

THE UNITED KINGDOM DEFENCE INSURANCE
ASSOCIATION (ISLE OF MAN) LIMITED

2007

ANNUAL REPORT

DIRECTORS' REPORT & FINANCIAL STATEMENTS

THE UNITED KINGDOM DEFENCE INSURANCE ASSOCIATION (ISLE OF MAN) LIMITED

For the year ended 20th February, 2007

CONTENTS

Notice of Meeting **2**

Directors **3**

Report of the Directors **4**

Appendix to the Report of the Directors **6**

Report of the Auditors **7**

Income and Expenditure Account **9**

Balance Sheet **10**

Cash Flow Statement **11**

Notes to the Financial Statements **12–18**

Managers **19**

NOTICE OF MEETING

THE UNITED KINGDOM DEFENCE INSURANCE ASSOCIATION (ISLE OF MAN) LIMITED

Notice is hereby given that the Annual General Meeting of the Members will be held in Douglas, Isle of Man on 18 September 2007 at 9.30 a.m. for the following purposes:

to receive and adopt the Directors' Report and Financial Statements for the year ended 20th February, 2007;

to re-elect Directors;

to re-appoint the Auditors and authorise the Directors to fix their remuneration; and

to transact any other business.

Any Member of the Association entitled to attend and vote is entitled to appoint a proxy and that proxy need not be a Member of the Association.

By Order of the Board

Havelock Insurance Management Limited

Secretary

4 April, 2007

Directors

Dr. D. L. Moore

E. Shallcross

K. A. Button

M. Cor

E. A. Keane

REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their Report and the Financial Statements of the Association for the year ended 20 February 2007.

PRINCIPAL ACTIVITY

The Association's principal activity is that of an insurance company, accepting reinsurance from the United Kingdom Freight Demurrage and Defence Association Limited on a quota share basis. The Association is authorised by the Isle of Man Government Insurance and Pensions Authority to carry on an insurance business in or from the Isle of Man.

The Association was incorporated on 9 February 1999 and is limited by guarantee.

DIRECTORS

The Directors of the Association who served during the year and to date are shown on page 3.

REVIEW OF THE YEAR

Operations for the year resulted in a profit of £2,541,000 (2006: £1,888,000).

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the statement of auditors' responsibilities, set out on page 7, is made for the purpose of clarifying for Members the respective responsibilities of the Directors and the Auditors in the preparation of the accounts.

Company law requires the Directors to have prepared Financial Statements, which give a true and fair view of the state of affairs of the Association as at 20 February 2007 and of its profit for the year then ended. In the preparation of these Financial Statements, the Directors are required to ensure that:

- suitable accounting policies have been selected and applied consistently;
- judgements and estimates which have been made are reasonable and prudent;
- the Financial Statements state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Financial Statements;
- the Financial Statements are prepared on a going concern basis.

The Directors confirm that the above requirements have been complied with in the preparation of the Financial Statements.

REPORT OF THE DIRECTORS (CONTINUED)

STATEMENT OF DIRECTORS' RESPONSIBILITIES (CONTINUED)

The Directors are responsible for the keeping of proper accounting records which disclose, with reasonable accuracy, at any time, the financial position of the Association and to enable them to ensure that the Financial Statements comply with the Companies Acts 1931 to 2004, as modified by the Insurance Act 1986. They are also responsible for safeguarding the assets of the Association and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

AUDITORS

Moore Stephens, the Association's auditors, are willing to continue in office pursuant to section 12(2) of the Companies Act 1982.

By Order of the Board

I.R. Simpson

For and on behalf of
Havelock Insurance Management Limited

Secretary

4 April 2007

APPENDIX TO THE REPORT OF THE DIRECTORS

CLAIMS AND OUTSTANDING CLAIMS

as at 20 February 2007

These include all claims incurred during the year, whether paid, estimated or unreported, together with internal claims management costs and future claims management costs and adjustments for claims outstanding from previous years.

A forecast of unreported claims is based on the estimated ultimate cost of claims arising out of events which have occurred before the end of the accounting period but have not yet been reported. These future claims are based on the Managers' best estimate of unreported claims on each policy year. The estimates are calculated by comparing the pattern of claims payments in current policy years with earlier policy years, and then projecting the likely outcome of the more recent years.

Summary of future outgoings

	2007 £000's	2006 £000's
Estimated outstanding claims as at 20 February	28,133	29,110

REPORT OF THE AUDITORS

Independent Auditors' Report to the Members of The United Kingdom Defence Insurance Association (Isle of Man) Limited

We have audited the financial statements of The United Kingdom Defence Insurance Association (Isle of Man) Limited for the year ended 20 February 2007 which are set out on pages 9 to 18. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members as a body, in accordance with Section 15 of the Isle of Man Companies Act 1982. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Acts 1931 to 2004, as modified by the Insurance Act 1986. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law is not disclosed.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

REPORT OF THE AUDITORS (CONTINUED)

Opinion

In our opinion the financial statements

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 20 February 2007 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Acts 1931 to 2004 as modified by the Insurance Act 1986.

