

Assuranceforeningen SKULD (Gjensidig)

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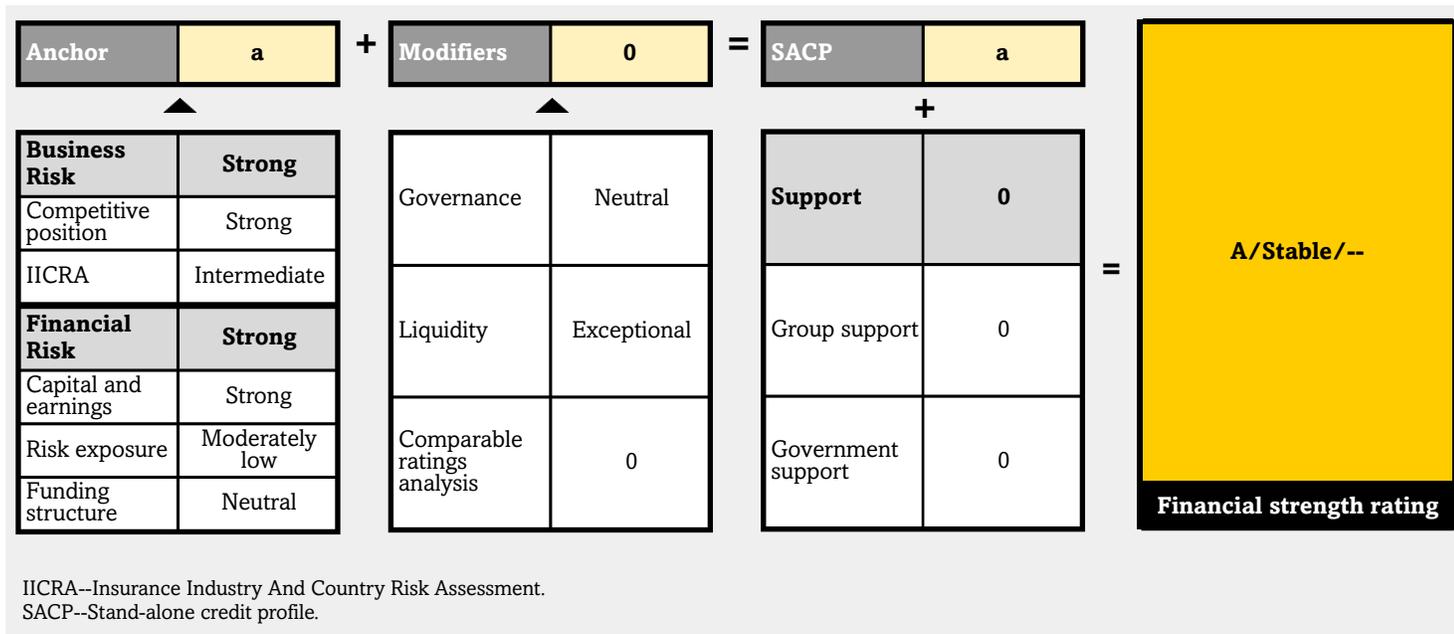
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Assuranceforeningen SKULD (Gjensidig)



Credit Highlights

Overview	
Key strengths	Key risks
Skuld has a strong reputation and a market position in the Marine and protection and indemnity insurance (P&I) market.	As with its peers, Skuld is largely undiversified outside of its marine specialism.
The club is well capitalized and likely to remain so across the next two years.	COVID-19 is likely to negatively impact the club's underwriting and investment performance.
The club has historically recorded less volatility in results compared with P&I club peers.	The club is exposed to the volatility of other International Group (IG) clubs' claims through the IG's pooling system

Skuld continues to maintain a strong competitive position in the P&I and marine markets. In our opinion, Skuld maintains a strong relationship with both its members and brokers due to its strong service fundamentals and recognized brand.

Skuld, while of the more diversified P&I clubs, remains largely undiversified outside of its marine specialism. Skuld writes hull and energy covers alongside its P&I mutual business. Despite the club's Lloyd's syndicate closure, Skuld continues to offer non-P&I covers on its own company paper. Despite offering these additional lines of business, the club is more exposed to the fortunes of one sector compared with other 'A' rated insurers.

We believe Skuld is likely to maintain capital at levels above our AA benchmark per our risk-based model over the next two years. We expect the club is likely to record another loss in financial year (FY) 2020-2021, due to both claims and investment losses as the result of COVID-19. Skuld is likely to return to profit in FY2021-2022. Skuld, like other P&I clubs, has the option to make unbudgeted calls on members and it is this ability that influences are selection of the 'a' anchor.

