



NOVEMBER 20, 2008

CIRCULAR NO. 22/08

TO MEMBERS OF THE ASSOCIATION

Dear Member:

**CLUB PERFORMANCE IN THE CURRENT ECONOMIC CLIMATE.
CAPITAL ADEQUACY AND SURPLUS FUNDING.
CLOSING OF THE 2005 POLICY YEAR.
DEVELOPMENT OF OPEN YEAR POLICY YEARS: SUPPLEMENTARY CALLS.
PREMIUM REQUIREMENTS FOR THE 2009 POLICY YEAR.**

At its meeting in Istanbul last week, your Board reviewed the Club's recent performance in light of the continuing turmoil in the global financial markets. Against this background, and the need to maintain appropriate surplus, it made important decisions in regard to the closing of the 2005 policy year, the development and further funding of open policy years, and the setting of premium levels for 2009.

This Circular describes the issues which were discussed by your Board and the decisions it reached.

Club Performance in the Current Economic Climate

General Background

The challenges which currently confront the global economy are almost without precedent in their severity and scope. The recent collapse in the value of assets, the availability of credit, the price of commodities, the confidence of consumers and, consequently, financial prospects in general have been described as a "once-in-a-century" malignant confluence of negative factors.

Despite government intervention to forestall, or at least mitigate, the worst of these recessionary trends, the current slump is predicted to endure over the medium-term at best and, by reason of modern market integration, to have an extensive global reach.

Members will not need to be reminded of the effect this downturn has had on the maritime industry. The precipitous fall in certain freight indices in recent months, reflecting paralysis in the banking sector and a concomitant reduction in demand, has placed great pressure on operating results, particularly in the dry bulk trades.

American Club circumstances in context

Despite the hostile environment described above, and the stress it has inevitably placed upon its balance sheet, there are several positive elements characterizing the Club's present financial condition.

First, despite the severe downturn in most financial market indices since the beginning of 2008, the year-to-date value of the Club's invested assets had only declined by some 10% as of October 31. Since the great majority of the Club's portfolio is held in fixed income securities and cash, amounting at present to some 75% of the total fund, the fall in equity prices has been offset by a rise in the value of its fixed income holdings where, in particular, the Club's investments in tax-free municipal bonds have recently outperformed. Moreover, all recent redemptions from the Club's alternative investments have been committed to the fixed income sector in order further to promote its policy of capital preservation in these difficult times.

Secondly, the recent strengthening of the US Dollar as a currency of refuge in the teeth of the present crisis benefits the American Club in several ways. Most importantly, it reduces its overseas costs in US Dollar terms and, since its investment exposure in non-US Dollar denominated assets is of a small order, the Club's susceptibility to currency exchange losses is probably much less than that of the market in general.

Thirdly, and as a matter of central importance to the American Club's long-term operational strength, its underwriting results in recent years continue to place it among the very best performers within the International Group. A recent independent analysis of the American Club's underwriting performance for the years 2003 to 2007 inclusive placed it in second place out of ten major Group clubs by reference to both pure loss ratio and to net combined ratio results. In the former case, the American Club's figures were fully 20% better than the weighted market average and in the latter case the Club outperformed the market by some 10%. In short, the Club's underwriting performance, the backbone and ultimate strength of any insurer, places it at the forefront of the industry.

It is worth noting in this context that, since the American Club has been much less reliant than others on investment income to subsidize underwriting losses, focusing instead on the need to produce respectable technical results, it is comparatively less vulnerable to downturns in investment earnings than those insurers for whom such income has been a much larger part of total revenue, and for whom a sharp decrease in such earnings may be more immediately problematical.

Fourthly, and as a contributory factor to the better-than-market underwriting performance described above, the comprehensive review and subsequent consolidation of the Club's risk portfolio which began in mid-2006 continues to exert a favorable influence on trends for the current year.

From a whole account perspective, the cumulative results of all fleets historically entered in the Club between 2003 and 2007 exhibit an overall loss ratio of 83% exclusive of additional supplementary calls. Following the process of review and consolidation mentioned above, this figure has improved to 66% for the sailing fleets of currently entered Members, a token of the better results which have emerged from the actions taken.

On the claims front specifically, there are also encouraging signs. The incidence and severity of attritional claims, i.e. those with an incurred value of up to \$250,000 per incident, continue to show improvement into 2008 consistent with the trend which began to develop in 2007. For example, the Club's incident count has declined steadily over the recent past. From a highpoint of 3437 in 2005, the number declined to 2723 in 2006, 2102 in 2007 and stands at 1202 so far in 2008. While the figures reflect planned reductions in tonnage over

the period, and while 2008 is immature, there are grounds for cautious optimism that this positive trend will continue. By any reckoning, it augurs well for the future.

