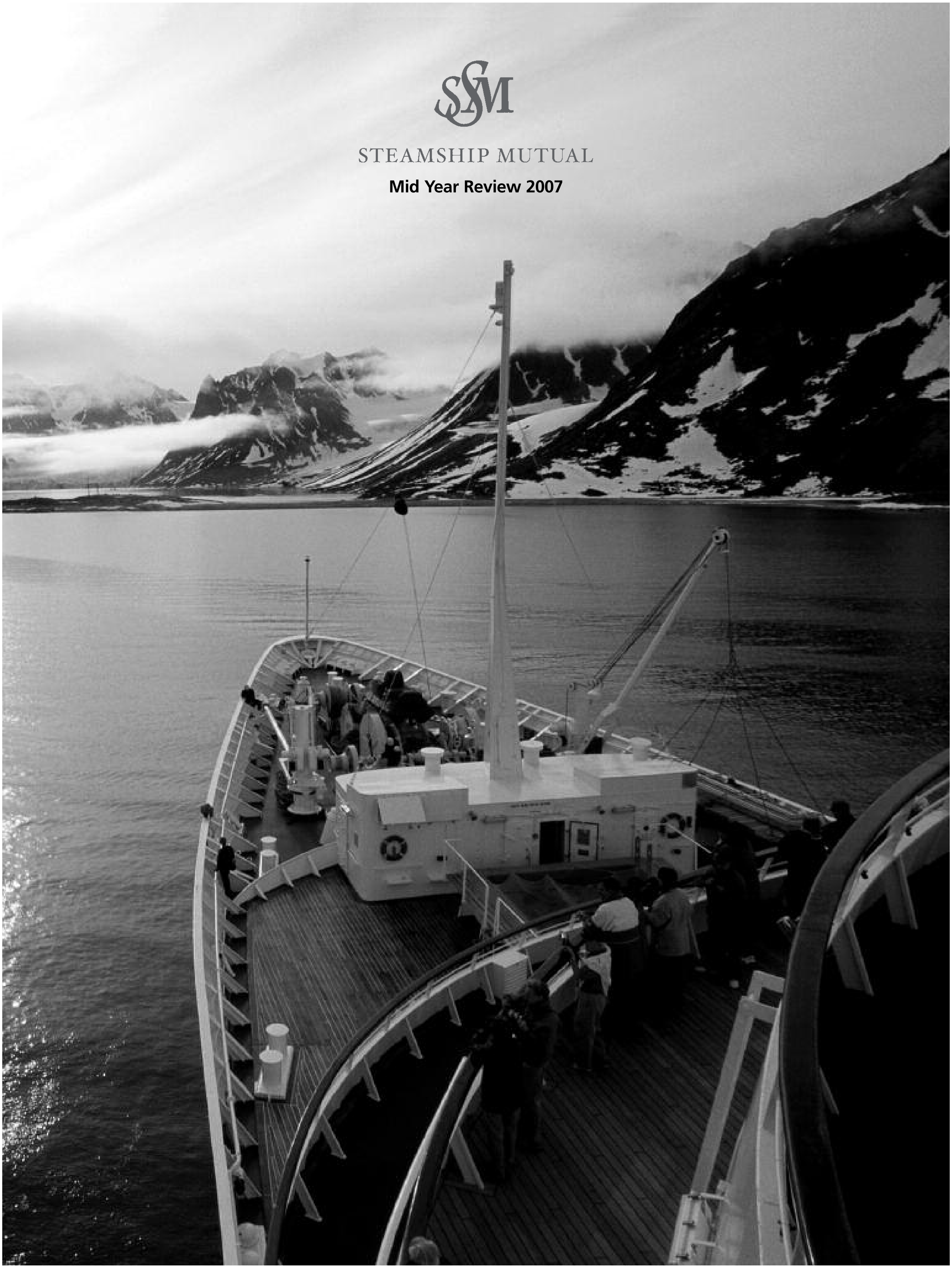
STEAMSHIP MUTUAL

Mid Year Review 2007



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Highlights

- Owned entered tonnage increased by 2.75 million GT since 20th February, to 46 million GT
- Combined investment income earned to date of US$ 34.9 million, equivalent to a return of 5.35%
- Combined cash and investments rise by US$ 63 million to US$ 700.8 million
- International Group Pool claims notified for 2007/08 total US$ 165 million, a new all time high at the nine month stage
- 2005/06 policy year pure underwriting surplus has continued to improve and now stands at US$ 23 million
- 2006/07 policy year pure underwriting deficit has reduced to US$ 21.5 million
- Higher premiums and less severe claims in 2007/08 policy year projected to restore the pure underwriting result to surplus
- Standard increase for 2008/09 set at 15% for all premiums


James Stockdale Chief Executive

Overview

The 2007/08 financial year started well with an adjusted premium increase of 8.6% being achieved on renewed business and a modest further increase in entered tonnage. Since the renewal owned entered tonnage has grown steadily, by 2.75 million GT, ahead of the growth in world tonnage. If this trend continues until the end of the year, the Club's total entered tonnage is projected to reach 70 million GT before renewal.

Despite turbulence in the world credit markets, as the result of uncertainties over the impact of subprime mortgages and the level of growth of the world economy, the Club's combined investment income earned to date is currently ahead of budget at US$ 34.9 million.

Claims on prior years up to and including 2006/07 have continued to improve. At the halfway stage, the Club's own claims in 2007/08 in the volatile layer above US$ 250,000 up to US$ 7 million per claim, were well below projected levels. However, in the most recent quarter larger claims have reverted to 2006/07 levels, with three claims being estimated close to or above the Pool entry point. Unfortunately overall the Group Clubs' 2007/08 Pool exposure is showing no sign of improvement over 2006/07, with total incurred claims after nine months reported at US$ 165 million compared to US$ 163 million the previous year.

Shipping activity continues to be buoyant in almost all sectors. Claims related costs are continuing to escalate, as is the shortage of experienced crew. It is likely therefore that the Club will continue to face high levels of industry risk and rising Pool costs.

