POTEN & PARTNERS

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POTEN TANKER OPINION

Shipping Oil At Your Own Risk

The EU and UK plan to block insurance for Russian oil cargoes

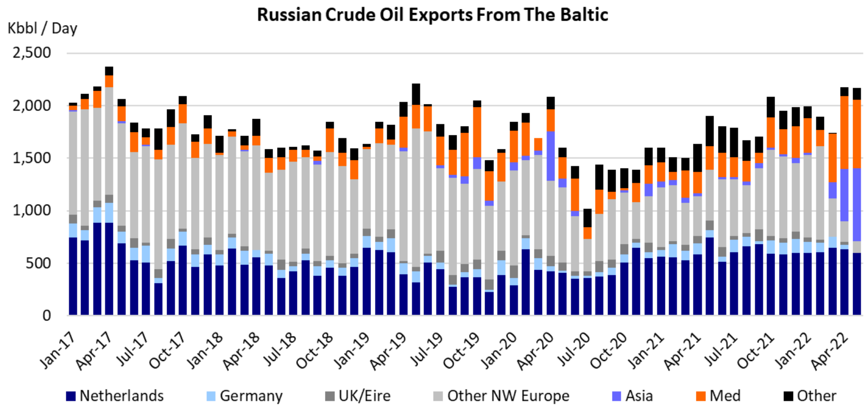
The EU is expected to announce a new set of sanctions aimed at eliminating all seaborne movements of Russian oil to Europe. To convince EU member Hungary to go along with the new measures, pipeline exports are to be excluded. However, since more than two-thirds of the European imports of oil are seaborne, these actions will likely have a significant impact. In response, Russia could try to divert more crude oil to other customers, like China or India, which have already increased their purchases. However, in a move that could be interpreted as an attempt to restrict Russia's options, the EU, in coordination with the UK, is preparing to block insurance coverage for tankers carrying Russian oil anywhere in the world. This is a critical measure that could have a dramatic impact on the seaborne trade of Russian oil and oil products.

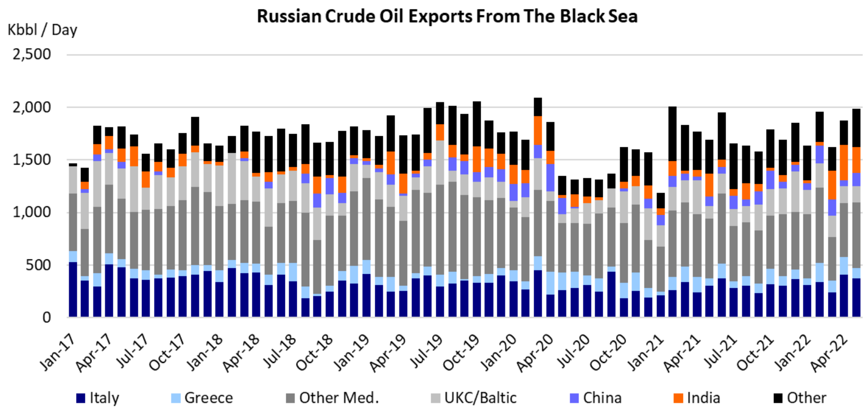
Oil tankers typically carry two types of insurance: Hull & Machinery (H&M) insurance and Protection & Indemnity (P&I) insurance. H&M insurance covers physical damage to a vessel. P&I insurance is designed to complement a vessel's H&M insurance. It covers a wide array of third-party liabilities, including cargo loss, shortage or damage, collision, and pollution. The primary providers of P&I insurance for oceangoing vessels are "clubs". These clubs are mutual associations controlled by the vessel owners they insure. A group of thirteen P&I clubs, called the International Group of P&I Clubs provide marine liability cover to approximately 90% of the world's ocean-going tonnage. The members of this group share between them the large loss exposures.

The global marine insurance market is dominated by European companies. Almost all the members of the International Group are based in the United Kingdom or in other European countries. If they need to comply with EU/UK sanctions, this will cover a very significant portion of the global tanker fleet. The potential implications cannot be overstated. A ban on insurance coverage for all vessels carrying Russian oil would potentially eliminate all vessels that are covered by the International Group of P&I Clubs from the Russian export trades.

An EU/UK insurance ban would severely restrict Russia's ability to export its crude oil. It is likely that any insurance ban would not be immediate but implemented over time. This would give Russia and some of its key customers time to create a workaround. However, even with six months advance warning, we expect that Russia will have to cut its exports dramatically.

Using marine insurance as a sanctions weapon is not new. In 2012, a European Union oil embargo on Iran, prohibited EU insurers from covering Iranian oil exports anywhere in the world. This proved to be a very powerful tool. Iranian exports





Source: Lloyd's List Intelligence

dropped 25-30% and it ultimately brought the country to the negotiating table. These are obviously different situations. Russia is a much larger producer (and exporter) than Iran and unlike the situation in 2012, countries like China and India are not on board with current sanctions.

However, let's assume that Russia is forced to cut its exports from the Black Sea and the Baltic by 50% to one million barrels per day each. Given the already very tight global oil markets, this will create a significant spike in the oil price. This may be enough to convince OPEC to use it spare capacity to prevent a global recession. If not, or if OPEC's spare capacity is not enough, we could see a "demand destruction" scenario play out, where prices increase so much so quickly that global demand will be curtailed.

The shipping implications of such cutbacks will be significant as well. Aframaxes and Suezmaxes are the preferred tankers to export crude from the Baltic and the Black Sea. If an insurance ban takes most of the international tanker fleet out the equation, Russia, China and India will have to use domestically owned or controlled tonnage to move the crude. For the Baltic exports, we expect they will need a fleet of 20 Aframaxes (for lightering) and 23 VLCC's to move 500,000 b/d to China and 31 Suezmaxes to move a similar volume to India. For the exports from the Black Sea, the requirement is for 10 Aframaxes, 20-25 VLCCs and 20 Suezmaxes. Finding these vessels and arranging insurance for them outside the EU and UK markets could be very challenging. It may also make it difficult for these vessels to get employed in regular international oil trades. This will create further inefficiencies in an already volatile oil and tanker market.