

# DIRECTORS' REPORT & FINANCIAL STATEMENTS

For the Year Ended 20th February 2005

The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited



**UK P&I CLUB**



FINANCIAL HIGHLIGHTS

TOTAL FUNDS

\$965M

TOTAL LIABILITIES

\$759M

FREE RESERVES

\$206M

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# CHAIRMAN'S STATEMENT

Last year, I referred to 2003 being a remarkably good year for most shipowners and the continuation of this happy state through 2004 has been almost unprecedented. The Association's experience in 2004 appears to have shown the impact of this healthy climate in two ways. We have seen a pleasing increase in the tonnage entered in the Association during the year, mainly with the addition of new ships to existing Members' fleets. The confidence of Members in placing their new buildings and acquisitions with the Association is particularly gratifying.

Less welcome is the increase in claims which has occurred in 2004. As I remarked last year, past experience has shown that increased shipping activity tends to bring an increase in liability claims and a number of high profile casualties have been suffered by Members during the year.

This does not necessarily imply any reduction in standards of ship operation and maintenance. We remain vigilant in monitoring the quality of our membership through our ship inspection programme and are committed to playing our part in the wider campaign against sub-standard ships. But misfortune can strike even the best operated ships. In the case of the oil pollution incident in the Delaware river referred to in the Review of the Year which follows, all the evidence indicates no fault at all on the ship or the crew. Yet the cost to the Association has to date been huge. Some recovery of the financial expenditure may hopefully be achieved but not without considerably more effort on top of the numerous problems already encountered by the Owner and the Managers' staff in dealing with the aftermath of the casualty. The ability of the Managers' staff in their offices around the world to respond professionally and sympathetically to such crises is one of the strengths of the Association, albeit fortunately not called upon by most Members. I am confident this will continue to be the case for any Member unlucky enough to encounter such an experience.

Although it is possible to predict on the basis of past experience that the level of liability claims

is likely to increase when ships are busy and in demand, the actual level of claims which will be incurred is extremely difficult to predict in advance. Indeed, even at the end of the policy year, it is too early to make an accurate assessment of the year's claims. Even so, it is clear that 2004 is showing signs at this early stage of being a heavy claims year and that claims levels are likely to exceed those even of the 2002 policy year. This would be consistent with the picture of a steadily worsening claims environment were it not for the experience of the intervening year. The 2003 policy year is remarkable, not least because it is the first year in the Association's history when no claim has been made for recovery under the Group pooling arrangements. The general experience of claims within the Club retention in this year has also improved over the last twelve months and it is now clear that 2003 is a much better year for claims than either 2002 or 2004. There is therefore no easy way of predicting how claims will turn out in 2005 and the Board must be conscious of this volatility in the claims experience when planning for the future.

It was clear that the record investment return achieved in 2003 was unlikely to be repeated. Indeed, midway through the year an investment return in the region of 2 per cent seemed likely. Fortunately, a rally in the markets later in the year combined with increased dollar weakness has pushed the return up to over 5 per cent. This is in line with the long term average investment return which we are using in our planning. However, this is an average and the volatility of the investment return which we have seen, particularly when combined with the effect of exchange rate differences, is also a significant factor for the Board in planning for the continuing financial strength of the Association.

The volatility of both claims experience and the investment return emphasises the need to maintain the free reserves of the Association at a level which will enable the Association to cope with adverse experience in the future. In addition, the attention of the regulatory

authorities by which the Association is authorised is increasingly being directed to the capital requirements appropriate for the Association. New European regulations in this respect are in the course of being adopted by the Financial Services Authority in the United Kingdom. These will have their own impact on the level of reserves which must be held. It was against this background of claims volatility and increasing regulatory requirements that the Board decided to order another general increase of 12.5 per cent in Members' premium ratings for the 2005 policy year. This is consistent with the Board's determination to maintain the financial strength of the Association for the future. Our plans are governed by this objective and by our Managers' commitment to maintaining and improving the service which the Association gives our Members.

As is evident from the Review of the Year, the Board has considered a wide range of issues both in the conduct of the Association's own affairs and in ensuring the Association plays its full part in the International Group's representation on wider industry issues where appropriate. The work of the Board is ever more demanding and I am grateful to the Directors for the time they devote and the contribution which they make to the Association.

Since my last statement when I recorded our sadness at the untimely death of Dato' Ali, six of our Directors have left the Board – Norman Baptist, Michael Garvey, Gregory Hadjieleftheriadis, Nicholas Lykiardopulo, Kensaku Saito and Kunio Suzuki. I thank them for their work on our behalf and the contribution they have made to the affairs of the Association. At the Annual General Meeting in October, Tokinao Hojo of Mitsui OSK Lines, Agenor Junqueira of Petrobras, Costis Kertsikoff of Eletson and David Lim of Neptune Orient Lines were elected to the Board for the first time.

This is my last Chairman's statement as I shall be handing over the chair to my successor at the Annual General Meeting in October, 2005 on completion of my five year term of office.

It has been both an honour to serve as Chairman and a rewarding experience to have been able to work closely with the Managers in the conduct of the Association's business. The Managers' role is crucial to the success of the Association as a whole, as well as to the quality of the service which we receive as Members. This was recognised five years ago when the Association decided under my predecessor's chairmanship to invest in the new corporate structure they had just established. It is particularly satisfying to me that we have recently been able to complete, on satisfactory terms, the arrangements envisaged at that time for converting the original loan into an equity stake in the Managers' holding company. This will ensure even closer alignment of our mutual goals and help them to maintain their independence from outside interests.

During my term as Chairman, I have been fortunate in being able to rely on the constant support and advice of the Deputy Chairmen and I would like to record my particular gratitude to Klas Kleberg who stepped down in October 2004, after six years as a Deputy Chairman. He has been assiduous in his attention to the affairs of the Association and its subsidiary reinsurance companies whose boards he has chaired in recent years. The Board and the membership have benefited greatly from the wisdom of his counsel and his total commitment to the success of the Association. On our behalf I thank him. His place has been taken by Eric André who has joined Tullio Biggi and Dinos Caroussis as Deputy Chairmen from October 2004. I would like also to thank them for the time that they devote to the Association's affairs and for their invaluable support.

A.G. Kairis  
Chairman  
5th May, 2005



# 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, 2005.

### 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, 2005 the owned tonnage entered in the Association on mutual terms totalled more than 100 million gross tons. In addition, on average at any time in the year approximately 50 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.

However, because the Directors are themselves active shipowners, and are therefore 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.

Contact between the Managers and the Board is through the four Board meetings per year, and also through Board sub-committees, in particular through regular contact with the Chairman and Deputy Chairmen at four additional meetings per annum and at other times on an ad hoc basis. In addition, the Chairman and individual Directors are frequently involved with the Managers in meeting with individual shipowner Members to discuss matters of interest.

### Directors

The present Directors of the Association are shown on page 32. Also shown are those who retired from the Board since February, 2004 and the Board wishes to record its thanks to those Directors for the contribution they have made to the work of the Board and the affairs of the Association.

Bye-Law 14 (c)(i) provides for Directors to retire who have been in office for three years since their last election. Consequently Messrs André, Caroussis, Carthew, Sato, Vasilchenko and von Rantzau will retire at the forthcoming Annual General Meeting in Bermuda on 17th October, 2005. All these Directors have offered themselves for re-election.

In October, 2004, Mr A.G. Kairis was re-elected as Chairman of the Board of Directors and Messrs T. Biggi and C.I. Caroussis were re-elected as Deputy Chairmen. Mr E. André was elected as a Deputy Chairman.

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# REVIEW OF THE YEAR

## Financial strength

The Association's free reserves have dropped this year to \$206 million from \$219 million in 2004. The principal factor has been the high level of incurred claims for the 2004 policy year. Apart from the performance of the 2004 policy year the Association has seen favourable development in the more recent policy years. It is the Association's practice to take a prudent approach to reserving in the early development of a policy year. This reflects the longer tail nature of liability claims as well as delays in notification and initial uncertainties on setting reserves on specific cases. It is nevertheless still encouraging to be able to record an improvement in the anticipated deficit for the 2002 policy year as well as a significant decrease in the claims provision for 2003. The closed policy years have shown marginal change made up of favourable development on 2001 coupled with minor deterioration on some of the more developed years. A more detailed review of the policy years is shown in the appendices.

Investment income has produced a return of 5.2 per cent over the year resulting in \$39 million, due to strong performance by equity markets toward the end of the year and a decision to position bond portfolios to the shorter end of the yield curve in anticipation of increasing interest rates in the United States.

The dollar continues to be an important factor in determining the level of liabilities and by way of offset the value of non dollar investment holdings. The dollar's deterioration was not as marked in the last financial year, but it still has a material impact. As the majority of the Association's cost base is incurred in sterling, dollar weakness increases operating costs. After we exclude the effect of the dollar, these costs came in under budget. This in itself is an achievement given the increasing cost pressures from the greater burden of regulation and corporate activity during the year.

The general increase in premium rates is set by the Board as part of the financial planning process. In its financial planning, the Board has always placed great importance on maintaining a sound capital base through the development of the free reserves. This approach is in line with the increasing emphasis placed by regulators and rating agencies on insurers holding an appropriate level of capital relative to their business risk. The Club needs to take account in its planning of the volatility in both the investment markets and the claims experience. Against this background and the emerging evidence of higher claims in the 2004 year, the Board ordered a 12.5 per cent general increase of premium ratings for the 2005 policy year.

Under the 10 year reinsurance contract with Swiss Re, the Association is able to make a reinsurance recovery of outstanding claims if the ratio of total funds to outstanding claims at the year end would otherwise fall below 125 per cent.

The Association notified a claim under this reinsurance policy at 20th February, 2003 in respect of then outstanding claims in all policy years up to and including 2002. The recovery was quantified at that time at \$42 million which was then increased at 20th February, 2004 to \$47 million. However, over the year to 20th February, 2005, development of the outstanding claims has improved significantly, particularly in the recent policy years. This improvement is sufficient to eliminate the reinsurance recovery. There is an equivalent increase in the amount of commutation premium which will be returned to the Association in the event of no further claims on this reinsurance. Although the Swiss Re contract has been modified as noted later in this Review, it will continue to enable reinsurance recoveries to be made in the next five years if the Association's ratio of funds to outstanding claims would otherwise fall below the levels set in the contract.

During the year the Standard and Poor's rating agency reaffirmed the Association's A (strong) rating. However, later in the year the impact of the high level of incurred claims referred to earlier was greater than both the Association and Standard and Poor's had expected and this led to the rating being maintained at A, but with the outlook being revised to negative outlook from stable.

