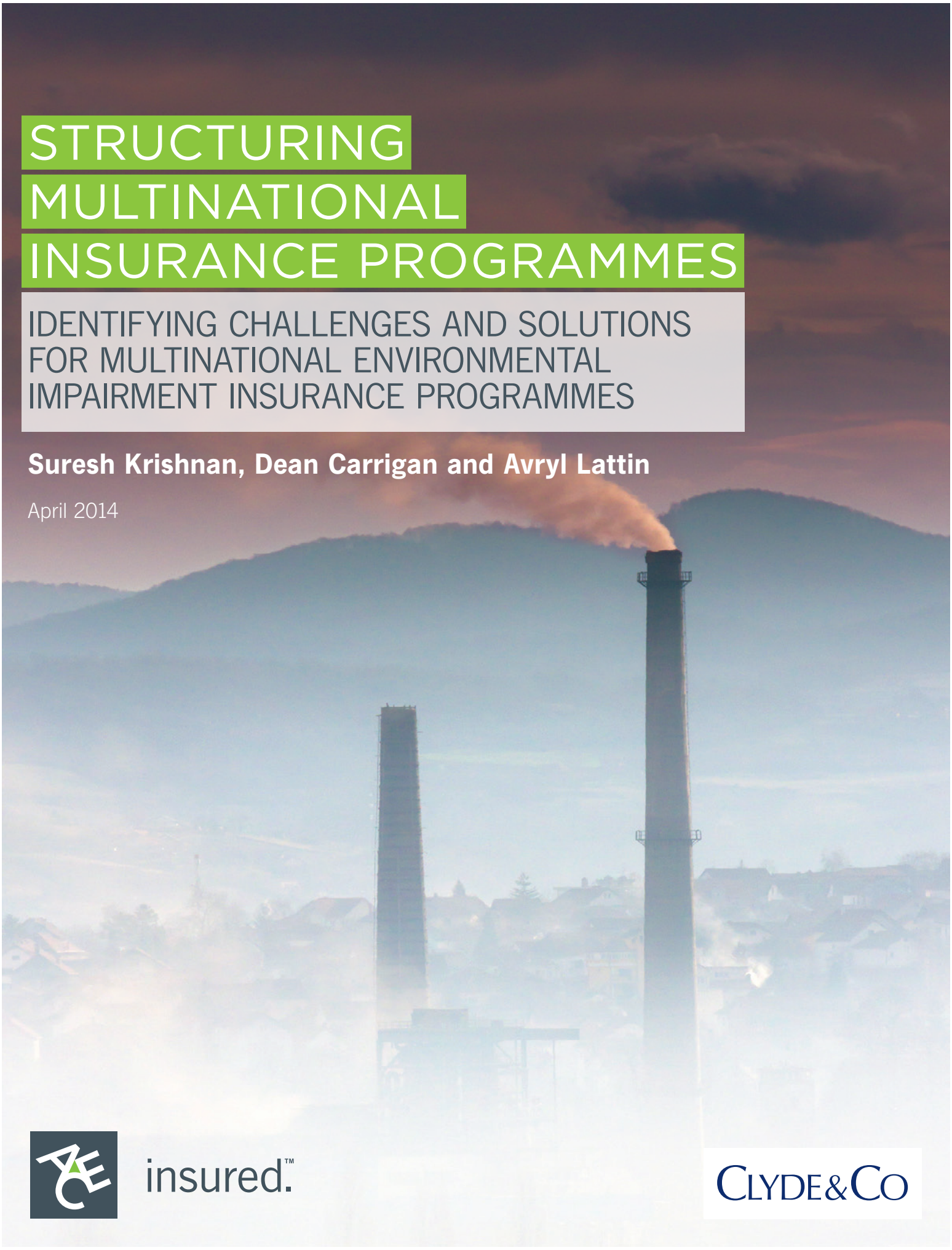

STRUCTURING MULTINATIONAL INSURANCE PROGRAMMES

IDENTIFYING CHALLENGES AND SOLUTIONS FOR MULTINATIONAL ENVIRONMENTAL IMPAIRMENT INSURANCE PROGRAMMES

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April 2014

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As patterns of business and trade continue to globalise, shift and grow in complexity, risk managers of international companies are increasingly seeking risk management and insurance solutions that respond to their changing multinational business activities.

Traditionally, demand for multinational insurance solutions has focused on property and casualty risks. However, as the risk environment grows ever more complex, companies are now seeking more robust solutions in respect of emerging risks as well, including environmental risks.

Environmental risk ranks as the second-highest emerging risk concern (following supply chain and infrastructure risk), according to research conducted by ACE in 2013 among 650 companies across a range of industries within the EMEA region[1]. This underlines that environmental risks are an issue that affects all sectors today, not just the traditional 'polluting' industries.

Given recent high-profile pollution incidents and an increasingly complex network of environmental laws and regulations around the world, focus on environmental issues is only likely to grow in future. Yet, despite general agreement on the principle of 'polluter pays', there is little consistency in environmental regulation globally. It has been estimated that there are now in existence more than 17,000 separate regulations worldwide addressing air, water, land and soil contamination.

This report begins by outlining the importance of understanding environmental risks and what needs to be considered when insuring such risks across borders. It will then identify some of the regulatory trends in the United States, the European Union, Australia, China, India and Brazil, before highlighting some recent environmental enforcement actions in Australia, the United States, China and Brazil and the impact these actions have on multinationals. The effects of the changing regulatory landscape on the personal liabilities of directors and officers are highlighted as well as the countries where environmental impairment liability insurance is (or is soon to be) mandatory. Consistent with previous ACE reports, this report concludes with a checklist of questions that risk managers and brokers should ask when developing a multinational environmental impairment insurance programme.

1. Managing Environmental Risks

The steady march of globalisation has opened up new markets and new opportunities for businesses around the world. At the same time, a range of stakeholders are putting an increased focus on protecting the environment. Indeed, as outlined in ACE's research, some three-quarters of companies agree that their shareholders are taking environmental risk more seriously.

As part of their risk management strategy, companies today therefore need to identify and assess their potential pollution exposures and institute policies and procedures to address those risks. They need to be aware of current regulations that govern the production, handling and discharge of potentially hazardous substances in each of the jurisdictions in which they operate.

