

DEPARTMENT OF THE TREASURY

Departmental Offices

31 CFR Part 50

RIN 1505-AA98

Terrorism Risk Insurance Program

AGENCY: Departmental Offices, Treasury.

ACTION: Final rule.

SUMMARY: The Department of the Treasury (Treasury) is issuing this final rule concerning disclosures and mandatory availability requirements as part of its implementation of Title I of the Terrorism Risk Insurance Act of 2002 (Act). The final rule incorporates and clarifies conditions for federal payment, set forth in section 103(b) of the Act, that require insurers to make certain disclosures to policyholders. It also incorporates and clarifies the section 103(c) requirements that insurers “make available”

in their commercial property and casualty policies terrorism risk insurance coverage for insured losses resulting from certified acts of terrorism under the Act. Treasury issued an interim final rule and proposed rule with request for comment. This final rule, which is the second in a series of regulations that Treasury is issuing to implement the Program, adopts the interim final rule with several modifications as discussed below.

DATES: This final rule is effective [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]

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SUPPLEMENTARY INFORMATION:

I. Background

A. Terrorism Risk Insurance Act of 2002

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002 (Public Law 107-297, 116 Stat. 2322). The Act was effective

immediately. The Act's purposes are to address market disruptions, ensure the continued widespread availability and affordability of commercial property and casualty insurance for terrorism risk, and to allow for a transition period for the private markets to stabilize and build capacity while preserving State insurance regulation and consumer protections.

Title I of the Act establishes a temporary federal program of shared public and private compensation for insured commercial property and casualty losses resulting from an act of terrorism which, as defined by the Act, is certified by the Secretary of the Treasury, in concurrence with the Secretary of State and the Attorney General. The Act authorizes Treasury to administer and implement the Terrorism Risk Insurance Program, including the issuance of regulations and procedures. The Program will end on December 31, 2005.

Each entity that meets the Act's definition of "insurer" (well over 2000 firms) must participate in the Program. The amount of federal payment for an insured loss resulting from an act of terrorism is to be determined, based upon the insurance company deductibles and excess loss sharing with the Federal Government, as specified by the Act and the implementing regulations. An insurer's deductible increases each year of the Program, thereby reducing the Federal Government's involvement prior to expiration of the Program. An insurer's deductible is calculated based on the value of "direct earned premiums" collected over certain statutory periods. Once an insurer has met its individual deductible, the federal payments cover 90 percent of the insured losses above the deductible, subject to an industry-aggregate limit of \$100 billion.

The Program provides a federal reinsurance backstop for three years. The Act gives Treasury authority to recoup federal payments made under the Program through policyholder surcharges, up to a maximum annual limit. The Act also prohibits duplicative federal payments for insured losses that have been covered under any other federal program.

The mandatory availability or “make available” provisions in section 103(c) of the Act require that, for Program Year 1 and Program Year 2 and, if so determined by Treasury, in Program Year 3, all entities that meet the Act’s definition of insurer must make available, in all of their property and casualty insurance policies, coverage for insured losses resulting from an act of terrorism. This coverage can not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.

As conditions for federal payment under the Program, clear and conspicuous disclosures must be provided by insurers to the policyholders of the premium charged for insured losses covered by the Program and the federal share of compensation for insured losses under the Program. In addition, the Act requires that insurers submit a claim to Treasury for federal payment as well as certain certifications. Treasury will engage in rulemaking to prescribe claims procedures for the Program at a later date.

The Act also contains provisions designed to manage litigation arising from or relating to a certified act of terrorism. Section 107 of the Act creates an exclusive federal cause of action, provides for claims consolidation in federal court, and contains a prohibition on federal payments for punitive damages under the Program. The Act provides the United States with the right of subrogation with respect to any payment or claim paid by the United States under the Program.

1. Three Year Program

The duration of the Program is three years. The Act was signed into law on November 26, 2002 and section 108(a) of the Act provides that, “[t]he Program shall terminate on December 31, 2005.” Thereafter, the Act provides Treasury with certain continuing authority to take actions as necessary to ensure payment, recoupment, adjustments of compensation and reimbursement for insured losses arising out of any act of terrorism occurring during the period between November 26, 2002 and December 31, 2005. The duration of the Program and the Program’s termination date should *not* be confused with the make available requirements contained in section 103(c). As reflected in both the interim final and final rules, the make available requirements in section 103(c) of the Act apply to all insurers, through the end of Program Year 2. However, the Secretary of the Treasury may determine, not later than September 1, 2004, to extend the make available requirements through Program Year 3, based on factors referenced in section 108(d)(1) of the Act. Regardless of whether the make available requirements of

section 103 are extended, the Program and the Act's federal backstop for insured losses for acts of terrorism continue through December 31, 2005.

