# DIRECTORS' Report 2012

NORTH

SERVICE, STRENGTH, QUALITY

NORTH

SERVICE, STRENGTH, QUALITY

# ANNUAL GENERAL MEETING

North of England Protecting and Indemnity Association Limited
20 February 2012

Notice is hereby given that the ANNUAL GENERAL MEETING of the Members of the Association will be held at Close House Hotel, Heddon-on-the-Wall, Newcastle upon Tyne, NE15 0HT, United Kingdom, on 17 October 2012 at 09:30 hours when the following business will be transacted:

1. To receive and consider the reports of the Directors and the Auditors together with the financial statements for the year ended 20 February 2012.
2. To elect Directors.
3. To fix the Directors' remuneration.
4. To re-appoint Auditors and to authorise the Directors to fix their remuneration.
5. Any other business which may be transacted at the Annual General Meeting.

By order of the Board

**AA Wilson**

Secretary
17 September 2012

Registered in London: Limited by Guarantee

The Quayside
Newcastle upon Tyne
NE1 3DU UK
Telephone: +44 191 2325221
Fax: +44 191 2610540

Registered in England: 505456
VAT Registration: 828 5711 10

# DIRECTORS

## North of England Protecting and Indemnity Association Limited

20 February 2012

| | |
|---|---|
| PB Shirke ▲●■ | Chairman |
| LB Christensen ▲ | Vice-Chairman |
| AJ Agarwal | |
| W Al Dawood | |
| MHAK Bakri | |
| A Bergshaven | |
| I Butorac | |
| JAF Cowderoy ▲*● | |
| PA Curtis | |
| A Engelsman ▲*■◆ | |
| Lord N Fairfax | (Appointed 10 January 2012) |
| F Gao | |
| JM de Groot * | |
| A le Guillard | |
| PA Jennings | Joint Managing Director |
| CF Kanellakis ▲● | |
| PE Kollakis ▲● | |
| DR Kurz | |
| ECM Lim | |
| C Lui | (Resigned 10 January 2012) |
| SY Michael | |
| A Mohanna | |
| LH Pfeiff ▲* | (Resigned 26 January 2012) |
| SM Polemis *◆ | |
| G Procopiou | |
| JS Reith ▲◆ | |
| A Schmidt | |
| JC Severin ▲ | |
| B Sheth | |
| RB Sumantri ● | |
| JS Tyrrell ■ | |
| T Veniamis | (Appointed 5 September 2011) |
| G Westgarth | |
| AA Wilson | Joint Managing Director |

▲ Member of the Advisory Committee
* Member of the Audit Committee
● Member of the Investment Committee
■ Member of the Nomination Committee
◆ Member of the Remuneration Committee

## Management

North Insurance Management Limited
Newcastle upon Tyne
NE1 3DU

## Auditors

Ernst & Young LLP
1 More London Place
London SE1 2AF

## Bankers

Nordea Bank Finland plc
8th Floor, City Place House
55 Basinghall Street
London EC2V 5NB

# REPORT OF THE DIRECTORS

North of England Protecting and Indemnity Association Limited
20 February 2012

The Directors have pleasure in presenting their report together with the financial statements of the Association for the year ended 20 February 2012.

## Principal Activities

The principal activities of the Group were the insurance and reinsurance of marine Protecting & Indemnity, Freight, Demurrage & Defence and War Risks on behalf of Members. The Association mainly operates out of its head office in Newcastle but also has branch offices in Greece, Hong Kong, Japan and Singapore.

## Membership

At 20 February 2012 the owned gross tonnage entered in the Association totalled 122,504,423 (2011 – 105,146,434) and there were 6,805 owned ships (2011 – 3,670).

## Review of Business Activities

The Association's business continues to develop successfully and the Association was in a sound financial position at 20 February 2012. On 2 November 2011 the Association entered into an agreement with Marine Shipping Mutual Insurance Limited ("MSMI"), which ceased underwriting on 30 June 2011, under which control of the assets and liabilities of MSMI passed to the Association for nil consideration with the Association becoming the sole Member of MSMI. As a result MSMI is consolidated into the financial statements of the Group.

The Association's key financial and other performance indicators were as follows:

| | 2012<br>US$M | 2011<br>US$M | Change<br>% |
|---|---|---|---|
| Gross written premiums | 349.3 | 314.2 | +11.2% |
| Underwriting income / (loss) | 21.6 | 4.3 | +402.3% |
| Surplus after tax | 26.2 | 7.8 | +235.9% |
| Free Reserves | 57.1 | 36.9 | +54.7% |
| Combined ratio | 91% | 98% | -7% |
| Average number of employees | 218 | 205 | +6% |

Underwriting (loss) / income is calculated as earned premiums net of reinsurance ceded less claims incurred net of reinsurance recoveries, less acquisition, marketing and administration costs. The combined ratio is calculated as claims incurred, net of reinsurance, plus acquisition, marketing and administration costs as a percentage of net earned premiums.

The increase in the average number of employees is consistent with the development strategy of the Association which produced an increase in gross written premiums of 11.2%.

The surplus for the year and the proposed transfer to reserves are shown in the following financial statements. The Directors anticipate no significant changes in the Association's future activities.

The principal risks that the Association face are discussed in Note 4.

## Directors

The Directors of the Association are shown on page 2.

The Association maintains insurance policies on behalf of all the Directors against liability arising from negligence, breach of duty and breach of trust in relation to the Association.

# REPORT OF THE DIRECTORS (CONTINUED)

North of England Protecting and Indemnity Association Limited
20 February 2012

## Statement of Disclosure of Information to Auditors

Each person who is a Director at the date of approval of this report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware;
- he or she has taken all the steps that ought to have been taken in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

### Directors' responsibilities

The Directors have voluntarily adopted International Financial Reporting Standards (IFRS) and are therefore required to prepare accounts for each accounting period that comply with the relevant provisions of the Companies Act 2006 and International Financial Reporting Standards (IFRS) as adopted by the European Union, and which present fairly the financial position, financial performance and cash flows of the Company and the Group at the end of the accounting period. A fair presentation of the financial statements in accordance with IFRS requires the Directors to:

- select suitable accounting policies and verify they are applied consistently in preparing the accounts, on a going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company and the Group's financial position and financial performance; and
- state that the Company and the Group have complied with applicable IFRS, subject to any material departures disclosed and explained in the accounts.

The Directors are responsible for maintaining proper accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Company and the Group. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### Going concern

The Association's business activities, together with the factors likely to affect its future development, performance and position are set out in the Review of Business Activities report on page 3. The financial position of the Association, its cash flows, liquidity position and borrowing facilities are described in the Financial Report on pages 9 to 49. In addition, Note 4 to the consolidated financial statements includes the Association's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and its exposures to credit risk and liquidity risk. The Association has considerable financial resources together with contracts with a number of Members and suppliers across different geographic areas. Furthermore, the Association is a mutual organisation and can raise supplementary calls from its Members for open policy years. Consequently, the Directors believe that the Association is well placed to manage its business risks successfully despite the current uncertain economic outlook. After making enquiries, the Directors have formed a judgment at the time of approving the consolidated financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future.
For this reason, the Directors continue to adopt the going concern basis in preparing the consolidated financial statements.

North of England Protecting and Indemnity Association Limited
20 February 2012

## Committees

The following committees have been established by resolution of the Board of Directors:

### Advisory Committee

The Advisory Committee comprises the Chairman, the Vice-Chairman, the past Chairman, the Chairmen of the other Committees and three Directors appointed by the Board. The Committee meets prior to each Board meeting, and as necessary between meetings, and its principal duties are: to receive reports from the Managers on the financial position, and on bad and doubtful debts of the Association; to agree with the Managers the Annual Expenses Budget of the Association and monitor the performance of the Employee Incentive Scheme and Company Pension Scheme; to keep up to date and fully informed about strategic issues and commercial changes affecting the Association and the market in which it operates; to consider proposals from the Managers on new business development ideas with a view to making recommendations to the Board if appropriate; to receive reports from the Managers on the management of Marine Shipping Mutual Insurance Company Limited and on the level of insurance intermediary fee to be paid by that company; to be available to the Managers and to advise and take decisions on matters relating to the management of the Association requiring attention between Board meetings; and to consider such other matters relating to the Association or P&I matters generally upon which the Managers may need guidance with a view to making recommendations to the Board.

### Audit Committee

The Audit Committee consists of four Non-executive Directors and meetings are also attended by representatives of the Association's management and staff. The Committee meets not less than twice a year, and its principal duties are: to consider the appointment of the external auditor, the audit fee, and any questions of their resignation or dismissal; to review and monitor the external auditors' independence and objectivity and the effectiveness of the audit process; to discuss with the external auditor, before the audit commences, the nature and scope of the audit; to review the annual financial statements before submission to the Board; to discuss the results of the interim and final audits and any matters the auditor may wish to discuss; to review the external auditor's management letter and management's response; to receive and review minutes and reports from the Enterprise Risk Management Committee; to review the Company's risk register; in respect of the Company's FSA compliance, to review the measures taken by the Company to establish and maintain systems and controls appropriate to its business and to review the measures taken by the Company to establish and maintain its Individual Capital Assessment; to consider and approve the internal audit plan; to consider the work of internal audit against the plan and to consider the reports of internal audit.

### Investment Committee

The Investment Committee consists of four Non-executive Directors and two independent consultants. It meets a minimum of three times a year and its principal duties are: to periodically review the investment strategy of the Association and make recommendations to the Board; to periodically review the reinsurance arrangements, including investment strategy, with North of England Mutual Insurance Association (Bermuda) Limited ["North of England (Bermuda)"] and to provide the Board with recommendations to be considered by North of England (Bermuda); to ensure the adequacy of the custodian arrangements of the Association and North of England (Bermuda); to review and monitor the performance of investment managers, to receive written and personal presentations and report and make recommendations to the Board; and to investigate and make recommendations to the Board regarding the employment of investment managers.

### Nomination Committee

The Nomination Committee consists of the Chairman of the Board and two other Non-executive Directors. Meetings are held not less than once a year and its principal duties are: to review regularly the structure, size and composition (including the skills, knowledge and experience) required of the Board compared to its current position and make recommendations to the Board with regard to any changes; to give full consideration to succession planning for Directors, taking into account the challenges and opportunities facing the Association, and what skills and expertise are therefore needed on the Board in future; to be responsible for identifying and nominating for approval of the Board candidates to fill Board vacancies; to keep under review the leadership needs of the Association, both executive and non-executive, with a view to ensuring the continued ability of the Association to compete effectively in the market place; to consider and if appropriate agree recommendations from the Managing Director(s) with regard to senior management appointments; to review annually the performance of the Board; and to ensure that on appointment to the Board, Non-executive Directors are advised of what is expected of them in terms of committee service and involvement outside Board meetings.

# REPORT OF THE DIRECTORS (CONTINUED)

North of England Protecting and Indemnity Association Limited
20 February 2012

## Remuneration Committee

The Remuneration Committee consists of the Chairman of the Board and three other Non-executive Directors, meets not less than once a year and its principal duties are: to determine and agree with the Board the broad policy for the remuneration of the Chairman, Vice Chairman, the Joint Managing Directors, the Company Secretary and the senior managers; to make recommendations regarding the remuneration of the Chairman, Vice Chairman and the Non-executive Directors; within the terms of the agreed policy, to determine the total individual remuneration package of the Executive Directors; to determine the policy for and scope of the pension arrangements for the Joint Managing Directors and Executive Directors; to oversee the operation of the Company's pension scheme; to ensure that contractual terms on termination, and any payments made, are fair to the individual and the Company; to ensure that relevant statutory and regulatory provisions regarding disclosure of remuneration, including pensions, are fulfilled; to be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee.

## Donations

The Association made charitable donations totalling £49,081 (2011 – £6,017) to the following:

| | |
|---|---|
| Save Our Seafarers campaign | £6,258 |
| Piraeus Marine Club | £1,665 |
| Seafarers' UK | £685 |
| Will Fetherston Fund | £150 |

As part of the 150 Year Fund:

| | |
|---|---|
| Royal National Lifeboat Institution | £13,441 |
| Sailors' Society | £13,441 |
| Local charities | £13,441 |

The Association made no political donations (2011 – nil).

