

CIRCULAR

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TO MEMBERS OF THE ASSOCIATION

Dear Member:

PUTTING RECENT EVENTS INTO PERSPECTIVE: A LOOK BACK AND A LOOK AHEAD

In light of the public comment the American Club has attracted of late, your Managers felt it would be helpful to give Members – and the Club's other friends – a better-informed and more accurate description of its affairs than some of those which may recently have been circulating.

The review which follows is also intended to demonstrate how the Club has acquitted itself with credit over recent years by comparison with others, and how it is poised for further promising development in the future.

Putting recent events into perspective

Over the next few weeks, Members will be receiving the Club's Annual Report and Accounts for the year ended December 31, 2003. Publication has been delayed through difficulties encountered in the implementation of the Club's new IT system. The Managers are pleased to report that these difficulties are now either fully resolved, or in the process of resolution. They will not arise in the future.

The IT problems – and the delays they created in the filing of the Club's annual returns with the New York regulator – were reported in the press. Shortly thereafter your Board made a decision in regard to the treatment of unreserved and unreported claims arising in policy years prior to 1989 (being the year the American Club joined the International Group). This will restore greater equity to the use of current Members' funds and enhance the financial strength of the Club in forthcoming years.

Although it is safe to assume that the overwhelming majority of current Members understand the reasons for – and are content with – the Board's decision, it raised some nervous reactions externally. Most of these have since been assuaged through the explanation of the principles underpinning the Board's resolutions, the timing of which was caused by an unexpected procedural development in some long-running litigation involving a former Member.

Any negative interpretations of the Club's motives in connection with this action were unfortunately magnified by the announcement a few weeks later of additional calls on the 2000, 2001 and 2002 policy years. The relatively precipitous emergence of this news was also influenced by the Club's IT problems which impaired the processing of policy year statistical analysis and, consequently, the promptness with which Members could be notified of certain deteriorating trends.

Circulars 14/04 and 16/04 of June 7 and June 18, 2004 were issued soon after these decisions. Although they sought to describe in the fullest detail the reasons for them, it was perhaps inevitable that negative implications would be drawn from two news items of this kind coming so rapidly together into the public domain. Those of an alarmist – or conspiratorial – disposition were at the same time reminded of the earlier news concerning the late filing of the statutory accounts and saw a further linkage.

In fact, and despite such speculation as may exist to the contrary, all these recent issues are completely and utterly unrelated, and are entirely unconnected.



The purpose of this Circular, in addition to reaffirming the above by way of putting these recent events into a better-informed perspective, is to provide Members with a timely review of the positive features of the Club's business at this important stage of its history as it moves on to its next era of development.

In reality, the American Club's future is now more promising than ever but, in order to see that future, it is vitally important to understand its past.

The American Club in recent years: sensible growth with a sensible plan

The American Club has undergone great change over the past decade since it first adopted its Vision 2000 initiative. It has done so in accordance with a strategic plan. As is always the case with plans, unforeseen circumstances have required changes to originally intended directions. But, in the main, the development of the Club has proceeded in line with the Board's designs.

If anything, the Club is larger both in tonnage and in premium terms than was originally envisioned even five years ago. This development, through the American Club's focused efforts by way of marketing and service supply to broaden its appeal to the maritime industry, has also been energized by structural changes which have taken place in the P&I world over the past several years.

During this period, a number of mutuals withdrew from the industry. Some significant fixed premium facilities entered, expanded their share and then, in one notable case, subsequently ceased underwriting. Most Group clubs – the American Club among them – took advantage of the market liquidity which this created.

In more recent years, the hardening of P&I rates after a long period of weak pricing created new circumstances for more realistic premium terms. This, too, has been a source of strength to the Club and helped it grow. And the continuing intrinsic appeal of the American Club has led to steady underlying development both from existing Members and from those who seek to join in the normal course of daily business.

In short, the American Club's tonnage and premium growth over the past few years, while robust, has not followed an unusual pattern given dynamic changes in the industry and the counterpoint effect to the law of diminishing returns. This holds that in the early stages of expansion from a relatively small point of departure, an exponentially larger rate of growth is likely to be experienced until, as a market position matures, the rate begins to flatten.

Growth with responsibility: maintaining strong operational results in a difficult market

In any event, even throughout this period of substantial development, the American Club was able to maintain an operating performance second-to-none by comparison with its peers. As the Appendix shows, the Club has one of the best underwriting ratios of all clubs within the International Group.

The figures are taken from no less authoritative a source than Standard & Poor's most recent Marine Mutual Report. Moreover, since the document from which they are extracted was produced last February, they take no account of the Club's most recent calls.

In this context, the Managers are conscious of perceptions in certain quarters – which are entirely misguided – that more recent entries in the Club may have caused the deterioration of its overall results. In fact, nothing could be further from the truth.

The overall loss ratio of new Members joining the Club for the three policy years 2002 to 2004 inclusive stands, to date, at 39% i.e., they represent, at present, a dilution rather than a concentration of risk. Even allowing for the deterioration of claims results on more recent years, such new Members are – at worst – likely to be statistically neutral over time to the overall loss profile of the Club.

