THE LINK

MARINE NEWSLETTER JULY 2016

The end of the road: Britannia and UK P&I Club merger

The mooted merger between Britannia and UK P&I Club is no longer happening, but it has provoked renewed interest in how P&I clubs operate and whether other mergers may be on the table.

Talks between Britannia and UK P&I Club about a merger to create a super club eventually fizzled out in June. However, the potential tie-up has sparked conversations about the benefits of mergers between other clubs, and particularly the smaller ones operating in the market.

At a first look, it's not clear what the benefits of any such tie-ups would be for the ship owners that comprise the clubs' memberships. Many ship owners enjoy being members of clubs where they know that their fellow members, the directors and the club managers all have a shared understanding of the club's aims. To them there may be no obvious impetus to change the status quo.

However, the merger speculation has ignited questions over whether P&I clubs are commercially competitive enough. In this specialist area of coverage — ship owners' liability to third parties — P&I clubs have a dominant position, with a market share north of 80%.

Ship owners clearly enjoy the mutual ethos and the strong service culture of the club system. At face value the answer is yes. "The clubs claim they understand the business better than any commercial counterpart," says Mark Cracknell, Senior Partner in the Marine Division at JLT Specialty. "Most of them have been around for more than 100 years, so they have a longevity that strongly suggests a tried and tested product delivering sound value for money."

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FOREWORD

Welcome to the latest edition of The Link. Our main feature this issue looks at the attempted Britannia and UK P&I Club merger and considers the drivers behind bringing mutual entities together. We also provide an update on the offshore market, where we hear how flexibility from underwriters around lay up returns is helping ship owners through the low point in the oil and gas market cycle.

On page 4, we have a feature about changes to the Iranian sanctions, provided by Ince Law for the benefit of our readers. While a wide range of sanctions were lifted on Implementation Day in January, a considerable number remain in place and companies need to make sure they understand the new rules.

Also on page 6, our Q&A is with David Smith from JLT Specialty's Marine Division, and there's a reminder of the Insurance Act, which is coming into force in August 2016.

We have an update from MS Risk on page 7 about pirates targeting vessels in the Gulf of Guinea, especially off the coast of Nigeria. Incidents are becoming more widespread and violent, and the threat of crewmembers being kidnapped is sadly a reality.

On the back page, we talk to John Betz, who heads up JLT Group's new marine specialty practice in the US. John tells us about why he joined JLT and how the transition has gone so far.

We hope you enjoy the issue. Please feel free to get in touch with any feedback.

Kevin Lugg
CEO of Marine Division,
JLT Specialty Limited

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DIFFERENT STYLES

JLT Specialty places business across the P&I clubs, supporting ship owners in presenting risks, helping them to decide where to place business and negotiating competitive rates. "Ship owners want to know that they're getting the right price, and that they're in the right club. We enable them to benchmark; we are skilled negotiators and have very strong trading relationships with the clubs: plus we provide a full service, such as advice on coverage issues and contractual exposure," says Cracknell.

Clubs certainly have different styles. This can be seen in their different management arrangements. At one end of the spectrum is Standard Club, which is managed by the publicly quoted professional services company Charles Taylor. At the other end, the management of the Swedish Club, for example, is entirely on the club payroll. This can influence how a club operates.

Britannia and UK Club are both managed by independent private firms, but there are differences in style. Britannia is seen as the more conservative, and less commercial, of the two. It has historically lacked appetite for the cruise ship industry and limited the business that it accepted to territories the Club felt it thoroughly understood, only relatively recently becoming significantly involved in Greek and Chinese business.

"The process of them doing that took a number of years, in each case, before they felt sufficiently familiar with how those markets function to take the plunge and write business in a meaningful way," says Cracknell.

By contrast, UK Club is a broader church, open for most classes of business provided that it meets the Club's standards and will make a positive mutual contribution.

