Allianz Global Corporate & Specialty

Quality Matters

Evaluating the quality of insurance carriers in the oil and gas sector

Allianz

Foreword

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AGCS Global Energy Head
Paul O'Neill is a chemical engineer who began his career in the energy industry before moving into the insurance sector. With 20+ years' experience in risk engineering and underwriting, he leads the AGCS global onshore and offshore energy division.

The oil and gas industry faces a challenging future where both energy companies and their insurance partners will have to adapt in order to benefit from new opportunities and a changing landscape. In recent years, global demand, changing relationships and technological advances have turned previously inaccessible resources into lucrative opportunities.

However, with opportunity comes risk. An uncertain global economy paired with volatile oil prices make long-term projects unpredictable. The risks involved for the companies exploring these new opportunities, combined with those risks inherent in an industry constantly facing economic, political and environmental factors, increase the potential for losses. The subsequent financial, strategic and reputational consequences for the companies involved can be significant.

As a result, it is critical for oil and gas companies to focus on the quality, as well as the price, of their insurance cover. The following pages explore why, in the current environment, the quality of the product matters more than ever and discuss the key measures we believe a company can employ in seeking out and evaluating a long-term insurance partner.

Paul O'Neill
Global Energy Head

Executive Summary

Recent catastrophes and evolving trends are impacting both large and mid-sized oil and gas companies as they look to protect their assets and capitalize on the opportunities that lie ahead.

Trends in risk

- A shift in power from the international oil companies (IOCs) to national oil companies (NOCs) is causing IOCs to forge new relationships and explore untapped resources in remote locations.
- An aging workforce and new technology are heightening competition for skilled workers.
- Increasing political instability in some energy-producing regions is being felt on a global basis and prompting oil and gas companies to find new and better ways to measure and manage geopolitical risk.
- Experts predict that climate change stands to increase natural catastrophe losses over the next decade. As new projects emerge, accumulation of assets in exposed regions will require careful modeling.
- Incidents such as the Deepwater Horizon disaster, coupled with greenhouse gas concerns and political uncertainty, are putting pressure from both regulators and consumers on oil and gas companies. Compliance with legal and regulatory requirements is an ongoing challenge.

Consequently, we believe evaluating the quality of an organization's partners, especially their insurance partners, is more important than ever.

Key criteria for evaluating the quality of an energy insurance partner

- Commitment to the oil and gas industry – track record, reputation, consistency, capacity and investment in the energy sector
- Financial strength – solvency ratio, market capitalization, credit rating, diversified portfolio, quality reinsurer relationships and a willingness to pay
- Quality of solutions – creative approach, experienced energy underwriters, risk engineering and claim professionals and a full range of products and services
- Global presence and resources – hubs in energy-intensive regions and the capacity and capability to issue policies and handle claims wherever a client is operating
- Customer-centric business model – focus on long-term relationships, key account teams with a single access point, centralized claims handling and risk control

"Shrinking reserves, shifting relationships, political constraints, uncertain energy policy, global climate change and an aging workforce are posing evolving risk-related challenges." **Pete Connors**

The age of easy energy is over

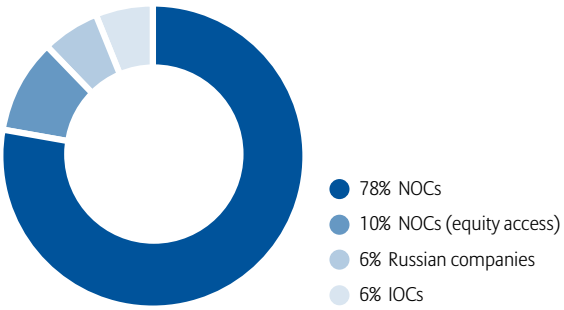
Pete Connors
AGCS Global Energy Head, Offshore
Pete Connors comes from a broad industry and risk engineering background. He has 25 years of experience in the energy business, including 15 years with American International Group. He currently oversees AGCS offshore business worldwide.

Power shift

Despite the global recession, demand for energy continues to rise. Heightened competition for resources combined with the fact that national oil companies (NOCs) control 88 percent of reserves today[1], compared to 15 percent in the early 1960s, is resulting in fundamental changes in the way business is done.

