ENVIRONMENTAL RISK
NEWSLETTER
May 2008

GLOBAL ENVIRONMENTAL LIABILITY MANAGEMENT: WORLDWIDE ENVIRONMENTAL INSURANCE SOLUTIONS

By: Rick Ringenwald
Senior Vice President
Environmental Practice

The business world is getting smaller. Our ability to communicate globally and in seconds has expanded trade and commerce into the far reaches of the world. Many U.S. companies are looking to overseas expansion for continued business growth, at the same time as they are increasingly centralizing their risk management programs.

As insurance brokers and risk management consultants, we are faced with a myriad of questions regarding coverage for our clients in non-U.S. jurisdictions. Our clients may ask:

- Does my company have an environmental exposure there?
- Are there any environmental regulations that may apply to my operations? If so, does the country enforce them?
- Are there any compulsory requirements for environmental insurance?
- Do underwriters understand the political and regulatory frameworks of each jurisdiction to enable them to make a sound decision in issuing coverage?
- If the underwriter can write a policy, will it be on local, admitted paper or non-admitted paper?
- Does that country allow non-admitted insurance? If not, what's our potential exposure if non-admitted paper is used?
- What are the tax consequences associated with different program options – in terms of local premium taxes, the tax deductibility of local premium allocations and the tax treatment of loss proceeds?

And while there are no absolute answers, it is important for organizations to work with a broker that can help them understand

(continued on page 2)

NEW APPLICATIONS FOR INSURANCE PRODUCTS

By Michael Balmer
Environmental Practice Leader

One of the distinguishing features of the environmental insurance market is the appetite for creativity and flexibility among the relatively small, but evolving, cadre of insurers. Brokers and insurers continue to develop new program applications and innovations. It is a market that is supported by a technical approach to underwriting and tends to require the most experienced broking professionals. Clients present their unique concerns and/or exposures, and

(continued on page 4)

GLOBAL ENVIRONMENTAL LIABILITY

(continued from page 1)

their global exposure, appreciate the advantages and disadvantages of the various structuring alternatives and implement effective pollution coverage on a worldwide basis.

This article explores some of the legislative and economic factors driving the need for environmental insurance, discusses the international environmental insurance marketplace, and provides some conceptual options for the design of a global environmental insurance program.

WHY PURCHASE ENVIRONMENTAL INSURANCE?

The drivers for environmental insurance, in both the U.S. and internationally, generally include:

- Regulatory requirements
- Contractual obligations
- Risk management strategy

REGULATORY REQUIREMENTS

In April 2004, the European Parliament and Council for the European Union adopted the Environmental Liability Directive (the Directive) to prevent damage to water, protected species, natural habitats and land, and to increase the liability or responsibility of facility operators that caused such damage. While existing civil liability schemes already held operators responsible for third-party bodily injury and property damage claims, the Directive added new requirements affecting the potential extent of remedial measures required in the event of a pollution condition. As reported in previous Willis newsletters, member states were required to incorporate the provisions of the Directive into national legislation by April 2007. Some member countries have met that deadline (e.g., Italy). Others have not, but most are well on their way towards compliance.

In some EU countries, such as Germany, operators involved in certain industrial activities are already required to purchase pollution insurance in order to obtain their operating permits. However, the Directive will likely require on a wider basis the maintenance of financial guarantees (starting in 2010) to ensure that companies have the financial resources to fulfill their obligations under the legislation. While not finally determined at this point, in many cases, insurance will serve as the most likely vehicle for the financial guarantee.

In addition to the Directive and its effect on EU-member countries, certain forms of environmental insurance are compulsory in a number of countries. Requirements may only apply to certain classes of business; however, some countries (Argentina, the Czech Republic, Finland, France, Germany, India, Kazakhstan, the Netherlands, Portugal, Russia and Spain) may require environmental insurance or some form of associated financial assurance.

In another example of this trend, the Chinese Environmental Protection Administration (SEPA) recently announced plans for establishing an environmental pollution liability insurance system in China.

CONTRACTUAL OBLIGATIONS

Often, there is simply a contractual requirement for environmental insurance. For example, a landlord may require a tenant to purchase environmental insurance as part of a lease agreement, especially if the tenant will store or use hazardous materials at the leased site. Similarly, a construction project owner may require contractors working at the job site to carry environmental insurance, on either a project-specific or practice basis.

Also, as a contractual requirement, environmental insurance is routinely incorporated into merger and acquisition or purchase/sale agreements to handle liability for pre-existing pollution conditions. While these obligations have been commonplace in the U.S., they are coming to bear on a more frequent basis outside of the U.S.