Outlook: Stable

The stable outlook reflects our expectation that Skuld's capital adequacy will remain well above our 'AA' benchmark over the next two years. We also anticipate the club will improve its operating performance on an underlying basis in FY2021 and return to underwriting profitability in FY2022. We expect the club will also continue to maintain its position as one of the leading insurers in the P&I market.

Downside scenario

We might take a negative rating action if, contrary to our expectations over the next two years:

- Capital adequacy deteriorates significantly below our 'AA' benchmark and we do not expect the club to return to the 'AA' level within two years. This could result from premium growth outstripping capital accumulation; or
- If we do not see underlying earnings improve from current levels such that the club does not return to profitable underwriting by February 2022.

Upside scenario

We do not expect to raise the rating over the next two years.

CreditWatch

Key Assumptions

- COVID-19 will lead to a global recession in 2020. We forecast GDP will fall 5.2% in the U.S., 7.3% in the eurozone, and 6.2% in Norway.
- Central bank monetary policy responses will cement interest rates at lower levels for a longer period, pressuring insurers' investment yields. We expect U.S. 10-year yields will fall to 1.3% in 2019, before slightly increasing to 1.8% in 2022.
- Despite some recent rate improvements in 2020 P&I renewal, we still believe business conditions in the sector remain weak following years of falling rates.
- Conditions in the hull market will improve throughout 2020 with some significant rate increases. However, we believe the increases are coming from a low starting point and many insurers will still fail to breakeven in this line in 2020.
- COVID-19 and the oil price shock will test marine insurers, both through investment losses and their underwriting portfolios. Investment losses will be generated through equity market falls and credit spreads widening, whereas underwriting losses will flow from COVID-19-related claims and premium returns due to lower trading activity, with

those writing cruise and passenger vessels most affected.

Assuranceforeningen SKULD (Gjensidig)--Key Metrics						
	2022f	2021f	2020	2019	2018	2017
S&P Global Ratings capital adequacy	Very Strong	Very Strong	Excellent	Excellent	Very Strong	Very Strong
Gross premium written (mil. \$)	~405	~395	390.8	401.6	412.7	389.7
Net income (mil. \$)	15.0	~(30)	25.5	10.7	57.5	50.6
Return on shareholders' equity (%)	~4	~(8)	5.6	2.4	13.9	13.7
P/C: net combined ratio (%)	~100%	~105%	110.3	97.7	98.4	95.8

f--Forecast.

Business Risk Profile: Strong

Skuld is a mutual marine insurer and one of the largest members of the IG--a group of 13 clubs that provide protection and indemnity cover for about 90% of the world's ocean going tonnage. It ranks second by overall premiums written. One of the key strengths of the club is its membership of the IG, which provides the P&I sector with a high barrier to entry and efficiencies in reinsurance purchase.

Skuld's strategic desire to diversify its business offering has led to an expanded product range including hull and energy lines of business. The club started writing much of this diversifying business through its own Lloyd's syndicate 1897 and through Skuld Marine Agency. The club has now ceased underwriting at Lloyd's and will sell its legacy syndicate business to Riverstone. The club continues to write hull and energy covers through its main operating company Assuranceforeningen Skuld (Gjensidig). In 2019-2020, the club wrote just under \$400 million of premiums, with the majority (just over 60%) coming from its P&I business.

Skuld has been consistently one of the better performers in the P&I sector. Over the past five years it has recorded a rolling average combined ratio of 99%. However, in FY2019-2020, the club broke its record of 16 years recording an underwriting profit. Both large claims from other clubs causing a heavy year on the IG's pool and some reserve deterioration on Skuld syndicate business resulted in it recording a net combined ratio of 110.3% (FY 2018-2019: 97.7%). We expect Skuld will also record an underwriting loss in 2020-2021, due to claims and premium returns related to the COVID-19 pandemic. The club is also likely to record investment losses in FY2021, due to mark to market losses on its equity portfolio and credit spread widening. Overall, we believe that if markets remain depressed Skuld will record a net loss in the region of \$30 million. We expect the club will return to breakeven levels of underwriting profits in 2021-2022, as rate increases work through their P&I portfolio. We expect that investment gains in FY2022 will allow the club to record a small net profit of around \$15 million.

