Aon Risk Solutions
Global Broking Centre | Marine & Energy

P&I One
Q1 bulletin

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Introduction

As we suggested in our 2015 P&I Review, this year's renewal was destined to be flat with little in the way of increased premiums. Given the continued falling freight market, coupled with record free reserves, one could argue the very mention of general increases would have been completely out of the question. If there was ever a time to adopt a more relaxed stance, then this was it.

Pleasingly negotiations kicked off with an upfront saving as International Group (IG or the Group) reinsurance rates saw a sizeable reduction in January.

The clubs' ability to satisfy the financial regulators is of course paramount but we must not forget that it is the members' money that has been reserved and therefore, in the current climate, those reserves should have been used to soften premiums, even if by way of returns in previous years.

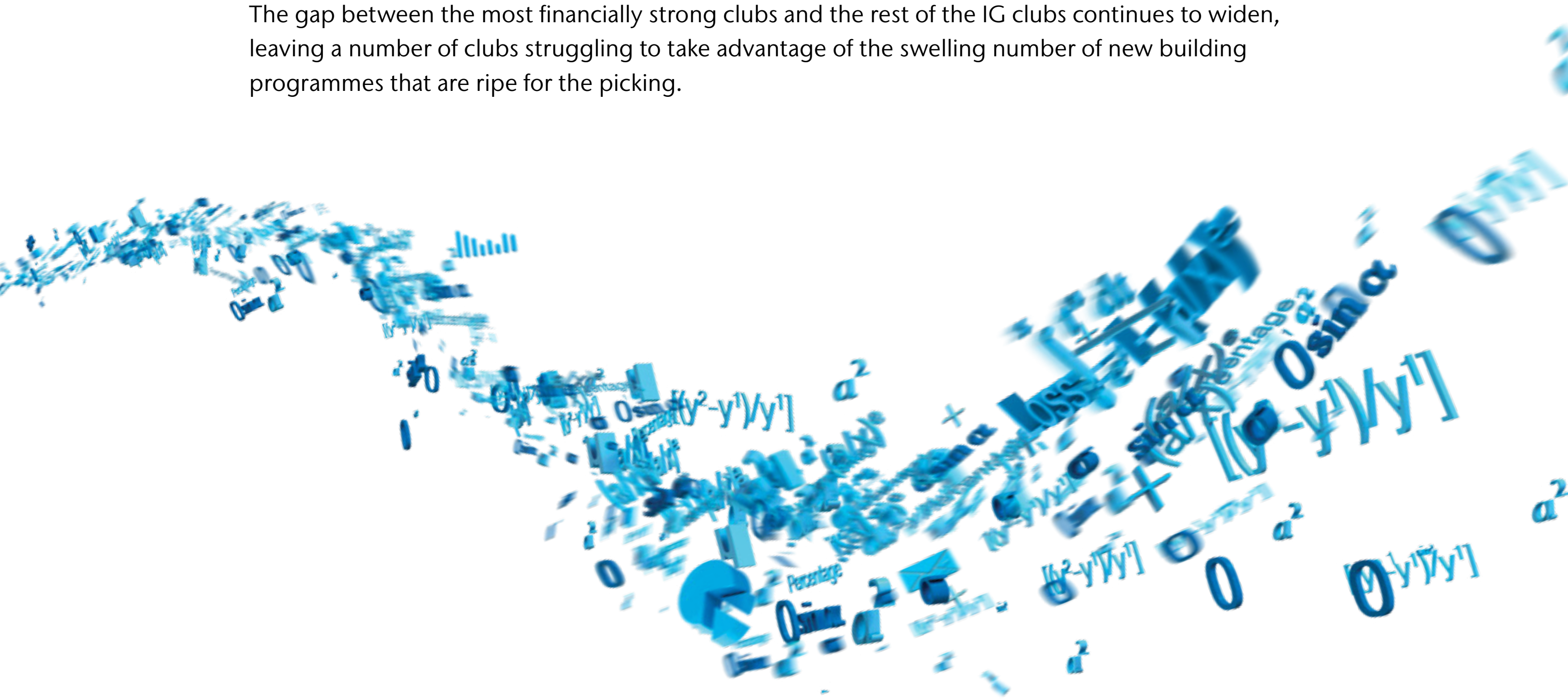
We are yet to receive the final figures from each club, but we believe that few, if any, of the clubs saw premiums increase. Certainly clients or members boasting good loss records received 'as before' and in several cases a reduction in premiums.

