THE UNITED KINGDOM MUTUAL STEAM SHIP ASSURANCE ASSOCIATION (BERMUDA) LIMITED

DRAFT

DIRECTORS' REPORT

& FINANCIAL

STATEMENTS FOR

THE YEAR ENDED

20TH FEBRUARY, 2007

THE UNITED KINGDOM MUTUAL STEAM SHIP ASSURANCE

ASSOCIATION (BERMUDA) LIMITED

CONTENTS **Page**

CHAIRMAN'S STATEMENT

It is pleasing to be able to report an increase in the Club's free reserves by $46 million to $263 million at the end of the 2006 year. During the year Standard and Poor's also lifted their negative outlook on the Club's "A" rating, which is now "A" Strong (stable outlook). This has been achieved as a result of another good year for our investments which produced a return of nine per cent and has been boosted by a further reinsurance recovery on the Club's reinsurance contract with Swiss Re. However, this good news is somewhat offset by a more substantial deficit in the underlying operating account than we would have liked to see.

The primary reason for this is the experience of the International Group Pool. Our own premium income duly increased following the general increase ordered by the Board for 2006, and our Members' own claims in the latest policy year have not shown a significant increase either at the attritional level or as a result of major claims. However, the Pool has seen what may be a record year for the number and value of claims recoverable from the Pool, and the Club's contribution to these claims has adversely impacted the Club's claims experience for the year.

The Pool experience is particularly remarkable in that out of a total of 28 Pool claims notified by the end of the year (as against a normal average of 13 claims at this stage), only three small claims originated from the UK Club. It is tempting to suggest that this positive experience reflects the quality of our membership and their operational standards, but experience indicates that claims at these high levels tend to strike clubs on a fairly random basis.

For this policy year, the Club's contribution to claims from other clubs will far exceed our own recovery, but it can be expected that this will not always be the case, as was demonstrated by our own experience in the 2004 policy year. In any event, the Club's contribution to the Pool will be adjusted downwards to reflect our record if it continues to be favourable.

Even so, the number and quantum of claims at this level remains a concern, especially if the recent experience is the beginning of a new trend. We continue to enjoy the benefit of reinsurance protection through the Swiss Re contract for abnormally high numbers of large claims, but we will be investigating closely whether more reinsurance would prove cost effective. However, even with the benefit of reinsurance, in the current regulatory climate capital requirements can be expected to increase to cover potential volatility in claims. The Board will therefore need to ensure that premium income keeps pace with foreseeable claims developments.

There is no doubt that the Pool and the International Group reinsurance arrangements continue to be of value to the Club, especially if the Pool adapts to the requirements of changing circumstances. Sometimes, it is necessary to compromise the Club's preferred position in order to reach an agreement between the clubs in the International Group on whose goodwill these benefits ultimately depend. The issue of a limit on cover for passenger risks is an example.

Over recent years there has been much discussion between the International Group clubs on whether to restrict the exposure of the clubs to claims in respect of passenger liabilities. The prospect of early entry into force of the Athens Convention 2002 with its very high limits of liability per passenger and the increasing size of passenger ships provided a focus for this debate during the last year.

This culminated late in the year in an agreement by all of the clubs to impose a limit on the cover for passenger and crew liabilities for the 2007 policy year. Although set at the highest levels consistent with the Group's reinsurance programme, this limit still represents a departure from previous tradition in that the restriction was voluntary and not imposed by reinsurers, as was the case originally with the limit on oil pollution risks.

The result is that all members of International Group clubs are now protected from an overspill call arising from passenger risks, whilst passenger ship operators still have adequate cover in relation to the Athens Convention 2002 limits of liability for all but the very largest passenger ships.

During the year, the Board has completed its review of the governance structure of the Club. Whilst decision making remains with the full Board, it is assisted in the effective discharge of its duties by

three main committees of the Board - the Strategy Committee, Audit Committee and Nominations Committee (for each of which revised Terms of Reference have been agreed), and the creation of a new committee on Ship and Membership Quality. The relationship between the Club Board and the operations of the Club's subsidiary companies has also been clarified. The subsidiaries now include the new London based mutual, UK (Europe), which we have successfully established from 2007 to ensure that those Members who need or wish to do so, can access the Club through an insurer with a European regulatory passport.

I noted in my last Chairman's Statement the demands on the Board's time and attention arising from increasing regulatory requirements. This can only be expected to continue. The new European solvency regime, Solvency 2, continues to evolve, although the final form of the regulation will not be established for some time. Our Managers have been actively engaged in industry discussions of its development in addition to the regular contact we also maintain with the Club's own regulators, particularly the Financial Services Authority in the UK. Developments in this area need to be constantly monitored to guard against unwelcome surprises.

The revised governance structure inevitably imposes more demands on some Directors, particularly those involved in the work of the committees of the Board. I am grateful to them for their willing commitment of the necessary time, and especially to the three Deputy Chairmen on whom much of the burden falls. Without the constant support and assistance they have given me, the role of the Chairman would be very much more difficult.

Over the year, four Directors have left the Board. The contribution of Klas Kleberg to the conduct of the Club for many years as Deputy Chairman has been immense and we will miss his wise counsel. Annarita Marion and Giorgio Sulser have also been long serving members of the Board whose commitment to the Club has been exceptional. To them and Ma Zehua I extend our thanks. I also welcome to the Board new Directors: Mrs Lone Fønss Schroder, Myles Itkin, Mrs Kathryn Siggins, Nikolas Tsakos and Paul Wogan, and look forward to their participation in our affairs.

Finally, I would like to thank our Managers and all those working in their various offices around the world for the work they do for our Members. Their ability and willingness to provide assistance to Members, especially in times of crisis, remains one of the most important and valuable features of our Club.

Tullio Biggi

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, 2007.

Principal activities of the Association

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

At 20th February, 2007 the owned tonnage entered in the Association on mutual terms totalled more than 106 million gross tons. In addition, on average at any time in the year approximately 55 million gross tons of chartered tonnage was entered in the Association.

The 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 of the Board and a Strategy Committee. The Strategy Committee meets at least four 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 on page 5. Also shown are those who retired from the Board since February, 2006. 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 and to express

its particular appreciation of the service rendered to the Association by Mr Kleberg, both as a Director and as a Deputy Chairman.

Bye-Law 14 (c)(i) provides for Directors to retire who have been in office for three years since their last election. Consequently Messrs A.H. Al-Roumi, T. Biggi, T. Hojo, J.P. Ioannidis, A.C. Junqueira, C. Kertsikoff, J. Kopernicki, A.M. Lemos, J.B. Lee and D. Lim will retire at the forthcoming Annual General Meeting in Bermuda on 22nd October, 2007. All these Directors, with the exception of Messrs A.H. Al-Roumi, T. Hojo and D. Lim, have offered themselves for re-election.

In October 2006, Mr T. Biggi was re-elected as Chairman of the Board of Directors and Messrs E. André, C.I. Caroussis and A.K. Olivier were re-elected as Deputy Chairmen.

DIRECTORS

T. Biggi — V. Ships Group Ltd, Monaco
Chairman and President

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

C.I. Caroussis — Chios Navigation Co. Ltd, London
Deputy Chairman & Vice President

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

A.H. Al-Roumi	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. Decavèle	Broström Tankers S.A.S., Paris
L. Fønss Schrøder *	Wallenius Lines, Stockholm
S. Frank	OAO Sovcomflot, Moscow
O. Gast	Hamburg Südamerikanische Dampfschifffahrts-Gesellschaft K.G.,Hamburg
I.J. Gaunt	Carnival Corporation & plc, London
T. Hojo	Mitsui O.S.K. Lines Ltd, Tokyo
N.G. Inglessis	Samos Steamship Co, Athens
J.P. Ioannidis	Olympic Shipping and Management S.A., Athens
M.R. Itkin *	Overseas Shipholding Group Inc, New York
A.C. Junqueira	Petrobras Transporte SA - Transpetro, Rio de Janeiro
C.E. Kertsikoff	Eletson Corporation, Piraeus
J.M. Kopernicki	Shell International Trading and Shipping Co. Ltd, London
P. Kragic	Tankerska Plovidba d.d., Zadar
J.B. Lee	Korea Line Corporation, Seoul
A.M. Lemos	Unisea Shipping Ltd, Piraeus
D. Lim	Neptune Orient Lines Ltd, Singapore
P. Louis-Dreyfus, OBE	Louis Dreyfus Armateurs S.A.S., Paris
A.C. Margaronis	Diana Shipping Inc, Athens
E.T. Richards	Hamilton, Bermuda
M. Sato	NYK Line, Tokyo
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
P. Wogan *	Teekay Tanker Services, London

* New Directors elected in October 2006

The following Directors have left the Board since February 2006:

K. Kleberg
Ma Zehua
A. Woolridge Marion
G.P. Sulser

REVIEW OF THE YEAR

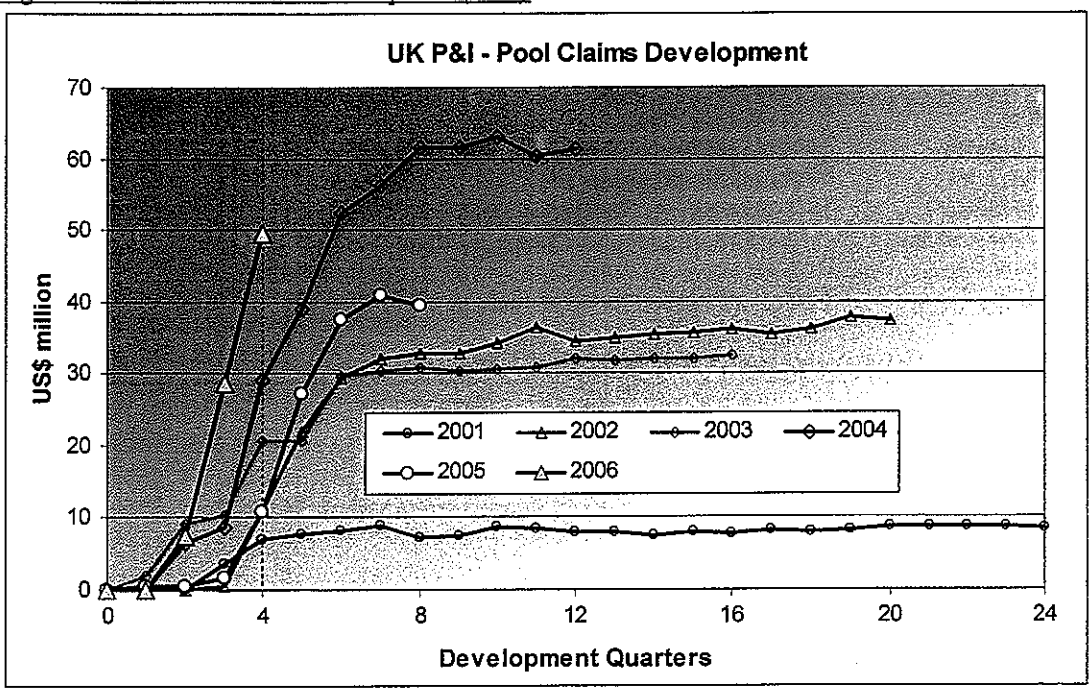
FINANCIAL

Performance for the year to February 2007
The outcome for the year to February 2007 has been dominated by three factors: a particularly heavy year for Pool claims being offset by an investment return of 9.7% and a net recovery on the Club's reinsurance contract with Swiss Re of $43m. The experience of the Club's own claims was in line with previous years but contribution to other clubs' Pool claims has been running at record levels. Investment performance was driven by strong equity markets and a short duration position on the fixed income markets. The underlying result produced a surplus of $2m and free reserves of $219m before the Swiss Re policy is taken into account. The effect of the recovery from Swiss Re of $43m increased free reserves to $263 m (2005: $217m).

