



## NON-TECHNICAL MEASURES TO PROMOTE QUALITY SHIPPING FOR CARRIAGE OF OIL BY SEA

### STUDY BY THE SECRETARIAT

#### Note by the Director

**Summary:**

At its third meeting in June 2007, following a proposal by the French delegation, the 4th intersessional Working Group invited the Secretariat to undertake a study in cooperation with the International Union of Marine Insurance (IUMI) and the Comité Maritime International (CMI) to examine the role that providers of hull insurance could play in the identification and elimination of substandard vessels, the promotion of insurance which was sensitive to the condition of vessels and in the promotion of conditions of operation and management which could contribute to quality transportation of oil.

The Director wrote to the French Government, IUMI and CMI inviting their views as to how such a study might best be undertaken. At the time of the Working Group's 4th meeting in March 2008, responses had been received from IUMI and the French delegation. Since then, a response has been received from CMI. On the basis of these responses the Director has made a preliminary study and analysis of the issues. This document sets out the results and contains suggestions as to how the Working Group could proceed with the issue, if it so wished.

**Action to be taken:**

Decide whether to instruct the Director to discuss and design, with suitable candidates, a possible in-depth research project on the issues involved and to provide the Working Group with an indication of the costs likely to be incurred.

### **1 Considerations by the third meeting of the 4th intersessional Working Group in June 2007**

- 1.1 At its third meeting in June 2007 the 4th intersessional Working Group noted document 92FUND/WGR.4/7/3, submitted by the French delegation. In introducing the document that delegation pointed out that the Working Group had, in accordance with point (a) of its mandate, focused at its first and second meetings on the liability insurance sector. That delegation reminded the Working Group that part of its mandate was to consider 'related issues' (point (d) of the mandate) and it proposed that one of the related issues that could be helpful in fulfilling the Working Group's task was that of hull insurance for vessels transporting oil.
- 1.2 It was pointed out that the issue of hull insurance had been the subject of several discussions in the Organisation for Economic Co-operation and Development (OECD) report of June 2004 concerning the contribution of the insurance sector to the elimination

of substandard shipping. The OECD report is available in English and French via the OECD website (<http://www.oecd.org/dataoecd/58/15/32144381.pdf> and <http://www.oecd.org/dataoecd/39/4/340299659.pdf> respectively).

- 1.3 It was also pointed out that, according to the OECD report, a provider of hull insurance might be more interested in the state of the hull and machinery than an insurer providing liability insurance, because a provider of hull insurance was interested in anything that could malfunction, as long as the event fell under the insurance policy, and not just that which could bring into question the liability to a third party. The report also noted that providers of hull insurance were increasingly taking into account issues of management and operation of vessels. The French delegation had therefore concluded in its document that hull insurance seemed to be more closely linked to considerations concerning the quality of vessels than liability insurance, stating that 'substandard' vessels would earlier and more frequently be faced with incidents that involved their hull insurance than with incidents that involved their liability insurance.
- 1.4 The French delegation further concluded that providers of hull insurance for vessels transporting oil could play a role in the identification and elimination of substandard vessels and, more generally, in the promotion of insurance which was very sensitive to the condition of vessels (or fleets of vessels) and also to conditions of operation and management, capable of contributing to the promotion of the quality transportation of oil.
- 1.5 That delegation suggested that in that regard several difficulties arose, namely the absence of an obligation to insure vessels' hulls, the varying quality or rigorousness of providers of hull insurance and the diversity of types of contracts. The French delegation proposed a series of questions (document 92FUND/WGR.4/7/3, paragraph 2.4) and suggested that, in order to answer those questions, the Working Group should initially identify possible correlations between hull insurance provided for tankers and incidents recorded that might involve the liability of their owners. Then, if certain links were found, that delegation suggested that it would be appropriate to study which measures concerning hull insurance would be capable of promoting quality shipping of oil (eg mandatory insurance or an obligation on the insurer or the owner etc to provide information).
- 1.6 The French delegation requested the Working Group invite the Secretariat to carry out the required study, in cooperation with the parties concerned, in order to answer the questions raised in their document.
- 1.7 In response to a question from one delegation, the delegation of France confirmed to the Working Group that, whilst the OECD report had considered this matter in some detail, no clear recommendations had been given and that, as a result, any study carried out for the Working Group would not duplicate the work of the OECD.
- 1.8 The majority of delegations were in favour of conducting the study although some delegations expressed doubts that the issue fell within the scope of the 1992 Civil Liability and Fund Conventions. The Chairman clarified, however, that, provided that the Working Group continued to seek non-technical measures to promote quality shipping and did not attempt to amend the Conventions, nor stray into the areas of IMO, then the study would fall within the mandate of the Working Group.
- 1.9 The Chairman expressed the view that it was unfortunate that no representative of IUMI was present at the meeting, but that the Secretariat should have the flexibility to discuss the proposed questions with IUMI before embarking on the study. The Chairman suggested that some information might already be available, particularly in relation to the OECD study, which could be of use to the Secretariat and invited the Director to take this into account.
- 1.10 The Director confirmed that the Secretariat was willing to undertake the study, but suggested that perhaps external expertise might also be needed and expressed his hope that the Secretariat would be able to carry out the study with the assistance of IUMI, CMI and the French delegation.

