

The North of England Protecting & Indemnity Association Ltd.

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Related Criteria

The North of England Protecting & Indemnity Association Ltd.

Anchor	a	+	Modifiers	0	=	SACP	a	
▲			▲			+		
Business Risk	Strong					Support	0	<div>A/Stable/--</div> <div>Financial strength rating</div>
Competitive position	Strong		Governance	Neutral				
IICRA	Intermediate					Group support	0	
Financial Risk	Strong		Liquidity	Adequate				
Capital and earnings	Very strong					Government support	0	
Risk exposure	Moderately high		Comparable ratings analysis	0				
Funding structure	Neutral							

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths

We expect The North of England Protecting & Indemnity Association Ltd.'s (NEPIA's) risk-based capital adequacy to remain consistent with our 'AAA' requirements.

Leading position in the International Group of Protection & Indemnity (P&I) Club (IG) members by premium and gross tonnage.

Key risks

In line with peers in the sector, NEPIA's sole marine focus leads to an undiversified product offering.

Recent underwriting deficits.

We expect NEPIA's capital adequacy to remain above our 'AAA' requirements. In our opinion, this is a key rating strength, which will help the club absorb the technical losses anticipated over the two-year outlook horizon. The deterioration in technical performance is due to two large claims, as well as challenging conditions within the P&I market.

NEPIA is one of the largest P&I clubs by premiums and gross tonnage. The club is one of the largest members of the IG by gross tonnage, capturing 12% of the P&I market share in 2019. NEPIA successfully translated this position into a competitive advantage relative to peers. For the year ending Feb. 20, 2020, NEPIA reported gross written premium (GWP) of \$357 million, about 5% higher than the prior year.

Outlook: Stable

The stable outlook reflects our expectation that NEPIA will retain its focus on controlled growth in a difficult market environment, maintain its competitive position, and achieve profitable operating performance in the long term. It also indicates our expectation that NEPIA's capital adequacy will remain above our 'AAA' benchmark over the two-year outlook horizon.

Downside scenario

We are unlikely to lower the ratings on NEPIA over the next two years, thanks to the excess levels of capital it holds above our 'AAA' confidence level. We anticipate that this will allow NEPIA to absorb expected technical losses over the next two years, caused by continued pricing pressures in the P&I sector. However, we could lower the ratings if capital adequacy falls below the 'AAA' level for a prolonged period.

Upside scenario

An upgrade is also unlikely, principally because of the club's limited scope for further material diversification within the P&I sector.

Key Assumptions

- With the ongoing COVID-19 pandemic, we now see global GDP falling 2.4% this year, with the eurozone and U.K. shrinking by 7.3% and 6.5%, respectively, this year before rebounding by 5.6% and 6% in 2021.
- Central bank policy will likely keep interest rates low, limiting returns on fixed-income securities.

Business Risk Profile: Strong

Table 1

Key Metrics	--Year ending Feb. 20--						
	(Mil. \$, unless stated otherwise)	2022f	2021f	2020	2019	2018	2017
Gross premiums written		~408	~374	~357	340	368	420
Net combined ratio (%)		~105	~110	124.2	104.5	104.1	96.6
Net income		11	(2)	(1)	22	13	37
Members' funds		441	430	444	463	451	431
Return on members' funds (%)		2.5	(0.5)	(0.3)	4.8	2.9	8.6

f--S&P Global Ratings' forecast.

Headquartered in Newcastle, the combined North of England P&I Club, North of England Mutual Insurance Association (Bermuda) Ltd. (NEMIA), North of England Protecting & Indemnity DAC (North P&I DAC), and

Sunderland Marine Insurance Co. Ltd. (SMI) (collectively, NEPIA) is a U.K.-based mutual insurance association. It mainly provides P&I cover for its members and is one of the largest clubs within the IG by owned tonnage. The club has offices in Hong Kong, Greece, Singapore, Shanghai, Japan, Australia, and New Zealand. North P&I DAC is an Ireland-based subsidiary from which the club writes its EU business.

