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A growing concern

Toxic Mold and Texas Homeowners Insurance

Homeowners insurance costs more in Texas than anywhere else in the nation. Texas homeowners pay premiums averaging $879 per year, 83 percent more than the national average. Now, Texas insurers are calling for steep increases on top of these rates, pointing to the problem of toxic mold as a key cost driver.

At hearings held by the Texas Department of Insurance (TDI), major insurers warned that unless they are allowed to exclude mold coverage from the standard homeowners policy, they might have to raise premiums by 40 to 60 percent to cover their losses. According to industry estimates, insured losses from water and mold damage in Texas will reach at least $780 million this year, up 60 percent from one year ago. The number of claims has risen more than fivefold since the first quarter of 2000, while the average cost per claimant has leaped from $3,000 to $38,000.

So far, most official action on this issue has been administrative. TDI's authority extends mainly to the content of the standard homeowners policy, handling of claims, and discriminatory practices in underwriting. At the insurance commissioner's request, the Attorney General's Office is investigating allegations of price gouging by Corpus Christi businesses that provide mold remediation.

Besides insurers and homeowners, other stakeholders in the toxic mold issue include real estate brokers, mortgage bankers, home builders, and construction and home repair businesses. The Legislature may be asked to consider some of the following range of options:

- regulating the rates and underwriting guidelines of so-called Lloyd's companies;
- developing standards or licensing requirements for businesses involved in mold remediation or air-quality testing;
- enhancing the building code for new home construction to ensure that materials are less susceptible to water and mold damage and that builders who use low-quality materials are held liable for subsequent losses; and

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New Prescription Sought for TDH

A report by a study team led by former Secretary of State Elton Bomer has spurred calls for administrative changes at the Texas Department of Health (TDH). The report stemmed in part from lawmakers' complaints that TDH obscures financial information, surprises them with bad news, and fails to follow legislative intent. At the same time, TDH has kept expanding to encompass new programs created by the Legislature each session. In its first Comprehensive Strategic and Operational Plan, the department referred to itself as "more of a colony of separate programs than an organism of coordinated functions."

The 77th Legislature inserted a rider in the general appropriations act requiring TDH and the Board of Health to develop and implement a comprehensive business improvement plan. Meanwhile, the Health and Human Services Commission (HHSC) has brought under its purview most of the Medicaid program, previously administered by TDH. As a result, TDH is evaluating its public health mission as well as its business plan.

TDH review and legislation

TDH received a $6.4 billion appropriation in fiscal 2001, second

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- developing air-quality standards for residential properties, similar to existing standards for public schools and other government buildings.

Toxic mold complaints

In the 1990s, TDI fielded only two complaints from consumers against insurers in regard to coverage for mold damage. So far in 2001, more than 100 complaints have been filed, including 21 related to Tropical Storm Allison. Homeowners exposed to toxic mold allege many adverse health effects, and evaluation and remediation of mold contamination can displace owners from their homes for months. Consumers also are leveling complaints against new-home builders, faulting them for shoddy work and the use of cheap, low-quality construction materials that readily absorb and retain water.

In a high-profile case, a Travis County jury awarded a Dripping Springs family $32 million in their lawsuit against Farmers Insurance Group. Ron Allison and Melinda Ballard claimed that Farmers' delay in remediating repairs for a water leak allowed toxic mold to spread throughout their 22-room new home. Allison also alleged that the mold caused him to suffer neurological damage and memory loss, forcing him to abandon his investment banking career. The couple had asked for $25 million in actual damages and $75 million in punitive damages, but Judge John Dietz excluded expert testimony regarding possible health effects.

The verdict in this case, handed down in June 2001, prompted Farmers and several other insurance companies to stop offering comprehensive homeowners policies to new customers. At the insurance commissioner's request, most companies resumed writing new policies this summer. But after TDI released a proposal that would cap losses for mold damage at $5,000, Farmers, State Farm, Allstate, and Safeco, which write more than 50 percent of the homeowners policies in Texas, discontinued selling new property insurance in the state.

