

## Advisory Opinion 2002-7

The following Advisory Opinion is to advise the reader of the current position of the Kentucky Department of Insurance. The Advisory Opinion is not legally binding on either the Department of Insurance or the reader.

**TO: 1. ALL PROPERTY & CASUALTY INSURERS WRITING COMMERCIAL LINES INSURANCE PRODUCTS**

**AND**

**2. ALL INSURERS ON THE NAIC QUARTERLY LISTING OF ALIEN INSURERS.**

**FROM: JANIE A. MILLER, COMMISSIONER OF INSURANCE**

**RE: Implementation of the Terrorism Risk Insurance Act of 2002**

**DATE: DECEMBER 19, 2002**

### Background

On November 26, 2002, the Terrorism Risk Insurance Act of 2002 ( Pub. L. 107-297) (The Act) became effective. This federal law provides a backstop for defined acts of terrorism and imposes certain obligations on insurers, including preempting the states' authority to approve certain terrorism exclusions.

All *insurers*, as defined in the Act, are required by the Act to participate in the Terrorism Insurance Program (the Program) and make available coverage for *insured losses*, as defined in the Act, in all of their covered commercial lines policies.

The intent of this document is to advise you of certain provisions of the Act, and to inform you about filing procedures, since the Act requires admitted insurers to submit filings. The Kentucky Department of Insurance (the "Department") strongly encourages you to read the Act, which can be found on the internet at ([thomas.loc.gov](http://thomas.loc.gov)) (the website of the United States Congress). Additionally, the Secretary of the Treasury has already begun posting bulletins on the Treasury website ([www.ustreas.gov](http://www.ustreas.gov)) and will continue to post updates. Insurers should monitor these websites as further bulletins are expected.

### Who needs to submit a filing?

Read the following definitions carefully. If you fall into one of the categories of *insurers* who had terrorism exclusions approved by this Department that meet criteria contained in the following, then you will need to submit a filing to the Department as soon as possible.

### DEFINITIONS UNDER THE ACT

*"Insurer"*, under subsection 102(6) of the Act, means any entity and affiliate thereof—(A) that is—(i) licensed or admitted to engage in the business of providing primary or excess insurance in any State; (ii) an eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers of the NAIC, or any

successor thereto; (iii) approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy, or aviation activity; (iv) a state residual market insurance entity or state workers' compensation fund; (B) that receives direct earned premium for any type of commercial property and casualty insurance coverage. The Secretary of Treasury may extend the Act to other classes or types of captive insurers and other self-insured arrangements by municipalities and other entities as well as to group life insurance.

**"Property and casualty insurance,"** under subsection 102(12) of the Act, (A) means commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance and surety insurance, and (B) does not include crop or livestock insurance, private mortgage or title insurance, financial guaranty insurance issued by monoline financial guaranty insurance corporations, medical malpractice, health or life insurance including group life, flood insurance provided under the National Flood Insurance Act, or reinsurance or retrocessional reinsurance. Treasury Bulletin 4810-25-M identifies lines of business from the NAIC Exhibit of Premiums and Losses (commonly known as Statutory Page 14) to be included in the Program: 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—Worker's 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.

**"Act of terrorism,"** under section 102(1), means any act that is certified by the Secretary of the Treasury, in concurrence with the Secretary of State, and the Attorney General of the United States (i) to be an act of terrorism; (ii) to be a violent act or an act that is dangerous to—(I) human life; (II) property; or (III) infrastructure; (iii) to have resulted in damage within the United States, or outside the United States in the case of (I) an air carrier or vessel described in paragraph (5)(B); or (II) the premises of a United States mission; and (iv) to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion." Section 102(1)(B) states, "No act shall be certified by the Secretary as an act of terrorism if—(i) the act is committed as part of the course of a war declared by the Congress, except that this clause shall not apply with respect to any coverage for workers' compensation; or (ii) property and casualty insurance losses resulting from the act, in the aggregate, do not exceed \$5,000,000." Sections 102(c) and (D) specify that the determinations are final and not subject to judicial review and that the Secretary of the Treasury cannot delegate the determination to anyone.

