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TO MERGE OR NOT TO MERGE

THE ESSENTIAL DYNAMICS OF THE INTERNATIONAL GROUP OF P&I CLUBS

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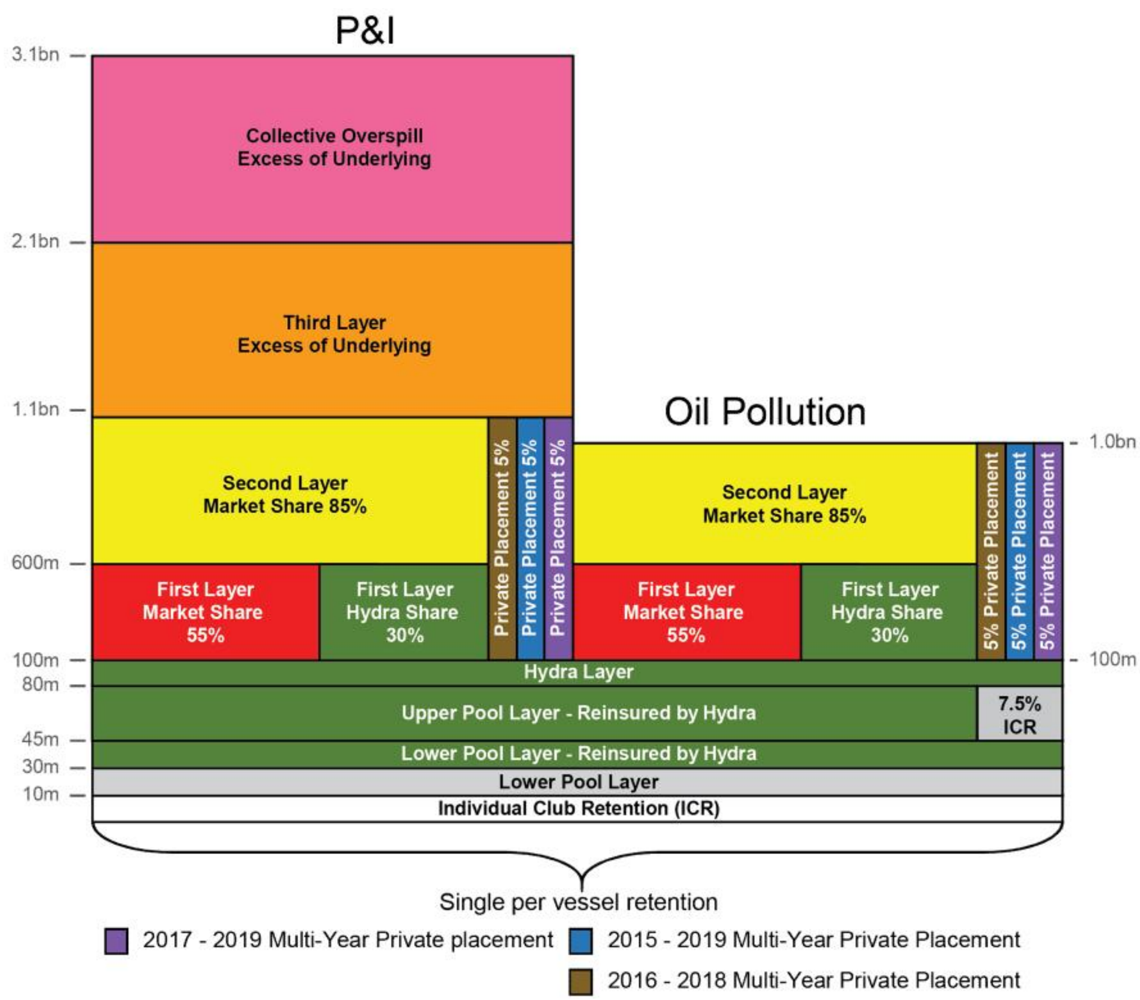
Background

