

Strategic **RISK**



A GUIDE TO

Environmental Liability in Europe

SPONSORED BY



25 years of
insuring progress



with nature in mind, **ACE** insures progress

Property & Casualty | Accident & Health | Life

It takes the right people, a strong balance sheet, worldwide capabilities and a flexible approach to understand the delicate balance between industry and the environment. These are the strengths of ACE and our innovative environmental liability insurance. We take on the responsibility of your risks so that you can take on the responsibility of making things happen. We call this *insuring progress*. Visit us at acegreen.com



FOREWORD

ENVIRONMENTAL LIABILITY IS nothing new in Europe. Yet European risk managers still aren't seeing the need to buy a standalone environmental insurance product. Many are happy to seek out extensions in their general liability policies to cover risks introduced by the Environmental Liability Directive (ELD).



A number of environmental disasters have occurred in Europe since the ELD passed into law. France's Bouches-du-Rhône oil spill received a great deal of media attention, yet the take-up of environmental insurance products remains low. And in the case of the Hungarian toxic spill, the government fears cracking down on the company involved for political and economic reasons. Neither incident has provided particularly accurate data for what constitutes environmental liability or shown how regulators will approach the subject in a post-ELD world.

So, as risk managers mull the consequences of a major incident, insurance could start to look like the right option. But the decision might not be left in their hands for much longer. The European Commission is considering introducing a Europe-wide mandatory financial protection scheme. Companies may have to buy insurance or find another way of reserving cash to pay for the clean-up if they cause damage to the environment.

Nathan Skinner is editor of StrategicRISK

2 | Introduction

The ELD brings consequences

4 | Germany

A two-tier system makes life difficult for risk managers

6 | France

The Bouches-du-Rhône disaster illustrated the cost of pollution

8 | United Kingdom

Firms are still burying their head in the sand over the ELD

10 | Spain & Portugal

Cover is mandatory but firms still lack awareness

12 | Eastern Europe

The fall-out from the toxic spill

14 | Scandinavia

Why Scania won't buy ELD cover

16 | Resolving a claim

The environment's true value

18 | Buying the right cover

Assessing the impact of the ELD

20 | Conclusion

More data is needed before ELD take-up will increase

Editor Nathan Skinner

Editor-in-chief Sue Copeman

Market analyst Andrew Leslie

Group production editor Aine Kelly

Deputy chief sub-editor Laura Sharp

Business development manager

Donna Penfold tel: +44 (0)20 7618 3426

Production designer Nikki Easton

Group production manager

Tricia McBride

Senior production controller

Gareth Kime

Head of events Debbie Kidman

Events logistics manager

Katherine Ball

Publisher William Sanders

tel: +44 (0)20 7618 3452

Managing director Tim Whitehouse

To email anyone at Newsquest

Specialist Media

please use the following:

firstname.surname@

newsquestspecialistmedia.com

SPONSORED BY



25 years of insuring progress

Do you know the consequences of environmental liability?

Focusing on the financial repercussions of pollution, the Environmental Liability Directive brings much-needed clarity

WITHOUT QUESTION, THE Environmental Liability Directive (ELD) is a significant development in environmental law, but we must be mindful not to focus solely on this most recent legislation and ignore existing law, which is well regulated in many territories. These laws still exist and will still be enforced alongside the ELD, not replaced by it. In some EU member states, however, the position is very different, as less well-developed environmental law means the ELD has meant a more fundamental change.

What the ELD does do well is focus far more attention on the consequences of environmental damage, particularly with respect to natural habitats and protected species, which we may call 'biodiversity'. Indeed, the introduction of complementary and compensatory remediation costs is testament to this core focus, and demonstrates how the financial consequences of environmental damage for the polluter will be more severe under the new regime. The introduction of strict liability is another important development, replacing the need to prove fault or negligence for many 'regulated' industry sectors.

The ELD also looks closely at preventing incidents in the first place, as

operators are required to take preventative measures in the event of an imminent threat of environmental damage. This proactive approach contrasts with established environmental law, which is mainly concerned with repairing the damage after the event.

Financial drivers

There is still much uncertainty surrounding the operation and enforcement of the ELD, particularly in terms of financial penalties for polluters. This is understandable given how wide-reaching it is geographically and with respect to the liabilities created, so only time will tell as the law is allowed to 'bed in' across the EU.

One key driver behind enforcement will be the resources available to the regulators. Unfortunately, tough economic times see public bodies reducing staff numbers, which will only weaken their ability to enforce new regulations.

The economic climate may also be responsible for government reluctance in enforcing environmental regulations too strictly. The need to help industry out of recession means a heavy-handed approach to enforcement may not be the right way to go at this time.

Regardless of enforcement activity, changes in legislation are a positive driver in companies' growing awareness of their environmental responsibilities, which is coupled with an increased focus on corporate responsibility across the board. Reputational risk is certainly a big part of this as customers, shareholders, investors and other stakeholders will increasingly look at environmental performance when making decisions.

While companies may be more aware of environmental risk, recognition of the consequences – despite the legislative drivers – is questionable. Many will

associate such risks with large-scale pollution events, such as that which occurred in the Gulf of Mexico last year.

This focus on severity means businesses, regardless of type and size, overlook their own environmental exposures, plus it must be remembered that financial consequences for each company are relative. Indeed, the costs of remedying environmental damage may easily be absorbed by one organisation, but could threaten the solvency of another.

Covering yourself

One very important development championed by the ELD in particular is the concept of financial provision for environmental damage. While this initiative is still in its infancy across the EU and has without doubt been slowed by the current economic downturn, it is a significant change and presents good opportunities for the insurance industry. Insurance is seen by many as the most obvious and arguably efficient solution to satisfy financial provision requirements.

Transferring the financial consequences of environmental risks to the insurance market should be a key consideration for companies whether legislation encourages it or not. While many organisations are unlikely to act unless forced to by legal or contractual requirements, it is evident that as awareness of environmental risks has developed, so too has demand for environmental insurance solutions.

