The Willis Index

Willis

Environmental Newsletter

The Environmental Insurance and Risk Management Quarterly

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Market Review 2006

The Willis Index provides informed commentary on the Environmental Insurance Market, including updates on market conditions, case studies and the availability of new product offerings. In this edition, we have included a review of developments during 2006.

Market Activity

The Environmental Insurance Market has shown further signs of growth during 2006, with insurers interviewed reporting an increase of up to 100% in the number of policies placed compared to 2005. A corresponding increase in total premium placed has been evident, with total premium spend within the London and European Environmental Insurance Market estimated to be in the region of £60million (EUR90million). Annual premium placed into "Pollution Pool" insurance schemes available in countries such as France, Italy, Spain and The Netherlands comprises approximately EUR70million, whilst premium spend on environmental coverage available through the German general liability market has been estimated to account for approximately EUR250million (see page 4).

The increase in premium spent has been tempered by the continuing soft market conditions as well as an increase in the number of policies placed for operational risk exposures, as these tend to be written for shorter policy periods (and thus attract lower premium levels) than long term policies covering historic contamination risks.

The London and European Environmental Insurance Market comprises four insurers; ACE, AIG, Chubb and XL. Despite the exit of Quanta from the market in March 2006 (Quanta was put into orderly run-off in March 2006 due in part to heavy losses sustained during the 2005 US hurricane season), the entry of ACE into the London Market in October 2005 served to fuel competition. As a result, the market is now more competitive than at any other time, providing the opportunity for broader coverage for reduced premium levels compared to recent years.

Individual insurers are able to offer a capacity of up to approximately £25million (EUR35million), with higher limits available through the use of excess layers. Such an approach is seldom required however, as the vast majority of policies proceed with a limit of £10million (EUR15million) or less taken up, as reported in our Autumn 2006 Index.

Market Resources

Insurers have continued to build on the significant investment made in recent years in underwriting resources, enhancing the Market's ability to deliver technically robust and cost effective insurance solutions in a timely manner — a prerequisite for many transactions. Insurers have also enhanced their local service offering in many territories, for example by developing local language policies and local policy issuance capability.

Underwriters comment that the same cannot necessarily be said of brokers, many of whom seem unfamiliar with the environmental insurance products and uncertain how they can be applied. Although there are signs that brokers are taking more interest in the Environmental Insurance Market, one insurer commented, "We need to have more advocates of the benefits of insurance and to have a wider intermediary capability..." Another commented, "I am continually amazed at the lack of awareness of environmental risk and almost more importantly, the lack of knowledge of what standard insurance policies cover, or do not cover".

The need for specialist input from brokers and legal firms is never more apparent than when negotiating policy wording amendments with insurers. For the majority of placements, there is simply no "one size fits all" approach to Environmental Insurance policies; policy coverage and wording requires careful consideration to ensure that they adequately address the client's key concerns. According to insurers, policy exclusions such as "known" pollution conditions, development/change in use restrictions as well as claims notifications conditions are commonly the focus of negotiations, particularly on policies placed for large scale transactions.

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.

Willis voted "European Commercial Broker of the Year 2006" by StrategicRISK magazine for the second consecutive year.

Willis voted "Best and Most Innovative Insurance Broker of the Year" by Reactions magazine for the second consecutive year.

Willis voted "National Broker of the Year 2006" by Insurance Times for the second consecutive year.

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Market Review 2006 continued

"Environmental Insurance is no longer viewed as an esoteric niche product."

Uptake of Environmental Insurance

Our latest market survey indicates that mergers and acquisitions activity remains a major driver for the uptake of Environmental Insurance, often being used to support or replace environmental warranties and indemnities, particularly where the organisation offering the indemnity is of limited financial strength. However, there has been a significant increase in the uptake of Environmental Insurance for operational risks, with a number of insurers reporting that they have placed more policies for operational risks than for transactions (see graph below). Contractors also appear to be increasingly turning to Environmental Insurance, whether as part of Private Finance Initiatives (PFIs) or independent of such project drivers. Large Scale Voluntary Transfers (LSVTs) also continue to be an important source of Environmental Insurance opportunities. A recent UK court case has, however, served to highlight the potential deficiencies in pollution cover under general liability policies (see breaking news on page 6).

