West of England

Report and Accounts 2010

The West of England is a leading International Group Club with a diverse Membership and secure financial position.

We provide high quality insurance products and a broad range of tailored services.

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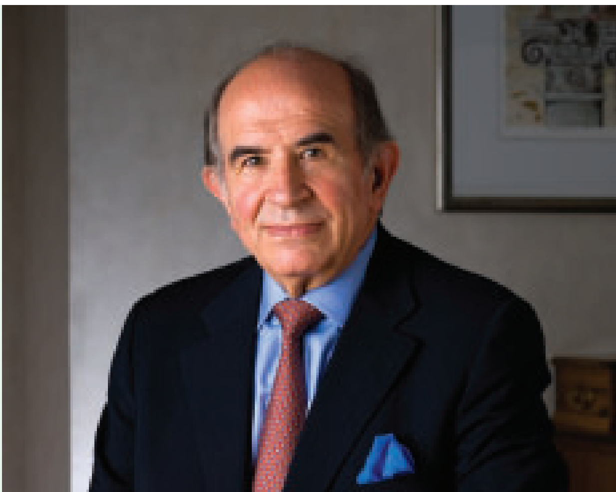
Chairman's statement

I am pleased to report that 2009 has in many respects been a more satisfactory year than 2008. Over the past twelve months the Club has made steady progress in recovering from the effects of the banking and credit crisis which so adversely affected our business that year. Most importantly a recovery in investment markets in most asset classes enabled us to recoup a significant proportion of the unrealised investment losses that we experienced in the final months of 2008. An overall investment gain on liquid assets of more than $55 million during 2009 has contributed to a 5% increase in the Club's free reserve to a total of nearly $170 million at year end.

The Club's current free reserve does, however, include the full value of the additional call for the 2008 policy year which was set by the Board in December 2008. At its meeting in May this year the Board confirmed that the second instalment of the call would be payable by August 2010 as scheduled, because despite the generally more favourable position that the Club experienced during 2009, significant uncertainties remain.

On the positive side, the claims experience for our Members for 2009 has been encouraging. Despite an unwelcome surge in the number of larger claims in the last two months of the year, volumes overall are significantly lower than prior years and the cost appears so far to be developing to a lower level than for any of the years from 2004. It remains the case that 2006 and 2007 were the most expensive claims years in the Club's history no doubt reflecting the very positive trading conditions enjoyed by shipowners during those years. However, as freight rates and volumes declined in 2008 and 2009, claims for our Members appear to have moderated both in number and in value. This development does not however appear to have been evident from claims involving the International Group Pool. Although Pool claims declined significantly in 2008, there appears to have been a resurgence to nearer 2006 and 2007 levels in 2009. At year end recoverable Pool claims for 2009 totalled about $230 million compared with just $87 million at year end for 2008 and $310 million and $303 million for 2006 and 2007 respectively.

It remains to be seen if such a pattern for Members' claims will continue for 2010, not least because the incidence of large claims is largely random. Trading prospects and freight rates generally have been recovering steadily for some markets for the first few months of this year with fewer vessels idle than for some time. It is not possible to predict whether or not these more favourable conditions will lead to a renewed increase in the cost of claims, but, as I noted a year ago, the cost of certain categories of claim is in any case unlikely to reduce regardless of any market movements. The cost of personal injury and environmental damage will continue to rise along with liabilities that are set by reference to International Conventions or national laws. The environmentally catastrophic losses that may result from the destruction of the 'Deepwater Horizon' drill rig in the Gulf of Mexico this April will no doubt have long-term and direct consequences for all shipowners. Discussions already under way indicate that pollution claims resulting from vessels trading to or in the United States in particular are likely to be treated more harshly than ever before, and amendments to OPA 90 and other legislation that will affect shipowners seem inevitable irrespective of the fact that this catastrophic pollution incident has arisen not from a seagoing vessel but from a deep sea oil rig. Furthermore, reinsurance rates for pollution risks worldwide are likely to be affected, and the present limit of cover to $1 billion for oil pollution risks may now be thought to be too low, especially for vessels trading with large



Matheos Los
Chairman

volumes of oil as cargo or bunkers to some jurisdictions around the world.

The claims extremes of recent years and the investment volatility of the last two years have required us to review whether or not our current investment strategy remains appropriate. During 2009 your Board examined in great detail whether or not our long standing allocation to fixed income, equity, absolute return and property (primarily Tower Bridge Court in London) continues to offer the most robust and effective investment balance to preserve capital. The Board's deliberations have been assisted by the Board of ISRe, the Club's reinsurance subsidiary responsible for investment management, which now includes two non- executive investment professionals. The conclusion reached by ISRe and the Board this February is that broadly, the balance remains appropriate but with some reduction in the neutral position for absolute return funds from 20% to 15% and an increase in the neutral position for fixed income from 45% to 50%. The annualised return objective has been reduced to 4.5% to reflect a generally lower investment expectation, with the currency exposure remaining in line with the currency profile of the Club's claims at 60% - 90% invested in the US dollar.

Time will tell if our investment strategy proves to be as robust as we anticipate. In the first few weeks of 2010 the investment environment was again subject to further significant shocks, this time resulting from concerns over sovereign debt levels in a number of European Union countries. Whether or not these concerns will be severe enough to destabilise all investment markets in the coming months is not known, but our expectation is that our diversified investment approach will enable us to limit the downside risk.

As I remarked a year ago, volatile claims and investment performance create considerable uncertainty in our business. Some of this uncertainty can be moderated by effective reinsurance arrangements. The importance of the Group's claims sharing arrangements through the Pool and the Group's excess of loss reinsurance programme is without parallel. Taken together they provide the most cost-effective way of delivering for our Members the highest level and scope of cover that is commercially available at a cost that is still sustainable. For 2010, by a narrow majority, Group Clubs agreed to increase the individual Club retention from $7 million to $8 million. We did not support this increase. The efficiency of the Pool is assured if Clubs absorb working layer losses within their retention, but we are concerned that at $8 million per claim a Club is carrying individual claims which are too infrequent to be termed 'working layer' losses even if there is evidence that larger claims are becoming more frequent. This has resulted in an increase in the buying of separate retention reinsurance by most Clubs to control claims volatility on terms that are less financially efficient than the 'at cost' basis on which claims are pooled.

However, despite rising cost, reinsurance for our retained risks remains important. For many years we have developed relationships with our retention reinsurers which have proved to be of great value for both Class 1 and Class 2 risks. We intend to maintain those relationships in the years to come.

In 2005, the Group's captive, Hydra, was established to undertake risks on behalf of the Group by reinsuring the upper layer of the pool and the 25% coinsurance retained from the first layer of the Group's reinsurance programme for individual claims of more than $50 million. The timing was inauspicious. The early years of its operation coincided

Financial highlights
($ million)

at 20 February	2006	2007	2008	2009	**2010**
Net assets*	551.9	658.8	585.4	599.2	**625.4**
Outstanding claims	(419.4)	(454.1)	(411.8)	(438.4)	**(456.3)**
Free reserves	132.5	204.7	173.6	160.8	**169.1**

* including forecast additional calls

Chairman's statement

Continued

with the extraordinary escalation in claims which occurred in 2006 and 2007 and required additional contributions from all Group Clubs amounting to more than $200 million. 2008 was a much better year, but 2009, in line with the general Pool experience for the year to date, as I have already mentioned, has again been adverse with a loss ratio already in excess of 125%. Whether or not further additional funding will be required is not clear. Hydra's long-term objective is to create a stable capital reserve to give it the ability on behalf of Group Clubs to underwrite progressively more risk at realistic rates especially at times when market reinsurers, for whatever reason, may be more risk averse. We believe this objective remains sound despite the experience so far.

At the end of 2008, the 2001 Bunkers Convention entered into force. It has widespread application to all commercial vessels except dirty tankers, and it makes mandatory the provision of certificates of financial responsibility ('blue cards') by insurers and provides for rights of direct action. After more than a year in operation there have been few issues of concern with the Convention itself, although, as a result of the 'Pacific Adventurer' incident in Australia in March 2009 the IMO Legal Committee is being asked to look at increasing the limits of liability under the 1976 Limitation Convention which sets the cap on shipowners' liabilities under the Bunkers Convention in many jurisdictions. The number of vessels that needed convention certificates to enable them to trade to signatory countries had their requirements met by individual State administrations; in time the entry into force of the HNS Convention, the Wreck Removal Convention, and the revision to the Athens Convention will each require the provision of 'blue cards' for increased levels of liability. The proliferation of bureaucratic requirements is therefore set to continue indefinitely. These will not be confined to the implementation of international conventions. For example, recent regulations published by China on the prevention and control of pollution from ships aim to establish comprehensive rules governing oil pollution prevention, response and clean up in Chinese waters. Significantly, as presently drafted, the regulations require shipowners to pre-contract with a Chinese oil spill response organisation before they enter any Chinese port.

Regulation of our industry, while welcome in many respects, has continued to expand. Nowhere is this more apparent than in the context of the Solvency 2 rules that are scheduled to enter into effect in 2012. So far the insurance industry has undergone four quantitative impact studies (QIS) which are intended to assess the impact of the new rules on individual insurance enterprises. QIS 4, carried out in 2009, was expected to be, for practical purposes, definitive in calibrating solvency requirements, but in recent weeks details of a fifth study, QIS 5, have been advised which will modify the requirements for individual entities with the expectation that a higher capital requirement may result. There are also indications that the implementation date may again be delayed.

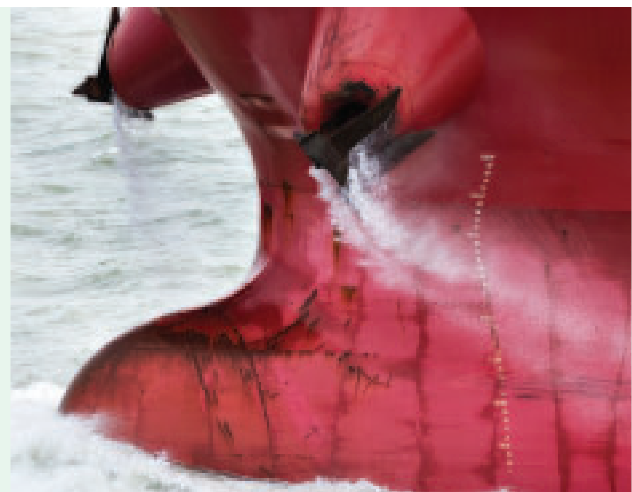
Two years ago, I commented on the shortage of new and properly trained seafarers, and the concern that the problem would worsen as new ships entered the market for trading. The continuing downturn in shipping through 2009 lessened the concern but it may resume as the shipping market recovers. Another aspect of particular relevance to seafarers continues to be the incidence of acts of piracy off Somalia. National governments have taken steps to co-ordinate their efforts to eradicate the problem with the formation of protective arrangements for vessels transiting the Gulf of Aden, but the rules of engagement for national

navies continue to be unclear and less forceful than may be necessary to ensure safe passage. An increased awareness in the United States that US interests may be at risk has resulted in an Executive Order from the President which seeks to block payments to 'Specially Designated Nationals' who may be described as pirates or terrorists. Whilst the objectives of the Order may have merit, its scope is not clear nor is its application to non US interests. Limited progress has been made so far to clarify these issues, with the result that efforts to eradicate piracy continue to lack momentum. What remains certain is that shipowners regard the safety of their crews as fundamental and they will continue to do whatever is necessary to safeguard their interests. It is incumbent on national administrations to preserve the equally fundamental principle of 'freedom of the high seas' and so enable vessels to continue to meet the trade demands of the world's population. In particular, it will be necessary for them to consider whether or not their strategic approach should be modified so that pirates can be arrested and prosecuted throughout the Indian Ocean and from other areas where they are beginning to operate.

A related issue that similarly lacks clarity is the status of legislation pending in the United States in relation to the Iran Refined Petroleum Sanctions Act 2009. The Act seeks to prohibit commercial activities between US entities, or entities with US based interests which may include insurers doing business in the US, and certain shipping companies in Iran. However, the scope and application of the Act is unclear as the US administration continues to debate whether or not to implement a version of the Act unilaterally, or see what alternative multilateral UN sponsored sanctions might instead be agreed.

For a number of years the salvage industry has been suggesting that payments made under the 1989 Salvage Convention do not sufficiently reward Salvor's efforts to protect the environment. The International Salvage Union has proposed that salvors should be entitled to a separate environmental salvage award for carrying out operations in relation to ships or cargo that pose a threat of damage to the environment. Shipowners have long argued that a similar concept of 'Liability Salvage' was debated at great length up to 1989 when the Salvage Convention was being negotiated. The concept was rejected in favour of Articles 13 and 14 of the Salvage Convention and the introduction several years later of the Special Compensation P&I Clause, SCOPIC, in Lloyd's Open Form. SCOPIC is itself a mechanism for remunerating salvors for preventing or minimising damage to the environment. It contains agreed tariff rates which are profitable and generous for personnel, equipment and tugs. The International Group's position continues to be that it favours a buoyant and viable salvage industry and that the 1989 Salvage Convention and SCOPIC demonstrably work well, but the International Salvage Union's campaign has recently changed direction. Since their dialogue through the International Group, the International Chamber of Shipping and with property underwriters did not appear to be moving in the direction they wished, they have this year sought a review of the Convention through the Comité Maritime Internationale (CMI). Whether or not this initiative will be more successful remains to be seen. The most recent meeting of interested parties before a CMI panel reached no clear consensus other than to reconfirm that so far as shipowners and the Clubs were concerned, the initiative is misconceived.

