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Ratings

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Shipowners' Mutual Protection & Indemnity Association (Luxembourg)

Primary Credit Analyst:
Simran K Parmar, London + 44 20 7176 3579; simran.parmar@spglobal.com

Secondary Contacts:
Charles-Marie Delpuech, London + 44 20 7176 7967; charles-marie.delpuech@spglobal.com
Mark D Nicholson, London + 44 20 7176 7991; mark.nicholson@spglobal.com

Research Contributor:
Rachit Chauhan, CRISIL Global Analytical Center, an S&P Global Ratings affiliate, Mumbai

Table Of Contents

Shipowners' Mutual Protection & Indemnity Association (Luxembourg)

Anchor	a
Business Risk	**Strong**
Competitive position	Strong
IICRA	Intermediate
Financial Risk	**Strong**
Capital and earnings	Very strong
Risk exposure	Moderately high
Funding structure	Neutral

+

Modifiers	0
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0

=

SACP	a

+

Support	**0**
Group support	0
Government support	0

=

A/Stable/--

Financial strength rating

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

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, combined with global macroeconomic stresses from COVID-19, could 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 capital and earnings volatility.
Capitalized in excess of 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.	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 continue to benefit from the competitive advantage that its unique position within the IG provides. We expect levels of premium and tonnage to broadly remain the same, since growth from rising rates could be offset by global macroeconomic pressures from COVID-19 over the next one-to-two years.

We expect that 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 and pool claims. We expect that the 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, in comparison to the peers, including non-P&I clubs that 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 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 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

- The economic recovery from COVID-19 looks set to accelerate in mid-2021, particularly in the U.S. on the back of a massive fiscal stimulus plan, although a high degree of unevenness and uncertainty persists. We have revised our 2021 global GDP growth forecast up by 50 basis points, to 5.5%.
- Orderly reflation is a positive development for both the macroeconomy and credit, and U.S. inflation fears are overblown in our view; however, we are watching the fast rise in U.S. yields and the lack of convergence in vaccine rollouts, mobility restrictions, sector recoveries, and country growth prospects.
- No significant changes to the IG pool structure or pool-sharing methodology.
- Hardening conditions in the reinsurance markets, which could gradually weigh on the IG group's reinsurance protection premium and terms.
- See "Global Economic Outlook Q2 2021: The Recovery Gains Traction As Unevenness Abounds," published March 31, 2021, on RatingsDirect for further details.

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

	--Year ended Dec. 31--						
	2016a	**2017a**	**2018a**	**2019a**	**2020a**	**2021f**	**2022f**
Gross premiums written (mil. $)	228.6	217.8	228.4	230.5	234.1	About 240	About 245
Net income (mil. $)	14.7	47.7	(37.9)	36.1	39.1	About 7	About 7
S&P Global Ratings' net combined ratio (%)	98.6	99.1	104.2	105.1	101.0	About 100	About 100

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

	--Year ended Dec. 31--						
	2016a	**2017a**	**2018a**	**2019a**	**2020a**	**2021f**	**2022f**
S&P Global Ratings' capital adequacy	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent

a--Actual. f--Forecast. Forecast data represent S&P Global Ratings' base-case assumptions. Return on revenue and net investment yield excludes net realised and unrealised gains.

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. The P&I industry has also faced a high level of claims in the past few years, further compressing SMP's margins via its share of pool losses, and we remain cautious that the trend could continue in 2021, for example with the recent Suez Canal blockage incident.

