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Risk Management or Insurance, Is There a Choice?

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Article abstract

Nous avons le plaisir de publier ici une allocution de notre collaborateur, M. Angus Ross, mettant en lumière la nécessité de maîtriser les risques reliés aux atteintes à l'environnement. Dans ce domaine, la gestion des risques se pose avec d'autant plus d'acuité que leur assurabilité est limitée dans certains cas, et même devenue impossible dans plusieurs types d'assurance. La maîtrise des risques implique de nouvelles façons d'opérer de la part des entreprises et impose l'instauration de normes préventives efficaces, tant au niveau des secteurs gouvernementaux que privés, et ce, à tous les échelons hiérarchiques. Plus encore, la gestion et le contrôle des risques environnementaux deviennent des prérequis indispensables à tout programme d'assurance.

Controlling Environmental Impact

Risk Management or Insurance

Is There a Choice?

by

Angus H. Ross[1]

Nous avons le plaisir de publier ici une allocution de notre collaborateur, M. Angus Ross, mettant en lumière la nécessité de maîtriser les risques reliés aux atteintes à l'environnement. Dans ce domaine, la gestion des risques se pose avec d'autant plus d'acuité que leur assurabilité est limitée dans certains cas, et même devenue impossible dans plusieurs types d'assurance. La maîtrise des risques implique de nouvelles façons d'opérer de la part des entreprises et impose l'instauration de normes préventives efficaces, tant au niveau des secteurs gouvernementaux que privés, et ce, à tous les échelons hiérarchiques.

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The fight against environmental degradation of our planet is one which must concern everyone for the survival of all living things on Earth, and the opportunity to broaden perspectives by talking, listening and discussing can only help lead to concerted action which will be of universal benefit.

I would like to begin by reminding the reader of some basic facts about the role of insurance in our society. Firstly, insurance is not gambling. Gambling is based on the *certainty* of an event taking place in which neither party need have a financial interest. Insurance, on the other hand, covers the *possibility* of an event taking place which would financially impact one of the parties — the

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insured. It is extremely important to remember that insurance is intended to cover the sudden and unexpected loss, not the gradual or foreseeable. I will return to this point later.

There is also the feeling in our society that (especially in Automobile insurance) insurers are a bottomless pit of money. In reality, as you know, the cost of insurance losses and all the associated expenses and legal fees are passed back to the public in terms of higher premiums for car insurance, or higher prices where manufacturers or retailers must pass on their own increased premiums in order to remain profitable. As an example of this, some vaccine manufacturers must charge well in excess of ten dollars per vaccination unit merely for insurance.

Unfortunately, nowadays there appears to have been a change in the perceived role of insurers. Going back to the bottomless pit theory, insurers are expected to pay for almost whatever loss occurs, regardless of whether there was negligence, blame or even the inevitability of that loss occurring. In the field of pollution, insurers can be a convenient way for governments to bypass responsibility; if an industry has a potential for widespread pollution then governments can slough off their policing role by legislating that these companies must carry pollution liability coverage but not necessarily regulating the conditions for controlling pollution. The emphasis is on post-disaster clean-up, not pre-disaster prevention.

Society is in a permanent state of evolution, not necessarily improvement, but at least change. As such, we discover that processes, products and even previously acceptable levels of pollution are now considered carcinogenic, harmful and unacceptable. We as an industry are waiting in trepidation for a veritable flood of claims to come from latent health hazards which, when the risks were underwritten, were deemed acceptable by regulators and legislators. New technologies become available which reduce pollution, as in the case of oxygenation bleaching for pulp and paper rather than the chlorine process which produces dioxins and furans. The new mills will be an acceptable pollution risk, but the old ones are now changed into lawsuits waiting to happen. There is now a closed-circuit process in pulp and paper which apparently totally eliminates pollution.

Pollution is a by-product of economic activity. Nineteen thousand lakes are acidified to a greater or lesser extent in Ontario alone. The Great Lakes, from which more than twenty million people draw their drinking water, have been described as "the world's largest sewer" and contain in excess of 360 toxic substances. Pollutants are created, buried, discharged into the oceans, burned and, from the moment of their creation to their final elimination, society asks — or makes — insurers carry the burden of financial responsibility against their escaping with deleterious effect.

