MARSH JLT SPECIALTY

QUARTERLY NEWSLETTER | JULY 2020

Energy and Power Newsletter

Focus On: Offshore Construction

MARSH

Energy and Power Newsletter

We are pleased to provide our existing, and potential clients with our third Energy Insurance Quarterly Newsletter of 2020.

As the full impact of COVID-19 continues to be felt across the globe, the energy and power industries are analysing the effects on their balance sheets and overall risk landscape.

Within this edition we again consider the state of the insurance market for energy and power companies, providing insight into the conditions and what is driving them. Over the last quarter, the insurance market has remained turbulent. Insurance capacity remains scarce, particularly in downstream, as the global insurance market continues to harden and insurers look to introduce additional coverage restrictions to manage their exposure to cyber and pandemic risks.

In addition to the market update, this quarter we consider Operability the new upstream business interruption insurance issued by the insurers behind the long-standing Chrysalis 'Excess OIL' policy. The policy has been designed as a production hedge, to mitigate the unpredictability of production revenue.

Finally, this quarter we focus on offshore construction insurance – considering the risk, the insurance market, and the standard wording used for this specialist line of business WELCAR 2001.

We hope that readers will find this newsletter interesting and informative and would welcome any feedback you may have, which you can email to: john.cooper@marsh.com or pass on to your usual Marsh JLT Specialty contact.

John Cooper ACII
Global Chief Client Officer
Marsh JLT Specialty | Energy & Power

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General State of the Market Overview

General Backdrop

As we reach the mid-point of the year, it is perhaps a time to reflect on the changes that have taken place within the insurance industry. The global COVID-19 pandemic forced the closure of Lloyd's, and remote working has been the salient feature of most, if not all, global markets. The sense of business as usual has prevailed, and the reliance on electronic trading has never been greater. It has been remarkable how successfully both clients and market practitioners have adapted and managed remote trading in such difficult trading conditions; this has been a commendable feat and a demonstration of resilience.

If there is a concern, it is that many clients, and markets, get great value out of their annual roadshows and these have been put on hold under COVID-19 precautions. We encourage clients to set time aside to make contact with their carriers during this time via video conference facilities.

The energy market remains a two-speed market, with upstream continuing to attract low or no rate increases, whilst downstream and casualty pricing levels continue to gather pace.

While the traditional risk transfer market has been very efficient for many years, with pricing and capacity pressures, many clients are looking at alternatives to the commercial insurance market.

Unsurprisingly, there has also been an increased interest in mutuals, and a growing appetite to retain more risk within captives or on balance sheets for those who can. The use of captive retention or self-insured retention strategies are expected to be used to replace capacity with outlying pricing.

If the market wants sustainability and stability, insurers should apply clear differentiation on risk profile, profitability and scale. Otherwise, the clients most able to do so will seek alternatives outside of the market, inevitably destabilizing the commercial pool.

A common theme across all sectors is the introduction of communicable disease exclusions, which is to be expected based on the market's historical reactions to new sets of risk. Recent events such as terrorism or cyber-attacks resulted in exclusions being introduced into the market, followed by a new line of business. Will the market's reaction to COVID-19 lead to separate pandemic insurance offerings?

Upstream Energy

We would describe the state of the upstream insurance market as it arrives at the half-year mark as calm on the surface.

The trend of diminishing premiums has continued through 2020, particularly for offshore construction. With the exception of Operators Extra Expense, the other upstream risks (Physical Damage, US Gulf Windstorm and Offshore Construction) have provided low loss ratios for 2019. However, these low percentages will trend up as some large outstanding claims are settled out in the coming months.

The upstream market itself is developing into a dual market. The smaller premium accounts are usually seeing an approximate 5% rise. However, clients with a bigger spend, in excess of approximately USD10 million, have seen heavy signing pressures (oversubscription dilutes the original written line, reducing each individual share). In some cases, where there is a significant amount of premium on the placement, underwriters are not imposing any rate increase at all.

The Gulf of Mexico Windstorm aggregate sold by underwriters essentially remained unchanged. However, due to the downward trend in the size of premiums, likely coupled with increased treaty reinsurance costs, this part of the book will become almost marginal to underwriters in the present rating environment.

The standout claim settlement during the first half was the USD120 million Loss of Contract claim suffered by a drilling contractor in Angola. This further erodes the unappealing economics of the contractor book for insurers as lay ups, value reductions and potential insolvency consequences rattle the customer base. Whereas in better times the rig fleets could supply 20% of an underwriter's premium income, this has now slumped to nearer 5%, again rendering this subsector almost marginal.

Starstone has withdrawn their London operation, and we suspect this will be an indication of a contraction in capacity, as the ambitions of many players cannot be sustained by the premium they can attract. While oil prices have recovered from the shocking lows seen in March 2020, we cannot see a return to the energy industry boom activity of 2014, causing the current surplus of capacity to right-size.

The modest rate rises, and the historic low levels of premium in the system, make the return on capital for upstream increasingly weak, especially when compared to other non-energy insurance classes which attract higher returns. Although the environment continues to be challenging, the low loss ratios in upstream have, meant that insureds already struggling with cyclical issues within their own industry, have at least avoided drastic cost increases in this sector. However, the thin premium coverage, coupled with spiky limits, means that it would not take much to upset this balance.

Downstream Energy

The second quarter of 2020 has been an extraordinary time in the downstream energy market.

The sustained collapse in oil price, driven by weak demand as the world locked down over the COVID-19 pandemic, has loaded pressure on the client base. Refineries and plants are being idled and earnings projections downgraded. The terminal operators are one of the few beneficiaries of the contango market, as every spare cubic foot of storage is utilised.

Midstream operators with fixed tariffs, or 'take or pay' agreements, also have some insulation in the short term. Inevitably, cost savings are high on every client's agenda and insurance spend is very much in scope.

Insurers have their own concerns as they strive for profitability within the sector. They continue to seek substantive rate increases whilst being conscious of the potential for business interruption claims or legal expense arising from COVID-19. These concerns also extend to the impact of client cost cutting, potential expenditure on plant maintenance, delays in turnarounds and onsite audit oversight.

In the downstream insurance space, all this creates a frictional interface with different dynamics for individual clients relating to region, scale, profile and insurer perception. The only common denominators seem to be a move to more centralised hub control by insurers and increased rates for all.

Capacity levels remain tight for large limit requirements, particularly those requiring natural catastrophe exposure and consequential loss extensions. There has been further erosion of working capacity as another insurer has put their book into orderly run off. However, as with any market moving off the bottom of the cycle, there is considerable interest being shown by a number of entities in moving into the space. This includes both upstream insurers expanding further into midstream business to compensate for competition within the upstream sector to shore up income, and broader capacity providers looking at the headline optics within downstream. Some of this capacity will be able to deploy quickly whilst some may be looking to engage from 2021.

In terms of underwriting trends, environmental, social and governance (ESG) factors are becoming more of a consideration in insurers' decision making process. Beyond that, insurers are also looking closely at contract wordings and are pushing back on extension scope and sub limits. There continues to be no overall consensus on clauses relating to cyber resultant damage or to pandemic exclusions.

The London market associations have provided affirmative clauses for cyber resultant physical damage, and many insurers in the European market are pushing to restrict the coverage to non-malicious acts or exclude it altogether. Nevertheless, brokers have been able to push back on this, and retain the malicious coverage albeit with restricted perils. Brokers have been driving hard to ensure clients get the required coverage, working with underwriters to maximise capacities and provide continuity of coverage.

For Midstream, the process becomes slightly more challenging as there remains a different approach between Upstream and Downstream insurers, which can result in non-concurrent terms. The approach for Pandemic exclusions aimed at communicable diseases is slightly more disparate, and although the bulk of European insurers will look to support the LMA 5393 or JR2020-16 a number of insurers have their own

requirements. The discussions around Volatility Clauses has been somewhat toned down by the economic environment.

Downstream rates have continued the upward momentum for the past 18 months with increases of 35% to 40% during the last nine months. Naturally, there have been exceptions, both above and below depending on where the base rate started and the account profile.

Midstream rises are trending under Downstream as that sector has the benefit of utilising capacity from both Upstream and Downstream markets. A watershed moment is approaching where placements that were previously subject to substantive corrective action in 2019 have upcoming renewals, and will be faced with a market currently geared to continuing the current trend.

There is some evidence to indicate that this business is approaching insurers' 'technical adequacy' rating; further sustained increases will push rates beyond those. This results in a considerably more robust global premium level; in 2021 it is likely to be in excess of USD3.5 billion for this sector and capable of absorbing normal levels of annual sector losses.

Further, insurers transact approximately 70% of their business in the first half of the year. They have almost certainly achieved a greater median level of rate increase than forecast when initial budgets were set for 2020, but it is unlikely this will have a moderating effect on how they approach rates in the latter part of the year.

There are, of course, many material variables that could affect the second half-year business transactions. Losses in 2020 to date are manageable – although there is some uncertainty over development of known claims and COVID-19's impact – currently leaving insurers in a favourable position.

Wind season activity in the Gulf of Mexico is predicted to be above average. Should this translate into market losses of any severity, it would likely have an effect on capacity in 2021 and underpin more volatility in the rating cycle.

