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AIMU Marine Insurance Day

LOSS COSTS ON THE RISE UNDERSTANDING THE IMPACT OF INFLATION ON OCEAN MARINE LINES

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Agenda

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1st Party Marine Lines
Sean Dalton

3rd Party Marine Lines
Jerry Theodorou

Joint Q & A

Inflation Basics

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Definition: Inflation is the rate of increase in prices over a given period of time. Inflation is typically a broad measure, such as the overall increase in prices or the increase in the cost of living in a country. (Source: IMF https://www.imf.org/external/pubs/ft/fandd/basics/inflat.htm)

Causes of Inflation:

- Demand-Pull
- Cost-Push
- Increase in Money Supply
- Sustained Low Interest Rates
- Government Policies.

Inflation and Impacts on Marine Insurers
1st Party Marine Lines of Business

- Cargo
- Hull & Machinery
- Marine Builders Risk
- Yacht Insurance
- Marine Property
- Commercial Inland Marine Lines

Inflation and Impacts on Marine Insurers
Areas of Concerns

- Increased Cost of Loss
- Increased Values / Exposure at Risk
- Adequacy of Limits
- Premium / Rate Keeping Pace With Inflation
- Deductible Adequacy
- Vessel Valuation
- Marine Builders Risk Escalation Clauses

Impact of Inflation on 1st Party Ocean Marine Lines

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Marine LoB	Inflationary Impact(s)	Ramifications for Marine Insurance	Comments
Cargo	CPI at 40 Year Record High, US Import Price Index Increase, High Shipping Costs, Supply / Supply Chain Constraints	Increased Cost of Loss, Policy Limit(s), Valuation, Rating Base, Deductible Adequacy.	Lack of Warehouse Capacity. Rating base / exposure base should reflect impact of inflation and absent rate reduction and / or flat premium premiums should track. Selling price valuation on unsold goods presents challenging exposures and loss adjustment complications.
Yacht	Cost and availability of materials. Higher labor costs. Demand surge post Hurricane IAN	Increased Cost of Repair, Impact on Estimated Vessel Valuation (Replacement Cost and Fair Market Value), Deductible Adequacy.	Cost of loss Increasing. Adequacy of deductibles and policy limits factors. Greater tendency to CTL on smaller yachts / boats.
Hull & Machinery	Inflation for non military shipbuilding and repair at record highs. Cost and availability of materials. Higher labor costs.	Increased Cost of Repair, Impact on Estimated Vessel Valuation (Replacement Cost and Fair Market Value), Deductible Adequacy.	Cost of loss Increasing. Adequacy of deductibles and policy limits factors.

Consumer Price Index (CPI)