MERGER BENEFITS

A merger between Britannia and a UK Club would have created a second mega P&I club, the other being Gard, and may even have formed the largest. As well as Gard, Britannia and UK P&I, there are ten other mostly smaller P&I clubs — about which some of the merger chatter in the market has been swirling.

"The prospect of the merger had prompted a lot of the club managers to talk informally to one another about whether they should be proposing something similar to their boards of directors, but the discussions don't seem to have gone very far," says Cracknell.

The benefits of clubs merging could have included a combined, stronger management team and greater capital efficiency, reducing the need to fund a capital base from the membership, perhaps thereby reducing premiums.

"Capital in the clubs is raised from ship owners. The larger your portfolio, in simple terms, the less capital you need — you can make money go further if you're larger, because there are economies of scale. So that's a potential advantage of a merger," explains Cracknell. "In principle, we could see the advantages of a merger between Britannia and the UK P&I Club, but equally we could see why it might not be attractive to all members of both clubs. They are quite different in culture and business mix."

COMBINED FORCES

As well as bringing together management expertise, such an enlarged environment might also have provided a more dynamic workplace for employees, potentially attracting the best people.

With pros and cons on both sides of the argument, what probably broke the deal was the reality that the capital position of each club is different, and that trying to create a value proposition for members of both clubs proved to be an insurmountable challenge.

"Britannia members most likely feel that their capital position is stronger, relatively speaking, than UK Club, while UK Club members would be unlikely to see any need to concede ground on that score to Britannia," says Cracknell. "Most believe it fell through over the question of establishing valuations of both businesses that were mutually acceptable to each other."

There will be disappointment on the part of some members of both clubs that the failure to agree a merger will prevent the dividend of surplus capital many had anticipated a merger would bring. That disappointment may linger as it becomes evident that – merger or not – these two clubs and virtually all the others now enjoy record surplus funds, equivalent in many cases to the requirement for an AAA rating based on the capital model of at least one well-known ratings agency. The challenge now and in the future for P&I clubs is how they will manage this.

"They are — arguably — over capitalised, and that's a big challenge for the clubs going forward. What do they do about that? How do they deal with the fact that they have all accumulated huge surpluses, while continuing to navigate a marine liability environment that is not getting any easier?" asks Cracknell.

P&I rates have been held pretty steady for some years, and the clubs will not wish to see the weight of their surpluses put rates under pressure. Despite the operation of the International Group Agreement, the clubs' anti-competition agreement, there have been 'soft' P&I markets in the past, with disastrous results. The clubs will not wish to see P&I rates take the same path as the hull market, but it remains for them to address the fact that members increasingly consider clubs to be simply too wealthy and the pressure is on to bring premiums down. ■

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Offshore market update

Flexibility on insured values and lay up returns are helping ship owners through the tough part of the offshore market cycle, with signs that activity could begin picking up again in the autumn.

With oil prices staying at a low of around USD 48 a barrel in June, the number of new offshore oil and gas installations that are going ahead this year remains in the small numbers.

Operators in some cases are bidding at cost, and other times are facing the tough option of having to put vessels into lay up.

In such situations, JLT Specialty is stepping up to support marine clients with flexibility on conditions around lay up and by obtaining significant returns on premiums.

"We have a very big book of offshore supply boats that supply the rigs, and they are suffering because the rigs are unemployed," explains Nick Berry, Senior Partner in the Marine Division at JLT Specialty. "A lot of our owners are having to lay up vessels, because the daily hire rate doesn't support the cost of running the ship. We are being very proactive and trying to get the best insurance solutions for them."

This includes introducing 'very generous' lay up returns on a lot of policies, as well as potentially obtaining deals to lay up vessels in certain areas. "That should help a lot. Some owners reduce their values accordingly, and where they can't, because of their loan requirements, they tend to reduce their loss of hire insurances, which saves a lot of money, because there are so few charters — until the market returns."

Where ship owners have no terms on lay up returns, JLT Specialty is introducing them on renewal, thereby providing a reduction in premium, or introducing mid-term where possible. Meanwhile, although the offshore market has hit a low point, some seismic activity is going on, offering potentially positive signs that new projects may be on the horizon.

