American Steamship Owners Mutual Protection and Indemnity Association, Inc.

Shipowners Claims Bureau, Inc., Manager
One Battery Park Plaza - 31st Floor New York, New York 10004 USA
Tel: +1.212.847.4500 Fax: +1.212.847.4599 Web: www.american-club.com

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TO MEMBERS OF THE ASSOCIATION

Dear Member:

PROGRESS REPORT FOR MEMBERS.
S&P GLOBAL RATINGS ANNOUNCEMENT.

In November 2023, S&P Global Ratings (S&P) published a revised risk-based capital model for rating insurers and reinsurers, changing certain criteria as well as the methodology of calculating risk charges. The S&P announcement also included a list of insurance companies, including the Association, that could be affected by the changes in the methodology. These changes in criteria negatively impact narrow product line insurers, increasing capital charges for investment, reserve, and premium risk, and with greater impact on longer-tailed reserve lines, such as those in assessable P&I mutuals.

Within this context, the Board and Managers of the American Club acknowledge the recent decision by S&P to lower the Association's credit rating from BBB- to BB+ Stable based on the revised risk-based capital model, but question the rationale behind this action, including the applicability of the revised model to the unique not-for-profit assessable mutual nature of the Association. The Board and its Managers believe the resilient structure of the Association, warrants a more favorable assessment.

According to the published statement by S&P, the decision was driven by their assessment of the Association's "weakness in its capital position". According to S&P, the Association has "not generated sufficient underwriting earnings that would be capital accretive".

While the Board and its Managers understand the explanation within the context of the revised model, affected also by the unavoidable impact of negative investment returns in the region of 10% for the 2022 financial year, they also express much disappointment and skepticism on several levels.

S&P's decision is founded on an anchor rating and assumptions applicable at a point in time dating more than 12 months ago that are no longer relevant. It is not truly reflective of the current financial position nor the trajectory of the Association, which includes:

- a consistently decreasing combined loss ratio over the past three years;
- a rebound in investment returns as of December 31, 2023 to a positive 8%;
- consistent rectification of technical deficiencies which are innate to the structure of the mutual; and
- year on year rising tonnage and premium reflective of the high loyalty factor recognized by the rating agency in this and past assessments.

Ultimately, the revised model does not effectively account for the not-for-profit assessable mutual structure and foundation of the Association and creates concerns affecting the transparency of the application of the model.

Further, based on the agency's own definition of the context and purpose of the rating, and the complexity of the methodology as it applies to the impact of assessments, the Board and the Managers have difficulty in reconciling the decision. The S&P website states, "The analyses, including ratings, of S&P Global Ratings and its affiliates (together, S&P Global Ratings) are statements of opinion as of the date they are expressed. … An S&P Global Ratings issue credit rating is a forward-looking opinion about the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program (including ratings on medium-term note programs and commercial paper programs). It takes into consideration the creditworthiness of guarantors, insurers, ... The opinion reflects S&P Global Ratings' view of ***the obligor's capacity and willingness to meet its financial commitments as they come due***, and this opinion may assess terms, such as collateral security and subordination, which could affect ultimate payment in the event of default."

The Board and the Managers believe the rating is neither "forward looking," nor reflective of the Association's "capacity and willingness to meet its financial commitments as they come due." Unfortunately, while the agency is well aware of the common renewal date of the Association's niche industry, it has shown a disregard for the competitive impact of the timing of their decision.

Further, while historically, the agency has evidenced an understanding of the very special nature of mutual P&I clubs, especially those entered in the International Group, through special rating methods in the past, and until recently, used a more appropriate application of models created to assess stockholding profit-geared insurance companies, it would appear from the recent revised modeling that this is no longer the case. In fact, the revised modeling ignores the most unique aspect of the pooling agreement within the IG, equally enabling every member to pay any covered claim that may arise.

The relevance of credit ratings depends on the specific nature and structure of the entity being assessed. In the case of a mutual not-for-profit insurance company, there are several reasons why the current S&P rating model is inappropriate.

Not-for-profit mutual insurance companies are owned by their policyholders, not by shareholders seeking financial returns. The strategy is dictated and driven by policy-holders themselves. As a result, the focus is on serving the policyholders' interests rather than generating profits for investors. They have a more conservative investment approach and focus on maintaining adequate reserves to meet policyholder obligations. Not-for-profit insurers may have a unique risk profile and risk management strategy, which may not be fully captured by traditional credit rating methodologies. While a stock-holding insurance company could find itself in the precarious position of investors unwilling to add capital, this is not a factor in a shipowners' mutual. Finally, the success of mutual insurers often relies on member loyalty and satisfaction. This is driven by factors such as fair claims handling and competitive premiums.

Recent years have been riddled with disruption and a deteriorating claims environment. Adaption to disruption and the changing risk landscape must take place over time and in stages and that is exactly what the Association has been doing. In fact, it has been steadily taking measures to manage disruption, retreating reinsurance, social inflation, general inflation, geopolitical conflict, regulatory changes, investment volatility, claims impact of crew competency issues, and most importantly, constantly updating and adapting its risk profile assessment and an alignment in rating strategy to maintain resiliency for the future.

As a result, the Association has improved the renewing fleet underwriting loss ratio from 63% after the 2022 renewal, to 53% after the 2023 renewal. From a financial year perspective, the combined loss ratio dropped from 129% in 2021 to 108% in 2022 and is expected to finalize below 100% for 2023. It has continued to grow during the current policy year and the combined annualized premium for all classes and EOM totals approximately $145m, which is the highest achieved in 15 years when comparing budgeted premiums year-on-year, excluding unbudgeted calls.

These are strong indicators of performance going forward and an important factor that unfortunately is not taken into consideration by the mechanical S&P rating model. The steady strategy measures taken by the Association over the last three years are now manifesting positively and have placed it on the desired upward trajectory.

Yours faithfully,

Dorothea Ioannou, CEO
Shipowners Claims Bureau, Inc., Managers for
THE AMERICAN CLUB