14 February 2023

IUMI Policy Agenda

11. Macroeconomic factors

Brief description

Inflation and its impact on marine insurance

Inflation rates in many economies around the globe have been on the rise. The Russia-Ukraine war adds to inflationary pressures due to its impact on energy, commodity and food prices. High shipping costs paired with supply and/or supply chain constraints have furthered fueled inflation in many countries. Goods and services have thus become more expensive, consequently insurance claims also increase in cost. For marine lines, the cost of loss is increasing, and the impact of inflation on the adequacy of deductibles and policy limits factors must further be considered.

For cargo insurers, these developments have led to requests for increased policy limits and premiums are increasing due to the rise in exposure and rating bases. Selling price valuations on unsold goods present challenging exposures as can lead to over-indemnifying an insured and loss adjustment complications. Cargo insurers are also faced with soaring inventory exposures.

In hull and yacht insurance markets, the cost and availability of materials as well as higher labour costs are significant. Increased repair costs and the impact on estimated vessel valuation (replacement cost and fair market value) are considerable.

While economic inflation is the most prominent example, social inflation is becoming increasingly relevant. It refers to the increase in compensation costs, settlements and verdicts as well as societal trends such as changing attitudes toward large corporations, expanding concepts of liability, and a growing readiness to resolve conflicts via the legal system.

Trade agreements

Multinational marine insurers are affected by a wide range of barriers of doing business abroad; limited movement of data across borders, unfair competition from state-owned enterprises, lack of transparency and need for due process of law, and forced local ownership and discrimination in obtaining business licenses and permits. Some countries also require that import or export shipments have to be insured by a locally registered insurer, while buyers are only allowed to buy insurance coverage for import shipments abroad or on basis CIF. Any agreement which leads to a reduction of the aforesaid restrictions would contribute to enable marine insurers to achieve their full potential.

Recent developments with a view to a “trade war” between large importing and exporting nations are affecting the movement of goods and trade flows. Consequently, this is also affecting marine insurance and the cargo market in particular.

Brexit

Following the UK vote in June 2016 to leave the European Union there has been ongoing negotiations about what any future post-Brexit trading relationship might look like. Following the triggering of Article 50 of the Lisbon Treaty in March 2017, the UK initiated the process of formally exiting the EU and this became effective as of 1 January 2021 when the transitional period expired.

Additionally, until the end of the transitional period on 31 December 2020, the UK was treated as an EU member state by the EEA-EFTA states. Accordingly, the rights and obligations contained in the EEA Agreement continued to apply between the UK and the EEA-EFTA states. The prevailing view is that the UK ceased to be a party to the EEA Agreement on 31 January 2020, when it withdrew from the EU. Accordingly, after the end of the transitional period, the UK is a third country within the meaning of the EEA Agreement and the territory of the UK is no longer part of the EEA.

Two kinds of negotiations took place simultaneously and, indeed in some areas, remain ongoing.

1. The Withdrawal Agreement – the terms on which the UK departs the EU. Key political issues included the financial settlement, citizens’ rights and the Irish border.

2. The Future Economic Partnership – the new relationship between the EU and the UK. Key issues included goods, agricultural, food, fishery products, customs, transport, energy and services including financial services. A trade deal has been agreed but does not cater for financial services.

For financial services, industry bodies have argued for a bespoke trade deal or, failing that, agreed regulatory equivalence to manage the post-Brexit UK / EU relationship. We currently have neither, posing questions on the implications for London market insurers providing cross-border (re)insurance into the EU (and vice-versa) and, also, the wider impact of Brexit on maritime insured’s in their day-to-day operation.

