



# NON-CATASTROPHIC HOMEOWNERS WATER CLAIMS

JANUARY 2016

Citizens Property Insurance Corporation

## EXECUTIVE SUMMARY: AOB AND LITIGATION ARE A POCKETBOOK PROBLEM

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In October 2015, the Office of Insurance Regulation (OIR) issued an Assignment of Benefits (AOB) Data Call to Citizens along with Florida's most active private market property insurance companies. Citizens Property Insurance Corporation (Citizens) responded to this Data Call and also provided the results to Florida's Insurance Consumer Advocate. Citizens also matched the Data Call response to larger, more credible actuarial datasets to probe deeply into the question of the impact of AOB, and more generally of litigation, on non-catastrophe claims costs and rates for consumers.

AOB is an agreement used by contractors remediating damage to secure the legal right to "stand in the shoes" of the policyholder and directly access policy benefits, without accepting the responsibility to perform the duties after a loss as required in the policy. AOB at Citizens primarily manifests as an accelerant to water damage claims, while private insurers often see AOB used on roof damage claims. AOB is strongly associated with eventual litigation of demands for payment that exceed industry standards. While root cause analysis is outside the scope of this paper, the public record shows that contractors often work closely with attorneys to expand the scope of claims and to litigate the claims, triggering Florida's "one-way attorney's fee" law that requires the insurer to pay all legal fees for the plaintiff.

Citizens has closely monitored water damage claim cost trends that have skyrocketed since late 2013 and almost exclusively driven actuarially sound rate increases in South Florida in 2015 and 2016. With windstorm costs near all-time lows and steadily declining administrative expenses, were it not for these trends, rates would be dropping for many more customers in the region. To isolate the impact of AOB and litigation, Citizens has performed more detailed analysis of individual claim files. Key insights include the following.

- The prevalence of AOB on water claims, particularly litigated claims, is increasing in the Tri-County (Miami-Dade, Broward and Palm Beach) region. There is evidence that this has spread around the state in the past year.
- The Data Call shows that the group of claims with AOB, whether litigated or not, incur higher paid losses and expenses than those without AOB.
- The Data Call also shows that average cost for litigated claims is more than double that of non-litigated claims, and the average cost for non-litigated claims with AOB is more than double that for non-litigated claims without AOB.
- Litigated water claims drive the need for rate increases for non-wind perils.
- Overall frequency of water claims in Tri-County *and* around the state began a rapid increase in late 2013 that continues today. In Tri-County, severity has increased as well. Frequency and severity both drive rate hikes.
- There is a very strong connection between the increase in litigated water claims and increases in AOB and representation at First Notice of Loss (FNOL).
- There does not appear to be a strong correlation between water loss claims and the age of the home.

The body of evidence that AOB and litigation, both separately and together, are the drivers of Citizens' claim costs and rate increases is indisputable. These findings primarily impact the Tri-County region, but all of Florida is at risk. The steady increase in frequency of reported water claims all over Florida, comprising a much larger percentage of the companywide reported water claims in 2015, is troubling, and the percentage of these claims being represented at FNOL has increased significantly. Absent a reversal of these trends, non-wind rates would be expected to increase annually at or near the limits imposed by the 10% "glide path" law for years to come for most Citizens policyholders.

