A succession of natural catastrophes in 2011 has led to insured losses only equalled once before, in 2005. Marine insurers did not escape the impact.

The Japanese earthquake in March and, in particular, flooding in Thailand in the second half of 2011 resulted in huge cargo insurance claims. Matters haven’t improved in 2012. The loss of the Costa Concordia will result in the largest ever claim from a single ship, exceeding the Exxon Valdez – about US$1 billion split between hull and liability underwriters.

The timing of the Costa Concordia casualty and significant deterioration of the reserves for oil pollution liabilities following the grounding of the Rena, led to problems behind the scenes at the time of the February Protection and Indemnity (P&I) renewal. The International Group’s reinsurance contract could not be placed at the rates advertised, meaning the clubs had to subsidise the shortfall from reserves, which will need addressing next year.

Despite poor claims’ experience from these and other disasters, the underwriting surplus for marine risks remains and is preventing the imposition of premium increases that, insurers argue, the overall loss record demands. There is no expectation of capacity falling in the short term. Indeed, the pattern of previous years is being repeated in 2012 as new capacity exceeds that pulling out.

Perceived benefits of economies of scale has led to bigger and bigger ships, with Maersk’s contract with Daewoo Shipbuilding for twenty 18,000 TEU container ships just one example. Structural integrity of untested designs is a serious concern to insurers and the hull and cargo claims that would follow the failure of one of these huge ships would be enormous.

Faced with increased competition, underwriters have looked hard for new areas to utilise capacity. Cargo insurers have identified an opportunity to underwrite stock throughput cover as property insurers respond to natural catastrophe losses by increasing premium. Hull underwriters have increasingly sought diversification into relatively profitable builders’ risks, although this has been hampered by a shortage of new construction orders.

Sanctions imposed by the United States and the European Union on trade with Iran and Syria have exercised the insurance industry. P&I clubs have taken the lead on behalf of their members, with hull and cargo insurers also drawn in.

“Ignite in the Indian Ocean and increasingly off the West African coast remains an unpleasant thorn in the side of international trade. Attitudes on the use of armed guards have crystallized during 2012 and Marsh has been instrumental in developing a comprehensive insurance facility specifically designed to meet the needs of private maritime security companies, enabling them to meet the recommendations of the International Maritime Organisation.”
CARGO

The Tohuku earthquake, the subsequent tsunami in Japan in March 2011 and the floods in Thailand during the second half of that year contributed to some of the largest marine cargo losses ever recorded. Guy Carpenter has estimated cargo losses following the earthquake of about US$225 million, which is relatively low when compared with the overall severity of the earthquake and its aftermath. Total marine cargo losses attributable to the flooding in Thailand has been estimated at about US$500 million.

Although significant, these figures are put into context when compared with global annual cargo premium, estimated at US$12.8 billion in 2011.

Nevertheless, recent losses are having a negative effect on cargo markets with underwriters unable to deliver the returns that they anticipated as margins are squeezed. This has led to some underwriters taking a tough stance, refusing to renew risks unless their pricing expectations are met. However, any market desire to deliver a more technical price for cargo insurance has been undermined by new capacity entering the market. Buyers have been able to make use of this new capacity to replace those underwriters refusing to renew cover without a premium increase.

The cost of insurance will always be determined in large part by the availability of capacity, and despite recent losses...
there are no signs to suggest that overall market capacity will do anything other than increase in the foreseeable future. At Lloyd’s alone the Alterra, Apollo, Channel, Flagstone, Pro-Sight and WR Berkley syndicates have all commenced underwriting a cargo account in the recent past.

The easy availability of underwriting capacity has meant that insurance buyers delivering a well managed and profitable marine cargo account to the market can still expect to secure reductions when renewing their programs. While reductions are not likely to be of the level seen in the recent past, savings of 10-20% can be achieved if loss ratios and risk profiles are deemed to warrant this.

The property damage losses attributable to the extraordinary succession of natural catastrophes recently has led to an increase in property insurance premium and has brought with it a stock throughput opportunity to the marine cargo market. Cargo underwriters are able to offer stock throughput coverage competitively as property premiums have risen and as a result are securing significant new business. In general underwriters have approached this opportunity cautiously and will focus closely on each insured’s exposure modeling as it related to catastrophe perils as well as their loss prevention strategies.

