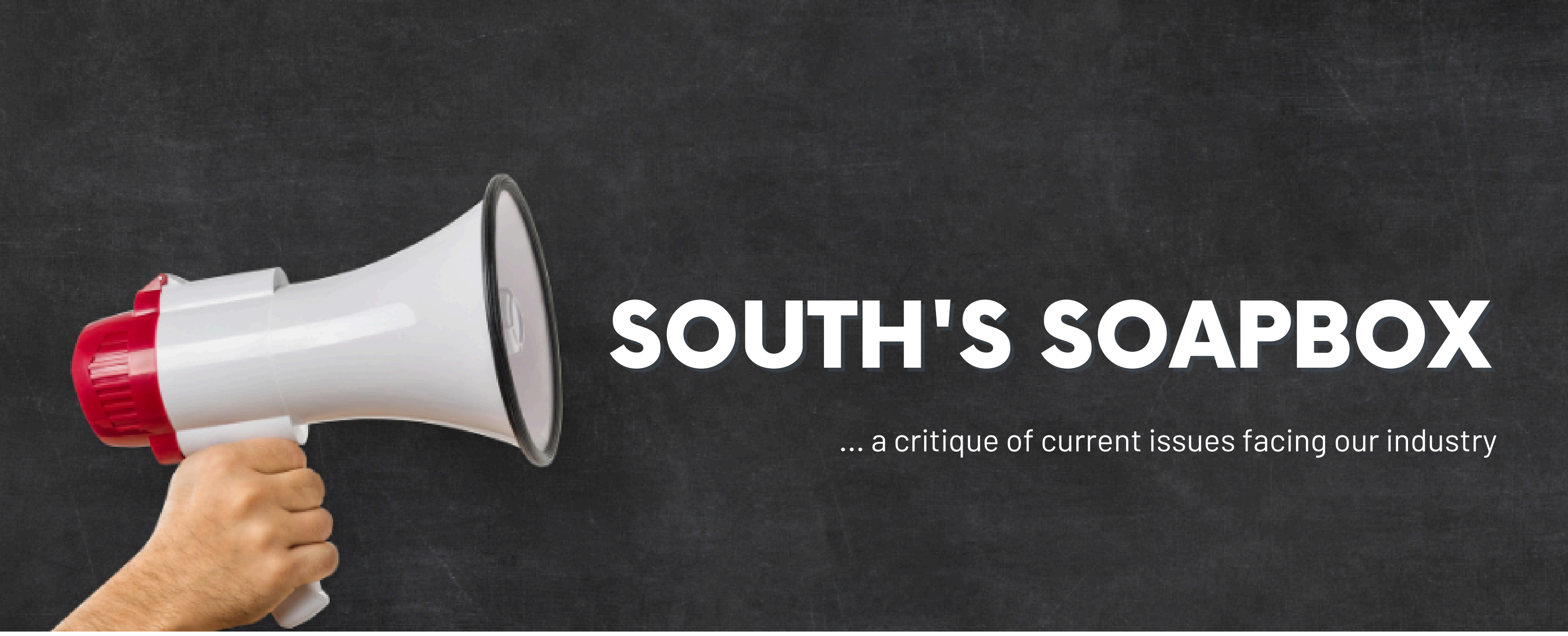

Capital Redistribution in its Various Guises

Pleasingly the finances of most, if not all Clubs are now much improved. This follows a sustained period of high general increases, penalty rises, more robust renewal negotiations and in some cases unbudgeted supplementary calls. Good investment income and reduced Pool claims (both in number and quantum) have also played a significant role in improving Clubs' finances. As a result, the mid-range performing Clubs are now actively prioritising a perceived need to announce "capital returns", even if in some cases they can't actually afford them!

"Mid-ranking Clubs are now desperate to emulate the successes of Steamship, Gard and Britannia"

The pressure on Club Managers to announce returns, from both their Boards and Members of the less well-off Clubs is building. This is in an effort to emulate the successes of Steamship, Gard and Britannia.

