Mold and Insurance: Is the Worst Behind Us?

Casualty Actuarial Society
Seminar on Ratemaking
San Antonio, TX

March 27, 2003

Robert P. Hartwig, Ph.D., CPCU, Senior Vice President & Chief Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: (212) 346-5520 ♦ Fax: (212) 732-1916 ♦ bobh@iii.org ♦ www.iii.org
Presentation Outline

Mold, the Consumer & the Insurance Industry

• Overview of Mold Issue
• A Brief History of Mold & Insurance
  ➢ Experience in Texas & California
  ➢ Influence of Legal Environment & Profiteering
• Media Perception of the Mold Issue
• The Economics Of Mold
• Commercial Lines & Mold
• Regulatory/Legislative Considerations
• Q&A
Overview of Mold Issue

- Complex issue involving
  - **Homeowners**—fear of mold; hysteria in some areas
  - **Businesses & Workers**—property, construction, WC & liability issues
  - **Science**—taking a back seat to fact; misinformation
    - Astounding array of ailments attributed to mold
  - **Trial Lawyers**—profiting from fear and hype over mold
  - **Remediators**—profiteering?
  - **Media**—media attention increases as mold claims increase
  - **Regulators**—struggling with the issue; options limited
A BRIEF HISTORY OF MOLD &
THE INSURANCE INDUSTRY
Great Pyramid of Mold

Hysteria

Trial Lawyers

$ Toxic Mold?
HOW DID WE GET HERE & WHERE ARE WE GOING?

Texas was Mold’s Ground Zero, but Effects Have Spread
The number of mold claims rose 1,306% between 2000:I and 2001:IV.
The average cost of mold claims rose 152% between 2000:I and 2001:II.

*Includes loss and loss adjustment expenses.
Source: Texas Department of Insurance; Insurance Information Institute estimates.
Texas: Mold Losses/Claims Are Finally Moderating*

* Data are for TDI Cause 61: Discharge – Other Damage. Not all claims in cause 61 are mold and mold claims may also arise from other (non-water) causes of loss.

Source: Texas Department of Insurance; Insurance Information Institute
Texas HO: Paid Loss Ratio Up Sharply, Premiums Haven’t Kept Pace

Paid loss ratio is up 90.1% since 1999 while average premium is up just 40.1%


Source: Texas Department of Insurance; Insurance Information Institute
Texas HO: Per Policy Water Losses Have Skyrocketed

Water damage losses per policy are up 328% between 2000 and 2002*


Source: Texas Department of Insurance; Insurance Information Institute
Texas HO: Water Loss and Claim Share Up Sharply

Water as % Total # Losses
Water as % Total $ Losses

Source: Texas Department of Insurance; Insurance Information Institute
California: Surging Water Claim
Frequency and Costs:
Symptom of Growing Mold Problem

- Water losses paid rose 109% from 1997 to 2001 and 50% since 1999
- Water claims accounted for less than 1/4 of all HO claims in 1997, now they account for nearly 1/3.

California may be in a drought, but homeowners say they’re drowning

Paid Water Losses ($ Mill)  Water Claims as % of All Homeowners Claims

Source: Insurance Information Network of California; Insurance Information Institute
Consistently Rising Average Water
Claim Cost in CA: Mold Symptom

The cost of the average water loss in CA surged 27% in 2001 and 80% since 1998

Source: Insurance Information Institute based on data from the Insurance Information Network of California;
California: Surging Water Claim Frequency and Costs: Symptom of Growing Mold Problem

- Water losses paid rose 109% from 1997 to 2001 and 50% since 1999
- Water claims accounted for less than 1/4 of all HO claims in 1997, now they account for nearly 1/3.

California may be in a drought, but homeowners say they’re drowning.

Source: Insurance Information Network of California; Insurance Information Institute
ISO Mold Exclusions

Homeowners policy mold exclusions approved by insurance departments in more than 30 states + DC*

*As of July 29, 2002.
Source: Insurance Services Office
Wide Variety of Illnesses Alleged to be the Result of Mold Exposure

**ALLEGED ILL-EFFECTS**
- Burning eyes
- Headache
- Nausea
- Nose bleeds
- Allergic Reactions
- Asthma
- Exhaustion
- Sinus infections
- Cognitive disorders
- Pulmonary hemorrhage
- Liver damage
- Central nervous system damage
- Brain damage
- Cancer
- Death

*Stachybotrys chartarum*
The Science Doesn’t Support Those Allegations

List of Known Maladies

• “There are very few case reports that toxic molds inside homes can cause unique or rare health conditions...” “The common health concerns from molds include hay-fever like allergic symptoms.”