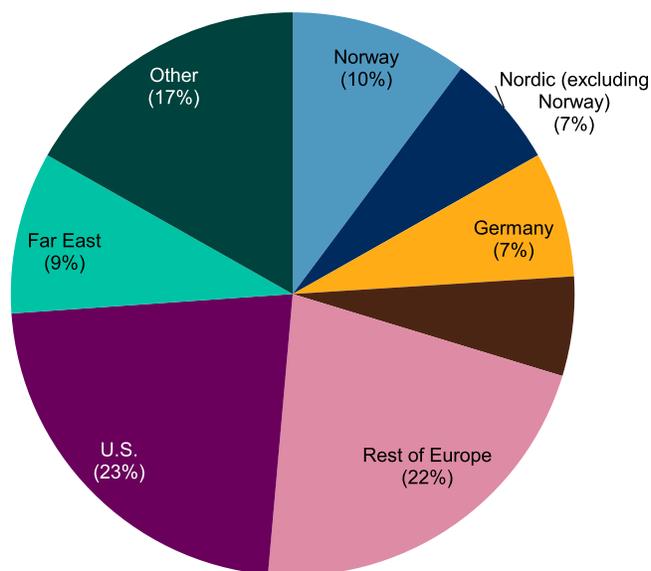
Skuld has a diverse geographic membership with premiums sourced from Asia, the U.S., and Europe. Members in these regions are supported by offices in Norway, Bermuda, Denmark, Germany, Hong Kong, the U.K., the U.S., Greece, and Singapore. Although these offices do add to the expense burden of the club, like other P&I mutuals, Skuld sees them as key to ensuring the high quality service that clients require.

Although Skuld is more diversified than the majority of its peers in terms of lines of business--only Gard and the

Swedish Club have significant levels of diversification and most P&I clubs do not offer hull and energy covers--we view it as less diversified than many other 'A' rated peers. Virtually all of the club's income derives from the marine sector and it is therefore exposed to the fortunes of this sector. The performance of Skuld's hull and energy lines has improved over time so that in the last two financial years its commercial business has outperformed its mutual business. In particular the club's 'Skuld Hull' product line was a significant contributor the overall bottom line in 2019-2020. We expect Skuld to remain committed to its diversification strategy over the next two years.

Chart 1

Skuld's Portfolio Weighted Towards Europe But Remains Very Well Diversified Geographically



Source: S&P Global Ratings.
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Financial Risk Profile: Strong

Skuld is very well capitalized with an excess of capital above our 'AAA' benchmark currently. We expect that the club will continue to remain well capitalized holding an excess of capital above at least the 'AA' level at the end of our two-year horizon. Although the club's net earnings will be limited by tough operating conditions over the next two years (due to COVID-19 and the poor rating environment in the P&I sector at present) we do not expect significant premium growth at Skuld or a significant increase in its risk appetite. In the past, Skuld has made distributions to its members following profitable years. We expect the club will not make such a return in 2020-2021, due to the poor current market conditions.

Skuld's regulatory capital position was a healthy 176% for the overall group at year-end 2020, based on the standard formula. The club benefits from about \$145 million of so-called 'ancillary own funds', reflecting its ability to make unbudgeted calls on its mutual members. We do not give credit for this in our capital model but it does influence our choice of the higher 'a' anchor. We believe that the club's use of such a call would mean a deterioration in its competitive position.

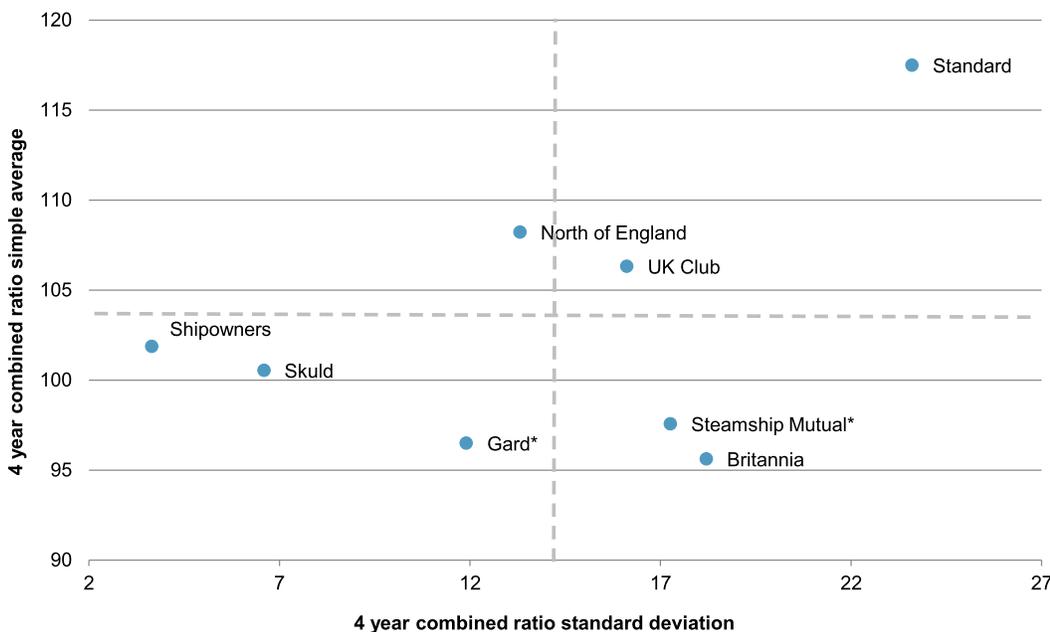
Like all P&I clubs, Skuld's earnings are exposed to volatility from the IG's pool. The IG pool allows IG members to share the cost of individual claims of \$10 million-\$100 million. The random nature of large claims means the pooled claims amount varies significantly year to year. In 2018-2019, Skuld had pool costs of over \$40 million, whereas in 2016-2017 it was closer to \$13 million. Despite this, Skuld has been able to limit the amount of volatility in its result. As stated before, before 2019-2020, the club had recorded a positive underwriting result in each of the last 16 years, the longest such run in the IG, which reflects the strength of its underwriting risk controls.

