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Mutuals losing their mutuality

JERRY WESTMORE: 'Creeping unmutuality' Photo: Jim Mulrenan

A leading broker says owners could suffer as a result of pressure on clubs.

Jim Mulrenan London

An erosion of mutuality may be changing the protection-and-indemnity (P&I) market to the disadvantage of shipowners, according to top broker Jerry Westmore of Marsh.

He labelled the trend as "creeping unmutuality" at the annual Marsh P&I seminar held in New York this week.

Westmore notes that cash calls are being demonised by rating agencies and regulators, who largely judge the P&I mutuals by their free reserves.

One effect of this is that clubs are becoming more conservative in their investment policies, with the use of equities and hedge funds declining, as there is a retreat to the worse-performing but more stable bond market.

Westmore says the focus on capital preservation rather than investment gain has perhaps gone too far as the average return from club portfolios was 6.5% last year, as compared with the more than 10% that could have been achieved by even a simple tracker fund following the London or New York bourses.

The former Steamship Mutual underwriter, who now heads the P&I operation of the biggest broking group, also questions whether the mutuality of the clubs is being further undermined by their business strategies.

Many clubs are currently keen to attract both LPG and LNG newbuildings and are quoting rates so low there is minimal premium retention. This may be good for gas-carrier owners but the other side of the deal is that other shipowners are being discriminated against to support these low rates.

The clubs' continued use of general increases, which last year averaged 7.5% and ran as high as 12.5%, also came under fire.

The unmutual reality is that better-performing shipowners are able to negotiate away a good part of the general increase and Westmore makes the marketing pitch that Marsh has got the average increase made by its clients down to just 1.5%.

Westmore says he could accept that a general increase of perhaps 2.5% is needed to cover inflation but large double-digit increases are really down to lack of investment income, rising operating costs and poor underwriting.

Despite the West of England Club announcing cash calls of as much as $122m, Westmore suggests most clubs are currently not far off their target of at least a break-even technical-underwriting result.

He views predictions by some soothsayers of double-digit increases at the February 2007 renewal as excessively pessimistic and says they will only be seen in a minority of cases.

Westmore suggests that club mergers — such as that of Skuld and the Swedish Club currently under negotiation — could be driven by pressure from some of the larger clubs to raise the amount of risk retained by individual mutuals.

"Is there a need for higher retentions to concentrate the mind of underwriters and drive out substandard vessels, or is it a case of the bigger players flexing corporate muscle to drive out weaker clubs?" Westmore asked.

At the catastrophe end of the liability spectrum, there is also debate over reducing the maximum overspill cover available from the clubs as growth of the world fleet has driven the maximum cover available from the P&I mutuals to around $5bn.

The upper limit of cover is based on 2.5% of the limitation value of the world fleet under the 1976 Limitation Convention but this could be cut to 1.5% if some clubs get their way.

Westmore also notes that, against the background of the increased liabilities of the Athens protocol, there is heated debate on whether cover for passenger claims should be limited to a maximum of $2bn.

But if passenger claims should be limited because of the huge liabilities they pose, what about mega-containerships or gas carriers that could also be the cause of a hugely expensive catastrophe?

Westmore also points out that lowly general cargoships continue to be lost in large numbers, cost the lives of more seafarers than all other vessel types combined and account for many port-state-control detentions.

The Marsh seminar was attended by 115 shipowners and managers who are clients or prospective clients of the broker.