



E

INTERNATIONAL CONFERENCE ON THE
REVISION OF THE ATHENS
CONVENTION RELATING TO THE
CARRIAGE OF PASSENGERS AND THEIR
LUGGAGE BY SEA, 1974
Agenda item 6

LEG/CONF.13/10
22 August 2002
Original: ENGLISH

**CONSIDERATION OF A DRAFT PROTOCOL OF 2002 TO AMEND THE ATHENS
CONVENTION RELATING TO THE CARRIAGE OF PASSENGERS AND THEIR
LUGGAGE BY SEA, 1974**

Submitted by the International Union of Marine Insurance (IUMI)

SUMMARY

Executive summary: This document attaches two papers produced by insurance brokers regarding insurance-related issues of relevance to the discussion of the draft protocol to the Athens Convention.

Action to be taken: The Conference is invited to consider the information and take action as appropriate.

Related documents: -

1 The International Union of Marine Insurance (IUMI) has expressed views at numerous sessions of the Legal Committee in recent years concerning:

- (a) the importance of security behind insurance cover;
- (b) whether the cover should include wilful misconduct and scope of cover generally;
- (c) the importance of International Group of P&I Clubs cover, with regard to the confidence shipowners have in it and the specialized service it provides; and
- (e) the capacity of insurance cover available.

2 IUMI feels that many of the above issues are considered in papers produced by two leading insurance brokers and we suggest that it may assist deliberations at the Diplomatic Conference for delegates to see these papers, which are reproduced with the permission of the authors.

3 IUMI will be holding its Annual Meeting in September 2002, when the Athens protocol may again be discussed. Any matters forthcoming from that discussion will be reported verbally to the Diplomatic Conference in October.

For reasons of economy, this document is printed in a limited number. Delegates are kindly asked to bring their copies to meetings and not to request additional copies.
--

Athens Convention – Proposed New Protocol

Introduction

Willis has undertaken a brief independent review of the insurance implications of the proposed protocol to the Athens Convention.

Willis the global insurance broker, is one of the world's largest marine brokers and in addition to a large and wide range of shipping industry and marine reinsurance clients, Willis bring an almost unique insight into the insurance ramifications of this proposed legislation as Willis co-brokers the Shoreline reinsurance programme. (Shoreline is a guarantor for Certificates of Financial Responsibility (COFRs) required by the US Coast Guard (USCG) under the US Oil Pollution Act (OPA 90)).

Existing Cover for Passenger Liabilities

Almost all internationally trading ships, including all types of passenger ships are insured by one of the 12 International Group (IG) Protection and Indemnity (P&I) Clubs.

The IG Clubs are mutual insurers, effectively owned and controlled by the shipowners themselves, though day to day running of the Clubs is entrusted to professional managers.

All 12 of the IG Clubs share, or pool, all their claims above US\$5 million each loss up to a limit of US\$30 million. In excess of this US\$30 million 'retention' the IG collectively buys reinsurance up to US\$2.03 billion. In excess of the US\$2.03 billion level the risk reverts to the IG as a whole, up to the maximum limit available, which is a theoretical figure somewhere between US\$4.25 and US\$4.5 billion.

The cover offered by the Clubs is extremely wide, is tried and tested (for around 150 years) and would respond to the vast majority of current ship based passenger liability exposures.

The mutuality and reinsurance arrangements of the IG offer substantial advantages. It unfortunately also limits the activities of the Clubs.

The advantages of IG Clubs include:

- Massive bulk buying of reinsurance. The IG buys reinsurance on behalf of 90-95% of the world fleet, almost certainly the largest reinsurance contract in the world.
- The pool arrangement allows a huge deductible before the reinsurance starts. The size of this deductible enables the reinsurance to be bought more competitively.
- No profit motive. The mutuality of the Club system drives only for an overall break-even result.
- Wide coverage. Because the Clubs are owned / run by shipowners for shipowners extremely wide coverage is maintained.

