JULY 6, 2001

CIRCULAR NO. 8/01

TO MEMBERS OF THE ASSOCIATION

Dear Member:

CLOSING OF THE 1997 POLICY YEAR
DEVELOPMENT OF OTHER POLICY YEARS

At its recent meeting in New York, your Board of Directors took a number of decisions in regard to the status of open policy years. The remainder of this Circular describes those decisions and comments generally on recent developments.

Closing of the 1997 Policy Year

The surplus on this year was noted as having further increased during the first quarter of 2001. Accordingly, the Board resolved formally to close 1997 without further call in excess of that originally forecast for the year. The surplus has in the interim been credited to the Club's contingency fund.

Open Policy Years

1998 Policy Year

This year is presently in deficit, although only to a modest degree. Indeed, results improved by nearly $1.75 million during the three months to March 31, 2001. It is therefore expected that the year will ultimately prove capable of closure within the original forecast in due course. Members are advised to mark their records accordingly.

1999 and 2000 Policy Years

Comments as might be made specifically in respect of each of these years are essentially applicable to both. Accordingly, for present purposes, they can be analyzed together.

As will be evident from the Club's latest Annual Report, exhibiting its financial circum- stances as of December 31, 2000, both policy years are in substantial deficit. These deficits are attributable to a number of factors.

First, there has been an increase in claims exposure across both years, much in line with the Club's growth in tonnage over the period. It is worth noting in this context that claims inflation has featured as an essentially consistent phenomenon across all sectors of the Club's business.

Other Clubs have also referred, in recent reports, to similar experiences. In particular, 2000 appears to be developing as the worst period for claims within the International Group's pooling layer for several years. Although the American Club itself had no such claims – and continues to have the best record of any club on the Pool – contributions to other Clubs' losses entailed a significant increase in its own costs in this area.

Secondly, in conjunction with the foregoing, the P&I market at large, for a variety of reasons, has for the past several years suffered from a persistent lack of pricing power. Accordingly, as widely commented upon by other Clubs and reported in the press, P&I premiums were probably at their lowest points in the rating cycle during 1999 and 2000. However, as discussed later in this Circular, the 2001 policy year appears to have commenced more robustly in this respect.

Thirdly, again as widely discussed across the industry in general, returns from the investment markets – particularly in relation to earnings from equities – began to fall away toward the end of 1999. This trend continued unrelentingly into 2000 during which the value of certain securities – especially in the hi-tech sector – declined at almost unprecedented speed. All Clubs have been affected by this and all have, over the past twelve months, experienced significant erosion of their net worth.

Taken together, these factors have inevitably had a negative impact upon the Club's free reserves overall and, specifically, the current financial position of the 1999 and 2000 policy years. However, the Club's contingency fund grew by nearly $4 million over the twelve months to December 31, 2000 as the global results for closed years continued to improve. And, as mentioned earlier in this Circular, the surplus attributable to the 1997 year as at year-end 2000 grew further over the quarter to March 31, 2001 making it possible to close that year, as reported above, comfortably within original forecasts.

In addition, and as alluded to in earlier Annual Reports and Club Circulars, policy years tend to improve as they mature and early 'deficit overhangs' tend to diminish in size as years proceed to closure. This is a function of the Club's highly conservative claims reserving practices, driven to a significant extent by the requirements of its statutory regulator, the New York State Insurance Department. It is also a reflection of the fact that the Club does not discount either its known reserves or its allowances for IBNR while, concomitantly, the most recent policy years do not get full credit for investment earnings in their earliest stages of development. The upshot of these observations – and of recent experience – is that there are grounds for cautious optimism that the 1999 and 2000 policy years will improve as they develop further with a similarly beneficial effect upon the Club's free reserves in general.

However, even taking these positive factors into account, 1999 and 2000 can scarcely be described as good years and, as matters currently stand, some remedial action will no doubt be required to bring each into greater economic equilibrium. To this end, the Managers are undertaking a full review of outstanding claims on both policy years with a view to achieving an entirely updated picture of likely exposures which will be reported to the Board of Directors at its meeting in September. For example, there are currently indications that the Club's historical reserves for its contribution to other Club's pool claims may be appreciably overstated at present – based on the most recent statistics available to the Group – and this, as well as similar issues, will be addressed as part of the current review.

Following this exercise, a further statement will be made as to the possible requirements for further contribution to the 1999 and 2000 policy years in due course.

2001 Policy Year

Although the claims development of this year is in its earliest stages, there are encouraging signs that it will prove to be significantly better than its predecessor years. The Club was largely successful in achieving its intended uplift in rates as at the last renewal, coupled with increases in deductibles and other adjustments to cover where appropriate.

There are signs, therefore, that 1999 and 2000 may in retrospect come to represent the bottom of the current cycle of underwriting results – and its associated drag on earnings – and that the current year and those which lie beyond can be viewed with much greater optimism.

A further report to Members will be made in the early fall. In the meantime, the Managers will be pleased to respond to any questions from Members in regard to the foregoing, or generally.

Yours faithfully,

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

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