

Troubled Water

An analysis of water damage claims and the impact on homeowner's insurance premiums in Florida



Prepared by:

Locke Burt

President, Security First Insurance Company

140 S. Atlantic Avenue

Ormond Beach, FL 32176

LBurt@SecurityFirstFlorida.com

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Introduction

Elected officials and consumers have expressed concerns about rising insurance prices, particularly in three southeast Florida counties: Broward, Miami-Dade, and Palm Beach (tri-county). This concern has been driven by:

- **The Office of Insurance Regulation's "Report on Review of the 2015 Assignment of Benefits Data Call" issued on February 8, 2016** - The report analyzed 155,000 paid water damage claims from the top 25 writers of homeowners insurance in Florida. It concluded that in the last six years, the frequency of water damage claims had increased by 46% and the severity of water claims increased by 28%.
- **Citizens Property Insurance Corporation's reported increase in the frequency and severity of water damage claims** - The increases have resulted in an indicated rate increase of more than 70% for the 140,000 HO3 policies written by Citizens. While state law limits Citizens rate increases to a maximum of 10% per year, Citizens has warned its customers in Southeast Florida that rates in that area "would have to nearly triple to pay for non-weather related losses," and that they can "expect to see annual rate hikes approaching 10 percent in 2017 and for years to come." (Source: Citizens 2017 Rates Frequently Asked Questions)
- **The increase in approved rate increases submitted by Florida homeowners insurance companies**

Some elected officials and industry representatives have even suggested that this is a "crisis" caused by rapidly escalating water damage claims, which demands a legislative solution.

To provide greater insight on this public policy issue and ensure transparency of the effect water damage claims have on insurance premiums, Security First Insurance conducted an analysis of water damage claims over a six-year time period from the beginning of 2010 to the end of 2015.

Description of Data Analyzed

Security First Insurance Company is the fourth largest homeowners insurance company in Florida and provides insurance coverage to more than 300,000 Florida homeowners. The insurance policies sold by the company include a standard homeowners policy (HO3), dwelling fire policy (DP), condominium unit owners policy (HO6), and a renters policy (HO4).

Types of Policies Analyzed

For the purpose of this analysis, Security First Insurance limited the policies analyzed to HO3 policies with full water damage coverage. These policies include replacement cost on contents (valued brand new) and had a minimum of 25% ordinance or law coverage.

Over the time period analyzed, Security First Insurance insured a total of 483,392 homes. According to the insured's indication on the insurance application, 96.3% of those homes were primary residences. The remainder of the homes were either secondary (3.6%) or seasonal (0.1%). Since Security First Insurance expected to see significant differences in the claims experience by county, in addition to the statewide totals, Security First Insurance supplemented the analysis to include exhibits showing the water loss experience in the tri-county area (Miami-Dade, Broward, and Palm Beach), Central Florida (Orange and Seminole) and North Florida (Duval).

Types of Claims Analyzed

The analysis was prepared on an "accident year" basis rather than a "calendar year" basis. "Accident year" means the cost of the claim is reflected in the year the claim occurred rather than the year in which the claim was reported. Since 90% of Security First Insurance's water damage claims (including claims with and without an assignment of benefits agreement) are reported within 30 days of the date of the loss, using "accident year" will give a more accurate picture of claim frequency.

The claim frequency can be thought of as how often claims occur (Number of Reported Claims/Total Earned House Years) and severity can be thought of as size in terms of average amount of damage and cost for each claim. In short, how often and how big. Because of the delay in settling AOB claims, particularly those in litigation, the severity of claims in 2014 and 2015 could be understated.

Below is a chart showing the summary of the policies and claims analyzed by region:

Total Earned House Years
 (HO3 Policies With Full Coverage For Water Damage - 2010-2015)

	Statewide	Tri-County	Central	North
Homes Insured	483,921	64,784	51,900	19,687
Water Claims	11,010	2,799	1,688	577

An earned house year represents one dwelling insured for one year and is a measure of the earned exposure rather than the written exposure.

Security First Insurance also differentiated between claims with and without an Assignment of Benefits (AOB). The following is a definition of an Assignment of Benefits agreement published by Citizens Property Insurance Corporation:

“Assignment of benefits (AOB) is a contract between an insurance policyholder and a third party, such as a roofer or a water remediation vendor. An AOB transfers control of the claim benefits and other rights and provisions to a third party. This includes all responsibility for dealing with the insurance company to evaluate damages, file a policyholder claim, settle the claim and receive payment.”

Source: Citizens 2017 Rates Frequently Asked Questions

Highlights of Analysis

- The average total annual premium for an HO3 policy with full coverage for water damage claims, replacement cost coverage on contents, and 25% coverage for ordinance and law has decreased 14.6% from \$1,523 to \$1,300.

Average Total Premium Per Policy (HO3 Policies with Full Coverage for Water Damage)

	Statewide	Tri-County	Central	North
Avg Total Premium 2010	\$1,523	\$2,032	\$1,171	\$1,111
Avg Total Premium 2015	\$1,300	\$2,527	\$1,165	\$891
\$ Change	-\$223	\$495	-\$6	-\$220
% Change	-14.6%	24.4%	-0.5%	-19.8%

- The frequency of water claims reported to Security First Insurance increased by 8.2%. According to the Office of Insurance Regulation (OIR), the average increase reported for Florida's voluntary homeowners insurance market was 46% during this same time period. Citizens' frequency increased 100%.
- The average severity of water claims incurred by Security First Insurance decreased by 12.5%. This is a marked difference from the 28% increase in the severity of 155,000 paid water claims analyzed by the OIR in its "Report on Review of the 2015 Assignment of Benefits Data Call" issued on February 8, 2016. The figure for Security First Insurance has been positively affected by the substantial reduction in the percentage of our business written in the tri-county region since 2010.

The statewide average decrease in claim severity reported by Security First Insurance over the six-year period hides the 70% increase in average severity of water claims in Jacksonville over the last four years and the 30% increase in the size of the average water claim in central Florida during the same time period.

- The changes in frequency and severity combined has increased the average cost of water claims per policy for Security First Insurance from \$210 in 2013 to \$224 in 2015. This was an increase of 6.7%. During the same three-year period, Citizens' cost of water claims per policy increased 109.8% from \$551 per policy to \$1,156 per policy.
- The increased cost of water claims required a 5% increase in the premiums charged by Security First Insurance effective August 1, 2016. Citizens' actuaries have calculated an indicated rate change of over 70% for all HO3 policies sold by Citizens. Since state law limits the annual increase in Citizens' premiums to a maximum of 10% per year, Citizens' customers have been warned to expect rate increases of 10% for years to come.

- 59.4% of all water claims are reported to Security First Insurance within three days of the reported date of the damage. This is only slightly better than the statewide average reported by the OIR. Approximately 12% of water claims are reported to Security First Insurance more than 30 days after the reported date of loss.
- 15.4% of the water damage claims presented to Security First Insurance in 2015 were subject to an Assignment of Benefits (AOB). This frequency of AOB's is similar to the 15.9% reported by the OIR for the voluntary market. This figure is 25% less than the frequency of 20.5% for AOB's reported by Citizens for 2015.
- Surprisingly, water claims with AOB's and water claims from secondary and seasonal homes are being reported faster than water claims from insureds living in their primary residence who don't sign an AOB.
- The average water claim costs Security First Insurance \$10,000. That average figure masks the large differences in costs between claims with an AOB and claims without an AOB. While the average water claim without an AOB costs \$6,700, the average cost of a water claim with an AOB is \$13,750 and the average cost of a water claim with an AOB which goes into litigation costs \$26,000.
- Claims litigation is actually decreasing at Security First Insurance. In 2013, 2.6% of water claims were litigated. That figure fell to 2.2% in 2015, a decrease of 16%.
- Claims with an AOB take longer to settle than claims without an AOB. Security First Insurance investigated and paid 56% of water claims within thirty days of the date of loss. Only 20% of the claims with an AOB were paid within 30 days of the loss.
- The number of cases of suspected insurance fraud referred to the Florida Division of Insurance Fraud is increasing. Security First's Special Investigations Unit referred 33 cases of suspected fraud to DIF in 2015. The number of referrals increased to 57 cases during the first five months of 2016.

