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3

Organizational Choice in UK Marine Insurance

Robin Pearson and Helen Doe

During the eighteenth and early nineteenth centuries there were three principal forms of organization in British marine insurance: individual underwriters working at Lloyd's or the outports, two large chartered corporations in London, and small mutual associations of shipowners in London and provincial ports. The two corporations, the Royal Exchange Assurance and the London Assurance, enjoyed monopoly privileges granted by the famous Bubble Act of 1720, by which no other stock companies or partnerships were permitted to write marine insurance. Other organizational vehicles were added when the Bubble Act was finally repealed in 1824, including new unincorporated joint-stock and mutual companies and new 'protection and indemnity' (P&I) clubs that evolved from the older shipowners' associations. The growth and internationalization of one of the P&I clubs, the Steamship Mutual Underwriting Association of 1909, is examined in the fourth section below.

At times the issue of what was the best organizational vehicle to deliver marine insurance became a hotly debated topic both within the industry and in parliament. The questions that this chapter addresses are: why did these different organizational forms emerge; what were the relative advantages and disadvantages that might explain their subsequent performance; and what conclusions can be drawn from this history that have relevance for organizational theory?

EARLY MARINE INSURANCE: FINDING SOLUTIONS TO THE PROBLEM OF ADVERSE SELECTION?

By 1700 maritime insurance had diffused from the Mediterranean to the Atlantic, Baltic, and North Sea routes and specialist communities of underwriters had

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emerged in northern Europe. Edward Lloyd's coffee house in London became the most important of several places where underwriters, brokers, and shippers exchanged the latest commercial news and did business. Lloyd's was the first coffee house systematically to collect intelligence on shipping movements and political developments affecting trading routes. Some information came from customers, some from runners employed by Lloyd's on the docks, some from correspondents paid to collect shipping news from English and foreign ports. Lloyd's also had an arrangement with the Post Office by which, in return for an annual fee, letters were delivered free of postage and sorted for collection by a Lloyd's messenger. From 1692 a weekly newspaper that collated the latest information relevant to brokers and merchants was issued by the coffee house, the forerunner to *Lloyd's List* (published from 1734).[1] These features of the early market indicate that good information was critical for the success of durable and large-scale marine underwriting. Maritime risks were extraordinarily heterogeneous, differing by type of ship, crew, route, sea currents, weather, and by political factors affecting the routes. The market was especially volatile during the Anglo-French wars of the 1690s and 1700s, when ships were vulnerable to attack by enemy navies, privateers, and pirates and when marine underwriting was subject to 'many frauds and deceits . . . to the great discouragement of the fair traders and navigation'.[2]

Notwithstanding such uncertainties, the market grew. In 1720 about 150 marine underwriters in London were joined by the two new stock corporations noted above.[3] In the months before their incorporation, the petitions of the two groups of promoters were met with counter-petitions from hundreds of merchants and underwriters in London and Bristol. The arguments reveal what contemporaries considered to be the advantages and disadvantages of different ways of organizing marine insurance at this time.[4] A corporation, the promoters claimed, offered three advantages over private underwriters: first, its large capital fund would provide greater security for merchants; second, it could offer lower premium rates; third, a corporation would make it easier for merchants to make claims, in so far as a law suit could be brought against one body in its corporate name, in contrast to the trouble and expense of suing each individual who might underwrite the policy at Lloyd's.

The counter petitioners argued, first, that the existing market arrangements provided marine insurance more efficiently and more cheaply than anywhere else, and that this attracted many foreign merchants to buy their insurance in

[1] McCusker 1991.

[2] Citing a merchants' petition to the English parliament in 1700 for a bill 'to prevent fraudulent insurance'. *Journal of the House of Commons* 13, 19 February 1700–4 April 1700. No details of the bill have been traced. The bill passed through three readings in the House of Commons but failed to win the final vote. On the impact of war on marine insurers in the 1690s, see Raynes 1948, 98–9.

[3] Estimate from Cockerell and Green 1994, 5.

[4] Raynes 1948, 102–3.

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London. Second, a corporation would discourage brokers from seeking out persons of 'good substance' to underwrite policies. This would inevitably lead to a monopoly. As to the supposed superiority of a capital fund, the counter petitioners pointed out that a corporation 'has no sense of shame'. In other words, because it was answerable to its shareholders, it would not operate on the same basis of reputation and trust that underpinned the business of the private underwriters. Furthermore, the counter petitioners claimed that the real motives of the investor syndicates behind the petitions was to job stocks for their own personal gain, part of the wave of speculative promotions in 1719–20 that became the infamous South Sea Bubble.

In the end, charters were sold to the two insurance groups as part of Robert Walpole's plan to reduce Crown debt and a bill was passed to this effect. All other partnerships and stock companies were henceforth banned from doing marine insurance.[5] Thus the 'Bubble Act' gave the two London corporations a legal monopoly on corporate marine insurance until it was repealed in 1824. Shortly after the act was passed, the bubble burst. As their shares lost value, both corporations sought additional charters to permit them to write fire and life insurance, without monopoly rights. Table 3.1 indicates that marine insurance, although much more volatile than other lines (see the coefficients of variation), remained the staple business of both corporations through the rest of the century. Yet they probably never captured more than 10 per cent of British marine insurance at any time. In 1809 together they insured 3.8 per cent of the £162.5m insured. A further 14 per cent of marine insurance was written outside London, in English and Scottish ports. Lloyd's transacted most of the rest.[6]

Why did corporate competition not drive out the private underwriters as the latter had initially feared? Different and to some extent competing explanations have recently been offered. Kingston has argued that information asymmetries and agency problems inherent to contemporary overseas trade hold the answer.[7] Marine risks remained highly discrete, particular to one ship on one voyage with a specified route and cargo and often subject to deviations from the standard terms. The accurate evaluation of risk required reliable information about the reputation of the merchant applying for insurance, the condition and size of the vessel, the nature of the cargo, the expertise and character of the captain, the number and quality of the crew and armaments, sea and weather conditions en route, political conditions and the likelihood of war, the danger of capture by enemy ships, privateers, or pirates, and risk of

[5] Supple 1970, 30.

[6] Calculated from *Select Committee on Marine Insurance* 1810, report 6. Kingston has estimated that the average market share of the two corporations between 1800 and 1823 was just 6 per cent. Kingston 2007, 384.