Increasing reinsurance costs and reductions in capacity, both treaty and facultative, are also likely to shore up the current climate. Inevitably, the hardening market has attracted some interest from new capacity, or capacity that is available to deploy at short notice. The challenge for these vehicles, and those already active, is where the tipping point is on the supply/demand balance, and when that balance shifts.

For clients, any return to oversupply, however marginal, will be a welcome relief. Whereas most have been realistic in terms of market positioning, many have had to mitigate cost impact by using levers on retentions, limits and coverage grants. Further, business interruption coverage requirements in the current climate are also under scrutiny by clients with a view to restricting scope or dropping the coverage altogether.

A watershed moment is approaching where placements that were previously subject to substantive corrective action in 2019 have upcoming renewals.

Power

The power market continues to undergo a period of adjustment as we move into the third quarter of 2020. Insurance carriers continue their push to re-underwrite terms and conditions and increase premiums after many years of consistent loss-making activity, which has led to a number of power insurers exiting the class. This phase of adjustment, combined with the uncertainty created by the global pandemic, is resulting in a market that is more challenging than we have seen for a number of years.

Primarily, this adjustment is resulting in increasing self-insured retentions and higher premiums for clients as insurers look to return to profitability. Furthermore, carriers have continued with a strategy of providing reduced capacity on any one risk. This results in a more complex placement process, and some placements are only finalised across multiple contracts at differing terms and conditions.

As frustrating as the current market conditions are for clients, it is worth considering them in the context of perhaps a ten-year market cycle. Broadly, working with clients, brokers have been able to generate double digit percentage rate and premium reductions each year during these last ten years. While the adjustment the market is undergoing now seems protracted, we are still able to finish placements, generate competition between markets, hold coverage and deductible levels, all using markets with good security. The market may still have some way to go on its recalibration journey, and therefore underwriters may well begin to focus on problematic perils and begin to curtail, sublimit or further increase deductibles.

Renewable Energy

As we enter the third quarter, we will gain perspective as to the true extent and longevity of the market readjustment. It will be telling to observe whether markets continue to apply rating increases and changes to terms, despite doing so at previous renewals.

As we saw in the second quarter, the market is focused on older wind projects, particularly onshore, where turbines are out-of-warranty – these have tended to attract increased pricing and/or deductible uplifts. Similarly, ageing solar projects are also attracting higher pricing. Therefore, engineering surveys have become important for these types of assets, particularly if the risk is new to the London market.

Whilst all renewable energy risks face increased scrutiny from insurers, there is a particular focus from underwriters on natural catastrophe exposed locations, particularly (but not exclusively) to solar projects, where the premiums and terms have come under significant pressure due to historic losses.

Latin America and the Caribbean has become a very challenging area of the renewable energy market due to sustained periods of poor performance driven by supply chain issues and natural catastrophe losses. A number of renewable energy insurers are no longer permitted to write business in the region due to treaty reinsurance restrictions. Other markets tend to tread very carefully, and apply limited terms and conditions to control their exposure, resulting in restrictive coverage and higher pricing in this region.

The availability of natural catastrophe coverage (such as earthquake and windstorm) has become increasingly limited within the traditional renewable energy market for onshore renewable energy sites. This means that extra capacity is often required from the facultative property market. Generally, these insurers are more expensive than renewable energy insurers meaning that this coverage comes at a disproportionately high

price compared to the rest of the programme. One way to minimise the impact is for buyers to assess the level of coverage required in respect of natural catastrophe to reduce the overall cost of their programme. Meanwhile, the market's position around hail and wildfire has hardened, and areas exposed to these perils are likely to encounter limited coverage, at an increased price, due to recent global events and market losses.

In respect of the offshore renewable sector, market conditions have followed much the same trend as we have experienced in the onshore renewable energy market. Clients can expect a rating increase on a straightforward operational renewal, whilst construction projects carry significantly increased deductibles and higher pricing than we have seen previously. As the offshore sector establishes itself in natural catastrophe-exposed regions such as China and Taiwan, we have seen challenges in the placement of projects due to the inherent typhoon and tsunami exposure.

These shifts are reflective of a market that has withdrawn from many risks that underwriters see as peripheral, or outside of their traditional underwriting appetite. As a result, biomass, hydro and geothermal assets have suffered from a withdrawal of capacity meaning prices have risen disproportionately in comparison to wind and solar placements.

As society calls for a 'green recovery' from the devastating effects of COVID-19, it appears that we are reaching a critical point for the industry as greater investment enters the sector and the energy transition away from traditional fossil fuels gathers momentum. Due to coverage and pricing moving to a point that insurers deem sustainable, coupled with the global shift away from traditional fossil fuels, many traditional power markets are strengthening their renewable energy offering. As the transition to renewable energy accelerates, we expect that insurers will be motivated to diversify their portfolio.

Traditional Power

With the continued firming of the market, straightforward renewals with a clean loss record and no natural catastrophe exposures are generally experiencing a minimum of 20% - 30% increases. Accounts that have natural catastrophe exposure or losses are seeing greater increases, along with the tightening of policy conditions and increasing deductible levels. The renewal process has been further complicated through the loss of two key insurers within the London power market in the past month alone. One is an established Lloyd's syndicate which and the other a prominent London company market. As a result, many renewals start with lost capacity, which means our regular exercise of seeking alternative renewal strategies is more important than ever.

In the third quarter, those accounts which were the first to experience significant rate increases in 2019 renew. Although there is speculation that insurers may seek rate increases on top of what they charged last year, we are pushing for a more pragmatic approach.

As the transition to renewable energy accelerates, we expect that insurers will be motivated to diversify their portfolio.

Energy Casualty

Since our last quarterly update, the liability market has become significantly more difficult and harder to navigate. There is likely to be more pain to come in the next two quarters, and a possibility that in the late third or early fourth quarter, Lloyd's markets may run out of premium income capacity, and Lloyd's may or may not allow underwriters to exceed original targets (known as pre-emptions).

US Primary Energy

There is currently no real primary market in London for US clients, except on an exceptional basis (offshore contractors). The delay in White Bear/Blenheim starting up has extended this. The US market has not filled this vacuum, as some expected, so clients currently have very few options in this distressed sector.

US Excess Energy

The excess market for US clients is largely stable, though the recent decision by Enstar to enter Starstone into run-off has removed USD25 million of capacity from the market. Average rises are still between 0-10%, with some exceptions for contractors due to the difficulties they face in their industry.

International Energy

A great deal of 'right-sizing' and pricing correction has been going on in the international space, especially for Latin American, Eastern European, and Asian business. Increases that are multiples of the current premium levels have occurred as a major carrier's stance on this sector takes hold. Many clients have sacrificed limit to manage costs, especially those who started with USD800 million-USD1 billion and were arguably 'over-buying' in a market where the price for excess capacity had been extremely competitive.

Bermuda Casualty

The Bermuda market continues to be challenging in the first half of 2020, continuing the momentum of rate increases and stricter underwriting which started to impact the market towards the end of 2019.

In some instances, we have seen the market deteriorating further in respect of the amount of rate increases being obtained and the corresponding reduction in limits being available.

Underwriters are still looking to support their insureds, but only where they consider the pricing levels to be acceptable.

All these factors have led to the increased costs of insurance programmes and/or reduction in total limit purchased and/or the use of self-insurance and captives where appropriate.

Market conditions will likely continue through the remainder of the year – with strict underwriting discipline enforced and underwriters instructed to move rating levels toward what they consider to be their 'technical' price.

Marine Exposures

There is a significantly reduced panel of insurers in the marine market, and those that have been able to navigate the last 12 months are now demonstrating a pattern of increased focus and scrutiny on shipowner experience and credentials, operating standards and previous loss experience.

Another feature of the current conditions is that, due to much tighter monitoring and control, there is a more disciplined and consistent approach across the market.

The trend towards increased rating levels on new and renewal business that was once an unfamiliar feature of the marine hull market has become well established, and sustained over the past 18 months.

In terms of actual placement of risk, the major shift since the start of the year has been that the support of the following market cannot be taken for granted. 'Verticalised' placements, with multiple different levels of pricing, have become increasingly prevalent and necessary, in order to complete many placements. Lead underwriters' terms can no longer be relied upon to complete 100% of a policy at one price, with following insurers setting their own terms at which they are prepared to commit their capacity. Each underwriter is now subject to far greater internal checks than they have been used to, so many are treating their individual follow lines as if it was the lead line. We have also seen an increased emphasis on modelling and actuary-driven input on minimum premium rating levels, leading to some insurers coming off accounts that, although profitable, simply do not meet their internal modelling tests.

The combination of more independently minded underwriters and a less efficient and unfamiliar trading environment during lockdown, has led to a slower and more unpredictable marketplace, where much more time and planning is needed to achieve the best results for Insureds.

The trend towards increased rating levels on new and renewal business has become well-established and sustained over the past 18 months.

Regional Update: United States Energy Casualty

Last quarter we had a regional update from the Middle East. This quarter we look at energy casualty in the US.

For upstream and downstream energy physical damage classes, the US market is an integral part of the overall global market and the dynamics align with global trends. However, primary casualty for US insureds is essentially a self-contained US marketplace, and certain segments have been firming for well over a year. A favourable, but flattening workers' compensation environment, is more than offset by an increasingly challenging liability landscape, especially in auto and umbrella/excess.