2. Program Implementation Goals

In implementing the Program, Treasury is guided by several goals. First, Treasury strives to implement the Act in a transparent and effective manner that treats comparably those insurers required to participate in the Program and provides necessary information to policyholders. Second, in accord with the Act's stated purposes, Treasury seeks to rely as much as possible on the State insurance regulatory structure. In that regard, Treasury has closely coordinated its implementation of all aspects of the Program with the National Association of Insurance Commissioners (NAIC). Third, to the extent possible within statutory constraints, Treasury seeks to allow insurers to participate in the Program in a manner consistent with procedures used in their normal course of business. Finally, given the temporary and transitional nature of the Program, Treasury is guided by the Act's goal for insurers to develop their own capacity, resources, and mechanisms for terrorism insurance coverage when the Program expires on December 31, 2005.

B. The Interim Final Rule

The interim final rule was published in the *Federal Register* at 68 FR 19302 (April 18, 2003). It added sections 50.10 through 50.14 and 50.17 through 50.19 to Subpart B, and sections 50.20, 50.21, 50.23, and 50.24 to Subpart C of Part 50 in Title

31, Code of Federal Regulations. Subpart A of Part 50, which addresses the scope and purpose of the Program, key definitions and certain general provisions, was finalized and published in the *Federal Register* at 68 FR 41250 (July 11, 2003) and subsequently revised at 68 FR 48280 (August 13, 2003). Subpart B incorporates and clarifies certain conditions for federal payment contained in section 103(b) of the Act that require insurers to make certain clear and conspicuous disclosures to their policyholders with regard to terrorism risk insurance for insured losses under the Program. Subpart C incorporates and clarifies requirements in section 103(c) of the Act that insurers “make available,” in all of their commercial property and casualty insurance policies, coverage for insured losses resulting from an act of terrorism as defined by section 102(1) of the Act. In this regard, section 103(c) requires insurers to make such terrorism risk coverage available at terms, amounts, and other coverage limitations that do not differ materially from those applicable to losses arising from events other than from acts of terrorism.

This final rule (and the preceding interim final rule) reflect earlier interim guidance, issued by Treasury in notices that were published soon after the Act’s enactment date, and were designed to assist insurers, policyholders and other interested parties in complying with immediately applicable and time-sensitive requirements.¹ In finalizing the interim final rule, Treasury carefully considered the comments submitted and consulted with the NAIC.

¹ These interim guidance notices were published in the *Federal Register* at 67 FR 76206 (Dec. 11, 2002); 67 FR 78864 (Dec. 26, 2002) and at 68 FR 4544 (Jan. 29, 2003). Treasury also issued a fourth interim guidance at 68 FR 15039 (Mar. 27, 2003), which has subsequently been superceded by a new provision in the final rule for Subpart A, published at 68 FR 41250 (July 11, 2003). The interim guidance and all regulations can also be located on Treasury’s Terrorism Risk Insurance Program website at www.treasury.gov/trip.

II. Summary of Comments and Final Rule

Treasury received 12 comments on the interim final rule. Comments were submitted by individual insurance companies and their legal counsel, by insurance and mortgage banker industry trade associations, by a coalition of trade and professional associations and by the American Academy of Actuaries. After review and careful consideration of these comments, as well as additional research and consultation with the NAIC, Treasury is now promulgating a final rule concerning the Act's disclosure and make available requirements. The final rule makes few changes to the interim final rule. Clarifications were made in several areas based on comments received. These clarifications are discussed in the summary of comments below.

A. Disclosures

1. General Disclosure Requirements (Section 50.10)

Section 103(b) of the Act requires insurers to make certain disclosures to policyholders as a condition for federal payment under the Act. The general disclosure requirements of section 50.10 of the interim final rule incorporate the Act's requirements. This section of the final rule is unchanged from the interim final rule. Section 50.10 states, in part, that an insurer must provide clear and conspicuous disclosure to the policyholder of: (1) the premium charged for insured losses covered by the Program; and

(2) the federal share of compensation for insured losses under the Program. As discussed below, the disclosure provisions are a condition for federal payment under the Act and a mechanism through which Congress sought to enhance competition and comparison shopping in the purchase of terrorism risk insurance and to increase awareness of the federal contribution to the Program.

One commenter, a mortgage banking trade association, urged Treasury to revise the interim final rule to specifically require insurers to notify lenders, securitizers, and servicers of commercial mortgages (collectively referred to in this preamble as mortgage finance providers) of the terrorism coverage options offered under the Act. The commenter also requested that the interim final rule be changed to require insurers to provide notice to these mortgage finance providers of their borrowers' acceptance or rejection of the terrorism risk insurance coverage made available by the insurer. In support of these suggested revisions, the commenter stated that mortgage finance providers are having difficulty determining "whether most of the properties in their portfolios carry adequate terrorism risk insurance as required by loan documents." The commenter also asserts that the absence of these suggested extensions to the current regulatory disclosure requirements produces inefficiencies in the commercial real estate and capital markets, including information gaps that may have an adverse effect on economic growth and on the condition of key financial institutions.