[7] The following is based on Kingston 2007 and 2011.

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Table 3.1. Marine and fire insurance premiums of the two London corporations, 1720–1819

Royal Exchange Assurance			London Assurance		
Gross premiums £ (annual averages rounded)			Premiums net of returns £ (annual averages rounded)		
	Marine	Fire		Marine	Fire
1761–65	36,000	10,700	1720–9	26,500	3,331
1766–70	18,400	14,700	1730–9	20,191	5,477
1771–75	23,000	19,200	1740–9	55,837	5,554
1776–80	76,500	20,300	1750–9	54,690	6,233
1781–85	116,500	29,100	1760–9	33,719	6,984
1786–90	73,900	28,800	1770–9	18,838	7,583
1791–95	155,200	45,800	1780–9	32,320	6,316
1796–1800	275,100	64,000	1790–9	52,241	6,901
1801–05	165,000	79,800	1800–9	56,420	8,251
1806–10	220,200	72,900	1810–19	128,454	8,878
SD	86,933	25,425	SD	31,979	1,576
CV	75.0	66.0	CV	66.7	24.1

Note: SD = standard deviation (£); CV = coefficient of variation (%). Gross marine premiums include returns. Supple 1970, table 3.1 states that the Royal Exchange's returns averaged just over 25 per cent of gross marine premiums in 1796–1815. Life assurance income was much smaller than fire or marine for both corporations until after 1800.

Sources: Supple 1970, 62, table 3.1, 61 n.2: London Metropolitan Archive, Ms 8735, London Assurance, Board of Directors' Minutes, 1721–1820; London Metropolitan Archive, Ms 8746A, London Assurance, Fire Assurance Annual Account, 1721–1854.

seizure while in a foreign port. Such discrete risks to be underwritten profitably required a good flow of information between merchant and insurer to minimize the problems of adverse selection and moral hazard. The latter could range from excessive risk taking by the insured to outright fraud, such as the deliberate wrecking of an insured ship, misrepresenting the value of cargoes, insuring the same goods or hulls more than once, or seeking to insure a ship already known to be lost.

Individual underwriters, who were often merchants themselves, were in a good position to evaluate information flows. Coffee houses and the brokers' offices in and around the Royal Exchange provided hubs for merchants and underwriters to exchange information about shipping movements, the supply of goods, issues with masters and crews, or political developments overseas. Regular flows of shipping intelligence from around the world were gathered in *Lloyd's List*, and later in *Lloyd's Register of Shipping* (established in 1760). Within Lloyd's, underwriters' specialization in particular routes enhanced the quality of information and risk assessment. As the link between merchants and underwriters, brokers had an important monitoring function that could enhance levels of trust. Reputable brokers could get policies written more quickly and cheaply than others, so merchants valued their relationship with

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them. The credit mechanism provided another metric by which trust could be measured. Underwriters often gave brokers a year or more to collect the premiums from their clients, while in turn brokers granted credit to merchants. Brokers received percentage shares of premium income and net underwriting profits as their customary fee, so they had an interest in this credit system. It was also in the underwriter's interest to maintain a credit balance with the broker, for if a loss should occur a proportion of it would fall on the broker. Thus, all market players had incentives to avoid acting opportunistically and to maintain a reputation for prudence and honesty. In sum, underwriters developed formal and informal institutions that helped to mitigate the problems of asymmetric information, agency, and transaction costs that accompanied overseas trade.

The capital funds of the stock corporations were no substitute for good information. According to Kingston, asymmetric information problems outweighed the greater security provided by large capital resources. The best risks insured with the private underwriters who charged lower premiums than the corporations because they were better placed to recognize risk quality. This left the corporations with poorer risks, forcing them to raise their premium rates, which in turn induced more of the better risks to go to Lloyd's. The market, therefore, was characterized by multiple equilibria, where the better risks were insured by private underwriters at lower rates, while corporations charged higher rates for worse risks. The corporations were also less informed. They were not allowed to write lines on Lloyd's policies, so they had to issue their own policies with their own terms and conditions. Moreover, their underwriters did not interact on a daily basis with those at Lloyd's and did not benefit from their social and business networks.

Leonard has challenged this view.[8] He claims that 'opportunities for knowledge shortfalls' were 'limited' in the small and well-informed London marine insurance market of the eighteenth century, where 'information was as complete as perhaps is possible'. At least one of the London corporations subscribed to the Lloyd's publications—a point that Kingston also makes—and regular interaction between the corporations and brokers operating in Lloyd's would have minimized any information disadvantages that the former may have laboured under.[9] According to Leonard, the principal reason for the corporations failing to capture a larger share of the marine insurance market was their cautious risk selection and high pricing policy, reflecting their 'limited appetite for marine risk'.[10]

[8] Leonard 2013, 52–3. [9] Kingston 2007, n.71.

[10] Leonard has subsequently conceded that there may have been a 'lemons' problem in marine insurance, but insists that the corporation's pricing policy was the more important factor in shaping the market. Personal communication, Adrian Leonard to Robin Pearson, 21 January 2014.

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We cannot be absolutely sure of the reasoning behind the corporations' approach to marine insurance—the records of both corporations were extensively destroyed by fires in 1748 and 1838. Nevertheless, it seems that the corporations did become more conservative in their marine underwriting over time. Their premiums were 20 to 30 per cent higher than Lloyd's by the end of the eighteenth century. Following several frauds, they became reluctant to insure cross risks—ships sailing between two foreign ports—and they refused to cover the risk of seizure in a foreign port. They placed low ceilings on the amount they would insure on a single risk, restricted the deviations permitted from the planned routes of ships they insured, and made a greater fuss about establishing the identity of claimants after a loss. Such lack of flexibility appears to have pushed merchants to insure at Lloyd's. Because Lloyd's captured a large part of the market, this further discouraged the corporations from raising their acceptance limits. Evidence of cautious underwriting and a high pricing policy, however, does not necessarily undermine the argument that the corporations suffered under asymmetric information problems of the type that Kingston identifies. If information flows in the London market were as perfect as Leonard claims, and eighteenth-century shipping as predictable, presumably there would have been little need for Lloyd's to invest in the *List* and the *Register* and an expanding network of agents in overseas ports. Presumably also the corporations would have been able to charge lower—not higher—premiums for their carefully selected risks. As Table 3.1 indicates, however, the corporations' appetite for marine insurance risks was not so 'limited' that it precluded these from becoming by far the largest part of their business. While some merchants may have purposefully chosen to pay higher rates for insuring their quality risks with the corporations because of the perceived security of their capital, it is not improbable that the corporations also, inadvertently, picked up some lower-quality risks that could not find cheaper insurance in Lloyd's. At the same time, some of the poorer risks also appear to have been accepted at Lloyd's if they were bundled up by brokers with better quality insurances. A witness to the Select Committee on Marine Insurance of 1810 argued that the greater opportunity to insure inferior risks at Lloyd's also attracted most of the better risks to Lloyd's, as brokers knew that the former would only be accepted by underwriters in conjunction with the latter.[11]

