Guide to U.S. Cargo Insurance

This guide has been prepared by the American Institute of Marine Underwriters as a service to international traders, actual and potential, upon whose venturing into the world market our own fortunes depend.

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2005

The American Marine Insurance Market

Marine insurance is primarily an international business and is highly competitive. It concerns itself principally with insuring vessels, cargoes and related liabilities. The premium income of the American marine insurance underwriters is an important contribution toward the United States balance of international payments. Premiums written by the market exceed $1 billion annually. This is a strong and growing market, capable of serving the needs of foreign traders and ship owners.

The need for a United States domestic marine insurance industry was recognized when Congress adopted the Merchant Marine Act of 1920. That Act created a national policy to encourage further development of the American marine insurance market as an instrument to foster the foreign commerce of the United States.

The strength of a marine insurance market is measured principally by the skills and judgment of experienced underwriting personnel and the capacity to insure a broad range of risks. The United States is the largest trading nation in world commerce. Such trade requires the best in supporting services such as insurance, banking, transportation and communications. Therefore, it is essential for the United States to continue to have and maintain a strong and substantial marine insurance market.

The American Institute of Marine Underwriters is a trade association whose membership includes all of the major U.S. insurance companies writing marine insurance.

Ocean Cargo Insurance in International Trade

Ocean cargo insurance is concerned primarily with international commerce. Basically, anyone who has an insurable interest in a cargo shipment (i.e., anyone who would suffer a loss if the cargo were damaged or destroyed or who would benefit from the safe arrival of the cargo) has a need for an ocean cargo policy. The cargo insurance policy indemnifies the exporter or importer in the event of loss or damage to goods due to a peril insured against while at risk under the policy.

Historically, each voyage of an ocean-going vessel is a joint venture of the ship owner and all the cargo owners. Centuries of tradition, trade practices, maritime and international commercial law affect the interests of the international trader.

Cargo insurance protection is an aid to commercial negotiations. It allows traders to proceed with confidence in the knowledge that each party to the transaction is properly protected. In most cases the cost of marine insurance is nominal when compared with the value of the goods and the freight cost.

The marine cargo insurance policy can be designed to meet the individual needs of the exporter or importer in an international transaction.

Incoterms

One of the many important questions that must be decided in every transaction involving a sale of goods is "Which party to the contract of sale is obligated to arrange marine and war risk insurance protection?" An excellent reference relative to the obligations of buyer and seller under the various terms of sale are the INCOTERMS 2000. Copies of the pamphlet are available in the United States from the ICC Publishing Corporation Inc., website: http://www.iccbooksusa.com/.

The basic function of the INCOTERMS, which have been widely accepted by international traders, is to simplify the quotation of prices in international trade and to define the responsibilities and rights of sellers and buyers under each of the terms of sale. It is important to understand that the terms of sale must be accepted by both seller and buyer as part of the total contract to become legally binding upon all parties.

Some of the most frequently employed terms in international trade are F.O.B. (free on board, named point of shipment), F.A.S. Vessel (free along side, named point of shipment), C. & F. (cost and freight, named point of destination) and C.I.F. (cost, insurance and freight, named point of destination).

Generally speaking, a favorable "balance of payments" places the international traders of that nation in a better position to negotiate sales. It is in the best interest of the United States balance of trade for every U.S. international trader to control the marine insurance on any transaction. Under such terms the premium dollars remain in this country.

In many transactions it is common for American exporters, even though selling on F.A.S. or F.O.B. terms, to control the placing or arranging of marine and war risk insurance on a "warehouse-to-warehouse" basis,[*] for account of whom it may concern, as an additional provision in the over-all contract of sale. In this situation the cost of the insurance is charged to the buyer as a separate item of expense in addition to the F.A.S or F.O.B. price. There are many reasons for this, including the desire of many foreign buyers for United States dollar insurance protection. It is also often the fact that the American exporter has sold the goods on extended payment terms, meaning that he is financially at risk while the goods are in transit to the overseas destination. When financially at risk he can benefit from the security of the marine and war risk insurance arranged through his own American insurance agent or broker with a sound American insurance company.

