DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE HALF YEAR TO 20 AUGUST 2011

gard

Highlights

Gross written premium on ETC basis **USD692m**	General contingency reserve **USD798m**	Total assets **USD2.7bn**
Combined net ratio on ETC basis **102%**	Surplus after tax on ETC basis **USD6m**	Standard & Poor's rating **A** (positive outlook)

Chief Executive's statement

After a successful 2010 policy year, this financial year is proving to be more difficult. The first six months have been challenging for everyone working across the maritime industries and the insurance markets have been no exception to that trend.

Steady results in a challenging climate

For the first half of the 2011 policy year our surplus after tax was USD 6 million, increasing our free reserves to USD 798 million, with assets now totalling USD 2.7 billion. The combined ratio net at group level was 102 per cent.

This slightly negative technical underwriting result was affected by a higher than expected number of large claims in the first quarter. While the second quarter developed more favourably, this was insufficient to offset the previous period. It is also clear that claims inflation will be a factor for consideration going forward. However, managing the claims development is an integral part of our business, and we have the balance sheet strength and processes to manage them efficiently and effectively.

We achieved better gross written premiums than expected across all areas except P&I mutual where, for the last two years, we have not asked for any general increase.

Investments performed well until mid-July since when markets have developed unfavourably. Bonds fared better than equities in the period and were the main contributor to a positive non-technical result. The volatility of the investment markets and the low interest rate environment underpin the need to achieve positive technical underwriting results through prudent risk selection and the correct pricing of of the insurance portfolios.

Dealing with difficult times

We are aware that the economic conditions facing our Members and clients are tough and, as their business partners, our focus is – and always will be – on helping them to manage their cost base, risk profile and balance sheet. That is the strategic underpinning of everything we do.

However, we have a responsibility to rate our mutual book correctly, and to manage our business to preserve its long term strength to the benefit of our owners and policyholders. General premium increases are used to ensure that income remains in line with expected claim costs, taking into account shipping liability trends and other claims inflation factors. The other side of this coin is that, when possible, we have reduced the deferred call for a policy year when the forecast result has been strong enough to justify it.

Investing in the future

Our job is to offer the most intelligent risk solutions possible, which means that we need to evaluate the corporate structures and tools that we use in order to create genuine alternatives.

We also continue to invest in our capabilities around the group. We are strengthening our product development team in order to provide better products and services to our Members and clients. In Japan, where the market is undergoing considerable change, we are recruiting more local staff to ensure we are well-positioned to cater to this need, and we are also looking to increase the number of staff who work at Lingard in Bermuda, as our reporting and regulatory activities become more focussed on the island.

Getting closer to clients

Finally, a better understanding of the business and risk transfer needs of our shipowners and operators is reliant on direct, personal and frequent contact with our Members and clients. As the policy year progresses we will be travelling to the developing markets more frequently, as well as meeting many of you at Gard evenings and other events to gain a greater understanding of the issues you face.

This knowledge, combined with our experience and expertise, will help us – and we hope you – to navigate safely through what continue to be turbulent times.

Claes Isacson
Chief Executive Officer

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Underwriting

Business development

For the first six months of the 2011 policy year, the combined ratio net was 111 per cent for P&I and 88 per cent across the marine and energy business areas. We saw a positive inflow of P&I business in terms of tonnage, types of vessel, size and age. Premium volume has also held up well for both marine and energy.

This is against a market backdrop which continues to pose challenges across all areas. The conditions for P&I have received considerable focus in the media for some time. Increased market capacity in marine and keen competition have also resulted in softening rates. Despite this we have had some success in persuading buyers that the range of cover, as well as the scope and quality of service, is worth a slightly higher premium than the average slip rate. During this period the energy market has been more positive and rates have held up well. However, capacity is coming back to the market and the 1/1 renewals on the direct and reinsurance side will be important indicators for this market segment.

The development of the claims picture is a key part of the jigsaw when looking at underwriting trends. The high combined ratio net for P&I resulted from some higher than expected claims in the first quarter. The severity of certain categories of P&I claims appears to be increasing, and there are clear signs of underlying claims inflation. The figures for marine also indicate an upward trend in the average cost per claim.

