

UK WAR RISKS 

Review of the Year

For the year ended 20 February 2011



UK WAR RISKS
IS MANAGED
BY **THOMAS
MILLER**

Chairman's Statement

In his closing remarks in last year's statement, my predecessor, Bob Crawford, advised of the loss of the Association's largest Member. It is therefore especially pleasing to be able to report that, despite this, the 2010 Policy Year generated a surplus for the Association, serving to strengthen its reserves further.

The fall in value of entered ships during the 2010 Policy Year, resulting from the above mentioned withdrawal, was offset by both the entries of new Members and deliveries of new ships to existing Members. In overall terms the number of entered ships consequently only decreased by a marginal amount. Following the decision to open the Club to an international Membership from February 2009, it is encouraging to note that new, internationally based Members have recognised the competitive rating, stability and strong service ethos that the Association offers and prides itself upon.

The Directors decided to change the reporting currency to US dollars from 20 February 2010. Whilst the Association remains domiciled in the UK and regulated by the FSA, the change from UK Sterling to US dollars reflects the fact that most of the Association's premium income is in dollars; as is the ship valuation currency of most of the Membership in common with much of the shipping industry. The majority of the Association's investments have been converted into US dollars dominated investments and cash.

Other financial developments in the year included continued preparation for the impending Solvency II regime, which is designed to provide extra reassurance to policyholders that insurance claims will be paid. The Association's reserves comfortably exceed the level of reserves that are estimated to be required under Solvency II and work will continue to ensure the Association will be fully compliant with the requirements of the regime.

The make up of the Board also changed this year. Following the retirements of Bob Crawford on 14 April 2010 and John Freeman on 20 February 2010, two new Directors, Hugh Scheffer and Philip Johnson, were appointed and I would like to take this opportunity to welcome them as Directors of the Association, as well as to thank Bob and John for their years of service as Members of the Board.

The last twelve months has regrettably seen the Somali piracy situation continue to be a major issue for the shipping industry. The pirates' area of operation increased yet further, with frequent reports of attacks well over 1,000nm from the Somali coast. As a result, the Indian Ocean Additional Premium area increased in size and now extends to include part of the Arabian Sea and the Gulf of Oman. The cost and duration of piracy incidents also increased.

One ship entered in the Association was attacked in the Indian Ocean and boarded by pirates. Fortunately, the crew were able to withdraw to a citadel which the pirates were unable to penetrate, leaving the ship before naval forces arrived to give assistance. The precautions taken by the owners and crew illustrate the importance of taking risk mitigation measures to deter piracy.

The summary of Best Management Practices ("BMP") to deter piracy, which the Association strongly endorses, remains an essential reference document for owners of ships transiting the Indian Ocean and Gulf of Aden Additional Premium ("AP") area. In June 2010, BMP3 was published, updating guidance given in the previous version of the document, to assist companies and ships in avoiding and deterring attacks by pirates. It includes sections on:

- Risk assessment;
- Typical attack profiles;
- Planning by companies and masters;
- Pre-transit and voyage planning;
- Defensive measures;
- In transit operations; and
- Steps to take if the ship is attacked or boarded.

A copy of BMP3 can be downloaded from the Association's website. It should be read and implemented by all Members of the Association intending any of their entered vessels to transit the Indian Ocean / Arabian Sea / Gulf of Aden / Gulf of Oman and Southern Red Sea AP areas.

Liaison with naval forces is an essential part of good management practice. Members should register with MSC-HOA as well as contacting UKMTO and MARLO as outlined in BMP3. Members should note that failure to implement BMP3 and/or a failure to register with MSC-HOA and UKMTO, could potentially affect their cover in the event of a claim.

Recent events in Egypt, Libya and other areas of the Middle East highlight the potential for geo-political instability. It remains to be seen what the outcome of these events will be, particularly with regard to Libya, which became an AP area with effect from 18 March 2011. Although there have been no attacks reported on shipping in these areas as yet, the potential for loss or damage to ships is ever present. There is thus an even more pressing need for high quality war risks insurance cover to respond should this change. The Association is well placed to respond to this need.

C.D. Wannell
Chairman

Market Review

Two of the prominent marine war risks issues during the 2010 Policy Year attracted considerable comment and coverage in the news and wider media. The activities of Somali pirates and the imposition of sanctions against Iranian interests were regularly featured in the trade and general news. Other countries were also affected by conflict or political instability.

During the 2010 Policy Year, however, Somalia was the issue that caused most concern. According to data provided by EU NAVFOR, the percentage of ships attacked by Somali pirates that were actually seized fell slightly during the 2010 Policy Year. However, the overall increase in the number of attacks meant that the number of ships seized in the 2010 Policy Year was more than in the 2009 Policy Year, despite the increased attention of naval forces.

The striking feature of pirate activity in 2010 was the range at which pirates were able to operate. By early December, pirate groups were active well over 1,000nm from the coast of Somalia and, in some cases, less than 300nm from India.

