

Terrorism Risk Insurance Program Reauthorization

On January 12, 2015, the President signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2015.¹ This Act reauthorizes the federal terrorism risk insurance backstop put in place in 2002 and reauthorized in 2005 and in 2007, but which expired on December 31, 2014. It extends the program for six years, through December 31, 2020.

The reauthorization retains the basic structure of the previous federal terrorism risk insurance program (described in our earlier memorandum, dated November 2002, and attached as Attachment A), and makes certain modifications to the program. The Act reduces the federal share of compensation by increasing insurance companies' copayments one percent per year from 15 percent in the first year to 20 percent in the sixth year. In addition, the industry's aggregate retention amount would increase by \$2 billion per year from a base of \$29.5 billion in the first year to \$37.5 billion in the fifth year. In the final year the retention amount will be the annual average of "insurer deductibles" for all insurers participating in the program over the previous three years, as determined by the Secretary of the Treasury (or about \$50 billion as estimated by the Congressional Budget Office). The Act raises by \$20 million per year during the next six years the threshold from which federal assistance is triggered starting from a base of \$100 million in the first year to \$200 million in the sixth year. The Act also increases the potential post-loss risk spreading premiums from 133% to 140% of any mandatory recoupment amount for such period.

In addition, the Act includes a few unrelated new provisions, including provisions on registered insurance agents and brokers which will create an association to license insurance agents and brokers outside their states, and an amendment to the Dodd-Frank Act to exempt certain non-financial companies from the requirements of posting collateral on certain derivative trades.

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If you have any questions about the issues addressed in the memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Thorn Rosenthal at 212.701.3823 or trosenthal@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Kathy S. Strom at 202.862.8944 or kstrom@cahill.com.

¹ <https://www.congress.gov/114/bills/hr26/BILLS-114hr26enr.pdf>.

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Terrorism Risk Insurance Act of 2002

I. Overview

On November 14, 2002, and November 19, 2002, respectively, the House of Representatives and the Senate passed H.R. 3210 entitled the "Terrorism Risk Insurance Act of 2002" (hereinafter the "Act") which provides for assistance by the United States Federal government to property and casualty insurers (defined generally as U.S. property and casualty companies and their affiliates) in providing payment on insurance claims based on acts, certified by the Secretary of Treasury (the

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"Secretary"), as acts of terrorism (as defined).¹ Subject to limited exception, the Act nullifies any terrorism exclusions in a contract for property and casualty insurance and preempts state law that approved such exclusion. Such coverage for acts of terrorism must be made available from the date of enactment of the Act through December 31, 2004 and, if the Secretary so determines, through December 31, 2005. Insurers may increase premiums for providing the required terrorism coverage, subject to the ability of a State to invalidate a rate as excessive, inadequate, or unfairly discriminatory; the limited "sur-charges" authorized by the Act will be imposed only to recoup certain losses paid by the Federal government in the event of an act of terrorism.

The Act creates a Terrorism Insurance Program (hereinafter the "Program"), intended to "share the risk of loss from future terrorist attacks with the commercial property and casualty insurance marketplace", for a three year period of time. The Program, to be administered by the Secretary, provides that the Federal government, subject to provisions for recoupment of amounts paid, pay 90% of that portion of the amount of such insured losses that exceeds the applicable insurer's "deductible" required to be paid, as defined therein,

¹ The President has said that he will sign the bill soon.

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while the insurer pays 10%. The maximum aggregate incurred terrorism loss that is so covered in any year is \$100 billion, to be so shared by the government and industry.

II. Covered Insurers and Acts of Terrorism

The Act applies to commercial property and casualty insurance companies defined by the Act to include any affiliate of such company. Property and casualty insurance means commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance and surety insurance, but does not include reinsurance or retrocessional insurance or other types of insurance.²

Insurer is defined by the Act as an entity (including any affiliate thereof) which is 1) a) licensed or admitted to provide primary or excess insurance in any State, or b) is an eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers of the NAIC, or c) approved to offer property and casualty insurance by a Federal agency in connection with maritime, energy or aviation activity or d) a State residual

² Specifically excluded from the definition of property and casualty insurance is Federal crop insurance, private mortgage insurance, financial guaranty insurance issued by monoline financial guaranty insurance corporations, insurance for medical malpractice, health or life insurance, including group life insurance, and flood insurance.

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market insurance entity or State workers' compensation fund or e) any other entity (captive insurers and other self-insurance arrangements) to the extent provided in rules of the Secretary and 2) "that receives direct earned premiums for any type of commercial property and casualty insurance coverage" (other than in the case of captive insurers and other self-insurance arrangements), plus any affiliate thereof, as described in the paragraph below.

