UK P&I CLUB

Directors' Report & Financial Statements

For the year ended 20th February 2009

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

Total funds & capital

$1,141.2 million

Outstanding claims

$807.5 million

Free reserves & capital

$333.7 million

Contents

Chairman's statement

Dino Caroussis

This is my first Chairman's statement having taken over from Tullio Biggi in October of last year and I take this opportunity of thanking him for his very substantial contribution and wise counsel both before and during his Chairmanship. We shall miss him.

Over the last year, we have probably witnessed the most dramatic reversal in economic conditions that the world has experienced in our working lifetimes. The effects have been felt by all our Members in their own businesses and inevitably by the Club itself which could not have expected to have been insulated from these events.

Fortunately the Board had already taken steps to reduce risk by selling the majority of the Club's equity investments in October 2007 and to increase regulatory capital and underpin its free reserves by issuing $100 million of perpetual bonds in August 2008.

Nevertheless when the Board met in October, we were faced with two major changes to the Club's financial environment. First, investment income which had been comfortably positive in July had turned negative; second, the latest claims reserving review had shown significant deterioration over a number of past policy years, particularly in respect of crew illness and injury claims.

The combination of these two factors, against a background of great economic uncertainty, created a radically heightened risk to the financial objectives of the Club than was evident only a few weeks earlier.

The Board took into consideration the possibility that the financial position might improve. The Club did not hold any 'toxic assets' and much of the investment loss had come from the effect of currency changes, reflecting the impact of a strongly strengthening US dollar against the major currencies held (in proportion to anticipated claims as required by the regulator) in the investment portfolio.

Although difficult to measure on the same daily basis, a corresponding fall in the US dollar value of non-dollar claims might therefore be anticipated. There was also a reasonable expectation based on previous experience that a prolonged recession would in due course have the effect of reducing P&I claims generally.

On balance however the Board felt that it would not be prudent to defer the decision on supplementary premiums on the basis of these or other hopes for the future. We were convinced that it was neither possible nor appropriate to rely on investment income or future premium increases to support the deficits that were apparent in the open years and that the projected size of these deficits presented an unacceptable threat to the reserves of the Club and its future financial health.

The Board therefore reluctantly decided to mitigate that risk by levying supplementary premiums in an equitable manner with a view to minimising the projected deficits on the open policy years and thereby preserving the Club's reserves for the future.

The full year results being reported now show the impact of that decision and the development of the financial risks we foresaw in October. Investment income for the year has indeed been negative. Two thirds of the investment loss of $56 million is due to the currency effect of the strengthening of the US dollar.

The supplementary premiums called for the 2006 and 2007 policy years have been included in the results and have enabled the Club to increase its free reserves to $334 million (including hybrid capital) at this year end.

The review of the year contains further analysis of the claims experience, but both the 2006 and 2007 policy years have been marked by very high Pool claims. It is too early to make an informed assessment of the 2008 policy year claims experience, but the early indication is that Pool claims should be a less significant feature.

However, a better experience on the Pool has been offset by a much higher level of claims within the Club's own retention. By this October, the position will be clearer and at that time the Board will decide the level of supplementary premium for the year. In the meantime, the estimate remains at 20 per cent as previously advised.

Although financial issues have dominated the work of the Board over the last year, the Board has been active in other areas as well, both at our main meetings and in the meetings of the various committees.

The Strategy Committee has assumed an increasingly important role not only in formulating the long term strategy for the Club, but also in detailed preparation with our Managers of the key issues to be decided by the Board.

Topics such as reinsurance, investment policy and analysis of claims used to be considered independently, but the Strategy Committee has been increasingly approaching these topics within a risk management framework which enables the risks to be managed at an enterprise level, rather than as individual risks. The Strategy Committee plays an important role in ensuring that these issues are brought to the Board for decision in an orderly and timely way.

Over the year, we have lost the services of two Directors who served on this committee - Ian Gaunt and Minoru Sato - and I would like to thank them both for the important contributions they have made to the deliberations of this committee as well as to the Board.

The Audit Committee, which is chaired by one of the Deputy Chairmen - Eric André - also devotes an ever increasing amount of time to the duties imposed on it by the Board, and the detailed work of this committee gives a great degree of comfort to the Board that the Club complies in all respects with the appropriate financial and regulatory standards.

In addition, Eric André also chairs the board of the Club's subsidiary reinsurance company in the Isle of Man - IPIR. This board has a special responsibility for investment matters and, again, the detailed work that it does in monitoring the performance of the Club's investment managers enables the main Board to concentrate on investment policy and to determine the level of investment risk appropriate to the Club.

The Board reviewed the Club's investment policy at the beginning of this year and decided that the restrictions placed in October 2007 on the purchase of equities should now be partially relaxed to allow the investment managers the flexibility to take advantage of the stock market rallies which many expect in the latter part of this year and early next. The implementation of the new policy will continue to be monitored closely.

Claims are, of course, a constant theme of all our Board meetings and we receive reports at every meeting of claims which have been paid and developments in cases of interest which are likely to result in payments in future.This enables the Board to see where the Club's money is being spent and also what could be done to help Members avoid claims. Loss prevention and the Club's ship inspection programme fall within the scope of our Ship and Membership Quality Committee.

With the Club's finances impacted by high levels of crew claims in recent years, there was a particular focus in 2008 on the education and safety of seafarers, from the forum on "Life at Sea", to publications designed to be used directly by crew - including a pocket guide to life-saving appliances, good/bad practice posters, survival craft booklet, and advice on mooring incidents.

Feedback from Members confirms that loss prevention information continues to be a highly valued service from the Club. The Committee is therefore encouraging the Managers' plans to develop new services to maximise the utility of risk information collected through the ship inspection program, and to help Members identify and address the risk of their own individual fleets.

The demands on the time of all Directors, especially those serving on these committees, are very considerable. I would like to thank them and particularly the Deputy Chairmen, Eric André and Alan Olivier, who have now been joined by Patrick Decavèle and on whose collective support I am very reliant.

I have already noted Eric's role as chairman of the Audit Committee and IPIR and we owe a great debt to him for his hard work on behalf of us all. Alan Olivier, in addition to his membership of all committees, also sits on the board of our Managers' holding company in which the Club continues to maintain its investment and I wish to thank him for putting in the air miles to attend and contribute so effectively in all our meetings.

I would also like to welcome the new Directors who have joined the Board since last year, Peter Evensen from Teekay and Masamichi Morooka from NYK, and look forward to their contributions.

I am very aware that the decisions the Board has taken on supplementary premiums have imposed an additional financial burden on our Members at a time when there are so many other financial pressures to absorb. I am therefore particularly grateful for the support which our Members have continued to give to the Club at the last renewal. The confidence they have shown in the strength of the Club going forward is most gratifying.

For our part, the Directors and I will work hard to repay that confidence and to ensure that the Club continues to give to all its Members the service, protection and financial security which we expect from the UK Club.

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 2009.

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 2009 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 110 million gross tons (2008: 110 million). In addition, on average at any time in the year in excess of 50 million gross tons of chartered tonnage was entered in the Association.

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 with the Managers 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 at least six 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 matter 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 Mr Eric André who is a Deputy Chairman of the Club, the other members being Mrs Kathryn Siggins and Mr Adamantios Lemos, Directors of the Club, Mr Albrecht Metze, a former Director of the Club and Mr Nigel Smith, an independent member of the Audit Committee who was previously a partner with KPMG with insurance and shipping experience. Nigel Smith has specific responsibility for liaison, on behalf of the Committee, with the Club's internal auditor.

Other sub-committees of the Board are formed to review specific issues as delegated by the Board, or to take decisions on behalf of the Board for instance in connection with the operation of the Club's War Risks cover where urgent decisions may be required.

Directors

The present Directors of the Association are shown below. Also shown are those who retired from the Board since February 2008. 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 for Directors to retire who have been in office for three years since their last election. Consequently Messrs Bottiglieri, Decavèle, Gast, Itkin, Kragic, Louis-Dreyfus, Olivier, Richards, Seyedan, Tsakos and Mrs Fønss Schrøder and Mrs Siggins will retire at the forthcoming Annual General Meeting in Bermuda on 26th October 2009. All these Directors, with the exception of Mrs Fønss Schrøder and Messrs Kragic and Richards, have offered themselves for re-election.

In October 2008, Mr C.I. Caroussis was elected as Chairman of the Board of Directors, Mr P. Decavèle was elected as Deputy Chairman. Mr E. André and Mr A.K. Olivier were re-elected as Deputy Chairmen.