- Centers for Disease Control and Prevention

Stachybotrys chartarum
Litigiousness in US Society Compounded the Problem Documented Toxic Mold Suits

- Former Owners of Sold Homes 10%
- Builder for Construction Defects 20%
- HO Associations for Improper Maintenance 20%
- Bad Faith Against Insurers 50%

Source: www.toxlaw.com; Guy Carpenter
As Did Countless Profiteers...

TOXIC MOLD?
What are the real dangers of molds and mildews?
Are there medical risks? Can you sue or be sued? Can you get rid of mold?
Learn the answers to these questions
August 14 - Austin Radisson • August 16 - Cityplace Dallas
“BREAKING THE MOLD”
A One-Day Workshop Sponsored by
The BioSafety Institute
Featuring a team of experts speaking on biomedical issues, legislative interests, remediation and current legal issues (plaintiff and defense perspectives) related to toxic mold
$225 per person (including valuable reference materials, continental breakfast and lunch)
Register Online www.biosafetyinstitute.com
Or by telephone 972-503-8852 • Limited Seating

Source: The Austin Chronicle, August 10, 2001
Since January 1, 2000, more than 10,000 articles have been published on the subject of “toxic” mold.

Source: Insurance Information Institute based Nexis search.
Media Attention on the Mold Issue
Peaked in 2002

More Than 10,000 “Toxic Mold” Articles Since 2000

Sources: Insurance Information Institute based on Nexis search.
* Estimate.
2001: Increased Media Attention
In the Papers Two Years Ago

“Haunted by Mold”

“Beware: Toxic Mold”
- *Time Magazine*, July 2, 2001

“Insurers, Builders Criticized Over Mold”
- *Austin American Statesman*, June 27, 2001

“Mold Problems Spur Hearings Across Texas”
- *Corpus Christi Caller Times*, June 17, 2001

“Insurers Blanch at Proliferation of Mold Claims”

“Insurer Must Pay Family $32 Million”
- *San Antonio Express-News*, June 11, 2001
KIPS BAY TENANTS SAY:

WE’VE GOT KILLER MOLD

It comes in through their vents. They say it makes them sick, even kills – and now, they’re suing.

SEE PAGE 3

Source: *New York Times Magazine*,
August 12, 2001
“Heeeeeere’s Stachy…”
Mold Goes Hollywood

• Ed McMahon filed $20 million suit against insurer & mold remediation contractor
• Ed only gave away $10 million in sweepstakes
• Says mold sickened him, his wife and staff
• Says mold killed Muffin the family dog
• Alleges breach of contract, negligence and intentional infliction of emotional distress

“Ed McMahon Sues Over Toxic Mold Invasion,”
--USA Today, April 11, 2002

• Nearly 100 articles between April 10 and May 17, 2002!
2002/3: Financial & Market Consequences

In the Papers Over the Past Year

- “The Turmoil Over Mold in Buildings”
- “Landlords Add Mold Clauses to Apartment Leases"
- “Insurers in Kansas Won’t Cover Mold"
- “More Limited Form of Mold Insurance Emerges"
- "State Farm Halts New Policies [in FL]"
  - *Tampa Tribune*, June 29, 2002
- “Hit With Big Losses, Insurers Put Squeeze on Homeowners”
- “Can Toxic Mold Spoil a Stock Offering?”
  - *Business Week*, April 29, 2002
- “Apartment Owners Face Growing Liability”
  - *Wall Street Journal*, April 24, 2002
- “State Farm Won’t Write New Homeowners Policies [in CA]”
  - *Los Angeles Times*, April 23, 2002
- “Oklahoma Home Insurers Limiting Fungus Coverage”
  - *The Oklahoman*, April 2, 2002
- “Some Insurers Ending Coverage for Home Builders”
  - *Minneapolis Star Tribune*, February 16, 2002
Great Pyramid of Mold