**"Insured losses"** means any loss resulting from an act of terrorism (including an act of war, in the case of workers' compensation) that is covered by primary or excess property and casualty insurance issued by an insurer if such loss—(i) occurs within the United States; or (ii) occurs in an air carrier (as described in section 40102 of title 49, United States Code), to a United States flag vessel (or a vessel based principally in the United States, on which United States income tax is paid and whose insurance coverage is subject to regulation in the United States), regardless of where the loss occurs, or at the premises of a United States mission. The Act also advises that **insured loss** excludes amounts awarded in a civil action that are attributable to punitive damages. The Act further requires **insurers** to make available **property and casualty insurance** coverage for insured losses that do not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than **acts of terrorism** . All

*insurers*, as defined in the Act, are required by the Act to participate in the Terrorism Insurance Program and make available coverage for *insured losses* in all of their covered commercial lines policies.

As a result of the definition contained in the Act, there are essentially two distinct types of losses that a business might face that result from terrorism. “*Certified loss*” refers to *insured losses* resulting from certified acts of terrorism, involving a foreign person or foreign interest as covered by the Act. “*Non-certified loss*” is a term adopted for convenience to refer to a type of loss that a business might face from an *act of terrorism* that would not fit within the definition of *insured loss*, as described in the Act. The most significant difference between these losses is that the *certified losses* will always involve a foreign person or a foreign interest, while the *non-certified losses* may not.

This Act voids any terrorism exclusions in a contract for *property and casualty insurance* that is in force on the date of enactment of this Act to the extent that it excludes losses that would otherwise be *insured losses*. The Act also voids any state approval of any terrorism exclusion from a contract for *property or casualty insurance* that is in force on the date of enactment of this Act to the extent that it excludes losses that would otherwise be *insured losses*. The Act allows *insurers* to “reinstate a preexisting provision in a contract for commercial *property and casualty insurance* that is in force on the date of enactment of this Act and that excludes coverage for *acts of terrorism* only “ if one of two conditions are met: (1) the *insurer* must have received a written statement from the insured that affirmatively authorizes such reinstatement, or (2) if the *insurer* has provided notice to the insured, at least 30 days before any such reinstatement and the insured fails to pay any increased premium charged by the *insurer* for providing such terrorism coverage.”

### **ALLOWABLE EXCLUSIONS**

Please note that the preemption of Kentucky’s form filing law, KRS 304.14.120 applies only to contract language that is applicable to *certified losses*. If an insurer intends to reinstate an exclusion on in-force policies as allowed under the Act, it may only reinstate an exclusion that previously existed on the policy.

Kentucky has allowed, and will continue to allow, certain exclusions that are essentially identical to those filed by and approved for ISO or which are less restrictive. These provisions are as follows:

For policies providing *property insurance* coverage the following limitations apply to

#### ***non-certified losses:***

- Exclusion for *acts of terrorism* only apply if the *acts of terrorism* result in industry-wide insured losses that exceed \$25,000,000 for related incidents that occur within a 72 hour period;
- Exclusions for *acts of terrorism* are not subject to the limitations above if:
  1. The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;
  2. The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
  3. Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

For policies providing liability insurance coverage the following limitations apply to

***non-certified losses:***

- Exclusion for ***acts of terrorism*** only apply if the ***acts of terrorism*** result in industry-wide insured losses that exceed \$25,000,000 for related incidents that occur within a 72 hour period; or
- Fifty or more persons sustain death or serious physical injury for related incidents that occur within a 72 hour period. For purposes of this provision serious physical injury means:
  1. Physical injury that involves a substantial risk of death;
  2. Protracted and obvious physical disfigurement; or
  3. Protracted loss of or impairment of the function of a bodily member or organ.
- Exclusions for ***acts of terrorism*** are not subject to the limitations above if:
  1. The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;
  2. The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
  3. Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

