Trends in Marine Insurance

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Michael Hill established Australia's leading marine insurance organisation, Associated Marine Insurers, in 1982 and is the company's managing director. He was previously a general manager of GRE Insurance. Associated Marine is a 50/50 joint venture of CGU and Zurich.

Michael is a Fellow of the Chartered Insurance Institute with 45 years hands-on marine and management experience. He is a past Vice-Chairman and member of the Executive Committee of the International Union of Marine Insurance (IUMI). He was previously a member of the IUMI Cargo Committee and is presently Chairman of the Nominating Committee. He is a frequent speaker at conferences in Australia and overseas.

Michael's papers on catastrophe risks of dry bulk cargo presented at the IUMI conferences in the USA and Switzerland highlighted the appalling losses of vessels, crew and cargo especially on iron ore carriers from Western Australia. All the tables of loss statistics in his papers were reproduced in the subsequent Australian Government "Ships of Shame" report, which led directly to the total abolition of such losses following wide publicity.

A persistent campaigner for the removal of discriminatory taxes, Michael's campaign resulted in 1986 in the abolition of heavy state stamp duties on marine insurance premiums in all Australian states and territories – still the only business class so exempted. Michael has been a consultant to the Australian Law Reform Commission on admiralty jurisdiction and on marine insurance and a member of a government working party on the law of liability of sea carriers for cargo damage. He also won the individual Exporter of the Year award in 1995 in recognition of his success in exporting marine insurance services.

Presently he is a member of the Marine Standing Committee of the Insurance Council of Australia and is a past chairman of this committee and its predecessors. Last year he co-authored the study courses for the two marine insurance subjects in the Institute's Senior Associate courses.

Trends in Marine Insurance – An Australian Perspective

A paper presented by Michael A. Hill, managing director, Associated Marine Insurers Agents Pty. Ltd., at the Melbourne conference of The Maritime Law Association of Australia and New Zealand, October 2002

Marine insurance forms a small but not unimportant part of the general[1] insurance industry in Australia.[2] It also forms part of the global marine insurance industry.

In marine insurance and maritime law Australians are highly skilled, dynamic and innovative having both the ability and the courage to initiate change. Australia has an important regional role as an exporter of marine insurance and of maritime services, including legal services, and has a high standing in the global maritime environment. It is both a trend setter and a trend follower.

The business of marine insurance is concerned with insuring cargo in transit by sea, air, road and rail; with insurance of ships of all types and sizes from pleasurecraft to oceangoing commercial vessels and with insurance of associated liabilities. Risks are exposed and dispersed around the world. Marine insurance is therefore affected by changes in the worldwide commercial and consumer environment and by legal and legislative trends, national and international.

This paper focuses on marketing and commercial trends in marine insurance. Trends in legal practice and judgements are beyond its scope but the impact of legislative changes on the marine insurance industry will be considered.

A Shrinking Industry

In the days before trucks, interstate railways and aircraft, all movement of cargo and people into or out of Australia or from one part of the vast continent to another was by sea. The high premium rates needed to cover the high incidence of losses of cargo and ships made marine insurance the largest class of general insurance. These days the marine share of total general insurance premiums in Australia has dropped to only 2.0%.[3] This percentage is likely to decline further with other classes of insurance such as home and motor expected to continue to grow at a faster rate than marine.

Marine insurance is shrinking in real terms not just in terms of share of total general insurance premiums written.[4] Marine insurance losses have been massively reduced over the years[5] and so too have marine insurance premium rates. Major loss reduction drivers have been the transition from long and hazardous voyages by wooden sailing ships to fast transits by modern ships and aircraft, the containerisation of cargo, the political imperative of avoiding environmental degradation by oil pollution from ship casualties and, in respect of land transit, better roads and more effective regulation.

The shrinkage of Australian shipping is also having a negative impact on the Australian marine insurance market. There are now just 45 major trading vessels registered in Australia, compared with 78 in 1996, and the numbers are falling.[6]

In free markets excessive and sometimes unskilled competition can drive prices down below cost. This certainly happened with marine insurance. Presently premium rates are rising. But in many cases rates are still less than they were a decade or so ago before successive annual rate reductions were conceded by over supplied insurance markets over focussed on market share growth.

The trend for commercial and industrial enterprises to become ever larger and for big buyers to buy less insurance has been a negative factor in the growth of general insurance, including marine insurance, for some time. It has been accentuated by the development over the last 30 years of the concept of risk management. The drying up of the supply of below cost insurance and the application by insurers of more realistic risk assessment and pricing may further accelerate the trend of insurance buyers retaining more of their own risks.

