Weathering the fall

By Robin Waller Head of Energy

Pick up any paper or watch any TV news programme and the price of oil is a big story: not because it is so high, as we are accustomed to reading about – quite the opposite.

The peak of Brent crude, hitting almost $140 in 2008, seems a long time ago. Despite all the analysts seemingly caught by surprise, there is no shortage of predictions now, right down to an almost unthinkable $20 a barrel. In the past month or so we have seen the reaction of companies in the oil and gas sector, which certainly suggests their view is the depressed price is not going to move significantly upwards any time soon. They have been swift to cut costs; almost daily another headline reads of job losses or projects cancelled. The effects of all of this will ripple into the insurance market, raising a number of questions for underwriters and brokers alike.

With oil companies busy slashing costs, the most obvious consequence for insurers is the lack of values and assets to insure. Loss of production income figures and premium will be adjusted to reflect the oil price. The amount of exploration activity, already under pressure in the UK sector, is slowing down markedly globally. Construction activity looks very limited for the foreseeable future and companies seem to be announcing 20% to 30% of their original planned spend on all capital expenditure. Clients and risk managers in particular will be looking for savings to their premium cost.

Uplift costs

As the oil price falls, the varying uplift costs across the globe increasingly become a factor, which will influence the insurance market. At today's cost per barrel levels US shale gas production, which has markedly shaped market dynamics in recent years, becomes increasingly uneconomic. Similarly, production costs – particularly for regions outside the Middle East – require a significantly higher cost per barrel to incentivise increased production and exploration. While political measures to retain market share are likely to influence production levels in the short term, a return to a less diversified oil market where self-retention or placement in local markets is the norm will undoubtedly have an impact on global insurance markets.

The resulting effect on pricing and competition for a reducing pool of business could well lead to operating costs coming under increasing scrutiny. The question this ultimately poses for London, other developing hubs and for individual insurer and brokers is how they can differentiate themselves from their peers aside from price alone.

Innovation represents one avenue by which companies can introduce new criteria upon which they are assessed against their peers, to carve a niche and potentially enhance their reputations in an increasingly crowded sector. Traditionally much of the market is written on similar or identical wordings and present pressures could lead to reassessment and creativity in an effort to introduce new coverages, products or services. As a market, this is an opportunity for those that understand the business to tailor solutions for their clients, acknowledging the industry has changed extremely quickly.

Those of us in long-experienced teams will have seen similar themes in the insurance market and industry. However, if present conditions persist and even intensify, newer entrants may begin to reassess their positions and even look to deploy their capacity elsewhere. There is also the growing potential for knee-jerk reactions and less disciplined risk selection. Accordingly, perhaps now more than ever, experience and a long-term approach are vital if carriers are to weather the present conditions and retain market share.

In the past decade, the investment which companies and syndicates have made in actuarial personnel and expertise has had a significant benefit, allowing more informed, prudent risk selection. However, the present market pressures will test whether the pricing levels that have been established with the benefit of actuarial rigour will be maintained. Again, central to these decisions will be market experience, combined with broker relationships and client understanding.

Risk management

For clients and brokers, underwriters' thought process will be aimed at obvious concerns such as: with so many jobs being cut and budgets under pressure will risk management practices remain at industry-leading standards? Have the skilled, experienced and more expensive workers been let go? What is the impact on maintenance budgets?

Mature areas of the world have unique challenges such as ageing infrastructure, where experience and maintenance are critical. Contractors who had been living in a hyper-inflated market now find themselves suffering from a lack of contracts. As they stack idle fleets, there is less premium spend but increased accumulation risks. Any industry where equipment lies unused in a deflated market will have risks of moral hazard. What about the countries so dependent on oil to balance their budgets? What of threats of political violence and risk?

Like the price of oil, predicting the future of the insurance market is something of a fool's game; any number of events could cause rapid unpredicted change. However, it is hard to believe an already competitive market will find the next 12 months anything but challenging.

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