## Meetings

The Directors met on three occasions during the year and matters considered and reviewed included the following:

- Policy year accounts
- Mutual premium
- Reinsurance
- Renewal and Market reports
- Membership reports
- Audit Committee reports
- Advisory Committee reports
- Investment Committee reports
- Nomination Committee reports
- Directors' Report and Financial Statements
- Branch office reports
- Loss prevention working party
- Errors & Omissions and Directors' & Officers' insurance
- Bad debts
- Solvency II
- 150 Years Fund
- Hazardous noxious substances
- Claims co-operation committee
- International Group and the European Commission
- MSMI
- FSA compliance
- Individual Capital Assessment and stress testing.

North of England Protecting and Indemnity Association Limited
20 February 2012

## Protecting & Indemnity Class

It was agreed that the 2008/2009 policy year should be closed and amalgamated with the previous closed years. No Supplementary Calls are anticipated for open policy years. A general increase of 5% was agreed for the 2012/2013 Mutual Premium.

## Freight Demurrage & Defence Class

The Directors representing the FD&D Members agreed to close the 2008/2009 policy year. No Supplementary Calls are anticipated for open policy years. A general increase of 10% was agreed for the 2012/2013 Mutual Premium.

## War Risks Class

The Directors representing the War Risks Members agreed to close the 2009/2010 policy year. No Supplementary Calls are anticipated for open policy years.

On behalf of the Board

**AA Wilson**

Joint Managing Director
30 May 2012

# INDEPENDENT AUDITOR'S REPORT

North of England Protecting and Indemnity Association Limited
20 February 2012

## Independent Auditor's Report to the Members of North of England Protecting & Indemnity Association Limited

We have audited the financial statements of North of England Protecting & Indemnity Association Limited for the year ended 20 February 2012 which comprise the Consolidated Statement of Financial Position, the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated Statement of Cash Flows, the Parent Company Statement of Financial Position, the Parent Company Statement of Changes in Equity, the Parent Company Statement of Cash Flows, and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's Members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's Members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's Members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of Directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 4, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Directors' report and financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 20 February 2012 and of the Group's surplus for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

TJ Leggett (Senior Statutory Auditor) for and on behalf of Ernst & Young LLP, Statutory Auditor
London
31 May 2012

# CONSOLIDATED STATEMENT OF FINAL POSITION

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

| | Note | 2012 | 2011 |
|---|---|---|---|
| **Assets** | | | |
| Intangible assets | 6 | 2,788 | 2,844 |
| Property, plant and equipment | 7 | 15,982 | 24,058 |
| Reinsurers' share of technical provision | | | |
| Provision for unearned premium | | 2,255 | - |
| Claims outstanding | 11 | 756,231 | 646,211 |
| Financial assets | | | |
| Equity securities - at fair value through income | 8 | 51 | 52 |
| Debt securities - at fair value through income | 8 | 130,893 | 109,436 |
| Loans and receivables including insurance and reinsurance receivables | 9 | 21,279 | 12,878 |
| Retirement benefit asset | 28 | 14,418 | 19,603 |
| Current tax asset | | - | 221 |
| Cash and cash equivalents | 10 | 66,139 | 37,500 |
| Total assets | | 1,010,036 | 852,803 |
| **Accumulated Surplus** | | | |
| Income and expenditure account | 21 | 10,938 | (14,059) |
| Contingency funds | 21 | 46,171 | 45,004 |
| Revaluation reserve | 21 | - | 5,990 |
| Total accumulated surplus | | 57,109 | 36,935 |
| **Liabilities** | | | |
| Technical provision | | | |
| Provision for unearned premium | | 2,984 | - |
| Claims outstanding | 11 | 814,450 | 696,008 |
| Derivative financial instruments | | 71 | 264 |
| Reinsurance payables | | 110,431 | 111,072 |
| Trade and other payables | 12 | 23,542 | 8,524 |
| Current tax liability | | 1,449 | - |
| Total liabilities | | 952,927 | 815,868 |
| Total accumulated surplus and liabilities | | 1,010,036 | 852,803 |

These financial statements were approved by the Board on 30 May 2012

**AA Wilson**

Joint Managing Director

# CONSOLIDATED INCOME STATEMENT

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

| | Note | 2012 | 2011 |
|---|---|---|---|
| Gross insurance premium revenue | | 349,332 | 314,243 |
| Gross insurance premium ceded to reinsurers | | (245,899) | (237,658) |
| Net insurance premium revenue | | 103,433 | 76,585 |
| Change in provision for unearned premium | | (2,984) | – |
| Reinsurers' share of change in unearned premium | | 2,255 | – |
| Change in the net provision for unearned premium | | (729) | – |
| Earned premiums net of reinsurance | | 102,704 | 76,585 |
| Investment income | 13 | 96 | 60 |
| Net fair value gains at fair value through income | 14 | 7,207 | 2,336 |
| Other gains and losses | 5 | 440 | – |
| Net income | | 110,447 | 78,981 |
| Insurance claims and loss adjustment expenses | 15 | (246,421) | (66,257) |
| Insurance claims and loss adjustment expenses recovered from reinsurers | 15 | 216,477 | 37,238 |
| Net insurance claims | | (29,944) | (29,019) |
| Expenses for the acquisition of insurance and investment contracts | | (28,315) | (24,278) |
| Expenses for marketing and administration | | (22,863) | (18,979) |
| Expenses for asset management services rendered | | (356) | (323) |
| Operating expenses | 16 | (51,534) | (43,580) |
| Total expenses | | (81,478) | (72,599) |
| Results of operating activities | | 28,969 | 6,382 |
| Finance (expense) / income | 19 | (1,140) | 1,888 |
| Surplus before tax | | 27,829 | 8,270 |
| Tax expense | 20 | (1,665) | (511) |
| Surplus for the year | | 26,164 | 7,759 |

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| | 2012 | 2011 |
|---|---|---|
| Surplus for the year | 26,164 | 7,759 |
| Foreign exchange (loss) / gain on revaluation of land and buildings | (5,990) | 562 |
| | 20,174 | 8,321 |

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

| | Note | Attributable to Members | | | |
|---|---|---|---|---|---|
| | | I&E Account | Contingency Fund | Revaluation Reserve | Accumulated Surplus |
| At 20 February 2011 | | (14,059) | 45,004 | 5,990 | 36,935 |
| Surplus for the year | 21 | 26,164 | – | – | 26,164 |
| Revaluation of land and buildings | 21 | – | – | (5,990) | (5,990) |
| Transfer to contingency fund | 21 | (1,167) | 1,167 | – | – |
| **At 20 February 2012** | | **10,938** | **46,171** | **–** | **57,109** |

| | Note | Attributable to Members | | | |
|---|---|---|---|---|---|
| | | I&E Account | Contingency Fund | Revaluation Reserve | Accumulated Surplus |
| At 20 February 2010 | | (21,590) | 44,776 | 5,428 | 28,614 |
| Surplus for the year | 21 | 7,759 | – | – | 7,759 |
| Revaluation of land and buildings | 21 | – | – | 562 | 562 |
| Transfer to contingency fund | 21 | (228) | 228 | – | – |
| **At 20 February 2011** | | **(14,059)** | **45,004** | **5,990** | **36,935** |

# CONSOLIDATED STATEMENT OF CASH FLOWS

| | Note | 2012 | 2011 |
|---|---|---|---|
| **Operating Activities** | | | |
| Cash generated from operating activities | 27 | 28,210 | 14,652 |
| Tax paid | | – | (423) |
| **Net cash from operating activities** | | **28,210** | **14,229** |
| **Cash Flows from Investing Activities** | | | |
| Purchases of property, plant and equipment | | (1,727) | (11,282) |
| Purchases of intangibles | | (967) | (1,879) |
| Proceeds from sale of property, plant and equipment | | 92 | 157 |
| Cash acquired on acquisition of MSMI | | 2,736 | – |
| **Net cash used in investing activities** | | **134** | **(13,004)** |
| Net increase in cash and cash equivalents | | 28,344 | 1,225 |
| Foreign exchange | | 295 | 1,890 |
| Cash and bank overdrafts at beginning of year | | 37,500 | 34,385 |
| **Cash and cash equivalents at end of year** | 10 | **66,139** | **37,500** |

# PARENT COMPANY STATEMENT OF FINANCIAL POSITION

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

| | Note | 2012 | 2011 |
|---|---|---|---|
| **Assets** | | | |
| Intangible assets | 6 | 2,788 | 2,844 |
| Property, plant and equipment | 7 | 15,982 | 24,058 |
| Investment in group undertakings | 22 | 11,927 | 4,627 |
| Reinsurers' share of technical provision | | | |
| Provision for unearned premium | | 2,255 | – |
| Claims outstanding | 11 | 749,580 | 667,289 |
| Financial assets | | | |
| Equity securities – at fair value through income | 8 | 51 | 52 |
| Debt securities – at fair value through income | 8 | 71,775 | 71,783 |
| Loans and receivables including insurance and reinsurance receivables | 9 | 34,235 | 13,690 |
| Retirement benefit asset | 28 | 14,418 | 19,603 |
| Current tax asset | | – | 221 |
| Cash and cash equivalents | 10 | 56,847 | 36,235 |
| Total assets | | 959,858 | 840,402 |
| **Accumulated Surplus** | | | |
| Income and expenditure account | 21 | (4,367) | (26,390) |
| Contingency funds | 21 | 46,171 | 45,004 |
| Revaluation reserve | 21 | – | 5,990 |
| Total accumulated surplus | | 41,804 | 24,604 |
| **Liabilities** | | | |
| Technical provision | | | |
| Provision for unearned premium | | 2,984 | – |
| Insurance contracts | 11 | 775,838 | 696,008 |
| Derivative financial instruments | | 71 | 264 |
| Reinsurance payables | | 108,119 | 111,072 |
| Trade and other payables | 12 | 29,593 | 8,454 |
| Current tax liability | | 1,449 | – |
| Total liabilities | | 918,054 | 815,798 |
| Total accumulated surplus and liabilities | | 959,858 | 840,402 |

These financial statements were approved by the Board on 30 May 2012

**AA Wilson**

Joint Managing Director

# PARENT COMPANY STATEMENT OF CHANCE IN EQUITY

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

| | Note | Attributable to Members | | | |
|---|---|---|---|---|---|
| | | I&E Account | Contingency Fund | Revaluation Reserve | Accumulated Surplus |
| At 20 February 2011 | | (26,390) | 45,004 | 5,990 | 24,604 |
| Surplus for the year | | 23,190 | – | – | 23,190 |
| Revaluation of land and buildings | 7 | – | – | (5,990) | (5,990) |
| Transfer to contingency fund | | (1,167) | 1,167 | – | – |
| **At 20 February 2012** | | **(4,367)** | **46,171** | **–** | **41,804** |

| | Note | Attributable to Members | | | |
|---|---|---|---|---|---|
| | | I&E Account | Contingency Fund | Revaluation Reserve | Accumulated Surplus |
| At 20 February 2010 | | (23,328) | 44,776 | 5,428 | 26,876 |
| Surplus for the year | | (2,834) | – | – | (2,834) |
| Revaluation of land and buildings | 7 | – | – | 562 | 562 |
| Transfer to contingency fund | | (228) | 228 | – | – |
| **At 20 February 2011** | | **(26,390)** | **45,004** | **5,990** | **24,604** |

# PARENT COMPANY STATEMENT OF CASH FLOWS

| | Note | 2012 | 2011 |
|---|---|---|---|
| **Operating Activities** | | | |
| Cash generated from operating activities | 27 | 30,229 | 16,665 |
| Tax paid | | – | (423) |
| **Net cash from operating activities** | | **30,229** | **16,242** |
| **Cash Flows from Investing Activities** | | | |
| Purchases of property, plant and equipment | | (1,727) | (11,282) |
| Purchases of intangibles | | (967) | (1,879) |
| Purchase of investment in group undertaking | | (7,300) | (50) |
| Proceeds from sale of property, plant and equipment | | 92 | 157 |
| **Net cash used in investing activities** | | **(9,902)** | **(13,054)** |
| Net increase in cash and cash equivalents | | 20,327 | 3,188 |
| Foreign exchange | | 285 | 1,890 |
| Cash and bank overdrafts at beginning of year | | 36,235 | 31,157 |
| **Cash and cash equivalents at end of year** | 10 | **56,847** | **36,235** |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 1. General Information

The North of England P&I Association Limited ("the Association") is a non profit making mutual organisation. The Association is a company limited by guarantee, has no share capital and is registered in the United Kingdom under the Companies Act 2006. No one Member controls the Association. The address of the registered office is given on page 1.

