FEDERATION OF AFRO-ASIAN INSURERS AND REINSURERS

SIXTH GENERAL MEETING

UNCTAD POLICY IN MARINE CARGO INSURANCE

by L.P. Buol

Nairobi, 26-29 June, 1979

National character of most developed insurance markets

1. According to a slogan used very frequently in various economic circles, insurance is supposed to be of predominantly international nature. I beg to disagree with this opinion, which is not at all borne out by facts. One look at most of the developed insurance markets of the world suffices to convince us that insurance is predominantly German in Germany, predominantly French in France, predominantly Swedish in Sweden, predominantly American in the United States, predominantly Japanese in Japan, and so on.

2. I think it is necessary to clarify right away a point which otherwise might create a serious misunderstanding: when I say that any given developed insurance market, for instance that of Switzerland, is not international in its nature but predominantly Swiss, I do not deny the fact that a certain number of branch offices and agencies of foreign insurers, duly registered and licensed, do operate in the Swiss market. What I _am_ saying is that these foreign branches and agencies play a very small role on the Swiss market, and that they offer services similar to those offered by the country' domestic insurers and not what their Head Offices offer to their own public at home.

3. In other words, the national character of all local insurance portfolios predominates in most classes of insurance, such as motor, fire, accident and

UNCTAD/INS/25
GE.79-52621

life insurance, a situation which is largely due to the existence in each country of a specific framework within which the local insurance operations evolve. Insurance legislation and supervision play of course the main role in shaping this framework, together with some other legal, economic and social factors. One of the basic rules of most national insurance regulations is that "all local risks, in principle, should be covered in the country's domestic insurance market".

4. The above basic rule, applied already for many decades by practically all developed countries, is now being used by many countries of the Third World, with beneficial results for the growth of domestic insurance markets. Through its resolution 42/III on insurance and reinsurance, which was adopted in Santiago in May 1972, UNCTAD gave its official, overall recognition to a principle already in use in most developed countries and recommended its adoption also by the developing countries. The relevant operative article 1 of the UNCTAD resolution reads as follows:

> "The United Nations Conference on Trade and Development, at its third session, affirms that developing countries should take steps to enable their domestic insurance markets to cover in these markets - taking into account their national economic interests as well as the insured interests - the insurance operations generated by their economic activities, including their foreign trade, as far as is technically feasible."

5. As you may have probably noted, insurance of foreign trade - which is precisely the subject of my present paper - is specifically mentioned in the UNCTAD resolution, this for two reasons: first, because the volume of foreign trade insurance business tends to be very large in most developing countries as compared with the volume of business generated by other classes of insurance; second, because when it comes to insurance of foreign trade, i.e. to marine cargo insurance, the concept of national risks is not as obvious as it is in the other classes of insurance business and requires a certain amount of explanation. I shall elaborate on these two important points in the paragraphs that follow.

Importance of covering marine cargo risks in the local insurance markets of developing countries

6. In order to appreciate the importance of the contribution that local cargo marine insurance could make to the sound and rapid growth of the domestic insurance markets of most developing countries, one should recall the situation prevailing on many of these markets. The analysis of the distribution of premiums written in developing countries points to the fact that, apart from the risks of which insurance is obligatory, such as motor third party liability insurance, the bulk of the business covered represents a few risks characterized by high values or high exposure, such as industrial fire, construction and engineering risks, marine hull, aviation, etc. The reason for this situation is that in spite of the developing countries' efforts to modernize their economies, the predominant economic sector in these countries is made up of the rural population. This sector does not resort to insurance in a systematic manner, partly because of lack of insurance awareness and partly because of low income per capita, which restricts the demand for cover of ordinary risks.

7. The resulting unbalanced nature of the local portfolios is a serious obstacle to the sound growth of the insurance markets in developing countries and results in heavy reliance upon foreign reinsurance, which in turn drains the resources of the local insurance companies and prevents them from building up their own capacity. It is clear that this situation has to be remedied, the obvious remedy being the rapid increase of insurance business written in the country. It is no secret that in developing countries, out of all insurance classes, marine cargo, premium-wise, is the most promising class of business. Its close connection with import and export trade, which represents the fastest expanding sector of the national economy, makes marine cargo insurance particularly important. The rise in prices of commodities imported and exported contributes further to the increase of premiums in this category of risks. Marine cargo insurance is also characterised by a sufficient spread of risks. Furthermore, in markets where rates are not forced down to uneconomic levels, and under normal circumstances, cargo insurance in developing countries is a profitable business. For all the above reasons, underwriting in developing countries of cargo insurance on a large scale is crucial to the local insurance industry.