MOORE STEPHENS,

Chartered Accountants,
Douglas, Isle of Man.
8 May 2007

INCOME AND EXPENDITURE ACCOUNT

For the year ended 20 February 2007 (Amounts in £000's)

	Note	2007	2007	2006	2006
PREMIUMS					
Premiums receivable	4		10,863		9,957
Commissions payable			(3,383)		(3,071)
			7,480		6,886
INVESTMENT RETURN					
Investment income	5		1,619		1,427
(Losses)/Gains on investments					
Realised			(671)		260
Unrealised			(474)		1,023
			474		2,710
CLAIMS					
Claims paid			(6,767)		(6,816)
Claims recoveries			577		–
Change in provision for outstanding claims			977		(870)
			(5,213)		(7,686)
EXPENSES					
Management fee	6		(145)		(145)
General and administrative expenses	7		(49)		(53)
			(194)		(198)
Differences on exchange			(6)		176
Profit for the year			2,541		1,888
Retained profit brought forward			9,887		7,999
Retained profit carried forward	12		12,428		9,887

BALANCE SHEET

At 20 February 2007 (Amounts in £000's)

	Notes	2007	2006
ASSETS			
Investments	8	40,714	39,692
Cash balances	8	170	215
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Total cash and investments	8	40,884	39,907
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Accrued interest		511	351
Prepaid expenses		7	8
Due from investment brokers		1,118	3
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		42,520	40,269
<hr/>			
LIABILITIES			
Outstanding claims	9	(28,133)	(29,110)
Due to investment brokers		(1,120)	–
Related party balances		(707)	(1,141)
Accrued expenses		(32)	(31)
<hr/>			
		(29,992)	(30,282)
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NET ASSETS		12,528	9,987
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Reserves			
Guarantee Fund	12	100	100
Retained earnings		12,428	9,887
<hr/>			
TOTAL RESERVES		12,528	9,987

DIRECTORS

E. Shallcross

E.A. Keane

4 April 2007

MANAGERS

K.A. Button

For and on behalf of Havelock Insurance Management Limited

4 April 2007

CASH FLOW STATEMENT

For the year ended 20 February 2007 (Amounts in £000's)

	Note	2007	2006
OPERATING ACTIVITIES			
Calls and premiums received		10,863	9,957
Interest received and exchange movement		1,453	1,690
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		12,316	11,647
<hr/>			
Claims paid		(6,624)	(7,588)
Commission		(3,383)	(3,071)
Management fee, general and administration expenses		(192)	(198)
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		(10,199)	(10,857)
<hr/>			
Net cash flow from operating activities	10	2,117	790
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INVESTING ACTIVITIES			
Purchase of investments		(119,699)	(81,131)
Sale of investments		117,537	80,293
<hr/>			
Net cash flow from investing activities		(2,162)	(838)
<hr/>			
Net decrease in cash and cash equivalents		(45)	(48)
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Cash and cash equivalents at beginning of year		215	263
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Cash and cash equivalents at end of year	8	170	215

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 20 February 2007 (Amounts in £000's)

1. Constitution

The Association was incorporated in the Isle of Man on 9 February 1999 and received authorisation from the Isle of Man Government Insurance and Pensions Authority to carry on an insurance business in or from the Isle of Man on 17 February 1999.

The Directors have the right to make supplementary calls on their Members (see note 14) for any open policy year to make good any deficit of income on that year, and similarly may return any surplus arising on a year to the members.

The Association reinsures 90% of the retained legal costs and expenses insurance risks of the United Kingdom Freight Demurrage and Defence Association Limited as set out in the reinsurance agreement.

In the event of the company's liquidation the net assets of the Association are to be distributed in proportion to the amount of contributions paid by Members to the United Kingdom Freight Demurrage and Defence Association Limited during the period of six years preceding the commencement of the winding-up.

2. Accounting policies

In the absence of comparable standards in the Isle of Man, the Directors have resolved to adopt United Kingdom Accounting Standards published by the Accounting Standards Board of the United Kingdom in the preparation of the Financial Statements, provided they are consistent with the Isle of Man Companies Acts 1931 to 2004 and also in accordance with the Isle of Man Insurance Act 1986 and related Regulations, except that investments are carried at market value. The Insurance Act 1986 and related Regulations prescribe the format of certain elements of the Financial Statements. The Directors have also considered the disclosure requirements of The Statement of Recommended Practice on Accounting for Insurance, December 2005, and adopted the recommendations as applicable to the Association.

