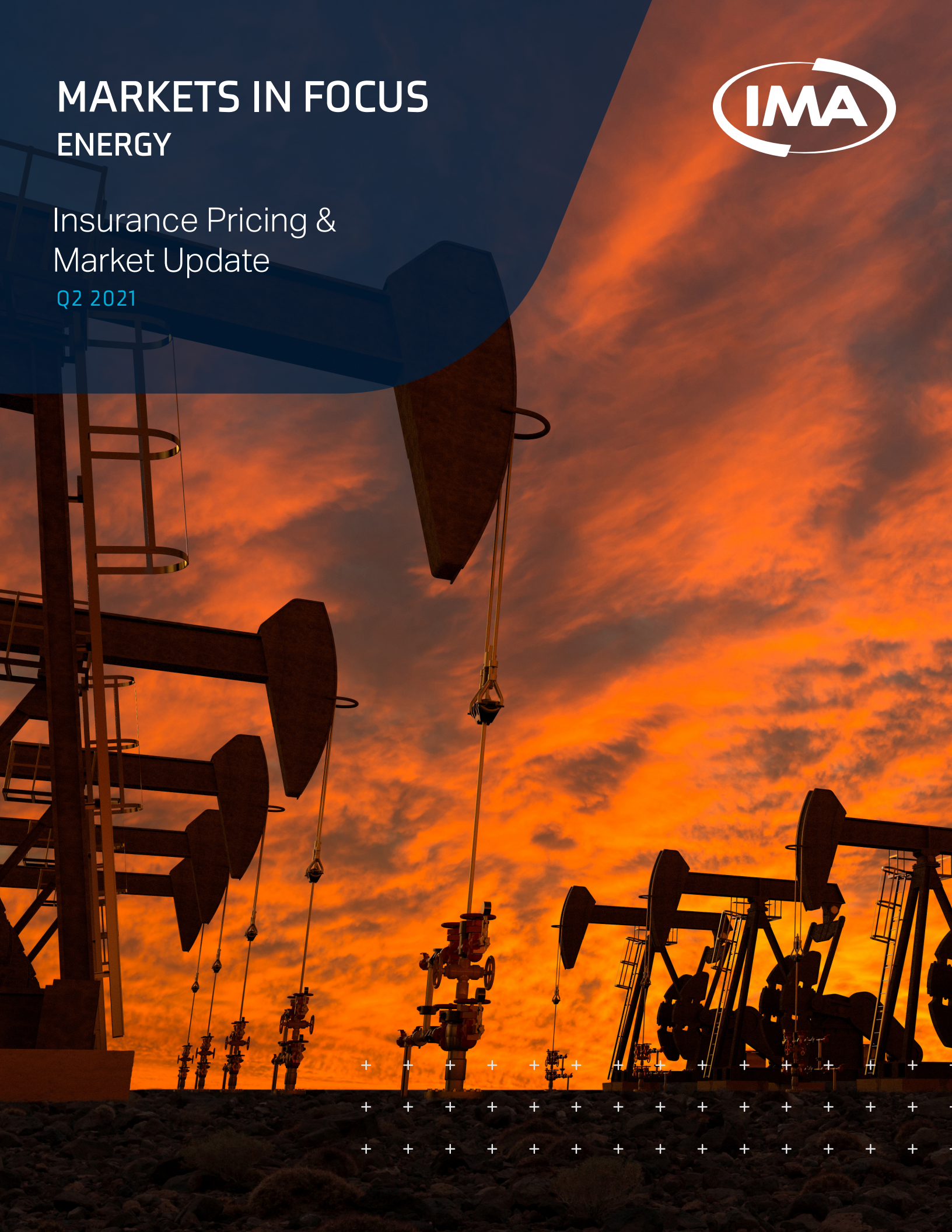
MARKETS IN FOCUS

ENERGY

Insurance Pricing &
Market Update

Q2 2021



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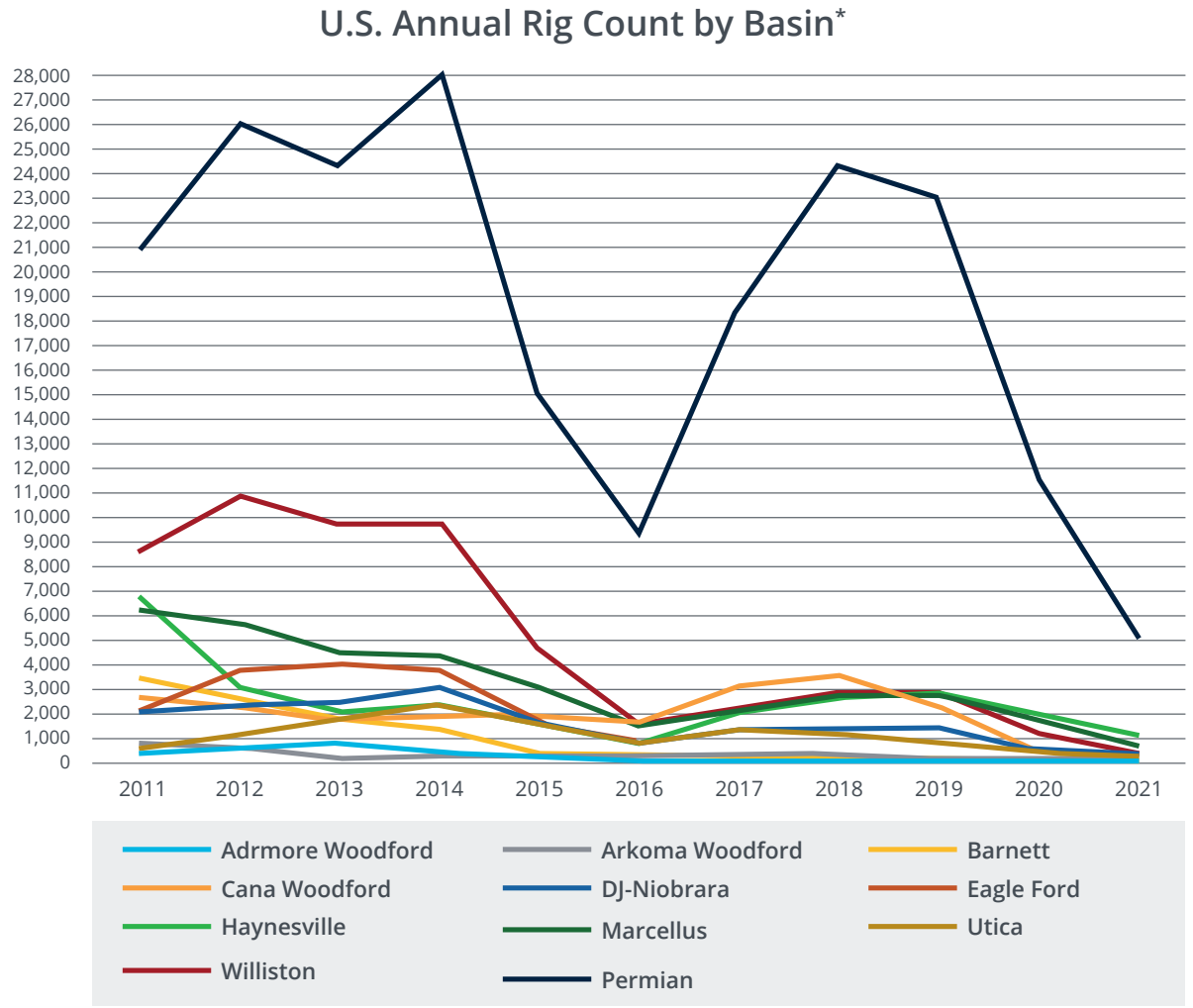
Introduction

