



**STATE OF NEW YORK
INSURANCE DEPARTMENT**
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**December 23, 2002
Circular Letter No. 25 (2002)**

TO: All Property/Casualty Insurers and Rate Service Organizations Doing Business in New York State, New York Property Insurance Underwriting Association, State Insurance Fund, New York Automobile Insurance Plan, and Excess Line Association of New York

RE: Applicability, Guidelines and Procedures for Compliance with the Provisions of the Terrorism Risk Insurance Act of 2002; Guidelines for the Use of Limitations for Acts of Terrorism in Commercial Property/Casualty Policies

STATUTORY REFERENCE: Articles 21, 23, 34, 54 and 63 of the Insurance Law; Terrorism Risk Insurance Act of 2002

OVERVIEW

The President has signed into law, effective November 26, 2002, the Terrorism Risk Insurance Act of 2002 (Pub. L. 107-297) (the Act). The Act provides a federal backstop for commercial lines property and casualty insurance covering acts of terrorism and imposes certain obligations on property/casualty insurers and takes other actions designed to improve the availability and affordability of insurance for losses arising out of certain acts of terrorism. The purpose of this Circular Letter is to provide guidelines to insurers with respect to the issuance in New York of policies subject to the Act and to supplement the Interim Guidances issued by the Department of the Treasury on December 3 and 18, 2002. Reference is also made to the Model Bulletin on terrorism issued by the National Association of Insurance Commissioners (NAIC) on November 26, 2002. This Circular Letter also provides guidance to property/casualty insurers with respect to the underwriting criteria and policy terms and conditions applicable to limitations of coverage in property/casualty policies for terrorist acts that are not covered by the Act.

COVERAGE IN NEW YORK PRIOR TO THE ACT FOR ACTS OF TERRORISM

In accordance with the provisions of the Insurance Law, the Superintendent has not approved any terrorism exclusions for use in New York. The Superintendent concluded that proposed terrorism exclusions were misleading and/or against public policy, pursuant to Insurance Law Section 2307(b). Terrorism exclusions are also statutorily barred in policies providing certain types of coverages, including policies providing coverage with respect to the peril of fire that are subject to Insurance Law Section 3404 (whether issued by an authorized insurer or by an unauthorized insurer); motor vehicle liability policies satisfying the financial responsibility requirements of the Vehicle and Traffic Law, including no-fault coverage; and workers' compensation insurance.

Although most property/casualty insurance policies are subject to the requirements of Insurance Law Article 23, there are certain exceptions to prior approval requirements generally applicable to rates and policy forms. These exceptions include policies written as special risk insurance pursuant to Insurance Law Article 63 (also known as "Free Trade Zone"). Insurers may have implemented terrorism exclusions, notwithstanding the Superintendent's disapproval of all such exclusions filed with the Department. The Department has expressed its position on the use of terrorism exclusions under these circumstances in several opinions that may be found on the Department's website, including Opinion 02-05-19 (May 17, 2002). However, one of the purposes of this Circular Letter is to provide

guidance to all insurers that may have implemented terrorism exclusions, including excess line insurers.

SCOPE OF THE ACT

INSURANCE COVERAGE

Insurers, as defined in the Act, are required to participate in the Terrorism Insurance Program (the Program) and make available coverage for "insured losses" in "property and casualty insurance" policies, which are defined in Section 102(12) of the Act to mean "commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance and surety insurance" but does not include:

- crop or livestock insurance, including Federal crop insurance;
- private mortgage insurance;
- financial guaranty insurance issued by monoline financial guaranty insurance corporations;
- medical malpractice insurance;
- health or life insurance, including group life insurance;
- flood insurance provided under the Federal flood program;
- title insurance; or
- reinsurance or retrocessional reinsurance.

In order to promote availability, the Insurance Department, consistent with the Interim Guidelines issued by the Department of Treasury on December 18, 2002, considers a voluntary "joint underwriting association" subject to Section 2317 of the Insurance Law or a "risk sharing plan" formed pursuant to Section 2318 of the Insurance Law to be an "entity" included in the definition of "insurer" in Section 102(6) of the Act. Accordingly, two or more insurers that participate in such an association or plan will be in compliance with the "make available" standard under the Act if, in the aggregate, the voluntary joint underwriting association or the risk sharing plan makes available property and casualty insurance coverage for insured losses, in accordance with the Act.

