The Willis Index

Willis

Environmental Newsletter

The Environmental Insurance and Risk Management Quarterly

Q1 2006

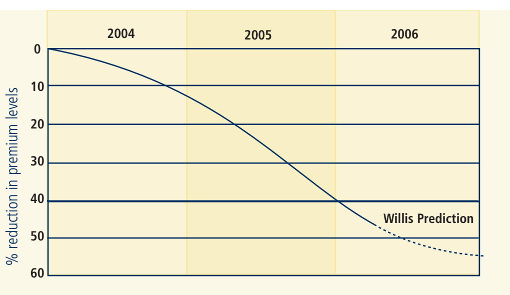
Market Conditions and Premium Survey

Premiums at all time low

The Environmental Insurance Market is more competitive now than at any time, providing the opportunity for reduced premiums and broader coverage than in recent years. At least that's the view of our specialist Environmental Team. But what's the view of environmental insurers?

It is difficult to directly compare premium levels over time, as each case is assessed by insurers on its own merits. As with policy wording requirements, there is no "one size fits all" approach to setting premium levels. Nonetheless, a clear trend in premium level reduction is evident in cases handled at Willis, both on one-off and renewable policies. Whilst not every enquiry has benefited from premium reductions, we have seen premium levels as much as 50% lower than levels quoted two years ago for many comparable risks. Even within the last year, some 30% reduction in premium levels has been evident (see figure) - a view supported by most insurers.

Reduction in premium levels for comparable risks



Whilst some environmental insurers have tried to maintain largely static premium levels, the majority acknowledge that market pressures have driven rates down recently. This is hardly surprising in a growing market - three insurers have entered the London Market within the last two years alone.

In addition to premium level, the terms and conditions of policy coverage will be critical in determining the value of Environmental Insurance. Indeed, a key role of the broker is to ensure the coverage meets the Client's requirements. Nonetheless, lack of perceived value in policy coverage is sometimes expressed as frustration with price - a view shared by a number of insurers. In recognition of this, there is a growing range of environmental insurance products aimed at providing tailored cover at attractive premium levels.

In our last edition of the Willis Index (Q4, 2005) we reported the findings of a survey on the uptake of Environmental Insurance in property and corporate transactions. Responses indicated that premium levels were often considered too expensive, making Environmental Insurance an unattractive option for many transactions. However, at Willis we have seen a dramatic decrease in premium levels recently, suggesting that such views may not be consistent with current market conditions.

Environmental Insurance, as with any insurance, works on the principle that the contributions of the many make up for the losses of the few. Premiums will thus be dependent in part on expected future claims. The claims seen so far are almost certainly the tip of the iceberg, particularly in view of the rapid pace of development of environmental legislation, coupled with increasing public awareness of environmental issues. Indeed, one of the key benefits of environmental insurance, particularly long term policies, is that they are intended to respond to changing legislation, regulator attitude and third party liability triggers. Given all this, it could be argued that, for some policies, it is simply a question of "when?" not "will?" a claim arise.

But what does the future hold? Premium rates obviously cannot continue to fall indefinitely. Some insurers consider that we will soon see rates level out. However, the intense market competition looks set to continue, so it seems unlikely that rates will rise in the near future.

The Willis Index is a quarterly publication reporting on the relevant issues affecting the insurance industry and the impact they have upon our clients.

Our quarterly review provides analysis of the Environmental Insurance Market, assisting buyers and their advisors on available solutions.

Regular features include updates on the market conditions, case studies, technical analysis of coverage specifics and special features highlighting significant changes in regulation, insurance market news and forthcoming events and seminars.

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Property Funds — Safe as Houses?

Property portfolios have long been an attractive asset base for funds, offering a relatively "safe" investment generating steady and reliable returns. Property portfolios are not without their risks, however, as local, regional and indeed global economic trends will inevitably affect asset value and revenue returns.

Environmental risks can also present potential liabilities to fund stakeholders, including property owners, fund managers and lenders, and thus ultimately investors. The increasing use of innovative funding mechanisms, such as mezzanine financing (whereby lenders take a share of the fund equity in return for the loan) and securitisation (enabling lenders to trade the debt) potentially increases the risks faced by lenders and debt traders.

Property fund stakeholders, particularly institutional investors, financial institutions and life and pension funds, are typically conservative in their appetite for risk. The "low probability-high severity" nature of environmental risks often clashes with the "zero risk" financial models of such organisations. In today's legislative and business environment, there is simply no such thing as a "clean" site. Environmental risks are notoriously difficult to quantify, verify and manage, often leading to significant perceived risk for even "low risk" funds. Funds that target "high risk" properties in the hope of increased returns following clean-up, are of course more likely to face liabilities and potential cost overruns as a result of contamination.

Whatever the risk profile of the portfolio, environmental insurance can help by transferring environmental liabilities to insurers, enabling fund stakeholders to maintain business objectives, whilst enabling fund managers to maximise property returns.

Case Study:
Securitised property unit trust

A property fund was launched to offer investors the opportunity of holding equity interest in property assets through a tax efficient offshore vehicle. The fund was securitised via tradable bonds, a significant proportion of which were debt financed by a major bank.

The fund portfolio comprised approximately 60 tenanted industrial, retail and mixed use properties throughout the UK, which were transferred from an existing portfolio owned by several life funds. Environmental due diligence concluded that environmental issues at five of the properties within the portfolio presented significant potential liabilities.