It is only recently that pollution claims have really made an impact. Until just a few years ago there were very few pollution exclusion clauses in insurance policies — even for chemical producers. But the exposure has been there all along. About five years ago I was speaking with a Lloyd's underwriter who told me of a pollution claim he had just paid — on a policy issued in the late 1800's! The surprising thing was that they found the policy.

But as insurers begin to see more pollution exposures and claims come out of the past, they must reevaluate their role as providers of coverage against negligent acts. As I said earlier, insurance covers the sudden and accidental — but what does this mean? In one case of a rusted-out storage tank south of the border, the first drop that leaked out was deemed sudden by the courts, and the remainder accidental. The insurance company was forced to pay up. Should insurers pay for the inevitable?

I believe that as an industry we have been too slow to react to the dangers that face us on the environmental front, both in terms of assumed risk and in terms of our responsibility to society. From the early days of underwriting training, insurance personnel are taught to ask "can I write this risk?" — i.e. does it fall within my underwriting guidelines — rather than looking at the broader social aspect of "should I write this risk?".

Unfortunately, in a highly competitive business world, we tend to need protection from ourselves and also to turn a blind eye to our social responsibilities. Should a continuing polluter be able to obtain insurance protection? In my view the answer must be "not without correcting the condition that leads to the pollution occurring." Yet I am sure you could find a few underwriters who feel

that, for a high premium, they could take the risk of losses being less than the premium charged.

If we look at the disastrous affair of the Exxon Valdez there is surely culpability on the parts of governments, insurers and — most certainly — Exxon. Why was a convicted impaired driver permitted to be at the helm (or not as it turned out in this instance) of a laden oil-tanker? If you are impaired at the wheel of a boat in Ontario, you lose your driver's license. Should not the converse be true for merchant skippers worldwide? Why do insurers grant coverage to single-bottom tankers plying ecologically super-sensitive areas where there are also a great many marine hazards. It is easy to say this in hindsight, but where was the risk management in advance? Again I come back to insurance covering the sudden and unexpected. With the Exxon Valdez the confluence of circumstances was such as to render an accident not fortuitous but inevitable and, as such, uninsurable.

And this leads me to the second part of the equation — risk management. Risk management can simply be described as a cost-effective way of avoiding loss or damage. On an individual basis, a defensive driving course could be considered risk management against the possibility of an auto accident. The cost of the course is less than the cost of an accident or the increased premium after an accident.

I stated earlier that in matters of pollution government emphasis appeared to be on post- not pre-disaster activities. If insurers are to continue in a position where they are expected to assume the risk of disaster, then they can only do it where risk management has been practiced and maintained to current levels of technological knowledge and capability. The pulp and paper mills are an example. In Howe Sound, British Columbia there are nineteen mills. Three have a process with reduced pollution emissions. The others are permitted to continue *without a change of process*. Oh, just as an aside, the fisheries in Howe Sound have been closed down indefinitely. But why should we continue to insure known polluting processes when the technology is readily (although expensively) available to eliminate pollution? Should insurance coverage be readily available for the planned mills on the Athabasca River in Alberta if they do not use available non-polluting technology? As I said, we need protection from ourselves.

In North America, sixty million tons of nitrogen oxide and sulphur oxide put in air each year. Many of the 19,000 acidified Ontario lakes are as a result of emissions from Sudbury — Inco and Falconbridge. Probably the greatest barrier to improved scrubbing processes was the erection of the stacks. There was then no local incentive or pressure to clean up, after all the emissions were then going to be spread by the winds with no ill effects. If you really want to see rapid advances in anti-pollution technology, then blow up the stacks! Acid rain damage is estimated at $2 billion per annum in USA and $350 million in Canada.

But Canada is by no means alone in turning a blind eye to the prevention or risk management side of pollution. In fact we are far more stringent and caring in many areas than our European cousins. One in three Poles lives in an area designated as an "ecological hazard" because of dirty air and water. The Mediterranean, Adriatic and Aegean seas are awash with detritus. In Holland and West Germany, municipalities have had to evacuate, decontaminate or demolish homes built on former waste sites. The clean-up cost of inactive dumps is estimated to absorb one quarter of the gross national products of European countries. The so-called "green revolution" of the sixties and seventies (and for those younger members of the audience it means intensive chemical assisted agriculture, not ecologically sound practices) has now given rise to a growing number of pollution claims in Britain. There have been numerous pollution incidents following fires in different countries. The Eastern bloc appears to have had no concern whatsoever for the environment.

