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

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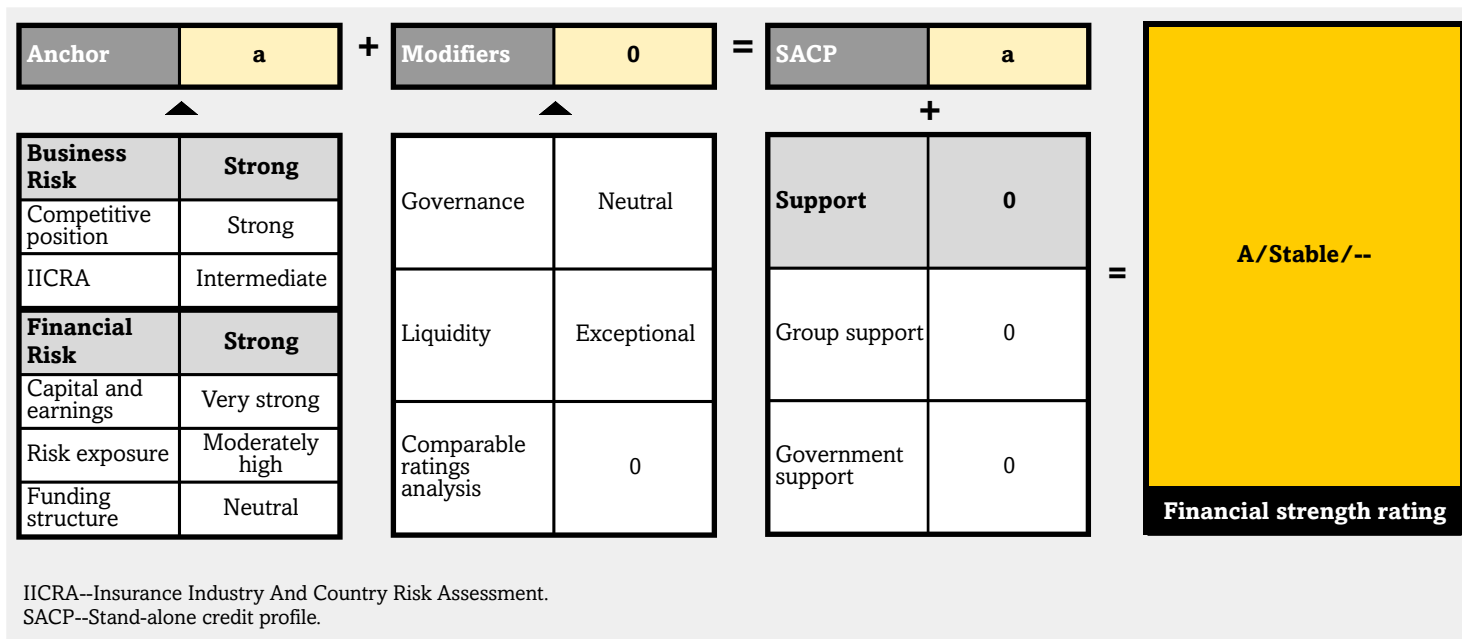
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# Shipowners' Mutual Protection & Indemnity Association (Luxembourg)



## Credit Highlights

Overview	
Key strengths	Key risks
Membership of the International Group (IG) of protection and indemnity (P&I) clubs provides market access.	Concentrated product range and exposure to equity markets, especially considering current turbulent financial markets, can cause capital and earnings volatility.
Capitalized at the 'AAA' level, according to S&P Global Ratings' risk-based capital model, with relatively stable underwriting records that compare well with those of IG peers.	Weaker macroeconomic conditions, geopolitical tensions, and competition from fixed-premium players and within the IG, could temper growth and underwriting results.
Leading and resilient position in the P&I insurance market for small and specialist ships, underpinned by sector expertise and sound intermediary relationships.	Compared with IG peers, the larger number of members increases diversification but creates a higher expense base and 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.* Although macroeconomic and geopolitical headwinds could temper growth, S&P Global Ratings expects that SMP will defend its market share and continue to benefit from the competitive advantage that its unique position within the IG provides. We expect the Club to continue to demonstrate sound underwriting discipline with combined ratios at about breakeven level and retention rates within the high 90% range (2022: 99%).

