

**New Insurance Exclusions for Terrorism and Mold
Create Unprecedented Levels of Uninsured
Risks for Property Managers, Property Owners and Lenders.**

Or

Sorry We Forgot to Tell You...

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Faced with rapidly increasing and unpredictable claims costs, the insurance industry has over the past year methodically excluded insurance coverage for mold and domestic terrorism losses on virtually all of the property and general liability insurance policies sold in the US. The impact on the risk management community from either of these new exclusions individually would be significant. Together they leave a broad cross section of insurance buyers including property managers, property owners and lenders with unprecedented levels of newly uninsured risks.

In light of the magnitude of these loss exposures, it is surprising how complacent insurance buyers, insurance agents and lenders have been in dealing with them. One reason for the complacency could be that it is very difficult for insurance consumers to put these new sources of uninsured loss exposures into perspective. Maybe insurance consumers would have reacted differently to the unilateral changes in their insurance coverage if the following cover letter had been sent out explaining the new mold and terrorism exclusions.

The plain English full disclosure cover letter to introduce mold and terrorism exclusions that was never written.

Your Insurance Company
123 Forest Home Ave
Everywhere, IN USA

Re: New exclusions on your policies

Dear Valued Customer,

We are writing to inform you about a couple of changes we made the insurance policies on your business this year. We want you to be aware that we have severely restricted the insurance we will provide you in the future for losses arising from domestic terrorism and mold.

Because of the explosive growth in mold related claims over the past couple of years, we have decided not to renew your property insurance for any damages related to mold, fungus or microbial matter. The definition of “Microbial Matter” we use in the policy includes anthrax and any other biological weapons, in case you were wondering. We will also be excluding all claims in any way associated with mold, fungus or microbial matter on all of your liability insurance policies. This exclusion applies to all your liability insurance for your premises and operations as well as any claims that may arise from your products and completed operations. It really is a “total” exclusion for mold related damages that you may become liable for.

We realize there has been a lot of confusion on the meaning of “absolute” versus “total” pollution exclusions in the general liability insurance policies we have been selling you over the past sixteen years. Especially when the “absolute” pollution exclusion does not absolutely exclude all claims arising from pollutants. We do not want to dance around the partial coverage issues raised by absolute versus total exclusions for mold related damages on your liability insurance policies. It is better for both of us to have a solid understanding of this insurance coverage issue as we go forward. Therefore we want you to know that if you run into a liability issue associated with mold, you are your own, do not even look to us to defend you.

Although the claims frequency, severity and aggregate loss statistics for mold damages under property insurance policies appear to mirror fire insurance claims in the United States, there is a big difference between insuring mold losses and fire losses. We know how to predict fire losses and how to charge premiums for them. We cannot predict mold related losses because they are growing too fast to measure. Although our historical loss data is still sketchy, what we think we know about mold claims is, on average, they cost about as much as a fire loss, which is close to \$20,000 per claim on a homeowners

insurance policy and \$200,000 on commercial property insurance policies without a liability loss component. (Not that we want to down play the liability component.) There were about 350,000 mold related property insurance losses compared to 500,000 fire claims in 2002 on commercial and personal lines insurance policies. Similar to fires, mold can make an entire building valueless. Just like fires, there are many mold related remediation losses measured in the tens of millions of dollars. We know fire losses cost insurance companies \$12.6 billion in 2000. We think there were about \$8 billion in mold related damage claims made under property policies in 2002. It is a little difficult to make an “apples to apples” comparison of these two sources of losses for the full 2002 calendar year because our new exclusions for mold related losses seem to be working pretty well in deflecting most of the new mold related losses back onto our customers.

Unlike fire losses, there is another component to mold losses we find particularly spooky - *toxic torts*. The above loss costs do not include losses from mold related toxic torts. It is difficult to get a clear picture on how many liability claims there are related to mold today because so few of them have actually been paid. It is safe to say there are billions of dollars in mold liability claims working their way through the courts today. Unlike a fire insurance claim, toxic tort claims are the Energizer Bunny in the claims arena; they just keep going and going, looking for the ultimate deep pocket. Unfortunately for us, that ultimate deep pocket is disproportionately an insurance company. Sometimes a single toxic tort case on an apartment complex can reach a billion dollars in damages, although none have ever been paid in those amounts. We think an ounce of prevention is worth a pound of cure on toxic mold claims, so we are excluding all liability claims in any way related to mold on all your general liability insurance and some professional liability policies. We do not want another asbestos or superfund issue on our hands. We are still paying on those toxic tort claims after twenty years! We cannot afford another batch of these claims.

We have also eliminated the insurance coverage you had last year for acts of domestic terrorism. In the letter we sent you offering a buy back option for terrorism losses, we were only offering to insure you for losses arising from federally declared international terrorism; you are still uninsured for domestic acts of terrorism. We realize now there might have been some confusion on the international versus domestic terrorism issue, so we wanted to clarify this today. In case you are concerned about being uninsured for terrorism, you can rest assured that statistically there is a very remote chance that it will ever affect your business. If it makes you feel any better, you are more than two hundred thousand times more likely to have a mold claim than a terrorist claim. In case this knowledge makes you euphoric, in the spirit of full disclosure we do need to caution you, the problem with terrorism caused losses is they can be very very expensive. Unlike mold, there is no such thing as a \$22,000 average terrorism caused loss.

As part of our continuing effort to provide you with excellent service we want to inform you that you may be able to obtain coverage for mold related damages in the environmental insurance market place and there is also insurance coverage for terrorism available.

