Upstream energy: The quality gulf widens

An uneventful reinsurance renewal season

Compared to last year, the 2024 reinsurance treaty renewal season was decidedly benign, with most markets seeing flat renewals or small rises in their reinsurance protections.

The increased treaty retentions that were imposed by reinsurers during the 2023 renewals have clearly borne fruit during the last year and protected treaty reinsurers from picking up most of the direct losses. Whilst this strategy proved to be successful in protecting the treaty account, direct insurers have felt the pain of this change. This is especially the case for those markets writing a book of smaller accounts where treaties are now much less likely to be exposed due to the size of the insured values and the carrier's line size. Additionally, signed lines on the most favoured business have been reducing due to increased competition for market share and this has also reduced the proportion of a market's line which is protected by its reinsurance treaty. As result, a number of direct insurers had their worst net results in a decade in 2023, despite there being no major losses excess $1 billion.

It appears a new baseline of treaty retentions has been established and there has been no sign of retention levels coming back down again, much to the dismay of direct carriers. We have seen markets respond by carefully reviewing the deductible levels on direct placements and, in some cases, pushing to increase deductibles they deem insufficient. It remains to be seen whether markets will be successful in achieving any increases in deductibles in the competitive market environment in which we currently find ourselves or whether they will need to continue to bear the exposed gap with their treaty protection.

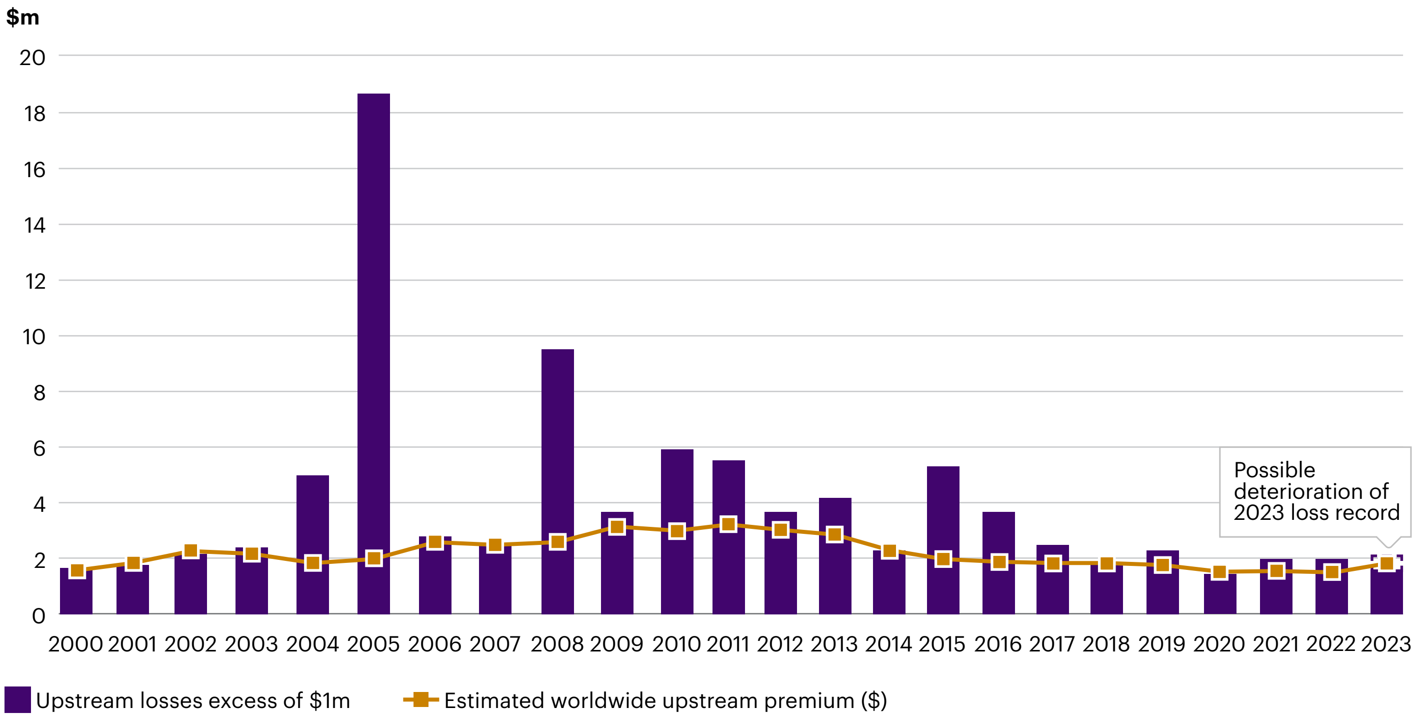
The large loss that didn't move the market

However, despite all of this, many markets still made money in 2023, primarily due to another fairly benign year on the loss front.

