

Energy Market Review Update

October 2021

Better news for buyers - but ESG issues beginning to take centre stage





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Market Capacity Figures

The figures quoted in this update 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 Willis Towers Watson.

Willis Towers Watson Energy Loss Database

All loss figures quoted 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
PMD	Performance Management Directorate



Introduction

Welcome to our Energy Market Review Update for October 2021. Nothing ever seems to stand still in the new era that we all now live in; as many major economies begin to recover from the ordeal of COVID-19 related lockdowns, so fresh challenges make their way to centre stage. Without question, one of these will be the need for fossil fuel companies to continue to access capital in the years ahead, as the energy transition begins to gather pace and Environmental, Social and Governance (ESG) issues rise to the forefront of minds in the risk management, risk intermediary and insurer communities.

At Willis Towers Watson, we strongly believe that an accreditation model is an appropriate and fair way forward for natural resources companies to continue to access optimum levels of insurance capacity from the market in the future. That's why we have recently launched Climate Transition Pathways (CTP), an accreditation framework within which we are building an insurance standard to address the need for a consistent way of identifying and supporting organisations committed to low-carbon transition. With CTP, insurance can contribute to climate transition and be recognised as a force for good. So in this update we have included a feature on CTP written by two of our experts: Liz Lister who is Global Head of Innovation and Sustainability at Natural Resources and Tony Rooke, who is Willis Towers Watson's Director of Climate Transition Risk.

Meanwhile conditions in the global Energy insurance markets are no longer quite as grim from a buyer perspective as they were 12 months ago. While it's still true to say that this remains a hardening market, at least the actual rate of hardening has now eased in all three of our major markets. In the past, the improved loss records in both the Upstream and Downstream markets might well mean that the drive for premium income and market

share would outweigh any determination to maintain the hardening momentum. However, much as we would like to announce the beginnings of an actual market softening, the impact of 2021's major natural catastrophe losses on the overall Property & Casualty portfolio and the degree of management scrutiny on individual insurer portfolios has meant that, for the time being, rating increases generally still remain the norm.

However, in the long-term it is clear that risk managers in the fossil fuel industries are going to have to focus more on their ESG profiles than the actual price of their product. Indeed, as we recently pointed out in our article "Climate risk and the energy transition: a wake-up call for natural resources risk managers?"¹ buyers will have to come to terms with a renewed focus on ESG issues from the insurance market as 2022 approaches. At the moment, insurers are adopting a variety of positions on ESG so there is little by way of market consistency on this issue. Going forward, it will therefore be up to us as risk intermediaries to guide our clients through what is going to become an increasingly complicated market environment.



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¹ <https://www.willistowerswatson.com/en-GB/Insights/2021/10/climate-risk-and-the-energy-transition>





Accreditation: the key to unlocking future insurance capital?

Introduction: the capital access challenge ahead for the energy industry

Insurers and financial institutions are feeling increasing pressure from all sides to focus on their own Net-Zero commitments and on the role that they must play as stewards of the climate transition. This shift in focus is due to pressure from regulators, investors and activists, and could significantly impact energy companies' ability to access insurance capacity and capital in the future. So if they can mitigate this risk effectively, risk managers will have an important part to play in driving your company's survival strategy.

Net-Zero initiatives

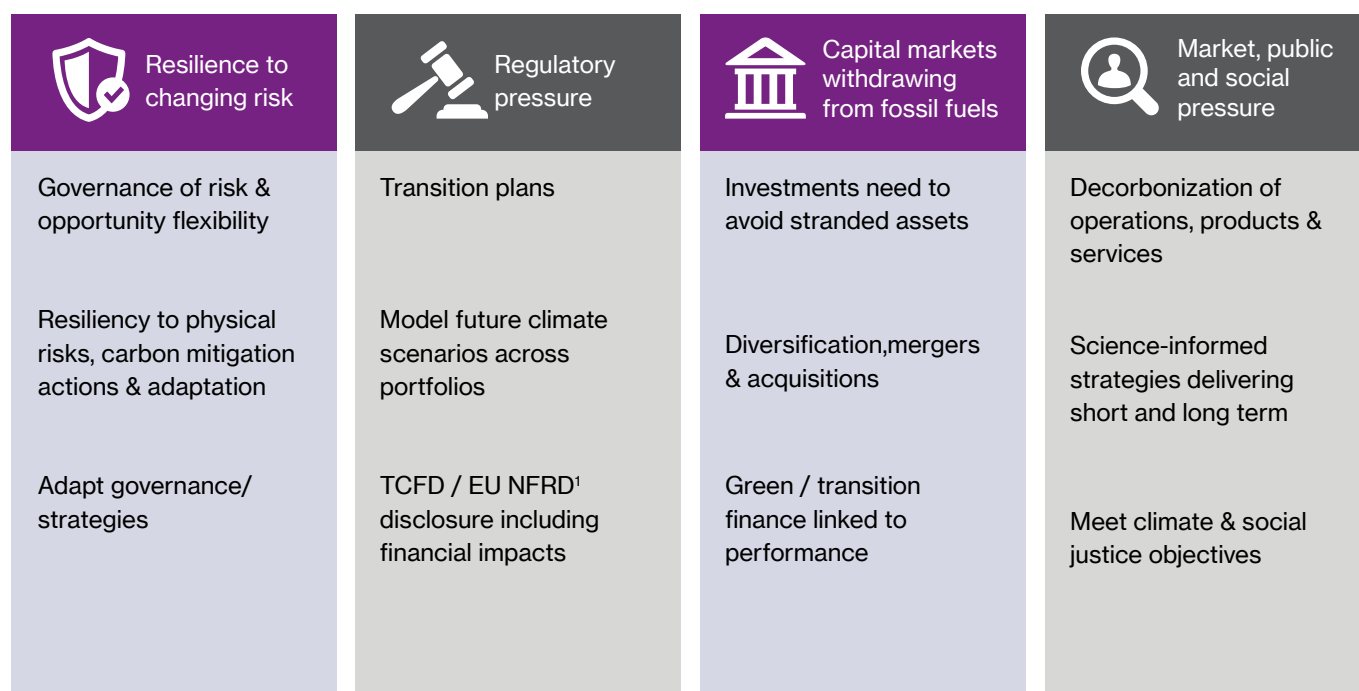
We are now seeing a wide number of Net-Zero initiatives emerging across the financial services industries, including Bankers for Net-Zero, Net-Zero Bankers Alliance, Lloyd's Sustainable Markets Initiative and, in July this year, the Net-Zero Insurance Alliance, which has been established by eight European insurers.

Fig 1: Summary of Net-Zero initiatives, October 2021

Banking and debt market	Insurance	Equity	Financial system climate resilience
Bankers for Net Zero	Net Zero Insurance Alliance	Climate Action 100+	Coalition for Climate Resilient Investment (CCRI)
Climate Transition Bonds	Sustainable Markets Initiative	Net Zero Asset Managers Alliance	Network for Greening Financial Systems (NGFS)
Climate Transition Finance Issuers		Net Zero Asset Owners Alliance	Task Force on Climate-Related Disclosures (TCFD)
Net Zero Banking Alliance		Say on Climate	Race to Resilience
Climate Transition Pathways			
Science-Based Targets Initiative			
EU Sustainable Finance Taxonomy (EU SFT)			
Glasgow Financial Alliance for Net Zero (GFANZ)			

Source: Willis Towers Watson

Fig 2: climate transition impact on risk management



Source: Willis Towers Watson

Most insurers and financial institutions (FIs) have already reviewed their operational and investor impact and are now turning their focus on the carbon exposure that sits within their underwriting and lending portfolios. Now they must decide which types of organisations they should be supporting going forward, to enable them not only to achieve their Net-Zero commitments but also to protect them from reputational damage.

Momentum is building

The direction of travel is becoming increasingly clear; over 100 FIs have already divested from coal², and increasing numbers of insurers are committing to withdrawing from insuring fossil fuel companies. In the 2020 *Insure Our Future* report, six new insurers have chosen to end or limit their coal insurance since 2019, bringing the total number to 23. The report also states that at least 65 insurance companies divested from coal last year – almost double the number for 2019³. We have also seen stances taken against Arctic drilling and Oil Sands operations.

Meanwhile, methane is also in the spotlight. The IPCC's 2021 climate science report clearly stated that there should be clear targets to reduce methane because of the high global warming impact⁴.

How will the climate transition impact your management of risk?

Risk managers have a key part to play to navigate the challenges and support organisational strategic planning. They need to quantify and create mitigation plans for climate risks, be they physical, liability or transition risks, and to ensure that their company is well-positioned to access insurance capacity and capital in the future.

In responding to these challenges, Willis Towers Watson recognises the need for innovative solutions to support organisations through the energy transition and, specifically, support the capacity and capital challenge.

¹ Non-Financial Reporting Directive

² <https://ieefa.org/finance-exiting-coal/>

³ <https://static1.squarespace.com/static/5b7c9307f79392b49031d551/t/5fc6e94defc65c5b7a3437fa/1606871389086/2020+Insurance+Scorecard.pdf>

⁴ <https://www.climatechangenews.com/2021/08/09/five-takeaways-ipccs-2021-climate-science-report/>

Unlocking access to insurance capacity and capital

In May this year, Willis Towers Watson launched **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 essence, CTP accredits 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.

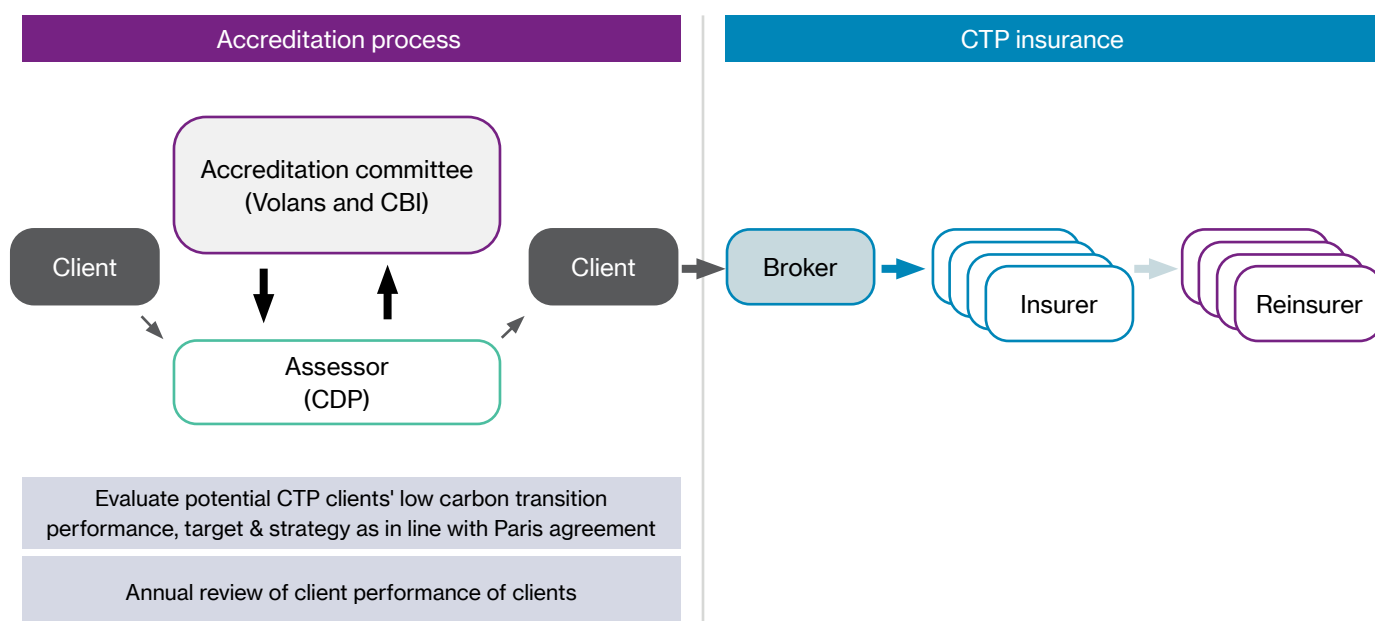
Sustainability consultants Volans and the Climate Bonds Initiative sit on the accreditation committee, and act as the independent assessors. As CTP progresses, the goal will be for Willis Towers Watson to step back and transfer the committee into a “not for profit” organisation as it becomes a self-sufficient industry standard.

