OCEAN MARINE RATE MAKING

BY

D. DOUGLAS ROBERTSON

The subject of rating for Ocean Marine Insurance is a complex one. Also, the same complexities exist in Marine Insurance which, in addition to ocean carriage, embraces a considerable volume of true Marine Insurance in respect to vessels and cargoes operating not only on the Great Lakes but on other inland lakes and waters such as the McKenzie River System and the St. Lawrence River. To deal with the subject properly, it is essential to divide it into at least two major categories, i.e., Cargo Insurance and Hull Insurance.

CARGO INSURANCE

Unlike a majority of underwriters of other forms of insurance, cargo underwriters are, by and large, individualists who not only have little if any desire to pool their knowledge of the business with competitors, but who actively resist efforts put forward on occasion to achieve such a pooling of results.

The reason for this is simple. There are many different types of cargo which can be insured for anything from very limited to very broad insuring conditions, even including in some instances inherent vice or defect. An underwriter may experiment with a certain commodity at certain rates insured against certain perils and discover that such a basis, which might be quite different from the generally accepted practice in that particular trade, works out quite satisfactorily and therefore gives him specialized knowledge not generally known to his competitors. This may permit him to expand his writings in that particular field.

Cargo underwriting is very competitive. This is partly due to the fact that on a large account shipping to or from many parts of the World one can with justice say he is competing with cargo underwriters the World over. This is due to the fact that a large percentage of ocean trade is done under Contracts of Sale where insurance can be arranged either by the shipper or the consignee, depending upon which of the two parties involved can secure in his home insurance market the better contract either rate-wise or cover-wise, or both. This is another good reason for not making specialized knowledge the common property of all underwriters.

There are, of course, exceptions or partial exceptions to this practice, particularly in fields where the volume of traffic is exceptionally heavy, such as the transportation of grain where World-wide practice, to a large degree at least, dictates certain standard insuring conditions possibly set by the principal marketing Associations dealing in such commodities. In the case of grain shipments, the bulk of such shipments are insured under Corn Trade Association (an English organization) clauses which provide comparatively limited coverage. Due to the volume of business involved and the restricted insuring terms granted in this trade, rates are low and have a tendency to keep getting lower and lower over a period of years as one office competes with another until, either after a disastrous year due to a number of total losses or a general acceptance of the fact that all profit or even hope of profit has long disappeared, most underwriters will put drastically increased rates into effect. Then within a fairly short time the same old cycle of competition is repeated all over again.

Cargo rates basically depend on the experience of the individual accounts. Accounts handling similar commodities on similar trade routes can have widely dissimilar experience. This could be accounted for by various factors:

(a) Difference in the quality of packing. One might use cartons, another wood cases.

(b) Recoveries from carriers. One concern might do an excellent job in recovering all they can from steamship carriers before calling on their underwriters to pay, whereas another might just present their claims to their insurance company and let the company exercise their subrogation rights against carriers. Naturally, the importer or exporter has a bigger stick to wield against carriers than any insurance company has. The shipper can threaten to ship by some other line if the carrier does not honour his obligations.

(c) Salvage of damaged merchandise. Losses can be minimized on certain commodities (i.e., cherries or olives in brine) by prompt action on the part of the importer in rebrining slack barrels promptly on arrival at destination. Some importers are more prone to cooperate with underwriters in such matters than others.

(d) Absorption of claims. Some importers claim for every loss no matter how minor, whereas others absorb the smaller claims without reference to their underwriters.

These factors and others can have considerable influence in making an account profitable or otherwise and eventually they are reflected in reduced rates for the better accounts and increased rates for the poorer ones.

Underwriters and claims adjusters continually carry on an education campaign to teach insureds how to keep losses down or, if they do occur, how to minimize them or assist in recovery work against third parties if the claims are of the type which should be paid for by the steamship carriers or others who might be held responsible such as stevedores, rail or highway carriers.