One particular risk for companies operating in emerging markets is the potential cost of cleaning up an accidental spill or leak of pollutants on property owned or leased by their local subsidiaries. A spill of pollutants, even where it remains within a property's boundaries, must often be cleaned up to protect workers and prevent further damage to soil and groundwater. These costs can easily run into the hundreds of thousands or even millions of dollars. Today, companies everywhere may also face significant fines or be required to bear the brunt of the cost of mitigating the environmental damage to neighbouring properties.

Beyond the risks of spills and accidents, companies should take into account changes in environmental regulations and stricter enforcement regimes that may require costly remediation work or to previously conforming property or operations and should consider whether their insurance policies provide coverage for such changes. In addition, in today's fast-paced business environment, the damage to corporate brand and reputation from an environmental incident can be significant and can emerge quickly, adding further complexity.

"By taking a proactive approach to environmental risk management and adequately insuring the exposures within their daily operations, businesses can better protect themselves in a complex and changing global operating environment."

Because accidents or unexpected events happen even to the best prepared businesses, companies should also make sure that they are adequately covered by insurance that responds to their potential environmental exposures across the world. To protect their investments, companies need to consider environmental impairment insurance policies that include premises pollution cover (which provides coverage for the first-party costs of environmental remediation and on-site clean-up costs such as soil and ground water on the site) as well as third-party liability cover for losses incurred as a consequence of on-site incidents. Companies may also want to consider purchasing an insurance product that provides expert help in a crisis to manage any resulting threat to their reputation. Today, crisis management services can be as valuable to a company as the financial benefit that liability insurance provides.

Companies may not realise that pollution liabilities arising out of their daily operations will not be covered by traditional general liability and property insurance programmes. In many countries, insurers apply pollution exclusions to their general liability policies, for example. Too often stand-alone environmental impairment insurance is a crucial but missing piece of an otherwise thorough risk management approach.

Indeed, one of the conclusions from ACE's research over the past few years is that there is considerable confusion among many companies as to whether or not and to what extent environmental risks are covered by their existing insurance programmes. It appears that in many cases businesses think they are covered when this isn't the case.

However, environmental impairment insurance, which absorbs the financial costs associated with cleaning up accidental spills or leaks of pollutants, can address the coverage gaps created by the pollution exclusions in general liability, property, and directors and officers liability insurance products. By taking a proactive approach to environmental risk management and adequately insuring the exposures within their daily operations, businesses can better protect themselves in a complex and changing global operating environment.

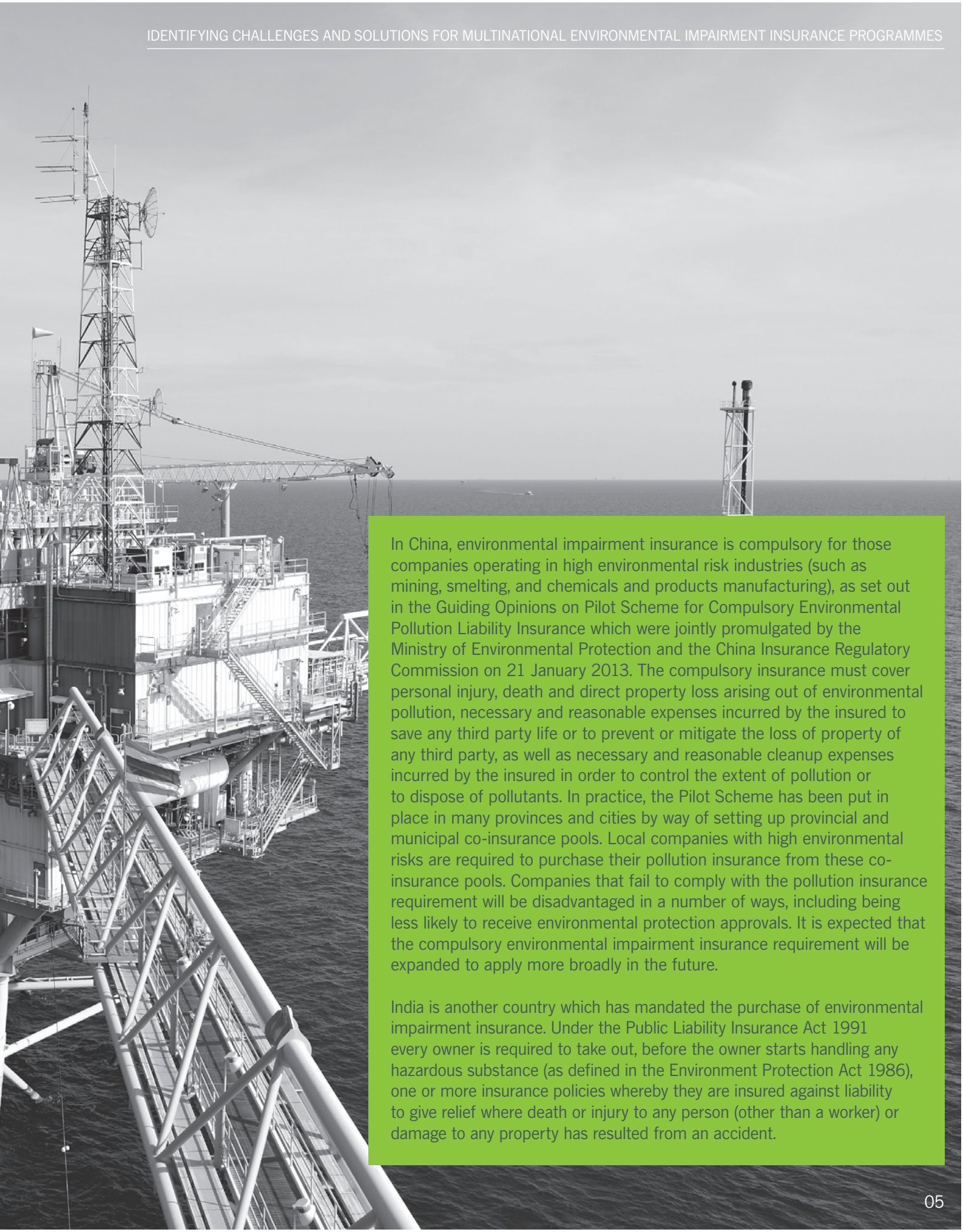
COMPULSORY ENVIRONMENTAL IMPAIRMENT INSURANCE

An increasing number of countries are imposing a mandatory requirement on companies to carry environmental impairment or pollution insurance.