We have recently announced Liberty Specialty Markets as the first insurer to support the CTP sector solution for electric utilities and oil and gas, and we will be announcing more supporting insurers soon. As CTP develops, it will also expand to support multiple high-carbon emitting sectors. It is underpinned by an accreditation model with principles consistent with the transition goals of the Paris Agreement and to a number of Net-Zero initiatives. It recognises evolving climate science and policy, the Science Based Targets Initiative, the EU Sustainable finance taxonomy and TCFD reporting.

How does it work?

The accreditation process is run independently of, and as a pre-cursor to, the broking transaction. It effectively acts as a “climate transition passport” for insurers to have confidence that an organisation’s transition plan and performance has been assessed rigorously in relation to the Paris Agreement. It allows insurers and financial institutions to have an engagement strategy with high carbon industries instead of an exclusion strategy.

Fig 3: the accreditation process and CTP



Source: Climate Transition Pathways

Fig 4: principles of accreditation

Transition plans align to Paris agreement	#	Principle that insured transition plan needs to align with	Reasoning / Basis	Mechanism	Type
	1	Target: Client needs to align with net-zero carbon by 2050 and Paris aligned short & medium term targets	Ensuring short, medium and long term targets align with the Paris agreement.	Target should be approved or consistent Science Based Targets Initiative and the Sector Decarbonisation Approach: i.e. based on absolute emissions budget	Foundation of transition
	2	Pathway: Client transition pathway needs to be aligned by science, not exceeding company specific carbon budgets	Avoiding locking-in of fossil fuel assets that may become stranded assets across operations & value chain		Foundation of transition
	3	Goal: Transition goals are credible and pathways don't count offsets as mean to transition		EU Sustainable Finance Taxonomy will be applied, where mitigation efforts of GhG ⁵ emissions meet requirements of "Substantial contribution" under EU Sustainable Finance Taxonomy	Pathway principle
	4	Technology: Include an assessment of current and expected technologies which can be used to determine a decarbonization pathway			Pathway principle
	5	Ongoing: Be backed by operating metrics rather than a commitment or pledge.	Demonstrate achievement against Paris agreement goals and carbon budget	Ability to track performance against plan, demonstrating keeping within carbon budget. Disclose against TCFD and similar frameworks,	Progress

Source: Climate Transition Pathways

Principles of accreditation

The framework is built to recognise the evolving science and policy in the climate space, aligning to the Paris Agreement goals, the Science Based Targets Initiative and the EU Sustainable finance taxonomy. It also drives disclosure in line with the TCFD and is consistent with scenarios to keep warming below a target of 2.0°C above pre-industrial levels. The set of accreditation governance principles that ultimately set the standard for entry into CTP are shown in Figure 4 above.

Companies wanting accreditation will initially engage with CDP (a third-party assessor who are industry recognised and used by the World Benchmarking Alliance) and will undergo assessment in the form of a standard Assessment of low Carbon Transition (ACT). Once this assessment is complete, the outcome is used by the accreditation governance committee and mapped against the five key principles to decide if the transition plan is Paris-aligned in order to grant the CTP accreditation.

Giving you time to create a plan

Companies who do not have a robust, Paris-aligned transition plan in place will have the option to be granted access to CTP for the period of one year if they commit to the following transition commitments:

- One year to put in place a transition plan (or otherwise they will be ejected from the facility)
- The commitment needs to be signed off by the board with a delivery plan
- The transition plan also needs to be put to the shareholders/owners within two years
- The company must annually disclose emissions through TCFD disclosure (and similar frameworks)

CTP builds upon existing initiatives

Figures 5 and 6 overleaf show how CTP builds upon, and aligns with, finance initiatives across debt finance, equity, insurance and COP26.




⁵ Greenhouse Gas

Fig 5: how CTP aligns with existing initiatives

Debt finance for transition <ul style="list-style-type: none"> ▪ All 5 principles of the Climate Bonds Initiative / Credit Suisse principles on transition bonds ▪ All 4 key elements in the ICMA's Climate Transition Finance Handbook for issuers 	Climate Transition Pathways	Insurance <ul style="list-style-type: none"> ▪ UNEP-FI Principles of Sustainable Insurance ▪ Will work closely with the forthcoming Net Zero Insurance Alliance
Equity initiatives to promote transition <ul style="list-style-type: none"> ▪ Goals and targets of the UNEP-FI led Net Zero Asset Owners Alliance ▪ Commitments under the Net Zero Asset Managers Initiative ▪ "Say on climate" initiative 	COP26 Private Finance (Goals) <ul style="list-style-type: none"> ▪ Promote disclosure to TCFD ▪ Assess the resilience of companies to climate risks ▪ Assess the Credibility of net zero transition plans ▪ Encouraging new market structures and products 	Policy and climate science <ul style="list-style-type: none"> ▪ Delivering Paris-aligned outcomes ▪ Use of EU Sustainable Finance Taxonomy ▪ Science Based Targets Initiative

Source: Climate Transition Pathways

Fig 6: types of climate risk

Climate risk driver	 <p>Physical</p> <p>The immediate risk arising from weather-related events and slow onset climatic changes</p>	 <p>Transition</p> <p>Financial risks arising from the transition to a lower-carbon economy</p>	 <p>Liability</p> <p>Risk of actions initiated by claimants who have suffered loss and damage arising from climate change</p>
Challenges	<p>Acute</p> <ul style="list-style-type: none"> ▪ Change in frequency and severity of weather events (Flooding, typhoons, wildfires) <p>Chronic</p> <ul style="list-style-type: none"> ▪ Sea level rise ▪ Rising temperatures 	<ul style="list-style-type: none"> ▪ Arising from changes in policy, technology, societal pressure and consumer preference ▪ Some sectors of the economy face big shifts in asset values or higher costs of doing business 	<ul style="list-style-type: none"> ▪ Active litigation ranges from individuals, corporates and class actions ▪ New area of law being developed and tested in different jurisdictions

Source: Willis Towers Watson

Conclusion: time to take the first steps?

The role of the Risk Manager will be pivotal in helping shape the strategy to navigate the energy transition, so understanding your climate risk drivers across the physical, transition and liability spheres (see Figure 6 above) and having robust plans in place will be key. So, we think Risk Managers need to start planning now for future changes to access to capacity and capital to ensure your organisation is well placed to be a winner during the energy transition.



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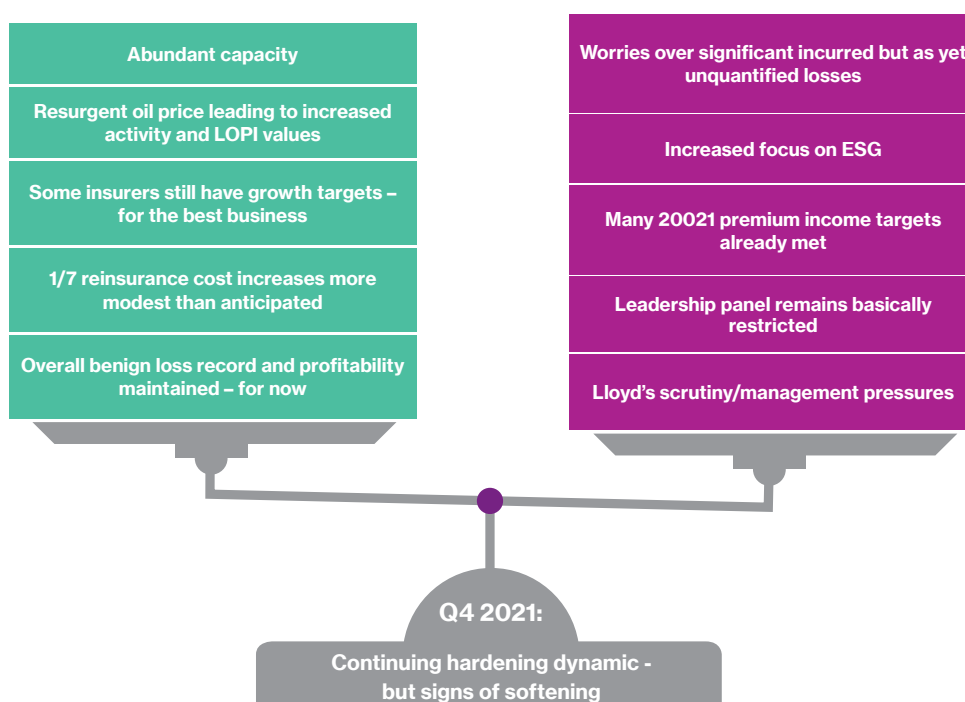


Upstream: a gentle easing, but some concerns on the horizon

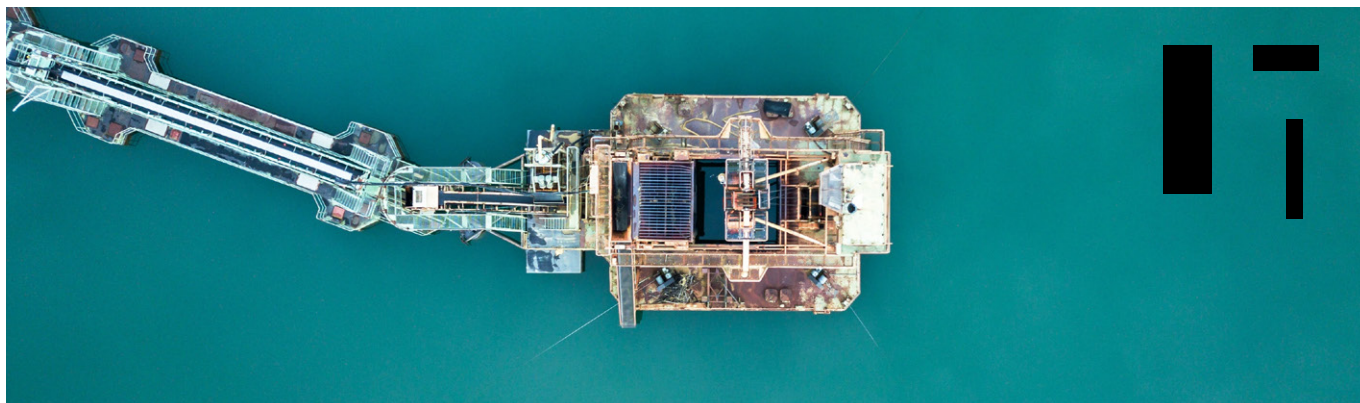
Slowly but surely, the hardening dynamic that has been so evident in the Upstream market for the last three years or so is beginning to loosen its grip. While overall market conditions continue to result in year-on-year price increases for the vast majority of buyers, we can now say that the rate of increases has certainly slowed still further since our April 2021 Energy Market Review as the positive factors, outlined in Figure 1 below, begin to increase in significance – if not sufficiently to alter the overall balance of power.

So, does this mean an eventual end to the current hard market? Can buyers expect prices to reduce in the future? Let's take a closer look at both the positive and negative factors currently in play to discern the overall direction of travel as the January 1 renewal season looms ever closer.

Fig 1: Slightly hardening - the Upstream underwriting environment, October 2020



Things have been looking up for Upstream insurers – but losses on the horizon are still fuelling insurer concerns



Positive factors

Capacity remains buoyant

One of the signs of a truly hard market is a contraction of supply; as we pointed out in our April Review¹, there is no sign at all of any contraction in market capacity. This has produced something of an artificial brake on the extent of the rating increases, as there have been no market withdrawals of any significance and maximum realistic capacity remains at US\$7 billion - exactly where it was in April.

Of course, simple capacity maximums do not in themselves tell the full story of the current market climate, as we shall demonstrate later. But it does mean that the market's appetite for the choicest business remains undimmed and that leading underwriters are not in a position to "name their price" - unless the programme concerned is truly distressed.

