

IUA Non-Marine Environmental Committee – Policy Positions

Preamble

The note below represents a précis of the key environmental issues currently under discussion by the IUA Non-Marine Environmental Committee. It is not intended to be exhaustive and is subject to change as developments occur. It has been drafted to indicate the Association's broad policy position when in discussions with third parties, focussing specifically on a London market / UK emphasis. In many areas the IUA position will complement that of CEA (of which IUA is a member) and IUA recognises the excellent lobbying role that CEA performs on a range of non-marine liability issues, particularly with EU institutions.

Headline Messages

- § **Whilst traditional liability policies provide a degree of environmental cover, there are often gaps in the cover that require extensions or the utilisation of specific environmental products.**
- § **There is a wide and competitive range of environmental insurance products available in the UK and European markets.**
- § **Market-driven solutions competitively constructed and freely available are preferable to compulsory financial security requirements.**
- § **In the event that compulsory financial security requirements are proposed, they should be targeted to meet designated environmental problem areas.**
- § **The education and increasing awareness of clients in respect of their potential environmental liabilities, the law and commercial security options, particularly on the benefits and limitations of insurance, should be promoted.**

Policy Positions

1. Introduction, Impact and Extension of the Environmental Liability Directive (ELD)

- i *Support the key principles underpinning the ELD;*
- i *Recognise the need for operators to have sufficient economic resources in place;*
- i *Need to review Member State requirements on an individual State basis – differing rules and 'gold-plating' in transposing the ELD;*
- i *The ELD should not be extended to offshore risks beyond the current scope – developments in this regard should be undertaken through existing global bodies and initiatives or through adding to the body of EU maritime safety legislation;*

- i *Further guidance on the ELD should be provided at the national level when the Directive has bedded in further.*

The ELD was introduced in 2004 and has since been transposed into Member States' legislation variously – with most governments missing the 2007 transposition deadline. The final transposition took place in 2010 (each UK country implemented the Directive separately, all done in 2009 – in England the Environmental Damage (Prevention and Remediation) Regulations (EDR)) was passed in March 2009. The European Commission published a report on the effectiveness of the ELD in October 2010 and a further review is scheduled for 2014.

IUA supports the key objectives of the ELD to prevent and remedy environmental damage in Europe and to clarify the environmental liabilities of operators carrying out potentially hazardous activities based upon the 'polluter pays' principle. We recognise the efforts of the European Commission to ensure that there are sufficient economic resources in place available to remedy environmental damage and associated losses due to large environmental accidents.

Due to the slow implementation of the ELD it is difficult to fully assess its impact at this time. There have been relatively few incidents that have fallen within the scope of the Directive, all of which have been relatively small in scale. The October 2010 Hungarian toxic spill would have been a useful barometer of the effectiveness of the Directive, particularly in terms of assessing the restoration requirements. However, this was stifled by the late implementation of the ELD in Hungary and limited commercial insurance coverage purchased by the operator in question.

Further investigation is needed into the application and enforcement of the ELD by national competent authorities. Not only has the transposition of the ELD differed in some countries (whilst maintaining the same underlying principles), but other Member States have added financial security requirements for operators (not limited to insurance) in differing forms. The UK has chosen multiple competent authorities for each country where most others have decided to give this work to the permitting environmental authority. Sites of Specific Scientific Interest (SSSIs) have been identified and included in the Environmental Damage Regulations but it is difficult to say at this point whether this widens or simply clarifies the areas included under the new legislation.

Any review on the effectiveness of the ELD and transposed national regulation needs to be carried out in the context of assessing the practical ability of operators to deal with the problems they face as quickly as possible ensuring that sufficient financial security is in place to facilitate that.

In terms of extending the ELD, the Commission is considering whether offshore environmental risks should be brought within the remit of the Directive (beyond the geographical limits already contained in the Directive). This was addressed in a March 2011 consultation paper. IUA believes that, whilst the key principles of the ELD remain supportable in the marine context, particularly the 'polluter pays' principle, separate EU legislation supporting the existing distinct body of EU maritime safety and environmental legislation might be more suitable to deal with specific marine activities. In practical

terms, it is also arguable that assessing damage and effecting remediation - functions inherent to the ELD - might prove more difficult in the maritime context and would need further, thorough assessment before committing to such an extension of the ELD.

