

LLOYD'S PMD RING-FENCES ENERGY LIABILITIES

BUT A MIXED MARKET REACTION, TO SAY THE LEAST...

In an unprecedented letter to Lloyd's syndicates dated July 29, 2011 Tom Bolt, the Director of Performance Management at Lloyd's, has informed all active underwriters that all Energy Liability business written at Lloyd's is to be underwritten on a 'stand alone' basis (rather than as part of a package policy with other risks such as Property) if they are to receive approval for their business plans in 2012. In essence, this primarily affects upstream risks, as the vast majority of downstream liability programmes are already placed on a stand-alone basis.

Furthermore the Performance Management Directorate (PMD) has simultaneously issued the Energy Liability Plan Approval Requirements and Best Practice 2012, a document that lists a number of 'Best Practices' that will be 'taken into account' when approving Syndicate Business Plans. In our opinion, this will effectively make their adoption mandatory if a Syndicate's Business Plan is to be adopted.

- **Pollution:** All offshore pollution business, including the Seepage and Pollution element in Operators Extra Expense (OEE) risks, Offshore Voluntary Pollution Liability Agreement (OPOL) risks and Oil Pollution Act/Certificates of Financial Responsibility (OPA/COFRs), is to be written into the liability policy/account.
- **Sudden and Accidental Pollution:** Pollution cover is to be written on a sudden and accidental (time element) basis and not on a gradual basis.
- **Contingent OEE for drilling contractors:** Syndicates should not write contractors contingent OEE in the liability policies and should instead address contingent OEE requests in the OEE portfolio.
- **Removal of Wreck/Debris:** Syndicates should not write 'First Party' Removal of Wreck/Debris in the liability policy unless coverage provided for removal of wreck is limited to legal liability at law. Where statutory removal of first party property is given, consideration of this exposure should be accounted for in the pricing methodology and included in aggregations arising out of catastrophe events.



The Willis Energy Market Review (EMR) newsletter is a monthly publication that provides its readers with a round-up of news affecting the energy insurance arena.

The newsletter should be treated as a supplement to the Willis Energy Market Review, which is published in April each year.

Where information has been obtained from external sources, this is indicated at the end of each item.

This newsletter is published for the benefit of clients and prospective clients of Willis. It is intended to highlight general issues relating to the subject matter which may be of interest and does not necessarily deal with every important subject nor cover every aspect of the subjects contained herein. If you intend to take any action or make any decision on the basis of the content of this bulletin, you should first seek specific professional advice and verify its content. Copyright Willis 2011. All rights reserved.

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- **Limits:** Syndicates should write 100% limits scaled for interests, subject to a joint venture clause. Policies should have an overall each accident, and in the annual aggregate, limit for the coverages provided, and all policies should be written on a CSL (combined single limit) basis for all Insureds, Named Insureds and Additional Insureds combined.
- **Legal Costs:** Limits should be inclusive of legal costs.

(The document also outlines other Best Practices relating to Policy Wordings, Reinsurance, Pricing Methodologies, Aggregation Management, Limit Profile and 'Clash' Stress Test.)

What does this mean for buyers?

Traditionally, offshore liabilities have generally been written within a package format; under this proposal, this will no longer be possible for programmes that include Lloyd's security. From an OEE perspective, all exposures (including Control of Well, Re-drilling Expenses and Seepage and Pollution) are currently captured under one OEE policy form, the EED/8/86. The changes suggest that seepage and pollution from wells (generally covered under Section C of the EED 8/86) will need to be separately insured. However, there is potentially a 'grey area' in that Section C covers first party clean up as well as third party liability. We therefore believe that this aspect in particular will be strongly resisted by our clients and indeed by many insurers.

A bolt from the blue?

Perhaps we should not be surprised that the upstream liability portfolio – and in particular seepage and pollution from wells - is back in the Lloyd's underwriting spotlight. In our 2011 Energy Market Review published last April we highlighted:

- How the upstream market remained cushioned from well pollution risks by the rest of the upstream portfolio
- How historical data had provided insurers with a false sense of security on this issue
- How well pollution risks were not given a specific focus by the market, with ambiguities in the coverage provided continuing to persist

- That there was now going to be an increasing reliance on specialist liability underwriters to provide terms which, until now, the major upstream underwriters were happy to price and indeed 'take a view on' themselves

From our perspective, this latest development is clearly an attempt by the PMD to deal once and for all with the vexed question of upstream Energy Liability risks by isolating them from the remainder of the upstream portfolio and ensuring that they are underwritten and rated by specialist liability underwriters.

