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## The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd.

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### Table Of Contents

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Rationale

Outlook

Base-Case Scenario

Company Description

Business Risk Profile

Financial Risk Profile

Other Assessments

Accounting Considerations

Related Criteria And Research

# The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd.

SACP* Assessments				SACP*		Support		Ratings		
Anchor	a	+	Modifiers	0	=	a	+	0	=	Financial Strength Rating
Business Risk			ERM and Management	0		Liquidity	0	Group Support	0	A/Stable/--
Strong			Holistic Analysis	0		Sovereign Risk	0	Gov't Support	0	

\*Stand-alone credit profile.  
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

## Rationale

### Business Risk Profile: Strong

- International Group of P&I Clubs (IG) membership provides market access.
- Longstanding relationships with members.
- Improved operating performance.
- Exclusive focus on marine lines.

### Financial Risk Profile: Strong

- Extremely strong capital adequacy is a key strength to the rating.
- A more stable technical profit since 2010.
- Low interest coverage limits financial flexibility score.
- Underlying strong financial flexibility due to United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd.'s ability to make supplementary calls on members
- We have elected to assign the higher of the two anchor ratings implied by our assessments of the Club's business and financial risk profiles to reflect the Club's underlying financial flexibility.

## Outlook: Stable

The stable outlook on reflects our view that the club will maintain its capitalization and underwriting performance at the recent stronger and more stable level through the financial years from 2015-2017. We anticipate an average combined ratio of about 103%-104% and an annual bottom-line profit averaging \$9 million-\$12 million over this period. We anticipate that the club's conservative reserving, reinsurance program, and smaller share of the IG pool will serve to stabilize results improved in recent years by enhanced underwriting standards.

### Upside Scenario

We do not consider an upgrade to be likely over the two-year rating horizon. The competitive dynamics of the protection and indemnity (P&I) sector and the fact that the club already enjoys the highest assessment for capital and earnings under our criteria serves to limit rating upside.

### Downside Scenario

We could take a negative rating action should the club revert to its former pattern of unstable results or should capitalization, as measured using our model, fall below the 'AA' range.

## Base-Case Scenario

### Macroeconomic Assumptions

- The global shipping sector will recover slowly from its current depressed state.
- Claims frequency across the P&I sector will increase slowly.
- The IG agreement (IGA) between the P&I clubs will remain unchanged.

### Company-Specific Assumptions

- The club will retain a leading position among the IG clubs. We expect premiums to increase by around 6% per year over 2015-2017 as premium rates go up to keep pace with claims inflation.
- Net income will be £10 million-£12 million per year over financial years 2015-2017. Interest coverage will stay at 2x-3x.
- Capital adequacy on our model will remain extremely strong.

## Key Metrics

(Mil. \$)	--Financial year ending February--				
	2016F	2015F	2014	2013	2012
Gross written premiums	441	420	396	360.2	360.5
Net income	11	10	35.9	7.6	7.5
Combined ratio (%)	103	102	102	107.2	98.5
Capital adequacy	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong
Financial coverage (x)	2.5	2.4	4.7	2.7	1.9

F--Standard & Poor's Forecast.

## Company Description

The United Kingdom Mutual Steamship Association (Bermuda) Ltd. and the U.K.-based The United Kingdom Mutual Steamship Association (Europe) Ltd. together comprise the U.K. Club, which has licensed branches in Japan, Singapore, and Hong Kong. We assess the club on a consolidated basis. The two underwriting entities share the same rating.

The U.K. Club is a member of the IG, an association of 13 mutual clubs, which between them write 90% of global P&I business. IG members benefit from a joint excess-of-loss reinsurance program and from the pooling of risks. A recent EU investigation into whether the IG constitutes a cartel concluded that it does not. The U.K. Club is one of the largest IG members, insuring 124 million gross register tonnage (grt) of shipping at February 2014. The club is owned by its participating mutual members, although it also writes fixed-premium business to nonmembers. The club is managed by Thomas Miller (Bermuda) Ltd., in which it owns a 15% stake.

