

**THE MARINE INSURANCE WORLD
IN TRANSITION**

BY

J. E. M. HUGHES

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**by J E M Hughes
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Ladies and Gentlemen

Introduction

It is a great pleasure to have the opportunity of addressing this distinguished gathering in such agreeable surroundings. I am honoured to have been invited by the Maritime Law Association of Australia and New Zealand to make this speech and I hope that you will find what I have to say interesting.

Perhaps I can begin by introducing myself. My name is Joe Hughes and I am a director of Jardine Insurance Brokers International Limited, which is part of JIB Group plc. Our Group is publicly quoted in London, but the majority shareholding remains with Jardine Matheson, a company of which there is ample evidence here in Hong Kong!

Jardine Insurance Brokers International Limited is the main wholesale arm of our Group's business - which includes retail operations in Australia and New Zealand - broking a wide range of specialised risks into the international markets. On the marine side specifically, we are one of the larger brokers in London and have contact and dealings with all the major international players in this sphere.

The subject of my talk to you this morning is a description of the way in which the marine insurance world - from a commercial viewpoint - has developed over the past few years and where it is likely to go in the future.

Specifically, I will be looking at the two major areas of marine insurance - Hull insurance and Protection and Indemnity cover.

Marine Cargo is, of course, another important area but the main body of my remarks will relate to marine insurance as it affects ship owners and operators as opposed to cargo interests which, of course, are quite separate in operational and, for that matter, insurance terms.

I would suggest that a review of the commercial trends which have affected the marine insurance market over the recent past - and are likely to continue to affect them in the future - is timely.

The insurance dimension to ship operations has never been more problematic than at present. The insurance part of the daily running costs of ship owners is now much greater than in the recent past and the collective mind of the shipping industry has never been more firmly fixed on this element of overhead.

On a wider scale few can have failed to notice the massive publicity which has surrounded the difficulties being faced by all insurance markets, particularly Lloyd's of London. It is impossible to open any trade journal in the shipping and insurance industries these days without some reference to the difficulties facing underwriters. Indeed, the problems at Lloyd's have attracted the attention of the popular dailies in the UK and thus become public property.

The Issues

How has this come about and what is likely to happen in the short to medium term? In answering this question I wish to examine:

- firstly, the way in which the Hull market has performed over the recent past and the factors which have created current problems;
- secondly, to review, in similar terms, the performance of the Protection and Indemnity Clubs;
- thirdly, to suggest what the future may hold in both these areas over the next few years.

The subject is, of course, a very large one. However, I will keep my comments as brief as possible, concentrating mainly on a review of recent history as the best insight into future development.

Brian Turner is here to provide a commentary on what I say and if there are any questions no doubt they can be raised in that context before the end.

The Hull insurance market now

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I thought it would be useful to begin by identifying the location and characteristics of the major Hull markets. I apologise to those amongst you to whom this may be elementary knowledge, but I hope others will find it useful.

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As you can see, the United Kingdom, the United States, France, Norway and Sweden insure all classes of business with substantial capacity.

So far as the Far East is concerned, there is capacity to insure all classes of business, but participation in international insurances is rather more limited.

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The influences that have exerted themselves on these major markets - wherever they are - can be identified as the following:

- Open Years 1989/90
- Rationalisation of underwriters
- Reinsurance cost increases
- More retention amongst direct insurers

- Limited reinsurance capacity
- Catastrophe losses
- Asbestos
- Pollution
- The "Claims Made" form
- The growing influence of health hazard.

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Turning specifically to Hull claims, there has been a substantial uplift in claims reported during the years from 1985 to 1989.

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Looking at this in the context of the Lloyd's three year accounting pattern, the uplift in claims reported took place at a time when rates were falling, creating a serious gap as between income and expenditure which, as is well known, has created the very bad results reported by the marine market in particular over the past two years.

