International liability

Sunlit uplands or false dawn: Where to now for International Energy Liability?

2023 has seen a relative stabilisation in capacity, a lack of major Liability Energy catastrophe claims and a moderation in rate increases. Is the market now finally heading back to the promised land of rate neutrality or even (whisper quietly) towards that long-forgotten territory of rate reductions?

Whilst the dynamics are directionally positive for the insurance buyer, there are some underlying concerns that caution against too early a celebration. In short: trends are broadly positive and cautious optimism is justified but some negative drivers give continued cause for thought.

Back in the black: Casualty underwriting results

The most recent set of annual results announced by Lloyds in March 2023 shows that Casualty, as a class, finally returned to an underwriting profit — the first time in eight years.

Whilst the Lloyds results represent only a part of the global Casualty market, albeit a very significant one, and include all Casualty lines (including D&O and Financial Lines, Cyber and Accident & Health), they are nevertheless a good barometer of the overall health of the General Liability sector.

Figure 1:

Lloyds annual results for the Casualty sector:

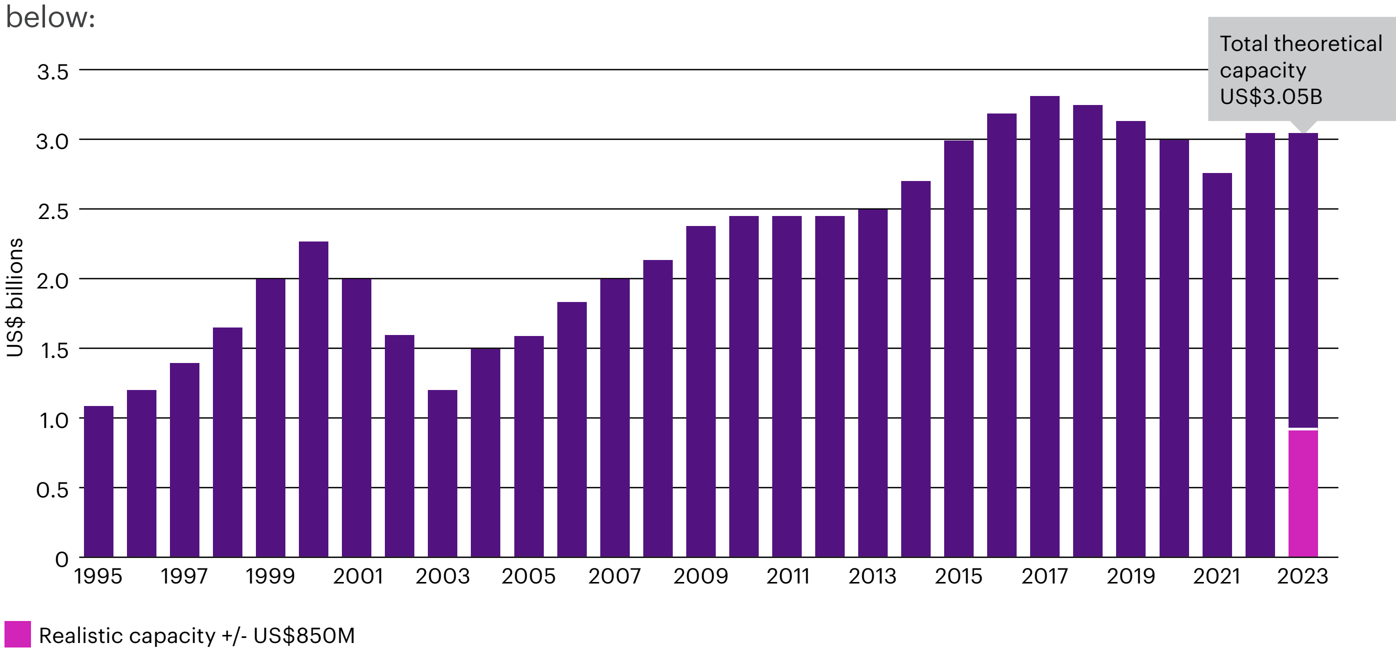
Year	Gross Written Premium £M	Combined Ratio %	Underwriting Result £M
2014	4,959	98.1	74
2015	5,764	100.1	(5)
2016	7,131	102.7	(146)
2017	8,464	103.1	(189)
2018	9,094	102.9	(183)
2019	9,459	105.7	(390)
2020	9,067	110.3	(688)
2021	10,360	100.3	(17)
2022	12,987	93.7	536

Source: WTW

Figure 2:

Market capacity: Steady as she goes...

