The Seven Critical Flaws in Shipowners Insurance!

I have worked inside the insurance industry as a broker/agent, consultant, instructor and expert witness for more than 30 years, and have created this report to highlight the seven critical gaps you might find in your insurance program.

Too many people discover these gaps only after they have an unpaid claim or years after they sign up for the program that keeps coming back to attack their bank balance. During my years of reviewing policies either for agents or as an expert witness, I have seen real life examples of each of these flaws, costing shipowners hundreds of thousands or even millions of dollars. In some cases, literally costing the owner their business.

When you are buying a car, it is easy to tell the difference between a $10,000 and a $50,000 car, quality, reliability and safety are clearly the top concerns. However, insurance programs and individual insurance policies are complex and you cannot go around and kick the tires to find out how they will perform. Clearly, not everyone needs a Cadillac, but you do need to know how to evaluate the specific problems of your insurance policies and where it is wise to spend the money to plug the gaps.

Knowledge is power - read on.

Ian R. Greenway

LIG Educational & Consulting Services, Inc.

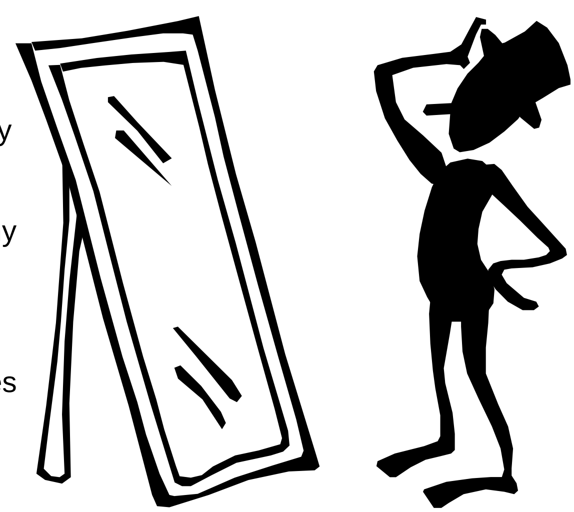
FLAW #1 DUBIOUS COMPANIES

Marine insurance is probably the most deregulated form of insurance, and therefore it tends to be an area where the undercapitalized, poorly run, and even fraudulent company is encountered. The first question to ask is whether the company that is offering you insurance is “Licensed” or “Surplus Lines Approved” in your home state. Licensed carriers offer a greater degree of security than Surplus Lines companies, but both give you the ability to resolve the contentious claim with the assistance of your state’s insurance department or, if necessary, the courts in your state.

If the carrier you have is neither surplus lines nor licensed in your domicile, you might have difficulty bringing any type of action against them, particularly in many “offshore” locations. In addition, these “unapproved” carriers often have little or no supervision by regulatory authorities and their assets, on more than one occasion, have proved to be a figment of somebody’s imagination.

SOLUTION: ask the agent for the full name of the company and their home office city, state and country. Call your Insurance Department (the number will be in the government section in your telephone directory under the state government heading) and ask if the carrier is licensed or surplus line approved? Plus, ask what other information they have about the carrier. One phone call could save you Millions!

CAUTION: Watch out for “look alike” names. One of the favorite tricks of these types of companies is to pick a name that is similar to a top quality, respectable company. If the name and city/country do not match exactly, make sure you are talking about the same company. One of the classic frauds was perpetrated by a company who simply changed the last (fourth) word of their name from “company” to “corporation” (the former being a very respectable and well-known business). Imagine the abbreviation of both names to “Co.”



FLAW #2 ASSESSMENTS

Well over 90 percent of the world's Protection and Indemnity premiums are written by groups called P&I clubs. These vary greatly in financial stability. But all of these Clubs have one thing in common; they have the right (and sometimes plan directly) to assess their members (the shipowners) if the premiums they receive, do not cover the losses and expenses for running the club. If this is clearly explained to you, and you are with one of the clubs whose numbers are very predictable, you can hold on to part of your cash for a while to pay those assessments down the road. If, however, this was not clearly explained up front, or your club is one of the less secure, these assessments can be a very nasty surprise.

Take for example one (now defunct) club. If you had joined this club in 1994, their recent past history at that time, supported an assessment (or "call") of 20% each year, which they had delivered. Thus, the shipowner with say, $100,000 of annual premiums with this club, simply allocated $20,000 each year to pay the "call" when requested. Now take their most recent five years, their calls ran 110%, 180%, 180%, 95%, 95% ***in addition*** to their base premiums. So that $100,000 a year (or $500,000 over five years) became a total premium of $1,150,000 or an additional $650,000 - way over the 5 x $20,000 salted away. Could you survive if you had to come up with more than double your original premiums? (By the way if you leave a club when you find out about the assessments, you could also get hit with a further penalty called a "release call".)

