STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURANCE

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

AND THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE
COMMITTEE ON FINANCIAL SERVICES
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

ON

"A Review of TRIA and its Effect on the Economy: Helping America Move Forward."

April 28, 2004

The American Council of Life Insurers represents three hundred sixty-eight (368) legal reserve life insurance companies operating in the United States. Of these companies, three (3) are domiciled in Canada. These 368 companies account for 69 percent of the life insurance premiums, 76 percent of annuity considerations, 53 percent of disability income insurance premiums, and 72 percent of long-term care insurance premiums in the United States among legal reserve life insurance companies. ACLI member company assets account for 71 percent of legal reserve life insurance company total assets. The Council appreciates this opportunity to communicate its perspective on this important matter to the Congress.

The American Council of Life Insurers supports reauthorization of the Terrorism Risk Insurance Act (TRIA). There is no doubt that the United States is at war with international terrorists and that substantial risk persists of future attacks upon the United States that could result in substantial mortality. This is especially true if such attacks are nuclear, biological, chemical or radiological (NBCR) in nature. Every department of the federal government is aware of the implications of heightened risks to American security. Thus it is advisable to extend the benefits of the existing federal program, which has provided stable property and commercial markets supporting continued economic growth. The experience of the TRIA has been useful both in delivering immediate benefits as well as in revealing program deficiencies that might be addressed in congressional reauthorization. Inasmuch as the TRIA provides differentiated guidance to the Treasury Department between Group Life and Individual Life insurance, the ACLI comments upon both of these lines of insurance.

Individual Life and Other Lines

It is prudent for the federal government to consider the benefits of a federal backstop for individual life and individual disability, and a potential design for a market stabilization mechanism should be prepared for a future terrorist event of such catastrophic proportions that its utilization becomes necessary. TRIA provided for a study of such a scenario. In particular, TRIA § 103(i) provides that the Secretary of the Treasury study the potential effects of acts of terrorism on the availability of life insurance and other lines of insurance coverage, and report to Congress by September 2002. ACLI is unaware whether the Treasury accomplished its task in this regard. If not, the nation is no better prepared in this important area than it was at the time TRIA was enacted. Appended to this statement is the principal information ACLI contributed to the Treasury study in August of 2002.

Group Life Insurance

TRIA § 103(h) separately required the Treasury to study, on an expedited basis, whether adequate and affordable catastrophe reinsurance for acts of terrorism is available to life insurers that issue group life insurance, and the extent to which the threat of terrorism is reducing the availability of group life insurance coverage for consumers in the United States. Unlike the study of individual life insurance mandated by the statute, the Treasury was specifically granted additional authority to extend the Terrorism Risk Insurance Program (TRIP) to group life insurers to the extent that it determined that such coverage is not *or will not be* reasonably available to *both* insurers and consumers (emphasis added).

The ACLI provided the Treasury in January 2003 with what we believe to be convincing evidence that catastrophe reinsurance for acts of terrorism – and especially NBCR events – had become substantially unavailable or unaffordable. Numerous communications between the ACLI and Treasury officials convinced the industry that inclusion of group life insurance in the TRIP was imminent. Instead, ACLI was surprised to learn in August of 2003 that Treasury would not include group life but instead merely continue its studies of the market and the implications of terrorism. This decision not to make a decision did not help to bring reinsurance back to the group life insurance market.

The result is a market that is nervously stable only because there has not been another attack by terrorists within the United States. But the Congress wisely requested the Treasury to extend the federal program if it determined that such coverage is not *or will not be* reasonably available to both such insurers and consumers. Whereas the Treasury looks at the current market and sees stability even in the absence of catastrophe reinsurance, it failed *to look forward and prepare* for the market dislocation that can be expected if another significant attack within the United States occurs. This failure is contrary to the guidance of TRIA and contrary to the planning and preparation that is underway in every other department of the federal government.

The Treasury acknowledges that no catastrophe reinsurance exists today but finds that group life insurance remains available today, thus concluding it to be unreasonable to believe there will be no availability tomorrow despite the lack of catastrophe reinsurance. ACLI argues that there is no catastrophe reinsurance today and there will be none tomorrow because the terrorism risk is fundamentally uninsurable. Consequently, carriers are "betting the company" that there will be either no more catastrophes or that there eventually will be a federal backstop established. The Homeland Security and Defense Departments indicate a high probability of future attacks while the Treasury feels either that there will none or that, even if there are other attacks, industry will somehow manage. The ACLI has notified Treasury about the dissonance in Administration agency policy perspectives but without apparent effect.

Hence, the ACLI supports reauthorization of TRIA and recommends Congress expressly include group life insurance in the reauthorized program in order to address the unavailability of catastrophe reinsurance and to prepare a mechanism that will calm life insurance markets should another attack occur. If no attack occurs, there will be no expense to government or industry. If an attack does occur, group life will be covered by TRIP and insurers will be able to maintain protections for American workers and their families, most of whom are covered by group life insurance plans.

We appreciate the opportunity to bring these issues to the attention of the subcommittees.

Accompanying Documents:

- ACLI Comments on Group Life Insurance Study pursuant to 67 Federal Register 76208 (12/11/02), Terrorism Risk Insurance Act, P.L. 107-297, Section 103(h), 10 January 2003
- ACLI Comments on Treasury Study of Individual Life Insurance and Other Lines, Letter to Ms. Lucy Huffman, Office of Microeconomic Analysis, Treasury, 13 August 2003

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ACLI AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

10 January 2003

Department of the Treasury
Departmental Offices
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RE: Comments on Group Life Insurance Study
67 Federal Register 76208 (12/11/02)
Terrorism Risk Insurance Act, P.L. 107-297, Section 103(h)

Ladies, Gentlemen:

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment upon the expedited study of whether adequate and affordable catastrophe reinsurance for acts of terrorism is available to life insurers that issue group life insurance, and the extent to which the threat of terrorism is impacting insurance and financial markets absent adequate private and public based safety nets. The ACLI represents 399 legal reserve life insurance companies operating in the United States. The companies account for 76 percent of the life insurance premiums and 75 percent of the total assets of such life insurers. This commentary begins with an overview of ACLI perspective, provides general observations regarding the challenges confronting life insurers, and then responds to the questions enumerated in the Notice and Request for Comments.

Overview

The stability of the insurance industry and its role in the national economy is premised on the faith of employers, employees and investors in the ability of insurers to deliver promptly on their promises – no matter the severity of the loss of life. The life insurance industry did deliver as promised in the days following September 11, 2001. The fundamental purpose of this submission is to assure that the life insurance industry can continue to deliver on its promises in the environment now confronting us.

Before 9/11, the insurance industry did not price for risks of terrorism. Since 9/11, we know this risk is very real. Pricing for it is not possible because neither the likelihood nor the severity of terrorist attacks can be actuarially predicted. At the same time, in the interest of public policy, insurance regulators disallow insurance policies from excluding terrorism risk, including nuclear, biological, chemical or radiological risk ("NBCR"), notwithstanding the industry's inability to price for it. Since risk cannot be eliminated or capped in this context, a government terrorism risk insurance backstop is the only option to protect the long-term viability of the life insurance industry.

Terrorism risk must be addressed in advance of a catastrophic loss that would otherwise

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become a solvency issue for the entire industry. Group life insurance is the right starting point because of its disproportionate concentration of risk and because of the fundamental importance of the product. In many cases, group life insurance is the only insurance on the lives of middle and lower income American employees.

Both the aggregate amount of life insurance losses due to terrorism and their potentially uneven distribution among companies must be addressed. First is the potential for a loss -- or series of losses -- so large that it destroys the ability of the industry to replace capital and remain a viable provider of life insurance coverage. Second, an individual company can face financial impairment or bankruptcy from one or more events that impacts it disproportionately. Up to a point, industry risk sharing and pooling arrangements may be able to address threats to individual company solvency. For group life insurers today, there are no risk sharing mechanisms to deal with large-scale terrorism risk. The new law gives Treasury authority to include group life insurance in the three-year federal program. Group life insurance should be included now. Treasury should then use its authority to study life insurance to determine an appropriate federal risk insurance program for all insurance.

General Observations

In the event a government insurance backstop is not available when terrorist losses of a certain magnitude threaten the ruin of either the entire industry or a significant number of companies, the potential consequences are: (1) the life insurance industry ceases to function – either entirely or in its ability to provide future group life insurance coverage; and (2) the insurance market is dislocated – to the extent the risk of industry ruin impedes development of traditional risk pooling mechanisms.

Critical to the payment of hundreds of million of dollars in life insurance to those loved by the victims of 9/11 was a seamless, efficient and well capitalized worldwide reinsurance market. The challenge was the greater because the loss of life was concentrated in a small geographic area that housed employers, each of which had hundreds of employees on the premises.

This concentration of risk is characteristic of group life insurance. In many instances, employers have thousands of employees concentrated in a discrete space. Until 9/11, the life insurance industry in the United States had never experienced nor anticipated such a concentrated loss of life and the need to respond instantly to keep its promises to the employees and their families, so as to maintain the faith of the American public. The presence or absence of appropriate safeguards in the future has a profound effect on the confidence of all Americans in the nation's life insurance industry. They are unlikely to appreciate the distinction between promises made to them in their insurance policy, be it a group policy or an individual policy.

The terrorist attack of 9/11 profoundly changed traditional risk assessment, increasing the perceived value of catastrophe reinsurance at the same time that insurers have become unable to obtain at any price the levels of protection they enjoyed prior to 9/11. The risk that a future terrorist attack will result in even greater loss cannot be ignored. Loss-of-life scenarios unimaginable two years ago are now entirely plausible. For example, in a scenario discussed in more detail below, roughly $200 Billion of group life insurance is in force in Los Angeles County, a number that exceeds the entire surplus of the life insurance industry. A concentrated attack on Los Angeles could prove ruinous. No one can predict if, when, or where another terrorist attack will take place, but the risk of a given insurer being unable to pay benefits quickly without disrupting the capital markets, in which life insurers own $3.2 Trillion in assets, is very real today. Reinsurance they can obtain now, if available at all, is far more limited and expensive.

Because no one can know if, when, or where the next attack may occur, each insurer must limit its risk concentration, reduce limits, or have assurance that there is a safety net available if and when needed. The arbitrary nature of the risk that each group writer faces was demonstrated on 9/11, when one member company was called upon to process quickly more than 900 death benefit claims totaling $143 million, with its worldwide network of reinsurers then reimbursing it $137 million. Reinsurance comparable to that protecting the company on 9/11 is no longer available.

