UK P&I CLUB

Directors' Report & Financial Statements

For the year ended 20th February 2010

UK P&I CLUB
IS MANAGED
BY **THOMAS MILLER**

Total funds & capital

$1,207.1 million

Outstanding claims

$797.7 million

Free reserves & capital

$409.3 million

Contents

Chairman's statement

Dino Caroussis, chairman

It is pleasing to be able to report that the Club has successfully weathered the storms of the last 18 months and that our free reserves and capital (including hybrid) have now increased to more than $400 million. Holding capital at this level puts the Club in a strong position as we look forward, both to meet the stern regulatory challenges expected under the new European solvency regime and also to give confidence to Members in the overall financial strength of our Club. The Board's decision last October to levy the supplementary premium on the 2008 policy year at 20 per cent as estimated, has achieved the overall objective the Board set in October 2008 of minimising the deficits on the then open policy years - 2006, 2007 and 2008. Indeed, the surplus generated on the 2008 policy year has now effectively eliminated the remaining deficits on the other two policy years.

A number of positive features have contributed to this year's surplus of $75 million. Investment income has made an important contribution with an investment return of more than 8 per cent, which has been most welcome when compared to the negative investment return of last year. Encouragingly, claims levels in the 2009 policy year have begun to show the reduction we expected to see as a result of the slow down experienced in most world shipping markets. This is of great significance as lower claims mean that our goal of achieving balanced underwriting, with a combined ratio of 100 per cent, is made easier without the need for more substantial premium increases. The early signs of this better claims experience enabled the Board to set the general increase for the 2010 policy year at 5 per cent, a happily lower level than for many years. The Board however remains conscious of the need to maintain premium levels against an anticipated increase in claims activity as economic conditions improve.

Although it is still too early to make an accurate forecast of the eventual result of the 2009 policy year the reduction in the number of claims reported at this stage, particularly cargo claims and injury and illness claims, is encouraging, even if the average value of those claims is slightly higher than in previous years. The number and cost of the more serious casualties in any year is more random and after what now appears to have been an exceptionally good year for Pool claims in 2008, the 2009 Pool has seen a higher incidence of claims including two claims from the UK Club. Despite this, the cost of Pool claims in 2009 has not approached the very high levels of 2006 and 2007. The cost of the Club's own casualty claims in 2009 is also marginally below the five year average at this stage.

Claims levels will always remain difficult to predict in advance of any policy year, and during this past year we have conducted an extensive review of reinsurance protection for the Club's own claims. As a result of this review, which was closely monitored by the Board's Strategy Committee, the Club has now put in place for the 2010 policy year a more comprehensive reinsurance programme than we have ever had before, in addition of course to the Group reinsurance contract which continues with the same structure. This new programme is designed to protect the Club against not only single major losses but also a materially adverse aggregation of claims at lower levels, both within the Club retention and at Pool level.

The cost of this programme is offset by the expiry, at 20th February 2010, of our ten year contract with Swiss Re under which no further premium is now due. The ability of the new programme to substantially reduce the impact of claims volatility, not only assists in restraining our combined ratio mentioned previously but also has a beneficial effect on the Club's capital requirements under the regulatory regimes with which we must comply and also those of the rating agencies' models.

The work of the Board's Strategy Committee has become increasingly important to the effective governance of the Club and I am grateful to all the Directors who serve on this Committee for the time, energy and commitment they have given over the year. The deputy chairmen, Eric André, Alan Olivier and Patrick Decavèle are members of

nearly all the other committees of the Board as well, and their support and wise counsel is greatly appreciated. Eric André also undertakes the onerous task of chairing both the Audit Committee and the board of the Club's reinsurance subsidiary, IPIR, and his workload and contribution to the Club has been enormous. I would like to record our special thanks to him for all that he does. Two senior Directors left the Board in October 2009 who also made a very significant contribution to the Club over their periods in office - Petar Kragic who served for 15 years, latterly also as a member of the Strategy Committee and as a director of IPIR, and Bob Richards who remains on the board of IPIR where his investment expertise is especially valued. Our thanks go to both of them.

The evolving regulatory regime under which the Club operates is placing increasing importance on issues of corporate governance as well as understanding and management of risk. Our system of (effectively non-executive) directors drawn from, and elected by, the Membership, with independent professional managers responsible for the day to day running of the Club, is one which meets the expectations of our regulators. The organisation of the Board's committees and the work that these committees do in preparing, with the Managers, the appropriate information and recommendations for the full Board is a key ingredient in establishing that the level of risk management and corporate governance remains of an appropriate high standard for the Club.

A balance needs to be struck between the demands on the time of all our Directors and the delegation of responsibilities to the Managers. It is however inevitable that the Board, with the help of its committees, will be devoting increasing time to ensure a full understanding of the risks faced by the Club, the effective management of those risks through appropriate board policies and the implementation of those policies by the Managers.

The Managers' role in this process is critical and it is of course the Managers' staff who are in day to day contact with us as individual Members whether on underwriting matters, claims or general problems. Their ability to respond quickly and effectively to our needs as Members all over the world is one of the defining characteristics of our Club. During the year, we will be conducting another Member satisfaction survey and the results will be used to help the Directors monitor and the Managers maintain, and where necessary improve, the quality of the service Members receive from the Club. I hope you will participate as your input is critical in obtaining an accurate assessment of Members' concerns.

Although understandably the principal pre-occupation of the regulators is financial risk and this inevitably occupies much of the attention of the Board, we are ultimately a board of shipowners and Members of the Club and as such we devote time at each of our Board meetings to the current concerns of our Members and shipowners generally. Often these are demonstrated by the incidents which are giving rise to claims. We receive a regular report at each of our meetings on current claims and developments in claims which have not as yet been finalised as well as reports on the largest claims paid by the Club.

This enables us to see the problems actually being experienced by our Members as well as monitoring where the Club's claims expenditure is going. Translating this experience into useful loss prevention advice for all Members has become a highly valued and expected service from our Managers.

Matters of general industry concern also come to the Board, often in the form of reports on issues which are being considered by the International Group. Piracy, for instance, although the Club is not an insurer of ransom payments, is a major problem for us all. The Club can, and does, play a part in industry attempts to find practical solutions to avoid such problems or mitigate their effects. Closer to the insurance interests of the Club and its Members is the almost continual need to monitor and respond to legislative proposals for new or increased liabilities on shipowners at international, regional or national level. Under guidance from the Board, our Managers have continued to play a leading role in representing the clubs' views on a large number of these issues.

In considering the very wide range of issues that come before the Board, the shipowning background and experience of individual Directors proves invaluable. In October, seven new Directors joined the Board: Mr H.V. Franco of Harley Marine Services Inc.; Mr S.L. Ghomri of Hyproc Shipping Company SPA.; Mr R.C. Gillett, Bermuda resident; Mr J. Liberty of Royal Caribbean Cruises Ltd; Mr N. Mukae of Kumiai Senpaku Co. Ltd.; Mr H. Takahashi of

Nippon Oil Tanker Corporation; and Mr R.D. Widdows of Neptune Orient Lines Limited. Each of our new Directors has a different shipowning background and in the case of Roger Gillett, experience of the insurance industry. We welcome these new Directors and the benefits which their individual experience brings to the collective Board table.

Finally, I would like to thank all of our Members for the continuing support and confidence they have shown in the Club. We have been through a challenging period and for our part the Directors and I will work hard to build on the firmer financial base that has now been established and to ensure that the UK Club delivers the protection and service which we as Members require and expect.

Dino Caroussis, Chairman

Report of the Directors

The Directors have pleasure in presenting their Review of the Year and Financial Statements of the Association for the year ended 20th February 2010.

Principal activities of the Association

The principal activities of the Association, including its subsidiary companies, during the year were the insurance and reinsurance of marine protecting and indemnity risks on behalf of the Members.

At 20th February 2010 the owned tonnage entered in the Association and through its subsidiary, The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited, on mutual terms totalled approximately 105 million gross tons (110 million in 2009). In addition, in excess of 70 million gross tons of chartered tonnage was, on average, entered in the Association at any time during the year.

Direction and management of the Association

Ultimate control over the Association's affairs rests with the Board of Directors, who are all elected by the shipowner Members of the Association. With the exception of the two Bermuda resident Directors, all the Directors are officers or agents of Members.

The Directors meet on four occasions each year to carry out the general and specific responsibilities entrusted to them under the Rules and Bye-Laws, and a commentary on the matters considered during the past year is contained in the Review that follows. The Directors are themselves active shipowners and are restricted in the amount of time that they can make available to running the Association's affairs. The Board delegates the day to day running of the Association to the Managers, Thomas Miller (Bermuda) Ltd.

The Managers, through their London agents, Thomas Miller P&I Ltd., and also through a network of offices in Asia, America and Europe, form the principal contact between the Association and the Members. In addition to carrying out the policies laid down by the Board, they also act as the conduit for feedback to the Board of the Members' views.

At the Board meetings, the Directors receive reports from the Managers on all areas of the Club's operations in accordance with an agreed schedule of reports. The Board also considers and decides issues of policy on general matters concerning the Club and the Members' interests.

The Chairman and Deputy Chairmen meet with the Managers regularly during the year to discuss current developments and the preparation of matters for consideration and decision by the Board.

The Board has established a number of committees. The Strategy Committee meets eight times a year to provide in depth discussion and analysis of strategic issues which are to be considered by the Board and of any particular matters which the Board decides to refer to it. The Committee reports to the full Board with the results of its deliberations and its recommendations. The Audit Committee of the Board meets three times a year. Its current chairman is Eric André who is a Deputy Chairman of the Club. The other members of the Committee are Kathryn Siggins and Adamantios Lemos, both Directors of the Club, plus two independent members - Robert Quayle, a director of IPIR, and Nigel Smith, who has accounting expertise in the insurance and shipping sectors. Nigel Smith has specific responsibility for liaison, on behalf of the Committee, with the head of internal assurance of Thomas Miller. The Nominations Committee makes recommendations to the Board regarding its composition as and when new Directors are to be appointed. It also makes recommendations on the composition of committees and subsidiary boards.

The Ship and Membership Quality Committee oversees ship and membership quality and makes reports to the Board. IPIR, the Association's wholly owned quota share reinsurance subsidiary, is responsible for managing the majority of the investment portfolio. Its board comprises shipowner directors of the Association, as well as independent investment directors and Isle of Man resident directors. The Association's wholly owned European subsidiary's board is made up from shipowner directors, who are also directors of the Association.

Other committees of the Board are formed, as needed, in order to review specific issues as delegated by the Board, or take decisions on behalf of the Board, for instance regarding the operation of the Club's war risks cover where urgent decisions may be required.

Directors

The present Directors of the Association are shown overleaf along with those who retired from the Board since February 2009. The Board wishes to record its thanks to those Directors for the contribution they have made to the work of the Board and the affairs of the Association.

Bye-Law 14 (c)(i) provides that Directors will retire after having been in office for three years since their last election. Consequently, Messrs F.A.H. Ali, J.P. Ioannidis, A.C. Junqueira, C.E. Kertsikoff, J.M. Kopernicki, J.B. Lee, A. Lemos and Zhang Liang will retire at the forthcoming Annual General Meeting in Shanghai on 18th October 2010. All these Directors, with the exception of Mr Ioannidis, have offered themselves for re-election.

In October 2009, Mr C.I. Caroussis was re-elected as Chairman of the Board of Directors and Messrs E. André, P. Decavèle and A.K. Olivier were re-elected as Deputy Chairmen.

C.I. Caroussis
Chairman and President
Chios Navigation (Hellas) Co. Ltd, Piraeus

E. André
Deputy Chairman & Vice President
Suisse-Atlantique S.A., Renens/Lausanne

P. Decavèle
Deputy Chairman & Vice President
CMA CGM, Paris

A.K. Olivier
Deputy Chairman & Vice President
Grindrod Ltd, Durban

F.A.H. Ali
Kuwait Oil Tanker Co. S.A.K., Kuwait

A.H. Azizan
MISC Berhad, Kuala Lumpur

G. Bottiglieri
Giuseppe Bottiglieri Shipping Company S.p.A., Naples

M.L. Carthew
Chevron Shipping Company LLC, San Ramon

P. B. Evensen
Teekay Corporation, Vancouver

H.V. Franco*
Harley Marine Services, Inc, Seattle

S. Frank
OAO Sovcomflot, Moscow

O. Gast
Hamburg Südamerikanische Dampfschifffahrts-Gesellschaft K.G., Hamburg

S.L. Ghomri*
Hyproc Shipping Company SPA, Oran

R.C. Gillett*
Hamilton, Bermuda

N.G. Inglessis
Samos Steamship Co, Athens

J.P. Ioannidis
Olympic Shipping and Management S.A., Athens

M.R. Itkin
Overseas Shipholding Group Inc, New York

A.C. Junqueira
Petrobras Transporte SA - Transpetro, Rio de Janeiro

C.E. Kertsikoff
Eletson Corporation, Piraeus

J.M. Kopernicki
Shell International Trading and Shipping Co. Ltd, London

J.B. Lee
Korea Line Corporation, Seoul

A.M. Lemos
Unisea Shipping Ltd, Piraeus

J. Liberty*
Royal Caribbean Cruises Ltd, Miami

P. Louis-Dreyfus
Louis Dreyfus Armateurs S.A.S., Paris

A.C. Margaronis
Diana Shipping Inc, Athens

N. Mukae*
Kumiai Senpaku Co. Ltd, Tokyo

M. Morooka
NYK Group Europe Ltd, London

S.H. Seyedan
National Iranian Tanker Co, Tehran

K. Siggins
Hamilton, Bermuda

H. Takahashi*
Nippon Oil Tanker Corporation, Yokohama

N.P. Tsakos
Tsakos Energy Navigation Limited, Athens

P.A. Vasilchenko
Far Eastern Shipping Company, Vladivostok

H. von Rantzau
DAL Deutsche Afrika-Linien GmbH & Co, Hamburg

R.D. Widdows*
Neptune Orient Lines Limited, Singapore

Zhang Liang
China Ocean Shipping Group Company, Beijing

* New Directors elected in October 2009

Directors who have left the Board since February 2009: Mrs L. Fønss Schrøder, T. Kaneko, P. Kragic, E.T. Richards

Performance for the year to February 2010

This year has seen the Club continue to rebuild its capital position and move closer to underwriting breakeven. With a background of continuing uncertainty in the world economy, and doubts about the recovery, the Club has strengthened its free reserves and capital as well as strengthening its claims reserves. This overall improvement in the Club's finances and underwriting position is particularly important given the current regulatory environment.