## ASSIGNMENT OF BENEFITS AND LITIGATION INTERACT TO DRIVE COSTS

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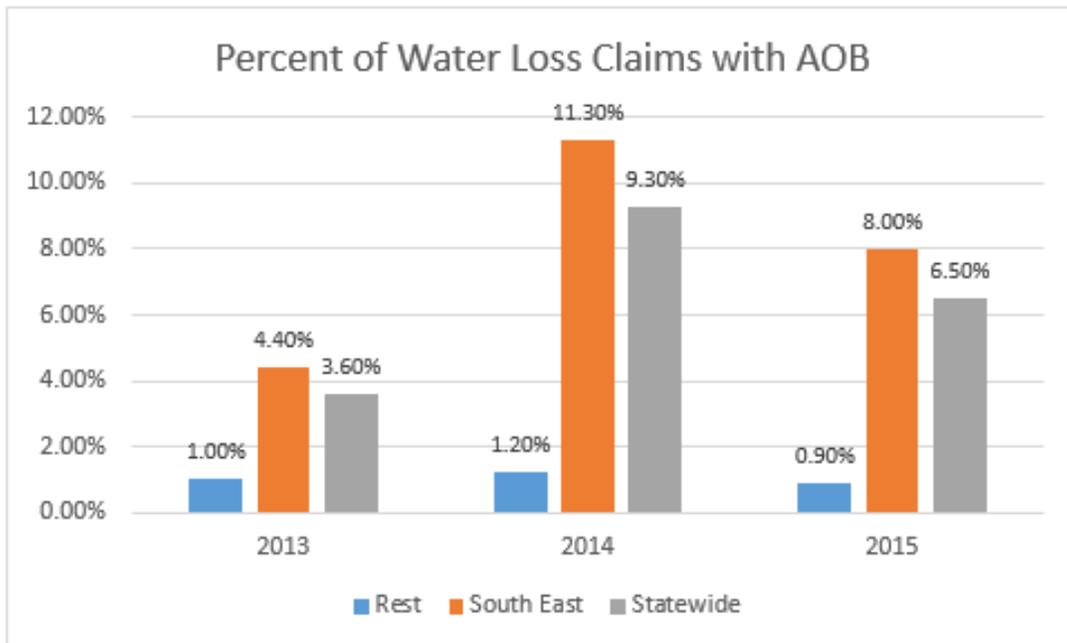
AOB occurs when a policyholder agrees with a contractor, often at the time of initial damage remediation, to authorize the insurer to issue checks directly to the contractor. The vendor provides service to an insured and then presents Citizens with a bill. Very often this occurs well prior to a claim being reported to or adjusted by Citizens.

Three issues are clear regarding AOB:

1. Citizens is seeing a general uptick in the percentage of water claims that have an assignment of benefits.
2. AOB claims are comprising a larger percentage of total litigated claims.
3. Average litigated AOB losses and loss adjustment expenses (LAE) per claim are higher than litigated claims without an assignment of benefits.

Exhibit 1 displays trends in percentage of reported water claims that had an assignment of benefits. "South East" (Tri-County) had a large uptick between 2013 and 2014. Currently 2015 is slightly lower, but this is an incomplete report year. The "Rest" (of Florida) has been slowly and steadily increasing from 2013 through 2015.

Exhibit 1



AOB claims comprise a steadily increasing percentage of the total litigated claims. Table 1 below includes litigated water claims in South East Florida only. It demonstrates that both litigation and AOB drive higher claims costs, both separately and together.

Table 1

Reported Litigated Water Claims in South East Florida as of 9/30/2015

Report Year*	% of Claims Litigated with AOB	Loss Severity		ALAE Severity	
		AOB	Non-AOB	AOB	Non-AOB
2012	9.6%	\$26,580	\$22,116	\$16,514	\$7,339
2013	14.9%	\$26,411	\$24,222	\$13,401	\$6,278
2014	29.3%	\$29,594	\$25,331	\$8,993	\$5,910
2015**	46.9%	\$31,987	\$23,776	\$6,437	\$6,350

\* Undeveloped Report Year info. It is expected the most recent years will increase.

\*\* Incomplete and immature Report Year

Concerning Table 1, Citizens only began to track AOB claims systematically in 2014. There may be additional AOB claims in report years 2012 and 2013 that were not identified as such. However, even if the percentages for 2012 and 2013 are slightly understated, there is no indication that the 2012 and 2013 levels are close to the 2014 and 2015 levels. This has been verified by manually reviewing randomly sampled claims files.

At this point in time we can only identify AOB claims that went into litigation unless a manual review of a sample is performed, as was the case for the OIR Data Call. The manual data mining continues as a

joint effort among Claims, Actuarial, and Corporate Analytics; underlying text files that include the claims adjusters' notes may help identify other AOB claims.

## DATA CALL SHOWS AOB DRIVES NON-LITIGATED AND LITIGATED CLAIM COSTS

The Data Call focused on closed claims only, of water losses resulting from roof or pipe damages. At the time of the response, Citizens did not collect AOB status and vendor details for claims other than claims in litigation over the past two years. To improve the effectiveness of our response, we manually reviewed a statistically valid random sample of non-litigated claims to capture the incidence of closed claims with AOB. The litigated and non-litigated data sets were provided in the response, with the caveats about the scope of the sample. Since the data call, Citizens has been able to identify additional claims that would qualify, but such claims do not include the detail necessary to report a full record to the OIR – for example, attorney name(s), AOB vendor, public adjuster name.

