

Sustainability and Environmental Risk Management

The Evolving Role of Risk Management and Insurance

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Overview

- Overview of Aon ESG
- Sustainability and Environmental Risk Management
 - What is it and why now?
- Emerging Issue
 - Environmental liability disclosures
- Environmental Liability Insurance
- Case Studies
 - what's happening

Aon Environmental Services Group (ESG)

- What We Do
 - Environmental risk exposure identification and analysis
 - Understanding organizational approaches to environmental loss control (pre- and post-loss)
 - Design, negotiate and implement effective environmental risk financing and insurance programs
- Who We Are
 - The most experienced sustainable and environmental risk management team in the world
 - Largest broker of environmental insurance
 - Focused disciplines of engineering, environmental, risk management, finance, legal and insurance professionals, and
 - Significant understanding of the financial, development and sustainable/environmental risks and how they interact with client goals and objectives.

- Climate Change: global warming
- Energy Crisis: increased prices/increased demand
- Water Shortage: some have too little/some have too much
- Pollution and Disease: pandemics; air, water, soil pollution
- War on Poverty: the widening gap between rich and poor
- Stakeholder Activism: consumers/investors have influence
- National Security: terrorism real or perceived
- Globalization: being global is very difficult
- Erosion of Trust: transparency & disclosure is critical

Sustainability



“The LORD God took the man and put him in the Garden of Eden to work it and take care of it.”

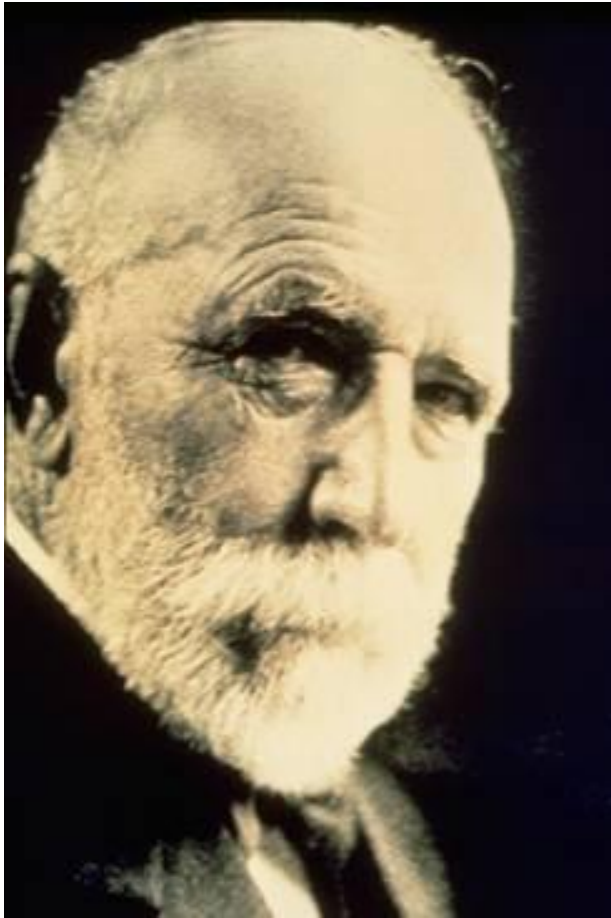
- Genesis 2:15;

Sustainability

Chiefs are always to consider the effects of their actions on their descendants through the seventh generation of the future.

- Seventh Generation philosophy, the Great Law of Peace from the Six Nations Iroquois Confederacy, circa 1142.

Sustainability



“This is not for us, nor for our children, but for our grandchildren.”

Frederick Weyerhaeuser
Founder, 1900

Sustainability

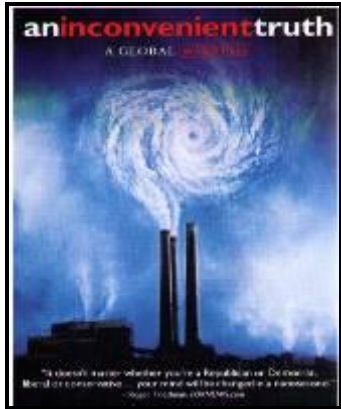
“Meeting the needs of the present generation without compromising the ability of future generations to meet their needs.”

