

**ENVIRONMENTAL IMPAIRMENT  
LIABILITY FINANCIAL REPORTING  
ISSUES (ENVIRONMENTAL ISSUES  
SEMINAR, 10/90)**

*Walter Wright*



## **ENVIRONMENTAL IMPAIRMENT LIABILITY FINANCIAL REPORTING ISSUES**

GOOD MORNING.

I AM GOING TO DISCUSS ENVIRONMENTAL IMPAIRMENT LIABILITY (EIL) FINANCIAL REPORTING ISSUES, BUT FROM AN ACTUARIAL RATHER THAN AN ACCOUNTING PERSPECTIVE.

THERE ARE FOUR AREAS THAT I INTEND TO COVER (EXHIBIT I). FIRST, I'LL REVIEW SOME INSURANCE COMPANY DISCLOSURES, FROM 1989 FINANCIAL STATEMENTS THAT I'VE DISTRIBUTED TO YOU. THESE PROVIDE A CLUE REGARDING WHAT INSURANCE COMPANIES ARE CURRENTLY DOING TO REPORT THEIR ENVIRONMENTAL IMPAIRMENT LIABILITIES.

SECOND, I'D LIKE TO TALK TO YOU ABOUT THE ACTIVITIES OF THE AMERICAN ACADEMY OF ACTUARIES' COMMITTEE ON PROPERTY/LIABILITY INSURANCE FINANCIAL REPORTING. ACTUALLY, I BELIEVE THE REASON I WAS PUT ON THE AGENDA FOR THIS SEMINAR WAS TO TALK ABOUT THE WORK THIS COMMITTEE IS DOING IN REGARD TO ENVIRONMENTAL IMPAIRMENT LIABILITIES. WE HAVE NOT ACTUALLY DONE MUCH IN THAT AREA YET, BUT THERE ARE SEVERAL OTHER AREAS OF ACTIVITIES THAT I THINK WILL BE OF INTEREST TO YOU.

THIRD, I WANT TO TALK ABOUT LOSS RESERVE OPINIONS, AND THE PROFESSIONAL GUIDANCE OFFERED BY THE ACADEMY AND THE CAS THAT OFFERS HELP TO US IN DEALING WITH ENVIRONMENTAL IMPAIRMENT LIABILITIES. AS YOU'LL SEE, THIS PROFESSIONAL GUIDANCE RAISES AS MANY QUESTIONS AS IT ANSWERS.

FOURTH, AND MOST IMPORTANTLY, I LOOK FORWARD TO GETTING YOUR IDEAS ON THE RESPONSIBILITY OF THE ACTUARY WHEN IT COMES TO REPORTING ENVIRONMENTAL IMPAIRMENT LIABILITIES. IN ORDER TO PROVOKE DISCUSSION AND SOLICIT OPINIONS, I DEVELOPED, WITH ASSISTANCE FROM AMY BOUSKA, THE TWO PART QUESTIONNAIRE THAT YOU COMPLETED PRIOR TO MY TALK. THE RESULTS OF THE QUESTIONNAIRE HAVE BEEN TABULATED, AND I'LL SHARE THEM WITH YOU AT THE END OF THIS SESSION.

#### **DISCLOSURES IN ANNUAL REPORTS (EXHIBIT II)**

THE PACKET OF DISCLOSURES THAT WERE DISTRIBUTED TO YOU CONTAIN DISCLOSURES FROM 1989 ANNUAL REPORTS FOR SIX COMPANIES: AETNA, CHUBB, CIGNA, CRUM & FORSTER, THE HOME AND THE TRAVELERS (APPENDIX). THESE ARE THE ONLY DISCLOSURES THAT WE FOUND, USING THE NEXUS DATA BASE, WHICH CONTAINS FINANCIAL INFORMATION FOR SEC REGISTRANTS.

AS YOU REVIEW THESE SIX DISCLOSURES, YOU'LL FIND SEVERAL COMMON THEMES. GENERALLY, THESE COMPANIES REPORT:

- o RESERVE ADJUSTMENTS FOR ENVIRONMENTAL IMPAIRMENT LIABILITIES IN OLD YEARS, MEANING IN THE 1970s AND PRIOR IN MANY CASES;
- o STATEMENTS THAT FURTHER RESERVE INCREASES ARE POSSIBLE (WHICH MAY IN FACT SUGGEST THAT THEY ARE PROBABLE);

- EXPRESSIONS THAT THERE IS SIGNIFICANT JUDICIAL UNCERTAINTY REGARDING THIS LIABILITY;
  
- AND THAT THE LIABILITIES CANNOT REASONABLY BE ESTIMATED (WHICH SETS THE STAGE FOR THE COMPANIES TO EXCLUDE ESTIMATES OF THE ENVIRONMENTAL IMPAIRMENT LIABILITIES FROM THEIR FINANCIAL REPORTS, IN ACCORDANCE WITH FINANCIAL ACCOUNTING STANDARD #5. YOU MIGHT CALL THIS THE ACCOUNTANTS' VERSION OF "TAKING THE FIFTH.")

