UK P&I CLUB

STRENGTH & STABILITY

October Review 2014

UK P&I CLUB
IS MANAGED
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FINANCIAL OVERVIEW

$529
Free reserves & hybrid capital $m

A (STABLE)
Standard & Poor's rating

$4.27
Free reserves & hybrid capital per gt

109%
Combined ratio

OVERVIEW

The strength of the Club has enabled it to weather the particularly intense claims year of 2013 and to return a break-even result for the half year.

After the first six months of the year, the Club holds free reserves and hybrid capital of $529 million.

A small number of significant claims has increased the total cost of the 2013 policy year to the extent that it is now projected to be one of the most expensive years of the last two decades.

Conversely, the 2014 policy year has performed in line with expectations but the late development on prior policy years has increased the combined ratio for the half year to 109%. This underwriting deficit has been covered by a positive return on the Club's investment portfolio.

The Club's reinsurance programme has played an important part in managing volatility arising from large claims, particularly in the 2012 and 2013 policy years. This reinsurance can reduce the Club's exposure to claims volatility but not remove it. The availability of capital and free reserves enables the Club to manage the impact of the very expensive claims years.

A combination of an increase in the frequency of higher value claims on the one hand, and the underlying inflation in the attritional claims on the other, underlines the need to keep the premium moving.

FINANCIAL HIGHLIGHTS

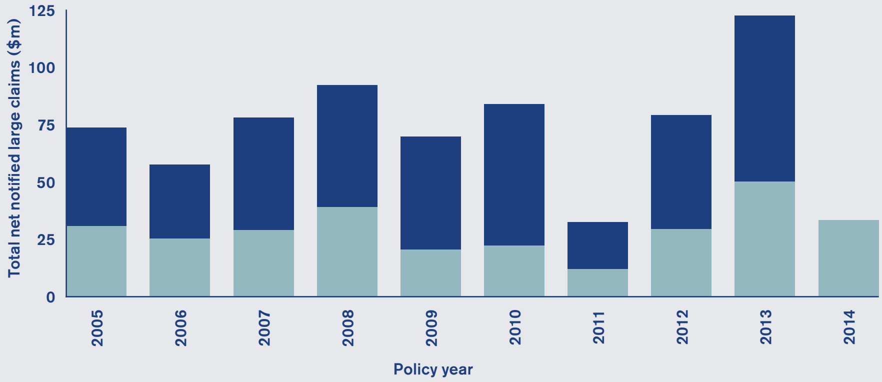
In the first six months of the year, the Club's free reserves and hybrid capital have been maintained at the year end level.

LARGE CLAIMS

- Large claims represent over half the total cost of a policy year despite being only 1% by number
- The 2013 policy year suffered approximately twice as many large claims as an average year
- The unpredictability of large claims brings volatility to the overall cost of a policy year

Key
18 months
6 months

Net notified large claims (>$0.5m) at 6 and 18 months by policy year

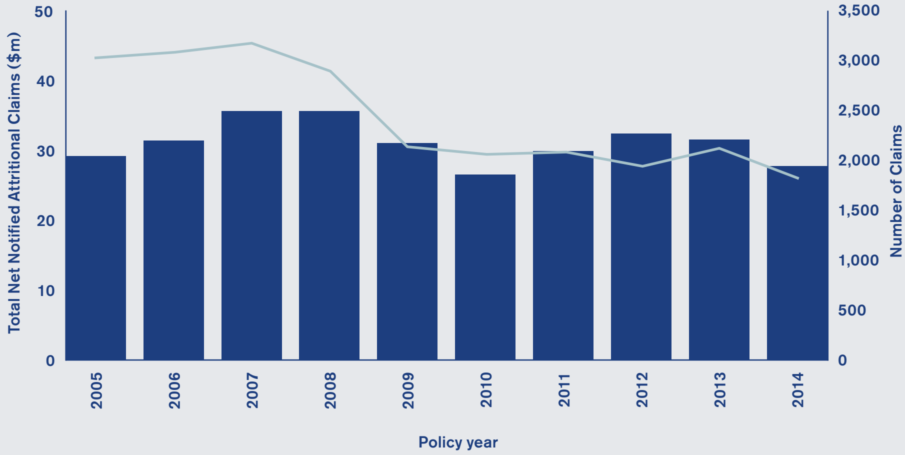


ATTRITIONAL CLAIMS FREQUENCY & VALUE

- Claims frequency remains low having fallen sharply during the economic slow down
- The average cost of a claim has increased by 50% over the last 10 years

