MANAGEMENT REPORT 2006

NORTH OF ENGLAND

Photography front cover: The Sage Gateshead, designed by Foster and Partners was recently constructed on the south bank of the River Tyne opposite North of England offices. This cover design continues the recent theme of incorporating iconic pictures from the North East of England.

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CONTENTS

MANAGEMENT HIGHLIGHTS

Finance

- Total free reserves increased by 18% to US$168.0 million
- Investment income return of all classes before tax was US$26.1 million
- Standard and Poor's reaffirm full A rating with a stable outlook

Membership

- Entered tonnage increased to 62 million GT
- Annual net tonnage gain of 8 million GT
- Club welcomes additional new high quality members

Service

- Growing commitment to direct loss prevention support
- Profiling the Club as an extension of the member's office
- Recruiting for enhanced service delivery

FINANCIAL SUMMARY

Five Year Combined Summary

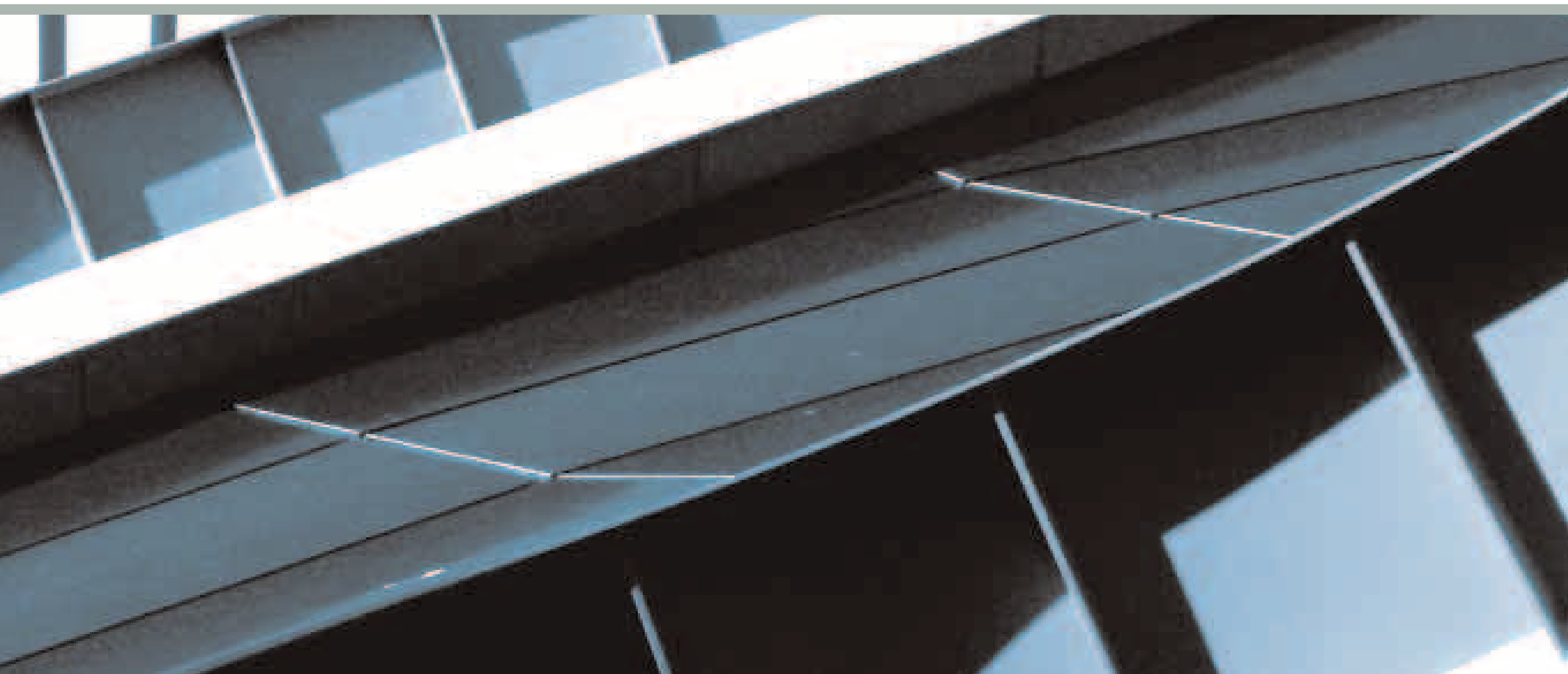
Amount in US$ million; All classes

Income and expenditure

	2005/6	2004/5	2003/4	2002/3	2001/2
Premium	177.1	174.5	156.5	133.1	106.7
Investment income less tax	30.1	20.6	39.7	7.5	0.8
Exchange gain / (loss)	(4.9)	1.5	12.5	10.1	(2.6)
Reinsurance costs	(24.0)	(32.6)	(31.7)	(23.9)	(19.4)
Net claims incurred	(130.9)	(136.2)	(126.7)	(99.1)	(71.2)
Expenses	(24.3)	(19.4)	(16.4)	(15.1)	(11.7)
Surplus for the year	23.1	8.4	33.9	12.6	2.6
Increase in revaluation reserve	2.9	0.1			
Increase in free reserve	26.0	8.5			

Balance sheet

	Feb-06	Feb-05	Feb-04	Feb-03	Feb-02
Investments	433.8	355.8	282.5	352.0	321.5
Cash and cash equivalents	96.2	121.3	149.2	20.3	10.3
Other assets	38.1	25.9	33.9	37.1	41.1
	568.1	503.0	465.6	409.4	372.9
Creditors	(27.0)	(17.8)	(19.4)	(27.7)	(26.8)
Net assets	541.1	485.2	446.2	381.7	346.1
Net outstanding claims	(373.1)	(343.2)	(312.7)	(282.1)	(259.1)
Free reserves	**168.0**	**142.0**	**133.5**	**99.6**	**87.0**



CHAIRMAN'S STATEMENT

BILL THOMSON

North of England's successful renewal brought a remarkable year to a close. The period was characterised by vigorous growth, enhanced portfolio quality and the achievement of satisfactory increases in rates and deductibles. The total entered P&I tonnage has more than doubled over the six years to February 2006 and now stands at 62 million GT. North of England is now established as one of the leading International Group Clubs by several key measures including, membership quality, financial strength and service excellence.

As one of the major International Group Clubs, North of England champions the interests of members and the wider maritime community. We are staunch supporters of new initiatives to project a more positive and accurate image of this industry. Shipping has many positive achievements to its credit, including a very significant improvement in safety and environmental performance. It has also successfully partnered the oil industry in a new, voluntary agreement sharing liabilities for pollution damage when accidents do occur.

Further regulatory challenges are in prospect, in areas such as the control of air pollution from vessels. In addition, passenger ship liabilities are about to increase under the Athens Convention Protocol. Meanwhile, the EU continues to refuse to heed industry arguments against the excessive criminalisation of marine accidents. Instead, Brussels pressed ahead with the introduction of the Ship Source Pollution Directive. Clearly, in this area and in others, the industry has a fight on its hands.

AN ENCOURAGING RENEWAL

There was an encouraging result to the 2006-07 renewal. Members supported North of England's renewal objectives. There was some tough talking, as always, but the conclusion invariably proved satisfactory to all concerned. Taken overall, the outcome was amongst the most favourable within the P&I community.

North of England sought a 7.5% general increase – a figure significantly lower than that of recent years. The vast majority of members accepted the case for accurate rating and the need to keep the Club progressing towards technical underwriting balance.

North of England emerged from renewal stronger than ever. The portfolio expanded by over 10%, to 62 million GT. P&I ship numbers rose by a more modest 5%, to 2,850 vessels. The difference between the percentages is explained by a steady increase in vessel size.

As in previous years, the growth was largely organic in nature and achieved, for the most part, prior to renewal. Nevertheless, we welcomed eight new members during the year and a further 10 from 20 February 2006. The new members are shipping organisations of the highest quality. It was pleasing to see the Club's sustained development efforts have resulted in vigorous growth in the Far East. This region now accounts for over 20% of entered tonnage.

The level of departures at renewal was significantly less than previous renewals. This suggests that the Club's portfolio quality targets are within close reach.

FULL "A" RATING CONFIRMED

North of England continues to enhance its financial strength and stability. The Club's successful strategy in this area contributed to Standard and Poor's confirmation of the full "A" rating obtained last year. North of England's vibrant performance drew favourable comment from Standard and Poor's, with particular reference to the Club's out-performance of its peers, strong capitalisation and high level of financial flexibility.

During 2005-06 North of England retained its status as one of the International Group's top performers in the period under review by Standard and Poors, with the best average combined ratio (an 8-year average to February 2005 of 105.1%, as against the International Group average of 123.5%). The North of England 9 year average to February 2006 has improved yet further to 104.7%. During 2005-06 North of England's combined ratio improved again from 109.5% to 100.6%.

Standard and Poor's concluded that North of England's exceptional performance reflects prudent member selection, sound risk-related decisions, claims handling excellence, conservative reserving and firm control of management and reinsurance costs.

On renewal the Club's free reserves rose to US$168 million, an 18% increase on the US$142.3 million reported 12 months earlier. Financial strength is underlined by the 13.9% compound annual growth rate in free reserves since 1998, compared to an International Group average of just 1.9%.

BEST PRACTICE SOLUTIONS

International Group members form part of a wider maritime community still adjusting to the onerous demands of a zero tolerance world. In this climate, the once widely held view that "every risk is rateable" is no longer viable and, indeed, can be seen as positively dangerous.

North of England incurred 21 major claims, with a potential value in excess of US$1 million in 2003-04 and 23 during the following year. Fortunately, such major claims in 2005-06 fell to 13, demonstrating once again P&I's inherent volatility. We are all aware that when causation is identified there can often be little difference between a collision costing millions and another costing next to nothing. The 2004-05 outcome was one of the worst ever in terms of the number and value of pool claims. A positive contrast is offered by 2005-06, which was one of the most favourable of recent years.

This degree of volatility can be frustrating, at the personal level, for our loss prevention specialists. Yet the reality is that any year can develop as a bad year for major claims. The Club, however, is not resigned to this fact. The only practical way forward is to work ever harder to reduce claims numbers at the "base of the pyramid" – many of which have the potential to develop into major claims.

We already place greater emphasis on the provision of direct loss prevention support for members. This new focus applies best practice to improve performance, in both commercial and claims prevention terms. We want to make more effective use of Club data to identify loss prevention priorities and apply best practice solutions.

HIGH PERFORMANCE AND CONTINUITY

North of England's concept of service excellence is founded on a warm, friendly approach which has real meaning across all cultures. This emphasis will continue. Over the past 18 months, for example, the Club's claims and underwriting teams have been strengthened and each new team member has been encouraged to build a distinct relationship with members and their brokers.

Continuity in Club management and strategy is of great importance. Here, the Club and its members have benefited from the strong and successful leadership of Joint Managing Directors Peter Crichton and Rodney Eccleston. Peter retired in May 2006 after 36 years' service, the last 18 as Joint Managing Director. It is impossible to overstate Peter's personal contribution to North of England's continued success. Since 1988, when he and Rodney became Joint Managing Directors, the Club's book of business has grown from 5 million to 62 million GT.

Rodney Eccleston remains as Managing Director, supported by Underwriting Director Paul Jennings and Finance Director Alan Wilson, in their new roles as Deputy Managing Directors. Thus, succession planning has maintained a senior management team at full strength. There will be complete continuity in progressing the Club's plans for future development.

There will also be total continuity in the vital areas of transparency and good governance. Transparency nurtures the spirit of mutuality, underlines the Club's core values and allows prospective members to make informed choices in North of England's favour. Transparency is the natural companion of good governance which, in turn, promotes consistency, cohesion and the delivery of good service.

BUILDING AN APPRECIATION OF SHIPPING

Work began during 2005 on the important task of fostering a more positive view of shipping. Progress on this front included INTERTANKO's "Poseidon Challenge", which seeks commitment to continuous improvement and the establishment of the Maritime Industry Foundation. The Foundation's brief is to project a more positive industry profile.

There is growing awareness in shipping circles that other global industries are more appreciated due to planned profiling and more effective communication with opinion-formers. Our industry is rich in human wealth, with its disciplines filled with pioneering engineers, creative designers and innovative scientists, naval architects and other specialists. Taken together this formidable pool of talent and energy can achieve much in this area, if put to work.