The year saw few Pool claims and thankfully none that reached into the Group reinsurance layers.

We saw a little movement between clubs, with some owners voting with their feet and shifting their allegiance. As is common place, lost tonnage was often the result of clubs being reluctant to renew certain business. In many cases this is simply a case of failing to agree renewal terms.

Perhaps the most significant headline at renewal was Gard's decision to enter the US Cruise sector. Gard's voice will add extra weight to the clubs' negotiation of next year's Passenger Group reinsurance rate.

The gap between the most financially strong clubs and the rest of the IG clubs continues to widen, leaving a number of clubs struggling to take advantage of the swelling number of new building programmes that are ripe for the picking.



Fixed premiums

Surprisingly the 2016 renewal was also quiet on the fixed premium side. One would have expected that, in a market with too many providers and with the available business and shipowners struggling to turn a profit, fleets would be keen to take advantage of the reduced premiums being offered.

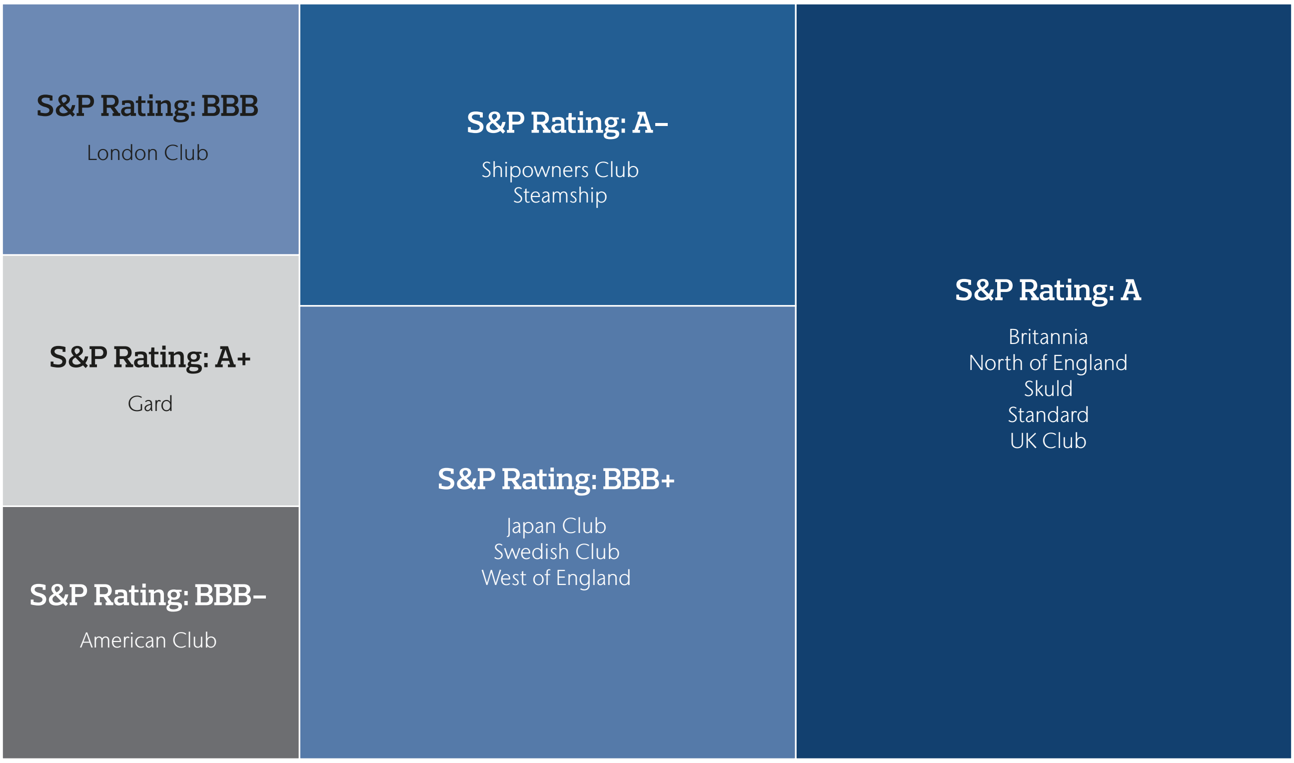
Whilst it is certainly the case that accounts moved, they were not in the volumes expected and they tended to be from fixed premium provider to fixed premium provider or from the Shipowners' Club to the fixed market rather than tonnage moving from the 'big' ship Clubs.

