FEDERAL MARITIME COMMISSION

FACT FINDING INVESTIGATION NO. 30

COVID-19 IMPACT ON CRUISE INDUSTRY

INITIAL REPORT – LICENSING AND BONDS

June 30, 2020

Table of Contents

I. Summary 3
II. Investigatory Method 4
III. Preliminary Observations 5
A. Bonds [Large and Medium Size Passenger Vessel Operators] 5
B. Bonds [Small Passenger Vessel Operators] 6
IV. Next Steps 7
V. Conclusion 8

I. Summary

In April, the Federal Maritime Commission (FMC or Commission) initiated a fact-finding investigation (Fact Finding Investigation No. 30 or FF30). The Order of Investigation[1] directed Commissioner Sola to investigate and respond to the current challenges impacting the cruise industry and the U.S. ports that rely on it. As an initial step in carrying out this mission, a concerted effort was made to contact the leadership at key ports across the United States, as well as trade associations, individual business enterprises related to the industry, and labor organizations. These conversations led to the creation of various consultative panels and a determination to divide the mission between a review of immediate and long-term needs and then, if possible, offer solutions to any observable problems. Initial panel member discussions revealed a pressing need to explore the possibility of regulatory reform in limited areas to assist the small business enterprises and the sailing public during the difficult financial times wrought by the current pandemic. This initial report is intended to address one of those concerns.

Much media attention has been focused upon the financial health of passenger vessel operators (PVO) and their ability to survive the economic pressures brought to bear by the inability to sail for much of the year. It is therefore not surprising that these concerns along with consumer protection were front and center during the initial discussions presented to the consultative panels. Initial investigations revealed that the smaller PVOs tend to be the carriers with the most limited sailing seasons and therefore were the most heavily impacted by the current no sail order issued by the Centers for Disease Control and Prevention (CDC). Indeed, it was reported that due to the CDC order and the limited sailing season, some carriers would not sail this year. Discussions were focused on what the Commission might do to assist the PVOs without placing consumer interests at risk. This question led to an analysis and evaluation of the financial instrument, most commonly performance bonds, that PVOs are required to have to be issued a certificate by the FMC.

The PVO program administered by the Commission (46 U.S.C. §§ 44102-44103), requires evidence of financial responsibility for vessels which have berth or stateroom accommodations for 50 or more passengers and embark passengers at U.S. ports and territories. Certificates of performance cover financial responsibility used to reimburse passengers in the event their cruise is cancelled.[2] The Commission's regulations at 46 C.F.R. § 540.5 provide that the amount of coverage generally required shall be in an amount determined by the Commission to be no less than 110 percent of the unearned passenger revenue (UPR) of the applicant on the date within the two fiscal years immediately prior to the filing of the application which reflects the greatest amount of unearned passenger revenue.

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[1] Order of Investigation, Fact Finding Investigation No. 30, COVID-19 Impact on Cruise Industry (FMC April 30, 2020), https://www2.fmc.gov/readingroom/docs/FFno30/ffno30_ord.pdf/.

[2] Federal Maritime Commission 58th Annual Report for Fiscal Year 2019 (FMC 2020, p. 26), https://www.fmc.gov/wp-content/uploads/2020/04/58thAnnualReport.pdf.

The analysis of this program was facilitated through the use of consultative panels comprised of some of the most senior executives of both U.S. and foreign flagged cruise lines, the chief executives of ports across the United States which service the lines, consumer advocates, longshore labor leaders, and members of the insurance industry. The ability of certain lines to be able to compensate consumers without the need to call upon the bonds filed with the Commission was of great interest.

In order to better evaluate this requirement, surveys were conducted of representative carriers to determine the extent of current exposure wrought by the current CDC no sail order. This review helped reveal both the true expense of the performance bonding requirement and its ability to adequately protect the consumer. The panels attempted to identify how often claims against the bonds had been filed historically and what the claim rate might be going forward.

Executive Order 13924 states that "Agencies should address this economic emergency by rescinding, modifying, waiving, or providing exemptions from regulations and other requirements that may inhibit economic recovery, consistent with applicable law and with protection of the public health and safety, with national and homeland security, and with budgetary priorities and operational feasibility." [3] Concerns about the fiscal burden the bonding requirement places upon the carriers were weighed against the benefits to the sailing public.

II. Investigatory Method

Commissioner Sola met with several PVOs of varying sizes, both individually and as representative groups. Small PVOs have been most eager to discuss their financial instrument situation and Commissioner Sola has heard a range of experiences from small PVOs.