Article 14 of the European Liability Directive (ELD) requires European Union member states to take measures to encourage the development of financial security instruments to ensure that operators have sufficient financial resources to make good their obligations and liabilities under the ELD. To date, eight countries (Bulgaria, Czech Republic, Greece, Hungary, Portugal, Romania, Slovakia and Spain) have implemented compulsory financial security arrangements, but only Bulgaria and Portugal have implemented mandatory environmental impairment insurance schemes.

In Spain, legislation exists that will require certain operators to purchase environmental impairment insurance with a limit of liability of up to €20 million and establish a statutory pool (to be funded by contributions from insurance premiums) to cover losses that exceed the insurance limits. The cover must have a separate limit from any other cover but sub-limits are permissible. The deductible must not exceed 0.5% of the overall limit of cover. Policies are commonly written with a retroactive date set at 30 April 2007, being the date the relevant legislation came into effect.

Since 2008, Argentina has required that environmental impairment insurance (or other financial guarantee) be maintained by any company that may pose an environmental threat. The cover must provide for the clean-up costs of pollution incidents. Non-compliance with the requirement to maintain appropriate insurance or financial guarantee arrangements can lead to non-renewal of operating permits.



In China, environmental impairment insurance is compulsory for those companies operating in high environmental risk industries (such as mining, smelting, and chemicals and products manufacturing), as set out in the Guiding Opinions on Pilot Scheme for Compulsory Environmental Pollution Liability Insurance which were jointly promulgated by the Ministry of Environmental Protection and the China Insurance Regulatory Commission on 21 January 2013. The compulsory insurance must cover personal injury, death and direct property loss arising out of environmental pollution, necessary and reasonable expenses incurred by the insured to save any third party life or to prevent or mitigate the loss of property of any third party, as well as necessary and reasonable cleanup expenses incurred by the insured in order to control the extent of pollution or to dispose of pollutants. In practice, the Pilot Scheme has been put in place in many provinces and cities by way of setting up provincial and municipal co-insurance pools. Local companies with high environmental risks are required to purchase their pollution insurance from these co-insurance pools. Companies that fail to comply with the pollution insurance requirement will be disadvantaged in a number of ways, including being less likely to receive environmental protection approvals. It is expected that the compulsory environmental impairment insurance requirement will be expanded to apply more broadly in the future.

India is another country which has mandated the purchase of environmental impairment insurance. Under the Public Liability Insurance Act 1991 every owner is required to take out, before the owner starts handling any hazardous substance (as defined in the Environment Protection Act 1986), one or more insurance policies whereby they are insured against liability to give relief where death or injury to any person (other than a worker) or damage to any property has resulted from an accident.

2. Environmental Liability: Changing International Regulations

In recent years, the legal frameworks for environmental protection have been strengthened in many countries, particularly in emerging markets.

The United States

The first strict liability rules for pollution were introduced by the United States in the 1970s through the introduction of the Clean Air Act 1970 and the Clean Water Act 1972. Since this time, many additional laws have been introduced in the US, including the Comprehensive Environmental Response, Compensation and Liability Act 1980 which deals with the clean-up of hazardous substances and imposes a strict liability scheme that makes one party potentially liable for the entire cost of the remediation even where multiple parties were involved.

Reporting requirements for companies operating in the US are extremely wide-ranging, with mandatory reporting required in relation to 41 different industries. Failure to properly collect data or comply with reporting requirements can result in fines.

The US Environmental Protection Agency (EPA) administers over 80 statutory civil provisions and a range of criminal offences. In 2012, the EPA imposed US$252 million in criminal fines and civil penalties to deter pollution.

The European Union

The European Union has followed the US approach in terms of introducing environmental liability that affects a wide range of industries. In 2004, the Environmental Liability Directive (ELD) was passed by the European Parliament and Council of Ministers to deal with the prevention and remedy of environmental damage. Under the ELD, companies can be held financially liable for environmental damage caused by their actions. There is no cap on potential liability although, unlike many other countries, there is no application of the principle of joint and several liability.

The ELD also provides that companies are required to prevent and remedy imminent environmental damage. The law covers a wide range of environmental damage, including damage to protected species, natural habitats, water and soil, and damage caused by the release of genetically modified organisms. Liability can be avoided where the company has acted in accordance with conditions of authorisation by an EU member country or in accordance with the state of scientific and technical knowledge that existed at the time of the damage.

By 2010 each member of the EU had transposed provisions of the ELD into their own national laws. However, the manner in which the ELD has been transposed varies significantly between member states. In addition to the ELD, many EU member states have also implemented additional environmental laws at the national or sub-national level. For example, Germany has imposed additional environmental laws on a number of industries relating to air quality, waste management, soil protection and noise pollution. This has resulted in different regulatory systems and therefore different liability risk exposures for companies operating across EU states.

Australia

The legal framework for environmental protection in Australia is complex, with responsibility for environmental issues shared amongst the federal, state and local levels of government. Each state in Australia has a different environmental protection regime.

Since the Montara incident in 2009, there has been an increasing focus in Australia on how the marine environment may be affected by the offshore and shoreline industries. Recent amendments to Offshore Petroleum Greenhouse Gas Storage Act Amendment (Compliance Measures No. 2) Act 2013 (Cth) impose an obligation on all petroleum title-holders to maintain financial assurance (which can be provided by way of insurance, including surety bonds) sufficient to demonstrate they have capacity to respond to, and clean up after, any pollution incident; before a licence to undertake a petroleum activity will be granted.

There is also an extensive regulatory regime that applies specifically to Australia's mining industry, particularly in Western Australia and Queensland. In Western Australia new legislation has been introduced that will establish a Mining Rehabilitation Fund (MRF) whereby a pooled industry fund will be created to rehabilitate land affected by mining operations, where the original operator does not fulfil its mine rehabilitation and closure obligations.

China

The overall framework for China's environmental legislation is the Environmental Protection Law which was promulgated by the Standing Committee of the National People's Congress (NPC) on 26 December 1989. The law provides basic principles, general requirements and legal responsibilities for the protection of wildlife and control of pollution. The Environmental Protection Law sets out three types of offences. The normal category offences will result in administrative penalties. If the conduct also causes damage to other enterprises and individuals, the party that committed the environmental damage shall also be subject to pay compensation to the affected enterprises and individuals. For the most serious offences, where there is proof of wilfulness or negligence, criminal liability will be triggered.

In accordance with Article 41 of the Environmental Protection Law, an enterprise that has caused an environmental pollution hazard shall bear the obligation to eliminate it. Chinese law does not specify the extent of rectification. If the enterprise fails to eliminate the damage, it shall face civil liability, which may include cessation of the infringement, restoration of original condition and elimination of dangers.

