

# Insurance Fraud



*A recession-driven inevitability?*

*The recession may have come to an end in most parts of the world, but here Nick Smith of Charles Taylor adjusting warns there could be hidden hazards as things return to normal. He looks at recession-effect on insurance and suggests it's when – not if – we will see a fraudulent superyacht claim.*

Superyacht owners reacted to the economic slowdown in a rational and responsible manner – much to the disappointment of some newspaper editors. Journalists like to see the super-rich on their knees but, by and large, the most dramatic scenarios simply did not occur. Unlike some purchasers of smaller vessels, superyacht owners buy within their means (*well, most do – Ed*).

Although some purchases have admittedly entailed eye-watering finance deals, superyacht owners are generally by nature sophisticated enough to know what they are doing. The financial overstretching backed by real estate values (long since gone), prevalent in certain sectors of the small-to-medium sized yacht business, has not become the norm in our market.

By contrast, there has been a genuine increase in questionable and downright fraudulent insurance practices involving financially distressed owners of yachts below 24 metres. Adjusting and investigation companies such as ours have seen the number of fraudulent, inflated claims and scuttling cases rise steadily and dramatically since the end of 2008, with no end apparently in sight. Incidents of owners arranging to have their boats 'stolen' has become so common as to become tedious. I am not, however, aware of any of this applying to superyachts...yet.

That is not to deny there have been very real difficulties. As widely reported, superyacht prices have fallen by about 35%, usage has dropped, the yachts have spent more time out of active service than normal and the bottom has fallen out of the charter market. There have been the inevitable knock-on effects in terms of crews laid off and less work for the yards, and a few individuals have found their vessels something of a financial burden. Superyacht repossession was inevitable and, however frilly the language used to describe it, will certainly remain with us for the foreseeable future.

Somewhat mirroring trends in the shipping industry, it is clear that a number of individuals tried to delay or cancel new-builds or simply chose more modest fit-outs. Whilst this practice has been less prevalent than among shipowners, it is still a far cry from two years ago when yards were booked four years in advance, with buyers gazumping each other to jump the queue.

Italian superyacht builders have suffered a particularly sharp downturn in business, although the Dutch and German yards have fared better and the smaller UK sector is actually rapidly expanding. When it comes to those superyachts that are being built – and according to a recent edition of *The Yacht Report* there are nearly 500 in the pipeline (see issue 110) – many

owners are cutting back on extras such as top-of-the-range interiors. This sort of spending cut may be a disappointment to those suppliers it concerns, but it is hardly a picture of desperation.

The consensus at last year's Monaco Yacht Show, a good occasion to use as a barometer, was that the market had bottomed. The boom times are not returning any time soon, but at least we avoided meltdown. Realistic optimism is the name of the game.

In some respects the economic slowdown has proved a blessing in disguise. Insurance is much cheaper, partly because rates have dropped but also because vessels have lost value and therefore require less cover. Despite the loss of the *Lady Michelle* in the Bahamas, there have actually been fewer accidents involving superyachts, presumably reflecting lower usage.

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Meanwhile, it is easier and less costly to get into yards for repairs, and the shortage of skilled crews, although still a factor, is significantly less acute.

All in all, the superyacht sector has weathered the storm better than many others and we can reasonably expect calmer waters ahead. It is, however, worth sounding a note of caution. There may be hidden hazards to negotiate even if the global economy returns to some kind of normality. Firstly, 'repossessions' will not end immediately. Clients bought slots at well-known yards at the top of the market to stay ahead of the pack. They are now only too well aware their yachts will never again be worth what they paid for them. Most pundits agree that superyacht values will stabilise, but the idea of inflation making them a profitable investment is history.

Secondly, and please bear with me as I provide an overview of how the marine insurance market works, there may be an increase in illegal and unscrupulous practices by some financially stressed owners. Most marine insurance policies taken out on superyachts are on an "Agreed Value Basis". The term is explained within the English Marine Insurance Act 1906, but broadly speaking, if an underwriter and an owner agree on a value of the yacht, then that is fixed between them and, unless there is fraud, it cannot be re-opened. As will be noted from the date of the Act, marine insurance is much older than the large-yacht industry. The practice of "Agreed Value" came



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## FRAUD | AN IMPACT OF THE RECESSION

about where ship values fluctuated depending upon trade but marine mortgages remained the same.

For example, an owner might buy a bulk carrier for US\$10 million in a particularly good year. He raises a mortgage or two against the ship in the amount of US\$8 million. His broker approaches his underwriter who agrees to insure the vessel for 10. Two months later the vessel sinks. The underwriter pays the full US\$10 million. However, what if 10 months into the policy the vessel sinks? The bottom has fallen out of bulk carriage rates and the vessel is worth less than US\$5 million on the market but the underwriter still pays 10. "Agreed Value" policies have for centuries encouraged some unscrupulous owners to attempt to scuttle their own vessels.

The reasons have been numerous and personal: the vessel needs repair beyond the owner's means or beyond economic sense; the vessel was designed for a specialist trade that no longer exists; the mortgage payments are too high. The list is endless. Any review of law reports under the word "scuttling" brings forth numerous cases (some including yachts) reaching back centuries.

As I have explained above, scuttling of small-to-medium sized yachts on "Agreed Value" policies has been on the increase for nearly two years. Could it be that there is a superyacht owner out there for whom the temptation becomes too great? I believe the answer must be "yes". Superyacht owners have not faced a crisis on this scale before, so there is no previous history to guide us. They are, however, exposed to the same temptations as some shipowners were before them.

Thirdly, there is a question mark over the way some superyachts may have been maintained during the economic slowdown. On the whole superyacht owners have been fairly conscientious in this respect – especially when compared to some

of their commercial or small-yacht brethren. Nonetheless, one of the reasons some yards are struggling to find work is that refits and other work have been delayed. Will this make some yachts less reliable and less safe? Only time will tell but it is a situation to watch closely, particularly if you are an underwriter.

are gone. Insurance rates are very low and owners should realise that in the event of claims, losses are arguably more heavily scrutinised now than ever before.

Overall, the superyacht sector has navigated the global slowdown in a controlled way. The next few years

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Next, how easy will it be to retrieve the skills lost to the industry through lay-offs of crews and masters, for example? Will they be readily available or will they have found other avenues of employment? Lastly, and back to insurance arrangements again, superyacht values will recover lost ground as the economy picks up. If an "Agreed Value" was reduced, in the future it's easy to become under-insured if not re-agreed when values start to regain some lost ground. Under-insurance may not invalidate your policy but in the event of a total loss you will lose out. Additionally, certain sections of the policy may be subject to "average". This means you recover only a proportion of your loss.

On the whole yacht insurance is currently a buyer's market. However, as with any purchase, make sure you are getting what you need, not just what you pay for. Not all policies are created equal. The days of a couple of globally recognised sets of clauses

will certainly see their numbers grow steadily, whilst the biggest and most expensive may well exceed what we have known to date. The unanswerable questions are how long will this take, and what will it take to get there?

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