Managing risk and its consequences

Half Year Management Report
20 August 2008

Chief Executive's statement

The results for the first half of the 2008 policy year have been affected both by the current claims environment and the volatility in the investment markets. During this period, there were only two Pool claims for this policy year – significantly lower than recent years – however, both the frequency and severity of claims in marine and P&I have deteriorated across the industry. The increasing number of accidents can be accounted for by the rising incidence of navigational errors, while claims inflation is still being driven by high commodity prices affecting cargo claims, the cost of raw materials such as steel, and the restricted availability of repair capacity.

While we know that one day there will be a severe financial downturn, what we do not know is when – which is why the maintenance of a strong financial position has always been one of our key goals. While events so far have had no material impact on Gard's operations and strong security, it is almost impossible to escape the current problems in the financial markets. As a result, the value of our investment fund has been negatively affected by the broad decline in most asset classes, despite the fact that there have been no credit losses due to the failure or suspension of activities of counterparties.

This means that we are reporting a deficit for the period of USD 49 million and a decrease in our free reserves to USD 532 million. Our total assets are now just over USD 2 billion. The financial market crisis is still evolving and we remain vigilant, focused on our long-term objectives in terms of our investment policy. We are also proactive in relation to issues such as reinsurance security, and all participating reinsurers currently comply with our reinsurance security guidelines. We are confident that we have put in place robust processes to enable us to weather the storm.

From an underwriting perspective, the volume of business written in each business area is ahead of target. Our P&I tonnage is growing slightly faster than world tonnage, we are seeing a steady increase in the number of vessels in our marine book, and the number of vessels for which we have the marine claims lead has risen by nearly 65% – up from 2,186 in 2005 to 3,454 in 2008. Our combined net ratio for the first six months was 102%, an improvement on the budget of 105%, and our marine and energy business has performed well and posted an overall surplus, despite poor investment returns.

Further disruptions, government interventions and other realignments may still occur in the coming months, but we want to focus on business as usual as much as possible as we go into the renewal season. Our core purpose – the basic reason why we exist – is to help our Members and clients in the marine industries to manage risk and its consequences. Recent history shows all too clearly what happens to companies who stray too far from their core businesses, and we believe that being a long-term partner for our Members and clients means taking decisions today, while very much considering the consequences for tomorrow and beyond.

Claes Isacson
Chief Executive Officer

Underwriting

P&I

The results for the mutual P&I business for the first half of the year are disappointing, having been adversely affected by increased severity of claims. With each and every claim becoming more expensive, previously minor claims have ceased to be minor anymore.

After reaching record-breaking levels last year, the 2008 policy year has seen only two Pool claims in the first six months. This makes for a complex and somewhat contradictory claims story. In such a challenging market, the improvement of our technical underwriting results for mutual P&I is a core area of focus.

There has, however, been steady development in the area, and volumes overall have continued to grow. We are still seeing second-hand tonnage being entered by existing Members, showing that they are still choosing to put their ships with Gard – even though we may not always be the cheapest option. In addition, we saw a net increase in tonnage of 4.5 million gt, growing in line with our market share.

As we move closer to the renewal date, it is clear that clients want to understand the financial position of their insurers in these troubled times, and for our part we must achieve pricing levels that reflect the real costs, as well as better risk prevention and loss management.

Marine

The first half of the year has delivered better than expected results, especially given that market conditions remain challenging. Our combined net ratio is better than budget and we have avoided the worst of the big market losses that have occurred.

The essential problem remains constant – premium increases are not sufficient to compensate for claims inflation. The marine market as a whole is still experiencing poor underwriting results and much has been written about the increasing severity of claims across the sector.

However, we are starting to see the first signs that the market may be reacting with the withdrawal of capacity from the Norwegian market – something that may have an effect on pricing, although given the size of the London market the changes may only filter through slowly.

We are looking actively at all the tools available to us to establish the right level of pricing, and we believe that we can build on these foundations to improve this process further in the coming year.

Energy

Energy has performed exceptionally well for the first half of the year, with first-class risk selection taking place, and the combined net ratio well ahead of budget.

Asset values for rigs and platforms are still high, which has increased demand and sustained the price of cover. Earlier in the year, the market started to become increasingly competitive as new players looked at the opportunities that this sector could offer and this, combined with good industry results, created downward pressure on pricing.

However, these results are deceptive and the overall claims picture is more complex than it might first appear. There are new claims coming through the system, although fortunately they are not always in the types of risk that we write. Nevertheless, the result is that market prices are starting to flatten and even increase.

We have also benefited from the fact that we have settled a number of old claims more favourably than expected, and with a possible turn in market pricing on the horizon, we are well-positioned in this area.

Claims

P&I

The P&I claims picture for the first half of the year could have been better. Total liabilities for 2008 incidents are considerably higher compared to the first half of last year, caused by a mixture of rising frequency and individual claims becoming more expensive. While there have been a number of both middle layer and major incidents, the Club is not likely to submit a claim exceeding USD 7 million to the IG reinsurance pool.

The causes remain broadly the same – with around a third coming from collisions and groundings (usually caused by human error), while the rest are a mixture of cargo, personal injury and third party property.

The upside in this slightly depressing picture is that the deterioration of prior years' claims has slowed, and our ability to set reserves and assess the potential claims exposure earlier in the process has improved.