C.I. Caroussis
Chairman and President
Chios Navigation Co. Ltd, London

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

P. Decavèle
Deputy Chairman & Vice President
Broström Tankers S.A.S., 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
AET UK Limited, London

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

L. Fønss Schrøder
Wallenius Lines, Stockholm

S. Frank
OAO Sovcomflot, Moscow

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

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

E.D. Jones*
Carnival UK, Southampton

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

T. Kaneko
Nippon Oil Tanker Corporation, Yokohama

C.E. Kertsikoff
Eletson Corporation, Piraeus

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

P. Kragic
Tankerska Plovidba d.d., Zadar

J.B. Lee
Korea Line Corporation, Seoul

A.M. Lemos
Unisea Shipping Ltd, Piraeus

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

A.C. Margaronis
Diana Shipping Inc, Athens

M. Morooka*
NYK Group Europe Ltd, London

E.T. Richards
Hamilton, Bermuda

S.H. Seyedan
National Iranian Tanker Co, Tehran

K. Siggins
Hamilton, Bermuda

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

Zhang Liang
China Ocean Shipping Group Company, Beijing

* *New Directors elected in October 2008*

The following Directors have left the Board since February 2008:

T. Biggi; I.J. Gaunt; T. Held; E.D. Jones; M. Sato.

Performance for the year to February 2009

The extraordinary financial events sweeping the world economy have had a profound impact on economies, financial markets, shipping and inevitably insurers. The Club continues to weather the storm well with both confidence in the steps taken and also humility that those steps taken rely on the quality and loyalty of the Club's membership. The Club's commitment is to provide early and transparent information to the membership.

The effect on the Club has been threefold. Its Members have seen the returns from shipping activity drop significantly, investment returns moved from the comfortable 5 per cent or more positive return of the past five years to a negative return for the year, and, finally at the very moment that the financial markets were collapsing, the Club (and indeed the entire P&I market) were facing unprecedented levels of claims as a result of the hangover from the boom in the shipping market.

Claims

In the last annual report the various drivers on the levels of claims were identified and those trends continued into the current year with claims within the Club's retention increasing, particularly those relating to crew personal injury, where rates of wage inflation up until recently have been particularly high. In addition to increasing costs of the Club's own claims, those on the Pool years 2006 and 2007 continued to deteriorate, though some of that deterioration was covered by the outward reinsurance of the Hydra captive. Whilst these years have been some of the costliest of recent times for the Pool, the 2008 year has seen a far lower level of activity and has to a considerable extent offset the strength of claims within the Club's retention for the year.

Investments

Disappointingly, though beating markets generally, the Club incurred an investment loss of $56 million with only one third ($18 million) representing underlying investment loss. The remaining $38 million loss was due to the translation effect of revaluing non US dollar assets.

The Club had lowered investment portfolio risk in October 2007 by considerably reducing its equity holdings. The Club entered the period of financial turmoil holding only 3 per cent equities and 11 per cent in absolute return funds, with the balance in fixed interest and cash. Despite this defensive position the Club suffered losses on equities and, to a lesser extent, absolute return funds. Losses in these parts of the portfolio were considerably offset by the positive returns on the cash and fixed interest portfolio which made up the remainder of the portfolio of the total invested assets.

Two-thirds of the income loss, therefore, arose from the mark-to-market valuation of non US dollar assets, which the Club is required to hold to match non US dollar liabilities. Whilst a natural currency hedge over time because currency changes on investments are *eventually* matched by currency changes in claims, the Club has recognised the full asset portfolio negative currency impact on a mark-to-market basis.

Capital

During 2008 the Club raised $100 million of "hybrid capital", technically a bond issue of perpetual capital securities. This capital augments what members recognise as the Club's traditional free reserves and it counts as capital for regulatory and rating agency purposes. It is also an important step in preparation for Solvency 2.

Supplementary premium

The impact of continued claims deterioration, the increased cost of personal injury claims and the absence of investment income however, posed a threat to the underlying free reserves of the Club. With these factors in mind it became clear to the Board in October that it could not plan on anything but a disappointing outcome for the year and that despite raising this additional hybrid capital, it was necessary to restore the level of underlying free reserves by levying supplementary premiums on the open policy years. Whilst unwelcome, the action ensures the UK Club is financially stronger and better placed to meet the extraordinary level of uncertainty in the global economy that lies ahead.

Reserves

Free reserves at the 20th February 2009 increased to $236 million (2008: $229 million), which includes the supplementary premium on the 2006 and 2007 policy years but not the estimated supplementary premium on the 2008 policy year. The hybrid capital increases the Club's capital and reserves to $334 million. The supplementary premium levies

raised $54 million and $70 million for the 2006 and 2007 policy years respectively and have reduced the deficits on those years to $12.6 million and $34 million.The decision on the estimated 20 per cent supplementary premium on the 2008 policy is scheduled for the October 2009 Board meeting and would reduce the currently projected deficit on that policy year from $50 million to a surplus of $13 million.

Underwriting

Premium income

At the 2009 renewal the Club set a general increase of 12.5 per cent on renewing mutual owned tonnage and achieved 11.7 per cent before terms (deductible changes etc). The general increase was set with the continued aim of achieving a break-even underwriting result. This has become even more important in the current climate where the level of investment risk is considerably higher than in the past and returns on lower risk assets are at historic lows. The general increase was set with the backdrop of changes to the Pool which was anticipated to be favourable to the Club, as well as the deficit on the 2008 policy year. In addition the lower inflation and commodity price environment combined with the lower US dollar cost of the Managers' operations will mean that underwriting breakeven will be closer to being achieved in the short term.

If the current shipping recession follows the patterns of the previous recessions in the past three decades, claims values will drop substantially. Whilst this expected downturn will help to move the combined ratio to below 100 per cent, the extent and timing of such a fall in claims will be uncertain.

The supplementary premium approved by the Board was levied at a rate of 20 per cent on 2006, 25 per cent on 2007 and an estimate of 20 per cent on 2008 policy years, with the 2006 and 2007 premiums being debited in March and June 2009. This undoubtedly had some effect on the renewal season, but in the Club's core areas levels of loyalty remained high.

Claims performance by policy year

Claims for the 2008 policy year are projected at $322 million, marginally lower than the 2007 policy year projection of $336 million, which was close to a record year on the Pool as well as more costly on the Club's own retained claims. The table below (Fig.1) sets out the projected ultimate cost of incurred and Pool claims for the 1999 – 2008 policy years.

The 2008 policy year has two important features. First, net retained claims from Members have increased by approximately 10 per cent from the 2007 policy year with most of the 2008 increase attributable to crew claims. This trend is of concern and bears a close relationship to the general increase level. Secondly, on the positive side, the lower level of Pool claims in 2008 offset to some extent the increase in retained Member claims. The Club's reserves have been prudently set in conjunction with an independent firm of consulting actuaries.