- 1.11 The observer delegation of CMI offered assistance with the study. That delegation pointed out that hull insurance was a private contract between the insurer and the shipowner and that, unlike in the case of liability insurance, a shipowner was under no obligation to produce a blue card to prove that hull insurance was in place and that it was therefore difficult to verify whether or not the ship was fully covered.
- 1.12 The observer delegation of CMI also pointed out that some larger companies preferred not to enter into contracts with insurance companies but to provide their own insurance. In light of that statement, that delegation requested clarification of the first question proposed by the French delegation relating to the number of vessels used to transport oil which navigated without hull insurance and whether there was a correlation between the absence of such insurance and the number of incidents recorded involving those vessels. That delegation asked whether the French delegation intended that ships referred to in this question as transporting oil 'without hull insurance' should extend to those which were self-insured.
- 1.13 The French delegation confirmed that the distinction between ships for the purpose of the study should be between ships which had no insurance and those which had insurance, either through an independent insurance company or through an insurance company which was very closely linked to itself. That delegation stressed that the study should then focus on those ships which had no insurance and whether more incidents occurred involving such ships.
- 1.14 In response to a question by one delegation regarding the possibility that the results of the study and subsequent conclusions of the Working Group could be that hull insurance should be mandatory and that the Working Group would therefore be led to making recommendations on an instrument outside of the 1992 Conventions, the Chairman warned against jumping to any such conclusions and again stressed that the Working Group was simply discussing insurance practices and that it was not aiming to amend the Conventions. The Chairman repeated that the Working Group could make recommendations in areas which were not in conflict with the Conventions nor strayed into the areas of IMO, but that the Working Group was not at that stage.
- 1.15 The Working Group invited the Secretariat to go ahead with the required study, in cooperation with the parties concerned, in order to answer the questions raised in document 92FUND/WGR.4/7/3.

## **2 Consideration by the fourth meeting of the 4th intersessional Working Group in March 2008**

- 2.1 At the fourth meeting of the Working Group held in March 2008, the Director informed the Group that since its previous meeting he had written to the French delegation, IUMI and CMI, requesting ideas as to how the study should be conducted, what its focus should be and how best to proceed. At the time of the fourth meeting, two responses had been received and the Director pointed out that, given that the letters had not been sent particularly early, he was not surprised that one response was pending.
- 2.2 The Director informed the Working Group that, although it had not been possible to prepare anything concrete in time for the March meeting, the Secretariat hoped to be able to do so before June. Taking into account that the aim of the study was initially to identify possible correlations between hull insurance provided for tankers and incidents recorded that might involve the liability of their owners and then consider in that context possible measures to promote quality shipping, the Director informed the Group that the initial responses did not give any clear indication of this. He warned the Working Group that there was a possibility that in June it would become clear that the Group was unable to draw a firm conclusion on this matter due to lack of information.

**3 Consideration of the relevant questions**

3.1 Based on the questions suggested by the French delegation in document 92FUND/WGR.4/7/3, the Director has made a preliminary study of the following issues, in particular as regards a possible link between the absence of any form of hull insurance, or of hull insurance with certain characteristics or on certain conditions, and the quality of the ship and its operation.