RISK MANAGEMENT STRATEGY

From an environmental regulatory perspective, a common theme resonates worldwide: ever more stringent environmental legislation, stronger enforcement practices and, therefore, enhanced environmental liabilities.

In the absence of any regulatory or contractual obligation, environmental insurance is being purchased more frequently simply because it makes sense to have it as part of a risk management portfolio. There are a number of reasons for this, including:

- Mitigation of the financial impact from environmental loss on a company's balance sheet, driven by stakeholder influences and corporate fiduciary responsibility to shareholders
- Financial disclosure requirements, driven by increasing transparency in financial reporting requirements
- Increased enforcement in local jurisdictions

For example, with the implementation of the EU Environmental Liability Directive, we are already seeing increased enforcement and additional remedial requirements in EU member states. Similarly, there has been a growing trend toward environmental enforcement initiatives in other territories. A recent article published by Reuters News Agency on November 12, 2007 ("China Raises Pollution Charges to Clean Up Lake") stated that more than 1,000 chemical plants may be forced to close around the shores of China's third largest lake due to an increase in pollution in the lake. Clearly, as companies look to expand their operations into new countries, they must now consider environmental compliance as part of the overall business plans.

THE INTERNATIONAL ENVIRONMENTAL INSURANCE MARKET

Global environmental insurance premiums are dominated by U.S. placements, but the market outside of the U.S. is growing at a significant rate. The use of environmental insurance is on the rise, and regular announcements of new market entrants confirm that insurers believe in the long-term growth of this product line.

For non-U.S. exposures, there are many ways to obtain coverage, including U.S.-based specialty environmental insurers with international capability, non-U.S. liability insurers that offer environmental products – typically through endorsements to their General Liability form – and local insurance pools in certain countries (e.g., Assurpol in France).

Regarding U.S.-based specialty environmental insurers, many companies have, over the last few years, developed significant underwriting infrastructure throughout the EU. Additionally, once these insurers understand the political and regulatory frameworks of other countries, they are looking to expand their operations accordingly. For example, some insurers can now issue local admitted policies, in the local language, in countries like India and China. Growth has also been seen in South America and the Asian-Pacific countries, as environmental insurers start to locate environmental underwriters in these territories.

A new trend in the worldwide environmental insurance market includes the addition of environmental coverage to EU-based General Liability (GL) policies. Some GL insurers are even including endorsements designed to pick up coverage for liability associated with the EU Environmental Liability Directive. These policies are generally written with a worldwide territory endorsement.

Note: Specialty environmental insurers are also modifying their forms to pick up coverage for liability associated with the EU Environmental Liability Directive. In addition, as a general rule of thumb, the environmental coverage grant on a GL policy is limited compared to a specialty environmental insurance policy.

CONCEPTUAL OPTIONS FOR PROGRAM DESIGN

In our experience, there are three basic options for designing a multinational or global environmental insurance program.

- Reliance on admitted, local policies (where available)
- Reliance on non-admitted insurance – typically a single non-admitted policy with a worldwide territory endorsement
- The use of a controlled Master program comprising locally admitted policies for all appropriate overseas locations supported by a Master policy, which ultimately dictates the global terms and conditions through "Difference in Conditions/Difference in Limits" (DIC/DIL) provisions

Clearly, designing, placing and servicing a global environmental insurance program can be a complex process, with many critical issues to consider, such as the impact of bulk purchasing leverage tax benefits, claims management and the central administration and coordination of a large program. There may also be an opportunity to manage risk retentions and "fronting" requirements using a captive insurance company.

Remember that some countries do not allow non-admitted insurance. In such countries, a non-admitted insurance policy can't be used to meet compulsory insurance requirements or provide evidence of coverage. In addition, insurers may not be able to pay claims directly to the location with a loss. If claims are paid, they would need to be paid to the U.S. business entity and then repatriated to the foreign country. Such money may need to be treated as taxable income, instead of an insurance loss receivable. Furthermore, local business entities cannot be listed as additional insureds on the policy.

Ultimately, the insured and insurer may be subject to penalty. However, environmental insurers may not have locally admitted paper in every jurisdiction, so if coverage is desired, the only option would be a non-admitted policy. Keep in mind that although certain countries may not allow non-admitted insurance as a general rule, there may be exemptions or exceptions when coverage is not available from local markets.