- *Our Common Future: Report of the (United Nation) World Commission on Environment and Development, 20 March 1987 (aka “Brundtland Report”)*

Triple Bottom Line Concept

“To reach sustainability, one must achieve not only economic ‘bottom line’ performance but environmental and social performance as well.”

British Economist John Elkington - 1997



+ Greenhouse gases + Weird weather
+ Rising oil prices + Globalization

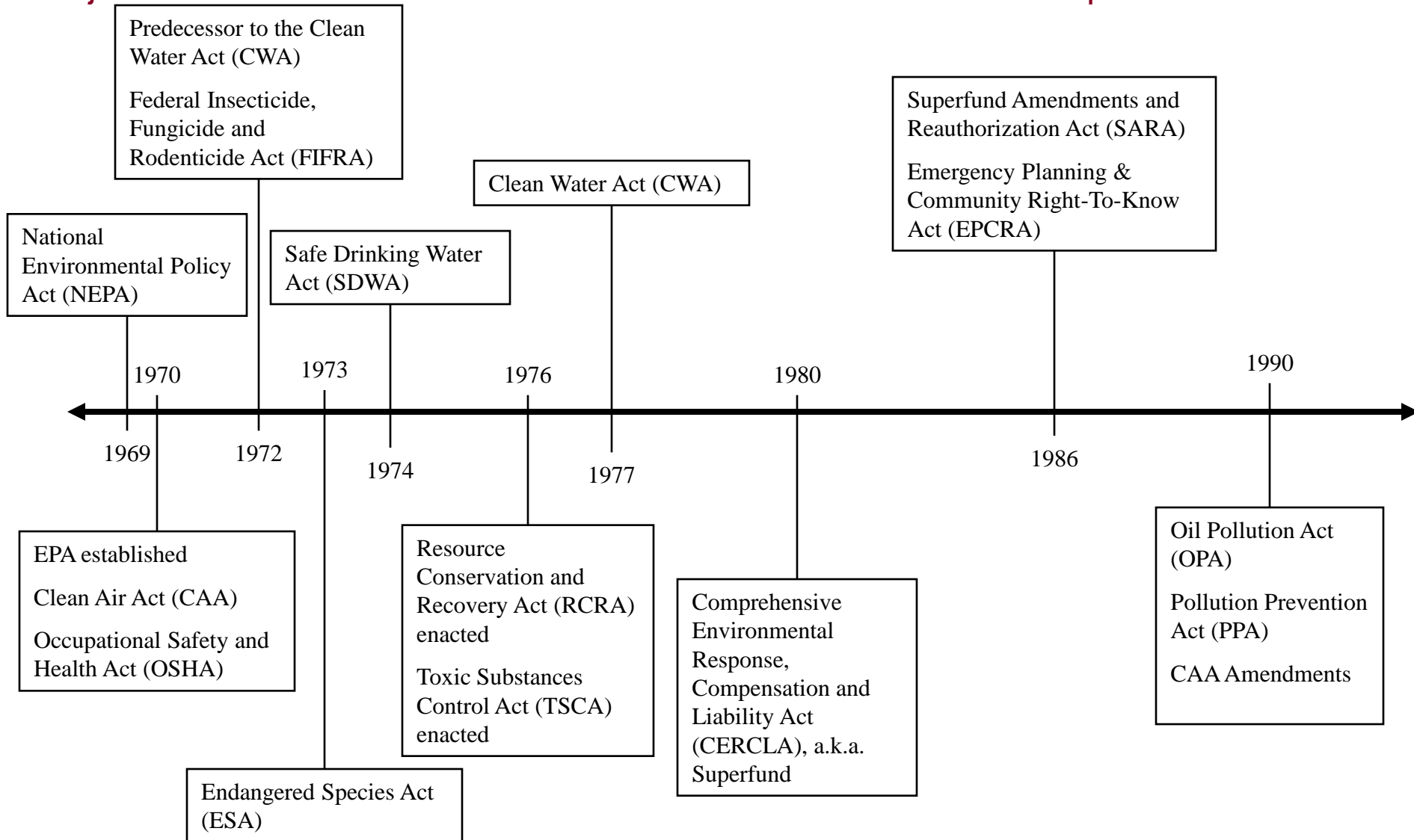
**** It's all over the News ****

- 70-80% of consumers say they are switching to “green” companies; **30%** actually did in 2008





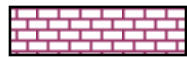

Environmental Liabilities – Where do they come from?

