Marsh

Marsh Specialty

Energy & Power Quarterly Newsletter

January 2022

This edition of Marsh Specialty's quarterly Energy & Power newsletter includes a review of insurance market conditions experienced during the last quarter of 2021, a legal roundup, a look at common clauses, news briefs, and an article about the evolving offshore windfarm technology and insurance considerations for investors.

Across all insurance lines, roadshows, recent engineering reports, and the ability to demonstrate commitment to continual improvement to risk management remain crucial to positioning for optimal cover, terms, and conditions. As global uncertainty re-emerges due to the impact of the Covid Omicron variant, virtual risk engineering surveys will again become important.

We continue to stress the importance of early engagement with comprehensive underwriting information ahead of any renewal or placement process to provide sufficient time for negotiation and consideration before placement.

John Cooper, Global Chief Client Officer Energy & Power, Marsh Specialty.

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State of the market update

Upstream energy

COVID-19 and its variants notwithstanding, a benign upstream insurance market is developing for 2022. The business models of many oil and gas companies have improved. With better commodity pricing, insured physical damage values have stabilized, and BI values are increasing substantially. The International Union of Marine Insurance (IUMI) reported that their members had seen an 8.6% year-on-year increase in overall upstream energy premiums for 2020; further increases are expected in both 2021 and 2022 as oil and gas activity increases, buoyed by higher commodity prices.

As 2021 unfolded, the previous standard application of a 5% increase weakened, and signing pressures (where oversubscription of a risk reduces the amount signed to each insurer from the amount they offered to write) intensified. The surplus capacity has seen more markets willing to compete for business and quote aggressive lead terms to secure maximum market share and increase their premium volumes in 2022. Increased competition should have a positive pricing impact for clients.

As reported at the IUMI conference (September 2021, Seoul Online) only two prominent losses impacted 2021 — the deterioration in an LNG loss from 2019, and the loss of a jack-up rig in Malaysia. Losses from Hurricane Ida were not as significant as initially thought; however, smaller, attrition-type losses have continued to increase. Rising inflation, global logistics challenges, and an undersupply of labor means that any claims occurring in 2022 may be inflated. This has the potential to impact insurers' margins.

There are signs that "blind" following capacity may become increasingly prevalent, especially as Lloyd's have approved a much higher premium income amount for syndicates whose business plans are to follow specific leaders.

In 2022, we expect to see increased competition for those clients that are aligned to insurers' risk appetite —those with demonstrable risk management processes, good claims record, the ability to articulate their ESG journey, and no/low exposure to NatCat risk. While clients and brokers will be pushing hard to break the ''reduction barrier'' on incumbent led accounts, insurers may struggle to provide reductions as syndicate plans agreed by Lloyd's do not allow for them.

Downstream energy

The fourth quarter of 2021 was relatively stable for both customers and insurers within the downstream energy segment. Blended physical damage and business interruption (BI) renewal rates were close to flat, and there was modest large loss activity. Relaxed global travel restrictions in many regions meant customers were able to meet with insurers and re-establish relationships that had inevitably weakened after 18 months of virtual interaction. At the time of writing it seems engagement will be disrupted again as many countries seek to control outbreaks of the Omicron variant.

Besides rating, the energy transition and environmental, social, and governance (ESG) issues have been focus areas through the quarter. Clients have increasingly put sustainability front and center in their discussions with markets, showing proactive responses to the changing dynamics. There is an understanding that being able to demonstrate a clear pathway through the energy transition is important, and engagement allows insurers and clients to work together through the process. Further, insurers will have an opportunity to diversify their portfolios as downstream refining companies make the transition.

Longstanding wordings should be reconsidered in order to address potential claims settlement challenges around the non-replacement of traditional hydrocarbon assets that are either no longer commercially attractive or have become strategically redundant. Where a loss culminates in the non-replacement of an asset by the client, policies are well established in defining asset value settlement, but not the BI loss. We expect this will become more of a focus for insurers.

Overall market losses in 2021, for the second consecutive year, look to be below USD2 billion. Some deterioration of losses impacted heavily on both 2021 and 2020 claims figures. There has been focus from clients around coverage for contingency expenses and preservation of property. Some of these claims will be complex and are likely to require intense negotiation. The impact has seen a number of insurers reconsidering policy coverage extensions and sub-limits. BI volatility clauses have found favor with insurers; a great number of customers have re-declared their earnings projections through the policy period to avoid cap limitations. Much of this activity has depended on customers' initial projections over the preceding 12 months, which inevitably spanned between bear and bull depending on future recovery projections for regional economies. We expect that this approach will need to be maintained into 2022.

Currently there is no lack of capacity for traditional downstream risks, in fact insurers are again deploying full capacity as rates are at a high. However, there is often inconsistency of approach between markets. Oversupply continues to come almost solely from incumbent insurers, and a few new entrants are expected to provide additional capacity in the near future. It appears that rates reached their upper limit in the fourth quarter and are now set to decline. However, there are complexities within this dynamic. The insurer perspective is that rates are still shy of technical adequacy levels and there is little headroom to accommodate the anticipated one-in-five year exceptional impact of natural catastrophe (NatCat) losses. Additionally, there is lack of certainty regarding potential treaty reinsurance cost increases. As such, insurers may take a soft approach towards a downward rating trend.

There is, however, a pragmatic view that market forces inevitably prevail. Creativity around long-term agreements (LTA) to allow for smoothing of declining rates, the impact of ESG constraints, and managing potential pricing volatility is being implemented. A concern for insurers is that a fast rating decline may result in similar market issues to those experienced at the beginning of 2018. While clients will welcome cost savings, particularly after three years of rate increases, a sustainable market brings greater value. As such, a partial LTA hedge can be an attractive option. The immediate potential dividend for customers can be the removal of expensive insurer outliers, and the greater concurrency of policy terms. The pricing difference on many policies is expected to apply across the program, which translates to a greater blended premium saving than the headline market rate movement. This may benefit clients and those insurers who applied year-on-year rate increases in a more sustainable way. As such, pandemic implications aside, 2022 could potentially, deliver a relatively stable market for insureds.

Traditional power

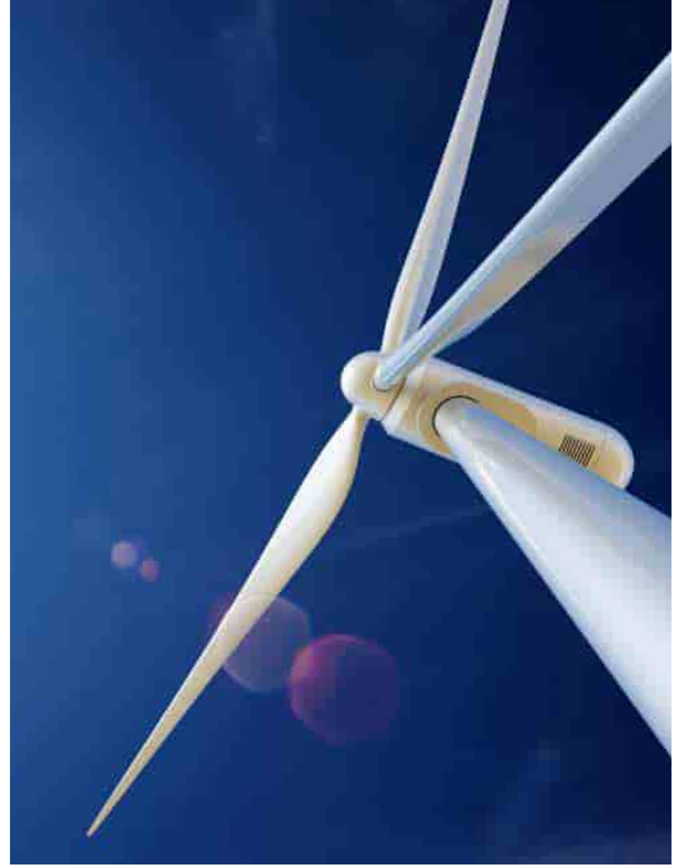
The final quarter saw continued slowing of rate rises for straightforward renewals with clean loss records and no NatCat exposures. An increasing number of clients experienced premium increases of less than 10%, and rate reductions were achieved on a few placements. This stabilizing of rate increases was underpinned by:

- Engagement of global insurance markets to increase access to capacity and reduce local market control.
- Tightening of terms and conditions by insurers resulting in companies retaining higher levels of risk.
- Emerging managing general agents (MGAs) adding capacity to the market.

