INTERNATIONAL EDITION

INSURANCE BROKER'S

Introductory Guide *to* Marine Cargo Insurance

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INSURANCE BROKER'S

INTRODUCTORY GUIDE TO MARINE CARGO INSURANCE

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Chapter One

Welcome to the World of Marine Cargo Insurance!

Introduction

From the very moment your client's overseas bound cargo leaves your warehouse, it is at risk.

Depending on the type of commodity or merchandise your client is shipping overseas, its cargo can be subject to over 20 types of transit loss or damage ranging from partial losses such as pilferage, rough handling or water damage, on the one hand, to total loss arising from a major casualty such as a fire or a vessel sinking, a truck overturn or a derailment, on the other.

With all these transit risks in mind, this is an investment well worth protecting. Before your client's cargo even leaves his premises, he will have already expended thousands, hundreds of thousands or even, in some cases, millions of dollars in product research, manufacture, testing, marketing, quality control, packing protection and freight costs.

The cost of securing proper marine insurance protection is only a fraction of the overall cost of the finished product delivered to his customer's door overseas. Yet having transit protection in place is

an important investment, one that plays a pivotal role within the international trade cycle. In effect, marine insurance in general is inextricably linked to international trade and, therefore, should be an integral part of your own trading cycle.

The whole concept behind insurance in general is to transfer risk and there can be no other area of insurance where the seeking of protection through a marine cargo insurance policy is so vital. Moving cargo overseas brings about risks that are often extremely unpredictable and completely outside the control of the exporter or importer. Fundamentally, why should a cargo owner absorb the risk of an entire gauntlet of potential losses ranging from the minute to the catastrophic when at such little cost, insurance protection is readily available?

Just as it is important to have marine insurance in place to protect your client's cargo during the various stages of its journey overseas, so too one must ensure that the policy he is about to purchase offers both proper and adequate protection.

The purpose of this publication, therefore, is to offer you, the broker, as an insurance professional, a powerhouse of tools and resources that will help you assist your client in securing cargo insurance protection that properly meets their business needs. You will also be provided with responses to address common areas of resistance to purchasing a cargo policy. The publication will offer an explanation of the types of cover available in the marketplace, ranging from "named perils" to "all risks". You will also be introduced to little known policy extensions or additional coverages that may be available from insurers. Such extensions may offer your client's business additional protection when things go wrong during the course of an international sale or transaction, particularly in situations where, for example, your client's buyer overseas fails to meet its contractual obligations following a claim.

The publication will explain what is and what is not normally covered under a marine insurance policy. It will provide important tips and guidelines that you, the broker should look for in arranging transit insurance on behalf of your client. It will also discuss the pitfalls that are to be avoided particularly those that will leave your client uninsured, inadequately insured or overexposed for certain types of risks. Furthermore, guidance will be offered on how to avoid insuring conditions that may be too onerous on your client's business.

This publication will also introduce you to the claims handling, survey and adjusting process. Again, we will offer guidelines and tips to assist you and your client in expediting the claim and avoiding

pitfalls that may delay or even impede an early settlement. Finally, we will guide you through the lesser known areas of transportation risks such as the very old principle of General Average, the procedures to be followed to secure release of the cargo and how, having a marine cargo policy in place, provides relief to your client from such eventualities.

Lastly, you will note from the introductory pages of this publication, I have included some frequently asked questions. I trust these will help you find what you are looking for.

A Little History

It is said that the first form of marine insurance goes back as far as around 3000 BC when merchants dispersed their shipments amongst several vessels so as to address the possibility of damage to their products. But the earlier account of insurance came in the form of bottomry, a monetary payment that protected traders from debt in the event of loss or damage to cargo.

Although primitive forms of marine insurance existed in Europe in the 11th to 14th century, it was not until 1688 that the risky business of marine underwriting began in the form of Lloyds of London, named after the coffee merchant Edward Lloyd, thus beginning an institution that has evolved over the last centuries into the modern marine insurance market.