The Association's primary business is the provision on a mutual basis of third-party liability or 'protection and indemnity' ("P&I") insurance to shipowners. 'Protection' generally means cover for people and ships whereas 'indemnity' means cover for cargo. The cover provided by this Class of the Association is as set out in the Rules of the Class and provides insurance for a Member against loss, damage, liability or expense incurred by them which arises:

(a) in respect of the Member's interest in an Entered Ship,

(b) out of events occurring during the period of entry of the Ship in the Association, and

(c) in connection with the operation of the Ship.

Approximately 44% of the ships entered in the Association for P&I insurance are also covered by the Association for otherwise uninsured legal costs, known as 'freight, demurrage and defence' ("FD&D") insurance. The cover provided by this Class of the Association is as set out in the Rules of the Class and provides insurance for a Member against costs, expenses or liabilities for costs or expenses incurred by them which arise:

(a) in respect of the Member's interest in an Entered Ship;

(b) in relation to any dispute or matter arising during the period of Entry of the Ship in the Association, and;

(c) in connection with the operation, ownership, management or chartering of the Ship.

The FD&D Class is run on a mutual basis similar to the P&I Class, with premiums being pooled and invested to pay claims directly and to buy reinsurance.

The Association also operates a separate War Risks class to provide cover for war and terrorism losses which are generally excluded from normal P&I and hull and machinery policies. However, membership of the class is currently restricted to British flagged or beneficially owned ships. The War Risks cover includes both physical loss and damage to ships as well as third party liability caused by war perils. It also includes compensation for being blocked or trapped in an area due to conflict. The War Risks class also operates on a mutual basis.

During the year the Association assumed control of Marine Shipping Mutual Insurance Company Limited. Further details are provided in note 5.

## 2. Summary of Significant Accounting Policies

The principal accounting policies applied in the preparation of the consolidated and company financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### 2.1 Basis of presentation

These consolidated and company financial statements are prepared in accordance with International Financial Reporting Standards (IFRS's) as adopted for use in the European Union. The standard definitions of profit and loss have been replaced by the terms surplus and deficit because, as a mutual, the Directors believe this is more relevant terminology.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of land and buildings and financial instruments.

The consolidated financial statements are presented in US dollars ($) rounded to the nearest thousand, unless otherwise stated.

The consolidated financial statements are presented broadly in order of liquidity.

## 2.1 Basis of presentation (continued)

The Association has adopted the "corridor" method under IAS 19 'Employee Benefits', recognising a portion of the scheme's actuarial gains and losses as income or expense. The Association has applied the amended IAS 19 taking into account amendments to paragraphs 32A, 34, 61 and 121.

In accordance with section 408 of Companies Act 2006, the Parent Company income statement and related notes have not been presented separately. The surplus dealt with in the account of the parent company was US$23.6m (2011 US$2.8m deficit).

At the date of authorisation of these financial statements, the following standards which have not been applied in these financial statements were in issue but not yet effective:

IFRS 9 Financial Instruments – Periods commencing on or after 1 January 2015

IAS 19 Employee Benefits – Periods commencing on or after 1 January 2013

The preparation of financial statements in conformity with IFRS's requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 3.

## 2.2 Consolidation

The consolidated financial statements incorporate the assets, liabilities, results and cash flows of the Association and its subsidiaries made up to 20 February each year. The results of subsidiaries acquired or sold during the period are included in the consolidated results from the date of acquisition or up to the date of disposal.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Association. Intra-group balances and income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

## 2.3 Business combinations

Business combinations are accounted for under IFRS 3: *Business Combinations*. Subsidiaries are fully consolidated from the date on which control is transferred to the Association. They are deconsolidated from the date on which control ceases. Subsidiaries are all entities, over which the Association has the power, directly or indirectly, to govern the financial and operating policies so as to obtain economic benefits.

## 2.4 Foreign currency translation

The Association's consolidated financial statements are presented in US dollars ($) which is also the Association's functional currency.

### Transactions and balances

Transactions in foreign currencies are initially recorded at the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date.

Translation differences on monetary items, such as equities held at fair value through income, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as land and buildings, are included in the revaluation reserve.

## 2.5 Intangible assets

Intangible assets with a finite life are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Costs in respect of major software developments are capitalised. Capitalised software costs that are not an integral part of the related hardware are included in intangible assets on the statement of financial position and amortised over the expected life of the software of up to 5 years.

In a business combination, where the purchase consideration is lower than the fair value of the net assets acquired, a gain on acquisition arises, sometimes referred to as negative goodwill. Such a gain on acquisition is recognised in the income statement on acquisition.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 2. Summary of Significant Accounting Policies (Continued)

### 2.6 Property, plant and equipment

Land and building is comprised of the office occupied by the Association. Land and building is shown at fair value, based on periodic, but at least triennial, valuations by external independent appraisers. All other property, plant and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Association and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of land and buildings are credited to the revaluation reserve. Decreases that offset previous increases of the same asset and other decreases are charged to the revaluation reserve in the first instance.

Depreciation on property, plant and equipment is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

| | |
|---|---|
| Land | No depreciation charged. |
| Building | 2% per annum reducing balance method. |
| Computer Equipment | 20% per annum straight line method. |
| Motor Vehicles | 25% per annum reducing balance method. |
| Office Equipment and Fittings | 20% per annum straight line method. |

The asset's residual values and useful lives are reviewed at each reporting date and adjusted if appropriate.

An asset's carrying amount is written down immediately through the Income Statement to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the Income Statement.

### 2.7 Investments

#### Financial assets at fair value through income

Management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date. The Association classifies its investments as financial assets at fair value through income. Financial assets at fair value through income are subsequently carried at fair value. Realised and unrealised gains and losses arising from changes in the fair value of financial assets value through income are included in the Income Statement in the period in which they arise.

Regular purchases and sales of investments are recognised on trade date, the date on which the Association commits to purchase or sell the asset. Investments are initially recognised at fair value. Investments are derecognised when the rights to receive cash flows from the investments have expired or where they have been transferred and the Association has also transferred substantially all risks and rewards of ownership.

The fair values of quoted investments are based on current bid prices.

#### Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. The Association does not engage in hedge accounting and changes in the fair value of all derivative instruments are recognised immediately in the Income Statement.

#### Loans & receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Association intends to sell in the short term or that it has designated as at fair value through income or available-for-sale. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables.

(All amounts in US Dollar thousands unless otherwise stated)

## 2. Summary of Significant Accounting Policies (Continued)

### Investments in subsidiaries

In the Company's financial statements, other financial investments in subsidiary undertakings are stated at cost and are reviewed for impairment when events or changes in circumstances indicate the carrying value may be impaired.

### Determination of fair value and fair value hierarchy

The following table shows an analysis of financial assets by level of the fair value hierarchy:

| | Level 1 | | Level 2 | | Level 3 | | Total Fair Value | |
|---|---|---|---|---|---|---|---|---|
| | The Group | The Company | The Group | The Company | The Group | The Company | The Group | The Company |
| Equity securities | – | – | – | – | 51 | 51 | 51 | 51 |
| Debt securities | 130,893 | 71,775 | – | – | – | – | 130,893 | 71,775 |
| Cash and cash equivalents | 66,139 | 56,847 | – | – | – | – | 66,139 | 56,847 |
| | 197,032 | 128,622 | – | – | 51 | 51 | 197,083 | 128,673 |

The opening position is shown in the table below:

| | Level 1 | | Level 2 | | Level 3 | | Total Fair Value | |
|---|---|---|---|---|---|---|---|---|
| | The Group | The Company | The Group | The Company | The Group | The Company | The Group | The Company |
| Equity securities | – | – | – | – | 52 | 52 | 52 | 52 |
| Debt securities | 109,436 | 71,783 | – | – | – | – | 109,436 | 71,783 |
| Cash and cash equivalents | 37,500 | 36,235 | – | – | – | – | 37,500 | 36,235 |
| | 146,936 | 108,018 | – | – | 52 | 52 | 146,988 | 108,070 |

Level 1 consists of financial assets that are valued according to published quotes in an active market. A financial asset is regarded as quoted in an active market if quoted prices are readily available from a broker, dealer, exchange, pricing service, industry group or regulatory agency. Level 2 assets are similar to Level 1 but the pricing of those assets have not been determined in an active market. Level 3 financial assets are assets for which a value cannot be obtained from observable data.

### 2.8 Impairment of assets

The Association assesses at each reporting date whether there is any objective evidence that a financial asset or non financial asset is impaired. An asset is deemed to be impaired, and impairment losses are incurred, only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the asset that can be reliably estimated.

Objective evidence that an asset or group of assets is impaired includes observable data that comes to the attention of the Association about the following events:

- significant financial difficulty of the issuer or debtor;
- a breach of contract, such as a default or delinquency in payments;
- it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flow or carrying amount from an asset or group of assets since the initial recognition of those assets.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 2. Summary of Significant Accounting Policies (Continued)

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed. The amount of the reversal is recognised in the Income Statement.

### 2.9 Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts.

### 2.10 Government grants

Government grants relating to assets are accounted for by deducting the grant from the asset's carrying amount. If a grant becomes repayable, the repayment is accounted for as an increase to the carrying amount of the asset. The cumulative depreciation which would have been charged had the grant not been received will be charged as an expense.

### 2.11 Provisions and contingent liabilities

A provision is recognised when the Group has a present legal or constructive obligation, as a result of a past event, which is likely to result in an outflow of resources and where a reliable estimate of the amount of the obligation can be made. Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event or if there is a present obligation as a result of a past event but either a payment is not probable of the amount cannot be reliably estimated.

### 2.12 Revenue and expense recognition

#### Premium income

All elements of revenue arising from insurance contracts and other related services offered by the Association are recognised on an accruals basis in the accounting period in which the contract is related or services are rendered. The Association's policy year runs from noon GMT on any 20 February to noon GMT on the next following 20 February. The Association's financial year is coterminous with its policy year. The significant categories of revenue arising from insurance contracts are as follows:

#### Mutual premium

The estimated total premium payable to the Association in relation to an Entered Ship and in respect of any policy year is calculated in accordance with Rules 12 and 13 of the Association and with the terms of insurance agreed from time to time with the Member. The Directors may at any time or times during or after the end of each Policy Year (but not after such Policy Year has been closed in accordance with Rule 42(5)) direct that an Additional Call shall be paid by each Member in respect of Ships entered for such Policy Year of such amount as the Directors in their sole discretion think fit. All Additional Calls so made shall be calculated pro rata to the Mutual Premium (less any returns) in the relevant Policy Year. Additional calls are accounted for, where appropriate, on an accrual basis when the Additional Call has been approved by the Directors of the Association.

If the Directors at any time determine that funds are or may in future be required to pay part of an Overspill Claim (whether incurred by the Association or by any other party to the Pooling Agreement), and the Directors have made a declaration under Rule 42(1) or 42(3) that a Policy Year shall remain open for the purpose of levying an Overspill Call or Calls in respect of that Overspill Claim, the Directors in their discretion, at any time or times after such declaration has been made, may levy one or more Overspill Calls in respect of that Overspill Claim in accordance with Rule 13(4).

#### Laid up returns

When a Ship shall have been laid up in any safe port approved by the Managers for a period of thirty or more consecutive days after finally mooring there the Member may be entitled to an allowance at a rate fixed by the Managers. Provision is made for notifications made post statement of financial position date which refer to laid up periods before the statement of financial position date.

#### Fixed premium

The Managers may accept the entry of a Ship on terms that the Member is liable to pay a Fixed Premium.

#### Time charter premium

A Member may be insured against liabilities, together with costs and expenses incidental thereto, which may be incurred by reason of his interest as charterer. Some charterer business is declared for cover on a bordereaux basis. Provision is made for the estimated receivable in respect of business not declared at the statement of financial position date.

## 2. Summary of Significant Accounting Policies (Continued)

### Unearned premiums

Unearned premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned premiums are calculated on a daily pro rata basis. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums.