Questionnaires were sent out to a randomly selected group of carriers equally representative of large, medium, and small PVOs. Questions focused on areas related to:

- Nonperformance financial instrument on file;
- Current ability to refund unearned passenger revenue (UPR);
- Ability to fully refund passengers in a normal operating environment;
- Collateral PVOs are required to provide for their financial instruments;
- Premiums PVOs are required to pay for financial instruments; and
- Internal process for refunding passengers due to nonperformance.

[3] Executive order 13924, Regulatory Relief to Support Economic Recovery (The White House May 19, 2020), https://www.whitehouse.gov/presidential-actions/executive-order-regulatory-relief-support-economic-recovery/.

III. Preliminary Observations

A. Bonds [Large and Medium Size Passenger Vessel Operators]

To date, the study has the following observations to offer:

The study found that of the PVOs reviewed, all indicated that at time of their response, their unearned passenger revenue was significantly higher than the amount required to be bonded by the FMC (maximum $32 million per cruise line[4]).

- All large PVOs also indicated that they have the funds to fully refund all unearned passenger revenue.
- More than one large PVO indicated that 100% of UPR is being kept as cash or its equivalent and available for refunds for nonperformance, which is in line with their capability during normal operations.

No PVOs reviewed in this category are required to provide collateral for their financial instruments. One PVO indicated that though they do not currently have to provide collateral, their financial instrument holder has the right to request it under certain circumstances.

PVOs are required to pay a premium on their bonds at varying levels ranging anywhere between $200,000 and $600,000.

Every PVO reviewed in this category brought up prior situations, such as the 2008-2009 financial crisis and shipboard health incidents, to point out that there has never been a situation when a cruise line, backed by the appropriate financial instrument as required by the FMC, have failed to honor refund requirements. The questionnaires stress that " New refund protection requirements that increase cruise line working capital requirements or necessitate ticket price increases will weaken cruise operators' financial soundness, increasing risks of failure on an industry-wide basis, possibly making it more, rather than less, likely there could be a failure of the system."

When individual PVOs were asked by the study to suggest means by which the Commission might address the situation, the following responses were received:

- "The Commission could use its platform to inform passengers where to get financial information about cruise lines, and what cruise cancellation insurance covers, and how to shop for it if it makes sense for the individual passenger's situation."
- "The Commission should take advantage of the vastly increased transparency in the industry to make sure that both passengers and the government are better informed."

[4] Federal Maritime Commission 58th Annual Report for Fiscal Year 2019, *supra* note 2, at 3.

- “As the Commission has done in some prior situations, the Commission can act as an information source for passengers seeking refunds, providing details of how and where to apply and what to expect.”
- “The best protection for passenger refunds is a strong and stable industry. This is clearly emerging from the shadows of the COVID-19 threat as the weeks advance toward reopening.”

B. Bonds [Small Passenger Vessel Operators]

To date, the study has the following observations to offer:

A variety of bond and escrow accounts are being used to meet the financial responsibility requirements imposed.

Of those PVOs who utilize bonds to satisfy financial responsibility requirements, most maintain a cooperative, understanding relationship with their financial instrument holder. Indeed, as of this writing, only one PVO reported a negative opinion of their financial instrument holder due to a recent demand that their collateral amount be increased to one hundred (100) percent of the bonded amount.

When a bond is utilized, PVOs are required to pay a premium on said bonds at varying levels ranging anywhere in between $75,000 and $300,000.

Many small PVOs only operate in the summer. These PVOs often do maintenance and refurbishing over the winter months. Some had cancelled their entire 2020 season and are not looking at having any new revenue coming in until 2021.

All PVOs who responded to the questionnaires indicated that they have sufficient funds to fully refund all UPR. This is in line with their capability during normal operations. Of note however, one PVO, whose bond amount exceeds current UPR, indicated that without the bond, they are not capable of refunding all UPR, as to do so would result in the loss of all working capital necessary to operate with the possible commensurate result of a default on current financial obligations.

Most small PVOs are required by their surety to provide collateral at varying levels of the bond amount. In some cases, it is reported that the cost to maintain collateral exceeds the bond’s premium.

When individual PVOs were asked by the study to suggest means by which the Commission might address the situation, the following responses were received:

- Mentioning the ease by which customers may obtain a refund from their credit card company (which will be discussed more in the next interim report) it was proposed that the FMC bonded amount take into account the number of purchases made with credit cards.

- Observing that the financial instrument amount required is based on the highest UPR for the last two years and that UPR is lower during the COVID-19 recovery period, it was proposed that a reduction in nonperformance requirements be made to accurately reflect current UPR levels.