8. Another argument in favour of insuring marine cargo locally is the savings in foreign exchange which local cover of foreign trade risks might bring about. To quantify exactly these savings is quite difficult, because in most countries the statistics reflecting this expenditure are rather misleading. In fact, at present, goods insured by an exporter are generally debited to the importer on a CIF basis. Thus, although the importer bears the cost of the insurance, as pointed out below, it is rare that the insurance expenditure is shown separately. Consequently, it is not easy to isolate the cost of insurance associated with CIF sales to and FOB purchases from the developing countries as a whole. In order to estimate the cost, it would be necessary to carry out in-depth research, involving complex computation of the volume of imports and exports received and shipped on CIF contracts, with a view to isolating the cost of insurance of the CIF trade of each country.

9. But one could justifiably wonder whether such an operation would be really necessary in order to reach valid conclusions. Import of goods or services into a developing country, however expensive, cannot be considered a waste if these goods or services are of strict necessity to the welfare of the population and to the development of the country's economy. The concept of "waste" would only be applicable if the country imported goods and services which could be produced in the country. Consequently, the total expenditure for foreign marine insurance would be relevant only if it were compared with the ability of the given market to provide the goods and services being imported from abroad. In other words, we could say that if, with the help of some adjustments and corrective measures, the local insurance market was enabled to provide such goods and services, imports on CIF basis would be a waste of foreign exchange, whatever the amount involved.

<u>Should developing countries prescribe local insurance for part of their foreign trade?</u>

10. In principle, where and by whom an import or export of goods is insured depends on the kind of trade contract used. The conditions of the contract of sale, or in the absence of these, the corresponding laws, establish not only the liabilities of the parties involved but also their rights. Among other things, the insurable interest of the contractors at various stages of the transaction can be determined on the basis of such a contract. It is

of particular importance to the marine insurer to know exactly when the ownership of the goods passes from the seller to the buyer, because in the event of loss of or damage to the goods it is essential to know which party should be indemnified. In this connexion, the British Sale of Goods Act of 1893, following the Roman law, provides in section 32 that: "Where, in pursuance of a contract of sale, the seller is authorized as required to send the goods to the buyer, delivery of the goods to a carrier, whether named by the buyer or not, for the purpose of transmission to the buyer is, prima facie, deemed to be a delivery of the goods to the buyer."

11. The INCOTERMS 1953 of the International Chamber of Commerce, codifying and interpreting the main terms used in foreign trade, take a similar view. In fact, under the CIF terms the seller must contract for the carriage of goods to the agreed port of destination and pay the freight and load the goods on board the vessel at the port of shipment; he must also contract and pay for the insurance cover; thereafter the buyer must bear all risks until the goods arrive at the final destination point. In other words, under CIF rules, the seller's responsibility ends when he has delivered the goods on board the ship and from then on they travel at the buyer's risk, although the seller is responsible for the payment of freight and the marine insurance premium. It therefore follows that from the point of view of risk bearing there is no fundamental difference between CIF and FOB terms. In the latter, the responsibility of the seller ends at exactly the same point, namely when he has delivered the goods to the carrier who was designated (and paid) by the buyer. The fact that under the FOB terms it is the buyer who is responsible for contracting (and paying) for carriage of the goods and marine insurance in no way alters the position as regards transfer of the risk.

12. Since under both the CIF and FOB terms it is invariably the buyer who bears all risks from the time the goods are on board ship, he should also have the right to choose his insurer in both cases. As a consequence, the authorities of the buyer's country - the importing country - should have the right to prescribe that all imports be insured in the country's own domestic insurance market. This is the basic UNCTAD theory as regards marine cargo insurance. Our theory, when first put before the UNCTAD Committee on Invisibles in 1975, raised considerable objections. Fortunately, both the Governments of developed countries and the large international

insurance centres finally accepted our proposals, recognizing that in order to promote their domestic marine insurance markets the developing countries should have the right to take protective measures such as the localization in their country of insurance of all their imports. UNCTAD resolution 9(VII), which advocates this measure, was adopted unanimously.

13. For the sake of being fair, I wish to underline at this point that the UNCTAD recommendation refers specifically to local insurance of all imports and not to insurance of the entire foreign trade of developing countries. As regards the insurance of exports, no valid arguments can be found justifying coercive measures by the exporting countries; on the contrary, such measures might clash with corresponding measures of importing countries and lead to double insurance, as well as create other obstacles to international trade. Recognizing this fact, in its insurance regulation, Brazil points out that "whoever buys goods from Brazil has the fullest freedom of contracting wherever he wishes the services of transportation and insurance; as a corollary, Brazil claims the same rights from its international suppliers as regards its imports".