As anticipated in our November update, further 2023 loss activity has now materialised in the above statistics. However, despite there being two large losses totalling at nearly $1 billion between them, the market does not appear to have hardened as a result.

Figure 1:

Meaningful offshore construction activity bolstered 2023 premiums



Approximately $2 million of total upstream premium provides some headroom for insurers but the tail of construction projects may yet come to bite

Source: WTW/WTW Energy Loss Database as of October 16th, 2023 (figures include both insured and uninsured losses)

Figure 2:

2023 loss record has shown expected deterioration

Upstream losses excess of $10 million, 2023

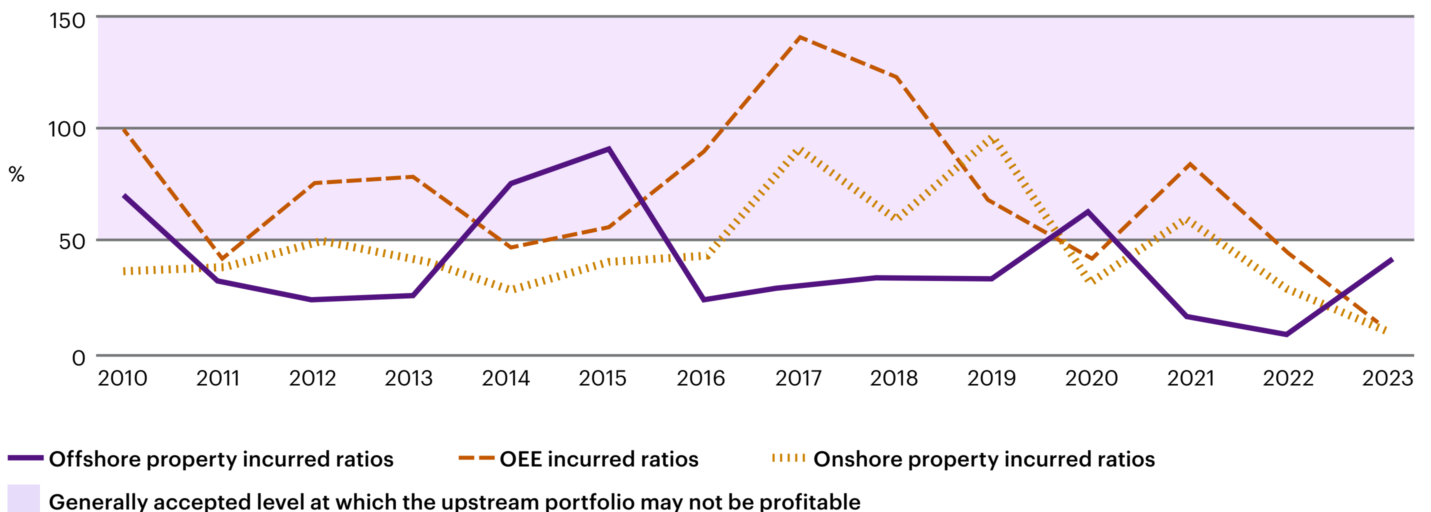
Type	Cause	Country	PD $	OEE $	BI $	Total $
Platform	Fire + explosion/VCE	Latin America	725,000,000	—	—	725,000,000
Plant	Fire/lightning/explosion	North America	220,436,490	—	—	220,436,490
MOPU	Unknown	Asia Pacific	55,625,000	—	—	55,625,000
Rig	Capsize	Africa	55,000,000	—	—	55,000,000
Platform	Unknown	Australsia	54,890,000	—	—	54,890,000
MOPU	Unknown	Europe	—	43,000,000	—	43,000,000
Rig	Collision	Europe	25,500,000	—	—	25,500,000
Rig	Mechanical failure	North America	22,571,240	—	—	22,571,240
MOPU	Corrosion	Africa	20,000,000	—	—	20,000,000
MOPU	Unknown	Europe	20,000,000	—	—	20,000,000
Pipeline	Faulty work/op error	Africa	20,000,000	—	—	20,000,000
Well	Blowout no fire	Asia Pacific	—	—	18,800,000	18,800,000
Platform	Heavy weather	Middle East	17,000,000	—	—	17,000,000
MOPU	Corrosion	Latin America	15,000,000	—	—	15,000,000
Well	Blowout no fire	North America	—	—	13,340,000	13,340,000
Vessel	Collapse	Middle East	12,600,000	—	—	12,600,000
Rig	Fire no explosion	North America	12,500,000	—	—	12,500,000
MOPU	Corrosion	Latin America	12,000,000	—	—	12,000,000
Well	Blowout no fire	Latin America	—	—	11,780,000	11,780,000
Rig	Contamination	North America	11,600,000	—	—	11,600,000
Well	Blowout + fire	Asia Pacific	—	—	11,500,000	11,500,000
Well	Blowout no fire	North America	—	—	10,850,000	10,850,000
MOPU	Unknown	Europe	10,100,000	—	—	10,100,000
Rig	Heavy weather	Europe	10,000,000	—	—	10,000,000

