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Aftermath of 9/11: The Effect on Group Life & Health Carriers

Track: Health

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Panelists: JANET M. CARSTENS
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Summary: Panelists discuss the implications of 9/11, such as geographic concentrations of risk, terrorism clauses, carrier response, legislative changes that may help carriers limit risk, accidental death-only programs, effects on health and disability costs, changes in practices and changes in claim incurrence and payment patterns. Attendees gain an overview of the effect that 9/11 has had and is expected to have on the group life and health marketplace.

MR. DANIEL L. WOLAK: I'm senior vice president at General Cologne Life Re in Stamford, Conn. We're part of Berkshire Hathaway, which is a large holding company, and Gen Re is part of that.

Gen Re had substantial losses from 9/11; so from the reinsurance side, it's an event that had serious financial impact on our company. We've had to think a lot about it, not necessarily from losses from the group life side or from the group side, but from the property and casualty (P&C) side. Our owner, Warren Buffett, in talking about 9/11 and the fact that we possibly hadn't planned for it properly, said Gen Re violated Noah's rule, which is: "Predicting rain doesn't count; building arks does." And that's the one thing from our business side: We want to make sure we have ourselves set in case of another event, that we're in a sound position.

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Also on the panel is Jan Carstens. Jan is a consultant for Milliman U.S.A. in Minneapolis. During the past year, she's been a vice chair for the Health Practice Council of the American Academy of Actuaries and will be a vice president for the Academy as we move to the new year.

Geoff Sandler works at Empire Blue Cross/Blue Shield in New York City. Geoff is going to have an interesting business perspective today on the impact of 9/11, simply because Geoff's firm was in the North Tower of the World Trade Center. Geoff has been the vice president of the Academy and has been the chair of the Health Practice Council during the past year. So we have two people who have been very active on the Academy side.

Finally, we have Dale Hagstrom, who's a consultant for Milliman U.S.A. in New York City, and he will round out our panel.

First, Geoff will talk about the business impact, the business being the personal business and the personal impact on the employees of such an event. Next, Jan Carstens will be speaking about the Academy's view and what the Academy has been working on as far as the paper on the impact of such an event.

Finally, Dale Hagstrom is going to be getting us back to the insurance risk-taker's impact of 9/11. And, finally, we'll end up with some discussion items.

But to open it up, Dale, what has been the impact of 9/11 on you and your business and their clients? What would be a quick synopsis?

MR. DALE S. HAGSTROM: A brief version is that I happened to be in California when 9/11 hit, so I was on the ground there for a week. Our office was in Midtown; so that day was chaos, but we got back to business. Our building manager figured their way of protecting us was to make it impossible to get to the lobby, because they figured that's where the next thing would come through, I guess. But it has not had a large effect on us—obviously it has impacted in different ways, with respect to our clients.

MR. WOLAK: Jan, from your side, you were a little bit further away in the heartland of America in Minneapolis. What do you see has been the impact of 9/11 to you and your clients?

MS. JANET M. CARSTENS: Well, I'll take the opportunity to address how it has affected my clients. It's quite interesting.

I'm a health care consultant. I consult primarily in the medical insurance arena, and there hasn't been a whole lot of impact yet. There's a lot of curiosity on the part of my clients. I've had some clients who have considered putting in some premium adjustments to maybe cover other possible bioterrorism attacks. I've had some clients who have been curious as to what reinsurance options might be available. I

had a conversation with one broker who indicated that one of his reinsurance clients was putting together a type of medical catastrophic terrorism coverage. But so far, I've only heard talk and not really seen anything.

MR. WOLAK: Rather than ask Geoff that question, he will begin his presentation.

MR. GEOFFREY C. SANDLER: There's been a lot of discussion over the past year about the effects of 9/11 on insurance products and markets. Some of this session will address the impact on health plans. But I'm sure many of you have also been thinking about how your companies would be affected operationally by a major event like 9/11.

For Empire Blue Cross/Blue Shield, 9/11 was a very personal experience. It affected our business operations and our lives. I'd like to share with you some of Empire's experiences and observations about our own recovery effort.

Empire Bio

First, I'd like to give a little background on Empire. We're a not-for-profit health insurer operating in 28 counties of eastern New York. We're also a Medicare intermediary. We have more than 6,000 employees spread out over a number of locations, and we commenced operations in the '30s.

Besides the 1,900 employees we had at the World Trade Center, we have more than 4,000 employees spread over a number of other locations outside of New York City.

A little more than three years ago, Empire moved its corporate headquarters from Midtown, New York, to the World Trade Center. At that time, we substantially upgraded our systems. We standardized our workstations and moved to a single set of systems and servers, eliminating what are called rogue individual servers that didn't integrate with the rest of our system. And we substantially increased our disaster plan.

We actually began initial disaster planning in 1995 and built it up over time. We took the opportunity to substantially increase our disaster planning efforts because of the new infrastructure that we would build concurrent with that move.

We established a recovery team, representing the key operational areas. We built a specific focus around how to keep the company operational in the event of a disaster—the key areas that, in the event of a disaster, needed to continue operating, both internally and for the public.

Human Impact of Attacks

In terms of the human resource impact, as I said, we had more than 1,900 employees and consultants working at the World Trade Center. We lost nine of our employees and two outside consultants who were on the premises at the time.

Among the employees we lost were two that you might have heard about; Ed Beyea, who's a quadriplegic, and Abe Zelmanowitz, his best friend, who stayed with him in the stairwell awaiting rescue that unfortunately never came.

Physical Losses and Recovery

At Empire, we lost more than 2,000 computers. In terms of the square footage, we were the largest tenant in the North Tower of the World Trade Center. We had almost 500,000 square feet of office space. And we had more than 1,900 employees. Our physical losses were one of the things that we had to focus on immediately just in terms of getting back to work—replacing office space and replacing equipment.