Despite the strong market surplus and sustained low interest rates, the greater frequency and severity of claims, reserve deficiencies, and deteriorating combined loss ratios in automobile liability, general liability, umbrella and excess placements and medical malpractice have led to increases in commercial liability pricing and a general contraction in umbrella/excess capacity.

Perceived exposure and loss concerns around large fleets, non-owned auto, long haul trucking, glyphosate, traumatic brain injury, sexual abuse and molestation, opioids, wildfire, CBD (cannabis), and active shooters have continued to grow throughout these market challenges.

While the ultimate impact of COVID-19 on the casualty insurance market in the US remains unclear, we can expect the following:

- Liability lines will likely remain challenging for the balance of 2020 and into 2021, due to the continuing increase in the frequency and severity of claims.
- New exposure adjustment features will be requested/ negotiated, including pay as you go workers' compensation policies, adjustability features on umbrella/excess, and lower minimum premiums.
- Insurer demand will grow for communicable disease exclusions and other restrictive modifications (such as anti-stacking language), possibly driven by reinsurers.
- Insurer concern is likely to increase around state legislation on workers' compensation compensability for COVID-19 claims.

There is, of course, the reality that state directives will increase the number of COVID-19 claims and dollars paid, which will impact insurers as well as insureds in terms of retained losses and collateral requirements.

However, this assumes that such an increase in activity is widespread, rather than only impacting certain states, industries, segments, or risks. There is also a strong likelihood that such increases in COVID-19 claims will be more than offset by significant decreases in frequency stemming from the widespread reduction in core operations.

Current observations on the US casualty market rating environment are as follows, with rates fluctuating based on performance of supporting lines:

- Workers' Compensation: -5% to +5%.
- General Liability: +5% to +15%.
- Auto Liability: +12% to +25%.

Recent Quotes

The following are 'soundbites' taken from speeches, statements or articles by prominent market figures about the insurance market. While we have tried not to take their words out of context, the excerpt may not be the entire speech or article.

Alex Maloney, Lancashire Holdings CEO

"COVID-19 will exacerbate rate hardening but possibly reduce demand for certain cover later in the year. We believe this event to be the catalyst for a steeper hardening curve in the insurance and reinsurance pricing cycle. This loss is truly unprecedented. This is an overused word in our industry, but this time it is appropriate. We expect the rating curve to steepen and are confident in the broad direction of travel, with rate increases seen across all sub-classes of property, aviation and marine."

Speaking during his firms first quarter earnings call.

Kevin O'Donnell, RenaissanceRe CEO

We will now find ourselves in a traditional hard market Even before March, the price of risk was rapidly rising across most, if not all, P&C lines. Casualty rates are continuing to harden, with significant rate momentum across casualty classes. Market uncertainty about the breadth and depth of COVID-19 losses will reduce risk appetite and constrain the supply of reinsurance. The coronavirus epidemic has caused a scarcity of capital that will continue to drive up rates. Secondly, there is now a shortage of retro capacity, as investors retreat from the market. COVID-19 losses could trap substantial amounts of collateral at year-end, and the correlation of pandemic claims could be problematic for ILS [insurance-linked securities] investors after multiple years of losses. I think investors are more likely to deploy capital in traditional asset classes, which are now attractively priced, than in the struggling ILS market. The plaintiffs' bar will seek to make the most of the COVID-19 crisis by launching yet more lawsuits, a trend that will drive increased casualty losses. The world is changing quickly."

Speaking during his firms first quarter earnings call.

John Neal, Lloyd's CEO

"Repricing [of insurance premiums] has to happen. You can't put a potential USD200 billion loss into the non-life insurance industry and not expect the market to reprice. I hope we will learn from experiences of the past, whether that was 9/11 or another event, and realise that this has to be a significant pricing event.

Interview with the Insurance Insider published 14 May 2020.

Vincent Vandendael, Everest Insurance International CEO

"Artificial intelligence (AI) and technology are helping companies to improve underwriting processes, and those who do not embrace the new technology could be left behind. We have seen the use of AI and tech tools improve our underwriting decisions and our risk engineering before the underwriting.... I view AI as an enabler, not a disruptor or as a replacement of people. One major advantage of new technologies is that they create fairness and transparency for insureds. The way this is happening is if everyone works with the same set of data, that has to create transparency, and from transparency will come fairness. For example, drone technology which allows us to carry out risk engineering of high-rise buildings in areas exposed to potential wind damage. I think it's a win-win situation for customer and insurer in this case, as high-resolution drone images could help to determine the precise levels of damage. I can only applaud initiatives from Lloyd's to exploit technology to speed up the claims process, which will improve the standing of the London market.... There is no doubt that allowing technology to increase that connectivity straight to the customer and allow that faster payment is going to help. Technological initiatives have previously focused on helping to drive down loss ratios, but claims handling is becoming more of a focus.

Interview with the Insurance Insider published 14 May 2020.

The quotes referenced above are included herein to provide readers with a broad overview and insight into what is currently being said in the marketplace, however the inclusion of such does not mean Marsh JLT Specialty, Marsh, or Marsh & McLennan Company endorse or agree with any of the foregoing.

Market Moves/People in the News

- **Adam Wakeley** hub leader for Marsh Energy and Power in Dubai, is relocating to Hong Kong, to lead the Multinational Companies Services team in Asia. **William Beach**, currently Head of Placements for Marsh Energy in Dubai, has been appointed as Head of Energy and Power for the Middle East, based in Dubai.
- **Shivan Hutton** has been appointed to the role of specialty leader for Africa at Marsh JLT Specialty, with effect from August 1, 2020, when he will relocate to Johannesburg.
- **Paul Greensmith**, former Axa XL UK and Lloyd's market CEO, has been hired by AIG as global head of specialty. The role was left vacant by Peter Bilsby who stepped down in February this year; Gordon Browne has held it on an interim basis since then.
- **Jon Hancock** is due to begin his new job as CEO of international general insurance at AIG on June 1, 2020.
- **Simon Williams** has been appointed as active underwriter for Arch Syndicate.
- **Olivier Decombes**, former-Barbican offshore underwriter, has joined AqualisBraemar as a loss adjuster.
- **Jonathan Zaffino**, former Everest Insurance CEO is to join Ascot as group president, where he will assume responsibility for the US and Bermuda operations.
- **Simon Anthony** is leaving WR Berkley to join Blenheim.
- **Charlie Rawlins** at Hiscox has resigned to join Beat Capital-backed MGA Brace Underwriting as CEO.
- **Alex Waite**, at the Brit syndicate, has transferred to their marine and energy liability team, from the offshore energy property team.
- **Paul Sankey** has resigned as global head of oil and gas at Liberty Specialty Markets to join Convex as head up their downstream energy business.
- **Ben Atkins**, CFC Underwriting's terrorism head, is to leave the firm and take up a position on Convex's crisis management team.
- **Lorena Gallagher**, who was heading the London Downstream team at Liberty in London, is moving to Convex.
- **Peter O'Neill**, Downstream Underwriter at AXA XL, has resigned to join Convex.
- **Richard Tomlin** (previously at Atrium) is joining Convex to write a marine book.
- **Dermot Dick**, former CEO QIC Re, has joined Elseco as a strategic adviser to CEO Laurent Lemaire.
- **Magne Nilsen** will become the managing director of Gard (UK) from July 1, 2020. He will take over from Thomas Nordberg who will return to Norway to take up a new position as head of claims services, reporting to the chief claims officer.
- **Radmil Kranda** (currently senior claims executive, energy) has been appointed the new head of energy at Gard. He is taking over the role from Gunnar Aasberg who will continue in a senior underwriter role until his retirement.
- **Harry Salmon**, CFC terrorism underwriter, has resigned to join IGI.
- **Vicky Hopgood**, who left AmTrust following their acquisition by Canopius, has joined Liberty Specialty Markets syndicate.
- **Kevin Jarman** has stepped down as CEO of MatthewsDaniel to become a special advisor. **David Cox** becomes CEO of MatthewsDaniel Group and will take on all Kevin's current responsibilities.
- **Rob McAdams** is joining the Munich Re Syndicate from Axa XL as its new head of marine, replacing Simon Parnell, who is retiring after 21 years at the company.
- **Fabrizio Mastrantonio** (Eni) has been elected chairman of the board of Oil Insurance Limited (OIL) for 2020, with **Lars Ostebo** (Equinor) as deputy chairman.
- **John Weisner** (ConocoPhillips) has been elected chairman of the board of Oil Casualty Insurance Limited (OCIL) for 2020, with **John Talarico** (Hess) as deputy chairman.
- **Ollie Paine**, previously with the Standard Syndicate, has been appointed global head of upstream energy at Scor.
- **Lionel Kpoze** at Scor is moving to Houston to focus on onshore energy; Scor is looking to appoint a replacement for Lionel in the upstream team in either Paris or London.
- **Inga Brand** and **Tom Davies** (formerly of Liberty and Aspen) are joining White Bear MGA to write an energy casualty book.
- **Matt Holmes, Sarah Warren** and **Pierre Cirak** have resigned from Elseco.
- **Gilles Hussey** is leaving Elseco in Dubai, has announced plans to move back to the UK.

What's New?

Products and Market Developments

The insurers behind the long-standing Chrysalis 'Excess OIL' policy have launched a new type of upstream business interruption insurance called 'Operability'. It is different from traditional loss of production insurance (LOPI) in that it covers the energy company's whole production portfolio and responds to under-performance below agreed aggregate thresholds during accounting terms. The Chrysalis insurers have said they hope that the new policy will prove to be useful as a production hedge, for mitigating the unpredictability of companies' production revenue.