This has resulted in the return of over-placement and signing issues (where oversubscription or more than 100% capacity leads to markets being signed to a lower amount than their written line) on some sought after accounts. Additionally, regional insurance markets are re-emerging as hubs, having witnessed a return to profitability of the London market over the past 18 months.

There has not been a change in the rating trend despite the number of large losses hitting the market earlier in the year, and the storms experienced in the US during the third quarter.

Standalone coal placements continued to experience challenges. As an increasing number of insurers have no appetite for such placements, regardless of risk quality or loss history, larger retentions and further rate increases are expected to persist. Insurers, and Lloyd’s, are re-aligning underwriting in support of revised ESG policies, further reducing capacity, in some cases earlier than anticipated. With demand for capacity exceeding supply, rates are often considerably higher than expiring policies, and are felt more acutely by companies without an established relationship with the insurer. In our experience, restructuring of programs and a strategic approach using global insurance markets has become commonplace.



Renewable energy

The renewable energy market continues to grow as we see traditional oil and gas, and other energy insurance markets entering the sector. These insurers are looking to diversify their book of business to align to the opportunities offered by the energy transition. Generally, these markets enter the market conservatively, looking to provide a small amount of follow capacity as opposed to providing lead terms. As such, the increased capacity has not had a significant impact on terms or pricing in the third quarter. However, as these carriers grow their technical expertise, experience, and book size, the changing market dynamics and increased competition could provide greater benefits to clients. Specifically, we have seen continued stabilization in deductibles and terms for loss-free, operational risks with lead markets focused on rating adjustments as they continue to seek profitability. In the fourth quarter, this resulted in rating increases of about 10% to 15% on loss-free accounts, with further increases reserved for risks that are exposed to NatCat, assets coming out of warranty, or those that have incurred losses or experienced issues during the previous year.

Insurers continue to look for increases in self-insured retentions in the construction sector as wind technology evolves and turbine sizes increase, while retention levels on solar projects remain largely consistent. Project location remains an important factor across all technologies, and as developers invest in more remote regions, insurers are becoming more concerned around supply chain lead times, which remain a key factor in driving deductible levels, particularly in respect of delay in start-up (DSU) coverage.

While historically the traditional renewable energy market has comprised mostly wind and solar placements, we have seen significant growth in commercial scale battery energy storage systems (BESS) globally. The technology is relatively immature, and insurers generally take a conservative approach to such prototypical and rapidly evolving technologies, particularly as there have been a spate of recent fire related loss incidents. As a result, there remains relatively few lead markets in the BESS space. Early engagement with a specialist broker throughout the project development process is important to help secure coverage in this challenging market.

Another key challenge is around particular original equipment manufacturers (OEM) on the wind side, driven by recent losses. Similarly, early engagement with your broker will allow them to provide advice early in the development process and help to mitigate the risk.

Challenges around remote working, blended with the rapid growth of the sector, may allow underwriters to more easily dismiss risks that do not fit their core appetite. The quality and quantity of the risk information presented during the placement process is vital. Program optimization and strategic purchasing are key tools to inform a detailed whole of portfolio strategy in order to optimize coverage and pricing.

Terrorism/political violence

The terrorism and political violence insurance lines remains profitable, and there has not been any major withdrawal of capacity over the course of 2021. There was an influx of new capacity at the end of 2020, and we expect that there may be a small number of new entrants at the start of 2022. In addition, some current markets are expected to increase their line sizes and offerings for 2022. This indicates that rates that had been generally flat at renewal (for assets that are loss free and well regarded) may see small reductions. On the other hand, there are and will continue to be localized increases in rates in parts of the world that have experienced losses from riots or looting, particularly those with a retail background.

Thankfully, there have been no severe and catastrophic losses as a result of terrorism. The quantum from incidents in South Africa are being confirmed, and though the claims might be high, it is unlikely that there will be a knock-on effect to the market at large.

The trend of “all risks” property insurers looking to exclude the perils of strikes, riots, civil commotions, and malicious damage (SRCCMD) will likely continue, with such coverage being sought in the terrorism and political violence market.

With deductibles and retentions already at low levels, we do not anticipate much change to the current structures. Exposure to third parties, and by that nature sub-limits to policies that include contingent BI, might come under more scrutiny, especially in areas where looting and civil disturbance have been issues. The market remains stable, with ample capacity and a willingness to be flexible and accommodative, particularly for longstanding clients. We may start to see more policies with longer-term deals.

Energy casualty

During the fourth quarter, average rate increases at renewal of around 15% were experienced on like-for-like upstream/offshore casualty exposures, though the rate of increase declined throughout December 2021.

There have been a couple of new insurance market entrants in the upstream and offshore sector; each is writing cautiously and selectively offering relatively small lines (around USD10 million). In addition, a new managing general agent emerged bringing new capacity from a major carrier not currently in the casualty arena, offering up to USD20 million, written by underwriters with a proven track record in this sector. Staffing movements have resulted in an underwriter with a proven track record joining a insurer looking to start a casualty book, which may add another market. However, these new entrants are unlikely to impact the rate increases being experienced as there is still an overall lack of competition, and capacity remains tight.

Downstream/onshore casualty market renewals through the fourth quarter, on average, experienced rate increases of around 20%, before any change in the risk exposure metrics. As with the upstream sector, there was a lack of competition, and insureds looking to purchase high limits (in excess of USD500 million) were likely to face enforced self-insurance gaps in the program.

Reinsurance treaty renewals at January 1 may be a factor for early 2022 renewals. Insurers are increasingly seeking climate change exclusions, particularly if restrictive wording is imposed on them through their casualty treaty insurance program renewals.

Bermuda casualty

Over the past two years, large Bermuda carriers (offering USD100 million plus of capacity) have either withdrawn from the energy class or dramatically cut back their capacity to no more than USD25 million each. This dramatic reduction in available capacity drove an often top-down increase in rating where the Bermuda markets capacity, usually used at high excess lines, have applied rate increases of 20% to 25% for two consecutive years. In 2021 there was less pressure from the excess Bermuda carriers that were typically supporting rate increases of underlying London/European insurers at a minimum double-digit rate increase level.

There have been a few new start-ups in the Bermuda casualty market, but all have been cautious in writing the energy class, to a maximum of USD10 million on selected energy risks.

One Bermuda market (that typically participates in the first layer above London/Europe) is looking to specifically add the emission of greenhouse gases to their pollution exclusion to placements, and excess Bermuda markets are looking to impose the same restrictive language as the underlying polices.

