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REPORT TO THE CONGRESS

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Opportunity For Savings In  
Providing War Risk Insurance  
For Contractor Property  
And Employees B-172699

Department of Defense  
Department of State  
Department of Commerce

BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES

NOV. 9, 1971

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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-172699

To the President of the Senate and the  
Speaker of the House of Representatives

This is our report on the opportunity for savings in providing war risk insurance for contractor property and employees. The report is based on a study we made in various commands and offices of the Department of Defense, the Department of State, and the Department of Commerce.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Defense; the Secretary of State; and the Secretary of Commerce.

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General  
of the United States

D I G E S T

WHY THE REVIEW WAS MADE

The Department of Defense (DOD) and the Agency for International Development (AID) generally reimbursed Government contractors for the cost of insurance purchased to provide protection against war hazards to their property and employees. 5 + 7 2

Because of indications that war-risk-insurance costs were considerably greater than losses, the General Accounting Office (GAO) reviewed the insurance practices of the Navy's Military Sealift Command and the Defense Fuel Supply Center, a unit in the Defense Supply Agency. 13

FINDINGS AND CONCLUSIONS

The cost of war risk insurance to the Government has substantially exceeded the losses experienced by its contractors. This is true for insurance purchased for contractor-owned vessels, contractor employees, and third-country nationals.

Contractor-owned vessels

Savings of \$16.2 million could have been realized over the 3-year period ended June 30, 1969, if DOD and AID had followed the Government's long-standing policy of self-insurance. On the basis of actuarial principles, significant savings can be expected if these agencies adopt a self-insurance policy for future years. (See p. 7.)

Both agencies have followed the practice of reimbursing private shipowners for the cost of war risk insurance on vessels used to transport materials into Southeast Asia. In July 1968, however, the Military Sea Transportation Service, predecessor to the Military Sealift Command, replaced the war risk insurance on officers and crews of chartered vessels but not on the vessels with Government insurance obtained through the Maritime Administration. The Defense Fuel Supply Center continues to reimburse shipowners for war-risk-insurance coverage on officers and crews. (See p. 8 to 15.)

Contractor employees

DOD and AID have reimbursed contractors for commercial war risk insurance to provide contractor employees with supplemental coverage for war-hazard death or injury. The coverage provides lump-sum

NOV. 9, 1971

benefits in addition to the workmen's compensation type of benefits provided under the Defense Base Act and the War Hazards Compensation Act. The cost of such insurance has exceeded the losses incurred (claims paid, approved, or pending) by \$2.7 million over the 3-year period ended June 30, 1969. (See p. 17.)

DOD and AID have participated in negotiations of, and have approved the terms for, war-risk-insurance coverage on contractor employees under a blanket policy with a commercial insurance company. Terms of the blanket policy, however, omit any provision for Government audit. (See p. 19.)

#### Third-country nationals

AID and two military commands have continued to reimburse contractors in Vietnam for the cost of commercial war-risk-insurance coverage of third-country nationals (citizens of countries other than the United States and Vietnam) employed by the contractors, even though a program of self-insurance generally adopted by DOD for such employees has offered substantial savings. Insurance costs exceed losses by about \$542,000, and GAO believes that future savings could be realized if such a program were followed by the above agencies for these employees. (See p. 27.)

### RECOMMENDATIONS OR SUGGESTIONS

#### Vessels

The Secretary of Defense should establish a plan of self-insurance for contractor-owned vessels. If feasible, this coverage should be obtained from the Maritime Administration, as authorized by the Merchant Marine Act of 1936. (See p. 16.)

#### Employees

The Secretary of Defense and the Secretary of State should

- seek legislation to authorize lump-sum benefit payments to contractor employees for war-hazard death or injury (There should be appropriate dollar limitations and the employees should be allowed to select either a lump-sum payment or an annuity-type payment of insurance benefits.) and
- discontinue reimbursing contractors for the cost of supplemental war risk insurance, and, in the interim, reopen negotiations on the present policy to bring the administrative costs, brokers' commissions, and profit under Government audit. (See p. 26.)

The Secretary of State should seek authority from the Congress to self-insure for war-risk losses incurred by third-country nationals under AID contracts, and the Secretary of Defense should issue instructions to all DOD procurement activities to provide for self-insurance of third-country nationals as authorized by Defense Procurement Circular 64. (See p. 31.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

GAO proposed in its draft report that the Secretary of Defense review war-risk-insurance practices and cost experiences of the Military Sealift Command and the Defense Fuel Supply Center, with a view toward providing Government self-insurance for war-risk hazards to contractor-owned vessels and officers and crews, if feasible, through the Maritime Administration. DOD informed GAO that it had initiated such a study. This study was still in progress on September 9, 1971. The Maritime Administration has advised us that it will be happy to provide war risk insurance to the extent allowed by the Merchant Marine Act of 1936. (See p. 15.)

With regard to supplemental war risk insurance on contractor employees, DOD believes that, pending a suitable substitute for commercial war risk insurance, no action to modify existing policy should be initiated because such action could cause contractors serious difficulty in recruiting and retaining employees. DOD advised GAO that it had effected reductions in the premium rates and reserve fund required under the blanket policy and would discuss other matters relating to the policy in future meetings with the insurance company. AID said that it was conducting an in-depth study of GAO's recommendation. This study was still in progress on September 9, 1971.

The Bureau of Employees' Compensation, Department of Labor, which administers the Defense Base Act and the War Hazards Compensation Act, agreed with GAO.

DOD and AID proposed to reexamine their policies with regard to war risk insurance on third-country nationals. (See p. 25.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

Legislation may be necessary for lump-sum war-risk insurance payments to contractor employees.

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ABBREVIATIONS

- |      |                                       |
|------|---------------------------------------|
| AID  | Agency for International Development  |
| ASPR | Armed Services Procurement Regulation |
| DOD  | Department of Defense                 |
| GAO  | General Accounting Office             |

D I G E S T

WHY THE REVIEW WAS MADE

The Department of Defense (DOD) and the Agency for International Development (AID) generally reimbursed Government contractors for the cost of insurance purchased to provide protection against war hazards to their property and employees.

Because of indications that war-risk-insurance costs were considerably greater than losses, the General Accounting Office (GAO) reviewed the insurance practices of the Navy's Military Sealift Command and the Defense Fuel Supply Center, a unit in the Defense Supply Agency.

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## CHAPTER 1

### INTRODUCTION

The Government's war-risk-insurance program had its origin in legislation dating back to World War I when a Government agency was created within the Treasury Department to supplement the inadequate war risk insurance then available in the commercial insurance market. This agency--the Bureau of War Risk Insurance--had authority to insure American vessels, freight, cargo, and crews against loss or damage arising from the risks of war. Subsequently this agency was abolished, and its functions with respect to merchant shipping now are carried out by the Maritime Administration, Department of Commerce.

Because of significant losses suffered by American marine insurers in the early stages of World War II, the Federal Government activated a war-risk-indemnity program in 1942 to prevent the disruption of waterborne commerce by providing protection to shipowners and preventing undue increases in insurance rates. This Government indemnity program ended with the cessation of World War II hostilities, and the commercial insurers returned to the war-risk field. At the time of our review in fiscal year 1970, the American insurers' share of the maritime war-risk-insurance market for American-flag vessels was relatively small because over 90 percent of all commercial war risk insurance on such vessels was being written by British insurance firms.

### WAR-RISK-INSURANCE LEGISLATION ON CONTRACTOR-OWNED PROPERTY

The Merchant Marine Act of 1936, as amended (46 U.S.C. 1285), the Federal Aviation Act of 1958 (49 U.S.C. 1534), and Public Law 85-804 as implemented by Executive Order No. 10789 (50 U.S.C. 1431) provide a means by which Government contractors may obtain Government war-risk-insurance coverage on contractor-owned property. Under 46 U.S.C. 1285 and 49 U.S.C. 1534, the Secretary of Commerce and the Secretary of Transportation are authorized to provide war-risk-insurance coverage on contractor-owned vessels and aircraft, respectively, upon request by the Department of Defense and such other agencies as the President may prescribe.

The contracting agencies involved must agree to indemnify the Departments of Commerce and Transportation for any war-risk losses sustained under such Government insurance. Also DOD and various civil agencies are authorized by Public Law 85-804 as implemented by Executive Order No. 10789 to indemnify Government contractors against unusually hazardous losses or claims when it will facilitate the national defense without regard to the availability of funds.