The American Club's positive underwriting results disclosed in the Standard & Poor's figures have continued during the interim period, as has its ability to compare itself favorably against its competitors.



Even without the uplifting effect of investment income, the Club expects to produce a small underwriting profit for the 2003 policy year or, put another way, projects a combined ratio of about 90% to 95%. To a significant degree, this is a reflection of its premium strength. It is the Club's surest proof against the threat of rising claims in the future. It is also the platform from which future economic development will take place. This is described in the next section of this Circular.

The American Club is not, nor ever has been, an intrinsically under-rated insurer. It has moved through a difficult market period with the integrity of its underlying rating structures intact.

This continues. By way of example, the following table compares the American Club's open policy year development with that of five other International Group mutuals, four of which are A-rated associations according to the Standard & Poor's canon.

The percentages represent the surplus or deficit (the percentages in brackets) of net premium income or net expenditure (always excluding investment income or transfers from reserves) for the 2001 to 2003 policy years derived from each club's very latest annual report. *In the case of the American Club it excludes the recently announced additional calls.*

<u>Club</u>	<u>Policy Year</u>		
	<u>2001</u>	<u>2002</u>	<u>2003</u>
Club A	(6%)	(16%)	(21%)
Club B	(10%)	(23%)	(15%)
Club C	(35%)	(28%)	(15%)
Club D	(55%)	(47%)	(20%)
Club E	(42%)	(59%)	(24%)
American Club	(30%)	(23%)	4%

This provides further evidence of the favorable comparability of the American Club's more recent year results. Naturally, when the additional calls are taken into account, the American Club's figures are even better. It implies, of course, that other clubs have relied heavily on transfers from reserves, or on investment income, to subvent persistent deficits on the policy years in question.

While there is value in being able to rely upon such contingent subventions, investment markets are capricious and, as many clubs have this year admitted, the rates of return during the past twelve months – particularly against the weakness of the US dollar – may not be achievable in the next.

Accordingly, the importance of a good – and improving – underwriting portfolio has never been greater.

Moving on: pulling through a temporary difficulty and building on strengths for future success

Against a history of noteworthy underwriting results, it may appear paradoxical to require additional calls. The paradox, however, is rooted in the Club's more distant history. In solving it, by this undesired – but ultimately short term – expedient, the Club will place its financial affairs on a sturdy basis for the future.

To a large extent, the background to the Board's decision to require additional calls has already been described in Circular No. 16/04 of June 18, 2004. Many factors weighed on the Board's deliberations. An important issue was to maintain the Club's contingency fund at a level sufficiently large to match regulators' future expectations given the Club's ongoing size. Since 2002 had developed so unexpectedly in a negative direction, and since pure investment income was unlikely to provide an immediate remedy, it was decided to take admittedly unpopular action, ultimately for the long-term good.



Historically, the American Club eschewed the accumulation of its Members' funds on its own balance sheet, preferring to leave those assets in its Members' hands. In the modern P&I era, of course, market expectations are very different. All clubs are expected to hold reserves to "smooth" policy year results and to generate investment income to contribute to them.

There will always exist a philosophical debate as to what an appropriate level of free reserves a club should maintain, and how much it should rely upon investment earnings rather than premium income to fund policy years. In the final analysis, it is for each club to decide.

Given the American Club's historical disinclination toward the excessive diversion of Member assets to its own balance sheet, the Club at its current juncture has had to rely – in a manner which it did not intend – on additional supplementary calls to refortify its balance sheet to a level of financial comfort which it sees as both necessary and sufficient to take it through to its next stage of development.

It does so to extinguish deficits on specific policy years and not as a generalized cash flow exercise. It does so against a background of second-to-none underwriting results which are as good as, or better than, a majority of its competitors. And it does so to sustain levels of reserve funding which the Board will keep under constant review so that, without losing sight of the mutual principle, financial prudence and budgeting certainty remain of paramount importance in the pursuit of Members' interests.

Your Board is acutely conscious that reliance on the supplementary call mechanism is the unacceptable face of P&I as it is practiced in the modern world. It regrets the current need to do so. Having taken this prudent action, however, your Board is confident that present operational trends – linked to prospective reinsurance options now being examined – will return reliability to the Club's calls pattern over the years ahead.

So the upside of the paradox explained above suggests a promising future! An American Club guided by a coherent strategy, directed by a supportive Board, enjoying above-average underwriting results, exhibiting a refortified balance sheet, recording levels of premium and entered tonnage unprecedented in its history, together with a diversity of membership and global reach commensurate with its peers, stands at the threshold of yet further success.

Although the Club was disappointed by its recent downgrade by Standard & Poor's – which it considers arose from misunderstandings of the Club's position on certain issues – it nonetheless notes its removal from S&P's Creditwatch and the improvement of the Club's outlook from negative to stable.

