Headlines and Highlights

– Carriers differ significantly as respects target clientele, capacity, policy terms and special-purpose Environmental coverage offerings.
– Finite programs associated with legacy Environmental liabilities continue to grow, driven by corporate governance activities.
– Mold remains a major issue for the US real estate and construction industries.
– Property-related transactions are heating up as M&A activity rebounds with the recovering economy.
– Capacity is strong despite the loss of a major market (Kemper) and the retrenchment of another (Chubb).

State of the Market

An Overview

Despite some changes in the cast of carriers playing on the Environmental stage, capacity remains strong, and this sector continues to avoid the remarkable premium increases seen in the recent past in other insurance market segments. At the same time, the Environmental market is now exhibiting a form of hardening as challenges appear in underwriting terms and engineering requirements.

The scope of required engineering information has increased significantly, in particular with cost cap (remediation stop loss) products. Phase I surveys are often the minimum requirement. If there are no surveys available, carriers are looking for protocols – such as self-audits – to be established by the insured.

Conservative underwriting attitudes are also reducing appetites for unusual placements. More effort – and more management involvement – is required by organizations seeking complicated types of coverage.

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The Markets

During 2003, we lost a major market as Kemper struggled with financial challenges and put its environmental business into run-off. We also witnessed an exodus of Chubb senior managers, who left to join a start-up, Quanta Insurance.

Primary market capacity is now provided by major markets that include: ACE, AIG, Chubb, Gulf, Liberty International, XL (formerly ECS) and Zurich. There are also a number of small and new markets servicing environmental program needs.

The following survey of the major insurance carriers highlights new products, coverage enhancements and other hot topics.

ACE Environmental

ACE Environmental Risk (AER) offers a range of pollution products targeted at both the largest organizations and the middle market, and continues to work closely with the traditional primary and excess casualty units of ACE USA to offer a whole-account approach to environmental risk.

In the coming months, look for ACE to expand into additional regions where ACE USA maintains a presence, and to expand its offerings for the Energy and Construction sectors. Efforts in these large-risk areas will likely be balanced by high-volume, lower risk business with small contractors and those with underground storage tank (UST) exposures. To this end, ACE recently launched a web-based UST underwriting platform called ACE Tanksafe.

AIG Environmental

The passage of Sarbanes-Oxley has created a need for companies to reconsider their approach to reporting environmental matters in SEC filings, especially when it comes to the required certifications of financial controls and "fairness" of financial reporting. Pressure is growing for industrial companies with environmental exposures (known or unknown, past or future) to take a proactive approach in communicating meaningful and useful information to shareholders and prospective investors concerning their environmental liabilities.

AIG views this as a major growth opportunity over the next few years, as companies strive to be more transparent in their accounting and to demonstrate adequate financial control over potential loss scenarios. Accordingly, AIG is positioning itself as a provider of appropriately structured Environmental insurance programs that demonstrate compliance with clients' corporate governance obligations while also building certainty for shareholders regarding the potential maximum costs of contamination at specific sites.

AIG is still the largest Environmental insurance carrier, with a capacity of $100 million and the ability to write a range of multiyear contracts. AIG can also develop combination finite programs that support long-term multiyear policies. The carrier offers a combination Errors & Omissions and Contractors Pollution Liability product for medium to small projects.

Chubb and Quanta

Chubb lost a significant number of its Environmental underwriters this past year, but remains committed to writing Environmental business.

The parting of the ways occurred when Chubb shut down its credit derivative business, which housed the Environmental underwriters. A number of the Environmental staff took the opportunity to join a new start-up operation called Quanta Capital Holdings Ltd., a Bermuda-based holding company that provides specialist insurance and reinsurance products, as well as risk management and consulting services.

Chubb, meanwhile, is reconstituting its Environmental resources in key areas and will continue to offer Environmental insurance from within Chubb Commercial Insurance.

Gulf Insurance

Gulf Insurance Group continues to focus on contractors and consultants of varying sizes, targeting accounts with revenues ranging from $1 million to $25 million.

Gulf is also seeing increased opportunities in site policies as the market picks up for traditional risks such as shopping centers, office complexes and property transfer accounts.