*We expect SMP will maintain excess capital at our 'AAA' benchmark.* That said, we remain aware of the potential volatility in the capital surplus from investment exposure, especially as the surplus at the 'AAA' level has reduced following the ongoing market turmoil. Some of the capital reduction for unrealized losses on fixed income securities

could be temporary. Furthermore, SMP is potentially exposed to volatile pool claims, similar to its IG peers. We expect management will take action if needed to maintain capital adequacy 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, compared to its peers, including non-P&I clubs that we rate more highly, SMP's lack of diversity makes its business less diversified 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 the club will maintain its competitive position and sustain high member retention and underwriting results, at least in line with the averages for its P&I peers during this period.

### Downside scenario

We could lower the rating on SMP if its competitive position deteriorates, 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 weakened below our 'AAA' level.

### Upside scenario

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

## Key Assumptions

- Downside risks have increased. Tighter financing conditions, combined with more conservative lending standards, could push many economies closer to a hard landing. Shifts in market sentiment or any potential hidden stresses could spark renewed volatility. Geopolitical risks from the Ukraine war and U.S.-China tensions remain acute.
- The full impact of sharply higher interest rates is yet to be realized. Banking stress in the U.S. and Europe is a reminder of how quickly confidence can erode. The rapid response by authorities suggests broader contagion will be avoided. Nevertheless, high interest rates will likely further strain credit financing costs and asset prices (see "Global Credit Conditions Q2 2021: Balancing Resilience And Turbulence," published March 30, 2023).

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

	--Year ended Dec. 31--							
	2025f	2024f	2023f	2022a	2021a	2020a	2019a	2018a
Gross premiums written (Mil. \$)	~280	~275	~271	270.8	257.5	234.1	230.5	228.4
Net income (Mil. \$)	~26	~25	~26	-59.1	17.4	39.1	36.1	-37.9
S&P Global Ratings' Net combined ratio (%)	~99	~99	~99	97.4	98.7	101.0	105.1	104.2
S&P Global Ratings' capital adequacy	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent

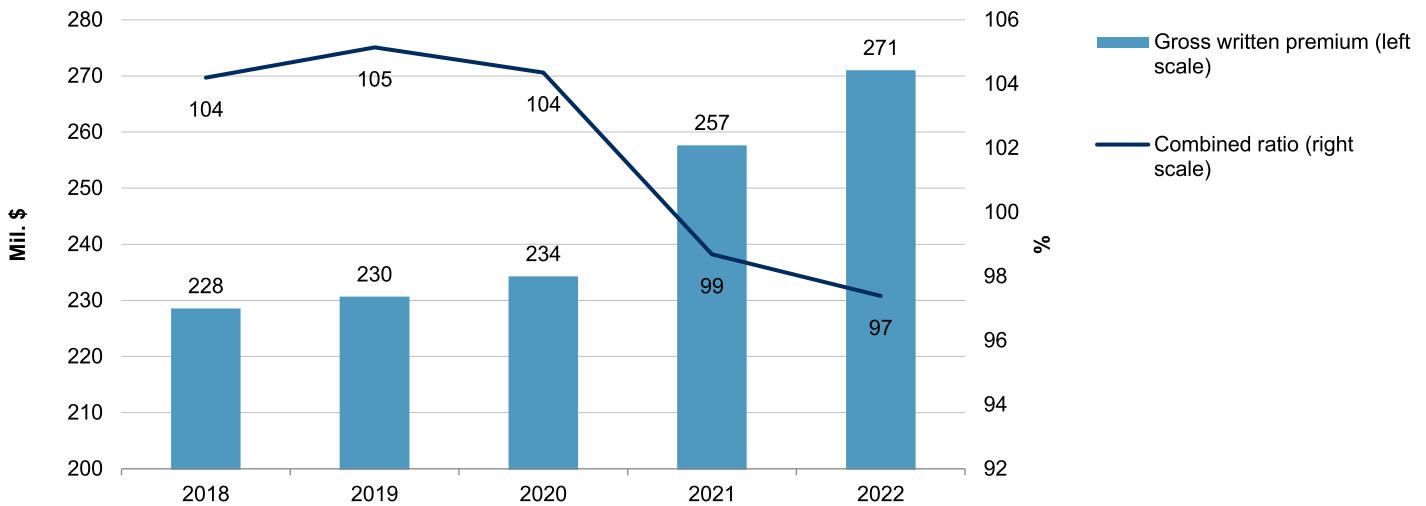
a--Actual. f--Forecast. Forecast data represent S&P Global Ratings' base-case assumptions.

