

September 24, 2004

Dear Mr. N:

This is a response to the request for a written interpretation of [two] questions relating to Treasury's implementation of the Terrorism Risk Insurance Act ("TRIA").¹

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1. Issue One: The ability to issue a Terrorism (TRIA) Insurance Policy on a Standalone Basis via a TRIA Qualifying Captive: Excess Policy

Your first inquiry addresses the issue of captives being utilized to provide excess limits coverage for terrorism-only losses over the limits of a property policy that insures a number of specified perils, including TRIA related terrorism risks. You label the policy a "standalone" terrorism policy. You note that there is no express prohibition in TRIA or Treasury's regulations "in terms of providing TRIA coverage in excess of the original coverage grant." You specifically ask "can a qualifying captive with a \$700 mm property policy with TRIA coverage issue a \$300 mm terrorism-only policy excess of the \$700 mm property policy and access TRIA"?

You are correct that neither TRIA nor Treasury's regulations prohibit any insurer from issuing stand-alone TRIA-only excess insurance with policy limits different from the limits of the underlying primary layer of coverage, whether or not issued by the same insurer. We believe that a terrorism-related loss sustained under the \$300 mm terrorism-only excess policy you describe would likely be an insured loss under TRIA and eligible for the Federal share of compensation under the Program. "Insured loss" is defined as "any loss resulting from an act of terrorism ... that is covered by primary or excess property and casualty insurance issued by an insurer" provided the loss occurs at certain specified locations.² Property and casualty insurance under TRIA is defined generally as commercial lines of property and casualty insurance and specifically includes excess insurance.³ Moreover, we have said in our regulations that a qualifying State-licensed captive is an "insurer" under TRIA.⁴ Thus, terrorism-related losses arising under the \$300 mm excess policy you describe are "insured losses" provided the underlying property policy insures a commercial lines risk and the loss occurs at a location covered by the Act.⁵

¹ Public Law 107-297, 116 Stat. 2322, 15 U.S.C. §6701, note.

² P.L. 107-297 at § 102(5).

³ P.L. 107-297 at § 102(12)(A).

⁴ 31 C.F.R. §50.5(f)(1)(i)(A); 68 Fed. Reg. 41260 (July 11, 2003).

⁵ The Act states losses must occur in the United States or outside the United States in very limited circumstances specified in the Act. See 107-297 at § 102(5).

2. Issue Two. The ability to issue a Terrorism (TRIA) Insurance Policy on a Standalone Basis via a TRIA Qualifying Captive: Primary Policy

Your second inquiry is simply a permutation of the first question. Instead of the qualifying captive writing a terrorism-only standalone excess policy, the qualifying captive writes a terrorism-only standalone primary policy. You indicate Vermont insurance regulators have approved this insurance structure for certain captives. We see no conceptual or legal difference in the TRIA result for the excess limits or primary terrorism-only standalone coverage. The same conclusions regarding the material elements of the definition of “insured loss” apply. Because the TRIA definition of “insured loss” includes losses from both “primary” and “excess” property and casualty insurance, a terrorism-related loss under the “primary” policy would similarly be an “insured loss” as long as the policy insured a commercial lines risk and the loss occurred at a location covered by the Act.

Your letter and others that we have received raise issues surrounding the strategic use of captives to deal with terrorism risks. We have concerns about the possibility that captives may be used as a tool for avoiding the requirements of the Act and implementing regulations, particularly where the Act’s deductible and mandatory recoupment provisions are involved. In a notice of proposed rulemaking in February, 2003, Treasury solicited public comment on whether it should prescribe other criteria for certain insurers pursuant to its authority under section 102(6)(C) of the Act. In particular, Treasury asked whether criteria should be developed to prevent newly formed insurance companies from participating in the Program if these companies were established for the purpose of evading the Act’s deductible requirements. Treasury explained that “preventing evasion of insurer deductible requirements by special purpose entities formed to provide terrorism risk only coverage” was one objective additional criteria would serve.⁶ In its final rule published in July, 2003, Treasury explained that it was not proposing additional criteria at that time but that it would continue to monitor developments in the market for terrorism risk insurance and the market’s response to the Act.⁷

Notwithstanding our conclusions above, the issues raised in your letter and others seeking Treasury interpretations of the role of captives under TRIA cause us to reconsider whether possible future rulemaking is needed to address the special circumstances and issues being raised *vis-à-vis* captives.⁸ The *post*-enactment formation or utilization of a captive insurer that will only provide stand-alone, single-risk *TRIA-only* coverage for losses from acts of terrorism raises questions regarding the integrity of the Program. We believe that anyone considering forming a captive insurer for stand-alone, single risk terrorism insurance should be cautioned against undertaking such action if there is any evidence of an intent to avoid the Act’s deductible or recoupment requirements.

⁶ 68 Fed. Reg. 9,815 (Feb. 28, 2003).

⁷ *Id.* at 41263 (July 11, 2003).

⁸ Under section 102(6)(C) of the Act, the Secretary may reasonably prescribe other criteria that an entity must meet to qualify as an “insurer” under the Program.

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This response addresses the application of the Act and regulations to the specific facts and circumstances set forth in your request, as you have represented them to Treasury. If these facts and circumstances are not correct, or if there is a change to any of these facts or circumstances that is material to a conclusion presented in this response, then you may not rely on the conclusions in this letter 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.

Sincerely,

Jeffrey Bragg
Executive Director
Terrorism Risk Insurance Program