REPORT ON STATUS OF MARINE INSURANCE IN THE U.S.

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REPORT

ON

STATUS OF MARINE INSURANCE IN THE UNITED STATES

By

S. S. HUEBNER

Expert in Insurance to the United States Shipping Board
and the Committee on the Merchant Marine and Fisheries

Including the

RECOMMENDATIONS OF THE SUBCOMMITTEE ON MERCHANT MARINE AND FISHERIES

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REPORT ON STATUS OF MARINE INSURANCE IN THE UNITED STATES.

CHAPTER I.

THE ECONOMIC IMPORTANCE OF MARINE INSURANCE.

Marine insurance a vital part of commence.—Marine insurance is conceded to be an integral part of modern overseas commerce. It exists to indemnify interested parties against loss, damage, or expense occasioned accidentally in connection with vessels, cargoes, freight, and other marine interests through any of the many perils connected with water transportation. Water carriers and shippers of goods by water probably exceed all other business interests in the extent to which they protect their property through insurance. As has been aptly stated, "Marine insurance bears to commerce the relation of bodyguard rather than mere servile attendant. * * * Of the active forces which influence, control, or forbid the employment of shipping none has greater effect than the marine insurance power." [1]

The fundamental purpose of marine insurance is to indemnify such loss and damage as is accidental, unavoidable, and unusual. But subject to this condition the modern marine insurance policy affords a very broad protection; in fact, nearly every conceivable contingency is assumed. The modern "warehouse to warehouse" clause enables goods to be protected from the time they leave the shipper's warehouse in the interior of this country, through all the various stages of the journey either by water or land carriers, until they are safely delivered into the warehouse of the foreign consignee. In fact, it is asserted that modern marine insurance should justly be called "transportation insurance."

The universal use of credit in commercial transactions and the small margin of profit on which such transactions are customarily conducted make marine insurance almost as necessary an instrumentality of overseas trade as the vessel itself. Owners of vessels must necessarily protect themselves against the loss of vessel and freight charges, and, in the case of ordinary cargo carriers, willingly pay for such protection a sum equal to the current rate of interest on the invested capital. Where the vessel is only paid for in part, the mortgagee will want his equity protected just as certainly as is the practice in fire insurance under the so-called "mortgage clause." Should the owner charter his vessel to some one else, the contract of hire—"the charter party," as it is called—will set forth in detail the obligation of the respective parties to arrange for adequate protection against loss of the vessel; while the charterer, in turn,

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[1] William W. Bates: The American Marine, p. 182.

will want to protect himself against possible loss of freight earnings. Shippers and consignees need marine insurance protection against (1) loss of the capital, usually borrowed to the extent of 80 to 90 per cent, invested in the cargo; (2) loss of profits because the goods fail to reach destination or arrive in damaged condition, and (3) loss of prepaid or collectible freight and other prepaid expenses on lost or damaged goods.

Creditors are also vitally dependent upon adequate protection of cargo against which they have a lien, and a marine insurance certificate thus invariably accompanies a bill of lading or a foreign bill of exchange. Ordinarily four documents, known as the "commercial set," represent and serve as a substitute for the goods constituting a shipment, viz., the invoice ("the merchant's bill for the goods"), the bill of lading ("the carrier's receipt for the goods"), the draft or bill of exchange ("the merchant's payment"), and the marine insurance certificate ("the document of guaranty"). The marine insurance certificate is thus an integral part of the modern commercial set of documents, and emphasis should be placed on the fact that it is the document of guaranty. Commercial history shows that the introduction of the draft or bill of exchange completely revolutionized commercial procedure and made possible the enormous development of modern international commerce. But the bill of exchange could never have attained its usefulness if it represented merely an unsecured debt. Its ready acceptance lies in the fact that it represents a secured debt, and the security is guaranteed by the insurance certificate which promises indemnification of the goods on the security of which the bill of lading was issued.

So essential has the marine insurance certificate become, owing to the requirements of modern commerce for certainty, convenience and speed, that it has largely taken the place of the insurance policy itself as the document used in financing commercial transactions. The same requirements have also led to the general practice of large exporters and others taking out "open contracts" of marine insurance which will protect all their shipments over certain described routes. Under such policies the insured is usually given the privilege of issuing certificates from time to time on a prescribed form provided by the underwriter. These certificates, when properly countersigned, serve as a convenient way of issuing successive negotiable evidences of the insurance itself. By this method the insured is enabled, as occasion requires, to draw against his insurance account in much the same manner as checks are drawn against a bank account. Such certificates make unnecessary the issuance of many copies of the policy, i. e., for each individual shipment, loan, or other purpose. Exporters are thus enabled to negotiate a lump-sum total of insurance under one policy, and, as occasion arises, to protect their consignees, bankers, or other creditors, by issuing to them separate documents which evidence the original policy and which, by transferring to the holder the benefit of the insurance, act as a substitute therefor. The wording of the certificate can be made such as to give it quasi negotiability, thus making it readily acceptable, where the responsibility of the underwriter is beyond doubt, in all the leading banking centers of the world.