**THE AMERICAN ACADEMY OF ACTUARIES (AAA) - COMMITTEE ON PROPERTY/LIABILITY INSURANCE FINANCIAL REPORTING (EXHIBIT III) HAD ITS LAST MEETING IN JUNE. THE COMMITTEE DECIDED TO PROCEED IN THE DEVELOPMENT OF A "WHITE PAPER" PERTAINING TO ENVIRONMENTAL IMPAIRMENT LIABILITIES. HOWEVER, AS OF THIS TIME, THE WHITE PAPER HAS NOT BEEN DEVELOPED AND SO THERE IS NOTHING FOR ME TO REPORT IN THIS REGARD. HOWEVER, THE COMMITTEE HAS HAD SIGNIFICANT ACTIVITY RELATED TO LOSS RESERVE OPINIONS.**

**IN THE FALL OF 1989 THE COMMITTEE LAUNCHED A STUDY OF INSURANCE COMPANY INSOLVENCIES. ALL INSOLVENCIES FOR THE PERIOD 1969 THROUGH 1987 WERE IDENTIFIED, AND REGULATORS IN ALL FIFTY STATES WERE ASKED TO COMPLETE A QUESTIONNAIRE PERTAINING TO THE INSOLVENCIES IN THEIR STATES. THE RESULTS OF THIS SURVEY, WHICH WILL BE RELEASED SHORTLY, WILL PROVIDE INFORMATION ON WHETHER OR NOT LOSS RESERVE OPINIONS HAD BEEN REQUIRED FOR THE INSOLVENT COMPANIES, WHETHER OR NOT THE OPINION WAS QUALIFIED IN ANY MANNER, WHETHER THE SIGNER OF THE OPINION WAS A MEMBER**

OF THE AMERICAN ACADEMY OF ACTUARIES, AN FCAS, AN ACAS, ETC. (EDITOR'S NOTE: SEE "STUDY OF INSURANCE COMPANY INSOLVENCIES FROM 1969 - 1987 TO MEASURE THE EFFECTIVENESS OF CASUALTY LOSS RESERVE OPINIONS"; CASUALTY ACTUARIAL SOCIETY FORUM; WINTER 1991 EDITION.)

AS ANOTHER WAY TO LEARN MORE ABOUT INSOLVENCIES, THE COMMITTEE IDENTIFIED, FROM A SAMPLE OF ALL PROPERTY/CASUALTY INSURERS WITH LOSS RESERVES IN EXCESS OF \$100 MILLION, THOSE 25 THAT HAD EXPERIENCED THE MOST ADVERSE DEVELOPMENT FROM 1985 THROUGH 1988. WE HAVE OBTAINED COPIES OF THE 1985 LOSS RESERVE OPINIONS THAT HAD BEEN PREPARED FOR ABOUT 19 OF THESE COMPANIES, AND INTEND TO INVITE THE SIGNERS OF THESE OPINIONS TO MEET WITH REPRESENTATIVES OF OUR COMMITTEE TO DISCUSS "WHAT WENT WRONG." OUR INTENT IS TO GATHER INFORMATION THAT MAY BE USEFUL TO ACADEMY MEMBERS, SO THAT WE CAN LEARN BY THE EXPERIENCES OF FELLOW ACTUARIES.

FINALLY, WE WILL BE WORKING TO DEVELOP COMMON LANGUAGE TO BE USED FOR "QUALIFIED" OPINIONS. WE BELIEVE IT IS IMPORTANT, BOTH FOR ACTUARIES AND FOR REGULATORS, THAT WE CODIFY THE LANGUAGE USED IN LOSS RESERVE OPINIONS TO THE EXTENT POSSIBLE AND APPROPRIATE, SO THAT OUR FINDINGS ARE COMMUNICATED AS EFFECTIVELY AND AS EFFICIENTLY AS POSSIBLE.

## **LOSS RESERVE OPINIONS - PROFESSIONAL GUIDANCE (EXHIBIT IV)**

IN LOOKING FOR PROFESSIONAL GUIDANCE REGARDING LOSS RESERVE OPINIONS WHERE THERE ARE ENVIRONMENTAL IMPAIRMENT LIABILITIES, I HAVE IDENTIFIED FIVE SOURCES:

- THE STANDARD OPINION WORDING, AS RECOMMENDED BY THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)
- THE ACADEMY'S QUALIFICATION STANDARDS
- THE STATEMENT OF PRINCIPLES REGARDING PROPERTY AND CASUALTY LOSS ADJUSTMENT EXPENSE RESERVES, PUBLISHED BY THE CASUALTY ACTUARIAL SOCIETY (CAS)
- CAS PROCEEDINGS
- THE LOSS RESERVE QUESTIONNAIRE, WHICH HAS BEEN DISTRIBUTED AT THE 1988, 1989, AND 1990 CASUALTY LOSS RESERVE SEMINARS.