When several insurers stopped underwriting policies for houses with previous water damage, the real estate and mortgage banking industries protested as many home-sale closings were delayed due to prospective buyers' inability to obtain property insurance. Liability issues have arisen regarding sellers' disclosure of previous water damage and mold contamination. Also, insurers complain of unscrupulous contractors who prey on consumer fears about toxic mold to profit from unnecessary diagnostic testing and inadequate remediation services.

Health issues

Under most circumstances, a homeowner can clean up a minor mold problem with household bleach and water. While mold is a common problem in buildings with water leaks and excessive humidity, it can become a serious problem when mold spores multiply unchecked on wet, porous materials, such as sheetrock, carpets, ceiling tiles, or insulation.

About three dozen species of mold cause health problems in humans. The "toxic mold" cited most commonly is *Stachybotrys chartarum*, a greenish-black mold that releases mycotoxins into the air, which then are spread further by closed ventilation systems. Mold also can spread by attaching to people's clothing or shoes, as well as to animals.

According to the U.S. Centers for Disease Control and Prevention and the U.S. Environmental Protection Agency, no conclusive links have been established between mold exposure and serious health problems. However, people with allergies and suppressed immune systems may be more sensitive to molds and fungal infections.

While no official government studies support claims of adverse health effects, some doctors in private practice assert otherwise. Alleged effects include chronic respiratory infections, asthma, skin rashes, chronic fatigue, short-term memory loss, anxiety and depression, headaches, and nosebleeds. Some consumers have complained that because insurance companies did not respond quickly enough, their families became gravely ill, and even that their pets died from exposure to toxic mold in their homes.

Exposure to mold does not cause illness in all people. The variation in individual response to mold exposure makes it difficult to establish standards for acceptable levels of mold. Such standards would be a key to determining insurance companies' liability for mounting health costs associated with mold-damage claims.

Policy issues

The toxic mold problem raises several policy issues, the first set of which involves the insurance industry. To what extent should the state regulate rates and coverage for water and mold damage in the Texas homeowners insurance market?

In 1991, in an effort to stabilize rates and stimulate price competition in the insurance industry, the Legislature set up a benchmark system for flexible rate-setting. Flexible rating allows insurers to charge 30 percent more or less than a benchmark rate set by the state. Insurers must justify rates outside the benchmark flexibility bands to the insurance commissioner.

The mold problem raises issues in regard to state regulation of insurance rates and coverage and of controlling toxic exposures.

Over the past 10 years, insurance companies have shifted more and more of their business toward unregulated branches of their businesses, called Lloyd's companies. The Legislature exempted Lloyd's plans from the benchmark rating system because in 1991, they comprised only 20 percent of the market and generally covered specialty risks at rates lower than the standard rates. Texas Lloyd's plans differ from a traditional Lloyd's of London plan, in which individual underwriters, rather than the parent company, assume financial risk. TDI estimates that about 95 percent of Texas homeowners policies now are written by Lloyd's companies.

The Office of Public Insurance Counsel (OPIC), a state consumer watchdog agency, recently filed a proposal to prohibit insurance companies from refusing to insure homes because of prior water-damage claims. OPIC asserts that insurers are revising their underwriting guidelines to avoid future claims for water and mold damage. In a 1994 review of underwriting guidelines in Texas, OPIC noted that more than 90 percent of insurers refused to sell homeowners insurance policies if a consumer had made any kind of claim on a previous policy, no matter what the dollar amount of the previous claim.