The United States government warns that future significant terrorist attacks remain likely. Indeed, the President recently made smallpox vaccine available to the citizenry and mandated the inoculation of our armed forces. The re-appearance of traditionally priced catastrophe reinsurance at necessary levels of coverage is remote. In sum, increased retained risk, increased charges for the limited available reinsurance, and reduced competition will result in greater group life insurance costs to employers. If the anticipated cost increases occur, they may have a more significant societal cost than merely increased premiums to employers, as it seems inevitable that cost conscious employers will respond by reducing or eliminating the only life insurance protection available to a majority of American families.

Impact on Insurance Availability and Affordability Versus Potential for Industry Insolvency

Property and casualty insurers sustained losses estimated at $35-55 Billion from 9/11. While such loss did not ruin the industry, it dislocated primary commercial property insurance markets and had an adverse impact on employment and business viability. Champions of the legislation that became the Terrorism Risk Insurance Act, including the President, frequently cited the deleterious effect on economic growth attributable to the losses sustained by the property and casualty insurance industry on 9/11 and the absence of insurance for new projects. That is, the impact of 9/11 so affected the availability and affordability of certain lines of property and casualty insurance that the dislocation was perceived to affect that national economy.

Treasury's questions regarding group life insurance are representative of the considerations regarding the provision of a government backstop to the property and casualty insurance industry. Group life insurance shares a number of characteristics that are similar to those of property and casualty insurers. For example, group life insurers often cover geographically concentrated risks, many in iconic buildings, plants, factories and installations. Group life insurers, like property and casualty insurers, also purchase reinsurance annually.

Another important similarity of group life with property and casualty insurance arises out of the provisions of the new federal program itself. That is, a characteristic of the federal program is the ability to surcharge policyholders for participation in the funding of loss. The federal program provides for property and casualty insurers to surcharge policyholders to recoup some of the loss sustained by industry and government. Group life insurers similarly would be able to surcharge their policyholders based on the typical annual group life contract.

The loss of 3,030 lives on 9/11 resulted in insured losses estimated to range from $2-3 Billion. There is no accounting of how much of this amount is attributable to individual life insurance compared to group life insurance. The magnitude of the human loss did not dislocate financial markets or have impact upon employment and businesses beyond those actually located within the World Trade Towers. Due to the strength of the life insurance industry, the sad toll of 9/11 measured in mortality and disability was not of a magnitude to raise immediate solvency or availability concerns for the life insurance industry as a whole. What 9/11 did reveal, however, was the very real possibility of magnitudes of terrorism catastrophe to human lives never before appreciated. For instance, if the World Trade Towers had not held as long as they did, allowing many people to escape, the loss of lives and impact to group carriers would have been far greater. However, with the potential for terrorist events that would cause frequent widespread mortality losses – especially NBCR events – the threat of insolvency of the entire industry is quite real.

Interrelationship of Group Life and Individual Life Insurance

This commentary focuses on the subject matter set forth in the Terrorism Risk Insurance Act, P.L. 107-297, Section 103(h) and the specific request for comments regarding inclusion of group life insurance in the new federal program. Yet the interrelationships of the provision of group life and individual life insurance to consumers complicate an observer's ability to opine on the effect of terrorism attacks on one without appreciation of effect on the other. Life insurers may issue either individual or group life insurance policies. Some companies issue both forms but many focus primarily on individual life insurance and others focus primarily on group life insurance. Indeed, the complexity of situation is even greater when one considers that a terrorist loss of substantial magnitude could so affect insurer liquidity that its effects ripple through all lines of insurance including disability, accident and health, and long-term care.

The complexity of such interrelationships is especially seen when the market analysis is based upon the availability and affordability of any element of insurance or reinsurance common to both group and individual life insurance. Thus NBCR reinsurance has not only disappeared for primary group life insurers but for individual life insurers as well. The refusal of the states to permit exclusions in new or renewal policies for losses attributable to terrorist attack applies equally to both group life insurance contracts as well as individual life insurance policies. Over $9 Trillion of existing individual life insurance policies in force typically do not contain such exclusions. Thus insurers are compelled to provide coverage for a quite real risk but with no ability to price for it.

These larger issues and the implications of terrorist attacks upon the life insurance industry will be addressed by ACLI for the government study provided for in Section 103(i) of the Terrorism Risk Insurance Act. But they have also oriented ACLI evaluation of the implications of terrorism losses for group life insurers toward entire industry solvency considerations rather than only affordability and availability constraints. Hence the principal approach of this commentary is toward appreciating what size of loss might significantly impair the entire industry, the better perhaps for government policy makers to identify attachment points for group life insurer participation in the federal program.

Ruinous Terrorist Attacks

Life insurers issuing group life insurance must now be concerned about the potential occurrence of future terrorism events that could take a toll of human life potentially greater than that of 9/11. ACLI believes that, the larger the event, the more likely individual life insurers will suffer detrimental impact equal to or greater than group life insurers. That is, a catastrophe affecting all of Los Angeles County might be expected to impair the individual life insurance industry as much as the group life insurance industry, whereas a catastrophe centered on, e.g., the Sears Tower in Chicago might impair the group life insurance industry to a much greater degree.

Regarding such losses in the context of the current Treasury study, we are quite concerned by the potentially uneven distribution of group life costs among different insurers. This distribution is partly random but is also a function of the concentration of risk that is an essential feature of group life insurance. In a situation in which the entire industry participates in an insurance backstop arrangement, cost might be spread efficiently. Absent such a situation, insurers are exposed to a level of risk that cannot be priced in a reasonable way. Hence, the ACLI perspective arises from scenarios of loss that could ruin the life insurance industry. They are of two types: (1) one or more calamities so widespread as to directly impact a significant number of insurers simultaneously, and (2) single or multiple calamities so intense as to ruin one or more major insurers, driving them into insolvencies that cannot be borne by state guaranty funds.

ACLI actuaries studying the implications of terrorist disasters have considered the experience of an existing private industry catastrophe risk pool, Special Pooled Risk Administrators, Inc. (SPRA). The experience of this pool on 9/11 was that certain group life insurers had twenty times the death claims that would have been expected based on their exposure, which was variability four times that of individual life insurers. In other words, catastrophes do not hit proportionally across lines of insurance or among insurance companies.

There is \$9.3 Trillion of individual life insurance in force and \$6.8 Trillion of group life insurance in force nationally. Total industry surplus is estimated to be \$187 Billion. In California, there is \$1.2 Trillion of individual life insurance and \$0.7 Trillion of group life insurance in force. About one-third of the population of California resides in Los Angeles County (9.6 million lives). The data above indicates that a catastrophe in Los Angeles County that results in the death of 30% of its population would also destroy the entire life insurance industry surplus.

A terrorist catastrophe in Los Angeles County will certainly result in substantial loss to both individual and group life insurance. Using existing pool data, which assumes a disproportional effect of 0-11.6 times the average (i.e., the weighted average of individual and group life insurance disproportions), ACLI perceives that a 2.5% Los Angeles mortality rate would likely cause an insolvency of a company. The question becomes at what level of catastrophe is industry solvency jeopardized? If a catastrophe with mortality of 30% of the population of Los Angeles County destroys 100% of industry surplus, while a catastrophe with 2.5% Los Angeles County mortality of the County could render at least one insurer insolvent, where is the threshold at which industry solvency is jeopardized? Loss of even half of industry surplus, or $94 Billion, likely is tantamount to industry ruin. Given required risk based capital ratios and effect on consumer confidence of the repercussions of such losses, industry ruin probably occurs far before loss of half of surplus. Further, the shock of a catastrophe of magnitude could be expected to create negative economic dynamics on a national and even global scale, as insurer financial investments deteriorate, lessening insurer reserves and capacity, which lessen external investors confidence in insurers, affecting the ability the industry to raise capital, and so on.

ACLI is considering scenarios other than those relating to Los Angeles County. One, for example, looks at the Sears Tower in Chicago, the largest building in the United States, an icon of American achievement. It houses about 10,000 employees and 25,000 daily visitors. One could assume the employees to be similar in insurance levels to those employed in the World Trade Towers, and visitors to be similar to the general population. If the World Trade Tower death toll was about 2,800 lives with about $2-3 Billion life insurance lost, one could estimate a total destruction of the Sears Tower (i.e., if it did not stand for the time the World Trade Towers stood) to result in life insurance losses of roughly four times the World Trade Center loss, or about $8-12 Billion.

Final results of these studies are not available at this time. ACLI proposes to supplement this communication with additional data when it is available.

ACLI Response to Treasury Questions

1.1 Who are the suppliers of group life insurance in the U.S.; who are the users; and how are sellers and buyer brought together?

Appendix A provides a ranking of 311

group life insurers in descending order from the largest, based upon Group Life Insurance Net Premiums as reported to the National Association of Insurance Commissioners (NAIC). In addition, the carriers' premiums for other potentially relevant lines of insurance are indicated.

In general, the "users" of group life insurance coverage are government; unionized industries; and high-income service industries such as medical and financial services. The greater the concentration of these industries within a geographic area, the more likely there exists group life insurance coverage.

Most employer-sponsored group insurance is distributed through independent insurance brokers, who provide several price and coverage quotes to the purchaser. Large cases may have the same services provided by an independent consultant.

1.2 What is the corporate status of group life insurers? Are they generally stand-alone companies, or affiliates of other corporations? If the latter, what are the major business interests of the other corporations?

Group life insurers are generally *not* stand-alone companies offering only group life coverage. In many cases, they also provide group accident and health coverage, and many also provide individual life insurance, either directly, or through an affiliate. See Appendix A.

1.3 What characterizes group life insurance offerings? Please describe typical terms of coverage, offer and renewal procedures, and other relevant information.

Most group life insurance is employer-sponsored term insurance, in an amount that is a function of employee salary or other scheduled amounts. Such plans often include an accidental death feature which doubles the benefit in the event of an accidental death, and a waiver of premium feature which waives future premiums in the event of employee disability. Such plans are typically renewed (between employer and insurer) annually, although two-year rate guarantees are common. Employees generally are able to purchase coverage at the inception of employment without evidence of insurability (large amounts will require some evidence), but may not subsequently elect coverage without providing evidence. Coverage usually ceases at termination of employment, but may be converted to individual plans although, in some cases, group term life insurance coverage may be maintained after employment ends. Employers may pay the entire premium, or they may require contributions from employees.