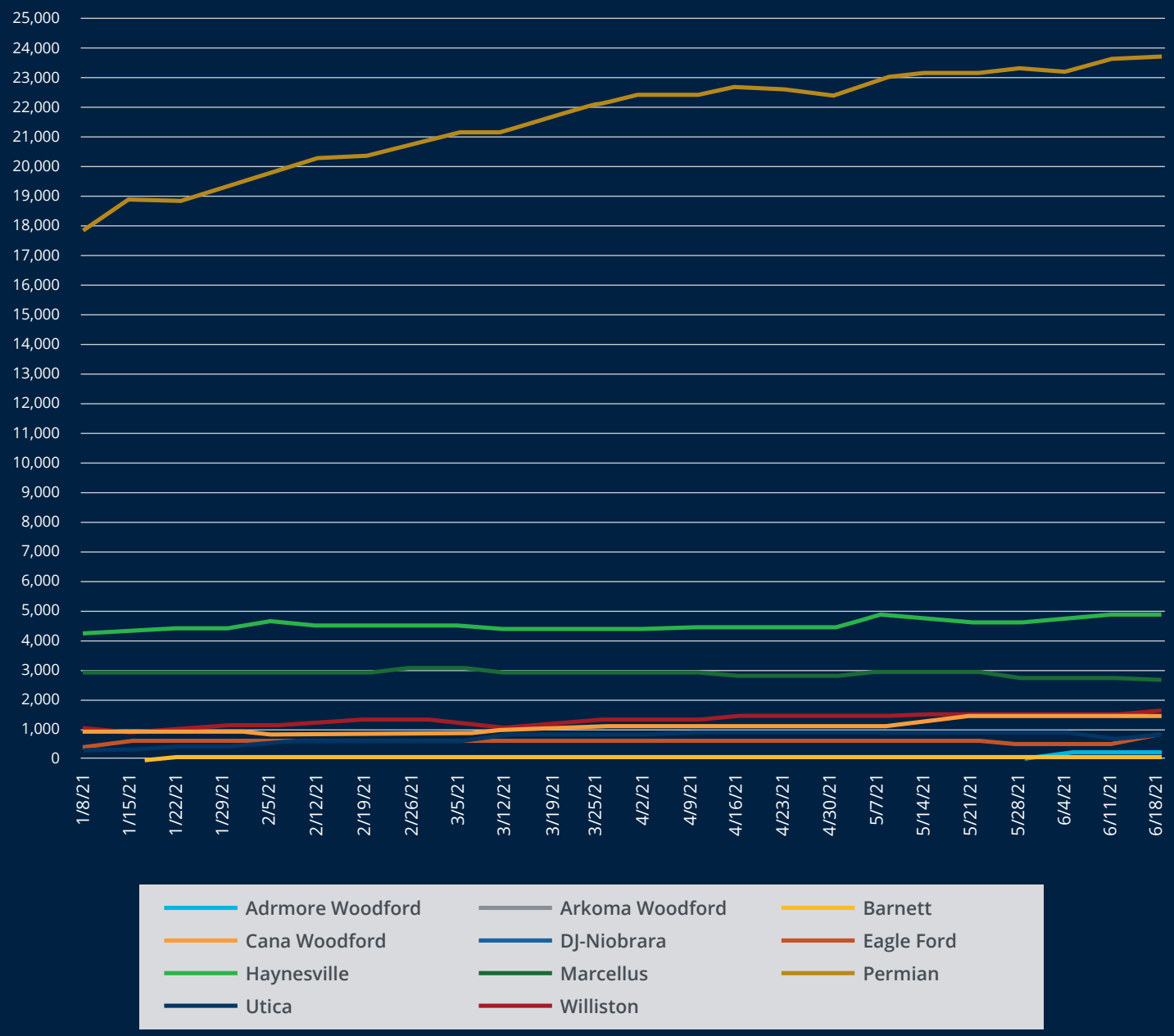
To say that 2020 was a challenging year for the oil and gas industry would be a gross understatement considering the events that took place. Given sub $2.00/mcf Henry Hub prices for most of the year, a sub $50/bbl WTI price environment (including a day of negative prices) for much of the year, increasing ESG requirements, the rising cost of debt for the industry, a stagnant A&D market and multiple years of faltering commodity prices prior to 2020, all culminated to tremendous pressure on the industry. As a result, 107 companies (46 E&P and 61 OFS companies) filed for Chapter-11 bankruptcy protection in 2020, which was the most in a single year since 2016 when 142 companies filed.[1] Furthermore, it is estimated that 120,000 jobs were lost in the U.S. oil and gas industry in 2020.[2]

However, today the industry is in a much stronger position. Commodity prices have improved significantly in 2021 due to OPEC production cuts and an improved economic outlook resulting in higher consumption estimates. Despite the improved commodity price environment, there is still pressure on everyone in the industry to continue focusing on reducing costs, deleveraging, and finding operational efficiencies. Higher commodity prices are also supporting limited growth activity and Capex spending from those who have access to capital. This is particularly true of the Permian Basin, which has seen a 32% increase in rig count from 179 to 237 between 1/1/2021 and 6/18/2021.[3] As for other basins, activity has been steady but relatively flat in comparison.



