Report and Accounts 2009

Chairman's Statement 2009

FINANCIAL HIGHLIGHTS at 20 February					
($ million)	2005	2006	2007	2008	**2009**
Net assets*	541.6	551.9	658.8	585.4	**599.2**
Outstanding claims	(407.3)	(419.4)	(454.1)	(411.8)	**(438.4)**
Free reserves	134.3	132.5	204.7	173.6	**160.8**

* including forecast additional calls

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Chairman's Statement

When I became Chairman in February last year, no one could have imagined that 2008 would be quite as challenging as it has proved to be. The crisis in the banking sector and its ultimate effect on investment and financial markets by late last summer has been profound not only for our business but for every business operating in the maritime world and indeed elsewhere. We can only hope that those whose outlook for the next twelve months looks more encouraging are proved correct.

The most obvious problem that confronted us during the year was the rapid and unprecedented collapse in investment performance which took us from a positive overall return last May to an overall investment loss, including unrealised valuation losses on property, of close to $100 million by the financial year end. This required us to raise additional capital last December to ensure that our overall financial position in February 2009 remained substantially unchanged from the position last February. As a result, free reserves are only marginally down from $174 million to $161 million over that period and remain at a level well in excess of the prospective requirements prescribed by the new Solvency 2 regulations which the European Parliament has now confirmed are to enter into effect in October 2012.

Measures of this kind are never easy and, for our Members, will always be unwelcome especially at a time of collapsing freight rates. However, the positive news today is that it seems likely that the decisions taken last December will in fact have taken full account of what looks to be the low point in the global sell-off. It is encouraging to see that since the year end some sense of normality has begun to return to investment markets. More than a quarter of the year end's unrealised loss has since been recovered as markets have stabilised. We cannot, of course, know whether or not this better trend will continue but even if there are more negative months ahead, there is some hope that the lows of November 2008 and February 2009 may not recur.

The investment loss suffered during 2008 was unprecedented. Indeed the Club had experienced no overall negative return for any individual policy year for over 20 years. The fact that it happened has reinforced the Board's resolve, expressed in 2007, that the setting of premium should take no account of investment income. Significant progress in meeting this requirement was achieved at renewal for 2008 and again at renewal this year: but as always, a satisfactory underwriting result for the current year will only materialise if claims costs prove to be within expectations.

A significant problem I highlighted last year was the apparently inexorable rise in the frequency and value of large claims. For 2006 and 2007 the cost and frequency of large claims reached record levels and greatly exceeded forecasts for claims involving our Members and indeed for claims involving the Pool. For the first half of 2008 this trend appeared to be continuing, but the indications for the second half of the year are more encouraging. Both the number and value of large claims has apparently reduced, a trend which appears so far to be continuing into 2009. In some respects this apparent change in the claims outlook may perhaps be explained by simple economic factors. Although of little comfort to shipowners, the universal and dramatic reduction in freight rates across most shipping sectors from September last year and a reduction in both the value and demand for commodities may have had a positive impact on claims costs in part because asset values, in particular vessel values, have fallen when compared with the previous two years. Any longer-term claims trend is however virtually impossible to predict. When commodity prices recover and freight rates stabilise, asset prices may also recover with a consequent increase in the cost of claims. The cost of certain categories of claim is anyway unlikely to reduce regardless of these market movements. The cost of personal injury and environmental damage will doubtless continue to rise along with liabilities set by reference to International Conventions more of which are scheduled to enter into force in the coming years. Efforts by our Managers to ensure balanced underwriting without dependence on investment returns must therefore be rigorously maintained. The claims extremes combined with the investment volatility of the last two years require us to review again whether or not our long-standing investment strategy remains appropriate. A strategic allocation to fixed income, equity, absolute return and property, primarily Tower Bridge Court in London, has served the Club well for many years. For the time being it is being maintained.However, if the sort of market conditions experienced since the middle of last year are to recur more frequently, the prudent priority may be to focus more on capital preservation than on seeking outperformance from the sort of returns that have been achieved for many of the last 20 years. To ensure that our strategic direction is robust and that any revisions that are made are critically re-evaluated regularly, the Board has decided to appoint to the Board of ISRe, the Club's reinsurance and investment subsidiary responsible for investment management, two non-executive Directors. Neither of the appointments will be linked to a particular investment institution, and each Director will have independent professional expertise with specific knowledge and experience not only in particular asset classes but also in investment strategy.

Increased claims costs and investment volatility will always introduce uncertainty into our business. The part played by our reinsurers in moderating these risks continues to be of crucial importance from year to year. The value of the International Group's claims sharing arrangements through the Pool, and the Group's excess of loss reinsurance programme, cannot be overstated since together they continue to be the most cost-effective way of delivering for our Members the highest level and scope of cover that is commercially available.