The Environmental Protection Law is expected to be revised in the near future for the first time since 1989. The Second Draft, which has been released for consultation, increases public disclosure requirements, ensures public participation in impact assessments and raises potential penalties. In addition, the Law on the Prevention and Control of Atmospheric Pollution and the Law on Environmental Impact Assessment are expected to be revised in the near future.

The agencies of the State Council and local governments promulgated a number of rules and regulations dealing with the management and supervision of environmental protection.

There have been a number of major legislative changes to environmental liability law in China in the past few years. Amendment VIII issued by the Standing Committee of the NPC has been in force since 1 May 2011. Amendment VIII increases environmental liability exposures by broadening the scope of pollutants and lowering the threshold for conviction of crimes for environmental pollution.

In order to enforce Amendment VIII, the Supreme People's Court together with the Supreme People's Procuratorate promulgated the Interpretations on Certain Issues Concerning the Application of Law in Handling Criminal Cases of Environmental Pollution which entered into force as of 19 June 2013, further regulating crimes of environmental pollution.

India

India boasts of a very exhaustive legal framework in the area of environmental protection. Under a two-tiered structure, policy and law is formulated by the central government and the respective state governments and implementation is carried out by several central, state and local agencies and instrumentalities.

Until the catastrophic Bhopal gas disaster in 1984, limited attention was given to environmental issues in India by legislators, the executive and the judiciary. However, the 1984 incident in which the leak of lethal methyl isocyanide gas claimed over 5000 lives and injured over half a million people, compelled stakeholders to bring in tougher laws, improve accountability and ensure better enforcement. Over the years, jurisprudence in this area has significantly evolved, particularly in light of pressure from non-governmental organisations and the judiciary.

The Environment Protection Act 1986 is the umbrella legislation in India and is supported by specific legislation for pollution prevention and control, forest conservation and wildlife protection. Indian environment statutes chiefly employ a system of licensing, permits, environment impact assessment, environmental clearances, and criminal sanctions to preserve natural resources and regulate their use.

All enterprises whether owned by Indian residents or non-residents are required to obtain statutory clearances relating to pollution control and environment protection, if applicable, for setting up an industrial project for over 40 categories of industries including industrial activity related to petrochemicals, petroleum refineries, cement, thermal power plants, bulk drugs, fertilisers, dyes, paper, etc. There are also emission and discharge standards for several industrial activities.

In recent years, Indian Courts have been more vigorously enforcing the 'polluter pays' principle by heavily penalising corporations for violations and breaches. Launch of criminal sanctions against directors and senior management has also compelled corporations to take necessary steps for compliance, risk management and mitigation.

Brazil

The legal framework that governs environmental pollution in Brazil encompasses several infra-constitutional laws and regulations, the main statutes, being the National Policy on the Environment, the National Policy on Water Resources, the National Policy for Solid Waste, Oil Law, New Brazilian Forestry Code and the Environmental Crimes Law.

Liability for environmental damage in Brazil can be assessed in three different spheres: civil, administrative and criminal. It is worth noting that the federal, state and municipal governments have concurrent competency to levy administrative fines for the same infraction at the same time.

The civil liability regime for damage caused to the environment or to third parties is one of joint strict liability, i.e. the polluter and its insurer, as well as any other guarantor or party involved in the pollution incident are jointly liable for damages independent

"The legal framework which governs environmental pollution in Brazil encompasses several infra-constitutional laws and regulations."

of fault. The recoverability of damages in Brazil is proportional to the severity of the damage pursuant to the principle of full responsibility provided under Article 944 of the Civil Code which states simply that "the indemnification is measured by the extent of the damage". As regards administrative liability, the Environmental Crimes Law establishes that the administrative liability regime for environmental damage is also one of strict liability. In the event of oil pollution, the administrative penalties can vary from simple warnings to fines in total up to R$50 million (approximately US$30 million) per infraction, in addition to the seizure of any vessel, suspension of activity, restriction of rights, and loss or restriction of tax benefits, amongst others.

> "In Mexico, Panama, Colombia and Peru, legislation exists which requires companies in certain industries to provide financial guarantees for environmental damage they may cause."

Insofar as the criminal liability regime for environmental damage, this is based on the fault of the causing agent, and varies from fines to imprisonment, the suspension of activities of the company in Brazil, the rendering of community services, funding of environmental projects, contributions to environmental and cultural public entities, amongst others. Criminal liability can also be attributed to corporate entities in Brazil.

Pursuant to Brazilian law, the construction, installation, expansion and operation of any establishment or activity that uses environmental resources, and that is deemed actually or potentially polluting, or capable of causing any kind of environmental degradation, are subject to environmental licensing. Brazilian authorities are also focusing their attention on improving the internal oil and gas legislation in order to organise the sector and protect not only the country's economy, but also the environment.

Other emerging markets

Rapid urbanisation, industrialisation and intensified agricultural production and fishing in recent decades has caused severe degradation of the environment in Thailand despite over one hundred laws and more than one thousand pieces of subordinate legislation aimed at protecting its natural resources. The Law Reform Commission of Thailand (LRCT) has a mandate to reconsider the existing legal framework with a view to recommending new laws which will be more effective at abating the continued degradation of the environment and unsustainable depletion of natural resources. Time will tell what form these new laws will take. Of interest, public statements by members of the LRCT in early 2013 indicate a reluctance to adopt the 'polluter pays' principle into Thai law, preferring to focus on broad based stakeholder engagement.[2]

Most countries in the Latin American region have developed laws intended to protect land, water, air and natural resources adopting the 'polluter pays' principle. In Mexico, Panama, Colombia and Peru, legislation exists which requires companies in certain industries to provide financial guarantees for environmental damage they may cause. Mexico has also recently introduced legislation imposing civil liability and a requirement to pay compensation on companies that cause damage to the environment.

RECENT CASES OF ENVIRONMENTAL LIABILITY

Montara oil spill in the Timor Sea off the coast of Western Australia - 2009

On 29 August 2009 a blowout from a Montara wellhead platform, in the Timor Sea off the northern coast of Western Australia, resulted in an estimated 30,000 barrels of crude oil leaking into the water over a 74-day period. By 3 September 2009, the Australian Maritime Safety Authority (AMSA) reported that the slick was 170 km from the coast of Western Australia, and moving closer to the shore. The slick was reported to have spread over 6,000 km^2 (2,300 sq miles) of ocean and has been described as one of Australia's "worst oil disasters".

