

GLOBAL ENVIRONMENTAL LIABILITY MANAGEMENT: WORLDWIDE ENVIRONMENTAL INSURANCE SOLUTIONS

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 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 in locations far from our clients' home countries. Our clients may ask:

- Does my company have an environmental exposure in a foreign location?
- Are there any environmental regulations that may apply to my operations? If so, are they commonly enforced?
- Are there any compulsory requirements for environmental insurance in our foreign locations?
- 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?



While there are no absolute answers, it is important for organizations to work with a broker that can help them understand 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 most countries 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 enforce remediation following 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 hold operators responsible for third-party bodily injury and property damage claims, the Directive adds 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. Others have not, but most are well on their way toward 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 is likely to require the maintenance of financial guarantees on a wider basis (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 China State 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 in other jurisdictions 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 mandates
- 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.

There are many ways to obtain coverage, including specialty environmental insurers with international capability, 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).

Many U.S.-based specialty environmental insurers 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 look 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 that 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.

It should be noted 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 home 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 penalties. 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.

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