CEA response to European Commission's public consultation on improving offshore safety in Europe

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Introduction

The CEA, the European federation for insurers and reinsurers, would like to take this opportunity to respond to the European Commission's consultation on improving offshore safety in Europe. Having worked directly with the European Commission's Directorate-General for Environment with respect to the Environmental Liability Directive (ELD), including participation and speaking arrangements at various workshops involving this department, the CEA would like to take this opportunity to specifically address the following three questions concerning the issue of liability for damages.

(8) In your view, should the existing environmental liability legislation (Directive 2004/35/EC) be extended to cover environmental damage to all marine waters under the jurisdiction of the EU Member States? (1000 words)

ANSWER:

No. The geographical scope of the guarantee system for offshore oil spills should be worldwide, rather than resolved through European law, as offshore oil spills are international risks that easily cross the borders of the EU. Considering the expertise of most environmental liability insurers, which do not generally include offshore oil sector risks, the ELD is more likely to be effective with respect to onshore risks.

Moreover, insurers have developed cover for the ELD with onshore risks in mind, thus, traditional environmental liability insurers are not in a position to cover risks posed by the offshore oil sector.

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International liability regimes are already in place for marine oil pollution

The objective of protecting the marine environment is a global concern that would be best enhanced through cooperation with the international community. Considering that offshore oil spills constitute an environmental problem that can easily surpass the borders of the EU, more effort should be placed on addressing offshore safety and liability measures at the international level.

There are already several international liability regimes in place for the losses caused by oil pollution. The International Convention on Civil Liability for Oil Pollution Damage (1969) was adopted to ensure that adequate, prompt, and effective compensation is available to persons who suffer damage caused by spills of oil, when carried as fuel in ships' bunkers. This Convention applies to damage caused on the territory, including the territorial sea, and in exclusive economic zones of States Parties. Moreover, the UN Convention on Law of the Seas defines the rights and responsibilities of nations in the use of oceans and gives guidelines for business, the environment and the management of marine natural resources. The EU, in particular, is a signatory to this framework agreement.

A focus on these existing treaties and other pertinent international legislation would, in our view, be more appropriate before introducing an EU-wide mandatory insurance scheme or revising the ELD. Likewise, it seems crucial to seek solutions through international channels, as EU regulation will not prevent the severe marine pollution that can still be caused by offshore oil exploration and extraction conducted in nearby third countries. Finally, the creation of a further liability regime could create unnecessary duplication and legal uncertainty over which regime is immediately applicable.

The marine and energy insurance markets have regularly dealt with these conventions and are most adept at covering the liability under them. These types of insurers have been able to respond to the civil liability measures regulated at an international level and there is no evidence to suggest they could not do so within the realm of environmental liability.

In addition, the insured sums that the insurance industry would be able to provide within a *mandatory financial security scheme* at the EU level are entirely unfeasible, regardless of whether they are encompassed within the scope of the ELD or not. These insured sums would likely be much more limited and of little use in covering the extent of environmental damage that can be posed by an offshore oil spill.

Offshore oil sector risks are not covered by traditional environmental liability insurers

The EU-wide insurance market has been steadily developing appropriate cover for environmental liability risks through environmental impairment liability (EIL) policies as well as General Third Party Liability (GTPL) policies. Since the introduction of the ELD, the insurance industry has begun modifying some of these policies to specifically cover ELD risks as well. This development, however, is ongoing and there is currently not sufficient capacity within the environmental liability insurance sector to cover the risks of offshore oil sector activities.

Risks posed by offshore oil sector activities are not generally addressed in EIL and GTPL policies. To the contrary, these risks are covered by specialised policies offered by the **marine and energy lines of the insurance market**. These markets have the detailed expertise to assess and manage the complex oil sector risks. These markets also have the means to perform risk assessments and pricing for losses caused by oil spills as well as a track record of responding to such losses. As mentioned above, these types of insurers have effectively offered related liability cover under the primary international conventions dealing with sea pollution.

While the insurance industry may be exploring ways to build capacity for the cover of offshore oil sector liabilities in Europe, these products represent a highly specialised market of marine and energy insurers with a limited consumer base. This **small and specialist market** is vastly different from the widely established markets that fall under an EU compulsory insurance scheme already (eg motor liability insurance). If a market is too small to handle the demand brought about by compulsion, as is clearly the case with the insurance market presently available for offshore oil companies, many insurers are likely to: (1) withdraw their services due to an inability to offer the promised cover; or (2) otherwise severely restrict their policies in order to continue offering the statutory cover. The result is a level of severely diminished competition in the insurance market, leading to fewer and less viable options for the oil companies themselves.

(9) In your view, is the current legislative framework sufficient for treating compensation or remedial claims for traditional damage caused by accidents on offshore installations? If not, how would you recommend improving it? (1000 words)

ANSWER:

As discussed in the CEA's answer to Question 8, marine and energy insurance markets have effectively offered cover for risks in the offshore oil sector under the international conventions that regulate civil liability. **Thus, these international forums should be look toward for effectively addressing this sector**. The risk of offshore oils spills is an international risk, generally covered by global marine and energy (re)insurers as opposed to European-based entities. Additionally, the introduction of European measures cannot assist in protection against spills from nearby third countries – with large offshore oil operations – that are outside the scope of European Union law (eg Norway).

Look toward best practices within the oil sector rather than EU regulatory reform

While insurance plays a significant role in the cover of damages under the ELD – **with respect to risk assessment and prevention as well as risk transfer** – the CEA strongly advises to look toward the offshore oil industry for best practices that can enhance the insurability of risks and lead in the prevention of environmental damage. For example, the oil industry is most adept at advising and developing risk management with respect to offshore oil drilling, safety and loss prevention. These measures already help to protect human beings and the environment from catastrophic oil spills.