#### WAR-RISK LEGISLATION FOR CONTRACTOR EMPLOYEES

After the start of World War II, it was found that certain gaps existed in workmen's compensation protection for employees of Government contractors at locations outside the continental United States. As a result, the Defense Base Act (42 U.S.C. 1651) was enacted to cover such employees. This was an extension of the Longshoremen's and Harbor Workers' Compensation Act (33 U.S.C. 901) which provided workmen's compensation benefits for employees of private employers, excluding crews of vessels and Government employees, engaged in employment upon the navigable waters of the United States. Under the Defense Base Act, the scale of benefits is generally the same as that provided by the Longshoremen's Act. Under both acts the insurance coverage was to be provided by the contractor from commercial sources or from its own resources.

To broaden the Defense Base Act, the War Hazards Compensation Act (42 U.S.C. 1701) was enacted. In essence, this act amended the Defense Base Act to specifically provide war-risk coverage for employees of Government contractors engaged in work outside the United States who would not be entitled to benefits for war hazards under the Defense Base Act. The scale of benefits generally is the same as that provided by the Longshoremen's Act.

Under the War Hazards Compensation Act, the Bureau of Employees' Compensation, Department of Labor, is authorized to reimburse employers, insurance carriers, or compensation funds for benefit payments to employees covered by the act or to their beneficiaries for death or injury due to war hazards and to make direct payment of such benefits. The act also provided for payments to dependents of employees who are captured or detained by enemy action.

## RECENT WAR-RISK-INSURANCE EXPERIENCE

It is estimated that several hundred Government contractors have been actively engaged in construction work and other activities in Southeast Asia. On the basis of our review of selected major contracts and DOD records on contractor owned and operated ships, we estimate that, during fiscal years 1967 through 1969, the costs of war risk insurance amounted to \$18.5 million for contractor-owned property (see p. 8) and \$4.6 million for employees (see pp. 20 and 29) insured under these selected contracts. During the same period total losses to contractor equipment and employees under these contracts are estimated at \$2.3 million and \$1.3 million, respectively.

Our estimates represent actual and estimated insurance costs and losses shown by the records of selected major contractors, by reports of costs and losses under a blanket insurance policy for war-risk coverage on contractor employees, and by DOD records on shipping operations. The last item included chartered-ship operations of the Military Sealift Command and ship operations of three major petroleum contractors of the Defense Fuel Supply Center.

## CHAPTER 2

### POTENTIAL SAVINGS OF SELF-INSURANCE PROGRAM FOR

### WAR RISK INSURANCE ON CONTRACTOR-OWNED VESSELS

DOD generally has followed the practice of reimbursing contractors for premiums paid for war-risk-insurance coverage of contractor-owned vessels and crews although the cost of such insurance has greatly exceeded war-risk losses.

Our review of war risk insurance practices of the Military Sealift Command,<sup>1</sup> Department of the Navy, and the Defense Fuel Supply Center, Defense Supply Agency--the two major DOD agencies which contract with private shipowners and suppliers for shipment of material to Southeast Asia--indicates that savings of about \$16.2 million could have been realized over the 3-year period ended June 30, 1969, had these agencies followed the Government's long-standing policy of self-insuring where practicable.

We believe that significant savings could be realized in the current and future years by these agencies. Also because a substantial portion of this insurance has been acquired through foreign insurance firms, the use of Government self-insurance may have a beneficial effect upon the balance of payments of the United States.

Under certain contracts DOD has adopted the practice of self-insurance whereby it reimburses the contractors for war-risk damage or loss of contractor-owned property. We believe that a broader application of this self-insurance practice would afford DOD an opportunity for significant savings. Such action would be in accordance with the long-standing Government war-risk self-insurance practices authorized by statute.

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<sup>1</sup>Prior to August 1, 1970, the Military Sealift Command was called the Military Sea Transportation Service.

Government self-insurance against war-risk hazards to contractor-owned vessels and crews is provided for in the Merchant Marine Act of 1936, as amended (46 U.S.C. 1285). This legislation authorizes the Secretary of Commerce to provide war risk insurance for loss or damage of contractor-owned vessels and for death, injury, or detention of the officers and crews or loss of their personal effects (second seamen's insurance).

Under this legislation the Secretary of Commerce is to make this insurance coverage available upon request and without premium to DOD and such other agencies as the President may prescribe. This program is administered by the Maritime Administration, and the contracting agency involved is required to indemnify Maritime for loss claims approved and paid.

We have observed, however, that the Military Sealift Command and the Defense Fuel Supply Center have followed a practice of reimbursing contractors for premiums paid for commercial war-risk coverage on vessels and crews in lieu of obtaining similar insurance coverage through the Government program administered by the Secretary of Commerce. The estimated cost of war risk insurance for which the contractors have been reimbursed during fiscal years ended June 30, 1967, 1968, and 1969, and the estimated losses incurred (loss claims paid, approved, or pending) for the same periods are summarized below.

	<u>Total</u>	<u>Fiscal years ended June 30</u>		
		<u>1969</u>	<u>1968</u>	<u>1967</u>
War-risk-insurance costs:				
Military Sealift Command	\$11,652,001	\$6,971,102	\$3,231,350	\$1,449,549
Defense Fuel Supply Center	<u>6,872,673</u>	<u>2,313,164</u>	<u>2,340,589</u>	<u>2,218,920</u>
	<u>18,524,674</u>	<u>9,284,266</u>	<u>5,571,939</u>	<u>3,668,469</u>
War-risk losses:				
Military Sealift Command	646,956	60,675	586,113	168
Defense Fuel Supply Center	<u>1,664,352</u>	<u>310,206</u>	<u>1,550</u>	<u>1,352,596</u>
	<u>2,311,308</u>	<u>370,881</u>	<u>587,663</u>	<u>1,352,764</u>
Excess of costs over losses	<u>\$16,213,366</u>	<u>\$8,913,385</u>	<u>\$4,984,276</u>	<u>\$2,315,705</u>

MILITARY SEALIFT COMMAND

The Military Sealift Command is responsible for providing sealift requirements for the military services in Southeast Asia and elsewhere. To accomplish its requirements, the command makes use of Government-owned vessels and vessels chartered from commercial sources. These vessels include cargo ships, passenger ships, tankers, and special project ships.

Charter agreements entered into by the command provide for full reimbursement to the shipowner for the cost of war risk insurance purchased from commercial insurance companies to provide coverage on hulls and machinery of chartered vessels. Information obtained during our review indicated that the command provided about 45 percent of the shipping required for petroleum requirements and essentially all other shipping requirements for DOD in Southeast Asia. The remainder of DOD's petroleum shipping requirement, or 55 percent, was provided by the Defense Fuel Supply Center under contracts with suppliers for purchase and shipment of the petroleum, using foreign-flag vessels.

The total war-risk-insurance cost charged to the command under contracts for shipment of cargo during fiscal year 1967 through fiscal year 1969 is estimated at \$11.6 million, compared with estimated losses of \$0.6 million, as shown below.

	<u>Total</u>	<u>Fiscal years ended June 30</u>		
		<u>1969</u>	<u>1968</u>	<u>1967</u>
War-risk-insurance costs:				
Hull and machinery (note a)	\$11,652,001	\$6,971,102	\$3,231,350	\$1,449,549
War-risk losses:				
Hull and machinery	<u>646,956</u>	<u>60,675</u>	<u>586,113</u>	<u>168</u>
Excess of costs over losses	<u>\$11,005,045</u>	<u>\$6,910,427</u>	<u>\$2,645,237</u>	<u>\$1,449,381</u>

<sup>a</sup>Includes an undetermined amount for protection and indemnity insurance on officers and crews which is not considered significant.



Management of the command was concerned over the high cost of war risk insurance for officers and crews, and it took action in July 1968 to cancel commercial coverage for the second seamen's insurance on chartered vessels and to replace this coverage with self-insurance obtained through Maritime. Second seamen's insurance for Government-owned tankers operated by contractors for the command has been provided by Maritime since 1954. As early as 1965 the Navy, on behalf of the command, had inquired into Maritime's ability to provide war risk insurance on hulls and machinery for chartered vessels. In its response Maritime generally agreed to provide such insurance if requested.

We were informed that this type of insurance could be initiated by a request to Maritime from the command and by agreement with the command to indemnify Maritime for any losses incurred.

Officials of the command informed us that they had not requested this coverage from Maritime because (1) heavy war-risk losses could wipe out the command's industrial fund and (2) shippers would not accept the Government's evaluation of current domestic market value on their vessels for insurance purposes.

