

**Mold Forces Restoration Contractors
To Face
A New Insurance Reality**

by

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When mold became a specifically excluded “pollutant” in insurance policies, firms that worked with water in buildings essentially became “hazardous materials contractors” for commercial insurance purposes. Contractors that deal with materials that can cause environmental damages have for years purchased separate Contractor’s Pollution Liability insurance. Today with mold being treated as a specifically excluded “pollutant” in insurance policies, restoration contractors now need the same kinds of liability insurance purchased by hazardous materials contractors.

This fundamental change in the insurance needs of restoration contractors will force thousands of restoration firms to access the complex and highly specialized insurance products offered in the environmental insurance market place. Environmental liability insurance covering mold is readily available to qualified restoration contractors. However, qualifying for this insurance, finding assistance in procuring it and affording the premiums will all be new challenges for most restoration contracting businesses.

Universal mold exclusions and limitations have permanently changed the business insurance and risk management needs of restoration contractors. When mold exploded onto the insurance scene as the “toxic pollutant” of the new millennium in 2001, the insurance industry responded with unprecedented vigor and purpose to cut it’s loss exposure by excluding or limiting insurance coverage for mold related claims as quickly as possible. By 2004 the insurance companies had accomplished their goal to avoid paying for mold damages by issuing more than one hundred million mold related claims exclusions and limitations. These exclusions have left property owners and contractors with a significant gap in their insurance coverage. The full effects of these changes are yet to be felt in the restoration contracting business. However, two changes are already being felt: first, in addition to excluding mold claims, some insurance companies are trying to purge their books of perceived high mold risk accounts by refusing to renew existing accounts. Restoration firms in this situation will need to turn to the environmental insurance market for their General Liability and Contractor’s Pollution Liability insurance coverage needs. Efficiently filling the insurance coverage gaps for restoration contractors created by mold exclusions and restrictive underwriting guidelines will require customized environmental insurance products from the environmental insurance market and the assistance of specialized environmental insurance brokers. Most off the shelf environmental insurance products are not well suited for restoration contractors. Second, some customers and third party administrators are coming to grips with mold exclusions and are demanding that restoration contractors procure environmental insurance programs that cover them for mold related damages. These trends are perfectly rational on the part of insurers, customers and third party administrators and are not the product of misinformation in the market place. Therefore, the movement of restoration contractors from their traditional insurance world into the environmental insurance market place is likely to be a permanent one.

A smooth transformation into the environmental insurance market will require specialized environmental insurance brokerage skill sets and planning in order to maximize the value of the insurance purchased while minimizing the premiums paid and professional exposures to all parties. Contractors can expect to pay more for insurance that covers them for mold related claims than what they would pay for a policy that does not cover mold claims. Without environmental insurance, restoration contractors are not covered for a source of loss (mold) that made professional risk takers (insurance companies) run for

cover, refusing to insure mold risk at any price. Only a very small sector of the insurance business has the skill sets and appropriate insurance policy forms to properly insure the new liabilities of restoration contractors.

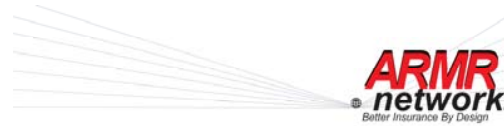
What Caused This Change The Restoration Business Sector

Between 2001 and 2002 mold claims were growing so fast, some insurance companies feared that mold would soon eclipse asbestos and environmental losses as a leading cause of insurance company insolvency. In response to the explosion of mold claims, insurance companies added tens of millions of new exclusions and limitations for mold related losses to virtually all personal lines of insurance (homeowners and auto liability), commercial lines (general liability and property) and professional liability policies (insurance agents and architects). These new mold/fungus exclusions were rolled out faster and on a wider scale than terrorism exclusions, with virtually no advice being offered to insurance agents or insurance consumers as to the impact of the exclusion on the insurance coverages being sold. No one knows for certain how many mold claims there were during this period, estimates range from twenty eight thousand to three hundred thousand claims annually. On the high end of the range mold claims would have mirrored the damages caused by fires in the United States, with both causes of loss costing the US economy twelve billion dollars per year. There is more evidence supporting the high end of the range than the low end. In a hearing on the need for new mold exclusions on November 7, 2002 with the insurance commissioner in Maryland, State Farm testified that they had paid \$446,000,000 in mold damage claims in just eight months between 2001 and 2002. Considering State Farm is just one out of over two thousand insurance companies doing business in the United States, it is a safe assumption that a significant source of losses are now uninsured in off-the-shelf insurance programs. If the high end of the range is accurate, then the insurance companies have artfully shifted a loss exposure equivalent to the losses caused by fires back onto insurance consumers without even a whimper of protest by consumer groups or insurance agents.