The disadvantages of IG Clubs include:

- Cover is very wide, but can be relatively inflexible. To be consistent across all the individual Clubs and Members within the Clubs, the resistance to any changes in the 'standard' wordings is intense.
- Linked with the potential inflexibility of cover, minority interests in the shipping world may be not fully accommodated within the system.
- Changes of cover or policy need to be agreed by the ship owning Boards of the Clubs, which requires consensus of a diverse variety of owners across all the Clubs. Consequently the process of change can be time consuming and the consensus achieved can be something of a 'lowest common denominator' decision.

Potential Insurance Problems Presented by the Proposed Protocol to the Athens Convention

There are three principal areas of potential difficulty arising from the proposed protocol from an insurance perspective. These are general difficulties, which would present potential problems, whether or not the current market was a mutual or commercial one.

1. Right of direct action against the insurer.
2. Waiving of cover defences under the insurance policy.
3. Very high compulsory limits.

Each of these significantly increases the difficulty of an effective insurance solution and each limits the availability of insurers able to participate.

Possible Insurance Solutions to the Proposed Protocol

A number of theoretical solutions have been proposed to address the potential insurance difficulties in the draft Protocol. The two main suggestions from a ship liability perspective are:

- Full Cover product: A new insurance product to cover all passenger liabilities suggested under the Protocol. This model would envisage the P&I Club excluding passenger liabilities entirely (though presumably owners would maintain cover for pollution, crew, collision etc with the P&I Club).
- Difference in Conditions product: Again a new vehicle, but this time the main risk is retained with the P&I Club and the new insurance will only respond in respect of risks the Clubs are unwilling or unable to cover. As a template this suggested solution uses the system of guarantors as previously set up to provide Certificates of Financial Responsibility (COFRs) required by the US Coast Guard (USCG) under the US Oil Pollution Act (OPA 90). This model requires co-operation of the IG Clubs.

The following comments apply to the 'Difference in Conditions' model, as the difficulties inherent in this model will be mirrored, but amplified greatly in the 'Full cover model'.

The Difference in Conditions model

The Difference in Conditions model (described by Graham Barnes of BankServe as the 'Inexpensive Solution') uses as a template the COFR guarantor 'solution'. This is a theoretically interesting comparison, however it has serious practical limitations. These will be investigated under the following headings:

- A. Comparison with COFR model**
- B. Availability of Capacity**
- C. Sustainability**
- D. Practical Implications**

A. Comparison with COFR model

As mentioned above the COFR model is theoretically appealing, however the translation to the Athens convention is not as compelling as it first appears. The following highlights some of the material differences.

Existing COFR insurance has the following characteristics:

- Minimal actual risk covered (the 'difference in conditions' cover with the Clubs is very contingent)
- Very low frequency of incident requiring response from COFR provider.
- Potentially high cost if loss in some way remains with the COFR provider
- Relatively low limits of guarantee required.
- Wide spread of tonnage and type – almost all ships trading to and within the USA
- Includes a number of defences for the guarantor under OPA 90, e.g.: act of God, act or omission of a third party, act of war.

The 'Difference in Conditions' Solution to Athens would have the following characteristics:

- Material levels of actual cover required (the 'difference in conditions' with Club cover could be significant – dependent on what is eventually agreed)
- High frequency of incident
- Much higher potential cost of loss
- Very high limits required
- Spread of risk limited to passenger ships
- Proposed that no defences are to be allowed.

It is worth emphasising the different levels of limits required between the two models. The maximum limit required under the COFR model currently is US\$396 million (as noted by Bankserve). This maximum limit however belies the fact that the vast majority of ships obtaining COFRs require limits significantly less than US\$100 million.

The limits required under the COFR model are not the maximum potential liability under OPA 90, but the minimum requirement for a guarantee to support a COFR application.

By a similar criteria, the currently proposed Athens protocol may need a product with a maximum limit of around US\$2.3 billion (based on the largest, 3,500 passenger vessel, at a limit of SDR 500,000 per capita and exchange rate of US\$1.31 to SDR1).

Both of the above models require the support and co-operation of the P&I Clubs.

B. Availability of Capacity

The International Group of P&I Clubs offer the highest limits currently readily available to any transport industry. As mentioned previously the maximum limit for non-oil pollution claims is a theoretical figure, which equates to between US\$4.25 and 4.5 billion. It is important to appreciate however that the world insurance / reinsurance market supplies only US\$2 billion of this total capacity. The additional capacity is provided essentially by the world shipping industry, by a mechanism of retroactive additional premiums.

