

CIRCULAR

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TO MEMBERS OF THE ASSOCIATION

Dear Member:

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THE AMERICAN CLUB'S FINANCIAL POSITION: FURTHER INSIGHTS, RECENT DEVELOPMENTS AND FUTURE PLANS

Reference is made to Circular 10/06 of April 12, 2006 which described decisions taken by your Board last March in relation to a Supplementary Call requirement for 2003 as well as the position on other open policy years. It also reviewed the status of the American Club's contingency fund.

The purpose of this Circular is to provide some further insights into the Club's financial position, to review recent developments in that area and to describe in outline the plans it has to remedy issues of capital adequacy over the months ahead.

The American Club's Annual Report for the Year Ending December 31, 2005

Members will shortly be receiving their copies of the Club's Annual Report for 2005. This was reviewed and adopted by those Members who either attended or were represented by proxy at the Club's Annual Meeting which took place here in New York yesterday, June 22.

There are several matters which your Managers believe should be of specific interest to the membership, since they affect not only current underlying realities as to the Club's financial position, but also its prospects for the future. They are set out briefly below and should be viewed against the issues discussed in the Club's earlier Circular of April 12.

- During the twelve months to December 31, 2005, the Club's cash and funds under investment grew by nearly 40%. By comparison with year-end 2003, (i.e. over the past 30 months or so) they have more than trebled to stand, currently, at a figure in excess of \$200 million. Assisted by the appointment of a new investment consulting team, and the greater diversification of the Club's portfolio, it is not unreasonable to assume a significantly higher contribution of investment income to policy year funding over the forthcoming period.
- The 2004 policy year continues to perform respectably and is not anticipated to require any call in excess of the original forecast. This, inter alia, is despite an uncommonly high level of International Group Pool claims for the year.
- At a very early stage of development, the 2005 policy year exhibits an underwriting deficit of about 15%. This highly immature result – which obviously has an effect on the Club's overall capital adequacy – is a function, in part, of two significant, but somewhat atypical,



- factors. First, the (hopefully) non-recurring losses inflicted by Hurricane Katrina had a deleterious impact on the year's results to the tune of some \$8 million. Some of these losses, due to the intense disruption created by the storm, were notified comparatively late. Secondly, the year has been allocated a value for claims Incurred But Not Reported (IBNR) which is much more conservative than has normally been the case in the past. This may, of course, prove not to have been overstated as the year comes to closure, but your Managers, in conjunction with the Club's actuaries and its Board, have considered it prudent to use a conservative figure in this regard.

Standard & Poor's and the New York State Regulator

A discussion of the contrast between the reaction of Standard & Poor's to the American Club's recent results and that of the New York State Insurance Department (being the Club's local regulator) was contained in the Circular of last April referenced above.

Briefly to recapitulate, while both Standard & Poor's and the New York regulator employ not dissimilar financial models to calculate the Club's capital adequacy, the philosophy governing the rating agency's and the regulator's respective assessments are markedly different.

As mentioned in the earlier Circular, Standard & Poor's tends to examine P&I Clubs as joint-stock, fixed-premium insurance companies rather than as not-for-profit, fully assessable mutuals whose financial underpinning is, of course, ultimately a function of its members' aggregate economic strength. The recognition of the American Club's mutuality, and its implications, have always been the basis for the traditional approach used by the local regulator which, of course, has been intimately familiar with the Club and its fortunes since it commenced doing business in 1917.

It is believed that this difference in approach was an important factor in the recent downgrade by Standard & Poor's, although the Club continues to be in compliance the New York authorities' calculation of surplus adequacy. This has been communicated to Standard & Poor's with whom further meetings are scheduled in the months ahead.

In short, the American Club remains fully approved by, and compliant with, the requirements of, the New York insurance watchdog. This should be a source of comfort to Members having concerns about the Club's ability to pay claims - which remains unimpaired - as well as its future prospects in general.

Quality Control

While the foregoing is intended to show - on close analysis - that the American Club's underlying financial condition is more robust than it might initially appear, it should not be taken to imply that your Board - as well as your Managers - are complacent about current circumstances.

Part of the requirement to develop higher levels of capitalization over the months and years ahead is a need to extinguish underwriting deficits.



The Club is taking several practical initiatives in this respect. They embrace a wide range of issues. In addition to the obvious matters of vessel and management quality – where the Managers' surveying and technical department is taking a leading role as many Members will be aware – tighter underwriting guidelines have been introduced, supplemented by the substantial improvement in the Club's data processing capabilities, as well as the development of prescribed quality control procedures in the Managers' various departments.

The implementation of these initiatives has had a positive effect upon the risk profile of tonnage renewed for both the 2005 and 2006 policy years. This process will continue with determination.

Future Plans

Having already gained momentum from action taken to date, a prime focus of your Managers – with the approval and support of the Board – is to develop an ongoing analysis of the current book of business with a view to establishing further guidelines in regard to the underwriting of individual accounts for both the forthcoming months and the 2007 renewal.

This phased process will include, inter alia, close consideration of the risk profile of both individual Members and the exposure brought to the Club by reference to vessel types and market segments. Record, vessel age, vessel type, financial viability, tonnage concentration and other factors will be issues taken into account in this respect.

Conclusion

It is hoped that the foregoing review of recent events and future intentions will be of genuine assistance to Members, their brokers and other friends of the Club.

Your Board has given your Managers clear instructions as to the priorities which should govern the development of greater capitalization in the future. Moreover, it takes no pleasure in having to provide bad news – particularly in regard to the unforecast supplementary call required for 2003 – but, as it has made clear in the past, it will not resile from its responsibilities to consolidate Club financial strength when it is clearly required.

Once again, Members will shortly be receipt of the Club's latest Annual Report. If there are any questions in respect of this Circular, in respect of the Annual Report when it is received, or generally, Members are, as always, invited to contact the Managers who will be pleased to respond to any inquiries.

Yours faithfully,



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