The second set of policy issues involves the state's authority to monitor or control toxic exposures. The Legislature has enacted two laws to address indoor air quality in response to problems with "sick building syndrome" in public buildings. Health and Safety Code, chapter 385, enacted in 1995, required the Texas Department of Health (TDH) to set voluntary guidelines for indoor air quality in public schools. TDH guidelines took effect in May 1998 (28 TAC, part 1, chapter 297, subchapter A). In March 2000, Hill Elementary School in Austin was evacuated for a $4.6 million cleanup after the discovery of *Stachybotrys* and another mold. Remediation of mold problems at eight other Austin schools is expected to cost $10.4 million.

This year, the 77th Legislature enacted HB 2008 by Naishtat, directing the Board of Health to develop voluntary indoor air-quality guidelines for all buildings owned or leased by state or local governments. HB 2006 and HB 2007, also by Rep. Naishtat, would have established mandatory air-quality guidelines for newly built or renovated schools, required school districts to test indoor air quality periodically, and authorized a statewide education program for improving air quality in schools. Both bills stalled in the Senate Education Committee after passing the House. The Legislature has enacted no laws aimed at protecting consumers from "sick housing syndrome."

Homeowners policies in Texas

Although Texans generally pay more for homeowners insurance, they also get more coverage than is available in other states. A standard Texas homeowners policy covers damage to or loss of one's dwelling, outbuildings, and personal property, liability for someone else's injury or property damage, medical payments to people hurt on one's property, and loss of use if the home is too damaged to live in during repairs.

Three standard policies are available — the HO-A, HO-B, and HO-C — but 96 percent of all homeowners buy an HO-B policy, which covers replacement costs for most kinds of damage. Most policies provide coverage for storm damage except for floods or earthquakes, as well as coverage for accidental discharge, leakage, or overflow of water or steam. Mold damage is covered if it results from a covered loss, such as a roof, plumbing, or foundation leak.

Some consumers who live on the Gulf Coast or other areas with a history of severe weather are subject to exclusions for wind and hail damage. Homeowners who live in floodprone areas must buy flood insurance, available only through the National Flood Insurance Program. In many other states, homeowners cannot obtain coverage for water or mold damage except through riders at significant additional expense.

TDI's proposed solution

On September 18, 2001, Insurance Commissioner Jose Montemayor issued a proposal that essentially would cap current coverage for mold remediation while enabling policyholders to buy additional levels of coverage. In sum, TDI would make the following changes to the standard HO-B policy in Texas:

- require an amendatory endorsement that limits basic coverage for mold-related claims to $5,000, which would not count toward overall policy limits;
- apply the cost of testing, repair, mold remediation, and additional living expenses toward the $5,000 cap on basic mold coverage;
- enable policyholders who want more than $5,000 of mold coverage to buy additional coverage in amounts equal to 25 percent, 50 percent, and 100 percent of policy limits; and
- allow multiple claims within a year up to the policy limit selected by the consumer.

The commissioner held a public hearing on the proposal on October 16. Interested parties may comment through October 29, after which the commissioner could adopt the proposal with or without changes.

Supporters say: TDI's proposal is a compromise that balances the needs of consumers and insurers. Responses to a TDI survey of the top five underwriters of homeowners insurance in Texas indicate that slightly more than half of mold-related claims cost less than $5,000 each. By maintaining a reasonable amount of mold coverage for all consumers, the plan would keep insurance rates affordable while helping insurance companies remain solvent. Consumers who want more comprehensive coverage still could acquire that coverage at an additional cost.

It would be appropriate to cap damages for these types of claims. The inordinate share of the burden borne by insurers is putting the entire industry at risk. The reasonable limits set by this plan would encourage more consumers to take preventive action to keep mold from growing and spreading after water damage occurs. If consumers know that only $5,000 would be paid on such claims, they will work harder to ensure that they have done everything possible to prevent more expensive damage to their property. They also can evaluate the risk of such damage ahead of time and can buy additional coverage if they want protection under all circumstances.