Legal developments also likely played a role in shaping the organizational structure of marine insurance by reducing the risks and costs of insuring with the private underwriters. First, the principle of insurable interest was enshrined in statute in 1746 after mounting concern about marine insurance

[11] Cited by Supple 1970, 189.

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frauds.[12] Second, Lord Mansfield, Chief Justice of King's Bench 1754–88, developed the principle of 'utmost good faith' as the basis of all insurance contracts. In a series of judgements Mansfield tried to remove the dangers of concealment and misrepresentation and to eliminate the legal requirement for the insured to bring an action against each individual underwriter separately in the event of a disputed claim.[13] Lloyd's also benefited from the exclusive privileges of the corporations, which prevented other stock companies from entering the market. The ban on marine reinsurance imposed by the 1746 statute drove the market towards coinsurance, the basis of underwriting at Lloyd's. The lack of a reinsurance facility restricted the capacity of the corporations to accept the larger risks. For shipowners who wanted as much cover as they could get, the high transaction costs of taking out one policy with one of the corporations, and then searching for the remaining cover elsewhere, seems to have been a disincentive for many, if they could get all their insurance needs more easily and more cheaply through a broker at Lloyd's.

During the American and French wars in the final quarter of the century demand for marine insurance rose. The number of subscribers at Lloyd's rose from 179 in 1775 to over 2,000 by 1801.[14] This expansion accelerated the development of formal institutions at Lloyd's. A standard policy form was introduced in 1779 and a method of claims settlement was developed to ensure that losses were promptly paid by brokers. The previously ad-hoc Lloyd's committee began to produce annual reports from 1796. New corresponding agents were appointed, 269 of them by 1820. A deed of association was drawn up in 1811 to formalize the committee's powers and responsibilities, which included the right to elect subscribers and to represent the underwriters as a group. These institutional changes helped secure Lloyd's as a world centre for marine insurance.

SHIPOWNERS' MUTUAL ASSOCIATIONS: THE PRIMACY OF RISK SELECTION

During the late eighteenth century a number of mutual shipping insurance associations, or 'hull clubs', were organized by shipowners among collier and fishing fleets of the northeast and southwest and in the London timber and coal trades.[15] Having no capital and no transferrable shares ensured that they

[12] *Journal of the House of Commons* 19 Geo. II, 1746, *c.* 37 and see the debate on marine insurance in the *Journal of the House of Commons* 14 Geo. II, 1740, 180–200.

[13] Raynes 1948, 163–4; Oldham 2004, 174.

[14] Kingston 2007, 389.

[15] See, for example, the advertisement in 1785 for a new mutual shipping insurance society in North Shields, *Newcastle Courant* 11 June 1785.

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did not fall foul of the corporations' monopoly. Raynes suggests that there were about twenty such associations around 1800, including several in Sunderland, Whitby, Shields, and Newcastle. They averaged about eighty to 100 members, all owners or part-owners of one or more ships.[16] It is probable, therefore, that these mutual associations evolved from, or were directly influenced by, the customary fractional shareholding form of shipownership that was later regulated by maritime law. Under this system each ship was held to be a separate enterprise divided into a number of transferable shares.[17] Each share owner was regarded as a joint-adventurer or 'tenant-in-common'. Thus, they had a closer and more direct relationship with their asset than was generally the case with shareholders in ordinary stock companies. The majority of owners were actively involved in the trades that their ships undertook, often appointing a manager, or 'ship's husband', from among their own ranks.[18] Forming an insurance club together with other local owners to cover their risks and handle claims may have been a natural extension of the business of shipownership for many.

Some associations had rules stating that if membership fell below twenty, they would automatically dissolve.[19] Some fixed a term for their business, for example twenty-one years in the case of the associations in North and South Shields. They usually elected a committee each year to manage their affairs, insured only hulls, and issued twelve-month policies, balances being settled at the annual meeting of members.[20] The system was therefore geared to coastal and short-sea trades, where multiple voyages could be made within a year, rather than to long-distance ocean shipping. Indeed, the associations in Shields excluded the winter months between November and February from their cover because of the icing up of the Baltic Sea.[21]

[16] The Unanimous Association of South Shields, established in 1786, had ninety-one members by 1794. The London Union Society of 1803, also in the coal trade, had around eighty members in 1810, insuring about 100 ships. The Unanimous Association for the Mutual Insurance of their Ships, *Articles of Agreement, 3 January 1791* (South Shields, 1794); Raynes 1948, 186–7.

[17] A maximum of sixty-four shares and thirty-two owners per ship was fixed by the Registry Act, 4 Geo. IV, 1823, *c.* 41, but before this, and even after the legislation, a remarkable range of different fractions were used. See Jarvis 1959. For the relationship between this form of ownership and the earliest joint-stock companies in UK shipping, see Freeman et al. 2007. Boyce 1992 shows how the 64th system and private capital, raised through local networks, continued to characterize the finance of shipping companies into the early twentieth century.

[18] Doe 2013; Freeman, Pearson and Taylor 2007, 577–8.

[19] The Union Association for the Mutual Insurance of their Ships, *Articles of Agreement, 12 January 1786* (North Shields, 1790).

[20] Some mutual associations for cargo insurance, however, were also established. Cf. *Copy of Articles of the Tyne Cargo Insurance, established in North Shields, May 28th 1799* (North Shields: W. Kelley, 1799).

