



ANNUAL REVIEW 2011/12

IGP&I



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|---|-------|
| Introduction | 3 – 4 |
| Chairman's statement | 5 |
| Executive officer's statement | 6 |
| Piracy | 7 |
| European Union competition review | 8 |
| Sanctions | 9 |
| Solid bulk cargo liquefaction | 10 |
| Athens Convention 2002 Protocol/EU Passenger Liability Regulation 329/2009 (PLR) | 11 |

Supporting sea-borne trade



We live in a world that is dependent on the global economy – and that economy simply could not function if it were not for ships and the shipping industry. To understand the importance of shipping in everyone's lives, it is worth looking at the diverse range of products that are used everyday. From the technology that is a vital part of today's economy to the fuel that powers transport and factories, the items that are considered basic necessities of modern life are brought to their respective markets by sea.

While shipping is perhaps the most international of all the world's great industries, it is also one of the most dangerous. Despite the fact that ships have never been so technically advanced, carried so much cargo, or been as environmentally-friendly as they are today, accidents still happen, and the consequences of catastrophes at sea can affect a much wider number

of people than are directly involved, as for example in cases involving significant loss of life or pollution.

However, without shipping, intercontinental trade, the bulk transport of raw materials and the import/export of affordable food and manufactured goods would simply not be possible. It is the job of the global insurance industry to help shipowners and operators to mitigate and manage their risks so that trade can continue – and it is here that the International Group of P&I Associations plays its part.

Insuring a vessel's liabilities

The world merchant fleet currently exceeds 85,000 vessels with a combined gross tonnage of in excess of 1 billion GT. Marine property insurers provide cover for known quantifiable risks, for example, in hull and machinery insurance for shipowners and cargo insurance for cargo owners. However, there is also a requirement for shipowners to have third party liability insurance for broader indeterminate risks, for example loss of life or personal injury, liability for loss of or damage to cargo, collision and pollution liabilities and wreck removal.

Shipowners who control over 90% of the world's merchant fleet buy insurance for these third-party risks from one of the

13 Protection and Indemnity (P&I) Clubs that form the International Group of P&I Associations (the International Group). P&I insurance originated in the 1850's and the system has developed over the centuries to help deliver compensation and support to the victims of maritime accidents.

The Clubs are mutual insurance associations of which the shipowners are the members. They are owned by, and run for the benefit of, their members. Unlike commercial marine insurers, who are answerable to their shareholders, the Clubs are run as non-profit-making businesses. The Group Clubs compete between themselves – and with other mutual and commercial insurers of P&I liabilities, but through the structure of the International Group Agreement the member Clubs share between them liabilities in excess of US \$8 million up to a maximum limit of around US \$7 billion.

The International Group performs three key functions: the operation of the claims pooling and reinsurance programme, providing a forum for the exchange and consideration of views on matters relating to shipowners' marine liabilities and insurance arrangements, and external representation.

Supporting sea-borne trade



Pooling and reinsurance

One of the main roles of the International Group is the administration of the claims sharing arrangement funded by all the member Clubs and known as “the Pool”, and its associated reinsurance programme. This pooling system provides a simple, but highly efficient and fair, system of spreading risk and enhancing the financial security that Clubs offer their members. The Group pooling system is structured to meet the needs of claimants in maritime disasters by facilitating speedy and certain payment of very substantial amounts of compensation, a factor which is recognised

by governments, maritime authorities and organisations around the world. The importance of the Group pool system is recognised in the IMO provisions relating to insurance and financial security in its guidelines to member states on shipowners’ responsibilities in respect of maritime claims.

