Statement of
Major General George R. Fay
Executive Vice President,
Worldwide Property and Casualty Claim
CNA Financial Corporation

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Chairman Kucinich, Ranking Member Jordan, Senator Sanders, and distinguished members of the Subcommittee, thank you for the opportunity to appear before you today on behalf of CNA Insurance and, specifically, to address CNA's handling of the insurance claims process for civilian contractors under the Defense Base Act.

I am George R. Fay, Executive Vice President of Worldwide Property and Casualty Claim for CNA Financial Corporation. Before joining CNA in July 2006, I was Executive Vice President & Chief Services Officer at The Chubb Corporation. I have more than 30 years of experience in the insurance industry. I retired from the U.S. Army Reserve as Major General in May 2008, after 38 years of service including almost 4 years on active duty in support of the Global

War on Terrorism and Operation Iraqi Freedom. During those 4 years, I served in many parts of the world, including Iraq and Afghanistan, side-by-side with defense contractors in every location. I graduated from St. Peter's College with a degree in Economics and from St. John's University with an MBA in Finance. It is based on this background that I believe I am well-equipped to testify today.

CNA understands that this hearing focuses on two categories of concern under the Defense Base Act: (1) allegations of profiteering; and (2) concerns regarding claims handling. CNA is pleased to be able to respond today and to have the opportunity to demonstrate that neither of these categories of concern applies to CNA.

This Subcommittee and its full Committee have focused on one part of this business as deeply troubled by charges of improperly inflated premiums amounting to war profiteering and other serious financial concerns. I will explain why CNA's role in this part of the business has been miniscule since 2006. The full Committee and the Subcommittee have also raised concerns of a pattern of routine, intentional, unjustified denials of claims by injured workers. If true, these would be tragic stories, but they are not CNA's story. The most egregious statistics referenced by Chairman Waxman in the 2008 Subcommittee hearing related to this subject—95 percent losses in administrative hearings, 30-

40 percent of claims ending up in administrative hearings—are not part of CNA's record. Like people, no company is perfect. CNA too can improve its performance and we will continue to strive to do so. But I will show how, overall, CNA is part of the solution, not the problems that concern this Subcommittee.

CNA shares the Subcommittee's view that civilian workers in Afghanistan, Iraq and elsewhere around the world are performing a crucial service for the military and this country and that they deserve fair treatment in the administration of insurance claims. I understand well the sacrifices being made by the men and women who support our military operations in Iraq and Afghanistan, and those who support them, and I am pleased to be part of the CNA family, which takes pride in supporting those who make such sacrifices.

I will begin today by providing some background about CNA, after which I will briefly describe the Defense Base Act, and the difference between at-large contracts (known as "non-program") and government competitively-bid request for proposal ("RFP") program contracts (known as "program"). As I will explain, CNA policies comprise only a small percentage of the so-called "at-large" contracts, which are those at the core of the Subcommittee's focus on financial concerns today and were the subject of the Subcommittee's hearing last year. In contrast, CNA is currently the sole provider of the widely-praised "program"

contracts. We believe that our chief contribution to this discussion is the opportunity to share our experience as the provider of choice in the program business, which can serve as a model for our peers who dominate the non-program business.

I will also address the Subcommittee's other category of concern by discussing CNA's claims-handling process, detailing our efforts to provide resources to civilian workers overseas, our commitment to each and every policy holder, and our attempts to review each claim thoughtfully, while operating within the strict standards required by law. The Subcommittee has concerns that there are intentional, systemic delays and denials in the overall DBA claims handling process. I can say with certainty that CNA is not engaging in these tactics; a preliminary review of a significant and representative number of our files clearly supports this conclusion. Finally, I will provide CNA's recommendations for improving the process governing DBA contracts—recommendations that will lead to more efficient and cost-effective claims-handling, a goal CNA shares with the Subcommittee.

Since 1897, CNA has built a tradition of anticipating and responding to the needs of our customers, distributors and business partners. From our early years of insuring railroad workers, we have honored our commitments with

integrity and provided products that keep pace with our customers' ever-changing business risks, in the process making CNA one of the most trusted names in commercial insurance.

We are committed to providing superior customer service and building lasting relationships through our expert underwriting as well as risk control and claims services, which have been recognized by leading industry associations. In 2008, CNA received the Greenwich Associates Claims Management Quality Award for consistently high claims ratings among the majority of our clients. And, with our industry partners, we have developed safety equipment and risk control training programs that protect thousands of workers.

