UK P&I CLUB

2018 Review of the Year

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

Contents

Financial Overview

2017 was a good year for the Club. The underwriting surplus of $29 million was the largest in recent years. This, when coupled with a strong investment return of over $43 million, delivered a total surplus of $72 million. After adjusting for forward currency contracts, the Free Reserves at 20 February 2018 increased by $82 million to $540 million.

Preserving underwriting discipline continues to be a key financial objective of the Club. The combined ratio for the year of 90% brings the average combined ratio for the last 5 years to 99%.

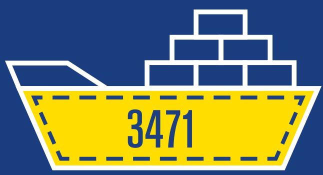
Premium rates across the market have steadily declined over recent years. Although financial year combined ratios have remained strong, the pressure on policy year results is increasing. It remains, therefore, essential that the Club stays focussed on maintaining breakeven underwriting.

At 20 February 2018 the Club continued to meet all capital targets and hold an appropriate buffer which is designed to avoid a breach of any target even in an extreme event.

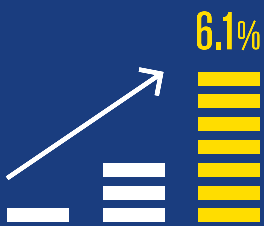
The Club holds Free Reserves of $540 million with a further $100 million in hybrid capital.

The Club has a strong track record of balanced underwriting.

139 million entered owned tonnage gt.



Number of ships over 1,500 gt.

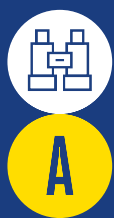


Investment return
(*including currency gains).

Combined ratio (excluding Currency gains in claims).

$540M

Free reserves $m.



STABLE
OUTLOOK

Standard and Poor's

Chairman's Statement

A strong result

This year the Club has produced a surplus of $72 million increasing the Free Reserve by $82 million to $540 million after adjustment for forward currency contracts. The addition of the Club's hybrid capital brings the Free Reserves and capital to $640 million. The surplus is a record for recent times and is the result of an excellent investment return of 6.1% (including currency gains) and good underwriting discipline with a combined ratio for the financial year of 90%. In last year's report I mentioned that one of the Club's most important objectives was to maintain underwriting discipline. This year's combined ratio means that we have achieved an average combined ratio for the last 5 years of 99%; an enviable record.

Underpinning these results has been a favourable claims environment. Once again, we experienced a decrease in claims frequency and a further reduction in the cost of our attritional claims (those claims costing less than $500,000). In fact the cost of the attritional claims was the lowest we had seen in 10 years. The cost of the larger claims above $500,000, which are much less predictable, was broadly in line with the experience of the past few years. In the Review of the Year which follows this statement we explore in a little more detail the changing pattern of our claims and the impact that this will have on how we underwrite, and how we service claims in the future. These factors together with the fundamental changes we have seen in the shipping market, all form part of our Corporate Plan review, on which I touch below.

Renewals and Pricing

For the second year in a row, the Board elected not to announce a general increase for all Members in advance of the renewal. We were able to do this because of the consistency of our underwriting results and the strength of our capital base.

As shipowners, the Board is very well aware of the state of the shipping market and the need for the Club to deliver the most cost-efficient P&I insurance to the Members. We were pleased to adopt this approach once again, but must be careful to avoid complacency. We know that there is underlying P&I claims inflation of around 4% per annum. This has not come through in the claims figures because we continue to enjoy a period of low claims frequency. While there is an element of good fortune in that result, it is not purely a matter of luck. The Members of the Club have worked hard on safety and loss prevention and these efforts are reflected in the results. We know, however that this is only part of the story and that increased economic activity could quickly reverse the claims frequency trend. For the time being however, the Club is extremely well placed to deal with any sudden correction.

There was considerable turnover of tonnage during the year leading up to the renewal. Tonnage entered into the Club during the year totalled 15.2 million gt and tonnage leaving the Club through sales and scrapping totalled 10.5 million gt. This represents the highest turnover in the Club's recent history. As everyone involved in shipping will be aware it was a very active year for M&A activity in shipping markets and as the results for the year show there was considerable activity in the S&P market. The renewal itself was tough but by the 20th February the tonnage in the Club was a little up on the tonnage at the end of last year at around 139 million gt. Premium on renewing business was down by around 4% reflecting market conditions and the improving loss records of the majority of the Members.

Nothing is agreed before everything is agreed

Brexit and its impact on the Club's ability to trade in Europe still looms large in our planning. Despite recent announcements the access of UK Financial Services firms to the EU single market remains uncertain. This means that we have had to continue with our Brexit plans to be able to insure our European Members. We are now moving to form an insurance company in the Netherlands, based in Rotterdam, which will also front for most of the other Thomas Miller managed businesses trading in Europe. This company will be ready for business at the end of March 2019 for the start of the planned "transition" period.

Industry Issues

The Club continues to monitor industry developments with a view to helping Members meet the impact of regulatory changes, especially where related to liability issues. In 2017, the Directors received reports amongst other matters on MLC, Sanctions, Piracy, the Ballast Water Management Convention, Air emissions, Overspill limits, the 1992 Conventions (IOPCF and CLC), and Russian domestic implementation of HNS. The common theme was identification of liability risk and of the extent to which it can be insured or mitigated.

A significant part of this work is carried out in collaboration with other members of the International Group of P&I Clubs (IG), where our Managers make a substantial contribution, chairing or serving on many IG subcommittees and working groups, and providing the current chairman of the IG Managers.

The UK Club has been a strong advocate of the mutual system and of the benefit of making the IG's collective expertise available to IMO and other bodies involved in shipping regulation and maritime law. This year the IG's arrangements were themselves the subject of an internal strategic review, conducted by the IG Managers with external facilitators, in a process that will identify and address any areas where change may be required to ensure that the system remains fit for purpose in an evolving shipping environment.

Looking forward

Last year I reported that we would be taking the opportunity in the coming year to review our strategy for the Club. We have come a long way in the past decade. Ten years ago, the Board embarked on a journey to strengthen the financial position of the Club. In 2008 the Club became the first in the International Group to raise capital in the financial markets, and in 2010 a comprehensive reinsurance programme enhanced stability in the Club's underwriting results. After nearly ten years at breakeven underwriting the financial strength of the Club today is amongst the best in the industry. Over that period the Club has developed an internal model which has regulatory approval for modelling of underwriting risks. The model has enabled us to develop a reinsurance programme which is one of the most comprehensive in the market. It also enables analysis of risks specifically relating to Club business, which in turn delivers a solvency capital requirement approximately $75 million below that calculated by the more general standard factors. In looking at our plan for the next five years we were very conscious that many of the challenges since the financial crash of 2008 remain today. We need to maintain underwriting discipline and to enhance our already strong service offering to the Club's Members.

We have new challenges such as Brexit and as new technology enters the shipping market and need to make sure that we can adapt the Club's core product to meet the new challenges.

In addition to looking to improve our service and maintaining the capital strength of the Club, we want to put particular emphasis on promoting safety and developing market-leading risk management and loss prevention tools to support our Members' own loss prevention programmes. In looking at the strategy, we also reaffirmed our conviction that scale delivers value. As a result we will continue to seek opportunities for merger or acquisition, where the combination with another P&I club would produce value for the Members of both clubs.

150 anniversary

Next year will mark the 150th anniversary of the Club. We are planning a number ways to mark this significant event and shortly after the publication of financial statements we will be announcing details of an exciting project which we hope will engage the next generation of seafarers and shore staff of our Members.

People

This year saw the retirement of two of the Club's Deputy Chairmen, Dr Ottmar Gast and Mr Masamichi Morooka. Highly respected individuals in their respective sectors of the shipping industry, these gentlemen have made significant contributions during their time on the Board and we thank them for their guidance and support. We also thank Captain Nilson Nunes, who retired from the Members' Committee in October 2017, for his commitment to the work of that Committee and the Club more widely.

In May 2017 Niko Schües and Paul Wogan were appointed to join Nicholas Inglessis as Deputy Chairmen. The Deputy Chairmen fulfil an integral part of the governance of the Club supporting the Chairman, Boards, and Committees. At our October AGM we were pleased to welcome to the Members' Committee: Captain H. Boudia of Hyproc Shipping Company, Mr R.F. Figueiró of Transpetro and Mr Y. Higurashi of NYK Line.

As part of the Club's long-term management succession planning, Hugo Wynn-Williams will step down as CEO at the end of May and be succeeded by Andrew Taylor, currently the Club CFO. Hugo, who has been CEO since 2004, will not be lost to the UK Club. In his role as Chairman of the Thomas Miller group and Chairman of the Thomas Miller P&I management subsidiary, he will continue to be actively involved in Club affairs.

Hugo's wealth of experience has been invaluable and he has been instrumental in getting the Club to the very healthy financial position it is in today. We thank Hugo for his outstanding contribution.

Andrew has been involved with the business of the P&I Club since he joined Thomas Miller in 2007, and became Club CFO in 2014. More recently, Andrew has been closely involved with the development and implementation of the Club's future strategy and I am confident that the Club is in good hands for the future.