Key
Notified attritional claims cost
Number of claims

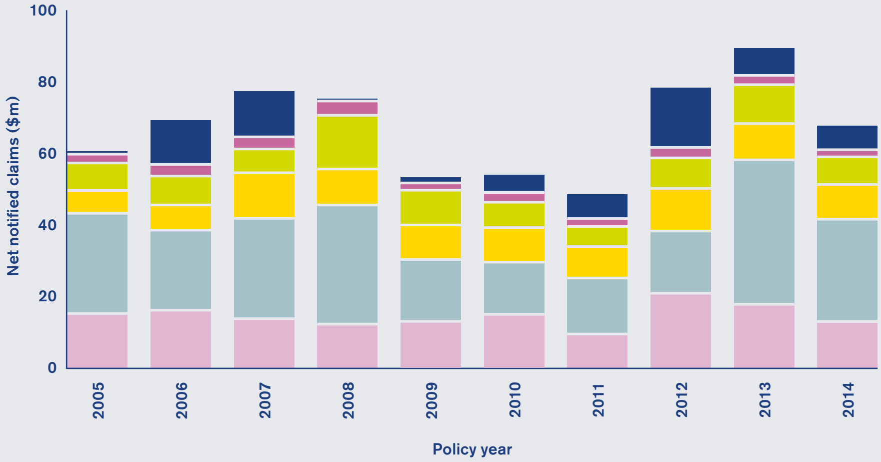
Attritional claims (<$0.5m) - total cost and claims frequency at 6 months for years 2005-2014



CLAIMS VALUES

- The 2013 policy year will be one of the most expensive years of the last two decades following a cluster of large casualty and injury claims
- After six months, the 2014 policy year is more encouraging with total claims 25% below the expensive 2013 year
- Large casualty claims continue to have a significant impact on the Club's results
- The Club's excellent record on the Pool has reduced the Club's Pool contribution steadily over recent years and shielded the Club from the increasing costs of the very largest P&I claims in the market

Net notified claims at 6 months for policy years 2005-2014



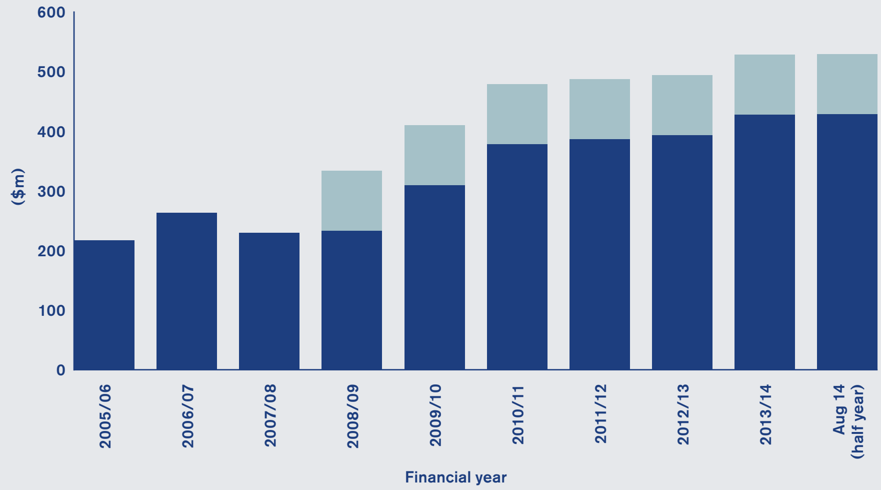
Key

Pool, Injury, Casualty, Charterers, Illness, Cargo

FINANCIAL STRENGTH

- Free reserves and hybrid capital increased to $529 million
- Total capital has increased despite the expensive 2013 policy year
- The Club continues to hold sufficient capital to meet regulatory requirements