In a careful evaluation of whether the suggested revisions to the interim final rule were appropriate, Treasury first reviewed the scope of the disclosure provisions of

section 103(b) of the Act and then considered the legislative history concerning those disclosure requirements. Treasury also considered whether there were alternative ways in which these mortgage finance providers may obtain the insurance coverage information they seek from their borrowers. Treasury consulted with the NAIC concerning definitions in various state laws and typical industry business practices and standards. For the reasons discussed below, Treasury is not extending the disclosure requirement in the interim final rule as suggested by the commenter.

Section 103(b) requires that clear and conspicuous disclosure of certain information be provided by insurers to “policyholders.” The Conference Report to the Act states that Congress required the disclosures in section 103(b) in order, “to enhance the competitiveness of the marketplace by better enabling consumers to comparison shop for terrorism insurance coverage, and to make policyholders better aware that the Federal government will be sharing the costs of such coverage with insurers thereby reducing the insurers’ exposure.” H.R. Conf. Rep. No. 107-779, at 24 (2002). Neither the language in section 103(b) of the Act, nor the congressional intent of these disclosures as explained in the Conference Report, requires that these disclosures be made to mortgage finance providers or other entities that are not policyholders. Similarly, there is no third party notification requirement in the Act concerning whether a policyholder has, or has not, elected to purchase terrorism risk insurance coverage. The stated legislative intent of the disclosures is to enhance comparison shopping and Program awareness by policyholders.

For purposes of the Program, policyholder refers to the “person” to whom the insurer issues a commercial property and casualty insurance policy and who has apparent authority to negotiate, determine or modify the terms of the insurance contract. In this regard, the Act and Treasury’s regulations require insurers to disclose information about the premium and the federal share of compensation to policyholders at the time of offer, purchase, and renewal.

In its comment, the association also expressed a concern that, “under notice provisions to the mortgagee contained in existing insurance policies, a partial cancellation of coverage for terrorism (as opposed to a cancellation of the entire policy) may be deemed by the insurers as an endorsement of the policy that does not require the insurer to send notice to the mortgage lender.” Thus, the commenter is concerned that mortgage finance providers may not be notified if there is a subsequent change in the policy with regard to terrorism risk insurance. However, the commenter also acknowledges that the failure of mortgage finance providers to obtain such notice appears to be due to the drafting of notice provisions in policies.

Treasury considered whether there were other, perhaps more appropriate ways, in which mortgage finance providers could obtain the information they seek from their borrowers instead of through the expansion of the statutory disclosure requirements under this temporary Program. Treasury understands that mortgage finance providers generally may obtain the information about the status of a borrower’s coverage for terrorism risks (whether the losses are those covered by the Program or broader in scope) through their

underwriting requirements and/or by contract. For example, loan documents generally require that borrowers provide appropriate insurance coverage information to their mortgage finance providers, including information on terrorism risk insurance coverage. In its comment, the association acknowledged this, but stated that these requirements are frequently ignored by borrowers and costly to enforce. In Treasury's view, the issue appears to be one of contract negotiation, monitoring and enforcement by the parties rather than of regulation under the Program.

In this regard, we also understand that ACORD, an independent, nonprofit insurance group comprised of insurance company, reinsurance company and financial service institution affiliated members that assists in the cooperative development and implementation of insurance (and related financial services) standards, has agreed to work with mortgage finance providers to revise standard insurance certificates. The goal of this market driven effort is to better facilitate access by the mortgage finance providers to the insurance coverage information concerning terrorism risk insurance and other types of insurance coverage.

Based on our review of section 103(b) and of the legislative intent of the disclosure requirements as described in the Conference Report, and our understanding of industry practice and ongoing initiatives, as indicated by the commenter and in consultations with NAIC, Treasury is not expanding the reach of the disclosure to policyholder requirements set forth in the interim final rule.

2. Clear and conspicuous disclosure (Section 50.12)

As stated above, section 50.10 reflects the requirement in section 103(b) of the Act that the insurer must provide “clear and conspicuous disclosure” to the policyholder of the premium charged and the federal share of payments for insured losses under the Program. Section 50.12 of the interim final rule addresses the meaning of “clear and conspicuous” disclosure for purposes of the Program. Except as noted below with respect to section 50.12(d), this final rule adopts interim section 50.12 without change.

Section 50.12(a) of the interim final rule provides that whether a disclosure is clear and conspicuous depends on the totality of the facts and circumstances. Consistent with the Program implementation goals, the interim final rule does not specify an exclusive form or means of satisfying the statutory disclosure requirements, nor does it prescribe precise language, typeface, or font for the disclosures. In interim guidance issued by Treasury soon after enactment of the Act, Treasury deemed certain NAIC model forms to be an acceptable, nonexclusive way in which an insurer could satisfy the disclosure requirement. (These model forms are available at the Program’s website: www.treasury.gov/trip). Treasury stated that insurers could modify the NAIC model forms to meet individual circumstances, or use other forms, as long as the modifications met the statutory standards. This interim guidance was incorporated into the interim final rule and is now in the final rule, which also provides a safe harbor (see section 50.17). Insurers may continue to use certain NAIC model forms if appropriate or they may develop other disclosure forms that meet the requirements of the Act and the regulations.