OIL PRICE OUTLOOK

"Seismic vessels go first, and there is some seismic activity at the moment, so there is hope," says Miles Dymock, Director of global marine broker Offshore Shipbrokers, explaining how the offshore cycle generally unfolds. "Next is exploratory drilling, then construction vessels, cable lay vessels, and finally heavy lift vessels to do the top side lift."

The cycle is likely to begin picking up more fully once oil prices hit about USD 60 a barrel. The International Energy Agency offers hope of an oil price rise because it expects global demand for oil to begin outstripping supply in October this year. "With the cost cutting that's going on at the moment, and all the initiatives that are going on, activity would pick up a decent amount at USD 60 a barrel," says Dymock.

When the market does recover, JLT Specialty will be well placed to continue offering appropriate and flexible deals. "We have a great relationship with our markets, in terms of volume and co-operation. We are able to obtain lay up returns to help owners through the hard times, because of our relationship with the market," says Berry. "We're a leader in supply boats in the London market, operating for 33 years: a long-term player in marine hull insurance with expert market knowledge." ■

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LIFTING OF IRANIAN SANCTIONS

On 16 January 2016, the EU and UN nuclear-related economic and financial sanctions against Iran were terminated in line with the Joint Comprehensive Plan of Action (JCPOA) agreed between Iran, the EU and the 'P5+1' (permanent UN Security Council members France, China, Russia, the UK and the US 'plus' Germany) in July 2015. *Article by Michelle Linderman, Ince & Co*

This included the delisting of many entities and individuals. US secondary legislation imposing nuclear-related economic sanctions was also suspended.

As a result of the lifting of EU sanctions, EU entities have been able to recommence trade with Iran. Restrictions prohibiting the purchase/sale and/or transport of certain Iranian cargoes (including crude oil, petroleum or petrochemical products or gas) or the provision of insurance (including P&I insurance) in respect of the carriage of those cargoes have, amongst others, all been lifted and numerous Iranian persons and entities have been removed from the sanctions lists. Some EU restrictive measures remain in place (but these relate largely to military goods, weapons and items that might be used for internal repression) and some entities and individuals remain listed. However, this 'opening up' presents a wealth of opportunity for those keen to take advantage of opportunities in Iran's oil, gas, shipping, trade and aviation sectors.

Many EU companies have started looking at opportunities in Iran, but, the initial rush to do business with Iran has slowed as companies find that, despite the lifting of many of the restrictions, there are still numerous hurdles to overcome not least of which are the remaining US restrictions and the impact those have had on banks.

THE US ANGLE

While the lifting of UN and EU sanctions represents a huge step forward, those looking to commence or recommence business with Iran need to bear in mind that many US primary sanctions i.e. those that affect US persons and entities, have not been lifted and there are still a number of Iranian Specially Designated Nationals. As such, US persons and entities still cannot do business with Iran although non-US- based subsidiaries of US companies can now carry out certain business with Iran pursuant to General Licence H issued by the US authorities on 16 January 2016. Further, any goods that are of US origin are subject to US export control restrictions, which means that US origin goods and technology for the oil and gas sectors remain off limits for Iran.

Perhaps the greatest impact of the remaining US sanctions has been on the banking sector. US banks are unable to process US dollar transactions relating to Iran which has made some of Europe's biggest banks nervous about doing deals in Iran, or processing payments relating to Iran for fear of breaking US laws. Such reluctance to take the risk of handling Iranian transactions is understandable in the wake of the eye-watering fines that have been imposed on banks by the US authorities, including a record USD 9 billion fine imposed on BNP Paribas in 2014 for processing banned transactions involving Cuba, Sudan and Iran.