## Closed policy years and Contingency Account

Although there were fluctuations up and down in the individual closed policy years' claims provisions, overall there was a small improvement of some \$740,000 which was transferred to the Contingency Account.

The Contingency Account funded the closure of the 2001 policy year at a cost of some \$79 million. In addition, the Contingency Account funded the costs of the multi-year reinsurance contract with the Swiss Re (\$3 million) and minor adjustments to the Reinsurance Retention and US Oil Pollution Additional Premium reserves (\$1 million). On the credit side, investment income accruing to the Contingency Account during the year totalled some \$27 million.

As at 20th February, 2005 the Contingency Account stood at \$305 million.



### Development of open policy years

#### 2001 policy year

The 2001 policy year was closed in May, 2004 and the Members were advised by circular. No supplementary premium was levied by the Association; this was in line with the original estimate of no supplementary premium for the year.

On closure, as noted in Appendix 3 to the Directors' Report, funds of \$2.151 million and \$1.609 million were transferred to the United States Oil Pollution Additional Premium reserve and the Reinsurance Retention reserve respectively. Following these transfers, the sums of \$100,000 (to purchase the anticipated future investment income) and \$74.829 million (to cover the anticipated deficit on the year) were transferred to the 2001 policy year account from the Contingency Account and the year was then closed.

#### 2002 policy year

As noted in previous years' Directors' Reports and Financial Statements, the 2002 policy year saw a marked increase in claims compared with previous policy years. During the twelve month period under review, however, there was an improvement in the claims provisions, and the anticipated deficit on the year had reduced to \$109 million as at 20th February, 2005.

In May, 2005, subsequent to the end of the financial year under review, the Board decided to close the 2002 policy year without any supplementary premium being required. This was in line with the estimate given to Members prior to the beginning of the policy year.

#### 2003 policy year

Last year's Directors' Report and Financial Statements noted that the 2003 policy year was not following the sharp upward trend in the cost of claims that was experienced in the 2002 policy year. In fact, over the twelve month period under review, the claims provisions have reduced markedly, and the anticipated deficit on the year now stands at \$6 million.

No supplementary premium is estimated for this policy year, and the Board expects to close the year in April, 2006.

#### 2004 policy year

Although the 2004 policy year is only twelve months old, it is abundantly clear that claims on this policy year are at a level equal to the adverse 2002 policy year, if not higher. It is difficult to

predict accurately the outcome of a policy year at the twelve month stage, but notified claims on the Pool by all associations in the International Group are running at a record level, and within the Association's retention notified claims are close to matching 2002 at the same stage. The current anticipated deficit on the year is \$83 million, though this may well change going forward. The estimate of supplementary premium for the year remains at nil.

#### 2005 policy year

At the meeting in October, 2004, the Board decided to impose a general increase of 12.5 per cent of premium rating for the 2005 policy year. The supplementary premium estimate is nil, and in October, 2006 the Board will decide whether any mutual premium discount is appropriate.

### Catastrophe reserve

This reserve remains available to offset the cost of the Association's share of overspill Pool claims, i.e. that part of the claim on an International Group club which exceeds the limit of the Group's excess of loss reinsurance contract arrangements. For some time, it has been the policy of the Board to purchase additional overspill reinsurance cover and to debit the cost of this cover to the Catastrophe reserve. For the 2004 policy year, the Board authorised the purchase of reinsurance cover for 100 per cent of its estimated share of an overspill Pool claim of up to \$1 billion, for a cost of some \$4 million. Further cover is available under the Swiss Re reinsurance contract and the Catastrophe reserve provides further support for this Association's share of an overspill claim of approximately \$300 million, though the extent to which these protections are used to minimise or avoid the need for an overspill call on the membership would be a decision for the Directors to take in the light of all the circumstances of a potential claim.

The overspill cover arrangements for 2005 are detailed below under "Pool and reinsurance arrangements".

### United States Oil Pollution Additional Premium reserve

This reserve was established in May, 1994 to enable surplus funds arising in the years when the United States trading tanker oil pollution surcharges exceeded the cost of the excess reinsurance and Pool contributions to be used

to subsidise policy years where such costs exceed the voyage surcharges. Any such surpluses are transferred to the reserve on closure of the policy year. In May, 2004 the relevant 2001 policy year surplus – \$2.551 million – was transferred to the reserve, which now stands at \$50 million.

### Reinsurance Retention reserve

This reserve was created by the Directors in April, 1998 on closure of the 1995 policy year. The 1995 policy year was the first year of the International Group's reinsurance policy of deliberately retaining and co-insuring a vertical percentage portion of the International Group's reinsurance contract.

In May, 2004, on closure of the 2001 policy year, the surplus of the premium "saved" through the vertical co-insurance by the Group for the 2001 policy year was, for this Association, \$1.609 million and this was transferred to the Reinsurance Retention reserve.

As at 20th February, 2005 the Reinsurance Retention reserve stood at \$11 million, and it remains available to fund this Association's share of any Pooling claims falling on the co-insurance of the International Group's reinsurance contract, irrespective of the policy year concerned.

### The Investment Year

Whilst the rate of growth slowed from the very fast pace seen during the previous year, the global economy continued to expand. Similar to last year, it was the strength of consumer and government spending in the United States' economy that was the key influence in that expansion. Whilst many Far East countries benefited from the strong demand, China and Japan continued to be the principal beneficiaries. The continued economic strength and consequential pick-up in world trade increased demand for energy and raw materials. The increase in demand, following a prolonged period of underinvestment in the oil and gas and other commodity related industries, led to a sharp rise in prices. Shipping freight rates also rose substantially during the year as demand for ships outstripped supply.

European economies continued to be badly affected by the poor employment conditions. Corporations, eager to reduce costs in order to improve their competitive position, continued to reduce the number of workers or renegotiate compensation levels. As a consequence, the level

of unemployment rose and consumer confidence fell. The exception amongst the larger European economies was the United Kingdom whose government continued to commit to raising standards within the public sector through increased spending. This additional spending, financed by a rise in the budget deficit, was the main driver behind the improvement in the economy.

The closing value of the US dollar when measured against the euro was little changed from the opening value. This masked, however, two distinct and different periods. The first period saw the US dollar rally on the news that the economic growth in the United States was much stronger than that of other industrialised countries. The second period saw a reversal of the dollar's fortunes as fears emerged over the rise in the current account deficit and the possibility that a number of central banks would reduce the percentage of reserves held in dollars.

The weakness of the dollar, curiously, took place against the backdrop of a tightening of monetary policy, through increased interest rates, by the Federal Reserve Board. Having raised interest rates earlier, the Bank of England held rates steady during the second half of the year to assess the impact on the economy. The European Central Bank and the Bank of Japan kept interest rates at very low levels in response to the poor domestic conditions. An erratic upward movement in bond yields accompanied the increase in interest rates.

### Financial Markets

The rise in bond yields during the year reduced the returns available from fixed income portfolios. The very small depreciation of the US dollar during the year helped reduce the impact of the rise in yields. Absolute return funds, whilst lower than the previous year, produced returns in line with expectations. The improvement in productivity and corporate earnings went unrecognised through most of the year as concerns over the impact of higher interest rates and energy costs influenced valuations. The recognition of the improvement in corporate earnings, when it came, gave rise to a significant increase in equity valuations during the latter half of the Association's financial year.

The Association's policy of linking its liabilities and reserves with investments in similar currencies minimises the impact on its finances







## REVIEW OF THE YEAR

of currency fluctuations, but investment returns do fluctuate in response to periods of dollar strength and weakness. Similar to last year, the year under review was marked by higher returns generated by a modestly weaker dollar.

Within the Investment Fund the modest rise in bond yields reduced in local currency terms the returns of the fixed income portfolios in the Fixed Income Fund, although those returns were boosted by the rise of the value of the euro, sterling and yen. Additionally, the decision to hold a lower than historic percentage of the Fixed Income Fund in dollars, during the final six months of the year, contributed strongly to the final result. The increased investment in absolute return funds during the year was also a positive influence in the final return for the Fixed Income Fund of 4.2 per cent. The combination of a weaker dollar and a rise in equity values during the last six months of the year resulted in a return from the Equity Fund of 9 per cent. The Investment Fund, a combination of the Fixed Income and Equity Funds, produced a total return of 6.5 per cent.

The overall investment return achieved by the Association, after including the results of the Operating Funds, was 5.2 per cent.

### Pool and reinsurance arrangements

The Association, through its participation in the Group Pool, shares in the purchase of the International Group's general excess of loss reinsurance arrangements.

#### 2004 policy year arrangements

For the 2004 policy year, the key elements of the Group Pool's excess of loss reinsurance were as follows:

- The Pool retention was increased from \$30 million to \$50 million. This increase reflected the long standing intention of the International Group clubs to retain more risk within the working layer of the programme so that the Group Pool reinsurance could be preserved for more serious or catastrophic losses. This increase in the Pool retention introduced a new third tier within the Pool. For 2004, the distribution of claims within this tier reflected the tonnage entered in each club without an adjustment for the club whose member had the claim.
- The conventional excess of loss reinsurance contract of the Pool was therefore placed in excess of \$50 million, and covered 75 per cent of the risk up to \$500 million and 100 per cent

of the risk on the remaining three layers up to \$2.05 billion.

- There was no increase in the percentage of risk that the Group co-insured on the first layer of the contract (25 per cent). This co-insurance was protected by a stop loss policy in the amount of \$500 million in the aggregate, excess of \$50 million (on a 25 per cent basis).

- For 2004, the individual club retention remained at \$5 million.

#### 2005 policy year arrangements

For the 2005 policy year, the Group Pool's excess of loss contract was renewed subject to the following modifications:

- In line with the Board's desire to see the Club retention begin to rise once again, after ten years at \$5 million, the Club retention increased to \$6 million.

- The Pool returned to two layers. The new layers are \$6 million-\$30 million (the lower Pool) and \$30 million-\$50 million (the upper Pool). Each club's share for the lower Pool will continue 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. Up to and including the 2003 policy year, the one third formula was based on claims since 1970. From 20th February, 2005, the claims proportion of the formula will be based on a rolling 20 year claims record. The formula also provides for a loss ratio adjustment mechanism which, for the time being, will continue to be based on the historical record back to 1970.

- Contributions to the Pool layer (\$30 million – \$50 million) will be based on each club's share of the premium on the first layer of the main Group reinsurance contract with no adjustment or loading for the club bringing the claim into that layer. From 20th February, 2005, this layer, together with the co-insurance on the first layer of the Group contract, will be reinsured into the Group captive, Hydra.