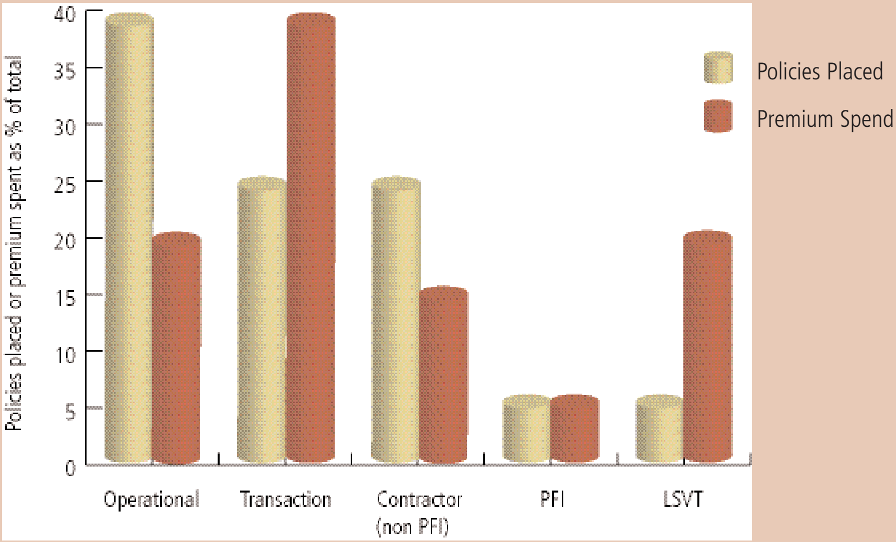
As shown in the graph, premium spend is still dominated by transactions and LSVTs, as these tend to involve long term policies, and thus attract higher premiums than policies providing annual operational cover.

Whilst there has been an increase in the uptake of Environmental Insurance across the board, insurers report that small to medium size companies are increasingly turning to Environmental Insurance to assist on transactions and to fill the gaps in their general insurance programme; a trend helped by the availability of low cost environmental insurance solutions as part of public liability/property insurance programmes (see article on page 5). One insurer commented, "Environmental Insurance is no longer viewed as an esoteric niche product. It can be used not only to fill the gaps in a company's general liability policy but also to protect the company's property assets."

Regional variations in the uptake of Environmental Insurance are becoming evident, with London based insurers reporting a significant increase in the uptake of environmental insurance outside the UK. One insurer indicated that non-UK risks accounted for approximately 20% of policies placed during 2006. The majority of growth appears to have been seen in continental Europe, particularly in countries such as Spain, The Netherlands, Germany and Italy, however significant interest is also developing in parts of Asia and Australasia for both operational and transactional risks.

A key factor in the uptake of environmental insurance, particularly for long term policies, is the potential for future environmental liabilities to arise through changing legislation or enforcement practices. Environmental Insurers have mixed views on whether the forthcoming EU Environmental Liability Directive, due for implementation in all Member States by 30 April 2007, is having any effect on the uptake of environmental insurance yet. Whilst, in most Member States, there are no current proposals to bring in compulsory financial provision measures (such as insurance), this could change following a planned review of the uptake of such measures to be undertaken by the European Commission in 2010.

Relative number of policies placed and premium spent per sector in 2006*
***Based on representative data provided by environmental insurers**



Premium Levels

At Willis, we have seen substantial premium reductions in recent years, with premiums for one-off accounts down to as little as 50% of levels quoted several years ago. Current premium rates are typically from less than 1% up to approximately 4% of the policy limit, depending on the nature of the risk as well as the policy period, limit and deductible selected. In our Q1 2006 Index, we surveyed insurers on their experience, and most acknowledged that market competition had been the main factor driving rates down. A recent UK court case has, however, served to highlight the potential deficiencies in pollution cover under general liability policies (see breaking news on page 6).

During 2006, premium levels have continued to fall slightly, particularly for short-term policies, with premium levels of less than £1000 achievable for certain risks. Despite this, one insurer commented that they had experienced an increase in their average premium level; possibly a function of the nature of risks they have underwritten in 2006 compared to previous years. The availability of environmental cover as extensions to public liability policies (see page 5) has also increased the range of options available to companies looking for cover at a competitive premium, although it is too early to assess the uptake of such products.

Claims Experience

The payment of valid claims is a fundamental aspect of any Insurance Market. Environmental Insurers recognise that effective and fair claims management is important in demonstrating the value of Environmental Insurance. A number of environmental insurers interviewed considered that consistency in the handling of pollution related claims under general liability policies is also needed. One insurer commented: "There needs to be a clear message on the scope of environmental cover, or lack of it, available under general liability policies." This is made all the more difficult due to the low visibility of claims, as most are settled out of court.