Capital Adequacy and Surplus Funding

The foregoing paragraphs are intended to provide Members with a properly informed perspective of the Club's current circumstances.

While the Club has suffered some devaluation of its investment portfolio, it has been a smaller than benchmark decline from which it is well placed to recover. Its liquidity remains excellent. Its ability to fulfill all its obligations to Members, and to all others with whom it does business, remains entirely unimpaired.

While in recent times the American Club has been building its invested funds at an unprecedented rate and has thus enhanced the potential contribution of investment earnings to operating results, the sharp downturn in the financial markets has inevitably placed unforeseen pressure on its free reserves.

During the quarter to September 30, 2008 – being the reporting period upon which the financial actions described in this Circular have been based – the contingency fund lost somewhat over \$10 million by reason of the reduction in asset values discussed above. Taken in conjunction with the less precipitous, but nonetheless significant, decline in the value of the Club's investments during the first half of the year, this overall diminution in surplus requires immediate remediation so as to maintain a comfortable level of future funding.

Accordingly, in light of all the above factors, the actions which your Board has resolved to take, as described below, are designed to generate statutory and GAAP surpluses in the order of \$40 million by year-end which, in the case of the former, is comfortably above the basic requirements of the regulator while providing sufficient margin to withstand any further downturn in the investment markets. It is important to note that, in a year when most clubs will most likely experience a withering of free reserves, your Board has actually taken steps to increase the Club's surplus, adding strength to its balance sheet to comfortably meet the uncertainties of the near term.

In the context of balance sheet strengthening, and given recent press speculation on the subject, Members should be aware that your Board has given consideration to raising statutory surplus through the issue of subordinated debt in the form of surplus notes. However, having reviewed the matter in depth, your Board and your Managers have come to the conclusion that, for the time being, given current market conditions, it is better to raise capital directly for purposes of surplus enhancement than to encumber the Club with debt.

Members should also know that your Board has been under no illusions as to the undesirability of price increases in any form at present, but has nonetheless been prepared to take the tough decisions necessary to sustain the Club's continuing financial strength in the challenging business climate which currently prevails.

Closing of the 2005 Policy Year

The overall results for this year continue to improve. Indeed, your Board noted that the surplus for the year had risen by some \$1.3 million over the previous quarter and by over \$2.6 million since the beginning of 2008.

Your Board has therefore resolved to close the 2005 policy year as of September 30, 2008 without further call and to transfer its surplus of just under \$10 million (inclusive of an allowance of \$500,000 for incurred but not reported occupational disease claims) to the Club's contingency fund in order, inter alia, further to support the Club's overall surplus requirements.

Development of Open Policy Years: Supplementary Calls

2006 Policy Year

As in the case of 2005 discussed above, this year also continues to operate in healthy surplus, despite some negative emergence during the most recent quarter. At present, the year exhibits a positive balance of slightly over \$5 million.

Accordingly, no further action in respect of this year is considered necessary. Absent any unforeseen deterioration in its future results, your Board hopes to order its closure without further call within the second quarter of 2009.

The release call margin over and above currently estimated total premium for this year will remain at 10% of advance call premium as originally notified in November last year.

2007 Policy Year

This year is currently operating at a deficit of approximately \$7.5 million. While this is a better result than that which appeared to be emerging at the beginning of 2008, when a total deficit of nearly \$13 million was forecast, your Board has determined that the deficit should be cured as soon as possible and that the year should further support the Club's overall surplus requirements.

Accordingly, it has been decided to levy an additional supplementary call of 25% of advance call premium for both Class I (Protection and Indemnity) and Class II (Freight, Demurrage and Defense) mutual entries. The call will be debited with immediate effect and fall due for payment in full on May 20, 2009.

The release call margin for this year over and above currently estimated total premium will remain at 25% of relevant advance call premium.

2008 Policy Year

This year, although at an early stage of development, presently discloses a loss to date of nearly \$8.5 million, its results having deteriorated by some \$2.44 million during the third quarter.

In like manner to the position taken in regard to its predecessor year, your Board has resolved to take early action both to cure the deficit and in the process lend further support to the Club's overall surplus funding.

