STEAMSHIP MUTUAL

Mid Year Review 2009

Highlights

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- Owned entered tonnage increased by 3.2 million GT since 20th February
- Overall increase in renewal premium approximately 13.5%
- Standard increase for 2010/11 set at 5% for Class 1 P&I. No standard increase for FD&D
- Investment income earned to date of US$ 47.2 million equivalent to a return of 8%
- Prior year release US$ 16.1 million confirming conservative IBNR estimating policy
- Projected increase in free reserves by year end of over US$ 50 million

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Overview

1909 – 2009
STEAMSHIP MUTUAL
100
A century of service to shipping

Performance for the first nine months of the year has been excellent. Underwriting performance was strengthened by a 13.5% increase in premium, including changes in terms, at the 2009 renewal, the frequency and severity of attritional claims in 2009 is to date lower than last year, there are further releases from prior year reserves and investment performance has been boosted by the recovery in financial markets.

It is too early to forecast the current year outturn as the fourth quarter can be hazardous for claims but in the absence of any serious deterioration we expect an underwriting surplus and further improvement in the three year average combined ratio. There is less scope for investment return in the short term as markets are showing signs of weakness following the rapid correction over the summer. However, assuming no major deterioration in the final quarter the Club projects an increase in its free reserves of over US$ 50 million at year end, on target with its objectives.

After the storm that was 2008 everyone in the financial and shipping world is left trying to understand exactly where we are now and how best to plan for the future. We know that the financial system has experienced a profound shock, that banks will need to re-capitalise and that their risk appetite is reduced. We know that government debt has spiralled and that this will need to be addressed, probably by a combination of reductions in public expenditure and increases in taxation. We do not know how effectively and over what timescale these accumulated problems will be addressed and hopefully resolved; clearly there is plenty of scope for further volatility in the financial markets and in the economy at large. So far as the shipping market is concerned the outlook is complicated by the delivery of large numbers of new ships in 2009 – 2011. This is likely to have a detrimental effect on freight markets, increase the lay-up of vessels and result in the scrapping of older tonnage.

Against such an uncertain backdrop the Club is focused on ensuring that the underwriting result is sound and that investment strategy is prudent. For a number of years the Club's underwriting results have been amongst the best in the International Group. The Board is determined that this will continue and as part of that process has authorised a standard increase of 5%. Furthermore, the investment strategy has been revised so that outstanding claims liabilities are closely matched in amount, duration and currency by government bonds, the portfolio in excess of these amounts will be invested in accordance with a new risk budget.

Underwriting

Stephen Quartermaine Head of Underwriting and Reinsurance

In the first nine months of the year, owned tonnage increased by approximately 3.2 million GT, net of disposals. This net figure includes the impact of the UK Treasury's Financial Restrictions (Iran) Order 2009, which has obliged the Club to terminate its very longstanding entry with the Islamic Republic of Iran Shipping Lines (IRISL). The growth in the Club has reflected continuing increases in world tonnage, resulting in new entries from existing Members.

The world fleet has continued to grow in spite of the recession, although more slowly than forecast last year because of cancellations and delays in the new building order book. The degree to which this process will continue remains very uncertain. Scrapping is likely to continue at a high level and the Club is also likely to feel the effect of laid-up returns. Cold lay-ups have not yet been as common as, perhaps, might have been expected, but it is not easy to establish the full extent of laid-up tonnage at any time, and the current Rules allow for a considerable delay in making a claim for a return of premium. For the coming policy year, the Directors have authorised changes to the Rules which should make it easier to claim laid-up returns, though the time allowed for making such claims is considerably shortened.

The Club continues to experience the phenomenon of "churn" whereby well-rated older vessels leave the Club to be replaced by modern vessels, rated very competitively. This structural change cannot be avoided, but the Club will have to pay careful attention to its effects during renewal discussions, to ensure that any discussion of record takes account of real levels of premium for current vessels.

