

THE  
AMERICAN  
CLUB  
2001  
ANNUAL  
REPORT



## THE AMERICAN CLUB 2001 ANNUAL REPORT

### HIGHLIGHTS

- Although September 11 casts dark shadow, 2001 features continuing development of entered tonnage and operational strength.
- Membership grows again during the year with entries approaching 12 million gross tons by close. 2002 renewal sees further increase to nearly 14 million gross tons.
- Decisive action taken in mid-2001 to enhance reserves through additional calls on 1999 and 2000 policy years.
- 1997 closed without further contribution in excess of original forecast. 1998 year slated for closure in June 2002, again within budget.
- Statutory and GAAP surpluses increase during 2001 despite unprecedentedly difficult market conditions.
- 2002 shows substantial increase in projected premium volume. Augurs well for future, coupled with likely growth in investment earnings.
- Shipowners Claims Bureau demerged from Marsh acquiring independent status. Heralds new era for Club adding fresh dynamic to service capabilities.
- Expansion of resources in London extends outreach to business partners in Europe and beyond.
- Industry developments during 2001 confirm expectations of twelve months earlier. Market conditions going forward suggest positive outlook for both Club and industry at large.



*2001 WAS A YEAR TO REMEMBER, BUT NOT FOR THE BEST OF REASONS. THE TERRORIST ATTACKS OF SEPTEMBER 11 CAST A DARK SHADOW EVERYWHERE. HOWEVER, DESPITE THE TRAUMA OF LAST SEPTEMBER AND OTHER NEGATIVE CONDITIONS – NOTABLY CONTINUING WEAKNESS IN THE INVESTMENT MARKETS AND A LACK OF PRICING POWER IN THE INSURANCE SECTOR – 2001 WAS A YEAR OF SOLID PROGRESS FOR THE AMERICAN CLUB. REFLECTING ON ITS PAST, IT LOOKS FORWARD WITH ITS CUSTOMARY ENTHUSIASM TO A BRIGHT FUTURE DEDICATED TO THE SERVICE OF ITS MEMBERS.*





# REPORT OF THE DIRECTORS

***The Board of Directors and Managers of American Steamship Owners Mutual Protection and Indemnity Association, Inc. (the American Club) are pleased to present the Club's Annual Report and Accounts for the year ended December 31, 2001.***

The Club's principal activity continued to be the insurance of marine Protection and Indemnity and Freight, Demurrage and Defense risks on behalf of its Members, both owners and charterers.

The Club's annual meeting took place in New York City on June 14, 2001. At that meeting, the Directors listed on page 30 were elected to serve for the ensuing twelve-month period, Ms. Hariklia N. Moundreas of Good Faith Shipping S.A. being then elected as a new member of the Board. Ms. Moundreas' fellow Directors welcomed her most warmly to their ranks knowing that she would make a valuable contribution to the Club's affairs over the years to come.

At the same meeting, Mr. Paul Sa of Standard Shipping, Inc. was re-elected as Chairman, as was Mr. James P. Sweeney of Penn Maritime, Inc. as Deputy Chairman. Mr. Joseph E.M. Hughes, the Chairman and CEO of the Managers, was reappointed Secretary of the Club.

In addition to their participation in the annual meeting, the Directors convened on five occasions during the year. One of those meetings, in November 2001, had been intended to take place in Singapore. However, in view of the terrorist attacks of September 11, to which further reference is made below, it was decided to make other arrangements. Accordingly, the Board met in New York on November 15, a week later than planned. The Club nevertheless proceeded with the hosting of a reception for the shipping community in Singapore, originally scheduled to coincide with the Board meeting. It proved to be a thoroughly successful occasion.

In addition to the postponement of the November meeting and the relocation of its originally intended venue, the events of September 11 also caused the Board's September meeting to be put back to early October. However, notwithstanding these changes, the Directors remained able to conduct the Club's business in an uninterrupted manner and continued to supply seamless attention to its affairs despite the disruption to the normal schedule.



In the course of the meetings which took place in 2001, the Directors considered a wide range of matters including, among others:

- **Election of Directors**
- **Policy year accounts and supplementary calls**
- **Settlement of claims of the Club's Members**
- **Settlement of International Group of P&I Clubs' pool claims**
- **Setting of premium levels for the subsequent policy year**
- **Reinsurance**
- **Meetings of Managers of the International Group of P&I Clubs**
- **Changes to the Club's By-Laws and Rules**
- **Investment policy**
- **Developments in international shipping regulations**
- **Outcome of renewal negotiations**
- **Budgeting policy for relevant policy years**
- **Reports of the business of the Club's liaison office in London**
- **Implications for the Club of the events of September 11, 2001**
- **Demerger of the management company from Marsh, Inc. and its establishment as an independent entity.**

In addition to some difficult decisions which needed to be made in regard to supplementary calls for the 1999 and 2000 policy years, in respect of which the Managers provide further detail in their own report, the most important issues which fell to be considered by the Board during 2001 were the implications of the aftermath of the September terrorist attacks and the demerger of Shipowners Claims Bureau, Inc. from Marsh, Inc.

The latter subject is described in more detail below. As to the former, Members, as well as the Club's other friends across the world, will have observed that, despite the attacks, the United States in general, and New York in particular, remained steadfast and determined to conduct business as usual. For its own part, the American Club was similarly motivated in the period after the attacks and remains dedicated to providing the best of service environments for its customers.

The speed at which New York rebounded from September 11 speaks volumes for the underlying fortitude of the commercial milieu to which the American Club belongs. The Directors thank all

Members for their continuing support of the Club – especially at the last renewal which followed hard on the heels of the period immediately after the tragedy.

On a happier note, the demerger of Shipowners Claims Bureau, Inc. (SCB) from Marsh, Inc. (Marsh) took place as of January 1, 2002. SCB was historically a wholly-owned subsidiary of Johnson & Higgins (J&H), a major insurance broker and risk consultant based in New York.

In 1997, J&H was taken over by Marsh, a member of the Marsh & McLennan Companies (MMC) which had purchased J&H from its private shareholders. MMC is a large, publicly-held organization, quoted on the New York Stock Exchange and in other major markets around the world.



Consequently, SCB became part of Marsh. This was at a time when the American Club's Vision 2000 initiative was gaining momentum by way of growth and diversification internationally and through the enhancement of service capability. This dynamic remains a central feature of the Club's direction to this day.

In accordance with a policy which had long characterized its management of the American Club, SCB continued to adopt an independent operational posture vis-à-vis its new parent. All parties recognized that it was in the vital interests of the Club that SCB be able to conduct its business, and promote the Club's agenda, free of proprietor influence.

However, despite the historical existence of a practical modus operandi between the different parties interested in SCB,

the continuing development of the American Club's activities began to raise concerns as to potential conflict between the Managers' status as the Club's alter ego and the expectations of Marsh whose shareholders' interests were clearly – and legitimately – not identical to those of the Club.

Accordingly, an agreement in principle between Marsh and the American Club as to the demerger of SCB began to take shape in the early summer of 2001. From this original meeting of minds, and subsequently through extensive internal discussion within the Board and between the parties, a contract between Marsh and the Club for the purchase of SCB and its new premises at 60 Broad Street, New York was concluded at the end of 2001, the agreement taking effect as of January 1, 2002.

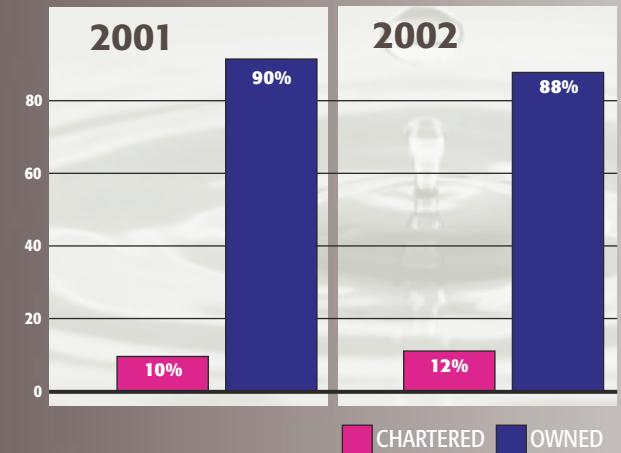
In addition to recognizing the merit in detaching SCB from its erstwhile parent so as to give it greater scope to devote its energies to the American Club, close consideration was also given to the future status of SCB in general. After further discussion among the Directors, it was concluded that, while the interests of the Club would be better served by a management free of third-party ownership, they were, in the final analysis, best served by ensuring complete independence of the day-to-day operational function.

