IMPACT OF RUSSIAN-UKRAINIAN WAR ON GLOBAL MARINE AND AVIATION INSURANCE MARKET

Abstract. Ukraine’s economic output will likely contract by a staggering 45.1% this year as Russia’s invasion has shuttered businesses, slashed exports and rendered economic activity impossible in large swaths of the country. Over half of the country’s businesses are closed, while others are operating at well under normal capacity. The closure of Black Sea shipping from Ukraine has cut off some 90% of the country’s grain exports and half of its total exports.
The World Bank also forecast Russia’s 2022 GDP output to fall 11.2% due to punishing financial sanctions imposed by the United States and its Western allies on Russia’s banks, state-owned enterprises and other institutions. 30% of Ukraine’s infrastructure is damaged or destroyed close to $100 bn. More than 300 bridges, 8,000 km of roads had to be repaired or rebuilt. Total bill for damage to everything from transport to homes and other buildings runs to about $500 billion so far.

The European Union has been seeking to create an international fund for reconstruction, while both Ukrainian and EU politicians have called for using Russian assets frozen by the West, including $300 billion in Russian Central bank reserves.

While there is still huge uncertainty in several areas – including, of course, the duration of the war – market estimates for the industry loss coalesced around a $10bn-$20bn range, with many sources saying they felt $10bn would be the floor for this loss event.

As a result, the conflict in Ukraine has the potential to become the largest industry-wide insured loss, across all classes of business, in history, even exceeding that of the terror attacks of September 11, 2001.

At this size, the loss is manageable for the industry – a $10bn-$20bn hurricane wouldn’t provoke much more than a shrug of the shoulders in terms of loss quantum. However, the industry is facing a cross-class loss which will fall asymmetrically on the market, depending on the weighting of individual carriers to the affected classes. In insurance these are primarily: (1) aviation, (2) political risk, (3) political violence (PV) and, to a lesser extent, (4) marine.

From an insurance perspective this is a London-centric loss, with the Lloyd’s market comparatively overweight on aviation, marine war and PV – although London company market players such as AIG, Chubb, Liberty, Fidelis and Convex also write here. Political risk and credit losses will be spread more globally, although Lloyd’s still writes a lot of this business alongside major global players.

The loss is bad news for a fragile Lloyd’s market that has made an underwriting profit only one year in the last five.

Keywords: Russian – Ukrainian war, insurance industry, reinsurance, Lloyd’s of London, P&I Clubs, marine reinsurance, aviation insurance.

Literature review. The problems of insurance protection as well as the newest tendencies on the global insurance market, got their coverage by many domestic and foreign scientists, among them – Basilevich V., Tatarina T., Pikus R., Carter R., Riley, K., Schwepecke A., who analyzed the influence of the pandemic factors to increasing poverty and welfare as well as social tension. They also study the characteristics of global insurance and reinsurance markets influenced by global catastrophes as 09/11 and pandemic of COVID-19. The main statistic concerned the
impact of the war crisis on the global economy contained the reports of Bank of America, International Monetary Fund, Moody’s, as well as global insurers’ and reinsurers’ reports such as Allianz, Chubb, American International, Lloyd's, Swiss Re, Hannover Re, Munich Re etc.

However, not all aspects of this complex and multifaceted problem fully investigated equally. Required the further investigation the assessment of the impact of the duration and intensity of war on the global insurance and reinsurance market. In particular, such a significant and expensive part of it as marine and aviation risk insurance.

The purpose of the paper. In this study, we aim to determine the impact of the Russian-Ukrainian war on the insurance market of Ukraine and the global aviation and marine insurance market. Also we aim to compile some data on the insurance facilities lost or nationalized by Russia.

Results.

Compared to the start of the invasion, there is relatively less panic and nervousness in the market around this loss – particularly with respect to aviation. However, there is generally a sense of gritted teeth that there are a complex and challenging few years ahead as the loss starts to unravel.