The claims pooling arrangements are underpinned by a very extensive, annually renewed, market reinsurance programme. Over 80 reinsurers worldwide participate in this and it provides up to US \$3 billion of reinsurance cover for pool liabilities in excess of US \$60 million. Through these pooling and reinsurance arrangements the Group Clubs are able to offer the highest level and broadest range of liability insurance cover on a cost-effective basis. The large volume of tonnage and wide range of vessel types entered in the Group Clubs help to minimise the volatility of shipowners’ contributions, and is a key factor in the very competitive terms and cost of the Group reinsurance programme. In addition, through the Group’s wholly-owned captive – Hydra – reinsurance is provided for claims between US \$30 million and US \$60 million, and for a 25% share of the first US \$500 million layer of the Group reinsurance programme.

This means that Group Clubs can more effectively control reinsurance costs and protect against the volatility and risks of the commercial reinsurance markets.

Forum

The Group Clubs between them provide cover for shipowners from every maritime nation, and virtually every type and size of vessel. This enormous range of nationality of ownership and vessel type makes the International Group a unique forum for the promotion and exchange of views on matters relating to shipowners’ liabilities and insurance cover. The International Group has over 90 sub-committees and working groups addressing a broad range of practical, technical and legal issues that relate to shipowners’ liability.

Representation

The International Group provides an effective voice for the members of the individual Clubs to speak collectively on important industry issues, for example on international conventions and legislation affecting shipowners’ liabilities and related insurance matters.

It also promotes, participates in and implements initiatives aimed at improving ship quality and safety standards. All the Group Clubs have in-house expertise in loss prevention and claims management which is shared amongst the International Group, and provides an unparalleled knowledge and expertise base for the benefit of the Clubs and the shipowners who are their members, as well as assisting other industry associations, governments and regulators.

The International Group also assists states and inter-governmental bodies and agencies in reviewing and drafting legislation and regulation which impacts on maritime liabilities.



Chairman's statement

Claes Isacson

There is no doubt that mutuality is not a widely adopted ownership structure but, for our industry, it is a structure that has stood the test of time. This is demonstrated by the steady growth of tonnage protected by the International Group members against the liabilities imposed by different legislative and governmental bodies.

A history of responding to change

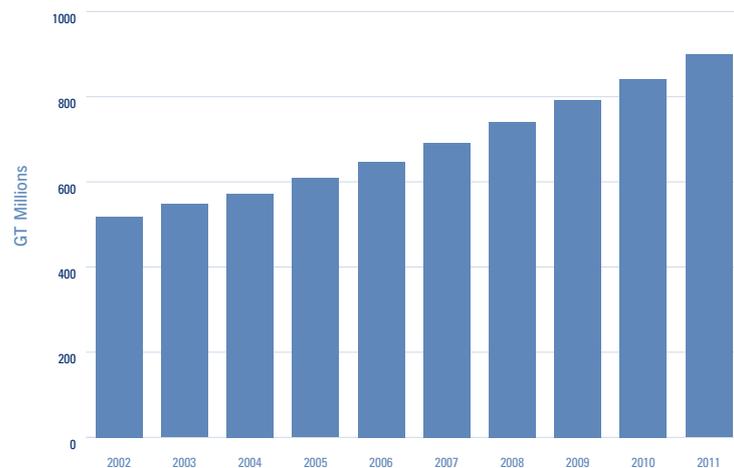
Clubs are an integral part of both the short and long-term response to casualties, not just meeting the needs of the owners, but also those of the victims of maritime accidents and the authorities involved. Time after time, we have seen major shipping incidents leading to new legislation to which the industry has responded with new products or extended covers. Clubs are able to provide the most extensive insurance cover available because of the International Group pooling and reinsurance arrangements.

The market today – meeting shipowners' needs

Despite competition from other systems, the vast majority of owners have remained within the mutual system because they can, in contrast to the commercial insurance markets, obtain insurance cover 'at cost'. However, it is not just about price.

Prevention is undoubtedly better than cure, and one of the key areas which sets Clubs apart from their commercial market competitors is their focus on initiatives aimed at averting incidents and limiting the exposure of shipowners. This includes promoting and implementing standards and safety measures through

International Group owners' tonnage



proper risk assessment, as well as the sharing of knowledge and expertise gained from casualty work within and between the International Group Clubs, states, regulators and other key areas of the shipping industry.