Club mechanisms for capital redistribution are now quite nuanced and varied, which will likely only increase as pressure grows. The Britannia currently returns capital on a Board of Directors selected day mid-policy year and based on Member's entered tonnage. Importantly and arguably crucially, these monies are paid out of central Club funds and thus do not in any way negatively impact on the Members' loss record results or trends e.g. by depriving the loss record of anticipated premium being unexpectedly returned to the Member. Steamship Mutual adopt a broadly similar approach but calculate their return as a percentage of the premium the Member pays in the given policy year of the return. As with Britannia, the returns are taken from Club central funds and do not in any way impact the Members' loss records. Both mechanisms genuinely reward the mutual Members for their Club's overall exceptional performance for the policy year of the return.

"Both mechanisms genuinely reward the mutual Members for their Club's overall exceptional performance for the policy year of the return."

Gard adopt a different approach to capital returns, if indeed that is what they are. They allow a 'for one policy year only' mutual Members' premium discount. At the following renewal the Members' ratings are again uplifted to the previous year's agreed renewal rates as the starting point for the new policy year's renewal negotiation. It can perhaps be argued that this approach is more of a continuity credit, or perhaps akin to that of an upmarket department store annual winter sale.

Since these OGDs (owner's general discounts) have been awarded for some fifteen consecutive years, spanning challenging worldwide financial and underwriting highs and lows, they now look somewhat anticipatable and baked into the underwriting model, and the Club's capital base continues to grow unabated. It perhaps can also be argued that since Members' premiums are discounted, the loss records are deprived of anticipated premium and thus potentially has a detrimental effect on the Members' loss record trend and result. This could trigger a need for previously unexpected premium rises. A further modest benefit to Gard may be that their contributions to the Pool are reduced as one third of all Clubs' Pool contributions are calculated on the premiums it charges its Members. Perhaps Gard could afford to be rather more generous in rewarding their mutual Members, who after all are the financial guarantors of a very substantial, successful and varied non P&I fixed premium portfolio.

"Club Managers are searching behind the sofa cushions for loose change"

Mid-ranking Clubs are now desperate to match the three most financially successful Clubs by also announcing capital returns, as by so doing, is perceived as evidence of financial strength and competitiveness when compared with their better performing rivals. Boards and Members should be alert to such shallow, unaffordable strategies of those Clubs, who frankly cannot afford to give cash backs, merely to divert gaze from more fundamental operational issues. Some Club Managers are now frantically searching 'behind the sofa cushions' for loose change, in an effort to deliver these Board and Member pressures. It remains to be seen how Clubs will ultimately address these challenges, however clearly 'cash' returns, paid out of central funds (and therefore not directly impacting on individual Members' loss ratios) is the true mutual way to return surplus capital. However, in whatever guise, affordable capital returns to mutual only Members are always most welcome!

Time for Change

It seems completely incongruous that (Shipowner) Club Chairs or their fellow Directors are not actually 'sitting at the table' of the Board of the International Group. The IG appoints a Chairman, drawn from the Pool of now just twelve Club Managers (who are either independent or Club controlled). Originally there were at least sixteen Managers, largely if not entirely independent profit-making Managers. The IG has a CEO, who is neither a Club representative, Shipowner nor Club Manager, which also seems somewhat inappropriate given the authority the title role affords.

"It is surely time for the Shipowners to influence and control the destiny of the P&I industry by also having a voice on the IG Committee"

Club Managers will often remind those willing to listen, that neither Shipowners nor Brokers are party to the IGA (except of course when it suits them or vested interests come into play). Usually this is where an ambiguity opportunity arises for the IG rules to be stretched or distorted for a Club's benefit. And yet it is the Shipowners who are the critical mass that enables the system and who are directly impacted by every aspect of this committees' ultimate decision making. This apparent anomaly has largely come about from a bygone era when most Clubs were effectively owned by their Manager. A significant number of independent Club Managers have been dispensed with over the decades, largely due to impropriety and/or incompetence. As the industry evolves and now in most cases, to fully Shipowner managed Clubs, surely it is time for the Shipowners to influence and control the destiny of the P&I industry, by having a meaningful voice on the IG Committee, and not be controlled by their Managers... who will often have conflicting goals.