In any event, it would be preferable, given the global nature of marine activities, to pursue legislation through new or improved International Maritime Organisation (IMO) measures and other established international pollution control measures. In underwriting terms, including marine activities in the remit of the ELD would raise some interesting questions on where the coverage would be written – either through an extension of cover provided in the marine and EIL markets or a new, hybrid niche market?

In our view it is too early for further interpretive guidance – as proposed in the October 2010 Commission report – given the limited time the ELD has been in operation. In due course, it may be preferable to consider the implementation of the ELD at the national level to highlight local issues that have arisen. This could either be done at the national level at an applicable time (perhaps a review timetable mandated by the EU) or through an EU review of each transposition, done in cooperation, or submitted by, national competent associations.

2. Financial Security Requirements for Operators

- i *Market-driven solutions competitively constructed and freely available are the preferred option;*
- i *Any compulsory measures should be done on a targeted, proportionate basis in areas potentially causing the most damage to the environment;*
- i *It would be beneficial to develop some basic central guidance for all parties on the features of an acceptable financial provision.*

As part of their 2010 review of the ELD, the European Commission looked at the potential mandatory / optional requirements for operators to hold financial security for environmental risks. However, any ruling on this was delayed, the rationale being to allow further time for the Directive to bed-in and suitable financial security products to evolve. The Commission acknowledged that it is premature and without sufficient justification to propose mandatory financial security at the EU level at present. However it will revisit this issue in the interim to, and as part, of the 2014 report on the ELD. Notwithstanding this, eight EU Member States have introduced national mandatory financial security requirements (including Spain, Hungary, Portugal, Romania, Slovakia, Bulgaria and the Czech Republic). Such a fragmented approach is to be expected given differing cultural and legal approaches to environmental risks across the continent and differing exposures to high-cost incidents. Clearly, though, this will drive the demand for financial security products, including insurance.

Compulsory financial security requirements have worked well in some jurisdictions and in certain targeted industries (for example relating to nuclear and aviation liability requirements). However, measures have proven to be less effective in other areas (for example transfrontier shipment of

hazardous waste, waste disposal facilities). It is therefore difficult to make a comprehensive judgment on compulsory financial security and consequently each proposal to introduce such measures has to be considered on its own merits.

In general terms, IUA is of the view that mandatory EU requirements in respect of environmental damage would be problematic for several reasons and therefore should not, at this stage, be supported. Mandated requirements might suffer from difficulties in assessing and maintaining a suitable EU minimum requirement – what is a reasonable requirement in one state may be inadequate in others. Furthermore, setting minimum requirements may have the impact of companies looking to buy the minimum levels of security to meet the statutory obligation rather than a level which reflects their actual risk exposure.

Instead, market-driven solutions competitively put together and freely available are the preferred option. Essentially, each company should choose how to protect itself against environmental liabilities and to show that they will be in a position to cover the losses caused by their activities. We therefore support the evolution of voluntary financial security options (including insurance) but recognise the significant work that needs to be done by clients in managing this on a voluntary basis, in terms of assessing their potential exposure and mitigation options.

Notwithstanding the previous point, should EU compulsory measures be proposed, these should be targeted and limited to activities that are identified as potentially causing the most damage to the environment (for example activities within the IPCC regime and within a designated geographical area).

More widely, it would be beneficial to develop some basic central guidance for all parties on the features of an acceptable financial provision – considering the capabilities and the limitations of insurance and facets of other measures such as Bonds and ESCROW provisions. This would help clients and carriers alike across the EU to make a more informed assessment as to the product(s) that would be most suitable to their particular circumstances.

3. Market Capability / Coverage Issues

- i *There are a number of environmental exposures that remain outside the scope of the public liability policy.*
- i *There is an increasingly wide and competitive range of environmental insurance products available in the UK and European markets.*

The mix of liability in tort and statutory liability for environmental exposures is complex. It is important to remember that the insuring clause of traditional liability policies covers environmental liabilities established in tort but stops short of fully covering liabilities established under the statutory environmental system.