Treasury received one comment on section 50.12(a) of the interim final rule, which was supportive of Treasury's approach. Section 50.12(a) of the interim final rule is adopted without change.

Section 50.12(b) of the interim final rule provides that, in describing the premium charged for insured losses covered by the Program, an insurer may refer to it as a portion or percentage of an annual premium, if consistent with normal business practice; but, may not describe this premium in a manner that would be misleading in the context of the Program, such as by characterizing it as a "surcharge." It is inappropriate and misleading to use the term "surcharge" in the disclosures because surcharge is a term used in section 103(e)(8) of the Act in connection with the statutorily required recoupment.

Treasury received two comments on this provision. One commenter, an association of insurance brokers and agents, strongly supported Treasury's position. This commenter believed the use of the term "surcharge" in disclosing the premium, "threatened both to undermine the ability of consumers to properly evaluate their coverage needs and to call into question the legitimacy of the Program." An insurance industry association commented that the group had "no objection" to this section in the interim final rule. Section 50.12(b) of the interim final rule is adopted without change.

Section 50.12(c) of the interim final rule allows insurers to make the required disclosures using normal business practices, including forms and methods of

communication used to communicate similar policyholder information to policyholders. The comments generally supported this approach, which is adopted without change.

Section 50.12(d) of the interim final rule provides further guidance on the use of an agent to provide the required disclosures to policyholders. The interim final rule refers to an insurance broker or other intermediary acting as agent for the insurer, if the insurer normally communicates with a policyholder in this fashion. An insurance industry association commenter suggested that, in view of the diverse treatment of the legal status of insurance brokers under the laws of the various States, unnecessary confusion may result from the use of terms such as “agent” and “broker” with varying implications in different jurisdictions. The commenter suggested that the final rule instead use the term “producer.” Treasury agrees with this suggestion, but emphasizes that if the insurer elects to make the required disclosure through a producer or other intermediary, regardless of on whose behalf the producer or other intermediary is acting, the insurer remains responsible for ensuring that the disclosures are provided by the producer or other intermediary to policyholders in accordance with the Act. Accordingly, Treasury is modifying section 50.12(d) consistent with this comment.

Section 50.12(e) of the interim final rule provides generally that an insurer may demonstrate that it has satisfied the requirement to provide clear and conspicuous disclosure through use of appropriate systems and normal business practices that demonstrate a practice of compliance. Although no comments explicitly addressed this

provision, the comments generally supported the overall approach in section 50.12. Section 50.12(e) is adopted without change.

Section 50.12(f) of the interim final rule provides that an insurer must certify that it has complied with the requirement to provide disclosure to the policyholder on all policies that form the basis for the underlying claim(s) submitted by the insurer for federal payment under the Program. One commenter believed the language of section 50.12(f) itself was clear, but stated that the corresponding discussion in the preamble to the interim final rule was not as clear and requested further clarification in the final rule.

This final rule adopts section 50.12(f) of the interim final rule without change. Section 50.12(f) requires that, on all policies that form the basis for any claim that the insurer submits for federal payment for insured losses under the Program, an insurer must certify that it has complied with requirements to make disclosures to those policyholders covered by the policies. These insured losses are used in determining whether an insurer has met its insurer deductible under the Program. If an insurer chooses not to provide disclosures on a block of policies covered by the Program, the insurer will not receive federal payment for any claims it may submit to Treasury for insured losses covered by such policies because the required disclosures - a condition for federal payment - were not made. The insurer could submit a claim for federal payment under the Program on another block of policies, as long as the insurer made the required disclosures to those policyholders, and otherwise met all other conditions for payment of those insured losses.

Treasury will initiate a future rulemaking concerning claims and certification procedures for purposes of the Program.

The following example provides further clarification of section 50.12(f). A surety insurer may satisfy the Act's make available requirement by providing terrorism risk insurance coverage under the Program to a block of notary public bond policyholders at no cost. The surety insurer may decide not to provide disclosure notices to those policyholders because it considers the expense of making the disclosures as being greater than the benefit of receiving the federal payments under the Program. Therefore, the insurer would be liable for any insured losses on the notary public bonds, but would not be eligible to receive any federal payment under the Program backstop on such losses because a condition for federal payment (making the requisite disclosures to policyholders) was not met. However, if the insurer provides the required disclosures to policyholders insured under a separate block of construction bond policies, the failure to make disclosures to the notary public bond policyholders would not prevent the insurer from certifying that it provided the required disclosure to policyholders insured under the construction bond policies for which the insurer was seeking federal payment for insured losses under the Program. The insured losses under the construction bond policies "form the basis" for a claim submitted for federal payment; the insured losses under the notary public bonds do not. Regardless of whether disclosures are provided, *direct earned premiums* on the notary public bonds *would be included* in the calculation of the insurer deductible for purposes of the Program and such notary public bond policyholders *would be subject* to any subsequent recoupment. The insurer's calculation of insured losses

under the Program for purposes of meeting its insurer deductible would include only those losses on the construction bonds.