This decision was reached for a variety of sound business reasons. Consideration was given, inter alia, to the legal and regulatory environment in which the Club operated and the desirability of maintaining those high standards of independent thought and deed traditionally associated with the management of P&I mutuals.

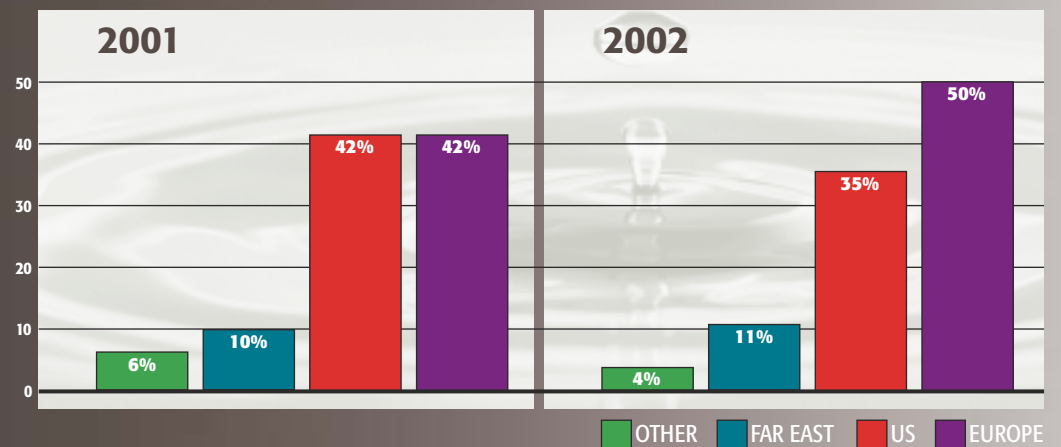
Accordingly, having completed the acquisition of SCB, the American Club subsequently entered into an arrangement with a new holding company, Eagle Ocean Management, LLC, a New York corporation. Under the terms of this arrangement, the Club retained the fixed assets of SCB acquired upon its purchase from Marsh, and thus secured for its own benefit the 60 Broad Street premises together with the leasehold improvements thereto, but passed its SCB stockholding to Eagle Ocean at a price consistent with the company's valuation on its transfer from Marsh. The stockholders of Eagle Ocean consist exclusively of members of the management staff. No outside interests are involved.

This new arrangement will enable the American Club to pursue its agenda with renewed vigor. The Directors are certain that management independence will add impetus to the fulfillment of the Club's goals and insure the highest levels of Member service unaffected by considerations ulterior to the exclusive interests of the Club. The change marks the beginning of a new era for the American Club. The Directors thank all those who have supported the Club in the past, including Marsh and its predecessors, and look forward to the continuing accomplishment of its aims in the future.

## SPLIT BETWEEN OWNED AND CHARTERED ENTRIES



## OWNED AND CHARTERED TONNAGE BY MANAGEMENT DOMICILE



During the year the Club continued to benefit from meetings of the Finance and Safety and Environmental Protection Committees. The latter, in particular, has assumed an increasingly important role as the emphasis on loss prevention continues to be a central theme in the protection and indemnity industry at large.

The Club started 2001 on a high note gaining new Members from a variety of sources and placing total entered tonnage in excess of 10 million gross tons for the first time. A significant proportion of this tonnage came from foreign operators. This served further to increase the Club's balance of entries in the non-US sector. However, the Directors are pleased to report that – in absolute terms – the US entry continued to grow during 2001, although the proportion of total tonnage entered from US sources has been overtaken in recent years by entries from overseas.

The organic development of tonnage during the first half of 2001 was not as vigorous as in previous years. However, the final quarter saw a marked growth in tonnage attributable mainly to the enhancement of the Club's profile among owners who had previously been insured by the JL Jones and British Marine facilities following the recruitment by the Club of their leading underwriter, Stuart Todd.

This, coupled with an excellent renewal season as the 2002 policy year commenced, meant that, as of February 20, 2002, the total entry approached 14 million gross tons, its highest ever. This reflected market recognition of the benefits associated with membership of the American Club.

The Club remained during the year subject to the regulatory control of the New York State Insurance Department. The submission of quarterly and annual statutory returns continued. By reason of the unsurpassed levels of operational and financial transparency stipulated by the New York regulator, the Club was required to take prompt remedial action in regard to the decline in its statutory and GAAP surpluses which had occurred – and been fully reported – as of December 31, 2000.

Accordingly, the decision was taken at the Board meeting in early October to raise additional supplementary calls for the 1999 policy year of 20% over and above the original estimate, and of 50% for the 2000 policy year. While the Directors undertook this course of action with little enthusiasm, they correctly viewed it as prudent to take early steps to remedy the decline in reserves.

This was, to some extent, attributable to a reduction in investment returns during 2000 and the first half of 2001, later exacerbated by



the events of September 11. The entire P&I industry faced similar conditions, compounded by a universal deterioration in claims development for the 2000 year. Indeed, the American Club's pure underwriting results for the last three completed policy years are significantly better than the International Group average and, even in regard to the year 2000, substantially better than certain other much larger mutuals.

Although it proved possible to close 1997 in June 2001 in line with the original forecast, there later emerged a clear need to increase P&I rating overall, the industry at large having suffered from a lack of pricing power for several years.

Accordingly, for the 2002 policy year, a general increase in estimated total premium for P&I entries of 26% was ordered by the Board at its meeting in November 2001. For mutual entries this comprised a 12.5% general increase in expiring advance calls

and an increase in the estimated supplementary call for 2002 to 40% in comparison with the expiring year's requirement of 25%. Freight, Demurrage & Defense entries were to undergo a general rise of 12% only in estimated total premium for 2002.

The Club accomplished the increases it required on renewing business and, taking into account the substantial amount of new



## REPORT OF THE MANAGERS

tonnage which entered as of February 20, 2002, an overall rise in year-on-year estimated total premium of 53% was achieved. This augurs well for the future.

The Club's office in London – originally opened at the end of 1998 – continued to be a source of strength. During the year, additional space was acquired in order to accommodate growing customer demand and further staff were recruited to support the Club's expanding service base. This trend has continued into 2002 as the growth of the Club's tonnage – particularly in the Eastern hemisphere – has developed robustly. The Club is committed to building on its representation in London – an important crossroads of the P&I world – and is confident that the office there will continue to add to the Club's capabilities in the future.

By any standards, 2001 was not a good year. Irrespective of the suffering occasioned by the events of September 11 – which will reverberate for years to come – the more mundane realities of insurance life, notably poor investment returns and soft pricing, militated against the short-term strengthening of financial results.

However, there are now signs that market trends are improving. That rates are hardening, that the Club was successful in expanding its portfolio yet again at the latest renewal, and that investment earnings might reasonably be expected to grow over the forthcoming months, suggest a positive outlook. If 2001 represented the lowest point of the recent underwriting and investment cycle, there are grounds for optimism that 2002 and the years which lie ahead promise further improvement in the American Club's prospects, as well as those for the industry at large.

Given these trends, it was appropriate that the Club adopted a new strategic plan in June 2001 in succession to the Vision 2000 initiative. The new initiative is discussed in greater detail in the report of the Managers. However, the Directors wish to record their satisfaction with the accomplishment of the aims originally defined in the Vision 2000 strategy and their confidence that the new plan will yet further advance the Club's mission in the future.

As in previous years, the Directors take this opportunity of thanking Members for their continued support of the Club. Thanks are also due to the many others who worked hard in 2001 to progress its aims. Despite the negative climate which prevailed during the year, it remains possible to say that 2001 was characterized by further achievement for the Club, and that the results of the most recent renewal – as well as the many other initiatives currently underway – bear witness to the exciting prospects which the new millennium holds for the Club, and its many friends at home and abroad.

It is unlikely that anyone will remember 2001 with affection. Because so much has been written over the period since September 11 as to the impact of the events of that terrible day, it is unnecessary to dwell on it here. Irrespective of the business implications of the atrocity – particularly in the insurance sector – the human cost has laid heavily upon all those who work or have their homes in lower Manhattan.