Traditional public liability policies only respond to claims from third parties where the remedy is damages. They do not cover damage to property owned by the insured or in their custody or control, nor do they normally respond to the range of costs either to prevent environmental damage (whether to first party property or third party property) or to monitor it or to put it right. It is unlikely that a material damage policy will cover costs imposed by an Enforcing Authority if they are greater than those for simply repairing the damage. There have been attempts to extend traditional liability policies to cover these expenses which result from damage to third party property but such cover is always limited to a sudden and accidental write back provision in such policies.

In practical terms this means that there are a number of environmental exposures that remain outside the scope of the public liability policy. These include the recoverability for statutory liability for remediation of own site pollution, statutory liability for biodiversity damage and also liability incurred as a result of 'gradual' pollution where the originating cause of the incident is not a sudden and accidental event, the latter being subject to an exclusion historically.

Other insurances fall similarly short of providing comprehensive cover for environmental risks. Property policies are designed to cover specific buildings and do not necessarily cover contaminated land, particularly land other than where the property is located. Coverage for damage to buildings during the clean up process may also not be provided. Another example is the D&O market, which has differing approaches to environmental cover and may indemnify for costs incurred in defending criminal and civil environmental related claims. However most D&O policies have traditionally included an absolute pollution exclusion. Professional Indemnity classes - surveyors, architects and consultants for example - are also impacted by environmental events but are not likely to be covered for the full range of environmental risks.

As a result of such coverage omissions, and the strengthening of the statutory regime, there is a growing and strong argument for the use of specialist environmental products for relevant risks. However, the evolution of EIL products has been sporadic in the EU, developing greatly in some jurisdictions but more slowly in others. This is partially explained by differing cultural and legal approaches in individual jurisdictions to environmental liability. Some markets such as Germany, Italy and Spain have stronger environmental liability cultures, whilst others such as those in Eastern European countries are still emerging. There also remains a lack of understanding by clients as to the legislative requirements and their potential liabilities therein. It is also likely that some clients believe that their existing coverage, PL or otherwise, provides sufficient indemnity.

So, in general terms, the evolution of insurance products continues in line with increasing client and market awareness of environmental issues and the need to purchase compulsory cover on a national basis. In the latter case, the market evolution of products has been slower where national legislation has stipulated terms (e.g. Bulgaria) rather than where there is a request for financial security but limited guidance as to its terms (e.g. Portugal). For the UK there is a definite viable EIL Market and insurance products have evolved as new legislation is implemented. An increasing number of carriers

are providing cover for ELD driven exposures such as Biodiversity Damage and more policies also include cover for environmental damages arising from non-pollution events.

4. Risk Management

- i *An increased emphasis on risk management, prevention and assessment is required.*

The French Department of Ecology, Energy, Sustainable Development and the Sea estimates that the regulatory costs of pollution under the ELD are around 40 times greater than those seen in the late 1990s. An increased emphasis on risk management, prevention and assessment – essentially changing the culture of operators - is therefore a crucial next step for the industry. This should include encouraging operators to undertake expeditious risk assessments to identify the potential scope and quantum of environmental damage and encouraging those operators to ensure that the requisite security (insurance or otherwise) is at the centre of their activity. It is also important to drive home the message that risk management applies across all entities regardless of size – the capacity to cause environmental damage is not always a function of company size, but of company activity.

Clearly there is a greater role for brokers and risk managers in ensuring there is an adequate risk assessment in place and that the right product is bought for the risk in question. Failure to do so, particularly if clients erroneously believe that their existing general liability cover is sufficient, could potentially lead to errors & omissions claims against brokers. For their part, insurers also need to be clear in outlining what additional protections are provided by environmental extensions to the existing liability cover, where such extensions are purchased.

