



The Environment

Pollution Insurance: What is the Problem?

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It has become customary to introduce the difficult subject of pollution insurance for industrial sites by starting with an account of the trials endured by American insurers over the past 15 years. They have had a bitter pill to swallow: hundreds of interminable lawsuits involving tens of billions of dollars. Nevertheless it would appear that because of inordinately exacting environmental legislation and judicial practices that are sometimes extravagant, the experience of the United States cannot be transposed to the European market without some reservations. So it seems useful to take stock of the real problems raised by coverage of this risk, which, apart from certain exceptions, have not yet caused a financial catastrophe in Europe.

The difficulties with this insurance product stem from serious technical, legal and insurance uncertainties.

Technical assessment is difficult,

The first difficulty encountered by a pollution insurer is weighing up the risk. Deciding the level of environmental protection at an industrial site and assessing the consequences of a possible accident call for methods that are still being developed and increasingly complex and detailed technologies, all of this in a rapidly changing regulatory framework. Insurers are starting to establish teams of engineers trained in the subject, but we are still far from being able to put in place certification procedures such as those used in fire insurance for well protected risks. It is doubtful whether we will ever be able to do so.

Or physically impossible

Although an expert can nowadays determine the insurability requirements of a single site, things are not so simple with large industrial groups operating on many sites. For them, insurers have to rely on indirect methods, monitored by sampling at a limited number of plants. This hit-and-miss method is hardly satisfactory because it is these groups whose sites are most exposed to risk.

Risk is hard to calculate

A second tricky point is assessing financial exposure. As far as loss insurance is concerned, this can be calculated with some precision, but this is not the case in the area that concerns us here. Potential losses involve not only the replacement cost of the insureds own property but also environmental cleanup costs, which may easily come to more than the value of the property insured, and loss caused to third parties, which in some countries is unlimited.

A shifting legal situation...

The uncertainties are probably greatest in the legal field. The whole range of environmental questions is governed by jurisprudence that is emerging from very varied and complex legal texts which, on an underpinning of civil law, are establishing a body of specifically environmental laws which are very technical and which often override the usual rules. What is more, these laws are changing very rapidly and are introducing new notions such as no-fault liability and shifting the burden of proof (suspected polluters must show that they are not responsible for the damage), or even de facto retroactivity of laws or standards: lawmakers or judges can decide that situations previously considered acceptable henceforth require expensive cleanup operations.

...That is very complex



Pollution insurance straddles direct loss insurance and legal liability insurance (LL). It is therefore vital to determine the legal status (own property, third-party property, and common property or res nullius) of the environmental elements at risk: watercourses, water tables, air, countryside). This raises the acute problem of how to define the word environment and set limits on it. It is essential to know what type of cover will apply to potential losses. The reply can vary widely from one country to another. In the Netherlands, for example, the law on surface water is drafted in such a way that polluting it can not give rise to compensation for individuals. Similarly, insurers must take a very close interest in everything related to what is termed ecological damage, that is, to res nullius, assets belonging to no-one, not even the community at large; for example damage to an unused natural habitat or aesthetic harm to the countryside. These losses, which are liable to be the subject of all sorts of irrational outbursts, can hardly be covered at all.

Strong national differences

Another characteristic of the pollution insurance market is that it is very segmented. National differences are so strong that conditions have to be revised every time you cross a border. Everything changes:

Environmental legislation, legal liability laws, judicial and administrative practices, industrial standards and methods, and, perhaps most important, peoples attitude towards protecting their rights and the environment. It is clear that the countries of northern Europe are much more problematic for pollution insurers than those in the south, but on the other hand their regulations are more straightforward. Building the European Union will simplify matters eventually, but this is a long-term prospect. Meanwhile, pollution insurers and reinsurers will have to bear a heavy and unending burden of paperwork.

Gradual or accidental pollution?

