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QUARTERLY NEWSLETTER | OCTOBER 2020

Energy and Power Newsletter

Focus On: Onshore Construction Insurance

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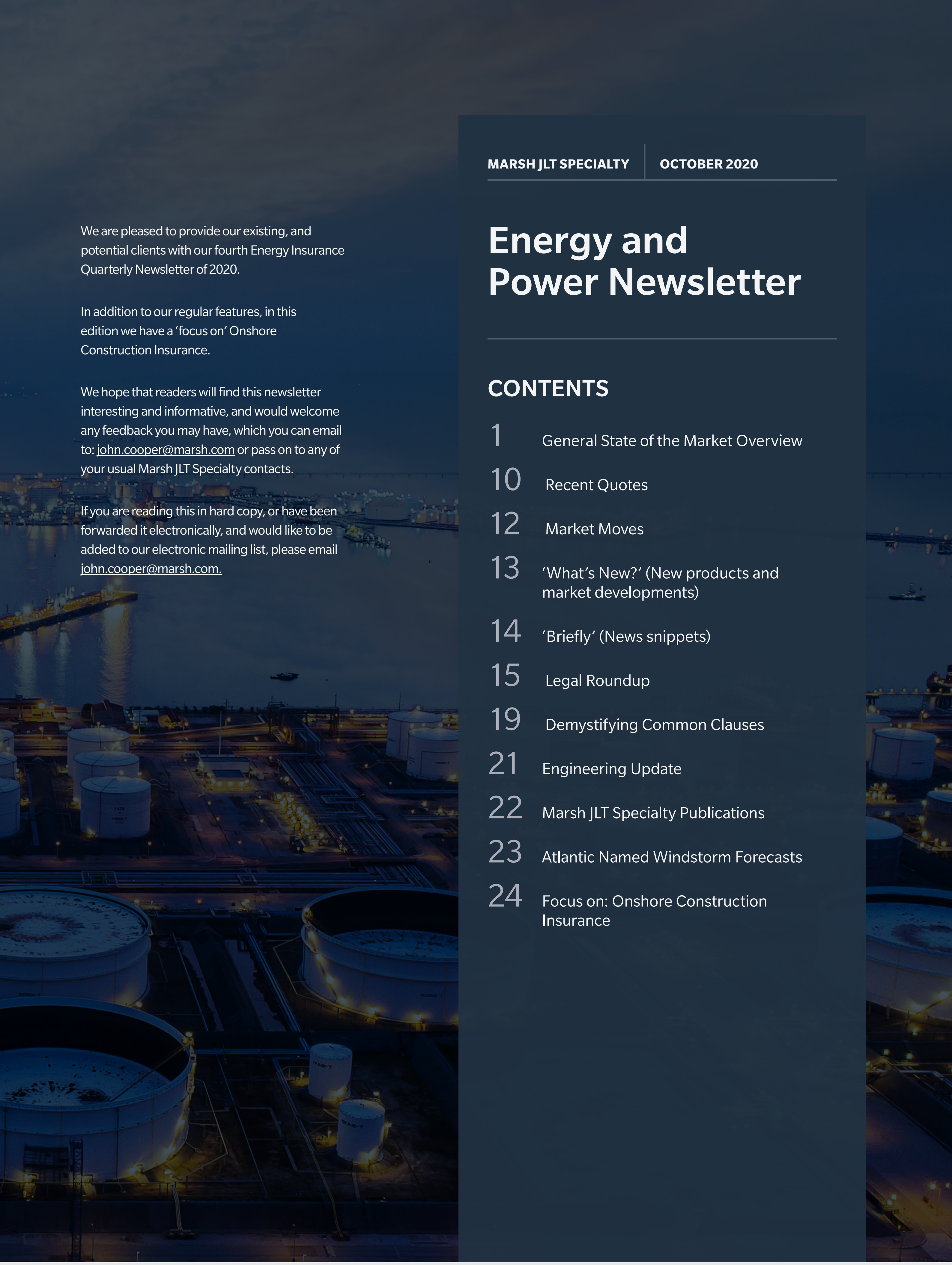

We are pleased to provide our existing, and potential clients with our fourth Energy Insurance Quarterly Newsletter of 2020.

In addition to our regular features, in this edition we have a 'focus on' Onshore Construction Insurance.

We hope that readers will find this newsletter interesting and informative, and would welcome any feedback you may have, which you can email to: john.cooper@marsh.com or pass on to any of your usual Marsh JLT Specialty contacts.

If you are reading this in hard copy, or have been forwarded it electronically, and would like to be added to our electronic mailing list, please email john.cooper@marsh.com.

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Energy and Power Newsletter

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General State of the Market Overview

General Backdrop

In general terms, the various component parts of the energy and power insurance market (upstream, downstream, casualty, traditional power, renewable energy and marine related energy) all continue to harden. Each of these sectors have their own pressure points and nuances, which we discuss within this article. Even where the loss environment has improved (such as downstream), or was benign (upstream), there is still momentum from insurers to pursue premium rises in some cases on top of rises over the past two years. This is driven by wider issues affecting the insurers including COVID-19, natural catastrophe losses from hurricanes, derechos and wildfires, and for some syndicates intervention from Lloyd's.

Several years ago, in response to unprofitable results in particular classes at some syndicates, Lloyd's implemented a plan to remediate underwriting in certain businesses introducing stricter guidelines on the business plan approval process of syndicates. Those various reviews have resulted in withdrawals from certain classes, reduction of capacity in various lines, and the closure of some syndicates entirely. Some syndicates' results mean that they now enjoy 'light touch' status where by their business plans are approved automatically, while Lloyd's remain more closely involved in the approval of others.

Coverage restrictions, including exclusions related to COVID-19 or communicable disease and differing approaches across insurers in relation to cyber write backs – resultant damage and/or deliberate acts – present a further challenge for clients.

That said, the energy and power insurance markets have coped well with the logistical challenges of trading in a locked down marketplace, though response times are often slower. Both insurers and brokers have adapted to this new trading environment, accelerating the transition to universal adoption of digital trading platforms by several years.

Upstream Energy

At the same time as many upstream clients find their business models under significant financial strain, their overall insurance spend is rising. Across most lines, clients are coping with an increasing rating environment. Smaller clients, in particular, are finding the purchasing process much more difficult to navigate. Insurers are looking to impose minimum premiums for individual lines, meaning business which has a premium below USD500,000 is increasingly tough to find cost effective capacity for in the open market. On accounts with premium of less than USD1 million, insurers are looking to impose 7.5% to 10% rises. On accounts with a larger premium base, more modest rating changes are achievable, and in some cases renewal terms can be secured on “as before” or expiring basis, but reductions are extremely rare.

The onshore North American portfolio of frackers, shale wells and midstream risks has received particular attention. A focal point for this sector are saltwater disposal operations, prone to lightning strikes, which have seen significant upward rate changes along with restricted coverage.

The two previous stalwarts of the class – drilling and construction – are also coming under pressure. The offshore drilling contractor market is showing resistance, with a number of insurers who previously underwrote the class becoming cooler in their reaction to supporting lead renewal terms. A significant (USD120 million) offshore construction pipeline loss has exacerbated concerns.

Hurricane Laura, which made landfall in Louisiana, US as a Category 4 storm in August, has produced minimal claims, and the high excess points on these shelf wind placements, imposed by insurers, undermines clients’ appetite to continue buying coverage.

There continues to be an abundance of capacity available to insureds, with over USD8.25 billion available from nearly 60 core commercial market insurers (excluding markets offering capacity in certain geographic locations only, as well as captives and mutuals) which, for most risks, gives choice and the potential for competition.

Despite the availability of market, there are some challenges with attracting capacity at the right price. Although loss ratios are good in the sector, underwriter appetite for the class, which has driven capacity to this level, is beginning to wane due to a pricing environment that remains relatively moderate.

The previously active markets hubs in the Middle East and Singapore have started to show signs of pulling back with much of the underwriting returning to London. There is also a more conservative underwriting stance currently prevailing, although these hubs remain an important market place for many accounts in the regions.

As we look into 2021, we expect that markets will continue to try to achieve premium increases driven in part by aniticipated increases in reinsurance cost.

Challenging market conditions continue. Catastrophe modeling, and current engineering surveys, including estimated maximum loss information, can help better differentiate risks.

Downstream Energy

As we complete the third quarter of 2020 the market remains precariously balanced. Downstream energy companies continue to operate in an extremely challenging trading climate. However, refinery utilisation has begun to ramp up again, although still well short of normal. Oil prices have recovered to more sustainable levels although a resurgence of pandemic cases are, once again, destabilising the position.

The impacts of this ongoing uncertainty are idle plants (some permanently or subject to conversion), delayed projects, and movement to shore up liquidity through this crisis. Although a high proportion of projects and major turnarounds has been delayed, some smaller turnaround work has been brought forward to take advantage of the slowdown in activity.

Most refiners have continued to deploy capital expenditure on both critical and routine maintenance pending ramping up. There is a political understanding that economies require kick-starting, and levels of normality are expected to return in the next two quarters. Such crises normally allow for elements of natural selection (including mergers and acquisitions) and adaptation, and there are signs that the industry will evolve leaner and ever more resilient.

The issue of engineering insight affects both clients and insurers. Catastrophe modelling is essential to insurers, and estimated maximum loss/foreseeable maximum loss information inevitably becomes dated. This is even more challenging for new assets as they come to market. The immediate impact of postponed surveys appears manageable, and there have been good levels of workarounds through virtual and desktop surveys. There is improving technology to assist in these virtual surveys, such as the use of live head cameras and drones. Virtual surveys are becoming increasingly acceptable within the underwriting community, and there is certainly a case that in post COVID-19 business models may dictate that they remain. Nonetheless, on site face-to-face surveys are continuing where geographies permit, and it is recognised that engineering surveys, conducted effectively, are a benefit to clients and underwriters alike.

