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THE CHALLENGES OF SEPTEMBER 11TH TEST THE RESOURCES AND RESOLVE OF INSURANCE, BUSINESS AND GOVERNMENTS COMMUNITIES WORLDWIDE

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I. INTRODUCTION.

The horrific consequences of September 11th have directly impacted insurance establishments worldwide. Coverage demands for the losses flowing from that event call upon: Personal Lines -- life, accident, health, and workers' compensation insurance; Property Lines --first party property (fire, and like losses), business interruption, and physical damage automobile insurance; and Casualty Lines -- various forms of third party liability insurance held by individuals (home and auto), airlines, building owners, other business entities and local, state and Federal Governmental agencies. All of these Lines responded to what many argue was a single act that took over 3,000 lives, devastated four to five times that number of other lives, and resulted in catastrophic commercial losses. Many highly regarded analysts currently estimate that, if quantified in terms of dollars (as opposed to the very real misery, suffering and harm that is at the core of this event) the loss will eventually amount to approximately $50 billion.

Each of the aforesaid Lines of insurance will cover a significant amount of that loss. With rare exception, the Property/Casualty Lines are not invoking act of war exclusions. These carriers and the Personal Lines (who do not have act of war exclusions) are trying to do what insurance companies have done historically -- to protect, to make secure, and to help turn fear, anger and loss into resolve and hope. Direct insurers, those who actually handle the claims and deal with claimants and policyholders, will pay about one-third of the total loss, while most re-insurers will pay two-thirds.[1] However, some re-insurers are threatening to dispute coverage based on war risk exclusions.

[1] Re-insurers "cover" direct insurer's by repaying them a significant portion (generally 60 to 80%) of their indemnity losses, under either an individual policy (facultative cover) or group of policies (treaty cover). Re-insurers are themselves covered by retrocessionaires. Retrocessionaires lay off some of their risk to yet other insurance groups. Generally these post-direct market carriers charge their "insureds" a percentage of the premium collected by the latter from their policyholders for this cover.

September 11th losses are being paid by specific types of insurance as follows: (1) workers' compensation carriers will cover approximately $5 billion; (2) life carriers will cover approximately $6 billion; (3) Property Lines will pay about $12 billion; and (4) Casualty Lines will pay between $18 and 20 billion. Target defendants for third party casualty claims include building owners, lessors, airlines, and local, state and federal government agencies that provided protection and rescue services. Many of the carriers responding to September 11th are domestic, yet, of that loss, 60% will be covered by carriers whose principle place of business is outside of the United States.

In a companion paper from this panel, James L. Seal, Esq., of Berkes Crane Robinson & Seal, LLP in Los Angeles, California, discusses the availability of insurance coverage for terrorist-related losses under policies which currently exist and the inadequacy of policy provisions, as presently drafted, to focus on the types of terrorist-related risks which insurers may now wish to limit or exclude. Traditionally, life, workers' compensation and first party (at least fire coverage) insurance does and must respond to any act of terrorism. Even acts of nuclear, chemical or biological terrorism are not excluded from most Personal Lines. This is because these are traditionally "all risk" as opposed to "specific peril" covers. Likewise, Casualty Lines generally use "all risk" forms (except for E&O, D&O, and personal injury covers) and these carriers are liable for terrorist losses unless they fall within the definition of a war risk or other applicable exclusion or condition.[2] In the United States, insurance companies are regulated separately in each state, the District of Columbia and Puerto Rico (the "52 jurisdictions"), rather than on a national or federal basis. Therefore, there are some anomalies in the foregoing, but not in the industrial states or the major centers of commerce.

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[2] See the discussion on the currently proposed ISO terrorism exclusion for Property, and Casualty Lines in Part II. D. below.

To put the impact of the $50 billion loss of September 11th into perspective, the Pan Am jet that exploded over Lockerbie, Scotland in December 1988 killed 270 people and resulted in an insured loss of approximately $138 million. The destruction of the Federal Building in Oklahoma City in April 1995 killed 168 people, injured 487, and resulted in an insured loss of $145 million. Hurricane Andrew resulted in $19-22 billion in insured losses in 1992. It is estimated that Andrew's losses equaled 6.3% of the total 1992 U.S. insurance surplus for *all* Lines. Assuming a current U. S. a $300 billion insurance surplus for all Lines, the consensus loss of $50 billion would amount to approximately 16% of that amount. Note, however, that the Property and Casualty Lines that cover about 60% of the total loss, ($30 billion), account for only one third of that surplus ($100 billion). This specific loss is equal to 30% of that *segregated* portion of the surplus. To that equation must be added about $125 billion in re-insurance surplus. Thus, at the end of the day, the direct Property/Casualty market *and* its re-insurers will pay 13% of their *combined* surplus. This puts into graphic relief the impact on direct insurers of any loss of re-insurance cover.

