PARKER SMITH & FEEK

An IMA Company

COMMERCIAL INSURANCE

EMPLOYEE BENEFITS

PERSONAL INSURANCE

RISK MANAGEMENT

SURETY

ENERGY

Markets in Focus

Insurance Pricing & Market Update

Q3 2023

MACRO ECONOMIC/ENERGY INDUSTRY ISSUES

PROPERTY VALUATIONS

Property valuations are another issue on top of mind for energy company leaders in 2023. The global energy marketplace remains unstable due in large part to labor shortages and supply chain/ transportation bottlenecks carrying over from the pandemic. With the more recent inflationary pressures affecting supply and component costs, it's little wonder that property valuations aren't keeping up with true replacement costs.

To protect themselves from under-valuation, underwriters are scrutinizing reported values and routinely making requests for more frequent formal appraisals. Appraisals are expensive, however, and the services of reputable appraisers must be scheduled many months in advance of a renewal. Thus, companies are making more frequent indexed valuation adjustments in the interim.

While underwriters don't have as much confidence in valuations derived through indexing, the use of an historically valid index methodology often serves as a suitable compromise. But in the absence of appraisal or index documentation, underwriters may be inclined to adjust a reported valuation by a relatively high percentage as a matter of course.

Click here for a full analysis of the impacted valuations.

SUPPLY CHAIN DISRUPTIONS

Regarding supply chains, the situation is improving overall, with just a few significant exceptions. Equipment containing electrical components is still difficult to obtain given copper and circuit board shortages. Smaller items with electrical components used to be readily available but now can take four months to arrive. Larger items in this category, compressors, for example, often are not available for up to a year. Until these situations resolve, companies are likely to stockpile harder-to-obtain, business-critical items and components and maintain backup equipment to ensure business continuity and avoid significant Business Interruption Insurance claims.

ESG

The traditional energy industry is facing increasing scrutiny related to their focus around environment, social, and governance (ESG) practices from growing population of diverse stakeholders. This is particularly true in the area related to the environment and their ability to future proof their carbon intensive business model. However, energy companies and their suppliers are stepping up to the challenge by accelerating the deployment of innovative solutions that decrease environmental impact while increasing transparency and accountability to all interested stakeholders. One area that has seen great strides focuses on efforts to reduce methane emissions from across the oil and gas supply chain. Companies in the upstream and midstream can now monitor and quantify their methane intensity from operations supporting efforts to continually improve their footprint while differentiating their delivered product based on its measured climate performance. While these efforts may not be widely known today, the technology and practices to scale them across industries are gaining momentum quickly moving from best practices to standard procedure. The ability to reward these types of proactive environmentally beneficial measures will be dependent on driving objective consensus around the methodologies by which companies are assessed and rewarded for the practices they adopt.

Despite concerns around ESG investment agendas impacting capacity for the oil and gas industry, we have generally seen ample volume for favorable risks even with some insurance carriers pulling out of oil and gas for ESG concerns.

CHUBB UNDERWRITING STANDARDS

Recently, Chubb announced their new climate and conservation focused underwriting standards in this press release. In follow up conversations with Chubb, below are further details:

In Scope
Companies that produce more than 30% of their total revenue from directly operated crude oil extraction, and/or natural gas extraction upstream assets classified under SIC code 1311.

Data Requirements
For business with effective dates beginning July 1, 2023, Chubb is requesting the following from all “in scope” insureds:

+ Evidenced based plan to manage methane emissions with a minimum of
  - A Leak Detection and Repair Program (“LDAR”) program
  - Elimination of non-emergency venting e.g. elimination of uncontrolled storage tanks and high-bleed pneumatics
+ Evidenced based plan to reduce flaring emissions
+ Identification, within the scheduled assets, of any new upstream projects involved in the exploration for, drilling, and production of oil, gas, or other gaseous and liquid hydrocarbons crude oil extraction and/or natural gas extraction assets classified under SIC code 1311 that are located within conservation areas covered by International Union for the Conservation of Nature (IUCN) management categories I-V in the World Database of Protected Areas.

