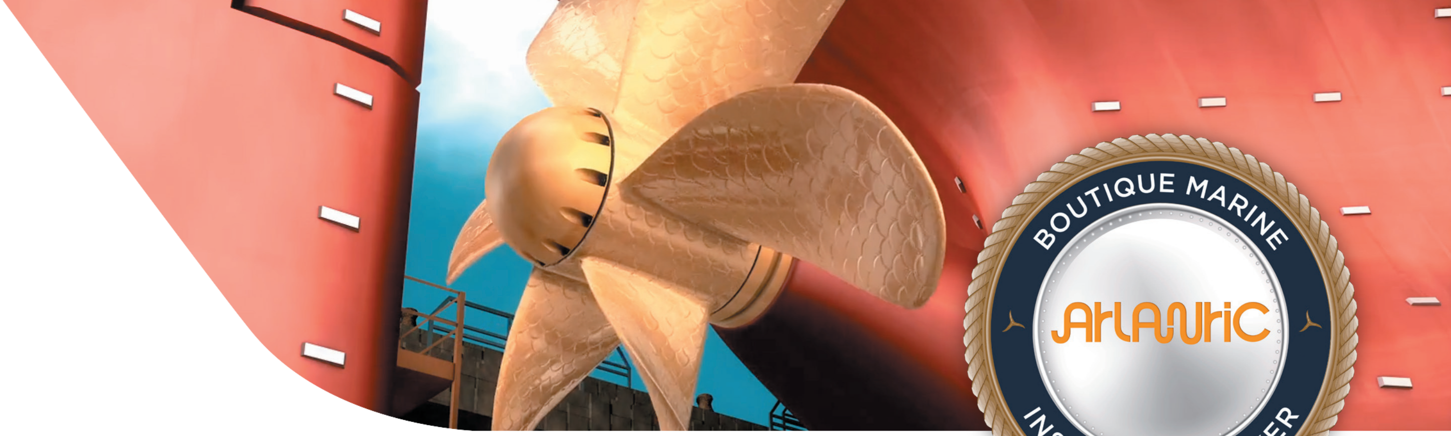


Mid-term P&I Review 2022

Panorama

RICHARD ADLER
CCO

If you read our last year's P&I Review and are now reading this year's report you will quickly notice how different things have become in only 12 months' time. Matter of fact it wouldn't be an overstatement to say we are living in a different world altogether!

Russia's invasion of the Ukraine has not only caught the world by surprise, but the conflict has also impacted our daily lives with great speed on a number of levels causing hefty rises in the cost of living and in energy prices for consumers and businesses.

As a major contributor to the world's granary, Ukraine was hand-cuffed by its inability to export grain, the consequence of which was hefty surges in the price of cereal-based food products which in turn brought poorer countries who depend on World Food Programme grain imports onto the brink of famine. Russia then turned the tap down on its gas pipelines to Europe with the apparent result that Europe (at least) finds itself facing a recession! Who saw that coming?

The western world has reacted with various rounds of sanctions against Russia which in turn have an impact on global trade at a crucial time where economic activity was just starting to recover from the pandemic. The sanctions are, as always, a legal minefield for shipping and insurance and probably are here to stay for some time to come.

Whilst in recent days the war in the Ukraine seems to be taking a positive turn, the damage is done, and we are far away from a resolution to the conflict.

For Shipping, the year 2022 already held more than enough challenges having to prepare for IMO's reduced emissions roadmap which comes into force on 1st January 2023. On the positive side, most shipping segments are trading profitably.

Last but not least important, just days after the February 2022 P&I renewal The North of England and the Standard Club announced their intent to merge, major news in a market where consolidation was, in our opinion, well overdue!

The P&I market: combined ratios & financial results

How has all of this impacted the P&I world?

