



# Marine Market Monitor

Q1/Q2 | July 2009

## Executive summary

The global financial crisis continues to influence almost all of the maritime insurance sectors and the overall premium volume for most classes is down on this time a year ago. This is due to a number of factors including vessel values, vessel trading patterns, cargo volumes and general reductions in income for the maritime industries. Against this backdrop the insurance market is attempting to increase premiums due to a number of years of poor results and the lack of investment return. Clearly this is creating a significant challenge in that insurance buyers are trying to find ways to cut costs, while insurance sellers are trying to find ways to increase revenue.

Capacity in the blue water hull market remains at a level which means that the average vessel can still be placed many times over (in theory). So despite much of what has been said above, there is little real pressure on premium. Individual rates are increasing but much of this is being offset by the reduction in hull values. There remains concern that the fundamental level of losses will increase in this current environment and this in itself could have a further negative impact on underwriters' profitability. However with a plentiful supply of capacity, options for many shipowners still exist.

Piracy remains at the forefront of many people's minds; with copy cat strikes taking place throughout the globe, it has become a world wide phenomenon. The market continues to deal with claims in a sympathetic manner despite the concerns as to precisely where cover sits.

However, we may see some changes on this front in the near future if the rise in the number of attacks continues.

Marine liability, as a class, has always been seen as a product line with a good track record, and therefore we continue to see a level of capacity that can quite easily deal with most risks. As with many other classes there is a desire to increase rates where possible due to the impact of losses, but the effect of the capacity surge is restricting these rises to a relatively small level.

Since our last publication the Protection and Indemnity Clubs have been through their annual round of negotiation and counter negotiation. This year was always going to be a tough renewal round, principally due to the impact of poor returns from the financial markets that have dominated the clubs' ability to break even. Most clubs are having to take a long hard look at their pure underwriting philosophy and endeavour to rebuild free reserves to a level that will allow them a greater degree of financial resilience. While the majority of Clubs achieved broadly what they set out to this year, in terms of rating increases, we will have to wait to see what the 2010 renewal will bring. Despite a relatively benign claims environment (in comparison to past years) so far this year, there can be little reliance upon investment returns to prop up underwriting results.

The cargo market still suffers from a global lack of volume and, while the insurance market seems to be trying to push the rating up, the continued glut of capacity means that options are available for most clients. Local capacity for many risks continues to grow, as does genuine new capacity, and that is leading to further pressure on the pricing of many risks. Natural catastrophe perils still receive a good deal of attention and cost is a factor, but the cargo market's appetite for stock-throughput risks remains plentiful. As long as the results for the book remain profitable there will be a plentiful supply of capacity in other areas as well.

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# Blue Water Hull insurance

## Blue Water Hull – Renewal experience over the last six months

Marketplace	Rate changes based on loss ratios		
	Excellent	Good	Poor
N. America	Flat to 2.5% increase	Flat to 5% increase	15% to 25% increase
UK	At least 5% increase	At least 10% increase	At least 15% increase
Scandinavia	At least 5% increase	At least 10% increase	At least 15% increase
Continental Europe	Flat to 2.5% increase	2.5% to 20% increase	At least 20% increase
Asia	Flat	Flat to 5% increase	7.5% increase or more

Note: Rate changes indicated are only a guide. Actual performance depends on the merits of each submission

Source: Marsh

## Trends and developments

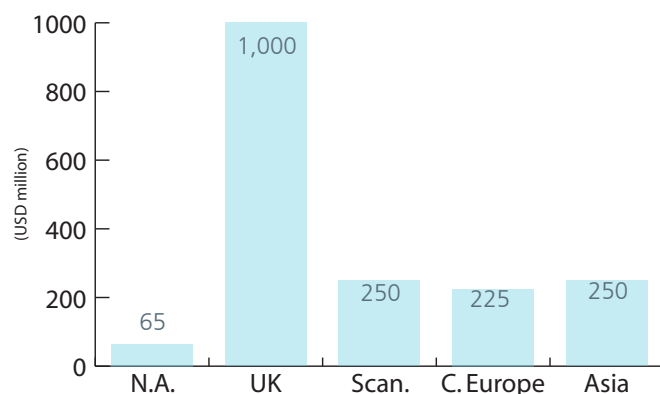
The past six months have seen unprecedented events in the global economy that have impacted all industrial and commercial sectors. The current climate is having a significant impact upon the shipping industry and thus affecting the marine hull insurance market. Shipowners are struggling with their income caused by the fall in freight rates due to the reduction in world trade. In addition vessel market values are reducing and this is putting pressure on balance sheets as many owners remain highly leveraged.