Recent mold claims research shows that insurance companies are paying many fewer mold claims than they were in 2002. Since the number of water damage events are more or less constant if the impact of major water events like hurricanes and floods are taken into account, the loss data implies that the insurance companies have successfully been able to shift mold losses away from their policies and back on to insurance consumers. Most restoration contractors have felt the early signs of these changes in the insurance market with less mold work being paid for under homeowner's insurance policies. The full effects of this change in the insurance market are yet to be felt by the restoration contracting industry. Experience with pollution and asbestos claims proves that adding exclusions into insurance policies does not make all the losses disappear. Some uninsured property losses will certainly find their way back to restoration contractors in the form of liability claims.

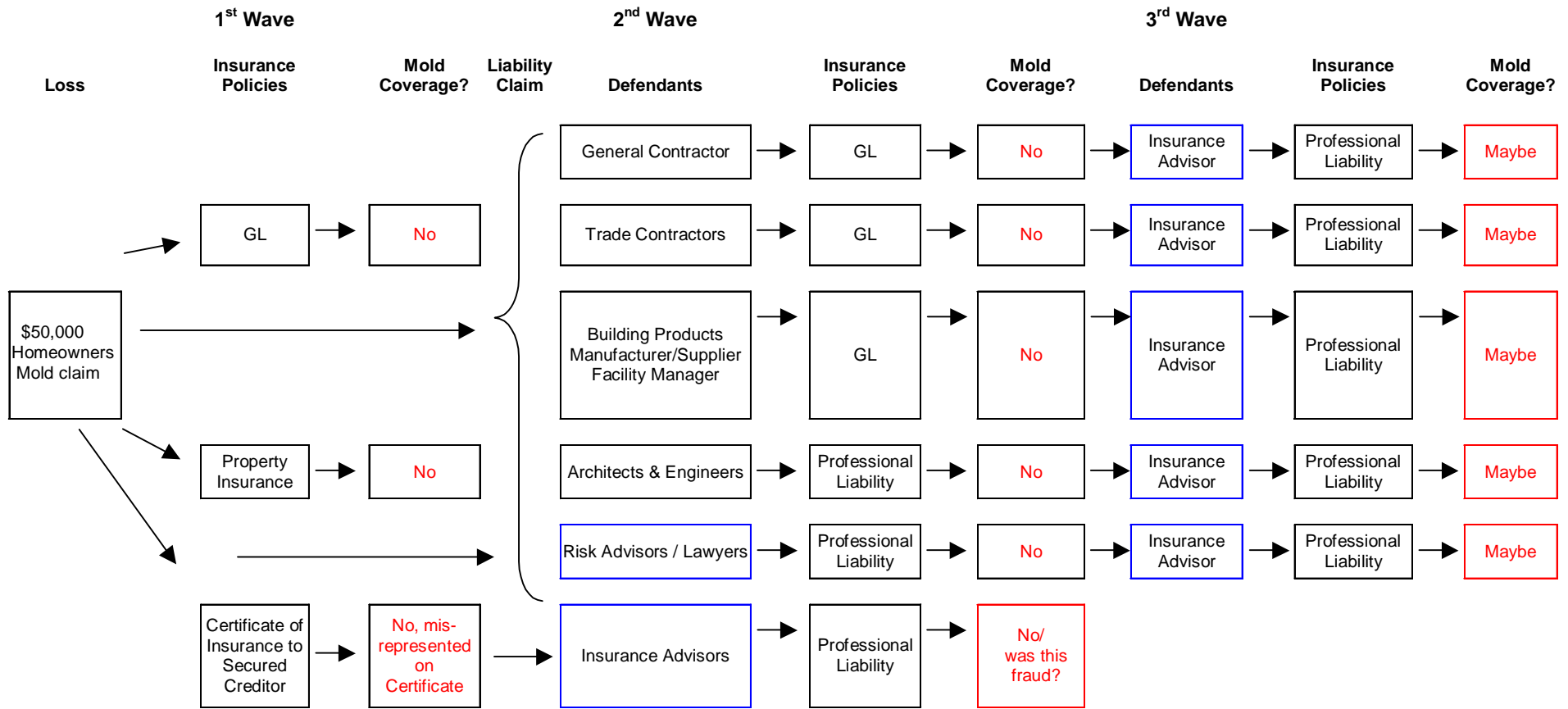
In the case of mold losses, specific mold exclusions may force the person who suffers a mold loss on their property to pursue other avenues of recovery for their damages, in some cases that will mean accessing the court system and bringing action against all responsible parties. In one famous mold damages case in Hawaii, even the electrical contractor along with all the other contractors on the new construction of a Hilton Hotel were sued for seventy seven million dollars of mold related damages. Anyone working with water in the built environment needs to be keenly aware that without primary insurance in the cost recovery mix, the chances of being sued for mold related damages increases dramatically. The domino effect of an uninsured mold claim illustrates how an uninsured mold claim on a homeowner's insurance policy transforms into a toxic tort claim against a restoration contractor and other potential responsible parties.