In conclusion

This will be my last Chairman's Statement as I will be completing my five year tenure at the AGM in October 2018. In the past five years we have continued to make excellent progress building on the work led by my predecessor, Dino Caroussis. The Club's free reserves have increased by almost $150 million and the Club tonnage has grown by 20 million gt; we have gained approval for our internal model, and placed even greater emphasis on our service to our Members by enhancing our risk management and loss prevention advice.

We could not have made the advances in the development of our Club without the contributions made by my fellow Directors and the close cooperation we have enjoyed with the Managers of the Club. I would like to take this opportunity to thank them all for their support and advice during my tenure. One of the most satisfying elements of my role as Chairman has been to witness the development of the relationship between the Board and the Managers which has evolved into a market leading team. In these days of enhanced regulatory supervision and the need to focus on understanding our risk and enhancing our capital, it is important that we do not lose sight of our overriding objective which is to provide a first class service to our Members. This has guided me over the past five years and I have no doubt that my successor will be equally committed to that same goal.

Alan Olivier
Chairman

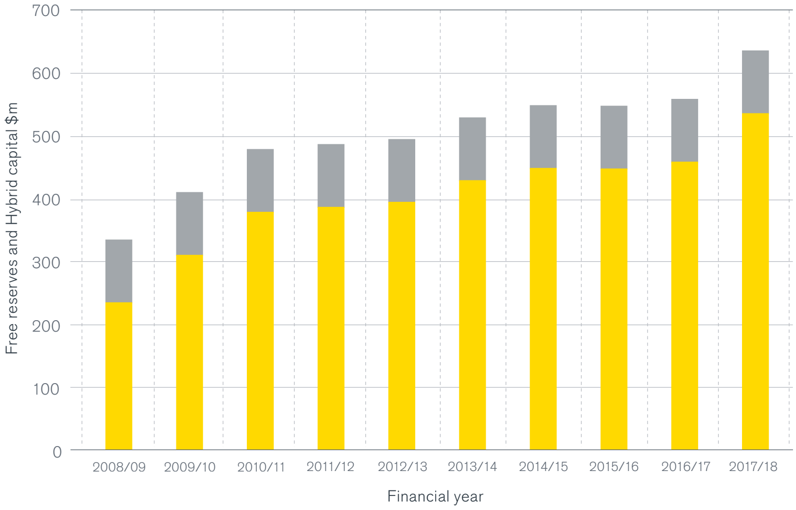
Financial Highlights

The Club holds Free reserves of $540 million with a further $100 million in hybrid capital.

Capital
Free reserves and hybrid capital for financial years 2009-2018

- Free reserves increased by $82 million to $540 million in 2017/18 with a further $100 million in hybrid capital.
- Capital sufficiency remains AAA on the S&P capital model supporting an A stable rating.
- The Club has capital coverage of 200% over the Solvency II capital requirement.

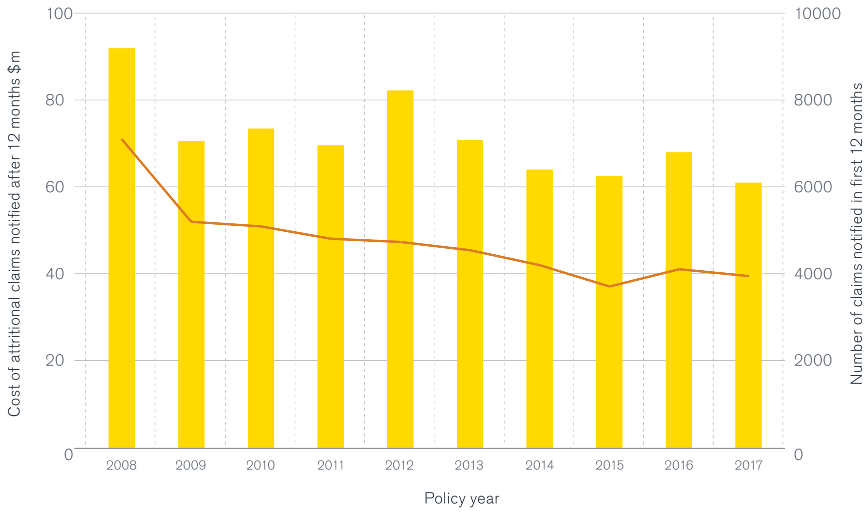
Free reserves
Hybrid capital



Claims Frequency
Attritional claims (<$0.5m) and claims frequency for policy years 2008-2017 at 12 months

- Claims frequency continues to fall.
- Claims inflation running at 4% but aggregate cost of attritional claims is falling.

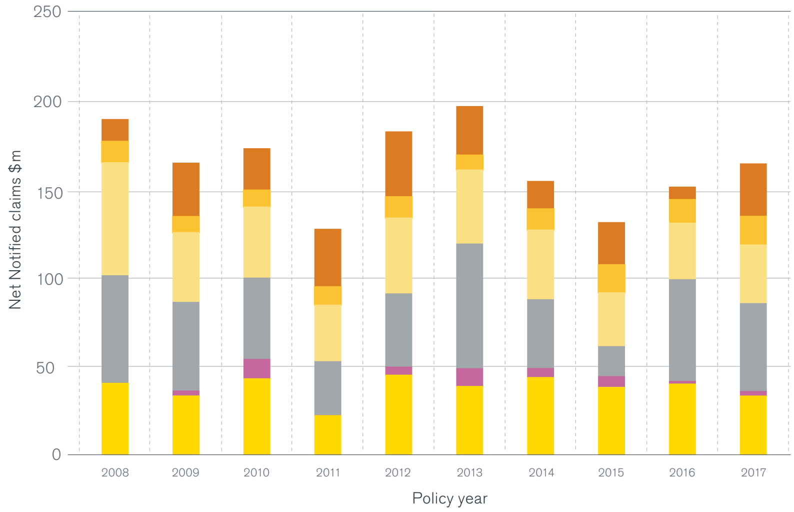
Cost
Number of claims notified



Claims Values
Total net notified claims for policy years 2008-2017 at 12 months by claims category

- The cost of claims on the 2017 policy year is in line with the average of previous years.
- Total cost of pool claims on the 2017 policy year was more expensive than the four previous years.
- The total cost of casualty and pool claims are the most variable and have a significant impact on the overall cost of a policy year.

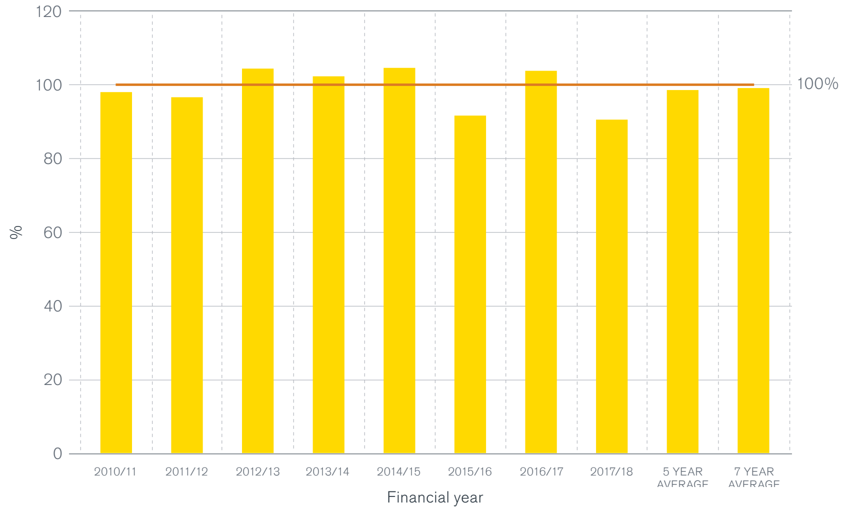
Cargo
Other
Casualty
Personal injury
Charterers
Pool



Combined ratio
Combined ratio for financial years 2010-2018

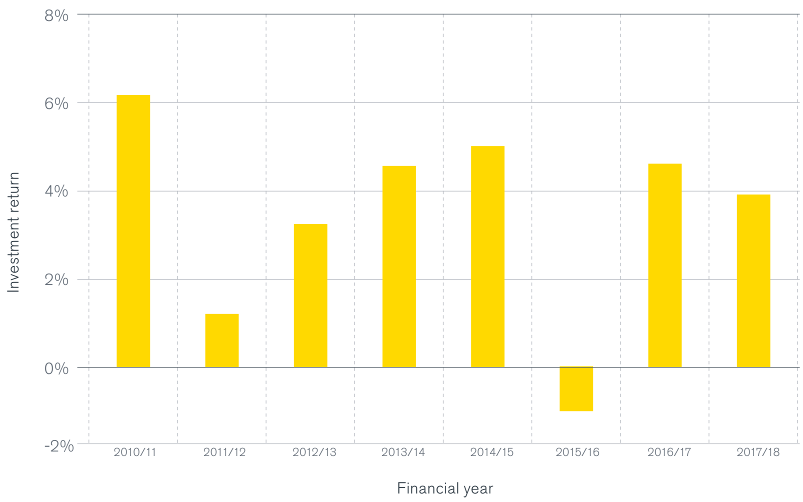
- The combined ratio on each financial year is at, or close to, the Club's breakeven target.
- Disciplined underwriting has been maintained.
- Continued reduction in rates has put recent policy years under considerable pressure.