Free reserves and capital at 20th February 2010 increased by $75 million to $409 million ($334 million in the prior year), which includes the supplementary premium on the 2008 year of $63 million and net investment return of over 8 per cent, or $77 million before hybrid capital interest costs. On a financial year basis the combined ratio was 98 per cent (86 per cent in the prior year).

Underwriting

At the 2010 renewal, the Club set a general increase of 5 per cent. The modest general increase recognised that claims costs are likely to increase over time but that the experience of the Club is that subdued shipping markets will, in the short term at least, lead to reduced retained claims levels. Claims in the 2009 policy year have moderated, assisting with the Club's goal of consistently underwriting at levels approaching breakeven.

If the current shipping recession follows the pattern of previous recessions, claims values will remain moderate. Whilst this expected claims downturn will help to move the combined ratio to 100 per cent, the duration of such respite will be uncertain.

In a time of pressure on shipping income and hence P&I premium rates, many Members are electing to increase deductibles over and above the published standard deductibles in the Rules which are reviewed by the Board annually. In the future, the Managers expect that more Members will take higher deductibles, both to support internal loss prevention through assumption of risk and also to reduce gross premium.

At the 2010 renewal, approximately 20 per cent of Members amended their deductible structures in some manner. The Club will continue to encourage all Members to assess deductibles as part of the overall target of balanced underwriting. During the year the Managers have worked closely with Members and brokers to explain and bring clarity to the renewal documentation. From November 2009 a new loss record format was available to Members via the Underwriting Online section of the Club's website. The statement was improved for ease of reading and is expressed on a scale of 100 per cent. This change in presentation did not change any claims or premium data. Online access to underwriting information also increased, with about one third of Members or their brokers using Underwriting Online during the renewal.

During the 2009 policy year, the Club processed laid up returns of $3.5 million involving just 105 ships out of more than 3,400 entered in the Club and accrued for a further $3.5 million. The accrual reflects pending applications at the year end and recognises that Members have until 20th August 2010 in which to apply for 2009 policy year returns. Encouragingly, the number of ships laid up is not greater than the number laid up in 2008 and, perhaps, reflects the Club's lower exposure in the container ship market. The policy for laid up returns was amended at the commencement of the 2009 policy year to provide a 50 per cent return, after reinsurance costs, for vessels in hot lay up and a 90 per cent return for vessels in cold lay up. About half the number of ships for which laid up returns have been approved have been in hot lay up.

Lastly, and not least in a P&I club, the quality of the entered fleet remains a core principle of underwriting and during the year the Ship Inspection Department inspected just over 500 of the 3,400 ships entered in the Club. Additionally, loss prevention efforts are moving away from hardware inspection for many owners towards assisting owners in the analysis of their risk. In pursuance of this aim, the Managers have provided tailored risk analyses to Members showing factors such as claims pattern changes, port state detentions or other risk factors.

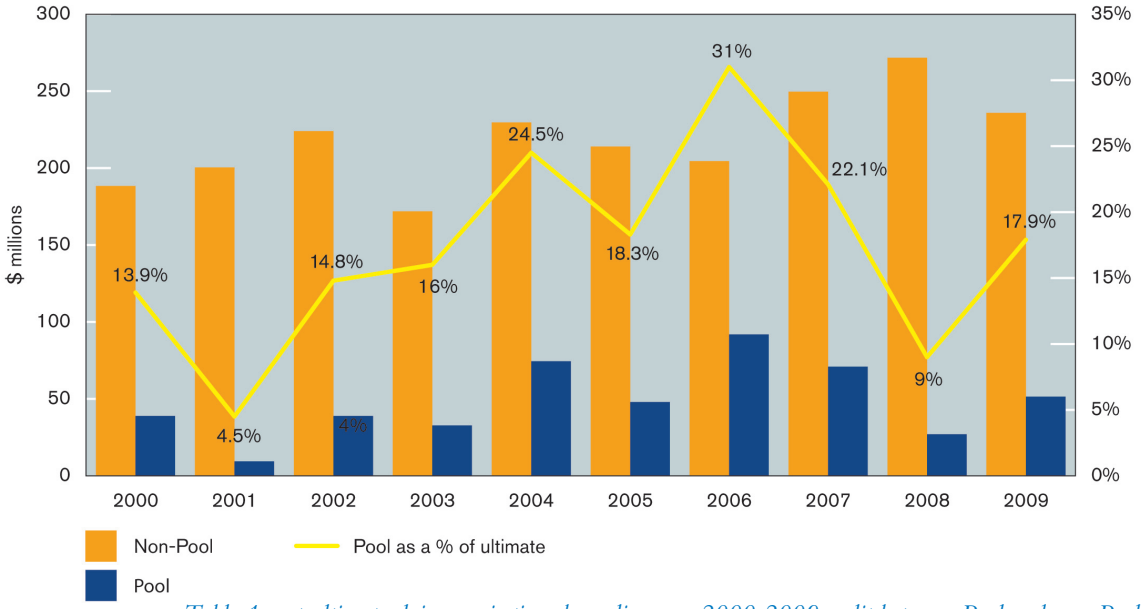


Table 1: net ultimate claims projections by policy year 2000-2009, split between Pool and non-Pool claims

Claims

In this report last year it was noted that claims pressures tend to moderate during shipping market recessions. This expectation has been borne out: net incurred claims on the 2009 policy year after 12 months are lower by $26.9 million or 14 per cent compared to 2008 and $47.8 million or 23 per cent compared to 2007.

Table 1 shows that the net ultimate claims projection for 2009 (both retained and Pool claims) is lower than the three previous heavy claims years of 2006 -2008, and, although still at an early stage, the expected downturn in net retained claims reflects the trend expected in the economic cycle.Until the last quarter of the year, claims development for the 2009 policy year had been much lower than in previous years. In the final quarter claims showed an increase and as a result the ultimate for the year was maintained at the level in the Corporate Plan.

It will not be until after the sixth quarter that the claims development pattern can be reassessed with more confidence and, if anything, it is expected to improve rather than deteriorate. Another notable feature of the 2009 year has been the significant reduction in the number of claims in most categories.

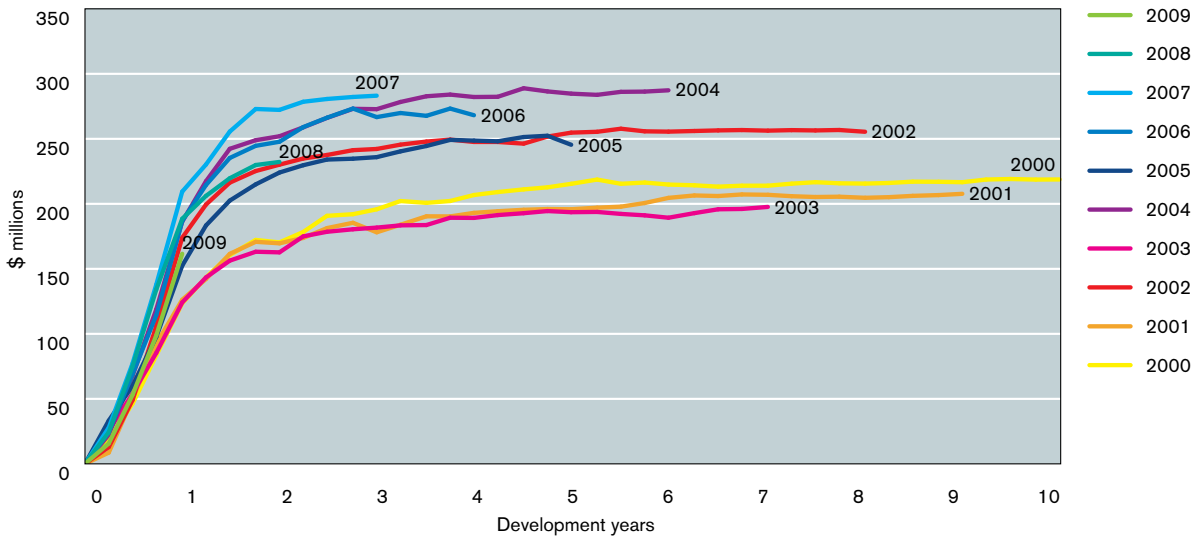


Table 2: net notified claims development policy years 2000-2009

As last year, the Club's reserves have been prudently set in conjunction with an independent firm of consulting actuaries.

Like all broad trends, a reduced level of ton-miles or other measures of shipping activity will by no means guarantee a favourable claims year for the Club. A handful of very large claims could overshadow the more predictable trends of declining attritional claims, and the Club must remain diligent in 2010 and beyond for signs of a return to total claims costs witnessed from 2007 through 2008.

Table 2 tracks notified claims and excludes, therefore, the IBNR (incurred but not reported) projections for the ultimate cost of the year shown in Table 1. Table 2 shows that policy years prior to 2009 have all developed as expected over the last year. The table further indicates that the 2009 policy year has consistently tracked below the most recent policy years over the 12 months to 20th February 2010.

A comparison of Tables 1 and 2 is useful as it highlights the difference between notified claims and the ultimate projections. As noted above, net notified claims on the 2009 policy year are 14 per cent below the 2008 claims at the same stage ($162 million in 2009 and $189 million in 2008 - see Table 2), whereas the projected ultimate for 2009 is only 4 per cent below 2008 ($287 million for 2009 and $298 million for 2008 - see Table 1).

Pool

Claims on the Pool in the 2006 and 2007 policy years were unexpectedly large and were a major factor behind the decision to call supplementary premiums to balance those policy years. Fortunately, there have been amendments to the Pool sharing arrangements as between clubs in the International Group and this, together with the UK Club's good record on the Pool, has lowered the Club's required contribution to the Pool for the 2009 policy year.

While not as favourable as the 2008 policy year, the 2009 policy year has not seen a recurrence of the high levels of Pool claims seen in the 2006 and 2007 policy years although it has developed ahead of previous expectations due to a larger number of reported claims than 2008. The number of Pool claims on the 2009 policy year at 20th February was 22 of which two involved UK Club Members. Much more will be known about the development of the 2009 Pool at the critical 18 month stage in August 2010.

Table 3 shows the wide variation from year to year on the Pool, and emphasises the high cost to the Club of the 2006 and 2007 policy years.

Table 3: net notified pool claims by policy year 2000-2009

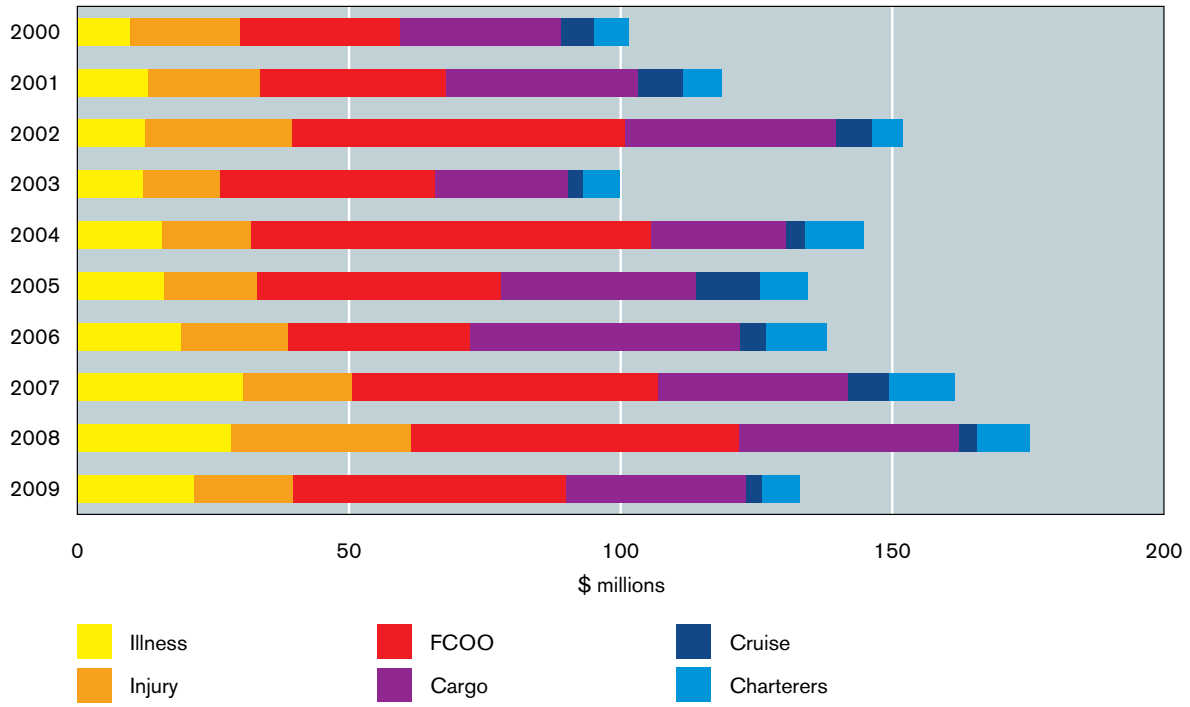


Table 4: net notified claims by category at twelve months' development 2000-2009 (excluding pool claims)

Retained claims

Table 4 shows the net notified claims by category at twelve months' development. This shows how the cost of people claims (comprised of the illness and injury categories) increased significantly up to the 2008 policy year, and has since fallen back due largely to a marked fall in the frequency of such claims.