*2021 year through 6/18/2021
Source: Baker Hughes as of 6/18/21 (https://rigcount.bakerhughes.com/na-rig-count)

Weekly 2021 Active Rig Count by Basin



Source: Baker Hughes as of 6/18/21 (https://rigcount.bakerhughes.com/na-rig-count)

Upstream

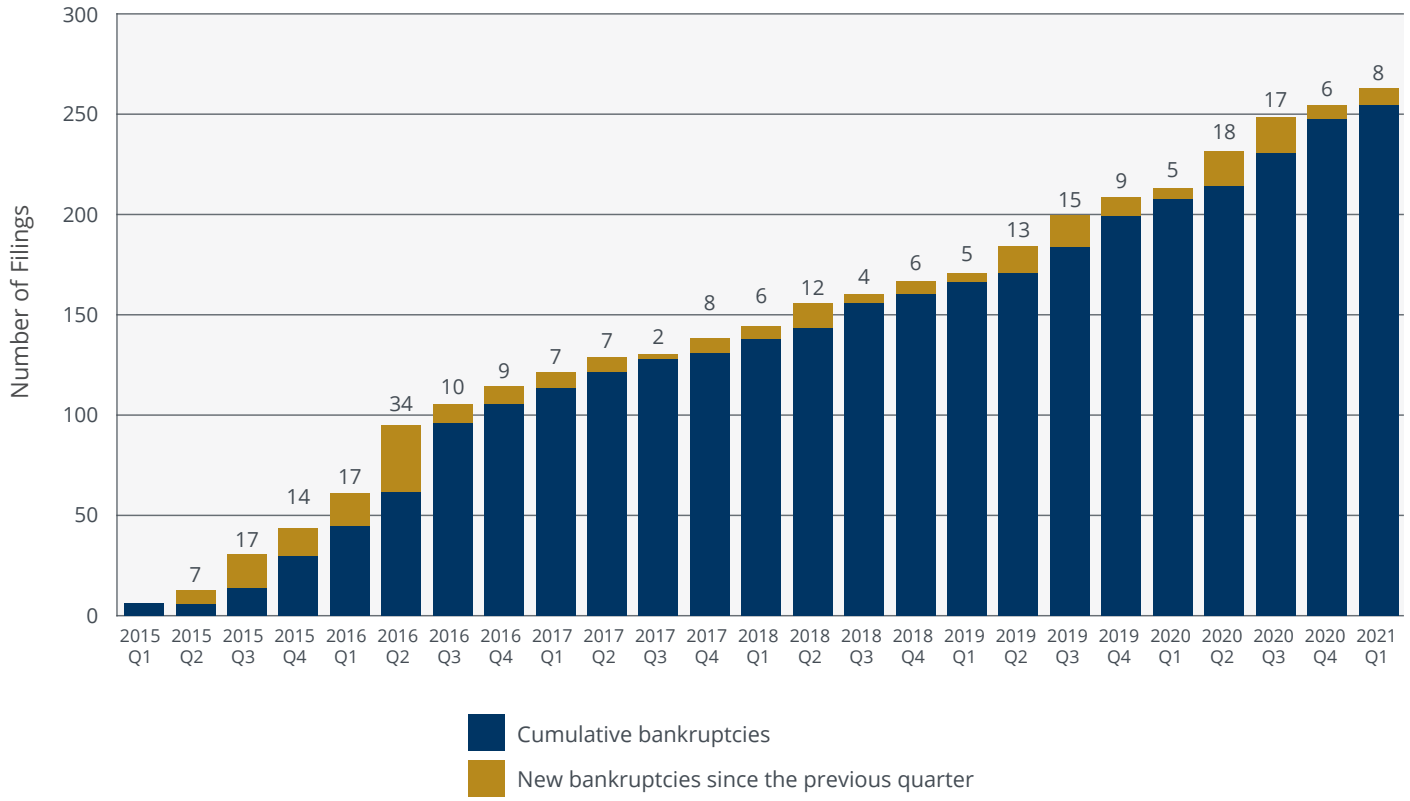
Given the improved price environment, many operators are taking this opportunity to layer in additional hedges at higher floor prices, using additional free cash flow to pay debt and strategically allocating capital to the drill bit. Even shale producers, who traditionally look to ramp production and replace reserves in times of higher prices (typically at the expense of free cash flow and their revolving credit facilities), are generally conserving their capital and avoiding drilling marginal wells that they may have historically drilled.[4] The Shale Boom 3.0, as many in the industry are calling it, is all about free cash flow and not flooding the market with production. In general, shale and traditional operators believe that the worst has passed and are exercising cautious optimism.[4] However, despite cautious optimism, disciplined capital spending and higher commodity prices, there were still eight bankruptcy filings in 1Q21 compared to eighteen filings in the depths of the global pandemic in 2Q21.

Another prevalent theme in the E&P space in 2021 is consolidation. Transactions have always played a major role in the space, but the old model of "lease and flip" in a single basin that drew interest from private equity is no longer a viable option (in part due to challenges in the debt capital markets, banks and acquirers applying little to no value to PUD reserves, wide chasms between bid-ask prices in A&D transactions and a need for immediate free cash flow from acquirers.) Instead of proving up fields and adding as much production as possible at the expense of free cash flow, PE funds and operators are now having to view assets with much longer time horizons and rely on sustainable free cash flow. As such, the A&D market is still stagnant and dependent on PD reserves, but there has been a significant uptick in M&A activity as single-basin companies (which describes most private E&P companies) look to gain economies of scale, improve their positioning with their bank syndicates by increasing PDP reserves, reduce G&A costs and increase their viable drilling inventory.