Historically, NOCs have provided access to reserves and relied on international oil companies (IOCs) for expertise, project management and carrying out the bulk of the work. The shift in control of reserves is making NOCs increasingly confident in their abilities to build internal capabilities or source financial, human and technical resources directly. As a result, IOCs are rethinking their strategies. In addition to exploring new, untapped areas, they will be under increasing pressure to create joint ventures with national oil companies and forge relationships with the governments that own them.

Control of Resources



[1] US Energy Information Administration

Demanding environments and advancing technology

Access to resources at a reasonable cost is a key challenge. Political constraints and competition for proven resources are forcing energy companies to explore harsh environments, such as the Canadian oil sands, the Arctic and deep water. In these environments, exploration and production costs are high and transportation to market may be difficult. Both increase the risk of new investments.

Improved seismic mapping and significant technological advances such as ultra-deep/extended reach drilling and gas-to-liquid/floating LNG technologies are making recovery of these resources possible. Advances in horizontal drilling technology make significant shale gas formations newly accessible for development. It is an environment of increasing risk, not only in the context of offshore events like the Deepwater Horizon disaster but also by the exposures consistent with the use of new technologies. For the energy and insurance industries alike, understanding and mitigating these risks is paramount.

Competition for talent

An aging global population and challenging technology are creating a shortage of skilled labor. Shortages are most evident in highly technical areas such as geology, geophysics and petroleum engineering and the more complex information technologies. However, both national and independent oil and gas companies are also facing difficulties in attracting enough young people with the skill and experience to carry out operational and project work. Since human error is still one of the main causes of losses, this poses a risk to both companies and their insurers.

"Without doubt the energy environment represents a challenging future in which both quality energy companies and insurance partners will recognize opportunities." **Tracey Hunt**

Tracey Hunt
AGCS Head of Underwriting Growth Markets, Energy
Tracey Hunt has a diverse background in claims, client management and program design. She has 18 years of experience in the insurance industry and has worked for an international energy broker as well as a risk management consultancy to the oil and gas industry.

Climate change

Earthquakes in Japan and New Zealand and flooding and fires in the US made 2011 the costliest year on record in terms of property damage. 2012 was also an above-average year for natural catastrophe losses. In the US, it was the second-highest year on record for natural catastrophe insured losses.[2]

Climate change stands to increase insured losses from extreme events in an average year by 37 percent within just a decade.[3] Urbanization, coastal/flood plain development and higher values/concentrations of exposures will increase overall loss potential. In light of the globalization of business, natural catastrophes have the potential to disrupt supply chains and production resulting in business interruption on a global scale. As new projects emerge, assets in natural catastrophe exposed regions will require careful modeling. Proper risk management prior to an event and preparation for a possible natural disaster will be more critical than ever in reducing the impact.

Increasing legal/regulatory risks and compliance

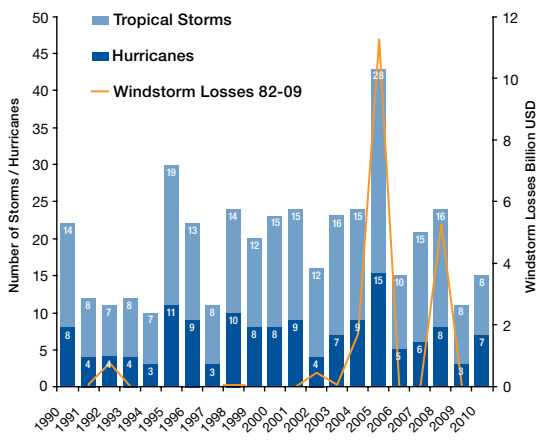
Climate change is also resulting in new litigation and regulatory risks for companies and their insurers, ranging from ongoing litigation against carbon-intensive companies to evolving greenhouse gas regulations. With increasing regulatory pressure, oil and gas companies cannot afford to be noncompliant. In addition to the challenge of compliance, companies run the risk of damage to their brand if they are associated with environmental incidents.

Growing geopolitical risk

Nationalization of resources, increasing instability in some of the largest energy-producing countries and geopolitical influences on market and price are forcing companies to reassess their risk management strategies. Even companies without a physical presence in troubled regions may be subject to the fallout. As a result, energy companies and insurers are looking for better ways to model, measure, manage and potentially mitigate geopolitical risk.

Political uncertainty, litigation, unstable tax regimes, political instability and constantly evolving regulations governing business, accounting and financial practices have implications for both the oil and gas and insurance industries.

