

FROM: Director, Worldwide Markets
LOCATION: G12
EXTENSION: 5998
DATE: 25 November 2003
REFERENCE: Y3192
SUBJECT: U.S. TERRORISM RISK INSURANCE ACT OF
2002: US TREASURY 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 released a new Final Rule, which clarifies and finalizes provisions of a previous Interim Final Rule governing the "make available" requirement under the Terrorism Risk Insurance Act (TRIA). See Lloyd's bulletin Y3129 issued on the 29 August 2003 for details of previous rules or the Treasury web site detailed below.

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 this Final Rule

Areas that will likely be of particular interest to underwriters are highlighted below:

➤ **Potential "Make Available" Requirement Extension**

The requirement to "make available" TRIA coverage in all commercial property and casualty policies expires at year-end 2004, subject to the Secretary's discretion to extend the requirement until year-end 2005. The Secretary must make his decision with respect to this by September 1, 2004. Because there has been some confusion in the public domain on the point, the Final Rule makes clear that the federal backstop

will be in place until year-end 2005 regardless of the Secretary's decision with respect to the "make available" requirement. Thus the backstop will be available to compensate for insured losses in 2005 whether TRIA coverage is provided voluntarily or involuntarily.

➤ **Consequences of Failure to Provide Policyholder Notice.**

Treasury commented on the stated desire of some insurers to decline to provide policyholder notices where the insurer decides that the administrative burden of doing so outweighs the benefits. The Final Rule confirms that insurers can make that choice, but those who fail to provide notices to policyholders with respect to a particular block of business will not be able to claim against the backstop with respect to that business. However, such insurers could still claim against the backstop with respect to other blocks of business for which the notice is provided. Importantly, the "make available" requirement still applies and all relevant premium will be used to calculate the deductible whether or not it relates to business for which a notice is given.

To illustrate, an insurer who decides not to provide notices to policyholders on single-peril windstorm risks (because the chances of a terrorism-related loss are slim) would not lose the right to claim against the federal backstop with respect to other property policies the insurer writes as long as notices are provided to the property policyholders (and all other conditions of claiming against the backstop are met). Coverage for "acts of terrorism" must still be provided on the windstorm risks and the premium associated with the coverage will be included in the base for determining the TRIA insurer deductible.¹

➤ **When Does the "Make Available" Requirement Apply?**

Consistent with our previous advice, the Final Rule clarifies that TRIA coverage must be made available at the time of initial offer and at the time of renewal. Insurers are not required to make the coverage available at any other time (*e.g.*, in response to a mid-term policyholder request). It is thus a commercial decision whether underwriters offer TRIA coverage mid-term, but it would perhaps be consistent to offer it at this time - particularly if the underwriter may likely be involved in the renewal of the policy, at which time he would then be required to make TRIA coverage available again. Such mid-term offers need not be at the same price as the original offer.

➤ **DIC and Umbrella Policies**

The Final Rule makes it clear that DIC coverages are subject to TRIA. Drop-down features of umbrella coverage can exclude TRIA if the policyholder declined TRIA coverage on the underlying coverage. If TRIA coverage is provided in the underlying coverage, it must be provided in the drop down coverage as well.

➤ **NBC Exclusions**

The Final Rule clarifies that any coverage provided for losses related to nuclear, biological, or chemical (NBC) risks is included under TRIA. Some commentators and press reports have erroneously suggested that TRIA excludes NBC risks, but the Final Rule makes it clear that this is not the case. While the statute's deference to state law does result in NBC risks being excluded from TRIA coverage where state

¹ Treasury separately confirmed again that windstorm risks are covered under TRIA, but reiterated the possibility that it may seek comments on this issue at a later date.

law permits NBC risks to be excluded from the underlying policy, the federal backstop is nevertheless available to the extent that coverage for NBC risks is provided.

Other Issues

In addition to those matters discussed above, the Final Rule also:

- Confirmed Treasury's previous advice regarding the requirement to provide the policyholder notice as a "separate line item" in the policy (but clarified that the notice can be included in any document that becomes a part of the policy). I.e. in the Lloyd's market the separate line item requirement could be met by the use of NMA 2969²; and
- Declined a request from mortgage providers that Treasury require insurers to notify mortgage lenders, securitizers, and servicers of commercial mortgages of borrowers' decisions to purchase or decline to purchase TRIA coverage.

In a separate rulemaking, Treasury also issued a final rule governing policyholder notice requirements for state residual market entities and state workers compensation funds. The requirements are similar in most respects to those for other insurers.

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.

² Within the Lloyd's market, the LMA has also been working with the LMBC in order to standardise the procedure between brokers and leaders to support ongoing compliance with TRIA requirements and also to ensure following underwriters on a subscription placement receive all relevant TRIA compliance information. Further details on these proposals were issued by the LMA on 20 November 2003.