Free reserves and hybrid capital for financial years 2005-2014



Key

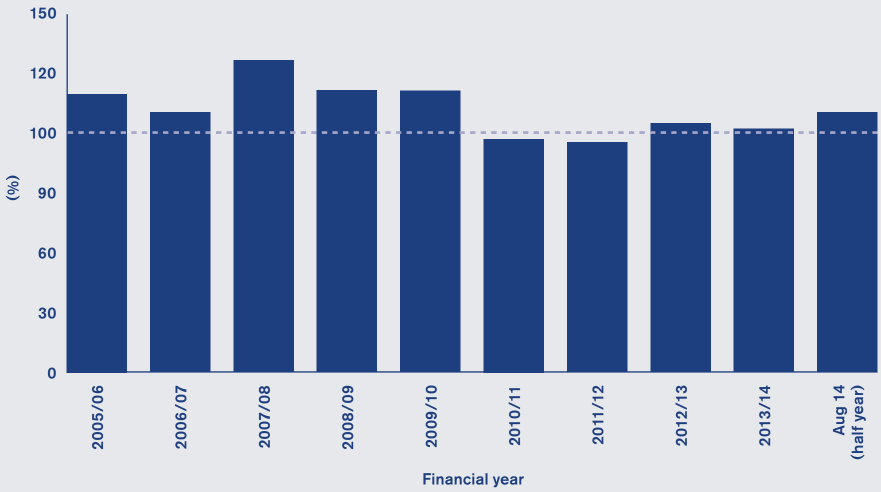
Free reserves

Hybrid capital

UNDERWRITING DISCIPLINE

- Combined ratio of 109% at the half year is outside the Club's acceptable range
- A small number of large claims on the 2013 policy has led to the increase in combined ratio
- 2014 policy year running in line with expectations

Combined ratio for financial years 2005-2014



Key

Combined ratio (%) excluding supplementary premium and mutual premium discount

Target

CLAIMS

The 2014 policy year has performed in line with expectations but the development on prior policy years has increased the combined ratio for the half year to 109%.

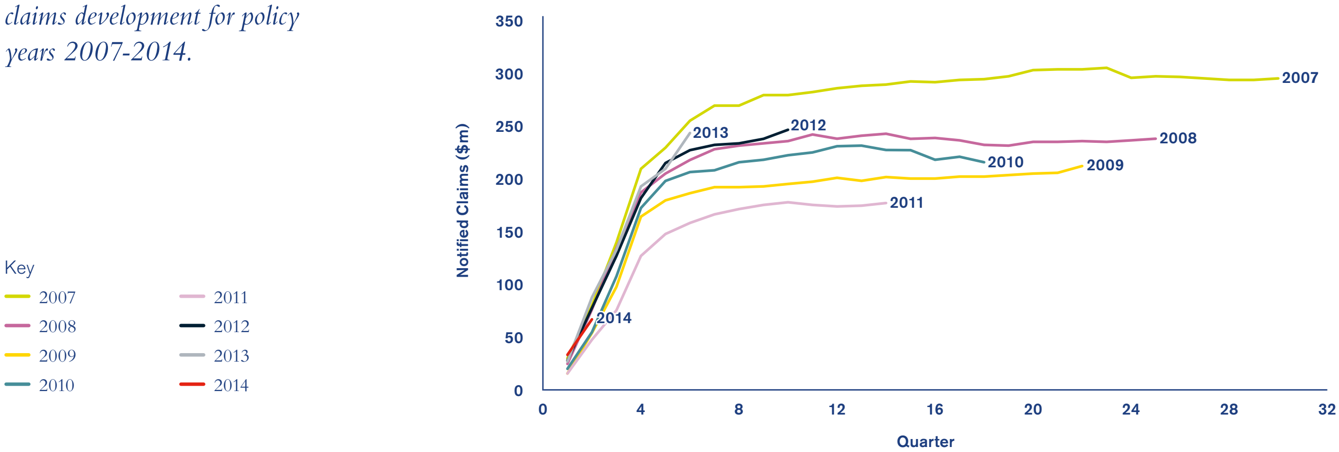
As reported in our 2014 Review of the Year, the 2013 policy year, after 12 months' development, was already one of the most expensive years of the last decade. A small number of large injury claims notified in the six month period since the year end means that the 2013 year has continued to develop at a faster rate than other recent years.

Historically, development of notified claims slows considerably after 18 months when the final outcome of a year can be predicted with greater certainty. Having reached this maturity, development on the 2013 policy year should slow significantly but it is already set to be one of the most expensive years of the last two decades.

