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MARINE P&I

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LAID UP RETURNS

"Arthur J. Gallagher calls for consistency on internal allocation costs, amongst P&I Clubs for laid up vessels"

In the 1980s the shipping market experienced the worst trading conditions in history at that time. In Greece, for example, owners were laying up vessels side by side in Eleusis Bay for miles. During that period, many clients thought that the freight market would not return to sustainable daily levels; little did we foresee what would actually transpire in the thirty years to come. Back then, when laid up returns were more prominent, P&I clubs used to deduct the general excess of loss reinsurance cost (or the allocation of reinsurance for laid up tonnage) and return 90% of the remaining premium back to owners. It was a simple calculation and generally there was less complexity in the P&I market on the whole.

Today, we see the shipping market back in its "downturn" cyclical phase, although this time it is the worst shipping market in history, we are seeing the full cycle move again. Whilst many of the clubs are not experiencing many owners laying up their vessels, it has been a topical subject of interest when visiting our clients in the past year. Our clients generally foresee that the dry bulk market will not change drastically in the years to come, and therefore we feel that the laid up return aspect of P&I may become prominent once again as it was back in the 80s. However this time it could be worse.

What has changed since then is the way P&I clubs calculate costs of laid up returns, which have become more complex, less transparent and in some cases outright ambiguous with some P&I clubs (among other parts of the industry). P&I on the whole has evolved to become more sophisticated, more commercial and less mutual, in some cases, compared to the so called "good old days" in our opinion – whilst parts of the P&I evolution have benefited members, other dynamics such as fairness on laid up returns for the entire membership perhaps have not. Part of the reason for the change in why laid up returns have changed is due to the nature in which the group reinsurance contract is constructed today. In fairness, however, the P&I clubs will issue wreck removal convention blue cards (where needed), in essence certify the biggest risk to the clubs during lay up.

P&I clubs will allow for laid up returns (unless the policy is CRO*) allocating a percentage return based on what qualifying factors are applicable to the Member (i.e. type of layup, cold or hot etc.). The main difference today is that not only will a P&I club deduct the portion of group reinsurance (which is a fixed cost), they may also deduct for a portion of abatement costs, pool costs and management costs, based on net premiums. The only transparent part of the way laid up returns are calculated is the allocation of the main general excess reinsurance cost for laid up vessels, which is the rate allocated for the general excess of loss reinsurance contract, for cover excess of US$80million, excluding all Hydra's participation, war and private placements. Five of the six segments have no "laid up rate" applicable and are payable in full. The main general excess of loss placement laid up rates is as follows:

*cancelling returns only

2016/17 Group Reinsurance Rates for Laid up Tonnage – Main General Excess of Loss Layer excess of USD 80 Million, excluding all of Hydra's participation, war and private placements:

(This is a fixed reinsurance cost for each club).

CLUB	LAYER ONE	LAYER TWO	LAYER THREE	COLLECTIVE OVERSPILL	TOTAL
Tankers	$0.0406	$0.021	$0.0388	$0.0186	$0.119 ($0.1457)
Non- Tankers	$0.0448	$0.0332	$0.0388	$0.0186	$0.1354 ($0.1482)
Passengers	$0.0879	$0.1505	$0.4894	$0.2345	$0.9623 ($1.2017)

(Figures in the parentheses are 2015 allocations)

What is not fully transparent in the P&I market, which Arthur J. Gallagher has been able to learn as part of the research involved in preparing this article, is what the P&I clubs actually pay away as a fixed cost in full to its reinsurers. This is the cost attributed for vessels that are laid up and what the additional expenditure for all private placements is in addition to the main excess of loss contract. These three private excess of loss placements (which are also fixed costs) are made of the following:

1. Hydra "L Share" (which is the main general excess of loss contract, for which the laid up rate is transparent)
2. Hydra USD 50million excess of USD 30million
3. National Indemnity
4. Liberty Mutual
5. Hanover Re
6. Excess War Cover (USD 500 million excess of hull value)

We have come to understand, from our discussions with various clubs is that the group fixed reinsurance cost for a laid up vessel, taking all of these private placements into consideration, is made up as follows (2016/17 policy year):

2016/17 Actual Group Reinsurance Rates for Laid up Tonnage*

(This is a fixed reinsurance cost for each club).