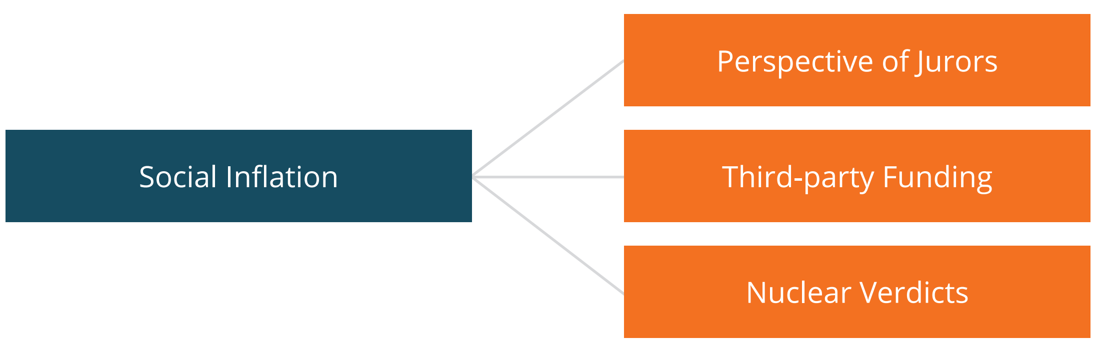
KEY INSURANCE HEADWINDS

SOCIAL INFLATION AND INFLATION OF GOODS AND SERVICES

Rising costs of services have artificially increased claims payouts. In many cases, particularly for property insurers, the policies were written on a replacement cost basis without consideration for any under reporting of values. This allowed for carriers to pay out more than they received benefit of premium dollars. This same concept would apply to liability losses where the insurance carrier is responsible to make a third party whole, yet the cost to "make them whole" has now increased significantly.

Claims costs that rise above general economic inflation are considered "Social Inflation". These "added" claims costs are particularly difficult to predict as they are generally tied to social shifts of a new accepted norm. These losses tend to:

+ Longer legal proceedings – artificially increasing expenses for any given loss.
+ Third-party litigation funding has provided the means for claimants to hold out for larger jury awards allowing attorneys to dig for the deepest pockets.
+ Result in large jury awards. With public perception that of mistrust for big business, often the punitive awards are much higher than the actual damage one might sustain (nuclear verdicts). This is designed as a form of punishment to a company in an effort to "fix" the company to their perceived notion of what public policy should look like even if it is unsupported by the law today.



Natural catastrophic losses exceeded $400 billion for two consecutive years.

RISE IN CATASTROPHIC INSURANCE CLAIMS

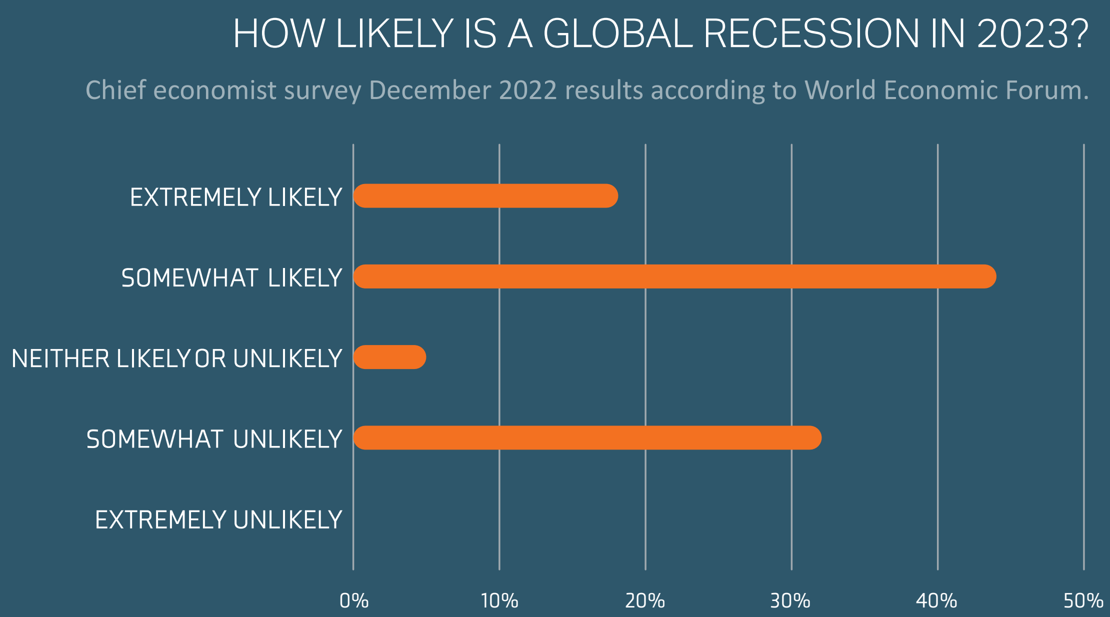
For two consecutive years natural catastrophic losses exceeded $400 billion, with 2022 exceeding the 10-year average by 40%, according to some carriers. While it is easy to focus on hurricanes as the only natural disaster, it seems that catastrophic events are hitting virtually all states as can be witnessed in several notable examples: Hurricane Ian, the 2021 deep freeze in Texas, wildfires in virtually every state from Colorado westward, convective storms in the Plains and Midwest, large earthquakes in California and 100-year flood events that seem to be every few years. Regardless of the cause of these natural disasters the frequency and rising severity has continued to grow indicating that this is a trend that is here to stay. With these large losses we have seen some large primary property carriers who have restricted the cat limit they will provide for clients, while still increasing the rates significantly. This means that in order to get the same coverages and balance sheet protection any property program would have to be stacked causing even more volatility in true rate increases.

