STANDARD & POOR'S

Global Credit Portal®
Insurance Markets

Research Update:

# Sunderland Marine Mutual Insurance Co. Ratings Affirmed At 'BBB+' After Insurance Criteria Change; Outlook Stable

**Primary Credit Analyst:**
Robert J Greensted, London (44) 20-7176-7247; robert.greensted@standardandpoors.com

**Secondary Contact:**
Peter McClean, London (44) 20-7176-7075; peter.mcclean@standardandpoors.com

## Table Of Contents

Research Update:

# Sunderland Marine Mutual Insurance Co. Ratings Affirmed At 'BBB+' After Insurance Criteria Change; Outlook Stable

## Overview

- Following a review of U.K.-based Sunderland Marine Mutual Insurance Co. Ltd. (SMMI) under our revised insurance criteria, we are affirming our 'BBB+' ratings on the company.
- The ratings reflect our view of the company's upper adequate financial risk profile and satisfactory business risk profile.
- The stable outlook reflects our view that the company is likely to maintain moderately strong capital and earnings over the next two-to-three years. It also reflects our expectation that SMMI will experience less volatility in its results than it has historically.

## Rating Action

On July 18, 2013, Standard & Poor's Ratings Services affirmed its 'BBB+' insurer financial strength and counterparty credit ratings on U.K.-based insurer Sunderland Marine Mutual Insurance Co. Ltd. (SMMI). The outlook is stable.

## Rationale

The ratings reflect our view of SMMI's upper adequate financial risk profile and satisfactory business risk profile. The financial risk profile is driven by the company's moderately strong capital and earnings and less than adequate financial flexibility. The business risk profile is based on the company's adequate competitive position. We combine these factors to derive a 'bbb+' anchor for SMMI.

SMMI primarily writes marine hull insurance globally, but most significantly in the U.K., Australia, the U.S., and Canada. In our opinion, this mix of business represents intermediate industry and country risk. SMMI benefits from high barriers to entry created through the legal burden of obtaining the licenses required to write marine business in certain locations. Conversely, in our assessment of industry risk we factor in slightly higher product risk from SMMI's main line of business--marine hull--than for our general assessment of property/casualty insurance.

In our opinion, SMMI has an adequate competitive position. This is based on SMMI's specialist position in the marine hull market as a leading provider of fishing vessel cover. SMMI's reputation in the market, and its close relationships with vessel owners, result in retention levels that are regularly above 90%. SMMI's client base is very geographically diverse; however, we do not currently factor this into the rating owing to the company's recent poor operating performance. SMMI also writes aquaculture insurance and a small amount of marine liability insurance; however, both lines are heavily reinsured and, as such, product diversification is limited. In our base-case scenario, we expect SMMI's competitive position to improve over the next two-to-three years. In addition, as some of SMMI's main competitors leave the market, we believe it will benefit from rate increases, particularly in hull lines. By the end of 2015, we expect SMMI's net earned premium to exceed £45 million. We do not anticipate that SMMI will significantly change its product lines during this period.

We view SMMI's capital and earnings as moderately strong, despite its recent performance being lower than we had expected--SMMI recorded a combined (loss and expense) ratio of 119% in 2011 and 106% in 2012. However, we expect that the company will hold capital in excess of our requirements at the 'A' confidence level by the end of 2015. Our view of capital is constrained, however, by the company's small amount of absolute capital, which leaves it more vulnerable to single-event losses. In our base-case scenario, we expect SMMI's capital adequacy to improve over the next two-to-three years and to reach an 'A' range confidence level, according to our capital model. We expect underwriting performance to improve over the same period as the company benefits from recent increases to rates and deductibles. By 2015, we anticipate that the company will return to underwriting profitability and report net profits of at least £1.5 million.