Insurers within the sector have, of course, been managing their own challenges for some time in a sector that has been beset by large losses over the past few years. Rates have been moving up for over the past 21 months, and meaningfully over the last 12 months.

Insurer and client interests are aligned on the sustainability of the market, but the deviation comes with the sustained scale and pace of implementation. A particular issue is the differing approach to rate movements within the underwriting market itself. Certain core insurers have been pursuing a measured stair stepping of rate increases, while others have looked to take maximum advantage of the reduced capacity supply and changing appetite. The issue with the opportunistic approach is that the severity to clients becomes exacerbated. It seems that almost the same sector of the insurer market that drove the market cycle down to unsustainable lows is now pursuing a course that will quickly hit the top of the cycle in the same unsustainable way.

OIL is becoming the beneficiary of this, and clients will retain more risk particularly in areas such as business interruption, where business plans and protocols permit. Good business will be lost, frustrating those insurers who are more adept at managing the cycle. Nevertheless, it should also be noted that, at this point, there has not been any material change in new capacity entrants to provide additional competition, and this competition may not materialise until 2021.

Another factor is that underwriters expect their treaty costs to increase, which would impact both direct costs and appetite for retentions.

Fortunately, there are some optimistic signs for experience in the sector. To date 2020 losses are well within insurer expectations. The hurricane season in the Gulf of Mexico is not finished, but the later in the season we get, the more likely any hurricane trajectories will deviate away from the concentrated energy assets.

Although fragile, insurer's experience in the class is improving, and rate increases should ease for most clients as insurers become more account specific in their attentions. Many of those clients renewing in the fourth quarter are facing their third rate increase in as many years, and will be expecting some moderation. Projected earnings for the next annual period will be down, which will affect future business interruption premiums and a flow of reverse income can be expected as 2020 policies adjust. For singleton refiners, and private equity backed enterprises, the fourth quarter is likely to be very challenging as there is little pressure on insurers to chase income. Strong data and broker application will be needed to address these renewals.

Midstream clients will continue to receive the benefit of a greater availability of competition for their business, and should be prepared to move into alternative geographical markets to maximise cost benefits. Clients remain somewhat bemused by the myriad of clauses underwriters are attempting to push within the market, particularly pandemic clauses, and there remain too many non-concurrencies within policy terms and conditions.

Power

The power market is now renewing programmes that underwent rate adjustments last year, and the rate increases are continuing along the same trajectory. Insurance carriers continue in a push to re-underwrite terms and conditions, and increase premiums, in an effort to address consistent years of loss-making activity.

Primarily, this adjustment takes shape in the form of increasing self-insured retentions and higher premiums for clients as insurers work to return to profitability. Furthermore, carriers have continued with a strategy of providing reduced capacity on any one risk. This results in a more complex placement process whereby placements may be finalised across multiple contracts at different terms and conditions.

To ensure optimum coverage and a smooth placement process, we highly recommend participating in insurer roadshows (we are hosting these virtually), carrying out annual engineering reports, and providing ample project information (particularly for new business) to ensure that each risks receives the best possible treatment from underwriters. In a market where insurers are increasingly critical in their risk selection process, these details become ever more important. With the ongoing effects of the global pandemic, site access may be restricted. In these circumstances we recommend undertaking a virtual engineering survey. Meanwhile, insurers are focusing increasingly on COVID-19 contingency plans; this has become a key discussion in the placement process.

Clients are facing increasing retentions and higher premiums as insurers try address years of loss-making activity.

To summarise, our recommendation for all clients, with both renewable energy and traditional power source exposures, is to engage with their broker at the earliest opportunity to allow discussions to begin with the market. The market is however becoming very congested with clients seeking alternative quotations and structures, therefore time is critical to ensure the best results. Underwriters will be looking for an increase in price, particularly for older/out of warranty projects, clients with losses or those located in natural catastrophe (CAT)-exposed regions, and historically low deductibles.

Renewable Energy

In both offshore and onshore, the momentum of the 'green recovery' continues to intensify as we move towards the end of the year. From the insurance market's perspective, this means underwriters are managing a substantial and consistent flow of new business opportunities.

Increased internal scrutiny on underwriting discipline on the back of a number of years of perceived under-pricing and generous terms and conditions, coupled with the global events impacting the market generally, have resulted in this market becoming increasingly challenging.

Insurers continue to remodel the risk of the escalating environmental CAT perils, including wildfire and hail.

Time is also a valuable commodity for this class level, and detailed underwriting information is also valuable – this speeds up the placement process by addressing potential concerns upfront and makes it easier for insurers to prioritise the submission.

To date, we have continued to see the trend of rating uplifts and deductibles tend to be subject to adjustment in line with current market conditions. Recent months have also seen increased examination on policy wordings, resulting in some policy sub limits and coverages being reduced.

Particular focus from the market is being placed on old and new assets. Insurers are seeking higher rates for both out-of-warranty wind turbines and solar projects, as well as prototypical designs, and coverage is limited. As such, engineering reports are a crucial component for achieving the best terms from the market for risks with these characteristics.

Wildfire and hail, previously considered peripheral CAT exposures, are a greater concern for insurers. In regions deemed to be exposed to these perils, there has been a significant reduction in coverage offered by a number of insurers, as well as premium increases, as underwriters continue to tread carefully to understand the risk of these escalating perils.

Coverage for projects in areas located within traditional CAT exposed regions remains challenging. Insurers reserve their most significant rating increases for these regions (particularly for solar placements), such as Latin America and the Caribbean – we have seen a number of London markets withdraw capacity entirely from these areas specifically.

If we consider the offshore sector, market conditions have followed a similar path to the onshore world. Generally, clients are continuing to experience rating increases, even for programmes which historically would have been considered a straightforward renewal. Construction programmes continue to experience changes to deductible levels and increasing pricing.

A particular challenge in recent months has been obtaining policy period extensions for construction programmes. The underwriting philosophy has shifted dramatically for this class in recent years, and so market appetite and availability is often different to when the project was placed. Detailed information on this shift is available on page 28.

Many markets have continued to focus their energies increasingly on wind and solar, meaning that market capacity for geothermal, hydro and biomass/biofuels has been significantly reduced. As a consequence, prices have been increasing, and coverage has become more limited.

Traditional Power

During the third quarter, with the continued firming of the market, straightforward renewals with a clean loss record and no CAT exposures experienced on average increases in the range of 20%-30%. Accounts that had CAT exposure or losses are likely to have experienced greater increases, along with the tightening of policy coverages, and increasing deductible levels.

The fourth quarter is the start of a crucial period when underwriters' strategies will become apparent, as we begin to see the beginning of renewal cycles that 12 months ago, saw widespread and significant rate increases. Markets are attempting to continue this pattern of rate increases on top of what they charged last year and, as capacity being offered by markets tends to be less than last year, this has created a challenging environment for renewals to the end of 2020.

Energy Casualty

2019 was a tumultuous year for energy casualty, and the market has attempted to exact a measure of correction after many consecutive years of premium reductions and widening of terms and conditions. Clients are now facing the challenges of a hardening market, although it is by no means consistent across all areas.

Although there have not been any market-turning energy casualty losses in the past few years, there have been some meaningful claims and incidents arising from the energy and non-energy sector that have resulted in loss making years for many insurers. Underwriter caution has been exacerbated by the increasing costs of remediation and clean-up in various jurisdictions, especially in the US where "social inflation" has resulted in many unexpected verdicts and awards, which, even if appealed successfully, are raising costs exponentially.

Underwriters are now under greater pressure from their management to justify every risk that that they write, and for that reason market focus continues on topics such as pipeline integrity and risk management, US auto, drones, cyber (no more silence as respects cyber coverage) and wildfire.

International Downstream/Power/Mining/Midstream

This has become the most difficult class to place. Many years of a buyer-friendly pricing environment, and good loss experience has resulted in an expectation by the underwriting community for rate growth. The extreme variation in starting points mean that a premium percentage increase is not possible to predict – some accounts have even experienced increases of several times the original premium to try to "correct" what is perceived by the underwriter as previous pricing inadequacy.

International Upstream

After a few very positive years in this class , there have been almost no meaningful losses so far in 2020. Unlike the downstream sector however, the property part of this class has also run very well, so there is far less pressure on cross-class companies to impose increases on their liability book. While we are not seeing reductions, the price increases being sought by the market are minimal in this class.

Integrated up and downstream accounts are the most challenging to place, especially if significant limits are needed; here the pricing patterns follow those of the downstream/power/mining/midstream sectors.

Underwriter caution has been exacerbated by the increasing costs of remediation and clean-up in various jurisdictions.

North American Downstream/ Power/Mining/Utilities/Midstream

Utilities remain a very challenging class, and even though the wildfire losses in California (estimated at circa USD11 billion) mean wildfire is practically an uninsurable coverage right now, many insurers are re-evaluating their view of US utility accounts in general, irrespective of their exposure to wildfire. Canadian wildfire coverage is also starting to be resisted, though not to the extent of the US or Australian market. There is an established concern about tailings dams – this is a global issue now, with mining requiring significant amounts of survey information, and many mining accounts will have either layers, or whole programmes, excluding this exposure if the underwriting data is not sufficient to meet underwriters' requirements.