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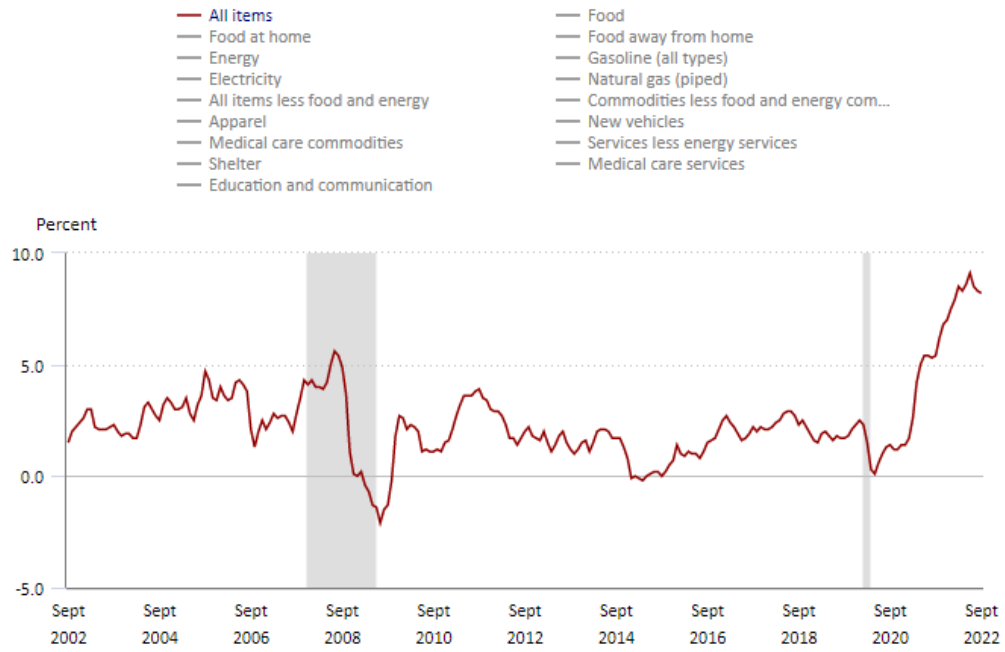
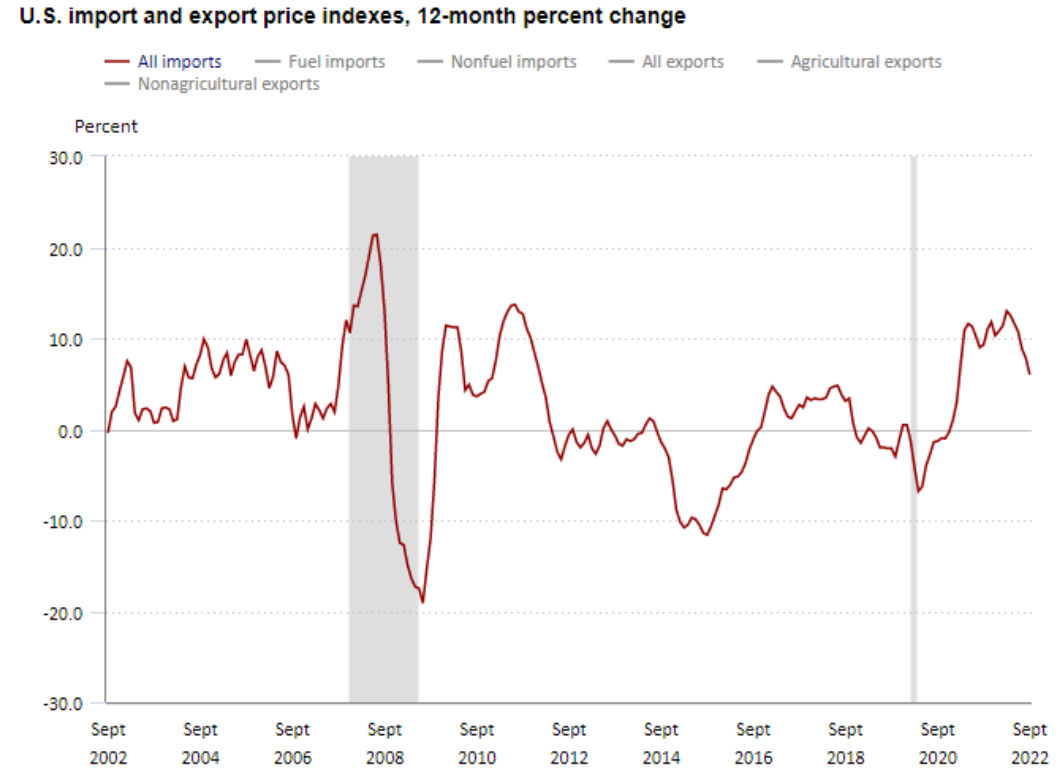
12-month percentage change, Consumer Price Index, selected categories, not seasonally adjusted



Hover over chart to view data.
Note: Shaded area represents recession, as determined by the National Bureau of Economic Research.
Source: U.S. Bureau of Labor Statistics.

