UK P&I CLUB

Good result in difficult times

Our chairman, Mr Dinos Caroussis, outlines the Club's financial results and summarises the other activities in support of our Members during these uncertain times for ship operators.

This year we report another operating surplus and a further increase in the Club's free reserves and hybrid capital to $486 million. This level of capital, puts our Club's financial strength at the top level of its peer group in the P&I sector. This result is particularly pleasing as it comes in a year which has seen results elsewhere in the market adversely affected by an increase in claims and volatile investment returns.

Overall the Club produced a surplus of $11 million. The main driver behind this positive outcome was the continuing improvement in the claims reserves on the more recent policy years and the early indications that 2011 will be a low claims year.

Lower claims

The improving claims position on all policy years since 2008 has been largely brought about by a reduction in the number of claims. Claims on the 2011 policy year were down five per cent on 2010, itself a low year for the number of claims, and some 30 per cent lower than the number of claims in 2007. Most significantly, the Club's exposure to the larger claims (those exceeding $2 million) was below the experience of recent years. The total cost of larger claims retained by the Club in 2011 was approximately 15 per cent of the historical average.

Clearly the reduction in world trade since the boom years in shipping in the earlier part of the decade has had a significant impact on the volume of claims. There is also an element of good fortune in the 2011 result, but we have been able to contribute to that reduction by careful management of our risks; from monitoring the Club's entry criteria, an extensive loss prevention program, and strong claims management, through to the purchase of reinsurance designed to avoid the problems we faced when claims spiked

- The Directors, at their meeting, approved the Report and Financial Statements for the year ended 20 February 2012.
- A detailed summary of the Club's financial results is contained in the separate publication "Review of the Year" published in May.
- The full Report & Accounts for the UK Club is due for publication in mid June this year.

at the height of the shipping boom. Looking back now to those high claims years, it is interesting to note that even at that time the UK Club's record on the International Group Pool was well below the Club's share of the Pool, which explains why the UK Club still has the largest credit balance on the Pool.

Despite the improving claims position we have maintained our prudent approach to claims reserving. The 2011 policy year is only one year old and given that policy years can develop adversely after the first year, we have taken a cautious approach when setting the expected overall claims outcome. Nonetheless, we believe the year will continue to improve and this is a comforting position to be in as we enter the new 2012 policy year which could produce a higher level of claims.

Claims inflation

We must not, however, allow the reduction in claims frequency to cause us to drop our guard against future claims inflation. Underlying claims inflation measured in terms of average cost per claim has been running at about five per cent each year, with some categories of claims inflating at rates of up to 15 per cent. While the shipping markets remain depressed, it is expected that the total cost of claims will remain lower because inflation in the costs of individual claims is offset by reduced frequency. However, improvements, even in regional markets eg intra-Asian trade or in particular shipping sectors, could change the position from one year to the next - which is why we must ensure that the premium charged by the Club keeps moving forward at subsequent renewals.

Comprehensive reinsurance

Another measure we have taken to ensure the Club is protected against an adverse movement in claims is the introduction of a comprehensive reinsurance programme. Using our internal model developed for Solvency 2 compliance to design our own reinsurance programme, the reinsurances we have in place will protect the Club from a run of larger than usual claims, whether within our own retention or the Pool. They will also protect the Club from a one-off very large claim. Although these reinsurances will not turn a bad year for claims into a good year, they will most definitely protect the Club from the worst effects of a surge in claims.

Positive investment return

Investment income contributed $18.6 million to the overall result. This is a lower return than last year, but one which reflects our decision to reduce risk in our investment portfolio. Although the Club's investment portfolio was not directly exposed to the most affected areas, we decided, in the light of the ongoing Eurozone crisis and heightened geopolitical concerns, to lower our investment risk by reducing the proportion of the funds held in equities from about 15 per cent to about 10 per cent of the portfolio. The proceeds from the sale of the equities were invested in short duration fixed interest securities.

Following a strong rally in equities since the end of last year, these measures have inevitably reduced the return for the policy year, but we believed that preservation of our Members' capital was the sensible approach to have adopted at a time of uncertainty and market volatility.

Balanced underwriting

Most importantly of all, we have achieved a balanced underwriting result for the second successive financial year with a combined ratio of 97 per cent. This very positive result underlines the Club's commitment to its long term target of maintaining a combined ratio of 100 per cent or better.