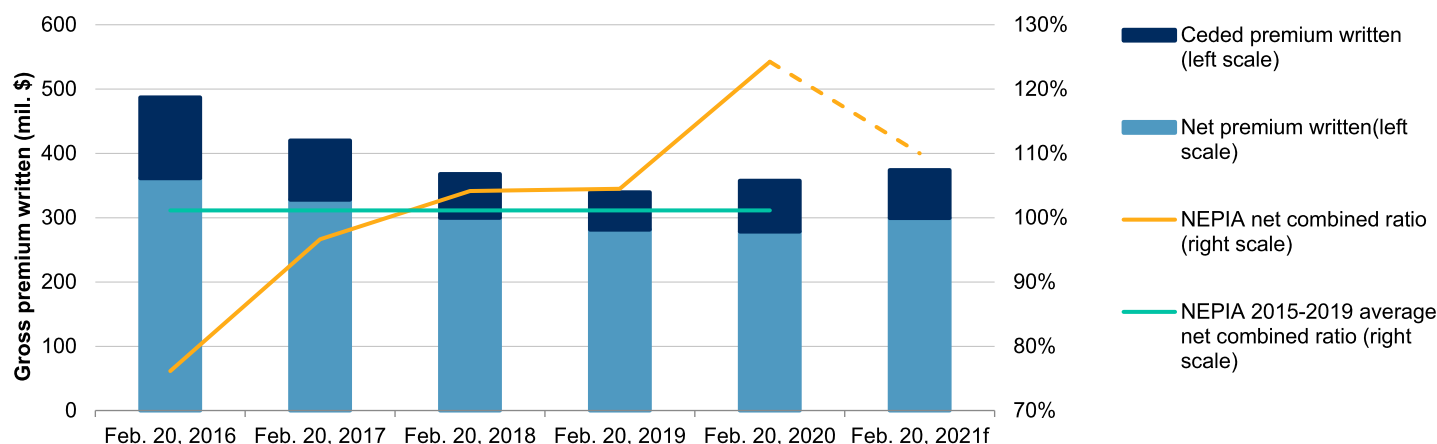
For the year ending Feb. 20, 2020, we estimate a net combined ratio for the sector of around 110%. While most of the P&I clubs continue to enjoy 'AAA' risk-based capital adequacy under our model, the sector's poor performance highlights the inadequate rates across the market. In the February 2020 renewals, NEPIA booked on average a mid-single-digit general increase on its members. This follows many years of declining rates and is a step that many of NEPIA's peers have followed. While this should help improve the club's prospective operating performance on the mutual P&I business, it is our view that additional general increases will be needed in future renewals.

In the latest financial year, NEPIA's net combined ratio was around 124%, which is worse than initially budgeted. This is due to the soft rate environment, NEPIA's exposure to two large claims in 2019, as well as adverse developments on prior-year reserve movements. More positively, NEPIA has limited exposure to cruises, which have recently seen a number of COVID-19 cases. Nevertheless, NEPIA's operating performance may be affected through pool claims.

NEPIA continues to implement strategic decisions that will ultimately help move the net combined ratio closer to 100%. These include strategic considerations for SMI and potential additional general increases for the mutual business at future renewals. Additionally, NEPIA aims to increase the fixed-premium business so it contributes to about one-third of total gross premium written by 2023-2024, from 25% currently. We are therefore unlikely to revise downward our assessment of the club's competitive position.

Chart 1

NEPIA's Operating Performance Has Been Deteriorating, But The Company's Actions Should Help The Net Combined Ratio Converge Closer To 100%



Source: S&P Global Ratings. f--S&P Global Ratings' forecast.

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Financial Risk Profile: Strong

NEPIA enjoys robust risk-based capitalization at the 'AAA' benchmark, measured using our internal model. We expect this will remain the case over the next two years, despite the expected deterioration in operating performance.

Moreover, the club's regulatory solvency ratio at Feb. 20, 2020 stood at 218%. At the same date, NEPIA reported a total accumulated surplus of \$444 million (Feb. 20, 2019: \$463 million).