In my report last year, I made clear that the overall strategic direction for the Club is to continue to be appropriately



Chairman's statement

Continued

conservative in uncertain times. We shall continue to aim for excellence by providing the very best cost-effective service for our Members, and will not therefore seek to grow for growth's sake or provide alternative products in direct competition with the commercial markets which require separate and additional capital.

In line with our plan to continue to deliver the best service levels, we have made substantial improvements to the structure and manning of our claims teams in London and our overseas offices this year. We are also in the process of upgrading our website. In particular our extranet is scheduled to be in operation in September which will give Members and their brokers comprehensive on-line access to data about their own claims and records.

Since last year's report, Ejgil Kromann, and Ivan Heesom-Green have retired from the Executive Committee and from the Board. Together they have devoted a generous amount of time to the Club. On behalf of all my colleagues I would like to thank them for their considerable and valuable contributions to our affairs. For particular mention, Ejgil Kromann has since 2002 been Vice-Chairman of the Club and Chairman of the Class 2 Claims Committee. His clear, balanced and principled approach to the consideration of Class 2 discretionary claims will be greatly missed.

During the year Alex Staring, Frode Haukedal, Tomas Dyrbye, Ali Obaid Al-Yabhouni and Yudhishthir Khatau have joined the Board. We wish them a warm welcome and look forward to benefiting from their advice in the coming years.

As always, I would like to thank all my colleagues for their continued commitment to the Club. Their support in these demanding times is very much appreciated. May I also express my gratitude to our Managers on behalf of the Board. They are the face of the Club from our offices around the world and as always work with dedication and skill to provide a professional and responsive level of service that the complexities of ship operation today demand. I am confident they will continue to keep us well placed to meet the challenges ahead.

Finally, may I conclude by recognising and thanking on behalf of the Board Philip Aspden, who retires from the Association as our General Manager in Luxembourg this year after 30 years of service. His professional, dedicated and loyal commitment to our affairs for so many years has been of immense value and will be greatly missed. We warmly welcome Carolina Lockwood as Philip's successor.

Matheos Los
Chairman

General information

Directors

M T Los Chairman
Athens

L Criel Vice-Chairman
Antwerp

E Kromann Vice-Chairman
Copenhagen

P R L Lorenz-Meyer Vice-Chairman
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Riyadh

A O Al-Yabhouni
Abu Dhabi

Chen Hongsheng
Beijing

A R C B Cooke
London

H I Donev
Varna

J A Drakos
Connecticut

T Dyrbye
Antwerp

M B Ergin
Istanbul

F M Haukedal
Lysaker

Huang Shao Jie
Hong Kong

Y Khatau
Mumbai

V A Mednikov
Moscow

T Petalas
Monaco

K S Rajvanshy
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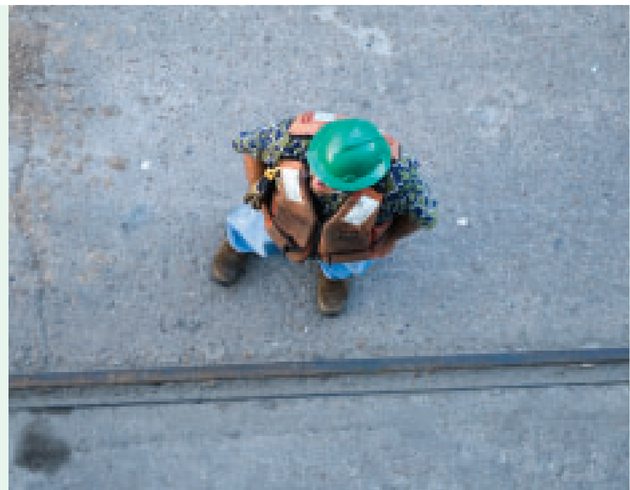


Managing a challenging claims environment

The cost of certain categories of claim is unlikely to reduce

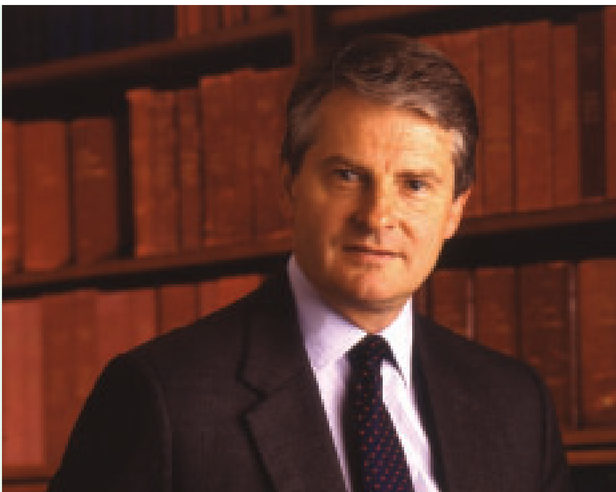
Managers' review

Underwriting Class 1 (P&I)

As has been the strategy for several years, the Club remains committed to retaining a stable membership, to maintaining calls at levels which are predictable and to steady but measured growth. Stability of membership means maintaining strong long term relationships and providing high quality services to Members in return for a fair contribution through premium sufficient to meet the cost of funding and operating the Club. Predictability of calls is best achieved through an underwriting strategy which over time aims to break even, which does not require support from investment income and which looks to achieve measured growth. While the contribution from investment funds will always be part of a mutual insurer's long-term income, it cannot be relied upon to underpin the underwriting result. The past year was successful for the Club in terms of maintaining its membership and achieving growth as planned. However, although the overall financial result was positive in terms of an increased free reserve, the 2009 year is forecast to have an underwriting deficit which is larger than was anticipated at the mid-year position principally because of higher than expected levels of claims on the Club from other members of the International Group Pool. It is therefore clear that the Club has further progress to make to achieve the underwriting balance highlighted in previous reports as a prerequisite to long term financial strength. Measures in the form of the underwriting metric and matrix with appropriate refinements will continue to be applied robustly to ensure that Members' advance calls are set at levels which reflect their own and the Club's overall future claims exposure.

During the year mutual tonnage grew from 50.9 million GT at 20 February 2009 to 53.7 million GT at year end, but reduced slightly to 52.5 million GT following the 2010 renewal. This represents a net growth of about 3% over the period which is in line with expectations in the current recessionary cycle and with the Club's business objective. Charterers' entries during the year were about 17 million GT pro-rata, slightly lower than in 2008 reflecting the fact that most of the Club's chartered tonnage is linked to an owners' entry and that Members' chartering requirements have reduced as a result of a global over-supply of tonnage. New tonnage came largely from additions to currently entered fleets. A number of new fleets, predominantly from Europe and the Far East, were entered during the year and at the 2010 renewal. The overall spread of tonnage by vessel type and trading pattern as well as location of operator remained largely unchanged, so that there was no significant alteration to the Club's overall risk profile.

The Board set a general increase in premiums net of Group Excess Loss Insurance costs for the 2010 renewal at 5%. The forecast additional call for the new policy year was set at 30%. In line with measures adopted by marine insurers generally, deductibles were increased in order to reduce the cost of attritional claims. As in the previous two years, the 2010 renewal used the methodology of the underwriting metric and to a lesser extent the matrix to set Members' individual rates and terms. Both of these underwriting tools are designed to provide the Club and Members with an objective assessment of risk and to move premium rates towards a break-even underwriting result for the Club as a whole. Premiums at 20 February 2010 for mutual entries increased by 6.2%. Increases in deductibles and changes in terms to reduce the scope of cover were agreed with a



Peter Spendlove
Managing Director

number of Members in order to mitigate premium increases. These deductible and term changes are expected to produce savings in claims costs and associated legal and other costs equivalent to a further premium increase of 3.8% so that the overall renewal result for the Club's mutual entries was equivalent to approximately a 10% increase in premium. Rates and terms for charterers' entries remained generally unchanged. New fleets entered at the renewal added approximately 1.2 million GT to the mutual tonnage. All of the Club's larger fleets renewed their entries, but some small fleets each with an entered tonnage totaling less than 50,000 GT, placed their cover elsewhere.

No changes were made to the calls and forecast calls on open policy years during 2009 and similarly at their meeting in May 2010 the Board made no changes to those calls and forecast calls. The underwriting result for the closed and open years was in summary as follows:

Closed years

All years up to and including 2007 are now closed. Policy years up to 2002 have continued to be stable and to generally develop in line with projections. The 2003 to 2005 policy years mark the start of the trend towards the higher claims levels experienced in more recent years. There was some increase during the latter part of the year in their projected cost, but this has been absorbed by the Club's retention reinsurances so that the overall result for these years remains largely unchanged. 2006 and 2007 continue to be the worst claims years in the Club's history. Both years have benefited from retention and stop loss reinsurance. Because of such reinsurance, the potential for a negative impact on the Club's reserves through further movements in claims is limited. The 2007 policy year was closed in May 2010 with no further call.

2008

Claims numbers to date for the year are similar to those of 2006 and 2007 but there are fewer large claims from Members. As a result the claims outcome for the year is projected at a lower level than in those prior years. Claims by Clubs on the Pool have also proved to be notably different. Twenty four months after the start of the year the projected cost of all claims on the Pool is about a quarter of the total cost projected at that stage for the two previous years.

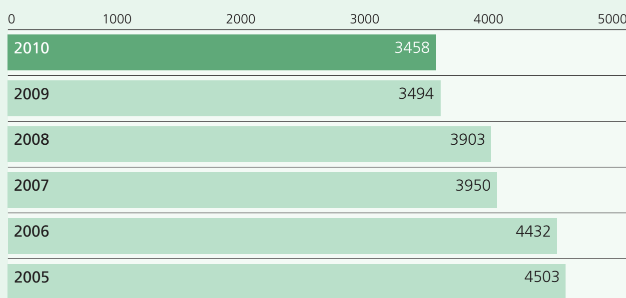
The year currently has a technical surplus of $31.4 million. This surplus takes account of the 45% additional call set by the Board in December 2008, although it will be recalled that the call was made primarily to rebuild the Club's capital following large investment losses at the height of the global financial crisis in the latter part of that year. There was a prospect that the full call for 2008 might not be required, but only if there was both a strong recovery in investments and if underwriting results for all policy years and in particular for 2009 significantly exceeded expectations. In the event there was a strong recovery in the year's investment return, but underwriting results were less positive. Accordingly in May 2010, taking a broad and long term view of the Club's capital and funding, forecast underwriting results and the future prospects for investment income in an uncertain and volatile market, the Board decided the call should be maintained. The release percentage for the year was however reduced to 5% and the year is scheduled to be closed in 2011.

2009

The 2009 policy year has once again shown how claims patterns in recent years have proved to be unpredictable. The year has so far exhibited divergent characteristics from any recent year and, despite a similar macroeconomic environment,

Class 1 Vessels

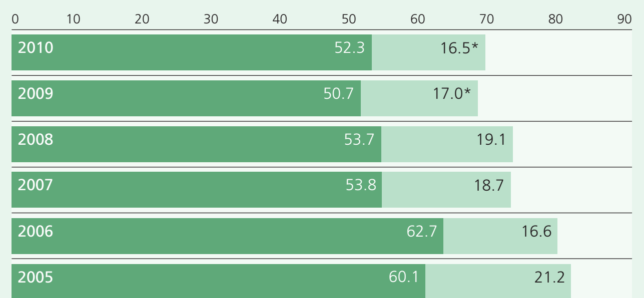
(Number of ownership entries)*



* By Policy Year (vessel numbers are ownership entries only pro rata by entered tonnage and by period of entry)

Class 1 Tonnage

By Policy Year (Pro rata)



Navigating the right course

To continue to be appropriately conservative in uncertain times

Managers' review

Continued

behaved quite differently from 2008. From the start claims activity was lower than expected and this pattern has been sustained since the year end. The number of open claims was 20 to 25% lower at the same stage of development than in any year in the past decade. In contrast there was a surge in the number of large and medium sized claims reported at the year end. A significant difference however between 2009 and 2008 was that, while the West of England has made no claim to date on the Pool for the year, other Clubs notified a significant number of Pool claims in the last quarter; the total estimated value of all claims on the Pool has already reached more than $230 million, an outcome so far more like that of the 2006 and 2007 policy years than that of 2008.

The year is nevertheless still at an early stage of development and benefits from stop loss and retention reinsurance. The additional call of 30% for the policy year remains as originally forecast.

The result for the year to date clearly demonstrates that claims frequency and values continue to be volatile and are likely to remain so in the foreseeable future. It also underlines the caution required in deriving conclusions about future claims patterns both from past claims experience in earlier years and from broader macroeconomic indicators within the shipping industry. The continuing volatility in claims on the Pool from year to year makes projecting their cost difficult not least because they generally occur at random. The West of England has had a satisfactory Pool record for 2008 and 2009, with no claims approaching the Pool retention for the latter year. The fact that the Club's results this year have been adversely impacted by other Clubs' Pool claims does not detract from the value of the pooling system as a whole. However, the increase in the cost of Pool claims in the autumn of 2009 explains why the result at the end of the year differed from the early indications published mid-year when Pool claims appeared to be following the more benign pattern established in 2008.

Outlook

Last year the Managers' Review suggested that for 2010 and beyond premium rates would continue to rise, even though there was likely to be an extended period of recession which could moderate some of the volatility and unpredictability in claims cost. In the event most Clubs looked for and appear to have achieved significant premium increases at the 2010 renewal. Although there may be a correlation between the number and value of attritional claims and the economic downturn, that appears not to be so in the case of large claims. The incidence and cost of large claims remain the principal cause of rising claims costs for policy years as a whole. The additional impact of an increasingly burdensome liability environment makes it highly likely that premiums will go on increasing in the foreseeable future. At this early stage in its development, claims at the attritional level for 2010 appear to be slightly higher in value than in both 2009 and 2008 although the number of new claims reported to date is similar to that of the average of the past two years. There are no clear indications yet as to how claims on the Pool by other Clubs might develop in 2010 and it is too early to say what the cost of Members' large claims will be.

