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# Insurance Renewals Trending Toward Flat, Modest Rate Increases

By Ted Dimitry

HOUSTON–Insurance is a tricky beast.

Many commercial buyers view insurance as a necessary evil, a line-item expense for a financial product they never plan to use, and therefore, which should be kept as inexpensive as possible. Others view it as "sleep well" security, allowing their companies to undertake all manner of operations in the exploration, production, processing and transmission of hydrocarbons.

Still others, including bankers, attorneys, risk managers and other risk-averse buyers who have been burned before by an uninsured or underinsured loss, see insurance as a financial backstop to allow business to continue when the proverbial "ordure" hits the fan.

In a sense, they are all correct. Insurance costs should be reasonable. The mechanism that is insurance exists to allow businesses and individuals to be "made whole" should an incident occur that results in a financial and/or operational loss, thereby transferring the risk of such a loss.

But, of course, there is another group: the oddballs in the business of insurance and risk management, who somehow find the marriage of quantifying exposures to various risks, qualifying those exposures in a sprawling and ultracompetitive global marketplace, and engaging in the transfer of that risk through a complex contract of adhesion (the insurance policy).

These are the insurance agents, brokers, wholesalers and underwriters who engage in the business of transferring risk through the payment of premiums in exchange of a promise to pay from an unrelated entity. Others thrive in the arena of interpreting and enforcing these contracts. These are the claims advocates, loss adjusters, claims underwriters and sometimes insurance coverage attorneys who really determine exactly how insurance works. It is an odd group indeed.

The risk exposures in the upstream and midstream sectors are substantial, yet the oil and gas market–while healthy, full of optionality and ultracompetitive–is miniscule compared with so-called standard insurance lines, especially in the United States and Canada. To those in the energy business seeking to buy insurance products to mitigate very serious exposures to potentially catastrophic losses, the world in which the brokers, agents, wholesalers, underwriters, claims professionals and coverage attorneys live is often seen as one of complete chaos.

To help rein in some of that chaos, and provide a clearer view of what lies ahead in the oil and gas insurance market in 2019, it is first necessary to take a quick look back. The onshore remains the driver of North American oil and gas insurance trends, as has been the case for some time. As the shale revolution took hold and economies of scale created unprecedented economic efficiencies, many operating companies and contractors barely noticed insurance pricing. Of course, premium payments are always important, but there was good money to be made in resource plays from the Marcellus and Bakken, to the Eagle Ford and Permian Basin.

Stakeholders from all corners of the insurance and risk management sector were ready, willing and able to assist in transferring risks during the shale activity heyday, and many made modest profits as well. Robust competition and an abundance of insurance capacity kept the profits from running away with themselves, resulting in a prolonged period of soft insurance pricing.

Of course, the crash in global oil pricing in late 2014, followed by a prolonged period of low oil and natural gas prices, put a significant damper on the business for insurers. Fortunately for the upstream sector, however, insurance capacity did not contract. Instead, insurance providers began to compete ever-more vigorously to maintain relevant shares of a dwindling market.

Then came 2017, which was the absolute worst year of insured losses in history. Hurricanes Harvey, Irma and Maria battered the United States and Caribbean, causing unprecedented damage. They soon were followed by several massive wildfires in California. Most of the losses were not related to oil and gas, although the sector certainly was impacted by Hurricane Harvey.

### Insurance Capacity

A year ago, many insurance experts around the world were anticipating a global retraction of insurance capacity due to the record insured losses of 2017. In insurance and risk management parlance, this is often referred to as a "hard market," meaning that insurance pricing swings the other way as insurance providers seek to recuperate some of the losses suffered in the previous year. This has happened many times, with recent examples including the hard market immediately following the Sept. 11, 2001, terrorist attacks (and subsequent recession) and the 2008 financial crisis (and subsequent recession).

However, as 2018 matured into its second quarter, it became apparent that the capital markets still saw insurance as a safe bet, so insurance capacity was recharged at lightning speed. The first half of 2018 has been dubbed by many as "the hard market that wasn't." There are a lot of opinions as to how or why the insurance market–and by extension, the global reinsurance market–did not harden in early 2018. These range from the general health of the global economy to the increased efficiencies of global capital markets.

Regardless, as 2018 progressed, it became apparent that an insurance market correction was already under way. Some of this was engineered by major global insurance players for various specialty lines of business, including energy, with Lloyd's of London being the most obvious example. Other aspects of the hardening of the insurance market have to do with widespread consolidation across the global market.

While not as bad as 2017, the 2018 hurricane season certainly has not been a gentle summer breeze. Hurricanes Florence and Michael caused significant damage in the Carolinas, Georgia and Florida. Meanwhile, the wildfires in California continued to rage in mid-November with devastating results. Of course, very little (if any) of this has had much of an impact on the North American upstream or midstream sectors. However, drilling activity has increased throughout 2018 with stabilizing commodity prices, resulting in a spike of operational losses arising from all manner of issues, ranging from green crews to resurrecting laid up equipment.

Although anticipated, the losses are happening in the field and they are impacting the performance of the insurance segment that services the upstream and midstream sectors. So while 2018 started off as the hard market that wasn't, 2019 looks to be a hard market indeed.

So what can companies with upstream and midstream assets and operations expect next year? Of course, pricing, terms and conditions will vary. Loss-free companies with assets/operations well away from exposure to coastal windstorms or prolific wildfire perils may hardly notice a hardening of the insurance market. Others may feel it right away. Someone somewhere will get a great deal, while someone else may get hammered. But insurance is much like any other market in that a variety of potential results are possible depending on overall market conditions as well as the specific risks associated with an individual company's business.

