Marine and logistics report 2023

Trends and future risks

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Kennedys

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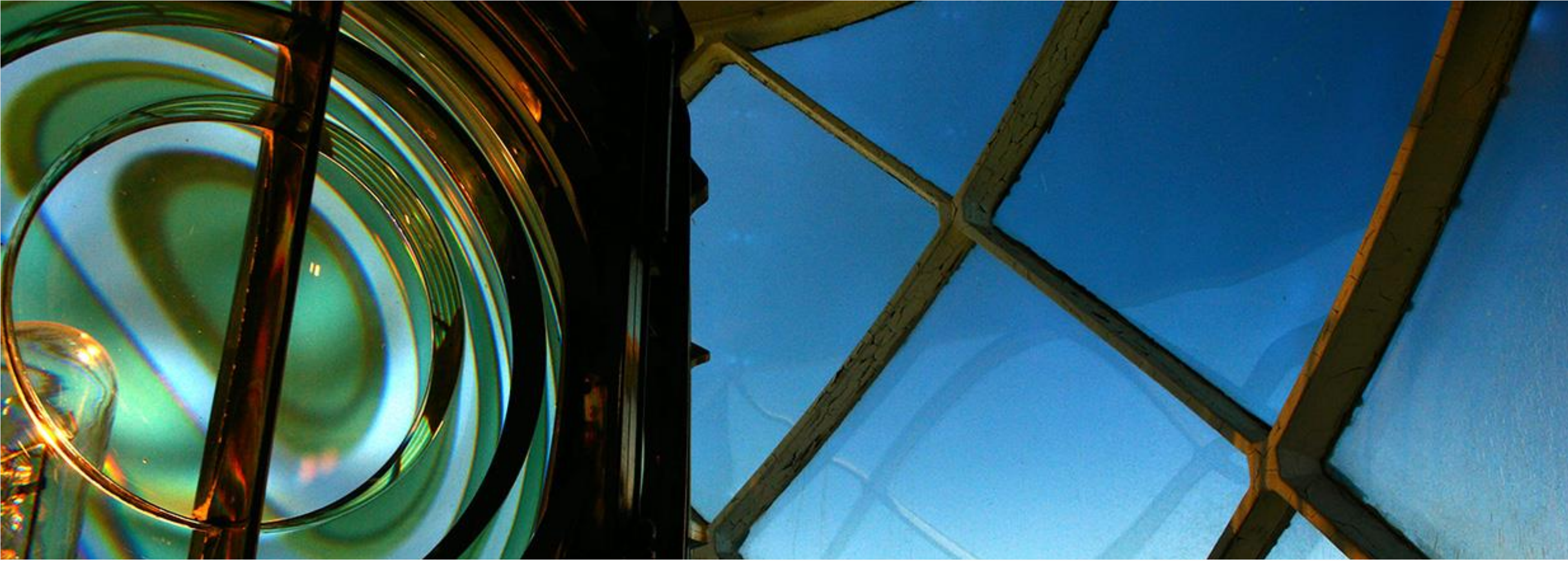

Foreword

The global marine and logistics markets have weathered another challenging year.

As businesses started to look towards a post-COVID-19 recovery, the war in Ukraine threw global supply chain resilience back into the spotlight. This, along with ongoing technological change, environmental, social and governance (ESG) related risks and a fragile economic environment, makes it increasingly important for insurers to consider those key trends driving claims activity.

> The pandemic and extreme weather events of 2021 and 2022 led to a sharp spike in claims. Across the globe, transport infrastructure and routes were affected by flooding, wildfires, extreme cold and extreme highs in temperatures.

The war in Ukraine added additional challenges to global supply chains, and while these are hopefully easing, the volatile geopolitical landscape means that trade wars and civil protests are likely to continue to impact the marine and logistics sectors and their insurers as a result of supply chain disruption.

We have also seen efficiencies made by embracing technological advancements cancelled out by an inability to trade as a result of a cyber attack, and pandemic outbreaks resulting in manufacturing shutdowns, port closures and labour shortages.

In addition to global events, the domestic legislative and regulatory environment is continuing to shift in order to respond to the growing use of technology and the need to innovate towards greener modes of transportation.

Against this background, we examine the priority topics that insurers in the marine and logistics sectors need to consider to ensure business resilience.

Environmental, social and governance (ESG)

2023 is likely to produce more global regulatory intervention in the ESG space as the drive for transparency, clarity and consistency gathers pace. As well as climate related activity, we anticipate seeing an escalating focus on social issues such as diversity, equity and inclusion (DEI), human rights, and modern slavery.

