

Piracy & Sanctions - The Challenges for Marine Insurance

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Introduction

I have been asked to talk to you today with a London-market perspective on the challenges facing marine insurers in 2011, and through the remainder of this decade, and I have chosen two main issues to address.

Neither of the topics I am going to cover are new challenges. But they are both subjects which are focusing attention within London, and globally, over recent months, and are likely to remain high on our agenda over the years ahead. The first topic I will look at is piracy. It has put the marine sector very firmly into the media spotlight, both in the UK and internationally, and it would be fair to say that it has also brought the attention of Governments and regulators into the maritime sector, and to the marine insurance segment in particular.

The second subject, which I will not cover in so much detail, is that of sanctions. The treatment of trade and economic sanctions is not a new problem for international property insurers, but it would be fair to say that over the last 12 months or so regulators are extending or confirming the impact of sanctions into the financial sector, and insurers ignore these at their peril.

Piracy

So first to piracy. Of course, this is not a new problem, it's probably been around for as long as there has been maritime trade. The first recorded reference to it relate to incidents around the Aegean and Mediterranean in the 13 Century BC. I also note that in 68BC pirates attacked and sacked Ostia, and that in 67BC the Roman Senate invested Pompeius with powers to deal with piracy. Following 3 months of naval warfare, the threat was suppressed. In some ways, I wish it was as simple these days...

Since then, pirates have operated in many guises, across all oceans of the world. Our most popular view of the pirate comes from the period from the 1500s to the early 1700s in and around the Caribbean where our psyche has been fed by images of Johnny Depp and his Hollywood compatriots. the romantic image of the carefree pirate, parrot on shoulder, bottle in hand, girl in port.

Those involved in shipping have had to deal with the brutal reality of piracy in varying forms and differing locations throughout the intervening centuries. In 1992 the IMB Piracy Reporting Centre was established. Their Annual Report for 1998 included an overview of attacks between 1991 and 1998 averaging around 160 per year.

During this period I used to get regular calls from journalists looking for a story on the insurance impact of these attacks. But the truth was, from a marine insurance perspective, the attacks had little impact because the financial losses were not significant, particularly in view of the way that piracy has traditionally been insured in the marine market.

How is piracy insured in the London Market?

Within the London market, certainly through the 20th Century, piracy has been regarded as a "peril of the sea", and therefore cover has been provided under the marine insurers' hull policy - as opposed to it being covered under the separate war and related perils insurance. One of the major reasons why piracy has now become an issue is that the activities and operations of the pirates has changed from that seen through the majority of the 20th Century.

Through the last Century there were pockets of activity, mainly based around Asian waters. In the latter part of the century the modus operandi would be for groups of pirates to use small high speed craft to board vessels. The pirates would target smaller coastal craft, and they would look for items which could be readily sold on for cash. Mobile 'phones, lap-top computers, crew wages. The pirates would board the vessel, tie up the crew, ransack the stores and crew quarters for relevant items, and then disembark. With this model, the losses were low in value, usually falling below the hull deductible. Crew were traumatised, but not usually injured, and the vessel could continue on its way. There was a significant additional risk, which never actually materialised into a loss for insurers, in that the pirates would not release the crew before getting off the vessel. There were instances of vessels ploughing through busy shipping lanes with no one at the helm until the crew members had managed to release themselves...

These behaviours were particularly prevalent in the early part of the 21st Century in and around the Malacca Straits - long a hot bed of piratical attacks, and a major trade route for vessels moving goods to/from Asia to global markets. Along with an increase in the number of attacks in the Straits, the perpetrators also seemed to be improving their equipment and their organisation. In the post 9/11 environment there were suggestions that these developments were due to terrorist groups using these activities to fund their operations.

Concerns regarding the Malacca Straits led the Joint War Committee to add the Straits to its listed areas.

The increased sophistication of the pirates also led the hull market to re-consider the way in which it provided piracy coverage. Merchant ships were being approached by small vessels, the crews of which would be waving assorted weaponry, including AK47s and Rocket Propelled Grenade launchers. Were these people pirates or terrorists? How could you tell? While seeming to be an academic question in fact, from an insurance perspective, it is a fundamental issue. Traditionally, piracy cover in London was provided by the marine hull insurers, while terrorism was a coverage which fell under the war policy. Two separate heads of cover, often written by different insurers. In the event that an incident escalated there was potential for the two different sets of insurers to become involved in a legal wrangle over where the loss would fall. In these circumstances the only loser would be the ship-owner whose claim couldn't be settled until the question of cover had been resolved. To address this problem, in 2005 the London market produced a bouquet of clauses which gave insurers the ability to move cover from the hull policy over into the war policy, thus removing the element of uncertainty and making the method of attack more the issue rather than the motive.