Resurgent oil prices increase premium flow

In our April 2021 Review we stated that the effect of COVID-19 on the global economy - and oil & gas prices in particular, due to lack of demand following various lockdowns - had led to Upstream premium income being generated by rate rises being cancelled out by a fall in E&P activity. Now as major global economies re-open, and oil prices having soared to US\$80 per barrel (it appears that some are even betting on US\$200 per barrel prices in the future²) - we expect a consequent increase in E&P operations and, critically, a significant rise in Loss of Production Income (LOPI) values declared to the market. This is particularly likely to impact the January 1 renewal season, where we expect major buyers to declare significantly increased values - and therefore offer the market more premium income.

Growth targets remain for some insurers

Despite the increase in oil prices, at the time of writing some insurers still seem to be chasing 2021 premium income targets set by their management earlier in the year. It may still be a hardening market, but it appears that some insurers have missed out on premium income opportunities that they thought might be presented to them earlier in the year and are now looking to augment their portfolio by competing more aggressively for new business. This dynamic is continuing to undermine the strength of resolve in the market to maintain the current rate of percentage rating rises.

July 1 reinsurance costs more modest than anticipated

On July 1, 2021, Willis Re published its "First View: Emerging Equilibrium" report, covering current market conditions within the reinsurance industry, including the changes in pricing levels and conditions experienced by Willis Re brokers and product experts³. Commenting specifically on the Marine Reinsurance market (which affects most Upstream energy portfolios) the report stated that:

"(Marine) Reinsurance market capacity continues to significantly exceed demand, encouraging Global and International cedants to explore new purchases to address continuing concerns around volatility. This is taking the form of both new pro-rata treaties and increased excess of loss protection. Reinsurance market pricing showed signs of suffering from the excess capacity, with the rate of increase slowing since 1 January."

This in turn has had a contributory effect of slowing down the rate of hardening in the Upstream market. Buoyed by more attractive reinsurance terms than might have been expected earlier in the year, some Upstream insurers may well have bought more cover than they had earlier expected to. This in turn has probably given them more confidence to increase their own line sizes and perhaps to consider writing more new business.

¹ <https://www.willistowerswatson.com/en-GB/Insights/2021/04/energy-market-review-2021>

² https://www.energyvoice.com/oilandgas/353502/oil-200-barrel/?mkt_tok=NzQyLUxaWS0yMzEAAAF_2WvIUzsw9sdHpt4fyl3rJWnTnwEUhGr5ld9VAXm0u1pGJzPjWPzwmZQ7yFvpTB26Ci665XUSi8j4ZutLNOptGw_0IMt7nK9LQ880OPECasIV

³ <https://www.willistowerswatson.com/en-GB/Insights/2021/07/emerging-equilibrium-willis-re-1st-view>

Fig 2: Upstream losses excess of US\$1 million, 2021 (to date)

Type	Cause	Region	PD US\$	OEE US\$	BI US\$	Total US\$
Jackup	Leg punch through	Asia Pacific	135,200,000	0	0	135,200,000
Well	Blowout no fire	North America	0	70,000,000	0	70,000,000
FPSO	Unknown	Latin America	31,000,000	0	0	31,000,000
Well	Fire + explosion/VCE	North America	28,000,000	0	0	28,000,000
FPSO	Pipelaying/trenching	Europe	11,500,000	0	0	11,500,000
Well	Blowout no fire	North America	0	10,000,000	0	10,000,000
Pipeline	Misc	Asia Pacific	6,600,000	0	0	6,600,000
Platform	Faulty work/op error	Europe	4,800,000	0	0	4,800,000
Pipeline	Misc	South Asia	4,750,000	0	0	4,750,000
Tank farm/terminal	Lightning + fire	North America	4,150,000	0	0	4,150,000
Land rig	Mechanical failure	Middle East	3,600,000	0	0	3,600,000
Platform	Unknown	Asia Pacific	3,300,000	0	0	3,300,000
Well	Blowout no fire	Australasia	0	2,600,000	0	2,600,000
Tank farm/terminal	Mechanical failure	North America	2,500,000	0	0	2,500,000
Pipeline	Ice/snow/freeze	Europe	2,430,000	0	0	2,430,000
Land rig	Fire no explosion	Eurasia	1,890,000	0	0	1,890,000
Seismic	Misc	Asia Pacific	1,014,500	0	0	1,014,500
Equipment	Collision	Asia Pacific	1,000,000	0	0	1,000,000
SALM Buoy	Faulty work/op error	Middle East	1,000,000	0	0	1,000,000

2021 is looking good to date, but hurricane Ida losses are likely to impact the overall total

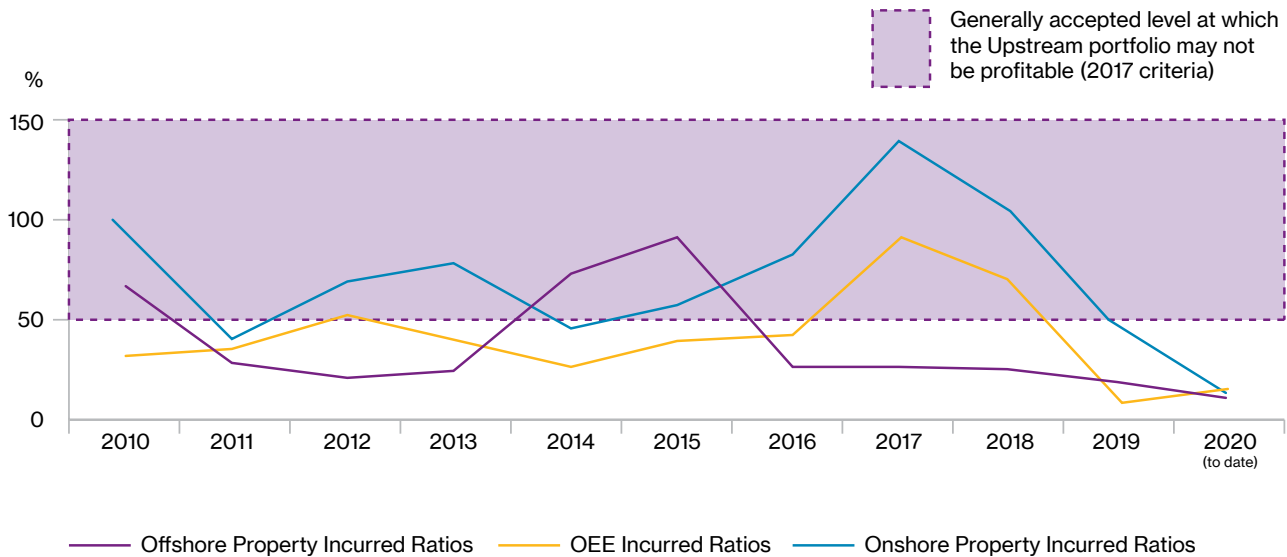
Source: WTW Energy Loss Database as of September 21, 2021 (figures include both insured and uninsured losses)

Benign loss record and profitability maintained - for now

As we have advised in previous Reviews, the Upstream loss record has generally been improving since 2015. To date in 2021, it seems as if that improvement is being maintained. At the time of writing, only one loss excess of US\$100 million has been reported to our database, and indeed only 19 losses in total (see Figure 2 above).



Fig 3: Upstream Market Profitability 2010 – 2020



2019 looks as if it will turn out to be profitable for Lloyd's Upstream portfolios - 2020 looks good for now, but is likely to deteriorate

Source: Lloyd's Market Association Quarterly Loss Report Q1 2021. "Offshore Property" – combination of ET/EC/EM/EN Audit Codes "OEE" – combination of EW, EY and EZ Audit Codes. "Onshore Property" – EF audit code.

Moreover, the latest Incurred Ratio (net premiums versus paid and outstanding claims) statistics from Lloyd's (Figure 3 above) continues to suggest ratios below 50% for the various Upstream audit codes for the last two years, providing perhaps another pointer to why the hardening dynamic in this market is starting to ease. It's also worth noting that the Offshore Property ratios have been below 50% since 2015, demonstrating why there is still a healthy market appetite for this class of business.

Negative factors

Worries over unquantified losses

Figure 4 overleaf shows overall Upstream losses excess of US\$1 million set against estimated global Upstream premium income over the last 20 years. Given that our database includes both insured and uninsured losses, it seems reasonable to suggest that where losses are roughly equal to, or below, premium income levels, the portfolio as a whole may be considered to be profitable. On the face of it, the purple bars for 2020 and 2021 look to be considerably less than our global premium estimates; however, there are grounds for assuming that there are plenty more losses to be recorded before the figures for both years are truly mature. For example:

- For 2020, the final adjusted Physical Damage (PD) and Business Interruption (BI) losses (both direct and contingent) from a serious fire and explosion at an LNG plant in Scandinavia that occurred last year have yet to be included in our database. We understand from our market intelligence that the total PD/BI loss from this explosion is very likely to exceed US\$1 billion; furthermore, not only is the contingent BI loss from several offshore facilities connected to this plant likely to be substantial, but also the actual PD coverage for

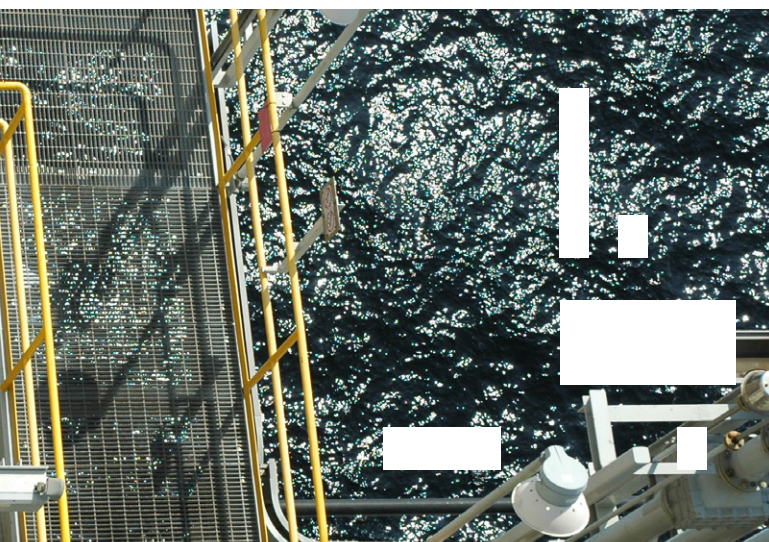
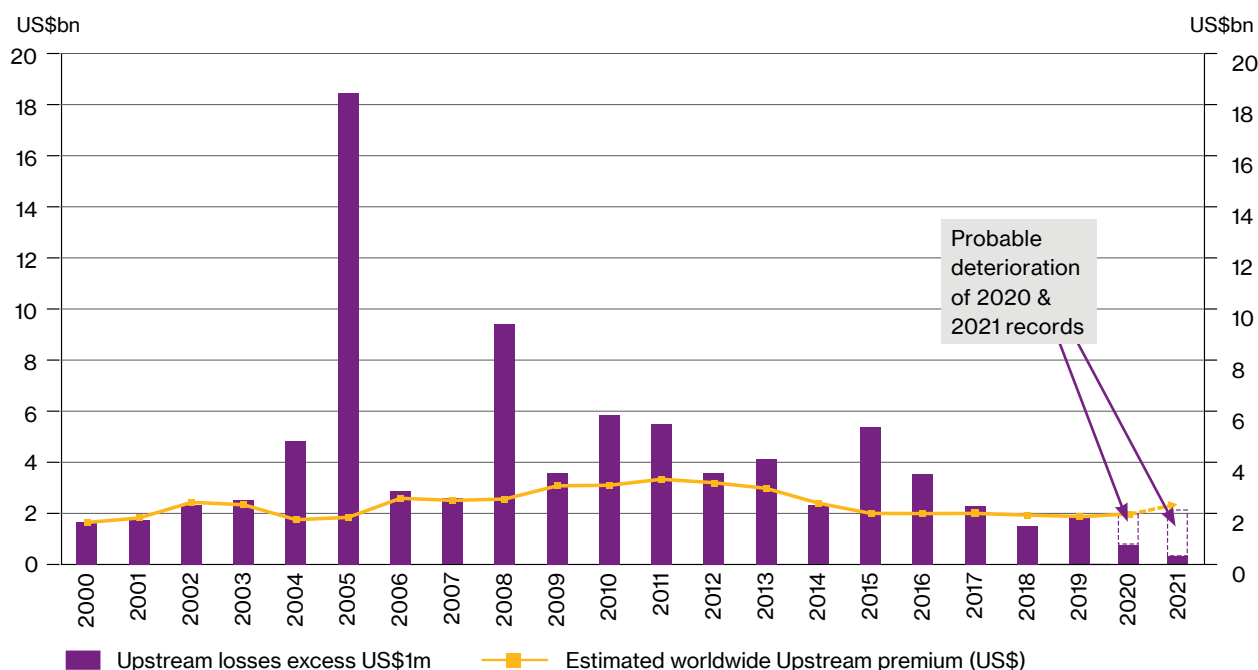