While loss prevention is a key objective, accidents inevitably occur and responding properly when they do occur is a critical part of the service provided by Clubs. The prompt and efficient payment of compensation is a vital part of this, and the Clubs' reputation for responding has remained second to none despite having to deliver ever broader and higher limits of compensation.

The way ahead – evolving to meet the future

The future is uncertain, with ongoing and new challenges to be faced. The focus on the protection of the marine environment is increasingly stringent, so the role of the Clubs in providing both compensation and technical expertise is growing in importance. Equally, significant increases

in compensation limits for passengers, and the cost of pollution incidents and wreck removal will test the system in the coming years. The continuing attention from competition regulators on the Clubs, and International Group system, remains significant and could undermine the ability to deliver the range and levels of compensation required.

Nevertheless, the Clubs and the International Group have gone from strength to strength over the last 150 years. I believe that this is down to three key attributes; resilience, responsiveness and robustness, all of which mean that the system will continue to adapt to a changing environment and to provide unparalleled cover for both shipowners and victims of maritime incidents.



Executive officer's statement

Andrew Bardot

2011 was another year of diverse and interesting challenges and issues for the International Group and, in consequence, for our Secretariat which manages the day-to-day co-ordination of internal administration on Group matters, external engagement and representation of the International Group.

Challenges and issues

The EU investigation

This was initiated in 2009 into the International Group and member clubs and is set to continue into 2012, further occupying everyone's time and attention.

Sanctions legislation and regulation

The extension of existing, and introduction of new, sanctions during 2011 – and their impact on insurance arrangements – have kept us busy identifying potential changes to cover and on the pooling and reinsurance arrangements.

Piracy

The problem in the Gulf of Aden/Horn of Africa/Indian Ocean region continues unabated, and we have been working closely with other concerned organisations on a number of industry and naval/military initiatives. Through them we are seeking to address the underlying piracy problem, and the impact of these violent incidents – particularly the short and long-term effects on the welfare of hijacked crews.

Cargo concerns

Periodically there are specific problems relating to the carriage of particular types of cargo and, in 2011, it was the turn of solid bulk cargoes with liquefaction propensities. This came under the spotlight following a series of total losses, which also sadly involved a heavy death toll.

Regulatory changes

There are three issues that are occupying a considerable amount of time, both within the Secretariat and Club managements.

These include:

- the state ratifications of the Athens Convention 2002 Protocol;
- the 31 December 2012 implementation date for the EU Passenger Liability; and,
- the likely entry into force of the ILO Maritime Labour Convention.

The process of bringing the EU Insurance Directive into force within member states has required extensive engagement with them, and the International Group has also been involved in providing industry input into the application, and review, of the EU Environmental Liability Directive.

Elsewhere, China continues to demand considerable time and input in relation to the implementation of new regulations, particularly relating to oil pollution liability, spill response and liability insurance arrangements. India has also been another focus of attention in relation to insurance requirements for vessels using its ports.

Other regulatory issues

As well as the regulatory changes already mentioned in this review, the International Group has been actively engaged in a wide range of regulatory issues related to the development of draft rules and regulations in various jurisdictions around the world for example, in the US, Indonesia, Italy, Turkey, Panama, the Russian Federation and India, amongst others. This work is in addition to providing advice on the application of legislation adopted at a regional and international level.

During 2011, the International Group has actively participated in a range of discussions and meetings that have taken place at the International Maritime Organization (IMO), notably the IMO's Legal Committee, Facilitation Committee, Maritime Safety Committee and the Sub-Committee on Dangerous Goods, Solid Cargoes and Containers, as well as

continuing to take an active role in the meetings of the 1992 International Oil Pollution Compensation Fund governing bodies and intersessional working group.