### Reinsurance premiums and recoveries

Reinsurance premiums, less returns, are charged to the Income Statement on an accrual basis, including a provision for the future expected costs of adjustments to the premium due under existing reinsurance policies. Recoveries under policies purchased by the Association are accrued so as to match the relevant gross claims and associated provisions and reserves upon which the Association is entitled to make recoveries.

### Unearned reinsurance premiums

Unearned reinsurance premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned reinsurance premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts and over the term of the reinsurance contract for losses occurring contracts.

### Claims and related expenses

Claims paid are defined as those claims transactions settled up to the statement of financial position date including the internal and external claims settlement expenses allocated to those transactions. The reinsurers' share represents recoveries received from reinsurance protections in the period plus recoveries receivable against claims paid that have not been received at the statement of financial position date, net of any provision for bad debt.

Claims reserves are estimated on an undiscounted basis. Claims reserves are made for known or anticipated liabilities under insurance contracts which have not been settled up to the statement of financial position date. Included within the provision is an allowance for the future costs of handling those claims. This is estimated based on past experience and current expectations of future cost levels.

Although the claims reserves are considered to be reasonable, having regard to previous claims experience (including the use of certain statistically based projections), case by case reviews of notified losses and on the basis of information available at the date of determining the provision, the ultimate liabilities will vary as a result of subsequent information and events. This uncertainty is discussed further in note 3.

### Interest

Interest comprises interest on cash deposits and interest bearing securities and is recognised on an accruals basis.

### Acquisition costs

Acquisition costs are expensed in the period to which they relate.

### Employee benefits

Salaries and other employee benefits, including holiday pay, are accounted for on an accrual basis. Payments to staff under the discretionary staff performance related bonus scheme are accounted for in the financial year in which they are awarded.

### Retirement benefit scheme

The Association operates a pension scheme providing benefits based upon final pensionable salary, known as a defined benefit scheme. The assets of the scheme are held separately from those of the Association, being invested with professional managers.

The cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each statement of financial position date. In accordance with IAS 19, the Association recognises a portion of the scheme's actuarial gains and losses as income or expense if the net cumulative unrecognised actuarial gains and losses at the end of the preceding reporting period exceeded the greater of (a) 10% of the present value of the defined benefit obligation at that date; and (b) 10% of the fair value of any plan assets at that date. The portion of actuarial gains and losses to be recognised is the excess, determined as described above, divided by the expected remaining average working lives of the employees participating in the plan. The revised IAS 19 comes into force for the year ending 20 February 2014 which will result in the Association having to recognise all actuarial gains and losses in full.

The defined benefits scheme was closed to new members on 31 March 2006. The Association also operates a defined contribution scheme.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 2. Summary of Significant Accounting Policies (Continued)

### Leases

Where a significant portion of the risks and rewards of ownership is retained by the lessor, they are classified as operating leases. Payments made as lessee under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight line basis over the period of the relevant leases.

### Taxation

UK Corporation Tax is provided on relevant investment income. There is no deferred tax in the year to 20 February 2012 (2011 – nil).

## 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates and judgements are continually evaluated and are based on historical information and experience, actuarial analyses, financial modelling and other analytical techniques.

### Receivables

Receivables are measured at initial recognition at fair value. Appropriate allowances for estimated irrecoverable amounts are recognised as expense when there is objective evidence that the asset is impaired. In making their assessment of the recoverability of premiums and the likely provision for impairment of Member receivables the management take into account the right of retrospective cancellation of cover permitted under the Rules of the Association in the event of non payment of premium. The assessment of impairment also includes an assessment of whole account recoverability based upon historical experience of managing a book of premiums through a number of insurance cycles.

### Pensions and other post-retirement benefits

The Association operates a defined benefit pension scheme. The key assumptions used for the actuarial valuation are based on the Directors' best estimate of the variables that will determine the ultimate cost of providing post-employment benefits, on which further detail is provided in note 28.

The key assumptions concerning the future, and other key sources of estimation uncertainty at the statement of financial position sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

### Claims reserves – Members

The estimation of the ultimate liability arising from claims made under insurance contracts is the Association's most critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the liability that the Association will ultimately pay for such claims, such as the extent to which claims have occurred but not been reported to the Association, the length of time it takes to finalise a claims award, the extent to which fees will be incurred in the management of a case and the potential outcomes that can arise from being involved in litigation.

Each individual claim reserve is set at an appropriate level by an experienced claims adjuster, based upon their judgement and experience, who is responsible for the 'hands on' management of the case. The case reserves are monitored and agreed by members of the Claims department management team and Members are encouraged to scrutinise and comment upon the reserves held by the Association. Internal file audits are performed on a continuous basis in order to maintain the high standards of claims management and reserving.

The ultimate cost of claims is only known at their conclusion. Provision is made for outstanding claims based upon management's estimate of the ultimate likely cost of individual claims following advice from the Association's actuary.

### Claims reserves – Pool

The reserves maintained in the books and records of the Association in respect of claims arising for the Association's participation in the Pooling Agreement (see note 4.1) are initially based upon the Association's share of claims reserves established by the notifying Club. In addition, based upon historical evidence and statistical analysis, the Association makes additional provisions for claims incurred but not reported ("IBNR") and claims incurred but not enough reserved ("IBNER"), based upon management's own assessment of the likely ultimate outcome of the Pool.

The additional provision covers the likelihood that:

- there are claims that have been incurred but have not been reported to the respective Clubs and hence not notified to the Pool;
- where claims are reserved at a level which does not require notification to the Pool but subsequently that reserve is increased becoming a Pool claim; and
- for uncertainty surrounding the Pool contribution proportion subject to the finalisation of the confirmation of contribution levels based upon tonnage, premium and record, as set out in the Pooling Agreement.

### Claims reserves – asbestosis

The Association has limited exposure to cases presented as a result of exposure to asbestos. The cases presented primarily relate to exposure to the substance during the 1960's and 1970's. As with all claims presented to the Association a reserve is set at an appropriate level by an experienced claims adjuster on each claim. The Association also provides for IBNR in respect of asbestosis claims based upon actuarial analysis and advice.

### Claims reserves – future in-house claims handling costs for previous policy years

The Association is required to provide for the future in house claims handling costs for previous policy years. The future claims handling costs which would be incurred in managing previous policy years is unknown. A review is performed annually by management of expected run off costs and a provision made accordingly. The basis for the provision is a judgemental assessment based upon the experience of management.

### Reinsurance recoveries

Reinsurance recoveries are accrued against gross claims reserves, as noted above, including estimates and provisions where the Association has an entitlement to make such recoveries.

## 4. Management of Insurance Risk and Financial Risk

### 4.1 Insurance risk

The Association issues contracts that transfer insurance risk. The risks under any one insurance contract are the possibility that an insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Association faces under its insurance contracts is that the actual claims exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual number and amount of claims will vary from year to year from the estimate established using statistical techniques.

The Association models its claims development using primarily an internal chain ladder model. The output from the internal model is compared to the results derived from an external stochastically based model which is updated and processed annually and actuarially certified.

The objective of the Association's management of insurance risk is to achieve a breakeven technical result and to ensure that the carrying amount of the insurance liabilities are not exceeded by the actual experience of claims development. The Association manages insurance risk through its underwriting strategy, proactive claims handling and adequate reinsurance arrangements.

The limit of cover under the P&I Class, unless specifically limited under the Member's terms of entry, is the overspill limit (US$ equivalent of the Convention on Limitation of Liability for Maritime Claims (LLMC), 1976, SDR figure) in excess of the International Group excess of loss reinsurance program, estimated to be in the order of US$6.0 billion. Oil pollution is limited to US$1.0 billion. FD&D cover is in theory unlimited, albeit subject to the discretion of the Directors, however, disputes arising in relation to ship building, purchase, sale, negligent repair, alteration or conversion are limited to US$250,000, unless a higher amount is otherwise agreed between Members and Managers. War risks cover is limited to the hull and machinery value of the entered ship.

The underwriting strategy attempts to ensure that the underwritten risks (as discussed in note 1) are of appropriate quality, correctly rated and well diversified in terms of type and amount of risk, industry and geography.

## 4. Management of Insurance Risk and Financial Risk (Continued)

The Association has a specialised claims department dealing with the mitigation of risks surrounding known claims. Claims are reviewed individually at least bi-annually and adjusted to reflect the latest information on the underlying facts, current law, jurisdiction, contractual terms and conditions, and other factors.

The Association is one of the 13 members of the International Group of P&I Clubs which, between them, provide liability insurance for over 90% of the world's deep-sea shipowners. All International Group Clubs operate on a mutual, not-for-profit basis with premiums being pooled and invested to pay claims directly and to buy various levels of reinsurance. The system is now recognised throughout the world as the most cost-effective and reliable method of providing marine liability insurance.

The Association is reinsured for P&I claims up to US$3.06 billion (2010/11 – US$3.05 billion) through a combination of the International Group of P&I Club's pooling and excess loss programme and the Association's own retention reinsurance.

All claims up to US$60.0 million are shared by the 13 International Group members and each Club in 2010/11 carried US$8.0 million retention. The International Group buys Excess Loss reinsurance cover at Lloyd's for claims between US$60.0 million and US$3.06 billion, after which costs fall back on the pool, known as 'Overspill'.

Exposure under the Pooling Agreement for claims falling to the layer US$30.0 million in excess of US$30.0 million, as well as a 25% quota share retention under the first layer of the Excess Loss contract, up to US$560.0 million, is reinsured by Hydra Insurance Company Limited ("Hydra"), the International Group's Bermuda based captive.

The Association also has a 'quota share' reinsurance contract with North of England Mutual Insurance Association (Bermuda) Limited ("NoE Bermuda"), a company wholly owned by Members, which reinsures 90% of the Association's retained risks.

#### Closing of policy years for overspill calls

If at the expiry date of the period of thirty-six months, no Overspill Notice has been sent, the relevant Policy Year shall be closed automatically for the purpose of levying Overspill Calls.

#### Closing of policy years for other purposes

For all purposes other than levying Overspill Calls the Directors shall with effect from such date after the end of each Policy Year as they think fit declare that such Policy Year will be closed.

### 4.2 Financial risk

The Association is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities. In particular the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance contracts.

#### Investment risk

The most important components of this investment risk are market risk (including interest rate risk), currency risk and credit risk.

#### Market risk

Market risk is the risk that as a result of market movements a firm may be exposed to fluctuations in the value of its assets, the amount of its liabilities, or the income from its assets. Sources of general market risk include movements in interest rates, equities, exchange rates and real estate prices. It is important to note that none of these sources of risk is independent of the others. Market risk is managed through diversification of allocation to asset classes and restricting the concentration of investment into any one asset. A 1% increase/decrease in interest rates would have resulted in an increase/decrease in the valuation of fixed income securities of US$3.0 million.

#### Currency risk

The Association operates internationally and its exposures to foreign exchange risk arise primarily with respect to the US Dollar and the UK Sterling but also Euro and other global currencies. The asset allocation policy within the Board's Statement of Investment Principles contains provisions for the matching of assets and liabilities by currency type. The enforcement of that policy is through the specific investment guidelines under which the investment managers operate.

# 4. Management of Insurance Risk and Financial Risk (Continued)

Asset / liability currency management is executed in the bond fund with assets held to match liabilities in the required individual currency proportions. At present the neutral currency position for the bond fund is:

| | |
|---|---|
| US$ | 89% |
| £STG | 4% |
| Other | 7% |

The bond managers who manage discretionary portfolios are allowed to deviate from the neutral position but only to a maximum of 10% and are allowed to invest up to 15% of the fund in alternative OECD currencies.

## Credit risk

The Association has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Investment related counterparty risk is managed through the investment guidelines issued to the fixed income managers. The guidelines allow up to 10% of the bond portfolio to be invested in securities rated BBB/Baa by S&P or Moody's with the balance in securities rated AA or better. The portfolio may not hold more than 5% of any single issue except for Sovereign and US Government issues. No more than 10% of the portfolio may be invested in the long term (over one year) obligations of a single issuer except for sovereign borrowers, supranational borrowers and US Government Agencies where a limit of 20% shall apply and in relation to BBB borrowers where a limit of 1% shall apply. There is no restriction on the exposure of the portfolio to obligations of sovereign or supranational borrowers rated AAA by S&P or Moody's.