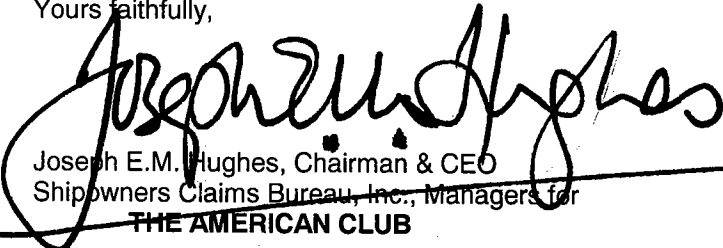
This is undoubtedly in recognition of issues discussed in the preceding paragraphs. A further exchange with S&P is scheduled to take place over the next three to four months after which it is hoped a more positive review will emerge.

Conclusion

This Circular is intended as neither a polemic nor an apology. However, the Club having been much in the news, it was felt that a more discursive explanation of recent events than that available from more subject-specific messages would be helpful, particularly where those might be susceptible to misinterpretation.

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

Yours faithfully,


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

THE AMERICAN CLUB

International Group Statistics

Paid Loss Ratio						
Ratio 4.4	2003	2002	2001	2000	1999	1998
The United Kingdom Mutual Steam Ship Ass. Assoc. (Bermuda) Ltd	115.2%	150.2%	103.7%	130.3%	130.3%	71.2%
The London Steam-Ship Owners' Mutual Insurance Association Ltd	122.7%	120.4%	144.1%	162.1%	112.4%	81.8%
The Steamship Mutual Underwriting Assoc. (Bermuda) Limited	121.3%	70.5%	116.3%	110.1%	88.3%	32.9%
Assuranceforeningen Skuld (Gjensidig)	103.4%	113.1%	164.9%	101.3%	88.5%	73.2%
The Japan Ship Owners' Mutual P&I Association	95.8%	71.9%	76.6%	98.3%	87.8%	97.4%
West of England Ship Owners Mutual Ins Assoc (Luxembourg)	95.6%	119.9%	122.4%	114.3%	98.8%	89.6%
Sveriges Angfartygs Assurans Forening (The Swedish Club)	94.2%	134.0%	161.1%	119.4%	118.4%	148.5%
Assuranceforeningen Gard	81.6%	96.1%	133.6%	106.3%	98.8%	98.3%
The Standard Steamship Owners' P&I Association (Bermuda) Ltd	78.7%	126.5%	123.9%	123.0%	126.0%	102.6%
The Britannia Steam Ship Insurance Association Limited	70.0%	92.0%	119.9%	127.3%	113.8%	108.7%
North of England Protecting & Indemnity Association Ltd	59.9%	75.1%	88.4%	110.3%	39.9%	67.8%
American Steamship Owners Mutual P&I Assoc Inc	53.1%	76.3%	91.3%	79.5%	63.9%	85.1%
The Shipowners' Mutual P&I Association (Luxembourg)	51.1%	61.8%	78.0%	67.1%	57.3%	66.3%
The Standard Steamship Owners' P&I Association (London) Ltd	41.9%	61.4%	63.0%	58.7%	21.8%	19.0%
G Average	86.8%	99.5%	120.4%	114.1%	92.7%	95.1%

Combined ratio						
Ratio 4.1	2003	2002	2001	2000	1999	1998
The United Kingdom Mutual Steam Ship Ass. Assoc. (Bermuda) Ltd	147.0%	175.5%	111.5%	160.6%	120.3%	134.0%
The Steamship Mutual Underwriting Assoc (Bermuda) Limited	141.3%	69.4%	109.9%	134.3%	119.3%	118.9%
The Standard Steamship Owners' P&I Association (Bermuda) Ltd	134.4%	140.7%	137.0%	141.3%	157.0%	146.4%
Assuranceforeningen Skuld (Gjensidig)	133.7%	112.9%	135.0%	125.3%	121.7%	110.5%
West of England Ship Owners Mutual Ins Assoc (Luxembourg)	119.8%	127.1%	121.2%	112.7%	113.9%	96.8%
Sveriges Angfartygs Assurans Forening (The Swedish Club)	119.5%	161.9%	120.4%	137.0%	153.3%	125.0%
The Japan Ship Owners' Mutual P&I Association	106.2%	89.1%	108.7%	115.2%	105.3%	101.1%
North of England Protecting & Indemnity Association Ltd	103.1%	94.3%	118.7%	91.9%	99.9%	107.3%
The London Steam-Ship Owners' Mutual Insurance Association Ltd	96.1%	133.6%	136.8%	141.4%	164.3%	124.1%
The Standard Steamship Owners' P&I Association (London) Ltd	95.6%	98.3%	118.3%	140.9%	107.0%	85.3%
The Britannia Steam Ship Insurance Association Limited	94.0%	105.3%	123.4%	128.9%	130.0%	125.4%
Assuranceforeningen Gard	93.7%	93.1%	142.4%	153.8%	142.1%	107.2%
American Steamship Owners' Mutual P&I Assoc Inc	92.7%	82.9%	100.7%	134.0%	99.9%	107.1%
The Shipowners' Mutual P&I Association (Luxembourg)	89.4%	91.2%	89.3%	98.9%	101.9%	97.4%
G Average	111.9%	128.5%	121.7%	132.2%	122.4%	116.9%