Whilst the environmental press routinely highlight the potential to be prosecuted by the regulators for pollution incidents, many companies are unlikely to be concerned given the low level of fines typically faced. However, the fines are not the whole story, as with any pollution incident there will almost inevitably be clean up requirements or a third party claim, the cost of which may far exceed any fines imposed by the regulators. Business interruption losses can also be substantial, even if the clean-up costs are not.

In our Summer (Q2) Index, we surveyed environmental insurers on their recent claims experience, and found that up to 10% of policies underwritten in the last few years were subject to claims; a trend which most insurers agree is increasing, in terms of both the frequency and magnitude of loss.

One of the key benefits of environmental insurance, particularly long term policies, is that they are designed to respond to changing legislation. However, insurers interviewed were unanimous that the variable approach of environmental regulators in implementing and enforcing the legislation presented an even greater risk. Regional and temporal variability in local enforcement practices create significant difficulties in predicting the long-term potential for future regulatory action, even in cases that have previously been 'signed off' by the regulators. One insurer considered that this not only presented difficulties in assessing the risk, but also a challenge in generating client interest in insurance in the first place.

North American Experience

The Willis Environmental Team provides a global resource to assist clients in managing environmental liabilities, often working with Willis offices and other intermediaries throughout the world, including of course our colleagues in the North American Environmental Practice who have provided the following update on the North American Environmental Insurance market.

Overall, the North American Environmental Insurance market has maintained the moderate but steady growth pattern that we have experienced in recent years. This US$2 billion to US$3 billion market, however, is being propelled now by a new set of drivers that include:

— The routine application of Environmental Insurance to a wider array of properties (including non industrial sites) and transactions (both M&A and real estate)
— The burgeoning brownfield and military base redevelopment markets
— New demands for greater financial disclosure of environmental liabilities
— The trend towards insured, fixed-price clean-up projects

Summary

As the global Environmental Insurance Market develops, we are seeing a gradual change in underwriting profile, with less emphasis on one-off, long-term, project-specific placements and an increasing proportion of short-term, renewable programmes. It is clear that this market has now evolved from that of a specialty niche product line into a mainstream purchase, addressing a wide range of circumstances and needs. As the claims experience matures, the value of environmental cover will become

"There needs to be a clear message on the scope of environmental cover, or lack of it, available under general liability policies."

Country profile: Germany

A sound understanding of the applicable environmental legislation is fundamental to the assessment and management of environmental risks in any country. In this article, we provide a brief overview of environmental legislation and the Environmental Insurance Market in Germany.

Environmental Legislation

Environmental law in Germany is enacted at the federal level, complemented by state laws and ordinances. The principal regimes include the Federal Emission Control Act (Bundesimissionsschutzgesetz) relating to the control of emissions, Economic Cycle and Waste Law (Kreislaufwirtschafts- und Abfallgesetz) relating to the control, disposal and management of waste, the Federal Water Resources Act (Wasserhaushaltsgesetz) relating to the control and management of water, and the Soil Protection Act (Bundes-Bodenschutzgesetz). Civil law also includes various statutes relevant to environmental matters, including the Environmental Liabilities Act 1990 (Umwelthaftungsgesetz).

Land contamination is regulated under the Soil Protection Act. Federal and state water protection laws also apply to ground water pollution. The appropriate regulatory enforcement authority will depend on which environmental media is affected (soil, soil and air, or groundwater and leachate).

The German government recently published a draft Environmental Damages Act (Umweltschadensgesetz), intended to implement EC Directive 2000/35 on Environmental Liability. The proposed Act closely follows the provisions of the Directive, which is designed to prevent and remedy damage caused to protected habitats and species, inland waters and soils. Claims for damage to third party property or the health of individuals will continue to be brought under the Environmental Liabilities Act.

Under the Soil Protection Act, a competent authority must have sufficient grounds for suspecting that a site is contaminated before it can demand potentially responsible parties to undertake an investigation. If the identified levels of contamination exceed specified threshold levels and are considered to be a threat to the environment, then remediation measures such as clean-up, containment or monitoring can be ordered. Various persons are potentially liable under the Act to investigate and remediate contamination at their own expense, these being:

- The "disturber by conduct", comprising the original polluter or their legal successor;
- The "disturber by fact", including:
  - The owner, lessee or any operator of the relevant property
  - Any former owner of the property has ongoing liability if they transferred the property after 1 March 1999; and were aware of the presence of contamination when they sold the property
- Shareholders and parent companies may also be liable if held responsible for a disturber either in conduct or fact.

