Marine insurance: a mid-year review

It may be summer, but the insurance market is still busy. Heinz Gohlish discusses impending developments in the compensation regime; the review of the Joint Hull Committee's Institute Time Clauses; and the London Market Principles Initiative

The recently hardened marine insurance market is now established as a fact of life with which tanker operators will need to live - at least for the time being. Policy years 2000 to 2001 saw a trough in insurance rates, followed by an unambiguous increase from the start of 2002. Almost certainly, the premium increases will continue throughout 2002 and possibly through 2003. Somewhere near the end of this period the rate of increase will level off as new underwriting capacity begins to have an impact on the marine insurance market and shortly thereafter the quantum of increases will also first stabilise and then settle at a level sustainable over a medium range period.
The two questions of most interest are:

1. whether such stability will be achieved at a level acceptable both to insurers and ship operators, and
2. what might be the additional cost to operators before achieving a more stable insurance environment.

This scenario will probably play itself out over the next two to three years and an answer will therefore not be long in coming.
Such analysis in isolation is a relatively straightforward exercise. Individual operators will have a fairly good idea where they stand relative to the current round of increases. Good operators with large fleets probably need to budget only 10 per cent year-on-year increases, while the less good and those with poor claims records will need to think about +25 per cent increases.
But there are other pending issues which complicate this type of analysis. The wild card of course is future claims. One or two significant (say, $100m plus), headline-grabbing (severe environmental damage, significant loss of life) tanker claims will push the window of continuing increases further into the future. While no specific allowance can be made for such eventualities at this time, the possibility of aggravating an already difficult market must always be kept in mind.
Therefore, as we approach the summer lull in insurance activity, this may be an appropriate time to review two aspects which will affect the next tranche of premium increases: claims activity and proposed changes in terms and conditions of marine insurance. A third important aspect - the increasing impact of the international regulatory environment - was noted last month in discussing the importance of the IMO on marine insurance issues.

Tanker Claims

Despite the increasingly poor public image of important marine issues such as flags of convenience, substandard ships and crew training, the marine industry has remained remarkably free of serious claims over the recent years. Indeed, the main maritime incident issues today are those claims in the political arena such as terrorism, piracy and stowaways/ refugees. Pure 'wet' claims have been relatively routine, although the P&I clubs are reporting an increasing number of such claims.
The main concern of insurers affecting tanker operations remains the thorny issue of oil spill compensation which concerns mainly the P&I insurers. The insurance issues are two-fold: actual pollution liability payments and increasing exposure to pollution liability through more onerous national legislations and international conventions.

To date, a total of 15 pollution incidents have fallen within the provisions of the 1992 Fund Convention. Of these, two have exceeded the Fund limit. Three recent pollution accidents have been sufficiently serious to draw the attention of legislators. These are:

- Erika (France, 1999) - 19,800 tonnes of heavy fuel oil was spilled. The 1992 convention makes available a compensation of $175m. Total claims will exceed this figure.
- Nakhodka (Japan 1997) - 6,200 tonnes of oil was spilled and the total claims exceed the 1992 Fund Convention compensation fund of $188m. (For more details on the above claims, see TO March, 2002)
- Sea Empress (Wales, 1996) - 72,000 tonnes of crude oil and 360 tonnes of heavy oil was spilled. Total payments to date are about $74m and these will fall within the compensation figures of the 1971 Fund Convention.

[Tonnage and compensation figures from Seaways , The International Journal of the Nautical Institute, June 2002, pp. 10-11.]

These high profile accidents have led to several governments, as well as IMO and the EU, to call for higher compensation figures and a more stringent liability regime for both ship and cargo owners. Already, higher limits under the 1992 Fund Convention have been agreed up to a maximum of $256m for a vessel over 140,000 gt, of which $113m is the shipowner's liability. These will come into effect on November 1, 2003.
It will not stop there and tanker operators and their insurers can expect further activity in this area over the next few years. However, for the immediate future, these adjustments should already have been factored into the renewal terms. With no further major accidents, liability insurance costs for tanker operators should achieve some reasonable equilibrium over the next two to three years.
The great unknown is what will happen if there is another oil spill accident at the level noted above. Almost certainly the pressure on legislators will become too severe to allow for any compromise and shipowners will feel the full effect of a substantially increased Fund and a tougher liability regime. Insurers will respond in kind and controlled moderate increases will be harder to sustain. The bottom line would be significantly higher insurance costs.

New terms and conditions
The impact of terrorism on war risk insurance has already been noted (TO November, 2001). However, the overall effect of terrorist activity on marine insurance goes well beyond war risk cover, which can be described as a self-contained sub-set of marine hull insurance. It spills over into the very fabric of marine insurance with a direct impact on hull clauses and conditions of accepting risk.
It is fair to say that a major review of hull clauses was already underway before terrorism and war risk took centre stage. The Joint Hull Committee (JHC), for instance, had already begun to conduct a comprehensive review of its Institute Time Clauses 1/11/95 (ITC). The committee hopes to have a new version in place by November 1, 2002, and therefore ready for the 2003 renewals. The new wording will also address such back office issues as claims handling procedures and payment of premiums, and may also incorporate certain non-marine concepts such as dealing with fraud and reform of insurance contract law.
The importance of this review and any changes to clauses and concepts go beyond the London-based JHC. The wording tends, in part, to become the model for hull insurers worldwide. The committee is therefore consulting insurers and legislators on a much wider basis than in the past. The 2002 wording will likely incorporate some of

the better provisions of the 1983 wording and that of the USA and Norway. The result could be a more widely accepted form shifting somewhat in favour of the insured.
The JHC is also reviewing the concept of Warranties in some detail. There is the question of whether warranties, as traditionally used in a policy of marine insurance, can survive in their current form. They are seen by insurers and insured alike as inflexible and unfair in that a breach of warranty cannot be corrected in order to re-instate cover and a warranty can be used to reject a claim even if not directly related to the incident. Implied warranties such as seaworthiness may also be abolished. One alternative is to replace these with express terms that clearly lay out the condition of cover and which are relevant only if directly affecting the claim. This is also more in line with international insurance practice.
Warranties, or their successor clauses, may also be used to give effect to IMO conventions and national legislation where relevant. This will be welcomed by those ship operators who comply rigorously with best practice in order to differentiate themselves in a meaningful way from the non-compliant competitor. The impact on tanker operators will be significant if such clauses become conditions under a charterparty. It is also a tentative step in the direction of insurers having a monitoring role in the enforcement of agreed standards.

Other developments

Finally, as a separate development, there is the London Market Principles 2001 (LMP) initiative. This is designed to be a fundamental reform of the way the London insurance market conducts its business. This will include a more transparent comparison of performance, both among insurers and insurance brokers. A new joint committee, the London Markets Standards Committee, will help to implement these reforms. Ideally, these initiatives should assist the ship operator in distinguishing between the various levels of underwriting security, claims support and broker assistance that may be available to him. Whether or not the reforms will provide this assistance remains to be seen.
The next few months will therefore not be without interest. The direction taken with the fundamental issues of pollution compensation, wording changes and market reforms will directly affect the premiums required for the next round of marine insurance renewals. Many insurers do not see a reasonable prospect of at least breaking even in the 2003 policy year without premium increases - let alone recovering past losses.
Ship operators will therefore need to be aware not only of potentially higher insurance costs but also of possible reductions in available cover and of changes in principles in the application of underwriting clauses.