

FROM: Senior Manager, US, Worldwide Markets
LOCATION: G12
EXTENSION: 5131
DATE: 18th January 2002
REFERENCE: Y2700
SUBJECT: ILLINOIS: TERRORISM EXCLUSIONS ON
COMMERCIAL INSURANCE POLICIES
ATTACHMENTS: Illinois Department of Insurance Bulletin dated 31st
December 2001
ACTION POINTS: **Underwriters and brokers to comply with
instructions**
DEADLINE: **Immediate effect**

The attached bulletin (“the Dept bulletin”) entitled “Filing procedures and requirements for exclusions related to acts of terrorism” has been sent to all licensed property & casualty insurers writing commercial lines insurance in Illinois, including Lloyd’s. It is summarised in the attached appendix.

The Dept bulletin applies to commercial contracts with Illinois insureds written as “licensed business” incepting after 1st January 2002. These are referred to in this document as “licensed commercial contracts”. Licensed commercial contracts incepting prior to 1st January 2002 may not incorporate terrorism exclusion clauses.

The requirements do not apply to reinsurance contracts with cedants based in Illinois or to business written on a surplus lines basis.

In essence, and in relation to licensed commercial contracts, the Dept bulletin:

- Restricts terrorism exclusions to those in ISO endorsements it lists or to substantially similar wordings;
- Requires an insurer using terrorism exclusions to provide evidence to the Dept of Insurance that it does not have adequate reinsurance cover for terrorism; and

- Requires every contract containing a terrorism exclusion to include a specified wording restricting the exclusion's validity.

Required procedures for Lloyd's underwriters

Licensed commercial contracts incepting from 1st January 2002 onwards may incorporate the terrorism exclusions in the ISO endorsements verbatim provided that syndicates can prove that they have no adequate reinsurance cover for terrorism.

1. Certification of compliance

The Dept bulletin requires all insurers to certify to the Dept of Insurance their compliance with the Dept bulletin's requirements, as set out in paragraph 1) on page 5 of the Dept bulletin.

Lloyd's arranged filing of this certification on 15th January on behalf of the market as a whole. Underwriters do not therefore need to arrange individual certification.

2. Terrorism exclusions that may be used

- The terrorism exclusions that Lloyd's underwriters may use are at present restricted to those in the ISO endorsements specified in the Dept bulletin.
- Lloyd's has filed two terrorism exclusions with the Department of Insurance: NMA 2918 and NMA 2920. The Department has advised Lloyd's Attorney in Fact in Illinois that these wordings are disapproved and must not be used for Illinois licensed business.
- Underwriters may wish to file additional terrorism exclusion clauses. Any such wording must provide coverage at least as broad as that in the filed and accepted ISO endorsements. They must also comply with the Dept bulletin's requirements for the definition of "terrorism" (see page 3 of the Dept bulletin). Underwriters must not use any such clause until confirmation has been received from the Illinois Department of Insurance (via the Attorney in Fact's office) that it has been approved.

3. Syndicates that may use ISO terrorism exclusions

Syndicates may only use the ISO terrorism exclusions in licensed commercial contracts if they can provide "loss of reinsurance" documentation as set out in section 4 below.

A syndicate with terrorism reinsurance in place cannot underwrite licensed commercial contracts with any form of terrorism exclusion clause. All such contracts must be placed 100% with syndicates that have met (or will shortly meet) the requirements in 4 below.

4. Loss of reinsurance documentation

At present Lloyd's Attorney in Fact is awaiting a response from the Department of Insurance to a request to clarify the documentation required and the precise meaning of "adequate reinsurance coverage". The Department of Insurance has agreed to permit Lloyd's syndicates a "reasonable amount of time" to provide the documentation. We have asked that syndicates

be allowed until 15 February 2002 to comply but the Dept has neither confirmed nor denied its approval of this request.

Lloyd's Worldwide Markets and the NMA will provide additional instructions on compliance with these requirements as soon as possible. Underwriters may wish to review their reinsurance contracts and the correspondence concerning them to help ensure that they can comply with the Department's filing requirements relatively quickly.

Some syndicates may have adequate reinsurance cover for terrorism in place at present, but with the likelihood that at renewal reinsurers will insist on terrorism being excluded. In such cases syndicates need to consider providing to Lloyd's Attorney in Fact's office the stipulated loss of reinsurance documentation at or shortly after renewal of the reinsurance. Only once this documentation has been filed can the syndicate concerned underwrite licensed commercial contracts with a terrorism exclusion either from the ISO endorsements or in a similar form.