North American Upstream and Contractors

This segment is very similar to the international upstream segment, with excellent loss experience meaning rates are not going up significantly. Again, it is rare to find markets that are solely exposed to this class and do not underwrite other classes that have suffered losses (marine, cargo, downstream energy); however there is less rating pressure on this class. US auto exposures for contractors continue to be an issue for some insurers, due to the magnitude of some of the court awards and settlements in the last 24 months. Canadian contractors with cross border exposure are finding the market particularly challenging with some insurers insisting on being excess of between USD/CAD10 million to 25 million in respect of auto. Tolerance for "incidental US exposure" is much lower, and insurers are more likely to decline to accept these risks as a result. Offshore contractors are faring a little better than most, with many underwriters trying to support their clients as they face a variety of challenges.

Latin America

As a geography, Latin American business is probably the biggest challenge. What has historically been an incredibly competitive region is now facing significant rate increases sometimes of many multiples of the expiring price, with clients having few alternatives. Coverages such as force majeure and illegal tapping, are being focused on and typically excluded, especially on midstream or transmission risks.

Bermuda Casualty

The Bermuda market continues to be challenging due to the ongoing rate increases and strict underwriting procedures which started to impact the market toward the end of 2019. In some instances, we have seen the market deteriorating further both in respect of rate increases and limit reductions.

Some carriers are attempting to 'de-risk' their book of business by withdrawing from certain classes regardless of the premium, or reducing limits where they perceive pricing levels do not support the limits purchased.

Renewal placements are being referred to underwriting committees or chief underwriting officers for sign off on the majority of accounts, and are generally subject to increased scrutiny.

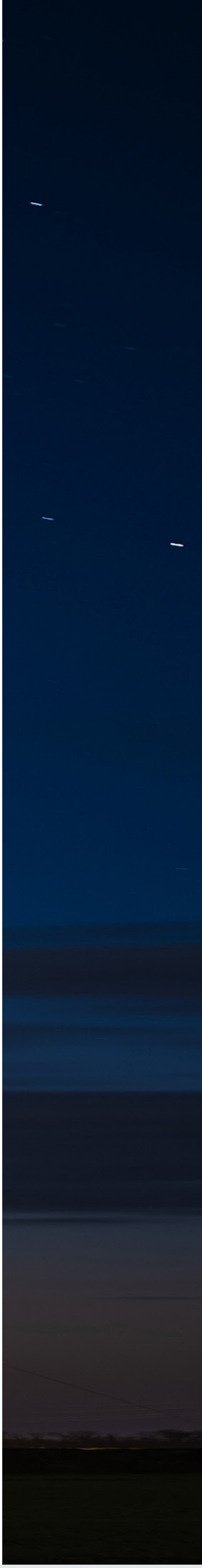
These factors can lead to any combination of increased costs, reduced limits purchased, and/or the increased use of self-insurance or captives.

We see this trend continuing through the remainder of 2020, and beyond – with strict underwriting discipline being enforced and underwriters being instructed to move rates towards what is considered their 'technical' price.

Summary

We remain in a challenging market, and the deepening of the capacity crunch seems to be gathering pace. We are focused on identifying all possible options for our clients, and providing as much information as possible to help navigate these difficult market trends.

Terms and conditions are being reviewed, along with capacity, pricing and retentions, and predictions are increasingly difficult and unreliable. Starting early is key and detailed submissions with full schedules of assets, turnover, throughput, payroll, employees, maps and locations of risk, are now required for almost all accounts to ensure we can attract the appropriate capacity to support these risks.



Marine Exposures

COVID-19 and the impacts associated with the pandemic, including reduced economic activity, falling oil prices, the almost complete shutdown of the international cruise passenger trade, dislocation of ships and their crews, and difficulties in accessing port and shipyard facilities, have all taken their toll on the world's maritime industries during the past six months.

The marine offshore support and construction sector have been particularly impacted during the pandemic, reflecting the same challenges experienced by their oil and gas company customers of falling oil prices, and resultant cutbacks on investments in exploration and development.

The marine insurance industry naturally has been affected by the challenges facing its clients, during a period when the sector has itself been struggling to return to profitability after more than a decade of poor underwriting results. Falling international trade, vessel lay ups, and reductions in insured values have all impacted premium volumes across the sector. Throughout this period, the hull market has maintained its upward trend in rating levels and greater attention towards risk selection. Many markets have targeted minimum increases of 10%, with underperforming accounts experiencing more meaningful rises. In spite of these increases, the reduced level of marine activity has resulted in a levelling off in global premiums. However, the market has begun to see a slow recovery in underwriting profitability with the recent unusually low level of claims, especially total losses, creating improving loss ratios.

Underwriters will be wary of increasing claims activity as the shipping industry returns to normal trading levels. An increase in attritional claims is expected, arising from operational difficulties during the pandemic for shipowners carrying out surveys, obtaining spare parts, and conducting routine maintenance.

The newfound determination of marine insurers to return to a more stable and profitable trading pattern seems set to continue, with individual insurers prepared to walk away from business if pricing levels do not meet their expectations. "Verticalised" placements with multiple pricing levels between insurers are now a common feature of the hull market. Capacity, in terms of numbers of insurers and total values, has reduced but is still more than adequate to meet demand in all but the highest value ships and construction risks.

Falling international trade, vessel lay ups, and reductions in insured values have continued the pressure on premiums to improve sector profitability, despite improving claims ratios.

Recent Quotes

The following are 'sound bites' taken from speeches, statements or articles by prominent market figures in the insurance market and while we have tried not to take their words out of context, the excerpt may not be the entire speech or article.

Ken Brandt president, global underwriting for TransRe

The US casualty market still needs more pricing improvement over and above what has already been imposed as it strives to get a handle on the adverse reserve development emanating from the 2013 to 2018 prior years. Those primary rate increases are significant and aren't coming because there's a lack of capacity - it's because there's a need. And, even though there has already been significant loss development from the 2013 to 2018 accident years, there's still a lot more pain to be realised in those years. Reserve levels in the casualty lines are the most problematic for the industry in my opinion. Factoring in the close-to zero interest rate environment the need remains for further rate improvements in the casualty market. The US casualty market, and the large global casualty market has a lot of need for price. Even though it's getting it now, it's going to need a lot more.

Interview with 'The Insurer' 2 September 2020.

David Perez, executive vice president and chief underwriting officer of global risk solutions at Liberty Mutual

Social inflation might be an overused term, but the impact is real. Social inflation is real. It's with us for a while. The challenge is that we've seen a change in the social dynamic of the country [US] over the last six months. We may be sitting on an even worse loss development trend that's masked by the court closures that we see right now. Big awards drive big messages and valuation has been left up to juries in many cases. Those jury verdicts raise the costs for all similar cases in a particular venue, as well as in a carrier's portfolio. Insurers are making pricing adjustments now to account for unanticipated loss deterioration, based in part on social inflation. All of this decision-making, this jury deliberations countrywide is what creates the body of loss costs for our industry. These factors have been building for a while but they're really peaking over the last couple of years because it is such a money-making enterprise that it's drawing investment capital into it.

Speaking during Advisen's Casualty Currents virtual conference in August 2020.

Neil Smallcombe, head of casualty for AIG's Lexington Insurance Company

Social Inflation pushes through into the premium that we pay for every piece of insurance we buy. The average verdict [in the US] has essentially doubled over the last five years, from USD27 million to USD50 million third-party litigation, a relatively new phenomenon financing effectively didn't exist as recently as 2011. In 2020, 65% of plaintiff firms reported being funded in part by third-party investors and there has been an estimated USD3 billion invested in specific vehicles to fuel a practice that is exploiting the legal system to maximize returns. To me, it's just no coincidence that you see this sequential, way ahead of inflation increase in nuclear verdicts at the same time that this third-party litigation money is flowing into the investment universe and partnering up with plaintiff firms. It's insidious in nature, it's very prevalent and there's no doubt in my mind that it's driving up verdict numbers and increasing the duration for which claims stay open.

Speaking during Advisen's Casualty Currents virtual conference in August 2020.

Paul Brand deputy CEO of Convex

London remains a great platform for US excess and surplus business with hardening rates driving improvements in terms for underwriters willing to cease the opportunity. As the market hardens we're going to see improvements in the flow of that business into London, and the terms on that businesses. It's a great opportunity for underwriters to achieve profitable growth. Clearly there is a huge amount of variance between individual lines and I'd expect that to continue. At the moment we're seeing prices rise and we would expect that to continue. Certain market commentary suggests that perhaps the [insurance] industry's COVID-19 losses are less than are currently being guided for. I'd be surprised if that is the case. It would be the first time that I've seen a major loss event come inside the early estimate instead of moving beyond them. I'm looking at an environment where we will continue to get some bad news coming out that offsets the good news – this will keep prices harder.

Interview with The Reinsurer 4 September 2020.

Juan Andrade president and CEO of Everest Re

The so-called class of 2020 start-ups are unlikely to significantly disrupt the [(re)insurance] market. It is unlikely that the wave of start-ups anticipated this year will look the same as the new business creation seen after 9/11 or hurricanes Katrina, Rita and Wilma. The days where you raised USD1 billion and went to market, they may be past. I think at this point unless you have USD7 billion or more of capital, I don't think it will make a big difference in my mind to some of the key customers we have out there.

Speaking at the (Re)Connect virtual conference in September 2020.

