

## **Trade Disruption: A Case for Tankers**

**Historically, tanker operators have not been notable participants in this specialised and complex area of marine insurance. However, with international trade facing increasing uncertainties and politically motivated interference in shipping becoming more commonplace, is this a time for ship managers to review their position on trade disruption insurance?**

Tanker operators have tended to stay clear of the various forms of Loss of Hire (LOH) and strikes insurances, and generally for valid reasons. First, tanker owners and cargo owners are able to avoid many of the charterparty off-hire disputes which cause grief in the dry cargo market. Secondly, terminals are more commonly owned by either the ship owner or the cargo owner and the threat of strikes is considerably less. Thirdly, when freight margins are tight this class of insurance is seen as "discretionary", unlike Hull or P&I which are unavoidable. Fourthly, this class of insurance is often driven by banks that are protecting the earning power of their asset during the life of their loan, and is often seen to be less important when banks are not involved.

### **Evolution of TD**

Simon Bradley of Transmarine states that about 12% of Transmarine's total entered vessels are classified as tankers in their various types. This is surprisingly low in relation to the wet cargo industry as a whole. But are tanker operators missing a beat here? The last few years have seen important changes not just in the risk environment but also in the LOH product which is now available to operators. Changes in the international shipping risk environment affect all vessels, but perhaps tankers more than most: Refugees and political migrants can cause severe disruption to contracted voyages (the "Tampa" could just as easily have been a tanker); tankers are being forcibly diverted from their usual routes in defiance of international law; trade embargoes are increasingly becoming a tool of international diplomacy; certain illnesses are having a wild-fire effect on regional trade (eg; the Sars virus, which has caused many masters to check their locker for Flag Quebec); and also the good news - freight rates are currently strong and these need to be protected when the times are good.

At the same time, and quite separately, at least one LOH insurer has developing a much wider and significantly more sophisticated package of insured perils - those that go well beyond the traditional loss of hire scenario. Loss of Hire has evolved into a more widely applicable Trade Disruption (TD) insurance, which broad objective is to protect the ship operator from any fortuitous perils that interrupt his flow of earnings. This is now an "earnings" protection insurance to be used in the same manner has hull insurance which is simply an "asset" protection. All this follows best business practice elsewhere where large assets generate a variable and lumpy income stream.

### **TD in Action**

From a pure charterparty loss of hire protection, the trend has been to widen the "protection of earnings" aspects in order to cover trade disruption from whatever reasonable source, including:

#### **General Trade Disruption Cover:**

- Fire or explosion on land, including contact with aircraft
- Weather related delays
- Natural disasters such as earthquakes

- Capsize of conveyance (eg fuelling or cargo barge)
- Emergency port closures; Master's refusal to enter
- Machinery breakdown - Hull perils
- Abnormal obstruction of a berth
- Political risks, incl. border closure, expropriation, embargo
- Illnesses etc. incl. Infectious diseases, arrest, quarantine
- Pollution
- Stowaways, refugees, detention, acts of piracy, drugs
- Blocking and trapping

Trade Disruption insurance is therefore activated on the occurrence of an insured event which deprives the ship owner of the gainful employment of his vessel. The insurers recognise the extent of capital that is applied to a sea going venture and the cover is designed to ensure that this capital is not left idle due to forces beyond the control of the ship operator. The premium is usually a multiple of an agreed daily running cost (drc) or freight earnings, and the cover is expressed in number of days of drc compensation beyond an initial excess period, also expressed in days.

Therein lies one of the perceived problems of this type of insurance. The minimum excess tends to be as high as 14 days for Hull and Machinery perils (but 4 days for other perils). Some operators can improve on this if they are large enough (spread of risk) and if they already have an established record. For most however, 14 days is the entry point. For tanker managers, working on a voyage basis, this may seem high, The maximum cover is usually 90 days which appears reasonable and should be sufficient time for tanker operators to re-deploy their ships.

The cost is also not insignificant. For a standard 14/90 days cover, the premium will run between 3½ to 4½ days hire. Therefore, with a daily freight income of, say, \$30,000, a premium of about \$120,000 (\$330/day) will buy an indemnity of over \$2 million once the excess has been exceeded. Is a premium/indemnity ratio over 5% a reasonable trade-off? This is at the serious war risk level. But this covers a full year's operation in a nominated trade and may therefore be a valid comparison. Another way of looking at this is that about 1.1% of the gross income stream will protect that income, excess of \$420,000, from the various forms of trade disruption. If the excess were a bit lower, say 7 to 10 days, then Trade Disruption may evolve into a "must-have" insurance for the serious operator.

### **Strikes Insurance**

An important sub-set of trade disruption, but entirely separate from it, is Strikes Insurance. This had previously been the central focus of disruption type insurances but the recent widening of Trade Disruption has put the two on a more or less equal footing, albeit still with its specialist providers.

Strike insurance is usually divided into two separate classes - strikes by own crew and strikes by shoreside personnel. In each case the premium is a multiple of the daily running costs (or charter hire) and the cover excess is expressed in days, usually 2 to 6 days, and the cover limit is usually between 15 to 45 days. The total indemnity is therefore drc × days insured and this operates on the same principles as Trade Disruption. Two significant events of last year - the USA west coast strikes and the Venezuela debacle - lasted well beyond the usual indemnity period.

The potential benefits of strike insurance depend very much on the vessel's trading pattern. Strike hot spots vary from year to year but usually Brazil, Finland, Israel, Canada, Australia, Nigeria and Korea feature on most lists. The trend appears to be towards increasing strikes after a bad 2002 experience in the USA West Coast and in Venezuela. Both Europe and Australia are considered vulnerable. The Strike Club earlier this year announced a 12.5% general increase for 2003, thereby capitalizing on the general upward trend of insurance premiums elsewhere, but at a more moderate level than the P&I Clubs.

## **Insurers**

Traditional loss of hire insurance was often an add-on to hull insurance and covered by the same underwriters while strikes insurance was covered by a more specialised market. Some P&I Clubs offer strikes insurance as a separate class of cover although this is not a dynamic area for them. Nevertheless, a mutual market developed over the recent years for both strikes and TD, albeit the mainstream P&I Clubs have generally steered clear of LOH/TD risks.

Today the ship owner has a choice between two experienced specialist providers of this insurance - each operating under a different principle: Transmarine having been successfully converted from a mutual to a fixed premium facility, managed by Michael Else and Co. Ltd. and underwritten by Great Lakes Reinsurance (UK) Ltd., backed by Munich Re, and the Shipowner's Mutual Strike Insurance Association (Bermuda) Ltd. (The Strike Club) which remains resolutely mutual with over 45 years of operation. The Strike Club is managed from Monte Carlo and directed by its board of ship owners.

Trade disruption and strikes can seriously ruin a tanker operator's day. In a more volatile world with increased political activism, a lower tolerance for commercial priorities and a general lack of support for the maritime industry by legislators and extra-national bodies such as the EU, the dangers of loss of revenues are increasing. With the current reasonable freight rates, an operator should be looking very seriously at his existing trade and enumerating the many potential impediments to his income stream. The numbers are getting larger and are best not left exposed to the vagaries of international perils that can cause his vessel to swing idly at anchor. It may be that Trade Disruption Insurance, including both loss of hire and strikes, will eventually be seen as an unavoidable cost of ship operations - a third tier of insurance standing beside Hull and P&I. For that to happen, risk managers need to perceive this insurance as a necessary adjunct to their risk management programme. A lower excess point would help but there is a cost attached. At the end this is, as ever, a trade-off but one which could prove beneficial to a tanker operator.

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