1.4 How is group life insurance regulated in the U.S.? Are there significant differences in group life regulation among the states and, if so, what are these differences?

Group life insurance is regulated by the individual states. Regulation tends to be similar from state to state.

1.5 What are the risk exposures of customers and how are they concentrated-by locality, by type of employer, other? What is the annual premium structure for these different exposures?

There are a number of examples of concentrated risk such as where employers occupy a high-rise building. Many areas of high employment, e.g., cities or research centers, may present concentrations of risk that are not easily measured because the exposures may result from employees who work for a number of different employers.

1.6 What amounts of loss exposure are typically reinsured? Please describe the structure of typical reinsurance contracts, including the period of coverage and typical renewal process.

Reinsurance for group life insurance comes in several forms. In general, group life insurers will purchase coverage on two bases, excess of loss on individual lives, and catastrophic coverage on the entire block of business.

<u>Excess of Loss on Individual Lives</u>: Ceding companies will normally reinsure excess amounts of group life insurance using a risk retention level that is commensurate with the size of their block of group life insurance business, the insurers capital and surplus position, and with the company risk management philosophy. Smaller group life insurers will typically cede 100% of all amounts in excess of $50,000 or $75,000 per employee and the larger group life insurers will cede 100% of all amounts in excess of $500,000 or $750,000 per employee. Risk retention levels tend to be smaller (approximately 50%) than those for individual life insurance due to the concentration risk. Excess group life reinsurance contracts are normally written on a yearly renewable term (YRT) basis for a 12-month contract period. Excess group life reinsurance contracts normally provide reinsurance coverage for both deaths and waiver of premium benefits. Disability caused by terrorist attack may trigger this benefit. Excess group life reinsurance is often provided using a monthly composite premium rate per $1,000 of volume, in order to simplify administration. Excess group life reinsurance treaties (a "treaty" implies an arrangement for automatic acceptance) are typically annually renewable and can be cancelled by either party with 90 days notice. The typical renewal process will begin with a request from the reinsurer to the insured company for updated annual census for all of their business reinsured. This census must include, at a minimum, each persons age, amount reinsured, gender and work location. Work location request is new since 9/11. This data is then evaluated and validated against administration data and contract provisions. In addition, since 9/11, location information is evaluated for concentration, buildings and terrorist targets. From the updated exposure data and financial experience analysis, a renewal action is determined. This could range from a decision to terminate to a decision to offer a rate decrease. In the event of a covered loss, reinsurers would be required to pay their portion of the claim, regardless of cause.

The typical per person excess group life reinsurance contract has at least four major sections: Definition of Risk, Administration, Financial and Special Provisions. Within those sections, the contract will cover the scope, automatic acceptances and facultative submissions, liability, premium accounting, conversions (from group to individual coverage), risk retention, maximums, claims, arbitration, insolvency, tax, duration and exhibits that fully describe the agreement between the two parties. These exhibits typically include the rate basis or rate table, exclusions from automatic acceptance and experience refunding arrangements (if any).

Catastrophic Coverage: This coverage is also called Per Occurrence Excess of Loss. Ceding companies will normally insure the entire block of business against catastrophic claims by purchasing a certain amount of coverage per occurrence on the entire block over and above a deductible amount. Once again, the amount of coverage purchased is commensurate with the size of their block of group life insurance business, the insurers capital and surplus position, and with the company's risk management philosophy. Smaller group life insurers will typically purchase reinsurance that reimburses $5-30 million of claims after a deductible of $2-5 million, whereas larger group life insurers may purchase up to $1 Billion of coverage after a $100 million deductible. This coverage generally will contain restrictions on the events covered and the minimum number of deaths in an event for coverage to be effective. After 9/11, terrorism and NBCR exclusions were added to this type of coverage. While NBCR coverage is not obtainable at this point, some reinsurers will cover terrorism (excluding NBCR) for an extra premium of 50% or more. Reinstatement of catastrophic coverage (a clause that replaces capacity after an event has depleted coverage), which was generally free and unlimited, has been reduced to one reinstatement for 100% of the original premium. Catastrophic coverage generally is renewable annually.

1.7 What was the amount of group life insurance losses in the terrorist attack of September 11, 2001; and how was it distributed-losses to insurers versus losses to reinsurers? How was it distributed within each group?

Because companies have reported both group and individual losses as one number, it is difficult to answer this question. Suffice it to say that, while the events of 9/11 resulted in significant losses for the group life insurance industry, it did not raise solvency concerns. The industry is concerned with the potential magnitude of future events.

1.8 What was the availability and price of reinsurance in the period before and following September 11, 2001, for group life insurance? What is it today? Please be specific by type and amount of coverage available, deductible, sublimit, renewability, and other relevant characteristics.

The events of 9/11 had minimal impact on the cost and availability of reinsurance for Excess of Loss On Individual Lives. Rather, Catastrophic Coverage was impacted, both in terms of coverage and price. The cost of Catastrophic Coverage, even without terrorist coverage, has increased greatly. Rates on Line (reinsurance premium divided by reinsurance limit) have increased from 600% to 1200%, with required deductibles increasing by up to 2000%. Coverage for terrorism involves an additional premium of 50% or more and NBCR coverage is generally unavailable. Maximum coverage for any one insurer has declined significantly as well, from roughly $1 Billion to $300-$400 million.

1.9 What is the current capacity of group life insurers in the U.S. to bear terrorism risk, individually and as affiliates of other companies, taking into consideration their reinsurance situation? Please provide empirical support for responses as available and appropriate.

The entire capital and surplus of the life insurance industry is estimated to be approximately $187 Billion. This capital and surplus backs all of the liabilities of United States life insurers, including individual life, disability, long-term care, and accident and health insurance, as well as group life insurance.

In the case of smaller companies that write only group life insurance, it would be possible to view all of their capital and surplus as solely standing behind their group exposure. In the case of multi-line companies, capital and surplus is not legally segregated for a particular line of business. Life insurers do, however, manage their companies by determining an appropriate level of capital and surplus for each line of business. These levels are typically based on a multiple of NAIC required risk based capital for the line of business. We estimate that the level of capital and surplus for the group life business is approximately 5% to 10% of the $187 Billion, or roughly $10 to $20 Billion. In considering the industry's capital position, we are mindful that an event causing large group life insurance losses would also cause large individual life and disability insurance losses. This, in turn, would significantly impact the entire industry's capital and surplus. We believe that another terrorist event in the range of $2 – $5 Billion group life insured loss could cause a significant number of insurers with large concentrations of group life business to fall below minimum required capital levels.

1.10 Are there other sources of protection for terrorism risks in group life insurance, e.g., through capital markets? To what extent are these sources used currently? What are the issues associated with expanded use of these sources?

The capital markets generally are not available to provide catastrophe coverage to group life insurers. Due to the historically low frequency and high severity of multiple life catastrophic occurrences, there is no generally accepted life insurance catastrophe modeling tool available.

There is one existing private industry catastrophe risk pool, Special Pooled Risk Administrators, Inc. (SPRA). Established in 1972, SPRA is a New Jersey subsidiary of Swiss Re, administering a unique program to enable life insurers to address problems of concentrated risk of catastrophic accidental death claims for both individual and group life risks. SPRA paid $104 million of group life insurance from 9/11. Since 9/11 its capacity has grown to possibly pay as high as $750 million in claims. As helpful as this might be, the SPRA does not remove the catastrophe risk of ACLI concern. In industry ruin scenarios, the value of participation in such a voluntary pool decreases because it cannot distribute risk beyond the industry or even to all members of the industry. ACLI members agree that this pool, in its current configuration, cannot address the dilemma of group life insurers confronting large terrorist loss exposures today.

Considerable questions exist as to whether private market pooling mechanisms could develop to address the concentration of risk problem besetting the group life insurance industry today. With the time that would be provided by the temporary federal program, private, voluntary pools might develop for levels of exposure below federal participation levels. Such potential voluntary pools may help determine to what extent, if any, federal assistance is needed for overall life insurance terrorism loss exposures. Because no voluntary pool can accommodate the magnitude of terrorism risk contemplated here without a federal backstop similar in nature to the federal program for property and casualty insurers, ACLI members see value in federal backstop for group life insurance losses attributable to terrorism. A federal program that is available only for catastrophes threatening ruin of our entire financial system is seen as too remote to encourage voluntary pooling remedies to form. From these considerations emerge the notion that federal program attachment points either too low or too high might frustrate the re-emergence of private risk-sharing mechanisms to address the problems challenging the group life insurance industry.

1.11 Please address and provide empirical support for whether group life insurers have reasonable access to adequate and affordable catastrophe reinsurance, and, if not, why inclusion in the Act would correct this situation. In so doing, please compare the magnitude and scope of the situation of group life insurers to the situation previous to the passage of the Act of those property and casualty insurers that are included in the Act.

Group life insurers have access to limited catastrophe reinsurance, but general terrorism and specific NBCR exclusions leave the industry exposed to potentially ruinous risks. Such risks, because of their unpredictable frequency and potentially high magnitude cannot be adequately priced by anybody, whether insurer, reinsurer, or capital markets. The development of a government-sponsored backstop program is the only viable method of insuring such a risk.

In December 2001, ACLI actuaries evaluated characteristics of different threshold amounts of loss to better evaluate the nature of industry afflictions from terrorist loss and the benefits of different approaches to remediation. This work effort did not distinguish between individual and group life exposures. The actuaries developed scenarios at four levels: $5 Billion, $10 Billion, $15 Billion, and $20 Billion. A $10 Billion event would increase industry death claims by 22.5%, reducing overall industry surplus by 5.3%. In comparison, a $10 Billion loss for property and casualty insurers would have the effect of increasing industry claims by 4.2%, and reducing overall property and casualty insurance industry surplus by 3.2% (and 8.0% of the surplus backing commercial lines). Even acknowledging that, e.g., a $10 Billion event does not necessarily translate into a $10 Billion insured loss (as premium and reserve release must be netted), and that lost capital can often be replaced through public or private equity markets, some conclusions might be derived from the above analysis. Thus, for a given size event, the resulting financial impact is much greater for the life insurance industry compared to the property and casualty insurance sector.