When we moved to the World Trade Center and moved to a new platform, we implemented intelligent routing, which means that in the event that one of our systems goes down, the system controller automatically reroutes electronically to other servers. That is what happened on Sept. 11 as the World Trade Center buildings went down.

At the same time, our call center had adopted intelligent contact management, and calls would automatically be routed to our various centers. When the World Trade Center went down, they were automatically rerouted to some of our other facilities. We did suffer some disruption in terms of customer service and telephone lines for a few hours on the afternoon of Sept. 11, because major telephone service in the Northeast was disrupted; but we were back online within a few hours.

Backup Plan

I mentioned before that our system controller automatically reroutes things. We also have a primary and a backup controller.

One of the things that happened as part of our disaster recovery effort, in the midst of all that chaos, was that Empire did benefit from having employees who sensed the potential for problems as they developed and took some very quick action, in about an 18-minute window, to make a key decision that kept our system up and running.

TAPED COMMENTS: One of the first things that clicked in my head was that PDC, our primary domain server—our domain is located in the World Trade Center—had collapsed, and we didn't know what issues would arise from it. Would the network be accessible by anybody? Would we be able to rebuild it? Would our backup restore it? Or was it even backed up at that point?

So the first thing I did was run up to a VP here in Albany and inform her that I thought the best idea at the time would be to move the PDC to Albany. And she said, "Well, what would be the consequences of doing that?" And I said, "If we didn't do it, we may be in some dire position here."

And while we were talking, another individual came up and said that the UPSs, which control the power in the World Trade, were falling down and that we needed to make a decision fast. And so she said, "Go ahead and promote one of PDC's backup domain controllers here in Albany through the primary domain controller."

MR. SANDLER: As I said a moment ago, that turned out to be a very key decision by two employees who understood what role they and their function played in the company.

There were countless examples of similar kinds of things as we moved through the recovery process of employees who understood their functions and felt empowered to make certain decisions to help us back on the road to recovery. And I can't stress how important that was, in retrospect.

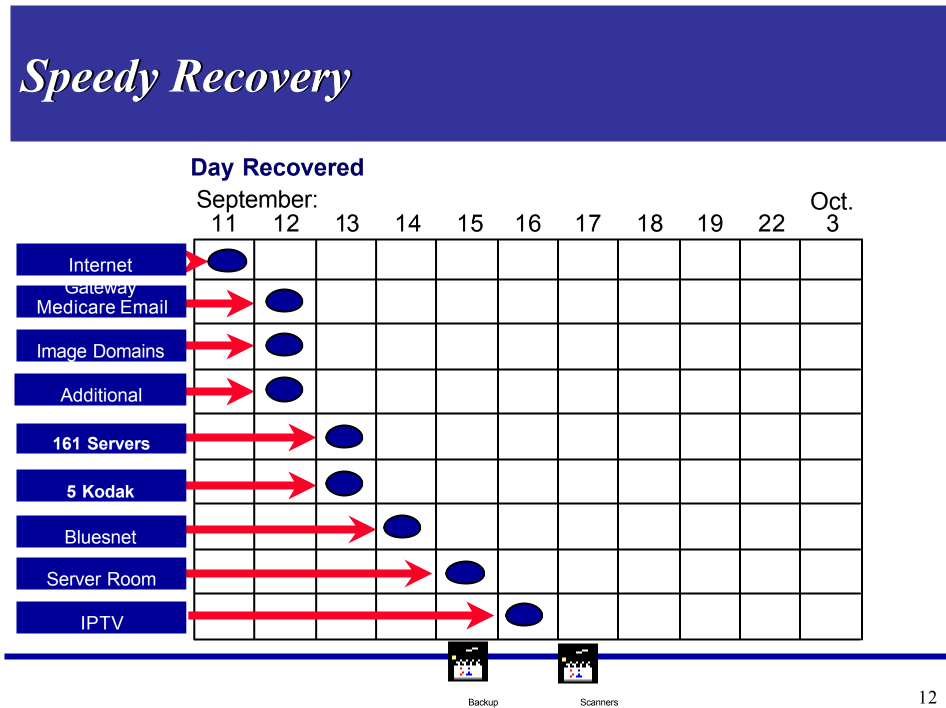
TAPED COMMENTS: Within that first day—which was really about a 22-, 23-hour day—we stabilized our internal network, our infrastructure, our claims system, our phone systems and our call centers. We were able to set up a command center within this building quickly and sought a couple of different areas where we could take calls up on the administrative side and on the call center side.

We set up an outbound call center from the technical side, and some of the operations people were running that to reach out and try to locate our employees.

MR. SANDLER: Some of the things you're hearing about here were contemplated in our disaster planning, and others were decisions that were made on the fly

This, to me, it is fascinating, to chart our overall infrastructure recovery on a day-by-day basis (Figure 1). You can see exactly what came online and when. I'd encourage you to all think about how you would approach organizing these specific tasks—identifying the tasks, figuring out what order to do them in, and actually making the physical arrangements to get them all to happen.

Figure 1



TAPED COMMENTS: I got to Albany Wednesday morning. We started seeing equipment trickle in Wednesday afternoon and Thursday. So our primary goal here was to build the servers as fast as possible.