If you are currently with a club, you have two options:

1) Consider a fixed cost alternative. Often of similar price, you can eliminate the potential for unplanned assessments down the road.

2) Review the financial structure of your club. Are they properly funded for future claims? What's the likelihood of unplanned calls in the future? Even though most of the top clubs have an agreement that they will not compete by undercutting your premiums, potential future assessments might just be the right reason to move.

FLAW #3 CREW COVERAGE

Or should I say, the lack of it. All major protection & indemnity policy forms in current use today for shipowners automatically include coverage for injury to your crew. However underwriters do on occasion add riders called endorsements to the back of their policies that can exclude "crew" and/or your "other employees." These deals look cheap, but in reality they are leaving a huge gap in the insurance program.

Consider for a moment, the shipowner who has an unpaid crew claim. That injured crewman can, at a minimum, have the ship arrested - that stops you working and earning money! Then in certain cases they can have the ship sold and take the proceeds before payment, not only to you, the owner, but also the bank or lender!

You are not only out of business with that vessel, but will also have a hungry bank breathing down your neck for repayment . . . Now is ***not*** the time to check if anyone personally guaranteed that loan!

Please do not assume that this coverage is there. Policies are complex and often poorly structured, and only reading every line of the policy and all its endorsements will tell you what you have.

FLAW #4 CARGO COVERAGE

Just like crew coverage, Cargo Legal Liability is a critical element of the shipowner's insurance program. Common policies in use today are mixed in the inclusion or exclusion of cargo coverage, but all can either exclude or include by endorsement. The critical question is, whether it is worth the dollars to insure, and that is a commercial decision you must make.

The first step here is to identify the exposure. Simply saying that you require the cargo owner/shipper to carry cargo insurance does not avoid any liability on the shipowner's part. Perhaps the shipper wants to come directly at you for negligence, perhaps the claim comes as subrogation from the cargo owners insurance, either way you could be on the hook for it.

Here are the questions to consider:

1. Do I carry cargo legal liability in my current policy?
2. If not, what would it cost to add?
3. If my current insurer will not add that coverage, what would it cost to switch to another carrier?
4. How much cargo could I destroy in one incident?
5. Is that additional premium worth the risk of the destroyed cargo?

Your premium, your choice: but make the choice, don't find out when the cargo claim occurs.

FLAW #5 HULL RESTRICTED CONDITIONS

Hull policy forms are cloaked in mysteries, form titles “CL280", “CL284" or the notorious “CL289" mean little to most owners and even to most insurance agents (with the exception of a few specialist commercial marine agents) and yet their differences can be enormous.

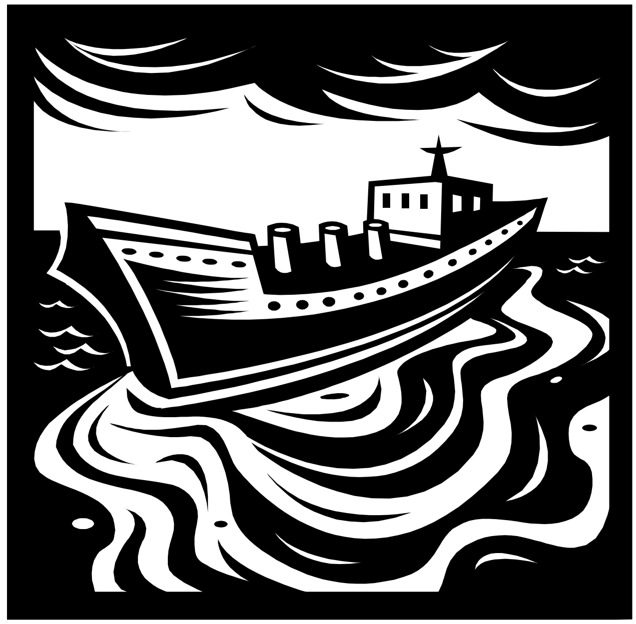
In this short report it is impossible to go into the comparison of every form, but you must research and find out what your form does and does not cover. Even when you understand the basic policy form understood, you still have a long way to go.

Take for example the term “F.P.A.”, a very common marine insurance abbreviation, meaning Free of Particular Average. That cleared it right up didn’t it??? No?, well read on.

“F.P.A.” simply translated means that the only time the insurance company is going to pay a claim is in the event of a total loss of the vessel (“particular average” means a partial loss - “free of” means it is not covered!). Shock!! Gasp!! - that $500,000 loss due to a fire on your $1,000,000 ship is not covered!.

Find out up front exactly what is or is not covered. Often a few extra dollars on the premium (and sometimes no extra dollars) will get you a lot more coverage, just for the asking!

FLAW #6 POLLUTION COVERAGE



An issue of growing concern, particularly since the Exxon Valdiz spill in Alaska, has two distinct elements.