Alex Maloney CEO of Lancashire

When you look at return on equity figures for the industry over the past five years, we are not on a strong base... Until we get to a stronger market it will be a death by 1,000 cuts, I am sure this year we will see more businesses fold. It is very hard to think about the future if you can't make money today... We do need to think about how to be sustainable, charging the right price for our products and making a sensible return, then we can look at the more ambitious goals we have. If you think about the London market, we are currently struggling to write marine business [profitably] after we have been writing it for 300 years. It is very difficult to think about the future if you can't master what you have been doing for 300 years. There are differing levels of rate adequacy in the market, but the signs are positive that forward momentum will continue. Given the modelled estimates on go-forward investment returns, climate change and uncertainty around both casualty reserves and COVID-19, I am very confident to say that reinsurance rates will rise for the foreseeable. We don't think [the rate acceleration in] Q2 was a short-term blip, we think this is sustainable and we raised capital on that basis. I am very comfortable that the current level of capital raising seen across the market is not going to slow positive rating change. If you look at the aggregate number, I don't believe all that capital has been raised for growth. I think an element has been to replace capital which is no longer there for whatever reason – whether that is trapped capital, or perhaps capital providers are unhappy with their returns, perhaps carriers are raising capital because of the uncertainty on their books.

Speaking at the (Re)Connect virtual conference in September 2020.

The quotes referenced above are included herein to provide readers with a broad overview and insight into what is currently being said in the marketplace, however the inclusion of such does not mean Marsh JLT Specialty or any of its affiliates endorse or agree with any of the foregoing.

Market Moves

- **Jerry Wosleger** has joined the Marsh JLT Specialty US Energy & Power team, as a senior property client advisor, based out of New York. He was previously an underwriter at Navigator, and before that Arch.
- **Rob Hale** will join Marsh JLT Specialty to lead the power and renewable team in the UK from the first quarter of 2021.
- **Ian Noble** has been appointed as head of casualty and professional lines at International General Insurance Holdings (IGI), replacing Chris Mauduit who retired on June 30.
- **Rob Rider** (ex Travelers) has joined IGI, from Elseco, to write sabotage and terrorism and political violence from Dubai.
- **Warren Diogo** and **Sam Bishop** have joined Sompo in London, from Pioneer, to write renewable energy.
- **Anna Woolley** has joined AXIS Insurance, from GCube, as a senior underwriter in its international construction team.
- **Jim Lye** has been appointed as Active Underwriter of Antares Syndicate 1274 replacing Alexander Craggs who has been named as acting Chief Executive Officer of QIC Global, the international specialty re/insurance arm of Qatar Insurance Group.
- **Huw Jones** has left Axa XL where he held the role of global chief underwriting officer (CUO) of Energy, following an internal restructuring of reporting lines.
- **Luis Prato** has been appointed chief underwriting officer for the UK and Lloyd's region for Axa
- **Lidia Prestipino**, currently head of London casualty lines, is leaving Munich Re.
- **Ross Louden** will lead Nephila Capital's new specialty Lloyd's syndicate, having resigned as deputy CUO of Axis Insurance's international division.
- **David Indge**, former CUO at Acappella has returned to the market, taking a leadership role at Barents Re.
- **Stephen Pike** has been named as head of the credit and political risk team at Canopius.
- **George Foxall** is leaving his role as assistance Energy Underwriter for Beazley (London).
- **Jatin Sharma** has left Tokio Marine HCC-owned renewable energy-focused managing general agent GCube.
- **Josh Cantwell,** previously Talbot's interim energy head (following the departure of James McDonald, global marine and energy head, to Sompo International), has joined Tokio Marine HCC's renewable energy MGA GCube as head of offshore renewables.
- **Kate O´Reilly** has resigned from Barents Re to join Munich Re in London (the company market not the Lloyd's syndicate).

What's New?

Products and Market Developments

The London Joint Rig Committee (JRC) have issued a new loss of production income (LOPI) wording. This replaces the draft wording issued in 2018, which was not issued following input from brokers on necessary amendments, and updates the previous 2005 wording. The JRC have argued that the intention of the new form is to give more clarity around loss adjusting, and not to be more restrictive.

However, one significant change is not allowing the waiting period to be eroded by partial loss where partial loss is "minimal" (under the current form, one barrel reduction counts as a full day). There will be a negotiated "qualifying loss of production day" (the JRC have suggested a percentage set to be "meaningful" but no specific percentage is set).

One area of improvement is a 10% uplift margin on declared production. The JRC have said they have taken into account a lot of the previous broker criticisms of the 2018 version (including where the waiting period starts from inception; the waiting period to the indemnity period will now be added at the end).

The JRC have advised that they created a complex claims scenario, and sent it to a number of different loss adjusters to adjust the hypothetical claims under booth the 2005 LOPI wording and this new version (fully expecting to have a range of answers). The spread of quantum was around 6% with the old wording, and under 2% with the new wording, leaving the JRC to claim that they have achieved their goal of greater clarity. The average quantum was comparatively 6% higher under the new form (which the JRC said demonstrates that the new form is not more restrictive - accepting however that that was mainly due to the uplift margin provision). The JRC also confirmed the intention is to offer this as a better alternative, but if the insured and insurers both agree to use the old form, then they are free to do so.

Lloyd's is giving up its admitted licenses in Kentucky, Illinois and the US Virgin Islands (USVI) as it strengthens its focus on the US reinsurance and excess and surplus lines markets from which it derives the vast majority of its premium volume.

The UK Treasury has initiated its latest five-year review of UK terrorism reinsurance mutual Pool Re, the findings of which will be published in the second quarter of 2021. It will assess current risk-sharing arrangements between the government and the mutual, evaluate scheme rules to see if they need adapting, and ensure Pool Re can meet new Office for National Statistics (ONS) and government requirements, while operating effectively. The review will be conducted by the Treasury, with close engagement with Pool Re and consultation with the UK (re)insurance sector. Alongside the review Pool Re has formed a Review Advisory Group, consisting of CEOs from member insurers, captives and other stakeholders, to advise during the process.

Briefly

Allianz Global Corporate & Specialty (AGCS)'s Safety and Shipping Review 2020 is now available. The review identifies shipping loss and incident statistics from the past 10 years, including loss trends, and highlights coronavirus, climate, security and technology related challenges for the maritime sector. The sector saw the number of reported total shipping losses of over 100GT decline again during 2019, to 41 – the lowest total this century, and a close to 70% fall over 10 years. Improved ship design and technology, stepped-up regulation and risk management advances, such as more robust safety management systems and procedures on vessels, are some of the factors behind the long-term improvement in losses according to AGCS. The report can be downloaded from https://www.agcs.allianz.com/news-and-insights/reports/shipping-safety.htm.

Energy Industry Mutual Oil Insurance Limited (OIL) has announced a dividend of USD200 million. They said in letter to shareholders that in making the decision, the board considered OIL's current capital position, the situation in the energy industry, the financial performance of OIL through June 30, the equity and fixed income markets, and other factors. They also advised that they are beginning to initiate their next strategic planning cycle, which will culminate with the Board approving a new five-year strategic plan at its December 2021 board meeting. The Bermuda based mutual has recently gained three new members taking their membership to 60 companies; several other potential members are weighing up membership. As of the close of business on June 30, 2020, OIL booked USD104 million of incurred losses, excluding incurred but not reported (IBNR), for the first six months of the year. OIL's expected losses for the year are USD628 million. To avoid an increase in OIL premiums next year, the 2020 total will need to be below USD260 million (which is the 2015 level of loses that falls out of the 5 year pay back formula to be replaced by 2020).

Legal Roundup

UK Financial Conduct Authority (FCA) Test Case: Update on Appeals.

Following the FCA Business Interruption (BI) Test Case judgment which was handed down on the 15th September, the parties attended a 'consequentials' hearing which took place on Friday 2nd October. Following this hearing and in light of the court order, the FCA and 6 of the 8 participating insurers have been granted permission to apply to the Supreme Court for permission to appeal, which is likely to lead to an appeal hearing in the coming weeks.

The FCA has indicated that while it is pressing on with its application to appeal to the Supreme Court, it is also continuing to discuss with insurers to find a solution that avoids the need for appeal and enables pay-outs of eligible claims as quickly as possible. Zurich has not sought permission to appeal the judgment and Ecclesiastical withdrew its application prior to the recent hearing.

WHAT THIS MEANS FOR POLICYHOLDERS?

Certain policyholders may now face further delay and uncertainty. The majority of issues on which the Court made findings in favour of the FCA look likely to be appealed by insurers. As such, those policyholders that were set to benefit from the original judgment will now need to wait to see if the Supreme Court upholds the lower court ruling. Meanwhile some policyholders that did not benefit from the original judgment perhaps have another opportunity for a more favourable ruling by the higher court, as the FCA also seeks to appeal some (albeit not all) of the findings in favour of insurers.

A REMINDER OF WHAT THE ORIGINAL JUDGMENT MEANT.

Individual circumstances will vary depending upon the actual policy wording and the effect on the specific policyholder's business. However, claims can broadly be divided into the following categories:

1. **Policies with cover for notifiable diseases causing interruption or interference to the business occurring within the vicinity of the premises:** the judgment broadly held that the majority of these wordings would respond to COVID-19 BI losses, although there are exceptions.

2. **Policies with prevention of access wordings**: the Court took a more restrictive approach in interpreting the scope of these clauses albeit their findings provide for cover for some insureds under some wordings. Recovery of losses under such wordings will depend very specifically on the individual wording and business impact.

Each wording should be considered carefully in light of the judgment in determining whether or not there may be cover.

The test case did **not** consider:

1. Wordings that required the disease to be physically present at the premises. We would expect that where the insured can demonstrate that an outbreak occurred at the premises such cover would be triggered to the extent that the premises suffered a loss as a result solely of the outbreak at the premises, rather than for example the wider pandemic, and the judgment does not alter that position. However, the potential impact of the judgment on any more extensive recovery under these wordings is unclear.