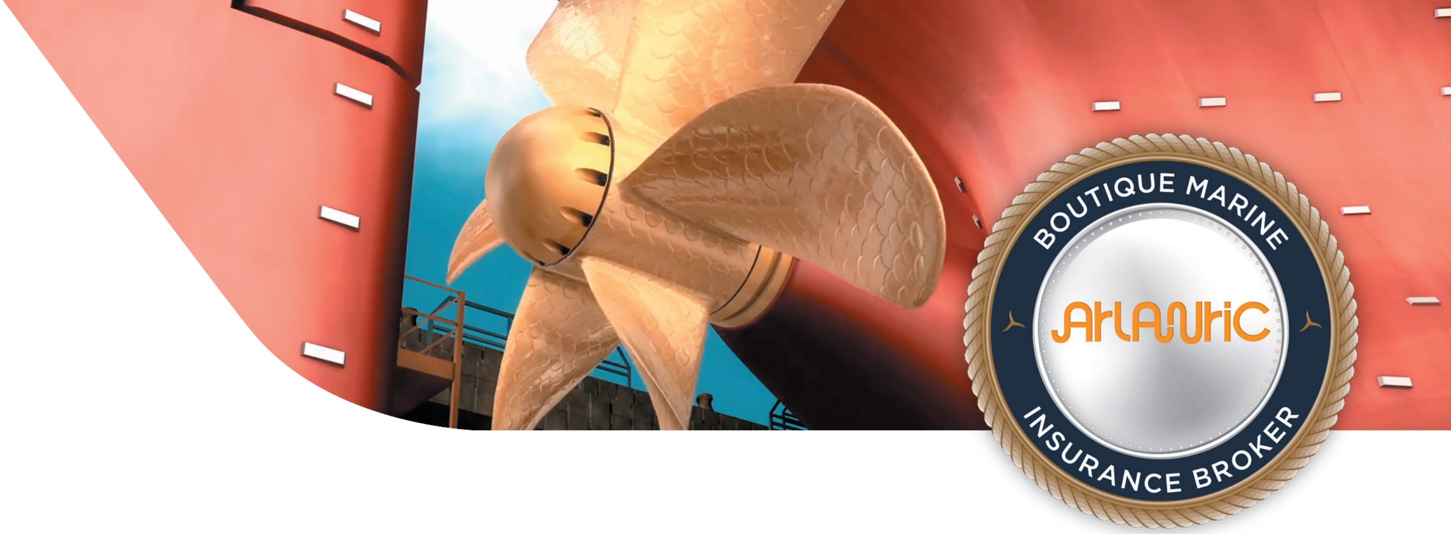
The multiple fallouts from the war in the Ukraine have eliminated the investment returns the Clubs had generated the year before: 7 of the 13 Clubs have now booked losses for the 2021/2022 P&I year ending February 2022 on their investments and the remaining 6 only gained marginally leaving the overall investment return across the International Group basically flat.

On a more positive note, the Clubs maintained their technical underwriting discipline through the 2022 renewal, recognising the continuing need for improvement as flagged by the financial Rating Agencies and which we highlighted in our last year's report. As such, the Clubs' combined ratios (claims over premium) improved from 120% on average (2020/2021) to 115% on average during the 2021/2022 year. The average general increase amounted to 11,5% during the February 2022 P&I renewal compared to 8% on average as announced the previous year.

However, a 115% combined ratio unfortunately still implies an underwriting loss and given that investment returns were practically non-existent, the Clubs' overall free reserves have taken a dive by USD 268 million. To put this into context, last year, despite larger technical underwriting deficits, the level of free reserves did not decrease because sizeable investment returns compensated for the losses altogether.

The below graph illustrates how the majority of the P&I Clubs have booked a loss for the 2021/2022 P&I year.

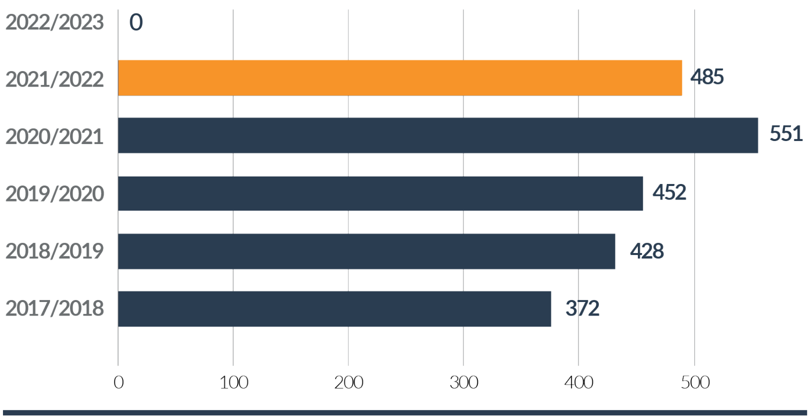
P&I Clubs' 2021/2022 Combined Ratio and overall Surplus/Loss



