

**ADDRESS OF
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to the
MARITIME LAW ASSOCIATION**

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Thank you for giving me the opportunity to share some thoughts about the terrorism threat and the response of the ocean marine insurance industry, particularly the work of the American Institute of Marine Underwriters which I serve as chairman.

Both the AIMU and the MLA share a deep commitment to continuing education and enhancing professionalism.

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I'm sure a review of past MLA conferences since the organization's creation in 1899 would reveal a host of topics that ask a common question: what's been the impact of (name a maritime law and regulation) on marine insurers? Anyone of you here could rattle off a few – the Jones Act, the Carriage of Goods By Sea Act, for example.

In recent years, of course, the Oil Pollution Act of 1990 served as fodder for a myriad of conferences and panels. That law, in large part, was generated by a catastrophic event: the Exxon Valdez oil spill. The federal and state laws, regulations and rules that arose from serious environmental concerns had an impact on marine underwriters and maritime attorneys that was unprecedented in its scope – until now.

On September 11, 2001, a catastrophic event profoundly changed the business and legal environment in which marine underwriters operate. The global effort to combat international terrorism has resulted in a myriad of significant international and U.S. codes, laws, rules and regulations that dwarf anything marine underwriters have seen in the past. This is understandable and proper.

The scope of this effort and the enormous stakes involved demand a vigorous and thorough response by government, business and every profession.

Today, I'd like to briefly review the nature of that threat, discuss some of the significant international and domestic measures enacted to enhance transportation security – particularly how they impact marine insurers – and the response of the marine insurance industry to this new environment.

Two years ago it became abundantly clear – not only to those involved in maritime trade, but to those entrusted with our national security – that our national transportation infrastructure was vulnerable to terrorist attack. Moreover, it was understood that the disruption of this infrastructure would have a catastrophic effect on the nation's and the world's economy.

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Here are a few facts from the National Cargo Security Council:

- 95 percent of U.S. trade moves by water.
- Nearly 8 million loaded containers arrive and are offloaded at U.S. seaports each year.
- That's 21,000 containers every day.
- Nearly 5 million containers pass through U.S. seaports carrying export cargo.
- A typical cargo transaction (end-to-end supply move) can involve 25 different parties and 30 to 40 different documents.
- A typical container ship sailing 80 percent full may carry as many as 3,000 containers of various sizes.

- The value of container trade moving through U.S. seaports is estimated at \$737 billion annually.

These are big numbers. Staggering sums. Here's another number – a much smaller one – of equally staggering impact.

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- Less than one percent of shipped cargo is screened worldwide.

There is some good news on the inspection front. The commissioner of customs recently reported that two years ago only two percent of marine containers entering the United States were inspected. Today, that number has more than doubled to 5.2 percent. We've got a long way to go to be sure, but significant progress is being made.

As an independent task force of the Council on Foreign Relations reported earlier this year, the shipping container can serve as an adjunct to terrorism – a means of illicitly transporting people and materials. But designing an adequate response to this threat is complex and expensive.

The U.S. Coast Guard has estimated that implementing new maritime security regulations will cost \$7 billion over the next decade and affect 10,000 vessels, 5,000 facilities, 36 port and 40 offshore facilities.

But as U.S. Coast Guard commandant Admiral Thomas Collins has stated: "A terrorist incident against our marine transport system would have a serious and long-lasting negative impact on global shipping, international trade and the world economy."

The U.S. laws and regulations are addressing this issue in a number of ways. They are part of a strategy that recognizes that the first line of defense against

terrorism cannot begin at U.S. ports and borders and that the availability of insurance against terrorism is vital to the economy.

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Maritime Transportation Security Act

Let's begin with the Maritime Transportation Security Act of 2002. The law requires that the Coast Guard will assess U.S. ports for vulnerability to terrorism, with the results used to implement a comprehensive maritime security plan and specific area plans.

The security systems in foreign ports also will be assessed. The legislation provides unilateral authority for the U.S. to deny entry to vessels from ports that do not maintain effective security.

As you might guess, this could become a sticky issue. The U.S. rules largely parallel security standards and voluntary guidelines adopted by the International Maritime Organization (IMO) at its December 2002 conference.