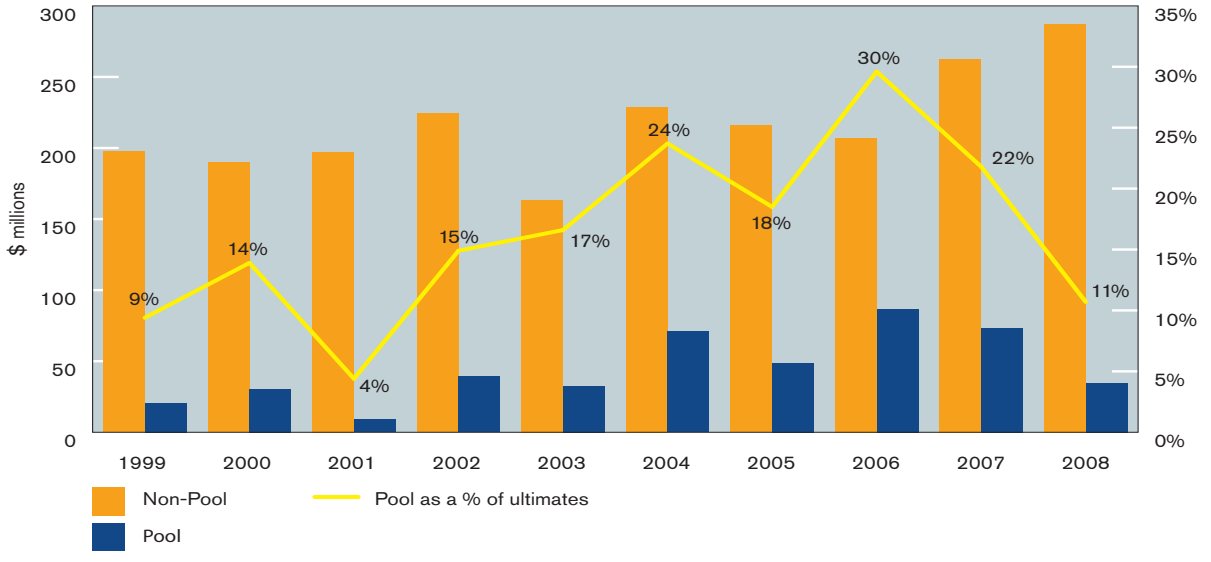

Figure 1: Composition of policy year ultimates between Pool and non-Pool claims

Figure 2: Net incurred claims development – Pool claims

Pool claims

In October 2007 the Club reported to Members that the high levels of shipping activity and increased size of the world fleet would generally increase the likelihood of large claims. The high commercial activity indeed resulted in record claims on the Pool. Although still at an early stage in its development, 2008 has unexpectedly not presented the high level of major casualties which were such a feature of the Pool in 2006 and 2007. The Club believes, however, it would be premature to anticipate a long-term reduction in Pool liabilities into the coming policy years and has already factored this into its financial planning and the setting of the general increase for 2009. Figure 2 shows the net incurred Pool claims by policy year and demonstrates the considerable projected cost to the Club of the 2006 and 2007 policy years and in contrast the much lower net incurred claims position of the 2008 Pool at 12 months.

Retained claims

In contrast to the favourable movement in the projected Pool claims on the 2008 Policy year, incurred claims within the Club retention have edged upward in value by approximately 11 per cent compared to the 2007 policy year as shown in Figure 3 below.

People claims – Crew factor

People claims (comprising passenger liabilities, stevedore, pilots, visitors and, above all, crew illness, death and injury claims) increased more than any other category. Of the $24.6 million increase in Member claims from 2007 to 2008, a striking $21.5 million is attributable to people claims. Whilst not a new report to the membership, escalating crew wages and compensation for crew illness, death and injury have driven crew claims upwards. Additionally, enhanced medical care inflation has also been a significant factor.

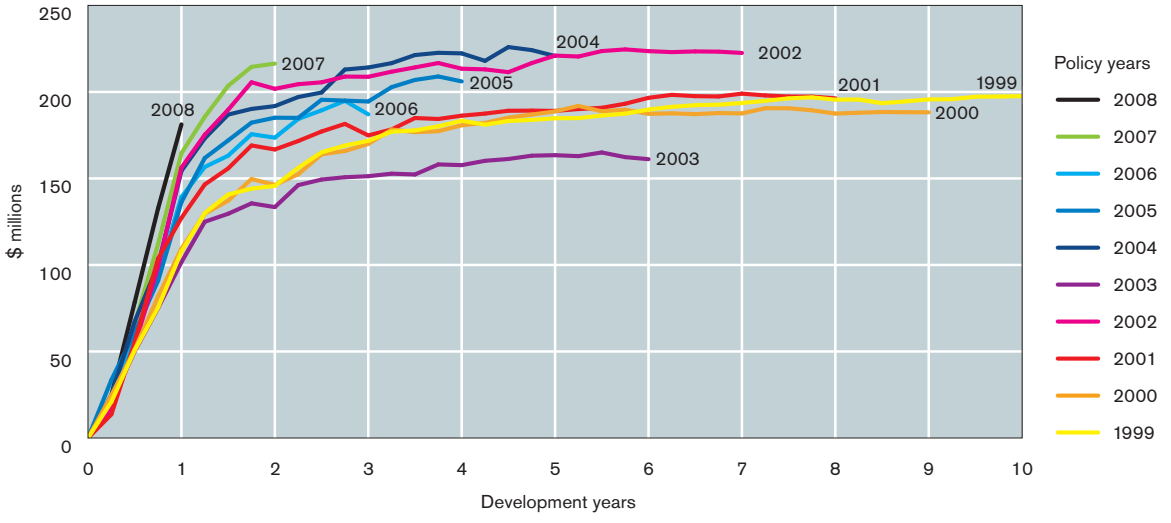

Figure 3: Net incurred claims development – non-Pool claims

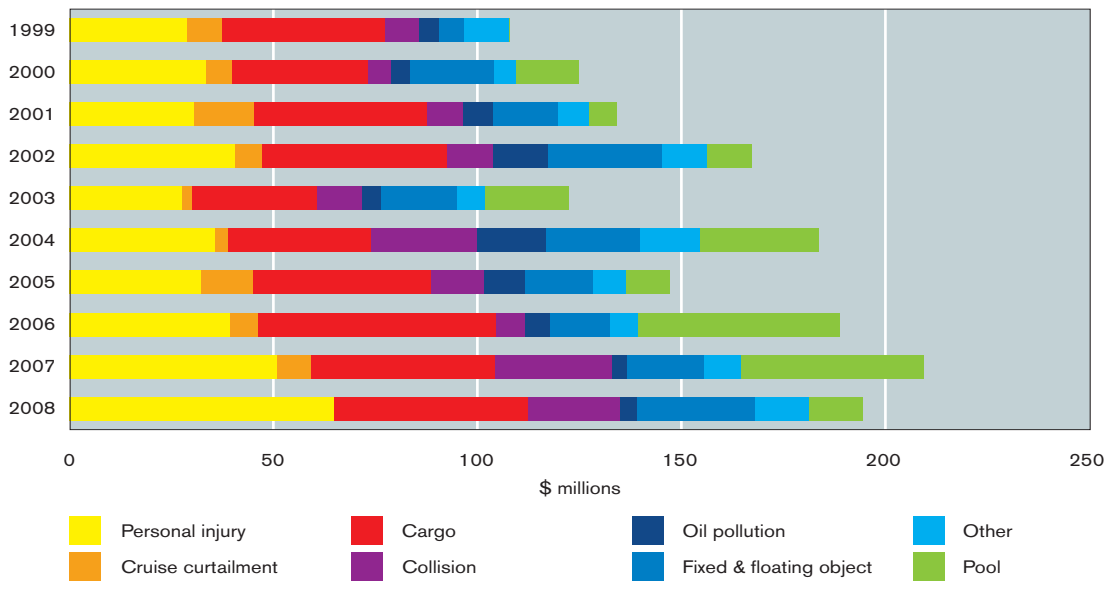

Figure 4: Net incurred claims by category at twelve months' development

Figure 4 shows the net incurred claims by category at twelve months and highlights the incurred cost of personal injury claims in proportion to the total claims.

An immediate question is whether claims numbers are rising, possibly revealing deteriorating safety standards. Fortunately, this is not the case. Crew injury claims by number of claims involving payments have declined by nearly 28 per cent from 1999 to 2008. During the same period, crew illness claims involving medical costs or compensation have decreased in numbers by 16 per cent. These reductions in numbers of claims speak well of Members' efforts to maintain high safety standards and to properly screen crew at the employment stage.

Despite the favourable reductions in claims numbers, the average cost per claim has grown well above normal inflation levels. For crew illness claims, whilst the number of claims dropped, the average cost rose by 305 per cent from $7,525 to $22,920 (1999 to 2008). The increase reflects changes onshore as well as aboard ships, in particular rises globally in the cost of medical care and hospitalisation. Undoubtedly the increase also reflects recent escalations in crew wages and the impact on sick wages and disability payments.

As a consequence, a significant amount of the Club's loss prevention programme has shifted from cargo care to people issues. Club publications during the year have addressed enclosed space precautions, mooring safety, life boat practices, protective clothing, pre-employment medical checks, and so on. In May 2008 the Club held a seminar relating to crew claims and personal injury entitled "Life at Sea" to provide a forum for members in this important area of loss prevention activity.

Casualty related FFO and Collision claims

The Club experienced several large dock and shore installation damage claims during the early months of the 2008 policy year. Two of those claims have been reported to the Pool, though both with gross estimates of less than $15 million. The Club's experience over the last ten policy years shows that this category can be volatile from one policy year to another, but does not represent a trend. As ship utilisation decreases, the category of claim may head downward, as well.

Figure 5 sets out the development of this category of claim by net reported claims for each policy year from 1999 and shows that 2008 was near the upper end of the range for this type of claim.