In our experience the reason behind this tended to be that when in danger of losing business the fixed providers dropped their premiums or improved their terms considerably meaning that owners did not have to move insurer to achieve significant savings. The Shipowners' Club did see some loss of business in instances where they did not follow the ratings down and/or did not want to compete with providers they see as offering an inferior product.

When it comes to the lack of movement of larger vessels, this is explained easily: whilst many fixed premium providers can offer cover for larger (up to 40,000 GT) particularly dry cargo vessels, they actually rarely tend to be competitive with the premiums the IG can provide for good quality business. Therefore unless a fleet is significantly overrated by a P&I Club or the fixed market is offering markedly reduces coverage, the incentive for owners to move outside of the Group is not great.

The competition amongst fixed premium providers is still intense and with the further reductions in already competitive premiums we have seen at this renewal it is inevitable that there will have to be either consolidation or we will see some providers going out of business in the short to medium term.

Club's Standard & Poor Ratings



The UK Club and Britannia merger

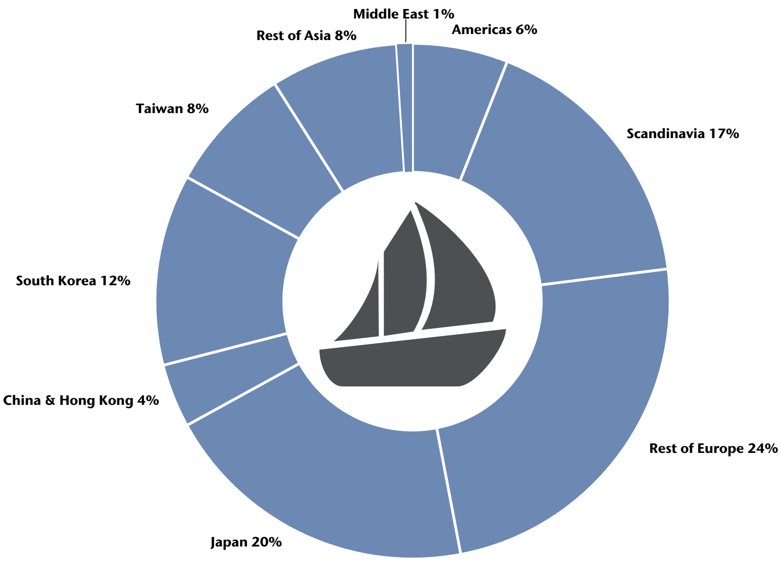
The dust had hardly settled on this year's renewal before news broke of the proposed merger between two of the biggest IG clubs: Britannia and the UK Club. Rumours regarding this possible union have been rife in the market for over a year but were thought to have little substance. Needless to say, there were a number of parties who questioned whether this news would have been best delivered prior to renewal.

It is important to remember that the clubs have only entered into discussions on a possible merger, so there may well be a few twists and turns as this plays out over the next few months.

While both clubs will have sought the view of a select group of members prior to the February announcement, the eventual vote will still go down to one vessel one vote, with the outcome decided by an overall majority. It should be noted that owned ships below 1,500 gross tonnes and charterer members will have diminished voting rights.