Fig 4: WELD Upstream Energy losses 2000–2021 (excess of US\$1m) versus estimated Upstream premium income



The 2020 Upstream loss record is likely to deteriorate further, and although 2021 looks promising to date, hurricane Ida losses may have to be factored in

Source: WTW/WTW Energy Loss Database as of September 21 2021 (figures include both insured and uninsured losses)

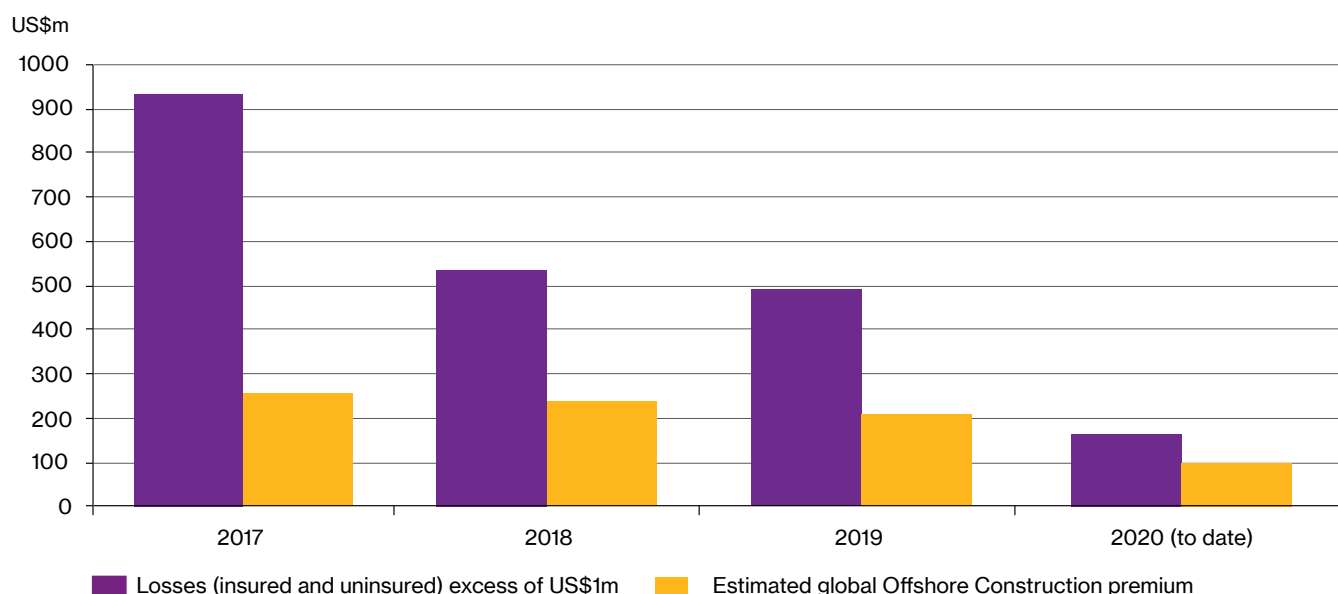
the LNG plant itself was also placed in the Upstream market, on account of being classified as Midstream business. It is therefore likely that a very significant part of the overall loss will be borne by the Upstream market. For this reason, we believe the final total for 2020 may well exceed US\$2 billion, and that is reflected in Figure 4 above.

- For 2021, none of the potential Upstream losses arising out of hurricane Ida have yet found their way onto our database, although we should point out that most market observers believe the bulk of the hurricane Ida damage from an energy perspective occurred onshore or in the marshland/bayous south of New Orleans. We should also bear in mind that the hurricane season is by no means over, and that furthermore there is certainly the potential for the last three months of the year to yield even further losses. We have therefore elected to project 2021 as also potentially totalling as much as US\$2 billion.

Should both these projections turn out to be accurate, this would still probably leave the overall Upstream portfolio in profit. However, as these losses get settled, they will provide a rationale for the market to stand firm against any further slackening of the current hardening process.

Finally, there is also the potential for further Offshore Construction losses to materialise as we move towards the close of 2021. Figure 5 overleaf still shows that the mature years of 2017-19 have produced a very negative underwriting result, while we still believe that the figures for 2020 are too immature to be truly germane. It remains to be seen whether brokers will be able to apply sufficient leverage to the market to enable insurers to continue to provide capacity for this class, in return for greater shares in the more profitable operating portfolio.

Fig 5: Offshore Construction losses reported to date, 2017-20



Most of the deterioration of the overall Offshore Construction loss record falls back onto the 2017-19 years of account - the outlook for 2020 looks more promising, but both premium and loss data for this year is still immature

Source: Willis Towers Watson/Willis Towers Watson Energy Loss Database as at September 21 2021)

Increased focus on ESG

We have just seen how unprofitable the Offshore Construction portfolio continues to be; in the future, it will be interesting to see how many insurers will continue to support this class of business, given the well-documented pressure to withdraw insurance cover for new fossil fuel projects from various pressure groups.

In the meantime, buyers are finding that the market is still not adopting a consistent approach to ESG issues. A few insurers have their own mandates on Arctic drilling/exploration and are not writing applicable new programmes, but this is by no means a universal stance. There is also still no accepted definition of the Arctic Circle, although it is reported that one is being worked on in Lloyd's. Having said that, we understand that the Joint Rig Committee is considering a standard London market ESG questionnaire; of course, it remains to be seen whether this will enable any consistency of approach to materialise. What we can say for sure is that insurers are generally keen to be able to continue to underwrite this class and simultaneously maintain their own ESG credentials. Finally, we must point out that ESG issues are not materially affecting most Upstream programmes as yet, but brokers and underwriters alike are in general agreement that this critical issue will become more of a focus in the long-term.

Many insurers premium income targets already met

Regarding the need to fulfil premium income targets mentioned earlier, it is also true that, in contrast to some leading insurers, other leaders (and indeed a significant number of the following market) have already met their 2021 premium income targets. While it is difficult to generalise, it would seem clear that those who have already met their targets are likely to have adopted a more flexible approach to the choicest business than those who have not. However, this does leave the buyer whose programme renews later in the year than many of its peers with the challenge of with electing to select a leader that has fulfilled its premium income targets - and therefore has less pressure to offer competitive terms - or those who have not, who are likely to adopt a more conservative approach.

Of course, for those buyers whose programmes renew on January 1, this factor will no longer be in play and it will be interesting to see which leaders exhibit the most appetite for the major programmes renewing on this date.

Leadership panel remains restricted

A further factor which is currently acting as a break on the easing of the hardening conditions is that the panel of leaders in this market remains relatively restricted. Such is the atmosphere in today's market that it is in practice very challenging for new leaders to draw attention to themselves by offering more generous terms than the existing leadership group, although of course there is still plenty of evidence of existing leaders quoting against each other. The market is very conscious of what has happened in previous underwriting eras, where a hardening market has not lasted for more than a year or two, due to the swift return to profitability of the Upstream portfolio and the emergence of new competition, particularly from outside of Lloyd's. Today, it appears to be much easier for many insurers to continue to toe the line behind the existing leadership panel, although there are cases for smaller programmes where brokers have found it possible to complete the placement in question at terms set by a less familiar leader.

Lloyd's scrutiny/management pressures

During the last few years we have continued to stress that the Upstream portfolio remains under close management scrutiny, and this remains the case today. Individual underwriters continue to have to justify their decisions, both to their own management and in the case of Lloyd's underwriters, the Performance Management Directorate. This scrutiny continues to act as an additional dampener in terms of the generation of more competitive market conditions.

Today's Upstream market

Impact of commodity price increases/fluctuations

Commodity price fluctuations, particularly the spectacular increase in wholesale oil and gas prices, have significantly affected many economies as countries try to reactivate activity following COVID-19 lockdowns. From an Energy insurance market perspective, as many rigs reactivate following an extensive lay-up during the pandemic, there is now an increased focus in the market on Reactivation Warranties, with individual leaders keeping a sharp eye on their adherence by buyers.

Meanwhile steel prices have also increased, affecting the replacement cost of major upstream infrastructure while the rise in oil and gas prices will continue to affect LOPI values.

Upstream market Cyber overage remains limited

The options available to buyers within the Upstream market for cyber coverage remain limited. The Joint Rig Committee (JRC) Cyber Affirmation Exclusion, which replaced the old CL380 clause, remains unchanged and while the market does have a product to offer in the form of the Cyber Attack Buy Back Endorsement (CABBE) the reality is that there have been very few take-ups to date. While it's true that further individual offerings are available from certain insurers, the cover on offer remains fragmented and inconsistent from a buyer's perspective - at a time when the risk of cyber attack has never been greater.