Although, thankfully, everyone who was present at 60 Broad Street on September 11 was safely evacuated from the building, much pain resulted from the loss of friends who worked at the World Trade Center. It is a cruel irony that the downtown panorama which the Club's new headquarters so splendidly afford became, on that day, a backdrop to unutterable tragedy.

Yet the United States in general – and New York in particular – possess deep reserves of character. Although the return to normal was not easy given the destruction which had been endured, the natural dynamic of lower Manhattan gradually returned, the spirit of its people undimmed. Happily, the collective optimism characteristic of America began to reassert itself in business circles toward the end of 2001 and has gained further momentum during the first quarter of 2002.

To say that 2001 was a difficult year would be an egregious understatement. Nevertheless, the Club continued to make progress in a variety of areas. In a sense, 2001 might be regarded as the bottom of the current cycle, measured by reference both to anemic investment returns and to rising claims expenditure as the tail attributable to losses incurred on the 1999 and 2000 policy years generated an unwelcome drag on earnings.

As reported twelve months ago, the Club's statutory and GAAP surpluses fell to their lowest points at the end of 2000. However, they were on the rise once again by the end of 2001 following the levying of additional calls for the 1999 and 2000 policy years – the latter being the worst performing claims year for some time. These calls have subvented the decline in asset values which had emerged by the end of 2001, particularly after September 11. There are now grounds for optimism that the Club's wealth will increase respectably during 2002 helped by an improving investment market and a marked uplift in cash flow.

### **Entered Tonnage, Underwriting and Reinsurance**

As in the case of its predecessor years, 2001 featured growth in the Club's entered tonnage. Having enjoyed a successful renewal, entries continued to increase during the year so that, at year-end, total entries stood at some 11.9 million gross tons compared with approximately 10.3 million twelve months earlier.

This growth was attributable in large measure to new business entered on behalf of both owners and charterers. As will be seen from the chart on page 7, the split between these two categories remained broadly constant from year to year. As will also be seen from the statistics on page 7, the period under review saw a continuing increase in the number of foreign flag operators joining the Club but at a more gradual rate than that seen in earlier years.

For the 2002 renewal, the Directors ordered that a general increase of 12.5% be applied to expiring P&I advance call rates. In addition, it was decided that the estimated supplementary call proportion of total premium be increased from 25% to 40%. Taken together, the increases in the advance call and the supplementary forecast for 2002 represented a 26% increase in estimated total premium year-on-year. Fixed premium rates for charterers' cover were made subject to the 26% general increase applicable to estimated total premium for mutual entries. For Freight, Demurrage and Defense cover it was determined that advance call rates remain as expiry, but that the supplementary forecast be increased from 25% to 40% in line with the P&I class, connoting an uplift of 12% in estimated total premium and, *mutatis mutandis*, in fixed premium charterers' rates as well.

Overall, and taking into account adjustments to individual Members' rating referable to record, the Club was successful in obtaining the prescribed general increases. Indeed, inclusive of new business, the total projected premium income for the 2002 policy year is some 53% higher than that for 2001.

The growth in new entries resulted in total entered tonnage rising to nearly 14 million gross tons as of February 20, 2002 – a record figure. Reflecting a trend of several years, many of those new entries came from overseas. As a result, tonnage operated from foreign domiciles now comfortably exceeds that managed from within the United States. As to the balance of vessel types covered by the American Club, it will be seen from the table on page 11 that the dry bulk sector continues to show substantial growth.

The latest accounts indicate that the Club's underlying finances improved during 2001 by reference to both statutory and GAAP analysis. The Club's financial posture is aimed to achieve steady reserve strengthening which is likely to be assisted by the expected recovery of the investment markets during the second half of 2002 and the increase in premium volume reported above. Thus, there are sound reasons to believe that the Club's financial circumstances will continue to improve over the months to come.

In addition to the figures set out in this document, i.e. those assembled in accordance with GAAP, the Club is also required to submit its results under the regulatory regime imposed by the New York State Insurance Department. The requisite filings for 2001 were submitted in March 2002 and, once again, exhibited a policyholders' surplus in excess of statutory requirements.

The Club's reinsurance arrangements during the year under review remained essentially unchanged from those which had obtained during 2000. The reinsurance of claims in excess of \$5 million per incident, in respect of which the Club participates with other members of the International Group, retained the same structure as that which had applied for the prior year, 2001 being the second year of a three-year contract originally negotiated at the commencement of the 2000 policy year.

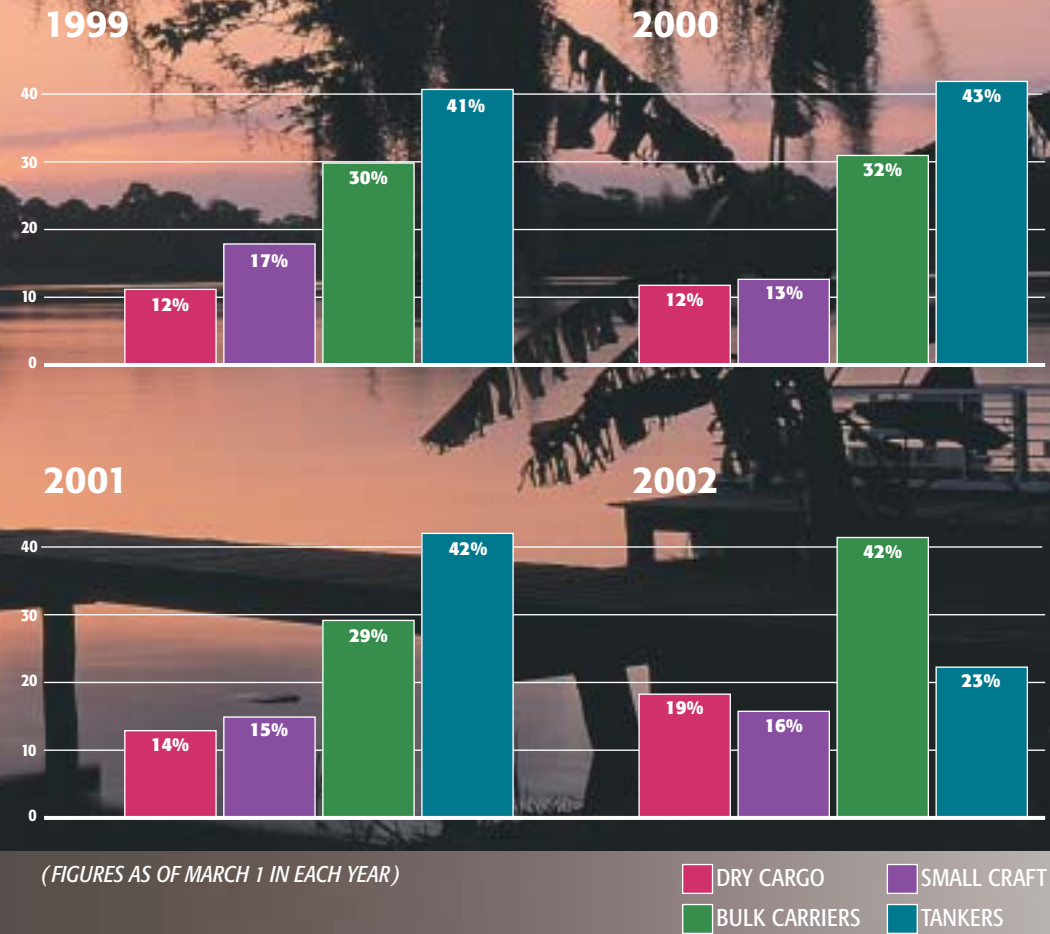
However, for 2002, although the limits remain the same – as do the different layers of cover for both oil pollution and non-oil pollution risks – rates have risen by just under 30%. This is attributable to a previously agreed uplift of 20% on the first two layers of the Group's market placing, but a more substantial increase on the top layers for non-oil pollution claims (up to \$2 billion per incident) where, although the volume of premium is less than that which applies to the lower layers, the rise demanded by reinsuring underwriters was much greater. A schematic of the International Group's arrangements is set out on page 15.

2001 also saw the American Club continuing to protect its underlying retention. However, while the upper layer of \$3 million excess of \$2 million per claim was renewed on broadly similar terms to those which had applied in 2000, the bottom layer of protection was bought down to an excess point of \$500,000 per claim.

