**The National Commission on Terrorist Attacks Upon the United States, an independent, bipartisan commission created by congressional legislation and the signature of President George W. Bush in late 2002, is chartered to prepare a full and complete account of the circumstances surrounding the September 11, 2001 terrorist attacks, including preparedness for and the immediate response to the attacks. The Commission is also mandated to provide recommendations designed to guard against future attacks.**

# NATIONAL COMMISSION ON TERRORIST ATTACKS UPON THE UNITED STATES

## Public Hearing

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Drew University
Madison, New Jersey

## PRIVATE-PUBLIC SECTOR PARTNERSHIPS FOR EMERGENCY PREPAREDNESS

CHAIRED BY: THOMAS H. KEAN

RISKS AND CONSEQUENCES OF TERRORISM FOR THE PRIVATE SECTOR

MR. KEAN: Perhaps no aspect of the private sector is more keenly attuned to the challenges of private sector preparedness than the insurance industry, which must value and allocate the risks associated with a possible terrorist attack. Chubb took the lead in the immediate aftermath of 9/11 when it decided to honor all claims, declining to invoke the standard wartime exclusion, notwithstanding the President's statement that the nation was at war, and in a climate of great uncertainty in the rest of the insurance industry about what to do. Here to talk about Chubb's experience on 9/11, the current climate for terrorism insurance, and future challenges is John Degnan, vice chairman of Chubb Corporation, and former attorney general for the state of New Jersey.

MR. JOHN DEGNAN: Thank you, Governor Kean. With your permission I've asked Matt Campbell, who's the general counsel of our Commercial Insurance Division to join me here, in case the Commission has any technical questions which Matt may be more able to answer than I am. Governor Kean, Vice Chairman Hamilton, members of the commission, I welcome this opportunity to appear before you this morning on behalf of the Chubb Corporation. I'm vice chairman of that company, as the governor has said, and the company has been in the business of providing property and casualty insurance for over 120 years.

We were one of the largest insurers of the World Trade Center itself and of the tenants of the World Trade Center, and expect to pay, as a company, $3.2 billion in gross losses arising out of the September 11 attack on the World Trade Center. It's obviously the largest loss that we've ever experienced and surely the greatest tragedy that we've ever managed, and we're very proud of the role that both Chubb, and for that matter, the entire property and casualty insurance industry has played in meeting our promise of claims payments.

You've asked me this morning to address three subjects, and I'll try to do so briefly. I've submitted to the Commission a more extended set of comments. The first question was our experience as a company in the aftermath immediately after September 11. Second was our experience in the current insurance marketplace in the context of a Terrorism Risk Insurance Act, sometimes called TRIA. And third, the consequences, at least from our perspective, of a failure to reauthorize TRIA, which would -- or substitute legislation, which without congressional intervention will inspire at year end 2005.

So let me start with how we responded to the September 11 attack. I suppose like most folks did, I'm sure members of the Commission, we first confirmed that our family members, our employees, our colleagues and our friends were safe. We reached out to hear their voices, we rejoiced over their emails, we generally reassured ourselves as human being that the awesome horror generated by that event would not cripple us, either as individuals or as a business.

Then within only hours, we had to set about the task at hand, as so many others did. As a company, we had to determine whether, in the absence of a full understanding at that time of who the responsible parties were for this event, whether the attack fell within the wording of the traditional War Act exclusion that most insurance policies have. If it did fall within the definition of a war, then the event would not have triggered covered losses under many of the policies then governing the tenants and the owners of the World Trade Center.

That analysis, as you can imagine, was undertaken in the context of an unknown dimension of the ultimate loss, Who knew on September 11, aside from the personal tragedy dimensions, what the economic consequences would be? But we all knew that it would be many billions of dollars, and surely the largest loss the insurance industry has ever experienced.

Obviously it could have been about the company proposition, although no one had that on their mind that day. Frankly, the debate even within our own company was intense and often emotional about whether this was a war, whether there was coverage under the policies, and whether we would pay the claims. We had no idea whether our reinsurers -- in our business, when a risk is too large we pass off some of that - re-insurer who stands in our stead in paying the losses. And we had no idea, because they had War Act exclusions in their reinsurance treaties with us, whether they would invoke the War Act, many of these not being U.S. reinsurers. And if we said that the War Act did not apply and paid claims and the reinsurers said, yes it did, we won't reinsure you, it meant that we would lose the benefit of the reinsurance.

The President and others in authority that day were, it turns our correctly, probably referring to the event as an act of war, and that had an impact on our deliberations.

Finally, though, within about 12 hours of debate, we did what Chubb has, in my judgment, always done, the right thing, and we announced that we would not apply the War Act exclusion and we would adjust and pay all covered claims with speed, empathy and integrity.

