RISK MANAGER'S GUIDE TO

Marine Cargo Insurance

– Protecting Your Company's Investment!

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RISK MANAGER'S 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 overseas bound cargo leaves your warehouse, it is at risk.

Depending on the type of commodity or merchandise you are shipping overseas, your 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, your investment is worth protecting. Before your cargo even leaves your premises, you 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 your 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 organization's cargo during the various stages of its journey overseas, so too one must ensure that the policy you are about to purchase offers both proper and adequate protection.

The purpose of this publication, therefore, is to offer all the important reasons for arranging proper and adequate cargo insurance. It 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 grants of coverage that may be available from insurers. Such extensions may offer your business additional protection when things go wrong during the course of an international sale or transaction, particularly in situations where, for example, your 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 cargo policy. It will provide important tips and guidelines that you, the importer or exporter should look for in arranging transit insurance. It will also discuss the pitfalls that are to be avoided particularly those that will leave you 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 you or your 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 in expediting your claim and avoid 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 your cargo and how, having a marine cargo policy in place, provides you with relief 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.

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 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 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, you 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.

You may also require storage cover for your international shipment of goods outside the ordinary course of transit. Such periods of storage could also be covered under your marine cargo policy, usually upon application to insurers through your broker.

Why does my Organization need Cargo Insurance? Resistance to Purchasing a Marine Cargo Policy!

Whether you are new to importing or exporting or, whether you are a seasoned, well established business, you need marine cargo insurance protection on the movement of your goods. Moreover, you need your own cargo policy rather than chance on relying on someone else's to respond to your transportation losses that you must bear.

Your insurance broker is normally equipped with the skills and knowledge to ensure that you have the best cover available to match your 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 corporation, your organization will enjoy the insurance protection of what is most frequently a highly regulated insurance institution in your own country. This will ensure that if you do have a claim that 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: "We do not need cargo insurance as our goods are insured overseas with our 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 005Abn x 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: "We have never had a claim and our 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 your organization has 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: "We do not need cargo insurance as we rely on our 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: "We have insurance through our 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 a freight 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 Do We Need To Insure Our Cargo?

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

You have "Insurable interest" when you stand to gain from the cargo arriving safely, or, you 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 you have the responsibility to insure the cargo you are exporting or importing 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. 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 your responsibility as shipper or buyer to insure the cargo in a given case, it may be wise to secure a form of 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!