Ability of local insurance markets to provide cover for imported goods

14. Although the formal objections to the principle of localization of marine cargo insurance in developing countries have more or less abated, other kinds of objections are still very frequent, namely from those who question the ability of most insurance markets of developing countries to provide adequate cover for imported goods. My reply to such critics is that as long as local insurance markets receive a very limited volume of marine cargo business, it is only natural that these markets are unable to improve their skills and capacities and, therefore, unable to provide insurance services comparable to those offered by the large foreign insurance companies. However, should a local insurance market manage to secure a constant flow of a considerable volume of marine cargo insurance business - namely the bulk of all imports - then this market would gradually overcome its initial weaknesses and develop into a stable marine insurance market able to provide its users with both adequate cover at fair prices and satisfactory services.

15. As you all know, the principle of protection of an emerging industry in a young nation is generally accepted. The superiority of one country

over another in a given branch of business often arises simply because one started sooner than others. This is indeed the case in the international marine insurance markets, where some nations have had the opportunity, much earlier, to build up their markets and to acquire broad skills and experience. Plans should be formulated and implemented to guide the emerging marine insurance markets of developing countries towards skills and experience necessary to service the insured and to support their national trade. At present there are a number of negative factors inherent in the inherited structure and the modus operandi of the insurance industry in developing countries, which prevent it from being fully efficient when dealing with marine cargo covers. It might be useful to attempt to single out these factors and to propose appropriate measures to eliminate or, at least, decrease their negative impact.

16. First, many marine insurance markets of developing countries, so far, have not succeeded in securing the services of experienced and technically qualified marine underwriters with a thorough knowledge of the nature of perils and risks to which goods in transit are exposed. However, this statement calls for a clarification: obviously technicians can develop their skills only when professional opportunities are available. It is therefore true to say that lack of skills and technical know-how is a direct result of the present very restricted volume of business available in these markets and that a substantial increase in the flow of marine insurance business, combined with intensive training programmes, would bring about a rapid improvement in local skills and experience for underwriting marine cargo insurance risks.

17. Second, small volumes of marine insurance business written so far in the insurance markets of many developing countries preclude these markets from obtaining sufficient spread of risks, which in turn results in heavy reliance on foreign reinsurance; furthermore, small portfolios generate higher management expenses. This explains why premium rates quoted in many developing countries are higher locally than those offered on the international marine insurance markets. Here again it is easy to see that a substantial increase in the volume of business written locally would stabilize the marine portfolios, reduce the relative management expenses and allow for a higher retention of risks, which factors are conducive to lower premium rates.

18. Finally, what matters most in marine cargo insurance is the efficient handling of claims and speedy settlement of losses. It is essential that the marine insurers of developing countries can call upon a sufficiently wide network of expert loss adjusters able to provide adequate services for claim settlements. A sufficiently large marine insurance portfolio is what is required to promote such services, and make legal and banking facilities availabl to the marine insurers in developing countries. The foreign exchange situation in many developing countries and lack of foreign currencies often does not allow for sufficient mobility of funds and prevents speedy settlement of losses. This last point is perhaps the only problem which would not be solved by a substantial increase in the size of local portfolios; a clear decision of the Authorities (Central Bank or other) to make foreign exchange for settling claims abroad readily available to marine insurers is absolutely essential.

19. The above considerations may sound somewhat theoretical to some of you, but I can assure you that they are not. By now we have a significant number of developing countries which have followed the course of action proposed by us and have succeeded in turning their domestic marine cargo insurance portfolios into the most successful classes of insurance business operated in their markets. The most successful among these countries are those which, in addition to localizing marine cargo insurance for their imports, have also devoted considerable efforts to loss prevention and claim minimization, which implies the supervision of loading and unloading operations, stacking, storage and arranging watch and ward, as well as improvement of port conditions, packing, etc. In order to be effective and economic, claim minimization has to be undertaken at a market level rather than on a company by company basis.

20. So far, I have spoken to you on behalf of UNCTAD, explaining the official policy of my Organization in the field of insurance, in general, and marine cargo insurance, in particular. May I close my speech with a personal remark ? I believe that economic development has two facets: one is technical and is based on pure logic; the other is psychological and requires faith in the objectives of development. I invite you to share my belief that measures aimed at increasing self-reliance of developing countries *will* succeed because they simply *must* succeed. There is no other way for the developing countries, nor for the world as a whole.