The Club has made a satisfactory start to underwriting without dependence upon subsidy from investment income. The current forecast indicates a financial year combined ratio for 2009 at or near 100%. Routine, lower value claims appear to be lower than last year, both in terms of frequency and severity, although it is, of course, too early to be able to present a clear picture of the year. Claims from the International Group Pool, however, are showing a significant increase over the 2008 year. A modest standard increase of 5% for 2010 thus represents a continuation of the Club's prudent underwriting policy. The Club's new cover for yacht owners has been launched successfully and has attracted several members, with good performance so far.

In respect of Class 2 (Defence), we expected and saw an increase in legal disputes and litigation during 2008, the effect (particularly upon contractual performance) of the economic downturn. However, in 2009 the level of claims has thus far reflected more normal levels, and no standard increase has been ordered for 2010.

Reinsurance

The International Group has agreed to raise the level of the individual Club retention before pooling from US$ 7 million to US$ 8 million for the 2010 policy year. Although Steamship Mutual Directors voted in favour of this increase, it remains their conviction that it is unwise to raise the retention in a very substantial way, bearing in mind that, for most Clubs, the result is that a highly efficient pooling system is to some extent replaced by a relatively expensive market alternative. Having accepted this increase in recognition of the need for compromise within the Group, they will be likely to resist further change in this direction in the near future.

The Excess Loss layer is, of course, still more volatile than the Pool. At the time of writing, the ten year record on the International Group's contract is still positive, even taking into account only the premium of the first layer, where all the claims lie. Furthermore, the 2008 year (and 2009 so far) looks extremely positive for underwriters. However, the five year record of incurred claims against first layer premium now shows a loss to underwriters. The Group participates in the results of this layer through a 25% co-insurance which is then placed with the Group's captive Hydra. It would obviously be open to the Group to alter the present structure of Hydra's participation in the risk if this were economically attractive.

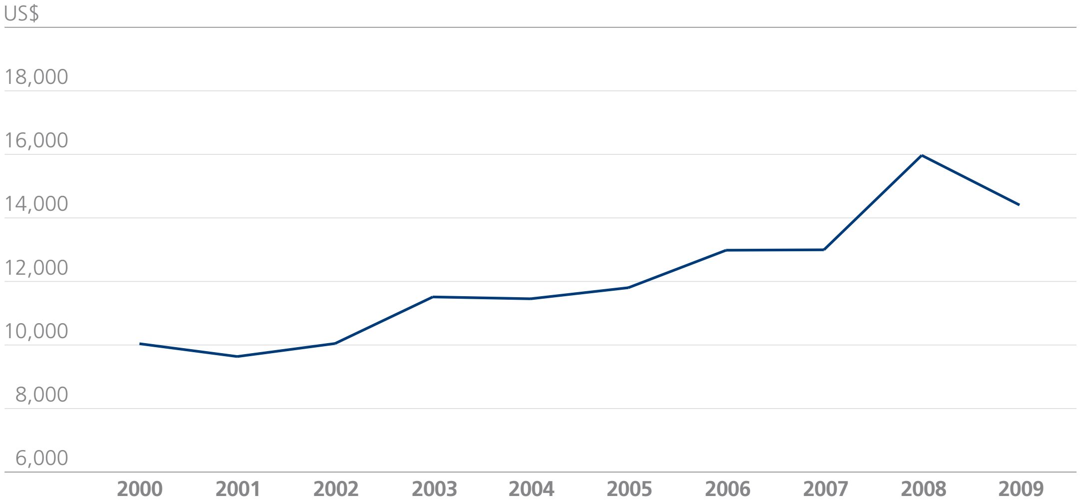
Claims

Colin Williams Head of Claims

It has been suggested that the reduction in shipping activity caused by the recent global recession may result in a corresponding reduction in claims. However, a fall off in trade can have the opposite effect of increasing liabilities as well, and there is as yet no clear evidence of a reducing claims trend.

Whilst the average size of attritional claims for 2009 has reduced by nearly 10%, the long term trend continues to show an increase in severity, as can be seen from the following graph.