The trigger for coverage is 'physical impairment' of covered assets as opposed to the traditional LOPI trigger of blowout/physical damage. Physical impairment is not defined, but is understood to be any physical reason why a facility is producing less than anticipated and so could include gradual impairment of the assets (but the insurers have stated this is not intended to cover reservoir under performance), and there are limited exclusions (war, civil war, nuclear, hostile cyber, communicable disease).

The insured agrees with insurers an aggregate production 'floor' over the term, and if that floor is not reached, the policy pays out (at an agreed commodity price times the deficit). The floor must be under the expected 100% production efficiency level of the assets covered (the closer the floor to 100% efficiency, the higher the premium, and vice versa). The floor must also take into account expected shut-downs.

Overall capacity is up to USD200 million per policy. This product requires a lot of disclosure and information from the insured, and in depth modelling and engineering review by insurers. The process takes at least 3 months from initial discussions through to inception of a policy.

Another change at Chrysalis is that the three original insurers (Axa XL, WR Berkley and QBE) are being joined by Convex. They have also formed an underwriting consortium. In addition to the original Chrysalis product and now Operability, Chrysalis are able to write bespoke policies for upstream energy companies' unique or unusual risks.

Briefly

A Spot Poll, was carried out by Marsh JLT Specialty in April 2020 surveying almost 4,500 energy and power operators from around the world. The purpose of the survey was to understand how the industry was responding to, and mitigating the impact of, the sudden reduction in global demand due to COVID-19 Respondents ranged from small to very large operators and included energy companies across oil, gas, petrochemicals, and derivatives as well as power companies.

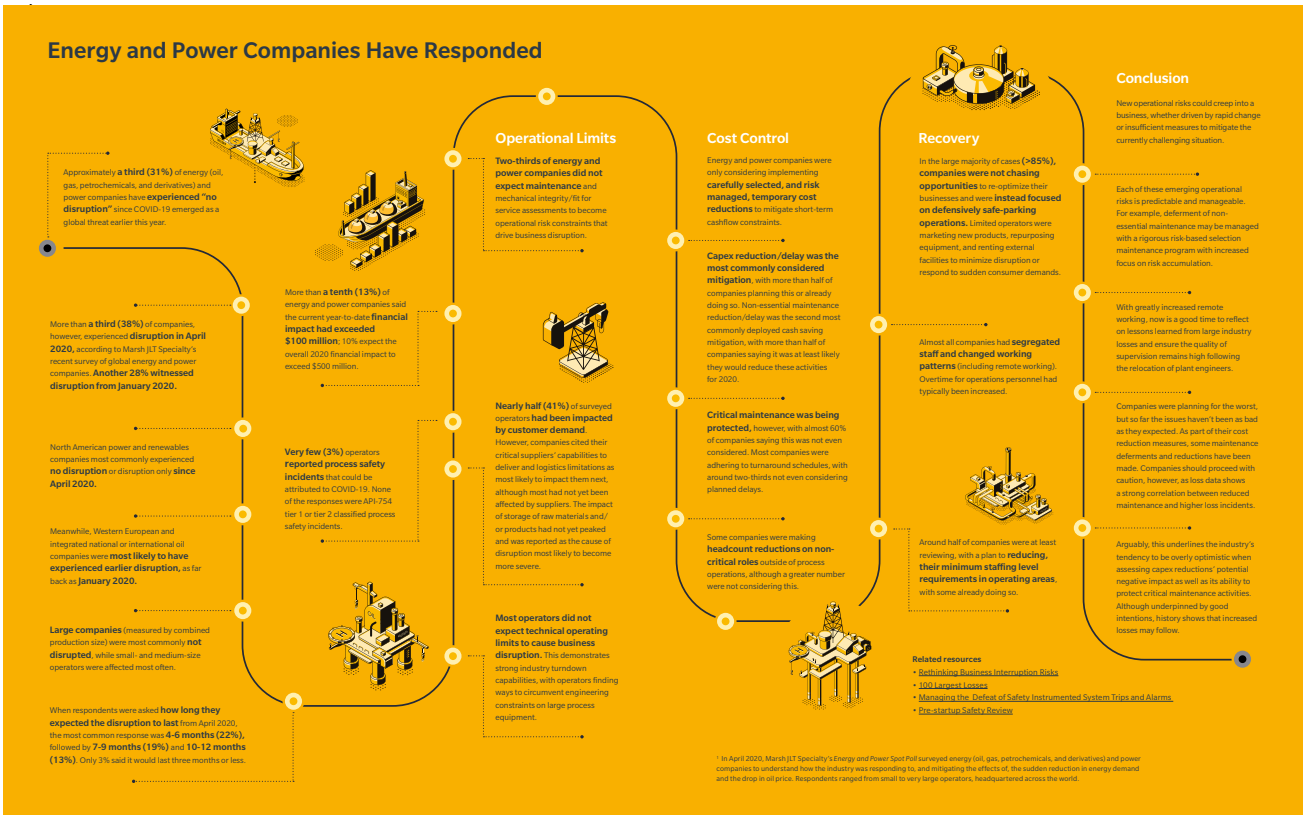
More than a third (38%) of respondents had experienced disruption in April 2020, another 28% witnessed disruption from January 2020. When asked how long they expected the disruption to last, the most common response was 4-6 months (22%), followed by 7-9 months (19%) and 10-12 months (13%).

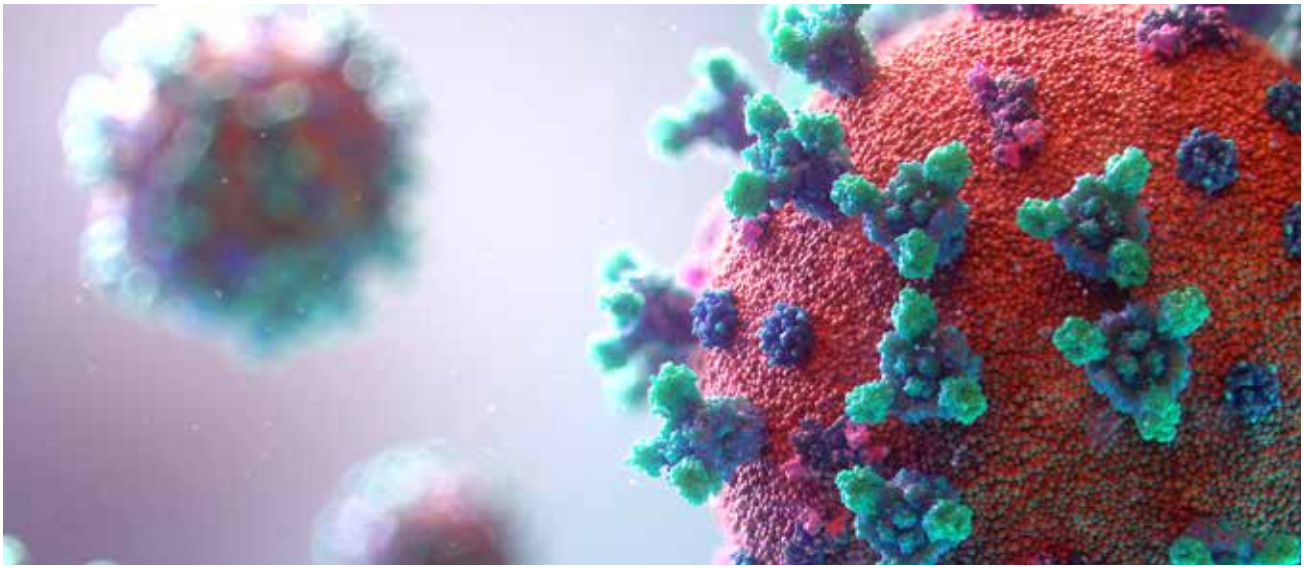
Capex reduction/delay was the most commonly considered mitigation, with more than half of companies planning this or already doing so. Non-essential maintenance reduction/delay was the second most commonly deployed cash-saving mitigation, with more than half of companies saying it was at least likely they would reduce these activities in 2020.

The infographic of the survey results can be downloaded at https://coronavirus.marsh.com/gb/en/insights/research-and-briefings/covid-19-impact-on-the-global-energy-and-power-industry.html?utm_source=colleague-share&utm_medium=email-oft&utm_campaign=energy-&-power-spot-poll-2020

According to a World Economic Forum (WEF) report written in partnership with Marsh & McLennan and Zurich, the economic fallout from COVID-19 dominates business concerns, with two-thirds identifying a prolonged global recession as a top risk. According to the findings from the April 2020 survey, a rise in cyberattacks, and data fraud, due to a shift in working patterns is another top threat, as is the breakdown of information technology infrastructure and networks. Bankruptcies and industry consolidation, the failure of industries to recover and disrupted supply chains are "crucial worries" cited by half of the 350 senior risk professionals respondents. Businesses are also concerned about geopolitical disruptions to operations, with more than 40% citing tighter restrictions on the movement of people and goods among the most worrisome effects of COVID-19. Some 31% of respondents also rated another global outbreak of COVID-19 or another infectious disease as a top risk. The WEF's COVID-19 Risks Perception Survey can be downloaded at: https://www.mmc.com/insights/publications/2020/may/wef-covid-19-risk-outlook.html.