Claims Scenario

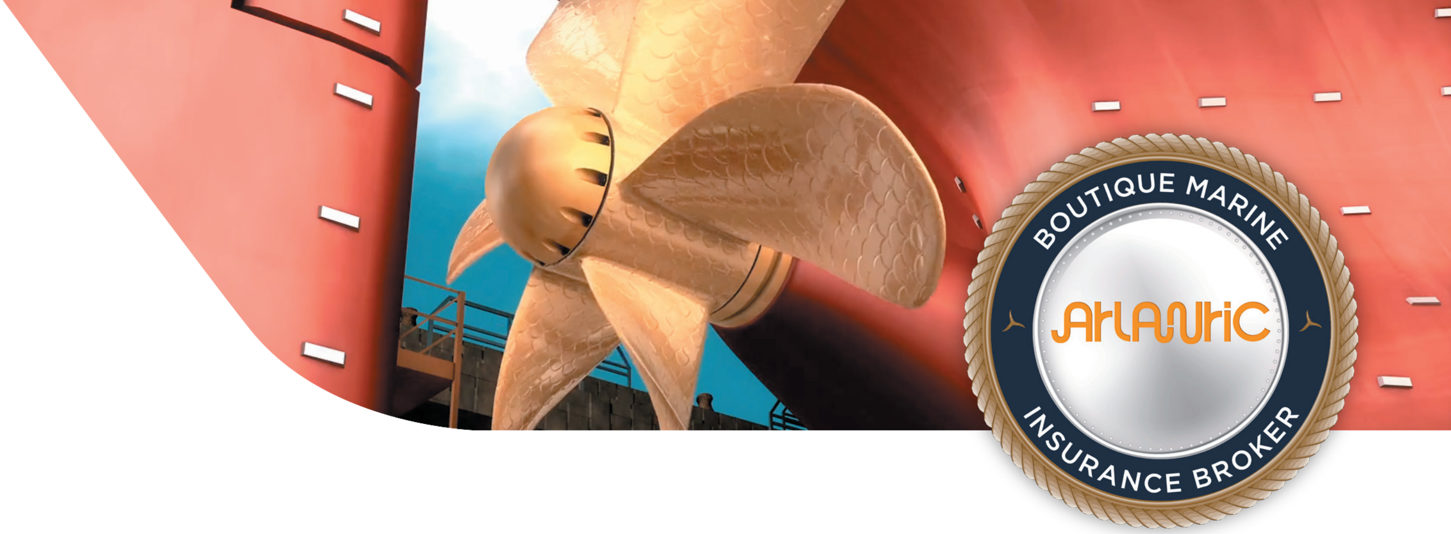
When it comes to claims, all Clubs are reporting the effects of increased inflation, with various indications of rates of between 7.5% and 10%. But it is not all bad news: in the range of claims between USD 10-100 Mio., the so-called pool claims, not a single claim has occurred in the first 6 months of the ongoing P&I year. This stands, again, in stark contrast to past years where 2020 and 2021 saw record high pool claims amounting to 551 Mio and 485 Mio respectively.

P&I Clubs' 2021/2022
P&I Pool Claims
(Mio USD)



The North of England and Standard Club Merger

As was to be expected, the announcement of the merger between the North of England and the Standard Club has reignited the debate about consolidation and the alleged risk of reduced choice and the possible need for an overhaul of the IGA with the ambition to introduce more competition into the IGP&I. Whilst some Clubs and brokers were quick to highlight the risks and dangers of the change of the current status quo, most seem to agree that this merger will be a breath of fresh air and the opportunity to prepare the mutual P&I system and shipping for the challenges that new environmental regulation, climate change, increased sanctions and other possible black swan events will bring.

