AMERICAN STEAMSHIP OWNERS MUTUAL PROTECTION AND INDEMNITY ASSOCIATION, INC.

THE AMERICAN CLUB

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CIRCULAR NO. 23/06

TO MEMBERS OF THE ASSOCIATION

Dear Member:

**CAPITAL ADEQUACY FOR STATUTORY AND INVESTMENT GRADE RATING PURPOSES.
DEVELOPMENT OF OPEN POLICY YEARS.
PREMIUM REQUIREMENTS FOR THE 2007 POLICY YEAR.**

The purpose of this Circular is to set out the background to important decisions reached by your Board at its meeting earlier in the month. It also describes the specific action to be taken by the Club over the coming period as to the further funding of recent open years. Finally, it sets out the Club's premium requirements for the February 20, 2007 renewal.

Capital Adequacy

Your Board has given considerable thought over the recent past as to the Club's future capital adequacy requirements. This has been motivated by a desire to ensure that it will be able to meet the challenges of a regulatory and rating environment which places increasing pressure on mutuals to maintain capital levels closer to those expected of joint-stock, fixed premium enterprises than to those traditionally associated with P&I clubs.

These trends have come to characterize the regulatory climate in Europe through the demands of the existing regime (sometimes referred to as "Solvency I") scheduled for amplification in 2010 by the more comprehensive requirements of "Solvency II".

The position is essentially no different in the United States. As foreshadowed in Circular No. 32/05 of December 7, 2005, the New York regulator has been setting increasingly onerous measures in regard to the Club's risk-based capital (RBC) requirements so as to place mounting pressure on its level of free reserves.

Concomitantly, the capital models of rating agencies such as Standard and Poor's (S&P) have also become more demanding. Both developments are of more than academic interest, the former being of obvious importance to the Club notwithstanding its continuing compliance with New York State surplus tests, the latter because a growing number of foreign regulators base their acceptance of insurers on S&P and AM Best ratings.

Until quite recently the American Club did not, as a matter of policy, seek to accrue free reserves as a means of funding technical losses either directly or through investment income generated on the back of such reserves. Accordingly, the Club's underwriting results have been the chief factor in contributing to the development of surplus. As to these results per se, the Club has acquitted itself respectably by comparison with other International Group clubs. However, unlike many others, the American Club has not relied to any great extent upon the subvention of technical shortfalls by investment earnings.

Nevertheless, the contribution to surplus by way of investment income should increase markedly over the period ahead. This growing income is likely to flow from the greater size of the Club's invested funds as they have developed over the past thirty months. It is also worth noting that the Club's liquidity continues to be strong, and is likely to remain so over the forthcoming period, regardless of capitalization issues.

In the final analysis, however, the Club's ability to achieve an investment grade insurance rating and to fulfill New York State's increasingly RBC surplus requirements depends for the most part on the raising of capital through premium contributions. Your Board realizes, of course, that this can entail, and has entailed, the levying of unforecast supplementary calls in excess of original estimates. Naturally, it takes no pleasure in pursuing this course.

Be that as it may, the need for the Club to obtain investment grade rating in the short-term has been the dominant issue informing the Board's most recent deliberations. Bearing this in mind, the remainder of this Circular discusses the development of open policy years, proposals for raising further funds in respect of them, and premium rating for 2007.

Development of Open Policy Years

<u>2004</u>

It is encouraging to note that this year remains in respectable surplus as of September 30, 2006 (being the end of the statutory third quarter). Absent unforeseen circumstances, it is expected that the year will be closed in due course – the exact timing thereof to be subject to further consideration by the Board – without supplementary call in excess of the original forecast.

<u>2005</u>

Twelve months ago, when this year was still current, 2005 appeared to be developing much as 2004, that is to say in surplus as of the end of the statutory third quarter of the then fiscal year.

Regrettably, however, due in large part to the effects of Hurricane Katrina from which there ensued an unanticipated incidence of mainly barge wreck removal claims, the year deteriorated substantially over the following six to nine months. This was as a result, too, of a highly conservative year-end IBNR allowance significantly greater than those set for earlier years.