5. Data Sharing

- i *Insufficient data about the frequency and cost of ELD claims – more work needs be done where possible.*

Within the boundaries of European and UK legislation, IUA supports information exchange and communication between key stakeholders on environmental issues and claims. Thus, we would welcome the establishment of an ELD record / registry system in Member States collecting and sharing of statistical data on the cost and frequency of ELD claims. We do, however, recognise the difficulties in establishing robust claims data and trends, given that claims notifications are often put on hold as long-term investigations take place. Furthermore, we recognise that the interpretation of data collection may be complicated by the use of differing collation methodologies and terminology use across Member States. It is also apparent that the UK regulators are using their existing regulatory powers to ensure remedial works are completed. This leads to the increased likelihood that the number of 'ELD incidents' will actually be underreported.

6. Promoting Awareness

- i *IUA strongly supports the cooperation of industry associations, financial security associations and competent authorities in promoting ELD awareness amongst operators.*

It is essential that national competent authorities, insurers and brokers continue to educate companies at operational risk management level and in the boardroom about their environmental liabilities, the status of the UK (and other applicable) EIL markets and explain the coverage options available to them to ensure that they can obtain the most suitable security for their risk.

As part of a wider education process, one needs to consider and study further the pros / cons of existing environmental products, GL extensions – identifying possible problem areas, potential gaps in coverage and uncertainties (for example remediation process, gradual events, events caused by something other than pollution (e.g. fire)).

In order to improve awareness the IUA has worked with broker associations such as the British Insurance Brokers' Association (BIBA) to educate insureds. A further, recent initiative has also seen the Chartered Insurance Institute (CII) accrediting a suite of environmental liability training materials, predominantly directed at brokers, developed by Chartis Insurance UK.

7. Claims Frequency / Insurability of Large Environmental Losses

- i *There needs to be more focus on the smaller, SME type incidents when looking at the environmental claims*

As noted, the number of ELD incidents has thus far been quite low, given the infancy of the legislation. Environmental disasters are low in frequency (depending upon the definition of disasters) therefore reliable data will likely take years to emerge, especially where compensatory remediation is involved. However, we believe that a key focus on the ELD claims experience should be more on the smaller, circa £500k losses that can be faced by SMEs and which can cause such companies to go into liquidation should the liabilities be enforced.

Insurance provides just one option in helping meet the liability for large environmental losses. Self insurance, national State cover and improved safety and risk management regulation are other, complimentary options. Nonetheless, whilst insurance capacity for large losses can be problematic and risks need to be carefully identified and managed, insurers are proactive in developing products to meet consumer demand (for example the offshore reinsurance product under development in the US).

8. Civil Sanctions for Environmental Offences

- i *There remains a need to monitor developments in this area due to the ongoing government review and potential impact of fines and penalties policy language.*

The Regulatory Enforcement and Sanctions Act 2008 introduced new civil sanctions that could, under certain conditions, be provided to regulators. Thus, the Environment Agency has available a number of civil sanctions to deal with breaches of environment law. These supplement rather than replace the existing criminal enforcement options and include:

- *Fixed Monetary Penalties (FMPs)*
- *Variable Monetary Penalties (VMPs)*
- *Compliance Notices*
- *Restoration Notices*
- *Stop Notices*
- *Enforcement Undertakings*

The application of these sanctions was clarified by the Environment Agency in revised guidance on Enforcement and Sanctions, which came into force for enforcement decisions on 4 January 2011. It has been indicated that the sanctions will, at least initially, be used primarily in the hazardous waste, waste resources and waste packaging sectors.

However, the current UK government, through Oliver Letwin, Minister of State for Policy, has raised an objection to the use of civil sanctions in this way, focussing on natural justice arguments in the sense that an operator subject to a civil fine or penalty is essentially deemed guilty until proven innocent. This has led to the delay in the implementation of the sanctions whilst the government more formally reviews its position. Thus, the situation remains uncertain. However, given that the 2008 Act was subject to significant and lengthy consultation in creating a civil sanctions regime it is doubtful whether the regime will be completely dropped.

In terms of policy issues, it is likely that many incidents leading to a potential civil sanction would not normally be covered under environmental policies in terms of remediation, clean-up or restoration costs. The offences and penalties relating to packaging waste are a good example of this. However, there remains a potential impact for insurers and, as and when the civil sanctions regime evolves, a further evaluation of the application of such sanctions to the PL or extended PL policy and, inter alia, fines and penalties clauses, may be prudent.

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