Fewer But Larger Insurers

Belief in the value of specialisation underpinned the formation in 1982 of Australia's first joint venture marine insurer, Associated Marine Insurers. The prediction of the joint venturers was for a future with fewer, larger and hopefully more professional marine insurers. This has proved to be the case. Four more joint venture marine insurers were subsequently formed, two in Australia and one each in New Zealand and South Africa, all modelled on Associated Marine and each having two insurance companies. They are all still operating but only one remains a joint venture. The founding fathers of Associated Marine definitely set a trend back in 1982.

Australian and overseas mergers, the withdrawal of overseas insurers from Australia and the collapse of HIH have all reduced the number of insurers active in the Australian marine insurance market. This has reduced the over supply of marine insurance in what is after all only a small market by global standards. The remaining marine insurers now have better prospects of achieving the critical mass needed to operate effectively.

Overseas too the trend of consolidation in marine insurance markets continues. This is most evident in London, the historic centre of modern marine insurance and still the world's leading international marine insurance market. The historically distinct Lloyd's and company markets are moving inexorably towards union. The number of marine insurers has dramatically reduced and this trend is expected to continue.[7] The distinction between the company and the Lloyd's market segments is blurring. The largest marine insurer in the London company insurance market vaulted the fence and joined Lloyd's.[8] The subscription or co-insurance market has almost disappeared and Lloyd's will soon be entirely comprised of corporate capital underwriters – insurance companies in all but name. In reinsurance Lloyd's is in danger of falling behind the very fast growing market in Bermuda.[9]

Inexpert underwriters with wet pens urged on by their management to achieve uncosted market share growth targets have been a feature of marine insurance markets in Australia and overseas. Many such underwriters have burnt themselves out – promoted one year and sacked the next. Whilst it may be wishful thinking that marine insurance markets have seen the last of such enthusiastic amateur underwriters, there is presently a flight to quality which offers hope for the future of marine insurance. The more discerning buyers and their brokers are increasingly realising that the lack of professionalism demonstrated by the underwriter offering cheap premiums and often sloppy and restrictive policy wordings is likely to be reflected in poor claims management and in seeking all possible ways of delaying or avoiding payment of claims. You get what you pay for. Surely sensible and realistic pricing is as much a feature of professionalism in marine insurance as it is with any other professional service.

Distribution Trends

The use of brokers to arrange insurance has been a feature of marine insurance for centuries, especially at Lloyd's, but the dominance of insurance brokers in the distribution of marine insurance products globally is a relatively recent phenomena. Commercial insurance buyers found irresistible the broker's promise of more cover for less premium and of free advice and service with the underwriter paying for everything. With the broker billing his client for the gross premium and separately billing the insurer for the brokerage, the cost of the broker's services can be hidden from the consumer. But it is a cost nevertheless and is ultimately reflected in the gross premium paid.

The trend continues for larger and more astute buyers to have the cost of brokerage reflected in up front fees in the same way as for other professional services and with the underwriters charging net premium rates.

The seemingly insatiable appetites of the US insurance brokers, Marsh and Aon, for global expansion by acquisition of other national and international brokers resulted in two global giants in commercial insurance including marine.[10] In reaction, many of the remaining independently owned Australian insurance brokers formed themselves into three so called cluster groups.[11]

An outcome of brokers as well as insurers forming a smaller number of much larger groups has been a change in the way most brokers access Australian marine insurance markets particularly for cargo insurance. The costly and inefficient practice of brokers seeking quotations from numerous underwriters for a single risk with focus on price alone has largely given way to brokers dealing mostly with only a few carefully selected insurers in a move designed to provide clients with more professional services and brokers with increased profitability.

Efficiency Trends

The quill pen and the abacus have given way to computers, fax, email, desktop printing and websites all changing beyond recognition the way marine insurance is conducted and vastly improving its efficiency. Much reduced ratios of administration expenses to gross premiums have to an extent been offset by higher rates of brokerage. In Australia the proportion of gross premium paid for marine insurance brokerage services has in the past ten to fifteen years increased by at least 50% and in some cases has more than doubled.

Trade in Services

Greatly assisted by the abolition of previously onerous stamp duties on marine insurance in all Australian states and territories,[12] Australia now imports less and exports more marine insurance. This demonstrates it is not only in the UK that insurance can positively contribute to the national balance of international trade in services. Some importers still import marine insurance, often unwittingly, by buying on CIF[13] terms of trade and some exporters have yet to recognise the benefits of selling CIF. The need to sell clients on the benefits of buying C &

F[14] and selling CIF presents an ongoing opportunity for insurance brokers to grow their earnings.

