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**MEMORANDUM**

March 4, 2003

To Our Clients and Friends

Re: Treasury's Interim 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 an interim final rule that defines the purposes and scope of the Act and key terms that Treasury will use in implementing the Program, and a proposed rule that requests comments on certain aspects of the definitions contained in the interim rule. Additional rules are expected to be issued in the future.

This interim final rule, which was effective February 28th, generally incorporates the three notices of interim guidance the Treasury had previously issued.<sup>1</sup> Written comments on both the interim and proposed rules are due by March 31.

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>2</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.

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<sup>1</sup> Prior Treasury releases can be found at 67 Fed. Reg. 76206 (December 11, 2002); 67 Fed. Reg. 78864 (December 26, 2002); and 68 Fed. Reg. 4544 (January 29, 2003).

<sup>2</sup> The Treasury may extend the make available requirement for an additional year based upon its analysis of factors specified in the Act.

## 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 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. 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;
  - 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 (Reinsurance is excluded from the Program); and
- meet any other criteria that the Secretary may reasonably prescribe.<sup>3</sup>

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<sup>3</sup> Currently, there are no additional criteria defined but in the proposed rule the Treasury is requesting comment on 1) appropriate criteria to prevent participation in the Program by newly formed insurance companies deemed by Treasury to be established for the purpose of evading the insurer deductible requirements of the Act; 2) appropriate additional criteria, including financial standards, that should be proposed for federally approved insurers as there are no uniform requirements for federal approval under various federal programs; and 3) appropriate criteria to ensure that payments under the Program do not benefit entities with connections to terrorist organizations.

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An “affiliate” means any entity that controls, is controlled by or is under common control with the insurer. The interim rule contains specific language as to what constitutes “control.” An affiliate must meet all the definitions of an insurer to participate in the program. The Treasury will treat the 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 in the Program is based.

### **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. It includes excess insurance, workers compensation insurance and surety insurance. It does not include federal crop insurance, private mortgage insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance and reinsurance. As guidance in determining what are commercial lines of property and casualty insurance, the rule states that property and casualty insurance that is reported on the NAIC Annual Statement of the Exhibit of Premiums and Losses (“Statutory Page 14”) are covered by the Program.

“Direct earned premiums” are direct earned premiums received by an insurer for commercial property and casualty insurance issued by any 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, with adjustments to remove any personal insurance coverage. 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:

- Program Year 1 (January 1, 2003 through December 31, 2003), the value of an insurer’s direct earned premiums over calendar 2002, multiplied by 7 percent;
- Program Year 2 (January 1, 2004 through December 31, 2004), the value of an insurer’s direct earned premiums over calendar 2003, multiplied by 10 percent;
- Program Year 3 (January 1, 2005 through December 31, 2005), the value of an insurer’s direct earned premiums over calendar 2004, multiplied by 15 percent.

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The Federal Register notice can be found at [www.schwartzandballen.com/WhatsNew.htm](http://www.schwartzandballen.com/WhatsNew.htm).

If you have any questions concerning this rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.