At the end of last year the Club modified its approach to estimating claims costs with the aim of getting a better view earlier in the life of a claim of its final outcome. While the best estimate of the likely outcome of each claim continues to be the basis of any estimate, claims handling will be more

Numbers of Members' claims
at 12 months of development (P&I only)

Policy Year	2005	2006	2007	2008	2009
All claims to $500,000	8,391	8,453	7,306	7,116	5,746
$0.5m to $1m	12	18	13	18	16
$1m to $2m	11	8	7	6	7
$2m to $5m	4	3	5	5	4
$5m to $7m	3	0	0	0	2
$7m+	1	2	3	0	0
All Claims	**8,422**	**8,484**	**7,334**	**7,145**	**5 ,775**

proactive in gathering information about claims in their initial stages. The purpose is to get an earlier indication of the probable cost of each claim in a policy year and to be able to rely less on overall projections to determine the year's final outcome. Projections may in time be adjusted to take account of the change in estimating practice and it will take some time for the change in approach to become fully apparent. In addition to improving overall claims forecasting, the new approach is expected to support underwriting processes so that Members' past claims records become more representative of future claims performance at an earlier stage than may currently be the case.

Claims - Class 1 (P & I)

Claims numbers and their development are covered in the underwriting section of the review. Two noteworthy claims features emerged during the year. First, the average value of attritional claims (up to $100,000) increased by over 50% in 2009 compared with 2008 although the number of claims was 45% lower. The change will need further examination over time, but it may be the result of increased deductibles in 2009 or possibly attributable to the changed approach to the speed of estimating. The second significant feature of 2009 has been the replication of personal injury claim patterns from the United States to other countries particularly Greece, China and Hong Kong. Personal injury claims in the United States have for a long time increased in cost during the life of the claim because of changes in prognosis and prospective recovery of the injured person as well as the effect of surgical or medical treatment which has not always produced the results initially anticipated. Similar features are beginning to emerge in other countries. Whether this represents some form of globalisation of a United States claims culture or whether it reflects subtle changes in medical practice is unclear at this stage, but it is obvious that in future the assessment of the outcome of personal injury cases will need to be more conservative in a number of countries as well as in the United States.

Class 2 – Freight, Demurrage and Defence

Claims patterns and activity in this class of business have remained similar to the experience of 2008. Premium income fell by about 3% and claims were higher by the same percentage, producing an underwriting loss of $1.7 million which will lead to an increase in premium requirements next year unless projected claims costs fall in the meantime.

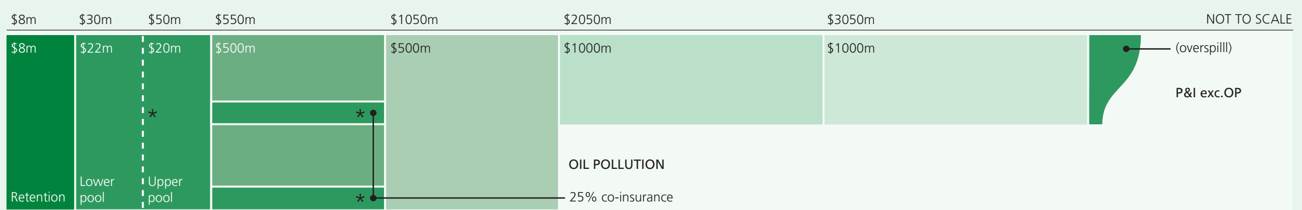
The Class has an overall free reserve of just over $19.3 million on open and closed years, an improvement of 12% over 2008.

Pooling and Group Reinsurance

In 2009 the Club maintained its reinsurances through the Pool and International Group's excess loss reinsurance programme and with Hydra on the same basis as in 2008. The cover has continued on the same terms for 2010, although rates have been increased and the Club retention has risen from $7 million to $8 million per incident. It is encouraging that Hydra's underwriting results overall have continued to stabilize notwithstanding a poor claims result for 2009. As a cell captive designed to enable Group Clubs to retain more risk and provide additional underwriting capacity Hydra appears to have a sound future.

Group Excess of Loss Reinsurance Programme

Policy Year 2010



Individual club retention
Pool, co-insurance and overspill
First general excess (unlimited reinstatements)
Second general excess (unlimited reinstatements)
Third general excess (unlimited reinstatements)
Overspill reinsurance (one reinstatement)
* Hydra

Managers' review

Continued

Retention reinsurance

Excess of loss reinsurances for claims within the Club's retention were maintained in 2009 as pure reinsurance contracts placed with Swiss Re, Partner Re and Barbican. All these reinsurance policies have proved their worth in terms of limiting the adverse effect of the high level of claims costs experienced in recent policy years, although reinsurance premiums have increased as a result. For 2010 the Club has taken steps to reduce the overall cost of its reinsurance and the overall structure of the programme has been changed.

The ten year stop loss reinsurance programme in place with Munich Re since 2000 has now ended. As a result the structure of the retention excess of loss covers has been changed to include elements of aggregate protection. Additional reinsurers have been added to the placing for 2010 - Torus Insurance (UK) Limited, a newly established reinsurer operating in Bermuda and London, together with Ascot 1414 and Novae 2007, both Lloyd's Syndicates.

Investments

The Club's overall return on investments in the 2009 financial year, excluding property, was 14.1% or approximately $59 million including currency gains and before tax. The Club's property portfolio was revalued and, together with exchange gains on the London property, a further $6 million was added to the return. As a result about two-thirds of the previous year's investment loss was recovered over a period when markets remained volatile. Equities and absolute return funds performed particularly well in producing respective returns of 58% and just under 17%. Both portfolios also outperformed their benchmarks, equities by 8% and absolute return funds by nearly 5%. The fixed income portfolio produced a positive return of about 9% but was about 3% below its benchmark. Although the Club maintained the strategic allocation to equities within its investment policy, it maintained a relatively underweight position throughout the year because, as reported in last year's Managers' Review, concerns were beginning to emerge about how governments were going to moderate quantitative easing and accommodative monetary and fiscal policies which had provided a surge in risk asset values and government bond yields in the early part of 2009. Looking back, greater exposure to equities would have further enhanced the return for a period but, as recent market response to austerity measures now being implemented in European countries and elsewhere has shown, equity gains have been reversed in the last few months.

During the year a full review was carried out of the Club's investment strategy. The investment principles were updated but no major changes were made to the long term investment strategy or investment objectives. The strategic allocation to absolute return funds was however reduced in favour of the fixed income portfolio and in particular directed towards inflation linked bonds. Measures were also put in place to enable both the Club and its subsidiaries to take tactical investment decisions within the scope of the general strategy more rapidly between Board meetings.

The outlook for the investment environment seems likely to remain uncertain for some time. On the one hand the sovereign debt crisis and concern about the future of the Euro are likely to make the transition from growth oriented fiscal strategies to reductions in public spending, higher taxes and monetary tightening difficult for many governments. On the other hand manufacturing growth in China and other

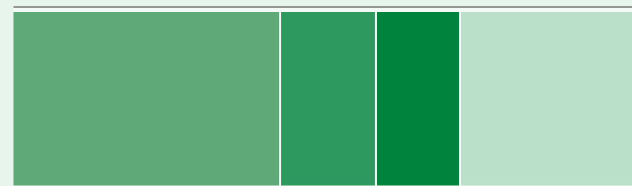
Investment by currency

(Excluding property)
At 20 February 2010

US $ 82.0%
Euro 9.1%
£ Sterling 1.5%
Yen 1.4%
Other 6.0%

Investments by asset type

(Excluding property)
At 20 February 2010



Fixed income 43.1%
Equities 15.5%
Absolute return 13.6%
Cash 27.8%

emerging economies is creating other tensions while their currencies appear to be undervalued and their economic growth remains high. Inflation also remains a threat in the view of some commentators. The debate as to whether a 'double dip' return to global recession is imminent or whether recovery will be sustained looks likely to continue for some time. Despite these uncertainties the Club has decided to maintain a longer term focus in its investment strategy and to maintain significant diversity in its asset allocation. The Club's exposure to European sovereign debt and the Euro has been and remains limited and is likely to remain so while Greece and other states in similar positions set about implementing measures to reduce spending and increase taxes.

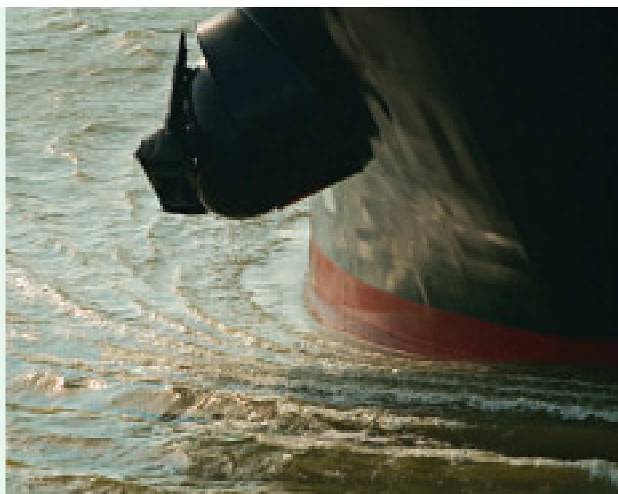
Loss prevention

The Club's loss prevention capability was further strengthened over the past year. The loss prevention team continues to perform its core functions of implementing the Club's condition survey and safety management appraisal programmes as well as providing a wide range of advice to both individual Members and the Club's own claims teams. Additional staff resource in London has enabled greater emphasis to be placed on broadening its services through more publications, more news items and more loss prevention bulletins being made available to the membership as a whole.

During the year the number of vessel condition surveys carried out was slightly higher at 23 surveys per 100 entered vessels, compared with 22 in 2008. Several comprehensive safety management appraisals were performed during the year, half of which were at the Members' request. There were also follow up reviews with various Members who had undergone appraisals to assess their progress in implementing the Club's safety management recommendations and requirements. Safety management appraisals cover both shipboard and shore side operations and continue to be a valuable means of both helping Members reduce risk and of addressing concerns about their operational controls following a significant casualty or a particular trend in attritional claims. The Club's Board continues to take a direct interest in lessons to be learned from major claims and measures taken by the Managers to require Members to modify safety practices. At each of its four meetings in the year its Claims Committee considers a loss prevention report in relation to all major claims.

During the year, 21 loss prevention articles and notices were published compared with 11 in the previous year and 25 to date in 2010. There were 12 loss prevention seminars held for Members in several countries including India, Iran and Thailand. Broader dissemination of loss prevention information and advice to the membership as a whole is an increasingly important element in the Club's longer term loss prevention strategy.

In the second half of the year agreement was reached with Det Norske Veritas Petroleum Services (DNVPS) to publish their bunker alerts to Members and other authorised users of the Club's website one week after issue. DNVPS specialise in marine fuel management and are market leaders in contracted fuel quality testing. Their bunker alerts identify potential problems with fuel supplies in different locations and approximately two or three are published every month. Feedback from Members has been positive and the alerts have significant potential to help Members to reduce the risk of engine damage or disputes with bunker suppliers and time charterers in relation to the suitability or quality of marine fuels.



Moving forward

The Club has made steady progress in recovering from the effects of the banking and credit crisis

Managers' review

Continued

In last year's Managers' Review it was reported that safety standards in the industry might be under pressure because of a shortage of skilled experienced seafarers. That pressure appears to have eased a little as a result of the global economic downturn and a less buoyant shipping market. The demand for manpower has fallen slightly and there are some indications that the frequency of claims attributable to poor skills or limited experience may have reduced. Regrettably but predictably the continuing high cost of large claims and particularly claims by Clubs on the Pool remains attributable in large part to human error, often of an elementary kind and not infrequently linked to a lack of training or the absence of core competences. If the incidence and high cost of these claims is to be mitigated Clubs and their members will need to continue to work hard together to improve further the safety culture and safety management of shipboard and shore side personnel.

Although shipping markets have remained generally flat, the level of laid up returns requested by Members has been lower than expected over the last 12 months. While there have been concerns that many recognised lay-up locations and particularly hot lay-up areas such as Singapore might represent an increased collision or other casualty risk because of overcrowding, there appear so far to have been few problems in connection with lay-up arrangements and locations or with re-activation of laid up vessels. Re-activation may nevertheless create risks not found in normal trading and the loss prevention team will be going ahead with its plan to provide Members with a risk focused re-activation guide. Particular attention may be necessary in the case of electronic and similar high technology equipment and materials where more sophisticated and comprehensive protection may be required if vessels are laid up for extended periods or where reactivation requires complicated processes to be undertaken.

Port state control in the European Union is undergoing a major change and a new inspection regime for vessels contained in Directive No 2009/16/EC may represent a significant challenge for some shipowners. European port state control will become more focused and selective from 1 January 2011. The European Union member states will now adopt a more formulaic approach to the selection of vessels for inspection and ships and operators will be categorised in terms of risk and performance. The European Union states will also be publishing the details of 'very low' and 'low' performing operators and introducing additional controls to ban ships from EU ports based on their flag and port state control detention records. Ships assessed as being 'high risk' may expect more frequent and more rigorous inspections. Conversely, 'low risk' vessels will be examined less often. Provided the categorisations are made fairly and are evidence based the new measures are likely to benefit the industry, but they may well affect acceptability to certain charterers and a vessel's earning potential. Port state control inspection records already form part of the Club's assessment of a Member's overall risk profile and the European Union categorisations may become an additional element in that process.