Operational developments

The Secretariat team has been bolstered during 2011 by the arrival of Pauline Marchand, a lawyer with pollution expertise, and David Bolomini who previously headed the UK government's delegation to the IMO Legal Committee where he served for five years. He led on all maritime issues in the EU (including the Erika III package) and ILO, and was the UK's board member to EMSA and a member of their panel of experts assisting new accession states. Both will add considerably to the expertise and reach of the Secretariat team.

Hugh Hurst, who has played a central role in the activities of the Secretariat for over 10 years, has now headed off to enjoy a very well earned retirement. His tireless efforts and valuable input on a wide range of complex International Group issues over the years has been greatly appreciated and will be missed.

The Secretariat has continued to work closely with representatives from a number of Clubs on the further development and full CII accreditation of the Group P&I Qualification program. Four modules are up and running with two series of examinations having been held during 2011 and a further three are under development for 2012.

We are very grateful for the investment of time and energy that representatives of the Club managers make in participating on the numerous sub-committees and working groups that are key to our operations. Currently there are over 90 such sub-committees and working groups addressing issues impacting on the cover provided by Clubs and the operation of the Group pooling and reinsurance arrangements. The extensive intellectual and practical input they provide is an unparalleled resource for everyone involved in maritime activities.

Piracy



Pirate attacks on merchant vessels continued unabated in 2011 across the Gulf of Aden, the Horn of Africa and into the Indian Ocean – a trend which is still preoccupying the shipping industry and marine insurers – despite the continuing efforts of the multi-national naval coalitions operating in the regions.



The International Group has made extensive efforts to promote 'self help' through the development and implementation of best management practices, which are now on their fourth version.

The escalating levels of pirate activity have been partly due to the increased use of 'mother ships' to launch attacks, and a wider theatre of operations, which have made attacks less weather-dependent. Reported attacks from 2008 to 2011 also reveal an increasing incidence of armed engagement by pirates. In addition, there has been a sharp rise in the cost of ransom payments, from an average of US \$1.5 million in 2007 to US \$5.2 million in 2010, which can be increased by as much as 50% again in terms of expenses. A number of ransom payments have reportedly exceeded US \$10 million.

The Group Clubs have continued to work alongside shipowner and insurer industry associations, the United Nations, IMO states, and naval coalition forces to improve guidance to shipowners about how to protect against the risk of piracy attacks, as well as the more contentious subject

of deploying armed security personnel onboard vessels. There is recognition that shipowners are increasingly using, or at least considering, armed personnel, so flag states are becoming more receptive to shipowners' wishes, taking steps to accommodate them in changes to national legislation. Clubs are providing guidance to shipowners on implications for their P&I insurance, as well as the contractual terms offered to security providers, whose numbers have proliferated as many new companies seek to capitalise on the opportunities afforded by the increasing number of piracy attacks.

The Group Clubs are also actively supporting a number of piracy-related shipping campaigns, including Save Our Seafarers and the Maritime Piracy Humanitarian Response Programme.

It is universally recognised that these are long-term problems, the resolution of which is dependent on restoring political stability in Somalia. In the meantime, the Group Clubs will continue to participate in and support initiatives to alleviate the impact of piracy on seafarers and their dependents.

European Union competition review

The most recent European Union (EU) review of the organisation and operation of the International Group and its member Clubs was formally launched by the Directorate General of Competition in August 2010.

In contrast to previous investigations in the mid-1980s and mid-1990s, the current review was not prompted by specific complaints about the operation of the International Group, but was part of a wider review of general insurance arrangements.

The Commission is carrying out a detailed review of a number of aspects of the International Group and its members with a focus on the International Group's claim sharing and reinsurance arrangements. Since the start of the investigation, a substantial amount of information and data has been provided to the investigating case team by everyone involved.

So far, no specific concerns have been articulated by the Commission. The former case team manager has publicly stated that the intention of the review is not to damage or undermine the International Group system, but rather to see if it can be made to work more effectively for shipowners. This is despite the fact that the shipowners are – through the mutual structure of the Clubs – the owners of the system that is under review.