Total published Global Liability capacity continues to track at approximately US$3.05 billion, with actual working capacity at approx. US$850 million, as illustrated in the Global Liability capacity chart below:



Source: WTW

This apparent stasis hides some underlying changes. There has actually been a measured influx of additional capacity both from increased line sizes of certain existing insurers and also from some limited additional new capacity. However, this has been balanced out by a capacity contraction from other insurers who have curtailed their purchase of Treaty Reinsurance, reducing their overall line size.

Encouragingly, an increased appetite from certain insurers and Lloyds syndicates to deploy capacity lower down on a programme, at Primary or first excess levels, is aiding competition. We also expect the entrance of one major new insurer into the International Energy Liability arena at 1st January 2024, if not before.

Treaty and Facultative Reinsurance: The power behind the throne

As insureds will be aware, most insurers rely on Treaty and occasionally Facultative reinsurance to support and augment their own net capacity. Pricing and rate changes experienced by an insurance buyer are therefore not only influenced by an insurer's own profitability but also by the back-end cost of their reinsurance purchases.

Many key treaties renewing in Q1 2023 saw increases, although not as severe as first feared. Interestingly, some insurers renewing their Treaties at 1st July 2023 were faced with meaningful rate increases. In one such example, an insurer who was quoted a 20% rate increase elected not to purchase the same level of Treaty capacity protection, because the direct market would not sustain such an increase. Increases of 10% have been more common, although insurers have often elected to change their retention levels to further mitigate the effects.

All eyes are now on the forthcoming Year End/Q1 2024 season which will strongly influence the future climate for direct liability rates in 2024.

Is Facultative Capacity starting to dry up?

Whilst Treaty capacity remains relatively abundant and reinsurance negotiations focus on attachment point, profitability and level of US exposures (an issue of particular concern for Treaty reinsurers given the losses from the region), a more concerning trend is the diminishing appetite of the Facultative Reinsurance market for Energy Liability business. Facultative Reinsurers, wary of the increasing ESG issues on the horizon for many Energy insurers, have chosen to trim their capacity, become much more selective and focus more on other industry sectors.

Energy Liability losses

Whilst the Lloyd's results inform the overall profitability of Casualty as a class, profitability varies by industry sector and by region.

Variations by region:

Our separate North American Casualty commentary considers the market conditions for what remains the most litigious and loss impacted territory. Whilst this is a separate dynamic to the international sector, it should be noted that many of the major International Liability capacity providers also have US exposed activities in their client portfolios and remain vulnerable to and impacted by losses from the US. This is reflected by Treaty Reinsurers' increased focus on the amount of US exposure in their Insurers portfolios and the contraction of Direct Liability insurance capacity for international operations with US exposures.

Latin America remains as an area of caution for Energy underwriters in terms of jurisdictional, Nat Cat and pipeline maintenance issues. Whilst the region has several well managed quality risks, insurers are highly discerning and differentiate strongly between these and less desirable accounts in countries with less proven jurisdictions. Good information, availability of survey reports and closer insurer/client and cedant relationships remain crucial to aid differentiation and achieve the best results for insureds.

Variations by Sector:
We have commented that 2023 has been relatively free from major Energy Liability losses. Profitability has however been impacted by prior year deterioration and a series of small to mid-sized claims.

As an example, one loss in the terminal operator sector, originally estimated at US$150 million, then US$450 million is now being reserved by some insurers at over US$600 million.

There has also been a prevalence of smaller to mid-size pipeline pollution claims in the magnitude of US$10 million to US$25 million which directly impact the net retentions of many primary Energy insurers.

The areas producing the most losses to an Energy liability underwriter's portfolio are: Pipelines/Midstream, Marine Terminals, US Auto (where applicable) and Wildfire claims (most particularly from Power Utilities). Underwriters also remain more cautious about the Wet/Offshore/Marine exposures which have generated losses including excess Charterers and Terminal Operations.

Inflation: So "last year" or still an issue?

We have differentiated in the past between Social and Economic inflation, and this distinction remains particularly relevant for Liability as a class. Whilst economic inflation still persists, its impact is diminishing as inflation levels globally start to ease. As a result, the default of an automatic +5% to +7% loading inflationary factor is no longer the required norm.

Social Inflation however remains a consistent and increasing concern. As Liability is a long tail class, it also takes longer for inflationary considerations to feed through to loss results, hence the emerging impact on deterioration of prior year loss reserves.

One insurer cited a case of a Bodily Injury claims in Australia where the per person claim amount more than quadrupled This terminal operator loss is another example of back year loss deterioration, as increased claims filter through.