By defining "insurer" to include any affiliate of the entities described above, the Act will also apply to non-U.S. entities which have "affiliates" that are "insurers" under the Act. This provision is meant "to ensure that affiliated insurers are treated as a consolidated entity for calculating direct earned premiums." "Affiliate" is defined as any entity that controls, is controlled by or is under common control with the insurer. "Control" over another entity is defined as existing if 1) an entity directly or indirectly has the power to vote 25% or more of any class of the voting securities of the other entity, or 2) an entity controls a majority of the directors or trustees of the other entity, or 3) an entity is determined by the Secretary to exercise a controlling influence over the other entity's management or policies.

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The referenced premiums are in respect of risks occurring within the United States,³ or outside the U.S. for air carrier or vessels on which U.S. income tax is paid and whose insurance coverage is subject to regulation in the U.S., regardless of where the loss occurs or at the premises of any United States mission.⁴ Each insurance company that meets this definition shall (i.e., participation is mandatory) participate in the Program and shall make available property and casualty coverage for insured losses under the Act that does not differ materially from the terms, amounts and other coverage limitations applicable to losses arising from events other than acts of terrorism.

To be deemed an act of terrorism covered by the Program the act must be a violent act, or act that is dangerous to human life, property or infrastructure, and must have been com-

³ Includes the territorial sea and the continental shelf of the United States as defined in 18 U.S.C. §§2280 and 2281.

⁴ While the Act does not now apply to life insurance companies, the Secretary of Treasury is directed to expeditiously study and determine whether adequate and affordable catastrophe reinsurance for terrorism is available to group life insurers, and the effects of acts of terrorism on the availability of group life insurance coverage for consumers in the United States. If the Secretary determines that such coverage is not available, it, in consultation with the NAIC, may apply the Act to providers of group life insurance.

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mitted by persons acting on behalf of foreign persons or interests and finally must be certified by the Secretary as an "act of terrorism", in concurrence with the Secretary of State and the Attorney General. No act shall be so certified as an act of terrorism if losses resulting from the act or event, in the aggregate, do not exceed \$5,000,000 or if the act is committed "as part of the course of war declared by the Congress".⁵

The Act covers insured losses, which means any loss resulting from an act of terrorism covered by primary or excess property and casualty insurance issued by an insurer causing damage within the U.S., or outside the U.S. for air carriers or vessels on which U.S. income tax is paid and whose insurance coverage is subject to regulation in the U.S., regardless of where the loss occurs or at the premises of any United States mission.

III. Program

The Program which is mandatory for covered insurers is to exist for three years commencing January 1, 2003 and for the Transition Period which is from the date of enactment

⁵ This war exclusion does not apply with respect to any coverage for workers' compensation.

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through December 31, 2002. It covers acts of terrorism taking place during the term of the Program.

During the Transition Period and the first two years of the Program, covered insurers must make available insurance for an "insured loss", as defined above, on terms that do not differ materially from the terms, amounts and other coverage limitations applicable to losses arising from events other than acts of terrorism.

The Federal government will pay for insured losses in an amount equal to 90% of that portion of the amount of aggregate insured losses that exceeds the participating insurance company deductibles required to be paid by the insurer for those insured losses. The Federal government shall not pay and the insurer shall not be liable for any portion of the amount that exceeds \$100,000,000,000 (provided the insurer has met its insurer deductible). During the Transition Period a company's deductible is "the value" of its direct earned premiums over the calendar year immediately preceding the date of enactment of the Act, multiplied by 1 %; for the first year of the Program, the deductible is "the value" of direct earned premiums over the calendar year immediately preceding program year 1 multiplied by 7%; in Program Year Two the deductible is "the value" of direct earned premiums over the calendar year immediately preceding program year 2, multiplied by 10%; and in Pro-

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gram Year Three the deductible is the value of direct earned premiums over the calendar year immediately preceding program year 3, multiplied by 15%.

IV. Application to Reinsurers

The Act does not prevent insurers from obtaining reinsurance coverage for insurer deductibles or insured losses retained by insurers, nor shall the obtaining of such coverage affect the calculation of such deductibles or retentions. The Act shall not be deemed to amend existing reinsurance agreements in effect on the date of enactment of the Act. The amount of financial assistance shall not be reduced by reinsurance paid or payable to an insurer from other sources, except that recoveries from such other sources, taken together with financial assistance for the Transition Year or a Program Year may not exceed the aggregate amount of the insurer's insured losses for such period. However, if such recoveries and financial assistance exceed such losses, such excess must be returned to the Secretary if "there is no agreement between the insurer and any reinsurer to the contrary."