Upon transfer of properties to the trustees, the life funds were required to indemnify the trustees for environmental liabilities associated with such properties. It was agreed, however, that the indemnity would be cancelled in the event that environmental insurance was placed for the five sites to offset such liabilities.

The Solution

Despite the known or anticipated presence of contamination at each of the five sites, Willis was successful in placing environmental insurance to cover the life funds, the trustees and the bank. A separate policy was placed for each property, thus providing a "ringfenced" limit of insurance for each property, which correlated with the environmental consultant's estimates of "worst case" remedial costs.

Furthermore, this approach enabled policies to be transferred upon possible future sale of individual properties.

The policy was placed for an initial ten year period, thereby extending beyond the fund life of eight years. However, a "rolling renewal" facility was also agreed with insurers whereby the policy could be extended annually, providing the insureds, and ultimately the individual investors, with the assurance that long term cover was maintained beyond the life of the fund, enhancing the value of the properties upon fund closure.

As the properties were all tenanted, a key risk exposure was the potential loss of rental income in the event of clean-up works, for example due to the need to relocate tenants. Coverage was expanded to cover such losses. Willis worked closely with lawyers representing life funds, trustees and the bank to negotiate policy wording with the insurer.

The Benefits

Through the use of environmental insurance, the life funds were able to maximise the transfer value of the properties to the new fund, whilst also cancelling the indemnity originally provided. The trustees gained the certainty of cover for identified "problem" sites, whilst the bank was able to protect both its direct risk (as equity holder) and indirect credit risk.

Property Case Studies

United Kingdom

A major UK property fund management company was looking to establish an investment fund comprising a portfolio of more than 30 commercial properties. The fund trustee was concerned that the sites could suffer significant environmental liabilities as a result of former industrial use, however the fund manager was unwilling to provide an environmental indemnity. To resolve such issues, Willis structured environmental insurance on behalf of the trustee, thus removing the need for the fund manager to provide an indemnity.

Switzerland

A major property developer was planning to acquire an area of land for development as a logistics distribution warehouse. The site had formerly been used as a landfill for the disposal of hazardous wastes. The developer was, not surprisingly, concerned about environmental liabilities associated with the site, particularly as they were required to give an environmental indemnity to the seller. Despite the known presence of contamination in the former landfill, Willis secured environmental insurance for the developer, providing certainty that environmental liabilities would be effectively covered both during and after the development.

Germany

A property investor was looking to acquire a modern office complex in Frankfurt. The site had previously been a factory, and it was known that remediation works had taken place in the past, but it was not clear whether any further works would be required by the regulators. Despite such uncertainties, Willis was successful in placing environmental insurance for the investor to provide long term protection from such risks.

France

A client was looking to acquire a French manufacturing company, however was concerned about potential environmental liabilities associated with one of the target company's sites which was known to be heavily contaminated. Despite the limited time available before the transaction, Willis negotiated cover to include the identified contamination, enabling the Client to fix their maximum cost exposure to environmental liabilities and factor the cost into the deal negotiations.

Poland

A Polish company responsible for the operation of a motorway was required by its lenders to take out environmental insurance to cover the risk of spillage and/or petrol release from the motorway service stations. Willis structured environmental insurance that satisfied the lenders requirements and provided robust protection from environmental liabilities.

Italy

A property developer was looking to purchase a large former electricity transformer station for residential development. As part of the purchase, the developer was required to indemnify the seller for contamination liabilities. However, as the developer had established a Special Purpose Company for the acquisition and redevelopment, the seller also required a parent company guarantee - something the developer was not willing to provide. Willis placed environmental insurance jointly for the developer and seller, satisfying the sellers' concerns and avoiding the need for the developer to provide a parent company guarantee.

Breaking News

The Willis Environmental Team attended MIPIM again this year, one of the world's largest property exhibition and conference events, held in Cannes, France, from 14 to 17 March. We were joined by our colleagues in the Property Investors Division and Professional Indemnity Team, providing a great opportunity to discuss a wide range of issues with us. John Dilley, Managing Director of the Willis Property Investors Division, comments "*Our clients are at the heart of everything we do. Our aspiration is to be regarded as their "in-house" insurance resource, and as a valued member of their professional team. They are then free to concentrate on the issues that drive their business, safe in the knowledge that, as far as insurance in concerned, someone is doing the thinking for them*".

The Willis Environmental Insurance Market Review

Willis Environmental Insurance Market Review is now available. Our review provides insurance buyers, professional advisers, financiers and other interested parties with a unique and invaluable insight into the current state of the global environmental insurance market, including the following:

- an update on market conditions
- an overview of recent product developments
- an insight into how these products are being applied
- a review of developing trends.

Much has changed in the environmental insurance market since our last review in 2002. Insurers have continued to build on the successful foundations laid down during the late 1990s, by broadening the market offering in line with clients' requirements.

Although the UK market remains small compared to its North American counterpart, it is now host to more environmental insurers than at any time, and has seen a steadily increasing portfolio of specialist risk transfer products that can be tailored to individual requirements.

Please contact us if you would like a copy, or visit www.willis.com/environmental to download a copy.

Meet the Team

Sandra Garfia Humanes

Sandra joined Willis in 2005, prior to which she worked at a leading global environmental consultancy for three years. During this period, Sandra also completed her diploma course, which included environmental science. Sandra is based in our Frankfurt office, where her work has focused on the delivery of environmental insurance solutions for a number of property and corporate transactions in Germany.

Willis is one of the World's leading risk management and insurance intermediaries. We have 15,800 professionals in over 300 offices around the World.

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FIN/3595/03/06