



**SUMMARY OF THE TERRORISM RISK INSURANCE ACT OF 2002 AND THE  
TERRORISM RISK INSURANCE EXTENSION ACT OF 2005**

**Updated as of December 22, 2005**

This FAQ regarding the Terrorism Risk Insurance Act of 2002 and the Terrorism Risk Insurance Extension Act of 2005 is not intended to provide specific advice about individual legal, business or other questions. It was prepared solely for use as a guide, and is not a recommendation that a particular course of action be followed. If specific legal or other expert advice is required or desired, the services of an appropriate, competent professional, such as an attorney, should be sought.

## **Background and Purpose of this Summary**

The Terrorism Risk Insurance Extension Act of 2005 (“TRIA Extension”) was signed into law by President Bush on December 22, 2005 in order to extend the Terrorism Risk Insurance Act of 2002 (“TRIA”), which was set to expire at the end of 2005. The TRIA Extension and TRIA are together referred to in this document as the “Acts”.

The Acts provide a federal backstop for certain acts of terrorism via a temporary federal program for sharing with the insurance industry the risk of loss from foreign terrorist attacks. This federal backstop program (“Program”) is designed to “protect consumers by addressing market disruptions and ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk” and “allow for a transitional period for the private markets to stabilize, resume pricing of such insurance, and build capacity to absorb any future losses, while preserving State insurance regulation and consumer protections.”

The purpose of this summary is to provide an overview of the major features of the Acts and Regulations and to consider some of the issues related to their implementation. A copy of the Acts, Regulations, and information about them, as well as a comprehensive overview of the proactive advocacy work of the Big “I” Federal Government Affairs team on the deliberations and coordination of industry efforts leading to passage of the legislation, are available for IIABA members on [www.independentagent.com](http://www.independentagent.com), under Legal Advocacy, by selecting Memoranda & FAQs.

### **1. Do the Acts cover independent insurance agents and brokers?**

The Acts do not impose any duties or responsibilities on independent insurance agents and brokers. However, agents and brokers may have a role in working with insurers on their compliance with the Acts since agents and brokers often are the first or primary point of contact for policyholders. Information on possible ways agents and brokers may

be involved in working with insurers on their compliance with the Acts is addressed in FAQ 2., below.

## **2. What is the role of independent insurance agents and brokers under the Acts?**

The Acts do not impose any duties or responsibilities on independent insurance agents or brokers (referred to as “producers” or “intermediaries” in Regulations issued by the Treasury Department effective on October 17, 2003). However, agents and brokers may have a role in working with insurers on their compliance because agents and brokers often are the first or primary point of contact for policyholders. Thus, insurers may want to look to agents and brokers to provide notices of the: (i) premium charges for insured losses covered by the federal backstop Program and federal government share of compensation for insured losses (see FAQ 13.); or (ii) notices that allow insurers to exclude coverage for acts of terrorism (see FAQ 15.). This option is available to insurers that normally communicate with a policyholder through an agent or broker. Conversely, an insurer that normally communicates directly with a policyholder must make its disclosure directly, not through its agent or broker.

Agents and brokers can use forms and information provided by the insurers whose products they sell to provide such notices when requested. This is most likely to occur at the time of an offer or purchase of a policy, and on renewals of policies that are billed by the agent or broker. However, insurers remain responsible for ensuring that the disclosures are provided to policyholders in accordance with the Acts.

## **3. What are “acts of terrorism” under the Acts?**

The Acts are applicable when the Secretary of the Treasury, in concurrence with the Secretary of State and Attorney General, certifies an event as an “act of terrorism.” To be certified as an “act of terrorism,” the act must:

- Be violent or dangerous to human life, property, or infrastructure;
- Result in damage within the U.S., (or outside the U.S. in the case of certain air carriers, vessels or U.S. missions); and
- Be committed by someone acting on behalf of a foreign person or interest, as part of an effort to coerce the civilian population of the U.S. or to influence the policy or affect the conduct of the U.S. government by coercion.

**An act is NOT an act of terrorism under the Acts if:**

- It is committed as part of the course of a war declared by Congress (except that this exclusion does not apply to workers’ compensation claims);

- It results in damage within the U.S. but is not committed by someone acting on behalf of a foreign person or interest (for example, the bombing in Oklahoma City, committed within the U.S. but not by someone acting on behalf of a foreign person or interest);
- Property and casualty insurance losses from the act of terrorism, in the aggregate, do not exceed \$5 million; or
- It is any other occurrence not defined by the Acts as an act of terrorism.

