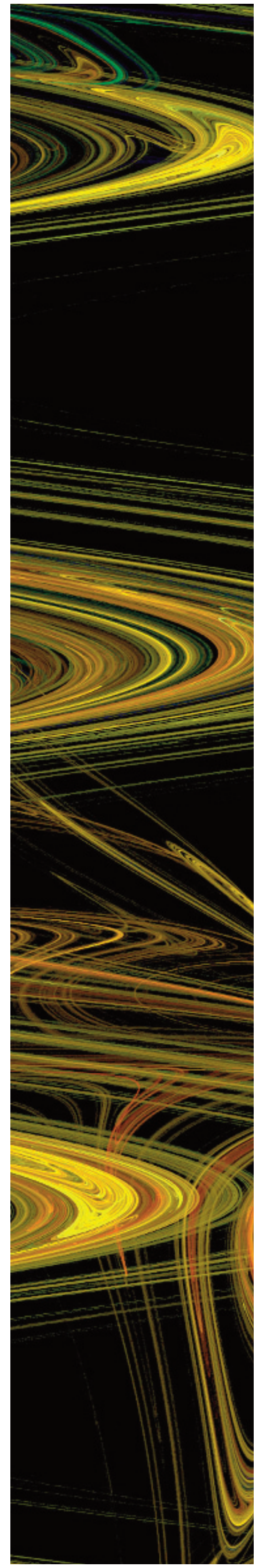
ENVIRONMENTAL

THE TURN IN THE ROAD?



The question facing most lines of insurance these days is simple enough: when will the market turn? In Environmental insurance, the answer is complicated by the variability in the market conditions for the individual Environmental products. In general, however, the softening trend appears to have reached its peak and the market is beginning to firm. The main reason: the rate decreases of the last few years were unsustainable – a situation exacerbated by the current condition of the general economy.

At such turning points, buyers are often motivated to consider locking in current terms and conditions on attractive multi-year deals. At the same time, however, the financial stability of potential insurers should be an important consideration, especially on longer-term placements.

MARKET CONDITIONS

A potential turn in the road notwithstanding, the specialist Environmental market remains vibrant and continues to grow at a steady pace both in North America and globally. Insurers continue to accentuate profitable underwriting with increasing emphasis on short-term, renewable programs and less reliance on one-off, long-term, project-specific placements.

The recent turmoil in world financial markets has significantly impacted some of the most important insurers in the Environmental marketplace. The major rating agencies have downgraded the financial strength ratings for certain key Environmental insurers including AIG, the largest specialist Environmental insurer by premium volume. At the same time, many observers, including state insurance commissioners, have pointed out that AIG's insurance subsidiaries are financially sound. Inevitably, the fall-out from these recent events, particularly the associated credit squeeze, will have an impact that extends beyond the cadre of insurers with major subprime exposures.

While the financial strength ratings for the core insurance operating entities of the main Environmental insurance companies have remained above our minimum rating guidelines, the recent episode has reemphasized the critical importance of including appropriate financial viability assessments into the insurer selection process – especially for long-term policies. Choosing a market should not be just a price and coverage decision.

Aggregate capacity in the industry remains relatively stable; however, the per-policy aggregate limit of the major carriers is generally less than it was five to 10 years ago. Many of the leading carriers can provide $25 million to $50 million in limits for a single placement. In situations where more is required, some carriers can even increase this limit further, possibly on a 'net-of-reinsurance' basis. Further, we are seeing more layered programs involving more than one insurer to build capacity. Depending on the length of policy period, the nature of the risk and complexity of the coverage, program limits as high as $250 million are achievable, and potentially even higher with the direct involvement of reinsurers.