## Business Risk Profile: Strong

### Insurance industry and country risk: Global coverage, potentially volatile

We assess the industry and country risk for the U.K. Club as intermediate, reflecting the ratings on the global marine P&I sector. The overall country risk assessment is low because the insurers operating in this sector typically write business in multiple countries around the world, resulting in high geographic diversification. Our industry risk score is moderate; although we see profitability and product risk as negative, these factors are offset by the sector's operational barriers to entry.

The mutual marine sector is less focused on profitability than other sectors and is more exposed to high-risk assets than other non-life insurers, increasing earnings volatility. The size and frequency of claims are also unpredictable, increasing product risk. We do not expect our assessment of country and industry risk to change over the next two years.

**Table 1**

The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd. Insurance Industry And Country Risk (IICRA)		
Sector	IICRA	%
Global protection and indemnity	3	100

**Competitive position: IG membership is key**

The U.K. Club's membership of the IG is a key part of our assessment of its competitive position. The IG is a group of 13 mutual marine clubs providing P&I insurance cover to more than 90% of world shipping. Members operate within the framework of the IGA and benefit from a substantial excess-of-loss reinsurance program and the pooling of risks. The IG's dominance of the market is the key factor in our assessment of the operational barriers to entry. Historically, non-IG players and fixed-premium providers have enjoyed limited success in the sector.

We consider the group's competitive position to be strong, although entirely concentrated within the marine sector. As the second-largest P&I club by premium in 2013, its competitive strengths and weaknesses largely mirror those of the P&I sector, described above. Although premiums have been declining for several years, we expect this trend to be reversed in the financial years ending February 2014-2016 as the club imposes premium increases. The club has strong relationships with its members, as demonstrated by its high rate of business retention.

The U.K. Club's share of contributions to the IG pool fell to 8.5% in financial year 2015. The IG's pooling arrangement effectively shares risk across all members of the IG. If a member incurs large claims, it may access the pool for funds to settle those claims, but will then have to repay those amounts to the pool over time. We count these payments as reinsurance premiums ceded. Combined with higher premiums, we expect these lower pool contributions to enable the club to produce net premiums of \$325 million in financial year 2015, rising to \$360 million by financial year 2017.

**Table 2**

Competitive Position					
	2014	2013	2012	2011	2010
Gross premiums written (GPW)	396.3	360.2	360.5	364.8	383.9
Change in GPW	10.0	(0.1)	(1.2)	(5.0)	(8.7)

**Financial Risk Profile: Strong**

**Capital and earnings:Very strong**

We assess the U.K. Club's capital and earnings as very strong and a key strength of the rating. The club's current capitalization, as assessed on our capital model, is extremely strong, supported by a conservative reserving record. Our assessment is however limited to a degree by the relatively small size of the club in the context of our ratings on insurers.

The club enjoyed high profits of \$30 million in the year ending February 2014, on the back of a combined ratio of 102.3% and a strong investment result. The combined ratios for the past four years have been 102.3%, 107.2%, 98.5%, and 94.9%, which we consider to be strong evidence that future returns can be expected to move within a narrower band than they have so far.

Since 2010, the U.K. Club has been working to improve the quality of its book, and we view these efforts as positive. Exposures have been limited and the reinsurance program enhanced. Back-testing these measures against the troubled 2004-2008 years of account suggest that they would have significantly reduced the technical losses of those years.

We expect capitalization to be bolstered further by improved operating performance in financial years 2015-2017. Factoring in the club's lower contributions to the IG pool in the future, our base-case scenario predicts that the U.K. Club will produce a post-tax surplus of \$10 million in financial year 2015, rising to \$12 million by financial year 2017. These solid returns will likely be supported by a strong reserving record.

**Table 3**

<b>The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd. Capital</b>					
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Adjusted free reserves	528.3	493.8	485.8	477.9	409.3

**Table 4**

<b>The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd. Earnings</b>					
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Net income	35.9	7.6	7.5	68.1	11.9
Expense ratio	13.5	14.3	14.5	14.5	17.1
Loss ratio	88.8	90.1	83.9	80.3	104.7
Combined ratio	102.3	107.2	98.5	94.9	121.8

### **Risk position: Intermediate**

We regard the club's risk position as intermediate, under our criteria. This primarily reflects the club's improved management of the volatility inherent in the marine P&I sector. The club's membership has been refined, reinsurance protection strengthened, and the expense base controlled. The club's share of the International Group (IG) pooling arrangement is now considerably lower, thereby reducing the potential impact on the club's result. Positively for our assessment, investment risk is relatively low in the context of the club's available capital. The club's relative investment diversification is also a positive factor under our criteria.

