

FROM: Director, Worldwide Markets
LOCATION: G12
EXTENSION: 6677
DATE: 6 July 2004
REFERENCE: Y3352
SUBJECT: U.S. TERRORISM RISK INSURANCE ACT 2002:
FINAL RULE ON CLAIMS PROCEDURES

SUBJECT AREA(S): Procedures for filing claims for payment of the federal share of compensation under the Program
ATTACHMENTS: No attachments
ACTION POINTS: Underwriters and managing agents to note the changes made to the Proposed Rule, issued December 1, 2003 and that the Final Rule will take effect on July 29, 2004.

DEADLINE: July 29, 2004

Purpose of this communication

To inform the market that the US Treasury Department has published its Final Rule on claims procedures under the Terrorism Risk Insurance Act of 2002 (“TRIA”), which will take effect on July 29, 2004 and to summarise the major changes to the Proposed Rule issued December 1, 2003.

See Lloyd’s bulletin Y3215 issued on the 17 December 2003 for details of the Proposed Rule.

The Final Rule

The Final Rule may be found on the US Treasury website at:

[Final Rule - Claims Procedures - June 29, 2004](#)

This rule will become effective on July 29, 2004.

Response to Lloyd's Comments

Changes were made to the Notice of Proposed Rulemaking ("NPRM") in response to public comments, including those of Lloyd's. The following comments are taken from advice received from LeBoeuf, Lamb, Greene & MacRae LLP:

i) *Advance Payments.*

The NPRM proposed that Treasury would pay the Federal share of compensation only *after* the insurer had made payment to the insured. No provision was made for advance payments. Lloyd's expressed concern that such an approach could cause liquidity issues for the insurer. Treasury accommodated Lloyd's concern by permitting insurers to certify that "the insurer had paid *or is prepared to pay* an underlying insured loss. . ." (emphasis added).

However, Insurers are required to certify that, when they receive advance payments from the government, they will remit them to policyholders within five days of receipt and any interest earned on the funds will be returned to Treasury. Furthermore, insurers seeking advance payments are required to establish a segregated, interest-bearing account for the receipt and disbursement of the advances.¹

ii) *Prompt Payment.*

Lloyd's asked Treasury to provide further clarification of the requirement that Treasury "promptly" pay to an insurer the Federal share of compensation, and suggested that Treasury give itself the same 45-day time limit that is placed on insurers with respect to refunding overpayments. Although Treasury declined to adopt the suggested 45 day deadline, the preamble to the Final Rule does state that "Treasury intends to pay the Federal share of compensation due insurers as promptly as possible. . .". Treasury also cites the use of electronic funds transfer, which it says will also help to facility prompt payments.

iii) *Loss Certifications.*

The NPRM proposed that Initial Loss Certifications must include certification that "the insurer has complied with the disclosure requirements. . . for each underlying loss that is included in the amount of the insurer's aggregate losses." Lloyd's argued that the use of the word "each" in this sentence might be interpreted to mean that disclosure certifications must be specific to particular losses. This could conflict with other parts of the rule that require insurers to demonstrate compliance with the policyholder notice requirements "through use of appropriate systems and normal business practices that demonstrate a practice of compliance" (*i.e.*, failure to deliver notice to a single policyholder is not necessarily fatal).

Treasury declined to make a change in the rule, but in the preamble characterized the compliance requirement to mean that "for each underlying loss an insurer would be able

¹ All payments will be made via electronic funds transfer through the Automated Clearinghouse (ACH) network.

to demonstrate it had made an individual disclosure because it had a reliable system in its normal business practice that generated disclosures."

iv) ***Affiliated Groups.***

The NPRM had proposed to require that all insurers within an affiliated group must designate a single entity within the group to receive Federal payments and that all insurers in the group must assign their rights to be paid under TRIA to that single designated entity. Lloyd's opposed the assignment of payment rights provision, arguing that it inappropriately shifted the statutory rights of insurers in the group and could call the solvency position of insurers in the group into question.