We noted that losses experienced over the 3-year period as shown on page 9 amounted to only \$0.6 million, compared with the industrial fund corpus at March 31, 1969, of \$42 million and a net income of \$9.3 million for the 9 months then ended. Instead of being charged for losses of only \$0.6 million under a self-insurance program, the industrial fund of the command has been charged with costs of \$11.6 million for war-risk-insurance premiums purchased by shipowners. Charges to the industrial fund are spread to the Government agencies served by the command.

Although it is possible that heavy losses could deplete the fund, this risk must be taken by the Government in any one program when it follows its policy of self-insurance.

We believe that sufficient time has elapsed and sufficient experience has been gained to provide relatively valid actuarial science-oriented basis for determining the estimated fund requirements for a self-insurance program to

cover losses which may be experienced in the future. It is our opinion that the potential losses constitute a contingency which DOD is authorized to meet and that, on the basis of past experience, the cost of war-risk losses under a self-insurance program would be substantially less than the cost of war risk insurance.

With regard to the acceptance of the Government's evaluation of current domestic market value for insurance purposes, we noted that it was common for shipowners to insure their vessels at Government expense for amounts well in excess of the valuation placed upon these vessels by the Department of Commerce, as illustrated by the following examples.

<u>Vessel</u>	<u>Valuation by Department of Commerce</u>	<u>Valuation by owners for commercial insurance</u>
A	\$5,830,000	\$ 7,000,000
B	970,000	7,000,000
C	365,000	900,000
D	9,050,000	17,000,000

Department of Commerce valuations shown above were placed on the vessels for war-risk-insurance purposes. The basis for these valuations is the current domestic market value after upward or downward adjustments for substandard conditions or installation of special equipment. Appraisals obtained from private industry are utilized in arriving at the valuations. These appraisals, together with those of Maritime, are reviewed by Maritime's Ship Valuation Committee which establishes the valuation.

We believe that these procedures should provide for reasonable determination of ship values. We believe also that, as long as the command continues to bear the higher cost of commercial war risk insurance occasioned by the shipowners' practice of insuring vessels in excess of the Department of Commerce determination of current domestic market value, shipowners will prefer commercial war risk insurance because of the high potential return which they would receive in the event of loss.

The Merchant Marine Act of 1936 provides that insured shipowners have the right to reject the Government's valuation within 60 days after attachment of the Maritime insurance coverage or valuation by the Secretary of Commerce, whichever is later.

The act provides that, in the event of loss, the insured receive 75 percent of the rejected value and have the right to sue the Government for an amount which would have been payable if the vessel had been requisitioned or purchased in time of emergency by the Government under the act (46 U.S.C. 1289). The act states in effect that vessel owners may acquire at their own cost such additional war risk insurance as they desire and that the Government will not be entitled to the benefits of such insurance (46 U.S.C. 1293).

We found no evidence during our review that the command had attempted to formally obtain industry's views on Government assumption of war risk insurance on hulls and machinery or to negotiate provisions for this type of war-risk coverage in the charter agreements with shipowners.

DEFENSE FUEL SUPPLY CENTER

The Defense Fuel Supply Center, which is responsible for procuring petroleum products for DOD, has contracted directly with the petroleum suppliers for transportation of about 55 percent of DOD's petroleum product needs in Southeast Asia. We were advised that the vessels used to transport these petroleum products were entirely of foreign registry.

Each contract contains a provision for reimbursement of war-risk-insurance premiums, which is similar to the reimbursement provisions contained in charter agreements of the command. On the basis of records of the Defense Fuel Supply Center, we estimate that the Center reimbursed its contractors for war-risk-insurance premiums on hull, machinery, and personnel of vessels used in shipment of petroleum products to Vietnam for fiscal years 1967 through 1969 in the amount of \$6.9 million and that the losses incurred incident to such coverage were about \$1.7 million, as shown in the following summary.

	<u>Total</u>	<u>Fiscal years ended June 30</u>		
		<u>1969</u>	<u>1968</u>	<u>1967</u>
War-risk-insurance costs (note a)	\$6,872,673	\$2,313,164	\$2,340,589	\$2,218,920
War-risk losses (note b)	<u>1,664,352</u>	<u>310,206</u>	<u>1,550</u>	<u>1,352,596</u>
Excess of insurance cost over losses	<u>\$5,208,321</u>	<u>\$2,002,958</u>	<u>\$2,339,039</u>	<u>\$ 866,324</u>

<sup>a</sup> Includes an undetermined amount for war-risk coverage on officers and crews.

<sup>b</sup> Does not include rocket-fire damage sustained in fiscal year 1968 by one vessel or losses sustained by its officers and crew because this information was not available. In our opinion these losses are not considered likely to materially effect results of the above comparison.

The amounts shown above include war-risk-insurance premium costs for hulls and machinery, loss of hire, life insurance for officers and crew, and insurance on personal effects of officers and crew. Although a breakdown of the insurance cost applicable to each category could not be determined, the available information indicates that the bulk of the cost was for hull and machinery war risk insurance.

The Center has recognized the need for reducing the high cost of war-risk-insurance premiums and since June 1969 has ceased reimbursing the premiums on war risk insurance of Government-owned petroleum cargo at savings estimated at \$1.4 million to \$2.5 million a year. After we brought this to the attention of Center officials, the Center requested Maritime for information concerning the feasibility of providing war risk insurance on hulls, machinery, and crews in accordance with the provision of the Merchant Marine Act of 1936.

Maritime has advised Center officials that it may be feasible to provide this type of coverage but that additional information should first be obtained from the contractors. At the close of our fieldwork, the Center had received only one reply to its requests for information from contractors. This contractor replied that, based on a cursory check, the shipowners were not receptive to Government war risk insurance. In most cases, according to this contractor, shipowners use insurance firms of their own nationality and prefer not to be placed in a position that requires them to obtain payments from the U.S. Government on commercially insurable risks.

We noted that, since the Government reimbursed shipowners for the costs of commercial war risk insurance through the petroleum contractors, the shipowners, in effect, obtained payment from the United States for the insurance cost on commercially insurable risks. The major difference between present insurance practice and insurance provided by Maritime would be that, in the latter case, shipowners would file their claims for war-risk losses with the Government and would receive reimbursement directly from the Government.

Maritime, the command, and the Center have existing facilities and personnel that may be utilized in administering a self-insurance program. Insurance industry statistics indicate that administrative costs, exclusive of brokers' fees and commissions, of insurance companies allocated to ocean marine insurance average 8 to 11 percent of gross premiums. An official of Maritime indicated that no additional cost would be incurred by the agency.

#### CONCLUSION

We believe that the Government can realize significant savings through action by DOD to self-insure for war risks to contractor-owned vessels required for the performance of Government contracts. We did not attempt to determine the costs to administer such a program, but we believe that, by using the existing facilities of Maritime and DOD, the Government would not incur significant additional administrative costs.

#### AGENCY COMMENTS

We proposed in our draft report that the Secretary of Defense initiate a review of the war-risk-insurance practices and cost experience of the command and the Center with a view toward obtaining, if feasible, war-risk-insurance coverage from Maritime on contractor-owned vessels, as authorized by the Merchant Marine Act of 1936.

In commenting on our draft report, DOD stated that it concurred in our recommendation and that it was initiating a study to determine what course of action was in the best interest of the Government. This study was still in progress on September 9, 1971.

Maritime has stated in reply to our draft report that the provision in section 902(a) of the Merchant Marine Act of 1936, which limits insurable hull values to "just compensation"--actually current domestic market value--appears to be the reason why the command has not requested war-risk hull insurance under the act. As noted on page 11, it is our view that this condition will prevail as long as the command continues to reimburse shipowners for the cost of insuring vessels in excess of current domestic market values

as determined by the Department of Commerce. We believe that this matter should be covered in DOD's study.

Maritime has advised us that, to the extent war-risk-insurance needs of contractors of the command, AID, and the Center can be met under the act, it will be happy to provide war risk insurance to those agencies.

#### RECOMMENDATION

We recommend that the Secretary of Defense should establish a plan for self-insurance for contractor-owned vessels. If feasible, this coverage should be obtained from Maritime, as authorized by the Merchant Marine Act of 1936.