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[*] *Generally, coverage attaches at commencement of transit from the point of shipment at the risk of the assured and the coverage continues in due course of transit until the goods are delivered into the warehouse at the destination.*

Generally, no difficulty should be experienced in determining the cost of marine and war risk insurance and ocean freight for a reasonable period of time. When there is question about the possibility of a change in insurance or ocean freight rates, a C.I.F. quotation can always be qualified with the words: "Changes in insurance and freight rates shall be for account of the buyer." Where it is not practical to sell on C.I.F. or buy on C. & F. terms, it is recommended that American traders control the arranging of insurance, particularly when they are financially at risk. Control of the marine and war risk insurance is an advantage to the American trader desiring to compete effectively in world markets. The following section cites many of the reasons why it is important for international traders to control their own insurance.

The Advantages of Your Own Ocean Cargo Policy

Marine insurance covering an international transaction may be arranged by either the exporter or importer, depending upon the terms of sale. The terms of sale are all-important in the placing of marine insurance. The subject is a complex one and varies by trade and commodity.

Because marine insurance is a highly competitive business, the trader is well advised to seek the counsel and guidance of his insurance broker or agent who will normally canvass the marine insurance market for the desired terms of coverage at the best rates available. The broker/agent and underwriter will consider the overall interests of the trader, tailor-make the terms of coverage, and then issue the appropriate insurance policy.

Under sales whereby the buyer is obligated to arrange a portion of the insurance protection, there may often be different insurance contracts in effect for different portions of the "warehouse-to-warehouse" movement. In the case of loss or damage, particularly latent loss or damage, it could become exceedingly difficult to determine which insurer is responsible. This situation could produce delay and dissatisfaction in the handling of claims which would be a disservice to both parties. "Warehouse-to-warehouse" coverage with a single underwriter eliminates this possibility.

Financial institutions that advance credit in international transactions protect their interests at all times. They are likely to be more cautious about extending credit when the insurance is placed with an unfamiliar insurance company overseas; when there is uncertainty as to a foreign insurer's ability to pay claims in the desired currency; and when the financial status of that insurer is unknown.

The open cargo insurance policy, accompanied by a companion war risk policy, is a continuous contract designed to insure automatically all the Assured's shipments which move at his risk. Shipments are reported as soon as practical and amounts declared as soon as known. The inadvertent failure to report a shipment does not void coverage and such shipments are held covered subject to policy conditions.

Advantages to the Exporter

Under the usual form of open cargo policy issued to exporters, the Assured has authority to issue his own special policies of insurance (or insurance certificates). In most transactions involving the granting of credit by a bank, one of these is a prerequisite. These constitute evidence of insurance protection on the shipment specifically described therein and provide the means for transferring the insurance protection to other parties at interest. The original and generally the duplicate of such forms become part of the commercial set of documents transmitted to the consignee of an export transaction.

Frequently exporters sell on other than C.I.F. terms and maintain the initiative and control with respect to the terms and placement of marine insurance. Such terms of sale are aggressive, practical salesmanship. They put the strength and influence of the American marine insurance market squarely on the side of the exporter.

There are other very clear, practical reasons why the exporter should control the insurance. The exporter is more likely to have complete and necessary knowledge of the technicalities and problems pertaining to the goods, rates of insurance and other matters. Furthermore, the worldwide volume of the exporter's business in his special line may give him an insurance rate advantage.

With an open cargo policy, the exporter knows that his insurable interest in a specific transaction is protected. This explains why his overseas selling is facilitated by arranging insurance protection "for account of whom it may concern," -- i.e., for the benefit of both parties to the sales contract.