The only brake on the movement of stock throughput to the cargo market is the level of premium reduction that property insurers will allow if the inventory risk is removed from their coverage. This can be a difficult balancing act, but there does seem to be at least a general willingness on the part of the property market to take a realistic approach to this issue.

New business opportunities to the cargo market from stock throughputs will help offset a reduction in project cargo business, as infrastructure projects are postponed or cancelled due to the precarious state of much of the world’s economy.

From 1 July 2012 organizations that are based in countries that are members of the European Union are prevented from importing oil from Iran, extending a similar ban imposed earlier by the United States. These sanctions are designed to reduce Iran’s oil revenue, which the US and EU believe it relies on to fund a nuclear weapon development program. The sanctions also prevent insurers and reinsurers in member countries from insuring Iran’s oil exports. This has proved problematic for China, India, Japan and the Republic of Korea, which reportedly between them buy two-thirds of the oil exported by Iran but in large part rely on insurance companies in the US and EU for insurance and reinsurance covering oil shipments.

Governmental solutions have been considered within these importing countries and it was reported in June 2012 that the Japanese parliament has agreed to provide governmental guarantees on insurance covering crude oil imported from Iran.

Piracy and the seizure of cargo laden ships in the Indian Ocean and elsewhere has been an ongoing headache for the cargo insurance market. Pirates have become better organized and better informed and fully appreciate the value of both the ship and its cargo, which has contributed to increasing ransom demands. The value of the cargo on board a captured ship will frequently easily exceed the insured value of the ship itself, particularly as ship values have fallen in recent years. This means that the cargo market’s proportion of any general average claim following a ship’s seizure by pirates is likely to be proportionately large.
HULL AND MACHINERY

Despite the pressures on the hull market from piracy, the Costa Concordia loss and the looming implementation of sanctions on the export of Iranian oil, the insurance market still shows no real signs of turning.

Overcapacity in the market and the low impact on the sector from the natural disasters of 2011 has continued to pressure rates at a time when the risk environment remains volatile.

The International Union of Marine Insurance (IUMI), the organization that represents the global marine insurance sector, has issued its 2012 Spring Statistics which provide a comprehensive view of the scale and size of global marine markets and current claims trends.

For hull and machinery underwriters, the major cause of serious losses remains machinery damage and engine room problems, accounting for more than 35% of incidents over the last five years. Age matters to underwriters as IUMI’s figures showed that 50% of all major incidents reported occurred to vessels in excess of 20 years of age.

While the number of major incidents in 2011 remained consistent with the trends over the previous four years, deterioration of back years has continued with the likelihood that the past year will follow a similar path.

The number of total losses recorded worldwide for 2011 stands, at present, at 55. This is down from the 63 total losses reported by IUMI a year ago for 2010. However, the 2010 year has since deteriorated. Reported total losses have increased for the year from 63 to 87 and for 2009 from 67 to 86. The concern is that this might suggest that 2011 will eventually return a similar number to both of the preceding years.

Piracy is still a major issue for the insurance market on a number of levels – the cost coverage and questions remain over how to structure the cover alongside kidnap and ransom products. While piracy in the Indian Ocean and the Gulf of Aden remains the biggest concern, there is a growing threat in West Africa, particularly off the coast of Nigeria.

In terms of the war risks, the piracy issue has seen pricing harden as loss ratios increase and the debate on the use of armed guards has continued. The majority of underwriters are now willing to accept armed guards on board. However, this has prompted discussion between underwriters and shipowners over the terms on which armed personnel are on board and liability issues that would arise should there be an incident. This was highlighted earlier this year when two Italian marines on board a vessel opened fire on a group of Indian fishing vessels believing them to be pirates preparing to launch an assault, killing two men.

The planned sanctions on the coverage of Iranian government-backed companies and their activities have been in place for some time. However, the implementation of the ban on insurance coverage for the exportation or transport of Iranian oil which comes into force in July is causing the underwriting market and clients significant problems.

With countries such as Japan, India, South Korea and China being the major importers of Iranian oil, it has been a major issue for the P&I Clubs, but it is also impacting hull insurers to a significant extent. Given the heavy weighting of hull capacity in London, elsewhere in Europe and the United States it is difficult for owners to find the level of coverage needed. While there is talk of governments looking to create sovereign solutions to ensure exports, the talk has yet to be transferred into any concrete action.

