

FROM: Director, Worldwide Markets
LOCATION: G12
EXTENSION: 5998
DATE: 17 December 2003
REFERENCE: Y3215
SUBJECT: US TERRORISM RISK INSURANCE ACT:
PROPOSED RULE ON CLAIMS PROCEDURES
SUBJECT AREA(S): Procedures for filing claims for payment of the federal share of compensation under the Program
ATTACHMENTS:
ACTION POINTS: **Underwriters and managing agents may decide to contribute to a Lloyd's/LMA response to the US Treasury's Proposed Rule**
DEADLINE: **24 December 2003**

Purpose of bulletin

To inform the market that the US Treasury Department has released a Proposed Rule setting out procedures for the presentation and payment of claims under the Terrorism Risk Insurance Act ("TRIA")

The Proposed Rule

The Proposed Rule may be found on the US Treasury website at:
http://www.ustreas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/regulations/12_01_03.pdf

This Rule will not become effective until a Final Rule is published, following a period of public comment that expires on 31 December 2003.

The Proposed Rule includes statutory conditions for federal payment, including:

- Requirements for loss certification and associated recordkeeping requirements;

- Guidance on what is payable as the federal share of insured losses
- Requirements for investigating and auditing claims under the Program.

Highlights of the Proposed Rule are set out in the attached appendix.

Responses to the Proposed Rule

Worldwide Markets and the LMA are working together to provide a single, co-ordinated response on behalf of the Lloyd's market to the US Treasury on the Proposed Rule. Underwriters and Managing Agents who wish to contribute to this response can do so by e-mailing comments to:

The LMA – contact Martin Roberts on Lloyd's extension 8370, by email at martin.roberts@lloyds.com

or

Worldwide Markets – contact James Walmsley via Worldwide Market Services on Lloyd's extension 6677, by email to market.services@lloyds.com

To enable the Lloyd's/LMA response to reach the US Treasury by their deadline of 31 December 2003, it would be appreciated if underwriters and managing agents could provide any comments to the LMA or Worldwide Markets **by 24 December 2003**.

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

Appendix 1

TRIA Claims Procedure: Highlights of Proposed Rule

The following highlights are taken from advice received from LeBoeuf, Lamb, Greene & MacRae LLP:

Claims Against Backstop Contingent on Insurer Payment of Claims. The Proposed Rule provides that claims against the federal backstop will not be made until certain preconditions are met, one of which is that the insurer "has paid all underlying claims comprising the insured losses. . ." No provision is made for advances against outstanding claims (OCAs) to give direct insurers liquidity assistance or for circumstances where a direct insurer becomes insolvent.

"Insured Losses" Redefined to Include "Loss Adjustment Expenses". The Proposed Rule would revise the definition of "insured loss" in current regulations to permit insurers to include loss adjustment expenses.¹ This would allow insurers to recover such expenses from the government once the insurer deductible and 10% copayment have been paid. It could also cause insurers to reach their deductibles more quickly.²

Adjustments to Federal Share of Compensation. The Proposed Rule would provide that compensable "insured losses" will be reduced by: (i) recoveries for salvage and subrogation; (ii) reinsurance recoveries that, along with an insurer's TRIA recoveries, exceed that insurer's aggregate insured losses (except where the reinsurance agreement provides that the reinsurer's right to any excess recover has priority over the recovery rights of the Treasury); and (iii) any duplicate amount of compensation otherwise provided by the Federal Government. Items (ii) and (iii) above implement provisions of the statute and are not surprising. Item (i) regarding salvage and subrogation is not mentioned in the statute or in prior regulations.

TRIA Claims Procedures.

Initial Notice of Insured Loss. When an insurer's aggregate insured losses (including IBNR reserves) within a program year exceeds 50% of the insurer's deductible, the insurer must provide Treasury with notice of such loss on a Treasury-prescribed form. Such notice must include: (i) the insurer's estimated aggregate loss for a given Program Year; (ii) an estimate of the insurer deductible; (iii) an estimate of the Federal share of the insurer's aggregate losses; and (iv) the identity of a contact person designated by the insurer to make the required TRIA certifications and receive Federal payments.