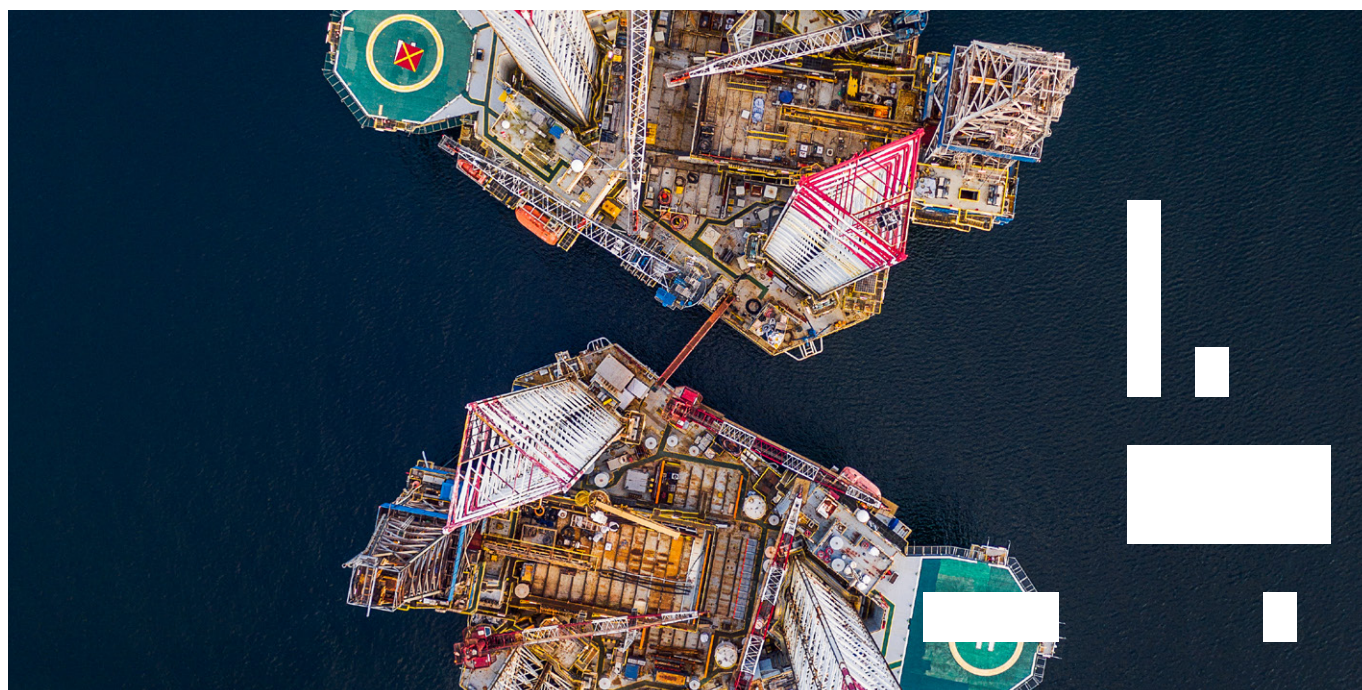
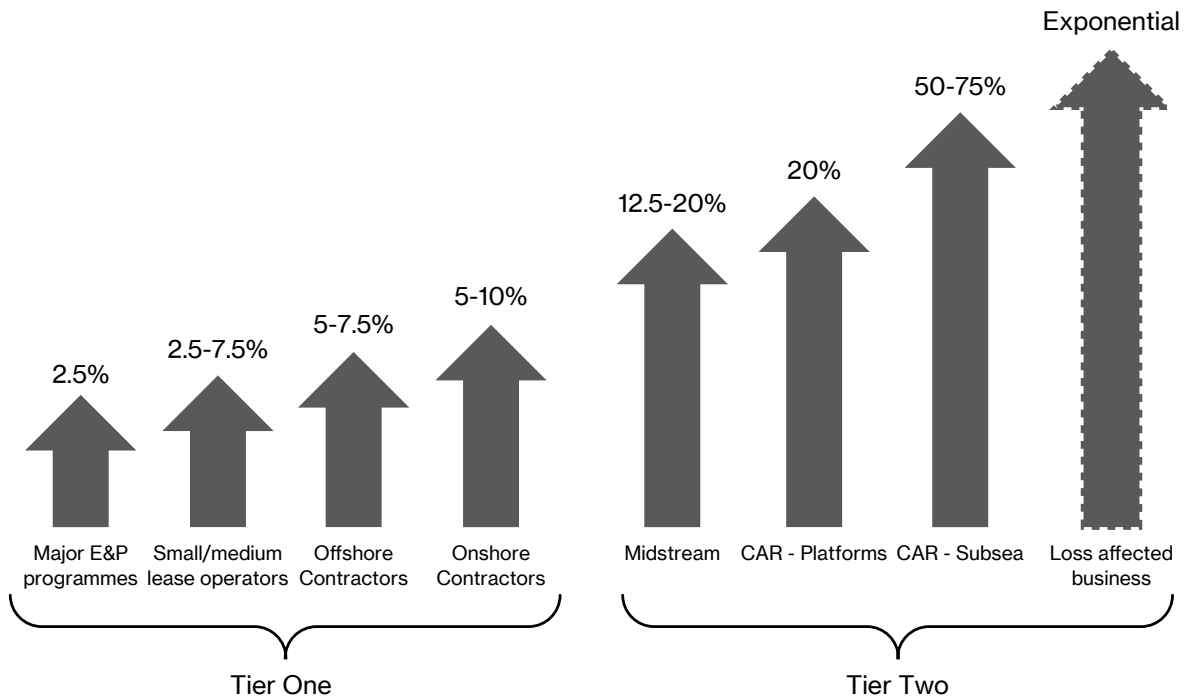


Fig 6: Current Upstream rating increases, October 2021



There is now more interest being shown for the most highly regarded Tier One programmes, signalling a gradual easing of the recent hard market conditions

Source: Willis Towers Watson

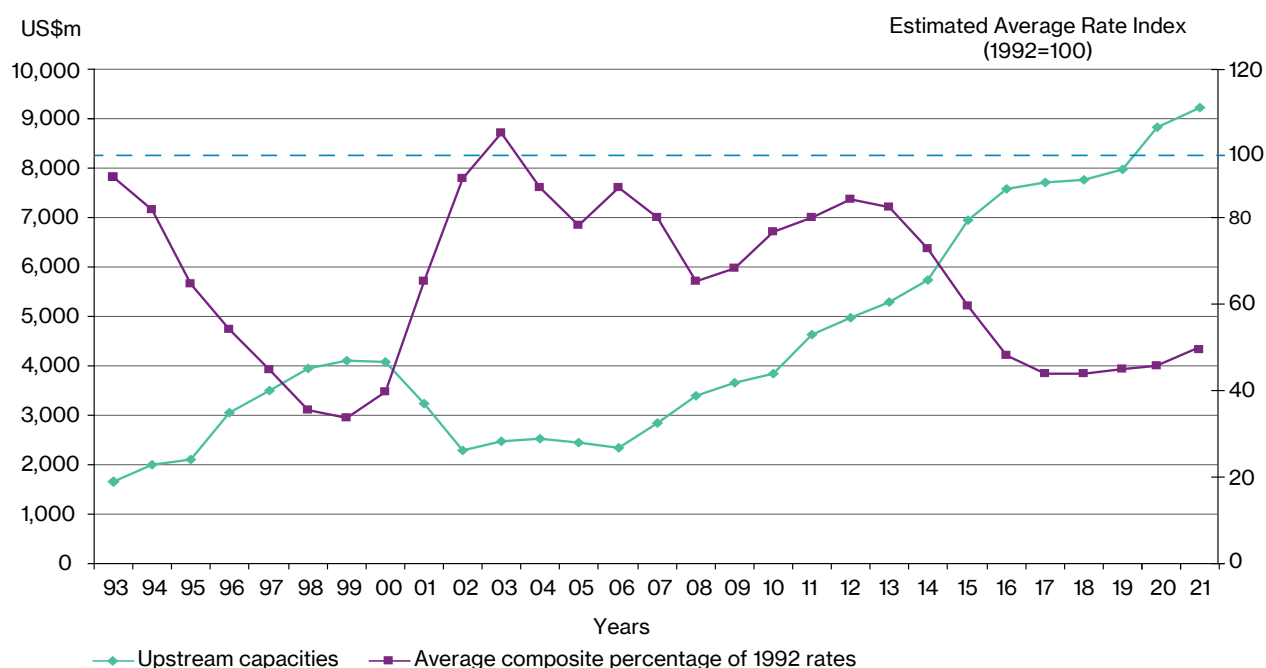


The two-tier market remains

Figure 6 above shows that the various trends that we have been discussing, including both positive and negative factors, continue to point to a hardening market, but with the rate of hardening significantly decreasing.

- Tier One consists of major Exploration and Production programs, smaller lease operators and Offshore and Onshore Contractor business, with increases ranging from +2.5% to +10%. This is slightly down on the increases we were advising in April, which ranged from +5 to +12.5%.
- Tier Two consists of Midstream, Offshore Construction and smaller/loss-impacted programmes, with increases ranging from +12.5% to +75%. This is the same range as we advised in April but in general terms more programmes are being renewed at the bottom end of the range than six months ago.

Fig 7: Upstream capacity versus rating levels, 1993–2021, (Excluding Gulf of Mexico Windstorm)



Economics teaches us that supply and prices cannot both rise for ever - pressures on rates will begin to intensify if positive loss record is maintained

Source: Willis Towers Watson

Conclusion: the outlook for 2022

What is the reader to make of the conflict of trends in the Upstream market that we have outlined? There is no doubt that there are various different dynamics in play at present; while the current position is that the market hardening is beginning to ease a little further, there are plenty of factors in play that could change the current balance of power, either in favour of the market or the buyer.

Perhaps the most challenging aspect of the current situation is that it really is no longer a simple matter of supply and demand. For the last 28 years, we have carefully been collating actual capacity figures and set them against our overall estimated rating trend, as outlined in Figure 7 above. But in some ways, this chart has become rather over-simplistic. In showing year-on year increases in both supply (i.e. capacity) and prices, the Upstream market seems to be defying the economic laws of gravity. The reality is that maximum theoretical capacity levels often bear little relation to the amount of capacity offered in practice, particularly for Tier Two risks; but in contrast, a further complication is that by carefully re-structuring and re-layering programmes, brokers can often secure more competitive terms than the current market norms.

It is of course quite possible that increasing supply will eventually lead to lower prices, as Figure 7 suggests. But it is equally possible that a deteriorating loss record, coupled with insurer concerns around their clients' ESG profiles, may also lead to a reduction of supply for the least favoured programmes as the January 1 renewal season approaches. Buyers will need to consult carefully with their risk intermediaries to navigate their way through an Upstream insurance market that is becoming increasingly focused on their own ESG profiles.



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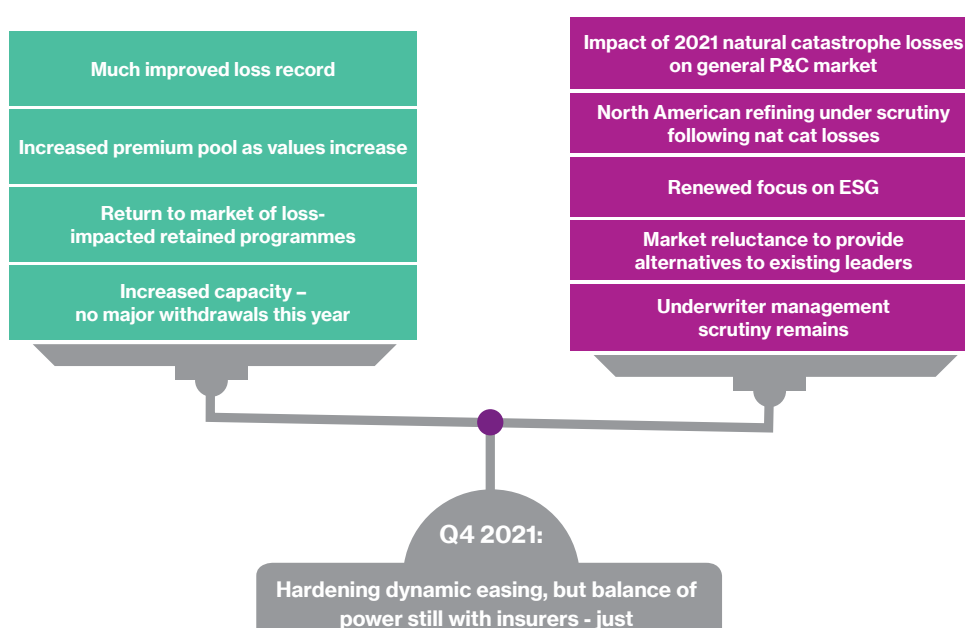


Downstream: still a disciplined market as hardening eases

During the last few years, it has been the Downstream market that has suffered the more challenging trading conditions from a buyer perspective than its Upstream counterpart. With the market having suffered significant losses during the last five years, rating increases have been generally sharp and consistently applied across the market. However, we are now beginning to see signs of an improving picture for buyers, with conditions easing as most insurers have recorded a profitable 2020 and are on course to do so again in 2021.

So has the balance of power in the market (see Figure 1 below) now shifted in favour of the buyer? Well, not quite. For reasons that we will examine later, the market still holds the upper hand; furthermore, recent losses, together with insurers' increased focus on ESG issues, will ensure that Downstream risk managers will have plenty to think about as the January 1 renewal season approaches.