The Costa Concordia loss is expected to cost the hull market US$500 million and liability underwriters a similar sum. The loss is estimated to have accounted for between 6% and 7% of the world’s hull premiums with the majority of losses likely to end up in the Lloyd’s market. However, the loss’ impact is contained as the risks were not extensively spread across the underwriting community.

While there have not been any significant rate increases some capacity has exited the market this year, the most notable being CV Starr in the United States. However, there has been little contraction as new entrants have also been in evidence, such as Aegis in the London market, so the pricing pressure caused by excess capacity has not lessened.
Given that there is between US$1.5 billion and US$2 billion of capacity for hull risks there is still more than enough capacity to meet the demands of shipowners. As such, pricing is still deflated.

New entrants are hunting volume to enable them to write the level of premiums that makes the class viable. To do so they are using price as the core attraction.

Reinsurers may have a say in the market with what looks to be a tougher stance on risks but at present there is no discernible trend on programs.

Despite the major losses of the past two years in the marine and energy sectors, there is still no realistic natural disaster scenario that would have the potential to cause a significant turn in the market.

In terms of man made catastrophes, with the ongoing sanctions surrounding the export of Iranian oil in mind, the “Armageddon” scenario would be the total blockage of the Strait of Hormuz for a period of months. This would cause a huge loss to the market, although in our view such a scenario is highly unlikely as there would almost certainly be military intervention to reopen the seaway should it occur.
SHIPBUILDERS’ RISK

Insurers face walking a tightrope between pricing discipline and the need to utilize their capacity as the level of newbuilding contracts fell dramatically in the first half of the year.

This comes against a backdrop of shipyards and shipbuilders facing some tough questions over their future as orders dry up and underwriters look to meet the challenges of downward pressure on rates against the need to balance their risk portfolios across marine classes.

The start of 2012 has seen record numbers of newbuilding deliveries but a stagnation of the number of new shipbuilding orders. In January 2012, no new containership orders were received according to Clarkson’s, which is in stark contrast to January 2011 when a glut of new containership orders continued unabated through to the end of 2011.

Shipbuilders are fighting to maintain market share in a difficult shipping environment which has seen a significant slump in freight rates across all conventional shipping sectors. With the shipping industry already facing a serious oversupply issue this is unlikely to change in the short term.

Nevertheless, there are still some owners looking to make speculative newbuilding orders having viewed the challenging conditions of the ship charter market as temporary. Shipbuilders, however, are mindful of the economic situation in Europe and the potential for this to make financing hard to come by for existing and new orders, with some order cancellations having already been experienced.

The major global shipbuilding groups have been proactive in focusing their sales towards segments of the shipping and offshore markets where demand is increasing. In addition, the ability of the larger conglomerates to soften newbuilding prices to exploit buying interest amongst their customers is securing market share. The demand from Japanese and South Korean consumers for Liquefied Natural Gas (LNG) and the seemingly endless drive towards oil exploration and production is continuing to generate a more than adequate diversion from conventional shipbuilding activities.

Overall however, we predict a period of consolidation in the shipbuilding sector and also a period where some of the smaller yards will see orders dry up altogether, inevitably resulting in yard failure. Shipyards are also trying to mitigate their exposure to current trends by focusing efforts on improving the efficiency of their ship designs to promote overall cost savings for shipowners.

A number of marine market insurers have focused on achieving a greater balance in their portfolio between marine navigating risks and construction risks in recent months, in light of favorable underwriting results in the shipbuilding sector and unfavorable navigating results. Shipbuilding risks are producing profitable underwriting results for insurers, especially for those insurers writing a good spread of risk.

The recent fall in newbuilding volumes should have given insurers sufficient ammunition to increase premium levels as shipbuilders’ insurance buying power is diminished and pricing levels had already reached a minimum for top quality yards. However, on the back of worsening marine results in the latter part of 2011 and early 2012, insurers are unlikely to take any radical steps in the short term towards increasing prices for those yards which have reduced volumes but have consistently generated good underwriting profit.

A drought of new conventional vessel contracts combined with an abundance of marine capacity will see insurers continuing to compete for market share. This will result in continuing downward pressure on rating and undermining of theoretical pricing boundaries, potentially jeopardizing the stability of pricing and insurer profitability.
Notwithstanding this, with increasing reinsurance costs for direct insurers, following the spate of significant natural catastrophe losses during 2011, the downward pressure on rating could be mitigated in part by direct insurers passing on these costs to direct insurance buyers. In reality this may not happen with insurers favoring to reduce their capacity for yard risks in areas with high aggregation or high wind storm exposure.

