

Advisory Opinion 2002-1

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: ALL PROPERTY & CASUALTY INSURERS WRITING

COMMERCIAL LINES INSURANCE PRODUCTS

FROM: JANIE A. MILLER, COMMISSIONER OF INSURANCE

RE: VOLUNTARY EXPEDITED FILING PROCEDURES FOR

EXCLUSIONS RELATED TO ACTS OF TERRORISM

DATE: JANUARY 25, 2002

Background

There has been much uncertainty in the markets for commercial lines property and casualty insurance coverage in light of the substantial losses experienced by the industry on September 11, 2001. Soon after the events, many reinsurers announced that they did not intend to provide coverage for acts of terrorism in future reinsurance contracts. This led to a concerted effort on behalf of all interested parties to seek a temporary federal backstop to calm market fears over future terrorists attacks and the ability of the insurance industry to allocate capital to provide coverage for these unpredictable and potentially catastrophic events. Unfortunately, Congress has been unable to reach agreement on the terms of a temporary federal solution. As a result, insurance regulators find themselves having to consider approval of certain coverage exclusions for acts of terrorism or risk possible serious solvency concerns in the insurance industry and/or market disruptions.

The intent of this bulletin is to inform you of the decision in this state to approve certain limited exclusions for acts of terrorism and to provide a voluntary procedure for insurers

to use to expedite the filing and timely review of these limited exclusions. As commissioner, I was involved in recent discussions at the National Association of Insurance Commissioners (NAIC) related to this issue. In a recent conference call the members of the NAIC adopted a motion that "if the Congress adjourns without enacting federal terrorism legislation, the states should grant conditional approval to commercial lines endorsements that exclude coverage for acts of terrorism consistent with the exclusion

framework developed by ISO. To the extent permitted by state law, such approvals would sunset or be withdrawn 15 business days after the President signs into law a federal backstop to address insurance losses attributed to acts of terrorism, or be

subject to other conditions on the approval consistent with state law." By this bulletin, I am informing you of my intent to act in a manner consistent with the recommendation from the NAIC membership. I believe this to be the best course of action as it balances the need of insurers to have some certainty related to solvency concerns with the business consumer's concerns that their interests businesses not be subject to uninsured events.

To date many exclusions have been filed by insurers to be attached to commercial lines insurance products. Those containing overly broad exclusionary language have been disapproved as non-compliant with KRS 304.14-130(1). This statute provides in part that forms shall be disapproved only on one (1) or more of the following grounds:

(a) If it is in any respect in violation of, or does not comply with, this code.

(b) If it contains or incorporates by reference, where the incorporation is

otherwise permissible, any inconsistent, ambiguous, or misleading clauses, or

exceptions and conditions which deceptively affect the risk purported to be

assumed in the general coverage of the contract.

Instead of approving the very broad total exclusions of coverage for acts of terrorism, Kentucky would prefer to grant approval to exclusions that are substantially similar to the series of optional endorsements developed by the Insurance Services Office, Inc. (ISO). These endorsements include the following:

COMMERCIAL PROPERTY INTERLINE ENDORSEMENT: IL 09 41 01 02

COMMERCIAL GENERAL LIABILITY ENDORSEMENT: CG 21 69 0102

COMMERCIAL GENERAL LIABILITY ENDORSEMENT: CG 31 42 01 02

COMMERCIAL GENERAL LIABILITY ENDORSEMENT: CG 31 43 01 02

COMMERCIAL LIABILITY UMBRELLA ENDORSEMENT: CU 21 29 01 02

BUSINESSOWNERS ENDORSEMENT: BP 05 11 01 02

BUSINESSOWNERS ENDORSEMENT: BP 05 13 01 02

FARM LIABILITY ENDORSEMENT: FL 10 30 01 02

The commercial policy exclusions filed by ISO and approved by this state have some significant limitations that 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:
 - 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;
 - The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - 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:
 - Physical injury that involves a substantial risk of death;
 - Protracted and obvious physical disfigurement; or
 - 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;
 - 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;
 - The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

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.

Insurers that are current licensees of ISO for policy forms can use the new language pursuant to their current ISO agreements and approval by this state of its forms. If you are properly affiliated with ISO, and have given them authorization to file on your behalf for the line of business, no further action is needed on your part. Likewise, if you have previously filed a blanket reference for the appropriate line of business with our department adopting all current and future ISO forms and rules as filed, no further action is needed on your part. See 806 KAR 14:006 for additional rules regarding filing authorization, blanket reference, delayed adoption, or non-adoption.

In an unprecedented move in recognition of the seriousness of the situation, ISO has indicated that it will permit the use of its copyrighted language by any insurer, including one that is not a current licensee of ISO for policy forms. Any insurer that does not have a license agreement in effect with ISO for policy forms is required to execute a short, limited license agreement that authorizes the use of the new language. ISO has indicated that there will be no fee for this limited license. You may contact ISO's Customer Service department directly for more information at 1-800-888-4ISO(4476) using option 2. You may also contact ISO at "info@ISO.com." You will be responsible for assuring compliance with Kentucky's filing requirements for each line of business, however, you may find that the expedited approval process outlined in this bulletin to be helpful in receiving prompt approval of your form filing.

Explanation and Instructions for Expedited Review

Kentucky will accept the above definition of acts of terrorism or definitions that are more liberal to policyholders. For an insurer to receive expedited approval of its exclusions for commercial lines insurance coverages, the exclusionary endorsements must comply with the terms and conditions set forth in this bulletin and be submitted in accordance with the instructions specified below. Further, you must certify that you are either using the ISO endorsements or using an endorsement that provides coverage at least as broad as the approved ISO endorsements.

Instructions

An insurer wishing to receive expedited treatment of its filing for approval pursuant to KRS 304.14-120 shall write EXPEDITED FILING-TERRORIST EXCLUSIONS APPLICATION 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 it is either using one or more of the ISO endorsements or has developed its own exclusionary language that provides coverage at least as broad as the approved ISO endorsement with respect to coverage granted to policyholders. Further, the insurer(s) must certify that the reason for seeking approval of these endorsements is that it is unable to obtain reinsurance coverage for acts of terrorism.

In 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:// insurance.ky.gov](http://insurance.ky.gov).

Note regarding Personal Lines Terrorism Exclusions

I am currently not convinced there is the need for widespread application of terrorism exclusions on personal lines products. The ISO personal lines filings remain under review. Therefore, personal lines filings should be submitted for individual review and accompanied by documentation of need (copy of reinsurance exclusion, statement of impact upon the company financial condition of a lack of reinsurance and/or the cost of reinsurance for terrorism losses in personal lines). In addition, the filing should include a copy of the notice which will be used to alert the policyholder of the reduction in coverage and verification that it will be provided per KRS 304.20-040 and KRS 304.20-310.

Notice requirements

As the use of these exclusions will result in a reduction of coverage, see KRS 304.20-300 through 350 regarding requirements for notice to policyholders about the change.

Effective Date

This bulletin shall take immediate effect and the expedited review process shall expire on March 1, 2002. This Advisory Opinion, the statutes, administrative regulations, and forms are available on the Department of Insurance's website, insurance.ky.gov. Any questions should be directed to Robin Coombs, Assistant Director, Property and Casualty Division, (502) 564-6046.

Janie A. Miller, Commissioner

Kentucky Department of Insurance

Date