To combat the loss of EU passporting rights, most UK based insurers have adapted their corporate structures to operate via subsidiaries within an EU State, at least until there is a future agreement. Dublin and Luxembourg are the two most popular although Brussels, Paris, Munich, Malta and Lichtenstein are all chosen options depending on the business operation of the insurer. Most insurers wish to continue to use resources based in London and to retain minimal risk within the new EU subsidiary, at least in the early years of operation. EU entities wishing to underwrite UK business need to have an authorised branch or subsidiary already in place or be in the process of creating one and therefore in the UK Temporary Permissions Regime (TPR). To continue trading in the UK under the TPR regime, firms must have submitted an application for UK authorisation before the (now expired) deadline in order to be considered 'in' the TPR regime while they await full authorisation.

For those contracts requiring run-off following Brexit, the UK gives EEA insurers a 15 year period (part of the Financial Services Contracts Scheme). Individual EU States have differing rules for UK insurers running off business, but all ensure that insureds are not disadvantaged.

On a future services deal for insurance, it should be noted that equivalence has significant limitations since Solvency II has no equivalence regime for direct insurance, and the Insurance Distribution Directive - which gives cross border access to brokers - has no equivalence regime and no third country branch regime. Consequently, an enhanced equivalence regime has been proposed by the London market associations, based on Solvency II precedents, to cover large risks (i.e. including marine).

The difficulty in the negotiations on equivalence is future divergence. Here, the UK Government are pushing for "structured withdrawal of equivalence", which would make the ongoing assessment of equivalence less political and increase certainty for both the EU and UK in the longer term. The aim is to ensure equivalence could not be withdrawn at short notice. In particular, the insurance industry would like to see the establishment of a Financial Regulatory Forum, enabling a regular exchange of information and consultation between the financial services regulators of the UK and EU, most notably on the implementation of international standards. This Forum could be used to monitor equivalence assessments.

With no current regulatory equivalency in place, from a supervisory perspective the UK will be treated as a "third country" in relation to the EU. In a pre-emptive move, the UK Government has assessed and granted equivalence to EU reinsurers. Therefore, similar reciprocity is awaited with optimism by the London market.

The EU has already reached an agreement with certain UK central counterparties, but the bloc has not confirmed whether it will assess the UK's equivalence for reinsurance purposes under the Solvency II framework. USA, Japan and Bermuda currently hold reinsurance equivalence with the EU although the Japanese agreement is subject to renewal, having expired on 31 December 2020.

However, UK-based underwriters will still be able to write reinsurance business originating from the majority of EEA countries on a cross-border basis as long as local regulatory requirements are met. That is not the case for German or Polish reinsurance business however, and those risks will have to be written via an EU subsidiary. The UK Government has also published a guidance document for the UK's equivalence framework for financial services. This outlines the principles and processes which will govern the UK's equivalence framework from the end of the transition period. In addition, HM Treasury has published a table of its equivalence decisions and an annex showing the lead regulator for each of the decisions.

Whilst the current lack of a financial services deal is disappointing, the two sides committed to a Memorandum of Understanding (MoU) that would allow for close coordination, including the sharing of information, while also ensuring that each side can take autonomous decisions on financial markets regulation. The technical discussions on this were concluded in March 2021 and a broad text agreed but no MoU has been formally published as yet, amid continuing political disputes on the wider aspects of the Brexit withdrawal agreement. Though it is disappointing that progress has stalled in the latter part of 2021, the insurance industry will welcome the fact that a deal has been reached as it will potentially reduce uncertainty and the cost of cross-border business for the real economy customers of financial services firms. It also sets a broad basis for the discussions which are still to conclude on equivalence and regulatory cooperation.

Whether the UK will become a contracting party to the EEA Agreement in the future is currently not apparent. If the EEA territory is expressly referred to in insurance conditions, the territorial scope of the insurance cover may change. Likewise, the insured interest may change if it is linked to conduct by authorities from states in the EEA area.