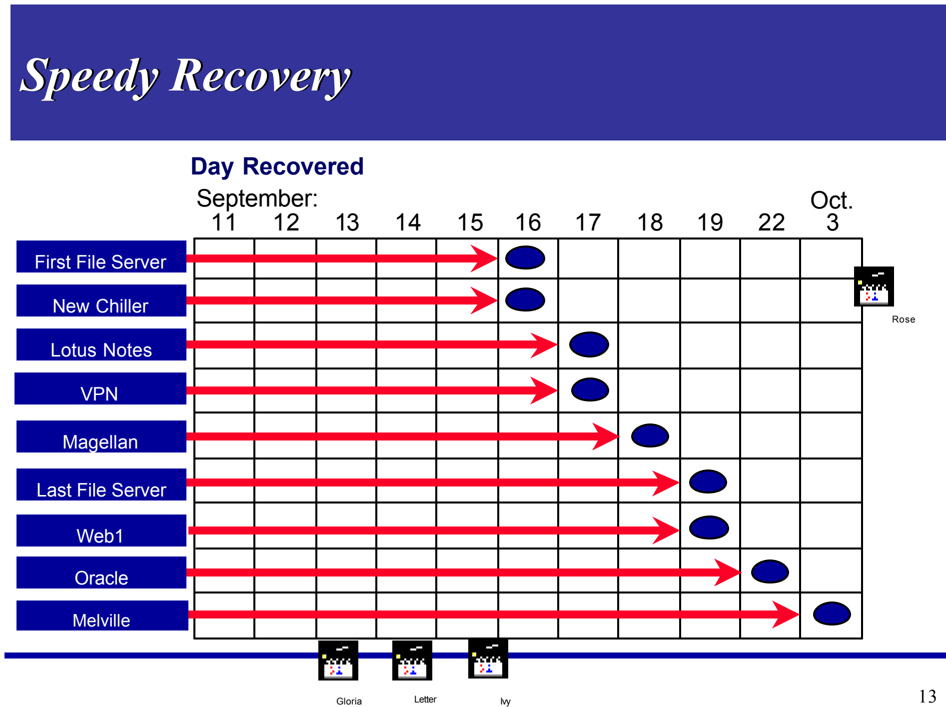
Remember: What did we lose when we lost the World Trade Center? We lost all our e-mailing access. So any e-mail leaving the company or coming into the company was gone. We lost all our access to the Internet, all of our outgoing access to the Internet. We lost specialized servers. We lost online benefits. We lost our Internet servers.

We identified critical servers; Lotus Notes being one, file servers—where the customers' data files reside—being the second.

Then we would take the backup tapes and start restoring the data. And this was 24 by seven. We broke the teams up into two shifts, 12 hours each, and we designed a way of building servers. We had a team of guys building the servers, restoring them in server form. A separate team went behind them doing the restores of the data onto the servers.

MR. SANDLER: Within a little over a month, we had made some unbelievable, in retrospect, progress in rebuilding our operations (Figure 2).

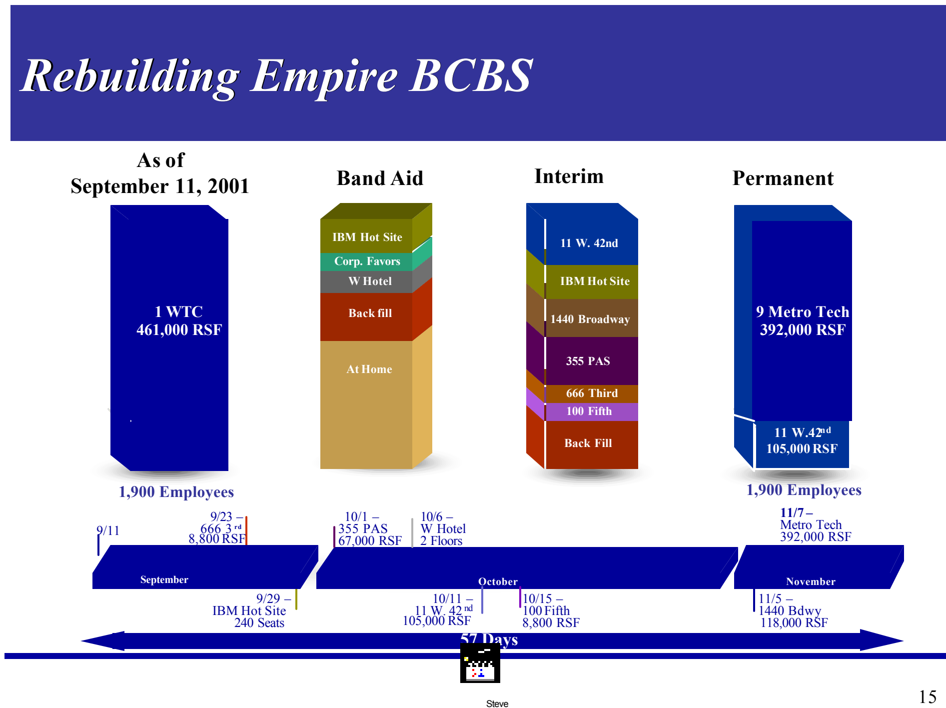
Figure 2



Office Space: The Gargantuan Task

MR. SANDLER: As I indicated before, we had almost 500,000 square feet. In the days after Sept. 11, it was pretty much impossible to find 500,000 square feet available just about anywhere in the New York City area. We began within two days to scout real estate locations, to operate from home and from hotel rooms. There were companies that we do business with as vendors or have other relationships with that offered us available office space within their buildings (Figure 3). Our sister Blue Cross Plan across the river, the Horizon Blue Cross in Newark, N.J., offered us 120 desks to use for about eight weeks.