3.2 Before dealing with the relevant questions, it is important to note that CMI has informed the Director that it does not view the matters considered in this study as susceptible to responses such as those received from National Maritime Law Associations to the questionnaire circulated last October (document 92FUND/WGR.4/10). CMI further stated that it had not found itself able to add significantly to the comments provided by IUMI and France on the matters raised by the Director's letter of 11 February 2008, but in general saw no proven link between sub standard ships and insurance.

3.3 Question 1

*How many oil tankers are navigating without hull insurance?*

3.3.1 As suggested by the French delegation, this question appears to be relevant since hull insurers in practice exercise a certain quality control in determining which ships they accept to insure and under what conditions. A ship which does not have hull insurance does not benefit from the quality control of hull insurers and it would therefore not seem illogical to assume that such ships would – generally speaking – have lower quality standards than ships which do have hull insurance. If ships without hull insurance were to be involved in incidents more often than ships which do have hull insurance, it might be worthwhile investigating whether this effect could be compensated by more stringent or more frequent checks in other frameworks, such as, for example, Port State controls. In order to be able to investigate these questions, however, sufficient information regarding the existence or not of hull insurance for a particular ship would need to be available and accessible.

3.3.2 According to IUMI, the term 'tanker' includes a wide range of vessels, from the largest ultra-large crude carriers (ULCC) to smallish coastal or river tonnage and from vessels which ply the high seas to units which serve local communities located near the seashore or inland, accessible through rivers and lakes. Therefore it would be important to differentiate within that very broad category of ships and to be more specific as to the different types of ships.

3.3.3 Hull insurance *per se* is not mandatory and whilst, in practice, most large (blue water) tonnage will be insured against physical damage as well as entered into a P&I Club to permit serving ports which would not allow access to uninsured tankers, a great number of tankers, mainly smaller and/or older tonnage (coastal tankers, brown water tankers) will, according to IUMI, not be insured and will never have applied for entry in a P&I Club.

3.3.4 Since there is no central register of uninsured vessels in any sector of the industry, it does not seem possible to assess accurately the number of vessels which are uninsured either within the tanker sector or any other maritime vessel category without extensive factual research.

3.3.5 Accurate information regarding this question, therefore, does not seem to be available. IUMI supposes that a large part of the world tanker tonnage afloat will be insured but has stated that it is unable to indicate how many vessels are uninsured.

3.4 Question 2

*Is there a link between the absence of hull insurance and the number of incidents in which an oil tanker is involved?*

- 3.4.1 Since uninsured vessels are not, or not sufficiently, recorded statistically, IUMI is not capable of providing data directly relevant to this question.
- 3.4.2 In IUMI's view, it can be assumed, however, that uninsured tonnage will not comply with the same quality requirements and that it will tend to be older and not subject to regular periodic quality checks (dry docking, class requirements, etc). IUMI has stated that it is a statistical fact that old tonnage is more present in incident reports than new, ie the number of old tankers which suffer casualties is, in relation to the total afloat, higher. On that basis, IUMI assumes that uninsured vessels produce a higher number of incidents, always as a percentage of the entire group, than insured tonnage, but has no conclusive evidence for that assumption.
- 3.4.3 There appears also to be a connection with the quality of the crew in that, according to IUMI, qualified crew members generally prefer vessels which are younger and/or larger. It seems reasonable to assume that the same would apply to high quality standards, in respect of both the maintenance of the ship and its operation.
- 3.4.4 CMI has pointed out, however, that the main thrust of the OECD report was that there was no proven link between sub standard ships and insurance. To illustrate this, CMI mentioned a number of well-known casualties, where neither the management nor the state of maintenance of the ship had been deficient and where proper insurance had been in place. It also stated that the insurance arrangements of shipowners are, in practice, often dictated by banks to a large extent and suggested that any sub standard shipowner would probably rather be over-insured than take the risk of sailing uninsured.
- 3.4.5 Although it might not seem illogical to assume that shipowners without hull insurance are generally of less quality than shipowners with such insurance, CMI has pointed out that, based upon the experience of lawyers who are members of their National Maritime Law Associations, it would be inclined to say that shipowners of lesser quality tend to be over-insured rather than uninsured, possibly because they might be hoping for a profitable total loss.
- 3.4.6 The OECD report states on page 10, as part of the overview of the report, that there is a generally weak correlation between the quality of ship operation and the incidence of maritime liability claims, in particular for larger claims. Even if it would be justified, on the basis of common sense and experience in other fields, to assume some correlation between the quality of the ship's operator and small to medium-sized claims, this correlation becomes weaker as the size of the claim increases. According to the report, it is generally agreed within the marine insurance industry that for incidents generating claims of over US\$ 2 million it is not possible to identify any such correlation at all; such incidents appear to come more or less at random from operators of all quality standards (OECD report, page 44). It appears therefore that, even if a correlation between the absence of hull insurance and the quality of the ship and its operation could be established, this would not automatically lead to the conclusion that the absence of hull insurance was an indication of the likelihood that a ship would be involved in a serious incident.
- 3.4.7 It appears, therefore, that also in respect of this question, accurate, directly-relevant information is not available at the moment. It is difficult to predict whether such information could be acquired by field surveys and/or other research aimed at collecting statistically-reliable data but, in any event, extensive factual research would seem necessary. The information available on the correlation between the quality of the ship and its operation and the likelihood that it would be involved in a serious incident seems to give rise to the assumption that there is a similar correlation with an absence of hull insurance but, without further research/fact-finding, it is not possible to draw any conclusions.

