Managing Director’s 2014 Annual Review

The International Group continues to prosper financially and has achieved its fifth successive surplus, raising its combined free reserves to US$4.3 billion and achieving an all-time record high!

Asia’s economic outlook remains very positive, with growth still around 6% despite signs of moderating in China and India. The American economy is now recovering, but the ending of quantitative easing has introduced some volatility to the markets and may signal a fall in asset values. The European economy appears to be heading for a period of deflation, which the European Central Bank seems reluctant to address. These issues will place more financial pressures on Club investment managers and Club underwriters.

However, notwithstanding the state of the market and the continuing difficulties many Shipowners and operators are enduring, there are signs that market conditions are improving and global growth is increasing. However new ship deliveries are slowing and there has been only a modest rise in the tonnage insured by the International Group – just 2.3%, taking the total gt insured by the group to 1.058 billion gt.

The Clubs continue to focus their concerns on the issues referred to in the Chairman’s commentary, however we believe the truth is that smaller attritional claims remain within anticipated limits, and the cost of IG pool claims for the 2013 policy year (after twelve months) was lower than for the previous year. With relatively constant incurred claims costs, the underwriting deficits of the group fell from $244m to $74m. With the inclusion of investment income of $345m the group achieved a further surplus of $271m – compared to $204m the previous year. Investment income fell from $449m to $345m, delivering a return of 3.5%. The Clubs with the largest equity exposures produced the best investment return results. For the most part Clubs are enjoying “rude health”!

Currently the Clubs appear reluctant to be transparent with their membership, as already commented upon by our Chairman. The average expense ratios referred to in the KPI’s shown within the Wilson Europe Club Insights do not properly clarify the actual cost of Club management - with claims staffing and other management costs are regularly included and therefore disguised within the overall claims reserves. Allocated abatement layer costs rarely reflect the actual costs of mutualising claims in excess of the Clubs stated abatement layer levels. Other purchases of reinsurance and stop loss policies are often included within the acceptable loss ratio, but the cost of these insurances are not made public to the members and his broker. Abatement layer levels are being increased without advice to the membership at large, resulting in members and their records being exposed to higher levels of claims retention and thus potentially incurring renewal penalties greater than previously! These and other opaque techniques drive up costs and therefore premiums. This may be being done for financial reasons to create surplus capital, thus enabling some Club managers to move into the fixed premium market with the hard earned capital provided by the Club’s mutual membership!

A number of Clubs are now engaged in avid diversification programmes which appear to meet the approval of the ratings agencies, which view “mono-line” insurers as a higher risk. We wonder if the mutual members of the P&I Clubs really appreciate the liabilities that they are “signing up” to, in sanctioning their Club managers and/or their Board of Directors to underwrite non P&I, fixed premium commercial market activities.

We believe that some Clubs now have just 60% of their (mutual) membership underwriting and being responsible for the financial results of 100% of the Club. This potentially puts a substantial financial exposure on the mutual membership who will ultimately act as financial guarantors in the event of the Club’s poor underwriting results of the fixed premium (and often non P&I class), which may result in unbudgeted supplementary calls. Other factors that seem to have been overlooked include the regulatory and fiscal issues. How much fixed premium business may a mutual underwrite before it ceases to be a mutual and becomes a normal profit making Insurance Company?

All the major mutuals in the International Group enjoy the advantages of "mutual status", with no taxation on their underwriting activities and low rates of taxation on their investment income. In addition, concessions have been gained which reduces regulatory reporting and assists with meeting solvency requirements. It would be very costly for the clubs/industry if these advantages were lost.

- Do Club managers really have the formal approval of their mutual membership to deviate from providing substantially P&I only cover, capitalised by mutual member's free reserves, into non P&I commercial market activities?
- Do the mutual members really understand the financial (guarantor) exposure that these non P&I risks bring to them and their Club?
- What real benefits are there for the Club and its members?
- Why are only small ships being given the advantage of fixed premiums and at the expense of large ships and their owners?

The Clubs are now well financed (with the exception of one or two) and the need for any general increases is unfounded. Solvency 2, which may well come into force in the next couple of years should not now hold any concerns for the Clubs.

The trend of increasing claims has halted (for the time being at least). The Clubs have never been more "de risked", financially healthy and more than able to meet most anticipatable future financial eventualities. With record high free reserves and more than adequate levels of capital, 2015 general increases really should be nil.

Julian South
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