5. Policyholder notification

Every licensed commercial contract incorporating a terrorism exclusion clause must contain the following wording:

“This Endorsement is valid for use in the State of Illinois unless and until (1) the underwriters obtain reinsurance covering the excluded risks of loss due to “Terrorism” as defined by the Endorsement; or (2) the Director of Insurance determines that the underwriters are eligible to participate in a federal reinsurance program or a risk pooling program adequate to spread the excluded risks of loss due to “Terrorism” as defined by the Endorsement in a financially responsible manner.”

Please contact the following if you have any questions about this Market Bulletin:

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NMA members may also wish to consult NMA circular 02/2002 dated 11th January 2002 and headed “Use of terrorism exclusion endorsements in the United States”.

This market bulletin has been sent to active underwriters, market associations and the compliance officers of managing agents and Lloyd's brokers.

James Walmsley
Senior Manager, US
Worldwide Markets

Appendix

Summary of Illinois Department of Insurance bulletin's provisions

Intention of bulletin: To inform of the decision in Illinois to accept certain limited exclusions for acts of terrorism and to provide a procedure for insurers to use to expedite the filing and timely review of these limited exclusions.

Bulletin's provisions:

- Many of the commercial lines terrorism exclusions already filed by insurers will be disapproved for use in Illinois as inconsistent with the interests of public policy and inconsistent with s. 143(2) of the Illinois Insurance Code.
- Dept of Insurance will require insurers to remove any such disapproved forms from policies that have already been issued.
- The Dept of Insurance will permit exclusions that are substantially similar to the series of optional endorsements developed by ISO, a list of which is included on page 2 of the Dept bulletin. These are referred to here as the "ISO endorsements". Insurers wanting to include terrorism exclusion clauses in their licensed commercial contracts therefore have two choices:
 - To use the ISO endorsements verbatim; or
 - To develop their own terrorism exclusions. An insurer doing this must ensure that their terrorism exclusions are equal to or more favourable to insureds than the ISO endorsements. Otherwise the Dept of Insurance is unlikely to approved them for use if Illinois.
- An insurer that decides to use the ISO endorsements verbatim may either have:
 - *given the ISO filing authority in Illinois (this includes Lloyd's)*. In this case it is not necessary to submit the ISO endorsements to the Dept of Insurance, but it is still necessary to comply with the other "form filing requirements" set out on pages 4 and 5 of the Dept bulletin; or
 - *not given the ISO filing authority in Illinois*. Additional requirements then apply, set out on page 4 of the Dept bulletin.
- An insurer that decides not to use the ISO endorsements verbatim must file the terrorism exclusions it proposes to use with the Dept of Insurance, in accordance with the Dept's filing requirements. In line with those requirements it will not be able to use the exclusions until they are approved by the Dept of Insurance.
- The ISO endorsements acceptable in Illinois in accordance with the Dept bulletin have some significant limitations that provide coverage for acts of terrorism under certain circumstances. These are set out in page 2 of the Dept bulletin.
- The Dept bulletin sets out (on page 3) the definition of terrorism that it will accept, so long as the definition is accompanied by limitations equal or more favourable to policyholders than those in the ISO endorsements.

- The Dept will only permit an insurer to use terrorism exclusions (either the ISO endorsements or its own wordings) for licensed commercial business if it has provided proof of loss of adequate terrorism reinsurance for lines of coverage to which the exclusion applies.
- The Dept will not accept any terrorism exclusions for workers compensation policies.
- All exclusions must comply with terms and conditions in Illinois laws, regulations and the bulletin.



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DEPARTMENT OF INSURANCE
320 WEST WASHINGTON STREET
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GEORGE H. RYAN
GOVERNOR

NATHANIEL S. SHAPO
DIRECTOR

December 31, 2001

TO: All Licensed Property & Casualty Insurers Writing Commercial Lines Insurance Products

FROM: Nathaniel S. Shapo, Director

RE: (CB #2001-11) Filing Procedures and Requirements for Exclusions Related to Acts of Terrorism

REPLY TO: For Forms Filing Questions: Keith Fanning, P&C Compliance Unit (217)782-1792; FAX: (217)782-5020; E-MAIL: keith_fanning@ins.state.il.us

For Questions regarding Policy Renewal, Cancellation, or Nonrenewal: Gayle Neuman, Consumer Services Unit (217) 782-6361; FAX (217) 782-5020; E-mail: gayle_neuman@ins.state.il.us

*****Due to the number of expected inquiries, we request that you e-mail your questions or inquiries as much as possible.**