### CHAPTER 3

#### OPPORTUNITY TO REDUCE COST OF SUPPLEMENTAL

#### WAR RISK INSURANCE ON CONTRACTOR EMPLOYEES

DOD and AID reimburse Government contractors for premiums paid for war-risk-insurance policies purchased from commercial insurance companies to provide contractor employees with supplemental coverage for death or injury from war hazards. Such insurance supplements the workmen's compensation type of insurance coverage for war hazards already provided by the Government without charge to contractors under the Defense Base Act and the War Hazards Compensation Act. The cost to the Government for this supplemental insurance has greatly exceeded the incurred war-risk losses.

On the basis of our review of agency and contractor records, we estimated that savings to the Government of about \$2.7 million could have been realized over the 3-year period ended June 30, 1969, if DOD and AID had been authorized to make lump-sum benefit payments for war-risk death or injury similar to the payments provided by supplemental war risk insurance purchased by contractors. Under existing legislation Government payment of such benefits is limited to the workmen's compensation type of benefits.

The Defense Base Act extended the workmen's compensation coverage of the Longshoremen's and Harbor Workers' Compensation Act to employment at military bases, Government installations, and public works outside the continental United States. The scale of benefits under the Defense Base Act is generally the same as that provided by the Longshoremen's Act and consists of workmen's compensation type of payments in specified amounts for accidental injury or death during the course of employment. Benefit payments to an employee or his beneficiaries for disability or death cannot exceed a maximum of \$70 a week.<sup>1</sup> Where the disability is

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<sup>1</sup>In January 1971 bills were introduced in the Senate and the House of Representatives (S. 525 and H.R. 247) to increase the maximum to \$119 and \$132, respectively.



not total and permanent, the cumulative benefit payments are limited to a maximum of \$24,000.

There is no limit on the aggregate of benefit payments for total and permanent disability or for death. It is estimated that over a 30-year period such benefit payments could aggregate as high as \$109,000 for total disability and \$85,000 for death. The act provides for benefit payments to be made in semimonthly installments, except that the Department of Labor may authorize installments to be made monthly, or at some other period, and may, in the interest of justice, authorize lump-sum payments.

The War Hazards Compensation Act extends the workmen's compensation benefits provided under the Longshoremen's Act and the Defense Base Act to employees of Government contractors who suffer injury or death as the result of a war-risk hazard and provides for payments to dependents of employees who are captured or detained due to belligerent action of an enemy. It also authorizes the Government to reimburse employers, insurance carriers, or compensation funds for payments for disability or death from war-risk hazards and to assume responsibility for payment of benefits to employees or their dependents, with the effect that the Government becomes a self-insurer under the act.

Benefits payable for death or injuries are generally the same under the War Hazards Compensation Act as those provided by the Longshoremen's Act and are subject to the same maximum limits. In the case of employees detained or captured by hostile forces, the War Hazards Compensation Act provides that employees' accounts be credited with 100 percent of their average weekly wage, not to exceed the average weekly wage of a civilian employee of the United States performing the same type of work in the same area, and that employees' dependents be paid 70 percent thereof. These acts are administered by the Bureau of Employees' Compensation, Department of Labor.

The Armed Services Procurement Regulation (ASPR) 15-205.16(a)(1) and the Federal Procurement Regulations (41 CFR 1-10.3) contain provisions which authorize agencies to reimburse contractors for the cost of necessary and approved insurance. Therefore DOD and AID follow a practice

of accepting premiums for supplemental war risk insurance as an allowable cost under negotiated contracts.

Since June 1, 1965, many DOD and AID contractors in Southeast Asia have obtained supplemental war-risk-insurance coverage under a unique blanket insurance policy offered by a commercial insurance company. Government contractors who acquire supplemental war-risk-insurance coverage for their employees under this blanket policy are reimbursed by DOD and AID for the cost of premiums paid. A retrospective premium agreement applicable to the policy contains a provision under which the Government will receive a refund of premiums after deductions by the insurance company of (1) 25 percent of total premiums for administrative costs, broker's commissions, and profit, (2) losses for the period, (3) State taxes on premiums, and (4) amounts necessary to maintain a stabilization fund.

The stabilization fund balance, originally set at \$1.5 million and later reduced to \$500,000, was established to provide a reserve to cover war-risk losses under the policy. Under the terms of the agreement, the Government receives 4-percent interest on the fund balance, and upon policy termination the fund balance will be paid to the Government.

Officials of DOD and AID do not consider the blanket policy to be a Government contract although the Government is party to the refund and its officials have participated in negotiations of policy terms with the insurer. There is no signature by Government officials on the policy or on the retrospective premium agreement. Neither the policy nor the retrospective agreement provides for Government audit of pertinent insurance company records.

Contractors also may purchase supplemental war risk insurance from commercial sources other than the blanket-policy insurer. Certain contractors have obtained supplemental war-risk coverage from other insurance companies, and the Government has reimbursed them for the cost of such insurance.

As shown in the following schedule, the total estimated costs to the Government for supplemental war risk insurance

for fiscal years 1967 through 1969 for contractors covered by the blanket policy and for other selected contractors including major contractors covered by other insurance policies, exceeded losses incurred for the same period by about \$2.7 million.

<u>Supplemental war risk insurance on employees</u>	<u>Total</u>	<u>Fiscal years ended June 30</u>		
		<u>1969</u>	<u>1968</u>	<u>1967</u>
War-risk-insurance costs:				
Blanket policy (after refunds)	\$2,998,219 <sup>a</sup>	\$ 850,109	\$ 853,550	\$1,294,560
Other	<u>974,594</u>	<u>254,204</u>	<u>334,596</u>	<u>385,794</u>
	<u>3,972,813</u>	<u>1,104,313</u>	<u>1,188,146</u>	<u>1,680,354</u>
War-risk losses:				
Blanket policy	1,060,000	150,000	335,000	575,000
Other	<u>200,000</u>	<u>-</u> <sup>b</sup>	<u>-</u>	<u>200,000</u>
	<u>1,260,000</u>	<u>150,000</u>	<u>335,000</u>	<u>775,000</u>
Excess of costs over losses	<u>\$2,712,813</u>	<u>\$ 954,313</u>	<u>\$ 853,146</u>	<u>\$ 905,354</u>

<sup>a</sup>Consists of administrative costs and profits, \$1,878,062; additional coverage premiums, \$166,672; and amounts to cover losses, \$1,060,000 less interest on stabilization fund, \$106,515.

<sup>b</sup>Through April 18, 1969.

Although the blanket policy is unique in that the premium refunds are paid by the insurance company directly to the Government instead of to the insured, the overall effect is that the Government absorbs all war-risk losses and pays the insurance company a fee which, at the time of our review, was 25 percent of total premiums and which covered administrative costs, brokers' commissions, and profits. This fee was 30 percent at the outset of the policy in 1965 and later was reduced to 25 percent as the result of DOD's negotiations with the insurance company. DOD representatives advised that the insurance company could not provide cost data in support of the fee.

The current rate of 25 percent appears excessive when compared with the much lower rates generally charged for administrative costs and profit on group life insurance policies and disability income policies of 3.9 percent and 8.9 percent, respectively, plus brokers' commissions ranging from 1 to 3.5 percent. The group life and disability income insurance policies are reasonably comparable with the war-risk blanket policy.

In May 1966 the ASPR Committee received information that, as a result of the escalation of activities in Southeast Asia, contractors were including in their contract proposals significant items of costs to provide for supplemental war-risk-insurance coverage on their employees. The ASPR Committee appointed a subcommittee to perform a review of war-risk-insurance coverage and to consider development of DOD guidance which would be uniformly applied to all contractors involved.

In March 1967 the subcommittee concluded that it was in the best interest of the Government to assume all war risk insurance on contractor employees. With cooperation of the Bureau of Employees' Compensation, DOD prepared a proposed amendment to ASPR which would have eliminated reimbursement to contractors for the cost of supplemental war-risk-insurance coverage and which would have increased the maximum benefits available to contractor employees under the Defense Base Act and War Hazards Compensation Act from the existing \$70 a week to \$150 a week.

GAO also was given the opportunity to review the proposed change to ASPR. In a letter dated October 30, 1967, to the chairman of the ASPR Committee, GAO commented as follows:

"We understand that the proposed clause is an attempt to gain better control over indemnification of contractor personnel in such areas as Vietnam where existing Defense Base Act coverage has been competitively supplemented by the defense contractors involved in order to successfully recruit employees for work in hazardous areas. We consider the proposed ASPR clause a logical step toward achieving the desired governmental control over employee indemnification and see no objection to its issuance."