[21] Echoes of this practice can be found in today's P&I clubs—discussed below in the fourth section—where the underwriting year and club membership begins on 20 February, the traditional date for the opening of the Baltic Sea.

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The constitutions of most associations contained provisions for monitoring the quality of risks insured. Members were admitted by election and had to 'enter an interest . . . nowhere else insured' in ships or parts of ships to a given value, for example £800 in the case of the Union Association of North Shields, £1,400 in the Unanimous Association of South Shields. All ships proposed for insurance had to be of a minimum value—£1,000 in North Shields, £1,800 in South Shields. In the latter association ships had also to be 'British built . . . and not trading from Sunderland'. Inferior and badly built vessels were not accepted and an annual inspection of insured ships was carried out. Any repair and maintenance work required had to be carried out within a given period, or members faced expulsion and a loss of cover. Details of the vessels insured—size, value, master's name—were entered into a register and attested by the member concerned and the managing committee. Ships engaging in 'unlawful' or contraband trades were excluded, as were ships in the Greenland trade, or ships 'when carrying stones, rock, salt, or iron ore, or when lying on the main shore'. Vessels going to the East and West Indies were required to be 'sheathed' (against worms), or their insurance was void. In wartime there were further stipulations about the number of cannon to be carried and sailing in convoys.[22]

There were also limits to the cover provided—£700 in North Shields, £1,200 in South Shields. Thus, members had to carry a significant amount of self-insurance, 30 and 33 per cent respectively. Later the general rule was to confine insurance to three quarters of the value of a hull. Expenses and losses were met from a central fund accumulated from the annual subscriptions of members, which were proportionate to the sum insured. Not all associations were clear about the liability of individual members, but in North Shields they were liable to pay for losses in proportion to the number or parts of ships they had insured, and members failing to meet their share of calls to cover losses were expelled. Measures were also taken to offset the dangers of multiple losses within a short period, which was a device to reduce any moral hazard in the case of a member insuring more than one ship. In both the Shields associations, when two or more ships were lost within a forty-eight-hour period, the victims were required to contribute to each other's losses in proportion with the other members. Other regulations to contain moral hazard and minimize adverse selection include proscriptions against deliberate overinsurance and attempts to parcel up different levels of risk within the association and to ring-fence the most risky members.[23]

The main concern of these mutuals, therefore, was not market competition, but to maximize the effectiveness of risk selection and monitoring of moral

[22] Unanimous Association, *Articles of Agreement, 3 January 1791*, appendix: bye-law 18 February 1793.

[23] Union Association, *Articles of Agreement*, bye-law 8 January 1789.

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hazard for the benefit of the membership as a whole. Their system of underwriting presented few organizational problems. Administrative costs were low—no agents were employed or commission paid. It was fairly easy for committee members personally involved in shipping to identify bad risks and false claims and this, together with low overheads, allowed the associations to provide cheaper cover than could be obtained at Lloyd's. In 1809 the secretary of the London Union estimated that, once all losses had been paid, the cost of insurance to their members was about 5 guineas per cent, compared to the usual Lloyd's rate of 9 guineas per cent for similar ships in the coal trade.[24] Despite their exclusions, the insurances offered by the associations were also more comprehensive than those issued at Lloyd's. Collision at sea, for instance, was normally covered, but not by Lloyd's. This was a prime benefit for those in the coastal trades, where the risk of collision was much higher than in ocean shipping.

It is uncertain how many shipowners in the provincial coal and fishing trades sought out Lloyd's or the stock corporations to obtain insurance. The London Assurance Corporation had agents in Newcastle between 1769 and 1784 and Whitby from 1780 to 1789, but they mostly insured property against fire, including ships in dock.[25] It was said that one of the London mutuals, the Friendly Insurance, established in 1804, 'arose from several gentlemen thinking it better to insure as is the practice in the north of England in clubs than go to the Coffee house', which implies that some comparison took place between the different systems of underwriting to hand.[26] With their small specialist field of insurance and localized area of operations, however, the mutual associations probably did not represent much of a threat to Lloyd's or the corporations. Although they were cheaper than these alternative suppliers of insurance, their survival depended above all on careful selection based on local knowledge and small pools of risk, so that the limits to their growth remained narrow. Their tight quality controls over members and ships were less practical in larger organizations.

THE NEW MARKET STRUCTURE AFTER 1824

After 1800 Lloyd's and the chartered corporations came under sustained attack, the former for the alleged inadequacy of their capital reserves, the latter for their monopoly privileges. The promoters of two new joint-stock projects led the attack. They claimed that the supply of marine insurance in the UK had failed to keep pace with the expansion of trade and that business

[24] Raynes 1948, 187. [25] Pearson 2004, 105. [26] Cited by Raynes 1948, 187.

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was moving away from London to new companies being formed abroad. Large new corporations and repeal of the monopoly were needed to attract insurance back to Britain.[27] In response, representatives of Lloyd's claimed that the promoters were merely seeking to set up a new monopoly and lacked the expertise to write marine insurance. Echoing Adam Smith, they also argued that marine insurance could not be reduced to a routine, like fire or life insurance, and therefore was not generally suitable for joint-stock companies.[28]

The House of Commons appointed a committee to consider the arguments. It reported that the monopoly had worked to the benefit of both Lloyd's and the corporations, and unfairly had prevented the merchants of outports from associating legally. The committee concluded that the best mode of insurance was that which delivered the best security at the lowest price, and that free trade was most likely to deliver this. It recommended that the monopoly be repealed and the business thrown open to a range of suppliers: partnerships, companies, private underwriters, and mutual associations. A bill to this effect, however, provoked a hostile response from the corporations, underwriters, brokers, shipowners, and City merchants, and was defeated in the Commons, narrowly, in 1811.[29]

Nevertheless, with the abolition of other monopolies such as the East India Company in 1813 and the Bank of Ireland in 1821, political opinion was swinging decisively towards free trade. In 1824, during the next wave of company promotions, the founders of the Alliance British and Foreign Fire and Life Assurance Company petitioned for repeal in order to be allowed to write marine insurance. Counter-petitions were lodged by the two corporations, by Lloyd's, and by underwriters at Hull and Newcastle. Despite this support for vested rights, the repeal bill was passed. Following the abolition of the corporations' monopolies, several new marine insurance companies were formed, but they entered a depressed market and some of the smaller ventures did not survive for long.[30]

It was not, therefore, obvious that the joint-stock company, operating in a market free of monopoly restrictions, was the natural successor to the private underwriter or the mutual association. The debate about the optimal organizational form for marine insurance continued beyond repeal.[31] Underwriters at Lloyd's, for instance, claimed that the low proportion of capital actually paid

[27] Raynes 1948, 191–2.