In parallel, the Maritime Labour Convention of 2006 will come into force in 2011 if ratified by the required number of flag states. The Convention consolidates the provisions of over 60 existing conventions and legal regimes in relation to welfare and engagement of seafarers. It covers matters such as employment terms, payment of wages, provision of adequate accommodation, food and medical and health care. Provisions are also included which deal with safety and security. The new Convention allows for port state control inspections and for detention of vessels which are not compliant.

International Group Pool – Development of numbers of claims by Policy Year

People, service and technology

People are key to the Club's identity, its success and the service and value it brings to Members. During the year a number of appointments and changes were made in senior management positions and a number of new staff joined. Changes have been made to claims teams in London and the management structure in Greece and Hong Kong. Key responsibilities in a number of areas are being reviewed and in two areas – marketing and business development and service quality – new roles have been assigned to directors of the Managers.

In London Jerry Westmore joined the Managers as an underwriting director with particular responsibility for marketing and business development and Tony Paulson has assumed overall responsibility for service standards and service delivery while retaining an involvement in claims handling and developing the Club's future knowledge management capabilities.

The loss prevention team in London has been increased through the appointment of Simon Rapley and Matt Tong joins Joe Yu in Hong Kong to complete the team there. A number of legally qualified claims handlers have joined the London claims teams both to strengthen the current resource and to meet the requirements of succession planning.

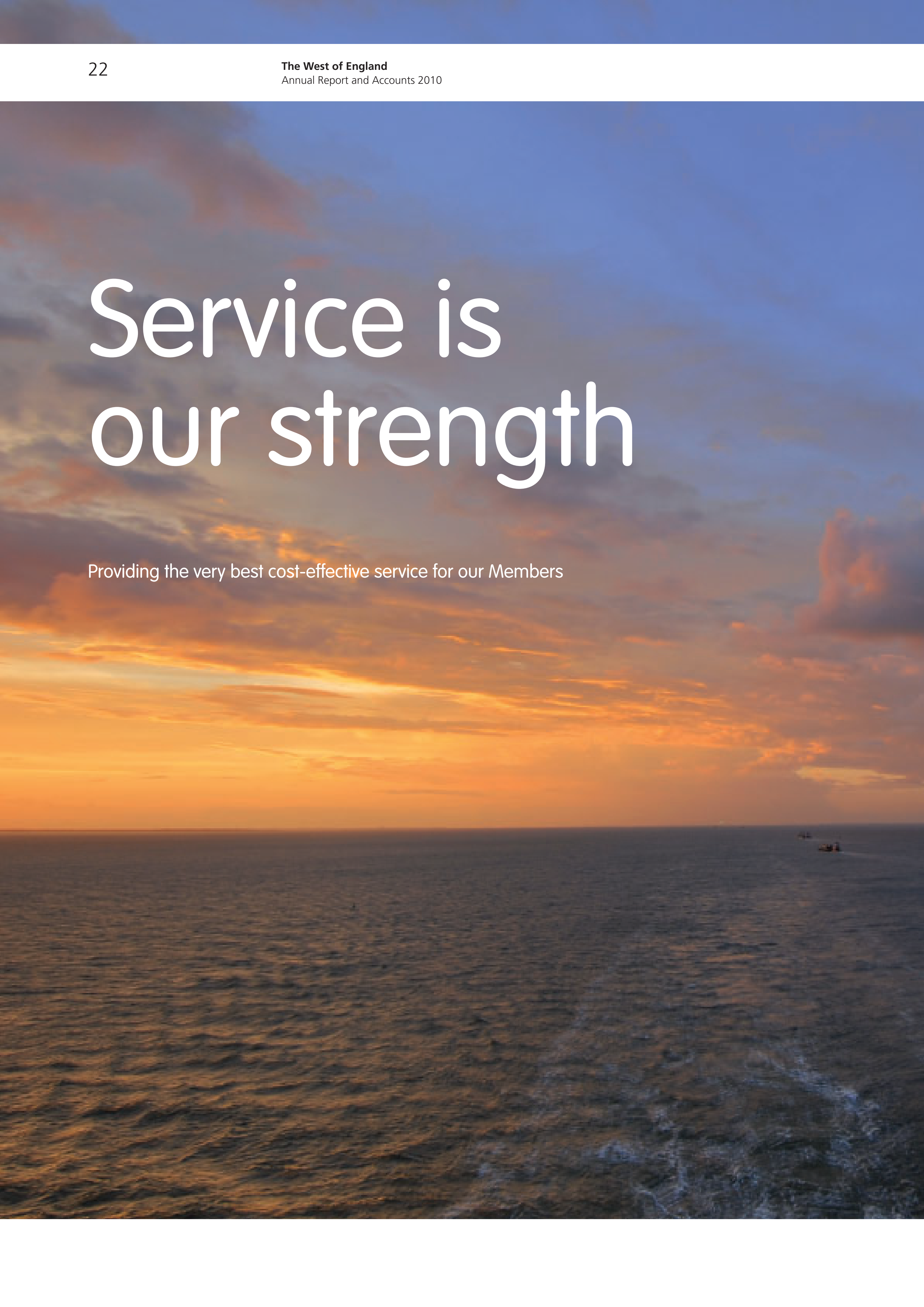
As reported in the Chairman's statement, in Luxembourg Philip Aspden retires this year as Company Secretary and General Manager. The Managers add their thanks to that of the Board for Philip's considerable and valuable work for the Club over 30 years. His successor is Carolina Lockwood who has become the executive director of ISRe and a director of the management company.

In 2009 a full review was made of the Club's service delivery with the help of more than 100 Members and brokers from various areas of the Club's business. The review focused on what objectives and services are important to Members and brokers and how the Managers' performance measured against expectation. The process involved questionnaires, meetings and telephone interviews. Feedback was both comprehensive and helpful. It was encouraging that the review showed not only that the Club was generally successful in identifying Members' main service expectations but also that they are usually being met. A number of areas were identified where improvements can be made. In particular Members wanted more information about underwriting products ancillary to core P & I cover, greater opportunities for seminars and training and a broader range of contact with key staff in the Club in addition to their designated underwriter and fleet handler. Each of these requirements has been recognised and the Club's services in each of these areas are now being enhanced.

Two important technical initiatives are underway. The first is to update the current information technology for claims handling by transferring data and processes from the existing CALM system to a new platform, Gateway, which will be operational soon. Not only will it provide quicker and simpler access to the claims database but it should also streamline claims processing through better document management and a set of task based and more transparent claims handling processes. It is also anticipated that there will be a significant reduction in paper based systems, although the longer term goal of a substantially paper free

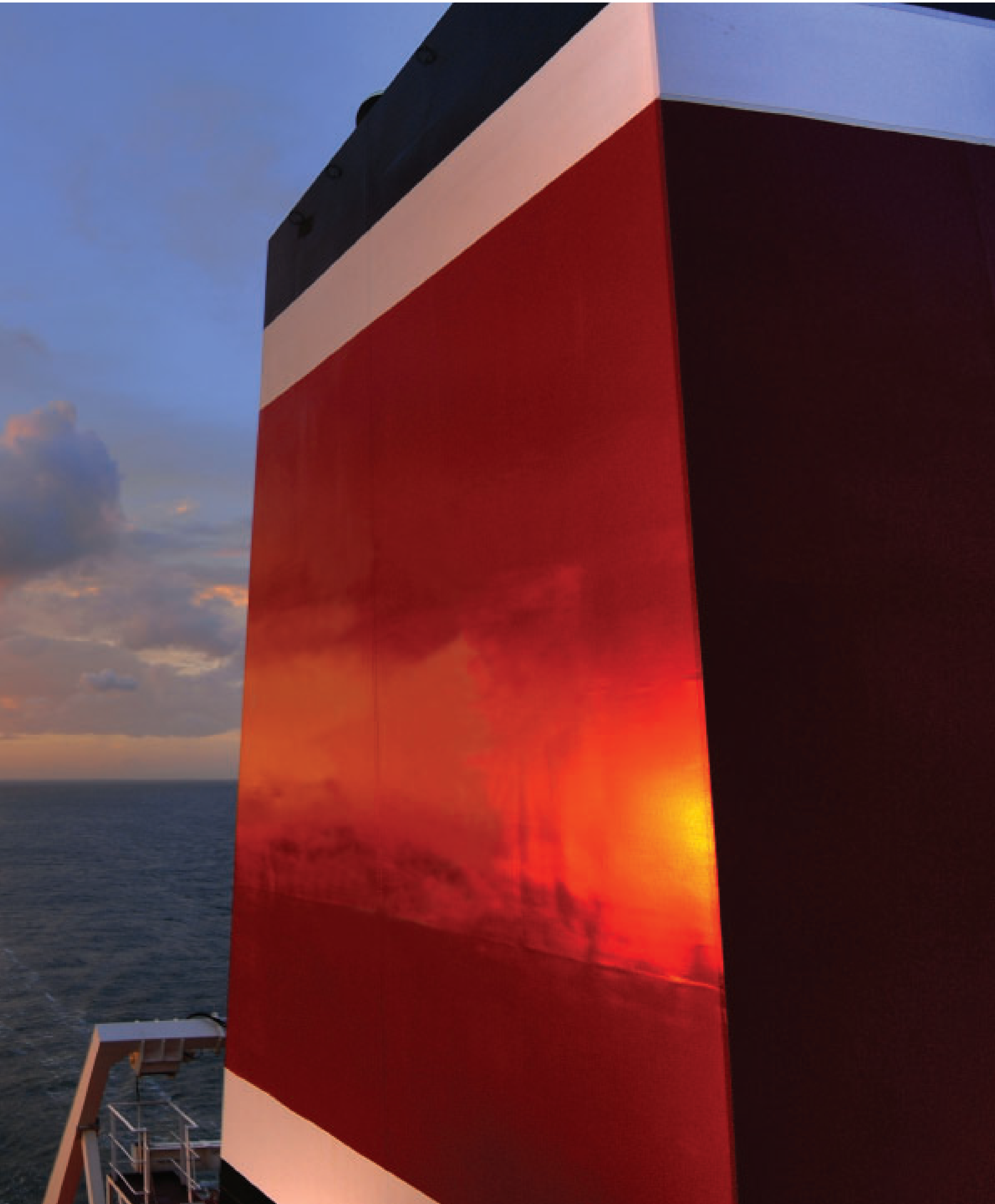
International Group Pool – Development of incurred claims by Policy Year

(Figures are at 6 month development periods and include the Group's co-insured share of the Group excess reinsurance programme)



Service is our strength

Providing the very best cost-effective service for our Members



Managers' review
Continued

office may be some way away. The second initiative is to update the Club's website and, perhaps more importantly, to provide access through a new online facility - Westnet - for Members and brokers to review key information about their entry with the Club, including invoices, claims records, premiums and loss ratios.

Legislation, law and conventions

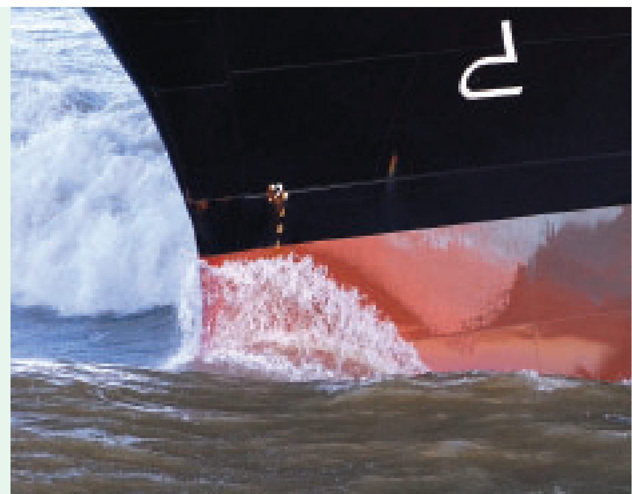
There has been a significant amount of legislative activity over the past year in various parts of the world; notably the official publishing of the Third European Union Maritime Safety Package, the implementation of the European Union Directive on Environmental Liability (ELD), the Rotterdam Rules, increases in the limits under the United State Oil Pollution Act of 1990 – OPA 90, new Regulations in China on the Prevention and Control of Marine Pollution and, in various countries, sanctions legislation against Iran. With the exception of the Iranian sanctions which present other challenges, all the new legislation, laws and conventions further increase the burden of liability on shipowners.

The key liability provisions of European Union Maritime Safety Package include an extension of the Athens Convention on liability to passengers to cover domestic carriage and require carriers to make advance payments to cover 'immediate economic needs' in respect of passenger death or injury. The payments are required to be 'on a basis proportionate to the damage suffered'. The economic needs are not further defined and appear to be at the discretion of a domestic court. Significant advance payments may be required in cases where passengers are injured.

The Rotterdam Rules were signed on 23 September 2009 as a first step towards ratification. The required number of states has indicated an intention to ratify and the United States are likely to be among the first to do so. As a regime which promotes international uniformity and which may head off, particularly in Europe, new but fragmented regional regimes, the Rotterdam Rules are welcome. They represent a step change from the Hague/Hague Visby Rules in terms of imposing greater liability on carriers and in terms of increasing both the scope and limits of liability. The key defence of error in navigation will be lost and carriers will have a continuing obligation of maintaining a vessel's seaworthiness throughout a cargo voyage. It may be some time however before the Convention is ratified by the required 20 states.

