LLOYD'S MARKET ASSOCIATION

STATEMENT

OF

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BEFORE A HEARING OF

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ENTITLED

"UPDATE OF EFFORTS TO COMBAT PIRACY"

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Introduction

Good afternoon, Chairman Hunter, Ranking Member Garamendi, and members of the subcommittee. I am pleased to be here today to discuss the role of the insurance sector in the ongoing efforts to combat piracy. I appreciate the opportunity to do so.

While there are a number of other maritime insurance hubs, I am speaking here on behalf of the Lloyd's insurance market based in London. I should also make it clear that Lloyd's is not an insurance company but is an international insurance market where syndicates of underwriters transact business on behalf of managing agents for their own account and risk. Individual insurance policies are arranged by firms of insurance brokers, authorised to transact business in the Lloyd's Market with the syndicates.

Apart from the Market itself, the role of two other bodies require comment: Firstly, the Corporation of Lloyd's, a body incorporated by Lloyd's Act 1871 (an Act of the UK Parliament), supervises and provides the physical premises and support services for the Lloyd's Market but does not insure or underwrite risks.

The second body is the Lloyd's Market Association (LMA) which is an independent association providing services to and representing the interests of the managing agents represented in the market across the broad spread of market activity. All managing agents at Lloyd's are members of the LMA.

Background

In order to understand the role of the marine insurance industry in relation to the treatment of maritime piracy it is important to understand some background. The maritime sector has had to deal with the problem of piracy since the very earliest days of maritime trade. The first recorded reference to piracy relates to incidents in and around the Aegean and Mediterranean in the 13th Century BC. Since then, pirates have operated in many guises, across all oceans of the world. For many people, their perception of piracy is heavily influenced by the many popular entertainment depictions of pirates -- such as the recent films with Johnny Depp. The reality, however, is that piracy has plagued our oceans long before and long since the period reflected in these swashbuckling films.

Reflecting this reality, from the insurance perspective, piracy has been a traditional coverage for our clients for as long as there have been marine policies. Within London and the Lloyd's market, the detailed treatment of piracy has changed over the years, but the cover has been available as a basic part of their insurance protection.

In the latter part of the 20th Century piracy was an ongoing problem, evidenced by the International Chamber of Commerce (ICC) establishing the International Maritime Bureau (IMB) Piracy Reporting Centre in 1992. In the period between 1991 and 1998 the IMB reported an average of 160 piracy attacks per year.[1] From an insurance perspective however, because of the nature of these attacks, the impact was not significant. The reported events were limited in geographical scope, focussed mainly on small, coastal vessels with the pirates boarding and leaving the targeted craft having taken cash and easily portable items. Crew were traumatised, but not usually injured, and the vessel could continue on its way. Even if the vessel were insured in a major international market the monetary amounts involved would fall below the insured's deductible (the amount which the shipowner would self-insure).

In the early part of the 21st Century, pirate activity became a new focus of attention for the shipping and insurance community in and around the Malacca Straits – long a hot bed of piratical attacks, and a major trade route for vessels moving goods between Asia and global markets. Along with an increase in the number of attacks in the Straits, the perpetrators were more sophisticated in terms of equipment and their organisation. In the post 9/11 environment there were suggestions that these developments could be due to terrorist groups using these activities to fund their operations.

Pressure from the maritime community, including steps taken by marine insurers, to highlight the security and policing arrangements around Malacca meant that the Governments in Indonesia, Malaysia and Singapore worked together to co-ordinate anti-piracy activity thus reducing the level of incidents down to a more manageable level.

It is against this background of ongoing pirate activity in other regions that the Somalian situation first came to public attention in November 2008 when the *Sirius Star*, a fully laden oil tanker, was taken by pirates. It was not the first attack in the region, but it was the first event to raise the profile of these activities to the general public and media.

From the maritime perspective, the interesting development with regard to this region is that the pirates' behaviours have fundamentally altered in that the pirate groups recognise that the vessel, crew and cargo are valuable assets. The political environment which existed in Somalia, along with the geographical location alongside one of the world's major shipping lanes, combined with the seagoing expertise of the original pirate groups, and the long tradition of on land kidnap and ransom created a "perfect storm" which the pirate groups exploited to the maximum.

The change in behaviours, linked to the high level of activity, have caused some technical coverage issues for the insurance market where the traditional focus for piracy cover has been related to physical loss or damage to the vessel. The Somalia model, which equates more to a kidnap and ransom scenario, has meant that the marine market has had to

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[1] ICC IMB Piracy Reporting Centre Annual Report 1998

adapt its traditional approach to this particular peril. It has also led to the development of specific insurance products to meet this new challenge for the marine client base.

Setting Somalia aside, during 2012 there has been a developing trend of attacks on vessels moving oil offshore in the Gulf of Guinea. These attacks are in three types; the opportunist theft of portable goods from the ship, the organised theft and transhipment of oil cargoes and the kidnapping of crew from service vessels. It is believed that these attacks are undertaken by local groups, and are not linked to pirate groups from Somalia.

