Insured energy losses record high

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Insured energy losses are rising. IAIN DALE talked to CIGNA's Brian Instone who has compiled statistics showing the total claims incurred during 1989 for non-marine oil, gas and petrochemical losses.

During 1989 the number of total insured claims incurred for worldwide non-marine oil, gas and petrochemical losses reached an all time peak and topped $2 billion for the first time.

Figures compiled by CIGNA demonstrate that total loss values for insured claims under property damage and business interruption policies for incidents on land rose dramatically in 1987, 1988 and 1989. They comfortably exceeded the previous worst figures recorded in 1984.

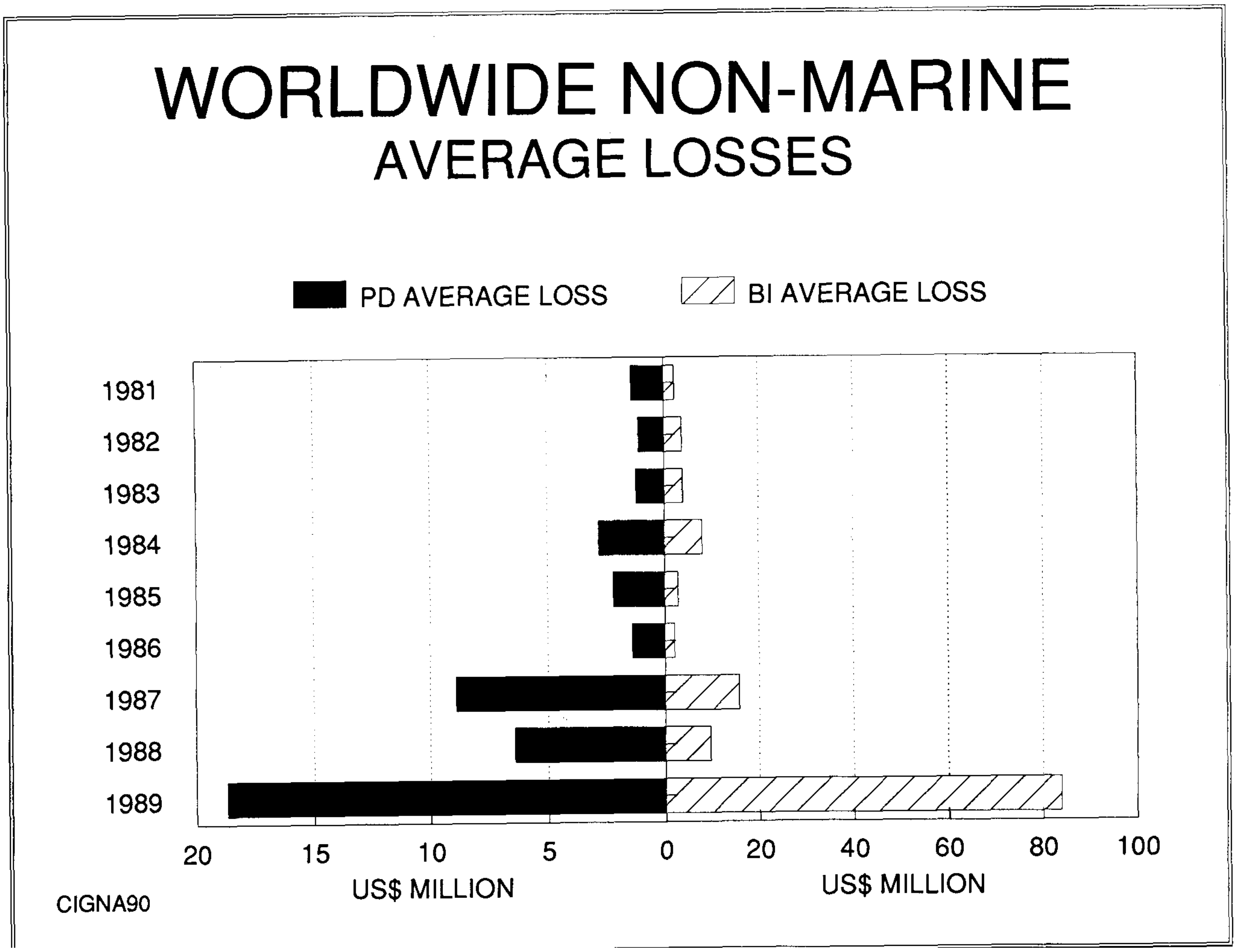
In 1981 the total losses on both types of policies amounted to less than $300 million. They reached $1 billion in 1984 but then tailed off over the next four years. The losses from business interruption claims remained fairly static throughout the 1980's but rocketed in 1989 to account for more than half the total losses of $2.8 billion.

The actual number of claims has dropped steadily but this fall has been negated by a staggering increase in the average size of each claim. In 1983 the average claim for property damage was less than $2 million while for business interruption it was twice that. In 1989 the figures had shot up to $18 million for property damage and more than $80 million for business interruption.

Brian Instone, technical services manager in CIGNA's energy department, says the statistics illustrate the wide fluctuations in the total value of losses and the numbers of losses each year.

"The dramatic increase in the average US dollar equivalent property damage and business interruption loss over the last three years compared with previous years over the decade is an obvious development," he said.

He said the consistently higher average value of business interruption losses over property damage average values may reflect plant design, construction practised by the industry over the last two decades. Mr. Instone said that a number of developments explain the record increase in average loss values:



- Replacing a number of small low value plants by one worldscale stream plans costing hundreds of millions of dollars.
- A massive single stream plant has a larger flammable liquid inventory than individual small-scale plants, which can cause greater damage if accidentally released.
- Plants running close to capacity for optimum economies of scale.
- Increased downstream and upstream plant dependencies since there are no alternative production facilities.
- Higher gross margins in operating single stream plants which justified the original investment.
- Minimised stock levels resulting in no loss mitigation.
- Non availability of intermediates or alternatives in the open market.

There are several consequences of these developments. When losses occur, even if they are less frequent due to higher loss prevention standards, the result is a high average property damage claim due to the concentration of values.

The business interruption claim would no doubt be even higher because of the large production volume that would be lost. High current gross margins and increased plant interdependencies also play their part.

Interestingly, the largest losses during 1989 occurred in territories officially classed as developed mature countries and not third world or developing countries.

Business interruption claims have also increased significantly because industry risk managers are well aware of the potential catastrophic loss exposures of their plants and are comparatively recent purchasers of business interruption insurance.

Brian Instone says that in the current soft market this type of policy is available at "irresistable rates from markets which do not appear to be aware of the increased exposures in this specialist energy risk business".

Significantly, the largest business interruption claims in 1989 happened at plants which were first time purchasers of this type of insurance.

Mr. Instone says CIGNA has specialist underwriters in this type of business and have been conscious of the necessity to set premiums which reflect the current exposures and losses in the catastrophic loss potential hydrocarbon processing industries.

The current soft market conditions demonstrate that the recent loss history of non-marine oil, gas and petrochemical risks has still to be recognised and responded to in this specialist competitive market.