Companies that appreciate the importance of such risks and the need to manage them strategically also recognise that environmental insurance can be an efficient and effective means to support this strategy.

The environmental insurance market is well established in the UK and many

SUMMARY

The Environmental Liability Directive

- The ELD focuses on the consequences of environmental damage and recognises the need to expand existing laws.
- Financial provision for environmental damage is a rapidly developing requirement in the EU, and companies should protect their business regardless of legal requirements.
- Demand for environmental insurance has risen in line with risk awareness.
- Economic conditions mean many organisations cannot afford to assess environmental risks or take out insurance – but they cannot afford the uninsured losses either.

other EU territories, but of late has focused on 'operational' environmental risks: those that companies face as a result of their ongoing business activities. The goal here is that this type of insurance be considered in the same way as other lines, like public liability or property.

There is room for development, but specialist insurers in this sector have made significant strides in making this type of insurance accessible and affordable for all organisations, irrespective of size or industry sector. Certainly, environmental risk insurance is not exclusively for large multinational corporations; a wide range of entities from small family-run firms to global organisations have adopted this level of risk management.

Current economic conditions are making it difficult for many to assess environmental risks or indeed purchase adequate insurance protection, but companies must ask whether they are able to afford the consequences of uninsured environmental events. **SR**

Wayne Harrington is UK and Ireland manager of environmental risk at ACE

In this environmental state, the polluter always pays

But a 'patchwork of regulation' makes Germany a tough place for risk managers to get to grips with environmental exposures

KEY POINTS

01: Authorities can intervene if they believe there is a possibility of pollution.

02: The polluter must pay for all clean-up costs.

03: Environmental protection is a subject at the forefront of public opinion.

04: A duty to protect the public means companies creating environmental hazards must take reasonable precautions to prevent damage.

ENVIRONMENTAL LIABILITY IN Germany is split into three main principles:

- The 'precautionary principle' is aimed at avoiding or minimising the possibility of pollution in the first place. Authorities can intervene and regulate facilities even if they have not yet polluted.
- The 'polluter pays' principle means that anyone responsible for causing environmental harm will be liable for the clean-up costs.
- The 'co-operation principle' means that environmental policy must be developed in close collaboration with public and private organisations.

German environmental law is mostly governed by federal acts. Administering and enforcing the laws, however, is left to its 16 states. Important federal authorities include the Federal Ministry for the Environment and the Federal Environment Agency.

"While the Federal Ministry defines the political agenda, the Environmental Agency is in charge of environmental research, planning and administration," Freshfields Bruckhaus Deringer partner Wolf Friedrich Spieth explains.

This two-tier system makes it difficult for risk managers to get a grasp

KEY ADDITIONAL LIABILITIES FROM THE ELD

- **Operators have to report any pollution incident** – it is a criminal offence not to do so.
- **Strict liability** – fault or negligence is not a prerequisite for enforcement action in some industries. There is no limit on financial liability.
- **Increased scope for claims** – citizens or environmental groups can launch their own claims against polluters.
- **More onerous remediation.** There are three new types:
 - *primary remediation*: returning the environment to a baseline condition after pollution;
 - *complimentary remediation*: if baseline conditions can't be achieved then the polluter has to remediate, for example by creating a new habitat; and
 - *compensatory remediation*: compensation for losses until the primary or complimentary remediation is completed.
- **Mandatory financial security** – member states are developing mechanism to ensure polluters have the capability to carry out environmental remediation.

on their environmental exposures in Germany. "Germany is one of the hardest markets to find environmental insurance cover because there is a patchwork of regulation," Ferma's general secretary and environment expert, Pierre Sonigo, says. "Cover is available, but generally insurers are very strict with their terms."

Added to this, and making the climate even more onerous for business, Germany is regarded by many as an 'environmental state', meaning that it considers environmental protection as one of its central tasks.

"Public opinion in Germany is traditionally very sensitive to environmental issues," Freshfields Bruckhaus Deringer partner Michael Ramb says. The utmost care should be applied when dealing with these issues.

The nitty gritty

As in most countries, the heavy engineering and industrial companies (such as refineries, chemical plants and paper mills), which are more likely to harm the environment, are the subject of special licensing requirements.

If a company is directly responsible for pollution that causes danger to public health and the environment, the authorities can take action, including pursuing costs for remediation measures.

Notably, Germany's Federal Supreme Court has eased the rules of evidence for potential claimants and reversed the burden of proof. The courts have also applied the concept of a 'duty to protect the public' to environmental liability. Now, anyone creating environmental hazards has a duty to take reasonable precautions to prevent damage to third parties.

According to the Federal Water Act, any person who introduces or discharges a substance into the water that changes its physical, chemical or biological composition is liable if damage is caused.

Certain acts of environmental degradation are also regarded as criminal offences, including air and water pollution caused by noxious substances, waste disposal that endangers the environment, and the unauthorised operation of environmentally dangerous installations.

INSIGHT

Ferma says no to mandatory insurance

ONE OF THE MAIN IMPACTS OF THE HUNGARIAN TOXIC sludge disaster and the Deepwater Horizon Gulf oil spill has been to encourage the European Commission to reconsider its position on mandatory insurance protection for environmental liabilities. The Commission is currently considering a EU-wide compulsory scheme for all oil companies.

As it stands, financial protection is compulsory in eight European countries, but not all. Ferma, representing the interest of risk managers in Europe, is against the idea and any type of mandatory insurance for large risks. "We do not think there should be mandatory insurance," says chair of Ferma's environmental liability working group, Pierre Sonigo.

"We feel there are sufficient solutions for the oil industry in the commercial insurance market so there is no need to make it mandatory. As a principle, we are against mandatory insurance, because we think this increases prices and removes competition.

Other options, such as self insurance, disappear for risk managers if the government imposes mandatory insurance protection, says Sonigo. "The EU wants to add security by creating guaranteed security schemes to pay for environmental damage, because it is the government that ultimately will have to pay. But this is not the way to do it."