Significant amount of these losses (around 60-65%) are expected to be ceded to reinsurers. In specialty, retentions are bought low and large reinsurance limits are available. A blend of quota share and excess-of-loss structures are used – with the Lloyd's market leaning more towards the latter.

The bigger the loss swells from the conflict, the more is likely to land on reinsurers – and there is potential for these specialty reinsurance players to take greater net losses from this event than compared to a nat cat event, given the far more limited specialty retro market.

Some say the situation is more nuanced and would vary from cedant to cedant. They pointed to hours clauses and exclusionary language which would mean that a lesser proportion of cedant losses would fall on reinsurers. Given the complexity of this event, disputes between insurers and reinsurers are likely to happen, which will further delay the settlement of claims. This war has the potential to drive more exclusions into re/insurance.

There is a growing list of insurers & reinsurers that have taken steps to withdraw from Russia. Specialist re/insurance marketplace Lloyd’s of London has also confirmed that it will back sanctions introduced by the UK Government that aim to prevent Russian companies in the aviation and space industry from accessing the UK insurance sector. Some of the largest brokers in the world including Marsh McLennan, WTW and Aon, have all announced plans to exit Russia.

In response, The Bank of Russia has announced that it will increase the declared capital of reinsurance for RNPC from $0.6bn to $2.57bn.
Russia’s maritime sector is grappling with the winding down of services including ship certification by leading foreign providers – needed for accessing ports and securing insurance. IACS consists of eleven classification societies representing more than 90% of the world’s cargo carrying tonnage.

P&I Clubs are terminating cover for Russia’s shipping companies as multiple sanctions start to bite. In theory, owners could go in without insurance. However, because of how insurance works, that would have a knock-on effect that would ultimately put them on the hook for the risk of pollution, removal of wreck, cargo liability and any crew liability and repatriation.

In addition, some shipping companies have withdrawn and ship engine makers have suspended training on their equipment following the imposition of Western sanctions on Moscow.

While war can mean certain marine claims are discounted as invalid, there are a lot talks about blocking and trapping losses which can take time to manifest.

As well as this, physical damage and port or terminal related losses are another potential vector, as too are some contribution from cargo related losses including spoilage.

Given that much of the loss is time-related, it will be a while before reliable loss estimates come into the market.

A number of cargo underwriters are moving to cancel and avoid coverage on Russian exports and consignments coming into both Russia and Ukraine.

Underwriters are concerned about reputational risks and potential difficulties in paying out on insured claims. The market is quickly looking to avoid any business that could be seen as supporting the war from either side.

Guidance from the Joint War Committee, which comprises syndicate members from the Lloyd’s Market Association (LMA) and representatives from the London insurance company market, is watched closely and influences underwriters’ considerations over insurance premiums.

Following Russia’s invasion JWC added Ukrainian and Russian waters around the Black Sea and Sea of Azov to its high-risk areas, as well as waters close to Romania and Georgia. Vessels need to notify underwriters when sailing into ports as well as having to pay an additional premium for a seven-day cover period. Notice of cancellation now changed to 48 hours rather than traditional 7 days.

Russia is bracing for a sharp decline in cargo flows and a deficit of containers after world’s three largest container shipping lines, have suspended their bookings to and from Russia.

The exit of major container shipping companies — which transport most manufactured goods around the world and are essential to international trade — is expected to cause a major decline in shipments. The drop in the north container terminals is expected to be around 90% to 95%. By the way, Maersk still has vessels
calling at Russian ports to deliver containers booked before the invasion of Ukraine began and to pick up around 50,000 containers stranded in Russia.

In normal times, the Dutch port of Rotterdam and the Belgium port of Antwerp are like machines: hundreds of ships come and go each day, and tens of thousands of containers are loaded and unloaded from those vessels, all to keep Europe’s economy humming.

Out of the thousands of containers with each arriving vessel, dozens or hundreds may be destined toward Russia. They all need careful physical inspections to make sure that moving them on won’t somehow breach sanctions.