Marine insurers’ ability to maximize their role in leveraging pricing and maximize market share for marine and energy hybrid construction risks continues unabated. However, in light of some recent offshore operating losses which have been picked up by the marine market, there is general consensus that insurance of risks endemic to the offshore industry, for example, hook-up and commissioning risks at site of operation, are taken up with the energy market.

The marine market has more than adequate capacity for the majority of construction risks but large capacity risks will continue to test the market. This is evident in the construction of offshore units and naval risks where risks in excess of US$750 million present placement challenges in terms of pricing, breadth of coverage, availability and commitment of capacity, especially for risks where there are aggregation issues or natural catastrophe exposures. Theoretically a marine construction risk with a contract value in the region of US$1.8 billion can be placed in the international marine market, by layering the placement to limit insurers’ aggregate exposures where necessary and to optimize the breadth of coverage.

Brazil continues to lead the charge in terms of emerging shipbuilding markets especially within the offshore industry and associated industries. Shipbuilding contracts are typically drafted to promote local content in terms of labor and supply of equipment and insurers’ focus will continue to be on technology transfer agreements with established experienced shipyards, to ensure that best management practices are adopted and technology advances are shared.

Globally shipyards with naval/combat capabilities are increasingly looking to capitalize on their experience and are seeking viable export markets in much the same way as evidenced in recent years by the offshore sector. Where risks are insured in the commercial markets, marine insurers will want clarity of construction responsibilities between the export yard and the purchaser in terms of where the work will be undertaken, training of workforce, management of subcontractors and the scope of technology transfer agreements.

The risk assessment process for construction risks, typically performed by the undertaking of a JH143 survey for the yard or specific to the project, on behalf of underwriters, is as important today as when first introduced and has ultimately been responsible for the improvement in industry standards and greater transparency between insurers and shipbuilders globally. As risk profiles change, the JH143 survey will continue to play an integral part in the assessment of risk and ultimately insurers’ ability to offer coverage with pricing and retention levels commensurate to the perceived level of risk.

Whilst new business opportunities are present for insurers, the risk landscape has changed and insurers must weigh up the dynamics of writing more specialist construction risks, in terms of commitment of capacity for longer periods and management of reinsurance costs, against losing out on market share and a potential for imbalance within their overall marine portfolio.
MARINE LIABILITIES

The liability market remains flat. While there has been a great deal of talk over current market trends, it remains just talk, with very little actual movement.

The market has been marked by significant recent losses with oil pollution and other claims following the grounding of the Rena off New Zealand estimated at around US$125 million and liability claims from the Costa Concordia expected to be in the region of US$500 million.

At present these figures remain outstanding reserves, but when the claims are presented we expect underwriters will look to pricing. We anticipate that those insureds that have suffered sizeable losses will see significant increases to premium applied at renewal.

The Rena and Costa Concordia casualties have highlighted the changing risk dynamics of liability claims.

The environmental issues surrounding the Rena loss had highlighted the levels of potential exposure. In consequence underwriters are assessing how to react to rising claims values.

Local authorities are now placing greater responsibility on shipowners when problems occur. An owner whose ship is involved in a major casualty, and particularly a casualty with a serious environmental impact, cannot expect to secure free use of the ship quickly and the imprisonment of senior members of the crew of the Rena has brought the issue of criminalization of seafarers back into the spotlight.

One major and worrying issue for the market at present is the soaring costs associated with the removal of a wreck. The cost of wreck removal is escalating for a number of reasons, primarily because there is a shortage of specialist equipment which is shared across both marine and energy sectors, which means that cost of hiring the equipment is extremely high.

While the marine liability market in general is pushing for increases at renewal, their efforts are being undermined by new capacity. New insurers have not been affected by the recent major losses and their need for market share is putting downwards pressure on rates. We anticipate steady rating movement rather than any sizeable shift and certainly don’t expect to see the volatility encountered post 9/11 when rates across the industry rose sharply.

The TT club, the market leader for liability insurance for ports and terminals, has been looking to apply a 5% general claims inflation increase to all ports and terminals renewing on a like-for-like basis. In addition, any members with a program in place with limits above the TT Club’s own limit retention of US$5 million can expect to come under increased scrutiny due to an increase in reinsurance costs being experienced by the club. On certain renewals we have also experienced a desire from the TT Club to reduce their overall exposure to placements with high coverage limits.