2.1 Please describe in detail, current group life insurance market conditions, including availability and pricing, by type and location of employers and other purchasers.

This information is difficult to collect. ACLI has been informed by several insurers that prices have gone up, due to the recognized risk of terrorism, in certain locations, such as Washington DC and New York City. The states have not permitted group life insurers to exclude terrorism risk from policy coverage. While ACLI does not have detailed information on pricing and availability, we believe that some insurers have been unwilling to quote on certain risks due to terrorism exposure.

2.2 What is the impact of terrorism risk on group life insurance availability for employees and other consumers? Please describe in as much detail as possible which employees and other consumers have been significantly affected, including availability and pricing, by type and location of employer or other purchaser of group life coverage.

To the best of our knowledge, employers have not stopped offering group life insurance to employees. In many cases, group life insurance is the only insurance on the lives of middle and lower income American employees. The primary group life insurers did not, in most cases, retain the risk of large or concentrated ("catastrophe") losses. Because catastrophe losses were so infrequent, the primary group life carriers reinsured them at relatively insignificant costs. Today the situation is entirely different. Since the terrorist attack of 9/11, group life insurers cannot find either adequate or affordable catastrophe reinsurance. Further, reinsurance for loss from NBCR terrorist attacks has ceased to exist.

This means that group life insurers in today's marketplace are, at least temporarily, accepting markedly greater risk than they did when the risk was not perceived as significant and reinsurance was widely and inexpensively available to protect against catastrophic losses. Those carriers able to reinsure any part of their enhanced risk do so at great expense. This situation has not yet begun to reduce the availability of group life insurance for consumers because most group life insurers are remaining in the market by retaining the risk of catastrophic loss without the traditional benefits of risk spreading via reinsurance.

Following 9/11, group life insurers continued traditional market coverage and pricing during a period of negotiation with reinsurers in hope they would find a way to provide affordable reinsurance. This did not occur. Now traditional coverage and pricing is being maintained in the hope that there will be government support, which will make reasonable the continued acceptance of the concentrated risk inherent in group insurance. Without the assurance of a government terrorism risk insurance backstop, the present situation is likely problematic in two ways. The first is the potentially increased cost of group life insurance. The second is the reduction of availability, which may occur both from actions of group writers and from employer responses. In the absence of meaningful government support, and particularly if the potential remains for substantial terrorism losses, it seems likely that the number of group life insurers and coverage offered will shrink.

2.3 What is the cost and availability of alternative sources of life insurance coverage for those employees and other consumers affected by the reduced availability and affordability of group life insurance?

Availability of employee coverage has not yet been affected. Should group life insurance not be included in the federal program, it is likely that some writers will reassess the desirability of offering this coverage. If coverage is reduced or eliminated in the future, employees' alternative source of coverage will be individual life insurance. This form of insurance may be cost prohibitive or unavailable for some individuals.

2.4 Please explain and provide empirical support concerning the extent to which the threat of terrorism is reducing reasonable availability of group life coverage for employees and other consumers in the U.S., and whether it would continue to be reduced if group life insurers continue to be excluded from the Program. Please compare the magnitude and scope of the impact on consumers of not including group life insurance to the impact on consumers previous to the passage of the Act of those property and casualty insurance lines covered under the Act. Please explain how inclusion would correct this situation.

Failure to include group life insurance in the federal terrorism risk insurance program could result in higher costs and more restricted coverage for group life consumers. It is expected that the cost of capital will increase once investors begin to understand the risks being borne.

Inclusion of group life insurance in the program will likely assure that the product remains available to the broad range of employee groups.

3.1 Treasury presumes that, if it would be appropriate to include group life insurance under the Act, Treasury would apply the current provisions of the Act to group life insurers. If this is not the case, please discuss and provide a detailed explanation of the changes that would need to be made to implement the Program for group life insurers. Please include discussion of any operational difficulties with applying the current provision in the Act to group life insurance that should be considered with respect to any financial assistance if group life insurers were included under the Act, and the benefits and costs, including administrative cost, of any proposed changes to the provisions for group life insurers.

It is essential that, should group life insurance be covered under the Program, a separate and distinct pool be established for the life insurance risk. To establish appropriate parameters for inclusion of group life in the federal program, comparison of group and individual life premium to that of the property and casualty insurance industry might be appropriate. Given the similar concentration of risk issues, industry limits proportional to those established for the property and casualty insurance program might be appropriate. However, the coincidence of the Treasury comment period with the seasonal holidays has complicated the ability of the ACLI to formulate proposed program changes to address group life insurance characteristics and administration. ACLI proposes to supplement this communication with a detailed response to this question as soon as possible.

ACLI Communications

Thank you for your consideration of these comments. To expedite ACLI responsiveness to Treasury inquiries and requests for information, please use the following individuals as your contacts for ongoing communications:

Michael Lovendusky, Senior Counsel	Paul Graham, Chief Actuary
202.624.2390	202.624.2164

Sincerely,

The American Council of Life Insurers

John F. Barrett
Chairman of the Board, President, and Chief Executive Officer of
The Western & Southern Financial Group
Chairman of the Board, American Council of Life Insurers

Attachment: Appendix A (In Excel)

13 August 2003

Lucy Huffman
Office of Microeconomic Analysis
United State Treasury Department
1500 Pennsylvania Avenue
Washington DC 20220
Via otherlinesstudy@do.treas.gov

RE: Comments on Study of Other Lines

Ladies & Gentlemen:

The American Council of Life Insurers appreciates the opportunity to comment upon the potential effects of terrorism on the availability of life insurance and other lines of insurance. Following the Table of Contents, this document comments first generally on the situation confronting insurers with regard to terrorist threats; next reports on the findings of a survey of its members; responds then to each of the questions enumerated by Treasury; and finally suggests the concept of a possible government terrorism backstop mechanism, should future events prove it to be necessary.

Table of Contents

Summary Conclusions

The strength of the life insurance industry permitted it to withstand 9/11 losses without dislocation or the need for government assistance. The industry is strong enough to withstand catastrophes several times the magnitude of 9/11. A majority of ACLI members do not perceive an immediate need for a federal backstop for individual life insurance. However, the industry believes that it is hamstrung in reacting to the increased mortality and morbidity risk from terrorism because, while it believes that the increased risk is minimal, it cannot be quantified or specifically identified. Hence, a significant number of industry experts are troubled about the implications of catastrophic terrorist attacks for the vitality of their industry. The ACLI believes that it is prudent for the federal government to consider the benefits of a federal backstop for Individual Life and Individual Disability and that a potential design be prepared should a future terrorist event of such catastrophic proportions make such a mechanism necessary.

General Observations

There is ample reason for concern about the implications of future terrorist attacks for the availability of life insurance. The Administration advises that the terrorism threat is real and continuing, and that the US is likely to suffer other attacks within the next decade. Scientists and officials advise us that the nature of these attacks could result in extremely high mortality, especially if they involve nuclear, biological, chemical or radiological (NBCR) weapons. While the likelihood of additional terrorism loss is high and predicted in general, color-coded alerts, actual frequency, severity and locality cannot be predicted for insurance underwriting purposes. Indeed, the human agency behind terrorism denies its evaluation as a natural phenomenon reducible to an actuarial probability. Based on government and scientific information, it is reasonable to believe that there will be either individual incidents of extreme loss or multiple incidents of loss that, in aggregate, will be extreme and could test the strength of the life insurance industry.

There is not much life insurers can do to prepare for the terrorism risk. If the solvency of insurers were the only public policy concern, it would be reasonable to permit an insurer to manage such a risk with policy exclusions. But the States disallow any exclusion for terrorism loss to direct insurers. Reinsurers, on the other hand, are not constrained by regulation from excluding terrorism and especially NBCR loss in their treaties; rather, the constraints for reinsurers arise from competitive concerns in their relatively free market. Even Congress likely cannot permit exclusions for terrorism loss because they could be prospective only, i.e., constitutional obstacles likely prohibit application of terrorism exclusions to individual life policies in force.

Neither is there new private capital available to permit insurers to accommodate the risk to terrorism loss. Traditional sources of capital eschew risk that cannot be traditionally underwritten. Market competition inhibits increased pricing for the risk, at least until future attacks impress the reality of the situation upon everyone, and then too late. So it is that primary life insurers are caught between the rock of exclusion prohibitions and the hard place of no fresh capital for the new risk. Only federal government resources exist as a source of additional capital that might be made available to address catastrophic terrorism loss.

Survey of Terrorism Impact

Treasury noticed its interest in receiving comments on the implications of terrorist attack for individual life insurance and other lines on June 16.[i] The ACLI shortly thereafter surveyed its 383 legal reserve life insurers operating in the United States and Canada for data responsive to Treasury's request. These companies account for 70% of life insurance premiums, 77% of annuity considerations, 43% of disability premiums, and 63% of long-term care premiums in the United States among legal reserve life insurance companies. ACLI member company assets account for 73% of legal reserve life insurance company total assets. The surveys were sent to the attention of the chief actuaries and chief financial officers of each member company.

The survey was designed to gather information and feedback from the industry regarding their practices and experiences in the wake of 9/11, as well as their opinion regarding the need today for a federal backstop. Such questions could be answered with certainty. The survey did not ask respondents to speculate regarding the likely impact on the market of future terrorist attacks of unknown scope and magnitude. Such issues were deemed too subjective to be tabulated in a meaningful way through a survey, but are addressed in our response based on extensive consultations with the industry and internal analysis by ACLI staff.

Survey responses were received from 149 companies participating in 80 corporate holding systems, or fleets. These companies represent 40% of the ACLI membership and 36% of total life insurance industry assets. The tabulated responses to the ACLI survey are found at Appendix A.

A significant number of surveys were accompanied by editorial remarks that are reflected in this commentary. The ACLI commentary goes beyond the basic numerical tabulations of its survey data to include relevant editorial and analytical information from the survey data as well as that gleaned from discussions with its members.