It is, of course, not feasible to take major losses such as total loss of vessel or a serious general average loss into account and immediately revise rates on individual accounts which might suffer from such occurrences. It is necessary, however, annually to check accounts and see that a sufficient margin of profit is left over after paying the "mill run" losses and expenses, so that a backlog of profit is built up to pay the anticipated total loss or serious general average claim which on a large active account might be anticipated once every 15 to 20 years.

As a rule, the individual account records are examined annually and those with loss ratios, exceeding say 55%, are then examined in detail to ascertain the type of loss which has been occurring. In some cases remedies other than increased rates can be suggested. Accounts with exceptionally good records over the past five-year term can expect reductions in rate.

Many factors, other than "perils of the sea," such as fires, collisions, strandings, sinkings, explosions, or sea-water damage caused by excessive violence of the elements can produce cargo losses. A few of the better known perils are theft, pilferage, non-delivery, hook damage, oil damage, other cargo damage, fresh water damage, leakage, breakage, ullage, seepage, rats, rot, vermin infestation, scratching, marring and denting, ship's sweat, heating, etc. Some commodities are more susceptible to certain perils than others. Commodities, such as cameras, nylons, whiskey and lighters for example, are more likely to be stolen or pilfered than bags of flour or cement. Sea-water will do more damage to machinery than it will to a cargo of ore. Perishable foodstuffs are more susceptible to a host of perils such as infestation, other cargo damage, ship's sweat and heating than lumber would be.

All these factors and many others are reflected in rating. For example, a cargo of grain in bulk from Montreal to London, England might be rated as low as 10¢ per $100.00, whereas the rate on flour in cotton bags which are susceptible to tearing, taint from other cargo and stevedores' hooks might require a rate of 30¢ per $100.00 to produce any hope of profit. On the same voyage, polystyrene in 5-ply paper bags which sounds innocent enough would probably prove unprofitable at any rate lower than 75¢ per $100.00.

Many ports in the World are such that cargo, or at least a portion of it, requires lightering from ship to shore by small craft. At some few so-called ports the lighters have to land on a beach through heavy surf. As a result, serious water damages result, particularly at the surf landing points. The incidence of thievery is much greater in some areas of the World than others. Currency difficulties in certain countries necessitate the retention of much merchandise in customs; often housed (if housed at all) in inadequate premises for periods of months beyond a normal period of transit. Strikes at a port or in a country can delay delivery of property beyond normal periods or cause the overcarriage of cargo not unloaded back to the country of origin and finally back to the original destination. All these are factors in rating.

World conditions such as wars, whether they be local or World wars, are reflected in marine cargo underwriting. A review of a marine cargo open policy which had been in force continually, say from 1929 to the present time, without being rewritten would reflect in part at least the history of the World during that period of time. It would include endorsements dealing with War Risk coverage which came into being due to the Shanghai invasion in 1930, the Spanish Civil War, Italy's war against Ethiopia, numerous happenings during World War II, and later developments. Most insureds carry insurance against War Risks and rates for such protection are subject to change from time to time depending on World events. During 1942, at the peak of the submarine campaign, rate changes were almost daily affairs. The highest rate paid, for example, reached 35% for a two-week period during 1942 for shipments to India involving a trans-shipment. Rates of 10% to 20% during 1942 were very common and even at such high rates War Risk coverages during 1942 proved to be extremely unprofitable to underwriters on this side of the Atlantic.

In general, a cargo underwriter's rate making is based on his own past experience reflected in his statistical records which are produced (a) on an account basis and (b) on a commodity basis. To some degree the average cargo underwriter will compare notes with some of his friendly competitors. To some degree, particularly when dealing with large individual risks or exceptionally large individual policies, rates can be influenced by the availability of reinsurance markets.

HULL INSURANCE

The subject of hull insurance rating is one on which I am not as qualified to talk on as some others would be as I have had little to do with rating hulls in recent years. I am, however, more or less familiar with current practice.