While Chubb generally gets credit for having been the first insurance company to publicly acknowledge that position, I'm very proud to say that our industry all came to the same conclusion, reinsurers and insurers alike. And as my submitted testimony indicates, the private sector insurance proceeds, by and large, in my judgment, defeated the economic goals of the terrorists who sought to bring down our economy. It was certainly my proudest moment as an officer at Chubb and as a member of this industry.

I don't want to leave this subject, though, without giving the Commission just a glimpse of how our people at Chubb responded. There are too many incidences of personal sacrifices to recount here, but one set of them exemplifies them all. Our claims adjusters who handle workers' compensation claims came together as a team that day on a volunteer basis to service the most difficult of all claims that have come out of the World Trade Center, those involving injuries or deaths to the employees of our insurers.

Our claims personnel solicited and received permission from the New York Department of Insurance to condense the application required for a workers' compensation claim from about 108 questions to eight. We got permission to accept these claims on an oral basis rather than a written basis, and instead of waiting for the families to submit the claims, we put our people together in a crisis unit and asked them to call family members, and we had perhaps 900 plus of the deaths that emanated from the World Trade Center loss.

We wanted to try, as paltry as it seems, to soften the economic loss to families whose losses were obviously un-reimbursable, either emotionally or economically. But if we could make emergency benefits available, as we had the right to do under the policy within 72 hours, we didn't want to wait until somebody submitted the claim, that they needed the money that day. The calls we made were often emotional and sometimes reached family members who had not yet acknowledged their losses, and they often produced tears and certainly always empathy. In time, some of our own people needed grief counseling.

The Chubb adjusters did what needed to be done economically, as so many people did in those days after September 11, to soften the crushing, and as I said, the un-reimbursable loss of a family member. Like so many others in the company -- in the country -- Chubb and its people responded selflessly and generously and it made me proud to be part of a response which was so much more powerful and inspiring than the attack which prompted it.

Now, with your permission, let me turn to the current environment in the insurance marketplace. After a frustrating and often discouraging public debate, Congress passed and the President signed in November 2002, the Terrorism Risk Insurance Act, TRIA. It took consistent and firm leadership from President Bush and a handful of persistent and constructive Congressional leaders to secure passage of that bill more than a year after that event. There's general agreement, I would say, that at least as it is operating in its first year, TRIA does provide some level of solvency protection for insurers.

Nevertheless the program today has some significant shortcomings. First, perhaps of most concern, is that the per insurance company retentions simply are too high. Before September 11, for example, when an insurer looked at a workers' compensation risk for a financial services provider, as many of the companies in the World Trade Center were, the maximum probable loss of such a firm was relatively low compared to often other more dangerous lines of work. White collar workers generally don't experience the same incidence of claims or severity of claims that manufacturing workers experience, and we underwrote to that risk.

But after September 11, even a moderate sized financial services company can face a maximum risk of more than half a billion dollars. So even under TRIA, each individual risk that we write has a probably maximum loss of up to the per company deductible, and insurers continued to be faced with staggering potential losses. Second, TRIA does not effectively prevent states from preempting federal law. For example, because insurers are required to provide insurance for what we call fire following a terrorist attack in 26 of our states, we're forced to apply inconsistent standards of both underwriting and pricing to national clients who have risks that overlay many state involvements, and we have to tailor the product as well to that.

And third, unlike Pool Re, which is the reinsurance device put into place in the U.K. to deal with terrorist attacks, TRIA is voluntary for the policyholders. An insured makes a decision, based on the availability of terrorism coverage and the price, whether they want to buy it. As a result, the market is experiencing what we call adverse selection, that people with the greatest exposure to terrorist events.

Those who, for example, work in signature buildings, such as the Empire State Building in New York or the Sears Tower in Chicago, generally are buying the terrorist insurance. But if you live in a low -- or you work in a low-rise office building outside Des Moines, Iowa, you're less likely to buy terrorism insurance. And the only way insurance really works as a mechanism is if the fortunate many take care of the misfortunate few by allowing their money to be pooled to deal with catastrophic risk. But because terrorism presents such unique risk management issues and concerns, policyholder participation in a terrorism insurance arrangement should be compulsory.

About 80 percent of our clients and customers are buying terrorism insurance, but there are many companies in the insurance industry who are experiencing much lower rates of companies and customers actually buying the insurance. So as I noted, while TRIA does have some basic value in insuring protection for the solvency of the insurance industry, it does have defects.

And I'd now like to address the challenges that the marketplace will face in trying to manage the risk of terrorism after TRIA expires, the potential prospects of TRIA extension. And I'd like to begin with the very real concern of insurer solvency. TRIA will expire, if nothing else happens, on December 31, 2005. Sadly, the threat of catastrophic terrorism risk will remain after that date. The expiration of the current TRIA program will exacerbate the solvency challenge faced by insurers.