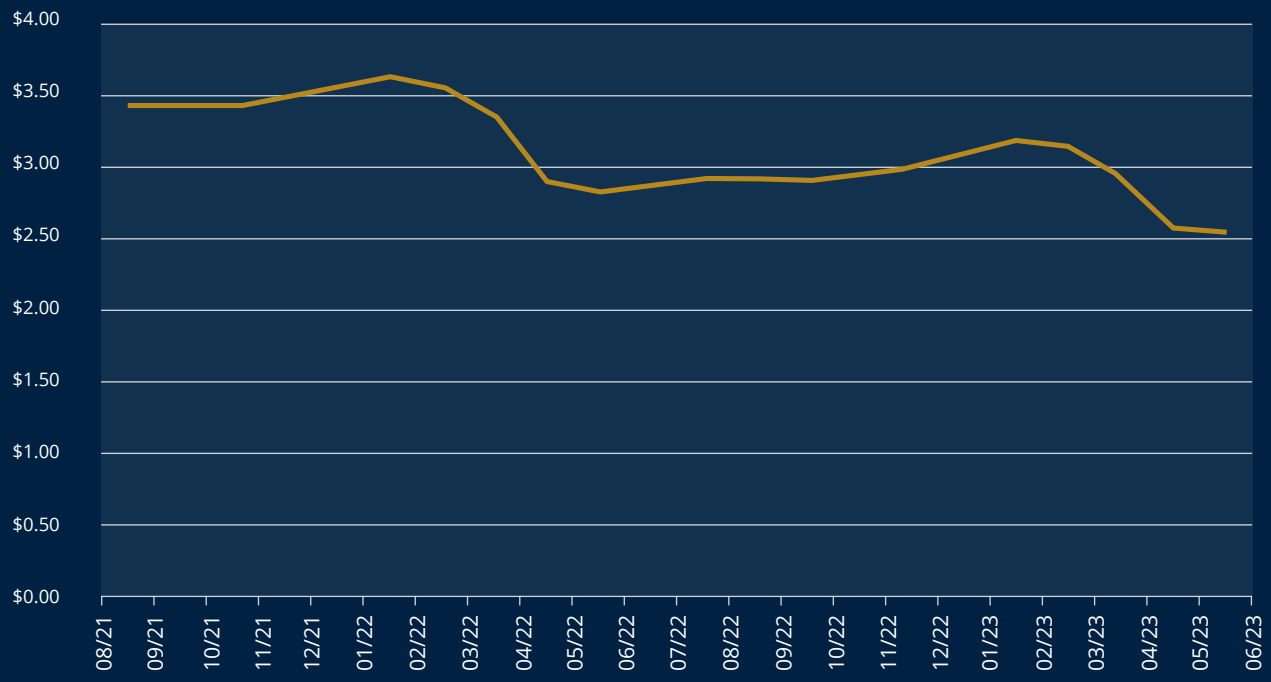
Recent examples of this include the combination of four DJ Basin operators (Extraction Oil and Gas, Crestone Peak, Bonanza Creek and High Point merging to form Civitas Energy) as well as the blending of three Kayne Anderson portfolio companies (Casillas Petroleum Resource Partners, Native Exploration Holdings and Acacia Exploration Partners to form 89 Energy III) in the SCOOP, STACK and Merge sub-basins of the Anadarko Basin. This is also occurring in the Permian Basin, primarily in the Midland Basin sub-play, with Pioneer Natural Resources' bolt-on acquisitions of DoublePoint Energy and Parsley Energy earlier this year and Diamondback Energy's bolt-on acquisition of QEP Resources. Even the large independents and majors are making deals as evidenced by ConocoPhillips' ~$10B acquisition of Concho Resources, Chevron's $13B acquisition of Noble Energy and rumors of a potential Chevron-Exxon merger at the beginning of the year.[5] It is expected that M&A activity will continue throughout 2021 as both the WTI and HH futures curves remain in backwardation, indicating a lack of confidence in sustained upward price momentum and a need for scale.

2015-2021 Cumulative North American E&P Bankruptcy Filings

Haynes and Boone Oil Patch Bankruptcy Monitor

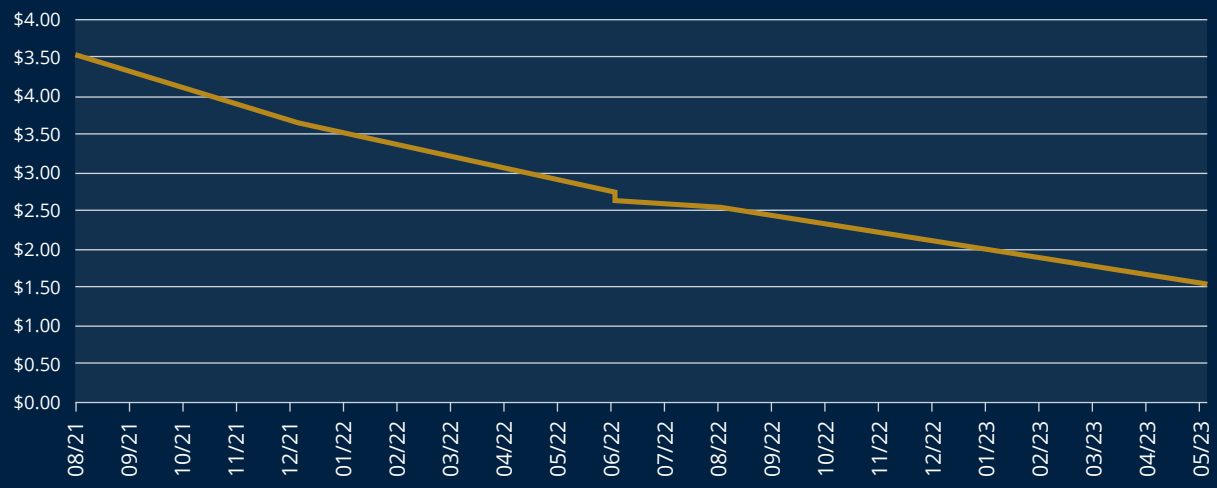


Henry Hub Futures Curve*



*As of 6/25/2021 - https://www.cmegroup.com/trading/energy/natural-gas/natural-gas_quotes_globex.html

West Texas Intermediate Futures Curve+



+As of 6/25/2021 - https://www.cmegroup.com/trading/energy/crude-oil/light-sweet-crude_quotes_settlements_futures.html

Oilfield Services

While 2020 was a challenging year for the whole industry, few were as negatively impacted by the downturn as the OFS sector. The plunge in commodity prices resulted in operators slashing budgets and Capex plans, which devastated the OFS sector and contributed to 61 companies filing for Chapter 11 bankruptcy protection in 2020.[6] Only 2016 saw more bankruptcy filings in the OFS sector with 72 that year.[6] Many OFS companies were still struggling with their balance sheets and profitability in the wake of the 2014 crash in prices, but 2020 delivered a crushing blow to many that were barely hanging on. This was particularly true of the companies that provide equipment and services to the shale oil industry, as these operators were hit the hardest.