Currently the IG voting rule is 'one Club one vote', but as mega Club Managers focus on eradicating their competitors, and with Brussels no longer seemingly interested or able to effectively keep in check the competition element of the system, Club Boards would be wise to demand Shipowner Director seats at the IG Committee table!

Risk vs Reward

Thomas Miller were perhaps the first and most successful multi mutual Club Manager, and is currently running some thirteen different Mutuals (and now many other businesses). These businesses all strive to be profit making income streams for the group shareholders. All staff, where opportunities arise, have a significant focus on cross selling services emanating from the management of the UK Club. Some independent Managers have sought to follow this business model, but with usually less successful outcomes. Charles Taylor (former Standard Club Manager for more than one hundred years - their services having now been dispensed with following the Lloyds' diversification debacle), were said to employ some 2,800 people, managing a multitude of widely varied businesses including Garage and Satellite Mutuals.

Independent P&I Club Managers fees are often the critical mass base for Manager start ups, but such diversification causes intellectual distraction and subsidisation drag, which ultimately negatively impacts on the performance of the very Club the Manager is employed to serve. So a question that perhaps should be asked by P&I Club Board Directors is *"exactly how much management fee do we pay and are getting value for money?"*

Mutual Clubs are moving 'headlong' into fixed premium facilities, which are potentially onerous as mutual Members are the ultimate financial guarantors of this non-core P&I diversification. These diversification initiatives enable Club Managers and their employees to substantially enhance their rewards, with often dubious benefits and certainly conflicting interests. An example of this might be that of the UK Club Board presumably being 'seduced' into signing up to insuring Thomas Miller Specialty... the Club Manager's former MGA (Managing General Agent). One can perhaps imagine somewhat esoteric advantages being extolled to the Board such as and amongst others no doubt, the need for the Club to diversify, to be looked at more favourably by rating agencies. However we now know that some of the subprime risks have caused, predictably in my view, heavy losses which apparently have significantly impacted negatively on the UK Club's underwriting results and therefore its ability to be genuinely competitive with its IG rivals. Somewhat ironically, and after such a short period of time, the Club Managers are now (allegedly) engaged in "kicking out" much of this business. We can only hope that these pruning measures result in the UK Club's underwriting combined ratio improving and the Club ultimately falling more in line with its IG competitors. The Club Board would do well in my view, to not continue to insure this portfolio (as apparently have done previous commercial market underwriters), not least due to their chronically poor claims results. The Manager might even consider returning Management fee for the introduction and handling of this Fixed Premium portfolio.

"Almost none of the risks underwritten by Club P&I Fixed premium facilities would ever find their way 'through the front door' of an IG Club!"

Almost none of the risks underwritten by these Club P&I Fixed Premium facilities would ever find their way 'through the front door' of an IG Club! Such exposures involve mutual Members incurring the liabilities in an area of business they simply do not fully understand, and by the way more often than not, nor does the Club Manager who mostly sees US$ opportunities. The Fixed Premium portfolio of P&I Clubs is normally expected to deliver a 10-15% profit element to its mutual Members, a reward for accepting these liabilities, but unfortunately this profit goal is always promoted but rarely achieved!

Clubs often find themselves with financial challenges or worse, underwriting such non-core, often subprime business. In most cases all the quality business goes to the SOP Club! A question that perhaps should be asked by the mutual Members is; *"why should this class of business enjoy the certainty of fixed premiums when we as Club owners do not... and yet we are exposed to their losses, resultant increased costs and potential unbudgeted supplementary calls caused by this non-core business?"* The Shipowner Board Members clearly have a duty of care to the wider Membership of their Clubs, to ensure any and all diversification is solely in the interest of the Club and its mutual Members. Surely it is incumbent on the Board of any Club to employ the services of truly independent specialist consultants to assess, advise and ultimately guide on the true value of proposed non-core initiatives. Considerable time for example, is spent by Managers and Boards on assessing investment risk strategies and other financial aspects which impact on overall Club performance and financial results, but little or no serious commentary or analysis can be found in Club R&As on the success or otherwise of their own fixed premium portfolios!

The P&I Club system is so important to those it serves... the Shipowners won't know what they had until it's gone!