2. Specified disease clauses, namely where cover was only provided for a closed list of specified diseases with COVID-19 not being one of these diseases. In such circumstances, we would not expect claims to be covered and the judgment does not alter that position.

3. Quantum, save in respect of the analysis of trends clauses and causation. Where insureds have cover in principle they will still need to quantify their claims.

NEXT STEPS.

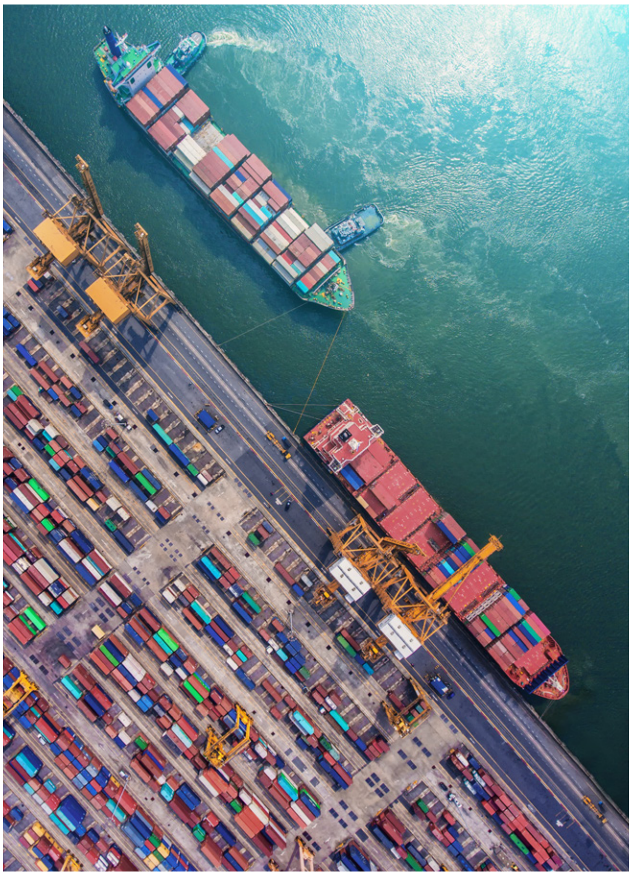
If your policy contains the language referred to in 1 or 2 above, your business has sustained a loss of revenue and you have not submitted a claim, we would encourage you to do so as soon as possible.

If you have already submitted a claim, we recommend investing time now on claim quantification as some insurers may be prepared to settle early, either before the appeals process develops further or straight after an appeal hearing (if favourable for policyholders). Having your claim fully quantified now will put you in the best position to take advantage of any such opportunities. At Marsh, we have a range of teams, expertise and tools that can support you to quantify your losses and drive these through to settlement.

We expect the quantification of losses on all claims to be complex. In order to drive the optimum settlement (both in time and value) we recommend a discussion with our Claims Solutions team who can provide expert guidance and assistance in managing your claim to conclusion.

UK Supreme Court to hear appeal on unseaworthiness.

The UK Supreme Court will hear a shipowners' appeal that will consider the legal test for unseaworthiness, the nature and limits of the carrier's non-delegable obligation to exercise due diligence, and the consequences of a defective passage plan. The case arises out of the grounding of a cargo vessel, while leaving the port of Xiamen in China. The grounding occurred because the ship's chart failed to record a warning that depths shown on the chart outside the fairway were unreliable, and waters were shallower than recorded on the chart. The Court of Appeal upheld the earlier decision that the defect in the chart rendered the vessel unseaworthy, and that the failure of the crew to mark the required warning on the chart was a failure to exercise due diligence attributable to the owners. The owners challenged the decision of the Court of Appeal on the basis that the crew's decision as to what to mark on the chart was a navigational decision rather than an "attribute of the ship", and that it was therefore incapable of making the ship unseaworthy. Alternatively, the owners argue that the failure to exercise due diligence on the part of the crew occurred outside of the owners' "orbit of responsibility". The owners' application for permission to appeal was supported by the International Group of P&I Clubs, who argued that the judgment had led to "a marked increase in cargo interests alleging unseaworthiness on the basis of navigational decisions", and sought to intervene in the appeal in support of the owners' position. The appeal is likely to be heard towards the end of 2021.



U.S. Court of Appeals questions its precedent for determining if an individual qualifies as a seaman.

A welder worked 61 out of 67 days aboard two jack-up drilling rigs. He spent most of those days on a jack-up rig next to an inland pier. While aboard one of these rigs, he sustained an injury. He filed suit against his employer in state court under the Jones Act. His employer had the case moved to the federal court in the Southern District of Texas, and sought summary judgment on the basis he was not a seaman. The district court granted summary judgment in favour of the employer, holding that the employee was not a seaman as he could not prove his connection to a vessel was substantial in nature.

The Appeals Court applied the Supreme Court's two-prong test for determining seaman status. For an individual to qualify as a seaman under this test, his duties must:

- Contribute to the function of the vessel or to the accomplishment of its mission.
- Have a connection to a vessel in navigation that is substantial in terms of both duration and nature.

The question was whether welder's duties were substantial in nature. The district court held that his work on vessels did not expose him to the perils of the sea such that he was not a seaman. But the Appeals Court stated that its precedent established in prior cases clearly sets forth that a worker exposed to the perils of the sea is a seaman, even if the vessel is docked or anchored at a pier. The Appeals Court therefore reversed the district court's holding. It held that the welder was a seaman despite the fact that most of his work was aboard a drilling rig jacked up above the water, and next to a pier.

In the concurring opinion, three Appeals Court judges agreed that, while the Appeal Court was bound by its precedent, precedent did not apply the Supreme Court's authority correctly, viewing the welder was not a seaman, and since he was a land-based welder whose duties did not take him to sea, he was never exposed to the perils of the sea. As a result, the judges urged the court to rehear the case en banc to bring its jurisprudence in line with the Supreme Court's case law. It is expected that the employer will seek an application for rehearing en banc, which could lead to a substantive change in the application of seaman status in the US marine and energy industry.

UK Court considered the circumstances in which the owners of a dock or marina could limit their liability for damage to ships and other property.

The decision concerned section 191 of the Merchant Shipping Act 1995, which grants "the owners of any dock or canal" a right to limit their liability, which is similar to the right of a shipowner under the 1976 Limitation Convention.

The liability of the dock or canal owner is limited by reference to the tonnage of the largest UK ship which has been within "the area over which the authority or person discharges any functions" at any time within the last five years.

Dock is given a wide meaning by section 191(9) to include "wet docks and basins, tidal docks and basins, locks, cuts, entrances, dry docks, graving docks, gridirons, slips, quays, wharves, piers, stages, landing places and jetties."

In 2018, Storm Emma caused very substantial damage to the marina, including the break-up and detachment of the floating elements of the marina itself. The storm, and the resulting break-up of the marina, caused loss and damage to a number of yachts and other ships which were present in and around the marina at the time.

The owners of the marina sought a general decree that they were entitled to limit their liability by reference to the tonnage of the largest UK ship to have been within the marina in the preceding five years.

The owners of yachts damaged by Storm Emma resisted the right to limit the grounds that:

1. The marina was not a 'dock' for the purposes of section 191.
2. The marina owner was deprived of the right to limit their liability, on the basis that the loss or damage had been caused by their reckless act or omission with knowledge that such loss would probably result. They alleged recklessness in connection with the design, construction and management of the marina, and argued that the required degree of knowledge and foresight could be inferred from the reckless nature of the acts and omissions.
3. "The area over which [the marina owner] discharges any functions" was not just the marina itself but extended to the whole of the harbour, so that the limitation amount should be calculated by reference to large passenger ferries which had called at the ferry terminal.

The Court accepted that, although the marina was not a "dock" on the natural meaning of that word, the floating pontoons, which comprised the marina, could properly be described as a landing place, jetty or stage (but not a "pier"), and rejected the argument that section 191 was only available to the owners of structures used for commercial ships. The purpose of section 191 (and its statutory predecessor, section 2(4) of the Merchant Shipping (Liability of Shipowners and others) Act 1900) was to extend the limitation regime to shore side structures.

The marina owners could therefore limit their liability on the grounds a marina is a "dock".

In terms of the vessel size it could limit to, the Court also agreed that "the area over which [the marina owner] discharges any functions" was the marina. Although one of the "functions" was to ensure that users of the marina complied with harbour regulations and byelaws throughout the area of the harbour, the Court agreed that the area over which that function was discharged was the marina itself and therefore: that was the only area of water over which the they exercised any control or authority.

The Court accepted that there could be merit in the allegation of reckless act or omission (that would deprive the marina owners of their right to limitation) but that would need to be heard further in the forthcoming case.

Demystifying Common Clauses

In this regular feature, we look at common clauses found in energy insurance that are often not well understood and consider what their intentions are, and what they cover or exclude.

In this article we look at 'Addendum 44'.

Brokers and insurers often talk to about 'Addendum 44', but what is it, and what is it an Addendum to?

The London Drilling Rig Committee (now known as the Joint Rig Committee) issued the 'Drilling Rig Memorandum' in May 1960, which was designed to establish parameters for the US cover holders controlling and writing US Energy business on behalf of London underwriters.

This memorandum set out terms, rates and conditions that the US cover holders should follow, and were used as a guideline for non-US business. Even after the number of brokers and insurers worldwide for energy business expanded, for many years the Drilling Rig Memorandum remained the 'bible' for offshore energy underwriting, and from time to time the Rig Committee would issue addenda to the memorandum updating rates, deductibles and wordings in line with prevailing experiences.

