Marsh

Marsh Specialty

Energy & Power quarterly newsletter

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This edition of Marsh Specialty's global newsletter includes analysis of insurance market conditions, an overview of the key dynamics in global regions, a risk engineering update, and an article about mutual insurers.

As we enter the last quarter of 2021, a common theme is the deceleration of insurance rate increases in most energy sectors, with some sub-sector exceptions, and in some cases, the early signs of an approaching softening market.

Hurricane Ida had threatened to knock the market cycle off course, but while the full losses are yet to be calculated, from early reports it looks unlikely that energy and power insurers will be significantly impacted. Many insured's that suffered losses either did not purchase named windstorm coverage, or the deductibles and waiting periods imposed by the market were not significantly exceeded. The cost of coverage and restrictive terms and conditions applied to this coverage means that some insureds are unable to purchase the desired level of protection for their operations.

We hope you enjoy this edition and welcome your feedback.

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

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State of the market update

Upstream energy

Competition and insurance capacity for accounts with premiums in excess of USD10 million remained strong over the last quarter. With aggressive underwriting of the sector in the lead up to January 2022 renewals, rates are likely to be flat for these large accounts. While the vertical towers for some risks are the biggest ever, there are far fewer insureds that spend in excess of USD50 million today than say five years ago. With fewer prized “mega premium” accounts, and the willingness of insurers to continue to deploy high limits, competition for market share is expected to increase. Accounts with premiums below USD10 million, and subclasses that insurers continue to find less attractive - such as drilling contractors, onshore exposures in the US, and Gulf of Mexico windstorm policies - are likely to experience small rate increases.

An emerging trend is that traditional upstream markets are increasingly seeking to diversify into offshore renewable energy technologies reflecting the heightened focus on energy transition. Some markets are now receiving an estimated 20% of their premium income from offshore wind as they look to balance their portfolio towards cleaner green assets.

While there have not been significant losses in the sector this year, insurers’ profitability continues to be eroded by a series of smaller losses (below USD200 million). These include a recent fire on an offshore platform in Mexico, and losses related to an offshore asset in India, following a cyclone. Losses from a fire last year at a Norwegian LNG plant, are also escalating and impacting upstream energy markets. These incidents have not yet led to any reduction in overall capacity deployed by insurers and a continued surplus of capacity will put downward pressure on rates.

Downstream energy

Although a much smaller number of renewals take place in the third quarter, the deceleration of rate increases continued. Insurers’ risk appetite for downstream risks improved in a relatively benign claims environment, as many looked to deploy more capacity to secure market share. This increase in capacity, from strong lead markets, is removing rating variance within some placements that started to emerge in 2020.

The recent announcement by OIL (the Bermuda-based energy industry mutual) of an increased limit from January 1, 2022, adds further capacity and increases competition among insurers, which is another positive for clients.

Towards the end of the quarter, Hurricane Ida, quickly followed by Tropical Storm Nicholas, caused concern for the markets. While damage to energy facilities appears minimal, the strength and size of the storms – from a wind and rain perspective – raised concerns about the estimated maximum loss calculations for natural catastrophe (NatCat) losses, and for some insurers, aggregated exposure. This is likely to put pressure on capacity and pricing for US Gulf flood and wind coverage over the next few quarters, particularly following the high level of claims from the Texas freeze in March caused by Storm Uri. Concerns about the potential impacts of climate change, and the management of exposures relating to extreme weather events, will continue to be key focus areas for downstream energy underwriters.

Although business interruption (BI) volatility clauses have become increasingly common, BI values and exposures are likely to get insurers’ attention. This is likely to be particularly true for petrochemical and chemical companies, many of which are reporting strong financial results due to favorable commodity pricing conditions and inflationary pressure in some regions. The easing of pressure on insurance capacity (excluding NatCat) will enable insureds to purchase higher insurance limits to cover increased BI exposures; however, this is likely to result in increased pressure to relax any previously imposed BI volatility clauses.

The next few months will be key in identifying the possible insurance trends for 2022 as insurers look to define new strategies to adapt to a changing pricing environment, while key management and underwriting personnel changes across the insurance community may add to the sector dynamics.

Midstream energy

The midstream energy sector covers a broad spectrum of operations from pipelines to storage, through to ports and terminal operations. There is not a distinct midstream insurance sector as such, and policies for midstream companies are written across the upstream, downstream and marine insurance markets (for ports and terminals). The more benign exposures of pipeline physical damage or gas plants can be written in either the downstream or upstream sectors, but more hazardous risks such as onshore US named windstorm, hydrocarbon blending or processing, or complex contingencies for BI exposures, are pushed towards the downstream market. Premium volumes tend to be lower than the traditional upstream and downstream sectors, leading to more volatile loss ratios. In general, rates have continued to trend upwards (at a decelerating rate) particularly for risks covered in the downstream market, or accounts with loss histories. Flat renewals or reductions are not generally being experienced by this cross-sector class.

Traditional power

Rate rises continued to slow to single-digit growth in the third quarter, for accounts with straight forward renewals, clean loss records and no NatCat exposures. A number of large losses in the second quarter, and recent US storms, have not yet interrupted the slowdown of rate increases. However, more accurate loss reserve calculations for the recent storms may provide a better indication of potential impact on rates.

Insurers' previous focus on pricing has shifted to the tightening of terms and conditions, and insureds have been willing to accept higher retention levels. Stabilizing of rates was further aided by new capacity from MGAs, and global marketing efforts to reduce the influence of individual insurers. This has led to the return of capacity for more sought after accounts. While London markets dominated the sector over the last 18 months, local markets are looking to regain their market share.

