

Managing hurricane risk in the Gulf of Mexico

ABS Consulting

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The 2004 and 2005 Gulf of Mexico hurricane seasons expanded the traditional definition of risk and asset management for the oil and gas industry. At the most important level, the industry did an excellent job of protecting the lives of people directly involved in operations. In addition, in the aftermath of Hurricanes Katrina and Rita, the industry expended an extraordinary effort in getting assets back on line. In spite of these efforts, both hurricanes had a significant financial impact on the performance of the industry due to the extensive asset damage, production loss and market disruption.

The impact of these losses also reduced the ability of companies to obtain adequate insurance at a reasonable cost. The insurance industry in general is raising prices, reducing limits and increasing deductibles/waiting periods for all Gulf of

Mexico (GOM) risks and in particular for offshore risks. Also, several insurance companies have completely stopped providing any GOM coverage, and this action further restricts the market. As a result, many companies are directly absorbing a larger portion, and in some cases all, of their GOM hurricane risk.

Looking ahead, it is very likely that more "bad" hurricane seasons will occur and this is a problem that will not go away. As a result, the financial risk from hurricanes in the GOM has become a major issue for the oil and gas industry that needs to be aggressively managed. Therefore, the challenge is how to efficiently manage in a rational way the economic losses and related consequences from GOM hurricanes over a multiyear time frame, in terms of asset damage, business interruption, contingent business interruption and extra expense.

Following a well-developed, three-phase process helps develop efficient and rational approaches for managing risks and assets against the financial impact of both natural and man-made hazards. This solution applies not only to companies' GOM risk

but also to all their major risks.

ABS Consulting's process includes risk identification and assessment (Phase I), financial impact analysis (Phase II) and Optimization of risk financing strategy (Phase III). The first phase involves identifying and quantifying assets in terms of location, value, construction characteristics, etc. During Phase II, basic risk assumptions are made about potential financial losses — using advanced modeling and analytical techniques to probabilistically quantify the company's financial loss potential and using standard financial metrics. While the first two phases concentrate on quantifying the risk in quantitative terms that can enable the company to make informed decisions, Phase III is the solution-finding phase that involves looking at different alternatives for handling the risk and quantitatively assessing the various options to see how well they meet the company's objectives.

The overall objective is to develop a strategy that uses risk transfer (insurance and/or alternative risk transfer options) and/or mitigation actions to create a program that reduces the risk to acceptable

levels. The key to this is providing financial risk metrics that enable the company to understand the cost/benefits within a given planning horizon of each alternative resulting in an optimal risk management program.

A good risk management program will be updated annually to incorporate changes in engineering, risk, finance and weather models. The analysis required to develop this kind of integrated risk management program is small in comparison to the risks involved.

Companies regularly invest in analysis to support decisions to buy, sell, upgrade, maintain, reduce cost or extend the life of assets. The analysis required to develop a risk management program for GOM hurricane risk is essential based on the complexity of the problem and the potential losses involved. As the alternatives for mitigating risk evolve, companies that can trade off these opportunities in a consistent, objective framework will have a distinct advantage.

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Improving Business Performance

ABS Consulting is a leading international independent provider of risk management services, including a full range of risk mitigation and transfer solutions for improving operational and financial performance. ABS Consulting is committed to help clients reduce business interruption and manage catastrophic, operational and security risks — while improving the safety, enhancing the quality and minimizing the potential adverse environmental impact of normal business activities.

Highlight of some key services and training areas:

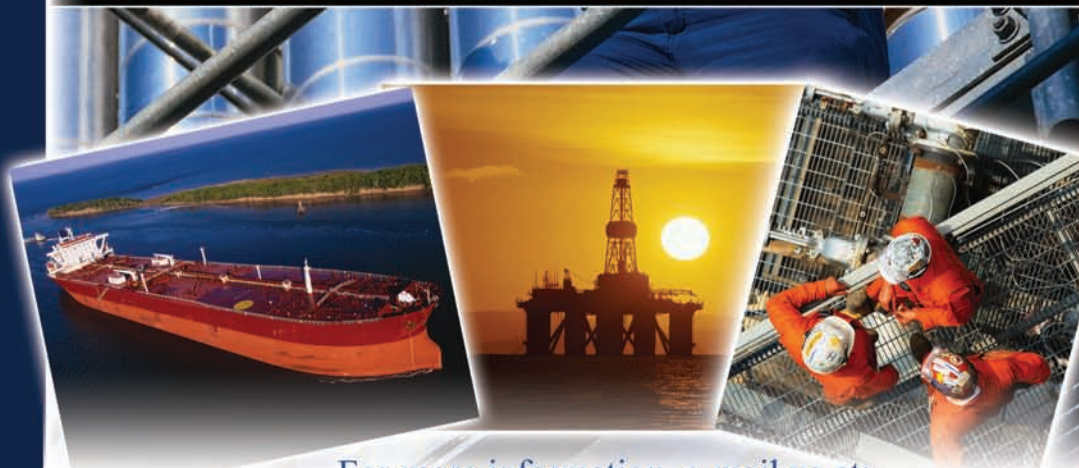
- Operational risk
- Asset integrity and life-cycle maintenance
- Natural hazards and emergency planning
- Preparing and response
- Vulnerability security assessments
- Catastrophe analysis and planning
- Process safety management

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