Source: WTW Energy Loss Database as of March 6th, 2024 (figures include both insured and uninsured losses)

Figure 3:

Lloyd’s upstream PD portfolio profitable despite loss uptick

Lloyd’s upstream incurred ratios, 2010-23



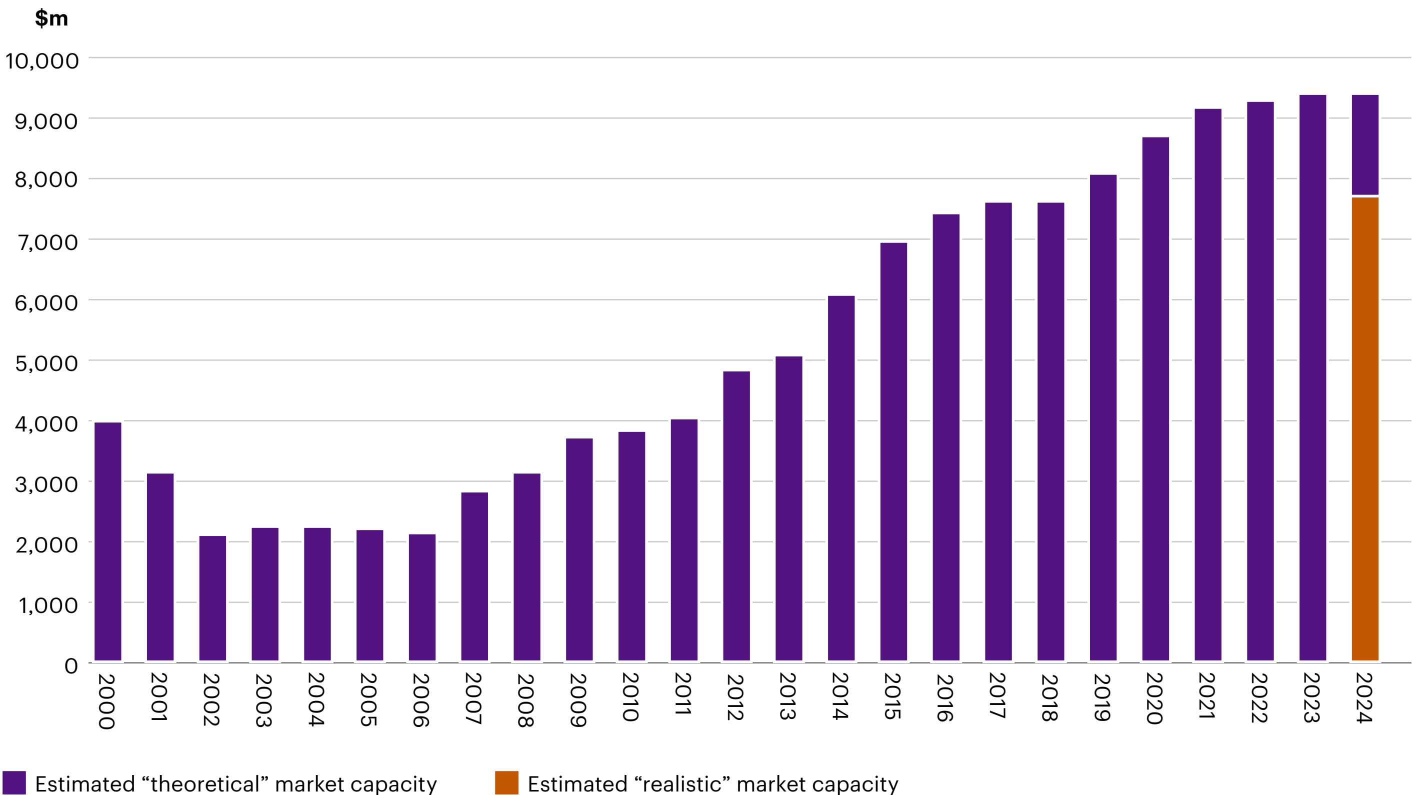
On the other hand, the OEE loss ratio for 2022 sits squarely in the red