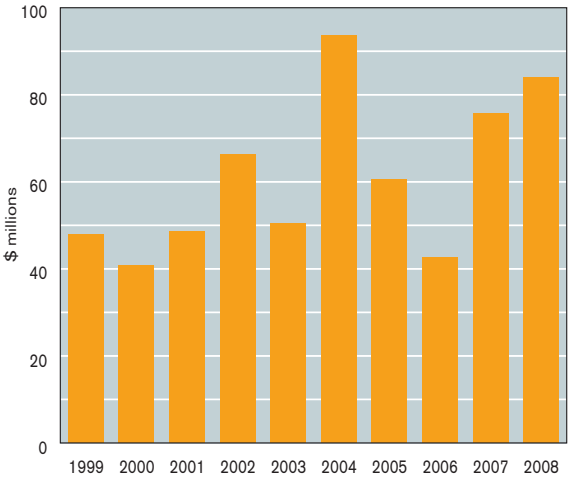

Figure 5: Collision, property and pollution ultimate claims projection by policy year 1999-2008

Cargo claims

Compared to other claims categories cargo claims have been relatively stable, even during the recent years of high commodity values. In part the stability may reflect the carriage of finished goods, as opposed to commodities but it is equally a tribute to the safe operating standard of Club Members. One could have expected a dramatic upward spike in cargo claims during 2007 and early 2008, which fortunately did not occur. Put in perspective, the net projected cost of people claims for 2008 will be more than double the cost of owners' cargo claims.

Capital and risk management and regulation

In 2008 the Club was the first P&I mutual to issue hybrid capital. The Club's financial planning has had the long term aim of ensuring that it is ready for Solvency 2, which is the European Community's proposal to change the regulation of insurance companies.

One key thrust of Solvency 2 is the assessment of capital levels. Whilst it was already anticipated that Solvency 2 would raise the capital levels required for insurers the events of the last six months in the financial sector are leading regulators and governments to consider even higher capital levels and evidence of comprehensive world class risk management.

P&I clubs are not immune to the capital tightening required by regulators and with this in mind the steps taken by the Club are all the more important.

With that backdrop the Club realised that it should raise additional capital for solvency purposes, but do so in a way that was an efficient use of Members' money. Raising $100 million of hybrid capital at a coupon of 9 per cent has meant that the Club has provided an additional level of capital that supplements the Club's free reserves, see diagram (Fig.6) below.

Although the Club was successful in raising the hybrid capital, the deterioration in the claims and the possible absence of investment income meant that the underlying free reserves were under pressure.

The hybrid capital was raised for solvency purposes and not as operational capital and therefore the Club in response to the higher claims and investment risk had to make the decision to levy supplementary premiums on the open policy years 2006 and 2007 and to estimate 20 per cent supplementary premium on 2008.

As a result of these decisions, the Club has considerably strengthened its financial position and comfortably meets the requirements of its regulators and is excellently placed to meet those of Solvency 2.

Standard & Poor's

During the year Standard & Poor's changed the Club's rating from A (stable) outlook to A- (stable). The change in rating reflected the lower financial flexibility taking into account the raising of hybrid capital and the supplementary premium levies, despite the increase in the financial strength of the Club.

The A- (stable) rating has been reaffirmed following the year end results and it is the Board's stated goal to return the Club to an A (stable) rating at the earliest opportunity.

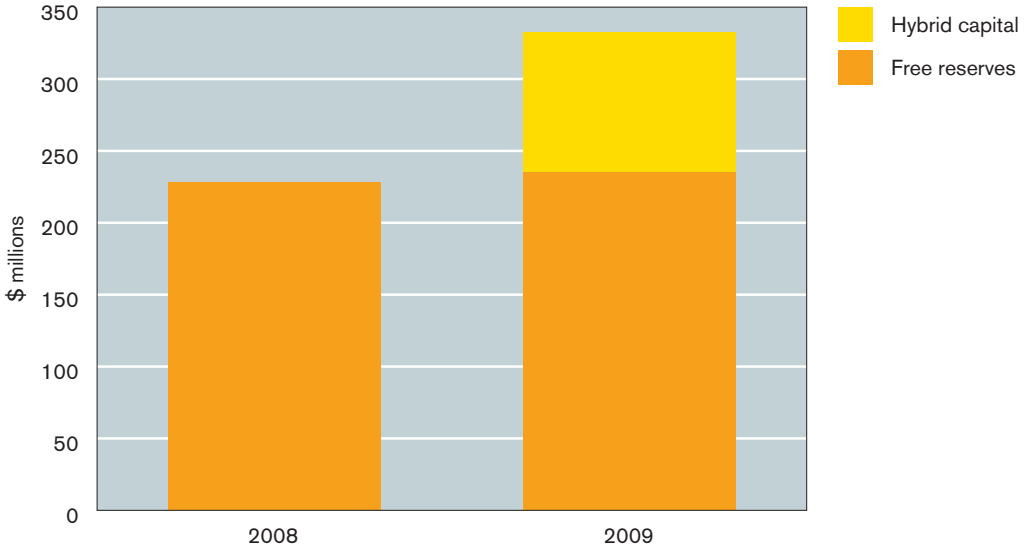

Figure 6: Composition of Club's capital position

Investments

Background

The forces at work within the United States were the most threatening since the Depression in the 1930s and have profoundly affected the global economy. A series of shocks impacted the financial system during 2008. The first struck when governments and investors alike had started to believe that the sub-prime debt crisis, which had emerged during August 2007, had been contained. Even in the aftermath of the collapse of Bear Stearns in March 2008, governments and central banks remained convinced that they could limit the impact of the liquidity crisis, which was promising to develop into a severe credit crunch.

As central banks worried about the commodity driven rise in headline inflation, the liquidity crisis deepened. The fragility of the banking system and the authorities' inability to control events were evident as Lehman Brothers collapsed. The contagion spread to other financial institutions - Merrill Lynch, Washington Mutual, AIG, Fannie Mae, Freddie Mac and other international names.

Although governments around the world acted quickly to provide capital, the extent of the losses threatened to overwhelm even the strongly capitalised banks. Investment banking stalled as fears mounted of a complete collapse and capital, previously provided to support financial markets, was withdrawn.

The pursuit of investment returns which had been the mantra since 2003 was abandoned for the protection of capital. Investors abandoned equity and corporate bond markets into the safety of government securities, taking yields down to levels not seen in several decades. The ability of the Club to deliver the hybrid capital strategy in the midst of this storm is a testament to the confidence in the Club.

Urged on by low interest rates and eager bankers, borrowers from individuals to corporations took on unsustainable levels of debt to finance housing, life styles, business expansions and, even, dividend payments and share buy-backs. The ease of access to cheap funding also spawned a rapid expansion in the number of hedge and private equity fund managers who, in normal times, would have struggled to find support. The withdrawal of investor and investment bank capital which sustained leverage in certain hedge fund strategies forced many managers to unwind positions rapidly, adding to the selling pressure in equity markets. This pressure, as the chart below shows, was most intense in the last quarter of 2008. The flight from equities was not confined to the United States, as the world index (Fig 8) shows.

Non government bond markets, including municipal bonds, suffered as demand evaporated and selling intensified as concerns over rising default rates materialised. Another important factor influencing the market was the forced departure of a number of important market intermediaries, notably Lehman Brothers and UBS. The difference in yield between government and non government bonds reached levels not seen since the 1930s, depressing

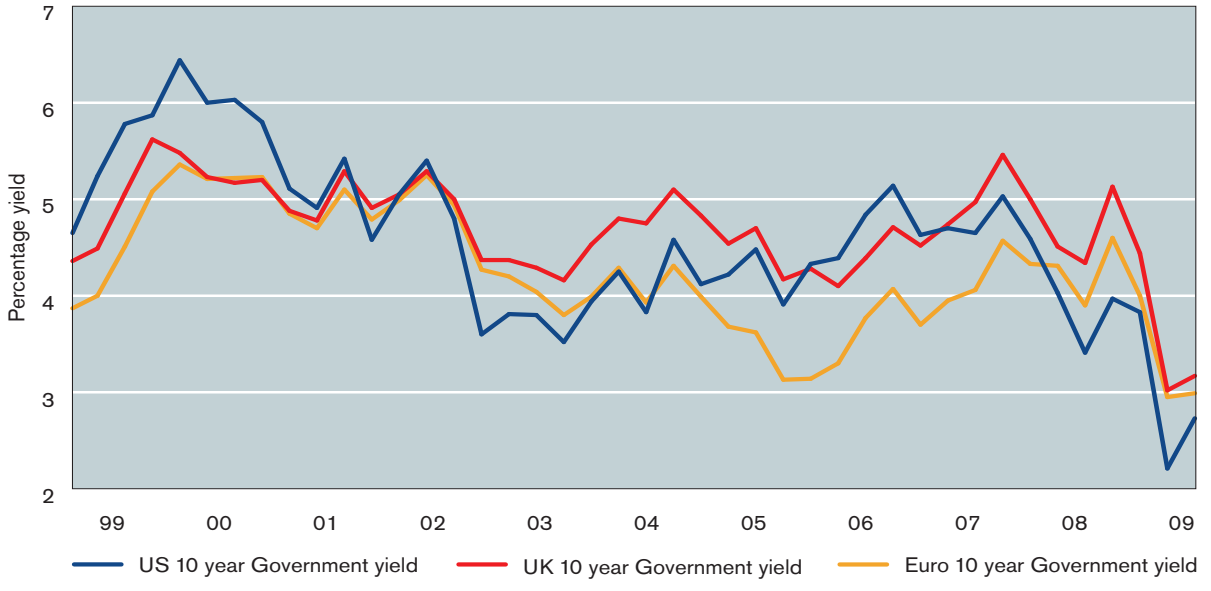

Figure 7: Yields on government securities

Figure 8: Equity market performance

investment returns. The main beneficiary of the flight to quality was government bonds.