Marine exposures

In 2019 and 2020, the marine market capacity reduced worldwide. Most remaining underwriters have adopted a pattern of increased focus and scrutiny on ship owner experience/credentials, reviewing operating standards and previous loss experience; a new, more challenging market has now developed.

A recent marine market review of 2020 premiums by the International Union of Marine Insurance (IUMI) concluded that global marine premium base has gone up by 6% from 2019.

In the fourth quarter of 2021, the marine market increasingly stabilized. With renewals for well-performing business seeing flat renewals, we expect that clients may start to experience some pricing stability in 2022. This could change quickly should the market suffer one or two large losses.

A 2021 mid-year hull loss trend analysis carried out by IUMI illustrated that the frequency of hull and machinery claims continued its long-term downwards trend, with an extraordinary drop in 2020. This is likely caused by the reduced shipping activity during the pandemic; more pessimistic underwriters are considering the impact once shipping activity returns to more normal levels, particularly the cruise sector.

In 2021, new capacity entered the market. Experienced and respected underwriters employed by established capacity, are looking to grow market share and this is creating improved market conditions and benefits for clients. However, they are likely to remain focused on revenue targets and not allow rates to fall too sharply.

Onshore construction

In January 2021, we suggested that, while portfolio pricing appeared to have improved, underwriting could be considered profitable and the class viable — prior years were still worsening, more losses were expected, and the expected profit levels were not being realised. Since then, rates rose steadily throughout the year, claims were experienced, and reserves on prior year losses worsened; however, three years of upwards pricing trend does not cover 15 years of downwards trend.

Has the onshore construction market reached its peak? It is unlikely. The rating direction is unlikely to change until more capacity is available to result in competitive tension. While capital is considering (cautiously) entering the class, new capacity is unlikely to arrive with enough scale in the immediate term to create the excess required to give insurance buyers useable alternatives. Clients seeking onshore construction coverage will need to work with a specialist broker to best positon their risk to address insurer concerns around issues such as cyber risk, delay in start-up (DSU), exposure to natural hazards and LEG 3 (latent defect) cover. Even then, the market will remain challenging with companies facing coverage restrictions and rating pressure. Extensions of policy periods on existing terms are rarely achievable.

A lack of consensus between underwriters in relation to opinion, or understanding where the losses will come from, is creating extremes. We are seeing some quite varied quotes and offers on coverage, and on occasion there has been 100% variance in lead quote pricing in recent quarters. This makes budgeting for insurance costs difficult for insureds, and there is a correlation between the required market capacity for a project placement and whether the placement is finalised at the best offered terms, the second best set of offered terms, the third best set, and so on.

A relatively common approach is to index link sub-limits and deductibles during a project period — as inflation rises the fear is that deductibles at the end of a project could have a real value significantly lower than at the outset. There is also a school of thought that policy sub-limits need to bear some proportion to the overall project value. But in both of these cases, not enough thought is being given by the underwriters as to what the clients' actual exposure is, where the contractual risk of loss falls, or how terms of insurance are fixed between owners and EPC parties (or lenders). More importantly, how much consideration is being given to what the client originally requested or requires?

Lastly, we might also see the law and jurisdiction of a construction policy be further scrutinized. Some insurers have concerns about the lack of consistency and the challenge of quantifying exposure under local regulatory regimes, particularly if a dispute may involve multiple regions.

Ultimately, markets will continue to focus on rates, so ensure that you engage with your broker, provide good information, and leave more than enough time for negotiations.

Regional updates

ASIA

Upstream insurance markets in Asia remain stable. While there were not any significant capacity withdrawals in the region over the last quarter, several Chinese-based markets started to withdraw from the sector, apart from where there are Chinese interests involved.

Operational programs saw no significant changes in underwriting approach, and rating movement remains in the range of 5% to 10% for programs with a minimum five-year clean loss record. Lead market options remained limited for contractor accounts. Hard market conditions also remained in the offshore construction sector, with increases in rates and deductibles, especially for subsea works. While we have not seen a change in capacity over the last quarter, focus remains on the sub-contractor quality and claims records.

The downstream market in Asia continued to stabilize, with overcapacity on placements now more common as underwriters seek to maintain their expiring shares and avoid signing pressures. Markets are now willing to be more flexible, particularly on loss free accounts, and, although rare, long-term agreements are being considered on a case-by-case basis.

Business interruption (BI) remains a focus and updated valuations are being increasingly sought to redress the reduced activity in this area over the last two years, coupled with expected value escalation concerns. However, underwriter loss ratios remain on the low side with no significant deterioration. While we have yet to see rate reductions in the Asia underwriting market, we may see movement in this direction in the next quarter. Regional underwriters are also cognizant of rate reductions in other market hubs, and will aim to ensure that their market share is not undermined.

A similar situation exists in the power sector. While premium increases are still being applied, a greater degree of flexibility is being shown for coverage terms and pricing on clean loss accounts. This is in line with the tapering effect that we have been reporting over the last two quarters, as markets seek to protect their top line following two years of significant rate increases. In contrast, accounts that have had poor loss records are still being heavily penalized with marked rate increases coupled with upwards adjustment on both property and BI deductibles.

Coal-related placements continued to experience minimum 30% rate increases, even for insureds with clean loss histories. Further rate escalation is expected as capacity continues to be squeezed from the sector, due to a number of recent Asia Pacific claims in the last quarter estimated at about USD350 million to USD500 million.

PACIFIC

The energy and power industry in Australia and New Zealand continues to face challenging insurance market conditions, particularly those insureds that have experienced losses and/or those with high natural catastrophe exposures. Despite these difficult conditions, the market steadied and increases stabilized over the final quarter for most clients.

The oil and gas sector continues to lead the recovery of the market, due to the relatively benign loss experience in the sector globally. While there is not an over supplied capacity, it now appears that markets are positioning themselves to take advantage for growth and recovery. This pursuit of market share should generate a continued level of competition and stability.

The region's power sector has suffered one of its worst underwriting performances in recent years due to two significant losses. The value of these two incidents is likely to exceed gross written premiums (GWP) by a significant margin. This will force insurers to reassess their portfolios for 2022, and likely add pressure for rates increases.

The focus on energy transition and a decrease in capacity for coal-related placements will continue to impact pricing throughout 2022. Although pricing appears to have reached an apex, many clients in this sector have started seeking alternative risk transfer solutions rather than continuing to pay unsustainable insurance costs.

Positively, the capacity once allocated to thermal power generation has made its way into the renewable energy sector. The rush of new markets into this sector has generated an oversupply of capacity as insurers seek to gain market share. This has increased competition, and projects that once required global insurance market participation can be comfortably placed in Australia or New Zealand markets.

Policy coverage and conditions will continue to be areas of focus for insurers in 2022. It is likely that policy clauses and language will tighten, particularly the removal of non-physical damage coverage, contingent BI coverage restrictions. This will affect insured perils, geographical radius limits, and reduced indemnity periods, as well as a continued restriction of communicable disease clauses, and limitations to cyber coverage.

MIDDLE EAST AND AFRICA

The ongoing transformation taking place in Saudi Arabia continues to be pivotal to the Middle East region's development. The aggressive goals of Saudi Arabia's Vision 2030 in terms of diversifying the economy away from oil continue to accelerate investments from the Public Investment Fund (PIF) across a broad cross section of industries including leisure and hospitality, agriculture, and renewable energy. As part of Saudi Arabia's commitment to be net zero by 2060, the PIF and private sector partnerships will seek to invest to achieve installed capacity of 58 gigawatts of renewable energy, mostly solar PV by 2030. The pace of change here should not be underestimated.