Faced with the possibility of a second successive year of record claims exposure, it is becoming clear that an underwriting approach based on a six year historical record is no longer satisfactory. Increasing emphasis has to be placed on future risk exposure if the Club is to be successful in maintaining a strong and conservative basis of underwriting, thereby meeting its strategic goal of a three year average combined ratio of 108%.

Gary Rynsard Chief Operating Officer

Underwriting

In the first nine months of the year 380 owned vessels comprising 5.92 million GT joined the Club resulting in a net increase of 2.75 million GT. The current total entered tonnage including chartered is 69 million GT. Most of this growth is due to additions to existing fleets in the Club's traditional markets, in particular Germany, the Far East, India, the Middle East and the United States. The increase in tonnage reflects both the continued vibrancy of the shipping markets, and the confidence of Members in the financial strength and quality of service provided by the Club.

The main underwriting challenge for the Club is posed by the dramatic increase in claims seen in the 2006 year, which early indications suggest may well be continuing in the 2007 year. The main area for concern is the value of the larger claims, i.e. those which fall in the Club's "abatement" layer, between US$ 1.8 million and US$ 7 million, and those which fall on the International Group Pool, i.e. between US$ 7 million and US$ 50 million.

An essential part of the response to this challenge is a recognition that the record of an individual fleet is only one factor in calculating the appropriate premium. Where a large part of a fleet record falls within the abatement layer, it ceases to be a factor in the individual record and becomes part of the overheads to be mutualised and distributed over the Membership as a whole. It is for this reason that the chief consideration for the forthcoming renewal has to be the Club's overall underwriting position, a comparison of net premium with net claims and administration costs, the so-called "combined ratio". An important strategic objective for the Club is to achieve an average combined ratio of no more than 108% over any three year period. This is consistent with the Board's aim to reduce reliance on investment income.

Set out below is the combined ratio record for the last four years.