Total notified claims on the 2012 policy year also developed more sharply over the last six months than anticipated, following deterioration in a small number of injury claims.

Figure 1: Total net notified claims development for policy years 2007-2014.

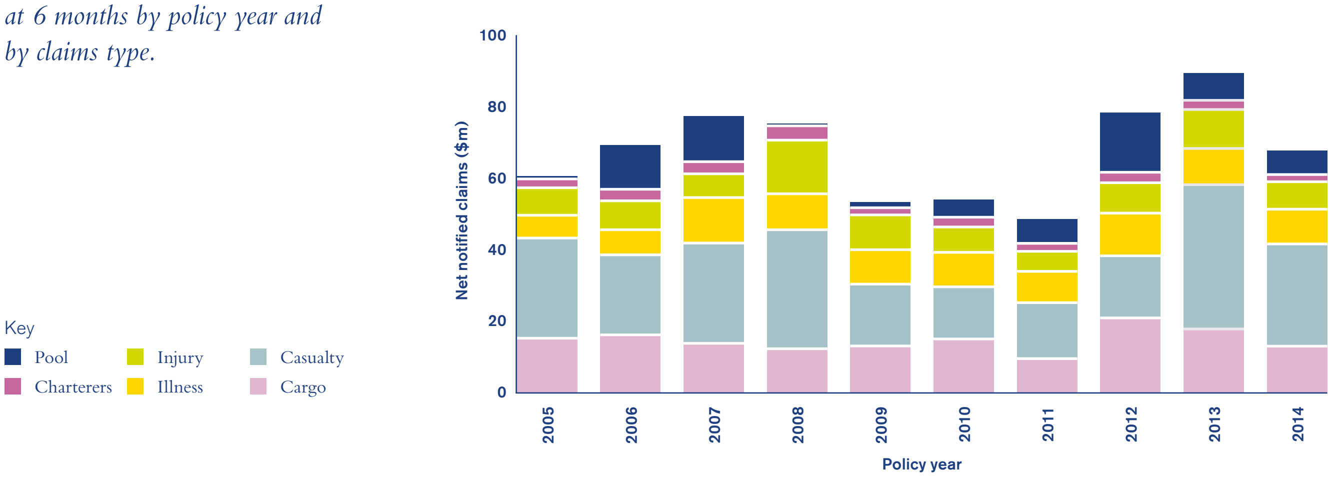
Total notified claims



Total claims have eased in the first half of the 2014 policy year when compared to the 2013 policy year at the same stage. The breakdown of notified claims by type, in figure 2, shows the impact of casualty claims on the 2013 policy year. Although the cost of these claims has reduced in the 2014 policy year, their relative importance to the overall cost of the year continues to be significant. However, the total cost of cargo claims and the Club's contribution to the Pool has fallen over the last two years.

Figure 2: Net notified claims at 6 months by policy year and by claims type.

Net notified claims at 6 months for policy years 2005-2014



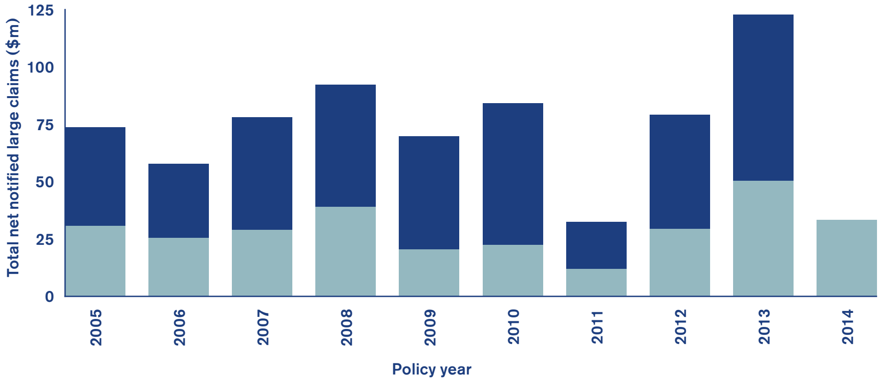
Large Claims (>$0.5m)

The number and severity of large claims continues to have a significant impact on the overall cost of a policy year. In an average year, large claims represent over half of the retained cost of claims despite representing less than 1% by number. It is the impact of a small number of these large claims that brings volatility to the total claims cost.