3.5 Question 3

*What possibilities do hull insurers have to examine the quality of ships and what is the quality of these controls?*

- 3.5.1 It is clear that the identification of a useful role for hull insurers in the promotion of quality transportation of oil by sea is only conceivable if hull insurers actually have the possibility to examine the quality of the ships they insure. It is also clear that the value of the actual contribution to safety which hull insurers are making at present depends on the quality of the mechanisms which are in place to make sure that the quality checks are actually carried out in such a manner that they fulfil their purpose. These questions therefore appear to be relevant to the work of the Working Group.
- 3.5.2 In the view of the French delegation, it should also be investigated whether there are any mechanisms for the sharing of information between hull insurers on the state of ships, to what extent the quality of the controls or audits which they carry out is checked, and to what extent there is homogeneity of practices in this area.
- 3.5.3 In respect of the question regarding the quality of checks and surveys carried out and/or verified by hull insurers, IUMI has stated that most hull insurers will follow underwriting guidelines and internal rules and regulations which will make it mandatory for the insurer to make sure that classification and surveys are carried out by reputable organisations and that periodic checks and dry-docking are performed at appropriate intervals. Insurers will also need to make sure that these surveys are correctly carried out after a casualty and during the policy period.
- 3.5.4 IUMI has, however, pointed out that a trade organisation such as itself could not establish binding underwriting guidelines. It regularly provides comments on quality aspects, showing how important it is to be able to rely on dependable and well-known classification societies and on good quality surveys. IUMI has also pointed out that insurers have access to reliable information on the quality of a ship (eg Equasis, SIRE, Green Awards, US Qualship, etc).
- 3.5.5 Within the available legal framework, IUMI is trying to make information available but it has stated that there is an underlying difficulty which is the strong competition regulations which limit the degree to which insurers can share information and that insurers' efforts would be greatly assisted if national and regional laws and regulations could be modified, allowing a freer flow of information.
- 3.5.6 IUMI considers that the main barriers to the sharing of information are the legal restrictions which prevent sharing of information either from a competition perspective, or which could lead to the sharing of information which could be detrimental to a third party organisation. These concerns are particularly prevalent with the European Union and the United States. IUMI considers that any steps which could be taken internationally to relax these restrictions in areas which will impact on sharing of information relating to vessels' operations and quality would greatly assist the marine insurance industry in supporting the drive towards quality shipping.
- 3.5.7 It seems clear from the information available that hull insurers too have already taken considerable steps towards being more sensitive and critical to the risks they insure. In particular hull insurers do tend to make a conscious effort to get to know the quality of the shipowner as it is recognised in the industry that, in order to enable a proper risk assessment, it is more important to assess the quality of the shipowner/ship operator than to solely assess the quality of the ship (cf OECD report, page 23).
- 3.5.8 It also seems clear that the hull insurance market is still very competitive. Firstly, this would logically make it difficult for hull insurers to acquire relevant information from and about shipowners, in particular when the information requested is not of direct benefit or use to the shipowner. Secondly, this would make it difficult to arrive at a different conclusion from the one reached in the OECD report, that is to say that as long as the hull insurance market remains the way it is, any further contribution that hull insurers can make to quality shipping will be limited (cf OECD report, page 65).