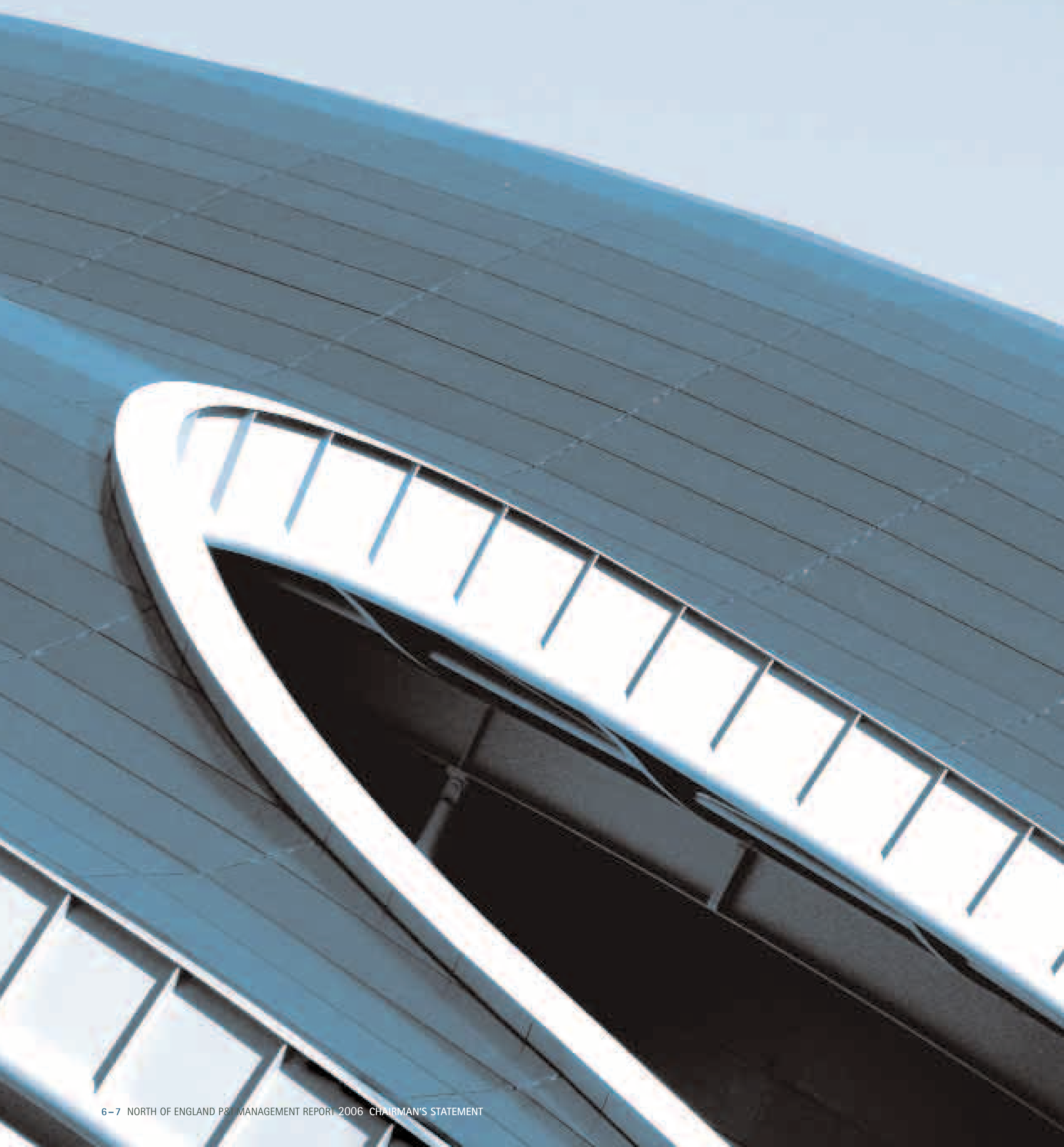
Positive profiling is essential, but this needs to be based on substance. We must be able to demonstrate real progress in difficult areas such as manning and crew quality. For these and other reasons, including the obvious priorities of risk reduction and enhanced claims performance, it is time to invest heavily in the industry's human assets.

CONVENTIONS AND CRIMINALISATION

External issues of significance include the EU preparations to implement the 2002 Athens Convention Protocol, with its huge increase in passenger-related liabilities, the introduction of TOPIA and STOPIA, creating a new balance of responsibility for oil pollution liabilities, and, of course, the industry's legal challenge to the controversial EU Ship Source Pollution Directive.

The industry's TOPIA/STOPIA proposals won acceptance as a viable alternative to full revision of the CLC/Fund regime for oil pollution compensation. North of England was a strong supporter, from the first, of an industry alternative to CLC/Fund review. It is pleasing to record, in this report, that TOPIA 2006 and STOPIA 2006 took effect on 20 February 2006.

THE CLUB OPERATES TO PROTECT AND SUPPORT ITS MEMBERSHIP AND TO TRULY FUNCTION AS AN EXTENSION OF A MEMBERS OFFICE.



CHAIRMAN'S STATEMENT (cont...)

The introduction of the EU's Ship Source Pollution Directive, in contrast, is a disturbing example of what happens when a constructive dialogue with industry is absent. Industry's legal challenge to this new Directive has North of England's support. It is time to take a stand against criminalisation. International conventions must be upheld and, clearly, this new Directive undermines MARPOL. When states introduce laws which contravene international law, the shipping community must resist. Brussels' increasingly dictatorial style is counter-productive and out of step with the times.

FUTURE PROSPECTS

As the EU makes ready to introduce the new Athens Convention Protocol on passenger liability, the potential consequences have yet to be fully assessed. The increase in liability is so extreme that it pushes the passenger shipping sector into an entirely new zone of risk. This coincides with a period of unprecedented growth in cruise vessel size. The combination of soaring liability and the entry into service of vessels with 3600 passengers or more raises a number of profound questions concerning P&I provision and mutuality.

There are also other new concerns to be addressed. During the past year environmental groups began a concerted campaign for tougher atmospheric emission controls under MARPOL Annex VI. In addition, California's State Lands Commission favours ballast water regulations which, in the longer term, would be based on "zero detectable" standards. This appears to be based on an *assumption* that technologies will be devised to make compliance possible before this standard is applied!

Meanwhile, North of England and the other International Group Clubs continue to take collective action in response to clear needs. One notable example is the recent introduction of harmonised surveys for tankers of 10 years and over carrying heavy fuel oil as cargo. There have been a few severe spills in recent years involving heavy oil carried as cargo. All clean-up operations are difficult, but a spill of heavy oil is by far the most difficult. It is encouraging to see the International Group take firm action in areas which pose special risks.

A new focus on human issues is now accepted in the industry. INTERTANKO's Council recently established a new group to address human issues such as recruitment, training and retention. This group's brief also includes an investigation of the many human aspects of ship design, operation and, significantly, the positive influence of sound compliance cultures within owners' and managers' organisations.

The shortage of high quality ships' officers is a serious matter, not least in Britain – given that the UK-flagged fleet has more than quadrupled in size in the space of just five years. The good news is tempered by repeated warnings from the UK's Marine Accidents Investigation Branch (MAIB) concerning the risks associated with fatigue and long working hours – especially amongst crews of ships with only two watchkeepers. The MAIB is highly critical of the fact that seafarers often work many months without leave.

The MAIB's fatigue model suggests that every day worked beyond 40, under such conditions, leads to "dangerously fatigued" seafarers. Significantly, this position improves dramatically when a third watchkeeper is available. It is the MAIB's view that a Master and two watchkeepers should be the minimum for vessels of over 500 GT.

The P&I community develops consensus on complex and sensitive issues through membership of the International Group. The Group is an indispensable contributor to the maintenance of sound operating standards. During 2005-06 the International Group continued to expand its role. We look forward to further progress during the current year.

The future of P&I, in the longer term, is increasingly exercising minds as 2009 approaches – the year in which the International Group Agreement's status under EU Competition Rules will change. This will open up the IGA to the theoretical possibility of legal challenge. In my view, the future of P&I remains in the hands of the Clubs and their ship owner members. International Group members can face the future with confidence if they work harder to increase appreciation of the Group's valuable contribution to safe, high quality and pollution-free shipping.

Our objectives over the next year should focus on further reinforcing the International Group's capabilities, to make it "fighting fit" to counter the flawed model of blame and criminalisation. The Group also needs to take fresh initiatives to target specific problems.

As for North of England, the Club continues to develop as a provider ready to demonstrate leadership in the new P&I environment post-2009. Every element of our strategy will be directed to continuing to try to out-perform our peers. There will be an even stronger emphasis on service excellence. Continuous improvement is the great challenge. It stimulates the creative thinking necessary for further progress, within the maxim that North of England remains, first and foremost, a members Club. Service excellence, not size, is the ultimate measure of success.

There can be little doubt that North of England's successful progress has benefited from the successes of the Club's high quality and industry leading members. The Club operates to protect and support its membership and to truly function as an extension of a members office.

To conclude at a personal level, once again I enjoyed the strong support of the Club's Vice Chairman, Albert Englesman, and my fellow Directors. During the year several board changes have taken place with the addition of five directors and the departure of another. New Directors include Dr Naser Bateni representing Islamic Republic of Iran Shipping Lines (IRISL), Bharat K Sheth from Indian shipowner Great Eastern Shipping Company, Ken Bloch Soerensen of United Arab Shipping Company (UASC), Lars Christensen, of Danish shipping group Norden A/S, and Job de Groot, of the Dutch dredging major Van Oord. I also take the opportunity to mark the departure from the Board of Qatar Shipping's Nasser Al-Romaihi and to thank him for his contribution to our work.

Finally, I must also thank the Club's Managers for their constant support during the year. They are responsible for a highly motivated team, well-equipped to deal with the challenges of the current year and beyond.

Bill Thomson, Chairman
July 2006

STRATEGY

CONTINUED COMMITMENT TO SERVICE

North of England is now one of the International Group's strongest Clubs. The immediate challenge is to entrench this position. The Club's strategy here is to continue to build service excellence – with an even stronger emphasis on the human dimension of interaction with the membership. Service remains the bedrock of Club strategy across its full range of activities. North of England's growth and development over the past decade is a story of total commitment to service. A significant milestone was reached in 2005, with a full 'A' rating from Standard & Poor's. This recognised the Club's financial strength and stable outlook. Yet an 'A' rating is an endorsement of quality which extends far beyond the purely financial.

North of England's full 'A' rating, granted in early 2005, was encouraging recognition of the Club's successful evolution. Currently, no International Group member has a higher rating.

The "A" rating strengthened North of England's profile. This is important as, in an increasingly competitive market, risk managers must deliver comfort to shareholders. North of England's rating provides such comfort.

It is interesting to compare the Club's position in 1994 with its status at the latest renewal. The most striking factor, perhaps, is the sheer consistency of Club strategy. In 1994, there were three key elements to strategy: service, financial strength and growth through the addition of quality tonnage. These elements remain the Club's priorities today.

Statistics set out the highlights of a remarkable period in the Club's history. In 1994, North of England's book totalled 11.7 million GT. It now stands at 62 million GT. Owned ships entered for P&I increased from 1,362 to 2,400. FD&D entries have almost trebled, from 369 to 1,020. P&I free reserves have grown by 450%, from US$27.9 million to US$153 million. The Club's personnel totalled 65 in 1994. That figure now stands at 154.

The outcome has firmly positioned North of England as one of the top three International Group Clubs. The largest Club had a 21.8% market share in 1994, which has since reduced to 17.4% – a fall of 20%. The second largest Club had an 11.6% market share in 1994 and has since managed a 10% increase, to 12.8%. In contrast, North of England's market share has grown from 2.8% to 7.7% – an increase of 175%. During this period, the world fleet increased in tonnage terms by over 50%.

SUCCESS FACTORS

One of the key factors in the success of North of England is its strong relationship with the membership. The Club has enjoyed strong support from existing members which has enabled the Club to flourish and ultimately attract more like minded, progressive and high quality ship owner members. The growth of the Club is dependent on the success and development of its membership coupled with strong and focussed management.

An analysis of key events in the Club's development over the past decade clearly shows that a well-defined strategy contributed heavily to the Club's progress. North of England achieved remarkable levels of growth and, furthermore, managed that process successfully.

The success factors included: service excellence, the well-timed achievement of "critical mass" through merger, the attraction of larger members of quality, consistency in the Club's goals, strong relationships with major brokers, the delivery of value added service through defence and loss prevention services, and the recruitment and retention of Club staff of the highest calibre.

A NEW PHASE OF DEVELOPMENT

North of England is now entering a new and stimulating phase of development. The Club's strategy will continue to emphasise service excellence and core values such as integrity, trust, transparency and accountability. There are three major objectives: to become the preferred P&I provider, to increase the owned tonnage portfolio to around 10% of the world owned fleet over the next three to four years and, thirdly, to work towards enhancement of the Club's 'A' rating. The successful formula of 1994 – service, financial strength and growth through the addition of quality tonnage – will continue to be followed, but with even greater vigour.

During 2006-07 the Club will continue progressing towards technical underwriting balance. North of England is approaching 100% (the combined ratio in 2005-06 improved to 100.6%, down from 109.5% in the preceding year). The financial outcome in any year is subject to the uncertainties of claims experience and developments in the investment markets. P&I's inherent volatility is an ever-present factor. Quality owners and their Clubs are not immune from major claims risks. North of England, however, has the comfort of strong reinsurance arrangements.

North of England is moving forward following a very encouraging renewal experience. The pleasing result is the outcome of a sustained, well-coordinated effort during renewal and, indeed, throughout the year. The results demonstrate a high level of confidence in the Club.

North of England's continued success in recent years has strengthened an already powerful sense of motivation within the organisation. This spirit will ensure North of England meets the challenges of P&I provision in a world characterised by zero tolerance of accidents and spills. In this context, this Club will continue to be outspoken on the need for greater emphasis on human issues surrounding safe shipping.

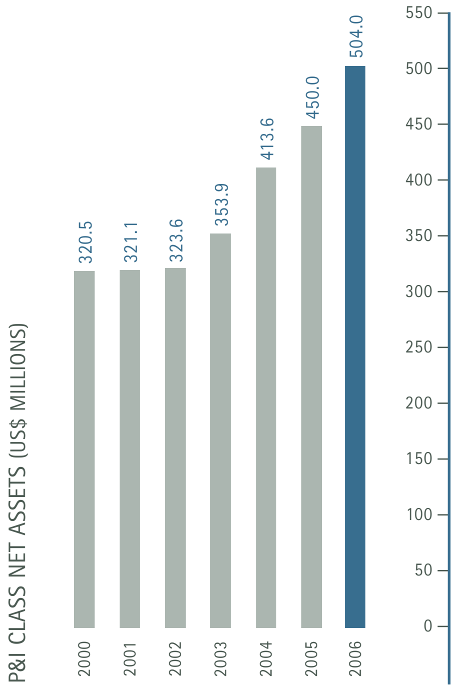
THE AIM IS TO ENTRENCH NORTH OF ENGLAND'S POSITION AMONGST THE TOP-RATED CLUBS.

