Market Bulletin

LLOYD'S

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FROM:	Manager, Overseas Reporting, Market Reporting
LOCATION:	G5/86
EXTENSION:	5490
DATE:	31 July 2003
REFERENCE:	Y3109
SUBJECT:	US TERRORISM RISK INSURANCE ACT OF 2002 – ANNUAL REPORTING TO CALCULATE SYNDICATES' DEDUCTIBLES
SUBJECT AREA(S):	US commercial property & casualty insurance business (as defined in the Act)
ATTACHMENTS:	Appendix: Definitions relevant to calculation of the insurer deductible
ACTION POINTS:	**ALL syndicates to note the requirements and timetable for reporting the deductible. Please see section 9 for timings.** ***Compliance will require immediate review of a syndicate's records and reporting capabilities.***
DEADLINE:	**1 October 2003.**

1 Purpose

1.1 To advise the market of the requirements and timetable for reporting the deductible as stipulated under the U.S Terrorism Risk Insurance Act of 2002, ("TRIA").

1.2 This communication is relevant to all syndicates with US exposures on insurance contracts with commercial clients, which may therefore make a claim against TRIA's federal programme in the event of an event arising that the programme covers.

1.3 ***It is important to note that the reporting requirement relates to a syndicate's entire US commercial property & casualty premiums (as defined in the Act and detailed in appendix 1) in a calendar year – not just to premiums received in relation to TRIA coverage.*** This point is set out in detail in this communication.

2 Provisions of the Act

2.1 The Act in its entirety can be viewed at http://thomas.loc.gov.

2.2 Lloyd's has issued a series of Market Bulletins on TRIA. They may be viewed at: http://www.lloyds.com/index.asp?ItemId=3421 - direct link to 'US Terrorism Risk Insurance Act 2002' page.

Alternatively, via:

www.lloyds.com - On the bottom right of the homepage under Lloyd's trading status select 'US', then click to accept 'terms of use', then from the menu on the left hand side select 'US Terrorism Risk Insurance Act 2002'.

3 Definition of the "insurer deductible" under TRIA

3.1 If an event covered by TRIA occurs (a "certified loss"), the Federal share of compensation under the TRIA programme is 90% of the portion of insured losses in aggregate in excess of the applicable insurer deductible. Each insurer therefore needs to report to the appropriate U.S. Authority its relevant premiums for the purposes of calculating the deductible. In the case of Lloyd's and other alien insurers, the US Treasury is relying on the International Insurance Department ("IID") of the National Association of Insurance Commissioners ("NAIC") to collect the required information.

3.2 TRIA states that "insurer deductible" means –

- For Program Year 1 (2003) – the value of the insurer's direct earned premium for 2002, multiplied by 7%;
- For Program Year 2 (2004) - the insurer's direct earned premium for 2003, multiplied by 10%; and
- For Program Year 3 (2005) - the insurer's direct earned premium for 2004, multiplied by 15%.

3.3 Definitions of "direct earned premium" and "property & casualty" insurance are set out in appendix 1.

4 What is the basis for the insurer deductible for the US admitted / licensed market?

4.1 The deductible for such insurers is based on "direct earned premiums" for lines of business designated by the U.S. Treasury Department and reported to the NAIC in their Annual Statements, under column 2 of the Exhibit of Premiums and Losses (commonly known as Statutory Page 14).

5 What is the basis of the insurer deductible for Lloyd's syndicates?

5.1 In the case of Lloyd's, the premium for calculating the deductible will be reported to the IID by syndicates.

5.2 The only filings of Statutory Page 14 that Lloyd's makes relate to licensed business in Illinois & Kentucky, and these are on a collective basis. Syndicates report their surplus lines business to the IID in a significantly different format. Furthermore, all Lloyd's US reporting is on the basis that the premiums reported are on a signed, not an earned basis (as is the case with other non-UK regulatory returns). This means that Lloyd's cannot comply with TRIA reporting obligations in precisely the same way as a US licenced insurer.

5.3 Lloyd's has therefore discussed how syndicates can comply with these requirements with the NAIC. It has made the following points:

- Lloyd's is moving to an 'earned' basis of reporting, but syndicates currently report on a signed basis (business processed in the calendar year)[1].

- Some syndicates report in parallel on a premium earned basis for certain external purposes, but this is generally only at whole account level. The breakdown of business required by TRIA will require further work on existing data.

- IT amendments and increased resourcing may be necessary for every syndicate to ascertain relevant premium.

