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DOCUMENT NO.	FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
001	Draft	Draft memorandum to be transmitted after President signs H.R.3210, Terrorism Insurance Act of 2002 [1 PAGE RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS]	1	N.D.	
002	Email	2:30pm, Wed. 20, 2002 [2 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: Elizabeth N. Camp - From: Jean M. Russell	2	03/20/2002	
003	Memorandum	Aviation War & Terrorism Insurance [6 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: NEC Principals - From: Carlos Bonilla	6	03/19/2002	

COLLECTION TITLE:
Counsel's Office, White House

SERIES:
Kavanaugh, Brett - Subject Files

FOLDER TITLE:
Terrorism Insurance [Folder 2]

FRC ID:
9633

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

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004	Email	Terrorism insurance bill and tort liability [2 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: Alberto R. Gonzales & Timothy E. Flanigan - From: Brett M. Kavanaugh	2	11/27/2001	
005	Draft	Sec. 15. Litigation Management. [5 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS]	5	11/14/2001	
006	Memorandum	Terrorism Insurance [with attachments] [9 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: NEC Principals - From: Marc Sumerlin	9	10/08/2001	
007	Email	Re: Insurance and Terrorism Meeting [2 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: Elizabeth N. Camp - From: Jean M. Russell	2	10/09/2001	

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008	Memorandum	Terrorism Insurance [6 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: NEC Principals - From: Marc Sumerlin	6	10/08/2001	
009	Memorandum	Insurance-Related Questions Raised by the September 11 Attack on the World Trade Center [6 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: Alberto R. Gonzales & Tim Flanigan - From: Courtney Simmons Elwood	6	09/16/2001	
010	Email	Insurance Coverage [1 PAGE RELEASED IN WHOLE ON PRA RE-REVIEW 09/03/2025 JLS] - To: Alberto R. Gonzales & Timothy E. Flanigan - From: Courtney S. Elwood	1	09/18/2001	

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006	Memorandum	Terrorism Insurance [with attachments] - To: NEC Principals - From: Marc Sumerlin	9	10/08/2001	P5;

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FILE

THE WHITE HOUSE

WASHINGTON

November 22, 2002

MEMORANDUM FOR HARRIET MIERS

FROM: ALBERTO R. GONZALES ARG/lmc

SUBJECT: STAFFING OF MEMOS REGARDING H.R. 3210

Please staff the attached to the appropriate individuals.

Comments should be returned to Brett Kavanaugh in my office no later than 1:00 p.m. on Monday, November 25, 2002. His phone number is 456-7984 and his fax number is 456-5104.

Thank you.

Draft memoranda to be transmitted after President signs H.R. 3210, Terrorism Insurance Act of 2002

Draft Memo from the President to the Secretary of the Treasury:

I hereby direct you to exercise your authority under section 102(6)(C) and section 104 of the Terrorism Risk Insurance Act of 2002, Pub. L. 107-___ ("Act"), to propose a rule that would require, as a criterion of qualifying as an "insurer" for purposes of the Terrorism Insurance Program ("Program") established under section 103 of that Act, an entity to agree to obtain in advance your approval of any payments for insured losses under the Program.

Draft Memo from the President to the Attorney General:

Section 107 of the Terrorism Risk Insurance Act of 2002, Pub. L. 107-___ ("Act"), creates an exclusive federal cause of action for property damage, personal injury, or death arising out of resulting from an act of terrorism and requires consolidation of all cases, for pre-trial and trial proceedings, arising out or resulting from an act of terrorism. The federal court will apply the substantive law of the State in which the act of terrorism occurred. Some States permit the award of punitive damages and do not impose limits on such awards. The possibility of punitive damage awards against American businesses who were themselves the victims of terrorism would pose an obstacle to the equitable and expeditious resolution of litigation arising out of a terrorist attack. Reasonable limits on punitive awards in mass tort terrorism cases are essential to ensure fair and equitable awards to injured parties, to avoid unnecessary bankruptcies by American businesses in the aftermath of a terrorism attack, and to protect American workers from loss of employment. Therefore, when the evidence indicates that a defendant to a cause of action under the Act has not knowingly participated in, conspired to commit, aided or abetted, or committed any act of terrorism, I direct you to prepare to have the Department of Justice intervene or otherwise participate in any action under the Act in which punitive damages are being sought and to oppose any award of punitive damages against such defendant.

Judge - Your schedule permits - Do you want to attend or do you want to ask Brett to go?

Jean M. Russell 03/20/2002 10:41:58 AM

Record Type: Record

To: Elizabeth N. Camp/WHO/EOP@EOP

cc:

Subject: 2:30pm, Wed. 20, 2002

Today at 2:30pm there will be a meeting on Foreign Sales Corporation (FSC) in his office. During staff meeting he asked if you could send someone from your office to attend the meeting. It is a Principals meeting and will last for 45 minutes to an hour.

Let me know who from your office is able to attend.
Jeannie

--------------------- Forwarded by Jean M. Russell/OPD/EOP on 03/20/2002 10:40 AM ---------------------------

Jean M. Russell 03/19/2002 06:25:35 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

Subject: 2:30pm, Wed. 20, 2002

Here's the memo for tomorrow's Economic Principals Meeting

Aviation War & Terrorism Insurance 3.19.02

File Aviation Insurance

Message Sent To:

Suzanne.scruggs@ost.dot.gov @ inet
Linda.figura@do.treas.gov @ inet
anna.hart@do.treas.gov @ inet
bvosburgh@doc.gov @ inet
kreaves@doc.gov @ inet
Michael J. Conway/WHO/EOP@EOP
Susan B. Ralston/WHO/EOP@EOP
Alice H. Williams/CEA/EOP@EOP
Douglas J. Holtz-Eakin/CEA/EOP@EOP
Karen E. Keller/OMB/EOP@EOP
Karen E. Keller/OMB/EOP@EOP
Lois E. Altoft/OMB/EOP@EOP
Leslie A. Mooney/OPD/EOP@EOP
Carlos E. Bonilla/OPD/EOP@EOP
barbara.lucas@ost.dot.gov @ inet

MARCH 19, 2002

MEMORANDUM TO NEC PRINCIPALS

FROM: CARLOS BONILLA

SUBJECT: AVIATION WAR & TERRORISM INSURANCE

As part of the Air Transportation and System Stabilization Act, the Federal Government began to directly provide war and terrorism insurance to the nation's airlines (and through the airlines indirectly to the airports, vendors and contractors who do business with the airlines). At the time the Act was passed, the nation faced a transportation crisis as the world's insurers had exercised their prerogative to cancel war and terrorism policies on seven day's notice. Airlines will not fly without insurance, either because their lenders and lessors will not permit the planes to be flown without insurance or because their Boards of Directors will not allow the carrier to operate without it. This federal insurance was understood by all the parties to be of a temporary nature.

Since September 11, a certain measure of stability has been achieved in the insurance markets. To be sure, prices have increased since September 11, but carriers are readily able to secure insurance should their planes be involved in an incident. The key exception is that insurance coverage for third party losses from acts of war and terrorism (the occupants of the World Trade Center, for example) has been limited to $50 million. Prior to September 11, the carriers were able to secure approximately $1.5 billion in coverage for all perils at about five cents a passenger. Today the much more limited private coverage which is in force costs about $1.25 a passenger.