Initial Certification of Loss. Insurers are instructed to use their "best efforts" to file with Treasury within 45 days of the date on which its insured losses first exceed its insurer deductible an Initial Certification of Loss. Treasury will prescribe a form for this Certification, which will include the following.

¹ For TRIA purposes, loss adjustment expenses include expenses incurred in the investigation, adjustment and defense of claims, but exclude staff adjuster salaries and any allocations of other internal insurer expenses.

² Treasury has not included losses in excess of policy limits (XPL) in the definition of "insured loss," but invites comments on whether such losses should be included.

Loss Bordereau. Treasury will issue operating procedures and a prescribed format for the bordereau later, but expects that the bordereau will identify losses by program year, industry catastrophe code, and line of business. The bordereau will also report: (i) claim number; (ii) loss location; (iii) date of loss; (iv) policy inception, term & limits; (v) loss paid; (vi) allocated loss adjustment expenses paid; (vii) reserves; (viii) loss adjustments due to salvage/subrogation recoveries, recoveries under other Federal programs, and potential and actual reinsurance recoveries. Treasury also expects the bordereau will identify any punitive damages (which are not compensable by the federal backstop).

Certification of Compliance with the Act. The Certificate of Loss will include a certification by the insurer that the insurer has met all preconditions for claiming against the backstop, including compliance with policyholder notice requirements. The Proposed Rule would also require certification that the insurer has complied with the "make available" requirement of Section 103(c) of the Act. In the preamble to the Proposed Rule, Treasury acknowledges that this is not a statutory precondition to claiming against the federal backstop, but Treasury nevertheless believes it is "necessary to effectively administer and implement the Program." Insurers will also be required to certify their direct earned premium together with the calculation of the insurer deductible (to the extent these figures were not provided in the Initial Notice of Insured Loss).

Supplemental Certifications Treasury will also prescribe a form on which insurers may make supplemental certifications with respect to losses for which an Initial Certificate of Loss has already been filed. These will be filed monthly as needed or as otherwise determined by Treasury.

Payment of TRIA Claims. The Proposed Rule indicates that Treasury will "promptly pay to an insurer the Federal share of compensation due to the insurer for its insured losses." The term "promptly" is not defined. Treasury reserves the right to make payments in installments "and on such conditions as determined by the Treasury to be appropriate." Any overpayments by Treasury will be offset from future payments if not returned to Treasury within 45 days.

Federal payments will be made to the insurer filing the Initial Notice of Loss. In the case of an affiliated group of insurers, payment will be made to a single entity designated by the group to receive payments on behalf of the group. Responsibility for distributing proceeds appropriately within the group rests with the entity appointed by the group. Insurers in affiliated groups will be required to assign rights to be paid amounts due to or to become due from Treasury to the single designated entity, and failure to execute such assignments may be grounds for Treasury to withhold full or partial payments.

Audit & Records Retentions Requirements. The Treasury is to have access to all pertinent books, documents, papers and records of an insurer. Insurers are required to retain such records as are necessary to fully disclose to Treasury all material pertinent to insured losses and the Federal share of compensation. Specifically, insurers are instructed to retain detailed records for not less than five (5) years from the termination dates of all reinsurance agreements involving commercial property and casualty insurance subject to the Act. Records relating to direct earned premiums are to be retained for a least three (3) years

following the conclusion of the policy year. Records relating to underlying claims are to be retained for not less than five (5) years following the final adjustment of the claim.

Ineligibility for Federal Share of Compensation. Insurers will be ineligible to receive federal payments if they: (1) intentionally conceal or misrepresent any material fact or circumstance; (2) engage in fraudulent conduct; or (3) make false statements relating to participation under the Act.