The US\$2 billion insurance capacity is provided to cover 90-95% of the world fleet with ships of all different types. Consequently an extremely wide spread of business is achieved.

The reinsurers' risk does not start until a claim exceeds US\$30 million each incident.

The 'Difference in Conditions' model would require roughly 15% more insurance capacity than is available for the current IG reinsurance programme. This US\$2.3 billion of insurance capacity would also have to be willing to cover a risk with a much narrower spread (passenger vessels falling under the proposed protocol would represent less than 5% of the total world tonnage) with probably much lower self-insured retentions.

The International Group reinsurance programme is the largest single marine contract currently in the market. Is an extra US\$0.3 billion of capacity available to write a much more narrowly spread risk starting from a lower level with unlimited reinstatements?

In our view, assuming a positive phase in the insurance market, it would be very difficult though probably possible to emulate the US\$2 billion of insured capacity offered through the International Group, despite the more 'concentrated risk'. The amount of capacity required however would require the participation of the vast majority, if not all of the world insurance market able to write such risks. Notwithstanding this, it is very questionable whether it would be possible at all, regardless of cost, to offer such limits with unlimited reinstatements in the event of a loss.

The cost structure would of course be completely different from that of the International Group. Any new product would require a critical mass of premium just to buy the capacity for the limits required. This critical mass of premium is not directly related to how many ships are involved in the programme, but to the limits needed. (This may be even more pertinent if only a limited number of countries enforce the Protocol in the first instance, as an even smaller sub-set of owners would have to meet the total cost of buying the limits required.) The rough 'guesstimates' of cost put forward in the Bankserve paper appear to be

rather simplistic and do not take into account the factors highlighted above, the unique nature of the insurance required and/or the difficulty involved to provide a solution to a revised regime. If almost the entire world reinsurance market were required to participate, just to complete, there would be no element of competition.

Additional limits above US\$2 billion would be much more speculative, even in the most favourable market conditions.

(NB. BankServe suggest limits required for either of their 'solutions' would be in the region of US\$3.5 billion to US\$4.9 billion each incident. This is based on the catastrophe scenario of two large cruise ships colliding. Such a scenario (and the potential reinsurance 'clash') would definitely be a factor increasing the difficulty of any placement, however in terms of limit per vessel for a product required to satisfy the proposed protocol, this is probably misleading.)

C. Sustainability

The amount of capacity in the market varies with the insurance cycle. If rating levels appear to be profitable, more capacity enters the market and conversely if results look adverse, capacity can withdraw from the market.

The amount of capacity required to provide even a relatively unsatisfactory insurance solution to the proposed protocol would be around the maximum available in the market even in a favourable market phase. As a consequence, even if the product runs without a loss, it may well still have difficulty in ensuring adequate capacity throughout the entire market cycle (roughly 10 years).

The variances in the risk profile of a 'difference in conditions' product to respond to Athens as compared with the COFR model was outlined above. The different risk profile would make an 'Athens' product more susceptible than the COFR model to withdrawal of capacity in the event of a loss under the cover.

Most commentators so far have glossed over the question of number of reinstatements within any proposed reinsurance cover. Even the IG reinsurance programme does not have unlimited reinstatement provisions up to the US\$2 billion level. The final US\$0.5 billion layer has no agreed reinstatement provision in the event of a total loss of this layer. Any new product would need to have unlimited reinstatements 'vertically' and be unlimited in the aggregate to be viable. Clearly any stand-alone programme with a much more limited spread would have less buying power and the questions of reinstatements and potential 'clash' would be major issues in terms of sustainability and cost.

As a final point, the proposed protocol is not likely to come into force for over five years. In the aftermath of September 11 there is a much greater appreciation of catastrophe exposure amongst reinsurers. Another major catastrophe, whether

marine or not, would have a significant impact on the plausibility of placing the limits required. With the market's current state of 'flux', estimates of the total capacity available are very difficult. To try to predict even whether there will be more or less capacity in five years time is almost impossible.

