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DEPARTMENT OF TRANSPORTATION

U.S. COAST GUARD

STATEMENT OF

MR. DANIEL F. SHEEHAN

ON THE ECONOMIC IMPACT OF VESSEL CERTIFICATES OF FINANCIAL RESPONSIBILITY

BEFORE THE

SUBCOMMITTEE ON COAST GUARD AND MARITIME TRANSPORTATION

U. S. HOUSE OF REPRESENTATIVES

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Mr. Daniel F. Sheehan assumed his duties as Director, National Pollution Funds Center, located in Arlington, Virginia, in June, 1992. He is responsible for managing the billion dollar Oil Spill Liability Trust Fund established by the Oil Pollution Act of 1990. The fund provides money for pollution response and damage compensation. The Funds Center also certificates the financial responsibility of vessels operating in U.S.Waters.

Prior to this assignment, Mr. Sheehan was responsible for international activities, research and development and program oversight for the office of Marine Safety, Security and Environmental Protection. He was the senior technical advisor to the Commandant on these issues.

Over the last 20 years, Mr. Sheehan has represented the United States as a member of delegations to the International Maritime Organization (IMO). He regularly participated in the Maritime Safety Committee, its 10 technical subcommittees, and the IMO Assembly. He has served as an advisor to the U.S. Delegations to the following diplomatic conferences: 1974 Safety of Life at Sea Conference, the 1978 Tanker Safety and Pollution Prevention Conference, the 1984 International Conference on Harmonization, Survey and Certification, the 1988 Conference on the Global Maritime Distress and Safety System and the 1990 Conference on International Cooperation on Oil Spill Preparedness and Response.

Mr. Sheehan is a 1965 graduate of the University of Maryland where he received a B.S. in Fire Protection Engineering. He is a 1988 graduate of the Industrial College of the Armed Forces and George Washington University where he received a Masters in Public Administration. He is a member of Pi Alpha Alpha, the National Honorary Society for Public Administration.

He has received the Secretary of Transportation's Meritorious Service Medal and Bronze Award, the Coast Guard's Superior Achievement Award and the Commander's Award for Civilian Service.

He is married to the former Judith Emanuel. They have two children, Kimberly and Nicole.

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Good morning, Mr. Chairman. It is my pleasure to be here this morning to address the economic impact of Certificates of Financial Responsibility (COFRs) for vessels. I am pleased to say that implementation of the COFR rule itself has been very smooth, and that the annual cost of obtaining COFRs for oceangoing vessels to private shipping interests has been approximately $70 million in gross combined annual premiums, which is only about fifteen percent of the hypothetical, worst-case scenario of $450 million identified by the Department of Transportation in the final regulatory impact analysis. This includes both tankers and other types of vessels, such as passenger vessels. The system that is in place is both reliable and practical.

On July 1, 1994, the Coast Guard published the interim rule implementing the vessel financial responsibility provisions of the Oil Pollution Act of 1990 (OPA 90) and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). That rule, for most intents and purposes, became the final rule on March 7, 1996. The Coast Guard last testified before the former Coast Guard and Navigation Subcommittee on this rule on July 21, 1994. That testimony outlined the rule and the Coast Guard's expectation for compliance. Today, I will summarize the experiences of the Coast Guard with the rule to date.

You may recall that the rule established three compliance dates: December 28, 1994, for self-propelled tank vessels; July 1, 1995, for tank barges and mobile offshore drilling units; and, for all other vessels (that is, passenger vessels, dry cargo vessels, etc.), the date their preexisting COFRs expire, beginning December 28, 1994. The catastrophic oil supply disruptions predicted by opponents of the rule did not materialize, and by December 28, 1994, most tank vessel owners and operators desiring to obtain new COFRs had done so.

International and domestic compliance with the COFR rule (33 CFR 138) was excellent, and all segments of the vessel operating industry met their respective deadlines. As of June 1996, thirty-five percent of the non-tanker segment were required to obtain new COFRs. They have done so. An overall, detailed breakdown of the new COFRs issued is attached to my statement, but can be summarized as follows.

As of June 1996, 1,839 self-propelled tank vessels, 3,978 tank barges, and 5,823 other vessels have complied with the rule. Thirty-seven percent of these 11,640 vessels are covered by self-insurance and financial guaranty, sixty-two percent by insurance guaranties, and about one percent by surety bond guaranties. Looking only at the self-propelled tank vessels, just over one third chose to self-insure.

As you will recall, one of the issues was whether the non-captive (i.e., non-Protection and Indemnity (P&I) club) portion of the world's marine liability insurance industry would fill the COFR guaranty void which was created by the non-participation of the vessel owners' P&I clubs? The answer is yes--many tanker owners who did not wish to purchase commercial COFR guaranties, could and did self-insure. Those that could not self-insure found other viable COFR guaranty options available to them. The threatened "train wreck" did not occur. The commercial insurance market rose to the challenge and filled the void left by the vessel owners' refusal to continue to allow their own insurers to issue financial responsibility guaranties to the Coast Guard. Referring back to the words of OPA 90's conference committee report, the rule accomplished one of Congress's stated objectives, which was to: "foster a continuing market for providers of financial responsibility." Had the world's commercial insurers not come forward, the American surety bond market, which is very closely related to the American insurance market, stood ready to issue the requisite guaranties in order for maritime commerce to continue unabated.

