

Global service  
built around you

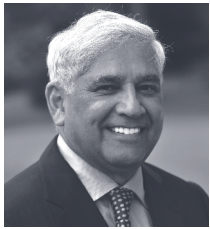
North



# MID-YEAR REVIEW<sup>2018</sup>



# CHAIRMAN'S STATEMENT AND OVERVIEW



*As I again review the performance of the Club at this customary mid-year point, it seems impossible to ignore the growing convergence of external pressures that come to bear on the management of any P&I Club.*

Indeed, it is difficult to recall a more critical period in the history of our industry, as the challenges we now face require ever more imaginative responses if we are to maintain our commitment to the essence of what we do: mutuality.

The more recent examples of those challenges in the wider shipping industry include the volatile global sanctions regime, the effects of the impending 2020 global sulphur cap, and the developing technological landscape – including a digital trading environment. North has engaged with these and other issues by assessing their likely impact on the operations of our Members and advising on the range of options available to manage the consequences. In so doing, we are displaying the fundamental difference between mutual P&I and other 'commodity' insurance solutions, as well as demonstrating the core purpose of the North Group, which is to enable our Members to trade with confidence.

We need to ensure that this difference is sustainable over the long term. While we have critical aspects in common with all insurers – such as financial strength and capital management – we also have a set of unique features that can only be sustained by constant reference to the needs of our Members. This is partly enabled through our deep commitment to the International Group of P&I Clubs (IG) and the very considerable benefits of that system. The squeeze in profitability is affecting not only the Clubs but the Lloyd's market. With falling P&I premiums and market 'churn' combined with the prospect of a claims environment which is less benign – all of this against the background of our Members experiencing continued variability in their earnings – this is a situation which applies to the industry as a whole, and it seems appropriate to take stock together of the challenges ahead of us and resolve to meet them 'head on'.

For our part, I am confident that North remains ever more diligent in addressing each of the key areas of Club management.

KEY FACTS: (AS AT 20 AUGUST 2016)

US\$ **11.9m** INVESTMENT RETURN

**110%** COMBINED RATIO (FORCAST)

**143m** TOTAL OWNED ENTERED GT

**A** STANDARD & POOR'S RATING

**AAA** CAPITAL STRENGTH

# CHAIRMAN'S STATEMENT AND OVERVIEW (cont.)

## Financial Performance

Our core financial strategy is to provide predictability in premium levels and to avoid unbudgeted calls; we have delivered successfully on this strategy for over 27 years. With the erosion of premium income over the past few years, this has become an increasingly complex balancing act. Added to this are concerns around increasing regulatory costs, political uncertainty with doubts around the impact of Brexit and disruption to worldwide trade from international protectionism. The Board well understands that the shipping community is experiencing volatility in freight markets and so, as their Club, we will continue to support our Members by keeping premiums as low as we can whilst managing the Club in a responsible way.

We may now be seeing signs of a changing claims environment, which is evidenced by our experience in the category of retained large claims in excess of US\$1 million. We are also making an allowance for a continuing pattern of elevated pool claims. At the same time, we have seen deterioration in investment returns so far this year. So, at the half-year point, we are projecting the combined ratio for the year to 20 February 2019 to be 110%. This result would inevitably lead to a decline in our free reserves, but these reserves are there to protect the Club in these circumstances.

The capital management strategy adopted by the Board is one designed to ensure that the Club retains adequate capital to meet the thresholds currently set by Standard & Poor's to support the "A" (stable) rating in the event of an adverse experience, whether that is caused by a changing claims experience or investment markets. We can also be confident that the reinsurance programme that we have in place will offer additional protection in the event that 2018 turns out to be an 'abnormal' year.

Going forward, there is some reason to expect that the recovery of the global shipping markets and an upturn in commercial activity will see an end to the 'soft' market; that, together with resulting increases in the number and scale of claims will lead to a more sustainable level of premium income. Until those shifts become evident in the market, we will continue to focus on our disciplines of prudent management of investment and underwriting risks with a view to maintaining a level of capital that is adequate to deliver predictability of cost.