ACTS OF TERRORISM

Section 102(1) of the Act defines "an act of terrorism" as any act certified by the Secretary of the Treasury, in concurrence with the Secretary of State and the Attorney General:

1. to be an act of terrorism;
2. to be a violent act or an act that is dangerous to:
 - a. human life;
 - b. property; or
 - c. infrastructure;
3. to have resulted in damage within the United States; or -- regardless of where the loss occurs -- to an air carrier, a vessel bearing the United States flag or certain other vessels whose insurance coverage is subject to regulation in the United States; or at the premises of a United States mission; and
4. 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.

An act does not qualify as an act of terrorism if:

1. committed as part of the course of a war declared by Congress (except in the case of workers' compensation coverage), or
2. property and casualty insurance losses resulting from the act, in the aggregate, do not exceed \$5,000,000.

INSURED LOSSES

Section 102(5) of the Act defines an "insured loss" to mean any loss resulting from an act of terrorism (including an act of war, in the case of workers' compensation insurance) that is covered by primary or excess property and casualty insurance issued by an insurer if such loss meets the criteria as set forth in the preceding section of this

REQUIREMENTS UNDER THE ACT

MANDATORY AVAILABILITY OF COVERAGE

Section 103(c) of the Act 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.

NULLIFICATION and REINSTATEMENT OF EXCLUSION

Section 105(a) of the Act nullifies any "terrorism exclusion in a contract for property and casualty insurance that is in force on" November 26, 2002, "to the extent that it excludes losses that would otherwise be insured losses." Section 105(b) of the Act also voids any State's approval of any such terrorism exclusion in force on such date to the extent that it excludes losses that would otherwise be insured losses. Section 105(c) of the Act provides that an insurer may reinstate such an exclusion only if the insured submits a written statement that affirmatively authorizes the reinstatement, or the insured fails to pay the increased premium within thirty days of receiving the disclosure notice required by said section of the Act.

As noted, the Superintendent has not approved any terrorism exclusion, and these notice and reinstatement requirements in the Act are not relevant to policies that do not contain such an exclusion. However, these provisions are applicable to policies providing coverage to New York policyholders through the excess line market or authorized insurers that nonetheless have implemented such an exclusion.

DISCLOSURE

The mandatory "make available" requirements of Section 103(c) of the Act apply to policies of property and casualty insurance (as defined in the Act) issued in New York. In order to be reimbursed by the Department of the Treasury for insured losses under the Program, insurers, under Section 103(b)(2), are required to provide "clear and conspicuous" disclosure to policyholders of the premium charge for the coverage and the federal share of compensation for insured losses under the Program. This notice must be provided, in all circumstances, whether terrorism coverage is included under the policy or the insured has the option to decline the terrorism coverage. Notice should be provided as follows:

- For existing (in-force) policies issued before the date of enactment (November 26, 2002), the Act requires that disclosure to the policyholder be made not later than 90 days after November 26, 2002. In accordance with the Interim Guidance by the Department of Treasury, for policies that had contained an exclusion for terrorism, an insurer may use one form to comply with the disclosure and the nullification and reinstatement requirements discussed above. For policies where terrorism coverage had been included, the notice should indicate what portion of the premium was attributable to the terrorism coverage and no additional premium may be charged. If no separately identifiable premium is attributable to terrorism coverage, the notice should so indicate;
- For policies issued within 90 days of November 26, 2002, the Act requires the disclosure to the policyholder be made at the time of offer, purchase and renewal of the policy; and
- For policies issued more than 90 days after November 26, 2002, the Act requires disclosure on a separate line item in the policy at the time of offer, purchase and renewal of the policy.

The NAIC has adopted two model notice forms. In its December 3, 2002 Interim Guidance, the Department of the Treasury deemed these forms to be in compliance with the notice requirements of the Act and supplied answers to questions regarding the use of notices. The Interim Guidance remains in effect until superseded by the issuance of regulations or further guidance by the Department of the Treasury. Insurers may modify the forms as appropriate. The forms may be accessed at <http://www.naic.org/pressroom/releases/rel02/index.htm>. This Department deems notices made pursuant to the Interim Guidance to be acceptable.

