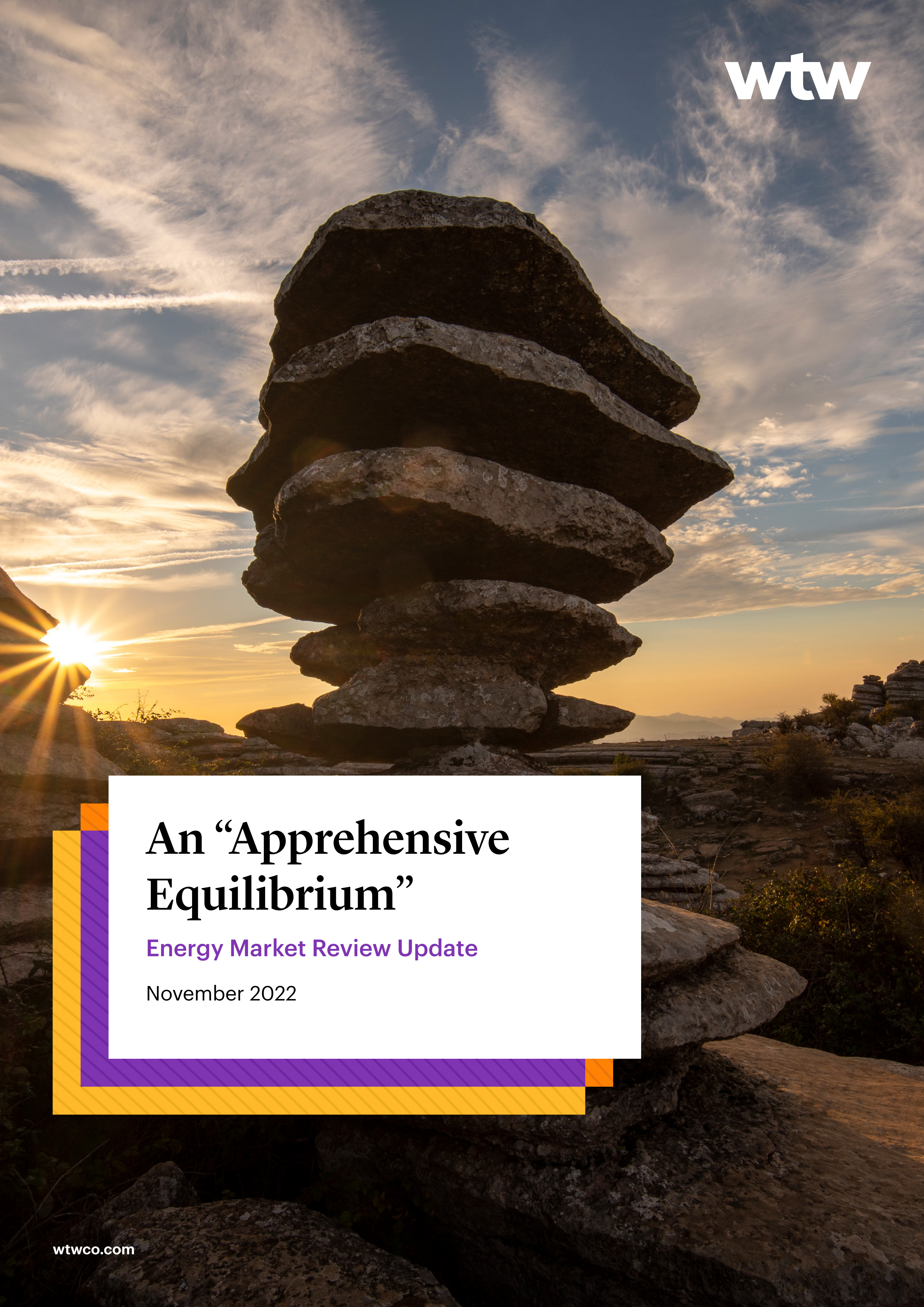

An “Apprehensive Equilibrium”

Energy Market Review Update

November 2022

wtwco.com

Energy Market Review Update

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Market capacity figures

The figures quoted in this Review are obtained from individual insurers as part of an annual review conducted in January each year. They are solicited from the insurance markets on the basis of securing their maximum theoretical capacity in US$ for any one risk. Although of course this capacity is offered to all buyers and their brokers, the individual capacity figures for each insurer provided to us are confidential and remain the intellectual property of WTW.

WTW Energy Loss Database

All loss figures quoted in this Update are from our Willis Energy Loss Database. We obtain loss figures for this database from a variety of market sources (including a range of loss adjusters), but we are unable to obtain final adjusted claims figures due to client confidentiality. The figures we therefore receive from our sources include both insured and uninsured losses.

Style

Our Review uses a mixture of American and English spelling, depending on the nationality of the author concerned. We have used capital letters to describe various classes of insurance products and markets, but otherwise we have used lower case to describe various parts of the energy industry itself.

Abbreviations

The following abbreviations are used throughout this Review:

CAR	Construction All Risks
CCS	Carbon, Capture and Storage
ESG	Environmental Social Governance
PD	Physical Damage
BI	Business Interruption
OEE	Operators Extra Expense
LNG	Liquefied Natural Gas
LOPI	Loss of Production Income
PMD	Performance Management Directorate
WELD	WTW Energy Loss Database

Introduction

Welcome to our Energy Market Review Update for the final quarter of 2022. As we look forwards towards the January 1 renewal season, both the energy and the insurance industries have a lot to be apprehensive about, as global geopolitical and economic uncertainties continue to intensify.

Indeed, those of us who are used to the rhythms of the traditional market cycle are having to take a fresh look at the rather peculiar dynamics currently affecting the market. Tradition would have it that a period of significant market hardening is then rapidly followed by an increased appetite for business at the new, higher rates – thereby ushering in the next phase of the market cycle, an equally rapid market softening as market imperatives switch from technical rating adequacy to meeting increased premium income targets.

This time round, instead we are left with the remnants of a hard market – a tapering off of the hardening dynamic but no sign yet of the softening that many by now had anticipated. A number of factors have contributed to this new "apprehensive equilibrium", not least the Ukraine crisis, global inflation, a renewed focus on ESG and the deterioration of the 2022 loss record, particularly for Midstream and Downstream business.

Perhaps one of the most reported developments of the last few weeks has been the announcement by the Lloyd's Munich Re Syndicate 457 (MRS) that it is to withdraw from traditional oil & gas business in 2023. This announcement relates to Upstream Property business and will therefore have a major impact on some sub-sectors of this market. These include major programme "capacity" risks where the Upstream market struggles to meet client demand, Gulf of Mexico Windstorm (where MRS has been a key player for many years), stand-alone OEE "one shot" wells and some construction projects where MRS capacity has also proved to be key in the past. Even if MRS' capacity as such will not prove to be such a major factor for these latter two sub-classes, at the very least prices for these risks are likely to rise further than they would have done in the absence of the Syndicate's withdrawal.

However, it is important to note that MRS is primarily exiting from core first party programmes related to Upstream Energy. Munich Re, through various entities, will continue to support Downstream and Midstream Energy, Cyber, Political Risk and certain other lines.

At WTW, we support the energy transition, but recognize the crucial role that oil & gas plays in the global economy and national security. We believe that this announcement underpins the need to utilize a specialist broker who is dedicated to this vital segment of the energy economy. WTW has made significant investments in all market hubs over the past few months to solidify its role as the leading global specialist broker within the energy, power & utilities, mining & metals and chemicals industries.

The other major development affecting the market has been the impact of global inflation levels around the world. Inflation doesn't only hit the business or its clients; it also has the potential to significantly impact the insurance market. It is for this reason that insurers have been so focussed on ensuring that inflationary provisions are adequately reflected at each renewal. It is difficult to fully assess the impact of higher inflation on claims at this stage, as the higher inflation environment has not been present for a sufficient amount of time to accurately measure this; however, logic suggests that this will inevitably feed through to higher claims costs in the long term. Concern is therefore being felt by many insurers, who are also looking more closely at property declared values. This includes business interruption, the impact of more volatile Energy markets and whether the positive impact of inflation on buyers' profits is being fully reflected in the values declared to the insurance market.

Today, a simple revaluation using current inflation rates may mask the actual exposure facing insurers; indeed, where brokers have encouraged a more detailed valuation/EML scenario exercise, this has generally been recognised by the market in terms of a more modest rating increase. In contrast, when the old methodology has been applied, a more punitive rating increase has generally resulted.

Our message to the energy industry on this topic is therefore really quite simple: it is vital that a more transparent understanding of how insured values are calculated is communicated from buyer to broker to insurer. When this is achieved, buyers will see greater price stability, which will in turn reduce the likelihood of large swings experienced between hard and soft market conditions, as we have experienced so often in the past. Furthermore, insurers will increase their confidence level on received insured values and the premiums they are requesting. At WTW, we have dedicated Natural Resources engineers located across the globe that can assist buyers in ensuring that the values presented to the insurance market are up to date and accurate.

We hope you enjoy this year's Update and as ever would much appreciate any feedback or questions you may have.

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Transition accreditation: renewed focus, despite slow beginnings

Introduction: framing the transition

With Munich Re Syndicate 457's[1] announcement at the end of September of their intention to cease underwriting new oil & gas risks through syndicate 457, what are the options for those firms still committed to a transition but ultimately still requiring their fossil fuel portfolio to deliver in the short and medium term?

The Munich Re Syndicate was not the first insurer to announce a withdrawal from new oil & gas operations and will certainly not be the last. The latest tracking from Insure our Future[2] shows that thirteen insurers now have exclusion policies to some degree against oil & gas companies, with just four of these thirteen[3] responsible for over 20% of oil & gas premium in the run-up to COP26 in Glasgow. In fact, our own analysis shows that taking a worst-case scenario from the typical international Upstream oil & gas markets, an insured who is unable to comply with all/any of the insurers' stated metrics, Paris Agreement targets, Net Zero plans etc, will have in excess of circa US$1.375 billion of capacity no longer available to them from 2023/24.

In addition to the specific exclusion policies being adopted by these insurers, all members of the Net Zero Insurance Alliance (NZIA) look set to adopt the Insurance Associated Emissions guidance being set out under the Partnership for Carbon Accounting Financials work.[4] Considered under the NZIA commitment of reducing insurance-facilitated emissions, it is not a stretch to imagine insurers soon instilling carbon budgets for their Natural Resources portfolios and decisions being made as to how to incorporate carbon measures into the underwriting process.

Up until now, the transition options for the oil & gas industry as a whole have been somewhat unclear. The IEA's Net-Zero by 2050 scenario called for the rapid decline in fossil fuel dependency but this was immediately met with the challenge of the crisis in Ukraine which has significantly altered the global outlook. In early 2021, the Science Based Targets initiative suspended their validation of targets from the

[1] https://www.theinsurer.com/news/munich-re-cites-esg-as-syndicate-exits-oil-and-gas-from-11/25419.article
[2] https://insure-our-future.com/wp-content/uploads/2022/10/2022-Scorecard-Final-Online.pdf
[3] https://www.theactuary.com/news/2021/11/10/four-companies-providing-20-all-oil-and-gas-insurance
[4] https://carbonaccountingfinancials.com/files/2022-07/2207-insurancestandard-03.pdf?899cf30b3c

industry, allowing for a refresh of the methodology; at time of writing in October 2022, this suspension still remains in place.[5] The latest guidance from the Glasgow Financial Allianz for Net Zero (GFANZ) was expected to set out the requirements for oil & gas firms; this was due in early October but has not yet been published.

Climate Transition Pathways objectives

Against this setting, the importance of communicating energy companies' current emissions profile, future projected emissions and overall transition plan has never been more important. In September 2022 GFANZ released their guidance for Expectations for Real Economy Transition Plans[6], within which five themes and ten components were identified as relevant within the eyes of financial institutions.

The work of GFANZ has been sponsored specifically for the purpose of accelerating the transition, an aim shared by Climate Transition Pathways (CTP), a global accreditation framework that will unlock continued access to insurance capacity and capital for high-carbon organisations committed to transitioning to a low carbon future.

In fact, CTP is built upon one of the transition plan assessment frameworks referenced in the GFANZ work – Assessing Low Carbon Transition, or ACT. Through this framework, CTP is able to accredit climate transition plans that are aligned to the Paris Agreement. Energy companies, as well as others involved in carbon-intensive sectors, will be able to apply for CTP accreditation to demonstrate that they are serious about having a robust climate transition plan in addition to simply setting low carbon targets. In return, insurance markets are committed to providing capacity aligned to their usual terms and conditions and are increasingly looking at ways to reward those with the most far-reaching transition plans. Of the thirteen insurers excluding certain oil & gas practices mentioned above, eight will override their exclusion if a suitable transition plan is in place.