The subcommittee obtained industry reaction to the proposed change so that the overseas contract effort would not be impaired in the event that the proposed change was unacceptable to the contractors.

Industry reaction was adverse. Contractors and industry organizations contended that the proposed increase in weekly benefit payments was inadequate and would not replace the need for lump-sum benefit payments which contractor employees allegedly required. As a result of the industry reaction, the subcommittee recommended in January 1968 that the proposed change to ASPR not be adopted and that war-risk-insurance costs under individual contracts continue to be approved subject to the test of reasonableness.

We found no evidence that the ASPR Committee or DOD explored the feasibility of obtaining authority for the Government to pay lump-sum benefits for war-hazard deaths and injuries in amounts acceptable to contractor employees. We were advised that consideration had been given to lump-sum payments for U.S. nationals but that the matter was dropped because it was believed that legislative authorization would be difficult to obtain at that time.

The concept of lump-sum payments by the Government for war-risk deaths or injuries is not new. DOD has acted to provide lump-sum, war-risk benefits to third-country nationals. (See p. 29.) Maritime has authorized lump-sum payments of \$20,000 under the war risk insurance provided by the Government for officers and crews of vessels (second seamen's insurance).

The cost to administer such a Government self-insurance program is not known. Presently DOD and Maritime administer the third-country nationals' war-risk program and the second seamen's war-risk program, respectively, and the Bureau of Employees' Compensation, Department of Labor, administers the Defense Base Act and the War Hazards Compensation Act. Each of those agencies becomes involved in reviewing and processing war-risk-loss claims. We do not believe that expansion of a Government self-insurance program would result in significantly increased costs.

DOD has continued to reimburse contractors for the costs of supplemental war risk insurance. The only instance we found, in which DOD or the ASPR Committee had attempted to determine the reasonableness of commercial versus Government war risk insurance, was in connection with

third-country nationals employed by Government contractors and insured by a Korean insurance firm.

DOD had noted that premiums proposed by that firm, which were initially high, underwent drastic increases, presumably as a result of the Tet offensive, even though there were no substantial employee losses. Therefore DOD developed a revision to ASPR--Defense Procurement Circular 64--which authorized DOD to indemnify contractors for losses to third-country nationals and to prohibit the allowance of expenditures for insurance premiums for third-country nationals. (See p. 28.)

The Longshoremen's Act, the Defense Base Act, and the War Hazards Compensation Act provide for lump-sum payments based upon installments otherwise payable when determined to be in the interest of justice. An amendment to one or more of these acts, however, probably would be needed to clearly authorize lump-sum payments of specific amounts for war-hazard deaths or injuries at the option of the insured.

## AGENCY COMMENTS

DOD made the following comments in their response to our draft report.

"As the GAO report notes, this matter was extensively reviewed by the Armed Service Procurement Regulation (ASPR) Committee several years back. The desirability of the Government becoming a self-insurer on war-risk insurance was actively considered. It was concluded after an extensive examination and interchange of views, both in house and with industry, that it was impractical to adopt a policy of Government self-insurance (indemnification) at the time. Further, since contractor recruitment in Southeast Asia was past its peak, the Committee determined that it was not feasible to pursue legislation to permit the payment of lump-sum benefit payments. In our opinion, pending a suitable substitute for commercial supplemental war-risk insurance, no action to modify existing policy should be initiated. Such a prohibition as recommended by GAO could result in serious difficulty for contractors in recruiting and retaining skilled technicians and specialists in areas of conflict."

With regard to the blanket policy, DOD stated that the last meeting by representatives of DOD and AID with representatives of the insurance company resulted in a rate decrease of about 20 percent, a reduction of the basic charge from 28 percent to 25 percent of the premium, and a reduction of the stabilization fund from \$1 million to \$500,000. DOD noted that this was the fourth reduction negotiated after inception of the policy and advised that any action to bring the policy records under Government audit would be voluntary on the part of the insurance carrier, because there was no contractual relationship with the Government. DOD stated, however, that these matters would be topics of discussion in future meetings with the insurance company. In February 1971 we were informed that DOD had effected another 20-percent reduction in premium rates under the policy.

AID in commenting on the draft report stated that it must consider further all aspects of the question before agreeing to seek legislation to permit self-insurance for war-hazard losses. AID advised that it was conducting an in-depth study of our recommendation on this matter. This study was still in progress on September 9, 1971.

The Department of Labor advised that this section of the report had no direct application to the Department. It agrees with our presentation and our conclusion that substantial savings could be made by the Government through a self-insurance program.

### CONCLUSION

The information obtained during our review indicated that substantial savings could be realized if the Government discontinued the general practice of reimbursing Government contractors for supplemental war risk insurance on employees and acted as a self-insurer to provide lump-sum benefit payments for war-hazard deaths or injuries in amounts comparable with those presently provided by the Maritime Act of 1936 or by the supplemental war-risk-insurance coverage purchased by contractors.

The major problem in DOD's attempt to eliminate war risk insurance on employees as an item of reimbursable cost appeared to be the preference by contractor employees for lump-sum benefit payments. The ASPR Committee's decision in January 1968 not to adopt a self-insurance or indemnification policy appeared to be based upon the industry's opposition to the proposed substitution of Government-sponsored benefits of \$150 a week in place of substantial lump-sum benefits payable under commercial insurance.

We believe that DOD should explore the matter further, particularly with regard to the feasibility of providing lump-sum benefits, and should, if necessary, request the Congress to consider an amendment to the law to provide such benefits.

With regard to the blanket policy for war risk insurance, we believe that, if use of this policy continues, its provisions should be revised so that the amounts retained



by the insurance company for administrative costs and profits will be based upon experienced costs subject to DOD audit. Also the rate of interest payable to the Government on the stabilization fund should be increased commensurate with the current rates of interest for borrowed funds. Interest should also be payable to the Government on the average annual amount of any additional funds held for payment of total disability and other claims pending final approval.

#### RECOMMENDATION

We recommend that the Secretary of Defense and the Secretary of State seek legislation as necessary to authorize the Government to make lump-sum benefit payments for war-hazard death or injury to contractor employees, with appropriate dollar limitations, and to allow the insured employees to select either lump-sum or annuity-type payment of insurance benefits. We recommend also that DOD and AID discontinue their practice of reimbursing contractors for the cost of supplemental war risk insurance.

We suggest that DOD and AID, pending the outcome of these recommendations, reopen negotiations on the blanket policy to bring the administrative costs, brokers' commissions, and profit under Government audit.

## CHAPTER 4

### OPPORTUNITY TO FURTHER REDUCE COST OF

#### WAR RISK INSURANCE ON

#### THIRD-COUNTRY NATIONALS EMPLOYED BY CONTRACTORS

AID and two military commands have continued to reimburse contractors in Vietnam for war-risk-insurance coverage of third-country nationals (citizens of countries other than the United States and Vietnam) employed by the contractors even though an indemnification program generally adopted by DOD for such employees has provided substantial savings.

Government agencies have followed the practice of obtaining from the Bureau of Employees' Compensation a waiver of the application of the Defense Base Act and the War Hazards Compensation Act coverage to foreign nationals employed by contractors in war-risk areas. In lieu of the coverage provided by those acts, workmen's compensation and war-risk-insurance coverage for waived employees has then been provided by the contractor in accordance with the legal requirements of the foreign countries involved. For certain categories of third-country nationals, the cost of the war risk insurance has been excessive and has resulted in DOD's establishing an indemnification program.

Information obtained during our review indicates that war-risk-insurance coverage for third-country nationals under certain AID and DOD contracts not converted to a Government indemnification program has cost the Government a total of about \$586,000 for insurance premiums although the insurer has experienced losses of only \$44,000--an additional cost to the Government of about \$542,000. (See p. 29.)

We believe that significant savings can be realized annually if AID adopts an indemnification program similar to that generally adopted by DOD. We believe also that additional savings can be realized if DOD requires all procurement activities in all military agencies to implement its existing indemnification program.

Prior to fiscal year 1969, the Government had incurred significant costs for war risk insurance covering third-country nationals employed by contractors in Vietnam although claims for war-risk-insurance benefits had been nominal. For example, a review in 1968 by the Deputy Comptroller for Internal Audit, DOD, disclosed that premiums of about \$6.3 million were paid during fiscal years 1967 and 1968 for war risk insurance with one insurance carrier under DOD contracts. Claims approved or pending during that period were only \$148,000.

