The Standard

STANDARD BULLETIN

SETTING THE STANDARD FOR SERVICE AND SECURITY

January 2011

EUROPEAN COMMISSION ENQUIRY SPECIAL EDITION

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Members will have seen many press reports concerning the European Commission's enquiry into the International Group, and some members may have been contacted directly by the Commission. This article explains the background to the enquiry and the International Group's position.

The Group operates two agreements. The first is the Pooling Agreement, which defines which claims can be pooled (and which cannot) within the Group pooling system and how the pooling arrangement should operate. Claims which are pooled are eligible to be covered under the Group's reinsurance programme, which enables the Group clubs to provide very high limits of cover to shipowners insured in Group clubs at reasonable cost, through the bulk purchasing that the Group is able to achieve on behalf of around 90% of the world's shipowners.

The second agreement is the International Group Agreement (IGA), which exists to underpin the Pooling Agreement and which, by introducing a light restraint on Group clubs' ability to attract business from other Group clubs at unfairly low rates, ensures the fairness between clubs and members that allows the pooling process to take place. The IGA was examined by the European Commission in the 1980s and again in the 1990s, and on both occasions was found, with relatively minor amendments on each occasion, not to be in breach of competition regulations. The investigation in the 1990s examined the whole pooling system and the European Commission's 1999 decision also confirmed that the Pooling Agreement did not infringe the EU competition rules and therefore did not require an exemption.

The 1999 decision granted exemption to the IGA for 10 years, absent any significant change in the market in that time. Owing to changes in competition law, there is no requirement on the Group to seek an extension of the 1999 decision but, the Commission decided, in 2009, that it would be appropriate to review the Group's arrangements. This review has now been proceeding for over a year, although it was only in August 2010 that the Commission formally opened proceedings.

The Group has been reassured by many shipowners and shipowner organisations that they would consider it very regrettable if the Group system were to be prejudiced as a result of the investigation. Some observers have commented negatively on some aspects of the Group system. Nevertheless, there is a widely-held view that the advantages that the Group system brings would be impossible to replicate if the Group were not to exist, and that the current Group arrangements are necessary to maintain the stability of the system.

The Group clubs, individually and collectively:

- provide unparalleled limits, and an unparalleled range, of cover for the benefit of member shipowners and the victims of maritime incidents worldwide
- guarantee and ensure prompt payment of compensation as provided under international liability conventions, and other national or regional liability regimes
- provide experienced and effective casualty response and management and claims servicing
- provide prompt and effective security for the claims of victims of maritime incidents and casualties
- promote, participate in and implement initiatives aimed at improving ship quality and safety standards
- assist states and inter-governmental bodies and agencies in reviewing and drafting legislation and regulations relating to maritime liabilities

The Group's pooling, or claims-sharing arrangement, is a simple but highly efficient and fair system of spreading the risk in respect of liabilities in excess of the current level of individual club retention. As the Pool operates on a cost-sharing, not-for-profit basis, the shipowner members of the clubs are able to obtain P&I insurance cover that is significantly higher in limit, wider in scope and more cost-effective than it would be if they had to individually seek such cover from the commercial insurance market. Pool cover is provided "at cost", and the spread of tonnage in the Pool enables the clubs to minimise the volatility of shipowner contributions. The Pool arrangement uniquely provides the most comprehensive form of sustainable P&I cover that is available for shipowners.

The Group clubs have already provided the Commission case team with a large amount of information to assist it with its investigation, and are in the process of providing more. It is expected that the discussions with the case team will continue for at least a number of months, and we will keep members informed of any significant developments.

The paper that follows sets out the process so far, identifies the issues that the case team has raised, and summarises the arguments that the Group has put to the case team.

Any member who would like any additional information is welcome to contact the managers.

INTERNATIONAL GROUP OF P&I CLUBS – IGA

GROUP'S SUBMISSION TO THE EUROPEAN COMMISSION

1. Introduction

1.1 On 26 August 2010, the European Commission announced that, following the expiry in February 2009 of the second 10 year exemption for the International Group Agreement ("IGA"), it had decided to carry out a review of certain aspects of the Group's claims-sharing and reinsurance arrangements.

1.2 Reforms to the Commission's procedures in 2004 mean that it is no longer open to the Group to seek a further individual exemption for the IGA, of the kind granted by the Commission in 1985 and 1999. An exemption now applies "automatically" to any agreement that meets the criteria of Article 101(3) of the EC Treaty without the need for notification to, or decision by, the Commission, although the Commission has power to investigate agreements and to ensure compliance with Article 101.

1.3 As there has been no material change in the Group's arrangements or the market since the Commission last exempted the IGA in 1999, the Group is not aware of any reason for the Commission to depart from its analysis of the Group's arrangements in the 1999 decision. That said, in view of the critical importance to shipowners globally of the P&I cover supported by the Group's arrangements, the Group decided that it would be appropriate to obtain clarity from the Commission about the implications of the expiry of the exemption in February 2009.

1.4 The Group had an initial meeting with the Commission for that purpose in the autumn of 2008, before the exemption expired. Shortly afterwards, the Group suggested a briefing meeting with the Commission's new case team (the 1999 case team having moved on) in order to explain the workings of the Clubs and the Group's arrangements and to answer any questions they might have.