Financial year	2003/04	2004/05	2005/06	2006/07
Combined ratio	114.1%	114.1%	100.8%	128.2%
3 year average (2003/04 – 2005/06)			109.7%	
3 year average (2004/05 – 2006/07)				114.3%

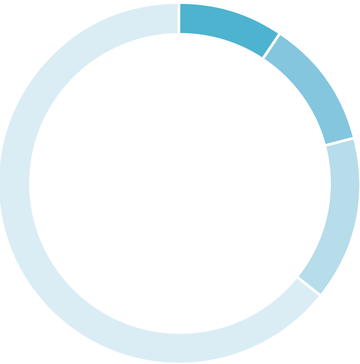
It is clear from the volatility displayed by these figures, particularly in relation to 2006/07, that immediate corrective action is required to achieve the strategic objective. Such action must include an increase in premium across the Club's entire book of business irrespective of the record.

Underwriting

Additionally the allowance made for contributions to the cost of the Pool and the abatement layers in the Club's calculation of a rate needs to be adjusted to reflect the increased risks. A more conservative approach to these layers will lead to a reduced amount available to pay for routine claims, the "burning cost" layer. The required adjustments are illustrated in the following pie charts.

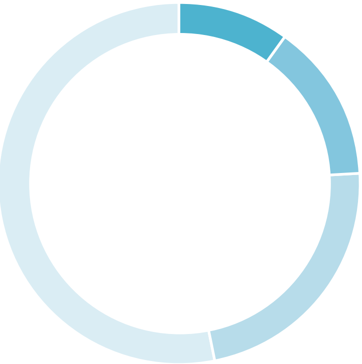
2007/08

- XL costs
- Pool costs
- Abatement
- Retained premium



2008/09

- XL costs
- Pool costs
- Abatement
- Retained premium



Note: These charts are for illustrative purposes only. The apportionment of these costs in any individual case will vary depending on the type of vessel and the rate per ton.

An allowance will also be made in these layers for claims handling costs.

In addition to analysing an individual fleet's record the Club will also assess the risk or exposure posed by a particular fleet, assisted by the Club's claims experience across specific vessel types, sizes, ages and geographical areas of management. This allows the risk to be viewed in a more balanced and broadly based context, enabling a more realistic assessment of the risk posed by the fleet to be made. Due weight will also be given to any clear change in claims trend evidenced by the record of the more recent years.

The Board has set a standard increase of 15% for 2008. This follows the 9% standard increase set by the Board for 2007. In the current circumstances, the Directors believe that this standard increase is a reasonable continuation of the action already taken at the 2007 renewal; a measured and appropriate response to the challenges outlined above to ensure the continued financial strength of the Club.

Claims

Stephen Martin Head of Claims

The projected net cost of claims arising on all policy years including 2006/07 has reduced by some US$ 20 million since February 2007. The improved outlook for these earlier years is evidence of the Club's conservative approach towards claims estimating and successful claims management.

In 2006, the average value of attritional claims up to US$ 250,000 increased significantly when compared to earlier years, reflecting many of the inflationary factors which are by now well recognised. However, the number of such claims was less than in previous years with the result that the overall outcome for claims in this category in 2006 remains in line with projections.