LET'S REVIEW EACH OF THESE TO SEE WHAT GUIDANCE IT PROVIDES TO THE ACTUARY.

LET'S LOOK AT THE STANDARD OPINION WORDING (EXHIBIT V):

- WE'RE TO OPINE WHETHER THE RESERVES ARE "COMPUTED IN ACCORDANCE WITH ACCEPTED LOSS RESERVING STANDARDS AND ARE FAIRLY STATED IN ACCORDANCE WITH SOUND LOSS RESERVING PRINCIPLES." WHAT ARE THE ACCEPTED LOSS

RESERVING STANDARDS FOR EIL? THAT'S ONE OF THE THINGS THAT WE'VE BEEN TRYING TO RESOLVE AT THIS SEMINAR.

- o WE'RE TO DETERMINE WHETHER THE RESERVES ARE "BASED ON FACTORS RELEVANT TO POLICY PROVISIONS." WHAT ARE THE POLICY PROVISIONS AS REGARDS EIL? A COMMON THEME THROUGHOUT THIS SEMINAR IS THAT THERE IS MUCH DEBATE AS TO WHAT THE POLICY PROVISIONS MEAN. INSURANCE COMPANIES, IN DENYING COVERAGE FOR EIL CLAIMS, APPEAR TO OBTAIN FAVORABLE COURT RULINGS ABOUT HALF THE TIME; THOSE CLAIMING THAT THE POLICIES COVER EIL ARE ALSO SUCCESSFUL ABOUT HALF THE TIME. SO HOW DO WE, AS ACTUARIES, INTERPRET THE POLICY PROVISIONS AS THEY REGARD EIL?
  
- o WE ARE TO OPINE AS TO WHETHER THE RESERVES "MEET THE REQUIREMENTS OF THE INSURANCE LAWS OF THE STATE OF DOMICILE." I'VE ALWAYS BEEN UNCOMFORTABLE WITH THIS CLAUSE, SINCE IT APPEARS TO REQUIRE THAT THE ACTUARY PROVIDE A LEGAL OPINION. BE THAT AS IT MAY, DOES THE SITUATION BECOME MORE COMPLICATED WHEN WE CONSIDER EIL? IS IT POSSIBLE THAT THERE MAY BE STATE LAWS THAT ARE SPECIFIC IN REGARD TO HOW INSURERS MUST COVER EIL? DO WE, AS ACTUARIES, HAVE ANY WAY OF MONITORING INSURANCE LAWS?
  
- o MOST IMPORTANT, WE'RE TO STATE WHETHER OR NOT THE RESERVES "MAKE A GOOD AND SUFFICIENT PROVISION FOR ALL UNPAID LOSS AND LOSS EXPENSE OBLIGATIONS OF THE COMPANY UNDER THE TERMS OF ITS POLICIES AND AGREEMENTS." THE WORDS "GOOD AND SUFFICIENT" APPEAR PRETTY CLEAR. ALTHOUGH ACTUARIES MIGHT DEBATE EXACTLY WHAT IS MEANT



BY "GOOD AND SUFFICIENT," CERTAINLY "GOOD AND SUFFICIENT" DOES NOT APPEAR TO IMPLY THAT NO RESERVE NEED BE CARRIED IF LOSSES ARE NOT REASONABLY ESTIMABLE, OR THAT, IN THE EVENT OF A RANGE OF EQUALLY LIKELY ESTIMATES, THE LOW END OF THE RANGE SHOULD BE BOOKED. THUS, ALTHOUGH FAS #5 PROVIDES AN "OUT" FOR THE ACCOUNTANT, IT IS NOT CLEAR THAT SUCH AN "OUT" IS PROVIDED FOR THE ACTUARY.

