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BULLETIN

TO: All Property and Casualty Insurers Writing Commercial Lines Insurance Products and all Insurers on the NAIC Quarterly Listing of Alien Insurers

FR: Paula A. Flowers, Commissioner *Paula A. Flowers*
Department of Commerce and Insurance

RE: Voluntary Expedited Filing Procedures for Compliance with the Provisions of the Terrorism Risk Insurance Extension Act of 2005

DT: January 17, 2006

Background

The Department issued a bulletin on April 9, 2003, advising property and casualty insurers writing commercial lines insurance products of the Terrorism Risk Insurance Act of 2002. The Act has now been extended for an additional two (2) years through December 31, 2007, with the enactment of the Terrorism Risk Insurance Extension Act of 2005.

Several provisions of the initial Act have changed in the extension. Those changes include: deleting commercial auto, burglary and theft, surety, professional liability, and farm owners multiperil coverages from eligible lines; increasing the individual company deductible for 2006 to 17.5 percent and the 2007 deductible to 20 percent; increasing the industry aggregate retention level from \$15 billion to \$25 billion in 2006 and to \$27.5 billion in 2007; reducing the federal share of compensation for covered losses from 90 percent to 85 percent for 2007; maintaining the \$5 million threshold for certification of a terrorist act, while establishing a per event trigger for federal participation in aggregate insured losses of \$50 million for losses occurring after March 31, 2006 and before January 1, 2007 and \$100 million for losses occurring in the 2007 Program Year; extending existing litigation management provisions and codification of regulations requiring submission and approval of proposed

settlements; and directing the President's Working Group on Financial Markets to study long-term availability and affordability of coverage for terrorism losses, including group life and nuclear, biological, chemical and radiological events. The President's Working Group on Financial Markets, in consultation with representatives of the National Association of Insurance Commissioners, the insurance and securities industries and policyholders, is directed to submit a report of its findings to the House Financial Services and Senate Banking Committees by September 30, 2006.

The intent of this bulletin is to advise you of certain provisions of the Act, as extended, that may require insurers to submit a filing to the Department of the disclosure notices, policy language and the applicable rates that are discussed in the Act. In many cases, insurers' current filings will be adequate to meet the needs of the nation's business. Interim guidance notices and other information related to the Act may be found at the United States Department of Treasury website at www.treasury.gov/trip.

Subsection 102(6) of the Act defines *insurers* for purposes of the Act. "Insurer" 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.

Subsection 102(12) of the Act states that the term "property and casualty insurance" (A) means commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance, and directors and officers liability 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, reinsurance or retrocessional reinsurance, commercial automobile insurance, burglary and theft insurance, surety insurance, professional liability insurance, or farm owners multiple peril insurance.

Certified and Non-Certified Losses

This Department has allowed, and will continue to allow, some significant limitations that provide coverage for acts of terrorism under certain circumstances. For policies providing property insurance coverage the following limitations apply to *non-certified losses*:

- Exclusions 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:
 - 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 to *non-certified losses*:

- Exclusions 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:
 - 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 the 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.

Definition of Act of Terrorism

Section 102(1) defines an *act of terrorism* for purposes of the Act. Section 102(1)(A) states, "The term "act of terrorism" 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." Section 102(1)(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.

The Act 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.

The Act includes a definition of acts of terrorism that is used within this bulletin to mean *certified losses*. Policies subject to policy form filing requirements should also define what constitutes an act of terrorism for *non-certified losses*. For *non-certified losses*, this Department will 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 that is dangerous to human life, property; or infrastructure that is

committed by an individual or individuals and 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 the act is not certified as a terrorist act pursuant to the Federal Terrorism Risk Insurance Act of 2002.

Submission of Rates, Policy Form Language and Disclosure Notices

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*. This Department will accept filings that contain a specified percentage of premium to provide for coverage for *certified losses*. Insurers (except workers' compensation) may also choose to use rating plans that take into account other 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 policy language that they intend to use in this State not later than January 31, 2006. 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 bulletin. The definitions, terms and conditions should be complete and accurately describe the coverage that will be provided in the policy. Insurers may conclude that current filings are in compliance with the Act, state law and the requirements of this bulletin.

The Department requests that the disclosure notices be filed for informational purposes, along with the policy forms, rates, and rating systems 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 should be consistent with the policy language and rates filed by the insurer.

Finally, as the Act's current extension excludes certain types of insurance, the Department recommends that insurance companies selling excluded types of insurance withdraw their previous filings.

Except to the extent this bulletin is inconsistent with the bulletin issued on April 9, 2003, such bulletin remains effective. This bulletin shall expire on December 31, 2007, unless Congress extends the duration of the Act.