Ratio
Target



Investment performance
Investment portfolio performance

- The investment portfolio returned 3.9% excluding currency gains.
- Strong return achieved from equity portfolio.
- Prudent portfolio positioning.



Underwriting

Underwriting

2017 is the eighth consecutive financial year with a combined ratio at or around the breakeven target. The average combined over the last five years, excluding the impact of currency, is 99%.

Maintaining breakeven underwriting is vital to the future financial health of the Club particularly in an environment where investment returns may not be available to absorb underwriting deficits.

The Club's strategy to preserve underwriting discipline encompasses risk selection, appropriate pricing, risk management and loss prevention.

Underwriting result for the financial year (excluding mutual premium discounts).

	Year to 20/02/2018	Year to 20/02/2017
Loss ratio	76.1%	89.7%
Expense ratio	14.4%	14.3%
Combined ratio (excluding currency movements within claims)	90.5%	104.0%
Currency*	7.1%	(3.6%)
Combined ratio (including currency movements within claims)	97.6%	100.4%

**All currency movements, including those relating to claims, are reported within "Foreign exchange gains" in the Consolidated Income Statement. The table shows the combined ratio both including and excluding the currency movements.*

Risk selection and growth objectives

By building critical mass, through increasing scale, the Club is better able to achieve its key objectives. Scale brings opportunity for greater breadth and depth to the service offering and reduces financial volatility.

However, the Club will not pursue new business at the expense of financial discipline and the breakeven underwriting target. The Club therefore selects risk carefully. Over the last twelve months, the Club has declined to quote on more than 9 million gt of potential new business because underwriting criteria was not met.

The underwriting criteria includes Know Your Client, credit and sanctions checks. Pre-entry inspections of one or more ships in the fleet are also often undertaken by the Club's dedicated team of risk assessors. All of these checks are required by our regulators and are targeted to ensure that the quality of membership entered into the Club is maintained at its current high standard.

Appropriate pricing

One of the Club's key targets is to call sufficient premium to cover claims and expenses incurred. Premium rates across the market have fallen considerably over the last five years. Breakeven underwriting on a financial year basis has been maintained for a number of years but pressure is increasing on the policy year result, which does not benefit from releases from prior year reserves.

Policy year results act as an early warning for future financial performance. The combined ratio on the 2017 policy year, based on ultimate claims projections after 12 months, of 110% is outside the Club's acceptable range despite a relatively favourable claims environment. At this stage, claims reserving for the 2017 policy year is prudent as the year is immature. Improvements to the 2017 policy year combined ratio might be anticipated as claims develop.

The Board continues to monitor the appropriateness of overall premium rates across the Club. Overall market premium rating for the 2018 policy year is again lower than the already tight rates achieved for the 2017 policy year. An underwriting deficit might therefore be expected for the 2018 policy year and it is important that premium rates stabilise and begin to recover across the market in the near future.

Safety and loss prevention

The Club continues to focus on building a leading loss prevention team to work with Members to mitigate the risk of loss at sea. The team includes seven Master Mariners and three Chief Engineers and an ex-member of the Royal Navy based in various offices around the world.

The team draws on previous experience at sea and information on recent Club claims experience to provide advice on technical and operational issues to Members at no additional cost.

The Club gathers significant information on the root causes of claims and one of the principal successes of the loss prevention team is ensuring that the wider membership are briefed of operational shortcomings on board ships so to avoid similar incidents. More recently the team has broadened the format of this feedback to provide accessible in depth analysis through the "Lessons Learnt" publications which will be further supplemented with training videos over the coming year.

Promoting safety and increasing risk awareness to the widest possible audience is another key objective of the Club. Reaching such an audience in a diverse industry requires imaginative initiatives.

Underwriting risk management and reinsurance

The Club's philosophy is to accept Members from a wide variety of trades and geographical locations, assuming entry criteria are met. The spread of risk protects the Club from decline in loss records within certain trades and provides the necessary flexibility to work with Members where records have deteriorated.

A particular focus recently has been the dry bulk Handysize and Handymax trades where many, though not all, Members have suffered adverse records. Correcting these records has been a focus of the last two renewal periods and there are signs of improvement. The loss record of the Club's container entry has, conversely, improved significantly over recent years.

A further risk management tool is the Club's comprehensive reinsurance programme. The programme was reviewed during 2016 and the revised structure brings enhanced cover at a significantly reduced premium. The premium saved improved the combined ratio for the year ending 20 February 2018 by 5 percentage points. The programme protects the Club in the event of an adverse claims year or a run of large claims in a single year.

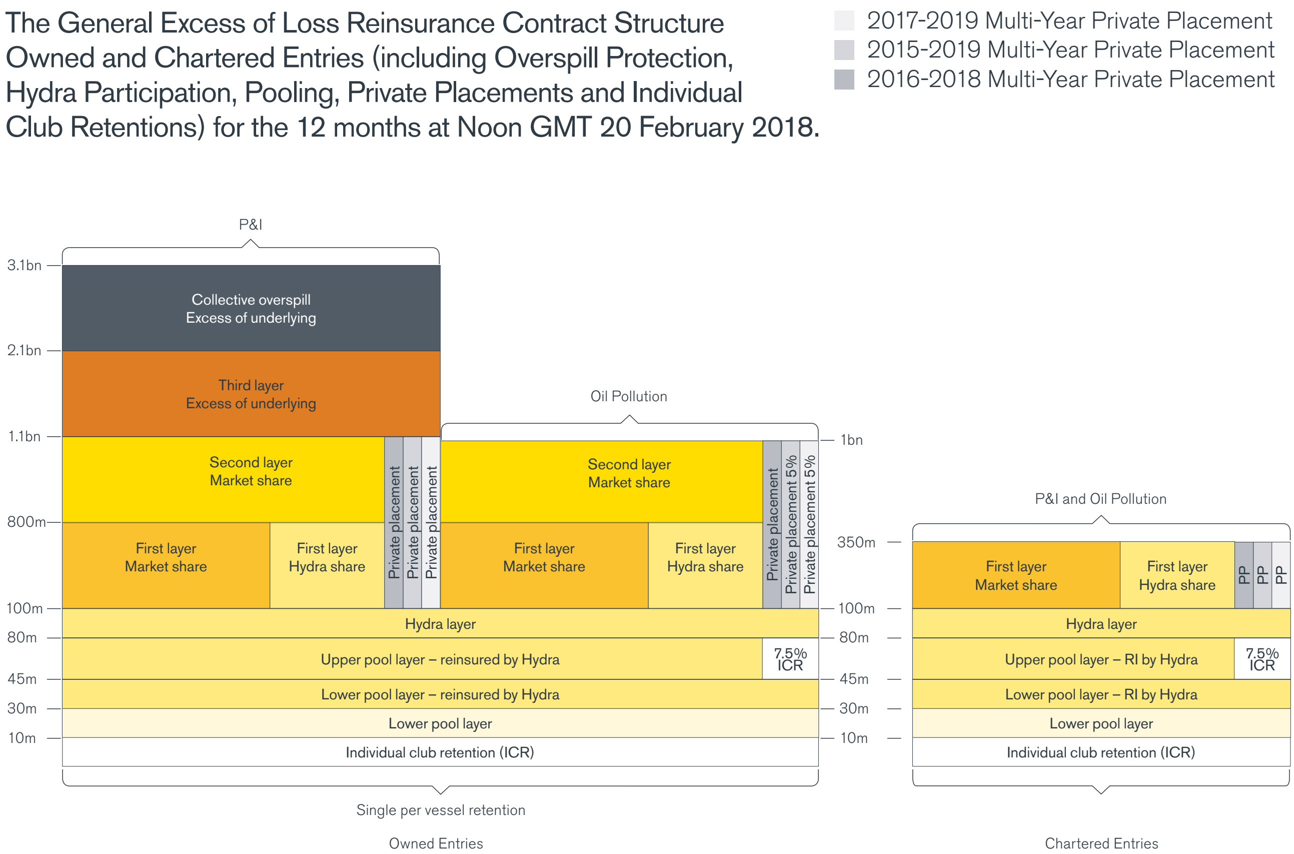
Pool and International Group reinsurance programme

The International Group reinsurance programme provides cover against the largest claims in the P&I market. The structure of the programme for the 2018 policy year is very similar to the previous year with the individual club retention of $10 million, the lower pool and the group reinsurance structure for claims exceeding $100 million remaining unchanged.

The individual club retention of 7.5% within the upper pool covers the layer from $50 million to $100 million (2017: $45 million to $80 million).

The International Group of P&I Associations

The General Excess of Loss Reinsurance Contract Structure Owned and Chartered Entries (including Overspill Protection, Hydra Participation, Pooling, Private Placements and Individual Club Retentions) for the 12 months at Noon GMT 20 February 2018.