Economic services rendered by marine insurance.—Before discussing *marine insurance* as a national weapon to acquire international trade, it is desirable that we analyze briefly its several economic functions. In the absence of marine insurance it is certain that general and continuous commerce by water would either have to cease or be conducted on an uneconomical and unscientific basis. Uncertainty would take the place of certainty and commerce would be reduced to a highly speculative if not a gambling plane. Freight charges and mercantile profits would necessarily have to be arranged with reference to an uncertain hazard and could no longer bring a fair, regular, and certain return to invested capital.

Eliminates the paralyzing effects of worry and fear.—Few enterprises are surrounded by so many serious hazards as maritime ventures. Therefore in the absence of underwriters who are willing to assume the consequences of such hazards for a definitely stated premium a paralyzing sense of fear and worry would be general in the shipping industry. Even at the beginning of the seventeenth century the British Parliament gave expression to the advantage of marine insurance by describing it (43 Elizabeth, c. 12) as a means—

> Whereby it cometh to pass that upon the loss or perishing of any ship there followeth not the undoing of anyone, but the loss lighteth rather easily upon many than heavily upon few, and rather upon them that adventure not than upon those who do adventure; whereby all merchants * * * are allowed to venture more willingly and freely.

During the present international war marine insurance proved so essential to the free movement of commerce, the very life blood of nations, that 11 governments, including the United States and Great Britain, saw fit to enter the insurance business at rates lower than cost. Vessel owners naturally desire to be protected against the loss of their investment or of freight charges which may not have been collected in advance. Shippers and consignees need such protection, since their goods have been financed with borrowed funds, and since bills of lading usually provide that "freight prepaid will not be returned, goods lost or not lost," or that "full freight is payable on damaged or unsound goods." By thus giving certainty instead of uncertainty, marine insurance enables merchants and vessel owners to venture more and to enlarge their commercial efforts.

Distribute losses to the ultimate consumer.—In the last analysis all costs in operating any business are reflected in the final price for the article or service. The consumer must ultimately pay all bills, and in commercial transactions this will include losses through marine disasters. The purpose of marine insurance is to reduce such losses to a statistical basis and to distribute the same equitably over all the interests making up the field of commerce. Vessel and cargo owners are thus enabled to buy certainty with a definitely stated premium. The sum thus paid is regarded as a normal item in the cost of operation, and like any other costs will be included in the price of the goods or service. In this way producers are freed from the burden of carrying uncertain losses, while consumers are made to assume the risks of industry in proportion to the volume of their consumption. This is as it should be, and may be regarded as one of the essential purposes of all kinds of insurance.

Causes the cheapest distribution of loss.—Not only does marine insurance distribute losses equitably to the ultimate consumer, but it materially reduces the amount thus distributed. This is due to the operation of the law of average when applied to a combination of a large number of separate risks. The larger the number of risks assumed, the less uncertainty will there be as to the total amount of loss on all the risks combined; and the less uncertainty of loss, the smaller is the accumulation of money necessary from the many who insure to meet the losses of the few.

Were there no system of marine insurance, the owner of a vessel, if obliged to carry the risk himself, would naturally want as a precautionary measure to increase his freight charges by probably some 10 or 20 per cent. And even then he would be gambling at heavy odds, since an early loss, before his self-insurance fund had reached an appreciable amount, would nearly wipe out his equity. Under marine insurance, however, this vessel owner is enabled to substitute for the great uncertainty confronting him as an individual a certain and definite payment (the premium) amounting on the average to probably not more than one-tenth of the allowance considered necessary under a noninsurance system. The burden of the consumer is limited to this smaller premium, whereas in the absence of insurance it would be substantially increased. By thus eliminating uncertainty, marine insurance greatly reduces the margin of profit. Merchants are enabled to handle goods on a much narrower margin of return, since they are assured of their anticipated trade profits. Vessel owners are no longer compelled to accumulate a substantial fund to meet an uncertain hazard; while creditors, assured of the greater financial stability of borrowers, will feel freer to enlarge their loans and to reduce their rates of interest.

Serves as a basis of credit.—Estimates are to the effect that about nine-tenths of the property values entering commerce represent borrowed funds, and that only about one-tenth is conducted on a cash basis. A hundred bales of cotton, for example, are purchased for $20,000 and are paid for with the purchaser's own capital. If this cotton had first to be shipped abroad and further purchases deferred until remittance of the sales price, only three or four purchases would be possible during the cotton-moving season. Instead, this cotton is at once graded, insured, and represented by a bill of lading, and this bill of lading, together with the marine insurance certificate, will serve as collateral for a loan of approximately 90 per cent of the market value. A new lot of cotton may be purchased immediately with the proceeds of this loan, and this purchase, after being graded and insured, may again serve as the basis for another loan. The process may be continued until the successive cargoes bought on credit, and probably all still afloat, may equal some eight times the original capital of $20,000. The opportunity for profit, it will be seen, is likewise eight times what it would be if business could be transacted only on a cash basis.

The same general process is followed in handling most of the Nation's leading products that enter our foreign and coastwise trade. Moreover, on most of these transactions the margin of profit is very small; in fact, the size of the insurance premium is often a deciding factor as to whether a commercial venture shall be undertaken. Under such conditions it is clear that creditors must insist that adequate protection shall be afforded them against the loss of the goods on which they have a lien. Insurance of the cargoes, assuming the financial reliability of the underwriter, makes the credit transactions as certain as though all payments had been made in cash.