The following table provides information regarding the aggregate credit risk exposure, for financial assets with external credit ratings, of the Group.

At 20 February 2012

| | AAA | AA | A | BBB | Speculative Grade | Not Rated | NoE (Bermuda) | Carrying Value $000s |
|---|---|---|---|---|---|---|---|---|
| Debt securities | 9.07% | 89.14% | 0.37% | 1.42% | 0.00% | 0.00% | 0.00% | 130,893 |
| Reinsurance assets | 0.11% | 8.84% | 19.08% | 1.34% | 0.97% | 0.24% | 69.42% | 756,231 |
| Other receivable | 1.65% | 10.55% | 15.09% | 4.48% | 3.15% | 65.08% | 0.00% | 21,279 |

At 20 February 2011

| | AAA | AA | A | BBB | Speculative Grade | Not Rated | NoE (Bermuda) | Carrying Value $000s |
|---|---|---|---|---|---|---|---|---|
| Debt securities | 95.8% | 4.2% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 109,436 |
| Reinsurance assets | 0.0% | 0.7% | 25.9% | 3.4% | 0.4% | 0.2% | 69.4% | 646,211 |
| Other receivable | 6.1% | 9.8% | 10.3% | 0.5% | 0.0% | 73.3% | 0.0% | 12,878 |

## Investment risk management

The Association manages its investment funds in accordance with an investment framework set out in the Statement of Investment Principles that is approved by the Directors. The framework determines investment policy and the management of investment risk and is reviewed on a regular basis. The detailed consideration of investment strategy is the responsibility of the Investment Committee, a sub committee of the Board of Directors. Investment management is outsourced to professional investment managers. When vacancies arise, prospective investment managers are interviewed and if suitable proposed by the Investment Committee and approved for appointment by the Directors. The performance of the investment managers against their respective benchmark is monitored on a monthly basis and there is a quarterly review of performance and measurement of portfolio risk by an independent consultant.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 4. Management of Insurance Risk and Financial Risk (Continued)

The asset class allocation policy is aligned so as to match the liabilities faced by the Association. The current asset allocation is 100% in fixed income and cash assets. The known claims liabilities facing the Association are matched against fixed income assets, representing secure and highly liquid assets known to preserve capital and which if called upon could be realised very quickly to settle liabilities.

Other areas where the Association is exposed to credit risk are:

### Reinsurer's share of insurance liabilities

Reinsurance is used to manage insurance risk as explained above. This does not, however, discharge the Association's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Association remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered on an ongoing basis by reviewing their financial strength prior to finalisation of any contract.

### Amounts due from Members

A Member shall cease to be insured by the Association in respect of any and all ships entered by him or on his behalf (or in a fleet entry in which any one or all of his ships are entered) if having failed to pay when due and demanded by the Managers any sum due from him to the Association. If, having failed to pay any sum due to the Association, a Member has ceased to be insured by the Association, the Association is not liable for any claims under the Rules whether the incident giving rise to such claim occurred before or after the cessation of insurance. Under the Rules, the Association shall be entitled to, and the Member grants, a lien on the entered ship in respect of any amount whatsoever owed by the Member to the Association.

### Amounts due from insurance intermediaries

As agents for the Members the rules applying above in respect of amounts due from Members apply to amounts due from insurance intermediaries. With regard to amounts due under contracts of reinsurance ceded, the Association employs insurance intermediaries that are subject to the regulation of and approved by the Financial Services Authority in the UK. As such, insurance intermediaries are required to operate client trust accounts to ring-fence the amounts held on their clients' behalf.

## 5. Other Gains and Losses

| | 2012 | 2011 |
|---|---|---|
| Negative goodwill written off on acquisition of MSMI | 1,940 | – |
| Revaluation of property | (1,500) | – |
| Other gains and losses | 440 | – |

As at 2 November 2011, the Association assumed the assets and liabilities of MSMI, which ceased underwriting on 30 June 2011. The primary reason for the acquisition was to maintain the Association's relationships in MSMI's market whilst utilising existing knowledge and resources to create value for the Association's Members through the run-off of MSMI's claims liabilities. The transaction involved the MSMI Board and Members appointing the Association as the sole Member of MSMI. At the same time, a payment equal to 75% of the agreed net asset value ("NAV") of MSMI at 30 June 2011 was distributed in accordance with a distribution formula determined by the MSMI Board. At the same time, the Association entered into a Reinsurance to Close ("RITC") contract with MSMI under which the Association has assumed all of the net claims liabilities after MSMI's market reinsurances.

(All amounts in US Dollar thousands unless otherwise stated)

# 5. Other Gains and Losses (Continued)

The balance sheet of MSMI on acquisition was as follows:

| | 2012 | 2011 |
|---|---|---|
| **Assets** | | |
| Financial investments | | 28,263 |
| Reinsurance recoveries on claims outstanding | | 51,481 |
| Debtors arising out of direct insurance operations | 595 | |
| Debtors arising out of reinsurance operations | 5,330 | |
| | | 5,925 |
| Cash at bank and in hand | | 2,736 |
| Prepayments and accrued income | | 113 |
| Total assets acquired | | 88,518 |
| **Liabilities** | | |
| Claims outstanding | | 66,238 |
| Creditors arising out of reinsurance operations | 972 | |
| Other creditors | 19,276 | |
| | | 20,248 |
| Accruals and deferred income | | 92 |
| Total liabilities acquired | | 86,578 |
| Net Assets Acquired | | 1,940 |
| Consideration Paid | | 0 |
| Negative goodwill arising on acquisition | | 1,940 |

The Directors consider that the value of assets and liabilities acquired at 2 November 2011 were held at a value consistent with fair value. In addition, the Directors consider MSMI's accounting policies to be in line with those adopted by the Association and as a consequence do not consider that any adjustments are required for the alignment of accounting policies.

The excess of net assets over net liabilities led to the recognition of negative goodwill on acquisition. In accordance with the Group's accounting policies this has been written off to the Income Statement on acquisition.

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 6. Intangible Assets

The Group

| | Computer Software | Negative Goodwill | Total |
|---|---|---|---|
| Year ended 20 February 2012 | | | |
| Opening net book amount | 2,844 | – | 2,844 |
| Negative goodwill arising on combination of MSMI | – | (1,940) | (1,940) |
| Negative goodwill written off during the year | – | 1,940 | 1,940 |
| Exchange differences | (69) | – | (69) |
| Additions | 967 | – | 967 |
| Amortisation charge | (954) | – | (954) |
| Closing net book amount | 2,788 | – | 2,788 |
| At 20 February 2012 | | | |
| Cost or valuation | 8,878 | – | 8,878 |
| Accumulated amortisation | (6,090) | – | (6,090) |
| Net book amount | 2,788 | – | 2,788 |
| Year ended 20 February 2011 | | | |
| Opening net book amount | 1,827 | – | 1,827 |
| Exchange differences | 94 | – | 94 |
| Additions | 1,879 | – | 1,879 |
| Amortisation charge | (956) | – | (956) |
| Closing net book amount | 2,844 | – | 2,844 |
| At 20 February 2011 | | | |
| Cost or valuation | 8,108 | – | 8,108 |
| Accumulated amortisation | (5,264) | – | (5,264) |
| Net book amount | 2,844 | – | 2,844 |

(All amounts in US Dollar thousands unless otherwise stated)

## 6. Intangible Assets (Continued)

The Company

| | Computer Software |
|---|---|
| **Year ended 20 February 2012** | |
| Opening net book amount | 2,844 |
| Exchange differences | (69) |
| Additions | 967 |
| Amortisation charge | (954) |
| **Closing net book amount** | **2,788** |
| **At 20 February 2012** | |
| Cost or valuation | 8,878 |
| Accumulated amortisation | (6,090) |
| **Net book amount** | **2,788** |
| **Year ended 20 February 2011** | |
| Opening net book amount | 1,827 |
| Exchange differences | 94 |
| Additions | 1,879 |
| Amortisation charge | (956) |
| **Closing net book amount** | **2,844** |
| **At 20 February 2011** | |
| Cost or valuation | 8,108 |
| Accumulated amortisation | (5,264) |
| **Net book amount** | **2,844** |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 7. Property, Plant and Equipment

The Group and the Company

| | Land and Buildings | Computer Equipment | Motor Vehicles | Office Equipment & Fittings | Total |
|---|---|---|---|---|---|
| **Year ended 20 February 2012** | | | | | |
| Opening net book amount | 20,294 | 2,231 | 673 | 860 | 24,058 |
| Exchange differences | (230) | (54) | (16) | (21) | (321) |
| Revaluation | (7,490) | – | – | – | (7,490) |
| Additions | 247 | 151 | 210 | 1,119 | 1,727 |
| Disposals | – | – | (92) | – | (92) |
| Depreciation charge | (406) | (727) | (195) | (572) | (1,900) |
| Closing net book amount | 12,415 | 1,601 | 580 | 1,386 | 15,982 |
| **At 20 February 2012** | | | | | |
| Cost or valuation | 12,415 | 7,148 | 1,141 | 4,370 | 25,074 |
| Accumulated depreciation | – | (5,547) | (561) | (2,984) | (9,092) |
| Net book amount | 12,415 | 1,601 | 580 | 1,386 | 15,982 |
| **Year ended 20 February 2011** | | | | | |
| Opening net book amount | 11,526 | 1,330 | 567 | 384 | 13,807 |
| Exchange differences | – | 68 | 29 | 20 | 117 |
| Revaluation | 562 | – | – | – | 562 |
| Additions | 8,437 | 1,659 | 469 | 717 | 11,282 |
| Disposals | – | – | (168) | – | (168) |
| Depreciation charge | (231) | (826) | (224) | (261) | (1,542) |
| Closing net book amount | 20,294 | 2,231 | 673 | 860 | 24,058 |
| **At 20 February 2011** | | | | | |
| Cost or valuation | 20,728 | 7,170 | 1,161 | 3,331 | 32,390 |
| Accumulated depreciation | (434) | (4,939) | (488) | (2,471) | (8,332) |
| Net book amount | 20,294 | 2,231 | 673 | 860 | 24,058 |

The fair value of the building has been assessed by the Directors, taking into account a valuation by Bradley Hall, an independent Chartered Surveyor.

Depreciation expense of US$1,900,000 (2011 – US$1,542,000) has been charged in expenses for marketing and administration.

If land and buildings were stated on a historical cost basis, the amounts would be as follows:

| At 20 February | 2012 | 2011 |
|---|---|---|
| Cost | 16,253 | 16,007 |
| Accumulated depreciation | (2,280) | (1,995) |
| Net book amount | 13,973 | 14,012 |

(All amounts in US Dollar thousands unless otherwise stated)

## 8. Financial Assets

Financial assets are summarised below by measurement category in the table below. All assets are current assets.

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Fair value through income | 130,944 | 71,826 | 109,488 | 71,835 |
| Loans and receivables including insurance and reinsurance receivables (note 9) | 21,279 | 34,235 | 12,878 | 13,690 |
| **Total financial assets** | **152,223** | **106,061** | **122,366** | **85,525** |

Financial assets at fair value through income

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Equity securities: | | | | |
| – unlisted | 51 | 51 | 52 | 52 |
| Debt securities – fixed interest rate | | | | |
| – government bonds | 130,893 | 71,775 | 104,818 | 67,165 |
| – other listed securities | – | – | 4,618 | 4,618 |
| | **130,893** | **71,775** | **109,436** | **71,783** |
| **Total financial assets at fair value through income** | **130,944** | **71,826** | **109,488** | **71,835** |

Maturity dates of the fixed interest debt securities are as follows:

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| In up to two years | 47,841 | 16,303 | 69,796 | 43,881 |
| In more than two years but not more than three years | 22,075 | 2,234 | 11,738 | – |
| In more than four years but not more than five years | 20,369 | 16,724 | 4,940 | 4,940 |
| In more than five years | 40,608 | 36,514 | 22,962 | 22,962 |
| | **130,893** | **71,775** | **109,436** | **71,783** |

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| At 20 February 2011 | 109,488 | 71,835 | 74,433 | 47,598 |
| Additions | 406,997 | 334,898 | 389,654 | 350,414 |
| Disposals (sale and redemptions) | (389,570) | (338,570) | (352,591) | (324,220) |
| Fair value net gains / (losses) (excluding net realised gains) | 4,029 | 3,663 | (2,008) | (1,957) |
| **At 20 February 2012** | **130,944** | **71,826** | **109,488** | **71,835** |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 9. Loans and Receivables

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Receivables arising from insurance and reinsurance contracts: | | | | |
| – due from contract holders | 10,920 | 10,296 | 7,233 | 7,233 |
| – due from reinsurers | 5,597 | 2,813 | 1,723 | 2,606 |
| Other loans and receivables: | | | | |
| – prepayments | 1,763 | 1,724 | 1,262 | 1,258 |
| – accrued interest | 511 | 445 | 457 | 390 |
| – other debtors | 2,488 | 18,957 | 2,203 | 2,203 |
| | 21,279 | 34,235 | 12,878 | 13,690 |

Included in other debtors in both the Group and the Company are US$9,375 (2011 – US$14,800) that are due more than twelve months after the reporting date.