- The conventional excess of loss reinsurance contract was renewed on the same terms as the 2004 policy year, with no overall increase in premium and relatively minor changes to the rate allocations by ship type.

#### Hydra

The Group's segregated account company, Hydra, commenced underwriting from 20th February, 2005. Hydra, acting through segregated accounts, reinsures each club in the International Group in respect of that club's liabilities. First, in the layer \$20 million excess of \$30 million in the Pool's retention of \$50 million and, second in the Group's 25 per cent co-insurance of the first layer of the general excess of loss contract of \$500 million excess of \$50 million. Hydra has in turn protected its exposure with a policy on the same terms as that taken out by the Group in 2004 i.e. a stop loss policy in the amount of \$500 million in the aggregate, excess of \$50 million on a 25 per cent basis. The establishment of Hydra brings a number of advantages, including the visible commitment of the International Group to retain more risk and an increase in security as between the clubs.

#### Swiss Re contract

In February, 2000 the Association entered into a ten year reinsurance contract with Swiss Re. Reinsurance recoveries under this contract are triggered by a fall in the Association'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, whether this is caused by increased claims, or by adverse performance on the underwriting account or investments. The contract had built into it a five year review clause. Under the original contract, there was an additional overspill claim protection for the first five years which is no longer available after February, 2005. The second five years of the contract now also includes a new excess of loss protection cover for high level claims.

#### Overspill cover

If a claim were to exceed \$2.05 billion, i.e. the limit of the Group Pool's excess of loss contract, the excess or overspill is pooled amongst the Group clubs. The overall Group Pool limit for such an overspill claim remains unchanged at 2.5 per cent of the property limitation funds under the 1976 Limitation Convention of all ships entered in the International Group Pool clubs. Members of each club remain ultimately liable to pay an overspill call up to a maximum of this limit for each entered ship, in accordance with Rule 22 of the Rules of the Association. For the 2004 policy year, the Association purchased a special overspill reinsurance to cover 100 per cent of its estimated share of the first \$1 billion of such an overspill claim. For the 2004 year,

the Association also still had available to it the additional protection under the reinsurance arrangements with the Swiss Re referred to above. In order to compensate in part for the loss of the additional overspill protection under the Swiss Re contract, and taking advantage of a further reduction in the price of overspill insurance in the market, the Association has increased the limit of its overspill cover for the 2005 policy year to \$200 million. This ensures the Association's share of a \$1 billion overspill claim can be recovered and still leaves a balance to meet a claim in excess of this level depending on the Association's share of the International Group's overspill Pool at the time the claim is made. The UK P&I Club is one of the few clubs in the International Group to fully protect its share of such a claim.

#### Additional reinsurances

The Association continues to purchase reinsurances to cover non-poolable risks such as the additional covers provided to charterers.

### Regulation

This year the Association has faced several new challenges in the area of regulation. As has been experienced in the wider shipping environment, the regulatory burden has continued to increase throughout the year. The Association, although domiciled and regulated in Bermuda, is also authorised and regulated by the Financial Services Authority in the United Kingdom. The FSA is seen by many to be leading the way in Europe in developing the scope of regulation, but there are now signs that other jurisdictions are following suit.

In line with this the FSA has taken a lead in developing the approach to solvency in the UK to raise the capital requirements and to make them more risk based than the current approach. The FSA has initiated its own risk-based capital approach (seen by many as a forerunner to Solvency II). The first stage has been to develop the Enhanced Capital Requirement, ECR, which is intended to provide a risk-responsive, but standardised, method for benchmarking non-life insurers' capital requirements. It is a first step to a more tailored approach to producing the Individual Capital Assessment (ICA). This ICA will be based on the firm's risk characteristics as a whole and would therefore get around some of the shortcomings of the ECR calculation. The Association is working with its Managers to produce the ICA report for discussion with the FSA.



## REVIEW OF THE YEAR

The work carried out to calculate the ICA and general moves towards a risk-based culture have been accompanied by activity required as a result of the enactment into UK law of the European Union's Insurance Mediation Directive (IMD), which seeks to regulate the activities of those providing intermediation (primarily broking) services within the European Union. While other Member States in the EU are in the process of implementing the Directive, the UK has moved more quickly and the Directive came into force in the UK on 14 January 2005. Unexpectedly, both the Association and its Managers' London agents, Thomas Miller P&I Ltd, were subject to the Directive and extensive preparations were necessary to meet the deadline. The Association is now regulated for the purposes of the Directive and the Managers' London agents, Thomas Miller P&I Ltd, have become the Association's "Appointed Representative" in the UK for the purposes of this regulation.

The IMD has also required changes to be made to the way the Association interacts with intermediaries. The Association is now obliged to ensure that it deals only with intermediaries that are properly regulated by their Home State and checks have to be made to ensure that their authorisation (by the Home State) is current. As a result of the very wide definition of intermediaries, many Members, particularly those with operations in the UK, have had to consider whether those operations come within the scope of the IMD and if so have then had to submit to regulation by the FSA.

### Loss Prevention

During the year the Managers continued to give high priority to the Association's Human Element programme, based around the successful DVD, 'No Room for Error'. Ten further workshops 'Getting to Grips with the Human Factor' were held in major cities and maritime training centres for Members' staff, and the programme continued to attract a high level of industry support and approval.

The Managers are now developing the programme both for use by the ship inspectors on board Members' ships and by Members themselves.

Loss Prevention News was published and contained a detailed description of accident causation as well a number of articles on issues such as stowaways. A special illustrated

supplement dealt with maritime security on board following the introduction of the ISPS Convention in July.

The Carefully to Carry Committee produced an issue of the Association's Carefully to Carry newsletter, with a substantial article on the carriage of liquefied gases and a detailed review of the LNG trade in which the Association's Members are particularly well represented. In addition the Association continued to publish its weekly Loss Prevention Bulletins and regular Good Practice posters and Technical Bulletins drawing mainly on the experience of the Association's ship inspectors.

### Membership quality and ships' standards

The quality of the Association's membership remains a key element in its strategy. It is controlled by a selective underwriting policy; by targeted ship inspection, condition survey, and loss prevention programmes; and by appropriate Rules relating to surveys, statutory requirements and classification. Together, these measures are intended to ensure a high quality of membership, with a shared commitment to the safe operation of ships. The Association continues to attract new entries from the world's top shipowners and Members can be confident that those with whom they are sharing the cost of claims observe high standards both in the operation and maintenance of their ships, and in their business dealings with the Association.

However, the mutual nature of the Pooling system makes it a matter of some importance that Members can also have confidence regarding the minimum standards observed by shipowners entered in other Associations, whose claims may be shared through the International Group Pool. This is achieved to an extent by measures in the Pooling Agreement to deny coverage where a ship fails to maintain classification or Flag State statutory certification. However, during 2004, the Board received a number of reports on other steps that could be taken to strengthen the commitment of Group clubs not to provide any support for substandard shipping.

At their April and July meetings, the Board received reports regarding a study on "The removal of insurance from substandard shipping" conducted, at the request of the Maritime Transport Committee of the OECD (Organisation

for Economic Co-operation and Development) by Terence Coghlin (a former Chairman of the Managers and of the International Group managers). As well as providing a comprehensive account of the current methods of operation of the marine insurance markets, the study was of interest for considering a wide range of issues touching on the general problem of identifying the substandard operator and ensuring that his lack of quality is not, through the mechanism of insurance, subsidised by higher quality operators to their detriment and to the potential detriment of third parties. The Board heard that the Ships' Standards Subcommittee of the International Group managers was tasked with examining the study and making recommendations for consideration by clubs as to what steps might be taken.

Publication of the OECD report had also been awaited with some interest by the IOPC Fund Working Group, to which, as is noted elsewhere in this report, a number of delegations had made submissions to propose that the issue of substandard transportation of oil should be addressed by changing shipowners' limitation rights. At the October meeting of the Board, the Directors discussed recommendations regarding a proposed response to the OECD report, in the context of a submission to the IOPC Fund Working Group on behalf of the International Group. The recommendations focused on six issues relating to the assessment by clubs of the standards of insured ships and their operators.

An agreed checklist of information was proposed to be used by all Group clubs as a guideline for assessing the quality of prospective members before agreeing to provide insurance; besides including many general questions relevant to assessing a risk, the guideline requires clubs to check with prospective members whether their P&I cover from other insurers has been declined for reasons related to the standards of operation of the ships. A second proposal was for an agreed minimum scope for the condition surveys that are used by clubs to check the standards of certain existing entries and of new entries of older ships. Another proposal was to harmonise the criteria used by clubs for targeting ships to be surveyed, and to share survey information when the insurance of a ship is transferred from one association to another. A fifth proposal envisaged a financial disincentive, such as the burden of a double retention, being borne by an association that knowingly insured a ship which another

association had found to be in unfit condition to insure. Under the sixth proposal, the Group clubs would explore the possibility of supplementing their risk assessment measures with information from third party providers of vetting information.

None of these proposals was intended to duplicate the work of classification societies or flag States, on whose certificates all parties, including clubs, should be able to rely in respect of the matters thereby certified. However, the proposals provide clubs with harmonised methods of checking the quality of prospective and existing members through an examination of their general standards of shipboard operation and management. The Directors agreed that the proposals should form the basis of an International Group submission, but noted that some of them would require further legal scrutiny before club boards could be asked to approve their implementation.

These recommendations, together with a description of existing measures taken by clubs to avoid giving insurance support to ships operated to unacceptably low standards, were contained in a report appended to the International Group's submission to the IOPC Fund Working Group, reviewed by the Board at its January meeting. The report sought to portray the insurer's role in a proper perspective, drawing attention to the vital role of other parties and their certification processes, particularly in relation to matters of structural integrity.

The accompanying submission reminded States of the reasons why shipowners generally opposed using changes in limitation rights as a method to change the conduct of the substandard operator. Where a substandard operator was prepared to risk incurring substantial liability under CLC, knowing that such liability was insured (as required under CLC), an increase in the amount of insured liability would provide no motive for him to change his conduct. Nor would a change in the limitation rights of the substandard operator have a punitive effect, since insurance would transfer any increased burden of liability to the shipping industry generally and, at higher levels, to the reinsurance industry.



### 2005 renewal

At the October 2004 meeting, the Board received reports regarding two Members whose quality was in question and decided that it was not appropriate to offer renewal terms for the 2005 policy year.

### Ship Condition Surveys

The Board received reports at its July and January meetings on the condition surveys, carried out by independent surveyors, which it is the Managers' policy to require as a condition of entry for all ships that are more than 10 years old. While it is preferred that surveys be conducted on a pre-entry basis, this is not always practical, so many condition surveys are conducted within a short period soon after entry, save for ships that are 20 or more years old, for which the pre-entry policy is strictly applied.