Liberty International

Liberty International is a growing Environmental market for industrial, commercial and contracting industries. Its capacity is $25 million per loss and in the aggregate.

Liberty underwrites on a traditional annual basis. While it maintains the capacity to write more complex deals, this business tends to be a much smaller part of its portfolio. Within these parameters, the hazard level of any particular class is not a limiting factor for Liberty. It is willing to write difficult Environment Impairment Liability (EIL) classes, with appropriate attachment points, pricing and risk management controls. Liberty participates as an excess underwriter on otherwise acceptable risks.

> As organizations approach Environmental risks with increasing sophistication, the implementation of programs grows in sophistication as well.

Liberty is also a Professional Liability market, focusing on environmental service firms rather than broadly diversified engineering service providers.

XL Environmental

XL will continue its strategy of offering clients fully integrated Environmental risk solutions. One of its key growth objectives is to expand its international business by nurturing relationships with global brokers. Domestically, XL will look to differentiate itself by maintaining a high service posture and capitalizing on its strong internal risk control and claims management resources.

XL is enjoying strong growth and is expecting to report a revenue increase of over 20 percent for 2003 and an increase in its US market share to over 15 percent. XL has been pushing to consolidate its position as the second largest Environmental insurer in the US market.

Zurich North America

Zurich North America is continuing its strategy of offering straightforward and affordable protection to corporations, municipalities and local governments against the full range of potential environmental liabilities. This includes everything from compliance with underground storage tank regulatory requirements to complex Superfund or legacy contamination liabilities.

In the past year, Zurich has experienced significant growth in business related to the redevelopment of previously contaminated land, working with local governments, developers, environmental regulators and contractors to resolve difficult liability issues and stimulate brownfield development.

The growing acceptance of risk-based corrective actions means that it will be more commonplace for contamination to remain at remediation sites following a negotiated agreement between the party responsible for the clean up and the local government, regulators or other involved parties. Zurich views this as a driver for further growth, as organizations seek protection from potential "re-openers" that could, after redevelopment of the site in question, expose them to additional risk.

Environmental Coverages

Mold emerged as one of the hot topics of 2002 and showed no signs of abatement in 2003. Headline cases such as the $55 million Hilton Kalia Tower remediation kept the issue front and center. Mold exclusions to Liability and Property policies are now a fact of life, but all major Environmental markets offer some form of coverage under Pollution Liability forms.

A similar pattern is also evident for **Bioterrorism** coverage. The risk is excluded from virtually all terrorism coverage outside of TRIA; environmental carriers have stepped in to offer coverage via site-specific EIL policies.

Long popular, **Contractors Pollution Liability** came into play in the past year as a key coverage instrument through which builders can address mold risks that have been excluded from their general liability policies.

Blended Finite Programs for Legacy Liabilities continue to be a focal point for the Environmental insurance market, driven by several factors:

– Corporate governance issues are driving organizations to fully evaluate and address the balance-sheet impact of their environmental liabilities.
– Companies seek financial strategies that allow them to "walk away" from environmental liabilities associated with remediation and long-term operation, maintenance and monitoring (OM&M) activities.
– With carriers becoming increasing reluctant to provide closure/postclosure or reclamation financial insurance (due to their inability to withdraw from a program once they enter into it), self-funding (finite) options are playing an increasingly important role in the financial assurance arena.

The beginnings of economic recovery appear to be stimulating renewed mergers and acquisitions activity, and with it increasing demand for **Property Transfer Coverage**. PTC policies back environmental representations, warranties and indemnities and protect both buyers and sellers from the financial consequences of unknown environmental contamination. Coverage enhancements such as Natural Resource Damages, Non-Owned Disposal Sites, and contingent protection in the event of financial failure of any of the parties to a transaction will likely remain popular.

As organizations approach environmental risks with increasing sophistication, the implementation of programs grows in sophistication as well. For **Remediation Cost Cap** programs, probabilistic cost modeling is now commonly used to set attachment points, establish co-payments, and compute premiums.

As predicted, **Underground Storage Tank** coverage re-emerged as a significant issue in 2003, driven by the insolvency and sunset provisions of many state UST funds. Coverage ranges from individual tanks operated by contractors to multi-site convenience store portfolio programs.