Within the EU, if a member state does not allow non-admitted insurance, there are exceptions under the Freedom of Services regulation as long as the policy is domiciled in another EU country. Of course, taxes may still apply on premium applicable to risk within that specific country. (See the 2001 European Court of Justice decision *Kvaerner plc v Staatssecretaris van Financien*, Case 191/99.) In addition, for non-EU countries that allow non-admitted insurance, taxes will generally apply on the premium related to the risk in that country. Such tax rates can be significant. Chile, for example, charges an insurance premium tax of 22% and VAT of 18%.

Further complicating things, certain insurers differ on how they prefer to structure a program. And, those preferences may change from time to time as regulatory requirements and legal interpretations change.

In the final analysis, no single solution will serve all situations or organizations. Each program brings its own needs and considerations, including insurance regulatory compliance issues, tax consequences, compulsory insurance requirements and market capabilities. ■

NEW APPLICATIONS

(continued from page 1)

the brokers and insurers work together to craft coverage tailored to these individual liabilities.

As an example, a Willis client in a significant service-related industry had some unique concerns relating to first- and third-party risks related to terrorist events – particularly a nuclear, biological, chemical or radiological (NBCR) attack. The client's facilities included a high-profile building in a large city with HQ functions and retail customer operations, sharing the building with third-party tenant occupants, including government entities.

The client's Property and Casualty insurers were not prepared to cover pollution liabilities related to a potential attack and would not cover pollution-related Property Damage (physical or business interruption) due to terrorist acts. Willis was able

to utilize the pollution markets to provide a long-term, high-limit solution involving a combination of environmental insurers. The program provides pollution liability coverage for cleanup costs and third-party liability for bodily injury and property damage. In addition, however, the program provides first-party Business Interruption and Extra Expense cover (including loss of use due to civil authority from TRIA and non-TRIA events) at the main location and affected satellite locations. It also includes first-party Property Damage for repair and replacement of the insured's property resulting from the event itself.

In another recent example, a Willis client was supplying key components to an unrelated consumer products company that assembled the components into a finished product under their own separate brand name. The client company is a multinational corporation with strong brand recognition.

The assembly plant had known pollution conditions as a result of historical and continuing operations at the site. The operator of the plant was in Chapter 11 proceedings, and our client was looking to acquire certain assets from the bankrupt entity; however, those assets did not include the subject plant, which was specifically excluded from the purchase-sale agreement.

Our client was concerned that the government could deem them a successor under CERCLA, despite the fact that the acquisition was structured as an asset purchase. Willis developed a solution to manage this contingent, successor liability by heavily manuscripting a pollution liability policy. The policy covers the supplier as the named insured for pre-existing known and unknown conditions, with no exclusions for known conditions, for a 10-year term.

Environmental insurance solutions have long been used by financial institutions to manage their environmental risks associated with owned properties and protect against any pollution exposures associated with their lending activities and equity investments. Some of the new, more flexible products available in the marketplace today do not require the individual scheduling of locations, disposal sites, transportation exposures or contracting operations. They can be used to provide parent companies, and their directors and officers, with blanket coverage for any environmental liabilities that "pierce the corporate veil," whether they emanate from lending activities, equity investments, joint venture enterprises or subsidiary operations.

The examples outlined above demonstrate the unique flexibility and creativity that have become the hallmark of the environmental insurance industry. If you have pollution-related concerns or exposures that do no fit the traditional model, challenge the market and your broker to find a solution! ■

CLIMATE CHANGE – LEADING THE WAY AT WILLIS

By Rick Hawkinberry
Senior Vice President
Environmental Practice

The issue of climate change has truly begun to affect the way the world thinks about the environment, and it is no wonder as climate change and its potential implications are likely to be the single largest environmental issue any of us will encounter in our lifetime.

As we have in response to other areas of emerging and complex liability, Willis is working with insurers and industry leaders to develop solutions for the new liabilities and exposures developing as a result of the current and future impacts of climate change.

One big step is the formation of the Willis Climate Change Task Force (WCCTF), a worldwide collaboration of all Willis Associates dealing with climate change issues. We established the WCCTF to keep pace with regulatory, scientific and marketplace developments. The WCCTF establishes a central point for monitoring, gathering and disseminating relevant climate change information both internally and to our clients. Its membership includes Associates from the Willis Environmental Practice, Willis Re, Willis Research Network, Willis Risk Solutions, Willis London and Willis Capital Markets.