Section 50.12(f) relates to other aspects of the Program in the following ways. First, regardless of whether an insurer intends to submit a claim for federal payment, all insurers must comply with the make available requirements of section 103(c) of the Act and in the regulations. Second, in calculating its direct earned premium and insurer deductible under the Program, an insurer must include premium income from all policies for commercial property and casualty insurance for losses occurring at certain locations (see section 50.5(d)), whether or not the insurer made the required disclosures. Third, an insurer may submit a claim for federal payment only for those “insured losses” on policies on which the insurer made required disclosures to policyholders. Finally, all commercial property and casualty insurance policies are subject to the Act’s surcharge provisions, regardless of whether the insurer made the disclosures. Accordingly, if an insurer fails to provide the disclosure notices to its policyholders, the insurer will not have met conditions for federal payment and will not be eligible for federal payment for insured losses under those policies. The insurer, however, will continue to be subject to the make available requirements, and the insurer and its policyholders will continue to be subject to the surcharge provisions under the Act and the Program.

3. *Separate line item (Section 50.14)*

Section 50.14 of the interim final rule incorporates interim guidance previously issued by Treasury that deems an insurer to be in compliance with the requirement of providing disclosure on a “separate line item in the policy” under section 50.10(d), and in compliance with section 103(b)(2)(C) of the Act, if the insurer makes the disclosure: (1) on the declarations page of the policy; (2) elsewhere within the policy itself; or (3) in any rider or endorsement that is made a part of the policy. In addition to the clear and conspicuous requirement, the Act requires that the separate line item disclosure be “in the policy.”

Rather than require insurers to rewrite all of their policies, Treasury has determined that the disclosure is sufficient if made on the declarations page or within any rider or endorsement that is made a part of the policy. One commenter suggested revising the interim final rule to clarify that other documents could be used. This commenter contended this would make it clear that compliance is not dependent on the name or title of the document, but rather on the fact that such disclosure document is made part of the policy. Treasury agrees and is amending section 50.14(c) accordingly.

B. Mandatory Availability

1. General Mandatory Availability Requirements (Sections 50.20 and 50.21)

Sections 103(c)(1)(A) and (B) of the Act require an insurer (as defined by the Act and the implementing regulations) to make available, in all of its property and casualty

insurance policies, coverage for insured losses; and to make available property and casualty insurance coverage for insured losses that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism. The make available requirements apply during the period beginning on the first day of the Transition Period and ending on the last day of Program Year 2 unless the make available requirements are extended by the Secretary through Program Year 3. The duration and possible extension of the make available requirements in section 103(c) should not be confused with the established three-year duration of the Program as provided by section 108 of the Act.

2. Policies in Existence on November 26, 2002

Section 50.21(a) of the interim final rule states, in part, that the make available requirement of the Act applies to insurance policies in existence on November 26, 2002 (the date of enactment of the Act). One commenter suggested this provision may not be technically correct. The commenter reasoned that the make available requirement applies at the time of initial offer of coverage and that for policies in existence on November 26, 2002, the initial offer of coverage had already occurred, and, further, that only section 105 (voiding of terrorism exclusions) is applicable for policies in existence at the time of enactment.

It is Treasury's view that the make available requirement applies to policies in existence on November 26, 2002. Section 103(c)(1)(A) of the Act mandates that

beginning on the first day of the Transition Period (defined in section 102(11) as of the date of enactment), an insurer shall make available coverage for insured losses in all of its property and casualty insurance policies. Section 105 of the Act, in effect, made coverage available upon enactment of the Act by voiding any exclusions within insurance policies that were in existence on November 26, 2002. Because the make available requirement and the process in section 105 of the Act for voiding terrorism risk insurance exclusions and offering coverage are generally consistent for commercial property and casualty policies in effect on November 26, 2002, Treasury has decided that no additional clarification is needed. See below for a discussion of the "initial offer of coverage" provision in the rule.

3. Initial Offer of Coverage

Section 50.21(a) of the interim final rule provides that the make available requirement also applies to new policies issued and renewals of existing policies during the period beginning on November 26, 2002 and ending on December 31, 2004 (the last day of Program Year 2) and, if the requirement is extended by the Secretary, to new policies issued and renewals of existing policies in Program Year 3 (calendar year 2005). The last line of 50.21(a) states that the “requirement applies at the time an insurer makes the initial offer of coverage.”