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This phenomenon was chiefly created by three things. In the first place, tonnage was over the period if not in absolute decline then at least static so far as the development of greater insurance demand was concerned.

At the same time, the number of underwriters competing within this static market grew, and the supply of capacity with it. This was at a time, also, when losses were increasing and, inevitably, falling rates and growing losses had a disastrous impact on results.

Not surprisingly, the market had to react. The reaction came rather later than many had predicted earlier in the cycle and, indeed, it is only over the last eighteen months or so that we have seen the kind of hardening - and not just in London - that had been awaited for a number of years previously.

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Market reaction has been predictable. It has included an increase in deductibles so that the ship owner takes a larger proportion of the risk. At the last round of renewals it was by no means uncommon to see a Hull deductible increase from, say, US\$75,000 to US\$200,000 as a matter of course.

In addition to this cover has become more restricted. This restriction has expressed itself in a number of ways, perhaps the most notable in recent months being the limits placed on the availability of additional perils clauses and growing demands in regard to survey, classification and so on.

Most obviously, of course, the market has reacted by charging higher premiums than before. There are many examples of accounts even with good records sustaining increases which would have been unthought of only twelve to twenty-four months previously.

Many of these increases have been based on what is known as "re-rating": that is to say an underwriting practice which ignores historical record as such and simply involves reassessment of risk and an upward mobility of pricing considered to be commensurate with exposure.

The Hull market in the future

It is, of course, a matter of pure speculation as to where Hull rates will eventually come to stabilise. In my own view I believe we have a further period of rating rigour ahead of us which will last for at least another twelve to eighteen months as the market struggles to return to traditional levels of profitability.

Whether, in the fullness of time, there will be a fall in rates to match that which occurred during the 1980s remains to be seen. In my opinion, however, I think that a new "benchmark" has been achieved in this area and I think that realistic Hull rating is likely to be a feature of the market for some time to come.

The P & I market now

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The P & I Clubs have probably attracted more publicity over a longer period of recent time than have Hull underwriters.

All of you will have read in the press over the recent past about the P & I world being in a state of crisis and that the Clubs as we now know them are, metaphorically speaking, about to spring this mortal coil.

I have consistently taken the view that this characterisation of the P & I scene was exaggerated, though there can be no doubt that the turbulence which the Clubs have endured over the last two to three years has been much more severe than at any time in the recent past.

But before going into an analysis of recent trends in the P & I world - and the direction that these trends may take in the future - perhaps I can just briefly review what the P & I market is.

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The majority of P & I Clubs are part of what is known collectively as the International Group. This Association of Mutuels covers some 95 per cent of all world shipping. It is governed by a non-competition agreement which has the approval of the European Commission in Brussels. This agreement forms the basis of the reinsurance arrangements which the Clubs make amongst themselves and which provide huge buying power, the more relevant against a background of depleted reinsurance capacity worldwide.

I want to examine some statistical evidence for the circumstances of the P & I Clubs over the past few years. These statistics are derived from the published accounts of the eight largest Clubs which in themselves account for about 80 per cent of the total market.

Most of these figures relate to financial rather than policy years, ie to figures attributed to the period between 20th February of each year. Where policy year figures are relevant they will be noted accordingly.

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Turning first to the retained claims exposure of the eight Clubs, you will see that there has been a very substantial growth over the past two financial years in this area.

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Looking at total investment income, you will see that - particularly for those Clubs which had significant equity portfolios - there was a good performance in the financial years from 1986 to 1988 which fell to much lower levels in subsequent years.

There has, as can be seen, been some improvement in the most recent financial year to 20th February 1992, chiefly attributable to the much greater volume of premium available for deployment in the international investment markets, but at the same time negatively influenced by losses on foreign exchange transactions.

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So far as budgetary reliability is concerned, there has over recent years been considerable volatility. It will be seen that the years from 1982 to 1986 were years of very considerable undershoot in terms of overall P & I cost which has been followed most recently by several years of very significant overshoot.

