

Environmental Risk Management in the Israeli Business Sector - Recent Trends and Developments

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Traditional environmental enforcement mechanisms are being supplemented by 'indirect' enforcement initiatives, emanating primarily from non-environmental regulatory agencies. These initiatives include a proposal by the Israel Securities Authority to significantly expand environmental disclosure obligations imposed on publicly traded companies and upcoming guidelines by the Israeli Supervisor of Banks on the management of environmental risks involved in financing activities. While such agencies' actions are seemingly secondary to mainstream enforcement activities by the Israeli Ministry of Environmental Protection, in practice they often have a greater effect on regulated entities.

One of the central issues being addressed today in the environmental arena is the management of environmental risks by the business sector. This particular sector's recognition of the risks involved in activities which have an effect on the environment has grown significantly in recent years, primarily due to the introduction of extensive and substantive legislation and enforcement actions, as well as growing public awareness and publicity. Commercial entities around the world and in Israel are taking steps to minimize the environmental risks they are exposed to, whilst at the same time increasing the scope of financial opportunities which can be derived from environmentally-sound management policies.

In Israel, two primary and parallel trends can be identified, both of which are focused on environmental enforcement: the first is the increased use of enforcement tools directed towards creating a direct incentive for commercial and industrial firms to avoid activities which can be detrimental to human health and the environment. These include enforcement actions by environmental agencies, expansion of the scope of criminal liability for environmental offences and increase in toxic tort law suits. The second trend involves the introduction of mechanisms which create financial incentives - whether positive or negative - to incorporate environmental considerations in business decisions.

Extensive activity can be currently seen on both described levels in Israel today. In this regard, several major environmental laws were passed in recent years in Israel. These laws deal with such areas as the protection of the coast and marine environment, electromagnetic radiation, and most recently - clean air. Another pending legislative item addresses liability for ground contamination. The scope of monetary fines levied upon environmental offenders is growing rapidly (both for firms and for their directors and officers), as is the number of environmentally-related civil suits.

Alongside this traditional environmental enforcement route, a new trend can be identified: the so called 'indirect' enforcement initiatives arising from non-environmental regulatory agencies. These initiatives are being used to motivate regulated entities to minimize the adverse environmental impacts of their activities. Among the central initiatives characterizing this trend are the following:

- **Israel Securities Authority - Environmental Disclosure Regulations:** the Israel Securities Authority has recently drafted a proposed revision to the regulations on public offerings, in connection with duty to disclose environmental risks arising from publicly traded companies' activities and the management of such risks. The proposed revision requires extensive reporting on such topics as applicable environmental laws and regulations, as well as expected environmentally-related expenditures and investments. Should the proposed regulations be promulgated, they will require publicly traded companies to comprehensively examine the environmental consequences of their activities and the manner by which such consequences are disclosed. As of today, the proposed regulatory revision has passed a vote by the Securities Authority assembly and has been published for public comment.
- **Supervisor of Banks - Guidelines on Environmental Risks:** guidelines on environmental risk management are slated to be issued by the Israel Supervisor of Banks within the coming weeks. The guidelines will focus primarily on setting policies and frameworks within banking institutions with regard to the management of exposure to environmentally-related risks. Such guidelines will require extensive adjustment not only by banking institutions which are active in Israel, but also by commercial and industrial firms being funded by these banks.
- **Ministry of Finance Capital Markets Division - Rule on Management of Environmental Risks in Financial Institutions:** a rule on the management of credit risk in investment activities was published in August 2007 by the Ministry of Finance Capital Markets Division. The rule applies to such financial institutions as pension funds and sets out requirements as to the establishment of management and supervisory mechanisms, which include a specific framework designed to identify exposures arising from the borrower's non-compliance with applicable environmental laws.
- Environmental considerations are further implemented within monetary grant programs under the Israeli Encouragement of Capital Investment Law and Encouragement of Industrial Research and Development Law. Environmental indicators are also being considered in setting benchmarks for government tenders.

In practice, these initiatives stem from the role of non-environmental regulatory agencies. However, there is no doubt that these agencies' actions, which are generally directed at risk management within their own respective arenas, play a key role in environmental enforcement. Such agencies' actions directly and significantly affect the behavior of regulated entities and often with greater impact than the traditional and direct environmental enforcement mechanisms we are familiar with.

The Israeli business sector's response to these developments is twofold: first, legal and strategic measures are being taken to minimize exposure to environmental risks. These measures include adoption of environmental management systems; establishment of policies on environmental due diligence in commercial and corporate transactions; adoption of environmental criteria for project financings; and identification of potentially significant exposure points, such as weather risk - which has gradually revealed itself as a major financial risk for the business sector today.

The second level of response by the business sector to these developments is the increased use of environmental finance instruments. Such instruments are designed to increase the financial stability of project financings and allow for leveraging of industrial activities having a potential effect on the environment. They include tools for financing and managing environmental risks within infrastructure projects; carbon-related projects under the Kyoto Protocol; renewable energy incentives and trading mechanisms; and contaminated land (brownfield) remediation programs.

The overall conclusion which can be drawn as to the role of environmental risk management within Israel's business sector today, is that increasing exposure to liability and pressures of regulatory action, along with a growing motivation to capitalize on markets developing in the field, are driving Israeli firms to take action to identify and manage their environmental risks more comprehensively than ever before. Such developments are rapidly streamlining Israel's business sector with global sustainability and corporate social responsibility trends.

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