Table 2 on the next page compares the data submitted to the OIR by litigation status, AOB status, and region. Non-litigated claims with AOB cost 74% more on average than claims without AOB in Tri-County and 116% more outside Tri-County. While the paid loss severity was higher for litigated claims with AOB than those without AOB, the differences were not as steep as for the non-litigated claims.

Litigated claims in the South East region are approximately 50% more expensive on average than elsewhere regardless of AOB. Separately, litigated claims are 182% more expensive on average statewide than non-litigated claims.

**Table 2**

Litigated and Sampled Non-Litigated Closed Claims with AOB

Assignment of Benefits	Closed NON-LITIGATED CLAIMS SAMPLE Loss/ALAE Severity*			Closed LITIGATED CLAIMS Loss/ALAE Severity**		
	Statewide	South East	Rest	Statewide	South East	Rest
Y	\$15,822	\$16,152	\$14,718	\$37,677	\$38,544	\$26,099
N	\$8,507	\$9,280	\$6,807	\$30,526	\$31,083	\$19,804
Total	\$11,677	\$12,450	\$9,658	\$32,882	\$33,506	\$22,380

\*Based on random sample of 983 claims reported in 2015

\*\*Based on claims reported in 2014 & 2015 as of 9-30-2015

Note: Data in other parts of this document is not based on the same data set as used in the OIR data call, as the larger actuarial data set includes a longer period of time and open and closed claims.

## WATER LOSSES DRIVE ALL OTHER PERILS RATE INCREASES

Citizens projected a 95.2% loss and LAE ratio (to premium) for 2016 for All Other Perils (AOP)<sup>1</sup> losses, based on rates in effect in 2015. This means that for every dollar of AOP premium earned for AOP

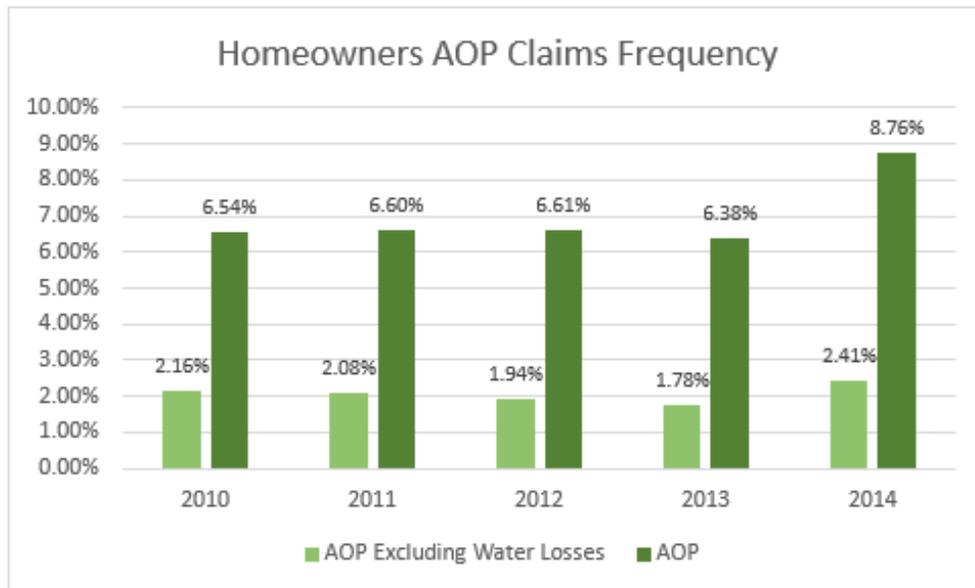
<sup>1</sup> Citizens makes rates separately for Fire, Liability, Sinkhole, Hurricane, Other Wind, and All Other Perils.

exposure, 95.2 cents would go towards paying loss and LAE. This does not leave enough to cover the non-loss expenses. In order to cover all expenses associated with these perils (such as agent’s commission and general overhead), the loss and LAE ratio needs to be 80.4%. The difference drives the indicated rate hike for HO-3 AOP of 17.2% for 2016. (The established rate increases were lower primarily due to the glide path law.) Importantly, this 17.2% rate need is not uniform throughout the state and was much higher in Tri-County. Additionally, alarming trends began to emerge in the supporting data.

In the data set ending at year-end 2014 that was used for the 2016 rate request, Citizens saw a steady and steep increase in the frequency and severity of AOP claims. The frequency has increased by 34% and the severity has increased by 15% over this time. These trends are troubling and if they continue unabated into 2016 and beyond, the actuarially sound premium rates required by Florida law will continue to increase. A further breakdown of the data illustrates the drivers.