German Environmental Insurance Model

At Willis, we have seen increasing appetite in the use of environmental insurance by German clients, particularly in transactions. The general liability insurance market in Germany also offers coverage for environmental losses, the scope of which is wider than is available in most general liability markets, providing an alternative to the specialist Environmental Insurance Market for operational risks. Coverage is provided via the 'Environmental Insurance Model' policy (Umwelthaftpflichtmodell), which was introduced by the German insurance market in response to the Environmental Liabilities Act 1990. For certain industrial operations/plants, the use of such insurance is mandatory.

The Environmental Insurance Model policy comprises seven different modules as listed below, each relating to a particular type of operational risk. The insured selects the appropriate module(s) to include in the insurance policy, depending on the nature of their operations.

Modules:

1 Plants listed in Water Resource Act (plants for production, processing, storage or transport of pollutants)
2 Plants listed in Annex 1 of Environmental Liability Act (e.g.mining,steel, energy, chemical production, timber, food, waste etc)
3 Other notifiable plants
4 Sewage treatment plants and other activities causing the pollution of watercourses
5 Plants listed in Annex 2 of Environmental Liability Act (hazardous plants, for which environmental insurance cover is compulsory)
6 Contractors' risks (e.g. risk of recourse due to faulty design, assembly or maintenance of plant resulting in a pollution incident)
7 Plants/activities not covered in the above Modules.

Scope of Cover

Country profile: Germany continued

The Environmental Insurance Model policy is intended to respond to third party claims arising from bodily injury, property damage or financial loss due to environmental impact. In addition to "sudden and accidental" pollution events, the policy can also cover third party claims arising from environmental damage caused by the gradual, unintended release of pollutants. Consequential losses such as damage caused by vibration, heat or smoke generated by an incident at the insured's site are also covered.

The "insured event" is not the pollution event leading to the loss or the resultant claim, but the first identification (so-called "manifestation") of the bodily injury, property damage or insured financial loss by the injured or another third party.

The cover is intended to respond to damage caused by "unforeseen" pollution events that take place during the policy period, although spillages may be excluded under the "spill clause" ("Klecker-Klausel"). Any environmental damage caused by the "normal" operation of an installation / plant is therefore excluded from the insurance cover, although the operator of an installation is still liable for such damage under the terms of the Environmental Liabilities Act. An exception to this rule applies only if the insured party proves that he could not have foreseen the possibility of such damage, based on the state of technology and knowledge at the time of the pollution incident.

Potential Role of Specialist Environmental Insurance

Whilst the German Environmental Insurance Model certainly provides broader cover than is available under general liability policies available in most countries, there are a number of gaps in the cover which can be addressed through the use of specialist Environmental Insurance. For example, first-party losses such as on-site clean-up costs and business interruption losses are excluded under the German policy, as are losses arising from historic contamination; typically a key concern during transactions. The restriction of cover solely to "unforeseen" pollution events and exclusion of losses arising from spillages may also be of concern. These and other aspects can be covered by specialist Environmental Insurance, enabling clients to obtain robust coverage for environmental losses by complementing the coverage available through the local German market.

Low Cost Environmental Insurance Products

Our review of market activity in 2006 confirms that companies are increasingly turning to Environmental Insurance to assist in managing their environmental liabilities. In response to this, Environmental Insurers have developed a range of affordable insurance solutions to supplement their existing products.

Traditionally, Environmental Insurance has been viewed as a specialist niche product, which can be costly and require detailed and time consuming underwriting. However, as reported in our 2006 Market Review (see page 1), this is not necessarily the case, as Environmental Insurers have sought to further reduce premium levels and information requirements, whilst still offering valuable environmental cover well beyond that available under standard public liability and property policies.

ACE offers environmental cover as an addition to the limited third party "sudden and accidental" coverage provided by their property/casualty insurance policy. A separate ring-fenced limit is available for first party losses arising from pollution incidents that occur during the policy period. Limits of indemnity of £1 million to £5 million are available with retention levels as low as £2,500. Premiums for this extension start at £750 for the most basic risks.

