

Marine Market Report

2021 in review

Our team

For further information, please contact:

Peter Townsend | Marine Specialist Consultant

E peter.townsend@miller-insurance.com



Phil Wheeler | Head of Marine

T ++44 20 7031 2366

E phil.wheeler@miller-insurance.com



Nick Summers | Head of Direct Marine

T +44 20 7031 2832

E nick.summers@miller-insurance.com



Anthony Burnell-Nugent | Hull Practice Lead

T +44 20 7031 2391

E anthony.burnell-nugent@miller-insurance.com



Alex Howard-Smith | Direct Marine

T ++44 20 7031 2537

E alex.howard-smith@miller-insurance.com



Seema Pandey | Direct Marine

T +44 20 7031 2714

E seema.pandey@miller-insurance.com



Supply chain 'whack-a-mole'

For the uninitiated, 'whack-a-mole' is a game in an amusement arcade in which players use a mallet to hit toy moles that appear at random. Points are scored for each one hit. As each mole is hit, it disappears only for another to appear. In a wider context, 'whack-a-mole' is sometimes used in reference to a situation where attempts to solve the problem are either piecemeal or result in temporary or minor improvement. As one issue is resolved another problem manifests itself.

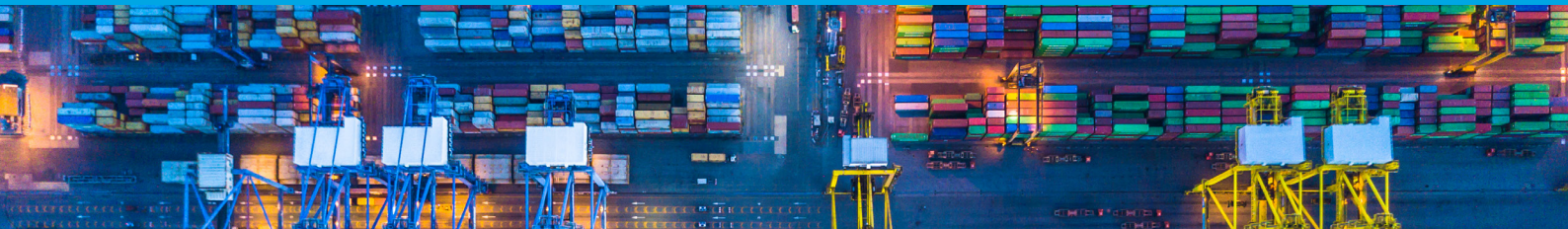
2021 has been the year of the supply chain 'whack-a-mole'.

The supply chain 'moles' include (in no particular order):

- Ever Given
- Covid port shutdowns
- Schedule backlogs
- Supply/demand mismatch following Covid
- Bomb cyclone in the US
- Typhoon Kompusa
- Lack of availability of lorry drivers
- Skipping of scheduled calls
- Lack of availability of empty containers
- Fire in a microchip manufacturer
- Delays leading into the Chinese New Year 2022

Any one of these 'moles', singularly, would have a negative impact to the supply chain. The successive cumulative impact in a short period had an exponential negative impact that has caused significant dislocation that will take some not inconsiderable time to fully repair. Some observers are of the view that it may take two or more years.

This is a golden age for almost all shipowners. The news is less good for cargo owners and freight forwarders. The bottlenecks at West Coast ports, for example, tied up container capacity and supply bottlenecks fuelled already-soaring rates for transpacific ocean freight. If not pushed through to the consumer, these increased freight costs have pinched margins for companies that import from Asia.



An enhanced risk landscape

So a healthy shipping market should equal a healthy insurance market one might contend? Not necessarily. Below are a few issues of enhanced risk that have manifested themselves as a result of the supply chain disruption (in no particular order):

- Increased number of containers overboard
- Huntingdon pipeline
- Bulkers carrying containers
- Zim Kingston
- Accumulation of vessel risk
- Increased terminal operators' liability exposure



Insurance market conditions

Following three years of compounded rises, the hull book ought to be in a far healthier condition for all insurers. The LMA market triangles for the 'T' risk classification (hull and machinery property damage) largely reflect that position. From being loss making 2015 through to 2019, the impact of remedial action is manifesting itself with a loss ratio for 2020 that looks like being a bumper year for Lloyd's hull underwriters. Before the bunting gets put out though, a cautionary note, at the end of the third quarter of 2021, the incurred loss ratio bears a much closer comparison to 2015-2019 than it does to 2020.

The premium flight from Lloyd's to the Company market is now tangible. The Corporation of Lloyd's has majored on syndicates remediating previous loss-making performance. This has now started to bear fruits, but it is not without cost, as much premium has been transferred out of the Lloyd's market. The same LMA figures show a premium reduction of around 40% in 2020 compared to 2016, and that is against a rising market.

Has all of this premium been lost from London? Not at all. It has been lost by Lloyd's but much of it has been retained by the London market. Many carriers with dual platforms have migrated business to their Company market platforms to circumvent the growth challenges at Lloyd's. Additionally, new capacity has emerged in the form of Navium, Convex and HDI and, in addition to the transfer to Company stamps of previously Lloyd's placed business, there has been a general upscaling of hull writing in single platform company stamps.