- Potential mergers a recurring discussion for several decades
- Comparatively rare in practice:
  - 1989 Sunderland Club
  - 1999 Newcastle Club
  - 2000 Liverpool and London Club
- Have taken different forms, typically insurer stress-related
- Non-stress-related mergers have recently proved unachievable
- Swedish/Skuld, Britannia/Standard, Britannia/UK
- Empirical evidence suggests mergers are difficult to consummate
- This reflects the dynamics of both IG and shipping industry

International Group - current structure

- Thirteen IG mutuals collectively cover >90% of world shipping
- Broadly standardized modus operandi and insurance product(s)
- Close cooperation as to reinsurance
  - Pool ($10m to $100m) and "overspill"
  - Market reinsurance: $100m+ to varying limits up to $3,000m
  - Hydra (Group segregated cell captive in Bermuda)
- Supported by several multilateral contracts
  - International Group Constitution
  - Pooling Agreement
  - International Group Agreement
- Secretariat coordinates broad consultative activity
- Regular meetings of senior Group club managers
- Facilitates global trade/regulation/protection of environment
- Compelling voice on behalf of global maritime community

International Group – reinsurance program



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Drivers of current structure (1)

Shipowner preference

- Group clubs are creatures of the shipping industry itself
- Mutuality means members are both insurers and insureds
- Policy direction of clubs is ultimately in the hands of shipowners
- Variation in club size and focus reflects diversity of maritime sector
- Also reflects differing regional/tonnage orientation, culture and service styles
- "Invisible hand" of choice fortifies current pluralism and competition
- Member loyalty also important factor in maintaining current structure
- Club diversity allows the many voices of shipping to be heard
- P&I is blend of pure insurance and relationship-based, added-value service
- Shipping industry approbation of a tried and tested system

Drivers of current structure (2)

Operational efficiencies

- Bulk purchasing power of Group maximizes cost benefit to shipowners
- Pooling/market R/I program create equal benefit for all club members
- This applies regardless of individual club size
- Enables highly competitive "at cost" insurance pricing for all shipowners
- Collectivisation of financial exposure above $10m de facto "merger"
- Collectivisation of industry knowledge/expertise a unique resource
- Collectivisation of industry networks/outreach a unique resource
- No single club could realistically match Group's combined capabilities
- Group ...*"the most important institution in the marine insurance world"*...
- Consumer collective, NOT cartel

Drivers of current structure (3)

Differentiation and brand choice

- Overarching benefits of collectivisation foster diversity and choice
- Shipowner preference and operational efficiencies fortify pluralism
- The Bergdorf Goodman analogy!
- Current structure allows for competitive differentiation and brand choice
- Financial integrity of individual clubs supported by entire system
- Given strength and virtues of current arrangements, why merge?
- Marginal economies of scale/problematic rebalancing of members' equity
- Major transactional/regulatory costs attendant upon mergers
- Humpty Dumpty: a cautionary tale!

Consequences of consolidation

The creation of a dystopian P&I oligopoly . . . . .

- Fewer clubs would limit shipowner freedom of choice and competition
- Diversity of sector experience, culture and service styles would be lost
- Operational efficiencies of current structure would be compromised
- Regulatory challenges to pooling/market reinsurance underpinned by IGA
- Governance of "megaclubs" would be dominated by largest operators
- Democracy intrinsic to current arrangements would be prejudiced
- The interests of the many subordinated to the agenda of the few
- The existing rich diversity of industry voices would be impaired
- Mutuality could be threatened by the incursions of "big insurance"
- Currently competitive "at cost" pricing could be superseded by a drive for profit
- The unique shipping industry service orientation of P&I would be lost
- The "invisible hand" of choice would wither away

In conclusion

- Current pluralism/diversity of IG reflects shipowner preference
- Ingenious balance of consumer choice and economies of scale
- Withstood regulatory investigation by EU and others over time
- The Yarrow Report to EU's DG Comp in 2013
- IG a unique example of "collaborative competition"
- A virtuous paradox at the heart of a tried and tested system
- Benefits of current arrangements explain why mergers lack appeal
- The Orwellian world of "megaclubs" not in shipping's interests
- If it ain't broke, don't fix it!


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