The Thai state-owned company PTT Exploration and Production admitted full responsibility for the incident, and expressed deep regret. PTTEP faced a maximum penalty of AU$1.7 million for the spill, but received a discount of 25% on its fines because it entered a guilty plea to the four charges. Subsequently in 2012, PTTEP was fined AU$510,000 by the Australian Government for its actions in relation to the disaster, a penalty intended to "deter others". In total the Montara Oil Spill is estimated to have cost PTTEP AU$319 million.

BP (Deepwater Horizon) oil spill in the Gulf of Mexico - 2010

The Deepwater Horizon Oil Spill occurred on 20 April 2010 in the Gulf Coast of Mexico in the BP-operated Macondo Prospect. The Deepwater Horizon oil rig exploded and sank causing a sea floor oil gusher to flow for 87 days, until it was capped on 15 July 2010. The total volume of the spill has been estimated at 4.9 million barrels or 780,000 m^3 and 11 lives were lost. This spill is the largest marine oil spill in the history of the petroleum industry.

In 2012, the US Department of Justice and BP settled federal criminal charges with BP pleading guilty to 11 counts of manslaughter, two misdemeanours, and a felony count of lying to Congress. BP also agreed to four years of government monitoring of its safety practices and ethics, and the US Government temporarily banned BP from new federal contracts over its "lack of business integrity".

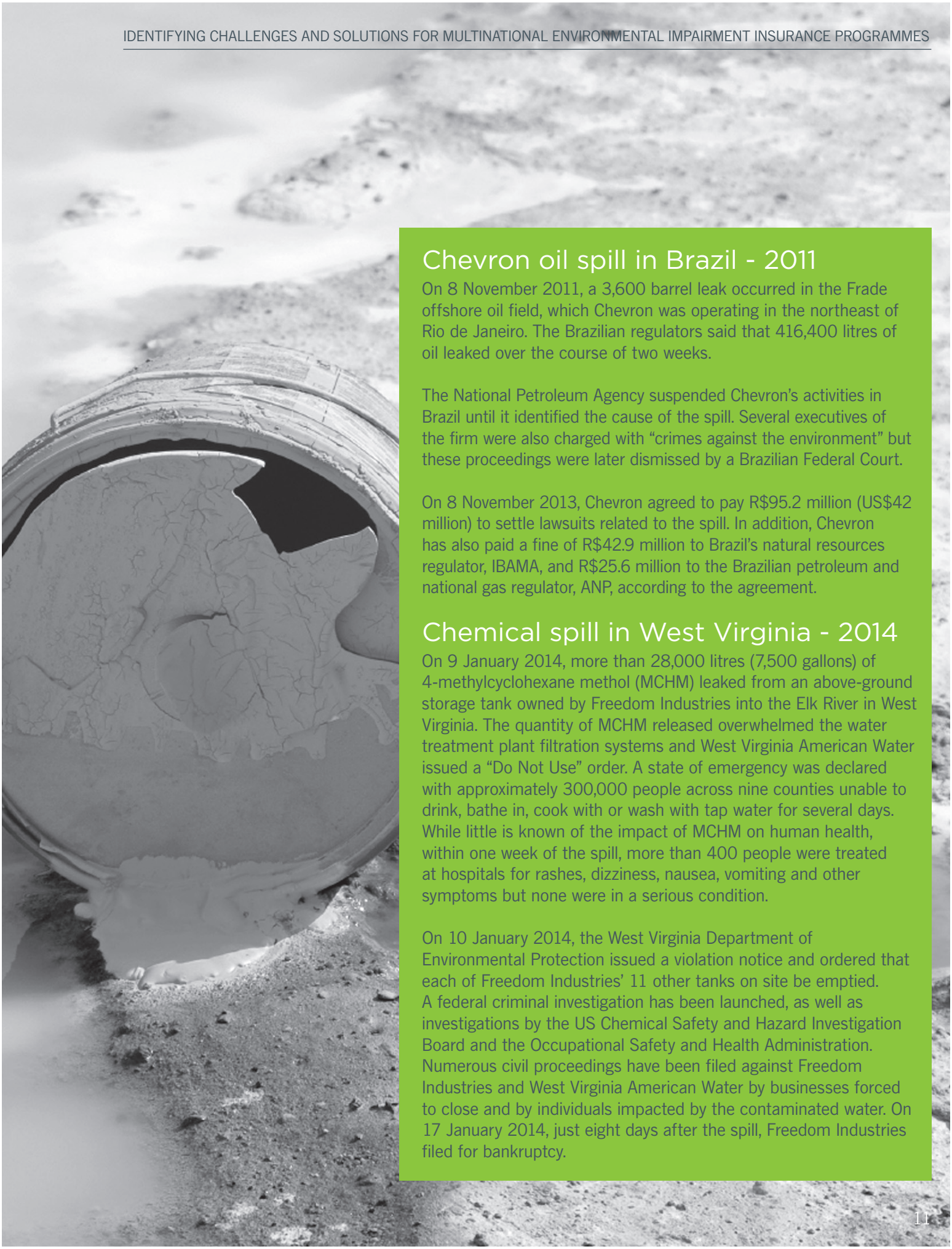
BP paid US$4.525 billion in the settlement in fines and other payments, but further legal proceedings continue and are not expected to conclude before 2014. As at February 2013, criminal and civil settlements and payments to a trust fund had cost BP approximately US$42.2 billion.

In the latest installment of the Deepwater Horizon Oil Spill litigation, the Texas Supreme Court is considering the extent to which the insurances maintained by Transocean (the owner of the exploded rig) naming BP as an additional insured will respond to cover BP's liabilities for the spill.

Toxic mine spill in Fujian, China - 2010

In July 2010, over 2.4 million gallons of acidic copper waste leaked from Zijin Mining's mine in Fujian China, polluting the Ting River and killing 2000 metric tonnes of fish. The spill was not disclosed by the company for nine days.

Zijin Mining was cited for seven environmental violations and was handed a criminal fine of RMB 30 million (US$4.9 million) for its significant environmental pollution. The related officers of Zijin were sentenced to jail terms ranging from six months to three and a half years.



Chevron oil spill in Brazil - 2011

On 8 November 2011, a 3,600 barrel leak occurred in the Frade offshore oil field, which Chevron was operating in the northeast of Rio de Janeiro. The Brazilian regulators said that 416,400 litres of oil leaked over the course of two weeks.

The National Petroleum Agency suspended Chevron's activities in Brazil until it identified the cause of the spill. Several executives of the firm were also charged with "crimes against the environment" but these proceedings were later dismissed by a Brazilian Federal Court.