As discussed previously, commodity prices have begun to recover in 2021, resulting in a stabilization in E&P activity and reinstatements of delayed or stalled projects. Though E&P spending is expected to be conservative in 2021, the 28% forecasted increase in onshore Capex spending will be a welcomed boost to OFS companies.[7] Additionally, for the companies that have survived the downturns, it is possible that they could receive a benefit from the departure of competitors in the form of improved price elasticity of their products and services. Given the challenging market environment in 2020, many OFS companies were offering discounts and rebates in order to keep crews busy and attract what little business was available. However, now that there are less competitors and there appears to be an increase in demand, there could be an opportunity for firms to increase prices and improve margins in 2021.[8]

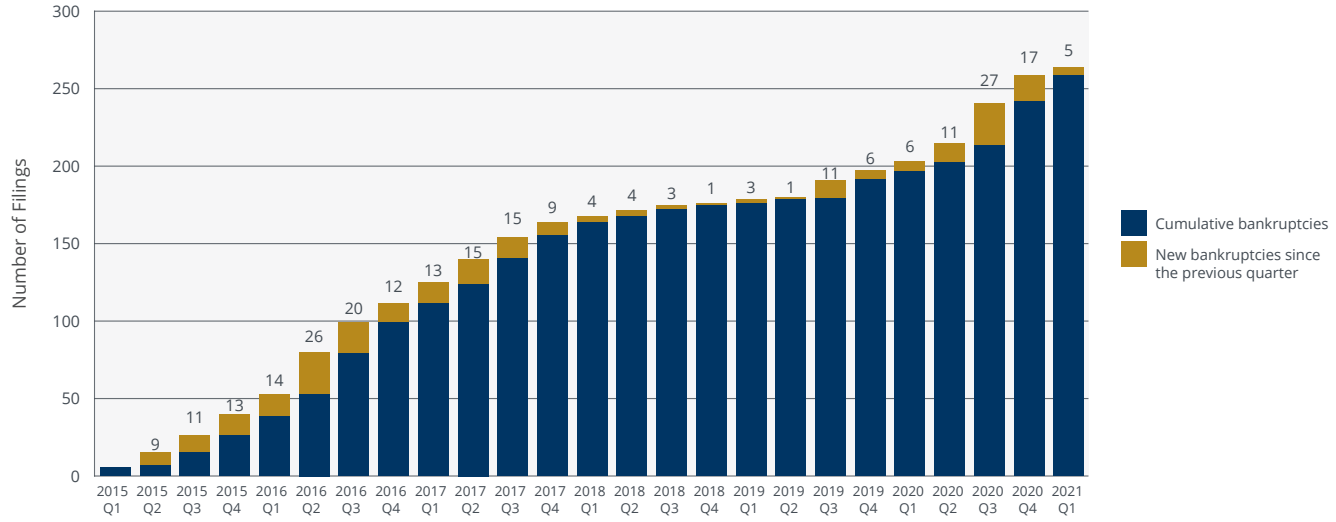
North American E&P capex (USD billion)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Onshore	249.5	273.0	290.8	318.0	153.6	88.5	147.0	183.9	161.0	84.0	108.0	141.0	156.0	165.0	178.0
Offshore	17.0	17.7	23.6	23.1	22.9	15.0	13.2	12.3	11.0	10.0	9.0	12.0	12.0	12.0	15.0
Total Spending	266.6	290.7	314.3	341.2	176.5	103.5	160.1	196.2	172.0	94.0	117.0	152.0	168.0	177.0	194.0

Source: The Council of Insurance Agents & Brokers

2015-2021 Cumulative North American Oilfield Services Bankruptcy Filings

Haynes and Boone Oil Patch Bankruptcy Monitor



Midstream

Given the nature of pricing agreements, minimum volume commitments and take-or-pay contracts, the midstream sector was sheltered from a lot of the fallout from 2020. However, the average credit worthiness of their E&P counterparties declined significantly and opportunities for new pipeline projects were limited, given the uncertainty in production volumes. Much like the OFS sector, the companies having significant capacity exposure to shale oil were negatively impacted by steep declines in volume and subsequent bankruptcies, while pipeline operators in other basins were generally able to weather the storm. However, midstream companies with significant exposure to associated gas were also adversely impacted by the demand destruction of crude and NGLs.[9]

Much like the E&P sector, midstream companies are cautiously optimistic in 2021 but are exercising capital discipline and are unwilling to sacrifice free cash flow for growth. Instead, companies will focus on climbing back to their previous peaks rather than growth over the next few years, as stunted production growth will force companies to fight for every barrel and cubic foot of natural gas they send through their pipelines.[9] The primary areas with growth opportunity for the midstream sector are in the crude infrastructure in the Permian Basin, gas processing and infrastructure in the Haynesville/Bossier shale play and gas processing and infrastructure in the Marcellus shale play. The Permian is the only major U.S. basin seeing an uptick in drilling activity and the Haynesville/Bossier shale play is benefiting from its geographic proximity to LNG exporters, the regions strong well results with low takeaway costs and rising natural gas demand. The Marcellus shale play is also benefiting from an increase in natural gas demand and higher netbacks. Given the upstream success in these basins, there could be opportunity for midstream companies to support producers with more infrastructure. However, the Biden administration presents risks for the midstream sector in the forms of more oversight, new climate regulations, slower permitting and new hurdles for certain pipe projects.[9] The industry may have gotten an early taste of this when the current administration revoked the permit for the Keystone Pipeline earlier this year. However, restricted supply should help rebuild pricing and margins.

Environmental, Social + Governance (ESG)

Investors and other stakeholders across all industries are holding businesses accountable not only for their financial performance, but also for their measurable impact on people and the planet.[10] Specifically, they're scrutinizing companies' actions and policies related to environmental, social and governance (ESG) matters and they have centered their sights on the oil and gas industry.

When ESG was first mentioned in 2006 in the United Nation's Principles for Responsible Investment (PRI) report[11], many thought this movement would be a fad or would only affect certain industries, but this has not been the case. Fast forward to 2021, and it's become common place to see ESG plans and commentary in public filings and in investor presentations, even in the oil and gas space. This appears to be in response to attacks on two fronts: equity and debt investors. Currently, activist ESG investors are putting pressure on large energy company institutional investors, money managers and the boards of these companies to start making changes having a positive impact on climate change.[12] Though these efforts have primarily been aimed at the majors, it is believed that smaller companies could be next.[12] Additionally, activist investors are putting pressure on insurers and banks to limit their oil and gas business. Insurers and reinsurers are seeing pressure to limit their (re)insurance and investment exposure to less ESG friendly industries which is affecting the entire insurance value chain.[13] Meanwhile, banks are feeling the same pressure, and many European banks have completely turned away from the industry or significantly decreased their involvement.[14] Major credit rating agencies, like Moody's Investor Service and S&P Global Ratings, are also zeroing in on ESG and the environmental records of oil and gas companies. Specifically, Moody's warned in September 2020 of long-term risks within the extractive energy industries related to access to capital as well as related risks regarding insurability and litigation.[15] Similarly, early in 2021 S&P downgraded its credit ratings for major U.S. oil companies, citing future stricter regulation and declining demand for oil and gas.[16]

Most recently, activist ESG investors have scored a major victory in their attack on Exxon Mobile's board of directors. During a proxy battle at Exxon's annual shareholder meeting in June 2021, a little-known hedge fund called Engine No. 1, which has just a 0.02% stake in Exxon and no history of activism in oil and gas, was able to gain three board seats after promising to push the company to diversify away from oil and gas.[17] Engine No. 1 was backed by two of the largest U.S. pension funds and some of the world's biggest asset management firms, including BlackRock Inc., in what appears to be a major signal to the oil and gas industry and the activist ESG investor community as a whole. ESG's impact on the cost of debt, investor attitudes, and insurance decisions for the oil and gas industry will continue to be a factor for the industry moving forward.

