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Workshop K

***NONTRADITIONAL INSURANCE FOR
RESIDENTIAL CONTRACTORS***

Presented by

**Robert Curtis
Senior Vice President
Zurich Corporate Solutions**

**Karen A. Reutter
Senior Vice President
Willis, Inc.**

Wednesday, November 10, 9 a.m.–noon

Workshop K

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Robert Curtis
Senior Vice President
Zurich Corporate Solutions

Mr. Curtis is one of the speakers for Workshop K, "Nontraditional Insurance for Residential Contractors," on Wednesday morning. He recently became senior vice president of Zurich Corporate Solutions in New York, having most recently served as vice president of Structural Underwriting for AIG Risk Finance—The Unconventional Solutions Group of AIG. There, he specialized in the following programs on a global basis: Enterprise/Integrated Risk Programs, Finite Risk, and Exotic Loss Portfolio Transfers (incorporating finite risk techniques) of unique risk exposures (e.g., asbestos, toxic torts, occupational diseases, medical malpractice, etc.). In his former role, he was in charge of business development for the Western Region of AIG Risk Finance, as well as serving as the lead/senior underwriter in structuring and pricing various risk finance programs to meet clients' business objectives.

He is also a frequent speaker to audiences regarding asbestos, finite risk, enterprise risk management, and strategic risk financing/capital markets. He has participated in International Business Communications seminars, the World Captive and Alternative Risk Financing Forum, Risk Management Society (RIMS) seminars, the Vermont Captive Insurance Association's annual meeting, and is a guest lecturer at the American Graduate School of International Management's (Thunderbird) International Risk Management class.

Mr. Curtis holds a bachelor of arts degree in economics from Pacific Lutheran University. He later earned a master of business administration degree from the American Graduate School of International Management (Thunderbird) emphasizing International Finance. Mr. Curtis was awarded the Associate in Risk Management (ARM) and Chartered Property and Casualty Underwriter (CPCU) designations in 1994 and 1996, respectively.

Karen A. Reutter
Senior Vice President
Willis, Inc.

Ms. Reutter is one of the presenters for Workshop K, "Nontraditional Insurance for Residential Contractors," on Wednesday morning. She has extensive experience in the risk management and insurance industry, beginning her career at International Risk Management Institute, where she was responsible for content and development of reference material and books for the construction and risk management community. She was specifically responsible for *Construction Risk Management* and *Risk Financing* as well as other industry publications and speaking engagements.

She joined St. Paul Companies in 1994 where she worked as a senior account underwriter within the Construction practice in St. Paul's home office. She moved quickly into product development, strategy, and planning for the Construction practice and later for the corporation overall. Her work at St. Paul Companies included construction market research and product development while located in Johannesburg, South Africa, and Bermuda. Ms. Reutter left the St. Paul in 1999 as a senior officer of the corporation and joined the Zurich Construction staff at its home office in Minneapolis as national director.

While at Zurich, Ms. Reutter was responsible for national marketing, large account management, product development, and operations/process redesign. She has specific experience with home builder risks and products as well as subcontractor default insurance. She has a background in captives and alternative risk financing solutions. Ms. Reutter joined the Willis National Construction team in January 2002 as senior vice president based in Nashville.

At Willis, Ms. Reutter is part of the national construction practice team and is responsible for assisting local office efforts throughout the nation in sales and marketing; large account management, including program structure and coverage design; national insurer relationships; planning; and strategy. In addition, she is the national leader for Willis's Homebuilder Practice and in this capacity manages and directs production of home builder and related business for Willis, develops insurance capacity and services, and leads efforts in solution development for this client base.

She holds master and bachelor of business administration degrees from the University of North Texas and has also earned the Chartered Property and Casualty Underwriter (CPCU) and Associate in Risk Management (ARM) professional designations.

NONTRADITIONAL INSURANCE FOR RESIDENTIAL CONTRACTORS

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Agenda Topics

- Construction Defects Defined
- Construction Defects and their Relationship to the CGL Coverage Form
- Issues in the Insurance Marketplace
- Alternative Program Structures for Addressing Construction Defect Risks



Construction Defects Defined

Construction defect claims (CDs) generally emanate from negligent acts, errors or omissions in the following areas.