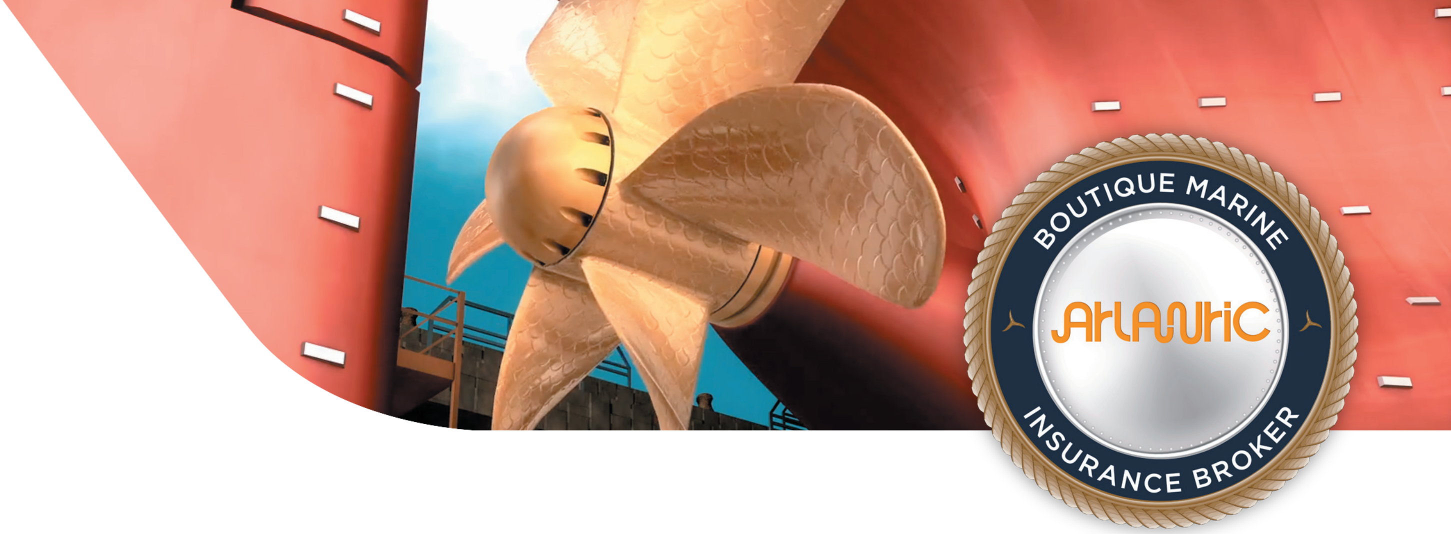


From the day of the announcement the messaging from both Clubs came across as clear and more importantly as united. On May 27th both shipowner boards voted resoundingly in favour of the merger to create NorthStandard. The next step will be to obtain regulatory approval although there seems to be common consensus that same will be given without any opposition.

Apart from the opportunities and synergies that this merger holds, we also believe that this particular combination of Clubs has the potential to create **a new standard of service for shipowners**. Both North and Standard are very service strong Clubs who also score very highly on our "commerciality" quadrant. Moreover, both belong to the group of the most far-sighted Clubs when it comes to exploiting Data driven knowledge and Loss Prevention (although there is still room for improvement in our humble opinion). If played wisely, NorthStandard will be able to compete on more equal terms with GARD, something that the Norwegian market leader and largest marine insurance company in the world welcomes, by the way. The merger will get more Clubs talking to each other, but it remains to be seen whether other Clubs follow in the near future. What we believe will happen, is that other top tier Clubs will slightly amend their strategies in order not to fall behind when it comes to service, commerciality and innovation. On the financial side, we would hope that most Clubs remain conservative (although at the same time we would argue that merging with the right partner will also lead to a stronger balance sheet).

What challenges lie ahead for Shipowners in the forthcoming February 2023 P&I renewal?