A greater degree of reliability is, however, now entering the scene and can probably be expected to continue for the foreseeable future.

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This, of course, can be related to general increases over the last several years. Again it will be seen that the middle of the last decade was characterised by very modest increases in advance call ratings and it is only recently - over the past three years or so - that general increases have grown substantially.

This has - and will hopefully continue to have - an impact on budgetary reliability, ie as more money comes into the Clubs as advance call yield, so the ultimate reliability of given policy years across the market as a whole should improve.

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Increases in gross premium have been substantial over the past two financial years. It will be seen that this in particular is the case if the middle to end years of the 1980s are compared with the current trend. I would expect that the volume of gross premium income within the Group will stabilise over the next few years, although it is unlikely to decline in terms of total cost.

The P & I market in the future

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How is the P & I world likely to develop over the next five to ten years?

As a general comment, I do not think that we are likely to come down from the current plateau of P & I exposure for the foreseeable future. This is, of course, bad news, but there are few signs that the inflationary trends of the recent past will reduce in the short-term. I think there are three chief factors which point to this.

The **first factor** is, I believe, the likelihood that shipping will remain relatively under-invested for the foreseeable future. The under-funding of the last few years coupled with the veritably dire state of the freight markets has placed, and will continue to place, strains upon traditional operating cultures within the industry, inhibiting investment in new buildings and continuing the process of ageing of the world fleet in general.

It has also placed pressure upon the need to reduce running costs, not only in a direct maintenance-oriented sense, but more particularly through the employment of non-traditional crewing sources and also through the fragmentation of ship operating functions into technical, commercial and other areas so that centralised control of management activity has declined.

The **second reason** for my view that the claims climate is unlikely to improve in the near future is what might be described as the socio-political dimension to modern claims exposure. In the most obvious way this expresses itself in terms of environmental concern - particularly in the United States - but this is not unique to America and the detectable hostility of public opinion and government policy towards ship-owning interests is, I fear, likely to persist.

The **third cause** for medium-term pessimism is something to which a number of Clubs have referred. This is "claimant awareness" in the broadest sense. Although, again, this phenomenon probably can be traced in origin to the United States, the "compensation culture", which is increasingly emerging in many parts of the world, demanding that someone somewhere must be liable - particularly if he happens to be a ship owner - for any given set of adverse circumstances, is unlikely to diminish in the short-term.

However, I do believe that things will ultimately improve. I think that the "invisible hand of cyclicity" will eventually play its role in reducing the level of claims and I am sure, as I have said earlier, that the budgetary reliability - if not the overall cost - of P & I insurance should improve over the medium-term as the Clubs get to grips with their problems and the volatility we have seen over the past few years diminishes.

Summary

I do hope that you will have found what I have said to be interesting and - at least to some degree - instructive. Perhaps I can conclude by summarising the main points which marked the recent past as being a period of transition for the marine insurance business giving direction to the way in which this sphere is likely to develop in the future.

The recent turbulence in both Hull and P & I is a phenomenon, in my opinion, more relative than absolute in its nature. That is to say that the steep price rises and volatility of cost which have occurred in the recent past came as a shock to the shipping industry not because - at least in historical terms - Marine Hull and P & I insurance is more expensive than it ever was, but mainly since it has become much more expensive than in the recent past which represented what might be described as an all-time low in terms of the relative cost of insuring high asset-values and the liabilities attendant upon their operation.

At the same time this hike in costs has coincided with a severe downturn in the freight market making insurance cost as a proportion of daily overhead much more significant than it was, say, only three to four years ago.

And when these unpleasant things occur against a background of a well-publicised breakdown of confidence in the insurance industry itself, the perspective from a consumer's point of view looks grim indeed.

But, in absolute terms, the picture is not necessarily as gloomy as some of the most pessimistic commentaries would suggest.