ACLI Responses to Treasury Questions

I. Exposure of Insurance Lines Not Covered Under Section 102(6) of the Act to Acts of Terrorism Defined in Section 102(1) of the Act

1.1 *What lines of insurance would not be likely to experience potentially significant reductions in availability as a result of the occurrence of future acts of terrorism or the risk of acts of terrorism?*

Based on our analysis, the following lines of insurance might not experience significant reductions in availability:

- Credit Life Insurance
- Individual Annuities
- Group Annuities
- Long Term Care

With respect to Individual Life and Individual Disability, a majority of the companies responding to our survey concluded that there is no immediate need for a federal backstop because the increased risk is currently minimal or cannot be quantified. While approximately 10% of life insurers have instituted risk mitigation techniques in the wake of 9/11 such as increasing diversification through reinsurance, limiting sales within certain geographic areas, or imposing underwriting criteria limiting concentrated groups, the majority of companies have carried on business as usual.

The targets of 9/11 were not quantified by insurers for terrorism risk (even though the World Trade Center experienced in 1993 a terrorist attack with loss of lives). It is not clear even now that the targets of 9/11 should have been identified as high-risk exposures for life insurers. From a life insurance standpoint, it cannot be assumed that an attack of the magnitude of 9/11 is the worst we are ever to endure. It is conceivable that an event with dramatically higher loss of life than 9/11 could happen. As uncomfortable as it is to consider, such an event is within the realm of possibility, particularly with the use of NBCR weaponry. The current market – the market reflected in the responses to the ACLI – continues to look at actual historical precedent for its cues. Congress asked Treasury to contemplate the effect on insurance availability of future acts of terrorism. We do not have, and may never have, reliable models to predict with any accuracy the frequency and severity of future terrorism events. It is not clear whether future acts of terrorism will be limited to the magnitudes of those of the past.

1.2 What lines of insurance would be likely to experience potentially significant reductions in availability as a result of the occurrence of future acts of terrorism or the risk of acts of terrorism?

According to our analysis, the following lines might experience significant reductions in availability:

- Individual Life
- Individual Disability
- Group Life Insurance
- Group Disability Income
- Reinsurance

As indicated in the response to Question 1.1, the majority of ACLI survey respondents indicated that there is no immediate need for a federal backstop against acts of terrorism for individual life insurance products at the company level. The inclusion of Individual Life and Individual Disability in the response to this Question is a result of industry concern about the potential impact of future terrorist attacks of such magnitude or frequency as to affect the fundamental conduct of the business of life insurance. Analysis of the particular responses generating these findings revealed that nearly all respondents that agreed that there is a need for a backstop for Group Life and Group Disability also believe the need extends to Reinsurance, while many respondents who believe there is not a need for a backstop for Individual Life or Individual Disability had no opinion as to whether a backstop should be extended to Reinsurance.

A few insurers that did not believe that an immediate backstop was necessary for Individual Life thought that it was necessary for reinsurers. The apparent peculiarity of this position is lessened if it is considered that much of the Individual Life exposure in force was reinsured before 9/11 and, consequently, the primary insurers are insulated to substantial degree from excess loss attributable to terrorist attack. Such exposure, however, likely would befall the reinsurers under pre-9/11 treaties. Hence it is not unreasonable to perceive a potential need for a federal backstop for reinsurers to address the heightened terrorist risk to Individual Life Insurance in force

That is, Individual Life insurance concerns the long-term contractual commitment life insurers make to their clients. Life insurers cannot cancel policies unless premiums are not paid. They also cannot increase prices above levels agreed upon at the inception of the policy. Terrorism exposure for life insurers and life reinsurers is locked in for all contracts in force. This is in contrast with, e.g., property and casualty insurers, who have an opportunity to cancel or reprice the coverage annually, allowing them to avoid the risk in the future or recoup the costs of a previous event. For life insurance in force, life insurers and life reinsurers have neither a market mechanism to price for terrorism risk nor a market mechanism to recoup terrorism losses from their clients. The long-term commitment of life insurance policies results in an exposure to terrorism threats that could be ruinous to the sector.

Thus, even though the majority of the companies responding to our survey concluded that there is no current need for a federal backstop for Individual Life and Individual Disability insurance, our analysis is that their conclusions did not envision a prospective industry ruin scenario. The life insurance industry contributes vitally to American strength. Employing 2.3 million workers and holding $3.4 trillion US assets, the stability of the industry should be of high concern to the government. This is especially true inasmuch as life insurers' assets are invested in direct support of government and other US industries, including $1.7 trillion of corporate and government bonds, $791 billion of corporate equity, and $251 billion of mortgages.[ii]

There will be little cost to government to plan for a federal backstop program. If terrorist attacks fail to materialize, or if they continue sporadically with minimal loss, there would be no federal payment even if a plan was put in place. On the other hand, the opinions of company actuaries about whether the terrorist risk is minimal, quantifiable, or identifiable may about-face in the nanosecond it takes to detonate a dirty bomb in an American downtown. Advance government planning, including consideration of a federal terrorism backstop, will serve the country and the insurance industry well in the event government predictions of significant future terrorism events become true.

1.3 What are the attributes of those lines cited in 1.2 that could lead to potentially significant reductions in availability? For example, are there unavoidable concentrations of risk? Is there a particular exposure to certain types of acts of terrorism?

Individual Life Insurance: The 9/11 attacks were not of a nature to raise concerns about the overall strength of the life insurance industry because the loss was not sufficiently large as to threaten the industry's overall strength. The impact of such kinds of attacks for individual life insurers would be expected to be dissimilar to that experienced by insurers with potentially large numbers of group policy certificate-holders concentrated in, e.g., iconic buildings or facilities. There is no assurance that future attacks will be of the nature of those of 9/11. The major concern today is that terrorists or hostile nations will acquire and detonate a weapon of mass destruction against an US target. Thus the nature of terrorist attack of concern to ACLI members include:

1. A NBCR attack affecting a large geographic or heavily populated area or both; and
2. Numerous attacks in one or more specific geographic areas (e.g., one or more state or metropolitan area) with relatively few insurers representing a high percentage of the market.

Other attributes relevant to individual life insurance and related to NBCR risk include:

- Availability constrictions attributable to higher reinsurance costs (affecting the pricing and profitability of new policies); and
- Availability constriction attributable to reinsurance treaty terrorism exclusions (affecting new policies only).

Group Life Insurance: Treasury is aware that there are unavoidable concentrations of risk for Group Life and Group Disability Insurance. ACLI submitted comments justifying inclusion of group life in the federal terrorism risk insurance program on 10 January 2003. It has provided supplementary information upon request, including new data regarding state-specific market concentration data, as recently as 27 June 2003. ACLI President Frank Keating and company officials have met several times with Treasury officials, including Secretary Snow, as recently as 18 June 2003. The ACLI refers Treasury to its existing collection of information, including the comment by the ACLI, regarding the implications of terrorism upon the availability and affordability of group life insurance.

Individual Disability Insurance: Individual Disability Insurance may be purchased as a stand-alone policy or as a supplemental benefit to an Individual Life Insurance policy, providing benefits to cover financial losses resulting from a sickness or injury. Stand-alone policies are designed as partial income replacement in the event of disability. Benefit payments commence after an elimination period and are generally paid monthly thereafter as long as the insured remains disabled or until he or she attains retirement age. The most common supplementary benefit is the waiver of premium benefit, which pays the life insurance premium while an insured is disabled. Of individual life policies in force in 2001, 27%, or 44 million, contained a waiver of premium provision, totaling $2.9 trillion, or 31%, of the individual life insurance face amount in force.[iii] Thus, concerns identified above for Individual Life Insurance extend to Individual Disability Insurance as well. An additional concern attributable to Individual Disability Insurance is the possibility that substantial experience of waiver of premium attributable to extremely high disability numbers would lessen insurer premium revenue in a manner exponentially increasing stress on insurer claims payment capability.

Group Disability Insurance: Similar to the inclusion of Individual Disability Insurance coverage in Individual Life Insurance, most group insurers bundle Group Life with Group Disability protection. Extraordinary claims on one product line can be expected to stress capital and surplus funds earmarked for another. For both Group Life and Group Disability, there is an effort to improve group underwriting with concentration of risk analyses, though such analyses are difficult when group certificate-holders are relatively anonymous and their daily location is unknown to the insurer. Because the viability of the Group Disability Insurance market is linked to that of the viability of Group Life Insurance, ACLI refers Treasury to its information relevant to whether to include Group Life Insurance in the existing federal program.

Reinsurance: For purposes of this discussion, Reinsurance should be understood as two categories of coverage, catastrophic and non-catestrophic. As can be seen from the survey, many insurers and reinsurers have already experienced decreased availability of catastrophe reinsurance coverage as a result of the events of 9/11. Additionally, if the coverage is available at all, the risk of loss from NBCR events is now being excluded and the price has increased exponentially from pre-9/11 levels. The diminished availability of catastrophe reinsurance and the associated increased pricing directly correlates to the inability of catastrophe reinsurers, like all insurers, to actuarially evaluate terrorism risk. On the other hand, there has been no reported lack of availability of other, non-catastrophic, traditional forms of life reinsurance, such as quota share and yearly renewable term. The concern expressed in this document about the future availability of life and disability insurance is echoed for non-catastrophic reinsurance. Reinsurers providing such coverage follow the fortunes of their direct writing client companies but are not able to purchase catastrophe reinsurance to spread their risk.

1.4 What is the market structure of those lines of insurance cited in 1.2? In your answer, please describe, as quantitatively as you can, the degree of competition in the markets for those lines, the net premiums to surplus ratios for companies in those lines, and other measures of market structure that you believe are relevant; and compare them to the insurance industry average. What is the distribution of market share (highly concentrated among a few entities, broadly distributed, other)? What types of insurers hold the majority of the market share (local, regional, national, other)?

US life insurance companies sell the vast majority of life insurance and annuities purchased in the United States. Fraternal organizations and federal government agencies are also in the marketplace, and certain Canadian life insurers with US legal reserves are allowed to sell insurance directly from their Canadian offices to US purchasers. The number of life insurance companies in business in the United States was 1,171 at the end of 2002. Most life companies are organized as either stock or mutual companies. The majority of life insurers are stock companies—1,076, or 92%, of the industry. Many life insurance companies are affiliated with other life and non-life insurance companies in fleets with a single parent. Together, stock and mutual life insurers provide 94% of the total insurance and annuities underwritten by US organizations. Mutual life insurance companies had $1.8 trillion of life insurance in force in 2002 and stock life insurance companies, $14.5 trillion.[iv]

The proportion of foreign-owned insurance companies operating in the United States increased to 11% by 2002. From 67 companies in 1996, foreign-owned life insurers expanded their presence to 132 companies in 2002. The same countries have fielded the major foreign players in the US market since the mid-1990s: the Netherlands (32 companies), Canada (24), Belgium (17), Switzerland (15), and the United Kingdom (12). Appendix B provides the Capital Ratios for the Top 50 Individual Life Insurance Companies. Appendix C provides Individual Life Insurance Market Share Ratios By State. Appendix D provides the Capital Ratios for the Top 50 Group Life Insurance Companies. Appendix E provides Group Life Insurance Market Share Ratios By State.[v] Insurers distributing products though-out the US hold the vast majority of the market share in each state.