In 2019, the club reported net investment income of \$65 million, materially offsetting the technical losses. We understand that NEPIA's exposure to the volatility in the capital markets associated with the COVID-19 pandemic was limited. As a result, NEPIA's free reserves have not moved materially since the end of the latest financial year. Moreover, we believe that the decrease in world trade and shipping usage as a result of the pandemic could lead to lower claims this year. However, this may subsequently weigh on premium, and consequently, on earnings.

NEPIA has a material defined benefit pension deficit, one of the largest among its P&I peers. The movement in the defined benefit scheme has historically been volatile. In financial year 2019, the club's net deficit resulted in a \$16 million adverse impact on free reserves. However, in January 2018, NEPIA closed the scheme to future accruals, and it is in a position to take additional steps to reduce the volatility experienced in the deficit.

NEPIA's investment portfolio largely consists of fixed-income securities. At year-end 2019, the club held around 78% in bonds, 12% in equities, and 10% in cash or cash equivalents. Historically operating a more-conservative investment portfolio than its peers, the club diversified its surplus asset allocation toward higher-yielding investments, including private debt and emerging market equities. Nevertheless, the overall exposure to these investments will not exceed 15% of total investments. We therefore do not believe that this will be a source of capital and earnings volatility. In our view, NEPIA also has sufficient risk controls in place to ensure that limits beyond the risk appetite are not breached.

NEPIA does not have any debt on its balance sheet, nor do we expect it to raise any. Its legally enforceable right to make unbudgeted supplementary calls on IG pool members enhances its ability to access additional sources of liquidity.

Other Key Credit Considerations

Governance

NEPIA benefits from an experienced management team with a long history in the sector. The club's strategic focus continues to be on maintaining the underlying underwriting discipline. We therefore view positively its decision to apply a general increase in the latest renewals. We have not identified any governance deficiencies in our analysis.

Liquidity

In our opinion, NEPIA's liquid assets are sufficient to cover its net technical reserves. The multiyear nature of its reserves mean that the club is unlikely to have high liquidity needs in the short term.

The North of England Protecting & Indemnity Association Ltd. Metrics History

	--Year-ending Feb. 20--	
(Mil. \$, unless stated otherwise)	2020	2019
S&P Global Ratings capital adequacy	Excellent	Excellent
Total invested assets	1,092	1,080
Total shareholder equity	444	463
Gross premium written	357	340
Net premium written	278	282
Net premium earned	281	283
Reinsurance utilisation (%)	22.1	17.1
EBIT	(0.6)	22.4
Net income (attributable to all shareholders)	(1.2)	21.9
Return on revenue (%)	(15.7)	3.2
Return on assets (excluding investment gains/losses) (%)	(3.9)	0.8
Return on shareholders' equity (%)	(0.3)	4.8
Property/casualty: Net combined ratio (%)	124.2	104.5
Property/casualty: Net expense ratio (%)	26.6	24.3
Property/casualty: Return on revenue (%)	(16.6)	0.8
EBITDA fixed-charge coverage (x)	N.M.	N.M.
EBIT fixed-charge coverage (x)	N.M.	N.M.
EBIT fixed-charge coverage including realised and unrealised gains/losses (x)	N.M.	N.M.
Financial obligations/adjusted EBITDA (x)	(1.4)	5.2
Financial leverage including pension deficit as debt (%)	12.6	9.9
Net investment yield (%)	1.7	1.4
Net investment yield including investment gains/(losses) (%)	6.0	2.5

N.M.--Not meaningful.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- 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

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-/bb+	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 August 6, 2020)*

Operating Company Covered By This Report

The North of England Protecting & Indemnity Association Ltd.

Financial Strength Rating

Local Currency

A/Stable/--

Issuer Credit Rating

Local Currency

A/Stable/--

Related Entities

North of England Mutual Insurance Association (Bermuda) Ltd.

Financial Strength Rating

Local Currency

A/Stable/--

Issuer Credit Rating

Local Currency

A/Stable/--

North of England P&I Designated Activity Company

Financial Strength Rating

Local Currency

A/Stable/--

Sunderland Marine Insurance Co. Ltd.

Financial Strength Rating

Local Currency

A/Stable/--

Domicile

United Kingdom

*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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