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MARSH REPORT | October 2015

Insurance considerations for the UK waste management sector

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STATE OF THE MARKET

The relationship between the needs of the waste management industry and the risk appetite of the insurance industry is in an uneasy state. A complex history of high-volume/high-value claims has resulted in the withdrawal of several insurers from the market, with significant ramifications on the availability, cost, efficacy, and security of cover. The industry faces an uphill reputational struggle and, as a result, securing comprehensive and affordable insurance in today's market can be extremely challenging for large and small companies alike.

In a sector as diverse as waste management, one underwriting model does not – and should not – fit all. Risk can, of course, be positively or adversely influenced by a number of variables. Technology, for example, continues to advance as industry strives to reduce diversion to landfill, recycle/reuse more materials, and capture energy in the process.

Claims and losses for waste projects under construction remain average. As such, insurer appetite, capacity, and rates are reflective of a softening insurance market overall. As in many industries, however, the placing of project and construction risks associated with prototypic technology or novel application is more complex.

In contrast, insurers are increasingly cautious when it comes to underwriting operational waste processing or recycling sites. There has been a growing focus on the industry's fire record, despite a slight decline in incident rates since 2012 (Figure 1). However, the scale and severity of fires at operational sites is rising and reoccurrence rates – multiple fires over a period of time at the same site – is concerning and indicative to some of an industry unwilling – or unable – to incorporate better preventative measures into day-to-day operations.

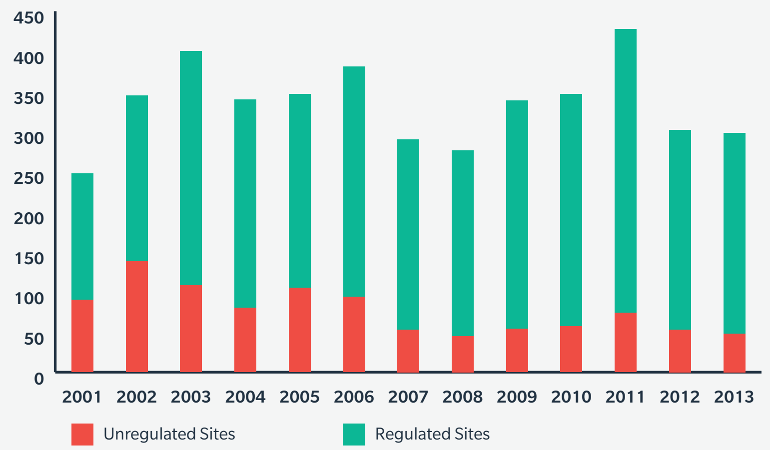
While the Fire and Rescue Authority continues to work closely with industry, agencies, and regulators to effect positive change, it is increasingly of the view that unless a fire poses threat to life then intervention will not be taken. Active firefighting is not always a viable option – deep-set fire within a waste stack, for example, can take thousands of gallons to extinguish, with run-off firewater most likely contaminated. Non-intervention does significantly increase the potential loss to both operator and to insurer however.

A lack of control over waste stream content is a major aggravator of fire risk and prevention. While black bin contents can be problematic, sullied commercial waste collections are a primary fire risk. Operators are only partially able to control this via their contractual terms and conditions, and when there is evidence of a breach – apparent in some instances only after a fire has already broken out.

As one of the leading brokers to the UK waste management industry, Marsh is working with the sector to directly address some of today's insurance challenges.

Marsh's Waste Centre of Excellence bridges the gap between insurer and client, going back to basics and helping clients to differentiate and market their risk profile in the most effective way.

FIGURE 1 **Number of UK Waste Fires, 2001 to 2013**
Source: As reported to the Environmental Agency and published by the Chief Fire Officers Association. http://www.cfoa.org.uk/17512



Regulated sites: permitting regime specific to the source has been identified.
Unregulated sites: no permitting regime specific to the source has been identified.

This can be further exacerbated by a number of factors: the type of reception or storage facility, segregation (and safe storage from environmental factors), and hot load identification and protection processes.

Stack heights also continue to be of concern to insurers since large stack sizes carry additional ignition risks and can limit the effectiveness of identification and suppression systems. Height and separation distances between stacks are still the mainstay of waste fire management techniques with much work being done on standards to minimise potential threats and losses. The industry is working closely with regulators and trade bodies such as the Environment Agency[1] and the Waste Industry Safety and Health (WISH) Forum on such standards but there are some fundamental constraints that these cannot address, namely planning and space limitations.

Insurers therefore require waste management companies to evidence robust stack management, particularly in relation to seasonality or unexpected business interruptions where operators may be under contractual liability to keep receiving waste. They also await the industry's findings on its ongoing analysis of burning characteristics of multiple waste, seen by insurers as a positive and proactive development.

