The effect of Maritime Piracy and Somalia on Marine Insurance

Piracy reporting centers have tracked piracy since 1992 and piracy has become an international media subject since then. Maritime Piracy has created an expanding concern and disruption of trade between Europe and Asia based on a continuing uncertainty over the prompt delivery of goods.

There is a variance as to the net costs of piracy which on the lower side is $1b and the higher side is $16b. The ransoms are in excess of $180m and insurance premiums vary from $470m to $3.3b. Security equipment varies from $363m to 2.5b and total estimated cost is between $7 to $12b per year.

Insurance and rerouting add costs pressures to those concerns. Four issues involving insurance: 1/ war risk, 2/ kidnap and ransom, 3/ cargo and 4/ hull in Lloyds Market Association classified the Gulf of Aden as a war risk. War risk premiums have increased 300 times from $500 per ship per voyage towards $150,000 per ship per voyage during the past year. Kidnap and ransom premiums usually cover only the crew. Hull insurance may cover any damage to the ship from piracy, weather or sinking.

The dramatic rise of Piracy in the area of Gulf of Aden is changing the insurance landscape continuously. While piracy is not a new insured risk, the increase in pirate attacks along the Gulf has affected premiums and coverage. Ships that continue to pass through the Gulf of Aden and Suez Canal have to purchase a war risk insurance coverage. According to a recent report by UNCTAD, insurance premiums for ships travelling through the Gulf have rose from between 0.05% and 0.1755 of the value of their cargo, compared to between the 0% and 0.05% in May 2008. Premiums of kidnap and ransom coverage have reportedly increased by as much as 1.000%. The additional costs due to piracy are passed on to consumers as shipping companies recoup most of their losses through their protection and indemnity clauses. Moreover, piracy has a direct economic impact in terms of fraud, stolen cargoes and delayed trips. On top of these, it is considered an economically driven phenomenon which affects us all and could also trigger a major environmental catastrophe.

It was in May 2008 when Maritime Piracy had reached its highest level since the International Maritime Bureau's Piracy Reporting center began tracking piracy incidents in 1992. However recently published reports show a further record increase of the number of incidents. The main reasons that seem to "feed" piracy are considered to be the enormous volume of commercial freight that moves by sea, the selected ship route that need to be followed to pass through "dangerous" sea areas like the Canals of Panama and Suez, the Straits of Malacca etc., the downgrading of the marine surveillance that has led to a further downgrading of the means of monitoring territorial waters and the prompt willingness of the ship-owners to pay increasingly large sums of money to get their vessels back.

The rapid increase in sea piracy has serious implications for insurance. It affects all the shipping companies placing "extra insurance costs" on them and it is evidently estimated that the payment of ransom to pirates have raised substantially the cost of claims. As one of the International insurance brokers we are seeing that ship-owners navigating the Gulf of Aden pay by ten times more increased kidnap and ransom premiums as piracy escalates.

However according to IMO the piracy incidents happen to be under-reported because of the subsequent increase in insurance premiums, and the time consuming procedure of reporting a pirate-attack that could lead to a significant delay. Estimates vary widely because of disagreement over whether insurance premiums, freight rates and the cost of rerouting should be included with the cost of ransoms.

The victims of piracy are the crews, the shipping companies and the owners of the vessel, the parties with an interest in the goods carried and the insurers. At first glance the shipping companies, the ship-owners and parties with an interest on the cargo appear to suffer losses because they are indemnified by insurers. To minimize the loss arising from acts of piracy insurers will seek to recover the lost cargo, however these efforts will be stopped by the frequently unclear legal basis for prosecuting these acts and by the associated cost. The insurance sector stands little chance of minimizing the incurred loss and therefore pays up.

The losses attributable to piracy primarily affect marine hull, marine cargo and protection and indemnity (P&I) insurance. Losses may also be indemnified under loss of hire (LoH) insurance. With regard to ransom payments, however the real issue is whether on certain facts such coverage will be excluded from the hull insurance and will fall on war risks. So, as long as even the smallest threat of hijack off Somalia remains, companies worldwide will make money trying to secure vessels against it. The K&R insurance for ships is a type of cover, a business offered so secretly that even the crew often don't know their ship is covered. In addition, security companies turned out to provide security guards for vessel sailing the Gulf of Aden, now more than 70% of their business, escorting the ship through the Gulf helping the Captain and crew to work out what they are going to do in case of an incident. In recent years, the security equipment industry has also presented a number of technical solutions to protect vessels and crews against pirate attacks including highly sensitive radar systems, special night vision equipment etc.

To conclude it is more than evident that the cooperation between security, safety and control authorities working in the maritime area is essential. The insurance impact will depend on the size of any ransom payments and no calm in the frequency of attacks is likely until a stable government is established in Somalia.