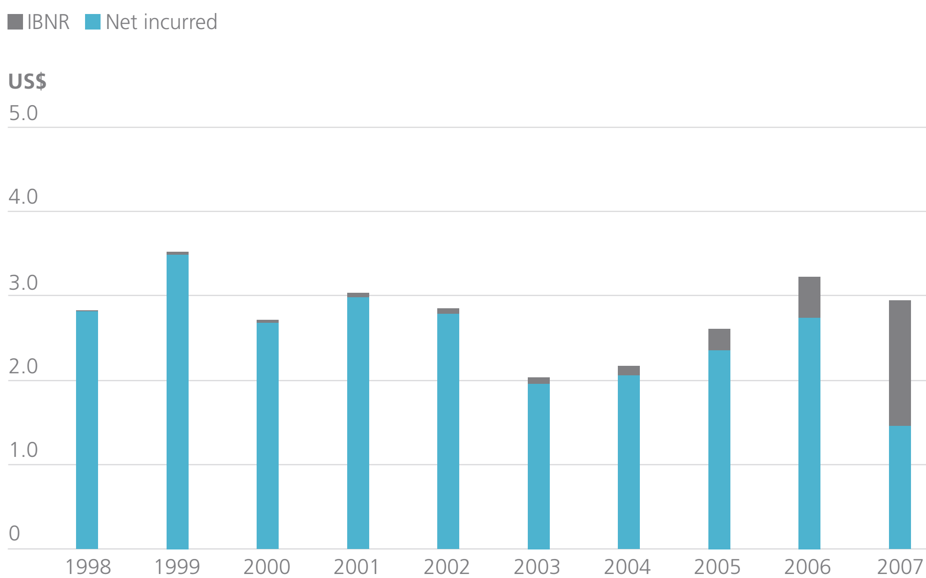
The same cannot be said of the larger claims in 2006. Claims on the International Group Pool are still expected to reach record levels, currently projected to be in the region of US$ 600 million. The question, of course, is whether the experience of 2006 is exceptional, or whether factors which have influenced claims in that year will give rise to similar or even greater levels of exposure in 2007 and beyond.

The claims experience thus far in 2007 offers little encouragement. Attritional claims remain, as they did in 2006, within overall projected levels, but those in excess of US$ 250,000 and in the Pool appear to be as high after nine months as in 2006 at the same point. Cargo claims below US$ 250,000 are, perhaps surprisingly, lower than in 2006, whilst crew claims within this level have risen significantly, by some 30%. There has, as yet, been no significant increase in the projected cost of other attritional claims.

The Pool, however, has developed throughout 2007 along similar lines as in 2006; 12 claims notified by all Group Clubs up to November 2007, as against 11 in 2006, with comparable values. After 21 months of large claims at these levels, it seems increasingly possible that the cost of claims in the Pool will be no less in this policy year than last.

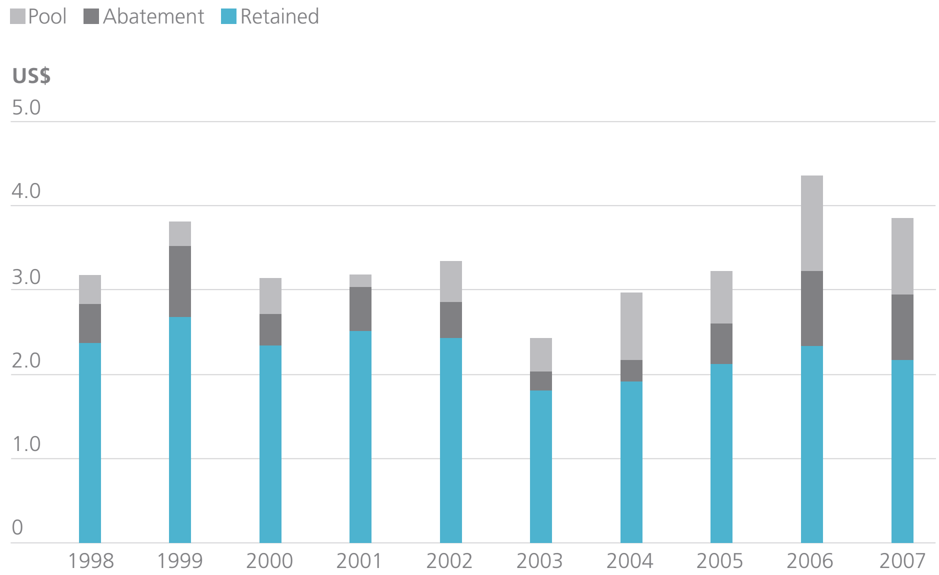
The following two graphs show the Club's overall projected claims per GT for the last ten years, demonstrating a clear upward trend in claim values since 2003, and significant increases in Pool and abatement layer claims in 2006 and 2007.