V. Requirements Imposed on Insurance Companies

Commencing on the date of enactment of the Act and continuing until the last day of Program Year Two (December 31, 2004), each insurer covered by the Act must make available in all of its property and casualty insurance policies 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 terrorism. The Secretary shall determine whether this requirement shall apply to Program Year Three. In order for payment to be made under the Program, the following must also occur: 1) the person that suffers the insured loss (or a representative) must have filed a claim with the insurer; 2) the insurer provides clear and conspicuous disclosure to the policyholder of the premium charged for insured losses covered by the Program and the Federal share of compensation for insured losses under the Program;⁶ 3) the claim must be processed in accordance with appropriate business practices and reasonable procedures that the Secretary may prescribe; and

⁶ For policies issued before the date of enactment of the Act, the disclosure must be provided not later than 90 days of the date of enactment. For policies issued within 90 days of the date of enactment the disclosure must be provided at the time of offer, purchase and renewal of the policy. For policies issued after 90 days of the date of enactment, the disclosure must be provided on a separate line item in the policy at the time of offer, purchase and renewal.

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4) the insurer must submit the claim for payment of the Federal share of compensation to the Secretary with a written certification of the underlying claim, of all payments made for insured losses, and with certification of compliance with these provisions. The Secretary is to issue interim and final rules implementing the Act, including as to claims and payment procedures.

VI. Recoupment of Federal Share

Federal assistance up to the lesser of \$10 billion in the Transition Period and ending on the last day of Program Year 1, the lesser of \$12.5 billion in Program Year 2, the lesser of \$15 billion in Program Year 3, and the aggregate amount, for all insurers, of insured losses during such period, must be recouped by the Secretary (subject to exceptions such as if uncompensated losses exceed insurance marketplace aggregate retention). Such recoupment will be authorized through surcharges paid by commercial property and casualty policyholders based on premium rates. Any year's surcharge is capped at 3% of the premium charged for property and casualty coverage under the policy for such year. These surcharges may be adjusted by the Secretary to take into account the economic impact on urban areas and smaller commercial or rural areas.

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The Secretary is also authorized, to the extent that the amount of Federal financial assistance exceeds the mandatory recoupment amount, to recoup such additional amounts through "terrorism loss risk-spending premiums". The Secretary shall consider, among other factors, costs to taxpayers of additional recoupment and the economic conditions in the marketplace.

VII. Workers' Compensation

The Act includes within the definition of insurer a State residual market insurance entity of State workers' compensation fund that receives direct earned premiums for any type of commercial property and casualty insurance coverage. The Secretary is directed to issue regulations to apply the Act to such entities. The Secretary is authorized, in consultation with the NAIC or appropriate state regulatory authority, to apply the Act to other classes or types of captive insurers and other self-insurance arrangements by municipalities and other entities (such as workers' compensation self-insurance programs and State workers' compensation reinsurance pools). However, such determination by the Secretary must be made before the occurrence of an act of terrorism in which such an entity incurs an insured loss.

VIII. Implementation, Penalties and Litigation

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The Secretary is authorized to issue rules and procedures to implement the Act. The Secretary is also authorized to assess civil penalties, after a hearing, against an insurer that fails to comply with provisions of the Act or provides false information regarding premiums or loss amounts.

The Act nullifies any terrorism exclusion in a contract for property and casualty insurance in force on the date of enactment of the Act, and preempts state law that approved the same exclusion. Exception to this nullification provision occurs if the insured provides a written statement affirmatively authorizing reinstatement of the terrorism exclusion as to a policy in effect, or if the insurer provides notice to the insured of the rights of the insured regarding such coverage and the insured fails to pay any increased premium charged by the insurer for terrorism coverage.

The Act provides for exclusive federal jurisdiction (in a court or courts to be designated by the Judicial Panel on Multidistrict Litigation) over claims arising out of terrorism, which are to be governed by state law (including choice of law rules). It is not clear if this encompasses coverage claims or only underlying liability claims. Amounts awarded in such action that are attributable to punitive damages shall not count as insured losses under the Act.

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There are many other significant provisions in the Act which will affect insurance companies. If there are other areas about which you would like further information, please contact any of the following: Immanuel Kohn, (212-701-3803), Thorn Rosenthal (212-701-3823), Michael Becker (212-701-3412), Donald Mulvihill (202-862-8950) or Kathy Silberthau Strom (202)862-8944).

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