Fig 1: Better news for buyers: the Downstream underwriting environment, October 2021



With an overall underwriting profit virtually guaranteed for 2020, the rate of increases are now decelerating - however, the insurance market's future focus on ESG will give some buyers cause for concern

Fig 2: Downstream losses excess of US\$50 million, 2021 (to date)

Type	Cause	Region	PD US\$	BI US\$	Total US\$
Olefins	Ice/snow/freeze	North America	100,000,000	540,000,000	640,000,000
Chemical	Fire no explosion	North America	160,000,000	18,000,000	178,000,000
Olefins	Unknown	Middle East	16,000,000	146,876,712	162,876,712
Fertilizer/agrochemical	Misc	Middle East	22,500,000	105,000,000	127,500,000
Secondary process	Fire + explosion/VCE	Europe	118,000,000	0	118,000,000
Olefins	Ice/snow/freeze	North America	90,000,000	15,000,000	105,000,000
Refinery	Lightning + fire	Asia Pacific	100,000,000	0	100,000,000
Isomerisation	Fire no explosion	North America	20,000,000	74,880,000	94,880,000
LNG	Unknown	Latin America	8,515,329	72,207,578	80,722,907
Chemical	Ice/snow/freeze	North America	22,780,103	55,112,836	77,892,939
Secondary process	Fire + explosion/VCE	North America	26,300,000	38,500,000	64,800,000
Olefins	Ice/snow/freeze	North America	54,000,000	0	54,000,000
LPG	Ice/snow/freeze	North America	11,000,000	42,000,000	53,000,000
Crude unit	Fire + explosion/VCE	South Asia	50,000,000	0	50,000,000

Source: WTW Energy Loss Database as of September 23 2021 (figures include both insured and uninsured losses)

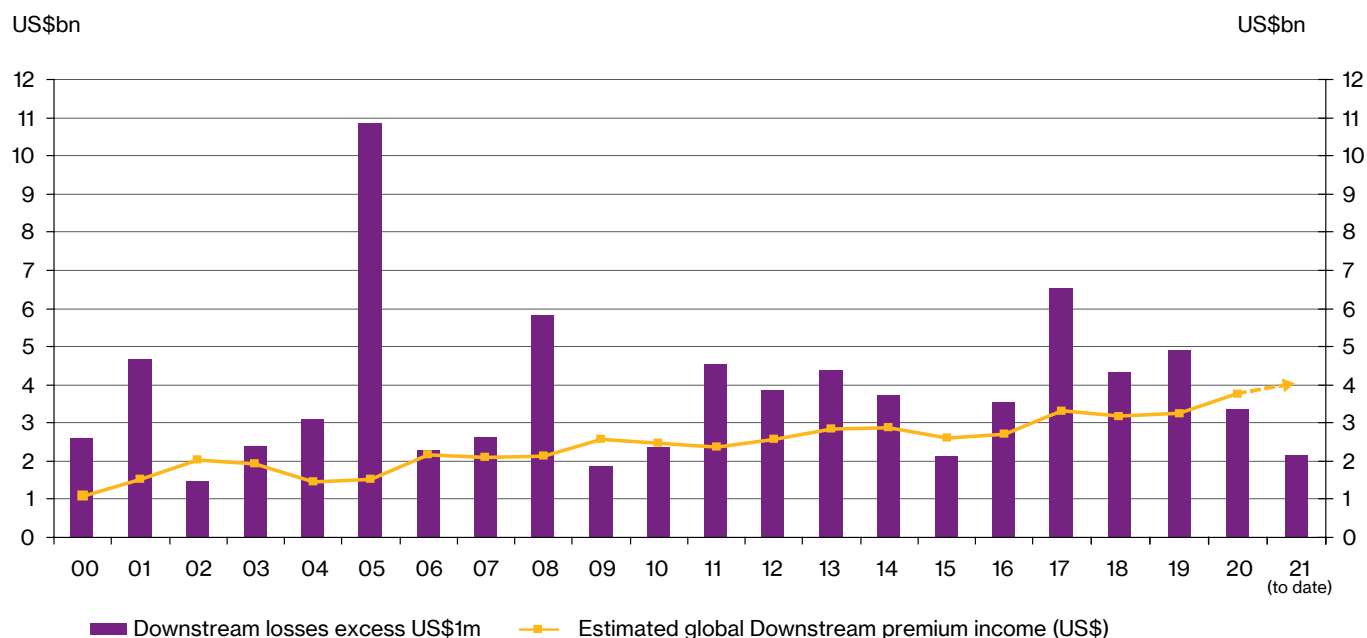
Positive factors

Much improved loss record

To date, our database has recorded only seven Downstream losses above US\$100 million in 2021, compared to eleven in 2020 and considerably more in previous years. Figure 2 above shows that a significant number of these losses have emanated from the Texas freeze in February and it still possible that further losses from this event may be reported to the database later in the year. It is also too early for our database to have recorded any major losses from hurricane Ida or other North Atlantic windstorms, so there is the potential for these figures to increase as we move further towards 2022. As was pointed out in the Upstream section of this

update, the Downstream market has emerged virtually unscathed from the LNG explosion in Scandinavia last year as we understand that most of the risk was either absorbed by captive insurance companies or underwritten by the Upstream market. Similarly, we also understand that most refinery losses emanating from hurricane Ida are likely to be either retained by captive insurance companies, mutualised, insured by the specialist Gulf of Mexico Windstorm (Gulf Wind) market on an aggregated basis or simply retained because the company in question has elected not to buy Gulf Wind cover. However, we are aware of possible other additions to these figures in the next few weeks, including two major African losses excess of US\$100 million each as well as an explosion/fire in a Caribbean Gas To Liquids plant.

Fig 3: WELD Downstream losses 2000 – 2021 (excess of US\$1m) versus estimated global Downstream premium income



Increased premium levels suggest that 2020 is likely to be profitable for most insurers, while 2021 looks promising – to date

Source: Willis Towers Watson/WTW Energy Loss Database as of September 17 2021 (figures include both insured and uninsured losses)

Increased premium pool as values increase

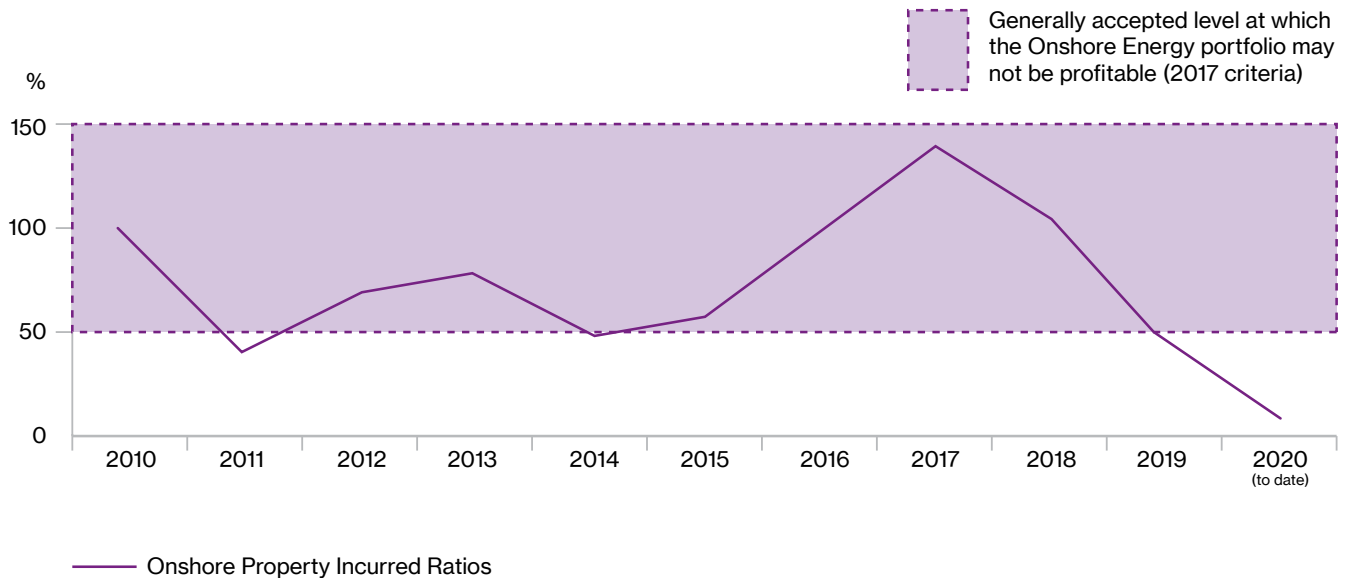
It has not just been an improved loss record that has led to a more profitable Downstream portfolio; premiums have also been on the increase, as demonstrated by Figure 3 above.

This chart compares losses in excess of US\$1 million declared to our database with our own estimates of overall global Downstream premium income. It shows that while overall losses have been generally decreasing since a high point in 2017, premium income levels have been on the rise for the last two years. Although part of the reason for this increase can be put down to the rating rises imposed during the last two years, additional premium

has also been generated by increased refinery utilization rates, increases in oil & gas prices and higher Business Interruption amounts now being declared to insurers due to the easing of COVID-19 lockdowns around the world. So even if the 2021 loss record deteriorates further in the aftermath of this year's hurricane season, we would still generally expect 2020's profitable record to be maintained for a further year.

Fig 4: Lloyd's Onshore Energy Profitability 2010 – 2020

Onshore Property Incurred Ratios



Lloyd's Onshore Energy Property portfolio has remained generally unprofitable – until 2019

Source: Lloyd's Market Association Quarterly Loss Report Q1 2021. “Onshore Property” - EF audit code.

Still a profitable portfolio

Indeed, a further indication of portfolio profitability is represented in Figure 4 above, which shows Onshore Energy Incurred Ratios (premiums earned versus paid and outstanding claims) for Lloyd's of London. Here we can see that the ratios for 2019 and 2020 are at 50% or below, indicating that for Lloyd's syndicates at least, they are on track for another successful year following a long period of unprofitability.

Return to market of loss-impacted retained programmes

Another reason for the increased premium flow has been the return to the market of some programmes which had previously been self-insured due to the impact of the hardening insurance market. Of course, when a given programme has been loss-free for many years, the option of electing to self-insure might make some sense to some, especially when prices have been rising as significantly as they have recently been doing in the Downstream market. However, it appears that some of those programmes that had become self-insured (or retained within a captive) during the last few years have recently sustained

significant losses; as a result, these companies have been forced to return to the market to obtain cover, at perhaps more punitive terms and with higher retentions that might have been expected.

No decrease in available capacity

Our final positive factor from a buyer perspective is that capacity levels increased in 2021; as yet there is no sign of any insurer scaling back their participations from what they were offering in April. As a result, we have kept to our April estimate of realistically available capacity, being US\$4 billion for International programmes and US\$2.5 billion for North American programmes. While by no means the most important factor in the easing of the hardening market dynamic, the availability of more capacity than was the case in 2020 still restrains existing leaders from imposing more draconian terms than if there had been a further reduction.

Negative factors

Impact of 2021 natural catastrophe losses on general P&C market

Set against the positive factors that we have outlined above is the grim reality of how recent natural catastrophes have affected the general Property & Casualty (P&C) portfolio. As many readers will acknowledge, the Downstream market remains very much part of the wider P&C market; while this portfolio has not been directly affected by much of this year's natural catastrophes around the world, the same can hardly be said for the P&C market in general. For example:

- Swiss Re have advised that there were US\$40 billion of natural catastrophe losses in the first half of 2021, with further US\$2 billion of man-made disasters¹
- Karen Clark & Co have advised that total Texas Freeze insured losses currently stand at US\$18 billion²
- The range of insured hurricane Ida losses currently stands between US\$30-40 billion, according to Goldman Sachs³

It is therefore likely that overall insured losses for natural catastrophes in 2021 is likely to near US\$100 billion by the close of the year. The North American Property portfolio is almost certain to be significantly impacted, which is likely to have a particular knock-on effect on North American refining and petrochemical programmes. And of course it is still too early in the year to declare an end to the North Atlantic hurricane season.

However, set against this macro-trend is the undoubted return to profitability of Lloyd's of London, who have announced a Combined Ratio of 92.2% for the first half of 2021 (compared to 110.4% at the same stage in 2020)⁴. It is also true to say that most Lloyd's underwriters feel that the Decile 10 initiative has done its job and that further closures of individual industry portfolios is now somewhat unlikely.

On balance, the impact of 2021's natural catastrophe losses is still going to provide Downstream underwriters – and their management – with the rationale to try to maintain the hardening momentum built up in recent years, despite the continued profitability of the portfolio.

Renewed focus on ESG

Of even greater significance, however, is the impact of a renewed focus on Environmental, Social and Governance (ESG) issues, which as we pointed out in the Upstream section, is a growing issue which is bound to affect almost all fossil fuel programmes. Some insurers are now coming under greater pressure than ever to review their Downstream book, to the point where is a very large loss were now to materialise for certain programmes, some insurers may decide to call time and withdraw from the programme in question. As yet, there remains no market consensus on this issue, with some major insurers taking their own, well-publicised stances while others have yet to make their positions clear. And with no standard questionnaire produced by the market, no one is yet in a position to forecast exactly how the Downstream portfolio is going to be impacted in the years ahead. For example, one insurer that had been underwriting risks located in the Arctic for many years suddenly had to withdraw recently from a major programme with assets located within the Arctic circle. And another programme featuring an oil refinery in Europe was recently refused cover because the conglomerate that owned the refinery also had a significant involvement in coal.