[28] Anon 1813; Anon 1811. For the opposition of Lloyd's members, see the account of their general meeting, *Caledonian Mercury* 30 June 1810.

[29] Raynes 1948, 193–8.

[30] E. S. Roscoe, 'The Progress of Marine Insurance in England', *Fraser's Magazine* 1877, 707–19.

[31] Cf. Anon, 'On the Most Preferable Plan of Ship Insurance', *Newcastle Magazine* 10, January 1831, 14–18.

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up in stock companies meant that the latter provided little security to the insured. By contrast the underwriters staked the whole of their property and were fully liable for losses. They were particularly keen to ensure that shareholders in the new companies did not benefit from limited liability, so that competition would be on a level playing field.[32]

Some thought that a hybrid form of organization combining features of the stock and mutual systems would be optimal for marine insurance. The Indemnity Marine, for example, was originally planned as a mutual company in 1824 but its promoters had second thoughts.[33] A revised prospectus noted that a lack of capital could lead to 'inconvenience and delay' before losses could be covered through a levy on members, and that a stock company could overcome this problem. The company plan, therefore, was restructured to comprise the 'mutual insurance of merchandise as well as ships', but with a capital of £5m in 50,000 shares, with compulsory insurance for shareholders, and profits to be distributed on the basis of number of shares held and premiums paid. This hybrid form of mutual membership with a capital stock, however, did not work out well. The take up of shares was poor, managers found it difficult to vet applicants for shares, and bad debts, bankrupt shareholders, and rising losses at sea forced the company to make further demands on the unpaid proportion of members' shares. In 1827 a new chairman identified the mutual element as the chief cause of the problems. Shareholders' obligation to insure was ended, the office was fully opened to the public and recovery followed. By 1832 the Indemnity Marine was insuring more on ships and cargoes than the venerable London Assurance Corporation.

The shipowners' mutuals survived the emergence of new mutual and joint-stock companies after 1824 but they often found themselves overloaded with older ships, while newer vessels were insured at Lloyd's and the new companies. Some went out of business. Others began to cover excess collision and other types of liability that were excluded by Lloyd's policies, giving rise to a new marine liability insurance sector that became big business in the twentieth century.[34] The development of mutual 'protection and indemnity' insurance clubs is examined in the following section.

The private underwriting system also survived, and even expanded in outports such as Liverpool, Bristol, Hull, and Glasgow. Growing numbers of brokers and marine insurance companies could also be found in overseas ports in Europe, North America, India, China, South-East Asia, and the West Indies. Underwriters in the major outports often took slices of larger or more difficult marine risks not fully covered by their counterparts at Lloyd's or by the London corporations. By 1860 the Liverpool Underwriters' Association

[32] *Morning Chronicle* 19 May 1824.
[33] The following is based on Palmer 1984.
[34] Morris 1956.

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consisted of eleven Lloyd's-type syndicates with nearly 300 private underwriters. Beginning that year, private underwriting partnerships began to join forces to launch stock companies that gradually replaced the syndicates in Liverpool.[35] The first of these companies, the Thames and Mersey, was launched in 1860 with a nominal capital of £2m, 20 per cent paid up. Its 100,000 shares were distributed in a fixed ratio to investors in London, Liverpool, and Manchester, although within a few decades the majority of shares found their way back to the northwest. The company operated local management boards in the three cities and appointed overseas agents in India, the Far East, Australia, and the US. By 1877 the Thames and Mersey was Britain's largest marine insurance company with a premium income of £310,000.[36] Other new stock companies followed, mainly in Liverpool and London, profiting from the huge transfer of US marine insurance to the UK during the American Civil War. By the 1870s there were several dozen companies underwriting marine insurance, together accounting for perhaps 40 per cent of the UK market.[37]

The economic conditions of the 1870s and 1880s, with the slowdown in international trade, the lower premium rates required for steamships, and the competition from the new companies that pooled information and standardized practice in trade associations—notably the Institute of London Underwriters founded in 1884—made life tougher for the private underwriters. Lloyd's responded by embracing regulatory and organizational change. It was incorporated by an act of parliament in 1871, though this did not remove the personal liability of its members for losses. Deposits and guarantees became compulsory for members to help safeguard against underwriting failures. The number of members and the average size of syndicates increased. Broking firms became larger, managing a growing volume of business through agencies in Britain and abroad. Lloyd's also diversified into new lines, such as loss of profits, burglary, trade credit, earthquake, hurricane, motor, and aviation insurance.[38] At the same time the newer stock companies and the two old London corporations experienced falling profits and dividends.[39] Between 1900 and 1920 across the industry there was a wave of mergers and acquisitions that left a smaller number of large composite companies writing multiple lines. These composites came to dominate the UK corporate market for insurance for the next fifty years. The result was that few specialist marine insurance companies remained in Britain by the second quarter of the twentieth century.

[35] The final private marine underwriting firm in Liverpool ceased business in 1908. Anon 1960, 27–8.

[36] Anon 1960, 40. [37] Raynes 1948, 316–23. [38] Pearson 2006; Brown 1980.

[39] The average annual net marine insurance premiums of the Royal Exchange Assurance, for instance, fell from £528,533 in 1856–60 to £114,058 by 1886–90. Supple 1970, 205, 258–9.

