

Statement of  
Richard L. Thomas  
Senior Vice President and Chief Underwriting Officer  
American International Group Companies

Concerning  
Boston Central Artery/Tunnel

Before the  
Committee on Commerce, Science, and Transportation  
United States Senate  
May 3, 2000

My name is Richard Thomas and I am here testifying on behalf of American International Group, Inc. AIG is the leading U. S. based international insurance organization and the largest underwriter of commercial and industrial coverages in the United States.

As requested, I would like to address my remarks this morning to the purpose and performance of the insurance program developed for the Central Artery/Tunnel Project. While there have been many reports circulating about the Project's budget and management issues, it is important to underscore that the insurance component of this enormous effort has been a positive contribution. To date, the Project's safety record and resultant cost efficiencies have exceeded our initial expectations and demonstrated the benefits that can be derived from a carefully designed and implemented insurance program.

The Central Artery/Tunnel Project is one of the largest, most complex highway transportation projects ever undertaken. It has involved hundreds of contractors and subcontractors and thousands of workers engaged in the wide multitude of tasks associated with a Project of this magnitude. Not surprisingly, the development and procurement of an efficient and effective insurance program was a priority for the Massachusetts Highway Department ("MHD") from the outset.

To that end, the MHD formed a committee in 1991 whose purpose was to create the bid specifications, solicit competing proposals from the insurance industry, and to select the insurance company and proposal that best achieved the objectives of the MHD at the most favorable price. That committee specified an Owner Controlled Insurance Program ("OCIP"). An OCIP is a program in which all the contractors and subcontractors working on the project are covered by a single master policy procured by the owner, thereby avoiding the redundancies and inefficiencies that would result from a multitude of policies purchased individually by contractors and subcontractors from different insurers. As is typically the case, the OCIP for the Project is designed to cover workers' compensation and general liability insurance.

It should be noted that the OCIP was designed at a time that the Massachusetts workers' compensation market was experiencing a period of significant uncertainty and instability stemming from

structural deficiencies in the workers' compensation system. These issues have compromised the validity of establishing adequate rates and produced large deficits in the States' residual market pool. Thus, in addition to the enormous challenges of creating a program to address the complex needs of this project, potential insurers also were confronted with the risks associated with a multi-year program design and coverage commitments in a highly uncertain environment.

A Request for Proposal (RFP) was issued to the insurance industry by the committee, which included a representative of a knowledgeable insurance broker retained by the MHD. Five carriers, including AIG, submitted proposals. AIG was selected as the winning bidder, in part, given its extensive experience in underwriting OCIP programs. In its proposal, AIG agreed to commit substantial resources to assist the MHD in its safety program, and AIG has had safety consultants on site from the inception of the program working side by side with professionals engaged by the MHD, the project manager, and the major contractors. In response to the RFP, AIG's proposal included substantial elements of self-insurance so that the MHD's ultimate insurance costs would be based on the success of the Project's safety program.

AIG's proposal also included other features tailored to meet the specific needs of the MHD. AIG created a claims-adjustment unit in Boston dedicated to adjusting and managing claims solely for this project. AIG created a dedicated affirmative-action office to ensure compliance with EEOC guidelines and the Project's commitment to affirmative action. AIG also agreed that it would not have the right to cancel the program for its initial three (3) year period and would be obligated to provide a one year notice thereafter. Throughout the life of the program, the MHD would have the right to cancel the insurance at any time upon 30 days notice.

Other terms of the agreement also reflected the vigorous negotiations among the parties. A trust was established to secure the funds that were allocated by the insurance plan to pay claims within the Project's self-insured retention. AIG and the MHD initially agreed that for funds held in the trust, up to the MHD's maximum premium obligation, all investment income would be split equally. This was memorialized in a written agreement negotiated with advice of counsel and entered into by the Commonwealth and AIG. In this agreement, AIG guaranteed the principal of all assets in the trust. As a result of the favorable loss experience on the program and the retention in the trust of return premiums due to the audit of actual expended payrolls, the terms of the agreement were modified in 1996, to be effective November, 1995, so that the MHD received a greater share of the investment income.

The terms of the insurance program were memorialized in a series of agreements that were negotiated with advice of counsel for all parties and were signed by the Commonwealth of Massachusetts, Bechtel Parsons (the project manager) and a subsidiary of AIG. The terms of the agreements were fully disclosed to the Federal Highway Administration and the various state agencies involved in this project. Those agencies have been kept fully informed of the performance of the program, both from an insurance and financial perspective, through regular reports and frequent communication. In addition, AIG made the appropriate filings with and received approval from the Massachusetts Department of Insurance.

From the perspective of public and worker safety and cost control, AIG's insurance program has been a success. Of greatest importance, due to the combined efforts of AIG, the MHD, the project manager and its many contractors and subcontractors, the safety record associated with this program has been extraordinary. We take, though certainly share, great pride in the fact that the number of workers and members of the public who have sustained serious injuries in connection with the project has been exceptionally low.

As a result, the costs associated with the program have also been extremely favorable for the MHD. In its original projections, AIG forecast that the cost of workers' compensation and general liability insurance over the lifetime of the project could exceed \$900 million. Because of the impact of the safety program and administrative reforms of the workers' compensation system implemented by the Commonwealth, the ultimate cost of the program of insurance will most likely be significantly less than the amount originally budgeted. Indeed, if current trends continue, the possibility exists that the ultimate costs could be 40% to 50% less than the amount initially forecast.

In addition, these reductions in cost are also due in part to the fact that, on two occasions, in 1996 and 1998, the MHD and AIG renegotiated certain terms of the original agreements. AIG agreed to modifications that reduced the Project's maximum contractual liability, increased MHD's share of the investment income, and reduced the amount of certain fixed cost elements of the insurance plan, thereby materially improving the economic terms of the program for the MHD.

Again, I would like to emphasize that the insurance program for the Project has been a success. While it is impossible to predict the final results of the program at this juncture, it is certainly our goal that it will continue to produce benefits both in terms of safety and cost efficiency.