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'SNAP BACK' PROVISIONS

For those who have identified that they are able to trade with Iran and are keen to sign contracts, it is also important to bear in mind that the JCPOA contains 'snap back' provisions that will reintroduce restrictions if Iran breaches its side of the deal or, indeed, if any of the other parties pulls out of its commitments. In light of this, consideration should be given to clauses that take the 'snap back' risk into account in any Iranian contracts that are signed.

CONSIDERATIONS FOR THE INSURANCE INDUSTRY

Due diligence

Where companies wish to arrange insurance for business with Iran, the underwriter needs to ensure that, none of the parties or the subject matter of the insurance are subject to any sanctions restrictions. Carrying out careful due diligence checks helps to ensure that no sanctions are breached but also means that in the event that a breach of sanctions occurs, the underwriter may be able to avoid liability by relying on the due diligence defence contained in the EU regulations. It does, however, require that the assured provides comprehensive and detailed information in order to enable the underwriter to assess what the sanctions risks might be. For marine cover for trips to Iran, this will normally include providing the following information:

- Identities of all parties to the proposed business
- Details of the vessel and vessel owner
- Type and ownership of cargo/details of consignees
- Where the cargo will be loaded (names of ports/origin of cargo)
- Whether the client is aware of any aspect of the transaction that could breach sanctions
- Whether there is any US connection to the transaction
- Currency to be used
- Whether there is any activity in relation to nuclear technology, arms or dual-use goods.

It is worth bearing in mind that this due diligence process needs to be carried out by each individual underwriter on the policy.

Problems paying claims

Aside from carrying out due diligence at inception, underwriters also need to carry out due diligence when claims arise and at the time of payment in order to ensure that the status of the involved parties has not changed and/or that no new restrictions have come into place that may make it illegal to pay the claim.

Even where due diligence checks have been cleared, there can still be issues with payment of claims in relation to Iranian business. As mentioned above, European banks have taken a risk averse approach to Iran and continue to have strict internal compliance programmes, often preventing them from making transfers relating to Iran.

CONTINUED NEED FOR VIGILANCE

As we have said, while Iran is now open to business, some entities and individuals are still subject to US designations and/or remain subject to EU restrictions, and certain other restrictive measures remain in place. Those considering conducting business with Iran should therefore remain vigilant, continue to carry out appropriate due diligence on proposed counterparties and seek legal advice in order to ensure that they comply with any remaining restrictions.

ANTI-BRIBERY AND CORRUPTION

Although the lifting of sanctions offers huge potential for EU businesses, it is also worth bearing in mind that Iran can present other risks: for example, Iran scores highly on Transparency International's Corruption Perceptions Index. It is important, therefore, that, as well as ensuring sanctions compliance, suitable anti-bribery and corruption policies are put in place to help to reduce such risks.

EU sanctions against Iran post Brexit

The UK's departure from the EU will have an impact on the sanctions landscape. While nothing will change in the immediate future (as with other areas of EU law, the UK will continue to implement EU regulations for two years after the UK has officially notified the EU of its wish to leave), going forwards the UK will be able to forge its own economic sanctions policy.

In relation to the sanctions against Iran, it is unlikely that the UK will take a different stance from the EU in the foreseeable future. The UK was one of the key negotiating countries in reaching the JCPOA agreement and there is no reason to think that Brexit will impact the UK's foreign policy relating to Iran.

More generally, while it is not clear what path the UK will take in relation to sanctions post-Brexit, it is probable that the UK will continue to favour the use of economic sanctions as a tool of foreign policy. Further, with the recent establishment of the Office of Financial Sanctions Implementation whose remit is to ensure that sanctions are properly understood, implemented and enforced in the UK, there is the likelihood that there will be an increasing number of prosecutions.

Whatever happens in the UK/EU discussions over the next few years, it is clear that the sanctions landscape will remain a complex one and those doing business in countries subject to sanctions will need to remain vigilant continue to carry out due diligence and, where necessary, seek legal advice. ■

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Meet David Smith

Q. What does your role involve?

I am Deputy Chief Executive of JLT Specialty Marine, a position I have held for six months. Prior to that I was at Lloyd & Partners Limited, where I headed up their marine team. Along with the CEO and Chairman, I work on driving our current marine business forward while actively seeking new business opportunities.