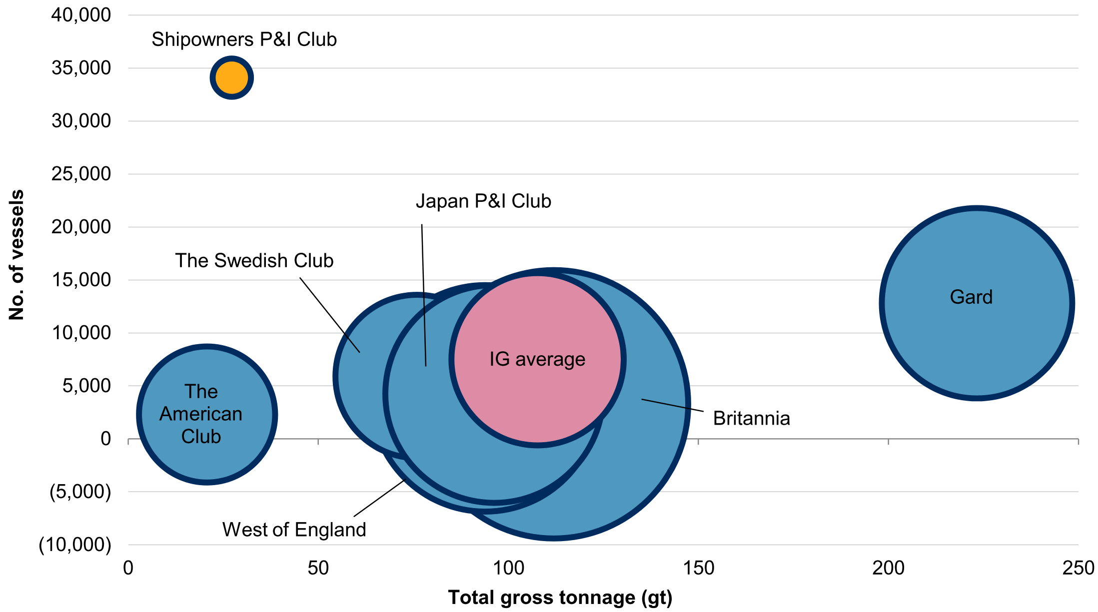
SMP has demonstrated high member retention levels (98% in 2020) and we expect retention to remain in the high-90s over the next two years. However, we also believe that prospective growth from attracting new members or rate rises could be challenged by ongoing pressures on the global economy, which could hamper demand and ability of members to absorb price increases, supply chain disruption due to lockdown restrictions, and potential changes in local regulations. Like most of its peers, SMP's revenue had 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, evidenced with a price increase of 5% for the 2020-2021 policy year, the first such increase since 2014.

We anticipate that SMP's underwriting performance will hover around breakeven for the next two years as the club seeks to redress the impact of soft pricing conditions over the past few years. Its improved combined (loss and expense) ratio of 101% (104.4% including pension charges) in 2020 was in line with our expectations and better than most peers, benefitting from SMP's risk controls over underwriting and reinsurance agreements. The improvement in operating performance has alleviated some of the recent pressures as SMP's combined ratio has been over the breakeven threshold of 100% for the last three years. The five-year average stands at about 102%, in line with the average for its P&I club peers over the same period.

SMP's portfolio is well diversified, and the club has a global presence, over 8,100 members, and nearly 34,000 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 with larger and higher rated insurers.

Chart 1

Shipowners Has A Larger Insured Portfolio Than P&I Peers' And Focuses On Small And Specialist Ships



Bubble size represents the average size per vessel (1,000 gt/ per vessel). Figures are based on company disclosures for the period: Dec. 31, 2018-March 31, 2019. IG average is based on IG P&I annual review 2018/19. *Number of vessels is based on its subsidiary, American Hellenic Insurance Co.

Financial Risk Profile: Strong

We expect that SMP's total adjusted capital will remain above our requirements at the 'AAA' level over 2021-2023. This reflects our expectation SMP will continue to build the capital surplus on the back of modest annual profits of about $7 million over 2021-2022.