- Reasonable lead time is required to undertake the necessary work.

5.4 To assist consideration of this issue, Lloyd's provided the NAIC with a signed against earned analysis of premium[2].

5.5 Within the context of needing to ensure proper compliance with TRIA, the NAIC has worked with Lloyd's to develop the procedure set out in section 6 below.

5.6 Lloyd's, like other insurers, is still in discussion with Treasury on technical aspects of TRIA, including the application of the affiliate provisions within the Act.

6 Syndicate reporting procedures

6.1 Syndicates will be required to report <u>their</u> relevant premium for the previous calendar year as follows (subject to de minimis provisions, see 6.4 below):

- Where possible, syndicates should report premiums on an earned basis. This must be done on the standard NAIC IID spreadsheet (attached) for Lloyd's syndicates and in accordance with agreed timings.

- If syndicates are unable to report and complete the spreadsheet on an earned basis, then they may report premiums on a signed basis. Signed premiums must be grossed up for brokerage and commissions. To avoid the possibility of premiums being under-reported, Lloyd's has agreed to certain safeguards. These are based on the syndicate-by-syndicate signed vs. earned whole account level premium analysis undertaken by Lloyd's centrally. The percentages below therefore relate to the comparison of **whole account all years of account**

[1] Required changes to Lloyd's statutory basis of accounting to move over to annual accounting are yet to be finalised - the earliest that such a change is likely to come into effect for the overall market is 01 Jan 2005.
[2] Analysis was undertaken by Lloyd's centrally to determine the variance on signed vs. earned premium for the 2002 calendar year. Using existing data, it was only possible to undertake this analysis at whole account level (covering all classes and locations), as opposed to specific covered lines and 'US business' as defined under TRIA.

combined level signed premiums with earned premiums (grossed up for brokerage and commission) for the previous calendar year.

The safeguard provisions are as follows:

- If the syndicate's signed premiums are 100% or more of earned premiums – it can submit signed figures with no adjustment.

  This will mean a syndicate potentially reporting a higher premium figure than if it had made the calculation on an earned basis.

- If the syndicate's signed premiums are 90% to 99.99% of earned premiums – if it submits signed premiums, its submission will be adjusted upwards in proportion with the difference at whole account level between signed and earned premiums.

  Example

	Whole Account		TRIA
	100	95	20
	(Earned)	(Signed)	(Signed)
TRIA premium for the deductible		=	100/95 x20
		=	21

- If the syndicate's signed premiums are less than 90% of earned premiums - if it submits signed premiums, its submission will be adjusted upwards in proportion with the difference at whole account level between signed premiums and earned premiums plus 10%.

  Example

	Whole Account		TRIA
	100	80	20
	(Earned)	(Signed)	(Signed)
TRIA premium for the deductible		=	110/80 x20
		=	27.5

The additional loading is added to take into account the uncertainties of the assumption that characteristics of the TRIA account will track the whole account / book of business.

6.2 Syndicates are expected to complete the IID spreadsheet using data relating to premium processed during the previous calendar year, provided in USM's by Xchanging In-sure Services to syndicates. Required breakdown of data will include information split by risk codes, FIL codes and trust code information. Syndicates should ensure that this information is retained for premium processed in 2002.

6.3 ***Detailed guidance and mapping of relevant Lloyd's risk codes into the required classes will be provided in a separate Market Bulletin, due to be issued shortly.***

6.4 ***De minimis provision***: All syndicates are encouraged to report on an earned basis if they are able to do so. However, a syndicate may report its premiums on signed basis, without applying the safeguard provision adjustments mentioned above, if the amount of relevant premium income it is reporting is below specified “de minimis” levels. This applies whatever the relationship of its signed to its earned premiums at a whole account level.

6.5 For reporting purposes, the NAIC agrees with Lloyd’s that an adjustment in the level of a deductible of $100,000 or less is “de minimis” under the agreed safeguard provisions and therefore does not need to be made. This means that in absolute terms there are premium levels below which syndicates are not required to make any adjustments to their signed figures under the above safeguard provisions. These have been set as follows:

- Program Year 1 (i.e.: 2002 reported in 2003) - Relevant income for the calculation of the deductible (calendar year signed, gross of all deductions) is $1.4m or less;

- Program Year 2 (i.e.: 2003 reported in 2004) - Relevant income for the calculation of the deductible (calendar year signed, gross of all deductions) is $1m or less;

- Program Year 3 - Relevant income for the calculation of the deductible (calendar year signed, gross of all deductions) is $700,000 or less.