Major Environmental Laws in the U.S. - 1969-1990 A Federal Perspective

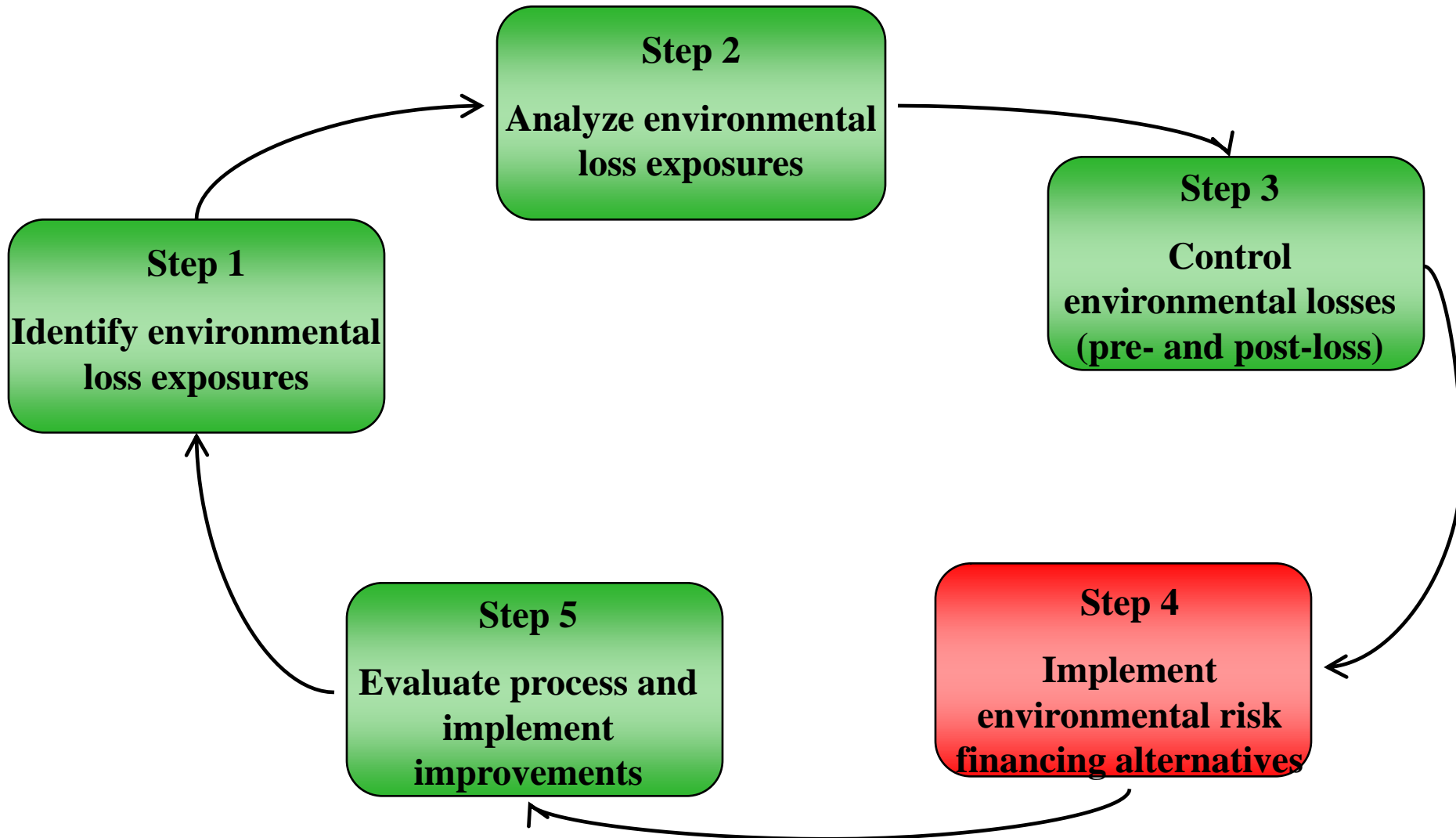




 Known/expected losses (e.g. cleanup)
 Cost overruns of known losses

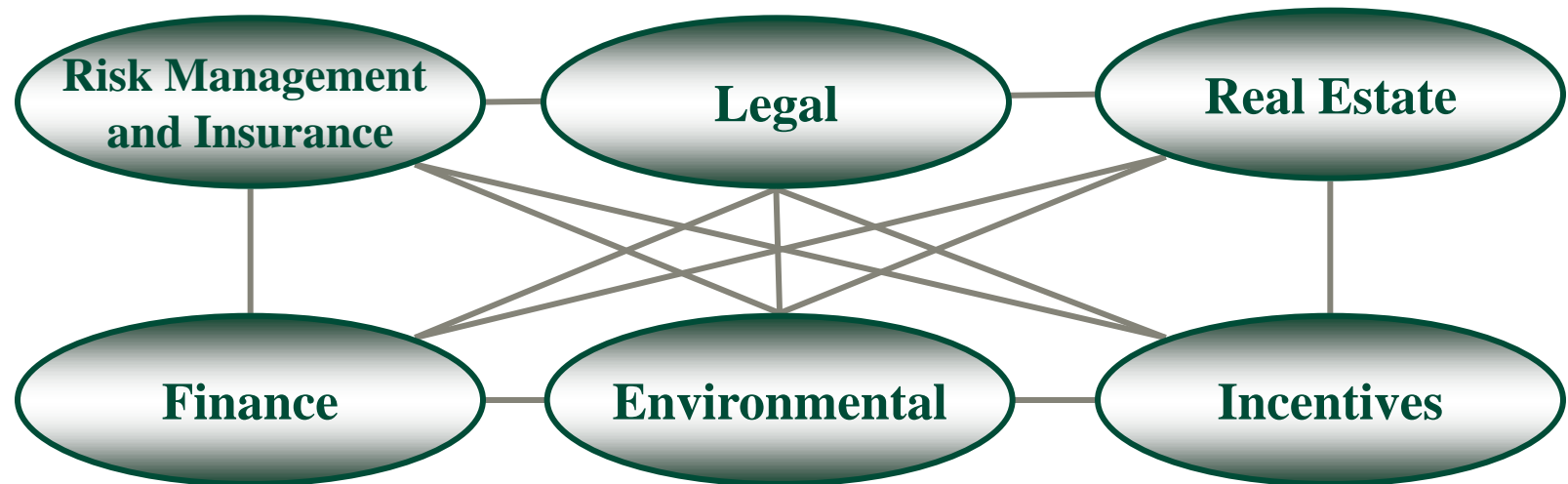
 Discovering or creating new contamination
 Third-party claims (e.g. bodily injuries and/or property damage)

The Environmental Risk Management Process



Environmental Risk Management - *A Unique Practice*

*A Convergence of Events and
Specialties*



Right-Sizing Environmental Liabilities

Background - Accounting 101

Balance Sheet

- **Assets (A)**

- The valued stuff we have
 - Cash
 - Accounts receivable
 - Property, plants, equipment
 - Goodwill
 - Others...

=

- **Liabilities (L)**

- The stuff we owe
 - Accounts payable
 - Contingencies
 - Others

- **Equity (Eq)**

- What our organization is worth

$$A - L = Eq$$

Environmental Liabilities –

Problems with Insurance and a Need for a Cure

- Insurance Services Office (ISO) pollution exclusions
 - 1972 “sudden and accidental”
 - 1986 “absolute”
 - 1992 “total and absolute” endorsement