Water claims comprise the bulk of reported AOP claims, about 75% of all claims over the last five years. Excluding water losses from AOP yields the frequency trends in Exhibit 2 on the following page.

Exhibit 2

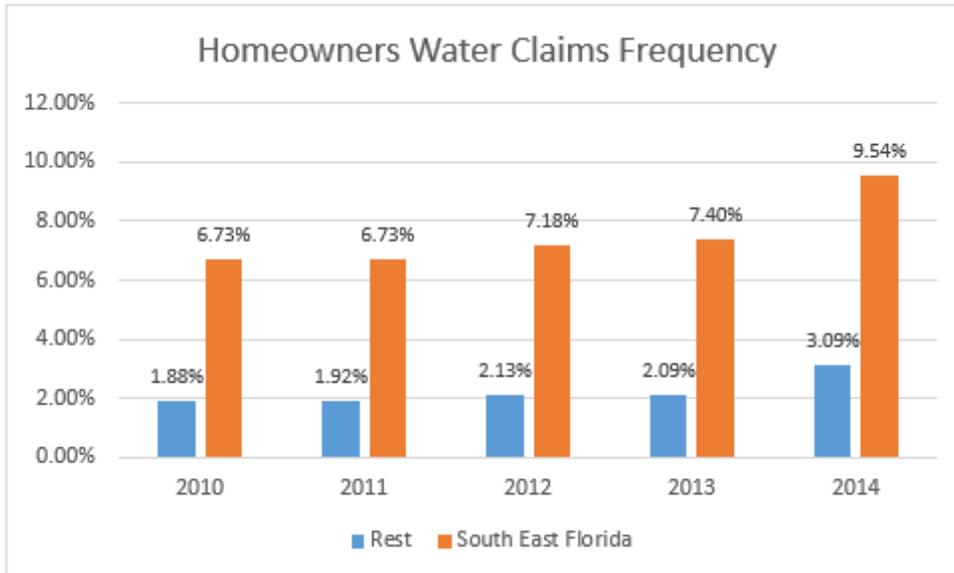


## WATER LOSSES: A TALE OF TWO REGIONS

Examining water claims separately, between 2010 and 2014, frequency has increased by **45%** and severity has increased by **43%**, foreshadowing large rate increases if trends continue.

These loss trends are not uniform across the state. Exhibit 3 shows that Tri-County has experienced a 42% increase in frequency and the Rest of the state has seen a 65% increase in frequency between calendar years 2010 and 2014.

