

# MARSH

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## **Construction Claim Task Force** Liability Insurance Discussion

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### **Overview**

- Types of liability insurance providers
  - Traditional marketplace
  - Specialty market (Surplus Lines Companies)
- No single solution for the entire industry
- Project specific liability insurance (General Liab. wrap-ups)
- Alternative Products
  - Captive insurance company
  - Risk retention group
- Other topical thoughts

## Types of providers

- Traditional insurance providers
  - File forms and rates with DCBS
  - Tend to avoid more difficult risks
  - Make up most of the marketplace
- Specialty insurance providers (Surplus Lines)
  - Don't file forms or rates with DCBS
  - Generally pursue tougher risks
  - Have greater flexibility over traditional market's

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## No Single Solution

There are many factors that negatively impact the “single solution” consideration. Among them are:

- Legal and jurisdictional issues
- Consistent construction industry standards (e.g., use of contracts, quality control, etc.)
- Premium to losses (rate adequacy)
- Premium cost to small firms and projects
- Inability to meet underwriting standards
- No one carrier with broad industry wide appetite
- Issues/problems are not industry wide. Issue is narrowly confined to mixed-use, residential and habitational

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## **Project Specific General Liability Insurance**

**Also known as GL Wrap-ups**

### **What is Project Specific General Liability Coverage?**

- A solution for commercial and residential construction projects, in which there is a perceived or actual issue with coverage availability from the contractors involved, is project specific insurance.
- Project specific general liability insurance is basically a general liability policy modified to cover a specific project for a specific term.
- The coverage can be procured by the developer or the contractor. It is done so prior to project inception. Coverage is inclusive of all contractors enrolled. Some trades can be excluded if desired (low hazard or not directly a part of the construction).
- Coverage will run during the construction phase and then for the full term of the statute of repose.

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## **Project Specific General Liability Insurance (cont.)**

### **Availability and limits?**

- There are several surplus lines companies that offer this coverage in our region.
- Limits for this coverage are offered in the same format as a typical GL policy (per occurrence/annual aggregate/products & completed operations aggregate). Primary limits are typically \$1 mil/\$2 mil/\$2 mil or \$2 mil/\$4mil/\$4 mil.
- Limits excess of the primary coverage are also available up to \$25 mil and \$50 mil.
- Deductibles or self-insured retentions are also a part of this coverage. They are typically in the range of \$50,000 to \$500,000 per occurrence. However, there is limited premium savings for deductibles or SIR's in this range. Project specific coverage is intended to be a catastrophic coverage, consequently, insurers give little credit to retentions below the \$500,000 level.

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## **Project Specific General Liability Insurance (cont.)**

### **Underwriting and pricing?**

- The underwriting process for this coverage is extensive and detailed. And can take up to 30-45 days to complete, if all information is available.
- Not all insurers price the risk the same. However, generally, pricing is based upon limits offered, total construction cost and (if it is a residential project) the ultimate sales value of the of the project. Since this coverage is designed to be in force during the statute of repose, the insurers true exposure is the ultimate value of the project, not the original cost to build.
- There is the perception that project specific coverage carries an exorbitant cost with it. Consideration must be given to the fact that the premium charge is actually the construction phase plus 10 years of insurance (the statute). If one were to calculate the cost of annual insurance for each contractor enrolled into a project program and extrapolate that 10 years, the pricing philosophy is better understood.

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## **Project Specific General Liability Insurance (cont.)**

- Minimum premiums for project specific programs are in the \$250,000 range for limits of \$1 mil/\$1 mil/\$1 mil (limits of this amount aren't practical due to average claim settlements).
- The marketplace is constantly in flux and it is possible to see minimum premiums as low as \$150,000 from some carriers by the end of the year.
- This minimum premium pricing range will generally fit, as an example, condo projects as small as 10 units.