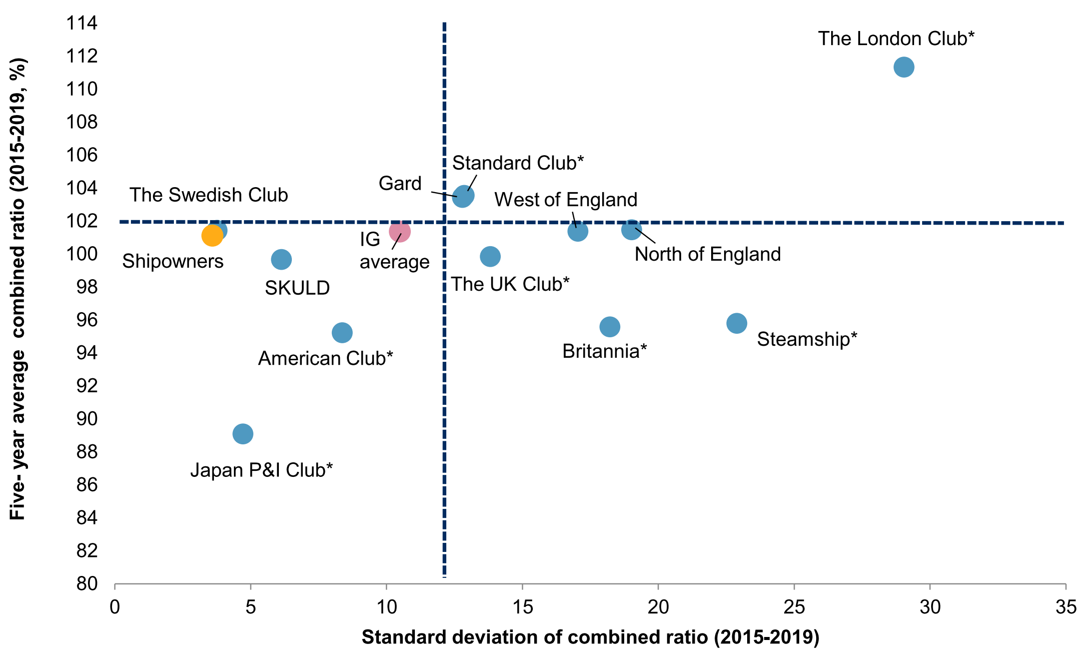
Our forecast reflects continued breakeven underwriting income and lower but positive investment returns. Considering the club's mutual status and financial position, we do not view medium-term decisions to underwrite at a loss too negatively. We believe that SMP will preserve its long-term objective 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 two years. That said, reliance on investment results to support capital adequacy exposes the club to risks from financial market volatility.

We assume annual investment returns, excluding capital gains, will be about 1.5%-2.0% in 2021-2022, given the investment portfolio's weighting toward equities. The club has a relatively high-risk investment allocation (a 25% equity target) compared with Western European nonlife insurers. This contributed to capital volatility during stock market turmoil in 2020 and in 2018. We recognize that SMP's investment strategy has shown long-term benefits, and capital position recovered with returns (including by capital gains) of about 7% in 2020 and 2019. We believe that the current capital surplus at the 'AAA'-level can withstand short-term bouts of market turbulence. However, we remain cognizant that SMP's ability to absorb market shocks and sustain 'AAA'-level capital adequacy may reduce if the surplus declines.

That said, 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 levels of risk retention, while the diversity of SMP's portfolio also provides earnings stability. This has been evidenced with SMP's relatively sound performance in 2020 when we observed heightened volatility for many P&I peers.

Chart 2

Shipowners' Underwriting Performance Is Historically Less Volatile Than P&I Peers'



Dotted lines represent the P&I peer group average. *Exclude 2019 combined ratio (not available), based on four-year average (2015-2018).

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 $600 million of liquid assets would be available in a stressed situation; this represents more than 2.2x the club's liquidity needs.

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
- 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		
(Mil. $)	**2020**	**2019**
S&P Global Ratings' capital adequacy	Excellent	Excellent
Total invested assets	752.7	692.6
Total shareholder equity	379.1	340.0
Gross premium written	234.1	230.5
Net premium written	209.7	205.6
Net premium earned	207.2	200.0
Reinsurance utilization (%)	10.4	10.8

Shipowners' Mutual Protection & Indemnity Association (Luxembourg)--Credit Metrics History (cont.)		
(Mil. $)	**2020**	**2019**
EBIT	40.4	38.0
Net income (attributable to all shareholders)	39.1	36.1
Return on revenue (%)	0.8	1.5
Return on assets (excluding investment gains/losses) (%)	0.2	0.4
Return on shareholders' equity (%)	10.9	11.2
Property/casualty: Net combined ratio (%)*	101.0	105.1
Property/casualty: Net expense ratio (%)	28.5	26.9
Property/casualty: Return on revenue (%)	1.0	1.9
Net investment yield (%)	1.5	2.1
Net investment yield including investment gains/(losses) (%)	6.9	7.2

*Net combined ratio of 2020 excludes one-off pension charge. The combined ratio would be 104.4% if we include the pension charges.

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 May 21, 2021)*

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