

## **Workshop W7**

***Wednesday, October 11, 1:30-3 p.m. and 3:30-5 p.m.***

# ***INSURING RESIDENTIAL CONTRACTORS***

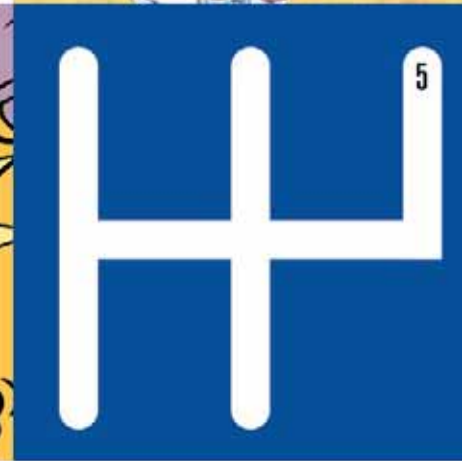
## **Presented by**

**David DeLaRue**  
**Senior Vice President**  
**Willis, Inc., National Construction Practice**

**Karen A. Reutter**  
**Senior Vice President**  
**Willis, Inc., National Construction Practice**

Over the last decade, residential contractors' insurance options have shrunk considerably. Some insurers have exited this market altogether. Others continue to write coverage for these contractors on a limited and selective basis. This session will outline residential contractors' current insurance options, including both traditional coverage options and residential wrap-ups. Find out how to evaluate coverage for residential exposures on traditional insurance policies, as well as the latest developments in home-builder wrap-up programs.

- Provides a general overview of the residential construction insurance market and conditions.
- Describes residential contractors' coverage options and the benefits and limitations of each approach.
- Reviews the structure of a residential wrap-up program, the market for these programs, and an overview of coverage issues.



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**David DeLaRue**  
**Senior Vice President**  
**National Construction Practice Group**  
**Willis, Inc.**

Mr. DeLaRue is a copresenter for Wednesday afternoon's Workshop W7, "Insuring Residential Contractors." He began his insurance career in 1985 as a claims adjuster with Texas Employers Casualty Company where he managed liability claims for commercial insureds, including owner controlled insurance programs (OCIPs). He was promoted to a home office position where his responsibilities included managing large claims on a multi-regional basis and working with state insurance regulatory authorities on claim management disputes. In 1988 Mr. DeLaRue joined Johnson & Higgins as a claims consultant serving as a client advocate on an array of sensitive property and casualty claims. He continues to maintain a multi-line adjusters license with the State of Texas.

In 1990 Mr. DeLaRue was promoted to the position of Account Executive in the property department of Johnson & Higgins. In this capacity he worked with commercial clients marketing and managing complex property and builder's risk programs, including a large light rail OCIP builder's risk program for Dallas Area Rapid Transit (DART). In 1992 he was appointed Account Manager for the DART light rail OCIP. In this position, Mr. DeLaRue was responsible for managing the broker's on-site OCIP team consisting of four full-time employees. Johnson & Higgins recognized his performance on DART by naming him the Dallas Account Manager of the Year in 1992.

In 1994 Mr. DeLaRue joined Willis's National Construction Practice as a member of the Wrap-Up Team. In this role, Mr. DeLaRue has worked closely with the Managing Director of wrap-ups over the past 11 years to grow the Willis Wrap-Up practice from five programs to more than 280 current or completed programs through 2005. Mr. DeLaRue works with prospective and current owner and contractor clients by providing guidance and advice on the design and application of wrap-ups for both commercial and residential construction risks. He is responsible for marketing wrap-ups throughout the United States and maintains active relationships with many of the key wrap-up underwriters.

Mr. DeLaRue earned a Bachelor of Business Administration degree in 1984. Since beginning his career in the insurance industry, he has augmented his work experience with formal study. As an adjuster and claim consultant he completed the required course work and received his Associate in Claims (AIC) designation. Then, as an account executive in a property unit, he received his Associate in Risk Management (ARM) designation and began the course work for his Chartered Property Casualty Underwriter (CPCU) designation. After joining Willis, Mr. DeLaRue successfully completed the course work for his CPCU and received his designation in 1995. He attends many industry conferences and completes annual continuing education studies as required for the maintenance of his insurance licenses.

**Karen A. Reutter**  
**Senior Vice President**  
**National Construction Practice Group**  
**Willis, Inc.**

Ms. Reutter is a copresenter for Workshop W7, "Insuring Residential Contractors," on Wednesday afternoon. 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 and habitational risks and products. 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 Minneapolis.

