ALESCO

# ENERGY INSURANCE: MARKET UPDATE

JUNE 2019

The short-term outlook in the upstream energy market remains stable with oil prices at around $67 per barrel for benchmark Brent crude in summer 2019 ($7 per barrel lower than summer 2018). The total world rig count according to Baker Hughes is 2150; a 3% decrease over the past 12 months. The Energy Information Administration (EIA) forecasts that the United States will be a net exporter of gasoline in summer 2019 for the first time since 1960.

Refining margins into Q2 2019 are continuing at a high level (the BP Global Refining Marker Margin Index $16.5 per barrel shows an 11% improvement from Q2 2018).

The overall demand for energy insurance could be viewed as moderately stronger in both the upstream and downstream markets but there remains an oversupply of upstream capacity which is continuing to hold down rates for all but the largest placements that are stretching the overall limits of market capacity.

Following poor underwriting results in 2017, the downstream energy market is attempting to apply double digit rate increases across the board and are paying specific attention to Business Interruption (BI) rates and accounts with Natural Catastrophe (NatCat) exposure.

In addition many large buyers are deploying well-capitalised captive vehicles or alternative capacity such as Oil Insurance Limited (OIL) to manage volatility in short-term pricing. In the past six months, OIL has added three new members, all in the downstream energy sectors (refinery and petrochemicals).

## LLOYD'S OF LONDON (LLOYD'S) MARKET UPDATE

For 2018, Lloyd's reported another loss of GBP1bn (2017: loss GBP2bn; 2016: profit GBP2.1bn) and a combined ratio of 105% (2017: 114%). There was a slight improvement in net claims reduction and a reduction in major loss activity compared to 2017. In fact, major claims in 2017 represented 11.6% of net earned premium which is broadly in line with the ten year average 2008-2017. Net operating expenses remained at just under 40% of Net Earned Premium and various initiatives are planned to try to reduce this significantly going forward. The Energy class again showed an overall profit in 2018 although the accident year result (106%) was again significantly improved by an 18% prior year reserve movement.

## ENERGY LOSS UPDATE

It is still too early to predict 2019 loss levels, but Q1 and Q2 appear to be relatively quiet in terms of Energy losses.

This is in contrast to 2018 where we are still seeing adverse development.

## 2018 ENERGY RISK LOSSES ABOVE USD250M

| Date of Loss | Land / Offshore | Country | Cause | Category | Total / Actual US$ |
|---|---|---|---|---|---|
| April 2018 | Land | USA | Fire/Explosion | Refinery | 1,205,000,000 |
| Sept 2018 | Land | Germany | Fire/Explosion | Refinery | 803,000,000 |
| Oct 2018 | Land | Saudi Arabia | Fire/Explosion | Petrochemical | 490,000,000 |
| Oct 2018 | Land | Canada | Fire/Explosion | Refinery | 405,000,000 |
| Feb 2018 | Land | Papua New Guinea | Earthquake | LNG plant | 270,000,000 |

## UPSTREAM ENERGY CAPACITY, DEMAND AND OUTLOOK

2019 is shaping up to be another benign loss year with no meaningful direct catastrophe impact to date. Traditional Exploration and Production markets remain active whilst more recent market entrants are also pursuing new business.

Underwriters are still rating new business competitively but seeking increases up to 10% on renewal business (but generally accepting less on clean business). Emotionally charged areas for underwriters include transportation heavy risks, environmental issues, earthquakes and unfavourable legal venues such as Louisiana, Texas, and the Northeast USA.

For rig accounts, flat renewals have been challenging due to losses across the book but despite this, incumbent markets are containing rises to reflect increasing activity levels. The rating environment is more challenging for equipment or 'frac' compared to conventional onshore drillers.

Overall total market capacity remains largely intact at over USD7bn but this is largely a theoretical number and actual working capacity for most placements could be considered to be no more than 50% of this level - taking into account regional players and markets averse to some coverages. Despite this, the short-term outlook still remains favourable for buyers with rates close to the historical low point.

## DOWNSTREAM ENERGY CAPACITY, DEMAND AND OUTLOOK

Results from corporate insurers in 2018 were poor compared to previous years largely attributed to Natural Catastrophe activity and the continuing deterioration of some large individual losses. This negative sentiment on the sector heightened following a series of major risk losses in 2018 (Nat Pet, Bayernoil and Irving Oil etc.) and further deterioration on the Abu Dhabi National Oil Company (ADNOC) loss which has seen the market achieving double digit rate increases. Some underwriters have withdrawn from the class and others, particularly in Lloyds, are no longer writing for income. Less attractive risks and those with Natural Catastrophe exposure are more of a challenge to attract competitively priced supporting capacity. There are a number of high profile examples in the marketplace where brokers have become distressed to complete placements, and required substantially higher terms to finish off programmes.

## POWER INSURANCE MARKET

Following Lloyd's review of the PG risk code, most business plans were signed off but at reduced premium income levels and there were some market withdrawals. Swiss Re, Allianz, Aviva, Axa and other European company markets are removing or restricting support for coal fired generators who are unable to demonstrate commitment towards feedstock diversification.

The general Property market, in recent years ever more prominent in broker's Power Gen schematics, are pulling back from this sector following directive from managing agents to focus on their core business. Accounts with attrition are coming under particular scrutiny, with even apparently profitable high rate on line primary offerings being rejected. Even clean renewals are being disproportionately penalised by the Property market, with the most severe treatment being imposed in developing economies with high Nat Cat exposure.

Despite another challenging year in terms of results for the traditional Power Generation underwriting community, business continues with clean renewals anywhere between flat and 10% up. There remains significant overall capacity and some new options for lead markets, despite some attempts by follower markets to hide behind the decision-making of certain leaders.

## OIL RECENT DEVELOPMENTS

At 31st December 2018, the Total Shareholders' Equity was USD3.2bn (2017: USD4.4bn) with written premiums for 2019 totalling USD464m compared to USD354m in 2018. This reflects the average 30% premium for most members following a poor 2018 loss year of USD783M which resulted in an underwriting loss of USD405m compounded by a loss of USD250m on investment income. However OIL declared at the shareholders AGM in March 2019 that a further dividend of USD250m would be paid in 2019. The OIL pool is likely to remain volatile for those members with high pool shares.

Overall membership has increased to 56 members.

## ALESCO'S RECOMMENDATIONS AND CONSIDERATIONS

Energy insurance buyers are continuing to trade in a fragile insurance market. The broker's role in maintaining a strong relationship with key lead underwriters in the commercial market coupled with an understanding of all the alternatives available seems to be fundamental to steering clients through these choppy waters as we hit the 2019 mid-point.

## OUR TEAM

Alesco's Energy division has one of the largest teams in London which has continued to grow despite the volatility in the energy industry, helping our clients of all sizes to recognise that we offer a high level of strategic advice and service. With over 400 clients spread across 6 continents, our team of over 65 experts works across the globe on projects throughout the industry, covering; Upstream, Downstream, Midstream, Power and Renewables.

## IF YOU WOULD LIKE TO DISCUSS ANY OF THE ABOVE PLEASE CONTACT:

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