To avoid costly uninsured claims, all service providers working with water in the built environment must now implement a proactive water intrusion/mold risk management protocol including loss prevention and environmental insurance to deal with the fundamental change that mold exclusions have made to the business world.

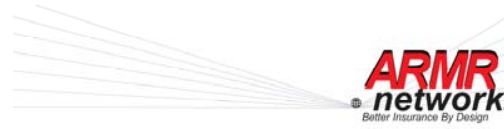


Domino Effect

Of An Uninsured Mold Claim from Property insurance to General Liability insurance to Professional Liability insurance



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The Effects of Mold Exclusions On Restoration Contactors

The introduction of universal mold exclusions will have eight major effects on the restoration industry:

- Any water damage claim in the built environment now has the potential to change into an uninsured toxic bodily injury claim. These claims are usually very expensive even to defend. Prior to mold becoming a health issue, restoration contractors did not have a measurable loss exposure to potential toxic tort claims. Also prior to universal mold exclusions most firms had liability insurance for such an event.
- The standard insurance policies purchased by restoration contractors have the same mold exclusions that their customers have, leaving them all potentially uninsured for mold related damages. Commercial General Liability insurance alone is no longer adequate liability insurance for any firm dealing with water in the built environment. The purchase of customized Contractor's Environmental Liability Insurance covering mold related liability is now necessary to fill the gap in business insurance created by mold exclusions.
- Without primary insurance for mold related damages on the building owner's insurance policies, there is an increased likelihood that the building owner will have to sue their vendors to recover mold damages.
- Sophisticated clients like insurance companies and third party administrators are coming to grips with the fact that restoration contractor's standard insurance packages now exclude mold related damages. These customers are starting to ask restoration contractors to provide environmental insurance covering mold in addition to general liability insurance. With these major sources of referral business routinely requiring environmental insurance, all restoration contractors will soon be pushed by market forces to procure environmental insurance if they work with water-affected conditions.
- Environmental insurance is available to qualified restoration contracting firms but it is not cheap (except in comparison to a toxic mold claim) and many restoration firms today cannot meet the rigorous underwriting requirements. As with all forms of contractor's pollution insurance, a cost advantage will go to the larger contractors because of the extreme economies of scale in the rating models the insurance companies use to charge premiums. Group insurance programs can help offset this advantage, but it is safe to predict that liability insurance cost considerations will force small mold remediators out of the market.
- For insurance purposes, when mold became a universally excluded or limited "pollutant" on insurance policies, restoration contractors moved into the insurance world of hazardous materials contractors. Hazardous material contractors have enjoyed a stable market for environmental insurance over the past twenty years. However, to obtain the appropriate insurance on their business, hazardous materials contractors must run a much more sophisticated business with more employee training and tighter financial management than many restoration firms are used to.
- The cost of business insurance will increase if the restoration firm decides to fill the gap in insurance coverage created by the mold exclusions.
- The degree of expertise necessary on the part of insurance agents to adequately service the insurance needs of a restoration contractor has shifted from the skill sets necessary to insure flower shops, grocery stores and restoration contractors on standardized Business Owners Package policies, into the insurance world of hazardous waste clean up contractors with highly specialized General Liability and Environmental Insurance policies. Although restoration contractors are not hazardous materials contractors per se, the liability insurance policies they will be purchasing to address mold will be the same policy forms used by asbestos abatement contractors and the contractors that clean up nuclear bomb plants. The vast majority of insurance agents have never worked with these complex insurance products. Therefore an additional level of insurance brokerage expertise will need to be added to the contractor's insurance agent team.

