

an insurer, or a pool of insurers, is more like direct primary or excess property and casualty insurance versus traditional reinsurance (*i.e.*, an insurer reinsuring another insurer).

After consulting with the NAIC and considering the characteristics described above, Treasury considers WCRA to be similar to a residual market mechanism. WCRA is a legislatively-established risk pool that issues insurance directly to policyholders, which risks are hard to place in the voluntary insurance market. WCRA also has a procedure through which it shares or allocates its profits and losses with private sector insurers. Therefore, for these reasons, Treasury has added WCRA to its *List of State Residual Market Mechanisms* and its participation in the Program is confirmed. If any other State workers' compensation reinsurance pool believes that it shares the characteristics of a residual market mechanism and believes it should be included on the list, under section 50.9, the reinsurance pool should submit a request for an interpretation of the application of these regulations to its particular circumstance.

B. Allocation of Premium (Sections 50.33 through 50.36)

Section 103(d)(2) of the Act divides residual market mechanisms 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) of the Act or for State workers' compensation funds, section 50.33 of the final rule provides that these mechanisms follow the regulations set forth in sections § 50.5(d)(1) or § 50.5(d)(2) for the purposes of calculating the appropriate measure of direct earned premium. Residual market mechanisms functioning in this manner are thus treated as risk bearers in the same manner as private sector insurers. Treasury received a comment from a group of trade associations that endorsed this approach. These provisions of the proposed rule are adopted without change.

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) of the Act provides that "any insurer that participates in sharing profits and losses of a State residual market insurance entity shall include in its calculations or premiums any premiums distributed to the insurer by the State residual market insurance entity." Residual market insurance mechanisms functioning in this manner are thus treated as risk apportioning entities and not risk bearing entities. Proposed section 50.35 reflected this treatment and also provided that these entities should continue to report, in accordance with normal business practices, to each participant insurer its share of premium income and insured losses, which is to be included respectively in the participant insurer's direct earned premium and insured loss calculations. Treasury received a comment from a group of trade associations that supported this approach. This provision of the proposed rule is adopted without change.

Section 50.36 of the proposed rule further addressed the calculation of direct earned premium based on the allocation of premium income shared between the residual market mechanism and its servicing carriers or participant insurers. Favorable comments were received on this provision, which is adopted without change.

C. Other Issues

State Residual Market Mechanisms and Natural Disaster Insurance

Treasury received a comment from a residual market mechanism that issues commercial policies that provide coverage only for the peril of wind. The commenter requested that Treasury modify section 50.5(l) of the regulations to exclude commercial single peril wind insurance from the provisions of the Act. The commenter analogized single peril wind insurance to that of flood insurance and earthquake insurance, which are not included in the Program. See section 50.5(l)(1). Upon consideration of the comment, Treasury is not revising section 50.5(l). However, as stated in the preamble to the final rule published July 11, 2003, Treasury may later request comment on the exclusion from the Program definition of commercial property and casualty insurance single-peril natural disaster

insurance currently included in the Program.

D. Disclosure Requirements (Section 50.19)

Subpart B of 31 CFR part 50 sets forth regulations that address, *inter alia*, the clear and conspicuous disclosures that all insurers are required by the Act to provide to policyholders. Section 50.19 of subpart B, entitled *Disclosure by State residual market insurance entities and State workers' compensation funds*, had been reserved pending this rulemaking. This final rule amends 50.19 to address how residual market mechanisms are to comply with the Act's disclosure requirements.

Section 102(6) of the Act specifically includes residual market mechanisms as insurers that are required to participate in the Program. As a condition for Federal payment under the Program, section 103(b)(2) of the Act requires that insurers provide clear and conspicuous disclosure to policyholders of the premium charged for insured losses covered by the Program and the Federal share of compensation under the Program. Section 103(d) of the Act directed the Secretary of the Treasury to issue regulations as soon as practicable that apply the provisions of the Act (including the disclosure requirements) to residual market mechanisms.

On December 18, 2002, Treasury issued a second notice of interim guidance (67 FR 78864). In this notice of interim guidance Treasury indicated it would temporarily waive the disclosure requirements for those insurers that: (1) are State residual market insurance entities and State workers' compensation funds; and (2) have insufficient information to issue the disclosures, until Treasury issued regulations as required under section 103(d) to apply the provisions of the Act to these entities. Thus, the waiver provided a safe harbor pending the issuance of this final rule. We expected residual market mechanisms to have provided the disclosures if they possessed sufficient information to do so.

In the preamble to the proposed rule, Treasury stated that it was still evaluating the applicability of the disclosure requirements to certain insurers in this category and asked for public comment. Treasury received two comments on this issue. One comment deferred the issue to Treasury. Another commenter requested that Treasury exempt State workers' compensation funds from the disclosure requirements. The commenter argued that the burden and cost associated with providing the disclosures outweighs the goals of such