While no formal announcement has been made by the TT Club in relation to the underwriting renewal parameters discussed above, we understand that these were approved at board level within the club. It may be that, in practice, the TT Club will take a generally more positive view or take a more commercial approach on large revenue generating accounts that are performing well.

The market for terminal operators’ business remains competitive with recent new entrants providing additional capacity. We can expect the market to remain competitive and to be eager to quote competitive terms on terminal accounts, particularly those that are performing well with evident good risk management procedures in place.

Individual underwriter appetite will in part be determined by the extent and size of the insured’s operation. Certain underwriters will avoid involvement on a primary basis with large and complex global terminal operations with multiple exposures. This might limit the availability of a “lead market” for a primary terminal operator’s liability program for large multinational terminal operations.
Generally though, the cost of primary terminal operators’ liability programs remains competitive. We are seeing pricing staying flat and even some reductions due to increased competition in the sector.

As terminal operators look for new ways to generate additional revenue to supplement their day-to-day business operations, we have seen them requesting input from insurers during the planning stage of new business ventures that may impact insurance arrangements. This is prudent risk management on the part of the insured and Marsh is well positioned to assist with this process through the assistance of colleagues within the Risk Management practice.

Ownership structures of ports and terminals are becoming increasingly complicated and we are seeing evidence of private equity investment having an increasing influence on insurance buying decisions. Terminal businesses with fragmented insurance programs are keen to explore ways to consolidate their insurance coverage and, where possible, benefit from the additional leverage and economies of scale that global programs can potentially provide.
ISSUES AFFECTING THE P&I MARKET POST 2012 RENEWAL

The renewal season that many shipowners had been hoping for turned sour, as the reality of the deterioration in old year claims and the increased loss incidence in the 2011 policy year was realized.

The impact of increasing claims only came to be felt as general increases were being assessed. Various clubs commented that, had they known just how severe the deterioration was against expectations, they would have sought increases considerably higher than those announced.

Proposed increases were strongly resisted by clubs’ boards. Managers at those clubs where free reserves had recovered to post 2009 target levels were being told to budget for losses in 2012 and accept the erosion in the club’s working capital.

At renewal both the clubs and their members were concerned about the immediate future; differences in opinion as to how renewals should be concluded were animated. Shipowners were doing all they could to limit increases and club managers were concerned how to limit the damage caused by the anticipated depletion of capital ahead of Solvency II.

This was complicated by certain clubs adopting a different approach to renewal. In simple terms 5% did not provide a persuasive signal to shipowners that urgent remedial treatment was needed. In reality, this was the year that securing increases approaching the announced general increase, both cash and deductibles, was deemed by the clubs’ senior management to be essential.

TRENDS DETECTED THROUGH RENEWAL

Britannia, Gard, Standard and Steamship all reported adverse underwriting results at mid-year. This was attributed to swings in expected year-end combined net ratios of as much as 20% higher than those recorded in February 2011.

UK Club and West of England adopted a softer approach, apparently not feeling the effect of the claims upswing that was noted by the majority of clubs. Not having been able to attract new tonnage in the years following their 2008/9 rounds of unbudgeted supplementary calls, might have benefited them. Their premium base will have been diluted less as the competition for new tonnage was concentrated at other clubs. UK Club are confident they will repeat their February 2011 break-even underwriting result, whilst West again expect their underwriting loss to have halved in percentage terms.

The low incidence of Pool losses during the 2010/11 financial year will have flattered most clubs’ underwriting results at the last reporting date. Since then, reserves previously set have been found to be inadequate, with one previously unreported 2007 claim being settled at over US$30 million. Combined with a 2011/12 policy year that is expected to be worse than any of the past three years, the outcome will be higher than the recent trend would have suggested but probably within what most clubs will have budgeted.

Marsh detected a more austere attitude to adverse claims records than in previous years. We have felt that the system of applying general increases, in excess of claims inflation, has been perpetuated because it compensates for the erosion of the average earned premium per gross ton brought about by “the churn”. The consequence, we believe, is a cost to members that is disproportionate for those with long-established tonnage in a club.
We have also concluded that clubs’ boards have sought to apply pressure on their managers to reduce the subsidy paid by good performers and a need to accelerate the redress of the more acute negative cash balances, by bringing retained premium levels closer into line with members’ medium-term loss cost. The effect is seen in some markedly higher increases than have been experienced before.