One of the earliest foundational statutes governing marine insurance – including of course cargo insurance – is the UK Marine Insurance Act 1906. Like any other statute, its purpose was to provide clarity in the law but it also had the effect of consolidating key marine principles that so formed an integral part of the marine insurance practices of the day. The 1906 Act remains solidly in force and its provisions have stood the test of time so much so that its language has been modelled by many other countries, including Canada, Australia, New Zealand, Singapore, Hong Kong, India and Malaysia.

Fundamental Principles Governing Marine Insurance

Whether there is marine insurance legislation in place in your country or not, there are fundamental principles that apply to the practice of marine and transportation insurance which universally apply

throughout the 5 Continents. Hence, it does not really matter whether you are an insurance broker based in Europe, Middle East, North and South America, Far East and Australasia, many of the principles applicable to the subject of marine insurance are the same, or very similar.

Here are some of the most basic universal principles applicable to marine insurance:

Utmost Good Faith in Marine Insurance

A contract of marine insurance is a contract based upon the utmost good faith, and if one party does not observe utmost good faith, the contract may be avoided by the other party.

The principle of utmost good faith (uberrimae fidei) is one of the most fundamental principles of marine insurance. Under this particular doctrine, not only does the insured have the duty to make to make proper, accurate and truthful disclosure of material information in presenting a risk to underwriters but this duty is also extended to you as insurance broker, the agent of the insured. The obligation of utmost good faith arises prior to inception of the risk (during the placement negotiations) and continues after execution of the contract.

The practical effect of the duty of utmost good faith for you as the agent of the insured is that:

There are certain items of information in the placement of a cargo risk which are often regarded as critical or material to the assessment of the risk.

These include:

- Description of cargo
- Method of packing or
- Voyage information
- Whether stowed on deck or under deck
- Valuation
- Claims and loss experience

As a broker, it is always prudent to establish that information relating to the above items in particular (as well as any other information which may affect the mind of a prudent underwriter) is accurate and properly disclosed.

It is also wise to avoid providing information to underwriters based on verbal information received from the client. Get it in writing!

Where possible, conduct proper research (e.g. websites) to gain a proper understanding of your client's import or export business including an understanding of the products it trades in.

Have your client read over the completed cargo application form to confirm that all information thereon is accurately stated.

Do not assume that if the application form is silent on any aspect of the risk that you do not have to disclose it.

It is prudent to also refer underwriters to your client's website as well as any other publications with regard to your client's business.

Remember that material information is material whether it is asked for by the underwriter or not. Therefore it is prudent that you disclose all information provided to you by your client and anything critical relating to your client's business that has an impact on their shipping practices.

Insurable interest

In marine insurance practice and in accordance with the majority of legislation on the subject, your client, the insured, must have an insurable interest.

An insurable interest means 'interested' in a marine adventure. In effect, an insurable interest exists if your client has an equitable or legal relation to any property at risk in the marine adventure which they may benefit by its safe arrival or be prejudiced by loss or damage.

It is particularly important to note that in marine insurance, your client does not have to have an insurable interest at the time the risk is concluded. On the other hand, he must have a reasonable expectation of acquiring such an interest and must have an interest at the time of the loss.

How do you determine whether your client has insurable interest in the sale or purchase of goods overseas?

The answer is very simple! Insurable interest is frequently determined by INCO terms.

INCO terms represent an international language as between buyer and seller that create a very clear understanding as to responsibilities and duties between the parties on such matters as payment of freight and, of course, insurance.

For more information on INCO terms, please see the link below.

http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/.

3 examples will be offered of common INCO terms and how the work:

- **EXW Ex Works**

  "Ex Works" means that the seller delivers when it places the goods at the disposal of the buyer at the seller's premises or at another named place (i.e.,works, factory, warehouse, etc.). The seller does not need to load the goods on any collecting vehicle, nor does it need to clear the goods for export, where such clearance is applicable. At this point (i.e. ex factory) it is the responsibility of the buyer to arrange insurance for the entire transit. It is the buyer that has the insurable interest.