FILING OF POLICY FORMS AND RATES

With regard to the filing and approval of rates and forms, Section 106(a)(2)(B) of the Act provides, until December 31, 2003, for an exemption from any State prior approval or waiting period requirement "for rates and forms for terrorism risk insurance covered by this title." Section 106(a)(2)(B) further provides that "nothing in this title affects the ability of any State to invalidate a rate as excessive, inadequate, or unfairly discriminatory, and, with respect to forms, where a State has prior approval authority, it shall apply to allow subsequent review of such forms."

The Federal exemption is limited to prior approval of rates and forms intended to provide terrorism risk insurance covered by the Act. Accordingly, the exemption does not apply to rates and forms that exclude or limit coverage for terrorism risks, nor to any other rates, forms and policy provisions applicable to perils other than those specifically providing coverage for acts of terrorism covered by the Act.

Further, the exemption applies solely to the prior approval requirements of New York law. As such, insurers must file any such exempted rates and forms with this Department promptly upon their implementation or, preferably, prior thereto. Since no exclusions or limitations for losses resulting from acts of terrorism have been approved for use by authorized insurers for in-force policies, there would appear to be no need for these insurers to amend their rates and policy forms to explicitly include the coverage. To the extent that insurers are not required under New York law to file rates or forms (such as for policies issued in the Free Trade Zone or excess line market), the Act does not impose any obligation on them to make such filings.

The Department intends to closely scrutinize rates and forms implemented by insurers pursuant to the exemption in the Act and to take appropriate action against insurers that utilize rates and forms that do not comply with New York statutory standards.

USE OF TERRORISM EXCLUSIONS OR LIMITATIONS IN NEW YORK

TERRORISM EXCLUSIONS OR LIMITATIONS FOR "INSURED LOSSES" UNDER THE ACT

In recognition of the limited definition of "insured loss" under the Act and the requirement that insurers must make available such coverage, the Superintendent will consider for approval, on an expedited basis, policy provisions that exclude coverage, or limit the amount thereof, for an "insured loss", provided that the insurer has first satisfied the "make available" requirements of the Act; the exclusion or limitation applies solely to "insured loss" under the Act; the language of the exclusion or limitation mirrors the definition of "insured loss"; and the policy language is otherwise clear and not misleading. Such exclusions and limitation provisions remain subject to the applicable prior approval and all other statutorily and regulatory requirements of the Insurance Law.

TERRORISM EXCLUSIONS OR LIMITATIONS FOR LOSSES OTHER THAN "INSURED LOSSES" UNDER THE ACT

The Insurance Department will consider, on a company-by-company basis, whether made individually or through an advisory organization, filings of policy forms and rates regarding losses resulting from acts of terrorism that are not "insured losses" under the Act, in connection with commercial property/casualty risks, under appropriate circumstances, subject to all statutorily and regulatory requirements. Insurers submitting such filings must be able to justify and document the reasons they need to use such forms and rates. Where policy forms or rates are not required to be filed with the Superintendent, the insurer should maintain records justifying and documenting the reasons for such forms and rates, in a manner consistent with this Circular Letter.

Terms and Conditions

In developing coverage limitations for losses resulting from acts of terrorism not covered by the Act, policy language should be clear, narrowly drafted and limited to true and recognized acts of terrorism. Though it is often difficult to clearly distinguish between anti-social acts that are committed with terrorist motivations and those that are generally characterized as 'vandalism' or other traditionally covered events, it is nonetheless essential that insurers not draft policy limitations in a manner that could result in an interpretation that the restriction applies to ordinary vandalism or other traditionally covered events. Limiting coverage restrictions to circumstances resulting in large-scale losses from

terrorism will prevent the unintended application of such restrictions to events that should continue to be covered. Policy provisions, underwriting rules, and rates must comply with all applicable laws and regulations of this state.

Underwriting and Rating

Policy coverage limitations for losses resulting from acts of terrorism not covered by the Act may be implemented in two different ways. Insurers may elect to file rating classifications for approval, setting forth the specific circumstances under which the coverage limitations would be applied. In this case, the appropriate rate would be reflected in the classification and would be applicable to all risks meeting the rating classification's criteria.