Regional differences persist

As ever, trends and prevailing rates vary region by region. Many territories have strong and growing local market capabilities which are imposing a downwards pressure on rate increases. This is particularly true in Australia, the Middle East and Latin America where healthy local competition is moderating rate increases and, in some instances, enabling flat renewals or even modest reductions, most particularly for insureds purchasing smaller limits and with non-complex risk profiles. Accounts requiring larger limits and or more complex coverages become subject to the prevailing wider UK/European and Bermuda global market conditions.

Prevailing rating level

So, what is the prevailing rate for Energy Liability business in the International/Global market? As ever the range is broad and depends on industry type, location, limit and exposure class (Onshore, On/Offshore, Offshore etc).

Since 1 January 2023, insurers have seen an average rate increase across their Energy Liability books of mid to high single digit increases (most in the +6% to +7% range and one at just over +10%). Those at the higher end tend to have a greater exposure to US and/or more loss heavy industry areas including Wildfire (where rate increases of +110% to +220% have been seen) and Marine/Offshore exposures. Those at the lower end often have greater exposure to Service Providers/Contractor business where prevailing rates are lower (+3% to +5%), driven by increased competition from the mainstream General Liability market.

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Coverage considerations

Whilst the heat has come out of rate increases, coverage remains a key focus for Insurers. There is a movement back to core coverages on updated industry wordings and, for example, one major insurer no longer provides professional indemnity insurance as part of its combined liability offering, following a major PI claim on a (non-Energy) Liability account. More specifically, PFAS and Climate Change are the two most commonly applied emergent restrictions.

PFAS: Out of the frying pan, into the fire?

Previously, we referred to the increasing prevalence of exclusions relating to Perfluoroalkyl and Polyfluoroalkyl Substances (PFAS) as a result of potential health concerns and their extreme persistence in the environment. Whilst only certain energy and petrochemical companies may have a direct involvement with PFAS as a product, there is still widespread use of PFAS as a constituent of fire-fighting foam, due to its highly effective fire-retardant properties. Early PFAS exclusions allowed certain buybacks in this regard but there is an increasing trend by many international insurers, often driven by Treaty restrictions, to apply broad restrictive clauses, most notably the LMA 5595. Insureds with most success in avoiding such clauses are those that can evidence their lack of PFAS products or fire-fighting foam exposure. The challenge for insureds is to ensure that, whilst limiting their exposure to PFAS they do not restrict their ability to effectively contain spread of fire, otherwise they may be swopping one potential liability exposure for another. Hopefully the continued development and improvement of fluorine-free fire-fighting foams will solve this conundrum.

Climate Change Liability Exclusions: Hot air or valid concern?

Climate Change Exclusions are also becoming increasingly prevalent. Whilst insurers argue that gradually occurring events would be excluded by virtue of sudden and accidental pollution limitations, Insurers and their Treaty Reinsurers are increasingly pushing for certainty and clarity. The concern amongst the broking community is the breadth and variation of these exclusion clauses, and the law of unintended consequences. For example, a methane gas explosion should not be inadvertently excluded because of a crudely worded “greenhouse gas liability” exclusion.

What of the future?

There are several conflicting factors that will influence International Energy market pricing and capacity in 2024.

Social Inflation remains a concern, as does the deterioration of prior loss reserves, a diminution of Facultative Reinsurance capacity and a desire by some Direct insurers to trim their exposures and line sizes in respect of Energy Liability business. In contrast we anticipate some new capacity in 2024, regional markets are increasingly competitive and there is a possibility that Treaty reinsurance renewal prices may ease.

We expect to see further easing of existing rate increases with average rate increases dropping to low single digit in 2024. Will the nirvana of flat rate or indeed price reductions be reached soon? In some limited cases and territories, it already has, but the smart money is on a forward budget approach of mid-single digit for the rest of 2023, easing to low single digit for 2024 (excluding exposure adjusted rate changes). Clearly this differs by industry sector with those risks having greater Offshore, Marine, US or Pipeline exposures expected to attract higher increases.

Controversially, some insurers have suggested that this could be a fictitious or non-sustainable softening followed by an ESG related rate-bounce as future capacity exits the Energy Liability sector, driving pricing back up.

There is certainly an increased focus and selectivity by insurers on how they deploy their capacity. Coal, fracking and Arctic drilling exposed insureds have already experienced serious capacity constriction and some insurers have exited the hydrocarbon sector completely.

As competition continues to increase for the carbon insurance dollar, those insureds that can best articulate and evidence the evolution of their low carbon transition plans will continue to have access to the widest capacity and the most preferential rates.

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