RISE IN REINSURANCE COSTS

As you may expect with Cat losses on the rise, inflation increases (social and otherwise) the insurance carriers have continued to absorb more losses and are now regularly exceeding their own financial positions and are now passing some of these losses to reinsurance markets, which has resulted in increased expenses with reinsurance renewal premiums skyrocketing to record levels in January 2023. The big companies will be able to take on more risks and drop their reinsurance coverage to try to offset the challenging renewals, but this will have a trickle-down effect in both risk control efforts of the oil and gas companies and increased rates and or premiums to further isolate carrier balance sheet from the brunt of large losses. While the big carriers will be able to be creative with not passing all the risk to customers by focusing on risk control, the smaller companies will likely pass 100% of costs off to customers.

INVESTMENT INCOME

While insurance companies are known to hold bonds and other long-term investments, the increase in interest rates should help increase investment yields for carriers for any new investments. Once realized, this increased return on investment should also help limit rate pressures. Unfortunately, just like all the other Insurance headwinds included herein, investment income faces its own challenges as economists largely predict a global recession is possible in 2023. See below graph from World Economic Forum:



NEW/EXISTING/MODIFIED INSURANCE MARKET CAPACITY

Probitas Managing Agency is launching an energy account with former Munich Re Syndicate energy chief James Grainger geared towards supporting traditional energy companies.[1] The energy offering will comprise a panel of consortium partners in the Lloyd's market.[1] This capacity is intended to support cleaner oil and gas producers, with those failing to show measurable improvement in sustainability over time being phased out of the portfolio.[1]

Berkley Oil and Gas has announced that with effect from July 1, they can no longer write excess layers above $10M which is reduced from their standard $25M capacity.