Energy Exposures



Source: NOAA and Willis database

[2] Mark E. Ruquet, 2012 Turns Out to Be Above-Average Year for Nat Cat Losses, www. propertycasualty360.com (Jan. 3, 2013)

[3] Angela Macdonald-Smith, Climate Change to Boost Insured Losses, Allianz Says, www.bloomberg.com (Sept. 18, 2007)

"While financial strength can demonstrate an ability to pay, an insurer's 'willingness to pay' is critical." **Steve Hanley**

The role of insurance

Insurance has been and continues to be an efficient tool for transferring risk, mitigating loss and protecting the earning power of oil and gas company assets.

Steve Hanley
AGCS Head of Global Energy Claims
Steve Hanley has led AGCS Energy Claims since 2008. He has worked as a consultant to the oil industry and spent more than 30 years on the insurer side, including Lloyds. He is a qualified mediator whose experience involves all aspects of the energy market, both offshore and onshore, as well as marine and associated liabilities.

Recent events demonstrate that the potential for loss cannot afford to be underestimated. Globalization, increasingly complex relationships, uncertain economics and emerging operational risks pose new threats to corporate balance sheets. Utilized correctly, insurance can be a cost-effective way to replace capital, protect cash flow, facilitate financing and maintain investor confidence.

The fundamental provision of a diversified pool enables this efficiency. In comparison to banks, there is strong evidence that with a suitable portfolio insurers do not pose a systemic risk. US insurers have higher capital requirements than banks. For example, the National Association of Insurance Commissioners sets the minimum amount of capital appropriate in consideration of the insurance carrier's size and risk profile.

Energy Losses 2012

DOL	Cause	Type	Location	Losses Est USD (50+ m)
DOWNSTREAM				
21st Jan	Fire/Explosion	PetroChem	Germany	65,000,000
31st March	Fire/Explosion	PetroChem	Germany	435,000,000
5th May	Fire/Explosion	PetroChem	Thailand	296,000,000
15th May	Fire/Explosion	Gas Plant	Arkansas USA	150,000,000
4th July	Fire	Refinery	Thailand	140,000,000
31st July	Fire	PetroChem	Kuwait	118,700,000
2nd Aug	Fire/Explosion	Refinery	Oklahoma USA	65,000,000
25th Aug	Fire/Explosion	Refinery	Venezuela	320,000,000
8th Oct	Fire/Explosion	PetroChem	Germany	173,200,000
25th Oct	Supply Interruption	PetroChem	Brazil	198,000,000
29th Oct	Storm	Terminal	New Jersey USA	126,500,000
14th Nov	Fire	Chemical	Alabama USA	60,000,000
Total To Date				**2,147,400,000**
UPSTREAM				
16th Jan	Blowout	Rig	Nigeria	452,000,000
15th Feb	Blowout	Well	Alaska	60,000,000
4th Feb	PD/S&P	Pipeline	Venezuela	65,300,000
9th Feb	Design	Semisub	Brazil	54,498,000
25th March	Blowout	Well	North Sea	400,000,000
20th March	Blowout	Well	Nigeria	200,000,000
9th March	Blowout	Well	BC Canada	54,850,000
7th June	S&P	Pipeline	Alberta Canada	60,000,000
Total To Date				**1,346,648,000**

All information from Willis DataBase 18th March 2013.

Quality matters

Oil and gas is highly complex. In no other industry is a top-quality insurance partner more critical.

Capitalizing on the opportunities that lie ahead in the oil and gas industry will be contingent upon having the foresight, imagination, capabilities, financial wherewithal and high-quality partnerships to succeed. The quality of your insurance partners is no exception.

So how can the quality of an insurer be quantified? We suggest five key measures that provide a sound starting point:

- Commitment to the oil and gas industry
- Strength of the capital offering
- Quality of solutions
- Global presence/resources
- Customer focus

Commitment to the oil and gas industry

Looking at an insurance company's track record is a good first step in determining depth of commitment. The number of years a company has been writing energy business and their ability to provide a consistent market over time can help separate long-term players from short-term opportunists. Client relationships and reputation among peers, brokers and reinsurers are also prime indicators. A company should also have a proven track record in working with organizations similar to your operation.