As of the end of the statutory third quarter of the current year, i.e. as of September 30, 2006, the year continues to develop in a deficit equivalent to about 15% of assessable premium. Although there are grounds for cautious optimism that 2005 may improve over time as more investment income is allocated to it and IBNR is reduced as claims exposures mature and possibly improve, your Board is of the view that, in light of the imperatives discussed above, it would be sensible to cure the deficit at this stage by levying an additional supplementary call of 15% of qualifying advance calls for the year.

The call will fall due for payment in one installment on May 20, 2007. The year will remain open subject to further notice as to closure in due course and in the interim the call to release will be reduced to a margin of 10% (from 25%) of advance call over and above the 15% additional call to be payable as described.

<u>2006</u>

Claims on the usual 2006 policy year moved steeply upward during the first quarter, although levels of exposure have since abated so that the year now seems to be developing much as 2005 did over a similar period.

However, given the usual tempo of claims growth over the winter and into the first half of next year, it is likely that a deficit of a similar order to that of 2005 will be evident for 2006 at a like point in its development.

Accordingly, in order to cover the probable deficit for the year and thus permit contribution to surplus, your Board has decided that it would be prudent to levy an additional call of 15% for 2006 payable in one installment on September 20, 2007.

As in the case of 2005, the year will remain open subject to further notice as to closure in due course. In the meantime, the call to release for the year will be reduced to a margin of 10% (from 25%) of advance call over and above the 15% additional call to be payable as described.

Premium Requirements for the 2007 Policy Year

As your Board has stated in the past, the need to make unforecast supplementary calls is always unpopular, but the Club's countervailing need to ensure decisive movement toward investment grade surplus funding is presently its chief concern.

Given recent circumstances, and the likelihood that prospective investment performance, although helpful, will not be a dominant factor in balancing overall results for 2007 and beyond, your Board has concluded that a general increase for the forthcoming renewal should be at a level both necessary and sufficient to foster solid underwriting results for the future. It has also had regard to the intended improvement on the Club's overall risk profile as a result of the extensive review of its entire book which has taken place over recent months.

Having taken these issues – and others – into account, your Board has adopted the following policy as to premium rating for the year commencing February 20, 2007.

Mutual Protection and Indemnity Insurance

- All expiring mutual premium to be subject to a general increase of 10% on annual estimated total premium (ETP).
- Any additional and disproportionate cost of the International Group's reinsurance arrangements to be added as an additional surcharge to ETP, recognizing, however, that the cost and structure of these arrangements have not, as at the time of this Circular, been finalized.
- Any additional and disproportionate cost of the Club's reinsurance of its retention under the Pooling Agreement to be added as an additional surcharge to ETP, again recognizing that the cost and structure of these arrangements have not, as at the time of this Circular, been finalized.
- All mutual premium to be characterized as advance premium (call) with a 0 (zero) % supplementary call estimate i.e. advance call to equal 100% of ETP.
- All mutual advance call premium to be debited in four equal installments due March 20, June 20, September 20 and December 20, 2007.
- Premium (call) to release to be 25% of relevant advance calls for 2007.

Mutual Freight, Demurrage and Defense Insurance

- All expiring mutual premium to be subject to a general increase of 10% on annual ETP.

- All mutual FD&D premium to be characterized as advance premium (call) with a 0% supplementary premium (call) estimate i.e. advance call to equate to 100% of ETP.

- All mutual advance call FD&D premium to be debited in two equal installments due March 20 and September 20, 2007.

- Premium (call) to release to be 25% of relevant advance calls.

Fixed Premium Protection and Indemnity and Damage to Hull Insurance

- All fixed premium P&I and DTH entries (e.g. those for charterers' risks) to be subject to a general increase of 10%.

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 10%.

As is routinely the case at every 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 and other relevant factors 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, 2007 as a condition of continuing cover, and

- All outstanding survey etc. requirements be completed prior to February 20, 2007 as a condition of continuing cover.

Next Steps

Your Board is aware that price increases are never welcome, but is committed to maintain sensible premium development, especially given its concerns about the Club's insurance rating and its continuing fulfillment of statutory requirements as mentioned above.

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, as always, be pleased to respond.

Yours faithfully,

Joseph E.M. Hughes

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