This memo outlines the three options that are under discussion to address the problem of third party losses from acts of war and terrorism:

- Private Insurance: One insurer, AIG, has come forward with a proposal to underwrite approximately $1 billion in war and terrorism coverage at an additional cost of $1.50-$1.85 a passenger.
- Equitime: The airline industry is attempting to create a captive insurer that would be capitalized by the industry and, over time, accumulate reserves to replace the federal insurance program.
- War Principles: This position argues that war (of which terrorism is a subset) should not be paid for through the tort and insurance system. The correct position is not to debate how to best pay for insurance against third-party losses but rather to recognize them as costs to be borne by society not litigated by the trial lawyers. This would require a legislative solution removing a third party's right to sue for losses suffered from acts of war and trerrorism.

On March 11 the Department of Transportation announced a 60 day extension in its current war risk insurance program. The clear understanding was that this time would be used to adopt a long-term solution to the problem, if needed.

The Private Market Option

Following September 11, the Administration formulated several core principles to guide policymaking efforts related to the federal provision of terrorism insurance in the context of property-casualty losses. These fundamental principles apply with equal force to the aviation industry. These principles included:

- The primary goal of government policy should be to held build private sector capacity: The private insurance market has, in the past, proven its ability to expand capacity in response to new risks. Private insurance markets have the ability to effectively spread risk, while simultaneously providing proper incentives for risk mitigation and loss containment through pricing. However, limited government intervention may be appropriate to provide some additional capacity and certainty to private markets during a transition period.
    - Private sector capacity is already beginning to develop. Already, a number of private insurance groups, including AIG, Berkshire Hathaway, and Allianz, have entered the international market for third party liability war risk insurance since the end of September 2001. Berkshire Hathaway and AIG are making package offers to a group of British airlines, with AIG currently offering up to $1 billion per occurrence coverage (excess of $50 million) for approximately *75 cents per passenger*. This is significantly lower than the $1.85 per passenger that has been assumed in many U.S. discussions – a price that appears to have been "floated" shortly after 9/11 – suggesting that market forces are beginning to work and that offer prices are falling.
    - The presence of the government in the private market likely dampens competition and distorts pricing. We cannot assume that today's distribution of observed prices for insurance is a market equilibrium, because the market cannot operate efficiently while the government provides insurance at prices below the actuarially fair level. In fact, there really is no true observed pricing distribution available in the U.S. at this time because no U.S. airline has sought out an official quote from the leading insurers. This lack of pricing requests is due to the existence of the FAA program.
    - Given an opportunity, market forces will continue to drive prices down. If AIG, for example, offers insurance at unreasonably high prices, other insurers (e.g., Berkshire Hathaway, Allianz) will have the profit incentive to come in to undercut AIG. It is important to bear in mind, however, that if expected losses from a terrorist related airline event could average $1 billion per year, as suggested in a recent DOT memo, then the total premia collected for that market should reasonably be expected to be at least $1 billion per year.
- Government policy should promote proper incentives for risk mitigation and loss containment: If the government provides excess loss insurance at taxpayer-subsidized rates, economic actors will not face the proper economic incentives. This distortion may result in sub-optimal investment in security or other prevention activities.

- Any government involvement should be strictly limited to a short transition period: The federal government should seek to limit the duration of its participation in insurance markets to the shortest possible time frame so as to encourage restoration of private markets.

The EQUITIME Solution

Through their trade association, the Air Transport Association (ATA), the major U.S. airlines have proposed forming a risk retention group (RRG) to provide passenger and third party war risk liability insurance. The RRG is tentatively named Equitime. It would provide direct insurance to its members, charging a premium and providing up to $2 billion in coverage. While Equitime accumulates sufficient reserves to cover potential claims, it would purchase reinsurance from the FAA. If commercial reinsurance becomes reasonably available, Equitime would purchase it and phase out FAA coverage. On February 28, the ATA board unanimously agreed to proceed with implementation of Equitime. ATA has stated to the FAA that Equitime could be operational as early as June. An international RRG is also being discussed by member states of the International Civil Aviation Organization (ICAO), but if ultimately approved by ICAO, implementation would take much longer than Equitime. In early March, the Association of European Airlines stated that it also is considering forming an RRG for its members.

If implemented, Equitime would provide war risk liability coverage to ground handlers and other vendors, agents and subcontractors of air carriers for appropriate premiums. The formation of Equitime would provide ground handlers and others with a competitive option in negotiating lower premium rates and higher coverage limits.

FAA EXIT OBJECTIVE

FAA war risk insurance is currently being provided as an emergency measure "necessary in the interest of air commerce." The FAA's long-term goal is to help to reestablish a private insurance market that provides aviation war risk insurance on reasonable terms. However, the means to achieve that goal should not derogate air commerce vital to the U.S. economy. In developing its exit strategy, the FAA should encourage competition among private insurers to the maximum degree possible while providing airlines and passengers with sufficient time to acclimate to the increased cost of war risk insurance.

In view of the present state of the private insurance market, the Department of Transportation has recommended that authorization for FAA insurance should be extended for a six-month period. The six-month extension would allow time to facilitate a transition by the FAA first to a reduced role in providing insurance, and eventually to an exit from the market.

During the six-month extension period, the FAA would pursue two paths. First, a six-month extension would provide Equitime and the participating U.S. carriers with a sufficient certainty to continue their efforts and make the necessary capital contributions to implement the RRG, with some assurance that there would not be an abrupt reversal of U.S. policy. Under Equitime, the FAA would act as a reinsurer and as Equitime's reserves grow, FAA's participation would decrease. FAA support for Equitime would not preclude support for an ICAO-sponsored RRG if it is formed. In addition, in either structure, FAA reinsurance would be replaced by private insurance if it became available on similar terms.

Second, DOT recommends that the FAA begin a phased withdrawal from providing direct war risk insurance. A six-month extension would facilitate such a phase out by minimizing the disruption likely to result from this change and by giving insurers additional time to return to the market. Such a phased exit would allow the FAA to better gauge, in steps, how quickly and to what degree private insurers were prepared to compete for the airlines' business. An initial step would likely be to raise the premium charged by the FAA. The FAA could subsequently begin raising the floor above which it writes insurance, now at $50 million, thereby requiring U.S. air carriers, in steps, to secure increased coverage from the private market.

DOT believes that both of these approaches would stimulate competition and hasten the return of the private market. Equitime would effectively inject a new competitor into the market, and, because it threatens to lock up a significant piece of the insurance business for a one-year period, may stimulate private insurers to attempt to preempt its formation by offering rates competitive with Equitime. Equitime could also stimulate insurers to offer reinsurance rates in competition with the FAA, thus hastening FAA's departure from the field.

The War Principles Option

Current US law does not differentiate between torts caused by normal forces, economic or otherwise, and acts of war, including terrorism. Individuals and corporations can be subject to the same processes we criticize as abusive in the normal course of business. No airline in the country, or its lenders, felt confident that juries would consistently reject the argument had they only acted in a certain manner – arming flight attendants for example – we could have avoided the disaster of September 11. The airlines, indeed all of American business, can deal with its own losses. It cannot and should not have to deal with the economy wide costs of war.

In the immediate aftermath of September 11, the Federal Government had a limited number of options. Notably, it could not retrospectively take away a perceived right to sue even when the cause of harm was an act of war or terrorism. For any future acts of war and terrorism, however, we currently have a clean slate to define the legal and social landscape for American society to operate under. The solution is to abolish the right to sue other individuals simply because they came before you in the chain of events that constituted an act of war.

This position argues that the costs of war are a societal obligation and that it is society not individuals (corporate or otherwise) who should shoulder the costs of war and terrorism. It was the fear of a torrent of litigation which gave rise to the structure of the airline stabilization act, notably its provision creating a special master to provide financial assistance to individuals harmed by the attack. A key point in the provision was the permanent exclusion from the fund of any individual who first tried to seek restitution through the tort system.

