Testimony of the National Association of Insurance Commissioners

Before the
Committee on Financial Services
United States House of Representatives

Regarding:
The Impact of the September 11, 2001 Terrorist Attacks
on America's Insurance System

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Testimony of Kathleen Sebelius, President
National Association of Insurance Commissioners

Introduction

My name is Kathleen Sebelius. I am the Commissioner of Insurance for the State of Kansas, and this year I am serving as President of the National Association of Insurance Commissioners (NAIC). Speaking for myself and my fellow insurance commissioners across America, we appreciate the opportunity to update Congress and the public today regarding the impact upon our Nation's insurance system of the disastrous terrorist attacks that occurred on September 11, 2001.

The United States Insurance System Remains Fundamentally Sound

Let me start by saying that NAIC believes the insurance industry is well-capitalized and financially able to withstand the pressures created by the terrorist attacks, despite monumental losses that may exceed the $30 billion mark. We are heartened by the response to date of our Nation's insurers. We intend to continue working with them closely to ensure their ongoing financial health and stability.

The United States insurance industry is a $1 trillion business with assets of more than $3 trillion. Preliminary loss estimates of $30 billion represent just 3 percent of the premiums written in 2000. In evaluating the industry's health, we should also keep in mind that special federal government assistance programs to help the airlines and other businesses may substantially reduce the amount of claims owed by private insurers. Insurance policies typically specify that direct payments from other sources to reimburse losses will be deducted from the amounts owed by the insurer in order to avoid dual compensation for the same loss.

America's insurance companies have time and again shown their ability to respond to huge disasters and successfully recover. Adjusted for inflation, Hurricane Andrew in

1992 caused $19.7 billion in insured losses, and California's Northridge Earthquake in 1994 cost $16.3 billion in insured losses. As with previous disasters, we believe insurers affected by the recent terrorist attacks will be able to pay projected claims arising from those events.

Insurance is the sale of a promise to pay when bad things happen. During the past two weeks, the Nation's insurance commissioners have been in contact with affected insurance companies to gauge their intentions regarding payment of claims, as well as to assess their financial health. Insurers are telling us they are committed to keeping their promises to policyholders, and that they will pay the resulting claims as quickly as possible.

As regulators, my colleagues and I will continue monitoring the process to make sure that insurance promises are kept. To do our job, we are backed by an impressive array of human and technical resources, including the NAIC and fifty-one state insurance departments that collectively employ more than 10,400 people and spend $910 million annually on insurance supervision. In addition, at this time state insurance guaranty funds have the capacity to provide up to $10 billion to compensate American consumers in the event of insurer insolvencies.

Attacks Spotlight the Special Role of Insurance as Financial Safety Net

Mr. Chairman, I want to commend you for convening this hearing because the terrorist attacks on September 11th are a stark reminder that insurance is different from other financial services products. It is involved in every aspect of our lives when we leave home each day. Insurance products provide the necessary assurance of financial safety that encourages Americans to accept daily risks in business, travel, and personal activities of every sort that we have come to believe are normal to the American way of life. Commercial insurance requirements provide front end incentives that help businesses avoid unnecessary risks, which in turn helps make the products and services we use everyday safer for consumers. Because nobody knows when unexpected tragedies might rob us of life, health, or material well-being, insurance also provides a necessary level of personal comfort in knowing that we and our families will receive the financial backing essential to making a recovery from tragedy.

And so, as the initial shock of seeing the World Trade Center attacked and destroyed began to settle, leaders in business, government, and the media immediately focused their attention on the insurance arrangements backing the persons and commercial firms who inhabited the area of Manhattan directly hit, as well as insurance coverage for the airline industry and those individuals who perished in four horrifying plane crashes. Before long, many other people across America and the world began wondering about the impact of these immense losses upon their own lives. The anguish of coping with what was known to be lost was soon augmented by uncertainty and fears over what might be lost in the future.

Insurance coverage is unique in that it is a product that most people only encounter when they are under the stress of unhappy, often extreme circumstances. Although insurance payments cannot fully compensate for personal and emotional losses, they typically do offer one of the first glimmers of hope for those who face the daunting prospects of starting life over again after disastrous losses.

State insurance regulators are keenly aware that people need assurances they will have promised financial resources available quickly to help them began the process of recovery. We understand the true role of insurance in America lies as much in rebuilding faith and hope as in rebuilding or replacing offices, homes, and property. The key to delivering on the true promise of insurance is prompt, caring, and effective handling of policyholder claims and payments.

