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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
Department of Commerce and Insurance
- RE:** Voluntary Expedited Filing Procedures for Compliance with the Provisions of the Terrorism Risk Insurance Act of 2002

DT:

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 tragic 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 terrorist attacks and the ability of the insurance industry to allocate capital to provide coverage for these unpredictable and potentially catastrophic events. Congress recently enacted and the President has signed into law, the Terrorism Risk Insurance Act of 2002 (The Act). This federal law provides a federal backstop for acts of terrorism and imposes certain obligations on insurers. The intent of this bulletin is to advise you of certain provisions of the Act that may require insurers to submit a filing in this state.

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 of 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; (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 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.

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* in all of their covered commercial lines policies. The term “*insured loss*” 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.

The Act voids any preexisting 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. The insurer must have received a written statement from the insured that affirmatively authorizes such reinstatement or 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.

Definition of Insured Loss

Section 102(5) of the Act provides a definition of *insured loss*. It states, “the term “insured loss” 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—(A) occurs within the United States; or (B) occurs to an air carrier (as defined 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 any United States mission.”

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. One type of loss is the *insured loss* that is defined within and covered by the provisions of the Act. For convenience, we will adopt the moniker of “certified loss” to refer to losses resulting from certified acts of terrorism. The second type of loss that a business might face is one that does not fit within the definition of *insured loss* as described in the Act. For convenience, we will adopt the moniker of “non-certified loss” to refer to losses resulting from terrorism that is not certified. The most significant difference between these losses is that the *certified losses* will always involve a foreign person or foreign interest, while the *non-certified losses* will not.

Please note that the preemption of this state's filing law, Tenn. Code Ann. § 56-5-306, 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.

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, 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 populations 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 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 state would accept the following definition, or one that is more liberal to policyholders:

The term "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

Section 106(a)(2)(B) of the Act states that "during the period beginning on the date of enactment of this Act and ending on December 31, 2003, rates and forms for terrorism risk insurance coverage covered by this title and filed with any State shall not be subject to prior approval or a waiting period under any law of a State that would otherwise be applicable...." The subsection further notes that rates remain subject to subsequent regulatory review based on whether a rate is "excessive, inadequate, or unfairly discriminatory." Similarly, policy forms are subject to subsequent review based on all applicable laws and regulations not specifically preempted by the Act. Thus, a use and file system similar to the system already in place in Tennessee is created by the Act where insurers can immediately implement prospective rate changes for coverage of *insured losses* related to *acts of terrorism* as defined in the Act. Policy language granting coverage or excluding coverage for *insured losses* is only exempt from prior approval or waiting periods to the extent that the policy language relates to *insured losses* as defined in the Act. Other policy language changes and related pricing remain subject to current applicable state law and will be processed in an expedited manner.

Insurers are required to comply with the Act and with state law. Insurers subject to rate regulation must submit rates and rating systems within a reasonable time after they are implemented. This state considers fifteen (15) days to be a reasonable time for purposes of completing an expedited filing of rates and rating systems. 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 state will accept filings that contain a specified percentage of premium to provide for coverage for *certified losses*. Insurers 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 within a reasonable time after they are implemented. This state considers fifteen (15) days to be a reasonable time for purposes of completing an 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 bulletin. The definitions, terms and conditions should be complete and accurately describe the coverage that will be provided in the policy.

The Department also 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. Details about the applicable requirements are contained in the following two paragraphs.

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 insurers must give policyholders at least 30 days before exclusions can be reinstated. The notices must disclose the price for providing terrorism coverage and include the date that any terrorism exclusion would be reinstated if the policyholder fails to pay the required premium. An insurer can only reinstate an exclusion if one of two conditions is met. First a policyholder can provide the insurer with written authorization that affirmatively authorizes the reinstatement. Alternatively, the insurer can provide notice of the price that it intends to charge for providing coverage for *insured losses* and the policyholder can decline to pay for the coverage. These disclosures must also comply with standards set forth in Section 103(b)(2).

There are also disclosures required for new business and renewals business. Although avoidance of contract language is not an issue, insurers must make certain disclosures to policyholders to remain in compliance with the Act. 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 Insurance Coverage

Treatment of workers' 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. This treatment occurs because of the statutory

nature of the workers' compensation program, which does not provide an exclusion for losses resulting from an act of war. Under Tennessee law there is no exclusion for workers' compensation losses resulting from an act of war. There is no provision in the Act that would preempt the compulsory coverage aspects of workers' compensation insurance policies. 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 estimated portion of the premium being charged a policyholder for acts of terrorism, as defined in the Act. As this state's workers' compensation law does not have any exclusions for terrorism or war, neither insurers nor policyholders may use the Act's procedures to create such an exclusion.

Effective Date

This bulletin shall take immediate effect. This bulletin shall expire on December 31, 2005, unless Congress extends the duration of the Act.

Paula A. Flowers, Commissioner
Department of Commerce and Insurance