D. Practical Implications

Should the IG Clubs choose to restrict their rules in response to the proposed protocol to the Athens Convention, real claims would not only have to be paid, but also handled by the new insurance product. This is a very different scenario from the COFR model.

Claims handling infrastructures would need to be established to handle claims not falling on the Club. The nature of passenger claims can make them particularly complex and sensitive. Depending on the final Protocol adopted and the approach of the Clubs, the number of low level claims could be substantial.

It is possible the new product could 'sub-contract' such claims handling back to the Club's personnel, however at best this presents additional cost and at worst the Clubs could view this as a conflict of interest. In the latter scenario we would have a situation with the new product essentially duplicating the claims structures already existing in the Clubs.

Athens Convention - Proposed New Protocol
18/07/02

Comparison with other Passenger Carrying Regimes

The two closest comparisons are transport by rail and by air. These two forms of transport are not directly comparable with sea transit, and particularly cruise operations (who are probably more analogous to moving hotels/resorts rather than methods of transport) but comparing different carriers obligations in respect of passengers is still interesting.

Air Transit

International air transit has historically been governed by the Warsaw Convention (1929) though it is probably more pertinent to review the more recent proposed amendment, the Montreal Convention. This was proposed in 1999 and though not yet ratified it is expected to be a matter of time before it is widely accepted.

The Montreal Convention imposes strict liability and mandatory insurance limits up to SDR 100,000 per capita. In excess of this threshold, liability is theoretically unlimited, however, the airline operator can escape liability where they are able to disprove negligence, wrongful act or omission on their part. The insurer can retain limited policy defences and there is no requirement for provision of guarantee by the insurers.

Aircraft have passenger capacity in the hundreds, rather than the thousands, hence the mandatory passenger liability limits are comparatively manageable and well within the norm for the insurance market. The minimum limit required by the CAA for UK airlines is £150 million, although the minimum purchased by airlines is at least £750,000,000.

As an aside the airline industry provided a good example of how limited capacity affects availability of cover. Following September 11, aviation war third party (excluding passenger) liability coverage was impossible to place and governmental intervention was required to enable air travel to continue.

Train Transit

The most recent convention on international carriage by rail (COTIF) entered into force in the UK in 1996. The uniform rules apply an upper limit per passenger of 70,000 SDR in the event of death or personal injury. The period of limitation is three years in respect of passengers. The Train companies retain defences under certain circumstances including actions of third parties or the plaintiffs themselves. It is intended that these limits will be revised by the Vilnius Protocol, which is expected to come into force after 2004. Under this Protocol, the upper limit per passenger will be increased to 175,000 SDR although similar defences will remain.

Interestingly these limits apply to the Eurostar, which directly competes with cross-Channel ferry services.

Limits of this size are again manageable within the insurance market.

Summary

The proposed Athens Protocol has reasonable goals: to ensure that adequate protection is provided to passengers carried on vessels and that a minimum amount of cover is guaranteed, regardless of the fortunes of the individual shipowner.

The currently proposed mechanism for ensuring such protection is guaranteed has a number of fundamental practical difficulties from an insurance perspective.

The guaranteed levels of limit proposed would exceed any known insurance market capacity to fulfil the insurance requirements over a sustained period.

The guaranteed protection 'per-passenger' proposed would be far greater than any other form of passenger transport.

It is true to say that 'necessity is the mother of invention' and if the current proposed protocol was ratified all manner of potential solutions would be investigated (also alternatives including, for example, Bank/bonding solutions). We would not completely discount the possibility that some sort of product could be developed in response to an eventual need. However even if possible, it is certain that any product would be extremely expensive and unlikely to be sustainable over the medium term. In the meantime the short-term cost would be substantial and the regime inequitable with other forms of transportation. This would create a competitive disadvantage, particularly for ferries (e.g. ferries vs. rail).

Almost all solutions would require the co-operation of the existing IG Club system. The IG Clubs also already currently cover the liabilities being considered and have the expertise in claims handling. It is conceivable therefore, that if the guaranteed limits being discussed were substantially moderated, a protocol, which fulfils the primary objectives, could be achieved.