DIRTY TANKER	CLEAN TANKER	DRY	PASSENGER
$0.4740	$0.2696	$0.3811	$2.6372

*Indicative laid up rate. [SOURCE: Various IG P&I Clubs]

Therefore after the clubs have finished allocating the total allocation cost (including reinsurance, abatement, pool and management), what is left to return (i.e. a percentage of ETC) to the member is only a fraction of what they used to get.

We at Arthur J. Gallagher have posed the question of laid up returns to all clubs, to see what the disparities are between clubs and who is transparent when it comes to laid up return internal allocations, as well as who is most favourable in returning premiums back to members . The responses from the clubs all varied and we were surprised to see these responses, some of which were totally transparent and others were a little disappointing.

Which P&I Clubs have the most exposure to Bulk and Container Operators?

P&I CLUB	CONTAINER MEMBERSHIP (PER GT) %	BULK MEMBERSHIP (PER GT) %	TOTAL DRY MEMBERSHIP (PER GT) %
Swedish	44%	35%	79%
London	18%	56%	74%
Britannia	36%	35%	71%
West	27.9%	37.2%	65.1%
MARKET AVERAGE			**59.08%**
North	20%	39%	59%
American	14%	44%	58%
UK	16%	38%	54%
Skuld	17%	34%	51%
Standard	25%	23%	48%
Gard	18%	29%	47%
Steamship	20%	23.8%	43.8%

[SOURCE: AJG P&I Review Oct 2015]

2016 P&I Club Internal Allocation Costs (retained rate per GT, before laid up return calculated)

CLUB	DIRTY TANKER	CLEAN TANKER	DRY	PASSENGER
American	$0.45	$0.29	$0.45	$2.47
Gard	$0.3875	$0.3875	$0.4125	$1.25
London	$0.55 ex Crew $0.63 Inc Crew	$0.41 ex Crew $0.49 Inc Crew	$0.49 ex Crew $0.57 Inc Crew	$2.04 ex Crew $2.11 Inc Crew
NEPIA	$0.655	$0.575	$0.595	$2.925
Skuld	$0.474	$0.2696	$0.3811	$2.6372
Standard	**	**	**	**
Steamship	$0.29	$0.29	$0.35	$1.90
UK	$0.36	$0.36	$0.35	$2.53
West	$0.119	$0.119	$0.1354	$0.9623

*Japan P&I Club has not been included in the above comparison table. [SOURCE: P&I Clubs]

** The Standard Club return a maximum of 75% of premium net of non-recoverable market reinsurance costs. Retained premium includes an allocation towards the club's own internal mutual overheads. Calculation of overheads includes percentages based on contributing factors, which vary between individual entered ships.

2016/17 Actual Group Reinsurance Rates for Laid up Tonnage*

(This is the full fixed reinsurance cost for each club for a laid up vessel)

DIRTY TANKER	CLEAN TANKER	DRY	PASSENGER
$0.4740	$0.2696	$0.3811	$2.6372

*Indicative laid up rate. [SOURCE: Various IG P&I Clubs

SMALLER TONNAGES	
Shipowners*	SOP will return the applicable percentage laid up return on ETC, thereafter will pay away the laid up reinsurance cost to the group reinsurance contract.

*SOP insures smaller vessels, typically under 10,000 GT, where the reinsurance costs is not a major factor in this comparison exercise.

DECLINED TO PROVIDE TRANSPARENT INTERNAL ALLOCATION COST INFORMATION	
Britannia	Declined to provide the transparent information for this comparison exercise
Swedish	Declined to provide the transparent information for this comparison exercise

Taking the above costs into consideration, it poses the question; Q: if there is a fixed cost that clubs pay away to reinsurers for laid up vessels, why are some clubs showing more competitive levels, or in other cases, a cost base that is much higher than the fixed cost benchmark price?

Using the example of a typical laid up return for a capesize bulk carrier on the next page, the clubs fall into the following categories for internal allocation costs:

#	COMPETITIVE ADVANTAGE LEVEL	BENCHMARK LEVEL @ $0.3811 PER GT	ABOVE BENCHMARK LEVEL
1	West of England	Skuld	NEPIA
2	Steamship		London
3	UK Club		American
4			Gard

COMPETITIVE ADVANTAGE LEVEL

Looking at the competitive advantage level clubs being West, Steamship and the UK Club, it poses the question in the event that an operator lays up a vessel, who exactly is paying for the reinsurance cost differential? – Logic would suggest that the navigating members may foot some of the bill here. However taking the level of container and dry bulk exposure each of these clubs have, they all fall below the market average and in the Steamship and Gard case have the lowest exposure in the group, therefore such margins would be minimal. Nevertheless, is that in the spirit of mutuality?