On 8 November 2013, Chevron agreed to pay R$95.2 million (US$42 million) to settle lawsuits related to the spill. In addition, Chevron has also paid a fine of R$42.9 million to Brazil's natural resources regulator, IBAMA, and R$25.6 million to the Brazilian petroleum and national gas regulator, ANP, according to the agreement.

Chemical spill in West Virginia - 2014

On 9 January 2014, more than 28,000 litres (7,500 gallons) of 4-methylcyclohexane methol (MCHM) leaked from an above-ground storage tank owned by Freedom Industries into the Elk River in West Virginia. The quantity of MCHM released overwhelmed the water treatment plant filtration systems and West Virginia American Water issued a "Do Not Use" order. A state of emergency was declared with approximately 300,000 people across nine counties unable to drink, bathe in, cook with or wash with tap water for several days. While little is known of the impact of MCHM on human health, within one week of the spill, more than 400 people were treated at hospitals for rashes, dizziness, nausea, vomiting and other symptoms but none were in a serious condition.

On 10 January 2014, the West Virginia Department of Environmental Protection issued a violation notice and ordered that each of Freedom Industries' 11 other tanks on site be emptied. A federal criminal investigation has been launched, as well as investigations by the US Chemical Safety and Hazard Investigation Board and the Occupational Safety and Health Administration. Numerous civil proceedings have been filed against Freedom Industries and West Virginia American Water by businesses forced to close and by individuals impacted by the contaminated water. On 17 January 2014, just eight days after the spill, Freedom Industries filed for bankruptcy.

3. Personal Liability of Directors and Officers for Environmental Impairment

In many countries, there are a number of laws that expose corporate directors and officers to both civil (or administrative) liabilities and criminal offences. The regimes are particularly complex in countries such as Australia, Canada and the US. In the area of environmental protection, there is also a trend by legislators to enact civil and criminal offences of strict liability – that is, offences that are deemed to be committed by virtue of the relevant occurrence (e.g. pollution incident) alone, without the need to prove intent or negligence on the part of the individual director or officer. Regulators in some jurisdictions appear to be increasingly motivated to pursue individual executives for corporate wrongdoings.

Canada

In a ground-breaking case in Canada, 12 former directors and officers of a publicly traded corporation have been ordered to personally fund remediation costs in circumstances where the corporation became insolvent before all remediation works were completed. The case involved an aircraft parts manufacturer, Northstar Aerospace (Canada) Inc, which in 2005 had commenced voluntary remediation of a site in Cambridge, Ontario, and hundreds of surrounding properties which had been contaminated by chemicals that had migrated from the site. The company became insolvent shortly after the Ontario Ministry of the Environment (MOE) issued orders against the company requiring further remediation works and requiring more than C$10 million in financial assurance. In June 2012, the MOE took over the remediation works and ordered the 12 former directors and officers to personally fund approximately C$15 million of further remediation costs. The directors and officers appealed but the case settled before hearing with the directors and officers agreeing to personally fund C$4.75 million in remediation costs (after having already personally funded some C$800,000 in remediation costs while awaiting the appeal).

The United States

In the United States, the Environmental Protection Agency (EPA) is openly aggressive in its approach to prosecution of corporate directors and officers for pollution incidents, stating as part of the Criminal Enforcement Program that the EPA "emphasises prosecution of individual defendants as high up the corporate hierarchy as the evidence permits".

The US is one of the countries in which laws expose corporate directors and officers to both civil liabilities and criminal offences. Some of the offences are strict liability offences to which there are effectively no defences available – if the incident occurred, the individual is liable irrespective of knowledge, intent or capacity to influence.

In the US, directors have been held personally liable for contaminated land as "operators" (upon whom the liability is imposed under the relevant statute) where they had some capacity to control the relevant business operation or site.

"In the European Union, the ELD principles provide that corporate directors and officers can be held personally liable for their company's non-compliance with the ELD."

The European Union and Asia Pacific

In the European Union, the ELD principles provide that corporate directors and officers can be held personally liable for their company's non-compliance with the ELD.

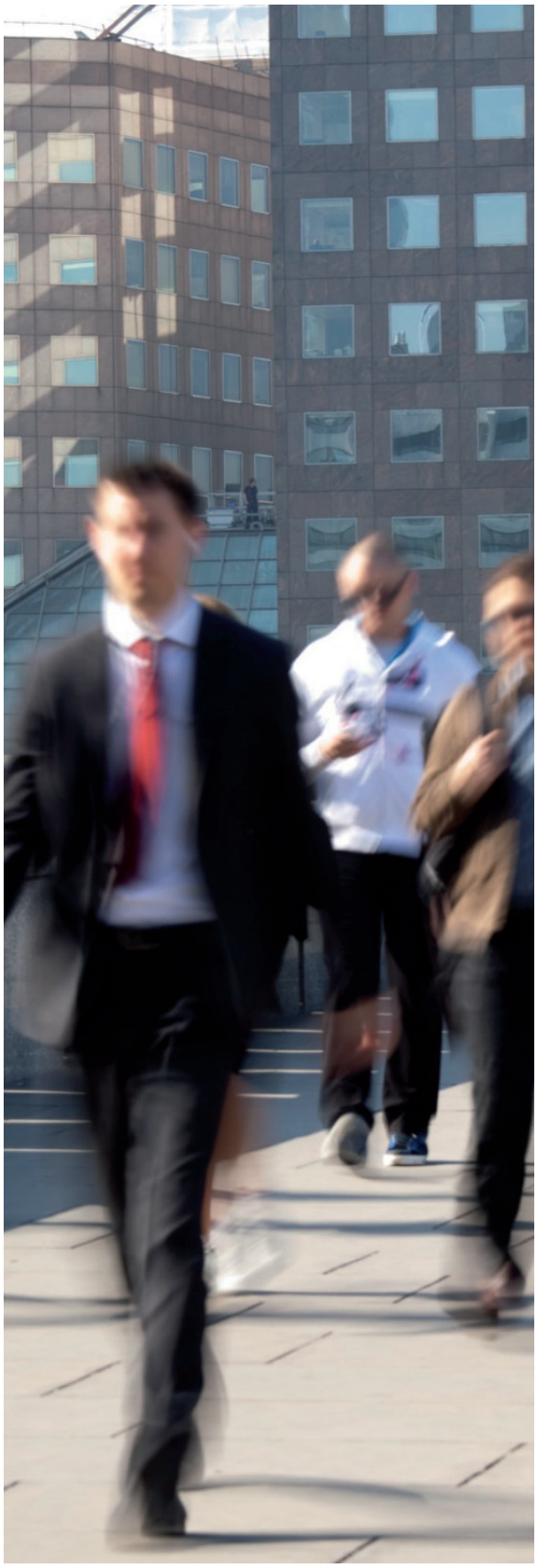
In India, criminal sanctions against directors and officers are increasingly accompanying heavy penalties imposed on corporations for breaches of environmental protection laws.