It is instructive to note that the Victims Compensation Fund had been offereing settlement averaging $1.65 million to the victims of 9/11 and raised the average to $1.85 million after those settlements were criticized as inadequate. It is highly unlikely that more than a handful of these victims carried that much personal insurance. We are setting a dangerous precedent that acts of war should yield greater compensation than individuals are willing to provide for themselves.

In addition, the War Principles option will create a measure of fairness and uniformity in victim assistance. Under current practice, where individuals search for a deep pocket to blame, financial assistance is dependent on the success or failure of that search. Individuals "fortunate enough" to be the victims of an attack which uses a Fortune 500 corporation as its instrument of war can expect to be highly compensated. Others may receive no compensation.

At the same time, it is not desirable to abolish all individual responsibility for acts of war and terrorism. We should encourage individuals to provide for their own financial compensation for their own losses and acquire insurance to cover those personal losses. Moreover, lien holders will likely continue to demand such coverage. Similarly, there is no reason why the federal government should offer more financial assistance to an individual who dies in a terrorist attack than we do to an individual who dies prematurely of a heart attack. We should continue to encourage these efforts, if for no other reason than to create a climate of individual responsibility.

Conversely, a system such as we have today can prove to be a stifling force. Businesses and individuals may very well curtail their activities, abandoning urban areas for example, if the costs of having to insure against the catastrophic and unpredictable costs of war may be placed on their shoulders.

Finally, a large incident would likely overwhelm the resources of the insurance system. When those resources are exhausted there will be no option but for the federal government to intervene with both compensation and legal remedies. Rather than wait until such a time it makes more sense to act preemptively and enhance market confidence.

Any such move must be accompanied by a clear statement that in the event of an act of war the federal government will step in to assist those members of society who have been harmed. The amount of assistance will depend on the extent of the losses suffered and cannot be set in advance, for we cannot know the costs of war in advance. In small incidents we will be able to make everyone whole. In larger incidents we may only be able to offer partial remedies.

File

Terrorism Insurance Bill

ag

Brett M. Kavanaugh
11/27/2001 10:15:26 AM

Record Type: Record

To: Alberto R. Gonzales/WHO/EOP@EOP, Timothy E. Flanigan/WHO/EOP@EOP

cc: Elizabeth N. Camp/WHO/EOP@EOP, Allison L. Riepenhoff/WHO/EOP@EOP
Subject: Terrorism insurance bill and tort liability

(Libby and Allison: please print out e-mail and attachment for Judge and Tim.)

Judge and Tim: Attached is the text of the House terrorism insurance bill w/r/t litigation procedures. Section 15(a)(7) contains the limitation on attorneys' fees that I discussed this morning. Section 15 as a whole contains 5 main provisions: consolidation of cases, exclusion of punitive damages, limits on non-economic damages, deductions for collateral source payments, and limits on attorneys' fees. The House leadership (Hastert, Armey, and Delay) forecasts a very tough fight on the bill because of these proposals (including with several Republicans such as Lindsey Graham who are strongly supportive of the plaintiffs' bar), but that we may be able to eke out a very narrow victory.

The Senate compromise (reached by Gramm, Enzi, Sarbanes, and Dodd) contained two of the five House provisions: consolidation of cases and an exclusion on punitive damages. But even that more modest proposal proved too much for Daschle, who has harshly rebuked Sarbanes for agreeing to this and has taken the extraordinary step of prohibiting Sarbanes from even introducing a bill containing those two provisions. Peter Fisher, Marc Sumerlin, and I are meeting today with Senator Gramm to discuss strategy for him to try to introduce a bill with Dodd, but obviously without Sarbanes.

It bears emphasis that the primary component of any terrorism insurance bill is NOT litigation procedure, but rather is the basic mechanism for government insurance backstop coverage in terrorism events. That is considered the primary issue by industry and by the leaders of both parties in Congress.

As to the views of the insurance and business community on the issue of litigation procedures, it also bears mention that several of us (Rove, Fisher, Sumerlin, and I) met with roughly 40 business and industry leaders a week ago Friday. We met with them because they apparently needed to be convinced that litigation procedures were a necessary part of this bill. The group in attendance included Jim Wooten of the Chamber, who went so far as to express the view in the meeting that "the litigation procedures were not a must-have" for them as part of this bill. Karl Rove, Marc Sumerlin, and I spoke to that point and forcefully explained that these litigation procedures were in fact a "must-have" for the President and that without litigation procedures, there would be no law. The business group has gotten the message and is now conveying as much, as press reports now indicate.

In short, based on my experience, the political and policy "analysis" apparently put forth by folks such as Michael Horowitz (which Tim referred to today in the staff meeting) regarding Congress and the business community is the exact opposite of what has been happening in reality.

Finally, with both the insurance/business community and the Democrats, our leverage for including and winning on the litigation procedures is the fact that Dems such as Dodd and Schumer, as well as the insurance industry, believe there is a crisis looming in the insurance industry as of January 1 (the date for cancellation of major insurance policies for property owners and businesses) without some kind of government-guaranteed insurance backstop for terrorism damage. And these people all also now know (i) that there is no way any bill will pass without Presidential support and (ii) that the President will insist on litigation procedures as part of this bill. On the other hand, Sen. Daschle frankly appears to be deep in the pocket of the trial lawyers on this issue (as he was w/r/t the airlines and victims compensation legislation enacted on Sept 22) and he seems more than willing to play chicken and blame the President for blocking the terrorism insurance bill by the President's alleged insistence on "radical tort reform."

- SEC15B_.PDF

SEC. 15. LITIGATION MANAGEMENT.

(a) FEDERAL CAUSE OF ACTION FOR CLAIMS RELATING TO TERRORIST ACTS.—

(1) IN GENERAL.—Subject to paragraph (2), if the Secretary makes a determination pursuant to section 5(b) that one or more acts of terrorism occurred, there shall exist a Federal cause of action, which, except as provided in subsection (b), shall be the exclusive remedy for claims arising out of, relating to, or resulting from such acts of terrorism.

(2) EFFECT OF DETERMINATION.—A determination referred to in paragraph (1)—

(A) shall not be subject to judicial review;

(B) shall take effect upon its publication in the Federal Register; and

(C) shall be subject to such changes as the Secretary may provide in one or more later determinations made in accordance with the provisions of this paragraph.

(3) SUBSTANTIVE LAW.—The substantive law for decision in any such action shall be derived from the law, including choice of law principles, of the State in which such acts of terrorism occurred, unless such law is inconsistent with or preempted by Federal law.

(4) JURISDICTION.—For each determination under paragraph (1), the Judicial Panel on Multidistrict Litigation shall designate one or more district courts of the United States which shall have original and exclusive jurisdiction over all actions for any claim (including any claim for loss of property, personal injury, or death) brought pursuant to this subsection. The Judicial Panel on Multidistrict Litigation shall select and assign the district court or courts based on the convenience of the parties and the just and efficient conduct of the proceedings. For purposes of personal jurisdiction, the district court or courts designated by the Judicial Panel on Multidistrict Litigation shall be deemed to sit in all judicial districts in the United States.

(5) LIMITS ON DAMAGES.—In an action brought under this subsection for damages:

(A) No punitive damages intended to punish or deter, exemplary damages, or other damages not intended to compensate a plaintiff for actual losses may be awarded, nor shall any party be liable for interest prior to the judgment.

(B)(i) Each defendant in such an action shall be liable only for the amount of non-economic damages allocated to the defendant in direct proportion to the percentage of responsibility of the defendant for the harm to the plaintiff, and no plaintiff may recover noneconomic damages unless the plaintiff suffered physical harm.

(ii) For purposes of clause (i), the term "noneconomic damages" means damages for losses for physical and emotional pain, suffering, inconvenience, physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium, hedonic damages, injury to reputation, and any other nonpecuniary losses.