In other parts of the Middle East, smaller scale transformations are taking place through continued divestments and privatizations. This process of raising capital is fuelling international investment outside of the Middle East, with much focused on the African continent — especially in the power and mining sectors — where Middle East national industries are seeking to diversify geographically.

The profile of the insurance landscape in the region continues on a positive trend from a buyer's perspective, with appetite and capacity deployment growing from the international markets as well as regional carriers and managing general agents.

The pace of change in the downstream energy and conventional power sectors has been particularly noticeable as the increased appetite has levelled the rates out to a flat benchmark. In some instances, buyers are able to obtain lower like-for-like premium costs through pushing out differential terms and layering strategies. Further, we have seen a willingness from markets to consider loss sensitive or risk quality discounts, as well as growing appetite for long-term deals for clients considered to be "core." For upstream risks, the relative global stability is reflected regionally — albeit still dominated by a limited number of credible lead markets in the region. The market for renewable energy is showing signs of modest growth with regional carriers in particular demonstrating a willingness to ensure this is part of their treaty protections going forward.

UNITED KINGDOM

As 2021 drew to a close, the UK based energy and power insurers could be reasonably satisfied with how the year progressed. The rating environment generally remained positive throughout, and the natural catastrophe events that resulted in estimated insured losses exceeding USD100 billion had a relatively minor impact on markets. Profitability for the portfolio is assured for most carriers and notably so for some, particularly in the downstream sector.

Against this background, it is no surprise that we are seeing risk appetite grow in the London market, with capacity increasing for 2022 to capitalize on continued favorable underwriting conditions. Managing general agents are finding it easy to expand into new sectors with support from capital providers keen to generate strong returns in a low interest rate environment. We have also seen strong growth in the new “full follow” insurance vehicles, where underwriting is done by algorithms, after a very positive first year in meeting performance targets.

As we look forward, we anticipate the impact of new capacity will drive a more competitive trading environment with differential terms and conditions largely being eliminated on renewals and more options being available to clients. Additional competition returning from regional markets should add to the pressure on incumbent insurers to provide more favourable terms, although the underwriting authority for many of the global energy and power insurers remains centred from London.

However, the outlook is not equally positive for all insurance buyers. The recent discussions at COP26 highlighted the urgency of addressing greenhouse gas emissions in the energy industry. Insurers’ responses have been immediate with announcements of a timetable for withdrawal of insurance support from certain sectors. This effective reduction of capacity in these sectors will result in reduced competition. Indeed, we are already seeing markets in London decline to renew accounts on broad ESG concerns and clients should put strong emphasis on their ESG approach as part of renewal submissions for all classes.

Many London markets have also highlighted the opportunity that the energy transition will bring. While in the past some were criticised for a slow response to support the renewable energy industry, there is an increasing appetite from insurers to enter this class today. This has resulted in the strongest battle for talent we have seen in the industry for a number of years, as all participants build teams capable of servicing this sector. With these increased underwriting capabilities, we expect to see the introduction of new facilities and new product development. There should be some positive outcomes for clients as the London market repositions to achieve the same relevance for the transitioning energy investors as it has for the traditional energy sectors.

NORTH AMERICA

The market continued to stabilize in the fourth quarter on the strength of rate increases experienced throughout 2021, with most regional underwriters reporting on or ahead of their targets. Indeed, for many in the sector attention has already turned to 2022 in anticipation of heightened competition for both risk and, quite noticeably, talent. At the product level, while property pressures are abating, casualty lines continue to prove challenging for even the most committed underwriters as both frequency and severity of losses continue to climb.

At the end of 2021, the record will likely demonstrate that while challenging for many, it was the year that entrants exceeded exits, and tier one underwriting capital began to emerge in force, with large multinational commercials and regional industry mutuals recommitting to the energy and power sectors. Rates are now supporting not only improved performance and expanded appetites, but in the case of the mutuals as healthy distributions have been announced for payment in the coming year.

Looking ahead to 2022, new commercial entrants are anticipated, but we also expect to see expansion of appetites, reversing localized trends that have made optimizing the utilization of available capacity challenging, even for those with the most attractive project and portfolio profiles.
In 2021 industry mutuals delivered on the promise of expanded support for their member companies, dampening volatility and absorbing market share; a trend which will likely continue. While supply-side view is now favorable for insureds, it will nonetheless be absolutely critical for insureds to continue to position themselves aggressively as demand too is projected to increase. In particular for renewable energy where both energy and power sub-sectors increasingly compete, and the pipeline for proven and less-proven technologies is equally robust. New wind, solar, battery storage, carbon capture, biofuels, and hydrogen projects will all compete for this expanded specialty risk capital, alongside existing established energy and power risks. Competition for catastrophic risk capital in particular will only continue to increase as footprints associated with distributed energy technologies expand.

Focus on Offshore windfarms: Project insurability can make or break a bid

The world's ever-growing interest in offshore wind turbines was evident during a recent tender in Scotland by the UK government. The auction for 15 seabed leases off the northeast coast attracted 74 bidders, including new entrants to the sector from the oil and gas industry, joint ventures, and a consortia of other interested parties from around the world.

Scotland's additional turbines are expected to provide an enviable 10 gigawatts (GW) of generating capacity — or enough energy for between 7-10 million households. Governments globally are pursuing similar offshore wind tenders, with over 284 GW planned for construction by 2036, according to intelligence provider 4C Offshore. The projected investment is significant, with 4C Offshore estimating a spend of USD840 billion by 2043; attracting the necessary finance is a key component of a successful bid.

With few licenses to go around, investors are primed and competition is fierce. And as competition for licenses intensifies, developers are increasingly looking to invest in windfarm projects further afield, leading to a sharp rise in the planned deployment of floating offshore wind technology. Floating technology represents the new frontier of offshore wind energy and allows for the development of windfarms in deeper waters compared to fixed-bottom turbines.

Adaptation to risk

Fixed-bottom offshore windfarms have been built at scale since the turn of the century. Over time, the risks have become widely understood and the insurance market has started to show signs of maturity in its approach to policy coverage and risk allocation. When breaking down the costs of claims, insurers are therefore well-versed with the issues, such as, maintenance delays due to weather conditions, availability of specialist offshore vessels and experience of crews, the continual evolution of technology, evolving supply chains, natural catastrophe exposures, and emerging markets. Unfortunately, some of the most common insurance claims that have persisted — especially with regard to sub-sea cables — continue to reveal manufacturing issues and installation-related losses.

These risks impact floating turbines too, and have the potential to be amplified. For example, turbines further off shore could require longer tow times back to the harbor when repairs are required. Insurers' perception of "tried and tested equipment" varies, and gray areas remain around cover for consequential property damage from defective components. Another example relates to "interface risk" — which is the compatibility of the wind turbine with the floating platform technology — which may result in uncertainty around warranties and performance guarantees.

In addition, insurers have raised concerns about suitable "remote monitoring" solutions for the dynamic components of turbines — such as moorings lines and the sub-sea cables — to ensure that fatigue and corrosion are managed and learnings are carried into future projects. A lack of remote monitoring can increase risks exponentially.