Lloyd's (have issued series of three reports on the renewable energy sector, in association with researchers





from Imperial College London's Centre for Energy Policy and Technology (commissioned via Imperial Consultants) which analyses the implications of the changes to the energy generating landscape for insurers, risk managers and brokers. According to Lloyd's, energy systems across the world are experiencing fundamental shifts driven by climate change policies and rapid technological changes. Over the past 10 years or so, renewable energy sources have expanded to such an extent they are now the dominant source of new power capacity additions in many countries. The major types of renewable energy are hydropower, wind, bioenergy, solar, geothermal and ocean/marine. For all technologies (apart from hydro power) the theoretical resource far exceeds current levels of power generation. The potential also far exceeds global energy consumption for solar in particular, and also for wind and ocean technologies, implying that renewable energy supply is only constrained by practical social and economic conditions. Unquestionably, the rapid growth in the renewables industry, the changing nature of risks in the sector and the fact that insurance is often a prerequisite for provision of project finance, mean that there may be a growing need for insurance.

The three Lloyd's reports are:

- Key trends and territories: provides an overview of energy market developments in the renewables sector, and outlines the prospects for renewables in general and details national developments.
- Risks and technologies: outlines the risks associated with a range of established and emerging renewable energy technologies and explains how Lloyd's is responding to them.
- Integrating renewables into grids and the role of energy storage: provides a deep dive into renewables integration and energy storage technology development.

Al three reports can be downloaded from: https://www.lloyds.com/news-and-risk-insight/risk-reports/library/understanding-risk/renewable-energy-risk-and-reward.

Marsh JLT Specialty Energy & Power Training Courses scheduled for 2020 have been impacted by COVID-19. Generally, we run three different Chartered Insurance Institute (CII) accredited training courses annually.

Delegate and colleague health and safety is of paramount importance to Marsh JLT Specialty and has been a key determinant in our division to take the following action

- The Energy Insurance Diploma Course (London - July 6–10, 2020) — cancelled
- The Energy Insurance & Risk Management Course (London - October 5–9, 2020) — will be held virtually and is currently open for registration

We continue to monitor the situation and will advise any changes as the situation develops. Questions regarding the Energy Courses may be directed to Sarah Verzola at sarah.verzola@marsh.com or visit the website https://www.marsh.com/uk/industries/energy-power/energy-insurance-training-courses.html

Legal Roundup

Further clarity on 'Seaman' status under US Jones Act.

The Jones Act is a United States federal legislation enacted a century ago, that provides significant remedies for those who can establish 'seaman' status.

Under U.S. maritime law, persons who claim the status of 'seaman' under the Jones Act have access to special rights not accorded to other workers. In particular, a seaman injured in the service of the ship has a cause of action for negligence against his/her employer, entitling the seaman to damages where the employer's fault can be proven. Persons who cannot claim seaman's status, on the other hand, are generally limited to statutory workers' compensation benefits for work-related injuries and are precluded from suing their employers.

The U.S. Supreme Court had previously established a two-prong test to determine Jones Act seaman's status:

1. The person's duties must contribute to the function or mission of a vessel; and

2. The person must have a connection to a vessel (or fleet of vessels) in navigation that is substantial in terms of both duration and nature.

In a recent case, the United States Court of Appeals for the Fifth Circuit revisited the test for determining Jones Act seaman's status. The Court provided some additional guidance on the application of the second prong of the test – addressing whether a person's connection to a vessel is substantial in nature.

The plaintiff was a welder working on board jacked-up offshore drilling rigs for a contractor in the business of steel fabrication and equipment repair.

The plaintiff was injured when he tripped on a pipe welded to the deck of one of the rigs, and subsequently filed a Jones Act negligence action against his employer in state court.

The employer in this case conceded the first prong of the test, and the district court easily found that the plaintiff had a substantial connection to a fleet of vessels in terms of duration – spending 65 of his 67 workdays on the rigs.

It was the nature of the plaintiff's connection to the vessel that his employer contested. The second prong of the Supreme Court case test is designed "to separate the sea-based maritime employees who are entitled to Jones Act protection from those land-based workers who have only a transitory or sporadic connection to a vessel in navigation".

Therefore, "the inquiry into the nature of the employee's connection to the vessel must concentrate on whether the employee's duties take him to sea" (per case law).

As the district court found, and the Fifth Circuit affirmed, the plaintiff's duties did not take him to sea in the sense contemplated by the Jones Act. The plaintiff worked on the rigs only when they were jacked-up on the ocean floor, with the body of the rigs out of the water and not subject to waves, tides, or other movement. The plaintiff's workplace was stable, flat, and well above the water. And the plaintiff did not perform tasks related to the operation or navigation of the rigs. The plaintiff was a welder, and he was injured when he tripped on a pipe welded to the deck, a circumstance unrelated to any perils of the sea. The only time the plaintiff's work might have taken him to sea in the sense contemplated by the Jones Act was during the four days when the rig he was injured on was under tow, and even then, he was treated as a passenger, not as a member of the crew.

The Fifth Circuit made a point of distinguishing this case from its prior pronouncement on Jones Act seaman's status where a plaintiff was a repair supervisor working on board lift-boats manufactured by his employer while the lift-boats were either moored, docked, or jacked-up in a shipyard canal. The distinction being that even though the lift-boats almost never ventured beyond the immediate area of the canal, they were found to be subject to the "vicissitudes" of a navigable waterway. Further, the plaintiff did perform tasks related to the operation of the lift-boats, including operating the vessels' cranes and jack-up legs, and his injury occurred while he was operating one of the lift-boat's cranes. In rejecting the argument that the plaintiff's work did not take him to sea, the Fifth Circuit emphasized that workers involved in operating vessels near the shore "still remain exposed to the perils of a maritime work environment" and therefore fall within the ambit of the Jones Act.

It is therefore clear that the determination of Jones Act seaman's status remains extremely fact-based.

Clarity on who can limit their liabilities under the Limitation Convention 1976.

Under the Limitation Convention 1976 'shipowners' can limit their liability to a sum based on the vessel's size. A shipowner for the purposes of the convention includes the owner, charterer, manager or operator of a ship. In a recent case before the UK Admiralty Court the court was required to establish who qualifies as a 'manager', and what is an 'operator'?

A large dumb barge was moored off Dover, UK. Storm Angus, with winds up to storm force 9, caused the barge to drag its anchor. Owners of the England-to-France electricity connection alleged that the barge's anchor tripped an undersea cable and caused EUR55 million worth of damage. Parties interested in the barge claimed to be entitled to limit their liabilities (if any) to about GBP5.5 million, based on its tonnage.

It was accepted by the owners of the cable that the registered owner of barge was entitled to limit its alleged liability. It was also accepted that the charterer or operator of the barge was also entitled to limit its alleged liability. The only issue is whether the 'operator' of the barge, whilst it was at anchor off Dover, was within the class of persons entitled to limit their alleged liability pursuant to the Limitation Convention 1976, which has the force of law in the UK pursuant to The Merchant Shipping Act 1995.

The cable owners said that the third company seeking to liability merely provided some services to the barge, but was not 'the operator' or 'the manager'. The cable owners argued that company's true role was as the buyer of the cargo of rock armour carried by the barge, transhipped to a smaller barge off Dover, and delivered to the beach for use in the repair of a railway line. It was said that any actions which the company took in relation to the barge were merely incidental to that role, and certainly did not make them the operator of the barge.

There was no doubt that the owners and/or charterers of the barge were also its operators and managers for the laden voyage from the Norway, where the cargo was quarried. However, the defendant company was involved in the anchoring off Dover. The defendant company chose the anchorage area, and the area was approved by the Marine Management Organization. When the barge arrived, under tow, a Barge Master and crewman employed by the company boarded the barge and dropped the anchor.

The Barge Master and crewman prepared the barge for being left unmanned, such as by setting navigation lights, and ensuring that the emergency towing wire was out and ready for use. Whilst at anchor, during the transhipment of the cargo, the same personnel ballasted the barge and maintained its generators. The company also monitored the position of the barge and monitored the weather. When the weather forecasts worsened, the company worked with the owner and charterer in deciding whether to leave the barge where it was or tow it to a place of shelter.

There was no previous authority on the meaning of operator or manager in the 1976 Convention, or in the 1958 Limitation Convention. In the absence of authority, some textbooks rely upon an Australian Federal Court decision on the meaning of ship 'operation' in the rather different context of the Australian Navigation Act.

The cable owners looked to rely on the travaux préparatoires of the 1976 Convention (documentary evidence of the negotiation, discussions, and drafting of a final treaty text), textbooks, the Australian case, and a range of industry dictionary definitions, to argue that engaging in some operating was not enough. It was said that being 'the operator' required something more: direct responsibility for the management and control of the ship as regards commercial, technical and crewing operations.

The Admiralty Court explained that the meaning of operator was closely related to the meaning of manager, and therefore it was difficult to discuss the meaning of one without having an understanding of the meaning of the other. The Admiralty Court traced the extent of shipowners' and therefore managers' duties in older commentary and authorities, up to the introduction of the ISM Code, and into the BIMCO SHIPMAN ship management agreement.