1.5 What is the current capacity of insurers in those lines cited in 1.2 to bear the risk of acts of terrorism, individually and as affiliates of other companies with support from them?

An insurer's ability to withstand losses from unexpected events is related to the size of its surplus. Surplus funds amounted to $198 billion for US life insurers at the end of 2002. These funds provide extra reserve safeguards for such contingencies as an unexpected rise in death rates among policyholders, unusual changes in the value of securities, and general protection for policy obligations. Several factors influence the amount of surplus retained by a life insurer, including the size of the company, kinds of insurance written, mortality experience, general business conditions, and government regulation.

One measure of the adequacy of a life insurer's surplus is its capital ratio: surplus funds plus capital stock plus the Asset Valuation Reserve (an amount set aside to dampen asset value fluctuation) as a percentage of general account assets. Theoretically, the higher the capital ratio, the better a company is able to withstand adverse investment and mortality experience. However, the type of company and the distribution of its book of business can make comparisons among companies and to an industry-wide average much less meaningful. In 2002, the aggregate capital ratio of U.S. life insurers dropped to 9.3% from 10.1% in 2001. Life insurance regulators created the risk-based capital (RBC) ratio to monitor life insurance company solvency. The RBC ratio is total adjusted capital divided by a risk-adjusted required capital amount, for a threshold ratio of 100 percent. The ratio provides a means for evaluating the adequacy of an insurer's capital relative to the *known* risks inherent in the insurer's operations. From 1993 when life insurers began reporting risk-based capital, the average RBC ratio rose steadily to a plateau of 290% in 1997, which remained unbroken until 2001. The ratio jumped to 346% in 2001, due mainly to two accounting changes. The ratio decreased to 325 percent in 2002. Most companies have an RBC ratio well above the regulatory minimum level of 100%. By year-end 2002, 1,002 companies, or 89% of life insurers, had a ratio of 200% or more. These companies carried 97% of the industry's total assets. Only 25 companies had inadequate capital triggering regulatory action at the end of 2002.[vi] It is important to note that, while an industry-wide RBC ratio in excess of 300% would indicate a strongly capitalized industry, the risk adjustment formula for required capital does not include the contingent risk of terrorist events. Because such events are difficult, or even impossible, to model, it is unclear how the inclusion of terrorism might impact RBC ratios. Most importantly, the statistical correlation between a terrorist induced high mortality/morbidity event and the financial markets' response to that event is unknown. It is likely that insurers are holding assets that would be seriously impaired in light of any major terrorist attack, undermining their surplus when it is most needed to pay increased death and disability claims.

1.6 Compared to the condition of reinsurance and alternative markets before the attack of September 11, 2001, what is the availability and affordability of reinsurance or of alternatives sources of protection, for insurers offering coverage in lines cited in 1.2? What is the degree to which those insurers can mitigate their exposure through other means? Are there additional loss control programs or mitigation measures that could be undertaken?

The capital markets generally are not available to provide catastrophe coverage to life insurers. Due to the historically low frequency and high severity of multiple life catastrophic occurrences, there is no generally accepted life insurance catastrophe modeling tool available.

There is one existing private industry catastrophe risk pool, Special Pooled Risk Administrators, Inc. (SPRA). Established in 1972, SPRA is a New Jersey subsidiary of Swiss Re, administering a unique program to enable life insurers to address problems of concentrated risk of catastrophic accidental death claims for both individual and group life risks. Individual risks are covered in the Ordinary Pool; group life risks are covered in the Group Pool.

An insurer joins the pool by contracting with SPRA, the administrator. Each participant makes a pro rata payment on each catastrophic accident claim presented to the pool by itself or any other member. Such payments, made after the occurrence and settlement by the insuring participant and its policyholders, are the actual experience of the pool and, thus, the only "premium" for the reinsurance provided.

On 9/11, the Ordinary Pool represented 111 individual life insurers, and the Group Pool represented 42 life insurers. SPRA paid $104 million of group life insurance and $180 million of individual life insurance from 9/11.

Since 9/11, SPRA capacity has grown to $750 million for the Group Pool and $450 million for the Ordinary Pool. As helpful as this might be, the SPRA does not remove the catastrophe risk of ACLI concern. SPRA does not address the issue of loss mitigation if the loss is substantial but it does address the risk associated with geographic concentration even if the loss is as large as the 9/11 loss. In industry ruin scenarios, the value of participation in such a voluntary pool decreases because it cannot distribute risk beyond the industry or even to all members of the industry. ACLI members agree that this pool cannot address the dilemma of life insurers confronting large terrorist loss exposures today.

Questions exist as to whether private market pool mechanisms could develop to fully address terrorism risk besetting the life insurance industry today. Because no voluntary pool can accommodate the magnitude of possible terrorism events, the ACLI sees value in the federal government exploring possible federal alternatives.

Other means of risk mitigation available to the life insurance industry include portfolio diversification through reinsurance, limiting sales in high-risk geographical or metropolitan areas, and limiting sales made to groups where a large number of covered lives are concentrated in a limited number of locations. However, these risk mitigation techniques address the problem only minimally, as insurers have limited means to identify high-risk areas or methodologies to properly quantify the risk.

1.7 *What is the Federal and State regulatory structure applicable to those lines of insurance cited in 1.2? In particular please describe whether exclusions are allowed and for what risks*.

There is no Federal regulatory structure applicable to Individual Life Insurance, Group Life Insurance, Individual Disability Income, Group Disability Income, or Reinsurance. Rather, the States regulate the identified lines. Reinsurance is not regulated *per se*, though States do evaluate reinsurance for purposes of determining to what extent credit for reinsurance will be granted to ceding insurers. The States, to some degree, coordinate their policies on various insurance matters through the offices and activities of the National Association of Insurance Commissioners (NAIC).

The States and the NAIC recognized the stress visited upon certain lines of property and casualty insurance following 9/11 and promptly approved terrorism exclusions for such lines. Turning then to other insurance lines, the NAIC discussed in February 2002 whether NAIC should recommend that state insurance departments approve applications for terrorism exclusions for property and casualty personal lines risks and group life and disability risks. There was no support for approving exclusions to property and casualty personal lines insurance.

With regard to group life and disability risks, there was an appreciation that there exists a concentration of risk factor similar to that present for commercial liability and property risks, the only two kinds of insurance for which NAIC recommended state approval of terrorism exclusions. Regulators were concerned that consumers relying on group and life and disability insurance for family needs might be misled by a terrorism exclusion without special disclosure.. The existence of markets for such risks, however, led regulators to believe that any problems are company-specific rather than affecting sector or line of business.

Terrorism exclusions. Special terrorism exclusions are not wholly new to life insurers. There appears to be some limited experience in requiring them for individuals working in locations where there is heightened terrorist risk, e.g., Northern Ireland. But the idea of including terrorism exclusions generally into both individual and group life insurance contracts as a result of the post-9/11 environment is new and raises several important and difficult questions.

On one hand, 9/11, the anthrax letters, and the Oklahoma City bombing indicate that the terrorist threat to American civilians has risen to a new dimension that may require insurers to respond. Experts testifying before the Congress and state regulators[vii] disagree whether it is possible to underwrite the terrorist risk, though the majority of them apparently conclude that underwriting is impossible.[viii]

On the other hand, it appears unlikely that the expected magnitude of increased risk would affect the mortality tables used in pricing and reserving life insurance. In general, actuaries use smoothing techniques to eliminate (what they believe to be) one-time mortality spikes. Even the 1917 influenza epidemic – the historical event contributing the worst US mortality experience – did not have a discernible impact upon the mortality tables. Short of an unprecedented NBCR attack using a weapon of mass destruction, or multiple attacks with several thousand deaths per event, it seems unlikely that there might be individually insured lives lost that even upon an aggregated basis would disrupt individual life underwriting. Thus it seems that terrorism exclusions on individual life insurance policies might be unwarranted without a particular demonstration of need by an insurer to its state regulator.

But group life and disability insurance presents geographical concentrations of risk that do clearly affect underwriting and risk management decisions that might touch on the exposure of the insurer to insolvency. Hence, group life and disability insurer applications for approval of terrorism exclusions should be considered on the merits by the state regulator.

The NAIC adopted a statement of guidance to the states regarding applications by life insurers for exclusions from policy coverage for acts of terrorism. The NAIC statement is as follows:

> *It is the sense of the NAIC membership that terrorism exclusions are not necessary for individual life and health products, and are generally not necessary to maintain a competitive market for group life and health products. They also may violate state law. However, we recognize that state laws vary in their authority and discretion. Further, there may be unique company circumstances in the group market that need to be considered on a case-by-case basis. We expect the need for the exceptions to be limited. We urge carriers and government entities to explore private and public pooling mechanisms in the group market to mitigate problems that arise from concentration of risk.*
>
> (Adopted 17 March 2002, NAIC Spring National Meeting, Reno, Nevada.)

Several states have adopted policy based upon NAIC guidance.[ix] Generally, states have not approved the use of terrorism exclusions for any line of life insurance.

War exclusions. The vast majority of states have historically permitted life insurance policy exclusions for war risk.[x] War clauses vary widely, ranging from absolute prohibition of payment if the insured was in the armed forces at the time of death to a clause which denies payment only if the insured's death resulted from war. In most cases, the insurer must refund the premium or an amount equal to the policy reserve.[xi] One reason there is such a variety of war clauses in existence is because courts often construe them to provide coverage when it was not intended by the insurer; hence the language of the clauses sometimes appear to contain excess verbiage or to be over-reaching.[xii] Also important is the fact that all members of the Uniformed Services are automatically insured for $250,000 under the federal Servicemembers' Group Life Insurance (SGLI) program unless the individual elects otherwise.[xiii]

The enforcement of war exclusion against a loss suffered due to terrorism likely raises two sets of questions in today's environment. The first set has to do with the precise articulation of the war clause in the policy. The second may relate to the facts of the loss. That is, the President of the United States and other national leaders speak of a "war on terrorism", and Al Qaeda, the Islamic terrorist organization against which current military action is being directed, declared "war" against the United States, expressly including US citizens. A loss attributable to an attack from Al Qaeda operatives may well be addressed by the traditional war exclusion. On the other hand, it is not clear that *any* loss attributable to terrorism would be addressed by the war exclusion.

