

The Potential Insurance and Reinsurance Implications of the Ukraine/Russia Conflict

2022 ARIAS US Spring Meeting
Michael A. Knoerzer
Clyde & Co LLP

The Ukraine/Russia Conflict Will Cause far Reaching, and Likely Far Lasting, Exposures.

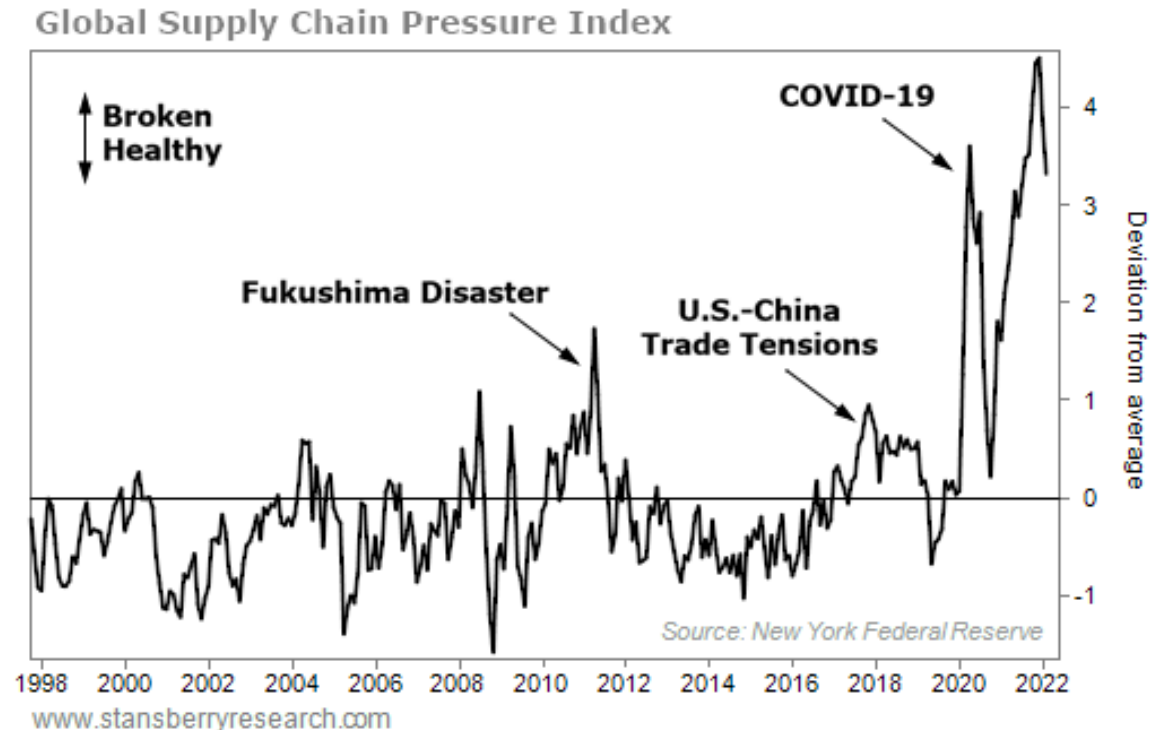
- We do not forget, but do not dwell here, upon the horrible humanitarian crises created by the Ukraine/Russia conflict.
- We focus today on the more prosaic concerns of insurers and reinsurers.
- Direct property losses may occur, but pale in comparison to exposures to other classes of business.
- The losses will arise, not primarily due to the fighting, but due to the *consequences* of the world's reaction to the fighting.

Some Figures

- Over 500 persons/entities sanctioned
- 12% of worldwide shipping volume stuck in “traffic jams”
- Ukraine and Russia are two countries with vast commodity exports: wheat, nickel, iron, aluminum and numerous rare earths.
- Ukraine exports 90% of the world’s neon gas (critical for refrigeration, but also certain electronics equipment).
- 11% of all seafarers come from Russia, and 4% come from Ukraine. 100,000 seafarers are said to be stuck in Ukrainian ports.

