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TERRORISM RISK INSURANCE ACT OF 2002

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On November 26th, President George W. Bush signed into law the Terrorism Risk Insurance Act of 2002 ("TRIA", or the "Act").[1] Under TRIA, property and casualty insurers are required to offer coverage against certain acts of terrorism, which coverage had often been excluded from policies since the terrorist attacks of September 11, 2001. Subject to a premium-based deductible, however, insurers will be reimbursed by the Federal Government for 90 percent of their terrorism-related losses. The Act does not establish prices for terrorism insurance; the power to regulate premium rates remains with the states. TRIA does not apply to personal lines of insurance (such as automobile and homeowners insurance), life and health insurance, reinsurance or to certain other forms of insurance described below. The Act is intended to serve as a temporary program and is scheduled to terminate on December 31, 2005.

DEFINITION OF TERRORISM

An "act of terrorism" under TRIA is an act certified by the Secretary of the Treasury in concurrence with the Secretary of State and the Attorney General: (i) to have resulted in damage within the United States (or outside the United States in the case of U.S. airliners or ships); (ii) to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of any effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government; and (iii) to have resulted in property and casualty insurance losses in excess of $5,000,000. Any such certification (or determination not to certify) by the Secretary of the Treasury is final and not subject to judicial review. Any act committed as part of the course of a war declared by Congress will not be considered an act of terrorism.[2]

1 Terrorism Risk Insurance Act of 2002, H.R. 3210, 107th Cong. (2002) (enacted).

2 The war exception does not apply to workers' compensation insurance.

APPLICABLE INSURERS/INSURANCE

TRIA applies to any insurer that is: (i) licensed or admitted to engage in the business of providing primary or excess insurance in the United States; (ii) listed as an eligible surplus lines carrier by the National Association of Insurance Commissioners ("NAIC"); (iii) approved by a Federal agency in connection with maritime, energy or aviation insurance; (iv) a state residual market insurance entity or workers' compensation fund; or (v) determined by the Secretary of the Treasury to otherwise fall under the Act (any such determination to have been made prior to the act of terrorism).

TRIA applies to commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance and surety insurance. It does not apply to crop insurance, livestock insurance, private mortgage insurance, financial guaranty insurance issued by monoline financial guaranty insurers, medical malpractice insurance, health or life insurance (including group life insurance), flood insurance provided under the National Flood Insurance Act, or to reinsurance.

MANDATORY AVAILABILITY OF TERRORISM INSURANCE; LIMITED PREEMPTION OF STATE LAW

Between November 26, 2002 and December 31, 2004, every property and casualty insurer must make available terrorism coverage in all of its insurance policies, in amounts and on conditions that do not differ materially from those offered by the insurer for other types of risks. Prior to September 1, 2004, the Secretary of the Treasury will determine whether this requirement should be extended through December 31, 2005.

Any terrorism exclusion for the type of insurance covered by TRIA is nullified, and any state approval of such an exclusion is preempted. However, an insurer may reinstate a terrorism exclusion that was in effect on November 26, 2002 if: (i) it obtains written authorization to do so from the insured; or (ii) the insured fails to pay any increased premium for the terrorism coverage after 30 days' notice.

TRIA does not regulate premium rates. Each state retains the authority to regulate both premium rates and policy forms (but it may not deviate from TRIA's definition of an "act of terrorism"). Any state may invalidate a rate if it is found to be excessive, inadequate or unfairly discriminatory. However, until December 31, 2003, state laws requiring the prior approval of rates and forms are preempted with respect to terrorism insurance. States may only regulate such rates and forms subsequent to their use.

NOTIFICATION TO POLICYHOLDERS

In order to be reimbursed for terrorism-related losses by the Federal Government, the insurer must provide "clear and conspicuous disclosure" to the policyholder of the premium to be charged for terrorism coverage and the federal share of compensation for any losses. The disclosure is to be given: (i) in the case of policies issued prior to November 26, 2002, within 90 days of that date; (ii) in the case of policies issued within 90 days of November 26, 2002, at the time of offer, purchase, and renewal of the policy; and (iii) in the case of policies issued thereafter, on a separate line item in the policy, at the time of offer, purchase, and renewal. We expect that details concerning the form of disclosure will be contained within regulations being developed by the Treasury Department. As of the date of this memorandum, the Treasury Department has not yet indicated when interim or final regulations will be released.

FEDERAL GOVERNMENT'S SHARE OF LOSSES; DEDUCTIBLES

The Federal Government will reimburse an insurer for 90 percent of all terrorism-related losses that exceed the applicable insurer's deductible. For any terrorism-related losses that occur between November 26, 2002 and December 31, 2002 (the "Transition Period"), the insurer deductible will be equal to one percent of its 2001 direct earned premiums; for calendar year 2003, the insurer deductible will be equal to seven percent of its 2002 direct earned premiums; for calendar year 2004, the insurer deductible will be equal to 10 percent of its 2003 direct earned premiums; and for calendar year 2005, the insurer deductible will be equal to 15 percent of its 2004 direct earned premiums.

The Federal Government's portion of insured losses will be reduced by the amount of compensation otherwise provided by the Federal Government to any person in connection with such losses. Without further authorization by Congress, the Federal Government's payment responsibility for insured losses cannot exceed $100 billion in any one year. Moreover, once an insurer has met its deductible, it will not be liable for any further payment with respect to terrorism-related losses that exceed the $100 billion annual cap. Any determinations made by the Secretary of the Treasury with respect to the allocation of losses between an insurer and the Federal Government are final and not subject to judicial review.

RECOUPMENT/POLICY SURCHARGES

Certain amounts expended by the Federal Government under TRIA may be recovered through policy surcharges. Any surcharges would be collected from policyholders by insurers and remitted to the Treasury. No surcharge could exceed three percent of the premium under any policy.

REINSURANCE

Insurers are free to obtain commercial reinsurance coverage for their remaining terrorism exposure (i.e., for the deductible and their 10% share). To the extent that the proceeds of commercial reinsurance — combined with recoveries under TRIA — exceed the aggregate amount of an insurer's terrorism-related losses, the excess must be returned to the Treasury, unless the reinsurance agreement provides otherwise. As stated above, a reinsurer's obligations for terrorism-related losses under a reinsurance policy are not covered under the Act.

EXCLUSIVE FEDERAL JURISDICTION; PUNITIVE DAMAGES

TRIA creates an exclusive federal cause of action for property damage, personal injury, or death arising out of or resulting from an act of terrorism. All state causes of action that are otherwise available under state law are preempted. The substantive law to be applied by the federal court will be derived from the law of the state in which the act of terrorism occurred.

Although TRIA does not prohibit an award of punitive damages in litigation arising out of acts of terrorism, no punitive damages will be paid by the Federal Government under the Act.

GROUP LIFE INSURANCE AND OTHER FORMS OF INSURANCE

The Secretary of the Treasury is directed under TRIA to study, on an expedited basis, the extent to which the threat of terrorism is reducing the availability of group life insurance coverage in the United States. To the extent the Secretary determines that such coverage is not reasonably available, he will, in consultation with the NAIC, apply the provisions of TRIA, as appropriate, to providers of group life insurance.

The Secretary of the Treasury is further directed to study the potential effects of acts of terrorism on the availability of individual life insurance and other lines of insurance coverage, including personal lines, and to report to Congress on his findings within nine months.

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