In addition, CNA takes its connection to the community seriously. We have a longstanding tradition of supporting local nonprofit organizations – from the USO to the American Red Cross – that work tirelessly to improve the quality of life in the communities where CNA does business and where our employees live, work and volunteer.

Headquartered in Chicago, CNA has approximately 9,000 employees in offices throughout the U.S., Canada, Argentina and Europe. We are the 7th largest U.S. commercial insurer and the 13th largest U.S. property and casualty

insurer, providing insurance protection to more than one million businesses and professionals in the U.S. and internationally.

The Defense Base Act

As the members of the Subcommittee are well aware, the Defense Base Act (DBA) of 1941 is an extension of the Longshore and Harbor Workers' Compensation Act (Longshore Act). Under the DBA, contractors or subcontractors are required to purchase private insurance that provides medical care and disability payments to civilian workers for injuries sustained on the job, as well as death benefits to the families of employees who are killed on the job. Essentially, DBA is a federally-mandated broad form of Workers' Compensation provided to overseas civilian workers.

The cost of DBA insurance premiums is borne by the contracting agency. The insurer covers all workers' compensation-type claims, but claims made as a result of war-related injuries are reimbursed by the government under the War Hazards Compensation Act.

Different agencies handle the DBA requirements differently. The State Department, United States Agency for International Development (USAID) and the Army Corps of Engineers (which is overseen by the Department of

Defense), accept bids from various insurance providers and, based on the bids, select one provider. Thus, these agencies conduct a competition to select insurance carriers using criteria including reasonable fixed rates and high-quality service. With these criteria in mind, these agencies have made CNA their provider of choice.

In contrast, the Department of Defense (DOD) (with the exception of the Army Corps of Engineers' pilot program), allows contractors to negotiate their own individual private insurance contracts to cover their employees, also known as "non-program" coverage, through an at-large system. This non-program policy results in coverage by many different private insurers. CNA provides only a very small and shrinking percentage of non-program coverage to the Department of Defense.

Thus, CNA has two markets for its Defense Base Act policies: at-large or "non-program" coverage and government competitively-bid "program" contracts. Neither at-large coverage nor program contracts comprises a significant portion of CNA's total business.

Government Agency Competitively-Bid Program Contracts

CNA is the *sole* provider of the program business for the State Department, USAID, and the Army Corps of Engineers, all of which accept competitive bids from insurance providers. This is widely believed to be the best way in which to award DBA insurance contracts. Indeed, in introducing the issue of DBA insurance in his 2008 hearing on the subject, Chairman Waxman lauded the manner in which these agencies went about choosing an insurer, stating that they had "approached this requirement responsibly." This approach creates competition among insurers to provide the best rates and services to the sponsoring agencies.

It is impressive, then, that after an open bidding process, these agencies have chosen to award us with these contracts again and again. This speaks not only to our fairness in setting rates—CNA is aware of no complaints on our pricing for these program contracts—but also our reputation for attention in claims handling and provision of services.

Indeed, in 2008, Chairman Waxman, in an illustration of how to operate under the DBA, stated that CNA actually *incurred 8 percent more* in claims and expenses than it received in premiums under those contracts. CNA estimates that we will pay out 8 percent eventually, but that this will not

develop for a number of years. In fact, CNA has net underwriting losses of approximately $15 million under these contracts of the $180 million in premiums it received. This underwriting loss is in line with losses typically experienced by Workers' Compensation insurers. CNA continues to handle the program business, despite these losses, which in our eyes are significantly worse than the industry average over the same years.

Non-Program Coverage

As stated earlier, with the exception of the Army Corps of Engineers pilot program, DOD contractors are required to follow a different approach to choosing insurers for their civilian employees. In contrast to the other agencies, DOD contractors may select the policy for their contractors from an insurer of their choice. This at-large system, under which, comparatively speaking, CNA currently has very little premium, is at the center of the Subcommittee's focus today on questions of profiteering.

In contrast to the coverage CNA provides on DBA program policies, from 2002 to 2007, our premium accounted for only an average of about 7 percent of all DBA non-program premium. More recently, in both 2006 and 2007, CNA's non-program market share was much lower, only about 3 percent. In

2008, we estimate that AIG had about an 80 percent market share, ACE had about a 10 percent share, Chubb occupied about a 4-5 percent market share, and CNA had about a 3 percent market share. Currently, CNA has only about 270 non-program DBA policies.