The 2009 policy year was also marked by a number of significant casualty, collision and pollution claims (FCOO), but despite this the 2009 experience in this particularly volatile category was still down on the experience of the 2007 and 2008 policy years.

People claims

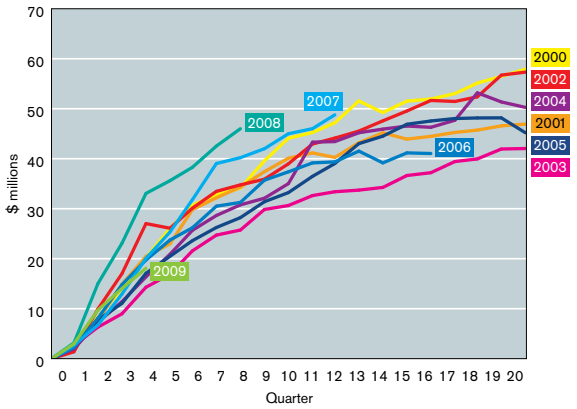
For many of the Club's Members, their fleet loss record is affected by crew claims more than any other category of claim. Whilst people-related claims may flow from passengers, stevedores, inspectors, pilots or others, the majority of the Club's people claims costs relate to crew.

In the 2009 policy year, the Club's overall experience improved because of a drop in the numbers of illness and injury claims, rather than because of any reduction in average claims costs. The following paired tables track the numbers of reported illness and injury claims for the policy years 2000-2009. In both instances the 2009 policy year shows a marked decline in reported claims numbers.

Typically, illness claims involve contractual obligations to provide medical care and sick pay, as well as to repatriate and substitute crew. During shipping recessions, salaries do not tend to decrease rapidly but global medical costs continue to inflate in a way unrelated to the shipping market. As these factors drive both injury and illness categories, the Club expects that the average costs per claim will remain at current levels or marginally increase despite the shipping recession, but that the drop in frequency will mean that the ultimate claims costs of these categories will be lower.

It is important that Members appreciate that underlying crew claims costs may continue to rise and that the focus on loss prevention and appropriate deductible levels should continue.

Value



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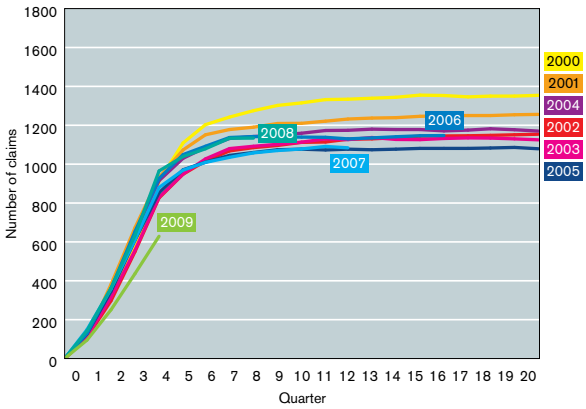
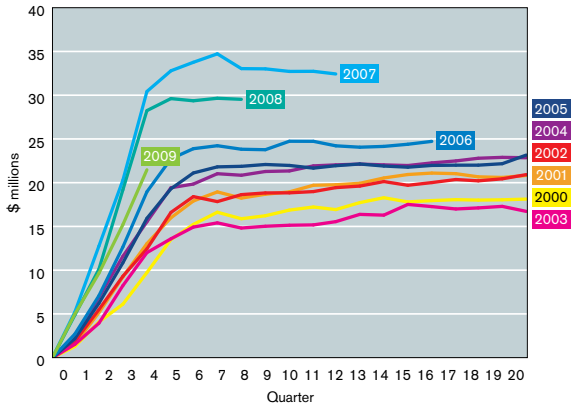


Table 5: net notified injury claims by policy year 2000-2009 by value and number of claims

Value



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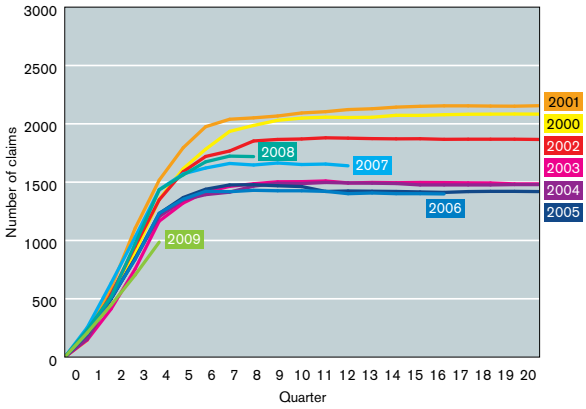


Table 6: net notified illness claims by policy year 2000-2009 by value and number of claims

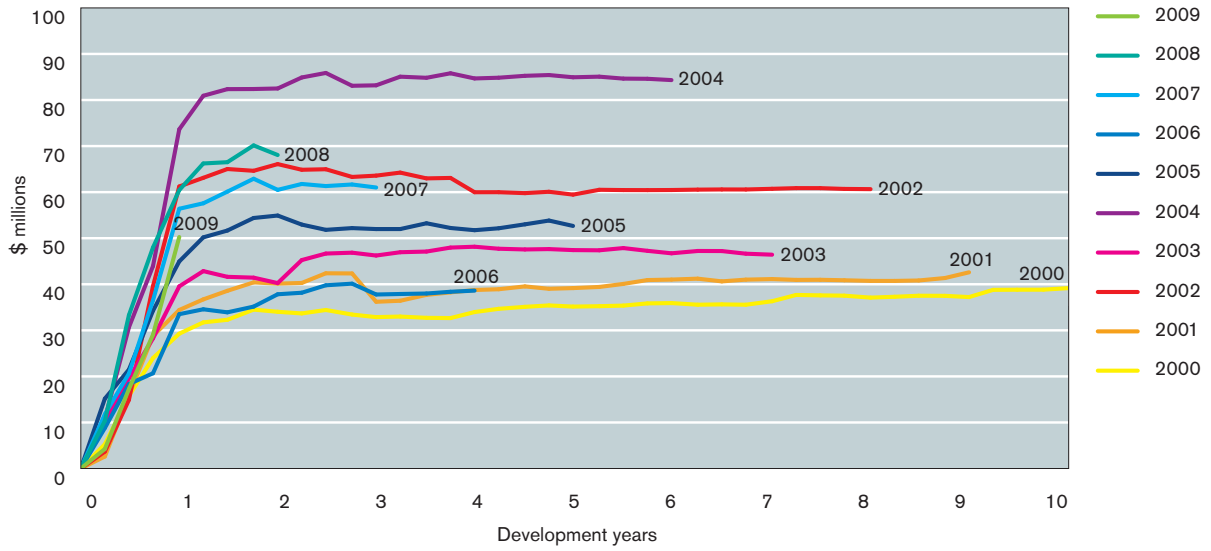


Table 7: net notified casualty and pollution claims 2000-2009

Casualty and pollution claims

This category of loss is particularly volatile as is shown in table 7 above. The net notified claims for the 2009 policy year are some 7 per cent below the average of the previous five policy years after 12 months from inception. Two of the Club's 2009 claims in this category reached Pool levels, in particular a collision in the Galveston ship channel involving the tanker EAGLE OTOME. Despite this, 2009 overall was an average or slightly favourable year for major collision and pollution incidents.

However, it is very difficult to predict the incidence of these types of event and it is just as likely that 2010 could see a repeat of an active year like 2004. In particular, if pressure on costs in owners' offices results in delays to planned maintenance of vessels, the risk of events such as fire or engine failure may increase.

Towards the end of the policy year, on 23rd January 2010, a major oil pollution incident occurred in the United States. The 52,504gt double hulled tanker EAGLE OTOME was on a voyage from Mexico to Beaumont, Texas, with a full cargo of Olmeca crude oil when she collided near Port Arthur with the lead barge of a two tank barge tow which was being pushed downstream by the tug DIXIE VENGEANCE. The tanker was holed in way of her number one starboard cargo tank and some 10,000 barrels of high sulphur cargo was lost.

The vessel response plan was activated immediately and clean up operations continued for some weeks.

Fortunately the spill, having taken place in the narrow Sabine-Neches Channel, was at first confined to a two mile stretch of the waterway. As a precaution, the neighbourhood adjacent to the channel was evacuated and some two to three thousand people were unable to return to their homes and business premises for much of the day of the incident.

Clean up response costs have been provisionally estimated and claims were expected from the owners of the two vessels which were damaged and the owner of a dock. In addition, economic loss claims were anticipated from oil refineries upstream as well as local craft and ocean going vessels whose operations were disrupted as a consequence of the closure of the waterway for five to six days whilst the major part of the clean up operation was undertaken. Claims have since been notified by residents of Port Arthur. It is not clear how these will develop but very few individuals reported to medical centres as a consequence of the temporary increase in hydrogen sulphide levels in the atmosphere following the spill.

Cargo claims

The encouraging feature of the 2009 policy year in terms of cargo claims is the decline in the number of reported claims, which are 23 per cent below the average of the previous five policy years after 12 months' development (1,958 claims reported in 2009 against an average of 2,551 for 2004-2008). This decrease is almost certainly a function of reduced shipping activity during the period.

By value 2009 claims were 11 per cent lower than the average of the previous five policy years at the same stage.

Claims commentary overview

As anticipated a year ago, the less buoyant shipping markets - characterised by less intensive ship utilisation - have resulted in a subdued claims picture. This has been largely driven by a moderate number of large casualties and declines in the frequency of other categories of claims.

While this is welcome news, the Club's challenge will be to anticipate the inevitable cyclical return to higher claims levels when shipping markets improve and ship utilisation increases.

Capital and regulation

Last year this review indicated that the recent financial crisis would lead regulators to demand that higher levels of capital be held by insurers and also require clear evidence of comprehensive risk management processes to be embedded in the way that those insurers operate. The development of Solvency 2 has borne this out, notably through the various consultation papers on the regulation itself and also the Quantitative Impact Studies, in which the Club has participated.

These studies are designed to build and calibrate standard models for assessing the level of capital that insurers should hold. Although the insurance industry in general has emerged relatively unscathed from the financial turmoil, it still needs to work with the European regulators to ensure that capital requirement for the insurance industry in general, and P&I in particular, reflects the true underlying business risk.

The International Group is continuing to liaise with regulatory authorities on the development of Solvency 2, particularly in the areas of the mutual capital structure of the clubs and also the calibration of these regulatory capital models. Whilst the progress is encouraging, each club must ensure that its own capital assessment and risk management remains appropriate for its size and complexity.

The UK Club is developing its own internal model so that both the specific nature of P&I marine liability risk and also the specific characteristics of mutual insurance clubs are taken into account. The UK Club is well placed as it has been using the modelling and risk analysis used for its Individual Capital Assessment (ICA), as well as its S&P rating model, for making significant business decisions such as changes in investment policy and reinsurance purchasing.

Capital structure and efficiency

The Club reported last year on the first successful issue of innovative tier 1 hybrid capital by a P&I club, raising $100 million, which was intended to put in place additional capital headroom for the Club in advance of Solvency 2. Regulators and rating agencies are looking at all sources of capital in order to assess the financial health of clubs and the Club's hybrid capital will continue to qualify as regulatory and rating capital as it ranks equally alongside the Club's free reserves.

In addition, the regulators are treating the ability to make supplementary calls as tier 2 capital, which encouragingly gives further recognition to the mutual capital structure in the development of Solvency 2.

Risk management

It is no longer sufficient or efficient to rely solely on a high level of free reserves if the Club is not maintaining the highest standards of risk management.

Although the development of regulation and rating agency requirements is imposing increasing cost and burdens on all insurers, the Club is aiming, wherever possible, to build Solvency 2 requirements into its strategic and operational management in order to gain commercial benefit as well as compliance. The Club is doing this as it develops its Corporate Plan alongside its risk appetite and Business Risk Log. The risk appetite explains what risks the Club is prepared to accept in the course of business. All these developments build on the solid foundation of the ICA process that has been explained in previous reviews.

By embedding these tools within its normal operations, the Club is well on the way to ensuring that it meets the requirements of Solvency 2 and the rating agencies. In using these tools, the Club has built on its commercial risk analysis derived from historical claims data, underwriting data and loss prevention activities, including ship inspection and pre-employment medical examinations.

