

Professional Team Report to the  
Florida Commission on Hurricane Loss Projection Methodology on  
Inquiries or Investigations from the  
2017 Hurricane Standards Report of Activities

A Report of Discussions with Modeling Organizations  
During the On-Site Reviews

September 10, 2019

***Impact of Legal and Claims Environment***

In conjunction with the model reviews to the 2017 Hurricane Standards, the Professional Team was mandated to collect information from the modeling organizations on the impact of legal and claims environment. Specifically, the Hurricane Standards Report of Activities from 2017 defines the Inquiry, as follows:

Investigate the impact of the legal and claims environment (e.g., assignment of benefits, attorney fees, increased litigation) on modeled hurricane loss costs and hurricane probable maximum loss levels. Is the impact of the legal and claims environment evident in the claims data provided to the modeling organizations for validation of the modeled hurricane loss costs and hurricane probable maximum loss levels? Should the impact of the legal and claims environment be incorporated in the hurricane model results, and if so, how? Should the impact of the legal and claims environment be incorporated into the hurricane standards?

The Modelers uniformly contend that modeling of the legal and claims environment should ***not*** be built into the standards at this time. Several Modelers do recognize that legal costs can infiltrate claims settlements but current insured loss reporting cannot support the development of legal models to capture the phenomenon. In some situations, the identification of legal fees is further complicated by pending litigation or a plethora of open claims (many of which could have associated legal costs).

The Modelers certainly recognize the problems of assignment of benefits, legal fees and so forth, but modeling such phenomena is generally beyond the modeling organization's scope and expertise. As one Modeler succinctly indicated, "We are not a legal modeling firm." The modeling organizations make substantial efforts to exclude such costs from client data used in model validation. Some insurance companies are providing the losses separately and exclusively for coverages A (building), C (contents), and D (additional living expense). The topic is actively discussed by Modelers both with clients and reinsurers.

Further complications were noted by the modeling organizations. For example, loss adjustment expenses and claims payment processes vary across insurance companies. In the catastrophe modeling world, Florida, in particular, is experiencing a growth in loss payments owing to the legal and claims environment. The problem is exacerbated by claimants (property owners) signing away the claims-handling to contractors, some of whom may inflate claims in fraudulent ways. This artificial inflation is reflected in claims data for Hurricanes Irma and Michael, leading to overestimates of losses. A consequence is that the role of these storms in model validation is diminished.

The modeling organizations and modeling community awaits the Office of Insurance Regulation or the Florida Legislature to address or mitigate the problem. In the meantime, it appears that the issue might be best handled by company actuaries through post-processing of claims data and adjustment factors in rate filings.

The information and analysis provided in this report were based on interviews with the Modelers on-site. The topic was addressed at each site once it was apparent that the standards had been verified by the Professional Team (although recognizing that the ultimate decision rested with the Commission). Each modeling organization was open and candid in these discussions.

Note to the Commission: The above summary of modeling organization input on these issues reflects non-attributable comments from modeling organizations following completion of the on-site review under the 2017 Hurricane Standards.

Professional Team members participating in the Modeler interviews:

Paul Fishwick, Ph.D., Computer/Information Scientist  
Tim Hall, Ph.D., Meteorologist  
Mark Johnson, Ph.D., Statistician, Team Leader  
Stuart Mathewson, FCAS, MAAA, Actuary  
Michael Bayard Smith, FCAS, FSA, MAAA, OMCAA, Actuary  
Masoud Zadeh, Ph.D., P.E., Structural Engineer

Modeling organizations participating in the interviews:

AIR Worldwide Corporation  
Applied Research Associates, Inc.  
CoreLogic, Inc.  
Florida International University  
Karen Clark & Company  
Risk Management Solutions, Inc.