A year ago the Group's captive, Hydra, which underwrites some of the risks which are currently pooled, and the 25% co-insurance retained from the first layer of the Group's reinsurance programme for claims above $50 million, was the subject of some criticism because it too had needed to call additional capital to pay its share of the exceptional Pool claims experienced in 2006 and 2007. The better news this year is that the extra capital called in 2007 appears to be all that is necessary to maintain Hydra's funding requirements for the time being not least because Hydra too appears to be benefitting from a more benign claims experience in 2008. Pool claims for the past twelve months have so far been less frequent and less expensive than for 2006 and 2007.

Short-term volatility for Hydra is inevitable as the frequency of large claims varies from year to year, but over the longer-term, Hydra's objective remains 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.

Our relationships, developed over many years, with our own reinsurers who reinsure risks which we retain within the Club retention are as important to us as those we have with the Group's reinsurers. For the 2006 and 2007 policy years in particular they proved to be of great value but they appear less likely to be called upon to any extent if at all for 2008 if initial claims indications are sustained at the present levels and frequency.

In November 2008 the 2001 Bunkers Convention entered into force. Although the limits of liability are not as high as for some other conventions, the Bunkers Convention has more or less universal application to all commercial vessels. More importantly, it makes mandatory the provision of certificates of financial responsibility ('Blue Cards') by insurers and provides for rights of direct action. In view of the number of ships that require convention certificates to enable them to trade to signatory countries, there had initially been concern that individual State administrations would be unable to cope with demand.
In the event, the concern proved unfounded, but in time the Hazardous and Noxious Substances (HNS) Convention, the Wreck Removal Convention and revisions to the Athens Convention are also due to enter into force and they too will each require the provision of 'Blue Cards' with higher guarantees than for the Bunkers Convention. Shipowners will therefore be obliged to respond not only for increased levels of responsibility for liabilities arising under each Convention, but also for the proliferation of bureaucratic requirements that will go with them.

During the last two or three years a prosperous shipping market raised a number of additional important concerns. In particular projected growth in the world fleet highlighted limitations in the supply of trained and experienced seafarers. A possible positive consequence of the current downturn may be that the shortage of new and properly trained seafarers will have less impact for the time being at least as fewer ships enter service than planned and others are scrapped. But depressed shipping markets in the past have frequently led to less satisfactory standards of operation as crewing, training and maintenance budgets are cut. There is a need for shipowners to reverse this tendency and not let their standards fall. The attitude of legislators around the world, and in particular the evident desire, for instance in the US and EU, to criminalise seafarers, however unreasonable, will make any reduction in safe operating standards particularly onerous. Regardless of the economic climate, Group Clubs remain committed to the eradication not only of sub-standard ships but also of poor quality vessel managements.

Whilst on the subject of seafarers two issues of particular relevance gained prominence during the year. Of great concern to shipowners is the escalation in acts of piracy in the Gulf of Aden and elsewhere off the African Coast which directly threatens the safety and lives of crews and others on board. National Governments have at last been persuaded to co-ordinate their efforts to fight this menace with the formation of protective arrangements for vessels transiting the region, but the response has been slow and often the rules of engagement less clear and less forceful than may be necessary to ensure a more permanent restoration of safe passage. In accordance with the inter-industry guidelines on 'Best Management Practices to Deter Piracy', shipowners can and must take measures to reduce the likelihood that attacks will be successful, but they rightly remain reluctant to deploy any form of armed response themselves to avoid making the threat to life and the likelihood of violence more severe. Piracy will prove to be an extremely difficult problem to resolve entirely since its roots lie in the political instability and lawlessness of certain areas of the world which permit the practice to flourish with impunity. The absence of a simple solution means it is likely to remain a problem for some time to come.

Another issue that has developed through the year concerns the treatment of seafarers who have been abandoned when unscrupulous or unsound shipowners have ceased to trade. However well intentioned they may be, attempts being made by ILO through the IMO to impose responsibility on all shipowners through their insurers for the financial default of a minority for accrued and future wages are misplaced. The proposed mutualisation of the consequences of a credit default remains a risk that more properly rests with banks and mortgagees than with P&I Clubs.

In September, as it does every year, your Board and our Managers will review the business plan which was put in place in 2007. The overall strategic objective for the Club is not likely to change significantly especially in such uncertain times. We shall continue to aim for excellence by being a mutual Club providing the very best quality and added value service to our Members. That means that we shall not grow for growth's sake and will not seek to take on the risk and provide cover for other products which are already widely available in the commercial market and for which we have no capital provision. However, after a year or two of consolidation, the strategic focus is likely to be on selective development in markets where we are already well established.

As part of the business plan review we also put into effect in September last year the Club's new Corporate Governance Charter. In the interests of transparency, and in order to operate to the standards now required of public companies, the Board decided that the governance process should be set out in a single document. This can be read in full, together with the Club's Constitution on the Club's website. The Charter is a voluntary code designed to assist the Board in carrying out its responsibilities for the conduct of the Club's business. The Board's activities on behalf of the Club are clearly set out as are the delegated responsibilities of the various Committees of the Board.

