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BULLETIN

TO: All Self-Insured Workers' Compensation Pools

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Department of Commerce and Insurance

RE: Compliance with Terrorism Risk Insurance Act of 2002

DT: August 25, 2005

The purpose of this Bulletin is to communicate the Department's position regarding the application of the Terrorism Risk Insurance Act of 2002, 15 USC § 6701 (hereinafter referred to as "TRIA" or the "Act") to self-insurance pools. It is the Department's position that all self-insurance pools must comply with the Act as the pools meet the definition of "insurer" as defined in the Act.

The purpose of the Act was to create a program where the federal government would share the risk of loss from future terrorist attacks with the insurance industry. The Act was necessary due to the reinsurance industry's announcement that they would not provide coverage for future acts of terrorism after the losses they experienced because of the terrorist events of September 11, 2001. The Act was signed into law by President George W. Bush on November 26, 2002. As written, the program created by the Act will expire on December 31, 2005, unless extended by Congress.

Participation in the TRIA program is mandatory for entities deemed to be an "insurer" under the definition created by the Act and it imposes two (2) mandatory requirements. The first requirement is that all insurers must make available terrorism coverage on all commercial property and casualty lines of insurance. The required coverage cannot differ materially from the terms, amounts and other coverage limitations applicable to losses from events other than terrorism. The second requirement is that all insurers are required to provide clear and conspicuous disclosures to their policyholders of the premium charged for the terrorism risk coverage.

Section 102(6) of the Act defines an "insurer" as any entity:

> (A) that is
>
> (i) licensed or admitted to engage in the business of providing primary or excess insurance in any State;
>
> (ii) is not licensed or admitted as described in clause (i), if it is an eligible surplus line carrier…;

(iii) approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy, or aviation activity;

(iv) a State residual market insurance entity or State workers' compensation fund; or

(v) any other entity described in section 103(f) to the extent provided in the rules of the Secretary issued under section 103(f);

(B) that receives direct earned premiums as required by section 102(6)(B); and

(C) that meets any additional criteria established by the Treasury pursuant to section 102(6)(C).

A. Licensed or Admitted to Engage in the Business of Primary or Excess Insurance Requirement

In order for the Act to apply to a self-insurance pool, the pool must meet the definition of "insurer" found in Section 102(6)(A). The Treasury Department has provided further guidance on whether self-insurance pools are considered "licensed or admitted to engage in the business of providing primary or excess insurance" under section 102(6)(A)(i) in an interpretive letter issued on October 5, 2004. In this letter, the Treasury Department recognized that in some instances entities that are not traditionally thought of as "insurers" could meet the definition provided under the Act. The Final Rule adopted by the Treasury Department requires a three (3) part test to be satisfied to define "insurer". Under this Rule, for an entity to be deemed to be an "insurer" for purposes of the Act, the entity must:

> (1) Have gone through a process of being licensed or admitted to engage in the business of providing primary or excess insurance that is administered by the State's insurance regulator, which process generally applies to insurance companies or is similar in scope and content to the process applicable to insurance companies; (2) be generally subject to State insurance regulation, including financial reporting requirements, applicable to insurance companies within the State; and (3) be managed independently from other insurers participating in the program.

31 C.F.R. § 50.5(f)(1)(i)(A)(1)-(3).

(1) Licensing Process.

Although self-insurance pools are not licensed in the same manner as insurance companies are licensed, a similar licensing process is in place for the pools. Prior to operating, a pool must obtain a certificate of authority in accordance with Tenn. Code Ann. § 50-6-405(c), and the licensing process outlined by Chapter 0780-1-54.

In order to receive a certificate of authority, a pool must submit an application to the Commissioner which includes information relative to the operation of the pool such as copies of the bylaws of the pool, information on the board of trustees and copies of

agreements entered into by the pool. The administrator and third party administrator for the pool must also be approved by the Commissioner. Evidence of the pool's financial condition must be submitted. To further review the pool's financial condition, the Department requires the following information: (1) proof of payment by each member of twenty-five percent (25%) of the member's first year premium; (2) evidence that the pool meets the annual standard premium requirement; (3) evidence of specific and aggregate excess insurance policies; and (4) posting of the required security.