Background

Determining the Price of an Insurance Policy

Florida is a large and diverse state. As a result, there are fairly significant differences in the size and insured value of homes in different counties. These differences, and the various probabilities of a hurricane striking different parts of the state, mean that there can be significant variances in the annual premium paid by the average homeowner in different counties.

The majority of owner-occupied single family homes in Florida are insured by an HO3 policy. Florida law requires that the HO3 policy provide replacement cost for the structure. However, Florida law gives consumers the option to:

- Choose a large deductible;
- Limit coverage for contents to actual cash value (depreciated value);
- Limit coverage for water damage;
- Exclude damage for sinkholes; and
- Refuse coverage for damage caused by a hurricane

These variations in coverage sometimes make it difficult to compare policies offered by different insurance companies.

The annual insurance premium paid by a homeowner has two parts:

- **Hurricane premium** - The hurricane portion of the premium is determined by computer models certified by the State of Florida. The amount of the hurricane premium depends on location, age of the home, type of construction, roof shape, roof covering, roof age, and opening protection.

Average Hurricane Premium Per Policy (HO3 Policies With Full Coverage for Water Damage)

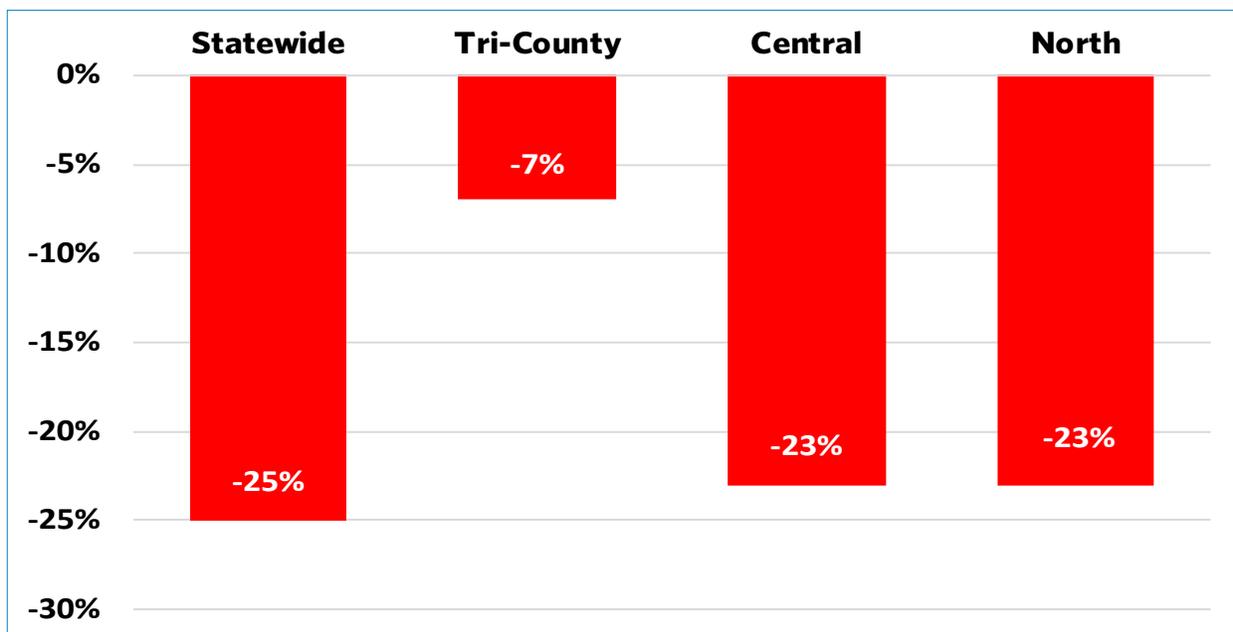
Year	Statewide	Tri-County	Central	North
2010	\$652	\$1,059	\$335	\$267
2011	\$604	\$1,095	\$318	\$260
2012	\$649	\$1,311	\$423	\$259
2013	\$756	\$1,513	\$575	\$332
2014	\$764	\$1,586	\$601	\$353
2015	\$650	\$1,621	\$522	\$239
% Change 2010/2015	0%	53%	56%	-10%

- **Non-hurricane premium** - The non-hurricane portion of the premium is determined by the loss experience of each individual insurance company. Loss experience is also affected by legislative action or inaction. Since the passage of SB 408, most Floridians have seen their non-hurricane premium decrease. Security First Insurance has reduced its non-hurricane premium by 25% since 2010.

Average Non-Hurricane Premium Per Policy By Region
 (HO3 Policies With Full Coverage for Water Damage)

Year	Statewide	Tri-County	Central	North
2010	\$871	\$973	\$837	\$844
2011	\$857	\$986	\$784	\$837
2012	\$834	\$956	\$740	\$818
2013	\$809	\$928	\$724	\$792
2014	\$736	\$924	\$675	\$692
2015	\$650	\$906	\$643	\$652
% Change 2010/2015	-25%	-7%	-23%	-23%

Average Change in Non-Hurricane Premium by Region
 (2010/2015)

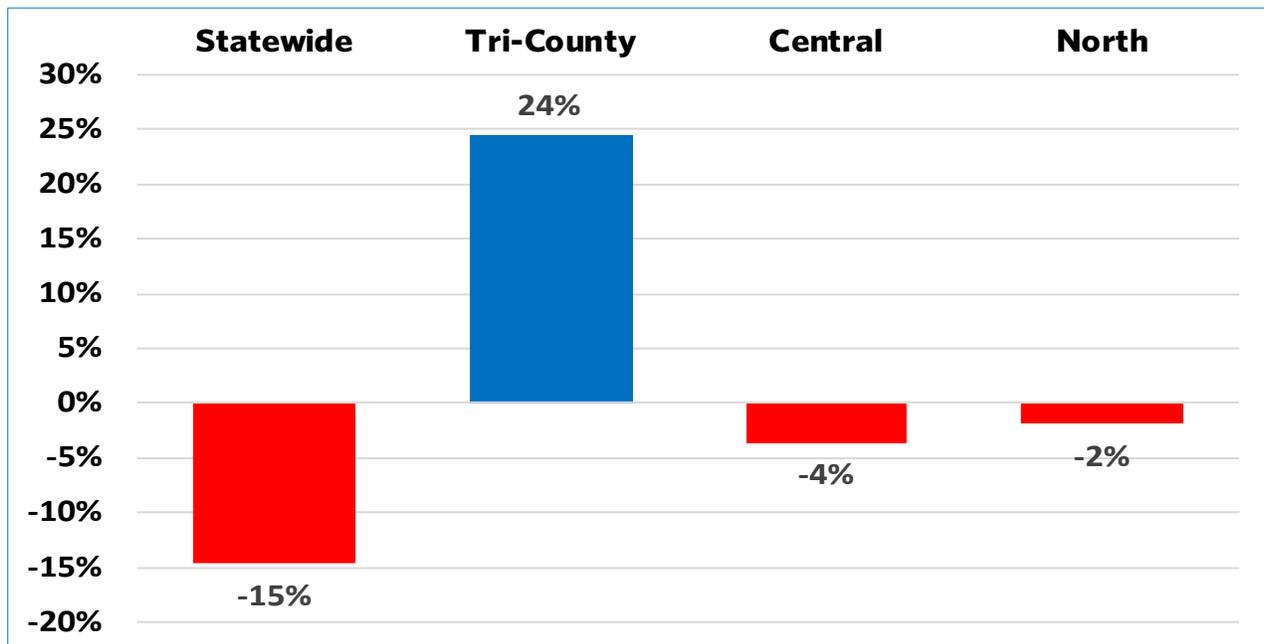


Security First Insurance’s average total premium (hurricane and non-hurricane) also decreased statewide and in Central and North Florida regions over the same six-year time period.