That exercise delivers constraints on the value chain in terms of physical space, manpower and time. Rotterdam and Antwerp each have around 5,000 containers that have been set aside for inspection while Belgium also has around 3,000 cars stranded at different ports. Near thousand were arrested because their value exceeded EUR 50,000. Just think about the accumulation.

Marine fuel sellers have stopped serving vessels flying the Russian flag at major European hubs including Spain and Malta in another blow to Moscow’s exports.

Losing access to refuelling points in the Mediterranean Sea poses major logistical problems for Russian oil tankers going from Baltic ports to Asia and also creates safety concerns over potentially being stuck at sea with flammable cargoes.

Many Russian-flagged vessels than usual switched their flags to other countries like Marshall Islands, possibly to avoid being caught up in sanctions. The flag switches come as Russian vessels ranging from oil tankers to multimillion-dollar yachts owned by oligarchs have gone dark, turning off identification and location transmitting systems that should always be on while at sea, in contravention to international maritime law. The practice helps avoid detection and can pose risks to maritime safety.

There were cases of so-called “dark activity” operations between Russian-flagged or owned ship and non-Russian vessels. Three hours is enough time to allow oil tankers to transfer their goods to a third vessel that’s not affected by sanctions or bans.

Analogies were drawn to movements of Iranian oil, highly sanctioned. Iranian crude gets stored at one of UAE ports, then gets blended into somebody else’s crude, and then gets shipped into the marketplace, nobody really knows how much Iranian crude they are buying. Same as with a ship to ship transfer, you don’t know how much of that is Iranian crude, and how much is a mixture of someone else’s crude.

When you get incredible discount, you have an incentive, if you are the right kind of buyer, to store it someplace, hold it in storage, and you can resell it without noting what the origins are.

As for yachts, dozens of them have already been seized. You should be aware, however, that a lot of them head for Turkey to flee Western sanctions. Turkey, being
a NATO member, shares a maritime border with Ukraine and Russia in the Black Sea, has good ties with both and mediates in the conflict. It has supported Kyiv, but also opposed sanctions on Moscow, including measures against Russian billionaires. Turkey relies heavily on Russian energy imports and tourists, and many Russians have invested in Turkish property.

Ports in the Russian Far East, the Black Sea and Sea of Azov would suffer less from the exit of major container shipping companies because their share of cargo traffic was smaller than that of northwestern Russia and because new players in those regions were beginning to emerge, some came from Turkey.

The Black Sea is normally a hub for exports of crops, oil, fuels and raw materials. Traders are diverting some bulk shipments i.e. coffee that were initially expected to go to Russia, and some have stopped selling to that market altogether.

But some countries from South America continue to supply Russia with products. Some sources say there are deals going on, using crypto. In addition, one coffee co-op was closing a barter deal with a Russian dealer, where coffee would be swapped for fertilizer. And you should be aware of the fact that it was a major channel of drug-trafficking. Narcotics were going to Ukraine and Russia from SA to be transferred to EU afterwards.

Ukrainian Danube ports of Izmail and Reni remained the only sea routes for Ukrainian agricultural exports. But they have rather limited bandwidth, leading to accumulation of transport on suitable roads and traffic along the Danube was significantly limited because of the danger of blowing up ships on drifting mines. Turkish and Romanian military diving teams have defused several stray mines around their waters.

More than a million containers set to ride 6,000-plus miles of railway linking Western Europe to Eastern China via Russia are now having to find new routes by sea, adding to costs and threatening to worsen the global supply chain chaos. The rail networks stretching from China, Kazakhstan, Russia, Belarus and beyond connect Chinese commercial centers to European cities including Moscow, Minsk, Hamburg, Milan, Warsaw, Munich and Madrid. It takes about two weeks to send Asian goods to Europe via rail compared with a month by ship. Ships are still the cheapest method. The cost of transporting a container by rail is roughly twice that of sea freight and a quarter of sending goods by air.