The Change In The Liability Insurance Needs of Restoration Contractors Is Permanent

The universal introduction of mold exclusions and limitations on insurance policies has created a permanent shift in the insurance market place for restoration contractors. Today any firm that has a loss exposure from water intrusion into the built environment needs to be serviced by highly skilled insurance brokers with the same complex environmental insurance tools used by hazardous materials contractors. This is not to imply water is hazardous, but the consequence of uncontrolled water can be mold and mold related claims are what the insurance companies have tried to avoid with new exclusions and limitations. The environmental insurance marketplace has evolved over the past twenty-five years with over one hundred different environmental insurance products. Special adaptations to a handful of these insurance products are what restoration contractors will need to purchase in order to get appropriate coverage for their water and mold work in the future.

It is important to note the need for environmental coverage is created by water related work, not necessarily mold remediation work. The reason for this is mold exclusions do not apply to only mold remediation jobs, they apply to any claim for mold damages on a blanket basis. Therefore any firm working with water in the built environment including roofing, plumbing and drying for example, in addition to those subcontracting or self-performing mold remediation, now needs an environmental insurance coverage to fill the gap in the business liability insurance package created by the mold exclusions now appearing in virtually all General Liability insurance policies.

It also does not matter if the work is being subcontracted or self-performed, there is still a need for the prime contractor to be properly insured. The purchase of a separate Contractor's Pollution Liability insurance is now necessary to bring the insurance coverage on the firm back to where it was before the mold exclusions on General Liability insurance policies stripped coverage away.

Restoration Contractors Face A Very Restricted General Liability Insurance Market

One of the general operating rules in the insurance business is that an underwriter should not provide insurance to a firm where exclusions in the policy being sold leave the insurance buyer uninsured for a significant part of the loss exposure of the business. Because of this unwritten ethical and practical rule, insurance underwriters are becoming increasingly nervous about providing liability insurance on firms that have the potential to be sued for mold related damages. This fear seems to have hit the restoration contracting industry harder than any other type of business as a class. For restoration contractors, the more the traditional general liability underwriter knows about a restoration contractor performing drying and mold remediation services either as a general or subcontractor, the more likely it is that restoration firms' General Liability insurance policies will not be renewed by that underwriter because of the "unwritten rule".

In addition to the fear of mold damages, the restoration industry across the board suffers from premium inadequacy in the eyes of insurers if the firm is classified as a "janitorial" firm for rating purposes, when in fact many restoration firms are providing services more closely related to "contracting". Any business that presents the chance for an increasing number of claims in the face of inadequate insurance rates is a prime candidate for the non-renewal of their insurance policies. Prior to the fear of toxic mold claims in the United States and Canada, the majority of restoration contractors were at least partially classified as janitorial firms for the purposes of premium pricing. Where some restoration firms would be best described as "janitorial", a firm that works with hammers or hires subcontractors with hammers is not a janitorial firm by any stretch of the imagination. Throw into the service mix drying services, mold abatement; any project involving negative air pressure containment or personal protective equipment and the janitorial classification would appear to be wildly inaccurate. That is the conclusion many general liability underwriters are coming to today and are therefore refusing to renew the General Liability insurance policies of restoration contractors that fall into the hammer swinging/drying/mold abatement services mix.

