

FROM: Head of Risk Management
LOCATION: GY5
EXTENSION: 5355
DATE: 14 February 2003
REFERENCE: Y2991
SUBJECT: US TERRORISM RISK INSURANCE ACT 2002
ATTACHMENTS: No
ACTION POINTS: **Managing agents to note action to be taken**

Risk Management (“RM”) previously advised managing agents (“agents”) of the issues and risks that they need to address as a result of the US Terrorism Risk Insurance Act 2002 (“the Act”). We also advised that RM would be visiting agents in January to understand the approach that they have been adopting to these issues in practice (see bulletin Y2952 dated 20th December 2002).

RM acknowledges that agents have been frustrated by the ambiguities and the administrative burden arising from the Act. However, the purpose of this bulletin is to identify market issues that require immediate action by agents, in view of the approaching deadline for issuing notices to insureds covered by the Act.

The recent RM visits to agents identified that:

- (i) there has been uncertainty as to whether non-US insureds, with exposure that could result in insured losses¹ in the US, are captured by the Act. As a result, a number of agents are unsure whether to issue notices to these policyholders;
- (ii) there has been uncertainty as to whether certain classes of business fall under the scope of the Act. The US Treasury guidance detailed in market bulletin Y2935, dated 5th December 2002, has produced further debate and leaders have adopted different practices on whether to issue notices, depending on whether they consider there to be any potential exposure to terrorism for those classes; and

¹ Insured losses are defined under s102 [5] of the Act

- (iii) a significant number of syndicates are concerned that they are not receiving adequate information from leaders or coverholders to enable them to assess the take-up of coverage and meet their obligations under the Act.

These issues present the following operational risks to the Franchise:

- (i) the possibility of syndicates losing the benefit of the Federal insurance program and facing increases in retained exposure due to inadequate notification and record keeping; and
- (ii) the reputational, punitive and litigation risks to agents and Lloyd's if a syndicate is not compliant with the notification and record keeping requirements under the Act.

These issues have been considered carefully in full consultation and agreement with Worldwide Markets ("WWM") and the Lloyd's Market Association ("LMA"). In order to ensure best practice and to meet the provisions under the Act, Lloyd's requires:

- i) that in view of Treasury guidance², notices should be issued and in future, TRIA coverage should be made available, to non-US insureds, by syndicates³, who know that these policyholders have potential exposure⁴ under policy terms and conditions to loss in the US, in order to preserve the right to claim against the Federal insurance program. Specific enquiries relating to potential US exposures should be directed to the LMA;
- ii) that notices should be issued on all policies falling within the applicable classes of business covered by the Act⁵ regardless of the level of perceived exposure to terrorism, or whether terrorism losses were included prior to the Act. This is because each syndicate at Lloyd's is an insurer³ falling within the jurisdiction of the Act and the Act requires notice to be given on in-force policies and for syndicates to continue to make cover available for "acts of terrorism". Specific enquiries relating to the applicable classes of business should be directed to the LMA.

Syndicates are further required to identify separately the portion of premium attributable to the exposure defined under the Act, whether as part of the original pricing of a policy or as an additional element to the policy; and

- iii) that leading underwriters on in-force policies should ensure that brokers, in a timely manner, comply with the procedures agreed between the LMA and the LMBC⁶, and provide to the following market copies of all notices issued where cover is taken up or written response declinatures received from insureds and the date of premium

² See bulletin Y2978 dated 23 January 2003 for Treasury guidance on non-US insurers.

³ The US Treasury recognises each syndicate at Lloyd's as an individual insurer under the Act. All Lloyd's syndicates fall within the jurisdiction of the Act because syndicates are subject to a Lloyd's License status in at least one State.

⁴ Whilst we note that the Aviation market has received specific verbal advice on interpreting potential exposures to non-US insureds in specific circumstances, legal advice is that the Treasury guidance given in bulletin Y2978 is the most influential advice and specific advice cannot be interpreted for other circumstances.

⁵ See bulletin Y2935 dated 5 December 2002.

⁶ See LMBC bulletin 13/2003 dated 11 February 2003 on TRIA-Leader Agreements.

settlement where cover is accepted, to ensure compliance with the Act⁷. This is because each syndicate at Lloyd's is an individual insurer³ for the purposes of compliance with the Act, regardless of whether it is a leader or follower on a risk, and therefore must have this documentation. Furthermore, leaders and followers should ensure that a similar standard of information is received from coverholders and that bordereaux received reflect the syndicate's own record keeping standards with regard to the Act. The binding authority agreement should be endorsed to include these additional requirements. Verbal advice from Brokers will not suffice.

A number of other issues were identified from this series of visits. Some agents expressed concern that they will be unable to quantify their retention under the Federal insurance program until they receive clarification on how the deductible will be calculated where affiliates are involved. WWM will comment on this issue as soon as clarification is available. For the remaining issues identified, a proposed treatment for each of these issues has been discussed with WWM and the LMA and responses will shortly be provided to agents on an individual basis, as appropriate.

RM will revisit those agents most affected by the Act in order to establish that the record keeping and audit trails maintained by syndicates are sufficient to ensure compliance with the Act. At the same time, RM will wish to establish the level of take up and exposure, the extent of any overwriting, and to obtain input on what would be an appropriate terrorism realistic disaster scenario for the market.

Any queries regarding the contents of this bulletin should be directed to Liz Rooke (extn: 6818) or to Terry Ferguson (extn: 5253). This Bulletin has been sent to all active underwriters, managing agents, members' agents, Lloyd's advisers, Lloyd's brokers, Market Associations, recognised accountants and corporate members.

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⁷ The Act gives the Secretary the right to conduct studies on "availability and affordability" of insurance s108[D(1)] and s104[F(1)].