II. Current Insurance Availability Conditions

2.1 Please describe current insurance availability conditions in as much detail as possible for customers of the lines cited in 1.2. If there is reduced availability of a particular line of insurance for some customers, please indicate the line and describe the reduced availability as quantitatively as possible, including, to the extent you can, which customers have been significantly affected, by type and location. Please indicate whether such customers have access to alternative sources of insurance, including the cost and availability of these alternative sources, or whether the customers are not covered.

The survey results show that there has been as yet no broad reduction in availability for any line of insurance due to the events of 9/11 and the ongoing threat of other terrorist attacks. However, certain group insurers have limited sales to groups where covered lives are concentrated in a limited number of locations and some insurers are limiting sales in what are perceived as high-risk geographic areas. *See* Appendix A, Question 5.

2.2 What is the impact on community and regional economies and well-being, and the national economy of such reduced availability and affordability for those customers?

The impact has been minimal thus far. The number of companies that have changed underwriting practices to limit availability is small and the remainder of the market has provided coverage for all who seek insurance. However, the current stability in the market could be expected to change if a material terrorist attack or series of attacks occurred. The capital market would likely be inhibited from continued investment in the insurance industry in an environment where the risk of large losses by insurers became evident, or would demand a much higher return on capital given the high degree of risk. Such events would cause many insurers to leave the market, while those remaining would likely be pressed to increase prices to accommodate the demanded higher return on capital by investors.

III. Impact of Potential Future Acts of Terrorism

In this section we solicit comment on the effect of potential future acts of terrorism—single events or aggregation of several events across locale or across a time period—that could cause significant and extended disruptions in availability of insurance lines cited in 1.2.

3.1 In order to facilitate our analysis, please set out the consequences of potential future acts of terrorism for each line of insurance cited in 1.2 within the following broad dimensions:

(1) The relative concentration of the insurance industry exposed to the loss (including the following categories: (a) Loss broadly distributed—share of loss is equivalent to market share; (b) concentration of loss among many small companies—share of loss is greater than market share for large number of small companies and less than market share among market leaders; (c) concentration of loss among market leaders—share of loss is greater than market share for large companies and less than market share among small companies; (d) other distributions deemed of interest); and (2) the size of the loss (including the following categories: net present value of losses of approximately the following sizes: \$5 billion, \$15 billion, \$30 billion, \$60 billion or larger). Within each ''cell'' identified by a single concentration and loss category, please describe as specifically as possible:

- *Impact on financial capacity of insurers in the line (e.g., as reduction in share of large local, regional or national market), whether and how many insolvencies might be the result, the extent to which state guarantee funds might be affected, any systemic impact on the insurance industry; and the length of time over which the industry might be able to recover.*
- *Scope of any significant reduction in availability of coverage in the line, including length of time over which coverage is reduced and numbers of customers or subsets of customers potentially affected.*
- *Scope of impact on the economies and well being of the communities in which the reductions in availability take place, the associated regions, and the national economy. Please be specific as to how the impact is transmitted from the affected community to the regional and national economy.*
- *If you do not believe this format allows you to adequately answer the question, please alter as needed. Please note that descriptions of scenarios of individual events are not likely to be as helpful as broad aggregates.*

This question, which asks for a matrix of sixty cells of information and then complicated analyses of their significance, might be accomplished by a sophisticated actuarial firm at great expense with sufficient time. It is beyond the ken of ACLI with such short notice and due within the statutory deadline.

However, one part of this Question inquires about the ability of state guaranty funds to handle large terrorism losses. The ACLI has brought Treasury's Federal Register notice to the attention of the National Organization of Life and Health Insurance Guaranty Associations (NOLGHA), and we respectfully recommend that Treasury address any specific question concerning state guaranty funds to that organization. ACLI takes this opportunity, however, to point out that the state guaranty funds have much the same limitations as other forms of pools, i.e., they operate within a closed system of funding limited by the total capital and surplus of the life insurance industry. Further, they operate only to address failed insurers. The failure of several major insurance companies would have broad economic consequences, as policyholders and investors alike could be expected to flee insurance companies, contributing more stress on a crippled industry. It is not difficult to imagine a snowballing effect, as more and more policyholders withdraw their money, leading to failures within the industry.

In order to better evaluate the nature of industry afflictions from terrorist loss and the benefits of different approaches to remediation, ACLI actuaries developed characteristics of different threshold amounts of loss (Threshold Amount). The actuaries developed scenarios at four levels: $5B, 10B, 15B, and 20B. For perspective, the actuaries measured approximate losses from 2 catastrophic events. Losses from 9/11 have been estimated at $2-3 Billion. An event that increases mortality rates by 30-40%, such as the 1918 influenza epidemic, would cause additional death claims of $14.5-19.3 Billion. Table 1 compares these four thresholds with other various measures. As can be seen, a $10 Billion event would have the effect of increasing industry death claims by 20.7%, and reducing overall industry surplus by 4.9%. For comparison, a $10 Billion event for property and casualty insurers would have the effect of increasing industry claims by 4.2%, and reducing overall property and casualty insurance industry surplus by 3.2% (and 8.0% of the surplus backing commercial lines). Hence, for a given size event, the resulting financial impact is much greater for the life insurance industry versus the property and casualty insurance industry. Similar comparisons are shown for all four scenarios. ACLI proffers the following analysis for consideration:

(continued…)

Table 1, Considerations in Setting Threshold

	Annual Threshold			
Quantitative	**$5 Billion**	**$10 Billion**	**$15 Billion**	**$20 Billion**
% of Life Industry Death Claims[1]	10.4%	20.7%	31.1%	41.5%
% of Life Industry Surplus[2]				
– Total	2.5	4.9	7.4	9.9
– Portion Attributable to C-2[3]	12.5	24.5	37.0	49.5
% of P&C Industry[4]				
– % of Total Claims	2.1	4.2	6.3	8.4
– % of Industry Surplus	1.6	3.2	4.7	6.3
– % of P&C Threshold[5]	50.0	100.0	150.0	200.0
– % of Surplus for Comm Lines	4.0	8.0	12.0	16.0

Qualitative	
$5 Billion	Approximately 2 times the size of WTC disaster — approximately 3,000 lives lost, $2.0-3.0 billion of life claims.
$15 Billion	Comparable to 1917 flu epidemic, which resulted in approximately 30-40% increase in mortality rates in 1918. If this had occurred in 2002, it would translate to $14.5-19.3 billion of additional claims.

[1] Total industry death claims = $48.2 billion (as of 12/31/02)
[2] Industry surplus as of 12/31/2002 = $202.1 billion
[3] Assumes C-2 (mortality/morbidity risk) component = 20% of total
[4] P&C industry reflects 2000 figures; $239 billion of total claims, $317 billion of total surplus, commercial lines surplus = $125 billion
[5] % of 2003 insurance marketplace aggregate retention amount established by HR3210

Other considerations:

1. Impact of terrorist attacks will vary by individual company
2. Analysis does not reflect impact of economic correlation with large terrorist attack (e.g., bond defaults, market declines)

3.2 If not already identified in the matrix above, please describe the class of events with the ''worst'' impact for the line of insurance affected, indicating the concentration and the size of the event (or aggregate of events).

Group insurers, both life and disability, are more subject to concentration risk, meaning that an isolated terrorist attack on a large center of employment could have a substantial impact on any insurer writing those lines of business.

On the other hand, Individual Life and Disability insurers, while exposed to less concentration risk in relation to employment location, still may have significant concentration of insureds within a particular metropolitan area or state. Therefore, any terrorist event that affected a population center could have a substantial impact on Individual Life insurers.

Obviously, the "worst" impact, based on scenarios described in Question 3.1, occurs with an event of $20 billion or more of claims. However, scenarios of substantial impact occur at significantly lower claims levels. *See* Table 1, supra, responding to Question 3.1.

3.3 Please describe, to the extent possible, the likelihood of the events included in the matrix above.

Treasury, with its Administration relationship to Departments of Homeland Security, Defense, and State, is much better positioned to answer this question than is ACLI. As recently as the last week of July 2003 government officials advised of a heightened possibility of suicide commercial jetliner attacks against American targets during August 2003 based on information obtained from Al Qaeda. ACLI observes that there is a rich history of analysis from government, academic and scientific sources discussing various events and their likelihood.[xiv] Most recently, federal and state authorities have engaged in drills in various municipalities for emergency events the authorities must believe are potentially realistic.

3.4 *Please indicate whether you believe that the severity and likelihood of these events as you have described them is accurately reflected in current insurance availability conditions. Please be as specific as possible, including citing instances from your answers to questions 2.1–2.4*.

ACLI believes its survey and commentary above addresses this Question.

Federal Options

The ACLI believes that it is prudent for the federal government to consider the benefits of a federal backstop for Individual Life and Individual Disability and that a potential design be prepared should a future terrorist event of such catastrophic proportions make such a mechanism necessary. For purposes of education and discussion, the ACLI has prepared a concept draft of a possible federal backstop mechanism. The concept draft contemplates that the United States government would provide stabilization funding to direct insurers for ordinary life, group life, or disability excess losses attributable to terrorism when excess losses reach a Threshold Amount. Life insurers would report all claims for terrorism losses (Covered Acts) to the Secretary of the Treasury as well as reinsurers with a direct interest in the claim. The Secretary would aggregate such losses, determining whether any particular incident was terrorism for reporting purposes. If the aggregated losses reach a Threshold Amount of excess loss, Treasury is authorized to fund 80-100% of the excess loss, depending on level of excess.

Federal stabilization payments would be based upon the terrorism losses experienced by individually reporting insurers, comparing each insurer's experience to the total, aggregated losses of all insurers and the ratio of aggregated excess over industry retained loss. The concept draft provides for federal distribution of funds by March 1 of the year following that of excess loss determination, though advance periodic payments are provided for should they be warranted.