No country or region has escaped the sharp fall in economic activity. Financial institutions facing rising default rates in business loans, housing, auto and credit card debt simply do not have sufficient capital to meet the losses, even after massive injections of government capital. Companies continue to struggle to gain access to new capital or re-negotiate existing debt arrangements. In order to control costs in a falling demand and earnings environment companies continue to shed labour at record pace. The extent of the rise in unemployment presents a challenge to all governments and the temptation to introduce measures to favour domestic labour forces is very strong.

Global industrial production and manufacturing output has collapsed. The conditions appear to be most evident in the Far East where Japan, China, India and Korea have been hit very hard. Central banks have reacted to the events with differing levels of enthusiasm, either cutting interest rates or providing capital, or in some cases doing both. The Federal Reserve Board and the Bank of England have both gone further by introducing quantitative measures designed to ease monetary policy. The United States and United Kingdom governments announced fiscal packages designed to ameliorate the impact of the recession and encourage growth. Other countries have been either unable or unwilling to follow their example. In Europe, where some countries are in considerable difficulty, the response has been fragmented and uncoordinated.

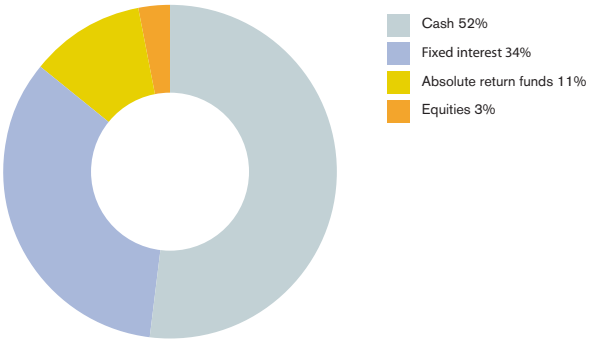

Figure 9: Investment portfolio holdings

Investment strategy and returns

The Club maintained the conservative strategy introduced during the previous year, which was beneficial during this turbulent period. Whilst the conservative nature of the investment fund's asset allocation gave considerable protection in a very difficult year, its exposure to currencies other than the US dollar, absolute return funds and, to a much lesser extent, equities depressed returns.

The return on the investment fund was -5.87 per cent for the year compared to 6.5 per cent in the previous year. The total investment loss for the year, including investments outside the main investment fund, amounted to $56 million, the market loss on investments was limited to just $18 million. The remaining $38 million was incurred through currency exchange losses on non-dollar assets, which are held in proportion to the currencies of anticipated claims.

Following a review of the investment policy at the beginning of this year, the Board decided to partially relax the restrictions placed on the purchase of equities to take advantage of potential stock market rallies in the latter part of this year and early next year. The implementation of this change in policy will be closely monitored by the Board.

Reinsurance

The structure of the reinsurance programme for the 2008 policy year remained unchanged from that of 2007. The actual 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 Figure 10.

The contract was renewed with an overall premium increase which represented an increase on the first layer of the contract and reductions on layers two and three. The increase in the price of the first layer was driven by the deterioration in the record on that layer, notably the 2004 and 2006 policy years which had moved to a net loss to the market.

The effect of the increase would have been broadly neutral on the reinsurance rates per gross ton once the anticipated growth in the world tonnage during 2008 had been factored in.

In fact the actual reinsurance rates per gross ton for 2008 were higher than those charged in 2007 as a result of the need to increase the premium to Hydra (the International Group's captive) to cover Hydra's exposure to the claims on the upper Pool layer. For the 2008 policy year the structure of the Pool remained unchanged and was made up of two layers: $7 million - $30 million (the lower Pool) and $30 million - $50 million (the upper Pool).

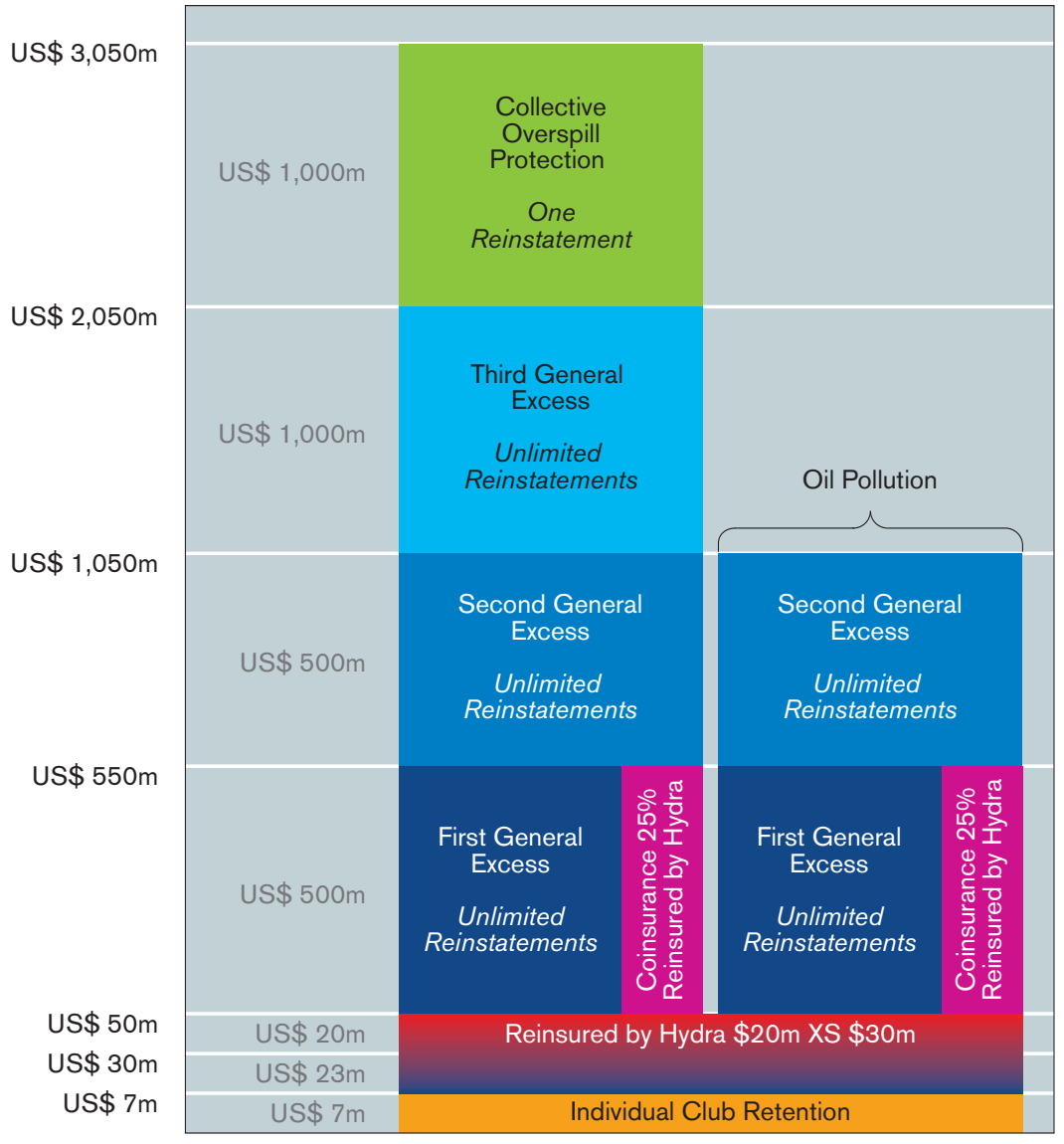

Figure 10: Structure of International Group Pool reinsurance protection

The Club's share of the lower Pool is based on the "one third" formula. This provides that a club's share is calculated as to: one third on the basis of the club's percentage proportion of the total tonnage in the Group for the policy year in question; one third on the basis of that club's percentage proportion of the total premium of the Group for that year; and one third on the basis of that club's own claims as a proportion of all claims on the Pool.