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 Habitational 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.

# ***INSURING RESIDENTIAL CONTRACTORS***

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***David DeLaRue  
Karen A. Reutter  
Willis, Inc., National Construction Practice***

## **I. Introduction and Overview**

- a. Define residential
- b. Residential contractors vs. home builders
- c. Key market metrics: why is this such a big deal?
  - i. Regional differences
- d. Coverage vs. Savings
- e. Unique risk factors of residential construction
- f. Claim experience and loss development

## **II. Program Options**

- a. Primary vs. excess liability coverage
- b. Wrap-ups vs. Standard program design
  - i. Owner vs. Contractor
  - ii. Program overviews
    - 1. Design
      - a. WC/GL & GL Only
    - 2. Terms/Conditions
    - 3. Unique issues
  - iii. Pros and cons of each program design
  - iv. How to evaluate competing programs

### **III. Coverage Issues and Challenges**

- a. Retentions
- b. Defense cost coverage
- c. Coverage gap for prior work
- d. Other coverage issues: what to watch out for in your liability form
  - i. Professional liability
  - ii. Environmental
- e. Warranty period premises operations

### **IV. Noninsurance Risk Mitigation**

- a. QA/QC
  - i. Preconstruction
    - 1. Contractor/Owner prequalification
  - ii. Construction operations
    - 1. Third-party review (forensic documentation)
  - iii. Postconstruction
    - 1. Building maintenance & review
- b. Subcontractor selection and management
- c. Consolidation in the industry: who are you hiring and who are you working for?
- d. Right to repair legislation
- e. Call-backs and customer care
- f. Contractual risk transfer

### **V. Summary**

- a. Where's the residential market risk transfer market heading?
- b. Trends and expectations: capacity, pricing, and program structures

### **VI. Audience Questions and Open Discussion**

# **Insuring Residential Contractors**

**Presented By:**

**Karen A. Reutter, CPCU, ARM  
Senior Vice President**

**David DeLaRue, CPCU, ARM  
Senior Vice President**

**Willis, Inc.  
National Construction Practice**

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## **Agenda**



- **Introduction and overview of the topic**
- **Program options**
- **Coverage issues and challenges**
- **Noninsurance risk mitigation – beyond risk transfer**
- **Summary**
- **Audience Q&A**

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## Introduction & Overview



### Definition of “residential” or “habitational”

- **Varies by insurer**
- **Usually includes attached product (i.e., condominiums)**
- **Issue is tied to HOAs, condominium associations**
- **“Ownership”**

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## Introduction & Overview



- **Home builders vs. Contractors**
  - **Key differences and impact with underwriters**
    - **Self-performed work**
    - **Mix of business (can leverage “commercial” jobs)**
    - **Risk management as a practice**
      - **Today vs. the past for home builders (contractors were/are seen as better risk due to more mature risk management as practice, recognition)**
      - **Drove two separate insurance markets, different products**
        - » **Both contractors and home builders pose construction defect risk**

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## Introduction & Overview



### Key Metrics

- **50% of U.S. construction market**
- **3/1 defense vs. indemnity dollars**
- **100% litigation on attached product in CA**
- **Claim**
  - **Reserve examples**
  - **Individual claim examples**
  - **Insurers' tracking of P/D completed operations losses on habitation**

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## Introduction & Overview



### Coverage vs. Savings

- **Program structure transition: early 2,000s**
- **High excess placements; catastrophic coverage, significant cost for first excess layer**
- **Subcontractor issues**
  - **Uninsured/underinsured for completed ops**
  - **A/I endorsements**
- **Buying coverage to statute of repose**

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## Program Options



- **Conventional or wrap-up (OCIP vs. CCIP)**
- **Regional issues**
- **Wrap-up structure**
- **Funding retentions**
  - **Finite/blended finite**
  - **Captive**
  - **Fronting paper**
- **Other coverage considerations**

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## Conventional or Wrap-Up



### Owner considerations

- **Coverage availability – short-term/long-term**
- **Coverage vs. Savings**
- **Regional insurance considerations**
- **Constructor experience and reputation**
  - **QA/QC**
- **Lender requirements**
- **Additional insured issues**
- **Coverage limitations – no silver bullet**
  - **EIFS, mold, E&O, limited defense**
- **Cost**

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## **Conventional or Wrap-Up**