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 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 terrorists attacks and the ability of the insurance industry to allocate capital to provide coverage for these unpredictable and potentially catastrophic events. Unfortunately, Congress has been unable to reach agreement on the terms of a temporary federal solution. As a result, insurance regulators find themselves having to consider approval of certain coverage exclusions 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 in Illinois to accept certain limited exclusions for acts of terrorism and to provide a procedure for insurers to use to expedite the filing and timely review of these limited exclusions. As Director, I was involved in recent discussions with the National Association of Insurance Commissioners (NAIC) related to this issue. In a recent conference call, the members of the NAIC adopted a motion that "if the Congress adjourns without enacting federal terrorism legislation, the states should grant conditional approval to commercial lines endorsements that exclude coverage for acts of terrorism consistent with the exclusion framework developed by ISO. To the extent permitted by state law, such approvals would sunset or be withdrawn 15 business days after the President signs into law a federal backstop to address insurance losses attributed to acts of terrorism, or be subject to other conditions on the approval consistent with state law." 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 business consumers' concerns that their businesses not be subject to uninsured events.

To date many insurers have filed commercial lines terrorism exclusions. **Many of these endorsements will be disapproved for use in this state as inconsistent with the interests of public policy and inconsistent with the following provisions of law:**

Section 143(2) of the Illinois Insurance Code (215 ILCS 5/143(2)) provides that the Director may order the company or companies using any policy form, rider, certificate, application blank or other material that contains exceptions and conditions that will unreasonably or deceptively affect the risks that are purported to be assumed by the policy, to discontinue their use.

In addition, we will require companies to remove any such disapproved forms from policies that have already been issued.

Instead of filing the very broad total terrorism exclusions we have received to date, Illinois will file exclusions that are substantially similar to the series of optional endorsements developed by ISO. These endorsements include the following:

- Commercial Property Interline Endorsement: IL 09 40 01 02
- Commercial Property Interline Endorsement: IL 09 42 01 02
- Commercial General Liability Endorsement: CG 21 69 01 02
- Commercial General Liability Endorsement: CG 31 42 01 02
- Commercial General Liability Endorsement: CG 31 43 01 02
- Commercial Liability Umbrella Endorsement: CU 21 29 01 02
- Businessowners Endorsement: BP 05 12 01 02
- Businessowners Endorsement: BP 05 13 01 02
- Farm Liability Endorsement: FL 10 30 01 02

The policy exclusions filed by ISO and accepted for filing by this state have some significant limitations that provide coverage for acts of terrorism under certain circumstances. For policies providing property insurance coverage the following limitations apply:

- Exclusion for acts of terrorism only apply if the acts of terrorism result in industry-wide insured losses that exceed \$25,000,000 in property damage for related incidents that occur within a 72 hour period;
- Exclusions for acts of terrorism are not subject to limitations above if:
 - o 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;
 - o The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - o 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:

- Exclusion for acts of terrorism only apply if the acts of terrorism result in industry-wide insured losses that exceed \$25,000,000 in property damage for related incidents that occur within a 72 hour period; or

- Fifty or more persons sustain death or serious physical injury. For purposes of this provision serious physical injury means:
 - o Physical injury that involves a substantial risk of death;
 - o Protracted and obvious physical disfigurement; or
 - o Protracted loss of or impairment of the function of a bodily member or organ.
- Exclusions for acts of terrorism are not subject to limitations above if;
 - o 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;
 - o The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - o Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

Illinois will accept the following definition of acts of terrorism or other similar definitions, so long as the definition is accompanied by limitations equal to or more favorable to policyholders as those in the ISO forms described above:

Terrorism means activities against persons, organizations or property of any nature:

1. That involve the following or preparation for the following:
 - a. Use or threat of force or violence; or
 - b. Commission or threat of a dangerous act; or
 - c. Commission or threat of an act that interferes with or disrupts an electronic, communication, information, or mechanical system; and
2. When one or both of the following applies:
 - a. The effect is to intimidate or coerce a government or the civilian population or any segment thereof, or to disrupt any segment of the economy; or
 - b. It appears that the intent is to intimidate or coerce a government, or to further political, ideological, religious, social or economic objectives or to express (or to express opposition to) a philosophy or ideology.

Illinois will only accept terrorism exclusions for companies that provide proof of loss of adequate terrorism reinsurance for the lines of coverage to which the exclusion applies.

Illinois will not be accepting any terrorism exclusions for Workers Compensation policies.

FORMS FILING REQUIREMENTS – All exclusionary endorsements must comply with the terms and conditions set forth in Illinois laws, regulations, and this bulletin, and must be submitted in accordance with the instructions below.