For ***non-certified losses*** , Kentucky would accept the following definition, or one that is more liberal to policyholders:

- The phrase “***non-certified act of terrorism***” means a violent act or an act (1) that is dangerous to human life, property, or infrastructure that is committed by an individual or individuals and, (2) that appears to be part of an effort to coerce a civilian population or to influence the policy or affect the conduct of any government by coercion, and, (3) is not certified as a terrorist act pursuant to the Federal Terrorism Risk Act of 2002.

Kentucky will not allow exclusions of coverage for ***acts of terrorism*** that fail to be ***certified losses*** solely because they fall below the \$5,000,000 threshold in Section 102(1)(B) on any policy that provides coverage for ***certified losses*** . Insurers required to file policy forms may submit language containing coverage limitations for certified losses that exceed \$100 billion.

**Submission of Rates, Policy Form Language and Disclosure Notices**

Insurers are required to comply with the Act and with state law. Until December 31, 2003, Section 106(a)(2)(B) of the Act preempts state laws pertaining to prior approval of rates or forms—including any law that imposes waiting periods prior to use -- for purposes of ***certified losses*** . Rates remain subject to subsequent regulatory review based on whether a rate is “excessive, inadequate, or unfairly discriminatory” and other applicable state law. Similarly, policy forms are subject to subsequent review based on all applicable laws and regulations.

If an insurer relies on an advisory organization to file loss costs and related rating systems on its behalf, no rate filing is required unless an insurer plans to use a different loss cost multiplier than is currently on file for coverage for ***certified losses*** . The rate filing should provide sufficient information for the reviewer to determine what price would be charged to a business seeking to cover ***certified losses*** .

Kentucky will accept filings that contain a specified percentage of premium to provide for coverage for ***certified losses for lines other than workers' compensation*** .

***Insurers*** may choose to use rating plans that take into account factors such as geography, building profile, proximity to target risks and other reasonable rating factors. The ***insurer*** should state in the filing the basis that it has for selection of the rates and rating systems that it chooses to apply. The supporting documentation should be sufficient for the reviewer to determine if the rates are excessive, inadequate or unfairly discriminatory.

***Insurers*** subject to policy form regulation must submit the ***certified loss*** policy language that they intend to use in Kentucky within a reasonable time after it is implemented. Kentucky considers 30 days to be a reasonable time for purposes of completing expedited filing of policy language.

The policy should define ***acts of terrorism*** and both ***certified*** and ***non-certified losses*** in ways that are consistent with the Act, state law and the guidance provided in this advisory opinion. The definitions, terms and conditions should be complete and accurately describe the coverage that will be provided in the policy. All policy language except that which relates solely to ***certified losses*** remains subject to prior approval.

Disclosure notices need not be filed, but, as they are an integral part of the process for notification of policyholders in this state and should be clear and not misleading to business owners in this state. The disclosures should comply with the requirements of the Act and the Treasury Bulletin, and should be consistent with the policy language and rates filed by the ***insurer***. Sample disclosure forms, deemed satisfactory by Treasury, are attached.

In-force business receives special consideration under the Act. Section 105(a) voids any terrorism exclusion on existing policies to the extent that it excludes losses that would otherwise be ***insured losses*** as defined in the Act. It details a process for ***insurers*** and policyholders to reinstate the voided exclusions. Under that process, an ***insurer*** may reinstate a preexisting provision in a contract that is in force on November 26, 2002, and that excludes coverage for an ***act of terrorism*** , only if the ***insurer*** has received a written statement from the insured that affirmatively authorizes such reinstatement, or if the insured fails to pay any increased premium charged by the ***insurer*** for providing such coverage and the ***insurer*** provided notice, at least 30 days before any such reinstatement as provided in Section 105 of the Act.

here are also disclosures required for new business and renewal business. Although voidance of contract language is not an issue, ***insurers*** must make certain disclosures to policyholders to come into compliance with the Act, and become eligible to receive compensation for its ***insured losses*** . Section 103(b)(2) requires ***insurers*** to provide a clear and conspicuous disclosure to the policyholder of the premium charged for covered ***insured losses*** and advise that a federal program exists where the federal government will share significant portions of major ***insured losses*** with insurers.