Stand-alone coal placements continued to see increased retentions and further rate increases, regardless of loss records. The restructuring of programs and utilization of international markets is now commonplace, as more insurers withdraw from this class. Road shows, recent engineering reports, and demonstrated commitment to continual risk management improvement are crucial in avoiding tougher market conditions.

Renewable energy

There has been a relative stabilizing in deductible levels, and policy terms and conditions for renewal business, following the significant adjustments markets imposed across their portfolios during 2020. Key exceptions include accounts exiting long-term agreements, or those with considerable loss history.

Rates have stabilized to single-digit or low double-digit rises, particularly for operational wind and solar accounts with limited or minimal NatCat exposure. Capacity continues to flow towards the onshore and offshore renewable energy sector, particularly from new entrants seeking to diversify their conventional power, or oil and gas portfolio. While historically this has been in support of MGAs, a number of carriers are now entering the space on an open market basis. Established markets also have ambitious growth targets, however, there remains a limited pool of insurers willing to provide lead terms.

Key challenges remain for wind and solar construction risks, particularly those with NatCat exposure, which reflects markets' poor experience over a number of years. These types of placements continue to experience adjustments to pricing and/or terms and conditions. In onshore wind, exclusions remain for issues with specific contractors that have experienced frequent losses in recent years. In offshore wind, exclusionary language is now standard for potential defects in cabling protection systems worldwide.

Markets continue to be cautious about the pace of technological advances. Some recent high-profile battery energy storage system (BESS) losses have raised insurers' concerns, and there remains a significant shortfall in capacity compared to other technologies. Markets may adjust their capacity position as they gain a better understanding of these recent incidents and the loss reserves emerge. The situation is similar for advancements in both onshore and offshore wind, as manufacturers develop larger turbines. There has been a significant increase in the self-insured retentions sought by insurers for unproven models.

Early engagement and open sharing of information with the markets remains vital for investors, and allows brokers time to review existing programs and optimization through strategic purchasing and/or policy restructuring. Virtual surveys or market road shows also help differentiate accounts in an incredibly busy sector.

Terrorism/political violence

The terrorism/political violence market experienced a further increase in capacity with a few new entrants throughout 2021. In general, rates have been flat, with most renewals being placed at the same rate as last year. However, steep increases remain for insureds with retail exposure or loss history, particularly in Latin America.

While the headline figures for the recent riots and destruction in South Africa are high, it is too early to know the effect this may have on rates for the terrorism/political violence market as a whole. The profitability of these lines of insurance may mean that capacity is unaffected.

Energy casualty

The hasty withdrawal in 2020 of approximately USD 200 million in capacity seems to have subsided. Capacity is generally stable and insurers are returning, seeking to take advantage of what they consider to be a favorable trading environment. While markets are still pushing for increased rates, it is at a more controlled pace than previous quarters. Rate rises are now around 10% or below for offshore risks, while insurers are seeking increases of up to 25% for onshore or chemical exposures. However, the Lloyd's market first half-year results show that casualty is the only class to post a loss, albeit at much lower levels than the same time last year. This may suggest that casualty markets will to look to rebalance their financial position. At the time of writing, an oil spill from an offshore platform and pipeline had affected beaches in California. This could result in a substantial loss to the casualty market, and may prompt markets to consider whether further rate rises are required.

While there is currently greater competition on excess layers, primary coverage remains challenging, and options for insureds in this area are often limited to captives or self-insurance.

The underwriting process continues to take longer than it did in the past, reinforcing the need for early engagement with markets and greater preparation. Within the insurers' process, there is a far greater degree of both peer review and actuarial intervention, which is leading to increases in exclusionary/restrictive language, and in some cases the deletion of historical coverages. For example, "occurrence" coverage for onshore risks is being changed to "claims made," "costs in addition" is being amended to "costs inclusive," free or fixed cost reinstatement provisions are being deleted, aggregate retention caps are being removed, and there are restrictions on definition of injury.

In January 2021 Lloyd's insurers proposed various cyber exclusions, that were adopted by most markets. However, some company markets continue to use their own clauses which is becoming a challenge for coverage continuity. For example, there are inconsistencies in the definition of malicious and non-malicious damage, with variations across geographies particularly for North America or international placements. While brokers have managed to carve out write backs for third party bodily injury and third party property damage, some markets are starting to resist this going forward.

Some markets are introducing exclusions for certain chemicals. The latest exclusion is for poly flouro alkyl's (PFAS). These are often referred to as "forever chemicals" as they do not break down, but accumulate over time. They are used in a variety of industries including firefighting (foam) and in fracking for oil and gas. Where they may not have been applied previously, exclusions are now being imposed for methyl tertiary butyl ether (MTBE) which is an additive that oxygenates gasoline. Gasoline containing MTBE spreads easily underground and estimated costs in the US for removing MTBE from groundwater, aquifers, municipal water supplies, or leaky underground oil tanks, range from USD1 billion to USD30 billion.

Bermuda casualty

Casualty insurers in Bermuda are still seeking rate increases from 15% to 20%. "Excess" capacity is still available at higher pricing. While there have been several new entrants into the Bermuda market, their approach to energy accounts has been cautious and their presence has not yet resulted in reduced pricing.

Marine exposures

The marine market remains stable with insurers returning to sustained profits following rate rises and minor adjustment to conditions over the last few years. Though rate increases look set to continue, there are signs that hardening of the market is slowing as rates reach sustainable levels. Any significant deterioration in claims could cause this to change.

