

September 21, 2004

Dear Mr. W:

This letter responds to your request for an interpretation concerning the application of the Terrorism Risk Insurance Act of 2002 (“TRIA”)¹ and Treasury’s regulations implementing TRIA² to your commercial umbrella insurance policies.³ Specifically, the Illinois Department of Insurance has questioned whether The XYZ Insurance Company (“XYZ”) can attach an endorsement to their umbrella policies that would in effect exclude coverage for losses caused by, *inter alia*, certified acts of terrorism.

Background

An umbrella policy generally provides two types of coverage: (1) following-form excess coverage which “follows the form” of, and generally provides coverage for, the same risks covered by a primary or other underlying insurance (“Coverage A”); and (2) broader coverage than that provided by the primary or underlying policy (“Coverage B”).⁴ In this sense, an umbrella policy is a hybrid policy which can provide both an excess layer of coverage (usually above a retention) and primary coverage.

As we explained in our Final Rule, umbrella insurance is a commercial line of business included within the definition of property and casualty insurance for purposes of the Program.⁵ As required by section 103(c) of TRIA, insurers must make coverage for insured losses available in all of their property and casualty insurance policies and the coverage cannot differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.⁶ The mandatory availability, or “make available” requirement, applies to commercial umbrella policies.

¹ P.L. 107-297, 116 Stat. 2322, 15 U.S.C. §6701, note.

² See 31 C.F.R., Part 50.

³ 31 C.F.R. Part 50. This response is being issued pursuant to 31 C.F.R. §50.9, which sets forth a procedure whereby persons actually or potentially affected by the Act or regulations may request an interpretation.

⁴ In standard umbrella policy forms, following-form excess coverage is found in Coverage A of the policy and the broader coverage is found in Coverage B of the policy. This is the case with XYZ policy form BX 0001(08/98).

⁵ 68 Fed. Reg. 59725-26 (Oct. 17, 2003). Commercial umbrella insurance is reported on Line 17 (Other liability) of Statutory Page 14 and is within the definition of “property and casualty insurance.” See 31 C.F.R. §50.5(l)(1).

⁶ See also 31 C.F.R. §§50.21, 50.23.

Umbrella Insurers' Obligation To "Make Available" Terrorism Cover

The "make available" requirement must be satisfied in some part of your umbrella insurance policy. With regard to Coverage A (Excess Liability), you have indicated that because terrorism coverage is addressed in the underlying policy and Coverage A "follows form," that section of your policy provides coverage for insured terrorism losses. Whether Coverage A of your policy actually satisfies the "make available" requirement depends on whether the terms and conditions of the underlying property and casualty insurance policy cover insured losses for certified acts of terrorism. The underlying policy will only cover such insured losses if primary coverage for acts of terrorism has been offered and purchased. If that is the case, the XYZ Insurance Company has satisfied the "make available" requirement by operation of the terms of Coverage A of a standard umbrella policy.

If coverage for insured losses is excluded from the scope of coverage of the underlying policy (*e.g.*, because it was not purchased), then coverage for insured losses is not provided through Coverage A of an umbrella policy and the insurer must independently make the coverage available elsewhere in the insurance policy. In the case of an insurer that provides following-form excess coverage (whether as part of an umbrella policy or as a stand-alone excess policy), the excess insurer cannot simply rely on the underlying insurer's initial offer of terrorism coverage to the same insured *vis-à-vis* the underlying, or primary policy.

XYZ 's Endorsement

With regard to Coverage B (Extended Liability) of your policy, the XYZ Insurance Company seeks state regulatory approval to attach an endorsement to the policy that would exclude what it defines as acts of war and terrorism only from the scope of coverage under Coverage B. XYZ 's endorsement defines "terrorism" broadly.⁷ The endorsement's definition of "terrorism" could include an act certified as an "act of terrorism" under TRIA.⁸

Whether an umbrella insurer can attach a blanket exclusion to Coverage B depends on whether the insurer has satisfied the "make available" requirement under the insurance policy, which in turn depends on the factors described above.⁹ An umbrella

⁷ XYZ 's endorsement defines "terrorism" as: "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 express opposition to) a philosophy or ideology."

⁸ P.L. 107-297 at §102(1).

⁹ In our Final Rule published at 68 Fed. Reg. at 59725, we suggested that an umbrella insurer could amend its policy language to exclude from an umbrella policy's "drop down" coverage (*i.e.*,

insurer cannot simply assume or rely on the fact that coverage for insured losses was made available (offered) by the insurer that issued the underlying insurance without determining whether the coverage was purchased. Here, since both the underlying and umbrella insurers are the same, the XYZ Insurance Company will know whether that is the case.¹⁰

XYZ can attach an endorsement excluding coverage for insured losses from certified acts of terrorism from the coverage granted in Coverage B of its umbrella policy if permitted by state law only 1) if the insured has coverage for insured losses by operation of Coverage A because such coverage was purchased in the underlying insurance policy; or 2) in a case where the insured does not have coverage for insured losses by operation of Coverage A, but the insurer has offered the coverage under Coverage B and the insured has declined that coverage.

Finally, this interpretation only applies to the extent the endorsement would apply to “acts of terrorism”; TRIA does not limit XYZ’s ability to exclude losses caused by acts falling outside the statutory definition if allowed by state law. We also offer no opinion as to the form of the endorsement and defer to the judgment of the Illinois Department of Insurance in that regard.

Thank you for your inquiry. For additional information or if you have any specific questions, please call the Program office at 202-622-6770.

* * *

This response addresses the application of the Act and regulations to the specific situation set forth in your request, as you have represented the facts to Treasury. If there is a change in any of the facts or assumptions presented, and such facts or assumptions are material to a conclusion presented in this response, then the requestor may not rely on the conclusion generally or as support for any proposed or subsequent activity. This response is provided by the Terrorism Risk Insurance Program as a means of stating its current interpretation of the Act and regulations. The Program may revise or revoke this

Coverage B in this situation) any losses arising from perils for which insurance was available from the primary or underlying insurer but was intentionally not purchased by the policyholder, provided that the exclusion applied to losses arising from all perils (not just acts of terrorism) and is permitted by state law. We wish to clarify that were an insurer to do so, it would also need to ensure that coverage for insured losses was made available under the “excess” coverage of the umbrella policy (*i.e.*, Coverage A). As we have stated, TRIA applies to excess insurance. An umbrella insurer should “make available” coverage for insured losses, which it can do several ways, including: 1) under Coverage A because the losses are covered by the terms and conditions of the primary, underlying policy (as determined during underwriting); 2) through amending the policy language to grant such cover under Coverage A regardless of the terms or conditions of the primary, underlying policy; 3) through an endorsement granting coverage; or 4) within the same policy under Coverage B. An umbrella insurer must ensure that coverage for insured losses is somehow offered and made available to its policyholder. As we stated in our Final Rule, the issues facing umbrella insurers can be best addressed through the insurer’s underwriting procedures, pricing, and policy drafting.

¹⁰ You report that your umbrella policy is used exclusively with your Businessowners policies.

interpretation upon its own initiative or upon the enactment of amendments to the Act or regulations.

TERRORISM RISK INSURANCE PROGRAM

Jeffrey S. Bragg
Executive Director