*"...to enable our Members to trade with confidence..."*

*"...provide predictability in premium levels and to avoid unbudgeted calls..."*

*"...continue to support our Members by keeping premiums as low as possible for as long as possible..."*

# CHAIRMAN'S STATEMENT AND OVERVIEW (cont.)

## Premium Requirements

We have been talking about the industry issue of premium dilution for a number of years now, and at this point last year we forecast a combined ratio moving out beyond 100%, which proved to be the case. We are now signposting that, in the current rating environment, we can expect this trend to continue. Although the claims environment is not alarming – it is in fact relatively stable despite the Club's recent experience in the high value retained and Pool claim categories – there comes a point at which those trends will combine to put at risk the notional equilibrium between pricing and capital management. In the current restricted investment market, we think that the combined ratio for 2018/19 will be 110% and therefore free reserves will be reducing.

That outcome means that the Club will sit in the middle of the prudent capital range established by the Board (whereas at 20 February 2018 we were positioned just above that range). As a result corrective action to premiums will be required to halt the decline in the capital in order to obviate the risk of it falling below the prudent range. The Board has therefore decided that in recognition of the continuing economic pressures being experienced by the Membership, the Club will not announce a General Increase in premium at the 2019/20 renewal. However, we will robustly review all Members' premiums to ensure that a fair rate commensurate with performance and exposure is applied. Should the trends in premium dilution and marginally elevated claims continue through next year, a scenario that is referred to by many other clubs and commentators this year, it will be difficult in the absence of significant investment returns to avoid an increase at the 2020 renewal.

## Claims Performance

The number of attritional claims – those valued below US\$1 million – has traditionally been taken as an indicator of claims inflation, not just at Club level but across the industry. The number of these claims, indeed the number of claims overall, appears to be fairly consistent over recent years. It may be that we will see a rise in the numbers, and in the general level of claims inflation, should the global trading environment improve with a consequent increase in shipping activity. Separately, however, the Club has seen an increase in the number and cost of claims over US\$1 million and of Pool claims in the year to date. Claims with a high value are fundamentally unpredictable and even a small number can have a disproportionate impact on the Club's overall claims performance. The first half of 2018 saw 18 high value claims across a variety of areas including DTH, cargo, FFO, pollution, wreck and oil removal. While the experience on the Pool is common across the International Group, the combination of the increase in all these high value claims against the background of lower premium levels and churn is a key driver of an increasing projected combined ratio.

*"...the recovery of the global shipping markets and an upturn in commercial activity..."*

*"...seeing signs of a changing claims environment..."*

*"...North's share of [the IG] insured tonnage is around 12%..."*

# CHAIRMAN'S STATEMENT AND OVERVIEW (cont.)

## Membership

Today the world fleet is approaching 95,000 vessels totalling over 1.3 billion GT, with the IG clubs insuring more than 90% of this tonnage. North's share of this insured tonnage is around 12%. Our most recent Annual Review reported the less than 1.5% year-on-year growth in owned tonnage to just over 142 million GT, as well as the 6% increase in chartered tonnage to 53 million GT. The main driver behind this growth was our existing Membership, but it was complemented by new Member growth from across the globe. We have also maintained a balanced portfolio during the year, with the types of ships entered in the Club reflecting the world fleet profile.

Although the growth in the world fleet has slowed to less than 3%, the Club's growth has been further constrained by the M&A activity across the shipping sector over the last 18 months. This activity is likely to continue for the near future because of continuing volatility in global freight markets and the increasing rates of vessel demolition. This uncertainty is likely only to be exacerbated by the introduction of the global fuel sulphur cap on 1 January 2020.

## Loss Prevention

Throughout the first half of 2018, our Loss Prevention teams have continued their work with Members to reduce the number of claims received, particularly high value claims. Our ongoing Member review programme, supported by an in-depth analysis of the root causes of claims received, has allowed the team to advise Members on a range of vessel and operational management risks including crew training, systems effectiveness and safety culture.