For 2002, despite the universal hardening of reinsurance markets, the Club was successful in obtaining renewal of its underlying protections on essentially the same terms as had applied during the previous year. There was a small increase in the annual aggregate deductible for the upper tranche, while the lower section was divided into two parts, being an intermediate layer of \$1 million excess of \$1 million and a new bottom layer of \$500,000 excess of \$500,000 per claim.

Munich Re led the placing, taking 75% of the order on both the top and intermediate tranches and 100% of the order on the bottom layer. They were supported by CGNU at Lloyd's and Swiss Re on the top and intermediate layers respectively. In committing to this placement, reinsurers continued to demonstrate their solidarity with the Club in maintaining their participation at reasonable cost. This, in turn, is an indication of their confidence in the Club's current circumstances and future prospects.

# OWNED AND CHARTERED TONNAGE BY VESSEL TYPE











War risks – and, in particular, cover for acts of terrorism – became a significant issue within the insurance sector at large following September 11. The P&I Clubs were not left unaffected by the events of that day and, in order to regularize the manner in which P&I war risks were covered by the International Group, notice of cancellation of excess war risk insurance for P&I risks was issued as of 24:00 GMT October 17, 2001 to become effective at 24:00 GMT on October 24, 2001 – the seven day notice period contained in most Clubs' Rules.

Cover was subsequently reinstated without additional premium, but on condition that it be in excess of the proper value of an entered vessel (as might be determined by Club Boards), or the amount recoverable from a Member's war risk underwriters, whichever were the greater.

Following further discussion within the International Group, a Rule change was adopted for 2002, specifically excluding acts of terrorism from the general catalog of primary war risks falling outside ordinary P&I cover in accordance with Rule 3, Section 2, but providing excess war risks cover up to a new limit of \$200 million any one incident, an increase over the expiring year's cap of \$100 million.

As to defining an act of terrorism, the new Rule relies upon Directors' discretion, it being thought better to leave individual cases to be determined in this way rather than, as attempted elsewhere, to seek an explicit definition of the term.

At the annual meeting in June 2001, it was resolved to close the 1997 policy year without further call in excess of that originally forecast for the year. It is also expected that, as of June 20, 2002, the 1998 year will be formally closed, again without any call in excess of that previously levied and in accordance with the Club's original forecast for the year.

So far as the 1999, 2000 and 2001 policy years are concerned, the decision was taken in October 2001 to levy an additional 20% supplementary call in regard to 1999 and 50% in regard to 2000.

As to the circumstances of 1999, although a claims review undertaken in the middle of 2001 indicated that the ultimate outturn for the year was likely to be better than that which appeared to be developing six months earlier, it was nonetheless considered prudent to make an additional call for this year in excess of the original forecast. In the interim, claims exposure has declined somewhat, and there are grounds for optimism that this will continue over the period into 2003 at which time the year is expected to be closed without further call.



As mentioned elsewhere in this report, the 2000 policy year was attended by negative results in every respect. First, there was an increase in claims attributable not only to the Club's growth in tonnage over recent years, but also referable to experience generally in the market where, for example, 2000 developed as the worst period for claims within the International Group's pool 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.

Second, 2000 was a period which, in conjunction with the foregoing, continued to feature the persistent lack of pricing power which had characterized the P&I market at large for several years.

Last, but by no means least, the year also exhibited an unrelentingly downward trend in investment returns and asset values which – in common with all Clubs – also had an unwelcome impact on overall financial performance.

Although 2001 could scarcely be described as a stellar year, it appears to be developing in a more favorable manner than 2000 – particularly in light of the growth of entered tonnage recorded during the February renewal of that year and subsequently as it progressed.

### **Claims**

The pattern of the Club's retained claims in recent times has largely tracked the development of its entered tonnage in terms of volume, frequency, type and profile of payment. Accordingly, tonnage increases have brought with them concomitant increases in overall volume, while the growing diversification of the Club's entries by reference to flag, domicile of management and vessel type has entailed growth in claims frequency and speed of settlement.



However, individual cases within the non-US sector of the Club's overall exposure have tended to remain less expensive than their US-generated counterparts.

In short, the Club's development of international status has inevitably brought with it a claims pattern seen elsewhere in the international market. However, this does not explain the significant rise in claims which occurred in 2000. Nevertheless, 2001 appears to be developing more favorably than its predecessor year, with a claims cost per ton more in line with 1999. In addition, the Club did not experience any pool claims for its own account during 2001 as, indeed, has been the case for several years in succession. Nevertheless, the Club's contribution to other Clubs' claims on the pool grew during period under review due to the Club's increase in size and the volume of such settlements during 2001.

This also affected the payment of claims for the Club's own account as many claims which had been incurred for the 1998 to 2000 years inclusive reached maturity. This had a negative effect upon cash flow, although the position is expected to improve during 2002 as the spike generated by 1999 and 2000 results in particular falls away as those years progress toward closure.

### Finance and Investments

Throughout 2001, stock markets continued to trend downwards from their high points of the previous year. From the peak of April 2000 to the trough which emerged after September 11, equities fell between 40% and 60% in Europe and between 20% and 60% in the United States. This decline in stock market value was the worst since the 1973/1974 period following the first oil shock.

The global economy was already in recession before September. Even after the terrorist attacks, world economic circumstances did not materially change. All leading indicators continued to show

persistent weakness. Although political developments consequent upon the events of September 11 did not significantly impact the markets in a negative sense, they nonetheless – and unsurprisingly – did little to add stability to the overall position.

During 2001, the Federal Reserve cut rates by 450 basis points and the European Central Bank by 150 basis points. This was in an effort in both the United States and to a lesser degree in Euroland – where a fear of inflation remained strong – to create liquidity through loose monetary policy and so relieve recessionary pressures. At the end of 2001, the Federal Funds rate stood at a 40-year low of 1.75%.

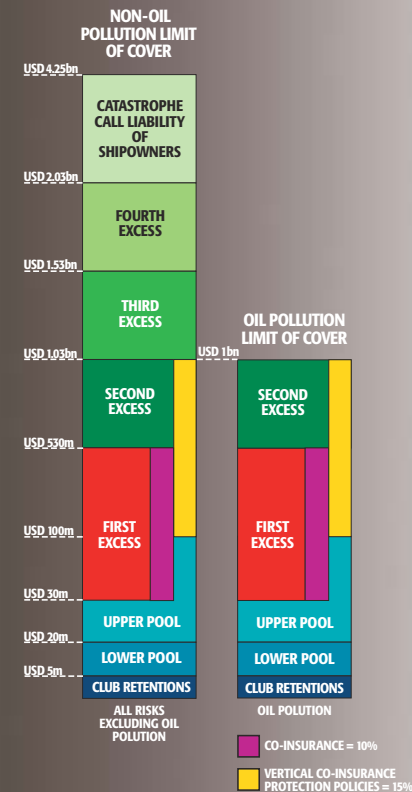
By the turn of 2002, high liquidity, the growth of money supply, US spending packages and interest rate cuts began to have a positive effect on equity markets, supporting increased returns in this sector.

While the resilience of the US economy was encouraging to domestic consumers and investors from abroad, it was worrisome to the bond-buying community. Fearful of inflation, fixed income investors steadily pushed rates higher. By the end of the first quarter of 2002, the five-year Treasury note offered a yield-to-maturity of 4.69%, in excess of 100 basis points above that offered only five months previously.

The catalyst of this rate rise was anticipation that the Federal Reserve would be quick to reverse the previous year's aggressive cuts in interest rates. However, it remains to be seen whether the Fed will act hastily to change its previous policy, although the sustainability of the US recovery – and its knock-on effects elsewhere in the world, notably in Southeast Asia – suggest optimism for the future and hope for at least a modest upswing during the third and fourth quarters of 2002.

Although the prospects for improving investment returns are better than they were twelve months ago, aided by what should prove

## SCHEMATIC OF INTERNATIONAL GROUP REINSURANCE COVER 2002/2003





to be a significant rise in cash flow during the months to come, the Club's consolidated financial earnings for 2001 were anemic at best.

