



1 • 8 0 0 • U S A • R S K

USA Risk Group of Vermont, Inc.  
P.O. Box 306  
Montpelier, Vermont 05601

802-229-5042  
Fax: 802-229-6280  
[www.usarisk.com](http://www.usarisk.com)

To: Clients & Friends of USA Risk Group

Andrew Sargeant, President

January 22, 2003

**Terrorism Risk Insurance Act of 2002 (TRIA)  
Effect on Captives & Risk Retention Groups**

You should by now have received information from your attorneys regarding TRIA. If not, please contact us and we will forward a copy of a memo provided by one of the Vermont based attorneys.

The purpose of this memo is not to run through all the legal ramifications of TRIA. We are not attorneys and cannot provide that advice. Our purpose is to do all we can to assist you in meeting the requirements of TRIA.

You need to be aware that, apart from exceptions noted below, TRIA applies to all onshore domiciled captives and risk retention groups and you must take certain action.

When the Act was first introduced, it was the general understanding that captives and risk retention groups were not included. Interim guidance issued by the Treasury in mid-December has changed that understanding and specifies that any insurer licensed in the United States and writing property and casualty coverage is a mandatory participant, including domestically-licensed captives. Various captive associations and certain state representatives have lobbied the Treasury to have captives excluded from the provisions of the Act. As we have no indication that this lobbying effort will be successful, you should assume, unless legal counsel advises you meet one of the exceptions, you are included under the Act.

To assist you in determining the necessary action, we have detailed below exceptions from the Act, the possible financial effect of the Act on a captive and compliance issues you will need to meet.

**1. EXCEPTIONS**

Specifically excluded from “commercial lines of property and casualty insurance” are:

- ❖ Personal lines insurance
- ❖ Federal crop insurance
- ❖ Private mortgage insurance
- ❖ Financial guaranty insurance
- ❖ Health or life insurance

- ❖ Title Insurance
- ❖ Medical malpractice
- ❖ Flood insurance
- ❖ Reinsurance or retrocessional insurance

Our clients who write medical malpractice cover should not assume they are exempted. In many cases, the coverage offered includes general liability coverages which means the captive/RRG is included under the Act. Please check this with your legal counsel.

A number of captives provide reinsurance to fronting companies. Although the captive reinsurer may be exempted, the fronting company is not. Please note that although the original insured can decline terrorism coverage, the front company will be subject to the assessment feature (see below) of the TRIA and will most likely require the captive reinsurer to reimburse the appropriate amount.

2. **FINANCIAL EFFECT**

Captives and RRGs can be directly affected financially through 2 parts of TRIA. First, if the captive/RRG provides coverage to an insured (see next section, insured can decline cover) and the insured is the victim of a terrorist event, the captive retains a deductible and a 10% quota share as detailed below. Please note the captive/RRG can reinsure these amounts. Second, if the program’s reinsurance payments are triggered and the Federal government makes payments, it can recoup these reinsurance payments, subject to certain caps, by assessing all insurers. This is regardless of whether the insurer finishes up providing terrorist coverage.

*Reinsurance Payment for Insured Losses*

Federal Government 90%	10% Quota Share Insurer
Deductible	

The programs reinsurance payments are triggered once the:

- a) Secretary has certified insured losses exceed \$5 million in the aggregate that are the result of terrorism;
- b) Deductible:

Each captive/RRG will pay a deductible from covered losses. The deductible is a percentage of all premiums (the Act uses “direct earned premium”).

Deductibles are:

For the period 11/26/02 to 12/31/02 1% of 2001 premium

For the period 01/01/03 to 12/31/03 7% of 2002 premium  
For the period 01/01/04 to 12/31/04 10% of 2003 premium  
For the period 01/01/05 to 12/31/05 15% of 2004 premium

c) Quota Share

For losses in excess of the deductible, the insurer pays 10% on a quota share basis, with 90% payable by the Federal Government.

d) Government Recoupment (Assessment)

The Act allows the government to recover a “mandatory recoupment amount”. This is the difference between a dollar amount (\$10 billion in 2003, \$12.5 billion in 2004 and \$15 billion in 2005) and the deductible and quota share payments made by insurers. The assessment can be up to 3% of an insurer’s premiums, regardless of whether the insurer finished up offering terrorism coverage.

Examples:

A captive writes \$20 million of premium in 2002, including terrorism cover. There is a \$50 billion terrorist event in 2003. The captive’s insureds suffer losses totaling \$15 million. The captive was unable to buy reinsurance for this risk.

- ❖ The captive’s deductible is \$1.4 million (7% x \$20 million)
- ❖ The captive’s quota share is \$1.86 million (10% of \$18.6 million).
- ❖ Losses in excess of \$3.26 million (\$1.4 million plus \$1.86 million) are recovered from the Federal government.
- ❖ On the assumption the Government recoups payments made, the captive will have to pay a 3% assessment, or \$600,000, to the Federal government. Please note the captive can also assess its policyholders to recover this amount.