The claims proportion of the formula is based on a rolling twenty year claims record. The formula also provides for a loss ratio adjustment mechanism which, for the time being, continues to be based on the historical record on the Pool back to 1970. The loss ratio adjustment was capped at a maximum penalty of 30 per cent for 2008 (see below for 2009 Pooling arrangements).

2009 Reinsurance arrangements

The International Group's general excess of loss contract was renewed on the same terms and structure as for the 2008 policy year. The overall cost of the Group's reinsurance, including the layers insured by the Group's captive Hydra, increased by just under 15 per cent.

This increase was driven by a significant deterioration on claims to the contract during 2008 in particular in respect of the 2006 and 2007 policy years. There has now been a total loss to the first layer of the contract in three out of the last five policy years.

By contrast Hydra was able to hold the 2008 rates for the upper Pool layer premium.

Pooling arrangements for 2009

For the 2009 policy year, the Club retention remains at $7 million.

The Group Pooling arrangements will change in two respects: (i) the cap on the loss ratio adjustment to clubs' proportions will increase to 60 per cent from the current 30 per cent; and (ii) the upper Pool (the layer $20 million excess of $30 million) will merge into the lower Pool ($23 million excess of $7 million).

The result of a single Pool formula is that clubs' contributions to Pool claims will now be calculated on one uniform basis, namely the 'one third' basis previously only used for the lower Pool apportionment. The changes to the Pool will reduce the UK Club's contributions to Pool claims for the 2009 policy year.

The old upper Pool layer will, however, continue to be reinsured by the Group captive, Hydra, and pre-funded by a premium contribution from each club. This premium is included in the reinsurance rates.

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 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 remain ultimately 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 Association.

For the 2009 policy year, the Group has once again purchased reinsurance protection on behalf of each club for an overspill claim of up to $1,000 million. 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 2009 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 2009 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 2009 policy year, the limit of the Group's excess war P&I insurance remains $500 million. The supplementary Pooling for "Bio Chem" claims will also continue to match the upper limit of the Pool at $50 million was also continued for the 2008 policy year. Details of the war risks P&I cover arrangements for the 2009 policy year were communicated to Members by circular 4/09.

Charterers' cover

For the 2009 policy year the Club renewed its reinsurance arrangements with the existing market. The reinsurance protection of this cover was arranged through the brokers Miller and Willis.

Service

The Club remains committed to providing the highest standards of claims and advisory service to its Members. The quality, location and organisation of the people employed by the Managers of the Club ensures this happens and is regularly reviewed by the senior managers.

In 2008 the Managers employed a range of staff with a diverse skill set based in a global network of offices located in London, Hong Kong, Singapore, Beijing, Shanghai, New York, San Francisco and Greece who were responsible for meeting the service needs of Members.

Many of the staff employed have legal qualifications and the others a broad mix of maritime, ship operation, commercial and insurance skills. In addition to the breadth of the skill base there is also considerable depth of experience.

During 2008, the Managers continued to invest in their ongoing training programme in order to ensure that the skill base of staff was maintained and developed to meet the evolving service requirements of Members.

The Managers' staff are organised on the basis of geographical teams, who are responsible for ensuring that the service needs of the Members in their area are understood and met. During 2008 the Managers' staff were involved in handling over 23,180 open claims files and logged inquiries, of which approximately 10,000 were new matters.

To meet the claims and underwriting service requirements of Members, the Managers regularly meet with Members. Often, visits to Members include the provision of face to face seminars, workshops, or briefings on topical claims or other issues. In USA, every October, a two day Bodily Injury Claims workshop is held for Members.

In November 2008 the Bunker Convention came into force. The Managers put in place a system so that Members could quickly and easily obtain the Blue Card they required from the Club in order to obtain certification from the relevant flag state.

The Managers were actively engaged in International Group discussions which focussed on how to resolve the practical problems Members faced in responding to the requirements imposed by the Convention. Between 14th July 2008 and 20th February 2009, over 3,100 Blue Cards were issued to 404 Members in 52 countries involving 31 flag states.

Core claims and underwriting service activities continued to be supplemented by the work of the PEME and SIGNUM teams. PEME, the Club's Pre-Employment Medical Screening programme, has now overseen approximately 200,000 pre-employment medical screenings since inception.

SIGNUM was set up in 1953 following a spate of cargo frauds and is staffed by experienced investigators with a background from the Metropolitan Police Serious Fraud Squad.

SIGNUM investigators have significant international contacts and experience in dealing with difficult investigations and are deployed to investigate suspicious or complicated matters either by the Managers' claims handlers, or directly by Members. Last year, SIGNUM undertook 50 different investigations.

During 2008 the Managers continued to look for opportunities to share knowledge, raise awareness and discuss topical issues with Members. The annual Insight Course was organised by Thomas Miller in September 2008. This intensive four day course, which provides an introduction to transport law and insurance, attracted a wide range of P&I Members from around the world and will repeat in 2009.

In May 2008, the Club organised a forum in Athens, "Life at Sea- tackling future crewing challenges", which coincided with the May meeting of the Club's Board of Directors. The forum addressed the issues of supply and training; standards and competence; experience and length of service; welfare; industrial relations and the impact of legislation. A wide range of international speakers contributed to the debate with presentations on various key facets of the crewing challenges the industry faces.

The Club's website (www.ukpandi.com) continues to play an important role in communicating and providing information to Members. The website content is updated regularly and each week there is a new editorial. On average, there are 30 to 40 new items posted on the Club's website every month and the number of visits to the site is now averaging 65,000 per month.

The Managers continue to review all aspects of the Club's service and are always pleased to hear from Members who wish to discuss or provide feedback on any aspect of the Club's service provision.

All Members are most welcome to contact the senior management, as it is a club for Members governed by Members.

Appendices to the Directors' report

Appendix 1 - Reserves of the Association

The following appendices are provided to show the movement of the reserves of the Association during the year, and the progress and the 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	2009	2008
Open policy years			
2008	2	(61,641)	-
2007	2	(38,102)	(77,616)
2006	2	(13,623)	(63,518)
2005		-	(28,577)
Deficit on Open years		(113,366)	(169,711)
Closed policy years	3	-	-
Contingency Account	3	254,162	288,440
Catastrophe reserve	3	42,458	49,518
Reinsurance Retention reserve		16,030	14,250
US Oil Pollution AP reserve		36,243	46,415
Statutory reserve		240	240
Total surplus		235,767	229,152
Outstanding claims		807,466	763,212
		1,043,233	992,364
Perpetual subordinated capital securities		97,950	-
		1,141,183	992,364

Appendix 2 - Development of open policy years

Amounts in $000	2008	2007	2006
Calls and premiums	418,958	449,992	414,510
Less reinsurance premiums	60,116	59,228	61,878
	358,842	390,764	352,632
Incurred claims:			
Paid	74,826	179,063	200,999
Known outstanding estimates	160,490	141,763	109,212
Unreported estimates	127,488	52,729	24,859
	362,804	373,555	335,070
Operating expenses	50,306	51,265	43,013
	413,110	424,820	378,083
Investment return	(7,373)	(4,046)	11,828
Deficit	(61,641)	(38,102)	(13,623)
Future investment income	12,000	4,000	1,000
Anticipated deficit	(49,641)	(34,102)	(12,623)

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) Included in the policy year funds is a surplus balance of $2.6 million for 2006, a deficit balance of $4.1 million for 2007 and a surplus of $5.1 million for 2008 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.

(c) The approximate yield of a 10 per cent supplementary premium on the open policy years would be $33 million (2008), $29 million (2007) and $28 million (2006).

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

(e) The outstanding contributions to other P&I associations' claims under the Group's pooling arrangement, including unreported claims, are $29 million (2008), $30 million, (2007), $31 million (2006) respectively.