Alternatively, insurers may maintain existing rating classifications and apply coverage limitations to individual risks, where warranted, on a case-by-case basis. The application of such restrictions would be considered an "excess rate" pursuant to the provisions of Section 2309 of the Insurance Law, and would require the specific consent of the insured and the approval of the Superintendent.

In either case, filings should limit the use of exclusions, sublimits or other limitations, as described below, to commercial risks, as this Circular Letter does not address personal lines. In evaluating such filings, the Department will review on a company-by-company basis, all the criteria proposed to be used by the insurer in applying such exclusions, sublimits or other limitations. Some of the criteria that may be considered include:

- Building characteristics (e.g., height of building, public notoriety of building)
- Occupancy characteristics (e.g., public use, office use, arena, government building)
- Measures used by the insured to mitigate its terrorism exposure (e.g., use of security guards, barricades, I.D Cards)
- Demographic characteristics of the geographic area around the location (e.g., rural, suburban, urban, population density, financial district, historic district)
- An insured's operations and the susceptibility to terrorist attack of the location and/or the general area around the location

Pricing methodologies should contain supporting documentation and a description of the rationale behind the approach. Any pricing approach should take into consideration the factors outlined above and must comply with the laws and regulations of this state applicable to rate making and standards for rates.

Sublimits

The use of sublimits for losses resulting from acts of terrorism not covered by the Act should be limited to appropriate circumstances and for location-specific terrorism coverage. An insurer must be able to justify and document the reasons it needs to use sublimits.

Classifications for the use and amount of the sublimit must be clear, objectively based and documented in the insurer's filing.

Exclusions

Specific exclusions for losses resulting from acts of terrorism not covered by the Act should only be used in those limited circumstances where the terrorism exposure is so extraordinary and of such magnitude that the only way a prudent underwriter would provide any insurance for the risk would be if the terrorism exposure were excluded outright and where sublimits would not sufficiently mitigate the terrorism exposure on a particular risk. The insurer should obtain the insured's written acknowledgement of the exclusion.

Classifications for the use of an exclusion must be clear, objectively based and documented in the insurer's filing. A sublimit that effectively excludes coverage will be treated as an exclusion.

The Insurance Department will monitor insurers' use of coverage limitations for terrorism and insurers will be expected to maintain statistics and to report periodically on their use. If it is determined that an insurer acts in a manner inconsistent with the Insurance Law and regulations promulgated thereunder, appropriate remedial action will be taken.

SPECIFIC PROHIBITIONS REGARDING TERRORISM EXCLUSIONS OR LIMITATIONS FOR BOTH "INSURED

LOSSES" AND LOSSES OTHER THAN "INSURED LOSSES" UNDER THE ACT

In connection with both "insured losses" under the Act and losses other than "insured losses" under the Act, no terrorism exclusion or limitation is permitted to the extent that coverage is otherwise required under the Insurance Law. Accordingly, no such exclusion or limitation is permissible for coverage with respect to the peril of fire that is subject to Insurance Law Section 3404; motor vehicle liability policies satisfying the financial responsibility requirements of the Vehicle and Traffic Law, including no-fault coverage; and workers' compensation insurance. An insured cannot voluntarily waive this statutorily mandated coverage. It is the position of this Department that any such exclusion or limitation would be unenforceable under Insurance Law Section 3103.

To the extent that a policy subject to the requirements of Section 3404 contains a terrorism exclusion or limitation in regard to loss or damage from perils other than fire, the policy language regarding the exclusion or limitation should clearly indicate that it does not apply to loss or damage caused by or resulting from fire that ensues from terrorism. Similarly, a policy that provides liability coverage in satisfaction of the financial responsibility requirements of the Vehicle and Traffic Law, or a policy that provides workers' compensation insurance, which contains an exclusion or limitation for loss or damage caused by an act of terrorism in regard to other coverages, must clearly indicate that such exclusion or limitation does not apply to the motor vehicle liability or workers' compensation coverages.

Questions regarding this Circular Letter may be addressed to Charles Rapacciuolo, Assistant Chief, Property Bureau at 212-480-5563 or Crapacci@ins.state.ny.us.

Very truly yours,
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