The elevated cost of the 2013 policy year is driven by large claims, in particular those over $2 million. The 2013 policy year has suffered 19 such claims compared to 10 in an average year. Although the number of claims has almost doubled there is no obvious trend.

Figure 3: Net notified large claims (>$0.5m) at 6 and 18 months by policy year.

Net notified large claims (>$0.5m) at 6 and 18 months by policy year



Key
- 18 months
- 6 months

A comparison of the experience of the 2013 policy year with that of the 2011 policy year highlights the volatility in large claims. The average annual cost of large claims to the Club over the last decade has been approximately $75 million. However, 2011 was $50 million below this level and 2013 is currently $50 million above. This implies a potential swing of $100 million depending on the number of large claims in any one year.

The Club has purchased reinsurance to mitigate the impact of large claims; however the considerable variation in the cost of these claims also demonstrates the need to hold sufficient capital to absorb the peak years without charging excessive premium to our Members.

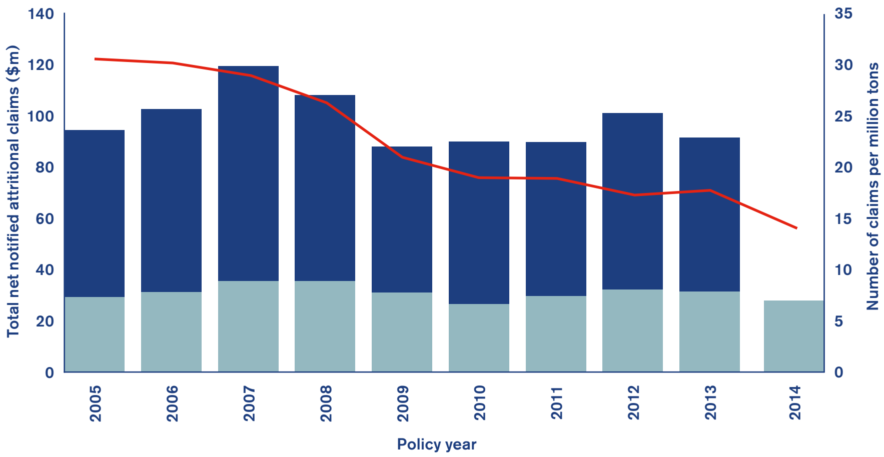
Attritional Claims (<$0.5m)

Encouragingly, the frequency of claims per entered ton has fallen steadily over the last ten years, driven almost entirely by the number of claims below $0.5 million. The number of claims per ton in 2014 is half that experienced ten years ago. There is clearly a correlation between the drop in claims frequency and the downturn in the world economy.

Although claims frequency has fallen, the average cost of claims has inflated at a rate of 4% each year since 2005. In certain categories, the inflation has been much higher, as seen in the illness and injury categories which are around 12 %. The total cost of attritional claims has therefore remained broadly consistent over the last 5 years.

Figure 4: Net notified attritional claims (<$0.5m) at 6 and 18 months by policy year.