Of the owners that self-insured, many were foreign, independent tanker owners. Much self-insurance was set up by parent companies as special purpose corporations whose sole function is to act as financial guarantors. A financial guarantor must meet the self-insurance criteria of the rule; that is, it must meet the so-called U.S. net worth formula. Mobil was the first to use this method.

Most of these special purpose guarantors have one asset, a demand note from the parent company, and no liabilities. The high-profile, U.S. accounting firms that scrutinized these arrangements assured themselves that the demand notes constitute assets in accordance with generally accepted accounting principles. These accountants audited the balance sheets of these companies in accordance with generally accepted auditing standards. Accordingly, these special purpose COFR guarantor companies are in full compliance with the rule. Not all owners and operators can or wish to avail themselves of this self-insurance arrangement, but they can and did purchase either surety bond guaranties or insurance guaranties.

Opponents of the "spiller pays" philosophy embodied in OPA 90 had argued that no commercial COFR guaranties would ever be made available by the commercial market and that, even if they were made available, the result would be unreasonable and excessive costs on industry. However, the Coast Guard has been advised by the commercial insurance and surety bond programs that their gross, combined annual premiums for COFR guaranties will be about $70 million for the 1995 policy year, and somewhat less for the current year. Compared to the hypothetical worst case scenario of $450 million, which would have resulted in an increase of less than a penny per gallon of gasoline at the pump, United States consumers have received assurance of payment of removal costs and damages at near bargain basement prices. Eighty to ninety percent of this cost is borne by the oil tanker industry, with the remainder borne by dry cargo vessels. If the tanker industry were to pass on one hundred percent of the $70 million cost to U.S. consumers, the impact at the pump for the American motorist would be even more invisible. The average economic impact on dry cargo and passenger units of carriage is too insignificant to mention.

In the post-implementation phase of the COFR rule we looked at the assertion of excessive costs on industry, we attempted to ascertain what the cost of COFR guaranties might have been had the vessel operating industry, that is, the P&I clubs, provided the guaranties themselves. We asked the representatives of the international group of P&I clubs what these costs might be. The clubs' representative confirmed that the clubs had no hard and fast information to support their testimony in July 1994 that the cost of commercial guaranties would greatly exceed the cost of coverage provided by P&I clubs. During discussions with other insurance industry representatives, we have learned that had the P&I clubs provided the COFR guaranties themselves, the cost to their vessel owner members would not have been much different than what is being paid for commercial COFR guaranties. This is because, regardless of who acts as the direct COFR insurer or guarantor, the increased cost of the commercial reinsurance applicable to OPA 90 COFR coverage would be about the same, since reinsurers assume the greater portion of the premium. The point is, that the international reinsurance market largely sets the cost of COFR coverage, not the person actually issuing the COFR insurance guaranties, be they commercial or P&I club.

The success story here is that for a relatively small cost, victims of oil and hazardous substance incidents in the United States now have written assurance of compensation by a responsible party, up to statutory limits, in a United States venue. If, in the future, a more efficient and less expensive means for compliance with Title I of OPA 90 is developed, the

Coast Guard will be ready to evaluate that proposal. The rule does not preclude new guarantor entities or the P&I clubs from entering the COFR guarantor field. The Coast Guard will continue to rely upon the free market to develop any improved guarantor schemes.

Mr. Chairman, I want to publicly thank the private sector for its commitment to finding ways to provide COFR guaranties under OPA 90 and CERCLA. This includes the United States surety industry, which played a vital role, as well as the American insurance market. With respect to the players in the American insurance market, which is represented by the Water Quality Insurance Syndicate, my hat is off to those folks. They charge not one penny more for issuing a COFR guaranty than the cost of the basic, underlying insurance cover.

I know that several persons and organizations around the globe, including members and managers of P&I clubs, and certain Lloyd's underwriters, labored long and hard to achieve what is a successful conclusion to the COFR story. I truly appreciate their efforts.

Thank you for the opportunity to share this information with you. I will be happy to respond to any questions that you may have.

OPA/CERCLA VESSEL CERTIFICATES OF FINANCIAL RESPONSIBILITY AS OF 06/04/96

METHOD OF GUARANTY	*Dry Cargo*	*Tanker*	*Tank Barge*	*MODU*	*Passenger*	*Fishing*	*Utility*	*TOTALS*
First Line	1509	575	0	0	30	8	30	2152
Shoreline	902	505	0	1	28	11	1	1448
WQIS	245	28	1391	24	109	204	812	2813
Financial Guaranty	248	630	1002	139	5	0	242	2266
Self-Insurance	80	46	1574	115	49	25	187	2076
Surety Bond	11	45	9	0	0	0	7	72
Other Insurance	189	10	2	0	2	549	61	813
TOTALS	3184	1839	3978	279	223	797	1340	11640

Dry cargo includes bulk carriers, containerships, reefers, ro-ro's, etc.

Tanker includes crude carriers, product carriers, chemical tankers, OBOs, LPG and LNG carriers

Fishing includes fishing and factory vessels

Utility includes deck barges, tug/tow boats, OSVs, research vessels, and oil spill response vessels

Other Insurers include Heddington Insurance, Ocean Marine Mutual P&I, Gyosen Chuokai, Highlands Insurance Sphere Drake, Travelers, ILU and Lloyds

The 1839 tank vessels total 83,428,503 gross tons and approximately 166,857,006 deadweight tons.