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THE P&I CLUBS: NETWORKS AND INNOVATION

As noted above, from the 1850s mutual 'protection and indemnity' (P&I) clubs emerged to cover other risks in UK marine insurance. While the existing mutual associations generally only insured hulls, and the stock companies only hulls and cargoes, the new P&Is offered cover for a different range of shipowners' liabilities. Several factors appear to have been behind this development.[40] First, there was the growing public debate in Britain about accidents, injuries, and loss of life on railways and emigrant ships. This was accompanied by a raft of legislation. The Passenger Acts of 1842 and 1847 and the Steam Navigation Act of 1846 stipulated the liability of shipowners, charterers, and masters for the construction and seaworthiness of their vessels, the provision of lifeboats, fire hoses, ship lights, fog horns, the condition of machinery (in the case of steamships), the lighting and ventilation of passenger decks, the quality of food on board, and the storage of gunpowder. Fines of up to £100 for owners and £50 for masters were specified for breach of these regulations through 'wilful neglect or negligence', or three months in prison if fines were not paid. Shipowners were required to return ticket money and pay compensation to their passengers for any avoidable delay or cancellation of voyages, while passengers maintained the right to take out private lawsuits against masters and owners for injury or loss of life or property.[41] An amendment act of 1852 stipulated that passengers' insurance of their passage money was not invalidated by any liabilities imposed on owners and masters by this legislation.[42] Furthermore, the Fatal Accidents Act of 1846, which was aimed at, but did not exclusively specify, railway companies, declared that a right of action at common law should not be entirely lost by the death of the person injured by the 'wrongful act, neglect or default' of the defendant, as had previously been the case.[43] Henceforth, the close relatives of a deceased plaintiff, or executors on their behalf, could sue to recover compensation to the extent of their financial loss.

Further legislation and judicial rulings increased the range of liabilities to which shipowners were subjected. For instance, the Harbours, Docks and Piers Clauses Act of 1847 gave harbour authorities the power to recover for damage done to port infrastructure by shipping, and for the cost of wreck removal.[44] Before 1870 liability for lost cargoes could be avoided by writing an appropriate exemption clause in the bill of lading, but a court ruling of that year, involving a ship lost off the Cape, held the shipowner liable, because the

[40] Ledwith et al. 1957, 4–5.

[41] 5 and 6 Vict. 1842, *c*. 107; 9 and 10 Vict. 1846, *c*. 100; 10 and 11 Vict. 1847, *c*. 103. For contemporary concerns outside parliament about safety at sea, see Jennings 1843, 1844.

[42] 15 and 16 Vict. 1852, *c*. 44, clause 51. [43] 9 and 10 Vict. 1846, *c*. 93.

[44] 10 and 11 Vict. 1847, *c*. 27, clauses 74–5.

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cargo had been carried beyond its destination and the exemption clauses in the bill of lading did not cover that eventuality.[45]

Various merchant shipping acts from 1894 also increased the statutory responsibilities of shipowners with regard to the illness and repatriation costs of their seamen. The Workmen's Compensation Act of 1906 extended this to groups of seamen and stevedores previously omitted. During the twentieth century such pressures increased with further crew liabilities, cargo claims, and the complications of new forms of transport. After the Second World War international law also paid greater attention to shipowners' liability issues, most notably in relation to the environmental risks resulting from oil tanker wreckages and the carriage of nuclear materials and other dangerous cargoes.

Some factors alleviated shipowners' liability for these various risks. During the nineteenth century any damages awarded by a court following a suit at common law were, apparently, subject to a deduction by the value of any other relief that the victim had received, including any sums paid out from insurance policies.[46] This deduction was finally abolished by the Fatal Accidents (Damages) Act of 1908, which stipulated that 'any sum payable on death under any contract of insurance should not be taken into account in assessing damages'.[47] The Merchant Shipping Act of 1854 also limited the risk exposure of shipowners in various ways, for instance, by stipulating that no owner was liable to make good any loss or damage to goods on board by fire or theft 'that may occur without his actual fault or privity of', and by restricting liability for damages, injury and loss of life to the value of the ship and freight.[48]

Nevertheless, the Victorian debate about safety at sea, and the legislation that accompanied it, instigated a fundamental change to the liability environment for mariners and shipowners and had a long-term impact on the UK insurance industry. First, it led to the formation of several new personal accident insurance companies by the early 1850s, including in marine insurance.[49] Second, shipowners' liability for third-party risks became a promising new field to develop. Managers of the mutual hull associations were aware that

[45] Ledwith et al. 1957, 5.

[46] Although there were exceptions, such as insurance against the loss of money paid for passenger tickets. See note 42 above.

[47] 8 Edw. VII 1908, *c.* 7, cited by Raynes 1948, 285. It should be noted that the 1849 incorporating act of the most important of the early accident insurance companies, the Railway Passengers Assurance Company, placed it in a privileged position, because it provided that in no circumstances should any sum payable under its policies be applied in relief of damages awarded against a negligent party. The fact that this was a special clause in an act suggests that the common law default was for such insurance sums to be deducted from court-awarded compensation. Dinsdale 1954, 63.

[48] 17 and 18 Vict. 1854, *c.* 104, part IX.

[49] Some of these companies also offered luggage insurance to ship passengers. Dinsdale 1954, 274 n. 3.

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in their traditional field they were getting the older and more hazardous risks and thus were in danger of going out of business from competition by Lloyd's and the stock companies. From the 1850s several of them formed new mutual clubs offering protection and indemnity insurance to their members on a familiar not-for-profit basis.[50] Some clubs covered hulls as well, a class of insurance that they inherited from the older associations. P&I clubs, like many of the mutual associations, did not issue individual policies.[51] Members joined for the year, supplied details of the risk they wished to insure, paid a contribution, known as an 'advanced call' calculated at the beginning of each insurance year, and agreed to abide by the club's rules and be liable for supplementary calls to meet any future losses.[52] Faced with an increasing range of liabilities, and driven in part by the new type of consumer protection legislation, shipowners turned to the P&I clubs for their insurance cover. Generally the new P&I clubs did not compete with Lloyd's underwriters or the stock companies. Some catered for the needs of liner and tramp owners and some covered particular trades, such as trawler owners operating out of Fleetwood.

By the end of the nineteenth century P&I was a well-established sector of the marine insurance industry. Liabilities, however, were getting larger, driven by the growth in the size of ships and the increase in new risks such as bulk oil tankers. In 1899 the first pooling agreement was drawn up between six British clubs, whereby large claims on one club in excess of a certain sum were shared, proportionate to their size, among all the member clubs.[53] The pool, later known as the London Group, also set up reinsurance facilities with other UK and foreign clubs that were not members of the pool. In this way the P&I clubs were able to offer unlimited cover on most risks, via coinsurance and excess loss reinsurance contracts. The same principle of mutuality underpinned the pool as it did the individual clubs. It only worked if smaller losses were retained by the insuring member, and if the risks shared across the pool were similar. Member clubs also agreed not to bring to the pool losses from new risks, hitherto excluded, that had occurred by a change of club rules. Indeed, the pooling system ensured that changes to clubs' liabilities resulting

[50] The first such club was the Shipowners' Mutual Protection Society, founded in 1855 and still operating today as the Britannia.

