2022 marine, aviation and logistics forecast: trends and future risks

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Kennedys

Contents

Foreword

2021 saw the marine and aviation insurance industry grapple with a multitude of challenges including pandemic impacts, disruptive technology and climate related risks. These challenges will continue throughout 2022. Adapting to new technologies and achieving net zero will be central to the insurance agenda, as will the shifting geopolitical landscape.

Geopolitical impacts have become an utmost priority to global governments and businesses. Concern over state conflicts remains high with trade impacts, physical losses, and cyber risk following sanctions looming large; the Russian invasion of Ukraine has brought into sharp focus the wide ranging and fast moving impact of these events. In addition, albeit somewhat in the background for now, post-Brexit negotiations continue as agreements around both goods and services remain unresolved.

Pandemic-related transport disruption is likely to linger throughout 2022, with laid-up aircraft and vessels reactivated after months of inactivity, and the massive backlog of cargoes to deliver. While COVID-19 accelerated the transition to digital solutions as a result of necessity, it has also resulted in increased customer demand for more interactive and efficient digital platforms and products.

This trend is set to continue, meaning those in the transport industry and their insurers will have to deal with the challenges of adapting to new technologies – including the associated cyber risks, with ransomware and supply chain attacks continuing to rise. However, digital transformation remains essential for those wanting to stay relevant, competitive and reputationally sound in the current market. The marine and aviation industry has plenty of challenges to navigate in the months ahead.

Against this background, we highlight some key legal and regulatory developments, and provide an overview of the business critical topics which marine and aviation insurers should consider as they plan for operational resilience in 2022.

Legal and regulatory developments

In 2021, the UK courts had to contend with pandemic related issues — not least the FCA business interruption test case — as well as an increase in group actions, cyber related claims and environmental disputes. Climate related regulation and post-Brexit reforms look set to continue, as will the impact to aviation and marine industries.

The stranding of the Ever Given made headline news in 2021, and the claims arising from associated delays and losses will continue through 2022.

The UK Supreme Court also handed down its long-awaited decision in the data privacy case of *Lloyd v Google* [2021]. The case dealt with the important questions of whether compensation may be sought following data breaches, and what constitutes the 'same interest' to enable individuals to rely on a representative action.

While the judgment suggests that representative claims for damages, rather than just for findings of liability may be difficult for data breaches, the door has been left ajar for other types of representative claims.

> **The move towards US-style opt-out group claims becoming the norm in the UK took a huge step forward when the Competition Appeal Tribunal (CAT) certified the first application for a collective proceedings order on an opt-out basis in *Merricks v Mastercard* [2021].**

This could be significant for the transport related group actions that are being progressed; the Road Haulage Association has proposed opt-in collective proceedings involving over 15,000 claimants (valued at more than £1 billion), which is due to be heard this year.

A raft of new rules and regulations were introduced during 2021, not least as the UK began to manage the end of the Brexit transition period. The ongoing impact of COVID-19 disrupted the usual programme of legislative change, and so much of what begun last year is set to continue in 2022, with big tech and sustainability taking centre stage.

For insurers, the proposed reform of the Solvency II regulations will be watched with great interest. The reform package demonstrates a desire from the UK Government to find money from financial institutions in the UK to fund its various projects - including Levelling up, Net Zero and new housing. The Government is due publish a consultation document on the proposed reforms in April 2022, ahead of planned legislation. This will be followed by a more detailed technical consultation from the PRA later in the year.

> **Maintaining its focus on technology innovation, in 2021 the UK Government launched a Future of Transport programme, with the aim to "shape transport innovation and make the UK a world leader in transport movement".**
>
> **The regulatory review included consultations on maritime autonomy, zero emission vehicles, the future of flight and modernising vehicle standards.**

A government response to the consultations is awaited, with indications being that substantive legislative reform will be required. While it is imperative that regulation adapts to technological advancements, caution must be exercised in light of the potential additional risks to insurers arising from the current proposals.