Net notified attritional claims (<$0.5m) at 6 and 18 months by policy year



Key
- 18 months
- 6 months
- Claims frequency per million tons

POOL

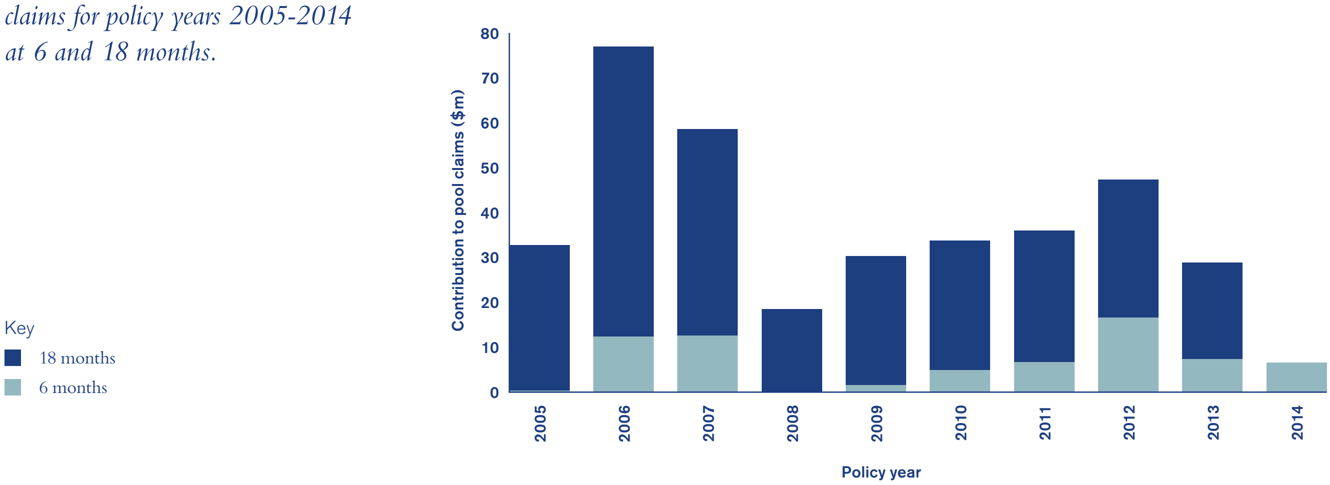
The Club's Pool record remains in surplus.

The Club's excellent record on the Pool has reduced the Club's Pool contribution steadily over recent years and shielded the Club from the increasing costs of the very largest P&I claims in the market. This has generated a surplus on the Club's Pool record which remains over $100 million.

After the first six months of the 2014 policy year, five claims have been notified to the Pool; this is broadly in line with expectations.

Figure 5: UK Club's share of Pool claims for policy years 2005-2014 at 6 and 18 months.

UK Club's share of Pool claims after 6 and 18 months by policy year



INSURANCE REGULATION & GOVERNANCE

The Club's Solvency II capital requirement will be reduced if the Club's internal model application is successful, thereby giving the Club greater capital flexibility.

The Club remains on track to comply with the Solvency II Directive.

The Club submitted its partial internal model for review by the regulator earlier this year. The Bank of England has made it clear to the insurance industry that approval will be subject to tight control, and models will need demonstrably to cover all risks facing the business. Power to grant final approval of the model will not be available to the regulator until 2015. As a result, the Club will need to make a further application next year in order to comply with the 1st January 2016 implementation date.

INVESTMENTS

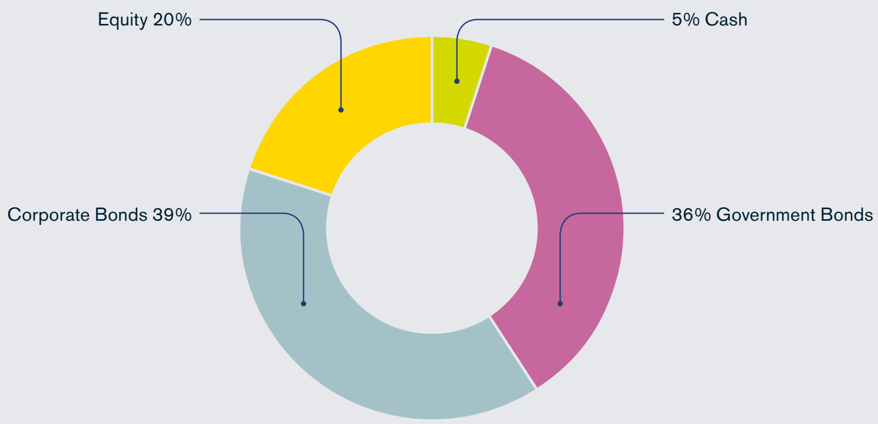
Positive return on investment.

The first half of the year produced a positive return from the investment portfolio contributing $22 million to Club reserves over the period. This was the result of positive returns from both equities and bonds. The exposure to hedge funds was reduced to a negligible amount during the period.

The portfolio remains relatively conservatively positioned, focussed on higher quality fixed interest investments with a relatively low duration and a benchmark position in equities of 20%.