Controlled growth

Our return to the top level of the P&I market has been rewarded by increased support from new and existing Members. Tonnage was up over the year and now stands at 112 million gross tons of owned tonnage and around 80 million gross tons of chartered tonnage. 2011 was also another year of higher than usual turnover of tonnage at around 20 per cent of the total owned tonnage. This reflects the increased demolition of older ships on the one hand and a high number of new buildings delivered during the year on the other.

Regulatory affairs

As the deadline for Solvency 2 compliance approaches the Club continues to make good progress. In addition to working towards the approval of our internal model through the Internal Model Approval Process (IMAP), we have also recently announced our plans to restructure the Club's group of companies. As a result of this project the UK Club Europe will become the sole provider of direct insurance business to the UK Club Members.

The reorganisation will not affect UK Club Members' terms of entry, cover, premium or availability of funds to meet claims payments. They continue to be Members of the UK Club Bermuda, but will be insured by UK Club Europe. The Bermuda Club will become the reinsurer of UK Europe and continue to be the holding company, controlled by its Members. The Club's reinsurance subsidiary in the Isle of Man, IPIR, will become dormant.

By reducing the number of separately regulated insurers from two to one, we aim to streamline our governance, reduce our compliance costs and more efficiently manage the Club's solvency capital requirements.

It is worthwhile noting that the $100 million Hybrid Capital raised in August 2008 has been and will continue to be a significant contributor to the Club's Tier One capital required under Solvency 2. Of course, compliance with Solvency 2 does not end with capital requirements and the Board and its committees have been taking steps during the year to ensure that we meet all our worldwide regulatory requirements.

Piracy and Sanctions

During the year we have also continued to follow and provide advice to our Members on many industry issues including the continuing challenges brought by piracy risks in the Gulf of Aden, Indian Ocean and more recently in West Africa, as well as monitoring the new sanctions regimes affecting, in particular, the export of oil and petrochemicals from Iran. In this debate, we and the other IG Clubs have been drawing the attention of governments to the potential risks to innocent third parties flowing from the targeting of liability insurance in sanctions legislation but with little evident success thus far.

Listening

In terms of our day to day activities the Directors of the Club are never complacent about what the Club does, nor how it is perceived in the market. Together with the Managers we are working hard to improve the Club in a number of ways. During 2011 we undertook a Satisfaction Survey, the results of which were published on the Club's website. The summary shows that the average Member satisfaction score was high at 81 per cent and that the broker score, although a little lower, was still a commendable 76 per cent. By listening to the Members and their brokers we have identified those areas where the Club must improve. Your Board and the Managers will be working hard to ensure the Club scores even higher in the next survey.

Governance

In each one of my reports to you since I took over the Chairmanship in 2008, I have commented on the growing burden of work which falls on the Board and in particular on our main committees. 2011 was no exception. I would like to express my thanks particularly to the deputy chairmen - Eric André, who is Chairman of both IPIR and the Audit & Risk committee, Alan Olivier who represents the Club on the Thomas Miller Board and Ottmar Gast who has joined this group following Patrick Decavèle's retirement last year.

I would also like to express my thanks to those Directors who retired from the Board in the past twelve months and make particular mention of Heinrich von Rantzau and Amir Azizan whose contributions to the Board and the affairs of the Club have been invaluable.

In October last year I was delighted to be able to welcome seven new Directors to our Board; Ibrahim Güngen of Güngen Maritime & Trading A/S; Grahaeme Henderson of Shell International Trading and Shipping Company Limited; Datuk Nasarudin Idris of MISC Berhad; Ng Yat Chung of Neptune Orient Lines Limited; Paul Pathy of Fednav Limited; Eamonn Rothwell of Irish Continental Group, plc; and Nikolaus Schües of Reederei F. Laeisz GmbH.

The 2011 intake of Directors is a very strong addition to our Board and I look forward to their valuable contribution over the coming years.

In conclusion

Finally, I would like to take this opportunity to thank all of our Members for the support they have shown us over recent years. As a Board, we are determined that the UK Club should be the leading shipowner controlled provider of P&I insurance and other services.

That commitment is the guiding principle for everything we do whether it is the competitive insurance and services that we provide to our members worldwide or the strengthening of the Club's capital position which has become absolutely essential for any insurance provider in the modern regulatory environment. That drive and determination is keenly felt by the Directors and Managers alike. In these uncertain times for shipping we are making every effort to ensure that the UK Club remains at the forefront of the P&I market.

Dino Caroussis, Chairman

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