In 2007, Germany adopted legislation that implements the European Environmental Liability Directive (ELD). The law closely mirrors the wording of the directive, which creates several new liabilities (see box, left).

There are two important additional provisions under the German laws. One is that it is the state's discretion whether to allow an operator to avoid liability for environmental damage by complying with the conditions of a permit.

The other is that non-governmental organisations are entitled to claim that remedial measures should be taken, even if they are not themselves affected by it. **SR**

The €20m environmental disaster that changed everything

French firms are not obligated to buy environmental insurance, but an oil spill was a painful illustration of how as liability increases, so must financial cover

KEY POINTS

- 01:** Environmental law was already well established in France pre-ELD.
- 02:** The Bouches-du-Rhône oil spill led to changes in the scope of the directive.
- 03:** There is steady growth in specific insurance cover but take-up remains low.
- 04:** Firms should take advantage of cheap cover as regulators ramp up enforcement efforts.

DIFFERING APPROACHES ADOPTED by each European country add complexity to the issue of environmental liability and mean the risks vary across the continent, depending on where a company has facilities.

In addition, it is the responsibility of the enforcement authorities to determine how much a company will have to pay to remediate the environmental damage caused by pollution. This means identical pollution incidents could be treated very differently, depending on the country and its enforcement approach.

French environmental law was well established before the Environmental Liability Directive (ELD) came along. France transposed the directive in August 2008. Unlike in other parts of Europe, there is no legal obligation for companies to buy financial security against environmental risks. It's still up to the

operator to decide if it's worth buying insurance protection.

Recently, France set in motion an imperative that will have major implications, particularly for oil companies transporting fuel via pipelines.

The Bouches-du-Rhône disaster

In August 2009, the French government declared an environmental disaster in one of Europe's most beautiful nature reserves after oil spilled from an underground pipeline in the southern region of Bouches-du-Rhône. More than 4,000 cubic metres of crude oil spilled over five acres of agricultural land.

The pipeline, operated by the South European Pipeline Company, reportedly carried 23 million metric tonnes of crude oil per year to refineries and petrochemical plants in France, Germany and Switzerland. The clean-up costs were



A question of liability: an oil spill in Bouches-du-Rhône covered over five acres of one of Europe's most beautiful nature reserves

Scania

around €20m, according to reports.

In this case, the French courts ruled that the operator was not bound by strict liability. As a result of the incident, however, a change in French law means that heavy industrial activities will in future fall under a regime of strict liability. That means the burden of proof falls on the operator to show that it is not liable for the incident.

“The French regulator intervened quickly,” says Dorothee Prunier from ACE’s environmental practice. “But in this case the loss did not enter within the ELD’s strict liability regime, which means that the regulator has to prove negligence which makes the procedure longer.”

Penetration remains low

The incident provides insurers and risk managers with an illustration of the likely costs associated with environmental pollution. “I think most of the costs in this case were because the pipeline was in a remote place, so it was difficult for the operator to get access to the site to do a clean-up,” Prunier comments.

Large companies are beginning to realise that the ELD has upped their environmental exposure and therefore their insurance needs, she adds. This is contributing to steady growth in the environmental insurance market.

Overall, however, the take-up of specific environmental insurance products by France’s industrial companies remains low. Medium-sized businesses in particular usually refrain from buying a specialist environmental policy. Estimates suggest there are around 10,000 policies in France. With around two million industrial companies in France, this suggests that penetration remains low.

In response to this, insurers point to evidence that suggests the frequency of

INSIGHT

Insuring against the ELD

ELD-RELATED LIABILITY IS A NEW TYPE OF LIABILITY AND IT cannot be adequately covered by standard general third-party or property insurance, Willis has warned.

A report by the broker states that some general liability insurers have developed new wordings to extend the coverage to include certain ELD liabilities. Brokers and insurers generally accept that the most comprehensive ELD cover is only available through the specialist environmental market.

“Environmental cover is quite cheap,” chairman of Ferma’s environmental working group Pierre Sonigo says. “Getting an extension for ELD risks is generally pretty easy.”

Environmental insurance provides cover for prevention and remediation costs as defined under the ELD. This is not limited to sudden or accidental and offsite clean-up only, but includes gradual pollution and other forms of damage to the environment. “It is much better to have a standalone environmental insurance policy,” Sonigo adds.

“Most large companies or sophisticated buyers have a standalone environmental policy. And most companies try to get hold of a global programme.”

pollution cases under the ELD is up and that clean-up costs could be 40 times higher under the new directive.

The environmental insurance market is expected to grow by 15%-25% per year, from a current estimated turnover of €40m. And competition is driving insurance prices down. “It is easy to find reasonable cover at a good price,” says Ferma’s environmental expert Pierre Sonigo.

The regulatory authorities in France, as in many other parts of the world, are under-resourced and therefore find it tough to enforce environmental laws everywhere and all the time. But insurers warn that the French authorities are looking to beef up their enforcement efforts. Now is the time for companies to make sure they’re fully covered. **SR**

EU directive leaves you to count the cost of pollution on your property

But many UK businesses are underprepared and underinsured for the extra liabilities they face after introduction of new environmental legislation

KEY POINTS

01: The ELD means businesses can now be held responsible for complementary and compensatory remediation costs arising from pollution.

02: Little is known about how the ELD will work, so the risks are being ignored by many.

03: Businesses are being urged to make sure their insurance covers the new liabilities.

THE ENVIRONMENTAL LIABILITY Directive (ELD) has added a substantial layer of liability in the UK, says Stephen Shergold, an environmental lawyer with SNR Denton. Before the ELD, people were only concerned with traditional remediation costs, such as removal of the pollution. Now complementary and compensatory remediation costs can be levied as well.

Those costs will depend on how the regulator chooses to enforce compensatory and complementary measures, says Shergold.