The development of Solvency 2 will result in increased disclosure on risk and regulatory requirements, and Members can expect to see the Club's accounts and publications build further on the already high levels of disclosure. In addition to rebuilding the capital base the Club has reviewed its reinsurance needs to provide additional protection and further reduce its regulatory and rating capital requirements.

Standard & Poor's

The Club is currently rated A- (stable outlook) by Standard & Poor's. According to the rating agency the Club's strong capitalisation is supported by its very strong capital adequacy, and progress towards underwriting breakeven will hopefully see a restoration of the A rating.

Reinsurance

The structure of the reinsurance programme for 2009 remained unchanged from that of 2008. The structure of the contract, which was divided into four layers including the collective overspill protection in excess of a third general excess layer is shown in Table 8.

The contract was renewed for the 2009 policy year with an increase of just under 15 per cent including the layers insured by the Group's captive, Hydra. The increase was driven by the significant deterioration on claims to the contract during 2008 in respect of the 2006 and 2007 policy years in particular. By contrast Hydra was able to hold the rates for the old upper Pool layer premium.

Pooling arrangements for 2010

For the 2010 policy year the individual club retention increased from $7m to $8m. The Group Pooling arrangements and structure of the Pool remain otherwise unaltered since the changes that were introduced during the 2009 policy year. Those changes involved an increase in the cap on the loss ratio adjustment to clubs' proportions and the merger of the old upper Pool layer into the lower Pool.

The effect of the latter change, combined with the UK Club's continuing good record on the Pool, resulted in a significant reduction in the UK Club's share of the Pool. The UK Club currently has a loss ratio on the Pool of less than 90 per cent and a credit balance of around $82 million.

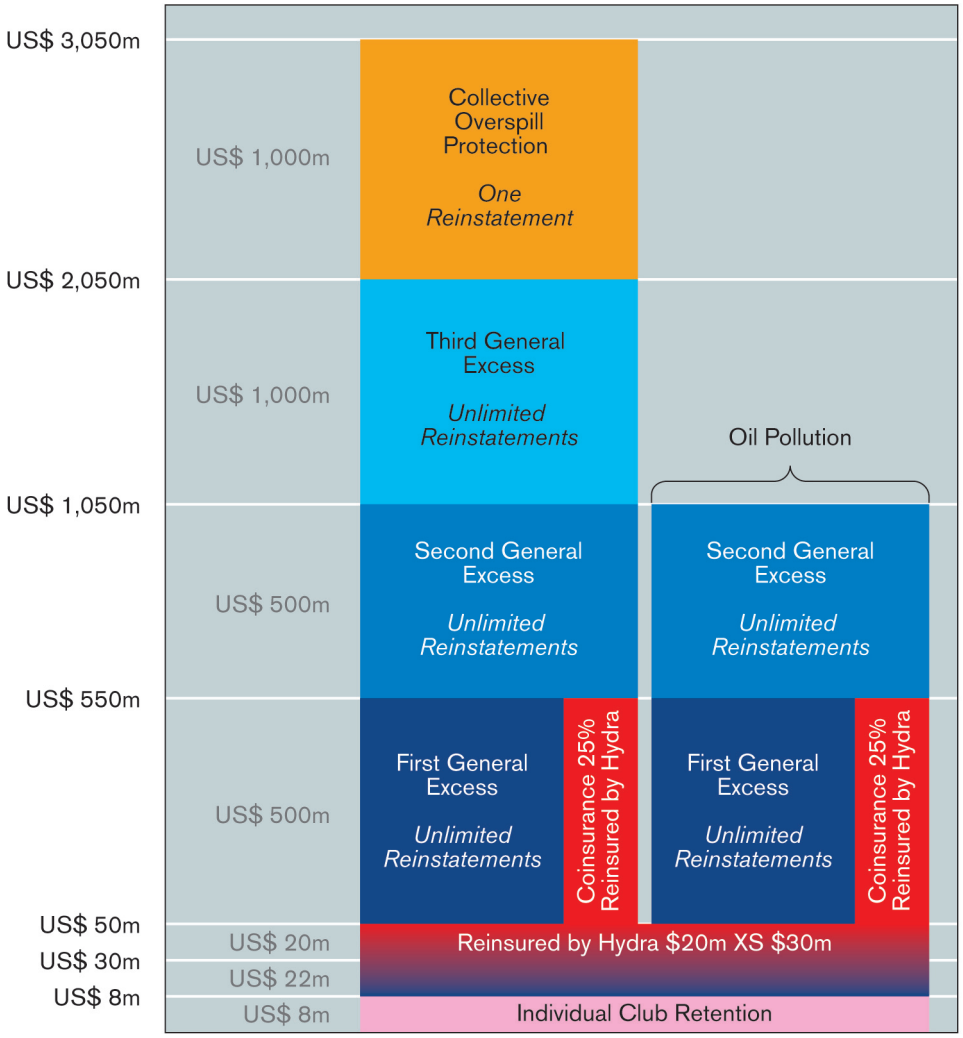


Table 8: International Group reinsurance arrangements 2010

Reinsurance arrangements for 2010

For 2010, there was no change to the structure of the Group contract. There was a small premium increase on the first layer of 5 per cent but the remaining layers of the contract, including the collective overspill layer, were renewed as before. The collective overspill layer was renewed on the basis of a 24 month policy. Once again the issue for the market underwriters on the first layer was the continued deterioration during the 2009 policy year in the claims to the contract for the 2006 and 2007 policy years. 2007 is now the most expensive P&I reinsurance year on record. In terms of allocation of cost of the contract there were reductions for tankers and passenger ships and a modest increase in the rate for dry cargo ships.

During the 2009 policy year, the Board conducted a reinsurance review based on the Club's ICA and risk appetite. As a result of that review, the Club has put in place for the 2010 policy year a number of new reinsurance policies to protect the Club's own account both within and in excess of the Club retention.

Overspill reinsurance

If a claim were to exceed $2.05 billion, i.e. the limit of the Group excess of loss contract, the excess or overspill will be pooled amongst the Group clubs. The overall Group Pool limit for such an overspill claim remains unchanged at 2.5 per cent of the property limitation funds under the 1976 Limitation Convention of all mutual ships entered in the International Group clubs. Mutual Members ultimately remain liable to pay an overspill call up to a maximum of this limit for each entered ship, in accordance with Rule 22 of the Rules of the Club.

For the 2010 policy year, the Group has once again purchased reinsurance protection on behalf of each club for an overspill claim of up to $1 billion. This reinsurance will be available to all Group clubs to reduce the need to make an overspill call on their members.

Oil pollution limit

There is no change for the 2010 policy year. The limit of the Club's aggregate liability for oil pollution claims remains $1 billion as set out in the Rules.

Passenger and crew limits

Similarly, there is no change to passenger cover for the 2010 policy year, and the Club's limit on cover remains at $2 billion for passenger claims and $3 billion, each event, in respect of liability to passengers and seamen.

War risk and terrorism cover

For the 2010 policy year, the limit of the Group's excess war P&I insurance remains $500 million. The supplementary Pooling for "Bio Chem" claims, which will also continue to match the upper limit of the Pool at $50 million, was also continued for the 2010 policy year. Details of the war risks P&I cover arrangements for the 2010 policy year were communicated to Members by circular 3/10.

Charterers' cover

For the 2010 policy year, the Club renewed its reinsurance arrangements with the existing market.

Investments

The beginning of the financial year coincided almost exactly with financial markets discounting the worst possible outcome from the failure of banks in the US and the seizing up of credit markets globally. At that point depression and deflation became a serious concern. The introduction of unconventional monetary policy by central banks, and government support to ailing financial institutions meant this potential repeat of the 1930s was avoided. The purchase of government and other securities by central banks was aimed at keeping financing costs low, injecting liquidity into the financial system when little existed, and boosting asset prices to help collateral positions and improve business and investor confidence. The S&P 500 index reached its nadir of 676.53 on 9th March 2009 and rose almost uninterrupted until 20th February 2010. During the financial year the S&P index rose by 42.39 per cent.

Contrastingly, government bonds were subject to two opposing factors–central bank purchases of bonds kept prices high and yields low, whilst institutional and private investors became increasingly concerned about the reflationary policies being adopted and what would happen when the central bank purchases ceased, or reversed. In the financial year, US five year bond yields rose from 1.83 per cent to 2.45 per cent. The US dollar, which had been the beneficiary of international flows and sentiment as the financial crisis unfolded, weakened against most currencies during the year, as risk aversion dissipated.

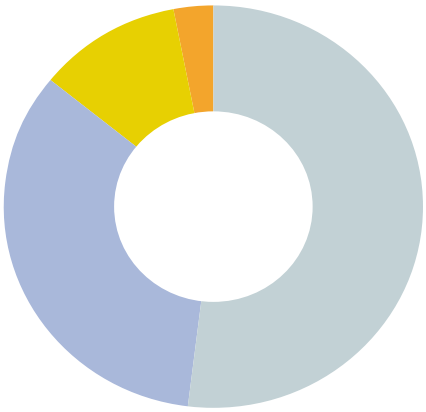
At the beginning of 2010, much of the corporate and banking gloom had lifted, although confidence in the sustainability of the recovery was still fragile. The deep recession many countries experienced in 2009 has put pressure on government finances, and the year ended with worries over the credit-worthiness of certain countries rather than the liquidity of their banking systems.

Positioning of the portfolio

To reflect the extremely negative economic prospects and volatile financial markets at the beginning of the financial year the investment portfolio was conservatively positioned.

Three main investment themes then dominated the portfolio for the rest of the year - the reduction of the cash position, the move back into equities and the investment into government backed securities. These initiatives added value during the year.

A three per cent weighting to equities at the beginning of the year was gradually increased with the net investment of $95.9 million. At the end of the financial year the weighting had increased to 15 per cent of the portfolio. Initially the equities purchased focussed on the US equity market. As momentum built, the portfolio was diversified globally and positions in the UK, Europe, Japan and emerging markets were added.



Cash 52%
Fixed interest 34%
Absolute return funds 11%
Equities 3%

Cash 50%
Fixed interest 26%
Absolute return funds 9%
Equities 15%

Table 9: portfolio composition at February 2009 (left) and February 2010 (right)

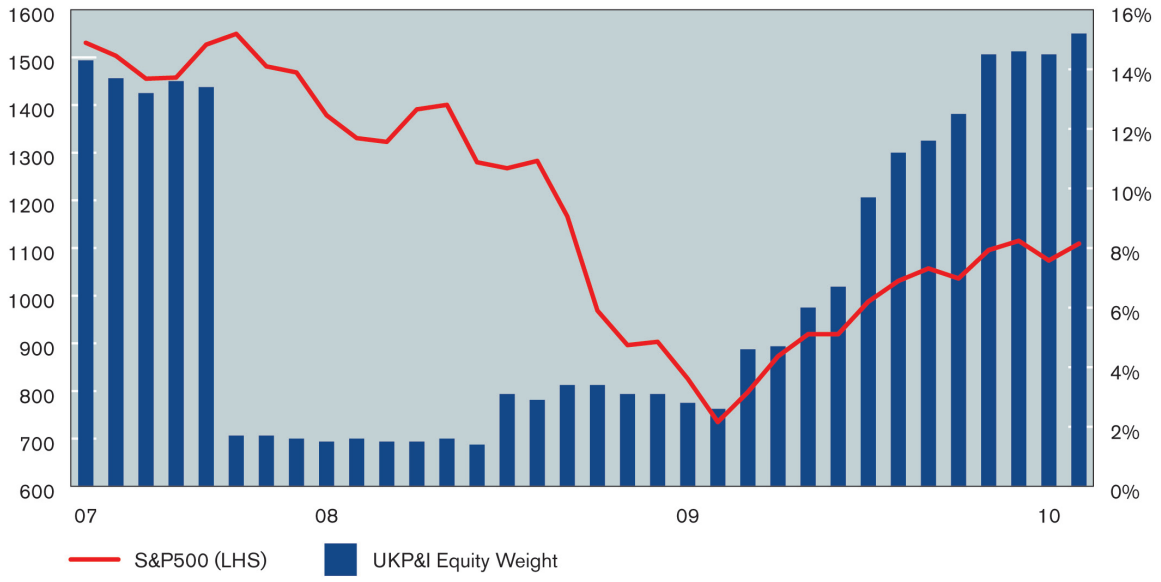


Table 10: Club's weighting in equities compared to S&P 500 index

Table 10 above shows the performance of the S&P 500 index since 2007, compared to the timing of the Club's withdrawal, in October 2007, and subsequent reinvestment into the equity market.

One of the measures adopted by governments in an attempt to bring stability back to financial markets was to offer a guarantee against default on corporate debt issued by economically important companies. The securities in which the portfolio invested were issued at spreads above the equivalent government securities of approximately 100 basis points. As the financial markets stabilised the spreads narrowed, ending the year at around 30 basis points which represented a healthy outperformance of the underlying government bond markets.

Performance

During the financial year, the portfolio returned 8.15 per cent, an appreciation of $78 million (negative $56 million in the prior year). It should be noted that this return more than offset the investment loss registered in the previous financial year. In general, therefore, the investment portfolio has performed well in absolute terms during the worst financial markets in living memory.