- **FOB Free On Board**

  "Free On Board" means that the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards, including the responsibility to insure the cargo. In other words, up to the FOB point (i.e. delivery to ship at port of loading) it is the seller's responsibility to insure the cargo (i.e. the seller has the insurable interest) After delivery to the ship, it is the buyer that has insurable interest and must arrange insurance on the remainder of the voyage.

- **CIF Cost, Insurance and Freight**

  "Cost, Insurance and Freight" means that the seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.

  'The seller also contracts for insurance cover against the buyer's risk of loss of or damage to the goods during the carriage. The buyer should note that under CIF the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the seller or to make its own extra insurance arrangements.

Whilst the INCO terms very clearly define the responsibilities of buyer and seller, there are sometimes situations – particularly in the event of a claim for loss or damage to goods – where either party may fail to meet their obligations. An example of such failure is where the buyer refuses to accept and pay for damaged goods. Or, where the seller's insurers decline to meet a legitimate claim filed by a buyer who is out of pocket.

In all of these cases, a buyer or seller, as the case may be, may have a contingent financial interest in the adventure i.e. the cargo.

To protect a buyer or seller in such circumstances, buyer's / seller's contingent interest cover is available. Sometimes, a contingent interest clause is included in an open policy. In other cases, a separate open policy can be purchased. The cover is inexpensive and is certainly available at only a fraction of the cost of regular insurance premiums on primary cargo covers.

As a broker you are advised to ensure that contingent cargo cover – if the circumstances so require – is in place to protect your client.

Warranties

Warranties are frequently employed in marine cargo insurance. They are designed to protect the underwriter but they also work to the advantage of the insured in that the underwriter may, through the vehicle of a warranty, offer wider cover than he would normally be able to offer.

A warranty represents a promise by the insured. As warranties are related to the doctrine of utmost good faith, they must be strictly complied with. Failure to do so will enable the underwriter to avoid coverage. Examples of common warranties include:

- Warranted loading survey
- Warranted machinery professionally packed
- Warranted goods carried under deck

If an underwriter imposes a warranty, it is extremely important that you bring this important condition to the attention of your client. It is also important that you confirm with your client that they are able to comply with the warranty. (i.e. Your client is physically capable of complying with it).

What is Marine Cargo Insurance?

The term "marine cargo insurance" also referred to as "wet marine" or "ocean marine" is somewhat of a misnomer. It may lead you to believe that it only embraces shipments by ocean going vessel. Such an understanding is quite incorrect. The method of transport is not the only criteria for determining whether your client's shipment is one to be covered by a marine cargo policy as opposed to any other type of policy. What is important in determining whether a marine cargo insurance policy would be the proper cover for your client's business is whether the shipment in question is of an international nature, typically – but not always – across a body of ocean between countries and or entire continents. Hence, a marine cargo policy would contemplate insurance protection for a shipment of say, consumer goods, by ocean going container vessel from China to New York. But it would also just as readily contemplate cover for a shipment of computer equipment, by an entirely different means of transportation, namely by air, from Tokyo to Paris. It could also possibly contemplate a shipment consisting of machinery, for example, moving by barge from Seattle to Hawaii.

On any one international shipment, there is infrequently a combination of different types of conveyance employed. Hence on a shipment of cargo by sea from say Berlin to Toronto, the cargo may first move by truck to the port of Hamburg at which point it is loaded on an ocean going container vessel. After a 10 day voyage across the Atlantic, the vessel arrives at the port of Montreal

and the goods are then moved by train to Toronto. From the rail terminal, the goods are then delivered by a local cartage company to the final warehouse at destination. This is all part of an international transit covered by a marine cargo policy and, provided that you have an insurable interest throughout the transit, your goods will be covered from door to door.