Success of CTP and the challenges that lie ahead

CTP has now been 'live' since May 2021, a little under 18 months at the time of writing. In that period the accreditation has received backing by four markets (Liberty Specialty Markets, SCOR, Arch and Fidelis), is delivered by three climate NGOs (Climate Bonds Initiative, Volans and RMI, previously known as Rocky Mountain Institute) and has currently accredited one organisation – Ørsted.

While there is still a considerable way to go to achieve market standard status as one of the stated goals, the progress has been consistent. In the past month alone CTP has won two industry awards, recognising the ambition and support that the accreditation can provide.

WTW's Paula Pagniez and Pietro Adreotti accepting the ESG Initiative of the Year award at the P&C Inside Honours in New York

WTW's Paul Clark receives the prestigious Broker Innovation award for Climate Transition Pathways at the 2022 Broker Innovation Awards in London

[5] https://sciencebasedtargets.org/sectors/oil-and-gas
[6] https://assets.bbhub.io/company/sites/63/2022/09/Expectations-for-Real-economy-Transition-Plans-September-2022.pdf

Conclusion: three ways to meet future challenges

The future of CTP, and the market standard that it is set to become, is not without its challenges. In particular, there are three imperatives which we believe need to be addressed:

- Firstly, CTP must transition to an industry body in order for wider adoption to be achieved. WTW's aim from the outset was always to incubate the accreditation framework, but the time has now come for that framework to be adopted by another party so that broader market and broker support can be achieved. Unless it is more broadly adopted, with the right supporting governance frameworks in place to guide the future direction, the assessment of transition plans will never become as consistent and transparent as it needs to be.
- Secondly, CTP must expand its industry applicability and continually review the threshold for accreditation as the world moves towards Net Zero. Although this initiative was initially launched for the power generation sector, expansion into the oil & gas sector must be next. There are complexities as to how this is to be achieved, given the unclear transition pathway that the industry currently faces, so flexibility in recognising at what stage of its transition an organisation is at is important. Paris-alignment is the ultimate goal, but since even the beginning of a company's transition must be recognised, providing a transparent assessment of the process is important.
- Finally, CTP must deliver value to high-carbon organisations and reward the leadership positions that those with developed transition plans are taking. In a similar way in which the financing world is now incentivising transitionary behaviour through differentiated product terms[7], the insurance industry needs to find a way to act as stewards through the transition. Whether that be rewarding these organisations with extended policy terms to better partner over the course of the transition, better or faster terms with respect to claims pay-outs or greater access to the expertise the industry has regarding the transition, the industry has the opportunity to accelerate this transition and it must take it.

If any energy industry readers of this Review have any thoughts on your own company transition plan, how it should be measured or rewarded, or the experience you are currently having with your risk management and transfer partners, we invite you to talk to us about Climate Transition Pathways and how it might work for your organisation.

> **In a similar way in which the financing world is now incentivising transitionary behaviour through differentiated product terms, the insurance industry needs to find a way to act as stewards through the transition.**

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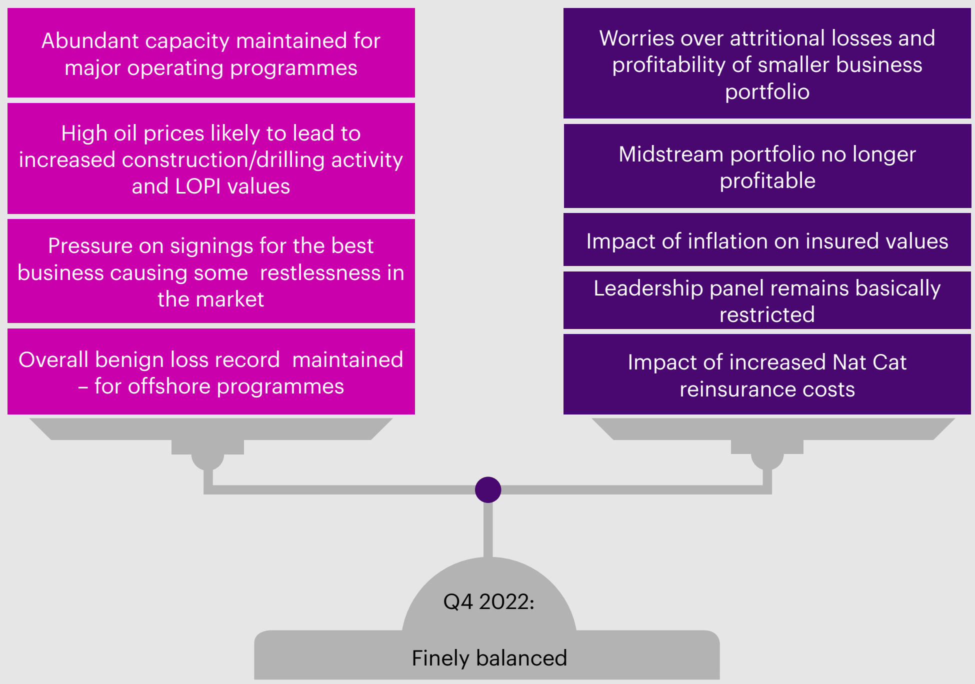
[7] See BIS Working Papers, No 946, The pricing of carbon risk in syndicated loans: which risks are priced and why?, for evidence of risk premium charged to borrowing firms with higher carbon intensities. https://www.bis.org/publ/work946.pdf

Global Upstream: a significant market bifurcation emerges

Figure 1: **Finely balanced - the Upstream underwriting environment, Q4 2022**



Despite good underwriting results and the prospect of more premium income to come, a major bifurcation is evolving in the Upstream market

Introduction: an apprehensive market, despite recent underwriting returns

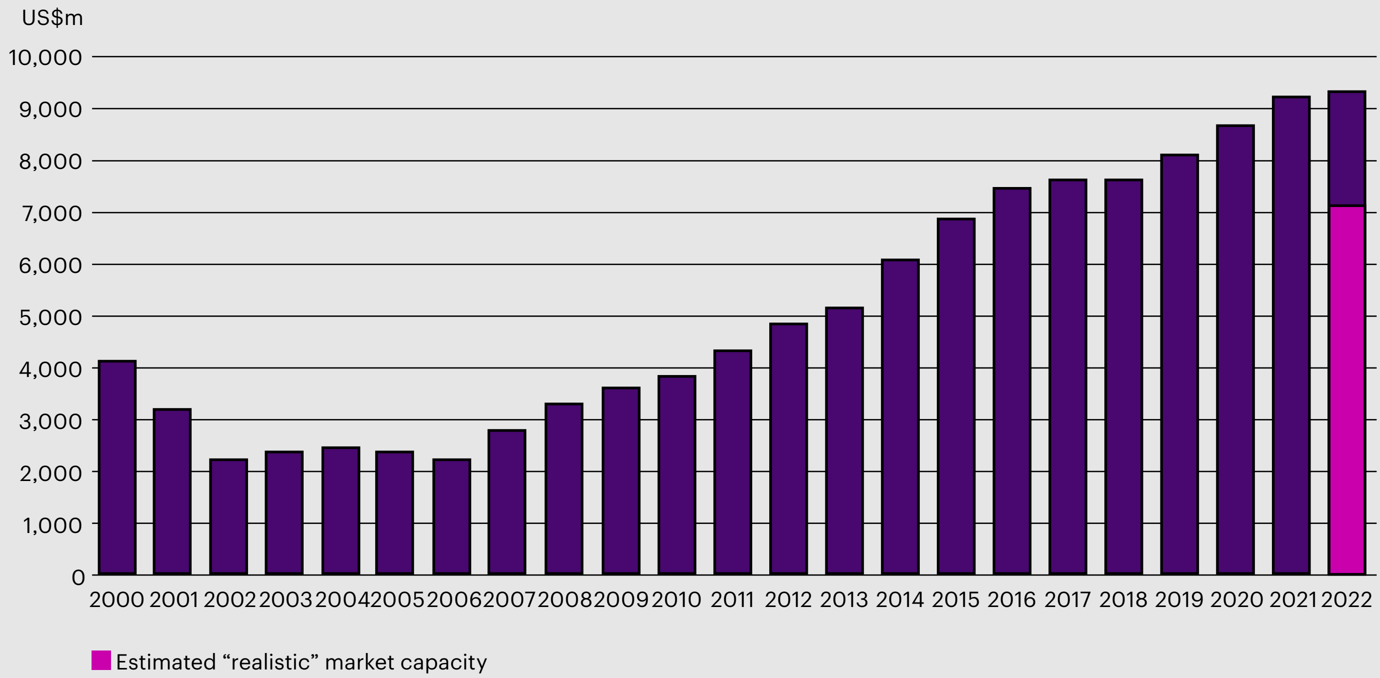
In our April 2022 Energy Market Review[8], we alluded to the overall profitability of the Upstream portfolio and commented that a lack of alternatives to the current leadership panel was perhaps enabling the market to increase (or at least maintain) current rating levels, despite the recent moderate loss record. However, the picture that has emerged during the last six months is one of a much more fragmented market. While competition continues to intensify for the most sought-after business, the less attractive elements of the portfolio, such as stand-alone OEE cover for single shot wells, sub-sea construction business and small land rig fleets (particularly from North America) have not been so well received by the market. There is little doubt that the Munich Re Syndicate 457's recent announcement of a withdrawal from this market in January 2023 will exacerbate this bifurcation still further.

As a result, describing the various factors that make up the current state of the market (see Figure 1 above) is not as simple as it might have been in previous underwriting eras. The overall net effect of recent developments has been to flatten the previous upwards trend in rating levels but at the same time to prevent any realistic market softening to materialise. Our "kitchen scales" graphic therefore shows a balanced market with the various positive factors generally being cancelled out by the negative ones, leaving the market effectively in equilibrium – albeit an equilibrium that is masking many of the underlying trends.

What can buyers expect as we draw closer to the January 1, 2023 renewal season? Much will depend on the nature of the risk in question, as we take a deeper dive into current Upstream market dynamics.

[8] https://www.wtwco.com/en-US/Insights/2022/04/energy-market-review-2022

Figure 2: **Upstream Operating insurer capacities 2000-2022 (excluding Gulf of Mexico Windstorm)**



Both theoretical and realistic capacity levels have increased in recent years – thwarting the efforts of insurers to accelerate the hardening process

Source: WTW

Capacity

Abundant capacity remains for the best programmes

With overall capacity at very much the same levels as earlier in 2022, buyers that require significant overall policy limits, such as major North Sea operating programmes, are finding that there is more than enough market enthusiasm for their risk to enable them to access the protection that they need from the market. These include fixed offshore assets, global upstream programmes, well-engineered risks and those programmes that stayed faithful to their existing market leader. The common denominator is, as always, the prospect of significant premium income.