The preparation of Financial Statements in conformity with generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Financial Statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Significant accounting policies are:

(a) Premiums

Premiums are recorded on an accruals basis. The Association has the ability to make supplementary calls upon Members.

The reinsurance agreement with the United Kingdom Freight Demurrage and Defence Association Limited contains provisions with respect to premium adjustments. The adjustments are dependent upon the invested assets of one party as a proportion of the total of both parties and may be made by either the United Kingdom Freight Demurrage and Defence Association Limited or the Association. Any such premium adjustments are recorded in the Financial Statements in the accounting period in which they are made.

(b) Claims

Losses are recorded on a reported basis. In addition, provision is made for claims incurred but not reported based on information provided to the Association by its reinsured and the estimates of the Managers.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 20 February 2007 (Amounts in £000's)

2. Accounting policies (continued)

Inherent in these estimates are expected trends in claim severity, frequency and other factors that could vary as claims are settled. Accordingly, the amount provided for estimated outstanding claims may differ materially from the Association's ultimate liability for such claims. Any differences will be recorded in the period in which they are determined.

(c) Foreign currencies

Revenue transactions in foreign currencies have been translated into Sterling at rates revised at monthly intervals. All exchange gains and losses whether realised or unrealised are included in the Income and Expenditure Account. The differences arising on currency translation and the realised differences arising on the sale of currencies are included within realised gains within investment income.

Foreign currency assets and liabilities including investments are carried at market value translated into Sterling at the rates of exchange ruling at the balance sheet date. The resulting difference is treated as unrealised.

(d) Expenses

Commissions payable, management fees and other general and administrative expenses are recorded on an accruals basis.

(e) Investments

The interest receivable from the investments together with the profits and losses on sale of investments and the amortised discount on zero coupon bonds are included within investment income in the Income and Expenditure Account. The unrealised gains and losses on the movement in the market value of the investments compared to the cost are included in unrealised gains and losses on investments within investment income.

Investments are stated at their market value at the balance sheet date. Investments purchased in foreign currencies are translated into Sterling on the date of purchase. The market values of foreign currency investments are translated at the rate of exchange ruling at the balance sheet date.

Undertakings for Collective Investments of Transferable Securities ("UCITS") are used as an alternative to cash deposits and are translated into Sterling on the date of purchase.

(f) Comparatives

Certain comparative figures have been re-stated from prior year financial statements in order to be consistent with current year presentation.

3. Taxation

The Association has obtained exemption from Isle of Man income tax in accordance with the provisions of the Income Tax (Exempt Insurance Companies) Act 1981, as amended.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 20 February 2007 (Amounts in £000's)

4. Premiums receivable

	2007	2006
Gross written premium	10,863	9,957

5. Investment return

	2007	2006
Investment income		
Bond interest	1,107	1,216
Bank deposit interest	451	274
Currency gains/(losses)	98	(21)
Custody fees	(37)	(42)
	1,619	1,427
Gains on investments		
Realised (losses)/gains on sale of investments	(671)	260
Unrealised (decrease)/increase in market value of investments	(474)	1,023
	474	2,710

6. Management fee

The fee paid to the Managers covers the cost of providing offices, staff and administration in the Isle of Man, and includes investment management services provided by a company in the same group as the Managers.

7. General and administrative expenses

	2007	2006
Directors' and Officers' insurance	12	15
Audit fees	17	15
Directors' fees	11	11
Directors' and Managers' travel	4	7
Government fees	3	3
Printing, stationery and communications	1	1
Sundry costs	1	1
	49	53

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 20 February 2007 (Amounts in £000's)

8. Cash and investments

(i) Cash balances

	2007	2006
Current and short term bank deposits	215	263

The Association is required by the Isle of Man Government Insurance and Pensions Authority to hold £100,000 with a bank licensed under the provisions of the Isle of Man Banking Acts, 1975 to 1986.

The current and short term bank deposits all mature within 30 days and carry interest at rates between 2% and 5% for Sterling (2006: 2% and 5%), 0% and 2% for Euros (2006: 0% and 2%) and between 0% and 3% for US dollars. (2006: 0% and 3%).

(ii) Investments

	Cost 2007	Market Value 2007	Cost 2006	Market Value 2006
Listed				
Government stocks	17,186	17,119	19,928	20,095
Unit trusts	2,579	3,485	5,240	6,400
Other Securities	15,765	15,802	–	–
UCITS	4,303	4,308	13,169	13,197
	39,833	40,714	38,337	39,692

The listed investments are all quoted on major recognised international stock exchanges. No loans have been made to Directors, Officers or Managers, and none is contemplated.

The Association's investment policy requires, that at the time of purchase, bonds have a credit rating of A minus or better.

