

# A Treatise on "Sum Insured" Concept in Hull and Machinery Insurances

The term "Sum Insured", being among utmost important elements of insurance, has undergone various transitions throughout centuries. The term, which initially came into being with strong semblance to a gambling mechanism, has evolved a great deal until it matured into it's current meaning in today's insurance industry.



In case of property insurances, the basic principle of which is to indemnify the damage and loss to any property of the insured following any loss taking place due to a risk covered, and to cover reasonable expenses incurred in order to prevent or mitigate possible damage, it is important that the insured sum, as noted in the policy, accords with the sum insured concept defined according to the terms of insurance contract. The fact that the sum insured has been determined in accordance with the principles agreed in this framework is one of the most important factors to be considered in order to determine the risk premium of the insured correctly and to ensure that the insured can benefit fully and completely from the policy in case of any damage.

This principle is of great importance in terms of Hull and Machine insurances, which is a type of property insurance that has evolved over the centuries in order to provide coverage for watercraft.

England, holding the market leadership of the maritime trade insurance through Lloyds in early 20TH century when the world trade volume continued to gain momentum, had emphasized the importance of the "sum insured" concept for the assets subject to marine risks under Marine Insurance Act dated 1906, and provided one of very first modern examples to the questions of which items shall be covered based on which principle under the sum insured not only for the cargo subject to carriage, but also for the vessel carrying such cargo. In particular, paragraph 1 of Article 16 of such British law, which is still form the basis of many insurance contracts today, specifies the issue of which values shall be considered as a basis for the sum insured under which conditions regarding the Hull and Machine insurances for floating assets.

Although such sub-article 16.1 is not fully applicable today due to the facts that said law has a history of more than hundred years, and both the varieties of floating assets used for maritime trade and the perception of Hull and Machine insurances in the market have evolved in time, basic principles such as the stipulations that the asset insured under hull and machines insurances is the hull, machine and other assemblies considered as integral parts of the vessel and the sum insured related to these assets insured must be the total fair value at the beginning of the risk, are still applicable today based on this article of the act.



**Umut CAN**

Asst. Technical Manager

+90 216 545 0300 (D.231)

+90 530 391 11 49

umut.can@turkpandi.com

Following his graduation from Istanbul Technical University with a degree in Mathematics Engineering, Umut started his marine risks insurance career in 2005 at Anadolu Insurance Company. He later joined Aon ve Omni as an insurance and reinsurance broker. In 2014 he took the position as Underwriter of Turkish P&I. Umut's responsibilities include establishment of Company's risk and business acceptance criteria, review and guidance of rating practices and application of these practices to both prospect business and portfolio, and ensuring smooth and continuous run of the Company's reinsurance treaty programmes. His articles on various insurance related topics continue to be published in maritime and insurance sector periodicals.



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Regarding the Hull and Machinery insurances, the role of this article is very important in terms of determining exactly what asset is covered under the insurance policy and clarifying basis for determining the sum insured for this asset.

By the time these issues have been highlighted bylaws in the UK insurance market, the use of P.P.I. - Policy Proof of Interest policies in maritime insurances with no significant insured assets behind it had gradually decreased, and especially the types of agreements that cannot be reconciled with the principle of transferring certain defined risks, such as, "Chinaman" and "Tonner". to the insurers and therefore considered like a bet-like arrangement rather than an insurance agreement, had encountered slow but a certain downfall.

Policy types such as "Increased Value & Disbursements" "Hull Interest" and "Freight Interest", which are recognized as per the rules of different insurance markets and different insurance rules for coming into effect based on the fair value of the Hull and Machine as a whole and in which the policy itself rather than the property is a consideration for the insured's interest, had started to be used in insurance markets once the insured could prove after long term efforts that, they had incurred additional material damages beyond the sum insured under Hull and Machine insurance following the total loss of the integrity of the hull and machine and thus, it had become possible for the concept of P.P.I to restore its reputation under the Hull and Machine insurances within certain limits and frameworks.

As with all property insurances, it is the responsibility of the insured having its property insured, to declare the sum insured to the insurer not more or less but exactly in accordance with the insurance rules.

Declaring the sum insured on the insurance policy more than the sum it should be, is a defect defined as "overinsurance" and does not allow the insured asset to be subject to a damage process as if it is insured above the sum insured. Since the insurance contract is not accepted as an instrument of enrichment in principle, in case of overinsurance, the claim process is carried out as if the insured asset has been insured at proper value as per terms of the insurance contract, and the

premium amount corresponding to the premium difference between the sum insured that should be and sum insured under overinsurance, is returned to the insured in most cases.