We have maintained a responsive and constructive relationship with the case team throughout the review, and will continue to do so. It is unlikely to conclude before 2013 and, in the meantime, the International Group and Clubs continue to operate under the arrangements approved as part of the last exemption granted in 1999.



Sanctions



Governments and regulators are increasingly targeting the financial services industries, including insurance, as a route to more effective enforcement of sanctions legislation. Recent sanctions legislation – targeted at Iran, the Ivory Coast, Libya and Syria – has created problems for shipowners and their Clubs by impacting insurance arrangements.

In some cases there has been a prohibition on the provision of insurance to designated shipowners or companies, the insurance of certain trading activity, or payments by insurers to designated individuals or entities. The ‘extra-territoriality’ of some sanctions – particularly those emanating from the US – have also created significant problems for shipowners, Clubs and the International Group.

A lack of clarity

Much of the regulation and legislation deliberately lacks clarity to provide flexibility in interpretation and enforcement by the relevant authorities, which in turn has created difficulties for all insurers, including the Clubs. For example, in response to the US and EU sanctions against Iran, all Clubs have had to introduce general sanctions rules to protect their members from exposure to sanctionable activities, and the effect of these rules are mirrored in the Group pooling arrangements.

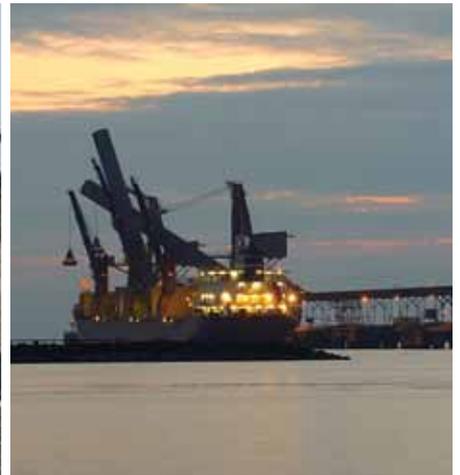
The International Group has engaged extensively with the US, the EU and national regulators on the interpretation of their various pieces of sanctions legislation. In relation to the EU sanctions against Iran, we have had some successful input into the final drafting process to achieve greater clarity in the proposed measures. However, given the underlying political objectives of the sanctions, there is not a great deal that can be done to steer or influence the drafting processes.

Widespread impact

The impact of sanctions has been felt not only on the underlying shipping and trading activity, but also on insurance and reinsurance arrangements. The International Group and Clubs have had to focus on the potential impact on the policies they provide to their members, and also on the risk to their individual and collective reinsurance arrangements. US regulators have already sanctioned US-domiciled reinsurers in relation to individual Club reinsurance arrangements. The risk of a similar action in the context of the International Group’s reinsurance programme cannot be ignored, and could have a significant impact on recoveries under our annually-renewed general excess of loss reinsurance programme.

It is clear that targeting the insurance industry is perceived to be an effective way of enforcing sanctions, and the burden of such measures on insurers is likely to increase in the future. Therefore, both at the Group and Club level, there will be ongoing extensive engagement with national and international regulators to ensure compliance with current and future sanctions legislation and regulations.

Solid bulk cargo liquefaction



Over a number of years, problems arising from the carriage of certain types of cargo have required both the International Group and its Clubs to coordinate efforts with other industry associations – in particular, the IMO. Last year, three vessels sank carrying cargoes of nickel ore from Indonesia to China, with the loss of 45 seafarers.

While the cause of these casualties has not yet been definitively determined, nickel ore (like iron ore fines) is a cargo that is likely to liquefy if its moisture content exceeds the Transportable Moisture Limit when loaded. Liquefaction of ore cargoes can also be caused by the normal incidents of a sea voyage, for example, the motion of the ship in the seaway or vibrations caused by the running of the main engine or other onboard machinery.