Source: Lloyd’s Market Association Quarterly Loss Report Q4 2023. “Offshore Property” — combination of ET/EC/EM/EN Audit Codes “OEE” — combination of EW, EY and EZ Audit Codes. “Onshore Property” — EF audit code.

Figure 4:

Abundant capacity maintained

Upstream operating insurer capacities 2000-2024 (excluding Gulf of Mexico Windstorm)



Theoretical and realistic capacity levels for operating assets remain stable at record high levels

Source: WTW

In fact, it is more likely the smaller sized attritional losses that will move underwriters’ positions, as they will be borne entirely by the direct markets without protection from their reinsurance treaties. When looking at carriers’ combined ratios, we can see a clear correlation between higher loss ratios and those markets writing the mid-market business that has seen the bulk of the recent loss activity.

Construction losses, especially those relating to subsea, remain at the forefront of mind for underwriters and their senior management. A recent pipeline construction loss in Australasia, which does not yet feature in the above statistics, will adversely affect the 2023 numbers further and will do nothing to alleviate the market’s concern about this subclass of upstream business.

Capacity remains abundant — but not for all of the portfolio

Upstream operating capacity has remained largely stable, both on a theoretical and a realistic level. Compared to 2023, increases in capacity from existing carriers have been more moderate in both the number of carriers and the amount of increase, which points to a stabilisation of the upstream market capacity.

There have been no new entrants to the upstream market as of 1st January 2024; however, we are expecting some further capacity to enter during the course of 2024 from both new MGAs and existing carriers that have set up new ESG vehicles.

For the most sought-after placements, the continued oversupply of capacity puts increasing pressure on smaller insurers, especially those who only write a narrow book of upstream business, who are increasingly being deselected by clients in favour of larger carriers who are able to support the breadth of the client’s risk portfolio.