Shipping

The Poseidon Principles for Marine Insurance were launched on 15 December 2021. They are a global framework set up to assess and disclose the climate alignment (the degree to which a vessel or portfolio's carbon intensity is in line

with the International Maritime Organization (IMO) and the Paris Agreement's decarbonisation trajectories) of marine insurers' underwriting portfolios. Key to this will be the use and availability of consistent and accurate data, allowing insurers to measure and report with confidence.

The Poseidon Principles are consistent with the policies and ambitions of the IMO, which has committed to reducing global shipping's greenhouse gas emissions by at least 50% by 2050. To move towards this goal, from 1 January 2020, the cap on the sulphur content of ships' fuel oil was cut to 0.5% from 3.5%. In order to comply with this requirement, vessels can switch to natural or blended low-sulphur fuels or fit so-called 'scrubbers'.

However, associated claims have already arisen — corrosive scrubber waste has caused flooding to engine rooms, ballast tanks and cargo holds; engine and machinery damage has occurred due to the use of low-sulphur fuels; and bunker quality disputes have arisen from the use of incorrect fuel mixes.

In addition to global regulations, national measures are also being implemented, for example:

- **Danish Shipping has launched a new climate neutral strategy which it says will "set the course for the next three years".**
- **The Port of San Diego is to develop a framework to reach net zero carbon emissions by 2035, ten years before the State of California's carbon neutrality goal.**
- **The Cyprus Shipping Deputy Ministry has announced a new range of green incentives to reward vessels that demonstrate effective emissions reductions.**

Keeping up with these regulatory demands will mean that many vessels will have to implement significant, technical modifications to comply with these new requirements.

Aviation

Since the end of the UK/EU transition period, UK aviation rights and obligations are governed by a combination of UK law and retained EU regulations. The UK Government has stated that it wants to help the UK's general aviation sector thrive "in a post EASA (European Union Aviation Safety Agency) context" by exploring opportunities where it can safely simplify regulation, and encourage innovation. This includes supporting the sector's recovery, its zero emissions ambitions and addressing airspace modernisation.

Responding to the rise in technological innovation, regulation and legislation has been introduced to adapt to the increased demand for drone use. In addition, the UK Government's Regulatory Horizons Council has made recommendations around unlocking the benefits

of drones and supporting the "wider commercial deployment through regulation".

As well as developing technologies, proposed regulations will impact the costs to those involved in the aviation industry.

In October 2021, the CAA published a consultation on its initial proposals for the next price control at Heathrow Airport Limited. This will ultimately set the maximum charges the airport operator can charge its airline customers for using the airport for the next five years.

The CAA expects to issue their final decision in spring 2022, before they come into force in summer.

Commercial aviation insurers will also be impacted by the UK Government's proposed reforms to the Civil Aviation Authority's consumer enforcement powers, consumer dispute resolution, flight delay compensation and accessible air travel. The Government's consultation closes on 27 March 2022 and, if the proposals are implemented, will introduce a new compensation regime similar in nature to those regimes to the UK rail and maritime sectors, with compensation based on the price of the ticket. It will also consider mandatory ADR for airlines in respect of baggage and consumer claims.

All of these developments will assist in ensuring the industry keeps up with this fast moving environment, but will bring with them new challenges and risks for insurers.

Haulage

The UK has seen a quick succession of updated regulations in response to the end of the UK/EU transition period, the impacts of the pandemic, and addressing the climate crisis.

These include:

- Changes to the UK operator licensing regime
- A temporary legislative extension of road haulage cabotage
- The introduction of Clean Air Zones.
- Changes to HGV driving tests requirements
- Updated customs provisions

Government consultations regarding amendments to regulations are often open for a very limited period only, with the revised rules implemented at short notice. For example, on 9 March 2022 the DfT opened a consultation on whether to continue or to end the existing flexibility in road cabotage rules for foreign hauliers. This consultation will close on 23 March 2022.

