AMERICAN STEAMSHIP OWNERS MUTUAL PROTECTION AND INDEMNITY ASSOCIATION, INC.
THE AMERICAN CLUB
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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CIRCULAR NO. 36/19

TO MEMBERS OF THE ASSOCIATION

Dear Member:

**BACKGROUND TO THE 2020 AMERICAN CLUB RENEWAL.
DEVELOPMENT OF CLOSED AND OPEN POLICY YEARS.
LEVYING OF SUPPLEMENTARY CALLS FOR 2016 AND 2017.
PREMIUM REQUIREMENTS FOR THE 2020 POLICY YEAR.**

At its meeting in New York earlier today, your Board reviewed the American Club's present and prospective circumstances by reference to a variety of factors. Specifically, they examined the development of closed and open policy years and made important decisions in regard to the levying of supplementary calls for, and the closure of, 2016 and 2017, release call margins in respect of the latter and subsequent years, and premium requirements for the 2020 policy year.

The remainder of this Circular describes the issues discussed by your Board, and the determinations it reached in consequence of those discussions.

Background to the 2020 American Club renewal

2020 will mark the twenty-fifth anniversary of the implementation, in 1995, of the American Club's strategy of growth and diversification, then entitled *Vision 2000*. Over the intervening years, and through several business cycles, the Club has been successful in building a market presence and range of proficiencies exponentially greater than those it possessed when that strategy began.

In addition to the expansion of its core mutuality, its Eagle Ocean Marine fixed premium facility, as well as its investment in American Hellenic Hull, have over the more recent past given the Club a broadly-based industry footprint well positioned to exploit the opportunities of the future. In conjunction with this, the American Club has also benefited from the augmentation of its Managers' capabilities through the reorganization of their existing resources, the recruitment of new professional talent and other initiatives aimed to secure the promise of further success over the years ahead.

In order to maximize its future potential, your Board sees a need to strengthen the Club's financial position. In doing so, and desiring to secure the Club's excellent prospects for the future, your Board has taken a long view in reaching decisions both as to the treatment of the Club's open policy years and as to premium requirements for 2020. In regard to the latter specifically, it has decided to take a new approach to future pricing requirements, forgoing the need for a standardized, or general, increase for the forthcoming policy year. This is explained in further detail below.

Development of closed and open policy years

Closed policy years

The Club's contingency fund, representing its surplus on closed policy years, grew by approximately $9.4 million – or about 15% – to slightly under $74 million during the nine months to September 30, 2019. This growth is mainly attributable to unrealized gains on the Club's investment portfolio (which has recently performed very well, recording a year-to-date return of just under 9% as of the end of October), and to largely favorable adjustments to outstanding claims reserves for earlier years.

Open policy years

2016

Despite its predecessor year having been closed in substantial surplus just over twelve months ago, and 2016 itself having experienced a level of attritional claims similar to the favorable results of 2015, this policy year was negatively affected by an untypical incidence of certain large claims, two of which exceeded the Club's pooling retention and impaired its overall underwriting results for the period.

As of September 30, 2019, the 2016 policy year exhibited a combined ratio of just under 123% which, although capable of subvention to some degree by investment income, is nonetheless at a level which in your Board's view should be treated on a stand-alone basis, rather than be subsidized by the Club's contingency fund.

Accordingly, your Board has ordered that a supplementary call of 22.5% of currently estimated total premium be levied to cure the deficit for the year and thereby bring 2016's overall results into equilibrium. This supplementary call, which will apply to all open entries of record as of September 30, 2019 will be debited in two equal installments due for payment on May 20 and October 20, 2020. Concomitantly, the 2016 policy year will be formally closed as of September 30, 2019.

The supplementary calls in question will only apply to Members entered during the 2016 policy year for coverage of P&I (Class I) risks and will not be levied in respect of its Freight, Demurrage and Defense (Class II) business.

2017

As of September 30, 2019, the 2017 policy year exhibited a combined ratio of just over 116%. While the financial year in question enjoyed a favorable investment return, its overall operating results were negatively impacted by an uplift in retained exposure, particularly as the year drew to a close in January and February of 2018, and more recently as certain claims reserves experienced untypical deterioration over the last several months.

In order to cure the deficit for the year, and for the same considerations of principle which informed the decisions it made in regard to 2016, your Board has ordered the levy of a supplementary call of 17.5% of currently estimated total premium. As in the case of the calls for 2016, these supplementary contributions will be debited in two equal installments due for payment on May 20 and October 20, 2020, and will apply to all open entries of record as of September 30, 2019.

There is not expected to be a need for any further calls for this year which will be scheduled for formal closure in the first half of 2020. In the interim, the release call for the 2017 policy year will be reduced to 5% of originally estimated total premium for both P&I (Class I) and Freight, Demurrage and Defense (Class II) entries.

Also, as in the case of its predecessor year noted above, the calls for 2017 will apply only to the Club's P&I (Class I) business and not to its Freight, Demurrage and Defense (Class II) entries.