This seemed a sensible development, but it would be fair to say that the marine client base was not quick to pick up on these new clauses and make the adjustment. From the owner's viewpoint the issue of piracy hadn't caused a problem for insurers in the past, and there was some suspicion as to why underwriters would want to make adjustments now.

Pressure from the maritime community to address the shortcomings around Malacca meant that the Governments in Indonesia, Malaysia and Singapore worked together to co-ordinate anti-piracy activity thus reducing the level of incidents down to a more manageable level.

It is interesting to note that while the activities in the Malacca Straits held most people's attention, in November 2005 the Seaborne Spirit, a Bahamian registered cruise ship was attacked by small boats off the coast of Somalia. The attack included the use of RPGs, at least one of which hit the ship, fortunately not exploding. The efforts of the crew prevented the vessel from being boarded, but this incident provided a clear indication that the dangers and threats associated with piracy were becoming more real.

And then the focus of the world's attention moved squarely across to the Horn of Africa and the coast of Somalia. Problems in this region first hit the headlines when the fully laden oil tanker the Sirius Star was taken by pirates in November 2008.

The interesting development with regard to this region is that the pirates' behaviours changed. The gangs were still using small craft and readily available weaponry – albeit that their organisation seemed to take a step up with the use of “mother ships” to extend their range. However, the fundamental change has come in that the pirates recognise that the vessel, crew and cargo are valuable assets.

The seizing of the ship and cargo causes a direct problem for the ship-owner and his insurers, although in practical terms, at this stage, there is no loss under the hull or cargo policies as the vessels are still there, along with the cargoes, and can be returned. I think it would be fair to say that if it was only a case of re-taking the vessels and cargoes various specialist security forces would probably be able to carry out these tasks relatively easily, but it is the presence of the crews which makes such operations more difficult.

In my personal view, given a straight choice between paying some money for the safe return of ship, crew and cargo, or the possibility of loss of life, there is really no choice to make. Some Governments and politicians have criticised ship-owners and insurers for negotiating with the pirates, and the US Executive Order on Somalia, which I will touch on later, threw the activities of the industry into doubt. However, it is difficult to see what other options there are if loss of life among innocent crew is to be avoided.

I should also make it clear that the hull and cargo insurers are not directly involved in the negotiation or payment of ransom moneys. These negotiations are taking place between ship-owner representatives and representatives of the pirate groups. Once agreement is reached insurers will be involved through the ancient marine concept of General Average (GA) (a concept as old as, if not older than, piracy itself). It is interesting to note, bearing in mind my earlier comments relating to the position of the crew in relation to the current problems, that the crew liability is not covered by hull and cargo underwriters. This is covered separately by the Protection & Indemnity Clubs. As liability insurers P & I Clubs are not traditionally involved in funding GA payments. But this is an issue which property insurers feel should be addressed in relation to the current problems, and

the necessary negotiations will certainly represent a significant challenge to the industry.

Solutions to Somalian Piracy

So what are the solutions to these problems? We don't have the freedom which the Senate enjoyed back in 68/67BC, even if the resources were available. In the 21 Century the maritime sector has been taking softer measures. Firstly, there has been the development of the Best Management Practice Guidelines, currently in their third version. These guidelines, developed across the merchant marine sector (including insurers) and the military, are designed to provide practical advice and guidance to ship-owners whose vessels are moving through the area in an attempt to reduce the chance of a successful attack.

An alternative solution is for vessels to re-route, turning south to go around the Southern tip of the African continent. Obviously, this option is not available for certain trades, only those using the Indian Ocean/Horn of Adrica as an access route through Suez. Re-routing takes vessels away from the immediate danger zone but adds considerably to the journey time, with commensurate increases in costs for fuel and crew and with a knock on effect for end-user supply in the just-in-time economy which has developed in recent years.