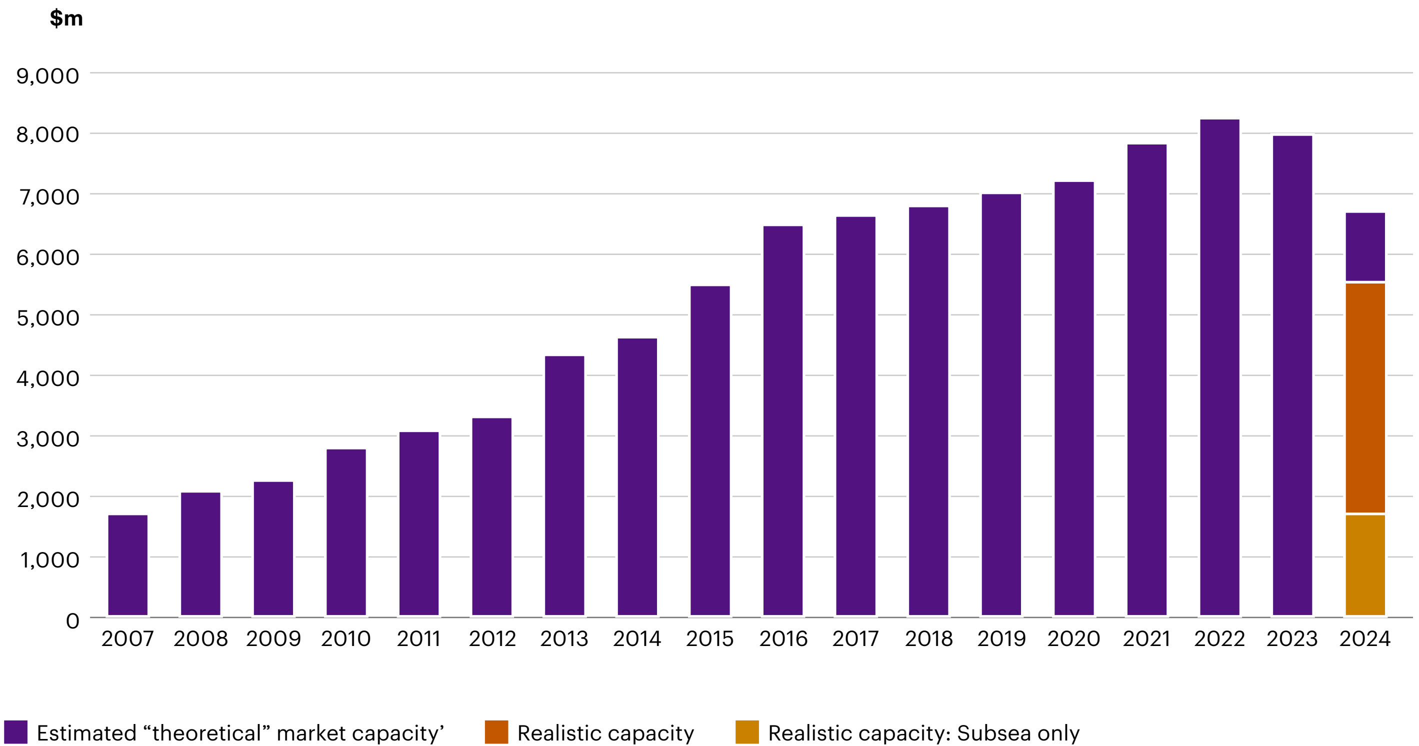
As competition for the most desirable business continues to increase, these smaller carriers face an increasing struggle to remain relevant to clients and brokers alike. If these markets are deselected or signed down significantly on this core Tier 1 business, they may well struggle to support the smaller risks in their book for which their capacity is very much required.

As a result, we see these markets becoming increasingly user friendly with quick response times as well as proactive interaction with brokers and clients and offering to support all of a client’s activities, be they operating or construction, in order to maintain an ongoing partnership with the core client base.

Figure 5:

Offshore construction capacity starting to reduce

Upstream construction insurer capacities 2007-2024



Theoretical capacity levels are reducing with realistic line deployment even more subdued

Source: WTW

One way for smaller insurers can build significant goodwill from their client base is by supporting their offshore construction projects. This subclass of the upstream portfolio has historically been marred by poor loss records, exacerbated by the long tail nature of the risk. As the class struggled with profitability over the last few years, we have seen a gradual falling decline in capacity for offshore construction.

In real terms, whilst theoretical capacity remains high, underwriters are deploying lines significantly below their maximum available capacity. This is most keenly felt on subsea only construction projects, which are seen as the least desirable part of the portfolio due to their loss record. We have recently observed several clients place their subsea construction alongside their sought-after operating programmes to ensure that they partner with markets willing to support them across their activities. Even with this incentive, many markets are only willing to deploy reduced capacity for construction and some would rather be signed down on the high-quality operating business than write construction at all.

How long will market discipline hold?

Despite the continued oversupply of capacity and the meaningful growth targets many insurers have for 2024, markets remain reluctant to challenge existing leaders on accounts on which they already have a position, albeit not with their desired line size. However, if an insurer does not currently participate on a risk, certain markets are willing to quote aggressively to win new business.

Until some of this discipline unravels and new leaders emerge, we are unlikely to see universally offered rate reductions on the upstream book of business as most of the portfolio is already well subscribed to by the current leadership candidates.

Market appetite: The desirability gulf widens

Whilst some other insurance market sectors are currently yielding significantly larger rate increases than upstream energy, carrier appetite to grow in the upstream business persists due to the ongoing profitability of the upstream portfolio. This continued investment in the sector can be seen through the hiring of new and additional underwriters to supplement existing teams at several insurers, with a veritable war on talent to attract the most skilled underwriters.