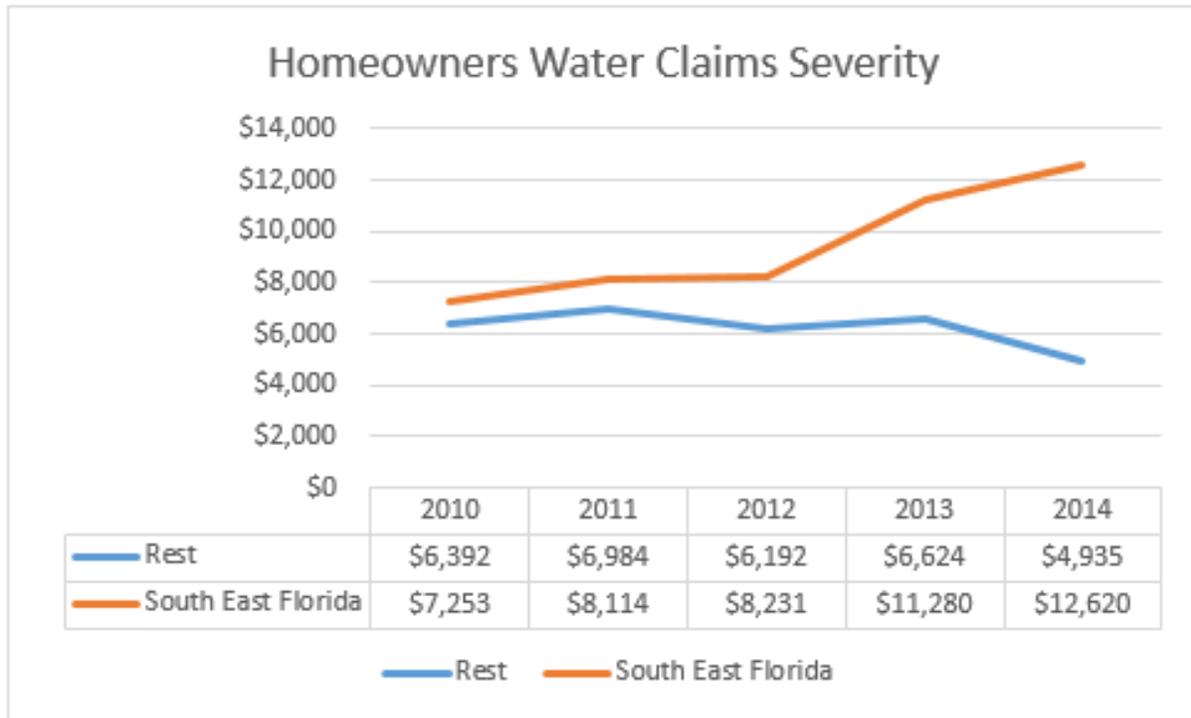
Exhibit 3



Note: Frequency is calculated as the number of claims closed in the period divided by the number of earned house years in the period.

According to the data in Exhibit 4, Tri-County has experienced a **74%** increase in severity between 2010 and 2014 while the Rest actually shows a 23% decrease in severity. The potential for overall costs to explode is alarming because the Rest of state overall frequency rate is only roughly a third of the frequency in South East Florida at this time.

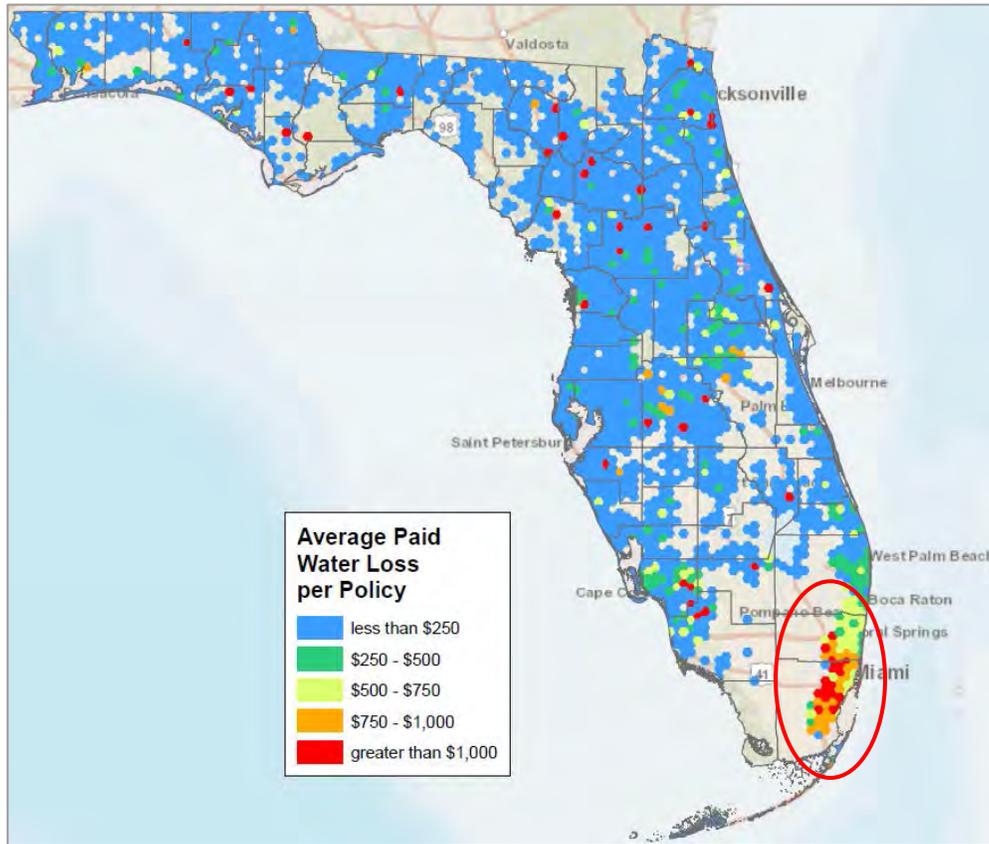
Exhibit 4



South East Florida has comprised roughly 50% of all earned water exposures in the last five years. During that same period South East Florida has comprised roughly **85%** of all incurred water losses. The rest of the state, which also comprises around 50% of all earned water exposures, comprised only 15% of all incurred water losses.