Although September 11th is the worst single disaster to befall the insurance establishment in history, it was able to and did fairly respond to the loss and continues to do so. Nevertheless, the response of the direct insurance establishment, including its decision not to assert its war risk exclusions, was not without criticism when it evoked classic defenses, such as disputing assertions by insureds of multiple occurrences (and hence multiple per occurrence limits) for the World Trade Center damages and strict application of loss definitions. What is beyond debate is that several more significant events, or even one event with losses greater than those of September 11th will present a demand on the insurance establishment in general and on individual carriers in particular that they cannot meet alone.

II. SEPTEMBER 11TH ALTERED THE FUTURE COURSES OF INSURANCE ESTABLISHMENTS, BUSINESS COMMUNITIES AND GOVERNMENTS WORLDWIDE.

A. The Response of the Insurance Establishment.

While direct primary, umbrella and excess carriers from all Lines responded admirably to the September 11th losses, they have now had to reconsider their future options in light of their $300 billion surplus. Questions of capacity for these losses are real and not easily answered. A number of government and private entities in the U.S. analyze and regulate the insurance establishment both directly and indirectly. Regulatory agencies in 52 U.S. jurisdictions, together with the National Association of Insurance Commissioners (NAIC), private sector rating and creditworthiness services, bank analysts and insurance professionals, all serve as insurance establishment "watchdogs." The foregoing entities have been monitoring direct insurance carriers' abilities to withstand present and future losses, while at the same time analyzing the coverage limits available in this market, the re-insurance market and the retrocessionaires market. The consensus judgment is that few carriers can stay solvent, let alone have sufficient cash, if called upon to respond fully but alone to all future terrorist caused losses. Market pressures already at play have served to put some companies on a negative rating watch or on a credit watch because of their September 11th payments and like future risks.

A great deal of cash had to be marshaled from the private sector to respond to these losses and numerous liquidity and solvency issues have been raised. For example, foreign insurers and re-insurers provide security for their losses in the United States by letter of credit, single or multi-beneficiary trusts or other forms of guarantees of coverage. Demands have been made on a number of foreign carriers, including London market insurers, to increase their contributions to these security mechanisms. Different foreign insurers and re-insurers have their security accounts in various of the 52 jurisdictions. One of the major controversies has been disparate treatment in these jurisdictions as regards the funding requirements of these security

mechanisms. The rush for security has served to create instability in the market because of charges of unfair competition by those carriers required to fund their September 11th losses faster or by a greater "security percentage" than others.

One of the key factors in this "solvency" debate is the refusal of many re-insurers to "follow the fortunes" of their policyholders (the direct insurance market). Many re-insurers are invoking or adding new risk of war and terrorism exclusions in their policies. The direct market has not invoked these bars to coverage and their "fortunes" now include responding to those claims. As re-insurance claims have found their way though the traditional processes and as renewals of re-insurance have come up for negotiation, the "exclusion" debate has brought added instability to the insurance markets worldwide. All of these circumstances have led to attempts to exclude terrorism from coverage in the direct market, at least until such time as this risk can be comprehended and undertaken again. (See discussion in Part II. D., below.)

In broad terms, insurance underwriting relies on measurements of the frequency and magnitude of losses using various statistical and record keeping methodologies. Carriers then calculate risks, assign premiums, and issue policies. However, there is no direct way currently to test or quantify the frequency or magnitude of future terrorist events. If the insurance establishment cannot rate a loss, it is very difficult to cover it, unless very specific language, liability limits and like safeguards can be put in place while the risk is quantified. Consequently, most of the direct insurance market is trying to withdraw terrorist cover by seeking specific exclusion for it until the current uncertainties can be resolved. This withdrawal process is complex because of the differing regulatory rules, legal requirements and administrative procedures in the 52 jurisdictions. For example, by law, terrorism losses cannot currently be excluded from workers' compensation, life or fire covers. There must be consent from each of the 52 jurisdictions in order for a carrier to withdraw or limit its coverage for those risks.

Moreover, insurance premiums in general must increase significantly to cover current and future terrorist losses. This is true because there is not now, and there probably will not be, a separate terrorist cover pricing mechanism that can succeed in general as opposed to special markets. Premium increases are now occurring in the context of an already "stiffening" market. That process began about a year before September 11th and served to significantly raise pricing for the first time in over 10 years. Since September 11th, depending on the Line of coverage, and *in the absence* of any terrorist exclusions, premiums have increased, anywhere from 10 to 20% or up to 200%, depending on the Line and the perceived terrorist risk. The few carriers who are today continuing to write terrorism cover, without recourse to newly proposed exclusions or limitations (see Part II. B., below), can only do so in limited markets. Thus, to the extent that coverage is being offered, it is available to only the few who have quantifiable terrorism risks and great financial resources.