(6) COLLATERAL SOURCES.—Any recovery by a plaintiff in an action under this subsection shall be reduced by the amount of collateral source compensation, if any, that the plaintiff has received or is entitled to receive as a result of the acts of terrorism with respect to which the determination under paragraph (1) was made.

(7) ATTORNEY FEES.—Reasonable attorneys fees for work performed shall be subject to the discretion of the court, but in no event shall any attor-

ney charge, demand, receive, or collect for services rendered, fees or compensation in an amount in excess of 20 percent of the damages ordered by the court to be paid pursuant to this section, or in excess of 20 percent of any court-approved settlement made of any claim cognizable under this section. Any attorney who charges, demands, receives, or collects for services rendered in connection with such claim any amount in excess of that allowed under this section, if recovery be had, shall be fined not more than $2,000 or imprisoned not more than 1 year, or both.

(b) EXCLUSION.—Nothing in this section shall apply to or in any way limit the liability of any person who—

(1) attempts to commit, knowingly participates in, aids and abets, or commits any act of terrorism with respect to which a determination under subsection (a)(1) was made, or any criminal act related to or resulting from such act of terrorism; or

(2) participates in a conspiracy to commit any such act of terrorism or any such criminal act.

(c) RIGHT OF SUBROGATION.—The United States shall have the right of subrogation with respect to any claim paid by the United States under this Act.

(d) RELATIONSHIP TO OTHER LAW.—Nothing in this section shall be construed to affect—

(1) any party's contractual right to arbitrate a dispute; or

(2) any provision of the Air Transportation Safety and System Stabilization Act (Public Law 107–42; 49 U.S.C. 40101 note).

File

October 8, 2001

MEMORANDUM TO NEC PRINCIPALS

THROUGH: LAWRENCE LINDSEY

FROM: MARC SUMERLIN

RE: TERRORISM INSURANCE

An NEC Deputies Committee consisting of Treasury, Transportation, NEC, CEA, OMB, and White House Counsel has prepared two options for principals to consider on terrorism insurance. The first option involves a very limited government role, while the second option would allow the federal government to absorb catastrophic losses due to terrorist acts.

Problem

The September 11 tragedy has generated considerable confusion in the insurance market. Reinsurers argue that they will no longer cover acts of terrorism after their existing policies expire because: 1) they cannot price the risk; and 2) they will not risk absorbing another enormous loss. In turn, primary insurers argue that they will not cover terrorist acts after their reinsurance contracts expire. Approximately 70 percent of reinsurance contracts expire on December 31. In addition, many contracts automatically expire if there is a second event during the contract period.

Lenders usually require businesses to insure any property they use to secure loans. Without terrorism coverage, banks may not lend to new construction projects and many existing commercial properties (skyscrapers, pipelines, power plants, etc.) may not be able to change hands. Furthermore, insurance companies argue that even if the industry as a whole is well-capitalized, individual companies will not be able to spread risk if reinsurers refuse to cover terrorism.

OPTION ONE: Enhance Capacity of Private Sector to Absorb Risk

Under this option, the federal government would allow private-sector reinsurance pools to accumulate assets tax free and would provide tort reforms to limit liability (discussed at the end of the memo). However, the federal government would not expressly provide a backstop for catastrophic losses arising from terrorist acts. Most of the insurance industry argues that the current market failure in pricing terrorism insurance coverage can be addressed only if the government establishes some parameters around private insurers' risk. Still, there are several reasons to consider a limited federal role:

- Moral hazard and improper incentives: If the government provides excess loss reinsurance at subsidized rates, economic actors will not face the right incentives. This may result in sub-optimal investment in security or other prevention activities. For example, the federal government recently provided terrorism insurance to airlines. Without this action, airlines may have immediately hardened cockpits and taken other measures to prove to the insurance industry that they were hijack-proof.

- Government cannot "solve" the market failure: To a large extent, the same information constraints that limit the private market's ability to estimate a loss distribution also apply to the government.

- Crowd-out of private insurance markets: The private insurance market has, in the past, proven its ability to expand capacity in response to new information. An overreaching government could dampen such innovation. For example, prior to Hurricane Andrew and the Northridge earthquake, few insurers protected themselves against industry losses of more than $10 billion. Today, protection of industry losses of $20-25 billion or more is common. In fact, the private insurance market has substantial resources:
  - The U.S. property and casualty insurance market had an annual revenue flow of $297 billion in 2000.
  - The U.S. property and casualty insurance market had a policyholder surplus of $320 billion in 2000. This surplus consists of unencumbered assets available to cover extreme losses.
  - Foreign reinsurance companies back 47 percent of all reinsured premiums. The top 25 foreign reinsurers had a shareholders' surplus of $208 billion.

OPTION TWO: Government Partially Reinsures against Terrorism

There are also numerous reasons why the government may want to intervene:

- Samaritan's Dilemma: Without clear policies about the government's role, the default position will be for the federal government to step in and offer aid whenever terrorists strike. Thus, doing nothing could be the quickest step towards nationalizing the cost of terrorism risk. An explicit policy towards terrorism insurance may actually reduce the government's ultimate liability.

- Possible market failure could lead to under-provision: Unlike natural disasters or other insurable events, it is extraordinarily difficult to estimate a loss distribution on which to base insurance prices for terrorist acts. Before September 11, the insurance industry had only experienced two events in history where losses exceeded $10 billion

– Hurricane Andrew and the Northridge earthquake. This pricing difficulty could lead the private market to under-provide terrorism insurance. As a consequence, some socially worthwhile economic activities may not occur. For instance, planes may not fly.

- Federal government incentives: The national security policies of the federal government directly affect the probability of a terrorist event. Some would argue that the government should therefore internalize part of the cost.

- Threats to national symbols: To the extent that terrorists target symbols of our nation's economic, political and military power, it can be viewed as an attack on the nation, not the symbol *per se*.

- Taxation is broadest risk spreading device: To the extent that these shocks are truly random, the right policy would be to spread the risk as thinly as possible. The "broadest back" in the U.S. is the taxpaying public.

Potential Plan

We are developing a plan to provide federal "excess loss" coverage should principals choose option two. Under this proposal, the federal government would reimburse insurance companies on a pro rata basis for annual losses due to terrorism that exceed a threshold amount. This proposal would encourage the rebuilding of private sector capacity by limiting the government's role. Below are the key decisions necessary to complete the proposal:

Scope of government coverage

We recommend that the government backstop be limited to property and casualty insurance and worker's compensation insurance. We do not believe there is a need to extend coverage to business interruption, health, or life insurance at this time.

The range of government coverage

There is disagreement over the level of losses that the industry should absorb before federal terrorism coverage starts. Option A is favored by Treasury and Option B is favored by CEA and OMB.

Option A
The insurance industry would be responsible for the first $10 billion of damages caused by terrorist events through 2002 and 10 percent of losses above that amount. This deductible would increase by $10 billion a year until the proposal sunsets – forcing the private sector to expand its capacity each year. In addition, the federal government

would not be able to pay losses in excess of $100 billion without explicit approval by the Congress. This option represents the upper bound of industry participants, who have suggested that private insurers' losses be limited to somewhere between $3 billion and $10 billion in the first year, given the loss that just occurred.

Option B
The proposal would be identical to Option A, except that the first year deductible would begin at $30 billion. This amount is equal to 10 percent of the property and casualty insurance industry's annual revenues. Proponents of this option believe that the insurance industry has the capacity to absorb such losses and that we need to begin Congressional negotiations from a high level since it is likely to be bid down.

Sunset

We recommend that the proposal sunset in three years so that lawmakers could reevaluate the need for federal intervention.