Overall, disruption to insurance contracts has been managed and largely limited to back office and operational complexities. On the maritime sector, though the trade and cooperation agreement between the EU and the UK regulates, among other things the conditions for duty-free goods traffic, there is a customs border created between the UK and EU (with special status for Northern Ireland). This may make the processing of customs formalities more complex and bureaucratic, and thus possibly also more susceptible to errors in the execution of customs orders. This can lead to a changed risk situation for insurance products that cover customs claims. The impact on shippers and supply chains of the expected delays at ports caused by border checks, increased paperwork and the availability of qualified staff has not yet flowed through into insurance claims and, thinking optimistically, may be short-lived. As always, the response of the cargo, freight forward or other relevant policies will depend on their specific terms – whether, for example, delay claims are excluded - and the specific policy trigger.

<u>China</u>

The Chinese Government deems Free Trade Agreements (FTAs) as a new platform to further opening up to the outside and to speeding up domestic reforms. This is seen as an effective approach to integrate into the global economy and to strengthen economic cooperation with other economies. It is also considered an important supplement to the multilateral trading system. Currently, China has signed and implemented 16 FTAs, and an additional 8 are being negotiated.

<u>Asia Free Trade Agreements (FTAs)</u>

Since January 1, 2022, the Regional Comprehensive Economic Partnership (RCEP) has been the world's largest free trade agreement between 15 participating Indo-Pacific nations, which together account for about one-third of the world's population and GDP. The RCEP links Western-oriented democracies with emerging economies, as well as with China. This was possible because RCEP remains at an economic level, without including any political issues. Human/ labour rights and environmental issues are not mentioned in a significant way. This approach also leaves room for individual states to exclude sensitive sectors such as agriculture or the automotive sector.

With RCEP and the prospects of enlarging the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), trade policy with and within Asia is gathering speed. In the greater East Asia region, consisting of Japan, South Korea, China and the Association of Southeast Asian nations (ASEAN), currently Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam, economic integration via trade, investment, supply chains and digital connectivity will accelerate.

Intra-Asian trade is now greater than Asia’s trade with the rest of the world. In fact, Asia itself has become the world’s largest trading region, with China as its centre. The shift towards geoeconomics is furthered by an erosion of the multilateral framework espoused by the World Trade Organization (WTO). The WTO, founded in 1994, has so far only rudimentarily fulfilled its contractual obligation to liberalise multilateral trade. The Organization’s trade dispute settlement mechanisms have been on hold since December 2019, when the judges’ positions first went unfilled.

Politically, both RCEP and CPTPP strengthen the ASEAN, which thereby consolidates its existing trade agreements in the region. ASEAN could become the world’s fourth-largest economy by 2030, comprising of a consumer market valued at over US$4 trillion. RCEP and PTPP can be added to ASEANs various free trade agreements (FTAs):

- The ASEAN-Australia-New Zealand Free Trade Area, which currently eliminates 90 percent of goods traded between ASEAN, Australia, and New Zealand and covers a population of approximately 653 million and over US$4.3 trillion. The agreement will be fully implemented in 2025, by which time, almost all trade will be tariff-free.
- The ASEAN-India Trade Area (AIFTA) building one of the world’s largest free trade markets, creating opportunities for over 1.9 billion people in ASEAN and India with a combined GDP of US$4.8 trillion.
- The ASEAN-Republic of Korea Free Trade Area (AKFTA) sets out preferential trade arrangements between ASEAN member states and South Korea by tariff elimination for 90 percent of products traded.

Transport networks

Large investments in transport networks may have an impact on marine insurers by fostering existing trade routes and facilitating new ones.

Belt and Road Initiative
China's Belt and Road Initiative (BRI) focuses on connectivity and cooperation throughout Eurasia and the Pacific, involving some 68 countries. The initiative aims to bridge the "infrastructure gap" in Asia and beyond through a network of roads, ports, bridges, tunnels and pipelines. The BRI comprises "The Silk Road Economic Belt" and the "21st century Maritime Silk Road". China's new foreign investment law that commenced on 1 January 2020 opens foreign company participation in BRI procurement projects.

