

January 12, 2004

Dear Mr. T:

This letter is written in response to your request for an interpretation concerning the application of the Terrorism Risk Insurance Act of 2002<sup>1</sup> (the "Act") and Treasury's regulations implementing the Act, to the corporate ownership structure of ABC Insurance Company ("ABC") and how that affects its insurer deductible under the Terrorism Risk Insurance Program.<sup>2</sup>

### **Background and Brief Conclusion**

ABC is a California-domiciled specialty workers' compensation insurer and is an "insurer" under the Program. ABC is a wholly owned subsidiary of ABC National Insurance Corporation ("ABC National"). According to your letter and ABC National's website,<sup>3</sup> ABC National is a holding company with assets of approximately \$1.5 billion which provides workers' compensation insurance through its subsidiaries and participates in the worldwide reinsurance business. The insurance subsidiaries of ABC National -- ABC, NAT Insurance Company, and SAT Insurance Company -- are licensed to engage in the property and casualty insurance business in various states and the District of Columbia.<sup>4</sup> According to your letter and ABC National's 2002 Annual Statement, the direct earned premiums of these ABC National-controlled insurer affiliates would result in an insurer deductible under the Act of approximately \$38 million.

Your letter and other materials also indicate that ABC National's stock, in turn, is owned in part by: (1) F Insurance Co., an "insurer" under the Program (17.6% stock interest); (2) T Insurance Co., also an "insurer" under the Program (15.8%); (3) OOO Reinsurance Corp. (6.4%); and (4) RRR Bermuda (1.7%). F Insurance Co. and T Insurance Co. are wholly owned by FFF, a Canadian public company, which itself is not an insurer under the Program.<sup>5</sup> FFF also owns 81 percent of OOO Reinsurance and 100 percent of RRR Bermuda, both non-insurers under the Program. F Insurance Co. and T Insurance Co. own a combined 33.4 percent of the common stock of ABC National. In

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Public Law 107-297, 116 Stat. 2322, 15 USC § 6701 *et. seq.*

<sup>2</sup> This response is being issued pursuant to 31 C.F.R. §50.9, which sets forth a procedure whereby persons actually or potentially affected by the Act or regulations may request an interpretation.

ABC's website (and its 2002 Annual Report) can be accessed at [www.theABC.com](http://www.theABC.com).

<sup>4</sup> See <http://investors.theABC.com/phoenix.zhtml?c=106044&p=irol-irhome>.

<sup>5</sup> FFF has an ownership interest of 100% in RRR Bermuda and 80% in OOO Reinsurance Corp. which do not appear to be "insurers" under the Program.

light of this ownership structure, you have requested clarification as to whether you must include the direct earned premium of all “insurers” under the above-described ownership structure because they could be considered your “affiliates” under the Program.<sup>6</sup> You explain in your letter that your insurer deductible under the Program, inclusive of all these insurers that are directly or indirectly owned by FFF, would be approximately \$182 million.<sup>7</sup>

Based on the information you provided, other information available to us, and for the reasons outlined below, we conclude that ABC is affiliated with each of the insurers directly or indirectly owned by FFF under the ownership structure described above.

### Analysis

Under the Program, once an insurer (including a group of affiliated insurers) has met its individual Program Year deductible, the federal payment covers 90 percent of insured losses above the insurer deductible amount, subject to an annual industry-aggregate insured loss limit of \$100 billion. An insurer’s deductible is calculated based on a percentage of the value of direct earned premiums collected over certain statutory periods.<sup>8</sup> The definition of “insurer” includes not only the insurance company that issued

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<sup>6</sup> ABC National’s 2003 Annual Report summarizes the issue as follows:

The U.S. Government worked throughout 2002 on a plan under which the risk of loss from future terrorist acts would be shared for a limited period of time between the insurance industry and the government. . . . Our deductible for 2003 appears to be about \$38 million, for which we have purchased about \$22.5 million of reinsurance. Unfortunately, the legislation is ambiguous with respect to a company like ABC, where companies controlled by FFF own 42% of our outstanding stock and FFF has disclaimed control. If we were considered part of the FFF Group for purposes of this statute, the deductible amount would be substantially greater because FFF’s total premiums would be added to ours.

ABC National Insurance Corp. Annual Report 2002 at p. 20; *see also* pp. 35-36.

<sup>7</sup> Treasury is not rendering any decision as to whether ABC has correctly calculated its estimated insurer deductible inclusive of all FFF-controlled “insurers.” We do point out, however, that ABC’s inclusion of other insurers’ direct earned premium to calculate its insurer deductible might not be limited to only FFF’s U.S. insurance subsidiaries.

<sup>8</sup> “Insurer Deductible” is defined, in relevant part, as

(1) For an insurer that was in existence on November 26, 2002 and has had a full year of operations during the calendar year immediately preceding the applicable Program Year:

... (ii) For Program Year 1 (January 1, 2003 through December 31, 2003), the value of an insurer’s direct earned premiums over calendar year 2002, multiplied by 7 percent;

(iii) For Program Year 2 (January 1, 2004 through December 31, 2004), the value of an insurer’s direct earned premiums over calendar year 2003, multiplied by 10 percent;

the relevant commercial property or casualty insurance policy, but includes the insurer's "affiliates" as well.<sup>9</sup> An "affiliate" is defined as "any entity that controls, is controlled by, or is under common control with an insurer."<sup>10</sup>

## 1 *Control of ABC*

Pursuant to Section 102(3) of the Act, and section 50.5(c)(2)(i) of the regulations, "control" exists if an insurer directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other insurer. This fact, if it exists, is conclusive of control.<sup>11</sup>