The first responsibility of the Nation's insurance regulators on September 11th and the days following was to find out what happened, determine how it might affect American policyholders and insurers, and identify any gaps or weaknesses in the insurance system. Our second responsibility was to take whatever steps are necessary to assure the system is functioning smoothly and properly, and to let government, industry, and the public know that we are there doing our job as expected to ensure a stable, solvent insurance system. We have met those responsibilities and done much more to respond to this emergency.

Measuring the Toll of Terrorism on America's Insurance System

The American insurance system is comprised of insurance companies that issue policies to customers and state regulators who supervise insurer solvency and handling of claims. Both segments of the system took a hard hit on September 11th. I'm pleased to report that both industry and regulators seem to have absorbed these devastating blows without harm to their basic operations.

First and foremost for regulators was the direct toll on NAIC's Securities Valuation Office (SVO) and the New York Insurance Department offices in New York City. SVO's offices in the 7 World Trade Center building were totally destroyed by the fire and ensuing building collapse. Fortunately, the 44 staff members at SVO were all found to be safe, and SVO reopened for business in temporary quarters on Monday, September 17th. The NAIC computer systems that support SVO operations were unaffected by destruction of the New York office. As a result, all SVO computer records were promptly restored. Insurance companies making paper filings with SVO are being notified to resubmit their documentation on investment securities previously filed by not yet reviewed by SVO staff before the office was destroyed.

Measuring the ultimate toll on the insurance industry will take years. Insurance is a unique financial product whose final costs depend on many variables that take time to evolve. Within days of the disaster, various organizations tendered potential damage estimates that ranged from $6 billion to $72 billion. This vast range of possibilities shows the difficulty in estimating potential insurance losses before businesses and individuals have an opportunity to assess the extent of their losses. Much of lower Manhattan has remained closed to facilitate search and rescue efforts, thus restricting the ability of insurance claims investigators to calculate losses.

At present, the number of people believed to be killed in New York, Pennsylvania, and Virginia is approaching 7,000, with a roughly similar number of injured. As time goes on, the number of those injured physically and mentally may rise significantly as the full extent of the human toll becomes clearer.

The total costs to America's insurance industry will thus be huge. Measuring those losses accurately will be an ongoing challenge for both industry and regulators.

Measuring the Amounts of Insurance Damages

While there are still many unknowns, there are some things that we do know about the damage that was done to property in New York. We know the twin towers at the World Trade Center and several other buildings are total losses. We also know there is substantial damage to many of the buildings that surround the World Trade Center in the financial district. We expect that some of them will be damaged so extensively that they must be imploded. Others may be structurally sound, but will require substantial repairs before they are habitable.

At this time, NAIC staff calculates that the property damage losses to the World Trade Center area will be roughly $5.5 billion. Not all of these losses are insured. This loss estimate does not include either contents or business interruption losses.

Building Contents

Most of the buildings that suffered damage in New York were designed for multiple occupancy. The wide variety of businesses that occupied the spaces make it difficult to develop damage estimates. However, we know most of them operated in the financial sector. Financial sector business contents are typical of that found in other offices, but would be expected to have extensive computer hardware and software. Our preliminary estimate for business and personal property damaged or destroyed in New York is between $2 billion and $3 billion.

Business Interruption and Extra Expense

The loss exposure for business interruption and extra expense is generally not included in basic property insurance policies. It is typically provided in a separate policy contract for business owners who choose to purchase it. There are many contractual variations that are classified as business interruption or extra expenses coverage.

Business interruption insurance typically indemnifies a business for loss of income during the period that is necessary to restore property damaged by an insured peril to a condition where the business can resume its operations. It often pays for expenses that continue and profits that would have been earned during the period of interruption. Such policies generally contain a provision that requires the policyholder to resume operations as soon as possible, even on a partial basis. Some policies include provisions for covering extra expenses that are associated with resuming business operations sooner.

To determine the amount of loss, an insurer considers the policyholder's experience before the loss and the probable future experience if no loss had occurred. Virtually all of these contracts have limitations concerning the duration of coverage (12 months would be typical) and are subject to a coinsurance provision so the policyholder shares a portion of the loss with the insurer. This is done to minimize any incentive for the policyholder to delay the recovery process for financial gain.