This will result in the need for close examination of supply chain contracts as well as extra consideration around the sourcing and routing of products.

'E' | Extreme weather events

The rise of extreme weather events has led to disruption across every element of supply chains, from delayed or damaged cargo to warehousing claims.

Heatwaves can also impact temperature-controlled carriage and storage. If parties arranged carriage on the assumption that the equipment would have to deal with temperatures in, for example, the low twenties, that equipment may struggle to handle temperatures in the high thirties or even as high as forty degrees centigrade.

As extreme weather patterns start to shift and areas of significant risk of fire or flood become apparent, carriers and their insurers will increasingly be expected to be aware of such risks and to have carried out proper risk assessments.

'S' | Modern slavery clauses

Modern slavery and anti-bribery clauses are appearing with increasing frequency in many commercial contracts. This means that a supplier will be bound by these regulations and required to comply with these provisions along all of their supply chain. It is not good enough just to agree to the clause - these need to be actioned.

Failure to do so could result in a fine and, potentially, subsequent claims if the breach forces a change of supplier which causes delays and business interruption.

An additional risk is to the reputation of the company if it is made publicly aware that they have failed in these duties. A rise of accountability and social media driven campaigns around concerns over labour conditions is resulting in an increase of risk to companies and their insurers.

'G' | Regulatory and legislative developments

United Nation's Agreement concerning the International Carriage of Dangerous Goods by Road
Emphasising the need for regulation to adapt to new (and often green) technologies, the 1 January 2023 amendments to the United Nation's Agreement concerning the International Carriage of Dangerous Goods by Road include provisions directly related to the carriage of lithium batteries.

There are increased risks of transporting lithium batteries due to their high risk of combustion, including their ability to re-ignite days after the fire has been extinguished. The provisions apply to international transport in the 53 contracting countries and allow for a six month transition period.

Energy Efficiency Existing Ship Index and Carbon Intensity Indicator requirements from the IMO
Aimed at making all vessels more efficient and limiting their carbon emissions, these regulations became effective at the beginning of the year.

> Vessel owners will now have to ensure that their vessels meet certain Energy Efficiency Existing Ship Index (EEXI) requirements and vessels will be rated from A to E on the carbon intensity indicator (CII), which requires a continuous improvement of the vessel's operational carbon intensity. Anything below a C rating requires rectification.

Owners' obligations will largely be met by vessels having to reduce speeds and so, initially, this will be a matter between the owners and their charterers. But an alteration in sailing speeds and, possibly, route choices will be an interesting trend to follow.

Insurers may also be keen to ensure that the vessels that they insure are environmentally friendly, and have a minimum CII rating of C.

Geopolitical risks

The impact of geopolitical risks – those risks associated with conflict or tension between countries or states - can be felt across all marine lines. There is also a clear interrelation between the geopolitical landscape and other priority topics for marine insurers, including rising inflation, ESG considerations and reputational risk.

The war in Ukraine

The conflict in Ukraine has drawn significant attention from all lines within marine insurance. Insurers felt the immediate impact with rising energy prices and food (particularly grain) shortages. As the conflict has progressed, insurers have had to navigate global sanctions and continued supply chain disruption.

The inability of vessels laden with cargo to leave Ukrainian ports has created uncertainty for the market with potential exposures exceeding US$1 billion. We have seen numerous examples of bespoke covers providing indemnities for total loss of vessel/cargo following the outbreak of the war and subsequent detainment, both on water and on land.

The introduction of the 'grain corridor' alleviated some of the exposures. However, insurers are understandably withdrawing from providing cover for the 'Sea Grain Initiative' as the uncertainty surrounding the trade route has returned. This will inevitably result in a further slow-down of global trade following a fresh backlog of agricultural commodities finding safe passage out of Ukraine. It is thought that Danube ports are already operating at capacity and their limited resource and infrastructure are unable to facilitate the volume of commodities.

> The short-term focus is on those vessels and cargoes that remain unable to safely leave Ukraine. The medium to long-term concern is the impact on global trade and, in particular, on one of the most significant shipping routes for agricultural commodities.

This political environment drives regulatory and legislative reform. Sanctions are regularly revised and trade between countries can become increasingly complex.

Unstable economic environment

2023 will be another challenging year as costs rise and margins squeezed. Government resources have been diverted as a result of pandemic support packages, resulting in reduced investment (and engagement) in many innovation and infrastructure projects.