Average Total Premium Per Policy By Region
 (HO3 Policies With Full Coverage for Water Damage)

Year	Statewide	Tri-County	Central	North
2010	\$1,523	\$2,032	\$1,208	\$1,111
2011	\$1,461	\$2,081	\$1,102	\$1,117
2012	\$1,483	\$2,267	\$1,163	\$1,093
2013	\$1,565	\$2,441	\$1,299	\$1,141
2014	\$1,500	\$2,510	\$1,276	\$1,089
2015	\$1,300	\$2,527	\$1,165	\$ 889
\$ Change	-\$223	\$495	-\$43	-\$222
% Change	-15%	24%	-4%	-2%

Average Change in Total Premium By Region
 (HO3 Policies With Full Coverage for Water Damage)



Some of the differences in average annual premium are a result of differences in the amount of coverage purchased in different counties. For additional detail on the average premium, average square footage, and average Schedule A value (Coverage A) by county, see supporting documentation: Average Coverage A-Square Footage-Premium HO3 Full Water Damage Coverage by County 5-31-16.

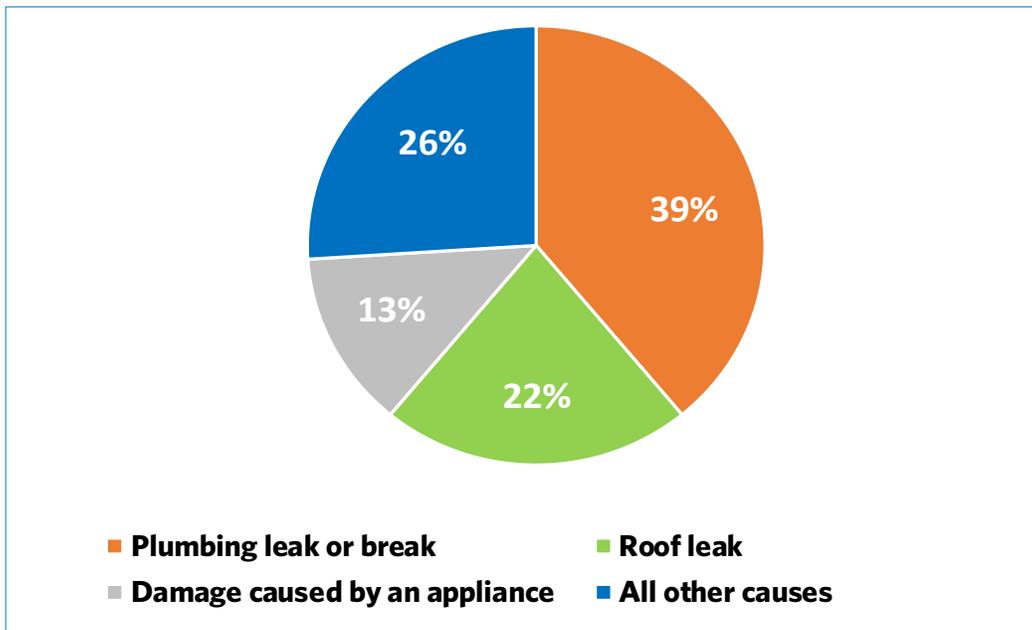
Cause of Water Claims

The total amount paid in claims by an insurance company is directly affected by frequency and severity. “Frequency” and “severity” can differ depending on the cause of damage. Water claims are particularly important because they usually represent about 50% of a company’s non-hurricane claims.

Below is a chart showing the major causes of water damage claims for Security First Insurance:

Percentage of Total Water Damage Claims by Cause

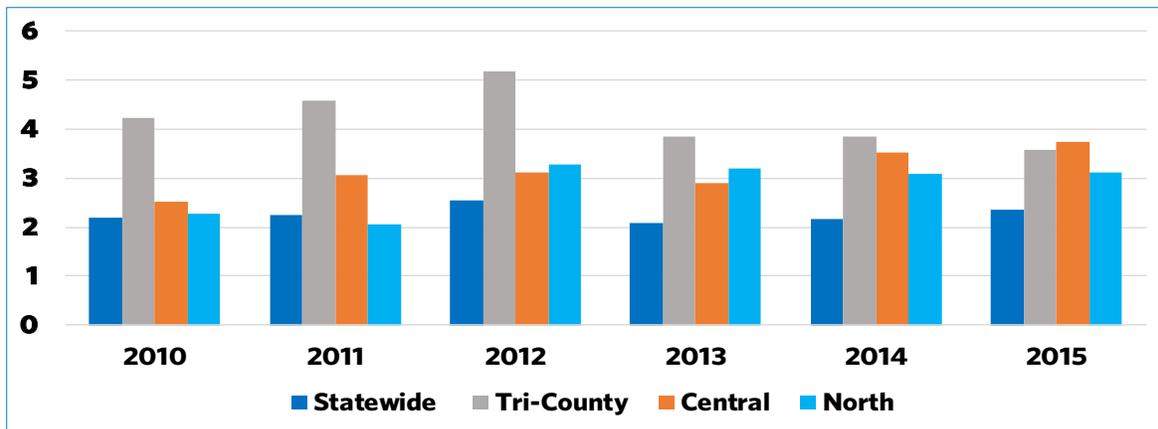
(January - May 2016)



Frequency of Water Damage Claims

The frequency of water damage claims statewide has been going up for the last three years at Security First Insurance. This upward trend is also occurring in Orlando and Jacksonville. The frequency of water claims in the Tri-County area has actually decreased significantly since the high point (5.189%) in 2012. This is probably the result of Security First Insurance’s substantial reduction in the number of policies written in southeast Florida and the company’s decision to only insure fully mitigated homes. The experience with water damage claims in southeast Florida was also helped by Security First Insurance’s decision to avoid “takeouts” from Citizens and to decline participation in the Citizens clearinghouse.