On the other hand, inland shipments of cargo moving by truck within the geographical parameters of a state, country or continent (For example, shipments confined to inland Continental Europe or shipments within Canada and the United States) would not normally be classified as marine cargo insurance. Such shipments would rightfully fall within the ambit of an inland cargo policy. The former is often referred to as "wet marine" whereas the latter is often referred to as "dry marine."

Often, your client may require cargo insurance for both international shipments as well as domestic truck shipments, in which case a marine cargo policy is the most suitable means for covering both.

Your client may also require storage cover for international shipments of goods outside the ordinary course of transit. Such periods of storage could also be covered under the marine cargo policy, usually upon application to insurers.

As a broker, an important question to ask your client is whether it contemplates storage outside the ordinary course of transit i.e. temporary storage.

My Clients Say That They Do Not Need Cargo Insurance: Resistance To Purchasing A Marine Cargo Policy!

Whether your client is new to importing or exporting or, whether your client is a seasoned, well established business, your client needs marine cargo insurance protection on the movement of its goods. Moreover, your client is well advised to secure an open cargo policy in their own name rather than chance on relying on someone else's to respond to the transportation losses that your client must bear.

As an insurance broker, you are equipped with the skills and knowledge to ensure that your client has the best cover available to match its marine insurance needs. Part of those skills involves the placement of a policy with an insurance company that is financially sound. Having a policy placed with an insurer that is based (or has an office) in your home country most probably means that the

insurer, in order to operate, must meet solvency criteria imposed by the local regulatory body. As a resident business owner, your client will enjoy the insurance protection of what is most frequently a highly regulated insurance institution in your own country. This will ensure that if a claim does occur, the insurer will always have sufficient funds to pay it. Depending on the insurance laws and regulations within your country, your client will also likely have the additional protection of ensuring that its business is treated fairly in the manner in which the policy is underwritten and the manner in which the claim is handled and paid. On the other hand, if your client decides to place the cargo policy with a foreign, overseas based insurer, it is likely to fall outside the protective net of your local insurance regulatory body and consequently, it will not enjoy the same financial protection. It may also just as easily fall outside the jurisdiction of the regulatory body that governs the foreign insurer, on the grounds that your client is not a resident business owner of that particular country. Hence, if your client has an issue on a claim with an insurer based overseas, it will not have access to anyone that can advocate (or stand up for) its rights.

Objection Number One: **"I do not need cargo insurance as my goods are insured overseas with my buyer or seller!"**

There are other reasons why relying on your buyer's or seller's cargo insurance policy overseas is not generally a good business practice. Firstly, you may be unaware of the terms and conditions of the overseas policy. There may be insurance protection in place but the cover could be very restrictive and you will not know of the policy's limitations until it is too late! Namely, when a claim occurs! There may well also be a very high deductible that has not been brought to your attention. The policy overseas may also contain warranties (i.e. promises that have been made by your buyer or seller) that have been broken thus denying you the right to claim under the policy. Secondly, you need to be certain that the overseas policy is expressed in your local currency.

If you are a company based in Canada and the USA, for example, you may not take too kindly if payment of your claim is in Russian Roubles (Or any other foreign currency)which, like any other currency, will be subject to daily currency fluctuations and may adversely affect the monetary amount of your claim settlement.

Thirdly, if you do select to rely on your buyer's or seller's policy overseas, it may also mean that your claim will be handled, adjusted and settled through an overseas office. That office could be located as many as several thousand miles away in different time zones. For logistical reasons,

therefore, this may result in delays in processing your claim. Whereas, on the other hand, a claim processed on a policy issued by an insurer based out of your own city, region or country may be handled more expeditiously.

Lastly, relying on your seller's or buyer's insurance policy overseas provides you with no or little leverage in the event that a policy or claim's issue materializes. If your claim is denied, you may not have any regulatory protection, you will not have an insurance broker to advocate your position and if you are contesting the denial, you will have to file suit in the insurer's home jurisdiction, an action that can bring both uncertainty in its result as well as significant legal fees.