Underwriters are also under pressure following many years of poor underwriting results. There is still an effort to increase rates across the marine hull insurance markets. However, overcapacity remains and therefore rates come under pressure; no significant 'general' increases being seen in the market.

The insurance market is perceived to be hardening as the current economic climate has removed investment income returns on underwriters' capital, increasing pressure on underwriters to make a pure underwriting profit. It is estimated that worldwide the insurance industry has lost an estimated USD75 billion in investment income in 2008. The fluctuation and uncertainty in the currency markets has impacted underwriters' income levels.

There are several key issues in the marine hull insurance market, namely:

### Theoretical capacity (USD)




Source: Marsh

Note: Theoretical capacity refers to total maximum capacity assuming no restriction

- claims cost inflation
- shortage of adequate repair facilities
- profitability
- vessel valuations
- the 'claims spike'
- piracy

Underwriters may well find the problems of claims cost inflation and the lack of adequate repair facilities are being solved. The price of steel has fallen from its peak in the middle of 2008 and there are now more yards available to repair vessels, as many have returned to their core ship-repairing activities due to the collapse in the new-building market.



Profitability varies from underwriter to underwriter, caused by the reduction in value of investment incomes, exposure to catastrophic losses, and the general economic environment. These factors will encourage the markets to review pricing, but as previously mentioned overcapacity in the hull market will reduce the effect of any significant upward rating trend.

The U.S. brown water market, while technically a separate market from the market for international blue water risks, is facing many of the same issues. There is however additional account movement in the market owing to the common practice of packaging hull risks with primary Protection and Indemnity (P&I) risks, and underwriters' changing risk appetites for P&I risks, particularly tank vessel pollution and towing risks in general.

The issue of vessel valuations is being addressed by underwriters, with many insisting on reviewing insured values. The perception is that insuring significantly above market values is not to their advantage. This concern may not become apparent in all cases but, where it does, owners need to be mindful of the requirements of any mortgage or other finance arrangements, especially where vessels carry a high proportion of financing risks.

In terms of piracy, there has been an increase in attacks on shipping in the Gulf of Aden and the pirates are now expanding their areas of activity by attacking vessels further out into the Indian Ocean. The favourable weather conditions in the area at this time of year aids the pirates in expanding their areas of operation. There has been much discussion about carrying security personnel on vessels as well as other solutions. There has also been debate on the precise definition of piracy as opposed to terrorism or other similar peril, with incidents being variously described as piracy or terrorism. For some underwriters, their advisers seem to suggest that the motive behind the attacks is to raise funds for the purposes of furthering terrorist causes. Whether the courts would have similar views is a matter of conjecture. For renewal the majority of underwriters are requiring the piracy peril to be deleted from the hull policies and added to the war risk policies.

Underwriters are also bracing themselves for an increase in the frequency of claims caused by incidents that may have occurred some time before their discovery. During the buoyant freight market shipowners were trading their vessels to take advantage of the prevailing economic climate. However following the recent downturn more owners can now put their vessels in drydock where any damages can be discovered.

In the U.S., the American Hull Insurance Syndicate has taken the firmest line on minimum increases, Zurich has re-entered the blue water market, albeit on a following line basis. Mutual Marine Office has offered terms on an adjustable premium basis, and CNA has reasserted itself as a significant player in the offshore/oil field support vessel field.

Other recent developments in the market include Amlin's USD490 million purchase of Fortis Corporate Insurance from the Dutch Government, the departure of much of the marine underwriting team in Swiss Re. London to the new Montpelier Re. syndicate in Lloyd's, and the move of the hull underwriter from the Catlin syndicate to Amlin. The signs are that this may be the beginning of a number of moves as underwriting organisations try to attract trained staff from a limited pool of talent, yet it remains to be seen whether these developments will have any effect on market conditions.

In conclusion, while the balance of 2009 will be difficult for all those involved in the shipping industry, the majority of the marine hull insurance market is currently looking for small increases in premium, but competition is reducing the effectiveness of those requirements.