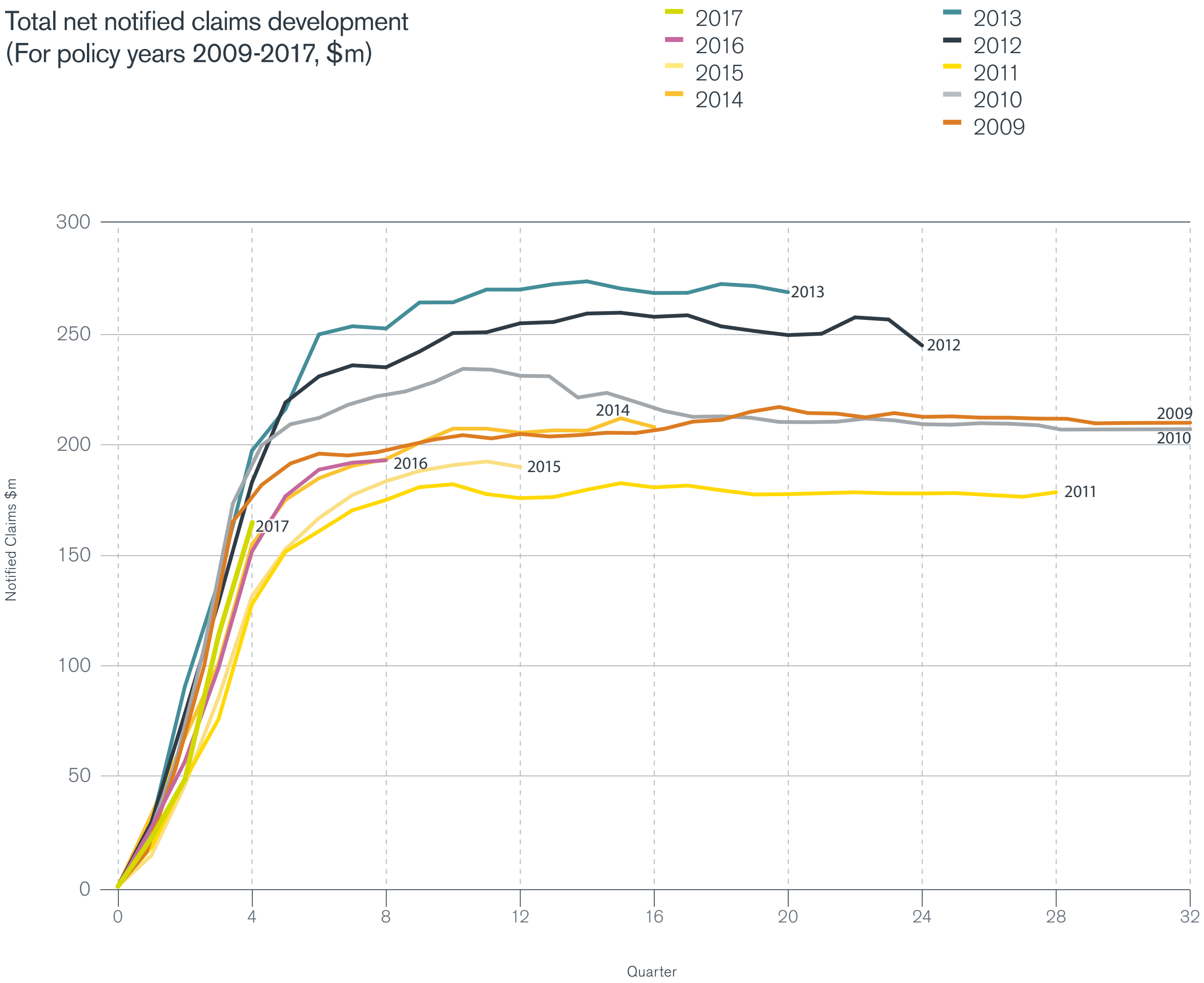
Claims

Overall claims development
Despite an increased cost of pool claims in 2017, the overall claims environment remained encouraging.

The Club experienced a decrease in claims frequency leading to one of the lowest cost years for attritional claims (those with a cost below $0.5 million) in the Club's recent history. The total cost of large claims, which are more variable, was broadly in line with previous years.

Prior policy years have developed favourably against prudent provisions. This has allowed a reduction in the provision for claims without diminishing the overall reserving confidence.

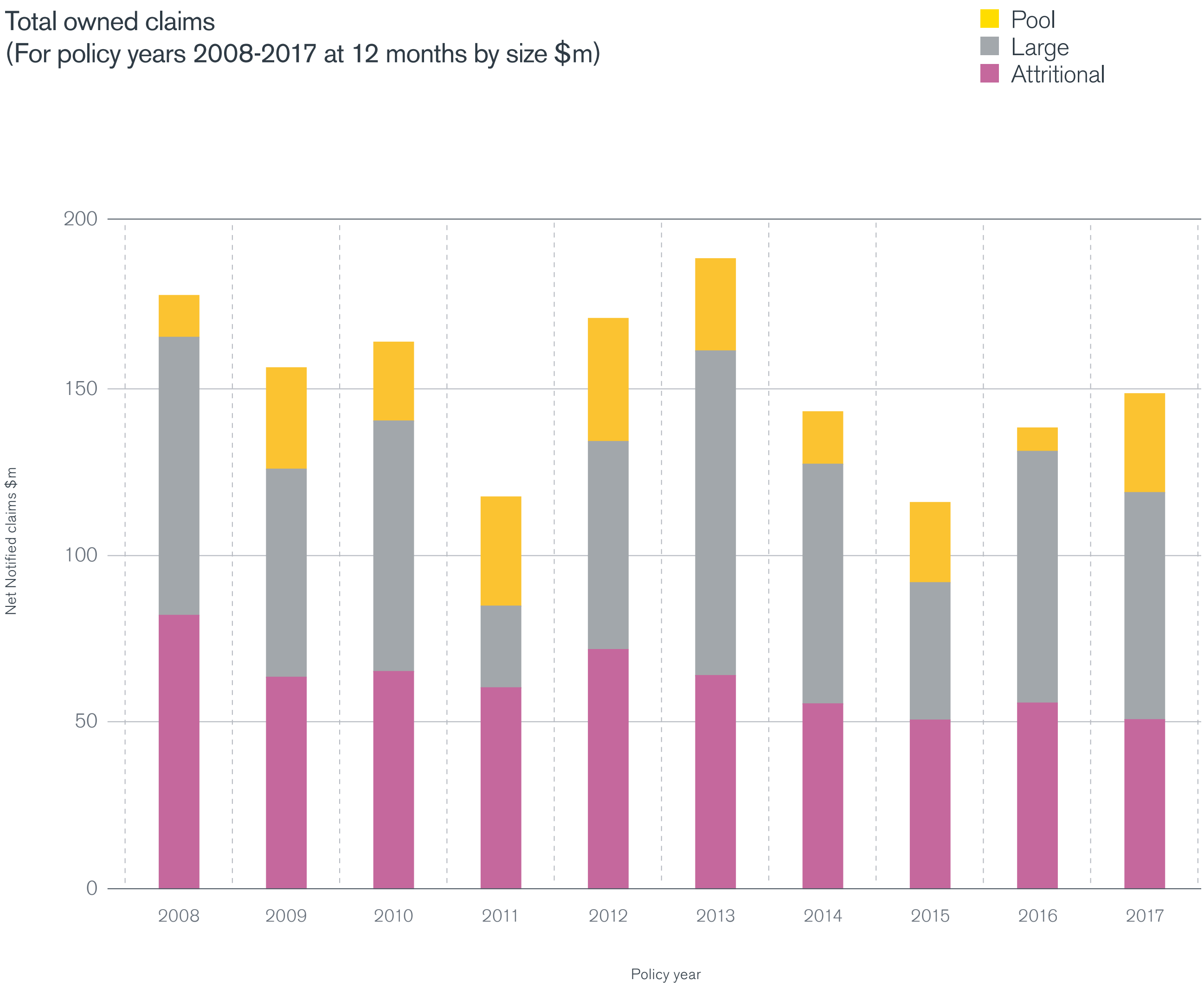
Total net notified claims development
(For policy years 2009-2017, $m)



Analysis by size of claim – a changing profile

The profile of claims notified to the Club has changed in recent years. Until the 2012 policy year the total cost of attritional claims outweighed the total cost of large claims. However, from 2013, the balance has changed and, with the exception of the 2015 policy year which suffered very few large claims, the cost of large claims outweighs that of the attritional claims.

Total owned claims
(For policy years 2008-2017 at 12 months by size $m)



Claims

The reason for a changing profile
A steady reduction in the number of claims notified to the Club, the vast majority of which are of low value, is the reason for this change in profile. The number of claims has fallen consistently since 2008 due to a number of factors, including the overall economic environment, the improved standards within the shipping industry, the Club's approach to risk selection, and the increase in deductibles taken by Members.