My role currently involves travelling to North America and Europe. When I am in the office, I like to actively involve myself in meeting clients and maintaining my broking role with underwriters at Lloyd's and other insurance companies. I think 'face-to-face' discussion and negotiation is becoming a bit of a lost art. Sitting down with someone will, 99% of the time, help you achieve a far better outcome.

Q. What experience do you bring to your role?

I have been a producing and placing broker at Lloyd's for 28 years; I started when I was 17 years old. My last role before joining the JLT Group was with Besso Group, where I was Managing Director of the Marine Division and a Member of the Board.

Q. Why did you become a marine broker?

I started out as an engineering apprentice. My mother was in marine insurance, so she suggested I pursue a career in the City. I was fortunate to obtain a position at Harris & Dixon Insurance Brokers in the Claims Division.

I have continued to work in the marine sector for my whole career because I genuinely find the subject interesting; I enjoy engineering and understanding the wide variety of vessel specifications, engines and the people that run the shipping companies.

Q. Tell us about an interesting placement you have worked on?

My real specialism is salvage insurance; I am the only insurance broker who is an associate member of the International Salvage Union. As a result of my expertise in this area, I was asked to place the entire insurance package for the salvage company that raised, refloated and delivered the 'Costa Concordia' cruise ship, which hit the rocks off 'Isola del Giglio'. All sorts of catastrophic problems could have occurred because it was a wreck removal project on a scale that had never been attempted before, using engineering that was relatively experimental.

Q. What challenges are your clients facing in the current climate?

The main challenges are economic – for example, our clients serving the oil sector whose earnings are massively down, or commodity sector clients affected by the Chinese economy slowdown. The universal theme is that every client needs to watch every dollar they spend. As their earnings are squeezed they simply need to get the most competitive deals for all their outgoings, of which insurance will be a significant proportion.

Q. What's happening in the marine market?

The market is still awash with financial capital. This is good for our clients because there is a lot of competition and opportunities for us to drive prices down. There is simply much more underwriting capacity in the market than there is premium at present and this is bringing significant deflationary pricing across all areas of commercial insurance and especially marine.

Preparing for the new Insurance Act

Insureds need to make sure they are prepared for the Insurance Act 2015, which is due to come into force on 12 August 2016.


JLT
TECHNICAL & LEGAL
JLT SPECIALTY BULLETIN OCTOBER 2015
Insurance Act 2015 Update
BACKGROUND

It will be the most significant reform of UK insurance law since the Marine Insurance Act 1906. It is designed to change the law governing insurance contracts to reflect modern business relationships and ensure that there are appropriate remedies in place for when things go wrong.

The Act will bring in a raft of changes, including updating an insured's disclosure obligations to the insurer (the duty of fair presentation) and introducing proportionate remedies for any breach of that duty. It will also make adjustments as to how non-compliance with policy terms will operate and provide remedies for fraudulent claims.

Our Technical & Legal team has produced a bulletin that looks at the steps that insureds should take to prepare for the Act. Download at www.jltspecialty.com/insuranceactupdate

Piracy in West Africa

Piracy and armed robbery against vessels transiting the Gulf of Guinea continues to be a major concern to the maritime industry as incidents are becoming more widespread and violent, while an increase in the kidnapping of crewmembers has marked a shift in trends.

The reporting period from January to June 2016 has particularly been marked by an increase in kidnappings in waters off West Africa, effectively making the region the world's piracy kidnapping hotspot. The latest figures indicate that kidnappings in this region are on the rise, with the Gulf of Guinea accounting for seven of the world's ten kidnapping incidents that were reported during this period. From January to June 2016, a total of 44 crewmembers were kidnapped for ransom globally, with 24 crewmembers being taken in waters off Nigeria – this is up from 10 during the same period in 2015. This shift from targeting oil tankers for their cargo to kidnapping sailors is due to lower oil prices and is a trend that is likely to continue for the remainder of this year.