The Role of Insurers

The main focus of the insurance sector has been to work alongside the shipping community to attempt, as far as possible, to reduce the risks from piracy in those areas of the world where the threat is significant. The marine insurance sector cannot do this in isolation, as it operates in a fiercely competitive commercial environment, and in many cases is also impacted by various competition restrictions which prevent the sector from being as proscriptive as it might otherwise wish to be.

As a starting point, the insurance industry as a whole has continued to provide piracy cover, as this is seen as a fundamental requirement for its client base. Alongside this, and with specific reference to Somalia, the insurance sector has worked with the wider shipping community and with associated naval and military forces on initiatives such as the development of the Best Management Practices (BMP). The BMP, which is currently in its fourth iteration, outlines a series of recommendations and measures which shipowners may adopt in order to mitigate the risk of a successful piracy attack in the high risk area in the Indian Ocean. Many observers have asked why the insurance sector has not mandated the use of BMP. Firstly it is not a legal document and has many subjectivities, but more broadly the regulatory environment which exists within the EU means that this option is not open to insurers as a body in the London market.

Individual insurers will ask detailed questions of shipowners whose vessels are trading into the areas impacted by the problem of Somalian piracy, including the adoption and use of BMP, and will make decisions on coverage dependant on the responses received.

A further focus for the shipping industry has been the increased use of private security firms which provide armed protection for vessels transiting the High Risk area. The carrying of weapons on commercial vessels is a thorny legal issue in itself. Individual insurers will look at the use of such firms as part of the vessel owner's overall package of actions taken to mitigate the piracy threat. This has to be measured against the potential downside that badly equipped and/or poorly trained armed guards could escalate the risk of loss of life among the crew and loss or damage to the vessel and its cargo.

Alongside these initiatives, insurers have been cognisant of the invaluable support of the various military units operating in and around the Gulf of Aden and out into the Indian Ocean. Insurers have been party to much of the communication with the shipping industry and recognise that the collective efforts being made by the naval forces have had a very beneficial impact in reducing the success rates of pirates in the affected area. The level of co-operation between the commercial sector and the military has been refreshing, and provides a useful lesson for future challenges. The co-operation between the militaries has been very remarkable. These efforts, and the associated financial commitment from the Governments involved, have been particularly appreciated in the current global economic environment.

Perhaps the most challenging aspect of the Somali piracy problem is the lack of an effective government onshore to assist international counter-piracy efforts. In its report *Maritime Security Partnerships*, the National Research Council of the National Academies concluded that in the 2005 Malacca Straits situation, Lloyd's and its network played a critical role, along with certain other maritime interests, in helping the coastal states improve regional cooperation and security, which the Council recognized to be an essential feature of counter-piracy efforts.[2] In Somalia, however, such avenues are limited given the lack of an effective government to exert any influence over pirate groups.

Insurers have also been engaged with the ongoing role of regulators in looking at the money trail which arises following the payment of ransoms following a piracy event. From a Lloyd's perspective this is a particularly important aspect of our work. Lloyd's has a valuable brand and reputation to protect in the US so our involvement in discussions with OFAC in the practical issues arising from the payment of ransoms has been particularly helpful.

I should make it clear here that property insurers are not directly involved in the negotiation or payment of ransom moneys. These negotiations take place between shipowner representatives and representatives of the pirate groups. Once an agreement is reached, property insurers will be involved through the ancient marine concept of General Average ("GA") (a concept as old as, if not older than, piracy itself). GA allows the shipowner to ensure that costs incurred for the safe completion of a maritime adventure are shared across all parties involved. Once an owner has declared General Average the various parties will contribute according to a complex charging structure based on values of the ship and cargo, and the hull and cargo insurers will therefore be major contributors. It is interesting to note, bearing in mind the earlier comments relating to the position of the crew in relation to the current problems, that the crew liability is not covered by hull and cargo underwriters. This is covered separately by the Protection & Indemnity Clubs, mutual groups funded by the shipowners. P & I Clubs are not traditionally involved, as a matter of maritime law and practice, in funding GA payments. But this is an issue which property insurers feel should be addressed in the longer term.

Conclusion

It is estimated that around 90% of world trade is carried by the international shipping industry. It is a largely invisible driver of global trade. The threat of piracy is one which the industry has had to address since the advent of international trade, and the most recent evolution in Somalia, and the more recent developments off Nigeria show that the problem continues to be a significant one.

Marine insurers see themselves as an integral part of the shipping sector, but do not have the power or influence to fundamentally impact the threat of piracy in isolation. Insurers can, and do, work alongside the other stakeholders in the shipping industry, including Governments and regulators, in order to help reduce the risks that pirate groups pose to international trade.

I would of course, be happy to answer any questions of detail you may have with regard to my comments.

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[2] See National Research Council, *Maritime Security Partnerships* 193-4 (2008).