Managers might be responsible for all safety, manning, technical and commercial tasks relating to a ship, or only for some of them. The Admiralty court held that, under the 1976 Limitation Convention, a 'manager' was the person entrusted by the owner with sufficient authority over the tasks involved in ensuring that a vessel was safely operated, properly manned, properly maintained and profitably employed to justify describing that person as the manager of the ship. If a person was entrusted with just one limited task it might be inappropriate to describe that person as the manager of the ship.

Turning to the meaning of 'operator', the judge decided that it included the manager, and that in many cases involving conventional merchant ships there might be little scope for operator to have any wider meaning. However, he noted that this case did not involve a conventional merchant ship. It involved a dumb barge, requiring far less by way of operation. In the case of a dumb barge, 'operator' included those who, with permission of the owner, sent their employees on board with instructions to operate the ship's machinery in the ordinary course of the ship's business. This is what the defendant company did.

The Judge said therefore that, even if some part of the operation of the barge remained with the charterer, the defendant company could therefore limit its alleged liability.

Demystifying Common Clauses

In this regular feature, we look at common clauses found in energy insurance that are often not well understood and consider what their intentions are, and what they cover or exclude.

The Waterborne Agreement

Marine insurance practitioners often talk to about the waterborne agreement, but what is it, and how does apply in practice today?

During the Spanish Civil war that started in 1936, non-marine underwriters first came to the realisation that warfare was no longer either confined to the seas or open battlefields, and towns and cities could be the target of warfare, especially by aerial bombardment, exposing insurers providing 'all risks' insurance policies to massive aggregation problems.

In a response to this concern, the Lloyd's Underwriters Association (LUA) and the Association of British Insurers (ABI) entered into an agreement to exclude war and civil war on all policies issued by Lloyd's and London Companies subscribing to the agreement. This led to the introduction of the War and Civil War Exclusion clause NMA 464 1/1/38, which is still included in many non-marine policies today.

On the 16 December 1937 an exception to this agreement was signed which became known as the waterborne agreement whereby underwriters would cover war risks on waterborne vessels and cargoes. This agreement also introduced the concept of notice of cancellation (at the time 48 hours), whereby all war polices would include a provision allowing insurers to issue notice of cancellation, subject to them offering revised terms and conditions to reflect the latest risk situation.

Overtime, amendments to the waterborne agreement were made, including changing the notice period for cancellation to 14 days and then to 7 days (which is generally applied today), and the absolute exclusion of an outbreak of war between the so-called 'major powers' being the five permanent members of the United Nations Security Council (the United Kingdom, the United States of America, France, the Russian Federation, and the Peoples Republic of China).

In 1997 Lloyd's offered a standalone war on land policy (LSW 667), with syndicates wishing to cover this peril needing to clearly demonstrate their intention to do so in their business plan submissions made to Lloyd's. As a result, the waterborne agreement is no longer imposed across the board by Lloyd's. However, most treaty reinsurances will contain war and civil war exclusions with an exception for waterborne risks.

The above is provided as a general overview of some of the coverage often provided by the aforementioned clauses. This is not intended to be an extensive and exhaustive analysis of the insurance coverage provided by such clauses. The comments above are the opinion of the Marsh JLT Specialty only and should not be relied on as a definitive or legal interpretation. We would encourage you to read the terms and conditions of your particular policy and seek professional advice if in any doubt.

CONTACT US

If readers have particular clauses they would like us to consider including in this newsletter in the future, or have any comments on the above, please contact john.cooper@marsh.com

Engineering Update

In our April update, we reported on a number of remote working strategies as we began implementing COVID-19 driven contingency engineering plans as an alternative to the traditional survey process. There has been excellent progress made in implementing these plans, in all geographies and across all segments including power generation, upstream energy, refining and petrochemicals.

As of late-June, we will have completed in excess of 150 'virtual surveys', many in conjunction with our risk-engineering colleagues from the insurance market. Feedback from both clients and insurers has been extremely encouraging.

For many of our clients, virtual surveys have tended to focus on providing detailed updates to insurers on their operational status of risks during the pandemic; the recent LMA Bulletin continues to provide useful guidance.

While a virtual survey cannot be expected to fully replace all components of the traditional model, particularly field inspections, it is fair to say that a new normal has taken shape. Marsh JLT Specialty is working in close collaboration with a number of clients to explore how we can further improve the process. This involves a range of possible solutions including leveraging technology. One thing remains abundantly clear – the necessity to provide good quality risk engineering information in support of the risk transfer process is paramount, particularly in the current insurance market conditions.

Unsurprisingly, reported reductions in levels of non-essential maintenance, capex, and deferments of maintenance schedules generally, have been important talking points. Our historical research suggests that the energy and power insurance industry, arguably tends to be over optimistic when assessing the potential negative impact of capex and opex reductions and, as a result, we anticipate that these will remain important topics for many months.

Equally unsurprisingly, as many organizations are now beginning to increase or recommence production, the focus of risk engineers is on ensuring that start up risks are managed properly. Risks associated with transient phase operations are well understood and, when mismanaged, contribute significantly to industry loss statistics. Clients should anticipate significant interest in how equipment and process plant were taken out of service at the beginning of the slow down.

Supporting our clients to drive improved risk management through their businesses has continued to be a key objective during the COVID-19 period. We have extended the range and number of remote training seminars and facilitated technical forums available for clients to include topics such as Process Safety, Business Interruption, Learning from Losses and Business Continuity Planning; we look forward to introducing additional topics in the coming weeks.

In the coming weeks we will release new or updated articles and propositions papers including:

- Inspection Deferrals in the Downstream Energy Industry.
- LNG Project Paint, Coatings & Insulation (updated).
- Remotely Operated Emergency Isolation Valves (ROEIV).
- Plant Water Chemistry.

Our global team of Risk Engineers are ready to work with you; please speak to your local Marsh JLT Specialty contact to understand how we can continue to help you.

"Excellent preparation of overall survey and very well executed given that it was held remote. Excellent knowledge of relevant topics. Easy to communicate with excellent multitasking skills. Have shared with engineer via phone call some observations that I hope will add value for planning of future surveys."

Risk Engineer, Reinsurance Company, London

What Post-Crisis Event Start-Ups and Capital Raises Mean for Market Capacity

History show us that after major catastrophic events, and the seismic shifts in the insurance industry that typically follow, we see a raft of new insurer start-ups and/or existing insurance carrier recapitalisation, looking to take advantage of an improved trading position for insurers.

This phenomenon is partly what drives insurance market cycles.

After Hurricane Andrew in 1992, Bermuda saw a rush of new reinsurance start-up including Ren Re, and Partner Re.

In 2002, we saw a number of post 9/11 start-ups including Axis, Montpelier Re, Platinum Re, AWAC, and Endurance.

Following Hurricanes Katrina, Rita, and Wilma in 2005 we saw the so-called Class of 2005 new (re)insurance start-ups, including Validus, and Lancashire.

With many suggesting COVID-19 is developing into a loss that will rival (in scale) any events to date, and may end up as the largest ever insured loss; we are now starting to see the emergence of capital raises, and talk of new start-ups.

Capital raises completed, or currently in play, total over USD5 billion, with rumoured start-ups said to be looking to raise another USD2 billion to USD3 billion to add to that figure.

Latest equity raises, targeted by existing carriers, include:

- QBE — over USD750 million.
- Ren Re — USD975 million.
- Hiscox — over USD375 million.
- Beazley — over USD250 million.
- Lancashire — over USD350 million.
- Fidelis – USD800 million in equity since February 2020, and USD300 million in senior notes.
- Arch – USD1 billion.
- Starstone US – USD630 million in new capital injection from Aquiline PE consortium, led by former Validus CEO Ed Noonan and American Finance Group CFO Jeff Consolino.

In addition, any number of the proposed new start-ups could look to get into the energy and power business, either on a direct or reinsurance basis, depending on their appetite, and their ability to attract the required underwriting teams.

How quickly, and to what extent this could stabilise the market, or put the brakes on the hardening energy and power insurance classes is to be seen, but it is certainly a feasible possibility.

While we do not expect much of this new capital to have an immediate impact on the energy and power markets, this is the first sign of a real expansion of potential capacity since the launch of Convex in 2019.

Note: All figures included within this article are sourced from the media releases or regulatory filings of the firms noted.

Atlantic Named Windstorm Forecasts

Colorado State University (CSU) Department of Atmospheric Science hurricane researchers are predicting a very active Atlantic hurricane season in 2020, citing the likely absence of El Niño as a primary factor.