It has therefore been decided to levy a supplementary call of 25% of advance call premium for both Class I (Protection and Indemnity) and Class II (Freight, Demurrage and Defense) mutual entries. The call will be debited with immediate effect and fall due for payment in full on November 20, 2009.

The release call margin for this year over and above currently estimated total premium will remain at 25% of relevant advance call premium.

Premium Requirements for the 2009 Policy Year

In light of all the circumstances reviewed above, and recognizing the favorable trends characterizing the Club's recent underwriting results, your Board has come to the conclusion that any increase in advance call ratings for 2009 should be comparatively modest.

At the same time, given the undesirability of unforecast supplementary calls, your Board has also determined that the advance call for mutual entries for the forthcoming policy year should be subject to a forecast supplementary call in due course, to allow for greater certainty in Members' budgeting for the future.

Should the investment markets recover more rapidly than is predicted, or if the claims and underwriting trends discussed above result in a sunnier financial landscape that that currently in prospect, it might be possible to forgo part of the forecast call in due course. However, Members should certainly make full allowance for the supplementary call requirements set out below.

Accordingly, your Board has therefore adopted the following policy as to premium rating for the year commencing February 20, 2009.

Mutual Protection and Indemnity (P&I) Insurance

- All expiring advance call premium to be subject to a general increase of 7.5%.
- Any additional costs of the Club's reinsurance arrangements for 2009 to be charged separately.
- Such advance call premium to be subject to a supplementary call in due course, estimated at 20% of the advance call.
- All advance call premium to be debited in four equal installments due March 20, June 20, September 20 and December 20, 2009.
- Premium (call) to release to be 45% of relevant advance calls.

Mutual Freight, Demurrage and Defense (FD&D) Insurance

- All expiring advance call premium to be subject to a general increase of 7.5%.

- Any additional costs of the Club's reinsurance arrangements for 2009 to be charged separately.
- Such advance call premium to be subject to a supplementary call in due course, estimated at 20% of advance call.
- All advance call FD&D premium to be debited in two equal installments due March 20 and September 20, 2009.
- Premium (call) to release to be 45% of relevant advance calls.

Fixed Premium Protection and Indemnity and Damage to Hull (DTH) Insurance

- All fixed premium P&I and DTH entries (e.g. those for charterers' risks) to be subject to a general increase of 27.5%.
- Any additional costs of the Club's reinsurance arrangements for 2009 to be charged separately.

Fixed Premium Freight, Demurrage and Defense Insurance

- All fixed premium FD&D entries (e.g. those for charterers' risks) to be subject to a general increase of 27.5%.
- Any additional costs of the Club's reinsurance arrangements for 2009 to be charged separately.

As is common practice at renewal, following the application of a general increase as set out above, Members' premium rates will be reviewed against the background of their individual loss records, vessel-type factors, as well as other relevant matters, and a further adjustment – either up or down – made as appropriate.

It will also be a condition for renewal that:

- All premiums and other sums due to the Club be fully paid up to date prior to February 20, 2009 as a condition of continuing cover; and
- All outstanding survey etc. requirements be completed prior to February 20, 2009 as a condition of continuing cover.

Summary

Your Managers offer their apologies for the length of this Circular, but the background to the decisions it contains are complex, given current economic conditions.

As mentioned above, price increases are never welcome, but your Board is resolute in its commitment to maintain the financial good standing of the American Club over the months and years ahead.



To recapitulate in brief the specific decisions reached and described in greater detail above:

- 2005 to be closed without further call.
- 2006 intended for closure in second quarter of 2009 without further call, absent unforeseen developments. Release call margin 10%.
- 2007 to be subject to a further call of 25% payable on May 20, 2009. Release call margin of 25% over and above this.
- 2008 to be subject to a further call of 25% payable on November 20, 2009. Release call margin of 25% over and above this.
- 2009 renewal to feature a 7½% general increase in advance call premium on mutual entries, plus additional costs of the Club's reinsurance, subject to a 20% estimated supplementary call in due course. Release call 45% of advance call premium.
- 2009 renewal to feature a 27.5% general increase in fixed premium entries plus additional costs of the Club's reinsurance, including P&I, DTH and FD&D.

The Managers will be in contact with individual Members with renewal proposals over the forthcoming weeks. If, in the meantime, any Member should require clarification in regard to the above, the Managers will be pleased to respond.

Yours faithfully,

Joseph E. M. Hughes, Chairman & CEO
Shipowners Claims Bureau, Inc., Managers for
THE AMERICAN CLUB