Losses and Reinsurance

The Property & Casualty and Reinsurance markets have had their own version of 'whack-a-mole':

- Hurricane IDA
- European storm Bernd
- Convective storms in December \$ 6 billion
- Colorado wildfires
- European storm Arwen
- British Columbia floods

Estimated insured losses of \$120 billion from natural catastrophes in 2021, increased from \$82 billion and \$57 billion in 2019 and 2020 respectively, according to Munich Re. Add to that mixture trapped ILS capital, looming S&P rating method changes and inflationary pressure. Like the primary market, a lot of the remedial pricing increases have been undone by increased loss incidence, both in frequency and in severity. As reinsurance is used as quasi capital, increased reinsurance cost equals increased cost of capital.

Sadly, rather like the previous year, 2021 will not be remembered with a great deal of affection. For the insurance market it was an okay-ish year. Although there were no abnormal hull losses, the supply chain moles kept appearing, the Covid claims, Cyber claims and other Property & Casualty claims conspired to result in combined ratios of carriers still unlikely to be too much better than 100%. New issues of ESG, Poseidon Principles and environmental matters are likely to consume resources. That having been said, the insurance industry is far more robustly capable of dealing with the challenges thrown at it than it has been for several years.



In other matters

Seafarers

The early signs of an exodus of seafarers could add to the supply chain disruption in 2022. Seafarers have faced endless challenges due to Covid and its many variants. Of the 1.5 million seafarers serving at sea, it is estimated that barely a quarter of them are vaccinated, which means significant obstacles to crew change and repatriation. Tens of thousands of seafarers are still stuck onboard vessels beyond expiry of their contracts, although there have been some efforts made to remedy that situation. This has translated into low morale and signs that many experienced seafarers are not prepared to continue to sail on this basis.



Environmental, Social and Governance (ESG)

ESG has now come to the top of the pile, and due to changes in the environmental outlook, it looks like it will remain there. Maritime transport emits around 940 million tonnes of CO₂ annually and is responsible for about 2.5% of global emissions according to the 3rd IMO Greenhouse Gas study. These emissions are projected to increase between 50% and 250% by 2050 if mitigation measures are not put in place quickly.

The International Maritime Organization (IMO) is recognising the need to accelerate efforts and the Marine Environment Protection Committee (MEPC) has agreed to initiate a revision of the initial IMO strategy on reduction of greenhouse gas emissions from ships. Disappointingly, the revised strategy will not be considered by the MEPC until spring 2023, although interested states have been invited to submit concrete proposals for a revised strategy to MEPC in June 2022.

The Poseidon Principles for banking is an attempt for Banks to show 'Green' credentials when it comes to lending. The insurance industry has partially mirrored this with six insurers to date adopting the Principles: Swiss Re, Gard, Hellenic Hull Management, SCOR, Victor International, and Norwegian Hull Club, although almost all insurers are reviewing their Greenhouse Gas Emission strategies.

The complex requirement for transparency and measurement will drive underwriter behaviour, and in turn determine available market depth. Underwriter ESG requirements will not be so much a pricing issue, but more a binary open or closed to specific risks issue. A fundamental understanding of the ramifications of ESG, both at individual risk level and holistically at portfolio level will, we believe, develop into being important drivers of pricing and marketing strategy.

At Miller we are closely watching developments and actively look to engage in dialogue and share with shipowners and other clients the mechanics of how insurers' views will be conditioned by the requirements of ESG.

The World fleet

As reported by UNCTAD, the World fleet has grown by only 3% in the 12 months to January 2021, reaching 99,800 ships of 100 gross tonnes and above. During 2020, delivery of ships fell by 12%, whilst orders for new ships in the same period fell by 16%. In early 2021, however, shipping companies reacted with a surge of new orders. This, of course, is relatively easily explained by the global pandemic but, nevertheless, is sharply down from the previous year's growth rate of around the 11% mark. A reduction in replacement tonnage results in an ageing of the World fleet. Older tonnage is almost certainly less efficient with higher levels of emissions. UNCTAD reports that at the beginning of 2021 some 30% of the carrying capacity of the global fleet was in ships between 5-9 years old. Since 2017, this age cohort has represented the highest proportion of capacity, but its proportion, and that for younger vessels, has been falling and the proportion of vessels 10-14 years has been rising at a steady rate.

MTSL and Ukraine

There will certainly be new problems facing the shipping industry. The newly enacted Marine Traffic Safety Legislation may cause shipping concern through the disputed waters of the South China sea and the Taiwan Straits. Much depends upon how vigorously (or not) the legislation is applied. To date there have been no advices of vessels having been detained under the legislation.

There is material political concern on the Ukraine borders at the moment. Whilst not specifically a marine problem, the fallout from any incursion will almost certainly affect the shipping industry and Sanctions screening is likely to remain very much on Insurers' radars.

2021 has now been consigned to the history books. In 2022 let us hope, back to our 'whack-a-mole' analogy, that there may be fewer moles and a bigger mallet!

About Miller

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With a client-first approach, we value our long-standing relationships and continue to build strong and rewarding partnerships.



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