LET'S TURN NOW TO THE ACADEMY'S QUALIFICATION STANDARDS AND SEE IF THEY PROVIDE ANY HELP IN THIS AREA (EXHIBIT VI). THERE DOES NOT APPEAR TO BE ANY SPECIFIC GUIDANCE. WE CAN MEET THE CONTINUING EDUCATION REQUIREMENT OF 12 HOURS PER YEAR BY ATTENDING SEMINARS SUCH AS THIS ONE. THERE'S ALSO THE REQUIREMENT OF THREE YEARS OF RELEVANT EXPERIENCE, BUT PRESUMABLY VERY FEW, OR NONE OF US, HAVE EXPERIENCE RESERVING FOR EIL. FORTUNATELY, THERE IS THE GENERAL COMMENT THAT SAYS THAT NEW APPLICATIONS OF ACTUARIAL SCIENCE WILL EMERGE, AND THAT CONTINUED EDUCATION AND APPLICATION OF KNOWLEDGE IN ANALOGOUS SUBJECTS WOULD PROVIDE SATISFACTION OF QUALIFICATION STANDARDS. SO, I SUPPOSE THAT MANY IF NOT ALL OF US ARE QUALIFIED TO SIGN LOSS RESERVE OPINIONS WHERE EIL IS INVOLVED. DOES THAT MAKE YOU MORE COMFORTABLE?

LET'S LOOK NOW AT THE STATEMENT OF PRINCIPLES REGARDING PROPERTY/CASUALTY LOSS RESERVES TO SEE IF THE STATEMENT OFFERS ANY GUIDANCE (EXHIBIT VII). FIRST, IN REVIEWING THE DEFINITIONS, WE SEE THAT THE TOTAL LOSS RESERVE IS COMPOSED OF FIVE ELEMENTS, INCLUDING PROVISION FOR FUTURE DEVELOPMENT OF KNOWN CLAIMS AND PROVISION FOR CLAIMS INCURRED BUT NOT REPORTED. THUS, THIS SUGGESTS THAT IT IS NOT PROPER TO RESERVE FOR EIL BASED SOLELY ON

CASE RESERVES, SINCE I BELIEVE THAT MOST OF US WOULD ANTICIPATE THAT THERE WOULD BE FUTURE DEVELOPMENT OF KNOWN CLAIMS AND THAT THERE IS ALSO PROBABLY SOME IBNR.

LOOKING AT THE CONSIDERATIONS SECTION OF THE STATEMENT, WE SEE A COMMENT THAT EXPLAINS THAT REPORTS TO SHAREHOLDERS AND TO SECURITY REGULATORS ARE GOVERNED BY GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP), AND THAT GAAP RESERVES MAY BE DEFINED DIFFERENTLY FROM STATUTORY RESERVES. WHAT BEARING DOES THIS COMMENT HAVE ON OUR ACTUARIAL OPINIONS? IT SEEMS TO INFORM US THAT GAAP APPLIES TO LOSS RESERVES AND HENCE FAS 5 WOULD APPLY TO LOSS RESERVES, BUT IT DOES NOT SAY THAT THE ACTUARY SHOULD DEFINE THE SCOPE OF HIS OR HER OPINION TO INCLUDE FAS 5 STANDARDS.

THERE IS ANOTHER CONSIDERATION THAT SAYS A RESERVE SHOULD "TAKE INTO ACCOUNT THE DEGREE OF UNCERTAINTY INHERENT IN ITS PROJECTION . . . AN EXPLICIT PROVISION FOR UNCERTAINTY MAY BE WARRANTED BUT THE INDICATED ULTIMATE RESERVE VALUE IS SUBJECT TO A HIGH DEGREE OF VARIABILITY." THIS SUGGESTS A RISK MARGIN IS APPROPRIATE, ESPECIALLY FOR EIL SINCE THERE IS A HIGH DEGREE OF UNCERTAINTY. HOW DOES THIS CONCEPT RELATE TO WHAT APPEARS TO BE THE PRACTICE OF RESERVING ON A CASE RESERVE BASIS.

SOME ACTUARIES HAVE INDICATED TO ME THAT THEY BELIEVE A "STEP LADDER" APPROACH TO RESERVING FOR EIL IS APPROPRIATE, INCREASING THE RESERVES GRADUALLY OVER TIME TO GET THEM TO AN ADEQUATE LEVEL. HOWEVER, SUCH AN APPROACH DOES NOT APPEAR TO BE JUSTIFIED BASED ON THE STATEMENT OF PRINCIPLES.

LET'S LOOK NOW AT THE PROCEEDINGS OF THE CASUALTY ACTUARIAL SOCIETY TO SEE WHAT ARTICLES ON ENVIRONMENTAL IMPAIRMENT THERE ARE THAT COULD BE HELPFUL TO US IN OUR WORK (EXHIBIT VIII). I'VE CHECKED, AND FOUND NO SUCH ARTICLES. PERHAPS IN THE FUTURE THERE WILL BE ARTICLES BY MANY OF THE PEOPLE THAT SPOKE AT THIS SEMINAR: AMY BOUSKA, STEVE D'ARCY, CHUCK MCCONNELL, ROGER HAYNE, AND OTHERS. BUT AT THIS POINT THERE ARE NONE. THE PROCEEDINGS OFFER NO HELP AT THIS TIME.

