# MARKETS IN FOCUS

## ENERGY

Insurance Pricing & Market Update

Q3 2022

# Introduction

Despite potential economic turmoil on the horizon, we continue to see an elevated commodity price market as we near the last quarter of 2022. This is most evident in the natural gas market, which remains in contango and has seen significant spot market gains as a result of the energy crisis in Europe. With winter months not too far away, significant upward pricing pressure (above the cyclicality of this commodity) is expected as global demand for natural gas rises and with no end in sight to the war between Russia and Ukraine.

Despite early concerns around ESG investment agendas impacting capacity for the oil and gas industry, we have generally seen ample volume for favorable risks and an improved pricing environment. Many companies have used this time in the elevated commodity pricing environment to improve free cash flow, decrease debt, invest in ESG initiatives, and originating stock buyback programs and better hedging contracts. These activities have not gone unnoticed by carriers. Additionally, in a time when many industries are slowing in activity and looking to slow growth further in the face of a global recession, activity in the oil and gas industry remains strong.

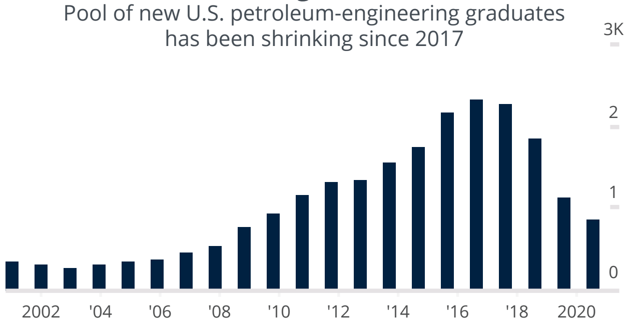
# Key Industry Headwinds

## LABOR SHORTAGES

The energy industry has seen a decline in their workforce, from the field to the office. Many of the field employees let go after consolidation or during the 2018-2020 downturn have not returned to the industry despite the improvements in profitability. Additionally, there has been a significant decline in students pursuing petroleum engineering degrees as younger generations appear to have moral conflicts with the industry or are concerned with cyclicality.

**Going Down**

Pool of new U.S. petroleum-engineering graduates has been shrinking since 2017

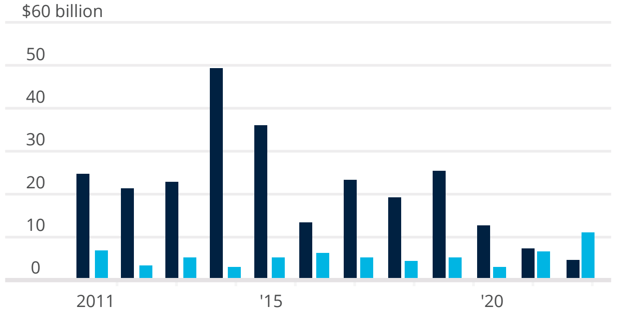



Source: Professor Lloyd Heinze at Texas Tech University

## PRIVATE EQUITY INVESTMENT

Profits from oil-and-gas production have surged, but volatile returns and a fraught political climate have created a divide among the biggest private-equity firms regarding the profitability of investing in the sector.[1]

**Fossil-Fuel Flight**
Aggregate transaction value of private-equity and venture-backed investments




Note: 2022 data are as of Aug. 23
Source: S&P Global Market Intelligence

## INFLATION

Rising demand for services and materials in conjunction with supply chain constraints have resulted in significant price increases for everyone in the energy value chain.

## PERMITTING ROADBLOCKS

The current administration has taken a more active stance in blocking offshore federal leases by citing climate change concerns.

# 2H Outlook

## PROPERTY

**The market continues to bifurcate between CAT exposed risk and non-CAT exposed risk, onshore versus offshore and the various parts of the value chain.**

+ Facultative reinsurance and 7/1 treaty reinsurance rates are on the rise for heavily CAT-exposed properties, which is expected to impact primary rates moving forward.
  – 5-year (2017–2021) CAT losses globally have been $96B versus $45B for the 5 years prior (2012–2016)
  – Global market losses are currently at $1.5B YTD
+ With multiple years of difficult hurricane losses, an anticipated 20 named-storm hurricane season in 2022[2] and reinsurance difficulties for some carriers[3], coastal assets will continue to be a challenge from pricing and capacity standpoints.
  – This is particularly true for the residential property market
+ Onshore property marketing, including Oilfield Lease Property, has been hardening for the last 36 months.
+ Wildfire-exposed properties are also receiving extra scrutiny in western states, but larger wildfire losses have primarily been associated with residential and hospitality-focused properties.
+ For fracking contractors, physical damage from fire is being sub-limited, which many companies are supplementing with an excess fire policy placement. This is making programs for fracking contractors more expensive, as excess policies can add an additional $1-2M in program cost.
  – In general, submissions should highlight fire suppression programs as coverage may be limited based on pumps and blenders with fire suppression, or the use of two or more mobile compressed air foam units per site

