

# High energy business

Climate change, global financial crisis fallout and sovereign risk have emerged as the mining sector's key immediate challenges. By Rosy Mobbs



Insurance brokers negotiate more than half a billion dollars of business a year in the mining industry, and will need to become even more specialised in this field in the future, according to Bill Green, Energy Managing Director at loss adjuster Charles Taylor.

“Given that the resource industry in all its forms is very capital intensive, huge sums have to be expended before a return is seen,” Mr Green says.

“Such investments have to be protected as much as possible, in part by transferring risk from mining company balance sheets to the balance sheets of insurers.

“Clearly such an exercise needs to be

done with extreme care and in substantial detail, to ensure that the mining company obtains the protection it is seeking and the insurer accepts only the risk the mining company has paid for.”

CBA Resources Strategist, David Moore, says resources are Australia’s biggest export.

“We had a commodities boom in 2006 and then a sharp drop in 2008. However, recently the market has picked up again and that means more machinery is being used, more mines being built and more exploration.”

QBE Insurance understands that the mining industry in Australia accounts for 8% of gross domestic product and

employs over 300,000 people. Australia is among the top five producers of the world’s key mineral commodities and a dominant player in iron ore, aluminium, copper and black coal. Key global players are BHP Billiton, Rio Tinto and Xstrata.

QBE’s market intelligence approximates the total per annum property premium for the industry at between \$100 million to \$120 million, with liability premium at between \$60 million to \$75 million.

QBE’s involvement spans a broad spectrum of the sector, covering key global players and some smaller mining operations to specialist service providers and mobile plant and equipment.



Forensic accountant Chris Ehlers, Director of Matson Driscoll & Damico, says the economic environment has a significant impact on the size of claims when they arise.

“The commodities price hike a few years ago pushed machines and production lines to their limit and there were not surprisingly more breakdowns as a result of this increased usage,” Mr Ehlers says.

“Most of our adjustments to claims are based upon a detailed analysis of large amounts of financial records which we use to gain an understanding of the true financial impact an insurable event had on the insured. Many times differences are due to inflated projections which do not take into account other contributing factors (such as the GFC or other losses not related to physical damage) and not taking credits for saved expenses and maintenance costs.

“We have seen an increase in the complexity of claims put forward due to the diversification, technological

“WHAT WOULD HAVE BEEN A RELATIVELY MINOR LOSS IN TERMS OF QUANTUM IN PREVIOUS YEARS BECAME A MAJOR LOSS DURING THE BOOM YEARS.”

breakthroughs and the sheer global reach of some of these massive companies that challenge policies on an international level.”

After the 2004 tsunami, a huge legal case emerged due to the ambiguity of words relating to earthquakes and whether they include tsunamis. One policyholder lost their case but was large enough to withstand the losses.

Paul Pryor, Mining Practice Head at Marsh, says increased commodity prices and production during the mining boom have the effect of increasing declared Business Interruption figures.

“Although declared values increased, rates decreased and self-insurance levels increased, which meant the premium pool remained relatively constant year on year,” he says.

“What would have been a relatively minor loss in terms of quantum in previous years became a major loss during the boom years.”

An enormous variety of losses can occur that can result in multimillion dollar claims, Mr Green says. For example: pit wall collapses, explosions, worker injury, storm damage, change of country laws resulting in projects stalling, or crane collapse.

One of the world’s largest mining companies, BHP Billiton, noted in its last annual report that its insurance program came with policies encompassing “property damage, business interruption, public and certain other liabilities and directors and officers’ exposures”. The program included a combination of self-insurance via subsidiary captive

## HOW MUCH IS THE MINING INDUSTRY WORTH?

Increased earnings from coal, liquefied natural gas (LNG), iron ore and gold helped Australia earn a record \$159.7 billion from mineral exports during the 2008/09 financial year, the government’s commodity forecaster says. This was up 37% on the 2007/08.

Metallurgical coal exports in 2008/09 surged 129% to \$36.7 billion, thermal coal rose 114% to \$17.9 billion and LNG increased by 72% to \$10.1 billion.

Iron ore exports were up 67% to \$34.2 billion and gold rose 48% to \$16.1 billion.

insurance companies, industry mutuals and external market reinsurance.

A similar approach is taken by most large mining companies when structuring insurance risk.

Loss Adjuster Stephen Hope from Cunningham Lindsey, Special Risks, says there are different ways of transferring risk to the insurance market, depending on the size of the insured company and the strength of its balance sheet.

“The larger miners have a greater capacity to manage the risk themselves and often have specialised in-house insurance companies known as

'captives',” Mr Hope says.

“These captives will usually pass some of the risk, at higher levels, onto reinsurance companies, thus reducing their overall exposure.

“Smaller companies, however, generally seek to transfer most of their risk onto insurance companies because they don't have the same capacity that the larger companies have.”

QBE notes that property risks are generally placed on a co-insured basis.

“QBE are prepared to lead these placements or take on a follow position for accounts that meet our underwriting standards,” a QBE spokesperson said.

### Climate change

One challenge emerging for the mining industry is the effect of climate change measures such as an Emissions Trading Scheme (ETS), which is expected to affect the price of materials such as coal.

BHP Billiton Chairman Don Argus commented on climate change at the recent

## “CARBON IS NOW A VERY POTENT VARIABLE USED WHEN MAKING THE PRICE”

annual general meeting, saying it was too early to determine the effect on the market of an Emissions Trading Scheme.

“The transitional arrangements will be crucial, ie who pays for what,” Mr Argus told the meeting. “Whichever option is adopted, it will be expensive and any cost will flow directly to industry and eventually to all consumers ... But as an industry and community we must reduce coal emissions.”

European based ETS Senior Consultant, Wallich&Matthes, Daniel Butler says an ETS in Australia would affect energy prices.

“Coal is more than ever subject to more volatility in price since the trader in the dealing room knows that carbon is now a very potent variable used when making the price,” Mr Butler says.

Bill Green suggests that an ETS might be a way for governments to reap extra cash following the global financial crisis.

“There are always many risks facing the mining sector around the world, and they wax and wane depending upon the state of the world at any point in time,” he says.

“But I think a big risk being faced at the moment by the mining sector is the desperate need for western governments around the world for more cash following the global financial crisis and forecast demographic changes. It almost does not matter about the science of climate change, mining is a very energy hungry industry and where energy is used pollution is produced. So someone will have to pay.”

However QBE does not believe that an ETS would directly impact on the amount or complexity of risk involved



for property claims.

“While still in development with Government, QBE’s early assessment is that it does not believe an ETS would have any effect on property insurance in the mining industry,” a spokesperson said.

### Sovereign risk

Sovereign risk is where a government discriminates against a particular company by, for instance, arbitrarily sequestering their property without lawful reason.

Peter Reid, Legal Partner at Energy & Resources, says sovereign risk remains a significant issue.

“Many mining companies invested in sovereign risk insurance to protect themselves from the policy and political vicissitudes of third world and non-democratic countries that could have an impact on the income of a mining venture,” Mr Reid says.

He notes that the insurance industry does offer sovereign risk insurance on a selective basis, but it is often “prohibitively expensive”.

“A topical example of sovereign risk is the arrest of Stern Hu and his three Rio Tinto colleagues in Shanghai where they are still languishing in jail awaiting ‘trial’ under Chinese law.”

## WHAT CAN GO WRONG?

Insurance can be purchased for numerous facets of mining:

- Material damage
- Plant and machinery
- Business Interruption
- Liability
- Construction damage
- Industrial special risks
- Delay in start-up
- Machinery breakdown
- Professional Indemnity
- Class actions
- Sovereign risk