2020 Insurance Market in Review

Unfortunately, the energy industry also saw difficulties in the insurance marketplace as P&C premiums in all industries generally increased as the broader insurance market continued to harden in 2020. This was particularly true for the property and umbrella insurance markets, which, on average, saw double-digit increases each quarter in 2020. The reasoning for the significant increases in these lines of coverage was due to a combination of factors:

- Several years of underpriced policies
- A record-setting year for named catastrophic storms in 2020
- A significant increase in losses related to wildfires
- The rising cost of claims due to social inflation
- Significant property damage claims related to civil unrest
- A low interest rate environment negatively impacting carrier's investment returns
- A reduction in overall market capacity as admitted carriers pulled back significantly in 2020

Moving forward, insurance carriers will be looking to recalibrate after yet another significant year of losses and the hard market has continued into 2021. Firms operating in all facets of the energy sector will need to work closely with their brokers in 2021 to minimize the impact on their insurance budgets.

By-Line Fourth Quarter 2020 Rate Changes Ranged from 0.4% to +21.3%

	Comm'l Auto	Workers' Comp	Comm'l Property	General Liability	Umbrella	Average
Fourth Quarter 2020	9.1%	0.4%	12.9%	7.3%	21.3%	10.2%
Third Quarter 2020	11.0%	1.5%	14.2%	6.7%	22.9%	11.3%
Second Quarter 2020	9.6%	.7%	13.3%	6.8%	20.0%	10.1%
First Quarter 2019	9.6%	-1.2%	12.0%	5.7%	17.3%	8.7%
Fourth Quarter 2019	10.5%	-1.9%	9.7%	5.8%	13.6%	7.6%
High	28.6%	24.9%	45.4%	26.0%	51.9%	35.3%
Low	-11.6%	-12.3%	-15.0%	-13.6%	-13.5%	-13.2%

Source: The Council of Insurance Agents & Brokers

2H 2021 Insurance Market Outlook

Many of the market factors leading to the further hardening of the insurance market in 2020 are still in effect in 2021. The U.S. is still in a low interest rate environment, and the storms of the first quarter of 2021 are already breaking records. February's Winter Storm Uri was the costliest winter storm in history and inflicted $18B in estimated insured losses. As discussed previously, ESG concerns are also limiting capacity to the energy sector. As such, carriers will continue to place an emphasis on generating revenue through more rigorous underwriting practices, as underwriters will closely scrutinize business performance, environmental impact, retentions, pricing and look to reduce limits and capacity.

This is particularly true for admitted carriers, causing a shift towards placing more business in the E&S market. These carriers are often better equipped to implement pricing and policy language more in line with the current risks in the market. It is expected that larger **Property** and **Umbrella/ Excess** programs in the energy space will require more carriers to achieve desired limits in 2021 as carriers once providing $15M to $20M layers will now offer reduced $5M to $10M layers.

+ **Property** – There was a significant infusion of capital into the **Property** market in the past 9 months as newly-formed Bermuda and London E&S carriers and recapitalized U.S. E&S carriers helped stabilize pricing and capacity. Despite this additional capital, rate increases are still expected, especially for companies with a poor loss history. While admitted carriers and carriers impacted by Uri look to rebalance their portfolios, the additional disciplined capital entering the space is looking to take advantage of firm market conditions and utilize E&S policies to achieve more advantageous pricing and policy language.
+ **Admitted and E&S** carriers are weary of insuring property exposed to catastrophic storms (such as coastal properties) and are simply declining submissions with wildfire exposures. Additionally, many carriers seek to increase All Other Peril deductibles and add or increase convective storm deductibles in higher-risk locations like Texas, Oklahoma and Colorado, even if an account has a favorable loss history. Many carriers are also looking to access limited lightning sublimits, implement very high retention to lightning losses or completely exclude lightning strike coverage altogether. This is particularly true of the Permian Basin, which has seen a lot of lightning strike losses, particularly in the Bone Spring and Central Basin sub-plays. As such, it will be important to partner with a broker utilizing technology to show underwriters how each lightning risk is different and provides loss control services to potentially limit lightning losses.

+ **Casualty** – Capacity in the casualty market continues to be very tight in the energy space, as the casualty market did not see the influx of capital experienced by the **Property** market. Many companies in the energy space are finding it difficult to obtain more than $1M or $2M in **General Liability** limits and are finding that **Umbrella/Excess** carriers are only willing to expose $5 million within the first $10M of **Excess** limits. There is generally more carrier appetite above the $25M attachment point, but even excess of the $25M attachment point we are seeing a greater need for quota share and layered participation.

+ In response to COVID-19, many **General Liability** carriers are adding communicable disease exclusions, thus removing coverage for the transmission of communicable diseases. This exclusion even applies when negligence is claimed in the form of testing for communicable diseases, failure to prevent the spread of disease or when employees infect or spread diseases to others. This is thus impacting Umbrella and Excess layers as many carriers are following the General Liability language. In some cases, Umbrella/Excess carriers are introducing their own harsher communicable disease policy language that is being followed by layers above their excess tower position. This situation can be especially problematic when excess carriers lower on the tower implement the harsher language.

+ **Auto** – Placing **Auto Liability** continues to be a challenge, particularly for accounts with large fleets, as this line of insurance has been a loss leader for many carriers for the last decade. It is not uncommon to see carriers that traditionally package **Auto**, **General Liability** and **Workers' Compensation** together now splitting out **Commercial Auto** from their product offerings as losses in this line have made this strategy suboptimal. Additionally, some **Umbrella/Excess** carriers are requiring higher attachments for Auto. Either buying a higher Auto limit or purchasing an Auto buffer, for which there are few markets, can significantly drive up premiums.

+ **Primary and Excess/Umbrella** underwriters, in general, are very concerned about "nuclear verdicts" particularly if an insured's loss history is indicative of a potential large loss. As such, casualty underwriters are requiring a longer history of loss information as well as more details related to losses and any subsequent changes made to prevent future loss.

