Mixing oil and insurance

Time and political deadlock on the side of Lebanon's would-be oil and gas underwriters

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Not even a political shutdown of the oil and gas file can discourage Lebanese insurers from preparing for this industry — they, after all, do know a thing or two about risk. But as local insurers gathered at a June conference to discuss the finer points of oil and gas indemnity, a lack of consensus surfaced as to whether they will have priority to assure the assets of exploration companies when they come to town — a right granted as per Lebanon's insurance law. The government is due to debate this aspect of the legal framework ironing out the details with Lebanon's insurance association.

While that all plays out, a more interesting aspect to ponder is whether local insurers will have the financial leverage to assure oil and gas projects. Together, Lebanese firms generate annual premiums of $1.5 billion and are liquid enough with equities totaling around $1 billion. One oil rig, for example, valued at around $150 million would have liabilities in the hundreds of millions of dollars. Talk of forming an insurance pool will allow them to share more risk limiting exposure and liability. Lebanese insurers want their piece of the cake, but it is yet unclear how much net premiums the local players might reap from an oil and gas industry.

Compromise between internal and Lebanese firms

Confusion over whether local companies will have insurance priority is the immediate point in a developing debate between ACAL — Lebanon's association of insurance companies — and the government. Lebanon's petroleum activities regulation — a collection of application decrees filling out the offshore petroleum resources law — says that oil and gas exploration companies will be free to self insure their operating risk through a wholly owned unit. Many international oil companies (IOCs) have captive insurance subsidiaries that they use to insure their operating risk. For them, it makes more sense economically to insource risk management because it allows profits generated from premium payments to float back up to the parent organization. In other words, self insuring would allow IOCs to skirt premium payments to Lebanese insurance firms. That, says ACAL, conflicts with the country's indemnity law stipulating the financial protection of any asset through a local insurer.

A compromise is in the works says Max Zaccar, president of ACAL. He told a conference audience in early June that an insurance pool might be formed, "We are putting in place a system so that all the insurances of the oil and gas industry are placed with the 50 insurance companies in Lebanon [through] international reinsurers." But the particulars of ACAL's ongoing discussion with the government, he said, were too precious for the public's ears. Wissam Zahabi, the Lebanese Petroleum Administration's economic pointman, told Executive on the sidelines of the conference that local insurers "retaining a percentage [of risk]" would add value and compound returns to Lebanon's economy. "This is an industry that has huge application," he says, adding that "ACAL is proposing a scheme and we are working with them to make sure [local insurers] are liable jointly and to ensure they have the solvency and the capacity."

Local solvency

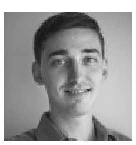
Whether local insurers do have the solvency or expertise to take on financially massive exploration projects in Lebanese waters is a different question entirely. They will most likely form an insurance pool to spread risk across the 50 insurance companies operating in Lebanon. According to expert brokers of international oil and gas insurance contracts, none or next to none of the local insurers have enough capital to insure the bigger projects of oil exploration. Lebanese insurance companies are too small to go it alone. Pooling their resources together would allow them to take on a greater share of risk, but at this point it's not really clear how much.

The likelihood is that such a pool might take on only a fraction of the risk while passing a greater portion of risk to the larger, more global insurance players. “We’ll definitely need a reinsurance market,” says Jalal Tabaja, a senior manager specialized in marine and energy reinsurance at Chedid Re, a regional firm. “We’re talking about billions of dollars in assets. Each one is a billion or $500 million or so, and it’s not easy to cover it locally. So we do need a reinsurance market to distribute the risk.”

Insurance would indeed represent a lust-worthy opportunity for the local economy, but nobody really knows how much in gross premiums an oil and gas insurance industry might be generated in the Lebanese market. The greater potential is for follow-on business not directly related to operating risk, the type of commercial activities not currently insured in Lebanon. These insurance demands may appear as companies spring up to facilitate oil and gas exploration — those companies servicing rigs and production facilities — and, possibly later, a refining industry.

Lebanese technocrats have taken note of the insurance experience from the Gulf oil producers. In most instances, Arab companies passed on all the risk to international reinsurers. Even later on they did not build these capabilities, with the possible exception of Saudi Aramco, which built its own risk management business line, but generally they have not been very strong in capability because their insurance markets are not robust.

Lebanese insurers have time on their side — we can thank politicians, for once, for the ongoing delay. Lebanon’s insurance industry will need to prepare its human and financial capital needs. There are yet further, more difficult hurdles to leap. Sharing information among competitors is currently a big barrier — an insurance pool will require certain levels of information sharing and collaboration among companies, a battle likely to unfold once an insurance pool is set up.



Jeremy Arbid

Jeremy is Executive's in house energy and public policy analyst.