Natural partners

Companies in the oil and gas sector have experience working with some areas of the floating offshore wind supply chain, and they have a developed and standardized approach to contracting, risk allocation, and insurance. Such companies can take lessons from the past (especially with regard to remote monitoring) and leverage their knowledge of floating technology and dynamic offshore structures. When you consider that they are also looking to invest in renewable energy as a means to decarbonize, it is not too surprising that this traditional energy sector is showing a strong interest in diversifying into floating offshore wind farms.

Improving insurability aids project financing

If a project can demonstrate a robust and well-structured insurance solution, it's easier for lenders to back it. Such solutions can lead to greater inflows of capital and ultimately growth of this expanding industry. In order to maximize the availability of insurance for a floating offshore wind farm, the following actions should be considered:

1. Early alignment of all the stakeholders in any given project including contractors, floating technology suppliers, and joint venture partners. Striking a fair allocation of risk at the beginning of the process will save time and money as the insurance placement starts to gather pace.
2. Careful assessment of the quality and experience of the supply chain. Consider working with as many "tier one" contractors as possible. Insurers will assess the contractors you work with, and their experience and quality of work will be a key differentiating factor for your project.
3. Appointment of a marine warranty surveyor at the earliest opportunity. Consider using them to participate in your early engineering process.
4. Ensure that a recognized certification body (such as DNV or ClassNK) has confirmed that the design process complies with performance objectives.
5. Early engagement with risk management brokers and pre-selection of an insurer to work closely with your project team. The insurance placement process will need to be carefully managed with a lead time of between six and nine months to ensure that the risks are properly defined and mitigated.

These actions are also recommended for controlling the cost of the insurance coverage, as the premium rates are usually higher for floating offshore wind farms when compared with fixed bottom offshore wind farms (due to the factors discussed above).

If you have any questions regarding offshore windfarm risk, please contact your Marsh Specialty advisor.

Watch the video of Hamish Roberts, Global Leader Renewable Energy, and Dan Gumsley, Senior Vice President, Renewable Energy UK, discussing the increasing interest in offshore wind and the insurance considerations for investors.

Risk engineering update

Deep dive risk surveys

Marsh Specialty reached a significant milestone in the fourth quarter of 2021 by completing the seventieth risk engineering deep dive survey of the year. Deep dive surveys provide energy and power companies with an in-depth understanding of risk quality in specific technical areas and tailored advice for risk mitigation. The information collected through these surveys allows engineers to identify recurring themes or early warning signs for potential loss incidents. Based on our extensive analysis of operating assets, some of the most prominent themes relate to:

- Weaknesses in piping inspection programs

Piping inspection programs frequently present as a second priority to vessel inspections, even though they account for more than 70% of known industry losses in the past 25 years. The adequacy of remaining-life-assessments is a particular area of concern.

- Deferral of inspections

Inspection deferrals are typically managed in accordance with corporate and/or local regulatory requirements. These vary greatly throughout the world. Too frequently, deferral requests are approved without comprehensive risk mitigation plans in place. However, good engineering and best practice require that a thorough risk assessment, supported by inspection data, must accompany all deferral requests.

Our thought leadership paper Inspection Deferrals in the Downstream Energy Industry offers best practice advice in this key subject area.

- Inadequate validation and interpretation of data

Robust inspection programs rely on effective interpretation and validation of large volumes of data in a structured way, often supported by powerful inspection management software tools. While the value of these tools is not disputed, they should never be considered as a "black box" that removes the necessity for engineers to understand, explain, and validate output data. Our specialist engineers have often seen illogical results, such as negative corrosion rates, go unchallenged.

- Unsafe maintenance on piping systems

Proprietary designs of mechanical connectors are increasingly being used in industry to facilitate cold-work methods of connecting piping systems. The key benefit of cold-work installations is to reduce the number of welding activities on site (and potential ignition sources). These components and related installation methods are often not as well understood as traditional methods of pipe connections, such as flanged assemblies or welding. The recently published EEMUA (Engineering Equipment and Materials Association) 243 report is intended to support technical teams in developing their corporate work instructions and management systems for installing mechanical connectors.

The paper was developed by a team of engineers and specialists, which was founded and chaired by a Marsh Specialty risk engineer.

Sustainability

The focus on climate and sustainability related initiatives has increased markedly over the last 12 months, with underwriters and their risk engineers increasingly interested in improving their understanding of clients' strategic plans and risk management programs. In the fourth quarter of 2021, Marsh Specialty piloted a number of studies designed to help clients model and evaluate climate-based risks, including catastrophe and chronic weather perils. The results of the work will assist our clients to:

- Understand current and future climate risks to sites and operations.
- Investigate the suitability of current defenses and mitigation measures.
- Build resilience through engineering design.
- Provide information to support reporting on climate resilience, sustainability, and ESG.

News brief

The Bermuda based energy industry mutual, Oil Insurance Limited (OIL), has issued a shareholder notice outlining the highlights of their five year strategic plan which was developed with support from Oliver Wyman. The key points include:

- A broadening of the definition of "energy" to include new sectors such as biofuels/biochemicals, electrical storage, hydrogen, offshore and onshore carbon capture and storage, offshore and onshore wind generation, solar generation. These new sectors will replace the existing "renewable" sector definition, to create more focused rate differentiation.
- A planned a review of OIL policy wording to ensure suitability for new technologies.
- A potential third party structure to facilitate "additional insureds" by simulating a rated captive used by many members to allow them to use OIL to meet contractual obligations for construction risks with contractors and lenders.
- Preliminary identification of a unique parametric type product that may help OIL members mitigate uncovered losses when they sustain property damage, control of well, or third party pollution events. OIL plans to further develop this product in 2022 and into 2023 while testing its feasibility with the members.
- Possible rebranding, which may include a name change. More information is expected by the end of June.
- Provision for a dedicated internal marketing resource; marketing responsibility is currently shared by the CEO and COO.

About OIL

Oil Insurance Limited (OIL) is a mutual insurance company that insures over USD3 trillion dollars of global assets for more than 60 members who are engaged in energy operations. The company provides its members with up to USD450 million of per occurrence limits which serves as cornerstone capacity for their global insurance programs. Contact your Marsh Specialty client executive for more information, or download a copy of the OIL Companion (Guide to OIL) or visit www.OIL.bm

Chubb has published a report on Strikes, Riots and Civil Commotion (SRCC) risks, Confidence in Conflict: Insuring Your Business Against Civil Unrest which includes legal input from global law firm Kennedys and data from information, analytics, and solutions specialists IHS Markit. The report analyses the current SRCC risk landscape, how it is evolving, and some of the critical issues that are impacting both businesses and individuals in different parts of the world.

How the increased frequency and severity of political and social upheaval is changing the risk profile of some multinational companies is a key consideration of the report. Traditionally, insurers offered SRCC protection; however, insurers have begun excluding events of social unrest from property policies.

According to Chubb, risk managers need to ensure bespoke insurance programs are in place to protect their balance sheets and assets. The report states that it is critical for companies to understand the limitations and exclusions that can affect the coverage of SRCC losses, as well as the specific risk exposures during events of civil unrest that will have an impact on their contracts.

Kennedys added that recent civil unrest events have brought into sharp focus the interpretation and application of traditional civil unrest perils typically seen in insurance policies. As always, clear policy drafting is critical, and both insurers and clients should carefully consider the terms of their policies and how they are likely to respond to various scenarios.