There are examples of regulatory authorities using the ELD to prosecute companies rather than using traditional forms of environmental regulations, because they consider it a simpler method.

The Environment Agency, the UK's environmental enforcer, is currently pursuing United Utilities for compensatory remediation after serious water pollution in July 2009, which caused the death of 6,000 fish at Three Pools Waterway in Southport. This is in addition to the €26,000 fine it also imposed on United and is intended to return the habitat to "the same level of natural resource or service as would have existed if the damage had not occurred".

But this is one of the few test cases working its way through the courts. Ferma general secretary Pierre Sonigo says: "Companies and their risk managers remain unsure of how the ELD will work

and many are simply waiting for something to happen." He says this is a dangerous attitude that leaves businesses exposed to substantial uninsured costs and reputational damage.

"We are still fighting to find an adequate frequency of losses to be able to build up a good database and understand the exposure," Sonigo says. "It's always difficult to understand if the damage would be under the ELD or existing environmental regulations. Many regulators are sticking to existing environmental regulations, rather than enforcing the ELD, because that's what they know."

Financial fears

Polestar Company group risk manager Gary Marshall says that in constrained times some companies may not buy environmental insurance to cover the new liabilities. "There is a very developed sophisticated market for environmental insurance but it is an extra cost that people may not be prepared to bear at the moment, even though the legislation has extended the scope of our liability," he says.

UK businesses are "dangerously exposed" to the possibility of heavy fines under the ELD, according to Aon. UK businesses are typically unaware of the consequences of the ELD, which holds them financially liable for damage to the environment caused by activities on their property, even if the damage occurred

because of the activities of former owners. This means that nearly every property owner in Britain needs to be aware of the environmental history of their property as well as the consequences of current operations.

“UK businesses are potentially sleepwalking into a real crisis if they continue to ignore the very real threat that environmental risks pose to their balance sheets,” says Aon Risk Solutions’ environmental director for the UK, Europe, Middle East and Africa, Simon Johnson.

“EU and UK regulation is increasingly placing the blame for damage to the environment at the feet of land owners, so it is vital they are aware of the history and issues involving their property.”

Priority change

Currently, environmental liability is not a day-to-day concern for businesses, adds Shergold. That’s because it’s still a challenge to get a handle on what the consequences will be. “The extent of the new liabilities and the circumstances in which they will be applied are still poorly understood,” he says.

That is not to say that organisations aren’t aware of the risk within their business. They are, for example, considering the proximity of their operations to sites of special scientific interest or natural importance, says Shergold.

Beyond that, the need to ensure that their insurance policies will cover liabilities, such as those arising from the ELD for example, may not be so well understood.

“A lot of businesses have extended their general liability policies to cover sudden and accidental events,” Shergold says. “But there’s no certainty over whether those policies will respond to the new types of remediation measures.” **SR**

FOCUS ON

Where is financial protection mandatory?

● BELGIUM
Not mandatory, but financial securities may be required once environmental damage has occurred

● GERMANY
Not mandatory. Operators of certain hazardous activities are required to hold environmental insurance

● CZECH REPUBLIC
Due to commence in 2013 for listed permitted activities

● SLOVAKIA
Due to be introduced in 2012

● HUNGARY
Introduced 1 January 2010

● BULGARIA
Due to commence in 2011

● PORTUGAL
Introduced 1 January 2010. Proof of the insurance to the authorities is required

● SPAIN
Delayed until May 2011 because industries need additional time to complete their risk assessments to determine their financial guarantee amounts

● ROMANIA
Introduced 1 January 2010. Currently only in force for shipment of waste

● GREECE
Introduced 1 May 2010. Biodiversity also protected by national laws

Source: Willis

CURRENTLY EIGHT MEMBER STATES IN EUROPE have already introduced mandatory financial provisions for the ELD. These are: Bulgaria, Czech Republic, Greece, Hungary, Portugal, Romania, Slovakia and Spain. The Commission is mulling a EU-wide compulsory scheme.

The rules may be stringent but have companies been too slow to react?

It may be mandatory for Spanish companies to cover themselves against environmental damage, but a lack of awareness lingers over the risks and cover available

KEY POINTS

01: Spain has adopted the most stringent approach in Europe to the ELD.

02: There is still a lack of awareness from companies about the legislation and the protection available to them.

03: A third of study respondents said they would not protect themselves against a possible accident.

04: Spanish companies' general business policies do not cover them against all requirements of environmental liability.

IN SPAIN, A DAM BREACH AT THE Boliden mine near Seville in April 1998 led to one of the most harmful environmental incidents in the history of the country. The rupture released around five million cubic metres of toxic slurry, containing lethal levels of lead and heavy metals.

The accident devastated the local environment, contaminating a 40km stretch of two local rivers as well as vast swathes of the surrounding farmland.

In total, almost 40 tonnes of fish were killed, and around 5,000 geese and 20,000 water birds seriously harmed. Remedial activities required the excavation of 12 million tonnes of contaminated soil and resulted in a total economic loss in the region of €400m.

The disaster was particularly damaging because the Doñana National Park is one of Europe's most important natural sites of biodiversity, thanks to its lagoons, marshland and scrubland. It is also an important resting place for migratory birds, and the accident occurred in the middle of nesting season.

Perhaps because the Boliden incident still looms so large in the Spanish collective memory, Spain has adopted the

most stringent approach to the implementation of the ELD.

No protection

Despite this, a survey of over 700 Spanish companies conducted by TNS Global Market Research and sponsored by ACE Iberia revealed a significant lack of awareness of environmental legislation and the risks affecting businesses.

The research, published in August 2011, also found a lack of knowledge about the insurance protection available to protect against these risks. The

FOCUS ON ASSESSING EXPOSURE TO THE ELD

OFFICIALLY, IT IS MANDATORY TO get financial security against environmental risks in Spain. But operators are still waiting for more information about what exactly they need to buy to meet the legal requirements. The Spanish regulators have not yet defined what companies need to buy or established any specific wordings or limits.