Underwriting and claims
Premium income
At the last renewal premium increased on renewing business but because there was a net loss of tonnage on renewal the overall premium was down. However, during the year the Club has seen tonnage grow again driven by both new buildings and new Members. Fixed premium business remained a strong contributor bringing in $65m of business overall with time charter accounting for $43m.

Claims
Net paid claims have fallen slightly to $266m compared to $274m in 2005. Incurred claims in the financial year rose to $264m (2005: $223m). In last year's report and accounts the factors underlying the growth in claims were reviewed highlighting the impact of large claims on the Club's year on year financial performance and the factors driving those large claims. These factors remain important but it is important to stress that large claims such as these have an element of randomness, representing the impact of external events rather than necessarily poor quality of ships or their operators. The 2006 policy year has been affected by what may be a record year for the number and value of claims recoverable from the Pool, see figure 1. As the Club bears the largest contribution to the Pool this has a significant effect on the Club's result for the financial year.

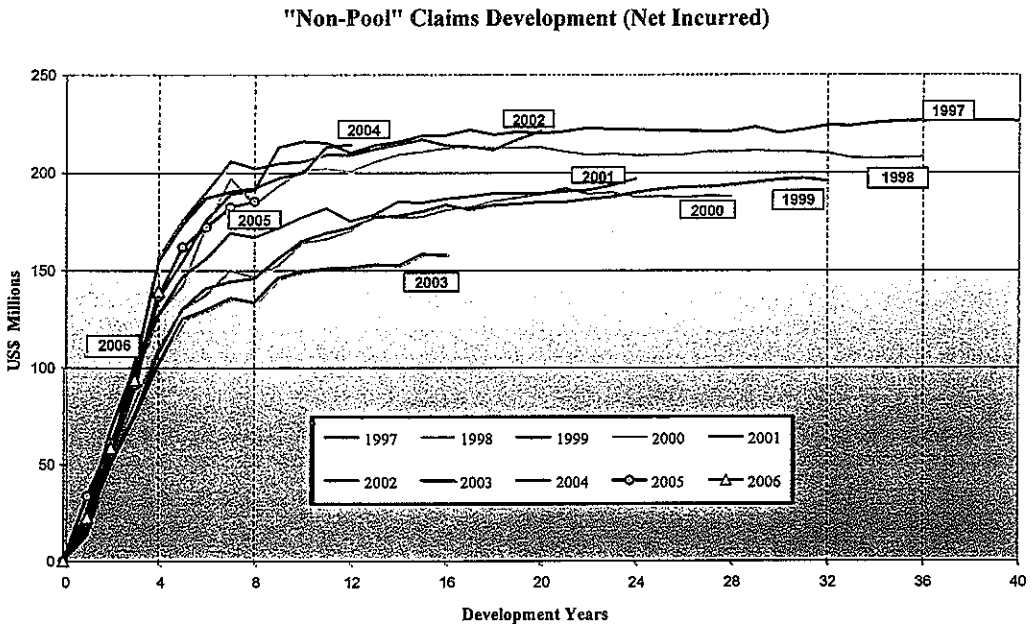
Figure 1: Net incurred claims development (Pool)



The development of the 2006 policy year for the Club's own claims was in line with the trend of previous policy years when non Pool claims are compared to the development of other policy years as

shown in figure 2. The ultimate claims expected on the Club's own claims, shown in figure 3, which indicates some stability for non Pool claims for recent policy years.

Figure 2: Net incurred claims (non Pool)



The effect of the Pool on the ultimate claims forecast for the year is also shown in figure 3, which demonstrates both the volatility and rising cost of the cost of the Pool since 2002. The exceptionally high level of claims and their speed of development for the 2006 policy year make it difficult to set a reserve at the twelve month stage.

Figure 3: Composition of policy year ultimates between Pool and Non Pool

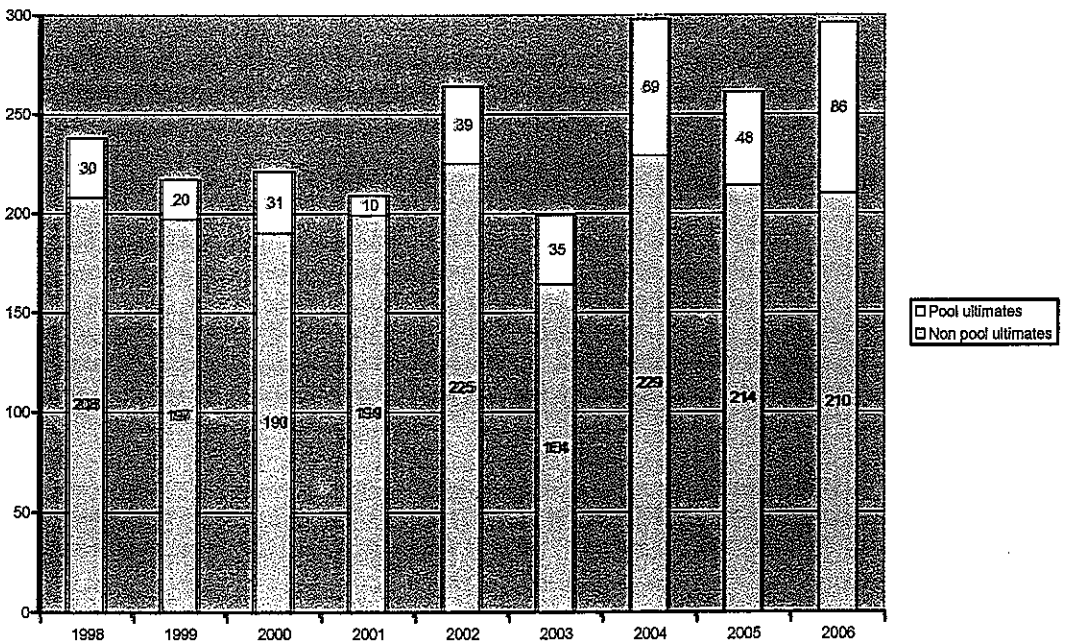
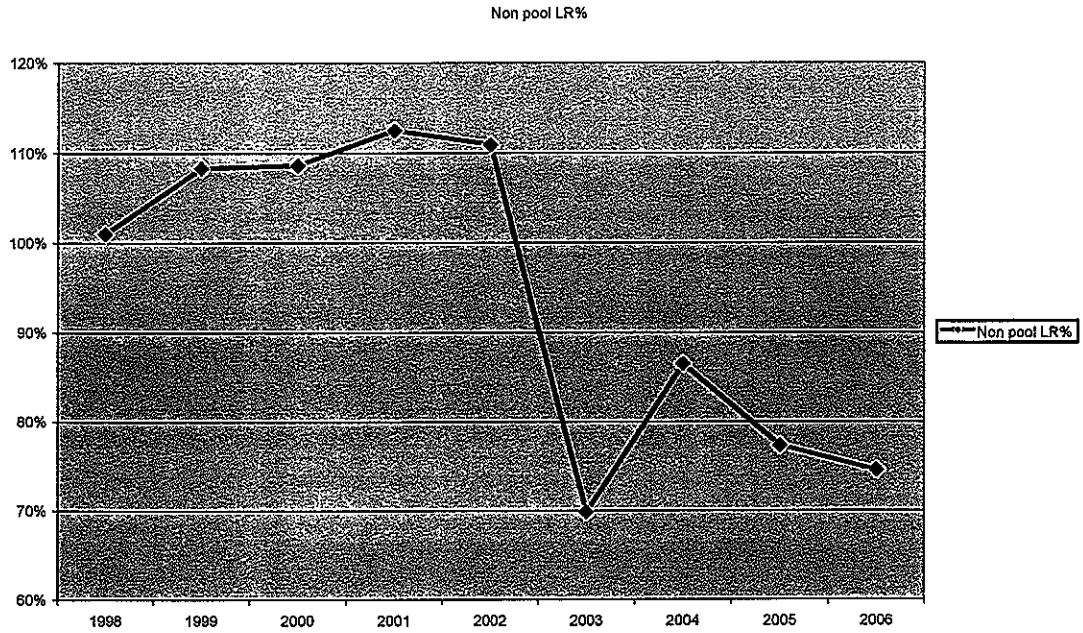


Figure 4: Net premium income by policy year compared to the net ultimate claims forecast for non Pool claims



The Club's non Pool record has improved since 2001 as the ratio between net premium and net ultimate claims for non Pool claims by policy year has fallen, as shown in figure 4. This is a result of a relatively stable performance on the Club's own claims combined with an improvement in premium income. However, although the premium has increased in recent years the Board will need to ensure that it keeps pace with foreseeable claims developments as well as future capital requirements. The Board decided when formulating the latest Corporate Plan to move closer to break-even underwriting in order to manage this risk and will need to ensure that premium levels remain appropriate to cope with what might be a higher level of Pool claims.

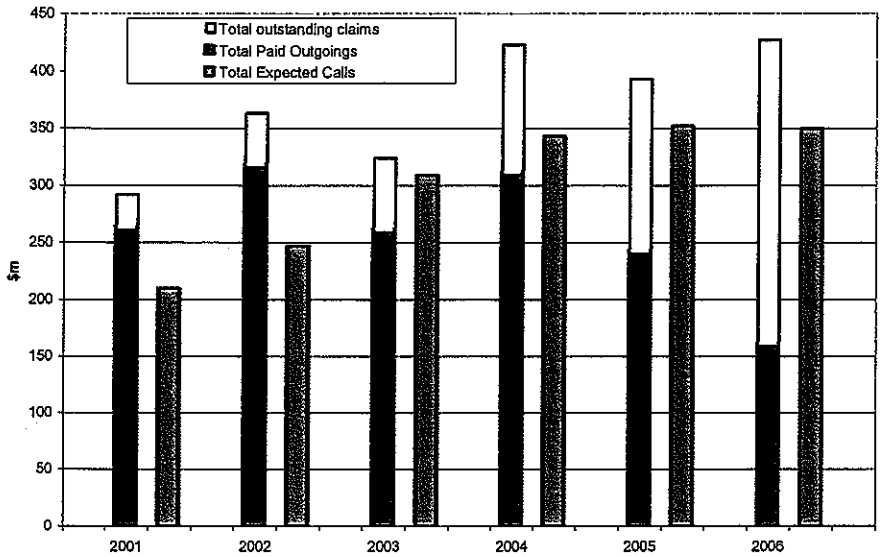
Clubs contribute to other clubs' Pool claims based on a formula determined by the level of tonnage, premium and also their Pool claims' record. It is anticipated that the UK Club's share may fall further as a result, amongst other factors, of its recent favourable Pool loss record.

Policy year development

The 2003 policy year was closed at 20th February, 2006 which resulted in a transfer of $2.5m to the closed years fund from the contingency account. This policy year remains one of the most favourable in recent times. In contrast the 2004 policy remains one of the most costly policy years for the Club as explained in previous annual reports. Whilst the 2005 policy year has been marked by a number of personal injury and passenger claims the deficit on the year is much lower than both 2004 and the 2006 policy years. As discussed above 2006 policy year is running at a similar level to 2004, as shown in appendix 2.

Figure 5 shows the latest view of the financial development of the last six years' underwriting, claims and expenses, but ignores the benefit of investment income, with the difference between the incomings and outgoings being the underwriting deficit. The total paid outgoings include reinsurance premiums, management expenses and costs, as well as Members' claims. There had been signs that the policy year deficit was narrowing, but heavy claims years on the 2004 and 2006 policy year have proved to have more than offset the progress being made on increasing premium income levels. It remains important to achieve an underwriting balance and a combined ratio, which is net incurred claims and expenses as a proportion of net premiums, approaching 100 per cent. In an environment of lower and volatile investment returns it is important to ensure that the Club moves towards an underwriting break-even result.