The Managers reported that 171 ships had been surveyed in relation to their prospective entry in the Association, of which 18 had been rejected for entry. Surveys on another 35 ships had been triggered by a variety of factors, including information arising from ship visits, information arising from claims, port state control detention records, reactivation after lay-up, and other third party information. Formal recommendations for repairs or other actions were issued in relation to 64 ships, the most common fault being (as it was in 2004) failure to maintain hatch covers and compression bars adequately.

### Ship Visits

The Board also received two reports during the year on the programme of ship visits conducted by a permanent team of master mariners from the Managers' staff – whose responsibility is to visit entered ships in order to assess the standard of operation and to encourage improvements where necessary. Ships may be chosen at random, but are increasingly likely to be targeted in the light of perceived risk.

These visits continue to provide an opportunity for ship inspectors to offer practical advice to masters and ships' crews regarding best practice in managing risks and in preventing losses. During 2004, some 456 ships were visited by the inspectors, resulting in recommendations being issued to 241 ships, mostly in relation to service and maintenance issues, or in relation to safety standards. In the case of 11 ships visited, the unsatisfactory nature of what was found led

the Association to require that a formal condition survey be carried out.

Inspections took place during the 2004 policy year in France, Netherlands, Belgium, Italy, Turkey, United Arab Emirates, India, Japan, South Korea, Singapore, China, and Taiwan. The pattern of ships visited was found to have been representative of the pattern of tonnage in the Association generally, save for a slight over-emphasis on bulk carriers and a corresponding under-emphasis on tankers.

Visits were also occasionally made by representatives from the ship inspection department to Members' shore offices, especially where there had been adverse survey findings, in order to determine the commitment of the Member to address problems and to avoid similar recurrences in future.

As reported last year, Members have since 2002 been able to access their ship visit records on-line and to use numerical performance indicators for each of six main areas of inspection (service and maintenance, safety, cargo-worthiness, pollution, manning, and operational performance) to compare their inspection results with a Club average figure, updated on a daily basis. During 2004, there was an increase in the number of Members who had chosen to use this service to monitor the relative performance of ships in a fleet.

The Managers also reported on the Association's proportion of International Group ships detained by PSC authorities – this continued to be well below the Association's share of the Group tonnage.

In continuing to support these programmes of ship visits and condition surveys, the Board has maintained its commitment to ensuring that the quality of tonnage entered in the Association is carefully monitored and controlled. Loss prevention and risk management measures are also developed from the knowledge thereby gained.

### The International Group

Much work on matters of common interest to International Group clubs is done by the Managers working collectively with those of other Group clubs. The Directors therefore receive at each meeting a general report on Group issues under consideration by the Managers, in addition to regular reports on specific matters involving the Group.



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In July, attention was drawn to a circular from another association in the International Group, indicating that it proposed no longer to pay occupational disease claims arising in closed policy years prior to 1989. The circular asserted that the decision was justified under New York law (governing the relevant P&I policy) which reportedly would not permit the levying of supplementary calls in respect of unreserved deficits of a closed policy year. The Directors were advised that an ad hoc committee of the International Group managers had considered the issue and had noted that it was a condition of joining the Pooling Agreement that clubs should have an unrestricted right to levy supplementary calls. They recommended this should apply in respect of deficits or shortfalls, irrespective of whether they arose in open, or in closed, policy years. All clubs were therefore invited to confirm that this condition was being met. The club concerned subsequently confirmed that it would comply with the condition in connection with policy years onwards from 1989, being the year when it joined the International Group Pool.

Other issues which featured prominently in these general reports to the Board were developments in maritime security, and the report of the Maritime Transport Committee of OECD on the removal of insurance from sub-standard shipping, both of which are described in more detail elsewhere in this review.

In January, 2005, the Directors received a summary report covering all issues that had been considered collectively by the managers of International Group clubs during the preceding twelve months, and describing the process by which this is done. Formal decisions of Group club managers are taken at meetings held three times a year, reflecting the outcome of much detailed work undertaken by sub-committees and working groups of Group managers. The administration of Group matters is performed by a small secretariat, which during 2004 recruited a second legal officer to assist the current Group Secretary.

### Maritime Security

The Directors received a report at their July meeting on the coming into force of the International Ship and Port Facility Security (ISPS) Code. In the run up to the 1st July deadline for compliance, there had been much public speculation as to whether delays on the part of Flag administrations in verifying and certifying

shipboard security systems would lead to a significant shortfall in compliance. The Directors agreed to delegate certain powers to the Managers to ensure that coverage issues arising from any significant shortfall could be promptly dealt with. In the event, the coming into force of the Code passed quietly, without reports of Members being affected by any significant problems arising from Flag state delays.

While it is perhaps still too early to make judgements as to what the Code has achieved, and while many shipowners have expressed concerns about adverse effects of security regulations on crew, one side benefit of increased shipboard security has been a drop in reported claims arising from maritime crime, according to preliminary reports from the Managers' investigative arm, Signum Services.

Earlier in the policy year, the Managers received a large volume of enquiries prompted by new US regulations requiring bulk and break-bulk ships to participate in the US automated manifest system (AMS). The requirements of AMS imposed, upon those who carry cargo into US territory, an obligation to submit manifests electronically, within strict time limits, and to have provided an International Carrier Bond and registered a unique 'carrier' number.

The Association, in common with others in the Group, declined to provide collateral for carriers' bonds, not being prepared to provide an anticipatory guarantee. However, the Managers worked with a number of major brokers, and subsequently with SIGCo, to ensure that a service providing uncollateralised bonds was available. As participants in the work of the Maritime Security Sub-committee of the Group, the Managers also sought to clarify whose duty it was to comply with the regulations where a ship was on charter, against a background of uncertain advice from regulators who seemed not to have fully appreciated some of the complexities of shipping when preparing the regulations. The Managers subsequently participated in a working party with BIMCO to draft time and voyage charter-party clauses to allocate responsibility and compliance costs.

Following the publication of two explanatory circulars on the legal requirements, the emergence of bonding facilities, and the development of appropriate charterparty clauses, the large volume of queries rapidly declined as Members integrated these new responsibilities into their commercial contracts.

### Rule changes

The Board considered at its April and July meetings draft changes to the Rules which were subsequently adopted by the Members at the Annual General Meeting of the Association in October.

An amendment to the pollution Rule provided for automatic participation of tankers up to 29,548 tons in STOPIA (the Small Tanker Oil Pollution Indemnification Agreement), and a related amendment provided for restoration of cover for liabilities arising from an act of terrorism where those liabilities are incurred under STOPIA.

The Association's commitment to ensuring the quality of entered tonnage was underlined by the addition of a power for Directors to terminate cover where an entered ship is found in breach of the Rule 5 survey provisions to be in a condition considered unacceptable for continued insurance.

Other Rule changes agreed in October included a provision to make clear that in respect of carriage by land, rail or air, contracts should comply with the International Group Pooling Guidelines; and in respect of dispute resolution, a wider liberty granted to the Directors to waive adjudication if they decide that a case should be directly referred to arbitration.

### Pollution

#### The International Convention system

In 2004, as in the previous year, much of the Board's time spent on pollution matters was occupied with reports on the work being undertaken to improve the international liability and compensation regime for pollution damage caused by tankers. A review of the 1992 CLC and Fund Conventions has been ongoing since April, 2000, when a Working Group of the IOPC Fund was set up for this purpose, prompted by the spill from the ERIKA.

Members may recall that the first issue for the IOPC Fund Working Group - that of the adequacy of the amount of compensation available - was addressed by the drafting of a Protocol to establish an optional third tier of compensation through a Supplementary Fund paid for by cargo receivers. This optional third tier of compensation provides, for pollution damage in those States which become parties to it, an amount of SDR 547 million (about US \$750

million) in addition to the amount of SDR 203 million which is available under the 1992 Conventions. The Protocol was adopted by a Diplomatic Conference in May, 2003, and during 2004 was ratified by sufficient states (Denmark, Finland, France, Germany, Ireland, Japan, Norway, and Spain) to ensure its coming into force on 3rd March, 2005.

A second issue was that of sharing. In a submission to the Diplomatic Conference, the International Group had recognised that a third tier of compensation contributed to only by cargo receivers would cause an imbalance in the burden of compensation. The Group's submission therefore proposed a scheme intended to maintain equitable sharing of the financial burden of compensation, by means of an agreement voluntarily to increase the minimum limit for small tankers under 1992 CLC. The agreement, known as STOPIA (Small Tanker Oil Pollution Indemnity Agreement), raises the minimum limit from SDR 4.5 million to SDR 20 million, in relation to any claim for damage in States parties to the Supplementary Fund, and affecting tankers up to 29,548 gross tons. The submission confirmed that the clubs would guarantee their members' contractual liabilities under STOPIA to the 1992 Fund, subject only to the defences available to shipowners and insurers under 1992 CLC, but reserved the right of shipowners and their clubs to withdraw the scheme if any essential element of the 1992 Conventions affecting tanker owners' liabilities were amended. The Board received updates during 2004 on the process of perfecting a text for STOPIA and for the related undertaking to the IOPC Fund.

Despite this proposal, sharing remained a hot topic of discussion, against the background of a study conducted by the IOPC Fund Secretariat on the historical cost of spills over 25 years, on which the Managers reported to the Board at its July, 2004 meeting. The study established that the net amounts paid historically, after taking recourse actions into account, were funded to the extent of 53 per cent by shipowners and 47 per cent by cargo receivers. If the amounts paid by shipowners to the Fund under recourse actions were disregarded, then the positions were reversed, with 45 per cent funded by shipowners and 55 per cent funded by cargo receivers. Taking account of the potential impact of the Supplementary Fund, a number of proposals to revise shipowners' limits of liability were made at both of the two meetings of the



Working Group held during 2004, the first in February and the second in May. Some delegations were opposed to voluntary schemes in principle, but for others the ability of STOPIA to produce a balanced result seemed to be an issue. The Board was therefore asked to agree that an alternative and more certain balancing mechanism should be offered, in the form of a proposal for voluntary sharing of the third tier instead of the STOPIA scheme, in order to give comfort to governments that balance could be preserved by means other than revision. The Directors agreed that this alternative – known as the Tanker Oil Pollution Indemnification Agreement (TOPIA) – should be offered, and the proposal was accordingly included in a submission to the Working Group.