The increased limits under OPA 90 set in July 2009 were a modest 5% for most vessels, but that was before the 'Deepwater Horizon' spill. Whether the United States administration's criticisms of BP reflect understandable anger at the response to the accident, a need to show strong and decisive government or the impotence of a powerful nation to handle a very large pollution event, remain a matter for debate. What seems clear is that the basis of shipowners' liability under OPA 90 is unlikely to remain entirely as it is now and there may at some point be pressure for the cover for oil pollution provided by the Clubs to be significantly increased above the current level of $1 billion.

Setting premiums to take account of these increasing liabilities is a constant challenge for the Clubs, particularly so long as loss ratio based underwriting remains the principal measure by which future risk is determined.



The legislation in relation to Iran passed in the United Kingdom and the rest of Europe and in the United States Congress raises different issues. Europe's legislation sets out with relative clarity what activity is prohibited in terms of goods and services provided to Iranian interests and which Iranian individuals or organizations a shipowner or operator may not do business with. The United States legislation currently passing through Congress is less clear. It would require the United States Government to impose a number of prescribed sanctions if it believes prohibited activity is being undertaken by the relevant party. In other words compliance is not a matter of understanding the law but what the United States Government thinks it is required to do and whether it thinks the shipowner or the Club's activities breach the sanctions. Interpretation of this legislation will present considerable difficulty to both Members and the Club in ensuring that they avoid being sanctioned.

China's proposed domestic legislation in respect of pollution which in most respects mirrors the 2001 Bunkers Convention threatens to introduce a feature that could also be a matter of concern. The authorities are indicating that Chinese flag vessels must be insured by an insurer which meets new financial criteria and solvency requirements under the legislation. The International Group is seeking to persuade them that, since all the Group Clubs are already regulated in their country of establishment and meet their own regulators' solvency requirements, additional solvency tests should not be required.

Entered tonnage by area of management
(Class 1 owner entry)
Policy Year 2010

Europe 45.6%
Asia 33.0%
Americas 13.1%
Mid East etc 8.3%

Entered tonnage by vessel type
(Class 1 owner entry)
Policy Year 2010

Bulk cargo carriers 31.5%
Tankers & OBOs (inc LPG/LNG) 27.3%
Container vessels 17.9%
General cargo and reefers 14.9%
Ferries and passenger liners 4.9%
Specialist vessels & misc 3.5%

Notice of meeting

Notice is hereby given that the Annual General Meeting of the Members of The West of England Ship Owners Mutual Insurance Association (Luxembourg) will be held in Hotel Le Royal, 12 Boulevard Royal, L-2449 Luxembourg on 22 September 2010 at 10:00 hours for the following purposes:

1. To approve the Report of the Directors and the Financial Statements for the year ended 20 February 2010 and to grant discharge to the Directors and Auditors for the period under review.
2. To elect Directors.
3. To reappoint PricewaterhouseCoopers S.à r.l. as Auditors of the Association and to fix their remuneration.
4. To transact any other ordinary business of the Association.

By order of the Board

C A P Lockwood
Secretary

33 Boulevard Prince Henri
L-1724 Luxembourg

19 May 2010

Note: A Member entitled to attend and vote is entitled to appoint a proxy to attend and, on a poll, to vote instead of him. A proxy need not be a Member of the Association. The instrument appointing a proxy shall be left with the Secretary not later than 48 hours before the holding of the Meeting.

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements of the Association for the year ended 20 February 2010.

Activities

The principal activity of the Association continues to be the insurance and reinsurance of Members' protection and indemnity risks (Class 1) and freight, demurrage and defence risks (Class 2).

In addition to its Head Office in Luxembourg, the Association has branches in London, Hong Kong and Piraeus to support its business activities on behalf of its Membership.

During the year, the Association has reinsured, through its wholly owned subsidiaries International Shipowners Reinsurance Company SA and The West of England Reinsurance (Hamilton) Limited, 75% and 15% respectively of its risks for all Classes.

The West of England Reinsurance (Hamilton) Limited has also reinsured various specific areas of the Association’s business on both a stop loss and excess of loss basis.

West of England Insurance Services (Luxembourg) SA, which is wholly owned by the Association, provides insurance and claims handling services for the Association.

The West of England Ship Owners Insurance Services Limited, which is wholly owned by the Association, acts as landlord to its tenant companies at its premises in London.

The Association, along with the other members of the International Group of P&I Clubs, has established a ‘segregated cell’ insurance company called Hydra Insurance Company Ltd in Bermuda, to reinsure certain pool and quota share risks. The Association has contributed share capital to Hydra, and share capital, contributed surplus and reinsurance premiums to the Hydra West of England Cell which is wholly owned by the Association and, during the year, participated in reinsurance activities.

The Association does not perform any research and development activity.

Future developments and events since the balance sheet date

The Association will continue to maintain and develop its activities as above. There have been no significant events after the balance sheet date.

Financial risk management

Luxembourg law requires disclosure, where material, of the risk management objectives and policy of the Association and of its exposure to price, credit, liquidity and cash flow risks. The Association issues contracts that transfer insurance risk. The Association is also exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. This is discussed in further detail in the Appendix to this Report of the Directors.

Financial statements

These financial statements conform to the Luxembourg law of 8 December 1994 (as amended) in all respects except for the fact that investments are stated at market value and land and buildings at valuation. Luxembourg legislation requires that investments, including land and buildings, are stated at the lower of cost or market value. The treatment adopted is consistent with the basis of accounting generally accepted by the other members of the International Group of P&I Clubs. The financial statements are set out on pages 34 to 51 with the principal accounting policies summarised on pages 37 to 39. Financial statements conforming fully to the Luxembourg legislation are filed with the Luxembourg authorities: copies are available on request from our principal office.

These statements show a surplus for the year of $4.0 million (2009 $2.9 million surplus) before the transfer to the Reserve Deposit Fund of $0.4 million (2009 $0.4 million) and after a net transfer to the Class 1 Policy Year Reserve Account of $48.1 million (2009 $46.1 million from). In addition the Revaluation Reserve increased by $4.3 million (2009 $15.2 million decrease). Total reserves at 20 February 2010 were therefore $169.1 million (2009 $160.8 million).

A more detailed review of the year is contained within the Managers’ review.

Report of the Directors
Continued

Directors

The present Directors of the Association, who are listed on page 7 held office throughout the year under review, with the exception of Mr A M W Staring who joined the Board with effect from 12 August 2009, Mr T Dyrbye and Mr F M Haukedal appointed with effect from 10 November 2009, Mr Y Khatau appointed with effect from 16 March 2010, and Mr A O Al-Yabhouni appointed with effect from 26 March 2010.

In addition, Mr S I Al Bassam retired from the Board with effect from 16 March 2009, Mr M S O Aldhaheri and Mr S A Terekhin with effect from 13 May 2009, and Mr I H Heesom-Green with effect from 23 September 2009.

In accordance with the Constitution of the Association all Directors will retire at the forthcoming Annual General Meeting but, being eligible, offer themselves for re-election.

General Manager

Mrs C A P Lockwood was appointed General Manager and Company Secretary of the Association with effect from 20 February 2010. She replaced Mr P A Aspden who, until his retirement, had held these positions since 30 June 1985 and 1 May 1979 respectively.

Directors and officers liability insurance

During the year, the Association maintained insurance cover for Directors and Officers against legal liabilities relating to the Association's activities.

Auditors

At the forthcoming Annual General Meeting on 22 September 2010 the Directors will propose a resolution for the appointment of PricewaterhouseCoopers S.à r.l. as Auditors for the period commencing 20 February 2010.

By order of the Board

C A P Lockwood
Secretary

19 May 2010

Appendix to the Report of the Directors

Financial risk management
(a) Insurance risk

The underwriting objective of the Association is to write business at a premium that reflects the underlying risks entered. The risk under any insurance contract is that the insured event(s) may occur and that the amount of any resulting claim(s) may be unpredictable and uncertain. For insurance contracts written by the Association the principal risk is that the actual claims payments will exceed the carrying amount held for insurance liabilities. This can occur because the frequency or severity of claims may be greater than estimated. In determining their estimate, the Association's Managers take account of advice from external actuaries who use established statistical techniques, and apply knowledge, experience and judgement to determine an estimate of the most likely outcome. The underwriting strategy ensures that risks underwritten are well diversified. Therefore, by the nature of the risks insured and the cover offered there is a sufficiently large and diverse population to reduce the variability of the expected outcome.

The frequency and severity of claims can be affected by several factors. For Class 1, the frequency of larger individual claims, those over $250,000 each, has a significant effect on an individual policy year's ultimate result. Such claims represent typically only 2 to 3% of the total number of claims in any year and are unpredictable in terms of frequency, particularly those which reach the International Group of P&I Clubs' (the 'Group') pooling arrangements and excess loss reinsurance.

Reinsurance is used to control risk. The Association's reinsurance acts, firstly, to mitigate its exposure to individual large claims by use of excess covers and, secondly, to protect the remaining net position from variation in claims volume and average cost by using aggregate protections. For Class 1, individual larger claims within the club retention may be recoverable under reinsurances, subject to the application of an aggregate deductible.

The Association is a party to the pooling arrangements of the Group, whereby individual claims are pooled between $7 million and $50 million and reinsured above this level through market reinsurance purchased on behalf of all member Associations of the Group (the retention rises to $8 million from 20 February 2010). The retained risk of a 'catastrophic occurrence' to the upper level of the Group reinsurance of $3bn (including $1 billion of overspill protection), under a 'one in 200 years' scenario, would result in a net exposure to the Association of approximately $8 million for the amount above the Club retention. For Class 2, reinsurance is placed for individual claims above $1 million.

(b) Financial risk and
(c) Investment risk

The Association is exposed to a range of financial risks through its financial assets, financial liabilities (investment contracts and borrowings, although in respect of borrowings the Association generally operates without loan or overdraft positions), reinsurance assets and insurance liabilities. In particular, the key financial risk has been identified as that, long-term, its investment proceeds may be insufficient to fund the obligations arising from its insurance and investment contracts. The shorter-term risk is that the financial assets of the Association may become insufficient to cover its liabilities, or not to allow it to maintain adequate operational solvency or a required margin of solvency for compliance purposes. The main components of this financial risk are interest rate risk, equity price risk, foreign currency risk, liquidity risk and credit risk. Risk within the fixed income portfolio arises primarily from interest rate movements and, for corporate bonds, credit risk and currency risk. Risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements.

The risks that the Association primarily faces due to the nature of its investments and liabilities are interest rate risk and price risk.

The Club's strategic asset allocation and investment performance are kept under consistent review, including in respect of liquidity and capital preservation.

The key methods the Association uses to manage financial and investment risk include:

- All its investment managers must operate in accordance with internal risk control procedures necessary to ensure compliance with the constraints placed on the portfolio by the guidelines agreed for that portfolio and undertake to comply with such additional reporting and monitoring procedures as may be required by the custodian (which performs checks on the whole portfolio) the Association or regulatory authorities.

- Where assets representing the technical provisions comprise derivative instruments, these instruments are used for hedging purposes or as a substitute for the use of cash instruments in situations where it is more efficient to take market exposure in this way.

Appendix to the Report of the Directors

Continued

- Adequate measures must be taken at all times by the custodian in liaison with the Association's staff to ensure that the use of derivative instruments for investment purposes and the exposure as a whole is tracked and monitored, and that all reporting and regulatory requirements can promptly be complied with. General written procedures are agreed and applied to all portfolios. Appropriate records must be maintained to ensure that the statutory and regulatory reporting requirements in force from time to time can be fulfilled.

- The Association also maintains investments in non-discretionary funds, which use derivative instruments as part of their investment strategies. An extract of each fund's prospectus, and specifically its investment policy to include its permitted policy as to derivative instruments, is attached to the investment agreements for these funds.

The Association's procedures concerning financial and investment risks including derivative transactions are:

- Approval of the use of derivative transactions: the Boards of the Association and its subsidiary companies are responsible for selecting portfolios which will be permitted to use derivatives and for approving the investment guidelines applicable to these portfolios, which cover the use of derivatives as well as other instruments.

- Overall review of compliance by the Association: the respective investment managers report to the Association in detail monthly and in summary form on a weekly basis. These reports are reviewed to ensure their reasonableness generally, and compliance with the investment guidelines in particular, and are discussed with these managers as appropriate.

- Monthly detailed compliance checking by the custodian of the investment portfolios which has a contractual responsibility to ensure compliance by each portfolio manager with the investment guidelines and to report any deviations.

(d) Liquidity risk

Liquidity risk is the risk that the Association will encounter difficulty in meeting obligations associated with financial liabilities, in particular because its assets cannot be liquidated at short notice. Liquidity is an important consideration and is managed in several ways, the most important of which are:

- The strategic allocation to fixed income and cash are 50% and 15% respectively of the overall investment portfolio. Together, the benchmark duration on the fixed income and cash portfolios is set to approximately match the duration of the Association's claims liabilities.

- More than 80% of the investment portfolio is invested in highly liquid marketable securities which can be liquidated at five days notice or less. Investments in illiquid securities, or those with a possibility of becoming illiquid, are generally avoided.

- The Association has significant credit line facilities with major banks. These have historically not been utilised but remain available for use in exceptional circumstances.

(e) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates, i.e. in a currency other than the functional currency in which they are measured. Currency risk does not arise from financial instruments denominated in the functional currency.