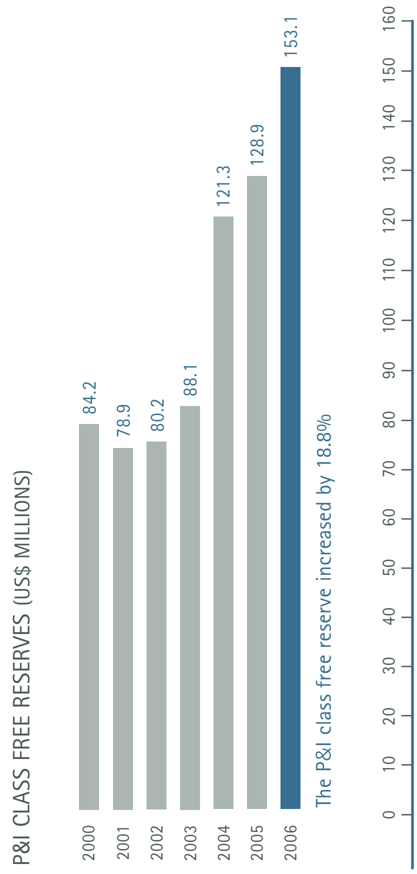
FINANCES

FURTHER INCREASE IN FREE RESERVES

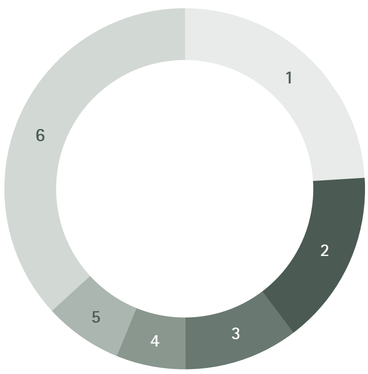
North of England's total free reserves increased by 18% over the year, from US$142.3 million to US$168.0 million. The Club's financial strength continues to grow, with 13.9% compound average free reserve growth in the 1998-2006 period.

- Combined ratio: 100.6%
- P&I class investment income: US$25.9 million
- P&I class investment return: 5.86%





INVESTMENT PORTFOLIO AT 20 FEBRUARY 2006



1	Cash	25%
2	Up to 2 years	14%
3	2 to 5 years	11%
4	5 to 10 years	6%
5	Over 10 years	7%
6	Equities	37%

The equity content of the P&I class investments increased to 37% with the remainder in bonds and cash.

North of England's financial strength continued to grow in the year to 20 February 2006. Total Free reserves (P&I, FD&D and War) rose by 18%, from US$142.3 million to US$168.0 million. P&I class free reserves increased from US$128.9 million to US$153.1 million. FD&D and War reserves totalled US$10.8 million and US$4.1 million respectively. P&I class net assets rose by US$54 million, to US$504 million.

Strong financial performance was reflected in a combined ratio of 100.6%. P&I investment income rose from US$21.2 million to US$25.9 million. The 5.86% return exceeded the 4% budgeted and the 5.34% benchmark. In contrast, the FD&D portfolio's performance was affected by exchange rate losses. The return was 0.33%, as against an index of 1.19%

Performance outcomes were influenced by a strong final quarter (as was the case in the preceding year). Taken overall, global equity markets rose strongly, ending the reporting period up 13.2% in US Dollar terms. The Dollar strengthened against all major currencies. The markets found support in merger and acquisition activity and the low interest rate environment, despite rising oil prices and a series of severe natural disasters.

As for bonds, most developed markets ended the period positively. The UK was the best performing market and the Euro bloc bond market followed – posting strong returns largely concentrated in the first half. The US economy continued to grow, yet the US market still yielded mediocre returns overall.

North of England's P&I class investment portfolio totalled US$494 million as at 20 February 2006. The outcome benefited from an increased weighting in equities. Investment in equities rose from 31% to 37%; the Club's growing financial strength now permits a more flexible approach to its portfolio. North of England's two equity managers took advantage of the favourable conditions. Both returned in excess of 14% for the year, so exceeding the benchmark.

A new equity manager, Alliance Bernstein, was appointed in March 2006. Whilst the view that equities would continue to outperform bonds has proved accurate to date, North of England retains its strongly defensive position in bonds – marked by a preference for short-dated investments. Taken overall, the Club's conservative investment strategy continues to function well.

As for the Club's general position, claims in 2005-06 were at lower levels than experienced in recent years. As a result, the estimated initial deficit was US$5.1 million, as against US$29.5 in the preceding year. Attritional claims followed a typical pattern. The real contrast between 2005-06 and the previous policy year was the marked reduction in the number of major claims.

The 2004-05 policy year deficit improved modestly, to US$27.2 million, and 2003-04 improved from a deficit of US$11 million to US$1.6 million. In general, the policy years are improving to a greater extent than anticipated. The Club, however, will continue to apply its highly conservative estimating strategy.

CONSISTENT PRINCIPLES

North of England's priorities include continued enhancement of the Club's financial strength and further development of a commanding position in P&I performance and service. The Club's combined ratio (premiums against costs) was 116% in 2003-04, 110% in 2004-05 and 100.6% in 2005-06. Steady progress towards technical balance hinges on the consistent application of the Club's five key financial principles:

- Prudent and cautious underwriting
- Careful and conservative claims management and reserving
- A low risk investment strategy, based on capital preservation
- Comprehensive and highly secure reinsurance
- Close monitoring of management expenses

Looking ahead, in the context of investments, it seems that the global economy and international equity markets display more positives than negatives. Corporate fundamentals remain good, boosted by resilient economic activity and high levels of free cash flow. Interest rates remain low in many parts of the world. Infrastructure requires continual improvement. Chinese demand remains strong and Japan's economy has a more stable footing. Corporate restructuring continues in Europe and Japan. Against this background, valuations are still attractive in many international markets.

Turning to bonds, the generous provision of liquidity enjoyed by financial markets around the world has lifted all asset markets. With growth expected to be moderate, the Dollar may find it difficult to advance further. It remains to be seen, however, whether cyclical recovery in Europe and Japan and the response from central bankers will prove powerful enough to provide a challenge to the US Dollar.

That said, however, the Club's objective is to maintain a pattern of outstanding performance without relying on investment income. Given the inherent uncertainties surrounding P&I claims and investment markets, North of England will continue to apply strategies centring on balance between premium income and claims costs. It is encouraging to see the Club moving ever closer to break-even underwriting.

Above all else, the Club must continue to take account of escalating shipowner liabilities, increasing claims values and constant exposure to large, random losses. These are the factors which exert a powerful influence on P&I premiums.

NORTH OF ENGLAND INTENDS TO CONTINUE ITS PROGRESS TOWARDS TECHNICAL BALANCE. REALISTIC UNDERWRITING IS THE KEY TO THIS IMPORTANT GOAL.

REINSURANCE

SUCCESSFUL RENEWAL

A series of extreme weather events in the US Gulf during 2005 produced the world's largest ever insured loss. This created an uncomfortable environment for the negotiation of the International Group's catastrophe insurance renewal. This is the world's largest marine reinsurance contract.

INTERNATIONAL GROUP REINSURANCE STRUCTURE 2006/2007

Overspill		Liability (shared by pool)	5,250 (approx)
Layer 4	500m	One reinstatement	2,050
Layer 3	500m	Unlimited reinstatements	1,550
Layer 2	500m	Unlimited reinstatements	1,050
Layer 1	500m	75% Unlimited reinstatements / 25% Co-insurance	550
Pool retention	44m		50
Club retention	6m		6

US$m (from the ground up)

Appropriate pricing is crucial for all concerned. Fortunately, the International Group renewal discussions for 2006 reached a broadly satisfactory conclusion. From North of England's perspective, the significant developments during the policy year also included the successful renegotiation of the Club's retention reinsurance with Swiss Re, effective from 20 February 2005. This outcome underlined the Club's emergence as a substantial underwriting entity, with the necessary capacity to absorb more risk and reduce dependence on commercial provision.

It is thought that the three hurricanes which devastated the US Gulf region during 2005 will result in claims exceeding US$80 billion – a sum equivalent to over twice the insured cost of the World Trade Centre's destruction.

There is also the unhappy prospect of global warming reaching the point where a steady increase in extreme weather events cannot be avoided. Not surprisingly, most buyers saw reinsurance rates rise steeply on renewal, accompanied by substantial increases in retention.

Direct insurers responded by attempting to pass on these increases. They had mixed results. Premiums were buoyant before those hurricanes made landfall and, therefore, most marine insurers struggled in their pursuit of hefty increases.

As for the International Group, renewal negotiations were also coloured by a major increase in entered tonnage, adverse claims experience during 2004 and higher exposure to oil pollution liabilities resulting from TOPIA's introduction.

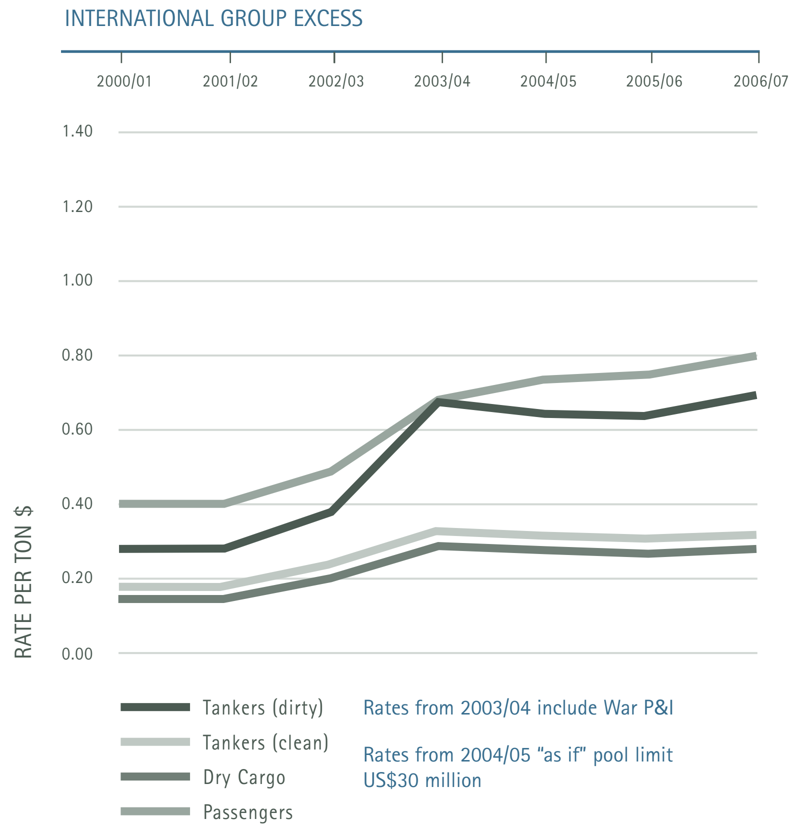
Nevertheless, the International Group's long-term record remains essentially favourable to the reinsurance community. Furthermore, the contract is placed widely on the world's leading markets. These factors facilitated renewal discussions, which ended in a single figure percentage increase of around 8%.

There were no changes to the "layering" framework during the year. Claims of up to US$6 million are protected by the Club's true risk transfer contracts with AA rated Swiss Re. North of England's long-term relationship with Swiss Re is characterised by good performance and satisfactory outcomes. The pool shares responsibility for claims between US$6 million and US$50 million. The International Group's reinsurance contract covers claims for a further US$2 billion.

SHARING RISK

North of England supports an appropriate sharing of risk between Club members and the pool, with protection provided by reinsurance arrangements of the highest quality.

Some International Group Clubs argue for a higher retention, maintaining that this would benefit the Group as a whole. Taken on an historic basis, North of England would be a net beneficiary of a higher retention, yet the Club's attitude is influenced by the depth of its commitment to mutuality and efficient pooling. In any event, claims inflation, in its own right, will certainly require a modest upward revision of the current threshold at some point.



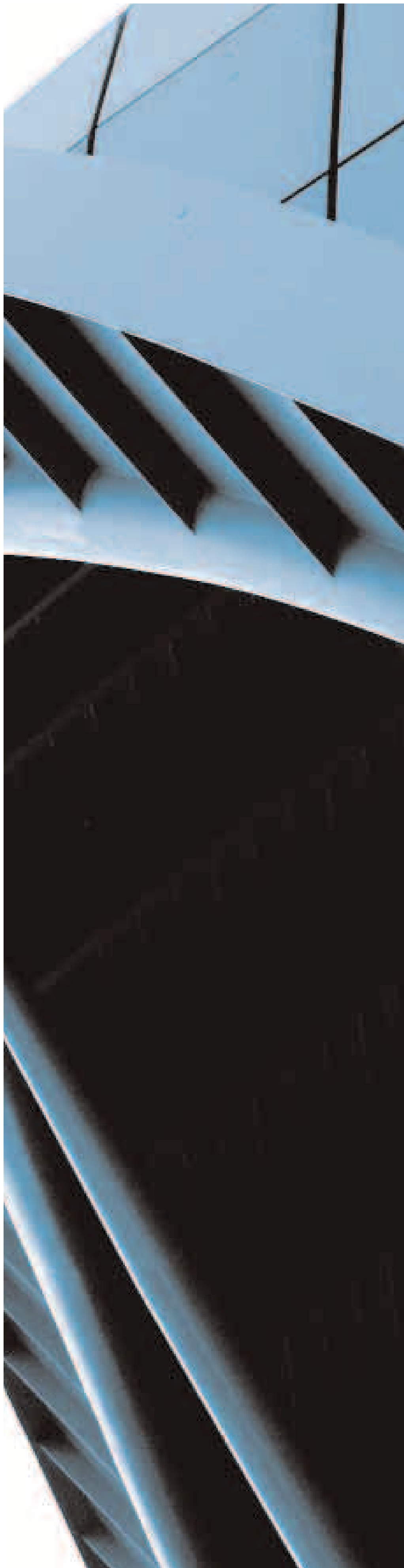
Hydra, the International Group's cellular captive, participates in both US$20 million excess of US$30 million and the International Group's co-insured 25% vertical slice of the first layer of the Group's excess of loss contract (covering claims between US$50 million and US$550 million). The year under review saw fewer large claims than experienced in 2004.

The year saw a change in brokers handling Hydra's supplementary reinsurance. This responsibility passed to Agnew Higgins.

CHARTERERS REINSURANCE

North of England continues to support the International Group's reinsurance facility. This allows the Club to provide charterers cover of up to US$350 million per event. It is disappointing, however, that such support is far from uniform across the International Group membership. Some Clubs now place this business, in whole or in part, with commercial entities.

North of England wishes to continue to support a fully competitive International Group charterers reinsurance facility. The Club will continue to do everything possible to encourage a uniform approach across the International Group's membership.