So far, there is little evidence that would justify a return to a zero general increase round at this renewal. As mentioned earlier, whilst the combined ratios have improved, the lack of investment returns lead 11 out of 13 Clubs to book overall losses reducing the groups' overall free reserves by 4.9% in the year to February 2022. Therefore, we see the Clubs requesting another round of general increases in the region of 5% to 12.5% (some might need more than that) even if only to hedge against impact of inflation on all aspects of trading and insuring ships.



As you might recall the Excess Loss Rates were increased significantly in December 2021 and whilst further increases could be in the pipeline, we would expect these to be much more moderate.

Whilst all of that does not make for a pretty picture at this coming renewal, there is some hope that the cycle will start to reverse in the following year, especially if 2022 enjoys a material reduction in major claims when compared with the 2020 and 2021 years and an air of competition starts to be introduced into the IG.

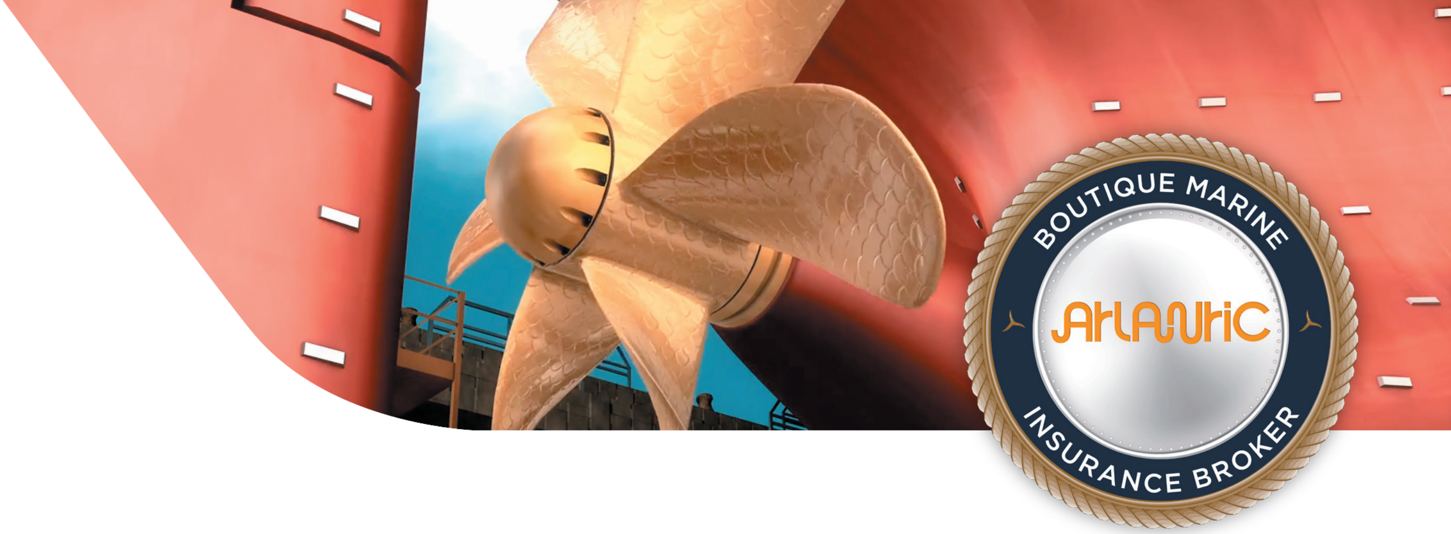
In summary, we believe there will be two pairs of "forces" that will determine the forthcoming P&I renewal:

On the negative side Clubs will need to address increasing inflation and deal with the continued lack of investment returns.

On the positive side the overall claims scenario appears to look considerably better (no pool claims have occurred at half year) and – not to be underestimated – we are moving into a new reality where the North of England and Standard Club merger will at last create **a higher degree of competition** amongst the Clubs of the International Group.

On a more general note, we are convinced that better performing owners will continue to be eligible to get better deals than those who continue to perform poorly. In any case professional representation usually makes a big difference. As your broker we deep-dive analyse your current P&I placement, benchmark your Clubs and - if need be - suggest viable alternatives. We also make sure on a daily basis that you get the maximum service and support from your Club.

That is why we call ourselves Atlantic, the Boutique Marine Insurance Broker.



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