The first is, do you have the appropriate pollution coverage (and limits) to pay for the spill. The decreasing tolerance for pollution of any variety means that shipowners are increasingly being tagged for spills, and the actual amount and scope of damages is constantly expanding. We see shipowners with limits as low as $500,000 on their pollution coverage. Remember you can pollute with just about any substance today, and it is not just restricted to oil.

The second element is the trading requirements. Is the pollution coverage you have in place adequate to allow you to trade not only with the countries you are currently in but also any place you might want to go? If suddenly that large, lucrative cargo opportunity comes, are you (and your pollution coverage) going to be able to respond quickly enough to seize the opportunity?

FLAW #7 LOSS OF HIRE

Every restaurant, hotel and store you walk into has as part of its insurance program a coverage variously called loss of income or business interruption. Whilst differing forms have slightly different coverages, their purpose is to pay for continuing expenses and a loss of profits after a claim.

If your ship is damaged and it takes weeks or months to repair, during that entire period you have to pay your loan, key clerical staff and probably the captain and some of the crew, your insurance company, and numerous other expenses. But whilst it's laid up under repair, you have ZERO income to cover these expenses (let alone the money you were planning as a profit!). Further, you may even have to charter a replacement vessel to fulfill a contact to which you have committed.

Loss of Hire is the marine term for this coverage. Yet few owners are even offered Loss of Hire.

Is it worth it? As with cargo coverage, it is a decision you have to make. But make it an informed decision... find out the cost of such a policy, and weigh it against your chance of a loss. If you feel it is too expensive, look at it again with a large deductible (or waiting period), maybe you can easily carry the risk if your ship is out for a week or two, but maybe if it's over a month it would stretch your resources. (Premiums can drop drastically with longer waiting periods.)

OVERCOMING THESE FLAWS

Simplistically, each of these flaws can be overcome by carefully studying and understanding each part of your insurance program. I like to think of it as a jig saw puzzle; many of the issues I have raised above are invisible if viewed alone, but if put together as part of your program, then the missing pieces become apparent.

If you have the knowledge to read these policies (and their exclusions), the dedication to call the insurance department, the resources to question your agent and, most of all, the time to put it all together then great, have at it and I hope that when your claims come it is NOT in one of these gaps.

For those of you who don't have the time or resources available to do this, or maybe you just want the comfort of someone else reviewing these policies, then you have a couple of options.

The first option is to have an agent perform an independent review of your policies. Usually free, but clearly most agents have a vested interest in pointing out the flaws that they can plug easily and those which will persuade you to switch the business to them. However it is a valuable tool, particularly if used mid-term in the policy.

Alternately, hire a consultant who can look at your program, identify gaps, and recommend coverages you are missing. It might cost you a few thousand dollars (dependant on your size and the depth of review you need) but that might be a bargain compared to the amount you might lose on an uncovered claim. Frequently consultants can also help you draft policy/bid specifications and help you access the best markets for your risks, in many cases saving more than their costs.

WARNING: Look in any yellow pages or Internet listings and you will find more insurance agents and consultants than you can imagine. But the vast majority of them do not specialize in marine business, and even if they do, it's often yachts, charter boats or marinas, and as such would be totally lost. Try a couple of loaded questions. For example:

1. What is Loss of Hire Insurance? (see page 9)
2. What does F.P.A. mean? (see page 7)

If the agent or consultant cannot give you those answers, then are they going to be able to properly review your policies and tell you how they will respond?

WHO IS LIG EDUCATIONAL AND CONSULTING SERVICES?

We are part of Florida based, LIG, our sister operations include LIG Marine Managers and LIG International Insurance who are MGA's (or wholesalers) of marine and international insurance for Domestic US, London and International markets, we are NOT insurance agents, we do not solicit insurance from shipowners, but accept applications only through independent insurance agencies across the USA and in the Carribean

LIGECS operates independently of our sister operations and provides services in marine and international insurance in three ways:

- Education and training of agents within the insurance industry in Marine and International topics
- Fee-based consultancy services on marine and international insurance
- Expert witness work in the marine and international insurance field

It is this last aspect that has allowed us to see so many of the problems that exist for shipowners and provides much of the material included in this report

HOW CAN WE HELP?

As LIGECS we can act as your consultant on a fee paid basis and can review your current program, identify gaps, write bid specifications, work with your current agent to obtain quotes to plug those gaps and refer you DIRECTLY to the best carriers, brokers and agents for your coverage.

Alternately, through LIG Marine Managers we can work with your current independent agent to identify those gaps and quote a comprehensive program where you can select those coverages that best suit your needs.

Either way, LIG can and will help your insurance program strike that vital balance between coverage and price.

Phew! Its over, 10 pages jammed packed with information, but information that you will find vital to your business. If you have struggled through every line of this, thank you and congratulations. I promise you that every minute you have invested will pay dividends

Happy Sailings

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