Particularly pleasing returns were achieved from the equity part of the portfolio which rose by 51.98 per cent during the year and the absolute return funds which rose by 13.71 per cent.

Service

The recent global economic climate has highlighted the financial elements of the Club's activities as never before. However, the highest standard of claims and advisory services is rightly expected from the Club and the quality of those services often makes a key difference to the commercial activities of the Members. Accordingly, the Managers' sharp focus on improving the range and quality of claims and ancillary services to Members remains and will continue to do so.

In 2009, the Managers maintained their network of offices to provide appropriate support to Members in the right time zone and geographical location. Offices are located in Beijing, Greece, Hong Kong, London, New York, San Francisco, Shanghai and Singapore so as to ensure global coverage. This network is unique in the P&I world and continues to meet the requirements of Members, taking into account a multitude of cultural and technical demands.

The activities of these offices are enhanced by extensive travel and Member education programmes.

Challenging times require even greater focus on the needs and requirements of Members and the Managers have appointed a marketing and development director to oversee account management activities, co ordinate travel and ensure appropriate provision of other activities being delivered to Members.

The Managers have rationalised the London claims groups into three Syndicates from the previous five Area Groups. This has freed up expertise from internal management and administration tasks for Member facing activities.

Provision of service inevitably incurs a cost, and consideration of this cost is of paramount importance during times of economic hardship. The Managers continue to work to ensure that the same or better levels of service are delivered at the least possible cost and, to this end, continue to streamline and improve the Value for Money initiative that seeks to control the cost of legal services while pushing for the best commercial outcomes on case files.

This initiative has focussed on improving the working practices and training of executives, developing relationships with key suppliers, negotiating special fee rates with those suppliers and using technology to inform and improve the claims process. This has allowed the Managers to reach an agreement that the hourly rates of Preferred Legal Partners will not increase for 2009/10, despite the high level of activity in marine transport law firms produced by the global economic turmoil. Some firms have reported increased turnover of 18-24 per cent and have sought to increase rates for some of their clients on the back of such high demand for their services.

Also, high demand on the marine transport practices within some firms has been expected to compensate for the fall-off in work of other departments within those firms. The standstill agreement achieved by the Managers should prove very valuable in these circumstances and build long-term relationships with the firms.

Further support to Members continues to be provided by the Club's loss prevention activities. These comprise loss prevention advice, seminars and publications, the ship inspection programme, the pre employment medical examination scheme and Signum investigations and consultancy on suspicious or fraudulent claims against Members. This year saw particular loss prevention focus on risk profiling for Members where a fundamental understanding of the claims experience was likely to assist those Members with their future operations. Full details of the extensive loss prevention service can be found on the Club's website at www.ukpandi.com.

The website supports core Member service delivery via the secure Members Area where Member documentation, loss records and up to date individual claims information can be accessed and US oil declarations submitted. General information on the Club's cover, its operation and 24/7 contact details for its entire network are published in the public area of the website.

The Managers continually seek to improve the range and quality of the Club's services, and are pleased to receive comments from Members which would help to further improve the relevance and usefulness of those services.

Appendices to the Directors' report

Appendix 1 - Reserves of the Association

The following appendices are provided to show the reserves of the Association during the year, and the progress and current best estimate of the outcome of the open policy years.

The appendices are prepared under the accounting policies used within the Financial Statements.

Summary of Reserves

Amounts in $000	Appendix	2010	2009
Open policy years			
2009	2	(32,198)	-
2008	2	39,291	(61,641)
2007	2	(10,685)	(38,102)
2006		-	(13,623)
Deficit on Open years		(3,592)	(113,366)
Closed policy years	3	-	-
Contingency Account	3	211,276	254,162
Catastrophe reserve	3	42,891	42,458
Reinsurance Retention reserve		13,046	16,030
US Oil Pollution AP reserve		47,079	36,243
Statutory reserve		240	240
Total surplus		310,940	235,767
Outstanding claims		797,710	807,466
		1,108,650	1,043,233
Perpetual subordinated capital securities		98,405	97,950
		1,207,055	1,141,183

Appendix 2 - Development of open policy years

Amounts in $000	2009	2008	2007
Calls and premiums	385,707	480,291	450,129
Less reinsurance premiums	60,717	60,874	59,563
	324,990	419,417	390,566
Incurred claims:			
Paid	74,346	154,538	245,092
Known outstanding estimates	126,082	129,029	81,849
Unreported estimates	124,696	60,902	32,532
	325,124	344,469	359,473
Operating expenses	41,597	49,227	49,571
	366,721	393,696	409,044
Investment return	9,533	13,570	7,793
Deficit	(32,198)	39,291	(10,685)
Future investment income	19,000	7,000	2,000
Anticipated deficit	(13,198)	46,291	(8,685)

Notes:

(a) Incurred claims comprise claims paid (net of reinsurance recoveries), together with contributions to other P&I associations under the Group's pooling arrangements, claims management costs and expenses and estimates for reported and unreported claims (including future claims management costs).

(b) The figures for unreported claims include a prudential margin, over and above the actuarial best estimate, to reflect the uncertainty within claims reserving. This margin is weighted towards the most recent policy year being the most uncertain at the financial year end.

(c) Included in the policy year funds is a surplus balance of $3.7 million for 2007, a surplus of $4.7 million for 2008 and a deficit balance of $11.1 million for 2009 arising from additional premiums charged less claims and reinsurance for the oil pollution risk pertaining to United States voyages by tankers. These balances are available to meet the Association's contribution to Pool claims arising from this risk.

(d) The approximate yield of a 10 per cent supplementary premium on the open policy years would be $32 million (2009), $32 million (2008) and $30 million (2007).

(e) Calls and premiums are shown gross; operating expenses include acquisition costs.

(f) The outstanding contributions to other P&I associations' claims under the Group's pooling arrangement, including unreported claims, are $41 million (2009), $11 million (2008), $20 million (2007) respectively.

(g) Future investment income reflects the investment income expected in respect of policy year funds.

Appendix 3 - Development of closed policy years, contingency account and catastrophe reserve

Amounts in $000	Closed policy years	Contingency Account	Catastrophe reserve
Balance at 20th February 2009	190,925	254,162	42,458
Investment return	538	24,773	4,047
Perpetual subordinated capital securities interest	-	(9,000)	-
Reinsurance premiums	-	(10,600)	(3,614)
Transfers on closure:			
Deficit on 2006 policy year	-	(12,395)	-
Balance of 2006 policy year	129,471	-	-
Premium adjustments	85	-	-
Reserve transfer	-	(3,755)	-
Claims paid net of reinsurance recoveries etc.	(108,310)	(2,000)	-
Transferred to Contingency account on review of estimated and unreported claims	29,909	(29,909)	-
Balance at 20th February, 2010	242,618	211,276	42,891
Outstanding claims	242,618		
Net surplus (see Appendix 1)	-	211,276	42,891

Notes:

(a) On closure of the 2006 policy year, the sum of $2.6 million was transferred to the United States Oil Pollution AP reserve, and $3.8 million was transferred from the Reinsurance Retention reserve. The US Oil Pollution AP reserve is intended to support the Association's Pool contribution in respect of tanker oil pollution claims in the United States. The Reinsurance Retention reserve was created in April 1998 to fund the Association's pooling share of claims falling on the co-insurance (with other International Group Pool associations) layer of the International Group's reinsurance contract. Both reserves have subsequently been credited with their share of the Association's investment income.

(b) TThe outstanding claims on closed years include a provision for Group pooled claims of $67.4 million (prior year $51 million) including a forecast for unreported claims. The outstanding claims figure is shown net of recoveries from excess loss underwriters of $33.7 million (prior year $31.6 million), from the Pool of $57.9 million (prior year $48 million) and from other reinsurers of $3.9 million.

(c) The Reserve transfer relates to claims on closed years falling on the Reinsurance Retention reserve and the US Oil Pollution AP reserve.

Appendix 4 - Total funds and liabilities

Summary of funds available, estimated and forecast claims, and discounted value of future claims at 20th February 2010.

Amounts in $000	Funds available	Estimated claims and forecast of unreported claims	Discounted liability
Total Closed Policy Years	242,618	242,618	226,722
Open policy years			
2007	103,698	114,384	106,890
2008	229,223	189,931	177,487
2009	218,579	250,777	234,347
Reserves			
Reinsurance Retention reserve	13,046	-	-
US Oil Pollution AP reserve	47,079	-	-
Contingency Account	211,276	-	-
Catastrophe reserve	42,891	-	-
Statutory reserve	240	-	-
Total funds	1,108,650	797,710	745,446

The estimated outstanding claims have not been discounted within the financial statements. This appendix shows the net present value of the future flow of premiums and claims when discounted at 2.6 per cent. The rate of discount is a conservative estimate of the longer term rate of investment return. This discounting demonstrates the potential effect of the investment income generated by the funds of the Association when applied to reducing the liabilities, and thus shows the otherwise undisclosed potential within the Association's reserves.

Report of the auditors & notice of meeting

Report of the Auditors

To the Members of the United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited

We have audited the consolidated financial statements of The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited on pages 28-50.

These consolidated financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in Bermuda and Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion these consolidated financial statements present fairly, in all material respects, the financial position of the Association as at 20th February 2010 and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in Bermuda and Canada.

Moore Stephens & Butterfield
Chartered Accountants
2 Reid Street
Hamilton
Bermuda

26th April 2010

Note:
The maintenance and integrity of Association's website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that have occurred to the financial statements since they were initially presented on the website.

The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited
Incorporated under the laws of Bermuda

Notice of Meeting

Notice is hereby given that the fortieth Annual General Meeting of the Members of the Association will be held at Shangri-La Hotel, Shanghai on Monday 18th October 2010 at 9.00 am for the following purposes-

To receive the Directors' Report and Financial Statements for the year ended 20th February, 2010 and if they are approved, to adopt them.

To elect Directors.

To appoint auditors and authorise the Directors to fix their remuneration.

To transact any other business of an Ordinary General Meeting.

By Order of the Board

D.W.R. Hunter
Secretary

26th April 2010

Note:
A Member entitled to attend and vote at the above Meeting is entitled to appoint a proxy to attend and vote instead of him. The instrument appointing a proxy shall be left with the Secretary at Thomas Miller (Bermuda) Ltd., 1st Floor Chevron House, 11 Church Street, Hamilton HM11, Bermuda not less than 12 hours before the holding of the meeting.

Financial statements

Consolidated statement of operations for the year ended 20th February 2010

Amounts in $000	Note	2010	2009
Income			
Calls and premiums	5	**447,183**	548,723
Reinsurance premiums	6	**(75,935)**	(78,402)
		371,248	470,321
Expenditure			
Net claims incurred	7	**(319,964)**	(353,079)
Acquisition costs		**(23,061)**	(27,600)
Net operating expenses	8	**(21,052)**	(24,039)
		(364,077)	(404,718)
Operating surplus		**7,171**	65,603
Investment return	9	**78,665**	(56,182)
Interest payable on perpetual subordinated capital securities		**(9,000)**	(4,500)
Surplus before taxation		**76,836**	4,921
Taxation (charge)/credit	10	**(1,663)**	1,694
Surplus after taxation		**75,173**	6,615
Reserves at beginning of year		**235,527**	228,912
Reserves at end of year	17	**310,700**	235,527

The notes form an integral part of these financial statements.

Consolidated balance sheet at 20th February 2010

Amounts in $000	Note	**2010**	2009
Assets			
Investments	11	**1,036,364**	872,277
Cash balances	12	**30,067**	61,035
Amounts due from Members	13	**138,935**	213,212
Reinsurer's share of outstanding claims	15	**333,300**	243,274
Accrued interest		**4,366**	1,569
Deferred taxation	10	-	817
Sundry debtors	14	**19,111**	12,659
		1,562,143	1,404,843
Liabilities			
Gross outstanding claims	15	**1,131,010**	1,050,740
Creditors	16	**20,857**	18,759
Provisions		**931**	1,627
		1,152,798	1,071,126
Capital and reserves			
Reserves	17	**310,700**	235,527
Statutory reserve	17	**240**	240
Perpetual subordinated capital securities	18	**98,405**	97,950
		409,345	333,717
		1,562,143	1,404,843

The notes form an integral part of these financial statements.

Directors

Mr C.I. Caroussis
Mr E. André

Mr H.J. Wynn-Williams
Thomas Miller (Bermuda) Ltd
Managers

26th April 2010

Consolidated cash flow statement at 20th February 2010

Amounts in $000	**2010**	2009
Operating Activities		
Calls and premiums received	**518,020**	414,474
Receipts from reinsurance recoveries	**32,774**	13,021
Interest and dividends received	**3,942**	23,820
	554,736	451,315
Claims paid	**316,306**	264,310
Acquisition costs	**23,060**	27,600
Operating expenses paid	**19,005**	24,734
Reinsurance premiums paid	**75,034**	76,862
Pool claims paid	**49,703**	46,609
Taxation paid/(refunded)	**1,432**	(1,517)
	484,540	438,598
Net cash operating activities	**70,196**	12,717
Investing Activities		
Purchase of investments	**(1,159,150)**	(1,978,728)
Sale of investments	**1,057,986**	1,741,733
Net cash used in investing activities	**(101,164)**	(236,995)
Financing Activities		
Issue of perpetual subordinated capital securities	**-**	98,180
Net decrease in cash and cash equivalents	**(30,968)**	(126,098)
Cash and cash equivalents at beginning of year	**61,035**	187,133
Cash and cash equivalents at end of year	**30,067**	61,035

Notes to the financial statements

Note 1 - Constitution

The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited ("the Association") is incorporated in Bermuda as a company limited by guarantee and having a statutory reserve but not share capital. The principal activities of the Association are the insurance and reinsurance of marine protecting and indemnity risks on behalf of the Members. The liability of the Members is limited to the calls and supplementary premiums set by the Directors and in the event of its liquidation, any net assets of the Association (including the Statutory Reserve) are to be returned equitably to those Members insured by it during the final five underwriting years.

