

FROM: Director, Worldwide Markets
LOCATION: G12
EXTENSION: 5998
DATE: 03/03/2003
REFERENCE: Y3004
SUBJECT: U.S.TERRORISM RISK INSURANCE ACT OF 2002:
US TREASURY INTERIM FINAL RULE
SUBJECT AREA(S): US Commercial P & C business
ACTION POINTS:
DEADLINE: Immediate

Purpose of bulletin

To notify the market that on 25th February 2003 the US Department of the Treasury issued an interim final rule addressing definitions under the Terrorism Risk Insurance Act of 2002 (TRIA).

Background

The Terrorism Risk Insurance Program is administered and implemented by Treasury. To date, it has issued three sets of interim guidance:

- Concerning New Statutory Disclosure and Mandatory availability Requirements of the TRIA – dated December 3 2002.
- Concerning Definition of Insurers, Scope of Insurance Coverage and Disclosures Mandated by the TRIA – dated December 18 2002.
- Concerning Certain Conditions for Federal Payment, Non-U.S. Insurers, and Scope of Insurance Coverage in the TRIA – dated January 22 2003.

Copies are available on the US Treasury's web site at www.treasury.gov/trip

The regulation issued on the 25th February 2003, is the “first round of regulations” under the Act. It builds on the previously issued interim guidance detailed above, which was “designed to assist insurers in determining how they may comply with certain immediately applicable provisions of the Terrorism Risk Insurance Act prior to the issuance of the regulations by the Treasury”.

The issues covered by the interim final rule

We suggest that underwriters and brokers obtain a copy of the interim final regulation from the Treasury web site. To some extent, much of the interim final regulation repeats information from the statute or information already provided by Treasury in the previous guidance documents. Exceptions to this and areas that will likely be of particular interest to underwriters are highlighted below:

➤ **Affiliate Control / Insurer Deductible**

The rule creates a series of rebuttable presumptions about ownership scenarios in which an insurer is deemed to be controlled by or under common control with another insurer, such that the insurers will be grouped together for purposes of calculating a common "insurer deductible." One of the rebuttable presumptions is that:

“...an insurer exercises directly or indirectly a controlling influence over the management or policies of a syndicate insurer if, at any time during the Program Year, the insurer supplies 25 percent or more of the underwriting capacity for that year to the other insurer that is a syndicate...”

This is comparable to the rule's tests of 25% of voting stock for stock insurers and 25% of policyholders' surplus for mutual insurers.

Lloyd's is continuing to review with Treasury the deductible applicable in respect of Lloyd's syndicates.

➤ **Direct Earned Premium**

The rule confirms Treasury's previous guidance that premium should be reported by reference to covered lines on the NAIC Exhibit of Premiums and Losses. Treasury acknowledges that some insurers do not file that Exhibit, but indicates that such insurers should nevertheless calculate direct earned premiums by reference to the Exhibit "as an analogy."

The preamble specifically instructs surplus lines insurers to allocate premium on covered and non-covered lines with respect to business incepting before 1 January 2003. The position in relation to business incepting after that date is discussed below (see "Separate pricing").

Lloyd's is discussing with Treasury and the NAIC the precise format in which premiums will be reported.

➤ **Personal vs. Commercial Lines**

The rule acknowledges that some personal lines business is reported on the NAIC Exhibit of Premiums and Losses. It clarifies that any premiums attributable to personal lines business may be subtracted from premiums reported to Treasury for purposes of calculating insurer deductibles.

The rule acknowledges differences among states in defining personal lines business and therefore declares that, for TRIA purposes, personal lines business is that "primarily designed to cover personal, family, or household purposes." Moreover, personal lines policies that contain "incidental" commercial coverages (*i.e.*, less than 25% of premium is attributable to commercial) are not covered.

➤ **Insured Loss**

The rule clarifies advice Treasury has previously provided regarding the definition of "insured loss":

"In general, if the property and casualty insurance coverage is provided within the geographic and other statutory parameters of the definition of "insured loss" in the Act as described above, and is provided by an "insurer" as defined in section 102(6) of the Act (whether or not the insurer is non-US based or owned), then such losses will be covered by the Program, subject to the conditions for payment and other requirements of the Act."

With respect to US-flag vessels and US air carriers, covered losses occurring outside the US are those that are "incurred by" the vessel or carrier and are covered by policies issued to the vessel or carrier owners. Insured losses covered by policies issued to others are not TRIA-covered unless the insurers qualify independently.

➤ **Separate pricing**

The preamble states that:

"For policies issued by eligible surplus line carriers after January 1 2003, as stated in Interim Guidance II, the premium for insurance coverage within the geographic scope of "insured loss" must be priced separately by eligible surplus line carrier insurers."

Following discussion of this point between LeBoeuf and Treasury, we understand that this requires a surplus line carrier to maintain an internal record of the portion of the total premium attributable to the US "geographic scope". This will facilitate reporting of premium, as required by the Act. It is not intended to impose a new requirement of premium disclosure to policyholders on surplus line carriers.

Submission of Comments

The US Treasury has invited comments on any aspect of the regulations. It seeks specific comment on several items, including:

- (1) whether additional qualifying criteria are needed to encourage the creation of new companies to provide additional capacity for underwriting capacity for terrorism risks while discouraging the use of newly formed entities to circumvent or manipulate insurer deductible requirements;
- (2) whether the scope of qualification of insurers approved for other purposes by federal agencies should be limited, as the regulation requires, to that coverage written pursuant to the federal approval and whether additional qualifying standards for such insurers should be imposed; and

(3) whether and how the definition of "control" should be further refined to address situations where corporate structures contain multiple insurers.

Lloyd's will provide a central response, in liaison with the LMA. Managing Agents and others wanting to comment can do so by providing input via the contacts given below.

For further information contact Worldwide Markets division in Lloyd's, on extension 6677 (email at market.services@lloyds.com).

The LMA has also provided extensive information to the market. Contact Martin Roberts on Lloyd's extension 8370 (by email at martin.roberts@lloyds.com).

This bulletin has been sent to active underwriters and compliance officers of managing agents and Lloyd's brokers.