MEMBERSHIP

CONTINUED GROWTH AND ENHANCED QUALITY

North of England continued to make solid progress in the area of portfolio quality during 2005-06. Vessels totalling 500,000 GT left the entered fleet, largely following the Club's decision not to offer renewal terms. The P&I book at 20 February 2006 consisted of 2,850 vessels. Owned tonnage entered for P&I increased over the year. The chartered tonnage book also grew. North of England's P&I portfolio at the beginning of 2006-07 had grown by 11% in 12 months, a net increase of 8 million GT.

Statistics prepared for the end of the 2005-06 policy year provide firm evidence that North of England is now approaching the demanding portfolio quality goals set some years ago.

Around 500,000 GT left the portfolio at renewal, for the most part following the Club's decision not to renew. This is less than 50% of the level of departing tonnage 12 months earlier – demonstrating that the book is reaching the standards of quality sought.

The geographical spread of North of England's entered fleet changed during the year. The most significant development was the high level of growth in the Far East. This region now accounts for 20% of total GT on risk, as against 14% 12 months earlier.

This growth is the product of several factors. The Club was pleased to welcome new members from China, Japan and Korea during the policy year. The Club welcomed its first Japanese member in 2005-06. This significant development is the culmination of six years of contact and relationship-building. It was an encouraging outcome for those responsible for implementing this component of the Club's strategy, which calls for targeted growth throughout the Far East.

GLOBAL EXPANSION

Progress in the Far East did not come at the expense of other regions. All expanded during the policy year and contributed to the P&I book's net increase of 8 million GT.

At 20 February 2006 Northern Europe accounted for 24% of entered tonnage, followed by Southern Europe (24%), the Far East (20%), the Middle East (15%), Scandinavia (11%), North America (5%) and others (1%).

As for vessel type, the year saw little change in the composition of the entered fleet. At renewal, tankers and bulk carriers each accounted for around one-third of all entries by tonnage. Tankers represented 32% of the book by tonnage and 22% by number of vessels. The equivalent figures for other vessel types were: bulk carriers, 35% and 25%; container vessels, 19% and 17%; and general cargo vessels, 3% and 11%. The balance was represented by: ro-ros/car carriers, 1% and 3%; reefers, 1% and 3%; and others, 8% and 19%.

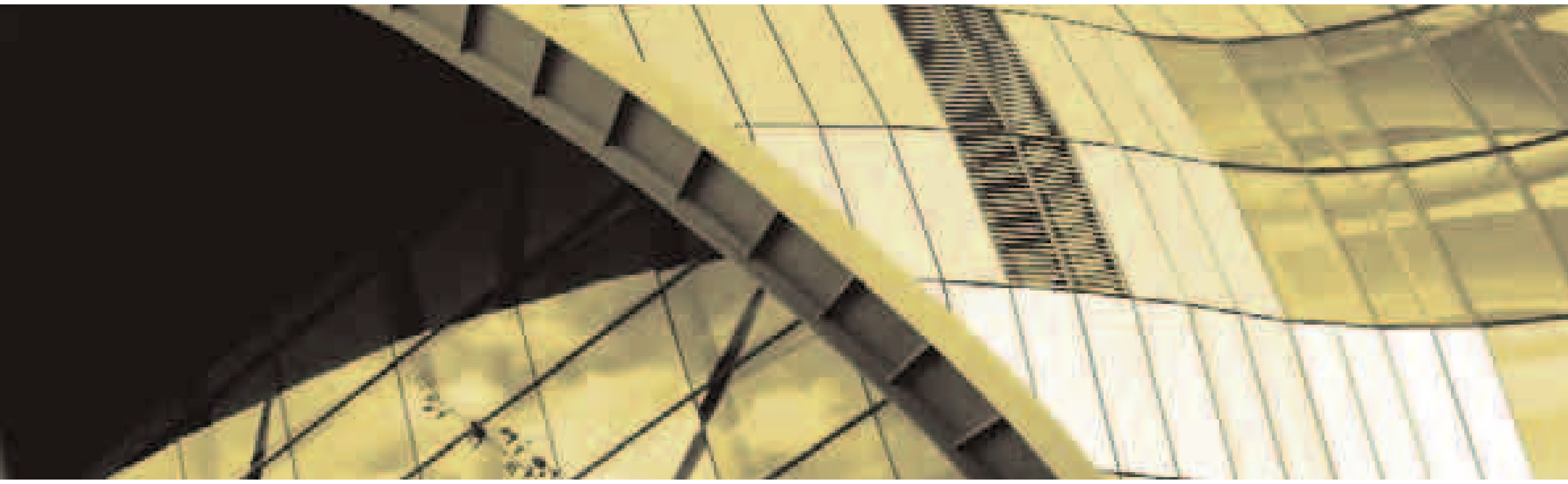
North of England continues to regard the managed development of the Club as a year-round process, rather than an activity confined to renewal. The 12 months to 20 February 2006 saw significant organic growth. Many long-standing members placed more ships with the Club. This reflects North of England's enhanced strength and, in addition, the existence of robust service relationships.

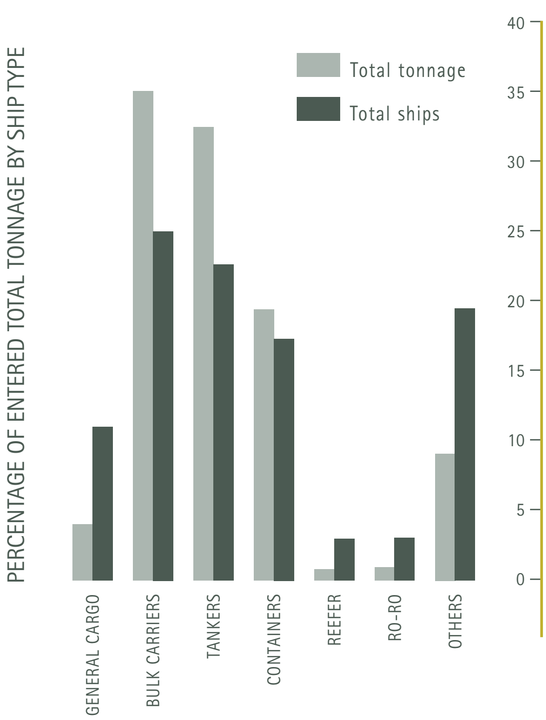
Over the course of the year North of England welcomed eight new members and a further 10 at renewal. The Club attracts quality owners of all sizes, from small and medium-sized organisations to large corporations. Several leading corporations placed vessels with the Club during the year.

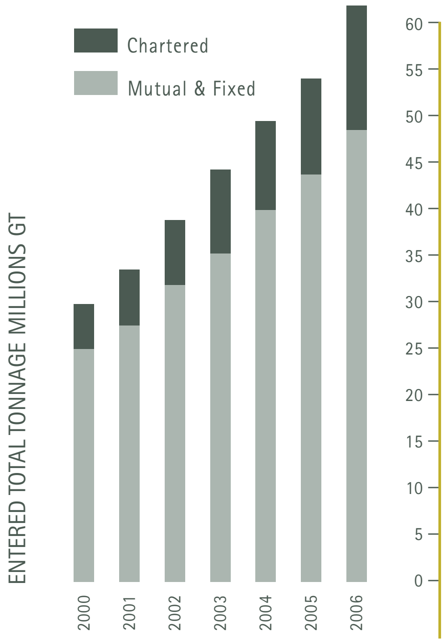
North of England recognises the growing prominence of large corporations in shipping. This trend has accelerated over the past five years. At the same time, the Club appreciates the importance of its historic roots amongst an international community of small to medium-sized owners of quality. North of England is comfortable with this, as all members – regardless of size – are bound together by a need for service excellence.

A cornerstone of North of England's successful development has been the partnership and growth with the Clubs high quality and market leading members. The Club's success has developed from the memberships successes, as the Club operates as an extension of it's members offices.

North of England's commitment to service excellence has brought the Club to the top table of the international P&I community. This strong emphasis on service and quality will continue. Future progress will be measured against new and more demanding benchmarks.

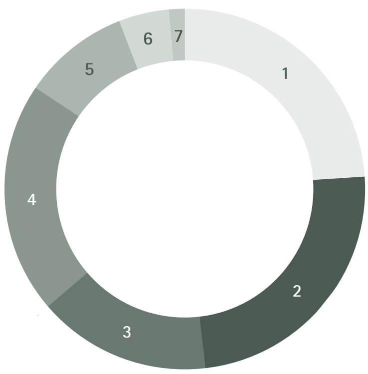






TOTAL ENTERED TONNAGE
(BY AREA OF MANAGEMENT)

1	Northern Europe	24%
2	Southern Europe	24%
3	Middle East	15%
4	Far East	20%
5	Scandinavia	11%
6	North America	5%
7	Others	1%



P&I CLAIMS

VOLATILITY AND EXPOSURE TO MAJOR INCIDENTS

P&I claims costs in 2005/06 fell by 16% on the previous year. There was a significant reduction in claims exceeding US$1 million. There were 13 major claims in 2005/06, as against 23 the previous year. The number of International Group Pool claims also fell during the year under review. Pool claims, totalling US$7.9 million, at February 2006 which compares to US$14.2 million at February 2005 as reported 12 months ago although the pool record for the 2004/05 policy year has since deteriorated significantly.

Claims experienced by North of England members decreased across all categories in 2005/06. Nevertheless, average values continued to display volatility, reflecting P&I's exposure to major incidents.

Two collisions with values exceeding US$5 million, for example, increased the average value of collision claims by 14 per cent compared to 2004-05. These cases involved a chemical tanker which sank after a collision in the English Channel and a bulk carrier which collided with another vessel.

In addition, a container vessel entered with the Club was involved in a major grounding incident in the approaches to a major European Port. A salvage operation resulted in a successful refloating. The claims value, in this case, may ultimately be sufficiently high to enter the pool.

Furthermore, a single pollution incident of over US$5 million inflated the average value of such claims by 93 per cent.

Other major claims included an alleged damage to a pipeline resulting from anchoring. This contested case carries an estimate of US$2 million. In addition, a claim for damage to a berth, with an estimate of US$1.7 million.

These type of claims, particularly 'Admiralty' claims, i.e. collisions, groundings and FFO claims, are the most volatile and difficult to predict in terms of value, (rather than number) on a year by year basis. As to causation, this is a product of many factors but 'human error' clearly is one of the most significant. 'Human error' can be used to describe a multitude of issues but some of the more topical relate to manning, fatigue, watchkeeping and bridge management and may even call into question the general standards of competence and experience currently available to the industry.

Some of these issues have long preoccupied minds at the UK's Marine Accident Investigation Branch. During 2004 the MAIB analysed 1,600 accidents spanning a 10-year period. It concluded that inadequate manning and fatigue were major causal factors behind collisions and groundings. The root cause of an accident may however be more difficult to identify.

If fatigue is identified as a major cause, is that fatigue itself actually caused by inadequate manning, poor training, an inappropriate mix of nationalities on board or other operational factors.

Further more, with modern telecommunications, the owners' and/or ship managers' offices ashore are in almost constant contact with the ship. Is this affecting the traditional command structure on board leading to a blurring of the chain of command or confusion as to the authority of the Master resulting in complacency, lack of confidence and a lack of experience of ships' senior officers.

On the other hand, is increased shore based guidance now an indispensable part of the operation of most vessels. If so, to what degree does responsibility for some accidents lie with shore based management procedures?

Naturally, such matters must be considered on a case-by-case basis, but there are no easy answers.

One key concern is the large number of dry cargo vessels continuing to operate in the short sea trades with Master and Mate as sole watchkeepers. Here, the MAIB offered a dry observation: "With only two watchkeepers, even if they did nothing but their bridge watches, they would work an 84-hour week." With other tasks, of course, the actual working week is often far longer.

The MAIB added: "It is an anachronism in the 21st century that seafarers are falsifying their time sheets to prove they are working **only** a 98-hour week."

The MAIB recommends that all merchant ships over 500 GT should have a minimum of a Master and two bridge watchkeeping officers.

During the third year of the shipping boom most companies appear more acclimatised to working under sustained pressure. Yet, in the final analysis, it is the individual who counts, *not* the organisation. The reality is that vessels and crews work harder when higher freight markets prevail. At the same time, commercial imperatives should not override commonsense. It is a sound commercial strategy to apply best practice based on appropriate manning levels, adequate rest periods, continuous training and respect for sound maintenance practices.

Training is a special concern, as most collisions and groundings result from human error. These basic mistakes can be avoided if individuals receive specialised bridge management training.

The industry has now reached a crossroads on human issues. It needs to answer a very direct question: are some of today's vessels inadequately manned? This question cannot be addressed properly if crews are regarded as a cost, rather than a resource.

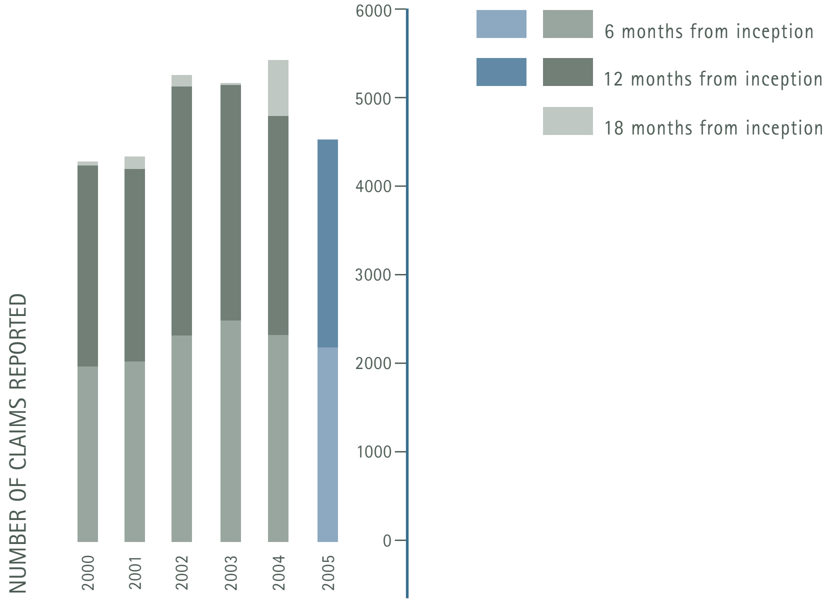
A newly-built, fully laden container vessel represents a value measured in hundreds of millions of dollars. If this asset was a shore-based manufacturing plant, its value would be protected by "defence in depth". A dense screen of senior managers, line managers and shift supervisors would provide this protection. Today's costly floating asset also needs defence in depth, not least because it must function in a hazardous environment.