Figure 3



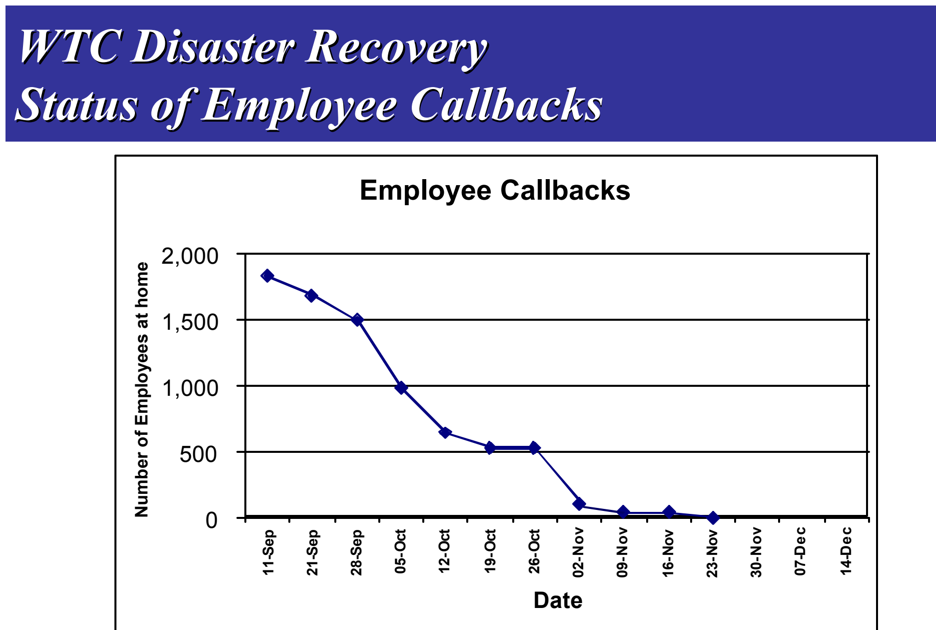
From there, we entered into a number of temporary leasing arrangements. And where we are right now is sort of between the third stage and fourth stage , which is an arrangement to go into a building that's being built in the corporate office park in Brooklyn called Metro Tech Center. That's under construction now and will be completed sometime next year. About 1,500 of our employees now in temporary locations will be moving into that building.

We have about 350 World Trade Center employees who are now at 11 West 42nd St. in New York City, which is our new corporate headquarters.

All of this evaluation of leases—doing the financial analyses to plot the long-term financial impact of these various lease arrangements, the pending resolutions and presentations for our board of directors to approve the decision that ultimately was made—all took place in a little less than eight weeks.

On the afternoon of Sept. 11, we had 1,900 employees who had no place to work. As we obtained temporary office space and built this supporting temporary infrastructure to go along with it, we began calling employees back to work (Figure 4).

Figure 4



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Helping the People
We talked a little bit before about some of the human resource aspects of 9/11.

We implemented a number of things right away; one of which was to set up a call center for employees to call in and identify themselves so that we would be able to determine their status. We also established case management for our injured employees and set up counseling.

Systems Restoration
Just very briefly, from a systems point of view, we have automatic backup. The last backup was Aug. 31, so we lost about 11 days of anything that was stored in our servers that had not yet been backed up to the main computers. We lost about 11 days' worth of material.

Document Dilemma
From a legal and compliance point of view, documents were lost. And if you haven't stopped to think about it, it's kind of overwhelming to think of all of the documents that were lost.

From an actuarial point of view, we certainly lost rate filings, correspondence with insurance departments, financial plans and so on. Some of those things were replaceable; some of them could be reconstructed; others were sort of lost to us.

We went to a number of other sources that had to replace documents, including board members who might have gotten mailings of certain things. We went to regulators to ask for copies of things that were in their files. We even went to an outside counsel with whom we had been involved in lawsuits and provided materials to during the discovery process and asked to get copies of that material back.

There were also some things that you might not have thought of in terms of credentialing that was lost. As a managed care organization, we lost, I believe, the number was somewhere in the magnitude of 50,000 provider credentialing files; because each of the doctors in the mainstream networks has individual credentials—the provider contacts themselves. We have vendor relationships with about 1,100 separate vendors, which includes actuarial consultants, systems, hardware vendors and other office supply suppliers. All of those contracts we lost.

Lease Issues

There were a number of lease issues to settle with our existing landlord at the World Trade Center. We had business interruption and other hardware insurance to cover some of our equipment losses, and all of that had to be sorted out.

Underwriting Issues

Actuarial financial underwriting issues: In terms of disaster recovery, doing actuarial studies was not high on anybody's list of things that had to be recovered on Day 2. However, we did have some rate filings—such as our Medicare + Choice HMO rate filing—which was due to CMS the following Monday, Sept. 17. We actually worked around the clock to complete that and actually did submit it to CMS with their assistance at about 4 o'clock on Monday, Sept. 17.

For those of you who aren't involved in Medicare + Choice filings, in addition to hard copy filings, they're filed electronically through an upload using special software that they supply. And, of course, the software and the computers that we had installed it on were all lost at the World Trade Center. We made the arrangements with them and they did the upload for us.

Renewals

We were in the process of doing a number of renewals of group customers. This was September, and we were already in the cycle of doing Jan. 1 renewals for a number of our groups. Of course, as sympathetic as everybody is with what happened on Sept. 11, each of those customers had their own employees whom they needed to make final decisions on, build communication materials, begin their open enrollment period.

So there was a lot of pressure on us internally—some generated by the client and some just generated by us because of the sense of urgency of wanting to be able to fulfill our obligations to our customers and to continue working on group renewals.

Insurance Settlement Issues

I mentioned insurance settlements—covering our equipment and business interruption losses. Of course, the finance division was involved in assembling all of the information that supported the claims that we had with our insureds, as well as evaluating new leases and managing the purchase of equipment.

Key Factors in Recovery

We were in multiple locations. One key to recovery was that we had employees who understood their functions and roles in the company and felt empowered to make decisions sometimes when there was no higher-level management available to approve any decisions that needed to be made.

The recent move to the World Trade Center was an opportunity for us to standardize and consolidate a lot of our infrastructure. Certainly we had a lot of cooperation and sympathy from customers, from the public and even from our competitors.

Recommendations

Some recommendations: The disaster planning that we did could not possibly have anticipated the magnitude of what we had to face on Sept. 11. So we are now expanding it along the lines of many of the things that we've seen here.

Lessons learned that we would build into our subsequent planning—better control over our documents; knowing where they are, how long they would be retained, how far back we need to keep them and where they're located.

We're also making more use of digital imaging.

Also, review lease and insurance policies: Know what's in them, know what the coverage is.