### **Effect on Workers' Compensation Coverage**

Treatment of worker's compensation is slightly different than for other property and casualty insurance coverages. First, Section 102(1)(B)(i) provides that the federal program will share the risk of loss for workers' compensation for acts of war in addition to ***acts of terrorism*** . As Kentucky's workers'

compensation statutes do not have any exclusions for terrorism or war, neither *insurers* nor policyholders may use the Act's procedures to create such exclusions. In other respects, however, workers' compensation coverage is treated under the Act as any other covered line of insurance. Therefore, the notice requirements of Section 103(b)(2) and the mandatory "make available" requirements of Section 103(c) apply to workers' compensation policies. In this connection, workers' compensation *insurers* are required to separately state (the amount of) the estimated premium being charged a policyholder for *acts of terrorism*, as defined in the Act. With regard to the filing and approval of rates and forms, workers' compensation *insurers* are also covered by the Act, specifically Section 106(a)(2)(B) that waives any state prior approval or time requirements for the first year of the Act. Such insurers shall therefore follow the alternative filing procedures established in this advisory opinion.

### **Instructions for Terrorism Rate and Form Review in Kentucky**

Consistent with these requirements of the Act, this advisory opinion establishes a system for rates and forms, requiring *insurers* or advisory organizations to file their rates and forms. As a practical matter in the first few weeks following the signing of the Act, it may not be practical for insurers to make filings for terrorism risk insurance coverage as of the date that it is offered to policyholders, and filings should be made within 30 days after first use. After January 1, 2003, filings should be made within 15 days after their first day of use. The procedure for obtaining an expedited review of such rates and forms is set forth below. Policy language changes and related pricing for *non-certified losses* remain subject to current applicable state law, but they may be flagged for expedited review.

As the Treasury Department will be looking to NAIC for information on rates, rates for commercial lines other than credit and workers' compensation need to be filed. While nothing in this Advisory Opinion shall be construed as establishing a rate or form filing review or approval requirement where one does not otherwise exist under Kentucky law, for commercial lines other than workers' compensation, the commissioner requests informational rate filings for *certified* and *noncertified losses*. Full supporting documentation is not required.

### **Instructions**

An insurer wishing to receive expedited treatment of its filing for approval pursuant to KRS 304.14-120 and 304.13-051 shall write EXPEDITED FILING—TERRORISM—CERTIFIED LOSSES OR NONCERTIFIED LOSSES beside the Line of Business on the F-1A Face & Verification Form. In addition, in the attached cover letter, the insurer(s) submitting this filing must certify that language used is consistent with the Act and with this Advisory Opinion.

This expedited filing procedure shall be used **ONLY** for material exclusively related to terrorism. For these filings, the Department requirement that forms and rates must be filed separately is suspended.

In all other respects, filings should follow the procedures set forth in 806 KAR 13:150, 806 KAR 14:006 and in the filing checklists available on our website, <http://doi.ppr.ky.gov/kentucky>.

### **Effective Date**

This Advisory Opinion shall take immediate effect and the expedited review process shall expire on December 31, 2003. The remainder of this Opinion shall expire December 31, 2005, unless Congress

extends the duration of the Act. This Advisory Opinion, the statutes, administrative regulations, and forms are available on the Kentucky Department of Insurance website, <http://doi.ppr.ky.gov/kentucky>. Any questions should be directed to Robin Coombs, Assistant Director, Property and Casualty Division, (502) 564-6046.

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Janie A. Miller, Commissioner

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Date

Kentucky Department of Insurance

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