US Import Price Index



Hover over chart to view data.
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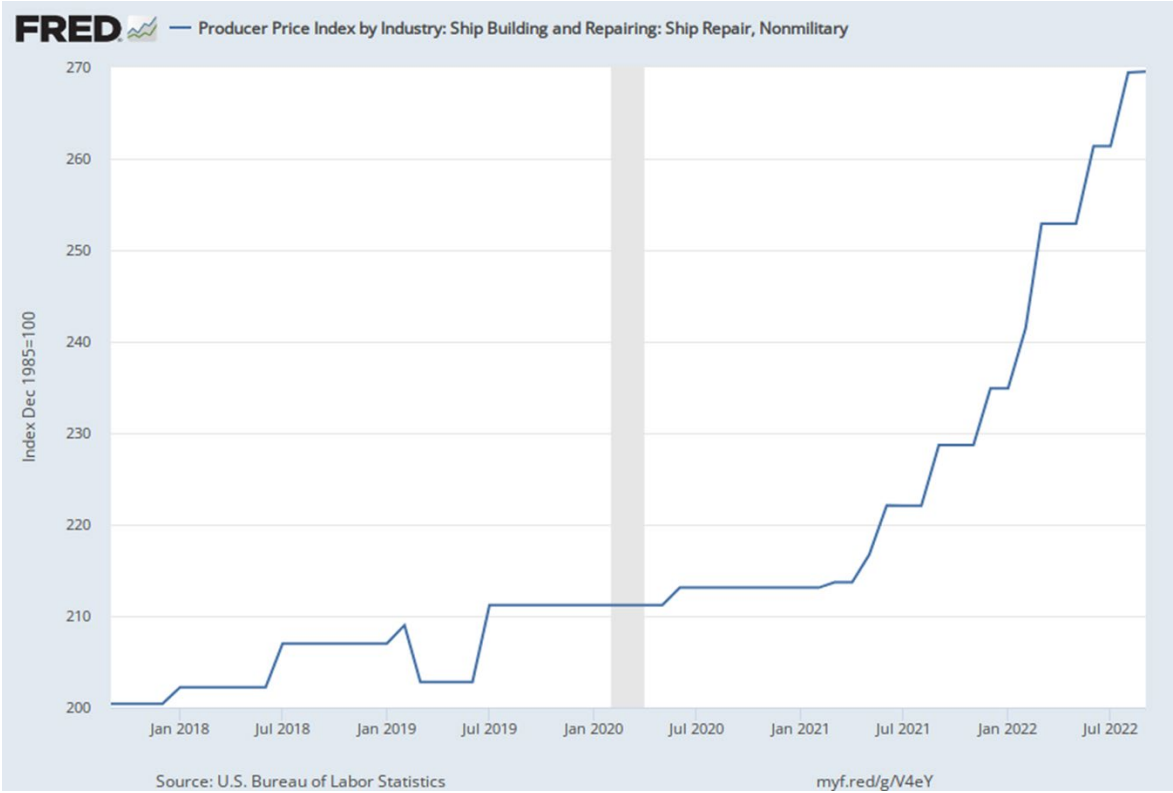
Source: U.S. Bureau of Labor Statistics.

Shipping Costs
Freightos Baltic Index (FBX): Global Container Freight Index

Source: https://fbx.freightos.com/

Producer Price Index Non-Military Ship Building and Repair



Yacht and Pleasurecraft Inflationary Impacts

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- 10% year-over-year average increase in boat MSRPs. Here are the 2021 and 2022 average price increases for some popular models:
  - Lund 1875 Crossover XS Sport increased 21.7%, from $25,206 to $32,055.
  - Mastercraft NXT 22 increased 28.1%, from $76,007 to $97,390.
  - The Sea Ray Sundancer 320 increased 20%, from $301,951 to $363,902.
  - The Crestliner 1860 Retriever Jon increased 180.2%, from $5,567 to $15,601.
- Outboards increased 49.3%, stern drives increased 49.2%, and outboard motors are up by 48.3%
- Pontoon deck and houseboats saw a 25.5% increase.

Source: Price Digests https://pricedigests.com/blog/rising-tide-consumer-interest-lifts-boat-prices-2/

Yacht and Pleasurecraft Inflationary Impacts

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- Higher material and technology costs
- Specialized labor / skills for service and repair
- Availability of boat repair yards
- Depreciating asset insured on an agreed value basis. Partial losses valued on “new for old” basis. Repair costs can quickly exceed insured value of the vessel resulting in a Constructive Total Loss (CTL).

Supply Chain Delays

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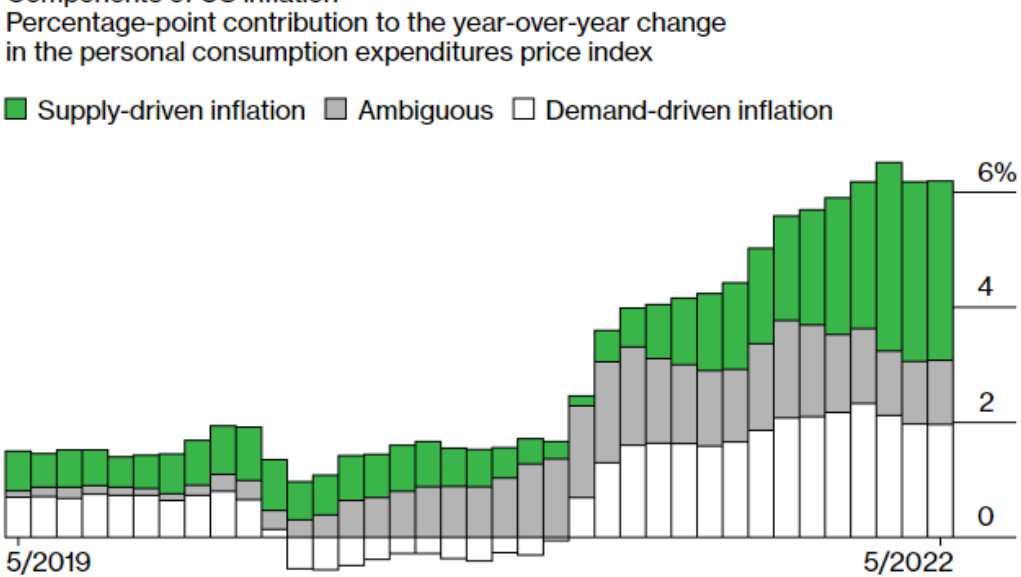
- Causes:
  - COVID – Impact on production and demand.
  - Supply Chain runs at maximum capacity. Not built for interruption or sudden change.
  - Bottlenecks and corresponding impacts.
  - Lack of Warehouse Space.
- Marine Insurance Implications:
  - Accumulation (aboard vessels and in port).
  - Longer transit times.
  - Higher warehouse values at risk (inventory management from “just in time” to “just in case”).
  - Inflation (increase in cost of loss).
  - Putting more stress on a market trying to emerge from challenging period of global unprofitability.