An exporter is interested in the solvency of his customers - a potential repeat buyer. When the consignee must pay dollars for his goods, the exporter wants to protect that purchasing power. The following illustrates the soundness of this interest: A consignee insured abroad could have a loss on goods in transit and be able to collect the loss from a foreign insurance company only in a foreign currency; or if able to obtain dollars for reordering goods, it may be at the free market rate instead of the official rate of exchange. The consignee's ability to continue trading could then be impaired and the exporter's chance of selling to him again could be reduced.

An uninsured exporter could be in danger of learning that his buyer has not taken up the negotiable papers on the transaction and has rejected the goods as not being in sound condition. Thus the exporter, under some terms of sale, may find himself still in possession of goods which are lying abroad at his own risk and expense. Similarly, an uninsured exporter who has granted credit may remain in doubt whether he is protected or whether, in event of loss, he will be compensated.

If goods sold on terms that do not include insurance are lost or damaged in transit and the buyer fails to take up the documents, the seller could be left without recourse against the foreign underwriters. Suits for non fulfillment of contract or other actions are expensive, troublesome and may take years to obtain results. Had the exporter been insured in the American market, he would have been able to apply promptly to his underwriters to make good any loss or damage recoverable under his policy.

Advantages to The Importer

The American importer buying under C.I.F. terms must rely upon foreign underwriters, since the insurance is placed by the seller. In general average,* the C.I.F. buyer may find that foreign underwriters are not in a position to furnish a general average guarantee or that the general average guarantee is not acceptable to the adjusters in this country. This would mean that the importer can secure possession of his goods only by making a cash deposit to cover the anticipated general average contribution, or by posting security in lieu of a cash deposit.

By purchasing on F.O.B., C. & F. or similar terms that do not include insurance, the American importer can control his own insurance. He will then be able to deal with his own underwriters in case of loss.

To sum up, these are the advantages of having your own ocean cargo policy:

1. Automatic "warehouse-to-warehouse" protection is provided with proper terms of insurance specifically designed for the Assured's goods and methods of shipment. Such insurance provides coverage for the full exposure, at proper values and adequate limits.
2. Claims are payable in United States dollars.
3. United States dollar insurance protection reduces the probability of misunderstandings, extensive correspondence and elapsed time in connection with the handling of claims. This practice facilitates prompt replacement of goods and contributes to generally improved trading relations.
4. Rates will be competitive and reflect the Assured's own experience.
5. Worldwide claims service is available by claims representatives appointed by the American underwriter.
6. The Assured has all the advantages of dealing through his own broker or agent; prompt, personal service, dependability and convenience.
7. You are free to choose your own insurance company.

Foreign Restrictions on The Free Placement of Cargo Insurance

Although the marine insurance industry services the international trading community and strives to operate in a free, competitive environment, there is a list of countries attempting to inhibit this

* *A partial loss involving all the interests in a maritime venture*.

freedom of marine cargo insurance. The principal barriers to the free placement of cargo insurance take the form of restrictive insurance legislation or decree, discriminatory taxation or foreign exchange controls. The American Institute of Marine Underwriters periodically provides on its website www.aimu.org for its Members a list, by country, of restrictive marine insurance practices.

Open Cargo Policy Provisions

An open cargo policy can be written to cover all cargoes shipped by the Assured in foreign trade by overseas vessels, aircraft and foreign parcel post. Coverage is afforded while goods are in due course of transit from the seller's warehouse to the buyer's warehouse. The contract is tailor-made to fit requirements of the individual Assured's shipments and can be written to cover on a broad or named perils basis.

The basic open cargo policy includes: 1. The Perils Clause, 2. One or more average clauses, and 3. Additional basic coverage clauses including general average.

PERILS CLAUSE

The majority of risks covered under this clause come within the comprehensive term, "perils of the seas" - that is, loss or damage due to heavy weather, stranding, collision, sinking, contact with seawater, etc. Other perils normally covered include:

1. **Fire** - both direct and consequential damage whether from smoke or steam or efforts to extinguish a fire. (Spontaneous combustion occurring in the insured shipment is excluded unless specifically assumed by the underwriters.)
2. **Assailing thieves** - forcible taking of a shipment rather than mysterious disappearance or pilferage.
3. **Jettison** - voluntary dumping overboard of cargo to relieve a vessel in distress.
4. **Barratry** - fraudulent, criminal or wrongful act of the ship's captain or crew that causes loss or damage to the ship or cargo.
5. **All other like perils** - perils of the same nature as those specifically mentioned above, but not "all risks" in the customary usage of the term.