In addition, the team have also advised on the wide range of technological and regulatory changes currently facing the global shipping industry. Challenges such as cyber resilience, the risks associated with autonomous ships, and the potential implications of the 2020 global sulphur fuel cap have all been addressed. The reduction of the MARPOL Annex VI global fuel sulphur cap to 0.5% on 1 January 2020 represents one of the most fundamental changes to global shipping in many years.

Our Loss Prevention and FD&D teams have worked closely on a "2020 Vision" campaign to assist Members with the technical, operational, regulatory and contractual challenges this change may pose. This has included a series of Member seminars, the first of which took place in London during July, along with an update to the Marine Fuels guide.

*"...demand for our in-house class leading FD&D team has never been greater..."*

*"...one of North's central business aims is to... play a leading role within the IG..."*

*"...Club will be further strengthened through our developing plans for additional diversification..."*

# CHAIRMAN'S STATEMENT AND OVERVIEW (cont.)

## FD&D

As economic uncertainties continue across the global shipping industry, demand for our in-house, class-leading FD&D team has never been greater. Our team, the largest specialist FD&D legal team in the world, comprises some 35 highly skilled and qualified lawyers devoted to helping Members pursue and defend their claims. Advising on disputes across the full FD&D spectrum, the team handles the vast majority of claims in-house and during the first half of 2018 the increasing number of claims received mirrored the recent accelerated growth of our FD&D class. The strength and depth of the FD&D team has been further boosted by the recruitment since February 2018 of 3 additional experienced lawyers to join our teams in Newcastle, Piraeus and Singapore. These appointments will further strengthen our service delivery and expand our support for Members navigating through developing global challenges such as the 2020 sulphur cap, cyber risks and the re-imposition of Iranian sanctions.

## Sunderland Marine

The reality of premium dilution in the mutual-owned class over the last five years has required the Club to pursue a strategy of wider diversification. However, our approach to these initiatives is one that includes taking the necessary care and rigour to ensure that profits can be generated to support the Group, rather than to introduce speculative risk that might undermine our overall venture. These initiatives can take time to mature, and so it is especially pleasing to see the benefits of Sunderland Marine refocusing on key business sectors around the world. The UK fishing fleet, the seventh largest in the EU, continues to perform well and the majority of catching sectors are profitable. Since June 2016, Sunderland Marine has added £130 million of total value in new UK vessels insured, representing 87% of the new builds delivered in this period. Additional new vessels, valued at £100 million, are expected to be added to the UK fleet before 2021 and Sunderland Marine is well placed to benefit from this expansion in fleet capacity.

Business performance in other parts of the world including Australia, New Zealand and Europe continues to improve with encouraging results reported in these key territories. Claims volumes received, in both H&M and P&I, continue their downward trend and are approximately 15% lower in number than the previous year.

The Hull insurance market is now 'hardening' after several years of market losses and many Lloyd's syndicates are now completely withdrawing from marine insurance.

New investment in technology, veterinary research and genetics is driving a rapid expansion of commercially viable aquaculture businesses across the world and the majority of these companies consider stock insurance as a key part of their financial security. Worldwide, aquaculture is the fastest growing animal-based food production sector but fish volumes from capture fisheries have plateaued over the past 20 years whilst the demand for fish and protein from a growing global population has increased significantly. According to World Bank projections, 62% of fish for human consumption will be supplied from aquaculture sources by 2030. The Sunderland Marine aquaculture team is ideally positioned to take advantage of this forecast growth.

## Members' Board Changes

A number of appointments have been made to the Members' Board during the first part of 2018. I'd like to welcome Mats Berglund (Pacific Basin), Antonis Kanellakis (Alpha Bulkers Shipmanagement Inc & Pantheon Tankers Management Ltd), Captain David Stockley (Oman Shipping Management Company), Andrew Roberts (Teekay Multigas Pool) and Captain Xie Chunlin (China Merchants Energy Shipping Co Ltd). Yang Yuntao, Atle Sebjornsen and Tim Horne resigned from the Board and I would like to thank them all for their service to the Club. In June 2018, Tom Rutter stepped down from the Sunderland Marine Board of Directors and Paul Jennings has assumed the position of Chief Executive of Sunderland Marine.