In 1960 the London Market devised a scale of control of well insurance charges under the Drilling Rig Memorandum, whereby a US dollar amount was charged on each foot of depth of the well.

These rates were grouped into geographic areas according to their perceived risk associated with the geography. Area 1 covered all onshore US with known low pressures zones; area 2 covered all other land areas; area 3 covered offshore US and area 4 covered all other offshore locations.

Area 2 rates were higher than area 1, and area 3 rates were higher than area 2, and so on. In addition, the rates within an area were 'banded' by depth; the deeper the well, the higher the rate because of the perceived increased risk of deeper wells (for example the rate applicable to well over 10,000 feet deep was 150% of a well under 10,000 feet).

In 1972, these rates were refined further with 'footage credits' (a reduction in rate the more footage being insured), and loads for additional coverages under the policy (such as underground control of well, redrilling, seepage & pollution, and care custody and control of contractors equipment) in a revised addendum to the Drilling Rig Memorandum called 'Addendum 44', which is still used today as the basis for most operator's extra expense (OEE) rating.

The resultant rates also increase proportionally, the higher the limit of coverage being purchased.

Obviously the final rate and premium is heavily influenced by market conditions, and what point the market is in the insurance cycle.

Many people however, have criticised the methodology of Addendum 44, which can throw up many anomalies. For example, there is unlikely to be any real difference in the risk of a well drilled to a depth of 9,999 feet and a neighbouring well drilled to 10,001 feet, yet the latter will cost 50% more to insure.

Another example is that each well drilled will have a unique set of problems and pressures facing the drilling team, and it is by no means certain that a shallower well will have less risk of blowing out than a deeper well, as often a blowout is caused by human error.

Because of the unique circumstances surrounding the drilling of an individual well and the equally unique circumstances of controlling a well, should a disaster occur, it is very difficult for underwriters to predict with any certainty, what future claims will be.

Historical claims data may show that a well blowout in a particular region at a particular depth cost USDX million to control. Yet a well drilled to the same depth, in the same region, might pose a very different problem to well control experts, and may cost much more to control due to the individual features of each well.

Also with redrilling expenses, underwriters face the challenge of keeping their rating up to date with the industry costs to drill a well (which also applies if the well control method employed is to drill a 'relief' well to reduce the pressure from the well out of control).

The costs of drilling a well is generally termed the AFE (from an industry standard form of agreement, between the operating company and the drilling contractor, called Authorisation for Expenditure).

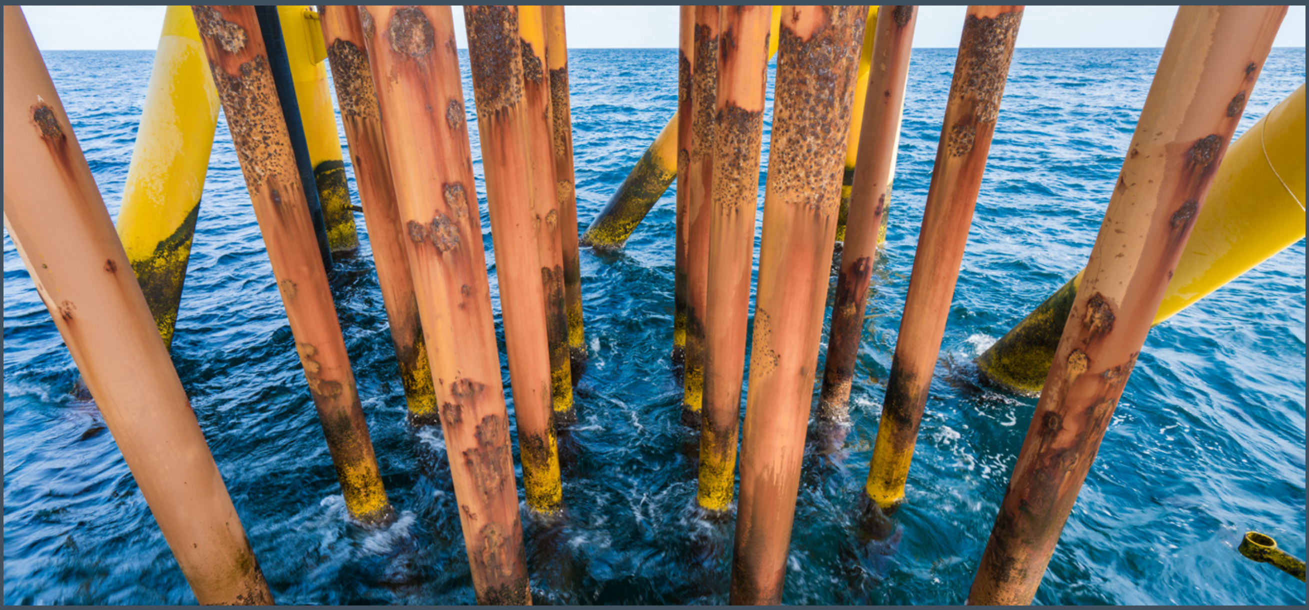
In an attempt to address the problem of ever increasing AFEs, as the unrelenting search for oil and gas results in more and more complicated wells, some polices are now rated as a percentage of the AFE. However, simply because a particular well has a high AFE (posing a higher cost to insurers for redrilling), it does not mean there is a greater chance of a blow-out than a lower AFE well.

Although imperfect, it seems likely that the primary method of rating OEE business will remain memorandum based rating scales. In reality, these are usually used to establish a starting point, with loads or credits dependent upon market conditions, the individual insured's loss record, and usually in conjunction with information on expected or average AFE levels to validate the rating.

The above is provided as a general overview of some of the coverage often provided by the aforementioned clauses. This is not intended to be an extensive and exhaustive analysis of the insurance coverage provided by such clauses. The comments above are the opinion of Marsh JLT Specialty only and should not be relied on as a definitive or legal interpretation. We would encourage you to read the terms and conditions of your particular policy and seek professional advice if in any doubt.

CONTACT US

If readers have particular clauses they would like us to consider including in this newsletter in the future, or have any comments on the above, please contact john.cooper@marsh.com



Engineering Update

In a market where insurers are increasingly analytical when considering which risks they will provide capacity for, comprehensive underwriting information, including current risk engineering reports, is important to articulate, and can help better differentiate risks.

With the ongoing effects of the global pandemic, travel continues to be extremely unpredictable, and site access may be restricted. Although we have successfully conducted 11 physical inspections across locations in Singapore, Taiwan, UK, US and the UAE – in line with local regulations, and following a robust risk assessment process – we envisage remote risk engineering (in some form) may be necessary for a considerable time. Marsh JLT Specialty have adapted our service offering to include virtual engineering surveys.

We have completed almost 300 virtual surveys since March, with 135 taking place in the third quarter. To enhance our current approach, we are working with a number of clients to pilot use of wearable technology to overcome the inability of engineers to be physically present for field inspections.

We have also strengthened our risk engineering offering by further building our suite of deep dive services. Available with a focus on inspection, control of work and/or operational discipline, deep dives spend time discussing and reviewing the additional records and field checks that are not normally practicable during a standard risk engineering survey. As a result, they provide clients with an in-depth understanding of risk quality, and considered insights that result in improvement advice tailored to the risks.

Helping to drive improvement in risk management is a key objective of the risk engineering community. Considering losses, their causes, and mitigation strategies to avoid reoccurrence continues to be a valuable service offering of our team. Unfortunately, the tragic ammonium nitrate incident at Port Beirut on August 4 served as a reminder that lessons from such explosions in the past may have been forgotten. Marsh JLT Specialty published a paper, Ammonium Nitrate Explosions – Learning and Applying Lessons from the Past (refer page 22), to provide guidance on the documents and regulations available for the safe storage and handling of ammonium nitrate.

Also on page 22 you will find details of our engineering paper Remotely Operated Emergency Isolation Valves (ROEIV). A major fire can occur in any installation that handles large quantities of hydrocarbons. The ability to promptly, and safely, isolate inventories is a key design consideration and risk-control measure; the proven method for isolation is by ROEIVs and the paper discusses industry best practices.

Finally, we are proud to report that the UAE Energy & Power Risk Engineering team have been shortlisted as an IChemE Global Awards 2020 finalist in the categories of Best Consultancy, and Best Team. While the winners will be announced throughout November 2020, being shortlisted for these highly prestigious awards is testament to the hard work and dedication of the team in serving clients across the MEA region, and globally.

Marsh JLT Specialty Publications

The following are recent or forthcoming Marsh JLT Specialty publications that we think will be of interest to Energy & Power clients.