Marine

While the worst of the winter weather is yet to come, we are pleased to say that the marine claims picture for the first half of the year has been relatively benign. The number of claims is moderate, most product areas are running smoothly, and we have managed to avoid most of the really big losses.

The area that is facing the most challenges is Hull & Machinery, where the severity of claims remains a concern. The causes of this have not changed, although in recent months there has been greater emphasis on the rising cost of delayed repairs – partly because of price increases during the waiting period – and also the need to build high fuel prices into the cost of towage as removals tend to be over greater distances to find repair availability.

As well as making current claims more expensive, it has also affected the reserving on claims from previous years as estimates are moved upwards to reflect the uncertainty in many areas of the market.

There has, however, been a positive trend in Loss of Hire compared to last year. This partly reflects the fact that freight rates have come off their peak, and also that insurance buyers are looking to protect themselves against an average rate rather than the highs in the spot market.

One of the major trends is the increase in the number of vessels for which we have the claims lead – rising from 2,186 in 2005 to 3,454 in 2008 – up nearly 65%. There is no doubt that this is a reflection of the service that clients see themselves receiving, as well as some of the economies of scale that we are able to achieve to reduce costs and get vessels back in service faster.

Energy

The first half of this policy year has seen very few claims on either the energy or marine builders' risks books. Although it has been a relatively active hurricane season this year, we are pleased to say that Gard has been relatively unaffected and the re-balancing of our energy portfolio means that the only assets we cover in the high-risk areas are mobile units that can be evacuated quickly to a safe distance. The claims that we have seen have tended not to be dramatic, and the common theme appears to be corrosion – either in pipelines or in tanks caused by micro-bacterial invasion.

Defence

The Defence team has been further strengthened through recruitment in various offices and the facilitation of exchanges between offices such as New York, Hong Kong and London.

Several presentations have been given to Members over the past six months and our bi-annual legal workshops in Athens, aimed at the Members' in-house lawyers, have already become an anticipated event.

As with P&I, the claims picture for Defence was not encouraging for the first six months. The financial exposure has increased significantly compared with last year across all value bands, but the major impact comes from a small but significant increase in the number of high-severity cases.

Risk assessment and loss prevention

There is still strong demand for our loss prevention services. Our loss prevention circulars – covering such topical subjects as piracy – are well received and we are seeing more and more shipowners relying on them as their sole source of written loss prevention advice, as well as directly implementing them into their QMS systems.

The increase in the size of our portfolio has generated a greater number of ship inspections, and we have increased the size of the team to meet this demand. We inaugurated the new crisis room in Arendal at the beginning of August. The room is part of our long-term crisis management strategy, and enables fast and accurate processing of information that will enhance decision-making under pressured conditions.

We also launched a new product in the early autumn: case studies for on board safety meetings. Relevant case studies will be distributed for discussion during on board safety meetings on a monthly basis. The package includes a work sheet for a correct risk assessment of the case.

Summary combined consolidated income and expenditure accounts and balance sheet

Summary combined consolidated income and expenditure accounts
(All amounts are stated in USD 000's)

Six months to 20 August	2008	2007
Premiums and calls*	390,564	343,306
Premiums earned net	341,267	299,739
Claims costs net**	300,150	262,762
Operating expenses net	49,263	48,021
Result on technical account	(8,146)	(11,044)
Result on non-technical account	(40,376)	22,217
Surplus/(Deficit)	(48,522)	11,173
Combined Ratio Net (CRN)	102%	104%

*Premiums and calls include one half of the estimated total calls for the P&I business and gross earned premium for the marine and energy business.
**Claims handling costs share of operating expenses net is included in claims costs net.

Summary combined consolidated balance sheet
(All amounts are stated in USD 000's)

As at	20 August 2008	20 February 2008
Investments at market value	1,224,019	1,327,015
Cash and equivalents	340,334	258,737
Other net assets	453,548	344,948
Net assets	2,017,901	1,930,700
Unearned premium reserve for own account	269,276	154,607
Provision for outstanding and unreported claims	1,138,280	1,100,606
Other liabilities	78,520	95,002
General contingency reserve	531,825	580,485
Net equity and liabilities	2,017,901	1,930,700

Net equity investment in the wholly-owned subsidiary Gard Marine & Energy Limited was USD 258 million as at 20 August 2008 (USD 255 million as at 20 February 2008).

Gard P&I and M&E result on technical account

Income and expenditure accounts on lines of business

(All amounts are stated in USD 000's)

Six months to 20 August 2008	P&I	M&E	Combined consolidated accounts
Premiums and calls	222,146	168,418	390,564
Premiums earned net	190,108	151,159	341,267
Claims incurred net	181,255	97,851	279,106
Claims handling costs*	17,000	4,044	21,044
Claims costs net	198,255	101,895	300,150
Operating expenses net (excluding claims handling costs)	18,922	30,341	49,263
Result on technical account	(27,069)	18,923	(8,146)
Result on non-technical account	(24,967)	(15,409)	(40,376)
Result ordinary operations	(52,036)	3,514	(48,522)
Claims ratio net	104%	67%	88%
Expense ratio net	10%	20%	14%
Combined ratio net	114%	87%	102%
Insurance margin	-27%	2%	-14%

*Claims handling costs share of operating expenses net is included in claims costs net.

This report has been prepared by Gard AS, managers of Assuranceforeningen Gard (the Association), from data and accounts provided by the Association and its 'sister' company, Gard P&I (Bermuda) Limited (the Bermuda Association), and Gard Marine & Energy Limited.