+ For all sectors of the value chain, coverage related to lightning losses remains difficult to achieve, with sub-limits most commonly being used and significant lightning protection being required to receive a quote.
  - Lloyds of London has products addressing lightning losses, but pricing can be high
+ Pipeline construction continues to generally be viewed as "low-risk" by the market, with builders' risk policies seeing favorable pricing and terms on these projects.
  - Liquified Natural Gas (LNG) construction and other heavy processing or cryogenic operations are seeing pricing and capacity challenges with underwriting emphasis on technology, plant configuration (modular vs other) and hot testing
+ Inflation and supply chain woes have resulted in a rise in demand for Business Interruption coverage, which has generally caused an increase in pricing and additional scrutiny from underwriters. Insureds with more complicated risks should be prepared to provide supply chain maps, forensic accounting reports and engineering analysis to get underwriters more comfortable with writing their risk.
+ Many underwriters are challenging valuations for properties and business interruptions due to recent deltas in reported property values and total claims costs.
  - Third-party valuation reports have become the norm for quotes

## GENERAL PRICING ESTIMATES

| | |
|---|---|
| **Non-CAT exposed property with favorable loss history** | Flat to single digit increases |
| **CAT exposed property with favorable loss history** | 5%+ increases |
| **Property with unfavorable loss history and/or a lack of demonstrated commitment to risk improvement (unresolved recs, pattern of same issues, etc.)** | 10%+ increases for non-CAT<br><br>10% to 20%+ for non-CAT with troubled loss history and lack of controls<br><br>25%+ increases for CAT exposed accounts and higher depending on frequency/severity of losses and when there are limited markets for a risk due to occupancy/class of business or concerns related to loss control |

## CASUALTY

**The industry experienced 24 months of dramatic rate increases and capacity reductions, but in recent months it has moderated.**

+ The overall casualty market remains in good standing, with primary general liability rates continuing to remain flat in areas of risk with favorable loss histories.
+ As the back-logged court systems catch up to the pace of pre-pandemic operations, carriers are keeping a close eye on loss trends across the country. Carriers are expecting large settlements and judgments from sympathetic juries, compounded more than ever with the pressure from social inflation.[4]
+ Carriers are typically looking for more history of loss information, more details related to past losses and any subsequent changes made to prevent future losses.
+ Regarding the first party coverage component of Control of Well, coverage related to lightning losses remains difficult to achieve. Submissions should highlight significant lightning protection to receive a quote, and the exposure is typically sub-limited.
  - Lloyds of London has products that address lightning losses, but pricing can be high

**Nuclear Verdicts (Verdicts Greater than $10M) –** In recent years, as plaintiff attorneys continue to push for increasingly higher awards, businesses can lower the chance of a nuclear verdict by implementing the proper risk management tactics.[5]

+ One strategy is to have proactive communication between your claims team and defense counsel. The outcome can be detrimental to a business if the claims team has delayed communication on a case that could have been settled earlier but is now headed to court.[6]
+ The best defense counsel can mitigate the risk of nuclear litigation. In selecting a lawyer, claims leaders should use data from past cases to match their most capable attorney with the right type of cases as they enter litigation.[7]
  - For some lines of coverage, council can only be selected from a list of firms approved by the carrier

**Umbrella/Excess –** Excess capacity remains adequate but lead Umbrella underwriter offerings are being required to reduce offered limits from traditional $25M layers to $15M with some offering as little as $5M. In turn, a stacking of insurance carrier tiers is generally needed to achieve desired limits.

**Control of Well –** Rates generally remain favorable for this line of coverage as underwriters are generally seeing more drilling activity on schedules (resulting in more premiums) in conjunction with very low historical claims activity.