At the same time the direct market is attempting to respond in a context of state regulation, the re-insurance market, free from those constraints, has signaled that it will, in large measure, apply terrorism exclusions to most existing cover and to all of its new policies and/or invoke war risk exclusions across the board. Without re-insurance, the direct market has to exclude this risk, obtain enough premium to protect solvency or "go bare." Classic market dynamics are driving this issue. As the parties continue to work their way through this impasse, there nevertheless appears to be no private market solution to this problem in the foreseeable future.

As noted above, there are segments of the market that are not facing the "exclusion question" just yet. Depending on the capacity of the insurer, the position of its re-insurers, and the potential to limit the risk either geographically or by line of business, some terrorism cover is still available at market driven premiums. (Up to 200% more than before September 11th). (See Part II. D., below.) Where this insurance is made available, carriers are increasing deductibles and lowering limits for this risk. This new reality is driven in part by the selective responses of re-insurers in

determining which policies with terrorist loss risk they will cover. Typically re-insurance contract renewals tend to be clustered around January and July, whereas the direct insurance market renews policies on any day of a given month throughout the year, usually depending on the date the business covered started or the date the insured first bought a policy from their carrier. Given all these circumstances, the risk has increased, premiums are going up, the availability of re-insurance is unclear, and continued or new terrorism coverage is rare.

B. The Insurance Establishment Considers Limits to and Exclusions For Terrorism Cover.

The Insurance Services Offices ("ISO") was, for nearly 75 years, an association of insurance companies that marshaled considerable resources to determine and propose premium rates and then to draft standard policy provisions to provide profitable cover at those rates. ISO is now an independent entity which, nevertheless, can act on behalf of Property and Casualty Lines to suggest a comprehensive approach to terrorism coverage in the 52 regulatory jurisdictions. Over the past several months, ISO drafted and presented a "terrorism exclusion" for Property and Casualty Lines in each of these jurisdictions. Currently, all but five jurisdictions have accepted the proposed exclusion as *an interim measure*. In the remaining five, the relevant regulatory agencies have either denied use of the exclusion or suggested revisions in language pending approval.

The stated reason for presenting and adopting the ISO exclusion was to protect insurer solvency while the current debate over the future of this cover plays out. The exclusion actually serves to limit as well as exclude coverage which individual companies must now, by law, provide, even without re-insurance. Under ISO's theory, carriers could provide the limited level of coverage in the exclusion without re-insurance until such time as that issue is solved. It is contemplated that the exclusion could be withdrawn and limits raised if the U.S. Government becomes involved in "back-stopping" private sector terrorism insurance; thereby assuming the part of the

loss that would otherwise risk insolvencies in the market. Thus, there is a debate as to whether there should be a "sunset clause" that ends the exclusion if there ever is governmental "back-stop" coverage. At this juncture, only California, Florida, Georgia, New York and Texas have not finalized their response to the exclusion. However, these states account for 35% or more of the total current U.S. insurance market.

Under the ISO exclusion, if a given terrorist attack (however that is ultimately defined) results in a total loss of $25 million *or less*, Property and Casualty Lines will cover the loss. If a given loss *exceeds* $25 million, there will be no coverage, not even the for the first $25 million. There are specific rules which govern calculation of the $25 million limit that use time, geographic area and loss definitions. Every terrorist loss covered in an all risk policy with this exclusion will contribute to the $25 million limit[3]. The exclusion defines multiple acts that are coordinated or carried out "in concert" as one event. The $25 million cap applies to one event. Splitting one event into two or more acts would permit multiple $25 million "payments." The exclusion serves to limit, not expand coverage. For example, there currently is a debate as to whether September 11th was a one, two or multiple-event loss; i.e., should separate limits apply to all losses flowing from each of the three buildings and from the plane lost in Philadelphia or are all these acts one event?

There is an alternative "limitation" in the exclusion that provides that if a terrorist event causes death or serious physical injury to 50 *or* fewer persons, the policies will cover those losses. However, if *more than* 50 persons are involved, there is no cover, not even for the first 50 claimants. This is true even if the total of all damage is $25 million *or less*. The breadth of the ISO exclusion's definition of a terrorist act and the provision for either *up to only a $25 million/50 person loss or no coverage at all* are still the subject of much debate. As yet un-addressed is the question of such an exclusion being added to Personal Lines.

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[3] All risk Casualty/Property policies are currently subject to exclusions for war and nuclear, biological or chemical losses caused by terrorism. The ISO exclusion does not add back cover for these losses.