A third key issue was that of whether measures should be introduced in CLC to discourage substandard transportation of oil. The Managers reported on various revision proposals submitted to the Working Group to change the test for limitation, or to provide for a higher limitation amount where incidents involve ships deemed to be defective or substandard. The Board considered that such changes were unlikely to make any difference to the ‘sub-standard’ owner, but were likely to harm the efficiency of the present compensation system by introducing a greater risk of litigation and its consequent delays. The Board emphasised the importance of preserving limitation rights, and of dealing with shipping quality in more practical ways, as noted in the comments relating to ships’ standards elsewhere in this report.

### Legislation in Europe

The Board received a report in April, 2004 on the scope of new French pollution legislation known, after its sponsor, as the Loi ‘Perben’. Penalties under the new law consisted of fines or imprisonment, varying according to the category of spill. Voluntary overboard discharges could attract a penalty of up to 10 years in prison, or a fine from euro 1 million up to the value of the ship, or 4 times the value of her cargo or freight. Penalties for involuntary discharges would vary according to the type of offence involved and the seriousness of damage caused, ranging from a fine of euro 200,000 for simple negligence, up to three times the value of the cargo, or 7 years in prison, for negligence involving deliberate breach of safety regulations coupled with serious pollution damage. Two French members of the Board assisted in monitoring developments and in providing updated information, at each

meeting, on the efforts being made by the French and the European Community Shipowners’ Associations to campaign for restraint in the use of penalties under the new law.

Reports were also provided to the Board on developments in the EU process to draft a directive on criminal sanctions for ship source pollution. An initial draft from the European Commission had contained provisions to criminalise accidental spills where caused by gross negligence. Amendments helpfully proposed by the European Parliament had sought to restrict application of the directive to discharges contravening MARPOL, where the liability basis is “intent to cause damage or recklessly and with knowledge that damage would probably result”. However, the amendments were reversed by the EU’s Transport Council, proposing that the basis of liability be “by intent, recklessly or by serious negligence”. The International Group had joined a wide coalition of industry bodies in arguing for consistency with MARPOL, but at a meeting with Commission representatives on the subject had found them to be unwilling to shift their view.

Other subjects reported to the Board included changes to the Panama SOPEP requirements, efforts to oppose laws in Spain that would make access to places of refuge more difficult, and new financial responsibility laws in Buzzards Bay, Massachusetts where it had been successfully argued that possession of a valid Club certificate of entry should be regarded as an adequate means to satisfy the requirements.

As usual, many other matters relating to pollution legislation were also addressed during the year by the Managers as participants in the work of the pollution sub-committee of the International Group.

### War risks & terrorism cover

At their meeting in January, 2005, the Directors decided that the Association should again provide the special war risks P&I cover which has been made available to Members in recent years. The terms of the cover are essentially the same as for the 2004 policy year, save for an increase in the limit of cover from \$400 million to \$500 million.

As for the previous policy years, Members continue to be required to maintain war risk P&I insurance cover in the market up to a minimum of the ship’s proper value. The terms of this cover for 2005 again contain exclusion in respect





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of “bio-chem” claims. Though an additional word “biological” has been added to the “Bio-chem” clause, the effect of the clause is unchanged, reinsurers having already clarified in 2002 that biological risks were within the scope of the exclusion. The terms of this cover were set out in detail in the Directors’ Resolution passed at the January Board meeting and circulated to all Members.

As in the 2004 policy year, the Directors again decided to cover the “bio-chem” claims which are excluded from the special war risk P&I cover by the operation of the “Bio-chem” exclusion clause. This cover, which is not reinsured, but pooled among the Group clubs, is provided on the same terms as for the 2004 policy year except that (i) the limit of cover is increased from \$20 million to \$30 million, and (ii) the Club’s retention is increased from \$5 million to \$6 million. The terms of this cover were set out in the Supplementary Directors’ Resolution passed at the same meeting and circulated to all Members.

The United States Terrorism Risk Insurance Act 2002 continues to apply, at least until the end of 2005. The effect is that, for this Association, in the event of claims being paid under the special war risks P&I cover or under the supplementary “bio-chem” cover, 90 per cent of the losses resulting from a United States act of terrorism as defined in that Act may be recovered from the United States Government.

### Claims considered by the Directors

At each of their meetings the Board received reports from the Managers of claims payments made during each quarter including full particulars of the ten largest settlements made during the period under review. In addition, by way of written and verbal reports, details were provided of developments in other significant cases including those recent incidents which were likely to result in the Association incurring substantial expenditure in the future. More than forty-five such claims were drawn to the attention of the Board during the year. These included ten collision incidents, eight groundings and two major oil spills.

#### Significant incidents

In March, 2004 a bulk carrier grounded close to the Florida shoreline in difficult weather conditions when she was manoeuvring to reach the inner anchorage at Port Everglades.

Fortunately no pollution occurred and the ship was successfully refloated under a LOF contract within twenty-four hours. However, the ship had come to rest on a reef and some 10,000 square metres were feared to have been adversely affected. Restoration, including the removal of several hundred tons of rubble and the reattaching of dislodged living coral, has resulted in the incurrence of costs in the region of \$5 million. Damage claims under a Natural Resource Damage Assessment (NRDA) are yet to be quantified.

In May, 2004 a west bound car carrier entered in the Club collided with an east bound VLCC in the Singapore Strait traffic separation scheme. She had on board 4,165 cars which had been loaded in Japan and Korea for discharge at ports in the United Kingdom and Germany. After the incident, she lost main engine power, drifted south into Indonesian waters and sank. Fortunately all of her crew members were rescued and no significant pollution occurred. The tanker, entered with the Britannia Association, suffered major damage to her bow and her cargo was transhipped in order to facilitate repairs being undertaken in Singapore.

Soon after the incident a salvor was contracted by the Association to remove bunkers and other potential pollutants from the wreck of the car carrier. These comprised 830mt of heavy fuel oil and various quantities of intermediate fuel oil, diesel and lubricating oil. This operation was successfully completed by the end of June, 2004. In the meantime, consideration was given to the need to remove the wreck, or at least to take steps to achieve a safe clearance over the wreck of at least 28 metres, bearing in mind the proximity of the traffic lane. Proposals from various potential contractors were received and analysed. The preferred option was put forward to the Indonesian authorities with whom negotiations have been prolonged. It is anticipated that costs in excess of \$20 million will be incurred in order to make safe the obstruction.

The two major oil pollution incidents provided an interesting contrast in approach to the handling of claims.

A 149,719 gt tanker struck the bank of the Suez Canal on 14th December, 2004. The ship was proceeding north with 198,500mt of Kuwaiti crude oil on board when a manoeuvre to pass a moored dredger was misjudged. As a consequence of the contact, No.2 starboard

cargo tank and No.1 starboard ballast tank were holed and approximately 8,500mt of oil were spilled into the Canal. The Suez Canal Authorities (SCA) activated their oil response spill plan but restricted access to the area by experts from ITOPF, only allowing them to view the affected area from a helicopter. The SCA did, however, provide details of the equipment deployed and it was possible to reach an agreement to settle their claim for clean up expenditure in the sum of \$3 million. In addition, the Egyptian Environmental Agency (EEAA) imposed a fine of \$4.5 million which was later reduced by negotiation to \$2 million. Considering the magnitude of this spill, the major claims were settled very swiftly, the agreements reached with the Egyptian authorities being concluded within one month of the incident.

By contrast, the resulting clean up operations in the other major incident were not to be completed in such a short time, and claims for loss and expenditure may take a number of years to conclude.

This spill occurred in the Delaware River during the night of 26th November, 2004. The Member’s 37,895 gt tanker had almost completed her voyage from Venezuela to Paulsboro, New Jersey with 48,838mt of Bachaquero crude oil on board and was being manoeuvred into position to berth alongside the Citgo terminal when she took on a eight degree list and oil was noted to be escaping from the ship. It was determined that tank Nos. 7 centre and 7 port had been breached. The actions of those on board in effecting swift transfers to other tanks stopped the flow of oil in just under an hour.

Daylight revealed that the oil had spread extensively along the Delaware River. The authorities closed the section of the river between the Walt Whitman Bridge and the Commodore Joseph Barry Bridge and navigation restrictions continued until mid-December. It was later determined that approximately 265,000 gallons of oil had been lost and that some 220 miles of shoreline had been affected of which 70 miles were heavily or moderately oiled. River frontage and surrounding facilities, including marshland areas and industrial and commercial sites, were impacted to varying degrees. Numerous docks, quays, marinas and boats required cleaning.

The Vessel Response Plan (VRP) was immediately put into effect. The shipowner’s QI contracted for the employment of personnel and the

deployment of equipment and resources under the overall command of the Federal On Scene Co-ordinator and based the response at a centre established on the outskirts of Philadelphia. At the highest level of activity some 1,800 field and command personnel were registered as being involved. A fleet of more than 50 boats and various other craft were utilised and some 145,000ft of containment boom and 3,500ft of sorbent boom were deployed.

The properties of this particular crude oil made the task of removal or recovery extremely difficult. The oil, which has a specific gravity close to that of water, was carried down stream within the water column but quantities also sank to the riverbed. High levels of clean up activity continued into January, 2005 and it was estimated that the task would not be finalised before the beginning of June, taking into account reduced operations during the worst of the winter weather. NRDA procedures were activated and a decision was taken that the shipowner should cooperate and participate with this process.

Under OPA 90, the owner of a tanker spilling oil is strictly liable for removal costs and damages. However, he may limit his liability to \$1,200 per gross ton if the incident was not proximately caused by his gross negligence or wilful misconduct, as a result of the violation of Federal safety, construction or operating regulations, and provided that the incident was properly reported and the owner undertook all reasonable cooperation and assistance with the clean up operations. In order to avoid the risk of losing the right to limit, a decision was taken to continue to organise and fund the clean-up operation even after the ship’s limit under OPA 90 had been exceeded. By the end of February, 2005 clean-up expenditure of more than double the ship’s OPA 90 limit of \$45.5 million had been incurred. Regular remittances of substantial amounts were made by the Association in settlement of contractors’ invoices during this period. However, claims for damage, loss or clean-up expenditure sustained or incurred by third party claimants were declined and referred to the National Pollution Fund Centre (NPFC) which published advice on how claims should be presented to them for consideration and potential reimbursement from the National Pollution Fund. These claimants included the operators of a nuclear power plant which was shut down when oil was allegedly interfering with the cooling systems.







Soon after the incident, it became clear that the ship's tanks had been punctured by an object which was resting on the river bed some 350 metres off the berth. With the permission of the authorities, a dive team was engaged to survey the area where the contact had occurred and a number of substantial objects were found in the vicinity of the ship's track to the berth. A team of experts was engaged to investigate and establish the precise cause of the incident. In the course of this intensive investigation, nothing has transpired to indicate any fault on the part of the ship.

