Notices to Members

No. 11 2008/2009 - Class 1 Policy Year Balances

December 2008

Dear Sirs

CLASS 1 POLICY YEAR BALANCES

At their meeting on 3 December 2008 the Board reviewed the latest Class 1 policy year balances.

BACKGROUND

In the Club's Notice to Members No. 7 dated September 2008 the Managers advised that the Board, when reviewing the Class 1 policy year positions at its September meeting, was concerned that two factors in particular appeared to be affecting the business, the second of which seemed unprecedented at that time.

First, initial indications of the likely cost of claims for the current policy year, 2008, were inconclusive. The assumption made at the beginning of the year that claims costs for 2008 might be similar overall to claims costs for 2006 and 2007, the most expensive years on record, could not prudently be revised at so early a stage in the year, notwithstanding any possible improvement that might eventually result from the slow-down in world trade.

In reviewing the most recent claims figures in mid-November the Board decided that any revision to this assumption still remains premature. Whilst to date in the current year Pool claims and claims from the Club's own Members are lower in number and in cost than the previous two years at the same stage, claims costs for some recent policy years have continued to increase, particularly for claims involving the Pool in 2006. A similar development in 2008 cannot be ruled out at this stage.

Secondly, and of much more profound impact, were the events then affecting investment markets. These had led the Board to conclude in September that there was a real risk that no investment income might be earned in the current year with the result that, if claims levels continued to be as high as for recent policy years, there would be a corresponding reduction in the Club's reserves at February 2009.

NOVEMBER 2008 POSITION

Whatever the impact of the events affecting investment markets may have been in early September it is now clear that those events, combined with subsequent adverse currency movements, have had an unprecedented negative impact on virtually all the Club's assets. As a result, a significant investment loss may now be anticipated by February 2009. In view of current investment volatility it is very difficult to predict what this may be at that date, but the Board has made allowance for the fact that investment, currency and property valuation losses might themselves cause the free reserve to reduce by more than $100 million by then.

The Board considers that there is no prospect that such a loss, much of which is unrealized, can be reversed before February 2009, or indeed for many months to come. The Board takes no comfort from the fact that investment and currency losses are certain to be profoundly damaging to any marine insurance business with a similar balanced investment strategy to the Club's.

In the circumstances the Board has decided to take the necessary decisions now to address the situation before February 2009 and certainly well before May 2009 when, in normal circumstances, it would next review the Class 1 policy year positions.

The Board's decisions are based on the following considerations:

* The measures taken should so far as possible ensure that the Club is in a similar financial position overall at February 2009, with reserves in excess of $150 million, as it was in at February 2008.

This level of free reserve is in line with the prospective solvency requirement (SCR) set by reference to the new Solvency 2 rules as calculated in accordance with the latest quantitative impact study (QIS 4) carried out in July 2008.

* There can be no assumption that investment losses to-date can be recovered by February 2009, or that further investment losses may not occur before or after that date.

* There can be no assumption that claims levels will in fact be lower for 2008 than for recent policy years or that claims will not increase in the coming months despite early indications to the contrary.

* Calls set for any open years should primarily address projected results for those years individually on the basis that no investment income is likely to be available to support any open year, or any adverse movements on any closed years as may occur in the future.

CALL DECISIONS DECEMBER 2008

2006 / 2007

In September 2006 the Board set a release for the year of 50% of which 35% was a deferred call to provide for an increase in the Club's reserves and 15% a margin to protect against unforeseen contingencies for the 2006 year itself.

For reasons of mutuality, the Board no longer considers it appropriate that the 2006 policy year should carry so high a proportion of any funding requirement.

However, as indicated in previous Notices, 2006 continues to be the most expensive year on record especially in relation to claims involving the Pool from across the industry. It is therefore possible that the forecast deficit for the year may continue to increase.

Taking both factors into account the Board has decided to cancel the 50% deferred call and release set in September 2006 and instead call an additional call of 20% of advance call (equivalent to 15% of ETC including Group reinsurance costs) to ensure that the year balances without the allocation of further investment income and has a margin to cover any contingencies for closed policy years.

The 20% call will be payable by 20 January 2009.

2007 / 2008

Although anticipated claims costs for 2007 have not materially changed since August, claims are in total projected to be higher than for any year except 2006. The Board has assumed that no further investment income can be allocated to it in the future and has therefore decided to call an additional call of 35% of advance call (equivalent to 25% of ETC) payable by 20 August 2009 to cover the projected deficit.

2008/2009

As already noted, the Board has assumed that claims costs for 2008 will ultimately be similar to the most recent policy years, and that, unlike any previous year, the forecast result will not be supported by any investment income at all. The original forecast additional call of 20% which is due for payment by 20 August 2009 shall remain payable by that date. In addition a further additional call of 45% of advance call (equivalent to 33% of ETC) has been set for payment in two equal instalments, the first in January 2010, and the second in August 2010.

The Board has set the dates for payment well into the future so that if against current expectations unrealized investment losses are in the meantime recovered and/or if claims levels do reduce the decision to call some or all of either instalment can be reconsidered.

RELEASES (2006-2008)

The further additional calls set for the policy years 2006, 2007 and 2008 as set out in this Notice are expected to generate approximately $140 million if called in full.

In view of the uncertainty in the outlook in investment markets and in claims development and in order to protect against contingencies or any other unforeseen circumstances, the Board has decided that releases need to be set at higher levels than might usually be required. Releases for open policy years have therefore been set as follows:

2006 : 20% of advance call with the year scheduled to be closed in May 2009.

2007 : 30% of advance call with the year scheduled to be closed in May 2010.

2008 : 40% of advance call with the year scheduled to be closed in May 2011.

The Board and Managers regret that these measures are necessary, but are concerned that the extent of the actual and potential impact of these extraordinary investment results and of the high level of claims on the Club are addressed adequately and as soon as possible, so that not only is the Club positioned to confront the challenges presented by the current and future operating environment, but also so that Members are provided with as much certainty as is practical.

Please do not hesitate to raise any questions with the Managers in the usual way.

Yours faithfully
For: **West of England Insurance Services (Luxembourg) S.A.**
(As Managers)

P E Spendlove
Managing Director