Over the last 24 months, the global hull market has seen a reduction in capacity, particularly in the Middle East and Asia. Some insurers have limited their underwriters to local fleets rather than international portfolios. While Scandinavian insurers have historically adopted independent pricing, their rate increases have been broadly in line with the global market and they remain commercially flexible for favored accounts with good loss records.

There is a cautious increase in capacity from existing participants, including some in London, mostly limited to profitable sub-sectors. For less profitable, more volatile or less popular sub-sectors, the market remains challenging with little sign of change to the hardening trend.

Placements in London markets seem to be increasing as local capacity reduces. So called “verticalization” (or different terms) is still a significant factor in many placements, particularly those with large fleet values or poor loss history. However, most placements are being completed at the lead market pricing without requiring recourse to more expensive options.

Onshore construction

The onshore construction market has remained stable and relatively predictable throughout 2021, with no significant changes to capacity. Moving into the treaty renewal season, rate reductions are unlikely while pressure for significant rate increases has subdued. Trends will become clearer when reinsurers complete their forward assessments and indications are that the impact of rate consistency and control over extensions and sub-limits is unlikely to result in further increases.

Risk quality is the highest priority for markets, and clients demonstrating continual improvement through timely, quality submissions are more likely to receive favorable outcomes from underwriters.

Deductibles for major projects have remained constant, although significantly higher than three years ago.

Regional updates

PACIFIC

There have been some significant legislative milestones in the Pacific region (Australia and New Zealand) over the last quarter, most notably in the offshore wind sector. In September, the Offshore Electricity Infrastructure Bill 2021 was introduced, enabling the Australian government to designate offshore electricity areas in Commonwealth waters more than three miles offshore. The legislation will create a licensing regime to permit exploration, construction, and operation of offshore renewable energy and transmission projects in these areas. The bill provides for the National Offshore Petroleum Titles Administrator to oversee licenses for offshore projects, and the National Offshore Petroleum Safety and Environmental Management Authority will be responsible for operations and safety. There are already more than 10 offshore wind projects planned around Australia, which may improve employment opportunities for many vulnerable to job losses in the coal mining and thermal power sectors as the energy transition accelerates.

Western Australia's hydrogen economy received a major boost, with the allocation of AUD61.5 million (approximately USD45 million) to support the growing industry. The funding will support a number of projects including a new AUD100 billion renewable hydrogen hub – the largest infrastructure project currently planned in Australia. About AUD50 million will be used to stimulate local demand for renewable hydrogen in the transport and industrial sectors.

With large-scale renewable energy and hydrogen projects planned across the Pacific region, there could be an insurance capacity crunch on the horizon for mega projects. Integrated components such as BESS are still being viewed by many insurers as prototypical technologies, due to the lack of local standards. Detailed risk engineering reports are proving valuable in assessing the amount and cost of required insurance.

UNITED KINGDOM

The UK government announced its strategy for the hydrogen industry during the quarter, stating how it will support UK industry to develop an annual five gigawatts of clean hydrogen production capacity by 2030. The strategy includes the launch in early 2022 of a GBP240 million net zero hydrogen fund for co-investment in early hydrogen production projects, aiming for one gigawatt of production installed by 2025. This announcement is a key plank in the government's Ten Point Plan for a Green Industrial Revolution and should result in opportunities for placement of insurances for the first projects in 2022.

With the UK hosting COP26 in November, and increasing pressure from activists, the timing of this announcement was no surprise. The government is also under pressure over the approval of the Cambo project, a new oil field development to the north of Scotland, expected to proceed before year-end.

Insurers, too, are increasingly wary of attracting adverse publicity from activists, which has resulted in withdrawal of support for some high profile projects. Some of these projects may not be able to achieve the same limits of cover available historically. It is becoming standard for insureds to demonstrate their environmental, social, and goverance (ESG) credentials and considerations as a requisite for successful renewal negotiations.

Half year results announced by insurers were generally positive, with combined ratios showing significant improvement over 2020 because of rate increases on nearly all lines of business, and an absence of major loss activity. Recent weather events such as Hurricane Ida and Storm Bernd, may result in losses but the impact on earnings is expected to be low given the exposure of their book for energy and power assets.

The most challenging class of insurance right now is cyber, where a torrent of ransomware claims with a frequency and severity far higher than expected, have impacted insurers. In response, insurers have reduced capacity, narrowed cover and substantially increased rates on renewals. In this environment, appetite from most UK cyber underwriters for stand-alone physical damage or business interruption cyber cover is low. Brokers are making every effort to secure the broadest cover possible in existing policy forms.

MIDDLE EAST & AFRICA

In a region dominated by national oil and energy companies, there are further signs of privatization as governments look for strategic divestments to raise capital. Saudi Arabia and United Arab Emirates (UAE) are front runners in this process, in part to fund their energy transition goals. The private sector is also progressing divestments to re-balance the profile of their asset base, especially where this aids ESG and sustainability goals. There is a noticeable shift towards ESG considerations by insureds and underwriters in the Middle East, as both search for ways to positively differentiate at a risk and corporate level.

Drilling and offshore construction activity has increased following the oil price recovery, enabling some long-planned projects to achieve necessary approvals, most notably in Qatar and the United Arab Emirates. Drilling plans that were put on hold in 2020 have been revived and marginal fields and other opportunities are being re-evaluated in line with the prevailing economics.

Insurance market capacity remains buoyant, and the growth of MGAs in the region has continued. The UAE is increasingly becoming a hot spot for energy and power related risks.

The market trends continue to track global dynamics and the overall theme of growing appetite, particularly in downstream energy and traditional power, has driven a further flattening of the rates in comparison to the prior year.