It is clear that there has to be some protection for insurance companies while this risk is assessed and the current disputes between the direct and re-insurance markets play out. Nevertheless, even at a $25 million or less level, if one entire loss is borne by a single insurer, it could still threaten its solvency (depending on its premium base and surplus). In the absence of re-insurance, approximately 44% of the Property/ Casualty insurance companies operating in the United States could very well have financial problems if paying a single $25 million loss. The obvious solution to this dilemma is to permit each company to limit its exposure based on its own unique surplus and premium base. However, in the current 52 jurisdiction regulatory system, such customizing is difficult and time consuming to present and approvals would probably be slow. Moreover, there would be insufficient cover under the ISO plan for most insureds who realistically face this threat. Meanwhile, a carrier has the choice of continuing to write this cover and living with its current exposure or of withdrawing from the market. Neither of these solutions is acceptable, let alone attractive. Neither of these solutions further the goal of a market driven specific peril insurance program to protect against the risk of terrorism.

To put the crisis in terrorism coverage in context, in any given year the Property and Casualty insurers in the U.S. collect approximately $300-400 billion in premiums. The current Property/Casualty surplus in the U.S. in about $100 billion of the total $300 billion for all Lines. Yet, the total possible loss that they protect has been estimated to amount to over $5 trillion in replacement value and another $5 trillion in inventory, equipment and software on the Property side, not to mention the untold value of the lives of more than 250 million people.

Certain policyholders in each jurisdiction (the so-called larger or sophisticated buyers of insurance) are exempted from state regulations governing the terms of their insurance contracts. If qualifying for the sophistication or size exemption, a policyholder can simply renew its insurance with or without terrorism coverage and the regulators cannot affect that decision. Sometimes the contracts between these

parties are referred to as manuscript policies. Nevertheless, the language in these "custom contracts" often reflects, relies on or outright borrows from the ISO standard provisions in the regulated contracts.

C. The Impact on the Business Community.

Following September 11th, the Olympic Games Committee in Salt Lake City was able to secure coverage, but not in amounts previously available. Their general premiums were also considerably higher than anticipated. All commercial property owners and businesses are now facing higher premiums, even though in many cases their policies soon will reduce or exclude terrorism coverage. This phenomenon has a direct and adverse impact on the nation's economy. For example, owners of large groups of buildings in major metropolitan centers can have a total risk of $100 million to $1 billion. Prior to September 11th, a loss caused by terrorism would be covered under various Lines of coverage held by these owners. Today, those owners could, in large part, only obtain $25 million of coverage, if it is to be available at all under the ISO exclusion. Those who can obtain more coverage can do so only at premium rates which, overall, are up. Otherwise, these owners must "go bare."

To the extent that banks still are backing loans on business and properties, they cannot obtain the previously guaranteed levels of insurance. Are banks to call their loans or, like the building owner, "go bare"? Suppose the tenants in the building are asked to absorb the premium increase. Can building owners simply pay 10%, 20%, 30% or up to 200% more than they did in the past and pass that cost on to tenants? Individuals or entities that buy shares in building loan programs have the same hard choices to make. Thus real estate and commercial lending entities are experiencing significant problems in protecting their existing properties and those difficulties are magnified tenfold for purchase or sale of real estate , for financing of businesses and for construction of large new projects.

The players in the commercial and business community are understandably concerned. They do not have the ability to allocate their risk or spread the loss on the scale that insurance companies can provide. Another terrorist attack raises the specter of bankruptcies, forced sales, loan defaults, and other losses. For example, the New York Giants have renewed their insurance coverage, but were unable to secure terrorism protection. An element of protection that historically was available to them at no cost, cannot today be bought at any price. Obviously, sports stadiums now present a unique risk that no one has yet figured out how to assume. Other sports teams likewise cannot buy the insurance. The business and commercial communities have, therefore, lobbied hard for a governmental "backstop" of terrorism insurance under a number of different proposals. Transportation, real estate, manufacturing, construction, entertainment, retail and sports businesses have formed the Coalition to Insure Against Terrorism ("CIAT"). This organization argues that neither the insurance establishment nor the private business sector alone has the capacity or even the knowledge to attempt to underwrite terrorism risks. Thus, CIAT has lobbied for a governmental role in the coverage.

D. Currently Available Insurance Cover for Future Acts of Terrorism is Limited and Expensive.

In addition to the coverage that may be available from some insurance companies under the ISO exclusion (a $25 million/50 person loss limit). Three carriers, the American Insurance Group ("AIG"), Berkshire Hathaway ("BH") and Lloyds of London (and to some extent the London Market ("London")) have attempted to offer insurance for terrorism. These are the policies discussed above whose premiums are 2, 3 or 20 times higher than previous pricing. The absence of re-insurance or government supplied "back-stop" cover is driving the premiums needed to protect the direct market higher and higher. Lloyds of London offers terrorism coverage capped at $150 million, except for the New York area where the cap is $50 million. Likewise AIG offers a $150 million cap policy priced at $15 million. More recently, AIG's price dropped to

$7.5 million, but few, if any, have bought even at that level. BH is offering coverage of up to $300 million at a premium of $600,000 *just* for terrorism coverage. However, all other BH coverages are "additional" and are rated and priced separately. Most of the businesses that have bought these covers are not discussing them publicly because of the fear of a negative impact on their "bottom line."