Most of the military contracts in Vietnam have since been revised to provide that contractors self-insure for losses to third-country nationals employed by them under an arrangement whereby the contractor is indemnified by the Government for any war-risk death or injury benefits paid to such employees. We have found, however, that two military commands and AID are continuing to incur excess costs for war risk insurance on third-country nationals.

The U.S. Army Procurement Agency, Vietnam made a determination during 1968 that significant savings could be realized by acting as self-insurer against war risks for third-country nationals employed by contractors. The Agency estimated that commercial insurance costs of \$4.1 million would be incurred in fiscal year 1969 under contracts with its three major contractors which were responsible for about 82 percent of the third-country nationals employed under contracts awarded by the Agency. Actual experience through the middle of June 1969 showed that only \$162,000 in claims had been paid during fiscal year 1969 under the self-insurance program of the U.S. Army Procurement Agency, Vietnam.

In March 1968 the Agency requested a revision to ASPR to provide authority to self-insure the third-country-national employees. As a result item VII, Defense Procurement Circular 64, dated October 28, 1968, was prepared. This item of the circular revised ASPR and authorized heads of procuring activities to determine that contractors not purchase war risk insurance for employees for whom coverage had been waived under the Defense Base Act and that the contractor's costs for assuming liability for war-risk protection be considered an allowable cost under the contract. In

essence, DOD authorized a form of Government self-insurance whereby the contractor could be indemnified by the Government for the cost of war-risk death or injury benefits paid by the contractor to his employees.

The U.S. Army Procurement Agency, Vietnam began to incorporate the provisions of item VII, Defense Procurement Circular 64, into all fiscal year 1969 contracts even before the circular was issued. Other military agencies incorporated the self-insurance provisions of item VII into contracts after becoming aware of this circular.

We found, however, that the two military commands and AID, the latter not being subject to the requirements of the circular, continued to reimburse contractors for commercial war risk insurance on third-country nationals, the estimated cost of which exceeded losses incurred under AID and military contracts as follows:

<u>Contractor</u>	<u>Period</u>	<u>Cost of insurance premiums</u>	<u>Losses</u>	<u>Excess premium cost over losses</u>
AID:				
RSEA	3-68 to 6-69	\$ 29,800	(a)	\$ 29,800
Han Yang Construction	4-67 to 3-69	133,624	\$25,213	108,411
Eastern Construction	7-66 to 5-69	89,362	6,119	83,243
Philco Ford	12-68 to 6-69	<u>59,500</u>	<u>-</u>	<u>59,500</u>
		<u>312,286</u>	<u>31,332</u>	<u>280,954</u>
Military:				
Eastern Construction	7-66 to 5-69	160,847	12,709	148,138
Page Communications	9-67 to 8-69	<u>112,843</u>	<u>106</u>	<u>112,737</u>
		<u>273,690</u>	<u>12,815</u>	<u>260,875</u>
Total		<u>\$585,976</u>	<u>\$44,147</u>	<u>\$541,829</u>

<sup>a</sup> Schedule does not include claims pending for war-risk injuries to RSEA employees. Maximum losses possible would be \$20,000 per claim or \$140,000, leaving an excess of insurance premiums in the amount of \$401,829.

The Eastern Construction military contracts are administered by the Military Assistance Command, Vietnam; the Page Communications contracts are administered by the Army Electronics Command, Fort Monmouth, New Jersey. These appear to be the major contracts with significant amounts of commercial

war risk insurance on third-country nationals; however, there may be others.

AID officials informed us that they had not adopted a self-insurance plan because it would be necessary but impractical to obligate funds to cover the maximum potential losses to avoid the possibility of overobligating appropriated funds if such losses did occur. We noted, however, that, under existing laws and regulations, AID obligated funds to cover the costs of reimbursable insurance premiums paid for war-risk coverage of third-country nationals and that such costs had greatly exceeded losses incurred to date.

We believe that there has been sufficient war-risk-loss experience under AID contracts to provide a basis for estimating future losses for the obligation of funds under a self-insurance program. Funds required to cover such estimates would be less than the funds required under the present practice of reimbursing contractors for the cost of war risk insurance purchased from insurance firms. A self-insurance reserve fund to cover the anticipated losses could be established by including appropriate provisions in the annual budget.

As a result of our review, the Contract Services Division of AID has advised its contracting officials for the East Asia and Vietnam areas of the provisions of Defense Procurement Circular 64 and has asked them to consider the feasibility of providing self-insurance for losses to third-country nationals employed by its contractors. Our discussions with AID officials, however, indicated that funding problems would be a deterrent to such action.

As stated on pages 4 and 5, DOD has authority under Public Law 85-804 to self-insure against war risks without regard to the availability of funds. The Department of State, however, did not receive similar authority because it was not included in the list of eligible Government departments in Executive Order No. 10789 which implemented the law.

Since DOD is administering a program of self-insurance covering losses to third-country nationals, we believe that its administrative costs would not be significantly increased by inclusion of the above contracts in its program.

## AGENCY COMMENTS

DOD informed us that it planned to reexamine its policies on this matter to determine whether further clarification was needed.

AID stated that it was conducting an in-depth study before making a decision regarding its future course of action on self-insurance. The study was still in progress on September 9, 1971.

## CONCLUSION

AID's policy of reimbursing contractors for commercial war risk insurance on third-country nationals is significantly more costly than a self-insurance policy would be, as evidenced by AID experience noted above and by actions taken by the U.S. Army Procurement Agency, Vietnam. Therefore we believe that a similar self-insurance plan should be adopted by AID. We believe also that DOD has ample evidence as to the economy of such action and should require implementation of Defense Procurement Circular 64 by all contracting officers and procuring activities in Vietnam and in any other areas where war risk insurance on third-country nationals is an element of contract cost.

## RECOMMENDATION

We recommend that the Secretary of State seek legislative authority to self-insure for losses to third-country nationals employed by contractors, including an amendment to Executive Order No. 10789, if necessary, and take the necessary action to establish a war-risk self-insurance program for third-country nationals under contracts administered by AID. We recommend also that the Secretary of Defense issue appropriate instructions to all DOD's procurement activities to provide for self-insurance of third-country nationals in accordance with the provisions of Defense Procurement Circular 64.

## CHAPTER 5

### SCOPE OF REVIEW

Our review of war risk insurance on personnel and property included a review of the applicable laws, policies, regulations, and practices of Government agencies and contractors located in Southeast Asia, Europe, the Middle East, Africa, Latin America, and the United States. We examined records maintained by Government agencies and contractors and had discussions with responsible officials as deemed necessary in the circumstances. We visited or contacted numerous Government departments, agencies, contractors, and insurance companies during our review.

The major part of our efforts was directed to the following departments and agencies: AID, Department of State; DOD agencies responsible for procurement and contract administration in Southeast Asia; Defense Fuel Supply Center, Defense Supply Agency; Military Sealift Command, Department of the Navy; Bureau of Employees' Compensation, Department of Labor; and Maritime Administration, Department of Commerce.

**APPENDIXES**





**THE ASSISTANT SECRETARY OF COMMERCE**  
Washington, D.C. 20230

OCT 19 1970

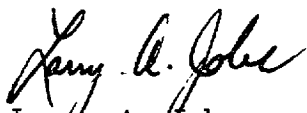
Mr. Eugene C. Wohlhorn  
Assistant Director  
International Division  
General Accounting Office  
Room 5E689  
The Pentagon  
Washington, D. C. 20301

Dear Mr. Wohlhorn:

This is in reply to Mr. Eschwege's letter of September 11, 1970, requesting comments on a proposed report to Congress on "Opportunity For Savings In Providing War-Risk Insurance Coverage For Government Contractor Employees and Contractor-Owned Property."

We have reviewed the comments of the Maritime Administration and believe they are appropriately responsive to the report.

Sincerely yours,

  
Larry A. Dobe

Enclosure

APPENDIX I



U.S. DEPARTMENT OF COMMERCE  
MARITIME ADMINISTRATION  
WASHINGTON, D.C. 20235

OFFICE OF THE ADMINISTRATOR

SEP 29 1970

Mr. Eugene C. Wohlhorn  
Assistant Director  
International Division  
General Accounting Office  
Room 5E689  
The Pentagon  
Washington, D. C. 20301

Dear Mr. Wohlhorn:

A review has been made of the draft report titled "Opportunity for Savings in Providing War Risk Insurance Coverage for Government Contractor Employees and Contractor-Owned Property" which was received by letter of September 11, 1970 from Mr. Henry Eschwege, Associate Director, Civil Division.

