

Shipowners face major increase in premiums

James Brewer - Thursday 6 September 2007

SOON, the early months of 2007 will be fondly known as “the good old days”.

That heady era — it seems so long ago — was when the 13 members of the International Group of P&I Clubs implemented premium renewal rises for shipowners and operators in the range of 5%-10%. One even structured the instalments so that there was a net gain for the members. Save for those customers with a poor claims record, this slotted smoothly into internal budgets.

Fixed premium providers were similarly undemanding.

Halfway through the P&I year, there is slim chance that this can be repeated. When noon strikes on February 20, 2008 and the renewal agreements are formally sealed, shipowners will almost certainly have been at the weaker end of a hard driven bargain.

Flags have been raised that many could be asked to stump up premiums in the range of 15%-20% dearer.

Of course, the shipowners collectively largely call the tune, as they are the owners of mutuals, which provide some 90% of the oceangoing fleet with liability cover, but the dilemma is to keep the insurance vehicles strong while accommodating to ever more onerous liability regimes, and to unforgiving financial and freight markets.

Although the frequency of everyday claims are under control, the major claims that weigh on the group pooling system have become an all-round headache, and financial market volatility looks likely to curb investment yields. Stunning performances from investment portfolios, with returns into the double digits, have kept managers smiling but the past few weeks have seen them paying urgent attention to adjusting the mix of equities, bonds, fixed income and cash to seek to keep results respectable. It will be of some comfort that they have become accustomed to volatility in the investment markets, and usually outperform their benchmarks.

Certainly, the mutuals and the majority of fixed premium facilities are considered well founded, and the former can always resort to a supplementary call if need be, but these days the regulators expect, and the rating agencies monitor, a healthy solvency margin.

A further concern is that reinsurers will seek to raise their prices in the light of the well documented volatility — albeit low level of super-claims — in the sector, and the need to lower the perceived risk of any relative newcomers.

In the past few weeks, as the mutuals issued their annual reports, they have been talking up the need for a stern approach with the UK Club for one making a formal decision to move towards break-even underwriting. This is a total departure from reliance on investment returns and a warning that even robust commercial reinsurance deals must not be seen as a cushion against excessive losses.

Income is rising, but then mutually entered tonnage has risen by well over 20% to 650m gt since the start of the decade.

The clubs, which together have built up free reserves of well over \$2bn, are still cautious.

UK Club chairman Tullio Biggi says: “Even with the benefit of reinsurance, in the current regulatory climate capital requirements can be expected to increase to cover potential volatility in claims.” He admitted that his own club in the year to February 2007 incurred “a more substantial deficit in the underlying operating account than we would have liked to see”.

With pool claims running rampant, 2006 was a considerably worse year than the dismal performance of 2004. Few are willing to bet on an explanation, save to say that the nature of claims is random.

Some 30 claims last year were expensive enough — gross estimates each of up to \$50m — to be referred to the pool, which deals with excess payments after the first \$7m. Every club in the group has at least one claim in the pool.

The solution? Increase the club retention, say managers, especially at the larger clubs, and most accept that this will have to happen. There is even a move to raise the retention to \$10m from next February, but this is generally seen as too harsh and would create more volatility in club results, as Skuld argues, but that Norwegian club for instance accepts that the figure could be phased in, during the next few years.

James Stockdale, chief executive of Steamship Mutual, fears that such medicine would cause more problems than it addressed by undermining the effectiveness of the pool as a mechanism for spreading risk on an at-cost basis. With the distribution of claims across the group there was little evidence that a change in retentions would protect the pool from exposure to substandard ships, said Mr Stockdale.

It was little surprise, although somewhat disappointing, that the clubs' Bermudian reinsurance vehicle Hydra, which contributes to claims between \$30m and \$50m, was obliged to spend more than its premium income in its first two years of operation, and itself made an extra call of \$50m on the clubs. Hopes remain high that Hydra will mature into a strong captive insurer which will ease the reliance of clubs on the more costly commercial underwriters.

Most clubs are majoring on loss prevention seminars, videos, onboard and shore training and other means of inculcating best practice, but even if human error could be eliminated fate would still deal some vicious casualty blows.

Stressing the random element of the claims, Standard P&I Club directors said: "The claims are from all ship types, all regions and involve all nature of casualties. And they are from big owners and small. The casualties have befallen excellent owners and were evidence that things can still go wrong in the best run companies."

Claim values have been increasing relentlessly through external impulse, too, as steel and other commodity prices have hit new highs.

North of England P&I Club has been among those to refer to "an appalling claims environment" but ventured reasons for the surge in large claims.

"We believe that the rapid growth of the world fleet coupled with a severe shortage of experienced seafarers is one key factor," said North of England managers. "Poor standards of maintenance and consequent mechanical breakdowns are also key causative factors."

The club differed from some of its contemporaries in questioning whether the competence of crew was at issue here.

Skuld president and chief executive Douglas Jacobsohn speaks for many of his fellow P&I managers when he says: "Although we are pleased with our current results, we cannot be complacent. The risks in the world around us are increasing and becoming increasingly more complex, whether financial, environmental, paramilitary or energy based, to name just a few.

"Unfortunately, the political and regulatory response to a number of these threats from national and regional players is also becoming increasingly complex, often generating reactions that with all the best intentions appeal more to emotion than fact."

Mr Jacobsohn points out that with global warming, the resulting extreme weather can make risk even more difficult to predict and manage.

Skuld has been one of the clubs to reach out to new geographical markets, as is happening at Swedish Club. Merger talks between these two broke down a year ago, so both are seeking to bulk up independently.

Clubs generally have been pleased by the performance of their charterers' business, which is rated as fixed premium, but which contributes to the mutual pool. This has been especially profitable at a time of substantial international trading, and the competition for declarations (charter voyage cover) is fierce, with highly respected organisations such as the once-mutual Charterers' P&I Club offering the service that few outside itself and the traditional kingpins can match.

Now, all this is before the overarching issues of the day. Mutuals and the Group spend considerable time in analysing and lobbying on the imponderables of the revised **Athens Convention** on passenger shipping, cover for terrorism risk, for biological and nuclear risks, and pollution guarantees, and constant efforts mainly by European

legislators to increase shipowners' exposures to liability.

If anyone believes that insurance is a straightforward matter, let them pore over the most dramatic incident of the year: the structural failure and grounding of the 4,400 teu containership MSC Napoli. The disaster calls into aid every facet of marine insurance and salvage and potentially law. Much depends on whether the liability of the carrier is established, and the cost of the various clear-up operations is quantified, before the financial implications for P&I cover are clear.

London P&I Club said in its annual report that the complex process of dealing with the ship "has taken the managers to areas of law which other casualties have not reached, namely landlord and tenant, for the [shipowner] member has needed to lease a substantial proportion of the port of Portland, and indeed obtain the requisite operator's licence to undertake these operations".

Analysts say that in the long run there will need to be a new look by the authorities at how such casualties and the recovery operations they entail affect the environment. Some P&I experts contend that the overall 'eco-cost' in terms of secondary emissions through dismantling the hull, assembling convoys of anti-pollution forces to patrol the beaches and the summoning of a host of other treatment services is being overlooked in an obsession with micro matters.

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