The TDI proposal includes rates that rate-regulated companies would have to charge for "buyback" endorsements, the add-ons that would allow consumers to "buy back" enough mold coverage to restore them to current levels of protection. This would protect consumers from rate hikes of 40 to 60 percent being threatened by insurers. Hefty increases in rates would harm all homeowners, even though only one in 100 homeowners ever files a claim based on mold or water damage. Higher rates also would reduce the availability of homeowners insurance and would impede home sales, which, in turn, would harm the real estate and mortgage banking industries.

The spike in high-cost mold-related claims is a temporary phenomenon created in part by extensive media coverage. TDI's proposal is a good stopgap measure that would help insurers stay in business while allowing homeowners to continue to buy affordable insurance.

Draconian changes to insurance policies would threaten the industry's long-term viability.

Opponents say: This proposal represents a one-size-fits-all government solution to the mold insurance problem. Rather than more regulation, free market competition will encourage insurers to provide the greatest variety of products and services at the lowest prices. Decisions about availability of and rates for mold insurance should be made by insurers and consumers in the open market, not by government regulators.

Homeowners insurance is designed to indemnify homeowners from covered losses on their property. It is not intended to provide health insurance, environmental protection, or a home warranty. The language of the standard HO-B policy needs to be reworded to define more specifically a covered loss. For example, flooding is not a covered peril, but an accidental discharge of water is. Damage done by seeping water that enters a structure because of poor construction or materials is not a covered loss. Many recent claims, especially the extremely costly ones, involve new houses that include new materials more susceptible to mold growth than wood and that are more air-tight than older houses. Insurers unfairly are being held liable for losses due to construction problems that are beyond their control.

Coverage of mold-related claims should be eliminated altogether. While water is a catalyst for mold, it does not create mold. Besides the question of whether mold is an insurable risk, questions exist as to whether mold poses a health hazard. Media attention and anecdotal evidence have blown this issue way out of proportion. No scientific evidence supports the outlay of millions of dollars by insurance companies to test and remediate mold claims under the threat of multimillion-dollar lawsuits and the glare of media scrutiny.

Regulators should pay more attention to unlicensed and noncertified remediators who are profiting from the mold issue without proper qualifications. Only licensed, certified remediators should be allowed to perform work on consumers' homes. Costs on a claim that is remediated improperly can double or triple if damage ensuing from remediation must be repaired.

Other opponents say: TDI should impose no restrictions on coverage for mold damage. Since Texas has the nation's highest homeowners insurance rates and this proposal would reduce a standard policy's value by limiting coverage for mold and water damage, rates should be coming down, not going up. Insurance companies, rather than the media or consumers, are blowing this issue out of proportion, and consumers, not insurers, are suffering from inflated premium rates for unregulated coverage. New premium comparisons by TDI show that the vast majority of insurers have priced their policies higher than the benchmark rates established to allow companies to earn a reasonable profit. Insurers could limit the cost of mold claims by responding more quickly after water damage claims are filed.

Requiring rate-regulated companies to charge certain rates for the "buyback" endorsements would not protect consumers from unfair rate hikes. Since most homeowners insurance carriers have moved their business to Lloyd's companies not subject to rate regulation, the TDI proposal would help only about 5 percent of consumers who buy homeowners insurance through rate-regulated firms.

A cap of $5,000 is inadequate and would shift costs from the insurance industry to consumers. Insurers would be guaranteed of certainty in evaluating risks and setting rates, but consumers would have to absorb any costs above the $5,000 cap. If adopted, any such measure should be limited to one year's duration so that its effects on consumers could be evaluated before the next legislative session.

Under current law, insurance companies dictate the market. Lawmakers should close the loophole that allows Lloyd's companies to dodge regulatory standards and should give the insurance commissioner authority to prevent insurers from "walking away" from the market. In addition to investigating charges of price gouging by mold remediation firms, the Attorney General's Office should examine the home building industry and claims that large insurance firms are conspiring to reduce coverage and raise rates.