Captives Trends and Insights

Marsh has issued the 13th annual edition of the Captive Landscape Report. Due to the pandemic and the tightening insurance market, more organizations are looking to captive insurance companies for financial flexibility and protection. The 2020 report contains insights from more than 1,200 captive insurance managers who share their insights on how they are maximizing the use of their captives, as well as the latest statistics and trends. A copy of this publication can be downloaded here.

https://www.marsh.com/us/insights/research/captive-landscape-report-2020.html?utm_source=publicrelations&utm_medium=referral-link&utm_campaign=2020-captive-landscape-report

Directors and Officers Coverage Trends: UK FTSE350 Market Update

Marsh JLT Specialty has issued an update to the 2019 report on directors and officers liability (D&O) insurance pricing changes for different segments. The analysis found the difficult market conditions seen at the start of 2020 continued, and increased in the second quarter. Insurers became increasingly concerned not just with historic sources of D&O claims, but with new exposures that may result from COVID-19. This caused a dramatic increase in pricing for FTSE 350 purchasers of D&O insurance over the first half of 2020. While this report focuses on the UK and on FTSE350 specifically, many of the trends are worldwide. A copy of the updated analysis can be downloaded here.

https://www.marsh.com/uk/insights/research/directors-officers-liability-uk-ftse-350-market-update-h1-2020.html

Beirut Port Explosion

The events leading up to the tragic explosion at the Port of Beirut are still being examined, but there are lessons to be learned from this and other similar incidents. Such events refocus the attention of the public, regulators, and other stakeholders, including the insurance industry, on what organisations that manufacture and store ammonium nitrate can do to prevent similar incidents. Marsh JLT Specialty has issued a paper that raises awareness of the risks, explores the common causes of losses, and provides initial guidance on the documents and regulations available for the storage, handling, and transfer of ammonium nitrate. Download the paper here.

https://www.marsh.com/uk/insights/research/ammonium-nitrate-explosions-learning-applying-past-lessons.html

Corrosion Exclusions: A Transitioning Market

The construction market is reconsidering the extent of coverage it offers for corrosion, and the subsequent damage arising therefrom. The corrosion exclusions have broadened, and this may have an impact upon contractual agreements between owners and their construction contractors.

Marsh JLT Specialty has released a blog Corrosion Exclusions: A Transitioning Market, which considers how coverage may be affected and, the actions available to companies.

The article covers:

- The large potential claim that is driving this change.
- What the change could mean for coverage.
- The impact on construction contract drafting.

The blog is available here.

https://www.marsh.com/uk/insights/risk-in-context/corrosion-exclusions-transitioning-market.html

Risk Engineering Paper: Remotely Operated Emergency Isolation Valves (ROEIVs)

A major fire can occur in any installation that handles large quantities of hydrocarbons. The ability to promptly and safely isolate inventories is a key design consideration and risk-control measure. The proven method for isolation is by remotely operated emergency isolation valves (ROEIVs). Marsh JLT Specialty has released a paper detailing the industry standards that would categorise a "very good" application of ROEIVs in the oil, gas, and petrochemical industry, whether for new projects or retrospective upgrades. Download the paper for insights from our energy engineers that can be used to support and define risk improvement recommendations, and enhance your emergency response systems.

https://www.marsh.com/uk/insights/research/risk-engineering-paper-remotely-operated-emergency-isolation-valves.html

Atlantic Named Windstorm Forecasts

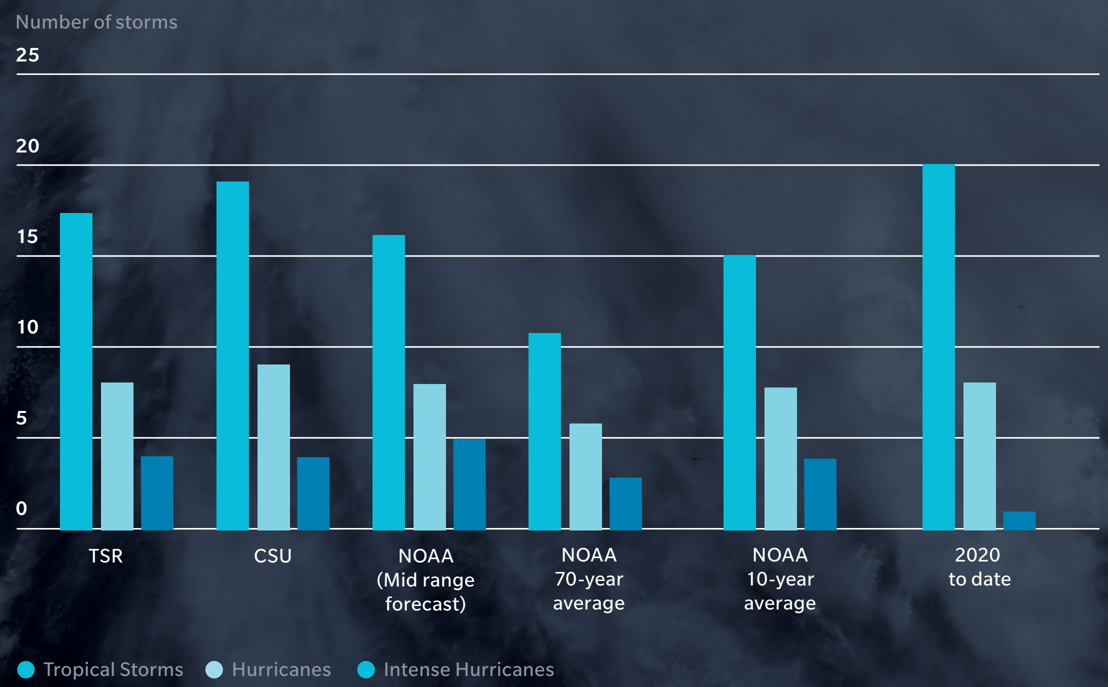
So far, the 2020 Atlantic hurricane season has featured a total of 23 tropical storms, 8 hurricanes, and 2 major hurricanes. Although several have been weak or short-lived and although Laura tracked over densely polluted offshore oil fields, there has been very little damage reported to energy facilities, onshore or offshore.

With 23 named storms, it is the second most active Atlantic hurricane season on record, second only to the 2005 Atlantic hurricane season – the year hurricanes Katrina and Rita wreaked damage to the offshore oil and gas sector. It is also only the second tropical cyclone season to feature Greek letter named storms, with the other season again being 2005.

The season officially started on June 1, and will officially end on November 30; however, the formation of tropical cyclones is possible at any time, as illustrated by tropical storms Arthur and Bertha, on May 16 and 27 respectively, making 2020 the sixth consecutive year to experience pre-season systems, a new record. This activity has been fuelled by an ongoing La Niña, which developed during the first quarter of 2020.

The Chart below plots Tropical Storm Risk (TSR), Colorado State University (CSU) and US National Oceanic and Atmospheric Administration (NOAA)'s forecasts (as of June) against the 70-year and 10-year averages, and the actual activity to date during 2020.

FIGURE 1 2020 Atlantic Hurricane Season Activity/Forecasts



Focus on: Onshore Construction

From well pad to plastics with many deviations into civil engineering, power production and many other sub-classes in between, onshore construction is a well-established and specialist insurance market. In this article we look at the recent market changes and what we may expect in the near future.

The Easy Bit

Once the oil or gas is out of the ground, significant infrastructure is required to treat, transport, process, refine and store either crude, interim or final products. That is where the onshore construction market operate. The roads, pipelines, power, water, accommodation for workers, even the jetty required for export or imports, the list goes on. It is often thought it is far simpler to build something you can see as opposed to drilling thousands of feet below the ground looking for oil or gas, or battling with hydrocarbons in a Force 8 gale right? Indeed it should be.

But of course as with all things we have need for progress. That arrives in the shape of building things faster and cheaper and the benefits of that are not just for respective company CEO's and shareholders, but to all of us in our daily lives. Better, cheaper products available to all. Progress is just one factor that changes risk. Along with economic, political, geographic and meteorological issues – every company's risk profile has changed over the last 20 years; the onshore construction market, and the insurance industry, may have miscalculated the risks.

Long-term Nature

The onshore construction market has been in a softening phase since circa 2006. After the tragic events of September 11 insurers saw rate rises, a narrowing of cover and general stability for four or five years. Thereafter, as buyers of insurance we have seen 13 or 14 years of improving insurance terms and conditions. This article is not about which capacity has redacted its appetite for the onshore construction sector - we know significant capacity has left – but it is about the reasons for its departure and what might occur next.

The complex hydrocarbon projects we typically deal with take time; three to four years and longer is not uncommon. Insurance terms and conditions are set at the outset for the project term, to comply with buyer requirements, lender requirements, contractor requirements and more. Broadly speaking insurance terms do not change much throughout the duration of a project, though insurers may have some reasonable flexibility to re-underwrite where a policy change is requested. Insurers have been shown their previous errors in the form of unprofitable books of business, they are now faced with a likelihood that they still have three or four years of their incorrect past rating to come to fruition. They are all mindful they have to act now. They are all well aware that the promises of change they make to their management, and reinsurers today, will be broken by the tail of the existing projects. In two or three years the insurers internal conversation between manager and underwriter are likely to go:

Manager: *You said two years ago the market was changing, it would all be better in the future.....and still the losses arrive, and still we lose money.*

Underwriter: *Yes, but it takes time because of the tail, I promise what we have been doing will yield better results in the future.*

You can permutate the next sentence from the manager as you see fit. But, for those who doubt this as a likely conversation, we have seen it all before, circa 2004, well in to the stable market period, and before the underwriting changes enacted two years prior started to alter onshore construction results. We apologise this is not what we wish to hear – whether we are a client, a broker or an insurer – but being prepared and advised correctly can help you through this.

I told you so....