ABOVE BENCHMARK LEVEL

Clubs that fall into the above benchmark level category are NEPIA, London, American and Gard, some of which are significantly higher than their peers in the market. These clubs would argue that they are acting in the spirit of mutuality compared to the competitive advantage level clubs, view that they may not be allocating any portion of laid up costs to navigating members. Whilst this may be the case, those members will be contributing a higher premium level compared to what is eventually paid away to reinsurers. For these clubs, the reason for a higher than benchmark level of premium is because such club may apply a portion of the internal allocation rate to abatement costs, pool and/or management costs.

Both methods of calculating the internal allocation costs will provide advantages and disadvantages for its members. However, in the event that members choose the layup vessels more in the future, this cost factor may become a more prominent feature for the member and its club. **Arthur J. Gallagher would call for consistency on internal allocation costs, amongst P&I Clubs for laid up vessels**, so that some sentiment of mutuality may be enforced and that all members that are trading and/or laid-up are treated equally.

EXAMPLE ONLY:

Capesize Bulk Carrier (95,000 GT) – ETC Rate of US$ 1.00 per GT (example rate only) = Annual Premium USD 95,000

CLUB	COLD LAY UP %	CLUB INTERNAL ALLOCATION COST PER GT	INTERNAL ALLOCATION COST PER ANNUM	2016 FIXED "DRY R/I" LAID UP RATE @ $0.3811 (ANNUALISED) *****	ACTUAL CLUB RETAINED BALANCE OF PREMIUM AFTER R/I DEDUCTIONS (ANNUALISED)	LAID UP RETURN TO MEMBER (ANNUALISED BASIS)	ACTUAL PERCENTAGE OF ETC RETURNED %
West of England***	75%	$0.1354	$12,863	$36,204.50	N/A	$69,163	72.81%
Steamship	90%	$0.3500	$33,250	$36,204.50	$3,220.50	$55,575	58.50%
UK	90%	$0.3500	$33,250	$36,204.50	$3,220.50	$55,575	58.50%
Skuld	80%	$0.3811	$36,204.50	$36,204.50	$11,759.10	$47,036.40	49.51%
Standard	75%	****	****	$36,204.50	$12,977	$45,818.50	48.23%
American	80%	$0.4500	$42,750	$36,204.50	$16,995.50	$41,800	44%
London	75%	$0.4900	$46,550	$36,204.50	$22,458	$36,337.50	38.25%
Gard	75%	$0.4125	$39,187.50	$36,204.50	$25,308.50	$33,487	35.25%
NEPIA*	**	$0.5950	$56,525	$36,204.50	$29,939.25	$28,856.25**	30.37%

*NEPIA has a discretionary policy when calculation laid up returns for its Members [SOURCE: IG P&I Clubs]

**AJG has used 75% as an example base ONLY for the purpose of calculating a laid up comparison

*** West of England have decided to only apply a portion of the reinsurance rate to its Members.

**** The Standard Club return a maximum of 75% of premium net of non-recoverable market reinsurance costs. Retained premium includes an allocation towards the club's own internal mutual overheads. Calculation of overheads includes percentages based on contributing factors, which vary between individual entered ships.

***** The group excess of loss laid up return rate (in this comparison chart) equates to 38.11% of the ETP

MARKET AVERAGE

Based on the above example, the market average is as follows:

CLUB	COLD LAY UP %	CLUB INTERNAL ALLOCATION COST PER GT	INTERNAL ALLOCATION COST PER ANNUM	2016 FIXED "DRY R/I" LAID UP RATE @ $0.3811 (ANNUALISED) *****	ACTUAL CLUB RETAINED BALANCE OF PREMIUM AFTER R/I DEDUCTIONS (ANNUALISED)	LAID UP RETURN TO MEMBER (ANNUALISED BASIS)	ACTUAL PERCENTAGE OF ETC RETURNED %
Market Average	80%	$0.3939	$37,420.50	$36,204.50	$11,618.54	$45,960.96	48.37%