Figure 5: Analysis of incomings and outgoings for policy years 2001-2006



Impact of Swiss Re

In April 2005, the Swiss Re contract was revised to include an excess of loss protection, providing $70m of reinsurance cover (section 2) along with the protection relating to the Club's solvency ratio, providing $110m of reinsurance cover (section 1). For the year to February 2007 there has been no recovery under the high level excess of loss section, but the Club's ratio of funds to outstanding claims triggered a recovery of $54.1m on the first section in the financial year. The limit on this section has now been reached. Under the first section of the policy the Club is required to build up a commutation premium balance during the life of the policy until a claim is made. When a claim is made then the benefit to the income and expenditure statement is the difference between the total claim made and the accrued commutation balance. For the year to February 2007 a commutation balance of $10.7m had been accrued and compared to the gross recovery of $54.1m this provides a net benefit of $43.4m to free reserves.

The Swiss Re contract allows for the commutation of the recovery on section 1 between 2010 and 2017. The commutation values rise each year from 2010 starting at $95m and rising to $110m. The decision on whether to commute the contract will be made at the time based on all the relevant information concerning the claim, the claims environment and economic factors.

Figure6: Impact of Swiss Re recovery on financial statements

	Before recovery from Swiss Re	Swiss Re recovery	After recovery from Swiss Re
Balance sheet			
Accrued commutation (within sundry debtors)	10.7	(10.7)	0.0
Reinsurance recoveries on outstanding claims	157.7	54.1	211.8
Income and expenditure statement			
Reinsurance premium	67.6	10.7	78.3
Incurred claims	318.9	(54.1)	264.8

Expenses and costs

Operating expenses have increased slightly during the year to $20m (2005: $19m). Acquisition costs, which include the brokerage paid on business produced to the Club and the expenses, including employment costs, of the underwriting function of the Managers, have decreased further during the year to $21m (2005: $22m). When looked at as a proportion of gross premium these costs remain in line with previous years, showing the exercise of budgetary discipline.

S&P rating
During the year Standard and Poor's removed its negative outlook on the Club's rating. The Club's rating is now A "strong" stable outlook.

Financial strategy and Corporate Plan
Balancing income with outgoings is a fundamental requirement for any business. Insurers, including mutual P&I clubs are no exception to that rule. The plan sets the financial objectives of the Club within the context of a robust risk framework, linking in to the Club's Individual Capital Assessment (ICA) analysis (the risk based approach to setting capital requirements introduced by the Financial Services Authority) as well as the Club's strategic objectives.

That planning process has set financial targets for solvency (exceeding regulatory minimum standards), underwriting discipline (a combined ratio of approximately 100 per cent), security (maintaining an S&P 'A' rating) and strength (a free reserve ratio in excess of 135 per cent). The Club is making good progress in meeting these objectives. A number of areas for action have been set so as to achieve those targets. The Club continues to pay close attention to costs, the efficient and economic structuring of reinsurance and an effective investment policy. However, the establishment of premium levels consistent with the anticipated volume and value of future claims and capable of ensuring adequate capital levels to support the business is the most important short term goal. Hence, the 7.5 per cent general increase for the 2006 policy year.

Investment Review 2007

Economic Developments

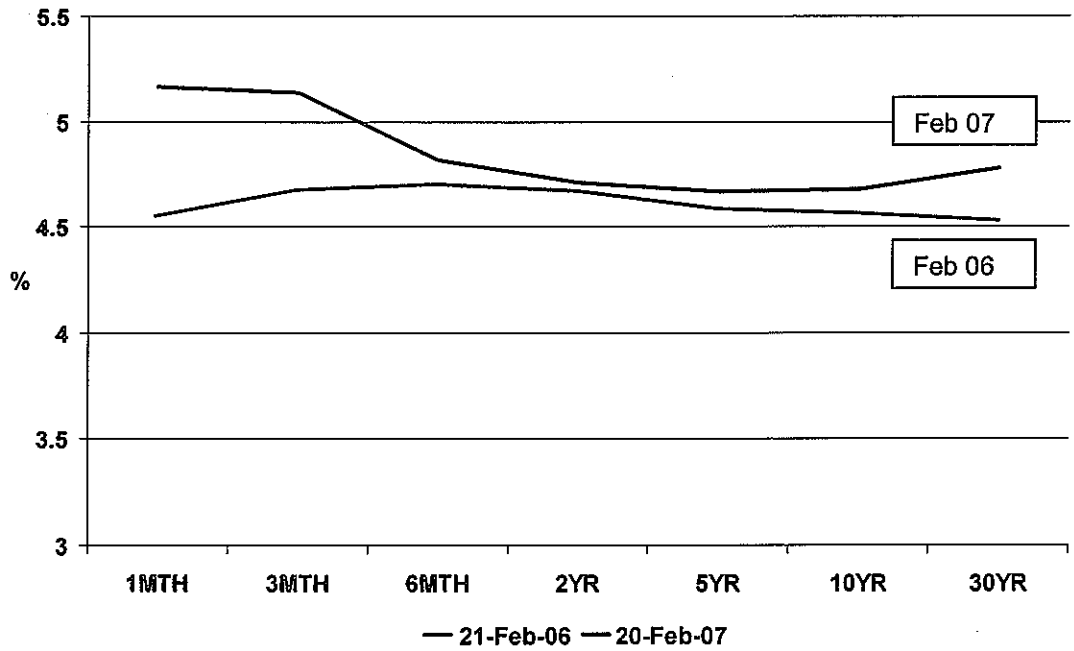
The global economy had another vintage year of economic growth in 2006, expanding by 4.8% after 4.3% in the previous year. Since 2004 annual growth has been higher than the ten year average of 3.7%. The acceleration in economic growth was in large part due to the structural changes in the emerging markets which unleashed a wave of economic development. Most notable beneficiaries were China and India. The developed economies benefited from the increase in global demand. Another positive development in 2006 was that the economies of Europe and Japan began to grow more rapidly and this reduced the reliance of developed economies on the United States.

There were two main headwinds to economic growth. The first, and potentially the most destabilising, was the further rise in energy prices in the first half of the year. However, the global economy absorbed the rise effortlessly. In fact there were some benefits as the oil producing economies spent a good deal of their additional income on infrastructure projects rather than accumulating financial assets as in the past. The shift in international trade from Asia towards the Middle East was a key factor for the improvement in European economic growth.

The sustained period of strong global growth caused central bankers to become concerned that rising inflation would be the undesirable by-product and monetary policy was tightened in the US, UK and Europe. The Federal Reserve Board, however, kept interest rates unchanged in the second part of the year.

US bond yields rose sharply in the first half of the year and then declined. Bond yields in Europe and the UK followed the US in the first part of the year but they did not follow US yields lower because of inflation concerns in Europe and the UK.

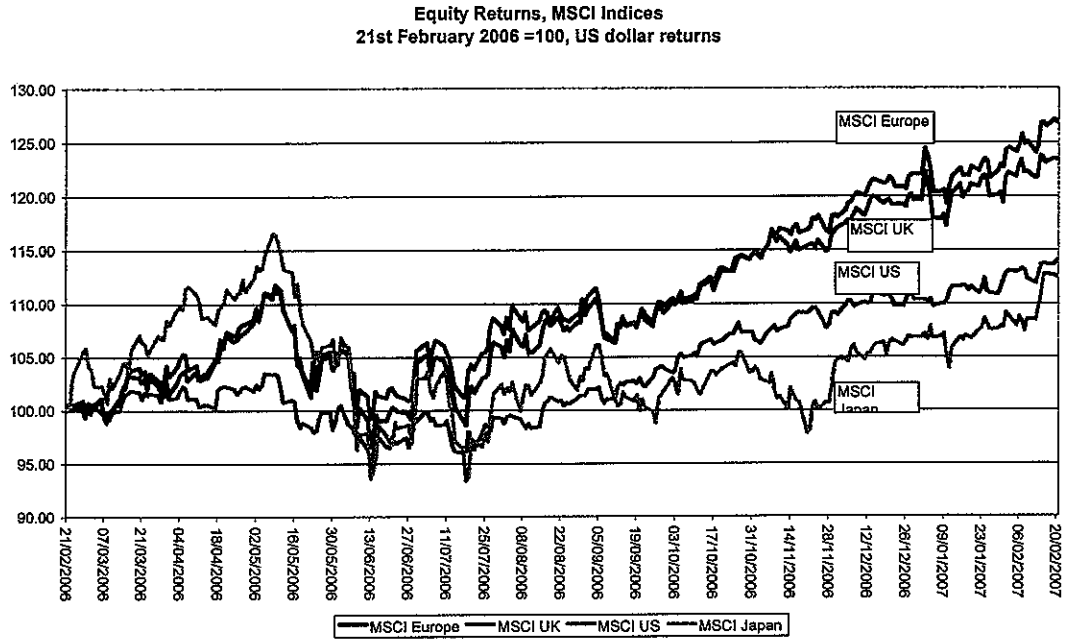
Figure 7: US yield curve history



The US yield curve was flat or inverted for the whole of 2006. The chart above shows the treasury yield curve at the beginning and end of the year. Demand for long-dated government securities to hedge liabilities by pension funds and other institutional investors was a major reason for the maintenance of the unusually shaped yield curve. Also, the general belief that inflation would be kept under control by the Federal Reserve kept the yield curve inverted.

Another feature of note of the yield curve was the maintenance of an historically low yield difference between all credit qualities and US treasuries. This reflected the low risk attached to low grade quality debt by investors.

Figure 8: Calendar Year Equity Returns



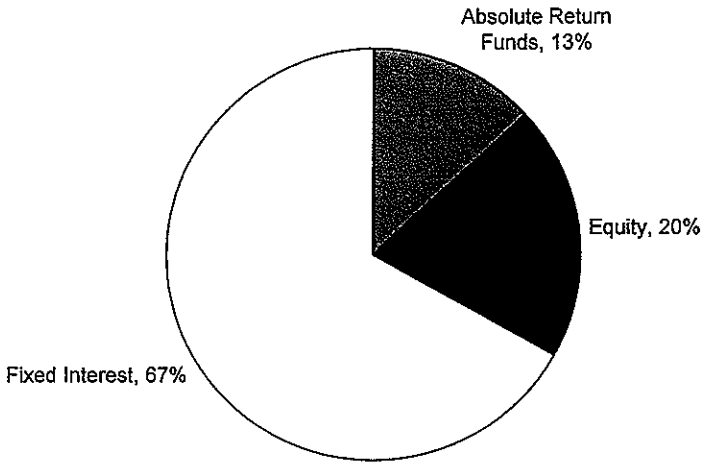
Equity markets started the year on a strong note, shrugging off the effects of higher US interest rates. In May the equity markets went into a sharp reversal as investors became concerned that the acceleration in inflation in the United States and elsewhere would result in much higher than expected US interest rates. The markets did not recover their poise until July after which the market indices rose for the remainder of the year.

Aside from the strong rise in corporate earnings during the year, the equity market was supported by a wave of corporate activity fuelled by high corporate cash holdings and private equity firms.