This fast moving regulatory landscape means that hauliers need to make sure they keep up to date with the provisions applicable to them, and be mindful of the increased or new risks which may arise – such as injuries and losses as a result of insufficient training and additional duties, and the application (or not) of existing contractual terms.

Key topics to watch in 2022

Disruptive technology

"Just a few years ago, when considering strategy and future risks, autonomy was at the forefront of legal and insurer minds. That has been quickly overtaken by the response needed to the tumultuous few years that the world has faced, and continues to face.

However, in the background, although perhaps not at the same pace as planned, autonomous technology has continued to develop, as have the discussions about how this will be integrated into the current legal framework. We anticipate that the technology, and legal and insurance support around it will gather momentum again, especially given the likely advantages that autonomy will offer to the climate crisis response."

Michael Biltoo, Partner, London

Autonomous aircrafts, vessels and lorries already exist and their use is increasing, for example:

- Autonomous vessels are being widely trialled, including in the North Sea, Japan and San Francisco.
- Drones are being used globally, from delivering medical supplies in remote locations to surveying dangerous structures.
- Convoys of driverless lorries are being tested in the US, Germany and the UK.

With the technology already in use, business practice, infrastructure, legislation and regulations need to keep pace.

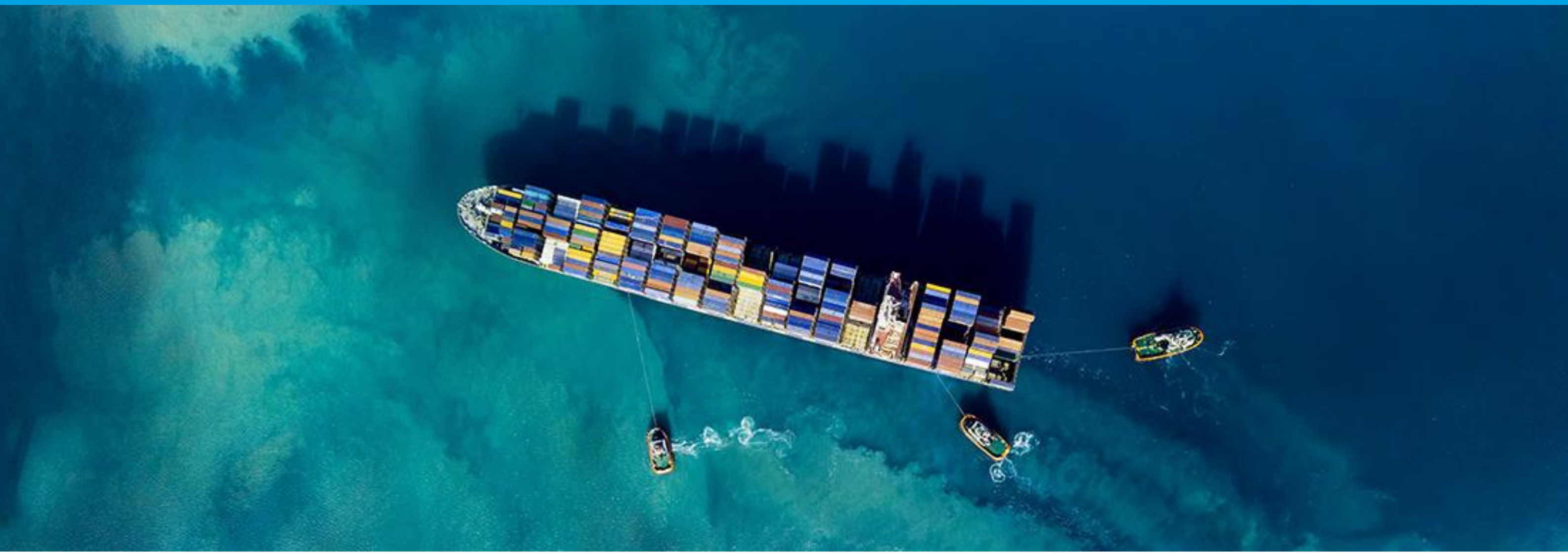
A significant barrier to large scale adoption of autonomous transport is the current inability to provide reliable, safe performance of these vehicles, vessels and aircrafts.

