



EUROPEAN COMMISSION

Insurance Committee  
The Chairman

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James CURRIE  
Director General  
Environment Directorate General  
Commission of the European  
Communities  
Rue de la Loi 200  
B-1049 Brussels

**Subject: Commission White Paper on Environmental liability**

The Insurance Committee (IC) of the European Union, which is composed of high level representatives drawn from the insurance regulatory and supervisory authorities of the Member States, would like to express its appreciation to your services in preparing such a comprehensive White Paper (WP) on environmental liability. It would also like to thank the officials of your department for the helpful presentation made to the Committee and for this opportunity to comment on the WP, which examines an important public policy issue where insurance clearly has a major role to play.

The IC agrees with the WP on the importance of the financial security underpinning an environmental liability regime. The members of the IC fully support the goals and the general thrust of an EU environmental liability regime, as outlined in the WP. In particular, there was recognition that the WP was right to refrain from making insurance compulsory, certainly for the foreseeable future – as there is (and is likely to be for some time) insufficient capacity in the market for this to work. However, this should not undermine the sometimes stricter rules of national compulsory environmental regimes already implemented in certain Member States. The present market in environmental impairment liability insurance is rather limited and tends to be handled by specialist insurers; if cover in this area were to become mandatory this would represent a major change for insurers and the mainstream market would need time to develop the necessary expertise to offer the widespread covers required for most enterprises.

Given that the WP has correctly identified system insurability as an important tool to achieve the goals of the environmental liability regime, the IC would wish to be kept up-to-date on the ongoing work of your department in this field. Furthermore, the IC considers that at this early stage of the project, further reflection on the insurability of bio-diversity/ecological damage may be necessary before such a system could become fully operational.

The effectiveness of any legal liability regime requires a workable insurance system, which means that the core elements constituting the regime must be insurable. Such a regime can only be effective where an efficient insurance market has developed with sufficient capacity to cover all environmental liability risks at accessible prices. However, this is **not** currently the case. The achievement of this objective requires in particular:

- Legal certainty: – especially as regards the point of time when and the length of time during which, the insurer is obliged to fulfil its contractual obligations (“event insured against”).
- Admissible defences: To promote product innovation in the field of environmental liability, some basic defences reflecting the nature and specificity of insurance business need to be applicable.
- Reliable statistics and generally accepted measurement techniques: Reliable calculation of risk-related tariffs and quantification of the amount of environmental damage and potential liability for the insurer is necessary. A list of qualitative and reliable quantitative criteria for the recognition and measurement of environmental damage is therefore a precondition for creating insurance programmes providing cover against environmental risks and thus rendering the EU regime both insurable and viable. At the moment there is no way of calculating the monetary value of damage to bio-diversity/ecological damage.

The IC would like to stress that the legal framework must provide economic operators, in particular insurance companies, with the necessary level of legal certainty, predictability and transparency with respect to risks they cover, and the timing and amount of the potential liability. Only if this is guaranteed, can insurers operate successfully and ensure that policyholders’ interests are not jeopardised.

Consequently, certain elements of a framework Directive, in particular the role of insurance in providing the financial security of the system, appear to need further analysis to make the system operable. Attached to this letter, we have summarised the core requirements to be met by an EU environmental liability regime whose financial security relies fundamentally on the insurability of environmental damage.

Although many issues remain to be resolved, we look forward positively to the continuation of this project and will be glad to provide further advice and comments.

Finally, should you have any questions concerning these comments, or require further clarification on any item, please do not hesitate to contact the IC secretariat (Mike Thom, ☎ +32-2-296.06.68, fax: +32-2-299.30.75).

Yours sincerely,

**(SIGNED)**  
John F. Mogg  
Chairman

## **Insurability of environmental damage – Core aspects of an EU environmental liability regime to be introduced by a framework Directive**

### **1. No retroactivity (4.1)**

Non-retroactivity is an essential element of an environmental liability regime. The IC therefore supports the intention to make the future EU liability regime work on a prospective basis as outlined in the WP. It shall remain the responsibility of Member States to deal with past pollution.

In a prospective system, legal certainty for an insurer as to the moment of responsibility also implies that the trigger event (act or omission entailing the subsequent damage) has taken place after the entry into force of the regime (and not beforehand). This is of particular relevance for the common types of liability insurance contracts (claims-made and occurrence-based) both of which can provide risk cover against incidents that took place before the inception of the insurance contract and when there is a causal link between the incident and the damage.