This, coupled with the increasing sophistication of technology, has led insurers to demand more efficient suppression systems be put in place. Insurers also require extensive data and analysis of a waste management site – its technology, waste streams, pile management, processes, as well as its fire prevention framework – as part of the underwriting process and are closing the data loop with greater scrutiny of claims and losses, root cause analysis and lessons learnt. This has led to a contraction in insurance capacity as some insurers withdraw from the sector, also driving up the cost of insurance and increasing rates and policy deductibles.

[1] Revised fire prevention requirements issued by the Environment Agency for the storing of combustible waste at permitted sites will come into force in the autumn. This will cover fire prevention plans, minimum stack size, separation standards, and storage periods.

IS YOUR POLICY DELIVERING WHAT YOU THINK IT DOES?

Organisations are all price sensitive, to some degree, when it comes to purchasing insurance. A good price can only be qualified if the policy actually covers what you think it will deliver in the event of an incident. Its value, therefore, should always be considered against the following three key principles:

WORDINGS – POLICY COVER, DEFINITIONS, AND EXCLUSIONS

Insurance cover for the waste sector is seen to carry increasingly restrictive terms, conditions, and warranties. It is important to understand the inter-relationship between perils, exclusions, and additional coverages, since a claim settlement is most usually based on proximate cause, as well as definitions of key terms such as "stock" as coverage can vary substantially. Actual protection may be less comprehensive and of more limited value than first appreciated.

Particular consideration needs to be given to areas, including:

- Stock definitions – cover for pre-processed waste materials, even under an all-risks programme, is very limited; conventional wordings may not trigger in the event of loss or damage.
- Exclusions relating to contamination and clean-up costs – for example, post-incident fire water and debris removal costs, which can be onerous.
- Equipment damage – for example, clauses relating to operator error, latent defects, and hot-works warranties.

Cover may be less comprehensive and of more limited value than first appreciated.

A good broker will provide clear guidance on calculating gross profit values. Good communication and teamwork between broker and client will help ensure full recovery in the event of a claim and reduce the likelihood of post-loss disputes.

BUSINESS INTERRUPTION – GETTING THE VALUES RIGHT

Returning to full operation following an interruption is of paramount importance. Waste stock may continue to arrive at the gate, often 24 hours a day, and there are significant contractual obligations to be managed in the interim.

Accurate values for waste, plant, and machinery are critical for robust property damage/ business interruption (PD/BI) cover otherwise under-insurance penalties, such as an averaging provision, may be applied or cover avoided entirely. It requires careful consideration of the true costs involved following a significant loss — the cost of diverting waste, debris removal, and professional fees, for example – and in accordance with policy definitions.

Calculating gross profit (or gross earning) values for BI cover is extremely complex and differs from gross profit as reported in corporate accounts. The Eurokey case study below illustrates how a miscalculation can have serious financial implications. Ultimately, the decision on sums insured and indemnity periods lies with the client. However, a detailed BI review is essential for any company seeking to accurately present its risks, enabling accurate policy limits and cover to be set and establishing policy extensions that reflect true risk exposure.

SPOTLIGHT

Recycling the numbers

May 2010

GBP550,000

GBP2.7 million

Insurers processing a claim following a fire at Eurokey Recycling in May 2010 focused on significant discrepancies between the sums declared for the values of stock, plant, machinery, and BI against the actual figures at the time of the loss.

With insurers seeking to avoid the policy and apply an averaging (co-insurance) provision due to underinsurance, Eurokey accepted a total recovery of GBP550,000.

In a later dispute with its broker, Eurokey said an insurance recovery of GBP2.7 million may have been possible if the values declared at inception had been more accurate.

The claim was subsequently rejected by Mr Justice Blair who found that the broker had provided an adequate explanation on business interruption cover to Eurokey and also had no reason to believe that figures provided by their client for business interruption and turnover insurance calculations were inadequate.

RATED VERSUS UNRATED INSURERS – CAN YOUR INSURER PAY OUT?

Insurance financial strength ratings, provided by independent agencies such as AM Best, Moody's, and Standard & Poor's, are a measure of an insurer's financial security and ability to meet its financial commitments – including paying out in the event of a claim. Where risks are traditionally difficult to place, where capacity is contracting or rates are increasing, or where keener pricing and less onerous terms, deductibles, and limits are required, unrated insurers – or passported insurers from other EU jurisdictions – do, undoubtedly, have a vital role to play.

However, companies should be aware that placing cover with an unrated insurer is not without risk. Capacity can be withdrawn at very short notice, often due to licenses being retracted or the insurer going into liquidation or administration. Organisations can very quickly be left without cover or facing significant difficulties in getting a claim-in-progress paid. This could also put companies in breach of financing covenants. Brokers cannot guarantee the financial security of any insurer; instead, a good broker should undertake robust due diligence on potential markets and advise clients accordingly.