Average size of attritional claims (up to US$ 250,000)



On the basis of claims notified in the first nine months of this year, attritional claims have reduced both in number (by approximately 15%) and in overall value (by approximately 20%); much of which can be explained by the general increase in deductibles introduced at the last renewal. These changes are most noticeable in cargo and chartered claims reflecting reduced trading activity over the last 12 months. Moreover, claims in the injury category are at their lowest level for many years. The experience so far as FD&D is concerned is more neutral, the number and cost of claims having returned to historical levels following the 2008 spike.

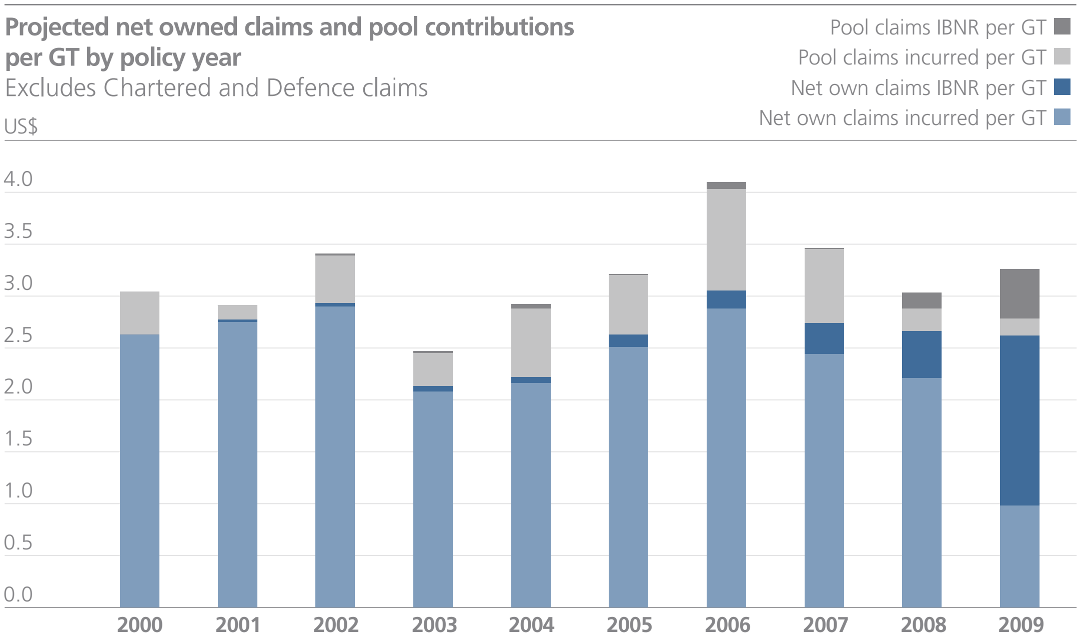
By contrast, the cost of larger claims has increased by over 30% compared to the same point last year. This is despite the fact that only seven claims have been notified so far this year for which the estimate exceeds US$ 1 million; a number comparable to previous years. However, these large claims occur quite randomly and are probably not indicative of fundamental claims trends.

The projected net cost of claims arising in all policy years including 2008 has reduced by approximately US$ 16.1 million since February 2009. This improved outlook for the earlier years reflects the Club's conservative approach to IBNRs, estimating and claims management.

Retained claims have remained at a reasonably constant level over the last three years as shown in the following graph which charts the Club's overall projected claims per GT for the last ten years. However, a significant increase in Pool claims is projected this year compared to the relatively benign 2008.

Projected net owned claims and pool contributions per GT by policy year

Excludes Chartered and Defence claims



Claims
Continued

So far this year, 14 Pool claims have been notified and the pattern has been particularly volatile with seven of these claims having been reported in the last two months. Only one Pool claim involves Steamship Mutual and this claim only just exceeds the Pool retention level.