P&I ONLY: NUMBER OF CLAIMS BY VALUE, EXCLUDING POOL CLAIMS

12 months from inception

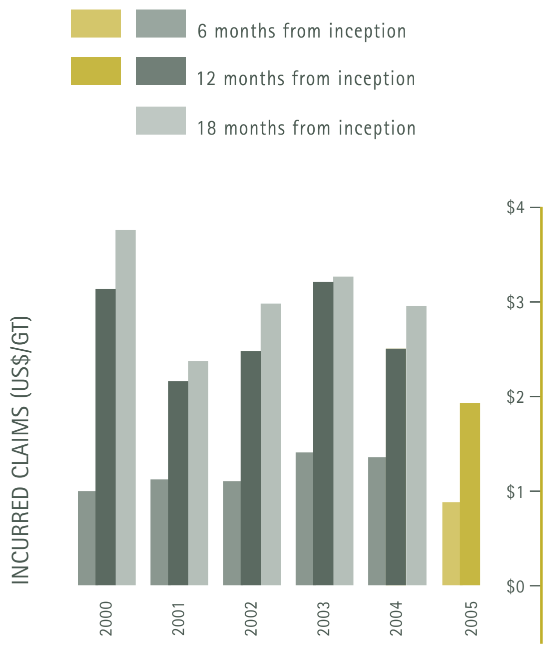
	2000	2001	2002	2003	2004	2005
Over $2.0m	10	2	3	11	9	7
$1.0m - $2.0m	3	4	8	10	14	6
$0.5m - $1.0m	15	14	22	24	21	18
$0 - $0.5m	4,218	4,196	5,080	5,137	4,768	4,465
Total	4,246	4,216	5,113	5,182	4,812	4,496

P&I claims breakdown by value



CREW QUALITY, MANNING LEVELS AND THE NEED FOR MORE SHIPBOARD TRAINING ARE ISSUES WHICH MUST BE ADDRESSED.

P&I CLAIMS (cont...)



North of England remains committed to proactive loss prevention. The Club's most important role is to raise awareness of risks and promote best practice. One topical example is the new ballast water regime. These regulations can give rise to major operational problems unless compliance planning moves forward in a timely manner.

On a more positive note, the 2005-06 policy year saw the International Group display greater awareness of its role in a broader industry context. The International Group's work is of growing significance. One example is the Claims Cooperation Committee's efforts to tackle common industry problems and unfair practices in some jurisdictions.

Meanwhile, North of England's entered tonnage continues to grow, whilst the number of claims per vessel continues to fall. Deductibles do have some influence here, but the fact remains that the Club's P&I portfolio is founded on modern tonnage, owned and operated by highly committed and professional individuals and companies.

Looking to the future, however, all International Group Clubs remain concerned at the persistent attempts to erode the shipowner's traditional rights and defences.

It has long been recognised that ships trading in many parts of the world are at the mercy of locally biased and sometimes even hostile jurisdictions. The industry, with no real political influence, is equally vulnerable to often ill conceived and "knee jerk" politically motivated legislation. Seafarers themselves are increasingly targeted and criminalised for the consequences of simple human error to a degree which would not be tolerated in any other profession.

RISK MANAGEMENT

IN A SPIRIT OF PARTNERSHIP

There can sometimes be confusion over the term risk management. In North of England's context, however, the meaning is clear. The Club's Risk Management Department is responsible for loss prevention initiatives. Its objectives are pursued in a spirit of partnership with Club members. In the area of loss prevention the Club and members represent one team. They share a common objective: the avoidance of loss. In these circumstances, the Club is, in every sense, an extension of the owner's office.

North of England provides loss prevention support at two levels. Firstly, loss prevention advice is circulated to all members, to raise awareness and, in some instances, to address specific issues of general concern to shipowners and operators. For example, the Club recently issued a circular on avoiding container losses from vessels employing specific types of fully automatic twistlocks. Support was also extended to individual owners seeking best practice in this area.

Similarly, over the past year the Club provided advice on shipboard preparation for Port State Control inspections. The aim is to help members exert a greater measure of control over the inspection process.

The provision of advice is an important loss prevention function. At the same time there is now a shift of emphasis towards direct loss prevention support for members at an individual level. This takes several forms. In the 12 months to February 2006, for example, Club teams visited over 50 members. They delivered a variety of loss prevention workshops and presentations.

North of England, together with the other International Group Clubs, remains concerned at the high level of major claims resulting from navigational errors experienced in recent years. Many of the Club's loss prevention workshops focus on this issue. Other workshops provide detailed briefings on the many new environmental measures emerging at national and international level, including proposals for much tougher controls over atmospheric emissions.

TAILORED BRIEFINGS

Tailored briefings for members during the year also included special presentations on cargo claims, with a particular emphasis on bulk liquid cargoes. A number of Club members in the Far East have experienced a run of shortage claims and these workshops demonstrated how to minimise the risk of such disputes.

Briefings were also presented on the new and disturbing developments relating to criminalisation in Europe and other world regions. Furthermore, a number of members requested guidance on claims performance in areas such as personal injury and cargo security. Some members went further and requested a comparison with the Club's data in specific claims categories – such as incidence rates for illness or for operational problems such as small spills occurring during bunkering. As always, a plan for remedial action is developed on a cooperative basis.

North of England's direct support also includes the Loss Prevention Review, a more formal process undertaken when a member encounters a significant problem. In these cases, Club and member work together to explore the surrounding issues and develop viable solutions. This partnership continues during monitoring and follow-up, so as to achieve an enhanced claims performance.

CONDITION SURVEYS

The Club's commitment to quality is underpinned by its programme of Vessel Condition Surveys. Ships of 12 years or more are surveyed prior to entry. Vessels may also be surveyed in specific circumstances, including involvement in a Port State Control issue. The International Group has also introduced harmonised surveys for tankers over 10 years carrying heavy fuel oil as cargo. This requirement took effect in February 2006. Exemption may be granted if a vessel has recently undergone a Condition Assessment Programme.

The Condition Survey can be regarded as the Club's front-line defence of membership quality. Almost certainly, the survey workload will continue to increase in the years ahead. Certainly, the number of vessels undergoing survey increased in the 12 months to 20 February, 2006.

Vessel Condition Surveys are now the responsibility of two regionally-focused teams. Over the past 12 months this new geographical arrangement has done much to build closer relationships with members and, in addition, secure best value from the surveyors undertaking this vital work.

EDUCATION AND TRAINING

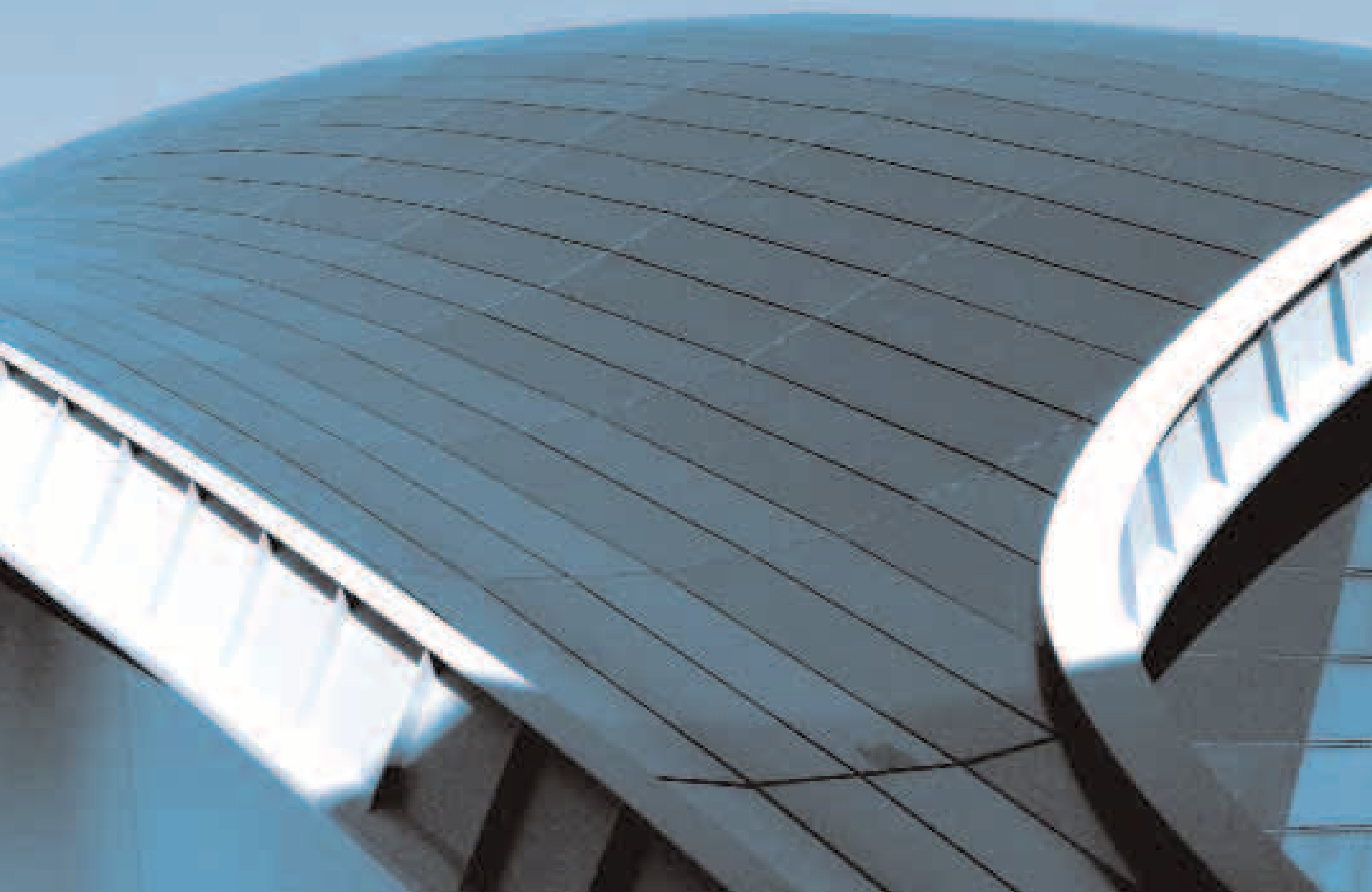
The Risk Management Department has continued to develop links with education and training institutions. North of England has always been proactive in this area. The Club has a long-standing relationship with South Tyneside College. Recent years have seen a similar association develop with the University of Newcastle upon Tyne. Over the past four years, the Club has provided course and tutorial support for the Marine Department.

Club workshops occupy an important place in this programme of education and training support, for both individual members and for students at maritime training facilities worldwide.

ENHANCED SERVICE DELIVERY

Looking ahead, the Risk Management Department's emphasis on targeted initiatives will continue to develop over the next 12 months. The Department will also seek further improvements in service delivery. Furthermore, the Club will continue to invest in loss prevention communications by providing more web-based information through it's industry news service and developing "E-news", the new electronic publishing venture providing a monthly overview of topical issues.

THE CLEAR LINK BETWEEN A SHIP'S CONDITION AND THE WAY IT IS MANAGED IS A MATTER OF GREAT SIGNIFICANCE.



FD&D

DEFENCE IN DEPTH

More vessels were entered for defence cover with North of England during 2005-06. Members have now placed over 1,400 ships with the Club for FD&D. This underlines the wide recognition, both within the Club's membership and the wider shipping community, of the quality of North of England's defence team. The spread of specialised expertise available to members continued to expand during the year.

- A total of 1,460 vessels entered for FD&D
- These vessels represent around 50% of the P&I portfolio
- FD&D free reserves increased to US$10.8 million

Freight markets began to fall during the 2005-06 policy year yet, contrary to expectation, there was no accompanying increase in the total number of charterparty disputes dealt with by North of England's 17-strong defence team.

A total of 996 claims were notified, as against 1,008 in 2004-05. The number of general enquiries fell by 17.25%, from 1,675 to 1,386. Nevertheless, the defence team's workload remained at a high level. There were a number of clear examples of charterers attempting to repudiate long-term charterparties, in an effort to break free of charters with hire rates above those currently prevailing in the markets. Yet these disputes were not as numerous as predicted by some industry observers.

The year saw an increase in speed and performance claims. These disputes assume greater significance when charterparty rates are high – as they remained, in relative terms. Significant sums are involved in some of these disputes and so many more claims of this type are now contested.

The 2005-06 policy year was also marked by an increase in hold-cleaning disputes, often resulting from the zero tolerance policies adopted by jurisdictions such as the United States and Australia. The Club's defence team also dealt with enquiries and disputes focusing on bunker quality. Stevedore damage disputes – a frequent cause of confrontation between owners and charterers, regardless of the state of the market – also featured in the workload.

There was an increase in requests for advice on matters relating to MARPOL Annex VI atmospheric emission regulations. This area has a strong potential for charterparty disputes turning on the responsibility for regulatory compliance and the availability of low sulphur fuels.

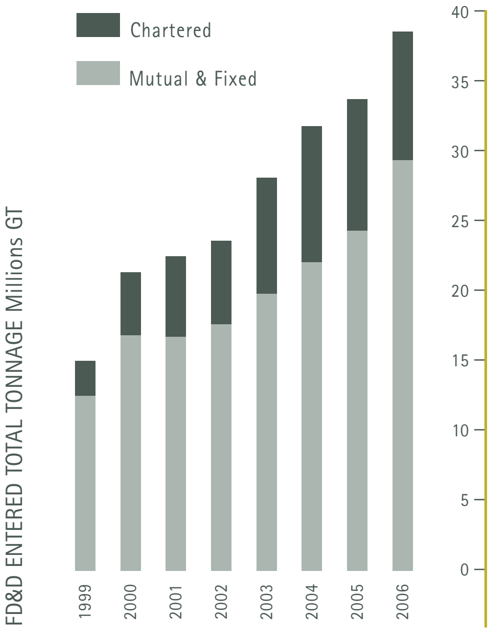
Members continued to require a very rapid response on defence issues. Timely support remains a key indicator of good service from the Club's FD&D team.