The insurance industry's experience has revealed that a **better focus on such risk management** is the best means of reducing environmental damage risks. This can be effectively promoted by public authorities in two ways:

- enforcement of risk management and prevention measures that is aimed at lowering the risk and, hence, the guarantee requisites; and
- widespread availability of information to better aid with risk assessment (eg technology and best practices).

In addition to the above, the CEA suggests that oil operators should act in accordance with well-established safety practices for offshore oil drilling and maintain a **strong, functional risk and claims management system**. Such measures can aid in significantly minimising the very risk that leads to offshore oil spills. Moreover, increased industry supervision of offshore oil drilling activities could be improved to encourage that more risk preventive measures are taken within the oil sector. This can help ensure that the controlling systems of oil operations work accurately and safely.

Finally, **cooperation amongst the operating oil companies** can promote safer offshore oil operations in the future. Such cooperation could include:

- wider information exchange and communication network between key stakeholders;
- joint effort by industry associations, financial security associations and competent authorities in promoting safety awareness and management amongst oil company operators;
- greater guidance through international law and institutions.

(10) In your view what would be the best way(s) to make sure that the costs for remedying and compensating for the environmental damages of an oil spill are paid even if those costs exceed the financial capacity of the responsible party?

ANSWER:

In designing a system for efficient financial solvency, a set of alternative or complementary financial instruments should be allowed to provide the maximum flexibility and choice

Insurers can play an important role in fulfilling the objective of ensuring that operations are solvent for potential liabilities, as they can offer financial security through insurance products that continue to be designed for the environmental liability field and, particularly, to address losses falling under the ELD. Contrary to mandatory schemes, **free and voluntary markets in the EU** can further the enhancement of suitable cover for environmental liability risks, as it encourages innovation in the market and permits the freedom to contract cover that is specific to a company's risk exposure. An EU-wide voluntary system is also more likely to lead to a mature and stable environmental liability insurance market in the long term, as opposed to the "quick fix" that may be sought through a mandatory insurance scheme.

The insurance industry alone, however, cannot provide the sole solution in protecting the EU against offshore oil spills, primarily because of the immense financial capacity that would be required if a mandatory insurance scheme were introduced. To provide these amounts would require each individual to be in a position to collect premiums that multiply the potential consequences of the most significant accidents so that its capital reserves could be sufficiently built in accordance with the European solvency law. In the context of offshore oil spills, this is incredibly difficult to achieve even in a worldwide context, much less if the geographical scope is Europe.

This is not to suggest that the European insurance industry cannot cover any catastrophic losses. Insurance products for the cover of natural catastrophes (eg floods, storms, earthquakes) are available in several markets, including globally. However, these risks pose a very different type of damage. The damage caused by natural catastrophes can be more quickly assessed with the help of advanced risk modeling tools (eg flood mapping, instruments to detect high-risk earthquake zones) and the detailed experience and capacity of a wide market of catastrophic insurers. The impact of natural catastrophes also can lead to a quick settlement of claims and speedy recovery of the cost through premiums based upon modeled risk patterns. This is contrary to the industry's experience with offshore oil spills, which present long-tail damage of which the full economic cost may not be realised for several years. The environmental consequences of offshore oil spills are further not predicted through such advanced risk modeling tools as those available for natural catastrophes. Hence, the long-tail characteristic of this risk is a serious concern for insurers not in a financial position to cover the potential environmental damage for such an extensive amount of time.

While the EC has been evaluating the Environmental Liability Directive (ELD) as a potential solution for the cover of offshore oils spills, it must be noted that the ELD gives Member States the option to implement a "joint and several liability" measure. This measure, which has been transposed widely across the EU, can impose liability on **all parties involved** and require them to **all contribute financially** to the remediation. If an insurer or reinsurer has issued cover to some or all of them, the actual loss could be substantially higher than the (re)insurer might have anticipated. Such a loss could thus only be managed through lower policy limits or the insurer's withdrawal from the market overall, both of which are likely to hinder further development of environmental liability insurance products.

Considering the enormity of financial losses that an offshore oil spill can present, companies in the offshore oil sector should be free to compound the required solvency guarantee alongside the range of options available for covering potential liabilities. This could be done through a combination of various methods:

- insurance / warranties and guarantees;
- self-insurance and private funds;
- public funds (properly designed to respect the principles of proportionality between the risk created by related sectors and their own contribution).

Offshore oil sector in the best position to determine their financial guarantee needs

The Deepwater Horizon oil spill clearly demonstrates why a voluntary financial guarantee scheme for the environmental pollution caused by offshore oil activities remains to be the best option. Firstly, the damages incurred in this incident exceed the level of coverage available from the insurance market. Based on media reports, the Deepwater Horizon damages amount to approximately $40B in total, including both civil and environmental liability. While insurance market capacity fluctuates according to the needs of the market, it is unlikely that the absolute maximum cover available for the offshore oil sector can go beyond $1.5B (which, additionally, may not be available for all offshore risks). Secondly, mandatory financial security schemes are generally restrictive in nature and make it difficult for insurers to match the cover demanded under the mandatory scheme as well as adapt their cover to complex risk profiles (eg of an oil company).

Being the most specialised experts within their own sector, offshore oil companies are also in the best position to assess their own appetite for insurance cover within their financial guarantee scheme and to determine to what extent they will require it. Moreover, many offshore oil companies **have as much, if not *more*, financial capacity than insurers** due to the amount of capital they regularly generate through their businesses. Thus, their own ability to cover these risks independently of any financial security instruments should be one of the options considered.

The CEA is the European insurance and reinsurance federation. Through its 33 member bodies — the national insurance associations — the CEA represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. The CEA 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 050bn, employ one million people and invest more than €6 800bn in the economy.
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