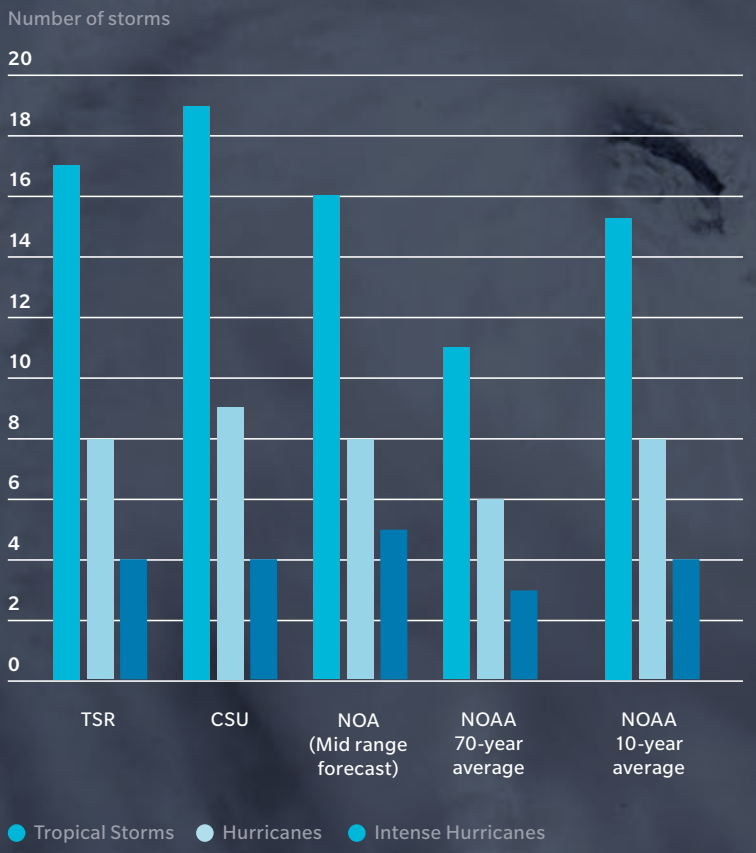
Sea surface temperatures, averaged across portions of the tropical Atlantic, are somewhat above normal, while the subtropical Atlantic is much warmer than average. This sea surface temperature configuration is also considered an indicator for an active 2020 Atlantic hurricane season.

The tropical eastern and central Pacific currently has cool neutral El Niño/ Southern Oscillation conditions; that is, the water temperatures are slightly below average. CSU anticipates that these waters will continue to cool relative to their long-term averages over the next several months, potentially reaching weak La Niña conditions by the peak of the Atlantic hurricane season. Consequently, they believe that El Niño is extremely unlikely this year. El Niño tends to increase upper-level westerly winds across the Caribbean into the tropical Atlantic, tearing apart hurricanes as they try to form.

The Caribbean and central tropical Atlantic are somewhat warmer than normal. Warmer-than-normal sea surface temperatures provide more fuel for tropical cyclone formation and intensification. They are also associated with a more unstable atmosphere as well as moister air, both of which favour the organized thunderstorm activity that is necessary for hurricane development.

The chart plots Tropical Storm Risk (TSR), CSU and US National Oceanic and Atmospheric Administration (NOAA)'s forecasts (as of June) against the 70 year and 10 year averages.

FIGURE 1 2020 Atlantic Hurricane Season Activity/Forecasts



Focus on: Offshore Construction Insurance

For many years, offshore construction insurance has been a specialist class of business within the offshore energy insurance market. In this article, we look at the class of insurance and its standard wording 'WELCAR 2001'.

The Risk Involved

When an oil or gas field is discovered offshore, the construction and installation of relevant infrastructure at the field is required to bring the product to market. For shallower water, this generally involves platforms fixed to the seabed, while in deeper water it involves floating platforms (Spars) which are maintained in place with mooring systems, tension legs, or subsea systems that are connected to floating production storage and offloading units (FPSOs). Some subsea wells may be tied-back to an existing (sometimes third-party-owned) platform or facility. There will also be in-field pipelines and, for those developments that do not include an FPSO, an export pipeline to shore.

Offshore construction all risks (CAR) policies will typically commence with, and cover the procurement of materials (covered by cargo clauses during delivery to the onshore construction site), and continue during onshore fabrication, offshore load-out, tow to offshore site, installation at offshore site, and finish once final hook up and commissioning has taken place and the project becomes operational.

Long-term Nature of the Risks

Offshore construction projects are often scheduled to take many years to complete, in some cases five years or more. As these projects can suffer delays, due to bad weather or from other operational issues, it is important that insurance policies are written to cover the entire period the project is at risk.

Projects currently underway are very likely to be delayed by the COVID-19 pandemic. Once revised schedules are known it may be necessary to seek an extended expiration date on existing insurance contracts.

CAR polices will often have a 12-months maintenance period (though this can be longer, usually if required by contract) from the completion of the project. This provides coverage for the manifestation of damage from faulty design, faulty materials and/or faulty workmanship (to the extent covered by the policy) and physical loss or damage caused during any contracted maintenance period resulting from the activities of 'other insureds' (for example, contractors or sub-contractors).

Insurers are likely to add the maintenance period to the construction period when ascertaining the full policy period, and whether or not the total period will impact their reinsurance coverages (which are often limited to a total period of five or six years) and need special acceptance in order for there to be coverage from reinsurers.

The Insurance Market

Market Capacity

The inherit risks associated with offshore construction projects means that some insurers do not write this class of business, while some are cautious and commit smaller lines. Others, often as a result of their treaty restrictions, are also not be willing to commit to projects beyond two or three years period.

The theoretical capacity is in excess of USD5 billion but is dependent on individual insurers' appetite for particular project types, the layer on offer, and of course the price the project is willing to pay. We estimate the realistic working level of capacity for offshore construction to be approximately USD3.5 billion. Traditionally this has been sufficient to cover even the largest projects, especially if any of the joint venture partners are OIL members (the Bermuda-based oil industry, which can provide capacity of up to USD400 million per insured, with an overall maximum exposure to any risk of USD1.2 billion) or have a captive with significant risk-bearing capacity and appetite.

The sums insured involved with Floating LNG vessels (FLNG), which are now being developed by the oil industry, challenge the amount of available capacity from insurance markets; indeed we have seen a FLNG project valued in the region of USD10 billion.

However, as with all insurable risks, premium rates and programme structure will all be important levers in whether or not insurers will deploy their capacity (for example, it may be possible to secure capacity from a market that will not write the full period or has less appetite for construction risks, to provide coverage on a top-up layer basis as the project value builds up over the construction period).

For Floating Production Storage and Offloading vessels (FPSOs), or FLNG, it may also be possible to secure capacity from the traditional hull builders insurance markets. For energy projects these insurers would generally be considered excess placements; however, they could add around USD500 million additional capacity (depending on any clash with their group insurers writing as an energy risk).

Lead Insurer Selection

When selecting a lead insurer for offshore construction risks it is important to match the project type and size to the prospective leader's credibility in the market (to ensure 100% support for the placement can be achieved), and their knowledge and willingness to lead certain project types.

Given the length and complexity of projects, it is also important to weigh up security rating, competiveness in both price and coverage (including deductibles and sub limits), flexibility, service, and of course claims-paying reputation and track record.

The Insurance Product

Historical Background

Until 1985, offshore construction risks were typically written on broker's manuscript wordings and, to a large extent, based on Institute Builders Risks clauses designed for vessel construction. In 1985, the London Rig Committee issued a London Offshore Construction Cover or LOCC 85/2 wording, but the wider coverage for faulty part, common within brokers' wordings, was generally preferred while leaders (and supporting markets) were still willing to quote on such wordings.

During the 1990's an extremely competitive energy insurance environment led to some very negative results for the offshore construction market, which led to attempts to tighten coverage. One such wording was introduced by Scor (the first with Quality Assurance/Quality Control restrictions on cover available for contractors), and another was issued by Zurich. In 1999, the Wellington Syndicate in Lloyd's then issued the 2020 wording (a reference to their Lloyd's syndicate number) which incorporated a number of the Scor and Zurich wording provisions and looked to clarify previous potential grey areas of cover, especially around faulty design and latent defect, to control the adverse claims experience which had developed in this class of insurance.

There was also an added discipline around policy limits with the introduction of Schedules A and B (Schedule A being the overall maximum sum insured, while Schedule B is a breakdown at any stage of the project) and by sub-limiting additional coverages. This new policy wording structure was ultimately reissued in 2001 as WELCAR 2001 (WELCAR), and remains the basis of cover for the vast majority of offshore constructions risks placed in the London and international insurance markets.

Key Coverage Considerations

In general terms, WELCAR is reasonably fit for purpose in that it provides 'all risks' cover for physical damage incurred during the construction phase (which can be extended to cover various other expenses incurred as a result of a loss), and covers third-party legal and contractual liability arising from the project. However, whilst this wording form offers more clarity of cover , in its standard form, it does introduce a number of restrictions to cover.

Marsh JLT Specialty has, over many years of working with the WELCAR form, developed a set of endorsements to the standard form that can be used to tailor the product on a case-by-case basis to meet the project's needs, depending on the scope of the project and the record of the insured and/or contractor. We have developed accepted endorsements to proactively address coverage concerns in areas including:

- Quality assurance/quality control.
- Aged vessels out of the insured's control.
- Pollution hazard/deliberate damage.
- Definition of perils within 'Defect Part' resultant damage buyback.
- Watercraft exclusion.
- Punitive damages.
- Bodily injury or third property damage resulting from professional services.
- Maintenance coverage under Section 2 of the policy.
- Pollution discovery and reporting periods.

While section 2 of WELCAR can be used to cover legal and contractual liabilities arising out of the project, it is also possible to place on a standalone basis in the specialist energy casualty market. We would always recommend that such an option is considered to make sure the most competitive price and broadest terms are achieved.