Once a restoration firm is rejected or non-renewed by the traditional insurance market, it is very likely that the firm and their insurance agent will be looking to purchase both general liability and environmental insurance from a handful of providers in the environmental insurance market place. In addition to some sticker-shock, restoration contractors will be faced with more stringent underwriting requirements.

These underwriting requirements include:

- The documented loss history of the account. (Four liability claims for \$500 each will be viewed much more critically than one claim for \$25,000.)
- Documented training of employees.
- Solid financial statements.
- A lengthy application.

Get Expert Help

One of the first steps to obtain a liability insurance package from the environmental insurance market is to find a qualified environmental insurance agent to assist in the process. Environmental insurances are very complex and unlike general liability insurance, lack standardization. Only about one out of every seventy-five insurance agents in the United States have ever sold even a single environmental insurance policy. Insurance agents cannot pick up a book to learn about environmental insurance. Insurance licensing exams and study guides in most states do not even mention the words “environmental insurance”. With over eighty different environmental insurance policies available in the market place with hundreds of customized endorsements, the need for specialty expertise in environmental insurance is obvious.

To find the expertise necessary to obtain the best choice of coverage most retail insurance agents will need to turn to a specialty environmental wholesale broker. Finding specialized experience is especially important because it is entirely possible in environmental insurance to pay top dollar for an insurance policy that excludes everything the firm does for a living, in contradiction to the “unwritten rule” mentioned earlier. One example of a specialized firm providing a high level of expertise in environmental insurance placements is American Risk Management Resources Network, LLC. The brokers at ARMR.Network each have over ten years of experience in environmental insurance and hold to their credit being the authors of the text materials on environmental insurance used to teach the most prestigious professional designations in the insurance business, CPCU and ARM.

Out of the five hundred thousand licensed insurance agents and brokers in the United States there are fewer than two hundred insurance agents that can be considered proficient in environmental insurance. These individuals have years of experience and various degrees of training specifically in environmental risk management and insurance. They also tend to be employed by the largest insurance brokerage firms and spend most of their time working with the largest companies in the United States. Therefore these retail environmental insurance specialists are generally not available to service the needs of the restoration business. Because of their more or less exclusive focus on the complex world of environmental insurance, environmental insurance specialists tend not to be the best insurance agents for the traditional lines of insurance needed by restoration contractors including the Workers Compensation, Property and Automobile insurance.

Keep Your Local Insurance Agent

The best servicing solution to address the new sophisticated insurance needs of restoration contractors will be to team a local independent insurance agent with the services of a specialty environmental wholesale brokerage firm that has trained and educated brokers on staff to help with the General Liability and Contractor’s Pollution Liability Policies. It important to realize that just because a wholesale broker holds themselves out to be a source of environmental insurance, that is no guarantee that the individual wholesale broker has any more capability, training or skill in the product line than the local insurance agent. Therefore it is important to ask a few questions about the background of the insurance brokers that

will be working on the firm's General Liability environmental insurance placements. Some of the best environmental insurance specialists in the world are wholesale brokers. Combined with the expertise of a local insurance agent, a restoration firm can build an expert service team that provides for all of their insurance needs.

Insure Your Entire Operation.

There will be a tendency for restoration firms looking into the purchase of environmental insurance to attempt to restrict the coverage purchased in order to save money on premiums. Some of the more popular strategies to do this involve insuring only jobs in which their client is demanding mold coverage while leaving the firm uninsured for other jobs, creating a subsidiary to do mold work while the remainder of the business remains uninsured for mold, or insuring only their mold-related jobs while leaving all of the other services provided by the firm uninsured. These strategies are never in the best interests of the firm.

The most efficient buying strategy for environmental insurance will always be to aggregate as much loss exposure onto one policy as much as possible. For restoration contractors that means insuring their entire operation. Where the focus on mold insurance may only be on self-performed mold remediation projects, contractors should remember a mold claim could come in from subcontracted remediation, or from drying, plumbing, roofing and window work. The incremental cost to insure the whole firm is usually a bargain in relation to the additional coverage gained.