#### 4. What insurers are covered by the Acts?

For the purpose of the Acts, “insurer” means any entity (or corporate affiliate of the entity) that is:

- A licensed or admitted insurer in any state;
- An eligible surplus lines carrier listed on the NAIC Quarterly Listing of Alien Insurers (for more information, go to: <http://www.naic.org/1finance/international-loyds/index.htm>);
- An insurer approved to offer property and casualty insurance by a federal agency in connection with maritime, energy or aviation activity;
- A state residual insurance entity or state workers’ compensation fund; or
- Any captive or other self-insuring entity approved by the Secretary of the Treasury, in its discretion. (Self-insurance arrangements by municipalities or other entities such as workers’ compensation and state workers’ compensations insurance pools also may be approved or, in some instances, designated as mandatory participants, by the Secretary of the Treasury.)

#### 5. What lines of insurance are covered by the Acts?

The Acts apply to insured losses from acts of terrorism for primary and excess **commercial lines** of property and casualty insurance, including umbrella or excess coverage, directors and officers liability insurance and worker’s compensation insurance. The Acts do **NOT** apply to **personal lines**; crop; livestock; mortgage; financial guaranty; medical malpractice; flood; life and health insurance; commercial automobile insurance; burglary and theft insurance; surety insurance; professional liability insurance; or farm owners multiple peril insurance. The Secretary of the Treasury conducted a study regarding the advisability of the inclusion of group life insurance coverage (as required by TRIA) and concluded that there is no need to extend the Acts to group life coverage.

The Acts requires that coverage for insured losses for acts of terrorism not differ materially from the terms, amounts, and other coverage limitations applicable to losses

arising from events other than acts of terrorism. Thus, to the extent that exclusions or limitations otherwise apply to coverages (e.g., nuclear, flood), it is possible that coverage for acts of terrorism may similarly be excluded or limited.

## **6. What time periods are covered by the Acts?**

The Acts establish time periods to calculate the financial obligations of insurers and the federal government under the Acts at different times. Those time periods are broken down as follows:

- **Transition Period:** November 26, 2002 to December 31, 2002
- **Program Year 1:** January 1, 2003 to December 31, 2003
- **Program Year 2:** January 1, 2004 to December 31, 2004
- **Program Year 3:** January 1, 2005 to December 31, 2005
- **Program Year 4:** January 1, 2006 to December 31, 2006
- **Program Year 5:** January 1, 2007 to December 31, 2007

## **7. How does loss sharing work under the Acts?**

The federal government will not share the loss of risk for losses from acts of terrorism that in the aggregate do not exceed specified amounts, referred to as the “Program Trigger.” The Program Trigger is \$5 million through March 31, 2006; \$50 million in Program Year 4 and \$100 million in Program Year 5. That means that each carrier will be responsible in accordance with the terms of the carrier’s policies for its share of losses resulting from any act of terrorism which does not cause industry losses exceeding the Program Trigger for a particular period.

For losses from acts of terrorism that exceed the Program Trigger for a particular period, the following rules apply:

- Each affected insurer pays its deductible (per the formula below in FAQ 9.), and the excess loss above the deductible for Program Year 4 is paid 10% by insurers and 90% by the federal government and the excess loss above the deductible for Program Year 5 is paid 15% by insurers and 85% by the federal government.
- Losses from a single or multiple acts of terrorism in a single Program Year in excess of \$100 billion – not payable by either the government or insurer (provided that the insurer has paid its deductible); that is policyholders are potentially subject to a proportionate reduction in coverage to the extent losses from all certified acts within the Program Year exceed this \$100 billion cap.

## 8. How are insurer deductibles calculated?

Insurer deductibles are calculated as follows:

- **Transition Period** (November 26 – December 31, 2002):  
1% of direct earned premiums from calendar year 2001
- **Program Year 1** (January 1, 2003 – December 31, 2003):  
7% of direct earned premiums from calendar year 2002
- **Program Year 2** (January 1, 2004 – December 31, 2004):  
10% of direct earned premiums from calendar year 2003
- **Program Year 3** (January 1, 2005 – December 31, 2005):  
15% of direct earned premiums from calendar year 2004
- **Program Year 4** (January 1, 2006 – December 31, 2006):  
17.5% of direct earned premiums from calendar year 2005
- **Program Year 5** (January 1, 2007 – December 31, 2007):  
20% of direct earned premiums from calendar year 2006

There are special rules for determining the deductible for a new insurer that has not had a full year of business on which to calculate its direct earned premiums.