As a result of workers retiring, moving professions or working in other countries induced, in part, by geopolitical events such as Brexit, there are continuing labour impacts, with a reduced available workforce particularly impacting HGV drivers and warehouse workers. This has resulted in a shortage of necessary skills and a more expensive wage bill – all of which will be felt by insurers.

Dissatisfaction with government policies resulting in strike actions also has a significant impact. When rail services are hit by restrictive strike actions, so increasing pressure is put on an already under strain road haulage network, resulting in further delays; if access to ports is blocked, vessels cannot discharge their intended cargo.

Fraud

The increasing number of claims termed ‘theft by deception’ is a growing concern for marine cargo and stock throughput underwriters.

> Marine cargo insurers may be unwillingly exposed to what is, at its core, a theft of insured goods under the guise of a fraudulent scheme designed to deceive an insured into parting with goods with no intention to ever pay for the same.

Such situations have the potential to blur the lines between physical loss covers and financial loss or crime policies. Questions as to title to the goods and timing of the act(s) of theft will invariably be determinative for policy cover and each case of theft by deception will likely turn on the facts at hand.

Supply chain disruption

As a result of multiple factors impacting supply chains, containers are unable to be delivered meaning that goods are delayed or find themselves stuck in warehouses or port facilities. We predict that these issues will see a rise in container demurrage claims as the logistics network struggles to deliver containers as required.

Much of the logistics industry works to a ‘just in time’ model, meaning that goods are transported (or intended to be) just in time for the required use. This applies to both manufacturing and to retail.

If seasonal goods are left sitting in ports, they are no longer wanted, and it is likely that we will see an increase in claims for loss or damage including an element for loss of profits for, for example, Christmas goods that have missed the prime retail window.

Some companies will try to claim a force majeure defence, but the reality is that this is unlikely to succeed if it can be shown that by using an alternative - if more costly - mode of transport would have assisted. The reality is, however, that companies are unwilling to spend more money when these cannot be passed on to the end user in an environment where everyone is trying to minimise their outlay.

Spotlight on Latin America

Many different variables have contributed to recent instability in the Latin American region.

The COVID-19 crisis resulted in containers and supplies shortages, which was followed by incidences of ‘social unrest’ and claims inflation fuelled by currency devaluation and global inflation. All these factors have contributed to an increase in the number and value of claims.

The social unrest strikes and protests seen in Chile, Colombia, Ecuador and now Peru, have had a direct effect on the transport industry.

Due to roads being blocked for days, or even months, because of the strikes and damages to essential infrastructure, the exposure of cargo during transit is severe. Perishable (especially refrigerated) cargoes often are lost due to the time lapse between when the transport vehicle is detained by strikers and when the authorities guarantee free movement.

During difficult economic conditions, duties regarding maintenance of properties or transportation may not be a priority for all insureds. This increases the risk of a casualty occurring and, in some cases, the circumstances in which the casualties happen causes underwriters to raise questions about the nature of the incident.

> While Latin America continues to be an interesting and gainful region to invest in, a rigorous underwriting and claims analysis process must be undertaken in order to ensure that the risks – and the insureds - meet the necessary underwriting standards.

Technology

Innovation through the use of technology is poised to continue transforming the marine insurance industry and its associated businesses, facilitating growth and furthering resilience. This transformation requires long-established practices and supporting legislation and regulation to evolve in order to fully embrace the benefits, and respond to additional challenges.

Autonomous vehicles

While the headlines often focus on driverless taxis and autonomous parcel deliveries, there are arguments to say the commercial freight sector is best placed to develop this technology.

One of the major factors is the use and availability of data. The driving systems used in autonomous vehicles use artificial intelligence technology which relies on a continuous flow of information to develop and improve; commercial freight vehicles spend considerably more time on the roads than domestic cars, thereby providing a regular stream of that crucial data.

> An example of this progression was seen in December 2022 when the port of Felixstowe was believed to be the first in Europe to introduce autonomous terminal tractor units into mixed traffic container terminal operations.

To operate on open roads will, however, require huge adjustments to existing infrastructure which requires significant economic investment. Therefore, while insurers and fleet operators should prepare for autonomous technology, fully integrated adoption is likely to take several more years.

Warehousing

The technology that is, however, driving claims in 2023 relates to warehousing. The increased use of warehouse management systems is giving rise to an increase in claims.

Stock management is being handed over to logistics companies to manage stock storage and distribution.

