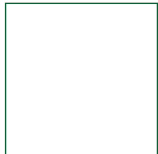
Financing Environmental Risk in the Chemical Sector



The global environmental agenda is developing at a rapid pace. New liabilities are continually being created as legislative frameworks evolve in response to the changing demands of the international community.

Changes to accounting procedures are altering the way in which companies can provide for liabilities thereby increasing the visibility of potential environmental risks to shareholders and investors.

Demonstrating effective management of environmental risk is a governance obligation and a key priority for companies wishing to reassure stakeholders and proactively manage their corporate reputation.

Whilst chemical companies face a diverse range of environmental liabilities, potentially the most financially significant exposures tend to fall into the following broad categories:

- Operational pollution risks that are customarily associated with the use and storage of potentially polluting materials
- The legacy of existing contamination resulting from historic day to day operations
- Liabilities associated with the off-site disposal of waste (especially relevant in the US)
- Contingent losses associated with the above issues - such as business interruption costs.

Most chemical companies have established reserves for known clean up obligations or budgeted capital expenditures for improvement programmes.

Unfortunately, however, the risks associated with pollution or land contamination are impossible to predict with any certainty and such provisions may therefore prove inadequate.

The discovery of new issues, the accelerated closure of plants, tightening legislation or increasingly strict enforcement could lead to additional liabilities. Such uncertainties can have a material effect on the company's liquidity or financial condition, which may in turn undermine investor confidence.

Environmental insurance and alternative risk transfer mechanisms are playing an increasingly prominent role in the management of such financial risks. The market can now offer significant capacity, with long policy periods and pricing is now realistic and competitive. There is substantial flexibility in the design of insurance contracts and the underwriting criteria are relatively straight forward.

Willis has extensive experience in the design and placement of such programmes and is one of the leading environmental insurance advisers.

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Environmental Impairment Liability
The continual improvement of environmental management systems within an organisation will reduce the probability of an environmental loss during ongoing operations, but cannot eliminate it entirely.

The growing need to address uninsured exposures has led to the incorporation of specialist environmental insurance policies within corporate risk management strategies. Environmental Impairment Liability programmes typically provide catastrophe protection for such exposures on a renewable basis. They are designed to dovetail with the general liability programme and cover operational pollution risks, historic contamination liabilities and associated contingent exposures.

Facilitation of Commercial Transactions
Most environmental liabilities do not crystallise until a site or business is to be sold or redeveloped. The complexity of modern deals, ever tighter timescales and pressing completion pressures require fast, effective solutions to the allocation of environmental risks between counterparties.

Environmental insurance is now being routinely used as a catalyst to unlock deals by removing uncertainty, maximising disposal values and avoiding the need for environmental indemnities.

Balance Sheet Protection
Environmental risk financing mechanisms can be used to cap the cost of 'known' remediation obligations (individually or as an aggregate), hedge against the impact of timing uncertainties and transfer the risk of encountering further 'unknown' issues.

Accounting standards require publicly quoted companies to disclose their environmental liabilities on their financial statements. Structured solutions based upon 'blended' programmes (incorporating an element of self funding and risk transfer) can be used to remove, or at least offset, environmental liability provisions from the balance sheet and reduce the risk of earnings volatility. They typically include a profit sharing provision to reward a favourable loss experience.

Such programmes help companies to release reserves, manage cash flows, cap liabilities and therefore enhance shareholder value.

"The legacy of the past should not affect the future"

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