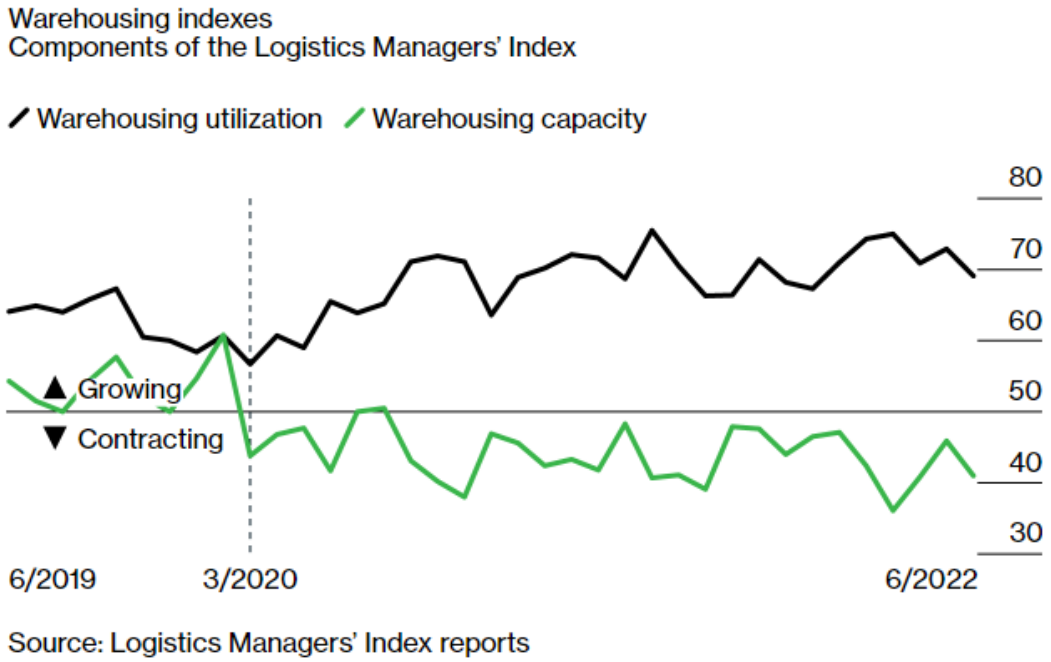
Supply Constraints Are Driving Inflation

Components of US inflation
Percentage-point contribution to the year-over-year change
in the personal consumption expenditures price index



Source: Federal Reserve Bank of San Francisco working paper

Warehouses Are Full



Source: Logistics Managers' Index reports

Cargo Inflationary Impacts
Policy Valuation – Selling Price on Unsold Goods

- Over indemnification, Increased Claims Handling Expenses (forensic accountants)
- Common Markups:
  - Clothing 100-350%
  - Shoes 100-500%
  - Furniture 200-400%
  - Cosmetics 60-80%
  - Prescription Medicine 200-5,600%
  - Eyeglasses 800-1,000%
  - Jewelry 100% average
  - Books 300% average
  - Electronics 750% average

Source: Wisebread https://www.wisebread.com/cheat-sheet-retail-markup-on-common-items https://pricemole.io/posts/7-highest-margin-products-2018

Rate Change and Loss Trend

Rate: A unit of cost that is multiplied by an exposure base to determine an insurance premium. An insurance rate is the amount of money necessary to cover losses, cover expenses, and provide a profit to the insurer for a single unit of exposure. Rates, as contrasted with loss costs, include provision for the insurer's profit and expenses.

Rate Change: Rate change is a key indicator of how an insurer’s loss ratios are likely to change.

Loss Trending: Adjusting historical losses to account for inflationary trends so that their value is in current dollar amounts. Historical loss amounts are multiplied by "trending factors" to convert historical loss amounts to current dollar amounts.

… it’s far easier to keep up than catch up.
- Gretchen Ruben