# Marine liabilities

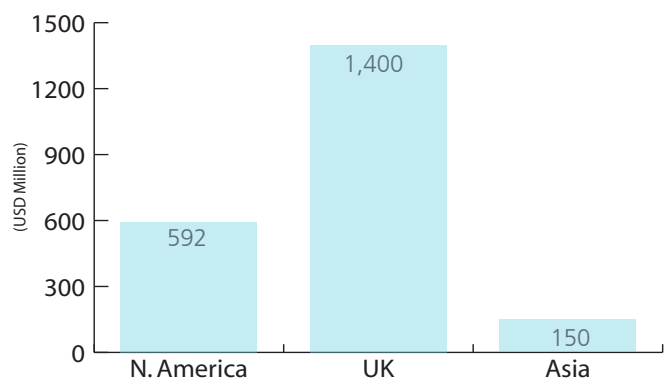
## Marine liabilities – Renewal experience over the last six months

Marketplace	Rate changes based on loss ratios		
	Excellent	Good	Poor
N. America	7.5% increase	12.5% increase	TBA
UK	5% to 7.5% increase	7.5% to 12.5% increase	TBA
Asia	Flat	5% increase	TBA

Source: Marsh

Note: Rate changes indicated are only a guide. Actual performance depends on the merits of each submission

## Theoretical capacity (USD)



Source: Marsh

Note: Theoretical capacity refers to total maximum capacity assuming no restriction

## Trends and developments

It is obvious that the North American marine liability insurance market trend we observed in the latter part of 2008 was accurate and is continuing on the same path, so far, in 2009; the market is looking for across-the-board hardening, and straight reductions, even with competition, are very difficult to achieve. However, primary placements that have improved loss results or have not been marketed for a few years may still see competition.

As discussed in our previous report, following the global financial crisis in the fall of 2008, the insurance market was impacted by reduced returns on their investments as well as experiencing a reduced confidence in the financial strength of a large number of their insureds. These factors, combined with a string of severe claims in 2007 and 2008, brought about a retrenching and a very tentative approach in utilising their capacities, particularly on certain classes of business. In fact, for the first time in recent memory, U.S. marine liability underwriters have reduced their capacities, in some cases dramatically. This pulling back on capacity, combined with a few companies actually withdrawing from the marine liability market, has resulted in the overall U.S. capacity reducing by 14 percent over the past year.

Further, we see a continuation of small-limit primary business being the target for most companies. The idea behind this approach is that, on primaries, underwriters believe they receive more detailed information, reduce their exposure in terms of limit output, and have control over claims handling. Before this re-evaluation of limit allocation, excess business was viewed by underwriters as a safer and more desirable position on a marine liability programme, particularly on the higher layers of excess. Contributing to the primary/excess shift in capacity allocation is many underwriters feeling that their capacity is undervalued on excess placements, given rising reinsurance costs and catastrophe risk factors. We understand that the following are direct effects on individual underwriters:

- ACE will only offer their USD10 million excess limit if they write the primary. Otherwise, they will only offer USD5 million on excess business

- Travelers is requiring primary liability involvement in order to be able to participate on excess for insureds containing Commercial General Liability (CGL)
- Liberty has reduced their total capacity from USD50 million to USD25 million, effective 1 June, 2009
- Markel, and Houston Casualty have recently withdrawn from the U.S. marine liability market. Although RLI is technically still in the primary marine liability market they have formally withdrawn from the excess market and are in effect out of the primary market also.

We must point out that the above effects on the market are further intensified by several underwriters shying away from certain classes of business, such as intense products risks, tank barge liabilities, pipeline exposures and, in general, risks that contain significant pollution exposures. We conclude that about half of the capacity in the market is adopting this position in the current marketplace.

Not all the news is bad, however. Starr Marine has increased their overall limit from USD50 million to USD100 million. This is purely theoretical and will not be utilised, except in the most unique of circumstances. In addition, we still expect at least two (and possibly three) new marine liability underwriters to enter the U.S. market during 2009, offering an additional USD50 million to USD80 million in capacity. Further, if the overall, market loss experience in 2009 is favourable, the continuation of the market-hardening excess trend may slow greatly. Also, tug and barge operators are purchasing more limit in the wake of the large loss on the Mississippi River in 2008.