So what, and where, did underwriters get things wrong? A few of the headline issues underwriters have discovered to their detriment:

1. The insufficient construction premiums of the many were not enough to pay the large losses of the few. That's an easy one, but of course the frequency of small losses also increased. There was always the fear in the latter stages of the softening market that there was nothing in reserve to pay for the overdue, expected big loss that would one day arrive. That day arrived, more than once.
2. Operating costs are too high, investment income too low, reinsurance costs have increased – insurers themselves are inefficient and need to reconsider their models.
3. Modularisation as a risk improvement – Once considered an improvement in risk control by onshore construction underwriters, and rewarded with premium discounts, modular fabrication was seen as a way of performing significant elements of a construction project in a clean, well-spaced and controlled environment. Construction could be started earlier removing on-site bottlenecks and time pressures. All seen as better than the risk factors experienced on the actual site where space/people/environmental logistics can add to the complexity and likelihood of a loss. Undiscovered, an error in a fabrication yard may be replicated many hundreds or thousands of times. When the loss is discovered, often on site, the repair costs may be exponentially expensive as local wage and/or access conditions may result in significantly higher costs than the original build.
4. Corrosion – Long seen as a problem, whether due to stress corrosion cracking or simple rust or oxidation – corrosion claims had become prevalent and expensive. Tighter exclusions are being sought by the market and a focus on paint and coatings is also high on the agenda.
5. Natural Catastrophe (CAT) – construction typically escapes large losses from high profile CAT events. When hurricanes hit or floods arrive, risk management plans perform adequately – and on the occasions they don't, the values exposed are generally low. This no longer seems to be the case. In addition, rising annual costs for CAT reinsurance cannot be passed onto the client (since the premium terms are set for the duration of the project).
6. Defects – Claims for defects and poor workmanship contribute significantly to the insurers' loss ratios, and they are consistent, expensive and not going away from the construction sector any time soon.

Newton's third law of motion – the one about equal and opposite reactions

Elements of the changes may be labelled outrageous, and unfair, but if the market does not adapt it will not survive creating a bigger problem. New capacity will come in right? Eventually yes. But, while the returns on insurers capital are good in short tail markets, a loss making longer tail market looks less attractive – so onshore construction is forced to adjust prices, and reduce cover and policy limits. The requirement is for construction insurers to demonstrate a continued improvement in their portfolio performance, and risk selection. The question is for how long, and how much improvement is required?

There has been a lot emanating from onshore construction insurers which cause concern, including.

- COVID-19 exclusions.
- Cyber exclusions.
- Price rises.
- Deductible increases.
- Curtailed sub-limits.
- New corrosion exclusions.
- Reluctance to offer LEG3 coverage (in accordance with London Engineering Group definition).
- Reluctance to offer delay in start-up (DSU) or advanced loss of profits (ALOP) cover.
- Refusal of, or resistance to, period extensions.
- Less insurers willing to offer lead terms.

But these issues can be managed so that a project remains bankable, and can proceed with adequate risk transfer in place. Relationships do count, as does a sensible and fair approach to a request for cover.

So what do companies need to do to smooth the process and gain coverage?

- **The smart buyer today will identify what is most important to them** – Is it cost certainty over the entire duration of the project, is it low deductibles, is it the broadest cover or a particular extension of cover you just cannot do without? Prioritise those needs. Then list the wants. You may not get all of the desired, but with a good strategy and the right risk controls in place, you can achieve the 'must haves'.
- **Plan properly.** Approach the market in good time and at good times. A quotation offered the week after a Hurricane or big market loss is not going to be viewed in the best light. Sometimes it cannot be avoided of course, but if insurers already had the project in mind before hand, or if you still have many months to go until likely final investment decision or notice to proceed, there is time for the 'unequal reaction' to subdue. You need to make time your ally not your enemy.
- **Take a sensible approach to the hurdles.** Using an example – you need LEG3 cover. Insurers may try not to offer it. So if it is a priority, the carrot needs to be fatter and the stick shorter if you wish to grab insurers attention. Maybe full value limits will not exist for LEG3 coverage (we estimate currently there may be circa. USD 750 million of useable Probable Maximum Loss (PML) capacity available for onshore energy projects with LEG3 – as opposed to circa USD2 billion of useable PML capacity with LEG2). Work out what you actually need, the deductible you can really bear and what the contractor, manufacturer or supplier can accept as a contractual obligation either by guarantee or warranty. Be mindful that to tempt insurers to come to the table, the premium loading over LEG2 has increased.

So what is a buyer of onshore construction insurance likely to experience?

Price increases –Whether as increased original premium, or a more significant percentage of pro-rata on extensions, on average prices are increasing and the trend is unlikely to slow until insurer profitability improves.

Quotes open for only short periods –Consider the timing of the works packages and whether 'early work' can be used to bind insurers to a price for the full works package. Are you able to purchase a 'futures option', giving you the right to purchase an insurance programme at a specific set of terms within a set period of time?

Automatic extension provisions –Insurers accept that a project may be delayed however, when an extension is needed (or when a significant change in risk has occurred) insurers have the ability to adjust policy terms and conditions to reflect current market conditions. If whole term certainty of price is a driving factor for you, insurers will consider that it, but it is akin to them offering a lump sum turnkey approach so you can be expected to be charged for that margin.

Lower sub-limits and higher deductibles – Work with your broker and risk engineers to fully evaluate your requirements. Insurers will curtail offered capacity if their exposure is too great on just one aspect of cover. Think about restructuring your programme and/or reviewing the value of sub-limits.

Focus on new technologies or processes – Continue to ensure you provide comprehensive details, data, and the validation of any new or scaled up processes to demonstrate to insurers you have fully considered all the issues that could arise.

Longer response times – We have mentioned already that time can be your ally or enemy Those insurers left trading are now seeing more business and cannot always cope with the volume, especially as additional peer reviews and referrals are included in the process. A period of up to six months should be considered as prudent, and allows for insurer presentations and roadshows. Less is of course achievable, but, make time your ally. See the below comments regarding period extensions and bear in mind that operational insurers may have similar issues, so approaches to transfer construction projects to operating programmes will also take longer.

Replacement of existing panel of insurers – For projects placed some years ago, it is possible that an insurer used then is now in run-off, or their security has been downgraded. Run-off does not necessarily mean bad, but run-off markets will not be looking to extend policies, even if obligated to do so. If replacement of an existing carrier is required allow sufficient time, and provide the relevant information for a new insurer to fully consider offering terms.

CAT –We plot values exposed during each season, and use that to guide the pricing and exposure to insurers. Under current market conditions, it may be worth considering smaller limits in the policy in the early years, and stepping them over time as values increase. Another option to consider is purchasing CAT annually rather than for term of the project, though consideration should be given to the risk of price volatility this may introduce. Parametric programmes may also be available and, depending on whether or not there are additional assets in the vicinity, the pricing may be applied across construction and operational assets.

Exclusions –Engage your project team with your broker and risk engineers to consider the impact of exclusions including cyber, COVID, corrosion, paint and coatings as well as challenges to LEG3. Work with insurers own engineers. Good insurers would prefer to work with you, and to get fully comfortable with the measures you are taking to fully understand risk, as opposed to applying blanket exclusions.

Further capacity reductions –This may just mean existing insurers look to offer lower capacity per risk than previously, or there may be further withdrawals of insurers from the market, consider your strategy when placing project coverage.

Be prepared and allow sufficient time, and seek advice from experts and you will be best placed to navigate the challenges of a changing market landscape.

Tips for dealing with policy extensions:

Fundamental to negotiating the best outcome on any contract change are time and information. The time required to negotiate any contract change has dramatically increased over recent months, meaning early engagement with insurers is essential. Being prepared with a comprehensive explanation of the project status is the best way to approach underwriters' - gaps in information often result in higher premium levels.

Bear in mind that onshore construction insurers may not wish to extend the construction policy, and onshore operational insurers may not be able to accept an incomplete plant in to an operational policy.

Your Marsh JLT Specialty team will engage you early in the lead-up to the expiry of your policy, and will look to provide both construction and operational insurers with detailed, current project information.

While each client, and project, is unique below we have summarised the information generally required for a construction period extension:

- Key reasons for the delay.
- Effects of COVID-19 shutdown or delay.
- Changes in the original scope of work or material change in risk (variation orders etc.).
- Current status of the project/works currently completed.
- Detailed description and value of remaining works, have any testing periods been exhausted?
- Detailed timeline and Gantt bar chart for the remaining works.
- A realistic anticipated project completion date. Avoid extending the policy for very short periods at a time if, in reality, the project will not be completed; DSU can complicate this.
- Confirmation of no known or reported losses, or up to date details and status of known losses/incidents.
- Details of any proportion of the project which may have been handed over or put into commercial operation.
- Confirmation of policy sums insured/contract value to ensure that they are still current.
- Copy of the latest progress report, or if available, a copy of the latest risk management report undertaken by the lead insurer or Marsh JLT Specialty Risk Engineer.
- Status of loss prevention recommendations highlighted in previous risk engineering reports. If not implemented yet, an update on the proposed plan.
- If DSU/ALOP cover is purchased, has a physical damage claim caused or contributed to the delay? If so:

  A. You should be aware that by extending the policy you may be removing the opportunity to make a DSU claim until the newly declared completion date(s) is reached. Indemnity will start from the newly declared completion date(s)!

  B. If you have a situation where one or more claims could have contributed to the delay, then discuss in good time with your broker – if it is 'late in the day' it's more challenging to resolve. Does the DSU section require reinstatement?

  C. Consider carefully the information you need to provide if you have multiple completion dates.

INTRODUCING MARSH JLT SPECIALTY

We are specialists who are committed to delivering consulting, placement, account management and claims solutions to clients who require specialist advice and support. We consider problems from every angle and challenge the status quo with entrepreneurial ideas and solutions.

With unparalleled breadth, our Marsh JLT Specialty global team is united by a determination to bring the most experienced and relevant specialist resources to our clients, regardless of where in the world they are located. This approach means our local specialists work seamlessly with global experts, together creating and delivering tailor-made risk and insurance solutions which address each client's unique challenges.

Our service offering is enhanced with insight-driven advice supported by tailored data, analytic and consultancy capabilities to support clients in making important decisions about their complex risks.

Exceptional service combined with transparency, integrity, and accessibility underpins our partnerships with clients.

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