## 10. Cash and Cash Equivalents

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Cash at bank and in hand | 30,699 | 22,224 | 11,374 | 11,235 |
| Short-term bank deposits | 34,623 | 34,623 | 25,000 | 25,000 |
| Money market funds | 817 | – | 1,126 | – |
| | 66,139 | 56,847 | 37,500 | 36,235 |

Cash and bank overdrafts include the following for the purposes of the cash flow statement:

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Cash and cash equivalents | 66,139 | 56,847 | 37,500 | 36,235 |
| Bank overdrafts | – | – | – | – |
| | 66,139 | 56,847 | 37,500 | 36,235 |

At 20 February 2012, the unused bank overdraft, repayable on demand, amounted to US$1,700,000 (2011 – US$1,700,000) for the Association and €1,000,000 for Marine Shipping Mutual Insurance Company Limited.

(All amounts in US Dollar thousands unless otherwise stated)

## 11. Insurance Liabilities and Reinsurance Assets

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Gross | | | | |
| Short term insurance contracts: | | | | |
| – claims reported and loss adjustment expenses | 759,894 | 721,282 | 634,160 | 634,160 |
| – claims incurred but not reported and claims handling reserve | 54,556 | 54,556 | 61,848 | 61,848 |
| Total insurance liabilities, gross | 814,450 | 775,838 | 696,008 | 696,008 |
| Recoverable from reinsurers | | | | |
| Short term insurance contracts: | | | | |
| – claims reported and loss adjustment expenses | 707,131 | 700,480 | 590,548 | 611,626 |
| – claims incurred but not reported and claims handling reserve | 49,100 | 49,100 | 55,663 | 55,663 |
| Total reinsurers' share of insurance liabilities | 756,231 | 749,580 | 646,211 | 667,289 |
| Net | | | | |
| Short term insurance contracts: | | | | |
| – claims reported and loss adjustment expenses | 52,763 | 20,802 | 43,612 | 22,534 |
| – claims incurred but not reported and claims handling reserve | 5,456 | 5,456 | 6,185 | 6,185 |
| Total insurance liability | 58,219 | 26,258 | 49,797 | 28,719 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 11. Insurance Liabilities and Reinsurance Assets (Continued)

### Movements in Insurance Liabilities and Reinsurance Assets

The Group

| | 2012 Gross | 2012 Reinsurance | 2012 Net | 2011 Gross | 2011 Reinsurance | 2011 Net |
|---|---|---|---|---|---|---|
| Outstanding claims at beginning of year | 696,008 | (646,211) | 49,797 | 772,236 | (725,592) | 46,644 |
| Cash (paid) / recovered for claims settled in the year | (122,316) | 111,922 | (10,394) | (99,418) | 90,980 | (8,438) |
| Increase / (decrease) in liabilities | | | | | | |
| – arising from current year claims | 243,060 | (234,971) | 8,089 | 186,763 | (170,571) | 16,192 |
| – arising on acquisition of MSMI | 66,238 | (51,481) | 14,757 | – | – | – |
| – arising from prior year claims | (68,540) | 64,510 | (4,030) | (163,573) | 158,972 | (4,601) |
| **Outstanding claims at end of year** | **814,450** | **(756,231)** | **58,219** | **696,008** | **(646,211)** | **49,797** |

The Company

| | 2012 Gross | 2012 Reinsurance | 2012 Net | 2011 Gross | 2011 Reinsurance | 2011 Net |
|---|---|---|---|---|---|---|
| Outstanding claims at beginning of year | 696,008 | (667,289) | 28,719 | 772,236 | (745,117) | 27,119 |
| Cash (paid) / recovered for claims settled in the year | (122,316) | 111,439 | (10,877) | (99,418) | 94,732 | (4,686) |
| Increase / (decrease) in liabilities | | | | | | |
| – arising from current year claims | 270,686 | (279,801) | (9,115) | 186,763 | (182,189) | 4,574 |
| – arising from prior year claims | (68,540) | 86,071 | 17,531 | (163,573) | 165,285 | 1,712 |
| **Outstanding claims at end of year** | **775,838** | **(749,580)** | **26,258** | **696,008** | **(667,289)** | **28,719** |

The Directors have re-evaluated the claims reserves in respect of prior policy year claims. Releases in these reserves are seen as a result of positive claims experience.

From 1 January 2012 the Association entered into a quota share reinsurance agreement with Sunderland Marine Mutual Insurance Limited with underlying business written on a risks attaching basis. An unearned premium reserve has been established in respect of written business falling to this agreement.

(All amounts in US Dollar thousands unless otherwise stated)

## 11. Insurance Liabilities and Reinsurance Assets (Continued)

Policy year analysis

| | Closed Years | Open Policy Years 2009 | 2010 | 2011 | Handling Reserve | Total |
|---|---|---|---|---|---|---|
| **All Classes** | | | | | | |
| At 20 February 2012 | | | | | | |
| Gross outstanding claims | 237,417 | 111,792 | 136,277 | 309,298 | 19,666 | 814,450 |
| Reinsurance amount | 221,307 | 105,003 | 125,767 | 286,455 | 17,699 | 756,231 |
| Net outstanding claims | 16,110 | 6,789 | 10,510 | 22,843 | 1,967 | 58,219 |
| At 20 February 2011 | | | | | | |
| Gross outstanding claims | 323,700 | 158,646 | 186,762 | – | 26,900 | 696,008 |
| Reinsurance amount | 301,951 | 149,485 | 170,565 | – | 24,210 | 646,211 |
| Net outstanding claims | 21,749 | 9,161 | 16,197 | – | 2,690 | 49,797 |

### Sensitivity analysis

The uncertainty surrounding the valuation, timing and cash flows of claims liabilities, the process of claims reserve estimation and the process and assumptions regarding the determination of other claims liability based reserves are set out in note 3.

Notified claim numbers in the 2011 policy year were 16% higher in 2011 compared to 2010 and claim values rose by 70% (in turn at the same point in the development of the policy years, 2010 claims were 18% higher and values 40% lower than 2009). The Pool produced more by way of liability in 2011 than in 2010 with exposure to other clubs' claims to the Pool assessed at 20 February to be more than half more than the 2010 figure at the same time last year (2010 was 144% of 2009).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 11. Insurance Liabilities and Reinsurance Assets (Continued)

There are a significant number of variables which lead to the uncertainty surrounding the valuation, timing and cash flows of claims liabilities although management are of the opinion that the Accumulated Surplus is not materially sensitive to any one variable. The extent to which the Accumulated Surplus may be sensitive to any individual variable or any groups of variables is best demonstrated by the development of claims liabilities. The development of claims liabilities by policy year is as follows:

Insurance claims development – Gross

| Policy Year | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|---|---|---|---|---|
| Estimate of ultimate claims cost | | | | | | | | | | |
| At end of policy year | 360,615 | 212,132 | 338,956 | 255,764 | 236,464 | 226,864 | 137,229 | 161,740 | 174,299 | 117,827 |
| One year later | | 203,260 | 261,336 | 256,301 | 201,491 | 229,315 | 150,880 | 176,857 | 155,467 | 135,252 |
| Two years later | | | 247,105 | 205,711 | 177,441 | 198,174 | 126,358 | 162,688 | 137,720 | 126,252 |
| Three years later | | | | 187,130 | 170,544 | 205,630 | 111,543 | 159,768 | 135,382 | 117,148 |
| Four years later | | | | | 167,641 | 181,631 | 113,368 | 154,178 | 125,283 | 113,038 |
| Five years later | | | | | | 176,082 | 113,850 | 156,403 | 121,404 | 110,193 |
| Six years later | | | | | | | 111,877 | 148,936 | 119,448 | 109,068 |
| Seven years later | | | | | | | | 150,815 | 116,881 | 107,276 |
| Eight years later | | | | | | | | | 117,390 | 106,430 |
| Nine years later | | | | | | | | | | 106,561 |
| Current estimate of cumulative claims | 360,615 | 203,260 | 247,105 | 187,130 | 167,641 | 176,082 | 111,877 | 150,815 | 117,390 | 106,561 |
| Cumulative payments to date | 51,317 | 66,983 | 135,313 | 126,205 | 131,291 | 131,949 | 86,523 | 126,482 | 109,381 | 98,553 |
| Liability recognised in the statement of financial position | 309,298 | 136,277 | 111,792 | 60,925 | 36,350 | 44,133 | 25,354 | 24,333 | 8,009 | 8,008 |
| Total of ten years | | | | | | | | | | 764,479 |
| Liability in respect of prior policy years | | | | | | | | | | 30,305 |
| Claims handling reserve | | | | | | | | | | 19,666 |
| **Total liability included in the statement of financial position** | | | | | | | | | | 814,450 |

(All amounts in US Dollar thousands unless otherwise stated)

## 11. Insurance Liabilities and Reinsurance Assets (Continued)

Insurance claims development – Net

| Policy Year | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|---|---|---|---|---|
| Estimate of ultimate claims cost | | | | | | | | | | |
| At end of policy year | 27,532 | 18,708 | 21,765 | 19,267 | 19,065 | 26,797 | 16,261 | 14,836 | 13,075 | 10,453 |
| One year later | | 17,175 | 19,238 | 16,731 | 16,624 | 16,960 | 14,987 | 14,660 | 12,266 | 10,698 |
| Two years later | | | 20,263 | 15,933 | 14,952 | 16,693 | 12,938 | 13,429 | 11,670 | 10,173 |
| Three years later | | | | 16,174 | 14,561 | 15,310 | 10,696 | 12,767 | 11,270 | 9,864 |
| Four years later | | | | | 15,097 | 15,108 | 11,631 | 12,310 | 10,616 | 9,431 |
| Five years later | | | | | | 15,664 | 11,341 | 12,524 | 10,491 | 9,284 |
| Six years later | | | | | | | 11,011 | 12,187 | 10,222 | 9,186 |
| Seven years later | | | | | | | | 13,096 | 10,114 | 8,999 |
| Eight years later | | | | | | | | | 10,273 | 8,915 |
| Nine years later | | | | | | | | | | 9,916 |
| Current estimate of cumulative claims | 27,532 | 17,175 | 20,263 | 16,174 | 15,097 | 15,664 | 11,011 | 13,096 | 10,273 | 9,916 |
| Cumulative payments to date | 4,689 | 6,665 | 13,474 | 12,450 | 12,682 | 12,895 | 8,595 | 11,801 | 9,538 | 9,280 |
| Liability recognised in the statement of financial position | 22,843 | 10,510 | 6,789 | 3,724 | 2,415 | 2,769 | 2,416 | 1,295 | 735 | 636 |
| Total of ten years | | | | | | | | | | 54,132 |
| Liability in respect of prior policy years | | | | | | | | | | 2,120 |
| Claims handling reserve | | | | | | | | | | 1,967 |
| Total liability included in the statement of financial position | | | | | | | | | | 58,219 |

## 12. Trade and other Payables

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Trade payables and accrued expenses | 23,542 | 29,593 | 8,524 | 8,454 |

All the above amounts were due within twelve months of the reporting date.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 13. Investment Income

The Group

| | 2012 | 2011 |
|---|---|---|
| Interest on bank deposits | 96 | 60 |
| | **96** | **60** |