### **Pros and Cons -**

#### **Pros:**

- Provides insurance coverage for the full statute of repose for all parties, enrolled for coverage, on the project
- Eliminates a project from a contractors completed operations portfolio and won't disrupt their existing coverage

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## **Project Specific General Liability Insurance (cont.)**

- This type of coverage can increase the available contractor pool for a project since coverage provided may be broader than what they have on their own.
- Quality control is elevated for all contractors on the project.
- In the event of a claim, the ultimate owner(s) of the project will have a single funding source for catastrophic claims.

### **Cons:**

- The cost does have an impact on project funding and economics since the full project premium must usually be paid up front or within 12 months of inception.
- How retentions and deductibles are funded and allocated need to be addressed up front

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## **Project Specific General Liability Insurance (cont.)**

- Contractors must maintain their existing liability insurance program since project specific insurance only covers work at the project site. Off site work (fabrication, prefabricated assembly, etc.) is not intended to be covered by project specific insurance.
- Meticulous recordkeeping is the cornerstone of a successful project and a good defense in the event of an allegation.

### **Other considerations:**

- It is important that the insurance agent working with the developer or contractor have a good understanding of the construction industry in general, the project specifically and the coverage being proposed.
- Long term insurer stability is critical when choosing an insurer. Though an insurance company's fortunes can not be foretold 5-10 years into the future, the financial strength and stability of the chosen insurer should be weighed as part of the decision making process.

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## **Project Specific General Liability Insurance (cont.)**

- As of today, these coverage's are being offered, at least in Oregon, through Excess & Surplus Lines brokers (wholesalers). To broaden the market to all insurance companies, a change in Oregon insurance regulations would be required. This would allow, but not guarantee, the more traditional insurers to enter this market.
- Having made the statement above, it is very likely the traditional insurance market would not participate in the residential construction insurance arena. They are likely content with their underwriting, pricing, coverage offering and would rather their marketplace not be altered.

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## **Alternative Products**

There are primarily two alternative products outside of the insurance company marketplace. Here, briefly, are the two most common products:

### **Captives**

- An entity formed primarily to insure (or reinsure) the risks of its participants
- Primary types: Single parent, rent-a-captive, group and association
- Only insures members
- Members control design, operation, finances and other features
- Requires capitalization by its owners above premium payment
- Must have a "fronting" insurance company if AM Best rated coverage is to be evidenced to third parties

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## **Alternative Products (cont.)**

### **Risk Retention Group**

- Specialized type of group created and authorized by Federal law
- Currently only for liability insurance coverage
- Somewhat complex and expensive to operate
- Does avoid the need for a fronting insurance company

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## **Other topical thoughts**

### **Use of contracts at all tiers of contracting**

- Provides roles and responsibilities
- Outlines scope and framework of expectation
- Allocates and transfers risk
- Provides an insurance requirement
- QA/QC process, recordkeeping retention, etc.
- Outlines claim process (arbitration, etc.)

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## **Other topical thoughts (cont.)**

### **Risk Management Practices**

#### **■ Pre-loss activities**

- Project planning and scheduling
- Subcontractor qualification
- QA/QC Programs
- Use of a inspection firm during construction
- Customer relations and education (preventative maintenance)
- Ongoing inspections
- Use of warranties

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## **Other topical thoughts (cont.)**

#### **■ Post-loss activities**

- What are customer expectations
- Does the customer service staff understand the program and responsibility
- Understand responsibility of warrantee (implied and expressed)
- Are the Right-to-Repair responsibilities understood, communicated to owner/buyer and can the process be made easy for all parties

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## Other topical thoughts (cont.)

### What are other states doing?

- Texas
  - Texas Residential Construction Commission (TRCC) was formed as a bull body of legislation that is aimed at addressing, mitigating and providing warrantee coverage for certain types of claims.
  
- Florida recently reduced its statute of repose to 10 years...from 15.
  
- There are +30 states that either have an existing Right-to-Repair statute or are in the process of creating such a statute.

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## Closing Discussion and Q & A

### Thank you

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