Business interruption and extra expense exposure is unique to each business. Since there are so many available options and no easy way to figure out what each business has selected, this is a very difficult area for which to estimate losses sustained in the New York disaster. There may also be some business interruption claims in areas outside the World Trade Center and Pentagon areas. A variety of firms have offered estimations that range from $5 billion (Morgan Stanley) to $8.8 billion (Friedman, Billings, Ramsey and

Co.) We believe it is reasonable to expect that these losses will fall somewhere within this range.

Workers' Compensation

Estimating the possible workers' compensation losses as a result of the terrorist attacks is one of the more straightforward exercises. Since the vast majority of injuries and deaths are associated with the fire and collapse of the twin World Trade Center towers and the Seven World Trade Center building, it seems safe to assume that most of the individuals injured or killed were engaged in work-related activities that would trigger a workers' compensation claim. It seems further safe to assume that most of these employees are entitled to benefits under New York law because their employer was operating in that state. There may be some employees from other states who were visiting New York's financial district, however for purposes of estimating overall losses, assuming that New York benefits will be paid provides a reasonable estimate of the overall loss exposure. Early estimates of the total workers' compensation losses attributable to the disaster are approximately $2.4 billion. It should be noted that this estimate does not include any claims involving inhalation of airborne contaminants. Those claims are impossible to estimate at this time.

For purposes of today's report, we are assuming the casualties and injuries suffered at the Pentagon were to federal employees who would not be eligible for benefits under state workers' compensation laws. Although there is a federal equivalent, those costs would be borne by United States taxpayers rather than the insurance industry.

Life Insurance

Many Americans choose to purchase life insurance products, and employers often provide life insurance as part of a comprehensive employee benefits package. Using the latest figures available from New York, the Pentagon, and the plane crash in Pennsylvania, individuals listed as either dead or missing is approaching 7,000. It is reasonable to assume that many of them had life insurance and are entitled to benefits under those policies. Using figures on average wages from the Bureau of Labor Statistics, as well as figures from the American Council of Life Insurers on typical life insurance amounts compared to disposable income, we estimate that life insurance claims will reach approximately $900 million.

To facilitate the payment of life insurance claims when many bodies are not likely to be recovered, states are working to implement a death certification plan similar to the one used for victims of the Oklahoma City bombing, where a similar situation existed. In that case, Oklahoma officials developed an Affidavit of Death that permitted a relative of the deceased to certify the deceased person worked in the destroyed building and would have been in contact with the relative submitting the affidavit if the victim were alive. New York, New Jersey, and Connecticut have developed such affidavits of death, and each of our states will be accepting such proof of death to help expedite the payment of insurance benefits to the heirs of victims.

Auto Insurance

Many cars sustained damage or were destroyed in lower Manhattan and, possibly, near the Pentagon. Using media reports, we estimate that 3,000 cars were damaged or destroyed. Assuming an average value of $30,000 in calculating our estimate, we believe the potential cost to insurers will be around $90 million.

General Liability

There are several types of potential liability for negligence and other damages related to the terrorist attacks that may be seen in the future. It is very difficult for us to estimate the types of legal actions that will be brought or the reactions of courts and juries to the allegations. However, we believe it is prudent to expect that such claims will result in substantial losses for insurers. Various sources have tendered estimates of potential liability losses, typically ranging from $2 billion to $6 billion. Losses within this range seem reasonable to anticipate. It is too early to develop reliable predictions of the ultimate liability losses.

Aviation Insurance

The most common types of insurance for aviation risks are aircraft liability and hull coverage. Aircraft liability coverage is very similar to auto liability insurance, with one important difference. The bodily injury liability is usually divided into two separate coverages: (1) bodily liability for passengers, and (2) bodily injury liability excluding passengers. Some contracts cover bodily injury to passengers, bodily injury excluding passengers, and property damage liability with a single limit to cover all three exposures.

Often insurers offer what is known as “voluntary settlement coverage” in conjunction with aircraft liability insurance. This extra coverage is written on a per-seat basis, and provides a specified sum for loss of life or certain debilitating injuries. The voluntary settlement coverage is offered to the heirs of those who die in exchange for a release of liability. If the heirs refuse to sign the liability release, the voluntary offer is withdrawn and the heirs must bring suit against the airline to seek compensation.