One small PVO recommended that the government temporarily guarantee the amount in the financial instrument, giving companies access to that cash. They also suggested lowering the percentage of the financial instrument and specified that lowering the percentage to 50% (down from 110%) “would improve our financial stability, especially during times operations are halted/restricted.”

One small PVO is permanently closing their business. They have been in contact with the FMC’s Bureau of Certification and Licensing regarding their bond requirement. They informed the FMC that all passengers were being sent refund checks. As the surety company has to reimburse any other passengers overlooked by the company, they were advised to provide the surety company with a recent audit of financial records, passengers due refunds, the amount, and other information to assist the surety company in determining all passengers have received refunds.

IV. Next Steps

The study has found that the sudden suspension of most cruise transportation due to COVID-19 has significantly reduced some PVOs’ current UPR, leading to substantial disparity between current UPR and the required coverage amount under 46 C.F.R. § 540.5. This disparity could result in unnecessarily high premiums and required collateral for PVOs to maintain their required financial instruments.

The Commission’s regulations at 46 C.F.R. §540.5 provides that the Commission may, for good cause shown, consider a time period other than the previous two-fiscal-year requirement or other methods acceptable to the Commission to determine the amount of coverage required. The Commission’s regulations at 46 C.F.R. § 540.9(l) further allow smaller PVOs to submit a request to substitute alternative forms of financial protection to evidence the financial responsibility as otherwise provided in the regulations.

The study has determined that COVID-19’s unprecedented effects on the cruise industry constitute good cause under 46 C.F.R. § 540.5 and 46 C.F.R. § 540.9(l) for the Commission to consider alternative forms of financial protection using a shorter period to determine the amount of PVOs’ financial responsibility.

To that end, the record suggests that a requested lower coverage amount should be favorably considered when a PVO whose UPR at no time for the two immediately prior fiscal years has exceeded 150% of the required cap[5] submits a request to the Director, Bureau of Certification

[5] Only PVOs whose UPR at no time during the two immediately prior fiscal years has exceeded 150% of the required cap may request alternative forms of financial responsibility under § 540.9(l).

and Licensing, seeking a temporary surety/financial responsibility amount based upon 110% of the PVO's previous month's UPR rather than the prior two fiscal years' UPR. Approval of such requests shall be granted by the Director provided the PVO submits documentation satisfactory to the Director demonstrating the PVO's UPR; said report shall comply with individual reporting requirements imposed by the Director of BCL regarding the submission of satisfactory documentation demonstrating the PVO's UPR on a monthly basis. The PVO must ensure that the surety, insurance, guaranties, or escrow account held is sufficient to cover the 110% of existing UPR. This filing should be in addition to all other filings required by this rule and shall not relieve the PVO of any other terms or conditions established by regulation or statute. As an additional condition of this approval, it must be understood that failure to provide said report on time or failure to maintain financial instruments covering 110% of existing UPR shall result in the immediate reinstatement of the financial responsibility amount on file with the Commission prior to the granting of the modification approved under this policy.

It is further recommended that the Commission maintain this policy as long as it determines that COVID-19's negative effects on the cruise industry continue and in no case shall this policy terminate prior to April 1, 2021.

These recommendations should not be considered this study's final proposal concerning PVO financial responsibility. Reviews are ongoing and may produce further suggested actions which, if proffered, will be included in the final report. This recommendation is being presented due to the urgent nature of the problem generated by the ongoing pandemic.

Large PVOs will likely be unaffected by the steps outlined above. The maximum amount of financial instruments that the FMC requires by large PVOs is so much less than their unearned passenger revenue, that the amount bonded would have to increase by an unreasonable, exponentially increased amount in order to come close to unearned passenger revenue, which would cause a further hardship for PVOs in this current crisis. The intent of the bonds is to protect consumers from PVOs that may go out of business. Even in this dire situation, no large PVOs are indicating at this time they are likely to go out of business.

Small PVOs, however, having less than the threshold amount of UPR to warrant a surety equal to the maximum mandatory should benefit from the proposal through the commensurate reduction of operational costs tied to surety premiums and collateral requirements. Allowing the review period for unearned passenger revenue and the bond amounts to be shorter will maintain the integrity of the FMC's PVO program while providing regulatory relief to small PVOs during the COVID-19 crisis, in line with Executive Order 13924.

V. Conclusion

During these unique times and in light of the assessment above, Commissioner Sola as Fact Finding Officer recommends that the Commission adopt a policy statement reflective of the next steps outlined above in order to protect the cruising public and address the current challenges impacting the cruise industry.

Commissioner Sola will continue his Fact Finding mission to study the area of PVO financial responsibility and shall be issuing another report related to consumer protection prior to the issuance of a final report to the Commission.