Investment Returns

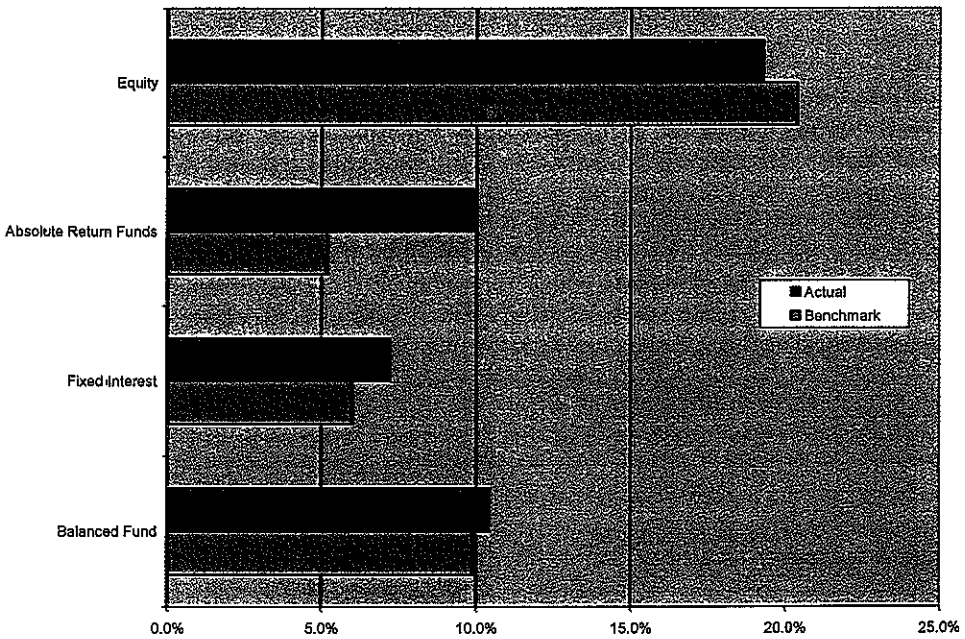
The return on the Club's investment portfolio was 9.7 per cent for the year ended 20th February 2006 compared to 6.07 per cent in the previous year. The balanced fund (the assets held by the Club's reinsurer, IPIR) returned 10.4 per cent which was higher than the benchmark return of 9.9 per cent. Figure 9 shows the make-up of the portfolio as at February 2007.

Figure 9: composition of investment portfolio at 20 February 2007



The investment portfolio benefited from the decision to allocate a high proportion of the fund to equities, although the proportion was sharply reduced towards the end of the year. The decision to hold a high proportion of the fixed income portfolio in cash or short term bonds also assisted the overall investment return. The chart below illustrates the contribution to investment returns relative to the benchmark from the major asset classes.

Figure 10: investment returns compared to benchmark



The fixed income returns exceeded their benchmark while the equity returns were less than the benchmark returns owing to the European specialist manager's under-performance. The investment in absolute return funds also made an important contribution to the overall returns as they provided an investment return of 9.56 per cent which was comfortably above the return on cash.

Claims

Pool claims

The 2006 policy year may be distinguished in one way at least from recent policy years by the high incidence of Pool claims which occurred (and the number which attracted payments from the Association during the course of the year). At each of their four meetings, the Board received their customary briefing of the ten largest claims paid during the latest quarter. Usually other clubs' Pool claims are represented two or three times, but, at the last two meetings six Pool claims were recorded within the ten largest claims for the respective quarters. Of the 40 largest claims reported during the policy year 15 were Pool claims. In monetary terms Pool claims which were amongst the top ten payments from each quarter approximated to 36% by value of those cases.

Amongst the Pool incidents which were first reported to the Board during 2006 was the sinking of the Egyptian passenger ferry AL SALAM BOCACCIO 98 which resulted in considerable loss of life. The ferry, entered in the Steamship Mutual Association, was en route to Safaga when she capsized and sank in the Red Sea, apparently following a fire on the car deck. Only 440 of the 1,400 passengers and crew survived despite extensive search and rescue operations. Following the intervention of the Egyptian authorities, the basis for the conclusion of the dependants' claims were agreed and the Association has contributed its proportion of those settlements as they have been concluded.

Other notable Pool claims reported included, in March 2006, the explosion and fire on board the 5,500 teu containership HYUNDAI FORTUNE, which destroyed more than 500 containers. In February 2006, GRIGOROUSSA I ran aground and spilled over 100 mts of fuel oil into the Suez Canal. The settlement with the Egyptian authorities exceeded $14 million. After a fire on board the containership ACONCAGUA in December 1998, caused by the heating of calcium hypochlorite in a container stored beside a bunker tank, the Association was able to report the recovery of the sum of $2.5 million on behalf of NYK from their consortium partner CSAV but, subsequently, contributed to Gard's supplementary Pool claim submitted on behalf of CSAV.

The abandonment and subsequent deliberate grounding of the containership MSC NAPOLI in January 2007 will unquestionably result in a considerable claim on the Pool. It is anticipated that the salvors' lightening of the ship by the removal of her containers, will take some months. Hopefully, she will then be able to be towed away from her position off the southern coast of England.

Non Pool Claims

A number of cruises were interrupted by contrasting events. Undoubtedly the most serious occurred on one ship when fire broke out during the night in an outboard cabin, almost certainly caused by a carelessly discarded cigarette. Because of the serious situation, passengers and crew were assembled at their emergency stations but thankfully the fire was brought under control within an hour. One passenger died, probably as a consequence of a heart attack brought about by smoke inhalation. The cruise was abandoned and passengers were disembarked at Montego Bay. In a contrasting incident, a ship from Florida and bound for New York developed a rapid list. It was later concluded that human error was the probable cause in the operation of the ship's navigation and control system. Serious injuries were sustained by a few passengers and many more sustained fractures and minor abrasions and bruises. The cruise was curtailed to enable investigations to be completed. One cruise was abandoned when many of the 2,200 passengers on board were taken ill with symptoms of the novovirus on a voyage which would have taken in the Channel Islands and Portuguese ports.

A number of containership casualties were, in part, caused by poor weather conditions. However, contributory factors in at least three cases appeared to be the use of fully automated twistlocks (FALs) manufactured by, or under licence from, a German company and approved by the relevant classification society. In two such cases 135 containers were lost overboard and 175 were damaged in rough but not extreme conditions. There were a number of similarities between the two cases, including the position of the lost containers above the engine room, about half way between the accommodation and the stern. Upon investigation it was noted that the principle behind the use of FALs is that, once secured, release should only be achieved when all four corners are subjected to neutral forces, for example, when a container is lifted by a spreader bar. The absence of any failed twistlocks on board after the incidents suggested that the motion of the ships may have replicated this neutral force, allowed the boxes to release, only to fall overboard as the ship rolled. Negotiations with the manufacturers and their insurers have taken place.

As usual, a wide range of circumstances and incidents created problems our the shipowner Members, some of which might be described as having a fortunate outcome and some where the outcome might be deemed quite bad enough. For example, a tanker loading fuel oil in Alaska's Cook Inlet was struck by a block of ice some 50 to 100ft in diameter causing all mooring lines to part and casting her adrift. Fortunately, she grounded half a mile downstream on one of the few sand and gravel areas for several miles. Less than 200 gallons of fuel oil spilled from the broken hoses. In relation to a tanker on a voyage to Fujairah it was determined that a crewmember had been unlawfully killed by his colleagues. In other incidents a ship was put into quarantine when a dead bird, suspected of carrying avian flu, was found in a cargo hold and a passenger ship was alleged to have caused substantial damage to consignments of cars awaiting shipment near a terminal consequent upon the discharge of soot from the ship's funnel. In a lighter vein, a gas carrier was twice called upon to rescue competitors engaged in the Atlantic Rowing Challenge when the two pairs of rowers got into difficulties. The captain of a containership is probably unlikely to make another scenic stop at a deserted tropical island after anchoring within a restricted and security sensitive area. The ensuing misunderstandings with the local authorities caused a month's delay and loss of income for his principals.

There appears to be an increasing prevalence of accidents in the coastal waters of China. This, in many ways, is only to be expected in view of the ever increasing trade which China is generating. During the year there were two major collisions which affected the Association, a significant grounding on an apparently uncharted rock pinnacle and a major oil spill.

Elsewhere, the master of a tanker which called at Novorossisk in May 2006 was detained on the orders of the customs authorities when drums of descaling liquid were found on board. This material is routinely used in the engine room and it still remains unclear why the local officers treated the alleged offence so seriously. Although not remanded in custody, the master was unable to return home until late November when the appeal court ordered his release.

There were regular reminders of the dangers which seafarers face during the course of their work. Amongst those incidents where lives were lost was one where a training exercise involved the lowering of a lifeboat. The aft hook had been set improperly and the boat fell ten metres into the sea. During the fall the second officer was rendered unconscious and he drowned before he could be found. In an incident off Scapa Flow in November 2006, the deck crew securing a forward anchor on a departing tanker were struck by a wave breaking over the bow and fo'csle when, without warning, the ship fell into a trough. Four crewmembers lost their footing and were washed along the deck and into the steps leading to the catwalk. Two were pronounced dead at the scene and another received serious injuries.

Amongst cases where satisfactory results were achieved in court was one where Signum, the Manager's claims investigation service, had made a large contribution. A fraudulent claim of some $4.5 million in respect of the alleged short delivery of a fictitious cargo of copper cathodes was defeated in the Jordanian courts. In relation to asbestos litigation, the Irish Supreme Court dismissed claims brought by existing and former employees of a local ferry company in respect of their alleged exposure to asbestos on board ship. These claims were distinguished by the fact that none of the claimants had succumbed to illness but had sought compensation in anticipation of such an illness occurring and for the fear of its onset. The discontinuance in favour of the defendants was accompanied by an order for defence costs to be paid by the plaintiffs. Notwithstanding the widespread knowledge of the dangers of asbestos dust, it was surprising to learn that certain steel mills in China use asbestos matting in the manufacturing process. Some of this matting routinely sticks to the coils. Such cargos created difficulties for a number of shipowners when the contaminant was recognised at ports in Europe. Special and time consuming arrangements had to be made to clean the steel and the ships' cargo holds before the discharge could safely be completed.

In the case of the ATHOS I which spilled a major quantity of oil in the Delaware River in November 2004 after striking a discarded anchor at Paulsboro, the National Pollution Fund Center (NPFC) confirmed approval of the owner's claim to limit their liability. This decision followed the United States Coast Guard's findings into the cause of the incident which had been published in January 2006. NPFC made an offer to reimburse the sum of a little more than $77 million. As a consequence of this very satisfactory result funds were credited in appropriate proportion to the Group reinsuring underwriters, members of the International Group Pool and the Association.

Three claims were referred to the Directors for a decision regarding cover. Two of these cases were presented under Section 24 of Rule 2, the "Omnibus Rule". In each of these cases the Directors decided that the member should recover running costs during the periods of delay whilst difficult negotiations were undertaken with claimants. In both cases it proved advantageous to conclude settlements rather than accede to excessive security demands. The Directors' decisions were consistent with the interests of the Association being in common with those of the member. One other case was referred to the Directors which concerned the delivery of cargo without the production of the bills of lading. The Directors decided that the member's claim fell within the terms of Rule 2, Section 17(c)(ii) and accordingly was only payable at the discretion of the Directors. In the exercise of their discretion under that Rule, the Directors decided unanimously that the claim was not recoverable either in whole or in part.

Reinsurance

The largest single element of the Club's reinsurance is its participation in the Group Pool's excess of loss contract.

For the 2006 policy year the key elements of the Group Pool's excess of loss contract were as follows:

The structure of the contract remained unchanged from that of 2005. The Pool was made up of two layers $6 million – $30 million (the lower Pool) and $30 million - $50 million (the upper Pool). Each club's share for the lower Pool continued to be 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 years 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. From 20th February 2005, the claims proportion of the formula was based on a rolling 20 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. During 2007 the International Group's Reinsurance Sub-Committee (RISC) will be reviewing the Pool mechanism to ensure that it continues to work as a fair risk sharing mechanism between the clubs in the Group Pool.

Contributions to the upper Pool layer continued to be pre-funded and premium for this layer was set by the Hydra Board based upon the figures suggested by the Group claims data model. The upper layer of the Pool was reinsured into the Group captive, Hydra.

Hydra

Hydra reinsures each club in the International Group acting through segregated accounts in respect of that club's liabilities: first, in the layer $20 million in excess of $30 million in the Pool's retention of $50 million and, secondly in the Group's 25% coinsurance of the first layer of the general excess loss contract of $500 million excess of $50 million.

Hydra protects its exposure via a stop loss policy in the amount of $200 million in the aggregate, excess of $50 million. For the 2006 and 2007 policy year the Board of Hydra appointed Agnew Higgins Pickering, as their reinsurance brokers.

