



MEMORANDUM

TO: Clients and Friends

FROM: Robert H. Myers, Jr. and Joseph T. Holahan

DATE: December 2, 2003

SUBJECT: Proposed Claims Procedures for the Terrorism Risk Insurance Act of 2002

The Department of the Treasury (Treasury) recently published a proposed rule establishing procedures for submitting claims for federal reimbursement under the Terrorism Risk Insurance Act of 2002 (TRIA).¹ Comments on the proposed TRIA claims procedures must be submitted to Treasury by December 31, 2003. A copy of the proposed rule is available by [clicking here](#).

The proposed rule establishes procedures for reporting insured losses to Treasury to obtain federal reimbursement and sets forth related record keeping requirements. In addition, the proposed rule clarifies what losses are payable by Treasury and addresses Treasury's authority to investigate and audit claims. Finally, the proposed rule specifies Treasury's authority to deny compensation to an insurer found to have engaged in fraudulent or other wrongful conduct in connection with TRIA.

Scope of Federal Reinsurance

Under TRIA, insurers are eligible for federal reinsurance covering 90 percent of any "insured loss" arising from a certified act of terrorism above a deductible calculated as a percentage of the insurer's direct earned premiums, subject to a market-wide cap of \$100 billion. The proposed rule defines an "insured loss" to include loss adjustment expenses allocable to the underlying loss. The proposed rule does not include losses in excess of policy limits (XPL) as insured losses, although Treasury invites comment on whether such losses should be reimbursed. In addition, the proposed rule does not include compensation for punitive or exemplary damages as insured losses, since TRIA expressly excludes such losses from federal compensation.

¹ 68 Fed. Reg. 67100 (Dec. 1, 2003).

The proposed rule establishes certain adjustments that must be made in calculating insured losses eligible for federal compensation. First, insured losses are to be reduced by amounts recovered through salvage and subrogation. Treasury states that it expects insurers will pursue salvage and subrogation as a matter of good business practice. It appears that an insurer's failure to pursue reasonable salvage or subrogation could be a basis for denying or reducing federal compensation. Second, insured losses are to be reduced by any duplicate amount of compensation provided by the federal government through programs other than TRIA.

The proposed rule also provides that if the amount of an insurer's compensation under TRIA and the amount of its recoveries from other sources, such as private reinsurance, exceed its aggregate insured losses in any year, the excess recovery must be returned to Treasury. The calculation of such excess recovery, however, does not include recoveries from a reinsurer under an agreement stipulating that the insurer's obligation to repay the reinsurer takes priority over its obligation to repay Treasury.

Reporting Insured Losses to Treasury

The proposed rule provides that an insurer seeking federal compensation must submit an Initial Notice to Treasury when has information that its insured losses will exceed 50 percent of its TRIA deductible. The Initial Notice must include an estimate of the insurer's aggregate losses for the year, its deductible, and the federal share of aggregate losses. In addition, it must identify the person who will make the certifications required by TRIA for federal payment and, if the insurer is part of an affiliated group, designate a single entity to coordinate submissions to Treasury on behalf of the group. Treasury intends to develop a form for the Initial Notice.

The proposed rule requires an insurer to submit an Initial Certification of Loss when its insured losses first exceed its TRIA deductible. If the insurer sustains ongoing, additional insured losses, it will be required to submit periodic Supplementary Certifications of Loss. Treasury intends to develop forms for these certifications.

The proposed rule also requires insurers seeking federal compensation to provide Treasury with a bordereau that identifies insured losses by year, industry catastrophe code, and line of business. Treasury intends to issue operating procedures and a prescribed format for the bordereau. For each underlying claim, Treasury expects to require submission of information typical of a claim for reinsurance, such as claim number, insured name, state code for the location of the loss, date of loss, policy effective date, length of the policy term, policy limits, amount of loss, allocated loss adjustment expenses, amounts reserved for those expenses, and recoveries from salvage and subrogation.

In addition, Treasury will require insurers to state whether an underlying claim could or does have other reinsurance; report total reinsurance recoveries from other sources; and report amounts paid for punitive or exemplary damages, which are excluded from federal reimbursement. Finally, Treasury will require insurers to inquire of each claimant whether the claimant has received any duplicate recovery from any federal source and report any such amount, since duplicate federal recoveries are excluded from compensation.

Certifications

The proposed rule addresses the various certifications that insurers are required to make under TRIA. Insurers submitting a claim for insured losses will be required to certify compliance with TRIA's "clear and conspicuous" policyholder disclosure requirements regarding the premium charged for insured losses and the federal share of compensation. Insurers submitting claims to Treasury also will be required to certify compliance with TRIA's "make available" requirement. In addition, insurers will be required to certify the amount of their direct earned premiums and the calculation of their TRIA deductible.

Payment Process

The proposed rule provides that Treasury "will promptly pay" the federal share of compensation due to an insurer for its insured losses, although it establishes no set schedule for payment. The proposed rule further provides that payment may be made in installments and on conditions determined by Treasury to be appropriate. If Treasury makes any payments before an insurer's total amount of insured losses is known, the payments will be subject to adjustment based on any overpayment or underpayment. Overpayments are to be offset against future payments or returned to Treasury "within 45 days". In the case of an affiliated group of insurers, payment will be made to a single insurance entity designated by the group.

The proposed rule establishes a number of conditions for federal payment keyed to the various requirements of TRIA and the claims submission procedures established by Treasury, including a determination by Treasury that the insurer "took all steps reasonably necessary to properly and carefully investigate the underlying insured loss and otherwise processed the underlying loss using appropriate business practices".

Record Keeping and Audit

The proposed rule states that Treasury, or its “authorized representative”, has authority to audit all records of an insurer pertinent to amounts paid for federal compensation under TRIA.

For purposes of regulatory audit, the proposed rule requires insurers to retain all “such records as are necessary to fully disclose all material matters pertinent to insured losses and the Federal share of compensation sought under the [Terrorism Risk Insurance] Program, including, but not limited to, records regarding premiums and insured losses for all commercial property and casualty insurance issued by the insurer and information relating to any adjustment in the amount of the Federal share of compensation payable.” Treasury states in the preamble that insurers are required to retain “all records and files pertaining to the handling and settlement of claims, including electronic documents and data....” The scope of these record keeping requirements may need to be clarified by Treasury.

The proposed rule provides that insurers are required to maintain “detailed records” for not less than five years following termination of all reinsurance agreements involving commercial property and casualty insurance subject to TRIA. Records relating to premiums must be retained for at least three years following the conclusion of the policy year. Records relating to underlying claims must be retained for at least 5 years following the final adjustment of the claim.

Fraud and Penalties

The proposed rule allows Treasury to deny federal compensation for a claim if an insurer intentionally conceals or misrepresents any material fact or circumstance, engages in fraudulent conduct, or makes false statements relating to TRIA. Treasury clarifies in the preamble that civil and criminal penalties also may apply to such conduct.

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