Example 2: Given that a large proportion of a capesize bulk carrier rate is the GXL-Reinsurance cost, we have used the following handysize bulk carrier as another example of a typical laid up return; however we have based the rating levels as per the market average example used on the previous page:

EXAMPLE ONLY:

Handysize Bulk Carrier (20,500 GT) – ETC Rate of US$ 4.00 per GT (example rate only) = Annual Premium USD 82,000

CLUB	COLD LAY UP %	CLUB INTERNAL ALLOCATION COST PER GT	INTERNAL ALLOCATION COST PER ANNUM	2016 FIXED "DRY R/I" LAID UP RATE @ $0.3811 (ANNUALISED) *****	ACTUAL CLUB RETAINED BALANCE OF PREMIUM AFTER R/I DEDUCTIONS (ANNUALISED)	LAID UP RE-TURN TO MEM-BER (ANNUAL-ISED BASIS)	ACTUAL PERCENTAGE OF ETC RETURNED %
Market Average	80%	$0.3939	$8,074.95	$7,812.55	$14,785.01	$59,140.04	72.12%

Advice to tanker clients: Current market conditions are indeed more favourable for tanker operators today; however, should this ever change in the future, a member should note that some P&I clubs differ on their internal allocation cost for clean and dirty tankers, if a vessel is in a laid up state it will not have cargo on board, therefore it will be important to pay attention to what rate is applied to a laid up tanker.

How does a member qualify for a laid up return?

If an entered vessel ceases trading or is put out of commission for a period of time, they may consider for a premium rebate under the laid up return club rules. The vessel may be moored alongside, be at anchor or at a buoy. Besides saving shipowners on their insurance premiums, a properly laid up vessel reduces P&I risks and after lay-up, the club will return a portion of calls to reflect this reduced risk. The clubs' policies differentiate between two types of lay-up – hot and cold – depending on the presence or absence of crew.

HOT LAY-UP:

- Suitable for a vessel out of service for a shorter period of time.
- Moored in a safe port location
- No machinery operating.
- Held within flag state and classification society requirements.
- Crew levels will be reduced.

COLD LAY-UP:

- This type of lay-up is generally suited towards vessels that will be out of service for a longer period of time.
- Moored in a safe port Location.
- Systems will be shut down.
- Crew levels will be minimal – only persons to deal with emergencies on board the vessel (such as fire or flooding) and security watch.

The reason for this differentiation in lay-up falls mainly down to crew. If crew still remain on board the vessel, then naturally there is a higher risk of injury, illness and death claims. Whereas 10 years ago cargo claims caused headaches for the club, nowadays, crew claims can now be particularly onerous and can result in the club paying out a significant amount of money. In order to qualify for laid-up returns, the lay-up must meet the following criteria:

CLUB	30 DAYS MINIMUM PERIOD	NO CARGO	EVIDENCE OF SAFE LAY-UP?	% OF CALL FOR HOT LAY-UP	% OF CALL FOR COLD LAY-UP
American	45 days	$0.3939	$37,420.50	80% Max	80%
Britannia	✓	✓	✓	50% Max	95%
Gard	✓	✓	✓	60% Max	75%
London	✓	✓	✓	50% Max	75%
NEPIA	✓	✓	✓	Discretionary	Discretionary
Shipowners	✓	✓	✓	40% Max	40%
Skuld	✓	✓	✓	50%-80% Max	80% Max
Standard	✓	✓	✓	75% Max	75% Max
Steamship	✓	✓	✓	50% Max	90%
Swedish	✓	✓	✓	50% Max	90%
UK	✓	✓	✓	50% Max	90%
West	✓	✓	✓	50% Max	75%

IMPORTANT NOTE

Whilst the above comparison tables have been complied with care and has been cross-checked with the individual clubs who have kindly participated. It is important to consider the above is a comparison snap shot for guidance only, based on the individual club 2016 Rule wordings on Laid up Returns. A club will generally determine what an applicable laid up return should be taking into consideration a number of variables, such as level of premium, age profile of the vessel, location, hot or cold etc. therefore the above numbers may vary when approaching your P&I club for a laid up calculation. The purpose of this exercise, however, is to try and offer a transparent "apples to apples" comparison overview of the market differentials when calculating laid up return premium to members, as well as, highlighting which clubs are more or less favourable when returning such premiums back to its members. For bespoke guidance or further information, please contact the team:

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