While incumbent underwriters need to show rating increases, there is still a market desire to grow, and with that desire comes some elements of price competition. However, as pointed out, this is generally only on the primary lines, which have been well detailed and do not expose underwriters to more challenging exposures.

We continue to be very cautious about making any great leaps of optimism about the near-term outlook for the U.S. liability market, and feel, regardless of

the positive effects experienced in 2009, that no meaningful softening will occur until at least 2010, after the year-end reinsurance renewals are completed.

In London, underwriters in the marine liability insurance market can be very competitive on new business, even if it is not new to the London market, as underwriters' management instructions about no reductions only apply to renewals. Capacity in London has increased slightly since the beginning of 2009 which has added to the downward pressure on rates, although underwriters are resisting this pressure, and on the whole are achieving the increases they require.

Most of our ports and terminals clients are reporting reduced throughput and revenue compared to 2008 as the full effects of the financial downturn are being felt. Underwriters are increasing adjustable rates but when applied to the reduced amounts should produce premium savings. The percentage reduction in premium is always much less than the percentage reduction in throughput and revenue.

Other news we have heard from London:

- Arch has established a Lloyd's Syndicate with a USD15 million capacity. This becomes USD30 million when combined with their insurance company capacity
- Most of Swiss Re's marine team have left to set up a marine account at Montpellier Re
- Kiln, the Lloyd's syndicate, has acquired a team from ITMU who specialise in ports and terminals, transport operator risks and containers
- David Sankey, formerly Marine Liability underwriter at AIG, has joined Liberty to write this class
- Andreas Mueller has left the TT Club. He ran the Club's Hong Kong and Singapore offices as Regional Director before returning to London to take on more of a sales role
- Andrew Farrant, has also left the TT Club, and is about to join Travelers to become the deputy underwriter for ports and terminals.

# Protection and Indemnity (P&I)

## Post renewal assessment

The 2009 renewal season was dominated by the impact on club finances caused by the turmoil in the financial markets.

The shock on the clubs has led them all to re-appraise their underwriting with a view to being able to achieve a balanced result between earned premium and claims plus expenses.

A clear divide is evident in the resilience of those clubs that were rated 'A' by Standard and Poor's (S&P) and those previously with a lower rate. In the former category, the five European Clubs that have not made unbudgeted supplementary calls (USC) all enjoyed free reserves at 20 February 2008 well in excess of Marsh's preferred benchmark indicator of 100 percent of call income. Most of the latter category called USCs and they were joined by the UK Club where the impact of medium term underwriting deficits had so eroded their capital relative to their call income that they, too, levied additional calls.

All Clubs are now going to have to realign their underwriting policies with a view to being able to re-build their free reserves from 'underwriting' to levels that will enable them to meet a combination of the delayed Solvency II requirements, the demands of their regulators over the interim period, and the internally imposed prudence stipulated by Clubs' boards.

## Allocations of Club assets . . . and their erosion

The way Clubs' assets have been invested and the resultant 'returns' or erosion of capital is proving to be the most influential driver on their financial results during the past 12 months.

Two Clubs showed foresight: UK Club withdrew from the equity market in October 2007 and Britannia arranged a 'collar' that ensured a positive return on their equity holdings through the period to February 2009. Additionally, North of England took measures to de-risk their portfolio during 2008.

Clubs who took action still lost capital, though only modestly (5 percent or less), while others (notably Gard, Steamship, and West of England) who 'hung in there' have all suffered significant (in excess of 11 percent) erosion in the value of their assets.

## Benchmark observations

Lloyd's financial results announced in 2009 reveal capital appreciation recorded at 2.0 percent across the market as a whole. This figure is down from 5.2 percent in 2007, which itself was a figure comparable to that achieved by the International Group.

North of England costed the budgeted loss of benefit from capital gains in the mark-to-market exercise at 20 February each year at 10 percent and structured their general increase to reflect this.

## Claims

The anxiety reported in our last market report, that the explosion in the quantum of Pool claims across the 2006/07 and 2007/08 years was setting a new trend in claims experience has somewhat abated, with 2008/09 proving to be a 'good year'. As far as we are aware only two claims are expected to exceed the limit of the lower pool at USD30 million.

Although most clubs remain sceptical, UK Club and West of England have expressed optimism regarding the anticipated fall off in claims following the slow down in economic activity.