We understand that both American Airlines and United Airlines have coverage for $1.5 billion per event. With four aircraft events, the total insurance coverage limits would be approximately $6 billion. This risk is shared by a number of large insurers. The amounts actually paid by insurers under this coverage may be affected by provisions in the Air Transportation Safety and System Stabilization Act just passed by Congress. As we understand it, the Act limits the liability exposure of the airlines to claims by passengers and employees only.

The second aviation exposure is coverage for damage or destruction of the aircraft itself. This is known as hull coverage. Hull coverage comes in two basic forms. The broader hull insurance provides coverage for many perils, both on the ground and in flight. The more limited form of hull insurance covers limited in-flight damages caused by fire, lightning and explosion, but excluding crash or collision. We believe that American and United had the broad hull coverage. The cost to replace a Boeing 757-300 is $89.5 million, and the cost to replace a Boeing 767-300ER is $127.5 million. Thus, the hull insurance claims should be settled for approximately $434 million.

Act of War Exclusions

Questions have been raised as to whether insurers or reinsurers might deny coverage by asserting "act of war" exclusions that may be included in some insurance policies. State insurance regulators are also concerned about this issue, and will be monitoring the situation closely. Here again, we are very pleased by the responses we have been receiving from our domestic industry leaders who have told us companies will not invoke war exclusions, and that they will fulfill their obligations to policyholders. So far, we are unaware of any insurance or reinsurance company taking the position that it will raise this exclusion as a basis to deny paying claims; however, we will be watching non-U.S. insurers very closely on this point, particularly with respect to the global reinsurance community.

Despite the comments made by President Bush, who at times has referred to the September 11^{th} attacks as "acts of war," courts in the United States appear to be consistent in distinguishing between true acts of war and terrorism. The United States generally regards terrorists as criminals, not soldiers, and therefore makes them subject to this country's criminal laws and justice system.

State insurance regulators will be watching closely to see if insurers try to invoke the act of war exclusion. Most states have laws that govern the handling and processing of claims (these are often referred to as unfair claims settlement laws). These laws provide state regulators with authority to supervise an insurer's claims settlement practices to assure they are fair.

Reinsurance

Like other commercial insurance, the business risks associated with the September 11th terrorist attacks are shared throughout the world by way of reinsurance. In the United States, the solvency and conduct of reinsurance companies licensed here are subject to same level of financial regulation as the primary insurance companies that issue policies to customers. However, regulators leave it to the managers of primary insurance companies to arrange and maintain adequate reinsurance coverage for their companies, subject to state supervision and solvency requirements that apply to primary insurers. Approximately 40 percent of the reinsurance covering American insurers is placed with reinsurers located in other countries. When supervising reinsurance arrangements, state regulators generally strive to balance the availability of adequate amounts of reinsurance protection for United States insurers against the ability to recover payments from reinsurers outside the United States.

State regulators use the following approaches to supervise reinsurance transactions:

- Statutory accounting rules and annual statement reporting requirements are designed to give regulators sufficient information to maintain effective oversight and control over an insurer's reinsurance arrangements, and
- State Credit for Reinsurance laws and regulations are designed to ensure that primary insurers transferring risks to other insurers place their reinsurance

protection with financially-sound reinsurers that are under regulatory control in the United States, or, in the case of non-U.S. reinsurers, to make sure the obligations of such reinsurers are properly collateralized with trust accounts maintained in the United States.

In general, state regulators can supervise reinsurance by deciding whether or not to allow a primary insurer to take credit on its financial statements for reinsurance recoveries due from reinsurers. In order to receive credit for these recoveries, the gross liabilities transferred to a reinsurer in another country must be funded using United States trust funds or letters of credit.

Additionally, an insolvency clause must be included in every reinsurance agreement. This clause states that payments from a reinsurer must be made in full in the event of an insolvency of the primary insurer. If an offshore reinsurer is unable or unwilling to pay claims, the primary company has the ability to draw down those trust funds held in the United States. In the event of insufficient trust funds, the primary insurer could be liable for those claims.

As a practical business matter, a reinsurer denying claims based upon certain definitions or exclusions would be causing irreparable harm to its reputation. Thus, a reinsurer that chooses to invoke a war or terrorism exclusion to deny reinsurance claims faces the likelihood that primary insurers would bring suit or choose not to do business with the reinsurer in the future.