The cost of insuring a typical VLCC, for example, at the present time is probably no more - and arguably less - than it was, say, twenty years ago in both nominal and real terms.

As mentioned above, it was a slump in rating - in both Hull and P & I - in the 1980s which created both the recent unprofitability of the marine business and the sharp reaction in rating resulting from it. But when insurance costs for a typical ship have increased over a period of, say, five years from less than ten per cent of daily running cost to closer to forty (in some cases), the alarm which these cost rises have created within the shipping community can well be understood.

And as mentioned above, the suffering this represents is exacerbated by a freight market in deep recession where profits are, to say the least, hard to come by and inflation of insurance costs in many cases does nothing more than add to the loss burden of many owners.

Problems of cost and capacity will remain in both the Hull and P & I markets for the foreseeable future. However, there are some small signs that a greater degree of stability will start to enter both areas over the next few years and, if nothing else, this will make budgeting more reliable.

In the final analysis, three factors will be critical in the development of both markets: first, the restoration of general profitability to the marine account in Lloyd's and other markets, hopefully taking pressure off the need to charge the huge increases recently seen; second, the extent of reinsurance capacity - particularly for the big liability risks - which may well impact upon the way in which the Clubs do their business over the years to come; and, perhaps most importantly, the restoration of profitability to the freight markets thus giving ship owners a greater degree of comfort in paying for increased insurance costs over the years to come.

Ladies and Gentlemen, it has been a pleasure to address you here this morning and - as I mentioned earlier in the context of Brian's commentary - I shall be delighted to expand on this address and answer any questions you may have.

