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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:

Mark D Nicholson, London (44) 20-7176-7991; mark.nicholson@spglobal.com

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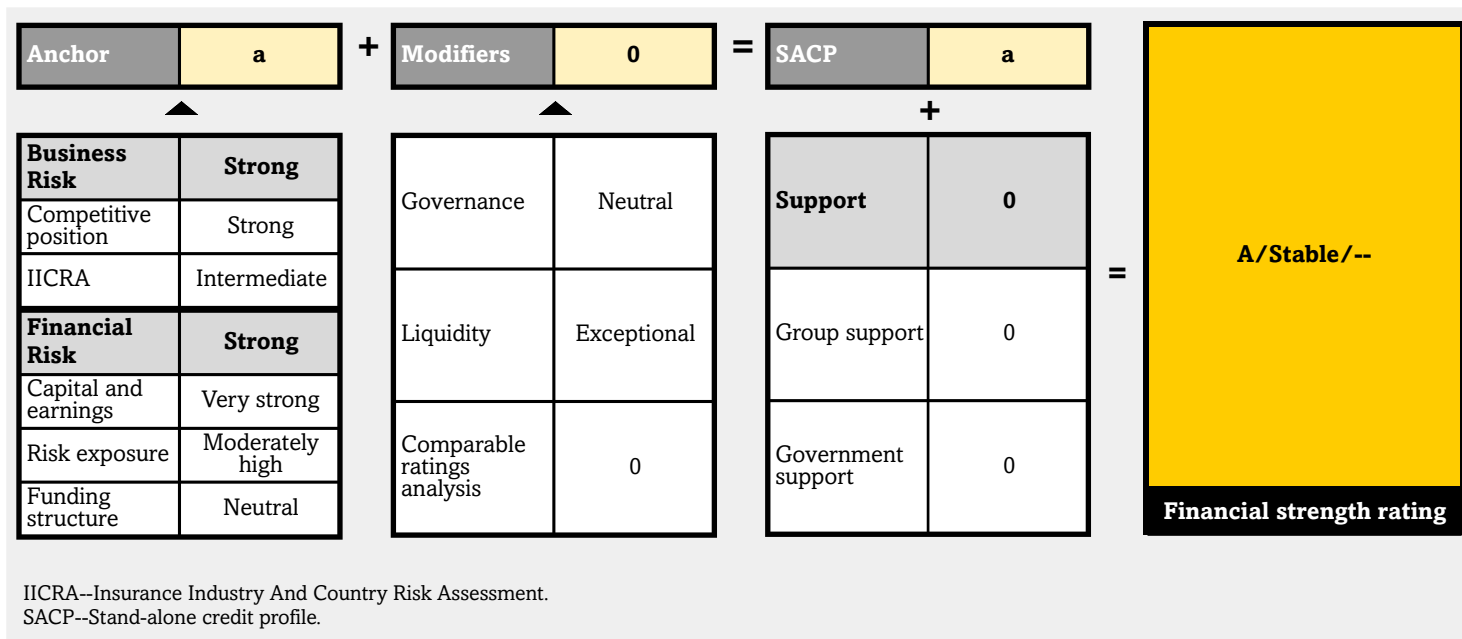
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Shipowners' Mutual Protection & Indemnity Association (Luxembourg)



Credit Highlights

Overview

Key strengths	Key risks
Membership of the International Group (IG) of protection and indemnity (P&I) clubs provides market access.	Competition from fixed-premium players and within the IG, together with persistently low premium rates, pressure underwriting profitability and growth rates.
Leading and resilient position in the P&I insurance market for small and specialist ships.	Largely undiversified product range and exposure to the equity markets can cause earnings volatility.
Well capitalized in excess of the 'AAA' level, with relatively stable underwriting records that compare well with those of IG peers.	Compared with IG peers, the unusually large number of members implies more reliance on broker relationships to retain business.

Shipowners' Mutual Protection & Indemnity Association (Luxembourg) (SMP) will maintain a leading position in its niche market of P&I insurance for small and specialist vessels. S&P Global Ratings expects that SMP will defend its market share and will continue to benefit from the competitive advantage that its unique position within the IG provides. We expect levels of premium and tonnage to remain the same, but anticipate that the impact of the COVID-19 pandemic on passenger vessel activity could put pressure on premiums in 2020-2021.

We expect that SMP will maintain excess capital at our 'AAA' benchmark. SMP holds reasonable excess capital over our 'AAA' benchmark, along with a regulatory solvency II capital level of 190%. We expect that because of COVID-19-related investment losses and a lack of underwriting profits, the club will see its capital surplus reduce over the next two years, but we expect it to remain at the 'AAA' level.