Treasury has deleted the requirement that affiliated insurers assign their rights to be paid under TRIA to a single insurance entity within the affiliated group. Although the Final Rule does not expressly dictate that the single entity act in a fiduciary capacity for other insurers in the group, it does expressly require that "[t]he designated insurer receiving payment from Treasury must distribute payment to affiliated insurers in a manner that ensures that each insurer in the affiliated group is compensated for its share of insured losses, taking into account a reasonable and fair allocation of the group deductible among affiliated insurers." In making this change, Treasury acknowledged that the NPRM approach was "overly restrictive" and that "different mechanisms may be used among affiliate groups to assure proper distribution of the Federal share of compensation."

v) ***Salvage and Subrogation.***

Lloyd's requested clarification of Treasury's stated expectation in the NPRM that "as normal good business practice, insurers will pursue salvage and subrogation." Lloyd's concern was that the cost of such recoveries may at times outweigh the benefits, thus making such recoveries contrary to sound business practices. Lloyd's noted that, while Treasury's use of the term "normal good business practice" might arguably permit the insurer discretion to determine when sound business judgment would dictate foregoing or abandoning salvage or subrogation, it would be helpful for Treasury to state this expressly. Although Treasury declined to do this in the text of the final regulation, it did state in the preamble that "normal business practice requires the use of discretion in determining salvage and/or subrogation efforts" and expects insurers "to use the appropriate discretion . . ."

Lloyd's also sought clarification on whether the costs of pursuing salvage and/or subrogation are included as part of an "insured loss" under the program. Treasury concurred with the Lloyd's that insurers should be able to recover such costs. However, rather than stating this explicitly in the rule, Treasury noted in the preamble that salvage and subrogation costs are properly included in Allocated Loss Adjustment Expenses (ALAE), which are included within the definition of "insured loss."

vi) ***Insurer Insolvency.***

Lloyd's asked Treasury to incorporate an "insolvency clause" into its procedures. The Final Rule does not address this issue, but the preamble notes that comments "concerning insurer insolvency...[are] secondary issues that Treasury intends to address through guidance or supplementary rulemaking."

Summary of other changes

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

i) *Suspension of Payments.*

The NPRM provided that an insurer may be ineligible to receive Federal payment if it intentionally concealed or misrepresented facts, engaged in fraud, or made false statements. The Final Rule deletes this section because Treasury has determined it has broad authority elsewhere in the statute to deny or suspend payment and to assess civil monetary penalties. Treasury has, however, added a new provision that gives Treasury the discretion to suspend payments to an insurer for all of that insurer's insured losses, on the reasoning that "failure to meet the requirements for payment of the Federal share of compensation with respect to one insured loss may be an indication of a broader pattern or practice of malfeasance or wrongdoing on the part of the insurer [.]"

ii) *Compensation from Other Federal Programs.*

Treasury made several changes with respect to the requirement that compensation from other Federal programs reduce the Federal share of compensation under TRIA. First, it gives examples of the types of Federal compensation that would reduce the Federal share (*i.e.*, only compensation "provided by Federal programs established for the purpose of compensating persons for losses in the event of emergencies, disasters, acts of terrorism, or similar events.") The Final Rule specifically excludes from the scope of this requirement Federal entitlement benefits such as Social Security, veterans benefits, and railroad retirement benefits.

Furthermore, noting that compensation by other Federal programs are often offset in the insurance claim to the insurer, Treasury clarified the Final Rule to reduce the Federal share of compensation only "to the extent such other compensation duplicates the insurance indemnification for those insured losses."

The requirement that insurers exercise due diligence at the time of claims settlement in ascertaining when policyholders receive payments from other sources was also modified. The Final Rule requires that insurers must inquire not only whether payments from other sources have been received, but also "whether it [the policyholder/claimant] expects to receive or is entitled to receive compensation from another Federal program for the insured loss. . ." Although Federal payments will be reduced by the amount of other Federal payments received, they will not be reduced by the amount of other Federal payments expected but not yet received.

iii) *XPLs and ECOs.*

Treasury made clear in the Final Rule that payments in excess of policy limits (XPLs) and payments made by insurers due to Extra-Contractual Obligations (ECOs) are not included within the definition of insured loss and thus are not compensable under the TRIA program. The Final Rule also states explicitly that the program will not compensate for punitive damages.

iv) *Allocated Loss Adjustment Expenses (ALAEs).*

The Final Rule clarifies that "staff salaries, overhead and other insurer expenses that would have been incurred notwithstanding the insured loss" are not included with ALAEs that fall within the definition of "insured loss."

Further Information

If you have any questions on the contents of this market bulletin please contact:

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