EU TEN-T
The Trans-European Transport Network (TEN-T) is a European Commission policy directed towards the implementation and development of a Europe-wide network of roads, railway lines, inland waterways, maritime shipping routes, ports, airports and rail-road terminals.

The ultimate objective of TEN-T is to close gaps, remove bottlenecks and eliminate technical barriers that exist between the transport networks of EU Member States, strengthening the social, economic and territorial cohesion of the Union and contributing to the creation of a single European transport area. The policy seeks to achieve this aim through the construction of new physical infrastructures; the adoption of innovative digital technologies, alternative fuels and universal standards; and the modernising and upgrading of existing infrastructures and platforms.

Establishing legal frameworks for transferable electronic cargo insurance certificates

Transport insurers contribute to the international cross-border movement of goods by providing insurance cover. In particular for documentary letter of credit transactions they issue transport insurance certificates as evidence of the existence of proper insurance cover. For various aspects of the international trade business, a variety of different trade documents has developed, including documentary letters of credit, bills of lading, delivery notes, warehouse receipts. If the trade documents are available in electronic form, this can simplify and speed up the transactions and make them more secure. The stakeholders involved could benefit from a common and complete electronic data set, which would inter alia make the dispatch of paper-based commercial documents superfluous.

For this reason, activities at national and multinational level have recently been intensified in order to "mirror" trade documents in electronic form. The crucial question is whether one succeeds in creating the necessary legal framework for electronic transferable documents. The core issue is to ensure the so-called functional equivalence, which requires equivalence between the electronic record and its paper-based predecessor.

The G7 states recently agreed to undertake domestic scoping exercises and to establish a comprehensible framework for G7 collaboration on electronic transferable records. The G7 states were asked in 2021 to respond to certain questions regarding national solutions for electronic transferable documents. For Germany, eleven associations, including the German Insurance Association (GDV), have described the current legal framework for electronic transferable trade documents in Germany in a paper addressed to the Federal Ministry of Justice and Consumer Protection and submitted proposals for amendments. The German legal framework basically offers the legal requirements for the use of electronic transport documents. However, the so-called digital opening clauses of the Commercial Code (Handelsgesetzbuch/HGB) have not yet been used in practice. The reasons for this are the legal challenges and uncertainties about the requirements, among other things, for functional equivalence between paper-based and electronic documents. The legal situation is different with regard to the electronic transport insurance certificates. Although it also belongs in the catalog of trade documents of the HGB, unlike other trade documents, there is no opening clause for the transport insurance certificate that entitles it to be issued in electronic form.

A cross industry working group of the International Chamber of Commerce (ICC) is currently preparing a proposal for an amendment of the legal framework to adequately cater for electronic commercial documents under German law. The German Insurance Association (GDV) contributes regarding provisions concerning the electronic transport insurance certificate. The package consisting of legal provisions and annotations shall be handed over to the German legislator in the second half of 2022.

In addition to the G7 initiative, the UNCITRAL Model Law on Electronic Transferable Records (MLETR) as well as national developments shall be mentioned in this context. The MLETR offers a template developed by the UN Commission on International Trade Law (UNCITRAL) for a legal framework for electronic negotiable trade documents for implementation in national law. It aims to enable the legal use of electronic transferable records both domestically and across borders. The MLETR applies to electronic transferable records that are functionally equivalent to transferable documents or instruments. Efforts are also being made at national level to enable electronic trade documents to be legally secure. Singapore has already introduced a law, as has Bahrain, and the Abu Dhabi Global Market. The US Uniform Commercial Code (UCC) also provides for recognition of electronic transferable records through amendments. The Law Commission for England and Wales conducted a consultation on proposals to allow for the digitalisation of documents used in trade.