1.5 In the months that followed there was further contact between the Commission's case team and the Group; the Commission also issued a number of requests for information. The Commission agreed to meet the Group in March 2010, but then postponed the meeting, not rearranging it until July 2010.

1.6 At the meeting in July, the case team informed the Group that the Commission intended to initiate a formal review to enable the case team to consider possible concerns about three aspects of the Group's arrangements. It was agreed that the case team would meet with the Group in London in October to discuss these issues further. The case team asked to receive a written submission ahead of the meeting setting out the Group's views on the three issues.

1.7 The Group sent its submission to the case team on 1 October 2010 (the "Submission"). The Submission provides an explanation of the nature of mutual P&I insurance, the workings of the Group Clubs and the nature of the arrangements between them; it also addresses the three specific issues mentioned by the case team.

1.8 This document is a summary of the Group's Submission on the three issues. It has been prepared for the information of directors and other members of Group Clubs.

2. The Three Issues

2.1 The three aspects of the Group's arrangements identified by the case team are:

- Provisions in the IGA about "quotation procedures" (Clause 3);
- Aspects of provisions in the IGA about "release calls" (Clause 8);
- Access by commercial insurers to reinsurance by the Group.

2.2 The precise nature of the case team's concerns on these issues is not clear. The Group has therefore submitted preliminary views on each of them. The views expressed by the Group in the Submission are summarised below.

3. The Group's Views on the Issues Relating to the Quotation Procedures

3.1 The case team appears to be concerned that, by preventing a new Club from quoting a lower rate than the holding Club at renewal (that is, 20 February), the IGA may prevent Clubs from attracting new business. This aspect of the IGA quotation procedures was the main focus of the Commission's decisions of 1985 and 1999 ("1985 Decision" and "1999 Decision") and of the exemption granted in those decisions.

3.2 It appears that the new case team is not convinced by the analysis on this point in the Commission's 1999 Decision. They understand the need to maintain financial stability and trust between Group Clubs so as to underpin the Pool, but consider that there may be less restrictive ways of achieving the same objective. The case team appears to think that the provision of relevant data, with a mere exhortation to rate fairly, would be sufficient to prevent discriminatory rating by a new Club.

3.3 The Group comments in the Submission that:

- in the context of the mutual, not-for-profit arrangements operated by Group Clubs, the concern about competition on "rates" is misplaced; such a concern also fails to take account of the importance of 'non-price competition' between Group Clubs;
- the same objective could not be achieved by the sharing of relevant data so that this particular suggestion is misplaced. The Group has consistently emphasised the necessity for the quotation procedures in underpinning the Pool.
- where there has been no material change in relevant circumstances it is not open to the Commission to reach a conclusion about the IGA which differs from the conclusion it reached in 1999.

3.4 The Group's Submission emphasises the need for the quotation procedures to be seen in the context of the critical function that the IGA serves in underpinning the mutual, not-for-profit claims-sharing arrangements operated by Group Clubs. It thus contains a detailed explanation of how the system works which includes the following key points.

- Essentials of mutuality. It is a basic feature of the mutual system that each member of a Club bears an equitable share of the total costs incurred by his Club in providing insurance in any given policy year. Competition on rates between the Clubs cannot reduce these total costs – all it can do is to allocate those total costs between shipowners. When assessing a member's rate, an underwriter must hold a fair balance between the interests of all members and must assess the rate solely on the basis of a professional assessment of the risk and cost of insuring that member's vessels. "Discriminatory" rates that depart from the fairness and equality of treatment of all members of a mutual Club could provide an advantage to a particular shipowner only by disadvantaging other shipowners.
- The Clubs quote "rates" not "prices". Rates quoted are the Estimated Total Costs for the shipowner made up of an initial contribution (Advance Call) and an estimated amount for the additional contribution (or contributions) payable at a later stage when the Club's total liabilities for that year are known (Supplementary Call(s)). If a shipowner is quoted a rate by two different Clubs, he cannot be certain at that stage which Club will prove to be the more expensive; that will become apparent only when both Clubs' final Supplementary Calls (or Returns) have been declared. It is inappropriate, therefore, to treat "rates" as if they were "prices" (or fixed premiums) and to analyse the effect of the IGA on competition on this basis.
- Confidentiality of rates. The rate set by a Club for any shipowner is unique to that shipowner because it reflects his own record and operations. It is confidential to that shipowner and, because shipowners are in competition with each other, one member's rate is not disclosed to other members of his Club. Accordingly, the effect of any under-rating would be masked by the obligation on all members to make good any shortfall in the Club's income and by the existence of significant Club reserves. It might never become apparent to other members of a Club that one (or more) of their fellow members was paying less than he should.
- Incentive to retain members. Clubs have strong incentives to retain their membership. A loss of tonnage reduces a Club's ability to spread both the cost of its members' claims and its administrative overheads. No Club (or its shipowner members) will welcome the loss of good members and the consequent reduction in the spread of risk within the Club.
- No incentive to over-rate members. In the Clubs' mutual, not-for-profit system, there is no incentive to over-rate any member.
- Need for individual rating. Generalised claims statistics on their own are not sufficient to enable an underwriter properly to analyse a shipowner's claims record and to make a fair estimate of the likely future costs of insuring the shipowner.