The development of claims on the International Group Pool up to US$ 50 million each claim is set out in the table below. This provides welcome confirmation of the original impression that the 2008 policy year will turn out to be relatively modest so far as the Pool is concerned. The recent surge in notifications of new Pool claims in 2009 is, so far, well ahead of 2008, but not at the very high levels experienced in 2006 and 2007. The most critical months for the Pool are, however, still ahead of us, and it remains too early to say whether the first full policy year of the shipping recession will ultimately reflect lower or higher claims in the Pool layer.

International Group's Pool experience
Annual claims development of incurred claims up to US$ 50 million
Data is as at 20th August of each year

US$ million

Policy Year	Aug 09	Aug 08	Aug 07	Aug 06	Aug 05	Aug 04	Aug 03	Aug 02	Aug 01	Aug 00
2000	148.8	149.0	144.1	139.6	144.6	142.1	143.1	144.9	132.3	11.9
2001	48.2	47.8	49.0	42.3	42.1	39.0	39.9	41.9	0.1	
2002	176.7	175.8	171.1	177.0	177.7	169.9	158.4	10.4		
2003	131.1	127.2	139.0	137.8	138.4	131.7	41.5			
2004	291.5	289.3	293.6	279.4	258.6	43.6				
2005	257.9	233.9	221.8	184.3	2.3					
2006	470.0	456.3	434.2	78.2						
2007	364.6	319.5	84.7							
2008	124.5	23.5								
2009	54.8									

Source: International Group statisticians, 2000 – 2003 claims are pooled up to US$ 30 million.

Investments

Steve Ward Finance Director

Stocks, corporate bonds and commodities have rallied this year as the benefits of unprecedented monetary and fiscal stimulus flowed through the global economy, helping to pull several countries out of recession. The combination of low interest rates, subdued inflation, restocking and better than expected corporate results has helped to boost investors' appetite for risk. Emerging markets have outpaced developed ones and credit markets have recovered sharply. The US dollar has fallen against most major currencies, undermined in part by a lack of yield support, while most commodity related currencies have appreciated. Central banks have continued to pump liquidity into markets by keeping official interest rates near record low levels and, in some cases, buying a broad range of fixed income securities. Despite the better economic data, government bonds also did well during the third quarter as fears that central banks would be quick to raise interest rates subsided.

More recently, however, stocks have retreated as investors have questioned the sustainability of global economic recovery once monetary and fiscal stimulus programmes have run their course. Corporate earnings are being supported by cost cutting rather than growth, underscoring the still fragile nature of the economic recovery. As this review went to print third quarter growth in the US economy was revised down to 2.8% reflecting weakness in consumer spending and a bigger trade deficit.

Against this backdrop the combined Club and Trust investment portfolio has recorded a gain of US$ 47.2 million, an 8% return, for the first nine months of the financial year. Combined cash and investments rose to US$ 711.3 million over the period. Despite its defensive position, the portfolio has benefited from the strong recovery in markets since March. Bonds have returned 12.6%, hedge funds of funds 14.6% and US dollar weakness accounts for 2.8% of the overall return.

There was significant distortion in fixed income market prices this time last year reflecting the fact that markets for many instruments were effectively closed. Government measures especially in the US have reopened markets causing a rapid correction in prices which has been fuelled by significant investment flows into corporate bonds. The new US fixed income managers outperformed their benchmark by 6.4% in the period to 31st October.

Hedge funds have also capitalised on the broad recovery in markets. In the first eight months of the year the Trust's funds of hedge funds have recovered all but 8% of last year's losses. In contrast the S&P500 is still 23% below its level at the beginning of the last financial year. The volatility of the Trust's hedge funds of funds returns is between one-third and one-half of that of equities reflecting their ability to capture much of market gains but avoid the full extent of market downturns.

