

INTERNATIONAL GROUP OF P&I CLUBS
REVIEW BY THE EUROPEAN COMMISSION -- SUMMARY OF ISSUES

1. INTRODUCTION

- 1.1 On 26 August 2010, the European Commission announced that, following the expiry in February 2009 of the second 10 year exemption for the International Group Agreement ("IGA"), it had decided to carry out a review of three aspects of the Group's claims-sharing and reinsurance arrangements, namely:
- provisions in the IGA relating to the "quotation procedures" that apply on movement of vessels on 20th February;
 - aspects of provisions in the IGA about "release calls";
 - access by commercial insurers to reinsurance by Group Clubs.
- 1.2 The Commission has confirmed that this review is being carried out at its own initiative, not as a result of a complaint.
- 1.3 The precise nature of the Commission's concerns is not clear. The Group has provided preliminary views on each of the issues to the Commission and discussions are ongoing. The issues are summarised below.

2. THE ISSUE RELATING TO THE QUOTATION PROCEDURES

- 2.1 The Commission appears to be concerned that, by preventing a new Club from quoting a lower rate than the holding Club at renewal, the IGA may prevent Clubs from attracting new business. This aspect of the quotation procedures was the main focus of the Commission's decisions of 1985 and 1999 and of the exemption granted in those decisions. It appears that the new case team is not convinced by the Commission's previous analysis, suggesting that the provision of relevant data, with a mere exhortation to rate fairly, would be sufficient to prevent discriminatory rating by a new Club.
- 2.2 In response, the Group has pointed out that the IGA quotation procedures are necessary to ensure fairness of rating between members within Clubs and are indispensable to the operation of mutuality within the Clubs' system. They restrain the quotation of (discriminatory) rates that favour one or more members at the expense of others, in order to attract business or to retain business. They do this by requiring a new Club to respect the experience of a shipowner's existing Club in assessing a fair rate and by requiring the new Club to charge not less than that rate for the year in which a ship or shipowner moves from one Club to another. The procedures valuably reinforce the obligations of Club managers to respect the principle of mutuality in the face of pressures from members seeking a lower rate than is justified.
- 2.3 In the absence of the IGA, if a shipowner was offered a lower rate by a new Club, the shipowner's existing Club would have an incentive to retain the shipowner in the Club so as to maintain its spread of risk. To achieve this, the existing Club would be forced to reduce its rate to the shipowner and to match or undercut the new Club's rate. The existing Club might thus be able to retain the spread of risk within the Club; but in doing so it would have destroyed the fairness of rating between members within its Club. Alternatively, the existing Club might decline to reduce its rate and risk the loss of the shipowner and the spread of risk across the shipowner's tonnage. In either case, the actions of the new Club would have produced an immediate adverse effect on the financial position (and mutuality) of the existing Club and all its members.
- 2.4 This process might ultimately cause the mutuality of the Clubs' arrangements to break down. Club underwriters would be forced into progressive "rate-shaving" to retain tonnage so that it would become difficult or impossible for Club underwriters to follow any general practice of assessing rates on a proper, mutual underwriting basis. The IGA quotation procedures provide the light restraint necessary to prevent this happening and thereby provide the necessary confidence in the fairness of the system that shipowners and Clubs require if they are to continue to participate in the Pool.

- 2.5 It is not possible for the Group to state with absolute certainty that termination of the IGA would lead to the break up of the Pool, though it believes this would happen. The Group can state with certainty, however, that termination of the IGA would create a very serious risk that the Pool would collapse. Moreover, the Commission itself recognised the seriousness of this risk in its 1985 Decision, concluding that there was a "strong likelihood" this would happen.
- 2.6 The IGA is based upon the interest of shipowners in safeguarding the equitable operation of their system of mutual self-insurance, as well as a recognition by shipowners that a breakdown of the existing Club system and of the Pool would be so seriously detrimental to shipowners around the world and to third-party interests who benefit from the compensation provided by the system that steps must be taken to avoid any serious risk of its occurring. If the system were lost, shipowners would be forced to make alternative arrangements, but would not be able to reproduce the benefits of the current system.
- 2.7 Finally, the Group has pointed out that where there has been no material change in relevant circumstances, it is not open to the Commission to reach a conclusion about the IGA which differs from the conclusion it reached in 1999.
- 2.8 When the Commission conducted its last review of the Group's arrangements in the late 1990s, shipowners and shipowner associations supported the quotation procedures as necessary to the continuance of the Group's mutual, not-for-profit claims-sharing arrangement.

3. THE ISSUE RELATING TO RELEASE CALLS

- 3.1 The Commission is understood to have concerns about two aspects of release calls.
- 3.2 First, that the calculation of release calls by a number of Clubs does not in its view accurately reflect the run off of future claims. In response, the Group has explained that the level of release calls is not simply a matter of mathematical calculation and varies from Club to Club depending on a range of factors; shipowners are informed of a Club's call structure and level of release call as part of the discussions leading to renewal; and the different approaches taken to calculating release calls are an aspect of competition between Clubs and a matter for each Club to determine individually. Moreover, if a shipowner has concerns about the level of a release call, he can refer this to an expert committee. In any event, shipowners can choose to provide a guarantee to meet outstanding liabilities once these have been finally assessed following closure of the relevant policy year/s rather than paying the release call.
- 3.3 Secondly, that the obligation of a Group Club under the IGA to accept a bank guarantee when a shipowner moves from one Group Club to another does not apply equally when a shipowner moves to an insurer outside the Group. The Group has explained that in practice all Group Clubs currently accept a bank guarantee in lieu of payment of a release call in both circumstances.

4. THE ISSUE RELATING TO THE PROVISION OF REINSURANCE

- 4.1 The Commission appears to be concerned that the Group's reinsurance contract may limit the availability of reinsurance for non-Group insurers; and that such insurers should in some way be given access to the Group's reinsurance contract. The concern appears to stem from an observation that commercial insurers offer lower cover limits not exceeding \$1 billion (and the mistaken conclusion that there are capacity constraints caused by the Group's reinsurance contract) rather than a conscious decision by non-Group insurers to target a different type and level of cover to that provided by Group Clubs.
- 4.2 The Group has explained that Group Clubs have been prepared in limited circumstances to provide reinsurance to commercial insurers, so as to enable shipowners who are prevented by national laws from insuring directly with a Group Club to access (indirectly) the scope and level of cover provided by Group Clubs. The mutual, self-insurance operated by Group Clubs does not extend to providing reinsurance to commercial insurers more widely.