Real world testing is expensive, time intensive and impractical as it has to deal with millions of operational scenarios and environments — many of which are not yet known. This is crucial to ensure not only safe use, but also public confidence and acceptance.

Legal liability is another huge consideration, especially around the transition from human user to autonomous function. There are already several definitions of what an autonomous vehicle actually is, and the various levels of autonomy used. Lack of consistency will, inevitably, lead to disputes.

There are also practical risks of autonomous technology which insurers need to factor into their underwriting practices. Theft from driverless lorries or crewless vessels can, arguably, be easier than from a manned version, and the associated cyber risks include diverted routes, hacked data, the takeover of the vessel/aircraft/vehicle, and damage to property and life.

Notwithstanding the challenges and barriers to adoption, the reality is that this disruptive technology will over time be deployed at scale. To ensure success, global collaboration is needed. This is recognised by Lloyd's of London, who is currently collaborating with maritime entities in the hope of developing an international framework for maritime autonomous systems.



A fractured patchwork of domestic regulation will result in increased confusion, contrary to the aims of the global transport community seeking to embrace the benefits of autonomous innovation.

The regulatory developments around self-driving light passenger vehicles are considered in our Motor trends report.

Supply chains

“Roads are the main method of transporting freight within the United Kingdom — a method which has long been seen as the most efficient, timely and cost effective way of moving goods. However, with Brexit, COVID-19 and extreme weather events, the robustness of the industry has been severely tested.

As a nation, we are wholly reliant on the timely running of the supply chain and recent years have shown just how fragile the surrounding infrastructure can be. These testing times are likely to continue well into the latter part of 2022, as both the industry and the UK Government try to come up with solutions to increase the resilience of our supply chains.”

Shaan Burton, Legal Director, London

Modern manufacturing is built on an efficient ‘just in time’ global supply chain, and this system has faced arguably its biggest test in the last two years. Insurers have had to deal with unprecedented and on-going problems — likely to continue throughout 2022 — arising from log-jammed ports, static transportation networks and cargo-loss events as a result of a combination of pandemic, geo-political and climate impacts overwhelming the industry.

The Ever Given grounding in the Suez highlighted problems of aggregation with an increase of cargo at terminals, vessels queuing often for months at outer anchor at ports, exacerbated by a global shortage of containers and container freight rates increasing three-fold.

Restrictions around ports and airspace as a result of current geo-political conflicts will create bottle necks and a lack of availability of warehousing space. There will be difficulties physically moving goods, resulting in an increased risk of hijacking and theft due to limited available routes, looting or security presence being removed.

The inability to move goods also leads to an increased risk of theft, and potential fraudulent claims with malicious actors taking advantage of the inability to track goods. Supply chain management may become more difficult to control. Global sanctions may change as situations develop, resulting in ports being declared unsafe and unavailable airspace routes, leading to policy coverage disputes.

Changes to regulations add another layer to the challenges faced. New customs controls came into force in the UK on 1 January 2022, with British importers now required to make a full customs declaration on goods entering Britain from the EU, and rules of origin requiring exporters to prove their goods qualify for zero tariff access before shipping.

Trade associations are already warning that this will hit food supply in particular, with smaller businesses likely to struggle the most.

To avoid the direct impact to operations and the associated reputational damage to a company's brand, supply chain resiliency is now a priority issue for all businesses, and their insurers.

Sustainability

" The aviation industry has set itself some challenging targets in terms of sustainability, and substantial investment will be required in sustainable fuels in order to meet those targets.