AIG launched the Pollution Legal Liability SiteGuard Policy in 2006. The policy is offered via SiteGuard, an environmental risk screening report developed for UK sites by Groundsure and AIG Consultants. The SiteGuard policy is based on AIG's Pollution Legal Liability policy form and provides cover for statutory clean-up costs, third party claims for bodily injury and property damage and associated legal defences. Coverage can extend to losses arising from both 'pre-existing' and 'new' pollution conditions. As with ACE and Chubb, AIG also offer environmental cover as an extension to their public liability policies. Unlike ACE and Chubb, AIG do not charge any premium for this extension, however the limit of liability offered is relatively low (typically £25,000).

Chubb's low cost product uses their Environmental Site Liability policy wording and provides cover for bodily injury, property damage and remediation costs arising from new pollution conditions only. Chubb are able to offer such cover on the basis of minimal information requirements such as a property/casualty survey, which the Insured will usually have available at renewal.

XL's Contaminated Land Insurance Policy (CLIP) is available via the environmental consultancy Argyll Environmental. The policy is placed on the basis of Argyll's Environmental Site Solutions due diligence report, and is aimed at UK properties assessed by Argyll as representing a low to moderate environmental risk. Policy periods of up to five years are available, providing coverage for third party claims for bodily injury and property damage, as well as on-site and off-site clean up costs arising from historic contamination, with optional cover also available for new pollution incidents.

Breaking News

Statutory Clean Up Costs Outside the Scope of Public Liability Coverage

In a recent UK court judgement, it has been ruled that costs owed to the Environment Agency, and costs incurred through complying with statutory notices, were not covered by the claimant's public liability policy. The judgement in Bartoline Limited v (1) Royal & Sun Alliance Insurance plc (2) Heath Lambert Limited (2006) confirms that such costs did not constitute a "legal liability for damages" as required by the policy wording.

The judgement thus draws a clear distinction between the statutory framework and the principles underpinning common law claims for damages. It remains to be seen how the general liability insurance industry will respond to this judgement, however it provides further evidence that the only way of obtaining more certain insurance cover for clean-up costs is through the use of Environmental Insurance. Further details of the case will be included in a future Willis Index.

European Union Environmental Liability Directive – UK Consultation

As reported in our Summer 2006 Willis Index, the EC Directive 2004/35 on Environmental Liability (the "Environmental Liability Directive") must be implemented by Member States by 30 April 2004. The Directive is intended to prevent damage occurring to water, protected species, natural habitats and land, and to increase the responsibility of operators to mitigate such damage when it does occur.

In November 2006, the UK government released a long awaited consultation document on options for implementing the Environmental Liability Directive in England, Wales and Northern Ireland. A separate consultation is being undertaken in Scotland. Many of the requirements of the Directive are mandatory, leaving member States with little or no flexibility as to how such measures are implemented. Certain aspects are, however, subject to the discretion and choice of individual Member States; it is these aspects on which the government is seeking opinion by raising specific questions.

For a number of aspects, the government sets out its own proposals for implementation. For example, it is proposed that the threshold for land damage for the purposes of the Environmental Liability Directive will be the same as for Contaminated Land under Part 2A of the Environmental Protection Act 1990 (i.e. at least a "significant possibility" of "significant harm" being caused). Unlike a number of other Member States, the UK government does not propose to implement compulsory financial security (such as Environmental Insurance), relying instead on the EC's planned review of the uptake of such provisions in 2010 to determine the need for such a requirement.

The deadline for responses to the consultation was 28 February 2007. The government plans to hold a second consultation on the draft legislation when issued.

Meet the Team

Will Booker

Will joined Willis in 2004 following graduation from Birmingham University where Will studied geography. Will has since gained experience in a number of insurance disciplines within Willis, including directors and officers (D&O) insurance, insurance due diligence, and Environmental Insurance. The latter has included the design and implementation of Environmental Insurance solutions for a range of projects, including large property and corporate transactions, operational and construction risks as well as various Private Finance Initiative (PFI) projects.

Environmental Index Breakfast Seminar

Willis will be holding a Breakfast Briefing Seminar on the 19th March 2007 at our office in Trinity Square, London, covering many of the issues in this Index. If you would like to attend and have not already received an invitation, please contact Amy Dawson on +44 (0)20 7975 2856 or email dawsonaca@willis.com

Willis is one of the world's leading risk management and insurance intermediaries. We have over 15,000 professionals in over 300 offices around the world.

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