Although the Club's fixed income portfolio achieved a return of slightly more than 5.6% during 2001, a little under benchmark, its equity portfolio lost money, underperforming the S&P 500 index by about 12% and contributing to a negative performance overall of some 1.5% during the year, compared with a positive result of nearly 4% in 2000.

The balance of the portfolio as between equity and fixed income securities remained broadly consistent year-on-year. As of December 31, 2001 some 71% of the Club's invested assets were held in cash and fixed income instruments, the remaining 29% being committed to equities.

### **American Hull Insurance Syndicate**

As reported in last year's Managers' Report, the American Club and the American Hull Insurance Syndicate signed a Memorandum of Understanding in August 2000, aimed at expanding their cover, service and other capabilities through mutual support and cooperation.

These initiatives progressed throughout 2001 and the synergies created by the relationship – although informal – continued to work in each party's favor. The joint strategy remains focused on the intrinsic strength of both insurers whose unique joint presence in the important North American market provides a dynamic point of departure for further growth and development overseas.

### **Club Committees**

The Club's Finance, and Safety & Environmental Protection, Committees worked closely with both the Board and the Managers during the period under review. In the area of safety and loss prevention, further additions of AC Currents were published containing material intended to be of assistance to Members' safety and loss prevention programs and, generally, to communicate news about recent developments at the Club.

The Club's Finance Committee continued to develop and review the Club's more diversified investment strategy first introduced in the middle of 1997. In this and other areas, the deliberations of the Finance Committee remain an important part of Club governance. The Committee maintains close contact with investment advisors both in the United States and in Europe. Representatives of these advisors took part in Finance Committee meetings during 2001 and helped to shape the Club's strategy in a difficult and uncertain market.

### **Rule Changes**

As has been the case for several years, Rule changes were introduced at the commencement of the 2001 policy year deriving from the Board's continuing review of the language of the existing Rules and the desire to maintain "good housekeeping" aimed at extending the clarity and efficacy of the terms under which Members are insured by the Club.

For 2002, further Rule changes have been implemented. Again, they are intended to converge Club practice with that generally prevailing within the market as well as to take account of new policies initiated within the International Group.

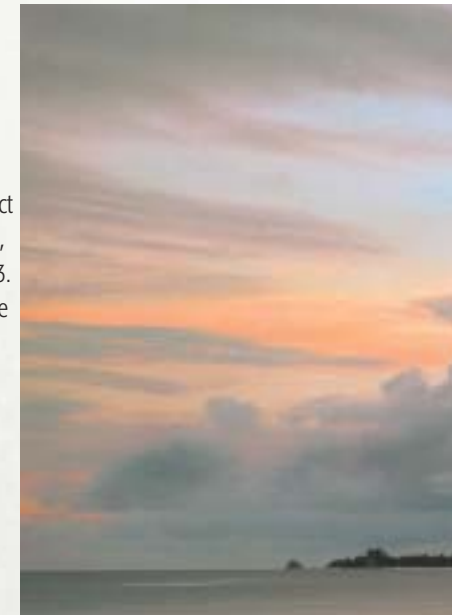
As part of the Club's ongoing strategic plan discussed below, a full review of the By-Laws and Rules is to be undertaken by the Managers during 2002 with a view to up-dating their contents in certain material respects as well as making them more user friendly. Although changes to the By-Laws are unlikely to take effect prior to February 20, 2004 owing to local regulatory requirements, the redesigned Rules are to be introduced from February 20, 2003. Members will be advised of the new regime well in advance of the implementation date.

### **Shipowners Claims Bureau, Inc. – Acquisition of Independent Status**

The Directors' report deals with this subject in detail. It is therefore unnecessary for the issue to be rehearsed once again by the Managers.

However, it is worth emphasizing on behalf of all those involved in the day-to-day operations of the Club that the new status of SCB will permit it to focus even more sharply on its mission to provide Members with unsurpassed levels of service.

The new status also allows greater flexibility in the manner in which SCB performs its managerial duties. Moreover, the arrangement will stimulate a fresh dynamic in SCB's prospects and, in the process, enhance both its service capabilities and its potential to provide exciting career opportunities for the talented people it currently employs and seeks to attract in the future.





### **The American Club's Strategic Plan**

As the twentieth century came to a close, the Managers were able to report to the Board that the major goals of the Club's Vision 2000 initiative had largely been achieved. Thanks are due to all who participated in the accomplishment of this strategy including, of course, the Members themselves and the Club's other friends and associates around the world.

Much of the successor strategy amounts to "more of the same" when compared with the original Vision 2000 plan. However, the plan reasserts the paramount aim of supplying exceptional levels of Member service as the bedrock upon which further progress can be established. This remains the primary mission of the Club and will continue to define its outreach.

The success of Vision 2000 has given the Club the opportunity of

### **The Future**

Twelve months ago it was suggested that rationality might be entering the marine insurance market with the likelihood that all sectors would become more stable over time. Specifically, it was noted that the reassertion of confidence in the traditional mutual system was a welcome sign for the future.



At the Club's annual meeting in June 2001, the Managers presented a successor strategy to the Vision 2000 plan. This was based on an analysis of the Club's circumstances and set goals in a number of areas, making assumptions as to the developments which were likely to take place in the market over the forthcoming five-year period.

consolidating the gains it has made in recent years in addition to extending its capabilities going forward. This is an important feature of the plan since Members must be confident – as, indeed, they can be – that the Club's commitment to excellence remains uncompromised. The greater stability currently asserting itself in the market at large will assist in fulfilling the Club's renewed purpose as well as contributing to the abatement of recent industry turmoil.

These observations have been confirmed by developments over the past year. However, none could have predicted the events of September 11 and their global impact. Although it was difficult to imagine at the time, some good has emerged from the tragedy. It is to be hoped that the political solidarity generated in reaction to that day will endure over time to universal benefit, including to that of the world of commerce.

Although the marine insurance industry in general, and the P&I sector in particular, were negatively affected by September 11, the aftermath has not been as damaging as it might. As noted above, although there was an increase in the cost of the International Group's excess of loss contract, the Club's underlying reinsurances proved to be capable of renewal on very favorable terms given prevailing market conditions.

The Managers echo the Directors' enthusiasm for the Club's future. As the Club expands and, concomitantly, shipowners' changing needs grow with it, the dedication of management resources to meet future challenges will also grow. The Managers commit themselves to the aim of not merely meeting Members' expectations, but exceeding them.

To this end, an emphasis on service is paramount. The P&I industry has attracted much attention over the past several years, most notably from the rating agencies. However, some of the comment which has been applied to the market – and to individual Clubs – misunderstands the true nature of P&I.

First and foremost, Clubs are service suppliers rather than simple money machines. They distinguish themselves by reference not only to the financial reserves they hold at any given time, but also to their service capabilities and, at the deepest level, their culture of response to shipowner needs. This is the key to understanding P&I and the qualities in respect of which Club reputation ultimately stands or falls.

The American Club is dedicated to providing the most accessible, effective and transparent elements of service to its Members. It is also, to a degree unsurpassed within the industry, subject to the most rigorous scrutiny of its operational and financial integrity. The Club is, and will remain, unrelenting in the application of its resources to the achievement of impeccable results under examination as to any component of P&I performance.

The Managers join the Directors in thanking all those who have helped the Club in progressing its aims over the past twelve months – not least, of course, the Members themselves. They look forward with their customary confidence and enthusiasm to the future, and the continuing development of the American Club's position in the P&I world.





# 2001 FINANCIAL REPORT

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21 Statement of Operations & Comprehensive Income

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22 Statement of Cash Flows

23 Notes to Financial Statements

# REPORT OF THE INDEPENDENT AUDITOR

## **Deloitte & Touche**

### **Deloitte & Touche LLP**

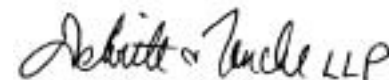
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To American Steamship Owners  
Mutual Protection and Indemnity  
Association, Inc.