For reasons of legal certainty, the IC generally prefers a regime that only applies to damage that occurred after the entry into force of the regime (furthermore this damage should also result from an act or omission that occurred after the entry into force of the regime). This would include also any act or omission which occurred after the entry into force of the regime (but not beforehand) and which is causal for the subsequent damage. In this context “pollution of the past”, “the event insured against”, “limits of insurance cover/retention” and “insurance cover after the contract term” need to be specified more precisely. However, it should also be further explored whether a direct reference to the first verifiable assessment of the personal or material damage will lead to a higher degree of legal certainty.

### **2. Scope of the regime (4.2)**

The envisaged EU environmental liability regime shall cover not only different types of damage (see comments below under 5.) but also different types of activities (dangerous and non-dangerous) causing such damage. For dangerous activities a strict liability regime with limited defences is proposed; for non-dangerous activities the liability regime shall be fault-based.

The IC favours excluding damage caused during terrestrial or maritime transportation from the scope of the regime. With regard to transportation activities already covered by other legislation, any overlap should be avoided. In addition, some activities are already the object of specific national (compulsory) liability regimes or are based on a international convention (e.g. Brussels-, Paris- or Vienna-Conventions for nuclear risks). It therefore appears necessary to precisely clarify the scope of the regime of the future environmental liability regime to avoid any duplication or overlap with existing liability regimes.

### **Admissible defences (4.3)**

The WP only envisages the allowance of commonly accepted defences such as Act of God, contribution to the damage or consent by the plaintiff, and intervention by a third party (e.g. order of a public authority). The WP leaves open the question whether or not other defences (e.g. state-of-the-art or development risk) could also be applied.

All forms of liability insurance can pose major problems for insurance companies in respect of both contracts issued in the past and new contracts. To promote innovation of new insurance programmes in the field of environmental damage further defences need to be allowed, in particular state-of-the-art or development risk. Both defences are allowed under the Product Liability Directive as an option for Member States.

Of the risks insurance companies bear, development risk is a major one. It refers to the risk of deviation of the actual development of claims frequency and extent, interest income and administration costs from the calculation basis used to fix premia. Such deviation notably comes from changes in:

- Progress in medicine and other sciences
- National legislation
- Social attitudes leading to more litigation (criminality)
- Price and wage levels (growing population and rising property values)
- Cancellation probability and falling interest rates

Development Risk includes the introduction of completely new products both by existing and new undertakings on known and new markets. It is difficult in many cases for an underwriter to price the risk, which may be affected by such future scientific, legal and social developments. Taking into account the need to provide economic operators with predictability as regards the environmental risks they take, the development risk defence should also be applicable.

The IC acknowledges that it is crucially important that the efficacy of a strict environmental liability regime should not be undermined and therefore that only a limited number of defined defences be allowed. However, in order to facilitate the development of an efficient and flexible market with sufficient capacity, the IC strongly also recommends, as a first step, including state-of-the-art and the development risk in the list of possible defences.

### **3. Burden of proof (4.3)**

With respect to the difficulty for the plaintiff in environmental cases to establish facts concerning the causal link (or the absence of it) between an activity carried out by the defendant and the damage, the WP envisages some easing of the traditional burden of proof for the plaintiff. It is not certain what the WP means in this respect, and in particular, it is not clear how uniform alleviation would fit in with the varying arrangements governing the burden of proof as currently used in the different Member States. The IC acknowledges that the efficacy of a strict environmental liability regime should not be undermined by imposing an impossible burden of proof on the plaintiff. However, for reasons of legal certainty regarding the party (insurance company) potentially obliged to cover the damage, the IC regards it preferable that the link of causality must be clearly established by the plaintiff. In this respect any easing of the burden of proof might jeopardise the development of viable insurance products in the field of environmental liability. Moreover, it is important that the rules of national environmental regimes already implemented in certain Member States should not be undermined.

#### **4. Criteria for the different types of damage (4.5)**

The WP differentiates between environmental damage (damage to “unowned” bio-diversity/ecological damage and significant damage in the form of contamination of sites) and traditional damage (damage to health and property). The future environmental liability regime is to cover not only environmental damage, but also “traditional” (classical) damage where caused by a dangerous activity as defined under the scope of the framework, because traditional damage and environmental damage will in many cases be caused by the same event. In this respect consideration shall also be given to the implementation of a threshold that limits the responsibility in the area of damage caused by natural catastrophes.

##### *Damage to “unowned” bio-diversity/ecological damage*

The IC notes that liability for damage to bio-diversity and ecological damage as proposed in the WP is essentially non-existent, not only within the EU, but also world-wide. Therefore, the inclusion of bio-diversity/ecological damage goes far beyond what is currently established in Member States.