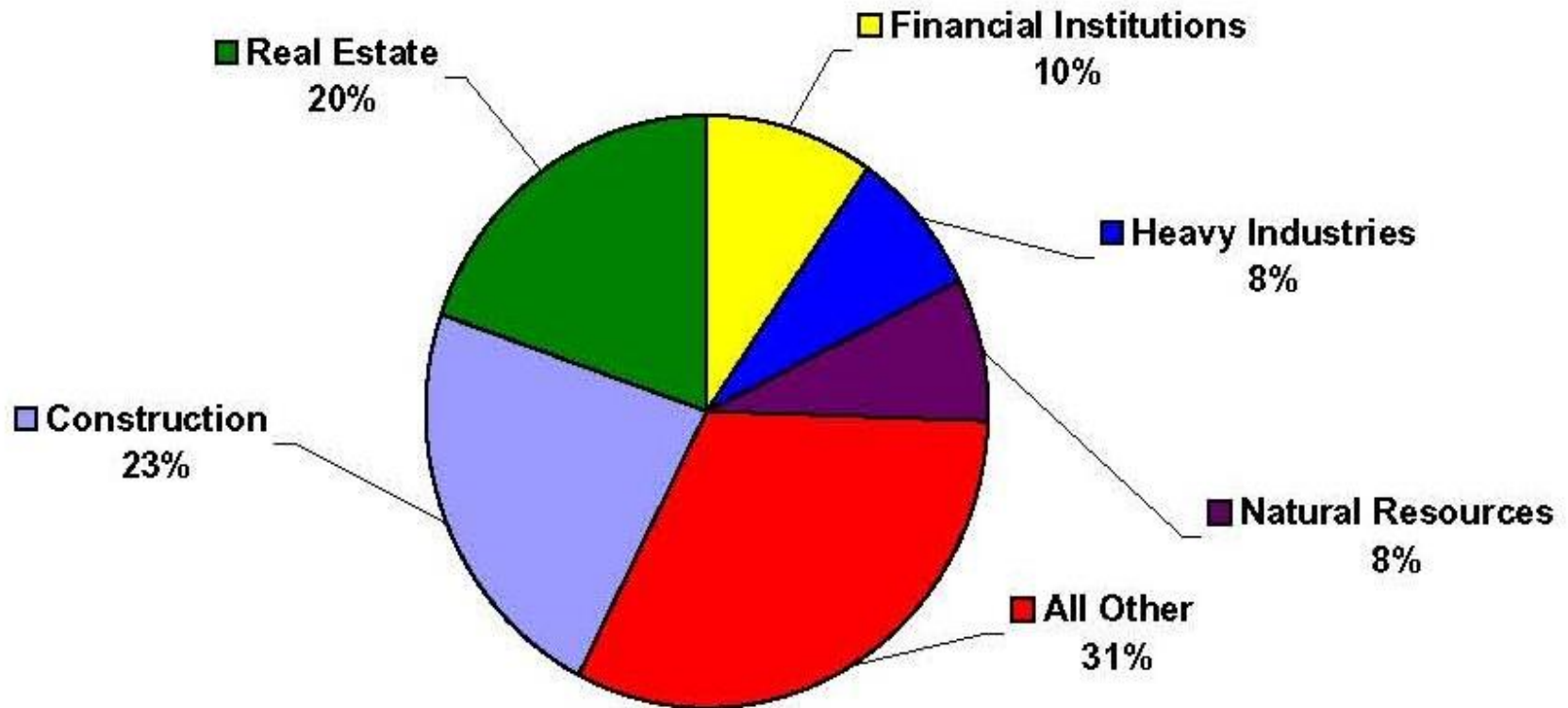
Environmental Liability Insurance Market

- Early Forms and Limits (1980 to mid-1990s)
 - Restrictive coverage
 - Low limits, rarely over \$1,000,000
 - Relatively expensive
- Today's Market (since circa 1995)
 - Flexible coverage
 - Often manuscripted endorsements and/or policies
 - Cost-effective
 - Significant limits
 - Well over \$100 million in limits available for most risks
 - Strong underwriting
 - Environmental engineers and scientists

Characteristics of the Environmental Insurance Marketplace

- Major Insurers
 - AIG, XL, Zurich, Chubb, ACE, Liberty International Underwriters, Navigators, Ironshore, Great American
- Very Competitive Pricing and Terms
 - However, subjectivity (schizophrenia) exists
- Underwriting Expertise with Environmental Risks
- 2008 Premiums Were Approximately \$3 Billion
 - \$2 billion U.S.; \$1 billion rest-of-world
- Historical and Future Contamination Insurable
- Multi-Year Policies Available

Who Uses Environmental Insurance?