The ABC of the pollution insurance business is to distinguish between accidental and gradual pollution. Accidental - or more accurately sudden accidental - pollution is the swift result of a brief practically simultaneous event. It is therefore easy to determine whether or not the event occurred while the policy was in force

Gradual pollution on the other hand develops slowly before it is noticed - a typical example is an underground leak from a corroded pipe. Corrosion develops, then the first drop seeps from the pipe, and later, at some indefinable moment, pollution can be said to have occurred; it is even later that the first signs of damage appear, and some time after that when victims file their claims. This spreading of the pollution over time sets a problem for insurers: what date should be fixed for entitlement to compensation, bearing in mind that the cover taken out (or not), the sums and the partners involved change over the periods insured?

Retroactive and extended cover

There are two other difficulties: compensation for loss caused by pollution that occurred before the policy was signed (prior acts cover) - which is a legitimate claim if the policyholder was unaware of the existence of the problem at the time of signature - and loss that appears after a policy expires but results from events during the period insured (extended cover). In this case too claims can be legitimate when the policy has been terminated because the holder has gone out of business.

Date of third-party claim

Insurers have traditionally dealt with the problem of gradual pollution by using (claims made) clauses to determine the timely application of cover, based on the date of the first claim made by an injured third party. The great interest of these clauses is that they enable the loss to be linked firmly to one insurance year, independently of the policyholder, and they allow full or partial retroactive cover while being compatible with cover for sudden accidental risks. For insurers, the (claims made) basis



has the clinching attraction of enabling them to calculate their financial exposure at the end of the insurance year. Unfortunately, these clauses are not to the liking of the judges and policyholders. The jurists base their criticisms on application of broad legal principles. Their legitimate purism clashes on this point with the no less legitimate pragmatism of the insurers. In practice, offering the retroactive cover mentioned above logically implies refusing extended cover: insurers cannot cover an excessive period on a single insurance year. Insureds therefore fear that after their policy expire they will face a

Or of first manifestation

For these reasons, in France and Germany we are seeing the emergence of clauses basing timely

extended cover. It is too soon to tell whether clauses of this type will stand up in court and what their economic effect will be. They are in any case only a makeshift solution.

Direct loss or LL?

Pollution claims raise one particularly acute problem for insurers: pollution knows no property boundaries and after affecting policyholders it is very likely to harm their neighbors. We therefore have to deal with two very different regimes; covering policyholders own property (direct loss) and legal liability (LL). The problem is further complicated by the fact that the loss might consist only of a legal or moral obligation to clean up, without there being any real damage to property, and especially because it might be in an LL insurers interest to finance a cleanup to avoid damage or reduce its impact. So in most cases the same contract will have to provide mixed cover for direct loss, LL and pollution. Cleanup costs. Reaching a difficult compromise can only do this.

The importance of cleanup costs

Very close attention must be paid to cleanup costs. These costs, involved in both direct loss and LL, seem from experience

to account for the greater part of claims costs.

Pollution LL insurers usually stipulate that they will cover only costs for eliminating or reducing damage to a third party. This practice does not seem to be very satisfactory. It is a poor protection for insurers; it deprives policyholders of cover that they really need and is often a cause of litigation between insurers and insureds. It might be preferable to provide coverage for these costs in the form of named perils insurance, bearing in mind that this type of cover would necessarily be expensive.

Complex insurance and reinsurance techniques

It is becoming increasingly impossible to cover pollution risk by using the traditional methods of mobilizing the financial capacity required: treaties between direct insurers and reinsurers, or case-by-case (voluntary) reinsurance. Many insurers in fact do not feel they can commit themselves with such uncertain medium-term visibility. So special solutions must often be devised for this exceptional type of risk. These could include co-reinsurance arrangements of pool financial capacity and technical expertise in an insurance and reinsurance market. Funding techniques could be used, or self-insurance through a captive insurance company. These solutions have been used for some years with other products, but they require high insurance skills //