

Uncertainty Related to Expiration of the Terrorism Risk Insurance Act of 2002 Exclusions Related to Acts of Terrorism

The following Advisory Opinion is to advise the reader of the current position of the Kentucky Office of Insurance ("the Office") on the specified issue. The Advisory Opinion is not legally binding on either the Office or the reader.

Kentucky Office of Insurance **Advisory Opinion 2004-02**

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

RE: UNCERTAINTY RELATED TO EXPIRATION OF THE TERRORISM RISK
INSURANCE ACT OF 2002 EXCLUSIONS RELATED TO ACTS OF
TERRORISM

FROM: Martin J. Koettters, Executive Director

DATE: September 3, 2004

Background

The Terrorism Risk Insurance Act of 2002 (TRIA) was adopted by Congress to provide a temporary federal shared loss program for incurred losses resulting from certain acts of terrorism to protect American businesses by minimizing market disruptions and to ensure widespread availability and affordability of property and casualty insurance for terrorism risks. Recently, a level of uncertainty has returned to the property and casualty commercial lines market because of the pending expiration of TRIA on December 31, 2005. This date appears to be in the distant future, but insurers will soon be called upon to make decisions about commercial insurance contracts extending beyond December 31, 2005.

This places insurers, businesses and regulators in a similar situation to that encountered in the aftermath of Sept. 11th which prompted TRIA's enactment. Once again, insurance regulators must consider approval of certain coverage exclusions for losses due to acts of terrorism or risk serious solvency concerns in the insurance industry.

Commercial insurance requires insurers and their policyholders to make decisions as early as September 2004 that will affect coverage well into 2006. Annual policy renewals with effective dates of Jan. 1, 2005 or later must contemplate no federal backstop for terrorism losses in 2006. For this reason, regulators expect insurers and advisory organizations to file contingent exclusions for terrorism losses and will attach them to renewal policies on a widespread basis.

As Executive Director, I concur with the National Association of Insurance Commissioners (NAIC) members that these contingent exclusions are a reasonable means to address TRIA's hard ending should

Congress fail to enact an extension of TRIA. This approach balances solvency concerns with the commercial insurance consumer's concerns that their businesses not be subject to uninsured events.

It must be stressed that determination of certain contractual thresholds is subject to disclosure and review by this office and that all forms must receive prior approval from the Office of Insurance before being issued or delivered in Kentucky and to provide a voluntary procedure for insurers to use to expedite the filing and timely review of these contingent exclusions.

Acceptable Language

The Kentucky Office of Insurance will grant approval to contingent exclusions substantially similar to those described in the following pages.

The contingent exclusions that have been or will be approved have some significant limitations; however, they continue to provide coverage for acts of terrorism under certain circumstances. For policies providing property insurance coverage the following limitations apply:

- 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 limitations above if:
 - o 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;
 - o The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - o 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:

- 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 purposes of this provision serious physical injury means:
 - o Physical injury that involves a substantial risk of death;
 - o Protracted and obvious physical disfigurement; or
 - o Protracted loss of or impairment of the function of a bodily member or organ.
- Exclusions for acts of terrorism are not subject to limitations above if:
 - o 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;
 - o The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - o Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

Kentucky will accept the following definition of acts of terrorism or definitions that are more liberal to policyholders:

Terrorism means activities against persons, organizations or property of any nature:

1. That involve the following or preparation for the following:
 - a. Use or threat of force or violence; or
 - b. Commission or threat of a dangerous act; or
 - c. Commission or threat of an act that interferes with or disrupts an electronic, communication, information, or mechanical system; and
2. When one or both of the following applies:
 - a. The effect is to intimidate or coerce a government or the civilian population or any segment thereof, or to disrupt any segment of the economy; or
 - b. It appears that the intent is to intimidate or coerce a government, or to further political, ideological, religious, social or economic objectives or to express (or to express opposition to) a philosophy or ideology.

These contingent exclusions shall only apply if Congress fails to enact an extension to TRIA or enacts changes to TRIA that substantially change the risk of loss an insurer or policyholder has assumed.

Insurers should be aware that although policy form language will provide that the insurer is to make a determination regarding when any of the thresholds described in this Advisory Opinion have been reached, insurers shall substantiate any decision made to deny coverage or benefits to an insured or claimant. KRS 304.12-230.

Instructions for Expedited Filings

An insurer wishing to receive expedited treatment of its filing for approval pursuant to KRS 304.14-120 shall write EXPEDITED FILING—CONTINGENT TERRORISM EXCLUSIONS beside the Line of Business on the F-1A Face & Verification Form. In addition, in the cover letter attached to the filing, the insurer(s) must certify that the forms provide coverage at least as broad as described in this Advisory Opinion and that the reason for seeking approval of these forms or exclusions is that it is unable to obtain reinsurance coverage for losses due to acts of terrorism.

In other respects, the filing should follow the procedures set forth in 806 KAR 13:150, 806 KAR 14:006 which are available at <http://insurance.ky.gov/kentucky>.

Effective Date

This Advisory Opinion shall take immediate effect and shall expire on Dec. 31, 2005, unless Congress acts to extend or modify TRIA.

Any questions can be addressed to Robin Coombs, Assistant Director, Property and Casualty Division, at (502) 564-3630 ext. 4294.

/s/Martin J. Koettters
Executive Director

09/03/2004
Date