Using Environmental Insurance

- Filling “Traditional” Insurance Gaps
 - Coverage for on-going and past operations
- Mergers, Acquisitions and Divestitures
- Property Transactions
- Insuring Long-term Indemnity and/or Escrow Obligations
- Vendors
 - Insurance gaps and/or excess of contractors, consultants

Environmental Liability Insurance - *Overview*

- Four Major Categories
 - Fixed Site
 - manufacturers, industry, etc.
 - property transfers
 - mergers and acquisitions
 - Cleanup Cost Cap
 - Contractors/Consultants
 - Lender Pollution Liability
 - banks
 - REITS

Environmental Liability Insurance Products - *Fixed Site*

- Known as Pollution Legal Liability (PLL) and Environmental Impairment Liability (EIL)
- Basic Policy Features:
 - pays for third-party claims of bodily injury, property damage and cleanup costs that arise from a pollution condition at, or emanating from and insured site
 - defense costs included within policy limits
 - claims made
- Policy Enhancements
 - discovery trigger
 - business interruption
 - transportation of products or waste
 - disposal site coverage (PRP liability)

Environmental Liability Insurance Products

(Fixed Site continued)

- Typical Insureds
 - manufacturers
 - industry
 - property transactions
 - commercial real estate portfolios
- Multi-year Policies are Available and Frequently Written
- Over \$100 Million in Available Limits by Stacking Insurers

Environmental Liability Insurance Products – *Cleanup Cost Cap*

- Also Known as Remediation Stop-loss
- Pays for Excess Costs Associated With a Cleanup Project
 - typically need a detailed cost estimate
- Defense Costs Are Not Included
 - this is not liability coverage
- Coverage Can Include the Errors and Omissions of the Design Firm
 - this coverage is optional, but recommended
- Over \$50 Million in Per-site Limits Are Available
- Policy Term Is the Length of the Project

Environmental Liability Insurance Products - *Cleanup Cost Cap (continued)*

- Can be Combined with PLL/EIL Coverage
 - package policy offers more complete coverage as third party bodily injury, property damage, cleanup costs are covered as well as the defense of claims
 - phased policy; many times the PLL coverage does not apply until after the remediation is complete
 - can insure just one or a portfolio of sites
- Typical Insureds
 - any site owner with environmental liabilities
 - potentially responsible parties (PRPs) at Superfund sites
 - project-specific coverage for environmental engineers and contractors

Environmental Liability Insurance Products – *Contractors/Consultants*

- Contractor's and Professional Liability
 - can be written separately or combined on one policy form
- Combined Form including Commercial General Liability Coverage is Available
 - smaller contractors (<\$5ML revenue)
- Contractor's Pollution Liability (CPL) Coverage Part
 - pays for third-party claims of bodily injury, property damage and cleanup costs that result from a pollution condition caused by a contractor's work
 - occurrence coverage is available

Environmental Liability Insurance Products - *Contractors/Consultants (continued)*

- Professional Liability (E&O) Coverage Part
 - pays for third party claims for acts, errors, or omissions in professional services rendered, including those that result in a pollution condition
 - claims made coverage
- Owner's Protective Coverage (OCIP) is available for site owners
- Typical Insureds
 - any contractor or engineering firm
 - Manufacturers/industry with significant environmental reserves
- \$50 million in Limits Are Available from a single insurer
 - over \$150 million in total market capacity

Environmental Liability Insurance Products – *Lender Pollution Liability*

- Protects a Creditor from Environmental Risks at Property Used to Secure a Loan
- Coverage
 - pays either costs to cleanup or loan balance (whichever is less)
 - loan balance only coverage is only limitedly available
 - covers potential third-party claims (BI, PD, cleanup) related to pollution conditions at secured properties
- Usually Written on a Portfolio of Loans
- Typical Insureds are Banks and REITs
- Limits are Typically Per Loan with a Policy Aggregate
- Policy Aggregate Limits of \$50 Million are Available