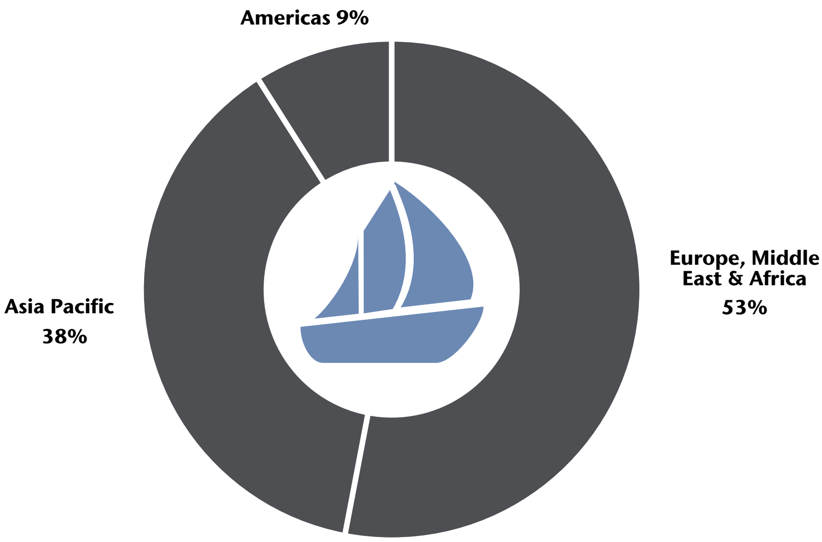
Financially, both clubs have performed well of late with the UK Club making a convincing return to the top table. However, in terms of capital, Britannia is by far the most well-reserved club and it will be interesting to see how those swelling funds will be apportioned. We think it is likely that Britannia members will expect to see some form of pay out, having steadfastly built up such a war chest over a significant period of time.

Britannia Club membership details



Source: brittainiapandi.com

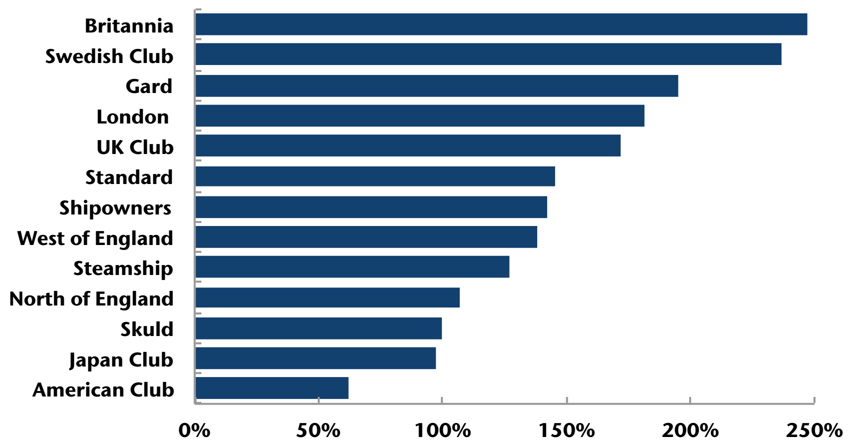
UK Club membership details



Whilst the UK Club has seen fortunes improve over the past few years, there is still some USD 100 million in hybrid capital to address at some stage.

Nevertheless there is little doubt that, if successful, the new "P&I giant" will be leagues ahead of its peers in terms of free reserves and entered tonnage.

Free reserves/Net call income (February 2015)



Free reserves shown as a percentage of net call premium as at 20 February 2015. Net call income reflects the Club's assessment of current and future exposure and free reserves are the Club's safety net. The greater the ratio between free reserves and net call income the greater the Club's safety net. The UK Club's free reserves include Hybrid Capital.

Upon learning of the anticipated merger, the first question we asked ourselves was - who benefits? Both clubs are privately managed so there is little doubt Tindall Riley (Britannia) and Thomas Miller (UK Club) will structure a good deal and even less doubt that certain individuals will benefit from it.

When it emerges, the new club will be a financial powerhouse as well as having the luxury of merging some the best shipowners and charterers.

As with most M&As, the move is also likely to lead to a restructure of the support operations and this unfortunately may result in job losses. In essence this should lead to lower management costs, though maintaining service levels throughout may not be an easy task.

While both clubs state the merger will provide members with greater capital efficiency, cost efficiencies and enhanced service levels, we suspect it may not be plain sailing.

Some of the more obvious hurdles are:

- A number of board directors left surplus to requirements
- Many shipowners will have split entries between the two clubs, meaning a loss of a 'holding club'
- Britannia has historically shied away from the cruise industry, an area the UK Club strongly favours
- There will be a number of disgruntled shipowners and charterers voting with their feet
- This move may serve to be a catalyst for more mergers, restricting competition further
- If this plays out, the M&A activity may well catch the eye of the EU and prompt another competition investigation

So there is plenty to digest and Britannia and the UK Club's announcement, which is more about strategic positioning (spiced with a little ego), has the potential to transform the P&I industry.