Note 2 - Accounting policies

(a) Basis of preparation

These financial statements have been prepared in accordance with accounting principles generally accepted in Bermuda and Canada. All transactions relate to continuing activities.

The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Subsequent results could differ from these estimates.

The Association has issued tradable securities on the London Stock Exchange. However the Association is not required to comply with the full disclosure requirements of the exchange since the securities are debt in nature.

(b) Basis of consolidation

These consolidated financial statements include the results of the wholly owned subsidiary companies, International P&I Reinsurance Company Limited ("IPIR"), which is registered in the Isle of Man, and The United Kingdom Mutual Steam Ship Assurance (Europe) Limited ("UK Europe"). IPIR reinsures 90 per cent of the risks retained by the holding company. The Association is the sole member of UK Europe which insures certain European Members of the holding company where a European insurer is required by statute.

The Association accounts for its investment in Hydra Insurance Company Limited ("Hydra") as a quasi-subsidiary. Hydra is a Bermudian segregated cell captive established by the International Group of P&I Clubs to reinsure part of the risk which clubs that are party to the Pooling Agreement previously reinsured in the market. Under the terms of the company's byelaws, the governing instrument assets are segregated in separate cells in such a way that they can be used only to satisfy the liabilities of the 'owning' club. The results of the separate cell "owned" by the Association are consolidated within the group financial statements, with all inter-company transactions eliminated on consolidation.

(c) Annual accounting

The consolidated statement of operations is prepared on an annual accounting basis and includes all the premiums for policies incepting in the year, the cost of claims incurred and reinsurance for the current year, and any adjustments relating to earlier years together with operating expenses and investment income. All revenue transactions appear in the statement of operations and are allocated to a policy year or to a reserve.

(d) Policy year accounting

The calls and premiums, reinsurance premiums payable, claims and reinsurance recoveries and outstanding claims are all allocated to the policy years to which they relate. Both the realised and unrealised investment income and exchange gains and losses are allocated proportionately to the average balance of funds on each open policy year and the other funds at quarterly intervals. Operating expenses are allocated to the current policy year.

(e) Closed policy years

On formally closing a policy year, an amount equivalent to the anticipated future investment income arising from funds attributable to that year is transferred into the policy year account from the Contingency account. This allows the policy year to close at the anticipated ultimate result. Thereafter, the actual income from such funds is credited to the Contingency Account so setting-off the original amount debited.

For a closed policy year, it is the policy of the Association to retain a balance sufficient to meet the outstanding and unreported claims on that year. Upon subsequent review (of that balance) any anticipated surplus or shortfall is allocated to or from the Contingency Account.

(f) Contingency Account

On closure of a policy year the anticipated surplus or deficit remaining on the year is transferred to or from the Account, bringing the year into balance. Thereafter, any subsequent increases or decreases in the anticipated level of outgoings on the policy year are absorbed by

the Account. The Account is charged with the policy year's anticipated future investment income at the time of closure; in return, it receives the actual investment income and exchange differences as they accrue. It is charged with the cost of the reinsurance contract with European Reinsurance Co. (see note 6). Any subsequent reinsurance recovery under the contract is transferred to the Account.

(g) Catastrophe reserve
The reserve is derived from calls specifically made on Members, together with its proportion of investment income and exchange differences, less transfers to the Contingency Account as resolved by the Board of Directors.

(h) US Oil Pollution Additional Premium reserve
This reserve is held to support the Association's Pool contributions in respect of oil pollution claims in the United States emanating from tankers carrying persistent oil cargoes. The balance of premiums less claims and reinsurance premiums arising from these voyages is transferred between the policy year and the reserve on closure of the policy year.

(i) Reinsurance Retention reserve
This reserve is derived from savings in the International Group reinsurance contract premium arising from co-insuring (with the other International Group Pool associations) a part of the contract. The savings arising are transferred from a policy year on closure to the reserve and are available to meet any claims on the co-insured portion.

(j) Calls and premiums
Calls and premiums include gross calls and supplementary premiums, less return premiums and provisions for bad and doubtful debts. These calls and premiums are the total receivable for the whole period of cover provided by the contracts incepting during the accounting period together with any premium adjustments relating to prior accounting periods.

The Directors retain the power to levy supplementary premiums, or give discounts on mutual premiums on open policy years. There are no unearned premiums.

(k) Claims
The claims include all claims incurred during the year, whether paid, estimated or unreported together with claims management costs and expenses, estimated future claims management costs and adjustments for claims outstanding from previous years. The claims also include this Association's share of similar associations' claims under International Group of P&I Clubs' pooling arrangements.

The estimates for known outstanding claims are based on the best estimates and judgement of the Managers of the likely final cost of individual cases based on current information. The individual estimates are reviewed regularly and include this Association's share of other associations' Pool claims.

The forecast of unreported claims is based on the estimated ultimate cost of claims arising out of events which have occurred before the end of the accounting period but have not been reported. These future claims are based on the Managers' best estimate of unreported claims on each policy year. The estimates are calculated by comparing the pattern of claims payments in the current policy years with earlier policy years, and then projecting the likely outcome of the more recent years adjusted by such variables required to project the likely ultimate cost of claims. The principal variables for which adjustment is made include the impact of large losses, changes in the mix of business written, the effects of inflation and changes in the Association's processes which may accelerate or decelerate claims development or the recording of claims. The principal assumption underlying this approach is that future claims development will follow past experience.

The more recent the policy year, the more difficult it is to judge the eventual outcome. The forecast of unreported claims for the current year, which has run only twelve months, is therefore the subject of some uncertainty. Accordingly, the Managers have taken a conservative approach when setting the level of unreported claims, preferring to be cautious in the most recent year until a clearer pattern emerges in the second year, when the level of uncertainty diminishes and forecasts may be made with greater certainty.

(l) Reinsurance recoveries
The liabilities of the Association are reinsured above certain levels with similar associations under the International Group's Pooling Agreement and with market underwriters. The figures in the consolidated statement of operations relate to recoveries on claims incurred during the year. Outstanding claims in the balance sheet are shown gross and the reinsurance recoveries are shown as an asset.

(m) Reinsurance premiums
These include premiums payable to market underwriters charged to the consolidated statement of operations on an accruals basis. The premiums are shown net of any commutations. The reinsurance contracts do not relieve the Association from its obligation to Members. The reinsurers are financially evaluated to minimise the

exposure of the Association to losses caused by reinsurer insolvencies.

(n) Acquisition costs
These comprise brokerage, commission and the management costs directly attributable to the processing of proposals and the issuing of policies; none of these costs have been deferred.

(o) Operating expenses
These include management costs and general expenses. The management costs cover the cost of premium collection, reinsurance and investment management and include the cost of providing offices, staff and administration but exclude acquisition and claims management costs. The general expenses include the cost of Board meetings, travel, communications and other costs directly attributed to the insurance activities.

(p) Foreign currency
Revenue transactions in foreign currencies have been translated into US dollars at rates revised at monthly intervals. All exchange gains and losses whether realised or unrealised are included in the consolidated statement of operations. The differences arising on currency translation and the realised differences arising on the sale of currencies are included within exchange gains and losses within investment income.

Foreign currency assets and liabilities except the cost of investments are translated into US dollars at the rates of exchange ruling at the balance sheet date. The resulting difference is treated as an exchange gain or loss within investment income.

Forward currency contracts are entered into in order to hedge the currency exposure of the investment portfolio. The contracts are for the forward sale of currencies which are matched by holdings of those currencies. The open contracts have been revalued at year-end rates of exchange and the potential profit or loss included with investments. The profit or loss is included within exchange gains and losses and the outstanding amounts on unsettled closed contracts are shown within debtors or creditors.

(q) Investments
The Association classifies financial assets as either 1) designated at fair value through profit and loss or 2) loans and receivables.

Financial assets at fair value through profit and loss
All of the financial investments of the Association are classified as designated at fair value through profit and loss. As a result, gains and losses are taken to the consolidated statement of operations, which reflects the management of the portfolio on a fair value basis. Fair values of investments traded in active markets are measured at bid price. Where there is no active market, fair value is measured by reference to other factors. Shareholdings in entities for which there is no recognised market are held at cost net of provision for any deemed permanent diminution in value.

The interest receivable from the investments together with the profits and losses on sales of investments, the amortised discount on zero coupon bonds, the amortised cost of options and dividend receipts are included within investment income in the consolidated statement of operations. The unrealised gains and losses on the movement in the market value of the investments compared to the cost are included in unrealised gains and losses on investments within investment income.

Loans and receivables
Loans and receivables are non derivative financial assets with fixed settlement values. Amounts due from Members and reinsurers are included in this category and are measured at cost less any provision for impairment in value.

(r) Taxation
The charge for UK taxation is shown in the consolidated statement of operations. The charge is based on a percentage of the investment income and both realised and unrealised investment gains less losses. Underwriting income is not taxable.

(s) Related party disclosures
The Association has no share capital and is controlled by the Members who are also the insureds. The subsequent insurance transactions are consequently deemed to be between related parties but these are the only transactions between the Association and the Members.

All of the Directors (except two who are Bermuda residents) are representatives or agents of Member companies and other than the insurance and membership interests of the Directors' companies, the Directors have no financial interests in the Association.

(t) Perpetual subordinated capital securities
Perpetual subordinated capital securities represents instruments which incorporate features of both debt and capital. The instruments are repayable at the option of the issuer on completion of an initial non settlement period.

The costs specifically associated with the issue of such instruments are deferred against monies received and

charged to the income and expenditure account over the period of five years until the capital can be repaid. Interest payable is accrued on a straight line basis. The securities are stated net of issue costs.

(u) Cash and cash equivalents

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value. Cash equivalents are investments with original maturity of three months or less from the date of acquisition.

(v) Future accounting standards

International Financial Reporting Standards (IFRS)

In February 2008, the CICA confirmed that Canadian reporting issuers will be required to report under IFRS effective from 1st January 2011, including comparative figures for the prior year.

New accounting standards

There are a number of new accounting standards applicable within Canada GAAP which are effective from 1st January 2011. These are as follows:

- Section 1582 Business combinations
- Section 1601 & 1602 Consolidated financial statements and non controlling interests

The Association does not believe that there will be any material impact on the consolidated financial statements upon the adoption of these pronouncements, unless the Association's circumstances change

Note 3 – Management of risk

The Association's appetite for, and management of, risk is set by the Board of Directors. The Association is primarily focussed on the identification and management of potential risks which fall into four key categories:

a) Insurance risk – incorporating underwriting and reserving risk

b) Market risk – incorporating investment risk, interest rate risk and currency rate risk

c) Credit risk – being the risk that a counterparty is unable to pay amounts in full when due

d) Liquidity risk – being the risk that cash may not be available to pay obligations as they fall due

In order to manage these risks, the Association has continued to develop the risk culture within the business by improving the internal and external governance frameworks and through the Individual Capital Assessment ("ICA") which is used to analyse the overall risks facing the Association and as a tool for testing significant business decisions.

The Board has sought to establish and embed risk management procedures within the business through a compliance manual, an internal quality management system and a risk management forum which considers and logs potential risks and how they are to be managed. The Board monitors the development and operation of risk management policies through a governance structure which includes an internal audit function and three sub committees:

1. The Ship and Membership Quality Committee ensures the quality of Association membership thereby managing insurance and credit risk
2. The Strategy Committee assists the Board in formulating strategic direction across the business including risk, investment and reinsurance strategy.
3. The Audit Committee considers the Business Risk Log and directs internal audit effort.

(a) Insurance Risk

The Association's exposure to insurance risk is initiated by the underwriting process and incorporates the possibility that an insured event occurs, leading to a claim on the Association from a Member. The risk is managed by the underwriting process, acquisition of reinsurance cover, cover provided by the International Group Pooling Agreement and the management of claims cost.

Underwriting process

The Association provides Protection and Indemnity risk cover to Members. The Association is a mono-line insurer writing complex risks. The Association utilises an acceptable loss ratio method of pricing risks and development of claims is monitored on a quarterly basis.

Underwriting authority is delegated to specific individuals who operate under set underwriting parameters and the ongoing guidance and review of senior management. These parameters cover areas such as screening of potential new members and risks.

Reinsurance and International Group Pooling agreement

The Association's reinsurance programme comprises excess of loss reinsurance cover purchased jointly with other members of the International Group, facultative reinsurance and a multi-year reinsurance contract.

The International Group Pooling agreement provides a sharing of claims costs between thirteen members. The first $7 million of each claim is retained by the Association with the next $43 million shared between Pool members at a rate calculated each year. Above $50 million, the excess of loss reinsurance provides cover up to a limit of $3.05 billion.

