

BP / Deepwater Horizon Drilling Platform Loss

How will the recent incident influence insurance prices going forward?

Insured losses from the Deepwater Horizon Drilling Platform explosion and subsequent oil leakage from the wellhead are still being calculated but with the leaking oil still to be controlled and stopped the final loss figure cannot be confirmed at this moment.

BP has said that it is unlikely to stop the flow of oil from the damaged well until August once they complete the drilling of relief wells. With the current clean up cost to BP around USD 1 billion a month, by August the clean up bill alone could be USD 3 billion.

The estimated total insured loss varies by quite a large amount for example Swiss Re estimated the loss to be approximately USD 3.5 billion whereas UBS say the final loss could be as much as USD 12 billion.

What has been confirmed is that this is now the worst oil spill in the USA's history. The Exxon Valdez in 1989 spilled 11 million gallons of oil into the surrounding waters. The most conservative estimate from this BP event is that the amount of oil spilled so far is 18 million gallons. US government scientists believe the actual amount is at least twice this figure. This will obviously increase if the flow of oil is not stopped until August.

The final loss figure for the sinking of the Deepwater Horizon and subsequent damage will be one of the largest for the global offshore energy insurance and reinsurance market.

The most expensive oil rig loss in world history occurred with the explosion and fire of Occidental Petroleum's Piper Alpha facility in the North Sea in 1988. 167 workers died in this incident compared to the 11 deaths from the Deepwater Horizon.

Insured losses from the Piper Alpha incident are equivalent to USD 3.4 billion in 2009 terms and this is despite there being no significant release of oil into the environment.

The clean up costs of the oil released from the Exxon Valdez incident totalled USD 2.5 billion.

Once the loss amount and legal responsibility for this incident has been decided insurers will then be asked to pay the submitted claims. Transocean who own the Deepwater Horizon platform currently have the actual platform insured for USD 540 million which has already been paid by insurers as a constructive total loss. Transocean also have a sub-limit of USD 145 million for Sue and Labour / Removal or Debris. Liability wise Transocean buy cover up to USD 950 million.



BP, like most major oil companies, makes use of extensive self-insurance and it is very likely that the majority of the claim could be financed through in-house resources rather than the insurance industry. The in-house financing could occur straight away or after the policies bought in the insurance market have been exhausted.

Lloyd's excess insurers for Transocean have recently filed a lawsuit asking for a declaration that they have no obligation to cover BP. The insurers moved after BP asked to access Transocean's coverage.

BP's share in the well and loss is 65% with the remaining share split with Anadarko Petroleum Corp (25%) and Mitsui Oil Exploration Co (10%). Anadarko have a Control of Well / Third Party Liability policy of USD 50 million and Mitsui buy USD 125 million.

BP has already announced that it will pay for all of the clean up costs as it endeavours to show itself as a good corporate citizen and also appease the US government.

Insurance in the offshore drilling rig market is expected to see some drastic changes with some underwriters currently looking for 40% to 50% increases in renewing offshore rig insurance policies. This could change once the final insured losses are submitted and paid.

Control of Well premiums could see an immediate increase of 10% on renewing business.

The response to the loss is not expected to affect the whole insurance market place though.

There are two main reasons for this is, the first being that although the final insured loss could be a very large figure it will be a large loss for one single insured and a select panel of insurers / reinsurers.

It will not be a loss for numerous Insureds and the whole of the energy insurance market.

Those parties involved in paying any losses will definitely be looking to recoup their losses but the insurance industry is huge and any insurers and markets that are not paying out on the claim should not be affected.

The second reason is that the reinsurance market at the moment is very strong. Reinsurer capital rose 8% in the first quarter of 2010 to USD 434 billion surpassing the record levels set in 2007. First quarter losses such as the Chilean earthquake and European winter storms failed to halt declining reinsurance rates as capital grew at a faster rate than demand. The record levels of capital pushed reinsurance rates down by 10% to 15% on average.

Downstream energy rates continue to fall for claims free business by an average of 10% to 15% and this should continue for the foreseeable future.

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