FINALLY, LET'S LOOK AT THE LOSS RESERVE QUESTIONNAIRE (EXHIBIT IX). BOB MICCOLIS AND I HAVE PASSED THESE OUT AT THE 1988, 1989 AND 1990 LOSS RESERVE SEMINARS AND THEY ARE AVAILABLE THIS MORNING TO THOSE WHO WOULD LIKE THEM. THE QUESTIONNAIRE IS INTENDED TO PROVIDE A THOROUGH CHECKLIST TO HELP THE ACTUARY ENSURE THAT HE OR SHE IS NOT MISSING ANY MAJOR AREAS OF INQUIRY WHEN EXAMINING LOSS RESERVES.

THERE IS VERY LITTLE ON THE QUESTIONNAIRE THAT CAN BE DIRECTLY RELATED TO EIL CLAIMS. THERE IS A QUESTION THAT SAYS, "DESCRIBE ANY SPECIAL PROCEDURES OR GUIDELINES FOR VERY LARGE OR CATASTROPHIC CLAIMS OR FOR UNUSUAL CLAIMS (ASBESTOS, DES, ENVIRONMENTAL IMPAIRMENT OR OTHER TOXIC TORTS)." FURTHER, THERE'S ANOTHER QUESTION THAT ASKS ABOUT THE EXTERNAL ENVIRONMENT--LEGAL AND JUDICIAL ISSUES. THUS, AN ACTUARY THAT CONSCIENTIOUSLY USES THIS QUESTIONNAIRE WOULD PROBABLY NOT OVERLOOK ENVIRONMENTAL LIABILITIES, BUT THE QUESTIONNAIRE PROVIDES NO GUIDANCE AS TO HOW THESE LIABILITIES SHOULD BE ESTIMATED OR RECORDED.

LET'S LOOK NOW AT THE SURVEY THAT YOU HAD COMPLETED PRIOR TO THIS SESSION. I THINK YOU'LL FIND THE RESULTS INTERESTING, I KNOW I DID. I WAS SURPRISED AT HOW CONSERVATIVE THIS GROUP WOULD BE WHEN IT COMES TO RESERVING FOR EIL CLAIMS.

THE FIRST "CASE" IS FAIRLY SIMPLE (EXHIBIT X, PAGE 1). ALTHOUGH THE COMPANY HAS NEVER THOUGHT IT WAS PROVIDING ANY EIL COVERAGE, COVERAGE ISSUES ARE BEING LITIGATED IN CONNECTION WITH SEVERAL CLAIMS. MANAGEMENT HAS MADE NO ATTEMPT TO ESTIMATE THE POTENTIAL LIABILITIES, ON THE GROUNDS THAT THERE IS NO COVERAGE. YOU, AS AN ACTUARY, ARE ASKED TO PROVIDE AN OPINION ON LOSS RESERVES.

ONLY ONE OF YOU RESPONDED THAT YOU WOULD PROVIDE A CLEAN OPINION IN THESE CIRCUMSTANCES. AT THE OTHER EXTREME, FOUR OF YOU SAID THAT YOU WOULD DECLINE TO PROVIDE A LOSS RESERVE OPINION.

THE REMAINING SIXTY-SEVEN RESPONDENTS STATED THAT THEY WOULD PROVIDE AN OPINION BUT WOULD QUALIFY IT. FORTY-THREE OF THESE WOULD HAVE USED QUALIFICATIONS D. OR E., AS SHOWN ON THE EXHIBIT. ALTHOUGH BRIEF, THESE ARE FAIRLY DETAILED DESCRIPTIONS OF THE SITUATION, ESPECIALLY RESPONSE E.

OF THE EIGHTEEN "OTHER" QUALIFICATIONS, MANY WOULD HAVE BEEN VARIATIONS OF CHOICES D AND E.

THE SECOND "CASE" WAS A BIT MORE COMPLICATED (EXHIBIT X, PAGE 2). GIVEN VARIOUS ESTIMATES REGARDING THE AMOUNT OF EIL COSTS AND THE TIMING OF LOSS AND EXPENSE PAYMENTS, YOU WERE ASKED TO PICK

THE LOWEST RESERVE AMOUNT FOR WHICH YOU COULD ISSUE A FAVORABLE, UNQUALIFIED OPINION. OF THE 74 PEOPLE RESPONDING TO THIS QUESTION, 13 "BACKED OUT", DECIDING THAT THEY WOULD NOT BE ABLE TO PROVIDE AN OPINION AT ALL (AT LEAST NOT AN UNQUALIFIED OPINION), BECAUSE THERE WAS TOO MUCH UNCERTAINTY.