Moreover, CNA's non-program DBA policies represent only a small fraction of our overall business. Non-program CNA DBA premiums account for only 1.7 percent of all of CNA's U.S. Workers' Compensation premiums (excluding residual markets), and only 0.2 percent of CNA's total premiums. Put another way, for every $500.00 of premium CNA wrote from 2002 to 2007, only about $1.00 was non-program premium. In sum, CNA is not a significant provider in this market—this market that is at the center of the Subcommittee's focus today.

No matter how small the market, CNA takes all of our responsibilities seriously, including underwriting. Although we occupy such a small share, I believe that a short explanation of our non-program underwriting process will put some numbers into perspective.

In our underwriting, CNA generally has based non-program premiums on analogous rates for similar benefit levels for Longshoremen and Harborworkers coverage, adjusted as appropriate, for DBA market forces,

exposure to loss and loss experience. Premiums paid to insurers cover losses arising from those policies, overhead for claims and underwriting expenses, and agent commissions and taxes. There is further netting of anticipated War Hazard Recoveries, which are payable directly to CNA from the federal government. Underwriting gain or loss is what is left after deducting these from total premiums.

Significantly, because CNA's at-large share and premium volume are low, this business can be highly volatile. Volatility in potential losses—particularly in the earliest years of an insurance program like this one with catastrophic injury potential—is usually reflected in higher initial rates. These initial rates will reduce over time, as the information we have becomes more stable and predictable with more mature program experience. This is particularly true for a Workers' Compensation policy that provides unlimited lifetime medical coverage for the covered injury. CNA has closely monitored our results for the at-large program and in response to results, lowered its rates on the non-program business by about 10 percent from 2007 to 2008 and an additional 14 percent so far in 2009. CNA is committed to providing fair rates, and we continue to monitor our results and adjust rates accordingly as our experience grows.

CNA estimated our combined profits on program and non-program policies in response to Congressman Waxman's request last year. At that time, we estimated that we had only a 14.6 percent underwriting gain on all DBA programs for the years 2002 through 2007. The best estimate we have now for our underwriting gain for 2008 under the DBA program is 9 percent.

Of all of the DBA business written by CNA in 2008, non-program DBA business accounts for only 13 percent. Significantly, 87 percent of CNA's DBA business is in the sector that was lauded by Chairman Waxman.

Claims-Handling Process

I will once again make this very clear: we take very seriously any concerns relating to how we handle our claims. But before directly addressing – and refuting – any allegations that we might be intentionally and systematically delaying or denying claims, I believe it would be helpful to provide a brief overview of what our claims personnel do and the challenges they face when handling DBA claims.

CNA has a dedicated team of experienced claims-handlers available around the clock to respond to DBA claims. We provide a centralized point of contact that is available 24 hours a day, seven days a week for all DBA claims.

We take each claim seriously as a company, and I take each claim seriously as an Executive Vice President. I would respectfully request that the Chairman and the other members of the Subcommittee please inform me of any individual who has shared any concerns or complaints with the members or their staffs of which we have not already been made aware.

Importantly, especially where DBA claims are concerned, we handle claims in eight languages – English, Arabic, Farsi, Urdu, Hindi, Tagalog, French, and Spanish. We offer medical transport worldwide for medical evacuation and repatriation for more serious cases.

CNA is dedicated to the timely and vigorous investigation of DBA insurance claims, and its selection as the primary insurer by the Department of State, USAID and the Army Corps of Engineers speaks volumes about the high-quality service we have provided. Still, many challenges inherent to the DBA insurance system exist, and CNA and other insurance providers must operate within a strict regulatory scheme created at a very different time for very different claims, a scheme that now has little applicability to today's changed realities.

Under the regulatory scheme, among other requirements, insurance providers have only 14 days to decide whether to provide compensation for or

deny any claim or portion thereof. This 14-day requirement did not contemplate the realities and complications of today's world. The DBA was created in 1941 to help civilian workers during World War II, when the United States used civilian contractors only sparingly. By comparison, there were 200,000 civilian contractors working in Iraq and Afghanistan last year. To put this in perspective, that is more than the highest number of military personnel that have ever served at any one time in Iraq and Afghanistan.

Each year between 2003 and 2007, 11,000 civilian contractors filed injury claims under the Defense Base Act, twenty times the number of claims made in previous years. Total payments for health care and benefits related to these claims rose fourteenfold during the first four years of the Iraq war, to more than $170 million annually.

This significant increase in the volume of claims submitted in recent years, however, is only part of the story. While DBA claims appear on their face to be nothing more than routine Workers' Compensation claims, in reality, they are far more complex. First, just the sheer logistics involved in processing these claims are daunting. There is a significant challenge in trying to communicate with claimants and gather information when both the people and the records are located halfway across the world. On top of this, of course, is that we are often

performing these services in a theatre of war, with the attendant strain on systems, schedules and psyches.