Capacity and the ability to deploy it on a global scale are also important. Capacity translates to confidence in the business as does a carrier's willingness to be at the forefront of a program. Market share is key. Insurers need to have a minimum "market share" of five to ten percent to survive in the business. A top-quality insurer should be expanding, rather than contracting, their networks and capabilities. Serious energy players strive to be market leaders. This provides them with greater flexibility when it comes to pricing, terms, conditions and policy changes.

Committed oil and gas insurers have a significant investment in the sector in terms of capital, resources, talent and training and development. Explore what the company is doing in terms of enhancing technological expertise, loss/damage analysis and loss prevention to assist clients in benchmarking their operations with the best available practices.

Ongoing investment in human capital is critical. Look at what processes are utilized to recruit proven talent and attract skilled and educated young people to the organization. Determine if the insurer has formal training and development programs in place to ensure their people are equipped with the most up-to-date skills, competencies and functional/technical knowledge.

David Robertson
AGCS Global Head of Energy Risk Consulting
David Robertson holds an HPR certification and has many years of experience in working in risk engineering and corporate research on oil, gas and chemical loss prevention. He is a specialist in onshore and offshore oil and gas, pipelines, refining, petrochemicals and chemicals.

Strength of the capital offering

Financial strength is obviously an important consideration in choosing an insurance partner. The high-quality insurance partner recognizes that exposure to loss is inevitable in the energy industry and that they must have the ability to absorb major losses. The company's balance sheet provides a number of key indicators on financial health, including:

- Solvency ratio - A strong solvency ratio provides a measure of how financially sound an insurer is and their capability to pay.
- Market capitalization - Market capitalization is a good gauge of company size and public opinion on the company's value.
- Credit rating - A strong credit rating (e.g., A.M. Best and Standard & Poor's) provides a third party perspective and takes into account the creditworthiness of the company.

Beyond the balance sheet, control of risk is integral to an insurance company's deployment of capital. The quality insurance company has a diversified portfolio in terms of both geography and line of business. This is a good indicator of balance and sustainability. The insurer should have relations with quality reinsurers; however, they should not be overly reliant on reinsurance.

Increasing regulations require companies to be mindful of compliance. For example, Solvency II is a European regulation. Its primary objective is to strengthen policyholder protection by aligning capital requirements with the insurer's risk profile. A quality company will ensure that their internal models are approved by regulators to ensure they do not have significant increases in capital requirements.

In judging an insurer's financial strength, these variables should be looked at on a collective, rather than individual, basis. Most importantly, while financial strength can demonstrate an ability to pay, an insurer's "willingness to pay" is critical.

Quality of solutions

Quality solutions require a creative approach to risk and products and services that can be tailored to the individual needs of the client. Quality insurers recognize that the right risk solutions demand partnership and a mutual exchange, not a monologue.

Solutions are only as good as the people behind them. Determine upfront who will be working on the company's account and how the organizations will work together. Ideally, an account team includes specialists from underwriting, risk engineering and claims who work collaboratively and are recognized as leads or co-leads in the marketplace. Open-minded underwriters with decision-making authority, risk engineers with experience on both sides of the desk and seasoned claims professionals add value to the equation. Knowledge of and insight into a client's business and a willingness to share best practices are key differentiators that will become apparent quickly in initial face-to-face meetings.

Top-quality insurers have an in-depth understanding of what the main drivers behind potential losses are and display the desire, creativity and flexibility to proactively address changing needs and mitigate risk. They provide a full range of value-added products and services for downstream, midstream and upstream clients. For global clients, the ability to provide program consistency on a worldwide basis with a global master policy, over and above local policies, is important. The initial risk assessment can provide good insight into the insurer's thinking.

"The quality insurance partner understands that exposure to loss is an inevitable consequence in the energy industry and what the main drivers behind the potential losses are." **David Robertson**

Global presence and resources

Oil and gas is a global business. As a result, a client does not have to be a large international oil and gas company to reap the benefits of a quality insurance partner with a global perspective and hands-on experience with the intricacies of the business on a worldwide basis.

All major and many independent oil companies have assets globally that may require insurance protection. National oil companies expanding into international areas also have risk transfer needs. Assets with mortgage protection requirements may necessitate a global capability for new assets being built and operated in foreign countries. These clients need an insurer that is everywhere they are or want to be.