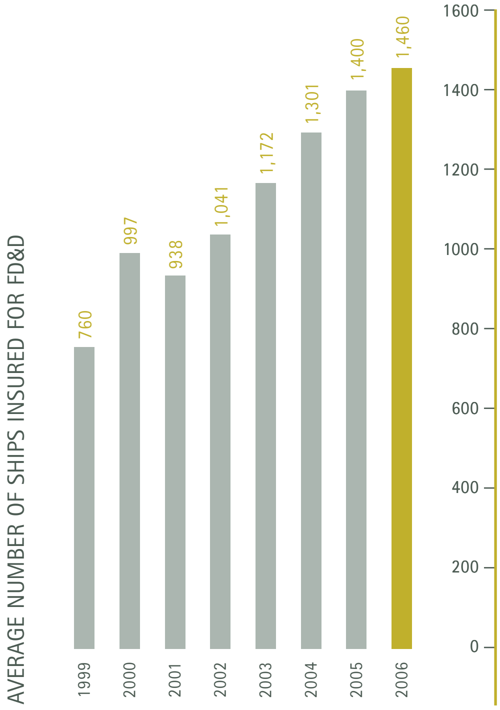
S&P DISPUTES: THE TIDE TURNS

Many North of England members ordered new vessels during the policy year. As always, the Club approached newbuilding defence risks with great caution. The market for secondhand tonnage remained lively although the number of disputes referred to North of England was relatively low. Buyers remained inclined to resolve issues which, in different circumstances, might have led to disputes. The tide, however, appears to be turning.

A downturn in the freight markets is likely to generate volatility in the S&P market and a higher level of S&P claims. For this reason North of England has organised a programme of seminars on the avoidance of S&P disputes. Three S&P seminars, organised in association with solicitors Ince & Co and Mills & Co, were presented in the second half of 2005. Newcastle, London and Piraeus were the venues and the seminars were well received by members and brokers. More seminars are planned this year, in Hamburg, Dubai, Singapore, Hong Kong and Monaco.

The seminars examine the obvious causes of S&P disputes, including the vessel's readiness for delivery under Norwegian Saleform 1993 and claims against sellers concerning vessel condition. In addition, however, the seminars explored other problems and set out buyers' remedies for misrepresentation and breaches of the UK Sale of Goods Act in the context of Norwegian Saleform 1993, as well as exploring the relationship between the sale contract and other contracts affecting the vessel such as charter parties. The main purpose of each seminar was the clear demonstration of the loss prevention strategies prudent buyers and sellers should follow to protect their positions and avoid disputes.





RECOVERING COSTS FOR MEMBERS

North of England is the only International Group defence provider regularly recovering in-house legal costs on behalf of its members. The Club's Rules include specific provisions for costs recovery as, from the first, it was intended to provide members with defence services of exceptional character and cost-efficiency.

It is a Club priority to ensure its members are fully aware of the defence services available to them. A new FD&D Guide has contributed to improved awareness. This Guide describes the many new FD&D services introduced in recent years. They include the link with ICC – International Maritime Bureau, which provides North of England members with zero-cost references on potential contractual partners. Other innovations include maritime lien insurance, free writ searches for buyers of secondhand tonnage and credit risk insurance which protects against the failure of a charterer during a voyage.

FD&D FINANCES

A disappointing investment return of 0.33% was largely as a consequence of currency losses. FD&D reserves, however, rose from US$9.54 million to US$10.8 million.

It might be expected that a downturn in the freight markets would show in higher FD&D claims costs, but this was not evident in the Club's claims experience during 2005-06. Nevertheless, this effect will almost certainly become apparent at some stage. Furthermore, there is the potential for a relatively small number of significant cases to have a major impact on FD&D finances. For these and other reasons, the continued strengthening of FD&D finances remains a Club priority.

INDUSTRY ISSUES

WORK STARTS ON BUILDING A POSITIVE PROFILE

Few global industries matched shipping for sheer dynamism during the past year. Boom conditions continued to dominate an industry experiencing unprecedented growth. Unfortunately, shipping still struggles with its poor public image. Yet there is a growing recognition that the industry must defend its corner on the world stage. Bad law and unjust practices are now being challenged.

This industry has been successful already in putting forward solutions to complex problems, such as the re-balancing of financial responsibility for oil pollution. These proposals found favour with governments. Clubs and their members are working in partnership to address outstanding problems and enhance standards. In addition, the International Group is becoming more proactive. Taken overall, there are grounds for cautious optimism. Things are moving!

Last year the European Parliament dismissed the industry's arguments against key provisions of the Ship Source Pollution Directive, which criminalises marine accidents. The Directive took effect on October 1. An industry coalition, led by INTERTANKO, subsequently mounted a legal challenge. The coalition – supported by North of England and other parties – applied to the London High Court for a judicial review of this Directive, on the grounds that it places EU states in breach of their MARPOL and UNCLOS obligations. In short, it is maintained that the Directive applies criminal sanctions in circumstances where such liability is excluded under established international law. It is hoped that the matter will be referred to the European Court of Justice in Luxembourg.

During March 2006 European Commission Vice-President and Transport Commissioner Jacques Barrot met with International Maritime Organization Secretary-General Efthimios Mitropoulos. Their discussions touched upon the sensitive issue of EU competences and IMO treaties.

Unfortunately, the encounter did nothing to temper the Commission's enthusiasm for the Ship Source Pollution Directive. Within a few weeks of the meeting Jacques Barrot reaffirmed his view that the Directive is compatible with international law. He added that he would be prepared to make the case before the High Court. Once again, industry arguments have fallen on deaf ears.

In marked contrast to Brussels' confrontational style, the industry has continued to demonstrate that self-regulation works. For example, INTERTANKO has won wide support for its "Poseidon Challenge", which seeks continuous improvement strategies from all industry sectors.

North of England, meanwhile, has contributed to the funding of the new Maritime Industry Foundation. Its mission is to build a more positive profile for shipping. On this front there could be no better start than to establish more effective lobbying in Brussels!

North of England is also acting for the Foundation in a sole P&I advisory capacity. The Club follows with interest the programme for developing an on-line Shipping Knowledge Centre, to increase shipping awareness amongst politicians, the media, teachers, other opinion-formers and, of course, the public at large. No-one imagines that changing the public's perception of shipping will be easy. Given the strategic importance of this industry, however, substantial resources should be devoted to the important task of building a more favourable public profile. This cost is shouldered without question in other global industries, such as pharmaceuticals and food.

TARGETED PSC INSPECTIONS

It is commonsense to invest in a more positive profile for shipping. Commonsense is also evident in the Paris MoU's welcome proposal to reduce the inspection frequency for vessels with good safety records. Reducing the inspection burden for responsible operators is a sensible approach. There can be no compromise on quality standards but, equally, there should be due recognition of good performance.

The Port State Control system is maturing in a constructive manner. The Paris MoU's "concentrated inspection campaigns", or CICs, are particularly effective. The latest CIC commenced in late January 2006 and involved over 4,000 ship inspections. The focus was on MARPOL Annex I compliance and non-conformities involving, for example, oil monitoring equipment and the maintenance of Oil Record Books. One in five port state inspections reveal Annex I deficiencies.

The 2007 CIC will concentrate on ISM Code compliance. At that point five years will have elapsed since the last ISM-related Port State Control campaign. Vessels and owners will be undergoing a new cycle of audit and certification. With this in mind, the MoU Secretariat has already issued a warning of its determination to stamp out "paper exercise compliance".

Port State data, however, does suggest that vessels of over 15 years may pose special risks. It is often argued – quite correctly – that age alone is no reliable measure of vessel quality. Yet the new data from the Paris Memorandum Secretariat on the influence of age cannot be ignored. There is now a clear body of evidence supporting the view that age is a *significant measure* of condition where maintenance practices fall anything short of excellent.

INCREASING LIABILITIES

Shipowners' liabilities continued to increase during the year, including liability for oil pollution compensation and clean-up costs. Proposals for cost-sharing between the tanker and oil industries, under CLC/Fund 1992 and the 2003 Supplementary Fund Protocol, were set out in TOPIA (Tanker Oil Pollution Indemnification Agreement) and STOPIA (Small Tankers Oil Pollution Indemnification Agreement). This package averted a full-scale review of the CLC/Fund regime. TOPIA 2006 and STOPIA 2006 took effect on February 20. Hopefully, this industry solution will remain in place for many years to come.

STOPIA's and TOPIA proved sufficient to avoid a renegotiation of the entire CLC/Fund system – a significant and positive outcome. It amounted to a convincing demonstration of the shipping and oil industries' ability to work together and find solutions acceptable to the international community. Clubs and reinsurers contributed to the process. The approach was based on dialogue and consensus, in sharp contrast to the lack of meaningful consultation surrounding the EU's Ship Source Pollution Directive.

Fresh regulatory challenges are developing. A coalition of environmental groups is campaigning for a tougher MARPOL Annex VI. Coalition members include Bluewater Network and Clean Air Task Force in the USA and the North Sea Foundation in Europe. The latter claims the EU would be prepared to act unilaterally in this area, if necessary. The coalition seeks a major reduction in the sulphur content in marine fuels, down from 4.5% to 1.5% – with 0.5% or less for vessels in port or trading in coastal zones.

A new regime for ballast water management has now been adopted but a final date for implementation has not yet been finalised. The ballast water exchange and performance standards failed to satisfy Californian regulators. They introduced new rules in March 2006 for vessels carrying ballast from "another port or place" in the Pacific coast region, supplementing the existing rules applying to vessels carrying ballast from beyond the region. Now California's State Lands Commission is recommending a final performance standard of "zero detectable" for all organism size classes by 2020 – despite the fact that no technology exists for achieving this on a day-to-day shipboard basis.

In the passenger shipping sector, EU enabling legislation this year will apply the new Athens Convention Protocol limits; strict liability increases to SDRs 250,000 per passenger. This dramatic rise in passenger-related liability raises important issues, not least the P&I position in respect of a new generation of vessels with 3,600 plus passengers. Some are asking whether the provision of P&I cover for very large cruise vessels is still a mutually acceptable risk and whether such cover should be limited, given that this relatively small sector of the industry now probably has the greatest potential for generating claims exceeding current reinsurance provision.

INTERNATIONAL GROUP'S ROLE

The International Group passed a stern test of its cohesion during the TOPIA/STOPIA discussions. North of England remains firmly committed to the International Group and its work. The Club's managers serve on an increasing number of Group committees. They make a significant contribution to the important task of building consensus on priorities and new initiatives.

The International Group's more proactive style reflects strong leadership and the availability of more resources. Real progress is being made. There is no desire to develop a policing role for the International Group but, at the same time, the organisation is evolving rapidly into a vigorous champion of quality shipping.

The International Group's important tasks include securing competitive reinsurance terms for the P&I community. Beyond such core functions, its activities are increasingly wide-ranging. It is achieving some success in raising awareness of the Clubs' collective contribution to maritime safety and environmental protection.

The International Group has a significant preventive role. For example, the Ship Standards Committee has acted on issues raised by the OECD shipping report. A new tanker audit system has been introduced as a result. This provides for harmonised surveys of tankers over 10 years of age with a history of carrying heavy fuel oil as cargo. Another initiative is concerned with Club-to-Club access to condition survey information. These initiatives show that the International Group is moving forward in several important areas.

North of England continues to be a strong advocate of claims information sharing. This increases transparency and provides a sharper focus for loss prevention programmes. In this and other areas, the International Group's role can only grow in significance in a zero tolerance world. A collective forum for P&I interests is essential. This point is crucial, as the present exemption for the International Group Agreement expires in 2009. At that stage the IGA will be open to legal challenge. In this new situation the value of the International Group's role needs to be better understood. The alternative might involve a free-for-all, post-2009, with new entrants having no particular experience of, or affinity with, vital objectives such as major accident avoidance and environmental awareness.

HUMAN ASSETS

The human element is the single most important challenge facing shipping. There is a growing appreciation that minimum manning provisions may have gone too far. Studies of major accidents have underlined the significance of fatigue and long hours as causal factors. Industry should take the opportunity to invest now in personnel of the highest quality and, at the same time, take action to enhance the professional status of their seafarers.

The recruitment and retention of high quality crews is an issue that has an impact on safety, environmental protection, claims reduction, profitability and, in the final analysis, the industry's public profile and regulatory framework. The failure to address these matters can only lead to increased financial liabilities.

Shipping has the resources to invest in quality crews. This opportunity should be seized. People need to be attracted to a career at sea. It should be appreciated that this investment in people will show in the claims record and the level of P&I premium. North of England will continue to benchmark carefully in this area. The robotic adoption of minimum manning levels may no longer be appropriate.

COMBINED FINANCIAL STATEMENTS

The financial statements of North of England P&I Association Limited ("NEPIA") and North of England Mutual Insurance Association (Bermuda) Limited ("NoE (Bermuda)") collectively "the Associations", are published separately. Financial Statements, which combine the results and financial position of the UK and Bermuda Associations, follow on pages 29 to 46.

The Associations have common Membership; Combined Financial Statements have been prepared to allow Members to have a full understanding of their interests. The statements have been prepared for illustrative purposes only and have no legal standing. The return to the Financial Services Authority is based upon the combined position.

Any reference to the Club in the preceding narrative relates to the combined position.

ACCOUNTANTS' REPORT

Accountants' Report to the Members of North of England Protecting and Indemnity Association Limited and North of England Mutual Insurance Association (Bermuda) Limited

We report on the unaudited combined financial statements and policy year statement of North of England Protecting and Indemnity Association Limited ("NEPIA") and North of England Mutual Insurance Association (Bermuda) Limited ("NoE(Bermuda)") for the year ended 20 February 2006 ("the combined financial statements").