Apart from consumer electronics and autos, wood-based products and petrochemicals also hitch a ride. Last year, trains moved about 1.46 million containers carrying goods valued at about $75 billion between China and Europe on the routes, or about 4% of total trade between the two sides. When online vendors rushed to meet a boom in demand for laptops and mobile phones during the pandemic, rail offered a crucial lifeline because some ports in China were locked down. This year, consumer electronics are likely to be impacted the most if rail isn’t used.
Security risks and payment hurdles stemming from sanctions are mounting, as is wariness that customers in Europe could boycott products that used Russian rail. Kuehne + Nagel International AG, one of Europe’s largest freight forwarders, is already rejecting rail cargo from China to Europe.

Some companies that use the rail network — from Dell Technologies Inc. to IKEA and Toyota Motor Corp. — have already paused their operations or sales in Russia.

The losses from the marine war market are easier to estimate than in other classes and they stem from boats stranded at Ukrainian ports. International Maritime Organization said there were 86 merchant ships still stuck in Ukrainian ports and waters as of March 30. Their value was previously estimated at $700mn-$800mn, although this could now grow, due to the breach zone being extended to include inland waters. However, a major loss event would only come to pass around March 2023 when ships will be written off as total losses. There is hope the conflict will be resolved by that date. Industry-wide insured marine losses could go up to $5 billion.

There is still the possibility of individual vessels being struck by missiles, but so far losses have been manageable. Six merchant vessels were hit by projectiles and two of them sunk.

As well as the threat of vessel damage, there are other risks like drifting mines and that both the Russian and Ukrainian navies could seize vessels for uses related to national security.

An expanded ban on Russian oil could raise the cost and availability of bunker fuel. Longer term, we may see a shortage of bunker fuel with more and more vessels having to turn to non-compliant or substandard fuels, which could result in machinery breakdown claims in the future.

The pool of insurers still quoting has substantially dried up, meaning those who remain are demanding higher prices. The charges would typically be met by companies hiring the ships (charterers), not vessel owners. They pay annual war-risk insurance cover as well as an additional “breach” premium when entering high-risk areas. These separate premiums are calculated according to the value of the ship for a seven-day period.

Ship insurers have quoted the additional premium rate for seven days up to 10% of insurance costs, from an estimated 0.025% before war started. Some underwriters simply quoting to cover at prices that they know will be refused.

This became a huge impediment to the movement of Russian cargoes from the region.

It means that insurance now likely exceeds the cost of hiring the vessel itself. A $50 million, five-year old tanker from the Russian Black Sea port of Novorossiysk to Italy costs about $3.5 million -- but the insurance adds another $5 million. The cost of vessel hire is extreme too $3.5 million was $700,000 earlier this year.
Marine war is a heavily Lloyd’s-focused market, but the class is highly reinsured into continental reinsurers. Most carriers have a reasonable retention of $5mn-$10mn on excess-of-loss contracts, but some do buy quota share. Again, whether this loss is defined as one event or several will be key in determining how much insurers can cede to their reinsurance partners.

As well as the dangers arising from bombardment, many of the stranded ships now lack food, fuel, fresh water, and other vital supplies. “Vast bulk” of the seafarers, from at least 20 countries had left, traveling overland to Poland and Romania, but some are still trapped.

After two years of pandemic-related stress and multi-billion dollar industry losses, the start of this year suggested a recovery for the global aviation marketplace. As 2022 began, passenger levels were approaching 2019 levels, or in some instances exceeding, leading to optimism across the industry as players eyed a return to profitability.

Western nations have imposed an array of sanctions on Russia designed to cripple its economy, and these actions pose significant logistical and financial challenges to airlines, aerospace firms, and lessors and financiers.

The Russian Ministry of Transport noted the risks of shortage of flight personnel. Around 1 500 of line pilots (13% of the total) and 1 300 of flight attendants (5%) are being idle now. Ministry monthly receives about 70 requests from foreign aviation regulators with a request to confirm the certificate of a specialist, which indicates how many pilots are looking for work in foreign airlines.