It was not surprising that, as a result, the Somalia / Yemen / Gulf of Aden / Indian Ocean transits Additional Premium Area was extended. In August 2010, the Southern Red Sea and Eritrea were added. With effect from January 2011, the area was extended further eastwards and northwards, so that it included parts of the Arabian Sea and the Gulf of Oman, as well as the Indian Ocean west of 75° east. Ships entered in the Association performed a total of 160 transits of the area during the year. Towards the end of the 2010 Policy Year, one entered ship was attacked in the Indian Ocean and boarded by pirates, believed to have been operating from a hijacked tanker, which they were using as a “mothership”. The owners had deployed razor wire and fire hoses to deter pirates who, nevertheless, boarded the ship. The crew had been prepared for a pirate attack and had in fact carried out a drill a few days before the attack took place. The entire crew withdrew to a citadel, which had been prepared on the engine room deck, from where control of the ship’s engines was maintained and the Master was able to communicate with the owners. The pirates abandoned the ship and the crew left the citadel once naval forces had attended and confirmed no pirates remained on board.

While there is no single action or procedure that will make a ship entirely secure against pirate attack, it is important for all owners to take appropriate steps to mitigate this risk. During the year, the third version of Best Management

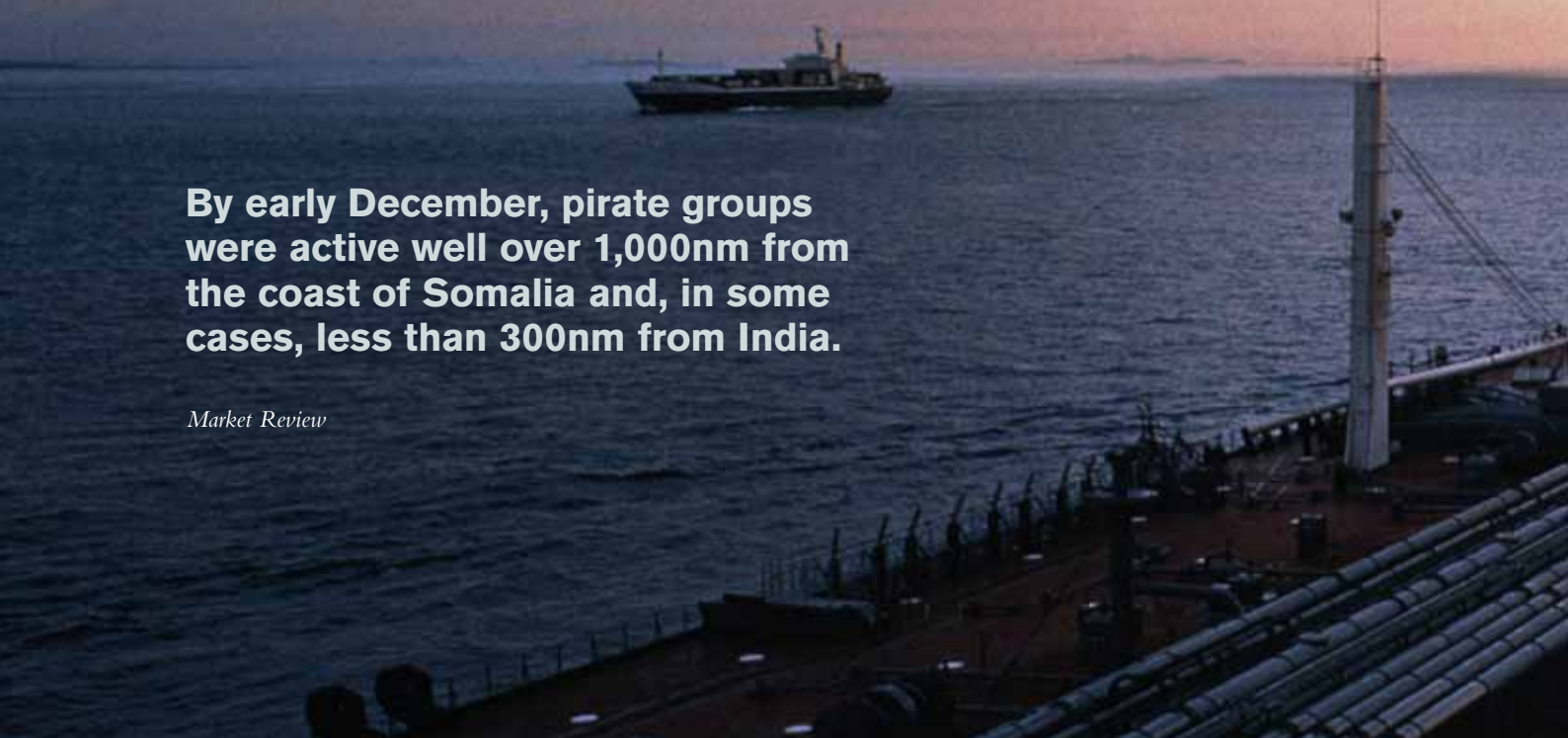
Practices (“BMP”) to deter piracy was published, updating the advice and guidance given in previous versions. Club circular C6-2010 drew BMP3 to the attention of the whole Membership, emphasising that the Association endorses BMP3 and strongly encourages Members to follow the recommendations in that document. Members were reminded that a failure to implement BMP3 and/or to liaise with naval forces through MSCHOA and UKMTO, could potentially affect cover in the event of a claim on the Association.