### **Constructor considerations**

- **Regional insurance considerations**
- **Owner qualifications**
  - **Quality before cost**
  - **Product commitment**
  - **Scheduling – including cover placement**
  - **QA/QC**
- **Subcontractor insurance**
- **Practice program – short-term/long-term**

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## **Conventional or Wrap-Up - Continued**

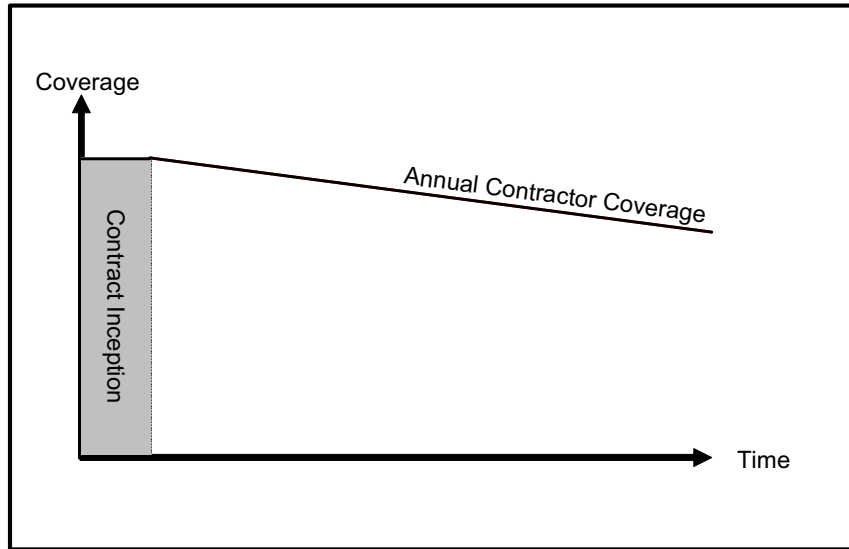


### **Constructor considerations - continued**

- **Wrap-up program coverage limitation**
- **Warranty period premises/operations exposure**
- **Wrap-up cover limitations**
- **Converting apartments**
- **Preventing sub-insurance erosion**
- **Cost**

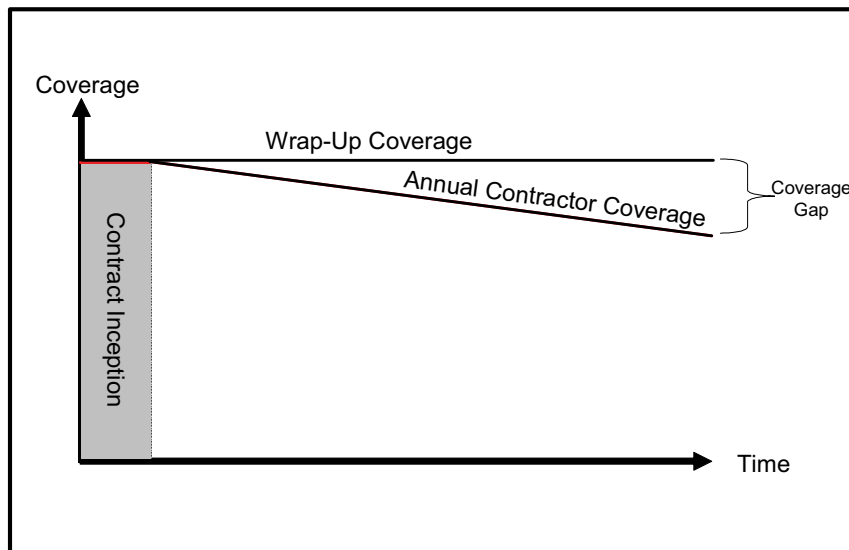
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## Coverage Gap



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## Coverage Gap



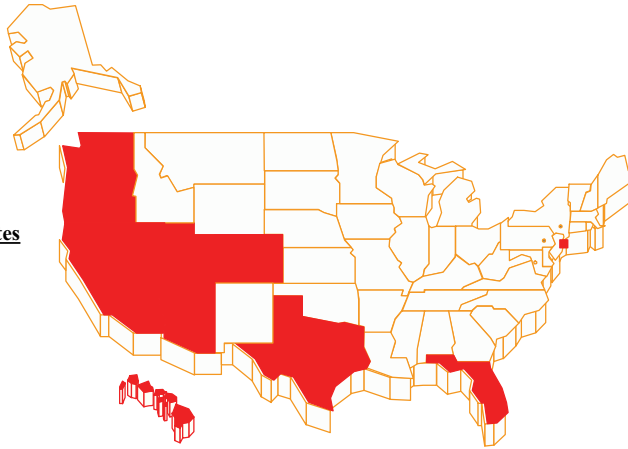
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## Regional Challenges