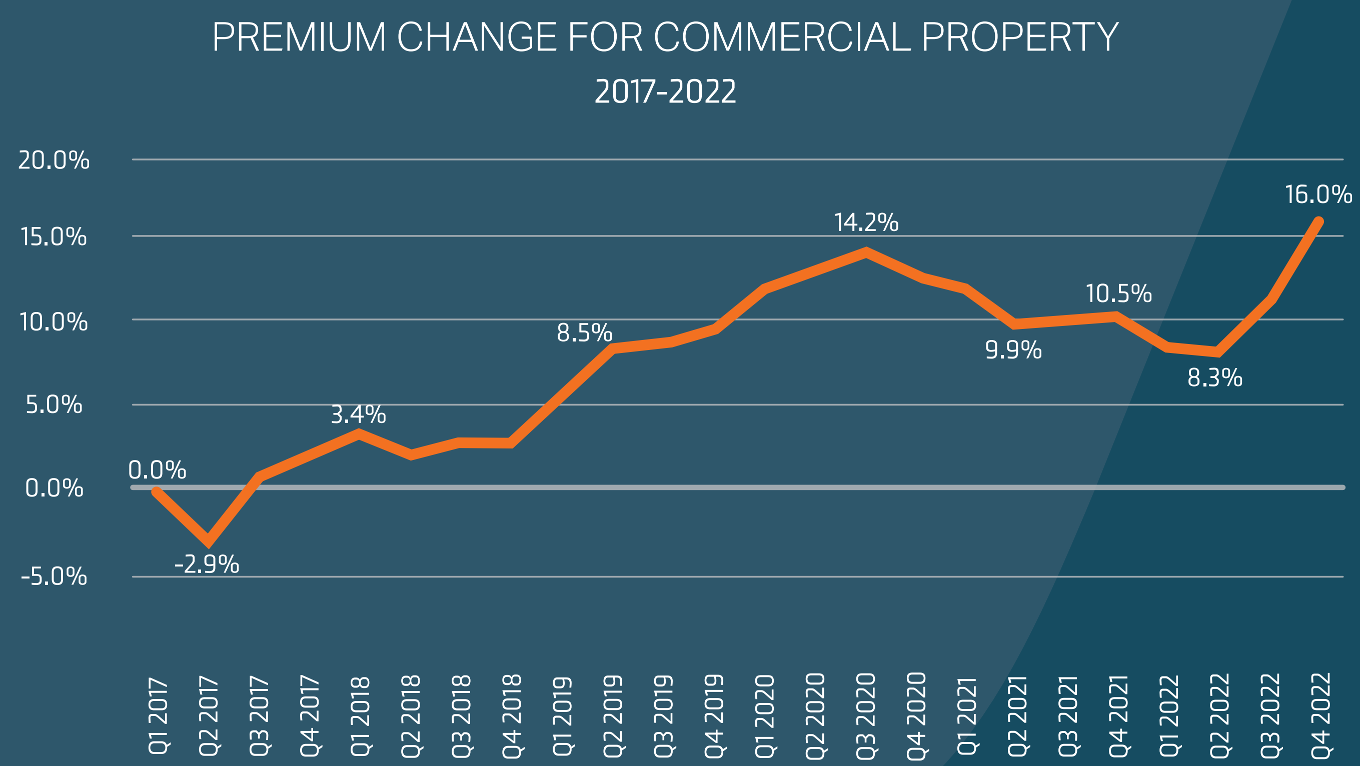
INSURANCE MARKET OUTLOOK

PROPERTY

The premiums of Commercial Property saw the greatest increase of all lines of business in Q4 of 2022, with an average increase of 16%.[2] However, 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.

+ Real and personal property has been seeing roughly 15% increases on non-cat exposed locations while rates increasing by 25% for cat exposed, with larger deductibles.
+ Contractor's equipment has been profitable (outside of fracking equipment) and have been able to obtain flat renewals to +/- 5% for this line of business.
+ Topside equipment for operators (Oil lease property OLP), aside from Saltwater Disposal facilities have also been a profitable book. We have seen OLP come in at flat to +/-5% rate changes.
+ 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. Insurance to Value (ITV) is a major concern within Commercial Property, as costs have been rising, leading to increased payouts for insurers to replace or rebuild damaged property.[1] Carriers are now mandating that values be raised, especially if they have not been adjusted in some time.

"Inflation and supply chain woes have resulted in a rise in demand for Business Interruption coverage."



https://www.ciab.com/download/35895/?tmstv=1668540348

General Liability

- Primary General Liability rates have remained stable for buyers who have adequate loss history. However, insurers are requiring more details about prior losses and any changes that have been put in place to prevent similar losses in the future, making the General Liability market relatively conservative.

- In the United States, the inclination towards litigation, with the occurrence of "nuclear verdicts" of seven figures or higher becoming more frequent, has a significant influence on the Casualty insurance lines. 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.

Excess Liability

+ In order to minimize risk, carriers have started offering excess layers between $5M and $15M, which is lower than the traditional $25M. Therefore, it is now necessary to combine several tiers of insurance carriers to reach the desired coverage limits.

+ Several carriers who have previously left the excess market have returned to certain business sectors.[3] In addition, many new carriers have joined the market and are trying to benefit from the current disruption.[2] This influx of carriers and MGA's has caused an increase in submissions, yet there is an insufficient number of experienced underwriters to meet the high demand.[2]

+ Certain classes of business with a high chance of experiencing significant losses are especially challenging to insure, such as wildfire, hazardous products, transportation, habitational, hotels, public entities, higher education, residential, New York construction and any risk with a prior record of subpar loss performance.[2]

Control of Well

+ The Control of Well market remains stringent. The smaller operators are being impacted the most due to the increased minimum and deposit premiums. Drilling schedules are still hefty but operators have begun to slow down after very aggressive schedules in 2022. As schedules and net footage to be drilled begins to go down, there is some uncertainty if rates will continue to rise even further to balance out the premium entering the market.