Although exposure to equities and other more-volatile investments is relatively high for a typical non-life insurer, Skuld's portfolio is conservative compared with many of its IG peers. Close to 80% of the club's investments are in bonds or cash, with only about 2% of the bond portfolio in noninvestment-grade bonds.

The club has no debt outstanding.

Chart 2

Skuld's Underwriting More Profitable And Less Volatile Than Most A And Above P&I Rated Peers



P&I--Protection and indemnity. *Excludes impact of premium returns. Grey dotted line shows the simple average for other A and above rated P&I peers. Source: S&P Global Ratings.

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Other Key Credit Considerations

Governance

We consider Skuld's governance to be in line with that of the majority of the P&I clubs. The majority of Skuld's board are ship-owner members and employee representatives. Skuld's executive team has been relatively stable in recent years. Stale Hansen has been president and CEO since 2015 and has an experienced team of executives around him.

Skuld also has a solid risk management framework in place with clear tolerances for underwriting and investment risk, in our opinion.

Liquidity

We have a favorable view of Skuld's liquidity. It has a large portfolio of liquid assets, comfortably covering our stressed liquidity requirements.

Group support

We assess both Assuranceforeningen Skuld (Gjensidig) and Skuld Mutual Protection and Indemnity Association (Bermuda) Ltd. as core to the Skuld group. These entities therefore share the rating of the overall group at A/Stable/--.

Accounting considerations

The group prepares its consolidated financial statements under local generally accepted accounting principles. We view the group's financial communication and disclosure as sound and transparent.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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

Appendix

Assuranceforeningen SKULD (Gjensidig)--Credit Metrics History		
	--Fiscal year ended February 20--	
\$000s, unless stated otherwise	2019	2018
S&P Global Ratings capital adequacy	Excellent	Excellent
Total invested assets	1,027,179.0	992,907.0
Total shareholder equity	462,449.0	449,327.0
Gross premium written	390,760.0	401,621.0
Net premium written	343,399.0	345,551.0
Net premium earned	343,399.0	345,551.0

Assuranceforeningen SKULD (Gjensidig)--Credit Metrics History (cont.)

	--Fiscal year ended February 20--	
\$000s, unless stated otherwise	2019	2018
Reinsurance utilization (%)	12.1	14.0
EBIT	20,447.0	11,155.0
Net income (attributable to all shareholders)	25,492.0	10,697.0
Return on revenue (%)	(5.8)	4.0
Return on assets (excluding investment gains/losses) (%)	(1.9)	1.3
Return on shareholders' equity (%)	5.6	2.4
Property/casualty: Net combined ratio (%)	110.3	97.7
Property/casualty: Net expense ratio (%)	26.1	26.9
Property/casualty: Return on revenue (%)	(7.7)	3.2
Financial obligations/adjusted EBITDA (x)	(0.3)	0.6
Financial leverage including pension deficit as debt (%)	1.3	1.7
Net investment yield (%)	0.8	0.3
Net investment yield including investment gains/(losses) (%)	4.8	0.0

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bbb	bb-/bb+	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of July 21, 2020)*

Operating Companies Covered By This Report

Assuranceforeningen SKULD (Gjensidig)

Financial Strength Rating

Local Currency

A/Stable/--

Issuer Credit Rating

Local Currency

A/Stable/--

SKULD Mutual Protection and Indemnity Association Ltd. (Bermuda)

Financial Strength Rating

Local Currency

A/Stable/--

Domicile

Norway

Ratings Detail (As Of July 21, 2020)*(cont.)

*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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