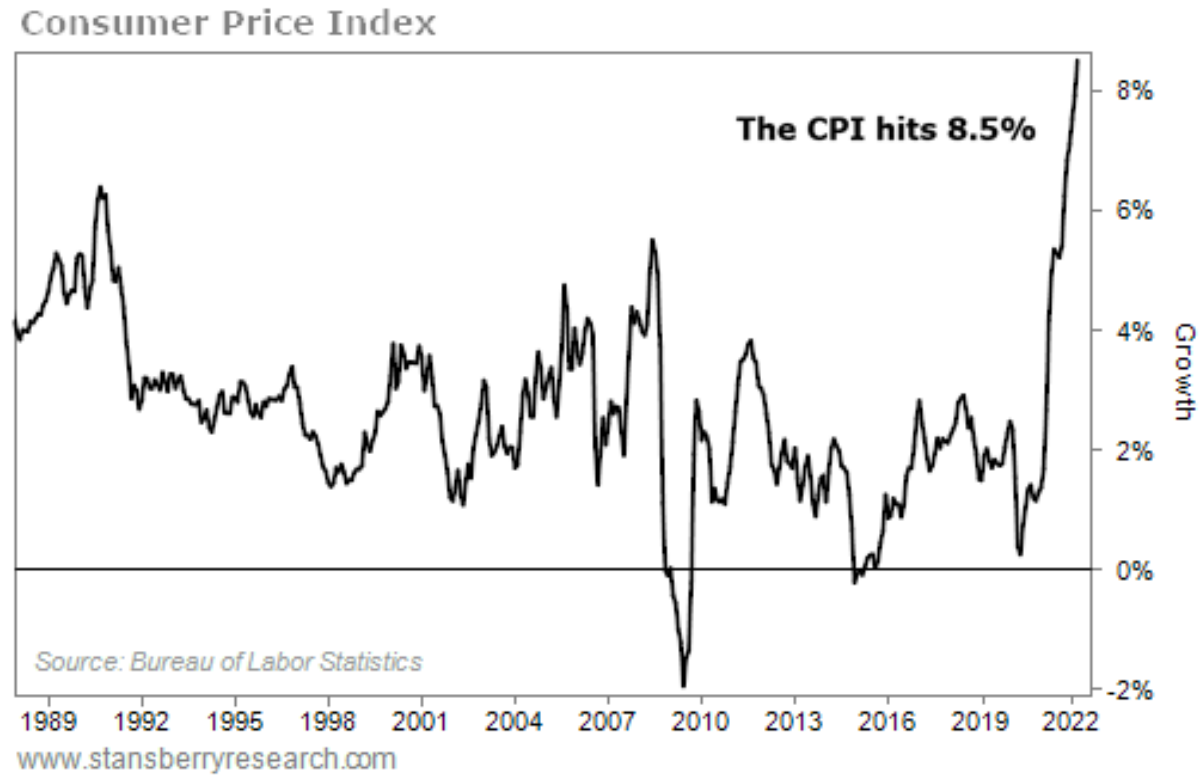
Worse than Covid?

- Below is a chart from the New York Federal Reserve showing stress on the global supply chain. It factors in shipping costs, delivery times and backlogs.



Whoever's Price Hike it is, it is a big one.

- Inflation was already on the rise, but the conflict adds fuel to the fire.



Classes of Insurance Impacted

- **Aviation** – estimates are that over \$12 billion in leased aircraft is trapped in Russia.
 - Airplanes are generally owned by leasing companies.
 - 500+ leased planes are in Russia, and many are formerly operated by Russian airlines.
 - Due to sanctions, the leasing companies are unable to conduct ordinary course business with Russian companies.
 - The Russian airlines have stopped flying internationally and are trapped in Russia.
 - There is a question of maintenance. Planes must have maintenance records. Without them, the plane cannot fly. It may not take long before a plane without maintenance records loses value.
- **Cross-sanctions:** Russian expropriation of planes?

Classes of Insurance Impacted

- **Political Risk/Political Violence Insurance** – PRI/PVI insurance covers loss arising from defined governmental action such as:
 - **Expropriation** – nationalization or confiscation by the host government of a multi-national's investment (such as airplanes on the ground in Russia or oligarchs' yachts in Italian harbors)
 - **Deprivation** – government denies you the ability to use your asset (e.g., a permit to run your plant in their country)
 - **Selective Discrimination** – government enforces regulations which are specific to your business and cause damages (e.g., repeated environmental assessments which halt business operations)
 - **Currency Inconvertibility** –the local currency becomes inconvertible to a hard currency, usually due to government restrictions (e.g., the ruble may not be convertible to hard currency required by lenders)

Classes of Insurance Impacted

- **Trade Credit Insurance**
 - TCI insures against non-payment of valid accounts receivable.
 - TCI does not require government action to be triggered.
 - Example: You sell something on credit to a company (the “Buyer”) in an emerging market. The Buyer cannot repay you within the time allowed by the agreement, whether because it has fallen on hard times, the economy is bad, or its markets are bad. If the seller has TCI, it might be able to make a claim.
- This class of business sees a good deal of fraud in the underlying transactions.