Trading with Iran

Whilst renewed trade to Iran is welcome news, the picture is still blurred. Until there is a clear message from US Banks that all transactions can be conducted without restriction any venture can be fraught with danger. The ability to service claims is an issue. Not just the transfer of claims payment or fees in USD, but the potential for the P&I clubs or Fixed P&I providers to recover from their own reinsurers.

The International Group will be able to service claims within the individual retention and from the Pool. However, full recovery from Group Reinsurers is an issue. There is an additional 'layer' available to International Group Members at no cost, but this is capped at EUR 100M. and that is in the aggregate. Liabilities under 'Blue Cards' would be unaffected as these would either be within the limitation or for International Group Members under the Supplemental Pooling Agreement.

Still this has not stopped the inevitable scramble for market share. Still extreme caution must be uppermost in any operators' mind until all restrictions are lifted.

We will be reporting again shortly when we hear the clubs financials.

Maritime Labour Convention Update

Following the initial implementation of the Maritime Labour Convention (MLC) back in August 2013, The Special Tripartite Committee, set up by the International Maritime Organization to review the MLC and amendments, has agreed that the financial security requirements are to be extended, effective from January 2017, to include:

- Abandonment of seafarers including not just repatriation costs but also payment of back wages and other entitlements (MLC standard clause 2.5)

- Contractual claims for death and injury (standard 4.2)

Financial security must therefore cover up to four months of outstanding wages and other entitlements under crew contract, Collective Bargaining Agreement or national law plus cost of repatriation and maintenance until arrival at the seaman's home and necessary medical care and transportation of effects. We therefore set out below a summary of the key points relating to these amendments as well as the latest position with regards to cover.

Outstanding/owed wages

With regards to "outstanding wages and other entitlements due from the shipowner", the International Group has advised that its interpretation of 'due' would mean wages and entitlements that have already been accrued but not been paid. This would therefore not include any future earnings for the remaining contractual period.

Definition of abandonment

A seafarer shall be deemed to have been abandoned where, in violation of the requirements of the MLC or the terms of the seafarer's employment agreement, the shipowner:

- fails to cover the cost of the seafarer's repatriation

- leaves the seafarer without the necessary maintenance and support

- has otherwise unilaterally severed their ties with the seafarer including failure to pay contractual wages for a period of at least two months

Financial security

Each shipowner shall ensure that a financial security system meeting the requirements of these amendments is in place for ships flying its flag. The financial security system may be in the form of a social security scheme or insurance or a national fund or other similar arrangements. Its form shall be determined by the shipowner after consultation with the shipowners' and seafarers' organizations concerned.

Each shipowner shall require that ships that fly its flag carry on board a certificate or other documentary evidence of financial security issued by the financial security provider.
A copy shall be posted in a conspicuous place on board where it is available to the seafarers.

Assistance provided by the financial security system shall be sufficient to cover the following:

a. outstanding wages and other entitlements due from the shipowner to the seafarer under their employment agreement, the relevant collective bargaining agreement or the national law of the flag state, limited to four months of any such outstanding wages and four months of any such outstanding entitlements.

b. all expenses reasonably incurred by the seafarer, including the cost of repatriation.

c. the essential needs of the seafarer including such items as: adequate food, clothing where necessary, accommodation, drinking water supplies, essential fuel for survival on board the ship, necessary medical care and any other reasonable costs or charges from the act or omission constituting the abandonment until the seafarer's arrival at home.

It is our understanding that 'at least ' two months, sets the minimum unpaid abandonment period, with the requirements relating to outstanding wages setting the maximum period which may be claimed by a seafarer. It therefore follows that the financial security requirements relating to outstanding wages shall be sufficient to cover up to a maximum of four months of outstanding wages and entitlements.

So far all club boards voted to provide financial security which meets the requirements of standards 2.5 and 4.2 of the MLC including the obligation under 2.5 to cover up to four months' outstanding wages. However the majority have voted that the pooling agreement should not be amended to support cover of all MLC liabilities to the extent of those that exceed the scope of current club cover and retentions. As a result, we understand that clubs in the International Group are in the process of exploring reinsurance options which will likely take the form of USD 90 million excess of the club's $US 10 million retention per fleet. Clubs with very large fleets, or cruise clubs are likely to have to buy some additional reinsurance on top of the initial USD 100 million and are currently in the process of working with their members and brokers to calculate their maximum exposures for these fleets.

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