Note that if the insured’s decline coverage, the captive still has an exposure to the 3% assessment, \$600,000 in this example.

3. COMPLIANCE ISSUES

To meet the requirements of TRIA, you must act relatively quickly on several compliance issues.

Coverage Disclosure

Terrorism coverage must be offered to policyholders. Additionally, the premium relating to terrorism coverage and information concerning the federal share must be clearly disclosed. You need to decide what premium, if any, should be charged for this coverage. Deadlines for making this disclosure are:

- ❖ Policies in force prior to 11/26/01 – deadline 2/24/03
- ❖ Policies issued 11/26/02 - 2/24/03 – at time of offer, purchase and renewal

- ❖ Policies issued after 2/24/03 – disclosure to be made on a separate line item in the policy

**Reinstatement of Terrorism Exclusion**

As noted earlier, all terrorism exclusions in policies issued before 11/26/02 are nullified. To restate these exclusions either i) policyholder advises the insurer in writing that they authorize reinstatement or ii) policyholder fails to pay an increased premium after receiving at least 30 days notice from the insurer of increased premiums.

The NAIC has issued 2 model disclosure forms to assist insurers in compliance. Both forms are attached to this memo and may be accessed on the NAIC website, [www.naic.org](http://www.naic.org).

Model Form No. 1 may be used to disclose the premium and federal share information and provide the insured the opportunity to accept or decline coverage.

Model Form No. 2 may be used to disclose premium and federal share information for policies already providing terrorism coverage.

We hope the above will be of assistance to you. Please call your account manager or contact me at [asargeant@vim.usarisk.com](mailto:asargeant@vim.usarisk.com) or 802/229-5042 x302 if we can help in any way. We will continue to monitor this issue and its effect on captives and risk retention groups.

Enclosures

Model Form No. 1  
**POLICYHOLDER DISCLOSURE  
NOTICE OF TERRORISM  
INSURANCE COVERAGE**

You are hereby notified that under the Terrorism Risk Insurance Act of 2002, effective November 26, 2002, that you now have a right to purchase insurance coverage for losses arising out of acts of terrorism, as defined in Section 102(1) of the Act. The term "act of terrorism" means any act that is certified by the Secretary of the Treasury, in concurrence with the Secretary of State, and the Attorney General of the United States—to be an act of terrorism; to be a violent act or an act that is dangerous to human life, property; or infrastructure; to have resulted in damage within the United States, or outside the United States in the case of an air carrier or vessel or the premises of a United States mission; and to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion. Coverage under your existing policy may be affected as follows:

ANY IN-FORCE TERRORISM **EXCLUSIONS** FOR ACTS OF TERRORISM, AS DEFINED IN THE ACT, ALREADY CONTAINED IN YOUR POLICY OR INCLUDED IN AN ENDORSEMENT ARE **NULLIFIED** AS OF NOVEMBER 26, 2002.

YOU SHOULD KNOW THAT COVERAGE PROVIDED BY THIS POLICY FOR LOSSES CAUSED BY CERTIFIED ACTS OF TERRORISM IS PARTIALLY REIMBURSED BY THE UNITED STATES UNDER A FORMULA ESTABLISHED BY FEDERAL LAW. UNDER THIS FORMULA, THE UNITED STATES PAYS 90% OF COVERED TERRORISM LOSSES EXCEEDING THE STATUTORILY ESTABLISHED DEDUCTIBLE PAID BY THE INSURANCE COMPANY PROVIDING THE COVERAGE. THE PREMIUM CHARGED FOR THIS COVERAGE IS PROVIDED BELOW AND DOES NOT INCLUDE ANY CHARGES FOR THE PORTION OF LOSS COVERED BY THE FEDERAL GOVERNMENT UNDER THE ACT.

**SELECTION OR REJECTION OF TERRORISM INSURANCE COVERAGE**

UNDER FEDERAL LAW, YOU HAVE THIRTY (30) DAYS TO CONSIDER THIS OFFER OF COVERAGE FOR TERRORIST ACTS AND SUBMIT THE PREMIUM REQUIRED. IF WE DO NOT RECEIVE THE QUOTED PREMIUM BY \_\_\_\_\_, THE TERRORISM EXCLUSION NULLIFIED BY THE ACT WILL BE REINSTATED ON \_\_\_\_\_, AND YOU WILL NOT BE COVERED FOR LOSSES ARISING FROM TERRORIST ACTS THAT WERE PREVIOUSLY EXCLUDED.

	I hereby elect to purchase Terrorism coverage for a prospective premium of \$ _____.
	I hereby elect to have the exclusion for terrorism coverage reinstated. I understand that I will have no coverage for losses arising from acts of terrorism that were previously excluded.

\_\_\_\_\_  
Policyholder/Applicant's Signature

\_\_\_\_\_  
Insurance Company

\_\_\_\_\_  
Print Name

\_\_\_\_\_  
Policy Number

\_\_\_\_\_  
Date