Pirate Action Groups (PAGs) operating in the Gulf of Guinea continue to comprise groups that vary in size. They include small, local criminal groups that are mostly active in ports and anchorages and larger groups that are capable of operating across the Gulf of Guinea. During this reporting period, PAGs boarded vessels 30 to 120 nautical miles from shore. In one incident, a vessel was hijacked 70 nautical miles south of Abidjan, Côte d'Ivoire, crossing through waters of Ghana and Togo into São Toméan waters before the Nigerian Navy recaptured it. While PAGs targeted a wide variety of vessels, most were commercial, such as oil or chemical tankers. As in previous reporting periods, piracy activity in the Gulf of Guinea, and particularly in waters off Nigeria, continued to be characterised by a high level of violence. Of the nine vessels that were fired upon worldwide during this reporting period, eight such incidents were recorded in waters off Nigeria.

Over the coming months, it is likely that Nigeria will remain the primary source of piracy incidents in the Gulf of Guinea. Across the region, the threat of hijacking will remain high, with the threat of kidnapping for ransom of crewmembers likely to continue for the remainder of this year. While increased counter-piracy operations are needed across the Gulf of Guinea, underreporting remains an issue.

MS | RISK

For more information, please visit MS Risk's website at www.msrisk.com

JLT Specialty Limited provides insurance broking, risk management and claims consulting services to large and international companies. Our success comes from focusing on sectors where we know we can make the greatest difference – using insight, intelligence and imagination to provide expert advice and robust, often unique, solutions. We build partner teams to work side-by-side with you, our network and the market to deliver responses that are carefully considered from all angles.

Our marine team of over 100 specialists has built its reputation over many years. The team is made up of a broad range of professionals who have all the necessary skills to help you manage your risk. We deliver a stronger approach based around your business, providing cost-effective solutions, service excellence and claims certainty.

CONTACTS

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Meet the US team

In November 2015, JLT Group launched a marine specialty practice in the US as part of our strategy to expand our US capabilities. In this article, we meet John Betz, who heads up the new team as Senior Vice President.

Q. What was the attraction of moving your team to JLT?

We met a number of firms, but when we got to JLT, the decision was made easy. I was already familiar with the company, which has a great reputation and a solid balance sheet, and once we started talking about JLT's commitment to the marine space and how we would be their US platform for marine business – as well as what capabilities and support they could provide – the decision was straightforward.

Q. What knowledge and experience does your team bring to clients?

Our team has more than 50 years' insurance experience. I joined from Arthur J. Gallagher, where I led the Blue and Brown Water Marine practice; Chris Maro was a Partner for the Howden Marine Group; and Ken Fichtelman was an Associate Partner for the Howden Marine Group. As well as providing insurance expertise, Chris and Ken are US Maritime Academy graduates who sailed professionally, so they bring with them some very practical experience.

Knowledge and experience are only part of the value we deliver to our clients. Our business is built on listening to our clients' challenges and providing them with superior service and competitive/comprehensive insurance products.

Q. What are the biggest challenges facing the marine industry in the US?

For our clients, the challenges are two-fold. First, there remains an overcapacity of ships, particularly on the dry bulk side, as a hangover from the shipping construction boom before the market

crash in 2008-9. The tanker market is somewhat more balanced, but new construction can threaten this sector at any time.

Second, the world economy is distressed and China is in transition. As China is a big importer of commodities and exporter of products, shipping is deeply affected by the fact that this nation and their economy is struggling.

Q. What is it like working with the marine team in London?

It has been a fantastic experience so far. The London wholesale team is a very strong team; they stepped up instantly to the servicing of our account and have made this a completely seamless transition for us and – more importantly – for our clients. We are also collaborating with them on new business production.

In addition to working closely with our London colleagues, we are ably supported by a team in Houston who do a fantastic job for us. ■