State regulators receive detailed financial statements that are put into a database and include specific information concerning reinsurance business that has been transferred to reinsurers. The NAIC's Reinsurance Task Force is currently analyzing the database to:

- Reconcile liabilities transferred to Lloyd's of London syndicates with the syndicate's trust fund balance; and

- Summarize the extent of reinsurance coverage for each primary company identified as having possible exposures to losses in the life and health lines of business in New York, New Jersey, and Connecticut, and in the property and casualty lines of business in New York.

The United States Insurance Industry is Financially Strong

The United States insurance industry is recognized by many financial rating agencies, institutional investors and economists as one the strongest in the global economy. The property/casualty and life/health industries boast nearly $3 trillion in invested assets. Much of these investments are in marketable securities, such as government and corporate bonds, publicly traded stocks and commercial paper, which are secure and carry a low degree of liquidity risk. As a measure of solvency, the insurance industry provides policyholders with a capital cushion of more than $550 billion to absorb unexpected downturns in the financial markets and adverse loss experience on its policies. An industry loss of $20 to $30 billion represents less than 6% of this capital cushion.

In terms of premium volume, the property/casualty and life/health industries produced over $300 billion and $700 billion, respectively, in the year 2000. Claims under all forms of property/casualty policies totaled $250 billion in 2000, while death benefits and contractual benefits under life and health policies reached $540 billion. Again, an industry loss of $20 to $30 billion would represent only 3% of industry premiums and less than 4% of total claims in the year 2000. By all measures of financial strength, the insurance industry was sound prior to September 11, 2001, and will remain so in the months and years to come.

We all recognize that the insurance system cannot withstand multiple hits on the scale caused by this terrible tragedy. We hope Congress will do its part to help state insurance regulators assure that adequate financial resources will be available to back the risks associated with terrorism in our economy as America recovers from this crisis and looks to the future.

Monitoring and Supervising Insurer Solvency

The state insurance regulatory system provides an extensive and comprehensive framework for ensuring that policyholder premium dollars are invested prudently and that insurers maintain an appropriate level of additional capital to support those risks which are inherent in the insurance business. In this regard, each state prescribes specific guidelines for insurers' investment holdings and related activities. Investment requirements typically specify the type, credit quality, and limitations of investments to ensure appropriate diversification and preservation of principal. Additionally, the NAIC risk-based capital formulas encourage insurers to invest in high quality issuers and in security issues that provide for appropriate diversification and liquidity. This is generally accomplished by requiring greater amounts of capital be held as the default rate or liquidity risk of a security or investment increases.

As with other financial institutions, periodic fluctuations in market interest rates and security prices affect an insurance company's balance sheet. Identifying and managing interest rate and investment risks, such as credit and market risks, is a core function of any insurance company's operation. Part of this process is keeping an eye on the equity portfolios of insurers. Insurance companies and regulators devote considerable time and resources to manage and regulate these risks, respectively.

Insurance company managers account for external factors by instituting specific policies and practices to help ensure necessary cash flows for claims payments and other benefits through future premium in-flows, as well as interest and dividend receipts under different economic scenarios. Larger insurance groups often employ dynamic financial analysis and purchase derivative instruments to better manage their investment holdings in relation to present and future liabilities. Regulators supervise these risks through actuarial requirements, on-site examinations, and on-going assessments of an insurer's investment policies and internal controls as they relate to the management of asset cash in-flows relative to liability cash out-flows. These risks are further regulated through conservative accounting treatments and extensive disclosures. For example, insurers report bond holdings either at amortized book value or at market value depending on the credit rating of the issuing entity (i.e., below investment grade bonds reported at market value).

An insurer's liabilities under policies and contracts are also recognized on a conservative basis, by requiring that all future liabilities be accounted for in the current period, on an undiscounted basis. Insurers share their underwriting risk with other insurers, known as reinsurers, to further manage the extent of severe policy losses. Under this sharing arrangement, insurance regulators regularly scrutinize the quality of the reinsurer involved, and often require these shared liabilities to be collateralized through trust agreements or letters of credit issued by United States financial institutions.

State Guaranty Funds Protect Consumers

Because the insurance industry is part of the larger United States capital market system that encourages competition, occasional insurer failures will occur. We must recognize the possibility that the events of September 11th could cause an insurer to fail. However, insurance regulators work hard to mitigate failures by identifying insurers operating in an unsound manner as early as possible, through on-going financial reporting, financial analysis, and on-site financial/actuarial examinations. These procedures focus heavily on an insurer's compliance with state investment, reinsurance, and actuarial laws and regulations, as well as compliance with statutory accounting and reporting requirements.