We find that only Chapter 2 concerns marine war risk insurance coverage, which could be provided under Section 1205 of Title XII, Merchant Marine Act, 1936, as amended, upon request of the Government Departments or Agencies.

With regard to Military Sealift Command, attention is called to the letter of July 23, 1965, copy attached, from the Maritime Administrator to the Assistant Secretary of the Navy (Installations and Logistics), particularly that paragraph which limits hull values insurable to the amount payable under Section 902(a) of the Act. This limitation appears to be the reason Military Sealift Command has not requested war risk hull insurance under Title XII.

[See GAO note.]


GAO note: The material deleted relates to matters which were presented in the draft report but which were revised in the final report.

APPENDIX I

We confirm that meetings as recited in the Report have been held from time to time not only with Military Sealift Command, but also with representatives of the Agency for International Development, and Defense Fuel Supply Center in an effort to enable those Agencies to determine whether or not they could take advantage of Section 1205 coverage. Only Military Sealift Command has arranged for the coverage described in the Report.

To the extent that the war risk insurance needs of the Agencies' contractors can be met within the limits of our authority under Section 1205 of the Merchant Marine Act, 1936, the Maritime Administration will be happy to provide war risk insurance to such Agencies.

Sincerely,

  
Robert J. Blackwell  
Deputy Maritime Administrator

APPENDIX I

G - G - P - Y

July 23, 1965

Honorable Graeme C. Bannerman  
Assistant Secretary of the Navy  
(Installations and Logistics)  
Department of the Navy  
Washington, D. C. 20360

Dear Mr. Bannerman:

Reference is made to your letter dated July 1, 1965, in which you state that the Department of the Navy desires to replace existing agreements with the Department of Commerce, Maritime Administration, for the availability of various war risk insurance coverages as authorized by Section 1205 of Title XII of the Merchant Marine Act, 1936, as amended, 46 U.S.C. 1235, with a single, broader agreement.

To the extent authorized by statute, the Maritime Administration hereby agrees to provide war risk insurance for the following programs conducted or to be conducted by the Department of the Navy:

1. Ships of all types owned by the Department of the Navy and operated by the Military Sea Transportation Service through commercial operators under contract -- Second Seamen's War Risk Insurance (currently involving three contract operators, Keystone Shipping Company, Marine Transport Lines, Inc., and Mathiasen's Tanker Industries, Inc., in the operation of contract-operated tankers and range instrumentation ships.)
2. Ships of all types owned by private commercial interests and bareboat chartered to the Military Sea Transportation Service -- Second Seamen's War Risk, War Risk Hull and War Risk Protection and Indemnity Insurance (currently involving only the SS SHENANDOAH, bareboat chartered to the Military Sea Transportation Service by Keystone Shipping Company). Binder No. 65-1 dated March 1, 1965, covers only War Risk Hull and Second Seamen's War Risk Insurance. War Risk Protection and Indemnity Insurance will be added by endorsement when and if required by the Department of the Navy.
3. Ships of all types owned by private commercial interests and time or voyage chartered to the Military Sea Transportation Service -- Second Seamen's War Risk, War Risk Hull and War Risk Protection and Indemnity at such time as the Commander, Military Sea Transportation Service, shall notify the Maritime Administrator of a need for such coverages. (It is understood that this will be a stand-by arrangement and that there are no ships assigned to this category at the present time.)
4. The SS WESTERN HUNTER -- War Risk Hull, including coverage of risks

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where hostilities exist other than those between the Five Great Powers. (This is also a stand-by arrangement. No War Risk Insurance to attach until requested by the Department of the Navy.)

In connection with all War Risk Hull Insurance provided for in this letter, your attention is invited to the fact that our authority in Section 1205(a) is limited by the provisions of Section 1207(a)(2) of the Act, which provides that the valuation for actual or constructive total loss of the vessel insured shall not exceed the amount that would be payable if the vessel had been requisitioned for title under Section 902(a) at the time of the attachment of the insurance under the policy.

You have agreed that in consideration of such insurance being provided without premium in the manner set forth in Section 1205(b) of the Act, the Department of the Navy will indemnify the Maritime Administration against all losses covered by such insurance. You have also agreed to provide the Maritime Administration with a quarterly report of the ships with respect to which insurance coverage was required during the quarter pursuant to this agreement.

It is understood that increased benefits under the Second Seamen's War Risk Insurance being furnished or to be furnished pursuant to this agreement, covering the Viet Nam war risk bonus area providing, among other things, a \$20,000 loss of life benefit, must be held in abeyance pending agreement between the Department of the Navy and the Maritime Administration with regard to the additional risks, if any, found to exist there.

The previous agreements hereby replaced will be considered terminated, except with respect to outstanding claims of the Maritime Administration for indemnity under any of the previous agreements. The indemnity provisions of these agreements shall remain in effect until the claims shall have been satisfied. The Maritime Administration will furnish a list of these pending or potential claims promptly.

The Maritime Administration staff will communicate with representatives of the Department of the Navy (NETS) to complete these arrangements.

Sincerely yours,

*/s/ Nicholas Stanton*

Maritime Administrator

cc:  
C. Keely Fox  
Room 2211 - Navy  
100  
101  
200  
400  
440  
442  
539 via 106

CRHart, Jr.:mh 7/14/65

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APPENDIX II



ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, D.C. 20301

13 Nov 1970

INSTALLATIONS AND LOGISTICS

Mr. Oye V. Stovall  
Director, International Division  
U.S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Stovall:

This is in response to your letter of September 11, 1970 forwarding a copy of your report titled, "Opportunity for Savings in Providing War-Risk Insurance Coverage for Government Contractor Employees and Contractor-Owned Property" (OSD Case #3180).

According to the report, this review was made to determine whether the methods being used to provide war-risk protection to contractors for their property and their employees in Southeast Asia and elsewhere were in the best interests of the Government. The report concludes that the cost of war-risk insurance has substantially exceeded war-risk losses experienced by Government contractors. In reaching this conclusion, the report cites the excess of insurance premiums over losses for the cost of war-risk insurance on privately owned vessels and the excess of insurance premiums over benefits paid for war-risk insurance on contractor personnel for death or injury resulting from war-hazards. It is GAO's view that the Government should generally be a self-insurer. We have listed each of the report recommendations addressed to the Department of Defense (DoD) and followed each with the Department's comment.

GAO Recommendation: "We recommend that the Secretary of Defense initiate a review of the war-risk insurance practices and cost experience of the Military Sealift Command and the Defense Fuel Supply Center with a view toward obtaining, at an early date, war-risk insurance coverage from the Maritime Administration on contractor-owned vessels...".

DoD Comment

We concur with this recommendation and propose to initiate a study of this matter to determine what course of action is in the best interests of the Government.

GAO Recommendation: "We recommend that DoD and AID establish appropriate dollar limitations for lump-sum benefits for war-hazard death or injury to contractor employees and seek legislation as necessary to authorize the Government to make such payments.... We also recommend that DoD and AID revise their regulations and contracting policies to discontinue the practice of reimbursing contractors for the cost of supplemental war-risk insurance."

DoD Comment

As the GAO report notes, this matter was extensively reviewed by the Armed Service Procurement Regulation (ASPR) Committee several years back. The desirability of the Government becoming a self-insurer on war-risk insurance was actively considered. It was concluded after an extensive examination and interchange of views, both in house and with industry, that it was impractical to adopt a policy of Government self-insurance (indemnification) at the time. Further, since contractor recruitment in Southeast Asia was past its peak, the Committee determined that it was not feasible to pursue legislation to permit the payment of lump-sum benefit payments. In our opinion, pending a suitable substitute for commercial supplemental war-risk insurance, no action to modify existing policy should be initiated. Such a prohibition as recommended by GAO could result in serious difficulty for contractors in recruiting and retaining skilled technicians and specialists in areas of conflict.

GAO Recommendation: "We suggest that DoD and AID reopen negotiations on policy FD-712 to establish more equitable rates for an administrative cost, profit, and interest rates, and to bring the policy records under Government audit."