"Spain is working on a way to assess insurance limits per location depending on the exposure and the sensitivity of the environment," continental Europe manager of environmental risk for ACE, Dorothée Prunier, says.

Businesses with operations in Spain, as well as other regulatory bodies, eagerly await the findings.

showed that over half of the businesses did not have specific environmental cover. But, more alarmingly, over 30% said they would not take any action to protect themselves against a possible environmental accident.

Companies said their public liability and general business insurance policies provided them with sufficient environmental risk protection. But ACE Iberia said that these products do not conform to the requirements of environmental liability.

Best intentions

The research also revealed that levels of awareness of the Environmental Liability Directive (ELD) were low, with 65% of respondents saying they were unaware that the Spanish government could make it obligatory for them to have a fund, collateral or insurance to cover their business against possible environmental damage.

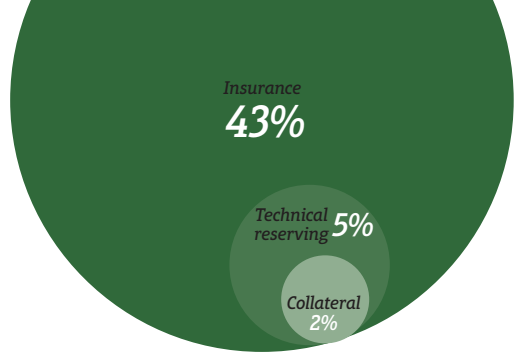
“Spanish companies are highly dedicated to the environment and are conscious of their role. But there is a major lack of awareness about current environmental legislation, and companies would like more information,” TNS research director Mariola Alfonso says.

“There are two sides to this situation because in spite of the clear lack of awareness, there is also a positive attitude towards improvement, demonstrated by the fact that one-third of the companies said they would be prepared to invest to protect the environment.”

Respondents placed insurance as the most likely form of environmental risk protection they would consider (see chart) – significantly ahead of other forms, including technical reserving and collateral. **SR**

TYPES OF PROTECTION

What is the most popular form of environmental risk protection?



IN A SURVEY, SPANISH COMPANIES PLACED INSURANCE AS the most likely form of environmental risk protection they would consider (43.1%). This was far ahead of other forms including technical reserving (4.8%) and collateral (2.4%).

Source: TNS study, sponsored by ACE Iberia

LATEST

New soil pollution directive

THE EUROPEAN COMMISSION IS WORKING ON A NEW directive – the Soil Management Ordinance – to complement the ELD and to define how regulators should test the quality of soil. The objective is to introduce a more systematic method for testing soil contamination.

“This could have a significant impact in some countries, such as Eastern Europe, because these places do not have strong regulations for soil pollution,” ACE environmental practice’s Dorothee Prunier says. “If the directive establishes a new way of testing soil contamination, then it could have a big effect on the local regulatory environment.”

Consequently, operators may be required to clean up more frequently.

The Hungarian toxic spill has brought the ELD into sharp focus

Risk management can not be taken lightly, and even those taking precautions can fall foul of accidents, proving adequate insurance is vital

KEY POINTS

- 01:** Insurers are not touching risks in Eastern Europe due to low environmental standards.
- 02:** Environmental liability is gaining prominence in light of the ELD.
- 03:** Inadequate insurance can result in serious costs to the business at fault.

ENVIRONMENTAL LIABILITY IN Eastern Europe is “a bit of a mess”, says Ferma environmental working group chairman Pierre Sonigo. Insurers are avoiding the risks there, he says, because there are a host of facilities with poor safety records and environmental issues.

European insurance association, the CEA, says that environmental liability is an emerging issue in Eastern Europe and is likely to receive renewed attention following the recent toxic spill in Hungary, which has been described as Europe’s worst environmental disaster.

The accident happened in the town of Ajka where more than 700,000 million cubic metres of industrial waste flooded

over surrounding towns, contaminating rivers and killing seven people.

A dam wall at the Ajka Timföldgyár aluminium processing plant, owned by MAL Hungarian Aluminium Production and Trade Company, was breached on 4 October 2010, unleashing a two-metre wave of red sludge that affected 16 square miles of land. Hungary’s government declared a state of emergency. Experts have placed the cost of clean-up at around €20m (official figures are yet to be released).

At the time of the spill, Aon warned that the Environmental Liability Directive (ELD) would “bare its teeth” and that the environmental disaster in

MILESTONES

July 1976: Toxic chemical release in Seveso suburb of Milan, Italy.

1982: First Seveso Directive, enforcing the ‘need to know’ principle whereby residents should be informed of local environmental risks.

April 1998: Dam containing toxic waste bursts at Aznalcoállar in southern Spain.

December 1999: Total Erika tanker sinks off the coast of Brittany, France, spilling 20,000 tonnes of oil.

January 2000: Europe publishes working paper on the Prevention and Restoration of Significant Environmental Damage.

September 2001: Fertiliser plant explosion in

Toulouse, France, moves emphasis away from ‘risk management’ to ‘risk mitigation’ and paves the way for a new dangerous chemicals regulation.

January 2002: Commission tables a proposal for a Directive on Environmental Liability.

April 2007: Deadline for member states to implement the Environmental Liability Directive.

October 2010: A flood of toxic red sludge is accidentally released from an aluminum processing plant in Hungary. It is the largest environmental disaster in Europe since the passing of the ELD.

October 2010: Commission advises against compulsory liability scheme.

Hungary should serve as a warning about the strength of new environmental liability laws.

ELD has strong teeth

The broker used the incident to draw attention to new ELD liabilities and the benefit of insurance. Aon Risk Solutions' environmental director for the UK, Europe, Middle East and Africa, Simon Johnson, commented: "While most companies are good corporate citizens and take risk management with regards to the environment extremely seriously, occasionally accidents or incidents beyond anyone's control can happen.

