

FROM: Director, Worldwide Markets
LOCATION: G12
EXTENSION: 5998
DATE: 29 August 2003
REFERENCE: Y3129
SUBJECT: U.S. TERRORISM RISK INSURANCE ACT OF 2002: US TREASURY FIRST INSTALMENT OF FINAL IMPLEMENTING RULES
SUBJECT AREA(S): US Commercial P & C Business
ACTION POINTS:
DEADLINE: Immediate

Purpose of bulletin

To notify the market that the US Department of the Treasury has issued two Final Rules, which are the first in an expected series of final regulations implementing the Terrorism Risk Insurance Act of 2002 ("TRIA"). The Final Rule, issued on the 8th July 2003, amends and makes permanent the previous Interim Final Rule (IFR) issued on 25th February 2003 and covered in Market Bulletin Y3004. The Final Rule issued on the 8th August 2003, merely provides clarification of a key term used in the 8th July Final Rule.

Background

The regulations build on the previously issued interim guidance, 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 Interim Guidance, Interim Final Rules and the Final Rules can all be viewed in full on the US Treasury's web site at: <http://www.treasury.gov/offices/domestic-finance/financial-institution/terrorism-insurance/>.

The issues covered by the 8th July Final Rule

Much of the substance is similar to the IFR and previously issued interim guidance documents. Areas that will likely be of particular interest to underwriters are highlighted below:

➤ Affiliate / Control / Insurer Deductible

Lloyd's and our legal advisers, LeBoeuf Lamb Greene & MacRae, are in continuing discussions with the U.S. Treasury regarding this issue and the treatment of Lloyd's syndicates.

➤ **Personal vs. Commercial Lines**

Like the IFR, the preamble to the Final Rule acknowledges ongoing confusion among insurers in relation to separation of personal and commercial lines business for purposes of calculating insurer deductibles and determining whether specific insurance policies are eligible for the TRIA Program. Personal lines are defined for TRIA purposes as those lines of business "primarily designed to cover personal, family, or household purposes." Premiums attributable to such lines of business may be subtracted from premiums reported to Treasury for purposes of calculating insurer deductibles. Moreover, Treasury clarified that TRIA does not apply to commercial coverages provided in policies that are predominantly personal lines if the commercial coverages are "incidental" (*i.e.*, as detailed in previous interim guidance, less than 25% of premium is attributable to commercial).

➤ **Covered Lines**

The preamble to the Final Rule confirms what we had previously assumed - lines of business not expressly *included* among the "included lines" set out in the Final Rule are *excluded* from participation in the TRIA Program. Nevertheless, Treasury did comment on the treatment of certain lines of business:

Fidelity Coverage: The Final Rule makes clear that fidelity coverage is excluded from the TRIA Program. In response to some commentators, however, Treasury acknowledges that traditional fidelity insurance coverage has been expanded in recent years to include other types of coverage that, taken alone, would be covered under TRIA (*e.g.*, property coverage for loss of firm assets due to crime committed by outsiders). Despite this, Treasury has made no change in its previous determination - all coverages reported on Statutory Page 14 as fidelity coverage are excluded from the TRIA Program. Nevertheless, Treasury has indicated that it will continue to evaluate how this decision affects the availability of terrorism coverage for affected risks.

Single Peril Natural Disaster Coverage. After noting that the statute and the IFR exclude certain single peril natural disaster coverages such as Federal flood insurance and earthquake insurance, from participation in the TRIA Program, Treasury indicates in the preamble to the Final Rule that it is considering requesting comment from interested parties on the potential exclusion of other lines of single peril natural disaster insurance. Treasury identifies stand alone, single peril wind storm insurance as one such line on which it might invite comment.

➤ **Captives and Federally Approved Insurers**

In response to interested party comments that questioned the applicability of TRIA to captive insurers, Treasury stated explicitly in the Final Rule that State licensed or admitted captive insurance companies are included in the definition of "insurer" required to participate under TRIA. The treatment of offshore, non-admitted captives is left to be determined in a later rulemaking.

Treasury maintained its previous position that Federally approved insurers that are not otherwise State licensed, admitted, or NAIC listed may only participate in the TRIA Program to the extent of their Federal approval. For example, if a non-admitted

insurer is approved by the Federal Aviation Administration (“FAA”) to provide aviation insurance to a U.S. airline, only the coverage for which FAA approval is required is eligible to participate in the TRIA Program.

➤ **Procedure for Requesting Interpretations**

The Final Rule invites persons affected by the statute or implementing regulations to request written interpretations from Treasury where the effect on a particular line of business or circumstance is not clear. Treasury is not required to respond to such requests, but will do so at its discretion. We have been advised informally that such written responses will be posted on Treasury's web site (although requesters may mark any confidential business or trade secret information provided in its request). Lloyd's is providing ongoing feedback to the U.S. Treasury, in consultation with the LMA. Managing Agents and others seeking clarification on interpretations or wanting to comment on elements of the Act should do so through Lloyd's centrally, via the contacts given below.

Subsequent Final Rule

The U.S. Treasury issued a subsequent Final Rule on the 8th August 2003. This, however, merely sought to clarify the current regulatory definition of ‘direct earned premium’, to ensure that it parallels the definition of ‘direct earned premium’ in section 102(4) of the Act. This followed concern that the definition of this term provided in the 8th July Final Rule could cause confusion and did not accurately parallel the Act itself.

Further Information

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).

The US Treasury's web site (‘Financial Markets’ section) at www.treasury.gov contains information on the U.S. Terrorism Risk Insurance Act of 2002, including downloadable copies of all guidelines and regulations.

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