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P&I Clubs Well Placed to Face Testing Times

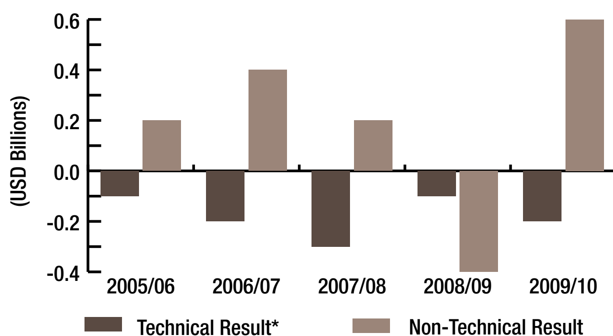
Insurers operating in the marine protection and indemnity (P&I) market went into the February 2011 renewal period in a good financial position. Reported balance sheets at year-end 2009/10 revealed that the free reserves of most clubs had been restored to pre-2008 levels, boosted by strong investment earnings and revenue from unbudgeted supplementary calls. With the market expected to report solid earnings for the 2010/11 financial year, this balance sheet strength is likely to have been maintained.

As a consequence, it was an uneventful renewal, with announced general increases ranging from 0% to 5% (with the exception of one club at 10%). This was in contrast to announced general increases of between 10% and 29% just two years ago, and in spite of a commitment by clubs to focus on underwriting performance.

The P&I market remains dominated by the members of the International Group of P&I clubs, which collectively insure approximately 90% of the world's oceangoing tonnage. As mutual insurers operating for the benefit of their members, the clubs have historically used investment income not only to enhance free reserves but also to subsidise weak underwriting results.

The sharp decline in investment markets in 2008, which led to large pretax losses and unbudgeted supplementary calls, forced many clubs to question this strategy, and in general clubs have reduced their appetite for investment risk. Unable to rely on strong investment income to support earnings, clubs have found it more urgent to meet their stated goal of break-even underwriting results.

Protection & Indemnity Clubs – Financial Performance of the International Group



*Technical results for 2008/09 and 2009/10 exclude additional/supplementary calls levied.
Source: Combined, consolidated accounts of the 13 principal clubs of the International Group (the whole of the International Group is not captured).

However, for many clubs this target remains elusive in an unpredictable claims environment. Loss experience continues to be volatile, and after a one-year dip reflecting a reduction in the number and magnitude of large claims shared through the International Group pooling system, the level of P&I claims increased in 2009/10. This was despite evidence of fewer voyages by ships, lower commodity prices and less competition for experienced crews, all of which resulted from a slowdown in world trade and would be expected to reduce the number of claims.

As the global economy gradually recovers, the frequency of claims is expected to increase. In addition, clubs face the prospect of higher losses due to an upward trend in shipowners' limitation of liability and general claims inflation. In this context, and with many clubs yet to achieve consistent technical profits, the modest general increases announced at the February 2011 renewal are unlikely to support profitable or even near break-even underwriting across the International Group.

Expanding Regulatory Reach

At the same time, the regulatory challenges P&I clubs face continue to mount, with the implementation of Solvency II less than two years away. The good news for the industry is that supplementary members' calls will constitute tier 2 ancillary own funds under the new regime, subject to supervisory approval. However, the recently published QIS 5 results showed that, as in QIS 4, P&I clubs had higher capital requirements under the Solvency II standard formula than under the existing regulatory regime.

In view of current balance sheet strength, A.M. Best expects the P&I clubs to meet Solvency II's capital requirements, particularly as a number of clubs will seek to use their own capital models to calculate their solvency capital requirement (SCR). However, it is almost certain that overall across the International Group, capital in excess of the regulatory minimum capital requirement will be lower.

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The P&I market also awaits with some apprehension the completion of the latest review by the European Commission (EC) of the claim-sharing and joint-reinsurance agreements among members of the International Group. As part of a pooling arrangement, participating clubs mutually reinsure one another by sharing claims in excess of USD 8 million among themselves. Additionally, the clubs arrange a market reinsurance contract that provides cover for claims that exceed USD 60 million up to USD 2.06 billion. By purchasing reinsurance in the open market as a group, rather than on an individual basis, the clubs are able to achieve protection on better terms.

The inquiry was launched in August 2010 and follows the expiry in February 2009 of a 10-year antitrust law exemption that had been granted to the group. It will consider whether the agreements restrict competition among P&I clubs and exclude from the market commercial and mutual insurers that are not party to the agreements.

The next 24 months are set to be a testing period for the P&I clubs. As a whole, the sector is much better placed than it was two years ago to face regulatory challenges and the prospect of a less favourable claims environment. Balance sheets have been rebuilt, there are signs of better underwriting discipline, and exposure to investment risk has been reduced.

However, the marked variance in the performance and financial strength of individual clubs is expected to grow over the next few years, as some clubs struggle to compete in a more demanding regulatory environment. This could lead to consolidation within the P&I market among clubs with weaker financial profiles, although cultural differences will remain a significant barrier to mergers.

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