Restoration contractors will find it increasingly difficult to purchase stripped down environmental coverages because their insurance agents are becoming aware that their own professional liability insurance is likely to also have a mold related claims exclusion. Without professional liability insurance for themselves, insurance agents will want to insure their clients properly for mold related events and will be increasingly reluctant to sell environmental insurance policies with glaring gaps in coverage.

This Insurance Problem Is Unlikely To Go Away.

The introduction of universal mold exclusion across the entire retail insurance market place was driven by a handful of insurance companies that sell their insurance products to other insurance companies. This type of an insurance transaction is called reinsurance and it is most easily thought of as one insurance company insuring the loss results of another insurance company. Although there are twenty four hundred property and casualty insurance companies licensed in the US, there are less than twenty reinsurance companies with any clout in the market place. Due to their need to be reinsured, (which is often driven by state insurance commissioners and financial rating agencies) the twenty four hundred insurance companies are very likely to blindly follow the lead of just a hand full of reinsurance companies. If the reinsurance policy on the insurance company excludes mold, than all of the policies that insurance company sells will exclude mold as well. Reinsurance policies have excluded mold since 2003.

The reinsurance companies' risk management solution for mold-related losses seems to be working. Claims managers and restoration contractors report that mold claims and jobs are down as much as 75% from 2002 levels in some markets. Based on these results insurance companies can call their mold exclusion risk management strategy a success. Therefore they are unlikely to back away from it and insure mold on traditional policies ever again.

Eventually, traditional general liability underwriters will realize that the reinsurance their company buys also has mold exclusions, which will force them to non-renew their existing books of restoration contractors, due to the inherent mold exposure and the unwritten ethical and practical underwriting rule discussed earlier. This has been happening in the restoration business over the past two years.

The New Reality

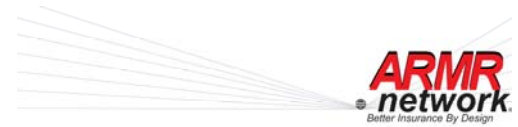
The restoration business is undergoing a period of change driven by the introduction of universal mold exclusions in the insurance industry. This is likely to be a permanent change in the insurance marketplace.

To find appropriate business liability insurance, which also covers their newly uninsured loss exposure to mold related claims, restoration contractors that perform water work will need to access customized insurance products within the complex world of the environmental insurance market place. The best approach to this will be to team a knowledgeable local insurance agent with the skill sets of a specialized environmental insurance wholesale broker.

Tips For Thriving In The New-Reality Marketplace

- 1) Make the changes to the insurance program on a timely basis. Do not let the actions of a general liability underwriter non-renewing the company's insurance policies put the firm in a crisis mode.
- 2) Try to avoid all general liability claims. Restoration firms with general liability claims frequency may not be able to find insurance at all. Hazardous materials contractors do not have claims frequency problems. Environmental insurance underwriters fear that the next \$2,000 liability claim for a bad drying job will turn into a toxic tort claim for a sick baby as a result of the contractors work. One claim, even if it is measured in the tens of thousands of dollars will likely be ignored by the underwriters, it is the frequency of claims that concerns them.
- 3) Run a tight financial ship. Environmental underwriters will likely be interested in the firm's financial performance. The balance sheet and income statement has to be good enough to get a loan for \$10,000. The reason for this is environmental policies have self insured retentions of at least \$10,000, smart underwriters want to see the firm has enough money to pay the premium and the self insured retention.
- 4) Prepare an accurate application. The application is a warranty statement on behalf of the contractor and is often incorporated into the policy itself. This means it will be referred to during a claim situation in order to establish that accurate information was provided to the underwriter, prior to purchasing coverage. Also in the new reality for restoration contractors a handful of environmental underwriters will have to handle what is likely to be a landslide of new insurance applications from restoration contractors. The good applications will receive favorable terms and conditions on their business insurance, the shoddy applications will be round filed as quickly as possible.
- 5) Work with an expert. Using a specialty broker with experience in environmental insurance policies will ensure that appropriate coverage is placed for the best possible price. Maximizing coverage for contractors will protect both the contractor's and the insurance broker's assets.

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