I offering, SMP's earnings are exposed to the fortune of one market, which we view as a competitive constraint compared with larger insurers.

**Chart 1**

**Shipowners' Unique Profile - Larger Insured Portfolio Than P&I Peers With A Focus On Small Ships**



\*Bubble size represents the average size per vessel (1,000 gt per vessel). Gt--Gross tonnage. Figures are estimates based on latest public information as of May 20, 2018.

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**Financial Risk Profile: Well Capitalized With Contained Underwriting Volatility**

We expect total adjusted capital will remain above our requirements at the 'AAA' level over 2018-2020. This reflects our expectations that, albeit at slower pace, surplus will continue to build on the back of modest annual profits in the \$5 million-\$10 million range.

Our forecast reflects subdued underwriting income for 2018-2020. We anticipate combined ratios to slightly deteriorate at just above breakeven for the period. This is broadly consistent with our expectations for the P&I sector, which has been in a soft phase for some years now. Our expectations also reflect the mutual nature of the club, which aims to provide cover at cost over the cycle.

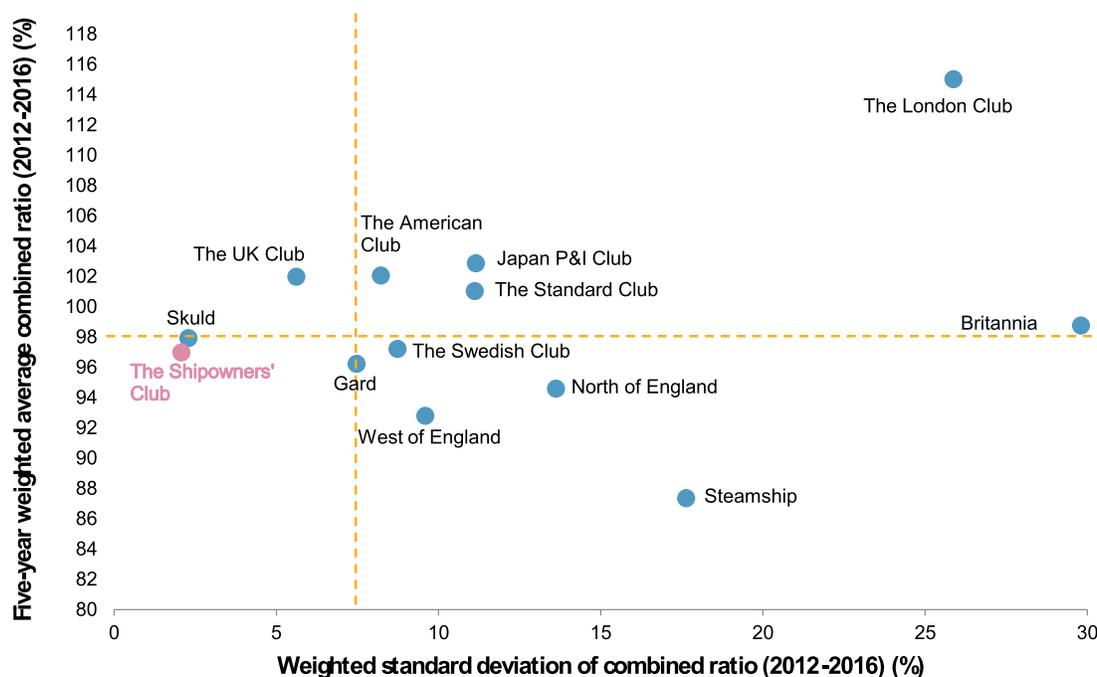
Mainly explained by large equity and currency one-off gains, overall investment returns have been strong in 2017 with

gains of \$47.5 million. On a normalized basis, we project returns to be lower but at least at 1.0% in 2018-2020.

The club's capital position could fluctuate because of the relatively high-risk investment allocation compared with Western European non-life insurers--26% of its investments are in equities. Conversely, we view positively that SMP has historically enjoyed lower underwriting volatility than its P&I peers. We believe the reinsurance program allows for relatively low retention levels while the diversity of SMP's portfolio also provides stability.

**Chart 2**

**Shipowners' Underwriting Performance Historically Less Volatile Than P&I Peers (2012-2016)**



\*Dotted orange lines represent the weighted average for the P&I peer group.

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Like its IG marine mutual peers, SMP has a legally enforceable right to collect unlimited additional premiums. We nevertheless think it is unlikely that the club will exercise this option and as such, we do not explicitly factor it in our capital analysis.

**Other Assessments**

We view SMP's enterprise risk management capabilities as appropriate for its monoline profile. SMP has developed pricing tools that it can use in its quoting procedures, and benefits from its large database and knowledge of the small ship sector.

We view positively SMP's management and governance. Over time, we have observed clarity and consistency in the

club strategy as well as a market-leading expertise in its chosen segment.

We believe the company is capable of managing unexpectedly large claims. We assess that about \$600 million of liquid assets would be available in a stressed situation--this represents more than 2.5x liquidity needs.

## Rating Score Snapshot

**Table 1**

Rating Score Snapshot	
Financial Strength Rating	A/Stable
SACP	a
Anchor	a
Business risk profile	Strong
IICRA	Intermediate Risk
Competitive position	Strong
Financial risk profile	Strong
Capital and earnings	Very Strong
Risk position	Moderate Risk
Financial flexibility	Adequate
Modifiers	0
ERM and management	0
Enterprise risk management	Adequate
Management and governance	Satisfactory
Holistic Analysis	0
Liquidity	Exceptional
Support	0
Group support	0
Government support	0

IICRA--Insurance Industry and Country Risk Assessment. SACP--Stand-alone credit profile.

## 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. Because the pooling agreement provides a mutual reinsurance mechanism for the IG, we have treated the \$11.2 million paid into the pool at year-end December 2017 as ceded reinsurance premiums, as opposed to gross claims incurred.

## Glossary

**P&I insurance:** Protection and indemnity insurance is a form of mutual maritime insurance that provides third party legal liability insurance for ship owners, operators, and charterers.

**Fixed premium:** Form of non-mutual P&I insurance offered at a fixed price. Fixed premium policyholders are not mutual members of a P&I Club.

## Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General: Enterprise Risk Management, May 7, 2013
- General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 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

## Related Research

- P&I Sector Remains Strong Despite Market Pressure, Feb. 20, 2018
- Insurance Industry And Country Risk Assessment: The Global Marine Protection And Indemnity Industry, Jan. 31, 2018

### Ratings Detail (As Of May 30, 2018)

#### 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.

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