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ASIA

Rate increases have stabilized in the downstream market in Asia, though regional underwriters continue to take a cautious approach, reflecting the base rating levels in Asia compared to other regions. Deductible levels remain constant, with a focus on NatCat exposures that invariably affect rates. Insurance capacity levels have remained constant and there has been little claims activity (or loss deterioration) in the last quarter. These trends are likely to continue over the coming months, with underwriters starting to shape their portfolio and prioritize accounts where they have longer term relationships or have seen minimal claims activity, and where there remains the prospect of further account development.

Similarly, the upstream sector remains stable with no major capacity changes during the last quarter. Operational risk rating has not changed significantly; rating movement remains in the range of 5% to 10%, with potential claims impact of Cyclone Tauktae yet to be seen.

Despite significant losses in the second quarter, coverage for contractor risks has remained steady with limited rate increases however, conditions may harden through the rest of 2021.

One of the most notable changes over the last quarter has been reduction of capacity in the geothermal segment. A number of international markets have withdrawn, leaving regional markets to fill the gaps where possible. Frequent losses in producing assets remains a concern for insurers and even loss free programs have experienced restricted coverage or rate increases on renewal in the 20% to 25% range.

The offshore construction market within the region continues to harden, with increases in rates and deductibles particularly for subsea works. While capacity is not reducing, the current volatility is impacting project insurance budgets.

The power market in Asia has shown signs of stabilizing. Premium rate increases started tapering off in the second quarter, a trend that has continued.

Based on third quarter renewals, pricing for loss-free, gas-fired power accounts in Asia increased 15% to 20% on average, and coal related accounts experienced increases upward of 30%. Enquiries are increasing about captive structures and alternative risk transfer options as companies attempt to address the longer-term cost implications of increasing rates and restrictive conditions. To offset the significant rate increases of the last two years, those affected are now considering reduced coverages, such as lower NatCat sub-limits, reduced policy limits, and higher deductibles.

Some markets are showing signs of softening premium increases for very large, significant premium power accounts. However, insurers are not relenting on deductible levels or their need for tighter policy wordings, particularly for cyber, communicable disease, and non-physical damage business interruptions triggers.

CONTINENTAL EUROPE

The European Union (EU) is driving forward the regulatory reforms required for its energy transition agenda to achieve the Paris agreement targets. Through the mega EUR503 billion “green deal” EU incentives, and regulated decarbonization targets and standards, are being deployed across the 27 countries. Coupled with funding from various COVID-19 recovery packages, clean energy related projects are underway across the continent.

The investment plans include a wide range of initiatives from energy efficiency renovation grants for residential housing, to infrastructure investments in electric vehicle charging stations, new renewable energy generation, and mega hydrogen clusters. Energy and power operators are now also legally bound to reduce emissions by 55% by 2030 under the “fit for 55” package launched in July. The package included many energy transition measures including revisions to the emissions trading system.

Energy economics are under pressure as Europe recorded an historical peak on electricity prices over the summer, driven by lower wind yields and gas shortages. This pushed up the gas price, as well as the cost of coal and carbon permits, and analysts forecast these conditions to continue throughout the coming winter. Measures and alternatives to balance out the natural gas shortage, and its subsequent impact on prices, are being discussed.

In terms of the insurance markets, some international insurers have closed their European offices and changed their “hub and spoke” underwriting model for energy and power lines, by moving expertise or authority to London. This might affect medium size midstream, chemical, and/or power operators, but is unlikely to impact large, integrated European energy companies whose insurance programs are typically geared towards global insurance markets.

There is favorable support for wind and solar projects as renewable energy insurers seek to grow their portfolios. The sector remains profitable for insurers, given the absence of significant NatCat exposures compared to other regions.

The NetZero Insurance Alliance (NZIA) was announced in July, involving eight global insurers and reinsurers. The alliance was convened by the UN Environment Programme and aims to build on net zero underwriting guidelines introduced over the last few years to accelerate decarbonization.

AMERICAS

The insurance market generally began to stabilize in the second quarter of 2021. While rate increases remained the norm, a surplus of available capacity helped to minimize volatility, particularly for loss free risks. The exceptions to this include NatCat exposed risks, claims heavy programs, and oil sands connected risks, which continue to be impacted by ESG considerations in underwriting. However, insurers remain generally supportive of clients with a strong ESG approach and a commitment to energy transition.

Domestic capacity remains strong across the energy and power sectors, with local insurers competing effectively to maintain market share onshore, particularly for power risks and downstream energy. Clients, particularly those with mature risk management strategies, are showing greater interest in industry mutuals and captive solutions as they look for an advantage in navigating the current conditions. However, social inflation and large plaintiff settlements are contributing to a continued reduction in available capacity for US casualty risks.

Renewable energy remains favorable, with increased interest from new insurers, particularly for utility scale onshore wind and solar projects. New entrants are expected over the coming months, fueled by an increase in the number of projects being constructed and in the pipeline. There has also been an increase in power purchase agreements from companies with net zero commitments which has accelerated project developments. Hydrogen and renewable natural gas are getting more attention and there are a large number of projects in feasibility stage for both.

There is increased merger and acquisition activity across the region in the traditional oil and gas, and power and utility sectors, often with larger players divesting assets that are now entering the insurance market as standalone risks. This is being driven by net zero commitments and asset optimization strategies.

Focus on: Growing interest in mutual insurers

There's growing interest in the use of mutual insurers, as commercial insurance markets continue to increase rates and withdraw capacity, particularly in the thermal power and downstream sectors.