Although it is the responsibility of the insurer to prove "overinsurance", the fact that such disagreements appear in a possible damage is a negative factor for both the shipowner's completion of the compensation process as soon as possible and the performance of the insurer in the damage and therefore it is always in the best interests of the shipowner to refrain from stating a value that is higher than the value required in the Hull and Machinery Insurance policy.

In terms of both the optimization of the total insurance premium cost and the correct insurance practices, if the insurance is required for a value exceeding the integrity of the hull and machinery, the right option to follow is to provide coverage for this additional value not under "hull and machinery" insurance, but under "increased value and costs" or an equivalent insurance.

A particular point that needs to be underlined for such insurances operating on hull and machine insurances is that the fact that these insurances operate completely above the value required for the insurances of the hull and machinery, is clearly defined in the insurance rules in writing form, so such additional value insurances are not equivalent to hull and machinery insurances under any circumstance.

In other words, if the fair value of the integrity of a hull and machinery, and hence the value that should be the basis for the hull and machine insurance is already known, the increased value insurances may only be applied as an excess insurance over this sum insured under the hull and machine insurance. Substituting the value that must be subject to hull and machinery insurance partially with increasing value insurance only in order to reduce the insurance costs, will be a practice in contrary to both insurances and may even affect a possible claim process adversely.

Since underinsurance, which defined as the fact that the sum insured is less than the sum insured defined according to insurance principles, unlike the overinsurance, will allow reduction of both individual and joint average damage payments recoverable under a hull and machinery insurance in case of any damage in the ratio between the sum insured under the underinsurance and insurance value of the ship,



underinsurance practice may result with devastating consequences for the insureds especially in case of high value claim processes.

In the evaluation of the principles on which the sum insured is determined in the policy, it is also important to note whether the sum insured is posted as agreed or not agreed on the policy. Hull and machinery insurance policies issued in accordance with British laws and rules approach this issue mostly within the framework of Marine Insurance Act 1906. Article 27 of the said law provides for the sum insured to be stated as "agreed" in the insurance policies, in which case the sum insured for the hull and machine integrity subject to the insurance becomes fixed by prior agreement between the insured and the insurer, so that many possibilities regarding the insurer's objection to the sum insured in case of damage are eliminated. Such policies are defined "valued policy" in the said law.

According to Article 28 of the same law, if the insurance policy is in force by using the terms "sum insured" or "insured limit", without reaching an agreement of the amount subject to the insurance, the sum insured is defined as "not agreed" and in these types of policies, which defined as "unvalued policies", it is considered by virtue of the law that the upper limit applicable as a basis in case of payment of the claim only rather than the value of the interest subject to the insurance.

When this topic is handled in terms of Turkish law, Article 1461 of the TCC uses the expression "The liability of the insurer is limited to the sum insured". However, Article 1462 of the Law stipulates that "In case the sum insured is less than the insurance value, if the insured interest is partly damaged, the insurer shall pay the insurance indemnity in the proportion that the sum insured bears to the insurance value, unless otherwise agreed". Therefore, only an agreement between the insurer and insured on the sum insured can lead to the emergence of "unless otherwise agreed" provision of article 1962 and allows the policy to be considered as a "valued policy"

One thing that must be underlined here particularly is that, issuing a "valued policy" by keeping the insured sum higher than the insured value that should be and thereby getting compensation higher than the insured value in case of a possible damage is not considered as a valid method. In reconciliation practices for the sum insured, insurance companies require an appraisal

survey, other than exceptions, in order to avoid such negativities and this possibility already becomes practically impossible. Moreover, the provisions of the Turkish Code of Obligations regarding the "error, are likely to prejudice the insurance policy in such a possibility as it will provide the insurer with strong defense opportunities that it is not bound to the insurance contract under the pretext that the price has been reconciled as a result of the error.

It is also important that the neutral survey firms that determine the value of the vessels are also an institution appointed by the insurer and the insured and agreed by both parties. Based on the fact that ships vary in their value according to their types and working area, even in the geographical region in which they operate, the fact that the assigned neutral institution makes a determination by taking into account the location of the ship and the geographical region where it operates sometimes causes sharp differences on the results.

When all these particulars are considered, we believe that it is appropriate to recommend that the sum insured regarding the ship in hull and machine insurances be the same as the current market fair value of the ship which is accepted as sum insured, and that the sum insured should be noted as the "agreed value".