In China, persons responsible for a serious environmental incident are subject to administrative and criminal sanctions, but the civil liabilities of corporations do not extend to impose joint liability with individual directors and officers.

In Australia, there are accessorial liability provisions under various environmental protection statutes that expose individuals to personal liability where they were knowingly concerned or otherwise involved in some way with an offence committed by the corporation.

Traditional directors and officers liability (D&O) insurance products provide some cover for defence costs incurred in relation to pollution incidents, but the coverage is often subject to sub-limits. Clean-up and remediation costs are inevitably excluded. While civil pecuniary penalties are sometimes covered, even where coverage for criminal pecuniary penalties is purportedly provided, the enforceability of such cover is uncertain given public policy considerations (e.g. a person cannot insure against their own criminal acts).

It is therefore important for risk managers to work with an internationally-experienced insurance broker who can guide them through the decision-making process of how best to protect the personal liabilities of the company's directors and officers.



4. Structuring a multinational insurance programme for environmental impairment risks

It is important that companies ensure their insurance programmes provide effective protection against risks in each jurisdiction where they do business.

Today's sophisticated multinational insurance programmes offer a combination of risk financing and risk transfer. A multinational programme for environmental impairment risks can be structured in a number of different ways – at the parent level only, at the subsidiary level only, or through a combination of parent and subsidiary level protection.

A multinational programme that offers a single global insurance policy issued to the parent company in the parent's home jurisdiction should be designed to insure the parent and its subsidiaries and joint venture partners, and in some cases their respective directors and officers as well, against environmental impairment risks. However, a parent level policy or a joint venture shareholder arranging a single global programme policy only may not comply with local requirements and a local policy may be required to conduct business in the jurisdiction where the subsidiary or other majority or minority shareholders in a joint venture reside or operate.

Companies with overseas operations in several countries may want to design a multinational insurance programme that includes local policies tailored to the individual regulatory regimes in each country. Given the changing legal and operating environment, it may in many cases be more appropriate to structure the multinational programme through stand-alone local policies with appropriate local coverage grants and limits that are then supplemented with a "master umbrella policy" issued to the parent company containing differences in conditions (DIC) and differences in limitations (DIL) coverage filling any gaps in coverage or limits provided under the local policies.

The arrangement of local policies by subsidiaries in the countries where they are based is common, especially in jurisdictions that mandate particular coverages, restrict or have local requirements for unlicensed insurance covering local risks, or place an onerous process on a local insured or local broker procuring non-admitted insurance. A locally admitted insurer will, in such cases, underwrite and issue the local policy complying with the local insurance laws, and will calculate and remit the applicable insurance taxes and fees. Claims under such local policies will be adjusted and paid locally.

For the parent, it will have a financial or economic interest in its subsidiary and affiliated companies through shareholding or other ownership interests, or perhaps via legal or contractual obligations. In the United States, many countries in the European Union (including the United Kingdom, France and Germany), Switzerland, Mexico and Brazil, as well as in Australia and several countries in Asia (including Singapore and Hong Kong), financial or economic interest is insurable – and the parent company may procure insurance directly for its 'insurable interest' in subsidiary entities. This parent policy can supplement local policies arranged by subsidiaries and offering the parent company DIC/DIL protection. In many countries, the parent's economic loss is measured by reference to the subsidiary's actual loss – essentially, a form of 'agreed value' policy. In other words, if a subsidiary suffers a loss, the parent company is deemed to suffer a concomitant loss by virtue of the parent's interest in the subsidiary. Should the local subsidiary not have the financial resources to meet local damage awards, pay fines or remediate properties as required, the parent can also insure against its costs in meeting those amounts on the subsidiary's behalf.

Checklist of Questions to Consider

Before arranging a multinational environmental impairment insurance programme, all participants in the programme should consider the following questions.

This 'bottom-up' approach focuses on identifying any requirements for local policies, supplemented by a 'top-down' approach that ensures that potential gaps in those local policies are covered by an excess DIC/DIL policy.

1 What are the conditions imposed by a local jurisdiction for a subsidiary to insure environmental risks?

(a) If insurance is arranged, must it be issued by a locally licensed insurance company?

(b) Are there circumstances in which risks can be insured by an unlicensed insurer?

2 If only local insurance is allowed or if local 'financial assurance' must be provided by a government-sponsored pool, does the local policy or pool provide the expected coverage?

(a) Does procuring a local policy tailored to insure the local subsidiary's environmental risk exposures filling coverage gaps in the local policies or pools provide appropriate and adequate insurance protection?

3 If DIC/DIL is needed and the subsidiary may purchase it from an unlicensed insurer, how may an unlicensed insurer compliantly (policy, premium, claims, tax) issue the policy and insure the local risks?

(a) How may an unlicensed insurer adjust and pay a covered claim in the local country?

(b) Are premium taxes due under the DIC/DIL policy?

(c) Which entity (the insured, broker or insurer) will calculate, collect and remit payment in the countries where such insurer is not licensed?

4 If DIC/DIL is needed and the subsidiary may not purchase it from an unlicensed insurer or if non-admitted insurance is restricted in the subsidiary's country, how may the DIC/DIL master policy be compliantly purchased and issued to meet expectations?

(a) What risks are covered and where are they located?

(b) How is premium allocated and paid?

(c) Where will premium taxes and/or other fees and surcharges be remitted?

(d) How will claims be adjusted and paid?

(e) Are related party transfer pricing agreements (between parent and subsidiary, affiliate, joint venture) agreed before binding insurance to address any potential tax consequences and promote transparency of cash flows?