Meeting those objectives will require co-operation between governments and industry in order to make meaningful progress on achieving those aims. "

Sam Mason, Senior Associate, London

The commercial transport sector poses major challenges in the fight to reduce emissions. Together, aviation and shipping account for 10% of UK greenhouse gas emissions and, on current trends, aviation will be the largest emitting sector by 2050. Road freight now accounts for 53% of CO_2 emissions within global trade-related transport, and this share is expected to rise to 56% by 2050 if current trends continue.

Currently, 80% of global trade by volume and 95% of UK trade is transported by ship. Of the global fleet of vessels, 97% are fuelled by heavy fuel oil or marine diesel. These are fossil fuels that produce CO_2 and other air pollutants when burnt. Therefore, despite being one of the most energy and cost-efficient modes of transport for international freight, the emissions from these vessels are directly linked to climate change, as well as negative environmental and health effects.

In the UK, the Government has set ambitious targets to reach net zero emissions by 2050 for the UK's share of international aviation and shipping.

Globally, at COP26 in November 2021, signatories to the Clydebank Declaration confirmed their support of the establishment of green shipping corridors — zero-emission maritime routes between two (or more) ports.

The industry's regulators, such as the IMO, have also set ambitious decarbonisation targets, and implemented regulations to enable the transition.

In July 2021, the UK Department for Transport said it could require flights departing the country to begin using a minimum sustainable aviation fuel (SAF) blend as early as 2025, rising to a 10.3% minimum blend rate by 2030, and reaching a 75% blending floor by 2050. This is even more ambitious than the levels proposed by the EU in the 'Fit for 55' pledge.

Meeting either of these targets will require a massive investment in SAF production, which is already underway. In December 2021, British Airways announced that it would be the first airline in the world to use SAF produced in the UK after signing a multi-year agreement with Phillips 66 Limited.

For road haulage, the UK Government has stated that sales of all new medium-sized trucks (up to 26m) are to have zero emission capability from 2035, and 26m and above by 2040.

Removing these emissions requires the development and deployment of clean technologies, and new policies and regulation. Technology will assist the larger goals, by implementing efficient routing systems, and clean air zones are already in place in a bid to improve the air quality in urban environments.

The implementation of new technologies and the improvised retrofitting of current vessels, vehicles and aircrafts in order to adapt to new alternative fuels and additional energy efficiency requirements will create new risks that are yet to be assessed.

> **There is little doubt that the transition from dirty and cheap energy to cleaner and more expensive energies will pose challenges yet to be ascertained from the technical and insurance standpoint.**

The role of technology

The ongoing digital transformation offers insurers a solution to allow them to meet their environmental, social and governance objectives, as well as offering their insureds the ability to transition to a more effective, efficient and often more climate friendly operation.

> **The use of accurate data will allow the maritime and aviation industries to more accurately predict extreme weather events, thereby minimising losses to property and cargo.**

Delays and route changes can be avoided, which as well as reducing the claims presented will also have a positive impact on a company's reputation.

Investors, banks, insurers and customers will all require information on the environmental impact of shipping companies. Failure to do so could be costly in relation to potential claims, access to investment and financing — and to the company's reputation.

> **Regulators, owners, operators and insurers are all responding to the call to reduce the harmful emissions caused by the maritime and aviation sectors. However, these changes will require huge investment and will create new risks.**

Geopolitical risks

Geopolitical risks have been brought into sharp focus following the Russian invasion of Ukraine. The impacts of the economic sanctions imposed by the global community have had an immediate impact on the maritime and aviation sectors. Ports, airspace and roads are no longer accessible. Cargoes are being diverted via alternative, longer routes. Assets are frozen, payments delayed.

We have considered the direct impact of this crisis on the global marine sector, charterparty clauses and aviation in separate articles.

Geopolitical risks were already moving up the agenda for insurers as a result of the pandemic. COVID-19 impacts caused increasingly fragile states, exposed political insecurities, diverted government resources and aggravated mental health problems, making people more vulnerable and susceptible to joining movements for change. This social activism ranges from shareholder demands for green financial products, to street protests against rising fuel costs, to social media campaigns boycotting products.