## Business Risk Profile: Strong

Within the IG—a group of 12 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 built a defensible and successful position 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 ebbs and flows in the competitive nature of the fixed-premium market, which has tended to add some pressure to the club's underwriting margins in the past. The P&I industry is also prone to highly unpredictable claims, and although SMP's low share of the pool helps somewhat mitigate the impact, it does drag on the loss ratio. We anticipate that SMP's underwriting performance will hover around breakeven for the next two years as the club remains disciplined on underwriting.

Chart 1

### Shipowners' technical performance has improved in recent years



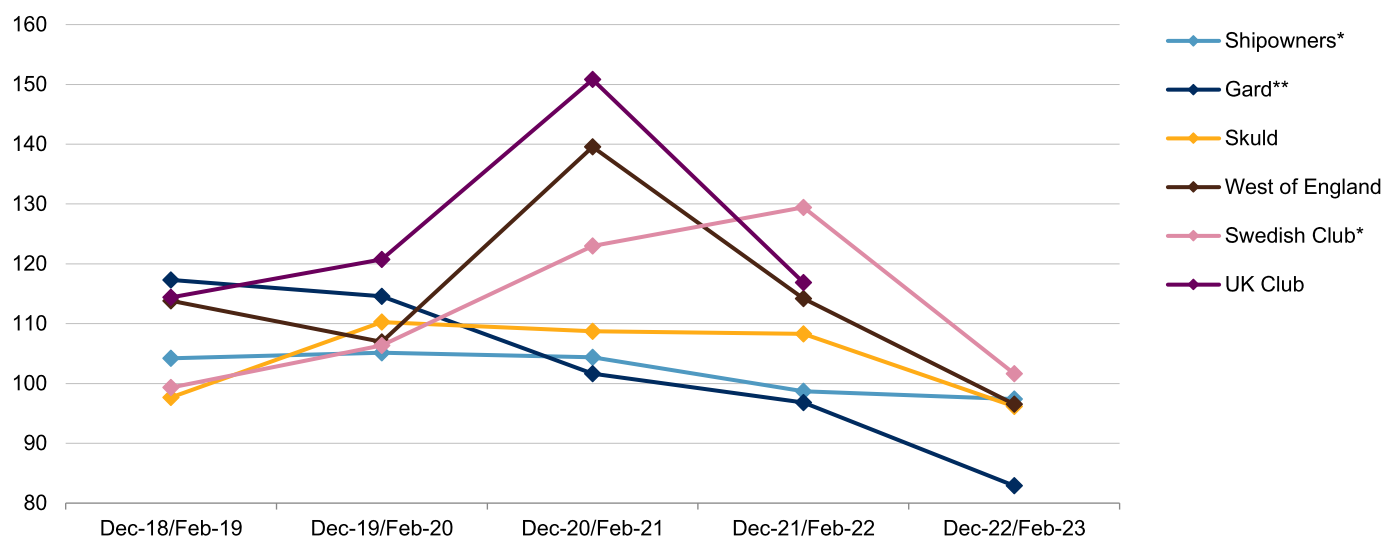
Source: S&P Global Ratings.

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The company's combined ratio of 97.4% in 2022 thanks to limited own claims and lower exposure to pool claims, was in line with our expectations. The recent improved operating performance has alleviated some of the pressures seen in SMP's combined ratio in 2018 and 2019. Due to the strong underwriting performance in the last two years, five-year (2018-2022) combined ratio average at about 102% is better than the average for its P&I club peers over the same period.

Chart 2

Underwriting performance (COR) versus peers



\*Companies with year end as Dec 31. \*\*For Gard, the reporting period is from March 1-Dec. 31.

f--Forecast. Source: S&P Global Ratings.

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SMP has demonstrated high member retention levels (99% in 2022) and we expect retention to remain in the high-90s over the next two years. We are cautious regarding prospective growth due to ongoing pressures on the global economy and geopolitical tensions, which could temper demand. Also, even though SMP has historically imposed none or much lower increases in premium rates than the majority of IG clubs, recent years have benefitted from general rate increases along with new business wins. We anticipate limited premium growth from general rate increases over the next two years compared to last year.

