

Insurance Europe comments on the BioIS study on feasibility of creating an EU industrial accident fund

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Introduction

Insurance Europe welcomes the invitation to contribute to the *BioIS Study to explore the feasibility of creating a fund to cover environmental liability and losses occurring from industrial accidents* (herein referred to as "the BioIS study"). By way of invitation from the European Commission (EC), we submit these comments outlining Insurance Europe's views and concerns in lieu of a response to BioIS's related questionnaire. Our comments also reflect the preliminary findings of BioIS's Background Document for the related workshop held by the EC on 7 November 2012 (herein referred to as "BioIS's Background Document").

I. Analysis of the situation

Insurance Europe supports the aim of the EC to work toward a constructive solution for protecting both the European public and the natural environment against the harms posed by industrial accidents. Insurance Europe also supports the objective of the Environmental Liability Directive (ELD) to focus on operator responsibility and the polluter pays principle. The prerequisite for the prevention of industrial disasters is, first and foremost, the operator's duty to maintain high security standards. In line with this duty, we also find that the level of security standards within the EU must be not less than state of the art.

II. Identification of the problem

Insurance Europe notes that the BioIS study highlights the problem of industrial accidents in Europe and provides a thorough analysis of severe industrial accidents. Insurance Europe firmly believes, however, that further study should be conducted before any fund proposal is considered at EU level. The purpose would be to bring attention to those parts of the current BioIS study that may need to be completed and/or reviewed with further stakeholder input from experts in risk management and transfer.

As discussed in the EC's 7 November 2012 workshop, Insurance Europe agrees that there are two factors that, among others, can create obstacles for the prompt and complete restitution of the damaged environmental resources to their baseline. With respect to the ELD, this would include:



- the insolvency of the responsible operator; and
- the delay in:
 - identifying the liable operator;
 - determining the proper restorative actions to take; and
 - enforcing the environmental remediation measures in cases where the liable operator does not collaborate with Member State competent authorities.

The above issues have been cited when a public administration must undertake remediation actions in place of the polluter (eg an insolvent operator) or when a solution is delayed due to the number of years required to determine liabilities.

III. Financial security situation in Europe

■ Industrial disasters should not be attributed to a failure of insurance

In principle, Insurance Europe does not find that there exists a **need** to introduce an industrial disaster fund **at EU level**. The BioIS Study does not, at this stage, demonstrate that the financial security instruments currently in place for the liabilities of industrial disasters (in particular, insurance) are insufficient.

With respect to the environmental liability insurance market, great developments have been made since the adoption of the Environmental Liability Directive (ELD) to adequately cover the needs of operators. This is an evolving market that grows and develops in response to consumer demand. It should be noted, however, that there are different degrees of development in the different EU Member States as well.

In addition, comprehensive insurance solutions exist for covering “traditional” damages (defined as bodily injury, property damage and economic loss in the BioIS Background Document). These solutions have existed for decades and are, with additional financial support from reinsurance, adequate to cover most of these risks.

Insurance Europe maintains that there is no failure of the insurance market in this respect, but rather, that more emphasis should be placed on the risks of industrial accidents, which often result from inadequate maintenance. The ability to insure these risks can be improved if two preconditions are met:

- reasonable preventive measures are required and implemented throughout different industrial sectors; and
- environmental liability rules, such as mandatory security/safety measures, are systematically applied.

The above would be better directed at the local/regional authorities and could, for example, be the subject of a thorough study into the security/safety practices by EU industrial operators.

■ EU Member States require different financial solutions

Member States also have different methods of resolving industrial accidents which factor in political culture, risk management practices, national liability legislation and judicial practices (differences which are evidenced by the case studies in the BioIS Background Document). This is due to the fact that Member States – and even the industrial sectors within those Member States – require *different* solutions based on their markets and potential risk exposure. The available insurance products correspond to these national differences.

■ Insurers hold the necessary experience in risk management and transfer

Insurance Europe also questions how the proposed industrial disaster fund would work more efficiently or effectively than insurance. **The private insurance sector is well experienced in risk assessment, risk transfer and claims management**, meaning it is likely to be in a better position to cover industrial accident damages. Insurance Europe cautions against the introduction of a fund scheme which contradicts the aim of the ELD to avoid environmental damage. The organisers of such a fund are unlikely to have the level of risk

expertise matching insurers, thereby potentially leading to more market difficulties and administrative problems than benefits.