SMMI's risk position is intermediate, in our view. The company has a significant exposure to a defined-benefit pension scheme with a gross liability of £25.7 million and a modest deficit of £1 million. The liability is significant compared with its total adjusted capital and leaves the company exposed to material volatility in asset values, life expectancy, and discount rates. We note, however, that the company has closed the scheme to new entrants and capped its contributions to the scheme. SMMI has a conservative approach to its investment management, in our opinion. High-risk assets such as equity holdings make up less than 7% of its investment portfolio. SMMI's capital and earnings have been volatile in recent years; however, we expect that the strengthening of its reinsurance program (including a quota share agreement with the North of England Protecting and Indemnity Association) and the de-risking of its investment portfolio will limit volatility in the next two-to-three years.

We view SMMI's financial flexibility as less than adequate. As a small mutual company, we do not believe that SMMI would be able to access more capital, either in the form of equity or debt. In addition, SMMI already relies heavily on reinsurance in its capital structure, with a utilization rate of 58% in 2012. Offsetting these factors, to a certain extent, are SMMI's current debt-free balance sheet and its ability to acquire short-term loans from its banking providers as it has in the past. We do not expect SMMI's financial flexibility to significantly improve over the next two-to-three years.

In our view, SMMI's enterprise risk management (ERM) and management and governance practices are neutral for the rating. We view SMMI's ERM as adequate, based on our opinion that the company has adequate risk controls, with clear underwriting guidelines, and investment controls that limit credit exposure and equity risk. Due to the limited product diversity and lack of complexity, we regard the importance of ERM to the rating as low. Management and governance practices are fair, in our opinion. We consider SMMI's management expertise and experience to be supportive of our expectation that operating performance will improve over the next two-to-three years.

We regard SMMI's liquidity as strong owing to the strength of available liquidity sources, mainly premium income and an asset portfolio that contains more than £64 million in liquid investment assets covering gross loss reserves of £62 million. In the event of major adverse claims development, we believe that SMMI is well positioned to meet any liquidity needs that may arise, largely due to the generally very strong credit quality of its bond portfolio.

## Outlook

The stable outlook reflects our view that SMMI's capital and earnings will remain moderately strong over the next two-to-three years. It also reflects our view that SMMI's underwriting performance will improve in 2013 following the rate increases that SMMI has managed to achieve in 2012/2013.

We could lower the ratings if:

- SMMI's capital adequacy deteriorated to only marginal coverage at a 'BBB' level, which could result from underwriting losses or a reduction in reinsurance protection.
- We viewed capital and earnings as more volatile, which could result from an increase in retained insurance or investment risk or heightened risks relating to the defined-benefit pension scheme deficit.

We currently consider a positive rating action as unlikely in the next two years.

## Rating Score Snapshot

| | |
|---|---|
| Financial Strength Rating | BBB+/Stable |
| Anchor | bbb+ |
| Business Risk Profile | Satisfactory |
| IICRA | Intermediate Risk |
| Competitive Position | Adequate |

| | |
|---|---|
| Financial Risk Profile | Upper Adequate |
| Capital & Earnings | Moderately Strong |
| Risk Position | Intermediate Risk |
| Financial Flexibility | Less Than Adequate |
| | |
| Modifiers | 0 |
| ERM and Management | 0 |
| Enterprise Risk Management | Adequate |
| Management & Governance | Fair |
| Holistic Analysis | 0 |
| | |
| Liquidity | Strong |
| | |
| Support | 0 |
| Group Support | 0 |
| Government Support | 0 |

IICRA—Insurance Industry And Country Risk Assessment.

## Related Criteria And Research

### Related criteria

- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

### Related research

- List Of Issuers With Ratings Under Criteria Observation Due To S&P's New Insurers Rating Methodology, May 7, 2013
- Standard & Poor's Assigns Insurance Industry And Country Risk Assessments, May 7, 2013

## Ratings List

Ratings Affirmed

| | |
|---|---|
| Sunderland Marine Mutual Insurance Co. Ltd. | |
| Counterparty Credit Rating | |
| Local Currency | BBB+/Stable/-- |
| Financial Strength Rating | |
| Local Currency | BBB+/Stable/-- |

**Additional Contact:**
Insurance Ratings Europe; InsuranceInteractive_Europe@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.