The issue of sanctions generally assumed a more prominent profile during the 2010 Policy Year. The EU, UK and US authorities all issued economic or trade sanctions, those targeting Iranian and Somali interests being the most relevant from the Association’s point of view. Some of the legislation prohibited the Association from providing insurance and paying claims in certain circumstances. As breaches of sanctions involved potential criminal liability, as well as damages to reputation, the Association took steps to comply, in order to protect the interests of the Association and also of the Membership as a whole. In July the US Comprehensive Iran Sanctions Accountability and Investment Act came into force.

With effect from August 2010, Members’ terms and conditions of insurance were made subject to a sanctions limitation and exclusion cause. At the Annual General Meeting held in October 2010, an amendment to the Rules was approved, incorporating the clause, which continues to apply from 20 February 2011 onwards. In December 2010, the Association provided Members with guidance on good practice regarding compliance with sanctions against Iran.

While the Gulf of Aden and Indian Ocean were the main focus for tension, there was conflict elsewhere during the year. Following a disputed presidential election in the Ivory Coast, tensions increased, leading to the possibility of intervention from the Economic Community of West African States. There was a marked increase of tension on the Korean peninsula following an exchange of fire between naval forces off the island of Yeon Pyeong. In January 2011, civilian demonstrations led to a change of government in Tunisia, followed by protests and demonstrations in Egypt, which led to the resignation of President Mubarak. The political turmoil did not, however, have a significant effect on trade or transport, with the Suez Canal remaining open and no maritime incidents being reported. These developments also increased a sense of instability in the Middle East.





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Market Review

Membership

Total Number of Ships Entered

872

Total Entered Value

\$17.6 billion

End of Year Reserves

\$29.5 million

For the year ended 20 February 2011

As the table below illustrates, both the total value and the number of ships entered in the Association was reduced during the year.

| Policy Year | 2010 | 2009 | 2008 |
|--|-------------|-------------|-------------|
| Number of ships | 872 | 890 | 877 |
| Total entered value (\$ billions) | 17.6 | 35.6 | 35.0 |

Since 20 February 2009, the Association has made mutual war risks insurance available to ship owners without any connection to the UK; the Association welcomes applications from companies from outside the UK without any previous connection to the Association. A number of new Members have joined the Association as a result. It also continues to provide UK registered ships with cover for risks arising out of war involving the UK (“Queen’s Enemy Risks”), which is reinsured by the UK Government.



Finances

There was a significant reduction in gross premium, following the decision of the Association's largest single Member not to renew for the 2010 Policy Year. There was, however, a corresponding reduction in reinsurance costs. After allowing for the 10% return of call given to renewing Members, the Advance Contribution income for the 2010 Policy Year amounted to \$1.25 million (27.7% of total premium written) with income from additional premiums amounting to \$3.26 million (72.3%). The increased proportion of additional premium income reflects the relatively large number of declarations made in respect of Gulf of Aden and Indian Ocean transits.

As a result, there was a small operating deficit for the year but, after allowing for investment income, there was a post tax surplus of \$3.06 million.

For the 2010 Policy Year, the Association increased the amount of brokerage paid. Brokerage on Advance Contributions, less any discounts for hull interest or restricted trading, was increased to 20%. Commission calculated on the same basis was paid to the Member where ships were entered directly. The increase in brokerage meant that acquisition and administration costs were not reduced in proportion to the reduction in gross premium written for the year, compared to the 2009 Policy Year.

The surplus for the 2010 Policy Year meant that the level of reserves increased to \$29.5 million, remaining comfortably above the current statutory solvency margin and leaving the Association very well positioned as regards the capital requirements of the Solvency II regime.

| All figures in \$000s | 2010 | 2009 |
|--|---------------|---------------|
| Gross premium written | 4,509 | 9,984 |
| Outward reinsurance premium | (3,756) | (7,332) |
| Other technical income | 248 | 207 |
| Acquisition and administration costs | (1,232) | (1,346) |
| Operating surplus | (231) | 1,513 |
| Net investment income / (expense) after tax | 3,287 | 2,338 |
| Surplus / (deficit) for the year (after tax) | 3,056 | 3,851 |
| Reserves at the year end | 29,549 | 26,493 |

The UK War Risks Club is an independent, mutual war risks association. We are not a class of another club and we concentrate exclusively on war risks insurance. As a mutual, we are run for our Members' benefit. We are UK shipping's biggest war risk insurer and we welcome Members from outside the UK. This combination makes us unique.

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