

captive insurers may have little or no exposure to terrorism risk, thus captive insurers should not be subject to the Act's potential recoupment provisions; and mandatory participation requirements for captives, in particular the Act's potential recoupment provisions, could negatively affect the formation of domestic captives as companies may find setting up off-shore captives to be advantageous.

Treasury received one comment letter in support of treating State licensed or admitted captive insurers as mandatory participants under the Program.

Treasury also received a comment letter from the NAIC that described a split view on the part of State regulators over mandatory participation requirements for state-licensed or admitted captive insurers. Although the NAIC's comments included some of the points noted above, the NAIC also acknowledged that allowing opt-in treatment for captive insurers could allow for adverse selection and could set a bad precedent as other entities would seek similar treatment. In addition, the NAIC noted that "when pressed for a decision regarding whether a complete inclusion is better than a complete exclusion for captives, regulators generally agree that inclusion is preferable."

Treasury disagrees with the suggestion in some comments that captive insurers should be provided with opt-in treatment. Requiring mandatory participation for State licensed or admitted captive insurers is in accord with the plain language of section 102(6)(A)(i) where no distinction is made regarding types of State licensed or admitted insurers. This treatment also furthers other statutory objectives such as ensuring that policyholders have widespread access to the terrorism risk insurance benefits of the Program, and spreading potential costs of the Program associated with any federal loss-sharing payments. For example, the cost spreading provisions in connection with recoupment as required by section 103(e)(7) and in connection with surcharges as required by section 103(e)(8) are to be applied to all commercial property and casualty policyholders.

As it relates to the overall administration of the Program, allowing for opt-in treatment would create the potential for adverse selection within the Program as those captive insurers that perceived themselves to have higher risk to terrorism would likely opt-in to the Program while others with lower perceived risks would likely opt-out of the Program. A major consequence of this type of action

would be the potential policyholder recoupment base would be reduced, which in turn would increase the potential recoupment costs on the policyholders of other mandatory participants in the Program.

Treasury does not support the view set forth by some of the commenters that limited risk exposure to terrorism of the coverage provided by some captive insurers is a reason to provide for an opt-in option. This same type of argument could be made by any number of insurers and policyholders that feel they have limited risk exposure to terrorism. Because the recoupment base applies to all commercial property and casualty policyholders, potentially limited risk exposure to terrorism is not a valid reason to limit participation under the Program.

Treasury also finds little or no support for assertions that the potential recoupment provisions of the Act would have an adverse effect on U.S. domestic captive jurisdictions. It should be noted that any such recoupment would only be imposed in the case of a terrorist event that triggers Federal payments under the Program, and that any potential recoupment is limited to a maximum 3 percent of premium surcharge in any given year. Although it is possible that certain state-licensed or admitted captive insurers would find these potential costs unattractive and search out other jurisdictions, other state-licensed or admitted captive insurers would recognize the benefits of Program participation. Therefore, the ultimate effect on any particular captive insurance jurisdiction is difficult to quantify.

In addition to the general comments on providing captive insurers opt-in treatment under the Program, two members of Congress offered the view that, in the case of captives, the Act must be read in the context of section 103(f). This section authorizes (but does not require) Treasury to apply the provisions of the Act to "other" classes or types of captive insurers. These commenters believe that the use of the word "other" in section 103(f) is a grammatical error in the Act and, for that reason, they contend that Treasury's interim final rule does not reflect the intent of Congress to create a process through which captive insurers could be integrated into the Program on an opt-in basis.

As previously noted, Section 102(6)(A)(i) of the Act mandates participation by insurers that are "licensed or admitted" by a State to engage in the business of providing property and casualty insurance. Following this state-licensed or

admitted category in the definition of "insurer", is a category for "any other entity described in Section 103(f), to the extent provided in the rules of the Secretary issued under section 103(f)." (emphasis added). Section 103(f) of the Act gives discretionary authority to the Secretary to add to the Program, "other classes or types of captive insurers * * *" (emphasis added). A key principle of statutory construction is that words in a statute must be read to have meaning unless the reading of those words produces an absurd result. The bar for interpreting words in a statute to be a legislative error is extremely high. If the words in a statute can be construed as having a rational meaning, then the rules of statutory construction preclude an interpretation that they were enacted by Congress in error.

In this case, the word "other" in these two provisions can be easily construed as referring to captives other than those that are State-licensed or admitted. Adopting the interpretation of legislative error suggested by the two commenters would require the conclusion that Congress erred in two places in the Act. In addition, we found nothing in the Act's language or legislative history that would support treating state-licensed or admitted captives differently from other state-licensed or admitted insurers for purposes of the Program. For these reasons, the definition of "insurer" in the final rule, as in the interim final rule, includes those entities, including any captives, that are state-licensed or admitted. Therefore, if a captive is not state licensed or admitted, then it is not in the Program, unless subsequently brought in by any rules issued under section 103(f).

Pooling Arrangements and Joint Underwriting Associations

Treasury received comments requesting clarification on how insurance pooling arrangements, such as joint underwriting associations, are treated under the Act. These commenters found the interim final rule and previously issued interim guidance to be unclear with regard to (a) whether such entities are insurers under the Act, and (b) if they are insurers, the category of insurer under which they would belong (e.g., State licensed or admitted, or federally approved). These commenters suggested that Treasury either clarify that State authorized joint underwriting associations are State licensed and admitted insurers under the Act, or directly inform a joint underwriting association of its status under the Act. Some commenters also