

Offshore financial security regime – 2019 Updated RIS

Strengthening the financial assurance regime for offshore oil and gas installations

This cover note has been prepared by the Ministry of Transport (Ministry) and updates Regulatory Impact Statements prepared in 2014 and 2017¹ as part of the review of the financial security regime for offshore oil and gas installations.

This update provides analysis on proposals to strengthen requirements on owners of offshore oil and gas installations to have insurance, or other financial assurance, for their liabilities for pollution damage resulting from an oil spill.

The recommended proposals would result in changes to the Maritime Transport Act 1994 (MTA) and the Marine Protection Rules Part 102 (relating to financial security requirements) and Part 131 (relating to marine oil spill contingency), which will be made by the Associate Minister of Transport.

The assumptions, dependencies and key gaps are still in keeping with the issues outlined in the 2017 RIS (attached). The proposed changes to the offshore financial assurance regime have been developed following significant consultation with stakeholders, including the insurance and oil and gas industries, since 2017. They also draw on decisions made by the previous government that were not brought into force prior to the 2017 general election.

Context and problem definition

The offshore financial assurance regime for oil and gas installations has been under review since 2011. Public consultation on previously proposed changes to the regime was undertaken twice in 2017, and again in 2018.

The drivers behind the ongoing policy work have been, and remain: concerns that the regime provides insufficient third party assurance relative to the potential risk and impact of an oil or gas spill; and, the insurability of the assurance regime.

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As noted in previous regulatory impact statements, a review of the financial assurance regime for offshore oil and gas installations identified that overall, the financial security tests for offshore permit holders work well.

However, issues were identified with the financial assurance requirements on owners of offshore oil and gas installations to cover the costs of pollution damage that could result from a spill at one of their facilities. These issues were:

- insufficient assurance requirements to meet potential clean-up costs associated with a credible worst-case spill;
- difficulty in securing insurance to cover the full range of liabilities owners of regulated offshore oil and gas installations have under the Maritime Transport Act 1994; and

¹ Also prepared by the Ministry of Transport.

- no specific assurance requirements for well control measures.

Additional issues identified during consultation

An additional issue identified during consultation with industry representatives and insurers in 2018 when consultation was being undertaken on the detailed rule that would:

- introduce a scaled framework for third party provided assurance requirements for offshore oil and gas installations, ranging from \$25 million to \$800 million, depending on the level of risk posed by an operation; and²
- refine the scope of liabilities, to exclude claims for pure economic loss or compensation for the broader impairment to the environment, to align with insurance products available in the energy market.

Stakeholders reiterated their views that the regime is uninsurable and conveyed that the regime (specifically Section 385J of the MTA), in its current state, implies a requirement for a “financial guarantee”, which when coupled with the higher amounts of assurance required, would make the regime uninsurable.

Insurers have said that financial guarantees to the quantum of several hundred million dollars cannot be obtained due to limitations imposed by insurance regulators and the risk appetite of the insurance market.

Further consultation in 2018 with the Insurance Council of New Zealand supported these concerns.

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Further analysis undertaken

As a result of this new issue, officials undertook further analysis and consultation with stakeholders, to ensure the objectives of the financial assurance regime for offshore oil and gas installations, outlined in the 2017 RIS, were updated and refined, these are:

Owners provide assurance proportionate to their risk profile

- New Zealand is assured that owners provide assurance proportionate to the risk profile of their operations.

The Crown, and other parties, are protected from financial risk

- The risk is managed so that the Crown, or other parties, do not carry the cost of pollution damage.

Requirements on owners are proportionate to their risk, clear and insurable

² The previous government had also consulted on an \$800 million maximum, but decided to set the limit at \$600 million because it aligned more closely with the Australian regime.

- Balances the potential economic benefits and costs of the operation by placing reasonable and proportionate compliance costs on business.
- Requirements on owners, and insurers, are clear and insurable.

Updated impact assessment from 2017

While the policy objectives remain the same as in 2017, the upper limit of the proposed scaled framework has increased from \$800 million to \$1.2 billion.