### Shaded States

Arizona  
Alaska  
California  
Colorado  
Florida  
Hawaii  
Texas  
Nevada  
Oregon  
Washington

\*city -- NYC



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## Wrap-Up Program Structure



- **Low deductible risk transfer**
  - **GL only wrap-up excess surplus lines – low retention**
  - **(\$\$\$)**
- **WC/GL wrap-up**
  - **Standard market – ISO form with modifications**
  - **(\$\$)**
- **High retention excess program**
  - **Self-insured retentions of \$2M plus**
  - **(\$) - (\$\$)**

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## Comparing Wrap-Up Structures

### Low Deductible GL Only

- Term Program
- E&S Market
- Intermediary Dependent
- \$50K - \$500K Deductible
- Mandatory QA/QC
- Bundled Administration
- Project Specific
- Owners or Constructors
- Costly

### Specialty Product

- HBPP
- Volume Builder

### WC/GL

- Term Programs
- Conventional Market
- \$500K - \$1M Deductible
- QA/QC Requirements
- Rolling or Project Specific
- Limited Market Appetite
- Current Relationships
- Pro Rata ALAE or Special Deductibles
- Costly

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## Comparing Wrap-Up Structures Continued

### High Retention Excess Program

- Annual Excess Programs
- \$2M and Higher Self-Insured Retentions
- High Production Builders & Developers
- Utilization of Fronts & Captives
- QA/QC Flexibility
- Greatest Flexibility & Control
- Single Family or Attached
- Long-term Commitment
- Excess Market Limitations



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## Coverage Limitations & Issues



- **Defense inside limit**
- **Pro rata sharing of ALAE**
- **Absolute pollution exclusion**
- **EIFS**
- **Fungus, spores, mold**
- **Property damage to project**
- **Silica**
- **Professional liability**
- **Subsidence**
- **Trailing SIR (excess)**
- **Absolute limits**
- **Warranty work**

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## The Cost of Risk Transfer

### Elizabeth Kubler-Ross's Five Stages of Death and Dying – 1969

- **Denial**
- **Anger**
- **Bargaining**
- **Depression**
- **Acceptance**



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## **The Cost of Risk Transfer**



### **GL only through E&S market**

- **2.5% to 10% on construction value**
- **Factors:**
  - **Limits**
  - **Type and size of construction**
  - **Location**
  - **Developer & constructor**

### **WC/GL through standard wrap-Up market**

- **3% to 6% on construction values**
- **Factors:**
  - **Limits & deductible**
  - **Owner or contractor**
  - **Project specific or rolling**
  - **Nonhabitational mix of business**

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## **The Cost of Risk Transfer**



### **Self-Insured w/Excess Limits**

- **\$ - \$\$ on construction value**
- **Factors:**
  - **Self-insured limits**
  - **Type of construction**
  - **Location**
  - **Project specific or rolling**
- **Program issues**
  - **Need for a front insurer**
  - **SIR (excess) – indemnity only**
  - **Jurisdictional issues**
  - **No stop-loss**

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## **Current Wrap-Up Market Conditions**



- **Project preference**
  - **“B”** - Concrete/Steel
  - **“C”** - Wood frame
  - **“D”** - Conversions
- **Standard market**
  - WC/GL
  - Contractor preference
- **Improved E&S Options**
  - Domestic & London
  - Premium stability & improving

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## **Other Coverage Considerations**



- **Professional liability**
- **Environmental**
- **Builder's risk**

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## **Beyond Risk Transfer Playing Offense & Defense**



- **Preconstruction**
  - **Prequalification**  
(Owner, constructor, & subcontractor)
  - **Design**
  - **Warranty programs & agreements**
- **Construction**
  - **Third-party review – QA/QC**
  - **Forensic documentation**
    - **Data management**
  - **Document review**
  - **Communication**

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## **Beyond Risk Transfer Playing Offense & Defense**



- **Postconstruction**
  - **Building maintenance programs**
  - **Customer service – above & beyond**
    - **Ignoring the problem won't make it go away!**
  - **Incentive programs**

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## Summary



- **Slowing residential market**
- **Appreciation for market realities**
- **Owner & constructor's view of risk are different**
- **Market options have improved**
- **Cost of risk remains high vis-à-vis other risks**
- **Mitigating risk**

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## Questions & Answers



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## ***Notes***

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