

Managing risk in cargo insurance: Current realities and future possibilities

Mr Ram Nair, Manager, Underwriting & Business Development with ACE American Insurance Co, assesses the changes giving rise to new challenge and opportunities in the marine cargo insurance business.



Though there have been many positive changes in shipping and marine cargo insurance, this class of business is never quite given the importance it deserves.

Despite the sophistication in many other areas, the management of the supply chain frequently faces undue pressures to reduce costs. Shipping and cargo insurance, at the bottom of this “food chain”, often has to bear the cumulative cost pressures. The collective value of the goods lost to such cost saving practices far outweighs the gains of the entrepreneur and it is his insurer who ends up “carrying the baby”.

Everyone then is forced to take a short-term view which can lead to a degree of instability in the market. Initiatives that could be rewarding in the long-term are made untenable due to the drastic swings in the market. The speculative mindset of some players – both cargo owners and insurers – can cause deep underlying problems for the entire industry.

The present

One of the major factors contributing to this short-term view is the availability of capacity in the cargo insurance market. Often insurers, in a quest to bring in bulk premiums (to increase the cash flow in order to service the capital), deploy their “marine capacities” at a lesser cost. And often, cargo insurance is given away almost at no cost in order to acquire large portfolios with bulk “non-marine” premiums.

Though this is the current scenario generally, there has been a growing demand for changes. The elements that necessitate changes in marine insurance can be summed up as follows:

Globalisation

Border demarcations in this global economy are slowly disappearing in economic processes. Though this has resulted in the expansion of transport capacities all over the world, they are being put under further strain by sheer demand. Within Asia, the nature of logistics will also change as pressure on classical trade routes grows. For many years, trade has been centred on the ports, but it will continue to move inland, putting further strain on roads, railroads and rivers.

As a result, the strain on the system will increase the potential risk of mistakes leading to an increase in losses.

Terrorism

The scale of the 9/11 attacks and the reach of the perpetrators

were, until that point, simply beyond anyone’s expectations. Measures to counter and prevent such events had to be implemented.

One such measure, now being contemplated by the US Congress, is a law requiring carriers to equip their containers with GPS transponders. These devices would store information about origin, travel route, destination and the container’s contents, making it easier for border security and customs to determine the container’s security status.

While incurring extra infrastructural investments for transporters, it would also mean large amounts of data would be available which could be of great value to shippers and insurers alike. The key would be to collate, analyse and organise the data in usable formats. Once that is possible, it would lead to improved service to the cargo owner and the calls will be there for better priced cargo insurance products.

Piracy

In the past, pirates attacked ships to get at the petty cash on board or to make off with the ship’s cargo. Today, hijacking is the new trend. It is much more lucrative. The ransom demands have increased tenfold in recent years. In the case of the *Sirius Star*, the hijackers are said to have taken an eight-figure sum before releasing the ship and the cargo.

Marine insurance will no doubt bear this burden (International Maritime Bureau put the cost of “crimes at sea” at about US\$18 billion in 2007). Soon, the industry will have to factor this into the costs and pass it on even to the cargo owners.

Climate

During the early days of 2008, three times the average number of tornados struck the Southern US. Recently, the Middle East and Southern China also had their share of erratic weather conditions. This local evidence is supported by broad scientific consensus that major climate change is underway. As the predominant share of the cargo business is carried on ships over oceans and stored in international ports close to water, insurers will need to be very sensitive to future climate development.

Cargo Clauses 2009

Cargo insurance policy clauses are being adjusted to reflect today’s ways of doing business and the technological changes. The new 2009 Clauses have started to enter regular use in some International markets and are expected to be used widely by the end of 2010. They reflect the current Trade

Condition's exposure profiles caused by modern logistics and technology, the threat of terrorism and marine fraud.

Some major changes include increased duration "shelf to tailgate", protection for good faith buyers/assignees of policies, alterations to exclusions (Insufficiency of Packing, Delay, Defining Terrorism etc), "held covered" supplemented by reasonable market test, change of voyage protecting innocent insured, Institute Cargo 'B' coverage, general updating of wording, supplementary coverage and so on.

The future

Insurance markets have recognised the need to play a proactive role and have realised the importance of "quick delivery". The revamped, net-based premium quotes are offered and the way insurance certificates (proof of protection) are transmitted demonstrates this. Technology is revolutionising the world of transportation and logistics.

It is easy to believe that arranging the transport and the insurance cover ends the entrepreneur's responsibilities, but when things go wrong, he would quickly discover that the consequences still affect him. These could range from damage to his reputation, a lost opportunity in a new market, delays to completion of a project, or contractual liability for late delivery. "The safe delivery to the "customer" is now regarded as the final stage in any successful business deal.

Efficient and direct process has become the key for a successful service industry. A successful marine cargo insurance strategy would have to address the following crucial issues:

Increased capacity at an acceptable price

This would be the key in the evolving scenario. As the amounts of cargo being shipped around the global economy increases, there will be a need for greater insurance limits and enlarged insurance capacity. The risk from weather-related hazards and terrorism-incurred losses also indicate larger capacity requirements in future.

Need-based solutions

This is right evaluation of the needs of the shipper and helping him to achieve the realisation of his business process or safe delivery. Statistics show that 70% to 80% of cargo losses could be avoided by proper risk management.

Cargo risk management concept

A new trend that is making inroads in the traditional cargo insurance programmes is the process of risk management or loss control engineering. This ensures that the owner's products are delivered on time and in undamaged condition to their clients.

The key elements here are:

- Review of cargo operations;
- Identifying the risk elements;
- Viable actions in minimisation – interaction with experienced mariners, etc, to decide on the best possible practices, etc;
- Use of multi-disciplined cargo risk management philosophy;
- Innovative approach and tailor made and viable solutions.

With increased globalisation, multinational insurance policies are also on the increase. Risk managers are increas-

ing their demands for adaptation to ensure their policies fully comply with all local legislation. Providing solutions in this area is fast becoming a speciality for many insurers.

Special challenge – Risk management of project cargo

In line with the trends of globalisation, the execution of projects – be it a new power station, petrochemical plant, railway line, hospital or other similar project – are also becoming global affairs. Engineering Procurement & Construction (EPC) contracts often include procurements from almost all parts of globe. Project cargo insurers are increasingly being called upon to deliver solution for situations involving;

- Multiple contractors and suppliers per project – coordination of equipment arriving on site and availability of lay down areas;
- Often no overall project freight forwarder;
- Long term booking of heavy lift vessels and land transport - limited availability;
- Problems of shipments being a mix of DDP, FOB, Ex works, CIP – who is responsible for what stage;
- Accumulation of equipment at staging points prior to shipment to final project location;
- Agreed procedures in the event of a claim.

Insurers are delivering solutions by using specialised risk engineers experienced in multiple disciplines such as being master mariners and engineers. Use of this multi-disciplinary approach of cargo risk management ensures a smooth and safe transportation of the components to the project locations in the most cost effective manner and on time.

Marine cargo insurers are sensitive to the fact that in this era of globalisation, the success will be with those who can offer:

- Secure and large capacity;
- Right cover and price;
- IT solutions;
- Competent risk management;
- International knowledge and reach;
- Tailored products and services; and
- Expert claims handling.