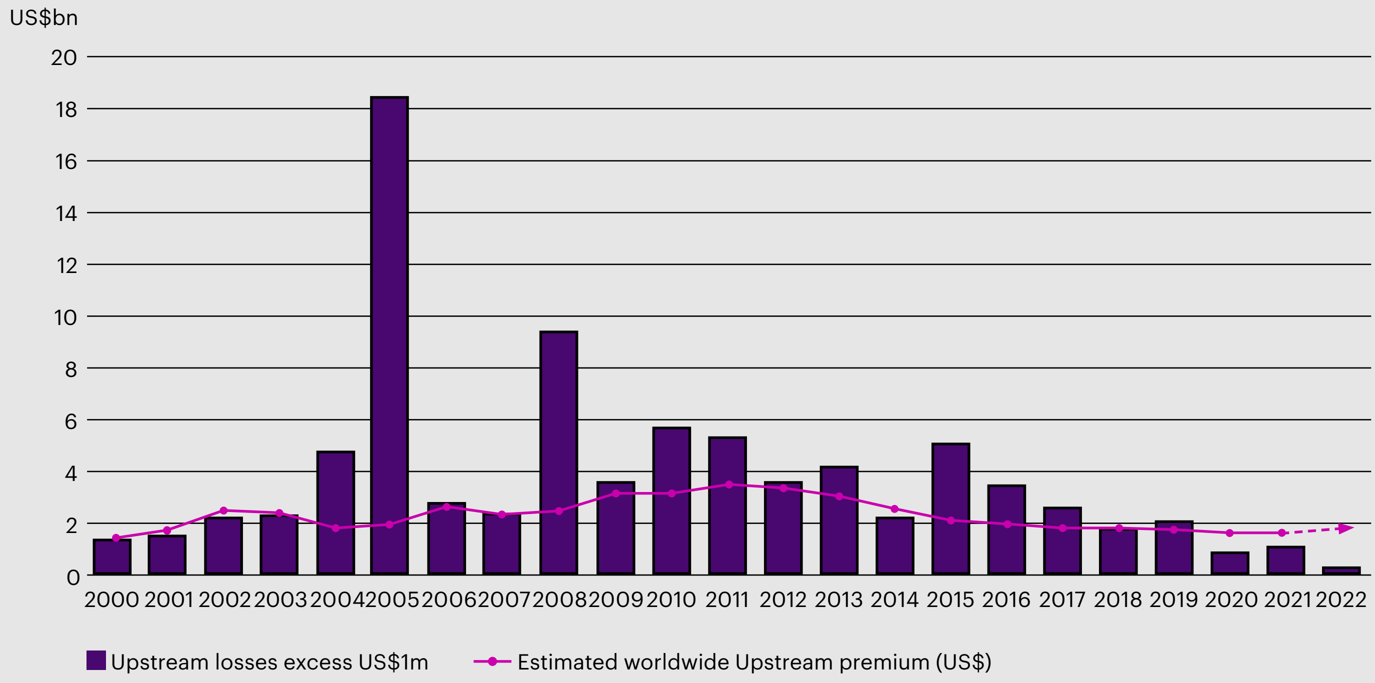
Realistic capacity continues to stand at some US$7.25 billion for these programmes (see Figure 2 above). While the Munich Re Syndicate 457's recent announcement will effectively reduce the overall theoretical capacity available to these buyers, in practice this is unlikely to be the case. Such is the current pressure on market signings for this part of the portfolio, buyers can be confident that other market players will be only too pleased to take up any slack created by this syndicate's withdrawal.

Of course, it is always possible that, with interest rates on the rise, some of the existing capital currently pledged to the insurance market may find more attractive havens elsewhere in the future, and this is something that buyers and their brokers should be looking out for in the future.

Capacity significantly affected for "attritional" business"

However, the reverse can be said for those parts of the portfolio which are deemed by the market to be "attritional". These include small, often non-renewable business such as one well programmes, small land rig fleets, some midstream operations written by this market and sub-sea construction business which has proved not to be profitable in recent years. Indeed, brokers' ability to complete some of these placements at reasonable terms is becoming increasingly challenging, even for programme limits below US$100 million. No insurer likes "dollar-swapping", particularly at the lowest end of the loss spectrum, so it seems that a significant number of Upstream underwriters have made commitments to their management and/or treaty reinsurers that they will not be writing this kind of business in the future, especially if the risk concerned is "non-renewable" – for example, the drilling of a single well is not an ongoing risk from year to year, although the well in question does become a renewable risk once it goes operating or is plugged and abandoned. This means that benchmarking the correct price for these risks is a more challenging process than for "renewable" business, making it more difficult to justify to senior management. Furthermore, losses from these types of programme tend to fall beneath the excess point on insurers' reinsurance treaties and therefore tend to be fully retained – an insurer only needs a few retained losses in the US$5-10 million range to ruin the prospects of a profitable Upstream portfolio for the year.

Figure 3: **WELD Upstream Energy losses 2000–2022 (excess of US$1m) versus estimated Upstream premium income**



How many losses below US$1 million are affecting the portfolio in 2022?

Source: WTW/WTW Energy Loss Database as of October 6 2022 (figures include both insured and uninsured losses)

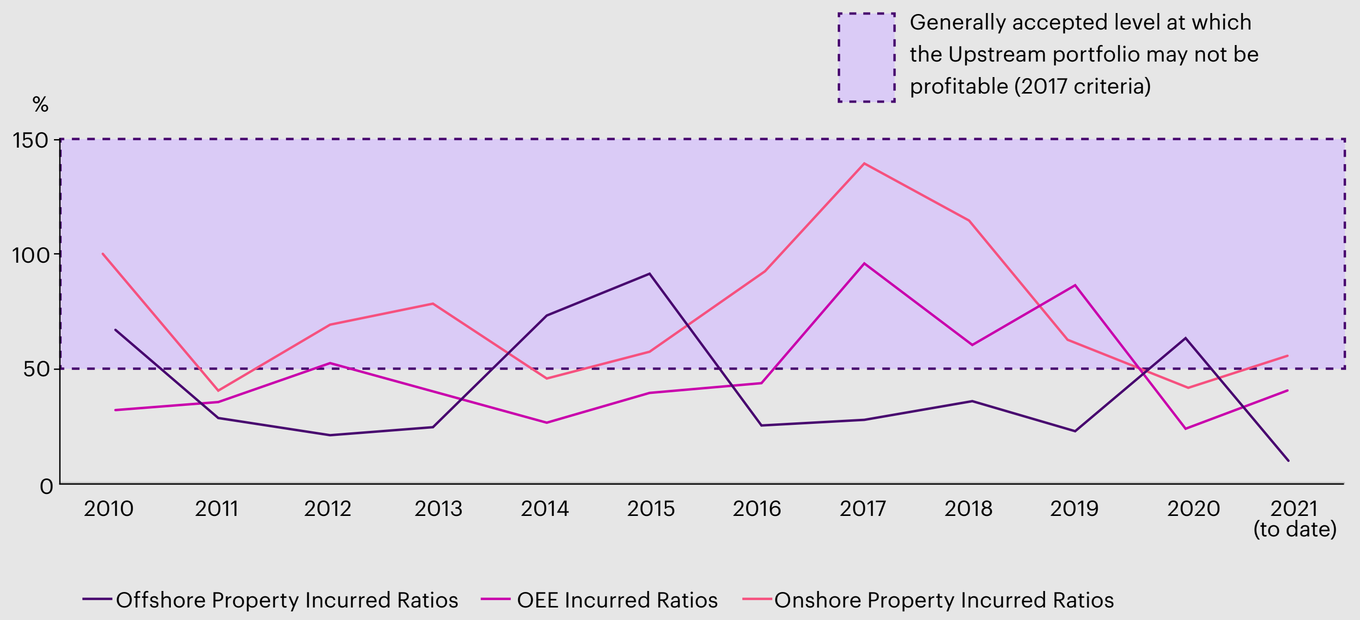
Figure 4: **WELD Upstream Energy losses excess of US$1 million reported to date, 2022**

Type	Cause	Region	PD US$	OEE US$	BI US$	Total US$
SSCS	Unknown	Europe	17,000,000	0	20,500,000	37,500,000
Platform	Mechanical failure	Europe	14,500,000	0	20,000,000	34,500,000
Well	Blowout no fire	North America	0	14,500,000	0	14,500,000
Well	Blowout no fire	North America	0	11,000,000	0	11,000,000
Well	Blowout no fire	Latin America	0	8,000,000	0	8,000,000
Land rig	Collapse	Middle East	6,500,000	0	0	6,500,000
Vessel	Unknown	Australasia	5,900,000	0	0	5,900,000
Land rig	Fire no explosion	North America	4,500,000	0	0	4,500,000
Production facility	Fire no explosion	North America	4,000,000	0	0	4,000,000
Land rig	Collapse	North America	2,750,000	0	0	2,750,000
Tank farm/terminal	Ice/snow/freeze	North America	2,300,000	0	0	2,300,000
Land rig	Unknown	North America	2,000,000	0	0	2,000,000
Equipment	Collision	North America	1,400,000	0	300,000	1,700,000
Production facility	Fire no explosion	North America	1,500,000	0	0	1,500,000
Land rig	Windstorm	North America	1,000,000	0	0	1,000,000

Just four 2022 Upstream losses in excess of US$10m have been reported to our database to date – but North American midstream losses of roughly US$100 million each have also recently reported to the market...

Source: WTW Energy Loss Database as of October 6 2022 (figures include both insured and uninsured losses)

Figure 5: **Lloyd's Upstream Incurred Ratios, 2010-21**



Lloyd's OEE and Onshore Incurred ratios are moving upwards – explaining the current market bifurcation

Source: Lloyd's Market Association Quarterly Loss Report Q2 2022. "Offshore Property" – combination of ET/EC/EM/EN Audit Codes "OEE" – combination of EW, EY and EZ Audit Codes. "Onshore Property" - EF audit code.

Losses

An apparently benign record in recent years

Figures 3 and 4 on the previous page continues to show that the current Upstream loss record remains relatively benign compared to previous eras. Although the loss record for 2021 has deteriorated somewhat since this chart was last updated for our April Energy Market Review, the last three years have shown an improvement on average loss levels during the last 20 years or so.

However, it is important to mention three caveats that suggest that the picture may not be quite as rosy from an underwriting perspective:

1. The losses reported by our Database only include those above US$1,000,000 any one accident or occurrence. Therefore, these statistics do not include losses below this figure which could be considered "attritional", such as small Property and OEE incidents.
2. It always takes a bit of time for losses to appear on our Database, as we can only add details once a reserve has been established. This is why the 2021 record on our Database has deteriorated since we last reported in April, and why we are sure that the very modest total recorded so far for 2022 is very likely to increase in the months ahead. Already we are aware of two North American Midstream losses reported to the market that we understand are totalling approximately US$100 million each.
3. The losses reflected in Figure 3 are losses deemed by our Database to be classified as Upstream; they therefore do not include a significant number of Midstream losses considered to be Downstream by the database, as historically such risks as LNG plants, oil and gas terminals and onshore pipelines have been written by the Downstream market.

Lloyd's statistics: do they tell a different story?

Perhaps a more accurate source to determine how recent attritional losses are currently affecting the Upstream portfolio are the statistics compiled by Lloyd's showing the various Upstream risk code Incurred Ratios (earned premium versus paid and outstanding losses) for Offshore Property, OEE and Onshore Property business over the course of the last 12 years (see Figure 5 above). It is generally accepted by the market that any Incurred Ratio in excess of 50% is likely to be generally unprofitable after operating and reinsurance costs are taken into consideration.

This chart paints a somewhat different picture to Figure 3. Both the OEE and Onshore Property ratios have actually increased during 2021, with the Onshore (including Midstream) portfolio now in potentially unprofitable territory. What's more, the Incurred Ratio for Offshore Property – seemingly the jewel in the crown of the Upstream portfolio – reached 58% in 2020, again in potentially unprofitable territory (this is almost certainly due to a major North Sea Contingent Business Interruption loss which is likely to have impacted that particular year of account).

This perhaps explains why Upstream insurers continue to be wary of this portfolio, despite its apparent profitability, and why the recent bifurcation in the market has materialised to the extent that it had done in recent months. Indeed, there has been a series of Midstream losses, especially relating to LNG assets, which have traditionally been underwritten by the Downstream market, but which are also written by a selection of Upstream insurers. This has surprised Upstream underwriters, as previously this business had been regarded as relatively low risk. Capacity is therefore becoming scarcer for this business and rating levels are increasing.

Inflation

Recent upswing fuels concerns over valuation accuracy

Due to the impact of COVID-19 and the restrictions imposed around the world since April 2020, Upstream underwriters are concerned that so few programmes have been independently valued in recent years. This concern has recently been exacerbated by the dramatic upturn in inflation levels around the world, which continues to distort the accuracy of the values that have historically been declared to the market. In particular, insurers are increasingly concerned about their Loss of Production Income (LOPI) exposure due to supply chain issues leading to increased lead times to replace damaged equipment. Before the recent upturn in inflation levels, insurers had not raised this issue in any meaningful way as they were reluctant to miss out on the premium income on offer from attractive programmes; now they have little choice but to do so.

We understand that Lloyd's has already set up a working group to ensure that PD values declared to the market begin to reflect the actual exposure facing insurers. It seems clear that if buyers are not demonstrating that they are getting their assets values reassessed, insurers are going to be wanting to know why, although recognition is being given in the market if buyers can prove that they have considered the impact of inflationary factors in their underwriting submissions.

> **Insurers are increasingly concerned about their Loss of Production Income (LOPI) exposure due to supply chain issues leading to increased lead times to replace damaged equipment.**

Where insurers are not comfortable with the valuation data presented to them, this may be reflected in the negotiations. So from a buyer's point of view, if it can be demonstrated that an evaluation has recently been conducted, and if they can prove that they are managing their supply chain effectively, then this will do much to improve the buyer's negotiating leverage with the market.