One commenter, an insurance trade association, proposed revising the interim final rule by adding language to the end of section 50.21 stating that the make available

requirement applies at the time an insurer makes the initial offer of coverage “*and at no other time.*” The commenter suggested this revision because of a concern that a policyholder may try to purchase terrorism risk insurance coverage during a policy period (for example, upon a heightened state of terror alert) despite having rejected an initial offer of coverage by an insurer.

In context, Treasury believes the requirement in section 50.21 (a) is clear. It is Treasury’s view that by offering the coverage at the time of initial offer, the insurer has satisfied the make available requirement. However, the commenter’s suggested change would limit the make available requirement more narrowly than intended by Treasury. This is because the initial offer of coverage is *not* the only time when the make available requirement applies. Treasury did not intend section 50.21 of the interim final rule to be read to mean that, as long as an insurer makes coverage available through an initial offer, the insurer has no further obligation to make coverage available to the policyholder during the Program’s duration (*e.g.*, at initial offer of renewal or in a new policy.) An insurer must make the coverage available, not only at the time of initial offer, but also upon offer of policy renewal.

It is Treasury’s view that an insurer need not make coverage available to a policyholder who did not accept an initial offer of coverage and later demands the coverage be added to the same policy during the policy period (*i.e.*, through endorsement). In such a situation, the policyholder is not left without options; a policyholder can cancel its policy and solicit a new offer or proposal for insurance.

Treasury is modifying section 50.21(a) to clarify the make available requirement applies at the time an insurer makes the initial offer of coverage as well as at the time an insurer makes an initial offer of renewal of an existing policy.

This insurance association commenter also suggested that Treasury consider changing the rule to eliminate the requirement that an insurer make available coverage through an initial offer. Instead, the commenter proposed that an insurer only be required to simply disclose that coverage is available for purchase and to invite policyholders to contact the insurer for an offer or quote, if desired. The commenter suggested that insurers could still make a formal offer of coverage if consistent with their normal business practice, but an offer would not be required. Treasury is not adopting this suggestion, which is inconsistent with the purposes of the statutory provisions.

4. Umbrella-Type Policies

An insurance industry trade association commenter raised several questions about the applicability of the make available requirement for insured losses through commercial property and casualty umbrella insurance. In response, Treasury emphasizes that commercial property and casualty umbrella insurance is included in the Program because it falls within the Program's definition of commercial property and casualty insurance. Therefore, an insurer that offers such umbrella insurance coverage is subject to the make available requirements.

Section 102(12) of the Act defines commercial lines of property and casualty insurance to specifically include “excess insurance.” Section 50.5(1) of the regulations further defines commercial property and casualty insurance with reference to certain lines of insurance business reported on NAIC’s Annual Statement’s Exhibit of Premiums and Losses, commonly known as Statutory Page 14. Commercial property and casualty umbrella insurance is reported on Statutory Page 14 and not otherwise excluded. Such umbrella policies are within the definition of “commercial property and casualty insurance.” If the umbrella policy issuer is an insurer under the Act, it must participate in the Program and it is subject to the Act’s requirements.

Accordingly, insurers that issue commercial property and casualty insurance through umbrella policies are subject to the make available requirements of the Program. This means that they must (1) make available in all of their commercial property and casualty insurance policies coverage for insured losses and (2) make available such coverage for insured losses that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.

The commenter also stated that some policyholders have declined insurance coverage for losses caused by an act of terrorism from their primary insurance carriers, electing instead to have such losses covered by the “drop down” coverage afforded through their (presumably less expensive) umbrella insurance policies. To prevent what the commenter characterizes as policyholder “gaming,” the commenter suggests that

“Treasury permit an umbrella insurer, in accordance with normal business practice, to refuse to drop down where the insured intentionally elected to forego primary coverage for acts of terrorism.”

Although Treasury understands that certain provisions of the Act may not fit neatly with typical business practice of umbrella policy underwriters and other insurers, Treasury has determined to not revise the interim final rule as suggested because it may create a situation that appears to excuse an insurer from fulfilling its contractual obligation to pay a policyholder’s claim for an insured loss that otherwise may be covered by the terms and conditions of a policy covered by the Program. Instead, it is Treasury’s view that the commenter’s concern is more appropriately addressed by the insurer that issues the umbrella policy, for example, through the insurer’s underwriting procedures, pricing, and/or policy drafting. Therefore, an umbrella insurer could draft policy language that excludes from “drop down” coverage any losses arising from perils for which insurance was available from the primary or underlying insurer but was intentionally not purchased by the policyholder, provided: (1) the language does not differ materially from the terms and other coverage limitations applicable to losses arising from events other than acts of terrorism and (2) the exclusion is otherwise permitted by State law.

Another commenter raised similar questions with regard to Difference-In-Conditions (DIC) commercial property and casualty insurance. DIC insurance is included within the Program definition of commercial property and casualty insurance.