A quarter of Poland's farmland is so polluted with lead, zinc, cadmium and mercury that it might be dangerous to grow vegetables in it. Ninety-five per cent of its rivers are undrinkable — and half so toxic that the water cannot even be used in industry for fear of destroying equipment. In Hungary, air pollution accounts for one in seventeen deaths. A quarter to a third of the forests in four of the six countries of Eastern Europe show signs of dying from air pollution. But how many of these incidents could have been prevented by earlier risk management? And how can countries rebuild shattered economies when they cannot breathe their air, till their soil or drink their water.

Unfortunately, in the headlong rush for economic advancement, concern for the environment came trailing in well behind of the pack, and it is only recently that it has moved up to take its rightful position in the lead.

But where should risk management start? In our society the responsibility should begin with those responsible for the overall results and direction of companies; the board of directors and senior officers. If directors and officers were found culpable and had to face financial penalties, jail terms and becoming social outcasts, then you could be sure that necessary measures to combat environmental impairment would be put into place. Insurance coverage should not be provided under directors and officers policies for preventable pollution incidents.

Encouragement should be given by the government for installation of pollution controls. Financial inducements could take the form of subsidies, or financial penalties. At a time when there is a clamouring that Canada is losing investment, not putting enough into research and development, there is a vast industry with worldwide application waiting to be tackled.

Risk management must be a *sine qua non* for eligibility for insurance coverage. No longer should insurers accept a risk with pollution hazards and hope that necessary steps have been taken to prevent an incident. And this applies on risks that people do not even think of as being hazardous. Take, for instance, underwriting a farm. Is the animal waste kept in a pool where it leaches down into a watercourse? Do pesticide and herbicide sprayings threaten neighbouring properties or risk running off into watercourses? Do fruit trees continue to be sprayed with alar?

In industrial risks has consideration been given to the effects of a fire, windstorm or earthquake on the release of pollutants? What disaster recovery mechanisms are in place? Hostile fire coverage, provided by endorsement, was supposed to be underwritten and charged for. It is now being thrown in with little concern for underwriting or loss considerations. What treatment is given to reduce toxicity of hazardous wastes prior to disposal? At present, about 2.4 million tons of hazardous waste in Ontario ends up each year in the environment untreated.

If insurers are to be able to give pollution coverage, then it must be for the genuine sudden and unexpected loss; risk management should have previously taken care of the possibility of the foreseeable and preventable ones.

There is a massive cost which must somehow be met in order to clean up the environment. Back to the deep-pockets theory for those who believe that insurers should meet all pollution claims, the cost of cleaning up *known* waste storage sites in the USA is conservatively estimated at $200 billion; the *total* capital/surplus of the insurance industry in the USA at December 31, 1989 was about $118 billion.

If insurance is considered to be the proper mechanism for cleaning the environment, that account must be taken of the enormous expenses which will be delivered elsewhere. An example of this is in asbestosis where it is estimated that only thirty five cents of every claims dollar actually reaches the injured worker; the bulk of the remainder goes in legal expenses. In Ontario automobile, in the current system some $500-600 million currently goes into the legal system. For claims with the complexity of pollution losses it is inevitable that much of the money which could otherwise be put to use in curbing pollution or cleaning up will wind up in non-productive pockets.

Risk management and/or insurance — is there a choice? The answer, in a perfect world, would be "risk management and insurance" for without risk management to eliminate the inevitable loss there would be no insurers to meet the unexpected. In the real world, with too many companies and too many insurers who really just don't care — unless the government tells them to — we remain with the irresponsible "or."

It has been said that a good planet is hard to find. Well I happen to believe that the one we are living on is a good planet. But we are 75% along the way to destroying it. We all have a responsibility — social, corporate and individual — to ensure that we move back from the 75% level and leave a fit planet to our children, for the alternative is too horrible to consider.