# CHAIRMAN'S STATEMENT AND OVERVIEW (cont.)

## Brexit

The UK's membership of the EU is due to expire on 29 March 2019. Despite generally positive indications regarding a successful transitional deal that would retain passporting rights for UK insurers until the end of December 2020, a 'hard Brexit' in March 2019 remains a real possibility. In its July 2018 White Paper the UK Government detailed its proposals for the future relationship between the UK and EU. In relation to financial services, a new economic and regulatory arrangement was proposed based on mutual recognition and an extension of current equivalence regimes.

There was little detail on the proposed arrangements but it recognised that the new system "cannot replicate the EU's passporting regime". Given the ongoing risk of a 'hard Brexit' and the explicit exclusion of passporting rights from the UK's proposed future relationship with the EU, our contingency plan to establish a subsidiary insurance company in Ireland is the appropriate response to this new environment.

Our Irish subsidiary, North of England P&I DAC, has been established and the application for authorisation as a non-life insurance company is with the Central Bank of Ireland. A further announcement will be made once the authorisation process is complete.

## The International Group

It has long been one of North's central business aims to remain a mutual insurance business and play a leading role within the IG. The 2017/18 IGP&I Annual Review underlines the key roles played by North personnel across many subcommittees.

I passionately believe that the IG provides significant benefits for Members, the global shipping industry and the broader communities in which we operate. Today it is more important than ever that these benefits are clearly explained to Members, the wider shipping community and other interested stakeholders and I encourage all IG clubs to take up this challenge.

I am personally delighted that North's Chief Executive, Paul Jennings, has been appointed for a 3-year term to the role of Chairman of the International Group of P&I Clubs with effect from 13 November 2018. With a deep understanding of the mutual P&I system, and its advantages and benefits to the shipping community, Paul is ideally placed to guide the IG through the next few years.