Equitable underwriting

While it is difficult to extrapolate a long term claims trend from a six month period, there are a number of serious macro economic factors which we know are important to insurance buyers – primarily the state of the world economy. There is no doubt that ship owners and others in the marine industries are suffering badly in current market conditions which are unlikely to improve if the more pessimistic views about the world economy prevail.

For insurers the prospect of very low investment returns for an extended period compounds the pressure that is created by very competitive market conditions and a likely increase in claims severity. The challenges created by this situation are particularly acute for P&I clubs who have responsibility for their mutual members.

All of these factors make it vital to rate the P&I mutual book correctly. Achieving a proper rating for each entered fleet is a prerequisite for providing premium stability, predictability and fairness across the membership over time. General increases are applied when the underlying claims inflation – including the exposure to large claims – so requires. When the group's results have been sufficiently strong, we have reduced our deferred call, which has effectively delivered a premium discount for our mutual members for the years concerned. This consistency of performance is evidenced by the fact that broker reports have commented that Members of Gard have been better off long term than those who were Members at other clubs. Our ambition is maintain this consistency as we move forward.

Developing the right solutions

We are strengthening our underwriting resources to provide better products and services to our Members and clients. Our focus remains to truly understand the particular risks faced by the each of them in their particular line of trade and how these risks interact, and engage in a constructive dialogue in order to offer the best fit of products, which offers seamless coverage and service for the risks concerned.

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Claims

Managing claims effectively is central to what we do. For the past two years, we have conducted a thorough review of our claims operations aimed at improving our service capability and reducing claims costs. As a result, our claims operations were reorganised with effect from 20 February 2011 into eight specialised processes, namely: Cargo, Collision, Defence, Environmental, Marine, Offshore Energy, People and Loss Prevention and Risk Assessment (LPRA), each with a process owner responsible for best practice handling of such claims in all our offices. In addition, we have created claim teams that facilitate hands-on management by team leaders close to their staff.

Cargo

Compared to the high 2008 levels and considering tonnage growth, the cargo claims frequency remains benign, but claim severity is increasing with high commodity values. Cargo liabilities arising from casualties and contamination of liquid cargos are among the main contributors to high severity claims. Our specialised liquid cargo claims team continues to gain and share experience.

We also continue to see a number of difficult cases and issues concerning dangerous solid bulk cargos, notably those that may liquefy. Members have in recent months had to reject the loading of certain nickel ore cargos in the Philippines and Indonesia. In the worst cases, bulk cargo liquefaction may cause ships and their crews to be lost. It is therefore important that the issue remains firmly on the agenda of the IMO, and that the industry continues its work to address the problems – notably unreliable cargo declarations by shippers.

Collision

The 2011 policy year has so far developed in line with expectations for collision claims, and has not followed the costly pattern seen for 2010, when claims costs increased significantly compared to previous years, primarily due to a few very expensive incidents.

Positive experiences have been gained from attendance on site to negotiate fixed property damage claims directly with claimants. Early settlements may in certain cases be cost-effective in preventing protracted litigation and increasingly entrenched positions, as well as reducing trade disruption to the Member.

Unfortunately, detention of crew members by local authorities after maritime casualties remains a problem, illustrated by a recent collision case in India.

Defence

As the economic climate and world events present ongoing challenges, we continue to see large volumes of all types of Defence claims, as well as some new types of dispute. For example, following the earthquake and tsunami in Japan and the subsequent incident at the Fukushima Nuclear Power Plant, Gard was the first club to advise its Members that it would relax its rule excluding Defence cover for legal costs to pursue or defend against claims arising from nuclear risks. Another new type of claim concerns disputes arising with private security companies relating to the provision of armed security personnel to help counter the risk of piracy attacks. In addition, we have seen an increase in the need for advice relating to piracy generally, sanctions and trading to certain areas of the world.

Despite large numbers of claims, their severity gives less cause for concern. This is largely because our Defence team is able to handle the majority of matters in-house to save costs.

Environmental

New environmental claims most worthy of mention include the loss and recovery of 26 containers following a collision off the coast of China, and a significant incident in India, involving a vessel moving away from the berth during bad weather, causing damage to some loading equipment.