7 Syndicates who must make the TRIA deductible return

7.1 Every syndicate that was trading in 2002 must make a TRIA deductible return, whatever its US trading status. The only exceptions are syndicates whose business is limited to life insurance or to UK motor business. Syndicates with no relevant premium to report must make a “nil” return to Market Reporting.

7.2 Syndicates are not required to make a return in the year in which they commence trading, although they must do so in subsequent years. Treasury Regulations have made provision for newly formed insurers and in the event of a certified event, it is likely that their deductible will be fixed in accordance with methodology drawn up by the US Treasury.

7.3 A syndicate in run-off that ceased trading prior to 2002 may be required to make a return, if it is still party to ongoing business that could lead to a claim on the TRIA Federal programme. Its return will report the relevant premium it received in the course of 2002. Every such syndicate should consider making a return – it should be noted that a failure to file a return will make it impossible to calculate a syndicate deductible and cover under TRIA could thus be jeopardised. A decision not to make a return should therefore follow a careful analysis of the syndicate’s book of business.

8 Year-on-year consistency

8.1 Over time syndicates are expected to move from reporting on a signed to an earned premium basis. A syndicate may not change mid-year and, having switched to reporting on an earned basis, the syndicate may not subsequently change back to a signed reporting basis.

8.2 TRIA is due to terminate by 31st December 2005. The agreement that syndicates may report on a signed basis is intended to accommodate the transition period, as Lloyd's moves over to annual accounting.

9 Timings

9.1 *2003 (Program Year 1)* – Returns (reporting 2002 premiums) must be submitted to Lloyd's Market Reporting by 1 October 2003. They will be collated and supplied to the NAIC by 15 October 2003.

9.2 *2004 and 2005 (Program Years 2 & 3*) – Returns must be submitted to Lloyd's Market Reporting by the standard annual reporting date (which was 1 May in 2003). They will be collated and supplied to the NAIC by 15 May.

10 Notarisation

10.1 Returns will need to be notarised. For 2004 this may be undertaken as part of the IID return and associated notarisation, but for 2003 (as the TRIA return will be made separately in September), separate notarisation will be required. A Jurat page will be issued in due course.

11 Further Information

11.1 If you have any questions on the reporting process please contact Market Reporting:

Leslie Redmond on extension 5490 (e-mail: leslie.redmond@lloyds.com).

Or Worldwide Markets:

Market Services on extension 6677 (email: market.services@lloyds.com).

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

Leslie Redmond

Appendix

Definitions relevant to calculation of the insurer deductible

Taken from TRIA s. 102

"Direct earned premium" means*, "direct earned premium for property and casualty insurance issued by any insurer for insurance against losses occurring at the locations described in subparagraphs (A) and (B) of paragraph (5)".* In brief, this means that the Act will apply to losses occurring within the U.S. States and territories, U.S. Territorial Sea and U.S. Continental Shelf of the U.S. It will also apply *"to an air carrier (as defined in section 40102 of title 49, United States Code), to U.S. flag vessels (or a vessel based principally in the United States, on which U.S. income tax is paid and whose insurance coverage is subject to regulation in the U.S.), regardless of where the loss occurs, or at the premises of any U.S. mission".*

Property and casualty insurance *—The term ''property and casualty insurance''—*

> *(A) means commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance, and surety insurance; and*
>
> *(B) does not include—*
>
> > *(i) Federal crop insurance issued or reinsured under the Federal Crop Insurance Act (7 U.S.C. 1501 et seq.), or any other type of crop or livestock insurance that is privately issued or reinsured;*
> > *(ii) private mortgage insurance (as that term is defined in section 2 of the Homeowners Protection Act of 1998 (12 U.S.C. 4901)) or title insurance;*
> > *(iii) financial guaranty insurance issued by monoline financial guaranty insurance corporations;*
> > *(iv) insurance for medical malpractice;*
> > *(v) health or life insurance, including group life insurance;*
> > *(vi) flood insurance provided under the National Flood Insurance Act of 1968 (42 U.S.C. 4001 et seq.);*
> > *or*
> > *(vii) reinsurance or retrocessional reinsurance.*

Further clarification on types of property and casualty insurance covered / excluded by the Program has subsequently been issued by the U.S. Treasury – see particularly Interim Final Rule of February 25, 2003, pages 24 - 29. Much of this guidance was highlighted to the market in Market Bulletin Y 2935, issued on the 5th December 2003.