Keep backups of key documents in multiple locations. I mentioned the use of digital imaging.

Reaching Out

In terms of reaching out to employees, we found that within each department, we did not have readily accessible—after we left the building—employees' home phone numbers and addresses and how to get a hold of them. So now each department has a list of all the employees' home phone numbers, cell phone numbers and e-mail addresses.

I should add that in the days following 9/11, when we were actually still trying to get some of our actuarial work done, some of us were working from homes or from other temporary locations. We had no infrastructure, and we were using personal phones, cell phones and our home e-mail as an informal network. Having

that information accessible is one thing that we have ensured that we have going forward.

Value of Creativity
We have employees who had to think on their feet. They were able to make decisions independently or go to a coworker or a next-level of manager; make some decisions; and go ahead and implement them, sometimes without the approval of senior management. People knew their jobs and knew what we had to do to keep the company going. And as Dan said at the beginning, we did predict rain to some extent; but we also did build an ark.

MR. WOLAK: Thanks, Geoff. I know in the last few days, the actuaries here have talked about what might be the risk of another event, how you price for it. We will probably never forget that this was a real event that has happened.

Next I would like to introduce Jan Carstens to talk about what the Academy is doing here.

MS. CARSTENS: Thanks, Dan. What I'd like to do today is provide you with an update of what the Academy's Health Practice Council is doing with respect to terrorism, primarily because of the events of 9/11 and the events following, but also because of requests from various industry groups regarding how the Academy was responding to Congressional standards and to public policymakers.

Background on Discussions
Discussion at the Health Practice Council level actually began in October and November, right after the events of 9/11. A large group of volunteers got together in March to form the Health Practice Council's Working Group on Terrorism and Extreme Events.

The end result of their work product is a monograph that's currently in draft form. It's in the process of peer review. We're hoping to have it available within the next few weeks. The monograph basically provides an introduction to Catastrophic Terrorist Events—CTEs, as I may refer to them; implications of CTEs for the future of the medical insurance industry; and implications of CTEs to the group nonmedical insurance industry.

The group recognized that there are some concepts and some implications of CTEs that would cross over between medical and nonmedical but thought that there were issues that were unique to the different coverages, such that we do need to look at each—the medical and nonmedical—separately.

Intro to CTEs
The introduction to the monograph recognizes that the events of 9/11 were, indeed singular and catastrophic; but they had an obvious and significant effect on the insurance industry, primarily in non-health-related lines. However, future forms

of terrorist activity could have a significant effect on the health insurance industry, such as dissemination of biological events or the possible spread of radiation. These events will affect financial security that comes from employee benefits and insurance programs.

Some of the effects probably will be immediate, such as the need for antibiotics or a general need to treat injuries. Or the effects may be longer-term, such as delayed or ongoing mental health services or treatment for disabilities. It goes without saying that CTEs may create a large initial demand, and they could create a sustained demand.

Group plans provided through employment have the unique characteristics that risks are concentrated. There may be a large concentration of risk in any particular geographic location, as many employers in New York realized on Sept. 11.

The Health Practice Council working group decided to form two subgroups—one to address medical insurance and one to address nonmedical insurance.

The nonmedical working group actually took a look at all nonmedical group insurance coverage, including group life, accidental death & dismemberment (AD&D) and long-term care. That group was chaired by Al Ford; the medical work group is chaired by Jeff Allen.

My presentation is really a summary of some of the conclusions that the two work groups came up with and what's included in the monograph.

Medical Group: Who Gets Hit?

The medical group first chose to define who the parties affected are and how they are affected.

Employees. This included not just the direct writers of insurance products—the medical insurance products and the reinsureds—but also individuals and employees that may be directly hit by an attack or individuals who respond to the attacks, such as rescue workers and emergency personnel.

Private Employers. Private employers also are affected. They may have a large concentration of risk in the area of CTEs, resulting in loss of employees, interruption of business and devastation to information systems. Employers also need to be reassessing their carriers' ability to accept risk.

Employers also are looking at loss control, such as making sure that security systems are in place.

Healthcare Providers. Another affected party would be healthcare providers who need to be prepared to respond to a CTE and who need to develop capacity in the

various procedures to respond. Providers also may suffer a financial risk because of late or reduced reimbursement for services that they performed.

Government Groups. Government organizations are another party that would be affected. Government needs to assist in data analysis and detection of an event, and they may be called upon to actually share an event.

Medical Group: Effect on Claims
What would be the impact in the medical insurance area in the event of a CTE? Whether biological, chemical or conventional, health care costs are likely to increase. Claims can increase immediately, and directly or indirectly.

Direct Causes. Some of the direct reasons why claims may increase are injury-related utilization. That would affect ambulance services, emergency room services and hospital stays.

Another direct effect could be shortage of resources, such as shortage of prescription drugs and shortage of hospital beds.

And then there may be an increase in cost of services because of increased out-of-network usage, higher out-of-network expense, unexpected out-of-network expense and just overall higher demand for services.

Indirect Effects. Indirect effects would be noninjury-related illnesses, such as those associated with post-traumatic stress disorder.

Also, there could be an increase in office visit utilization, because people may have symptoms that they're uncertain about; so they try to see a doctor.

Laid-off employees may cause health care costs to increase because of increased utilization. And there may also be an effect on, say, high-risk pools because of laid-off employees.

Offsets. There are likely to be some cost offsets—to medical cost increases, anyway—because of the public health security and the Bioterrorism Resource Act of 2002, which allocates approximately $4.5 billion to strengthen the nation's defenses against bioterrorism attacks. This law provides health services to victims. It provides for a strategic stockpile of vaccines and for assessments of the vulnerability of local water systems.

Medical Group: Effect on Premiums
Factors in an Increase. CTEs also will have an effect on medical insurance premiums, mostly because of the claim cost increases, but also because of a real or perceived increase in risk because of geographic location; a high visibility area; a central concentration of employees in any particular geographic location; or

because of potential reinsurance cost increases, especially for regional carriers in certain locations.