## A Resilient Club

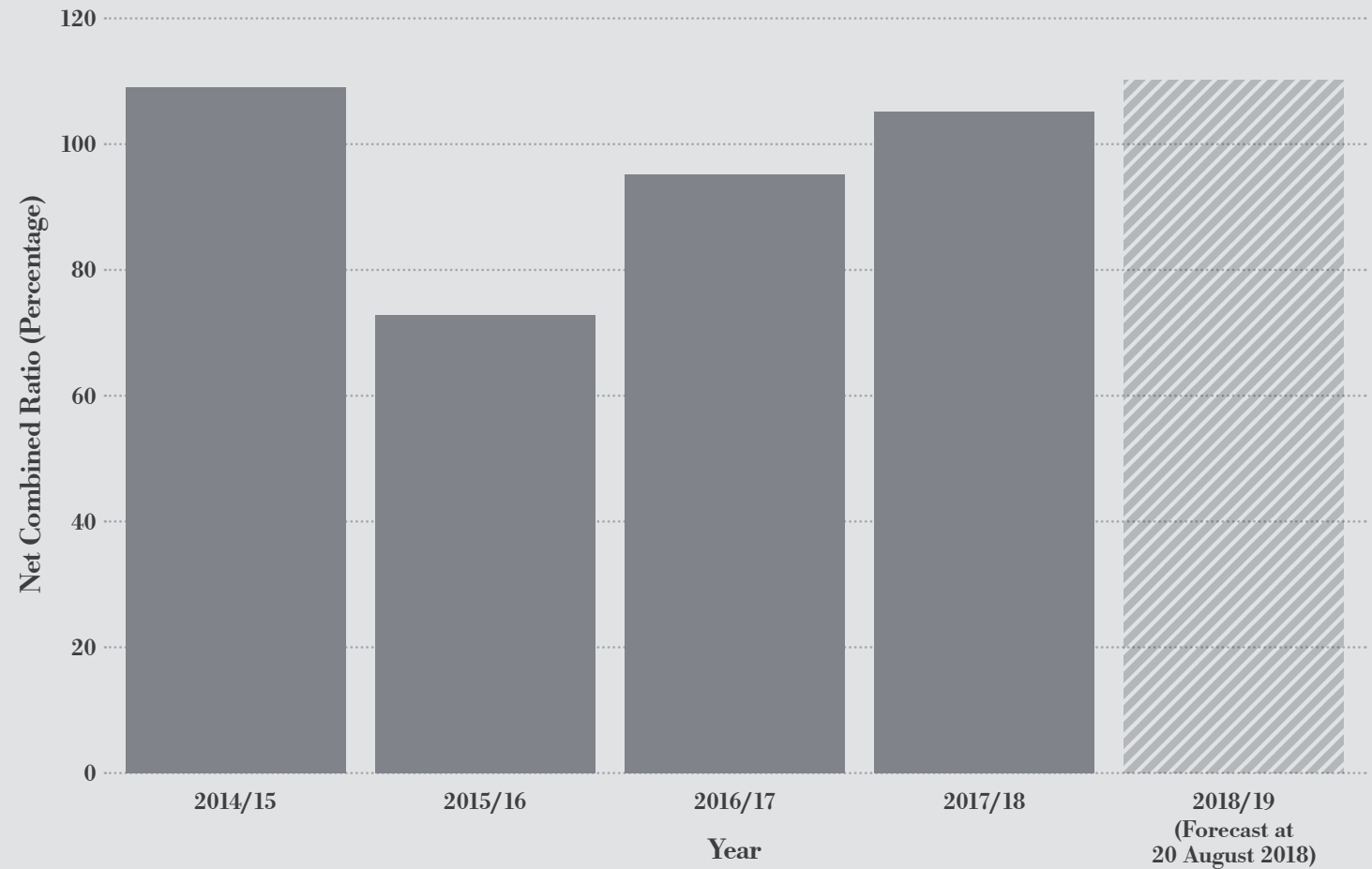
The future for the Club will be further strengthened through our developing plans for new business and additional diversification. During the first half of the year, the standalone FD&D and Chartered business continued its strong growth with Members benefitting from our market-leading expertise and further progress is anticipated. The Club's secure financial position, rigorous underwriting approach, and proactive claims and risk management ethos provide a strong foundation for our diversification strategy. This will ensure that the Club grows in line with the evolving expectations of our Members and sustains our commitment to premium predictability by generating new and complementary marine insurance income streams. Within the Club we remain determined that each of these individual diversification initiatives will be characterised by our long traditions of delivering service excellence and robust financial management.