> We have already seen high profile examples of where this can go wrong; after KFC introduced a new warehouse management system, their entire supply chain failed, resulting in delays and claims.

This is happening with increasing frequency. When new technological systems are introduced, there is a risk that they will not 'talk to' or seamlessly merge with the existing system – whether electronic or human, or a combination of the two. Where there is still a human element involved, the data that is input into the new system may be in the incorrect place, which will cause problems at a later date.

The causes of the issues often occur early in the process but are only discovered months or years later. This is resulting in delay and stock loss claims now being presented which are actually a result of incorrect data records. However, to establish the correct cause of loss is a timely and expensive process, requiring forensic management and invoice management investigations.

Legislative and regulatory developments

Electronic Trade Documents
On 12 October 2022, the Department for Digital, Culture, Media and Sport introduced the Electronic Trade Documents Bill (the Bill) to the House of Lords.

The Bill concerns electronic documents used in trade and trade finance that are not currently considered capable of being (physically) possessed under English law, such as electronic bills of lading. The aim of the Bill is to "put electronic trade documents on the same legal footing as paper documents, removing the need for wasteful paperwork and needless bureaucracy".

As set out in Kennedys' consultation response to this proposed Bill, reform in this area is welcomed – but there are many practical implications that we hope are considered by the government before the legislation is passed.

Self-driving vehicles
Deployment of self-driving vehicles on UK roads may still feel some way off. However, the recently published policy paper - Connected & Automated Mobility 2025: Realising the benefits of self-driving vehicles in the UK - sets an agenda for activity over the next three years, including 'commercial deployment pilots' from mid-2023 onwards, bringing the timeline into sharper focus for insurers.

The government's stated vision "views passenger transport, logistics and freight, and private land use as areas of particular interest for early self-driving vehicle services in the UK". This provides an indication of where we may see initial deployment of the technology that will help shape wider implementation.

Claims inflation

Rising inflation is a topic of continuing global concern. Similarly, excess claims inflation – that is, changes in the cost of claims beyond ordinary economic inflation - remains a priority for the entire insurance industry, requiring careful consideration to ensure business resilience and adequate claims management.

Such is the volatile business environment in which insurers are operating, historical claims data no longer provides sufficient information for the reserving process or for claims adjustment purposes. Without adequate allowance for the impact of claims inflation, insurers will potentially be exposed to inaccurate reserves and additional challenges when adjusting claims, including under-insurance, gaps in cover and the development of unexpected or unanticipated claims.

Supply chains

As well as an increase in the volume of claims presented as a result of supply chain disruption, the values of those losses are rising – and are increasingly difficult to accurately predict.

While it is anticipated that supply chain blockages and commodity prices should begin to ease this year, the ‘hangover’ of the inflated prices of goods purchased last year, together with interest rates remaining relatively high, means that the impact of claims inflation will continue to be felt. It is predicted that wage inflation will be the most prominent driver of increased supply chain costs.

> According to the UK’s Department for Transport’s December 2022 international road freight statistics, leaving the European Union along with the impact of the COVID-19 pandemic and resulting supply chain disruption, have caused "higher levels of volatility in freight statistics over the past two years".

Overall, an unstable economic environment makes the job of accurately predicting excess inflation increasingly difficult.

Group actions

Group actions, or 'class' or 'collective' actions as they are often described, are increasingly dominating the UK and EU litigation landscape as part of a growing, global trend of mass consumer led litigation. This is being facilitated by landmark legislative changes, the proliferation in third party litigation funders and experienced US class action law firms entering the EU and UK markets, resulting in an increased risk of both volume and value of claims.

> In particular, the UK courts are becoming an attractive jurisdiction for large group actions, and in recent years the transport sector has been at the fore of such actions, with significant numbers of claimants seeking redress in respect of diesel emissions, data breaches and truck cartels.

Although an increase in claim volume naturally correlates with an increased liability risk, this can be particularly prevalent in the context of group actions where individual consumer losses may be small but, collectively, amount to significant sums, often running into millions of pounds.

To safeguard business resilience and to provide efficient claims management, consideration will need to be given to the many factors continuing to drive excess claims inflation.

Insurers and brokers should continue to work closely with their insureds to facilitate clear information sharing regarding the business of the insured, declared values, replacement costs and scope of cover so that key aspects of the risk and the policy are understood by all parties.

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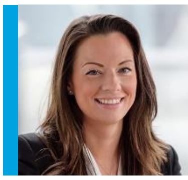

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