The extremely tight timeframe of 14 days that has been imposed by the regulatory scheme, however, allows no room for these realities. According to the law, 14 days is a hard deadline that applies without regard to whether the claims representative needs to contact a physician from a neighboring state or one halfway around the world in a combat zone. The unfortunate result is that claims representatives are in effect obliged to file a notice with the Department of Labor that, while often intended as nothing more than a placeholder, is improperly interpreted by the Department as either an improper delay, or worse, as an outright denial.

Beyond war, geography and time differences, there is a fundamentally different incentive structure for civilian contractors in these combat theatres than for employees who file more traditional Workers' Compensation claims. Civilian contractors earn double or triple what they can earn in their home countries, and our experience is that it is not uncommon for them to abandon claims that their employers filed on their behalf because even the maximum benefits available under DBA pale in comparison to their contractor wages. Often, however, their decisions not to not pursue claims are never

communicated to the claims representative, who has continued in the meantime to spend time and energy in pursuit of information under the previously-described circumstances. This significantly different financial incentive, with its effect on claim abandonment, is distinctly different from the typical Workers' Compensation claims experience.

Finally, even when an injured worker pursues a claim and the claims representative is able to assist with gathering the required information, cultural and structural differences can present real roadblocks, for reasons such as different disclosure rules for treating medical providers in foreign countries or different or functionally non-existent banking systems, which are needed as a repository for benefit payments.

CNA understands why these challenges exist and we do everything we can, as a company, to overcome these difficult conditions to serve our customers effectively. Given the seriousness with which we approach these claims, it is disturbing that we are here today facing accusations that carriers administering DBA programs routinely deny and delay payments to injured contractors. While I cannot comment on the practices of other carriers, I can unequivocally state that it is not CNA's practice to unfairly deny or delay any claim, let alone a DBA claim.

In order to give the Subcommittee a better sense as to how CNA goes about handling DBA claims, we conducted a preliminary analysis of 708 claims reported to CNA from June 1, 2008 to December 31, 2008. Our first order of business with any claim is to try to reach out to the claimant as fast as we can. I have set an internal goal to attempt to reach the claimant and insured within 24 hours of first notice to CNA. Obviously, as I previously mentioned, there are significant challenges in doing this with DBA claims because the claimants are often halfway way around the world in a war zone. Yet despite these challenges, I am pleased to state that our preliminary file review revealed that the CNA claim professionals make initial contact with the claimant within 24 hours of the claim 86 percent of the time.

Beyond simply making contact, our claims people must also attempt to gather key information to make important determinations within what I described earlier as the 14-day regulatory rule. Clearly, this is an unrealistically short period of time given the logistics of addressing overseas claims. There have been suggestions that because of the time pressure created by these logistical problems, carriers just routinely deny claims. Again, while I cannot comment on the practices of other carriers, despite the challenges, CNA absolutely attempts in good faith to make a compensability decision within the

14-day period. Indeed, in the file sample we reviewed, we found we only denied claims at the 14-day deadline approximately 25 percent of the time. Stated differently, CNA was able to make a compensability decision – meaning a decision to accept the claim – within the 14-day deadline approximately 75 percent of the time.

The 25 percent denial figure, though, also overstates the percentage of claims that we determined were non-compensable. For the 25 percent where we denied, we found that about 37 percent of those claims were denied for insufficient information. Of those files in which we denied within the initial 14 days, we later picked up benefits on approximately 12 percent based on the receipt of additional information. The fact that we are obliged to report as denials those situations where we do not yet have sufficient information to evaluate the claim is the unintended result of the arbitrary and misleading requirements of the 14-day rule. This is especially true when one considers that—even after being forced to file a notice of denial for insufficient information—our claims people continue to attempt to obtain supporting information.

Looking at the status of claims beyond the 14-day point bears this out as well. In our preliminary review of those claims in which compensability was

challenged, only about 9 percent of the claims were actively challenged through litigation by the injured worker. These statistics are consistent with my experience—we do what we can to quickly make claim decisions, we settle disputes when we can, and we only dispute a small portion of the claims, and only when absolutely necessary. In addition, we examined a claims file sample of about 200 closed claims from 2002 to 2005, with consistent results.