Attritional claims (<$0.5m) and claims frequency for policy years 2008-2017 at 12 months

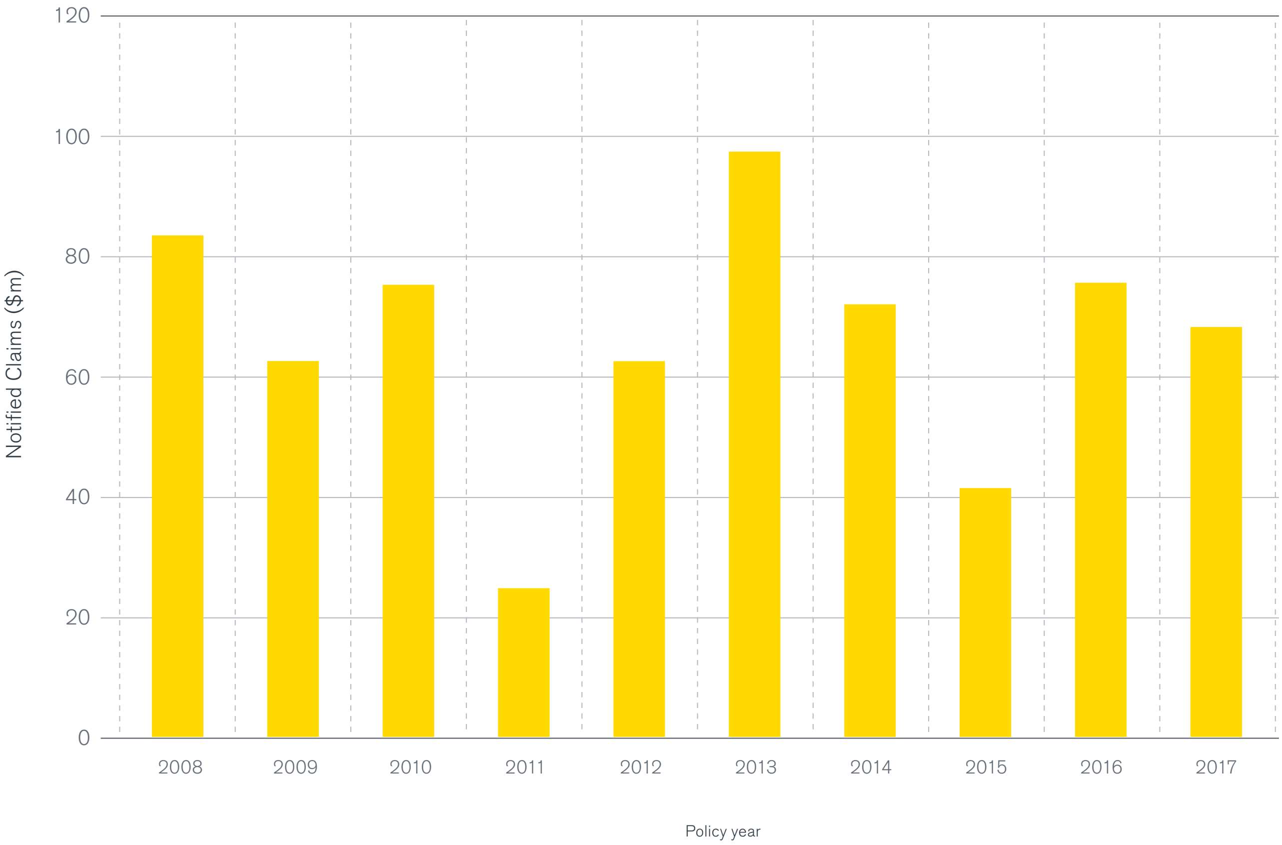
The volatility of large claims makes it difficult to discern trends within claims categories. Trends within attritional claims are more evident.

Since the 1998 policy year there has been a steady decline in the cost of casualty and cargo attritional claims. This decline reflects an ongoing reduction in the number of claims notified to the Club. People and cargo related claim numbers fell sharply following the slow-down in the world economy in 2009. Since then claims numbers have continued to decline steadily.

The reduction in cost of attritional claims over the last ten years has not been replicated in the cost of large claims. The cost of large claims is dependent on a small number of major incidents and therefore the profile is considerably more volatile from year to year.

The impact of a changing profile
Developments in the global economy more widely or the shipping market specifically may alter or reverse these trends. However the service demands on the Club are likely to change if the decline in attritional claims continues over an extended period of time. The P&I club of the future may handle fewer claims but each claim may be more significant and costly. Such a club would need to utilise underwriting techniques based on forward looking risk analysis rather than historic claims records and offer a service proposition focussed on larger incidents.

Large Claims (>$0.5m)
(For policy years 2008-2017 at 12 months, $m)



Claims

Case Study: The challenges of handling a large claim

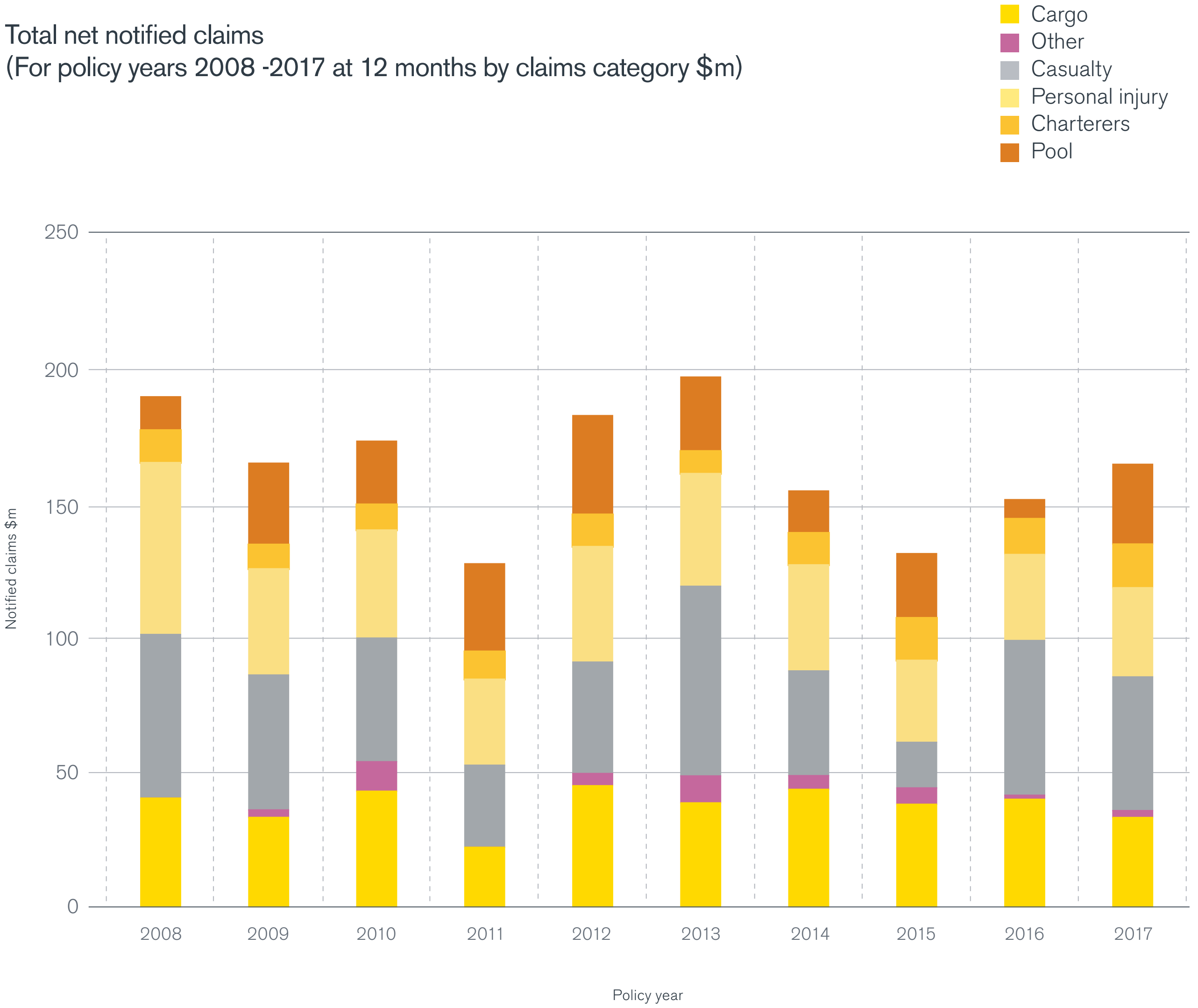
The challenge to the Club of the changing claims profile can best be demonstrated in the stark yearly contrast in the Club's large claims experience over the last 8 years. In 2011 after twelve months, large claims accounted for just over $25 million of the Club's claims experience that year. In 2013, the same period brought just under $100 million in large claims, a near fourfold increase.

The volatility continued in 2017, bringing with it an extraordinary spate of six large collisions off Singapore involving Members of the Club in the first six months of 2017 – all of which involve property and liability claims running into several million dollars. Two of the collisions happened within two miles and three days of each other. Beyond the obvious property damage, some of the incidents resulted in loss of life and pollution.

The Club's claim's staff includes several experienced casualty investigators. Thirty years ago, a steady stream of casualties ensured an equally steady supply of work. Cases were investigated at length, with the facts of each incident sometimes talking months to emerge, with the claims handling strategy usually evolving in a measured manner.

Today, technical advances such as AIS and VDR mean that what happened in the immediate build up to an incident is often known within days, sometimes hours, and the aftermath is often played out in front of the world's media. Such public interest also demands swift resolution. The feast and famine nature of these large cases requires the Club to maintain its pre-eminent experience, to be light on its feet and to be able swiftly to deploy the best team of claims handlers in the right place and at the right time, drawing on the Club's unrivalled worldwide network of offices.