F Insurance Co. and T Insurance Co. are wholly owned by FFF and thus are affiliates of one another under the Act because they are insurers under the "common control" of a non-insurer parent.<sup>12</sup> F and T control ABC National because these commonly controlled companies in turn own 33.5 percent of ABC National. Because ABC National owns 100 percent of ABC, F Insurance Co. and T Insurance Co. indirectly control ABC. As such, the direct earned premiums received by F Insurance Co. and T Insurance Co., as well as any other affiliates within the FFF-owned group of insurers, such as NAT Insurance Company and SAT Insurance Company, are to be included in ABC's (and its insurer affiliated group's) calculation of its insurer deductible. As I am sure you are aware, this deductible (of approximately \$182 million, according to your letter) is a Program Year deductible that applies to the group of affiliated insurers. Thus, if any one of the affiliated insurers in the FFF group satisfies the deductible in a Program Year, the deductible is met for the entire group during that Program Year.

## 2. *Disclaimed Control and Restructuring*

You explain that although FFF, and thus F Insurance Co. and T Insurance Co. directly or indirectly own more than 25 percent of ABC National's stock, they do not exercise actual control of ABC National and ABC because of various contractual and other agreements that limit the ability of these entities to exercise actual control over ABC National and its subsidiaries, including limitations on shareholder voting rights.

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(iv) For Program Year 3 (January 1, 2005 through December 31, 2005), the value of an insurer's direct earned premiums over calendar year 2004, multiplied by 15 percent; and ... 31 C.F.R. §50.5(g)

"Direct earned premium" is defined as "direct earned premium for all commercial property and casualty insurance issued by any insurer for insurance against all losses, including losses from an act of terrorism, occurring at the locations described in section 102(5)(A) and (B) of the Act." 31 C.F.R. §50.5(d)

*Id.* at §50.5(f).

<sup>10</sup> *Id.* at §50.5(c)(1).

<sup>11</sup> *See id.* at §50.5(c)(3).

<sup>12</sup> *See* Section 102(2) of the Act; 31 C.F.R. § 50.5(c)(1); 68 FR 9804, 9808 (Feb. 28, 2003); 68 FR 41250, 41253 (July 11, 2003).

These various contractual arrangements do not alter our conclusion that ABC is affiliated with each of the insurers discussed above that are within the FFF group of companies, including F Insurance Co. and T Insurance Co. Both section 102(3) of the Act and section 50.5(c)(3) of the TRIA regulations establish that the direct or indirect ownership or control of more than 25 percent of the voting securities of another insurer is conclusive of control. This conclusion is not rebuttable. Because the Act's 25 percent "bright line" test is triggered by either ownership or control over voting shares, voluntary relinquishment of certain *indicia* of control over voting shares that are owned by an entity does not change the fact that one entity still owns voting shares of another within the meaning of the Act. In addition, even if an entity voluntarily relinquishes certain *indicia* of control over voting shares, the share owner still ultimately retains the ability to control those voting shares through sale or otherwise.

Finally, your letter asks whether our determination would change if some of the ownership interests in ABC National were transferred from insurers F Insurance Co. and T Insurance Co. to two non-insurer subsidiaries of FFF, thereby bringing the total combined ownership by F and T below the 25 percent threshold. While the facts and circumstances you have presented are only hypothetical, it is unlikely that our conclusion regarding the affiliate relationship among F Insurance Co., T Insurance Co. and ABC would change after such a transfer. This is because all four of the companies involved in the ownership of ABC in your hypothetical would still be owned and commonly controlled by FFF.

Under §50.5(c)(1) of the regulations, there are three circumstances where one insurer will be considered an affiliate of another insurer:

- 1 if one insurer "controls" another insurer,
2. if one insurer "is controlled by" another insurer;<sup>13</sup> and
3. if one insurer "is under common control with" another insurer.<sup>14</sup>

Section 50.5(c)(2), upon which you rely, sets out the factors Treasury will consider when determining when "an insurer has control over another insurer" for purposes of 50.5(c)(1). Under your present corporate structure, ABC "is controlled by" another insurer for the reasons explained above.

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<sup>13</sup> These first two circumstances are similar but there is an important distinction depending on who submits a Certification of Loss. In one circumstance an insurer presenting a claim for Federal payment under the Program might be the *controller*; in another, the insurer might be the entity being *controlled*.

<sup>14</sup> Section 50.5(c)(1) of the regulations reads:

*Affiliate* means, with respect to an insurer, any entity that controls, is controlled by, or is under common control with the insurer. An affiliate must itself meet the definition of insurer to participate in the Program.

Under your suggested restructuring, section 50.5(c)(2) would no longer be relevant to determining ABC's affiliation. This is because section 50.5(c)(2) is intended to address those circumstances where "an insurer has control over another insurer." Instead, the restructuring would place ABC in the category of an insurer being "under common control with" another insurer. Just as F Insurance Co. and T Insurance Co. are affiliates of one another despite the fact that their parent does not meet the definition of "insurer," ABC would remain affiliated with F and T because all three insurers would be "under common control with" one another because all three insurers are owned by FFF, either directly or indirectly.<sup>15</sup>

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. As provided in Section 50.9 of the regulations, this response and your request for interpretation will be publicly available as soon as practicable.

Thank you for your interest in the Program. We apologize for the delay in answering your letter. For additional information or if you have any specific questions, please call our office at (202) 622-6770.

Dated: January 12, 2004

**TERRORISM RISK INSURANCE PROGRAM**

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Jeffrey S. Bragg  
Executive Director

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<sup>15</sup> See 68 Fed. Reg. 9804, 9808 (Feb. 28, 2003); 68 Fed. Reg. 41250, 41253 (July 11, 2003).