The interest in mutual insurers is driven by the fact that they offer large blocks of capacity and stable rates, despite fluctuations in commercial markets. There are a few primary features that differentiate mutual and commercial insurers.

- **Independence.** Rates do not usually track traditional market rate cycles but are driven by the mutual members' losses.
- **No profit basis.** Typically, mutual insurers have a low cost base with no built-in profit margin.
- **Value added services.** While membership benefits may vary between insurers, they may include focused loss control initiatives specialized claims professionals, captive management support service, and direct access to industry data and analysis.

Mutual insurers can be a valuable risk transfer option for energy and power companies, particularly during hard market conditions, or as a long-term hedge against commercial market cycles.

Oil Insurance Limited (OIL): An energy industry mutual

Membership of the Bermuda based energy mutual, OIL, has grown by over 20% since January 2018. In the same period, the mutual has issued over 100 premium indications to prospective members across a broad range of energy sectors and domiciles.[1]

In a recent survey 85% of OIL members expected commercial insurance markets to continue reducing coverage and capacity.

On the other hand, from January 2022, OIL's members will be offered up to USD450 million (currently USD400 million) of physical damage, control of well/redrilling costs, and pollution coverage "at cost". This is a key initiative within OIL's five year strategic plan to offer choice to energy companies striving to obtain the insurance protections they need for their current operations.

OIL's approach for members:

1. OIL's premiums do not track traditional market cycles and are driven exclusively by their members' losses. OIL premiums are calculated to equal losses plus operating costs, which are typically below 5%.
2. To avoid premium volatility in a higher than expected loss year, OIL uses a premium allocation model that smooths the payback of premium over a five year period.
3. OIL offers flexibility on whether capacity is used as primary (corner stone) or excess or quota share.

[1] *Source: OIL*

OIL membership eligibility requirements:

- At least 50% of either (1) gross assets, or (2) annual gross revenues derived from energy operations.
- A minimum of USD1 billion of gross assets.
- Investment grade credit rating of at least BBB (S&P) or BAA3 (Moody's).[2]
- Business operations that represent an appropriate spread of risk.
- A willingness and ability to absorb moderate premium volatility.
- A long-term, strategic risk management approach.
- A strong risk management record (acceptable 10 year loss record).

While OIL is a valuable risk transfer tool for many energy companies, its unique coverage needs careful dovetailing with the commercial market policies.

For more information please contact your Marsh Specialty team.

OIL may not be a suitable or the most cost effective solution for all eligible energy and power companies. Marsh Specialty recommends that any option obtained from OIL is fully evaluated against traditional commercial market solutions and the unique needs of your business.

[2] Companies without a credit rating can obtain a "shadow rating"; or be subject to financial analysis by OIL, and may be required to post acceptable security.

Risk engineering update

The majority of risk engineering surveys continue to be completed remotely however, as travel restrictions ease in several parts of the world, there are encouraging signs of physical site visits recommencing. The situation is far from uniform, with physical surveys accounting for 40 to 50% of activities in the Middle East and Latin America; while our London and Asian based teams have been more limited in their ability to travel (10 to15% completed physically). Use of wearable technology to live stream from locations has been an invaluable tool for broadening participation in the risk survey process with capabilities now established throughout all of the global hubs.

At the start of the last quarter, Marsh Specialty opened a new risk engineering hub in Al Khobar, Kingdom of Saudi Arabia, our third hub in the Middle East & Africa (MEA) region. The hub uses local resources to provide a full suite of risk engineering services including product liability surveys, business interruption reviews, and terrorism and political violence assessments to energy and power companies, and commercial property firms across the MEA region.

Demand is high and likely to grow for risk engineers with experience in renewable energy, particularly wind and solar and transition technologies such as hydrogen and carbon capture and storage. Marsh Specialty recruited 10 engineers across our global hubs in the third quarter, driven largely by the changing risk landscape for energy and power companies as many rapidly embark on a path towards decarbonization.

At the same time, our team is actively engaging in increased discussions with clients and market engineers about evolving and enhancing our risk engineering tools, methods, data and modelling capabilities, to help clients better understand and mitigate evolving exposures. For example, the ability to quantify the increased frequency and severity of extreme weather events is crucial for many of the renewable energy technologies. We are well advanced in building more sophisticated and more relevant risk engineering estimated maximum loss models.

Sharing industry best practices is a fundamental objective of the risk engineering process. In September, we released a new position paper, Management of Temporary Repairs, to address the issue that mechanical integrity failures amount to over a third of major insurance claims. The Liberty Speciality Market loss database shows that half of all claims from 2000-2020 were due to mechanical integrity issues, and over two thirds of those losses were due to corrosion of piping systems. Marsh Specialty's position paper provides essential guidance on best practice common repair techniques, raises awareness of industry standards, and provides recommendations for improved management of temporary repairs.

We are also pleased to have expanded our suite of deep dive surveys to include four services specifically tailored to key risks in the power sector:

- Process safety management
- Human elements
- Emergency systems
- Asset integrity management

Deep dives surveys focus on reviewing additional records and completing field checks that are not normally practicable during a standard risk engineering survey. As a result, they provide clients with an in-depth understanding of risk quality, and insights and advice tailored to specific risks.

Demystifying clauses

Making wells safe

A "making wells safe" endorsement is usually contained within an operators extra expense (OEE) policy, or energy exploration and development (EED) policy (named after the standard market form EED 8/86). In recent changes proposed to the standard EED form by the Joint Rig Committee, the making wells safe endorsement may be retitled "named perils loss prevention".