Effect on deductible levels

Global inflation is also undermining the value of current deductible levels, which have continued to remain at roughly the same levels for the last five years. While there have been no increases in deductibles imposed by the market to date, it is clear that they no longer represent the same relative value in terms of the attachment points at which current rating levels are calculated. It therefore goes without saying that insurers will feel much more comfortable with a client that can demonstrate that they have all the procedures in place to enable them to evaluate the risk properly; if they are not comfortable, the obvious remedy is to charge more money. In any event, should a broker be astute enough to go into the market and secure flat renewal terms, the insurer could now justifiably argue that the client is in reality being offered a reduction due to the existing deductible levels. While there have been no major market confrontations to date regarding this issue, brokers will have to be on their guard in the months ahead and do everything in their power to maintain deductibles should inflationary pressures continue to grow.

Reinsurance market concerns

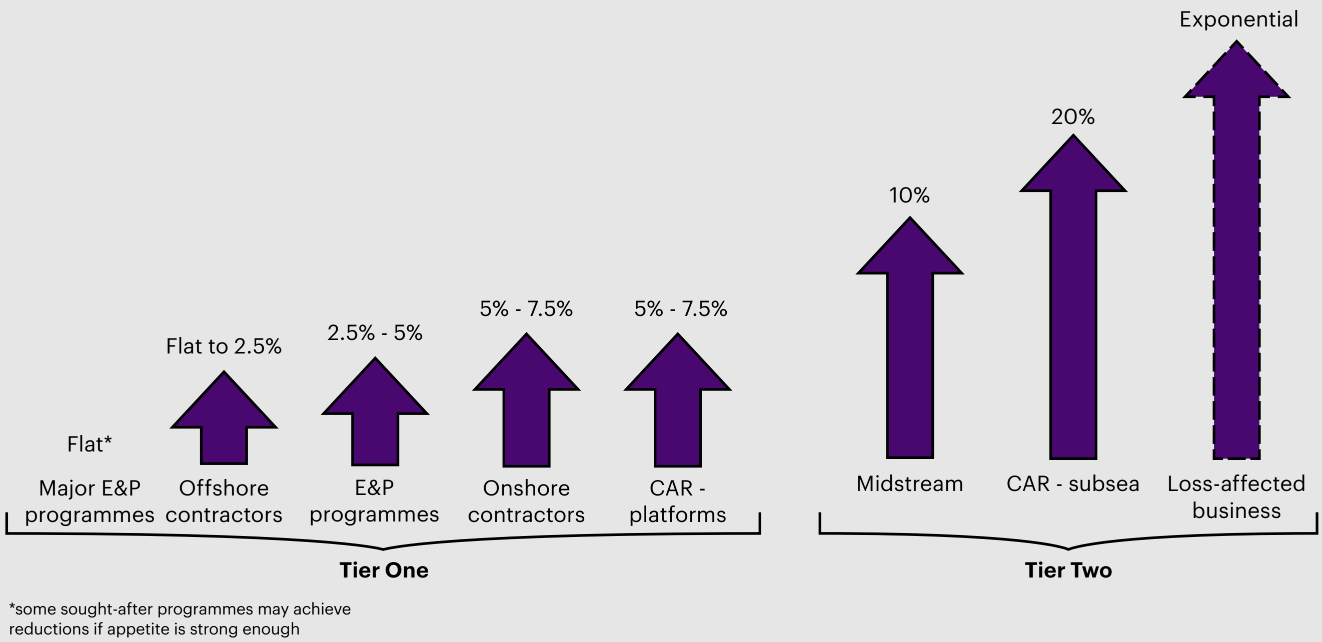
Natural Catastrophe risk

Another major concern for Upstream insurers is that they are having to pay increased prices for their Natural Catastrophe (Nat Cat) reinsurance protection, particularly if historically they have purchased reinsurance on a whole account basis. This is clearly serving to make insurers' Nat Cat reinsurance purchase more expensive, a trend that will doubtless continue in the wake of the recent devastation wrought by Hurricane Ian in Florida and elsewhere. This issue is currently the subject of an increased focus by Lloyd's, particularly regarding the issue of overall aggregates and retentions.

As a result, Upstream insurers are under pressure to maintain or increase pricing levels to ensure they can continue to afford to purchase the reinsurance protection required - regardless of the actual location of the risk.

Furthermore, those companies that buy Gulf of Mexico Windstorm (Gulf Wind) cover will also be doubly affected by the withdrawal of the Munich Re syndicate 457 from this market in January 2023, while it is also possible that other insurers could see increased reinsurance costs.

Figure 6: **Two-tier market differentials, Q4 2022 (General guide only)**



The market bifurcation is now evident in the range of rating increases now being offered by insurers

Source: Lloyd's Market Association Quarterly Loss Report Q2 2022. "Offshore Property" – combination of ET/EC/EM/EN Audit Codes "OEE" – combination of EW, EY and EZ Audit Codes. "Onshore Property" - EF audit code.

Effect of the Ukraine situation on Sabotage & Terrorism cover

To date, the events in Ukraine have had little material impact on the Upstream market. However, as we near the main January 1 renewal treaty season, it is becoming evident that the losses being felt in the broader marketplace, and specifically the Political Violence/Terrorism class, are likely to impact the whole account reinsurance programmes into which Upstream underwriters must contribute. Furthermore, the gas release incidents recently experienced at the Nordstream pipeline may trigger a review of Terrorism cover by Upstream insurers, who certainly now consider the Terrorism risk relating to their portfolio to be enhanced. It is far from clear how this will play out, but should the Treaty Reinsurance markets shift their position substantially, direct buyers of this increasingly valuable cover are likely to be facing some fundamental changes in how it is purchased.

Current rating levels

As ever, our summary rating chart reflected in Figure 6 above shows the market bifurcation referred to earlier. However, what this graphic can't show is the amount of premium associated with each of these sub-classes of Upstream business; major E&P programmes, shown on the extreme left of this graphic, attract by far the largest share of the overall Upstream premium income cake. In contrast, the single shot well business shown on the extreme right of this graphic attracts only a tiny percentage of the overall premium.

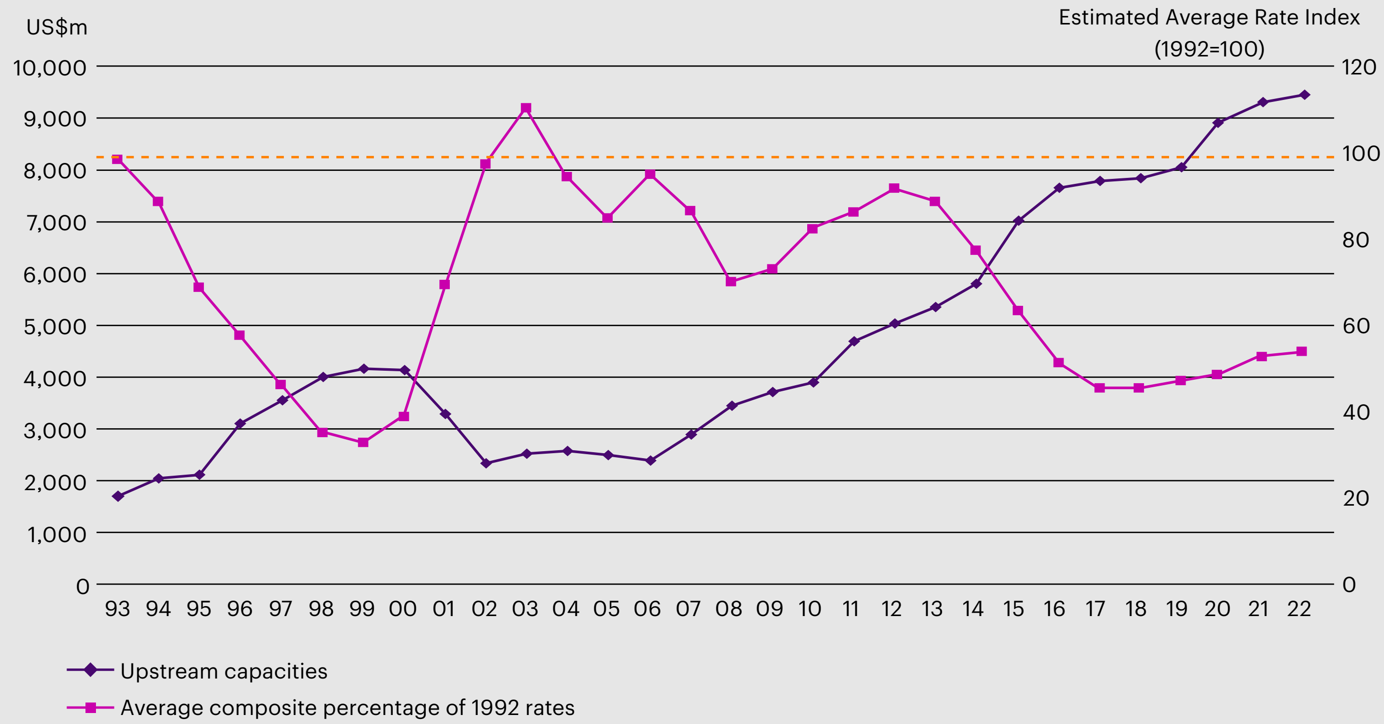
It should be pointed out that these series of rating increases are only meant to serve as a general guide to what buyers might expect in the market and should not be regarded as being definitive. Much will continue to depend on premium volume, loss record, accurate valuations and leading underwriter loyalty.

Conclusion: the outlook for 2023

We have explained why the Upstream market continues to generally experience rating rises and the factors involved in continuing to ensure that this remains a somewhat apprehensive market. We have also show why there is now a major bifurcation in the market, as underwriters' reluctance to participate in "attritional" risks is in marked contrast to their enthusiasm for major offshore E&P programmes featuring significant premium income.

But as Figure 7 overleaf shows, overall capacity continues to be plentiful. Despite the Munich Re Syndicate announcement, we do think that the market appetite for the most well-regarded programmes is likely to continue to increase next year as major insurers, looking to replace premium income lost due to the conflict in Ukraine and disappointed by the degree of competition and the degree of "signing down" of written lines, begin to adopt more aggressive strategies to meet their premium income targets.

Figure 7: **Upstream Operating insurer capacities 2000-2022 (excluding Gulf of Mexico Windstorm)**



As capacity continues to increase, so the pressure to compete further for the best business is likely to intensify in 2023

Source: WTW

Indeed, we do detect a significant change in the way in which the market is rearranging itself. For many years, we have continued to point out that the existing leadership panel has continued to be somewhat restricted; this is still very much a subscription market and one of the reasons for the continuing hardening of the market has been a lack of competition from following insurers, as no one has been prepared to "rock the boat" and challenge the existing leadership panel.

That may already be changing. Such is the disappointment of some insurers with regard to the signing down of their written lines for the best business that we would not be surprised to see them willing to lead some favoured programmes in exchange for a much more robust signed line. Should this dynamic begin to materialise, then we may find that the market actually begins to soften significantly for the best business, as new leaders step up to the plate, while continuing to harden for the "attritional" business, where market enthusiasm remains extremely limited.

In the meantime, one thing is clear. More favourable terms will only be available to those buyers who not only have completed the new market ESG form satisfactorily but who have also convinced the market that their underwriting submissions reflect realistic asset and LOPI values.