Projected net owned claims per GT by policy year



Claims

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



As far as the Club itself is concerned the first half of the year produced no claims upon the Pool. However since October 2007, two claims have exceeded the Pool level of US$ 7 million and one is approaching it. Each of these claims appears to be attributable, in one form or another, to human error. The most serious arose when a container vessel under the control of a local pilot contacted a bridge fender in San Francisco Bay, rupturing a bunker tank, spilling 200 tons of fuel oil and incurring extensive pollution clean-up costs.

Whilst Pool claims in recent years follow no particular trend in vessel type, cargo, age, geographical location or flag, many do appear to reflect problems experienced throughout the industry in the training, recruitment and retention of crews.

It is widely recognised that many officers and crew lack the experience of their peers in similar positions several years ago. STCW certification is no guarantee of practical competence, for which seagoing experience, no less than learning theory, is necessary. These problems are exacerbated when inexperienced crew must cope with challenging operational or weather conditions.

As many owners and operators struggle to find competent sea staff, so it has become necessary to place greater burdens on older and more experienced officers and crew, who because of their age inevitably face greater risk of injury and illness as a result. Owners are, of course, taking steps to meet these challenges. Unfortunately, the higher wage levels and greater benefits necessary to encourage recruitment and retention will, in turn, cause crew claims exposure to rise. In certain countries, the crew shortage may also increase the number of improperly and fraudulently certified seafarers, posing a clear threat not only to those who employ them, but also to others affected by their actions.

In the United States, and increasingly in Europe, the industry is accustomed to high levels of compensation for injury and death, levels which are likely to increase as new legislation comes into force. Initiatives within the EU, and at the IMO, are quite likely to raise the expectations of claimants further afield.

Against this somewhat uncomfortable background, the Club must and will continue to adhere to its policy of accepting new Members only when satisfied that their standards of operation and maintenance are acceptable. At the same time, the Club's survey programme is focused upon vessels which appear to present particular risks associated with age or cargo type.

Stephen Quartermaine Head of Reinsurance

Reinsurance

Having increased the Club retention before Pooling from US$ 6 million to US$ 7 million last year, the International Group has agreed to leave the retention unchanged at US$ 7 million for 2008, a decision welcomed by both the Board and Managers of the Club.

As is now well known, the incidence of claims on the International Group Pool in the 2006 policy year reached an all time record. The Club's current projections for claims in the layer from US$ 6 million to US$ 30 million are for them to reach an ultimate total of US$ 412 million, exceeding by a substantial margin the previous high point in 2004 (presently projected to reach US$ 237 million for a wider layer starting at US$ 5 million).

The critical question is now whether 2006 represents a peak year for the Pool, or a step change which will continue in the future. Notifications so far do not show an encouraging picture, with claims running at comparable levels to 2006.

The following triangulation shows the development of Pool claims in recent years. This demonstrates that, at six and nine months from inception, overall Pool claims in both 2006 and 2007 were reported to be at record levels. It is still, however, very early to draw conclusions.

International Group Pool notified claims up to US$ 50 million

Data is as at 20th August for each year, except for the first column which is as at 20th November for the last two policy years.

	Position as at									US$ millions	
Policy Year	**9 months**	**Aug 07**	**Aug 06**	**Aug 05**	**Aug 04**	**Aug 03**	**Aug 02**	**Aug 01**	**Aug 00**	**Aug 99**	**Aug 98**
1998*		136.4	134.1	134.1	129.9	127.0	126.0	112.1	107.9	78.4	4.8
1999*		99.8	96.0	98.4	96.2	94.3	90.4	90.0	46.8	1.5	
2000*		144.1	139.6	144.6	142.1	143.1	144.9	132.3	11.9		
2001*		49.0	42.3	42.1	39.0	39.9	41.9	0.1			
2002*		171.1	177.0	177.7	169.9	158.4	10.4				
2003*		139.0	137.8	138.4	131.7	41.5					
2004		293.6	279.4	258.6	43.6						
2005		221.8	183.3	2.3							
2006	162.9	434.2	78.2								
2007	165.0	84.7									

Source: International Group statisticians.
* 1998 – 2003 claims are pooled up to US$ 30 million.