ANNEX 2

July 2002

Proposed New Protocol to the Athens Convention**MARSH**

Adviser

Key messages

- Accurately predicting insurance market conditions and capacity is difficult
- P&I clubs might restrict cover for passenger liabilities
- Alternative insurers might find the proposed aggregation of exposure unacceptable
- Club cover restrictions might also necessitate an alternative global claims-handling facility
- Commercial insurance solutions would be vulnerable to market cycles

The proposed new protocol to the Athens Convention is likely to call for new insurance requirements. There are a number of issues raised by the debate surrounding the various proposals. There are obvious problems in attempting to predict accurately insurance market conditions and capacity some years hence. Some non-passenger ship operating International Group P&I club members are also unwilling to share in the higher risk presented by a more onerous liability regime for the passenger shipping industry. In addition, the insurance market might well find the suggested solutions unacceptable in view of the high limits required. And creating a global alternative to the current system for handling complex and often sensitive claims could well prove another stumbling block.

The time frame makes sensible debate now very difficult.

Any new protocol including the insurance requirements is unlikely to have legal force in any jurisdiction for several years after the diplomatic conference in October 2002. Therefore, much of what is being said at present is speculation on a problem that may require a solution several years hence. It is obviously extremely difficult to predict with any degree of reliable accuracy what conditions will prevail in the insurance markets in the future, particularly the insurance capacity likely to be available if capacity alternative to the International Group P&I clubs is required in any significant way in the terms some delegations propose.

The existing cover afforded through membership of an International Group P&I club is capable of responding to any legal liability imposed by a new protocol to the Athens Convention, unless the clubs determine otherwise. This includes a regime that requires waiver of defences, other than the wilful negligence of the insured. It is clear that among the overwhelming majority of non-passenger ship operating International Group P&I club members there is growing support for restrictions on club cover for passenger liabilities, should the passenger shipping industry face increasingly onerous liability regimes, especially of the sort described in Professor Rosaeg's paper (1). Such restrictions could take the form of a financial limit on cover, perhaps equivalent to the current US\$1 billion limit of cover for oil pollution liability. There is also a very real risk that International Group P&I club cover might only be available in respect of liabilities a club member would have incurred had some or all ordinary common law defences been available. Thus the imposition of the most generous regime to passengers may actually cause the limitation of International Group club cover, that the new regime would be primarily reliant upon for the most effective solution.

Current International Group P&I club cover has the highest available limits and a long-established performance record. It is the accepted insurance of passenger liabilities governed by US law, under which there are no limitations on the ship operator's liability.

BankServe's paper (2) makes the point that the theoretical limit of club cover of around US\$4.25 billion would be inadequate to meet a 'possible maximum loss' resulting from total loss of life following a collision between two of the very largest cruise vessels afloat. BankServe has calculated this to be something approaching US\$5 billion. Even allowing for the 'pay to be paid' rule that the P&I clubs operate and the necessity of collecting overspill call that would fall on the small minority of clubs that do not have either reinsurance protection or more than adequate free reserves, this is by far the highest limit of cover available for any similar line of exposure. It has been available to this extent or more for decades (in fact P&I club cover was theoretically financially unlimited until quite recently).



Furthermore, the International Group P&I clubs have a long track record of handling passenger ship claims, and have often used the mutuality of the International Group system to pay compensation amounts in excess of the Athens Convention limitation (eg 'Herald of Free Enterprise', 'Estonia' etc). It is a system of insurance that has certainly been fully acceptable to ship operators, claimants and financiers, as well as legislators concerned with the high proportion of cruise vessels trading within or subject to US law and jurisdiction, where there are no limits on liability towards passengers and where any new protocol is unlikely to have force.

Present availability of insurance capacity

The 'expensive solution' described in BankServe's paper - the separate insurance of passenger ship liabilities arising from the new protocol - would in our view be subject to all the problems that BankServe has identified and at least one more. This is the availability of insurance capacity in absolute terms and specifically to respond to the relatively very onerous terms (compared to the Montreal Convention, for example) that Professor Rosaeg has described.