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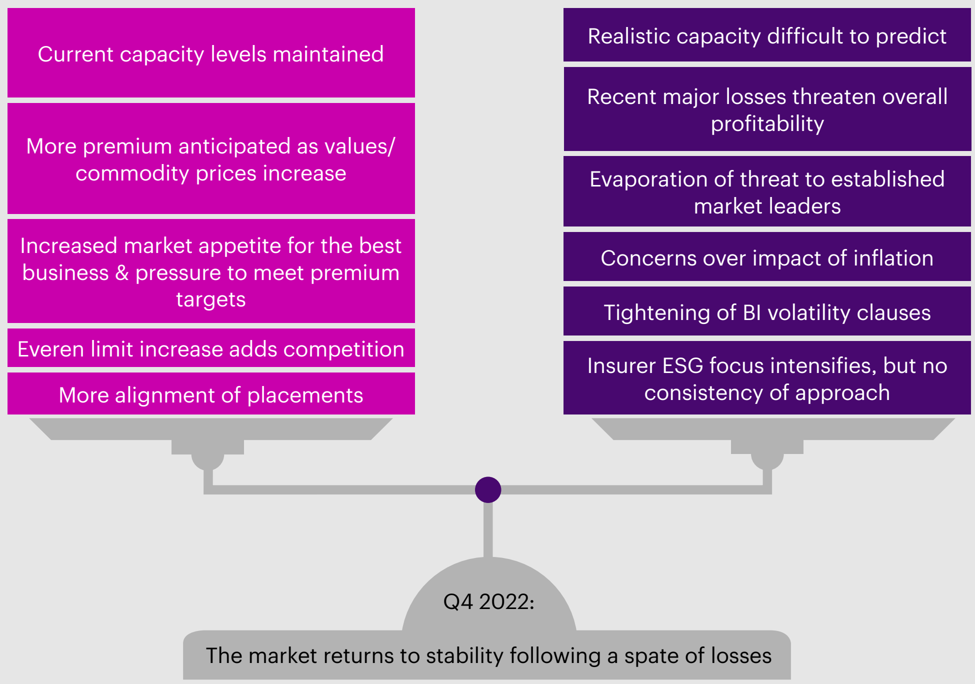
Global Downstream: market correction results from recent losses

Figure 1: **the Downstream underwriting environment, Q4 2022**



The market remains finely balanced now that recent softening pressures have generally been cancelled out

Introduction

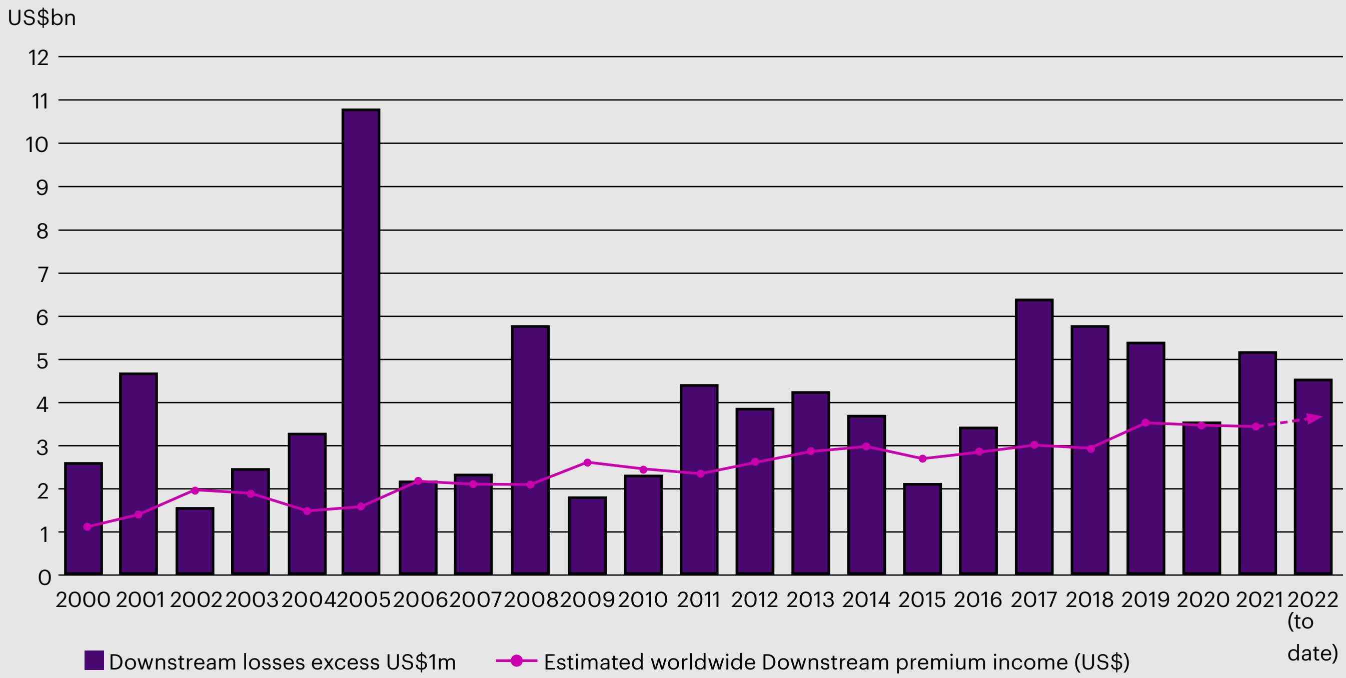
IIn our April 2022 Energy Market Review, we were keen to allude to the possibility of market conditions beginning to ease for most lines of Downstream business. The loss record for 2021 had, at that stage, appeared to be modest and from our conversations in the market it seemed that 2021 would generally turn out to be a profitable one, with the prospect of 2022 turning out equally favourably given the upturn in rating levels during the recent prolonged hard market.

In the weeks following its publication, it seemed as if this prediction was beginning to be fulfilled. Insurers appeared keen to compete for the most sought-after business and significant rating reductions began to be achieved. Indeed, we at WTW were all set to declare an end of the hard market conditions and the beginning of the next phase of the traditional underwriting cycle.

However, much as happened during the last few weeks to halt this recent softening dynamic in its tracks. As the market returns to stability, what can buyers expect as we move further towards the January 1 renewal season?

Figure 1 above shows that the current balance of positive and negative trends currently affecting the market. Let's examine three key factors to determine why the market has now essentially returned to equilibrium – the impact of recent losses, increases in inflation rates and the possibility of revised ESG stances in light of the crisis in Ukraine.

Figure 2: **WELD Downstream losses 2000 – 2022 (excess of US$1m) versus estimated global Downstream premium income**



How many losses below US$1 million are affecting the portfolio in 2022?

Source: Willis Towers Watson/WTW Energy Loss Database as of October 6 2022 (figures include both insured and uninsured losses)

Figure 3: **WELD Downstream losses excess of US$50 million, 2022 (to date)**

Type	Cause	Region	PD US$	BI US$	Total US$
Gas plant/trans	Fire + explosion/VCE	North America	257,250,000	721,309,420	978,559,420
LNG	Fire + explosion/VCE	North America	70,000,000	788,366,129	858,366,129
Primary process	Mechanical failure	Europe	40,000,000	525,000,000	565,000,000
Olefins	Mechanical failure	Middle East	0	461,000,000	461,000,000
Gas plant/trans	Fire + explosion/VCE	North America	160,000,000	40,000,000	200,000,000
Gas plant/trans	Fire no explosion	Middle East	10,000,000	143,877,550	153,877,550
Tank farm/terminal	Unknown	Latin America	118,000,000	20,000,000	138,000,000
Tank farm/terminal	Lightning + fire	Carribbean	138,000,000	0	138,000,000
GTL	Mechanical failure	North America	50,000,000	78,558,800	128,558,800
Secondary process	Fire + explosion/VCE	Asia Pacific	22,916,000	102,000,000	124,916,000
Tank farm/terminal	Collapse	North America	15,000,000	62,500,000	77,500,000
Olefins	Supply interruption	Middle East	6,800,000	69,000,000	75,800,000
Refinery	Contamination	Europe	73,800,000	0	73,800,000
Secondary process	Mechanical failure	Europe	2,000,000	69,500,000	71,500,000
Olefins	Fire no explosion	Europe	10,000,000	42,000,000	52,000,000

Source: WTW Energy Loss Database as of October 6 2022 (figures include both insured and uninsured losses)

The impact of the recent loss record

We have recently updated our Energy Loss Database to include a series of major losses occurring in 2021 and 2022 which have recently been updated and/or advised to the market (Figure 2 above). Back in April this chart showed only US$4 billion of losses for 2021 and we did not have enough data on our Database to show 2022 figures. However, as we move into the final quarter of 2022 the loss total in our database for 2022 is now higher than what we advised for 2021 back in April. Some of the major losses advised to us are included in Figure 3 above.

We understand from our conversations in the market that some of these losses, particularly those relating the BI element, may increases still further before final adjustment and settlement. It is also important to note that these losses have been across all the major Downstream occupancies and across all major geographies. Midstream losses have been particularly heavy, which may affect overall capacity and market appetite for this sub-class going forward, especially if there is a retreat from this class by the Upstream market, who have also been significantly affected by these losses.

Sending a shockwave

The impact of these losses has sent something of a shockwave across the Downstream market. Given that there is only approximately US$3.75 billion of Downstream premium across the global markets (see Figure 2 above), it can be seen that both 2021 and 2022 have produced overall loss totals some way in excess of that figure (although we should point out that these include both insured and uninsured losses).

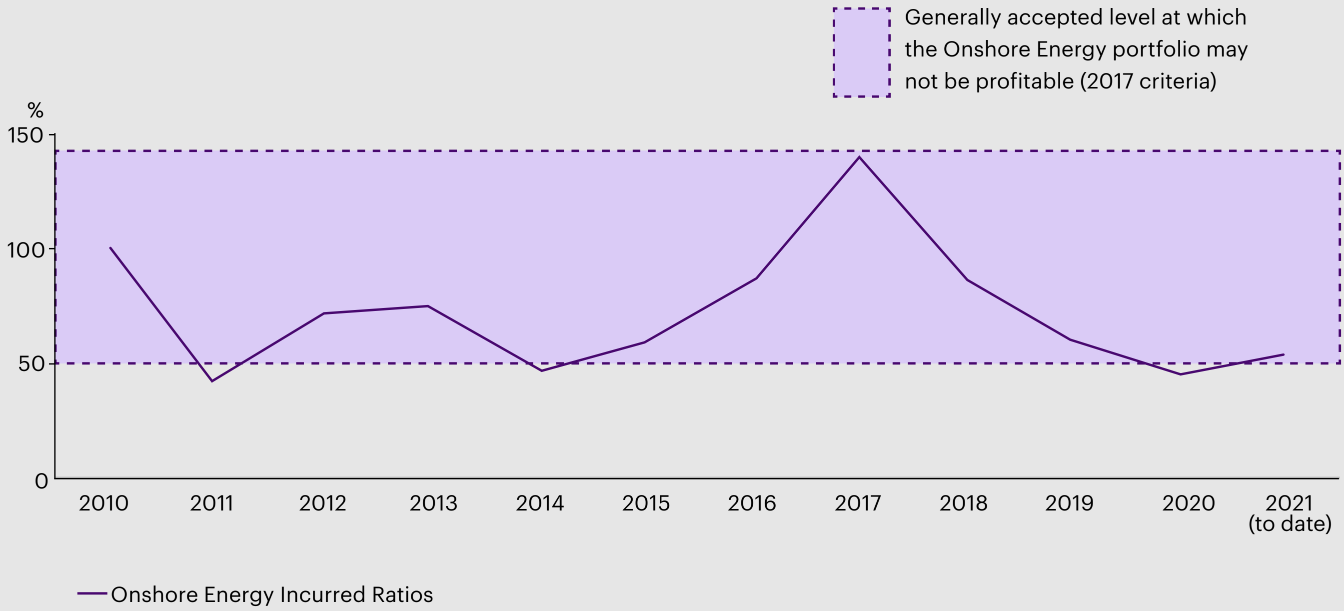
"**As we move into the final quarter of 2022 the loss total in our database for 2022 is now higher than what we advised for 2021 back in April.**"

It is therefore hardly surprising that there has been something of a retrenchment in the market, with written lines being reduced and competitive pressures easing. In particular, those insurers who had begun to challenge the exiting panel of leaders in the weeks following the publication of our April edition have now retreated and are now likely to offer no more capacity than they did at the beginning of the year.

For an independent assessment of the current profitability of the global Downstream portfolio, we have included the current Onshore Energy Incurred Ratio statistics for Lloyd's of London in Figure 4 overleaf (these Incurred Ratios show net premiums versus paid and outstanding claims but do not include operating costs or reinsurance expenses). It is generally assumed in the market that an Incurred Ratio of 50% or more suggests that the portfolio may not be generally profitable.

It can be seen that this line of business has proved to be generally unprofitable for many years, particularly during 2016-19. Although Onshore Energy had a better year in 2020, the ratio had deteriorated once gain in 2021 and we anticipate a further deterioration in 2022, given the frequency and severity of the losses already recorded on our Database.

Figure 4: **Onshore Energy Incurred Ratios 2010-2021**



Lloyd's Onshore Energy Property portfolio was thought to have returned to profitability – but the latest figures suggest otherwise

Source: Lloyd's Market Association Quarterly Loss Report Q2 2022. ""Onshore Property" - EF audit code.

Realistic capacity levels affected – but by how much?

In theoretical terms, capacity for Downstream Energy business remains buoyant, with over US$6 billion available for any one programme. However, various factors, including location, loss record, exposure to Natural Catastrophe risk and other underwriting submission details in reality continue to restrict the realistic capacity available to approximately 50% of this amount. While we were finding that this figure was on the increase during the second quarter of 2022, the rapid retrenchment following the advice of the recent losses suggests that realistic capacity levels may well be back to where they were at the beginning of the year. For the best-regarded business we still believe that as much as US$3 billion is available, although prices will rise somewhat if this level of cover is required.