Given its focus on its core P&I business, SMP remains largely undiversified. SMP's business composition is consistent with that of its P&I peers. However, in comparison to the peers we rate more highly, SMP's lack of diversity makes its business less stable and less resilient to stress.

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 that the club will maintain its competitive position and sustain high member retention and underwriting results, in line with the averages for its P&I peers during this period. That said, in line with its peers, we anticipate that economic conditions and competitive pressures may continue to slow SMP's growth rate and hinder its underwriting performance.

Downside scenario

We could lower the rating on SMP if we were to see a deterioration in its competitive position, evident from 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.

Key Assumptions

- A global recession in 2020 due to the COVID-19 pandemic. We forecast that GDP will fall by 5.2% in the U.S. and by 7.3% in the eurozone.
- A fall in U.S. 10-year treasury yields of 1.3% in 2019, before slightly increasing to 1.8% in 2022.
- Ongoing weak business conditions in the P&I sector following years of falling rates. This is despite some recent improvements in rates.
- Investment and underwriting losses for marine insurers due to COVID-19 and the recent oil price shock. Underwriting losses will flow from COVID-19-related claims and premium returns due to lower trading activity, with insurers of cruise and passenger vessels most affected.
- No significant changes to the IG pool structure or pool-sharing methodology.
- Hardening conditions in the reinsurance markets, which will gradually weigh on the IG group's reinsurance protection premium and terms.

Key Metrics

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

	--Fiscal year ended Dec. 31--						
	2015a*	2016a	2017a	2018a	2019a	2020f	2021f
Gross premiums written (mil. \$)	228.6	228.6	217.8	228.4	230.5	~230	~230

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

	--Fiscal year ended Dec. 31--						
	2015a*	2016a	2017a	2018a	2019a	2020f	2021f
Net income (mil. \$)	(20.9)	14.7	47.7	(37.9)	36.1	~(20)	~5
S&P Global Ratings' net combined ratio (%)	98.1	98.5	99.0	104.4	105.6	~103-106	~102-104
Return on shareholders' equity (reported) (%)	(7.2)	5.1	15.0	(11.7)	11.2	~(6)-(2)	~1-2
Return on revenue (%)	5.2	5.6	6.3	1.8	1.6	~(10)-(3)	~1-2
Net investment yield (%)	1.0	1.3	1.5	1.8	2.1	~(2)-0	~1.3
Total reported capital (mil. \$)	279.0	294.0	342.0	304.0	340.0	~320	~325
Revenue (mil. \$)	177.0	192.0	185.0	198.0	197.0	~195	~220
S&P Global Ratings' capital adequacy	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent

*The year-end 2015 financial figures do not reflect a full year, but the period from Feb. 20, 2015, to Dec. 31, 2015. a--Actual. f--Forecast. Forecast data represent S&P Global Ratings' base-case assumptions.

Business Risk Profile: Strong

Within the IG--a group of 13 clubs providing P&I cover to more than 90% of the world's ships--SMP occupies a unique position with its focus on the market of smaller and specialist vessels, 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 an alternative solution 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 the club's underwriting margins.

Like most of its peers, SMP's revenues have been somewhat constrained in recent years because of softening market conditions and competitive pressure from within and outside the IG group. SMP has historically imposed much lower increases in premium rates than the majority of IG clubs, but it has announced a price increase of 5% for the 2020-2021 policy year, the first such increase since 2014.

We continue to see a need for price increases in the coming years, but the effects of the COVID-19 pandemic and associated lockdowns, along with the fall in oil prices, are likely to lead to revenue contraction and make it more difficult to increase rates. We believe that these events have reduced volumes of global trade and travel, meaning that many ships, particularly in the passenger sector, are lying unused, resulting in a loss of revenues. As a result, while we expect member retention to remain high (it was more than 95% at year-end 2019), we anticipate that SMP's gross premium will only grow marginally. We anticipate that modest new business in 2020-2021 will only offset the short-term potential revenue contraction.