+ Specific underwriting considerations are focused on:
  - Long lateral planning
  - Anti-collision / directional drilling technologies
  - Continuity of contractor group
  - Casing QA/QC given supply chain
  - Well Control Emergency Response Preparedness
  - Inflation on AFE
  - Fire Protections on Frac Fleets

Commercial Auto

+ The commercial auto industry has been severely impacted by large settlements, legal expenses and payments for claims being higher than profits.[4] This is a major difficulty for those running large fleets of vehicles.[3] To manage this, numerous auto carriers have invested in telematics and fleet monitoring systems to decrease their loss ratios.[3]

Workers' Compensation

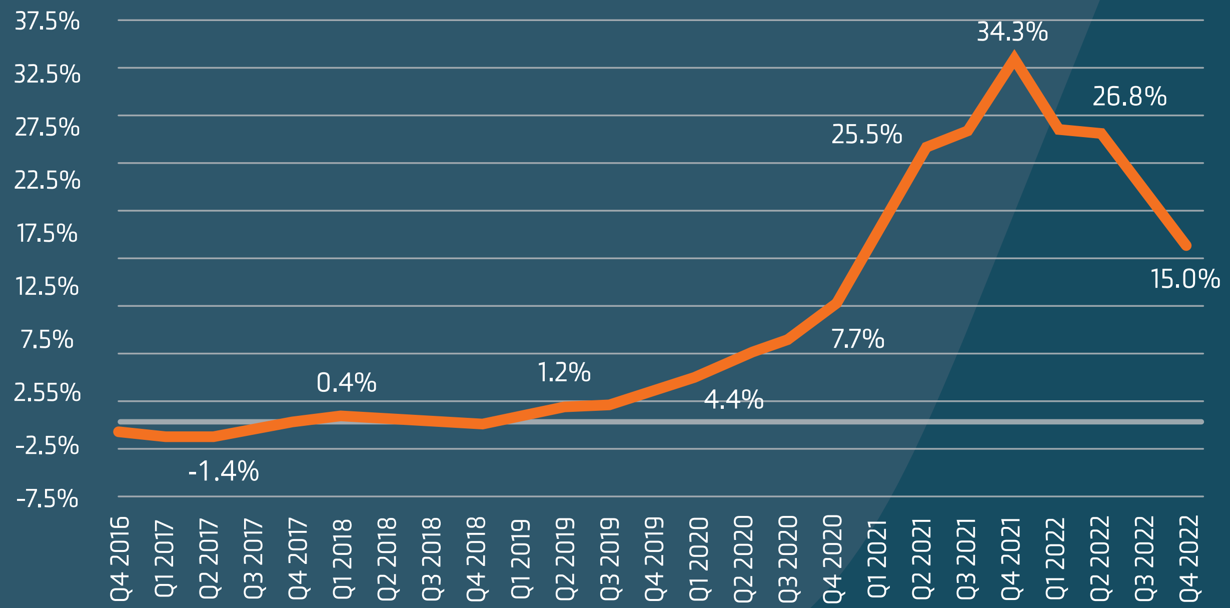
+ Carriers have found profitability in Workers' Compensation coverage, and buyers should expect competitive rates, subject to Modification Factors and prior loss history. Accounts with acceptable loss histories should be able to take advantage of the competitive market among carriers to secure more cost-effective pricing.

Cyber

+ In Q4 2022, the average increase in premiums for cyber dropped to 15.0%, significantly lower than the 20% that had been seen in the previous six quarters and the 34.3% peak recorded at the end of 2021.
+ Carriers have maintained their strict underwriting requirements, which will emphasize questions about Cyber hygiene.
+ Carriers continue to focus on "must have" controls and are increasingly reliant on non – invasive external scanning technologies in risk assessment.
+ Specific areas of focus:
  - Multi-Factor Authentication (MFA)
  - Remote Access
  - Privileged users
+ Enterprise implementation of Endpoint Detection & Response (EDR) solution
+ Segmentation of Operational Technology environment from Information Technology environment
+ Operational Technology environment segmented from the internet Data backup procedures:
  - Detection from the network or cloud-based
  - Encrypted
  - Restricted Access
  - Tested
  - Multiple Copies
+ Software patch management to ensure critical security patches are made within 30 days
+ Insureds that do not have satisfactory control in place may see non-renewals or a reduction in coverage. This reduction comes in the form of sub-limits or co-insurance provisions.
  - The previous rate increases and enhanced underwriting scrutiny have had the desired effect and carrier loss ratios have improved to target ranges.
  - This in combination with the number of new market entrants will result in a more favorable environment for buyers.