## The imperative of setting the correct premium levels

Realistic target combined net ratios in February 2008 for many Clubs were probably in excess of 110 percent, but given the 'new financial world' we have entered since the second half of 2008 such ratios are no longer sustainable or acceptable to either ratings agencies or regulators.

So the tone was set for this renewal; a determined step towards re-aligning underwriting policy for the generation of an underwriting profit which, in the medium term, will be needed as a source of recapitalising club funds.

## The outcome:

	General Increase – Owned P&I	Approx result
Britannia	12.5% plus deductibles	11.5% plus cash, plus deductibles
Gard	15%	15% plus
North of England	17.5%	17.5%
Standard	15%	11% plus terms: assessed as equivalent to 13% plus
Skuld	15%	Proclaiming 15%
Steamship	17.5% plus deductibles	Equivalent of 14% in cash and terms
West of England	19.1% (includes supplementary call change) plus deductibles	15% to 16% plus deductibles
UK	12.5%	Range of 9% to 11.5%

Note: Steamship, West of England, and UK Club have all levied USCs

Source: Marsh

## Comments

Of the four 'A' rated clubs that did not levy USCs, all have taken remedial action with respect to addressing their underwriting, such that deficits were cut back in 2008 and/or in earlier years. We also expect that these clubs will have had more scope to have been able to 'manufacture' some strong underwriting results for the financial year ending 20 February 2009 to offset the investment losses they suffered. To have drawn down on free reserves this past twelve months seems legitimate. For a number of Clubs, however, reserves had already been diminished by the volatility of Pool claims in the past two years and been stretched by tonnage and premium growth.

## Other features of the renewal

Pooling arrangements have been adjusted after much pressure from those clubs that had made significantly larger contributions than they had themselves received.

As predicted ahead of the renewal, group excess loss reinsurance rates increased following adverse results on the USD500 million excess of USD50 million layer, where three of the past five years have generated incurred loss ratios to reinsurers of in excess of 135 percent. Worst affected were the rates applied to dry cargo vessels on the back of their loss experience. We expect further increases next year in a shipping world of reduced entered navigating tonnage and pay-back still in demand despite the near claims-free results of 2008/09.

Various clubs imposed deductible increases as part of their general increases. Some clubs also sought to apply deductibles to all defence costs and/or fees incurred in surveys. Additionally, we have noted signs of increasing flexibility from some clubs regarding attitudes to higher deductibles and we hope this will be continued.

## Looking towards 2010

With the 2009 renewal dominated by the absolute necessity of avoiding an underwriting loss, success in the new environment faced by the Clubs will depend upon a myriad of factors including the adequacy of rating levels, reductions in premium volume due to lay-ups, severity of pool losses, and the attitudes of regulators.

Movement in P&I costs have historically been retrospective and have re-acted to market circumstances. Clubs' boards have not easily permitted prospective rating increases, so it is all the more regrettable that the severe increases of the past two years have coincided with the sharp downturn in the freight markets. We are optimistic that the peak of this rating adjustment is behind us and that, in the absence of further economic shocks, general increases next year will revert to much more affordable levels.

We would encourage a re-evaluation of the choice of Club(s) against an owner's key buying criteria; the value of the evident financial resilience of certain Clubs deserves attention.

# Marine cargo

## Marine cargo - renewal experience over last six months

Marketplace	Rate changes based on loss ratios		
	Excellent	Good	Poor
North America	5% to 10% decrease	Flat to 10% decrease	10% increase
UK	5% to 15% decrease	Flat to 5% decrease	10% increase
Continental Europe	20% decrease	10% decrease	Flat
Asia	10% to 20% decrease	10% decrease	Flat

Source: Marsh

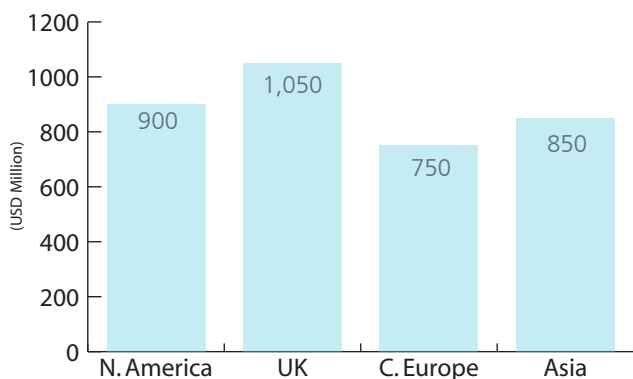
## Marine cargo (Stock-throughputs) - renewal experience over last six months