Lower Membership. A true catastrophic terrorist event, such as that of 9/11, could result in the loss of membership for an insurer, which could result in reduced premiums for that insured going forward.

Possible Reaction. To react to rising premiums, insurance carriers may include exclusions of terrorist events. I haven't really seen too many carriers doing that yet, but it's a possibility. They also may take inside limits.

Medical Group: Bankruptcy Risks
Catastrophic damages resulting from a catastrophic terrorist event could threaten the solvency of medical insurance carriers and self-insured plans.

An effective reinsurance market is essential, and reinsurance exclusions could create an insurance gap.

Nonmedical Group: Who Gets Hit?
The group that addressed the nonmedical insurance, or nonmedical group products, also took the track of defining who the entities affected are and how they are affected.

This group really focused more on solvency-related issues and the financial implications. I'm not going to go through each of one of these, but I encourage you to take a look at the monograph, just because the effect on each of these parties—as viewed from the nonmedical group side—is a little bit different than from the medical group side.

So for non-medical insurance, the impact on the capacity for this market really means ensuring that sufficient capital will be available to meet obligations.

Nonmedical Group: Decrease in Capacity
Less Market Capacity, Higher Deductibles. Catastrophic reinsurance covered many of the group life and AD&D claims from 9/11. But there's been a decrease in capacity in this market, partly because of an unwillingness of reinsurers and direct writers to share risks for an event in which they have little control over either the pricing or the risk.

And in the group life market, this has resulted in higher deductibles, decreased limits, exclusions of CTEs and exclusions of companies with a perceived concentration of risk.

Responses. As a result, group life and AD&D writers have explored alternative approaches to ensuring capacity. They include obtaining aggregate stop loss reinsurance, establishing reinsurance and purchasing cooperatives.

Direct writers do not appear to have made significant changes in their pricing in underwriting to ensure capacity. Part of this is because of state regulatory restrictions; part of it is because of competitive concerns. It depends also on which type of nonmedical group coverages you're looking at.

Government Help? Insurance groups have been working with Congress to establish a federal high deductible backstop program for CTE losses, to ensure availability and to ensure reasonably priced coverage.

Nonmedical Group: Loss of Capital?
The increased risk of loss increases the need for capital. There may be a closer examination by rating agencies, and there's probably a need to review current risk-based capital formulas.

At the same time that there's an increased need for capital, there may be a higher cost of capital, since it's harder to attract potential investors.

Nonmedical Group: Future Costs
Several factors will influence future pricing and underwriting responses to CTEs for nonmedical insurers in order to manage that risk. They include concentration of risk and potentially increased reinsurance cost. And it's likely that insurers either have or will turn to predictive risk models to determine the likely impact of a CTE.

There is a common summary in the monograph between medical and nonmedical group coverage.

The summary basically indicates that there are efforts underway to control CTE risk, and there are likely to be future efforts. As I indicated, the monograph should be available in about—we're hoping—three to four weeks. I encourage you to take a look at it.

MR. WOLAK: Next, Dale Hagstrom will discuss the business impact of 9/11.

MR. HAGSTROM: I'd like to address how the business has evolved.

Five Drivers
I see five drivers that I think everyone is aware of.

Less P&C Capital. First, the P&C insurers have less capital. They lost billions of dollars in physical damage in 9/11, and they can demand a higher return on capital. These insurers are either the same reinsurers, or they at least have the same capital sources. So their demand for a higher return on capital is turning over to the life reinsurers and the health reinsurers.

Terrorism Exclusions. Secondly, not surprisingly, the regulators do not want the personal line insurance to have terrorism exclusions.

They will buy individual life insurance, individual health insurance and even extending generally to group life insurance, the group health. The regulators don't want to see a terrorism exclusion. They think the insurer should be in the business of covering risk. So that turns over to a driver.

Federal Backstop? I've been told that the federal government very recently passed a law about P&C insurance. The law has a very vague reference to group life; but it's clear there is no real federal backstop at this point, and there's not likely to be.

And if you think about it, Congress appropriated billions of dollars; people gave billions. When they finally went to write the rules on how they were going to use federal money to support the victims' families and so forth, there was an explicit deduction for other sources, particularly individually provided or group insurance.

So on the margin, what they've just done for the feature is discouraged either groups providing insurance for their employees or individuals seeing their own need and buying insurance for it. If you think the only reason you're going to die is if somebody drops a building on your head and the program is going to take care of your survivors, why would you buy insurance? Why should your group buy insurance for employees? It's not the highest risk, but if that's the only time people pay attention, that's the message they'll get. It's not very fortunate, in my opinion.

Limit to Medical Services. In some sense, there's a limit on how many medical services you can provide. If you have a very large event that needs a lot of medical services, in the short run, there's only so much hospital time available. You run up this huge bill. It's not open-ended on the top end as it would be on life insurance or P&C. There's only so much medical coverage you can provide in an emergency.

The last thing that I think I want to emphasize today is that foresight is always viewed as speculation or rash or panic. But then hindsight always forgets that uncertainty beforehand. You have lawyers or people in the press saying, "Why didn't the builder, why didn't the port authorities, build a stronger building that could endure this event?" Well, you know, incredibly, there's already a deadweight loss in the economy—all the extra security, all the extra redundancies, the way you need to have multiple servers backing up everything. There's already a big loss in the economy.

If you needed to build buildings that could sustain a hit by a fully gassed giant airplane—there's extraordinarily volatile gasoline in the airplane fuel—you couldn't build buildings sufficiently or economically; but yet, in hindsight, it is clear that the port authority should be sued. The owner of that building should be sued. It is completely inappropriate that they didn't provide a jet-proof building for people to work in; and yet, in foresight, you have a current debate: Should George Bush worry about what could happen with terrorism? Well, it's not clear it's going to

happen. It's not clear you should go to war to prevent someone who's a known murderer. It's unclear. And maybe he's wrong.

