DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT
Division of Insurance

Frank H. Murkowski, Governor
William C. Noll, Commissioner
Linda S. Hall, Director

BULLETIN B 06-05

TO: ALL SURPLUS LINES AND PROPERTY AND CASUALTY INSURERS WRITING COMMERCIAL LINES INSURANCE PRODUCTS IN THE STATE OF ALASKA AND OTHER INTERESTED PARTIES

RE: THE TERRORISM RISK INSURANCE EXTENSION ACT OF 2005

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 because of the events that occurred 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. As a result, Congress enacted and the President signed into law in November 2002, the Terrorism Risk Insurance Act of 2002 (Act). This federal law provides a federal backstop for defined acts of terrorism and imposes certain obligations on insurers. With the enactment of the Terrorism Risk Insurance Extension Act of 2005, the Act has been extended for an additional two years, through December 31, 2007.

Several provisions of the initial Act have changed in the extension. Those changes include:

- deletion of commercial auto, burglary and theft, surety, professional liability, and farm owners multi-peril coverages from eligible lines;
- increase in the individual company deductible for 2006 to 17.5 percent and the 2007 deductible to 20 percent;
- increase in the industry aggregate retention level from $15 billion to $25 billion in 2006 and to $27.5 billion in 2007;
- reduction in the federal share of compensation for covered losses from 90 percent to 85 percent for 2007;
- maintenance of 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;
- extension of existing litigation management provisions and codification of regulations requiring submission and approval of proposed settlements;
- 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

550 W. 7th Avenue, Suite 1560, Anchorage, Alaska 99501-3567
Telephone: (907) 269-7900 Fax: (907) 269-7910 Text Telephone: (907) 465-5437
Email: insurance@commerce.state.ak.us Website: http://www.commerce.state.ak.us/insurance/

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.

This bulletin advises you of certain provisions of the Act, as extended, that may require insurers to submit a filing in Alaska of the disclosure notices, policy language, and rates. In many cases, an insurer's current filings may be adequate to comply with the requirements. This discussion of the Act is not intended to be an exhaustive analysis. For brevity sake, the provisions of the Act referenced below are in most cases summarized or paraphrased. Please review the Act in its entirety to ensure your compliance with it.

Section 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.

Section 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.

<u>Definition of Insured Loss</u>

All insurers, as defined in the Act in Section 102(6), are required by the Act to participate in the Terrorism Insurance Program (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--
(A) occurs within the United States; or (B) 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.

As a result of the definition of *insured loss* 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* may not.

Alaska has allowed and will continue to allow limitations to 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 above-limitations 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;
    - 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;
    - protracted loss of or impairment of the function of a bodily member or organ.
- Exclusions for acts of terrorism are not subject to the above-limitations 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.

<u>Definition of Act of Terrorism</u>

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.

Alaska 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,* Alaska 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 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.

<u>Submission of Rates, Policy Form Language, and Disclosure Notices</u>

Insurers are required to comply with the Act and with state law. Alaska law requires insurers subject to rate regulation under AS 21.39 to file rates. Rates for terrorism risk insurance covered by the Act may be filed under the file and use provisions of AS 21.39.220, the flex rating provisions of AS 21.39.210, or the prior approval provisions of AS 21.39.041. Insurers subject to policy form regulation under AS 21.42 are required to file the policy language they intend to use. Policy language for terrorism risk insurance covered under the Act may be filed under the prior approval provisions of AS 21.42.123 or the file and use provisions of AS 21.42.125.

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 for coverage for *certified losses* than is currently on file. 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*. The insurer should state in the filing the basis it has for the 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.

If an insurer that is a member of or subscriber to a rating organization desires to deviate from the loss costs or rating plan filed by the rating organization, the requirements of AS 21.39.070 must be followed.

The policy should define *acts of terrorism* and both *certified* and *non-certified losses* in ways that are consistent with the Act, Alaska 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.

Sample policyholder notices are attached to this bulletin. Insurers may use these policyholder disclosure notices without filing them with the Alaska Division of Insurance. Insurers electing to use their own policyholder disclosure notices should file the notices along with their policy forms, as the notices are an integral part of the process for notification of policyholders in Alaska. The notices should be clear and not misleading to business owners in Alaska. A surplus lines insurer must provide disclosure notices to its policyholders through the surplus lines producers.

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 Alaska 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 Alaska'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. With regard to the filing and approval of rates and forms, workers' compensation insurers are also covered by the Act.

Expiration Date

This bulletin expires on December 31, 2007, unless the United States Congress extends the duration of the Act.

DATED this 12th day of May, 2006 at Anchorage, Alaska.

Linda S. Hall

Linda S. Hall
Director