For the 2007 year, the Club has arranged a reinsurance of its liabilities in the first layer of the Pool, up to US$ 30 million, which will provide a considerable degree of protection at claim levels below those of 2006. Nevertheless, provision must be made for the possibility that claims on the Pool will continue at a high level in 2008 and beyond.

Claims have also intensified in the upper layer of the Pool, from US$ 30 million to US$ 50 million, which is reinsured into the Group's captive, Hydra. Claims in 2006 have considerably exceeded the premium paid to Hydra for that layer, and there are already claims in 2007. The Hydra Board has decided to make a second capital call of US$ 80 million to address this. The Hydra premium for 2008 may be expected to rise considerably as well.

By contrast, the record of the International Group's excess of loss programme, though not free of claims, continues to be satisfactory. Furthermore, the US hurricane season has again been kind to reinsurers, raising expectations of another profitable year. At this stage, therefore, the excess loss renewal can be approached with confidence.


Steve Ward Finance Director

Investments

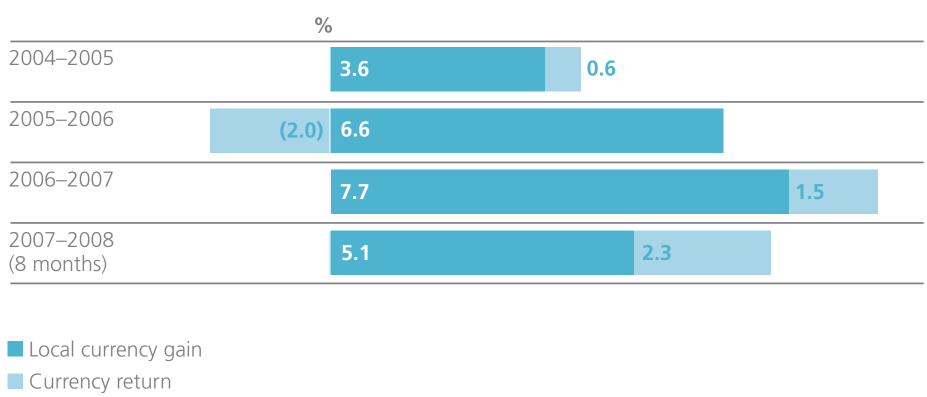
Investment returns are ahead of expectations in the first nine months of the year despite a sharp increase in market volatility in the third quarter. In the first nine months of the year the combined investment portfolio has produced an estimated total return of US$ 34.9 million, equivalent to 5.35%, only slightly below the return to the same point last year.

By the end of July increasing reports of defaults on lower quality, or subprime, US mortgages had spilled over into the broader international credit market causing widespread illiquidity and dislocation. Equity markets were very volatile in the summer but by the end of September had recovered their poise, having taken confidence from a half point cut in interest rates by the Federal Reserve and supportive action by other central banks. Growth stocks outperformed value stocks for the first time in two years and hedge fund results were highly variable as they sought to reduce leverage and risk exposures.

Headline inflation picked up driven mainly by rising energy prices and US housing market indicators deteriorated markedly as the year progressed. Despite the ongoing weakness in residential construction and the collapse of the subprime lending market, US economic growth picked up in the second and third quarters but rising uncertainty over the degree of subprime losses forced credit spreads sharply higher, negatively affecting mortgage-backed securities. The price of oil approached US$ 100 per barrel as the dollar lost substantial value against a trade-weighted basket of currencies. Gold and commodity prices approached all-time highs.

In common with last year, currency gains on the portfolio's non-dollar investments have made a significant contribution to the overall return; US$ 14.9 million or 31% of the total return for the first eight months is attributable to this factor. These are largely offset by equivalent but opposite movements in the value of non-dollar claims.