Since last year's report, Peter Livanos, Mohamed Aldhaheri and Mark Warren have retired from the Executive Committee and from the Board. Sulaiman Al Bassam, Mary Sloan and Sergey Terekhin have also retired from the Board during the year. On behalf of all my colleagues, I would like to thank them for their many valuable contributions to our affairs. Together they have devoted a considerable amount of time to the Club serving our interests with dedication. In December, Kevin Sheehan joined the Board. We wish him a very warm welcome.

I would like to express my appreciation to all my colleagues for their continued support and close commitment to the Club and our Members in what has been an unusually dramatic year.

Finally, I would like to express our thanks to our Managers on behalf of the Board. They continue to look after our interests with great dedication and will ensure that we continue to be well placed to meet the future with confidence.

Matheos Los
Chairman

Large Claims

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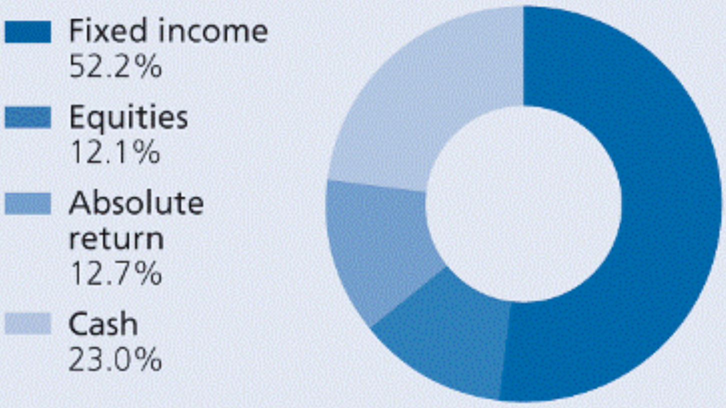
INVESTMENTS BY ASSET TYPE
(EXCLUDING PROPERTY)

At 20 February 2009



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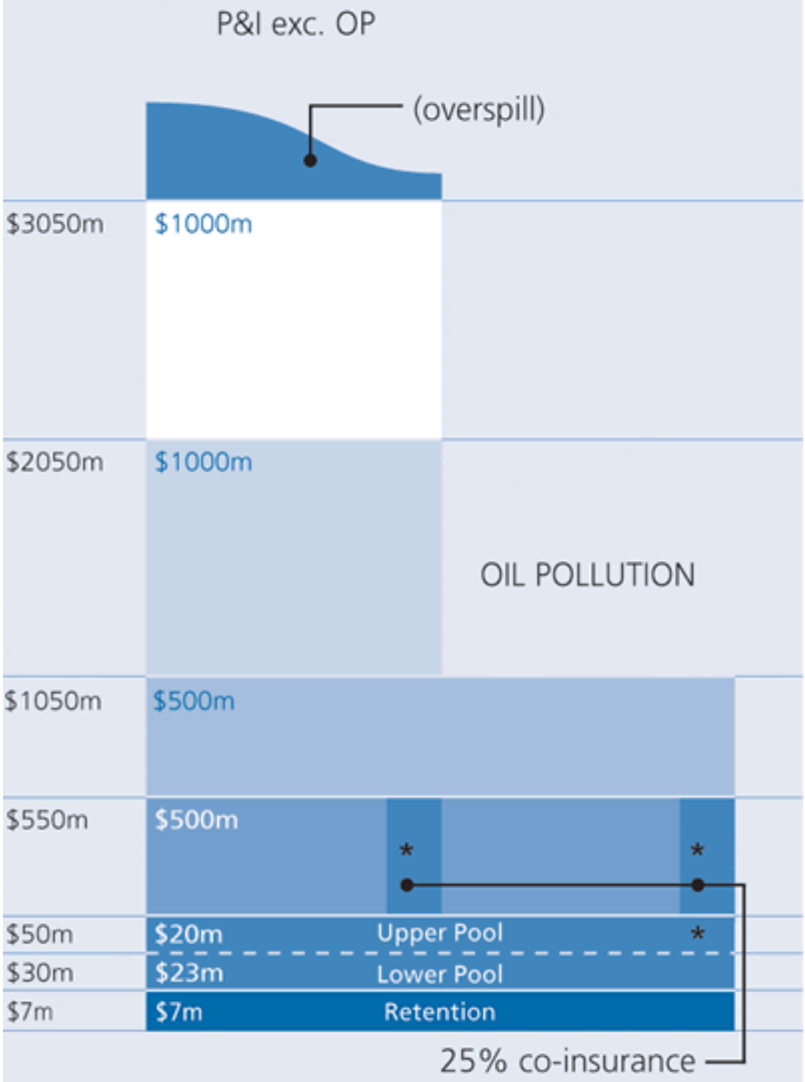
GROUP EXCESS OF LOSS REINSURANCE PROGRAMME

Policy Year 2009



- 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

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