The impact of inflation

Global inflation is also presenting significant challenges to the Downstream market. Since the onset of the COVID-19 pandemic, there has been an understandable marked decline in the number of independent valuations caried out on Downstream assets around the world. Before the onset of the recent global inflationary spiral buyers have generally been content to take the valuations of three years ago and simply apply a percentage increase using exiting inflation rates. Some insurers have suggested that some of their clients have simply taken what they think to be an average inflation rate and provided their own "guestimate" to the market of what they believed their PD assets and BI values are now worth, with extraordinarily little science being applied to the calculations. Regardless of the validity or otherwise of that point of view, there can be no doubt that the recent rises in inflation in recent months has focused insurers' attention on this key issue. This is particularly the case given the pricing "spikes" that we have seen in recent months, particularly for fossil fuels; this makes the presentation of accurate values to the insurance market even more challenging for buyers. In recent months European refining companies have therefore found that their BI numbers are rapidly increasing over the previous year's and for insurers such changes potentially impact Maximum Foreseeable Losses (MFLs).

LMA 5515 volatility clause tightened – but is that really the answer?

Given their concern about the accuracy of current BI values being advised to the market, insurers are looking at tightening the LMA 5515 volatility clause, reducing the percentage cap on both monthly and annual variations in what is declared by the buyer to their programme. For example, if a buyer had previously had a cap of say 150% per month and 130% per year imposed by the market, on renewal those figures are likely to be reduced to say 110% per month and 110% per annum.

However, we do not feel that a simple reduction in the value of the monthly and annual caps is necessarily the answer – such is the current volatility of fossil fuel and other prices that the tightening of this clause may well lead to multiple advices of revised values to insurers, necessitating the issuance of multiple endorsement documentation. This can hardly be in anyone's best interests, so perhaps the next step would be for the market to re-design their clause to introduce an average annual average cap to smooth out the effect of the recent volatility. It should also be pointed out that arranging physical valuations at site can take many months to arrange, during which time prices can move exponentially both upwards and downwards.

In reality therefore, there is no simple solution to the problem of ensuring precise and accurate values that will allow insurers to charge an accurate premium for the risk at all stages of the policy period. Of course, as ever, the design of any worthwhile insurance policy will be to try to place the buyer back in the same financial position as they would have been in but for the occurrence of a loss. Insurers are of course aware of the challenge of providing the right level of cover for a loss when it does occur; as a result, when they are not completely confident of the accuracy of a given set of values their only option may be to include a loading on the premium charged to take this uncertainty into account.

The impact of the Ukraine crisis on ESG stances

In recent weeks we have seen that the current crisis in Ukraine has done much to change the nature of the energy transition, particularly in Europe, which may well affect individual insurer stances on ESG issues. Before the escalation of the crisis, we saw several major European insurers harden their underwriting stances against any buyer whose ownership consisted of entities that still maintained significant coal interests. Brokers have therefore had to face the challenge of replacing capacity previously offered by these European (re) insurers for those Downstream energy companies owned by these entities. For the more well-regarded risks, this has not been particularly challenging, but for other programmes replacing this lost capacity has proved to be more difficult.

What about the "S"?

It seems that these (re)insurers' focus has been very much on the "E" of ESG, which can sometimes be seen by others as somewhat contradictory – for example, if a refining company is owned by a major national organisation whose business portfolio includes supply of electricity via coal-fired power stations to millions in a third world country, then to take a stance and not insure that organisation, nor any of its subsidiaries, might suggest that not enough attention is being paid to the "S" of ESG – the social responsibility to ensure that millions stay connected to existing power supplies. We understand that some in the market are now questioning whether the very term ESG should be used by the market in future, as possible inconsistencies between the constituent parts of the ESG framework come to light.

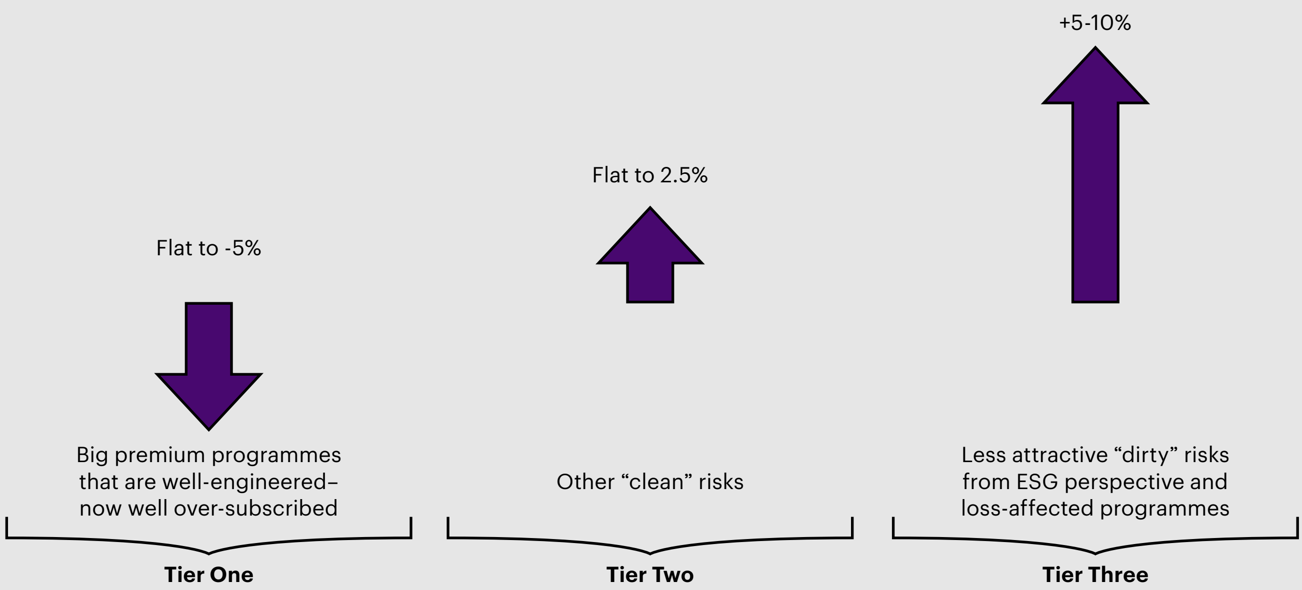
A disparity of insurer views, exacerbated by the Ukraine crisis

To date, we have found a wide disparity of views and stances within the global Downstream market, with no consensus emerging among insurers. While some in the market have taken a similar stance to these European (re)insurers, others have taken more pragmatic views and it will be interesting to see which stance prevails in the months and years ahead. This issue has been given even greater prominence in insurers' thinking since the onset of the crisis in Ukraine. With Russian gas supplies to Europe coming to a virtual standstill, it appears that certain European countries are considering a short-term return to coal to meet the shortfall in supply caused by the crisis while in the US, President Biden appears to be encouraging a return to increased oil and gas Exploration & Production activity. Furthermore, the UK government has also given the go-ahead for further Exploration and Production activity in the UK sector of the North Sea. Given the social imperative to maintain power supply, particularly in the winter months, it can be argued that the responsible thing to do from an ESG perspective is for the insurance market to actively support these new developments.

All of these factors mean that navigating a way through these myriad, inconsistent stances on ESG has become even more challenging for brokers than before the onset of the Ukraine crisis. It is possible that some insurers will revisit their existing stances and modify their positions; on the other hand, it is equally possible that more insurers will be forced to follow the same line as the major European (re)insurers due to pressure from shareholders, lenders and other stakeholders.

"In recent weeks we have seen that the current crisis in Ukraine has done much to change the nature of the energy transition, particularly in Europe, which may well affect individual insurer stances on ESG issues."

Figure 5: **Current Downstream market rating movements, Q4 2022 (General guide only)**



Only the choicest business is now seeing premium reductions, following a market correction during September 2022

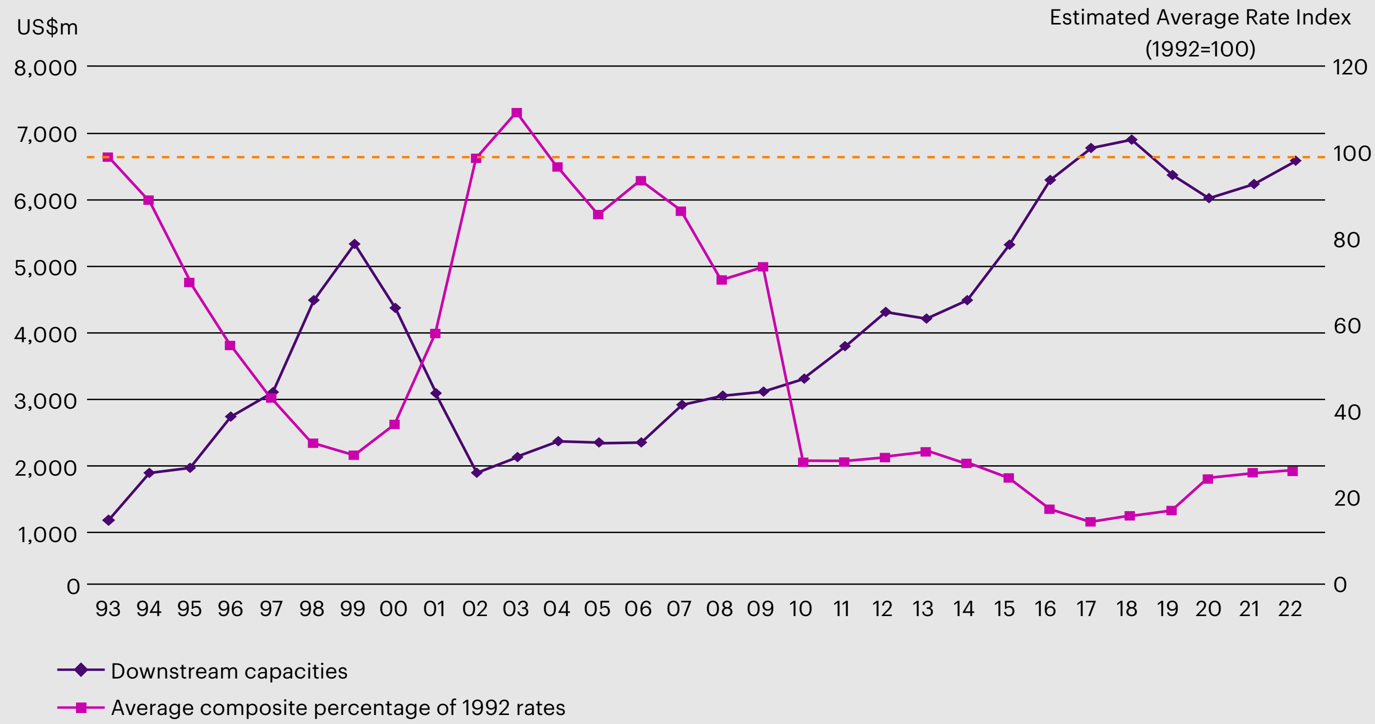
Current Downstream market rating levels

Given the severity of the deterioration of the recent Downstream loss record, it may be surprising to some that that reductions are still available for the most sought-after business, shown as Tier One in Figure 5 above. Such is the current level of over-subscription for this business in the market that brokers still have the leverage to drive these reductions, especially for loss-free programmes that feature well engineered risks that have little or no Natural Catastrophe (Nat Cat) exposure, where exiting values have been updated to insurers' satisfaction and which have shown loyalty to the exiting leader during the recent hard market.

Furthermore, other loss-free programmes featuring less premium income (Tier Two) are generally experiencing a very limited rating increase (if any) while even loss affected programmes are only attracting premium increases at a much more modest level than in the recent past.

While there has been something of a market retrenchment from what could be achieved in the second quarter of 2022, we are currently seeing more of a market correction rather than a return to a truly hard market. Indeed, we now see the existing panel of respected market leaders back out on their own, having been challenged by fresh competition earlier in the year. Somewhat understandably, these new challengers have retreated somewhat in the face of these new losses; indeed, we understand that some had taken reactively robust lines on programmes that have been significantly affected by the recent deterioration in the loss record. It is perhaps unsurprising that they no longer want to be regarded as being responsible for any further market softening.

Figure 6: **Global Downstream capacity versus estimated average rating levels, 1993–2022 (excluding Gulf of Mexico Windstorm)**



The recent increases in capacity would normally be forcing a change in pricing direction - but recent loses have put a stop to that dynamic

The outlook for 2023

Figure 6 above shows that overall capacity levels remain very robust, indeed at nearly record levels. Despite this, for the reasons we have outlined we show overall average rating levels at just above those shown for 2021.