SMP's expense ratio somewhat exceeds peers because of the business model and has factored inflationary pressures in the forecasts. That said, development and experience of claims inflation remains an uncertainty.

SMP has a global presence, over 8,500 members, and 33,808 insured vessels, representing close to 30 million gross tonnage. The large number of members increases diversity and reduces concentration risk. On the other hand, we also consider that the largely broker-based distribution model increases reliance on intermediaries. 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 with larger and higher rated insurers.

## Financial Risk Profile: Strong

We expect that SMP's total adjusted capital will remain above our requirements at the 'AAA' level over the next two

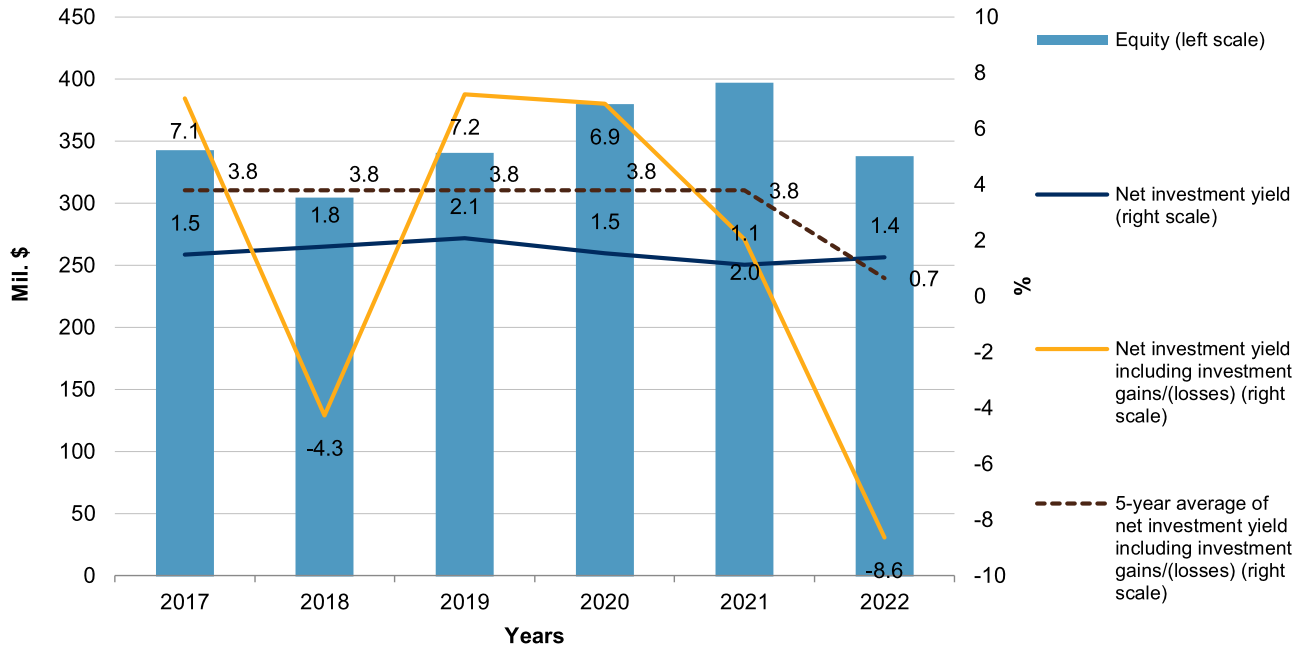
years. This reflects our expectation SMP will continue to build the capital surplus on the back of modest annual profits over the next two years, although the results are exposed to financial market volatility which is currently particularly elevated.

Our forecast reflects continued breakeven underwriting income and lower but positive investment returns based on the company's business plans. Considering the Club's mutual status and financial position, we do not view decisions to underwrite at a break-even too negatively. We believe SMP will preserve its long-term objective to provide its members with cover at cost. That said, reliance on investment results to support capital adequacy exposes the club to risks from financial market volatility.