2018

This policy year continues to develop favorably as to the Club's retained losses, indeed at levels similar to those recorded in 2015 which was itself an exceptional year in this respect. To the downside, however, International Group Pool claims are cumulatively at a figure already very close to that experienced for the significantly more mature 2012 year, which has so far proved to be the worst year for Pool claims since 2005.

As of September 30, 2019, the 2018 policy year is showing a modest deficit, taking account of the Club's exposure to those Pool claims of which, incidentally, it submitted none for its own account during the period. This deficit can be expected to moderate over the longer term as more investment income is credited to the year in due course. It is expected that it will eventually be closed without call in excess of original estimates in the first half of 2021.

In the meantime, the release call margin for 2018, will be maintained at 20% of estimated total premium for both P&I (Class I) and Freight, Demurrage and Defense (Class II) entries. However, the position will be reviewed once again before the end of the first quarter of 2020 and further action as might be appropriate at that point taken accordingly.

2019

The Club's retained exposures over the first six months of the current policy year were emerging at a level even better than that experienced during both 2017 and 2018 at the same stage of development. However, as part of a trend seen elsewhere among Group clubs, the more recent trajectory of losses has been significantly higher, although the spike of the last two months may be more a matter of timing rather than a longer-term trend.

As to the Pool, the losses so far notified for 2019 are also tracking rather higher than the median of more recent years, but it remains too early to say with confidence where the year will eventually settle given the long tail of such claims. Subject to further review in the first half of 2020, the release call margin for the 2019 policy year will remain at 20% of estimated total premium, as originally mandated, for both P&I (Class I) and FD&D (Class II) entries.

Release calls

Following the European Commission's decision during 2012 to conclude its investigations into the International Group of P&I Clubs' claims sharing and reinsurance arrangements, all clubs have agreed to publish, at least annually, a statement of their release call percentages, including factors taken into account in calculating those percentages by reference to the actual assessment of enterprise and other risks.

The current release call margins for open years are set out above. As will be clear from the discussion of individual years' results, which represent the context for those margins, considerable thought has been devoted by your Board, in consultation with your Managers, in calibrating them. As will also be evident from the foregoing commentary, the margins in question are kept under regular review.

As to the factors informing these decisions, the following are taken into account: premium risk, catastrophe risk, reserve risk, market risk and counterparty default risk, as well as the exposure of the Club generally to the wide variety of operational risks which, over time, it needs to consider in determining both its basic premium and, more particularly, release call needs in regard to all open policy years.

Premium requirements for the 2020 policy year

Industry context

In parallel with the experience of the American Club itself, the marine insurance market in general, and the P&I sector in particular, have undergone great change over the last decade. Some of this change has responded to evolving macroeconomic and geopolitical conditions affecting maritime trade. Some has been driven by the rising, and increasingly interventionist, demands of governments, regulators and rating agencies. And some has been generated by the growing service expectations of the global maritime community, in which International Group clubs play a vitally important role.

Against this background of both longer-term and more recent change, the clubs find themselves in a period of transition, characterized by a new reality of persistently low premium pricing, rising claims and the likelihood of less ample investment returns over the years ahead.

Recently deteriorating operational results across the industry at large provide clear evidence of this new reality. However, despite the financial challenges which this brings, the progress made by the American Club in the recent past has given it an excellent point of departure for future success, particularly as the business climate for marine insurers may be expected to improve over time.

Factors informing the Club's approach for 2020

In considering the American Club's premium requirements for the 2020 policy year, your Board was mindful of the fact that both current risk pricing and conditions of cover are, for many Members, both historically justified and prospectively sustainable. There is also a cohort of Members whose current level of premium, or terms of entry, may require reassessment not principally by reference to past experience but more in relation to the intrinsic risk they bring to the mutuality going forward, particularly in an era of rising claims. And there are some Members whose historical results – as a chief indicator of likely exposure for the future – are at a level requiring adjustment more immediately, in order to create better equilibrium between their experience and those of the rest of the membership.

In synthesizing these characteristics of its current business to establish a sensible point of departure for the Club's requirements for the next policy year, your Board concluded that the application of a standardized, or general, increase would not be the most effective way of generating the best balance of premium pricing to risk exposure across the mutuality as a whole.

Your Directors have therefore decided not to apply a standardized, or general, increase for the forthcoming year, preferring to employ an approach which takes better account of the different profiles of Members informed by the considerations discussed above, allowing for a more Member-specific treatment of pricing and terms of cover.

However, to take account of the more hostile trends developing in the claims environment, and a possibly less benign investment climate going forward, your Board expects to see a year-on-year increase in the pricing of risk for 2020 of a magnitude which will properly reflect future exposure. This intended adjustment upward will embrace not only the need for cash rises but also, as individual cases might demand, changes in deductibles and/or other terms of entry.

In light of the foregoing, it has been resolved to apply the following general conditions for the renewal of Members' entries for the 2020 policy year.

Mutual Protection and Indemnity (P&I) Insurance

- All expiring estimated total premium to have no standardized, or general, increase.