Pricing

There is also disagreement over whether the federal government should charge for its excess loss coverage. Treasury and Legislative Affairs prefer Option A and CEA favors Option B.

Option A
Treasury/Legislative Affairs argue against charging a premium because:
- The federal government has an obligation to protect against terrorist events. Hence, the excess loss coverage should be financed through general tax revenues.
- The development of mechanisms to price and assess premiums could be costly relative to premiums collected since the program is temporary.
- The high deductible (at least $10 billion plus 10 percent of excess losses) amounts to a meaningful commitment of industry resources.
- It will be no easier for the federal government to price terrorism insurance than it is for the private sector.
- A federal premium would exacerbate the premium hikes that are likely to occur to recoup losses from September 11.
- Conservative legislators may prefer that the government "stay out of the insurance business" as much as possible.
- The premiums could potentially be used to fund other programs.

Option B
CEA argues for a "fair market" *ex ante* premium determined by the Secretary of Treasury because:

- Economic actors must internalize the cost to maximize their incentive to prevent and respond to terrorist acts (such as investing in new security procedures and better back-up systems).
- The risk could be priced, without development of costly federal mechanisms, either by: 1) hiring a private actuarial firm; 2) selling a vertical slice (i.e. 1 percent) of the excess loss to a private firm such as Berkshire Hathaway and using that price as a basis to set premiums; or 3) selling catastrophic options similar to ones that already trade on the Chicago Board of Trade.
- Even an arbitrary cost-based price is better than no price for providing proper market incentives for risk mitigation.
- With positive premiums, private reinsurers can compete and have the incentive to develop ways to replace the government's role even prior to the sunset.

Definition of Terrorist Attack

The Secretary of Treasury, in consultation with any other official designated by the President, would certify that an event was an act of terrorism and that losses from such an act exceeded $25 million. The Treasury Department is working with the State Department to finalize a definition of terrorism. Below is our working version (controversial language is bracketed):

The term "act of terrorism" means a violent [or destructive] act causing [damage to any type of property or] injury to a person or persons, within the United States, for which (a) the perpetrator or perpetrators committed such act for political or ideological reasons and that (b) a principal purpose of the perpetrator or perpetrators was to (i) intimidate or engender fear among the U.S. civilian population; (ii) disrupt one or more segments of the U.S. national or U.S. regional economy or (iii) coerce, influence or retaliate against U.S. governmental action or policy. An act of terrorism shall include any act described above, whether or not perpetrated by an official, employee or agent of a foreign state acting on behalf of such state, [but shall not include an act committed pursuant to a declaration of war by the United States].

The primary decision needed is whether or not the definition should cover acts of war. Unlike terrorism exclusions, war exclusions on insurance policies are commonplace and accepted in the United States. These exclusions did not pose problems during the Gulf War. However, in the current environment it may be very difficult to distinguish between an act of war and an act of terrorism.

Limitations on Liability

We believe it is important to ensure that any liability arising from terrorist attacks results from genuine, avoidable negligence rather than overzealous litigation. The following policies would apply to any certified terrorist event where total insured losses exceed $25 million:

- Claims arising from a terrorist incident would be consolidated in a single federal forum to be chosen by the Judicial Panel on Multidistrict Litigation.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, punitive damages would not be available.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, non-economic damages would be proportional to the defendant's individual responsibility for the harm. For economic losses, ordinary rules of joint and several liability would apply. Non-economic losses include losses for pain and suffering, mental anguish, and loss of enjoyment of life; economic losses include medical expenses, lost earnings, and other out-of-pocket expenses.

We also recommend the following policies, but believe they will be difficult to pass:

- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, non-economic damages would be limited to a fixed amount and potentially available only to plaintiffs who suffered physical injury.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, defendants would be liable only for acts of gross negligence.

Private Sector Reinsurance of Terrorism

Private companies would be free to form reinsurance pools to diversify their risk. The federal government could also provide tax-exempt status to the assets of any new terrorism reinsurance pool. We believe that private pools could be formed under state laws, obviating the need for a federal charter. We continue to have many concerns about industry proposals for a federally structured and regulated reinsurance pool. These concerns include the length of time it would take to set up such a pool, how to capitalize it, the moral hazard created by utilizing a pool for claims processing, the industry split between mandatory and voluntary participation, and the difficulties of dismantling such an entity after three years.

October 9, 2001
TERRORISM INSURANCE

PROBLEM

Reinsurers will no longer cover acts of because: 1) they cannot price the risk; and 2) they will not risk absorbing another enormous loss.

Banks may not lend to new construction projects and many existing commercial properties may not be able to change hands.

OPTION ONE: Enhance Capacity of Private Sector to Absorb Risk

Federal government would not directly assume any liability for terrorist acts
- Provide tax incentives.
- Provide tort reforms.

Arguments:
- Moral hazard and improper incentives.
- Government cannot solve the market failure.
- Crowd-out of private insurance markets:
    - P&C insurance market had an annual revenue flow of $297 billion.
    - P&C insurance market had a policyholder surplus of $320 billion.

OPTION TWO: Government Partially Reinsures against Terrorism

Federal "excess loss" coverage above a threshold:

Arguments:
- Samaritan's Dilemma.
- Worthwhile economic activities may not occur.
- Threats to national symbols.
- The taxpayer is the broadest back to spread risk.

POTENTIAL PLAN

Limitations on Liability
Apply to any certified terrorist event:

- Claims consolidated in a single federal court.
- No punitive damages.
- Non-economic damages would be proportional to the defendant's individual responsibility for the harm.

Scope of government coverage
Limited to property, liability, and worker's compensation insurance, not business interruption, health, or life insurance at this time.

Range of government's coverage

Option One
$10 billion deductible through 2002 and 10 percent of losses above that amount.
Deductible increases by $10 billion a year. Sunset in three years.
Above $100 billion, need explicit approval by the Congress.

Option Two
Identical, but deductible would begin at $30 billion.

Pricing

Option One
Treasury/Legislative Affairs argues against charging a premium because:

- Mechanisms to price and assess premiums may be costly.
- High deductible is a meaningful commitment of industry resources.
- Federal premium would exacerbate the premium hikes that are likely to occur.

Option Two
CEA argues for a "fair market" *ex ante* premium determined by the Sec. of Treasury:

- Maximizes incentive to prevent and respond to terrorist.
- The risk could be priced either by: 1) private actuarial firm; 2) selling a vertical slice; or 3) selling catastrophic options.
- Even an arbitrary cost-based price is better than no price.

Definition of Terrorist Attack
The primary decision needed is whether or not the definition should cover acts of war.

The Secretary of Treasury, in consultation with any other official designated by the President, would certify that an event was an act of terrorism:

The term "act of terrorism" means a violent [or destructive] act causing [damage to any type of property or] injury to a person or persons, within the United States, for which (a) the perpetrator or perpetrators committed such act for political or ideological reasons and that (b) a principal purpose of the perpetrator or perpetrators was to (i) intimidate or engender fear among the U.S. civilian population; (ii) disrupt one or more segments of the U.S. national or U.S. regional economy or (iii) coerce, influence or retaliate against U.S. governmental action or policy. An act of terrorism shall include any act described above, whether or not perpetrated by an official, employee or agent of a foreign state acting on behalf of such state, [but shall not include an act committed pursuant to a declaration of war by the United States].

Private Sector Reinsurance of Terrorism

Private insurers would be free to form reinsurance pools to diversify their risk.

Tax-exempt status to the assets of any new terrorism reinsurance pool.

Do you want Tim and/or Brett to attend w/ you?