IV. Lack of support for finding of legislative gap

■ **Need for an EU fund should be determined before concluding legislative gap**

While the BioIS Background Document refers to a “gap” in the EU legislative framework for the cover of industrial accidents (p 15), the question should first be *whether* financial security legislation in the area of industrial accidents *is needed* and then, secondly, how a fund would work more efficiently than the current financial security schemes in place. Considering that the need for a fund has not yet been established, Insurance Europe finds the conclusion that there is a legislative “gap” to be premature at this time.

The need for new financial instruments to cover industrial accidents should only be considered if the presently available financial instruments (such as insurance) are determined to not be available, affordable or efficient. Therefore, some initial questions should be raised prior to considering an EU fund:

- Are the present financial instruments appropriate?
- Are they being commonly used?
- If the answer to the preceding questions is no, why?

■ **Focus EU work on increased security standards for operators**

Insurance Europe suggests that an economic framework for industrial disasters should fully incorporate operator responsibility and the “polluter pays” principle. This includes the **duty to maintain industrial security standards, as well as promote risk assessment and risk awareness**. Risk minimisation can also be promoted by making the access to any operational permit dependent and/or proportionate to the potential risks involved. This would include consideration of measures taken by the operator to reduce the risk to an acceptable – and even optimal – level for obtaining the permit.

Naturally, the above could include asking whether the operator is able to cover his potential risks with insurance cover. An insurer’s “risk appetite” (ie business decision to cover a particular risk) has always been highly dependent on the *quality* of the risk (ie the risk severity/frequency, ability to quantify losses). If an operator does not maintain high security standards, the risk grows more severe and becomes uninsurable.

The legal authority should also consider whether the operator’s activities are conducted in a manner that is not in line with national or local security standards. A failure to conform to these standards may signify that the operator is not in a position to be licensable.

V. Potential impact of EU Fund on European insurance market

Insurance Europe also wishes to present its concerns about the impact an EU fund would have on the risk management practices / exposures of industrial operators, as well as on the insurance market.

■ **Diminishment of safety (moral hazard)**

Similar to insurance, a fund must still deal with the question of operator responsibility and level of risk. The insurance industry promotes **risk prevention** and **risk management** as key to minimising industrial disasters. This can be done through enforcement of safety measures in high-risk sectors and sectoral cooperation on safety standards. Before issuing any permit, public authorities should question the safety compliance of the operator and the security of the operator’s activities.

An EU-wide fund does not properly consider individual risk assessment and risk minimisation, and could effectively diminish the incentive to take risk prevention and improvement measures. In other words, the introduction of an improperly designed fund could foster risky industrial practices and create an environment

of “moral hazard”. This is particularly important in light of the economic crisis that continues to plague many industrial sectors today and which may limit an operator’s financial ability to develop such measures.

There is a similar concern in using additional monies from the fund to finance safety improvements to operator installations, as was suggested during the EC’s 7 November 2012 workshop on this issue. This initiative can also reduce operator incentive to improve one’s security standards, as operators may begin to rely on the fund for this purpose. The result may be an increase in unsafe, risk-prone activities.

Consequently, insurers will be faced with industrial sectors that may be more prone to accidents, leading to an increase in claims. This can lead to a significant increase in premiums in order to compensate for the increase in risk, which will place an additional financial burden on operators. While the BioIS Study provides that the proposed fund is intended to apply from 100M EUR in losses onwards, it should be noted that an operator may require insurance cover at an economically practical level for the losses below that threshold.

The outcome of the above scenario is thus two-fold: operators unable to afford the increase in insurance premiums may be forced to leave the market due to their inability to cover liabilities below the fund’s 100M EUR threshold; and insurers unable to provide cover at economically competitive rates may need to withdraw from the market due to their inability to sell their products.

