

# Energy insurance market update

## Q4 2011

The energy insurance market appears to be becoming less soft as a result of a string of major international and industry specific losses and changes in the reinsurance markets.

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## Summary

- Capacity grew early in 2011, but major losses have forced underwriters to re-valuate their strategies
- Downstream and upstream face similar challenges, although abundant capacity should control rate increases

## Overview

As we approach the end of the 2011 and look to 2012, our outlook is very much determined by events at the start of the year.

Overall onshore energy capacity increased by around 10% between 2010 and 2011, which boded well for rate reductions.

The Australian floods, New Zealand earthquake and the catastrophic earthquake and tsunami in Japan caused heavy losses for many international underwriters, forcing a reevaluation of strategies, however. The downstream market has subsequently become less soft.

At the same time, power and mining losses and a major incident in the Canadian oil-sands reduced downstream profitability.

### Strategy changes

These natural disasters led to an expectation that reinsurance costs would rise as a result of senior management pressure on global underwriters. By the end of Q1 most markets were refusing to support rate reductions and the market was flat at best.

Many underwriters have subsequently sought rate increases on all renewals, particularly those with natural catastrophe exposure, poor loss record or low risk quality. Risks in heavy natural catastrophe areas have seen upward pressure on rates and deductibles.

While claims in subsequent quarters have been significantly lower, the fact that 2011 started so badly means that underwriters have spent the rest of the year trying to ensure profitability on their energy books. The healthy level of capacity has kept rate increases in check, but negotiations have been robust.

### Model switches

The introduction of Risk Management Solutions (RMS) US hurricane model version 11 by many markets is likely to put further pressure on terms. On major renewals exposed to natural catastrophe risk, underwriters have been requesting additional information such as the elevations of all wind exposed assets in addition to traditional zip codes and longitude and latitude coordinates in order to satisfy the more exacting modelling requirements of RMS 11.

It also appears that underwriters, while not abandoning natural catastrophe risks altogether, are generally looking to reduce participation. This natural catastrophe capacity supply-side development has predictably led to greater rate movement (in some cases of more than 10%) on risks with this exposure.

Therefore as we approach the end of the year we are faced with a downstream energy market that has been moderately hardening and being cautious about where it deploys capacity.

It remains to be seen how this trend will be affected during the rest of the year if there are no further major losses and capacity remains at current levels. The key driver however will be the underwriter reinsurance treaty renewals, which predominantly fall in Q4.

Early indications are that the hardening momentum in the market has now weakened and conditions are in general relatively flat with some small increases on more difficult risks. It remains to be seen whether the year end treaty renewals will trigger further change as we move in to 2012.

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## Upstream losses

In the immediate aftermath of the Deepwater Horizon loss, upstream insurance prices rose by 15-20% on average. While the very hard conditions were short lived, full year premium rose by 10-15% , but while the liability market remains volatile, this class of business continues to be underwritten by Lloyd's.

Two significant losses in Q1 and Q2 2011 have meant that the picture is not significantly better in 2011.

The Maersk Gryphon loss has been estimated at US\$850 million while the Polycrest Jupiter loss is in the region of US\$238 million (US\$160 million physical damage plus US\$78 million removal of wreck).

Together with Devon Energy tornado loss and the Cascade Chinook construction loss, underwriters

suffered the worst first half result for some time on a gross basis and putting aside year of account.

In anticipation of further increases on reinsurance renewals on January 1, 2012, we expect underwriters to attempt to maintain increases on clean accounts during the December renewal season.

As a result, even clients that suffered significant rises following Deepwater Horizon are likely to see premium increases of between 5-10%, a position that we expect to continue into 2012.

The high level of capacity in the upstream insurance markets will potentially curb the worst of the increases, particularly given that there is little expectation of any withdrawals from the upstream markets at this point.

## Meakin moves to Middle East, Westacott joins in Asia

Tony Meakin, most recently a regional director for Aon Risk Solutions (ARS) energy and power in Asia, has become the regional director for energy, power and construction in the Middle East.

Based in Bahrain, Meakin now reports directly to Latif Alreyes, CEO of Aon Middle East and North Africa (MENA) as well as close working relationships with the heads of Aon's global specialties.