In circumstances where an insurer is unable to meet its claims obligations, the various state guaranty funds provide the necessary funds. These funds are raised through proportional assessments against all licensed insurers operating within a state. State guaranty funds operate on post-funded basis, as opposed to pre-funded basis, such as the Federal Deposit Insurance Corporation (FDIC). When a state court declares an insurer to be insolvent, all states in which the insurer was licensed will activate their respective guaranty funds to make-up the capital shortfall. Based on year 2000 direct premium writings by all insurers, and accounting for the funding requirements of existing insolvencies, the industry presently has a guaranty fund capacity of more than $10 billion.

NAIC Actions in Response to the September 11th Tragedies

Following the tragic events of September 11, 2001, the NAIC quickly moved to understand the magnitude of these events upon the global insurance industry, and in particular upon those insurers that wrote a substantial amount of business in New York, New Jersey, and Connecticut. On September 13, 2001, the NAIC distributed reports to state insurance departments detailing all insurers writing property/casualty business in the State of New York, and life and health policies in New York, New Jersey and Connecticut. In addition to providing premium information, the NAIC reports contained information on insurer stock holdings. The NAIC and state regulators were also in contact with the Treasury Department, federal regulators, White House staff, and industry leaders.

During the week of September 16, 2001, the NAIC convened special conference calls for three of our key response groups – the Financial Analysis Working Group, the International Insurers Department (IID) Plan of Operation Review Group, and the Reinsurance Task Force – to begin organizing the NAIC's efforts for monitoring the impact of the terrorist attacks on the global insurance industry.

The Financial Analysis Working Group monitors the financial condition of approximately 1,350 U.S. insurers and reinsurers. The IID Plan of Operation Review Group is charged with setting policy for qualifying non-U.S. insurers desiring to conduct business in the U.S. surplus lines market, many of which are Lloyd's of London syndicates. The Reinsurance Task Force is charge with monitoring all issues relating to U.S. reinsurance transactions.

A general action plan arose from these conference calls, which was adopted unanimously by the NAIC membership on September 24, 2001.

The NAIC's Action Agenda

NAIC Action Plan to Assess the Financial Impact on the U.S. Insurance and Reinsurance Industries, International Insurers, and Reinsurers and Lloyd's of London Syndicates:

Purpose:

- To develop a collective assessment of the financial impact on the global insurance industry, based on first hand information from insurers, reinsurers, and Lloyd's syndicates. The assessment will focus on the potential impact upon the solvency of these entities.
- To form a consistent and comprehensive message regarding state oversight of the insurance industry in response to the tragedy of September 11, 2001.
- To identify legal, financial, policyholder and claimant issues stemming from the tragedies.
- To identify insurers that may require regulatory surveillance or intervention.

Scope:

The scope of this project will be limited to those insurers, reinsurers and Lloyd's syndicates with material exposure to claims arising from the terrorist attacks. In particular, the Financial Analysis Working Group will address roughly 50 U.S. insurance groups, comprising 275 companies, which account for a substantial part of the affected insurance markets in New York, New Jersey and Connecticut. With respect to the U.S. and international reinsurance industries and Lloyd's syndicates, the IID Plan of Operation (C) Review Group and the Reinsurance

Task Force will jointly look at approximately 30 global reinsurance groups, up to 35 further companies, and 90 syndicates.

Specific Activities and Current Status:

- Identify all insurance companies with business operations in the Wall Street District, in particular the World Trade Center Towers and buildings 5 and 7. Assess impact on those insurers with substantial "back-office" operations.

  Status: Insurers Identified. Assessment underway.

- Identify all life/health insurers writing business in the states of New York, New Jersey and Connecticut, as well as property/casualty insurers in New York. Compute each insurer's New York, New Jersey, and Connecticut books of business to total business. Breakdown premium writings by line of business. In conjunction with these reports, indicate each company's exposure to further decline in the equities market. Obtain company contact information.

  Status: Completed and Distributed to All States.

- Associate all insurers identified with parent, affiliate and subsidiary insurers.

  Status: Completed and Distributed to All States.

- Identify insurance groups and insurers with potentially heavy loss exposures.