Unfortunately our company is unwilling to offer you commercial insurance at any price for mold and domestic terrorism losses, it is just too risky. We are in the risk taking business to make money and we just do not have the specialized skill sets on board to make money in these two areas.

Good luck!

Have a good day ☺,
Your Insurance Company

It is difficult to explain consumer complacency on these new exclusions when insurance exclusions for mold losses expose insurance buyers to a greater degree of risk than being uninsured for fire claims.

Although the data is still rough, it looks like a rational insurance buyer that is comfortable with being uninsured for mold related claims should also be comfortable with being uninsured for losses arising from fires and a few other insured perils on property insurance policies. If a liability component to mold claims is added to the property damage caused by mold the frequency, severity and aggregate losses from mold claims looks very similar to fire claims, with both totaling about \$13 billion per year. To put domestic terrorism losses into perspective, the Oklahoma City tragedy cost \$140 million in financial terms. The 2001 anthrax loss was a small fraction of that amount and may not have even have fit common definitions of “terrorism”. The world trade center loss, which was an act of international terrorism and would now be covered under the Terrorism Risk Insurance Act, was monetarily a \$40.2 billion loss.

Because virtually all risk management programs rely on insurance as the backstop to finance unaffordable losses, adding new exclusions to all of the standard off-the-shelf general liability and property insurance policies sold in the U.S. will have a domino effect throughout the economy.

These exclusions will affect the indemnity agreements in the procurement contracts between the property owners and the property managers, since these agreements are commonly built with an insurance backstop between the parties. With the advent of these new exclusions, property managers may have assumed a lot more of the mold and terrorism risk of the property under their service contract indemnity agreements with owners than they realize. Most property managers enjoy some degree of insurance protection in the property and liability insurance provided by the owner. The loss

exposure of the property manager is exacerbated by the newly uninsured state of the property owner for mold and domestic terrorism losses and the new exclusions on the property manager's own business insurance policies.

There are prospective insurance alternatives for mold damages and domestic terrorism from a select group of highly specialized underwriters. However, the demand for both of these coverages continues to be surprisingly low considering the magnitude of the potential losses that have been shifted onto insurance consumers.

Property managers and property owners can fill the gaps in insurance coverage created by the mold and terrorism exclusions through the purchase of terrorism insurance and specially modified environmental impairment liability insurance policies. The indemnity agreements in the procurement contracts of services vendors will also have to be modified to reflect the mutual need for at least environmental insurance by both parties.

Terrorism insurance is a property insurance policy that applies to domestic and international terrorism acts. The policy will cover damage to the property. Business interruption coverage is also available. Bio and nuclear terrorism events are excluded in off-the-shelf policies. However, bio terrorism can be added to the coverage. The market capacity for this coverage is \$500,000,000. Minimum premiums are as low as \$1,000.

Filling the gap in insurance coverage for mold related damages is more complex, mostly because there are many more coverage options available in the environmental insurance industry. Environmental insurance policies have their roots in liability insurance but they also provide coverage for restoration expenses and business interruption, which are traditionally written in property policies. Most environmental policies do not have terrorism exclusions and they can provide coverage for nuclear damages. The off-the-shelf environmental insurance policy needs to be modified to provide coverage for mold related damages by adding mold, fungus and microbial matter to the definition of covered "pollutants" under the policy. Property owners and property managers can be covered under the same policy or either party could obtain their own environmental insurance policy. The market capacity for environmental insurance is about \$400,000,000 with minimum premiums in the \$8,000 range for a \$1,000,000 policy limit. Underwriters will usually demand that some form of mold risk management protocol be in place before they will issue a policy covering mold related damages. There are no standards on these protocols and they are available from a number of different vendors. A mold risk management protocol will usually contain a training element and a procedures manual.

With significant insurance market capacity for mold and terrorism insurance, the most significant constraint in obtaining appropriate insurance coverage may be in finding a qualified advisor to assist in the process. For example in environmental insurance, only one out of every hundred insurance agents sells even a single environmental insurance policy. Ninety nine percent of insurance agents that do sell an environmental insurance policy only sell and service one policy for one client. With over one hundred different environmental insurance policy forms in the market, the chances of a novice insurance agent finding the best solution for the client are very remote. Environmental and

Terrorism insurance are both highly specialized lines of insurance and it will require specialized help in crafting an insurance solution for most firms. There is more insurance coverage availability for both of these loss exposures than there is advisory capability in the agency force. Firms that desire these coverages should spend some time in due diligence looking for good advisors before looking for the insurance policies themselves. There is good advisory capability in both these areas available in the market place. For assistance on environmental insurance covering mold, a Directory of Environmental Insurance Professionals can be found on the website of the Environmental Risk Resources Association at www.erraonline.org. There are many specialty insurance brokerage operations for environmental insurance on the web as well. The search for “mold insurance “ produced 172,000 hits on the google search engine. The web is also an excellent source of experienced vendors for terrorism insurance. A site that was useful in the preparation of this article is www.terrorism-insurance-risk-management.com.

In conclusion, if being uninsured for losses arising from fires and a few other perils normally covered in a property insurance policy does not cause a property manager, owner or lender to be concerned, the risk of being uninsured for mold losses is about the same. There is a relatively high probability that a property manager will incur an uninsured loss for mold damages. There is a very low probability they will ever suffer a loss from terrorism. Terrorism losses have such low frequency they cannot be predicted or bench marked. Insurance for both of these newly uninsured loss exposures is available. But it will likely take specialists to craft these insurance solutions.

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