Water claims in South East Florida drove the +17.2% rate indication for AOP. This was a statewide average. If we had filed separately for the South East region, the rate need would have been +30% while the Rest of state would have indicated rate reductions. This is evident in Map 1 on the next page.

**Map 1**  
**Homeowners Average Paid Water Loss per Policy**  
**Calendar Year Data 10/1/2009 – 9/30/14**



## LITIGATED WATER LOSSES IN TRI-COUNTY DRIVE OVERALL RATE NEEDS

When further examining water losses in South East Florida, the steady and steep increase in the number of claims being litigated is apparent. Both the loss and LAE severities are considerably higher for litigated claims. Table 3 provides details on a report year basis.

**Table 3**  
**Reported Water Claims in South East Florida as of 9/30/2015**

Report Year*	% of Claims Litigated	Loss Severity		ALAE Severity	
		Litigated	Non-litigated	Litigated	Non-litigated
2010	15.8%	\$19,972	\$8,256	\$7,450	\$700
2011	18.3%	\$21,673	\$8,889	\$8,695	\$874
2012	21.1%	\$22,544	\$8,239	\$8,219	\$1,050
2013	29.6%	\$24,547	\$8,741	\$7,337	\$1,106
2014	38.4%	\$26,580	\$9,099	\$6,813	\$1,050
2015**	21.2%	\$27,631	\$9,028	\$6,391	\$868

\* Undeveloped Report Year info. It is expected the most recent years will increase.

\*\* Incomplete and immature Report Year

The overall increase in litigation is related to an increase in the number of claims that are first being reported with representation (either an attorney and/or a public adjuster), which is in turn related to the use of AOB.

## REPRESENTATION AT FIRST NOTICE OF LOSS: A SIGNAL OF LITIGATION TO COME

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Another observable trend is the percentage of claims that are first reported with an attorney and/or a public adjuster representing the insured. A customer is encouraged by its insurer to report a claim directly, but attorneys and public adjusters advertise and solicit heavily to become involved prior to notification of the insurer. Citizens sees a clear upward trend in the number of claims that have representation at FNOL. These claims are very likely to end up in litigation.

Table 4 displays the percentage of claims reported with representation at FNOL. Three points are clear. First, a very large percentage of water claims in South East Florida are historically and currently represented at FNOL, especially relative to the Rest of the state. Second, that percentage has increased significantly from 2014 thru 9/30/2015. And third, we see a significant initial representation on litigated claims in 2015 for the Rest of Florida. This could be another indication that the phenomenon driving this issue in South East Florida is spreading to other parts of the state. Additional validation of the data is underway to ensure that we are interpreting this accurately.

Table 4  
% of Claims Reported with Representation at FNOL

Report Year	Statewide	South East	Rest of State
2014	31.9%	39.3%	3.0%
2015	45.6%	56.0%	5.5%

Table 5  
% of Claims in Litigation that were reported with Representation

Report Year	Statewide	South East	Rest of State
2014	65.5%	66.4%	27.0%
2015*	88.6%	90.0%	27.3%

Table 5 displays the percentage of litigated claims for report year 2015 that were reported with representation at FNOL. This is a rather disturbing trend that supports anecdotal evidence that initial representation and AOB are tools that set the stage for litigation that was always intended.

## WATER LOSSES: IS AGE OF HOME THE REAL DRIVER?

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Age of home is a consideration in water loss analysis, due to the life expectancy of certain types of pipes. Many older homes were built using galvanized piping which is a steel pipe covered with a layer of zinc in order to protect it. Over time, the zinc erodes from the piping, causing the pipes to deteriorate from the inside. This causes a wide array of problems such as slow water pressure and stopped up faucets and toilets. As the pipes corrode they become filled with sediment which blocks water flow. Old galvanized pipes make all pipes susceptible to leaks. Some older homes have pipes made from concrete or cast iron and both are problematic.

Exhibit 4 provides the distribution of policies inforce as of November 30, 2015. In both South East Florida and the rest of the state, the median Citizens home is between 41-50 years old, with homes 41 years and older comprising 56% and 53% of the population, respectively.