Import of marine insurance services also occurs whenever an Australian insurance broker sources marine insurance from an overseas market, such as Lloyd's, rather than from local insurers. The need for this has greatly diminished with the Australian market having the expertise and the capacity to competitively meet most of Australia's marine insurance needs.

The increased focus of Australian insurers on meeting regional marine insurance needs has increased the direct export of marine insurance and reinsurance services. The national maritime industry has benefited as a flow on from this trend. When marine insurance from an overseas country is provided by or controlled by Australian insurers, the subsequent claim servicing needs are more likely also to be met from Australia. This means salvage, repair, survey and legal services being sourced from Australia. Just as in history trade followed the flag so in the present day do maritime services follow marine insurance.

Product Trends

There has been a discernible trend to the availability in Australia of a wider range of marine and transit insurance products. These feature simpler plain English wordings and cover better tailored to consumers' needs. This trend is most evident in goods in transit, carriers, personal lines and liability insurance where individual insurer's wordings apply. The insurance of import/export cargo and of commercial hull risks is almost invariably still subject to the internationally used London Institute Clauses. However, the use of Institute Cargo Clauses for purely land transits of cargo has all but ceased.

The Institute Time Clauses Hulls are presently being revised and hopefully simplified. There is a need to revise the 1982 Institute Cargo Clauses and especially the Risks Clause therein which is unchanged since 1963. The failure of the clause wordings to effectively link the insurable interest requirement with attachment of cover under the Transit Clause leads to much confusion and needs to be addressed. My attempt to achieve these reforms in 1995, aided and encouraged by one of your more active members, didn't succeed but it did get me an interview in London with those usually faceless men of the Technical and Clauses Committee.[15]

Carriers as Risk Bearers

The practice of large land transit carriers and of household removalists providing and charging shippers for cargo insurance but then retaining much of the risk and the premium themselves has long been a feature of marine insurance in Australia. Attempts to extend this practice to the insurance of overseas marine cargo through so called insured or full liability bills of lading failed. The onerous training and operational requirements of the recently enacted Financial Services Reform Act may cause general carriers and household removalists to change their practice of advising and offering clients insurance on the goods to be carried.

Loss of Independence

As the oldest class of general insurance, marine insurance has maintained a high level of independence in organisational, marketing and legal terms from the later developing fire and then accident classes of insurance. The more recent separation into commercial and personal lines of insurance has seen some loss of independence with marine underwriters often ending up as only a small segment of a commercial insurance division and with marine claims being bundled into a composite claims division. But market leadership in marine insurance still comes from organisations with specialist marine insurance divisions and with organisational structures conducive to the effective management of marine insurance and to the development of expertise in marine insurance including claims.

Trade associations for marine insurance are being wound up and their functions absorbed into composite insurance organisations. The oldest of all the state insurance associations and the oldest ancestor of today's Insurance Council of Australia was The Marine Underwriters and Salvage Association of Victoria. This was established in 1869 as The Merchant Shipping and Underwriters Association.[16] This was 23 years before the formation in 1888 of the famous Institute of London Underwriters which lost its independence in 1999 when it was absorbed by the non-marine London Underwriters Association. The French marine insurance association suffered a similar fate. Internationally the International Union of Marine Insurance, comprised of national insurance associations, still functions effectively as a forum for discussing marine insurance issues.

Legislative Tidal Wave

The 1924 Sea Carriage of Goods Act, implemented in Australia the internationally agreed Hague Rules and the 1959 Civil Aviation (Carriers Liability) Act implemented the Warsaw Convention. These Acts regulated insurers' rights under subrogation to hold sea and air carriers responsible for cargo loss or damage.

Apart from this, Australian marine insurers went about their business largely untroubled by legislative changes for 75 years from 1909, when Australia enacted its equivalent of the 1906 UK Marine Insurance Act, until 1984. In that year, instead of the forecast pervasive control of Big Brother,[17] marine insurers found themselves inundated by a tidal wave of new legislation that commenced pouring out of Canberra in an unprecedented burst of legislative zeal.[18] The crest of this wave hasn't yet broken.

Potential legislative changes are envisaged to reform the venerable Marine Insurance Act[19] and once again to reform the Hague Rules.[20] If change is stimulating, Australian marine insurers face a well stimulated future. Hopefully, in the time left over from coping with a world of almost constant change, they will be able to continue to provide a professional service to their clients, an adequate return to their shareholders and a positive contribution to the national economy.