## 9. Does the federal government get reimbursed?

Yes, there is a mandatory recoupment requirement whereby insurers will be required to collect a surcharge from their policyholders which must, in the aggregate, repay the federal government for specified amounts of insured losses based on a formula that varies by Program year. The recoupment formula requires the government to impose surcharges on policyholders to recoup the difference between the aggregate industry/policyholder retention amount for the time period at issue and the aggregate amount of insured losses paid for directly by insurers through application of the per insurer retention requirements and their co-share payments. The annual aggregate retention amounts required of the insurance marketplace are:

- **Transition Period through Program Year 1** (November 26, 2002 – December 31, 2003):

\$10 billion or the aggregate amount, for all insurers, of all insured losses during this period, whichever is less

- **Program Year 2** (January 1, 2004 – December 31, 2004):

\$12.5 billion or the aggregate amount, for all insurers, of insured losses during this period, whichever is less

- **Program Year 3** (January 1, 2005 – December 31, 2005):

\$15 billion or the aggregate amount, for all insurers, of insured losses during this period, whichever is less

- **Program Year 4** (January 1, 2006 – December 31, 2006):

\$25 billion or the aggregate amount, for all insurers, of insured losses during this period, whichever is less

- **Program Year 5** (January 1, 2007 – December 31, 2007):

\$27.5 billion or the aggregate amount, for all insurers, of insured losses during this period, whichever is less

The mandatory recoupment by the federal government will be funded by a policy surcharge of up to a 3% terrorism loss risk-spreading premium on commercial lines property and casualty policies.

The easiest way to illustrate how the recoupment requirement operates is an example. Assume that insured losses related to foreign acts of terrorism in 2003 total \$20 billion, that insurer retentions total \$5 billion, and that insurer co-pays total \$1.5 billion. The Department of the Treasury is required to impose policyholder surcharges sufficient to collect \$3.5 billion (\$10 billion less the \$6.5 billion in insurer payments related to insured losses), and it also has the discretion, but is not required, to impose policyholder surcharges to collect some or all of the other \$10 billion in federal government payments under the Program.

## 10. Can insurers charge for coverage for acts of terrorism?

Yes, the Act permits insurers to charge a premium for any terrorism exposures that are insured but not reimbursed by the federal government. Insurers may refer to the charge as a portion or percentage of annual premium, but may not characterize it as a surcharge

because that term would be misleading in the context of the Program (since the term “surcharge” is used in the Acts in connection with the statutorily required recoupment).

For the period beginning with enactment of TRIA and ending December 31, 2003, for acts of terrorism covered by the Acts, the rates and forms applied to individual properties and classes of exposures were not subject to prior approval or waiting periods under state laws, however: (i) rate filings that are determined to be excessive, inadequate or unfairly discriminatory can still be nullified by states; and (ii) forms previously subject to prior approval by states were, during that period subject only to subsequent review. Prior approval and waiting periods under state law once again apply after December 31, 2003.

**11. What are the penalties for non-compliance with the Acts?**

The Treasury Secretary has authority to assess a monetary penalty against any insurer that fails to charge, collect or remit terrorism loss risk-spreading premiums; intentionally provides erroneous premium or loss information; submits fraudulent claims; or otherwise fails to comply with the Acts or regulations issued under the Acts. The amount of such a civil penalty can be \$1 million and, in the case of a failure to charge, collect or remit premiums, the civil penalty can be the amount in dispute if it is more than \$1 million. Further, insurers that fail to comply with the notice provisions (described in FAQs 13. and 14.) are not permitted to receive loss sharing assistance from the federal government under the terms of the Acts.

**12. Is the Treasury Secretary’s decision on certification of acts of terrorism the final word, and are there any other litigation reforms in the Acts?**

The Treasury Secretary’s certification of, or determination not to certify, an act as an act of terrorism, is final and not subject to judicial review. It is possible that ISO and/or insurers will seek to implement punitive damage exclusion endorsements where permitted by law. If an act of terrorism has been certified, a federal cause of action is the exclusive remedy for property damage, personal injury or death, and the applicable law is the law of the state in which the act of terrorism occurred. Any punitive damages awarded in such litigation for acts of terrorism shall not count as insured losses under the Acts.