[51] Some mutuals appeared to have just kept lists of ships. Sometimes these were entered directly in the association rule book. Cf. 'A List of Ships entered in the Exeter Shipping Insurance Association' (1844), reproduced in Craig et al. 1994, 100. However, some association rule books also referred to the issue of policies. Cf. *Rules of the Gloucester & Severn Estuary Mutual Marine Insurance Society Limited*, Gloucester, 1904. The extent of either practice in the mutual marine insurance sector remains unclear.

[52] The amount of the 'advanced call' was based on an estimate made by the club's managers of the total income required for the next insurance year and the proportion of that income that each member should pay for his/her vessels, expressed as a rate per tonne.

[53] Young 1995, 20–5.

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from their insurance of new risks such as containerized cargoes, the use of helicopters for pilotage, or the pollution prevention costs of salvage operators, had to be agreed by all pool members, or else the risks would not be covered by the pool.[54]

The history of the last British P&I club to be established, the Steamship Mutual (SSM) of 1909, helps reveal the factors that led to the growth and internationalization of this little studied organizational form in marine insurance.[55] Typically, the SSM originated with a small hull club in the West of England, the Gloucester and Severn Estuary Mutual Marine Insurance Society. In 1906 the leaders of the latter incorporated the Sailing Ship Mutual Insurance Association, through which the SSM later reinsured. The Sailing Ship Mutual insured mostly small wooden sailing vessels in the UK coastal trade and was established in response to liabilities arising from the Workmen's Compensation Act.[56] In the early years both clubs were jointly managed. The prime movers were two shipowners from Gloucester, together with a shipbroker, Lionel Sage, and a marine lawyer, Alfred Stocken. The managers were part time and the club advertised the club committee's expertise in coastal shipping as a means of attracting subscribers.[57] As in other small clubs, the committee, or later 'board', members personally examined ships subject to claims, rather than appointing a permanent surveyor.[58]

Part of Sage's early tactics in expanding the SSM was to target small mutual clubs and point out the advantages of belonging to a larger organization, which included greater capital resources, a broader pooling of risks, and quicker loss adjustment for members. Although the business acquired in this way was not all P&I insurance, the targeting of the smaller sailing ship clubs, as well as members of other mutual steamship P&I clubs, helped expand the new organization.[59]

By 1919 the club's business remained firmly focused on British coastal ships and estuarine barges carrying coal, bricks, and other low-value cargoes.[60] Sage gave up his management role, apparently to concentrate on brokerage, and Stocken appointed another shipbroker, John Plincke, to fill his place. Managerial sclerosis, however, gradually became a problem. As the SSM and other clubs became larger, their management functions grew and became more complex, requiring full-time employees with specialist experience. Managers became organized into separate organizations, usually taking the form of partnerships, contracted to provide a range of services to the club. In the

[54] Ledwith et al. 1957, 28–40. [55] Doe 2009.

[56] Under the act, those seamen previously excluded from employee protection legislation could henceforth sue sailing shipowners for injuries received at work.

[57] Steamship Mutual Archives, Steamship Insurance Management Services Ltd, London, Sailing Ship Mutual booklet *c.* 1906; Doe 2009, 17 .

[58] SSM, Sailing ship committee meeting minutes, June 1912. [59] Doe 2009, 19.

[60] SSM, Steamship minutes, June 1925.

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case of the SSM, this was Alfred Stocken and Co (Managers) Ltd. Furthermore, there had always been a regular rotation of chairmen at the SSM, but this changed in 1923 when Abbie Anderson became chairman of the club. Anderson had joined the SSM in 1912, when it had acquired his own mutual club in the Whitstable coal trade. He commenced a reign as chairman that only ended with his death in 1950. Anderson's impact was to slow down innovation and to preserve an amateur approach to business. He was also determined to cling to power. As late as 1949 a special resolution allowed him to stay on in his post beyond the age of seventy-two. He died six months later, however, and the management committee then unanimously agreed to rotate the chairmanship every three years.[61]

It was a conservative environment, therefore, which Sydney Crowe entered when he joined Alfred Stocken and Co as a clerk in 1931. Crowe eventually became a partner and he transformed the club into a major international P&I insurer. Crowe's first gambit was in 1936, when, thanks to his friendship with a young fleet owner, Jack Billmeir, the SSM captured the business of large vessels carrying cargoes to and from Republican Spain. It was a risky step into the ocean maritime insurance market with a new and untried shipowner, but it paid off. After the Second World War, Crowe returned from naval service to become the senior full-time manager and by 1950 Anderson was no longer there to block his initiatives. The market had also changed. Britain no longer had the largest merchant fleet, but those of the US, Australia, Canada, and India had expanded while European countries had begun to rebuild their fleets.[62] This presented opportunities that Crowe and managers at the other UK clubs seized vigorously.[63] In 1948–49 Crowe gained personal introductions to German shipowners and managed to insure five vessels belonging to the DG Neptun Line of Bremen. Other British clubs were also successful in acquiring German business that before the war had been insured by the Norwegian P&I club Skuld. The SSM also wrote the P&I insurance of surplus American Liberty ships that had found their way into foreign merchant fleets after the war and, following the appointment of an agent in India, the club insured a major part of the expanding Indian fleet.

By 1960 the SSM was an established international club with assets of over £1m. Seven of its eleven board members were non-UK-based shipowners. It also gained admission to the London Group, which eventually expanded into the current International Group of P&I clubs. This was a direct result of the intensive lobbying of the managers, who were well rewarded since they were paid on performance. The growth of the SSM and other clubs was also good for shipowners, as joining a large well-managed pool led to a better sharing of risks.[64]

[61] SSM, Steamship minutes, May 1950. [62] Sturmey 1962.
[63] Young 1995, 44–5. [64] Young 1995, 46.