Market Reaction

We understand that there may be some insurers who do not feel that they have been properly consulted and who do not agree with some of these changes. In particular while there appears to be some degree of comfort within the market for the separation of the liability portfolio, this does not appear to extend to the extraction of seepage and pollution from the OEE portfolio. Furthermore, it seems clear to us that the real customers here, the clients of Lloyd's, also do not appear to have been consulted.

A reasonable step?

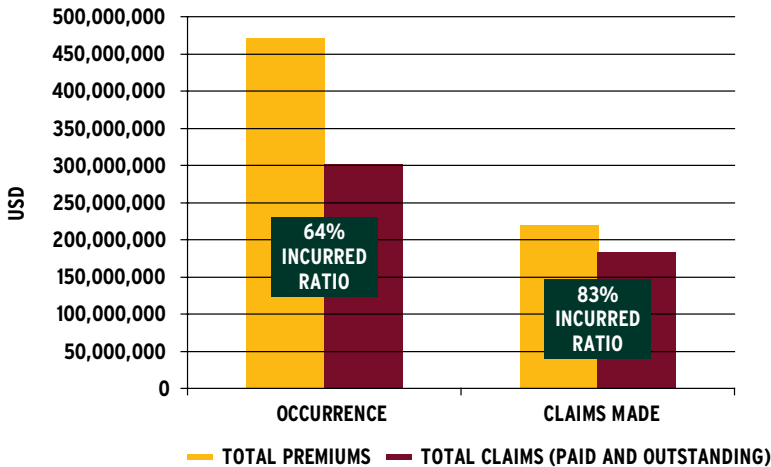
But is this a reasonable step for the PMD to take? After all, it could be argued that it is only logical for Lloyd's upstream liability risks to be treated separately and rated by specialist underwriters, as indeed has been the norm for downstream liability risks for many years. Furthermore, while there has still been no fresh legislation passed by Congress following the Macondo tragedy last year, it is clear that the risks involved in underwriting these exposures can only increase in the years ahead. Furthermore, the PMD can point to a Lloyd's market share of between 50 - 60% of the global upstream portfolio – a position which, on the face of it, suggests that the PMD do indeed have the leverage to bring about such a change in the upstream market.

Has Lloyd's lost money on these classes in the past?

But just how costly has this portfolio been to Lloyd's underwriters in the past? A quick glance at Lloyd's own figures for offshore liability over the last ten years suggests an overall incurred ratio of 64% for Audit Code EH (Occurrence Liabilities) and of 83% for Audit Code EG (Claims Made Liabilities).



LLOYD'S OFFSHORE LIABILITY PREMIUM/CLAIMS RECORD, 2001 - 2010



Source: Lloyd's Triangulations as at Q1 2011

From our perspective, although these figures are somewhat of a blunt instrument and do not in themselves give an entirely accurate portrayal of the overall profitability of this class, they do not suggest that such a drastic intervention by the PMD is really required. Of course, these figures do not include Seepage and Pollution (S&P) from wells, which currently forms part of the EW (OEE) Audit Code but for which separate figures are not available.

Our own view – wait and see...

We anticipate that, given the feedback that we have had to date from the Lloyd's upstream market, there may be some pressure on the PMD to amend some of their proposals. In the meantime, Willis will continue to keep our clients advised as this important development unfolds.

DAVID CLARKE RELOCATES TO LONDON

We are pleased to announce that Willis Energy liability expert David Clarke has re-located to our London office from New York, effective August 1. David now acts as Willis Energy's liability advocate in London. His role is to maintain communication with clients and Willis Global Energy offices and other Willis local offices at all stages of the quotation and placement process on Liability and related business, and to use his knowledge of the underwriting market to obtain appropriate insurance cover for clients at an optimum price.

David started his insurance career in 1983 in the liability/casualty section of the Marine and Energy division of Marsh and McLennan in New York. By 1990 he had been promoted to vice president responsible for the casualty placements on several Fortune 500 energy companies.

In 1991, David joined Willis Corroon as one of the original employees in its U.S. Energy unit. His work with major

energy clients includes several areas of specialisation: primary and excess casualty, marine liabilities and pollution risks. His combination of casualty and marine liability expertise and his in-depth knowledge of, and relationship with, markets in Europe, Bermuda, the U.K., and the U.S. has proved invaluable to our clients on many occasions.

In 2003, in addition to his work with our clients, David was appointed Risk Manager for Willis North America, responsible to our offices in the U.S., Canada, Bermuda and the Caymans, reporting to the Group Risk Manager in London. In October 2008, after assisting with risk management duties during the due diligence process for Willis's acquisition of HRH in the United States, he stepped down from the position and continued his focus on his clients' insurance placements. David then took on additional Client Advocate responsibilities within Willis Global Energy.