There are many different types of hull insurance where coverage can range from the minimum of "Absolute total loss of vessel only" to very broad forms of coverage which are practically an All Risk form comparable (although the words used will differ greatly) to the broad form of protection available under certain Inland Marine forms of policy with which you gentlemen will be familiar.

The variations in hull insurance are endless as there are many standard forms of wording used in different trades, fields, areas, countries and then many variations of these standard forms by the use of varying franchises or deductibles or other limitations or extensions. Some smart broker or underwriter is always coming up with a new angle in this field and many are the experiments which are tried. To attempt to give you anything worthwhile would require a rather large book, so I will limit my remarks to one or two facets of this field.

Basically, hull insurance is rated on a fleet basis and to a large degree the individual fleet owner makes his own rate. In other words, experience based on the last five-year premium and loss record will dictate the rate for renewal. Competition either in the underwriter's own local market or in some other market can also play a large factor in rating. For example, a broker placing a large ocean fleet may have placed his lead line in some market, let us say London, and may not like the proposition he gets for renewal from his leading underwriter. He may try some other underwriter in the same market in an effort to produce a better basis or he might try some other market, say New York or Toronto. Not infrequently some other broker who is trying to secure the account may produce a better lead than the broker who controls the business and the controlling broker conceivably could be forced to find a similar market if he wishes to retain the account. By and large, however, rates go up or down depending largely on the actual record of the business during the last five-year period of time.

Certain markets, such as London, have certain rating understandings or agreements which are followed, at least as a rule, by most underwriters in that market and may to a very large degree be honoured by underwriters in other World markets. Some markets, such as New York, have certain hull syndicates which meet and set rates for their members at least on some categories of hull business.

Another factor which complicates the rating of ocean hull business to a substantial degree has to do with the state of World trade. For example, at the time of the Suez crisis ships which would normally use the short route through the Suez Canal when trading to Far Eastern Ports found it necessary to go around the Cape of Good Hope, thereby prolonging the length of their trips very substantially. There was a general shortage of World tonnage which resulted in much higher freight rates being paid and greatly increased values being placed on vessels as a consequence, with the result that insurance values were increased on many vessels very substantially. At the present time, with World trade being more or less in the doldrums, many ship owners are radically reducing insured hull values which calls for remaking of rates. While the total loss possibilities are substantially diminished in amount, the partial loss probabilities do not change in amount to any substantial degree. Naturally if a hull which has been insured on the basis of a hull value of say \$2,000,000.00 is suddenly reduced to say \$1,200,000.00 because of such a factor, the underwriters on the line cannot afford to reduce their premium on a straight pro rata basis. Fortunately, total losses by comparison with partial losses are infrequent. Partial losses from many causes, the most common of which are strandings, fires, collisions, machinery breakdown, heavy weather damage, and sinkings are occurring all the time. It is therefore necessary to have not only a total loss rate in mind but a partial loss rate depending on the coverage granted.

Experience between individual fleets varies very widely. Some operators are either much better than others or possibly just more fortunate.

Another major factor having to do with the rating of hulls is the fact that for the past twelve to fifteen years the cost of hull repairs has kept rising practically without a break in all corners of the globe. The rate of increase will, of course, vary with economic conditions in the different countries. As many temporary repairs are made which will make a vessel seaworthy with the permanent repairs possibly deferred for a quite lengthy period of time, rising hull repair costs can and do have a material bearing on hull insurance rates. An estimate of say $150,000.00 set up in 1955 where permanent repairs may not be completed until 1958 could quite easily result in an actual payment of say $200,000.00. If an underwriter or his claims adjuster is not smart enough to revise his estimates upwards year-by-year in inflationary times where there is any substantial unrepaired damage involved, he may suddenly find himself with an account which he thought had produced a modest profit which in actual fact was unprofitable.

While I have only skimmed the surface of this subject, I trust that what I have written will be of some interest to you.