We have conducted a thorough review of our claims operations aimed at improving our service capability and reducing claims costs

Claims continued

In the case of an earlier serious incident in the South Atlantic, the southern hemisphere's winter is now coming to an end, creating the conditions for an inspection of the wreck of the vessel and the surrounding environment to take place.

Marine

There was a slight increase in the number of claims for the first half of the year, compared to the same period in 2009 and 2010, and severity is on an upward trend. One serious grounding ended up as a total loss, but overall claims were within projections made.

The number of vessels for which Gard is the claims lead has increased. This is a welcome development, because being claims lead increases our influence on the outcome of the claim. The repair market remains favourable with acceptable delivery time for spare parts. This has also had a positive effect on loss of hire claims.

Offshore energy

The development of MOU, hull, loss of hire and E&P claims was largely positive during the first half of the policy year.

A successful wreck removal and scuttling operation was completed in early August for an accommodation unit that capsized and sank in the Gulf of Mexico earlier this year. This year also saw another large MOU claim concerning a drillship, which was struck by a wreck tow while drilling offshore in Venezuela.

People

The Amended Migrant Workers' Act (AMWA) in the Philippines entered into force in the autumn of 2010. Claims involving AMWA benefits to Filipino crew have created issues concerning scope of P&I cover and are subject to discussion in the International Group.

Personal injury claims in the United States remain a focus due to their potential severity. Our capability to handle such claims efficiently has increased through teamwork between the People claims team in the head office and our New York office.

People claims is an area with a relatively high number of low to modest value claims. We are focusing attention on achieving more efficient workflows, which will make a difference to our handling costs.

Loss prevention and risk assessment

Most of the Gard Updates from the LPRA team are based on information about current claims trends, specific cases and important challenges for the industry, such as the most recent case study addressing voyage planning, which is based on two large navigational incidents. The updates have now been divided into three different categories: Gard Alerts, Loss Prevention Circulars and Case Studies for Training, which are used in interactive Gard workshops during crew seminars.

The four surveyors in the LPRA team have been assigned to different geographical underwriting teams and industry segments. The purpose is for the surveyors to work more closely with Underwriting and increase their knowledge about the relevant sections of the portfolio.

Finally, several new 'Spotlights' covering important industrial issues like piracy, arctic operations, bunkering and dangerous cargo – have been designed and will soon appear on www.gard.no.

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Gard P. & I. (Bermuda) Limited
Summary consolidated income and expenditure accounts

Amounts in USD 000's

Six months to 20 August	2011	2010
Premiums and calls*	413,658	388,824
Premiums earned net	346,737	335,816
Other insurance related income	654	0
Claims costs net**	307,059	235,829
Aquisition costs	44,996	42,520
Operating expenses net	1,450	1,421
Result on technical account	(6,114)	56,046
Result on non-technical account	12,143	51,076
Surplus / (deficit)	6,029	107,122
Combined Ratio Net (CRN)	102%	83%

* Premiums and calls include one half of 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 are included in claims costs net

Gard P. & I. (Bermuda) Limited
Summary consolidated balance sheet

Amounts in USD 000's

As at	20 August 2011	20 February 2010
Investments at market value	1,698,799	1,699,666
Reinsurers' share of technical provisions	304,406	165,108
Cash and equivalents	334,242	245,846
Other assets	324,520	241,520
Net assets	2,661,967	2,352,140
Gross unearned premium reserve	299,301	146,348
Gross provision for outstanding and unreported claims	1,373,466	1,277,702
General contingency reserve	797,916	789,694
Other liabilites	191,284	138,396
Net equity and liabilities	2,661,967	2,352,140

Gard P. & I. (Bermuda) Limited
Income and expenditure accounts on lines of business

Amounts in USD 000's

Six months to 20 August 2011	P&I	M&E	Consolidated accounts
Premiums and calls	252,761	160,897	413,658
Premiums earned net	208,536	138,201	346,737
Claims incurred net	180,949	89,176	270,125
Claims handling costs*	29,483	7,451	36,934
Claims costs net	210,432	96,627	307,059
Operating expenses net excluding claims handling costs	20,500	25,292	45,792
Result on technical account	(22,396)	16,282	(6,114)
Result on non-technical account	11,052	1,091	12,143
Result ordinary operations	(11,344)	17,373	6,029
Combined ratio net	111%	88%	102%

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

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