Choosing the right global partner requires careful due diligence. Some insurers position themselves as global, but, in reality, function as regional insurers issuing local policies to their local customers. It may be useful to do more research on the insurer's global capabilities and have a close dialogue with your broker and peers. Ask if the insurer has other clients in these countries and if they are capable of issuing local policies. If they are not familiar with the areas, it should raise a red flag about their ability to issue local policies.

"A true global insurer has the capacity and capabilities to issue policies wherever the customer is operating, not just in a few countries." **Paul O'Neill**

The quality insurance partner has a global presence with hubs in regions where energy business is concentrated. They offer clients access to professionals who know the territory, understand the culture and local language, and have a firm grasp of regional regulations and compliance issues. For example, some countries, such as Brazil, require that a certain percentage of an insurance policy be written with a local company to operate in the country. It is critical for an insurer to fully understand the risk environment in which operations are conducted and have a grasp of the climate on the ground.

Quality, efficient claims handling is extremely important to clients operating on foreign soil. Ask how claims are handled and be guided by the answers as to whether the insurer really has global capabilities.

"The top-quality insurance partner is committed to delivering value to customers by providing a consistent business model and structure built around how customers do business." **Steffen Halscheidt**

Steffen Halscheidt
AGCS Global Energy Head, Onshore
Steffen Halscheidt is a certified civil engineer with a wealth of experience on both the client and insurer sides of the business. He joined Allianz in 1995 and currently oversees AGCS onshore business on a global basis.

Customer focus

One characteristic quality insurers share is a focus on the customer. So how can customer focus be measured and evaluated? There are several indicators.

- Customer service as a core value. Customer-focused insurers are committed to listening to clients' needs and acting on them. Client attitudes and feedback are considered vital tools in monitoring customer satisfaction and ensuring ongoing improvement in products, services and processes. The quality insurance partner has metrics and processes in place to measure and improve customer satisfaction.
- A consistent, customer-centric business model. The quality insurance partner is committed to delivering value to customers by providing a consistent business model and structure built around how customers do business. Efficient and effective global core processes that accommodate local differences are crucial to delivering tailor-made solutions. Determine if the insurer operates on a global platform or a traditional geographic platform. A global platform ensures the same level of expertise, intelligence and service regardless of where operations are located.
- Focus on long-term relationships. In a fast-paced, constantly evolving industry like oil and gas, a long-term partnership with a quality insurer can provide consistency, foster understanding and mitigate the potential impact of cycle swings. So it is important to determine upfront if a prospective insurer is looking to meet a quota this year or viewing your operation in terms of the long haul. A top-quality insurance partner is interested in long-term relationships built on honesty, integrity and a full understanding of the client's business. Transparency that goes both ways is critical. An insurance carrier should clearly communicate information on processes, terms and conditions, and pricing and other financial information. Clients need to provide quality information about the projects they are involved in, the inherent risks that have been identified, and the controls that have been put in place to mitigate them. Openly sharing information helps eliminate surprises.
- Single point of access and key account teams. Making it as simple as possible to access people and resources is fundamental to a successful partnership. The quality insurance partner takes a holistic view of the client's businesses and provides single-point access to a dedicated team comprised of cross-departmental representatives from underwriting and operations to risk engineering and claims. The true test of an insurer's effectiveness comes in its deployment in practice. Know and meet the people you are going to be working with early in the process.
- Centralized and coordinated claims handling and risk control. Too often, when discussing insurance, the focus often falls on the coverage and not what could happen if a claim arises. However, claims are a critical time. If not managed correctly, they can have detrimental effects on the business. Effective partnership and understanding of a risk in advance have a positive impact when claims do arise. Talk to the insurer about how claims are managed. Centrally managed risk consulting and claims monitoring/coordination with local risk control and claims handling when needed enable clients to get the same high-quality service in Bangor as they do in Bangladesh. Determine what happens in the event of a claim, including who you will be dealing with and what processes are in place to ensure you stay in business (e.g., is the insurer willing to work with you to develop contingency plans to ensure that the financial loss remains low). These are issues a quality insurance partner addresses upfront. Bear in mind that all insurance is a promise. A high-quality insurance partner puts value in that promise.

Conclusion

The insurance industry has a long history of working with business to understand and adapt to emerging risks. From climate change, technological advances and geopolitical risk to changing economic, regulatory and legislative environments, insurers can be valuable allies in helping oil and gas companies navigate the road that lies ahead. That is why now, more than ever, the quality of your insurance partner does matter.

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