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**M E M O R A N D U M**

December 10, 2003

To Our Clients and Friends

Re: Terror Risk Insurance Program – Proposed Rule

The Treasury Department has issued a proposed rule as part of its implementation of the Terrorism Risk Insurance Program (the “Program”) established by the Terrorism Risk Insurance Act (the “Act”).<sup>1</sup> The proposed rule establishes procedures for insurers to follow in obtaining payment of the federal share of compensation for insured losses from a terrorist event. The proposed rule addresses requirements for loss certification, provides guidance on what is payable as the federal share of insured losses and sets forth requirements for investigating and auditing claims under the Program. The rule is modeled on customary business practices and procedures of the reinsurance industry. Comments are due by December 31.

**FEDERAL SHARE OF COMPENSATION**

The federal share of compensation payable to an insurer under the Program (the “Federal Share”) is 90 percent of that portion of the insurer’s insured losses that exceed its insurer deductible during a Program Year subject to specified adjustments and the Act’s cap of \$100 billion. The proposed rule provides that:

- aggregate insured losses shall be reduced by amounts recovered by insurers for salvage and subrogation;

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<sup>1</sup> The Terrorism Risk Insurance Act of 2002 establishes the Terrorism Risk Insurance 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. See our website for memoranda dated March 4, 2003, July 10, 2003 and October 15, 2003 that describe the Act and other implementing rules.

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- the sum of the Federal Share and the insurer's recoveries for insured losses from other sources shall not be greater than the insurer's aggregate amount of insured losses for acts of terrorism in that Program Year, and any amounts recovered in excess of the insured loss must be returned to Treasury; and
- the Federal Share shall be reduced by any amounts received by the insurer or an insured or a third party suffering the underlying loss from any other federal programs as compensation for those insured losses.

The proposed rule also modifies the definition of "insured loss" by including loss adjustment expenses incurred by an insurer in connection with insured losses that are allocated and identified by claim file in insurer records but excluding punitive or exemplary damages awarded or paid in connection with the federal cause of action, damages in excess of policy limits and extra contractual damages awarded, or obligations paid by an insurer.

### INFORMATION GATHERING

- *Initial Notice* – When an insurer obtains information indicating its insured losses will exceed 50% of its insurer deductible, the insurer is to submit to Treasury, on a form to be prescribed by Treasury, estimates of aggregated losses for the Program Year, its insurer deductible and the Federal Share of aggregate losses. For an affiliate group, the notice must include the designation of a single insurance entity to act for the group in all certification and payment matters.
- *Loss Reporting* – When insured losses first exceed the insurer's deductible, the insurer is to file an Initial Certification of Loss on a form to be prescribed by Treasury. The insurer is to identify insured losses by Program Year, by industry catastrophe code and by line of business as well as certain additional information and certifications regarding the claim.<sup>2</sup>

If an insurer sustains ongoing, additional insured losses, periodic Supplementary Certifications of Loss, on a form to be prescribed by Treasury, must be submitted.

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<sup>2</sup> This summary report of loss data is referred to in the proposed rule as a "bordereau." A "bordereau" is used within the reinsurance industry to track insured losses and otherwise establish the reinsurer's obligation to pay under a reinsurance agreement.

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### PAYMENT OF THE FEDERAL SHARE

- *Payment* – Treasury is proposing that it will promptly provide payment upon receipt of the required documentation. If payments are made before the total amount of loss is known, adjustments will be made to future payments or in the case of overpayments, the insurer is to repay Treasury within 45 days of the reporting of the overpayment.
- *Audits and Records* – The proposed rule requires insurers to retain all records and files pertaining to the handling and settlement of claims for subsequent financial and claims audits. Insurer records should be retained for a minimum of three years following the conclusion of the policy year for premium information and for a minimum of five years following the final adjustment of each individual claim.
- *Fraud and Civil Penalties* – Treasury may deny eligibility for payment of the Federal Share should an insurer intentionally conceal or misrepresent any material fact or circumstance, engage in fraudulent conduct or make false statements relating to participation under the Act or regulations. In addition, fines, civil penalties and imprisonment under applicable federal laws may also apply.

The proposed rule can be found at [http://www.schwartzandballen.com/whats\\_new.html](http://www.schwartzandballen.com/whats_new.html).

If you have any questions concerning the Terrorism Risk Insurance Act, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.