

**SCHWARTZ & BALLEN LLP**

1990 M STREET, N.W. · SUITE 500  
WASHINGTON, DC 20036-3465

(202) 776-0700

FACSIMILE  
(202) 776-0720

www.schwartzandballen.com

**MEMORANDUM**

July 10, 2003

To Our Clients and Friends

Re: Treasury's Final Rule: Terrorism Risk Insurance Act of 2002

The Terrorism Risk Insurance Act of 2002 ("Act") establishes a temporary Terrorism Risk Insurance Program ("Program") under which the federal government will share the risk of insured loss from certified acts of terrorism with commercial property and casualty insurers until December 31, 2005. The Treasury Department ("Treasury") has issued a final rule that implements the Program.

While the final rule is very similar to the interim final rule that Treasury issued last February, Treasury has clarified certain definitions. The rule is effective upon its publication in the *Federal Register*.

Under the Act, each entity that meets the definition of "insurer" must participate in the Program. Insurers must make available terrorism risk insurance in their commercial property and casualty insurance policies until December 31, 2004, and the coverage must not differ materially from the terms, amounts and other coverage limitations applicable to commercial property and casualty losses arising from events other than acts of terrorism.<sup>1</sup> An insurer's deductible increases each year of the Program and is based on "direct earned premiums" over a statutory transition period and the three Program years. Once an insurer has met its deductible, the federal payments cover 90 percent of insured losses above the deductible, subject to an aggregate annual cap of \$100 billion.

**WHAT IS AN ACT OF TERRORISM?**

An "act of terrorism" is any act that is certified by the Treasury Secretary ("Secretary"), in concurrence with the Secretary of State and the Attorney General, to be an act that is violent or dangerous to human life, property, or infrastructure and to have resulted in damage within the United States, or outside of the United States (in the case of an air carrier, a United States flag vessel or the premises of a United

---

<sup>1</sup> The Treasury may extend the requirement for an additional year based upon its analysis of factors specified in the Act.

## SCHWARTZ & BALLEN LLP

States mission), and to have been committed by a person acting on behalf of any foreign person or interest as part of an effort to coerce the U.S. civilian population or to influence the policy or affect the conduct of the U.S. government by coercion.

Acts of domestic civilian disturbance are not acts of terrorism, nor are acts committed as part of a war declared by Congress. An act of terrorism must meet a \$5 million *de minimis* aggregate loss before it can be certified as an act of terrorism. The Secretary's determination or certification of an act of terrorism is final and not subject to judicial review.

### **WHAT ENTITIES MUST PARTICIPATE IN THE PROGRAM?**

Each entity that meets the definition of "insurer" (as well as its affiliates) must participate in the Program. To be considered an insurer, a company must:

- fall within one of the following categories:
  - licensed or admitted to engage in the business of providing primary or excess insurance in any state (including, but not limited to, state licensed captive insurance companies, state licensed or admitted risk retention groups, and state licensed or admitted farm and county mutuals)<sup>2</sup>;
  - not licensed or admitted, but is an eligible surplus line carrier;
  - approved for the purpose of offering property and casualty insurance by a federal agency in connection with maritime, energy or aviation activity;
  - a state residual market insurance entity or state workers' compensation fund; or
  - as determined by the Secretary, any other class or type of captive insurer or other self-insurance arrangement by a municipality or other entity.
- receive "direct earned premiums" on any type of commercial property and casualty insurance; and
- meet any other criteria that the Secretary may reasonably prescribe.<sup>3</sup>

The Treasury will treat a parent company and all affiliates that meet the requirements of "insurer" as one insurer for purposes of calculating the direct earned premiums on which the insurer deductible is based. An "affiliate" means any entity that controls, is controlled by or is under common control with the insurer. A company controls an insurer if it controls 25 percent or more of the voting securities of the insurer, controls the election of a majority of the directors of the insurer or, after notice and opportunity for a hearing, is determined to exercise a controlling influence

---

<sup>2</sup> Joint underwriting associations, pooling arrangements or other similar entities are also included provided that they are 1) licensed or admitted to engage in the business of providing primary or excess insurance that is administered by the state's insurance regulator; 2) generally subject to state insurance regulation, including financial reporting requirements, applicable to insurance companies within the state; and 3) managed independently from other insurers participating in the Program.

<sup>3</sup> There are no additional criteria defined in the final rule.

## SCHWARTZ & BALLEN LLP

over the insurer. The rule describes specific conditions under which Treasury will presume control exists until rebutted by the insurer. The rule gives insurers an opportunity to request an informal hearing in which an insurer may seek to rebut a presumption of controlling influence or request a determination from Treasury as to whether a controlling influence exists.

### **WHAT IS THE SCOPE OF INSURANCE COVERAGE UNDER THE PROGRAM?**

An “insured loss” is covered under the Program if it is a loss resulting from a certified act of terrorism covered by primary or excess property and casualty insurance that is issued by an insurer.

“Property and casualty insurance” means commercial lines of property and casualty insurance. The rule states that specific lines of property and casualty insurance that are reported on the NAIC Annual Statement of the Exhibit of Premiums and Losses (“Statutory Page 14”) are the commercial lines of property and casualty insurance included in the Program. These lines include excess insurance, workers’ compensation insurance and surety insurance. They do not include federal crop insurance, private mortgage insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, reinsurance or fidelity insurance.

“Direct earned premiums” are direct earned premiums received by an insurer for commercial property and casualty insurance issued by an insurer for insurance against insured losses under the Program. Premiums for personal property and casualty insurance coverage are excluded. Insurers should use the premium information reported on Statutory Page 14 for the lines of commercial and property insurance covered by the Program to calculate direct earned premiums. Insurers that do not report on Statutory Page 14 should use it as a guideline in determining their direct earned premiums.

An “insurer deductible” is the value of an insurer’s direct earned premiums for a particular calendar year over the preceding calendar year multiplied by a specified factor as follows:

- January 1 through December 31, 2003, the value of an insurer’s direct earned premiums over calendar 2002, multiplied by 7 percent;
- January 1 through December 31, 2004, the value of an insurer’s direct earned premiums over calendar 2003, multiplied by 10 percent;
- January 1 through December 31, 2005, the value of an insurer’s direct earned premiums over calendar 2004, multiplied by 15 percent.

Additional rules on other aspects of the Program are to be issued in the future.

The final rule can be found at [www.schwartzandballen.com/WhatsNew.htm](http://www.schwartzandballen.com/WhatsNew.htm).