Not all clubs have adopted this approach, but our dealings with a couple certainly indicated the theory to be proven with owners with poor records being asked to pay a lot more than they might have expected in earlier years.

CONCLUSION

- The tougher negotiating stance adopted by most managers this year means that most clubs are reporting returns closer to their announced general increases than would normally be the case.
- Softer results were recorded at UK Club and West of England.
- In addition to the deductible increases integral to the general increase, some owners opted for voluntary deductible increases to offset against cash rises.

QUESTIONS THAT WILL SHAPE ATTITUDES AHEAD OF 2013 RENEWAL

- Just how bad are the predicted 2011/12 year losses really going to be when they are reported?
- Was the sharp acceleration in claims incurred in mid 2011 merely a blip or will the increase be sustained? We note that:
  - claims did slow through the third quarter of 2011
  - the fourth quarter produced, amongst others, the Costa Concordia loss
- Were the increases achieved adequate to meet the claims anticipated for 2012?
- If not, the general increases for 2013 will have to be inflated to make up the deficit brought about by the deferral imposed by clubs’ boards.
- Are there any signs of a resumption of economic growth?

RETURNS ON INVESTMENT OF CLUB ASSETS

All club managers will have set their sights lower for this year than in the past and this has placed greater focus on getting the underwriting right. Most managers continue with asset allocation strategies that have reduced the exposure to risk to their capital, partly out of prudence, partly to satisfy the ratings agencies and regulators.

Thanks to a strong (but unpredictable) performance from the markets in the first weeks of 2012, immediate post 20th February discussions reveal a much better closing result than any manager could have expected at the turn of the year.

In turn these positive returns could convert underwriting losses into positive contributions to free reserves, which themselves will need expanding given the GT 80 million of net new tonnage which will have attached through 2011/12 and the corresponding increase in call income.

Caution will continue to prevail and will not permit any relief in the pressure on the target underwriting ratios.

REINSURANCE

The announcement of the composite rates, to be passed on to shipowners to finance the International Group reinsurance programme, occurred only hours before the loss of Costa Concordia. Renewal premiums had been agreed by leaders however, many of the following markets had not yet been shown the renewal.

The reinsurance brokers had to withdraw and found themselves renegotiating revised terms on behalf of the clubs. This could have been due to the Costa Concordia loss but we are inclined to believe the hiatus arose from the significant upward revision to the claims payment for the Rena that took place at about the same time.

The original terms had seen welcome reductions in rates on the back of forecasts of a further large increase in tonnage trading during 2012 and continuing sound record. These rates were held for 2012 but the shortfall in
the premium that will now be raised against the clubs will have to be met from their retained premium. We understand that the additional charge is in the region of US$40 million, adding about 1.4% to clubs’ combined net ratios.

In February 2013 the reinsurance market will expect to achieve higher rates than it has managed this year through their obstructive stance. The challenge will be in gaining an equitable apportionment of the increases between the different classes of tonnage.

After a tough renewal process ahead of the 2011/12 policy year, attention was still focused on those clubs involved in the offshore sector and the associated non-poolable reinsurance programs. Standard did manage to renew to the limits they sought (US$1 billion) but others struggled, none more so than Gard who had suffered from an unfortunate series of losses.

The problems suffered by the Group brings into question the near monopoly appointment of T.R. Miller as brokers to the clubs. Their interaction with the market provides so much of the capital the clubs need to be able to offer the product they pronounce so proudly. We do not see it as a coincidence that Gard’s offshore reinsurances, also entrusted to Miller, suffered the same fate as the International Group and had to be renegotiated.

REGULATION

The date Solvency II comes into force has been deferred by a year. But this does nothing to remove the uncertainty surrounding the way in which these regulations will be enforced. With financial authorities increasingly risk averse, the concern is that the bar will be set even higher than has so far been anticipated.

DISCERNIBLE TRENDS

Two leading Scandinavian clubs are gradually converting the use of members’ free reserves into capital to be used for expansion into other insurance activities. Providing the commercial activity generates profit for members and reduces the amount by which members of the mutual part of the enterprise have to contribute in calls, then the trend can be endorsed as positive. Our concern, however, is that these activities are not necessarily counter-cyclical to their core business of P&I and therefore could, in some years, lead to higher increases being levied against mutual members in order to recapitalize their commercial activities.