Liquefaction of such cargo can result in a loss of stability, which in turn can lead to a vessel capsizing. It is therefore very possible that all three vessels were lost as a result of cargo liquefaction. There have been a number of other recent reports of cargoes of nickel ore – loaded in both Indonesia and the Philippines – liquefying and causing loss of stability to the carrying vessel, although fortunately none resulted in the loss of the vessel. In one such case the carrying vessel grounded, causing extensive hull damage.

The International Group has been co-operating with other industry organisations, including Intercargo, ICS and Bimco, to inform shipowners of the dangers

associated with the carriage of solid bulk cargoes that have a propensity to liquefy, and the importance of ensuring that shippers comply with the requirements of the IMSBC Code. In this context, the International Group has co-sponsored papers on the issue, which have been submitted to the IMO Maritime Safety Committee, and most recently the 16th Session of the IMO Sub-Committee on Dangerous Goods and Solid Bulk Cargoes held in September 2011. The International Group has also written to a number of states and to individual shippers expressing its concerns around the subject, as well as organising a number of meetings with relevant industry players and experts to address the technical issues arising in relation to the loading and carriage of such cargoes.

The International Group will continue to work with other industry associations to promote the reduction or elimination of the risks in this area.

Athens Convention 2002 Protocol/EU Passenger Liability Regulation 329/2009 (PLR)



The Athens Convention 2002 Protocol – under which existing passenger liability compensation limits from the Athens Convention 1974 will be very significantly increased – will come into force 12 months after it has been ratified by 10 states. By October 2011, there had been seven ratifications, and more are expected by the EU and others over the coming months. It is likely therefore that the Protocol will enter into force sometime during 2013.

Several years ago, the International Group expressed concern to the IMO about the absence of a terrorism exclusion under the Convention, and the ramifications this would have for insurance cover. As a result, in October 2006 the IMO Legal Committee adopted guidelines for implementation of the 2002 Protocol, which provided the dual certification of insurance required under the Convention, with one certificate covering non-war/terror liabilities. This certificate will be issued by the Clubs, and a separate certificate covering war and terrorism liabilities will be provided by war risk insurers.

In April 2009, the European Union Passenger Liability Regulation 329/2009 (PLR) – which incorporates the key provisions of the Athens Convention Protocol and will apply within EU member states – was signed by the European Parliament and Council. It will pass into law by 31 December 2012 at the latest in EU member states, regardless of whether or not the Athens Convention Protocol

has entered into force by that time. The PLR also extends the scope of the Athens Convention to cover domestic coastal (but not inland) vessels, and makes provision for payments of advanced compensation, as well as compensation for passenger mobility equipment.

The prospect of the PLR coming into force before the Athens Convention Protocol, combined with the extension of liabilities under the PLR to domestic passenger voyages, has raised a number of unique issues for the International Group and the Clubs. For example, the certification requirements for the purposes of the PLR, which have been considered by the International Group's managers and referred to Club boards and committees. Certification and evidence of insurance generally remains a challenge, and will necessarily entail extensive and continuing efforts by the International Group in years to come with states and with regulators worldwide.



International Group of P&I Associations

Members:

American Steamship Owners Mutual Protection and Indemnity Association, Inc
www.american-club.com

Assuranceforeningen Skuld
www.skuld.com

Gard P&I (Bermuda) Ltd
www.gard.no

The Britannia Steam Ship Insurance Association Limited
www.britanniapandi.com

The Japan Ship Owners' Mutual Protection & Indemnity Association
www.piclub.or.jp

The London Steam-Ship Owners' Mutual Insurance Association Limited
www.londonpandi.com

The North of England Protecting & Indemnity Association Limited
www.nepia.com

The Shipowners' Mutual Protection & Indemnity Association (Luxembourg)
www.shipownersclub.com

The Standard Steamship Owners' Protection & Indemnity Association (Bermuda) Limited
www.standard-club.com

The Steamship Mutual Underwriting Association (Bermuda) Limited
www.simsl.com

The Swedish Club
www.swedishclub.com

United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited
www.ukpandi.com

The West of England Ship Owners Mutual Insurance Association (Luxembourg)
www.westpandi.com

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