This upper limit of \$1.2 billion would only be required for an installation where the estimated clean-up costs of an oil spill is estimated to cost up to this amount. Based on our understanding of current operators, we would not expect this to be the case.

The material impact of this will likely be an increase in the amount of insurance premiums held by owners of regulated offshore installations. The impact of this however, will not be fully understood until these insurance policies begin to be negotiated by owners. It is known however, that policies of this nature and magnitude are required (and obtained) in other jurisdictions.

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Options analysis

- The approaches have been developed following significant engagement with industry, the insurers and other stakeholders. While a limit to the scaled framework of around US\$ 1 billion was discussed, an \$800 million limit to the scaled framework was the focus of this engagement. A limit of NZ\$1.2 billion, reflecting the uppermost estimate of the modelling to future proof the scaled framework in the event a installation proceeds in a higher-risk, deep water location.

Option	Objectives		
	Provide assurance	Protect the Crown and others	Insurable
Approach One PREFERRED APPROACH <i>Single-tiered scaled framework</i> <i>Changes to be given effect via amendments to the MTA and MPR Parts 102 and 131</i>	Meets	Partially meets	Meets
	<ul style="list-style-type: none"> The scaled framework provides greater assurance that owners have assurance for the likely cost of a spill proportionate to the risk profile of their operation. Insurance policies, available on the international market can be used to cover the main risks requiring cover. The \$1.2 billion limit of the scaled framework reflects the uppermost estimate for clean-up costs from an oil spill and serves to future-proof proof the scaled framework in the event that a new installation proceeds in a high-risk, deep water location.³ This upper limit of \$1.2 billion would only be required for an installation where the estimated clean-up costs of an oil spill is estimated to cost up to this amount. Based on our understanding of current operators, we would not expect this to be the case. Insurance policies offered on the international market should align to the installation insurance that creates the biggest risk, for example a floating production, storage and offloading unit (FPSO) out of control covered by P&I insurance⁴, and provide cover for the direct costs relating to the impact of the installation releasing oil into the environment. In practice these policies, are likely to cover most of an owner's liabilities under sections 385B and 385C of the MTA. Standard cover, however, does not cover pure economic loss, or compensation for the broader impairment to the environment.⁵ Third parties' claims are limited by the scope and quantum of the policy agreed between the owner and insurance provider. No other changes to the types of loss provided for in the MTA, and the owner's unlimited liability for this loss. Owners and insurers support the increased levels of assurance and consider that insurance should be able to be secured if the scope of an insurance policy can be relied on. In practice, owners are already using these types of policies to cover their operations. The most consistent approach with other jurisdictions. Policies covering liabilities of this nature are generally provided through a combined single limit (CSL) policy. CSL policies do not have the ability to prioritise charges (e.g. ring fence amounts for specific liabilities such as well containment). Owners will need to prove to MNZ that their insurance is sufficient to meet all estimated costs (including Part 131). No other changes to the types of loss provided for in the MTA and the owner's unlimited liability for this loss. 		

Option	Objectives		
	Provide assurance	Protect the Crown and others	Insurable
Approach Two <i>Two-step scaled framework</i> <i>Changes to be given effect via amendments to the MTA and MPR Parts 102 and 131</i>	Meets	Partially meets	Partially meets
	<ul style="list-style-type: none"> The scaled framework provides greater assurance that owners have provision for the likely cost of a spill proportionate to the risk profile of their operation. The \$1.2 billion limit of the scaled framework reflects the uppermost estimate for clean-up costs from an oil spill and serves to future-proof proof the scaled framework in the event that a new installation proceeds in a high-risk, deep water location This upper limit of \$1.2 billion would only be required for an installation where the estimated clean-up costs of an oil spill is estimated to cost up to this amount. Based on our understanding of current operators, we would not expect this to be the case. Oil and gas and insurance industry representatives have expressed their doubts that this two-step approach will be insurable, in combination with the higher upper limit of the scaled framework. This is despite some owners currently holding insurance from the international market for up to \$27.7 million covering the full scope of liabilities under the MTA. Alternatives such as parent company guarantees may be harder to secure due to the increased quantum required. Preserves current scope for third party claims against insurers for a specified (low) amount; though the scope of claims is limited under part two. Insurance policies offered on the international market should be able to provide cover for part two. In practice part two should cover an owner's most significant liabilities (though not for third party loss of profit from impairment of the environment). Policies covering liabilities of this nature are generally provided through a combined single limit (CSL) policy. CSL policies do not have the ability to prioritise charges (e.g. ring fence amounts for specific liabilities such as well containment). Owners will need to prove to MNZ that their insurance is sufficient to meet all estimated costs (including part 131). In practice, the first tier (\$27.7 million), will be used to cover the first costs incurred, which is likely to be containment and capping costs. No other changes to the types of loss provided for in the MTA and the owner's unlimited liability for this loss. 		