The Department analyzes the operations of the pool to ensure the pool is properly organized and managed. The qualifications of the board of trustees, administrator, and third party administrator are reviewed to ensure that these persons and entities are capable of making day-to-day operational decisions and providing claims handling services. The Division analyzes the pool's financial condition to determine that the pool is capable of paying all of the workers' compensation claims for the covered employees. The review of the pool's operations and financial condition is similar to the review that is conducted when determining whether to license an insurance company. Therefore, the licensing process for the pools is similar in scope and content to the process for insurance companies.

(2) Generally Subject to State Insurance Regulation

The second element to determine if an entity is an "insurer" is that the entity must be generally subject to state insurance regulation. The Treasury Department's October 5, 2004, interpretative letter provides relevant guidance on this element, and found that a self-insurance pool met this element despite the existence of a regulation which generally exempted the pool from the Kansas Insurance Code. The Treasury Department reasoned that the Kansas law, while not subjecting the pool to the insurance code per se, did place similar requirements on the pool that was placed on insurance companies by the Kansas Insurance Code.

The same holds true for the regulation of self-insurance pools in this state. The pools' regulation can be likened to that imposed on insurance companies in several different ways. The pools are required to submit annual financial statements and to file actuarial opinions addressing the pool's loss reserves. If a pool elects to issue a dividend to its members, the law places certain restrictions on its disbursement. The pools are subject to examination by the Commissioner and are required to be examined once every five (5) years. Finally, in the event a pool is operating in a financially hazardous condition, the Commissioner may place the pool in receivership in the same manner as domestic insurance companies.

Additional similarities can be drawn from the areas of rate filings, premium taxes, and the applicability of laws generally prohibiting unfair or deceptive methods of competition.

For the reasons stated above, the self-insurance pools are generally subject to insurance laws and would meet this element of the test. This element is met despite the fact that the current regulation states that the pools are not to be treated as insurance companies.

(3) Independent Management.

The third element requires the entity to be independently managed. The self-insurance pools must be independently managed apart from other insurers participating in the federal program. As the exclusive management authority of the pools is vested in the board of trustees, and not other insurers, this part is satisfied.

B. Direct Earned Premium Requirement

The second requirement for an entity to be deemed as "insurer" under the Act is found in Section 102(6)(B) and requires the entity to receive direct earned premium. This is defined as direct earned premium for property and casualty insurance issued by any insurers for insurance against losses generally occurring within the United States. A pool collects premiums from the members to enable the pool to pay its administrative costs and claims submitted by covered employees. The premiums charged to a member are based on the same factors as premium charged by an insurance company. The pool is required to adhere to the designated rate service organization's manual rules and filings to the same extent as insurance companies. Therefore, the pools are providing coverage from property and casualty lines and are collecting premiums for such insurance.

C. Additional Requirements

The third requirement for an entity to be deemed an "insurer" under the Act is found in section 102(6)(C) which allows the Treasury to adopt additional criteria. At this time, additional criteria have not been established by the Treasury.

In conclusion, it is the position of this Department that the self-insurance pools formed pursuant to Tenn. Code Ann. § 50-6-405(c) meet the definition of "insurer" under the Act. While, Tennessee law prohibits exclusions in workers' compensation policies for acts of war and terrorism, pools are still subject to the disclosure requirement of the Act. Pools charging for terrorism coverage must provide clear and conspicuous disclosures of the premium charged for the terrorism risk coverage. Additionally, if a pool charges its members for terrorism coverage, it would have to charge the amount filed by the Commissioner's designated rate service organization pursuant to Tenn. Code Ann.§ 56-5-320.