Supply and demand in marine insurance

Now **Simon Schnorr**, of StarStone, considers the changing patterns of marine insurance worldwide

Familiar, cyclical ups and downs in marine insurance pricing are caused by multiple factors. As most buyers will be well aware, the price of marine insurance has been trending downwards for some time. The soft market has been influenced by circumstances of two kinds: those internal to global insurance markets; and those external developments related to other industries or economic and political conditions that fuel insurance pricing trends.

From an internal perspective in 2016, almost all pricing pressure across the major marine lines helped to push prices lower. The greatest force acting here was supply and demand. In short, more capital than necessary has been chasing a shrinking pool of marine risks, which has driven competitive price-cutting, and competition over the terms and conditions of cover.

Hull and machinery has proved a particularly competitive line. Recently further new risk carriers have been attracted to the segment in spite of its historically relatively unattractive loss record. This is despite figures from the International Union of Marine Insurance showing a long-term, consistent decline in losses as a percentage of global tonnage since 2000. Marine liability insurances have also proved competitive, but for example with risk ceded as reinsurance from the P&I Clubs to international insurers continuing to be viewed as potentially sufficiently profitable, further capital has been attracted into this sector of the market also. The calamitous 2011/2012 year, with losses including *Costa Concordia* and *Rena*, brought only a relatively short-term blip in the pricing trend for certain segments of the marine market. 2015, which saw large losses such as the *Alpine Eternity* collision, had little pricing impact.

As the total amount of insurance capital increases, certain classes of marine risks at first sight may look somewhat more attractive to insurers as they can be more uncorrelated with natural catastrophe risks. The cargo market has also become even more competitive with many sectors of cargo pricing sliding further and faster than even hull insurance over the past few years. This is despite some recent major losses brought about by the Tianjin explosion and potentially Hanjin Shipping's bankruptcy. At the same time policy terms and conditions have often been expanded.

Externalities affecting marine insurance pricing are more varied, and have squeezed the demand side of the equation. Macroeconomic factors such as low international oil and commodity prices had a major impact. Generally muted global economic growth, including in China, somewhat tapered international insurance demand. More specifically, ongoing depressed freight rates continued to strain the economics of the shipping industry, negatively impacting vessel deployment and values. Little is set to change in 2017, although demand has held up or even risen for some niche types of marine insurance cover, which means that prices may show a little more resilience in certain sectors of the industry.

As alluded to above, the hull and machinery sector has been weighed down by the egregious state of the shipping market for some time now. Shipowners are enduring one of the freight market's longest downturns in a generation, which shows no sign of an early recovery in 2017. The perceived slowdown of the Chinese economy is one cause of waning shipping demand; the fall in global commodity prices is another (and of course these two factors are connected). Neither looks set to rebound in 2017, with the bulk sector having been particularly hard hit.

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From July 2015 until late in 2016, the price of oil remained stubbornly below US$50, after falling by more than half. A significant number of offshore support vessels have gone into lay-up, as producers and contractors significantly scaled back their exploration and production activities. Together these factors have pushed down demand for vessels and yet despite the reduction in tonnage, the market remains oversupplied. Insured values and trading activity both continued to reduce throughout 2016, which have also had an impact on underwriters, hull and war insurance

portfolios, as well as on the wider market too. This combination of factors does not look likely to reverse swiftly in 2017.

Sectors of the marine cargo market have similarly suffered from the downturn in global oil and commodity prices. Insured values and volumes for these raw materials have fallen within certain segments of insurers' portfolios as a result. These metrics have fared better for general manufacturing and consumer goods. Hesitant, cautious consumer confidence remains in North America and to a lesser extent in Europe. It has allowed insured values and trading volumes to hold up well in this sector of the market. Only a very brave man would forecast, for all to read, the direction of consumer confidence in Europe and America through 2017, but it is unlikely that we will begin the year with any major rebound in the oil and commodities cargo market, despite the slight year-end upticks seen in both areas.

Surprisingly, perhaps, the woeful oil price did have an element of positive impact in one area of the shipping market for a limited period in 2016: tankers. Both the low level and the volatility of the oil price appear to have stimulated an element of speculative oil trading activity. That in turn provided a modest stimulus to the tanker market, by driving a rise in chartering activity. Crude was more actively traded, which increased demand for tankers both for transportation and for short-term on-vessel storage. The latter seems to be the result of oil traders holding out for marginal upward movements in the oil price. Tanker demand increased towards the end of 2015, driving up charter rates and raising vessels' overall asset and insured values by around 50 per cent through the year. As a result of the aforementioned during 2016, an element of upwards movement in the insured values for certain tanker fleets was experienced in the hull market as well as some positive uplift in trading activity of certain clients in the cargo market.

Despite a backdrop of ongoing excess insurance supply, the marine liability insurance market has at least been bolstered by continued expansion of statutory liability requirements across the globe. These stimulants of demand have been seen in jurisdictions with established legal regimes, as well as in emerging markets and developing economies, and under international conventions. While removal of wrecks has attracted considerable attention, liabilities ranging from pollution to crew provisions have further supported the demand and need for marine liability insurance around the world. The direction is unlikely to change in 2017 and beyond.


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The energy liability market is another story, again driven by the oil price. The considerable decline in activity and revenues for many clients in this sector has resulted in a meaningful contraction in premium spend during 2016, as underlying exposures and revenues have continued to reduce. This will change when the oil price rises substantially, which will happen eventually, but perhaps not before the end of 2017, in the view of many experts.

All of these macroeconomic factors have combined to frame a challenging trading environment for insurers in all marine lines and solid buying opportunities for those in the market creating demand. While underwriters have recently observed that price decreases have slowed – if not halted – in certain marine lines, the downward trend is potentially set to continue overall. Sadly, too, the perceived value of specialty underwriting expertise is at risk of being eroded due to the facilitisation and commoditisation of marine insurance, at a time when it is arguably most needed. These developments are unlikely to recede suddenly in 2017.

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With prices still low, buyers have opportunities. One is to expand coverage, for example by considering the genuine threat of cyber risks and exploring the possible coverage options. Another is to consider the quality of the insurers they are using. Some of the weak ones may not survive the current soft pricing environment, or may not provide the levels of service and support that customers deserve and should expect. The best marine insurance underwriters are no longer competing aggressively on pricing. Instead they are differentiated by their financial wherewithal and their service levels in this difficult environment. Until the macroeconomic challenges which have descended upon us have lifted, high-quality insurers will be a major ally in difficult times. *MRI*


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