Figure 6: Investment portfolio allocation

Asset allocation at 20th August 2014



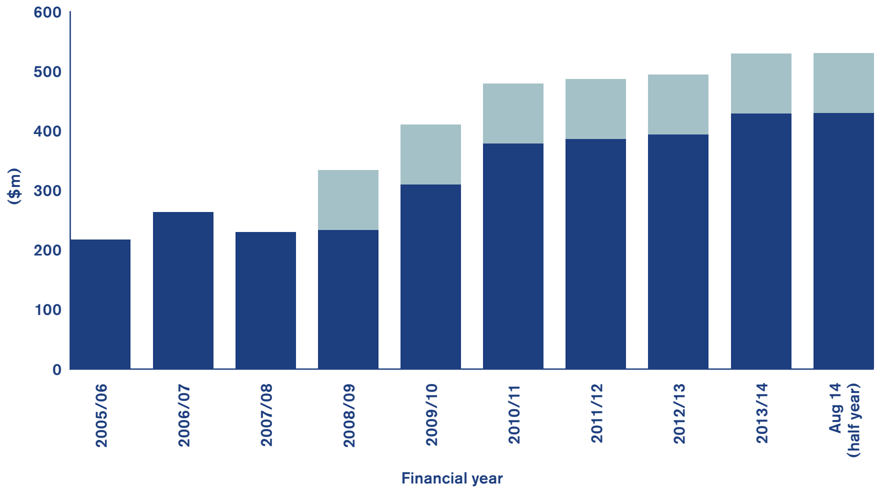
RISK & CAPITAL MANAGEMENT

At the 20th August 2014, the Club's free reserves and hybrid capital remained stable at $529 million.

Capital strength

Figure 7: Growth in the Club's free reserves and hybrid capital for financial years 2005-2014.

Free reserves and hybrid capital for financial years 2005-2014



Key
- Free reserves
- Hybrid capital

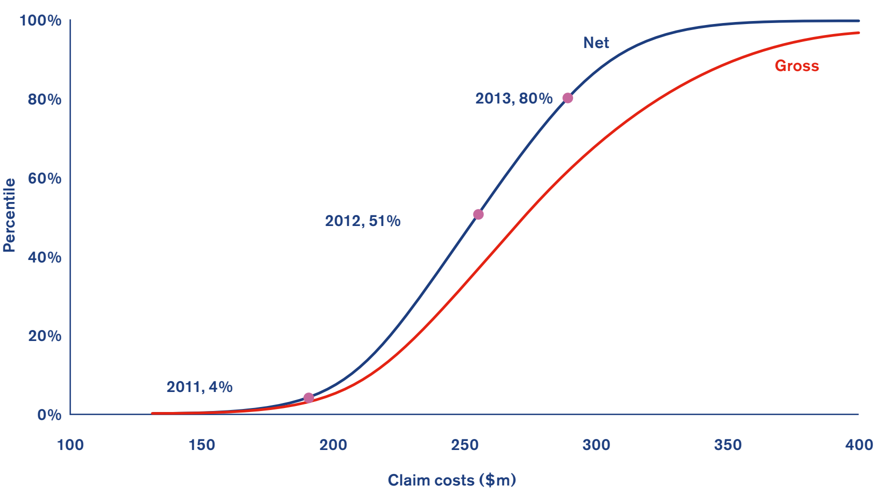
The Club's target is to hold sufficient capital to remain in the AA range on the S&P capital model while also meeting all regulatory requirements, plus a suitable buffer. This buffer is designed to enable the Club to withstand a shock event yet still continue to hold capital sufficient to meet the standard regulatory requirement.

A comparison of the total cost of the 2011 policy year with that of the 2013 policy year demonstrates why it is necessary for the Club to hold an adequate buffer. The Club seeks to call sufficient premium to cover the cost of an "average" year based on the outputs of the Club's internal model. The Club's reinsurance programme provides some mitigation in the event of an expensive claims year. However, reinsurance cannot be a substitute for adequate capital in the long term.

The graph shows that the Club might expect a year as benign as the 2011 policy year only once in a 25 year period. A year of at least the expense of the 2013 policy year might be expected once in every five years. After six months' development, the 2014 policy year is developing in line with an average year such as the 2012 policy year. The probability and impact of an expensive year, such as the 2013 policy year, illustrates the need for a strong capital base.

Figure 8: Range of claims outcomes for 2014 policy year.

2014 Claims distribution



Key
- Net of Club's own reinsurance
- Gross of Club's own reinsurance

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UK P&I CLUB GLOBAL NETWORK

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