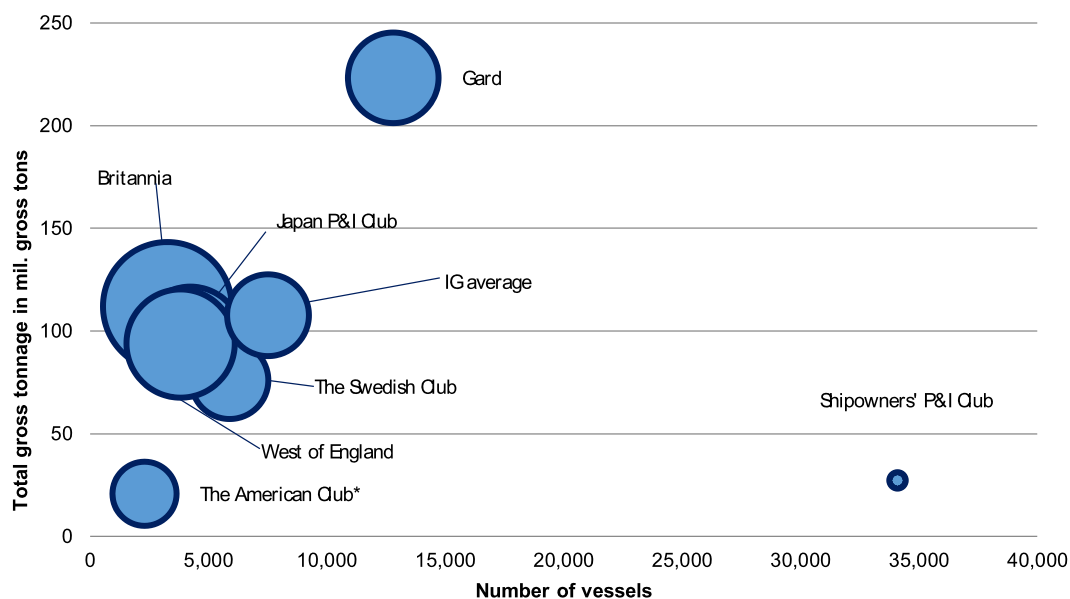
SMP's combined ratio over the past five years has averaged 101%, which is in line with the average for its P&I club peers over the same period. While SMP maintains discipline over the quality of its book and services, we expect that its performance will be below the strong historical levels, but broadly in line with the average performance of its peers. SMP's combined ratio of 105.6% in 2019 was in line with our expectation and better than the average of above 110%

that we expect for the IG clubs.

SMP's portfolio is well diversified, and the club has a global presence, 7,886 members, and 33,301 insured vessels. However, with no other significant lines of business outside its core P&I offering, SMP's earnings are exposed to the fortunes of one market, which we view as a competitive constraint compared to larger insurers.

Chart 1

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



Bubble size represents the average size per vessel (1,000 gross tons per vessel). Figures are based on company disclosures in the period from Dec. 31, 2018 to March 31, 2019, and are S&P Global Ratings' estimates. IG average is based on the IG P&I annual review 2018/2019. *The number of vessels for The American Club is based on its subsidiary, American Hellenic Insurance Co. Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

Financial Risk Profile: Strong

We expect that SMP's total adjusted capital will remain above our requirements at the 'AAA' level over 2020-2022. This reflects our expectation that despite the drop we anticipate in 2020, SMP will slowly rebuild the capital surplus on the back of modest annual profits of around \$5 million over 2021-2022.

Our forecast reflects continued subdued underwriting income for 2020-2022 and adds up to three percentage points to the combined ratio for claims related to COVID-19 in 2020. We anticipate that the underlying combined ratios will gradually revert toward breakeven for the period, factoring in SMP's decision to increase general prices by 5% in 2020. Considering the club's mutual status and financial position, we do not view medium-term decisions to underwrite at a loss too negatively. We believe that SMP will preserve its long-term objective to provide its members with cover at

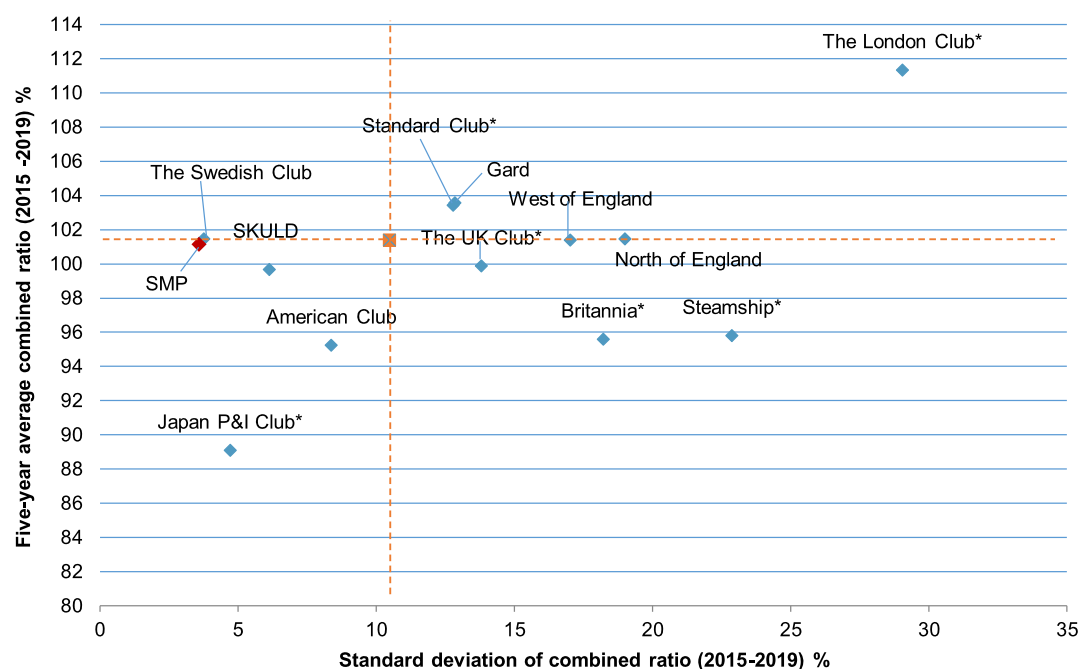
cost, but recognize that short-term competitive pressure might delay its ability to do so in the next three years.