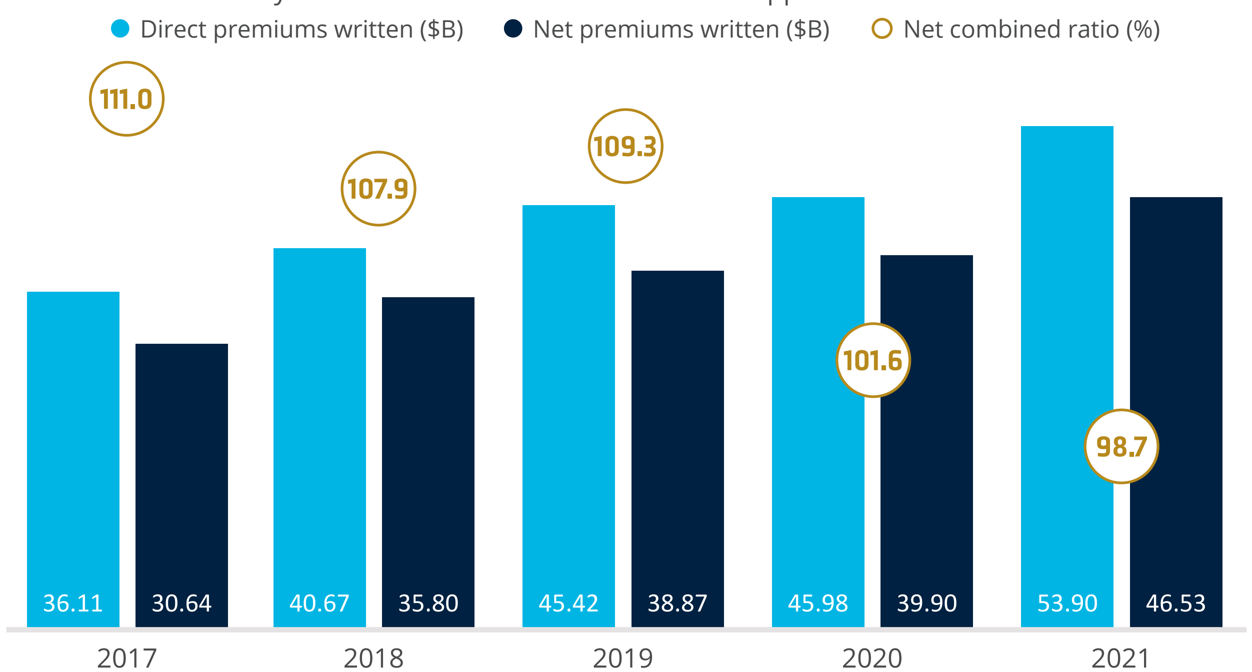
+ We are starting to see slight signs of tightening and increased scrutiny as Authorization for Expenditure's (AFE) climb across all U.S. onshore basins, particularly on AFE's in the $14-20M range, as laterals extend beyond 15k feet and Total Measured Depths (TMD) hit 25k+ feet. This has been most prominent in deeper gas basins like the Haynesville/ Bossier and the Utica.

**Auto** – The auto industry had loss ratios above 100.0 for the 10 years prior to 2021, which now has resulted in challenges for those who have large fleets. Social inflation and nuclear verdicts have hit this sector hard, and carriers have taken note. The demand for fleet monitoring technology is on the rise, and many auto carriers are investing in telematics in hopes of improving loss ratios.[8] New "insurtech" entrants are driving the trend toward telematics implementation and adoption in the auto industry, which will allow underwriters more rate flexibility on new business, but also help insure less favorable drivers.[9]

+ **Auto physical damage** (APD) coverages are seeing scrutiny from underwriters due to the difficulty of assessing vehicle valuations.[10] For the first time in the recent past, the values on in-use tractors and trailers have been on a steep incline as supply chain issues cause delays and an increased demand for equipment and critical components.[11] A trusted broker should advise their clients to carefully appraise their fleets, as actual cash value of their units listed on the policy may not be sufficient to replace with a comparable unit in the marketplace if they were to experience a loss.[12]

## Industry's combined ratio under 100% for first time in at least 5 years

Industry's commercial auto combined ratio dropped below 100% in 2021




Date compiled April 25, 2022.
Data reflects the aggregation of all individual property and casualty filers that submit regulatory statements to the NAIC. Based on the annual NAIC statutory property and casualty statements. U.S. filers only. May include business written outside of U.S., if reported in NAIC statement. Direct data is derived from exhibit of premiums and losses, prior to consideration of reinsurance for commercial auto physical damage, commercial auto liability, and commercial auto no fault reported lines of business. Net data is derived from insurance expense exhibit, after consideration of reinsurance for commercial auto physical damage in commercial auto liability reported lines of business. It was common practice to ensure premium credits during 2020 for auto insurers, but there was no standard practice for this among insurers. No effort was made in the exhibit to fully adjust the premiums for year over year premium growth beyond what was reported by each company. Combined ratios displayed hour before policyholder dividends. Source: S&P Global Market Intelligence.