— by Dana Jepson

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only to the Texas Education Agency, and employed more than 5,600. Its many bureaus varied widely in size and included health care financing (Medicaid), the Children's Health Insurance Program, Texas-Mexico border health, tobacco prevention, vendor drugs, kidney health, health care licensing, communicable disease, immunizations, environmental health, food and drug safety, radiation control, emergency management, and other programs. TDH operates more than 200 programs through nine offices, two hospitals, and many contracts with local health departments and other organizations.

In 1998, the Sunset Advisory Commission reviewed TDH and found that a lack of cohesive planning had resulted in overlapping programs and services and a system that was hard to navigate, both for service providers and for recipients. Sunset also found that TDH did not provide enough current, usable data for effective statewide and local planning.

The TDH sunset bill, HB 2085 by McCall, enacted by the 76th Legislature in 1999, directed TDH to develop a comprehensive strategic plan and to determine why it must provide each service and how it could integrate related activities to provide more efficient service. TDH published its first Comprehensive Strategic and Operational Plan at the beginning of fiscal 2001. That report presented a series of targets for improving operations, including:

- manage and administer TDH resources toward more effective public health practices;
- enhance the collection and use of health information for public health impact;
- increase alignment of TDH employees with the department's mission;
- build and enhance essential public health functions at the local level;
- strengthen regulatory activities;
- integrate the functions of health-care delivery programs; and
- involve stakeholders in agency planning and decision making.

Health Commissioner Reyn Archer left the agency in October 2000 and was replaced by Acting Commissioner Charles Bell. In part because of this change, TDH did not finish implementing its improvement targets. When the 77th Legislature convened in January 2001, lawmakers conveyed their frustration with the agency's lack of progress. This was particularly apparent during the appropriations process, when Medicaid caseloads were found to be higher than anticipated and the agency's contract with National Heritage Insurance Co. to deliver a new Medicaid claim system was unfulfilled.

In enacting SB 1 by Ellis, the general appropriations act for fiscal 2002-03, lawmakers added Rider 2 to TDH's budget, directing the agency to develop and implement a comprehensive business improvement plan with HHSC's assistance. The plan must include timelines, benchmarks, and projected outcomes for improvement in the areas of budgeting, finance, contract management, and other administrative functions. Evaluation of the TDH business plan coincides with the appointment of Dr. Eduardo Sanchez as the new health commissioner.

At the same time, the Legislature moved the bulk of Medicaid administration from TDH to HHSC by shifting funding in the appropriations bill pattern. This transfer also was a part of the Medicaid omnibus bill, SB 1156 by Zaffirini, vetoed by Gov. Rick Perry. HHSC later determined that it has the authority to proceed with the transfer without enabling legislation because it has oversight responsibility for all health and human services agencies.

TDH checkup

In response to Rider 2 and the agency's shifting workload, TDH asked former Secretary of State Elton Bomer and three employees from other state agencies to review and evaluate TDH operations over the course of 90 days. On August 31, 2001, the team reported its findings and recommendations. The *Texas Department of Health Business Practices Evaluation* concludes that TDH must address four areas of fundamental concern:

- the Legislature's lack of confidence in TDH's business practices;
- executive-level vacancies and high staff turnover;
- the need to coordinate administrative systems such

as finance and accounting, budgeting, and contract and grant management; and
- administrative information systems.

The report includes a series of recommendations, accompanied by target dates for completion and attributed to responsible parties so that lawmakers and TDH management can track implementation.

Restore legislative confidence. The Legislature's chief complaint against TDH is that lawmakers often are unaware of problems or newsworthy events until they hear about them from outside the agency. The report suggests that the agency hold regular meetings with lawmakers to apprise them of events as they unfold. It also suggests that the agency's communications department be more proactive in communicating with the media, releasing positive news in addition to responding to news stories.