Marketplace	Rate changes based on loss ratios		
	Excellent	Good	Poor
North America	Flat to 5% decrease	Flat	5% increase
UK	5% to 10% decrease	Flat to 5% decrease	15% increase
Continental Europe	10% decrease	5% decrease	5% increase
Asia	10% to 20% decrease	10% decrease	Flat to 10% increase

Note: Rate changes indicated are only a guide. Actual performance depends on the merits of each submission

Source: Marsh

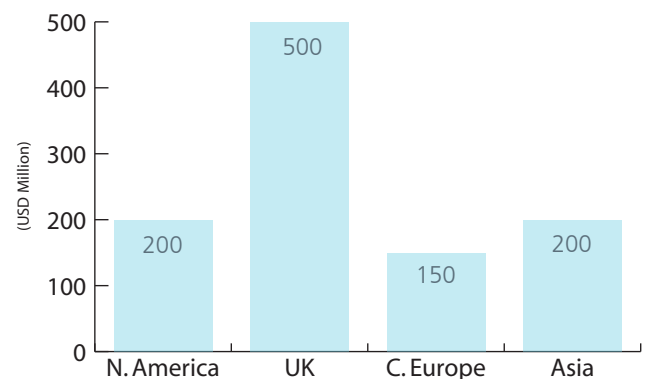
## Marine cargo theoretical capacity (USD)



Source: marsh

Note: Theoretical capacity refers to total maximum capacity assuming no restriction

## Marine cargo Stock-throughputs theoretical capacity (USD)




Source: marsh

Note: Theoretical capacity refers to total maximum capacity assuming no restriction

## Trends and developments

Towards the end of 2008 and going into January 2009 the cargo market was showing the initial signs of hardening, following a combination of the downturn in the global economy and the increased cost of capacity and reinsurance. Indeed, the initial months of 2009 saw a difficult round of renewals with underwriters seeking to pass on their increased cost of trading, yet most renewals were secured on an as expiring basis. That said, looking further ahead, the fourth quarter of 2009 is also likely to see a difficult round of renewals.



However, with the market continuing to enjoy a healthy level of profitability and with the continued competitive nature of the global markets, we are once again seeing reductions on accounts with good loss history. The only exceptions are the very large risks with catastrophe wind and earthquake exposures, where the cost of capacity can be a factor and where underwriters are seeking to, at least, hold current pricing levels.

The cargo market continued to attract new capacity during the first half of 2009. Montpelier and MarketForm increased their capacities in London, while the establishment of new underwriting agencies, representation from Lloyd's syndicates, and companies such as RSA, Starr Marine, Catlin, and others, also increased capacity in continental Europe. In the U.S. those underwriters (including Allianz, RLI, and Starr Marine) who expressed their intentions at the end of 2008 to increase their line structures in 2009, (for certain types of cargoes) did so. In China, Lloyd's will add up to three new syndicates by the end of 2009; and in Singapore Lloyd's will have 17 syndicates, with Beazley syndicate in Hong Kong adding a dedicated cargo underwriter. This is in addition to the domestic Asian markets that have also increased their cargo capacity. Clearly, cargo continues to be a line of business that the markets in Asia are keen to exploit.

With the cargo market giving reductions as opposed to the property markets increases, taking a look at stock-throughput options has been an interesting and necessary remarketing of business, with good success. With the reduced value of stock in storage, the stock portion of many of the integrated stock-throughput programmes is getting pricing pressure from the property market. While a stock-throughput programme can be a good option for clients with a traditionally structured placement, clients with stock-throughputs may do well to consider moving back to a more traditional placement, as property markets compete with each other to generate premium.

The number of small claims being reported by clients and clients' customers (on CIF shipments) has increased over the first quarter of 2009. We attribute this increase in claims reporting to the economic downturn, as companies look to maximise financial recovery wherever possible and, given the continued soft cargo market, no longer believe that a slightly deteriorated loss result is going to have a significant impact on their rates. Since the quantum of the claims has not yet impacted underwriters' overall results, this increased activity is not enough, on its own, to turn the market. However, it is a trend that should be monitored, as it increases loss ratios, as well as the cost of administering cargo programmes.



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