(f) 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 2008	198,860	288,440	49,518
Investment return	(472)	(20,508)	(3,104)
Perpetual subordinated capital securities	-	(4,500)	-
Reinsurance premiums	-	(10,600)	(3,956)
Transfers on closure:			
Deficit on 2005 policy year	-	(29,358)	-
Balance of 2005 policy year	95,099	-	-
Premium adjustments	980	-	-
Reserve transfer	-	5,363	-
Claims paid net of reinsurance recoveries etc.	(88,217)	10,000	-
Transferred to Contingency account on review of estimated and unreported claims	(15,325)	15,325	-
Balance at 20th February, 2009	190,925	254,162	42,458
Outstanding claims	190,925	-	-
Net surplus (see Appendix 1)	-	254,162	42,458

Notes:

(a) On closure of the 2005 policy year, the sum of $3.3 million was transferred from the United States Oil Pollution AP reserve, and $4.1 million was transferred to 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) The outstanding claims on closed years include a provision for Group pooled claims of $51 million (prior year $45 million) including a forecast for unreported claims. The outstanding claims figure is shown net of recoveries from excess loss underwriters of $31.6 million (prior year $33 million), from the Pool of $48 million (prior year $48 million) and from other reinsurers of $2.6 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 2009.

Amounts in $000	Funds available	Estimated claims and forecast of unreported claims	Discounted liability
Total Closed Policy Years	190,925	190,925	178,416
Open policy years			
2006	120,448	134,071	125,287
2007	156,390	194,492	181,749
2008	226,337	287,978	269,110
Reserves			
Reinsurance Retention reserve	16,030	-	-
US Oil Pollution AP reserve	36,243	-	-
Contingency Account	254,162	-	-
Catastrophe reserve	42,458	-	-
Statutory reserve	240	-	-
Total funds	1,043,233	807,466	754,562

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 24-43.

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 2009 and the results of its operations and its cash flow 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

27th April 2009

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 Tucker's Point Hotel, Bermuda on Monday, 26th October 2009 at 9.00 am for the following purposes-

To receive the Directors' Report and Financial Statements for the year ended 20th February, 2009 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

27th April 2009

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 2009

Amounts in $000	Note	2009	2008
Income			
Calls and premiums	5	**548,723**	386,034
Reinsurance premiums	6	**(78,402)**	(74,078)
		470,321	311,956
Expenditure			
Net claims incurred	7	**353,079**	361,413
Acquisition costs		**27,600**	23,718
Net operating expenses	8	**24,039**	23,118
		404,718	408,249
Operating surplus/(deficit)		**65,603**	(96,293)
Investment return	9	**(56,182)**	64,344
Interest payable on perpetual subordinated capital securities		**(4,500)**	-
Surplus/(deficit) before taxation		**4,921**	(31,949)
Taxation credit/(charge)	10	**1,694**	(1,655)
Surplus/(deficit) after taxation		**6,615**	(33,604)
Reserves at beginning of year		**228,912**	262,516
Reserves at end of year	17	**235,527**	228,912

The notes form an integral part of these financial statements.

Consolidated Balance Sheet at 20th February 2009

Amounts in $000	Note	**2009**	2008
Assets			
Investments	11	**872,277**	714,321
Cash balances	12	**61,035**	187,133
Amounts due from Members	13	**213,212**	79,220
Reinsurer's share of outstanding claims	15	**243,274**	238,636
Accrued interest		**1,569**	2,533
Deferred taxation	10	**817**	-
Sundry debtors	14	**12,659**	23,139
		1,404,843	1,244,982
Liabilities			
Gross outstanding claims	15	**1,050,740**	1,001,848
Creditors	16	**18,759**	13,982
Provisions		**1,627**	-
		1,071,126	1,015,830
Reserves	17	**235,527**	228,912
Statutory reserve		**240**	240
Perpetual subordinated capital securities	18	**97,950**	-
Capital and reserves		**333,717**	229,152
		1,404,843	1,244,982

Directors

Mr C.I. Caroussis

Mr E. André

Mr R.N. Readman

Thomas Miller (Bermuda) Ltd

Managers

27th April 2009

Consolidated Cash Flow Statement at 20th February 2009

Amounts in $000	**2009**	2008
Operating Activities		
Calls and premiums received	**414,474**	378,596
Receipts from reinsurance recoveries	**13,021**	37,192
Interest and dividends received	**23,820**	34,694
	451,315	450,482
Claims paid	**264,310**	261,133
Acquisition costs	**27,600**	23,718
Operating expenses paid	**24,734**	26,375
Reinsurance premiums paid	**76,862**	73,152
Pool claims paid	**46,609**	63,335
Taxation (refunded)/paid	**(1,517)**	3,715
	438,598	451,428
Cash inflow/(outflow) from operating activities	**12,717**	(946)
Investing Activities		
Purchase of investments	**(1,978,728)**	(2,191,201)
Sale of investments	**1,741,733**	2,266,711
Net cash (outflow)/inflow from investing activities	**(236,995)**	75,510
Financing		
Issue of perpetual subordinated capital securities	**98,180**	-
Net (decrease)/increase in cash and cash equivalents	**(126,098)**	74,564
Cash balances at beginning of year	**187,133**	112,569
Cash balances at end of year	**61,035**	187,133

Notes to the financial statements

Note 1 - Constitution

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) Accounting disclosures

These financial statements have been prepared in accordance with accounting principles generally accepted in Bermuda and Canada and under the historical cost convention except that listed investments are carried at market value as disclosed in note 2(q). 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.

(b) Subsidiary company

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 United Kingdom Mutual Steam Ship Assurance (Europe) Limited ("UK Europe"). IPIR reinsures 90 per cent of the risks retained by the holding company. The company 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 and 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 and 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 5). 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 coinsured 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 Club's 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 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 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.

Investments, for which there is an active market, are stated at their market value at the balance sheet date. Investments purchased in foreign currencies are translated into US dollars on the date of purchase. The market values of foreign currency investments are translated at the rate of exchange ruling at the balance sheet date.

The investment in United Kingdom Mutual Steam Ship Assurance (Europe) Limited represents capital contributions to that club which, since the holding company is the sole member, is under the control and hence a subsidiary of the holding company.

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 UCITS are Undertakings for Collective Investments of Transferable Securities and are used as an alternative to cash deposits, and those purchased in foreign currencies are translated into US dollars at the rate of exchange ruling at the date of purchase. They are not listed and are shown at market 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 5 years until the capital can be repaid. Interest payable is accrued on a straight line basis.

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:

1. Insurance risk – incorporating underwriting and reserving risk
2. Market risk – incorporating investment risk, interest rate risk and currency rate risk
3. Credit risk – being the risk that a counterparty is unable to pay amounts in full when due
4. 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 investment strategy.
3. The Audit Committee considers the risk register 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 monoline 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 $2.05 billion with an additional overspill layer of $1 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.

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 2009	2,396
As at 20 February 2008	1,698

Equity price risk

The Association is exposed to equity 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 3 per cent (2008: 2 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 $84 million (2008: $110 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 $15.6 million (2008: $19.9 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 $2.4 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 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

As at 20 February 2008

Amounts in $000	US Dollar	Sterling	Euro	Other	Total
Debt securities	84,236	24,155	65,733	5,418	179,542
Equities	32,992	-	-	-	32,992
Absolute return funds	109,850	-	-	-	109,850
UCITS	283,063	65,322	43,544	-	391,929
Forward currency contracts	39	(42)	148	(137)	8
Cash balances	143,124	4	29,459	14,546	187,133
Amounts due from Members	77,920	82	1,117	101	79,220
Reinsurers' share of outstanding claims	238,636	-	-	-	238,636
Accrued interest	2,533	-	-	-	2,533
Sundry debtors	21,048	389	658	1,044	23,139
Gross outstanding claims	(640,523)	(46,720)	(147,907)	(166,698)	(1,001,848)
Other liabilities	(13,060)	(366)	(548)	(8)	(13,982)
	339,858	42,824	(7,796)	(145,734)	229,152

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 investment valuation	
	Sterling	Euro
As at 20 February 2009	2,422	(530)
As at 20 February 2008	2,441	560

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 table provides information regarding aggregate credit risk exposure for financial assets with external credit ratings as at 20 February 2009. The credit rating bands are provided by independent ratings agencies:

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
Pool debtors	-	-	39,919	38,703	78,622
Reinsurance debtors	-	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 2008

Amounts in $000	AAA	AA	A	Not readily available/ not rated	Total
Debt securities	101,065	72,633	5,844	-	179,542
Equities	-	-	-	32,992	32,992
Absolute return funds	-	-	-	109,850	109,850
UCITS	391,929	-	-	-	391,929
Forward currency contracts	-	8	-	-	8
Cash balances	-	128,143	45,757	13,233	187,133
Amounts due from Members	-	-	-	79,220	79,220
Pool debtors	-	-	38,154	33,264	71,418
Reinsurance debtors	-	111,411	55,807	-	167,218
Accrued interest	-	-	-	2,533	2,533
Sundry debtors	-	-	-	23,139	23,139
Total assets	492,994	312,195	145,562	294,231	1,244,982

(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 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	-	212,141	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	1,176,586	226,843	1,298	32	84	1,404,843

As at 20 February 2008

Amounts in $000	Neither past due or impaired	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Debt securities	179,542	-	-	-	-	179,542
Equities	32,992	-	-	-	-	32,992
Absolute return funds	109,850	-	-	-	-	109,850
UCITS	391,929	-	-	-	-	391,929
Forward currency contracts	8	-	-	-	-	8
Cash balances	187,133	-	-	-	-	187,133
Amounts due from Members	-	79,220	-			79,220
Reinsurers share of outstanding claims	238,636	-	-	-	-	238,636
Accrued interest	-	2,533	-	-	-	2,533
Sundry debtors	-	22,682	339	30	88	23,139
Total assets	1,140,090	104,435	339	30	88	1,244,982

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 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

As at 20 February 2008

Amounts in $000	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Gross outstanding claims	334,212	218,074	306,183	143,379	1,001,848
Other liabilities	12,240	569	799	374	13,982
Total liabilities	346,452	218,643	306,982	143,753	1,015,830

(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.