**Pratap Shirke**  
Chairman



# FINANCIAL REVIEW

## COMBINED RATIO PERFORMANCE

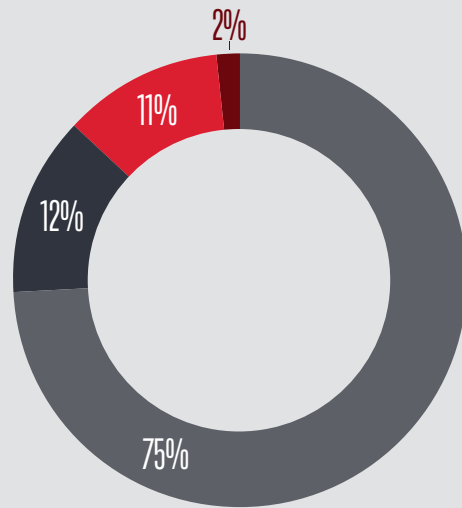


# FINANCIAL REVIEW

## ALL CLASSES ASSET ALLOCATION

AT 20 AUGUST 2018

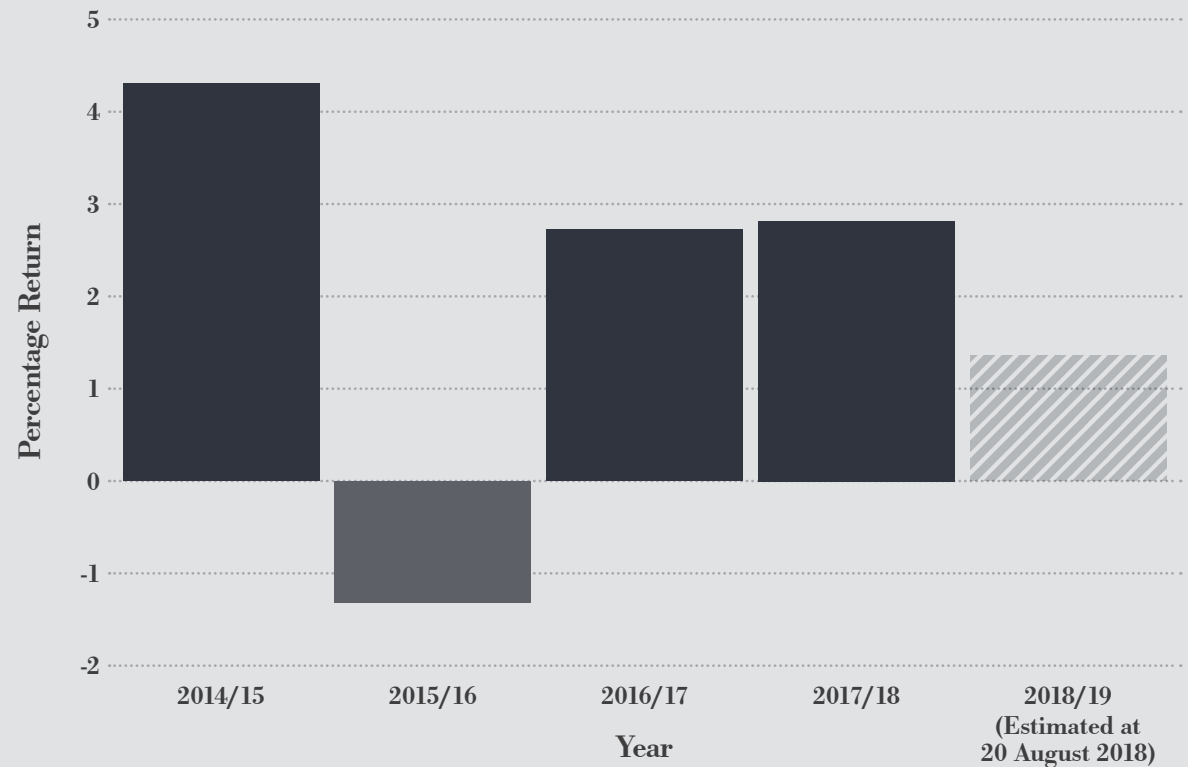
- CASH & CASH EQUIVALENTS
- EQUITIES
- CORPORATE BONDS
- GOVERNMENT BONDS



### Suppressed Equity and Investment Markets

- Total investment return of US\$11.9 million to date in volatile equity markets and rising US interest rates.
- The Club continues to invest prudently with approximately 89% of all assets invested in fixed income securities and cash.
- Equity markets have been unsettled since the half-year point and, with rising interest rates having an impact on fixed income investment, we see an uncertain future for investment returns over the remaining months of 2018/19.