The standard OEE wording usually has three sections:

- Section A - Control of well expenses.
- Section B - Redrilling and restoration expenses.
- Section C - Seepage and pollution.

The usual making wells safe endorsement is an extension of coverage under Section A.

The coverage is extended by reimbursing the insured for costs and expenses incurred in preventing the occurrence of a loss when the surface equipment has been lost or damaged by certain named perils. The standard named perils typically include:

- Lightning.
- Fire, explosion, or implosion above the surface of the ground or water bottom.
- Windstorm, collapse of derrick or mast.
- Flood.
- Collision with land, sea or air conveyance or vehicle.
- Collision or impact of anchors, chains, trawl boards, or fishing nets.
- Strikes, riots, civil commotions, or malicious damage.

To be consistent with perils usually granted elsewhere in the EED form, this list is commonly expanded to include earthquake, volcanic eruption, tidal wave (or tsunami), mudslide or landslide.

For coverage to be triggered by this endorsement the insured must also show it was necessary to re-enter the well in order to continue operations or restore production, or to plug and abandon the well in accordance with all regulations, requirements and normal and customary industry practices.

Underwriters' liability under this endorsement ceases at the time that operations or production can be safely resumed, or the well is, or can be, safely plugged and abandoned (whichever occurs first).

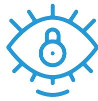
This information is a general overview of some of the coverage often provided by the aforementioned clauses. This is not intended to be an extensive and exhaustive analysis of the insurance coverage provided by such clauses. The comments are the opinion of Marsh Specialty only and should not be relied 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.

Marsh McLennan publications

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

Accelerating Renewable Energy Corporate Power Purchase Agreements in Emerging Economies

Marsh Specialty is proud to partner with the World Economic Forum on its Mobilizing investment in clean energy in emerging economies initiative, which is part of the WEF's Climate Action Platform and Shaping the Future of Energy, Materials and Infrastructure Platform. A new briefing paper was released through our collaboration, highlighting the significant economic and emission reduction benefits that can be realized if barriers are removed to facilitate the implementation of corporate power purchase agreements (CPPAs) in emerging economies. The benefits are numerous, from helping local companies to decarbonize, to protecting supply chains and incentivizing flows of investment capital into emerging markets - a necessary condition to achieving national and corporate climate goals. The paper also highlights specific barriers to CPPAs as well as various recommendations to help remove them.



Future of Construction

Marsh Specialty, in partnership with Oxford Economics and Guy Carpenter, released The Future of Construction report, a global forecast for construction to 2030. The global construction industry looks set to lead global economic recovery from the pandemic over the medium-term and is expected to grow faster than the manufacturing or service sectors. Construction is expected to grow by USD4.5 trillion over the decade to 2030 to reach USD15.2 trillion. Just four countries — China, India, US, and Indonesia — are predicted to account for almost 60% of this growth while the top 10 global construction markets are expected to account for almost 70% of the growth over the same period. The report considers the themes of climate change, ESG, the emergence of a deconstruction industry, and embedding modern methods of construction, and how each is changing the risk profile of the construction industry and creating opportunities.

Climate Action Navigator to help leaders plot a path through climate science

Through the Oliver Wyman Forum, Marsh McLennan has unveiled the Climate Action Navigator to help senior leaders explore the actions they need to take to halve emissions by 2030. The Climate Action Navigator helps public and private sector leaders plot a path through climate science. It identifies emissions levels for 22 industry sectors in 12 global regions and quantifies the effects of different carbon-reduction strategies. The Climate Action Library brings together, for the first time, an assessment of the impact of multiple different mitigation actions, including changes in energy and fuel usage, building construction and heating, industrial processes and transportation, land use and food efficiency, and negative emission technologies. The effect of each mitigation strategy can be analyzed for each sector and region, giving business and government leaders vital insights to realize their 2030 climate goals.

Political Risk Map: mid-year update

In September, Marsh Specialty issued a mid-year update to its political risk map which shows how the two-track COVID pandemic is leading to a multi speed recovery across the globe.

Although the ratings show that the economic risk scores of only nine countries have worsened in the last 12 months, out of the 197 jurisdictions analyzed, almost 60% of countries worldwide are experiencing a deterioration of their governments' sovereign debt profiles, and more than 50% have a higher risk of internal violence compared with mid-2020, when restrictions under the initial global lockdown had been widely removed.

Through this lens, the widening divide between rich and poor, "jabs" and "jabs-not" seems only apparent. So called "long COVID" is expected to affect several industries worldwide, generating supply-side interruptions, sudden closures and limitations to trade, and a deterioration of the investment environment even in countries that aren't used to such perils.

World Energy Trilemma Index 2021

The World Energy Trilemma Index presents a comparative ranking of the energy systems of 127 countries, estimating their performance across three dimensions: energy security, energy equity, and environmental sustainability. The Index, in its 11th edition, is the result of a collaboration between Marsh McLennan, Oliver Wyman, and the World Energy Council.

As in previous years, the performance ranking continues to be dominated by OECD members. The top three countries are Sweden, Switzerland, and Denmark. European countries occupy most of the top 10 positions, with the exceptions of Canada, New Zealand, and the US. This is the second edition of the World Energy Trilemma Index since the outbreak of COVID-19. The pandemic has exacerbated pre-existing societal and economic vulnerabilities, and its reverberations on energy systems has become apparent.

The complete list of rankings, individual country and regional profiles, and changes in key metrics can be accessed through the trilemma interactive online tool.