### OEE And Excess Wind

In December 2017, renewals for onshore North American property, oil field equipment and control of well insurance were projected to see increases of 5.0-7.5 percent with essentially the same activity level. However, the efficiency and speed with which capacity has been "reloaded" from the capital markets has been nothing short of astonishing. While insurance pricing is somewhat stabilized (premiums are no longer in free fall), there are more than 50 insurance products related to control of well or operator's extra expense (OEE) coverage. This includes coverage for blowouts, underground blowouts and resultant damages/expenses.

Therefore, if an oil and gas operator is more or less loss-free, there are still plenty of deals to be had. On the other hand, onshore operators/nonoperators with claims can expect an increase at renewal ranging from 7.5 to 20.0 percent or more depending on the severity and frequency of losses.

On the contractor side, pricing of coverage for drilling rigs, workover rigs and other onshore oil field equipment remains competitive. However, the uptick in activity has impacted some of the larger facilities for land rigs and other onshore equipment.

The named windstorms (NWS) of 2017–Harvey, Irma and Maria–and the major 2018 NWS that made landfall in the United States–Florence and Michael–had minimal impact on offshore oil and gas fields in the Gulf of Mexico. However, they have served as a reminder to the insurance market of how devastating such storms can be to offshore and near-coast assets. The various insurers in this space have a finite amount of NWS capacity, regardless of whether the risk is offshore platforms and rigs, coastal power plants and refineries, or high-rise condos and luxury hotels.

As we look to 2019, there is widespread conjecture that underwriters are likely to choose to reduce capacity for both the U.S. Gulf of Mexico offshore and coastal industrial/infrastructure in favor of condominiums and hotels, especially in Florida.

However, it should be noted that some niche players will continue to write excess wind coverage. Some insurance providers actually may increase their capacity outlays to the Gulf of Mexico both for offshore assets and industrial exposures along the coast. NWS rates are not yet to where they were in the mid-2000s, but it is not inconceivable that some opportunistic carriers may consider jumping into the mix, especially if there is a retraction of NWS capacity in 2019.

Underwriters have been concerned about the offshore contractor/construction space for several years (rig decommissioning, the sporadic work on the Outer Continental Shelf and the quality of the crews). However, while there is significant upward pressure on rates, some deals still can be had for loss-free insurance buyers. These deals may gain more traction as activity in the U.S. Gulf of Mexico shows signs of life.

### Liability And Auto

Market renewals for U.S. energy business liability is seeing flat to modest increases of up to 5 percent. However, contrary to many predictions, the liability markets seem to be disregarding the impact of the 2017 NWS and California wildfire losses on the overall industry.

The impact of 2018 NWS losses remains to be seen but, as noted, the U.S. upstream and midstream energy sectors seem to have been largely spared, at least so far. While the softening of the U.S. primary casualty market appears to have slowed, it is not clear if the market has bottomed out.

All of this said, business auto coverage, especially business auto liability, continues to be a thorn in most insurance carriers' (and brokers') sides, with fewer and fewer markets willing to offer monoline auto. Health, safety and environment managers need to implement, maintain and enforce best-practice driving, and vehicle use programs also are important. Using cell phones while operating a vehicle and driver fatigue are huge loss factors in auto accidents across North America, and jury awards in U.S. courts across the country reflect that. In many cases, those awards are paid out by insurance companies.

This trend on business auto insurance spans the United States and is across many different industries, not just oil and gas. The bigger the truck, the harder it is to obtain coverage. It is essential to operate a well-maintained fleet of vehicles and employ drivers who have very good records on their commercial driver licenses.

Some umbrella and/or excess liability markets are requiring a $5 million attachment point to sit above business auto liability, especially for companies operating large fleets of heavy trucks. This can, in turn, increase the premiums paid to the insurance company providing the business auto coverage.

Certain insurance providers remain very leery of underwriting risks in some areas. For example, some carriers are very selective about insuring operations of any kind in the state of Oklahoma because of the recent link of seismic activity to oil and gas-related activity in the state. Another example is a reluctance of many insurance companies to underwrite auto liabilities in the Permian Basin as a result of the large amount of losses that have occurred in the West Texas region.

Renewals outside of the United States continue to see less reductions and are predominantly flat, with some long-term deals available for larger risks with fewer claims. Smaller insureds in the energy and/or marine space that have international operations have very few choices for liability coverage outside of the Unites States and Canada.

Finally, in the midstream and downstream sectors, with the 2018 reinsurance treaty renewals not as steeply priced as prophesied, renewals are expected to face flat to modest (up to 5 percent) increases on clean midstream/downstream business. Exposures in the tier one and two areas may face greater challenges, but creativity in renewal placements can help limit cost increases, for example, adjusting NWS/catastrophe (CAT) deductibles, reducing NWS/CAT sublimits and buying excess over sublimits, separating NWS/CAT policies, using NWS/CAT carve-outs or buy-downs, etc.

The good news for oil and gas insurance buyers is that 2018 reinsurance renewals were not as dire as some had predicted. As a result, insurance renewal pricing for loss-free accounts appears to be trending toward flat to only modest increases. Obviously, accounts with recent losses are facing steeper increases and challenges in finding alternatives.

More of the same can be expected for 2019 renewals. However, one the general take-aways of note is that the London insurance market is undergoing a reassessment of various specific coverage lines, which may result in significant repatriation of energy-related insurance placements and premiums back into the U.S. insurance market. ❐

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