  – Accounts with large auto fleets or operations close to residential areas are finding it hard to place the first $5M of coverage as carriers have seen more losses in these categories.

+ **Directors & Officers** – Given the rash of bankruptcies in 2020, generally inflated public valuations, the rise of SPACs and M&A activity and the overall global economic uncertainty that still remains regarding COVID-19, D&O pricing is up significantly and capacity has shrunk across all industry sectors. This is especially true of the oil and gas industry, which has seen a large share of the bankruptcy activity in recent years. With the additional risk in the sector and added ESG concerns, insureds in the energy space are seeing significant increases in rate and retentions along with limited capacity. Underwriters are focusing on debt levels, maturity schedules, access to capital and hedge profiles as they analyze the likelihood of bankruptcy claims. It will be paramount for insureds and brokers to showcase these items in renewals and evidence liquidity and moderate leverage ratios to differentiate the risk from others.

+ **M&A and Representations & Warranties (R&W) Insurance** – After a sharp drop-off in M&A transactions (and by correlation, R&W insurance submissions) in the first half of 2020 due to the impact of COVID-19, deal flow significantly spiked in the second half of the year and continued into 2021 for most industries. In the oil & gas sector, it is expected that private equity investors and corporate/strategic buyers will look to be opportunistic through: (1) distressed investment opportunities, (2) minority investment positions, DrillCos and joint venture activity and (3) stock transactions and mergers for the larger companies. Given the volatility of commodity prices, asset package sales are not expected to be a major part of the transaction landscape.

  Due to these market dynamics, Reps & Warranties insurance will be an impactful risk transfer tool. This is especially true considering the projected increase in due diligence activity outside of traditional legal and financial due diligence; such as scrutiny surrounding operations, IP, environmental impact, and regulatory records. The additional due diligence is expected to lengthen the transaction process, which will in turn increase the potential for the deal to dissolve and increase the need for transactional insurance products. Capacity for these products is available and limits and pricing are based on the target's Total Enterprise Value.

+ **Environmental** – Unlike the P&C space, the environmental marketplace remains fairly stable from a rate perspective. The coverage continues to be an important backstop to any sudden and accidental coverage provided in the casualty tower and OEE (if applicable) and provides broader coverage terms such as civil fines and penalties. However, underwriters are taking a more critical eye with respect to terms and conditions. Exclusions and/or restrictions such as polyfluoroalkyl substances (PFAs), natural resource damages and choice of law are becoming more prevalent in specific jurisdictions such as California, Louisiana and Colorado. Capacity in the upstream market for operators is also more limited now with the exit of Zurich Insurance from the pollution marketplace. Coverage is more dynamic in the midstream and contractor spaces with additional carriers dipping their toe in the water to compete for business. With 95% of the placements in the E&S market, coverage remains nimble and can be crafted to address the specific needs of clients.

+ **Control of Well** – Pricing for Control of Well is also stable and has been for the last 10 years given that very few blowouts have occurred during this timeframe. Rate is based off of Total Vertical Depth which is then applied to Total Measured Depth and companies that are financially stable, have solid well profiles, aren't drilling in the most pressurized zones and are showing some sort of activity on their drilling schedules are seeing flat to low single digit renewal pricing in the current market. Capacity is available for single and multiple well limits, but there are only a few domestic carriers (primarily Travelers and Markel) and Lloyds of London Syndicates that will write the business, so options are limited. Aside from well profiles, financials, pressure and drilling schedules, underwriters are also scrutinizing casing profiles and how reputable the drilling contractors are that are being used.

- **Cyber** – Given the recent rash of ransomware cyberattacks, most notably the May 2021 attack on Colonial Pipeline, cyber coverage has become an extremely important topic. The most heavily cyberattacked firms are those in the 11 to 100 (30.2% of all attacks) and 101 to 1,000 (35.7% of all attacks) employee count range, which describes many companies in the energy space. Additionally, energy companies have traditionally relied on various technologies (particularly the use of "bring your own device" policies) to run their day-to-day operations and protect sensitive operational data, which has made themselves more susceptible to bad actors. As such, cyber policies in the energy industry have become harder to place and 15-20% renewal increases are not uncommon.
- **Tax Credit Incentives for Carbon Sequestration** – Internal Revenue Code 1986 §45Q provides a tax incentive centered around the development and use of carbon capture technology & facilities. Recent IRS guidance outlines statutory requirements for qualifying for these credits and determination of the credit amount. Tax credit insurers may provide an avenue for balance sheet protection through risk transfer that may afford comfort to project developers or tax equity investors as to qualification and recapture risk, and also supports required indemnities of tax equity investors independent of a sponsor's or counterparty's financial strength. In conjunction with 45Q, IRS Notice 2020-12 includes safe harbors that (1) provide guidance for certain partnership structures, and (2) moreover do not prohibit the tax equity investor from procuring insurance unrelated to the CCS project. Increased investor interest in renewable energy is expected to have a positive impact on both M&A activity and tax credit considerations in the second half of 2021. Additionally, as more companies diversify into carbon capture, renewables and other sustainable business, this product could become a lot more meaningful to the industry.
- One bright spot for insurance purchasers continues to be **Workers' Compensation**, which has been a profitable line of business for many carriers and capacity remains stable. Pricing is still dependent on loss history and Modification Factors, but carrier competition over accounts with adequate to strong loss history continues to help pricing. However, pricing and capacity could be challenged if claims increase as a result of more workers returning to the workplace.

Surety Update

After a decade-long soft market, the COVID-19 pandemic acted as a catalyst in tipping the scale in the surety markets. The overall economic uncertainty coupled with concerns within the oil and gas industry has led to enhanced scrutiny in surety underwriting standards.

In general, ESG concerns, bankruptcies, and proposed changes to multiple states' bonding requirements has incited an increase in financial assurance requirements across the country; particularly for upstream operators. Many states are concerned about the potential cost associated with plugging and abandoning ("P&A") orphaned wells as a result of operator insolvency, which is causing many state legislators to propose increases in financial assurance requirements for P&A bonds in 2021 legislative sessions.

