A closer look at mutual club funding

There was a time when all P&I Clubs used the same method of funding; the estimated total call (ETC) approach.

To understand this method it is necessary to consider the nature of liability insurance. Unlike hull insurance, in which it is reasonably clear whether the property insured has been damaged during the policy year, a liability loss may have occurred yet be unknown to the shipowner or their insurers. This is because the law generally allows a claimant three years or so to lodge a personal injury claim against the person responsible, during which time the defendant may not know that they are likely to face a law suit.

As noted in The mutual balance, premium and claims for a mutual P&I policy year must balance but this is clearly not possible if the size of the claims for the year are unknown at the start of the policy year when a premium needs to be set. For this reason, mutual P&I works on the basis of premium and claims *estimates* which are reviewed periodically until no further claims may be made against a Policy Year and it is formally closed.

The evolution of estimated total calls

The total premium required for the policy year is estimated and referred to as the 'estimated total call'. It is payable in stages. The first stage, the Advance Call, is paid within the policy year itself then additional (or supplementary) calls are made in later years. A figure will be given for the expected supplementary call, (often referred to as the 'budgeted supp' or deferred call) at the time the advance call is made and is, by tradition, expressed as a percentage of the advance call.

The additional or deferred call is due for payment around 16 months after inception of the Policy Year. The ultimate size of, or need for, any supplementary calls will be determined by the accuracy of the original estimated total call forecast. Indeed the additional supplementary call may be reduced or even waived, if the year appears to be developing better than expected.

The accuracy of the forecast is crucial to the ability of owners to budget for premium demands. Some Clubs have a better record of accurate forecasting than others. A typical advance call would be 80% of the estimated total call, with the remaining 20% to follow in year two. Whilst this approach has merit in deferring the cash flow burden of premium payments across more than one year, it also has a measure of uncertainty built into it and for this reason only a minority of clubs maintain this traditional approach nowadays. The majority prefer to 'call for' the premium they believe will be needed at one time, during the policy year itself.

The 100% ETC

This is a variation on the traditional Estimated Total Call method in which the entire estimated premium is paid during the first policy year and is intended to be the only payment. There are no budgeted supplementary calls. If further funds are required, these will come from an (unwelcome) unbudgeted supplementary call or will be drawn down from club reserves.

Moving beyond ETC - mutual calls

Mutual calls and fixed

The Shipowners' Club believes Members deserve to know what they will be required to pay when joining the Club and whenever they renew with us. As a result we have moved away from the traditional calling methods explained above. We offer Members two premium choices, both designed to alleviate the uncertainty intrinsic in the ETC approach: **mutual** calls and **fixed** calls.

The mutual call & mutual policy

Policies backed by the International Group claims sharing arrangement (the pool) and its reinsurance programme are known as mutual or pooled policies. In the event of a catastrophic loss, vessel owners insured on this basis are entitled to draw upon the resources of all Group P&I Clubs and their ship owning members. These resources are considerable, with over 50,000 vessels insured and a total tonnage 1.047 billion GT. We recommend the mutual policy for tankers, offshore vessels and larger passenger ships.

The mutual policy is subject to a mutual call which is a variation of the ETC method but offers greater certainty to Members as generally only one premium is paid. When the Policy Year is closed it is implied that any deficit will be met from Club reserves rather than by supplementary calls, which nonetheless in extreme circumstances could still be levied, and as such can be differentiated from a 100% ETC call. Hence why we apply a zero estimated supplementary call estimate. Other than for a few special cases, it is not possible to access International Group Pooled Policy limits on a Fixed Premium basis.

Our next blog will explain the role of the International Group in more detail.