**Table 5**

<b>The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd. Risk Position</b>					
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Total Assets	1,219	1,184	1,197	1,193	1,048
Bond investments (%)	66.7	61.8	66.0	52.4	49.0
Equity investments (%)	26.1	28.4	20.8	24.2	23.3
Cash investments (%)	7.2	13.4	13.2	23.4	27.6

### **Financial flexibility: Less than adequate**

We view financial flexibility as less than adequate. This assessment is triggered by the club's relatively low level of fixed-charge coverage--we forecast that this will remain below 4x over the next three years. The club's debt comprises a \$100 million hybrid issue, which will pay interest at 7.5% until August 2018.

Notwithstanding the low coverage ratio, we believe that the club's financial flexibility is greatly enhanced by its ability

to levy premium increases and make supplementary calls on its members.

Our base-case EBITDA forecasts suggest coverage ratios of 2x-3x over financial years 2015-2017. These low ratios overshadows other positive aspects of the club's financial flexibility; the club, unlike its peers, has a track record of raising debt capital.

Moreover, like its IG marine mutual peers, the club has a legally enforceable right to collect unlimited additional premiums on its mutual P&I business by making unbudgeted supplementary calls on open policy years--a right it last used in 2009 and which it could use again.

**Table 6**

The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd. Financial Flexibility					
	2014	2013	2012	2011	2010
Interest coverage	4.7	2.7	1.9	8.7	2.5
Interest leverage	15.9	16.8	17.1	17.3	19.6

## Other Assessments

### Enterprise risk management: Fit for purpose

We consider the club's enterprise risk management (ERM) to be adequate. Our view is that ERM is of low importance to the ratings given the club's size, relatively simple structure, and focus on one line of business. The combination of the club's ERM and management and governance scores leaves the 'a' anchor unchanged.

We consider that the club has adequate risk controls for its main risks--underwriting, reserving, and investment risk. It has been actively enhancing its ERM ahead of the implementation of the EU's Solvency II directive. In particular, the club has been defining and codifying more of its policies. It has made significant progress in developing its internal capital and pricing models and has produced a comprehensive and user-friendly own risk and solvency assessment (ORSA). The internal model is actively used in the business, for example in making reinsurance and underwriting decisions, and advises claims forecasting. The club has also enhanced its existing internal reporting and now explicitly incorporates risk factors into business decisions. We do not envisage revising our assessment above adequate; however, we do not expect ERM to constrain the rating.

### Management and governance: Improvement Under Current Management

We view the club's management and governance as satisfactory. The management team is stable and has made progress since it took over in 2008. The club has made great strides in improving its loss experience, revising its reinsurance strategy, modifying exposure limits, and achieving expense savings. This has led to a marked decrease in the combined ratio and appears to have become an embedded practice. We also note a marked improvement in the comprehensiveness of the club's financial standards and risk tolerances. It now sets investment allocation benchmarks and more clearly defines its combined ratio targets.

### Liquidity: Exceptional

We regard the U.K. Club's liquidity profile as exceptional; an assessment that is enhanced by the absence of confidence-sensitive liabilities, near-term refinancing concerns, or rating triggers. We do not regard liquidity as a

restraining factor in the rating.

## Accounting Considerations

We treat payments into the pool as ceded reinsurance premiums, as opposed to gross claims incurred. This treatment is based on the mutual reinsurance mechanism this agreement provides for the IG.

We consider unbudgeted calls as a capital event, rather than an earnings event, and therefore we have excluded these calls from the gross premiums in our analysis when calculating combined ratios.

## Related Criteria And Research

- Insurers: Rating Methodology, May 7, 2013
- Group Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

### Ratings Detail (As Of July 10, 2014)

#### Operating Company Covered By This Report

#### The United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd.

Financial Strength Rating

*Local Currency*

A/Stable/--

Counterparty Credit Rating

*Local Currency*

A/Stable/--

Junior Subordinated

BBB+

**Domicile**

Bermuda

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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