CONCLUSIONS

1 Environmental impairment is an emerging risk for all companies in today's global marketplace.

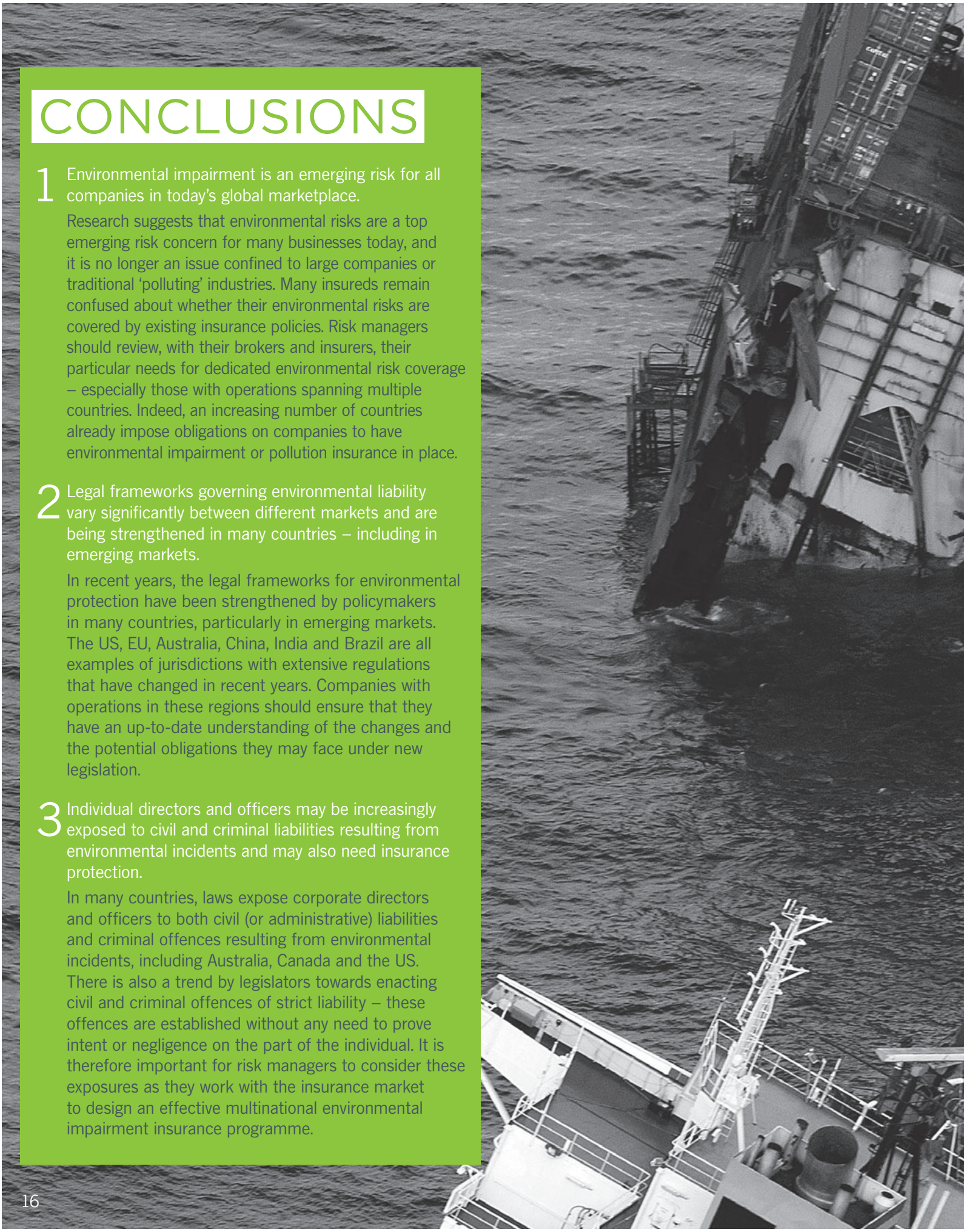
Research suggests that environmental risks are a top emerging risk concern for many businesses today, and it is no longer an issue confined to large companies or traditional 'polluting' industries. Many insureds remain confused about whether their environmental risks are covered by existing insurance policies. Risk managers should review, with their brokers and insurers, their particular needs for dedicated environmental risk coverage – especially those with operations spanning multiple countries. Indeed, an increasing number of countries already impose obligations on companies to have environmental impairment or pollution insurance in place.

2 Legal frameworks governing environmental liability vary significantly between different markets and are being strengthened in many countries – including in emerging markets.

In recent years, the legal frameworks for environmental protection have been strengthened by policymakers in many countries, particularly in emerging markets. The US, EU, Australia, China, India and Brazil are all examples of jurisdictions with extensive regulations that have changed in recent years. Companies with operations in these regions should ensure that they have an up-to-date understanding of the changes and the potential obligations they may face under new legislation.

3 Individual directors and officers may be increasingly exposed to civil and criminal liabilities resulting from environmental incidents and may also need insurance protection.

In many countries, laws expose corporate directors and officers to both civil (or administrative) liabilities and criminal offences resulting from environmental incidents, including Australia, Canada and the US. There is also a trend by legislators towards enacting civil and criminal offences of strict liability – these offences are established without any need to prove intent or negligence on the part of the individual. It is therefore important for risk managers to consider these exposures as they work with the insurance market to design an effective multinational environmental impairment insurance programme.



4 Multinationals should think carefully about the programme structure that will best perform for their needs.

A multinational programme for environmental impairment risks can be structured in a number of different ways – at the parent level only, at the subsidiary level only, or through a combination of parent and subsidiary level protection. In today's complex regulatory and operating environment, the most appropriate solution may be to supplement stand-alone local policies, which have appropriate local coverage grants and limits, with a 'master policy' issued to the parent company containing DIC/DIL coverage to fill any gaps.

5 Risk managers and their insurance market partners must be careful to ask the right questions before implementing a multinational programme and work with the right team.

Our checklist of questions recommends taking a 'bottom-up' approach that focuses on identifying any requirements for local policies, supplemented by a 'top-down' approach that ensures the potential gaps in those local policies are properly covered by the right excess DIC/DIL policies.

An experienced, independent team of accounting, legal, tax and financial specialists, including an insurance broker with international experience, can help structure a comprehensive and global insurance programme that fits the specific needs and goals of a multinational enterprise. Ultimately, giving adequate attention to the requirements of applicable laws and regulations – and the need for documentation and supporting contractual arrangements – should result in an international insurance programme that addresses the issues in this report and that satisfies the collective objectives of the client, the broker and the insurance carrier.

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Endnotes

1. ACE European Group, 'EMEA Emerging Risks Barometer', December 2013
2. See https://www.iucn.org/news_homepage/news_by_date/?12595/Thai-civil-society-discussed-principles-of-natural-resources-and-environmental-laws.

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