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COMMISSIONER OF INSURANCE

Bulletin 2004-10

To: Insurers Offering Property and Casualty Policies in Massachusetts

From: Julianne M. Bowler, Commissioner of Insurance

Date: November 19, 2004

Re: Uncertainty Related to Expiration of the Terrorism Risk Insurance Act of 2002 ("TRIA") Exclusions Related to Acts of Terrorism

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This bulletin is intended to address standards for riders, amendments, endorsements or other policy changes that carriers may propose to file with the Division concerning uncertainty related to the expiration of TRIA.

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. TRIA serves to protect American businesses by minimizing market disruptions and ensuring the widespread availability and affordability of property and casualty insurance for terrorism risk. Recently there has been uncertainty in the markets for commercial lines property and casualty insurance coverage because of the pending expiration of TRIA, December 31, 2005. While TRIA's expiration date appears to be in the distant future, insurers are being called upon to make decisions about commercial insurance coverage later this year.

The commercial insurance business cycle operates in such a way that insurers and their policyholders will be required to make decisions as early as this September that will affect coverage well into 2006. Annual policy renewals with effective dates of Jan. 1, 2005 or later will have to contemplate no federal backstop for any losses in 2006. For this reason, regulators anticipate that insurers and advisory organizations will file conditional exclusions for terrorism coverage and will attach them to renewal policies on a widespread basis.

This places insurers, businesses and regulators in the same situation we encountered in the aftermath of Sept. 11th and which in large part prompted TRIA's enactment. Once again, insurance regulators find themselves having to consider approval of certain coverage limitations for acts of terrorism or risk possible serious solvency concerns in the insurance industry.

The intent of this bulletin is to inform you of the decision to (i) approve certain conditional coverage limitations in the Commonwealth for acts of terrorism, and (ii) put insurers on notice that determination of certain contractual thresholds is subject to disclosure and review by this office. As Massachusetts Commissioner of Insurance, 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 agreed that the conditional endorsement approach, while not providing a perfect solution, offers the best hope for adding some certainty to address TRIA's "hard ending" should Congress fail to enact an extension of TRIA. By this bulletin, I am informing you of my intent to act in a manner consistent with the recommendation of 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 consumers' concerns that their businesses not be subject to uninsured events.

Instead of approving the very broad total exclusions of coverage for acts of terrorism, this state intends to grant approval to conditional coverage limitations that are substantially similar to those described in the following pages.

Explanation

The Commonwealth will allow insurers and advisory organizations to submit and receive approval for conditional endorsements, provided that the insurer certifies in writing that the filing complies with the terms of this bulletin. The conditional endorsements will be required to state that they will apply only if Congress fails to enact an extension to TRIA or enacts changes to TRIA that substantially change the risk of loss that an insurer or policyholder has assumed. The endorsement is to also clearly note that without an extension to TRIA, coverage for terrorism-related claims are changed as identified within the conditional endorsement. Such endorsements will only be permitted to be used if the insurer obtains, on the endorsement or associated document, the insured's signature in which the insured indicates that he or she understands that without an extension to TRIA, the policy's coverage for terrorism-related claims will change as described in the endorsement.

While the coverage limitations that will be approved for use in the Commonwealth have some significant limitations, business property and liability policies will continue to provide coverage for acts of terrorism under certain circumstances. Please do note, however, that the Division will not accept terrorism exclusions for workers' compensation, automobile or fire coverage which are not permitted under Massachusetts law. In all other cases, the Commonwealth will accept either 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, the effect of which is either to (i) intimidate or coerce a government or the civilian population or any segment thereof, or to disrupt any segment of the economy; or (ii) further political, ideological, religious, social or economic objectives or to express (or to express opposition to) a philosophy or ideology; but only when such activities involve the following or preparation for the following:

- Use or threat of force or violence; or
- Commission or threat of a dangerous act; or
- Commission or threat of an act that interferes with or disrupts an electronic, communication, information, or mechanical system.

For policies providing property insurance coverage the following limitations are in effect:

- An exclusion for acts of terrorism shall apply only 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; provided, however, that exclusions for acts of terrorism are not subject to the above limitation if:
  - The act involves the use, release or escape of nuclear materials, or 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 are in effect:

- An exclusion for acts of terrorism shall apply only if either (i) 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 (ii) fifty or more persons sustain death or serious physical injury as a result of the act.

- 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.

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 bulletin have been reached for purposes of settling a claim, insurers should be ready to substantiate any decision made that results in the denial of benefits to a claimant based on a terrorism exclusion subject to the provisions of M.G.L. c. 175, §4.

If you have any questions involving the subject matter of this bulletin, please consider contacting Kevin Beagan, Director, State Rating Bureau at (617) 521-7323.