Similarly, the 'cheaper solution' - an insurance of the difference between the new protocol and potentially restricted International Group P&I cover - though more attractive in purely theoretical terms, would face the same very serious difficulty, especially in the event of such restrictions on International Group P&I club cover. The current 'CoFR' system required under OPA '90 (which is very much not a 'fronting' facility for the International Group system), succeeds to a large extent because of the fact that there is very little difference between the insurance available from the P&I insurers and the 'CoFR' guarantees provided. It also relies on the fact that the highest guarantee requirement, which BankServe points out is less than US\$400 million, is well within the limits of capacity conventionally available from the international marine liability insurance market. US\$5 billion of reinsurance coverage - for each and every loss - would be unprecedented in the transportation liability insurance markets. Even if available in favourable market conditions, it would be very highly susceptible to adverse market conditions. Indeed, even if a lower limit of compulsory insurance were required - say US\$2 billion for the larger cruise and ferry vessels - an insurance policy including unlimited reinstatements of such a limit would be difficult to put in place. In the aftermath of the events of 11 September 2001, conditions in the insurance markets are very hard, especially for risks demanding high limits of cover, and it is somewhat doubtful that sufficient capacity could be raised for a single limit of cover of US\$5 billion.

However, either BankServe 'solution' would presumably be acceptable under Professor Rosaeg's proposals only on the basis of cover for each and every loss during the period for which the insurance is in force. This would result in a potential aggregation of exposure theoretically only limited by the number of passenger vessels in operation. It is likely that the insurance markets would now regard this aggregation of exposure as somewhat realistic, especially given that cruise vessels, in particular, often trade in close proximity, for example in Alaska and in the Caribbean. It is therefore extremely unlikely that either 'solution' could offer cover in that way.

Logistics of handling passenger claims

BankServe's description of the 'cheaper solution' does not make any reference to the infrastructure requirements such an entity would necessarily create. As BankServe points out, oil pollution claims in the US are relatively infrequent, and the P&I insurers have almost always taken the leading role in claims handling, up to final settlement. A new protocol to the Athens Convention that led to restrictions on club cover would mean that the International Group P&I clubs would be much less likely to undertake a claims handling role in all cases. In all likelihood, the 'cheapest solution' would require a global capability for handling what are often complex and highly sensitive claims. From a purely practical perspective, it is difficult to see how personnel with the requisite skills and experience could be attracted to such an entity in the face of serious doubts about its long-term sustainability.

Summary

A product to meet the more onerous insurance position promoted by some delegates to the IMO Legal Committee would not be required for several years. Therefore, we cannot rule out its availability from the insurance markets at any time and in any circumstances. However, a compulsory insurance regime of that kind requires very high limits of cover (well in excess of what is called for under OPA '90 or, perhaps more appropriately, the Montreal Convention), strict liability and the waiver of all defences on the part of the insurer. In view of this, we believe a potential commercial insurance solution, were it available in favourable market conditions, would be so only on very limited terms. And it would be highly vulnerable to changes in market conditions in accordance with the usual cycle in the commercial insurance markets, to say nothing of any actual claim upon it. Meanwhile, there is a tangible risk that International Group P&I club cover for passenger claims could be restricted in terms of scope and limit were these more onerous proposals adopted at October's diplomatic conference.



(1) 'Report of the Intercessional Liaison with Insurers on the Athens Convention' submitted to the participants of the Informal Meeting on the Revision of the Athens Convention on 24 April 2002 in the IMO Building (dated 8 April 2002), prepared by Professor Erik Rosaeg of the Scandinavian Institute of Maritime Law

(2) BankServe Insurance Services Limited's paper dated 9 May 2002, entitled 'An Opinion on the Feasibility of the Prospective Protocol to the Athens Convention Being Met'. This Adviser also takes into account subsequent papers prepared by Professor Rosaeg and others.



Adviser is intended to highlight issues on a general basis relating to insurance and risk management and does not contain legal advice. In view of its purpose, the publication cannot have regard to any individual circumstances nor can Marsh accept responsibility for the completeness and accuracy of its content for particular application. If you have legal queries regarding issues raised in the Adviser, you should contact your usual legal advisers.

No. 1, The Marsh Centre, London E1 8DX. Tel: 020 7357 1000
Please contact your local Marsh office for more information.

Marsh Ltd is a member of the General Insurance Standard Council (GISC)
www.marsh.co.uk

© Marsh Ltd 2002



Marsh & McLennan Companies