Hull market



Analysis of major hull markets

United Kingdom

Lloyd's of London
ILU Companies

United States of America

Insurance Companies

France

Insurance Companies

Norway

Insurance Companies
Mutual Hull Clubs

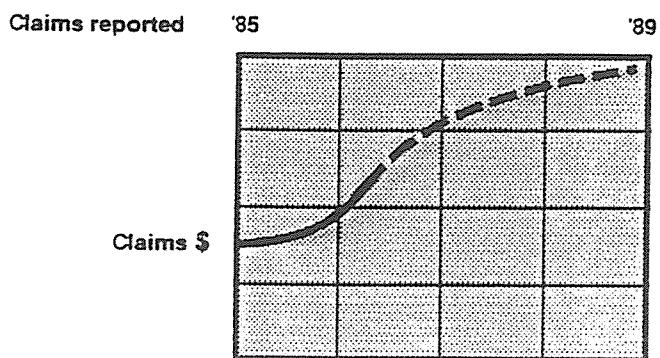
Sweden

Insurance Companies
Swedish Club

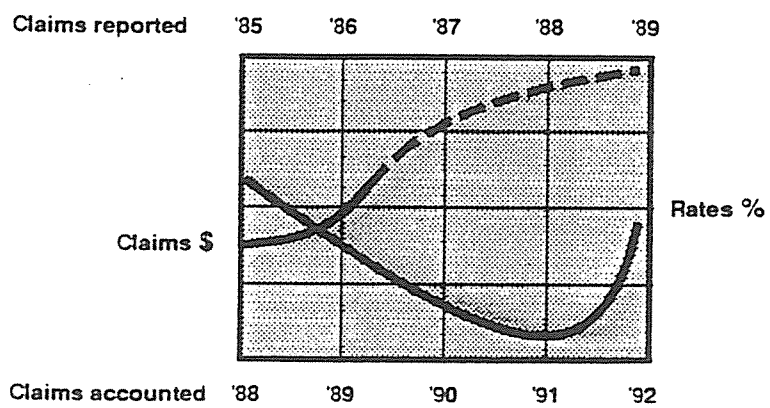
Far East

Insurance Companies







Hull claims



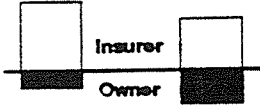


Lloyd's 3 year accounting



Hull market

Tonnage		
Underwriters		
Losses		

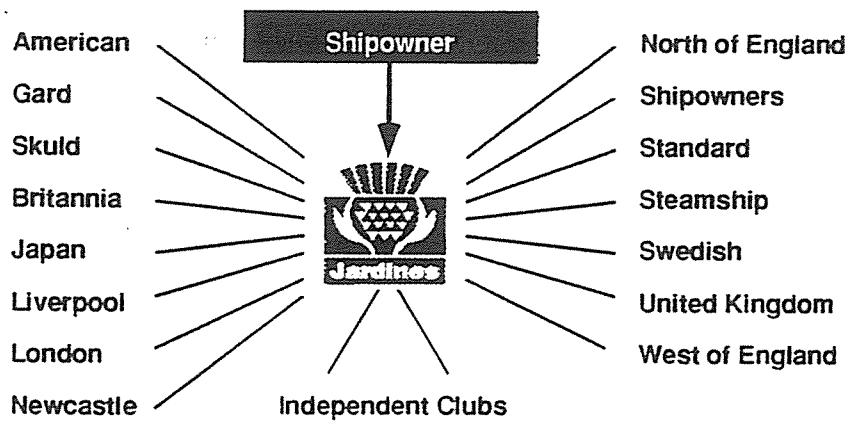
Market reaction

Deductibles	
Coverage	
Premiums	

P & I market