Combined investment return

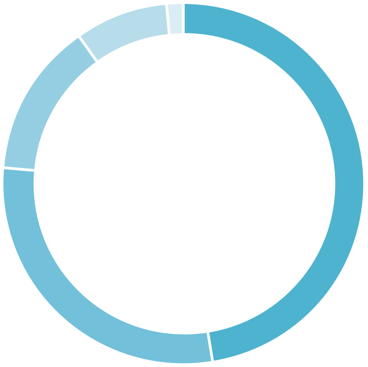


Investments

The Corporate Trustee revised the implementation of its asset allocation earlier this year, extending its investment in products designed to deliver a consistent absolute return at the expense of those exposed to short term market gyrations. The following charts show the make up of the portfolio by asset type and currency as at 31st October:

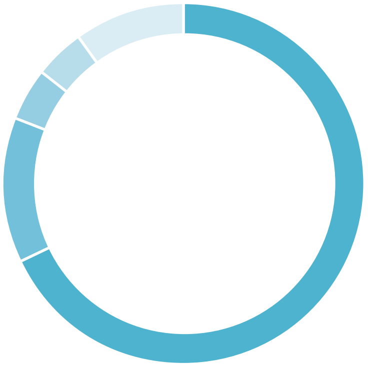
Investments shown by asset type

Bonds	**47.4%**
Equities	**29.0%**
Alternative investments	**13.8%**
Cash and deposits	**8.3%**
Property	**1.5%**



Investments shown by currency

US dollar	**67.9%**
Euro	**13.0%**
Yen	**4.7%**
UK sterling	**4.5%**
Other	**9.9%**



The portfolio outperformed its benchmark by 0.5% over the 12 months, and 0.8% over the three years, to 30th September. This performance represents a modest improvement on the three year rolling average outperformance to 20th February 2007. It is encouraging to note that both the non-US equities and the Hedge Funds of Funds outperformed their benchmarks in the recent period of increased volatility.

It is again difficult to predict what the full year investment return will be, with three months remaining. Plunging house sales and prices in the US, the extended credit market upheaval, surging oil prices and a plummeting dollar could trigger a US recession and depress growth in the European and Asian economies, and the risk of inflation has increased. On the other hand US corporate earnings and employment remains strong, inflation remains under control, booming exports have contracted the US trade deficit and central banks still have the scope to provide support through interest rate reductions. In any event it seems very unlikely that the credit markets will return to the glory days before the summer of this year. In the short term markets will continue to be prone to bouts of volatility while the uncertainty over further credit write downs persists and there is likely to be a longer period of adjustment as the wider impacts of the credit turmoil on the financial system and the real economy become clearer.

While investment income earned at the nine month stage is slightly ahead of budget, whether that can be sustained until the end of the financial year is a finely balanced question fraught with uncertainty. That uncertainty serves to reinforce the correctness of the Board's decision to place no reliance on investment income when setting underwriting policy.

2008/09

The unprecedented level of claims experienced by the whole P&I industry in 2006/07 is an example of the higher risk exposure now faced by the Group, stemming from the prolonged boom in shipping. The continuation of the buoyant shipping market and the resultant pressures on schedules, manning, maintenance etc. combined with ever increasing legislative and regulatory pressures, make it almost certain that higher claims levels will continue for the foreseeable future. In response to this, the Directors are determined to ensure that Steamship Mutual meets its strategic objective of a three year average combined ratio of 108%, continues to maintain a strong capital base and achieves premium levels which truly reflect the risks faced by the Club.

This requires a twofold approach. Firstly, a move to a more forward looking exposure based underwriting strategy. A Member's historic claims record may provide some guide to future risk exposure, but it is not sufficient in isolation. It needs to be combined with the experience drawn from a broad spectrum of similar risks as well as market developments and the increasingly burdensome legal climate shipping faces. Secondly, the rising trend in large claims has made it necessary for the Directors to take progressive steps to raise premium levels.

At the last renewal, this resulted in a standard increase of 9%. It is now clear that claims levels for 2006/07, particularly in the Pool, are even higher than originally projected and that claims in the current year may well be as high. Bearing in mind that volatility in the investment markets makes it imprudent to place reliance on investment returns for any dependable contribution to the Club's finances in the short term, the Board has directed the Managers to increase general premium levels by a further 15% for 2008/09.

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