**Exhibit 4**

**Homeowners Policy Count by Year Built Range and Location Region**

Data as of 11/30/15

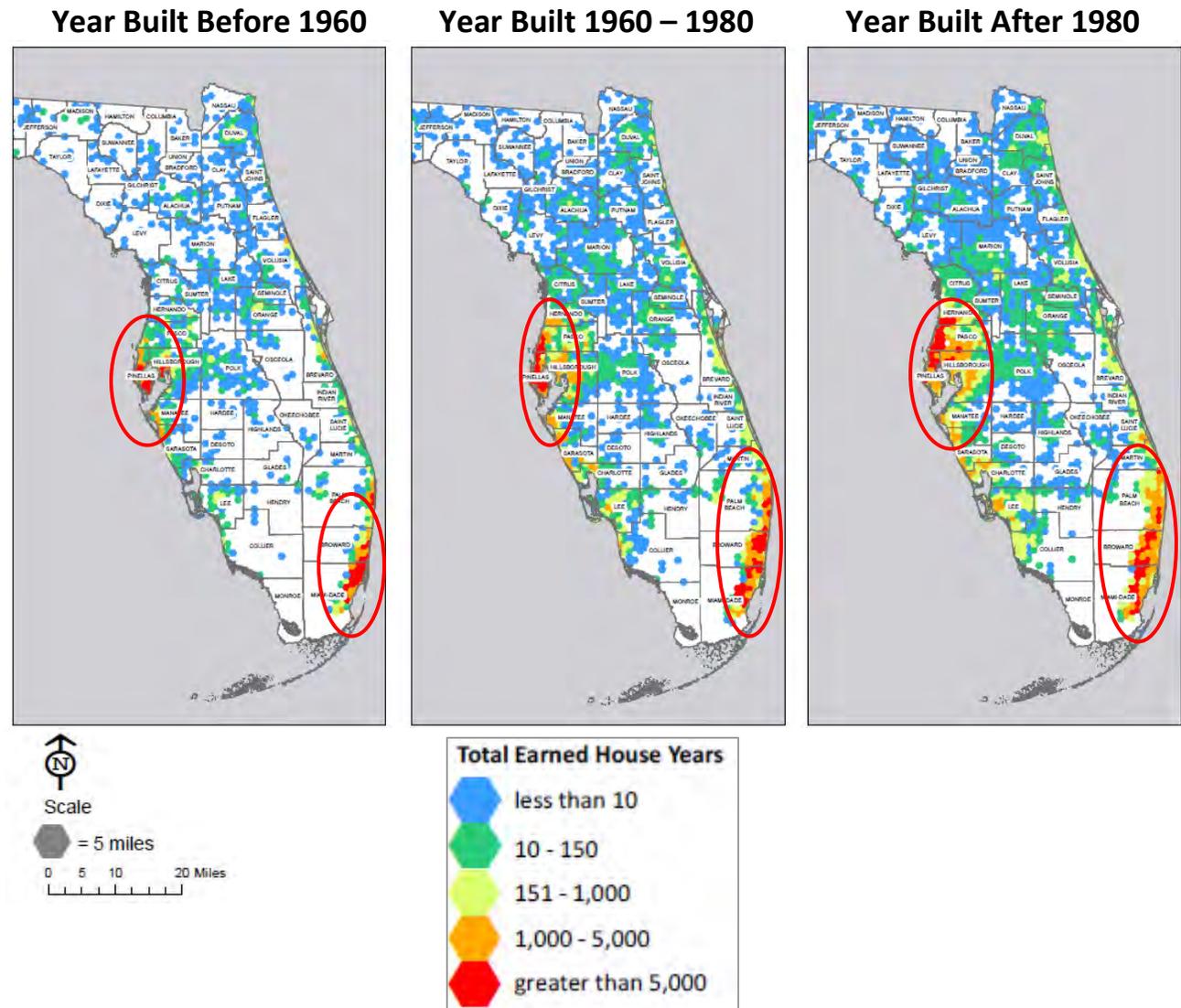
<b>Yearbuilt Range</b>	<b>Broward</b>	<b>% of Total</b>	<b>Miami-Dade</b>	<b>% of Total</b>	<b>Palm Beach</b>	<b>% of Total</b>	<b>South FL Total</b>	<b>% of Total</b>	<b>All Other Total</b>	<b>% of Total</b>	<b>Statewide Total</b>
Less than 10 years old	630	0%	2,386	1%	347	0%	3,363	1%	4,059	2%	7,422
11-20 years old	2,711	1%	6,468	3%	1,205	1%	10,384	4%	10,170	4%	20,554
21-30 years old	5,924	3%	12,645	5%	3,420	1%	21,989	9%	17,090	7%	39,079
31-40 years old	4,828	2%	11,505	5%	4,706	2%	21,039	9%	22,558	10%	43,597
41-50 years old	6,135	3%	9,476	4%	3,023	1%	18,634	8%	17,129	7%	35,763
51-60 years old	8,284	4%	11,389	5%	4,268	2%	23,941	10%	18,629	8%	42,570
61-70 years old	3,606	2%	16,273	7%	2,286	1%	22,165	9%	11,035	5%	33,200
Over 70 years old	467	0%	5,385	2%	1,176	1%	7,028	3%	5,707	2%	12,735
<b>Total</b>	<b>32,585</b>	<b>14%</b>	<b>75,527</b>	<b>32%</b>	<b>20,431</b>	<b>9%</b>	<b>128,543</b>	<b>55%</b>	<b>106,377</b>	<b>45%</b>	<b>234,920</b>

