

## Assuranceforeningen SKULD (Gjensidig)

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# Assuranceforeningen SKULD (Gjensidig)

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

- Membership of the International Group of Protection and Indemnity (P&I) Clubs (IG) provides market access.
- One of the most diversified of its IG peers, including a Lloyd's syndicate.
- Strong brand reputation and operating performance.

### Financial Risk Profile: Strong

- Capital adequacy will likely remain around the 'AA' level or above.
- The P&I sector is inherently volatile. IG joint reinsurance program helps to manage exposure.
- Less-volatile operating performance than most of its IG peers'.

## Outlook: Stable

The stable outlook reflects our expectation that the capital adequacy of Assuranceforeningen SKULD (Gjensidig) (Skuld) has strengthened and will remain at least in our 'AA' bracket. We also anticipate the club maintaining its operating performance at a level consistent with our base case, and maintaining at least a strong competitive position.

### Downside scenario

We might lower the rating if, contrary to our expectations:

- Capital adequacy deteriorates significantly below the 'AA' category for a prolonged period. This could result from premium growth outstripping capital accumulation;
- Earnings weaken to substantially less than our base-case assumptions and the company loses its momentum and ability to outperform its peers due to further losses from its Lloyd's syndicate and other activities, substantial uncontrolled growth, or extraordinary growth in the size or frequency of claims;
- The club proves unable to maintain its strong competitive position. This could occur if it does not manage its growth carefully, and so weakens its financial strength and lowers its level of service to members; or

### Upside scenario

We do not anticipate raising the rating during the next two years.

## Base-Case Scenario

### Macroeconomic Assumptions

- Global shipping companies will continue to face difficult operating conditions, characterized by fragile demand and chronic structural oversupply in the industry.
- Charter rates might finally be bottoming out in subsectors. That said, they remain subdued and this, combined with the rising price of the oil-based fuel used to run ships, will continue to constrain cash flow generation for most ship operators.
- Neither the IG pool structure nor the pool-sharing methodology will change significantly.
- Increased capacity in the reinsurance markets will continue to have a positive impact on IG group reinsurance and retention protection premium and terms.

## Company-Specific Assumptions

- Capital adequacy to remain around the 'AA' level or above.
- Net earned premiums to grow steadily to around \$400 million by February 2021.
- A net combined ratio of 97%-99% over 2018-2020, barring an abnormally high claims pattern.
- After-tax operating income of around \$20 million-\$30 million for the 2019-2021 financial years.

## Key Metrics

	--Year ending Feb. 20--							
	2014	2015	2016	2017	2018	2019F	2020F	2021F
Net premiums earned (mil. US\$)	309	347	353	327	351	366	380	395
Net income (mil. US\$)	29	12	10	40	33	23	10	10
Combined ratio (%)	98.70	99.80	94.30	97.70	99.80	97.00	98.00	98.00
Members' funds (mil. US\$)	334	334	347	391	442	465	475	485
Return on members' funds (%)	9.00	3.60	2.90	10.80	7.90	5.07	2.15	2.14
Return on revenues (%)	(0.50)	(0.30)	8.70	5.50	3.50	7.92	4.51	4.44

## Company Description: Fast Growing Mutual Primarily Providing P&I Cover

Skuld is a diversified marine insurer that offers a wide range of insurance products and consists of three main market brands: Skuld P&I, Skuld Marine Agency (SMA), and Skuld 1897--a syndicate at Lloyd's. In addition, there are two service companies: Skuld Services and Asta. Asta is a management agent managing syndicates at Lloyd's, where Skuld is part owner.

## Business Risk Profile: Strong

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

We assess the industry and country risk for Skuld as intermediate, reflecting our assessment of the global marine P&I sector.

We assess country risk as low. We believe the domicile of a P&I insurer has relatively little impact on the aggregate industry and country risks it faces and therefore we do not differentiate by domicile.

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.

One of the key strengths of the global marine P&I sector is the existence of the IG, which provides the sector with a

high barrier to entry. A weakening of the IG's position in the marine market would probably lead us to revise our view of industry risk and change our overall view of industry and country risk to moderate.