³ Ibid.

⁴ P&I (protection and indemnity) insurance is cover for third party liabilities incurred by shipping and offshore installation owners, arising from the operation of ships and offshore installations.

⁵ Again, limiting the scope of assurance was also the intent of the previous government. The purpose was make the regime insurable at the required financial levels.

Consultation

As noted above, public consultation was undertaken in 2017 and 2018 on proposals. There has been further engagement with oil and gas operators, the insurance industry and an environmental stakeholder, in the development of the updated proposals.

Owners and insurers support increased levels of assurance⁶ and consider that insurance should be able to be secured if the scope of an insurance policy can be relied on.

An environmental stakeholder has conveyed that they support the objectives that sit behind the proposed changes to the regime, and increasing the upper limit of assurance required. They consider that the upper limits discussed, ranging from \$800 million to US\$1 billion are too low. They also want the regime to go further to protect claimants from pure economic loss.

Subject to Cabinet decisions, further public consultation will be undertaken if any changes to the MTA are progressed and considered at select committee. Any changes to the Marine Protection Rules Parts 102 and 131 will also be subject to public consultation prior to approval by the Associate Minister for Transport.

Implementation plan

The preferred option will be given effect through amendments to the MTA via the Maritime Transport (Offshore Installations) Amendment Bill and to the Marine Protection Rules Parts 102 and 131.

The Maritime Transport (Offshore Installations) Amendment Bill will amend the Act to provide certainty in relation to the liability of insurers (or, in the case of financial security, the persons providing the financial security) to the Crown and to other third parties who are affected by the pollution.

The Bill also clarifies that rules may specify the types of liability that will need to be insured against and may provide for the insurance or other financial security to cover the cost of well control measures and other costs of implementing marine oil spill contingency plans.

The amendments to the Act will be supported by amendments to the rules, which will specify more detailed requirements relating to the insurance or financial security. The rules will include a scaled framework for specifying the amount of cover required, based on the modelling of a credible worst-case scenario event from that particular installation.

These changes will enable owners of regulated offshore installations to meet the Act's requirements using insurance policies that are consistent with internationally available best practice policy wording and available on the international market. These policies will be required to cover the key risks and costs of clean-up and pollution damage associated with the owner's installation.

⁶ A higher limit of US\$1 billion was also discussed as a possibility, however, the limit of \$800 million was the focus of discussions during stakeholder engagement.

The Bill is expected to be in force by 1 November 2019. Transitional arrangements will mean new operators are given three months to comply with the new regime. Existing operators will be given until 31 July 2020 to comply.

Maritime New Zealand will also develop guidelines, including detailed guidance on credible worst case scenario risk modelling, which will sit alongside the Marine Protection Rules Parts 102 and 131, to support owners in complying with the rules. Maritime New Zealand communicates regularly with owners and applicants to ensure they are well informed, and issues are addressed early to mitigate the impact of transitioning to the new regime. The impact of the costs of implementing this regime is not yet known.

Monitoring, evaluation and review

Maritime New Zealand and the Ministry of Transport will continue to monitor and review the new rules as part of their regulatory stewardship role. They will continue to work closely with industry, insurers and other key stakeholders to ensure the new regime is relevant, robust and fit for purpose.


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