No doubt insurers would predict that as the recent series of major losses turn into paid claims as the rest of the year progresses, insurers will begin take a more robust approach. However, we believe that it is more likely that the market will remain flat, as the effect of these losses is countered by the increased premium income that will inevitably result from revised valuations as buyers submit their fresh underwriting submissions to the market. If this new income proves to be sufficiently robust to meet their claims obligations, then insurers will not be under so much pressure to insist on a return to hard market conditions. Of course, if even more major losses materialise during the next few months, the existing equilibrium may once again come under threat.

Our advice to buyers is, as ever, to be well-prepared. Only those that have sufficient effort into presenting their risk and values to insurers in as accurate and detailed enough fashion will benefit from the best terms from a market that continues to remain apprehensive in the face of this new series of losses.

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International Liabilities: moderating rating increases

Introduction: movement in the right direction as capacity bounces back

Much like the navigation of a large oil tanker, conditions in long tail sectors of insurance such as Liabilities can take longer to turn than other classes. Buyers of Liability insurance have experienced several years of compound rate rises and shrinking limits, as underwriting results deteriorated and Liability capacity contracted (see the Lloyd's statistics in Figure 1 below).

However, after five years of net annual losses, Lloyd's reported that the Casualty sector has finally returned to the black, showing an underwriting profit for H1 2022 (as shown in Figure 2 below).

Figure 1: **Lloyd's Full Year Casualty Sector Results, 2017-2021**

	Gross written premium £m	Accident year ratio %	Prior year movement %	Combined ratio %	Underwriting result £m
2017	8,464	103.7	(0.6)	103.1	(189)
2018	9,094	103.9	(1.0)	102.9	(183)
2019	9,459	103.8	1.9	105.7	(390)
2020	9,067	105.2	5.1	110.3	(688)
2021	**10,360**	**95.6**	**4.7**	**100.3**	**(17)**

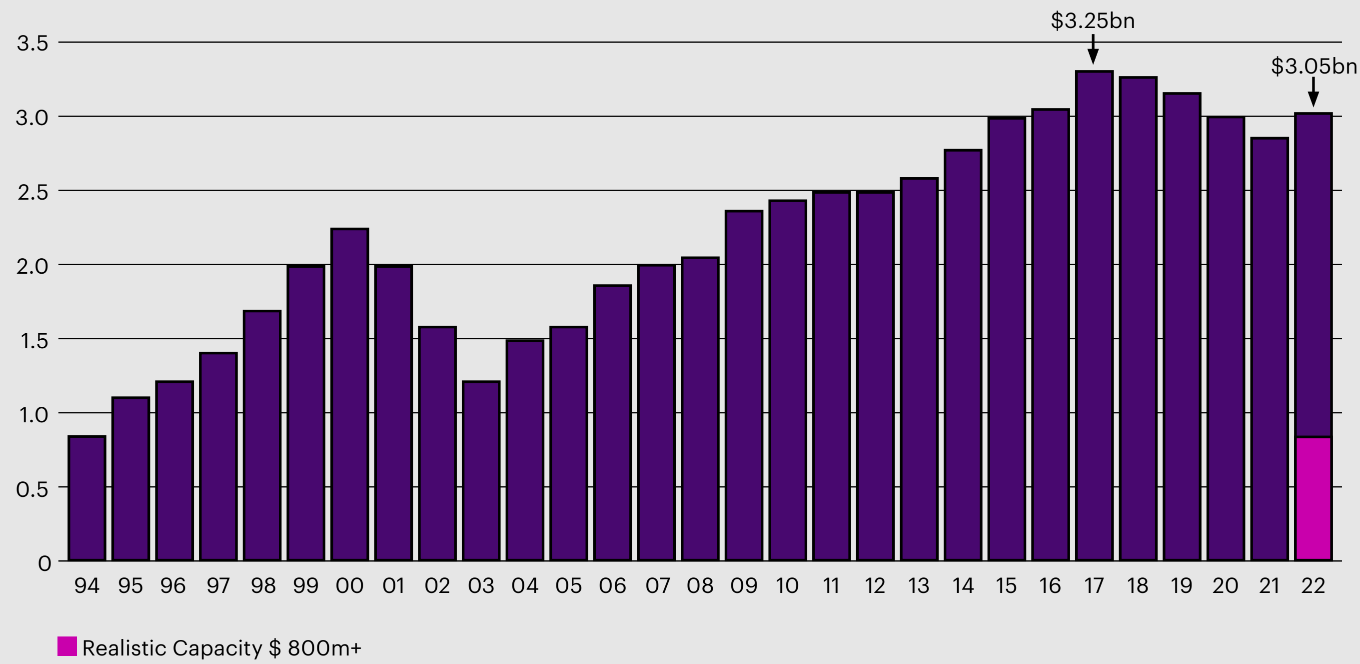
Source: https://assets.lloyds.com/media/81b1778b-e821-4424-b21e-26e0bf095f10/Lloyds_AR21_220323.pdf

Figure 2: **Lloyd's Casualty Sector Results, 2022 (6 months ended at 30 June 2022)**

Six months ended 30 June 2022	Gross written premium £m	Accident year ratio %	Prior year movement %	Combined ratio %	Underwriting result £m
Casualty	6,030	3,507	(1,670)	(1,412)	425

Source: https://assets.lloyds.com/media/81b1778b-e821-4424-b21e-26e0bf095f10/Lloyds_AR21_220323.pdf

Figure 3: **Estimated Global Liability Capacity 2022 (US$ bn)**



Source: WTW

This trend is also reflected more broadly across the International Liability company market.

This is positive news for buyers, with a greater degree of stability and some new capacity returning to the Liability market. As a result, we have seen a measured increase in both total theoretical capacity (US$3.05 billion) and actual working capacity (US$800 million) as illustrated in Figure 3 above.

Underlying concerns still remain

However, it should be noted that the drivers that have caused the previous profitability issues remain, most notably the inexorable increase in both the frequency of litigation and the average increase in court awards.

Overlaying these continuing social inflationary trends has been the more recent, and equally pronounced, issue of Loss Cost inflation. Indeed, all the key elements of Liability exposure, including Physical Damage, Bodily Injury, Pollution, Employers Liability/Workers Compensation and Auto Liability, have been impacted by inflationary pressures. As an example, one insurer cited that their average claim for a medium-sized pollution loss has risen from US$20 million to US$30 million, fuelled in part by increased legal fees and the increasing cost per hour rate of technical and remediation specialists.

From a Physical Damage perspective, average rebuild costs have increased substantially, following the significant increase in construction materials. Average Bodily Injury awards have been impacted by increased health care costs and wage inflation in many regions has increased the compensation costs for loss of salary.

In response to the above, many insurers are applying a base inflation loading to their renewals (separate to any exposure base change calculation) of 7% to 7.5%.

Leveraging effect of inflation

Interestingly, for major/catastrophe risks the dynamic of Loss Cost inflation can have different impacts across a Liability programme; for example, with the average size of large losses increasing, a major explosion and pollution event that previously cost US$150 million may now cost in the region of US$250 million. While a primary layer will always be exposed to such an event, the upper layers of a programme are becoming increasingly more exposed. The Loss Cost impact of inflation can therefore have a disproportionate impact on the higher layers of cover; as a result, inflationary factored pricing pressure can vary, depending upon the limit purchased and the layers involved.

Pricing conditions

The welcome arrival of some new capacity has increased competition and choice, which has been most pronounced for buyers of smaller indemnity limits. Buyers with larger limits still require the agreement and participation of most of the market; however, the increase in capacity has at least enabled them to fill self-insured gaps, reinstate limits that were by necessity previously reduced and deselect any opportunistic insurers.

As a result, the level of price increase volatility has reduced, and the double-digit rate increases of the past two years, driven by the previous capacity constraints and market pressure to achieve price correction, have moderated.

However, Social and Loss Cost inflation both remain continuing concerns and are factored into renewal pricing. Underwriters also continue to be discriminating as to where and whom they allocate their capacity, particularly from a risk quality, profitability and environmental perspective.

The net result is that average rate increases are currently in the high single digit region, although this is a broad average and will vary dependent upon geographic territory, local market considerations and insured sector. In particular, Midstream/Pipeline programmes, those with heavy US exposures and those with Wildfire Liability exposure are experiencing more substantial increases.

Clearly the supply, demand and inflationary trends will vary by region. Some domestic markets (for example in Continental Europe, Scandinavia and Australia) are emerging from the excesses of the harsh market environment faster, so the renewal experience of local and regional buyers with smaller limits will vary. However, programmes requiring larger capacity from the International/Global market are still governed by the broader pricing trends as described above.

Coverage and constraints

Aside from pricing considerations, insurers also remain focused on coverage and are watchful of emerging risks. In general, programmes are renewing with the same breadth of coverage as expiring, but one exception to this has been the increasing awareness of and reaction to liability arising from PFAS (Perfluoroalkyl and Polyfluoroalkyl Substances) - the "forever chemical".

PFAS exclusions that were initially only imposed by one lead Energy Liability market are now commonly applied. While many buyers are not involved with them in any production process, the use of PFAS in fire retardant foam remains a wider issue. Many buyers are switching to PFAS free foam retardant; those that have not or are involved with PFAS in the production process are subject to a PFAS exclusion clause.

Other exclusions seen more specifically in the Chemicals sector relate to Paraquat (N′-dimethyl-4,4′-bipyridinium dichloride) and Glyphosate (N-(phosphonomethyl)glycine).

Climate of change

The ever-increasing focus on Sustainability and ESG considerations pose both challenges and opportunities for Liability insurers and buyers alike.

Much debate is ongoing about the future viability of insurance coverage for the less sustainable Natural

> **"The ever-increasing focus on Sustainability and ESG considerations pose both challenges and opportunities for Liability insurers and buyers alike."**

Resources activities; capacity for Thermal Coal and

Resources activities; capacity for Thermal Coal and Oil Sands business is increasingly constrained as insurers respond to pressure from activist investors to decarbonise their portfolios. Mention is made elsewhere in this publication of recent market developments relating to oil and gas business and whether the limited capacity withdrawals by Munich Re and Chaucer Syndicates (on the Property rather than the Liability side) signal a trend.

What is certain is that insurers are motivated to favour buyers that have a strong climate transition plan and strong ESG credentials; insurers and brokers are also developing schemes to cover more appropriately the emerging liability exposures from such activities as Hydrogen, Battery Storage and Carbon Capture. A particular issue that is now recognised in the market is the need to suitably address liability for loss of Carbon Credits, particularly in the field of Carbon Capture and Storage, and at least one lead insurer is making good progress in developing a suitable solution.

The Climate Transition Pathways initiative referenced earlier in this publication is a further good example of product innovation. While this initiative is currently geared towards providing Property insurance capacity for those insureds transitioning but do not yet meet more narrow sustainability criteria, there may be increasing demand and opportunity for a similar Liability approach.

While solutions are emerging for buyers in respect of climate and sustainability issues, insurers are also seeking to clarify what is and is not covered in terms of Climate Change Liability, and so we have seen a plethora of Climate Liability exclusion clauses issued by various insurers. While it is commonly accepted that it is not Liability insurers' intention to indemnify gradually occurring events leading to climate change, clarification clauses (if not carefully worded) can end up excluding more than originally intended (for example, a Greenhouse Gas Limitation inadvertently excluding a methane gas explosion). While the increasingly broad application of Climate Change clauses / "clarificatory language" is a realistic inevitability, in is incumbent upon brokers to ensure there is consistency and clarity and such clauses should not be deemed to exclude anything that would otherwise be reasonably expected to be covered.

Out in the cold: Arctic Drilling

One specific environmentally related restriction applied by insurers is Arctic Drilling and related activities; this restriction is not new and applies equally across all insurance classes. However, the challenge lies in the varying definitions of Arctic Circle, leading to some anomalies in the application by different insurers. In any event, information in this regard is required early, so that insurers can seek approval where necessary from their respective Arctic Drilling committees. The same early information issue also applies to Sanctions, where again insurers require specific sign-off from their internal panels prior to binding.

What of the future?

Barring unforeseen events, we do not predict any dramatic changes to existing conditions. It is possible that we may see some further moderation in rate increases throughout 2023; however, while insurers continue to factor inflationary considerations into their pricing, some level of price increase is expected to continue to be the norm. Any continuing influx of capacity would clearly be welcome by further increasing increase choice and enabling buyers to build back programme limits to the levels they enjoyed a few years ago. The Liability sector has not recently been impacted by market-changing Cat Liability loss events; however, the increasing size and frequency of smaller claims (from General Liability, Employers Liability and Motor) will continue to put pressure on deductible and self-insured retention levels.