The Association's overall investment portfolio has a benchmark currency profile which approximates to that of the Association's historical claims liabilities. Thus sharp currency movements are effectively hedged. Determining the currency exposure within the claims liabilities is an area where exact measurement is not possible. However, by monitoring historical payment patterns and recording the currency exposure within figured claims reserves, it is possible to determine a measure of the currency risk and to determine the effectiveness of the currency hedge.

(f) Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Association is exposed to credit risk are:

- Reinsurers' share of insurance liabilities,
- Amounts due from reinsurers in respect of claims already paid,
- Amounts due from policyholders.

The Association is also exposed to credit risk through its investing activities, as described above. The investment policy of the Association acts to avoid unacceptable credit risk including counterparty risk for investment transactions.

Although reinsurance is used to manage insurance risk, this does not, however, discharge the Association's liability as insurer. If a reinsurer fails to pay a claim, the Association may remain liable for the payment to the policyholder. The strength of the reinsurance programme is fundamental to the management of the Association's business and the financial standing and spread of reinsurance security is kept constantly under review.

The Association monitors the debts of policyholders, who are Members of the Association. No one policyholder or group of policyholders is material enough to represent a high-risk individual credit exposure. Strong controls are maintained over debtors and appropriate action is taken where potential credit risk is identified, which may include the exercise of the Association's right to terminate insurance cover with retrospective effect.

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Audit Report

To the Members of
The West of England Ship Owners
Mutual Insurance Association (Luxembourg)

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of The West of England Ship Owners Mutual Insurance Association (Luxembourg) which comprise the consolidated balance sheet as at 20 February 2010, the income and expenditure account for the year then ended, a summary of significant accounting policies and other explanatory notes.

Board of Directors' responsibility for the consolidated financial statements

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with the identified basis of accounting as set out in Note 1 to the consolidated financial statements. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Responsibility of the 'Réviseur d'entreprises agréé'

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted for Luxembourg by the 'Commission de Surveillance du Secteur Financier'. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the judgement of the 'Réviseur d'entreprises agréé', including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk

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Expert-comptable (autorisation gouvernementale n°95992)
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assessments, the 'Réviseur d'entreprises agréé' considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

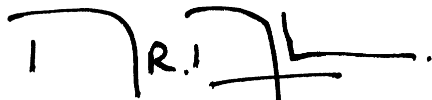
In our opinion, these consolidated financial statements give a true and fair view of the financial position of The West of England Ship Owners Mutual Insurance Association (Luxembourg) as of 20 February 2010 and of the results of its operations for the year then ended in accordance with the Accounting Policies adopted by the Association as presented in Note 1.

In order for these consolidated financial statements to be prepared on a basis consistent with accounting policies adopted by other members of the International Group of P&I Clubs, investments are stated at market value and, as described in Notes 1 and 2 and for the reasons stated therein, land and buildings are stated at estimated market value. At 20 February 2010, and previously, land and buildings were revalued, and the change in the total revaluation surplus transferred to the revaluation reserve. Luxembourg law requires investments and land and buildings to be stated at the lower of cost and market value, and for buildings to be depreciated over their estimated useful lives. Statutory consolidated financial statements in conformity with Luxembourg law (using the option of lower of cost and market value for the valuation of investments) which differ from these consolidated financial statements only in these respects and which do not include Notes 16, 17 and 18, (which relate to the Class 1 and 2 policy year positions and the Average Expense Ratio), are filed with the Commissariat Aux Assurances and the Registre de Commerce in Luxembourg, and our audit opinion thereon is unqualified.

Report on other legal and regulatory requirements

The Report of Directors, which is the responsibility of the Board of Directors, is in accordance with the consolidated financial statements.

PricewaterhouseCoopers S.à r.l.
Represented by



Mervyn R. Martins

Luxembourg, 19 May 2010

Consolidated balance sheet

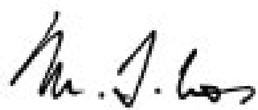
At 20 February 2010

	Note	**2010 $'000**	2009 $'000
Assets			
Investments			
Land and buildings	2	**36,558**	30,777
Other financial investments	3	**442,781**	425,460
		479,339	456,237
Reinsurers' share of technical provisions			
Claims outstanding	9	**246,942**	204,708
Debtors			
Member debtors		**13,301**	16,273
Reinsurance debtors		**4,589**	5,531
Additional calls not yet charged	4	**71,413**	146,367
Other debtors	5	**62,410**	64,315
		151,713	232,486
Other assets			
Tangible assets	6	**279**	342
Cash at bank and in hand		**47,760**	22,254
		48,039	22,596
Prepayments and accrued income			
Accrued interest		**1,615**	2,527
Other prepayments and accrued income		**373**	695
		1,988	3,222
Total assets		**928,021**	919,249

The accompanying notes are an integral part of these financial statements

	Note	**2010 $'000**	2009 $'000
Liabilities			
Capital and reserves			
Reserve deposit fund	1, 15	**18,850**	18,450
Revaluation reserve	2, 15	**9,652**	5,359
Class 1 policy year reserve account	15	**25,910**	2,805
Income and expenditure account	15	**114,697**	134,160
		169,109	160,774
Technical provisions			
Claims outstanding	9	**703,243**	643,065
Creditors			
Member creditors		**12,008**	13,005
Reinsurance creditors		**6,931**	6,279
Other creditors	7	**36,730**	96,126
		55,669	115,410
Total liabilities		**928,021**	919,249

Chairman



Director

19 May 2010

The accompanying notes are an integral part of these financial statements

Consolidated income and expenditure account

For the year ended 20 February 2010

	Note	**2010 $'000**	**2010 $'000**	2009 $'000	2009 $'000
Technical account					
Earned premiums, net of reinsurance					
Gross premiums written		**239,589**		408,549	
Outward reinsurance premiums		**(45,641)**		(44,967)	
Earned premiums, net of reinsurance	8		**193,948**		363,582
Allocated investment return transferred from the non-technical account			**62,299**		(80,891)
Claims incurred, net of reinsurance					
Claims paid					
Gross amount		**(256,205)**		(239,704)	
Reinsurers' share		**59,678**		34,317	
Net claims paid	9	**(196,527)**		(205,387)	
Change in the provision for claims					
Gross amount		**(60,178)**		(18,622)	
Reinsurers' share		**42,234**		(7,907)	
Change in the net provision for claims	9	**(17,944)**		(26,529)	
Claims incurred, net of reinsurance			**(214,471)**		(231,916)
Operating expenses	10		**(35,157)**		(49,917)
Balance on the technical account			**6,619**		858
Non-technical account					
Balance on the technical account			**6,619**		858
Investment income	12		**88,395**		81,528
Investment charges	12		**(26,096)**		(162,419)
Allocated investment return transferred to the technical account			**(62,299)**		80,891
Surplus on ordinary activities before tax			**6,619**		858
Tax on ordinary activities	13		**(2,663)**		1,997
Surplus on ordinary activities after tax			**3,956**		2,855

The accompanying notes are an integral part of these financial statements

Notes to the financial statements

For the year ended 20 February 2010

1 Accounting policies

General

The West of England Ship Owners Mutual Insurance Association (Luxembourg) is established in the Grand Duchy of Luxembourg as a mutual insurance association. As a mutual association under Luxembourg law, the Association has no share capital or subscribed capital.

In 1995, to comply with European Union and Luxembourg minimum insurance solvency margin requirements, a reserve fund, the Reserve deposit fund, was established, to which allocations are made periodically to meet the minimum solvency levels required.

Presentation of financial statements

These financial statements have been prepared in conformity with the law of 8 December 1994 (as amended) on financial statements with respect to insurance and reinsurance undertakings except for the fact that investments (including land and buildings) are not stated at cost but at valuation, and with the significant accounting policies generally adopted by the members of the International Group of P&I Clubs. A summary of the more important accounting policies is set out below.

The West of England Ship Owners Mutual Insurance Association (London) Limited

The financial statements have been drawn up to incorporate the terms of an agreement dated 18 October 1985 whereby the Association has reinsured the totality of the risks insured by The West of England Ship Owners Mutual Insurance Association (London) Limited up to 20 February 1986 for Class 2 and 20 February 1987 for Classes 3 and 4. The risks under Classes 3 and 4 may now be regarded as fully run off. In accordance with the agreement, the assets of The West of England Ship Owners Mutual Insurance Association (London) Limited have been held by that Association in trust for The West of England Ship Owners Mutual Insurance Association (Luxembourg) throughout the financial year.

Basis of consolidation

The consolidated financial statements have been prepared in US Dollars and incorporate the assets and liabilities of the Association and its group undertakings, listed below, at 20 February 2010 and the results of the year ended on that date. The group undertakings are 100% owned and are fully consolidated.

Group undertakings	Incorporated
Hydra Insurance Company Limited – The West of England Hydra Cell	Bermuda
International Shipowners Reinsurance Company SA	Luxembourg
The West of England Reinsurance (Hamilton) Limited	Bermuda
The West of England Ship Owners Insurance Services Limited	United Kingdom
West of England Insurance Services (Luxembourg) SA	Luxembourg

Classes and policy years

Members are insured in accordance with the Rules of the Association. Separate records are maintained for all Classes of insurance. Mutual policy balance accounts are maintained, individual accounts being held for all open policy years for each Class. The accumulated balance for all policy years is available, if required, for any exceptional future charges.

Calls and reinsurance premiums are credited or charged to the policy year to which cover relates except in the case of the reinsurance transactions with The West of England Ship Owners Mutual Insurance Association (London) Limited which are maintained separately. Claims are included in policy years by reference to the date of the incident and reinsurance recoveries are matched accordingly. General and management expenditure is allocated to Classes on the basis of calls and premium income and is charged to the policy year in which it is incurred. Investment income is allocated to policy years as determined by the Directors.

Notes to the financial statements

Continued

1 Accounting policies (continued)

Premiums

Gross premiums consist of calls, premiums and releases invoiced in respect of policies incepting prior to the balance sheet date together with movements in additional calls not yet charged which have been notified to Members. Reinsurance premiums are charged to the consolidated income and expenditure account on an accruals basis.

Debtors

Full provision is made for amounts owing which are more than one year in arrears and in respect of other balances considered to be doubtful.

Land and buildings

Land and buildings are stated at estimated market value, based on periodic evaluations by independent valuers. Buildings are amortised over their useful life on a straight-line basis, taking into account their residual value. The residual value and economic useful life of buildings are reassessed by the Directors on a periodic basis. Leasehold properties are written down over the period of the lease.

Investments

Investments are stated at market value or at values provided by independent brokers or managers, except for interest rate swaps and over-the-counter options which are valued at their intrinsic value and dealer-supplied valuations, respectively.

Investment income

Income from investments is included, together with the related tax credit, in the non-technical account on an accruals basis. Account is taken of dividend income when the related investment is declared ‘ex-dividend’.

Transfer of investment return

A transfer of investment return, including unrealised exchange gains and losses, expenses and charges, is made from the non-technical account to the technical account to reflect the return made on those assets directly attributable to the insurance business.

Claims incurred

Claims incurred comprises claims and related costs, including claims handling expenses, approved by the Directors and advances made on account of claims during the year, including the Association's share of claims under pooling agreements, and changes in provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years. Credit is taken for reinsurance recoveries due in respect of claims accounted for at the balance sheet date.

Claims outstanding

Statistical projections are calculated for claims outstanding at the balance sheet date based upon paid claims and estimates of notified outstanding claims. Provision is made for future claims handling expenses. Significant delays may occur before claims are settled and, accordingly, a substantial measure of experience and judgement is required in assessing the ultimate cost of outstanding and unnotified claims, which cannot be known with certainty at the balance sheet date.

Expenses

General and management expenditure is charged to the consolidated income and expenditure account on an accruals basis.

Pension costs

Defined benefit pension costs are charged to the income and expenditure account over the service lives of the eligible employees in accordance with the advice of qualified actuaries. Pension obligations relating to defined final salary benefits are determined on a projected unit method. Contributions are charged as an expense in the year of payment.

Tangible assets
Expenditure on significant tangible assets is capitalised and written off over four years in equal annual instalments. Other expenditure is expensed in the year of purchase.

Foreign currencies
Revenue and expense transactions are converted at the rate ruling at the date of the relevant transactions. Assets and liabilities in currencies other than US Dollars are converted to US Dollars at the rate prevailing at the balance sheet date. Exchange differences are analysed between realised and unrealised, and taken to the consolidated income and expenditure account. Exchange movements arising from the retranslation of brought forward reserve balances are taken directly to capital and reserves. Unsettled forward exchange transactions are translated into US Dollars at the forward rate prevailing on the balance sheet date for the remaining term of the contracts. Unrealised profit or loss on hedging transactions is charged in the consolidated income and expenditure account and disclosed as an asset or a liability in the balance sheet.

2 Investments

Land and buildings
Land and buildings comprise the Association's freehold premises at Tower Bridge Court, London, which are partly occupied by the Association, and a property in Hong Kong which is fully occupied by the Association. The London property was revalued at 20 February 2010 by Dron & Wright at £19.8 million ($30.6 million) and the Hong Kong property at 20 February 2010 by Jones Lang LaSalle Ltd at HK$46.6 million ($6.0 million). The resulting surpluses on revaluation were taken to the revaluation reserve.

If the properties were to be presented in conformity with Luxembourg law then the cost, depreciation and net book values would be as follows:

	2010 $’000	2009 $’000
Cost	**30,004**	30,004
Currency fluctuation adjustments	**(1,812)**	(3,199)
Accumulated depreciation brought forward	**(4,753)**	(4,357)
Depreciation charge for the year	**(396)**	(396)
Net book value	**23,043**	22,052

In determining the accumulated depreciation and depreciation charge above, which is based on an expected economic life of fifty years for the London property, no account has been taken of the Directors’ reassessment of the useful life and residual values of the buildings, nor of any reassessment of the relative values of land and buildings arising from the revaluation carried out at 20 February 2010.