At the moment there are no generally accepted methods nor reliable statistics for quantifying the monetary amounts needed for a minimum level of restoration of the environment or how much should be paid for damage to the “unowned” ecology (air, water, soil). If the probable amount of this type of damage cannot be assessed or quantified, it fails to meet one of the crucial prerequisites of insurability. The aims of the environmental liability regime may therefore be better served by the imposition of other measures or penalties upon the polluter, e.g. based on for example general principles for the precaution or rules of private, public or criminal law.

In the current situation, where even the basic criteria on the valuation of environmental damage leave considerable room for uncertainty, the IC would also be very reluctant to support a system that does not explicitly exclude immaterial considerations (e.g. ethical values etc.). Because, unlike bodily injuries, no party suffers directly from the damage, nor is it clear to whom compensation should be paid for the ethical damage. From the point of view of foreseeability and insurability of environmental risks, it is practically impossible to award a predictable monetary value. Only the material costs of repairing environmental damage should be taken into account. Otherwise, the uncertainty on how much the environmental damage will cost is aggravated.

Given the lack of legal certainty, transparency and reliable methods for calculation and determination of the potential amount of liability, the IC would like to express its doubts about the successful development of a deep and liquid market for insurance policies providing cover against environmental liability risks of bio-diversity/ecological damage. The IC therefore regards further reflection necessary as to how ecological damage should be included within the scope of damage to be covered by the future environmental liability regime.

##### *Significant damage in the form of contaminated sites*

Regarding the creation of clean-up standards and the application of clean-up objectives to remedy significant damage in the form of contaminated sites, practicable solutions in existing environmental liability laws have been created in the past and applied successfully.

However, the separation of historic and future pollution on a specific site usually creates problems. In addition the terms “*significant damage*”, “*minimum restoration standards*”, “*serious threat to man and the environment*”, “*economic or technical reasons for non-feasibility of a clean-up*” or “*full or partial containment*” need to be specified much more precisely in a framework Directive to be applicable.

## **5. Financial security (4.9)**

The WP stresses the importance of financial security underpinning an environmental liability regime at Community level, in particular, to ensure both that the polluter pays and that monies raised through liability are used for effective restoration of the environment. Apart from bank guarantees, internal reserves or sector-wide pooling systems, insurance can be regarded as one of the possible ways of achieving financial security.

Although the insurance industry seems to be interested in making progress in this area, the development of a deep and liquid environmental liability insurance market providing cover against environmental risks is still underdeveloped. This is true not only from a European perspective, where an environmental liability regime does not yet exist, but also valid for those Member States where the implementation of an environmental liability system does not yet work properly, in particular because of non-insurability of environmental damages.

The effectiveness of any legal liability regime requires a workable insurance system, which means that the core elements constituting the regime must be insurable. Such a regime can only be considered effective if there are sufficient insurers with enough capacity operating on an efficient and affordable market.

Environmental liability is a so-called “long-tail” risk, that reflects a particularly high settlement risk due to the generally long period for claims settlement. This is not a problem unique to environmental liability, but is also found in other highly volatile classes of insurance that have a high variability of claims and costs due to the risks covered and the long settlement period. According to a study carried out by European insurance supervisors in April 1997, this high settlement risk is not adequately covered adequately by current calculation methods for capital requirements. Therefore, an increase of capital requirements for companies running such long-tail business is under discussion at the moment.

The pooling of a large number of risks is the main characteristic for insurance business. Insurance premia must be calculated adequately with regard to the risks underwritten. Insurance companies are required to establish adequate technical (claims) provisions in respect of the entire business<sup>1</sup>. In the absence of proper statistical data and reliable methods to quantify the potential future losses of environmental risk cover, it will be difficult for insurers to establish sufficient provisions for outstanding claims, especially to meet incurred but not reported claims (IBNR). In particular, the amount of the provision for IBNR-claims should be determined having regard to past experience as to the number and magnitude of claims reported after the balance-sheet date. Both premiums and claims provisions are decisive elements in the calculation of the capital requirements European non-life insurance companies have to meet according to Community law.

1 Article 15(1) of Directive 73/239/EEC as replaced by Article 17 of Directive 92/49/EEC.

Past discussions also revealed that the views of insurance supervisors match those of industry as regards the necessity of legal certainty with respect to liability and the transparency needed to calculate adequate premiums for the risks covered. It is the central function of insurance supervisors to guarantee the financial stability of insurance companies in order to safeguard the interests of insured persons.

There are still many questions left open in the WP with respect to financial security. It is important that these points are analysed in-depth to guarantee the viability of the proposed environmental liability regime. The IC therefore welcomes the intention not to make financial security of the risks arising from that regime compulsory at the beginning.