We have audited the financial statements of American Steamship Owners Mutual Protection and Indemnity Association, Inc. ("the Association") as of December 31, 2001 and 2000, and for the years then ended, as listed in the accompanying table of contents. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant assumptions made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly in all material respects, the financial position of the Association at December 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



April 16, 2002

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**Deloitte & Touche  
Tohmatsu**

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## 2001 BALANCE SHEETS

IN THOUSANDS	NOTE	DECEMBER 31,	
		2001	2000
<b>ASSETS</b>			
Investments	3	\$ 56,893	\$ 80,585
Cash and cash equivalents		1,898	2,005
Premiums and assessments receivable		25,628	9,858
Reinsurance recoverable	5	12,278	13,825
Other	4	6,978	3,236
<b>Total Assets</b>		<b>103,675</b>	109,509
<b>LIABILITIES AND MEMBERS' EQUITY</b>			
<b>Liabilities:</b>			
Unpaid losses and allocated loss adjustment expenses	5	\$ 53,468	\$ 58,662
Unreported losses	5	18,500	24,500
Unearned premiums		6,345	4,054
Reinsurance payable		6,475	7,556
Other	4	1,211	1,012
<b>Total Liabilities</b>		<b>85,999</b>	95,784
<b>Commitments and contingencies</b>	8		
<b>Members' Equity:</b>			
Retained earnings		16,553	7,618
Accumulated other comprehensive income		1,123	6,107
<b>Total Members' Equity</b>	10, 12	<b>17,676</b>	13,725
<b>Total Liabilities and Members' Equity</b>		<b>\$103,675</b>	\$109,509

## 2001 STATEMENT OF OPERATIONS & COMPREHENSIVE INCOME

IN THOUSANDS	NOTE	DECEMBER 31,	
		2001	2000
<b>Income:</b>			
Net premiums and assessments earned	6	\$41,511	\$24,059
Net investment income		2,267	2,623
Realized investment gains		368	1,258
<b>Total Income</b>		<b>44,146</b>	27,940
<b>Expenses:</b>			
Losses and loss adjustment expenses incurred	5	24,902	31,243
Other operating expenses	7	10,244	6,983
<b>Total Expenses</b>		<b>35,146</b>	38,226
<b>Income (Loss) Before Income Taxes</b>		<b>9,000</b>	(10,286)
Provision for income taxes		(65)	(155)
<b>Net Income (Loss)</b>		<b>8,935</b>	(10,441)
<b>Other comprehensive income, net of tax:</b>			
Unrealized losses on investments		(4,984)	(1,952)
Other comprehensive loss		(4,984)	(1,952)
<b>Comprehensive Income (Loss)</b>		<b>\$ 3,951</b>	\$(12,393)

## 2001 STATEMENT OF CHANGES IN MEMBERS' EQUITY

IN THOUSANDS	NOTE	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME	TOTAL MEMBERS' EQUITY
Balance, January 1, 2000		\$18,059	\$ 8,059	\$26,118
Net loss		(10,441)	—	(10,441)
Unrealized investment losses		—	(1,952)	(1,952)
Balance, December 31, 2000	10	7,618	6,107	13,725
Net Income		8,935	—	8,935
Unrealized investment losses		—	(4,984)	(4,984)
Balance, December 31, 2001	10, 12	\$16,553	\$ 1,123	\$17,676

## 2001 STATEMENT OF CASH FLOWS

IN THOUSANDS	DECEMBER 31,	
	2001	2000
<b>Cash Flows from Operating Activities:</b>		
Premiums and assessments collected, net	<b>\$26,688</b>	\$23,374
Loss and loss adjustment expenses paid, net	<b>(39,489)</b>	(24,822)
Underwriting and other expenses paid	<b>(5,856)</b>	(4,450)
Interest received, net of expenses	<b>2,454</b>	2,894
Income taxes paid	<b>(204)</b>	(49)
Other, net	<b>(598)</b>	(265)
Net cash used for operating activities	<b>(17,005)</b>	(3,318)
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sales/maturities of investments	<b>85,171</b>	54,071
Payments for purchases of investments	<b>(67,415)</b>	(52,087)
Payments for purchases of computer equipment	<b>(858)</b>	(104)
Net cash from (used for) investment activities	<b>16,898</b>	1,880
<b>Net Change in Cash and Cash Equivalents</b>	<b>(107)</b>	(1,438)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<b>2,005</b>	3,443
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 1,898</b>	\$ 2,005

# 2001 NOTES TO FINANCIAL STATEMENTS

## 1 ORGANIZATION

American Steamship Owners Mutual Protection & Indemnity Association, Inc. ("the Association"), domiciled in New York State, was organized in 1917 to provide protection and indemnity insurance to maritime organizations. Pursuant to the terms of the agreements between the Association and its member-insureds, the members are charged premiums and subsequent assessments in amounts adequate to cover the Association's net operating expenses which are its total operating expenses, including net losses, less amounts earned by the Association from investment activities.

The Association is managed by Shipowners Claims Bureau, Inc. ("SCB"), an unrelated party (see note 9). SCB provides administrative, underwriting, accounting and claims processing services to the Association for an annual fee.

## 2 SUMMARY OF ACCOUNTING POLICIES

The accompanying financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America. Significant accounting policies include the following:

**Investments** - Debt securities and equity securities with readily determinable fair values that the Association does not intend to hold to maturity are classified as available for sale securities and are reported at fair value. Unrealized investment gains/(losses) are shown in Members' equity. The Association has no investments in securities classified as held-to-maturity securities. Securities' transactions are recorded on the trade date.

**Cash equivalents** - Cash equivalents include short-term, highly liquid investments with an original maturity of three months or less.

**Computer Equipment** - Computer equipment, consisting of computer hardware, systems and application software, and associated design, programming and installation costs, have been capitalized and are being depreciated using the straight-line method over the estimated useful life of five years.

**Liabilities for Losses and Loss Adjustment Expenses** - The liability for unpaid losses and allocated loss adjustment expenses represents the Association's best estimate of the gross amount of

losses and loss expenses to be paid on ultimate settlements and is provided on the basis of management's and counsel's evaluation of claims filed with the Association. The liability for unreported losses represents the Association's best estimate of the gross amount required to ultimately settle losses which have been incurred but not yet reported to the Association as well as an estimate for future development on reported losses. Given the nature of the coverages written and the size of the Association, fluctuations in the liabilities for losses from year to year are possible.

**Reinsurance** - The Association's reinsurance contracts do not relieve the Association of its obligations, and failure of a reinsurer to honor its obligations under a reinsurance contract could result in losses to the Association. The Association evaluates the financial condition of each potential reinsurer prior to entering into a contract to minimize its exposure to losses from reinsurer insolvency.

The Association records, as an asset, its best estimate of reinsurance recoverable on paid and unpaid losses, including amounts relating to unreported losses, on a basis consistent with the reserves for losses and in accordance with the terms of its reinsurance contracts. The Association reduces such reinsurance recoverables for amounts not collectible. Substantially all amounts recoverable from reinsurers are due from "A" or better rated reinsurance companies.

**Premiums and Revenue Recognition** - The statements of operations include those premiums which have been billed in the current year, together with estimates of unbilled assessments.

**Income Taxes** - The Association is exempt from income taxes except for Federal and New York State taxes on taxable interest and dividends received. Deferred income tax relating to accrued taxable interest and dividends is recorded.

**Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**Reclassifications** - Certain items in the 2000 financial statements have been reclassified to conform with the 2001 presentation.

### 3 INVESTMENTS

All of the Association's investments are classified as available-for-sale. Such investments are publicly traded; accordingly, fair values have been determined using quoted market prices.

	AMORTIZED COST	GROSS GAINS	UNREALIZED LOSSES	FAIR VALUE
<b>December 31, 2001:</b>				
US Treasury and obligations of other				
US government corporations and agencies	\$ 1,207	\$ 12	\$ —	\$ 1,219
Obligations of states and political subdivisions	37,378	875	(76)	38,177
Corporate bonds	1,460	40	—	1,500
Preferred stock	—	—	—	—
Common stock	15,724	2,410	(2,137)	15,997
<b>Total</b>	<b>\$55,769</b>	<b>\$3,337</b>	<b>\$(2,213)</b>	<b>\$56,893</b>

	AMORTIZED COST	GROSS GAINS	UNREALIZED LOSSES	FAIR VALUE
<b>December 31, 2000:</b>				
US Treasury and obligations of other				
US government corporations and agencies	\$ 2,127	\$ 18	\$ —	\$ 2,145
Obligations of states and political subdivisions	52,714	976	(92)	53,598
Corporate bonds	1,426	8	—	1,434
Preferred stock	104	—	(20)	84
Common stock	18,106	6,319	(1,101)	23,324
<b>Total</b>	<b>\$74,477</b>	<b>\$7,321</b>	<b>\$(1,213)</b>	<b>\$80,585</b>

The fair value and amortized cost of available-for-sale debt securities at December 31, 2001 by contractual maturity are shown below. Expected maturities may differ from stated maturities because borrowers may have the right to call or prepay certain obligations with or without pre-payment penalties.