The reserving committee of Hydra, advised by Milliman, consulting actuaries, have recommended the reserving position for the year to February 2007 for Hydra. The level of net claims reserves, including Incurred But Not Reported, IBNR, claims has risen such that Hydra's liabilities exceed its assets. The Hydra Board is therefore considering making an additional call of capital to provide for the shortfall and provide the appropriate level of capital going forward. It is expected that all clubs will contribute the capital required and that the solvency of Hydra will be restored.

The claims figures reported in the financial statements include the effect of Hydra claims deterioration.

Swiss Re contract

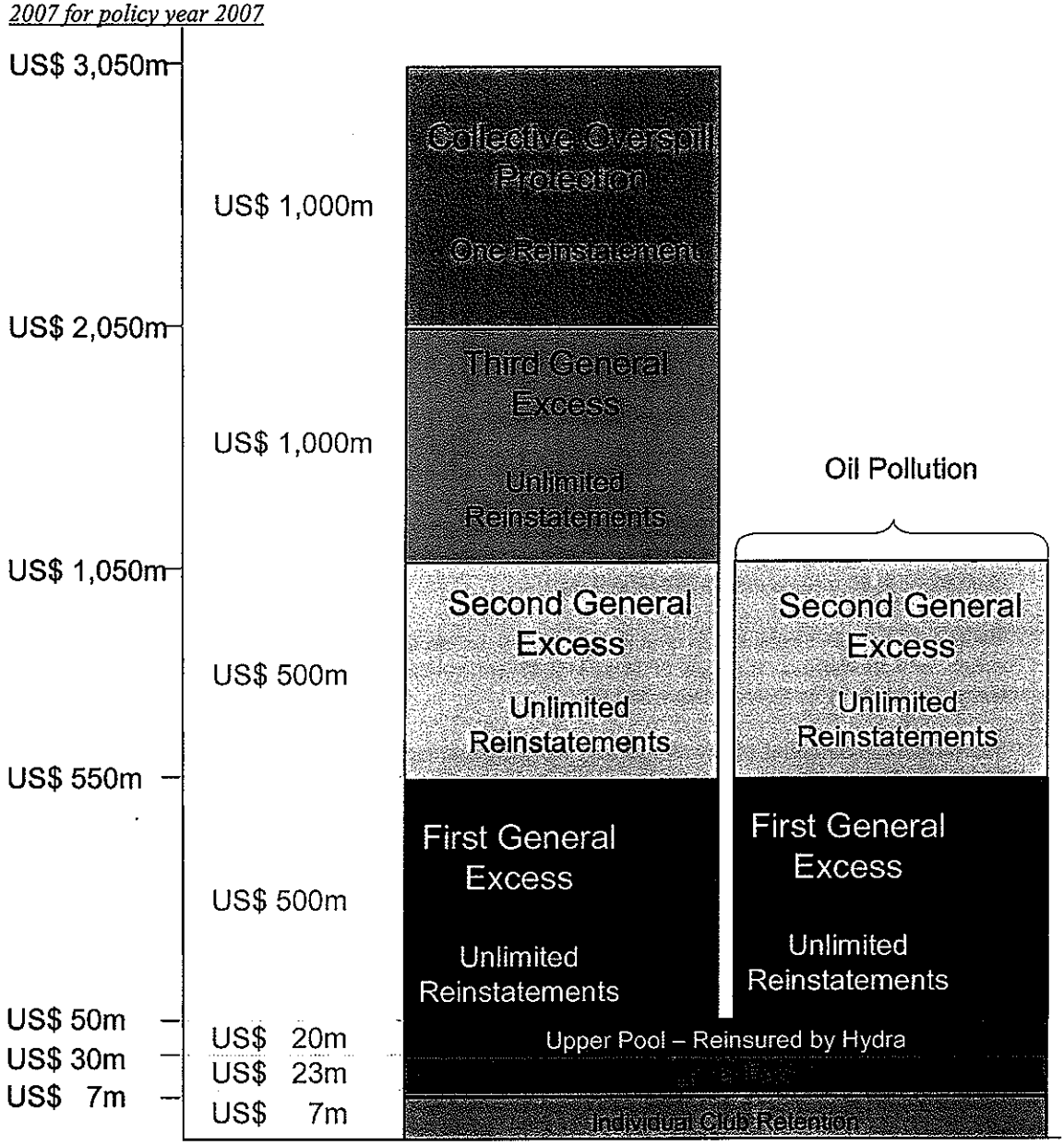
In February 2000, the Club entered into a ten year reinsurance contract with Swiss Re. Reinsurance recoveries under this contract are triggered by a fall in the Club's solvency ratio, as measured by total funds to outstanding claims at the end of each financial year. Claims are recoverable regardless of the reason for the fall in the solvency ratio. The contract included a five year review clause. Under the original contract there was an additional overspill protection for the first five years which ceased to be available after February 2005. The second five years of the contract now includes an excess of loss protection cover for a high level claims. Details of the change in the contract were notified to the Members by circular in May 2005. An explanation of how the recoveries under the first section of this contract affect the financial statement for the year ended February, 2007 can be found on page 9.

2007 policy year arrangements

The most significant change to the Group's reinsurance arrangements for 2007 was the decision by the Group to buy overspill insurance protection on behalf of each club for all categories of claim up to $1,000 million in excess of the limit of the Group's reinsurance ($2,050 million). This cover, which has been purchased following the decision by the Group clubs to introduce a limit on cover for claims in respect of passengers and seamen, will be available to all Group clubs to reduce the exposure of their

members to an overspill claim. The cost of the new collective overspill protection has been included in the reinsurance rates which are charged to the different ship categories by all clubs in the International Group. The background to the limit on Club cover for passengers and seamen and the approach taken by the Group Managers to the allocation of the cost of this new element in the programme was set out in a circular (ref 5/07) to all Members in February 2007. The structure of the Group reinsurance contract for the 2007 policy year is set out in figure 11 below.

Figure 11: structure of International Group excess of loss reinsurance programme at 20th February 2007 for policy year 2007



Pooling arrangements for 2007

For the 2007 policy year, the Club retention was increased to $7 million from $6 million. The structure of the Pool was otherwise unchanged.

Overspill arrangements

For the 2006 policy year, the Club purchased overspill reinsurance cover limited to its anticipated proportion of a $1,000 million overspill claim. Following the decision by the Group to buy collective reinsurance protection of such an overspill claim, the Board of the Club decided not to buy any additional overspill protection for the 2007 policy year.

War risk & terrorism cover
For the 2006 policy year and continued for the 2007 policy year, the limit of the Group's excess war P&I insurance was set at $500 million. The supplementary Pooling for "Bio-Chem" claims to match the upper limit of the Pool at $50 million was also continued for the 2007 policy year. Details of the war risk P&I cover arrangements for the 2007 policy year were communicated to the Members by circular reference 3/07 in February 2007.

Charterers' Cover
For the 2007 policy year the Club revised its reinsurance arrangements for its alternative time charter cover. The reinsurance protection for this cover was arranged through the brokers Miller, assisted by Willis. An explanation of the new charterers' liability cover was provided to Members in the winter edition of UK Club News.

Loss Prevention

The major Loss Prevention activity in 2006 was the publication of the package of books and DVD "Book it right, pack it tight". This was aimed at providing operational personnel with a quick reference and practical every-day guidance to the IMDG Code rules and also to increase the awareness of the risks involved in transporting hazardous goods in containers. The publication was developed for those engaged in all the stages of preparing dangerous goods for carried by sea from booking cargo to packing the container.

The guides were sent to all Members involved in the container trade for use in their own booking offices and to educate those in their packing chains.

The publication was complemented by series of one day conferences in Hamburg, Singapore, Hong Kong, Seoul, Taipei and Shanghai attended by many of the Club's Members involved in the carriage of dangerous goods and the conferences in Far East locations run in conjunction with the TT Club, whose participation attracted the other parties involved in the transportation chain.

Goods being exported from China have been identified as representing a particularly high risk and the Club supported the Chinese authorities by allowing them to translate the books in to Chinese.

Also in 2006, and in conjunction with Lloyds Register, the Club produced a pocket sized checklist to assist ships crews in dealing with Port State Control requirements relating to MARPOL and specifically the use of Oily Water Separators. This checklist which follows on from a publication produced in a similar format and again as a joint venture with Lloyds Register on Port State Control requirements which was well received by the Club's membership. The early signs are that the second booklet will be similarly well received and plans are in place to produce a third booklet on life saving equipment.

The major initiative in 2007 will be a DVD aimed at the LNG/LPG sector. The Club has a high market share of this market and is well placed to expand it share as the market continues to grown rapidly. As the market grows, however, the concerns regarding operating standards and particularly the competence and experience of crew increase and the DVD is aimed at all those involved in operating ships in the LNG/LPG sector to help them gain a better appreciation of the risks involved.

An activity which has developed significantly in 2007 has been desk-based risk assessments carried out for individual fleets based on their claims record data. These assessments analyse Members risk profiles and identify trends in the causation of claims in order to assist Members in reducing and eliminating the causes of claims in their own operations. Work is in hand to make some of these assessments automatically available to Members via the website.

The crews' pre-employment risk assessment programme, PEME, continued to assist Members in ensuring crews were fit to serve on ships. In 2007 over 19,000 medicals were carried out as a result of which 660 unfit seafarers were identified as unfit for duty. Future development of the PEME scheme will be focused on those Members whose records demonstrate that the pre-employment medical processes currently used are not sufficiently rigorous to exclude unfit seaman from serving on-board ships.

Finally, Signum, the Club's in-house team of investigators continued to investigate the causes of claims where criminal activity was suspected.

Service

The major service initiative in 2007 which was initiated as part of the third year of the operation of the Club's Corporate Plan was the Service Commitment. The Service Commitment is intended to set out clearly for Members what they can expect in their dealings with the Club particularly on claims, underwriting and Loss Prevention matters. It is also aimed at providing Members with a benchmark against which they can compare the service they received.

The Managers continue proactively to seek feedback on the quality of the Club's claim service. In 2007 members will be given the opportunity to comment on the claims service via an electronic questionnaire at the closure of a case file.

The Service Commitment

GENERAL

1. Our dealings with you will be conducted with integrity
2. We will strive to maintain the Club's leading position in terms of influence and innovation and be prepared to embrace change
3. We value feedback on our performance and will deal with it constructively and promptly. We will also actively seek your feedback on a sample of cases

UNDERWRITING

4. We will charge you a fair, transparent and competitive rate for the risk you bring to the Club
5. We will provide you with a comprehensive explanation of the risks covered by your entry
6. We will make available to you Certificates of Entry and other documentation within 24 hours of confirmation of entry
7. We will reply to all enquiries with the Club within 24 hours of receipt

CLAIMS

8. We will give you, as soon as it is possible to do so, an assessment of the likely result on a claim, together with an indication of the cost of achieving that result. We will then work with you to resolve the claim.
9. We will reimburse authorised claims within 10 days
10. We will provide you with an explanation of any items of a claim not recoverable from the Club
11. We will make your claims information available to you via the website and will work generally to increase the information available to you via the web
12. We will estimate the claim on your record on the "most likely outcome" basis

LOSS PREVENTION

13. We will provide you with loss prevention advice in order to minimise your claims exposure
14. We will, at your request, review your claims experience, produce a report and review the findings with your insurance and operations staff to identify claims trends and suggest loss prevention solutions
15. We will give you prior notice before one of the Club's ship inspectors visits your ship and will provide you with a copy of their report thereafter

Liability environment
Passenger risks

Last year this review focused in detail upon the Board's consideration of passenger risks under the 2002 Athens Convention, in anticipation that the IMO Legal Committee (and its Correspondence Group considering terrorism issues) would make substantial progress towards implementation of the Convention during 2006. As matters turned out, progress was indeed made and prompted such concern amongst shipowners that a majority of club boards eventually moved to favour the imposition of a limit on cover for passenger risks from 20th February 2007.