For companies that have given ISO filing authority in Illinois:

If, in accordance with Illinois law and regulations, ISO is authorized to file forms on your behalf in Illinois, and you are adopting the ISO endorsement(s) verbatim with the January 1, 2002 effective date, you need not submit the ISO endorsement(s) to the Department. **However, you must still comply with the additional requirements listed below under “For all companies.” Illinois will only accept terrorism exclusions for companies that provide proof of loss of adequate terrorism reinsurance for the lines of coverage to which the exclusion applies.**

If you are not adopting the ISO endorsements or are adopting them with a different effective date, you must advise the Department, in writing, of your non-adoption or your proposed effective date. **You must also comply with the additional requirements listed below under “For all companies.” Illinois will only accept terrorism exclusions for companies that provide proof of loss of adequate terrorism reinsurance for the lines of coverage to which the exclusion applies.**

For companies that have not given ISO filing authority in Illinois:

In an unprecedented move in recognition of the seriousness of the situation, ISO will permit any insurer to use its copyrighted language, including insurers that are not current ISO licensees for policy forms.

To use the copyrighted ISO language, you must execute a short, limited license agreement that authorizes the use of the new language. ISO will not charge a fee for this limited license. For more information, you may contact ISO’s Customer Service Department directly at 1-800-888-4ISO(4476), using option 2. You may also contact ISO at info@ISO.com.

This limited license agreement does not authorize ISO to file the endorsement(s) on your behalf. Therefore, you must file the form(s) directly with the Department in compliance with current Department filing requirements.

To receive an expedited review, you must ensure that your filing is complete. To be complete, the filing must contain, at a minimum, the following information:

- a form filing cover letter (in duplicate) that includes the following information:
 - company name;
 - company FEIN #;
 - filing number (15 characters or less);
 - descriptive title of form, form number, and edition date of form;
 - listing of all policies for which the endorsements are being used;
 - effective date of use;
 - number of forms being filed;
- duplicate copies of the filing;
- a self-addressed stamped envelope large enough, and including enough postage, to return your stamped filed copy.

Do not send payment with the filing. Companies are billed quarterly.

You must also comply with the additional requirements listed below under “For all companies.” Illinois will only accept terrorism exclusions for companies that provide proof of loss of adequate terrorism reinsurance for the lines of coverage to which the exclusion applies.

For all companies:

All companies are responsible for complying with current Illinois Department of Insurance filing requirements (as stated in Section 143(2) of the Illinois Insurance Code and Administrative Rule 753.

All companies must comply with the following specific terrorism exclusion-related requirements:

- 1) Certification regarding policy language: All companies must certify to the Department that the company is using either the ISO endorsements or an endorsement that provides coverage at least as broad as the filed and accepted ISO endorsements, and that the company will comply with all requirements of this bulletin. This certification must be signed by a corporate officer of the company. The Department's P&C Policy Compliance unit must receive this certification no later than January 15, 2002 from companies adopting the ISO exclusions verbatim effective January 1, 2002. For companies that adopt a different effective date, the certification must accompany the notification letter to the Department. All other companies must submit this certification with their terrorism exclusion filings.
- 2) Loss of reinsurance information: All companies must provide the Department with:
 - a) a copy of the reinsurer's letter, reinsurance agreement, cover slip, or cover note showing such loss of reinsurance; and
 - b) a copy of the reinsurer's terrorism exclusion and its effective date.

The Department's P&C Policy Compliance unit must receive this information no later than January 15, 2002 from companies adopting the ISO exclusions verbatim effective January 1, 2002. For companies that adopt a different effective date, the information must accompany the notification letter to the Department. All other companies must submit this information with their terrorism exclusion filings.

- 3) Policyholder notification: All companies must send the following policyholder notification with every commercial lines terrorism exclusion issued in Illinois:

This Endorsement is valid for use in the State of Illinois unless and until (1) the Company obtains reinsurance covering the excluded risks of loss due to "Terrorism" as defined by the Endorsement; or (2) the Director of Insurance determines that the Company is eligible to participate in a federal reinsurance program or a risk pooling program adequate to spread the excluded risks of loss due to "Terrorism" as defined by the Endorsement in a financially responsible manner.

Additional Reminders for All Companies

All companies must comply with current Illinois laws regarding cancellation of commercial insurance policies (including but not limited to: 215 ILCS 5/143.14, 143.16, 143.16a, and 143.23).

Companies are also required to comply with current Illinois law regarding nonrenewal of commercial insurance policies, and advance notice to commercial policyholders when a renewal policy includes any change in coverage, change in deductibles, or increase in premium (143.17a).

Effective date and Expiration Date

This bulletin shall take immediate effect and shall expire on March 1, 2002.