UK P&I CLUB

Supplementary Premium

Questions and Answers

Q1. Why supplementary premium?

A. The UK Club incurred sizeable operating deficits in the years ending February 2007 and 2008 and the Club will almost certainly have nil or negative investment income in the current financial year. In the light of the combined drain on the Club's balance sheet, the Board has decided to rectify the deficit in the policy years which caused the losses rather than intentionally shift the burden to future years in a most uncertain investment climate.

Q2. Why now?

A. The Club considers its call requirements as part of its financial planning and general increase discussions. The factors leading to the decision to levy supplementary premium are present now. It is possible that both the investment and claims climate could be significantly different by the year end, but the Board preferred to act on the basis of current expectations and not on future hopes.

Q3. Why go back to 2006?

A. A supplementary premium is levied with respect to open policy years. Both the 2006 and 2007 policy year deficits were characterised by exceptionally high Pool claims. It would not be equitable to levy a call on a single policy year as all the open years in deficit contribute to the current financial position.

Q4. Why so much?

A. The Club has made a decision on the level of supplementary premium based on the finances of the Club at present. The size of the supplementary premium has been set to minimise the deficits in the 2006 and 2007 Policy Years as currently forecast. The supplementary premium on the 2008 Policy Year is an estimate which will be reviewed as the year develops, with a view to a decision by the Board in October 2009 when the level of deficit can be assessed more accurately.

Q5. What has changed?

A. At the 20 August actuarial review the claims picture on the open policy years has deteriorated more than expected. In addition to the heavy cost of current open policy years, there has been unexpected deterioration on older, closed policy years arising from the cost of long tail personal injury claims. It would normally be expected that investment income will cover this underwriting deficit over time, but the current investment environment means that this has become unlikely. There is no indication that either the claims or investment environments will provide any respite in the short term. It is therefore prudent to make a supplementary premium to raise the base level of capital and avoid further erosion of free reserves.

Q6. Why didn't the Club just ask for a higher General Increase instead of supplementary premiums?

A. The Board resolved that every effort would be made to rate future years based on future risks and likely claims experience. If the Club could be certain of earning at well above a target level of +5% investment income the option might have existed to permit investment surpluses to support back year deficits. With both underwriting and likely investment deficits, the Board was given little option but to put the past years into balance.

Q7. Why a 12.5% general increase?

A. At some stage in the future, the Club would expect lower claims levels if there is a global recession which slows shipping activity. Despite predictive modelling, only actual experience after several elapsed policy years will provide a sound basis to judge if claim trends actually follow the market trends. Meantime the general increase has to be set with reference to the Club's expected outgoings in the forthcoming year.

Q8. Wasn't Hybrid Capital supposed to protect against supplementary premiums?

A No. The hybrid capital is there as additional solvency capital to prepare for Solvency 2, it was not intended as a fund to supplement premium, or absorb claims deterioration.

Q9. Future expectations of supplementary premium?

A. The decisions taken by the Board are intended to remove the need for any further supplementary premium.

Q10. Why can't investment income cover the deficits?

A. The Club anticipates it will have investment income in future years but cannot prudently project a positive return in the year which will end 20th February 2009. The Club has taken important steps as early as October 2007 to dramatically reduce equity exposure. The Club also matches currencies invested to major non-dollar liabilities. Despite these steps to cushion the Club from world market turmoil, it would be unrealistic to think that any investment portfolio could be insulated from the deep systemic shocks currently taking place.

Q11. Swiss Re contract?

A. The contract has operated successfully and after the current year has only one year of its 10 year duration remaining. The current risk transferred is for high level claims experience and it will not subsidise the absence of investment income in the year to 20th February 2008. The Club previously accrued reinsurance recoveries of $110 million on the contract and has a second risk transfer cover of $70 million should there be a series of high level losses over the relevant period The Club also benefits from other types of facultative reinsurances, such as in respect of charterers fixed premium business.

Q12. Pool Share?

A. The Club's share of the lower Pool has been coming down in recent years in line with the improving record. Despite this reduced proportion the Club estimates its contribution to the Pool in 2006 at $83 million and $70 million in 2007.

Q13. Does this mean we can expect supplementary premium in 2009 as well?

A. The measures are designed to restore the capital levels of the Club and, whilst unwelcome and a difficult decision for the Board, the Club is in a stronger position going forward. The 2009 general increase has been set with reference to the expected level of outgoings for the forthcoming year.

Q14. Why couldn't the Club wait and see if claims drop off when the shipping market cools? Wouldn't it be fairer to Members to wait and see what happens?

A. Failing to act and speculating that claims will immediately decline in lock step with freight markets would not be prudent. Based on historical patterns, some types of claims probably will moderate but the timing and quantum of any future fall in claims levels cannot be predicted with confidence.

Q15. Are the supplementary premiums a result of the Credit Crunch and the current financial crisis?

A. In part, yes, because the changes in global financial markets mean the Club may have negative investment income in the current financial year and considerable uncertainty exists around the prospects for 2009. However, the deficits that arose in 2006 and 2007 were results of heavy claims years.

Q16. When will the payment be due?

A. The supplementary premiums will be debited in November 2008 and due in March and June 2009.

Q17. The UK Club has been hit hard by Pool claims. Wasn't the Pool surcharge intended to deal with this problem?

A. The Pool surcharge levied for the 2008 Policy year was intended to deal with the anticipated Pool exposure for the 2008 policy year, based upon the historic levels of the Pool in 2006 and 2007. It therefore looked forward and not backwards. The current projection of the UK Club's exposure to the Pool (including its share of Hydra's exposure to the upper Pool and share of the first layer of the IG Reinsurance Contract) on the 2006 and 2007 policy years is $83 million and $70 million respectively. Pool claims represent 27% of the UK Club's 2006 total claims ultimate and 21% of the 2007 total claims ultimate. The UK Club has currently notified claims (net of the Club retention) on the Pool of $7 million for 2006 and $17 million for 2007. The 2009 acceptable loss ratio formula will include an allowance for the 2009 Pool cost at a similar level to that for 2008 (which took into account the Pool surcharge for that year).

Q18. Will the supplementary premiums be credited to my loss record for 2009 renewal purposes?

A. Yes. The renewal proposal will also take into account any adjustments for record and risk exposure after application of the general increase in the usual way.

Q19. What is the policy for assessing release calls?

A. In response to requests for clarification of the release calls policy announced in Circular 15/08, the Board has clarified and revised the formulae for assessing release calls which are now as follows:

2006 policy year
30% of mutual premium (being supplementary premium plus 10%).

2007 policy year
35% of mutual premium (being supplementary premium plus 10%) plus any outstanding instalments of mutual premium.

2008 policy year
35% of mutual premium (being estimated supplementary premium plus 15%) plus any outstanding instalments of mutual premium.

2009 policy year
25% of mutual premium plus any outstanding instalments of mutual premium.