A question of selection both in risk and M&A

In thesecond of our three roundtables for HMIS 2015 we ask leading members of the market for their views on the state of the market and the recent M&A activity.

ON THE PANEL

Peter Sydenham Global Head of Marine Swiss Re (PS)

Richard Martin CEO, J H Blades & Co Matthews Daniel (RM)

James Summers Global Head of Marine & Energy Specialty Guy Carpenter (JS)

Joe McMahon Chief Executive Officer of Lloyd Warwick International (JM)

Richard Whelan Underwriting Manager Exploration and Production Liberty International Underwriters (RW)

Richard Pursey SVP & Global E&P Manager Liberty Specialty Markets (RP)

Q: The global E&P market has reported incidents in excess of $2 billion during the first two quarters of the year against a reduced income pool of $2.5 billion, how will the market react?

JS: We are in the interesting position of seeing two markets collide within which there are considerable pressures. The E & P industry itself is currently experiencing an undeniable squeeze in the rising cost of equipment, the price of oil, and an increased competition base. This squeeze has understandably driven them to focus on their costs at a time when over-capacity in the insurance market means prices are already falling. For the insurance players with the largest lines, with a regular deployment of USD 75m -100m and above, it will remain difficult to ignore the downwards pressure on rates if they wish to maintain premium levels, more than ever risk selection will be key in running a profitable account.

RP: The first 2 quarters of 2015 have reminded insurers how volatile the industry is. Over the last 4 years there have been just a few significant incidents and no Gulf windstorms since 2008. Significant returns within the sector have been made. However, we now find the industry midway through the year with a 'handful' {?] of casualties which will exceed the total E&P annual estimated premium within the industry. This current tally does not include the normal annual attritional reported incidents and we still have over 4 months left in the year.
Therefore it appears 2015 will be a year where losses vastly exceed the premium due to factors discussed earlier. With reserves depleting and a bleak outlook for both our operators and insurers, the reaction will most probably come from senior management who will be focusing on all non-performing product lines. Reinsurers will also have something to say, with a focus on insurers who wisely manage their portfolio.
It will take a while for the market to appreciate the issues ahead of us. It will not be 'pretty' waiting for improved market conditions, but those who are prepared to 'walk away' from non-profitable terms, conditions and pricing, and manage the cycle, will be the ones who will survive to take advantage of the improved opportunities ahead.

RM: It won't. There is too much capacity and rates will continue to fall

PS: There is no doubt that the E&P market needs to pay higher rates than it is currently doing but there is such an excess of capital available and willing to write this business it looks unlikely to happen at this stage. Possibly a major event with the (almost always) subsequent increase in reinsurance premium would impact the market and influence insurance pricing more than 2 billion of losses in 2015.

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JM: Whilst low in number, the market has been notified of several very high value claims in the E&P sector. The effects of this on the market are not yet known but due to what is seen as abundant capacity there are no signs that so far these losses are having any significant effect on the market. It will be dependent upon what happens in the coming months as to whether these major claims will in any way turn the market.

Q: How will continued M&A activity within the oil and gas industry affect the future of the insurance industry?

RW: With the overall number of Oil and Gas Operators having reduced significantly during the past 5 years, it is safe to say that M&A activity has been prevalent in the insurance industry. The commodity price falling so dramatically in such a short space of time has given 'cash rich' operators opportunities to acquire assets, or entire operations, from those companies who have fallen foul of the volatile nature of the product.

As we know in the insurance industry, when these acquisitions occur 1 plus 1 does not always equal 2. This can lead to not just inadequate premium for additional exposures, but arguably, and more importantly, inadequate retentions and wind limits.

There is also a concern over the smaller more ambitious operators increasing the size of their asset pool significantly over a short space of time. Do they have an experienced enough workforce to manage these new operations? Do they know the quality of assets they are buying or have they just focussed on the potential product output? It is these kinds of dilemmas on which underwriters need to focus when it comes to M&A activity. We need to be flexible in working with the broker and stay as close to the client as possible whilst sharing knowledge in order to provide the correct amount of coverage at an adequate price.

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RM: Less business to place more competition = prices down. Some start-ups emerging.

JS: With Oil & Gas companies, as with most companies, mergers and acquisitions means that one plus one does not equal two. Larger companies buying smaller companies means higher deductibles with less leveraging, the knock-on effect in the insurance world, especially when the market is on a downward turn, means that the premium pot shrinks. Post TransOcean we have seen that self-insured BP have weathered the storm, this does little to help the energy insurance sector as they seek to highlight the dangers of self-insurance. There is little doubt that as Energy entities become larger through M & A deals this trend will continue.

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Q: What currently drives our clients' purchasing behaviour - is it all about price?

JM: It is no secret that the energy market is seeing some significant premium reductions. The sudden and perhaps unexpected fall in the oil price means that many companies in the energy sector are seeking to make significant cuts in their insurance budgets. It is therefore apparent that price is perhaps the most dominant factor at the moment, although some Underwriters are now beginning to see requests for extensions of cover which is another characteristic of a softer market. The old adage that there is only three things which count price, price and price is probably as true as it has ever been.

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JS: In an over-capacitised market which is buying from an over capacitised market, it is natural for the client to focus on price as the driving factor, as a broker we would always counsel that price should be balanced with coverage and an understanding of the underlying book. Relationships with markets are paramount. There is a difference between what something costs and what something is worth.

PS: All clients want a price that that gives them value but very few clients make cost the only factor in their decision making when buying insurance or reinsurance. At Swiss Re we pride ourselves on offering a differentiated service product. Many clients appreciate this and will reward us for it.

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RM; They would say "no" but realistically "yes"

RP: Every day we pick up one of the many Oil and Gas journals and newspapers and continue to study the current plight of the E&P industry.

The huge reduction in the price of a barrel of oil has changed the outlook beyond imagination from only a year ago. Operators' profits have fallen up to 50% on many S&P 500 companies and stock prices are significantly down across the industry. Many independent operators who have leveraged on debt find themselves in even greater difficulty as falling revenues will be insufficient to pay their future debt. There certainly doesn't appear to be an outlook for exploration or significant construction projects within the next 12 months. The current excess of oil production, and the additional factor of the slowdown of emerging markets escalates the problems ahead.

There has been a focus and drive for pure premium reduction over the past year. This is also inflated by the vast over-capacity within our sector. Reduced premium spend appears to be the focus over any change in our product offering, or any ability to prove differentiation.

So we are currently looking at a commoditised product which will continue until insurers begin to review the value and need for a differentiated product. m&er

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