E. State and Federal Governments in the U.S. Have Failed to Resolve the Crisis

State legislatures in the United States have introduced bills that would require terrorism coverage across all insurance Lines. The lack of any Federal Government "back-stop" for direct or re-insurance cover has created a conflicted response within the states, with elected officials demanding coverage while state administrative officials, recognizing the current threat to carrier solvency and the lack of re-insurance, approve exclusions for the very insurance the officials demand.

For the past six months, the Federal Government has faced a wide array of lobbying efforts as well as economic and moral arguments designed to persuade it to participate in the spreading of risk and allocation of loss occasioned by the threat of terrorist acts. These same pressures are at play in state legislatures and regulatory agencies. From the perspective of the business community, it is now a Hobson's choice of paying much more in premiums for limited coverage (even if it is available) or of "going bare." United States citizens have uniformly demanded compensation for the casualties of September 11th and have sought help for them from their government, their insurance/business sectors, and private charitable institutions. The U.S. House and Senate have, therefore, been presented with many governmental insurance program solutions, have considered some of them, but ultimately have done nothing except to enact the Federal Air Transportation Safety and Stabilization Act. (See Part II. F., below.)

One proposal called for government-backed insurance and/or re-insurance pools for terrorism losses. A pool of private insurers and re-insurers would provide a first tier or "layer" of coverage funded by premiums from participating carriers. The Federal Government would act as the "back-stop" retrocessionaire to this pool. The "trigger" for government coverage would be a call on private pool assets that exceeded a stated percentage through payment of claims arising solely from acts of terrorism. A variant of this proposal created state regulated mutual re-insurance companies backed by the Federal Government acting as a retrocessionaire. These proposals were aimed at covering Personal as well as Property and Casualty losses.

The Bush Administration proposed a co-insurance program where the Federal Government would pay 80% of losses up to $20 billion and 90% of losses in excess of that amount, with an overall cap of $100 billion. In other words the government would provide $16 billion of the first $20 billion of "primary layer" cover and would contribute $72 billion in excess of $20 billion as a sort of "umbrella layer" cover. The insurance establishment would handle the first $4 billion, part of $20 billion, and the remaining $38 billion in some *pro-rata* share arrangement to be determined later. These limits are in the context of a total Personal Property and Casualty Lines surplus of $300 billion, *i.e.,* the private sector would undertake a risk of $42 billion or something less than 1/6th of its total surplus.

The current Republican administration in the U.S. is understandably hesitant to enter into the "insurance business" on a permanent basis or to place itself in competition with the private sector. In its view, any governmental insurance solution must include litigation reform, tort reform, prohibitions on punitive damages, limitations on recovery of non-economic losses, the elimination of joint and several liability, limitations on pain and suffering awards, and changes in standards of proof. There has also been considerable discussion of a Federal-based regulatory system (which would replace the 52 jurisdiction system for terrorism coverage), tax deferred insurer catastrophe reserves, and long term Federal loans to insurers to help manage

losses. All of these proposals have been openly debated, with different constituencies finding fault with most of the parts thereof. The result has been no terrorism risk governmental partnership with the insurance establishment.

Recently, Senator Tom Daschle, Democrat, South Dakota, proposed a governmental "back-stop" program that would be in place for one year and could be extended year-by-year, as appropriate, under the authority of the Secretary of the Treasury. The following were the elements of his proposal: (1) all Property Lines would cover terrorism up to a specific amount; (2) individual companies would pay up to their limits until the insurance establishment as a whole had losses totaling $10 billion in the first year or $15 billion in the second year; (3) these losses would be limited on a company basis to 7% of premium for the first year and 10% for the second year; and (4) losses above the premium driven stated limits would be paid 80% by the Federal Government and 20% by all the companies. However, this proposal died on December 21, 2001.

F. The Federal Air Transportation Safety and System Stabilization Act Limits Certain Liabilities and Provides Controversial Compensation to the Casualties of September 11th.