## 14. Net Fair Value Gains on Assets and at Fair Value through Income

The Group

| | 2012 | 2011 |
|---|---|---|
| Net fair value gains on financial assets through income: | | |
| – fair value gains | 7,207 | 2,692 |
| – fair value losses | – | (356) |
| | 7,207 | 2,336 |

Net fair value gains on debt securities are as follows:

| | 2012 | 2011 |
|---|---|---|
| Bond interest | 2,185 | 2,216 |
| Net realised gains / (losses) | 3,785 | 476 |
| Net movement on unrealised gains / (losses) | 1,237 | (356) |
| | 7,207 | 2,336 |

Net fair value gains on equity are as follows:

| | | |
|---|---|---|
| Net movement on unrealised gains / (losses) | (1) | 1 |
| | (1) | 1 |

(All amounts in US Dollar thousands unless otherwise stated)

## 15. Insurance Claims

The Group

| | 2012 Gross | 2012 Reinsurance | 2012 Net |
|---|---|---|---|
| Current year claims and loss adjustment expenses | 314,961 | (272,530) | 42,431 |
| Reduction in cost for prior year claims and loss adjustment expenses | (61,306) | 49,542 | (11,764) |
| Movement in claims handling reserve | (7,234) | 6,511 | (723) |
| Total claims and loss adjustment expense | 246,421 | (216,477) | 29,944 |

The Group

| | 2011 Gross | 2011 Reinsurance | 2011 Net |
|---|---|---|---|
| Current year claims and loss adjustment expenses | 229,829 | (193,397) | 36,432 |
| Reduction in cost for prior year claims and loss adjustment expenses | (160,072) | 153,009 | (7,063) |
| Movement in claims handling reserve | (3,500) | 3,150 | (350) |
| Total claims and loss adjustment expense | 66,257 | (37,238) | 29,019 |

## 16. Operating Expenses by Nature

The Group

| | 2012 | 2011 |
|---|---|---|
| Auditors' remuneration – audit services | 368 | 286 |
| Depreciation and amortisation charges | 2,854 | 2,498 |
| Staff costs (note 17) | 35,499 | 30,637 |
| Allocation of staff costs to claims handling expenses | (21,494) | (17,728) |
| Lease payments | 103 | 340 |
| Brokerage | 21,998 | 19,310 |
| Purchase of goods and services | 12,206 | 8,237 |
| Total operating expenses | 51,534 | 43,580 |

The auditors were also remunerated US$8,730 (2011 – US$8,378) for the audit of the North of England Protecting and Indemnity Association Limited Retirement Benefit Scheme. The assets of the Association's pension scheme are held separately from those of the Association and as such the cost for the audit of the pension scheme was not borne by the Association.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 17. Staff Costs

The Group

The average monthly number of employees (including executive Directors) was:

| | 2012 Number | 2011 Number |
|---|---|---|
| P&I claims and MSMI | 90 | 85 |
| FD&D | 36 | 34 |
| Underwriting and entries | 28 | 25 |
| Risk management | 13 | 12 |
| Other | 51 | 49 |
| | 218 | 205 |

Their aggregate remuneration comprised:

| | 2012 | 2011 |
|---|---|---|
| Wages and salaries | 22,026 | 19,492 |
| Social security costs | 2,016 | 1,733 |
| Retirement benefit obligations – defined benefit plans | 9,570 | 7,461 |
| Other post-employment benefits | 1,887 | 1,951 |
| | 35,499 | 30,637 |

(All amounts in US Dollar thousands unless otherwise stated)

## 18. Directors' Remuneration

The Group

### Remuneration

The remuneration of the Directors was as follows:

| | 2012 | 2011 |
|---|---|---|
| Short-term employee benefits | 2,262 | 2,145 |

No Directors were members of the Company's defined benefit pension scheme during the year.

The aggregate value of Association contributions paid to defined contribution pension schemes in respect of Directors' qualifying services was as follows:

| | 2012 | 2011 |
|---|---|---|
| Pension contributions paid by the Association | – | – |

### Highest Paid Director

The above amounts for remuneration include the following in respect of the highest paid Director:

| | 2012 | 2011 |
|---|---|---|
| Emoluments | 966 | 920 |

The accrued pension entitlement under the Company's defined benefit scheme of the highest paid Director at 20 February 2012 was US$ nil (2011 – US$ nil).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 19. Finance (Expense) / Income

The Group

| | 2012 | 2011 |
|---|---|---|
| Gains on exchange - technical | (679) | 441 |
| Gains on exchange - investments | (461) | 1,447 |
| | (1,140) | 1,888 |

## 20. Tax Expense

The Group

| | 2012 | 2011 |
|---|---|---|
| Current tax | 1,665 | 511 |

The difference between the total tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax to investment income is as follows:

| | 2012 | 2011 |
|---|---|---|
| Investment income | 90 | 60 |
| Net fair value gains on financial assets | 6,374 | 1,892 |
| Expenses for asset management services rendered | (261) | (269) |
| Finance income | 149 | – |
| Investment return | 6,352 | 1,683 |
| Tax on the above at standard UK corporation tax rate of 26.21% (2011 – 28%) | 1,665 | 471 |
| Foreign exchange difference | – | 40 |
| | 1,665 | 511 |

There is no unrecognised deferred tax asset.

## 21. Reserves

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Income and expenditure reserve | 10,938 | (4,367) | (14,059) | (26,390) |
| Contingency fund | 46,171 | 46,171 | 45,004 | 45,004 |
| Revaluation reserve | – | – | 5,990 | 5,990 |
| | 57,109 | 41,804 | 36,935 | 24,604 |

(All amounts in US Dollar thousands unless otherwise stated)

## 21. Reserves (Continued)

(a) Income and expenditure account

The deficit represents the net balance on open policy years, the claims handling reserve plus unrealised gains on investments.

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Balance at 20 February 2011 | (14,059) | (26,390) | (21,590) | (23,328) |
| Surplus / (deficit) after tax | 26,164 | 23,190 | 7,759 | (2,834) |
| Transfer to contingency fund | (1,167) | (1,167) | (228) | (228) |
| **Balance at 20 February 2012** | **10,938** | **(4,367)** | **(14,059)** | **(26,390)** |

(b) Contingency funds

The Group and the Company

### Protecting & Indemnity Class

| | 2012 | 2012 | 2011 | 2011 |
|---|---|---|---|---|
| Balance at 20 February 2011 | | 41,860 | | 41,692 |
| The transfer from the income and expenditure account comprises: | | | | |
| Transfer of unrealised gains | (2,642) | | – | |
| Allocation of realised investment gains / losses and income | (407) | | (1,139) | |
| Surplus transferred from closed policy years | 4,032 | | 1,307 | |
| | | 983 | | 168 |
| Balance at 20 February 2012 | | 42,843 | | 41,860 |

The contingency fund was established by the Directors on 12 October 1983 in order to maintain call stability.

### Freight, Demurrage & Defence Class

| | 2012 | 2012 | 2011 | 2011 |
|---|---|---|---|---|
| Balance at 20 February 2011 | | 3,144 | | 3,084 |
| The transfer from the income and expenditure account comprises: | | | | |
| Allocation of realised investment gains / losses and income | (69) | | (31) | |
| Surplus transferred from closed policy years | 253 | | 91 | |
| | | 184 | | 60 |
| Balance at 20 February 2012 | | 3,328 | | 3,144 |

The contingency fund was established by the Directors on 23 September 1994 in order to maintain call stability.

(c) Revaluation Reserve

The Group and the Company

| | 2012 | 2011 |
|---|---|---|
| Balance brought forward | 5,990 | 5,428 |
| Exchange gain / (loss) | (5,990) | 562 |
| Balance carried forward | – | 5,990 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 22. Subsidiary Undertakings

The subsidiary undertakings, all wholly owned, are:

| | Place of Incorporation | Percentage Holding | Nature of Business |
|---|---|---|---|
| The North of England P&I Association (Bermuda) Limited | Bermuda | 100 | Marine insurance company |
| NEPIA Trust Company Limited | United Kingdom | 100 | Corporate trustee |
| North Insurance Management Limited | United Kingdom | 100 | Management services |
| Hydra Insurance Company Limited | Bermuda | 100 (of cell) | Reinsurance captive |
| Marine Shipping Mutual Insurance Company Limited | United Kingdom | 100 | Marine insurance company |
| The North of England Protecting and Indemnity Association Limited | Japan | 100 | Marine insurance company |

North Insurance Management Limited is a management company which manages the Association and Marine Shipping Mutual Insurance Company Limited.

The North of England P&I Association (Bermuda) Limited did not trade during the year and the NEPIA Trust Company Limited is dormant.

The segregated cell within Hydra Insurance Company Limited, which reinsures the Association for its liability under the upper layer of the pool and its share of the first layer of the International Group excess loss reinsurance contract, has also been consolidated.

The Association assumed 100% control of Marine Shipping Mutual Association Company Limited under a framework agreement signed 23 August 2011, with conditions precedent to the change of control under the agreement being met in full on 2 November 2011.

The North of England Protecting and Indemnity Association Limited in Japan is a branch incorporated on 11 January 2012.

The value of the subsidiary undertakings is as follows:

The Company

| | 2012 | 2011 |
|---|---|---|
| Balance brought forward | 4,627 | 4,627 |
| Capital injected into Marine Shipping Mutual Insurance Company Limited for solvency purposes | 7,250 | – |
| Other capital injections for solvency purposes | 50 | – |
| Balance carried forward | 11,927 | 4,627 |

As disclosed in note 5, no consideration was paid for the acquisition of Marine Shipping Mutual Insurance Company Limited. Subsequent to the acquisition and following the placement of the reinsurance contract with North of England Protecting & Indemnity Association Limited, a capital injection was made by the parent in order for Marine Shipping Mutual Insurance Company Limited to meet its solvency requirements.

In line with parent's accounting policies, the Directors consider that none of the investments in group companies is impaired at either the 20/02/12 or 20/02/11 year ends.

(All amounts in US Dollar thousands unless otherwise stated)

## 23. Designated Reserves

Given the increases in recent years of Pool retentions and the participation of International Group Clubs, by way of coinsurance, in the Group market reinsurance contract, for policy years up to and including 2008/2009, all members of the International Group of P&I Clubs have entered into arrangements (under an agreement dated 20 February 1996) whereby each Club has provided letters of credit in favour of the Bermuda Trust Company. Such letters of credit can only be drawn upon in the event that the Association fails to meet a call upon it in relation to its obligations under the Pooling Agreement. The Association has lodged US$17,430,287 (2011 – US$12,332,674) in relation to its participation in the arrangement. No calls have been made upon the facility.

## 24. Lease

Future contractual aggregate minimum lease payments under non-cancellable operating leases are as follows:

| | 2012 | 2011 |
|---|---|---|
| Within 1 year | – | 69 |
| | – | 69 |

## 25. Other Guarantees

In the normal course of business, the Association has provided letters of credit and guarantees on behalf of its Members. These are secured by investments lodged with the Association amounting to US$13.1 million (2011 – US$15.2 million).

## 26. Related Party Transactions

### Key management compensation

The remuneration of the Directors was as follows:

| | 2012 | 2011 |
|---|---|---|
| Short-term employee benefits | 2,262 | 2,145 |

### Other related parties

The Association and NoE (Bermuda) are related parties in so far as they have identical Members but there is no control by one company over another. The Association has a quota share reinsurance contract with NoE Bermuda, a company wholly owned by Members, which reinsures 90% of the Association’s retained risks.

Hydra, the International Group’s Bermuda based captive, is a segregated accounts company and the Association is an Account Owner. Exposure under the Pooling Agreement for claims falling to the layer US$30.0 million in excess of US$30.0 million, as well as a 25% quota share retention under the first layer of the Excess Loss contract, up to US$560.0 million, is reinsured by Hydra.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 26. Related Party Transactions (Continued)

Transactions with NoE Bermuda and Hydra have been entered into as follows:

The Group

| | 2012 NoE Bermuda | 2012 Hydra | 2011 NoE Bermuda | 2011 Hydra |
|---|---|---|---|---|
| Insurance premium ceded | 190,088 | 2,207 | 177,919 | 2,225 |
| Recoveries due on outstanding claims | 524,005 | 17,460 | 448,169 | 3,778 |

The Company

| | 2012 NoE Bermuda | 2012 Hydra | 2011 NoEBermuda | 2011 Hydra |
|---|---|---|---|---|
| Insurance premium ceded | 190,088 | 18,853 | 177,919 | 14,999 |
| Recoveries due on outstanding claims | 524,005 | 49,421 | 448,169 | 24,855 |

At 2 November 2011 the Association became the ultimate parent company of MSMI. The transaction involved the MSMI Board and Members appointing the Association as the sole Member of MSMI. During the year the Association entered into a Reinsurance to Close contract with MSMI under which the Association has assumed all of the net claims liabilities after MSMI's market reinsurances. Transactions between the Association and MSMI are eliminated on consolidation. At 20 February 2012 there is an investment of US$7.25 million by the Association in MSMI which is to provide capital to allow MSMI to meet its FSA regulatory capital.