## INVESTMENT RETURNS

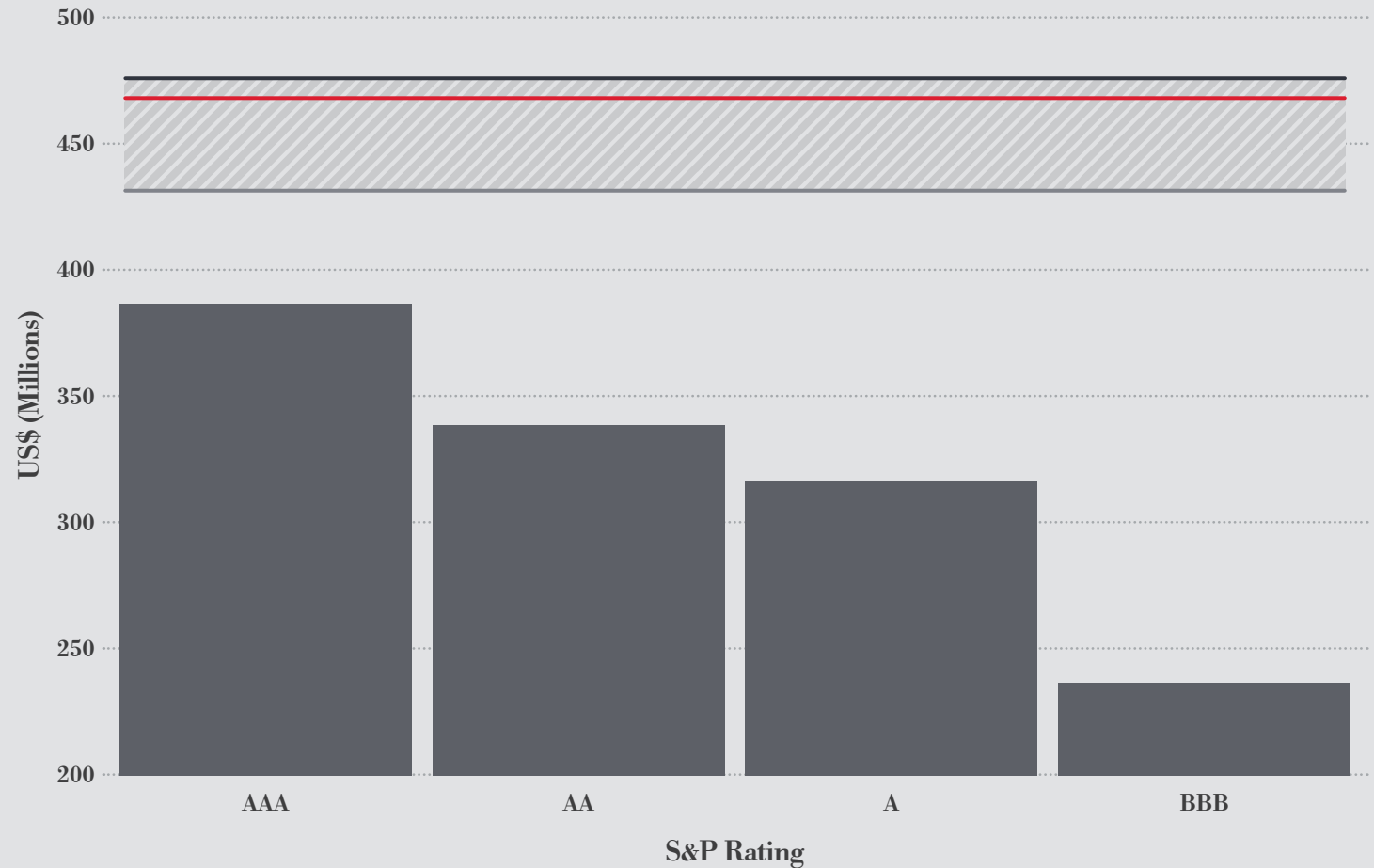


# FINANCIAL REVIEW



## CAPITAL POSITION

PROJECTED TO 20 FEBRUARY 2019



### Capital Targets

- We meet our regulatory capital requirements in all of the jurisdictions in which we operate, with appropriate buffers set by the Board.
- Full details of our UK position can be seen in the SFCR published on our website.
- We hold a rating of 'A' (stable) with Standard & Poor's, supported by capital sufficient to meet the 'AAA' requirement of the Standard & Poor's capital model.
- Our own internal capital management is focussed on a range which ensures that we can withstand a particularly adverse year without prejudice to our 'A' rating.