The physical impact of road blockages, along with increased risks of theft can result in haulage related delays and losses. An additional factor includes fuel price rises, which are frequently seen during times of geopolitical tensions. This potentially leads to attempts to cut costs elsewhere, which can be detrimental to driver and cargo safety.

While Somalian piracy cases have now reduced, a rise in geo-political tensions across the Gulf has led to an increase in piracy attacks across the Red Sea, and the Niger Delta region is seeing an increase of attacks.

The issue of ransom payments will remain contentious, notwithstanding recent decisions providing clarity around certain aspects, such as GA expenditure in the form of ransom payments (the *MV Polar*).

Businesses need to invest in better political intelligence in each market where they operate. Many of these risks are fuelled by grassroots concerns about the social and environment impacts of business, but they ultimately result in greater calls for further legislation and regulation.

Key contacts | get in touch

If you would like to discuss any of the issues raised in this report in more detail, please reach out to your Kennedys client relationship partner or get in touch with any of the contacts listed below.

To find out more about our services and expertise, and key contacts, please visit our Aviation, Shipping and International Trade and Transport and Logistics expertise areas.

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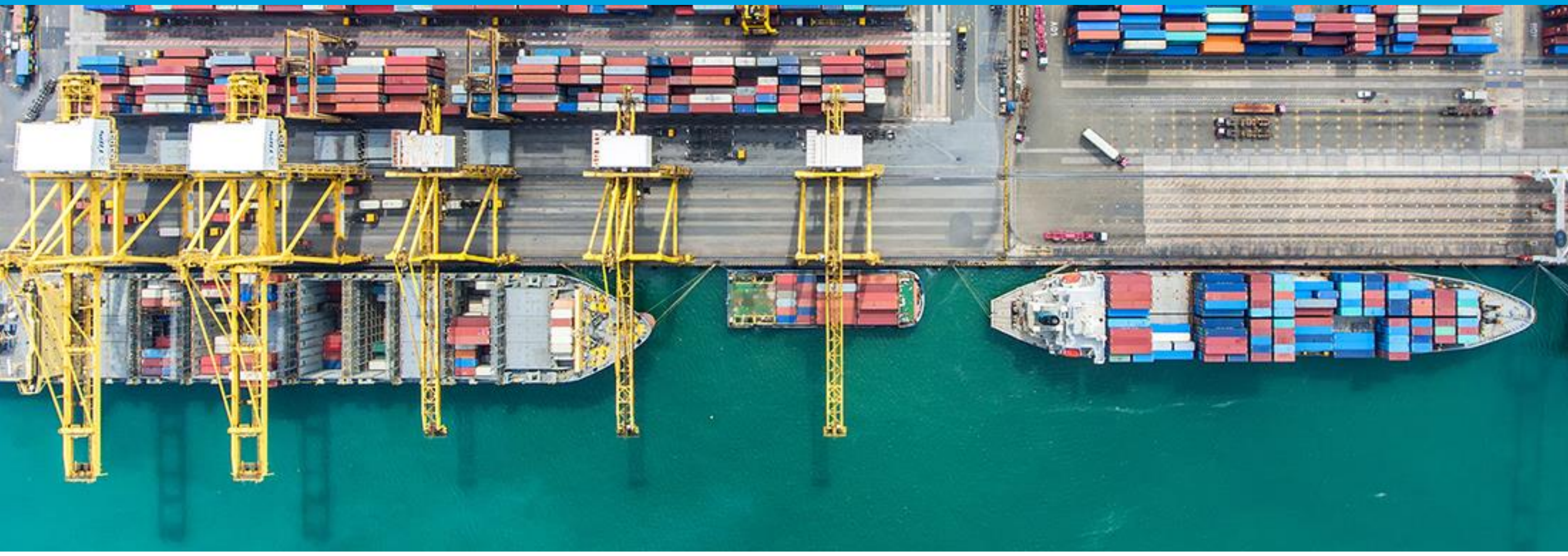

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