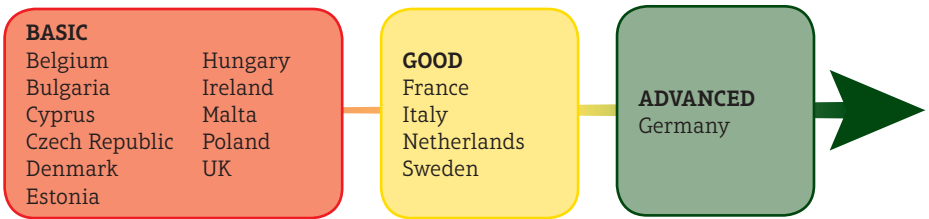
"Under the ELD, which has some extremely strong teeth, it is entirely possible that an accident such as the tragedy in Hungary could ultimately lead to the total collapse of the company at

fault if they do not have suitable insurance coverage in place."

The Hungarian government has expressed regret over the deaths and environmental damage caused by the spill, but it will be aware of the political and financial consequences of any action it takes. MAL can expect heavy fines but it is in the interest of the government to keep the company viable. If it goes bankrupt, it is the government that will be left with the very heavy costs of clean-up, and it would also lead to considerable job losses.

While the Hungarian government balances the need for strong punitive action against political and cost considerations, MAL and similar plants, both in Hungary and central and eastern Europe generally, remain a "toxic time bomb", according to Hungarian Greenpeace campaigner Balázs Tömöri. **SR**

EU MARKETS Environmental liability insurance



GENERALLY SPEAKING, INSURERS HAVE RESPONDED POSITIVELY TO THE LIABILITIES CREATED UNDER THE EU Environmental Liability Directive. Most insurers say there is good cover available for ELD risks, although insurers will never cover 100% of ELD-related liabilities for all activities. On the other hand, risk managers tend to show less interest in buying cover for ELD liabilities, and this lack of interest is increased by the slowdown in the economy.

The chart shows how European countries assess their ELD insurance market. France, Germany, Italy and Spain have a long-standing culture of environmental protection laws and, thus, have a rather mature insurance market designed to address environmental liability claims. Countries such as the UK, however, have less of an environmental liability culture and therefore fewer environmental liability insurance products. As for Eastern European countries, many are still developing a liability culture in general, meaning that the environmental liability insurance market is just emerging.

Source: European Commission study on the implementation effectiveness of the ELD, November 2009

The company that believes prevention is better than to insure

KEY POINTS

01: Scania consciously chooses to extend the coverage of its general liability policy rather than buy a specific policy.

02: It conducts environmental audits on its production sites to try to prevent pollution issues.

03: Insurance manager Sijmons believes brokers lack the expertise to understand Scania's exposures.

CASE STUDY

Scania is in no rush to buy specific environmental insurance

NOT ALL COMPANIES CHOOSE TO BUY a dedicated environmental insurance policy. In Scandinavia, the insurance manager for truck, bus and engine maker Scania decided to seek an alternative form of insurance protection.

"We don't buy a specific environmental insurance policy," Scania corporate insurance manager Martin Sijmons says. "We prefer to extend the coverage of our general liability policy to include sudden and accidental pollution."

He says the emphasis is on risk avoidance rather than risk transfer. "We have discussed internally the benefits of a standalone environmental insurance policy, but ultimately we would like to prevent rather than insure. That means making sure that we handle things properly. We don't use any prohibited chemicals and we make sure our people are protected properly."

As an engineering and manufacturing company, Scania is prone to a host of environmental risks, such as pollution from one of its many workshops or production sites. "We have three production sites in Sweden and 70 garage workshops," Sijmons says.

He describes the environmental assessment process. "We make our own audits of the production units but there are a lot of workshop sites, so the intention is to do spot checks on those.

With the environmental audit, we look at 20 categories and compare the protection measures with the Scania Group-wide standard. If it's good, the facility gets a blue mark and if it's bad they get a red one. Management can quickly see that if there's a lot of blue, then we are doing well."

This risk scorecard approach is popular with many large companies with sophisticated risk management procedures.

Another reason Scania doesn't buy a standalone environmental policy is because Sijmons believes there's a dearth of expertise in some parts of the market.

No one that I have spoken to so far has been able to put a financial figure on the worst-case environmental exposure for us'

Martin Sijmons Scania

"I don't think brokers are properly staffed on environmental insurance issues. No one that I have spoken to has been able to put a financial figure on the worst-case environmental exposure for us."

But being able to identify the worst-case environmental exposure for his company would help demonstrate the value of purchasing insurance

protection, he adds. “If I can identify the exposure, then I can identify the correct level of insurance. But at the moment that’s difficult to do with environmental liability.”

For the time being at least, Sijmons doesn’t think the products exist that can match his company’s unique requirements. “We haven’t looked at environmental insurance products because, in my opinion, the insurance is quite expensive and the breadth of cover is quite low.

“At the moment, the risk is on our balance sheet and we are one or two years away from looking for a specific environmental insurance solution.”

Building on the environmental work he has already done and as part of his risk assessment, Sijmons plans to map out where Scania’s Swedish facilities are in relation to sites of specific scientific or natural importance. The risk is greatest close to these sites, he says.

But in other countries, where the environmental risk profile differs, Sijmons is forced to adopt an alternative approach. “We are looking at environmental liability policies in some of the other jurisdictions, like Spain, where the risk is more onerous. We have to abide by the law so we have to buy environmental cover there. But the ELD has not had much of an impact in Sweden.” **SR**



Not for us: Scania has not yet purchased specific environmental insurance for its Swedish exposures

ENVIRONMENTAL INSURANCE UPTAKE

A EUROPEAN COMMISSION STUDY ON THE implementation of the ELD in 2009 said that, rather than there being “a problem in obtaining insurance for ELD liabilities”, there is a general lack of operator interest in purchasing ELD-related cover. The study said operators are either unaware of the ELD or do not consider that it applies to them. Insurers suggest greater media coverage of significant environmental damage may be needed to increase uptake.