There are several historic examples of Federal Government insurance programs including: the Federal Housing Administration Act -- which insures mortgages; the Veterans Administration -- which does the same thing; and the Price-Anderson Act -- which provides backup coverage for nuclear facilities. Yet, the first and only "insurance" support program to date crated by the U.S. Government in response to September 11th is the Federal Air Transportation Safety and Systems Stabilization Act. Its stated goal is to protect America's air carriers, as well as certain building owners, lessors, and the City of New York from massive losses arising from expected casualty suits and business interruption damages, all of which were perceived to threaten their solvency. Subsequently, this act was amended by the Aviation and Transportation Security Act ("The Acts"). The Acts provide compensation for business

interruption damages suffered by the protected parties separate and apart from what they receive under their private insurance programs. The Acts provide up to $5 billion for direct property damages. Next, The Acts provide reimbursement for the expected increases in protected parties insurance premiums. The Acts limited third party liability to $1.5 billion per loss event. Liability of the protected parties in future terrorists events would be limited to $100 million in the aggregate, after which the government would step in up to the $1.5 billion limit per event. Punitive damages were prohibited.

The Acts also establish the "September 11th Victim Compensation Fund of 2001." ("Victim's Fund"). Although the word "victim" is prominent in our lexicon, as reflected in the title of this part of the Act , some believe, that the men, women and children who lost mothers, fathers, brothers, sisters, family members and loved ones on September 11th are "casualties" of that attack rather than "victims." Kenneth R. Feinberg is the administrator of the Victim's Fund. Initially, Feinberg proposed a grant of $250,000 for "pain and suffering" on behalf of each "victim" who had died. An additional grant of $50,000 for each spouse and each child of such a "victim" was also planned. However, from these amounts would be deducted recoveries from 401(k) retirement plans, social security benefits, workers compensation benefits, life insurance, and other collateral sources, including charitable gifts. The "victims" of September 11th believe that similar "distinctions" made by private charities were ill conceived. Many charities established rigid documentation and economic screening criteria to allocate funds based on their views of need. Charities also tried to direct their "victim" recipients to spend their "gifts" in certain ways.

There was criticism of these criteria from all quarters. Various victim "action groups" in particular coalesced to create a rather effective lobbying organization that tried to rewrite or redirect charitable criteria and the administrative regulations governing The Acts and the Victim's Fund. Of particular concern were adverse eligibility distinctions made against those who had been prudent (i.e., had savings

accounts and/or had investments). Adjusting compensation on these bases were viewed by many "victims" as demeaning and insulting. The right criteria, these advocates believe, is simply the fact of loss. No one "victim" should be considered more deserving than any other and distinctions based on prudence or economic status is, in the view of many, inappropriate. In the end, $4 to 5 billion will be spent on compensating "victims" under the Acts. Yet many members of the "victim's" community have become bitter or have a strong sense of betrayal because of the subjective judgments made by those who controlled the money the nation wanted them to receive.

After much public debate at all levels, including the White House itself, individual spouse and child awards under the Victim's Fund were increased from $50,000 to $100,000, but the $250,000 pain and suffering grant for each person killed was not increased. Many believed that this latter amount was much too low and was, in effect, "closet" tort reform. Some benefits were no longer offset. However, life insurance and certain other benefit payments continued to be offset against awards because these deductions are mandated by The Acts, rather than by the disputed administrative rules. Of the approximately 10,000 plus claimants who could seek compensation under The Acts, less than 500 have filed for benefits to date. The "claims handling" and "eligibility review" mechanisms of The Acts and of charities were created from whole cloth. These distribution systems have been extremely unwieldy, unresponsive, and ultimately frustrating as well as sometimes damaging to those they seeks to serve, though no one intended such a result. There simply was not time to create this mechanism fast enough to fairly and promptly answer the need. The lessons learned from the operations of these entities are both a cautionary tale and a wakeup call.

One of the most controversial aspects of The Acts, however, is that claimants must waive their right to proceed in classic tort litigation against the airlines, building owners and lessors, as well as the City of New York. Yet the Federal

Government has reserved its rights of subrogation with respect to the claims it pays and can seek recovery from any third party defendant. In short, all of the supposed evils of "citizen" lawsuits have been eliminated, while all of the "parallel" evils of Federal litigation against the same target groups have been preserved. There will, no doubt, be numerous lawsuits over the various elements of The Acts and the spreading of risk and allocation of loss that it has mandated, including the decision to have disputes the exclusive province of the United States District Court of the Southern District of New York. Moreover, damages awarded in that exclusive jurisdiction against aircraft carriers, related business entities and the City of New York are limited to the amount of their respective insurance coverages. These restrictions will in turn engender multiple disputes over how the limited insurance resources of these entities are to be allocated; *i.e.*, by date of claim filing, by claimant economic circumstance, by simple *per capita* or other equitable *pro-rata* sharing theories. The specter of Federal subrogation lawsuits entering in this mix raises a number of additional questions.

It bears repeating that the "victims" of September 11th were further traumatized by ambiguities and uncertainties in the administration of charitable gifts and Victim's Fund awards. They believe that too much discretion as to the amount or the elements of such awards is inappropriate. Many argue persuasively that the Federal Government has in the end protected commercial entities more than "victims."