DIC insurance is reported by insurers on commercial lines of Statutory Page 14 included in the Program (see section 50.5(1)). DIC insurance policies generally provide coverage for certain risks not covered by other policies. The commenter suggested that DIC commercial property and casualty insurance should not be included in the Program. The commenter contended that the Act and section 50.23 mean that all underlying commercial property and casualty policies must provide for -- and cannot exclude -- insured losses caused by an act of terrorism, and thus DIC coverage will never be triggered.

Treasury does not agree. As stated above with regard to umbrella policies, the Act requires all insurers under the Program to make available commercial property and casualty coverage for insured losses under the Program. If the issuer of a DIC commercial property and casualty insurance policy is an insurer as defined under the Program, then the DIC insurer must comply with the requirements of the Act and Treasury's implementing regulations, including those concerning the make available requirements. Insurers can exclude coverage for insured losses if the policyholder declines or elects not to purchase the coverage. If a DIC insurer's policyholder declines or elects not to purchase terrorism risk insurance coverage in an underlying policy, the Act requires that the DIC insurer must make available terrorism risk insurance for insured losses as part of the DIC policy. As with umbrella policies, Treasury recognizes that certain provisions of the Act may not fit neatly within typical business practices of DIC insurers but it is Treasury's view that the commenter's concern is more appropriately addressed through DIC underwriting procedures, pricing or policy drafting. Thus, in the

final rule, Treasury is making no change to section 50.21 to provide special treatment to DIC or umbrella insurance policies.

5. Limitations on Types of Risk (Section 50.23)

Section 103(c)(1)(B) of the Act provides that insurers under the Program “shall make available property and casualty insurance coverage for insured losses that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.” Sections 50.20 through 50.24 of the interim final rule reflect the statutory language and previously issued interim guidance. Section 50.23(b) addresses limitations on types of risk and provides that if an insurer does not cover all types of commercial property and casualty risks, then it is not required to cover the excluded risks in satisfying the make available requirements. For example, if an insurer does not cover all types of commercial property and casualty risk, either because the insurer is outside of direct State regulatory oversight, or because a State permits certain exclusions for certain types of losses, such as nuclear, biological, or chemical events, then the insurer is not required to make such coverage available. In addition, Section 50.24 addresses the applicability of State law.

A comment, submitted by a coalition of trade and professional associations expressed concern about the make available provisions in the interim final regulation. The commenter contended that the interim final rule’s deference to State law exclusions for certain types of losses is not consistent with the purposes of the Act. The commenter

also stated that the purpose of the Act was to put policyholders back to the level of coverage (or availability) that existed prior to September 11, 2001. Although acknowledging that whether a policyholder purchases terrorism risk insurance may be related to the price of the coverage, the commenter suggested that a lack of coverage for biological and chemical perils may adversely affect the policyholder's decision to purchase of terrorism risk insurance.

After carefully considering the concerns expressed by the commenter and reviewing the purposes of the Act, Treasury is not making any change in the make available requirement as set forth in the interim final rule for the following reasons. First, it is Treasury's view that the make available requirement in the interim final rule, including the deference to state law exclusions, is fully consistent with the purposes of the Act. As stated in Section 101(b), the purposes of the Act include establishment of a temporary federal Program to "allow for a transitional period for the private markets to stabilize, resume pricing of such insurance and build capacity to absorb any future losses, *while preserving State insurance regulation and consumer protections.*" In addition, other provisions of the Act, such as section 106, generally support narrow State law preemption, consistent with the McCarran Ferguson Act. Moreover, throughout the implementation process, Treasury has followed Congress's direction to consult with the NAIC, and in that regard, has relied to the greatest extent possible on the existing State regulatory structure for this temporary Program.

Second, based on information provided by the NAIC, it is Treasury's understanding that, even prior to September 11, 2001, insurers offered limited coverage for nuclear reaction or radiation or radioactive contamination, however caused, in commercial property and casualty insurance. In addition, deference to existing State law as it relates to the make available requirement does not mean that all losses associated with a nuclear, biological or chemical event would be excluded under the Program. Even with State exclusions, there may be commercial property and casualty insurance coverage in certain circumstances for certain biological, chemical or nuclear events. Moreover, the make available requirements in the interim final rule do not limit an insurer's ability to provide coverage for nuclear, biological, or chemical exposures as part of the Program, if the insurer chooses to offer such coverage. If an insurer provided such coverage in a commercial property and casualty policy, and met its insurer deductible and other conditions for federal payment, the insurer would receive federal payment under the Program for a claim filed based on that policy.

Third, the availability of terrorism risk insurance is affected by the affordability of such insurance. Neither the Act nor the Program mandates particular pricing. Therefore even if the "make available" requirement were applied in markets where exclusions are permitted, insurers would be able to price the coverage as appropriate, within any constraints, if any, imposed by the particular State. In such cases, if insurers believed they had insufficient capacity or that they lacked the ability to adequately evaluate the risks associated with a nuclear, biological, or chemical event, the corresponding price for such coverage along with the overall price for terrorism coverage could remain relatively

high as insurers sought to build greater capacity and to account for greater uncertainty associated with these types of events.