The International Union of Marine Insurance (IUMI) recently released statistics showing the offshore energy market reported a global premium base of USD3.6 billion, which represented an increase in premiums of 8.6%. IUMI reported that it was the first increase in premium base since the 2014 drop in oil price, which drove an equally strong drop in premiums over those years. IUMI noted that in offshore energy, the level of premium income mirrored the oil price, and the premium base may have reached the bottom of the cycle in 2019. However, the report noted that the oil price remained volatile and was impacted significantly by the pandemic in 2020.

In 2020, claims were at an all-time-low and on track to produce the fewest upstream claims this century, both in numbers and value. Events such as Hurricane Ida and the COVID-19 pandemic had the potential to end the period of low claims and slow any underwriting improvement, the report warned. The IUMI report is available on their website.

The International Group of P&I Clubs, the International Oil Pollution Compensation (IOPC) Funds and ITOPF have collaborated on a new booklet on liability and compensation for ship-source oil pollution in the marine environment. The document provides an overview of the international and selected national arrangements in place, as well as background information on "who pays." The document was produced with support from IMO, the Canadian Ship-source Oil Pollution Fund, and the US National Pollution Funds Center.

The publication is based on the collaborators' experience applying the provisions of the compensation regimes to incidents around the world and the assessment of associated claims for compensation. The importance of a close relationship between those claiming compensation, those paying compensation, and technical advisers — which work together closely during the claims process — is highlighted throughout with case studies. A copy can be downloaded from the International Group of P&I Clubs website.

Swiss Re has reported that extreme weather events in 2021, including a deep winter freeze, floods, severe thunderstorms, heatwaves, and a major hurricane, resulted in preliminary estimated annual insured losses from NatCat of USD105 billion, the fourth highest since 1970. Manmade disasters reportedly triggered another USD7 billion of insured losses, resulting in estimated global insured losses of USD112 billion in 2021. Insured losses from natural disasters again exceeded the previous 10-year average, continuing the annual trend seen in recent decades of 5% to 6% rise in losses.

The two costliest natural disasters in 2021 were both in the US. Hurricane Ida resulted in estimated insured damages of USD30 billion to USD32 billion, including flooding in New York. Winter storm Uri is reported to have caused USD15 billion in insured losses. Uri brought extreme cold, heavy snowfall, and ice accumulation, especially in Texas, where the power grid experienced multiple failures on account of freezing conditions.

The costliest event in Europe was the July flooding in Germany and Belgium, while nearby countries were also impacted. The flooding was the costliest natural disaster for the region since 1970, and also the world's second highest, after the 2011 Thailand flood. The insured losses are said to be up to USD13 billion in comparison with economic losses of over USD40 billion. This, in part, highlights the large flood protection gap in Europe. These sigma catastrophe loss estimates are for property damage and exclude claims related to COVID-19.

The full report is available on the Swiss RE website.

Legal roundup

UK High Court ruling on breach of the duty of fair presentation under the 2015 Insurance Act

In this case, an insured made a claim under their policy that the insurer refused to pay as three individuals who were directors and shareholders of the insured had been directors of three other companies that had been involved in various insolvency events.

The insurer used an automated underwriting system where applications for insurance were evaluated by a computer. The automated application had a statement saying: “No owner, director, business partner or family member involved with the business has ever been the subject of a winding-up order or company/individual voluntary arrangement with creditors, or been placed into administration, administrative receivership or liquidation.” The drop-down options were “Agree” or “Disagree,” and the insured indicated that it agreed.

The insured property was damaged in a fire, and the insurers looked to avoid the policy from inception, arguing that there had been a material non-disclosure and/or misrepresentation regarding previous company liquidations, arguing if the insured had disclosed this they would not have offered cover.

The insured claimed the question only asked about insolvency events relating to any owner, director, business partner, or family member involved with business and did not ask about insolvency events of any other company with which any of them might have been connected and therefore the answer they had given was accurate.

The insurer argued that the question could clearly be seen to be concerned with insolvency events that could only affect companies and not individuals, and, therefore the only sensible meaning was that it was directed at ascertaining whether other corporate entities with which the directors or owners had been involved had been the subject of one of the various insolvency events referred to.

The Court found that the literal meaning of the crucial words should be applied, and as there was no express mention of any corporate body with which any of the persons expressly identified has been or is involved or connected with in some way, sided with the insured.

The Court found that a reasonable insurer should have understood the importance of using words that specifically referred to “other” companies if they wished to make inquiry into insolvency events of other companies with which directors of an applicant company had previously been involved.

The Court rejected the insurer’s argument that the position is different because the policy was arranged by and through a broker. The insurer’s argument was that a reasonable broker could be expected to have informed the claimant that the other insolvency events were material facts that the insurers would expect to be disclosed to it, notwithstanding the specific terms of the insolvency question, as it was not shown any evidence as to how a reasonable broker would have understood the insolvency question differently from the ordinary and natural meaning of the words

The insured further argued that, even if the question was found not to relate to other companies, the insured should still have disclosed as material information; however, the insured argued the insurer had waived his rights to further information by asking a limited question.

In deciding whether the insurer had limited its right to disclosure in respect of other persons or companies, the Court stated that when an insurer asks a question of the insured it may be inferred that the insurer has waived its right to information on the same matters outside of the question asked and it was a reasonable inference for the insured to draw that the insurer did not wish to know about any other liquidations other than those specified in the insolvency question.

This judgment highlights the importance of insurers clearly stating the information they seek when preparing application forms, to avoid costly litigation for both parties.

UK High Court decision on time zone differences

In a recent UK High Court case, the court analyzed how days and time are treated in a contract. In this case, the contract in question was a charterparty (chartering agreement) where a nine-hour time difference between where the parties were based and where the vessel discharged, led to a demurrage charge (a charge payable to the owner of a chartered ship on failure to load or discharge the ship within the time agreed).

The owners’ voyage chartered vessel, for the carriage of a cargo of crude oil from Brazil to the US West Coast, and the charterparty provided that: “Owners shall notify Charterers within 30 days after completion of discharge if demurrage has been incurred. If Owners fail to give notice Charterers’ liability for demurrage shall be extinguished.”

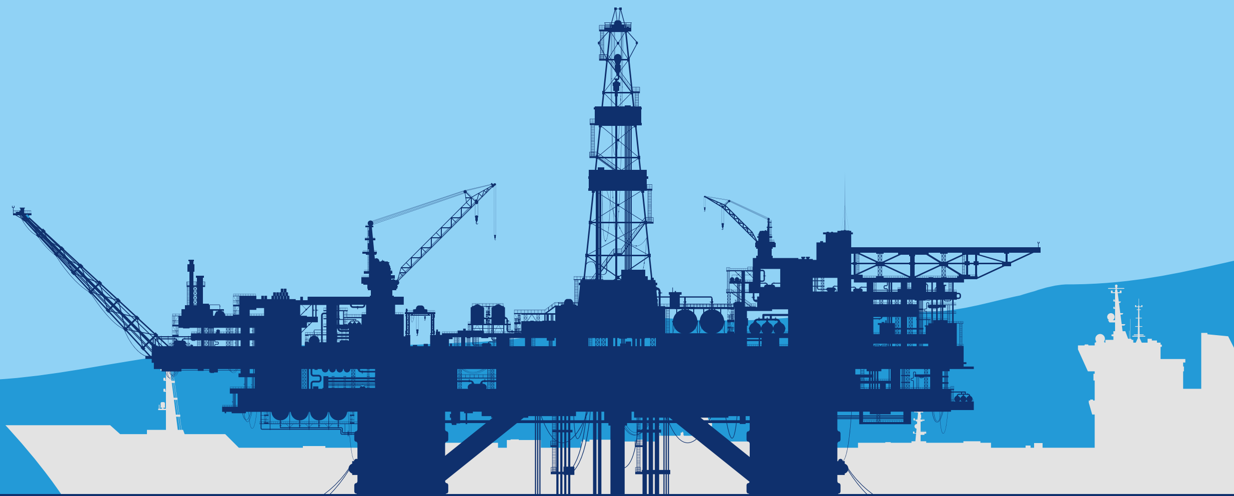
The vessel loaded at Santos, Brazil, and discharged at Long Beach, California, with the owners claiming a substantial amount of demurrage. The vessel disconnected cargo hoses at 21:54 Pacific Standard Time (PST) on December 24, 2019. This corresponded with 06:54 Central European Time on December 25, 2019, where both parties were based.