So where will this all end? At the time of writing, no one knows the full extent of this new application of ESG criteria and the consequent effect on individual buyer programmes. Of course, while it is certainly true that the market has renewed its focus on the “E” aspect of ESG, perhaps there has been less focus on the “S” – and the ramifications for various communities around the world should traditional fossil fuel industries close due to capital withdrawal from key projects. Indeed the Insurance Insider reported in September 2021 that at the recent virtual Rendez-Vous de Septembre (RVS) Lloyd's chief of markets Patrick Tiernan suggested that simply walking away from the fossil fuel industries would be “socially irresponsible”⁵. It will be interesting to see how many insurers end up agreeing with him or not.

For the moment, it will be up to individual buyers to consult with their risk intermediaries to navigate the best way forward in what is likely to become a much more challenging landscape in the future.

¹ <https://www.insurancejournal.com/news/international/2021/08/13/626900.htm>

² <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/reinsurance-plays-key-role-as-p-c-insurers-deal-with-texas-freeze-in-q1-64457632>

³ <https://www.artemis.bm/news/hurricane-ida-loss-estimates-rising-towards-30bn-to-40bn-goldman-sachs/>

⁴ <https://www.lloyds.com/about-lloyds/media-centre/press-releases/lloyds-reports-strong-2021-half-year-results>

⁵ <https://www.insuranceinsider.com/article/292838oz36ox1std9o5q8/carbon-intensive-companies-making-the-esg-transition-should-be-insured-tiernan>



Market reluctance to provide alternatives to existing leaders

Improved trading conditions from an insurer perspective usually mean that fresh competition to the existing panel of market leaders emerges to take advantage of the profitable underwriting climate. However, this does not appear to be materialising in this instance; while there are plenty of insurers who are able to lead, it seems clear that most, at least at this stage in the underwriting cycle, do not want to be seen to be challenging existing leads for fear of being accused of contributing to the deceleration of the hardening process – and even to the beginnings of a new soft market.

Underwriter management scrutiny remains

Our final negative factor that is preventing the usual transformation into a softening market is related to some of the others – the degree of management scrutiny still deployed to ensure that individual Downstream underwriters are not tempted to provide more competitive terms in exchange for a significant increase in premium volume. In most cases, such senior insurer management will be well aware of the negative impact of 2021's natural catastrophes on the overall P&C market and will be looking to all their underwriters to “toe the line” and maintain the hardening rating momentum.

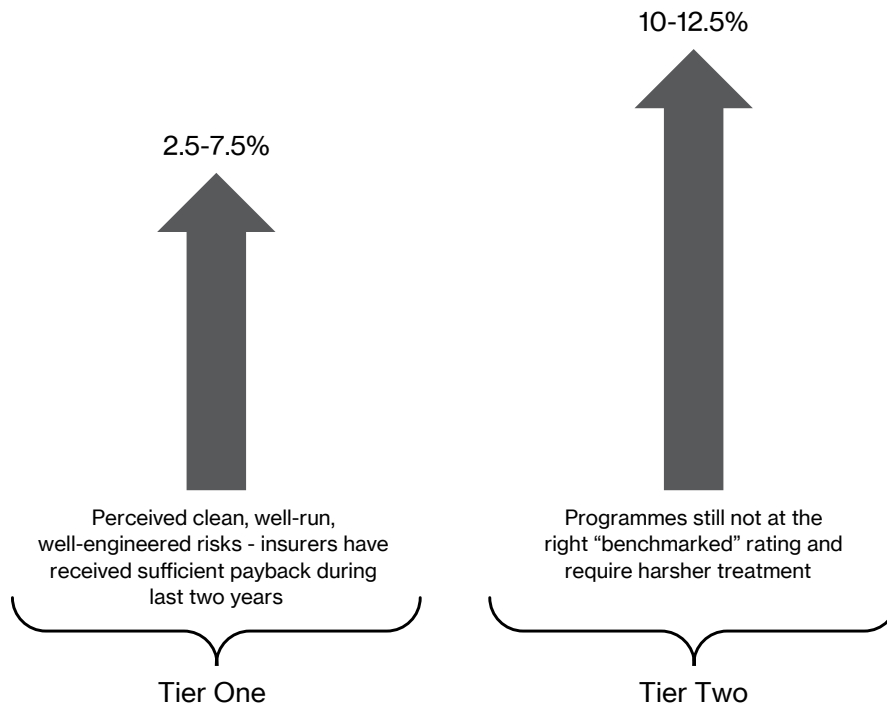
Today's Downstream market

Insurers continue to focus on tightening terms and conditions

Despite the improvement in trading conditions, insurers continue to focus on tightening current terms and conditions wherever possible, three examples of which are as follows:

- Insurers are now insisting on the application of the **Testing & Commissioning clause LMA5197A**, which still includes the requirement for 100% testing for 72 hours but also requires the need for more information from the buyer; this ultimately means that it is taking longer than in the past to attach a new asset to the policy. This is now a much tighter clause, linking through from the construction risk right through to the operational phase.
- Furthermore, the market is generally reverting to the use of the **traditional cyber exclusion clause NMA2915A**, as the new wording LMA5400 excluded the word “malicious” – this has led to some ambiguity as to the extent of the exclusion. The NMA 2915 is mainly being offered to midstream companies, due to the outside pressure from the more traditional Upstream markets being able to compete for shares and restricting the marketing of these types of risks just to the more traditional “Onshore” insurers.
- Finally in relation to BI values, the relatively new **market clause LMA 5515** factors in the maximum percentage of the margin of error between actual and declared values, as well as any premium adjustments. In view of the recent increases in commodity prices, we believe that it is vital for buyers to keep values up to date and accurate if the full quantum of future BI claims are to be paid.

Fig 5: Current Downstream rating increases, October 2021



Some buyers that can offer a significant premium spend (in excess of say US\$ 20m) are now being able to benefit from flat renewals, as insurers do not want to see any reduction in their Q4 premium income levels

Source: Willis Towers Watson

The “two-tier” market dynamic continues - albeit with lower rises than earlier in 2021

We have seen that there are currently a variety of trends emerging in the Downstream market, many of which are positive, but also some negative. So where does this leave the buyer in the run-up to the January 1 renewal season? In our April Review⁶ we commented on the emergence of a two-tier market, with more advantageous terms being awarded to the best regarded business and more punitive terms to others. Today, we can say that the two-tier dynamic still certainly exists, but with the percentage rate increases reduced from six months ago:

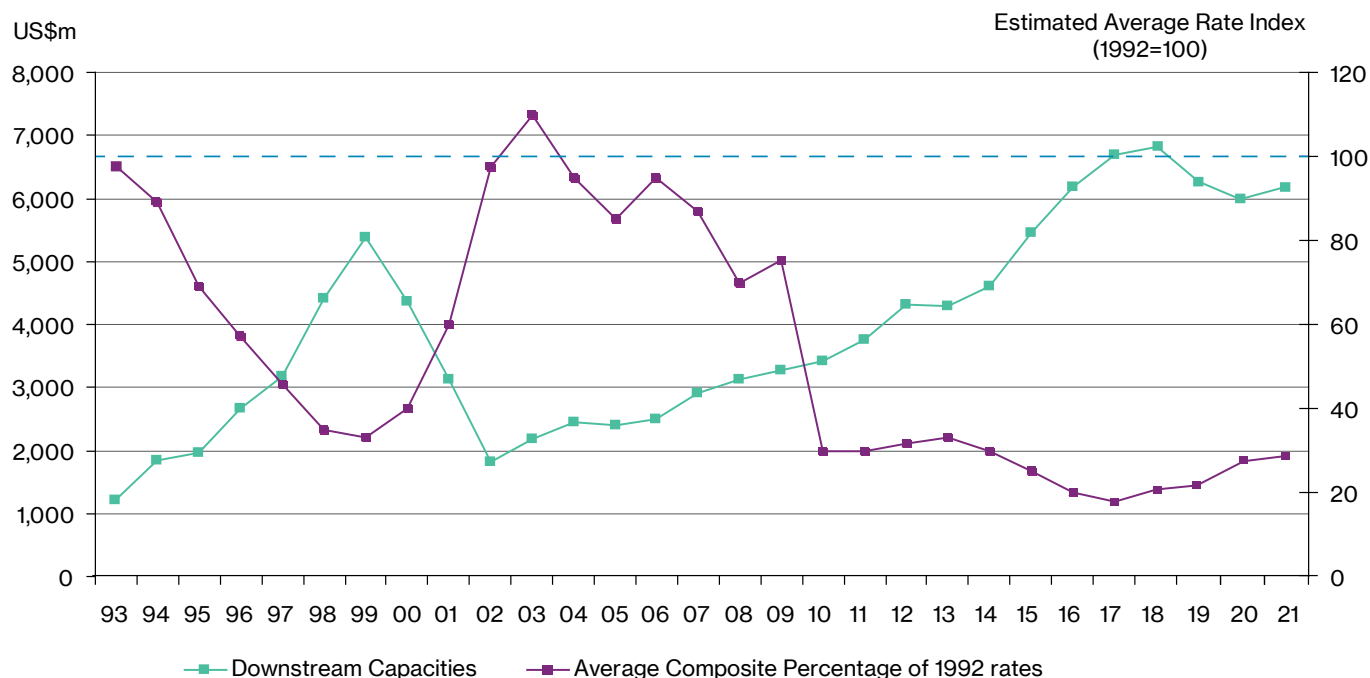
- As we advised in April, Tier One consists of well-engineered and perceived “good” clean well-run risks - insurers have received sufficient payback during last two years. In general terms, these programmes are attracting rate rises of between +2.5% to +7.5%, compared to +12.5% to +20% in April - a big decrease. Furthermore, some buyers that can offer a significant premium spend (in excess of say US\$20 million) are now being able to benefit from flat renewals, as a number of insurers do not want to see any reduction in their Q4 premium income levels.

- Tier Two consists of programmes that are still not at the right “benchmarked” rating and require harsher treatment. These now range from +10% to +12.5%, whereas in April we were advising a range of between +25% to +40%.

Of course, there are always exceptions to these general guidelines and sometimes it will be possible to improve on these ranges if programmes are effectively re-packaged and re-layered.

⁶ <https://www.willistowerswatson.com/en-GB/Insights/2021/04/energy-market-review-2021>

Fig 6: Global Downstream capacity versus estimated average rating levels, 1993–2021 (excluding Gulf of Mexico Windstorm)



Source: Willis Towers Watson

Conclusion: the outlook for the remainder of 2021

Our overall chart which maps maximum capacity against average rating levels now shows that the “false equilibrium” - increasing capacity and increasing rates - is still being maintained by the market, but only just. There is no doubt that for the most favoured programmes, there is now a genuine opportunity to improve existing terms if the underwriting submission continues to impress insurers.

And therein may lie a problem for the future. With the issue of ESG firmly in many insurers’ minds, we believe that in future this opportunity may become restricted to those buyers who can demonstrate to insurers that not only have they presented their own ESG credentials to insurers as effectively as possible, but that insurers’ own ESG credentials will not be impacted by continuing to trade with the company in question. How this dynamic will play out in the months ahead will be a key factor in securing optimum terms from a market that may have returned to profitability, but which is also keeping a watchful eye on the composition of its own portfolio.



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Liabilities: Specific drivers remain in play

Introduction: where to now for the Liability market?

Following on from a previously benign decade in the Liability sector, most buyers will have now experienced two annual renewals under significantly harsher market conditions. So where is the market now at, and what expectations should buyers have for the forthcoming renewal season?