In addition to the approach of creating a statutory solution, there are contract-based solutions for electronic trade documents for the international transport industry, inter alia the solution offered by Tradelens. These solutions rely on a contractual agreement between the parties involved in order to equate electronic commercial documents in their functions and effects with the paper-based originals. The participants agree to a set of multipartite contractual terms and recognize between themselves that electronic documentation can have legal effects similar to those achieved by their paper counterparts. Crucially, however, these rights are only binding on those parties who have signed up to the terms of a particular platform and have effectively contracted with each other to determine who will have possession throughout the transaction.

The cargo insurance certificate is of relevance in the letter of credit transaction. In particular, it is used by the financing bank to have proof that the goods are adequately insured against loss or damage during transport. It is therefore of considerable importance that legal frameworks for the legally secure and reliable use of transferable electronic cargo insurance certificates are created on national level and that the insurance sector gets involved

Relevant authority / organisations and documents

Brexit:

- **European Commission**
  - European Commission notice on post-Brexit servicing of existing contracts.
  - DG MOVE notice to stakeholders: Withdrawal of the United Kingdom and EU rules in the field of aviation security and maritime security, 5 July 2018.
- **UK Parliament**
  - The European Union (Withdrawal) Act 2018.
  - Chequers White Paper "the future relationship between the United Kingdom and the European Union".
- **UK Department for Exiting the EU**
  - Government Position Paper: Future customs arrangements, 15 August 2017.
- **London Market Group / UK Government Liaison Group**
  - LMG: A Brexit roadmap for the UK specialty commercial insurance sector.
- **Insurance Europe / Task Force 50 Liaison Group.**
- **HM Treasury:** Guidance document for the UK's equivalence framework for financial services, 9 November 2020.
- **GOV.UK:** Transporting goods between Great Britain and the EU: guidance for hauliers and commercial drivers, 8 January 2021.
- **UK Financial Conduct Authority:** Flowchart – How the TPR and financial services contracts regime will enable EEA-based firms to continue operating in the UK after the end of the transition period.
- **TT Club:** Brexit analysis for supply chain stakeholders.

China Free Trade Agreement Network

BRI:

- **The People's Republic of China:**
  - Vision for maritime cooperation under the Belt and Road Initiative, 20 June 2017.
  - China's Arctic Policy, 26 January 2018.

Trans-European Transport Network (TEN-T)

Electronic certificates:

- **G7 Digital and Technology Track** - Annex 4 FRAMEWORK FOR G7 COLLABORATION ON ELECTRONIC TRANSFERABLE RECORDS: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/986162/Annex_4__Framework_for_G7_collaboration_on_Electronic_Transferable_Records.pdf
- **UNCITRAL** Model Law on Electronic Transferable Records (2017): https://uncitral.un.org/en/texts/ecommerce/modellaw/electronic_transferable_records
- **Law Commission England and Wales**, Digital Assets: Electronic trade documents – a consultation paper (April 2021) & Electronic Trade Documents Report and Bill (March 2022): https://www.lawcom.gov.uk/project/electronic-trade-documents/
- **Singapore Electronic Transactions Act** https://sso.agc.gov.sg/Act/ETA2010
- **International Chamber of Commerce (ICC)**: Uniform Rules for Digital Trade Transactions, Version 1.0

Timeline / important dates

Brexit:

- Brexit referendum: 23 June 2016.
- Start of Brexit negotiations: 19 June 2017.
- Withdrawal Agreement covering financial settlement, citizens' rights and Northern Ireland: December 2017.
- UK original exit date from EU: March 2019.
- Extension of Brexit until 31 October 2019.
- Majority of MPs vote in favour of Withdrawal Agreement, 20 December 2019.
- Brexit: 31 January 2020.
- Transition period until 31 December 2020.
- Situation continues to evolve.

BRI:

- The People's Republic of China, announcement of the Belt and Road Initiative by President Xi Jinping in September & October 2013.
- IUMI conference: Presentation by Wai Yue Loh, Ince & Co, Tokyo, 20 September 2017.

TEN-T:

- Funding period 2014-2020 for 9 Core Network Corridors.