Marsh has established minimum financial guidelines for the insurers we use based on insurers' managerial capabilities, financial flexibility, and other key metrics.

Risk engineers work closely with waste management companies to help bridge the knowledge and expectation gap with insurers, challenging current attitudes and including any perceived difficulties in underwriting novel processes or applications.

RISK ENGINEERING – ACCESS ALL AREAS

Risk engineering can play a critical role in helping achieve satisfactory insurance cover for the waste sector and the evolving challenges that it presents, balancing the benefits of data evaluation with insurers' ever-increasing wish to be involved in testing and commissioning processes and the need to get things done within practical time frames.

Providing clients with independent technical guidance, advice, and risk evaluations, typical risk engineering services can include:

- Loss prevention assessments.
- New project reviews.
- Understanding retrofit challenges.
- Optimising capital expenditure programmes.
- Interfacing with insurers and other technical advisers.
- Implementation planning.
- Bespoke technology solutions.
- Emergency plan simulations.
- Compliance with new regulations.
- Fire prevention and protection analysis and guidance.

Qualifying risks in this way can help identify areas for targeted risk reduction measures. It can also help ensure that financial lenders' requirements are satisfied and improve the accuracy of asset valuations. This, in turn, enables a fair and accurate profile of a waste management company's risk exposures to be presented to insurers, enhancing negotiations on available coverage, pricing, and premiums.

DEMYSTIFYING ENVIRONMENTAL COVER

Environmental risks are inherent within the waste management sector and, to a large extent, their prevention and remediation are determined under a number of statutory provisions.

However, root cause, scale, and impact are often underestimated, and it is important to look beyond a site's physical boundaries and understand historical, existing, new, and indirect exposures — contamination arising from firewater run-off, for example, may not be an immediate consideration.

Organisations may only discover that their policies are not comprehensive enough after the fact. Moreover, management are often unaware that they could be held personally liable and at risk of criminal prosecution in some instances. And, of course, the reputational implications of an environmental incident are something that the industry is all too aware of.

Today, there are a number of different insurance products available, including coverage extensions for general liability lines, through to broad environmental impairment programmes and contractors' pollution liability policies. Pollution cover may be available under a standard public liability policy, but will be limited to incidents deemed "sudden and accidental". Potential coverage gaps can be extensive; own-site clean-up costs will not be covered, for example, even with a regulatory clean-up and contamination cost extension.

It is important to look beyond a site's physical boundaries and understand historical, existing, new and indirect environmental exposures.

FINANCE MODELS AT A CROSSROADS

Political uncertainty has dented the waste management industry's attractiveness to investors of late, significantly delaying project deliveries in some instances. At the heart of the matter lies the issue of public funding – and whether it is still required.

Waste processing capacity was traditionally developed under public or private finance initiatives, with credits paid out over the lifetime of the contract. Today, financing is weighed up against the wider backdrop of forecasted waste arisings, landfill costs, diversion targets, recycling capabilities, and, of course, the long-term commercial viability of a project. This is where opinion divides: with the UK on track to meet 2020 landfill targets, and with a need to reduce expenditure, the Department for Environment, Food and Rural Affairs (DEFRA) is withdrawing private finance initiative (PFI) support for a number of projects.

In parallel, the development of merchant waste facilities, typically for commercial/industrial waste processing and energy recovery infrastructure, continues and will undoubtedly play a growing role in the UK's 21st century waste management programme. More complex contractual liabilities may therefore arise as mutually beneficial relationships develop between local authorities looking for immediate processing capacity and merchant plant operators looking to secure long-term supply contracts.

Meanwhile, there is a steady flow of corporate activity in the sector as players of all sizes seek to build, consolidate, or strengthen against difficult market conditions. This, coupled with the revolving door of debt refinancing expected of such a capital-intensive industry – deal structures that increasingly involve bond, non-bank or alternative loans to refinance or raise new capital – creates an increasingly complex financial landscape.

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About Marsh

Marsh is a global leader in insurance broking and risk management. Marsh helps clients succeed by defining, designing, and delivering innovative industry specific solutions that help them effectively manage risk. Marsh's approximately 27,000 colleagues work together to serve clients in more than 130 countries.

As a leading insurance broker to the UK waste management industry, Marsh is working with the sector to address some of today's risk and insurance challenges. We leverage our industry knowledge and product line expertise to develop new, innovative services and solutions and to support clients through industry focussed market updates, analysis, and thought leadership.

About this report

With a long, complex history of claims, securing comprehensive and affordable insurance can be extremely difficult for UK waste management companies. Marsh examines how a contraction in underwriting capacity can have significant ramifications on availability, cost, efficacy, and security of insurance cover.

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