

Thinking ahead



Windstorm exposures require good broking and risk management

Since Hurricane Ike, underwriters have become very cautious about windstorm exposures in the Gulf of Mexico. According to **James Sage** now is the time for energy companies to enhance their risk management.

Hurricane Ike cost energy insurers between \$3.6 billion and \$4 billion. They also suffered some very large non-cat losses in 2008, only three years after the worst hurricane season of all, 2005 – when Katrina, Rita and Wilma devastated property in and around the Gulf.

Ike was more than just a big loss. The difference between Ike and the 2005 storms was the size of its footprint. Although Ike was only a category 2 storm, it caused a swathe of damage 250 miles wide, which threw out underwriters' modelling assumptions and accumulation calculations. Katrina and Rita were category 4 and 5 in the Gulf, and their footprint was significantly smaller. Ike showed that the loss potential from a category 2 storm could be as bad as for a severe hurricane.

It triggered a chain reaction. Retrocession, or reinsurance of reinsurance at the mega-cat levels, has almost disappeared. Reinsurance has become scarce or very, very expensive, to the extent that many insurers are running net, meaning they have little or no reinsurance, so they are significantly increasing their prices, reducing windstorm limits, raising retentions and restricting coverage.

Good risk management is the route to mitigation. Faced with coverage gaps or unacceptable insurance costs, the general economic climate and the substantial drop in the price of oil and gas, energy companies need to act. They should review their assets to identify which ones are essential to their cash flow and make insuring these assets their priority. Other options include taking a co-insurance or not insuring windstorm risks at all, as several assureds have already decided to do. To offset the increased financial exposure, greater investment in risk assessment and resilience may be necessary, as it would be in any industry in a similar situation.

Insurance outlook

The insurance market looks unlikely to change immediately because the claims history, reduced investment income and the need to conserve capital are creating

pressure for higher rates generally. And with early forecasts predicting 2009 hurricane activity to be above the long-term average, there is little new capacity charging over the hill. For us as brokers, this means using our skills to find the insurance products that give our clients the coverage they need at an acceptable price.

Although some energy companies have securitised catastrophe risks, the cost of the modelling that you need to make the coverage match the exposure is likely to outweigh the gains. Cat bonds are still expensive, and you cannot really be confident of collecting unless you come up with a very clever idea. It is not worth buying a cat in a box for a category 4 or 5 storm if another Ike is around the corner. **RS**

i James_Sage@jltgroup.com

James Sage is a Partner in the Marine, Oil & Gas Division at Jardine Lloyd Thompson.

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Jon Screech
+44 (0)20 7558 3316
Jon_Screech@jltgroup.com