■ **Disruption of insurance market development**

Faced with the requirement of contributing to an EU fund, industrial operators may be less inclined to seek out innovative, insurance solutions that can aid in covering their liabilities. As a result, an EU-wide fund can stifle the growth of the environmental liability insurance market by effectively lowering the demand for applicable insurance. Insurers may then be faced with little reason to refine their products and increase the available financial capacity in order to build cover for the future. Insurance Europe maintains that it is thus **crucial** to think of how this fund will impact the **environmental insurance market development**.

Additionally, general liability insurance markets have gained significant expertise with industrial disasters and would already be in a more knowledgeable position to handle the “traditional damages” cited by the BioIS Study. However, the introduction of a fund may deter investment by operators in this market, as they would face budget constraints by the proposed annual fund levy. The lower demand for general liability products could thus disrupt the functioning of a market currently able to design cover based on an operator’s specific risk profile and liability needs.

Moreover, the currently proposed fund appears oriented toward a short-term approach in managing environmental liability risks. These types of risks, however, often require a long-term approach to assess the remediation measures required to restore the environment back to “baseline condition”. The full extent of the loss from an industrial accident may not be realised for years or even decades. This is yet another area that insurance is more likely to have relevant expertise in and, thus, be in a more suitable position to cover.

■ **An EU fund may contradict the principle behind Article 14 of the ELD**

Article 14 of the ELD stipulates that EU Member States “shall take measures to encourage the development of financial security instruments and markets by the appropriate economic and financial operators, including financial mechanisms in case of insolvency, with the aim of enabling operators to use financial guarantees to cover their responsibilities”. However, the development of a “central” EU fund could counteract this objective. It may have an anti-competitive effect on the EU insurance market by adding an extra financial burden on operators and impeding the significant efforts made to accommodate the varying insurance needs, environmental risk exposures and administrative liability traditions of the Member States. This would appear contrary to the philosophy of EU law, which is strongly against any mechanism hindering market competition.

Competition in the market remains particularly important for the environmental liability insurance sector, considering the current state of economic and competitiveness conditions existing across many EU Member States. The operator uptake of environmental liability insurance is currently low compared to other, more

traditional covers. Additionally, operators and insurers alike face difficulty with the lack of implementation clarity of the ELD (eg what constitutes “significant damage” or “baseline condition”) as well as by the different levels of execution of the ELD practiced by the Member State authorities. A fund may compound this problem by forcing operators to reassess their budgetary constraints before purchasing *both* insurance *and* paying a mandatory annual levy to the fund, possibly concluding that they cannot afford both.

To address the above issue, a detailed cross-country analysis may be conducted to assess the current state of the ELD in various EU Member States. This is presumably already part of the EC’s work in view of its 2014 review of the ELD. Insurance Europe suggests that such a study could include a thorough risk assessment and cost-benefit analysis which would provide a more solid basis for the consideration of further policy intervention at EU level.

VI. Follow-up to the BioIS Study

Insurance Europe maintains that further work can be done to accompany the work done on the current BioIS Study. Such work includes the following.

■ Objective of the fund study

The intended objective of the study appears unclear. Insurance Europe maintains that **a clear and concise objective for an EU-wide industrial accident fund should be established** before the feasibility of the fund is considered.

■ Consideration of longer study timeline and more stakeholder input

Insurance Europe suggests that – in order to get as much information and stakeholder input as possible – this study (or additional, related studies) be conducted over a longer time period. Insurance Europe also recommends that different questionnaires may be developed for different stakeholders and sectors. These questionnaires could, for example, differentiate insurers by market (eg environmental liability, general liability, professional indemnity) and operators by sector (eg mining, oil, chemical).

Insurance Europe would also welcome further workshops/seminars at which relevant stakeholders can provide their views to the consultants, the Commission and each other.

■ Purpose of the cited case studies should be developed

While the BioIS Background Document contains case studies of various industrial accidents in Europe, these studies do not cite any reasons for introducing an industrial disaster fund at EU level or show how a fund would provide more effective financial security than the currently available financial mechanisms (such as insurance).