Reference Index

1 General Insurance means insurance other than life and health insurance.

2 Australian Prudential Regulatory Authority (APRA) Selected Statistics on the General Insurance Industry Year Ending December 2001 show in table 6 marine and aviation premium revenue of $369.9m. The last full year when aviation premium revenue was shown separately from marine was the year ending December 1996. Based on the APRA report for that and for the prior year aviation premium revenue was 8% of combined marine and aviation. Thus applying 92% to 369.9m produces 340.3m for marine only premium revenue for year ending December 2001. This was 2.0% of total premium revenue for all general insurance of 16,846.8m

3 See note 2 above.

4 The APRA annual Selected Statistics reports referred to in 2 above show marine and aviation premium revenue for years ending December of 507.1m in 1999, 380.3m in 2000 and 369.9m in 2001. The 2001 premium revenue is down 3% on 2000 and 27% on 1999. On a global basis a report presented by The Central Union of Marine Underwriters, Oslo, to the 2001 Genoa conference of the International Union of Marine Insurance (IUMI) revealed premiums reduced from US$12.1 billion in 1998 to $11.0 billion in 1999. In 1995 they were $16.7 billion.

5 Marine and Casualty Statistics of the International Underwriting Association of London presented at the 1999 Berlin conference of the IUMI showed in Chart C5 world loss ratios of shipping tonnage totally lost each year as a percentage of global tonnage afloat each year had reduced from .43% in 1991 to .16% in 1998. Unfortunately this very useful annual statistical report is no longer produced.

6 "Sailing far from smooth for local firms" by Mark Lawson in The Australian Financial Review 22.8.02.

7 Swiss Re Sigma report 3/2002 notes on p. 9 "At the start of the 1990's there were over 120 Lloyd's syndicates writing marine risks, while in the year 2002 there are only between 20 and 25. A similar incisive trend was to be observed among insurance companies: the membership of the marine insurance organisation Institute of London Underwriters shrank from 118 to 46 between 1990 and 1998."

8 This was CGU Insurance (previously Commercial Union) which in 1999 transferred its London marine insurance business from the International Underwriting Association (the London company market organisation) to Lloyd's by buying Marlborough Underwriting Agency Limited subsequently sold, along with the marine insurance portfolio, to Berkshire Hathaway in late 2000 following CGU's merger with Norwich Union.

9 See Sigma report 3/2002 (cited in 6 above) at p. 15 to 18.

10 Insurance Day 13.8.02 on p.5 "the worlds market leading insurance brokers, Marsh and Aon, which between them account for over 50% market share."

11 Steadfast, IBNA and Austbrokers.

12 The publication by Michael A. Hill in 1984 of a paper "Marine Insurance – a Neglected Service Industry" and subsequent lobbying led in 1986 to a decision of the Hawke federal government, on national interest grounds, to abolish stamp duty on marine insurance in the ACT and to recommend this action to the States. Following initial abolition by Victoria, all states and territories abolished stamp duty on marine insurance, other than on pleasurecraft and on marine liability insurances.

13 Cost, insurance and freight.

14 Cost and freight.

15 See "Beyond All Risks", a paper presented by Michael A. Hill at the 1995 IUMI Tokyo conference. The member of MLAANZ referred to is Andrew Tulloch of Phillips Fox, Melbourne.

[16] The Marine Underwriters and Salvage Association of Victoria Limited along with other state marine insurance organisations, the Council of Marine Underwriters of the Commonwealth of Australia and fire and accident associations were all wound up or disbanded in 1975 on the formation of The Insurance Council of Australia (ICA).

[17] See "1984" by George Orwell first published in 1949.

[18] Amongst the most significant legislation for marine insurers are
Insurance Contracts Act 1984
Insurance (Agents & Brokers) Act 1984
Admiralty Act 1988 (i)
Limitation of Liability for Maritime Claims Act 1989 (ii)
Carriage of Goods by Sea Act 1991 (iii)
Insurance Laws Amendment Act 1977 (iv)
A New Tax System (Goods and Services Tax) Act 1999
Privacy Amendment (Private Sector) Act 2000
Financial Services Reform Act 2001
General Insurance Reform Act 2001

(i) Reforming Admiralty jurisdiction in Australia
(ii) Whereby Australia adopted the 1976 Limitation Convention replacing the very outdated provisions of the Merchant Shipping Act 1894.
(iii) Whereby Australia replaced the 1924 Hague Rules by the 1968 Hague Visby Rules and the 1979 SDR Convention.
(iv) Taking pleasurecraft insurance out of the 1909 Marine Insurance Act and into the 1984 Insurance Contracts Act.

[19] Review of the Marine Insurance Act 1909 – Report 91 of Australian Law Reform Commission, April 2001.

[20] See Final Draft Outline Instrument prepared by the Working Group of CMI 2001 to be submitted to UNCITRAL as the basis of a new international convention to replace Hague, Hague Visby and Hamburg Rules.