

September 21, 2004

Dear Mr. D:

This letter responds to your request for an interpretation concerning the application of the Terrorism Risk Insurance Act of 2002 (“TRIA”)<sup>1</sup> and Treasury’s regulations implementing TRIA<sup>2</sup> to the use of a captive insurer that would insure the parent’s deductible under a separate workers’ compensation insurance policy, issued by a separate insurer, but only to the extent the deductible applies to losses from certified acts of terrorism.<sup>3</sup>

Your client currently purchases workers’ compensation insurance from a large commercial insurer. Under the policy, your client retains a large deductible. As we understand your letter, your client wishes to restructure its workers’ compensation policy to make all insured losses under the workers’ compensation policy that are caused by a certified act of terrorism to be within the policy’s deductible. As you state in your letter, this structure would make your client responsible for all terrorism losses under the workers’ compensation policy.<sup>4</sup> Your client would then obtain a stand-alone matching deductible policy from a domestic, wholly-owned, licensed or admitted captive insurance company which we understand will cover the terrorism losses within the other policy’s deductible. You request confirmation from Treasury that the captive insurer would have benefit of the TRIA backstop protection if such a workers’ compensation program were established.

A State licensed or admitted captive that receives direct earned premium<sup>5</sup> has the benefit of TRIA backstop protection for insured losses covered under workers’ compensation policies, which is a commercial line of property and casualty insurance included in the Terrorism Risk Insurance Program.<sup>6</sup> Nevertheless, Treasury has concerns about the strategic use of captives as a means of avoiding the requirements of the Act and its implementing regulations. For example, we have cautioned entities about forming captive insurers for the sole purpose of issuing stand-alone, single-risk terrorism insurance if they are doing so in order to avoid the Act’s deductible requirements.<sup>7</sup>

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<sup>1</sup> P.L. 107-297, 116 Stat. 2322, 15 U.S.C. §6701, note.

<sup>2</sup> See 31 C.F.R., Part 50.

<sup>3</sup> For purposes of this response, we assume that such an arrangement is permitted under state law though you have told us that state regulatory approval has not yet been sought.

<sup>4</sup> All terrorism losses, though covered by the workers’ compensation policy, would not be payable because the losses would be considered to be within the policy’s deductible regardless of the aggregate amount of the losses.

<sup>5</sup> 31 C.F.R. §50.5(f).

<sup>6</sup> *Id.* at §50.5(l).

<sup>7</sup> See Letter regarding TRIA-Only Captives (March 2, 2004), <http://www.treas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/>.

As stated in our regulations that govern the payment of claims, Treasury will not pay the Federal share of compensation, in whole or in part, should it determine that the insurer's claim for Federal payment has been designed to circumvent the purposes of the Act or regulations.<sup>8</sup> Here, your client, its insurer, and your client's wholly-owned captive appear to be acting in concert to design an atypical insurance program with its purpose being to transfer part of the terrorism risk to Treasury (through the captive with a lower TRIA deductible) that for all other perils your client is otherwise willing to retain or transfer to its current insurer with a higher TRIA deductible. This arrangement raises serious questions as to whether it has been designed to circumvent the purposes of the Act or regulations. For this reason, we strongly caution you and advise you against taking the proposed action if it is being undertaken to avoid TRIA's deductible requirements.

Thank you for your inquiry. For additional information or if you have other questions that need to be addressed, please write or call the Program office at 202-622-6770.

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This response addresses the application of the Act and regulations to the specific situation set forth in your request, as you have represented the facts to Treasury. If there is a change in any of the facts or assumptions presented, and such facts or assumptions are material to a conclusion presented in this response, then the requestor may not rely on that conclusion generally or as support for any proposed or subsequent activity. This response is provided by the Terrorism Risk Insurance Program as a means of stating its current interpretation of the Act and regulations. The Program may revise or revoke this interpretation upon its own initiative or upon the enactment of amendments to the Act or regulations.

## TERRORISM RISK INSURANCE PROGRAM

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Jeffrey S. Bragg  
Executive Director

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<sup>8</sup> 31 C.F.R. §50.50(a)(4).