

LOSS REIMBURSEMENT FOR STRUCTURE DAMAGE

History

Insurance is a contract of indemnity. The principle of indemnity states if insurance pays more than what is actually lost by the insured, a moral hazard is created which promotes behavior contrary to the goals of a responsible society; policyholders should never profit from any loss paid by an insurance company.

Traditionally, the insurance industry operated on this principal and the insurance policy was designed and priced to return the insured to the condition they were in immediately prior to the loss. This was done by giving the insured an amount equal to the estimated current market value of their home less depreciation (Actual Cash Value or ACV). The insured would receive ACV minus the applicable deductible specified in the contract.

Consumers Demanded Options

They requested insurance policies provide for loss reimbursement on the basis of Replacement Cost or RCV. Initially, insurance companies were reluctant to offer this coverage because 1.) it is often difficult to accurately estimate RCV until the work is completed and the damage is repaired; 2.) RCV violates the principle of indemnity since it could put the policyholder in a better position than where they were prior to the damage; and 3.) could create a financial incentive to file fraudulent claims

Maintaining Indemnity

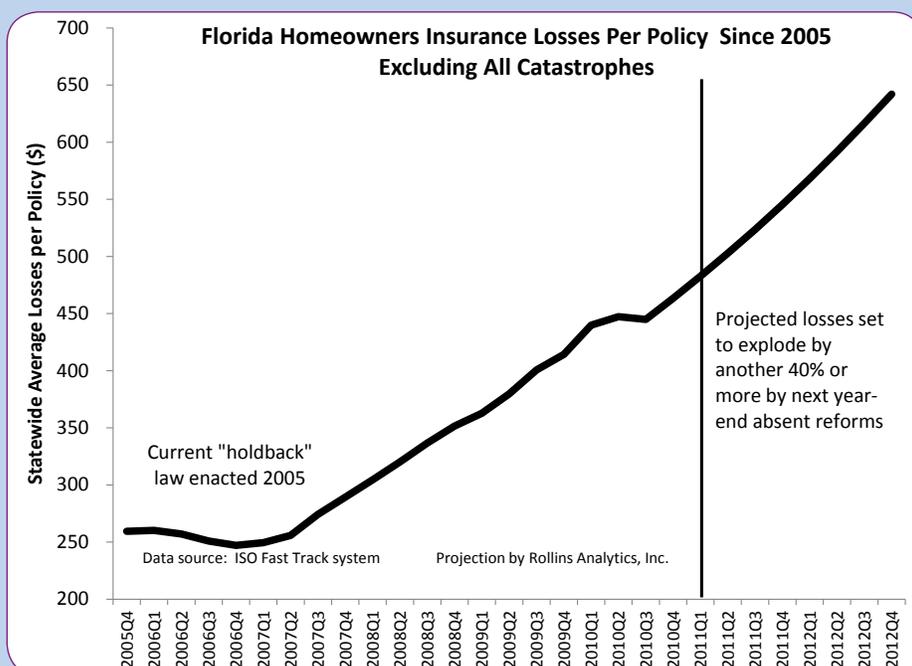
Insurance companies solved this dilemma by offering customers a choice of receiving either ACV or new for old Replacement Cost, provided they actually replaced. The process consisted of insurance companies providing ACV at the time of the loss and the remaining RCV, less any deductible, upon proof of repair or replacement.

A Unique Florida

In 2005, the Florida Legislature made Florida different than the other 49 states by requiring that loss reimbursement be paid in full, upfront, without receiving proof of repair or replacement.

FS 627.7011(3) 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. *(emphasis added)*

2005 legislative change has resulted in three unintended consequences.



1. The average loss per policy (excluding all catastrophes) has risen by 80% in less than five years, driving rate increases.
2. Damaged homes are not being repaired.
3. There is now a significant incentive for fraud.

Myth: If full Replacement Cost isn't provided upfront, construction cannot begin unless the full amount to replace or repair is paid upfront.

Fact: Actual Cash Value is a more than generous amount to fully cover the deposit required by contractors.

According to the Florida Homebuilders Association, the standard deposit required for construction to begin for small improvements is 35% and 20% for larger projects.

Location				Miami			Orlando		
Claim Type	Loss Type	Year Built	Living Sq. Ft.	ACV	RCV	ACV % RCV	ACV	RCV	ACV % RCV
Windstorm	Roof Damage	1949	2070	\$10,334.35	\$17,566.68	58.83%	\$8,552.60	\$14,005.64	61.07%
Mold/Water	Roof and Mold Damage	1987	1227	\$1,184.13	\$1,412.42	83.84%	\$1,040.39	\$1,252.42	83.07%
Fire	Cooking Fire/ Kitchen Damage	1977	883	\$5,892.62	\$9,568.37	61.58%	\$5,635.30	\$9,154.31	61.56%

Information gathered using real claim experiences processed through XACTIMATE, a widely used claims estimating software, to determine costs in each area

Most private insurance companies have a network of preferred contractors who are willing to begin work prior to any exchange of funds. Security First Insurance's preferred network consists of a minimum of four licensed, state-approved contractors in each of the 67 counties in Florida.

Fact: Florida law as currently written, negatively impacts all Florida homeowners by driving up rates.

Proposed Solution

Allow Florida's insurance companies to return to operating on the principal of indemnity as the industry did just prior to 2005. This provides homeowners with two options:

1. a more affordable policy based on ACV and not requiring proof of repairs; or
2. a policy based on RCV that pays money upfront (ACV or minimum needed by contractor to start repairs, whichever is greater), and the remaining RCV amount upon Proof of Repair.

Additionally, to prevent fraud and inflated claims, insurance companies would need to reserve the right to request a bid from the company's preferred licensed, state-approved contractor who is willing to guarantee the work. The bid could be used as a defense against a claim of Bad Faith.