However, when looking at markets' specific risk appetite, we note that there is now almost no differentiation in individual carriers' risk preferences. Almost all markets are seeking to grow their participation in the most desirable Tier 1 business with large premium volumes, clean loss records, and excellent risk management and market engagement, leading to aggressive competition for the limited lines available on this business. Huge pressure on signings on these accounts ensures that they can get placed with the following markets even following meaningful rate reductions provided that the placement remains led by a credible lead insurer because markets cannot afford to hold out for better terms and risk losing the significant premium income generated by these large accounts.

On the other hand, it is extremely challenging to find carriers looking to grow their book of risks in offshore construction, land rigs, or midstream subsectors, which are viewed as less desirable on account of the loss performance, and this business is likely to still see rate rises. As such, the divide in appetite between the most sought-after business and the remainder of the portfolio is getting wider.

Markets that had to historically be highly aggressive to come onto Tier 1 risks, have now successfully secured their position on this business and are shifting their focus to profitability over further growth. However, this is likely to be followed by a new tranche of markets seeking to do the same, and the market cycle will inevitably continue.

ESG considerations are now well understood

In our day-to-day discussions with underwriters, ESG appears to be less in focus than it has been over the last few years. The reason for this is twofold. Firstly, ESG information is now more readily available to insurers, either directly from clients who now routinely include ESG information in their market roadshows or through separate ESG teams within the insurer who review available information internally and advise the underwriters.

Secondly, most insurers now have a well-established ESG stance which they are confident will not alter significantly in the near future. The majority of carriers have adopted a collaborative approach of supporting clients through their energy transition journeys rather than seeking to exclude certain clients and risks from their portfolio, which has been welcomed by the client base.

What will 2024 bring for upstream buyers?

2023 saw the majority of carriers meeting their ambitious premium growth targets, driven by a significant uptick in offshore construction projects coming to market. This new business has bolstered the overall premium pool but concerns remain about the long tail risk and loss record of this subsector. Most insurers report overall rate rises across their upstream book in 2023, however, this is likely a balance of Tier 1 accounts at flat rates or reductions and less favoured or loss affected business with rate increases.

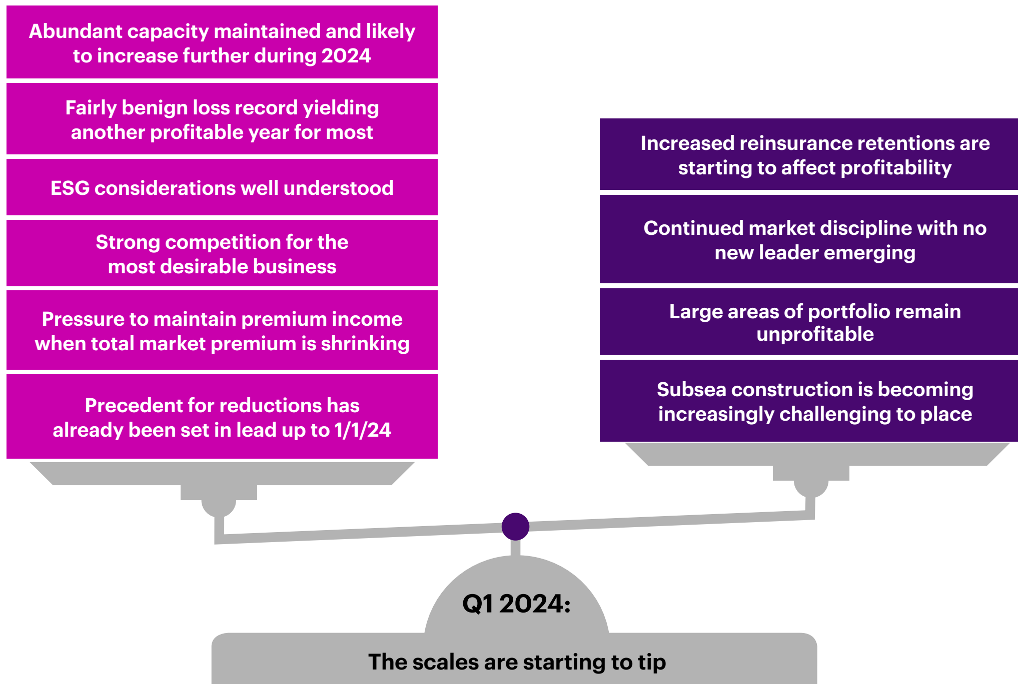
However, leading up to and at 1st January 2024 expected premium was significantly below insurers' expectations due to several large accounts, which had not been tendered in years, renewing at reduced rates, and a large capacity excess placement not being renewed. The latter has resulted in a number of markets missing out on one of the biggest placements in the market altogether with the majority of carriers seeing at least a reduction in the line size they were able to write. Consequently, many carriers would have entered 2024 significantly below their budgetary expectations and would have to commit to new risks or try to secure larger lines on existing risks to compensate for this shortfall, which will prove challenging in the current market dynamic.