Frequency of Water Damage Claims By Year and Region
 (HO3 Policies With Full Coverage For Water Damage)

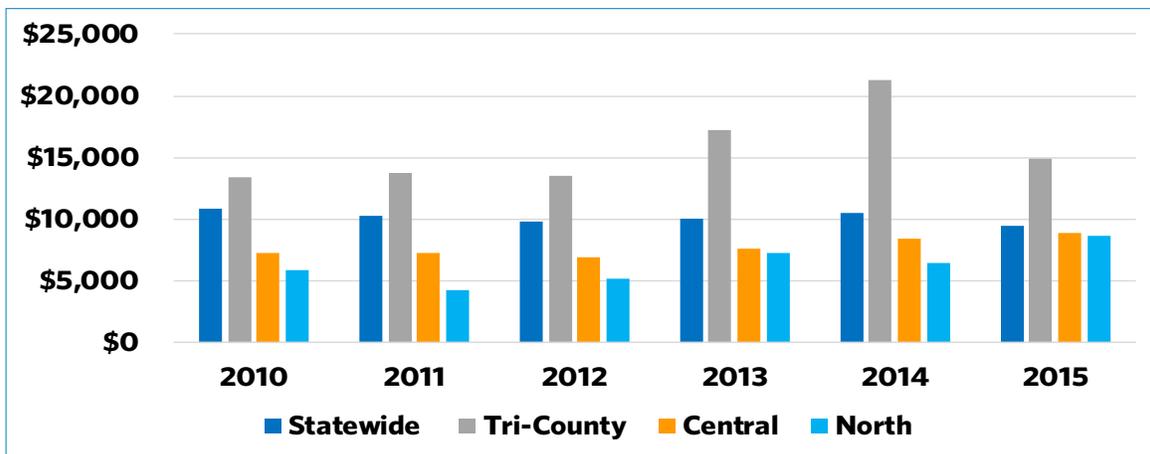


Year	Statewide	Tri-County	Central	North
2010	2.185%	4.221%	2.512%	2.275%
2011	2.237%	4.581%	3.054%	2.054%
2012	2.549%	5.189%	3.116%	3.282%
2013	2.082%	3.843%	2.894%	3.201%
2014	2.156%	3.852%	3.521%	3.087%
2015	2.363%	3.568%	3.746%	3.112%

Severity of Water Damage Claims

The severity of water claims has been going up significantly in Jacksonville and Orlando. The upward trend in severity in Miami was, apparently, interrupted in 2015. However, as water claims in litigation are settled in future years it's likely that the average severity of the water claims that occurred in the Tri-County in 2015 will increase. The statewide average cost of a water claim for Security First Insurance has remained essentially unchanged for the six year period. This is a reflection of the shift in the company's business from South Florida over the six-year period. Today over 80% of Security First Insurance's business is north of the I-4 and east of the I-75 corridors. That is unusual for companies writing homeowners business in Florida.

Severity of Water Damage Claims By Year and Region
 (HO3 Policies With Full Coverage For Water Damage)



Year	Statewide	Tri-County	Central	North
2010	\$10,810	\$13,457	\$7,280	\$5,847
2011	\$10,273	\$13,708	\$7,227	\$4,301
2012	\$9,778	\$13,558	\$6,888	\$5,140
2013	\$10,095	\$17,271	\$7,638	\$7,245
2014	\$10,564	\$21,260	\$8,418	\$6,466
2015	\$9,479	\$14,965	\$8,905	\$8,695

Assignment of Benefits and Increased Claim Costs

An Assignment of Benefits agreement is a legal document that transfers (“assigns”) the insured’s rights to an insurance claim, including the claim payment, to a third party. The third party can now act on behalf of the insured and has complete control of the claim process, including working with the insurance company.

The use of AOBs by water mitigation providers and contractors has contributed to the increased severity of the average water damage claim. Typically, a claim with an AOB costs Security First Insurance 140% more to settle than a water claim without an AOB. These are the statistics for 2015:

Average Total Cost of Water Damage Claims (2015 Accident Year - All Business)

	Claim Cost (With AOB)	Claim Cost (Without AOB)	Dollar Increase	% Increase
Statewide	\$15,873	\$6,573	\$9,280	141.2%
Miami-Dade	\$25,366	\$12,402	\$12,964	104.5%
Broward	\$26,636	\$11,281	\$15,355	136.1%
Palm Beach	\$24,312	\$9,961	\$14,351	144.1%
Orange	\$13,308	\$5,290	\$8,018	151.6%
Seminole	\$10,664	\$5,106	\$5,558	108.9%
Duval	\$12,094	\$4,872	\$7,222	148.2%

Reporting Delays on Water Claims

The homeowners insurance policy issued by Security First Insurance Company requires the insured to mitigate or prevent further damage to the home after a loss and promptly notify Security First Insurance of the loss.

The initial report of a claim is called a “first notice of loss” or “FNOL”. About 94% of claims are reported over the phone by either the insured (80%), the insurance agent (10%) or a third party (10%). The third party can be a public adjuster, an attorney, or a water remediation company. The remaining 6% of claims are reported electronically. About 75% of the claims are reported during normal business hours (8AM to 8PM Monday thru Friday).

About 49% of the water claims from the Tri-County are reported to Security First Insurance within three days of the reported date of loss. Claims in other portions of the state are reported sooner. In all areas of the state, between 11% and 12% of water damage claims are reported more than 30 days after the date of loss.

Reporting Delays on Water Damage Claims (HO3 Policies with Full Coverage for Water Damage)

Time from date of loss	Tri-County	Central	North	Statewide
0 to 3 days	49.2%	61.3%	78.5%	59.4%
4 to 30 days	39.0%	26.5%	9.4%	29.7%
Over 30 days	11.8%	12.2%	12.1%	10.9%

Delays in reporting claims often result in denying Security First Insurance the opportunity to inspect the damage and agree on an acceptable scope of work for repairing the home of our customer prior to the work being initiated.

Security First Insurance's Response to a Reported Water Damage Claim



When a water claim is reported the caller is asked for their name, contact information, and a brief description of the loss. If the caller needs immediate help to repair their home, they will be contacted within 15 minutes by our preferred contractor network. If they agree to use a preferred contractor (about 90% agree), the water mitigation contractor or other necessary resources will be dispatched to assist the homeowner. Our preferred vendors are required to be at the damaged home within two hours of the reported loss and most of the contractors beat that time limit.

If an urgent response is not required, the claim is assigned to an adjuster. An e-mail is sent to the insured giving them the name of the adjuster, the adjusters contact information, and a claim number. The adjuster is required to contact the insured within 24 hours of the FNOL and, if required by the size or nature of the claim, to conduct an on site inspection within 48 hours of the reported loss.

The on site inspection can be delayed to accommodate the schedule of the customer. The inspection can also be delayed if a third party, like a public adjuster or an attorney hired by the insured, has a scheduling conflict.

Settlement Times for Water Damage Claims

In 2015, Security First Insurance investigated and paid 56% of water claims that did not have an AOB within 30 days of the date of loss. Customer retention on HO3 policies is over 90% and, according to the surveys sent to all claimants, claim satisfaction was high. In the last 12 months, 88% of customers who completed their survey said they would recommend Security First Insurance to their friends and family.

In contrast, less than 20% of the claims with an AOB were able to be paid within 30 days of the date of loss. Industry experience with an AOB at Citizens, the largest writer of business in the Tri-County, reports that one in four of its claims in the Tri-County are subject to an AOB.

Four months after the date of loss only 6% of the water claims without an AOB remained open and many of those claims were reported late. The comparable figure for water claims with an AOB was 40% remained open and unresolved four months or more after the date of loss.