North, as parent of MSMI, has provided an indemnity to MSMI, which is effective from the date of acquisition, in respect of all potential contingent liabilities arising from the operations of the MSMI including the acquisition and subsequent run off of the business.

At 20 February 2012 there is a creditor for the payment of distributions to the Members of MSMI totalling US$2,406,625.

During the reporting period MSMI made payments of US$1,382,000 (2011 – US$2,334,000) to North Insurance Management Limited, a subsidiary of the Association.

(All amounts in US Dollar thousands unless otherwise stated)

## 27. Cash Generated from Operating Activities

| | The Group 2012 | The Company 2012 | The Group 2011 | The Company 2011 |
|---|---|---|---|---|
| Surplus / (deficit) before taxation | 27,829 | 24,855 | 8,270 | (2,323) |
| Adjustments for: | | | | |
| Depreciation and amortisation | 2,854 | 2,854 | 2,498 | 2,498 |
| Revaluation | 1,500 | 1,500 | – | – |
| Investment income | (4,684) | (4,372) | (122) | (173) |
| Loss on sale of property, plant and equipment | (1) | (1) | 5 | 5 |
| Increase / (decrease) in insurance contracts net of reinsurance recoverable | (6,335) | (2,461) | 3,153 | 1,600 |
| Increase in unearned premium reserve net of reinsurers' share | 729 | 729 | – | – |
| Increase / (decrease) in loans and receivables | (2,362) | (20,540) | 100 | 3,444 |
| Decrease in reinsurance payables | (1,613) | (2,953) | 33,958 | 33,958 |
| Increase / (decrease) in derivative financial instruments | (187) | (193) | 366 | 366 |
| Increase in trade and other payables | (4,350) | 21,139 | 4,155 | 4,152 |
| Increase in retirement benefit asset | 5,185 | 5,185 | (668) | (668) |
| Purchase of bonds at fair value through income | (378,165) | (334,323) | (389,654) | (350,414) |
| Sale of bonds at fair value through income | 389,750 | 338,810 | 352,591 | 324,220 |
| Negative goodwill written off on acquisition | (1,940) | – | – | – |
| Cash generated from operating activities | 28,210 | 30,229 | 14,652 | 16,665 |

Purchases of financial assets at fair value through income were included within cash flows from investing activities in the prior year financial statements and this financial year have been disclosed within the cash generated from operating activities. The prior year comparatives have been restated.

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 28. Retirement Benefit Scheme

The Association operates a defined benefit scheme in the United Kingdom. A triennial actuarial valuation was carried out at 31 August 2010 by a qualified independent actuary.

The Scheme Actuary has advised the Trustees of the Scheme that the Scheme is currently funded to 83% on an on-going basis.

There is a significant difference between the funding position on a normal scheme funding basis and the position under International Accounting Standard 19 'Employee Benefits' ('IAS 19'). The principal difference arises from the different discount factors applied in the calculation of the present value of scheme obligations. Under the scheme funding basis the discount factor used is related to the underlying asset mix of the scheme and based upon the returns expected to be earned from the scheme's funds. Under IAS 19 the discount factor used is based upon yields on AA corporate bonds of appropriate duration and currency. Since the yield on AA corporate bonds is less than the return expected on the actual assets held by the scheme, the discounted rate applied to the scheme liabilities under IAS 19 is lower than is applied under the scheme valuation basis and consequently produces larger liabilities.

As mentioned in notes 2.1 and 2.10, the Association has adopted the 'corridor' approach under IAS 19 where a portion of the net cumulative actuarial gains and losses are recognised over the remaining working lives of the scheme members. IAS 19 also permits systematic methods of faster recognition. Such permitted methods include immediate recognition of all actuarial gains and losses. The adoption of an alternative method of recognition where all actuarial gains and losses are recognised immediately on the statement of financial position would have required a statement of financial position provision under 'Retirement benefit obligations' of US$29.4 million (2011 – US$25 million).

The pension scheme, its assets and liabilities, assumptions and projections are based in sterling. The assets and liabilities of the scheme are converted into US Dollars, the Association's functional and presentational currency as shown in note 2.4.

### Actuarial assumptions for IAS19 – valuing the Scheme liabilities

IAS19 sets out prescribed (qualitative) conditions for selecting the actuarial assumptions used to calculate the pension liabilities and pension costs. A key assumption is the discount rate which is used to determine the value of pension liabilities at the statement of financial position date. The selection of the inflation assumption is also critical as this is relevant for the salary and the pre-retirement revaluation assumptions.

These assumptions are based on market yields at the statement of financial position date, and may not be borne out in practice due to the long-term expected duration of the Scheme. Within the prescribed conditions however assumptions must be mutually compatible and lead to the best estimate of the future cash flows in respect of pension liabilities. A summary of relevant considerations is set out below.

| Assumption for valuing pension liabilities | Comments on prescribed conditions |
|---|---|
| Discount rate (pre and post retirement) | Based on yields on AA corporate bonds of appropriate duration and currency, or a suitable proxy. |
| Price inflation | Based on the yield differential between index-linked corporate bonds and fixed-interest corporate bonds of similar credit standing (for example, using appropriate UK Government conventional and index-linked stocks). |
| Salary inflation | Reflecting the rate of price inflation assumed (for example, a fixed margin over the rate of price inflation). |
| Pension increases | Compatible with the rate of price inflation above taking into account the effects of scheme rules and valid expectations of discretionary increases based on past practice. |
| Demographic assumptions (for example, rates of mortality and early retirement) | Compatible assumptions that lead to a best estimate of future cash flows. |
| Administration expenses | As advised by the Company based on realistic forecasts. |

(All amounts in US Dollar thousands unless otherwise stated)

# 28. Retirement Benefit Scheme (Continued)

## Actuarial assumptions for IAS19 – expected return on Scheme assets

IAS19 requires assumptions to be made for the expected return on the various classes of Scheme assets to calculate the finance income element of the IAS19 pensions charge.

For bonds and cash, the market yields at the statement of financial position date are known and the overall expected rate for bonds should therefore reflect the actual portfolio of bonds (both corporate and Government issued bonds) held by the Scheme.

There is, therefore, a range of rates that can be used to calculate the expected return on assets element of the IAS19 pensions charge. The rates that are quoted are assumed to be net of Scheme expenses, although, as recommended by the scheme actuary, the calculated credit is a gross net of expenses figure.

### Mortality

Following the advice of the Scheme Actuary, the mortality table used for the 31 August 2010 valuation was the SAPS (S1PMA and S1PMF) Light table published by the Actuarial Profession's Continuous Mortality Investigation (CMI). An allowance for future improvements in longevity is to be included in accordance with the CMI 2009 projections with a 1% minimum annual increase or underpin. This mortality assumption is described in this report as the "SAPS Light 2009+underpin" tables.

The key rates assumed are:

| | 2012 | 2011 |
|---|---|---|
| Discount rate | 4.70% | 5.50% |
| Expected return on assets | 3.00% | 3.00% |
| Expected rate of salary increases | 4.75% | 5.50% |
| Pension increase rate | 4.20% | 4.20% |
| Inflation rate | 3.25% | 3.50% |

Amounts for the current and previous four periods are as follows:

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Defined benefit obligation | (92,034) | (82,551) | (62,201) | (37,440) | (51,195) |
| Fair value of plan assets | 62,676 | 57,539 | 47,133 | 36,725 | 42,854 |
| Deficit | (29,358) | (25,012) | (15,068) | (715) | (8,341) |
| Experience gains and losses on scheme liabilities | 2,651 | 9,649 | 17,191 | (4,701) | 4,318 |
| Percentage of the present value of the scheme liabilities | 2.9% | 11.5% | 27.6% | (12.6%) | 8.4% |

The assets in the Scheme and expected rates of return were as follows:

| | Long term rate of return expected at 20 February 2012 | Market value at 20 February 2012 | Long term rate of return expected at 20 February 2011 | Market value at 20 February 2011 |
|---|---|---|---|---|
| Fixed income | 3.0% | 13,005 | 3.0% | 10,781 |
| Other | 1.0% | 49,536 | 1.0% | 46,758 |
| Total | | 62,541 | | 57,539 |

North of England Protecting and Indemnity Association Limited

(All amounts in US Dollar thousands unless otherwise stated)

20 February 2012

## 28. Retirement Benefit Scheme (Continued)

### Sensitivity of key assumptions

The table below gives a broad indication of the IAS19 numbers to changes in assumptions and experience (away from the current position).

| Item | Approximate impact on current deficit US$M | Effect on IAS19 Income Statement charge next year US$M |
|---|---|---|
| Increase / reduce discount rate by 0.25% | - 4.7 / + 6.6 | - 0.3 / + 0.5 |
| Increase / reduce real salary growth by 0.25% | + 2.1 / - 2.1 | + 0.2 / - 0.2 |
| Increase / reduce inflation assumption by 0.25% (assumed affects deferred and pensioner increases and not salary increases) | + 2.2 / - 1.9 | + 0.2 / - 0.2 |
| Increase / reduce life expectancy by one year | + 2.5 / - 2.4 | + 0.03 / - 0.03 |

Amounts recognised as expense in respect of the defined benefit scheme is as follows:

| | 2012 | 2011 |
|---|---|---|
| Current service cost | 4,510 | 3,647 |
| Interest cost | 4,553 | 3,863 |
| Expected return on assets | (1,724) | (1,595) |
| Amortisation – net loss | 2,217 | 1,718 |
| Foreign exchange | 477 | (172) |
| | 10,033 | 7,461 |

The actual return on plan assets was a gain of US$3,000,000 (2011 a gain of US$631,000).

The amount included in the statement of financial position arising from the Association's obligations in respect of its defined benefit retirement scheme is as follows:

| | 2012 | 2011 |
|---|---|---|
| Present value of defined benefit obligations | 92,034 | 82,551 |
| Fair value of scheme assets | 62,676 | 57,539 |
| Deficit in scheme | 29,358 | 25,012 |
| Unrecognised actuarial loss | 43,776 | 44,615 |
| Asset recognised in statement of financial position | 14,418 | 19,603 |

(All amounts in US Dollar thousands unless otherwise stated)

## 28. Retirement Benefit Scheme (Continued)

Movements in the present value of defined benefit obligations were as follows:

| | 2012 | 2011 |
|---|---|---|
| Projected benefit obligation at start of year | 82,551 | 62,201 |
| Service cost | 4,510 | 3,647 |
| Interest cost | 4,553 | 3,863 |
| Plan participant contributions | 443 | 428 |
| Actuarial loss | 3,437 | 9,649 |
| Benefits paid | (1,453) | (433) |
| Exchange difference | (2,007) | 3,196 |
| Projected obligation at end of year | 92,034 | 82,551 |

Movements in the fair value of scheme assets were as follows:

| | 2012 | 2011 |
|---|---|---|
| Fair value of assets at start of year | 57,539 | 47,133 |
| Expected return on plan assets | 1,724 | 1,595 |
| Actuarial loss | 976 | (934) |
| Third party contributions | – | 289 |
| Plan participants contributions | 443 | 428 |
| Employer contributions | 4,847 | 7,040 |
| Benefits paid | (1,453) | (433) |
| Exchange difference | (1,400) | 2,421 |
| Fair value of plan assets at end of year | 62,676 | 57,539 |

The estimated value of contributions expected to be paid to the Scheme during the year to 20 February 2013 is US$4.7 million.

# NOTES

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**Cover photography:** Millennium Bridge, Newcastle upon Tyne


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