

will receive the Federal payment that is to be distributed within the consolidated insurer group in accordance with distribution of risk within the consolidated insurer group.

Treasury also solicited comment on various means to ensure the prompt distribution of the federal payment as appropriate to ensure that the purposes of the Program are not thwarted or evaded, and that the ultimate risk bearing entities are treated in an equitable manner, within the Act's requirements. Treasury will propose means of distribution of the federal payment in connection with the claims procedures at a later date.

*C. Direct Earned Premium (Section 50.5.d) and Property and Casualty Insurance (Section 50.5.l)*

The Act requires that "commercial property and casualty insurance" that falls within the scope of "insured loss" and that is written by an "insurer," is part of the Program, and thus eligible for Federal payments and also subject to other provisions of the Act. Losses arising from a certified act of terrorism that do not meet these requirements are not eligible for Federal payments under the Program. For those losses that are eligible, the amount of Federal payment that an insurer may receive is subject to the insurer's "insurer deductible," which is determined by a calculation based on the insurer's "direct earned premium".

In the interim final rule, Treasury initially looked to the Act's definition to ascertain the scope of commercial property and casualty insurance for purposes of the Program. Section 102(12) of the Act expressly includes several lines of insurance: excess insurance, workers' compensation insurance and surety insurance. It also expressly excludes several additional lines of insurance: (i) Federal crop insurance issued or reinsured under the Federal Crop Insurance Act or any other type of crop or livestock insurance that is privately issued or reinsured; (ii) private mortgage insurance as defined in the Homeowners Protection Act or title insurance; (iii) financial guaranty insurance issued by monoline financial guaranty insurance corporations; (iv) insurance for medical malpractice; (v) health or life insurance including group life insurance; (vi) flood insurance provided under the National Flood Insurance Act of 1968; and (vii) reinsurance or retrocessional reinsurance.

In addition to these specific statutory inclusions and exclusions, Treasury needed to develop a uniform regulatory definition of commercial property and

casualty insurance for purposes of the Program. Insurance is generally regulated by State law in the United States. After consulting with the NAIC and others, Treasury found no uniform or consistent definition of "commercial property and casualty insurance" among the States that could provide guidance or be used for purposes of the Program. In some States, a line of insurance may be considered as commercial; and, in other States, the same line of insurance may be considered as a personal line.

The closest reference point that Treasury found for a uniform definition was the NAIC's Annual Statement's Exhibit of Premiums and Losses ("Statutory Page 14"). Therefore, the interim final rule incorporated the interim guidance issued at 67 FR 76206 that designated those commercial lines reported on specified lines of Statutory Page 14 as commercial property and casualty lines of coverage to be included in the Program (subject to the Act's specific inclusions and exclusions). The lines so specified were: Line 1 (Fire); Line 2.1 (Allied Lines); Line 3 (Farmowners Multiple Peril); Line 5.1 (Commercial Multiple Peril—non-liability portion); Line 5.2 (Commercial Multiple Peril—liability portion); Line 8 (Ocean Marine); Line 9 (Inland Marine); Line 16 (Workers' Compensation); Line 17 (Other Liability); Line 18 (Products Liability); Line 19.3 (Commercial Auto No Fault—personal injury protection); Line 19.4 (Other Commercial Auto Liability); Line 21.2 (Commercial Auto Physical Damage); Line 22 (Aircraft—all perils); Line 24 (Surety); Line 26 (Burglary and Theft); and Line 27 (Boiler and Machinery). In making this determination Treasury considered the Act's definition of "commercial property and casualty insurance" and how it relates to the lines of coverage listed on Statutory Page 14, the Program structure, and what would be necessary to effectively administer the Program. In developing the interim final rule, Treasury consulted with the NAIC and others regarding State law and premium reports filed with insurance regulators in the respective States and with the NAIC.

Section 102(4) of the Act defines "direct earned premium" to mean direct earned premium (DEP) for property and casualty insurance issued by any "insurer" for losses within the scope of "insured loss." The interim final rule also clarified that premium information on the specified lines of Statutory Page 14 should be included in calculating an insurer's DEP *only to the extent that coverage under the Program is provided for commercial property and casualty exposures*. Therefore, policies (or

portions of policies) not eligible for Federal payments under the Program, such as personal lines or other lines of coverage (such as medical malpractice) specifically excluded by the Act, should not go into the calculation of an insurer's DEP. Treasury's approach is designed to maintain a close correlation between the lines of commercial property and casualty insurance eligible for the Federal payments under the Program, and the amount of premiums for those coverages that actually go into calculating an insurer's DEP under the Program.

Many policies have combined risk coverage (hybrid policies). Under some hybrid policies, some of the risks or lines are covered by the definition of commercial property and casualty insurance under the Program and some are not covered. To address these situations, the interim final rule allows (but does not require) an insurer to allocate a portion of the premium (*i.e.* that portion for covered lines or risks) in calculating an insurer's DEP under the Program. If an insurer does not choose to allocate its hybrid policy premiums in this manner, then the entire DEP reported on the specific lines of Statutory Page 14 must go into its DEP calculation, and also, potentially, into the recoupment base for that insurer. Treasury has not yet issued rules or procedures governing any potential recoupment under section 103(e)(7) of the Act or concerning the surcharges required by section 103(e)(8) of the Act. However, it is Treasury's expectation that an insurer's policies (or portions of policies) that go into calculating an insurer's DEP would be the same policies (or portions of policies) that go into determining an insurer's recoupment base.

Instead of issuing a new reporting requirement or mandating a specific allocation formula for hybrid policies, Treasury has suggested several methods that insurers may use in adjusting and calculating their DEP under the Program:

(1) For policies with predominant personal line coverages, but where the premiums might also cover a portion for coverage of commercial risks, Treasury indicated that a policy would be considered personal, and not included in DEP, if the commercial portion was incidental (less than 25 percent of the total premium). If the commercial coverage portion represented more than 25 percent of the total premium, then the company should allocate the appropriate portion of the premium as commercial to be included in DEP.

(2) For policies written by insurers required to participate in the Program, but for which the premiums are not reported on Statutory Page 14 (*e.g.* certain county or town