Number of Days Between Reported Date of Water Loss & Claims Settlement (2013-2015 All Business)

Days	Statewide		Tri-County		Central		North	
	AOB	Non AOB	AOB	Non AOB	AOB	Non AOB	AOB	Non AOB
0 to 30	19.7%	56.1%	6.0%	42.5%	22.4%	59.6%	26.3%	55.0%
31 to 60	17.8%	23.8%	6.0%	25.7%	23.8%	20.8%	14.0%	25.1%
61 to 90	13.2%	9.1%	18.1%	13.9%	9.9%	8.7%	17.5%	9.4%
91 To 120	9.0%	4.5%	9.6%	4.6%	6.5%	4.7%	10.5%	5.5%
Over 120	40.3%	6.6%	60.3%	13.3%	37.4%	6.2%	31.6%	4.9%

Number of Water Damage Claims with an AOB

Security First Insurance has been tracking AOB's on all claims since the fall of 2012. Security First's experience is radically different from the loss experience at Citizens where the average cost of a water claim per policy in the Tri-County has increased from \$1,443 in 2013 to \$1,955 in 2015. Security First Insurance is experiencing an increase in the percentage of claims with an AOB being filed in the Tri-County area, Orlando, and Jacksonville.

Percentage of Water Damage Claims Subject to an AOB (All Business)

Year	Statewide	Tri-County	Central	North
2013	18.7%	25.5%	21.5%	12.0%
2014	16.7%	27.6%	17.1%	12.8%
2015	15.4%	30.1%	21.6%	13.9%

Since 2013, the percentage of claims with water damage that are subject to an AOB has increased by 20% in the Tri-County area; however, 70% of the claims for water damage in the Tri-County area do not have an AOB. We are not sure this Security First Insurance experience in the Tri-County area is representative of the industry experience with an AOB.

The decreasing percentage of claims with an AOB reflected in the statewide total for Security First Insurance can be misleading, since it is a reflection of the changing geographical footprint of the company's business. As that change in mix stabilizes, we expect our statewide experience to follow more closely with the Central and North Florida trends, absent of any change to the system.

Cost of Water Damage Claims Per Policy

The cost per policy has been increasing for the last four years in Orlando and Jacksonville. As a result, Security First Insurance’s policyholders in those cities will experience premium increases that are significantly higher than our statewide average increase of 7.8%, which will take effect for new business on August 1st and renewal business on September 1st.

Average Cost of Water Damage Claims Per Policy (HO3 Policies with Full Coverage for Water Damage)

Year	Statewide	Tri-County	Central	North
2010	\$236	\$568	\$183	\$133
2011	\$230	\$628	\$221	\$88
2012	\$249	\$704	\$214	\$169
2013	\$210	\$664	\$221	\$232
2014	\$228	\$819	\$296	\$200
2015	\$224	\$534	\$334	\$271

The cost of water claims per policy in the Tri-County area has fluctuated rather dramatically over the six-year period and is currently at about the same level as it was in 2010. The statewide average has remained constant. Like severity, this is a reflection of the shift in business from south Florida to north Florida over the six-year period.

Loss Ratio of Water Damage Claims Per Policy

Decreasing non-hurricane premium per policy and the increasing frequency and severity of water claims have combined to produce increasing loss ratios for water claims over the last three years.

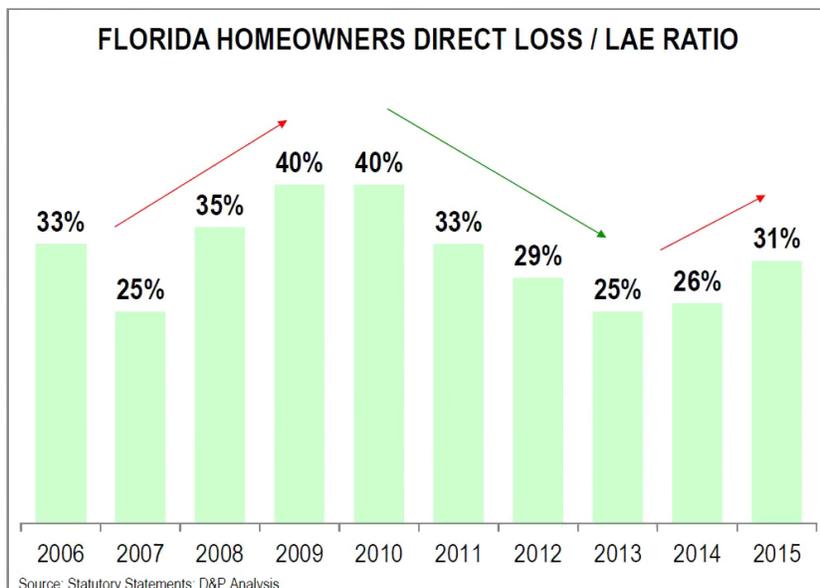
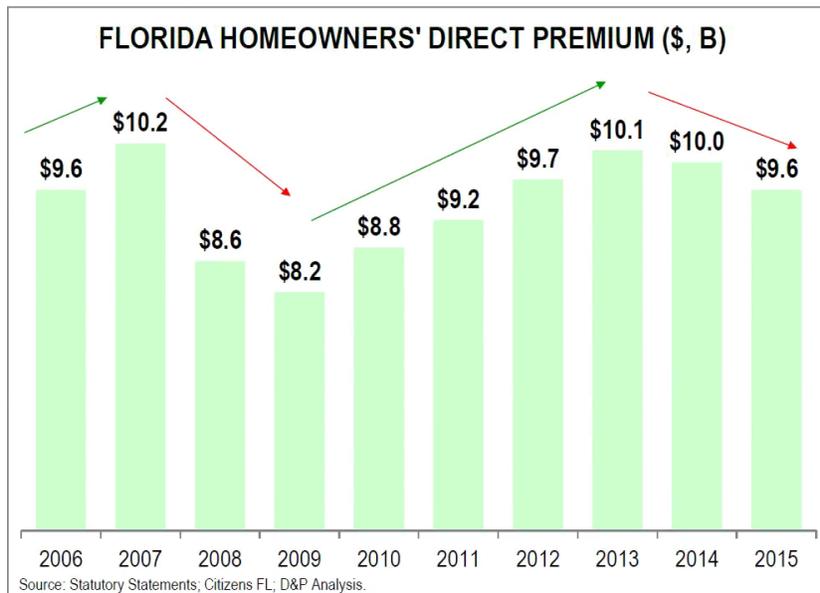
Loss Ratio Per Policy for Water Damage Claims (HO3 Policies with Full Coverage for Water Damage)

Year	Statewide	Tri-County	Central	North
2010	27.1%	58.4%	21.9%	15.8%
2011	26.8%	63.7%	28.2%	10.6%
2012	29.9%	73.6%	29.0%	20.6%
2013	26.0%	71.5%	30.5%	29.3%
2014	30.9%	88.6%	43.9%	28.9%
2015	34.5%	58.9%	51.9%	41.5%

Security First Insurance expects further increases in the loss ratio, for water damage claims in 2016 and beyond, as open and unresolved claims are ultimately settled.

While Security First Insurance made money in the first quarter of 2016, six of the twelve companies writing the largest amount of homeowners business in Florida reported an operating loss during that same period. Three of the top twelve companies that lost money during the first quarter are publicly traded: Federated, Heritage, and United Property and Casualty. That’s important since those results combine the results of the insurance company, the insurance company’s MGA, and any other affiliated companies. Industry critics can’t argue that the insurance companies are reporting losses while the affiliates are making money.

It’s likely that Security First Insurance will report a slight operating loss for 2016 even without a hurricane, which is long overdue. This makes premium increases inevitable. Unfortunately, those premium increases will likely continue in 2017 even if there is some legislative “fix” to this problem, because of the length of time it takes to implement policy changes and for those changes to be effective in reducing loss costs. We expect many of our competitors to show similar results because, according to an analysis published by Dowling and Partners on June 23, 2016, the reported results for homeowners insurance business in Florida show decreasing premiums and increasing loss ratios.