Meakin will be focused on retaining and growing Aon's position in the region and developing the specialty network in MENA that is recognized by our clients, suppliers and peers as best in class.

As a result of the move, Paul Young and Allen Nicely have become co-heads of Aon's energy business in Asia.

"My new role gives me the opportunity to assume a broader challenge and to be at the centre of one of the few regions in the world that will see significant investment and Capex expenditure over the next five years or so," Meakin says. "Its an extremely exciting region to be part of and fits well with my recent Asian experience. After eight years I am proud of our achievements across Asia and have no doubts Martin Westacott, Paul and Allen will take the business forward rapidly."

Westacott has joined ARS as regional director for energy in Asia. Based in Singapore, he reports to Ted Hodgkinson, executive vice president and chief broking officer for the region.

Martin Westacott  
Regional Director for  
Energy, Asia  
Aon Risk Solutions



Westacott will focus on Aon energy clients and prospects across Asia, and brings 25 years of experience in the upstream and downstream energy and chemical sectors.

He joins from ExxonMobil's corporate insurance department, where his roles included regional director of risk management for Asia Pacific with responsibility for directing the insurance and risk management philosophy across the region.

Westacott was the risk management lead on several multi-billion dollar development projects in Asia Pacific including PNG LNG in Papua New Guinea, Gorgon in Australia, and the Fujian Refinery & Ethylene Development in China.

"His global energy skills and experience provide a truly differentiated Aon offering, allowing us to connect with clients more broadly and deeply about their business and risk issues while delivering solutions through the full suite of Aon's global resources and services," says Hodgkinson.

Martin Westacott  
joins the Asia  
team while Tony  
Meakin moves to  
the Middle East



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What's your organization's risk maturity rating?

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## Aon Risk Maturity Index suggests risk management and financial performance relationship

The Aon Risk Maturity Index suggests a positive relationship between the maturity of an organization's risk management framework and financial performance.

The index, launched in partnership with The Wharton School of the University of Pennsylvania, allows risk and finance leaders to assess their organization's risk management framework. Upon completion of the index questions, participants receive an immediate risk maturity rating, suggestions for improvements and insight into the levels of risk maturity globally.

Questions examine corporate governance, management decision and risk management processes. Aon and Wharton are analyzing the answers to the questions to identify those activities associated with improved financial performance.

"The index helps organizations understand how their risk management framework compares to best practices and we use the data to support benchmarking," says Theresa Bourdon, group managing director, risk consulting Americas, Aon Global Risk Consulting (AGRC).

### Understanding differences in performance

Using a preliminary set of index data for publicly traded (primarily US) firms, Chris Ittner, Ernst & Young Professor of Accounting at The Wharton School, was able to determine a statistically significant relationship between an organization's risk maturity rating and its financial performance of recent years.

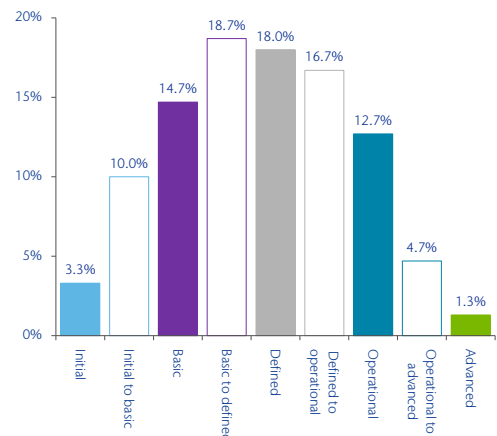


Professor Chris Ittner,  
Ernst & Young Professor of Accounting,  
The Wharton School,  
University of Pennsylvania

While the performance effects vary according to industry and competitive factors, the results, even using a small sample size, confirm long held notions on the relationship between an organization's enterprise risk management framework and sustained performance improvements. As the index database grows, Aon and Wharton will identify specific sets of activities that deliver the best value for a company.

Preliminary analysis of the responses points to common threads among organizations with an above average risk maturity rating.