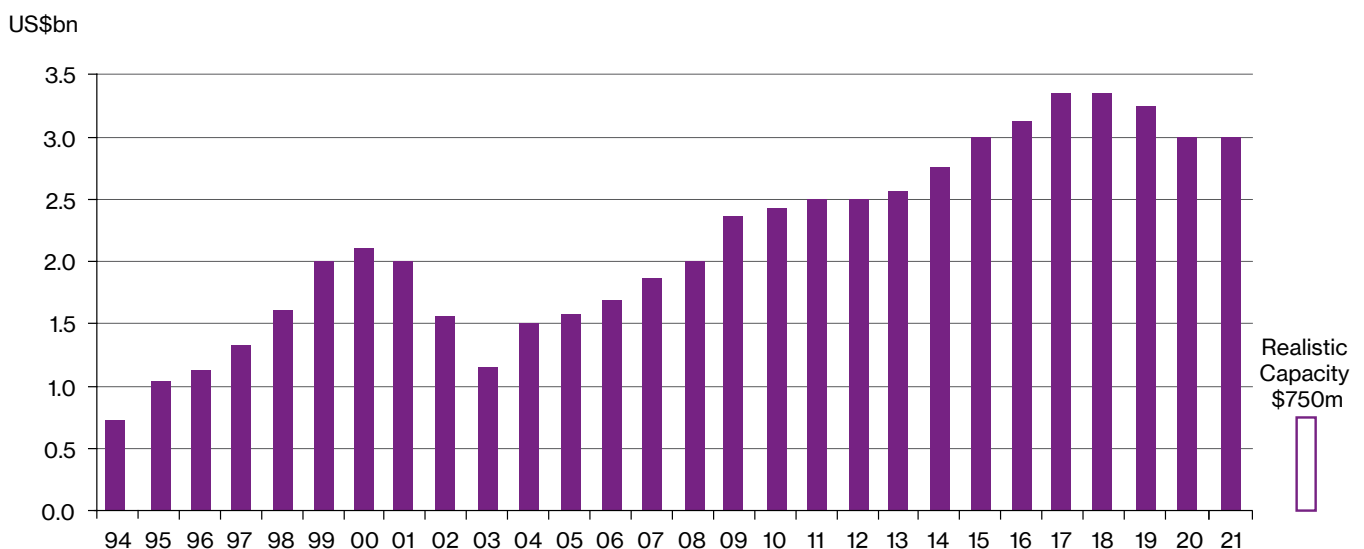
Some of the macroeconomic drivers that caused a general hardening across all insurance lines of business, for example general insurance industry loss ratios, reinsurance treaty costs and the effects of the COVID-19 pandemic, have now moderated. This is illustrated by the Lloyd's announcement in September 2021 of an overall £1.4bn profit across all lines of business for H1 2021 versus a £0.4bn loss in H1 2020¹.

Conversely however, many of the drivers more specific to the Liability sector remain in play - most particularly marginal loss ratios, historic under-reserving, social inflation, and a dearth of capacity.

Capacity: looking beyond the headlines

Published Global Liability capacity continues to appear to be relatively healthy at approximately US\$3 billion; however, realistic commercial capacity for any given risk for most buyers is approximately only 25% of this total. Moreover, for some sectors, such as wildfire exposed programmes, or buyers with poor ESG profiles, the available capacity from the market is now significantly less than in the past.

Fig 1: Global published Liability capacity, 1994-21



Source: Willis Towers Watson

¹ <https://www.lloyds.com/about-lloyds/media-centre/press-releases/lloyds-reports-strong-2021-half-year-results>

Ironically, the premium rises over the last couple of years, together with a desire to spread risk across a wider portfolio, have led many insurers to trim the average line size they are prepared to deploy across any given programme, which they have been able to do whilst still maintaining income growth.

A further factor limiting capacity expansion for Lloyd's syndicates has been the continuing limitations on premium income which come into greater focus towards the end of the year, when premium income allocations are close to being filled. This has led to significant limit challenges for those insurers seeking to maintain larger Liability limits, with many forced reduce their purchased limit, increase self-insured retentions and/or retain elements of their Excess Liability programme.

On the positive side, the emergence of new Liability capacity over the past couple of years has helped to mitigate this contraction and provide some alternative options, albeit mainly in the Excess of Loss space. Recent news of the emergence of a brand-new Liability primary and excess insurer, whose name is to be formally announced shortly, will provide a welcome supplement in 2022.

So what about premiums?

Whilst all buyers have encountered the challenges of harder Liability trading conditions, their experience has varied widely depending upon a number of factors: the programme limit required, the industry sector, the geographic/jurisdictional exposures, the perceived historic rate adequacy and, increasingly, their Environmental Social and Governance (ESG) profile.

Those buyers with heavy US exposures, large limit requirements, historically low rate on lines, poor risk management profiles and/or those engaged in certain more challenging industries (for example midstream/ pipeline operators and wildfire-exposed utilities) have been particularly badly impacted. In contrast, buyers purchasing smaller limits with a full range of local and international Liability market options have fared the best, with modest premium increases the norm.

The 2021 year to date rate increases across the portfolios of a number of major international Casualty insurers as of 1 October 2021 has been remarkably consistent, with average rate increases of + 15% to + 25% on Primary business and + 25% to + 35% on Excess business (although the latter range hides some significant variations).

Expectations are that the rate increases seen over the past two years should moderate as compounding takes effect and minimum rate adequacy levels are achieved. This is indeed the case for Q4 2021 and the most well-regarded with a wide choice of market options and a well-articulated loss profile proposition are seeing more favourable renewal results compared to the two prior renewal seasons. However, there is a marked lack of consistency in underwriting approach by many insurers and the level of required capacity to be secured has a strong influence on final results.

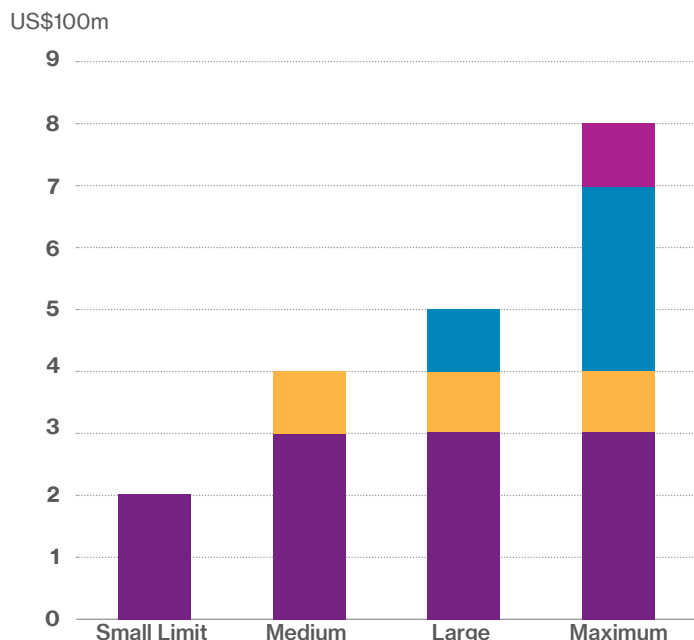


Fig 2: International Liability market dynamics for Energy programmes, October 2021

Market Pricing Dynamics

	Core Existing Markets: Measured and “fair” rate increases
	New Markets: Minimum rates often higher
	Volatile Existing Markets: Erratic. May totally re-rate pricing
	Opportunistic Markets: Highest price they can achieve

The larger the limit, the greater the price volatility



Source: Willis Towers Watson

The capacity conundrum

To understand the variety of renewal premium outcomes, it is helpful to understand the differing market dynamics at work. There are two important considerations:

1) *Hostage to fortune or pick of the players?*

Insurers continue to exhibit a range of behaviours, from the consistent and considered approach of long-term partners to volatile players with an inconsistent and/or opportunistic approach. A final group are the newer entrants to the market who have their own rating approach and minimum pricing requirements that may be very different from the existing programme pricing. This is illustrated by Figure 2 above, which we have shown before but remains valid today.

Clearly those buyers purchasing smaller limits and therefore able to focus on core, consistent and competitive insurers are benefiting from the most favourable and reliable renewal results.

2) *Budget base to costly summit: different pricing across a Liability tower*

The emergence of several Liability catastrophe losses over the past few years, most notably from the pipeline, tailings dam and wild-fire exposed industries, has prompted insurers to recalibrate their Increased Limit Factor (ILF) pricing models in order to recognise the greater than perceived exposure on previously considered “sleep easy” excess layers of a Liability programme. This, combined with a shrinkage in excess liability capacity, had resulted in disproportionate price increases on high excess layers versus the lower excess layers and primaries, which were already better geared in terms of their loss ratios for non-cat, working-loss exposures (see Figure 3 overleaf).

Other considerations

Aside from the pricing considerations, buyers are also faced with the following issues:

The rise of the risk engineer

There was a time when a programme renewal was concluded with a minimum of information and when an underwriter had full autonomy. Understandably, and correctly so, the underwriting process is now highly exacting, with tighter underwriter guidelines, strict management reporting requirements, sanctions checks, ESG profiling and engineering reports. The positive outcome of this is a far more professional process and an ability to positively differentiate high quality buyers; the challenge lies in the significant additional time and resource required to achieve the correct outcome.

A function of this increasingly technical approach, as well as the increase in submission flow, is an increased reliance by underwriters on their risk engineers to triage their enquiries. As result, an increasing number of renewal and new business opportunities are being rejected - on the basis of risk engineering advice - before a wider discussion can be had, as underwriters focus their bandwidth on the more positively vetted programmes. This in turn is placing more power and responsibility in the hands of leading insurers with risk engineering capabilities, who supporting markets will elect to follow or not, depending on the outcome.

A contagion of clauses

It is said that a hard market is not only about rate increases but also involves coverage constriction and that is indeed currently the case. In addition to the common and evolving clauses related to Communicable Disease and Cyber, we are seeing the gradual introduction of various forms of Climate Change Liability clauses.

More specifically in the Downstream and Chemical sector, there is increasing focus on exclusions relating to specific chemicals; for example, Paraquat (N'-dimethyl-4,4'-bipyridinium dichloride), Glyphosate (N-(phosphonomethyl) glycine) and PFAS (Perfluoroalkyl and Polyfluoroalkyl Substances). In all cases, information about their use or otherwise, those which are subject regulatory issues or not and the extent and scope can help to limit any unnecessary exclusions and facilitate the underwriting process.

In addition to these more specific clauses, we have also seen a contraction or removal of coverage in respect of peripheral, exotic or add on coverages, for example, Care Custody and Control, Pure Financial Loss and Fee related Professional Indemnity Coverage.

Fig 3: different pricing across Liability programme towers



Source: Willis Towers Watson

Whilst it is wise to advocate resistance to any unnecessary change or restriction of coverage, it is also sensible to take a pragmatic view of priorities and core exposures. Buyers purchasing larger limits may well elect to live-with a loss of some elements of peripheral cover rather than sacrificing access to the maximum available amount of a capacity.

ESG

As articulated earlier in this Update, insurers across all insurance lines are taking an increased focus on ESG considerations with many retaining their own ESG experts to positively vet buyers in advance of renewal discussions. This is particularly pertinent to the Energy sector, with the prime focus currently being on the E of ESG, i.e. the environmental aspect. As the criteria tighten, buyers with revenue of throughputs above certain maximum thresholds are struggling to find sufficient cover and being forced to self-insure. This binary approach is frustrating for buyers that are demonstrably working towards a managed energy transition; as we report in the leading article of this Update, positive progress is now being made to provide alternative risk transfer capacity for such clients.

On the positive side, buyers that can demonstrate and validate their ESG credentials (for example, initiatives to promote the circular economy, investment in recyclables for plastic producers, transitioning to renewable energy biofuels and good social governance) are receiving a favourable hearing from insurers who are keen to optimise their portfolios from an ESG perspective and will positively differentiate buyers with favourable ESG profiles.

Conclusion: conditions moderating, but challenges remain

The positive news is that after two years of hard market conditions and compounding rate increases, Liability price rises are starting to moderate. However, the renewal experience is very different for each buyer, depending on their individual risk profiles, limit required and industry sector. Market conditions are also changing at different rates, with local markets in certain territories exhibiting more flexibility than global insurers working to central edicts. Those programmes requiring large limits or deemed “below rating adequacy” still face challenging renewals and all buyers are faced with increasing renewal information requirements and coverage scrutiny.

As always, sustained market engagement through the insurance period, early information provision and a flexible approach to limits attachment and non-core coverage will ensure the most favourable and sustainable renewal result.



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