

Energy Market Monitor

First Quarter | February 2010

More choices, more options for energy insurance buyers

The energy market is starting 2010 on a strong footing.

2009 proved to be a turning point in many areas and after six months of the market fighting against it, a clear softening trend appeared in the second half with a particular emphasis in the 4th Quarter. As ever, there are differences between the upstream and the downstream markets and indeed the property and casualty markets specializing in energy risks nevertheless, we see distinctive softening trends in most areas.

What has been significant in 2009 has also been the much reduced loss activity. Of course, there have been some well publicized offshore claims (in particular the Ekofisk collision and the South Timor Sea explosion) but overall claims volumes are low. The benign North Atlantic wind storm season will have ensured that upstream underwriters managed an overall profitable book last year.

The downstream market has on the other hand probably enjoyed one of its most benign years with very few incidents (with none reported to date) of market significance.

We understand that the reinsurance treaty renewals which were put in place for January

1st 2010 reflect this positive environment. Capacity was plentiful and prices eased although modestly.

The step change in the latter part of 2009 has been the significant increase in capacity available - despite the fact that no new significant players emerged during that period.

For all classes within the energy space, we believe capacity is now at its highest since September 11th 2001. Carriers that want to deploy capacity are offering larger lines and thus creating a significantly competitive environment.

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Continued low activity and depressed price environment

The economic climate coupled with a depressed commodity price environment has led to weak demand.

Fewer new projects are started, less construction insurance is procured and lower commodity prices lead to reduced values to be insured. This environment has caused buyers to focus on value. While they can appreciate the market's need to recoup past losses, the reality is that they are under immense pressure to reduce cost and insurance programs are being evaluated from a 'need to have' perspective as opposed to a 'nice to have' perspective.

Offshore Gulf of Mexico wind

For the upcoming quarter, this class will once again be the single largest driver of overall premium volume for the energy market. Gulf wind will also be a key factor in whether or not insurers will make a profit or loss in any given year. It is now clear that while the market wrote 30-40% less in 2009, what was written was pure profit. Underwriters now realize that last year's product offering drove some very viable buyers out of the market along with a handful of risks that the market had had a real challenge to cover on an ongoing basis. The 2009 renewal season showed little differentiation of risk quality in a search for a quick return to profitability.

We believe that the market agrees with us that the 2010 renewal season may be the one realistic chance to bring some of these past buyers back into the market. This will take increased flexibility, differentiation and some easing of terms, including premium relief. We see a handful of leaders stepping up to the plate and answering the challenge while others are taking more of a wait and see approach.

Specifically for clients with deepwater assets, we expect to see significant improvement in pricing and coverage terms.

Upstream

The market has focused on the number of significant losses which occurred in 2009 and some contend that - regardless of the absence of hurricane losses - the upstream book is disappointing. The reality is that the overall upstream book has been profitable, capacity is strong and competition has returned to the upstream market.

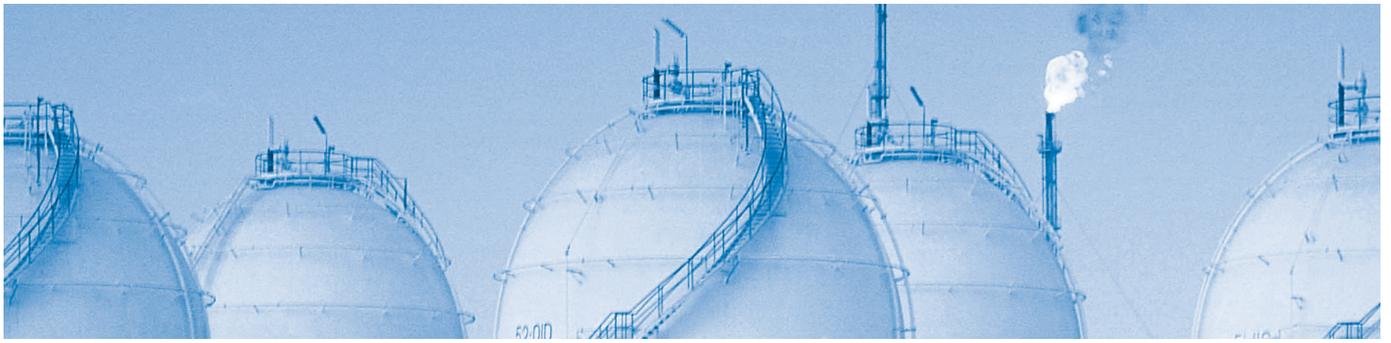
The sheer size of the capacity availability (in excess of US\$3 billion) means that most accounts have plenty of market options and more competitive terms can be obtained from new markets or the existing leaders.

Downstream

The downstream market face similar pressure and the prediction for 2010 is one of price reductions and increased competition. A lack of major incidents coupled with a reduction in insured values and limits, overall strong discipline on deductibles and coverage, and massive amounts of capacity have created a cocktail where we have already witnessed a strong return to competition.

The pressure on margin for energy clients has meant that many have bought or are planning to buy smaller limits. When coupled with a more aggressive use of capacity by nearly all onshore markets, this has pushed the offer and demand equation very much in favor of the assured.

The major question for the next few months and probably for the rest of the year will be — 'Will the discipline on deductible and coverage in place for the last eight years be maintained or will the desire to maintain premium volume cause underwriters to compete with reduced retentions as well?'



Construction

The market is hopeful that their clients will have more projects approved and go ahead in 2010 which will provide the volume that insurers desperately missed in 2009. An increase in activity will undoubtedly lead to more competition as capacity continues to exceed what is needed except for a handful of mega projects.

US Casualty

Major primary and excess casualty insurers generally continue to offer reductions in order to keep business. Competition is generally necessary to optimize savings as some carriers are more competitive on new business. Aegis and EIM are looking for increases but have largely exited the oil and gas sector over the past year to focus on their core utility clients.

Primary casualty insurers continue to scrutinize the security of the financial institutions that provide letters of credit to insureds and most carriers remain relatively inflexible on collateral.

In the excess casualty arena, there is little change in the availability of options for the lead layers but new markets in Bermuda are actively competing on all energy business and will in some cases offer lower attachment points than incumbent excess markets. Meaningful reductions can be achieved with restructuring of programs. Global capacity for excess liability remains above US\$1.3 billion.

International Casualty

The International Liability markets had an uneventful year in 2009 with stable pricing, little internal competition and mostly flat results for many insureds. The expectation for 2010 is that market forces will push for more competition and create opportunities to restructure existing programs and start a downward trend for pricing.

Conclusion

The basic laws of supply and demand are now in control. Underwriters may talk up the need for discipline but the facts are that the buyers are not buying unless they see real value. We are already experiencing clear softening of most energy classes, including non-natural catastrophe exposed property, casualty, well control, etc. and the upstream renewal season is shaping up to generate rate relief in this area as well. Underwriters are now focusing on preservation of market share. Most have budgets to protect and have capacity to deploy on those risks they view as preferred and will aggressively fight to maintain or expand their position.

This spells good news for insureds who should be able to get more value for their premium dollars in 2010 and will likely also look to trade a portion of potential rate reductions for concession in coverage terms and perhaps also long term policies.

The Energy Market Monitor is a quarterly publication from Marsh's Global Energy Practice. If you require additional data on specific trends within each individual class of the energy market, please contact your local Marsh Energy Practice.



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