Hunting for cover

Bunker credit insurance is becoming harder to arrange. **Graham Watts** of Bunker Insure gives an overview of the evolution of the marine credit market and offers some reasons for the recent tightening in available buyer capacity

First of all, a brief history. The Lloyd's of London Insurance market has always been divided between Marine and Non-Marine business. Marine being the coverage of Hull and Machinery, Loss of Hire, Cargo and P&I. Non-Marine encapsulates everything else from Aviation to Property, Bloodstock to Jewellery and so on. If there is an obvious difference in the way the two areas are treated it would be that Non-Marine largely covers onshore business, governed by a particular country's laws and jurisdiction while Marine is mainly offshore and adheres to international maritime law.

Credit Insurance grew up from the original design of governments to provide security to their own national companies wishing to export goods and services and it mainly covered political risks such as confiscation, embargo, riots or war which interfere with the completion or payment of a contract. In fact, it was then known by its full title: 'export credit insurance'. After a time they also started to provide a level of coverage against bankruptcy and subsequently these government institutions became privately owned and several grew into the credit insurers we know today.

However, importantly, credit insurance is not actually insurance in the strictest sense of the word. By definition, insurance must cover a 'fortuity' or simple misfortune. For example, damage caused by flood, explosion, fire, earthquake or collision. So, in that sense, one can insure an aging vessel on the basis that it is not a great deal more likely to be in a collision than a new one. The manner in which a vessel is managed does make a difference, but not to the extent that insurers have to concern themselves overly much with the management of a vessel.

Not so with credit risk which, although it occasionally occurs that a company will become bankrupt because of a fire or serious damage to plant or equipment, more often than not it is down to poor management, bad judgment , fraud or simply a sharp downturn within an industry sector. So, on the whole, not created by a fortuity. In effect, this manifests itself in the manner by which underwriters consider coverage. Unlike general insurers, who accept that, despite the very best efforts of the insured, accidents will inevitably happen and will not be any fault of the client, credit insurers take the view that with sufficient diligence they should be able to avoid or at the very least mitigate a loss. Insurers will monitor sectors and buyers on a continuous basis and will subsequently amend or even withdraw coverage in the event their analysis determines any material deterioration of risk.

In the early years there were not a large number of credit insurers worldwide and by the 1990s there were perhaps seven privately-owned insurers worldwide in total, with their underwriters specialising in assessing and managing domestic credit risk or debtor default.

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Why is this important? Well, in the examination of risk there are several advantages to writing domestic business. Being domestic and subject to their countries’ laws and jurisdictions, they could expect to be able to see full financials for any potential debtor. Companies, when exporting, would generally establish specific export contracts with their clients which would specify the volumes and price of the goods being exported as well as the dates and number of supplies each year. Usually these transactions were secured by Letters of Credit or Advance Payments and, less often, Export Credit Insurance. The number of overseas counterparties with whom exporters transacted business was also far more limited and, where the values were high, export credit insurance was used by the seller. Underwriters would even take the time to visit those overseas companies to appraise them.

So perhaps this will give you a small insight into the challenges we faced when negotiating the world’s first marine bunker credit coverage. We had to explain that they would rarely see financials; that very often an insured would need to make a decision to supply a new client within a matter of hours – so little time for examination of the risk. But the biggest challenge was that bunker companies would need to supply many dozens, if not hundreds of different clients each year.

To compound the issue, all this needed to be accomplished at a rate that would be affordable to bunker companies earning very fine margins. They would simply not be able to afford the sort of rates normally payable for credit insurance coverage where the standard rate for a single buyer coverage would be somewhere between 1%-3% on limit. What I mean by this is that a single buyer limit of $5 million would cost somewhere between $50,000-$150,000. Obviously, it would be impossible for the bunker industry to afford standard market rates.

But there were three key factors in its favour. It was a new revenue source. Reinsurance capacity, available but unused, could now be utilised. There also existed the safety net of the maritime lien, which although not perfect, would at least mitigate the general risk.

During the first stages of Marine Credit, and despite some large losses, it gradually became the universally accepted coverage it is today while the number of insurers wishing to venture into this area grew. If anything the coverage became cheaper as credit Insurers jockeyed for position and dominance.

Then we had the boom years for shipping between 2002 and 2008 when shipping bankruptcies became a rare event and the number of insurers wishing to offer this cover grew exponentially. Insurers tend to do this, of course, moving into a sector when it is booming and removing themselves as it becomes tougher. You have to also bear in mind that while marine insurers are experts at shipping and aviation insurers, experts at aviation, credit insurers must one day consider a potential insured exporting machine parts and later the same day another potential insured selling shoes. They are experts at credit rather than experts in a particular sector. Even at its zenith, bunker coverages never made up more than perhaps 5% of overall premium income. They can therefore withdraw from any sector which is in difficulty very quickly and, of course, they do.

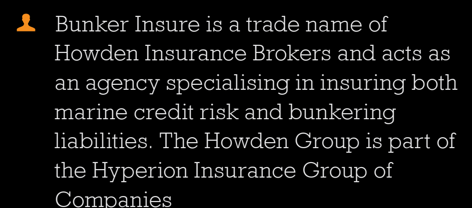
Losses arising from shipping bankruptcies have been relatively containable. This is partly due to the maritime lien but also the nature of the business. The biggest was probably the Hanjin collapse which led to losses of perhaps a total of around $100 million across the industry. The problems, when they came, arose from another source entirely which was unforeseen: the bunker companies themselves, starting with OW Bunker and more latterly, Macoil. These losses were significant and although final net losses are still to be established, they are still thought to be in the many hundreds of millions of dollars while worldwide bunker income is significantly lower.

Additionally, we have today a number of new issues. As fuel prices rise and bunker companies consolidate, the buyer limits required have risen in proportion. Higher limits are requested daily for companies that are no more credit-worthy than the day they were before.

To compound the problem with requests for higher limits, a large number of shipowners are fitting scrubbers, so, for the first time, bunker companies have a new source vying to buy marine credit coverage, namely the shipyards and banks. These entities know the limits they require and they will make full use of them. Thus there is not only a pressure on available capacity but also a pressure on price because these entities earn higher margins and are prepared to pay a higher price. At the same time, because of the heavy losses the large number of credit insurers who began offering marine credit in the mid-2000s have now withdrawn. Today, there are no more than three prepared to consider bunker coverage on a regular basis.

So to address the question, buyer limit capacity is quickly becoming exhausted while the number of insurers prepared to consider bunker coverage is tightening. This does not mean the end of this coverage but it does mean that from now on, buyer limit capacity will be harder to come by while prices will inevitably need to rise closer to market level.

If there is a light at the end of the tunnel it is in the hope that once the effects of the coronavirus subside and the shipping market eventually emerges from its downturn, more credit insurers and reinsurers will feel comfortable to support the market again making more capacity available and in turn reducing price. But for the time being it is a very difficult environment for the placement of marine credit.



Bunker Insure is a trade name of Howden Insurance Brokers and acts as an agency specialising in insuring both marine credit risk and bunkering liabilities. The Howden Group is part of the Hyperion Insurance Group of Companies

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