Another topic that regularly comes up for debate is the value of maintenance cover, and whether or not this is excluded from operational polices, and therefore whether it is worthwhile paying additional premium for under the CAR policy. Whether maintenance cover is worthwhile very much depends on the:

- Contractual relationship between the various members of the oil company group or joint venture commissioning the construction.
- Contractual obligations of the oil company (group) to the contractor (group).
- Oil company's reasons for buying insurance in the first place, including their general risk transfer philosophies.
- Relative deductibles between the insured's potentially available operating policy and the construction policy.
- Premium charged for the maintenance period under the construction policy.
- Limit purchased under the defective part buy-back.
- Desire to protect the operational policy from construction losses.
- Extent of coverage and any limitations in operating policies.

Extensions to Cover

Cover can be extended beyond physical loss or damage to cover various expenses incurred following a loss being:

- Tests, leak and/or damage search costs (covers repeated costs required as a result of physical loss or damage).
- Stand-by charges (on vessels engaged in repairs from bad weather).
- Forwarding charges (extra cargo costs incurred where transit terminated short of destination).
- Offshore cancellation costs (where damage to contract works causes the cancellation of pre-contracted vessels).
- Evacuation expenses (to evacuate personnel from the offshore site for the purpose of preserving life).
- Expediting expenses (incurred in expediting the commencement of repair, reinstatement or replacement).
- Defective part buyback (with an aggregate limit and deductible for each part).

The standard liability section can also be extend to cover damage to existing property (DTEP), where a contractual liability exists for damage to third parties' property in the proximity, or which is being crossed or tied-in to. This is normally limited to physical damage of the third-party asset but can be expanded to include loss of use (although capacity for that is limited).

Delay in Start-Up

While the purchase of delay in start-up (DSU) or advanced loss of profits (ALOP) coverage is common within the onshore construction market, it remains an uncommon purchase for offshore oil and gas construction projects. This is especially true for large capacity risks where any DSU limit purchased would accumulate with the CAR risk and reduce available capacity and competition. Where DSU is purchased on a project, it is typically lender driven.

'Broad form' DSU or ALOP coverage remains a very niche market that has limited capacity and is generally considered too expensive to purchase by most insureds. By 'broad-form', we mean a policy that would respond to a delay (in excess of an agreed waiting period, which would normally be 60 or 90 days minimum) from covered physical loss or physical damage to any part of the project.

An alternative approach by the offshore energy market is to offer a policy that responds to delay excess of a waiting period following any physical loss or physical damage, but such loss or damage has to be over a certain monetary threshold. Another approach is to limit coverage to a defined set of circumstances, such as a total loss of a scheduled project item (these limited coverages will typically be cheaper than the broad-form cover).

If coverage is limited to delay caused by loss or damage during the cargo shipment of critical parts, coverage can be provided by the cargo market as an add on to the cargo policy. This approach should be considerably cheaper than the above broad-form coverage, as the cargo insurance market is generally considered competitive with an abundance of capacity, especially for project cargo business. However, in order for the cargo market to cover DSU for the offshore elements of the project, they will need to provide coverage for physical loss or damage to such elements as well during the construction period. This can be achieved by either stripping the cargo risk out of the offshore CAR for a commensurate credit that could offset the cargo market premium, or alternatively have the cargo market provide 'Difference in Conditions, Limit or Deductible' coverage at a reduced premium.

Legal Cases

Despite being in existence for almost two decades, we are only aware of three court cases involving WELCAR.

The first (in a Texas court) hinged around whether the stand-by charges clause is a restriction of existing coverage, or a grant of broader coverage. The clause was struck through on the policy, with insurers arguing that meant no cover was granted for stand-by charges, whereas the insured argued that coverage for stand-by charges existed elsewhere in the policy wording's more general provisions, including references to "All Risks" coverage. The original trial court granted summary judgment in favour of the insured. The Court of Appeal and subsequently the Supreme Court found that the effect of the deletion of the stand-by charges provision was to remove coverage for stand-by charges from the policy.

The second case (also before a Texas court) was to establish whether or not a marine warranty surveyor (MWS), who had entered into a contract with the insured, automatically made them an 'other insured' and consequently did not allow insurers to seek subrogation from the MWS. The court ruled that insurers could not sue an insured to recover money paid for the risk that the insurer promised to insure, and also that insurers failed to prove damages were caused by the MWS's breach of the duty it owed to underwriters.

The third was before an English court relating to whether or not reinsurers, whose reinsurance policy period was not back-to-back with the original policy, could claim under a maintenance provision their policy had, even though the maintenance period had not started in the original policy. The court decided that the maintenance period had not started under the original policy when the loss had occurred, and therefore there could be no cover under the maintenance period under the reinsurance policy.

The Market's Attempt to Revise WELCAR

Between 2009 and 2011, the London Joint Rig Committee (JRC) worked on a revision to WELCAR, which was released into consultation with brokers, insureds, adjusters, contractor associations and lawyers late in 2011. The aim of the new wording was said to reflect ten years of underwriting experience, and to improve the quality of the wording by bringing greater clarity and consistency through the use of more contemporary language.

The new WELCAR wording ran to 59 pages, compared with 31 pages of the 2001 version, and the general consensus from insureds and brokers was it was more restrictive with more hurdles to overcome to secure cover. Specific criticisms were around the coverage granted to 'other insureds', new 'due diligence' provisions which introduced new duties on the 'principal insured', their contractors and sub-contractors, which could be very onerous, and the removal of reference to 'all risks' creating a limitation and imposing a burden of proof on insureds. Publication was due in January 2012 but was delayed pending further consultation with the market, and to date has never resurfaced.

Premium/Claims Record

Whilst there is no available data for offshore construction risk premiums and losses prior to Lloyd's introducing a separate risk code for this risk in 2011, a market loss database shows that since 1972 the energy industry has suffered over USD16 billion in losses from over 1,600 incidents.

From 2011 to 2017 (excluding 2018 and 2019, which do not have a matured loss picture yet), the Lloyd's 'EC' risk codes (for Offshore Construction) shows this book of business was much less profitable than the corresponding operational physical damage book.

We estimate that offshore construction premium is around 10% to 20% of the overall upstream insurance premium, and when losses in this sub-sector are higher than those in the remaining upstream book, we would expect some insurers to question the sustainability of the sub-sector. This leads to more volatility in pricing, as markets pull out of the sub-sector at lower rating levels, and return when they inevitably increase due to reduced competition that reduced capacity brings.

Recent Development

Over the years, a large number of losses in the offshore CAR sector have come from deepwater pipelines and subsea projects, as the industry pushed the boundaries of their offshore development from safer shallower waters where fields had become depleted, to the more hazardous environment of deepwater. This resulted in a significant increase in both rates and deductibles. However, this aforementioned change in the dynamics of the oil industry meant that deepwater subsea tie-ins became more prevalent in the market, and the construction of large fixed platforms became less common. At the same time, this move from shallower water to deepwater meant that the super large projects being developed, were almost exclusively done so by the major energy companies. Typically, these companies do not insure, or insure in their captives, leaving relatively small orders to the commercial insurance markets from joint ventures partners. This also coincided with oil prices crashing, from over USD100 a barrel at one point to under half of that high, resulting in a substantial slowdown of offshore construction. The result was that a few markets started to look to cut their deepwater subsea rates, presumably to gain market share of a class where the market's overall premium was falling.

The loss record of deepwater projects has, however, continued to plague the market and, coupled with a number of latent defect claims on prior year's platform constructions, the market once again showed a negative loss record, resulting in another round of rate hardening.

Insurers are now looking to reverse some of the widening of terms and conditions granted during more competitive market conditions, with particular attention being given to more granular 'Schedule B' (which acts as a sublimit at various stages of the project's build-up), along with more focus on MWS scopes of work.

The Outlook For Offshore Construction

Just as offshore construction activity was starting to pick-up pace, and return to a class of business where insurers could look to new projects to bolster their operational premium income, the current oil price crises (caused in part by a COVID-19 driven slump in global demand and partly by OPEC+ and US shale driven production surpluses) has again seen a shelving of the majority of planned construction activity.

What impact this lack of activity, and the associated premium, will have on this insurance sub-sector is to be seen. Will insurers maintain discipline on the few projects that reach final investment decision (FID), or will they once again look to compete with each other on price and conditions for the few projects available?

Marsh JLT Specialty's Offshore Construction Team

Whatever the future outcome is, and however the insurance market reacts, companies looking to undertake offshore construction projects require specialist advice to ensure that coverage is designed to meet the needs of the project and that the programme is structured in a way that delivers the expected coverage at the most competitive premium rate. Marsh JLT Specialty has a team of offshore construction specialists who work with clients to design an place insurance and risk transfer solutions to meet the needs of the project. For information on Marsh JLT Specialty's capabilities, expertise and experience in offshore construction please contact your Marsh JLT Specialty Account Executive.

INTRODUCING MARSH JLT SPECIALTY

We are specialists who are committed to delivering consulting, placement, account management and claims solutions to clients who require specialist advice and support. We consider problems from every angle and challenge the status quo with entrepreneurial ideas and solutions.

With unparalleled breadth, our Marsh JLT Specialty global team is united by a determination to bring the most experienced and relevant specialist resources to our clients, regardless of where in the world they are located. This approach means our local specialists work seamlessly with global experts, together creating and delivering tailor-made risk and insurance solutions which address each client's unique challenges.

Our service offering is enhanced with insight-driven advice supported by tailored data, analytic and consultancy capabilities to support clients in making important decisions about their complex risks.

Exceptional service combined with transparency, integrity, and accessibility underpins our partnerships with clients.

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