But if he goes to war and there's nothing, then, in hindsight, there would be no uncertainty; and vice versa, if he doesn't go to war and things do happen in Iraq, in hindsight, it would be very clear he should have done it.

It's very hard to separate all the things you looked at ahead of time versus after the fact. And that's driving part of this.

You are individual buyers for the company. You've seen 9/11; you've seen what happened; you've seen what happened to your group insurance or group health. Should you be getting out of that business because it could be a lot worse the next time? Why should you put yourself at risk? If terrorism does happen, in hindsight, you're going to look like, "What kind of foolishness kept him in the business after that thing had already happened?"

Parties to Risk

Various people are probably at risk—the original employee, the employer, the debt insurer, the reinsurer, the regional health plans, the market and the government, as well. Sometimes they carve out, if it's at the work site; but the next time may not be at a work site; it may just be on a subway.

Jan talked about there's a specific event, but there could be wider, more damaging kinds of terrorism than one could imagine. So I'm thinking of all these things in my imagination, which is part of the reason that foresight is not hard, because you spend your whole time being upset. You really don't want to deal with it. How many people want to think about their own deaths? So preplanning is very hard to find, but after the fact, it seems very obvious.

People are increasingly needing to ask, "OK, you can ask location for a 9/11 terrorism event. Are you all on a single campus? Do you divide yourself into three shifts, so you only have a third at risk at any one time?"

But you start thinking about something that's biological that spreads from person to person, to the third person to the fourth person. Then you start worrying about, "Well, is it just in an open area or a big subway?" What are the questions that you have to ask? It gets more and more difficult.

Group Life Factors

MR. WOLAK: A few comments on group life: I think initially after 9/11, there was some belief that people would want to buy more group life insurance. I know I did, but I don't know what your markets have seen. I think there's been a tendency for that, but I haven't heard of a large increase in the volume for life.

I think some carriers have had somewhat of an unspoken desire to move away from higher and higher maximums for group life. I perceive that some carriers became concerned about offering $3 million or $4 million maximum face amounts. And some carriers are trying to limit their maximum group life to a lower level—$1 million, $2 million at this time.

Regarding the reinsurance changes, there's a high cost of catastrophic coverage and more limited maximums. A year ago, for a cat cover, you could buy $50 million of coverage for probably less than $500,000, which would be less than what's called 1 percent rate online, as they say on the reinsurance side. Now you have lower maximums—maybe $20 million dollar caps—and you're paying 2 percent to 10 percent of that face. So maybe a $500,000 cost might be $1 million, $2 million, $3 million.

Some people are looking to cap their claims from accidental deaths. I think it's more common now with group life. Some companies are reinsuring all the accidental deaths. I guess it's a way of buying a cheap cat cover. So that is one potential approach.

Also, on the reinsurance side, we're seeing the reinsurers putting some caps on the maximum claims they'll pay in a year for accidental death; and it will be at a very high level—maybe four, five, six times premium, but still some caps.

One thing on the group life side: 98 percent of the group life volume is retained by the primary carriers. For the big players—the top five, the top 10, top 20—they're retaining more than 99 percent of their risk. This is unlike individual insurance, where, right now, I have read that 70 percent of insurance from new sales is reinsured.

On the group side, the carriers are keeping all the risks. The coverage that the group life carriers received, the reinsurance they received from 9/11, was from the cat cover, not from reinsurance of high excess amounts. There were very few high-excess claims.

And maybe the last point we had was higher direct rates. At this point, I don't think the direct carriers are willing to charge higher rates for heavy concentrations. So you have a new risk here. This is going back to the ark scenario—we're predicting rain, but I don't know if we really have the willingness to build the ark, to either price for it or create new underwriting guidelines to protect our surplus.

MR. HAGSTROM: I've seen news reports of some smaller groups, public volunteer fire department or something, where they're having to limit what their group insurance provides on terrorism, because their insurers don't want to take that risk. The direct writer can't get reinsurance. The reinsurers can and generally are excluding terrorism, frequently excluding biological, nuclear, or chemical; or they're having to pay a lot for different coverage.

If the direct writer can't get the reinsurance, more often than not, it'll go ahead and go in naked with this risk. But some are saying, "I can't get the reinsurance. It's dishonest of me to take the premium, because I wouldn't be able to pay the claim. So I'm going to make it explicit upfront—I am not covering this." And then the employer is saying, "Well, OK. If I can't get the insurance for it; I, too, would go bankrupt."

This also is for the employers that do have coverage. So they pass it down and say, "OK, your group insurance does not cover terrorism."

That's the honest presentation of it, because they can't get the insurance; the insurance can't get the reinsurance; the reinsurer is, not surprisingly, not willing to provide it cheaply.

MR. WOLAK: That's interesting. There were several times recently in which direct companies have come to us for a reinsurance quote; and now they're starting to ask, "Does the reinsurer buy reinsurance? Does reinsurance buy retro? If so, whom are we buying from? What is the rating of the companies that own the reinsurers that we might be working with?" So suddenly, there's an issue in the marketplace on who's behind the reinsurer you're dealing with.

MR. HAGSTROM: The same thing has happened with P&C with 9/11. It took a long time for people to sort out what their exclusions were, because not only do they have to figure out what the original loss was in the various pools they're in, but they, in turn, had reinsured it. How much of that reinsurance was actually any good? It took a while to sort of figure out your real net liability.

I think I mentioned earlier that the regional health plans are, in effect, at some risk. The regional health plans tend to be a very concentrated geographical risk. If there's a chemical event or a biological event, they're going to be hit disproportionately in the luck of the draw.

Sometimes in classic group insurance, the employer is taking the bulk of the risk and the direct insurer is just paying claims and getting reimbursed daily or monthly from the employer. They have a minimum premium process. But if the employer is hit hard, the insurer may find itself having to pay some claims and not getting reimbursed.