DoD Comment

As the GAO report notes, this is a rather unique insurance policy offered by the Insurance Company of North America for contractors to obtain supplemental war-risk insurance for employees. Many contractors obtain supplemental war-risk insurance under this policy. The Government was an active participant in the negotiation of this policy and receives certain benefits, such as refunds of premiums. Representatives of DoD and AID have been meeting with this insurance carrier about twice a year since the inception of the program in 1965. The last meeting resulted in a rate decrease of approximately 20%, a reduction in the basic charge

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## APPENDIX II

(retained by the company) from 28% to 25% of the premium, and a reduction in the stabilization fund from \$1 million to \$500,000 effective 1 July 1970. This is the fourth reduction in cost negotiated by DoD and AID since inception of the policy. With regard to bringing the policy records under audit scrutiny by the U.S. Government, this would have to be voluntary on the part of the contractor since the Government has no contractual relationship with the carrier. These matters will be topics of discussion at the future meetings with the carrier.

GAO Recommendation: "We recommend that DoD issue appropriate instructions to all of its procurement activities to provide for self-insurance of third-country nationals in accordance to the provisions of Defense Procurement Circular #64." (ASPR 10-403 and 10-502)

### DoD Comment

The comments in the GAO report on this matter seemingly reflect that the policy changes to ASPR 10-403 and 10-502 require Government self-insurance. However, the policy emphasis leans more towards the converse of this, in that ASPR 10-502(b) provides for the inclusion of the Government self-insurance clause (indemnification) "...only if the Head of a Procuring Activity or his designee has decided that the contractor shall not purchase insurance against the liability...". We propose to reexamine our policies on this matter to determine whether further clarification is needed.

We appreciate this opportunity to comment upon your report.

Sincerely,



GLENN V. GIBSON  
Acting Assistant Secretary of Defense  
(Installations and Logistics)

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DEPARTMENT OF STATE  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON, D.C. 20523

DEC 18 1970

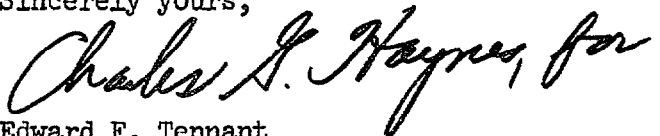
Mr. Eugene C. Wohlhorn  
Assistant Director, International Division  
U.S. General Accounting Office  
441 G Street, N.W.  
Washington, D. C. 20548

Dear Mr. Wohlhorn:

We have reviewed your report of September 11, 1970, concerning War-Risk Insurance coverage for government contractor employees and contractor-owned equipment.

We agree that the report's recommendations warrant careful consideration by this Agency as well as by the various Departments concerned. As you will note in the attached memorandum from the Assistant Administrator (Vietnam Bureau), we are conducting an in-depth study of the recommendations pertaining to A.I.D. We estimate that this will require approximately 90 days before we have the basis for making a decision regarding our future course of action on self insurance programs. However, we will be in touch with you regarding progress.

Sincerely yours,

  
Edward F. Tennant  
Auditor General

Enclosure: a/s

# APPENDIX III

OPTIONAL FORM NO. 10  
MAY 1962 EDITION  
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

## Memorandum

TO : AG, Mr. Edward F. Tennant

DATE: DEC 8 1970

FROM : AA/VN, Robert H. Nooter

SUBJECT: Agency Reply to Recommendations Made by the GAO in Draft Report Entitled "Opportunity for Savings in Providing War Risk Insurance Coverage for Government Contractor Employees and Contractor-Owned Property"

The draft report concludes that substantial savings would have been realized had organizations covered in the report, including AID, followed a policy of self insurance instead of reimbursing their contractors for the cost of war risk insurance purchased by them from commercial companies. The report recommends, in part, that AID seek legislation which would permit the Agency to self insure for war risk losses. As pointed out in the report, AID does not now have legislative authority to engage in any form of self insurance program. The GAO has compared the cost of insurance premiums paid during the last three years to the claims paid in the same period and has shown that premium costs have indeed exceeded claims paid in all cases. This, of course, is an argument for moving immediately to take advantage of potential savings through self insurance programs. However, at this time we are not in a position to unreservedly endorse the GAO's recommendation to seek legislation to permit self insurance for war hazard losses. We must further consider all aspects of the question before agreeing to seek the enabling legislation.

Some of the items to be considered are:

1. How much administrative cost will be involved in self insurance programs? The Agency does not have a staff to administer a self insurance program nor do we have any idea as to the cost of such staff.
2. What have other civilian agencies done in providing self insurance?
3. Are the potential savings large enough to justify a self insurance program?
4. To what extent should the risk of a future major claim from a calamity be taken into consideration?
5. To what extent, if any, should the pending reorganization of AID influence a decision to seek legislative authorization to self insure?



5010-108

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At the present time the Vietnam Bureau is conducting a study which will consider these and other questions. This study, which will be completed within the next 90 days, will provide the basis for making a decision regarding our future course of action on self insurance programs.

It is certain that the agency cannot self insure against war hazard losses under present legislation.

APPENDIX IV

PRINCIPAL OFFICIALS RESPONSIBLE FOR  
THE ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF DEFENSE</u>		
SECRETARY OF DEFENSE:		
Melvin R. Laird	Jan. 1969	Present
ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER):		
Robert C. Moot	Sept. 1968	Present
ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS):		
Barry J. Shillito	Feb. 1969	Present
<u>DEPARTMENT OF THE ARMY</u>		
SECRETARY OF THE ARMY:		
Robert F. Froehlke	July 1971	Present
Stanley R. Resor	July 1965	June 1971
<u>DEPARTMENT OF THE NAVY</u>		
SECRETARY OF THE NAVY:		
John H. Chafee	Jan. 1969	Present
COMMANDER, MILITARY SEALIFT COM- MAND:		
Vice Adm. Arthur R. Gralla	Mar. 1970	Present
<u>DEPARTMENT OF THE AIR FORCE</u>		
SECRETARY OF THE AIR FORCE:		
Dr. Robert C. Seamans, Jr.	Feb. 1969	Present

<u>Tenure of office</u>	
<u>From</u>	<u>To</u>

DEFENSE SUPPLY AGENCY

## DIRECTOR, DEFENSE SUPPLY AGENCY:

Lt. Gen. Wallace H. Robinson, Jr.	Aug. 1971	Present
Lt. Gen. Earl C. Hedlund	July 1967	July 1971

## COMMANDER, DEFENSE FUEL SUPPLY CENTER:

Maj. Gen. C. C. Case	Nov. 1969	Present
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DEFENSE CONTRACT AUDIT AGENCY

## DIRECTOR:

William B. Petty	July 1965	Present
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VIETNAM COMMANDS

## COMMANDER, MILITARY ASSISTANCE COMMAND, VIETNAM:

Gen. Creighton W. Abrams	July 1968	Present
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## COMMANDER, SEVENTH AIR FORCE:

Gen. Lucius D. Clay, Jr.	Sept. 1970	July 1971
Gen. George S. Brown	Aug. 1968	Aug. 1970

## OFFICER-IN-CHARGE OF CONSTRUCTION, VIETNAM:

Rear Adm. M. Labor Foster, Jr.	Mar. 1971	Present
Rear Adm. Albert R. Marshall	Mar. 1970	Feb. 1971
Rear Adm. Henry J. Johnson	July 1968	Mar. 1970

## DEPUTY COMMANDING GENERAL, UNITED STATES ARMY, VIETNAM:

Lt. Gen. William J. McCaffrey	July 1970	Present
Lt. Gen. Frank T. Mildren	May 1968	June 1970

APPENDIX IV

<u>Tenure of office</u>	
<u>From</u>	<u>To</u>

DEPARTMENT OF STATE

SECRETARY OF STATE:

William P. Rogers	Jan. 1969	Present
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AGENCY FOR INTERNATIONAL DEVELOPMENT

ADMINISTRATOR:

John A. Hannah	Apr. 1969	Present
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DIRECTOR, MISSION TO THE REPUBLIC  
OF VIETNAM:

John R. Mossler	July 1970	Present
Donald G. MacDonald	Aug. 1966	July 1970

DEPARTMENT OF LABOR

SECRETARY OF LABOR:

James D. Hodgson	July 1970	Present
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DIRECTOR, BUREAU OF EMPLOYEES'  
COMPENSATION:

John M. Ekeberg	Apr. 1969	Present
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DEPARTMENT OF COMMERCE

SECRETARY OF COMMERCE:

Maurice H. Stans	Jan. 1969	Present
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ADMINISTRATOR, MARITIME ADMINIS-  
TRATION:

Andrew E. Gibson	Mar. 1969	Present
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Copies of this report are available from the U. S. General Accounting Office, Room 6417, 441 G Street, N W., Washington, D.C., 20548.

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