File arg

Jean M. Russell 10/09/2001 08:02:28 AM

Record Type: Record

To: Elizabeth N. Camp/WHO/EOP@EOP
cc:
bcc:
Subject: Re: Insurance and Terrorism Meeting

Since the Judge has to leave early he should bring someone. It's in the Roosevelt Room so I am not sure what kind of space we have.

jeannie
Elizabeth N. Camp

Elizabeth N. Camp
10/08/2001 01:42:16 PM

Record Type: Record

To: Jean M. Russell/OPD/EOP@EOP
cc:
bcc:
Subject: Re: Insurance and Terrorism Meeting

The Judge will be there but will not be able to stay the entire 1 hour because he has a meeting on the Hill.

Question for you - is the the Principal only or is everyone bringing a plus one? A plus one would be helpful since ARG has to leave early.

Thanks!

Jean M. Russell 10/08/2001 10:17:06 AM

Jean M. Russell 10/08/2001 10:17:06 AM

Record Type: Record

To: See the distribution list at the bottom of this message
cc: See the distribution list at the bottom of this message
Subject: Insurance and Terrorism Meeting

This is a reminder that there will be an Insurance and Terrorism Meeting in the Roosevelt room tomorrow, Tuesday at 11:00am. please email me back to confirm attendance if you haven't done so already.

thanks,
Jeannie

---------------------- Forwarded by Jean M. Russell/OPD/EOP on 10/08/2001 10:14 AM ---------------------------

Jean M. Russell 10/04/2001 12:41:37 PM

Record Type: Record

To: linda.figura@do.treas.gov @ inet

cc:

Subject: Insurance and Terrorism Meeting

There will be a meeting on Terrorism and Insurance on Tuesday, 11:00am October 9, 2001 in the Roosevelt Room at the White House. Please email me back and let me know if you are able to attend.

Participants:
Secretary O'Neill
Secretary Evans
Secretary Mineta
Josh Bolten
Nick Calio
Larry Lindsey
Mitch Daniels
Judge Gonzales
Glenn Hubbard
Scooter Libby

If you have any questions, please call me
Jeannie
456-5805

Message Sent To:

Message Copied To:

Message Sent To:

Joshua B. Bolten/WHO/EOP@EOP
Nicholas E. Calio/WHO/EOP@EOP
Lawrence B. Lindsey/OPD/EOP@EOP
Mitch Daniels
Alberto R. Gonzales/WHO/EOP@EOP
Glenn Hubbard
Lewis Libby/OVP/EOP@EOP

October 8, 2001

MEMORANDUM TO NEC PRINCIPALS

THROUGH: **LAWRENCE LINDSEY**

FROM: **MARC SUMERLIN**

RE: **TERRORISM INSURANCE**

An NEC Deputies Committee consisting of Treasury, Transportation, NEC, CEA, OMB, and White House Counsel has prepared two options for principals to consider on terrorism insurance. The first option involves a very limited government role, while the second option would allow the federal government to absorb catastrophic losses due to terrorist acts.

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There are also numerous reasons why the government may want to intervene:

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– Hurricane Andrew and the Northridge earthquake. This pricing difficulty could lead the private market to under-provide terrorism insurance. As a consequence, some socially worthwhile economic activities may not occur. For instance, planes may not fly.

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We are developing a plan to provide federal "excess loss" coverage should principals choose option two. Under this proposal, the federal government would reimburse insurance companies on a pro rata basis for annual losses due to terrorism that exceed a threshold amount. This proposal would encourage the rebuilding of private sector capacity by limiting the government's role. Below are the key decisions necessary to complete the proposal:

Scope of government coverage

We recommend that the government backstop be limited to property and casualty insurance and worker's compensation insurance. We do not believe there is a need to extend coverage to business interruption, health, or life insurance at this time.

The range of government coverage

There is disagreement over the level of losses that the industry should absorb before federal terrorism coverage starts. Option A is favored by Treasury and Option B is favored by CEA and OMB.

Option A
The insurance industry would be responsible for the first $10 billion of damages caused by terrorist events through 2002 and 10 percent of losses above that amount. This deductible would increase by $10 billion a year until the proposal sunsets – forcing the private sector to expand its capacity each year. In addition, the federal government

would not be able to pay losses in excess of $100 billion without explicit approval by the Congress. This option represents the upper bound of industry participants, who have suggested that private insurers' losses be limited to somewhere between $3 billion and $10 billion in the first year, given the loss that just occurred.

Option B
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Pricing

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Treasury/Legislative Affairs argue against charging a premium because:

- The federal government has an obligation to protect against terrorist events. Hence, the excess loss coverage should be financed through general tax revenues.
- The development of mechanisms to price and assess premiums could be costly relative to premiums collected since the program is temporary.
- The high deductible (at least $10 billion plus 10 percent of excess losses) amounts to a meaningful commitment of industry resources.
- It will be no easier for the federal government to price terrorism insurance than it is for the private sector.
- A federal premium would exacerbate the premium hikes that are likely to occur to recoup losses from September 11.
- Conservative legislators may prefer that the government "stay out of the insurance business" as much as possible.
- The premiums could potentially be used to fund other programs.

Option B
CEA argues for a "fair market" *ex ante* premium determined by the Secretary of Treasury because:

- Economic actors must internalize the cost to maximize their incentive to prevent and respond to terrorist acts (such as investing in new security procedures and better back-up systems).
- The risk could be priced, without development of costly federal mechanisms, either by: 1) hiring a private actuarial firm; 2) selling a vertical slice (i.e. 1 percent) of the excess loss to a private firm such as Berkshire Hathaway and using that price as a basis to set premiums; or 3) selling catastrophic options similar to ones that already trade on the Chicago Board of Trade.
- Even an arbitrary cost-based price is better than no price for providing proper market incentives for risk mitigation.
- With positive premiums, private reinsurers can compete and have the incentive to develop ways to replace the government's role even prior to the sunset.

Definition of Terrorist Attack

The Secretary of Treasury, in consultation with any other official designated by the President, would certify that an event was an act of terrorism and that losses from such an act exceeded $25 million. The Treasury Department is working with the State Department to finalize a definition of terrorism. Below is our working version (controversial language is bracketed):

The term "act of terrorism" means a violent [or destructive] act causing [damage to any type of property or] injury to a person or persons, within the United States, for which (a) the perpetrator or perpetrators committed such act for political or ideological reasons and that (b) a principal purpose of the perpetrator or perpetrators was to (i) intimidate or engender fear among the U.S. civilian population; (ii) disrupt one or more segments of the U.S. national or U.S. regional economy or (iii) coerce, influence or retaliate against U.S. governmental action or policy. An act of terrorism shall include any act described above, whether or not perpetrated by an official, employee or agent of a foreign state acting on behalf of such state, [but shall not include an act committed pursuant to a declaration of war by the United States].

The primary decision needed is whether or not the definition should cover acts of war. Unlike terrorism exclusions, war exclusions on insurance policies are commonplace and accepted in the United States. These exclusions did not pose problems during the Gulf War. However, in the current environment it may be very difficult to distinguish between an act of war and an act of terrorism.

Limitations on Liability

We believe it is important to ensure that any liability arising from terrorist attacks results from genuine, avoidable negligence rather than overzealous litigation. The following policies would apply to any certified terrorist event where total insured losses exceed $25 million:

- Claims arising from a terrorist incident would be consolidated in a single federal forum to be chosen by the Judicial Panel on Multidistrict Litigation.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, punitive damages would not be available.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, non-economic damages would be proportional to the defendant's individual responsibility for the harm. For economic losses, ordinary rules of joint and several liability would apply. Non-economic losses include losses for pain and suffering, mental anguish, and loss of enjoyment of life; economic losses include medical expenses, lost earnings, and other out-of-pocket expenses.