AVERAGE CLAUSES

While total losses from any of the hazards listed in the perils clause are fully recoverable up to the policy limits, "particular average" or partial losses (other than general average) from these same perils, are recoverable only as specified by the average clause. The Assured selects the average clause best suited to his circumstances. There are five principal average clauses:

1) **FPAAC** - Free of Particular Average American Conditions - Limits recovery on partial losses to those directly caused by fire, stranding, sinking or collision of the vessel. This is the most limited average clause in general use today.

2) **FPAEC** - Free of Particular Average English Conditions - Similar to FPAAC except it is not necessary that the damage to cargo be a direct result of a specified peril, it being sufficient that one of these perils has occurred.

3) **With Average if Amounting to 3%** - Provides protection for "particular average" or partial loss from perils of the seas. The percentage is called a franchise and is the minimum amount of damage that must be incurred to permit a valid claim. For Example: If a shipment is insured for $1,000, the recoverable partial loss would have to amount to at least $30 to be paid. The franchise is not applied to losses recoverable under FPA conditions.

4) **Average Irrespective of Percentage** - All partial losses due to perils of the seas are fully recoverable regardless of percentage.

   Optional Named Peril Extensions - The foregoing average clauses may be extended to include additional perils depending upon the type of commodity to be insured, packaging, voyage, stowage, etc. These extensions may include theft, pilferage, non-delivery, sweat or steam in the ship's hold, fresh water damage, leakage, breakage, etc.

5) **All Risks** - This coverage insures against "all risks" of physical loss or damage from any external cause. The following are examples of losses which are not covered by the "all risks" form:

   a) Loss of market or loss, damage or deterioration arising from delay.
   b) Loss arising from inherent vice of goods.
   c) Loss or damage arising from strikes, riots, and civil commotions. (This coverage may be and usually is added by endorsement.)
   d) Loss or damage arising from acts of war. (This is usually covered under a companion war risk policy.)

Policies can be written with other specific exclusions or limitations. This might happen, for example, when goods or merchandise are highly susceptible to damage. Coverage may then be limited to make the risk insurable or in order to avoid the payment of high premiums. This flexibility is a major advantage of an open cargo policy.

ADDITIONAL COVERAGE CLAUSES

In addition to the perils clause and the average clauses already discussed, the typical open cargo policy contains the following clauses:

1) **Explosion Clause** - broadens coverage to include loss or damage due to explosion from any cause, other than a cause associated with a war risk.

2) **Inchmaree Clause** - provides coverage for loss or damage to cargo from bursting of boilers, breakage of shafts or through any latent defect in the hull or machinery of the

vessel or from errors in the navigation or management of the vessel by the master, mates, engineers, or pilots.

3) **Fumigation Clause** - provides coverage for damage to cargo caused by fumigation of the vessel.

4) **Warehousing and Forwarding Packages Lost in Loading, etc. Clause** - provides coverage for landing, warehousing, forwarding, and special charges in the event of loss or damage recoverable under the average terms; also provides for payment of the insured value of any package or packages which may be totally lost in loading, transshipment or discharge.

5) **Shore Clause** - provides coverage while on docks, wharves or elsewhere on shore and/or during land transportation and includes the risks of collision, derailment, over-turning or other accident to the conveyance, fire, lightning, sprinkler leakage, cyclones, hurricanes, earthquakes, floods (meaning the rising of navigable waters), and/or collapse or subsidence of docks or wharves.

6) **Both to Blame Collision Clause** - provides coverage for any amount which the cargo owner may be legally bound to pay the shipowner under the "both to blame" clause in the ocean bill of lading.