**13. How and when are policyholders notified of the availability and cost of coverage for acts of terrorism?**

Insurers must clearly and conspicuously disclose to policyholders as a separate line item the premium charged for insured losses covered by the federal backstop Program and the federal government’s share of compensation for insured losses, as follows:

- For any policy issued prior to November 26, 2002, notice was required to be given by February 24, 2003;

- For any policy issued between November 26, 2002 and February 24, 2003, notice must be given at the time of the initial offer, and at the time of the initial offer of renewal of the policy; and
- For any policy issued after February 24, 2003, notice must be given on a separate line item on the declarations page or within any rider or endorsement made part of the policy at the time of the initial offer, and at the time of the initial offer of renewal of the policy, and the terrorism charge also must be included in the policy as a separate line item.

**14. Is a specific form required to be used for policyholder notices about the availability and cost of coverage for acts of terrorism?**

No. There is no specific: (i) form required for policyholder notification; (ii) mandatory language required in any such form; or (iii) typeface or font needed for the notice. Certain National Association of Insurance Commissioners model forms have been approved by the Department of Treasury as “an acceptable, nonexclusive way in which an insurer could satisfy the disclosure requirement.” (These model forms are available at the Program’s Web site <http://www.treasury.gov/trip>.) Insurers that elect to modify those forms or use other forms can do so as long as the insurer’s notices comply with the “clear and conspicuous” standard in the Acts.

**15. Can insurers reinstate exclusions for acts of terrorism?**

Yes, exclusions for foreign acts of terrorism voided on November 26, 2002 when TRIA was signed into law can be reinstated in a commercial lines property and casualty policy in force on November 26, 2002, but **ONLY** if:

- The insurer receives a written statement from the insured authorizing reinstatement of the exclusion; or
- The insured fails to pay the premium for such coverage and the insurer provided at least 30 days notice before any such reinstatement of: (i) the increased premium for such terrorism coverage; and (ii) the rights of the insured with respect to such coverage, including the date the exclusion would be reinstated if no payment is received.

**16. Can insurers mandate that policyholders purchase terrorism coverage or risk having the policy cancelled?**

It depends. Nothing in the Acts or the Regulations issued under the Acts precludes carriers from canceling commercial lines insurance policies if insureds choose not to purchase terrorism coverage, and conversely, nothing authorizes them to do so. This issue is governed by applicable state law.



The Acts and the Regulations provide that carriers must “make available” terrorism coverage to all commercial lines insureds and that those policyholders must be notified of the availability of the terrorism coverage at specific times. However, the “make available” provisions of the Acts and the Regulations do not restrict carriers from attaching conditions to policies when such terrorism coverage must be offered if such conditions are permissible under applicable state law. Thus, because the terrorism coverage cannot differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism, if other coverage provisions can be offered on the basis that they must be accepted for a policy to remain in effect, then that same approach can be used for terrorism coverage. State law controls the acceptability of specific forms and terms of coverage, so state law will determine if coverage (such as terrorism coverage) can be offered in a manner that allows the carrier to cancel a policy if that coverage is not purchased.

## **17. How is agents’ errors and omissions insurance affected by the Acts?**

The Acts raises two key questions relative to agents’ errors and omissions coverage: (1) is there errors and omissions coverage arising from an act of terrorism; and (2) can potential claims against an agent or broker be prevented?

Agents and brokers should seek guidance from their errors and omissions providers about how they will handle coverage, premium charges, and potential exclusions from such policies relating to acts of terrorism. For IIABA members covered by the Big “I” Professional Liability Program through ERC/Westport (or its successor), an act of terrorism does not impact the coverage provided to them under their current errors and omissions policies; the trigger for a loss under the errors and omissions insurance is a negligent act, error or omission during the rendering of professional services, not the act of terrorism.

ERC/Westport has not made any premium charges in the past for providing errors and omissions coverage arising from terrorism.

## **18. Where is there additional information about the Act?**

A complete copy of the Terrorism Risk Insurance Act of 2002, the Terrorism Risk Insurance Extension Act of 2005, relevant Treasury Department information and Regulations, NAIC bulletins and model forms, ISO rules/forms analyses, and links to critical information from other sources on this issue, is available for IIABA members at [www.independentagent.com](http://www.independentagent.com), under Legal Advocacy by selecting Memoranda & FAQs.

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