

MEMORANDUM

**TO:** Terrorism Insurance Group Clients and Friends  
**FROM:** Terrorism Insurance Group  
**RE:** Latest Treasury Interim Guidance  
**DATE:** January 8, 2003

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On December 26, 2002 the U.S. Department of the Treasury published further interim guidance for the Terrorism Risk Insurance Act of 2002 (“TRIA”).<sup>1</sup> The interim guidance concerns the scope of insurance covered by the Terrorism Risk Insurance Program (“the TRIA Program”) established under the new law, including how the TRIA Program applies to certain captives and other self-insurance arrangements, alien surplus line carriers, insurers approved by federal agencies, state residual market and workers’ compensation funds and newly formed insurers. In addition, the guidance assists participating insurers in estimating their “insurer deductible,” based on how they report their “direct earned premium.” The interim guidance also gives additional information concerning required policyholder disclosures under TRIA.

The following are selected highlights of the December 26 interim guidance:

**Insurer Participation**

**Captives and Self-insurance Arrangements**

Treasury has taken the position that any entity licensed or admitted to engage in the business of providing primary or excess insurance in any state that receives or reports direct earned premiums for commercial property and casualty insurance coverage covered by TRIA (or reports comparable information to its licensing or admitting state) will be considered to be an “insurer” subject to TRIA, even if the entity is also a self-insured or captive arrangement. Such entities are required to participate in the TRIA Program. If, however, a captive or risk retention group is licensed or admitted by a state, but does not collect direct earned premiums for commercial property and casualty insurance covered by TRIA, such an entity is not considered an “insurer” covered by TRIA. For the time being, it appears that Treasury would not consider such entities

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<sup>1</sup> 67 Fed. Reg. 78864 (December 26, 2002). The December 26 interim guidance constitutes the second interim guidance document issued by Treasury to date. The first interim guidance document was published in the Federal Register at 67 Fed. Reg. 76206 (December 11, 2002).

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eligible to participate in the TRIA Program, although the agency has discretion under TRIA to include them in the Program and says that it may address this issue in future regulations.

### **Affiliates**

TRIA section 102(6) establishes a number of criteria that an entity must satisfy to be considered an “insurer” subject to TRIA. Treasury states that an affiliate of an entity that qualifies as an “insurer” will be considered “insurer” only if the affiliate *itself* meets all of the requirements to qualify as an “insurer.” Treasury further clarifies that if a parent company meets the definition of an “insurer” and one or more of its affiliates also meets the definition, the parent company together with all of the affiliates that qualify as “insurers” will be treated as a single “insurer” for purposes of the TRIA Program. If two affiliates each met the definition of “insurer” but their parent company does not, Treasury would consider the two affiliates to constitute a single “insurer” for purposes of the TRIA Program. The parent company would not be considered an “insurer” and would not be included in the TRIA Program.

### **Reinsurance**

Treasury clarifies that reinsurance is not included in the TRIA Program because reinsurers do not receive “direct earned premiums.”

### **State Residual Insurance Market and Workers’ Compensation Funds**

Treasury, in consultation with the NAIC, has developed a list of state residual insurance market and workers’ compensation funds that are considered to qualify as “insurers” for purposes of TRIA and are required to participate in the TRIA Program. The list is attached to the December 26 interim guidance. Treasury encourages any state residual market entity or workers’ compensation fund that is not on the list to notify the agency.

Treasury is working with the NAIC on a methodology to address a data reporting anomaly that arises when insurers act as servicing carriers for residual market mechanisms. Such insurers are being given a waiver from the disclosure requirements under section 103(b)(2) of TRIA until Treasury issues regulations addressing this issue.

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### **Determination of Deductible**

#### **State Licensed and Admitted Insurers**

Deductibles for State licensed and admitted insurers are calculated by multiplying the appropriate percentage (i.e. 7% in year 1) by the direct earned premium that the insurer reports on Statutory Page 14 (or as comparably reported by the insurer to its licensing or admitting State).

#### **Surplus Lines Carriers**

Eligible surplus lines carriers may use the premium base that corresponds to losses within the geographic scope of an "insured loss" under TRIA, within the lines of the property and casualty insurance previously describe by Treasury as included in the TRIA Program in its interim guidance published on December 11, 2002<sup>2</sup>, and with reference to premium information collected using a format consistent with Treasury's previous guidance for entities that report to the NAIC (i.e., direct earned premium information reported on Statutory Page 14). In calculating the deductible for TRIA Program Year 1, prior to the issuance of regulations implementing TRIA, eligible surplus line carriers may use and rely on the same allocation methodologies contained within the NAIC's "Allocation of Surplus Lines and Independently Procured Insurance Premium Tax on Multi-State Risks Model Regulation" for allocating premium between coverage within the geographic scope of "insured loss" and all other coverage to estimate the appropriate percentage of premium income for such policies that applies to such risks.

#### **Newly Formed Insurers**

Because new companies have only had limited business operations, it is likely that their premium income will be somewhat volatile. Such volatility could persist throughout the life of the three-year TRIA Program. Treasury intends to propose that the deductible measure for new companies formed after the date on which TRIA was enacted (November 26, 2002) will be based on contemporaneous data for direct earned premium that corresponds to the current TRIA Program Year. If a newly formed insurer does not have a full year of operations within a particular TRIA Program year, Treasury intends to propose that the insurer's direct earned premium for Program year will be annualized to determine an insurer's deductible.

### **Additional Disclosure Guidance**

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<sup>2</sup> 67 Fed. Reg. 76206 (Dec. 11, 2002).

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Insurers do not have to follow the NAIC Model Disclosure Forms exactly. The NAIC's Model Disclosure Forms reflect key information regarding the TRIA Program that is required to be disclosed to policyholders as a condition for Federal payment, such as Federal participation in the TRIA Program and any premium that is being charged by the insurer for "insured losses." However, insurers may decide to modify the model forms to fit individual circumstances. For example, if an insurer is providing disclosures under Section 103(b) and there is no change in the premium, the signature line on the model form may be unnecessary. In addition, in complying with the disclosure requirements, an insurer may communicate the price to a policyholder in a manner that is consistent with standard business practice—for example, as percentage of overall policy premium.

Treasury intends to propose regulations that will indicate that compliance with the disclosure provisions may be evidenced by an insurer in a variety of ways, including but not limited to, a proof of mailing process, certificates of mailing, returned forms signed by the policyholders, and other methods consistent with the normal forms of communication with policyholders that demonstrate that the disclosures have been provided.