In short, it most cases it is better to purchase a policy with both an insurance broker and an insurance company that are local to the place or country where you conduct your business. Be wary of relying on an overseas cargo policy based on price alone. You may save money on premiums but you may not enjoy the cover and protection you had expected!

Objection Number Two: **"I have never had a claim and my goods are resistant to loss or damage!"**

These are very poor reasons for not purchasing marine cargo insurance. World climatic conditions are changing to such a degree that natural disasters affecting shipping are substantially on the increase. The Japan Tsunami of 2011 and Hurricane Sandy in 2012 are prime recent examples of natural disasters that caused losses of a catastrophic nature to shipments of cargo. But even if your business is fortunate enough to escape losses resulting from natural disaster, you can never be too prepared for other events outside your control: Vessel sinking, grounding, collision, fire, truck overturn and derailment all constitute risks to the safety of your cargo.

There is also a lesser known type of casualty called a General Average. If the vessel carrying your cargo encounters problems at sea, the shipowner may declare a General Average. Under the principles of this very old doctrine, each party to the venture – cargo, ship and freight – must contribute to the costs of saving it. If you are not insured, you will have to pay a deposit in cash to secure the release of your cargo. Sometimes, the cash deposit can be quite significant. On the other hand, if you have a marine cargo insurance policy in place, your insurers will provide the shipowners with a guarantee to facilitate the expeditious release of your cargo. Likewise, if your

cargo is damaged or lost as a result of the General Average casualty, your insurance policy will indemnify you against such loss or damage.

Lastly, although attempts have been made to reduce cargo losses from theft over the years, cargo crime has become both very sophisticated and expensive. Your cargo is not immune to theft! Moreover, piracy on the High Seas continues to be an occurrence that even the best international security forces have not been able to prevent.

Objection Number Three: **"I do not need cargo insurance as I rely on my transportation company to pay for loss or damage to my goods!"**

Transportation companies – such as steamship companies, airlines, rail companies and truckers – will only pay for loss or damage to your goods if they are legally responsible. What is particularly challenging about this is that the onus is on you, the cargo owner, to prove that the loss or damage occurred whilst your cargo was within their custody and control. This may be difficult to prove in cases of concealed damage for example. It may also be a heavy burden for you if, as is frequently the case, there are multiple carriers involved with no evidence as to which point in transit the damage occurred. But even if you can prove negligence, transportation companies normally have the privilege and protection of being able to rely on both exclusions and limitations of liability under the contract of carriage. Under its conditions of carriage, the shipowner, trucker or airline may rightfully decline all liability based on contractual exclusions. But even if exclusions do not apply to the situation at hand, it is more likely than not that the carrier may nonetheless be able to restrict the amount of the payout to you, the cargo owner.

For example, an ocean carrier can potentially limit its liability to only $ 500 per package on a shipment of your cargo moving in or out of the USA by sea. Likewise, in relation to international shipments of cargo by air, an airline may be able to restrict its liability to approximately US $ 20 per kilo. In practice, it is extremely difficult to break such limitations. Hence, any payment you receive from the transportation company is likely to fall far short of the monetary loss you have incurred as a result of damage to your cargo.

Hence, without the benefit of an open cargo insurance policy in place and relying solely on the transportation company to respond to your claims, you are likely to find yourself seriously out of pocket! Also, transportation companies are not regulated in the same way as insurance companies

and as a result, there is a greater risk of insolvency or bankruptcy of a shipowner, airline or trucking company. Further, even if there is liability, there is no guarantee that you will be reimbursed quickly. You may even have to wait months for your settlement.

On the other hand, if you have an "all risks" policy with a local insurer, you need not be concerned with proving liability against the transportation company nor will you have to wait inordinate amounts of time for your settlement. The insurance company will indemnify you for your loss based on the terms of the policy and in most jurisdictions, is duty bound, within reason, to bring your claim to an early conclusion.