The U.S. Coast Guard is trying to minimize any inconsistencies between the mandates of the act and IMO's directives. It has been reported that some in Congress are unhappy that under the interim rules the Coast Guard is willing to accept International Ship Security Certificates from foreign governments as evidence of compliance with the law.

Container Security Initiative

The Container Security Initiative was developed to "push back the borders" through a set of bilateral agreements with trading partners by targeting high-risk cargo containers.

The CSI:

- Uses intelligence and automated information to identify and target high risk containers.
- Pre-screens those containers identified as high-risk at the port of departure before they arrive at U.S. ports.
- Uses detection technology to quickly pre-screen high risk containers and
- Uses smarter tamper evident containers.

The number of participating ports throughout the world is growing beyond the initial 20 major locations.

Enhanced Border Security and Visa Entry Reform Act

As with cargo, more detailed information than ever before is being required on passengers and crew. The Enhanced Border Security and Visa Entry Reform Act of 2002, requires the electronic transmission of passenger and crew manifests for inbound and outbound commercial carriers to the Advance Passenger Information System.

OFAC and the Patriot Act

Long established regulations which aim to hurt enemies of the United States through trading and economic sanctions gained renewed emphasis after 9/11 with the passage of the Patriot Act. Under these regulations administered by the Office of Foreign Assets Control, U.S. insurance companies and other businesses face potential fines, and even jail time, for failing to screen the names of claimants against a government list of potential terrorists. This list is maintained by OFAC.

The OFAC list, which contains some 5,000 "Specially Designated Nationals and Blocked Persons," such as foreign agents and front organizations, terrorists and

narcotics traffickers, has existed for 24 years. Its use was reinforced by an executive order issued by President Bush on September 14, 2001.

OFAC requires that before any financial transaction, including the payment of an insurance claim, the name of the customer must be checked against the list. If an insurance claimant is on the list, the claims-payer must notify OFAC. If they don't and it turns out that they are making a prohibited transaction, they face fines of up to \$1 million and up to 12 years in jail.

Among other examples of prohibited insurance transactions listed in a Treasury Department bulletin on OFAC are:

- A life insurance policy naming a Cuban resident as beneficiary.
- A reinsurance contract for policies underwritten in whole or in part by the Arab Commercial Insurance Company of the Channel Islands, named as a Specially Designated National of Libya.
- An aviation policy issued to a non-blocked foreign airline but which names as an additional insured another bank with a Libyan connection.

The bulletin warns that "All U.S. insurance companies and U.S. citizens and permanent resident aliens who are employees, officers or directors of U.S. or foreign insurance companies need to be aware that they may be held accountable for sanctions violations."

Marine insurers are concerned that the U.S. government has not provided sufficient guidance as to what level of due diligence is necessary to prevent substantial penalties for inadvertent failure to comply with the regulations.

AIMU has asked OFAC to add the impediment to compliance caused by lack of access to information as a "mitigating factor."

I also want to point out that property/casualty insurers -- for now at least -- are temporarily deferred from the enforcement regulations of the Patriot Act of

2001. This measure requires financial services companies to screen and spot money-laundering activities that finance terrorism. The enforcement regulations are still on the Treasury Department's "pending" agenda.

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TRIA

All property/casualty insurers, including marine insurers, do come under the Terrorism Risk Insurance Act of 2002 or TRIA, better known to us as the terrorism backstop. The measure is meant to increase the ability of businesses to obtain terrorism coverage.

Basically, the law provides for the federal government to share with the commercial insurance industry the risk of loss from future terrorist attacks. Each company has a retention (or deductible) which represents its share of terrorism losses that must be paid prior to any federal payment

The measure requires insurers subject to the act to make terrorism coverage available.

The program covers losses from terrorism which occur within the United States. It does not generally apply to losses which occur outside the U.S. with the exception of those which occur to U.S. citizen-operated air carriers, U.S. flag vessels and foreign flag vessels home-ported in the United States on which U.S. income tax is paid and whose insurance coverage is subject to regulation in the U.S.

TRIA allows exclusions for nuclear, biological and chemical risks.

Still, complex implementation issues remain to be resolved by all p/c insurers, in conjunction with the Treasury Department and state regulators. Only

time will tell how the law affects the marketplace. And the clock is ticking. TRIA is set to expire at the end of 2005.