The case studies provided in the BioIS background document provide the following:

- Aznalcollar, Spain (p 10-11)
 - This case study provides that the operator held liable for its insolvent subsidiary’s actions felt it would **“not suffer any substantial financial damage as a result of the legal proceedings described”** and that **“responsibility for the accident remains unclear”**.
- Buncefield, UK (p 12-13)
 - The summary reports that “a large number of the civil claims were covered by insurance” and that the oil companies were responsible for the storage and treatment of the contaminated waters.
 - The case study notes that the suspected air pollution “did not cause significant health and environment effects” and that “that there was no credible evidence of contamination of

the soil and grasses from the incident". Also, "concentrants of pollutants in surface water began to drop about one month after the incident".

- A report on the incident **noted "support that had been provided and recommended"**, including "the merits and mechanisms for providing immediate short-term financial assistance to communities affected by the incident as well as central government support to assist in recover of the affected areas".

- AZF, France

- The Court of Justice ruled that there was insufficient evidence to prove negligence of the operator, Grande Paroisse. On appeal, Grand Paroisse was fined for the accident and the former manager was sentenced for manslaughter.
- The case summary notes that the explosion "**led France to switch its emphasis from 'risk management' to 'risk prevention'**".

The above case studies **do not appear to support the introduction of a disaster fund at EU level**. To the contrary, they demonstrate how the aftermath of these accidents was handled by the EU Member States themselves, particularly the determination of liability by the courts and the manner in which the losses, both environmental and traditional, were resolved. Thus, Insurance Europe questions the purpose of these case studies and suggests that these cases be analysed not only within the context of a fund proposal, but as an analysis of the current European financial market situation overall.

- **Fund prerequisites and limitations**

Insurance Europe finds that the BioIS study needs to cite to the possible limitations of an EU fund. For instance, that the proposed fund would likely be faced with a set of criteria similar to that faced by the insurance industry.

Firstly, a fund will need to fulfil the same conditions and prerequisites required of insurers, including the need to perform adequate risk assessment, build sufficient financial capacity to cover risks and acquire the ability to effectively manage and pay out claims. Furthermore, should multiple severe accidents occur in one year it is expected that a fund would face the same financial limitations as insurers, ie requiring a significant increase in the proposed annual contribution. This increase could be considered unaffordable by some operators and result in pushing them out of the market.

Secondly, liability is determined through the filing of claims – whether via the court system for civil claims for bodily injury or by the environmental competent authorities of Member States. As a fund cannot speed up the determination of liability or eliminate liability defences that may be asserted (eg permit defence or state-of-the-art defence under the ELD), the fund will be delayed by these factors in the same manner that insurers are delayed today.

VII. Open questions to consider

In the event that an industrial disaster fund is contemplated at EU level, Insurance Europe maintains that there are several questions to consider before assessing its feasibility. These questions are as follows:

- What is the aim of the fund (eg to protect the environment or to compensate for bodily injury / property damage / business interruption)?
- How does the compensation mechanism work (eg local, regional, cross-border impact)?
- What are the limits and the threshold of the fund? What is the calculation of the limits/threshold?
- How will the fund be capitalised (eg taxes, appropriations from government funds, etc)?
- How could a fund manage the cover of environmental and traditional damages more efficiently and quicker than the present financial security instruments in place (particularly insurance)?
- How will political decisions in application of fund monies be controlled (eg favouritism for a particular country or sector)?



- Which entity would be responsible for implementing and managing the fund, as well as collecting operator contributions?
- How will the required contributions from operators remain cost-effective and affordable, so as not to push operators out of the market?
- How will the monies of the fund be equitably distributed, particularly if the fund runs out due to multiple industrial accidents within one year?
- How will the varying levels of risks be considered (eg high-risk v. low-risk operators/sectors)?
- What safeguards will be put in place to ensure that SMEs do not get pushed out of the market due to the burden of the proposed annual levy on operators for capitalising the fund?

Conclusion

Considering the concerns highlighted in this paper in addition to the above questions, Insurance Europe maintains that further study on this issue should be conducted before any proposal of an industrial disaster fund is contemplated at EU level. Insurance Europe welcomes the opportunity to participate in this further study and the chance to provide its input on any future related consultations or workshops.

Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of over €1 100bn, employ nearly one million people and invest almost €7 500bn in the economy.

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