Case Study 1 - Selling Properties with Known Contamination

- Fortune 1,000 company
- Concerns
 - Future Liabilities associated with 15 owned contaminated properties
 - Over \$40 million estimated for cleanup (NPV)
 - Inability to sell contaminated property
 - Various levels of site characterization
- Solutions
 - Fixed-cost remediation contract
 - A blended-risk policy paying remediation costs, cost overruns and third-party claims

Case Study 1 - Selling Properties with Known Contamination (continued)

- Impacts

- Sites were “sold” for (\$42,000,000) to a contractor/developer
- A blended risk policy was purchased by the contractor/developer for \$43,500,000
- Insurance contract purchased for third-party pollution liabilities and excess cleanup costs up to \$100,000,000 limits
- Seller revised environmental liability disclosures on financials to reflect the transaction

Case Study 2 – Off-setting Liabilities and Selling Assets

- Fortune 500 company
- Concerns
 - Carrying costs of environmentally-impacted assets
 - Inability to sell contaminated property
 - Known cleanup costs and potential third-party claims from pollution conditions at 7 sites
- Solutions
 - Reposition 5 sites for sale, donate one site to a state conservatory, and held 1 site
 - Purchased a 10-year insurance program covering excess cleanup costs, third-party claims from pollution conditions and defense.
 - Premium: \$1 million
 - Limits \$25ML each loss and \$50ML aggregate

Case Study 2 – Off-setting Liabilities and Selling Assets (continued)

- Impacts
 - Sold 3 sites for over \$15ML using indemnity and insurance to back sale. This removed total annual carrying costs of \$750,000.
 - Working on the sale of 2 others, significant interest
 - Donated property to state conservancy
 - Insurance premium amortized over 10 years (\$100,000/year)
 - Wrote off \$5ML in environmental liability reserves, effecting a net income event of \$4.9ML for the quarter (\$5ML reserve minus \$100K insurance premium expense)
 - Company is looking at similar approaches for dozens of other sites

Case Study 3 – Global Pollution Liability Insurance Program

- Fortune 500 company
 - Food industry
- Environmental Risks and Concerns
 - Processing oils
 - Refrigerants
 - Transportation
 - Waste disposal
- Insurance Solution
 - Incorporated environmental insurance as risk financing tool for cleanup costs, third-party claims from pollution conditions, natural resource damage claims and defense.
 - Number of Insured Locations; over 50 North American plants, 400 warehousing and/or office, 200 non-owned disposal sites
 - Policy Limits: \$20 million each loss and policy aggregate
 - Deductible: \$500,000 each loss cleanup on-site, \$100,000 other
 - Policy Term: 3-years
 - Premium: 475,000 paid once at the policy's inception

Case Study 4 - Selling Property

- Client Concerns
 - Sell a non-operating business location
 - Resolve dispute with buyer as to extent of contamination
 - Buyer views concern as \$1ML, seller as \$250K
 - Main property has known contamination
 - Concerns with additional, future State-lead actions
 - Potential third-party claims
- Solution
 - Purchase a 10-year insurance program covering excess cleanup costs, third-party claims from pollution conditions claims and defense.
 - Premium: \$95,000 (paid once at policy's inception)
 - Limits \$5ML each loss and policy aggregate

Case Study 4 - Selling Property (continued)

- Impacts
 - Sold property at increased value
 - Removed need for additional escrow for potential environmental costs
 - Reduced additional friction costs (negotiating time)
 - Increased certainty and comfort with buyer's lenders

Summary

- Environmental Liabilities are Certain
 - Whether recognized (identified, analyzed and measured) or not
- They Do Not Get Better with Time
 - Not a fine wine
- Disclosure Pressures and Increasing and Action Will be Taken
- Environmental Risk Management and Insurance Solutions are Available
 - Multi-disciplined approach needed; legal, finance, risk management/insurance, environmental, operations



Questions?

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