**Workers' Compensation –** This line of coverage continues to be a bright spot for insurance purchasers, 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.

### GENERAL PRICING ESTIMATES

| | |
|---|---|
| **General Liability** | Up 5% - 15% |
| **Workers' Compensation** | Flat to Up 5% |
| **Auto** | Up 10% to 25%<br>Up 30% if large fleet and/or poor loss history |
| **Umbrella & Excess Liability –** Middle Market | Up 10% to 25%+ |
| **Umbrella & Excess Liability –** Risk Management and other Complex/Hazardous Exposures | Up 25% to 150% |
| **Control of Well** | Flat to 5% |

## EXECUTIVE RISK

**D&O –** After a very hard market in 2020 and much of 2021, rates stabilized in early 2022 and there now appears to be small downward pressure on rates for the remaining part of 2022.

D&O & Cyber markets are seeing their own set of **unique challenges**.

+ Multiple years of substantial rate increases have lowered the insurers' loss ratios, returning them to profitability, broadly speaking.
+ Many energy companies are seeing an improvement in free cash flow generation and balance sheets as a result of higher commodity prices, which has also helped pricing for the space.
+ Due to the Colonial Pipeline ransomware event in May 2021, companies with midstream assets, particularly those serving third parties, are seeing underwriters focus on cyber controls and how that is being evaluated by their Board of Directors.
+ Because of the attractive rates in the D&O space from the insurers' point of view, additional insurance capital has entered the market over the last 6–12 months.
+ At the same time, there has been a large decrease in the number of traditional IPO's, SPAC IPO's and De-SPAC transactions. With these areas no longer demanding insurance capital, the insurers are competing more aggressively for traditional or mature companies. This, in addition to the reasons mentioned above, has shifted the supply / demand dynamic and created a more favorable market for policyholders over the last few months.
+ Despite the comments above, there are certain sectors that continue to be in a "hard" market, including certain industries (i.e., Crypto, Cannabis, etc.) and certain risks such as SPAC's and De-SPAC's.

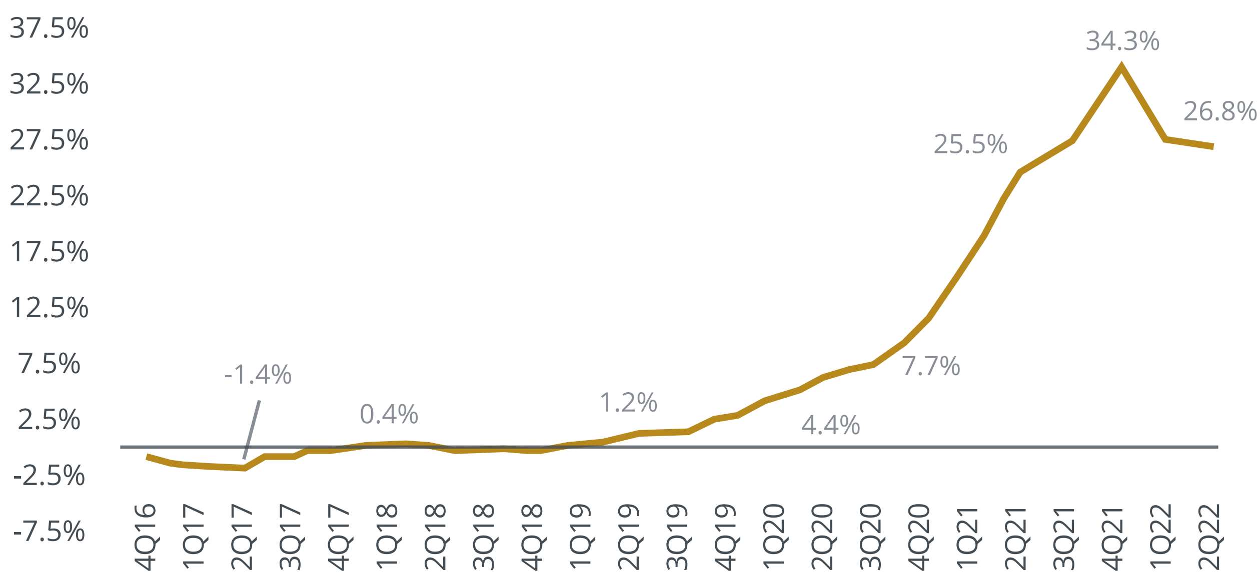
**Cyber** – The Cyber insurance market is best categorized as “transitioning out of a hard market”.