The market has remained relatively firm on long-term policies and more challenging product lines. In particular, the Cost Cap product line has seen unfavorable loss experience (loss ratios of up to 150-200% for some carriers in certain policy years), which has led to more detailed engineering requirements and more stringent underwriting and approval protocols. In contrast, we are seeing strong competition for the more attractive, renewable lines of business – with rates in some areas down 15-25%. However, increases in the frequency and severity of losses on site-specific pollution policies have tempered rate reductions. Recent experience suggests that this market segment is now beginning to firm up and tightening credit conditions are expected to accelerate this process.

On terms and conditions, insurers are being aggressive in some of the more competitive product areas. For mold exposures, insurers are now offering coverage without sublimits for Business Interruption/Property Damage and cleanup costs, and further, they are offering coverage for other conditions caused by microbial pathogens – such as Legionnaires' disease and illness related to *Cryptosporidium*.

Some of the established carriers are experiencing adverse loss development based on the broader coverage offered over the last several years, particularly in areas such as first-party business interruption, fines and penalties and on-site cleanup. We are also seeing a trend toward more restrictive terms and conditions for certain products (such as Cost Cap) as well as a retreat from certain sectors. For example, some Environmental insurers have been pulling away from providing Professional Liability programs for environmental engineering firms with a significant component of traditional design engineering, especially those with geotechnical exposures.

Coverage and pricing for long-tail pollution exposures, whether on an occurrence Contractors Pollution policy or a claims-made site-specific policy, need to be examined in the context of insurer security factors, as claims leading to long-term cleanup projects or toxic tort class-action lawsuits may take several years to conclude.

NEW DEVELOPMENTS

Carriers are developing new products to address emerging risk exposures and new opportunities. Some of the innovations include:

- **Green products** –a range of new products aimed at environmentally friendly construction initiatives, such as the U.S. Green Building Council LEED program. Some of these new programs offer premium discounts for certified buildings. Some insurers are considering green Contractor's Pollution Liability policies for contractors who work on green buildings or can demonstrate practices that go above and beyond regulatory requirements and focus on sustainability.

- **Parent company protection** – a growing appetite for high-retention, blanket programs structured to cover all operations, facilities and liabilities facing a parent company – including a new AIG program targeting financial institutions.

- **Climate change** – the development of insurance solutions to address some of the new risks resulting from climate change. Steps can be taken now to examine the exposure and the potential coverage – or exclusions – in the context of current General Liability, Directors & Officers (D&O) and Environmental policies.

Many Environmental insurers are developing small business solutions that enable them to offer cost-effective pollution programs to smaller operators. These programs typically incorporate lower rates, reduced minimum premiums and the efficient delivery of such offerings through online or semi-automated systems.

Environmental insurers have been combining distinct products into bundled or package programs for some time and experiencing solid growth – for example, AIG's successful EAGLE program and XL's Pollution and Professional package programs for environmental service companies. Two established environmental insurers have recently added combined Casualty and Environmental policies to their product offerings. Liberty International Underwriters (LIU) offers a combined General Liability-Contractor's Pollution Liability and Professional policy for contractors (LIU Environmental Advantage). Zurich Environmental has also launched their Z-Link Commercial General Liability and Pollution Liability policy, which includes pollution coverage for premises-related risks, including chemical blending, manufacturers, warehousing and waste-processing facilities.

ACE continues to offer the Site Sure endorsement on their Excess Casualty policy, typically for larger accounts. This endorsement is efficiently underwritten and attractively priced to offer coverage similar to a Pollution Legal Liability policy for prospective exposures.

The leading Environmental insurers are increasingly able to offer coverage for more locations outside of the U.S., including locally admitted Environmental policies in certain locales. We have witnessed a significant increase in interest and placement of global Environmental insurance programs.

The anticipated profitability of the Environmental product line continues to attract new market entrants, most recently Great American Insurance Company (GAIC). Great American offers a full array of environmental insurance products for Premises, Contractors and Professional Pollution coverage. They also offer niche policies for Indoor Air Quality and Mold Liability and Closure/Post-Closure Financial Assurance.

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