Aon Risk Maturity Index  
Distribution of risk maturity ratings (August 2011)



"Firms that are above average in risk maturity differentiate themselves in three areas," says Michael Joiner, associate director, enterprise risk management, AGRC. "First, in their approach to understanding the complexity of risk, second, in their formal agreement on risk management strategy and expectations and, third, in the degree to which their organizational architecture is aligned to support achievement of risk management objectives."

Are there companies that do well with lower risk maturity ratings? There are, but Ittner notes, this is observed in situations where the firm was uniquely positioned to capitalize on the economic downturn or where unique industry and competitive factors are at play. "This does not hold for most firms, and the open question is whether that is sustainable," he said.

### More information on participation

"We have developed some powerful new insights for our clients, but we need more data to refine these insights and draw conclusions for more industry sectors," notes Bourdon.

To receive access to the index, clients or their account managers should email [risk.maturity.index@aon.com](mailto:risk.maturity.index@aon.com). In addition to the immediate feedback provided by the index, participants will receive a detailed results report within three weeks of completion. Additional information can be found at [aon.com/riskmaturityindex](http://aon.com/riskmaturityindex).

There is a direct relationship between risk maturity and financial performance finds preliminary data from the Aon Risk Maturity Index

## New WELCAR consultation draft

The Joint Rig Committee (JRC) at Lloyd's has issued a consultation draft of the new WELCAR wording. The group is now seeking feedback insurance brokers, their clients and other interested parties. The new market wording, which has around 3,500 proposed changes, is expected to be published early in 2012.

WELCAR was introduced in 2001 to counter the broad form wordings used in the 1990s and bring stability to the offshore commercial energy construction insurance markets. Without this wording many believe capacity in the market would have simply dried up.

### Building on success

The current wording has been widely lauded. There has been no litigation regarding interpretation, although many claims have required commercial settlements.

For the rig committee, there were issues surrounding escalation, schedule B, warranty surveyor warranty clause and uncertainty regarding contractor access to "other assured" status.

The JRC says new wording is intended to address all of these issues as well as:

- update the London energy market's offshore construction project insurance wording to reflect a decade's experience of underwriting on the basis of WELCAR 2001, changes in the energy market's approach to such risks and recent revisions of market clauses
- improve the quality of the contract wording by making it clearer and more consistent, using more contemporary language

The committee has asked for brokers to coordinate review comments.

We would ask that anyone with an interest in the issue take the time to fill in a short survey, which outlines the key changes reviewed by Aon's specialist energy construction group. This can be found at by following this link: [svy.mk/u25CQg](http://svy.mk/u25CQg).

We are in discussion with the JRC and are using the results of the survey to influence the changes that are going to take place.

A draft of the WELCAR wording has been released. Aon is conducting a survey to ensure the rig committee understands our clients' opinions

## OIL members ratify resolutions

After a number of years of dealing with the challenges of the three Gulf of Mexico hurricanes, OIL, the energy industry mutual, has rebuilt its financial strength and is focused on the future.

Shareholders' equity stood at US\$3.2 billion in 2010, one of the strongest positions in OIL's 40 years. This has attracted new members and improved the marketing position.

While revenues, assets and expenses have increased substantially in the energy industry over the past decade, commercial insurance market capacity has failed to keep pace, with the capacity gap between insurable values and available insurance growing each year. This means that OIL moving to address its member's capacity requirements is welcome.

OIL's board and management are working hard with the support of the members to continue developing its operating model and risk transfer product.

The goal is to offer current and future members superior value in comparison with traditional insurance markets.

The OIL membership recently voted through a number of important resolutions and rule changes that will potentially have a meaningful effect on the mutual's profile.

Although each member will have its own view of the relative merit of the changes, we believe that the changes will further encourage members and potential members to look closely at what OIL offers as a capacity provider for insurable energy risks.

Aon has prepared a brief paper that outlines the major changes. It includes some of Aon's observations and commentary with the aim of explaining the relevance and impact of the changes.

If you would like to download a copy of the paper, please contact your Aon representative or follow this link: [bit.ly/rwpZLk](http://bit.ly/rwpZLk).

OIL is recovering after a challenging couple of years. Aon has published a paper on the ramifications of recent resolutions

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