Fraudulent Water Damage Claims

It is impossible to quantify the cost of fraudulent water claims. Focus groups have told industry researchers that people commit insurance fraud for three reasons:

- Save money or reduce costs
- Get expensive work done that they could not otherwise afford
- Get back at insurance companies which have charged high premiums for years w/o paying claims

Public opinion surveys have shown that over 80% of insureds believe that insurance fraud is wrong, 83% would agree to participate in claims processes like examinations under oath to combat fraud, 83% of the people agree with the statement that individuals who commit insurance fraud should be prosecuted, and 86% of the respondents agree that insurance fraud increases premium.

At the same time, public opinion surveys show that 38% of the public holds a negative attitude towards insurance companies and a significant number of people believe that it's acceptable to inflate a claim in certain circumstances:



Beyond the actions of individual claimants, there is the organized fraud practiced by a small group of unscrupulous water mitigation companies, roofers, and contractors that have been well documented by the Florida Division of Insurance Fraud. Both types of fraudulent activity increase claim frequency and claim severity. Both types of activity increase premiums. We just don't know how much.

Security First Insurance has made an effort to combat insurance fraud by increasing the number of employees assigned to our Special Investigations Unit (SIU) from four employees in 2013 to ten in 2016. The SIU unit includes six employees based in our home office in Ormond Beach and four field investigators.

In 2015 Security First's SIU unit made a total of 33 referrals to the Division of Insurance Fraud (DIF). One of those referrals resulted in an arrest and a guilty plea for filing fraudulent water claims. Another referral by Security First's SIU unit resulted in a guilty plea to a charge of arson. During the first five months of 2016, Security First's SIU unit made a total of 57 referrals to DIF. One arrest is expected shortly.

Typical Suspicious Water Damage Claims

Beyond the actions of individual claimants, there is organized insurance fraud practiced by a small group of attorneys, water mitigation contractors, and roofers that have been well documented. Here is an example of two separate customers with nearly the exact same claim experiences:

- Both customers live in Tampa Florida
- Both customers are represented by the same Miami-based law firm
- Both customers had water mitigation completed by a Miami-based water mitigation company
- Both customers filed two claims with losses that occurred on two different dates
- The reported date of loss was approximately one week apart for both claims for both customers
- The claims were not reported until after 30 days from the date of loss
- The total amount for the water mitigation bills are \$12,000-\$13,000
- The repair was handled the same way:
 - » Damaged material was discarded and repairs were completed before Security First Insurance could inspect the damage
 - » Plumbing repairs were made by the water mitigation company. They were not licensed plumbers.

Claim Information	What Happened?
Claim 1 Cause of Loss: Water Pipe Leak (Bathroom) Date of Loss Reported by Insured: 8/3/15 Date Claim Was Reported: 10/19/15	Customer A filed two water damage claims on October 19, 2015 for losses that occurred on two different dates. The customer with insured property located in Tampa, Florida, hired a water mitigation company located in Miami Florida (294 miles away).
Claim 2 Cause of Loss: Water Pipe Leak (Kitchen) Date of Loss Reported by Insured: 8/21/15 Date Claim Was Reported: 10/19/15	The water mitigation company removed the baseboards and drilled holes above the base boards, which required the need for drywall repair and/or replacement. All damaged water supply piping/lines and baseboards were removed and discarded before Security First Insurance was able to complete an inspection of the damage.
Water Mitigation Bills: Claim 1 - \$7,357.26 Claim 2 - \$5,856.67	Total: \$13,213.93

Claim Information	What Happened?
<p>Claim 1 Cause of Loss: Water Pipe Leak (Kitchen) Date of Loss Reported by Insured: 3/15/16 Date Claim Was Reported: 4/21/16</p> <p>Claim 2 Cause of Loss: Water Pipe Leak (Bathroom) Date of Loss Reported by Insured: 3/23/16 Date Claim Was Reported: 4/21/16</p>	<p>Customer B filed two water damage claims on April 21, 2016 for losses that occurred on different dates in March. The customer with insured property located in Tampa, Florida, hired a water mitigation company located in Miami Florida (286 miles away).</p> <p>The water mitigation company removed the baseboards and drilled holes above the base boards which required the need for drywall repair and/or replacement. All damaged water supply piping/lines and baseboards were removed and discarded before Security First Insurance was able to complete an inspection of the damage.</p>
<p>Water Mitigation Bills: Claim 1 - \$5,379.25 Claim 2 - \$6,820.87</p> <p style="text-align: center;">Total: \$12,200.12</p>	

Both of these examples increase the frequency and severity of claims. But, by how much?

Reporting Fraudulent Claims

Florida law requires insurance companies to report suspected cases of insurance fraud to the Division of Insurance Fraud (FS 626.989) and to report suspicious fires or explosions to the State Fire Marshall (FS 633.126). The statutes provide civil immunity for individuals that report suspected fraud. Rules adopted pursuant to those statutes require insurance companies to provide a description of their SIU unit or an outline of their anti-fraud plan to the division. Unfortunately, only 5% of the annual referrals to the DIF involve homeowners claims.

There are several possible explanations for this:

- Insurance companies are not doing a good job of looking for fraud because they don't have a full-time SIU unit or their anti-fraud effort has been outsourced to a third party who has no financial incentive to look for potential fraud.
- Homeowners insurance companies are discouraged by the response they receive from the DIF. The DIF only has 151 detectives to review 17,000 fraud referrals per year and none of those detectives are specifically assigned to work homeowners insurance claims. As a result, only 7% of the suspected cases of homeowners insurance fraud are referred to prosecutors.
- Homeowners insurance companies are reluctant to send information to the DIF because anything they send may become public record when the DIF's file is closed and, in a few cases, that information has been used to pursue a claim for malicious prosecution against the insurance company.

As a result, there are those who correctly believe that the chances of being penalized for engaging in homeowners insurance fraud are minimal.

AOB Litigation

The result of prompt settlement of legitimate claims and high customer satisfaction with the claim process has shown a decrease in the number of lawsuits filed against Security First in spite of the increased number of claims generated by a growing book of business:

Claims and Litigation Activity (All Causes of Loss)

Year	Claims per Month	Lawsuits Per Month	% Lawsuits	AOB Lawsuits Per Month	% Lawsuits
2013	590	26	4.4%	5	19.2%
2014	654	35	5.4%	8	22.9%
2015	886	53	6.0%	21	39.6%
2016	1,173	41	3.5%	16	39.0%

The decrease in the total number of lawsuits filed per month is, according to reports published by CaseGlide, extremely unusual for a Florida homeowner's insurance company at the current time. The decrease in the number of AOB lawsuits filed per month is also unusual in the sense that Security First Insurance's experience is not representative of the experience of the average homeowner's insurance company in Florida. Security First attributes at least some of that decrease to be the result of its decision to expand its litigation staff from 2 people in 2013 to 6 people in 2016.

It's unfortunate that AOB litigation represents 39% of the total number of lawsuits filed against Security First Insurance's because a water claim with an AOB in litigation ultimately costs twice as much as a water claim with an AOB that stays out of court and four times more than the average water claim without an AOB.

Average Total Cost of Water Damage Claim (All Business)

Year	Claims With AOB and Lawsuit	Claims With AOB and Without Lawsuit	Claims Without AOB and Without Lawsuits
2013	\$27,803	\$14,676	\$6,363
2014	\$26,168	\$15,438	\$6,522
2015	\$24,305	\$12,325	\$6,713
2016	\$21,116	\$8,524	\$6,684
Average Claim Cost	\$25,867	\$13,757	\$6,684

While it shouldn't come as a surprise that water claims with an AOB cost more than a claim without an AOB and claims in litigation ultimately cost more to settle than claims that don't end up in court, there is a very real question about how many water claims will be subject to an AOB in the months and years ahead and how many of the claims with an AOB will end up in litigation.