THERE WAS A WIDE RANGE OF ANSWERS TO THIS QUESTION (EXHIBIT X, PAGE 3). NOTE THAT 11 RESPONDENTS WOULD HAVE SIGNED OFF ON AN AMOUNT OF \$330 MILLION OR LESS, WHICH IS LESS THAN THE TOTAL OF THE NON-EIL RESERVES PLUS THE "LOW" ESTIMATE OF THE EIL RESERVES. STATED DIFFERENTLY, 11 OF YOU WOULD HAVE SIGNED OFF "CLEAN" ON RESERVES EXPECTED TO BE INADEQUATE BY 27% (OR MORE) OF SURPLUS.

ANOTHER 13 WOULD HAVE SIGNED OFF ON RESERVES IN THE RANGE OF \$367 MILLION TO \$377 MILLION, WHICH IS SLIGHTLY LESS THAN THE "FUZZY" BEST GUESS.

36 OF YOU WERE MORE CONSERVATIVE, AND WOULD HAVE REQUIRED RESERVES OF ANYWHERE FROM \$395 MILLION (THE BEST GUESS PLUS A PROVISION FOR COVERAGE DISPUTE COSTS) TO \$520 MILLION (THE HIGH ESTIMATE PLUS A PROVISION FOR COVERAGE DISPUTE COSTS). I WONDER HOW MANY INSURANCE COMPANIES WOULD ACTUALLY BE SO CONSERVATIVELY RESERVED?

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THANKS FOR THE OPPORTUNITY TO GIVE THIS PRESENTATION - YOU'VE BEEN A GREAT AUDIENCE. WHEN I WAS PREPARING THIS TALK, I WAS CONCERNED THAT THERE WOULD BE SO FEW QUESTIONS THAT I WOULDN'T BE ABLE TO COME CLOSE TO FILLING UP THE ALLOTTED TIME.

THE WAY IT'S TURNED OUT, YOU'VE ASKED SO MANY QUESTIONS AND GENERATED SO MUCH DISCUSSION THAT ITS BEEN A CHALLENGE TRYING TO FINISH THE PRESENTATION ON TIME.

**ENVIRONMENTAL ISSUES SEMINAR**  
**REPORTING ENVIRONMENTAL LIABILITIES**  
**(ACTUARIAL PERSPECTIVE)**

- **INSURANCE COMPANY DISCLOSURES**
- **ACTIVITIES OF THE AAA'S COMMITTEE  
ON PROPERTY LIABILITY INSURANCE  
FINANCIAL REPORTING**
- **LOSS RESERVE OPINIONS - PROFESSIONAL  
GUIDANCE**
- **SURVEY/DISCUSSION**

## DISCLOSURES IN ANNUAL REPORTS

### COMMON THEMES:

- RESERVE ADJUSTMENTS FOR  
EIL IN OLD YEARS
- FURTHER RESERVE INCREASES  
ARE POSSIBLE
- SIGNIFICANT JUDICIAL  
UNCERTAINTY
- CANNOT REASONABLY BE  
ESTIMATED



**AMERICAN ACADEMY OF ACTUARIES**  
**COMMITTEE ON PROPERTY-LIABILITY**  
**INSURANCE FINANCIAL REPORTING**

**ACTIVITIES RELATED TO LOSS  
RESERVE OPINIONS:**

- **STUDY OF INSURANCE COMPANY  
INSOLVENCIES FROM 1969-87 TO MEASURE  
THE EFFECTIVENESS OF CASUALTY LOSS  
RESERVE OPINIONS**
  
- **IDENTIFICATION OF 25 INSURERS WITH  
MOST ADVERSE DEVELOPMENT FROM  
1985-1988**
  
- **DEVELOPMENT OF RECOMMENDED  
WORDING FOR "QUALIFIED" OPINIONS**
  
- **DEVELOPMENT OF "WHITE PAPER" ON  
ENVIRONMENTAL LIABILITIES**

# LOSS RESERVE OPINIONS GUIDANCE

- STANDARD OPINION WORDING
- QUALIFICATION STANDARDS
- STATEMENT OF PRINCIPLES REGARDING  
PROPERTY AND CASUALTY LOSS  
ADJUSTMENT EXPENSE RESERVES
- CAS PROCEEDINGS
- LOSS RESERVE QUESTIONNAIRE

## STANDARD OPINION WORDING

- COMPUTED IN ACCORDANCE WITH ACCEPTED LOSS RESERVING STANDARDS AND ARE FAIRLY STATED IN ACCORDANCE WITH SOUND LOSS RESERVING PRINCIPLES
- BASED ON FACTORS RELEVANT TO POLICY PROVISIONS
- MEET THE REQUIREMENTS OF THE INSURANCE LAWS OF (STATE OF DOMICILE)
- MAKE A GOOD AND SUFFICIENT PROVISION FOR ALL UNPAID LOSS AND LOSS EXPENSE OBLIGATIONS OF THE COMPANY UNDER THE TERMS OF ITS POLICIES AND AGREEMENTS