We also recommend the following policies, but believe they will be difficult to pass:

- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, non-economic damages would be limited to a fixed amount and potentially available only to plaintiffs who suffered physical injury.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, defendants would be liable only for acts of gross negligence.

Private Sector Reinsurance of Terrorism

Private companies would be free to form reinsurance pools to diversify their risk. The federal government could also provide tax-exempt status to the assets of any new terrorism reinsurance pool. We believe that private pools could be formed under state laws, obviating the need for a federal charter. We continue to have many concerns about industry proposals for a federally structured and regulated reinsurance pool. These concerns include the length of time it would take to set up such a pool, how to capitalize it, the moral hazard created by utilizing a pool for claims processing, the industry split between mandatory and voluntary participation, and the difficulties of dismantling such an entity after three years.

THE WHITE HOUSE

WASHINGTON

September 16, 2001

MEMORANDUM FOR ALBERTO R. GONZALES
TIM FLANIGAN

FROM: COURTNEY SIMMONS ELWOOD CSE

SUBJECT: INSURANCE-RELATED QUESTIONS RAISED BY THE SEPTEMBER 11 ATTACK ON THE WORLD TRADE CENTER

This memorandum provides brief responses to insurance-related questions that may arise from the September 11 attacks on the World Trade Center (WTC). As additional insurance questions arise and facts become available (*e.g.* about the insurers and the extent of private coverage to the WTC), this memorandum will be updated.

How will the individuals injured and killed in the WTC attacks and their families be compensated?

Private Insurance Administered by New York's Worker's Compensation Program. Nearly all employees who worked in the WTC are covered by New York's Workers' Compensation Program, which covers workers in all businesses conducted for profit, employees of the State of New York, and others. The New York system is not self-funded. It acts simply as the processor and adjudicator of claims that are then paid by the employer's insurance carrier. Available benefits include medical care, disability benefits, death benefits, and funeral expenses.

Federal Resources. Under the Stafford Disaster Relief and Emergency Assistance Act, codified at 42 USC 5121-5204c, with associated regulations at 44 CFR Part 206, the President has broad authority to make the resources and services of federal departments and agencies available to states, localities, and individuals affected by declared emergencies or disasters. As a general matter, the President may direct any department or agency to use its authorities or resources to assist affected governments. The statute is extremely flexible; it very likely authorizes almost anything the President might wish to do in the nature of helping with disaster relief and recovery.

Both DOJ and FEMA appear to have existing programs capable of providing assistance to individual disaster victims. FEMA, DOJ, and HHS are planning to discuss this issue this weekend (September 15-16) and will prepare a matrix summarizing available sources of assistance for disaster victims. The following is our current understanding of available resources:

Department of Justice. DOJ manages a fund for crime victims, which was used to pay for some of the expenses incurred by victims of the Oklahoma City bombing, as well as the embassy bombings in Africa. One advantage of using DOJ's funds may be that there would be no restriction on providing assistance to victims of the disaster who do not reside in the State in which the disaster was declared (*e.g.*, residents of New Jersey). Another advantage may be that there is no requirement that a State provide matching funds.

FEMA. Under section 5155 of the Stafford Act, FEMA assistance is, in most cases, a last-in-line source of funding. If funds are available from any other source for the same purpose - including insurance - those funds should be used to pay for the loss sustained in a disaster. FEMA will take steps to recoup whatever funds it may have spent that have been duplicated by another source. The following sources of individual assistance are available under the Stafford Act.

The Individual and Family Grant Program makes cash grants for up to $13,900 (adjusted annually for inflation). Individuals who do not qualify for a disaster loan from the Small Business Administration may be eligible for these grants to help recover unmet disaster-related expenses and serious needs. Grant funds can be used for housing repairs, home cleaning and sanitation, necessary household items, replacement of tools of the applicant's trade, clothing, transportation, and medical/dental expenses. FEMA funds 75% of the grant program's eligible costs; the remaining 25% must come from the State.

The Temporary Assistance Program assures that people whose homes have been damaged by disasters have a safe place to live until repairs can be completed. The basic forms of temporary housing are rental assistance, provided for up to 18 months.

Disaster Unemployment Assistance may be available for those who are not eligible for regular unemployment benefits. Assistance is available for up to 26 weeks. The amount available for an unemployed shall not be more than the maximum available under the relevant state unemployment scheme.

Reemployment Assistance is available only in those states where the state lacks reemployment assistance.

Crisis Counseling helps relieve any grieving, stress or mental problems caused or aggravated by the disaster or its aftermath.

Food Relief is available with food stamps and foodstuffs.

Legal service assistance may be made available when the President determines that low-income individuals are unable to secure legal services to meet their needs as a consequence of a major disaster.

Is there private insurance available to cover the costs of rebuilding the WTC?

It is unclear the extent to which private insurance will cover rebuilding the WTC. FEMA says that the Port Authority has told it that it has estimated, very roughly, that it will cost $5.5 billion to rebuild. (It cost around $510 million to repair the facility after the 1993 bombing.) Current information suggests that private insurance will not be sufficient.

The WTC was owned by the Port Authority, which is a bistate agency operated by New York and New Jersey. In April 2001, the Port Authority granted a 99-year lease of the facility to Silverstein Developers (who took control of 10.6 million square feet made up of the towers and two nine-story office buildings) and Westfield America (who took control of the 427,000 square foot Mall at the World Trade Center).

FEMA believes that the Port Authority has a <u>total</u> of $1.5 billion in insurance coverage. This coverage is for <u>all</u> of the facilities the Port Authority operates (including NY metro region airports, bridges, tunnels, the PATH train). We have no information regarding any insurance coverage that the WTC lessees may have. The press reports that the towers may have been insured for about $2 billion.

If private insurance does not cover the costs of rebuilding the WTC, does existing authority allow the federal government to pick up the shortfall?

Probably so. Under current authority, FEMA may provide assistance for the repair, replacement, or restoration of damaged publicly owned facilities. 42 USC 5172. The WTC was owned by the Port Authority, which is an bistate agency operated by New York and New Jersey. As such, the WTC may be an eligible facility for relief under section 5172. The issue is complicated by the fact that, in April 2001, the Port Authority granted a 99-year lease of the facility to Silverstein Developers (who took control of 10.6 million square feet made up of the towers and two nine-story office buildings) and Westfield America (who took control of the 427,000 square foot Mall at the World Trade Center).

According to FEMA's General Counsel's office, a determination of eligibility is based on which party bears the legal financial responsibility for paying for the repairs under a given set of circumstances. Who bore legal responsibility for this disaster under the lease agreement in these circumstances is as yet unclear. Notwithstanding, FEMA GC's office believes that FEMA also paid to repair the damage to the World Trade Center that occurred in the 1993 bombing. And it appears to be the position of FEMA's General Counsel that the federal government will and must pay to rebuild the WTC.

If the airlines' insurance policies contain exclusions for acts of war (so-called war-risk exclusion clauses), will they be triggered by Tuesday's attacks?