Source: Insurance Information Institute
THE ECONOMICS OF MOLD:
WHAT WILL MOLD COST POLICYHOLDERS & THE INSURANCE INDUSTRY?
Impacts on Affordability and Availability

Real Consequences for Homeowners & Housing Markets
States With Highest HO-3 Insurance Premiums

<table>
<thead>
<tr>
<th>States</th>
<th>Expenditures/Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hawaii</td>
<td>$879</td>
</tr>
<tr>
<td>Louisiana</td>
<td>$714</td>
</tr>
<tr>
<td>Florida</td>
<td>$657</td>
</tr>
<tr>
<td>US</td>
<td>$606</td>
</tr>
<tr>
<td>Texas</td>
<td>$487</td>
</tr>
</tbody>
</table>

Source: Insurance Information Institute from NAIC Data, 1999.

FL is 3rd without the mold “stressor”
States with Highest Premium/Income Ratios*

HO insurance is very affordable, consuming less than 0.9% of the typical family’s income nationally, but 1.24% in FL and climbing! Can we afford another price stressor?

*As a % of the median family of 4’s income, 1998.
Source: NAIC, Insurance Information Institute
Mold-induced rate increases will impact affordability.}

Mold costs could push HO insurance costs to 2.5%+ of the typical family’s income in TX.

As a % of the median family of 4’s income.
Source: NAIC, Insurance Information Institute
Consumers Can’t Afford Mold, Neither Can Insurers
P/C Net Income After Taxes
1991-2002E ($ Millions)

$14,178
$5,840
$19,316
$10,870
$20,598
$24,404
$36,819
$30,773
$21,865
$20,559
-$6,970
$12,419

-2001 was the first year ever with a full year net loss
-2002 9-Month ROE = 4.4%

* I.I.I. estimate based on first 9 months of 2002 data.
Sources: A.M. Best, ISO, Insurance Information Institute.
Underwriting losses in homeowners insurance from 2000 to 2002 alone are estimated at $19.0 billion, 14.5% above the $20.3 billion in 9/11 property losses. Mold was not the only factor in these losses.
States with Most New Homes Built*, 2000

<table>
<thead>
<tr>
<th>State</th>
<th>New Private Housing Starts (000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TX</td>
<td>108.3</td>
</tr>
<tr>
<td>FL</td>
<td>104.9</td>
</tr>
<tr>
<td>CA</td>
<td>99.9</td>
</tr>
<tr>
<td>NC</td>
<td>59.2</td>
</tr>
<tr>
<td>AZ</td>
<td>48.2</td>
</tr>
</tbody>
</table>

* Single family units

Source: National Association of Homebuilders, Insurance Information Institute

States with biggest mold problems highly dependent on home construction sector
**Number of People Employed in Construction of Single-Family Homes**

<table>
<thead>
<tr>
<th>State</th>
<th>Number of People Employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Texas</td>
<td>265,118</td>
</tr>
<tr>
<td>Florida</td>
<td>256,795</td>
</tr>
<tr>
<td>California</td>
<td>244,555</td>
</tr>
</tbody>
</table>

**Mold Puts Jobs at Risk**

Construction of single-family homes supports about one-quarter million jobs in states with the biggest mold problems.

Source: National Association of Homebuilders, Insurance Information Institute

* Single family units, based on year 2000 construction figures
Billions in Wages Depend on Construction of Single-Family Homes

Construction of single-family homes supports $8 billion - $9 billion in wages in construction and related industries in states with biggest mold problems.

Source: National Association of Homebuilders, Insurance Information Institute

* Single family units, based on year 2000 construction figures
MOLD & COMMERCIAL INSURANCE
Condo construction in parts of CA has come to a virtual stop. Insurer costs rose 58% in just 2 years!

“Right-to-Cure” laws now in 5 states: AZ, CA, NV, TX, WA 16 considering such laws.

Source: ISO, Insurance Information Institute
Where are the Next Battlefields for Mold?