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In sum, key managers of the SSM actively pursued an expansionist strategy at critical periods in its history. Initially this involved the acquisition of other small local clubs. In a world of escalating liability, mutuality remained a favoured choice with shipowners, not just in the UK. P&I clubs, for example, were established in Sweden in 1909, in the US in 1917, and in Japan in 1950. Until the Second World War most of the British-based clubs had some foreign shipping on their books, but foreign shipowners rarely appeared on their managing committees. This changed after the war, when the managers of the British clubs began to travel the world seeking business that had previously gravitated to them.[65] The influence of entrepreneurship, the active seeking out of new risks and business opportunities, therefore, was significant in expanding and internationalizing the P&I form of organization. While Lionel Sage had worked hard to expand the SSM in its early days, this momentum faltered in the 1920s and early 1930s. Given a different set of circumstances and personalities, the SSM might have simply faded away. Without Sydney Crowe, the club would have continued quietly to insure the diminishing number of vessels in the coastal and estuarine trades. The arrival of an ambitious new type of manager, and the adventurous underwriting of ships owned by entrepreneurs such as Billmeir, set the SSM on a new path. This movement away from its traditional base placed it in a good position to seize the opportunities presented after 1945. The expansion of the global P&I market after the war provided the SSM with the final step change in its position. Important personal connections were nurtured, constant travel was undertaken by managers in Europe and India, and the club's business was internationalized. The SSM is indicative of the success and longevity of the British P&I industry. In 2012 eight of the thirteen members of the International P&I Group had UK origins, all founded between 1855 and 1909. Between them the British clubs have the greatest proportion of tonnage covered by the International Group. All are London based, even if they are now registered offshore and carry out their transactions in US dollars.

CONCLUSIONS

This chapter has sought answers to some questions about organizational forms in British marine insurance. Why did the marine insurance corporations emerge in the early eighteenth century? Why did they not compete more successfully with Lloyd's? Why did the mutual hull associations emerge and how did they survive? Why did the market structure change after 1824 in

[65] Young 1995, 45–6.

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the way it did? What drove the success of the P&I clubs after 1850 and through the twentieth century?

The two chartered corporations of 1720 were the product of specific financial and political circumstances—the speculative bubble of 1719–20, the willingness of the Crown to trade charters for cash—and more generally the culture of innovation that accompanied the financial revolution of the period. The corporations were certainly not the result of any prior experience of joint-stock forms of organization in marine insurance. There were none. In that sense they were an experiment that happened to work.

Yet the corporations did not drive out private underwriters as some had feared they would. On the contrary, the latter benefited from the exclusive privileges of the corporations, which prevented other groups of capitalists from entering the market. Underwriters, especially those operating out of Lloyd's, developed institutions that helped to mitigate the problems of asymmetric information, agency, and transaction costs that accompanied shipping and overseas trade in the period. These problems appear to have outweighed the greater security provided by the larger capital resources of the corporations. Cautious underwriting and pricing policies on the part of the corporations further drove business towards Lloyd's. The best risks insured with the private underwriters because they charged lower premiums than the corporations and offered more flexible policy terms. The underwriters were able to do this, at least in part, because they were better placed to recognize risk quality and because their overheads were low. In the later eighteenth century the development of formal governance structures at Lloyd's drove out the gamblers and provided greater security for the insured. These and later institutional changes helped secure Lloyd's as a world market for marine insurance for the next two centuries.

The mutual associations of shipowners that appeared from the late eighteenth century were the product of specialization in the marine insurance market, the growth of regional ports, and the traditional fractional form of shipownership. They offered a system of insurance that was geared to coastal and short-sea trades, where multiple voyages could be made within a year. They had the advantage of local knowledge and carefully monitored the quality of the risks that they insured. They suffered few agency problems, as they employed no agents or brokers and maintained simple flat managerial structures. They had lower transaction costs, charged lower premiums than Lloyd's or the corporations, provided more comprehensive cover, and aimed to offer good customer service, with rapid and non-litigious claims settlements. The close quality controls, however, placed narrow limits on their growth. They remained specialist niche operators tied to local trades.

One compelling reason for the structural changes after 1824 was the political swing towards free trade and the British parliament's removal of the corporate monopoly restrictions in marine insurance. However, the debate

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surrounding repeal suggests that it was not obvious that the stock company operating in a free market was the natural successor to the private underwriter or the mutual association. Supporters of Lloyd's argued that the low proportion of stock companies' capital paid up meant that the companies provided little security to the insured, whereas Lloyd's underwriters staked the whole of their property. The unlimited liability of Lloyd's members was held up as a badge of strength for much of the nineteenth century and beyond. Others argued that mutual schemes were optimal because they ensured lower costs, cheaper insurance, more liberal claims settlements, and bolstered the relationship between insurers and the merchant community. Proponents of joint-stock insurance claimed that the lack of capital in mutual organizations, and their need to call on their members to contribute towards each loss, led to delays in payment for the insured. Premium insurance, operated by all stock companies, as opposed to a posteriori calls operated by most mutuals, related the price to the risk run and thus attracted better quality risks. It also allowed the insured to know in advance the cost of insurance, which helped owners estimate their expenditure on their ships. Generally, the latter arguments appear to have gained the upper hand as the nineteenth century progressed. The global scale of business conducted by the new Liverpool and London companies entering marine insurance from the 1860s, and their close ties to local broking and shipping interests, gave them an edge in the competition with Lloyd's and forced the latter to diversify out of marine insurance.

Mutuality survived, however, and some of the mutual associations morphed into the successful P&I clubs still working in the London market today. Technological change and the transformation of the liability environment for shipowners and mariners from the middle of the nineteenth century, which was the result of growing public concern about safety at sea and subsequent legislative intervention, helped drive the growth of the P&I sector. These factors alone, however, do not explain why P&I insurance was largely delivered by not-for-profit mutuals rather than by stock companies or private underwriters. The case of the SSM indicates that the entrepreneurial qualities, risk taking, and innovation of individual managers could play an important role in the growth of clubs out of small or declining markets. Moreover, the fact that most P&I clubs have firmly resisted the trend to demutualize suggests that the attraction of mutuality remains strong in a sector where specialist knowledge, high-trust business relations, and extensive pooling and inter-club cooperation are more critical to success than the resolution of capital needs or agency conflicts in governance.