

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

Rationale

S&P Global Ratings considers its 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 strong underwriting results in aggregate over 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. Although 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.

The club performance has been relatively weak in 2018, but we expect underwriting performance to slowly revert to profitability in the next three year as pressure on rates lessens.

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 two years.

We also expect the club will maintain its competitive position, with sustained high retention levels and underwriting results aligned with 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 and hinder underwriting performance.

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.

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.

Macroeconomic Assumptions

- Global shipping companies will continue to face difficult operating conditions, characterized by fragile demand and chronic structural oversupply in the industry.
- Charter rates might finally be bottoming out in subsectors. That said, they remain subdued and this, combined with the rising price of the oil-based fuel used to run ships (bunker fuel), will continue to constrain cash flow generation for most ship operators.
- There will be no significant changes to the IG pool structure or pool-sharing methodology.
- Sustained high level of capacity in the reinsurance markets will continue to have a positive impact on IG group reinsurance and retention protection premium and terms

Table 1

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

	--Year ended Feb. 20--		Year ended Dec. 31				
	2015A	2015A*	2016A	2017A	2018A	2019F	2020F
Gross premiums written (mil. \$)	251.2	228.6	228.6	217.8	228.4	~230	~240
Net income (mil. \$)	1.5	-20.9	14.7	47.7	-37.9	~0	~6
S&P Global Ratings' net combined ratio (%)	94.4	98.1	98.5	99.0	104.4	~102-105	~102
Return on shareholders' equity (reported) (%)	0.5	-7.2	5.1	15.0	-11.7	~0	~1-2
Return on revenue (%)	9.4	5.2	5.6	6.3	1.8	~0	~2-3
Net investment yield (%)	1.3	1.0	1.3	1.5	1.8	~1.5	~1.5
Total reported capital (mil. \$)	300	279	294	342	304	~305	~310
Revenue (mil. \$)	212	177	192	185	198	~210	~215
S&P Global Ratings' capital adequacy	Extremely strong	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.

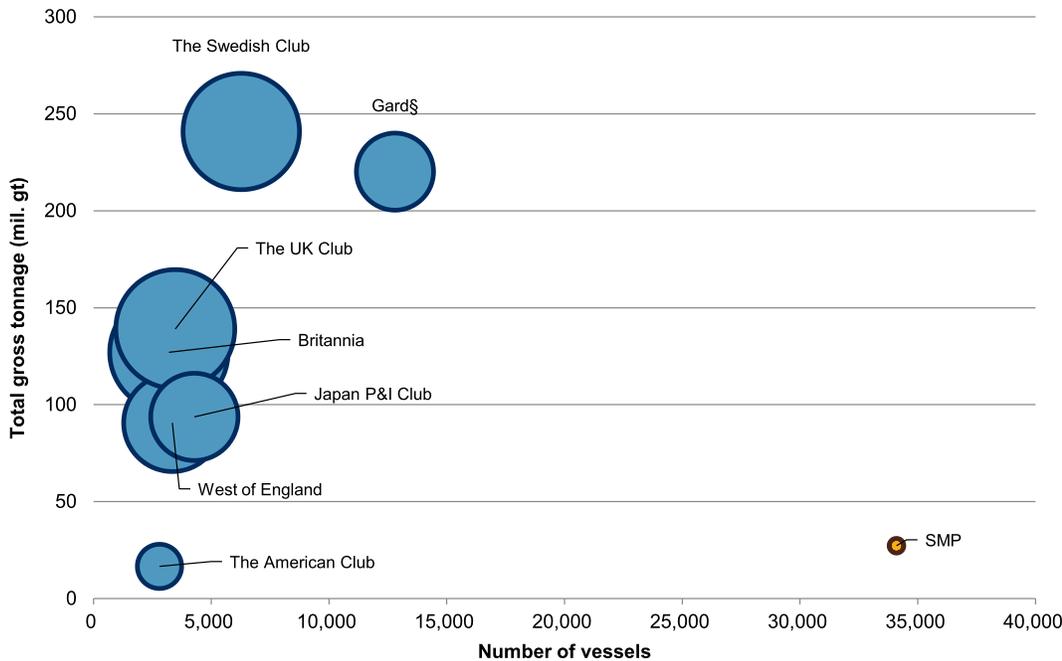
Like most of its peers, SMP's revenues have slightly reduced in the past couple of years because of the softening market trend. SMP has historically imposed general increases in premium rates that were much lower than the majority of IG clubs, but we expect intensified pressure for price increases in the next three years. We anticipate that SMP's gross premium will grow marginally as a result, with modest new business coming in over 2019-2021 and members' retention sustained at high levels (more than 95%).

SMP's combined ratio over the past five years has averaged 99%, which is in line with the P&I club average over the period. Although SMP has maintained discipline over the quality of its book and services, we expect performance to be below historical levels. It will likely be broadly aligned with that of peers, on average.