As for operators looking to obtain bonds for offshore assets, the latest ruling from the Department of the Interior may cause some challenges that could ripple into the onshore market. As a result of federal bankruptcy ruling for Fieldwood Energy LLC, an operator of offshore wells in the Gulf of Mexico, the Department of the Interior is requiring the previous owners and bonding companies of Fieldwood's assets to pay $7.2B in P&A and remediation costs despite having no current ownership.[18] Per the public bankruptcy filings, the surety companies will be responsible for $1.2B of the $7.2B while Exxon Mobil, BP, Hess, and Royal Dutch Shell, Chevron and Apache will share the reaming cost.[19]

Given the potential for increases in onshore bonding requirements and a large loss looming as a result of Fieldwood's bankruptcy, we see underwriting standards tightening. Capacity could also be waning as these events combined with ESG concerns could result in the exit of surety bond companies that were already hesitant to provide bonds to the oil and gas industry. Even though the surety industry, in general, has enjoyed a decade of record profits and amassed robust reserves, rate increases could be on the horizon. It will be imperative for operators and their brokers to evidence liquidity, free cash flow generation, active plugging and abandonment plans and manageable debt maturity schedules in order to obtain the best results in this market.

Navigating 2H 2021

- **Building Valuations** – Construction labor expenses and materials have been on the rise and, as such, insureds should evaluate if their limits could adequately cover a total loss and rebuild in the current cost environment. To help confirm proper coverage, asset values are being reported on a replacement cost basis using indices that detail cost trends by geographic area. The indices help provide a cost trend factor in order to make more accurate property schedules. IMA service teams can help provide these indices or consult on property schedule methodology.
- **Higher Claims in Times of Recession** – Statistics evidence a significant increase in claims (and fraudulent claims) during times of recession. In particular, there is a significant uptick in claims relating to slip and falls, workers' compensation and stolen equipment from job sites. Insureds in the oil and gas space should be aware of this trend and have a plan to address these incidents.
- **Business Interruption Assumptions** – Even though there is a lot of optimism around vaccines helping improve the economy and current commodity prices, companies should be realistic with their revenue projections when making assumptions for the purposes of business interruption calculations.

  Unlike **General Liability**, **Workers' Compensation** and **Auto** policies, **BI** are not always auditable; meaning there is no reconciliation at the end of the year or credits granted for overestimating revenues. Auditable BI policies can be achieved, but under special circumstances. As such, insureds should be conservative on their revenue estimates given how volatile commodity prices have been as of late. Conversely, underreporting too much can result in being significantly underinsured if/when commodity prices continue to rise or stay at their current levels. All of these factors should be contemplated so that insureds are not overpaying for their BI insurance but still carrying adequate coverage.
- **Higher Switching Costs** – If forced to switch from an admitted carrier to the E&S market, insureds must remember that these policies come with stamping fees and surplus lines taxes. Additionally, these policies are generally more expensive (before the additional taxes and fees) as they are designed to cover more risky lines of businesses/occupancies or provide coverage for non-traditional types of exposures.

Keys to Success in 2021

+ **Begin the Renewal Process Early** – The **General Liability**, **Excess/Umbrella**, and **D&O** markets have become constrained and more difficult to navigate in the hard market. Furthermore, many blue-chip admitted carriers in the oil and gas space are offering less capacity and more carriers are being required to achieve desired limits. Due to general price increases across all lines of coverage and all industry sectors, underwriters are being inundated with submissions as brokers and insureds look to minimize the additional costs. As such, turnaround times for quotes are increasing. **To achieve the best results, insureds should begin their renewal processes earlier than usual as to allow for brokers to successfully canvass the market, work diligently with underwriters in detail and negotiate the best terms.**

+ **Look to Partner with Carriers When Possible** – Strong relationships with key trading partners are always important, but even more so in difficult times. This business philosophy also applies to insureds' relationships with carriers. Where possible, insureds should look to meet (even virtually) with their current and prospective carriers. **This interaction not only builds rapport and allows them to put a face (or voice) to a submission by telling their company's story, it also allows for insureds to control the narrative of their risk versus letting underwriters decide.** This is particularly true if there have been losses and insureds are then able to explain what happened and use the opportunity to discuss lessons learned and what new practices have been implemented, in contrast to underwriters simply reading a loss run.

+ **M&A and R&W Insurance –** In an increasingly competitive M&A landscape, R&W insurance provides corporate/strategic buyers, private equity firms and other stakeholders with a risk mitigation solution for uncertainties surrounding the M&A process. If you are contemplating an M&A transaction and considering the use of R&W insurance, the following should act as your guide:

  1. **Contact your broker early in the process.** To obtain the most value out of the R&W process, this means around the LOI phase in the transaction. This provides for a better opportunity to align deal terms with the R&W policy provisions.

  2. **Policy Terms matter.** Limits placed are typically 10% of target's Total Enterprise Value. Pricing currently averages from 3 - 4%, which is expressed as a percentage of the limits placed. Self-Insured Retentions on average are 1% of TEV. For example, in a $100M TEV transactions: (1) $10M Limit, (2) $1M Self-Insured Retention, (3) $300K - $400K Premium.

  3. **The Process.** Be prepared to provide underwriters at the outset with financials, draft purchase agreements and any confidential investment memorandums. From there, you should expect underwriters to thoroughly be involved in the deal itself, as they will be given data room access, copies of diligence and advisor reports and be provided with the opportunity to ask any further questions during an underwriting call.

+ **Highlight Cybersecurity –** With cyber policies becoming more expensive and difficult to place for energy clients, it will be important for insureds to highlight the specificity of their cybersecurity programs. **Make sure to highlight any additions in cybersecurity staffing or upgrades to programs as well as lessons learned from previous attacks.**

+ **Highlight Safety –** Carriers are always looking to analyze EH&S practices, but underwriters will add more scrutiny to safety in the hard market. This is especially true when looking to obtain lightning strike coverage, as many underwriters will want an in-depth description of all lightning protection equipment and procedures included in the submission. If there have been claims in the past, it will be important to explain to carriers what lessons were learned and how the company is working to not have repeat incidents. **Additionally, IMA's Client Advantage EH&S and risk control professionals can help strengthen policies, provide training based on the latest regulations or provide on-site audits.**

+ **Contracts –** Carriers are becoming more and more interested in indemnity language in MSAs and other contracts. Many underwriters are even asking for samples of contracts to review as part of their renewal process in order to see what insureds are agreeing to indemnify. **IMA Client Advantage attorneys can help tighten indemnity language and give feedback on current contracts that will help protect our clients and make them more attractive to underwriters.**

+ **Familiarity of State Laws –** Insureds should work to be familiar with the state laws applicable to their insurance program, risk management strategy and operations. **There can be significant differences in litigation outcomes state by state and even county by county depending on the jurisdiction. This is especially true regarding ESG standards, which could start to make their way into legislation.**

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More Than Just Insurance

IMA is an integrated financial services company specializing in risk management, insurance, employee benefits and wealth management. It is the sixth-largest privately-held and employee-owned insurance broker in the country and employs more than 1,200 associates.

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