The mutual marine sector is less focused on profitability than other sectors and is more exposed to high-risk assets than other property/casualty insurers, increasing earnings volatility. The size and frequency of claims are also unpredictable, increasing product risk.

### **Competitive position: Membership of IG and increased diversification support strong competitive position**

Skuld has a strong competitive position stemming from its membership of the IG and also from its increasing brand reputation and strong operating performance. Unlike some of its competitors, Skuld has been actively pursuing further avenues of product and geographic diversification that it can offer to its ship owner members.

Skuld has its own Lloyd's syndicate, which has strengthened the club's presence in the important London marine market. Much of the syndicate's business has been drawn from Skuld's mutual members or other related marine entities. The syndicate's development has been slower than expected and has yet to make a profit.

The difficult market conditions have led Skuld to scale back its previous growth plans, particularly within its Lloyd's operations. While gross premiums increased by 6.5% to \$433 million in year-end 2018, this included the incorporation of the SMA renewal rights purchased in 2017. We expect that premiums will continue to grow moderately, at 3%-4% per year in fiscal years 2019-2021.

### **Financial Risk Profile: Strong**

Skuld has a strong track record of technical profitability, returning 15 consecutive annual combined ratios under 100%, the longest such record in the IG. In part, this reflects its diversification within the marine sector.

Despite six major marine loss events in fiscal year 2018 and continued losses from Skuld's Lloyd's operations, the club reported after-tax operating income of \$32.6 million in February 2018 (February 2017: \$40.1 million). A technical result of \$10 million was bolstered by an investment income of \$48.4 million.

In fiscal years 2019-2021, we expect Skuld to realize modest technical profits and that its investment performance will revert to a return on investment of 2% rather than repeat the exceptional gains of fiscal year 2018. This should maintain Skuld's capitalization around the 'AA' level based on S&P Global Ratings' capital model.

While exposure to equities and other more volatile investments is relatively high for an insurer, this is offset by the club's strong capital base. Skuld also benefits from significant positive pool balance.

The club has no debt and strong liquidity. Like its IG marine mutual peers, the club has a legally enforceable right to collect unlimited additional premiums on its mutual P&I business, although this is partly diluted by the significant fixed premium element of Skuld's book.

## Other Assessments

We have a positive view of the club's risk-management culture and underwriting risk controls. Consequently, we consider it unlikely that the company will experience losses that exceed its risk tolerance.

In our opinion, the experienced management team at Skuld has successfully maintained its brand reputation and market position while delivering good profitability. We note, however, the slow development of the Syndicate 1897 venture.

## Accounting Considerations

There has been a question for several years over the taxation of mutual insurers in Norway. In their 2017 and 2018 accounts, the club incorporated the latest regulatory guidance and set aside around 25% of its accumulated free reserves as "deferred cessation tax". This remained eligible as regulatory capital and would not be taxable while the mutual continued trading. We give credit for both balances in our assessment of the club's capital.

In February 2018, a consultation paper proposed that mutuals' underwriting results would not be taxable, but that investment return would be liable to tax (both in future and retrospectively). We do not regard the club's potential retrospective tax bill under these proposals to be material to our assessment of its capital.

## Ratings Score Snapshot

Financial Strength Rating	A/Stable/--
Anchor	a
Business Risk Profile	Strong
IICRA	Intermediate risk
Competitive Position	Strong
Financial Risk Profile	Strong
Capital and Earnings	Very strong
Risk Position	Intermediate
Financial Flexibility	Adequate
Modifiers	
ERM and Management	0
Enterprise Risk Management	Adequate
Management & Governance	Satisfactory
Holistic Analysis	0
Liquidity	Exceptional
Support	
Group Support	0
Government Support	0
SACP	a

## Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

### Ratings Detail (As Of September 13, 2018)

#### Operating Company Covered By This Report

##### Assuranceforeningen SKULD (Gjensidig)

Financial Strength Rating

*Local Currency*

A/Stable/--

Issuer Credit Rating

*Local Currency*

A/Stable/--

#### Related Entities

##### SKULD Mutual Protection and Indemnity Association Ltd. (Bermuda)

Financial Strength Rating

*Local Currency*

A/Stable/--

#### Domicile

Norway

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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