Members may recall that for passenger death and personal injury claims caused by shipping incidents, the 2002 Athens Convention will (when in force) impose strict liability up to a limit of SDR 250,000 per passenger, with further liability for losses exceeding this limit up to SDR 400,000 unless the carrier proves that the incident occurred without its fault or neglect. That same limit - SDR 400,000 per passenger, also applies to non-shipping incidents, although there the burden is on the claimant to establish that the loss was caused by the fault or negligence of the carrier.

A major obstacle to ratification of the Convention has been the absence of an express defence in the Convention to claims for losses caused by terrorism, coupled with fact that losses caused by terrorism are excluded from normal P&I cover. Since the International Group clubs are unable to certify that they provide cover for risks arising from terrorism, the clubs were unable to confirm that they could provide the certificates of financial responsibility that were envisaged under the Convention. The clubs, and the shipping industry in general, therefore proposed that this difficulty should be solved by providing carriers with a clear defence to claims arising from terrorism.

Against that background, the beginning of 2006 saw a majority of club boards favouring the provision of cover and certification for liabilities under Athens, provided that a satisfactory solution could be found to problem of liability for terrorism, and subject to a caveat that special arrangements might be necessary for very large passenger ships carrying in excess of 3,600 people.

During the year the IMO Legal Committee and Correspondence Group considered a number of successive proposals for possible solutions to the terrorism problem, culminating in a proposal to limit the owner's liability for terrorism to an amount equivalent to the 1996 LLMC limitation figure for passenger liabilities, SDR175,000 per passenger, and to limit the compulsory insurance requirement for terrorism risks to a figure equivalent to $500 million per ship per incident, based on assurances from market brokers that the availability of insurance at this level was sustainable over the long term. As a part of that solution, the Legal Committee agreed that there should be separate certificates of financial responsibility for Athens liabilities other than those arising from war or terrorism, and for those so arising.

As increasing attention was focussed on Athens issues by the protracted negotiation over terrorism, concerns grew in some sectors of the industry about the general magnitude of the risks under the Convention, resulting in a widening gap between clubs that saw the risk as manageable and those that felt it necessary to limit cover, with several suggesting a figure of $ 1 billion.

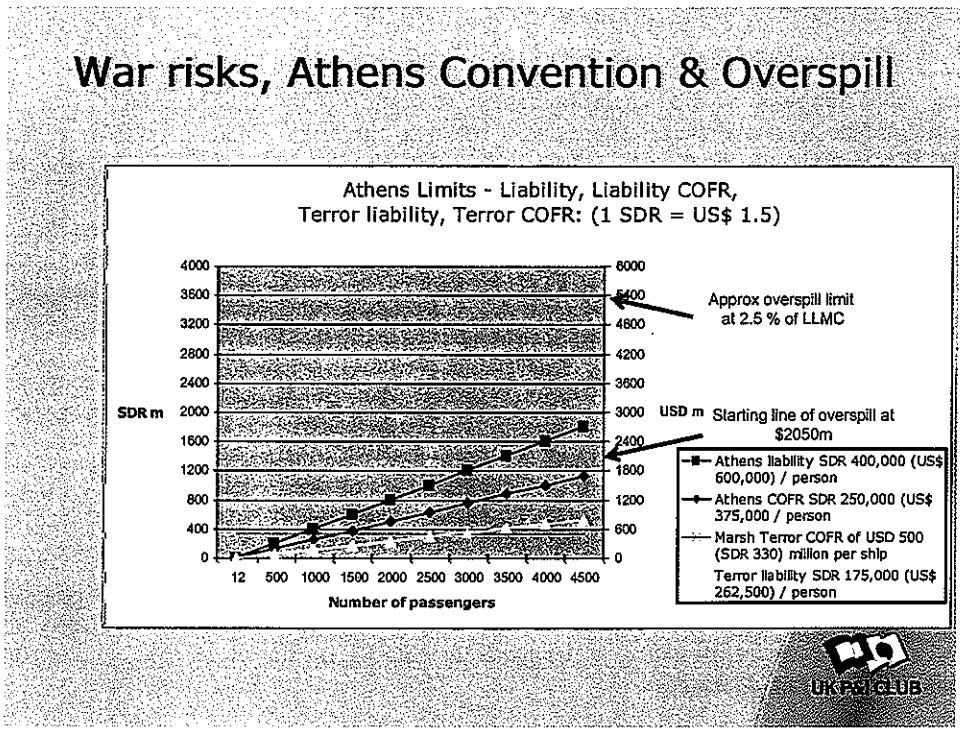
In an effort to find a compromise from which clubs could adopt a united stance, the Directors agreed that the UK Club should propose a limit on cover for passenger risks of $2 billion, coupled with a reduction in overspill exposure. While there was a general willingness to consider the higher $2 billion limit, there remained controversy regarding the proposal to reduce overspill exposure and regarding a suggestion that crew risks should be included in the $2 billion limit.

Further discussions resulted in a compromise finally agreed by all clubs whereby from 20th February 2007 cover for crew and passenger risks combined will be limited to $3 billion, with a sub-limit of $2 billion for passenger risks, with $1 billion of overspill reinsurance being bought by the Group as a whole.

The compromise regarding limits of cover has paved the way for clubs to provide certification for Athens liabilities, excluding liabilities arising from war and terrorism. It remains to be seen what arrangements may be made for certification of the latter, but it is widely expected that if primary war

risks underwriters do not provide certification, one or more special purpose vehicles will be created for that purpose.

Figure 12: comparison of limits on war risks, Athens Convention and Overspill



Oil pollution

Compared with recent years, 2006 was relatively quiet as regards consideration of changes to legislation concerning oil pollution. Following the decision of the IOPC Fund Assembly, reported on in last year's review, not to revise the CLC and Fund Conventions, the voluntary STOPIA and TOPIA agreements were implemented with effect from 20th February 2006.

A report was made to the Board on provisions, contained within the US Coast Guard and Maritime Transportation Act of 2006 (H.R. 889), to increase OPA 90 liability limits for the first time since OPA was enacted, by more than 50 per cent for nontank vessels and double hull tank vessels, and by more than 100 per cent for single hull tank vessels.

The Board also received reports regarding the action commenced by Intertanko and others in the English High Court to seek judicial review of the European Union Directive on criminal sanctions for ship source pollution. The first part of the challenge to the Directive proved to be successful, with the High Court agreeing the need for review. The matter was referred to the European Court of Justice, which is expected to hold an oral hearing in the early part of 2007 and to reach a decision in the latter half of the year.

IOPC Fund Working Group on quality shipping

In the course of reaching its decision not to revise the 1992 CLC and IOPC Fund Conventions, the IOPC Fund Assembly decided to set up an intersessional working group on "non-technical measures to promote quality shipping for carriage of oil by sea".

The terms of reference of the working group were as follows: "(a) to consider and make proposals on the development of common criteria to be uniformly applied by Contracting States to ensure that fully effective insurance is in place before States issue CLC Certificates; (b) to identify factors that prevent the sharing of information between marine insurers and seek to develop a common policy or other

measures that would facilitate such sharing of information; (c) to identify practical measures to achieve better and more transparent co-ordination between insurers, shipowners and cargo interests that would promote quality shipping; (d) to consider possible measures for the denial or withdrawal of insurance cover in order to improve the safer transportation of oil; (e) to consider the feasibility and impact of differentiated insurance rates and premiums that would encourage quality shipping; and (f) to examine ways of encouraging and strengthening the participation of classification societies in the promotion of quality shipping."

In considering what submissions should appropriately be made by the International Group, the Directors were mindful of two previous submissions made to the IOPC Fund in relation to ships standards. The first, in February 2005, had been a detailed account of measures, both old and new, that were responsive to the OECD study on withdrawal of insurance from substandard shipping. The second had been a factual study, commissioned by the International Group but written by Frank Wall (a former head of shipping policy for the UK Department for Transport), placing the contribution that can be made by insurers into the wider context of the roles and responsibilities of all those engaged in surveys and inspections of ships.

The Directors agreed that the Group should base its submission to the working group on the content of previous submissions, by way of an update on progress of the measures adopted by the Group and a reminder of the wider context in which the insurer's contribution is made.

Ships' standards - double retention procedure

A number of reports were made to the Directors during the year on the development of a proposed procedure within the Pooling Agreement to allow a club that had declined or terminated the entry of a ship, on grounds of unfitness for insurance, to designate the ship as one for which any insuring Club should bear a double retention on the Pool.

Under the procedure, a club which had either declined or terminated the entry of a ship would be able to give notice to the International Group Secretariat (and to the owner) to request that the condition of the ship be assessed by a committee to determine whether the ship should be designated as one for which any insuring Club should bear a double retention (a Designated Vessel). The club would be obliged to explain to the Owner the implications of the process and to request that the ship be made available for inspection. The term 'Condition' was widely defined and would extend to operation, management, and crewing of a ship in addition to aspects of physical condition. The Committee would make its assessment by reference to 10 elements: shipboard management; safety and environmental awareness; fire safety; life saving appliances; pollution; navigation; structural condition; machinery; cargo worthiness; and maintenance and housekeeping.

In the light of comments made by the Directors, changes were agreed by the International Group to improve the fairness of the proposed procedure and to introduce a one year time limit on designated vessel status, beyond which a ship would be treated as a 'proscribed vessel' with claims arising thereafter not being poolable at all.

The Directors were advised that the procedure had been designed to deal with the extreme case and might therefore not be used with great frequency. However, whether or not the procedure was frequently invoked, its existence, together with the other measures implemented by clubs in response to the OECD report, had sharply increased the awareness of club underwriters, managements, and boards, of the need for appropriate measures to avoid underwriting sub-standard ships.

Rule changes

The Board considered at its July and October meetings draft changes to the Rules which were subsequently approved by the Members at a Special General Meeting of the Association in January 2007.

An amendment to Rule 5H was made, to make clear beyond doubt that oil spill response activities are excluded from the normal scope of P&I cover. The Board also approved a proposal to widen the scope

of the Rule (40) on dispute resolution, to apply its provisions to any person claiming under or in connection with the Rules.

An amendment was made to Bye-Law 53, to extend to any member of a duly constituted committee the indemnities which were already provided to the Directors and the Managers. Currently the only committee duly constituted which can contain non-Director members, and so be affected by this change, is the Audit Committee.

The Directors also approved a proposal to combine into a single document the Rules of the Association and the Rules of its subsidiary, UK (Europe). The necessary amendments to the Rules and the Bye-Laws to achieve that effect were approved by an overwhelming majority of votes cast by the membership.

War risks & terrorism cover

At their meeting in February 2006, the Directors decided that the Association should continue to provide the special war risks P&I cover and that the "Bio-chem" claims, which are excluded from the special war risk P&I cover by the operation of the "Bio-chem" exclusion clause, should continue to be pooled among the Group clubs.

The terms of the special war risks P&I cover are the same as for the 2005 policy year (including the excess point, the limit of cover, the "Bio-chem" exclusion), with the only exception of an exclusion for TOPIA liabilities, to which reinsuring underwriters do not currently respond. The terms of the "Bio-chem" cover are also the same as for the 2005 policy year, including the restriction on the types of claims in respect of crew risks and legal costs relating to all P&I liabilities only, the limit of the cover and the Club's retention.

Since the US Congress has extended the governmental sharing program established under the Terrorism Risk Insurance Act 2002 (TRIA) for another two years throughout the end of 2007, the program continues to apply, though with a gradually decreased share of the governmental compensation for insured losses arising from an act of terrorism as defined in TRIA.