COMMENT: RAISES QUESTIONS REGARDING EIL

# QUALIFICATION STANDARDS

## **SPECIFIC:**

**EDUCATION - ASSOCIATESHIP EXAMS**

**RELEVANT EXPERIENCE - THREE YEARS**

**CONTINUING EDUCATION - 12 HOURS**

## **GENERAL:**

**NEW APPLICATIONS OF ACTUARIAL  
SCIENCE WILL EMERGE. CONTINUED  
EDUCATION AND APPLICATION OF  
KNOWLEDGE IN ANALOGOUS SUBJECTS  
WILL PROVIDE FOR SATISFACTION OF  
QUALIFICATION STANDARDS**

**COMMENT: NO SPECIFIC GUIDANCE REGARDING EIL**

# STATEMENT OF PRINCIPLES REGARDING PROPERTY AND CASUALTY LOSS RESERVES

## EXTRACTS

### DEFINITION:

A TOTAL LOSS RESERVE IS COMPOSED OF FIVE ELEMENTS...(INCLUDING)

- PROVISION FOR FUTURE DEVELOPMENT OF KNOWN CLAIMS
- PROVISION FOR CLAIMS INCURRED BUT NOT REPORTED

### CONSIDERATIONS:

REPORTS TO SHAREHOLDERS AND TO SECURITIES REGULATORS ARE GOVERNED BY GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP). GAAP RESERVES MAY BE DEFINED DIFFERENTLY FROM STATUTORY RESERVES

A RESERVE SHOULD TAKE INTO ACCOUNT THE DEGREE OF UNCERTAINTY INHERENT IN ITS PROJECTION...AN EXPLICIT PROVISION FOR UNCERTAINTY MAY BE WARRANTED WHEN THE INDICATED ULTIMATE RESERVE VALUE IS SUBJECT TO A HIGH DEGREE OF VARIABILITY

COMMENT: RAISES ISSUES REGARDING EIL.

**PROCEEDINGS  
OF THE  
CASUALTY ACTUARIAL SOCIETY**

**ARTICLES ON ENVIRONMENTAL LIABILITY:**

- 
- 
- 
- 
- 

**COMMENT: NOT MUCH HELP ON EIL**

## **LOSS RESERVE QUESTIONNAIRE**

**DESCRIBE ANY SPECIAL PROCEDURES OR  
GUIDELINES FOR VERY LARGE OR  
CATASTROPHIC CLAIMS OF FOR UNUSUAL  
CLAIMS (ASBESTOS, DES, ENVIRONMENTAL  
IMPAIRMENT OR OTHER TOXIC TORTS).**

**EXTERNAL ENVIRONMENT - LEGAL AND  
JUDICIAL ISSUES**

**COMMENT:**

**THESE MAY HELP TO IDENTIFY EXISTENCE  
OF ENVIRONMENTAL LIABILITIES, BUT  
PROVIDE NO GUIDANCE AS TO HOW THESE  
LIABILITIES SHOULD BE ESTIMATED OR  
RECORDED**

**SURVEY**

**CASE 1**

You are preparing to provide an actuarial opinion on an insurer's loss and loss adjustment expense reserves. You are informed that the company "has never covered environmental claims," but that coverage is being litigated in several cases. Management states that the company has made no attempt to estimate these potential liabilities, as any attempt to do so might weaken their argument that they have no liability.

<b>Question</b>	<b>No. of Responses</b>
<b>What action would you take?</b>	
A. Decline to provide a loss reserve opinion.	4
B. Provide a clean opinion.	1
<b>Qualify your opinion as follows:</b>	
C. "Actual losses are apt to vary, perhaps significantly, from estimated losses.	6
D. "My evaluation only provides for large, unusual claims, such as asbestos, environmental impairment, DES, etc. to the extent that such claims are reflected in the historical loss data base."	20
E. "The company is currently contesting several allegations that their policies have, in the past, provided coverage for environmental impairment claims. Management's opinion is that no such coverage exists, and thus no reserves have been established for environmental impairment claims. This appears reasonable."	23
F. Other?	18



**CASE 2**

(\$ in millions)

Surplus = \$100

Non-EIL reserves = \$300

EIL estimates on known sites:

	<u>Low</u>	<u>High</u>
Clean up	\$25	\$100
Third party	20	50
Natural resources	<u>12</u>	<u>50</u>
	\$57	\$200

"Fuzzy" best guess = \$85

Estimated coverage dispute costs = \$10 to \$20

Estimated total EIL costs = \$67 to \$220

Estimated portion of \$85 that will be paid in next 5 years = \$5 to \$20

Estimated portion of coverage disputes cost that will be paid in next 5 years = \$5 to \$10

Estimated total paid in next 5 years = \$10 to \$20

**CASE 2 (cont'd.)**

What is the lowest reserve amount for which you would issue a favorable, unqualified loss reserve opinion?