The ACLI concept draft contemplates industry retaining its historical proportion of risk and managing it with traditional underwriting, pooling and reinsurance tools. Federal stabilization funding is required only upon excess losses due to genuinely extraordinary catastrophic experience(s). The simple funds distribution method is admittedly insensitive to the possibility of geographic or market concentration that could result in disproportionate loss to an insurer or insurers, but it recognizes the impossibility of predicting terrorism loss by geography or market, and serves as an incentive for insurers to decentralize risk via underwriting, pooling and reinsurance.

The ACLI concept draft omits payback provisions such as those that exist in the Terrorism Risk Insurance Act (TRIA). This is because there is no way to retroactively surcharge in force Individual Life Insurance policies to recoup the additional terrorism exposure costs of the 21st Century. Inasmuch as the industry would retain its historical proportion of risk, it further seems appropriate as a matter of public policy that the loss attributable to a calamitous terrorist attack or series of attacks would be recognized as a public burden properly distributed via the federal backstop.

Another difference between the ACLI concept draft and the TRIA is the non-inclusion of company deductibles. The TRIA, which provides a backstop for property and casualty insurance risks and possibly a backstop for Group Life, includes threshold limits at a company level in addition to industry thresholds. This mechanism provides relief to a company distressed from terrorism losses even when the total catastrophe is not large enough to break through the industry threshold limit. The concept draft does not include a provision for company threshold limits. This is consistent with the ACLI Survey results suggesting that there is not a perceived need for a backstop at the company level but a perceived need at the Reinsurance level.

The concept draft is found at Appendix F. Briefly, it provides as follows:

CONCEPT DRAFT FEDERAL TERRORISM RESPONSE LEGISLATION

Section-by-Section Summary

Section 1. Short Title

The Act is entitled the “Life and Disability Insurance Terrorism Response and Financial Stabilization Act”.

Section 2. Congressional Findings and Declaration of Purpose

The provision finds that the September 11 attack threatens the availability and affordability of life and disability insurance because the risk of catastrophic mortality or disability was not underwritten. Finds further that terrorism is a social issue that should be addressed through shared commitment of industry and government. The purpose of the Act is to provide assurance to insurers and reinsurers that they can continue to provide life and disability insurance—including group coverage to employers—to cover the risk of catastrophic loss due to terrorism occurring within the US.

Section 3. Definitions

Defines 12 particular terms used in the Act. A “Covered Act” is any act of terrorism in the US occurring after 11 September 2001 including such acts in US territories and possessions, on non-military US flag aircraft or vessels anywhere in the world, and on any aircraft en route to or from a destination in the US. “Covered Disability Claims” are defined as those claims paid for which reserves are established resulting from a Covered Act. “Covered Disability Losses” are defined to mean an amount equal to reserves held on disability insurance for federal income tax purposes. “Covered Life Losses” means claims arising from Covered Acts incurred by direct insurers on policies in force. “Covered Losses” means the sum of Covered Life plus Disability Losses sustained by direct insurers. “Excess Losses” means Covered Losses in excess of the Threshold Amount. “Funding Amount” means:

1. 80% of Excess Loss up to [10] billions dollars;
2. 90% of additional Excess Loss to [20] billion dollars; and
3. 100% of additional Excess Loss above [20] billion dollars.

“Life Insurer” is a direct insurer licensed by a US State to write life or disability insurance that participates in a state guaranty fund. “Reinsurer” is a company or entity that has assumed Covered Life or Disability Losses from a Life Insurer pursuant to a reinsurance agreement that has paid all or a portion of the Covered Losses. The “Secretary” is the US Secretary of the Treasury. The “Threshold Amount” is numerically undefined, but provided to exceed a billion dollars except for any calendar year immediately following a year in which Covered Losses exceed a lesser numerical amount that itself exceeds at least a billion dollars. The dollar amount shall be increased annually by the same percentage as Social Security benefits. The multi-year flexibility built into the definition of Threshold Amount addresses the possibility that Covered Acts could occur but not reach the Threshold Amount in the first year though still substantially draining upon industry reserves. Hence the Threshold Amount is reduced in the second year to address Covered Losses over time.

Section 4. Federal Stabilization Funds

Authorizes the Secretary to provide funds to Life Insurers and Reinsurers to fund Excess Losses. All Life Insurers and Reinsurers shall report by January 15 of every relevant year both gross Covered Losses and Losses net of reinsurance recovery as of the end of the preceding year. An allocation formula is provided to calculate the distribution of federal funding, which is accomplished on a net basis utilizing the same ratio of funding amount over total Covered Losses. A fund distribution plan is provided for. A retrospective company analysis is required to enable government to recoup excess funds released compared to actual claims experience.

Section 5. Rulemaking Authority

The Treasury Secretary is granted regulatory authority.

Section 6. Applicability of State Law

States laws regulating the amount of coverage or policy form approval or disapproval are preempted to the extent they apply to terrorism coverage in life or disability insurance policy forms. Funds released under the Act become admitted assets of the insurer or reinsurer for reporting purposes. The domiciliary state insurance department is charged to audit the distribution of federal funding.

Section 7. Secretary's Determination

The Secretary is authorized to determine whether any incident constitutes a Covered Act of terrorism. In the absence of the Secretary' determination, insurers and reinsurers may appeal to, first, the Secretary and, second, to US District Court for a determination.

Section 8. Authorization of Appropriations

Such sums as may be necessary are authorized for appropriation.

Section 9. Federal Definition of Insurance

Certain policy charges are recognized as Qualified Additional Benefits for tax compliance purposes.

Section 10. Termination of Federal Stabilization Funding

The concept draft applies to Covered Acts occurring prior to 1 January 2007. A commission is authorized in 2005 to evaluate the terrorist threat as well as private insurance market resources to address such threat. The study is to be delivered to Congress by 2006.

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ACLI Communications

Thank you for considering these comments. To expedite ACLI responsiveness to Treasury inquiries and requests for information, please use the following individuals as your contacts for ongoing communications:

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Sincerely,

FRANK KEATING, PRESIDENT
The American Council of Life Insurers

Appendices

A: ACLI Terrorism Impact Survey
B: Capital Ratios for the Top 50 Individual Life Insurance Companies
C: Individual Life Insurance Market Share Ratios By State
D: Capital Ratios for the Top 35 Group Life Insurance Companies
E: Group Life Insurance Market Share Ratios By State
F: "Life and Disability Insurance Terrorism Response and Financial Stabilization Act"

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[i] 68 Fed. Reg. 35775.
[ii] *Life Insurers Fact Book 2003*, ACLI, Chapter 2, "Assets".
[iii] *Ibid*, Table 7.5 "Life Insurance With Disability Provisions in the United States, 2001".
[iv] *Life Insurers Fact Book 2003*, ACLI, Chapter 1, "Overview
[v]"Ibid.
[vi] See, generally, *Life Insurers Fact Book 2002*, ACLI, Chapter 3, "Liabilities".
[vii] Experts discussed this particular aspect of the situation on 17 January 2002 during the National Association of Insurance Commissioners Public Forum on the Availability and Affordability of Terrorism Reinsurance.
[viii] The argument divides between those who believe it impossible to underwrite a risk where the causal agent, i.e., the terrorist, learns from experience, has technology to increase his or her deadly effectiveness, and may be willing to sacrifice his or her own life to achieve the deadly goal; and those who believe it just as possible to evaluate possible mortality attributable to terrorism as it is to evaluate mortality attributable to earthquake or influenza.
[ix] See, e.g., North Carolina Department of Insurance Bulletin 02-B-2 (3/15/02).
[x] Two other standard exclusions are those for suicide and aviation risk.
[xi] Mehr & Cammack, Principles of Insurance, 1976, pp. 427-428.
[xii] That is, courts have held insurance contracts to be contracts of adhesion, where any ambiguity is interpreted against the insurer that prepared the text of the policy and its exclusions. An insurer intends to exclude war from coverage, for example, and includes a phrase "enemy attack by armed forces, including action taken by military, naval, or air forces in resisting an actual or an immediately pending attack." Along comes an insured with a loss who argues that it was not caused by "enemy attack" but rather by invasion. A court agrees with the insured, or beneficiary of the policy. The policy exclusion is then amended to add the word "invasion." See Mehr & Cammack, ibid., at pp. 162-163. Thus many war clauses have been extended to "war, declared or undeclared" to address the historical fact that it became politically unfashionable to have Congress declare war even though the United States was involved over the second half of the 20th Century in numerous military or "police" actions involving troops, naval and air forces, and resulting in many American casualties. Indeed, the current situation is rife with ambiguity of consternation to insurers, since the war against terrorism is unlikely to be formally declared by Congress and not directed against any recognized state or nation.
[xiii] Members of the Individual Ready Reserve (IRR), assigned to positions in which they may be required to perform active duty, are also automatically enrolled in the SGLI program for $250,000. The SGLI also covers spouses and children of members insured under the program.
[xiv] The Cold War generated numerous studies of potential nuclear calamities. See, e.g., *The Effects of Nuclear War*, Office of Technology Assessment (National Technical Information Service) August, 1979. Chapter II discusses the effects of the detonation of a one-megaton nuclear device over Detroit. More recently, the effects of a nuclear explosion at the World Trade Center was discussed in "Avoiding Nuclear Anarchy", *BCSIA Studies in International Security*, 1996 (G.T. Allison, editor). The ramifications of terrorist attack against commercial nuclear reactors is discussed in "Nuclear Power Plants and Their Fuel as Terrorist Targets", D.M. Chaplin, *Science* 297, pp. 997-998 (2002). See, also, *Science* 299, pp. 201-203 (2003). Biological threat scenarios are summarized in *Engineering and Science*, 64[3-4](2001)(Steven Koonin article). In July 2001, ACLI President Frank Keating, then Governor of Oklahoma, participated in the Dark Winter exercise (a simulated covert smallpox attack on the US) carried out by The Johns Hopkins University Center for Civilian Biodefense Strategies, in collaboration with the Center for Strategic and International Studies (CSIS), the Analytic Services Institute for Homeland Security, and the Oklahoma National Memorial Institute for the Prevention of Terrorism. This and other exercises are engagingly discussed in *Our Final Hour: A Scientist's Warning* by Dr. Martin Rees (New York)(2003).