Capital and risk management and regulation

The Club is regulated in a number of parts of the world with the principal areas being: Bermuda, UK, Hong Kong, Isle of Man, Japan, Singapore and the USA. Regulatory requirements vary by country but one theme common to all regimes is a move to more advanced risk based approaches to capital and solvency requirements. Last year saw further development by the EU of its work on Solvency 2. Solvency 2 covers risk capital requirements, the valuation of assets and liabilities, reporting and supervisory review, as shown in figure 13 below. The Solvency 2 legislation will draw upon the 3 pillar regime for capital management and supervision set out in the Basel Accords and already adopted by the banking sector. The diagram below sets out the three pillars that are at the heart of the Solvency 2 proposals:

Figure 13: overview of structure of Solvency 2

PILLAR 1	PILLAR 2	PILLAR 3
CAPITAL ADEQUACY AND MEASUREMENT	SUPERVISORY REVIEW	DISCLOSURE
Harmonised standards for the valuation of assets and liabilities, and the calculation of capital requirements	To help ensure insurers have good monitoring and management of risks, and adequate capital	Requirements that allow capital adequacy to be compared across institutions

Although Solvency 2 is not expected to be implemented until 2010, or later, most of the development work is currently taking place with the EU consulting with the industry across Europe. The two main areas where the clubs are affected are what constitutes capital and how to determine the risk capital required. The Club and the International Group have been active in participating in the consultation exercises on both areas during the year.

The main exercise being undertaken is to determine how much capital an insurer should hold. In 2006 the EU conducted Quantitative Impact Study 2, (QIS 2), to assess the structure of the calculation of this capital requirement. This will be followed by QIS 3 between April and June 2007 that will look at the factors used to calculate capital. The Club has been involved in QIS 2 and will also be involved in QIS 3, together with other members of the International Group taking advice from consulting actuaries and regulatory advisors.

The FSA in advance of Solvency 2 has developed its Individual Capital Assessment, ICA, approach to determining the levels of capital an insurer should hold. The ICA is intended to be equivalent to Solvency 2. Whilst Solvency 2 is still being consulted upon throughout the EU, the ICA regime is operational in the UK. The Club has had its ICA reviewed by the FSA during their Arrow visit, and subsequent receipt of the Individual Capital Guidance, ICG, by the Club marked a successful conclusion of that process. The UK Club maintains sufficient capital both for the FSA's ICG and also capital requirements in other countries where it is regulated.

APPENDIX 1

APPENDICES TO THE DIRECTORS' REPORT

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	**2007**	2006
Open policy years			
2006	2	**(78,287)**	
2005	2	**(36,071)**	(35,742)
2004	2	**(77,360)**	(80,986)
2003			(5,323)
Deficit on Open years		**(191,718)**	(122,051)
Closed policy years	3	**-**	-
Contingency Account	3	**337,434**	223,418
Catastrophe reserve	3	**49,490**	49,966
Reinsurance Retention reserve		**15,392**	10,712
US Oil Pollution AP reserve		**51,919**	54,774
Statutory reserve		**240**	240
Total surplus		**262,757**	217,059
Outstanding claims		**706,736**	708,167
		969,493	925,226

APPENDIX 2

DEVELOPMENT OF OPEN POLICY YEARS

Amounts in $000		2006	2005	2004
Calls and premiums		350,355	351,622	343,094
Less reinsurance premiums		57,530	59,924	59,833
	A	292,825	291,698	283,261
Incurred claims:				
Paid		70,568	144,994	217,909
Known outstanding estimates		159,850	116,339	91,450
Unreported estimates		108,000	37,000	23,000
		338,418	298,333	332,359
Operating expenses		40,892	41,317	42,877
	B	379,310	339,650	375,236
Investment income	C	8,198	11,881	14,615
Surplus / (deficit) (see Appendix 1)	A-B+C	(78,287)	(36,071)	(77,360)
Future investment income		8,000	5,000	1,000
Anticipated surplus / (deficit)		(70,287)	(31,071)	(76,360)

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 deficit balances of $ 16.1 million for 2004 and $8.1 million for 2005 and a surplus balance of $6,000 for 2006 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. The deficit on 2004 reflects is in respect of the ATHOS I claim and the deficit on 2005 reflects the Association's contribution to other clubs' claims. There were no oil pollution claims in the 2006 policy year.

(c) The approximate yield of a 10 per cent supplementary premium on the open policy years would be $29 million (2006), $29 million (2005), and $28 million (2004).

(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 $42 million (2006), $22 million (2005) and $42 million (2004) respectively.

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

DEVELOPMENT OF CLOSED POLICY YEARS, CONTINGENCY ACCOUNT AND CATASTROPHE RESERVE

Amounts in $000	Closed policy years	Contingency Account	Catastrophe reserve
Balance at 20th February, 2006	244,649	223,418	49,966
Investment income	1,628	40,707	3,647
Reinsurance premiums		(1,202)	(4,123)
Transfers on closure:			
Deficit on 2003 policy year		(2,545)	
Balance of 2003 policy year	74,109		
Premium adjustments	99		
Loss of commutation		(10,731)	
Reserve transfer	284	309	
Claims paid net or reinsurance recoveries etc	(62,194)		
Transferred to Contingency account on review of estimated and unreported claims	(33,331)	33,331	
ERZ reinsurance recovery	(54,147)	54,147	
Balance at 20th February, 2007	171,097	337,434	49,490
Outstanding claims	171,097		
Net surplus (see Appendix 1)	-	337,434	49,490

Notes:

(a) On closure of the 2003 policy year, the sum of $6.4million was transferred from the United States Oil Pollution AP reserve, and $3.6million 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 $39 million (2006 $54 million) including a forecast for unreported claims. The outstanding claims figure is shown net of recoveries from excess loss underwriters of $18 million (2006 $14 million) and from the Pool of $23 million (2006 $20 million).

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

(d) The transfer to the Contingency Account includes the reinsurance recovery on outstanding claims under the contract with the European Reinsurance Company of Zurich, Bermuda branch. This recovery has been allocated to the closed policy years and the subsequent surplus has been transferred to the Contingency Account. The Contingency Account has also been charged with the full premium for the current year and the previously accrued commutation premiums to the balance of the recovery amount.

APPENDIX 4

TOTAL FUNDS AND LIABILITIES

Summary of funds available, estimated and forecast claims and discounted value of future claims at 20th February, 2006.

Amounts in $000	Funds available	Estimated claims and forecast of unreported claims	Discounted liability
Total Closed Policy Years	171,097	171,097	152,105
Open Policy Years			
2004	37,090	114,450	101,748
2005	117,268	153,339	136,778
2006	189,563	267,850	238,875
Reserves			
Reinsurance Retention reserve	15,392		
US Oil Pollution AP reserve	51,919		
Contingency Account	337,434		
Catastrophe reserve	49,490		
Statutory reserve	240		
Total funds	969,493	706,736	629,506

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 4 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 AND 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 32 to 50. These consolidated financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion these consolidated financial statements present fairly, in all material respects, the financial position of the Association as at 20th February, 2007 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

Moore Stephens & Butterfield
Chartered Accountants
2 Reid Street
Hamilton
Bermuda
7th May , 2007

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 thirty eighth Annual General Meeting of the Members of the Association will be held at The Elbow Beach Hotel, Bermuda on Monday, the twenty-second day of October, 2007 at 9.00 am for the following purposes:-

To receive the Directors' Report and Financial Statements for the year ended 20th February, 2007 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

7th May, 2007

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., Windsor Place, Queen Street, PO Box 665, Hamilton, HMCX, Bermuda not less than 12 hours before the holding of the meeting.

THE UNITED KINGDOM MUTUAL STEAM SHIP ASSURANCE ASSOCIATION (BERMUDA) LIMITED

Consolidated statement of operations for the year ended 20th February, 2007

Amounts in $000	Note	2007	2006
Income			
Calls and premiums	4	358,419	354,943
Reinsurance premiums	5	(78,308)	(128,560)
		280,111	226,383
Expenditure			
Incurred claims	6	264,841	223,018
Acquisition costs		20,815	21,868
Operating expenses	7	20,314	19,426
		305,970	264,312
Operating surplus / (deficit)		(25,859)	(37,929)
Investment income	8	76,927	49,199
Surplus / (deficit) before taxation		51,068	11,270
Taxation		(5,371)	(664)
Surplus / (deficit) after taxation		45,697	10,606
Reserves at beginning of year		216,819	206,213
Reserves at end of year	17	262,516	216,819

Consolidated Balance Sheet
at 20th February, 2007

Amounts in $000	Note	2007	2006
ASSETS			
Investments	9	758,653	823,240
Cash balances	10	112,569	28,577
Amounts due from Members	13	2,792	5,801
Calls not yet due	13	68,649	63,534
Reinsurance recoveries on outstanding claims	15	211,795	160,948
Accrued interest		4,060	1,682
Sundry debtors	14	41,075	17,435
		1,199,593	1,101,217
LIABILITIES			
Outstanding claims (gross)	15	918,531	869,115
Creditors	16	18,306	15,043
		936,837	884,158
Reserves	17	262,516	216,819
Statutory Reserve		240	240
		262,756	217,059
		1,199,593	1,101,217

Directors

Mr

Mr

Mr
Thomas Miller (Bermuda) Ltd
Managers

7th May 2007

Holding Company Balance Sheet
at 20th February, 2007

Amounts in $000	Note	2007	2006
ASSETS			
Investments	3	65,780	64,014
Cash balances		57,859	22,214
Amounts due from Members	13	2,792	5,801
Calls not yet due	13	68,649	63,534
Reinsurance recoveries on outstanding claims		850,374	798,298
Accrued interest		199	344
Sundry debtors		40,969	17,393
		1,086,622	971,598
LIABILITIES			
Amounts due to subsidiary company		118,561	67,319
Outstanding claims (gross)	15	918,531	869,115
Creditors		18,146	14,088
		1,055,238	950,522
Reserves		31,144	20,836
Statutory Reserve		240	240
		31,384	21,076
		1,086,622	971,598

Directors

Mr

Mr

Mr
Thomas Miller (Bermuda) Ltd
Managers

7th May 2007

Consolidated Cash Flow Statement
at 20th February, 2007

Amounts in $000		2007	2006
Operating Activities			
Calls and premiums received		362,226	354,717
Receipts from reinsurance recoveries		(43,291)	131,181
Interest and dividends received		28,810	27,987
	A	347,745	513,885
Claims Paid		201,989	358,451
Acquisition costs		20,815	21,868
Operating expenses paid		23,161	18,974
Reinsurance premiums paid		80,022	74,458
Pool claims paid		44,633	33,748
Taxation paid		3,459	100
	B	374,079	507,599
Cashflow from / (used by) operating activities	A-B=C	(26,334)	6,286
Investing Activities			
Purchase of investments		(1,803,814)	(1,555,547)
Sale of investments		1,914,140	1,476,768
Net cashflow (used by)/from investing activities	D	110,326	(78,779)
Net (decrease)/increase in cash and cash equivalents	C+D	83,992	(72,493)
Cash balances at beginning of year		28,577	101,070
Cash balances at end of year		112,569	28,577

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 its final underwriting year.

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 company, International P&I Reinsurance Company Limited ("IPIR"), which is registered in the Isle of Man. IPIR reinsures 90 per cent of the risks retained by the holding company.
The investment in the UK cell of Hydra Insurance Co. Ltd, which is registered in Bermuda, is reported as an investment in a subsidiary undertaking within the Holding Company balance sheet. The results 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

The account of a policy year upon being formally closed is credited by transfer from the Contingency Account of the anticipated future investment income arising from the funds held for that year. 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

The purposes of the Account are described in Rule 24(B)(ii). 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 purpose of the reserve is described in Rule 24(B)(i). It 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 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 Associations' 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.

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 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 loan made to the UK Club Private Trust Co Ltd is shown at cost.

Each share purchase was translated into US dollars on the date of purchase, with disclosure at cost in the consolidated financial statements.

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. It is not based on the underwriting income.

(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.

No loans have been made to Directors and none are contemplated.

Note 3 – Holding Company Investments

The results of the Association's subsidiary, International P&I Reinsurance Company Limited, are consolidated within the group financial statements. The subsidiary company is registered in the Isle of Man.

The following details are from the holding company balance sheet.