- Design error or ambiguity
- Component defects or material deficiencies
- Substandard workmanship
- Subsurface, geotechnical issues



Construction Defects Further Defined

- Active defect involves known deficiencies
- Passive defect involves “expectation” of future deficiencies based on active defects
- Patent vs. Latent: statute of limitations, statute of repose



Construction Defects in Habitational Construction

- People
- HOAs
- Legal practice groups
- What was once only CA, now national
- Risk factors include subcontractors
- Industry claim experience and defense costs



Recurring CGL Coverage Issues

- Coverage Grant, Insuring Agreement
 - “Legally obligated to pay”
 - Definition of “Occurrence”
 - Definition of “Property Damage”
- Does an Exclusion preclude coverage?
 - Completed operations exclusion
 - “Business Risk” exclusions



Underwriters' Concerns

- Growth in residential/habitational construction
- Defense costs
- Coverage interpretation for risks they believe they were not covering
- This drives difficulty in risk identification and pricing



So, Underwriters Have...

- Excluded property damage completed operations coverage
- Targeted ALAE
- Deleted exception to the "Damage to Your Work" exclusion
- Adopted broader exclusionary endorsements
- Pulled out of the habitational marketplace
- Created alternative products and programs



Characteristics of Finite Risk/Motivations

- Realization of favorable loss experience
- Provide evidence of insurance for financial lenders and job site requirements
- Provide a foundation to build excess coverage
- Multiple-year program protects against adverse traditional insurance market fluctuations
- Potential of incorporating underwriting risk to address volatility of liabilities



Restructuring Current Insurance Programs

Finite Risk Policy

- Multi-year
- Profit sharing
- Insurance policy/certificate provided
- Minimal underwriting risk (dependent upon deal structure)
- Manuscript policy wording

Traditional GL Policy

- Annual policy
- Minimal/no profit sharing
- Insurance policy/certificate provided
- Underwriting risk provided
- Filed insurance company wording (limited flexibility)



Finite Risk vs. Blended Finite Risk

Finite Risk

- No underwriting risk
- Policy limits are fully funded/collateralized with cash
- Investment income on deposit

Blended Finite

- Incorporates underwriting risk
- Policy limits are partially funded/collateralized with cash, while unfunded/uncollateralized limits are underwriting risk borne by the underwriter
- Investment income on deposit



Finite Risk Example

Sample Design

- **Policy Term:** 3 years
- **Policy Limits:**
 - \$3,000,000 – Combined Products Completed and Premises Operations Policy Aggregate for the Policy Term subject to the following sublimit:
 - \$1,000,000 any occurrence
- **Self-Insured Retention:** \$25,000 each occurrence
- **Deposit:** \$3,000,000 (to be paid prior to Policy inception)



Finite Risk Example

Sample Design (cont.)

- **Administrative Fee:** \$300,000 (to be paid prior to Policy inception)
- **Experience Balance:** \$3,000,000 (this is the Deposit) – Note: all losses within the program are paid out of the Experience Balance
- **Crediting Rate:** 90-day U.S. Treasury (this is credited to the Experience Balance)
- **Commutation Clause:** In return for full release from past, present, and future liabilities under the Policy, the Insurer will return 100% of the remaining Experience Balance.



Blended Finite Risk Example

Sample Design:

- **Policy Term:** 3 years
- **Policy Limits:**
 - \$5,000,000 – Policy Aggregate for the Policy Term subject to the following sublimits:
 - \$3,000,000 in the term aggregate for Products Completed Operations
 - \$1,000,000 any occurrence
- **Self-Insured Retention:**
 - \$25,000 each occurrence for the first \$3,000,000 in total losses
 - Once \$3,000,000 in total losses have occurred, SIR is \$1,000,000 each occurrence.



Blended Finite Risk Example

Sample Design (cont.)

- **Premium:** \$3,500,000 (to be paid prior to Policy inception)
- **Experience Balance:** \$3,000,000 (this is established from the Premium)– Note: all losses within the program are paid out of the Experience Balance
- **Crediting Rate:** 90-day U.S. Treasury (this is credited to the Experience Balance)
- **Commutation Clause:** In return for full release from past, present, and future liabilities under the Policy, the Insurer will return 100% of the remaining Experience Balance.



Summary

- Need to consider your view of the marketplace in relation to your company's business needs and objectives
- Consider short-term and long-term solutions to match your company's risk philosophy, culture and appetite
- Identify and understand alternative solutions