3.6 Question 4

*Is there a correlation between the type of contract underwritten and the loss record of the ship?*

- 3.6.1 The last question which the French delegation wished to be answered was whether there was any correlation between certain types of hull insurance such as, for example, contracts which contain high deductibles and a higher incidence of accidents.
- 3.6.2 The French delegation has stated that this part of the study would probably be the most difficult to carry out as it would involve the examination of a large variety of contracts or clauses of which some might indicate the sign of a doubt on the part of the insurer as to the quality of the ship or of some of its components (equipment, crew, operations). Apart from the deductibles, the study could also look at the exclusion or wear and tear clauses.
- 3.6.3 IUMI has stated that it believes that this information is not, statistically-speaking, available. It did however, make a general comment that shipowners who buy hull policies with high deductibles tend to show higher financial standing than shipowners who are only prepared to carry a minimal deductible for their own account. It was pointed out that high financial standing normally meant that funds were available to be used on quality management.
- 3.6.4 CMI has pointed out that it is a universal condition of any ship-financing arrangement that the ship be insured, usually for a minimum amount well-exceeding the amount outstanding under the loan, with a reputable insurer and policy conditions ensuring the protection of, and endorsed by, the financing institution involved. In the view of CMI this will in practice not leave any room for the sort of insurance arrangements – or the lack of such arrangements – envisaged by the French delegation.
- 3.6.5 Apart from the limited information provided by IUMI, there is no information available which would allow any conclusions to be drawn regarding this question. Here again it will therefore be inevitable that extensive research aimed at collecting the relevant data is carried out if this issue is to be pursued further. It would need to be investigated whether this is possible, since it would require that rather subtle distinctions be made between the various types of hull insurance contracts and their clauses used in practice.

**4 Some preliminary conclusions**

- 4.1 At the March 2008 session of the Working Group, the Director already indicated that the information collected so far did not give clear indications in respect of the various issues involved and that there was a possibility that in June it would become clear that, due to a lack of information, it would be impossible to draw firm conclusions. The Director regrets to confirm that this appears to be the case. Although some information has become available, as set out above, it is very fragmented and not sufficiently conclusive for the purposes of the Working Group.
- 4.2 This lack of information could, in the view of the Director, only be resolved by in-depth research and fact-finding, which would require specific expertise and knowledge, both of the hull insurance market and of scientifically-sound methods of collecting statistically-reliable data. For this reason, the Director believes that the Secretariat would not be able to carry out such further research and fact-finding, but would have to engage a suitable researcher/consultant. Such research would primarily be aimed at collecting statistically-reliable data regarding the issues set out above, after which this information would have to be analysed with a view to drawing some meaningful and practical conclusions as regards possible measures concerning hull insurers and/or hull insurance arrangements to enhance the quality of transportation of oil in bulk by sea.
- 4.3 It is important to note, however, that the Director cannot state with any certainty whether such research would make the necessary information available since, even if it were possible to generate

this kind of information, it would be highly dependent on the cooperation of the industries involved. Neither can he state with any certainty whether such information would give clear indications as to possible improvements in respect of hull insurance arrangements in the market, leading to higher quality standards for the transportation of oil by sea.

- 4.4 Should the Working Group wish to have such in-depth research carried out, the Director could be instructed to discuss and design, with suitable candidates, a possible research project and provide the Working Group with an indication of the costs which are likely to be incurred. At the moment it is not possible to give an indication of these costs since it is unclear what the magnitude of such research would need to be. It would be a matter for the Working Group to consider the costs which are likely to be incurred and possibly for them to be endorsed by the 1992 Fund Assembly.

**5 Action to be taken by the Working Group**

The Working Group is invited:

- (a) to take note of the information contained in this document; and
  - (b) to decide whether to instruct the Director to discuss and design, with suitable candidates, a possible in-depth research project on the issues involved and to provide the Working Group with an indication of the costs that likely to be incurred.
-