Management of claims cost
As a mutual, the Association considers the management of claims cost for its Members with great importance. The Association's strategy is to help its Members prevent and avoid the occurrence of incidents as well as ensuring the efficient handling and management of claims when they occur. To facilitate this strategy the Association has established programmes to reduce claims risk including: information for Members on common claims and how they may be prevented, completion of inspections to review ship conditions, the pre employment medical examinations and production of various guides for safe carriage and shipping.

(b) Market Risk
Interest rate risk arises primarily from investments in fixed interest securities the value of which is inversely correlated to movements in market interest rates. In addition, to the extent that claims inflation is correlated to interest rates, liabilities to Members are exposed to interest rate risk.

Interest rate risk is managed through the investment strategy and accordingly debt and fixed interest securities are predominantly invested in high quality corporate and government backed bonds. These investments typically have a short duration and terms to maturity comparing favourably to the maturity profile of liabilities. Also the Association's financing structure includes perpetual subordinated capital securities which pay a fixed interest rate. The Association has no debt with interest payments which vary with changes in interest rate.

The Board of the Group's subsidiary undertaking, IPIR, manages the investment risk of the majority of the Association's assets.

Sensitivity analysis
It is estimated that the value of the Association's investment would decrease for the following amounts if market interest rates had increased by 100 basis points at the balance sheet dates and all assumptions had remained unchanged.

Amounts in $000	Effect on investment valuation
As at 20 February 2010	11,291
As at 20 February 2009	2,396

Equity and hedge fund price risk
The Association is exposed to price risk through its holding of equities and "fund of fund" hedge funds. The exposure through equities is limited to a small and controlled proportion of the overall portfolio. At the year end the holding in equity instruments amounted to 14 per cent (2009: 3 per cent).

The aim of the investment in the "fund of funds" is to reduce volatility through diversification. The exposure to this investment is limited by investment guidelines and at the year end amounted to $93 million (2009: $ 84 million).

Where available, the Association uses closing bid market values to determine the fair value of an investment holding. Unquoted investments are valued by reference to recent observable market transactions. The carrying value of non quoted equity holdings at the year end amounted to $16.8 million (2009: $15.6 million)

Sensitivity analysis
A 10 per cent increase in equity values would be estimated to have increased the surplus before tax and reserves at the year end by $15.2 million.

Currency risk
The Association is exposed to currency risk in respect of liabilities under policies of insurance denominated in currencies other than US Dollars. The most significant currencies to which the Association is exposed are Sterling and the Euro. In order to manage this risk, the Association holds a proportion of its investments in each currency at a level to match expected future claim payments in that currency. In addition, from time to time, the Association uses forward currency contracts to protect currency exposures and maintain investment policy benchmarks.

The profile of the Association's assets and liabilities, categorised by settlement currency, at their translated carrying amount, is set out below. Certain amounts, either due to their nature, notably reinsurer's share of outstanding claims, or the existence of forward contracts, may depend on a different underlying currency.

As at 20 February 2010

Amounts in $000	US Dollar	Sterling	Euro	Other	Total
Debt securities	369,769	49,397	69,499	24,938	513,603
Equities	123,584	29,410	15,461	-	168,455
Absolute return funds	93,011	-	-	-	93,011
UCITS	219,622	16,585	23,439	-	259,646
Forward currency contracts	(268)	899	1,018	-	1,649
Cash balances	19,061	1,309	2,062	7,635	30,067
Amounts due from Members	136,855	(8)	1,847	241	138,935
Reinsurers' share of outstanding claims	333,300	-	-	-	333,300
Accrued interest	2,326	880	1,120	40	4,366
Sundry debtors	20,556	(3,845)	409	1,991	19,111
Gross outstanding claims	(723,102)	(52,744)	(166,975)	(188,189)	(1,131,010)
Other liabilities	(19,707)	(510)	(1,529)	(42)	(21,788)
	575,007	41,373	(53,649)	(153,386)	409,345

As at 20 February 2009

Amounts in $000	US Dollar	Sterling	Euro	Other	Total
Debt securities	306,238	61,338	53,798	16,888	438,262
Equities	23,683	15,628	-	-	39,311
Absolute return funds	84,177	-	-	-	84,177
UCITS	232,615	10,479	67,928	-	311,022
Forward currency contracts	397	-	-	(892)	(495)
Cash balances	58,214	1,360	1,233	228	61,035
Amounts due from Members	210,289	24	2,622	277	213,212
Reinsurers' share of outstanding claims	243,274	-	-	-	243,274
Accrued interest	1,569	-	-	-	1,569
Sundry debtors	8,361	3,118	675	1,322	13,476
Gross outstanding claims	(671,782)	(49,000)	(155,125)	(174,833)	(1,050,740)
Other liabilities	(18,245)	(717)	(1,409)	(15)	(20,386)
	478,790	42,230	(30,278)	(157,025)	333,717

Sensitivity analysis

A 5 per cent strengthening of the following currencies against the US Dollar would be estimated to have decreased)/ increased the surplus before tax and reserves at the year end by the following amounts:

Amounts in $000	Effect on surplus after tax and reserves
As at 20 February 2010	
Sterling	2,061
Euro	(151)
As at 20 February 2009	
Sterling	2,422
Euro	(530)

A 5 per cent weakening of those currencies against the US Dollar would be estimated to have the equal and opposite effect.

(c) Credit risk

The key areas where the Association is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due, are

- Reinsurers' share of insurance liabilities
- Amounts due from reinsurers in respect of claims already paid
- Amounts due from Members
- Counterparty risk with respect to cash and investments

The following tables provide information regarding aggregate credit risk exposure for financial assets with external credit ratings and the profile of the date at which amounts are due for settlement. The credit rating bands are provided by independent ratings agencies:

As at 20 February 2010

Amounts in $000	AAA	AA	A	Not readily available/ not rated	Total
Debt securities	448,107	46,037	19,147	312	513,603
Equities	-	-	-	168,455	168,455
Absolute return funds	-	-	-	93,011	93,011
UCITS	259,646	-	-	-	259,646
Forward currency contracts	-	-	-	1,649	1,649
Cash balances	-	11,418	16,769	1,880	30,067
Amounts due from Members	-	-	-	138,935	138,935
Amounts due from group pooling arrangement	-	-	60,377	59,652	120,029
Amounts due from reinsurers	771	118,929	104,650	1,893	226,243
Accrued interest	3,851	292	223	-	4,366
Sundry debtors	-	-	-	6,139	6,139
Total assets	712,375	176,676	201,166	471,926	1,562,143

As at 20 February 2009

Amounts in $000	AAA	AA	A	Not readily available/ not rated	Total
Debt securities	378,780	38,469	21,013	-	438,262
Equities	-	-	-	39,311	39,311
Absolute return funds	-	-	-	84,177	84,177
UCITS	311,022	-	-	-	311,022
Forward currency contracts	-	(495)	-	-	(495)
Cash balances	-	23,097	30,812	7,126	61,035
Amounts due from Members	-	-	-	213,212	213,212
Amounts due from group pooling arrangement	-	-	39,919	38,703	78,622
Amounts due from reinsurers	-	111,913	46,530	6,209	164,652
Accrued interest	-	-	-	1,569	1,569
Sundry debtors	-	-	-	13,476	13,476
Total assets	689,802	172,984	138,274	403,783	1,404,843

As at 20 February 2010

Amounts in $000	Neither past due or impaired	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Debt securities	513,603	-	-	-	-	513,603
Equities	168,455	-	-	-	-	168,455
Absolute return funds	93,011	-	-	-	-	93,011
UCITS	259,646	-	-	-	-	259,646
Forward currency contracts	1,649	-	-	-	-	1,649
Cash balances	30,067	-	-	-	-	30,067
Amounts due from Members	131,882	7,053	-	-	-	138,935
Reinsurers share of outstanding claims	333,300	-	-	-	-	333,300
Accrued interest	4,366	-	-	-	-	4,366
Sundry debtors	14,928	3,624	183	286	90	19,111
Total assets	1,550,907	10,677	183	286	90	1,562,143

As at 20 February 2009

Amounts in $000	Neither past due or impaired	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Debt securities	438,262	-	-	-	-	438,262
Equities	39,311	-	-	-	-	39,311
Absolute return funds	84,177	-	-	-	-	84,177
UCITS	311,022	-	-	-	-	311,022
Forward currency contracts	(495)	-	-	-	-	(495)
Cash balances	61,035	-	-	-	-	61,035
Amounts due from Members	210,124	2,017	1,071	-	-	213,212
Reinsurers share of outstanding claims	243,274	-	-	-	-	243,274
Accrued interest	1,569	-	-	-	-	1,569
Sundry debtors	13,133	227	32	84	-	13,476
Total assets	1,401,412	2,244	1,103	84	-	1,404,843

(d) Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations as they fall due at a reasonable cost. The Association maintains holdings in short term deposits to ensure sufficient funds are available to cover anticipated liabilities and unexpected levels of demand.

The following table provides a maturity analysis of the Group's financial assets representing the date that a contract will mature, amounts are due for payment or the asset could be realised without significant additional cost:

As at 20 February 2010

Amounts in $000	Short term assets	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Debt securities	513,603	-	-	-	-	513,603
Equities	168,455	-	-	-	-	168,455
Absolute return funds	-	93,011	-	-	-	93,011
UCITS	259,646	-	-	-	-	259,646
Forward currency contracts	-	1,649	-	-	-	1,649
Cash balances	30,067	-	-	-	-	30,067
Amounts due from Members	2,194	136,741	-	-	-	138,935
Reinsurers share of outstanding claims	-	110,849	73,844	106,210	42,397	333,300
Accrued interest	-	4,366	-	-	-	4,366
Sundry debtors	4,183	14,928	-	-	-	19,111
Total assets	978,148	361,544	73,844	106,210	42,397	1,562,143

As at 20 February 2009

Amounts in $000	Short term assets	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Debt securities	438,262	-	-	-	-	438,262
Equities	39,311	-	-	-	-	39,311
Absolute return funds	84,177	-	-	-	-	84,177
UCITS	311,022	-	-	-	-	311,022
Forward currency contracts	(495)	-	-	-	-	(495)
Cash balances	61,035	-	-	-	-	61,035
Amounts due from Members	-	212,141	1,071	-	-	213,212
Reinsurers share of outstanding claims	-	79,177	50,646	75,539	37,912	243,274
Accrued interest	-	1,569	-	-	-	1,569
Sundry debtors	-	13,133	227	32	84	13,476
Total assets	933,312	306,020	51,944	75,571	37,996	1,404,843

The following is an analysis of the estimated timings of net cash flows by financial liability. The timing of cash flows are based on current estimates and historic trends and the actual timings of cash flows may be materially different from those disclosed below:

As at 20 February 2010

Amounts in $000	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Gross outstanding claims	376,150	250,580	360,409	143,871	1,131,010
Other liabilities	20,311	1,377	100	-	21,788
Total liabilities	396,461	251,957	360,509	143,871	1,152,798

As at 20 February 2009

Amounts in $000	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Gross outstanding claims	341,977	218,750	326,267	163,746	1,050,740
Other liabilities	18,914	454	678	340	20,386
Total liabilities	360,891	219,204	326,945	164,086	1,071,126

(e) Limitation of the sensitivity analysis

This sensitivity analysis shows the impact of a change in one input assumption with other assumptions remaining unchanged. In reality, there is normally correlation between the change in certain assumptions and other factors which would potentially have a significant impact on the effect noted above.

(f) Fair value estimations

From 1st February 2009, the group adopted the amendment to CICA 3862. This requires, for financial instruments held at fair value in the balance sheet, disclosure of fair value measurements by level of the following fair value hierarchy

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities
Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the assets or liability, either directly (that is, prices) or indirectly (that is, derived from prices)
Level 3 – Inputs for the assets or liability that are not based on observable market data (that is, unobservable inputs)

All of the Association's financial assets and liabilities that are measured at fair value at both 20th February 2010 and 20th February 2009 fall into the following categories

Amounts in $000	**2010**	2009
Categories		
Level 1	**151,616**	23,663
Level 2	**867,909**	832,966
Level 3	**16,839**	15,648
	1,036,364	872,277

The movement in Level 3 is as a result of fluctuations in the exchange rate since the shares are denominated in sterling.

The fair values of financial instruments traded on the active markets are based on quoted bid prices as at the balance sheet date. All valuations are taken from external price feeds based upon market prices or broker quotes.

Note 4 – Capital management

The Association maintains an efficient capital structure from a combination of Members' funds (reserves) and long term funding (perpetual subordinated capital securities), consistent with the Association's risk profile. The Association's objective is to maintain sufficient capital to ensure it is able to continue as a going concern, meet regulatory requirements and maintain an "A" rating with Standard and Poor's, with a substantial margin in each case.

The Association monitors available capital and its funding structure in the light of the prevailing economic environment, the risk associated with its asset holdings and regulatory developments impacting on the Association.

The Association's principal regulator, amongst others, is the Bermuda Monetary Authority. The Association also submits to regulation by the Financial Services Authority ("FSA") in the United Kingdom. Under the FSA's ICA regime the Association is obliged to assess and maintain the amount of capital required to meet the risks that it faces based on a 99.5 per cent confidence level of solvency over one year or a longer time frame with an equivalent probability. Throughout the period the Association complied with the FSA's capital requirements and the requirements in the other countries in which it operates.

