An eye on P&I: A marine podcast from Marsh

Episode 1 History of the P&I Club System, the concept mutuality, formation of the IG – the current Market

[Chloe Taylor]

Hello, and welcome to Episode 1 of "An eye on P&I", Marsh's new marine podcast about P&I clubs. I'm Chloe Taylor, and I'm a Client Manager in Marsh UK's Marine, Cargo, and Logistics practice. Today I'm here with John Trew, our practice's Special Adviser, who also happens to be our resident expert on all things P&I. Welcome John and thank you for joining us today.

So John, in this first episode we're going to be talking about the history of P&I clubs, and the concept of mutuality. Perhaps you could start by setting the scene: when, why, and how did the current P&I system develop?

[John Trew]

Well, Chloe, that's a good question. The first two P&I clubs were both founded in the UK, in 1855. Rather confusingly, one was called The Shipowners' Mutual Protection *Society* and the other was called The Shipowners' Protection *Association*. The first was the forerunner of the current Britannia Club and the second continues, to this day, as the Shipowners' Club – or S.O.P.

Those clubs, though modelled on existing mutual hull clubs, were specifically designed to cover the increased third-party liabilities that shipowners were facing at the time – liabilities for a proportion of the collision risk, not covered under their hull policies, and for personal injury and death claims. Those liabilities were collectively known as protection risks.

Then, due to a court judgment in the 1870s, shipowners unexpectedly found that they were unable to rely on standard exclusion clauses in their bills of lading – and, to make matters worse, cover for those liabilities was rejected by their hull underwriters! So, these new clubs were asked to cover cargo claims as well – the so-called Indemnity risks.

[Chloe Taylor]

So the P (for protection) was joined by the I (for indemnity)?

[John Trew]

Exactly. P&I.

[Chloe Taylor]

But presumably the two 'Shipowners' clubs didn't have the entire market to themselves for very long?

[John Trew]

No, that's right. Even before developments in the eighteen seventies, the continued growth of the British fleet encouraged competition and a number of new clubs entered the field. North was founded in 1860, the UK Club in 1869, and Standard in 1884.

The first club outside the UK was arguably the Swedish Club in 1872 – though it started as a pure hull club. Skuld was founded in 1897, Gard in 1907 and J.P.I.A in 1950.

[Chloe Taylor]

Right, so what would you say were the key elements that ensured the success of these new clubs?

[John Trew]

Well, first and foremost, they satisfied a need – the need to cover risks that previously had been uninsured.

Secondly, the system was based on mutuality. A mutual club was different to an ordinary insurance company: it consisted of a group of like-minded shipowners who were co-insuring their own risks. There were no shareholders in the clubs and therefore no profit element in the premium. The only additional cost – above the cost of the claims – was the fee paid to the company that managed the club. And that's why mutual insurance is often described as 'at cost' cover.

By paying premium into a common fund, which could be used to satisfy claims, shipowners accepted certain risks and benefits. Unlike normal, fixed premium commercial insurance, they faced the risk that the fund wouldn't be sufficient to pay all the claims – and therefore, they might be asked to pay more. But they also shared the potential benefit that, if claims were low and the fund was deemed to be more than sufficient, they could get money back, by way of returns.

[Chloe Taylor]

I see. But isn't it strange that shipowners would want to join a mutually owned club that also insured their commercial competitors?

[John Trew]

I suppose, in a way, yes. But the benefit was also mutual and the system was founded on trust. After all, as a shipowner, you only wanted to share your liabilities with shipowners who presented a similar risk – otherwise, you could easily end up paying the claims of a member who operated sub-standard tonnage and expected you to pick up part of their bill. There had to be a common purpose: a willingness to share risk amongst a select group is inherent in the system. So, if you thought that the quality of the membership in a particular club was poor, you wouldn't join it. On the other hand, if the quality was good, you would join – whether or not those members were your competitors.

[Chloe Taylor]

And presumably that meant that there was a lot of trust being placed in the hands of the club managers?

[John Trew]

Absolutely. The managers decide who can join and who might be asked to leave, and how much they should pay each year. On top of that, the managers handle all the claims. Of course, the managers have to make regular reports to the members' Board, which is the group of shipowners that controls the club's strategy and governance. But, as I shall explain in later Podcasts, a lot is undertaken on trust. And, in essence, one hundred and seventy years later, little has changed.

[Chloe Taylor]

So if the new clubs were competing for members, at some stage they must have started to think about ways to co-operate? How did the claims pooling arrangements come into being?

[John Trew]

Well, at the same time as the number of clubs was growing, so were the liabilities of their respective members. Rising claims created greater volatility. The solution, of course, was to arrange reinsurance. In eighteen ninety-nine, six clubs entered into a Pooling Agreement to share claims in excess of ten thousand pounds. These Clubs were known as the London Group – the forerunner of the current International Group, which now has twelve members and collectively covers over ninety percent of the world's ocean-going fleet.

[Chloe Taylor]

That means the origins of the current pool are actually very old?

[John Trew]

Yes, they are…of course, over the last 120 years, further clubs have emerged, some have disappeared or have merged together, some have grown significantly, and some have dwindled in size. But the basic principles have remained the same. Undoubtedly, the risks they cover have increased – both in type and scale; the clubs now cover charterers' risks as well as owners' – though on a fixed premium, non-mutual basis. And they can cover a number of specialist risks that are only faced by segments of their membership – again, on a fixed premium basis.

[Chloe Taylor]

In many ways, a lot of the change you've described sounds quite superficial. Would you agree with that?

[John Trew]

Yes, I think that the basic concept of mutuality, in all its aspects – at club and Group level – is still very much alive. It certainly works.

[Chloe Taylor]

And now a difficult question for you…do you think that the current system will survive another 120 years?

[John Trew]

Well, that's a very long time – and I'm afraid I don't have a crystal ball! I suppose that a lot could happen to threaten the system, both at a political and a commercial level. Many of the risks are external – but there could be internal threats as well – further consolidation of the market, either through failure or merger - and tensions brought about by differences in the way that shipowners operate.

The rise of the dark fleet could prove to be an omen that combines both those elements. And then there's the possibility of an overspill call – or just the threat of one; that could have implications for the levels of cover offered and raise questions as to the robustness of the overspill mechanism.

In the meantime, however, it must be said that the system works incredibly well; it's vital for global maritime trade and, though not perfect, shows few signs of fraying at the edges!

[Chloe Taylor]

Thanks John, this has been really fascinating! Hopefully we've given our listeners a good foundation on the background of P&I clubs.

[John Trew]

Yes, in the next podcast we'll be talking about the structure of P&I clubs and how they're governed.

[Chloe Taylor]

Perfect, speak to you again soon. And thank you to everyone who's listened to this first episode of An eye on P&I.