We were surprised to hear, from one club in a meeting with a member, the use of the expression ‘making a return on capital’ when assessing rating levels. We have also noted another club has amended their rules regarding voting rights to be based on premium volume, which looks more akin to a ‘one share – one vote’ structure seen in limited liability companies. Are these the seeds of a new generation of hybrid marine insurers who use the International Group framework as the foundation for commercial growth in other areas?

ATHENS CONVENTION 2002 PROTOCOL/EU PASSENGER LIABILITY REGULATION 329/2009 (PLR)

Existing passenger liability compensation limits will increase significantly when PLR comes into effect on 31 December 2012. Athens 2002 will follow during 2013. The clubs have now confirmed they will issue the prescribed certificates (blue cards) for risks other than war and/or terrorism. Marsh’s proposed scheme to issue the war/terrorism blue cards is well advanced.
PIRACY AND THE ARMED RESPONSE

Piracy remains a hot topic as the threat and the solutions to this threat continuously change. A year ago most transits were unarmed; today very few are. Flag states have, one by one, changed their policy to allow armed protection with the Netherlands now standing out as a notable exception in resisting this next step. This resistance remains questionable particularly as underwriters are losing their appetite for writing insurance on unarmed transits.

Successful pirate attacks in the Gulf of Aden and Indian Ocean have reduced a little over the last year but pirates are becoming more collaborative and a common view is that they are retrenching rather than retreating. There are also signs that the threat of piracy may be beginning to escalate in the Gulf of Guinea.

It is not difficult to identify the issues that will be the main features of the year ahead.

REGULATION

There are widespread concerns about the unregulated environment in which Maritime security Companies operate because the consequences of unprofessional and poor practices have a wide ranging impact upon individuals and companies alike. Views differ as to whether the solution should be statutory regulation or a ‘quality’ regime and whether the best solution can be found locally or through an international system.

At present the IMO are looking to the ISO organisation to introduce best practice and accreditation. In the meantime audits programmes such as the SAMI accreditation process and audits performed by other independent companies seem to the best solutions available.

GUARDCON

The BIMCO contract is generally seen as a valuable addition to the industry although PMSCs do not seem to have been consulted until the eleventh hour making this feel like an owner’s contract. That said, the insurance conditions of Guardcon (with the exception of the obligation to insure the uninsurable unlawful act) have built upon the IMO insurance guidelines and are now generally accepted as a sensible benchmark.

We are seeing a number of PMSCs adopting Guardcon as their standard contract, although many of the larger players still seem to be contracting with existing clients on their pre-existing terms. If this is a reflection of anything it probably suggests that Guardcon would have been happily received a year earlier.

CONSOLIDATION

The number of PMSCs looking for business still seems to be growing. SAMI now have 160 members but we estimate that there are another 100 to 150 companies offering Maritime Security that are not members.

Naturally the supply cannot continue to grow indefinitely and many forecast an imminent consolidation of the market. While rationalization is likely to happen, as it does with all new industries, only time will tell which companies will succeed through size and which will succeed through specialization and expertise.

INSURANCE

Whilst regulation, client relationships and financial strength will all define the industry, so will insurance. There are a number of organizations reviewing PMSCs insurance arrangements and providing advice to shipowners. Their guidance will have an impact on
which PMSCs are able to win business and ultimately survive. At present some PMSCs are prepared to underinsure as long as their premiums are low, but many others are oblivious to the deficiencies of their cover. The most common insurance problems arise through buying separate policies from separate underwriters that do not hang together properly, the used of ‘adapted’ policies that were designed for another purpose such as onshore security, policies with inappropriate exclusions and misunderstandings of the various contractual responsibilities that the PMSC has agreed to. It is for this reason that Marsh launched a comprehensive facility earlier this year with a panel of underwriters, all of whom share in each of the main risks in equal proportion.

PIRATES’ NEXT MOVE
At present the shipowners with armed security have the advantage. It is still the case that no armed vessel has yet been taken. That said, the pirates are well funded and clearly beginning to work together as we saw recently when about 20 skiffs attacked a vessel together. It seems to be just a matter of time before, with better arms and a better strategy, they become a greater threat to an armed vessel. This is why security companies are developing different operating models and some are beginning to use drones and helicopters.
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