THE MD'S SOAPBOX

IMPENDING GENERAL INCREASES.... NEEDED OR A 'KNEE-JERK' REACTION?

Industry renewal 'expectation management' (from Club Managers) is circulating, suggesting many will be seeking approval from their ship-owning boards to apply General Increases at next renewal. The pre-renewal narrative is somewhat negative with; an increase in large claims, tumbling premiums, a tough investment environment and the 'churn', all being sighted as responsible contributors for the deficits posted in their most recent Reports & Accounts. However there has been little or no mention thus far, that this year's investment returns for many Clubs have been good, and if crystallised now would likely generate rather more than any Club GI requirement and increased premium income at next renewal.

If we are about to return to a period of increasing P&I premiums due to increasing claims costs, it is perhaps worth focusing on some primary aspects...

THE ADVERSE 2018 YEAR.... IS IT ACTUALLY THE START OF A NEW CLAIMS TREND?

There is perhaps no escaping that 2018 is a challenging year for all Clubs, culminating in a combined IG deficit of some $243m. However, if one looks at the combined results over a longer period of time of say 5 years (which is over the same period Members' loss records are analysed by underwriters for premium renewal requirements) the picture looks somewhat healthier. Since 2015, the Clubs combined have achieved a very substantial surplus of $1.2bn, of which $709m has been added to their free reserves. Furthermore, the average combined ratio of the Group over the same period is in balance at 100%.

DIVERSIFICATION.... WILL CLUB MANAGERS EVER LEARN?

Following the challenging 2018 year, it is perhaps now more important than ever that Club Managers focus on rectifying their underwriting, rather than looking at ways to use surplus capital accrued for diversification projects. In our 2015 Wilson P&I Report we anticipated the outcome of 2 Clubs 'foolhardy adventures' into the Lloyd's market:

"Clubs should stay true to their core values and not seek perceived 'greener pastures' in the commercial market, gambling in a game they don't really understand, with money that isn't theirs, in risks that are not compatible with P&I, and the Members never really knowingly signing up to the (adverse) consequences of these new ventures."

Some 3 years later Lloyd's of London required those Clubs to present new business plans to put their underwriting activities on sound footings. Ultimately, they could not or at least failed to satisfy Lloyd's requirements! As a result, the 2 Clubs had to close down their Lloyd's syndicates, having accumulated combined Underwriting losses of a staggering c.$250m. We can only hope that Clubs Managers who insist on diversification, do not come back to their membership 'shaking the tin' in an effort to claw back lost (Members') money, by seeking to impose otherwise unnecessary General Increases, when capital returns or discounted instalments should have been the 'order of the day'!

CLAIM RESERVES.... HOW ACCURATE ARE THEY?

The Clubs are substantially opaque when it comes to informing their Members of their reserving of claims for IBNRs, Pool and indeed their non-Group reinsurance protection placement costs and recoveries. Most Clubs are now discreetly releasing claims reserves on closed policy years, resulting in surplus funds re-entering the Clubs' free reserve 'pots'. With ferocious competition, (often at the expense of long-established Members), these released funds prove very useful when seeking to bolster solvency or indeed acquiring new business, usually at subsidised/unsustainable premium rates. Most Clubs seek, indeed crave growth, to maintain or increase their market share, generally at the expense of the existing membership.

FREE RESERVES....ARE THEY NOT MORE THAN ADEQUATE?

The reserves Clubs hold, at least above minimum capital and solvency requirements, are substantially held to support unexpectedly adverse claims years. Clubs have only recently experienced one or possibly two such years. Therefore, this does not yet evidence any general new claims trend (but may be a product of unfettered competition on new business). It is perhaps appropriate at the present time at least, to draw down on the free reserves accrued (if ultimately it proves necessary), rather than arguably prematurely seeking General Increases from the memberships! This is particularly pertinent at a time when the Clubs are flush with Members' cash, which has in some cases been wasted on failed diversification or merger projects and/or overly aggressive underwriting to achieve greater market share, ultimately enjoyed by some, but at a cost to many!

A Reuters' article of 19th September reported that Charles Taylor PLC has recommended to its board a "take-over" bid from Jewel Bidco Ltd. This is yet another Club Manager's distraction from getting on with providing the focused service CTC's most important client The Standard Club and its membership rightfully expect!

ABATEMENT LAYERS.... HOW APPROPRIATE ARE THEY?

The Clubs' stated rationale for Abatement Layers is to assist the Members if and when they have a large claim, generally set at a level of around $2.5 mil. The excess claim amount is then shared across the Club membership as a whole. The vast majority of shipowners never have a claim of this magnitude. The real benefit to Club Managers is that they do not have to vex themselves too greatly when it comes to significant penalty adjustments at renewal, particularly for a very large Member and run the risk that that Member decides to 'wash' their record by changing Club. The abatement policy makes for lazy underwriting! As so often happens in the financial world, the smaller, often family owned shipowner Members (the founders and bedrock of the P&I system) who often have less leverage, have to bear the financial burden of sharing the costs (allocated by Club Managers) to mutualise such large claims. This policy also causes Members' loss record results to be artificially deteriorated with obvious benefits for the Underwriters.

When Dudley and I were Underwriters, we did not have the 'crutch' of Abatement Layers to mitigate the underwriting consequences of a few very large claims occurring from a handful of Members. Instead we had to seek meaningful premium adjustments from offenders, providing persuasive arguments, certainly aware we might lose the Member. Usually we did not! It is generally only serial offenders and poorly considered renewal penalty adjustments that cause a Member to decide to leave a Club. Therefore, such departures were rare and usually good for the Club finances and the remaining Members. It is however also interesting to note that the Britannia, who has been the most financially reliable Club for five decades certainly for not exceeding its originally set 'Estimated Total Cost', does not feel the need to adopt the Abatement Layer philosophy!

CONCLUSION...

There is no doubt that a few, less well performing Clubs, do need to take premium income remedial action, perhaps by way of General Increases – American and London have an average combined ratio over the last 5 years of 107% and 117% respectively. However, the majority of Clubs are running at 100% or less over the same period! With this in mind and against a continued backdrop of challenging and uncertain market conditions for Members, we do not believe that all Clubs should be adopting the 'pack mentality' and seeking to impose General Increases as a 'knee jerk' or opportunistic response to just one difficult year or perhaps two. Instead, we hope that Club Directors will recognise the recent financial successes enjoyed over the last 5 plus years and acknowledge that in most cases their free reserves should be more than sufficient to deal with current claims. One or even 2 adverse years 'a trend does not make'! The International Group remains financially very strong, with $5.3bn of combined free reserves and an average solvency ratio of 180%.

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