Commentary

Red Sea Crisis: War Insurance Rates to Increase Following U.S. and UK Airstrikes on Houthi Targets

Morningstar DBRS
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Key Highlights

- A U.S.-led multinational maritime coalition launched Operation Prosperity Guardian to protect commercial vessels and ensure freedom of navigation in the Red Sea and the Gulf of Aden.

- War insurance rates for marine hull have remained volatile since the beginning of the hostilities in October 2023, peaking at 0.7% of hull value before the beginning of Operation Prosperity Guardian.

- We expect an uptick in war insurance prices following the coalition's airstrikes on January 11, 2024 as Houthi rebels remain committed to disrupt commercial traffic in the Red Sea.

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Overview

Since October 2023, Houthi rebels in Yemen have launched several attacks on commercial vessels in the Red Sea, raising concerns about the safety of shipping lanes and the potential impact on global trade. The attacks on commercial ships in the area underscore the importance of maritime security and the need for a coordinated response from the international community. In our view, our rated insurers are not expected to be materially affected by the ongoing crisis in the Red Sea given their limited exposure to the war insurance market for marine hull and cargo.

To help defend against the attacks, the United States launched Operation Prosperity Guardian in the Red Sea and the Gulf of Aden on December 19, 2023, together with a multinational maritime coalition including the United Kingdom, Bahrain, Canada, and the Netherlands. The coalition's goal is to address the security challenges posed by the rebel group's naval attacks on commercial vessels while ensuring freedom of navigation in the area. On January 11, 2024, the U.S. and UK militaries carried out several airstrikes against Houthi targets in Yemen to signal the intention of the maritime coalition to deter the rebels from executing further attacks on commercial ships and to protect navigation in international waters. However, after an initial softening in war insurance rates following the announcement of Operation Prosperity Guardian, the marine insurance market is now expecting rates to go up in the following days as underwriters expect retaliatory attacks from the rebels.

Houthi Attacks on Commercial Ships Have Caused Severe Volatility in War Insurance Pricing

The Red Sea is a critical waterway for global trade, connecting the Mediterranean Sea and the Indian Ocean through the Suez Canal, one of the busiest shipping lanes in the world. The recent and continuous attacks on oil tankers and other commercial vessels threaten to disrupt this vital trade route and potentially increase the cost of shipping goods, including the cost of war marine insurance coverage for both hull and cargo.

Before the outbreak of the Hamas-Israel war and the involvement of the Houthi rebels in the conflict, war insurance rates for marine hull were a nominal 0.05%, with many underwriters waiving the cost of war coverage altogether for sailing in the Red Sea. However, since the onset of the hostilities, war rates have jumped, up to 0.7% at their peak. For a vessel (excluding the value of the cargo) with a total insurable value of $120 million, this translates to more than $800,000 in additional insurance costs per trip in the area.

With the announcement of Operation Prosperity Guardian in mid-December, war rates have been oscillating between 0.3% and 0.35% of hull value as underwriters priced a potential reduction in the risk of further Houthi missile and drone attacks. Nonetheless, critical participants in the marine market, including underwriters and brokers, are now expecting an uptick in war insurance rates as the Houthi rebels announce a wave of retaliatory attacks following the January 11 airstrikes.

The Outlook for the Marine War Insurance Market

Marine war insurance is a specialized type of insurance that covers risks associated with political violence, terrorism, and other perils in maritime transport. The recent attacks in the Red Sea are likely to increase the demand for this type of insurance as shipping companies and cargo owners seek to protect themselves against potential losses. This development is also expected to have broader implications for marine insurance prices, which are likely to rise in response to increased demand. At the same time, insurers may reassess their exposure in the region and adjust pricing accordingly.

If Operation Prosperity Guardian succeeds in weakening the striking capabilities of the Houthi rebels in the Red Sea and deters other geopolitical actors in the region from providing them with logistical support, we expect war insurance prices for marine hull and cargo to stabilize albeit at levels substantially higher than those preceding the Hamas-Israel War. However, if the U.S.-led coalition fails to thwart further attacks and ensure the freedom of navigation in the region, we anticipate that war insurance coverage will become unavailable, forcing most of the traffic to use the much longer route around the Cape of Good Hope (the Cape).

We note that war insurance coverage has remained available for Red Sea voyages despite the heightened tensions, but escalating violence has pushed up prices. Given their historical expertise covering this risk, war insurers have swiftly adapted to operate during times of elevated geopolitical turmoil.

The worst-case scenario for the marine insurance industry is that hostilities in the Red Sea become a regional conflagration, which could lead to the simultaneous loss of multiple vessels. This scenario is unlikely and the loss exposure remains limited at this point, especially since most shipping traffic is being rerouted around the Cape. According to Linerlytica[1], as of January 7, 2024, the number of containerships that has been diverted from the Suez Canal to the Cape route has climbed to 354 since December 15, 2023, accounting for 80% of all the ships travelling between the Atlantic/Mediterranean basins and the Indian Ocean.

1 Source: https://www.linerlytica.com/post/market-pulse-2024-week-02/

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