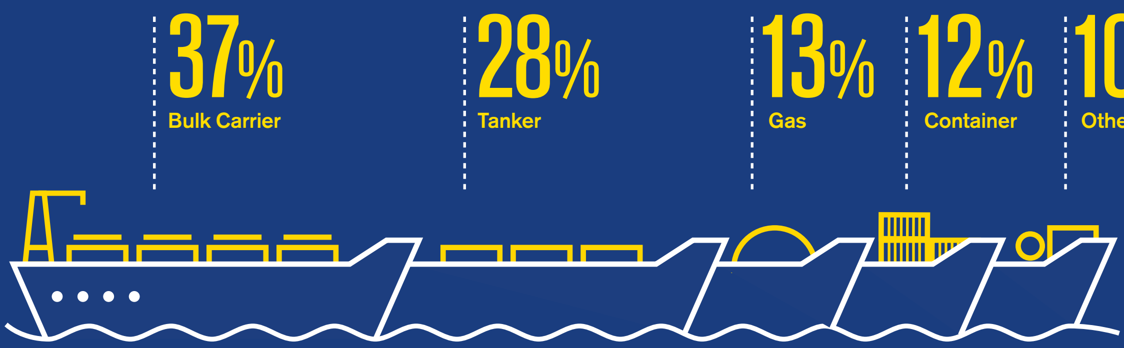
Total net notified claims
(For policy years 2008 -2017 at 12 months by claims category $m)



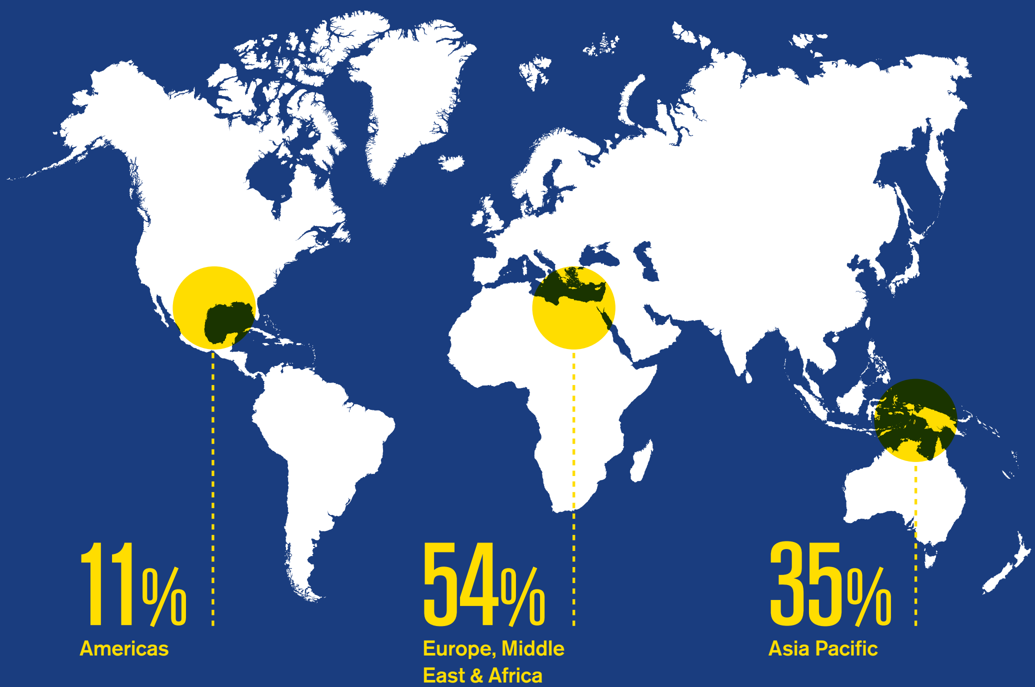
Fleet Profile

Owned fleet – figures as at 20 February 2018

Sector by share of total gt



Geographic regions



Industry Issues

The Club continually monitors shipping industry developments to assess implications for maritime liability and insurance, with information and guidance being developed for the benefit of Members in consultation with the Members' Committee and Boards.

As usual, a significant part of this work in 2017 was carried out in collaboration with other members of the International Group of P&I Clubs (IG), where UK Club's Managers continue to make a substantial contribution, chairing or serving on many IG subcommittees and working groups, and providing the current chairman of the IG Managers.

The UK Club has been a strong advocate of the mutual system and of the benefit of making the IG's collective expertise available to IMO and other bodies involved in regulation of shipping and development of maritime law. In 2017, the IG's arrangements were themselves the subject of internal strategic review by the IG Managers, in an exercise which will identify and address any areas where change may be required to ensure that the system remains fit for purpose in an evolving shipping environment.

Maritime Labour Convention (MLC)

A number of reports were made to the Board regarding the financial security requirements of the Maritime Labour Convention under which, since January 2017, Members have had to evidence financial security in respect of their crew responsibilities, in relation to traditional P&I risks of crew injury, illness, or death, and in respect of wages and repatriation in the event of abandonment. The Club provides the two financial security certificates required for each relevant vessel.

As the new system bedded down, queries arose early in 2017 regarding the identity of the party named in the financial security certificate. Clubs can only name an assured (which will be the registered owner wherever possible), but a different entity not necessarily insured under the P&I policy (e.g. an ISM manager), is sometimes named in other MLC documentation such as the Document of Maritime Labour Compliance and the flag state Maritime Labour Certificate. A small number of port state control (PSC) authorities had treated such differences as 'non-conformities'. Following discussion with the Clubs, several Flag States issued helpful public circulars to make clear that a difference in names used in these certificates should not be regarded as a problem; no further concerns were reported from PSC authorities.

Early in the year, a claim submitted by the crew of a vessel in another IG club raised two issues of principle. The claim was in respect of wages unpaid for two months before the financial security requirement came into force, and was made by crew who remained employed by and in contact with the ship owner. It was agreed that since the MLC financial security is designed to respond to a liability crystallised by the existence of a two month prior period of default, a claim for arrears of wages made during the period of validity of a financial security certificate could be covered even if the arrears was accrued prior to the validity of the certificate. Regarding the second issue, it was noted that liability to pay overdue wages under the financial security certificate arises only within provisions that envisage repatriation as a remedy for abandonment. The liability of the provider of financial security would therefore not be engaged where crew wish to continue working on board and do not agree to be repatriated.

A report was also made to the Members' Committee on a proposal from the International Transport Workers Federation (ITF) for an additional new security certificate to cover the risk that crew who are captured by pirates may remain unpaid for periods exceeding the four month cap under the existing financial security arrangements. It was agreed that such incidents are too rare to support the creation of a separate system of financial security and that a better course would be to extend the security under the existing system if necessary.

Sanctions

Following the election of Donald Trump in January 2017, a review was conducted with the Board of how the risk of a sanctions related shortfall in recovery from the IG's reinsurances had been addressed to date and what risks might arise in future having regard to uncertainties about the long term future of the JCPOA (Joint Comprehensive Plan of Action) agreement with Iran. Such shortfalls would arise where an IG Club outside the US pays a claim with an Iranian nexus, for which reinsurance is provided in part by companies that are unable to pay their share because they are subject to US primary sanctions.

Steps had been taken to reduce the risk of a sanctions related shortfall by removing US domiciled reinsurers from the Group Excess Loss contract. However, about 40% of the contract capacity was provided by European insurers with US parent companies who relied upon the US General Licence H to permit their subsidiaries to reinsure Iran related claims.

Under arrangements (first introduced in 2011) a sanctions related shortfall in reinsurance recovery could fall back on the insured Member, unless either (i) the claim arose under a blue card or other approved certificate (for which the IG operates a Supplemental Pool) or (ii) the claim does not arise under a blue card, but there is agreement on the part of three fourths of Clubs to pool the shortfall on a discretionary basis. The 'ALPINE ETERNITY' case in 2015 had illustrated that clubs were willing to exercise that discretion positively where a shipowner found himself facing a shortfall in circumstances where the Iranian aspect of the risk arose as a result of fortuity (a collision).

The IG Sanctions Subcommittee had considered whether to recommend that Supplemental Pooling be extended to all reinsurance shortfalls arising from non-certificated sanctions risks. In the light of President Trump's public opposition to the JCPOA and the risk of General Licence H becoming ineffective, the Members Committee considered that such a recommendation would be imprudent and should be opposed. Most IG clubs took a similar view and the arrangements were therefore left unchanged.

Ballast Water Management Convention

At its October meeting, the Members' Committee received an update on the 2004 International Convention for the Control and Management of Ships' Ballast Water and Sediments (BWMC) which had entered into force on 8th September 2017, triggered by Finland's accession to the Convention a year earlier, bringing the tonnage of ratifying States above the threshold of 35% of world merchant tonnage.

The UK Club had participated with others in an IG Working Group during 2016 to study the legislation and assess its implications for P&I cover, having regard to potential liabilities for fines or environmental damage claims. The Club had been vocal in resisting proposals that new exclusions of cover might be necessary to encourage compliance with the Convention. Operational requirements of the Convention are challenging enough, without the additional worry of finding that P&I protection has been reduced. It was pleasing to report agreement in the IG that neither the Convention nor the USCG regulations would require amendment of existing Club Rules. Liabilities, including fines for inadvertently introducing ballast into the environment, arising from the accidental escape or discharge overboard of untreated ballast through a "faulty" approved system, remain capable of cover as of right. Cover for other fines relating to a breach of BWM requirements is available only on a discretionary basis, reflecting the position that had already existed in relation to any other deliberate discharges from an entered ship.