You should be aware that by investigating publicly available data, Forbes identified at least 25 jets and nine helicopters linked to 15 sanctioned Russian-born billionaires. All but five of the aircraft are registered in Aruba, Austria, Bermuda, the Cayman Islands, the Isle of Man, Luxembourg and the U.K., all of which have implemented EU or U.K. sanctions. Collectively, the 34 aircraft are worth at least $1.9 billion.

Anyways, publicly reported estimates have tended to range from $10-25 billion, with even the low end potentially making this the largest aviation insured loss event in the market’s history.

While the market has been very focused on the aircraft leasing issue and the potential for that to drive a significant loss, losses may span segments of the aviation market, rather than involving outcomes specific to all-risk or war-hull. Losses from airports are a factor, as well as the impacts of lease and other loss vectors across the entire aviation supply-chain.

But for now, we should talk about leasing. Insurers are facing a year’s long legal battle with aircraft leasing firms over a potential claims from jets stranded in Russia. Because the potential litigation is very likely, insurers are not expected to recognise and disclose explicit claims reserves.
S&P Global Ratings said in last report that aviation losses could range from $6 billion to $15 billion across different scenarios. Optimistic scenario takes into account the 78 out of 515 foreign-owned aircraft leased to Russian airlines that were either outside Russia before the invasion or have been recovered since. It also assumes some coverage has been cancelled and that some court decisions do not include the highest levels of sums insured and coverage. S&P also assumes the remaining $10bn will be split across other specialty classes such as marine, political risks and political violence. Sources have indicated political risk/violence exposures to the event could total up to $5bn.

Big question is whether the signing of Russia's reregistration law or the seizure of the aircraft would act as the loss trigger. When Russia introduced a law that allowed Russian airlines to register planes locally, this was the first point in time that the country demonstrated an intent to confiscate the aircraft, so some sources view this date as the most likely trigger event.

War-risk policies tend to include a seven-day notice of exclusion/cancellation as standard, and most insurers probably started issuing this notice as soon as Russia invaded Ukraine, and up until end of February. As a result, most policies could potentially be cancelled between 7th and 12th March, and therefore off risk before the 14th (most likely date of loss).

If a clear war loss trigger is ultimately established, and cover was not cancelled at that time, it is still possible that claims will not be paid because broad EU and UK sanctions around insurance will be judged to have suspended coverage. Sanctions could prove a block in general to paying out on these losses, although the market’s legal advice is divided on this point. Not only the extent or timing of losses is unknown, as is whether any efforts were made by lessors to mitigate losses.

Ratings' pessimistic scenario, which exceeds the $12 billion insured value it estimates for the 515 aircraft, assumes the vast majority of policies are not cancellable and the vast majority of court cases allow lessors to collect the highest possible sums insured — for example, if the insured event is classified as theft instead of an act of war.

What lessors are able to collect from insurers will depend greatly on the coverage that is deemed applicable. Lessors are covered under policies taken out by airlines and also their own contingent all-risks and war cover if airlines' policies do not respond.

War cover contains aggregate limits, designed to cap payouts if a large number of aircraft are affected at the same time. Most executives said “common sense” would suggest this is a contingent aviation war loss, however, because aircraft lessors benefit from different types of coverage this, subject to interpretation, could trigger insurers' payments outside of aviation war aggregate limits.
AerCap – the world’s biggest aircraft leasing firm – has now filed a claim believed to be in the region of $3.5bn on its contingent all-risks policy. They had also $1.2bn of contingent war cover written in the London market which would typically respond to confiscation of aircraft. The policy is also unusual in that it is not subject to cancellation notices.

In pursuing an all-risks claim, AerCap opens a bigger pool of potential money to try to claw back its losses.

This will undoubtedly evolve into a years-long legal dispute – is the theft wording present in all-risks policies, and underwriters are likely to argue that this is not designed to cover this type of loss event.

At this point, there is lots of conjecture in the market and no concrete assurances on how or where the aviation losses from the Ukraine crisis will fall.