On January 24, 2020, the owners sent the charterers an email timed at 12:42 CET, stating that demurrage had been incurred on the voyage and that the email was notice of demurrage. A dispute arose about whether that notice had been sent in time.

As the charterparty was silent on the issue of time zone, the judge concluded that the date of final discharge of the cargo should be determined using local time at the place the cargo was discharged. That meant that the owners had until midnight PST on January 23, 2020, to give notification within the 30 days allowed, with the result that the notice sent to charterers the following day was out of time.

In reaching that decision the court concluded that days are ordinarily treated as calendar days counted from the day after the relevant event, and time is essentially a local concept. As such, the claim notification time bar was most closely connected with the place at which discharge was completed.

While this case is not directly linked to an insurance claim, it nevertheless highlights the importance of insurance policies having a clearly defined time zone establishing the inception and expiry of the policy.



Demystifying common clauses

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

The vast majority of policies (other than those specifically covering war for floating vessels, or onshore "political violence" policies providing war cover on land) contain a war exclusion. This is believed to date back to the Spanish Civil War of 1936, where non-marine underwriters first came to the realization that warfare was no longer either confined to the seas or open battlefields. Instead, towns and cities could be the target of warfare, especially by aerial bombardment, exposing insurers providing "all risks" insurance policies to massive aggregation problems.

In a response to this concern, the Lloyd's Underwriters Association (LUA) and the Association of British Insurers (ABI) entered into an agreement to exclude war and civil war on all policies issued by Lloyd's and London Companies subscribing to the agreement. This led to the introduction of the War and Civil War Exclusion clause NMA 464 1/1/38, which is still in use today in many non-marine policies.

The secret agents clause adds an exception to the war exclusion for property damage that might otherwise be excluded by the war exclusion, caused by acts committed by an agent of any government, party, or faction engaged in war, hostilities, or other warlike operations, provided the agent is acting secretly and not in connection with any operations of military or naval armed forces.

While there does not appear to be documented history of the evolution of the clause for energy insurance, the acts of secret agents are generally considered by the insurance industry as vandalism, sabotage, or malicious mischief type perils.

An example of such a clause is the American Institute Strikes, Riots and Civil Marine Hull Clause of 1959, which covers "destruction of the property insured directly caused by strikers, locked out workmen, or persons taking part in labor disturbances or riots or civil commotions or caused by vandalism, sabotage, or malicious mischief". This clause specifically states "'vandalism,' 'sabotage,' and 'malicious mischief,' shall be construed to include wilful or malicious physical injury to or destruction of the described property caused by acts committed by an agent of any Government, party or faction engaged in war, hostilities, or other warlike operations, provided such agent is acting secretly and not in connection with any operations of military or naval armed forces."

The assumption appears to be that the actions of a secret agent are not considered to pose the aggregation threat that a full outbreak of war and therefore coverage is often provided for this peril in an "all risks" policy.

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

CONTACT US

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

Marsh McLennan publications

The following are recent Marsh McLennan publications that may be of interest to energy and power companies.

The Global Risks Report 2022

Published by the World Economic Forum in collaboration with Marsh McLennan, the report examines how global divergence across multiple domains in the post-COVID-19 recovery threatens to widen disparities and aggravate societal fractures. Drawing on insights from over 950 experts and decision-makers worldwide, the 17th edition of the report unpacks some of the critical global tensions that may worsen the pandemic's cascading impacts and complicate the coordination needed to tackle common challenges. Long-term climate risks dominate global concerns, and as the world enters the third year of the pandemic, the top shorter-term global concerns include societal divides, livelihood crises and mental health deterioration. Additionally, most experts believe a global economic recovery will be volatile and uneven over the next three years, reinforcing the need for leaders to think outside the quarterly reporting cycle and create policies that manage risks and shape the agenda for the coming years. The report explores four areas of emerging risk: cybersecurity; competition in space; a disorderly climate transition; and migration pressures, each requiring global coordination for successful management. It concludes with reflections on enhancing national and organizational resilience, informed by lessons from year two of the pandemic.

The Global Maritime Issues Monitor 2021

Issued by Marsh in partnership with the Global Maritime Forum and the International Union of Marine Insurance *(IUMI),* the report tracks attitudes regarding critical issues facing the maritime industry. Key industry stakeholders comment on the concerns they believe are most likely to arise in the coming decade, which could have a high impact, and how well prepared the maritime industry is to meet the challenges. Environmental issues (decarbonization of shipping, regulation, and the failure of climate change mitigation and adaptation) scored high for perceived impact and likelihood, and worryingly low on preparedness. Survey respondents in 2020 viewed pandemic as the risk for which the industry was least prepared; however, in 2021 it ranks as an issue for which the industry is most prepared, reflecting many months of intense focus. Cyberattacks and data theft rank second in the survey for lack of preparedness, and third for likelihood, underscoring the industry's concern.

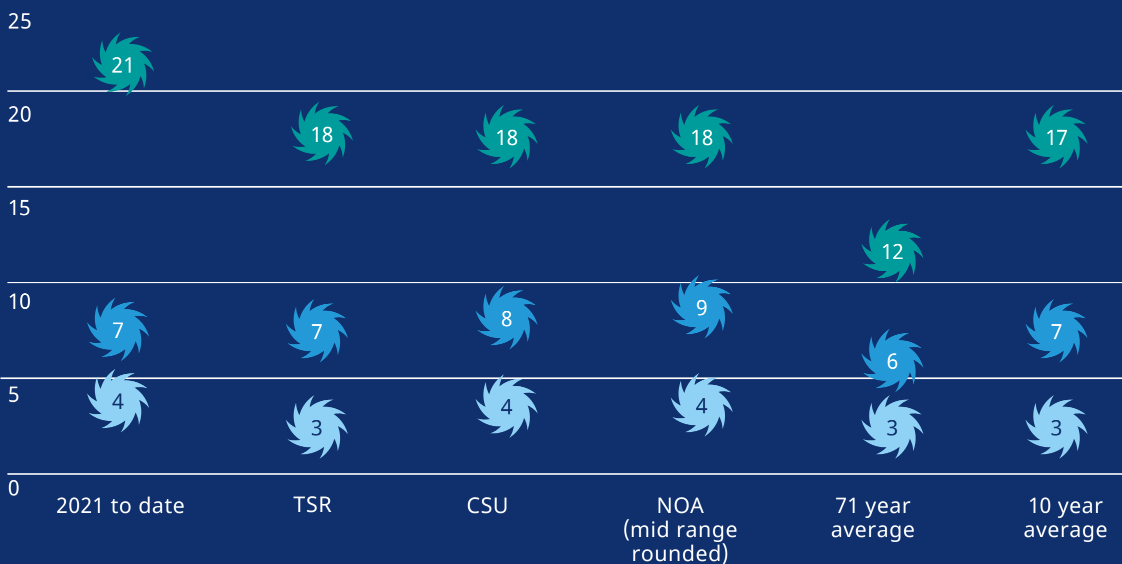
Atlantic named windstorm season update

The 2021 Atlantic hurricane season saw a flurry of tropical storms form in the first half of the season. Despite a relatively quiet second half of the season, 2021 will rank as one of the busiest on record. Only 2005 and 2020 experienced a larger number of named storms than the 21 that formed during 2021.