This, coupled with the ongoing trend towards increased captive retentions which further compresses market income, has caused a heightened search for alternative income sources at 1st January to fill the gaps in the budget with markets chasing Tier 1 income.

The question is whether this drive for premium income and the resulting rate reductions will continue as 2024 progresses. We could well be at the beginning of a new market softening spiral as the fundamental softening factors, being an oversupply of capacity, a benign loss record and a resulting desire to grow, continue to be present. These factors may well tip the balance further in the buyers' favour.

Figure 6:

The upstream underwriting environment, April 2024



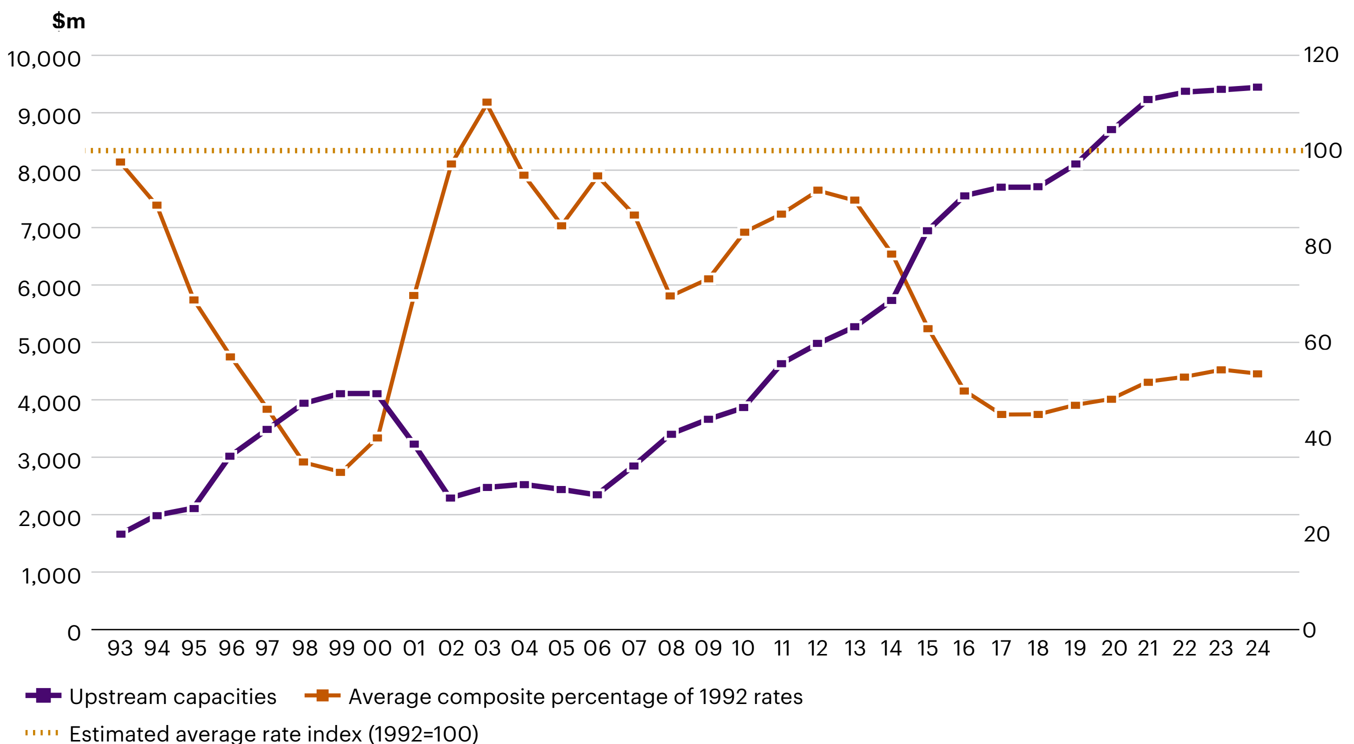
Reductions are on the horizon, but only for some of the portfolio