Classes of Insurance Impacted

- **Cyber**
 - Emerging loss profile
 - Ukraine has reportedly been subject to cyber attacks.
 - Does it spill over to the Western world where more insurance cover is available?
 - Types of losses:
 - Loss of privacy
 - Loss of use of assets (e.g., electricity distribution systems shut down)
 - Ransomware – pay up or your company is brought down
- **Business interruption**
 - Interruption of energy supplies may cause businesses to be shut down.
 - Supply chain interruption

Classes of Insurance Impacted

- **Event Cancellation**
 - Provides coverage for cancellation of events, typically sporting or entertainment
 - Sporting events and entertainment scheduled to occur in Russia have been cancelled or are being relocated:
 - Russian Grand Prix
 - Tennis
 - Music concerts
 - Soccer – FIFA and UEFA
 - Possible withdrawal of sponsors for Russian events/athletes could affect events

War Risk Cover

- **War Risk Cover**
 - Insures against losses arising from war, invasions, riots, strikes, insurrections, revolutions and terrorism
 - Most commonly used in marine and aviation
 - War risk liability: covers people inside the craft damaged by war risk
 - War risk hull: covers the craft itself
 - Business is priced based upon underwriters' perception of risks attendant to the country where vessel will travel.

War and Civil War Exclusion

- Does the Policy contain a War Exclusion?

- **WAR AND CIVIL WAR EXCLUSION CLAUSE:**

Notwithstanding anything to the contrary contained herein this Policy does not cover Loss or Damage directly or indirectly occasioned by, happening through or in consequence of war, invasion, acts of foreign enemies, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, military or usurped power or confiscation or nationalisation or requisition or destruction of or damage to property by or under the order of any government or public or local authority.

- *Questions arise as to what was the efficient cause of the loss.*

Far-Reaching Consequences and Challenging Questions

- **Consider a Seller of consumer products which has “self-sanctioned” by withdrawing from the Russian market.**
 - In so doing, the Seller may not only be in breach of its service agreements with Russian counterparties, but . . .
 - . . . may also be in breach of Russian law regarding warranties for consumer products.
 - What if the Seller’s Russian counterparties declare breach of contract and refuse to pay their accounts receivable?
 - Is there a valid accounts receivable insured under a trade credit policy?
- **Consider increases in commodity prices.**
 - Affects credit-worthiness of buyers, causing trade credit losses
 - Affects food prices, causing rising social unrest and political violence loss
 - Can you blame this on war? Are losses subject to a war exclusion?

Far-Reaching Consequences and Challenging Questions

- **Consider political violence losses in a country where students riot as a protest due to the government's 10 cent raise in subway fares.**
 - Assume \$1 billion in damage to various retail stores.
 - Is this a property loss, or a political violence loss?
 - Do both pay?
 - Who is primary?

Far-Reaching Consequences and Challenging Questions

- **Force Majeure**
 - From the French – “superior strength”
 - Used to describe circumstances where performance of a contract becomes impossible due to unforeseeable events outside of the contracting parties’ control
 - A party asserting “force majeure” would seek to justify its non-performance of its contractual obligations.
 - Under English law, it may not be an implied term, but must be an express clause.
 - U.S. law may be a bit less stringent about implying force majeure.
- How “impossible” must the contractual obligation be?
 - E.g., Sanctions make it impossible to pay a claim.
- Is it enough to argue that unforeseen circumstances render performance uncommercial?
 - The costs of performing are unforeseeably high is that enough?
 - What if the counterparty can only pay in local currency?

The Response of the Insurance Industry

- Even before hostilities, insurers were reducing exposure to Ukraine or including war exclusions in exposed coverages.
- In the current environment, claims payments to Russian insureds are subject to sanction and likely will not be paid.
- Risks touching upon Russia or the Ukraine will likely be avoided.
- Pricing increases generally
- The industry says that capacity has not been reduced.

Conclusions

- These issues are likely to be with us for some time.
- Even after the hostilities abate, Russia is likely to be commercially ring-fenced and subject to sanction.
- Western companies will likely continue to “self-sanction” regarding Russia.
- Liquidity issues and rising costs will likely propel trade credit claims for commercial entities.
- Rising inflation may produce political violence or other covered risks.
- Cold war hostilities such as cyber may also continue, spreading beyond just Ukraine and Russia.
- Most insurers will continue to write business in these classes, but with higher pricing and stronger terms.