July 7, 2004

Dear Mr. C:

This letter is in response to your request for an interpretation concerning the application of the Terrorism Risk Insurance Act of 2002 (the "Act")[1] and Treasury's regulations to the status of the Workers' Compensation Reinsurance Association ("WCRA").[2]

WCRA is a non-profit, tax-exempt association created by the Minnesota legislature in 1979. WCRA provides excess reinsurance to all primary workers' compensation insurers and self-insured employers in Minnesota, who by law are required to be members of the association. Although WCRA is a state workers' compensation reinsurance pool (a class of entities that the Secretary of the Treasury has not yet decided to include in the Program),[3] we determined and stated in our Final Rule on state residual market insurance entities that WCRA was a unique entity that shares the characteristics of a state residual market mechanism.[4] Treasury added WCRA to its *List of State Residual Market Mechanisms* and confirmed that WCRA is an insurer participating in the Program.

You asked whether Treasury considers WCRA to be a separate insurer (separate from its member insurers) under the Program. If treated as separate insurer, WCRA would submit the claim(s) for Federal payment for the Federal share of the insured losses insured through the association. If WCRA is not treated as a separate insurer, the Federal share would be based on the insured losses submitted by the association's member-insurers (and subject to the individual member deductibles) according to how the association allocates the insured losses among its members. For the reasons explained below, we have determined that WCRA is a separate insurer under the Program.

The Act recognizes only two categories of state residual market mechanisms -- those that share profits and losses with private sector insurers and those that do not. The regulations at 31 C.F.R. §§ 50.33 and 50.35 follow that structure. Under the Act and our regulations, a state residual market mechanism that does not share profits and losses with private-market insurers is treated as a separate insurer.[5] Conversely, a state residual market mechanism that does share profits and losses with private-market insurers is not

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[1] P.L. 107-297, 116 Stat. 2322, 15 U.S.C. § 6701, note.

[2] This response is being issued pursuant to 31 C.F.R. §50.9, which sets forth a procedure whereby persons actually or potentially affected by the Act or regulations may request an interpretation.

[3] *See* P.L. 107-297, Sec. 103(f).

[4] *See generally*, 68 Fed. Reg. 59715, 59717-18 (Oct. 17, 2003).

[5] P.L. 107-297, Sec. 103(d)(2)(A); 31 C.F.R. §50.33.

treated as a separate insurer under the Program.[6] In that case, the state residual market mechanism is required to report to each private sector insurance participant its share of the insured losses, which must be included in each member-insurer's insured losses.

State residual market mechanisms that do not share profits and losses with insurers must calculate their direct earned premium and insurer deductible (and submit claims for Federal payment) as a separate insurer. As we stated in our final rule, "[r]esidual market mechanisms functioning in this manner are thus treated as risk bearers in the same manner as private sector insurers."[7] State residual market mechanisms that do share profits and losses with participating insurers are "treated as risk apportioning entities and not risk bearing entities."[8]

As stated earlier, WCRA is a unique entity and although we found it to be similar enough to a residual market mechanism to be included in the Program as such, WCRA does not operate like a traditional residual market mechanism that shares its profits and losses. Even though WCRA has the ability to share losses with members, you indicate that WCRA has never shared losses with its members. Thus, it does not share its "profits and losses" as contemplated for treatment as an entity that is not a separate insurer. In addition, WCRA does not share its profits with its member insurers on an annual basis as do typical state residual market mechanisms that share profits and losses. WCRA has only occasionally distributed surplus funds (*i.e.*, profit) to its member insurers -- it has done so only 4 times in the last 24 years.

Under these circumstances, and because the regulations do not contemplate a unique entity such as WCRA, we have concluded that it is appropriate to treat WCRA as a separate insurer. WCRA functions as a risk bearer in the same manner as private sector insurers and is not simply a risk apportioning mechanism. Accordingly, we have determined WCRA to be a separate insurer under the Program.

We now address the more specific questions in your letter. Based on the above, in the event of a certified act of terrorism, WCRA will be eligible to submit a claim directly as a separate insurer. WCRA's direct earned premium and insurer deductible is to be calculated pursuant to our regulations based on the direct earned premium it receives from its members -- all primary workers' compensation insurers and self-insured employers in Minnesota. Primary workers' compensation insurers in Minnesota would be allowed to deduct premium paid to WCRA from their direct earned premium calculations under the Program, and they would not be able to include any insured losses associated with those premiums in their individual claims for Federal payment under the Program. Similarly, while Treasury has yet to address issues associated with any recoupment under the Program, Treasury expects there to be close correlation between

[6] *Id.* at 103(d)(2)(B), §50.35.

[7] 68 Fed. Reg. 59715, 59718 (Oct. 17, 2003).

[8] *Id.*

the policies from which an insurer's direct earned premium is derived and the policies subject to recoupment.

Thank you for your inquiry. For additional information or if you have any specific questions, please call the Program office at 202-622-6770.

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This response addresses the application of the Act and regulations to the specific situation set forth in your request, as you have represented the facts to Treasury. If there is a change in any of the facts or assumptions presented, and such facts or assumptions are material to a conclusion presented in this response, then the requestor may not rely on that conclusion generally or as support for any proposed or subsequent activity. This response is provided by the Terrorism Risk Insurance Program as a means of stating its current interpretation of the Act and regulations. The Program may revise or revoke this interpretation upon its own initiative or upon the enactment of amendments to the Act or regulations.

TERRORISM RISK INSURANCE PROGRAM

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Jeffrey S. Bragg
Executive Director