G. Businesses May Well Compete With the Insurance Establishment to Provide Terrorism Coverage.

Since September 11th, specific commercial/business communities have sought to create captive business insurance pools backed by the Federal Government to provide terrorism coverage that would be in competition with the insurance establishment coverages now available or which soon will become available. However, a governmental/business solution to the terrorism cover problem is perceived by many to be the only way to stabilize the market.

The Acts, discussed above, protect the levels of insurance premium due from the airline industry only through March 2002. After that date, unless The Acts are extended, the airline industry will have to obtain insurance in a free market. This is a critical issue because of the increasingly high but market driven premiums that could be required of airlines by the few insurance groups (noted above in Part II. D.) that are providing such protection. In response, the airline industry, through its Air Transportation Association, has proposed creation of an industry/government pool of insurance called Equitime. Equitime would offer $1.5 billion in per event/per plane limits for passenger and aircraft losses and third party suits arising from terrorism, war *and* all other losses combined. Equitime, proposes to retain $300 million of the $1.5 billion loss per event/plane and to ask the Federal Government to re-insure the remainder. Members of the ATA and 50 members of the Regional Airline Association would capitalize Equitime through the placement of a private issue of stock. This is a business sector variant on insurance company based proposals previously in play on the Federal level that were not adopted.

Equitime combines a "primary layer" or tier of captive business sector insurance "back-stopped" by a government "umbrella layer" or tier of re-insurance. This proposal created an immediate negative reaction in some quarters. Maurice R. Greenberg, Chairman of AIG, a company that offers selective terrorism coverage at market premium prices, accused both the United States Government and the airline industry of competing improperly with private insurers for the very premium dollars needed by the insurance establishment to recover from September 11th and prepare for the next attack. Greenberg pointed out that the insurance establishment in this limited market has the capacity to offer $1 billion to $1.5 billion in coverage per plane, depending on premiums. Under The Acts, the United States Government charges an airline $750.00 per trip for coverage of up to $850 million per plane. Greenberg believes this to be a characteristically low and anti-competitive government based premium. AIG offers $1 billion per plane coverage for a little over $2.00 per passenger and

1.5 billion per plane at a market price of $2.25 per passenger (about $1.4 billion annually). Michael Yascon, a spokesman for the ATA, estimated that under the Equitime plan $400 million would be put into a pool to obtain third party liability coverage of $1.5 billion per plane. The rest of the funding would come from the government.

The price of the government based cover proposal beats this private market premium price by a significant margin. Greenberg has responded that, the United States Government should create a "back-stop" cover to support the Property and Casualty Lines generally, with direct or re-insurance protection. However, terrorism cover for the aviation industry should be exempted from such a program because these risks are quantifiable, limited, and can be insured in the private sector. The airline industry argues in response that private insurance, such as that offered by AIG, could cost it as much as 64% more than it is currently paying for the "stop-gap" Federal cover in The Acts. Before September 11th, terrorism insurance was, at no extra cost, part of the standard $1.5 billion cover carried for each aircraft.

The International Civil Aviation Organization is also attempting to create a global pool of third party war risk and terrorism insurance. The pool would replace various governmental "stop-gap" measures put into place throughout Europe by different nations. According to the Association of European Airlines, in the absence of a government pool, their members would face an additional cost of $600 million Euro for private coverage. The main issue at play here mirrors the one in the U.S. commercial airline market: Should airlines or private aircraft be covered only by the insurance establishment, or should there be a government created "captive" cover? The airline industry worldwide says the latter is the best solution. The insurance establishment worldwide says that such an approach is unnecessary government intrusion into the private market that serves to divert needed premium dollars out of the private sector, all to the extreme detriment of the economy in general and the insurance establishment in particular.

III. CONCLUSION.

In the face of sobering insurance market realities after September 11th, the current debate over terrorism coverage in insurance establishments, business communities and governments around the world must be resolved and action taken now to stabilize this market. Any other response to very real insurer solvency threats is destined, without doubt, for a disastrous result.

Terrorist's ultimately seek the destruction of the individual's belief in personal security, trust in government and freedom from fear. The ultimate mission of the insurance establishment is the strengthening of an individual's sense of security, trust and courage when facing significant losses or personal danger. Achieving this goal directly attacks the terrorists' most valued weapon - - fear. Thus, the insurance community in each developed nation has a unique opportunity to continue to play and to expand its significant societal role to directly fight this old but newly dangerous enemy. Yet the magnitude of potential terrorist losses presents a threat to their solvency such that the insurance establishment cannot continue, let alone expand this coverage component alone.