The year built distribution has shifted slightly over time. Based on inforce data as of December 31, 2014, the South East Florida and the rest of the state regions contain homes 41 years and older at rates of 55% and 52%, respectively. The shift is driven by an aggressive depopulation of Citizens by private market insurers since 2013.

On the following page, Map 2 provides a view of the distribution of Citizens’ customers by year built for the majority of the state. One earned house years is equivalent to one home insured for one full year and represents a measure of the exposure. It is evident that Tampa Bay region (Hillsborough and Pinellas) and South East Florida have a relatively large volume of homes for all three year built ranges.

## Map 2

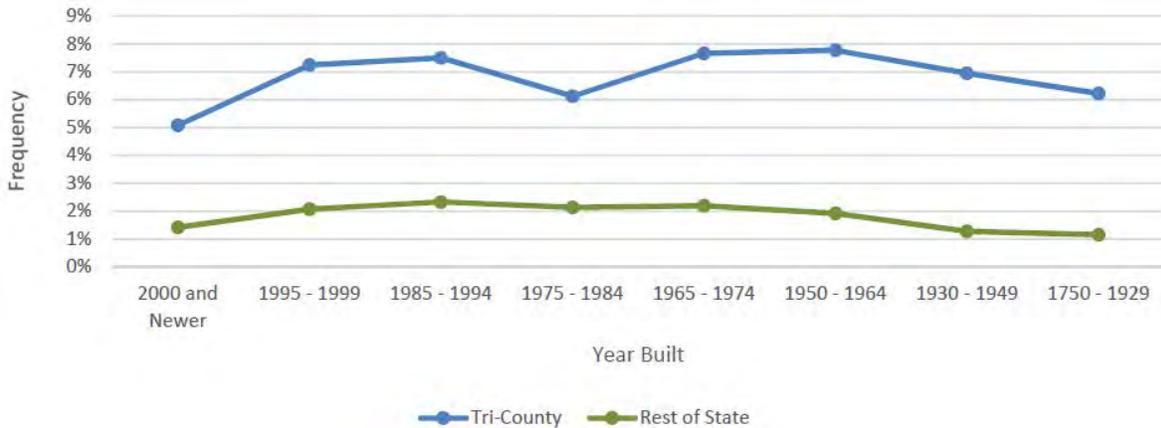
Homeowners Earned House Years by Year Built  
Calendar Year Data 10/1/2009 – 9/30/14



Reviewing water loss claims by age of home provides insight into whether Tri-County claim activity is anomalous due to a unique profile of aged homes. Exhibit 5 provides claims frequency by year built for water losses. With the exception of homes built after 1999, the South East region incurs 6% to 8% claim frequency across all age ranges, whereas the Rest of state hovers between 1% and 2% frequency. The key result is that historical frequency trends are rather consistent across the year built ranges for both regions.

**Exhibit 5**

**Non-Catastrophe Water Claim Frequency\* by Year Built (Calendar Years 2009-2013)**



\*Frequency is determined by taking the number of calendar year claims divided by calendar year earned house years.

Interestingly, when the paid water losses per annual policy is plotted in a map similar to Map 2, it becomes obvious that South East Florida stands out as having much higher water loss costs. According to Map 3, higher paid water losses per policy are a feature of the Tri-County region across all age ranges.

In short, there is little evidence to indicate that a large number of homes reaching a critical age is a driver of claim activity or costs specifically in South Florida.

**Map 3**

**Homeowners Paid Water Loss per Policy by Year Built  
Calendar Year Data 10/1/2009 – 9/30/14**