  Status: Based on a market share analysis, 50 insurance groups were selected. The market shares of these groups range from 75 to 85% of total premium, depending on the line of business involved.

- Design a limited survey to capture information on each insurer's net and gross estimated losses, as well as general information on the insurer's reinsurance program, reinsurers, and anticipated cash flow needs.

  Status: Discussed on Friday, September 20, 2001, conference call.

- For efficiency reasons, assign each group or insurer a "survey state" to facilitate the completion of the survey. The survey state will be a member of the Financial Analysis Working Group, and survey results will be shared with interested states. From the 50 groups, there are roughly 15 states with key regulatory interests. The states of Connecticut and Indiana will be added to the Financial Analysis Working Group because of certain large insurance groups. Collect survey responses electronically, using e-mail.

  Status: Discussed on Friday, September 20, 2001, conference call.

- IID Plan of Operation Review Group and the Reinsurance Task Force will work jointly in assessing the impact on the global reinsurance industry, international insurance companies, and Lloyd's syndicates.

  Status: The groups met on September 18, 2001, and discussed general reinsurance issues stemming from the September 11 events. NAIC staff, following the plan of the Financial Analysis Working Group, is identifying key reinsurers (companies and syndicates) providing coverage to the top 50 groups described above. The joint groups will also consider a survey form, including the appropriate questions and approach for obtaining information (i.e., through foreign regulatory offices or through direct contact with reinsurers).

- Review the 9/30/01 SEC 10Q filings of pre-identified publicly held groups with insurance or reinsurance operations and report to appropriate NAIC groups.

Review subsequent filings as considered appropriate, based on the completed work of the Financial Analysis Working Group. Monitor SEC 8K filings of such insurers, as well.

Status: Filings due the SEC by November 15th.

Ongoing Evaluation of Insurer Disaster Recovery Plans

State insurance regulators regularly visit insurers to conduct financial and market conduct examinations. During these examinations, one of the items that is reviewed is contingency planning of insurers, including the insurer's plans to restore its operations in the event of a disaster. In this evaluation insurance regulators typically look at a variety of items including, but not limited to the following:

- Evaluation of insurer data processing disaster recovery plans;
- Assuring that the insurer keeps copies of its plan off-site;
- Review of the insurer's identification of mission critical data processing applications;
- Evaluation of the insurer's off-site storage and back-up of critical data files and applications;
- Evaluation of telecommunications disaster recovery plans;
- Evaluation of whether insurer has negotiated the use of either a hot or cold site in the event of a disaster and of contracts with vendors that are involved in the restoration process;
- Determination of whether the insurer uses an uninterruptible power supply;
- Determination of the adequacy of the insurer's periodic disaster recovery testing;
- Determination of whether the insurer has developed a manual processing plan that can be used until their computer data center is restored; and
- Determination of whether the insurer's data center has proper fire protection and moisture sensors.

State Insurance Department Disaster Response Activity

State insurance departments are coordinating their disaster response activities to handle the impact of the September 11 terrorist attacks on America's insurance system. NAIC is assisting in this effort, which is made easier because most state insurance laws are based upon the same NAIC models. For example, unfair claims settlement practices laws are based on common standards of fair and equitable treatment for insurance claimants.

This approach worked well in Florida with Hurricane Andrew. Five months after Hurricane Andrew tore through Dade and Broward Counties, volunteers from insurance departments throughout the country were still helping the Florida Insurance Department's staff. Today, insurance departments in states close to New York, Virginia, and the District of Columbia have already offered their resources and staff as needed. The Oklahoma Insurance Department has shared relevant documents regarding its handling of the Oklahoma City bombing in 1995. These documents include issues such as limitations and exclusions in insurance policies, death certificates, handling of claims, and the recovery service center. In addition, personnel from other state insurance departments have volunteered to travel and do whatever is needed to help regulators and the insurance industry get through this crisis.

The New York Insurance Department itself has one of the best disaster response plans, and New Yorkers are benefiting from its implementation. The NAIC's own Emergency Response and Business Continuation Plan, recently revamped to address Y2K concerns, has proved the value of pre-disaster planning. The NAIC plan was put into use to coordinate the safe evacuation, relocation, and continuation of business in its Federal & International Relations Office in Washington and in its New York City Securities Valuation Office (SVO), which had been located in the now-collapsed Seven World Trade Center.