Our Report is prepared solely for the confidential use of NEPIA and NoE(Bermuda), and solely for the purpose of informing the members of NEPIA and NoE(Bermuda). To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than NEPIA and NoE(Bermuda) and of the common members of NEPIA and NoE(Bermuda) as a body, for our work, for this report, or for the opinions we have formed.

Responsibilities

NEPIA's Directors are responsible for the preparation of the combined financial statements and the policy year statement.

It is our responsibility to carry out procedures designed to enable us to express an opinion as to whether the combined financial statements and policy year statement have been accurately extracted from the financial statements of NEPIA and NoE(Bermuda) for the year ended 20 February 2006.

Basis of opinion

We have performed the procedures enumerated below with respect to the combined financial statements. The procedures were performed solely to assist the Directors with the preparation of the combined financial statements and are summarised as follows:

1. We agreed NEPIA's figures used in the combined financial statements working papers to the signed statutory consolidated financial statements of NEPIA as at 20 February 2006. The auditors' report on the statutory consolidated financial statements of NEPIA was issued by ourselves on 19 May 2006 and was unqualified;
2. We agreed NoE(Bermuda)'s figures used in the combined financial statements working papers to the signed statutory financial statements of NoE(Bermuda) as at 20 February 2006. The auditors' report on the statutory financial statements of NoE(Bermuda) was issued by Moore Stephens & Butterfield on 19 May 2006 and was unqualified;
3. We checked the numerical accuracy of the combined financial statements working papers, including the policy year statement;
4. We reviewed the accounting policies adopted by NEPIA and NoE(Bermuda), as defined in their respective statutory financial statements, to review whether they are consistent; and
5. Our procedures did not constitute an audit in accordance with International Standards on Auditing. In particular we have not verified any information or documentation provided to us and we should not be taken to have done so beyond the procedures described above.

Opinion

We report that:

a. The combined financial statements and policy year statement have been accurately compiled from the statutory financial statements of NEPIA and NoE(Bermuda); and

b. Consistent accounting policies have been adopted by NEPIA and NoE(Bermuda).

Deloitte & Touche LLP

Chartered Accountants
Newcastle upon Tyne
19 May 2006

(All Amounts in US Dollar thousands unless otherwise stated)

COMBINED BALANCE SHEET FOR THE YEAR ENDED 20 FEBRUARY 2006

	Note	2006	2005
ASSETS			
Property, plant and equipment		14,053	11,340
Intangible assets		1,162	1,231
Financial assets			
Equity securities – at fair value through income	3	186,487	140,404
Debt securities – at fair value through income	3	247,311	215,446
Loans and receivables including insurance and reinsurance receivables		13,099	12,946
Derivative financial instruments		–	341
Retirement benefit obligations		9,831	–
Reinsurance contracts		77,398	89,046
Cash and cash equivalents	4	96,163	121,272
Total assets		**645,504**	**592,026**
ACCUMULATED SURPLUS			
Income and expenditure account		(49,030)	(30,664)
Contingency funds	10	210,688	169,253
Revaluation reserve		6,347	3,415
Total accumulated surplus		**168,005**	**142,004**
LIABILITIES			
Insurance contracts		450,498	432,281
Reinsurance payables		7,110	7,405
Cash and cash equivalents		3,310	548
Financial liabilities – Borrowings		3,322	3,555
Derivative financial instruments		324	–
Trade and other payables		10,437	4,834
Retirement benefit obligations		1,842	1,101
Current tax liabilities		656	298
Total liabilities		**477,499**	**450,022**
Total accumulated surplus and liabilities		**645,504**	**592,026**

(All Amounts in US Dollar thousands unless otherwise stated)

COMBINED INCOME STATEMENT AT 20 FEBRUARY 2006

	Note	2006	2005
Insurance premium revenue		177,117	174,466
Insurance premium ceded to reinsurers	5	(23,991)	(32,669)
		153,126	141,797
Investment income		1,474	471
Net fair value gains at fair value through income	6	29,482	20,548
Net income		**184,082**	**162,816**
Insurance claims and loss adjustment expenses	7	(125,173)	(122,253)
Insurance claims and loss adjustment expenses recovered from reinsurers		(5,766)	(13,904)
Net insurance benefits and claims		(130,939)	(136,157)
Expenses for the acquisition of insurance and investment contracts	8	(15,506)	(15,524)
Expenses for marketing and administration	9	(7,341)	(2,664)
Expenses for asset management services rendered		(1,323)	(1,239)
Expenses		**(155,109)**	**(155,584)**
Results of operating activities		28,973	7,232
Finance income		-	1,814
Finance expenditure		(5,057)	(249)
Surplus before tax		23,916	8,797
Tax expense		(847)	(445)
Surplus for the year		**23,069**	**8,352**

NOTES TO THE ACCOUNTS

1. ACCOUNTING POLICIES

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

1.1 Basis of presentation

These combined financial statements do not constitute North of England P&I Association Limited's ("NEPIA") statutory accounts for the years ended 20 February 2006 and 20 February 2005. They are the non-statutory combined financial statements of NEPIA and North of England Mutual Insurance Association (Bermuda) Limited ("NoE Bermuda").

These combined financial statements have been prepared in accordance with recognition, measurement and presentation principles of International Financial Reporting Standards (IFRS's) as adopted for use in the European Union (and therefore comply with Article 4 of the EU IAS Regulation) for the first time. However, whilst the financial information included in these combined financial statements has been computed in accordance with IFRS's, these financial statements do not themselves contain sufficient information to comply with IFRS's.

The combined financial statements we previously prepared were in accordance with United Kingdom generally accepted accounting principles ("UK GAAP") until 20 February 2005. UK GAAP differs in certain respects from IFRS and certain accounting and valuation methods have been amended, when preparing these financial statements, to comply with IFRS. The comparative figures in respect of 2005 have been restated to reflect these amendments.

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

When preparing the consolidated balance sheet under IFRS at 20 February 2004, the date of transition, the following optional exemptions from full retrospective application of IFRS accounting policies have been adopted:

Business combinations – the provisions of IFRS 3 have been applied prospectively from 20 February 2004. Business combinations that occurred before 20 February 2004 have not been restated.

Fair value or revaluation – the Associations have elected to use fair value or a previous GAAP valuation of property, plant and equipment at 20 February 2004.

Designation of previously recognised financial instruments – under IAS 39 Financial Instruments: Recognition and measurement (as revised in 2003) – a financial instrument is to be designated on initial recognition as a financial asset or financial liability at fair value through income or as available for sale. The Associations are permitted and have made such a designation at the date of transition to IFRS.

The Associations have not taken advantage of the exemptions permitted under IFRS 4 Insurance Contracts to make changes to its accounting policies in relation to contracts of insurance, with the exception of requirements to comply with the IFRS framework, and have applied existing accounting practices for insurance contracts.

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

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 7- Financial instruments: Disclosures; and the related amendment to IAS1 on capital disclosures.

The Directors anticipate that the adoption of these Standards in future will have no material impact on the financial statements of the Associations except for additional disclosures on financial instruments when the relevant standards come into effect for periods commencing on or after 1 January 2007.

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 Companies' accounting policies.

1.2 Combination

The combined financial statements combine the consolidated financial statements of NEPIA and the financial statements of NoE(Bermuda) made up to 20 February each year.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by NEPIA.

All intra-group transactions, balances, income and expenses are eliminated on consolidation or combination.

1.3 Foreign currency translation

(a) Functional and presentation currency

Items included in these financial statements are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The combined financial statements are presented in thousands of United States Dollars, which is the functional currency of NEPIA and NoE(Bermuda).

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non-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.

1.4 Property, plant and equipment

Land and buildings comprise of offices occupied by NEPIA. Land and buildings are 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 NEPIA 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 to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

Land	No depreciation charged.
Buildings	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 assets' residual values and useful lives are reviewed at each balance sheet 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.

1.5 Intangible assets

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 balance sheet and amortised over the expected life of the software of up to 5 years.

1.6 Investments

Financial assets at fair value through income

The Associations classify their investments as financial assets at fair value through income. With the exception of the transitional provisions, management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date. 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 at fair value through income category are included in the Income Statement in the period in which they arise.

Regular way purchases and sales of investments are recognised on trade date, the date on which the Associations commit 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 Associations have also transferred substantially all risks and rewards of ownership.

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

NOTES TO THE ACCOUNTS CONTINUED

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 Associations do 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 Associations intend to sell in the short term or that they have 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.

1.7 Impairment of assets

The Associations assess at each balance sheet date whether there is objective evidence that a financial asset or non financial asset is impaired. An asset is 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 Associations 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.

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.

1.8 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.

1.9 Revenue and expense recognition

Premium income

All elements of revenue arising from insurance contracts and other related services offered by the Associations are recognised on an accruals basis in the accounting period in which the contract is related or services are rendered. The Associations policy years run from noon GMT on any 20 February to noon GMT on the next following 20 February. The Associations financial years are coterminous with their policy years.

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 Associations are accrued so as to match the relevant gross claims and associated provisions and reserves upon which the Associations are entitled to make recoveries.

Claims and related expenses

Claims paid are defined as those claims transactions settled up to the balance sheet 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 balance sheet date, net of any provision for bad debt.

Claims reserves are estimated on an undiscounted basis. Any changes to the amounts held are adjusted through the Income Statement. Claims reserves are made for known or anticipated liabilities under insurance contracts which have not been settled up to the balance sheet 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.

(All Amounts in US Dollar thousands unless otherwise stated)

Interest

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

Finance charges

NEPIA purchased the land and buildings of the office in Newcastle by way of a mortgage. Interest is payable on the mortgage and charged to expenditure on an accrual basis using the effective rate method.

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

NEPIA 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 NEPIA, 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 balance sheet date. In accordance with IAS 19, NEPIA 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.

Taxation

UK Corporation Tax is provided on relevant investment income.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of any deferred tax asset is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered, or to the extent that it has been utilised.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to the Income Statement. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and NEPIA intends to settle its current tax assets and liabilities on a net basis. Deferred tax assets and liabilities have not been discounted.

The principal rates of exchange ruling at the balance sheet date were as follows:

	2006			2005
United Kingdom	£0.574	=	US$1	(£0.528)
Euro	€0.839	=	US$1	(€0.765)
Japan	YEN118.460	=	US$1	(YEN105.745)

(All Amounts in US Dollar thousands unless otherwise stated)

NOTES TO THE ACCOUNTS CONTINUED

2. SEGMENTAL ANALYSIS BY CLASS

The segment financial position and results for the year ended 20 February 2006 are shown below:

Balance Sheet

	P&I	FD&D	War Risks	Total
ASSETS				
Property, plant and equipment	14,053	–	–	14,053
Intangible assets	1,162	–	–	1,162
Financial assets				
Equity securities:				
– at fair value through income	183,951	–	2,536	186,487
Debt securities:				
– at fair value through income	216,032	29,294	1,985	247,311
Loans and receivables including insurance and reinsurance receivables	11,056	2,027	16	13,099
Retirement benefit obligations	9,831	–	–	9,831
Reinsurance contracts	77,398	–	–	77,398
Cash and cash equivalents	93,717	2,431	15	96,163
Total assets	**607,200**	**33,752**	**4,552**	**645,504**
ACCUMULATED SURPLUS				
Income and expenditure account	(45,361)	(7,790)	4,121	(49,030)
Contingency funds	192,103	18,585	–	210,688
Revaluation reserve	6,347	–	–	6,347
Total accumulated surplus	**153,089**	**10,795**	**4,121**	**168,005**
LIABILITIES				
Insurance contracts	428,262	22,236	–	450,498
Reinsurance payables	6,931	98	81	7,110
Cash and cash equivalents	3,310	–	–	3,310
Financial liabilities				
Borrowings	3,322	–	–	3,322
Derivative financial instruments	310	14	–	324
Trade and other payables	9,478	609	350	10,437
Retirement benefit obligations	1,842	–	–	1,842
Current tax liabilities	656	–	–	656
Total liabilities	**454,111**	**22,957**	**431**	**477,499**
Total accumulated surplus and liabilities	**607,200**	**33,752**	**4,552**	**645,504**

(All Amounts in US Dollar thousands unless otherwise stated)

2. SEGMENTAL ANALYSIS BY CLASS (continued)

Income Statement

	P&I	FD&D	War Risks	Total
Insurance premium revenue	166,358	10,244	515	177,117
Insurance premium ceded to reinsurers	(23,075)	(594)	(322)	(23,991)
	143,283	9,650	193	153,126
Investment income	1,425	49	-	1,474
Net fair value gains at fair value through income	28,197	1,052	233	29,482
Net income	**172,905**	**10,751**	**426**	**184,082**
Insurance claims and loss adjustment expenses	119,865	5,308	-	125,173
Insurance claims and loss adjustment expenses recovered from reinsurers	5,945	(179)	-	5,766
Net insurance benefits and claims	125,810	5,129	-	130,939
Expenses for the acquisition of insurance and investment contracts	14,954	547	5	15,506
Expenses for marketing and administration	4,587	2,579	175	7,341
Expenses for asset management services rendered	1,213	81	29	1,323
Expenses	**146,564**	**8,336**	**209**	**155,109**
Results of operating activities	26,341	2,415	217	28,973
Finance costs	(3,917)	(1,165)	25	(5,057)
Surplus before tax	22,424	1,250	242	23,916
Tax expense	(846)	6	(7)	(847)
Surplus for the year	**21,578**	**1,256**	**235**	**23,069**

(All Amounts in US Dollar thousands unless otherwise stated)

NOTES TO THE ACCOUNTS CONTINUED

2. SEGMENTAL ANALYSIS BY CLASS (continued)

The segment financial position and results for the year ended 20 February 2005 are shown below:

Balance Sheet

	P&I	FD&D	War Risks	Total
ASSETS				
Property, plant and equipment	11,340	–	–	11,340
Intangible assets	1,231	–	–	1,231
Financial assets				
Equity securities:				
– at fair value through income	138,188	–	2,216	140,404
Debt securities:				
– at fair value through income	184,281	29,093	2,072	215,446
Loans and receivables including insurance and reinsurance receivables	11,275	1,970	(299)	12,946
Derivative financial instruments	271	70	–	341
Reinsurance contracts	89,046	–	–	89,046
Cash and cash equivalents	120,466	791	15	121,272
Total assets	**556,098**	**31,924**	**4,004**	**592,026**
ACCUMULATED SURPLUS				
Income and expenditure account	(28,764)	(5,786)	3,886	(30,664)
Contingency funds	153,928	15,325	–	169,253
Revaluation reserve	3,415	–	–	3,415
Total accumulated surplus	**128,579**	**9,539**	**3,886**	**142,004**
LIABILITIES				
Insurance contracts	410,256	22,025	–	432,281
Reinsurance payables	7,161	138	106	7,405
Cash and cash equivalents	548	–	–	548
Financial liabilities				
Borrowings	3,555	–	–	3,555
Trade and other payables	4,600	222	12	4,834
Retirement benefit obligations	1,101	–	–	1,101
Current tax liabilities	298	–	–	298
Total liabilities	**427,519**	**22,385**	**118**	**450,022**
Total accumulated surplus and liabilities	**556,098**	**31,924**	**4,004**	**592,026**

(All Amounts in US Dollar thousands unless otherwise stated)

2. SEGMENTAL ANALYSIS BY CLASS (continued)

Income Statement

	P&I	FD&D	War Risks	Total
Insurance premium revenue	164,033	9,767	666	174,466
Insurance premium ceded to reinsurers	(31,759)	(438)	(472)	(32,669)
	132,274	9,329	194	141,797
Investment income	423	48	-	471
Net fair value gains at fair value through income	19,164	1,113	271	20,548
Net income	**151,861**	**10,490**	**465**	**162,816**
Insurance claims and loss adjustment expenses	115,589	6,663	1	122,253
Insurance claims and loss adjustment expenses recovered from reinsurers	13,823	81	-	13,904
Net insurance benefits and claims	129,412	6,744	1	136,157
Expenses for the acquisition of insurance and investment contracts	15,036	482	6	15,524
Expenses for marketing and administration	192	2,292	180	2,664
Expenses for asset management services rendered	1,141	69	29	1,239
Expenses	**145,781**	**9,587**	**216**	**155,584**
Results of operating activities	6,080	903	249	7,232
Finance income	1,660	157	(3)	1,814
Finance expenditure	(249)	-	-	(249)
Surplus before tax	7,491	1,060	246	8,797
Tax expense	(416)	(24)	(5)	(445)
Surplus for the year	**7,075**	**1,036**	**241**	**8,352**

(All Amounts in US Dollar thousands unless otherwise stated)

NOTES TO THE ACCOUNTS CONTINUED

3. FAIR VALUE SECURITIES

	2006	2005
Market value		
Equity securities – at fair value through income	186,487	140,404
Debt securities – at fair value through income	247,311	215,446
	433,798	355,850
Cost		
Equity securities – at fair value through income	183,576	112,713
Debt securities – at fair value through income	247,906	213,155
	431,482	325,868

4. CASH AND CASH EQUIVALENTS

	2006	2005
Cash at bank and in hand	24,728	13,370
Short-term bank deposits	61,481	9,340
Short-term maturity bonds	9,954	98,562
	96,163	121,272

5. INSURANCE PREMIUM CEDED TO REINSURERS

	2006	2005
Market	8,874	17,710
International Group	13,878	14,661
Hydra	1,030	-
War Risks Group	209	298
	23,991	32,669

6. NET FAIR VALUE GAINS AT FAIR VALUE THROUGH INCOME

	2006	2005
Debt securities		
Fixed interest	9,982	7,948
Net realised gains	1,766	1,386
Net unrealised losses	(2,978)	(1,257)
	8,770	8,077
Equities		
Dividends	1,048	557
Net realised gains	44,443	12,222
Net unrealised losses	(24,779)	(308)
	20,712	12,471
Total	29,482	20,548

(All Amounts in US Dollar thousands unless otherwise stated)

7. INSURANCE CLAIMS AND LOSS ADJUSTMENT EXPENSES

All Classes	2006	2005
Gross claims paid		
Members' claims	83,114	89,633
Other P&I Clubs' pool claims	11,491	11,892
Claims handling costs	12,351	13,967
	106,956	115,492
Movement in gross outstanding claims		
Members	15,654	1,302
Pooling agreement	(527)	5,459
Hydra	3,090	-
	18,217	6,761
Total gross claims	125,173	122,253
Protecting and Indemnity Class		
Gross claims paid		
Members' claims	80,671	86,824
Other P&I Clubs' pool claims	11,491	11,892
Claims handling costs	9,697	11,650
	101,859	110,366
Movement in gross outstanding claims		
Members	15,443	(236)
Pooling agreement	(527)	5,459
Hydra	3,090	-
	18,006	5,223
Total gross claims	119,865	115,589

8. EXPENSES FOR THE ACQUISITION OF INSURANCE AND INVESTMENT CONTRACTS

	2006	2005
Brokerage	10,427	9,700
Acquisition costs	5,079	5,824
	15,506	15,524

In accordance with Schedule 3 of the International Group Agreement 1999 we are required to disclose the Average Expense Ratio for the Association's P&I business for the five years ended 20 February 2006. The Ratio of 9.2% (2005 – 9.2%) has been calculated in accordance with the Schedule and the guidelines issued by the International Group and is consistent with the relevant Financial Statements of NEPIA and NoE (Bermuda).

(All Amounts in US Dollar thousands unless otherwise stated)

NOTES TO THE ACCOUNTS CONTINUED

9. EXPENSES FOR MARKETING AND ADMINISTRATION

	2006	2005
Gross	26,620	24,190
Acquistion costs	(5,079)	(5,824)
Loan interest transferred to finance costs	(161)	(119)
Amount recharged to Marine Shipping Mutual Insurance Company Limited	(1,688)	(1,616)
Claims handling costs	(12,351)	(13,967)
	7,341	2,664

10. CONTINGENCY FUNDS

Protecting & Indemnity Class

	2006	2006	2005	2005
Balance at 20 February 2005		153,928		151,804
The transfer from the Income and Expenditure account comprises:				
Allocation of realised investment gains / (losses) and income	34,317		(11,402)	
Surplus transferred from closed policy years	3,858		13,526	
		38,175		2,124
Balance at 20 February 2006		192,103		153,928

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

Freight, Demurrage & Defence Class

	2006	2006	2005	2005
Balance at 20 February 2005		15,325		12,270
The transfer from the Income and Expenditure account comprises:				
Allocation of realised investment gains / (losses) and income	(722)		(659)	
Surplus transferred from closed policy years	3,982		3,714	
		3,260		3,055
Balance at 20 February 2006		18,585		15,325

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

(All Amounts in US Dollar thousands unless otherwise stated)

COMBINED P&I CLASS POLICY YEAR STATEMENT

	Closed Years	2003/ 2004	2004/ 2005	2005/ 2006	Claims Handling Reserve	Contingency Fund	Unrealised Gains	Total
Premium								
Mutual & Fixed Premium								
Invoiced in Prior Years		138,658	151,372	-	-	-	-	290,030
Invoiced in Current Year		495	1,021	154,621	-	-	-	156,137
		139,153	152,393	154,621	-	-	-	446,167
Release Premium		891	574	238	-	-	-	1,703
		140,044	152,967	154,859	-	-	-	447,870
Reinsurance Premiums		(31,021)	(32,132)	(24,856)	-	-	-	(88,009)
		109,023	120,835	130,003	-	-	-	359,861
Investment income, gains on sales of investments, and exchange movements		18,050	12,175	15,931	-	104,294	925	151,375
Transfers from closed years		-	-	-	-	90,874	-	90,874
		127,073	133,010	145,934	-	195,168	925	602,110
Members' & Pool Claims		(67,785)	(56,124)	(16,705)	-	-	-	(140,614)
Expenses & Tax		(16,698)	(19,279)	(21,582)	-	(3,065)	-	(60,624)
Surplus Available on Closed Years	96,734	-	-	-	-	-	-	96,734
Balances Available for Outstanding Claims	96,734	42,590	57,607	107,647	-	192,103	925	497,606
Outstanding Claims	(123,232)	(63,236)	(114,381)	(115,013)	(12,400)	-	-	(428,262)
Reinsurance Recoveries	26,498	19,053	29,539	2,308	-	-	-	77,398
	(96,734)	(44,183)	(84,842)	(112,705)	(12,400)	-	-	(350,864)
Revaluation Reserve	-	-	-	-	-	-	-	6,347
Surplus / (Deficit) at 20 February 2006	**-**	**(1,593)**	**(27,235)**	**(5,058)**	**(12,400)**	**192,103**	**925**	**153,089**
Surplus / (Deficit) at 20 February 2005	(5,540)	(11,039)	(29,727)	-	(11,600)	153,928	32,557	128,579

(All Amounts in US Dollar thousands unless otherwise stated)

NOTES TO THE COMBINED P&I CLASS POLICY YEAR STATEMENT

1. The Combined P&I Class Policy Year Statement ("the Statement") is based on the combined policy year results of the Association and NoE(Bermuda) ("the Associations"). The Statement aggregates the policy year statements of the Associations and eliminates the effect of the reinsurance transaction by which the Association reinsures 90% of its P&I risks and accumulated outstanding claims with NoE(Bermuda). The Associations have accounted for the reinsurance transaction in their respective accounts for the period ended 20 February 2006.
2. Investment income, gains and losses on sales of investments and exchange movements are allocated to open policy years on the basis of a seven year projection using the annualised return of the previous seven years, and the remainder is allocated to the contingency fund. The foreign exchange gain on the freehold building is included in unrealised gains and foreign exchange.
3. Premium is net of brokerage.
4. Expenses and tax charged to open policy years are as follows:

	2003/2004	2004/2005	2005/2006
General and administrative expenses	14,224	17,722	19,523
Investment expenses	1,398	1,141	1,213
Taxation	1,076	416	846
	16,698	19,279	21,582

5. Estimated outstanding claims include appropriate amounts in each policy year for incurred but not reported (IBNR) claims.
6. A deficit on any open policy year will be funded by expected future investment income and, if necessary, a transfer from the Contingency Fund or by making supplementary calls.
7. Future investment income has not been included in the statement and claims have not been discounted.
8. Transfers are made from the Contingency Fund to meet exceptional items and to maintain call stability. The surplus on closed years has been transferred to the Contingency Fund.
9. The approximate yield of a 10% supplementary call on the open policy years would be:

2003/04	US$12.1 million
2004/05	US$13.4 million
2005/06	US$13.7 million

(All Amounts in US Dollar thousands unless otherwise stated)

COMBINED FD&D CLASS POLICY YEAR STATEMENT

	Closed Years	2003/ 2004	2004/ 2005	2005/ 2006	Claims Handling Reserve	Contingency Fund	Unrealised Gains	Total
Premium								
Mutual & Fixed Premium								
Invoiced in Prior Years		8,601	9,107	–	–	–	–	17,708
Invoiced in Current Year		4	167	9,511	–	–	–	9,682
		8,605	9,274	9,511	–	–	–	27,390
Release Premium		49	23	10	–	–	–	82
		8,654	9,297	9,521	–	–	–	27,472
Reinsurance Premiums		(572)	(622)	(781)	–	–	–	(1,975)
		8,082	8,675	8,740	–	–	–	25,497
Investment income, gains on sales of investments, and exchange movements		973	698	322	–	3,786	(123)	5,656
Transfers from closed years		–	–	–	–	14,799	–	14,799
		9,055	9,373	9,062	–	18,585	(123)	45,952
Claims		(1,765)	(1,308)	(402)	–	–	–	(3,475)
Expenses & Tax		(4,399)	(4,702)	(5,308)	–	–	–	(14,409)
Surplus Available on Closed Years	4,963	–	–	–	–	–	–	4,963
Balances Available for Outstanding Claims	4,963	2,891	3,363	3,352	–	18,585	(123)	33,031
Outstanding Claims	(4,963)	(2,963)	(4,321)	(4,989)	(5,000)	–	–	(22,236)
Reinsurance Recoveries	–	–	–	–	–	–	–	–
	(4,963)	(2,963)	(4,321)	(4,989)	(5,000)	–	–	(22,236)
Surplus / (Deficit) at 20 February 2006	**–**	**(72)**	**(958)**	**(1,637)**	**(5,000)**	**18,585**	**(123)**	**10,795**
Surplus / (Deficit) at 20 February 2005	2,005	(1,018)	(1,743)	–	(5,000)	15,325	(30)	9,539

(All Amounts in US Dollar thousands unless otherwise stated)

NOTES TO THE COMBINED FD&D CLASS POLICY YEAR STATEMENT

1. The Combined FD&D Class Policy Year Statement ("the Statement") is based on the combined policy year results of the Association and NoE(Bermuda) ("the Associations"). The Statement aggregates the policy year statements of the Associations and eliminates the effect of the reinsurance transaction by which the Association reinsures 90% of its FD&D risks and accumulated outstanding claims with NoE(Bermuda). The Associations have accounted for the reinsurance transaction in their respective accounts for the period ended 20 February 2006.
2. Investment income, gains and losses on sales of investments and exchange movements are allocated to open policy years on the basis of a seven year projection using the annualised return of the previous seven years, and the remainder is allocated to the contingency fund.
3. Premium is net of brokerage.
4. Expenses and tax charged to open policy years are as follows:

	2003/2004	2004/2005	2005/2006
General and administrative expenses	4,239	4,609	5,233
Investment expenses	106	69	81
Taxation	54	24	(6)
	4,399	4,702	5,308

5. Estimated outstanding claims include appropriate amounts in each policy year for incurred but not reported (IBNR) claims.
6. A deficit on any open policy year will be funded by expected future investment income and, if necessary, a transfer from the Contingency Fund or by making supplementary calls.
7. Future investment income has not been included in the statement and claims have not been discounted.
8. Transfers are made from the Contingency Fund to meet exceptional items and to maintain call stability. The surplus on closed years has been transferred to the Contingency Fund.
9. The approximate yield of a 10% supplementary call on the open policy years would be:

2003/04	US$0.6 million
2004/05	US$0.6 million
2005/06	US$0.7 million

NOTES

NOTES

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