PREMIUM CHANGE FOR CYBER

Q4 2016 - Q4 2022



https://www.ciab.com/download/36848/?tmstv=1677010755

GENERAL PRICING ESTIMATES

Property - Non-CAT exposed with favorable loss history	10% to 15% increases
Property - CAT exposed with favorable loss history	15% to 25% 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 30% to 50%+ 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

GENERAL PRICING ESTIMATES

General Liability	Up 5% to 15%
Workers' Compensation – Dependent on experience modification factor and loss history	Down 10% to Up 5%
Auto	Up 10% to 25% Up 30% if large fleet and/or poor loss history
Umbrella & Excess Liability – Middle Market	Up 5% to 25%+
Umbrella & Excess Liability – Risk Management and other Complex/ Hazardous Exposures	Up 10% to 150%
London Placed Business with generally favorable loss history	Upstream E&P: 2.5% to 10% increases Midstream: 5% to 15% Increases Downstream: ~10% to 20% increases Onshore Contractors: 7.5% to 12.5% Offshore Contractors: 5% to 10% increases

INDUSTRY LOSSES

Date of Loss	Loss Details	Location	Incurred Amount
2016	Gas pipeline explosion kills two and injures several	USA	Pending
2017	Gass truck struck a motorcyclist, causing injuries	USA	$46M
2018	Oil services company truck driver plowed into the back of a pickup truck	USA	$33M
2019	Natural gas pipeline built in the 1950s exploded	USA	Pending
2019	Coastline damange allegedly caused by oil and gas drilling	USA	$100M
2019	Alleged willful misconduct in management of oil processing facility and gas well drilling	USA	$71.4M
2020	Oil spill from pipeline closed beaches and damaged environment	USA	$60.6M
2021	Additional environmental damage from 2006 oil spill	USA	$19.7M (in addition to $97M in earlier fines)
2021	Groundwater contamination by gas additive MTBE	USA	$25M
2021	Pipeline wastewater spill resulting from hydraulic fracturing (fracking)	Canada	$35M
2021	Failure to investigate multiple leaks of natural gas storage facility	USA	$1.1B
2022	Employee gas turbine technician was killed after he was struck by a fuel filter cover that blew off the equipment he was working on	USA	$150M

Source: https://www.chubb.com/us-en/benchmark-report.html

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 risk and partner with your operations is more important than ever during this disciplined market we are experiencing.

ENGAGE RISK CONTROL TEAMS & HIGHLIGHT PROACTIVE RISK MITIGATION INITIATIVES

Frequent communication with your broker's risk control team is a top priority, especially when a claim arises. Engaging your risk 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. Companies need to convey their risk mitigation tactics when working with underwriters to highlight their safety culture and robust mitigation plan.

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:
1 Probitas launches own managing agent after final approvals (insuranceinsider.com)
2 https://www.ciab.com/download/36848/?tmstv=1677010755
3 Excess & Umbrella REDY® Index January 2023 - News - Tools & Intel | CRC Group
4 What is a nuclear verdict and should you care? | CaseGlide

MORE THAN JUST INSURANCE

Based in North America, Parker, Smith & Feek is an integrated financial services company focused on protecting the assets of its widely varied client base through insurance, risk management and wealth management solutions. As an employee-owned company, Our 2,000-plus associates are empowered to provide customized solutions for their clients' unique needs.

PARKER SMITH & FEEK

An IMA Company

MARKETS IN FOCUS CONTRIBUTORS

ALEX FULLERTON, Marketing Specialist

BRIAN LEUGS, Writer

DANIEL POSNICK, Transactional Liability Leader, Executive Risk Solutions

STACY ROBERTS, National Energy Practice Director

AUSTIN STRUBLE, DFW Energy Practice Leader

www.psfinc.com