As a result of high interest rate conditions, the Club assumes annual investment returns will be about 3% to 4% for the next two years, despite the investment portfolio's tilt toward active management and weighting toward equities, which have weaker returns over 2022. Our expectations factor in the 2022 investment yield and the ongoing financial market rout. The Club has a relatively high-risk investment allocation (a 25% equity target) compared with Western European nonlife insurers. This contributed to capital volatility, resulting in investment losses and lower capital adequacy at the 'AAA' level for 2022 compared to 2021. SMP's investment strategy has led to volatility - capital position recovered with investment returns (including by capital gains) of about 7% in 2019 and 2020, but returns also dropped to nearly -9% in 2022, 2% in 2021, and -4% in 2018. We believe the current capital surplus at the 'AAA' level can withstand short-term bouts of market turbulence. However, we still expect that SMP's ability to absorb market shocks and sustain 'AAA' level capital adequacy may reduce if the surplus declines.

**Chart 3**

**Volatile investment returns raise potential capital and earnings risk**



Source: S&P Global Ratings.

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As mentioned, we view positively that SMP's underwriting volatility has historically been lower than that of its P&I peers. We believe that the reinsurance program allows for relatively low risk retention, while the diversity of SMP's portfolio also provides earnings stability. This is reflected in SMP's relatively sound performance over the past two years when we observed heightened volatility for many P&I peers.

## Other Key Credit Considerations

### Governance

We consider SMP's governance to be in line with that of the majority of other P&I clubs. The current CFO, Simon Peacock, will succeed the role of the CEO after the current CEO, Simon Swallow, retires in May 2023. Marcus Tarrant, the Director and Chief Actuary of the Club's management company, will become the Club's CFO. We expect a smooth transition and understand that the strategy is unlikely to materially change under the new leadership team. The Club's strategy has been consistent, and it continues to display 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 and liquid assets would be able to cover over 2.2x of the club's liquidity needs.

## Anchor selection

Selection of the 'a' anchor is influenced by the club's resilience to ongoing competition in the small ship P&I market and our expectation that SMP will continue to exhibit lower underwriting volatility than its peers. We also note our expectations of sound capital adequacy over the next two years.

## Environmental, social, and governance

### ESG Credit Indicators

E-1	<b>E-2</b>	E-3	E-4	E-5	S-1	<b>S-2</b>	S-3	S-4	S-5	G-1	<b>G-2</b>	G-3	G-4	G-5
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ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of SMP.

## 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

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010



## Appendix

Shipowners' Mutual Protection & Indemnity Association (Luxembourg)--Credit metrics history					
	2022	2021	2020	2019	2018
S&P Global Ratings capital adequacy	Excellent	Excellent	Excellent	Excellent	Excellent
Total invested assets	735.7	782.6	752.7	692.6	657.5
Total shareholder equity	337.4	396.4	379.1	340.0	303.8
Gross premium written	270.8	257.5	234.1	230.5	228.4
Net premium written	241.9	231.5	209.7	205.6	198.7
Net premium earned	236.4	223.2	207.2	200.0	195.0
Reinsurance utilization (%)	10.7	10.1	10.4	10.8	13.0
EBIT	-58.8	17.7	40.4	38.0	-37.2
Net income (attributable to all shareholders)	-59.1	17.4	39.1	36.1	-37.9
Return on revenue (%)	7.0	4.6	0.8	1.5	1.7
Return on assets (excluding investment gains/losses) (%)	2.0	1.2	0.2	0.4	0.5
Return on shareholders' equity (%)	-16.1	4.5	10.9	11.2	-11.7
Property/casualty: Net combined ratio (%)	97.4	98.7	104.4	105.1	104.2
Property/casualty: Net expense ratio (%)	26.6	26.5	28.6	26.9	26.8
Property/casualty: Return on revenue (%)	7.1	4.6	0.8	1.5	1.7
Net investment yield (%)	1.4	1.1	1.5	2.1	1.8
Net investment yield including investment gains/losses (%)	-8.6	2.0	6.9	7.2	-4.3

N/A--Not applicable. Source: Arrow Global

## 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+
<b>Strong</b>	aa-/a+	a+/a	<b>a/a-</b>	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 May 26, 2023)\*

## Operating Company Covered By This Report

**Ratings Detail (As Of May 26, 2023)\*(cont.)**

**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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