Status of Water Damage Claims (All Business)

Year	Claims With AOB and Lawsuit	Claims With AOB and Without Lawsuit	Claims Without AOB and Without Litigation
2013	2.6%	15.2%	82.1%
2014	4.3%	10.7%	85.0%
2015	2.2%	12.7%	85.1%
Three-Year Average	2.9%	12.7%	85.1%

Because of the increasing costs associated with water claims overall, Security First Insurance was granted a rate increase by the OIR. The average statewide increase approved for non-hurricane premium was about 10%. The water damage claims incurred since 2013 have caused the average total homeowners premium charged by Security First Insurance to increase by 5% this year.

We believe the increase in the percentage of claims filed without an AOB are largely a reflection of the shift in Security First Insurance's business away from the Tri-County area. There is a very real possibility that the increase in the percentage of water claims that are being filed with an AOB in Orlando and Jacksonville will increase the statewide percentage of claims being filed with an AOB and will increase claims costs in 2016 and 2017. There is also concern that in the event of a hurricane, there will be a substantial increase in the percentage of claims reported with an AOB. If this occurs, homeowner's premiums will increase in 2017.

Who Gets the Money?

The total cost of a water claim is split between the costs incurred by the insurance company in investigating the claim and the amount paid to the insured. The costs incurred by the insurance company are called "expenses". Typically, those expenses do not include the costs of the company's full-time employees and general claims overhead expense. The amount paid to the insured for the repair and replacement of their property is called the "indemnity" payment.

In 2015, this was the split between the expense portion of the average water claim and the indemnity payment for the average water claim:

Cost of Water Damage Claims (All Business - 2015)

	Claims With AOB	Claims With AOB and Without Lawsuit	Claims With AOB and in Litigation
Expense	\$1,063	\$2,056	\$8,645
Indemnity	\$5,645	\$10,241	\$18,049
Total Cost	\$6,708	\$12,297	\$26,940

The check for payment of the indemnity portion of the water loss typically includes many different payees. In addition to the named insured, the payees can include the mortgage company, a public adjuster, an attorney, and the water mitigation company or another contractor that performed work on the insured home.

Many times Security First Insurance does not know the exact amount of the financial interest of these third parties by the funds being paid to the insured. However, if you assumed that third parties other than the water mitigation company or contractor, had a 20% interest in the average AOB claim and a 30% interest in the typical AOB claim in litigation, the distribution of the proceeds of the average water damage claim in 2015 would look like this:

Split of Average Indemnity Payment for Water Damage Claims (All Business - 2015)

	Claim Without An AOB	Claim With AOB and Without Lawsuit	Claims With AOB and in Litigation
Indemnity Payment	\$5,645	\$10,241	\$18,049
Costs paid to 3rd Parties	\$0	\$2,048	\$5,415
Net to Water Mitigation Company or Contractor	\$5,645	\$8,193	\$12,634

The chart demonstrates the financial incentives for water mitigation companies and contractors to insist on an AOB before beginning work. The chart also gives you a measure of the financial interest that attorneys have for getting involved in water damage claims.

The Public Policy Argument About Water Damage Claims

The statistical evidence from multiple sources is clear and undisputed:

- The frequency of water claims is increasing
- The severity of water claims is increasing
- The cost of settling a claim with an assignment of benefits agreement is significantly higher than the cost of settling a claim without this agreement.

Critics of the insurance industry could easily point to the higher indemnity payments for AOB claims as proof positive that AOBs are a necessary tool to protect consumers from an industry that systematically underpays legitimate claims in order to increase profits. While that statement may sound convincing, the truth is a bit more complicated than that simple assertion. That notion ignores the following facts:

1. 85% of water claims are settled without an AOB
2. 88% of Security First Insurance's customers are satisfied with the claim process;
3. The rules set by the Florida Office of Insurance Regulation limit the profit and contingency factor in the rates charged by a homeowners insurance company to 4% of premium.

Insurance companies are in the business of paying legitimate claims quickly and fairly. When presented with a claim that is subject to an AOB, the insurance company is not dealing with a customer who wants their home repaired quickly and professionally, but instead the insurance company is dealing with a water mitigation company or an attorney that wants a *large*, rather than a *fair* settlement.

As a result, insurance companies incur significantly increased expenses from outside experts because, in the event of litigation, Florida law provides that an insurance company will be required to pay the plaintiff's attorney fees in addition to the damages suffered by the insured, if the insured prevails and the amount awarded is above the original settlement offer made by the insurance company.

The increased exposure of paying the opposing party's legal expenses is called "one-way" attorney fees. In short, the knowledge that AOB claims increase loss adjustment expenses and the threat of "one-way" attorney fees in litigated cases, in many instances, make it prudent for insurance companies to offer more money to settle AOB claims than Non-AOB claims prior to claims entering into litigation.

What's not clear is the financial interest that the insured has in this money:

- If the water mitigation company or contractor does a good job, their home is repaired with or without an AOB.
- The increased cost of a water claim doesn't put extra money in the insured's pocket.

What's clear is:

- The increased costs will be reflected in future premium increases
- The claim with an AOB will take longer to settle than a claim without an AOB. The insured will be unable to switch insurance carriers as long as the water claim is not paid.
- If the insured is unhappy with the repair work performed, it's possible that having signed an AOB will limit possible remedies to get the work done right. In some cases, Security First Insurance has already paid its part of the claim to the contractor in full, so if the work has not been done, the insured may be forced to bring in another contractor at their own cost to complete the restoration.
- If the water mitigation company is unhappy with the insurance company's payment for the work performed, the insured could be the target of litigation and, in the worst case, the contractor could place a lien on the home. The lien will prevent the home from being sold until it is paid off.

It is important to note that each of these results have been experienced by Security First Insurance's customers, and given the courts' upholding of the AOB, we are powerless to intervene on our insured's behalf.

Real Stories

Damaged Homes, Incomplete Repairs

An 84-year-old woman living in Sanford was at home when the pipes backed up and caused plumbing issues throughout her home. There was damage to multiple bathrooms, the bedroom carpet, and other areas of the home. Like many homeowners, she called a plumber and water mitigation company before contacting her homeowner's insurance company or agent.



The contractors had her sign an Assignment of Benefits (AOB) agreement before they would start any repairs on her home. By signing this agreement, the elderly woman lost her rights to both the claim settlement check and the management of repairs. The AOB agreement also changed the parties listed on the claim check to include all parties: the homeowner, water mitigation company, and the contractor. This meant that the check could not be cashed until all signatures were provided.

The contractor essentially hijacked the claim check and also demanded being paid an additional \$5,000 above the actual cost for repairs. The insurance company attempted to negotiate, but the water mitigation company hired a lawyer who also insisted on getting all of the claims funds, adding his legal fees and leaving nothing for the homeowner.

Where are they now? Even though the insurance company made timely, appropriate payments on this claim, the water mitigation company filed suit for its inflated invoices. Due to litigation, the claim remained open for more than a year. Around this time, the insurance company received a panicked phone call from Jane. She was three days away from closing on the sale of her home when she found out that the new owners could not get insurance on the home because the water loss claim was still open. By signing away her rights to the claim, Jane was unaware of the situation and unable to take action while the water and mold company acted purportedly "on her behalf." When homeowners sign an AOB form, the contractors now represent the homeowner, and the insurance company can no longer speak with the homeowner in detail about the claim.