3 Other financial investments

	2010 $’000	**2010 $’000**	2009 $’000	2009 $’000
	Market Value	**Cost**	Market Value	Cost
Shares and other variable yield securities and units in unit trusts	**151,636**	**121,828**	105,092	115,149
Debt securities and other fixed interest securities	**291,145**	**283,281**	313,368	314,914
Deposits with credit institutions	**–**	**–**	7,000	7,000
	442,781	**405,109**	425,460	437,063

Notes to the financial statements

Continued

3 Other financial investments (continued)

Debt securities include investments in collective investment schemes, the underlying investments of which are fixed interest securities.

Certain of the Association's investment managers have authority to invest, to a limited extent, for hedging purposes in derivative financial instruments. Derivatives can be broken down as follows:

	2010 $'000	2010 $'000	2010 $'000	2009 $'000	2009 $'000	2009 $'000
	Contract/ notional amount	Fair value asset	Fair value liability	Contract/ notional amount	Fair value asset	Fair value liability
Forward foreign exchange	37,327	1,251	637	14,786	281	1,043
Futures contracts	92,388	593	39	96,847	915	145
Interest rate swaps and credit default swaps	52,658	1,343	1,179	159,699	7,268	8,550
Options and warrants	58,210	357	65	67,031	1,595	337
Total at 20 February	240,583	3,544	1,920	338,363	10,059	10,075

At 20 February 2010 forward foreign exchange positions comprise net long positions in Chinese renminbi, Australian dollars and other currencies for a total value of $19.0 million (2009 $7.0 million) and net short positions in euros, Canadian dollars and other currencies for a total value of $18.4 million (2009 $7.8 million).

At 20 February 2010 futures contracts include US Dollar contracts for a notional commitment of $59.1 million (2009 $59.1 million) and other contracts denominated in Japanese yen and euros.

At 20 February 2010 swap contracts include US Dollar contracts for a notional commitment of $43.8 million (2009 $139.4 million) and other contracts denominated in euros, Brazilian real and Canadian dollars.

Derivative instruments are mainly used in the fixed income and short-term portfolios which represent 38% (2009 75%) of the total investments.

The Association itself and through its subsidiaries, International Shipowners Reinsurance Company SA and The West of England Reinsurance (Hamilton) Limited, has pledged certain investments as security for bank guarantees and other facilities with two banks. At 20 February 2010, the secured facilities for guarantees on behalf of Members and for security under the International Group of P&I Clubs Designated Reserves procedures, including an agreed margin where appropriate, amounted to $89.7 million (2009 $67.7 million) and guarantees issued against those facilities totalled $39.2 million (2009 $40.4 million). Total bank guarantees and letters of credit issued on behalf of the Association at 20 February 2010, including both the above and issuances against facilities unsecured by pledged investments, were:

	2010 $ million	2009 $ million
On behalf of Members	37.4	39.9
The International Group of P&I Clubs Designated Reserves procedures	22.7	22.7
Letters of credit and other guarantees	5.4	5.4

For guarantees issued on behalf of Members for claims, appropriate balance sheet provision has been made within claims outstanding.

4 Additional calls not yet charged

	2010 $'000	2009 $'000
Class 1 (Note 16)	**69,588**	144,607
Class 2 (Note 17)	**1,825**	1,760
	71,413	146,367

5 Other debtors

	2010 $'000	2009 $'000
Tax debtors	**79**	900
Mortgages	**662**	880
Investment debtors	**60,852**	61,715
Dividends receivable	**44**	50
Other debtors	**773**	770
	62,410	64,315

The mortgages are in respect of loans to Directors of West of England Insurance Services (Luxembourg) SA, a subsidiary, for house improvement or purchase. They are secured on the respective properties and other assets, have an interest rate of 5% (2009 5%) and are repayable over various periods up to the end of each Director's service.

Tax debtors include $ nil deferred tax (2009 $825,000) arising on taxable losses to be carried forward and offset against future taxable gains.

6 Tangible assets

	2010 $'000	2009 $'000
Cost		
At beginning of year	**894**	904
Additions	**155**	237
Disposals	**(298)**	(247)
At end of year	**751**	894
Depreciation		
At beginning of year	**552**	594
Provided during year	**142**	164
Disposals	**(222)**	(206)
At end of year	**472**	552
Net Book Value	**279**	342

Tangible assets consist of motor vehicles.

Notes to the financial statements

Continued

7 Other creditors

	2010 $'000	2009 $'000
UK Corporation Tax	**1,798**	482
Luxembourg municipal and state taxes	**1,232**	1,003
Accrued expenses	**917**	601
Investment creditors	**24,880**	80,674
Other creditors	**7,903**	13,366
	36,730	96,126

UK Corporation Tax includes $288,000 (2009 $283,000) of deferred tax arising on timing differences and $1,246,000 (2009 $ nil) deferred tax arising on unrealised gains on equity investments. All other creditors are payable within one year.

8 Earned premiums, net of reinsurance

2010 $'000	Class 1	Class 2	WoE Hamilton	**Total**
Gross premiums by policy year				
Policy year 2009/10	198,520	7,291	–	**205,811**
Policy year 2008/09	57,743	222	–	**57,965**
Policy year 2007/08	49,570	906	–	**50,476**
Other	214	77	–	**291**
Total gross premiums	306,047	8,496	–	**314,543**
Movement in additional calls not yet charged (Note 4)	(75,019)	65	–	**(74,954)**
	231,028	8,561	–	**239,589**
Reinsurance premiums	(46,090)	(1,022)	1,471	**(45,641)**
Earned premiums, net of reinsurance	**184,938**	**7,539**	**1,471**	**193,948**

2009 $'000	Class 1	Class 2	WoE Hamilton	Total
Gross premiums by policy year				
Policy year 2008/09	224,511	7,275	–	231,786
Policy year 2007/08	24,028	162	–	24,190
Policy year 2006/07	29,977	944	–	30,921
Other	(137)	44	–	(93)
Total gross premiums	278,379	8,425	–	286,804
Movement in additional calls not yet charged	121,771	(26)	–	121,745
	400,150	8,399	–	408,549
Reinsurance premiums	(48,641)	(986)	4,660	(44,967)
Earned premiums, net of reinsurance	351,509	7,413	4,660	363,582

Direct insurance premiums are all classified as marine, aviation and transport. All direct insurance contracts were concluded in a member state of the European Union other than the member state of the Association's principal office.

9 Insurance claims and loss adjustment expenses

	2010 $'000 Class 1	2010 $'000 Class 2	2010 $'000 Reinsurance of WoE (London)	2010 $'000 WoE Hamilton	2010 $'000 Total
Gross claims paid and loss adjustment expenses					
– Members' claims	221,833	7,850	35	–	**229,718**
– International Group of P&I Clubs	26,487	–	–	–	**26,487**
	248,320	7,850	35	–	**256,205**
Reinsurance recoveries on claims paid					
– Recoveries from other members of the International Group of P&I Clubs	(34,029)	–	–	–	**(34,029)**
– Recoveries from the Group Excess Loss reinsurance	(4,856)	–	–	–	**(4,856)**
– Other reinsurances and WoE Hamilton	(21,064)	(914)	–	1,185	**(20,793)**
Reinsurance recoveries on claims paid	(59,949)	(914)	–	1,185	**(59,678)**
Net claims paid and loss adjustment expenses	**188,371**	**6,936**	**35**	**1,185**	**196,527**
Insurance liabilities, gross	685,454	17,756	33	–	**703,243**
Reinsurers' share of insurance liabilities					
– Recoveries from other members of the International Group of P&I Clubs	(49,008)	–	–	–	**(49,008)**
– Recoveries from the Group Excess Loss reinsurance	(52,593)	–	–	–	**(52,593)**
– Other reinsurances and WoE Hamilton	(158,332)	(2,887)	–	15,878	**(145,341)**
Reinsurers' share of insurance liabilities	(259,933)	(2,887)	–	15,878	**(246,942)**
Net insurance liabilities carried forward	**425,521**	**14,869**	**33**	**15,878**	**456,301**
Net insurance liabilities brought forward	410,856	16,610	33	10,858	438,357
Change in the net provision for insurance liabilities	**14,665**	**(1,741)**	–	**5,020**	**17,944**
Net insurance claims and loss adjustment expenses	**203,036**	**5,195**	**35**	**6,205**	**214,471**

	2010 $'000 Gross	2010 $'000 Reinsurance	2010 $'000 Net
Current year claims and loss adjustment expenses	221,248	(16,994)	**204,254**
Movement in cost of prior year claims and loss adjustment expenses	95,135	(84,918)	**10,217**
Total insurance claims and loss adjustment expenses	**316,383**	**(101,912)**	**214,471**
Claims paid and loss adjustment expenses	256,205	(59,678)	**196,527**
Change in the provision for insurance liabilities	60,178	(42,234)	**17,944**
Total insurance claims and loss adjustment expenses	**316,383**	**(101,912)**	**214,471**

Claims outstanding includes $88.6 million (2009 $93.5 million) in respect of other clubs' claims through the International Group Pool, including appropriate provision for claims incurred but not reported. Recoveries shown include amounts statistically projected as recoverable against claims incurred but not reported.

Notes to the financial statements

Continued

9 Insurance claims and loss adjustment expenses (continued)

	2009 $'000 Class 1	2009 $'000 Class 2	2009 $'000 Reinsurance of WoE (London)	2009 $'000 WoE Hamilton	2009 $'000 Total
Gross claims paid and loss adjustment expenses					
– Members' claims	205,891	7,270	58	–	213,219
– International Group of P&I Clubs	26,485	–	–	–	26,485
	232,376	7,270	58	–	239,704
Reinsurance recoveries on claims paid					
– Recoveries from other members of the International Group of P&I Clubs	(21,344)	–	–	–	(21,344)
– Recoveries from the Group Excess Loss reinsurance	(6,195)	–	–	–	(6,195)
– Other reinsurances and WoE Hamilton	(19,906)	(2,033)	–	15,161	(6,778)
Reinsurance recoveries on claims paid	(47,445)	(2,033)	–	15,161	(34,317)
Net claims paid and loss adjustment expenses	184,931	5,237	58	15,161	205,387
Insurance liabilities, gross	625,665	17,367	33	–	643,065
Reinsurers' share of insurance liabilities					
– Recoveries from other members of the International Group of P&I Clubs	(56,709)	–	–	–	(56,709)
– Recoveries from the Group Excess Loss reinsurance	(38,490)	–	–	–	(38,490)
– Other reinsurances and WoE Hamilton	(119,610)	(757)	–	10,858	(109,509)
Reinsurers' share of insurance liabilities	(214,809)	(757)	–	10,858	(204,708)
Net insurance liabilities carried forward	410,856	16,610	33	10,858	438,357
Net insurance liabilities brought forward	372,894	16,449	55	22,430	411,828
Change in the net provision for insurance liabilities	37,962	161	(22)	(11,572)	26,529
Net insurance claims and loss adjustment expenses	222,893	5,398	36	3,589	231,916

	2009 $'000 Gross	2009 $'000 Reinsurance	2009 $'000 Net
Current year claims and loss adjustment expenses	201,181	(6,500)	194,681
Movement in cost of prior year claims and loss adjustment expenses	57,145	(19,910)	37,235
Total insurance claims and loss adjustment expenses	258,326	(26,410)	231,916
Claims paid and loss adjustment expenses	239,704	(34,317)	205,387
Change in the provision for insurance liabilities	18,622	7,907	26,529
Total insurance claims and loss adjustment expenses	258,326	(26,410)	231,916

10 Operating expenses

	2010 $'000	2009 $'000
Directors' fees	**339**	343
Audit and regulatory fees	**378**	512
Other expenses	**11,762**	14,721
Depreciation	**377**	467
Loss / (profit) on disposal of fixed assets	**18**	(33)
Administrative expenses	**12,874**	16,010
Acquisition costs	**22,283**	33,907
	35,157	49,917

Included within acquisition costs is $13.9 million (2009 $24.3 million) in respect of commission.

11 Staff costs

Staff costs disclosed below are in respect of the employees and Directors of West of England Insurance Services (Luxembourg) SA, together with the costs of the five (2009 five) staff directly employed by the Association and International Shipowners Reinsurance Company SA. The total costs for all staff are:

	2010 $'000	2009 $'000
Wages and salaries	**15,778**	16,490
Other staff related costs	**1,068**	1,427
Social security costs	**1,432**	1,966
Other pension costs	**8,384**	11,394
	26,662	31,277

The average weekly number of employees during the year, by department, was:

	2010 Number	2009 Number
Claims	**74**	73
Underwriting	**27**	27
Administration	**39**	43
	140	143

The majority of the staff is included in a defined benefit pension scheme. From 30 June 2004 the scheme was changed from one where benefits provided were based on final salaries to a cash contribution scheme where benefits are based on contributions linked to annual salaries and inflation.

The assets of the scheme are held in a separate fund, administered by trustees, and are invested independently of the Company's assets. Funding requirements are assessed by an independent professionally qualified actuary on the basis that the deficit for service up to 30 June 2004 is fully funded by 31 December 2012 and that the cost of benefits for service subsequent to that date is spread over the remaining service period of the staff concerned.

