CATASTROPHE COVER FOR OFFSHORE OIL DRILLING

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Torsten Jeworrek
Munich Re concept for offshore oil drilling

**Risks are becoming more complex**

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**BP Report Pins Most of Blame on Others**
Wall Street Journal, September 8, 2010

**Oil Spill’s Blow to BP’s Image May Eclipse Costs**
New York Times, April 29, 2010

**US government calls for new laws to halt repeat of deepwater oil spill**
The Guardian, 16 August 2010

**BP’s share price plunges as clean-up costs mount**
The Independent, 30 April 2010

**BP May Not Survive After Gulf of Mexico Spill, Arbuthnot Says**
Bloomberg, June 01, 2010

**BP chief Tony Hayward ‘negotiating exit deal’**
BBC, 25 July 2010

**Oil spill's animal victims struggle as experts fear a mounting toll**
Washington Post, May 27, 2010

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**Munich Re is extending the boundaries of insurability**
Insuring oil catastrophes – The dilemma today

- Objective: Long-term switch to renewable energies
- In the meantime, however, oil drilling operations are needed to cover rising energy consumption
- Complex and costly drilling operations are becoming increasingly attractive as the oil price rises
- Average of 300 new drilling operations every year in the Gulf of Mexico alone
- The cause of oil catastrophes and liability situation frequently unclear:
  - No certainty for injured parties where compensation payments will come from
  - Extremely high compensation claims possible
  - The state is concerned that the taxpayer will have to foot the bill for losses

The solution – A new type of insurance concept
**Basic premise: Greater safety in offshore drilling**

**Improved risk management**
- More stringent safety standards
- Risk management reviewed by independent experts
- Ongoing controls throughout the project’s lifetime, for example by specialist engineering firms

**Other factors**
- Increase in existing liability limits under the US Oil Pollution Act
- Cover through insurance
- Keep the hold harmless agreements for drilling companies, subcontractors, suppliers, etc.

**Improved risk management as integral part of the licensing process**
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The solution – Special policies for oil drilling operations

**New cover**

**Project-specific liability policy:**
- Cover for each drilling operation
- Insurance of all new and existing drilling operations
  - Exploration wells
  - Development wells (between discovery and production)
  - Production wells
  - Workovers (measures to improve production)

**Limit:** US$ 10bn to 20bn

**Retention:** approx. US$ 1bn

- Existing covers (company-specific liability policies) remain in place
- Possibly in order to cover the retention

**Better coverage through significant increase in liability limits**
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Details of the innovative insurance concept

Insurance cover for each individual drilling operation

Scope of cover

- Based on local liability law
- For the USA, scope of cover based on the Oil Pollution Act:
  - Removal work
  - Clean-up of polluted areas
  - Damage to natural resources
  - Third-party property damage
  - Loss of profits and earning capacity in other industries (e.g. fishing, tourism)

Limit of indemnity

- In excess of previous insurance solutions
- Independent of other covers
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Clear liability situation

Joint venture:
Oil company A
Oil company B
Oil company C

Cover for each drilling operation
Limit: US$ 10bn to 20bn

Hold harmless agreement
Retention:
approx. US$ 1bn

Drilling company A
Drilling company B

Subcontractor A
Subcontractor B

Supplier A
Supplier B
Supplier C
## Munich Re concept for offshore oil drilling

### Structure of the insurance solution

<table>
<thead>
<tr>
<th>Insurance consortium</th>
<th>Traditional (re)insurance</th>
<th>Pool</th>
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<tbody>
<tr>
<td>- Fixed group of (re)insurers</td>
<td>- Each drilling operation is placed on a co-insurance basis at current market conditions</td>
<td>- Consortium comprising all oil companies that carry out drilling operations</td>
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<tr>
<td>- Each participant agrees fixed capacities</td>
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<td>- Oil companies pay into the pool according to market share</td>
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<td>- Uniform prices and conditions</td>
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<td>- Losses are paid proportionally from the pool</td>
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<td>- Pool is reinsured on the free market</td>
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<td>- Relatively secure capacity</td>
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<tr>
<td>- Guaranteed capacity available</td>
<td>- Free competition</td>
<td>- Acceptance among oil companies may prove difficult</td>
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<tr>
<td>- Simple administration</td>
<td>- Flexible pricing, conditions and limits</td>
<td></td>
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<tr>
<td></td>
<td>- Capacity not secured</td>
<td></td>
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<tr>
<td>- Antitrust issues need to be clarified</td>
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12.09.2010

Munich Re Media Conference, Monte Carlo
Advantages of the new insurance concept

For injured parties: Clarity as regards who pays losses

For society: Clarity regarding who pays costs for damage to natural resources

For drilling companies, subcontractors and suppliers: Clearly defined liability situation (hold harmless agreements are protected)

For oil companies and their shareholders: Transfer of risks to the insurance industry possible, therefore reduced risk of losing capital and plummeting share prices

For small and medium-sized oil companies: Reduced risk of insolvency

Significant reduction in unknown accumulations for (re)insurers → therefore much greater capacity possible

Munich Re is offering substantial capacity for this concept
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Munich Re develops solutions

- Additional safety net for injured parties
- Initially developed for the USA
- Concept can be transferred to other countries

Next steps:

- Consultations with representatives of oil industry as well as with insurers and reinsurers
- Munich Re expects the concept to be taken up in the US administration’s ongoing discussions

Insurance industry is thus fulfilling its economic role
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