Source: WTW

Figure 7:

The outlook for later in 2023

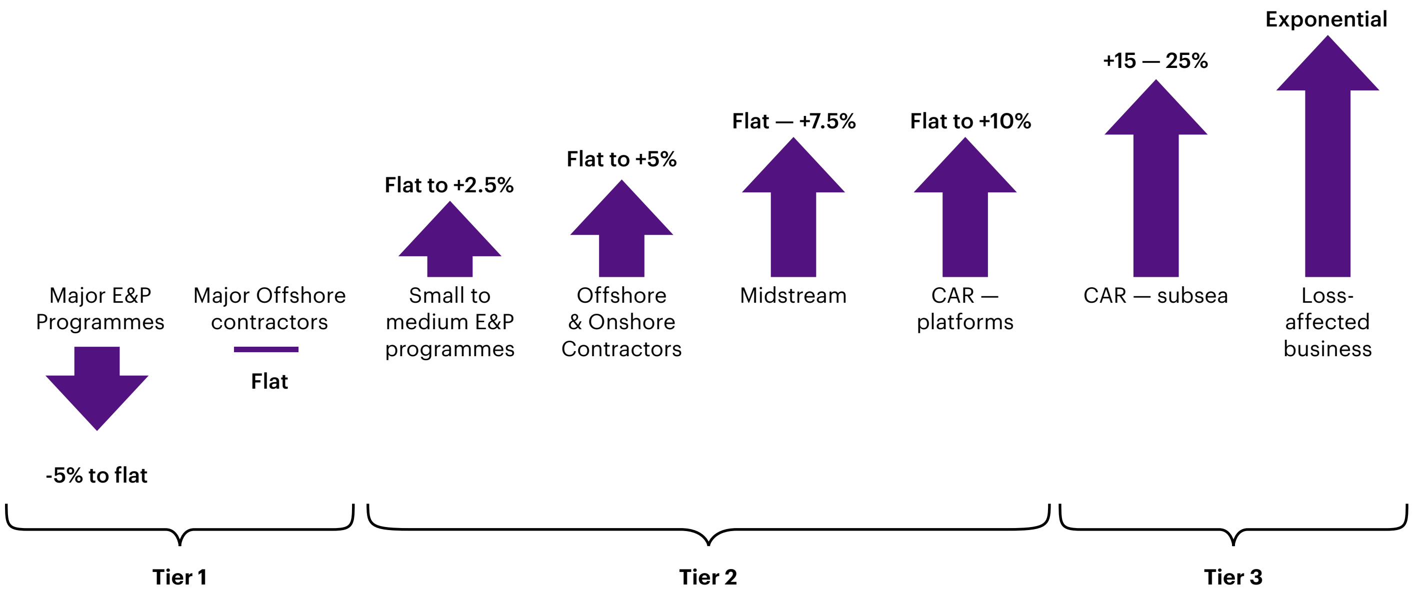
Upstream capacity versus rating levels, 1993–2024 (excluding Gulf of Mexico Windstorm)



Source: WTW

Figure 8:

Three-tier market differentials, April 2024



A widening gulf in rating between the best and the rest

Source: WTW

However, as yet, we are not seeing many outright rate reductions being offered by lead insurers. Instead, brokers are achieving reductions through restructuring of placements, application of new discounts, and changes to coverages, limits, and deductibles, which are receiving more generous credits than they have been in prior years. Insurers are considering all aspects of the placement in their renewal evaluations and the art of broking is very much required at the current point in the market cycle to achieve the best balance of renewal terms and conditions for upstream clients.

Looking forward into 2024, the old adage that a flat market seldom stays flat for long, continues to apply. The expectation for the best Tier 1 business should now be reductions even if markets continue to push for flat renewals, and this is especially the case on accounts where the broker can create competition between different leaders.

Unfortunately, the same cannot yet be said for the remainder of the upstream portfolio, which is still seeing, albeit more moderate, rate rises, causing a widening of the gulf between the different parts of the portfolio.

It is even more important than in the past for clients to work with their broker to positively differentiate their placement in the eyes of the market and allow them to be considered as belonging to the elite Tier 1 which is benefiting from the most favourable rating environment.

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