A topic of considerable interest at present is that ship-owners should arm their crews, or introduce armed guards for vessels transiting the high risk areas. It would be fair to say that the views of property insurers are widely divergent on this issue. Some regard use of properly trained and equipped armed guards as significantly reducing the risks, particularly in an environment where the pirates themselves are becoming more aggressive. However, some property insurers are reluctant to endorse this step for a number of reasons. The main concern is one of escalation. We recognise that the pirates are opportunistic. A robust defence by ship-owners will often deter an attack as the pirates will look for softer targets, but the enhanced risk of loss of life or loss or damage to the hull or cargo will significantly increase if the vessel and attackers become engaged in an exchange of fire.

Another option which has been aired, particularly in the media in the UK, is use of a "privately funded" naval force, to be used to escort vessels through the high-risk areas. There have been suggestions that Lloyd's would back such an initiative. In reality, the problems for such a solution are significant, in terms of funding, logistics, the legal issues which might arise in the event of an incident, and the command and control integration with Governmental naval forces.

All of these solutions are short term fixes, and in any case, should not be led by insurers. Marine insurers are providing a service to the shipping industry to support their operations. In this context insurers would prefer to work with their clients in assessing the validity of any of these solutions on a case by case basis

In the longer term, the incidence of piracy around the Horn of Africa is a direct result of local political and economic conditions, linked to an accident of geography. The political and economic problems cannot be resolved by insurers, or by the shipping industry, but is a problem for the international diplomatic community to take on.

Sanctions

Turning to my second topic, that of sanctions. I do not intend to spend too much time on this, but intend to make a number of general observations. The first reason for this is that I am not a lawyer, and certainly not one who can give you

advice on sanctions. Secondly, the impact and application of sanctions will vary depending on the structure, composition and location of the insurer, and the details of the specific sanctions themselves.

To provide some sort of link to my previous topic I should perhaps go back to the US Executive Order on Somalia, presented by US President Barack Obama on 13 April 2010. This Order was produced by the US President as a direct reaction to concerns over the payment of ransoms to pirates, and included language which prevented US Citizens and entities from making payments to certain named individuals, but also had the potential to prevent any payments to individuals or groups involved in, or supporting, piracy. The implications for the shipping community, and specifically for insurers, were significant. The LMA, alongside other representatives from the shipping sector, spent a great deal of time trying to obtain clarity from the US Office of Foreign Asset Control (OFAC) in the context of the practical realities of ransom payments and the mechanisms used, and the lack of control exercised by insurers once funds had been dropped.

In the wider context of sanctions, the behaviours evidenced in the US Executive Order are being witnessed now across the Board. Governments and regulators are recognising that the financial sector, specifically banking and insurance, can play a significant part in supporting trade to countries or regions which are subject to trade sanctions. In many cases, specific reference is now made to the fact that insurance and reinsurance transactions are prohibited. There is no doubt that insurers are subject to the relevant restrictions.

Specific application of the sanctions will vary, but again tend to be fairly broadly drawn, encompassing companies based on geographical location, Board Membership or even individual citizenship of staff. This reflects an attempt by the regulators to ramp up the impact of the sanctions. Insurance companies have always had to deal with sanction requirements, but in this new era need to be even more vigilant in ensuring that the cover they provide does not contravene any of a range of sanctions regulations.

In view of the growing concerns in this area, the marine sector in London, led by the Joint Hull Committee (JHC), looked at the options for insurers. Whilst a number of sanctions clauses were available, the JHC decided to work on a new wording to address the problem in its more modern context. The result was the Sanction Limitation & Exclusion Clause, JH2010/009, dated 29 July 2010. The clause was drafted in the light of the Somali situation, and ongoing efforts relative to Iran, but was also intended to be flexible enough to cover further regulations as and when introduced, such as those brought in more recently relative to Libya.

The clause was reviewed by the other marine sectors, and versions were adopted by other Joint committees. The clause was also seen as being a sensible model which could apply in the non-marine sector and was subsequently released by the LMA Non-Marine Committee as LMA3100.

The clause is by no means perfect, and insurers individually have to assess its suitability, and make decisions on how to address their obligations to comply with regulations alongside their duty to provide coverage to their clients. The important issue is that this should form part of the regular thought process for the underwriter when writing the risk.

Conclusion

In summing up, I hope that the above comments, both in relation to piracy, and my broad comments on sanctions, have given you an insight into two of the big

challenges currently facing the maritime sector. I hope I have given you some things to think about, even if I have been unable to provide you with simple solutions.

I have been in this industry for almost 30 years, and one of my over-riding impressions is that marine insurers are good at taking on and addressing new challenges. I am sure that the same will be true of the issues I have outlined to you today.

I would, of course, be happy to take any questions.

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