In the light of the evidence developed during these investigations, of which the authorities had been kept closely advised, and taking account of the extent of the owners' operational and financial commitment to the clean up, it has recently been possible, most unusually, to agree with the US Coast Guard for the federal authorities to take over and fund the ongoing response. Specific acknowledgement has been obtained that the owners' withdrawal from the clean-up operation does not constitute a breach of their obligations under OPA 90 to co-operate and assist with the clean-up.

Further substantial work is anticipated in finalising the accounts for clean-up expenditure to which the owners and the Club are already committed, and in seeking to make the maximum possible recovery of these costs, which are in the region of \$120 million. In addition, steps are being taken to ensure a successful defence to any other claims arising out of this incident.

### Ship's proportion of general average

The rapid increase in hull values gave rise to an unusual claim for recovery of ship's proportion of general average which was reported to the Board during the year. A bulk carrier suffered a fire in the crew accommodation while sailing between loading ports in China. The fire was brought under control with the assistance of the local port fire brigade, but extensive damage to the ship was incurred. Repairs were undertaken locally and final discharge of her cargo in the United States was not completed until January, 2004. General average was declared and the ship's contributing value, correctly assessed at the time of the completion of discharge, was determined to be \$18 million. However, at the date of the incident which gave rise to the general average in November, 2003, the insured value of the ship under her hull and excess value

policies was \$11 million. As a result, part of the ship's proportion of general average was not recoverable under the hull policies. The resulting shortfall is only recoverable from the Association under Rule 2, Section 20 if the ship has been insured under the hull policies at the proper value in accordance with Rule 5(D). The Managers accordingly investigated the Member's policy and practice for revising their fleet insured values in accordance with market conditions as indicated in the relevant note to Rule 5(D). It transpired that there had been regular and appropriate reviews of the hull values for insurance purposes. The insured value of \$11 million had been confirmed as an appropriate valuation shortly before the casualty and had been increased twice in the time between the casualty and the completion of the voyage. Since the claim had arisen solely as a result of the extraordinary escalation in the ship values over this period, the Member was entitled to recovery of the claim from the Association.

### Delivery of cargo without production of original bills of lading

During the year, the Directors considered two requests from Members for recovery of cargo claims which had arisen out delivery of the cargo without production of the original bill of lading. Under Rule 2, Section 17 proviso c (ii) such claims are not recoverable from the Association unless the Directors in their discretion decide otherwise.

In the first case, a bulk carrier loaded a cargo of 37,000mt soya bean meal in bulk in Brazil in June, 2000 destined for Tilbury. Two of the eight bills of lading, covering about 10,000mt, were made out to the shippers' order. The cargo had been sold on FOB terms to a Singaporean company who, in turn, had re-sold it to a sister company registered in the United Kingdom. The ship was on time charter to the Singaporean company's chartering arm and prior to the ship's arrival at the discharge port the charterers issued to the shipowner a letter of indemnity in support of their request to deliver the cargo without production of the original bills of lading. A clause in the governing charterparty gave the charterers the right to make such a request. Shortly before discharge, the shippers informed the shipowner that they were unpaid and instructed them not to deliver the cargo but two days later authorised discharge to the United Kingdom registered company and discharge and delivery were effected accordingly. During the period of discharge a bank in Singapore agreed to finance

the purchase of the cargo and appeared to be aware that the cargo would be delivered and sold following the issuance of the letter of indemnity. Despite the extent of the bank's knowledge of the background to the transaction, arbitration proceedings in London, in which the bank pursued a claim for mis-delivery against the owner, resulted in an award in the bank's favour in the region of \$2 million. The shipowner had become, effectively, the guarantor of the loan and were the only party to whom the bank turned when the Singaporean company went into liquidation soon after the cargo was delivered. The Board declined the Member's claim on the Association.

In the other case, the Member's agents in Italy had released containers of rubber in bales to unknown parties upon presentation of what purported to be delivery orders. The agents had not received authority from the owners to release the cargo in this way, and when a claim for wrongful delivery was made by the shippers, the Member in turn sought indemnity from the agent. The claims took some years to resolve and in the intervening period additional matters became the subject of dispute between the Member and the agents resulting eventually in a settlement agreement which the agents subsequently maintained included the claim for mis-delivery. Although the agents finally contributed a portion of the amount paid by the Member in satisfaction of the mis-delivery claim, the Member was unable to recover the balance and submitted a claim for consideration by the Directors. The Board declined to exercise their discretion to pay this claim.

### Case for adjudication

One claim was referred to the Board as a case for adjudication under the provisions of Rule 40(A).

In December, 1994 a 4,814gt general cargo ship was proceeding down the River Scheldt, after completion of loading at Antwerp, when she developed a 40 degree starboard list. The ship was laden with general cargo and containers loaded at various north European ports and bound for discharge at a number of ports in the Mediterranean. A local salvor was contracted under LOF terms but later in the day the Rijkswaterstaat intervened under the Wreck Act and declared the ship a hazard to navigation. The Rijkswaterstaat contracted for the removal of the ship and the recovery of containers which had fallen overboard. In order to recover the

costs which they had expended, the Rijkswaterstaat offered the ship back to the owners on the basis of an agreed sale price after tender, failing which the ship would be sold at auction. After one unsuccessful bid, the owners increased their offer and eventually paid \$1.55 million to recover the ship and to release her from arrest.

The owners' assessment of the unrepaired value of the ship was \$677,300 and they contended that they were entitled to recover from the Association the balance up to \$1.55 million under Rule 2, Section 15A covering wreck liabilities. The Managers, on behalf of the Association, declined the claim on the basis that the amount paid to the Rijkswaterstaat represented the value of the ship to the Member. There were a number of complex issues and arguments which may remain unique to this case. It was not possible to reach an agreement between the Association and the Member and the case was therefore referred to the Directors for adjudication on the basis of written submissions. The Directors decided the adjudication in favour of the Member.

### Other matters considered by the Board

The Directors also receive reports on a variety of other matters, including the annual review of underwriting result and renewal; the Association's reinsurance of the London based predecessor association; the progress of the Association's investment in the Managers' parent company, Thomas Miller Holdings Ltd; the Group Pool loss record; the annual review of the Association's budget for general expenses; overdue calls; the activities of SIGCo; the operations of the Association's subsidiary IPIR, and IPIR's subsidiary IPIER; management remuneration; and the work of the Strategy Working Group.

**A.G. Kairis**  
Chairman

5th May, 2005





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# DIRECTORS

<b>A.G. Kairis</b> N.J. Goulandris Ltd, London Chairman and President	<b>J. Kwok</b> American Eagle Tankers Inc. Ltd, Singapore
<b>E. André</b> Suisse-Atlantique S.A., Renens/Lausanne Deputy Chairman and Vice President	<b>J.B. Lee</b> Korea Line Corporation, Seoul
<b>T. Biggi</b> V. Ships Group Ltd, Monaco Deputy Chairman and Vice President	<b>A.M. Lemos</b> Ceres Hellenic Shipping Enterprises Ltd, Piraeus
<b>C.I. Caroussis</b> Chios Navigation Co. Ltd, London Deputy Chairman and Vice President	<b>D. Lim *</b> Neptune Orient Lines Ltd, Singapore
<b>A.H. Al-Roumi</b> Kuwait Oil Tanker Co. S.A.K., Kuwait	<b>P. Louis-Dreyfus</b> Louis Dreyfus Armateurs (SAS), Paris
<b>G. Bottiglieri</b> Bottiglieri di Navigazione SpA, Naples	<b>Ma Zehua</b> China Ocean Shipping (Group) Co, Beijing
<b>M.L. Carthew</b> Chevron Texaco Shipping Company LLC, San Ramon	<b>R.A. Malone</b> BP Shipping Ltd, Sunbury on Thames
<b>P. Decavèle</b> Broström Tankers SAS, Paris	<b>A. Woolridge Marion</b> Hamilton, Bermuda
<b>O. Gast</b> Hamburg-Südamerikanische Dampfschiffahrts- Gesellschaft K.G., Hamburg	<b>A.K. Olivier</b> Unicorn Tankers (International) Ltd, London
<b>I. J. Gaunt</b> Carnival Corporation & plc, London	<b>E.T. Richards</b> Hamilton, Bermuda
<b>T. Hojo *</b> Mitsui O.S.K. Lines Ltd, Tokyo	<b>M. Sato</b> NYK Line (Europe) Ltd, London
<b>J.P. Ioannidis</b> Olympic Shipping and Management S.A., Athens	<b>S.H. Seyedan</b> National Iranian Tanker Co, Tehran
<b>A.C. Junqueira Leite *</b> Petrobras Transporte SA, Rio de Janeiro	<b>G.P. Sulser</b> Massoel Gestion S.A., Geneva
<b>C.E Kertsikoff *</b> Eletson Corporation, Piraeus	<b>P.A. Vasilchenko</b> Far Eastern Shipping Company, Vladivostok
<b>K.G. Kleberg</b> Walleniusrederierna AB, Stockholm	<b>H. von Rantzau</b> DAL Deutsche Afrika-Linien GmbH & Co, Hamburg
<b>J.M. Kopernicki</b> Shell International Trading and Shipping Co. Ltd, London	
<b>P. Kragic</b> Tankerska Plovidba d.d., Zadar	

\* New Directors elected in October 2004

The following Directors have left the Board since February 2004:

**N.W.G. Baptist**  
**M.D. Garvey**  
**G.B. Hadjieleftheriadis**  
**N.F. Lykiardopulo**  
**K. Saito**  
**K. Suzuki**





APPENDIX 1

Reserves of the Association

The following appendices are provided to show the movement of the reserves of the Association during the year, and the progress and the current best estimate of the outcome of the open policy years.

The appendices are prepared under the accounting policies used within the Financial Statements.