<u>Amount</u>	<u>No. of Responses</u>	<u>Amount</u>	<u>No. of Responses</u>	<u>Amount</u>	<u>No. of Responses</u>
\$300	1	\$330	5	\$405	13
\$305	1	\$367	8	\$510	3
\$310	2	\$377	5	\$520	8
\$320	2	\$395	12	None	13

**AETNA LIFE & CASUALTY**  
**Annual Report 1989**

"Loss and loss expense reserves were increased by \$811 million in 1989; corresponding increases made in 1988 and 1987 were \$1,389 million, and \$1,587 million. The table below shows the increases attributable to prior accident years. The majority of these increases was for recurring losses and related expenses for product liability and toxic substance risks attributable to policies written prior to 1978. An increase in reserves is reflected in reduction of net income for the period in which the adjustment is made."

**THE CHUBB CORPORATION**  
**Annual Report 1989**

"The uncertainties relating to asbestos and toxic waste claims on insurance policies written many years ago are exacerbated by judicial interpretations of coverage that have tended to erode the clear intent of such policies and by expanded theories of liability. The industry is engaged in extensive litigation over these coverage issues. The outcome is not easily predictable. Management considers the reserves established for these claims to be adequate based on facts currently known and the current state of the law. However, given the expansion of coverage and liability by the courts in the past and the possibilities of similar interpretations in the future, an indeterminable amount of additional potential liability exists under adverse conditions.

"During 1989 and 1988, we experienced overall favorable development of \$14 million and \$42 million, respectively, on reserves established for losses incurred in previous years. These amounts compare with reserve strengthening of \$97 million in 1987. In each of the last three years, we substantially increased reserves relating to asbestos and toxic waste claims. Further increases in 1990 and future years are possible as legal issues concerning these claims are clarified."

**CIGNA CORPORATION**  
**Annual Report 1989**

"In addition, most major property and casualty insurers, including CIGNA, have been subject to asbestos-related and environmental pollution claims that involve significant unresolved issues regarding liability, policy coverage and other matters. As a result of these uncertainties, the amounts and timing of asbestos-related and environmental pollution unreported claims, and related litigation expenses for unreported and most reported claims, cannot reasonably be estimated. Consequently, charges are expected to be reflected in future results."

**CRUM & FORSTER**  
**Annual Report 1989**

"C&F continually monitors the adequacy of reserves established to cover claims costs on business written in both current and prior years. Management adjusts these reserve provisions to reflect evolving changes in various factors which affect ultimate claim settlement costs. Such factors include increased damage awards granted by the courts, changes in judicial interpretation of legal liability for environmental cleanup, other recently advanced new theories of liability, and difficulties in collecting reinsurance. Most of these judicial interpretations concerning liability for environmental cleanup are still evolving, and considerable disparity exists in legal determinations made in various jurisdictions. Until a pattern emerges and disparities are resolved through the appellate process, it is not possible to accurately assess their ultimate cost. C&F recognizes the impact of these developments in its financial statements as they evolve and become estimable."

**HOME GROUP, INC.**  
**Annual Report 1989**

\*The Home's loss and loss adjustment expense reserves include certain reserves for pollution liability claims principally relating to the period prior to 1980. These claims are at an early stage of discovery and are therefore not reasonably estimable at this time. Pollution liability claims have the potential for adding to reserve estimates. The process of estimating reserve requirements is necessarily imperfect and involves an evaluation of variables, such as claim frequency and severity, as well as social and economic conditions. Therefore, there can be no assurance that the ultimate liability will not exceed amounts reserved; however, the methods and assumptions used in establishing reserves are consistent with prevailing actuarial practice and are modified periodically based on changes in circumstances.\*

**THE TRAVELERS CORPORATION**  
**Annual Report 1989**

\*Certain of Travelers subsidiaries are involved in litigation with respect to claims arising with regard to insurance coverages that are taken into account in establishing benefit reserves. On insurance contracts written many years ago, Travelers continues to receive claims asserting alleged injuries and damages from asbestos and other hazardous and toxic substances.

\*In relation to these claims, Travelers carries on a continuing review of its overall position and its reserving techniques and reinsurance. The latest review confirms that adequate provision has been made for any obligations now foreseen. It is management's opinion that the ultimate resolution of all claims arising from hazardous and toxic substances will not have any material adverse effect on the consolidated financial position of Travelers.\*