The Managers advised that almost 60 ballast water management systems had received either basic or type approval by IMO, and that the United States, which had its own ballast water management legislation, had also approved 6 systems for use. However, in the light of concerns about capacity and the difficulties of fitting approved systems to all ships within the Convention deadlines, the Members' Committee welcomed the news that the date for compliance with BWMC requirements had been postponed by two years for ships built before 8th September 2017, following a revised implementation schedule agreed by IMO's Marine Environmental Protection Committee (MEPC) in July 2017.

Air Emission update

The attention of Directors was drawn to regular reports regarding the ongoing issue of ships emissions control under Marpol Annex VI, which are provided on the Club's website and updated from time to time. It was noted that that there are 4 designated ECAs (Baltic Sea, North Sea, North America, US Caribbean Sea) where the Sox emission is limited at 0.10% m/m since 1st January 2015 and that the fuel oil standard (0.50% m/m) should become effective on 1st January 2020 (Resolution MEPC.280(70) for all other areas. It was also noted that with effect from September 2017 China had established three ECAs, the Yangtze River ECA, the Pearl River ECA and the Bohai ECA, where the SOx emission was limited at 0.5mm. The Directors were advised that as far as P&I cover was concerned, the most likely claim relating to air emissions would be fines imposed on the vessels for failure to comply with the applicable requirements. As for fines for any other type of deliberate discharge, cover was available at the discretion of the Directors, if they were satisfied that the Member in question had taken reasonable measures to prevent the event giving rise to the fines.

Capital Management

The Club's overriding aim is to hold sufficient capital to provide Members with first class financial security without the need to retain more of the Members' funds than necessary.

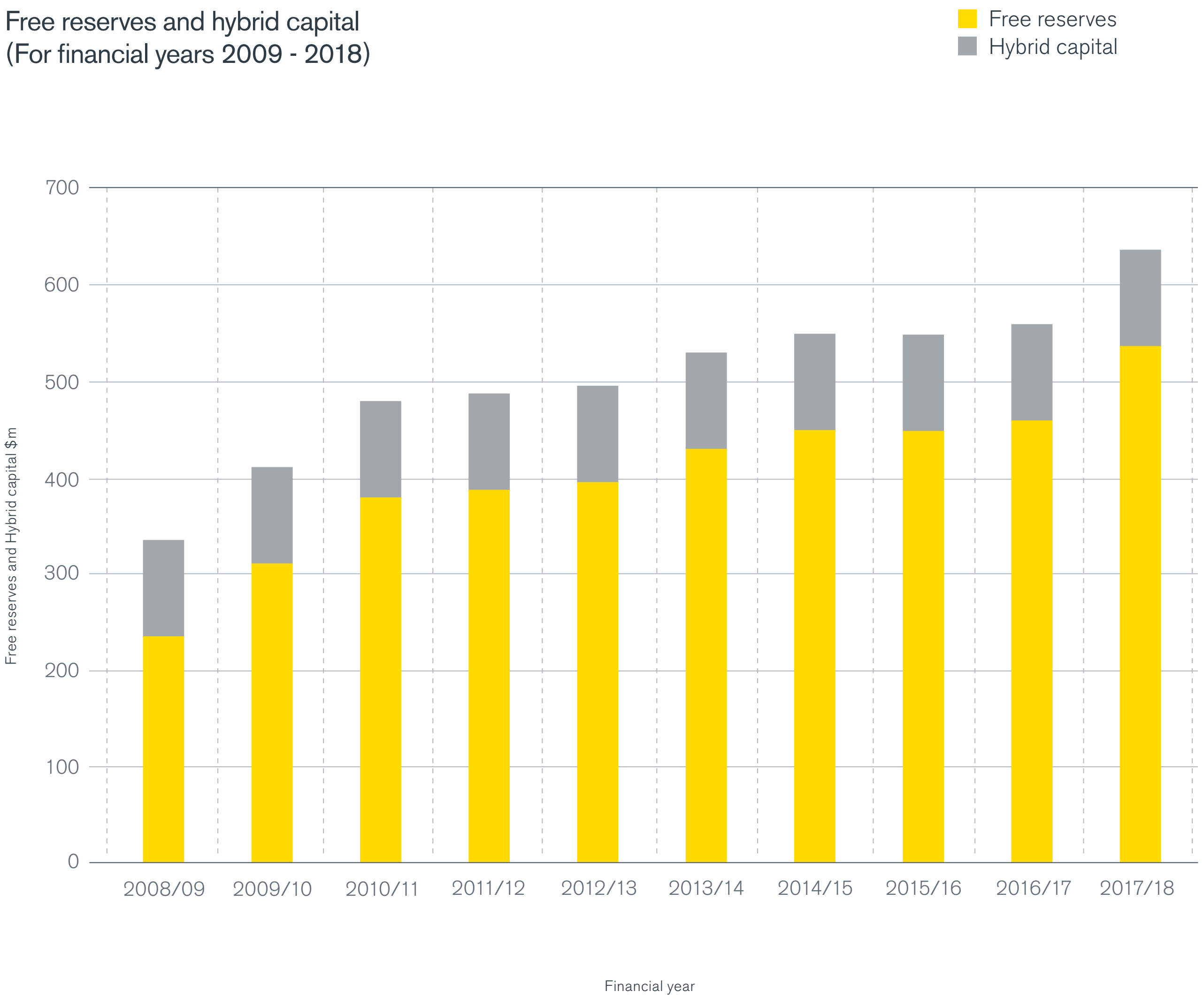
As part of this overall aim, the Club's key objectives are to maintain its A (stable) credit rating with S&P and to hold sufficient capital to meet regulatory requirements in all jurisdictions.

The Club's capital position exceeds all minimum capital targets, including appropriate buffers. The buffers are designed to protect the Club from breaching its capital targets following an extreme event.

Capital targets are determined by the risk accepted by the Club. The Club utilises risk management and sophisticated modelling techniques to identify, understand and mitigate the impact of extreme loss events. By utilising efficient risk mitigation techniques, such as reinsurance or asset allocation, capital targets are reduced.

To quantify the risk accepted by the Club, a sophisticated internal model has been developed. This model enables the Board to assess the capital impact of strategic decisions.

Free reserves and hybrid capital
(For financial years 2009 - 2018)



The model has been approved by the regulator for the calculation of the underwriting component of the group capital requirements for regulatory purposes under Solvency II. The model enables analysis of the risks specifically relating to Club business. This more accurate quantification of risk delivers a solvency capital requirement below that calculated by the more general standard factors.

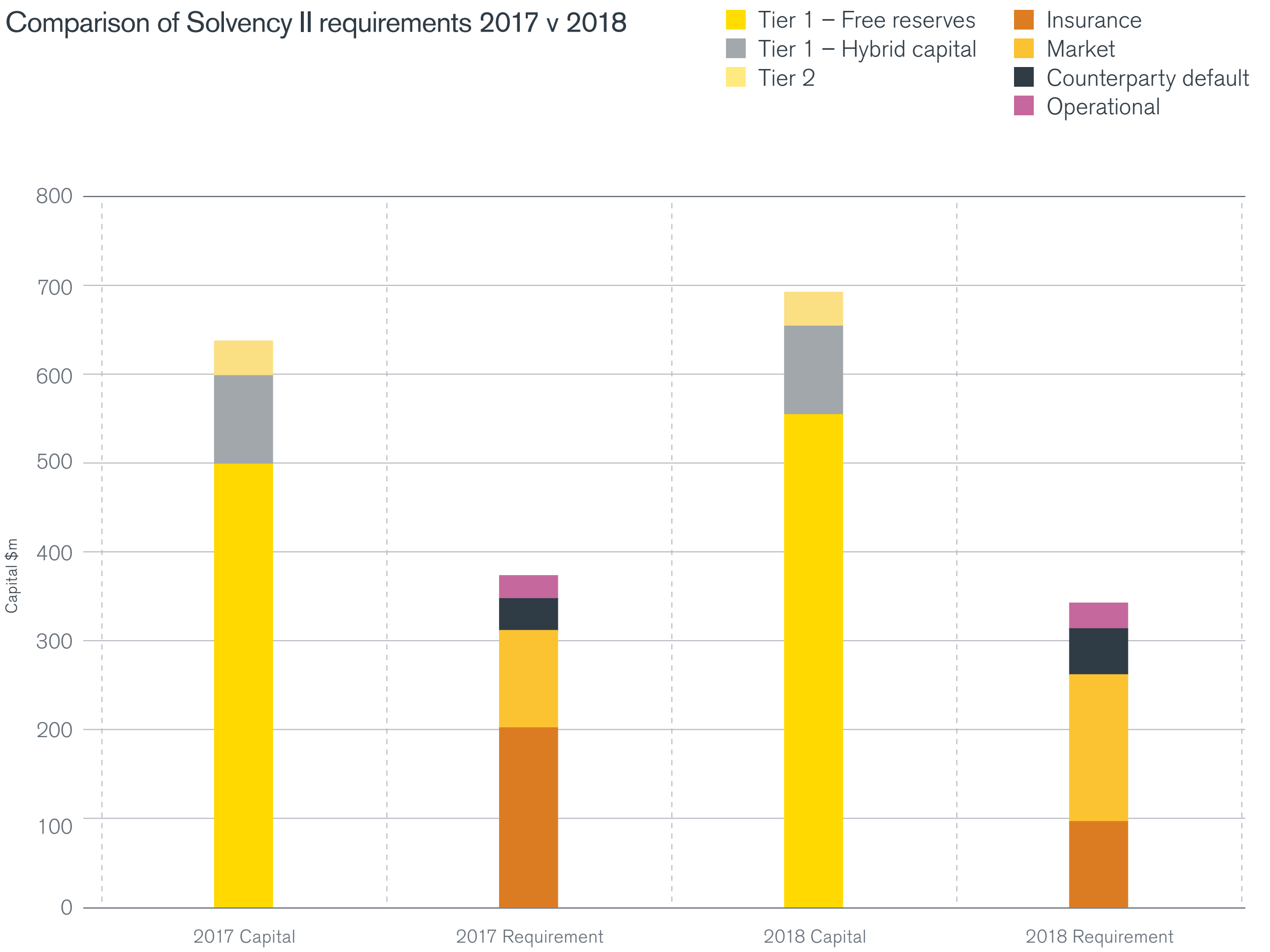
The full regulatory reporting under Solvency II was published for the first time in the summer of 2017. The Solvency and Financial Condition Report ("SFCR") provides information on various aspects of the Club including its solvency position. The following graph shows the coverage of regulatory capital requirements on a Solvency II valuation basis. In 2017, the standard factors were applied to calculate the group requirements whereas in 2018 the internal model has been used.