	AMORTIZED COST	FAIR VALUE
Due in one year or less	\$ 2,478	\$ 2,487
Due after one year through five years	10,260	10,577
Due after five years through ten years	19,525	19,857
Due after ten years	7,781	7,974
<b>Total bonds and notes</b>	<b>\$40,044</b>	<b>\$40,895</b>

Proceeds from sales of investments and gross realized gains and losses on such sales are shown below:

	2001	2000
Proceeds from sales of investments	\$60,257	\$46,463
Gross realized gains	2,330	3,317
Gross realized losses	1,962	2,059

At both December 31, 2001 and 2000, United States Government Treasury notes in the amount of \$310 thousand and \$310 thousand, respectively, were deposited with regulatory authorities as required by law.

### 4 OTHER ASSETS AND OTHER LIABILITIES

	2001	2000
<b>OTHER ASSETS</b>		
Computer equipment and software – net of accumulated depreciation of \$1,081 and \$948, respectively	\$ 1,339	\$ 682
Receivable for securities sold	1,976	—
Accrued interest receivable	599	778
Income tax recoverable	213	—
Deferred income tax	10	1
Prepaid reinsurance premiums	832	1,750
Management fee receivable	161	—
Other assets	623	25
Other receivables	1,225	—
	<b>\$ 6,978</b>	<b>\$ 3,236</b>

### OTHER LIABILITIES

	2001	2000
Management fee	\$ —	\$ 717
Accrued expenses	459	286
Income tax payable	2	5
Liability for securities purchased	750	4
	<b>\$ 1,211</b>	<b>\$ 1,012</b>



## 5 UNPAID LOSSES AND REINSURANCE RECOVERABLE

Activity in the liability for unpaid losses and allocated loss adjustment expenses and unreported losses is summarized as follows:

	<b>2001</b>	<b>2000</b>
Gross balance at January 1	\$83,162	\$72,283
Less reinsurance recoverables	12,190	11,557
Net balance at January 1	70,972	60,726
Incurred related to:		
Current year	26,478	25,103
Prior year	(1,576)	6,140
Total net incurred	24,902	31,243
Paid related to:		
Current year	6,423	4,882
Prior years	27,707	16,115
Total net paid	34,130	20,997
Net balance at December 31	61,744	70,972
Plus reinsurance recoverables	10,224	12,190
Gross balance at December 31	\$71,968	\$83,162

In 2001, loss emergence for prior years decreased by \$1,576. Most of the decrease is a reflection of the greater frequency and speed of settlement with individual non-U.S. sector cases in both the 1997 and 1998 years.

Current year net losses incurred reflects continued growth in tonnage at February 20, 2001 and losses on increased non-U.S. business, with their apparent greater frequency and lesser severity. Net claims paid increased by \$13,133 reflecting a change in the timing of claims payments and increased business. Loss reserves decreased overall by \$11,194.

In 2000, loss emergence for prior years increased due to greater than expected emergence in the 1999 year, partially offset by less than expected emergence in the 1995 and 1996 years.

	<b>2001</b>	<b>2000</b>
Reinsurance recoverable on unpaid losses	\$10,224	\$12,190
Reinsurance recoverable on paid losses	2,054	1,635
Total reinsurance recoverable	\$12,278	\$13,825

## 6 PREMIUMS AND ASSESSMENTS

	<b>2001</b>	<b>2000</b>
Premiums written and billed assessments	\$53,111	\$31,339
Return premiums	(107)	(525)
Reinsurance premiums ceded	(8,284)	(7,818)
Net premiums and assessments written (Increase) decrease in unearned premiums	44,720 (3,209)	22,996 1,063
Net premiums and assessments earned	\$41,511	\$24,059

There are no unbilled assessments at December 31, 2001 and 2000. Billed assessments at December 31, 2001 are collectible in various installments as follows: \$3,770 for the 1999 policy year due February 2002; \$10,321 for the 2000 policy year due in two installments August 2002 and November 2002; and \$7,160 for the 2001 policy year due May 2002. Billed assessments at December 31, 2000 were collectible in one installment in May 2001. Additional assessable amounts will be billed as, and if, management deems appropriate.

## 7 OTHER OPERATING EXPENSES

	<b>2001</b>	<b>2000</b>
Management fee	\$ 3,456	\$ 3,284
Bad debts	902	(471)
Brokerage	3,466	1,846
Other	2,420	2,324
Total operating expenses	\$10,244	\$ 6,983

## 8 COMMITMENTS AND CONTINGENCIES

**Letters of Credit** – At December 31, 2001, the Association had outstanding letters of credit for \$8.6 million.

**Exposure to Asbestos-Related Claims** – Since the early 1980's industry underwriting results have been adversely affected by claims developing from asbestos-related coverage exposures. The majority of such claims allege bodily injury resulting from exposure to asbestos products.

The Association establishes reserves for reported claims as well as an estimate for unreported losses. While management believes that reserves for unpaid losses, net of related reinsurance coverages, are adequate in the aggregate, uncertainties exist with respect to estimating the ultimate future amounts that may specifically be needed for unreported asbestos-related claims. Such uncertainties include estimations of the number and value of claims that may be reported, court decisions affecting the Association's liability and the continuing solvency of reinsurers who provided coverage during the applicable policy years.

<b>Asbestos-Related Claims</b>	<b>2001</b>	<b>2000</b>
Aggregate gross losses paid to date at December 31	\$3,596	\$3,117
Losses pending	\$2,569	\$3,701

**Bankruptcy of Prudential Lines, Inc.** - For some years, the Association has been involved in litigation with Maritime Asbestos Legal Clinic ("MALC") relating to claims filed against Prudential Lines Inc. ("PLI"), a former Member-insured now in bankruptcy, alleging injuries and illnesses to claimants arising from alleged exposure to asbestos on PLI vessels during their years of service. In October 1998, the United States Court of Appeals affirmed that the notorious loan arrangement entered into between asbestos claimants represented by the late Leonard Jaques and the PLI bankruptcy trustee resulted in no monetary loss to the insured and was a sham, thus effectively ending several years of particularly vexing litigation against the Club.

**Other Contingencies** - From time to time, asserted and unasserted claims are made against the Association in the ordinary course of business. Management of the Association does not believe that the outcome of any such proceedings will have a material adverse effect on the Association's financial position or result of operations.

## 9 RELATED PARTY TRANSACTIONS

On December 31, 2001, the Association purchased the outstanding capital stock of SCB from Marsh USA, Inc. for consideration of \$1,500,000 (\$750,000 payable upon execution and the remainder payable on January 1, 2003). This transaction was recorded as a purchase. On the date of purchase, SCB contributed the net book value of its fixed assets (\$750,000) to the Association as a return of capital.

Also on December 31, 2001, the Association subsequently sold its interest in SCB to Eagle Ocean Management, LLC, a related party to SCB. No gain or loss was recorded as a result of these transactions.

## 10 STATUTORY FILINGS

The Association is required to report the results of its operations to the Insurance Department of the State of New York ("Insurance Department") on the basis of accounting practices prescribed or permitted by the Insurance Department ("NY SAP"). Effective January 1, 2001, the State of NY adopted the National Association of Insurance Commissioners' Accounting Practices Manual, Version effective January 1, 2001 with certain modifications. NY SAP differs in some respects from accounting principles generally accepted in the United States of America. The principal differences affecting the Association are described below:

**Premiums and Revenue Recognition** - Under NY SAP, the Association may only record those premiums which are billed at the balance sheet date plus those that are unbilled for which either a letter of credit is held or which may be offset by unpaid losses. Unbilled and unsecured assessments are not reflected in the statutory financial statements, except that the Association is permitted by the Insurance Department to reflect as an admitted asset future assessments up to the difference between the ultimate and present values of unpaid losses. Such amount has been recorded as a direct credit to statutory surplus.

