

Guidance IV). Interim Guidance IV provided insurers a procedure by which they could seek to rebut a presumption of control established in Treasury's first set of interim final regulations. See Previously Issued Regulations in section C below and Treasury's Web site at <http://www.treasury.gov/trip>.

In issuing each notice of Interim Guidance, Treasury stated that the Interim Guidance may be relied upon by insurers until superseded by regulations or a subsequent notice. Treasury provided safe harbors for actions by those insurers taken in accordance with, and in reliance on, the interim guidance for the time period prior to the issuance of regulations.

C. Previously Issued Regulations

Treasury published the first regulation implementing the Act on February 28, 2003 (68 FR 9804) as an interim final rule together with a proposed rule. Both request comments by March 31, 2003. The first regulation, which is subpart A of new part 50 in Title 31 of the CFR, covers the purpose and scope of the Program, key definitions, and certain general provisions.

In addition, Treasury has published an interim final rule on requirements concerning disclosures that insurers must make to policyholders as a condition for federal payment under the Act, and requirements that insurers make available, in their commercial property and casualty insurance policies, terrorism risk coverage for insured losses under the Program. (See Subparts B and C of 31 CFR Part 50).

II. The Proposed Rule

Section 102(6) of the Act includes State residual market insurance entities and State workers' compensation funds as insurers that are required to participate in the Program. Section 103(d) of the Act requires Treasury to "issue regulations, as soon as practicable after the date of enactment of this Act, that apply the provisions of this title [Title I] to State residual market insurance entities and State workers' compensation funds." Pursuant to this statutory directive, Treasury is issuing this notice of proposed rulemaking.

A. Mandatory Participation as an "Insurer"

State residual market insurance entities and State workers' compensation funds have been established to provide insurance coverage where private insurance companies are unwilling or unable to provide coverage. Private insurance

companies may be unwilling or unable to provide coverage because of the policyholder's risk profile or because the economics of a particular transaction are not consistent with the types of risk the insurer is willing or able to underwrite. In some cases a residual market entity shares the risks of its underlying policies with insurance companies that provide certain types of coverage within the state, and in other cases a residual market entity operates on a stand alone basis.

All entities that meet the definition of "insurer" in section 102(6)(A) and (B) and, if prescribed by Treasury, criteria in 102(6)(C), of the Act are required to participate in the Program. Section 102(6)(A)(iv) includes State residual market insurance entities and State workers' compensation funds in the definition of insurer for purposes of the Program. Treasury considers the term State residual market insurance entity to encompass all such residual market entities that arrange for or provide commercial property and casualty insurance coverage. This includes residual market entities associated with the provision of commercial property, liability, workers' compensation, and automobile (including State automobile funds) coverage. Section 102(6)(B) provides an exception to the direct earned premium requirement for State residual market entities and State workers' compensation funds. Treasury has issued no regulatory criteria under section 102(6)(C). Therefore, State residual market insurance entities and State workers' compensation funds are insurers covered by the Program and required to participate in the Program. Section 103(d) of the Act requires Treasury to issue regulations as soon as practicable to apply the provisions of the Act to these types of insurers.

Following consultation with the NAIC, Treasury identified a group of entities that falls within the category of State residual market insurance entities and State workers compensation funds. Treasury included this list as part of its Interim Guidance II (67 FR 78864). In that notice of interim guidance, Treasury also requested that any State residual market insurance entity or State workers' compensation fund, not included on the list, notify Treasury. In response, Treasury received additional information and a number of suggestions concerning the State residual market entities and State workers' compensation funds on the list. After consideration of this additional information and further consultation with the NAIC, Treasury has updated and expanded the initial list in the interim guidance of State

residual market insurance entities and State workers' compensation funds. This revised list will be updated as necessary, and publicly available at <http://www.treasury.gov/trip>.

B. Treatment or Allocation of Premium

Section 103(d)(2) of the Act divides State residual market insurance entities into two broad classes for purposes of their treatment as insurers under the Program: (1) Entities that *do not* share profits and losses with private sector insurance companies; and (2) entities that *do* share profits and losses with private sector insurance companies. Section 103(d)(2)(A) provides that "a State residual market insurance entity that does not share its profits and losses with private sector insurers shall be treated as a separate insurer." For State residual market insurance entities that fall under section 103(d)(2)(A) or for State workers' compensation funds Treasury is proposing that these entities follow the regulatory guidelines set forth in 31 CFR 50.5(d)(1) or 50.5(d)(2) for the purposes of calculating the appropriate measure of direct earned premium.

Section 103(d)(2)(B) of the Act provides that "a State residual market insurance entity that shares its profits and losses with private sector insurers shall not be treated as a separate insurer, and shall report to each private sector insurance participant its share of the insured losses of the entity, which shall be included in each private sector insurer's insured losses." Section 103(d)(3) further provides that "any insurer that participates in sharing profits and losses of a State residual market insurance entity shall include in its calculations of premiums any premiums distributed to the insurer by the State residual market insurance entity." A significant number of State residual market entities share their profits and losses with private sector insurance companies, including entities that arrange for commercial automobile, property, and workers' compensation coverages. In addition, some State residual insurance market entities contract with private sector insurance companies, which act as servicing carriers. In a servicing carrier arrangement, a private sector insurance company issues and services the residual market entity's policies in exchange for a servicing fee. The servicing carrier does not bear the ultimate risk of such policies, but rather that risk is shared by all the insurance companies that participate in the residual market. However, other residual market entities (e.g., most property plans) do not use servicing