Some cargo owners have attempted to overcome transportation company limitations of liability by purchasing full value declared cover from the transport company. Firstly, this can be quite expensive. But more importantly, full value declared protection is not the same as – nor is it as broad as – an "all risks" insurance policy. What full value declared protection means is that in the event that the transportation company is liable, it will pay up to the value declared protection that has been purchased. But the transportation company will not respond unless it is legally liable. The practical effect of this is that the onus of proving the transport company's liability falls on your shoulders. Not always an easy burden!

Objection Number Four: **"I have insurance through my freight forwarder / transport intermediary!"**

As part of the many services that freight forwarders and other transport intermediaries provide, marine cargo insurance is offered to their import and export customers. Due to the economies of scale, freight forwarders have buying power to leverage policies that offer competitive insurance rates on the cargo they move. It can also make more economic sense for small business customers who have only one or two shipments per year to have marine cargo insurance placed through their freight forwarders rather than pay for a minimum deposit premium to have their own cargo policy. For business reasons it may also make sense for even a larger business customer to enjoy a one stop service package which includes the purchasing of cargo insurance through their freight forwarder.

The potential difficulty with such insurance arrangements is that if you do not enjoy a cargo policy in your own name but rather rely on your freight forwarder's insurance, you lose care, custody and control and most importantly, you lose ownership of this very important area of risk management.

In particular, you may not have an insurance broker to advocate and champion your rights under the policy. You would also have to normally remember to advise the freight forwarder to insure the cargo each and every time. And what if, all of a sudden, you had to move a shipment that did not involve that particular forwarder? You would have to remember to insure it! Also, if you were a customer having a good loss experience through that particular forwarder, you run the risk of subsidising the freight forwarder's other customers who have less than good claims experience.

That said, whether you are a large or small company, having insurance through afreight forwarder does have its advantages provided that both the forwarder and the insurance company they place the business with is both reputable and financially strong.

Whether an importer or exporter should have their own cargo policy must largely depend on the relationship they have with their freight forwarder. However, it is always important for the customer to be aware of the terms of cover that is being offered to them. Is it all risks? Or, is it more limited conditions such as named perils? What is the deductible?

When Does Your Client Have To Insure Their Cargo?

The quick answer to this question is: When they have insurable interest!

One has "Insurable interest" when one stands to gain from the cargo arriving safely, or, stand to lose by the cargo suffering loss or damage. (Or not arriving at all)

As a matter of both law and practice, you must have insurable interest at the time of the loss, not necessarily at the time the risk commences.

Whether or not your client has responsibility to insure the cargo they are shipping or bringing in all depends largely on the terms of sale. The international language that defines the respective responsibilities of the buyer and seller in any specific transaction is commonly known as the INCO terms. These terms are devised by the International Chamber of Commerce. Originally, the list of INCO terms used by importers and exporters was very short and most international transactions were generally on a cif, fob, ex works or c&f basis. These terms are still frequently employed in international commerce. However, new INCO terms have been introduced over the years to match the ever changing nature of international transactions. From a risk management standpoint, each

term, new or old, clearly defines at what stage in the transit the buyer or seller is responsible for insuring the cargo. Under cif terms, for example, the shipper (exporter) is responsible for insuring the cargo to the *cif* point overseas, against the buyer's risk of loss or damage during transit. If, on the other hand, the terms of sale are *ex works* or *ex factory*, then the buyer overseas is responsible for insuring the cargo from the point the goods leave the supplier's warehouse or factory all the way to final destination. In the case of the latter, it is the receiver or importer that has the insurable interest. As always, marine insurance follows international trade.

Even in cases where it is not the responsibility of your client, as shipper or buyer, (as the case may be) to insure the cargo in a given situation, it may be wise to secure a form of seller's or buyer's contingent cover. It is said to be "contingent" because the cover will only trigger if the overseas policy does not respond to a covered claim. More about this later!