The Real Cost of Inflated Claims

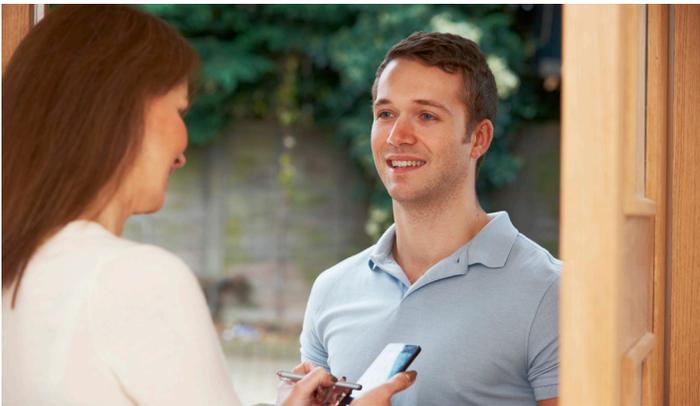
Hillsborough county homeowner "Jane Doe" contacted a plumber right away when her washing machine supply line failed. The plumber soon contacted a water mitigation company. The mitigation company arrived and instructed the homeowner to sign an AOB agreement so they could get started on home repairs. The company began replacing walls, tearing up the baseboards, and installing new carpet. By industry standards, this work should have cost about \$4,200, but the water mitigation company sent a bill to the insurance company for more than \$20,000. On top of this, the water mitigation company hired a mold company as a "consultant" on the repairs. Rather than being paid by the water mitigation company that hired them, the mold company sent a bill to the insurance company for its services. To make matters worse, the mold company did not actually do the reported work listed on its \$1,600 invoice.

Where are they now? The homeowner is facing a potential lawsuit against her by the contractor and his lawyer while living with damage and incomplete repairs in her home. Although the insurance company paid the claim in a timely manner, over a year later the homeowner has not received any funds from her claims settlement because she signed over her rights in the AOB agreement.

The Ripple Effect of Longstanding Open Claims in Litigation

“John Doe,” a homeowner in Lakeland, noticed a leak in his ceiling and discovered it was coming from a malfunctioning A/C unit. To clean up his home and repair the water damage, John reached out to a water mitigation and mold company. Before beginning any work on the home, the companies required John to sign an AOB agreement. It wasn’t long before the water and mold companies submitted heavily inflated invoices and sued John’s insurance company.

Where are they now? Months later, John attempted to purchase a separate policy for rental property from an entirely different insurance company and he was denied coverage due to the open claim on the other policy. The issue of contractors using an AOB agreement to obtain rights to a claim extends far beyond the associated policy and property.



Tech-Savvy Contractors Have Compelling Offers Homeowners Don’t Refuse

One of the trickiest parts about the AOB forms is that many consumers don’t even know they’re signing it. The contractor simply says they need it to “take care of everything” on the homeowner’s behalf. When said like this, AOB sounds great. But contractors do not actually need an assignment of benefits agreement to get paid. In fact, most reputable contractors do not use AOB forms.

Contractors who are using AOBs to get rich are also becoming more tech savvy. They are using mobile devices to collect signatures from homeowners.

This not only expedites the process for the contractor, but the homeowner never actually sees what they are signing.

Recommended Solutions

We need to take actions that will:

- Reduce the frequency of water claims; and
- Reduce severity of water claims

Here are some suggestions:

- 1. Educate consumers.** Consumers should be given a better understanding of what their homeowner's insurance policy does, and does not, cover. Consumers who can afford it, should consider increasing their deductible for all other perils (AOP) or eliminating unnecessary coverage to reduce their annual premium. Consumers should know how to turn off their water when there is a plumbing leak or break and when they leave home for an extended period.

Consumers should inspect their appliances to look for worn hoses or other conditions that could cause a water loss. Water heaters should regularly be inspected and replaced when necessary. If possible, water heaters should be placed on a pan or drain to catch any escaping water.

- 2. Prosecute property insurance fraud.** Fund a task force of investigators and prosecutors in the major metropolitan areas that are dedicated exclusively to prosecuting these types of criminal activity. Money for this could come from the Florida Hurricane Catastrophe Fund, which is required to spend money on mitigation activity or from the tax paid on property premium. Currently so few of the bad actors are held accountable by the criminal court system for their crimes. They have absolutely no incentive to change their behavior.
- 3. Reduce or regulate the activities of third parties that participate in the claim process.** Public adjusters are licensed by the state and regulated by statute. Water mitigation companies, loss consultants, and others are not subject to the same level of scrutiny. Often they engage in activities that are deceptive, unethical, and, sometimes, illegal. Require full disclosure of all fees and other charges in a third party contract. Provide a strong right of recession for consumers in all contracts signed by third parties in the claim process.
- 4. Eliminate assignment of benefits and replace it with a statutory direction to pay for those contractors that are worried about getting paid for the legitimate work that they do.** This approach obligates the insurance company to reconcile with the contractor without any harm to or relinquishing of rights from the insured.
- 5. Consider ways to reduce the time between the date of loss and the date of first report to the insurance carrier.**

- 6. Eliminate one-way attorney fees.** In those cases where the plaintiff is a corporation rather than an individual, remove the requirement of the company to pay one-way attorney fees.
- 7. Strengthen the immunity protections for loss adjusters, individuals, and companies reporting insurance fraud.** Create an exemption from public records for material turned over to DIF or the State Fire Marshall in cases of suspected insurance fraud
- 8. Manage the perceptions of the press and public regarding future rate increases.** SB 408 was passed in 2011. Those reforms did not result in reduced rates until 2013. In the company's FAQ's, Citizens put it this way "Due largely to non-weather related losses...Citizens' policyholders in South Florida can expect to see annual rate increases approaching 10% in 2017 and for years to come". Anything the legislature does in 2016 will not have a positive impact on rates until 2020.

Locke Burt, President
Security First Insurance Company
lburt@securityfirstflorida.com

Supporting Documentation

Further insight into the water loss claim experience of Security First Insurance can be obtained by reviewing the following statistical reports that are attached:

1. Water Claims 2007 to 2015- HO3 Policies With Full Coverage for Water Damage - Statewide Totals
2. Water Claims 2007 to 2015 - HO3 Policies with Full Coverage for Water Damage - Tri-County (Miami-Dade, Broward, and Palm Beach Counties Combined)
3. Water Claims 2007 to 2015 - HO3 Policies with Full Coverage for Water Damage - Central Florida (Orange and Seminole Counties Combined)
4. Water Claims 2007 to 2015 - HO3 Policies with Full Coverage for Water Damage - North Florida (Duval County)
5. Water Claims 2015 Accident Year - HO3 Policies with Full Coverage for Water Damage - Detail by County
6. Water Claims 2007 to 2015 - HO3 Policies with Full Coverage for Water Damage - Plumbing Leak or Break
7. Water Claims 2007 to 2015 - HO3 Policies with Full Coverage for Water Damage - Roof Leak
8. Water Claims 2007 to 2015 - HO3 Policies with Full Coverage for Water Damage - Damage Caused by Appliance
9. Water Claims 2007 to 2015 - HO3 Policies with Full Coverage for Water Damage - Damage from Causes other than Plumbing Leak, Plumbing Break, Roof Leak, or Appliance
10. Average Coverage A-Square Footage-Premium HO3 Full Water Damage Coverage by County 5-31-16