In a separate paper from this panel, this author outlines a new "Specific Peril Terrorism Cover – a Proposed Partnership of Insurance Establishments and Governments Worldwide." The proposed program calls for a partnership between the insurance establishment in each developed nation and its government that would effectively pair the infrastructures, unique resources and capital of these entities in order to unhesitatingly respond to future terrorist-caused losses ("Program"). Insurance establishments worldwide would not be called upon to assume more risk than they could underwrite in order to create this Program. Indeed, if governments will underwrite the risks of terrorism in partnership with them, in a manner that permits classic market forces to establish the line between private sector and government coverage, insurers can seize this opportunity to fulfill their ultimate mission without risking insolvency. This Program would not require dramatic changes to the

infrastructures of either the insurance market or the government of each nation participating in the Program, nor in the laws that govern both of them. Moreover, the creation of this Program need not be delayed until resolution of the myriad of general civil justice and public policy issues that dominated insurance, tort and government reform agendas before September 11th. As societies resolve these far reaching questions, the resulting solutions can simply be applied to this Program as well.

The Program would establish a considered and soundly structured Specific Peril Terrorism Cover. Reliance on "all risk" covers for future loss from terrorist attacks would not provide the certainty now needed for the assumption of this risk. All claim handling functions would remain the responsibility of the participating carriers. Once the losses from one given terrorist event, a series of such events, or a number of separate events exhaust fairly determined and specific "sub-limits" for these specific perils provided by an individual insurance company, its government would "back-stop" it by paying the remaining loss up to a similarly determined nation-based specific peril "limit." When an individual nation could not pay such a loss with the combined specified resources of its treasury and the relevant insurance, an international fund, created by nations choosing to partner one with the other, would serve as the "insurer of last resort". This fund would most effectively be created under the auspices of the United Nations, in whatever manner or charter was acceptable to participating nations (the "U. N. Fund").

The Program's three progressive tiers of coverage -- insurance sector, government sector and U. N. Fund -- would be financed by premium at the private layer, with governmental revenues and treasury surpluses being used at the national and international layers. Thus, a carrier, whose loss on a given claim reached either the government or the U. N. Fund limits (attachment points), would continue to administer that claim, but the monies necessary to pay the loss above its per event or aggregate limits would come first from its government and thereafter, if needed, from the U. N. Fund. Defense of disputed claims, however, would be funded only at the individual

carrier level. At the beginning of the Program, the governmental and U. N. Fund cover might also have to serve as a re-insurance backstop while certain disputes and issues, detailed below, relevant to this cover are resolved.

The insurance establishments in each developed nation can continue to provide protection from the consequences of terrorist acts. If insurers are to succeed in this mission, there must be changes made to permit classic coverage lines to continue to stay solvent. These lines include: (1) life, workers' compensation, health and accidental benefits ("Personal Lines"); (2) first party protection against fire and other forms of destruction ("Property Lines"); and (3) third party protection for casualty claims and lawsuits ("Casualty Lines"). The Program contemplates utilizing these Lines of cover and traditional market theories, insurance principles, and the "rule of large numbers" to keep solvent a voluntary partnership, on a national and worldwide scale, that can spread the risks and allocate the losses of terrorist events more effectively and safely than could either partner alone. As for those undeveloped nations that do not have insurance establishments, but seek the protection of such an economic asset, carriers worldwide would have an opportunity to help create "new markets" in those sovereign states. A Specific Peril Terrorism Cover ("SPTC") Program could thus ensure, in significant part, a global response to what is a global problem.

The insurance carriers in the various nations of the world have limited resources and cannot be called upon to bear an unrealistic or destructive share of a given terrorist loss event or the aggregate thereof. The sovereign governments in each nation can bear a greater risk than can the private sector and are equipped to share it on a broader basis. They can also provide re-insurance until that private sector cover can be stabilized and re-enters the market. Sovereigns can thereafter mandate SPTC in all Lines and thus spread losses more evenly below national and international attachment points. Private carriers can thereby broaden the base of premium payments and help stimulate the economic and tax revenues that ultimately fund the next two "layers." Each sovereign can provide stability and security while national and international

market forces adjust forms, illuminate underwriting choices and fix limits and attachment points. More importantly, as the Program matures, the insurance establishment can replenish and protect its surplus and premium base.

The role of the sovereign can, over time, be reduced or changed for some Lines in the Program or increased for others. Attachment points and limits can alter in different programs and sovereigns can reallocate their resources as market conditions dictate. All of this should serve to keep pace with the evolving threats of terrorism. Moreover, national market place responses and geopolitical mechanisms can efficiently work together to disclose the true roles being played by sovereign states in the war on terror. It simply won't be politically feasible for a nation to long both foster and be called upon to pay for terrorist acts. This realty will be one of the major benefits of a Program that, at its core seeks, to combat fear and build a sense of protection and security in the world as well as in individual nations.

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