How do you start to put a price on the environment?

The Hungarian pollution disaster highlights the problem of quantifying damage to the environment – after all, you can not manage what you do not measure

KEY POINTS

- 01:** A baseline of environmental quality should be agreed with the regulator before a pollution event.
- 02:** If no agreement exists, the regulator may speculate as to the environmental quality.
- 03:** Estimating the scale of environmental liabilities will take the form of a maximum probable loss estimate.

FOLLOWING A PROLONGED PERIOD of heavy rain, the retaining wall of a substantial waste sludge lagoon at an aluminium production plant in Hungary suffered a catastrophic failure. The resultant escape of large volumes of toxic and corrosive liquid waste caused death and injury to inhabitants in the nearby towns and significant amounts of property damage. The sludge engulfed large expanses of farmland and open ground, polluting substantial tracts of land and the local river system.

The ensuing contamination is believed to have extended over an area of some 40 square km, with adverse ecological effects on natural habitats and within a number of interconnecting rivers, including the Danube.

Hungary's environment minister described the spill as an "ecological disaster" and the predicted cost of clean-up is estimated to be in the region of €20m, with the necessary remediation works to take more than a year.

The environmental regulator is likely to deploy the EU's Environmental Liability Directive (ELD) as the primary piece of legislation to ensure that clean-up and restoration of the environment is achieved, which would lead to the operator being fully culpable under the 'polluter pays' principle.

On the understanding that 'you cannot manage what you do not measure', there will be an initial

requirement to define, as accurately and comprehensively as possible, the quality and natural status of the ecology and habitats that existed around the site prior to the environmental damage event.

Restoration required

Once a baseline of environmental quality has been established, the extent of remediation, restoration and compensation needed to return the ecosystems to their pre-damage event status will be defined. Where no accurate description of the baseline prior to the event is available, the regulator may infer a scope of restoration required based on a speculative view of the environmental quality prior to the event.

It would have been preferable, therefore, to establish, document and agree a baseline of environmental quality with the regulator prior to any environmental damage event occurring. Effectively defining the baseline would have involved an economic evaluation of the natural environment surrounding, and in close proximity to, the site of operation and including a detailed descriptive account of the ecology and habitats that existed naturally.

Estimating the potential scale of environmental liabilities that can be associated with a pollution and environmental damage event of this nature will usually take the form of a maximum probable loss estimate. This

will include an estimate of the extent of ecology and habitat destruction and the possibility of wider environmental damage that will inform the decision-making process in respect of issues such as the appropriate limit of indemnity to be gained should environmental insurance be considered necessary.

The maximum probable loss estimates should be based on scientific evidence concerning the species, ecosystems and habitats at risk and the potential loss scenarios envisaged.

The 'value' of the environment can be defined by quantifying the value of the resource the environment provides. Resource equivalency can be employed that takes account of the direct value (wood, agriculture, food, water and so on) and the indirect value (walking, leisure, and public open space) of the environment as provided by the ecology and habitats.

Standardised risk assessment

The implementation of the ELD in certain EU countries includes a requirement for operators of high-risk activities to hold financial security, the quantum of which may be predicated upon a standardised risk assessment procedure describing the potential liability as defined for specific types of operation and scale of commercial activity.

It will be important also to set the potential limit of indemnity on a site-specific assessment of the maximum probable loss, and not simply based upon a generic environmental risk table.

Defining the requirements for remediation should also take into account the demands for complementary and compensatory remediation, which research has shown could increase the primary remediation estimate by up to 40 times. Consideration should also be given to the fact that precise replacement

TOP TIPS

Quantifying the environmental risks

- Establish the environmental baseline for each site of operation. This should include a detailed description of the species, habitats and ecology that exists, and a statement on the potential sensitivity of ecosystems to pollution and environmental damage.
- Conduct a maximum probable loss analysis for each site of operation to identify and quantify the potential for environmental liabilities associated with realistic loss scenarios that could cause environmental damage.
- Establish site-specific contingency plans and emergency response procedures to ensure that requirements to prevent significant environmental damage from occurring are effectively managed.
- Review requirements of financial security and environmental insurance associated with the potential to cause environmental damage at individual sites of operation, based on nature and scale of activity.

and restocking of species, communities, habitats and ecosystems may not be possible on a like-for-like basis.

Requirements for actual remediation and the technical intricacies of how this would be done will depend largely on the requirements for complementary and compensatory remediation and the primary remediation or clean-up requirements.

It is likely the polluter will need to be responsive to the demands of the environmental regulator in terms of the type and amount of remediation required. A company is unlikely to be in control of the loss at this stage as the scope of remediation needs to be agreed with the regulator and, as such, the cost of the loss could be uncertain, unless an agreed baseline has been established. **SR**

Cliff Warman is Marsh's Environmental Practice leader for the EMEA region

EU's environmental regime should get companies running for cover

Now that the Environmental Liability Directive is in full force, many firms could find their current insurance cover seriously wanting

KEY POINTS

- 01:** The EU Environmental Liability Directive is now in force across Europe.
- 02:** Some countries have bolted on additional financial requirements.
- 03:** Research suggests that traditional insurance programmes fall short of providing adequate cover for environmental damage.

LAST YEAR, WE TOOK A FIRST LOOK at the EU Environmental Liability Directive (2004/53/EC) (ELD) and the implications it would have on the risks that companies faced, their exposure to liability and what questions they needed to ask in respect of their insurance and any environmental cover.

A year on, it is time to assess the impact of the directive and to ask: what should companies be doing to manage, control and transfer this risk.

The ELD was implemented on 30 April 2007, at which time all countries were supposed to have transposed it into national law. In reality, this position was not fully achieved until 2010. To that extent our experience is still developing.

It is worth reiterating some key points about the ELD:

- It covers damage to the environment, habitats and biodiversity, however that occurs, including pollution, but not exclusively from pollution incidents.
- Incidents that cause damage can be sudden and accidental, gradual or even a combination of the two, there is no distinction made.
- The operator is the principal liable person and that person can have strict liability where the operations fall within those described in Annex III of the ELD.

