UK P&I CLUB

Circular

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OUTLINE

- Supplementary premiums levied for 2006 and 2007
- Supplementary premium estimate for 2008
- General increase of 12.5 per cent in mutual premium required for 2009, plus any increase in the cost of the International Group reinsurance premium for 2009
- General increase for fixed premium rates is 7.5 per cent
- Release calls adjusted in line with supplementary premiums

TO THE MEMBERS

Dear Sirs

REVIEW OF OPEN POLICY YEARS
2009 POLICY YEAR GENERAL INCREASE

At its meeting on 27th October 2008, against a background of unparalleled uncertainty in financial markets and substantial claims deficits on the 2006 and 2007 policy years, the Board levied supplementary premiums on both years, issued an estimate of a supplementary premiums on the 2008 policy year, and ordered a general increase for the forthcoming 2009 policy year.

The Board believes that as the Club and its Members enter a period of change and uncertainty, the financial strength of the Club will be of even greater importance. The Board has therefore decided that the deficits should be funded by these supplementary premiums in order to prevent further erosion of the reserves to an unacceptably low level. Taking this step now, although unwelcome to Members, will also mitigate any pressure to protect the reserves by increasing future premiums to levels which could prove excessive.

Over the last year, in line with its commitment to sound financial planning the Board has been closely monitoring the financial climate and has taken a number of steps to preserve funds and ensure the Club remains well-funded against a background of deteriorating claims experience in the 2006 and 2007 policy years.

As early as October 2007, equity holdings were substantially reduced, which has insulated the Club from the collapse of the equity markets. The general increase for the 2008 policy year was set taking into account the recent experience of record Pool claims. The hybrid capital issue during August 2008 strengthened the Club's solvency by $100 million – an important measure to ensure the Club is sufficiently capitalised for the new EU regulatory requirements of Solvency 2, but hybrid capital is not intended to fund claims deterioration. The Club has experienced no losses from counterparty credit failures. The Club is necessarily exposed to exchange fluctuations between the major currencies, being required by regulation to match its currency holdings in proportion to the original currencies of the claims. This requirement substantially protects the Club, as currency gains and losses on the investments are matched eventually by proportionate movements in the claims; there is however a timing difference which has to be taken into account in the financial planning.

Even after these steps, in the current financial turmoil it is now clear that the investment income for the current year is likely to be negative, and unable to help reduce the deficits on the 2006 and later policy years. These deficits have also increased following the latest actuarial review at 20th August. While much of the shortfall in investment income is due to currency movements, which will in due course be offset by corresponding claims reductions, there is no underlying investment return sufficient to close the claims deficits on the 2006 and 2007 policy years, currently estimated at $61 million and $83 million respectively. A significant part of these deficits has been caused by Pool claims as previously reported, but the deficits have to be funded, and it would be both inequitable and unsound to seek to carry forward these deficits into future years. In these circumstances, the Board considers it has no alternative but to order supplementary premiums and payment requirements as follows:

2006 policy year
A supplementary premium set at 20 per cent of mutual premium; debited in November 2008 and payable in March 2009. Release calls are set at 35 per cent.

2007 policy year
A supplementary premium set at 25 per cent of mutual premium; debited in November 2008 and payable in June 2009. Release calls are set at 50 per cent of mutual premium.

2008 policy year
It is likely that there will be little or no underlying investment income (after allowing for currency movements) to strengthen the 2008 policy year. This policy year is only eight months old, and it is too early to form a clear view of the ultimate claims outcome. Nevertheless, taking into account the claims experience of the 2006 and 2007 years, Members are warned to estimate a 20 per cent supplementary premium. The Board anticipates making a decision on the level of supplementary premium at their October 2009 meeting. If the claims are clearly improving, it may be possible for the Board to reduce the supplementary premium.

Release calls for the 2008 policy year are set at 45 per cent of mutual premium.

2009 policy year - General increase
The measures above should ensure that the Club moves forward without significant burden from past years. In the financial climate currently prevailing, however, the Board recognises it is imperative that the mutual premium level in 2009 is set with minimal reliance on investment income – although the Board will take every opportunity to achieve a positive return consistent with ensuring no unacceptable risks are taken with the Club funds. Projecting from the most recent years, the Board has concluded that the premium rating of Members paying mutual premiums shall be increased by 12.5 per cent, plus any increase in the cost of the International Group reinsurance premium for 2009. The Board further decided that the time charterer and other fixed premium rates should be subject to a general increase in premium rating of 7.5 per cent. Release calls for the 2009 policy year are set at 25 per cent of mutual premium.

As normal, mutual premium for 2009 will be payable in four instalments.

Looking ahead
The Board Members are shipowners and face the same challenges in their individual businesses as are faced by the membership at large. They have taken the decisions with the greatest regret, fully

appreciating that they will add to the problems that many Members will be facing. Nevertheless, they recognise that the future of the UK P&I Club, and its continuing ability to serve its Members, requires that the Club remains properly financed and they consider the measures taken are necessary to achieve that goal. The Board is committed to close monitoring of developments, and to the extent that it can alleviate the pressure it is putting on Members particularly in relation to the 2008 year and future years, it will seek every opportunity to do so.

The Board's strategy remains that supplementary premiums should only be called in the most unusual circumstances. It is hoped that the measures taken on this occasion will enable the Board to return to the pattern of previous years, where fluctuations in claims experience from year to year are, with the benefit of investment income on the total funds of the Club, accommodated without recourse to supplementary premiums.

It is also likely that if the recession deepens, the frequency of claims will reduce and thus the total cost of claims will fall. Just as the 2006 and 2007 experience has been associated with high shipping activity, history suggests that the reverse will indeed occur. What cannot be predicted at the moment is when such a reversal in the claims will become evident, but the Board will remain alert to recognise any underlying change and aim to ensure they do not exacerbate the pressure on Members more than absolutely necessary.

Further guidance on the Club's decisions can be obtained from a "Questions and Answers" document which accompanies the web version of this circular. Both these documents are published electronically in the "Club Circulars" section on the homepage of www.ukpandi.com

Yours faithfully

THOMAS MILLER (BERMUDA) LTD.

CONTACT

▪ Members requiring further information should contact their usual underwriting contact at the Club.