- The component of premium represented by the Club's International Group reinsurance arrangements for 2020 to be adjusted separately.

- Premium to be defined as estimated total premium for 2020, subject to a zero (0) supplementary call forecast for the year.

- All estimated total premium to be debited in four equal installments due March 20, June 20, September 20 and December 20, 2020.

- Premium (call) to release to be charged as an additional margin of 20% of estimated total premium for the year.

Mutual Freight, Demurrage and Defense (FD&D) Insurance

- All expiring estimated total premium to have no standardized, or general, increase.

- Premium to be defined as estimated total premium for 2020, subject to a zero (0) supplementary call forecast for the year.

- All estimated total premium to be debited in two equal installments due March 20 and August 20, 2020.

- Premium (call) to release to be charged as an additional margin of 20% of estimated total premium for the year.

Fixed Premium Protection and Indemnity and Damage to Hull (DTH) Insurance

- All fixed premium P&I and DTH entries (e.g. those for charterers' risks) to have no standardized, or general, increase.

Fixed Premium Freight, Demurrage and Defense (FD&D) Insurance

- All fixed premium FD&D entries (e.g. those for charterers' risks) to have no standardized, or general, increase.

Subject to these general conditions, and as mentioned above, Members' premium rates and terms of entry for 2020 will be assessed by reference to their own particular circumstances, including their loss records, vessel-type, trade and regional factors, as well as other relevant matters, including the consideration of Members' individual risk profiles, in consequence of which further adjustments may be made as appropriate.

As to deductibles, it will be recalled that standard increases to some deductibles, as well as minimum deductibles for certain types of claim, were mandated at renewals a few years ago. For 2020, as was the case last year, your Board has ordered that no standard increases or minimum amounts should apply to any expiring deductibles.

However, in circumstances where, from an underwriting, claims performance or general risk perspective, a Member's terms of entry may warrant an uplift in deductible levels, such action will be taken in individual cases, as mentioned above, but will not apply as a matter of standard policy across the membership as a whole.

In addition to the foregoing, it will also be a condition for renewal that:

- all premiums and other sums due to the Club be fully paid up-to-date prior to February 20, 2020 as a condition of continuing cover; and
- all outstanding survey etc. requirements be completed prior to February 20, 2020 as a condition of continuing cover.

Summary

Your Board is aware that certain elements of the American Club's intended future action as set out above will not be welcome, but it remains resolute in its commitment to consolidate the financial standing of the Club in order to provide a firm footing for the exploitation of the exciting prospects for its core and related businesses over the years ahead.

As outlined above, much has been achieved over recent years and, as the American Club transitions, in many and different ways, to fulfill its aspirations for the future, your Board is determined that it does so in a financial condition equal to the challenges, and opportunities, which lie ahead. In taking these decisions, your Board has been fortified by the knowledge that the Club enjoys a loyal membership whose commitment to the Club's mutuality, and its culture of transparency, has been, and will remain, an abiding strength of the Club's appeal to the maritime community.

To recapitulate in brief the specific decisions reached, and described in greater detail above:

- 2016 to be subject to an additional supplementary call of 22.5% of currently estimated total premium for the year, payable in two equal installments on May 20 and October 20, 2020. Year to be formally closed as of September 30, 2019.
- 2017 to be subject to an additional supplementary call of 17.5% of currently estimated total premium for the year, payable in two equal installments on May 20 and October 20, 2020. Release call margin to be reduced to 5% in the interim. Year intended for formal closure in the first half of 2020.
- 2018 developing in line with original expectations, save for a significant increase in the cost of the Pool for the year in question. Release call margin to be maintained at 20% as originally mandated, the position to be revisited in the first quarter of 2020.
- 2019 indicating signs of claims deterioration at the mid-point, but development may be more a matter of timing rather than the indication of a trend. Release call margin to remain at 20% as originally prescribed, the position to be reviewed in the first half of 2020.

- 2020 renewal to feature no standardized, or general, increase on expiring estimated total premium for mutual P&I entries. Group reinsurance cost component of premium to be adjusted separately. Premium to be characterized as estimated total premium for the year and to be debited in four equal installments as in previous years. Release call to be 20% of estimated total premium.

- 2020 renewal to feature no standardized, or general, increase in premium for both mutual and fixed FD&D covers. Premium to be debited in two equal installments. Release call to be 20% of estimated total premium for mutual entries.

- 2020 renewal also to feature no standardized, or general, increase in premium for fixed P&I and Damage to Hull (DTH) covers.

- No standard increases, nor prescribed minimums, to apply to renewing deductibles for the 2020 policy year.

Your Managers will be in contact with individual Members with their proposals for renewal over the forthcoming weeks. If, in the meantime, any Members should require clarification in regard to the above, or generally, your Managers will be pleased to respond.

Yours faithfully,

Joseph E.M. Hughes, Chairman & CEO
Shipowners Claims Bureau, Inc., Managers for
THE AMERICAN CLUB