Conclusion: a turning of the corner, but ESG issues remain

Following two years of compound rating increases and capacity constraints, the International Liability market has finally and discernibly turned a corner, with rate rises moderating and capacity returning - heartening news for all buyers. However, market discipline remains strong and inflationary considerations are a key driver behind the more moderate but consistently applied high single digit rate increases that are commonly prevailing. More predictability and stability have returned to the market and knee jerk rate corrections and sudden capacity withdrawals of the recent past happily no longer apply.

However, commentators are watching the insurance market appetite closely and in particular, its commitment to those buyers with a heavier, less ecologically sustainable risk profile. While Coal and Oil Sands programmes remain an increasing challenge, now the focus is turning to Oil & Gas. Buyers who have the ability to clearly demonstrate and evidence their sustainability credentials, and/or their road map to a lower carbon intensive energy production mix, will therefore have the most success in maximising the available capacity and optimising the price of their programme.

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North American Energy Casualty: light at the end of the tunnel

Introduction: looking back on the hard market

The North American Energy Casualty market experienced a dramatic upswing in pricing and a significant reduction in capacity during the second half of 2019, with nearly all sub-segments of the energy industry experienced double-digit rate increases on their Excess Liability programs. The hardened market was a result of multiple underlying issues including:

- increased loss severity in Auto and General Liability claims stemming from social inflation
- an increase in "nuclear" verdicts
- a troubling trend of a well-financed plaintiff's bar targeting corporations, as larger losses became "the new normal"

The most impacted line was Lead Umbrella capacity, as insurers' prominent London underwriting desks at Aspen and Liberty were essentially put into run-off while the remaining US-based Lead Umbrella insurers reduced their offered capacity from US$25 million to more manageable offerings of US$5–15 million. Compounding matters for insurers, these reductions in market capacity also came with large rate increases to offset overall market losses. Lead umbrella insurers also focused their attention on underlying attachment levels, often forcing clients to purchase higher Primary Liability limits or "auto-buffer" layers in order offer protection from the increase in claims severity. These higher attachments seldom came with any rate or premium disposition.

The exception to this reduction in capacity and primary limit adjustment was the Upstream Operator portfolio. Ample Lead Umbrella limits were still available, and capacity remained stable, resulting in moderate price increases for this sector in comparison to the rest of the Energy Liability market.

Capacity challenges

Buyers that purchased large Excess Liability coverage limit "towers" (US$400 million+) also experienced challenges, as available global capacity in the US, London and Bermuda markets was significantly reduced, stifling potential market competition. This was especially true in Bermuda, where insurers who

were offering US$50-100 million in capacity decided to dramatically decrease the available limits for Energy buyers. Additionally, certain US insurers, many of whom historically participated in the first US$100 million of Energy Excess Liability programs, reduced their available capacity from US$25 million to US$15 million for most classes of Energy business. As a result, many buyers found themselves unable to purchase historically satisfactory limits, while in scenarios where capacity was indeed still available, others were unable to purchase such limits within the scope of their annual insurance budgets.

New capacity in 2021

The trend of dramatic double-digit rate increases continued until mid-2021, when an influx of capacity in the United States, London and Bermuda entered the market. As a result, competition for capacity increased and rate increases began to taper downwards, as insurers quickly realized that it would be difficult to achieve the lofty budgets set for the fiscal year. Successive rate increases had also established healthier premium bases for underwriters and so pricing volatility began to decelerate, with more manageable rate increases during renewal negotiations.

2022: further market easing

As a result, renewals through Q3 2022 have produced on average single-digit rate increases for most classes of business, as the period of drastic rate adjustments appears to be in the rear-view mirror. Most insurers have achieved rate adequacy that may support the increased underlying claims severity stemming from North American Energy risks.

> **Renewals through Q3 2022 have produced on average single-digit rate increases for most classes of business, as the period of drastic rate adjustments appears to be in the rear-view mirror.**

Market outlook - Primary Liability

Due to a combination of manageable limits (which have helped to reduce the impact of increased claims severity), an increased focus on risk-transfer attachments and an abundance of available capacity, the Primary Liability marketplace (Workers Compensation, General Liability, Auto Liability) finds itself in a stable position from both a pricing and capacity standpoint. Most Primary Liability insurers are currently attempting to grow their books of business via account retention and the pursuit of new business to attain their budgetary goals, which is helping to prevent an environment suitable for larger rate increases; this has naturally benefitted buyers in their marketing efforts.

Auto Liability

Incumbent insurers are still seeking mid-to high single-digit rate increases on their Auto Liability renewals, as the increase in claims severity and unaggregated limit structures are still putting pressure on the profitability of their portfolios. Additionally, while the 2021 year appears to have trended in a more positive direction for overall profitability in this line of business with a 101.3% combined loss ratio, the court systems are now working through the backlog of cases caused by pandemic-related staffing shortages; as a result, many 2020/2021 cases and associated settlements are now producing losses into the market. There has also been an uptick in Hired Auto claims in which the failure of the contracted insurer to maintain or certify sufficient insurance limits has resulted in large judgements against the hiring company and their auto insurance program. Due to the continued claims severity, we expect rate increases in the high-single digits to continue into 2023.

General Liability

Incumbent insurers are currently seeking mid-range single digit rate increases for General Liability renewals for historically profitable business. There has been an uptick in frequency and severity in “action-over” claims in the oilfield service sector and careful attention is being paid to this class of business by incumbent markets. The Upstream Operator sector has also seen an uptick in pollution claims, which is also causing apprehension in the established incumbent General Liability markets. While rate increases have remained minimal, this line of business bears watching as we move into 2023, as claim frequency and severity is trending in an upward direction in most sectors.

Workers' Compensation

Workers' Compensation has remained a consistently profitable line of business for Primary Liability insurers and has subsequently remained stable from a rating standpoint, with flat renewals and potentially small rate decreases offered via incumbent insurers.

While many insurers were voicing concerns about the potential for pandemic-related claims to impact their Workers' Compensation books, these have not come to meaningful fruition and so these concerns seem to have abated. Additionally, the impact of inflation on payrolls should assist in renewal negotiations, as payroll exposures will have increased without the addition of headcount, which should also offset the need for rate increases.

We expect the 2023 year to mirror the current environment, with ample capacity remaining and insurers offering flat renewals and even small decreases on profitable programs.

Market outlook - Excess Liability

After two prior years of contraction, 2021 saw a welcomed influx of Energy Excess Liability capacity stemming from the US, London and Bermuda markets. While this was indeed a positive sign, this has not completely offset the capacity that had exited this space in the prior two years. However, it has allowed many buyers to purchase higher limits on their Excess Liability towers and has lessened the volatility in renewal pricing.

Upstream

After a long period of relative prosperity, the Upstream Operator Excess Liability segment has experienced an uptick in claims, stemming from both Pollution and Auto Liability losses. As a result, the Lead Umbrella space has hardened considerably for a few of the insurers responsible for paying these claims; however, Lead Umbrella capacity has remained stable, and most insurers continue to package the General Liability and Umbrella Liability together. Excess Liability capacity also remains stable for this class of business and as a result most buyers are not having issues purchasing their desired limits within their budgets. We expect 2023 to mirror the current 2022 pricing environment, with Excess Liability insurers requesting single digit rate increases and capacity remaining relatively stable.

Oilfield Services

The Oilfield Services segment has also experienced an uptick in General Liability claims due to an increase in activity in the sector. In a similar manner to Auto Liability claims, "Action over" claims appear to be trending higher from a severity standpoint and large auto fleets are also seeing an uptick in both frequency and severity. However, despite these underlying issues capacity remains stable, and insurers are aggressively targeting this class of business when programs are being marketed. Incumbent markets are seeking single digit rate increases and we expect this to continue into 2023.

Midstream & Downstream

The Midstream and Downstream segments have both experienced a few significantly severe losses in 2022; however, despite this capacity remains stable for Downstream and has increased for Midstream companies during the last 12 months, with risk-transfer attachment levels remaining consistent year-over-year. There has been a slight uptick in capacity for middle-market Midstream business as well via the US market. Despite a few large losses experienced by the sector this year, the market continues to offer mid to high-single digit rate increases and we expect this to continue into 2023.

Market summary

Primary Liability capacity remains at record-levels and insurers are continuously looking to expand their books of business. Buyers with clean loss records are seeing very favorable results when marketing efforts are conducted, and favorable early renewal negotiations can be agreed with incumbent markets. As a result, outside of Auto Liability, we do not foresee the market shifting in an upwards direction and should trend forward in the same manner as 2022.

Excess Liability capacity has increased and while there are still underlying concerns about loss severity, the pricing volatility of the previous few years has subsided and we expect pricing to continue in the same manner as 2022, with most buyers experiencing single digit rate increases.

Market concerns

Claims trends

While North American Energy Excess Liability pricing appears to have plateaued to an acceptable level for insurers and capacity remains in a stable position, the underlying issues that were a direct cause of the hard market in 2020 and 2021 have not abated.

The perceived anti-corporate sentiment of juries over the last few years remains a prevalent concern for insurers and the normalization of larger awards and settlements bears monitoring. Desensitized jury pools and a highly organized plaintiffs' bar are impacting both jury awards and settlement amounts.

Large jury verdicts for Auto Liability continue to put pressure on Excess Liability pricing and without the intervention of statutory laws to limit future liability, we expect that this trend will continue.

Overall loss inflation trends are also continuing to trend upwards each year, oftentimes still outpacing the overall increases in Excess Liability rating.

Continued underwriting focus on fleet safety programs

As a result of the increase in Auto Liability settlements, insurers are paying closer attention to buyers' fleet safety programs. It is strongly recommended that buyers provide details of their auto safety programs in submissions and renewal presentations to differentiate themselves from their peer companies; they should also continue to focus on driver criteria improvement and consistency in applying standards for company vehicle use and polices. Driver training, consistent MVR reviews, telemetric devices in vehicles as well as in-cabin cameras in heavy tractors can assist in differentiating risks for both primary Auto and, more importantly, Excess Liability markets. However, if buyers are not actively enforcing in-force company fleet safety procedures, plaintiffs' counsel have argued that lack of enforcement can increase the company's negligence in a lawsuit.

"Overall loss inflation trends are also continuing to trend upwards each year, oftentimes still outpacing the overall increases in Excess Liability rating."

Focus on ESG

Much like the commercial financing sector, insurers are increasingly requesting detailed information concerning buyers' ESG initiatives and policies. While this has been a more prevalent concern for the European and Bermuda markets in recent years, we are beginning to see US insurers also request additional information about corporate ESG policies. We recommend buyers continue to educate and update all Liability insurers on an annual basis about continued ESG initiatives, as market focus continues to increase each year.

Cyber

Due to headlines of a breach in the Midstream sector, insurers are also paying closer attention to buyers' cyber practices and procedures. The London market has attempted to narrow coverage for Bodily Injury and Property Damage stemming from a malicious cyber-attack and we are seeing an increased push by other insurers to draft their own limiting language. We recommend that buyers, especially from the Midstream and Downstream sectors, educate their insurers and their management about the protocols and measures that have been put into place to protect their SCADA systems from outside cyber-attacks.

PFAS

Much like the environmental marketplace, as in the International Liability market many Excess Liability insurers have begun to focus further attention to PFAS (Perfluoroalkyl and Polyfluoroalkyl Substances), also known as “forever chemicals”. PFAS exclusions have become more prevalent in the London Excess Liability market and are beginning to appear on both US and Bermuda policies. While many companies do not have any PFAS exposure, insurers have been focusing their attention on fire suppression methods and associated chemical use. Buyers should expect inquiries into PFAS exposure as they head into renewals, especially those with terminal, plant or large fixed-asset exposures.

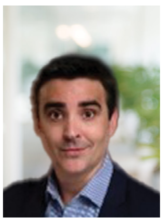
Climate change

Certain insurers within the Bermuda market have begun asking to modify policies with Climate Change exclusions on new business as well as on renewal business if the buyer has been named in a lawsuit. London insurers have also begun to pay further attention to any potential Climate Change lawsuits and have begun to push for exclusions on certain renewal policies. This topic is still being debated amongst insurers as certain insurers feel that the application of an exclusion would confirm that coverage indeed existed on prior policies.

Inflation

Inflation has been a headline throughout 2022, as governments continue to implement inflation-fighting interest rate increases. We expect insurers will remain focused on three key areas of inflation: claim cost inflation, wage inflation and interest rates.

The first two items provide negative headwinds for insurers, while the third potentially offsets these as insurers investment performance can generate higher returns which can offset the margin pressure created by both wage and claim cost inflation. Buyers should proactively address this by outlining and discussing price versus volume growth with their insurers during the renewal process.



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