

Research Update:

Skuld 'A' Ratings Affirmed On Capital Resilience To COVID-19 And 2019 Underwriting Losses; Outlook Stable

June 23, 2020

Overview

- Skuld (or the club) recorded its first underwriting loss in 16 years in 2020 and is likely to record further losses in 2021 due to the COVID-19 pandemic.
- Despite this, we believe the club will maintain a significant capital buffer above our 'AA' benchmark.
- We are affirming our 'A' ratings on Skuld's core operating subsidiaries.
- The stable outlook reflects our view that Skuld will maintain capital adequacy above our 'AA' benchmark in our risk-based model over the financial year 2020/2021 (FY2021; ending Feb. 20, 2021) and FY2022, and earnings will return to profitability in FY2022.

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Rating Action

On June 23, 2020, S&P Global Ratings affirmed its 'A' long-term financial strength and issuer credit ratings on the core subsidiaries of Norway-domiciled marine insurer Skuld (see the ratings list below for further details). The outlook is stable.

Rationale

Skuld recorded its first underwriting loss in 16 years in FY2020 with a combined (loss and expense) ratio of 109%. We believe the club is likely to suffer further losses (both underwriting and mark to market investment losses) in FY2021. However, we believe these losses are not part of a trend and that Skuld's underwriting performance will return to breakeven in FY2022. In our opinion, Skuld has sufficient excess of capital above our 'AA' benchmark to absorb these likely losses in FY2021 (as per our base-case expectations) and still maintain the 'A' rating.

Our base-case scenario is that Skuld will record a combined ratio close to 105% in FY2021 and about 100% in FY2022, largely due to claims and potentially premium returns arising from the

secondary effects of the COVID-19 pandemic. We expect the club will also suffer mark to market losses on its investment portfolio if the markets remain depressed over the course of FY2021. We therefore forecast a net loss after tax in FY2021 of about \$30 million but a \$15 million net profit in FY2022. We expect a breakeven result for underwriting in FY2022 and a small investment gain. Throughout this period, we expect Skuld will maintain capital above our 'AA' benchmark, measured by our risk-based capital model.

While Skuld's result in FY2020 showed the club is exposed to volatility--both from its own book of business and from pool claims from other International Group clubs--we have maintained our current view of the club's exposure to volatility. Gard is the only other protection and indemnity (P&I) club we view at this level; we consider all other clubs to be more volatile. We believe that Skuld's long history of robust and steady operating performance support this. We expect that the club, on an underlying basis, will improve its performance in FY2022 with a combined ratio of 100% or below. However, if it continued to record adverse volatility in underwriting or operating performance, we would revise our assessment of the club's exposure to volatility.

Outlook

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.

Ratings Score Snapshot

Financial strength rating	A
Anchor	a
Business risk	Strong
IICRA	Intermediate
Competitive position	Strong
Financial risk	Strong

Financial strength rating	A
Capital and earnings	Strong
Risk exposure	Moderately Low
Funding structure	Neutral
Modifiers	0
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Support	0
Group support	0
Government support	0

IICRA--Insurance Industry And Country Risk Assessment.

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

Related Research

Ratings List

Ratings Affirmed

Assuranceforeningen SKULD (Gjensidig)

Issuer Credit Rating A/Stable/--

Assuranceforeningen SKULD (Gjensidig)

SKULD Mutual Protection and Indemnity Association Ltd. (Bermuda)

Financial Strength Rating A/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support

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