Florida Property Loss Reimbursement

History

Pre-2005

Prior to the legislative change in 2005, the insurance industry operated on the principle of indemnity; the concept that if insurance pays more than what is actually lost by the insured (betterment), a moral hazard is created which promotes behavior contrary to a responsible society; **policyholders should <u>never</u> benefit from any loss paid from an insurance pool.** During this time, insurance companies valued damaged material and goods on the basis of items of 'like-kind' and quality **(Actual Cash Value)**.

Later, as the market became increasingly competitive with a greater need for completed repairs and consumers demanded options, the industry moved to providing policyholders with the choice of purchasing **Replacement Cost** coverage (market price to restore or replace property with material or goods that are brand new).

The process of repair and replacement changed to providing Actual Cash Value less the deductible at the time of the loss with full Replacement Cost provided upon proof of repair. This process enabled insurance companies to determine the <u>actual</u> Replacement Cost, preventing over-inflated claims and any threat of creating a moral hazard.

2005

Just after the four devastating storms in 2004, Florida's law changed, taking away the option of the more affordable ACV policies and mandating insurance companies include full Replacement Cost in their base policy and to pay the full amount prior to any repairs being made with no requirement for policyholders to repair their homes.

> "In the event of a loss for which a dwelling or personal property is insured on the basis of replacement costs, the insurer shall pay the replacement cost without reservation or holdback of any depreciation in value, whether or not the insured replaces or repairs the dwelling or property." FS 627.7011(3)

Current Situation

Current statute, although well intended but severly flawed, has created a society-wide moral hazard resulting in:

Betterment: it is impossible for insurance companies to determine actual replacement cost at the time of settlement. Therefore, in some cases, policyholders will receive a greater amount than what it costs to repair or replace the damage, leaving them in a better position than where they were prior to the damage.

Incentive for Fraud: when someone can receive new dollars for old depreciated property, or worse, more dollars than what it costs to replace brand new, there is an incentive to not maintain the property or protect it from a loss. If the reward is enough there can be an incentive to actually cause a loss or fraudulently inflate a claim.

Because homeowners are not required to complete repairs they have the ability to not only win the big payout, but cause a greater threat to surrounding communities and families. In today's economy, with several homeowners struggling financially, and Florida's unemployment rate at 11.9%, this is a golden ticket. Additionally, those homes that may have been properly maintained in surrounding communities may be in greater danger in the event of a catastrophe such as a hurricane. A homeowner who's waiting to cash-in hasn't fixed their dilapidated roof. Unfortunately, a more responsible neighbor down the street may wake up one day only to find that roof, in their living room.

Rates Continuing to Rise: insurance companies can no longer limit settlements to <u>actual</u> replacement cost. This has caused the severity (size of the loss) and frequency of claims filed to increase. Claims are now settled based on RCV, which is not limited to simply replacing the same material and goods with items that are brand new, but in numerous cases, replacing with a larger quantity or amount of goods and material that are brand new. Insurance companies must base their rates on their experience. As claims costs rise, premium rates will follow. Every Florida homeowner is paying the cost and not just the 4% who file claims each year.

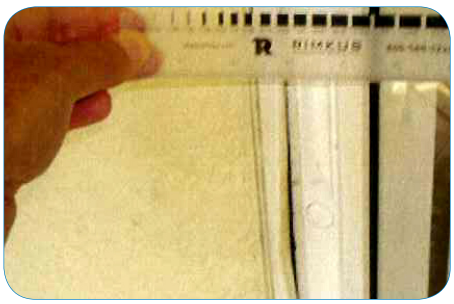
Recent data from the National Association of Insurance Commissioners (NAIC) measuring Florida's average loss per policy since the legislation change in 2005, confirms that in just the last three years (in which there was no storm or catastrophe) the average loss per policy (combination of loss frequency and severity) has increased by nearly 80%.

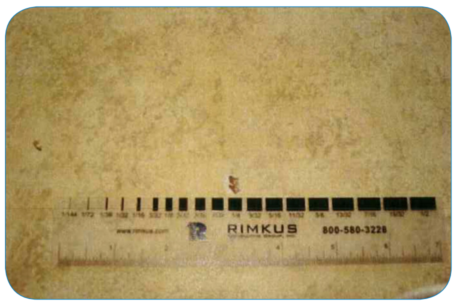
Typical Florida Claim

Here is an example of a claim filed by a Florida homeowner on September 17, 2008 on an HO-3 policy. The home was burglarized and items were stolen. The rear sliding glass door frame was damaged and the owner indicated that the intruders chipped a single tile near the point of entry (damage shown below). The full replacement cost amount provided was calculated using the *estimated* cost to remove and replace existing tile throughout the home and the sliding glass door frame along with the cost to replace all stolen items.

Actual Cash Value: $7,658
Full Replacement Cost (Claim Settlement): $21,095

This claim demonstrates an average difference between the Actual Cash Value and Replacement Cost Value commonly found in claims filed today. In some cases, this difference is much greater. If homeowners had the more affordable Actual Cash Value option of coverage and insurance companies were able to determine actual Replacement Cost based on the completion of repairs, it would significantly reduce the severity and frequency of claims, preventing all Florida homeowners from bearing the burden of inflated claims.





What are the 49 other states doing?

Current law has created a very unique Florida. We appear to be the only state requiring insurance companies to pay full Replacement Cost upfront and without proof of repair. So what are other states doing?

Example:
When losses occur, insurance companies provide homeowners with Actual Cash Value less Deductible, upfront. The homeowner then has two options:

1. use the amount received and make his/her own repairs; or
2. hire a contractor and provide the insurance company with Proof of Repair. Upon receiving Proof of Repair, the insurance company will provide the policyholder with the remaining amout of the full Replacement Cost amount

Proposed Solutions

Return to pre-2005 legislation where we:

1. Provide Florida homeowners with a more affordable option of coverage
2. Remove the moral hazard of betterment
3. Eliminate the incentive for fraud
4. Make communities safer for families
5. Stop premiums from continuing to increase

In addition, we propose making Florida's private insurance market more appealing by allowing companies to settle on Fair Market Value originated from a Good Faith Estimate provided by a state-approved, licensed contractor to reduce the industry's exposure to Bad Faith. This would ensure that the work is completed, reduces the cost of settling claims and rates are based on Actual Cash Value Replacement Cost and NOT betterment.

March 26, 2011