Offshore energy underwriters writing named windstorm cover in the Gulf of Mexico experienced a benign year in terms of losses — the 23rd year without significant loss — following the substantial losses the market suffered in 2004, 2005 and 2008 that changed the landscape of the market.

Onshore energy underwriters also appear to have suffered relatively light losses, with a lot of the flood damage caused to energy facilities being self-insured, in captives, or in mutuals.

The chart below plots the latest 2021 Atlantic Basin tropical storm activity against forecasts from Tropical Storm Risk (TSR), the National Oceanic and Atmospheric Administration (NOAA), and Colorado State University (CSU), as well as the 71 year (as far back a modern records go), and the 10-year averages.



2021 Hurricane Season Highlights

21

Twenty-one named storms formed in the Atlantic this season. This is the third most in a single Atlantic season on record, trailing 2020 (30 named storms) and 2005 (28 named storms).

05

Hurricane Elsa was the earliest fifth Atlantic named storm formation on record (named on July 1). Elsa broke the old earliest fifth Atlantic named storm formation record set by Edouard (on July 6, 2020).

04

Four hurricanes (Grace, Henri, Ida, and Larry) formed in the Atlantic between August 18 and September 2. This was the first time on record that more than three hurricanes formed between these two dates.

Hurricane Ida made landfall with maximum sustained winds of 150 mph — tied with the Last Island Hurricane of 1856 and Hurricane Laura (2020) for strongest winds for a Louisiana hurricane on record.

0

The Atlantic had no named storm activity between October 3 and October 30 — the first time since 2006 that the Atlantic had no named storm activity between these two dates.

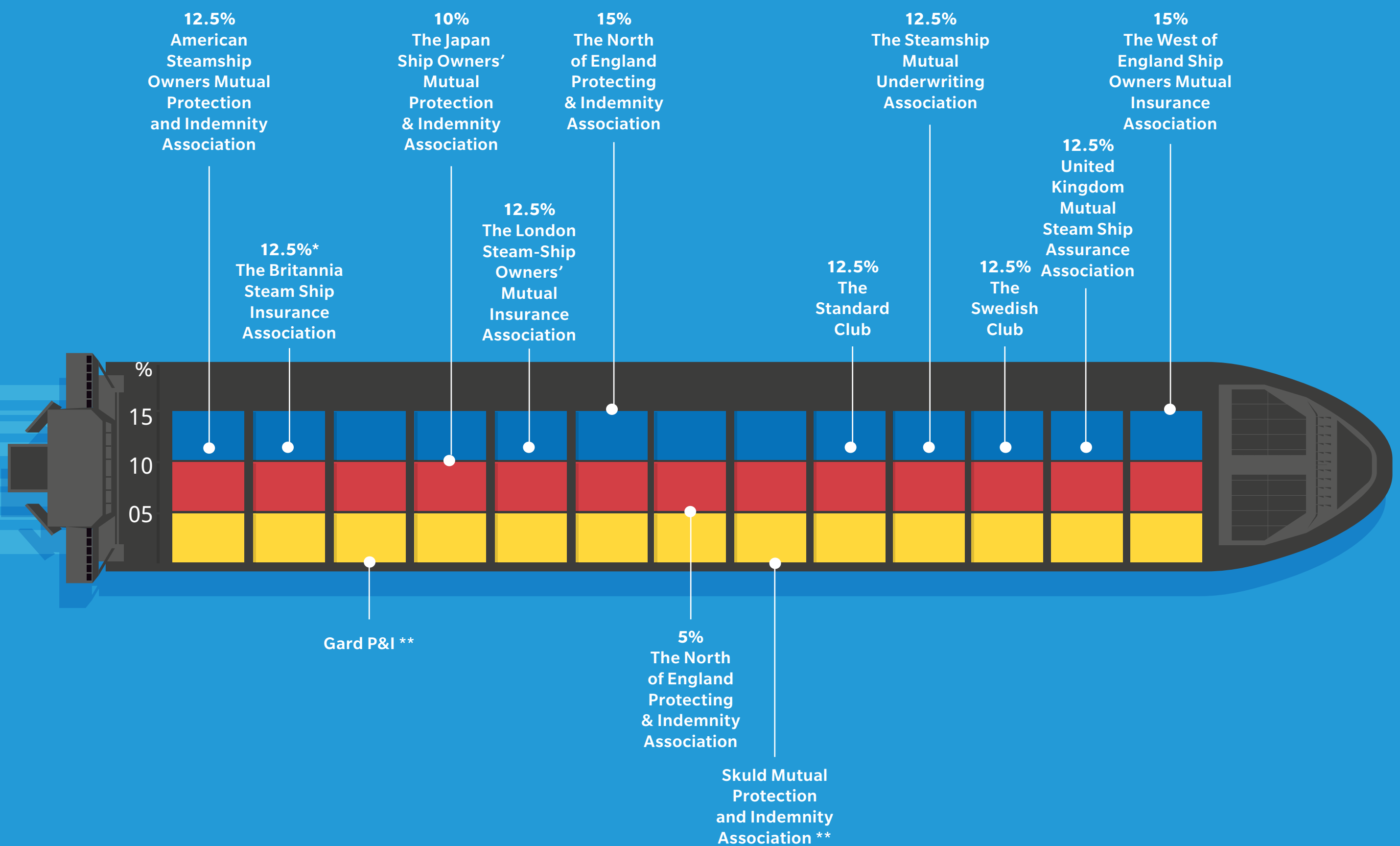
Hurricane Sam was a major hurricane for 7.75 days, tied with Hurricane Edouard (1996) for the fourth most consecutive days at major hurricane strength in the satellite era (1966 onwards).

Protection and indemnity club renewals

The average change in 2022 advance calls (premiums) for mutual P&I entries in the individual P&I clubs that form the 13 strong International Group of P&I Clubs[2] is approximately 12% as an average of those imposing general increases (excluding Skuld and Gard, which will access individual member's performance). This compares to an average rise of 6.50% in 2021.

The general reasoning behind premium increases from individual clubs has been the cost of mutual P&I claims in the current year being at an elevated level, with a high frequency of claims involving COVID-19 being a particular factor, along with the average severity of claims on the IG Pool being unusually high.

The individual changes are as follows:



*Overall target but each member to be assessed separately.

** Each member assessed separately but indicated rate increases will be applied.

2. Before adjustment for individual loss records, changes to risk profile, or for changes in reinsurance costs.

Source: individual club circulars.

About Marsh

Marsh is the world's leading insurance broker and risk advisor. With around 40,000 colleagues operating in more than 130 countries, Marsh serves commercial and individual clients with data-driven risk solutions and advisory services. Marsh is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. With annual revenue over $18 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses: Marsh, Guy Carpenter, Mercer and Oliver Wyman. For more information, visit mmc.com, follow us on LinkedIn and Twitter or subscribe to BRINK.

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