News Brief

IMB's latest global piracy report recorded 68 incidents of piracy and armed robbery against ships in the first half of 2021, down from 98 incidents during the same period last year, and the lowest total since 1994. In the first six months of 2021, IMB's Piracy Reporting Centre reported that 61 vessels had been boarded, there were four attempted attacks, two vessels were fired upon, and one vessel was hijacked. Violence against crews continues, with 50 crew kidnapped, three threatened and taken hostage, two assaulted, one injured and one killed.

Lloyd's has partnered with the University of Cambridge's Centre for Risk Studies to produce a new report Shifting powers: Meeting the challenges of the geopolitical landscape. The report aims to support leaders with the resources and knowledge required to help protect their organizations. It explores the transformation of the geopolitical risk landscape over the last decade and focuses on the 10 most pressing risks these themes present today, including cyber-attacks, social unrest, and the migration crisis. The report also details the existing insurance solutions available to help businesses stay resilient during periods of crises and uncertainty, and identifies opportunities where the insurance industry can help develop new solutions. A summary of key findings is also available alongside the full report.

Bermuda: Re+ILS have released a publication Bermuda's Class of 2020: The re/insurance start-ups and new capital report. The report features discussion with the senior executives at 13 Bermudian re/insurers, including start-ups, new Bermudian branches of more established businesses, and new capital raising activity from established Bermuda-based (re)insurers. It also outlines why executives saw 2020 as such an opportune moment to raise capital for new and existing businesses in Bermuda, as well as more information about the type of business the new start-ups may pursue.

Lloyd's has announced an aggregated profit of GBP1.4 billion for the first half of 2021 compared to a GBP0.4 billion loss for the first half of 2020. The combined ratio (CR) improved to 92.2% compared to 110.4% for the first half of 2020 (although 2020's figure was 97.0% excluding COVID-19 claims, resulting in an underlying improvement of 4.8% on the CR). The improved CR was driven by reductions to both the loss ratio (50.50% versus 52.6% for prior year) and the expense ratio (35.8% versus 37.7% for prior year). Over all classes, energy contributed an underwriting profit of GBP59 million compared to GBP62 million for the first half of 2020. Casualty was the only class to report a loss of GBP44 million, a much better result than the GBP386 million loss for same period 2020.

Lloyd's has published a new report, Insuring a sustainable, greener future, which outlines how the insurance industry will partner with critical industries to support and accelerate the transition to a low carbon economy. The report details the steps Lloyd's is taking now, and will take in the future, in relation to the key themes of greener industry, transport, and energy. Alongside the report, Lloyd's set out a climate action roadmap that includes a number of wide-ranging, practical steps that will help accelerate the transition of multiple industries to net zero carbon.

Legal Roundup

UK High Court ruled buyer was not entitled to reject off-spec oil

In a recent UK High Court judgement, a seller delivered off-spec fuel oil to a buyer that rejected the cargo and claimed for costs it had incurred in doing so. The seller disputed the buyer's entitlement to reject the cargo, and brought a counterclaim for losses it incurred when the cargo was returned.

One of the key issues was whether the contract specified terms relating to the quality of the product amounted to a condition or an intermediate term.

If product quality was considered a condition of the contract, the buyer would have legitimate reason to reject the shipment. But if it was an intermediate term, only a serious and substantial breach would entitle the shipment to be rejected.

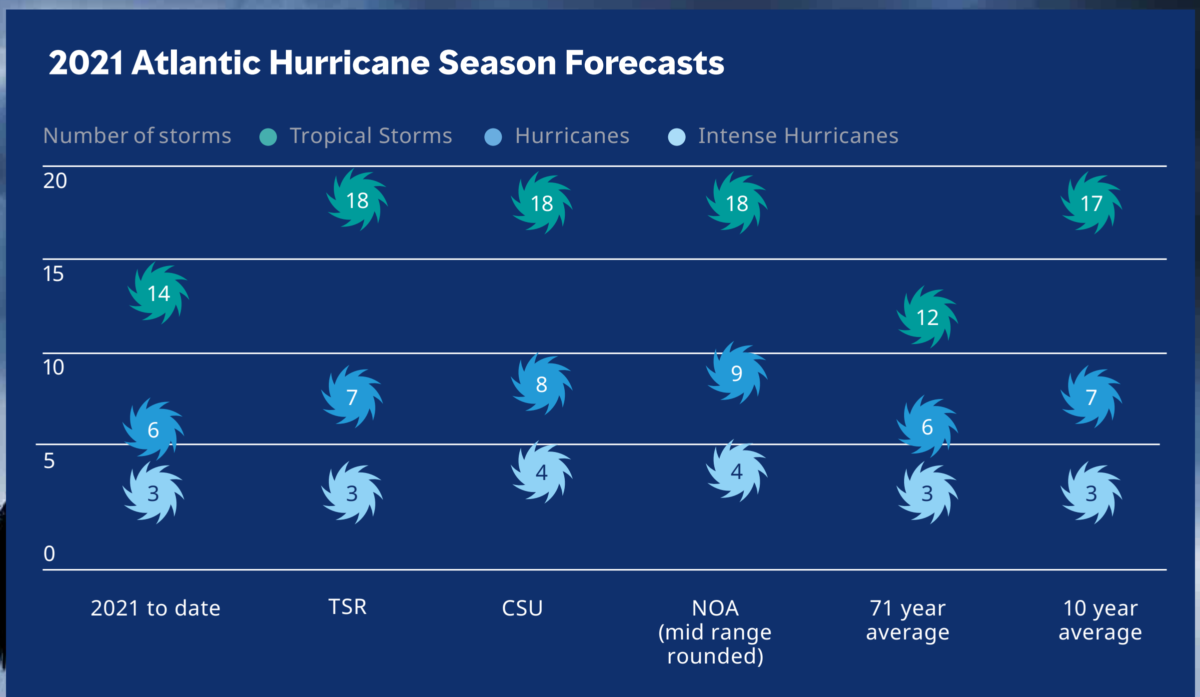
The court ruled that the list of guaranteed specifications in the contract were not strict "conditions" of the contract but were intermediate terms, stating that "...in the absence of any clear agreement or prior decision that this was to be a condition, the court should lean in favour of construing this provision as to impurities as an intermediate term." The court added, "...terms considered to be intermediate stipulations, so that a breach not going to the root of the contract, would give the buyer no more than a price allowance."