On a normalized basis, we project that SMP's investment returns, excluding capital gains, will be around 1.5% in 2021-2022. The club has a relatively high-risk investment allocation (a 25% equity target) compared with western European non-life insurers. This contributed to earnings volatility in 2018, and we anticipate that SMP's exposure to equity will also weaken its overall performance in 2020, with investment returns down to -2%. Nonetheless, we recognize that SMP's investment strategy has shown long-term benefits, evident from returns in excess of 7% in 2019 recovering the market losses of 2018.

On the other hand, we take a positive view of SMP's historically lower underwriting volatility than its P&I peers. We believe that the reinsurance program allows for relatively low levels of risk retention, while the diversity of SMP's portfolio also provides earnings stability.

Chart 2

SMP's Underwriting Performance In 2015-2019 Was Less Volatile Than Its P&I Peers'



Dotted orange lines represent the P&I peer group average. Figures are S&P Global Ratings' estimates.

*Excludes 2019 combined ratio (not available), based on a four-year average (2015-2018).

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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 into our capital analysis.

Other Key Credit Considerations

Governance

We consider SMP's governance to be in line with that of the majority of other P&I clubs. Over time, we have observed clarity and consistency in the club's strategy, as well as market-leading expertise in its chosen segment. We view SMP's 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 ships sector.

Liquidity

We believe that SMP is capable of managing unexpectedly large claims. We assess that about \$570 million of liquid assets would be available in a stressed situation; this represents more than 2.2x the club's liquidity needs.

Accounting considerations

The year-end 2015 financial statements 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 \$17 million paid into the pool at year-end December 2019 as ceded reinsurance premiums, as opposed to gross claims incurred.

Anchor selection

Selection of the 'a' anchor is influenced by the club's resilience to increased competition in the small ship P&I market and our expectation that SMP will continue to exhibit lower underwriting volatility than its peers.

Glossary

P&I Insurance

A form of mutual maritime insurance that provides third-party legal liability insurance for ship owners, operators, and charterers.

Fixed premium

A 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

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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

Related Research

- P&I Clubs Likely To Take Their Cue From The First Renewal Announcements, Oct. 15, 2019

Appendix

Shipowners' Mutual Protection & Indemnity Association (Luxembourg)--Credit Metrics History		
Ratio/Metric	2019	2018
S&P Global Ratings capital adequacy	Excellent	Excellent
Total invested assets	692.60	657.47
Total shareholder equity	339.97	303.83
Gross premium written	230.47	228.39
Net premium written	188.62	189.74
Net premium earned	183.01	185.99
Reinsurance utilization (%)	18.16	16.92
EBIT	38.01	(37.19)
Net income (attributable to all shareholders)	36.15	(37.90)
Return on revenue (%)	1.64	1.80
Return on assets (excluding investment gains/losses) (%)	0.41	0.47
Return on shareholders' equity (%)	11.23	(11.74)
Property/casualty: Net combined ratio (%)	105.61	104.41
Property/casualty: Net expense ratio (%)	29.36	28.04
Property/casualty: Return on revenue (%)	1.91	1.92
EBITDA fixed-charge coverage (x)	N/A	N/A
EBIT fixed-charge coverage (x)	N/A	N/A
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	N/A	N/A
Financial obligations/adjusted EBITDA (x)	N/A	N/A
Financial leverage including pension deficit as debt (%)	N/A	N/A
Net investment yield (%)	2.08	1.78
Net investment yield including investment gains/(losses) (%)	7.23	(4.26)

N/A--Not applicable.

Business And Financial Risk Matrix								
Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of June 19, 2020)*	
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.

Additional Contact:

Insurance Ratings Europe; insurance_interactive_europe@spglobal.com

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