Over the past 12 to 18 months, there have been a number of incidents where

environmental damage is significant, ranging from the tragic release in western Hungary of red sludge waste from an aluminium works and the oil pipeline failure in Bouches-du-Rhône in southern France, to more modest yet locally significant releases into rivers, such as the Three Pools Waterway incident in Southport in the UK.

The EU, in its update report on the ELD, estimates that around 50 cases to date have been, or are being, dealt with under the Directive. This will continue to rise as the regulations begin to take effect.

The broad yet non-homogeneous transposition across the EU into national law means that multinational companies have to be aware and keep abreast of these local differences. Many countries have gone beyond the statutory minimum transposition, for example by extending the definition of protected species, or the type of operations that have strict liability and allowable defences – permit defence, state-of-the-art defence, both or none.

Financial security

A number of countries have also put in place legal requirements for operations that fall within the strict liability regime to demonstrate financial security that would be able to recompense for damage under the ELD if the operator could not pay. To date, Portugal and recently Bulgaria have enforced such

schemes, and others, including Spain, Greece, Hungary, the Czech Republic, Romania and Slovenia, are yet to enforce their respective commitments. Where law and environmental insurance is available, it is often the preferred option.

The International Underwriting Association of London in its report *Environmental Risks: Insured or not?* concluded that when it comes to environmental liability risks, standard or traditional programmes fall short of providing comprehensive cover. Indeed, the gap is widening with regulations such as the ELD extending further environmental liabilities and risks.

Costs under ELD

This is demonstrated in a study by the French Ministère de l'Écologie, de l'Énergie, du Développement Durable et de la Mer published in April 2010, which took specific events in the past and assessed the costs under the new ELD regime.

The report concluded that costs were estimated to be around 40 times the regulatory costs originally incurred by the companies in the late 1990s. This trend, in very broad terms, is supported by North American experience with natural resource damage.

The factors above have all combined to provide added impetus for companies with multinational exposures across Europe and wider to consider not only if they are compliant with any local requirement to demonstrate financial security, but more importantly, if they have any potentially uninsured exposures.

Most environmental insurers now provide broad cover that includes the key elements that may not be covered or fully insured under traditional programmes, including environmental

SUMMARY

Key considerations in buying environmental insurance for multinational programmes

- Clear objectives – demonstrate financial security, cover uninsured exposures.
- Programme structure and design – master, freedom of services, local and so on.
- Insurer should have experience in European and international programmes and the ability to create and support the right structure.
- Commitment of the insurer to environmental business as environmental damage and therefore claims may take several years to resolve.
- Coverage should include non-pollution environmental damage, imminent threat, business activities on third-party properties, and transport.
- Access to and scope of the insurers' expert loss control and claims mitigation services.

damage, gradual pollution, own site clean-up costs and regulatory actions.

The ELD presents a liability and exposure to new types of damage across the EU. Costs are likely to be higher and potentially significant. Claims on environmental insurance policies covering these risks are already beginning to come through, so the risk is real.

Unless a specific environmental insurance policy with coverage for these damages is part of the insurance programme then full coverage is highly unlikely and companies risk a significant uninsured loss.

Finally, although the ELD is European regulation, the pressures for regulations that protect the environment are global and many countries have, or are in the process of, developing some form of liability for environmental damage. **SR**

Simon Johnson is director of Aon's Environmental Services Group

Will it take many more environmental disasters before opinions change?

A lack of data is blamed for the low take-up of ELD insurance, but unless demand increases and brings in more statistics, the issue will only continue

IN RESPONSE TO A EUROPEAN Commission paper on the implementation of the Environmental Liability Directive (ELD), the CEA, Europe's insurance association, had the following to say: "The insurance industry will continue to deliver creative and innovative products for ELD liabilities, but considering the newness and complexity of the ELD, in conjunction with the current lack of operator demand, its ability to do so is best ensured within the context of a voluntary market."

It shows that the insurance industry is against any mandatory rules dictating that companies purchase financial provisions to pay for environmental damage. This is a view shared by Ferma, which informs *StrategicRISK* that it opposes any mandatory insurance rules.

Even with some European markets imposing compulsory schemes, the uptake of ELD-specific insurance across the continent remains low. This guide has explored the reasons for the slow growth in the environmental insurance market, which includes a lack of relevant data to predict future claims and reluctance by some regulatory authorities to bring claims under the new regime.

Some buyers remain convinced that extending their general or public liability policies is the appropriate response. It will take time to convince them otherwise.

Insurers suggest that extensive media coverage of a case of significant

environmental damage is what's needed to increase uptake. But the truth is that media coverage of a single loss event won't make any difference to the difficulties insurers have in developing ELD insurance. Several losses would be necessary for insurers to gain the relevant data in order to build adequate capacity and price products appropriately.

The truth is that media coverage of a single loss event won't make any difference to the difficulties that insurers already have in developing ELD insurance

Meanwhile, a lack of strong demand for ELD insurance prolongs the problem, as it results in a lack of statistical data, which means insurers have trouble assessing the risks properly.

The Commission says some insurers that have developed ELD policies may decide that it's no longer commercially viable to continue to do so, as there's so little demand for them. The insurance industry, however, considers this a pessimistic view. Insurers will continue to provide ELD-related products as long as they have sufficient experience and expertise to do so at a sustainable level. **SR**

**This special report has been
produced with input from:**

Wayne Harrington, UK and Ireland manager of environmental risk, ACE
wayne.harrington@acegroup.com

Dorothee Prunier, continental Europe manager of environmental risk, ACE
dorothee.prunier@acegroup.com



thank you

On our 25th anniversary,
the people of ACE
would like to thank our friends,
distribution partners and customers
in over 170 countries.

With their support,
we have become one of the world's
leading property and casualty
insurance companies.



Property & Casualty | Accident & Health | Life