The market value of investments in bonds and government stocks may be affected by changes in prevailing levels of interest rates. At the balance sheet date the investments in UCITS and stocks have effective interest rates of between 3% and 6% and 2% and 8% respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 20 February 2007 (Amounts in £000's)

8. Cash and investments (continued)

(iii) Cash and investments maturity summary

	2007	2006
Cash and investments	40,884	39,907
	2007 %	2006 %
Cash and interest bearing securities repayable within one year	31.14	49.65
Interest bearing securities between one year and three years	61.83	16.42
Interest bearing securities between three years and seven years	7.03	28.71
Interest bearing securities after seven years	–	5.22
	100.00	100.00

(iv) Cash and investments currency exposure

	2007 %	2006 %
Sterling	69.98	59.31
U.S. dollar	11.33	22.18
Euro	18.69	18.51
	100.00	100.00

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 20 February 2007 (Amounts in £000's)

9. Outstanding claims

The provision for outstanding claims consists of the estimated cost of known outstanding claims, together with a forecast of claims incurred but not reported, on risks already written.

	2007	2006
Earlier years	1,792	2,358
Policy year		
2006	10,175	–
2005	5,605	11,196
2004	3,920	6,091
2003	2,513	3,793
2002	1,484	2,354
2001	1,028	1,314
2000	929	1,103
1999	687	901
	28,133	29,110

The total of outstanding claims of £28,133,000 consists of a forecast of unreported claims of £22,948,000 and an estimate of known claims of £5,185,000.

10. Cash flow statement

Reconciliation of operating profit to net cash flow from operating activities

	2007	2006
Operating profit	2,541	1,888
(Increase)/Decrease in accrued interest and prepaid expenses	(159)	88
Increase/(Decrease) in accrued expenses	1	(1)
(Decrease)/Increase in claims provision	(977)	870
Decrease/(Increase) in unrealised investment gains	474	(1,023)
Increase in related party balances	(434)	(772)
Loss/(Profit) on disposal of investments	671	(260)
Net cash inflow from operating activities	2,117	790

11. Exchange rates

As at the balance sheet date £1 equals

	2007	2006
US dollar	1.9553	1.7406
Euro	1.4883	1.4600

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 20 February 2007 (Amounts in £000's)

12. Reserves

	Guarantee Fund	Retained Earnings	Total
As at 20 February 2006	100	9,887	9,987
Transfer during the year	–	2,541	2,541
As at 20 February 2007	100	12,428	12,528

13. Debenture

The Association has charged by debenture certain liabilities to the United Kingdom Freight Demurrage and Defence Association Limited, to whom the Association provides reinsurance. The Association has covenanted to discharge the following liabilities:-

1. The Association's liabilities to the United Kingdom Freight Demurrage and Defence Association Limited including those under the reinsurance agreement
2. Any amount necessary to enable the United Kingdom Freight Demurrage and Defence Association Limited to meet its solvency margin, and
3. Any expenses incurred by the United Kingdom Freight Demurrage and Defence Association Limited relating to enforcing or exercising any power under the debenture.

The debenture is secured by floating charge over the Association's assets but excludes £700,000, this amount being sufficient to meet the solvency requirements of the Isle of Man Government Insurance and Pensions Authority.

14. Related party disclosures

The Association has no share capital and is controlled by the Members. A Member is any person to whom the United Kingdom Freight Demurrage and Defence Association Limited has afforded primary insurance which is subsequently reinsured into the Association. Members of the Association are therefore also members of the United Kingdom Freight Demurrage and Defence Association Limited, under that Association's rules. At 20 February 2007 £657,000 was due to the United Kingdom Freight Demurrage and Defence Association Limited (2006: £1,091,000).

At 20 February 2007 £50,000 was due to the United Kingdom Defence Reinsurance Association Limited (2006: £50,000). The United Kingdom Defence Reinsurance Association Limited is a wholly owned subsidiary of the United Kingdom Freight Demurrage and Defence Association Limited.

Ms M. Cor and Capt. E.A. Keane, who served as Directors during the year, were employees of Member companies. Other than the insurance and membership interests of the Member companies, the Directors have no financial interests in the Association.

Mr K.A. Button, who served as a Director during the year was also a Director of the Managers, Havelock Insurance Management Limited during the year. Havelock Insurance Management Limited provided the services detailed in Note 6 and the amounts paid to the Managers during the year are disclosed in the Income and Expenditure Account. These transactions were conducted at an arms length basis.

MANAGERS

HAVELOCK INSURANCE MANAGEMENT LIMITED

ADDRESS

16/17 Mount Havelock,
Douglas,
Isle of Man.
IM1 2QG

SECRETARY

Havelock Insurance Management Limited

REGISTERED OFFICE

16/17 Mount Havelock,
Douglas,
Isle of Man.
IM1 2QG