OPA '90

And now I come full circle – back to the Oil Pollution Act of 1990. This measure holds the source of an oil spill strictly liable for cleanup costs and damages. There are defenses for acts of God, war or a third party. But what about terrorism as a possible defense to the ship owner?

Some believe such a defense can be inferred from the act, although it's not cited. From a marine insurers' point of view, we'd prefer to see such a defense specifically spelled out. Such a defense has taken on greater importance with the recent decision of U.S. District Court Judge Alvin Hellerstein which allowed litigation to proceed against the airlines and others with roles in the 9/11 events on the basis that they may have been negligent in failing to prevent the losses on that day.

My brief review has spared you a few more acronyms. But it's pretty clear that the first thing faced by marine underwriters is education and communications on these measures. They also need administrative support to help in compliance and they also need new underwriting tools -- clauses and exclusions -- so they can assume the risks that are truly insurable. Through the AIMU, the marine insurance industry has responded effectively to these challenges.

Probably the most significant impact that the effect of terrorism has had on the marine market is manifested in the development of new clauses and endorsements which clarify and sometimes restate coverage in light of the terrorist threat and reflect the new world of TRIA, OFAC and the Patriot Act.

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AIMU's Forms and Clauses Committee developed an Extended Radioactive Contamination Exclusion Clause and a Chemical, Biological, Bio-Chemical and Electromagnetic Exclusion. While TRIA does not require coverage for NBC, as nuclear, biological and chemical risk are known, we thought it best to make the exclusion absolutely clear.

The extended radioactive contamination exclusion clause explicitly excludes coverage for radioactive contamination from various sources:

These include nuclear fuel and waste, nuclear installations and reactors, any weapon or device employing atomic or nuclear fission or fusion and the radioactive, toxic, explosive or other hazardous or contaminating properties of any radioactive matter – a dirty bomb. The exclusion does not extend to radioactive isotopes, other than nuclear fuel, when they are used for commercial, scientific, medical and agricultural purposes.

Similarly, the chemical, biological, bio-chemical and electromagnetic exclusion clause excludes damage or liability from an actual or threatened act involving these types of weapons, devices or materials.

As the risk of terrorism in the Open Cargo Policy is addressed in the Strikes Riots and Civil Commotions (SR&CC) warranty, AIMU felt it appropriate to take a fresh look at the coverage.

As a result of this review, a new SR&CC endorsement-- Form Number 11 -- was developed. It restates and clarifies that the insured goods are covered while in the ordinary course of transit, but no longer than 60 days after completion of discharge from the vessel or 30 days from an aircraft. This limits the carrier's exposure to loss while the insured cargo is sitting in a port facility.

In addition, AIMU authored Form 11A – the TRIA Form. It simply removes the exclusion for coverage of “insured losses” that would otherwise be covered under the endorsement caused by certified acts of terrorism as defined by TRIA.

Finally, AIMU has developed an Economic and Trade Sanctions clause for all lines of business (cargo, hull and liability). Let’s call it the OFAC clause. The clause states that whenever coverage provided by the policy violates any U.S. economic or trade sanctions, such as those enforced by OFAC, that coverage is null and void.

The Department of the Treasury’s instruction to the insurance industry is that an insurer decline business involving SDNs or structure the policy to exclude risks within the geographical limits of embargoed countries. OFAC will not offer an opinion regarding specific policy language. But its enforcement guidelines indicate that penalties will be lower for those making good faith efforts to avoid violations.

To further assist its members, AIMU has sponsored a special OFAC compliance training program.

In addition, working with a software vendor, AIMU has helped tailor a compliance product for marine underwriters to cross-check claimants against the OFAC list of “SDNs”.

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AIMU also has conducted educational seminars on terrorism and the impact of “9/11” on the transportation industry to create greater understanding among marine underwriters on the new environment in which they operate.

To supplement these educational efforts with the latest developments, AIMU regularly updates its members on changing regulations and rules through articles in its "Weekly Bulletin."

All this work is done with a common objective in mind – to create an environment in which marine underwriters can grow and prosper while providing vital financial protection to ships and their cargos. The strengths and vulnerabilities of the worldwide system of maritime trade are under closer scrutiny than ever before.

Protecting that system from the threat of terrorism requires a partnership of government with all components of maritime trade. Marine underwriters – working in concert with groups like the MLA -- are proud to be part of that effort. Thank You.

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