And to give this issue some context, consider that currently the United States domestic property and casualty industry has approximately $300 billion in surplus. But roughly half of that represents automobile insurance and homeowners insurance, leaving approximately only $150 billion -- if you can put an only before that amount. But that's set aside to pay for all types of commercial insurance losses. If we had another event in the order of magnitude of $70 billion, which was the early projection of loss for September 11 -- it's come in somewhat lower than that -- the economic consequences against that $150 billion surplus would be significant to say the least, and would seriously jeopardize the financial stability of the industry, clearly rendering insolvent many of the insurance companies whose capital base is less strong than others.

I would hope that the Commission would agree that were the insurance industry to be insolvent after the next terrorist, event, as it wasn't after this one -- it was solvent after this one -- the economic reverberations of our inability to pay would be felt not only in the United States but around the world. The insurance losses associated with the World Trade Center attack were huge and unprecedented, yet they could have been substantially larger if, for example, the attack had occurred only a few hours later, when even more people were in the towers, if the planes had hit a lower floor or if there was less time available for evacuation.

And the consequences for the primary insurance industry in the future would be far greater than those horrendous consequences of September 11, because if TRIA did not exist, private reinsurance for terrorism, private reinsurance that we would buy from other insurance companies, is generally unavailable today in the marketplace and certainly unavailable for nuclear, biological, chemical and radiological risks in particular. Accordingly, some governmental program is needed. And the approach of the Commission today to study private-public partnership in addressing this risk as a nation is critically important.

Currently the industry, the insurance industry, is looking at a variety of options. They include a federal reinsurance program, a combination of regulatory standards and terrorism reinsurance pools, a workers' compensation only backstop. If TRIA is not available for property risks going forward, would it make sense to make it available for at least workers' compensation risks, where coverage is mandated, an insurance company must provide terrorism coverage for a workers' compensation loss. A tax deduction, perhaps for terrorism reserves, or a federal terrorism reinsurance bond mechanism, state-based solution. Or even private sector solutions in combination with those.

Unfortunately, each of those options in some way has substantial flaws. Given the current reluctance of many to extent TRIA, it's doubtful that the administration and Congress would seriously consider a federal terrorism insurance program, despite the fact that nine countries already have such a program in place. The current system under TRIA of regulatory standards and federal reinsurance might be suitable for ultra high-risk facilities, such as nuclear reactors or chemical plants, biological plants or telecommunications and cyber infrastructure.

However, our attention cannot be limited to those exposures. Terrorists, as we know, most often strike at soft targets in an attempt to disrupt everyday life. An effective federal terrorism insurance program, therefore, has to address the exposures presented by high profile, and to a terrorist, highly desirable targets, like sports arenas, universities, shopping malls, daycare facilities, and even hospitals. And while these soft targets are perhaps the most emotional risks, the greatest terrorism threat to the insurance industry's solvency is workers' compensation.

Inconsistent state regulation limits insurers' ability to effectively respond to workers' compensation exposures. It would frankly benefit the insurance industry and all who rely on it if TRIA were improved and extended if only for workers' compensation. But a truly effective federal program should really address other lines of insurance as well. The tax deductibility of terrorism reserves, which are currently not tax deductible to an insurance company does create an adverse budget scoring implication, growing the federal deficit.

The TRIA bill, by the way, originally improved by the House Financial Services Committee, did have such a provision in it. It would have allowed insurance companies such as Chubb to set up reserves against the possibility of a terrorist loss, but it was stripped out by the House Ways and Means Committee. The purchase of federal reinsurance bonds would probably do little in the short term to build capacity. Those bonds would have to have fairly low interest rates and have restrictive access to the funds. State-based solutions would not be able to build sufficient capacity, nor would they address the reality that terrorism is truly a national problem that must be addressed nationally in a consistent way.

So to rely solely on the private sector to solve the problem cannot be the right way. The terrorism risk is too great, the consequences too terrible to rely only on the private sector's ability to solve it and absorb the loss. Another terrorist attack is sadly a virtual certainty. Only its manner and its timing and its magnitude are impossible to predict. Unfortunately, current prospects for improving or extending TRIA are dim. Even the administration which worked so hard to pass the original bill has indicated it does not plan to push for extension.

As I've said, though, insurers alone probably cannot provide the coverage needed in the face of an incalculable risk. If you can't quantify the risk and determine its probability, it becomes essentially an uninsurable risk. As a result, the insurance industry, and I would suggest even the economy as a whole, remains at great risk. An effective federal insurance program is an absolute necessity, and wouldn't it be a shame if it took another terrorist tragedy on U.S. soil in order to induce us all to do the right thing.

On that note, Governor, let me end by thanking you for the opportunity to appear before you today and particularly to you and Vice Chairman Hamilton and the other members of the Commission for your attention and your leadership on this critical issue. I would be happy to answer any questions that either you or members of the Commission might have.

MR. KEAN: General, thank you very much