3.5 The IGA quotation procedures are indispensable to the operation of mutuality within the Clubs' system. They restrain the quotation of (discriminatory) rates that favour one or more members at the expense of others, in order to attract business or to retain business. They do this by requiring a new Club to respect the experience of a shipowner's existing Club in assessing a fair rate and by requiring the new Club to charge not less than that rate for the year in which a ship or shipowner moves from one Club to another. In this way the procedures valuably reinforce the obligations of Club managers to respect the principle of mutuality in the face of pressures from members seeking a lower rate than is justified.

3.6 In the absence of the IGA, if a shipowner was offered a lower rate by a new Club, the shipowner's existing Club would have an incentive to retain the shipowner in the Club so as to maintain its spread of risk. To achieve this, the existing Club would be forced to reduce its rate to the shipowner and to match or undercut the new Club's rate. The existing Club might thus be able to retain the spread of risk within the Club; but in doing so it would have destroyed the fairness of rating between members within its Club. Alternatively, the existing Club might decline to reduce its rate and risk the loss of the shipowner and the spread of risk across the shipowner's tonnage. In either case, the actions of the new Club would have produced an immediate adverse effect on the financial position (and mutuality) of the existing Club and all its members.

3.7 This process might ultimately cause the mutuality of Clubs' arrangements to break down. Club underwriters would be forced into progressive "rate-shaving" to retain tonnage so that it would become difficult or impossible for Club underwriters to follow any general practice of assessing rates on a proper, mutual underwriting basis. The IGA quotation procedures provide the light restraint necessary to prevent this happening and thereby provide the necessary confidence in the fairness of the system that shipowners and Clubs require if they are to continue to participate in the Pool.

3.8 It is not possible for the Group to state with absolute certainty that termination of the IGA would lead to the break-up of the Pool, though it believes this would happen. The Group can state with certainty, however, that termination of the IGA would create a very serious risk that the Pool would collapse. Moreover, the Commission itself recognised the seriousness of this risk in the 1985 Decision, concluding that there was a "strong likelihood" that this would happen.

3.9 The IGA is based upon the interest of shipowners in safeguarding the equitable operation of their system of mutual self-insurance, as well as a recognition by shipowners that a breakdown of the existing Club system and of the Pool would be so seriously detrimental to shipowners around the world and to their customers that steps must be taken to avoid any serious risk of its occurring. If the system were lost, shipowners would be forced to make alternative arrangements – but they would not be able to reproduce the benefits of the current system.

4. The Group's Views on the Issues Relating to Release Calls

4.1 The case team is understood to have concerns about two aspects of Release Calls: (1) that the calculation of Release Calls by a number of Clubs does not accurately reflect the run off of future claims; and (2) the obligation of a Group Club under the IGA to accept a bank guarantee when a shipowner moves from one Group Club to another does not apply equally where a shipowner moves from a Group Club to an insurer outside the Group.

4.2 On the first aspect, the Group's Submission includes the following preliminary comments.

- The level of Release Calls is not simply a matter of mathematical calculation and varies from Club to Club depending on a range of factors.
- Shipowners are informed of a Club's call structure and level of Release Call as part of the discussions leading to renewal.

- If a shipowner has concerns about the level of a Release Call, he can refer this to an expert committee.
- The different approaches taken to calculating Release Calls are an aspect of competition between Clubs and a matter for each Club to decide upon individually.

4.3 On the second aspect, the Submission explains that, in practice, all Group Clubs currently accept a bank guarantee in lieu of payment of a Release Call, even where a shipowner moves to an insurer outside the Group. Thus the concerns of the case team on this aspect are ill-founded.

5. The Group's Views on the Issues Relating to the Provision of Reinsurance

5.1 The case team's concerns appear to stem from an observation that commercial insurers offer reinsurance of less than $1 billion – and from a (mistaken) belief that this results from some form of foreclosure effect resulting from the Group's reinsurance arrangements, rather than from a conscious decision by non-Group P&I insurers to target a different type and level of cover to that provided by Group Clubs.

5.2 The Submission explains the reasons why, historically, the Group has been prepared in limited circumstances to accept reinsurance, namely to enable shipowners who are prevented by national laws from insuring direct with a Group Club to access (albeit indirectly) the scope and level of cover provided by Group Clubs. Reinsurance by a Group Club in such circumstances is only permitted where the insurer meets certain objective criteria. The criteria are designed to safeguard the Group's Pooling arrangements, including the purchase of reinsurance and the overspill. The criteria were agreed with the Commission and approved in its 1999 Decision.

5.3 By providing reinsurance in such circumstances, Group Clubs are able to extend the benefits of their system of mutual, self-insurance to shipowners who would otherwise not have access to them. The system of mutual, self-insurance operated by Group Clubs does not extend to providing commercial reinsurance more widely.

The Standard Bulletin is published by the managers' London agents:

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