Lawmakers have found TDH's internal audits unreliable in the past, and the agency has had a troubled relationship with the State Auditor's Office (SAO). In 1999, the State Agency Internal Audit Forum (SAIAF), a peer review organization, began a review of TDH's internal audit division as required by the Internal Auditing Act (Government Code, chapter 2102). When the results appeared unfavorable, the former director of internal audit canceled the review and instead relied on an outside reviewer to meet the agency's statutory peer-review requirements. The evaluation report recommends that the SAIAF audit be completed; that TDH strive to improve its relationship with the SAO; and that TDH executives discuss audit reports at staff meetings to devise strategies for implementing audit recommendations.

Other recommendations include increasing the level of institutional knowledge of staff in the Government Relations office, screening requests for legislative action, establishing a plan for customer service, and creating a permanent implementation team with links to HHSC.

The Health and Human Services Commission recently has taken over the bulk of Medicaid administration, prompting reconsideration of TDH's health mission.

Recruit and retain staff. A different health commissioner has served during five of the past six legislative sessions, resulting in inconsistent leadership. Also, several executive positions have been filled on a temporary basis or left vacant — for example, the chief financial officer (CFO) position has been vacant since its creation earlier this year — and staff turnover is high. The appointment of a new commissioner may help, as this official will have a mandate to assemble a permanent executive team. Among other changes, the report also recommends that TDH implement "succession planning" to alleviate some of the strain of high turnover and perform a salary review to reduce turnover.

Standardize business functions. The Bomer review team found that TDH program executives expressed frustration over the lack of standardization of business functions and that they believed that TDH administration has grown larger and more expensive at the expense of program functions. The report focused on budget and accounting, cost allocation, identification of administrative costs, purchasing, grant and contract management, human resources, and automated systems.

Budget and accounting improvements would be implemented primarily by a CFO when that position is filled. These improvements include creating a standard procedure for the budget process, centralizing budget functions, and establishing oversight measures. Other recommended changes concern how the agency manages the mix of federal and state funding so that it does not "bank" federal funds, which can be carried forward to the next year, at the expense of state funds. The agency's mixed federal-state funding streams make cost allocation an important target for improvement, as jointly funded functions must be "billed" proportionately to the federal and state funds that support them.

Improve organizational structure. The review found that TDH's organizational structure hinders communication and accountability. The agency is headed by an appointed commissioner who may not have the business background required to run an agency of this size. The report recommends creating a chief operating officer (COO) position that would report directly to the commissioner and would complement the commissioner's public health expertise. Other recommendations involve executive-level positions, such as an executive deputy commissioner to oversee all programs and regions, while still others affect programs such as the Office of Equal Opportunity, which would be moved from Human Resources to the COO, and the creation of a strategic planning unit.

Completion timetable. Target dates for completing each recommendation range from immediate to the end of fiscal 2002-03. Most of the tasks are identified as the responsibility of the CFO and COO. TDH began informational meetings with legislators and their staff in September 2001 and has scheduled more meetings to apprise legislators of the agency's operational and implementation activities. Rider 2 requires TDH to submit quarterly reports on implementation of the recommendations. The agency expects to publish its next report by the end of 2001.

In its biennial sunset review scheduling bill, SB 309 by Harris, the 77th Legislature directed the Sunset Advisory Commission to perform a special-purpose review of TDH. The review is to focus on the extent to which TDH has implemented provisions of the 1999 sunset bill, including recommendations that required no statutory change, and recommendations in SAO reports issued since January 1, 1999. SB 309 also requires Sunset to review how TDH has implemented recommendations made by outside consultants after January 1, 2001, including those in the Bomer report. The Sunset commission is to report to the 78th Legislature and may make any recommendation it considers appropriate.

— by Kelli Donges

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Capitol Extension
Room E2.180

P.O. Box 2910
Austin, Texas 78768-2910

(512) 463-0752
FAX (512) 463-1962

www.capitol.state.tx.us/hrofr/hrofr.htm

Staff:

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