The issue of perpetual subordinated capital securities allowed the Association to strengthen its capital base in line with its objectives. The capital issued qualifies as tier one capital for the purposes of the FSA requirements. Its purpose is to provide long term capital without forming part of ongoing operational cash requirements.

At the year end the Association's capital resources included reserves of $311 million (2009: $236 million) and Perpetual Subordinated Capital Securities capital of $98 million (2009: $98 million).

Note 5 – Calls and premiums

Amounts in $000	**2010**	2009
Mutual		
Mutual premium	**319,111**	342,139
Supplementary calls	**63,316**	128,356
Return premiums	**(8,398)**	(3,647)
Release charges	**8,156**	2,617
	382,185	469,465
Fixed premium		
Chartered vessels	**48,515**	57,735
Owned vessels	**10,396**	11,810
US Oil Pollution	**6,087**	9,713
	64,998	79,258
	447,183	548,723

Note 6 – Reinsurance premiums

Amounts in $000	**2010**	2009
Market underwriters	**65,335**	67,802
Other reinsurance arrangements	**10,600**	10,600
	75,935	78,402

Note 7 - Net claims incurred

Amounts in $000	**2010**	2009
Gross claims paid:		
Members' claims	**316,560**	273,130
Group's pooling arrangements	**49,703**	46,609
	366,263	319,739
Less reinsurance recoveries:		
Group's pooling arrangements	**28,989**	243
Market underwriters	**7,554**	10,671
	36,543	10,914
Net claims paid	**329,720**	308,825
Movement in provision for outstanding claims:		
Provision carried forward	**1,131,010**	1,050,740
Less: Provision brought forward	**1,050,740**	1,001,848
	80,270	48,892
Less: Movement in reinsurer's share of gross outstanding claims		
Provision carried forward	**333,300**	243,274
Less: Provision brought forward	**243,274**	238,636
	90,026	4,638
Change in provision for net outstanding claims	**(9,756)**	44,254
Net incurred claims	**319,964**	353,079

Note 8 – Operating expenses

Amounts in $000	**2010**	2009
Residual management fee	**12,558**	14,611
Directors' meetings	**2,055**	2,702
Managers/Agent travel	**602**	688
Sales and marketing	**434**	558
Publications	**229**	251
Printing and telecommunications	**217**	273
Correspondent charges	**6**	9
Legal and professional expenses	**2,283**	1,469
Bank and financial expenses	**686**	791
Loss prevention initiatives	**190**	182
Ship inspection initiatives	**523**	539
Operating branch and subsidiary costs	**977**	640
Other expenses	**292**	1,326
	21,052	24,039
Included within operating expenses are the following:		
Directors' Fees	**823**	785
Auditors' fees - payable for the audit of the parent company	**163**	198
- payable for the audit of subsidiaries	**122**	151
- other services	**116**	152
	1,224	1 ,286

Note 9 – Investment return

Amounts in $000	**2010**	2009
Interest on fixed income securities	**12,441**	15,556
Bank deposit interest	**22**	6,346
Dividends receivable	**3,841**	1,105
Profit/(Loss) on sale of investments	**1,867**	(1,029)
Other investment charges	**(563)**	(151)
	17,608	21,827
Unrealised gains/(losses) on investments	**48,275**	(40,104)
Exchange gain/(loss)	**12,782**	(37,905)
	78,665	(56,182)

The investment portfolio incorporates holdings in a number of different currencies designed to protect the Association from fluctuations within claims outstanding as a result of movements in exchange rates. This leads to the exchange gain or loss noted in the table above. The associated fluctuations within claims outstanding are included within the change in provision for net outstanding claims (see note 7).

Note 10 – Taxation

Amounts in $000	**2010**	2009
Taxation charge based on investment income in the current financial year	**(1,663)**	-
Adjustment in respect of prior periods	**817**	877
Deferred taxation on investment losses	**-**	817
Deferred taxation in respect of prior periods	**(817)**	-
	(1,663)	1,694
Surplus/(Deficit) before taxation	**76,838**	4,921
Expected taxation charge at 28 per cent	**(21,515)**	(1,378)
Underwriting result not subject to taxation	**2,008**	18,369
Portion of investment income not subject to taxation	**17,844**	(16,174)
Net adjustment in respect of prior periods	**-**	877
Taxation (charge)/credit	**(1,663)**	1,694

A deferred tax asset of $Nil (2009: $817,000) has been recognised in the balance sheet and relates to investment losses.

Note 11 – Investments

Amounts in $000	**2010**	2009
Listed Investments		
Fixed income securities	**513,603**	438,262
Shares and other variable income securities	**151,616**	23,663
Undertakings for Collective Investments of Transferable Securities (UCITS)	**259,646**	311,022
Investments in unit trusts	**93,011**	84,177
Total listed investments	**1,017,876**	857,124
Cost $952,680 (2009: $554,100)		
Other Investments		
Thomas Miller Holdings Limited	**16,819**	15,628
Hydra Insurance Co. Ltd	**20**	20
Open forward currency contracts	**1,649**	(495)
Total investments	**1,036,364**	872,277

The listed investments, which are held for trading, are quoted on major recognised international stock exchanges.

The Association's investment policy requires that, at the time of purchase, fixed interest and government securities have a credit rating of A or better. The market value of the these investments may be affected by changes in prevailing levels of interest rates and other factors and, at the balance sheet date, the investments have effective yields of between 1 and 7 per cent (2009: 1 and 7 per cent).

Of the fixed income securities $246.7 million (2009: $135.4 million) relate to government securities.

The investment in Thomas Miller Holdings Limited represents approximately 15 per cent of the share capital of the entity. Thomas Miller Holdings is the ultimate parent of Thomas Miller (Bermuda) Limited which provides management services to the Association (see note 21). Since there is no active market for the shares in Thomas Miller Holdings Limited, the investment is held at cost, less provisions for any impairment. The increase in valuation during the year is the result of fluctuations in the exchange rate since the shares are denominated in sterling.

Open forward currency contracts represent potential losses or gains on forward contracts, which have been entered into for the purpose of protecting the assets of the Association. These contracts were matched against currency and asset holdings in excess of the amount of the contracts. The contracts have been revalued at 20th February 2010 using exchange rates prevailing at that date.

Note 12 – Cash and cash equivalents

Amounts in $000	**2010**	2009
Cash and cash equivalents	**30,067**	61,035

Note 13 – Amounts due from Members

Amounts in $000	**2010**	2009
Members' balances due	**138,935**	213,212

Note 14 – Sundry debtors

Amounts in $000	**2010**	2009
Reinsurance and pool recoveries	**12,992**	9,223
Funds with representatives	**185**	312
Claims recoverable from Members and third parties	**-**	126
Prepayments and other debtors	**5,934**	2,998
	19,111	12,659

Note 15 - Outstanding claims

Amounts in $000	**2010**	2009
Closed policy years	**242,621**	190,925
Open policy years		
2009	**250,777**	-
2008	**189,931**	287,978
2007	**114,381**	194,492
2006	**-**	134,071
	797,710	807,466
Gross outstanding claims		
Members' claims	**1,032,825**	909,319
Other clubs' Pool claims	**98,185**	141,421
	1,131,010	1,050,740
Reinsurer's share of gross outstanding claims		
Group excess of loss reinsurance	**(111,762)**	(54,652)
Pool recoveries	**(111,538)**	(78,622)
Other reinsurers	**(110,000)**	(110,000)
	(333,300)	(243,274)
Net outstanding claims	**797,710**	807,466

The total of outstanding claims of $1,131 million (2009: $1,051 million) includes a forecast of unreported claims of $341 million (2009: $289 million) on open and closed policy years and an estimate of $30 million (2009: $28 million) for future claims management costs. Claims outstanding includes provision for IBNR claims which is set by reference to, amongst other factors, standard actuarial techniques and projections. During the year the IBNR reserve for Occupational Disease claims was increased by $15 million to $50 million. The nature of Occupational Disease claims having significant delay before notification and sensitive to likelihood of notification, makes them particularly uncertain for reserving purposes.

Other reinsurance includes the recovery of $110 million on the multi year policy with Swiss Re. The Association has the option to commute this contract from August 2010.

Note 16 – Creditors

Amounts in $000	**2010**	2009
Reinsurance Premiums	**9,406**	8,505
Members' balances	**100**	240
Taxation	**470**	290
Others	**10,881**	9,724
	20,857	18,759

Note 17 - Reserves

Amounts in $000	**2010**	2009
Open policy years		
2009	**(32,198)**	-
2008	**39,291**	(61,641)
2007	**(10,685)**	(38,102)
2006	**-**	(13,623)
	(3,591)	(113,366)
Contingency Account	**211,276**	254,162
Catastrophe reserve	**42,891**	42,458
US Oil Pollution AP reserve	**47,079**	36,243
Reinsurance Retention reserve	**13,046**	16,030
Statutory Reserve	**240**	240
	310,940	235,767
Perpetual subordinated capital securities	**98,405**	97,950
	409,345	333,717

The reserves are available to meet any deterioration in the open and closed policy years and to contribute to overspill or pool claims for which no specific provision has been made. If necessary these funds may be supplemented by calls upon Members (other than those on a fixed premium basis) in accordance with Rules 19 to 25 inclusive. $1.5 million of the reserves are included in the Singapore Branch financial statements, as required by the Singapore regulator.

Note 18 – Perpetual subordinated capital securities

Amounts in $000	**2010**	2009
Issue of perpetual subordinated capital securities	**100,000**	100,000
Related transaction costs	**(1,595)**	(2,050)
	98,405	97,950

The securities were issued on 20th August 2008 and are listed for trading on the London Stock Exchange. Interest payable on the securities amounts to 9 per cent per annum until 2013. Following 2013, the interest rate will vary with LIBOR rates. The securities are perpetual but can be redeemed at the option of the Association after a five year non call period.

The structure of the perpetual capital securities as Innovative Tier 1 capital means that the Association has the right, but not the obligation, to defer interest payments if a Regulatory Intervention occurs or the Solvency Condition (being 125 per cent of the Association's Enhanced Capital Requireent) is not met. No interest will accrue on any Deferred Interest Payment. Any Deferred Interest Payment may be satisfied at any time at the Association's election, provided that the Association must satisfy such Deferred Interest Payment on the earliest of the following to occur:

- the date on which a Regulatory Intervention no longer applies and the Association meets and, after payment of the Deferred Interest will meet, the Solvency Condition;
- a distribution of assets is made to Members of the Association generally (other than in their capacity as Senior Creditors);
- the date on which a return of Surplus Calls is made;
- any payment is made on any securities or other obligations which rank pari passu with or junior to the Capital Securities;
- a redemption of the Capital Securities; and
- winding-up.

Where an Interest Payment is deferred, the Association will be restricted from making payments on, or redeeming, any Parity Securities or junior obligations unless and until it pays (including by way of alternative satisfaction mechanism, (ASM)) in full all current and Deferred Interest Payment.

The ASM provides that investors should always receive payments made in respect of Capital Securities in cash or by way of an issue to them of payment in kind, (PIK), securities.

For Deferred Interest Payment the Association must and for any other Interest Payments the Association may, use any of the following or combination thereof (as the Board deems appropriate) to satisfy that payment:

- out of the amounts raised after the relevant Interest Payment Date from new Capital Items which the Association determines in its sole discretion remain available for such use at that time;
- by issuing PIK Securities (i.e., a further issue of fully-fungible Capital Securities) to holders; or
- by issuing Other Payment Securities (i.e., a new issue of securities pari passu with the Capital Securities) – such amount to be calculated by a Calculation Agent appointed at the time - to the Trustee, which will then be sold to purchasers for a cash amount.

Note 19 – Designated reserves

In recent years the increase in the Group Pool retention has led the member associations of the International Group of P&I Clubs to enter into a joint agreement to provide each other with additional security. Under the agreement this Association maintains a letter of credit for $33.6 million to cover its share of the increased Group exposure.

Note 20 – Average expense ratio

In accordance with Schedule 3 of the International Group Agreement, the Association is required to disclose its average expense ratio, being the ratio of operating expenses to income, including premium and investment return.

The operating expenses include all expenditure incurred in operating the Association, excluding expenditure incurred in dealing with claims. The premium income includes all premiums and calls. The investment return includes all income and gains whether realised or un-realised, exchange gains and losses less tax, custodial fees and internal and external investment management costs.

The Association does not charge internal investment management costs to investment income but includes these costs within the management fee within operating expenses. To calculate the ratio, the figures are those disclosed within the statement of operations except that the internal investment management costs are taken as being the subsidiary company's management fee.

For the five years ended 20th February 2010, the ratio of 9.37 per cent (2009: 9.96 per cent) has been calculated in accordance with the Schedule and the guideline issued by the International Group and is consistent with the relevant financial statements.

Note 21 – Related party transactions

The Association has no share capital and is controlled by the Members who are also the insureds. The subsequent insurance transactions are consequently deemed to be between related parties but these are the only transactions between the Association and the Members.

All of the Directors (except two who are Bermuda residents) are representatives or agents of Member companies and other than the insurance and membership interests of the Directors' companies, the Directors have no financial interests in the Association.

Thomas Miller (Bermuda) Limited provides management services to the Association. This company is a subsidiary of Thomas Miller Holdings Limited in which the Association holds an investment.

Managers and Officer

Managers: Thomas Miller (Bermuda) Ltd
Secretary of the Association: D.W.R. Hunter

Registered Office and business address of the Association

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