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KNOWLEDGE IN TRANSIT

LETTER OF CREDIT

A letter of credit is a document detailing a bank's funding requirements and will include specifics on how insurance is to be arranged, the values to be insured, where claims are payable and how the cargo is to be described. Any brokers who have been involved in arranging marine export insurance certificates will understand the difficulty involved in getting the insurance documents to match the requirements of the letter of credit. Often banks will want to see words capitalized and will reject the insurance certificate if, for example, a full stop is missing or in the wrong place.

110%

It is common for the letter of credit to require that insurance is arranged for 110%. This means that cargo with an invoice sales price of $100,000 needs to be insured for $110,000. The 10% uplift is intended to account for things such as exchange rate variances and incidental costs.

MARINE INSURANCE AND INTERNATIONAL TRADE

A fundamental reason for consistency in the cover provided by marine cargo insurers is due to the integral part that marine insurance plays in international trade. As such, while most general insurance policies are unique to each insurer, cargo policies share a common basis with the Institute Cargo Clauses forming the backbone to the cover. The Institute Cargo Clauses also underpin the basis of contracts of marine insurance in many parts of the world.

Buyers, sellers and the banks that finance overseas sale and pur chase transactions need comfort that insurance will be fundamentally the same irrespective of where in the world the insurance is arranged.

A typical transaction for the sale of machinery to China will involve a seller in Australia and a buyer in China. Financing the purchase will be a bank in China who will insist that marine insurance is arranged by the seller prior to shipment. This would commonly be known as purchasing (or selling) the goods on "CIF" (cost, insurance, freight) sale terms. Without evidence of insurance the bank will not release the funds for the transaction.

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WHEN ARE CERTIFICATES NOT NEEDED?

It is important for clients to understand that marine certificates evidencing insurance for an export shipment are not needed by insurers. Unless a bank is demanding such a certificate they need not be issued. Rather, if an exporter wants to make it clear that they are assuming responsibility for arranging insurance it would be preferable for them to simply note on their invoice “CIF [destination]. This term of sale (INCOTERM) is the acronym for cost, insurance, freight and is evidence enough that the seller is agreeing to provide insurance (and the cost of freight) as part of their invoice cost.

For further information see the January 2011 edition of ‘Knowledge in Transit - Insurable Interest and Marine Insurance’.

DIFFERENT VERSIONS

Brokers should be aware that there are two versions of the Institute Cargo Clauses in use; the 1982 version and the 2009 version. The 2009 Clauses are increasingly being adopted by insurers and should be preferred by brokers as they provide a wider cover and remove many inconsistencies that previously existed when insurers used their own additional clauses and endorsements to enhance the cover provided by the 1982 Clauses.

MARINE INSURANCE CERTIFICATES

Banks will want to see a marine insurance export certificate signed by the insurer as evidence of the existence of insurance for cargo that is being funded by them. This differs to a standard certificate of currency in that the marine insurance certificate is a negotiable document that entitles the holder of the certificate to claim on the insurance. The certificate will often be ‘blank endorsed’, meaning that the original beneficiary (often the seller) has assigned the benefit of the insurance to another party (generally the buyer). This is effected by the seller signing and stamping (with their company stamp) the reverse side of the certificate.

Not so long ago insurers would provide clients with a pad of blank certificates for them to complete with a copy of the issued certificate being forwarded to the insurer. Under cargo open covers the insurer would then tally up the certificates and send the insured a monthly premium invoice for the total of all the certificates. Thankfully, with annually adjustable cargo policies now being common and with most insurers having an online export certificate system, the administration of these accounts is much more cost effective.

DIFFERENT INSTITUTE CARGO CLAUSES

While the Institute Cargo Clauses provide a common form to the cover there are different Cargo Clauses available that provide very different levels of cover. Importantly, many insurers will only provide limited cover when insuring cargo that doesn’t fit into a sealed container, particularly if that cargo is being shipped on deck. Insurers will be concerned about deck cargo as it is a higher risk due to being exposed to the weather.

THE ‘A’ CLAUSES

Most commonly used are the Institute Cargo Clauses ‘A’ which provide cover against “all risks of loss or damage”. This is essentially an accidental loss or damage cover.

THE ‘B’ CLAUSES

More restrictive are the Institute Cargo Clauses ‘B’ which, rather than being “all risks”, only covers cargo when lost or damaged by certain events including fire, explosion, overturning, capsizing, collision, cargo lost overboard or damage by seawater. Notice that with the ‘B’ Clauses the only water damage covered is that caused by seawater. If a hole in a container allowed fresh water (i.e. rain) to enter, such damage would not be covered.

THE ‘C’ CLAUSES

The Institute Cargo Clauses ‘C’ provide cover which is even more limited, with the main omissions being cover for cargo lost overboard and damage caused by sea water.

COMMODITY SPECIFIC CLAUSES

It is important to remember that the Cargo Clauses ‘A’, ‘B’ and ‘C’ are appropriate only for non-refrigerated general cargo. Institute Clauses exist that have been drafted specifically for certain types of cargo such as refrigerated cargo, meat and traded commodities. If anyone thought that marine insurance is easy it is sobering to consider that there are over 100 different Institute Clauses available for use by marine insurers.