**Nonadmitted Assets** - Under NY SAP, certain assets, principally premiums receivable over 90 days past due, are not reflected in the statutory statement of assets, liabilities and surplus. Such nonadmitted assets are charged directly against surplus. Under accounting principles generally accepted in the United States of America, such amounts are recorded as assets, net of an allowance for doubtful accounts.

**Computer Equipment, Furniture & Supplies** - Under NY SAP, the Association is not permitted to capitalize costs relating to applications software, consultants' fees, and furniture and supplies.

**Liability for Unauthorized Reinsurance** - Under NY SAP, the Association may take credit for reinsurance coverage from reinsurers who are "unauthorized" in New York State only where letters of credit or funds are held by the Association as of the balance sheet date. Additionally, the Association may not take credit for reinsurance recoverables from authorized reinsurers where such amounts are overdue. Such unsecured and overdue balances are reflected as a liability charged directly against surplus. Under accounting principles generally accepted in the United States of America, such amounts are recorded as assets, net of an allowance for uncollectible reinsurance.

**Deferred Income Tax** - Under NY SAP, deferred income tax is not recorded.

A reconciliation of statutory surplus as reported to the Insurance Department to Members' equity on the basis of accounting principles generally accepted in the United States of America is as follows:

	<b>2001</b>	<b>2000</b>
Statutory surplus, as reported	\$17,643	\$17,140
Future assessments receivable up to difference between ultimate and present values of losses	(8,227)	(8,874)
Nonadmitted assets	4,929	2,277
Carrying value of applications software and consultants' fees	996	566
Reserve for reinsurance	4,114	3,687
Allowance for doubtful accounts	(2,639)	(1,983)
Unrealized gain on available-for-sale securities	850	911
Deferred income tax	10	1
<hr/>		
Members' equity on the basis of Generally Accepted Accounting Principles	\$17,676	\$13,725

State insurance statutes require the Association to maintain a minimum statutory surplus of \$250,000, and permit the Insurance Department to specify a higher amount at its discretion. The Insurance Department has specified \$7.5 million as the minimum surplus to be maintained by the Association.

## 11 CASH FLOW STATEMENT

Reconciliation of net gain (loss) to net cash provided by operating activities:

	<b>2001</b>	<b>2000</b>
Net income (loss)	\$ 8,935	\$(10,441)
<hr/>		
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of bond premium	90	222
Gain on long term securities sold or redeemed	(368)	(1,258)
Depreciation	202	200
<hr/>		
	(76)	(836)

	<b>2001</b>	<b>2000</b>
Change in:		
Premiums and assessments receivable, net	\$(15,770)	\$ 78
Reinsurance recoverable	1,547	(994)
Other assets	(1,109)	(549)
Liabilities for unpaid and unreported losses and loss adjustment expenses	(11,194)	10,878
Unearned premiums	2,291	(226)
Reinsurance payable	(1,081)	(261)
Other liabilities	(548)	(967)
<hr/>		
	(25,864)	7,959
<hr/>		
Net cash used for operating activities	\$(17,005)	\$( 3,318)

## 12 OPEN AND CLOSED YEARS AND CONTINGENCY FUND

The Association maintains separate accounting for each policy year, which runs from February 20 through February 20, and keeps policy years open until the Board of Directors resolve to close the year. Years are closed after the ultimate liabilities for that year are known with a high degree of probability. The 1997/98 policy year was closed March 31, 2001.

The Association accounts for premiums, assessments and paid and incurred losses by policy year on a specific identification basis. Other amounts, such as investment income, gains and losses and expenses are allocated to policy years in a systematic and rational manner, so as to maintain equity between policy years.

In 1996 the Board of Directors resolved to create a Contingency Fund from the closed policy surplus and investment income of the Association. The purpose of the Contingency Fund would be to moderate the effect of supplementary calls in excess of those originally forecast for a particular policy year by reason of claims for that year having exceeded originally expected levels.

### Development of Open Policy Years at December 31, 2001

	1998-99	1999-00	2000-01	2001-02
<b>Income:</b>				
Calls and premiums	\$23,252	\$22,443	\$21,674	\$22,633
Supplementary calls debited	5,307	9,251	15,821	6,197
Provision for estimated future calls	—	—	—	—
Investment income	2,251	1,976	1,273	774
<b>Total income</b>	<b>30,810</b>	<b>33,670</b>	<b>38,768</b>	<b>29,604</b>
<b>Expenses:</b>				
Net paid losses	12,408	16,546	15,756	6,394
Net pending losses	4,640	8,061	15,811	14,055
Undiscounted IBNR	1,000	1,000	1,000	6,000
Reinsurance premiums	7,987	6,288	9,262	6,473
Other operating expenses	5,522	5,562	6,428	5,448
<b>Total expenses</b>	<b>31,557</b>	<b>37,457</b>	<b>48,257</b>	<b>38,370</b>
<b>Retained earnings</b>	<b>(747)</b>	<b>(3,787)</b>	<b>(9,489)</b>	<b>(8,766)</b>
Unrealized investment gain	171	—	—	—
<b>Members' equity: open years</b>	<b>\$ (576)</b>	<b>\$ (3,787)</b>	<b>\$ (9,489)</b>	<b>\$ (8,766)</b>

(a) A 10% assessment in each of the following open policy years would generate the following net income for the Association (in thousands):

1998/99	\$1,953
1999/00	\$2,033
2000/01	\$2,167
2001/02	\$2,833

(b) All amounts are reported in nominal dollars and do not give effect to any discounts.

(c) For the 2001-02 policy year calls and premiums are stated on an earned basis to December 31, 2001. Expenses are stated on an accrued basis for the same period.

### Development of Closed Policy Years and Contingency Fund

	2001-02	2000-01
<b>Closed years' balance, January 1</b>	<b>\$ —</b>	<b>\$ —</b>
Total income earned	796	1,189
Net paid losses	5,963	4,001
Net pending losses	(6,198)	(5,800)
Unreported losses (IBNR)	(500)	(2,050)
Reinsurance premiums	(480)	(683)
Other operating expenses	282	295
<b>Total expenses incurred</b>	<b>(933)</b>	<b>(4,237)</b>
Unrealized investment (loss) gain	(4,985)	(1,952)
Transfer from closed policy year 1997/98	1,192	312
Net change	(2,064)	3,786
Transfer to contingency fund	2,064	(3,786)
<b>Closed years' balance, January 1</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Contingency fund balance, January 1</b>	<b>\$42,358</b>	<b>\$38,572</b>
Transfer from closed policy years	(2,064)	3,786
<b>Contingency fund balance, December 31</b>	<b>40,294</b>	<b>42,358</b>
<b>Open policy years' equity</b>		
1997/98	—	393
1998/99	(576)	(3,997)
1999/00	(3,787)	(11,736)
2000/01	(9,489)	(13,293)
2001/02	(8,766)	—
<b>Total Members' Equity</b>	<b>\$17,676</b>	<b>\$13,725</b>

All amounts are reported in nominal dollars and do not give effect to any discounts.

### **13 AVERAGE EXPENSE RATIO**

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In accordance with Schedule 3 of the International Group Agreement 1999, the Association is required to disclose its Average Expense Ratio, being the ratio of operating expenses to income, including premium and investment income, averaged over the five years ended December 31, 2001.

The operating expenses include all expenditure incurred in operating the Association, excluding expenditure incurred in dealing with claims. The premium income includes all premiums and calls. The investment income includes all income and gains whether realized or unrealized, exchange gains and losses less tax, custodial fees and internal and external investment management costs. The relevant calculations entail adjustments to calls and premiums to reflect policy years rather than accounting periods. Adjustments are also required for transfers from operating costs to internal claims handling costs and internal investment management costs.

For the five years ended December 31, 2001 the ratio of 11.0% has been calculated in accordance with the Schedule mentioned above and the guidelines issued by the International Group. This compares with a figure of 10.0% recorded twelve months previously – that is to say a small increase.



## BOARD OF DIRECTORS

(AS OF FEBRUARY 20, 2002)

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**JAMES P. SWEENEY, Deputy Chairman**  
(Penn Maritime Inc.)

**RICHARD H. BROWN, JR., Counsel**  
(Nourse & Bowles, LLP)

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**RICHARD F. GRONDA**

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(Reinauer Transportation  
Companies, LLC)

**SERVET YARDIMCI**  
(Yardimci Group)

Secretary  
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