NAIC staff is working with all its members, federal regulators, and Congress to provide information and assistance as quickly as it becomes available. As unimaginable as these terrorists' attacks may have seemed a few weeks ago, regulatory contingency plans and procedures were already in place that enabled the resumption of normal operations this week.

The NAIC's Model State Disaster Response Plan

The Disaster Response Plan Subgroup of the Catastrophe Insurance Working Group is in the process of updating the NAIC model *State Disaster Response Plan* originally developed in 1996. Its primary objectives are to improve model systems and procedures for coordinating the immediate rescue and relocation of people and business, as well as the assessment of catastrophic loss with insurers, state emergency management agencies, other state agencies, FEMA, and victims' assistance organizations like the Red Cross. The goal is to draw on the best insurance department practices in place in states such as California, Florida, Oklahoma, and Texas where major disasters have occurred or happen more frequently. We aim to incorporate these concepts into an easily accessible reference guide for every state to use whether the disaster is caused by nature or other forces.

The subgroup and its parent Catastrophe Insurance Working Group have established working relationships with state emergency managers, FEMA, the Institute of Business and Home Safety, and the Western States Seismic Council, to name a few. The input of these organizations has been most useful in revising the NAIC's plan. Their expertise on disaster mitigation and recovery is important to insurance regulators who, after a catastrophe, may often be the first line of communication for policyholders having questions or problems with insurance policies or claims. We have also met with natural hazard experts, structural engineers, transportation managers, geographers, geologists, seismologists, and emergency management experts.

NAIC members are looking hard at alternative methods of funding catastrophic risk and accounting for insurer catastrophe reserves. We are working on recommendations for a tax-deferred catastrophe reserve plan, and studying catastrophe modeling and its impact upon catastrophe insurance rates.

Improvements to the NAIC's model disaster response plan include enhancing communication through technological advances in telecommunication services. They also include streamlining the process for emergency licensing of claims adjusters from other states, and allowing claims adjusters to have emergency access to disaster areas to assess damage more quickly. There are recommendations for organizing and staffing department "command posts" and communication networks, both internally and with other state agencies, insurers, consumers and the media. A model for establishing consumer assistance hotlines and use of volunteer resources are also made available.

A claims mediation program modeled after the Oklahoma Insurance Department's "Ending Arguments Gently, Legally and Effectively, (E.A.G.L.E) Program" is also being added to the NAIC's Disaster Response Plan. The Oklahoma Department created this program following the 1999 tornado disaster. The E.A.G.L.E. program uses mediators trained by the Oklahoma Supreme Court to help unhappy consumers and insurance companies work toward an agreement that puts their conflict to rest. The goal is to get disputes resolved before they get out of control, and before the parties have abandoned disputed issues to their respective attorneys. It has been highly praised as an efficient mechanism for resolving claims disputes between policyholders and companies.

The NAIC model plan, as drafted, contains model forms and instructions for regulators to use when asking insurers for special reports of damage estimates from catastrophes. These forms were developed with a great deal of input from the insurance industry. This collaborative effort has helped ensure that meaningful data will be obtained and reported in a timely and efficient manner – without additional costs to industry.

What Can Congress Do to Help?

There is a tendency in the insurance industry to react to traumatic events such as the September 11th disasters by taking steps to limit exposure for similar events in the future. This can occur through introducing coverage exclusions or canceling policies most likely to cause a future loss. If that happens, it will not be good for the American economy.

We believe there are two things that Congress can do to assist:

- We know the insurance industry cannot withstand multiple events of this magnitude without harm to all consumers. For this reason, we encourage Congress to look at proposals to form a terrorism reinsurance pool so that risk of loss from terrorist activities can be spread as broadly as possible.
- Congress should maintain close oversight of all participants – both foreign and domestic – who must work through this tragedy together in order to make sure the chain of insurance and reinsurance protecting American citizens does not falter or fail in meeting its responsibilities.

Conclusion

At this time, insurance regulators believe the insurance industry is strong, and that it stands ready to meet its obligations to provide funds where due under the contracts it has issued. State insurance regulators are working together to help assure that any glitches which occur do not disrupt the process of getting people's lives back in order and America's businesses back to work. The NAIC and its members plan to work closely with Congress and fellow regulators, as set forth in the Gramm-Leach-Bliley Act, so that the needs of Americans are met in a timely and compassionate way.