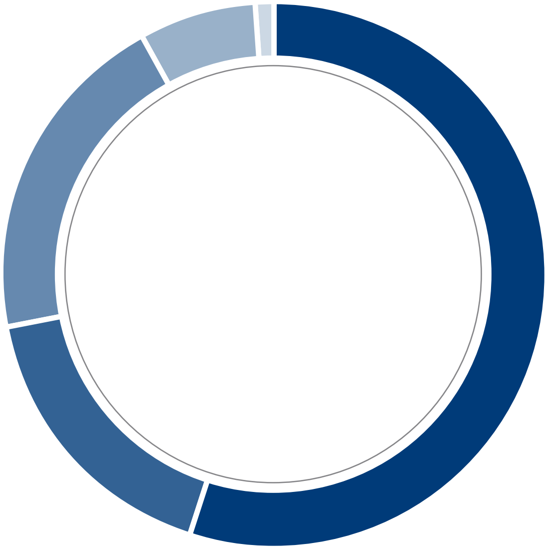
The Corporate Trustee and Club Board have considered carefully the appropriate level of investment risk, given the Club's business strategy and having regard to developing regulatory and rating agency assessments of risk based capital requirements. Watson Wyatt were appointed in May to advise on risk budgeting, asset allocation and manager selection.

Investments
Continued

A much reduced risk budget has been set relative to that portion of the portfolio which is in excess of the amount required to settle estimated and projected claim liabilities. The current and target allocations are set out in the charts below. These show that equities and alternative investments will make up 16% of the portfolio compared to 40% in the previous strategic asset allocation.

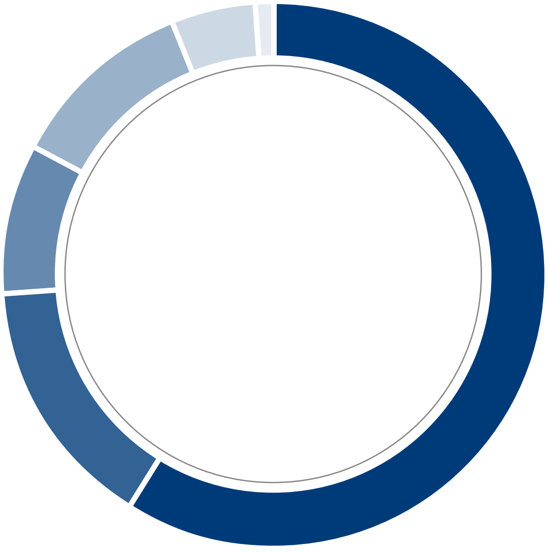
Combined assets
by asset type as at 20th November 2009

Government bonds	55%
Corporate bonds	17%
Cash and deposits	20%
Alternative investments	7%
Property	1%



Target combined assets
by asset type

Government bonds	59%
Corporate bonds	15%
Cash and deposits	9%
Alternative investments	11%
Equities	5%
Property	1%



As part of a more proactive approach to risk management the Corporate Trustee will regularly monitor prevailing levels of risk in investment markets, supported by Watson Wyatt, and in the Club's insurance business, and will make adjustments to asset allocations where necessary.

These measures are the result of a fundamental and comprehensive reappraisal of risk management which has been undertaken as an integral part of the Club's review of capital requirements. While no investment portfolio can be free of risk and capital reserves are maintained to cushion extraordinary circumstances, the Board is confident that its new arrangements will substantially reduce the chance of investment losses impacting on its capital position in the future.

Regulatory capital

European regulators have recently released a series of consultative papers which set out the latest detailed proposals for how the Solvency II insurance regulation regime will operate when it comes into force in October 2012. Regulators in other parts of the world are considering to what extent their own rules are equivalent to Solvency II and some are already developing new standards to ensure equivalence.

Early reaction to the latest papers confirms the view that the European regulator has tightened capital requirements in response to the financial crisis, despite the fact that no European insurer has failed as a result of the crisis. The approach of the UK Financial Services Authority in its regular reviews of individual capital assessments also appears to support the view that increased capital requirements for insurers are a fact of life.

The Club continues to invest in its management information resources and analytical capabilities to prepare for the new challenges under Solvency II and is well positioned to satisfy the higher capital requirements that will be introduced in 2012. Provided the detailed measures in the Directive adhere to the principle of proportionality there are real benefits to be gained from the increased alignment of capital requirements to the risk exposures of individual insurers and through the increased transparency and comparability of insurers' financial information.