• Homeowners issue probably crested in 2002
• Migration to commercial area affects many lines:
  ➢ Commercial Property  Commercial Liability
  ➢ Products Liability  Builders Risk/Construction Defects
  ➢ Workers Comp…(very little)
• Hot Spots:
  ➢ Apartments/Condos/Co-ops  Office Structures
  ➢ Schools  Municipal Buildings
  ➢ Cars? (GM case in NC)
• Trend toward class actions since science doesn’t support massive individual non-economic damages
  ➢ Much more lucrative for trial lawyers to form class

Source: Insurance Information Institute.
TEXAS INSURANCE REFORM:

IS MORE REGULATION THE ANSWER?
Texas Insurers Drowning in a Sea of New Regulation in 2003

Number of House/Senate Bills Introduced that Could Impact Insurers (as of Jan. 31)

- Property
- Insurance Scoring
- Regulation
- Auto
- Licensing
- Misc
- Ratemaking
- WC
- Privacy
- Tort Reform
- TWIA

• At least 66 pieces of legislation have been introduced, most of which would adversely impact insurers
The number of insurers writing HO coverage in Texas has been declining steadily.

Source: Texas Coalition for Affordable Insurance Solutions from A.M. Best data; Insurance Information Institute
Road to Reform: A Lot Like the Road to Baghdad

- It is a myth that insurers in TX are “unregulated”
  - E.g., solvency, forms…
- Solution to TX insurance problems will not be found in new, expansive, and expensive regulations as proposed
- Need market-based solutions that work to attract/retain insurers and fresh capital, not drive them away
- Issue needs to be de-politicized
- Prior approval will increase insurer and TDI expenses and increase politicization of insurance regulation
- Prior approval increases lag between recognition of change in trend and implementation of rate change
- Insurers need access to modern, fair and efficient underwriting tools such as credit
**Texas Auto: Relative Loss Ratio (by Credit Score Decile, Total Market)**

<table>
<thead>
<tr>
<th>Score Range</th>
<th>Avg. Relative Loss Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Score</td>
<td>1.07</td>
</tr>
<tr>
<td>1st Decile</td>
<td>1.53</td>
</tr>
<tr>
<td>2nd Decile</td>
<td>1.35</td>
</tr>
<tr>
<td>3rd Decile</td>
<td>1.14</td>
</tr>
<tr>
<td>4th Decile</td>
<td>0.99</td>
</tr>
<tr>
<td>5th Decile</td>
<td>0.94</td>
</tr>
<tr>
<td>6th Decile</td>
<td>0.99</td>
</tr>
<tr>
<td>7th Decile</td>
<td>0.83</td>
</tr>
<tr>
<td>8th Decile</td>
<td>0.81</td>
</tr>
<tr>
<td>9th Decile</td>
<td>0.74</td>
</tr>
<tr>
<td>10th Decile</td>
<td>0.75</td>
</tr>
</tbody>
</table>

**Interpretation:**
Those with poorest credit scores generated losses more than double that of those with the best scores.

Extremely strong statistical evidence linking credit score with loss/claim outcomes:
- Credit score & likelihood of positive claim (p<.0001)
- Size of loss related to credit score (p<.0001)
- Correlation between relative loss ratio and credit score (r = .95)

*Each decile contains approximately 15,300 policies. Includes standard and non-standard policyholders.

Source: University of Texas, Bureau of Business Research, March 2003.
Texas Auto: Relative Loss Ratio
(by Credit Score Decile, Standard Market)

Interpretation:
Those with poorest credit scores generated relative losses more than double that of those with the best scores*

*Correlation between relative loss ratio and credit score is .95 and statistically significant.
Source: University of Texas, Bureau of Business Research, March 2003.
Texas Auto: Average Loss per Policy
(by Credit Score Decile, Total Market)

Average Loss = $695

Interpretation:
Those with poorest credit scores generated incurred losses 65% higher those with the best scores

1st Decile = Lowest Credit Scores
10th Decile = Highest Credit Scores.

Source: University of Texas, Bureau of Business Research, March 2003.
Texas Auto: % Insureds with Relative Loss Ratio Above 1.0
(by Credit Score Decile, Total Market)

Interpretation:
Insureds with poorest credit scores are 33% more likely to have relative loss ratios greater than 1.0 (indicates higher frequency of claims)

Score Range

No Score 1st 2nd 3rd 4th 5th 6th 7th 8th 9th 10th

% With Relative Loss Ratio > 1.0

6 7 8 9 10 11 12 13 14

1st Decile = Lowest Credit Scores
10th Decile = Highest Credit Scores.

Source: University of Texas, Bureau of Business Research, March 2003.