Summary of Reserves

Amounts in \$000	Appendix	2005	2004
Open policy years			
2004	2	(90,928)	-
2003	2	(11,582)	(50,645)
2002	2	(108,950)	(122,918)
2001	-		(74,929)
Deficit on Open years		(211,460)	(248,492)
Closed policy years	3	-	-
Contingency Account	3	305,256	360,699
Catastrophe reserve	3	51,793	53,908
Reinsurance Retention reserve		10,914	7,750
US Oil Pollution AP reserve		49,710	45,569
Statutory reserve		240	240
Total surplus		206,453	219,674
Outstanding claims		759,293	732,714
		965,746	952,388



## APPENDIX 2

### Development of Open Policy Years

Amounts in \$000	2004	2003	2002
Calls and premiums	<b>333,702</b>	307,872	265,232
Less reinsurance premiums	<b>55,778</b>	59,500	48,675
A	<b>277,924</b>	248,372	216,557
Incurring claims:			
Paid	<b>94,362</b>	118,482	191,383
Known outstanding estimates	<b>123,168</b>	74,143	77,463
Unreported estimates	<b>115,000</b>	45,000	32,000
	<b>332,530</b>	237,625	300,846
Operating expenses	<b>42,711</b>	33,231	29,784
B	<b>375,241</b>	270,856	330,630
Investment income	C	10,902	5,123
Deficit (see Appendix 1)	A-B+C	(11,582)	(108,950)
Future investment income	<b>8,000</b>	6,000	0
Anticipated deficit	<b>(82,928)</b>	(5,582)	(108,950)

#### Notes:

(a) Incurred claims comprise claims paid (net of reinsurance recoveries), together with contributions to other P&I associations under the Group's pooling arrangement, claims management costs and expenses and estimates for reported and unreported claims (including future claims management costs).

(b) Included in the policy year funds are balances of \$2.551million for 2002, \$0.193 million for 2003 and a deficit of \$13.179 million for 2004 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 2004 deficit reflects the Association's contribution in respect of the ATHOS I claim.

(c) The approximate yield of a 10 per cent supplementary premium on the open policy years would be \$27 million (2004), \$25 million (2003), and \$22 million (2002).

(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 \$36 million (2004), \$23 million (2003) and \$15 million (2002) respectively.

## APPENDIX 3

### Development of Closed Policy Years, Contingency Account and Catastrophe reserve

Amounts in \$000	Closed policy years	Contingency Account	Catastrophe reserve
Balance at 20th February, 2004	256,309	360,699	53,908
Investment income	142	26,862	2,003
Reinsurance premiums		(3,243)	(4,118)
Transfers on closure:			
Deficit on 2001 policy year		(78,689)	
Balance of 2001 policy year	81,205		
Premium adjustments	304		
Gain of commutation premium		47,043	
Reserve transfer		(1,113)	
Claims paid net of reinsurance recoveries etc	(91,744)		
Transferred to Contingency account on review of estimated and unreported claims	(740)	740	
Return of ERZ reinsurance recovery	47,043	(47,043)	
Balance at 20th February, 2005	292,519	305,256	51,793
Outstanding claims	292,519		
Net surplus (see Appendix 1)	0	305,256	51,793

#### Notes:

(a) On closure of the 2001 policy year, the sum of \$2.151 million was transferred to the United States Oil Pollution AP reserve and \$1.609 million was transferred to the Reinsurance Retention reserve. The US Oil Pollution AP reserve is intended to support the Association's Pool contribution in respect of tanker oil pollution claims in the United States. The Reinsurance Retention reserve was created in April, 1998 to fund the Association's pooling share of claims falling on the co-insurance (with other International Group Pool associations) layer of the International Group's reinsurance contract. Both reserves have subsequently been credited with their share of the Association's investment income.

(b) The outstanding claims on closed years include a provision for Group pooled claims of \$47 million (2004 \$75 million) including a forecast for unreported claims. The outstanding claims figure is shown net of recoveries from excess loss underwriters of \$26 million (2004 \$43 million) and from the Pool of \$18 million (2004 \$20 million).

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

(d) An improvement in the claims development arising from policy years 2003 and prior has resulted in the return of the \$47 million reinsurance recovery on outstanding claims previously made under the contract with the European Reinsurance Company of Zurich, Bermuda branch. This recovery had been allocated to the Closed Policy Years with the subsequent surplus having been transferred to the Contingency account. The return of the recovery reverses this transfer. This return is wholly offset by a \$47 million increase in the accrued commutation premium. The Contingency account has been charged with the reinsurance premium payable net of commutation for the current accounting year.



APPENDIX 4

Total Funds and Liabilities

Summary of funds available, estimated and forecast claims and discounted value of future claims at 20th February, 2005.

Amounts in \$000	Funds available	Estimated claims and forecast of unreported claims	Discounted liability
Total closed policy years	292,519	292,519	260,049
Open Policy Years			
2002	513	109,463	97,314
2003	107,561	119,143	106,275
2004	147,240	238,168	212,404
Reserves			
Reinsurance Retention reserve	10,914		
US Oil Pollution AP reserve	49,710		
Contingency Account	305,256		
Catastrophe reserve	51,793		
Statutory reserve	240		
Total funds	965,746	759,293	676,042

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 40 to 58. 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, 2005 and the results of its operations and its cash flow for the year then ended in accordance with accounting principles generally accepted in Bermuda and Canada.

Moore Stephens & Butterfield

Chartered Accountants  
Crown House  
Hamilton  
Bermuda

5th May, 2005

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-sixth Annual General Meeting of the Members of the Association will be held at The Elbow Beach Hotel, Bermuda on Monday the seventeenth day of October, 2005 at 9.00 am for the following purposes:-

- To receive the Directors' Report and Financial Statements for the year ended 20th February, 2005 and if they are approved, to adopt them.
- To elect Directors.
- To consider amendments to the Rules and Bye-Laws.
- 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

5th May, 2005

**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.





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**Consolidated Statement of Operations**  
for the year ended 20th February, 2005

Amounts in \$000	Note	2005	2004
<b>Income</b>			
Calls and premiums	4	<b>340,305</b>	304,843
Reinsurance premiums	5	<b>(19,539)</b>	(75,043)
	A	<b>320,766</b>	229,800
<b>Expenditure</b>			
Incurred claims	6	<b>331,749</b>	282,910
Acquisition costs		<b>24,266</b>	17,407
Operating expenses	7	<b>18,451</b>	15,907
	B	<b>374,466</b>	316,224
Operating deficit		<b>(53,700)</b>	(86,424)
Investment income	8	<b>39,377</b>	129,430
(Deficit)/Surplus before taxation		<b>(14,323)</b>	43,006
Taxation		<b>1,102</b>	(2,630)
(Deficit)/Surplus after taxation		<b>(13,221)</b>	40,376
Reserves at beginning of year		<b>219,434</b>	179,058
Reserves at end of year	17	<b>206,213</b>	219,434

The notes form an integral part of these financial statements.

**Consolidated Balance Sheet**  
at 20th February, 2005

Amounts in \$000	Note	2005	2004
<b>Assets</b>			
Investments	9	<b>721,382</b>	800,544
Cash balances	10	<b>101,070</b>	84,743
Amounts due from Members	13	<b>6,932</b>	9,327
Calls not yet due	13	<b>62,374</b>	58,805
Reinsurance recoveries on outstanding claims	15	<b>177,636</b>	146,273
Accrued interest		<b>3,549</b>	5,203
Sundry debtors	14	<b>84,428</b>	11,867
		<b>1,157,371</b>	1,116,762
<b>Liabilities</b>			
Outstanding claims (gross)	15	<b>936,929</b>	878,987
Creditors	16	<b>13,989</b>	18,101
		<b>950,918</b>	897,088
Reserves	17	<b>206,213</b>	219,434
Statutory reserve		<b>240</b>	240
		<b>206,453</b>	219,674
		<b>1,157,371</b>	1,116,762

The notes form an integral part of these financial statements.

**Directors**

Mr A.G. Kairis  
Mr T. Biggi

Mr R.N. Readman  
Thomas Miller (Bermuda) Ltd  
Managers

5th May, 2005



**Holding Company Balance Sheet**  
at 20th February, 2005

Amounts in \$000	Note	2005	2004
<b>Assets</b>			
Investments	3	<b>49,145</b>	58,773
Cash balances		<b>73,536</b>	25,618
Amounts due from Members	13	<b>6,932</b>	9,327
Calls not yet due	13	<b>62,374</b>	58,805
Reinsurance recoveries on outstanding claims		<b>861,000</b>	805,716
Accrued interest		<b>568</b>	550
Sundry debtors		<b>84,412</b>	11,848
		<b>1,137,967</b>	970,637
<b>Liabilities</b>			
Amounts due to subsidiary company		<b>154,416</b>	47,039
Outstanding claims (gross)	15	<b>936,929</b>	878,987
Creditors		<b>13,130</b>	17,001
		<b>1,104,475</b>	943,027
Reserves		<b>33,252</b>	27,370
Statutory reserve		<b>240</b>	240
		<b>33,492</b>	27,610
		<b>1,137,967</b>	970,637

The notes form an integral part of these financial statements.

**Directors**

Mr A.G. Kairis  
Mr T. Biggi.

Mr R.N. Readman  
Thomas Miller (Bermuda) Ltd  
Managers

5th May, 2005

**Consolidated Cash Flow Statement**  
for the year ended 20th February, 2005

Amounts in \$000	2005	2004
<b>Operating Activities</b>		
Calls and premiums received	<b>339,083</b>	298,304
Receipts from reinsurance recoveries	<b>76,397</b>	16,334
Interest and dividends received	<b>46,795</b>	21,517
Taxation recovery	<b>1,102</b>	-
	<b>A</b>	<b>463,377</b>
Claims paid	<b>370,381</b>	243,421
Acquisition costs	<b>24,266</b>	17,407
Operating expenses paid	<b>25,799</b>	12,307
Reinsurance premiums paid	<b>71,455</b>	73,923
Pool claims paid	<b>28,547</b>	36,616
Taxation paid	<b>-</b>	2,800
	<b>B</b>	<b>520,448</b>
Cashflow used by operating activities	<b>A-B=C</b>	<b>(57,071)</b>

**Investing activities**

Purchase of investments	<b>(693,530)</b>	(796,960)
Sale of investments	<b>766,928</b>	831,020
Net cashflow from investing activities	<b>D</b>	<b>73,398</b>
Net increase/(decrease) in cash and cash equivalents	<b>C+D</b>	<b>16,327</b>
Cash balances at beginning of year		<b>84,743</b>
Cash balances at end of year		<b>101,070</b>



**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, and its wholly owned subsidiary International P&I Excess Reinsurance Company (Bermuda) Limited, which is registered in Bermuda. IPIR reinsures 90 per cent of the risks retained by the holding company. The investment in 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 the subscription for share capital and payment of the contributory surplus disclosed within cash balances. All inter-company transactions have been 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 multi year excess of loss reinsurance contract (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.

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

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	2005	2004
<b>Investments</b>		
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	-
UK Club Private Trust Co. Ltd		
paid up share capital of 12,000 shares of \$1 each	12	-
	A	2,252
Government bonds	29,977	34,572
Bonds	688	583
Total listed investments	B	30,665
UCITS	1,139	7,529
Loan	15,089	15,089
	C	16,228
Cost \$48,883 (2004: \$57,411)	A+B+C	49,145

The loan was made on 27 October, 2000, to the UK Club Private Trust Co Ltd, which is wholly owned by the Association and established in Bermuda. Interest at 5 per cent per annum is receivable on the loan. The UK Club Private Trust Co Ltd has in turn made a convertible loan to Thomas Miller Holdings Ltd with interest at 5 per cent per annum, and this loan may be converted into equity shares after five years at the Trust's discretion. The loan is disclosed at cost. The investment in Hydra Insurance Co. Ltd, a Bermuda Segregated Account Company, was made on 2 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.