III. Procedural Requirements

The Act established a Program to provide for loss sharing payments by the Federal Government for insured losses resulting from certified acts of terrorism. The Act became effective immediately upon the date of enactment (November 26, 2002). Preemptions of terrorism risk exclusions in policies, mandatory participation provisions, disclosure and other requirements, and conditions for federal payment contained in the Act applied immediately to those entities that came within the Act's definition of "insurer."

The disclosure requirements are statutory conditions for federal payment under the Program. The disclosure requirements were effective immediately upon enactment and remain ongoing requirements that apply to new and renewed policies throughout the life of the Program. In the event of an act of terrorism resulting in insured losses under the Program, insurers must certify, and Treasury must ascertain, that these disclosure requirements have been met before federal payment is made. Similarly, the make available requirements are important elements of the Act. These requirements were effective immediately upon enactment and applied to policies in effect at that time. The make available requirements will continue to apply to new and renewed policies through the end of 2004 (and if the requirements are extended by the Secretary, through 2005).

Given the significance of the disclosure and make available requirements to policyholders and insurers, there is an urgent need to issue immediately effective regulations. This includes the need to clarify, as necessary, the previously issued interim final rule. Moreover, because the changes are in the nature of clarifications, there should be no operational impact on insurers and no need for a delayed effective date.

Accordingly, pursuant to 5 U.S.C. 553(d)(3), Treasury has determined that there is good cause for this final rule to become effective immediately upon publication.

This final rule is a significant regulatory action and has been reviewed by the Office of Management and Budget under the terms of Executive Order 12866.

It is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. The Act requires all licensed or admitted insurers to participate in the Program. This includes all insurers regardless of size or sophistication. The Act also defines property and casualty insurance without any reference to the size or scope of the commercial entity. The disclosure and make available requirements are required by the Act. The final rule allows all insurers, whether large or small, to use existing systems and business practices to demonstrate compliance. Accordingly, any economic impact associated with the final rule flows from the Act and not the final rule. However, the Act and the Program are intended to provide benefits to the U.S. economy and all businesses, including small businesses, by providing a federal

reinsurance backstop to commercial property and casualty insurers and their policyholders and by spreading the risk of insured loss resulting from an act of terrorism.

List of Subjects in 31 CFR Part 50

Terrorism risk insurance.

Authority and Issuance

For the reasons set forth above, the interim final rule amending Subpart B and C of 31 CFR Part 50, which was published at 68 FR 19302 on April 18, 2003, is adopted as a final rule with the following changes:

PART 50 – TERRORISM RISK INSURANCE PROGRAM

1. The authority citation for 31 CFR Part 50 continues to read as follows:

Authority: 5 U.S.C. 301; 31 U.S.C. 321; Title I, Pub. L. 107-297, 116 Stat. 2322 (15 U.S.C. 6701 note).

2. Section 50.12(d) of Subpart B is revised to read as follows:

§ 50.12 Clear and conspicuous disclosure.

* * * * *

(d) Use of producer. If an insurer normally communicates with a policyholder through an insurance producer or other intermediary, an insurer may provide disclosures through such producer or other intermediary. If an insurer elects to make the disclosures through an insurance producer or other intermediary, the insurer remains responsible for ensuring that the disclosures are provided by the insurance producer or other intermediary to policyholders in accordance with the Act.

* * * * *

3. Section 50.14 of Subpart B is revised to read as follows:

§ 50.14 Separate line item.

An insurer is deemed to be in compliance with the requirement of providing disclosure on a “separate line item in the policy” under § 50.10(d) if the insurer makes the disclosure:

- (a) On the declarations page of the policy;
- (b) Elsewhere within the policy itself; or
- (c) In any rider or endorsement, or other document that is made a part of the policy.

4. Section 50.18(b)(2) of Subpart B is revised to read as follows:

§ 50.18 Disclosure required by reinstatement provision

* * * * *

(b) * * *

(2) The insurer provided notice at least 30 days before any such reinstatement of the increased premium for such terrorism coverage and the rights of the insured with respect to such coverage, including the date upon which the exclusion would be reinstated if no payment is received, and the insured fails to pay any increased premium charged by the insurer for providing such terrorism coverage.

5. Section 50.21(a) of Subpart C is revised to read as follows:

§ 50.21 Make available.

(a) General. The requirement to make available coverage as provided in § 50.20 applies to policies in existence on November 26, 2002, new policies issued and renewals of existing policies during the period beginning on November 26, 2002 and ending on December 31, 2004 (the last day of Program Year 2), and if the requirement is extended by the Secretary, to new policies issued and renewals of existing policies in Program Year 3 (calendar year 2005). The requirement applies at the time an insurer makes the

initial offer of coverage as well as at the time an insurer makes an initial offer of renewal of an existing policy.

* * * * *

Dated:

Wayne A. Abernathy

Assistant Secretary of the Treasury