There are a number of levers available to the Club should capital coverage diminish. One potential lever is to reduce the capital requirement.

48% of the total capital requirement relates to market risk factors. The Club's equity investment holding has delivered high returns in recent years but also attracts a high capital charge of around 40-50%. A reduction in equity holding would significantly reduce the capital requirement though the likely reduction in investment return would intensify pressure to achieve a breakeven underwriting result.

The current capital position comfortably supports an equity investment holding of around 20% of the portfolio at the year end.

Comparison of Solvency II requirements 2017 v 2018

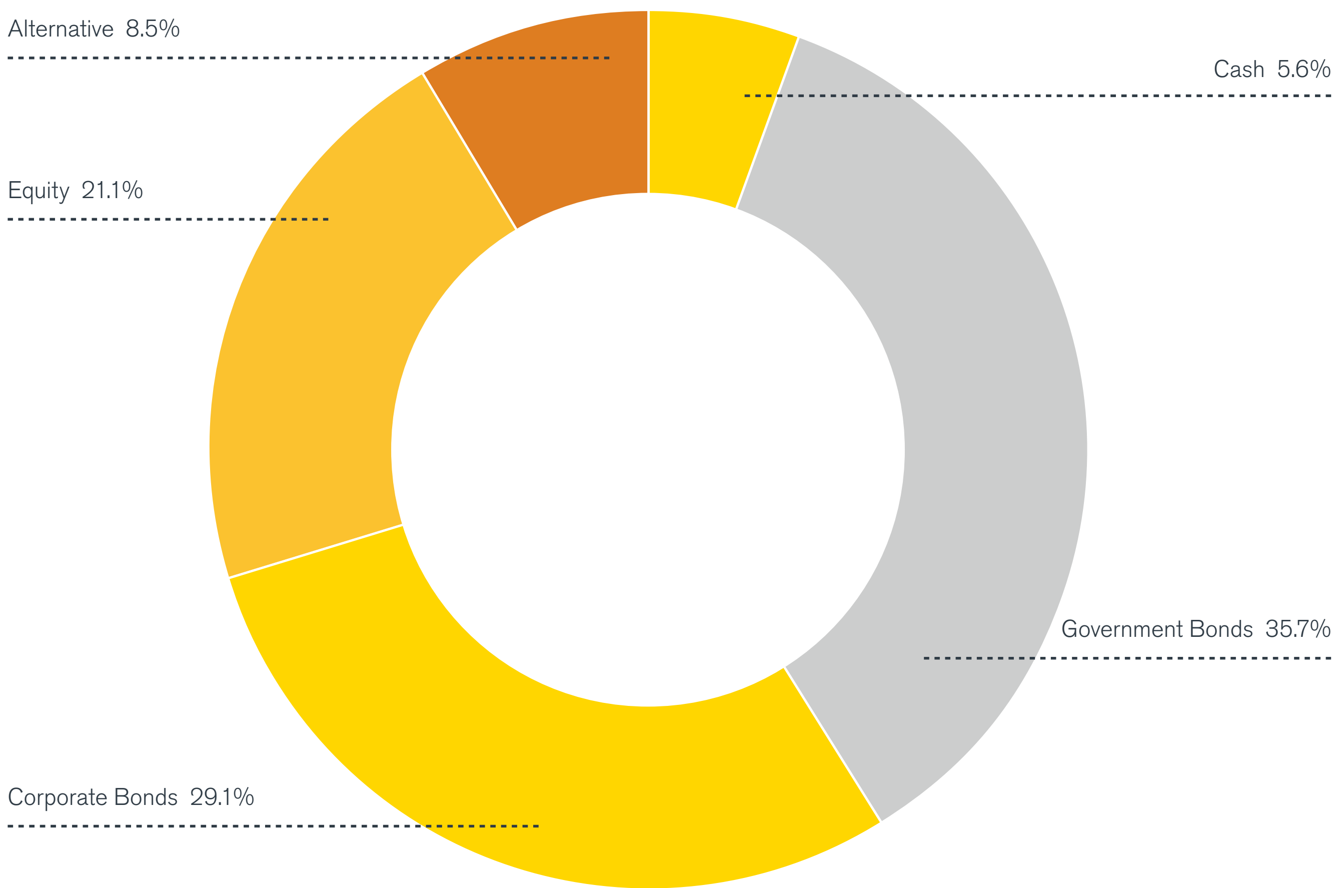


Investments

Economic Background and Investment Returns
The Club's investment portfolio performed strongly in the 2017 financial year as the backdrop of robust economic growth and supportive monetary policy helped to overcome concerns about geo-political uncertainty both in the UK and US.

The overall investment portfolio returned 3.9% excluding currency gains and 6.1% when currency gains are included. All component parts of the investment portfolio contributed positively to returns, led by another strong performance by the equity portfolio which returned over 19% for the year.

Investment Strategy
The Club's overarching investment strategy remains unchanged. The strategy focusses on maintaining a well-diversified portfolio, set within the risk appetite of the Club, which provides adequate liability cover while ensuring opportunities to maximise investment returns.



Looking Forward

During 2017, the Board took the opportunity to reconsider how trends in both the shipping and insurance markets might affect the Club in the future.

The investment return achieved for the year ended 20 February 2018 was extremely strong. However the general outlook for future return is likely to be more limited than Club has seen in the past. This places additional emphasis on a disciplined approach to underwriting to avoid pressure on the Club's capital.

Capital efficiency through risk mitigation techniques, based on a thorough understanding of risk, is increasingly important. Such techniques enable the Club to manage excessive risk but do not extinguish the need for disciplined underwriting.

A key part of disciplined underwriting is appropriate pricing of the risk accepted. New tools to determine appropriate pricing will be needed if the Club is exposed to fewer and larger claims. Where historically the Club could monitor risk through an historic claims record new techniques will be required if the claims throughput takes a different shape.

Another key element to disciplined underwriting is cost efficiency. The Club's aim is to provide market leading service to its Members. However the Club seeks to provide this service as efficiently as possible to avoid unnecessary strain on the combined ratio.

The service proposition will develop if the current trend towards larger claims continues. The number of claims related touch points between the Club and its Members may reduce but service more widely will be increasingly important.

One key area of the Club's service proposition is working with Members to prevent or mitigate the impact of losses. Improving safety at sea, early warning systems and crisis response is of vital importance to our Members and all those working on board ships. It also helps the Club to manage the risk of a growing importance of large claims. The Club's future plan puts greater emphasis on providing improved information and support to Members in respect of safety.

Developments in data and digital technology may offer additional opportunity to meet the demands of a number of these trends. Additional data sources may help the Club more accurately determine risk and changes to risk on a real time basis. Technology will also enable improved information flow from the Club to Members for the benefit of safety programmes and efficient transaction flows.

Finally, the Club will continue to invest in its people. The Club of the future will continue to need people of the highest calibre who are committed to the success of both the Club and its Members.

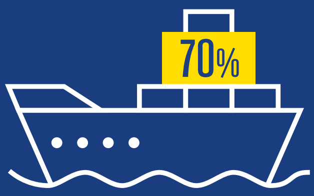
Management

UKP&I is managed by Thomas Miller, a group of specialist international insurance, professional services and investment businesses.

Thomas Miller managed transport businesses' annual premium income exceeds $700m.

TT Club insures 80% of the world's containers and 30% of the ports.

ITIC has over 2300 Members in more than 100 countries.



Hellenic War Risks insures over 70% of all Greek owned ships.

17 locations. 1 global guarantee. Wherever you are in the world, we will be there to ensure your best interests are secured.

UK War risks – Largest British war risks club.

The UK Defence Club is the largest defence club in the world insuring over 3900 ships.

Global network

On-the-spot help and local expertise is always available to Members.

ukpandi.com