The Willis Research Network (WRN) is an integral part of the WCCTF and will play a key role in the insurance industry's response to climate change. WRN is a unique group comprised of Willis Re and 12 universities in the U.K., Japan, Singapore and the U.S., focused on tackling the key risk issues of relevance to the insurance industry. The WRN has assembled a team, using the Earth Simulator Supercomputer in Yokohama (a supercomputer that is housed in a special earthquake-proof building, is the size of four tennis courts, and is one of a few computers in the world capable of running the complex "real-world" simulation models) to establish models that can predict the number and severity of hurricanes, typhoons, floods, heat waves and global temperature changes over varying scales of time and geography. Insurers will be able to use this information to anticipate future climates, which will assist in the setting of underwriting protocols and in demonstrating to their reinsurers and investors that they are making long-range business decisions based on sound data.

We'll have articles in future newsletters on the WCCTF and the science, regulatory and market solutions associated with climate change. For more information, please contact Rick Hawkinberry, who chairs the WCCTF.

For more detailed information on climate change issues, see the lead article in the Willis *Marketplace Realities – Spring 2008 Edition*. ■

RECENT AND UPCOMING EVENTS

Brownfields 2008, May 5-7 in Detroit. The Willis Environmental Practice will be an exhibitor. If you are in attendance, please stop by our booth and say hello. Members of our practice will also be participating in sessions.

- **Mike Balmer** will lead a panel discussion on May 6 entitled "Environmental Insurance: Getting What You Need in an Evolving Market." The panel will include leaders of the top four environmental insurance markets. In this interactive panel discussion, these industry leaders will discuss recent important changes in the industry, how these changes will affect brownfield projects, and how owners or contractors can get the best environmental insurance program for their brownfield project.
- **Rich Sheldon** will participate in a panel discussion on May 7 entitled "Passing the Buck: Environmental Liability Transfer," which will address the typical components of an environmental liability transfer deal, what to look out for in the contract, the relationship between end use and the remediation end point, the potential role of institutional controls, and what types of insurance are potentially available to help seal the deal.

Expert Meeting on Financing Carbon Capture and Storage Projects, May 28 & 29, 2008 in New York. Rick Hawkinberry will present "Risk Management and Insurance Considerations for Carbon Capture & Sequestration Projects." The meeting is organized by the IEA Greenhouse Gas R&D Program and the IEA Clean Coal Centre and is sponsored by the World Coal Institute and Chevron.

Pollution Liability Insurance – ACI Conference April 15 &16 New York. Anthony Wagar, Rick Hawkinberry and Mike Balmer presented sessions on different topics including emerging trends, liability transfer projects and broking techniques.

Risk and Insurance Management Society – Annual Conference April 28, San Diego. Rick Hawkinberry participated in a panel discussion on "Emerging Issues in Environmental Liability." ■

KEY CONTACTS

NORTH AMERICA

NATIONAL PRACTICE

Michael Balmer
Environmental Practice Leader
Boston
Office: 617 351 7530
Mobile: 781 500 9244
michael.balmer@willis.com

Rick Hawkinberry
Environmental Industry Leader
National Resource
Pittsburgh
Office: 412 586 3530
Mobile 412 370 5509
rick.hawkinberry@willis.com

REGIONAL TEAMS

Chuck Zaher
Regional Team Leader
Great Lakes/Chicago
Office: 312 621 4745
Mobile: 708 646 7080
chuck.zaher@willis.com

Beverly McCoy
Regional Team Leader
South Central/Houston
Office: 713 625 1011
Mobile: 713 253 7139
beverly.mccoy@willis.com

Richard Sheldon
Regional Team Leader
Philadelphia/Radnor
Office: 610 254 5625
Mobile: 610 639 1416
richard.sheldon@willis.com

Anthony Wagar
Regional Team Leader
New York
Office: 212 915 7768
Mobile: 908 902 9527
anthony.wagar@willis.com

Brian McBride
Regional Team Leader
Atlanta
Office: 404 224 5126
Mobile: 678 231 3096
brian.mcbride@willis.com

Jeff Clarke
Regional Team Leader
San Francisco
Office: 415 955 0219
Mobile: 415 254 5502
jeff.clarke@willis.com

INTERNATIONAL

Brian Hendry
Environmental/M&A
Practice Leader
London, England
Office: 44 20 3124 6851
Mobile: 44 7715 546 314
brian.hendry@willis.com

Fiona Gray
Reading, England
Office: 44 20 3124 6315
Mobile: 44 7801 179 481
fiona.gray@willis.com

Neil Cameron
London, England
Office: 44 20 3124 7097
Mobile: 44 7958 152 593
neil.cameron@willis.com