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 is 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 $236 million (2008: $229 million) and perpetual subordinated capital securities capital of $98 million (2008: Nil).

Note 5 – Calls and premiums

Amounts in $000	2009	2008
Mutual		
Mutual premium	**342,139**	303,956
Supplementary premiums	**128,356**	-
Return premiums	**(3,647)**	(2,311)
Release charges	**2,617**	4,277
	469,465	305,922
Fixed premium		
Chartered vessels	**57,735**	57,913
Owned vessels	**11,810**	10,898
US Oil Pollution	**9,713**	11,301
	79,258	80,112
	548,723	386,034

The supplementary premiums disclosed above relate to the 2006 and 2007 policy years. A supplementary premium relating to the 2008 policy year is under consideration by the Board and, if ratified, would yield a further premium of approximately $65 million. This premium is not included in the figure noted above.

Note 6 – Reinsurance premiums

Amounts in $000	2009	2008
Market underwriters	**60,235**	55,715
Other reinsurance arrangements	**10,600**	10,600
US Oil additional premiums	**7,567**	7,763
	78,402	74,078

Note 7 - Net claims incurred

Amounts in $000	2009	2008
Gross claims paid:		
Members' claims	**273,130**	261,873
Group's pooling arrangements	**46,609**	63,335
	319,739	325,208
Less reinsurance recoveries:		
Group's pooling arrangements	**243**	13,465
Market underwriters	**10,671**	6,806
	10,914	20,271
Net claims paid	**308,825**	304,937
Movement in provision for outstanding claims:		
Provision carried forward	**1,050,740**	1,001,848
Less: Provision brought forward	**1,001,848**	918,531
	48,892	83,317
Less: Movement in reinsurer's share of gross outstanding claims:		
Provision carried forward	**243,274**	238,636
Less: Provision brought forward	**238,636**	211,795
	4,638	26,841
Net changes in provision for net outstanding claims	**44,254**	56,476
Net incurred claims	**353,079**	361,413

Note 8 – Operating expenses

Amounts in $000	2009	2008
Residual management fee	**14,611**	13,701
Directors' meetings	**2,702**	2,432
Managers/Agent travel	**688**	1,154
Sales and marketing	**558**	559
Publications	**251**	446
Printing and telecommunications	**273**	421
Correspondent charges	**9**	15
Legal and professional expenses	**1,469**	1,435
Bank and financial expenses	**791**	767
Loss prevention initiatives	**182**	432
Ship inspection initiatives	**539**	483
Operating branch and subsidiary costs	**640**	534
Other expenses	**1,326**	739
	24,039	23,118
Included within operating expenses are the following:		
Directors' fees	**785**	681
Auditors' fees	**519**	624

Note 9 – Investment return

Amounts in $000	2009	2008
Interest on fixed income securities	**15,556**	22,855
Bank deposit interest	**6,346**	3,067
Dividends receivable	**1,105**	8,781
(Loss)/Profit on sale of investments	**(1,029)**	42,528
Other investment income	**(151)**	-
	21,827	77,231
Unrealised losses on investments	**(40,104)**	(11,623)
Exchange loss	**(37,905)**	(1,264)
	(56,182)	64,344

Note 10 – Taxation

Amounts in $000	2009	2008
Taxation charge based on investment income in the current financial year	**-**	(1,931)
Adjustment in respect of prior periods	**877**	276
Deferred taxation on investment losses	**817**	-
	1,694	(1,655)
Surplus/(Deficit) before taxation	**4,921**	(31,949)
Expected taxation charge at 28 per cent	**(1,378)**	9,585
Underwriting result not subject to taxation	**18,369**	(28,888)
Portion of investment (loss)/income not subject to taxation	**(16,174)**	17,372
Adjustment in respect of prior periods	**877**	276
Taxation credit/(charge)	**1,694**	(1,655)

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

Note 11 – Investments

Amounts in $000	2009	2008
Listed Investments		
Fixed income securities	**438,262**	179,542
Shares and other variable income securities	**23,663**	13,095
Undertakings for Collective Investments of Transferable Securities (UCITS)	**311,022**	391,929
Investments in unit trusts	**84,177**	109,850
Total listed investments	**857,124**	694,416
Cost $865,122 (2008: $664,142)		
Other Investments		
Thomas Miller Holdings Ltd	**15,628**	19,877
Hydra Insurance Co. Ltd	**20**	20
Open forward currency contracts	**(495)**	8
Total investments	**872,277**	714,321

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 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 (2008: 1 and 7 per cent).

Of the fixed income securities $135.4 million (2008: $64.9 million) relate to government securities.

The investment in Thomas Miller Holdings 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, the investment is held a cost, less provisions for any impairment. The reduction 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 2009 using exchange rates prevailing at that date.

Note 12 – Cash summary

Amounts in $000	2009	2008
Cash and cash equivalents	**61,035**	187,133

Note 13 – Amounts due from Members

Amounts in $000	2009	2008
Members' balances due	**213,212**	79,220

Note 14 – Sundry debtors

Amounts in $000	2009	2008
Reinsurance and Pool recoveries	**9,223**	11,330
Funds with representatives	**312**	356
Claims recoverable from Members and third parties	**126**	8,901
Prepayments and other debtors	**2,998**	2,552
	12,659	23,139

Note 15 - Outstanding claims

Amounts in $000	2009	2008
Closed policy years	**190,925**	198,860
Open policy years		
2008	**287,978**	-
2007	**194,492**	280,844
2006	**134,071**	182,159
2005	**-**	101,349
	807,466	763,212
Gross outstanding claims		
Members' claims	**909,319**	848,996
Other Clubs' Pool claims	**141,421**	152,852
	1,050,740	1,001,848
Reinsurer's share of gross outstanding claims		
Group excess of loss reinsurance	**(54,652)**	(57,219)
Pool recoveries	**(78,622)**	(71,417)
Other reinsurers	**(110,000)**	(110,000)
	(243,274)	(238,636)
Net outstanding claims	**807,466**	763,212

The total of outstanding claims of $1,051 million (2008: $1,002 million) includes a forecast of unreported claims of $289 million (2008: $261 million) on open and closed policy years and an estimate of $28 million (2008: $38 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.

Note 16 – Creditors

Amounts in $000	2009	2008
Reinsurance premiums	**8,505**	6,965
Members' balances	**240**	416
Taxation	**290**	546
Others	**9,724**	6,055
	18,759	13,982

Note 17 - Reserves

Amounts in $000	2009	2008
Open policy years		
2008	**(61,641)**	-
2007	**(38,102)**	(77,616)
2006	**(13,623)**	(63,518)
2005	**-**	(28,577)
	(113,366)	(169,711)
Contingency Account	**254,162**	288,440
Catastrophe reserve	**42,458**	49,518
US Oil Pollution AP reserve	**36,243**	46,415
Reinsurance Retention reserve	**16,030**	14,250
Statutory Reserve	**240**	240
	235,767	229,152
Perpetual subordinated capital securities	**97,950**	-
	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	2009	2008
Issue of perpetual subordinated capital securities	**100,000**	-
Related transaction costs	**(2,050)**	-
	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 5 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 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 unrealised, 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, 2009, the ratio of 9.96 per cent (2008: 9.46 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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The UK P&I Club is a mutual insurance company managed on behalf of its Members by Thomas Miller.

Thomas Miller provides a range of insurance solutions for the international shipping and transport sectors.

Hellenic War Risks, ITIC, TT, UK Defence, UK War Risks

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