Every actuary knows that once you make your projections and look backward, you're almost always wrong. I mean your projections don't fit exactly how it is.

There are also lines even more obvious. You may roll low, you may roll high, but you're rarely anywhere near being right about all of the lines.
If I really wanted to terrorize the nation or my enemy, where do I hit next? Do I hit the Empire State Building, or do I go out to some suburban area? You really don't

know what's next. So I think you have the chance; but you can't know. In effect, we're going to become more and more like the P&C business. You read about the cycle on the P&C business. It's driven by a number of things; but sometimes it's just very hard to figure out what's going to cost money. Right now, it's kind of steady. If we don't have another event for a number of years, the reinsurance will be easier to get and cheaper. But if another one hits, either sooner or later, it will get tight again. And I think it will start creating a more volatile swing.

One thing that is harder to draw a projection from is to start having more than one, and then you're going to start seeing more volatility. That is my suspicion.

MR. WOLAK: I have a few discussion topics. We could talk about these or any other questions. Any questions, comments on what you're doing or issues you see with concentration of risk issues that you have? This concentration of risk is a new risk, one that we didn't think about 14 months ago.

We had to look at a large program, I think, on Sept. 6 last year. It was a reinsurer, a law firm with maybe 300 partners with up to $2 million dollars of group life.

Of course the issue at that time was underwriting on a guaranteed issue. What's guaranteed issue? Six days later, we asked where were these lawyers located? They found Manhattan. It was like, "Oh, my goodness! We're quoting reinsurance on a large number of lawyers in Midtown Manhattan." Suddenly, concentration became an issue.

Concentration Pricing

What's the issue with concentration? Is anybody pricing for concentration?

MR. JOE POPLOSKI: We're not pricing for it, but we're Liberty Mutual; and we belong to a large P&C carrier. Our concerns will be stacking of risks. We've done enterprise across the board, including assets, and we've already had to decline business because of corporate exposure on concentration. We map at the street address, not at the state or anything else.

Another question I have is, how is it going to affect our reinsurance? It's quite a laborious process to get this. How are the reinsurers going to react to people who are able to provide it versus those who aren't able to provide it?

MR. WOLAK: I'd like to talk about your first comment, the location-based pricing. I know that at my company we are buying software to begin to monitor location base, something that the P&C side has.

It's very interesting. I think that five years ago, workers' comp carriers had very little information on location of employees. What do we, group insurers, have now? We know main office. We may know billing addresses. But we really don't know location by location. And I think over the next four or five years you, the group life

carriers, are going to have to get better information to really start to manage your risk and start to request that. Your employers have that information.

The question on the reinsurance side is interesting, because I know I've looked at Jan's monograph from the Academy, and she mentioned the impact of reinsurance.

Any reinsurance in the health market plays a very, very small role. I mean United Health Care doesn't buy reinsurance. Aetna doesn't buy reinsurance, and probably Blue Cross doesn't buy reinsurance. It's the smaller specialty carriers that are purchasing the reinsurance. So reinsurance availability is a small issue for the health markets at this point in time.

You might look to the reinsurers and say, "OK, we want to keep most of our risk or virtually all of our risk, except we want you to be there in case there's a catastrophe" There's somewhat of a mismatch; there isn't a spread of risk.

We have somewhat the same issue on some of the group life risks. If you, the carriers, are keeping 99.5 percent of a risk but are looking to the reinsurance market to be there for the catastrophes, there's going to be some hesitancy on the spread of risk.

I guess the cat market has been a different market than the traditional reinsurance life market. In cat, there were a lot of pools that developed, which underwrote and priced for that risk. The pool would be comprised of an underwriting manager; the underwriting manager would find a number of carriers—some reinsurers, some direct carriers—to take a part of the risk.

I can think of a few cases where there were some very small carriers, very regional, who maybe had $5 million or $10 million of surplus. They were part of a cat pool, and they had $300,000 of claims from 9/11. I mean they had maybe 3 percent to 5 percent of their surplus from something for which they were receiving $5,000 of premium a year. Of course their management was totally distraught with that kind of hit.

I don't know what's going to happen with the cat marketplace right now for the group life carriers or what you should expect on Jan. 1, 2003. It isn't a product that we offer right now as a reinsurer. It's been a specialty. It's come through Lloyds, and it's come through the pool managers; and right now the risk takers—the reinsureds and probably you, the direct carriers, that may have been part of the pools—you really don't want to get involved with something where you're two, three, four steps removed from really what is going into the pool.

Now the risk takers that are willing to take that have pushed up the costs significantly, as you know, and are requiring a lot more information. Suddenly they have a lot of issues of what's being stacked. And the problem that many of you

carriers have is that there's not a lot of good information to provide to the cat reinsurers to allow them to manage their concentrations.

We touched sort of quickly on legislative changes . The group life carriers formed a group led by UNUM Provident and Fortis to promote adding group life into the terrorism bill, which has been up on the Hill.

FROM THE FLOOR: It's sort of secondhand at this point, but I heard that the bill passed covers clearly P&C and more or less says, "Treasury, why don't you kind of look into this group life stuff? We're not saying yea or nay; we're just saying we're giving the Treasury the authority to go do something." So it is really unclear at the moment what, if anything, would come out of that.

MR. WOLAK: One problem I think, the Hill has had, according to ACLI, is that there have been very few stories of market disruption on the group life side. The only story of market disruption where coverage was not available, or limited coverage was made available, was, I believe, in the state of Utah. In Utah, the state self-funded the group life coverage. And for the government employees or firemen the amount of coverage available in case of terrorism for group life would be capped or reduced. So that's the only place where, at this point, there's been any market disruption. There's maybe been some subtle disruption where we, as carriers, have been hesitant to quote on certain large groups or certain locations; but that has not been very evident. Coverage still has been made available.