Amounts in $000		2007	2006
Investments			
Subsidiary company - International P&I Reinsurance Company Limited 200,000 authorised and issued ordinary $1 shares at $5 per share		1,000	1,000
Hydra Insurance Co. Ltd		1,240	1,240
UK Club Private Trust Co. Ltd - paid up share capital of 12,000 shares of $1 each		12	12
Balance at 20th February, 2007	A	2,252	2,252
Government bonds		46,972	42,373
Bonds		-	611
Total listed investments	B	46,972	42,984
UCITs		1,308	3,530
Loan		15,248	15,248
	C	16,556	18,778
Cost $64,415 (2006: $64,415)	A+B+C	65,780	64,014

The loan was made on 27th October 2000, to the UK Club Private Trust Co Ltd, which is wholly owned by the Association and established in Bermuda. The UK Club Private Trust Co Ltd in turn made a convertible loan to Thomas Miller Holdings Ltd with interest at 5 per cent per annum, with an option to convert into equity shares after five years at the Trust's discretion. An Investment Restructuring Agreement Was signed on behalf of the Association on 22 April 2005 and approved by the Thomas Miller Holdings Ltd (TMH) shareholders at a Special General Meeting on 29 April 2005.

The Trust has purchased 43,193 shares in TMH in two tranches during the year, with disclosure in the consolidated financial statements at cost, with translation into US dollars on the date of purchase.

The investment in Hydra Insurance Co Ltd, a Bermuda Segregated Account company, was made on 2nd February 2005. This included subscriptions for 20,000 ordinary shares of $1 each in the Hydra general account and 10,000 preferred shares of $1 each in the Hydra UK cell. A further contribution of $1,210,000 was made to the Hydra UK cell of Hydra.

As at 20th February 2007 the Club's Hydra cell had a net deficit of $5.5m which is consolidated in these financial statements. Under the terms of Hydra's governing instrument the directors of Hydra will be making a call for additional capital of which the amount relating to the Club is $9.3m.

Note 4 – Calls and Premiums
(see note 2 (j))

Amounts in $000		2007	2006
Mutual			
Mutual premium		**294,025**	288,617
Laid up returns		**(1,834)**	(1,673)
Releases		**988**	1,778
Reinsurance			112
	A	**293,179**	288,834
Less			
Bad debts written off		**-**	(2,516)
Movement in provision for bad debts		**740**	2,542
	B	**740**	26
	A+B=C	**293,919**	288,860
Fixed premium			
Time charter		**43,090**	42,992
Owned		**10,215**	9,205
Reinsurance			437
US Oil Pollution		**11,227**	13,361
		64,532	65,995
Laid up returns		**(32)**	88
	D	**64,500**	66,083
	C+D	**358,419**	354,943

Provision is made for all calls over twelve months old and for any subsequent calls where there are circumstances indicating that these debts may not be recoverable.

Note 5 – Reinsurance Premiums
(see note 2 (m))

Amounts in $000	2007	2006
Market underwriters and other P&I associations and Members	**56,222**	53,928
Reinsurance arrangements with European Reinsurance Co.	**11,933**	64,467
US Oil additional premiums	**10,153**	10,165
	78,308	128,560

The reinsurance premiums include the cost of the reinsurance arrangements with the European Reinsurance Company of Zurich, Bermuda branch, a wholly owned subsidiary of Swiss Re.
As a consequence of making a claim under the contract, the full premium cost for the current year and the previously accrued commutation premiums are charged as reinsurance premiums in the current year.

Note 6 - Incurred Claims
(see note 2(k))

Amounts in $000		2007	2006
Gross claims paid:			
Members' claims		**180,715**	358,200
Group's pooling arrangements		**44,633**	33,748
	A	**225,348**	391,948
Less recoveries:			
Group's pooling arrangements		**2,643**	49,505
Market underwriters		**(43,891)**	68,104
Other P&I associations and Members		**324**	195
	B	**(40,924)**	117,804
Net claims paid	A-B=C	**266,272**	274,144
Movement in provision for outstanding claims:			
Provision carried forward		**918,531**	869,115
Less: Provision brought forward		**869,115**	936,929
	D	**49,416**	(67,814)
Less: Movement in provision for reinsurance recoveries:			
Provision carried forward		**211,795**	160,948
Less: Provision brought forward		**160,948**	177,636
	E	**50,847**	(16,688)
Net changes in claims provision	D-E=F	**(1,431)**	(51,126)
Net incurred claims	C+F	**264,841**	223,018

The $54.147million claim under the reinsurance contract with the European Reinsurance Company of Zurich, Bermuda branch, for the year ended 20 February 2007 serves to increase the carried forward provision for reinsurance recoveries, with a consequent reduction in net incurred claims. The negative reinsurance recovery during the year reflects the repayment of reinsurance recoveries to market underwriters and members of the International Group Pool following a reimbursement of funds from the National Pollution Funds Center in respect of the ATHOS 1 claim.

Note 7 - Operating Expenses
(see note 2(o))

Amounts in $000	**2007**	2006
Management fee	**13,003**	12,492
Travel	**2,969**	2,003
Directors' fees	**488**	452
Printing and stationery	**114**	389
Communications	**321**	340
Promotions and seminars	**530**	221
Legal and financial	**1,433**	1,949
Strategy and planning	**287**	187
Auditors' fees	**465**	407
Japan branch	**252**	234
Ship inspection	**105**	449
Loss prevention	**347**	303
	20,314	19,426

Note 8 - Investment Income
(see note 2(q))

Amounts in $000	**2007**	2006
Bonds	**22,311**	7,862
Bank deposits	**1,548**	3,771
Dividends	**5,540**	5,059
Profit on sale of investments	**69,009**	17,115
Other investment income	**1,343**	-
	99,751	33,807
Unrealised (loss)/gain on investments	**(23,270)**	5,964
Exchange gain	**446**	9,428
	76,927	49,199

Note 9 - Investments
(see note 2(q))

Amounts in $000	2007	2006
Listed Investments		
Bonds	-	611
Government stocks	**356,720**	317,989
Equities	**143,429**	284,694
Unit trusts	**88,232**	75,726
Total listed investments	**588,381**	679,020
Cost $630,643 (2005: $630,643)		
Other Investments		
UCITS	**149,007**	125,144
Thomas Miller Holdings Ltd (see note 3)	**19,868**	19,529
Hydra Insurance Co. Ltd – General Account	**20**	20
Open forward currency contracts	**1,377**	(473)
Total investments	**758,653**	823,240

The listed investments are quoted on major recognised international stock exchanges.

The UCITS are Undertakings for Collective Investments of Transferable Securities and are an alternative to short term cash deposits and are shown at market value.

The Association's investment policy requires that, at the time of purchase, bonds have a credit rating of A or better.

The market value of the Association's investments in bonds and government stocks may be affected by changes in prevailing levels of interest rates. At the balance sheet date the investments in bonds and government stocks have effective yields of between 1 per cent and 7 per cent (2006: 1 per cent and 7 per cent). The UCITS have effective interest rates of between 2 per cent and 7 per cent (2006: 2 per cent and 5 per cent). The large spread of interest rates is due to investments being made in different currencies.

Open Forward Currency Contracts
This represents 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, 2007 using exchange rates prevailing at that date.

Amounts in $000	2007	2006
Forward sale of currencies	**(204,714)**	(315,004)
To produce	**206,091**	314,531
Potential gain / (loss)	**1,377**	(473)

Note 10 - Cash Balances

Amounts in $000	2007	2006
Current and short term bank deposits	**112,569**	28,577

Note 11 - Cash and Investment Maturity Summary

Amounts in $000	**2007**	2006
Cash and investments	**871,222**	851,817

	2007 Per Cent	2006 Per Cent
Cash, equities and interest bearing securities repayable within one year	**67.95**	63.75
Interest bearing securities repayable between one year and three years	**10.43**	15.01
Between three and seven years	**7.43**	15.42
Over seven years	**14.19**	5.82
	100.00	100.00

Note 12 - Cash and Investment Currency Exposure

	2007 Per Cent	2006 Per Cent
Swiss franc	**0.07**	0.07
Sterling	**17.22**	9.25
Japanese yen	**1.63**	1.37
Euro	**14.38**	9.64
US dollar	**66.70**	79.67
	100.00	100.00

Note 13 - Amounts due from Members

Amounts in $000	2007	2006
Members' balances due	**2,792**	6,541
Less provision against balances which may not be wholly recoverable	-	(740)
	2,792	5,801

$68.649 million (2006: $63.534 million) of debited mutual premium does not become due until December 2007.

Note 14 - Sundry Debtors

Amounts in $000	2007	2006
Reinsurance recoveries	**10,409**	2,260
Other P&I associations and insurance companies	**17,842**	5,821
Funds with representatives	**1,421**	1,385
Claims recoverable from Members and third parties	**8,435**	6,694
Claims advances and other balances	**2,968**	1,275
	41,075	17,435

Other P&I associations and insurance companies in 2006 includes the cumulative accrued premium of $1.333million that may be regarded as recoverable under the terms of the commutation within the reinsurance contract with the European Reinsurance Company of Zurich, Bermuda branch. Upon making a claim under the contract for the year ended 20th February 2007, the accrued commutation premium reduces to $ nil after allowing for the additional commutation premium of $9.398million arising during the current year.

Note 15 - Outstanding Claims (see note 2(k))

Amounts in $000	**2007**	2006
Closed policy years	**171,097**	244,649
Open policy years		
2006	**267,850**	-
2005	**153,339**	219,820
2004	**114,450**	162,589
2003	**-**	81,109
	706,736	708,167
Gross outstanding claims	**918,531**	869,115
Reinsurance recoveries	**(211,795)**	(160,948)
Net outstanding claims (above)	**706,736**	708,167

The total of outstanding claims of $919 million includes a forecast of unreported claims of $236 million on open and closed policy years and an estimate of $42 million for future claims management costs. The reinsurance recoveries include $64 million under the International Group's Pooling Agreement, and $38 million under the Group's excess of loss reinsurance contract and $110m under the reinsurance arrangement with the European Company of Zurich, Bermuda branch.

Note 16 - Creditors

Amounts in $000	**2007**	2006
Reinsurance Premiums	**6,039**	7,753
Members' balances	**205**	408
Taxation	**2,476**	564
Others	**9,587**	6,318
	18,307	15,043

Note 17 - Reserves

Amounts in $000	**2007**	2006
Open policy years		
2006	**(78,287)**	-
2005	**(36,071)**	(35,742)
2004	**(77,360)**	(80,986)
2003	**-**	(5,323)
	(191,718)	(122,051)
Contingency Account	**337,434**	223,418
Catastrophe reserve	**49,490**	49,966
US Oil Pollution AP reserve	**51,919**	54,774
Reinsurance Retention reserve	**15,392**	10,712
	262,516	216,819

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 - 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 holds a letter of credit for $36m to cover its share of the increased Group exposure.

Note 19 - 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 income.

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 income 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, 2007, the ratio of 9.27 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.

This represents a decrease over last year's five year ratio with reduced operating expenses set against higher investment and premium income. The increase in operating expenses during the 2006 year (see Note 7) reflects the higher management fee and the cost of additional legal and professional advice associated with the increased burden of financial and regulatory compliance. The ratio for the 2007 year was lower than 2006 at 8.83 per cent with the increased investment and premium income also increasing the formula denominator (see Notes 4 and 8).

Note 20 - Exchange Rates

The following rates of exchange were applicable at 20th February, 2007:

	2007 **$1 equals**	2006 $1 equals
Canadian dollar	**1.1639**	1.1511
Japanese yen	**119.305**	118.460
Euro	**0.762**	0.8388
Norwegian krone	**6.1231**	6.7544
Sterling	**0.5129**	0.5745
Swedish krona	**7.0502**	7.8556
Swiss franc	**1.2359**	1.3118

MANAGERS AND OFFICER

Managers: **Thomas Miller (Bermuda) Ltd**

Secretary of the Association: **D.W.R. Hunter**

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