7) **General Average and Salvage Clause** - provides coverage for the Assured's proportion of these charges incurred during the voyage.

8) **Sue and Labor Clause** - provides coverage, in the event of a loss recoverable under the policy, for expenses reasonably incurred by the Assured or his agents to protect the cargo from further harm and to assist in recovering the damaged cargo in an effort to minimize the loss.

DURATION OF COVERAGE

Normally, under an open cargo policy the goods are insured from the moment they leave the point of shipment, being at the risk of the Assured, and the coverage continues while the goods are in due course of transit until they are delivered to the final warehouse at destination.

In the absence of special arrangements, this period of coverage is determined by the Warehouse-to-Warehouse and/or Marine Extension Clauses. The Marine Extension Clause extends the coverage in certain circumstances by superseding the time limitations imposed by the Warehouse-to-Warehouse Clause. The Marine Extension Clause continues coverage during the ordinary course of transit including deviations, delays, re-shipments, transshipments or any other variations in the voyage so long as these interruptions are beyond the control of the Assured.

STRIKES, RIOTS AND CIVIL COMMOTIONS

Strikes, riots and civil commotions risks are covered by an optional endorsement to the open cargo policy. The S.R. & C.C. Endorsement covers loss or damage to the property insured caused by strikers, locked-out workmen, those taking part in labor disturbances, riots or civil commotions, vandalism, sabotage and malicious acts.

WAR RISKS

An open policy insuring against war and similar risks is usually issued as a companion to the marine open cargo policy. It covers most of the perils arising from hostilities, but excludes loss or damage resulting from the hostile use of nuclear weapons.

Coverage against major war perils applies only while the cargo is aboard the overseas vessel, but coverage against damage from mines and torpedoes also applies while cargo is aboard lighters or other craft, prior to or subsequent to the ocean voyage, or at a port of transshipment. A separate premium charge is made for war risk insurance.

It is recommended that both marine and war risk coverage be obtained from the same underwriters, thus obviating disputes when the actual cause of loss is in question, as in the case of a missing vessel.

Amount of Insurance

The open cargo policy contains a valuation clause - a formula for determining the amount of insurance in advance of shipment. This formula can be tailored to conform to trade customs or to follow variations in the value of any commodity which is subject to price fluctuations.

A common form of valuation clause reads:
"Valued at amount of invoice including all charges in the invoice and including prepaid and/or advanced and/or guaranteed freight not included in the invoice, plus ten per cent."

This formula establishes the insured value and generally approximates market or landed value at destination. In the case of a C.I.F. quotation, it is relatively simple to calculate the amount of insurance by increasing the C.I.F. price by the percentage of advance. In the above example this is 10 per cent. In the case of an F.A.S. or F.O.B. quotation, when the seller agrees to arrange marine insurance, it is important to add to the price quoted (if not already included) the cost of export packing, local cartage charges, ocean freight charges, forwarder's fees and consular fees. The total of these items is then increased by the percentage of advance to determine the amount of insurance. It is extremely important that adequate insurance be purchased; otherwise, in the event of loss, the Assured may be required to bear a portion of the loss.

Cost of Insurance

The loss experience developed on an Assured's own account heavily influences the judgment of the underwriter as respects rating. Cargo insurance premiums are calculated by applying a rate to each $100 of insured value. For example, a 25-cent rate on a $10,000 shipment develops a premium of $25.

It is the usual practice to issue a schedule of marine rates with each open cargo policy and this schedule can be used by the Assured to quickly and conveniently calculate the cost of insurance on each shipment. He applies the rate quoted in the policy for a specific destination or point of origin and the product to be shipped to the insured value to determine the premium charge. This method is especially convenient to exporters quoting C.I.F. prices in establishing the total cost of shipping goods to overseas destinations.