# OPERATIONAL REVIEW

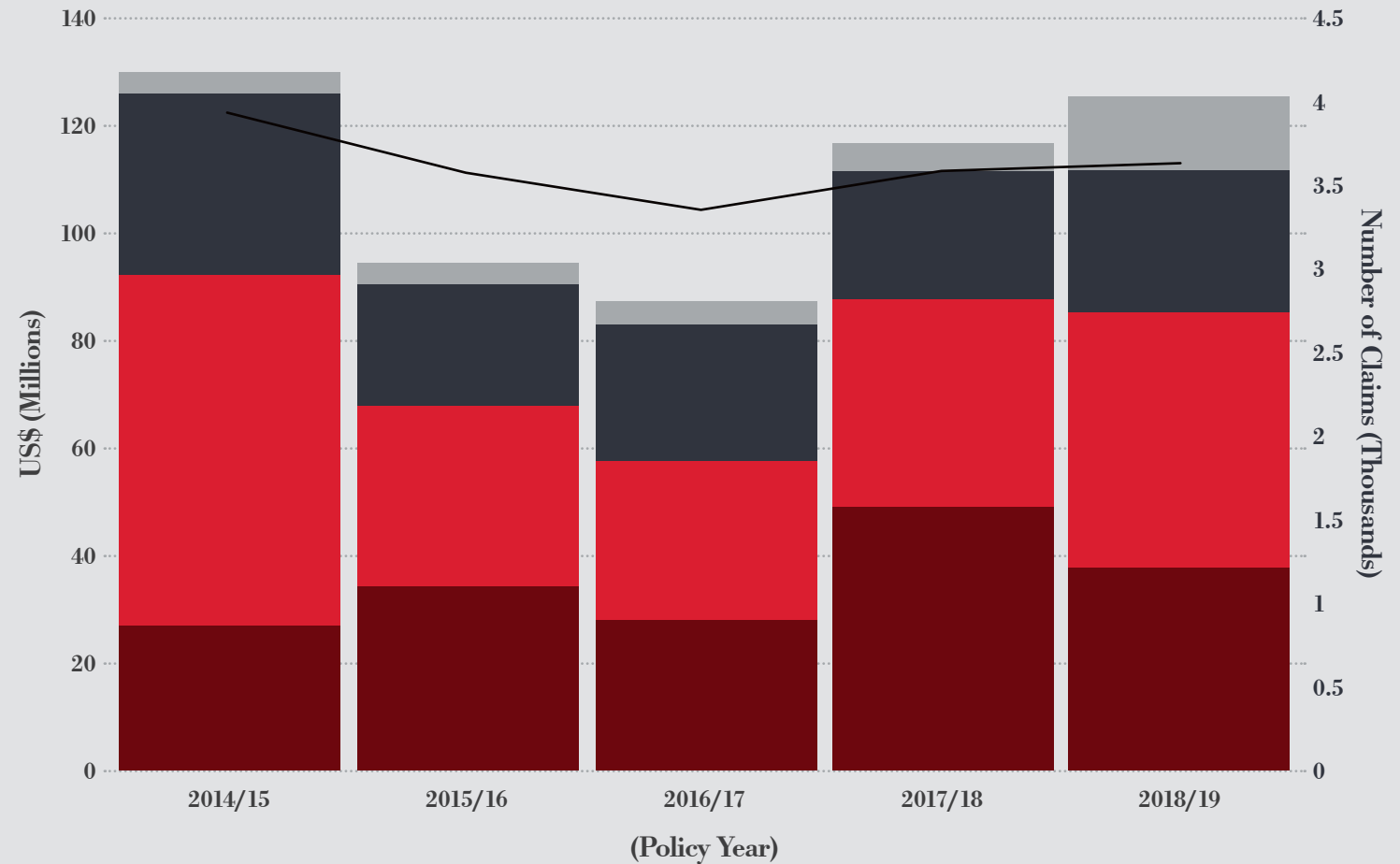


## RETAINED CLAIMS

AT SIX MONTH DEVELOPMENT POINT

### Claims Experience

- The total number of claims reported in the first six months of the 2018 policy year, some 3,643 claims, is broadly in line with the previous five years despite a 7% increase in the tonnage entered with the Club during that time.
- During the first six months of the year the number and value of people related claims has remained consistent with previous experience over the past five years. Cargo claim numbers have remained stable but the associated claims value has risen. Numbers of admiralty claims have been steady but overall values have reduced. The number of claims in other areas has remained consistent but values have increased.





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## Connect

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