Many lessors have issued rights of reservation but are still in the process of assessing their ultimate exposures ahead of filing loss notifications. A number of them have already started to write off the value of planes. Despite the termination of lease agreements, nearly 300 aircraft were identified as active during the end of April, mostly operating on domestic routes inside Russia.

However, the prospect of this situation spilling into the all-risks market underscores a very serious point around the systemic exposures in this aviation sector.

Unlike the aviation war market, which deploys annual aggregate caps, the aviation all-risks market works on an “each and every loss” basis, with unlimited aggregate. Insurers typically consider a PML event to be something involving two planes, or a handful of planes at the outside affected by hail or earthquake, pointing to a total mismatch around an event which could include hundreds of planes being lost. Under a scenario where the lessors pursue an all-risks claim, the available insured limits swell significantly and could be close to that $25bn top-end range.

Under this circumstance, it is not clear that reinsurers would allow cedants to aggregate these losses, potentially inflicting multiple sideways retention losses on insurers and leaving them recovering under proportional treaties only. On this point, much will depend on event definition. A single event would undoubtedly see most insurers go through the top of their programmes. Cedants would likely make maximum recoveries if they were able to treat the loss of each lessor as an event, allowing them to claim a full limit, and then reinstatements. Sources indicate that cedants will sometimes buy two reinstatements, although this can vary.

A third scenario whereby each aircraft constitutes an event could potentially be most painful for insurers – as they run the risk of taking a series of retention losses.

Most insurers and reinsurers would suffer only a hit to earnings, rather than capital depletion, although here might be rare exceptions among specialised Lloyd’s
carriers, where aviation losses in combination with other large claims could lead to modest capital depletion. Lloyd’s insurers that are most exposed to a downside aviation loss scenario, from most exposed to least exposed being Lancashire, Beazley, Hiscox and AXA. Major contingent war markets also include Atrium, Chubb, Fidelis, Liberty and Tokio Marine Kiln.

Lloyd’s would be relatively less exposed if the claims came more heavily on all-risks policies, as all-risks is more weighted to the company market in comparison to the very Lloyd’s-centric war market. Nevertheless, the size of the loss – wherever it lands – will send shockwaves through the whole aviation market (and potentially beyond). It has been suggested that there is around $7bn of combined aviation premium globally with only $200 million premium on aviation war market. The eventual loss will pale in comparison to recent losses from COVID or natural catastrophe claims, but aviation insurance exposure is more concentrated among insurers than business-interruption, event-cancellation insurance, or property catastrophe insurance. So, it is expected for insurers and reinsurers to respond by increasing premiums, incorporating more exclusion clauses in their contracts, and cutting their exposure.

At present, the reaction from the all-risks market does not appear to be particularly severe. Underwriters seem to largely have their “head in the sand” on the situation, while others said there had been some tightening in terms – such as the exclusion of Russian flights from policies.

It has been suggested that some underwriters are – whether wise or not – attempting to exclude theft from all-risks policies, a move which could lend weight to the idea that AerCap has some legitimacy in its claim.

The niche contingent war market is a different story – with brokers describing the market as paralysed by the situation. Very, very few markets are said to be quoting business, and when they are, rates increases are said to be in the 1000s of percent.

**Conclusion.**

1. While being at the epicentre of the protection of humanitarian values, Ukraine is directly involved in the formation of new global insurance market, which include integration of unions with partner countries.

2. This determines the relevance of the analysis of factors and components of the formation of new requirements and introduced incentives and tools for maintaining economic stability, which have already been formed and will continue to be formed, under the influence of the fight of Ukraine for freedom and independence.

3. The global risk landscape is in a permanent mode of change, confronting the reinsurance industry with new risks and growing or changing demand for
coverage and security. These challenges call for vitality and responsiveness in risk section and analysis, underwriting and risk management.

4. The reinsurance industry is able to rely on a set of instruments which has been developed and successfully applied over many years. War risks also need to be analysed in terms of their insurability and handled with appropriate covers.

5. The experience has shown that many of the established (re)insurance terms and principles, rules and products have to be changed in a changing risk environment.

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