The club's portfolio is well diversified, with a global presence, over 7,400 members, and nearly 34,000 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

SMP Has A Unique Profile, With A Larger Insured Portfolio Than P&I Peers And A Focus On Small Ships



*Bubble size represents the average size per vessel (1,000 gt/ per vessel). \$As per 2016 data.
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Financial Risk Profile:

Well-capitalized, with contained underwriting volatility

We expect total adjusted capital will remain above our expectations at the 'AAA' level over 2019-2021. This indicates that we expect surplus to continue to build on the back of modest annual profits of about \$5 million, although margins will be lower following the \$38 million loss recorded in 2018.

Our forecast reflects continued subdued underwriting income for 2019-2021. We anticipate that combined ratios will remain above breakeven for the period, following SMP's decision not to raise rates in 2018 and 2019. (Lower combined ratios indicate better profitability. A combined ratio of greater than 100% signifies an underwriting loss.) Considering the mutual status and the financial position of the club, we do not view these medium-term decisions negatively. We believe that SMP will preserve its long-term objective to provide their members with cover at cost over the cycle.

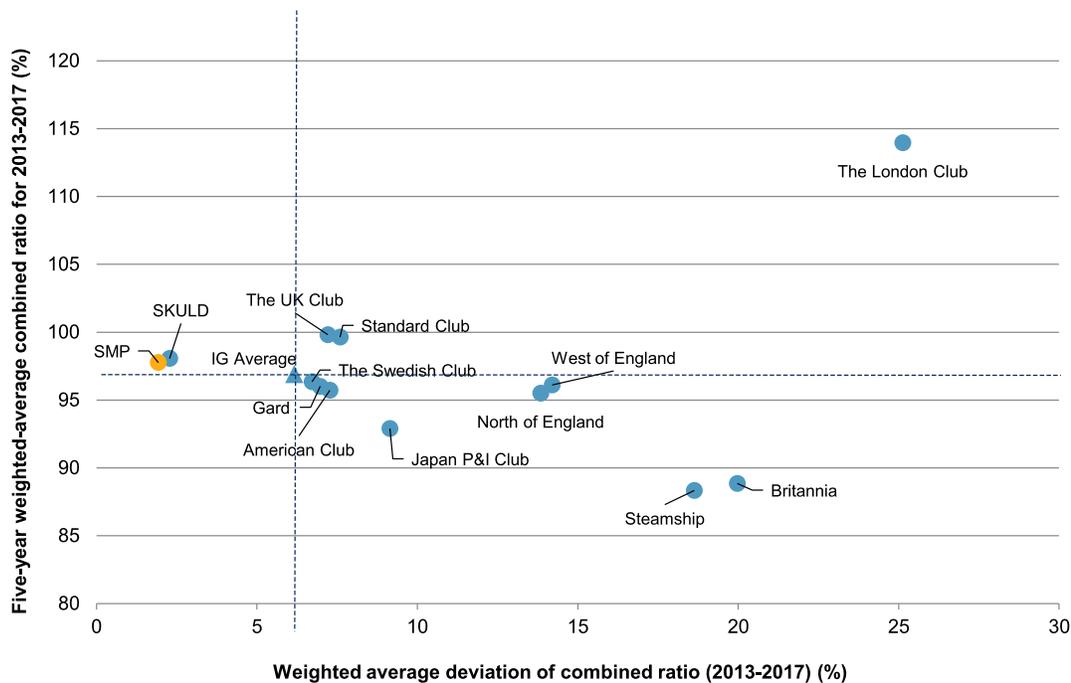
Overall investment returns have been weak in 2018; SMP reported losses of \$28.8 million, mainly because of large unrealized equity losses. On a normalized basis, we project returns to recover to around 1.5% in 2019-2021.

As observed in 2018, the club's capital position could fluctuate because of its relatively high-risk investment allocation

compared with Western European non-life insurers--24% of its investments are in equities. Conversely, we view positively that SMP has historically enjoyed lower underwriting volatility than its P&I peers. We consider that the reinsurance program allows for relatively low retention levels and the diversity of SMP's portfolio also provides stability.

Chart 2

SMP's Underwriting Performance Has Historically Been Less Volatile Than P&I Peers (2013-2017)



*Dotted 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 \$590 million of liquid assets would be available in a stressed situation--this represents more than 2.6x liquidity needs.

Rating Score Snapshot

Table 2

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--instead they cover 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 \$9.0 million paid into the pool at year-end December 2018 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 nonmutual 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
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria | Insurance | General: Enterprise Risk Management, 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 June 5, 2019)*

Operating Company Covered By This Report

Shipowners' Mutual Protection & Indemnity Association (Luxembourg)

Financial Strength Rating

Local Currency

A/Stable/--

Issuer 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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