Notes to the financial statements

Continued

11 Staff costs (continued)

At 20 February 2010 the market value of the scheme's assets, on an IAS 19 valuation basis, was £71.8million ($111.0 million) (2009 £62.3 million/$89.2 million) and the surplus £2.1 million ($3.2 million) (2009 a deficit of £1.1 million/$1.6 million). The principal assumptions underlying this valuation were an aggregate investment return of 6.90% (5.60%) and a discount rate of 5.8% (6.0%). The discount rate required by IAS 19 is based upon high quality corporate bond yields with a duration consistent with that of the scheme liabilities. The average duration of the scheme's liabilities is approximately 23 years.

The rate at which the Company funds the scheme has been set as a result of a valuation using government bond yields and mortality assumptions in line with required scheme valuation practice, with a view to fully funding the scheme on that basis by 31 December 2012, in line with a recovery plan approved by the UK pensions regulator. The Directors intend to maintain the rate of funding in order to meet the requirements of the plan.

A small number of staff have other pension arrangements provided.

12 Investment income

	2010 $'000	2009 $'000
Income from land and buildings	**1,249**	1,440
Investment income	**9,634**	11,321
Gains on realisation of investments	**21,055**	49,610
Unrealised gains on investments	**48,829**	1,559
Realised exchange gains	**1,685**	16,494
Unrealised forward currency gains	**1,472**	–
Unrealised exchange gains	**4,471**	1,104
Total investment income	**88,395**	81,528
Investment management expenses	**(1,679)**	(2,107)
Losses on realisation of investments	**(17,876)**	(63,959)
Unrealised losses on investments	**(1,903)**	(71,461)
Realised exchange losses	**(3,041)**	(173)
Unrealised exchange losses	**(1,597)**	(24,719)
Total investment charges	**(26,096)**	(162,419)
Total investment return	**62,299**	(80,891)

The investment return has been attributed as follows:

	2010 $'000	2009 $'000
Class 1	**50,651**	(66,794)
Class 2	**1,406**	(1,568)
The West of England Reinsurance (Hamilton) Limited	**9,842**	(12,929)
	61,899	(81,291)
Reserve deposit fund	**400**	400
	62,299	(80,891)

13 Taxation

	2010 $'000	2009 $'000
Luxembourg municipal and state taxes	**394**	17
UK Corporation Tax:		
Current tax on income for the period	**2,524**	(1,722)
Adjustment in respect of prior periods	**75**	16
Deferred tax	**(330)**	(308)
	2,269	(2,014)
	2,663	(1,997)

14 Summarised income and expenditure account by Class

2010 $'000

	Class 1	Class 2	Reinsurance of WoE (London)	WoE Hamilton	**Total**
Earned premiums, net of reinsurance (Note 8)	184,938	7,539	–	1,471	**193,948**
Claims incurred, net of reinsurance (Note 9)	(203,036)	(5,195)	(35)	(6,205)	**(214,471)**
Net operating expenses (Note 10)	(33,413)	(1,678)	–	(66)	**(35,157)**
	(51,511)	666	(35)	(4,800)	**(55,680)**
Investment return, net of tax (Notes 12 and 13)	48,460	1,334	–	9,842	**59,636**
Surplus/(deficit) for the financial year	**(3,051)**	**2,000**	**(35)**	**5,042**	**3,956**

2009 $'000

	Class 1	Class 2	Reinsurance of WoE (London)	WoE Hamilton	Total
Earned premiums, net of reinsurance (Note 8)	351,509	7,413	–	4,660	363,582
Claims incurred, net of reinsurance (Note 9)	(222,893)	(5,398)	(36)	(3,589)	(231,916)
Net operating expenses (Note 10)	(47,994)	(1,857)	–	(66)	(49,917)
	80,622	158	(36)	1,005	81,749
Investment return, net of tax (Notes 12 and 13)	(64,456)	(1,509)	–	(12,929)	(78,894)
Dividend paid by WoE Hamilton to parent	20,000	–	–	(20,000)	–
	(44,456)	(1,509)	–	(32,929)	(78,894)
Surplus/(deficit) for the financial year	36,166	(1,351)	(36)	(31,924)	2,855

Notes to the financial statements

Continued

15 Reserves

2010 $'000

	Reserve deposit fund	**Revaluation reserve**	**Class 1 policy year reserve account**	**Income and expenditure account**	**Total reserves**
As at 20 February 2009	18,450	5,359	2,805	134,160	**160,774**
Revaluation	–	3,911	–	–	**3,911**
Exchange	–	382	–	86	**468**
Surplus for financial year (Note 14)	–	–	–	3,956	**3,956**
Transfers from income and expenditure account	400	–	48,105	(48,505)	–
Release from reserve	–	–	(25,000)	25,000	–
At 20 February 2010	**18,850**	**9,652**	**25,910**	**114,697**	**169,109**

2009 $'000

	Reserve deposit fund	Revaluation reserve	Class 1 policy year reserve account	Income and expenditure account	Total reserves
As at 20 February 2008	18,050	20,591	48,878	86,098	173,617
Revaluation	–	(10,226)	–	–	(10,226)
Exchange	–	(5,006)	–	(466)	(5,472)
Deficit for financial year (Note 14)	–	–	–	2,855	2,855
Transfers from income and expenditure account	400	–	(46,073)	45,673	–
At 20 February 2009	18,450	5,359	2,805	134,160	160,774

The Class 1 policy year reserve account represents all Class 1 investment income not yet allocated to specific policy years by the Directors with the exception of amounts relating to unrealised net gains on land and buildings which are held in the revaluation reserve.

Reserves by Class	**2010 $'000**	2009 $'000
Class 1:		
– Open years (Note 16)	**59,036**	59,573
– Closed years	**35,227**	27,333
– Hydra Insurance Company Ltd	**(2,383)**	4,146
	91,880	91,052
Class 2:		
– Open years (Note 17)	**3,551**	2,997
– Closed years	**15,746**	14,197
	19,297	17,194
Other reserves	**57,932**	52,528
Total reserves at 20 February	**169,109**	160,774

Other reserves consist of reserves not specific to Class including The West of England Reinsurance (Hamilton) Ltd and the Reserve deposit fund.

15 Reserves (continued)

Revaluation reserve by Class

	2010 $'000	2009 $'000
The balance on the revaluation reserve is attributed to Classes as follows:		
Class 1	**9,234**	5,037
Class 2	**380**	284
Other	**38**	38
	9,652	5,359

16 Class 1 Policy Year position at 20 February 2010

$'000

	2007/08	2008/09	2009/10	Unallocated investment income	Total
Calls and premiums	282,679	282,254	198,519		763,452
Future additional calls	–	34,548	35,040		69,588
Gross premiums	282,679	316,802	233,559		833,040
Reinsurance premiums	(58,298)	(54,790)	(53,873)		(166,961)
Acquisition costs	(24,938)	(27,855)	(22,156)		(74,949)
Net premiums	**199,443**	**234,157**	**157,530**		**591,130**
Investment income	20,000	–	25,000	35,144	80,144
Net income	**219,443**	**234,157**	**182,530**	**35,144**	**671,274**
Net claims paid	(158,691)	(80,667)	(30,981)		(270,339)
Net claims outstanding	(41,938)	(107,467)	(151,488)		(300,893)
Net claims incurred	**(200,629)**	**(188,134)**	**(182,469)**		**(571,232)**
Administration expenses	(14,535)	(14,670)	(11,801)		(41,006)
Net expenditure	**(215,164)**	**(202,804)**	**(194,270)**		**(612,238)**
Forecast balance on Class 1 open years at 20 February 2010	**4,279**	**31,353**	**(11,740)**	**35,144**	**59,036**

Based on the position at 20 February 2010 a resolution will be put to the Board of Directors at their meeting on 19 May 2010 to close the 2007/08 policy year. In addition, under the same resolution, the Board of Directors will be asked to allocate $25 million to policy year 2009/10 from the Class 1 policy year reserve account.

Future additional calls represent 22.5% for the 2008/09 policy year (due 20 August 2010) and 30% for Policy Year 2009/10 (due 20 August 2010). Additional calls are chargeable on the advance call excluding the charge to Members for The International Group Excess of Loss Reinsurance premium. In addition, release calls have been set at 15% for policy year 2007/08, at 20% for policy year 2008/09 and at 30% for policy year 2009/10. The estimated yields of these releases, if charged, would be $21.4 million, $30.9 million and $43.1 million respectively. No account of these releases has been taken in the policy year figures above. Under the resolution referred to above, the Board of Directors will be asked to review these releases for the remaining open years and to set them at 5% for policy year 2008/09 and 30% for policy year 2009/10. The estimated yields of these releases would be $7.7 million and $43.1 million respectively if charged.

Notes to the Financial Statements

Continued

16 Class 1 Policy Year position at 20 February 2010 (continued)

The following disclosure is in conformity with the agreed accounting standards of the International Group of Protection and Indemnity Associations:

(a) Disclosure relating to calls	2007/08 $'000	2008/09 $'000	2009/10 $'000
Additional calls and releases already charged	83,085	70,845	8,216
Estimated product of a further 10% additional call	14,200	15,500	14,400

The additional call products shown take account of calls already charged, and Members released, at 20 February 2010 and therefore do not represent 10% of the original advance call for each year. The additional call is based on the advance call excluding the charge to Members for The International Group Excess of Loss Reinsurance premium.

(b) Disclosure relating to claims and reinsurance recoveries	Closed years $'000	2007/08 $'000	2008/09 $'000	2009/10 $'000
Claims paid – own business		(189,644)	(71,675)	(27,865)
Claims paid – other clubs' Pool claims		(31,645)	(10,119)	(3,116)
Gross claims paid		(221,289)	(81,794)	(30,981)
Recoveries from the Pool		45,087	–	–
Recoveries from the Group Excess Loss reinsurance		–	–	–
Recoveries from The West of England Reinsurance (Hamilton)		961	–	–
Recoveries from other reinsurances		7,046	–	–
Reinsurance recoveries on claims paid		53,094	–	–
Recoveries from Hydra Insurance Company Ltd		9,504	1,127	–
Reinsurance recoveries on claims paid (including Hydra)		62,598	1,127	–
Outstanding claims – own business	(212,838)	(115,362)	(117,837)	(150,783)
Outstanding claims – other clubs' Pool claims	(38,764)	(11,107)	(6,880)	(31,883)
Gross outstanding claims (Note 9)	(251,602)	(126,469)	(124,717)	(182,666)
Recoveries from the Pool	23,776	22,195	1,537	1,500
Recoveries from the Group Excess Loss reinsurance	36,105	10,183	–	–
Recoveries from Hydra Insurance Company Ltd	6,203	8,238	2,703	13,350
Recoveries from The West of England Reinsurance (Hamilton)	7,586	5,585	1,047	833
Recoveries from other reinsurances	77,493	38,330	11,963	15,495
Reinsurance recoveries on outstanding claims	151,163	84,531	17,250	31,178
Recoveries from Hydra Insurance Company Ltd	(5,605)	(2,531)	(2,703)	(13,350)
Reinsurance recoveries on outstanding claims (Note 9)	145,558	82,000	14,547	17,828

The figure for outstanding claims includes appropriate provision for claims incurred but not reported and future claims handling expenses. Recoveries include amounts statistically projected as recoverable against claims incurred but not reported. Recoveries from the Pool include the International Group's retained share of the Excess of Loss programme.

17 Class 2 Policy Year position at 20 February 2010

$'000	2005/06	2006/07	2007/08	2008/09	2009/10	Unallocated investment income	Total
Calls & premiums	8, 746	8,595	8,066	7,497	7,291		40,195
Future additional calls	–	–	–	881	944		1,825
Gross premiums	8,746	8,595	8,066	8,378	8,235		42,020
Reinsurance premiums	(1,356)	(1,117)	(953)	(997)	(1,000)		(5,423)
Acquisition costs	(683)	(605)	(590)	(635)	(687)		(3,200)
Net premiums	**6,707**	**6,873**	**6,523**	**6,746**	**6,548**		**33,397**
Investment income	75	–	–	–	–	6,695	6,770
Net income	**6,782**	**6,873**	**6,523**	**6,746**	**6,548**	**6,695**	**40,167**
Net claims paid	(5,098)	(3,801)	(3,747)	(3,223)	(1,240)		(17,109)
Net claims outstanding	(477)	(686)	(2,420)	(3,880)	(6,110)		(13,573)
Net claims incurred	**(5,575)**	**(4,487)**	**(6,167)**	**(7,103)**	**(7,350)**		**(30,682)**
Administration expenses	(1,202)	(1,225)	(1,316)	(1,221)	(970)		(5,934)
Net expenditure	**(6,777)**	**(5,712)**	**(7,483)**	**(8,324)**	**(8,320)**		**(36,616)**
Forecast balance on Class 2 open years at 20 February 2010	**5**	**1,161**	**(960)**	**(1,578)**	**(1,772)**	**6,695**	**3,551**

Investment income includes all amounts earned up to 20 February 2010. Based on the position at 20 February 2010 a resolution will be put to the Board of Directors at their meeting on 19 May 2010 to close the 2005/06 policy year following an allocation of $75 thousand from investment income.

Future additional calls represents 20% for each of the 2008/09 and 2009/10 policy years, due 20 August 2010 and 2011 respectively. In addition, releases have been set at 15% for all open years with the exception of policy year 2009/10 which is set at 30%. No account of these releases has been taken in the policy year figures above.

18 Average Expense Ratio

In accordance with Schedule 3 of the International Group Agreement 2008, all members of the International Group of P&I Clubs are required to prepare and disclose an 'average expense ratio' which expresses expenses as a percentage of total income, calculated as a five year moving average. The figure for the period ended 20 February 2010 is 13.79% (2009 13.82%).