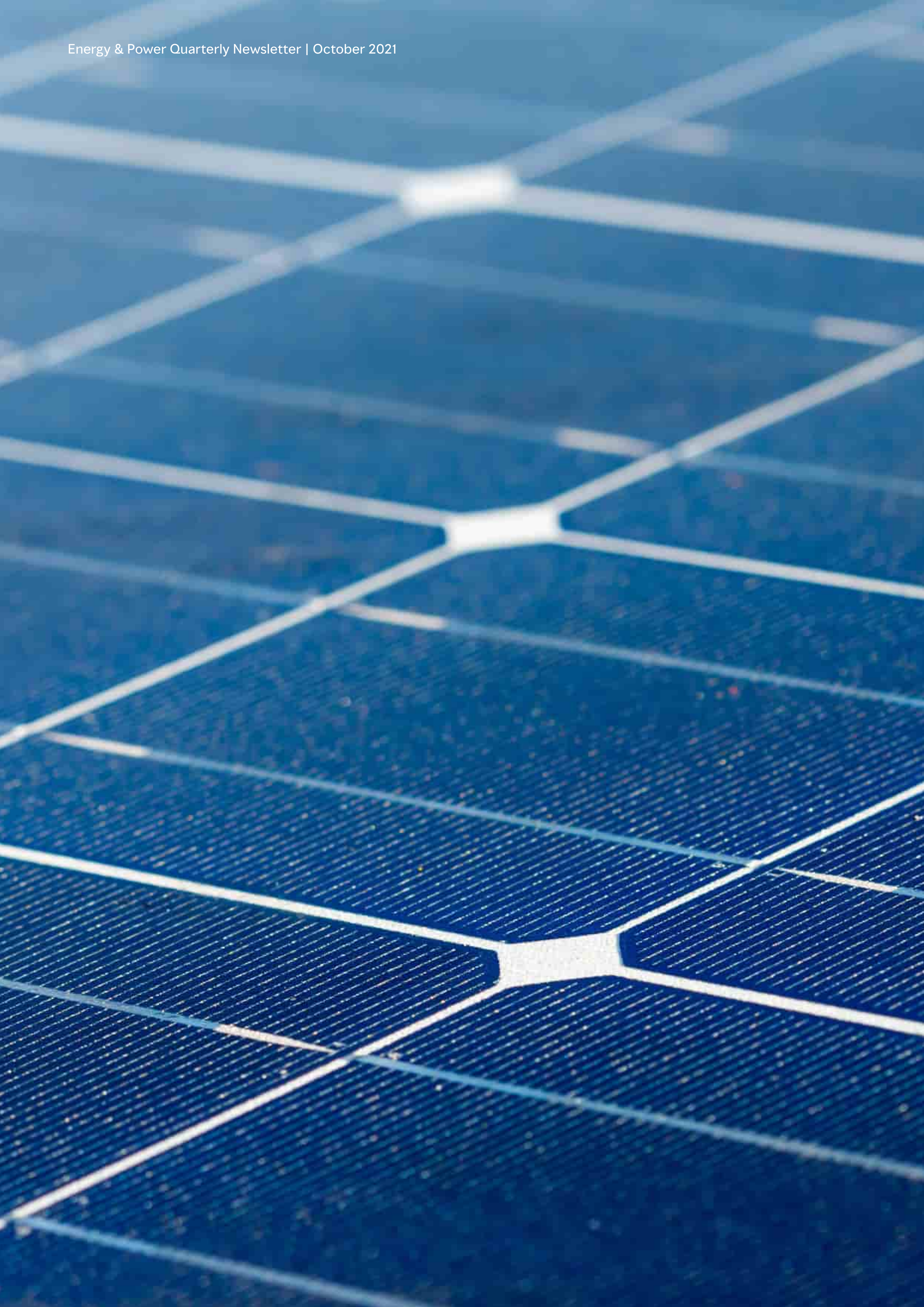
Therefore, the buyer would only be entitled to reject the goods if the seller's breach deprived the buyer of the whole benefit of the contract. This judgment highlights that where an exact specification of a product is of fundamental importance to a buyer, the buyer should specify quality related terms in the contract as a condition of the sale.

Atlantic named windstorm season forecast

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

Both TSR and CSU have slightly reduced their August forecast for the season's storm numbers. However, all forecasters are still predicting an above-average Atlantic hurricane season in 2021, citing anomalously warm tropical Atlantic waters and vertical wind shear across the tropical Atlantic and Caribbean in July as major factors. Warmer than normal water across the tropical Atlantic provides more fuel for tropical cyclones. Lower vertical wind shear allows hurricanes to better vertically couple and also inhibits entrainment of dry air into the circulation. Vertical wind shear in July typically has strong persistence, so if vertical wind shear is high in July it is likely to remain elevated during the peak of the season.





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