There also have been accusations that injured claimants are forced to pursue their claims through protracted litigation, and when they do, they prevail over 95 percent of the time before administrative hearings. Again, I cannot comment on the practices of other carriers, however this is wholly inconsistent with CNA's experience. First, it is not CNA's goal to engage in protracted litigation. Indeed, with the 5500 or so claims filed with us in the past seven years, we believe that we have only gone to an administrative ruling in fewer than 20 cases. Our goal is to try to settle disputes when we can. In those rare instances where that has not been possible, however, our experience has been that more often than not the administrative law judge—a neutral, third party—has validated our non-compensability determination in whole or in part. In short, our goal is not to litigate cases, but when we must, we have a good faith basis for doing so.

At least with regard to CNA, all of these concerns that have been raised are merely one side of the story – and, to our knowledge, there are very few such stories. Media reports neglect to tell the lengths to which CNA claim specialists endeavor to ensure that a claimant receives timely and appropriate medical and financial benefits. Federal and state statutes, as well as CNA's own corporate policy, prohibit me from commenting on individual claimants without their consent. However, to accuse our claim specialists – who view the injured workers who file claims as patriotic partners of our men and women in uniform – of intentionally delaying or denying claims is to deprive them of the meaning and value they derive from their tireless efforts to provide a comprehensive range of covered services, including arranging for medevacs and other urgent care, or long-term hospital, recuperative and care services, and insuring that claimants receive financial benefits owed.

Recommendations:

From our experience, these concerns clearly demonstrate the unfortunate but real effects of a flawed statutory and regulatory scheme. For that reason, CNA will be pleased to assist this Subcommittee in its efforts to consider changes and improvements to the DBA program. We share the

Subcommittee's concern that insurers not use the DBA system to inflate premiums and agree that the claims-handling process could be improved by adjustments to the DBA's archaic regulatory requirements.

Recommendations:

Change Unrealistic Claims-Handling and Compensation Requirements.

Our recommendations include, first, refining and in some instances extending, the 14-day rule to allow for a more detailed analysis and review of claims. It is important to CNA to be able to process all claims fairly, which, as I have detailed, is especially difficult in the case of DBA claims when they are received from remote areas in war zones where communications are difficult. Unfortunately, the result is that insurance carriers are often forced to file LS-207 forms initially denying a portion of the claim or the entire claim to avoid penalties or simply to buy more time, a necessary action that is often—and understandably—misinterpreted. A regulatory scheme that creates such incentives can only produce unintended, and sometimes, tragic results.

The Department of Labor requires that payments be made to claimants within 10 days, even if these payments are being made to individuals overseas. This requirement is extremely difficult to satisfy because payments to

DBA claimants are typically sent using wire transfers. This 10-day time requirement should also be adjusted to reflect the realities of the current day.

Finally, we further recommend an increase on the limit for funeral benefits. Under the Act, it is $3,000, which does not reflect current funeral costs.

Adopt a Competitively-Bid Program Method of Awarding Contracts.

Second, CNA believes that DOD should adopt a modified request for proposal-awarded program method, like the one used by the State Department, USAID, and the Army Corps of Engineers, to cover all of their civilian contractors. An RFP-awarded program could be established for each of the divisions of the military within DOD. If the Army, Navy, Air Force, Marines, Merchant Marine and other affiliated, but independent, branches were to each have their own DBA programs, the insurance market might respond favorably to the respective requests for proposals. Each division could possibly also further subdivide into smaller groups to create their own competitively-bid programs as well. The objective would be to have small enough groups to be relatively homogeneous and supportable by a single insurer, yet large enough to diversify the volatility of the risks. These fixed rate programs would also simplify the bidding (RFP) process for the contractors.

By some estimates, doing so could save the DOD $362 million. According to the GAO, in 2005, the State Department and USAID paid approximately $2 to $5 for every $100 of salary cost for DBA insurance, which was written by CNA, while the Defense Department contractors were paying DBA insurance rates between $10 and $21 per $100 of salary costs. GAO, Congress, and the Army's own auditors have recommended that the Defense Department implement an agency-wide single insurer risk-pool program for DBA insurance every year since 2005.

Conclusion

CNA's mission is to provide superior service to all of our customers, and we have been doing so for more than 100 years. We are a customer-focused company and we measure our success, in part, by our ability to deliver high-value products and high-quality service. In keeping with our mission, CNA shares the Subcommittee's view that civilian workers in Afghanistan and Iraq deserve fair treatment in the administration of insurance claims. Therefore, Mr. Chairman, I thank you for the opportunity to discuss these issues today. I will be pleased to answer any questions you may have.