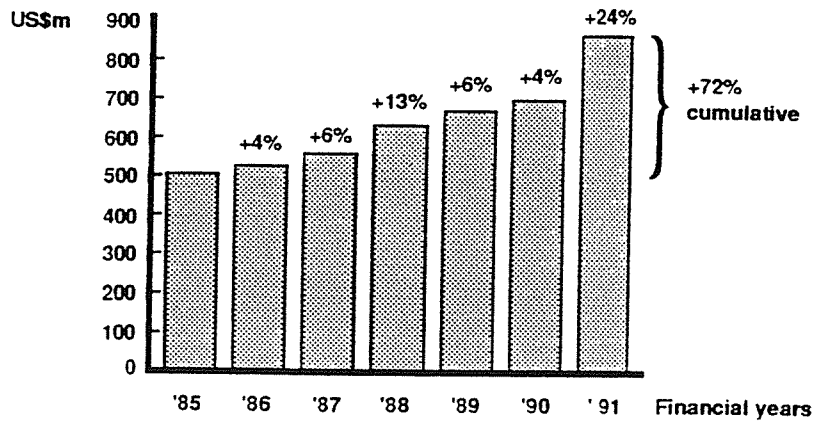


The P & I market

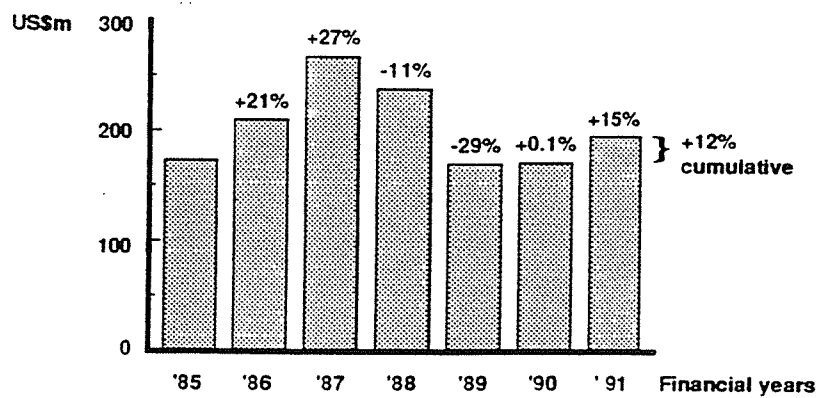


Retained claims exposure - 8 Clubs

Net of reinsurance recoveries

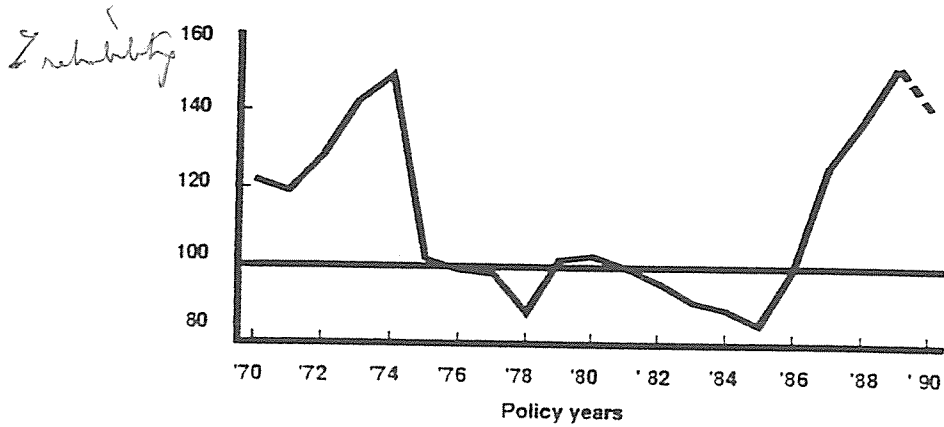


Total investment income - 8 Clubs



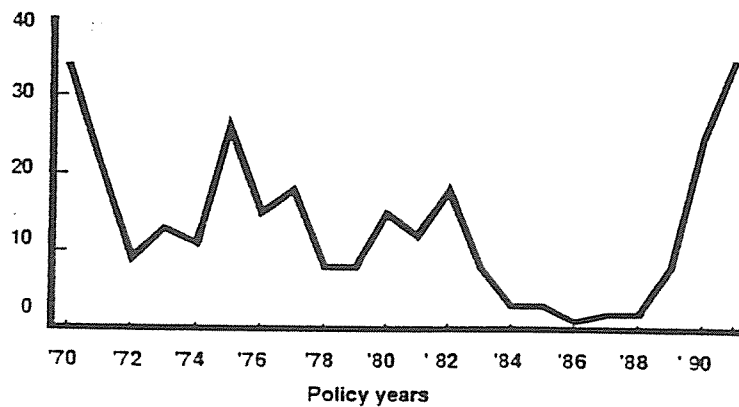
Budgetary reliability - 8 Clubs

100 = 100% of average estimated total cost

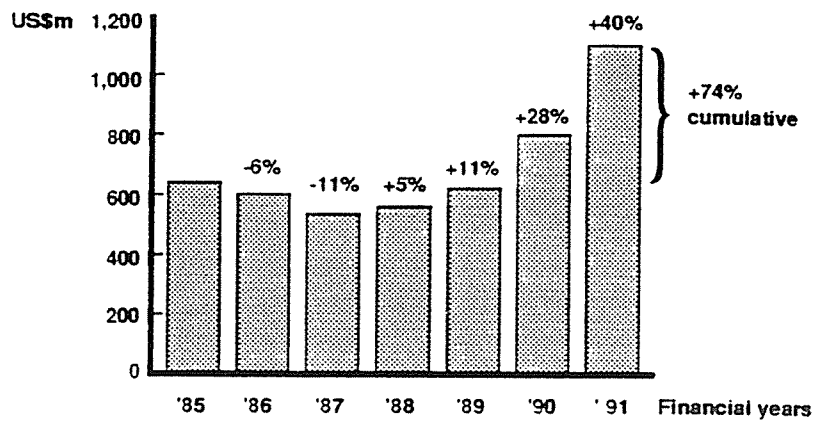


General increase averages - 8 Clubs

% increase



Gross premium income- 8 Clubs



P & I market

Prospects

Claims environment: not improve

Costs: better overall

Broker's role

Client's record: fair treatment