+ Loss activity has decreased in the aggregate.
+ According to Moody’s Investor Service, the sector’s loss ratio improved to 62% in 2021 from 65% in 2020.
+ Frequency has decreased, but severity remains an issue.

**Average and Median Ransom Payments in Q1 2022**

+ Average Ransom Payment: $211,529 (-34% from Q4 2021)[13]
+ Median Ransom Payment: $73,906 (-37% from Q4 2021)[14]
+ We continue to see a change in tactics amongst attackers. Due to improvements in data backups, the attackers are avoiding the encryption step altogether but instead are focusing exclusively on stealing data and demanding payment to prevent disclosure of that data.
+ Carriers are still focused on “must have” controls and are increasingly reliant on external scanning technology in risk assessment.
+ Pricing increases are still the norm.
+ According to the CIAB, the average premium increase in Q1 was 27%.
    - This comes with the caveat that the noted increase is an average, and certain industry groups continue to see substantially higher increases

## Premium Change for Cyber, Q4 2016 - Q2 2022




*Source: https://www.ciab.com/wp-content/uploads/dlm_uploads/2022/05/Q1-2022-PC_FINAL.pdf*

# Recent Claims

**CRUDE OIL SPILL OFF THE COAST OF CALIFORNIA**
On 8/26/2022, Amplify Energy agreed to pay $13M for a crude oil spill that killed wildlife and fouled southern California beaches. In October of 2021, a pipeline owned by Amplify was struck by an anchor, resulting in the release of 558 bbls of crude oil and the closure of beaches south of Los Angeles.

**SHUTDOWN OF FREEPORT LNG REFINERY IN TEXAS**
After experiencing an explosion very likely to exceed $300M, the worst-case scenario could spiral to over $1B.[15] The loss is fresh and in the early stages of development, with **Business Interruption** (BI) payouts expected to run more than $100M per month.[16] The company's BI coverage was placed in both U.S. and London markets.[17]

**NATURAL GAS BLOWOUT IN LOUISIANA**
On 6/30/2022, a natural gas well being drilled in Arnaudville, LA experienced a blowout resulting in the drilling rig being engulfed in flames and burning on the pad for 24 hours.[18] Nobody was injured, and claim costs are unknown at this time.

**OKLAHOMA NATURAL GAS FIRE**
On 7/9/2022, an explosion erupted at the ONEOK Gas Plant near Medford, Oklahoma when a natural gas liquids fractionation facility caught fire.[19] All residents within a two-mile radius were required to evacuate and ONEOK arranged temporary housing for evacuees at several hotels in the nearby city of Enid, Oklahoma. Nobody is believed to have been injured but claims from the fire are expected to be sizeable and may ripple through the greater market.

# Guidance

### BEGIN THE RENEWAL PROCESS EARLY

The **General Liability**, **Cyber**, **Excess/Umbrella** and **Property** markets are constrained and more challenging to navigate in the disciplined market. With an outcome of increasing prices across all lines of business and in every industry sector, brokers are being swamped with submissions from their insureds who want to minimize these additional costs.

### PARTNER WITH INDUSTRY EXPERTS

It is important to work with your broker's industry experts who truly understand the business and the market for placing the specific risk. Collaborating with a team who can best represent your risks, and partner with your operations, is more important than ever during this disciplined market we are experiencing.

### HIGHLIGHT CYBER SECURITY & PROACTIVE RISK MANAGEMENT

Frequency and severity of cyber claims are constantly on the rise, resulting in more underwriter scrutiny of companies' cybersecurity hygiene. The importance of **highlighting any additions in cybersecurity staffing or updated system protocols cannot be overstated.**

### ENGAGING LOSS CONTROL TEAMS

Frequent communication with your broker's loss control team is a top priority, especially when a claim arises. Engaging your loss control team in the event of a claim can help reduce the impacts to your business financially and operationally. We work with you to understand your financial goals and operational challenges so we can identify, develop and deliver Risk Control Solutions that strategically mesh with your objectives.

### CONTRACT REVIEW

Our **Contract Review** teams add value to our clients' overall risk management program by making sure the indemnity language is market standard and doesn't expose our clients to unforeseen losses that may not be insurable.


Sources

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