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CARGO INSURANCE
RATING A POLICY ON SALES TURNOVER

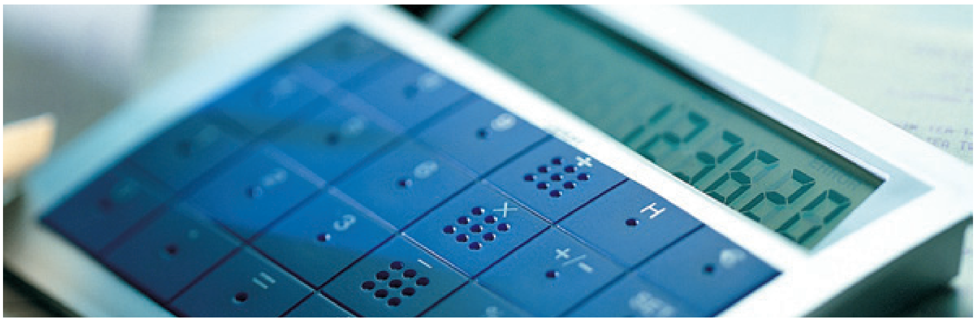
SURA MARINE

KNOWLEDGE IN TRANSIT

ANNUALLY DECLARED CARGO POLICIES

In time, insurers, and their customers, were attracted to the concept of an annually adjusted policy with a deposit premium that is based on an estimate of the insured sendings at the start of the policy period.

The premium would then be adjusted at the end of the policy period based on the actual value of insured shipments during the policy period. If the 'actual' insured sendings exceeded that estimated an additional premium would be payable and vice versa. It is common for cargo insurers to have a minimum premium provision that is often set at 100% of the deposit premium, meaning that while additional premiums are payable they are rarely refunded.



CARGO 'OPEN' POLICIES

Not so long ago, a cargo insurance policy would invariably be an 'open' declaration style policy where cover was dependent upon each and every shipment being recorded on a schedule that was given to the insurer each month. The insured would normally declare these in arrears. Each month the insurer would tally up the total insured shipments, or 'sendings', apply the pre-agreed premium rate and invoice the policyholder in arrears.

In those days it was quite common for different commodities and countries to attract different rates resulting in quite a bit of work to calculate the monthly cargo premium not to mention the work involved in invoicing each policyholder up to 12 times a year.

Under an open cargo policy, if a claim occurred and the shipment had not been declared this could mean that the claim would not be met by the insurer unless the policy contained an 'Errors & Omissions Clause' which protected the insured in the event of inadvertent failure to declare shipments or an incorrect declaration.

Although rarely used in the Australian market, 'open' declaration style policies are sometimes preferable where there are relatively few high-valued shipments occurring during the course of the year (e.g. bulk shipments) or where future sendings are difficult to forecast (e.g. commodity traders) and cash flow is derived from sales as and when they occur.

THE PROBLEM WITH DEPOSIT PREMIUM POLICIES ADJUSTABLE ON ANNUAL DECLARATION OF SENDINGS

Insurers need to know the value of the sendings to be insured under a policy in order to strike a fair deposit premium for their risk. It becomes a matter of convenience that this is based on an estimate and calculated annually, as is currently the norm, rather than calculated in arrears monthly.

Clearly, it can be a significant amount of work for a policy holder to record each and every insured shipment particularly when there are no sales or purchase transactions associated with the shipments. For example, a piece of machinery sent for repairs may not be included in the annual year-end cargo insurance declaration as the value of the machine won't be picked up when declaring purchases and sales.

Other non-invoiced cargo transits where insurers regularly pay claims but rarely receive an estimate of insured sendings are returned goods, stock transfers and customer's goods being serviced or repaired.

SALES TURNOVER

Quite often, insurers get asked whether a policy can be rated on company sales turnover rather than on the value of insured sendings. At first glance this is quite appealing (at least for the policy holder) as it will no longer be necessary to keep a separate record of insured sendings. Also, while a company's sales turnover is quite easy to establish, unless a company has a dedicated insurance department, an accurate record of insured sendings can be difficult to obtain. It is not uncommon to see cargo policies where an identical estimate of insured sendings is given to insurers each year without change.

A significant negative to rating a cargo policy on company sales turnover is that turnover does not give a true representation of the insurer's exposure to transit risks. For example, a manufacturer of computer components may not only export $10million worth of cargo but may also have a shopfront where they have $50million of over-the-counter sales. In this case their insured sendings are $10m while their sales turnover is $60million.

The difficulty therefore is that while insured sendings provide an absolute measure of a cargo insurer's exposure, sales turnover provides only a very crude alternative.

FOR BROKERS

There are occasions where rating a cargo policy on company turnover is desirable but caution needs to be exercised to ensure that a fair premium for risk is being charged by the underwriter. Given the comments made above, this can be difficult to achieve. The primary difficulty is that most insurers' cargo rates are founded on estimated sendings rather than turnover so the underwriter may be applying a significant amount of guess work in pricing the risk. This guess work can lead to spikes in the premium as claims occur and underwriters learn the expensive way about the true extent of their exposure. In such circumstances it would not be unusual to see a policy's premium rating reverting to being based on insured sendings.

Circumstances may also arise where sales turnover may substantially exceed the actual values at risk. For example, the insured may contract on terms of sale where the goods are mainly at the risk of their customers (selling 'Ex Works' or 'FOB' rather than 'Free in to Store' or 'CIF' refer Knowledge in Transit - January 2011).

The majority of cargo policies are rated on 'sendings'.