Probably not. Although, under existing judicial authority, a declaration of war is not required to trigger war clauses, "a course of hostility engaged in by entities that have at least significant attributes of sovereignty" is required. 10 Couch on Ins. § 152:5(3d ed.) The leading treatise on the subject states that, "[a]lthough war can exist between quasi-sovereign entities, and an undeclared de facto war may exist between sovereign states, a guerrilla group must have at least some incidents of sovereignty before its activities can properly be styled "war." Id. Consequently, "[a]s a practical matter, act of terrorism usually are not covered by war exclusion clauses." Andrew J. Nocas, *Are You Covered When We're At War? Are You Sure?* 20 The Brief 10, 14 (1991). Accord Pan American World Airways, Inc. v. Aetna Casualty & Surety Co., 505 F.2d 989 (2d Cir. 1974) (war clause was not triggered by the hijacking of a plane by a Palestinian terrorist group because "for there to be a 'war' a sovereign or quasi-sovereign must engage in hostilities"); Holiday Inns Inc. v. Aetna Ins. Co., 571 F. Supp. 1460 (S.D.N.Y. 1983) (war clause was not triggered by P.L.O.'s attack on insured's hotel in Beirut; "[w]hile the P.L.O. received certain recognitions and courtesies from the United Nations and the Arab League, they do not rise to the level of the status of a sovereign state, or that of an entity exercising the powers of de facto government within the boundaries of the Republic of Lebanon."). Given this authority, it seems extremely unlikely that a court would find that Tuesday's attacks triggered the war exclusion clauses – although the insurance carriers may very well bring such a claim in court.

The discussion of the war-risk exclusions is probably academic, in any event. In all likelihood, the airline carriers had coverage for terrorism, in addition to its coverage for war risks. "[M]ost standard aviation policies, both all-risk hull and liability, exclude coverage for losses due to terrorism and hijacking" and "insurers have begun to issue terrorist coverage as a separate premium." Nocas, supra.

Can the federal government provide insurance if the airlines are unable to obtain coverage on reasonable terms?

Insurance analysts predict that, as a result of Tuesday's events, airline carriers will no longer be able to obtain liability coverage for acts of terrorism and will see dramatic increases in the cost of other coverage. Two airlines have informed us that their insurance provider has imposed an immediate 900% increase in terrorism coverage; for each airline, this amounts to an additional cost of approximately $100 million.

Under the War Risk Insurance Act, the federal government has the authority to step in and provide airlines with insurance, but only for foreign flights. The Act (codified at 49 USC 44301 *et seq.*) authorizes "the Secretary of Transportation [to] provide insurance and reinsurance against loss or damage arising out of any risk from the operation of an American aircraft or foreign-flag aircraft" in "foreign air commerce"[1] or "between at least 2 places, all of which are outside the United States." 49 USC 44302(a)(1). "Insurance or reinsurance may be provided

[1] "Foreign air commerce" means "the transportation of passengers or property by aircraft for compensation, the transportation of mail by aircraft, or the operation of aircraft in furthering a business or vocation, between a place in the United States and a place outside the United States when any part of the transportation or operation is by aircraft." 49 USC 40102.

only when the Secretary decides that the insurance cannot be obtained on reasonable terms from an insurance carrier." Id. 44302(a)(2).

The Secretary may provide this insurance only with the approval of the President. Id. 44302(b). "The President may approve the insurance or reinsurance only after deciding that the continued operation of American aircraft or foreign-flag aircraft to be insured or reinsured is necessary to carry out the foreign policy of the United States Government." Id. The President may require the Secretary to consult with interested governmental agencies. Id. 44302(c).

The Secretary of Transportation, with the President's approval, has offered this coverage at least four times in history: during the Vietnam War, the Gulf War, the period close to the TWA hijacking, and in conjunction with the humanitarian relief air services to Haiti.

Proposal: The President may wish to propose legislation that would extend the Secretary of Transportation's authority under the War Risk Insurance Act to domestic flights. It may also be advisable to expand the circumstances under which the President can provide his approval for the issuance of insurance. The President should be permitted to approve the insurance if he determines it is necessary to ensure the continued operation of the air carriers. His authority should not be limited only where he deems the insurance "necessary to carry out the foreign policy."

What happens if an insurance carrier becomes insolvent?

State court rehabilitation and/or liquidation proceedings now provide the exclusive mechanism for dealing with the insolvency of an insurance company. Section 109(b) of the Bankruptcy Code (11 USC 109(b)) provides that neither a domestic nor foreign insurance company may be a debtor under chapter 7 or chapter 11. Therefore, under today's legal regime, if an insurance carrier declares insolvency as a result of claims arising out of the terrorist attacks, the carrier must look to state remedies.

Proposal: If we learn that an insurance carrier is nearing insolvency, the President may wish to propose legislation that would allow the federal government to intervene to bail-out the carrier and to ensure that policy holders receive their due compensation.

What happens if States try to prevent insurance carriers from withdrawing coverage or increasing rates?

If insurance carriers dramatically increase rates or withdraw coverage altogether, some States may attempt to prevent these events through legislation, as the State of Florida did in the wake of Hurricane Andrew. Not long after that 1992 disaster, insurance companies began canceling many residential line policies within Florida in an attempt to avoid paying losses caused by future hurricanes. In response, the Florida legislature enacted a Moratorium Phaseout Statute that allowed Florida insurers to cancel no "more than 5% of its residential policies in Florida or... 10% of its residential policies in a single Florida county" within a year's time.

If, in response to this disaster, States try to impose this sort of measure, insurance carriers will likely sue, claiming the legislation violates the Takings Clause, the Contract Clause, and substantive due process. It is difficult to predict whether such a suit would succeed without knowing the specific language contained in the challenged legislation. However, if carefully drafted, the legislation is likely to survive all but a regulatory takings claim – the success of which would be highly fact intensive. *See Vesta Fire Insur. Corp. v. Florida*, 141 F.3d 1427 (11th Cir. 1998).

What existing authority exists for the federal government to regulate the insurance industry? What new authority is likely to be introduced?

States regulate insurance in the United States. We have not been able to located any existing authority that would allow the President to regulate the insurance industry – even under the declared national emergency.

Whenever problems arise in the industry – as they did in the late 1980's with a series of large property- and casualty-insurer failures – certain Members of Congress introduce legislation that would give the federal government some authority to regulate insurance. If, as is likely to be the case, the September 11 disaster precipitates the failure or near-failure of insurance carriers, we are likely to see another push in Congress for such legislation. In particular, Congressman Dingell is likely to re-introduce a bill – the Federal Insurance Solvency Act – that was introduced, but failed to pass, in 1992 and 1993. That legislation would have created a system of dual regulation under which the federal government would have assumed control of some regulatory functions and shared others. The Act would have established a five-member Federal Insurance Solvency Commission (FISC) appointed by the President with the advice and consent of the Senate. Its duties would have included establishment of national, preemptive solvency standards for insurers and reinsurers involved in interstate commerce. In addition, the Act would have created two non-governmental, nonprofit corporations: the National Insurance Protection Corporation to protect policyholders in the event of a certified insurer's financial impairment or insolvency, and the National Association of Registered Agents and Brokers.

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Courtney S. Elwood
09/18/2001 08:11:21 AM

Record Type: Record

To: Alberto R. Gonzales/WHO/EOP@EOP, Timothy E. Flanigan/WHO/EOP@EOP
cc: Elizabeth N. Camp/WHO/EOP@EOP
Subject: Insurance Coverage

In the meeting last night with Mr. Thompson, you asked about insurance coverage -- who's on the hook for what. This is what I know from public sources:

World Trade Center reportedly held $4.1 billion in property coverage and $500 million in business interruption coverage (Swiss Re and Munich Re are believed to have taken the first $3 billion, with the excess taken by Lloyd's of London). The cost of rebuilding the WTC is estimated at $5.5 billion.

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REPORTS OF INSURERS' CLAIMS ESTIMATES (from BBC news 9/14)

Swiss Re	$1B
Munich Re	$900M
AIG	$500M
Zurich Financial	$400M
Axa	$300M-$400M
Scor	$150M-$200M
Chubb	$100M-$200M
CGNU	$51M
Berkshire Hathaway	3-5% of total loss
Lloyd's	"Substantial"