Factors in Underwriting

In underwriting marine cargo insurance, the underwriter must evaluate a number of fundamental factors in order to appraise each risk. Some of these factors are:

1) Desired average clauses. - The Assured may choose average clauses ranging from the most limited to the most comprehensive coverage. The choice of average clauses has a substantial effect on rates.
2) Destination or origin. - The geographical, physical or political conditions at destination or origin create differences in the risks involved.
3) Ocean carrier. - Basic rates contemplate the use of a metal self-propelled vessel of appropriate tonnage and age, classified by a recognized Classification Society (such as the American Bureau of Shipping). Any variance may result in additional premium.
4) Shipping routes. - No two shipping routes present identical risks.
5) Time of shipping. - Greater damage may be sustained by goods shipped across the North Atlantic in winter than in summer, and rain water damage is obviously more prevalent in the monsoon season than in the dry season.
6) Packing. - Standardization of packing, whether by container, pallet or otherwise, has been found to be impractical. Consequently, packing varies considerably, with resulting variance in rates, depending on the degree of protection provided.
7) Shipping practices. - Newcomers to foreign trade may not have experienced traffic personnel. Even experienced shippers vary greatly in their shipping practices.
8) The Consignee. - The character and business methods of the consignee may greatly affect the extent of damage payments. He can substantially reduce claims by making repairs locally and by promptly taking delivery. On the other hand, irresponsible behavior of the consignee can materially increase losses.
9) Salvage. - The proceeds of salvage operations reduce the net amount of loss. Salvage possibilities vary with the goods themselves, locality and economic conditions.
10) Underwriting experience. - The underwriter's experience with the Assured is a valuable guide in determining whether the rate is adequate or excessive, but it is not the sole determinant. An adverse loss ratio requires careful reconsideration of risk factors; it does not necessarily indicate that the rate should be revised. Rates are made for the future. An underwriter considers which losses can reasonably be expected to recur.

Loss Prevention

All those concerned with world trade are jointly interested in the delivery of merchandise in sound condition and in the avoidance of economic waste and dissatisfied customers as a result of loss or damage to goods in transit. Good business practice therefore dictates that any insurance plan must be combined with a comprehensive program for preventing or controlling losses. Identifying and understanding the susceptibilities of a particular cargo to various transportation hazards is an important first step in loss prevention. It is an accepted fact that approximately 70% of losses sustained during transportation could have been prevented by effective use of loss control measures. In this regard, the experience of a qualified Loss Control Engineer can provide valuable information on potential problems of specific cargoes, proper packing methods, carriers, routing, etc. You should consult with your underwriter to determine your specific needs.

Steps in Event of Loss

In the event of loss or damage, the Assured should notify the nearest agent of the underwriter to arrange a survey. For convenience, the underwriter's correspondents and settling agents are listed on the reverse of each special cargo policy (or insurance certificate), along with instructions in the event of loss. The survey is an inspection of the damaged goods to determine cause of loss or damage, value of the cargo and extent of damage. The survey report, together with the original special cargo policy (or insurance certificate), invoice, bill of lading, master's protest (if any), repair bills and a copy of the claim against the carrier are then sent to the underwriter's nearest claims settling agent, who is authorized to pay claims as per policy terms.

The American Institute of Marine Underwriters maintains a corps of correspondents throughout the world. These correspondents are available to assist in arranging for the services of surveyors and claims agents.

Foreign Credit Insurance

Foreign credit insurance is available to exporters from the Overseas Private Investment Corporation, www.opic.gov.

Export credit insurance protects the exporter in accordance with policy terms and conditions, in the event a foreign buyer fails to meet his payment obligations due to insolvency or other commercial reasons, or as a result of political risks such as currency inconvertibility, war or expropriation.

Ask your broker or agent for additional information.

Conclusion

While ocean marine insurance is perhaps the oldest form of insurance, this Guide demonstrates that ocean marine underwriters adapt to and serve the needs of modern international business. Marine underwriters in the United States can be proud of a strong and growing market standing ready with its capacity, stability and innovation which lends support to growth in international trade.