**Note 4 - Calls and Premiums (see note 2(j))**

Amounts in \$000	2005	2004
<b>Mutual</b>		
Mutual premium	<b>277,361</b>	257,050
Laid-up returns	<b>(1,561)</b>	(2,112)
Releases	<b>6,821</b>	2,660
Reinsurance	<b>104</b>	91
	<b>A</b>	<b>282,725</b>
Less		257,689
Bad debts written off	<b>(1,125)</b>	(611)
Movement in provision for bad debts	<b>737</b>	(1,105)
	<b>B</b>	<b>(388)</b>
	<b>A+B=C</b>	<b>282,337</b>
		255,973
<b>Fixed Premium</b>		
Time charter	<b>36,576</b>	31,946
Owned	<b>9,439</b>	7,807
Reinsurance	<b>442</b>	666
US Oil Pollution	<b>11,568</b>	8,487
	<b>58,025</b>	48,906
Laid up returns	<b>(57)</b>	(36)
	<b>D</b>	<b>57,968</b>
	<b>C+D</b>	<b>340,305</b>

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	2005	2004
Market underwriters and other P&I associations and Members	<b>56,812</b>	53,634
Multi-year arrangements	<b>(43,800)</b>	11,400
US Oil additional premiums	<b>6,527</b>	10,009
	<b>19,539</b>	75,043

The reinsurance premiums include the cost of the multi year reinsurance arrangements with the European Reinsurance Company of Zurich, Bermuda branch, a wholly owned subsidiary of the Swiss Re which provide cover of \$300m for claims in excess of an aggregate retention in addition to a further \$100m of cover which is available to meet an overspill claim. The Association has an option to terminate the contract at any time, in which event, a commutation payment will be made to the Association less any paid claims.

As a result of returning the claim recovery previously made under the contract, the cumulative accrued premium, to the value of the \$47 million recovery, that may be regarded as recoverable under the terms of the commutation upon extinguishing the recovery is credited against reinsurance premiums charged in the current accounting year. The reinsurance premium payable net of commutation in the year ended 20 February, 2005 was \$3.243 million..

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

Amounts in \$000	2005	2004
Gross claims paid:		
Members' claims	<b>370,617</b>	246,008
Group's pooling arrangements	<b>28,547</b>	36,616
	<b>A</b>	<b>399,164</b>
Less recoveries:		
Group's pooling arrangements	<b>56,935</b>	7,866
Market underwriters	<b>34,392</b>	4,400
Other P&I associations and Members	<b>2,667</b>	2,967
	<b>B</b>	<b>93,994</b>
Net claims paid	<b>A-B=C</b>	<b>305,170</b>
Movement in provision for outstanding claims:		
Provision carried forward	<b>936,929</b>	878,987
Provision brought forward	<b>878,987</b>	832,426
	<b>D</b>	<b>57,942</b>
Less: Movement in provision for reinsurance recoveries:		
Provision carried forward	<b>(177,636)</b>	(146,273)
Provision brought forward	<b>146,273</b>	115,231
	<b>E</b>	<b>(31,363)</b>
Net changes in claims provision	<b>D+E=F</b>	<b>26,579</b>
Net incurred claims	<b>C+F</b>	<b>331,749</b>



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

Amounts in \$000	2005	2004
Management fee	<b>11,481</b>	9,561
Travel	<b>2,030</b>	2,054
Directors' fees	<b>441</b>	429
Printing and stationery	<b>324</b>	297
Communications	<b>338</b>	371
Promotions and seminars	<b>243</b>	210
Legal and financial	<b>1,891</b>	1,631
Strategy and planning	<b>441</b>	259
Auditors' fees	<b>300</b>	250
Japan branch	<b>219</b>	228
Ship inspection	<b>458</b>	397
Loss prevention	<b>285</b>	220
	<b>18,451</b>	15,907

The increase in operating expenses reflects the inflationary effect of the prevailing weakness in the value of the US dollar, with operating costs largely denominated in sterling.

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

Amounts in \$000	2005	2004
Bonds	<b>16,377</b>	16,464
Bank deposits	<b>2,661</b>	1,678
Dividends	<b>4,473</b>	3,453
Profit on sales of investments	<b>21,840</b>	58,499
	<b>45,351</b>	80,094
Unrealised (loss)/gain on investments	<b>(27,604)</b>	47,782
Exchange gain	<b>21,630</b>	1,554
	<b>39,377</b>	129,430

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

Amounts in \$000	2005	2004
<b>Listed Investments</b>		
Bonds	<b>688</b>	583
Government stocks	<b>338,021</b>	400,037
Equities	<b>249,567</b>	291,025
Unit trusts	<b>60,263</b>	35,693
Total listed investments	<b>648,539</b>	727,338
Cost \$606,830 (2004: \$660,315)		
<b>Other Investments</b>		
UCITS	<b>58,096</b>	57,073
UK Club Private Trust Co. Ltd (see note 3)	<b>12</b>	-
Loan (see note 3)	<b>15,089</b>	15,089
Open forward currency contracts	<b>(354)</b>	1,044
Total investments	<b>721,382</b>	800,544

The listed investments are all 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 AA minus 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 5 per cent (2004: 1 per cent and 5 per cent). The UCITS have effective interest rates of between 2 per cent and 5 per cent (2004: 1 per cent and 4 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, 2005 using exchange rates prevailing at that date.

Amounts in \$000	2005	2004
Forward sale of currencies	<b>(100,846)</b>	(244,629)
To produce	<b>100,492</b>	245,673
Potential (loss)/gain	<b>(354)</b>	1,044



**Note 10 - Cash Balances**

Amounts in \$000	2005	2004
Current and short term bank deposits	<b>101,070</b>	84,743

**Note 11 - Cash and Investment Maturity Summary**

Amounts in \$000	2005	2004
Cash and investments	<b>822,452</b>	885,287

	2005 Per Cent	2004 Per Cent
Cash, equities and interest bearing securities repayable within one year	<b>64.78</b>	58.10
Interest bearing securities repayable between one year and three years	<b>16.38</b>	10.04
Between three and seven years	<b>16.85</b>	30.16
Over seven years	<b>1.99</b>	1.70
	<b>100.00</b>	100.00

**Note 12 - Cash and Investment Currency Exposure**

	2005 Per Cent	2004 Per Cent
Swiss franc	<b>0.08</b>	0.07
Sterling	<b>13.23</b>	7.66
Japanese yen	<b>1.48</b>	1.37
Euro	<b>4.45</b>	8.53
US dollar	<b>80.76</b>	82.37
	<b>100.00</b>	100.00

**Note 13 - Amounts Due From Members**

Amounts in \$000	2005	2004
Members' balances due	<b>10,213</b>	13,345
Less provision against balances which may not be wholly recoverable	<b>(3,281)</b>	(4,018)
	<b>6,932</b>	9,327

\$62.374 million (2004: \$58.805 million) of debited mutual premium does not become due until December 2005.

**Note 14 - Sundry Debtors**

Amounts in \$000	2005	2004
Reinsurance recoveries	<b>12,540</b>	1,412
Other P&I associations and insurance companies	<b>62,785</b>	1,116
Funds with representatives	<b>1,603</b>	1,485
Claims recoverable from Members and third parties	<b>5,065</b>	6,397
Claims advances and other balances	<b>2,435</b>	1,457
	<b>84,428</b>	11,867

Other P&I associations and insurance companies in 2005 includes the cumulative accrued premium of \$55.200 million 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.



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

Amounts in \$000	2005	2004
Closed policy years	<b>292,519</b>	256,309
Open policy years		
2004	<b>238,168</b>	-
2003	<b>119,143</b>	211,759
2002	<b>109,463</b>	176,441
2001	-	88,205
	<b>759,293</b>	732,714
Gross outstanding claims	<b>936,929</b>	878,987
Reinsurance recoveries	<b>(177,636)</b>	(146,273)
Net outstanding claims (above)	<b>759,293</b>	732,714

The total of outstanding claims of \$937 million includes a forecast of unreported claims of \$268 million on open and closed policy years and an estimate of \$42 million for future claims management costs. The reinsurance recoveries include \$67 million under the International Group's Pooling Agreement, and \$111 million under the Group's excess of loss reinsurance contract.

**Note 16 - Creditors**

Amounts in \$000	2005	2004
Reinsurance premiums	<b>7,518</b>	4,234
Members' balances	<b>605</b>	653
Others	<b>5,866</b>	13,214
	<b>13,989</b>	18,101

**Note 17 - Reserves**

Amounts in \$000	2005	2004
Open policy years:		
2004	<b>(90,928)</b>	-
2003	<b>(11,582)</b>	(50,645)
2002	<b>(108,950)</b>	(122,918)
2001	-	(74,929)
	<b>(211,460)</b>	(248,492)
Contingency Account	<b>305,256</b>	360,699
Catastrophe reserve	<b>51,793</b>	53,908
US Oil Pollution AP reserve	<b>49,710</b>	45,569
Reinsurance Retention reserve	<b>10,914</b>	7,750
	<b>206,213</b>	219,434

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 \$41m 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, 2005, the ratio of 10.85 per cent has been calculated in accordance with the Schedule and the guidelines issued by the International Group and is consistent with the relevant financial statements.

This represents a slight increase over last year's five year ratio with the comparatively lower investment income offsetting the increased average annual premium in this year's five year calculation. The increase in operating expenses during the 2005 year (see Note 7) reflects the cost of additional legal and professional advice associated with the increased burden of financial and regulatory compliance. Reported expenditure has been further inflated by a near 10 per cent currency depreciation, with the US dollar having remained weak against sterling throughout the financial year. The ratio for the 2005 year was higher than 2004 at 11.00 per cent with the decreased investment income reducing the formula denominator (see Notes 4 and 8).

Note 20 - Exchange Rates

The following rates of exchange were applicable at 20th February, 2005:

	2005 \$1 Equals:	2004 \$1 Equals:
Canadian dollar	1.2295	1.3455
Japanese yen	105.745	108.855
Euro	0.7653	0.7954
Norwegian krone	6.3413	6.9984
Sterling	0.5279	0.5348
Swedish krona	6.9651	7.3068
Swiss franc	1.1829	1.2550

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